

Labour's pugilist may turn out to have exaggerated Britain's economic woes

By David Marsh

Ed Balls, the UK opposition Labour Party's great new hope for a revival in its fortunes, is the man behind two clear choices which positively marked the economic policies of the Labour-run governments between 1997 and 2010. These were the decisions to give the Bank of England operational control of British interest rates and to keep the UK out of the euro after it was introduced in 1999.

Unfortunately, he is also the person who – as economic adviser to Gordon Brown during his 10 years as Chancellor of the Exchequer - did much to encourage his former boss to inflate public spending. This helped generate the ballooning budget deficits that have been one of the principal British legacies of the financial crisis.

Harvard-educated Balls' record overshadows his current actions now that his appointment as shadow Chancellor at the end of last month has shaken up British politics. Balls' Keynesian principles and pugilistic instincts have driven his fierce criticism of Prime Minister David Cameron and George Osborne, the Chancellor in the Conservative-Liberal Democrat coalition, for cutting back the budget deficit allegedly too rapidly for the good of the creaking British economy.

The jury is still out on whether Balls or Osborne has it right. An unexpected drop in Britain's gross domestic product (GDP) at the end of last year appeared to confirm Balls' scepticism on whether the UK was resilient enough to stand up to draconian budget cuts. However, other economic data seems to indicate that the economy can take the medicine. Last week the closely-watched purchasing managers' index showed a formidable rebound in the services sector, helping to adjust the pessimism touched off a week earlier by the GDP figures.

Rumours of sterling's imminent demise against the euro and other leading currencies have been – like reports of Mark Twain's death – much exaggerated. Two fundamental factors underpinning the pound have been the two key elements of Balls' period at the Treasury, sterling's non-membership of the euro (which would have been a disaster for the UK and Europe) and the policy credibility of the Bank of England.

Many observers believe a gigantic political battle is now in store between Balls and Osborne. The reality may be less dramatic, for two reasons. First, although Balls has carefully cultivated his image as a street-fighter, his ferocity is neither as intense nor as effective as popularly supposed.

Second, I believe that Balls has exaggerated the woes likely to afflict the British economy as a result of Osborne's attack on the deficit. If the economy does show reasonable resilience despite the spending cuts, then Balls will tone down his doom-laden rhetoric. But he will be clever enough to claim that the reason why the economy is doing better is because Osborne listened to his advice and went easy on the spending cuts.

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