

Thesis

Responding to the economic crisis: a primer for public health professionals

David Stuckler^{1,2}, Sanjay Basu³, Martin McKee⁴, Marc Suhrcke^{5,6}

¹Department of Sociology, Oxford University, Oxford, UK,

²Department of Public Health and Policy, London School of Hygiene and Tropical Medicine, London, UK

³Department of Medicine and San Francisco General Hospital, Division of General Internal Medicine, University of California San Francisco, San Francisco, USA

⁴London School of Hygiene and Tropical Medicine and European Observatory on Health Systems and Policies, London, UK

⁵School of Medicine, Health Policy and Practice, University of East Anglia, Norwich, UK

⁶Centre for Diet and Activity Research (CEDAR), Cambridge, UK

Address correspondence to Martin McKee, E-mail: martin.mckee@lshtm.ac.uk

ABSTRACT

Does the current economic crisis require the deep cuts in public spending announced in the June 2010 emergency budget, with potential implications for public health? The arguments for and against such cuts in response to economic recession are complex, but if public health professionals are to engage in debates about future public spending, they should be informed by relevant evidence. In this perspective, we note that opinions among politicians and economists about how to respond to economic downturns are divided, while other EU countries, many with greater levels of debt than the UK, are protecting public expenditure unless required to do so by the International Monetary Fund. Current UK debt may in fact be viewed as sustainable given current information about interest rates, inflation and economic growth. Before accepting large cuts in public spending, it is important to contrast the lack of evidence for such short-term fixes with potentially dire repercussions for population health and welfare.

Keywords economics, finance and industry

Introduction

Public health professionals in the UK are already feeling the impact of the ongoing economic crisis. For many, the consequences have been personal, such as those who had savings in Icelandic banks or who are unable to move to new employment because of stagnation in the housing market, as well as the majority that will suffer at least 2 year pay freezes at a time of rising inflation. For others, however, concerns focus on the population health implications of rising unemployment¹ and ‘savage budget cuts’ being enacted that, even if they spare so-called ‘front-line services’ in the National Health Service (NHS) to some extent, will inevitably have grave implications for the most vulnerable in society.^{2,3}

Yet the scale and nature of the economic crisis is debated. On the one hand, politicians in the ruling coalition express alarm about what they describe as ‘a grave debt crisis’, with ‘out-of-control’ public finances and, although

they have promised to protect health spending, the decisions already being made in the NHS imply large cuts ahead. The King’s Fund and Institute for Fiscal Studies ask *How Cold Will It Be?*, identifying three possible scenarios for the NHS: ‘tepid’, ‘cold’ or ‘arctic’.⁴ The cuts in other areas will be unprecedented, averaging 25% over the next parliament but reaching an estimated 34% for some government departments (enough to wipe out the entire higher education, prison and courts systems when applied to the corresponding departments). On the other hand, a number of economists counter that the severity of the crisis is being overstated,

David Stuckler, Research fellow

Sanjay Basu, Physician

Martin McKee, Professor of European Public Health

Marc Suhrcke, Professor of Public Health Economics

and that greater government spending may be required for economic recovery.^{5–7} Indeed, an editorial in one leading national newspaper stated earlier this year, before the most recent evidence that the deficit was falling, ‘The state’s wrecked balance sheet must certainly be repaired over time; but it is hard to find any economists of standing—whether they are right- or leftwing, working on a City trading floor or on a university campus—who believe that the fiscal tightening need be as rapid or as severe as the Conservatives say⁸ and the recently created Office of Budget Responsibility has reduced its estimate for growth as a result of the fiscal tightening in the budget. It is clear that the policies being pursued will have profound consequences for public health in general and the NHS in particular for many years.

If public health professionals are to participate in debates about public spending, they should be informed about the validity of arguments about budgets that impact on vulnerable members of society. From this perspective, we examine the assumptions and data behind these differing claims. We review the state of the public finances in the UK, and discuss the consequences of alternative health policy responses to the ongoing economic situation.

How much debt do we have and why is it rising? The actual numbers on public spending . . .

At the outset, we must define two measures. The first is the deficit, which is the difference between what the government takes in from taxes and other sources and what it spends in a year. One can think of it as a current account. It goes up and down and many people run overdrafts at particular times in their lives. The second is the debt. This is the money one borrows to invest in the long term and one can think of it a mortgage. Governments should run deficits during an economic crisis and if they do not they are failing in their responsibility. When the private sector contracts and people lose their jobs the government rightly steps in, supporting individuals losing their jobs through unemployment benefit and retraining, and in the recent crisis by providing fiscal stimuli. However, it will have less money to do so because taxes will fall. This is to be expected. Governments should not, however, maintain large structural deficits whereby they continually spend more than they take in. However, it is reasonable to maintain a certain level of debt, as long as it is used to invest (as a family would invest in their house) and the repayments are affordable.

In normal economic situations, conventional wisdom suggests reducing large deficits quickly. However, in times of

recession, such as the one from which we are now emerging, driven by a sharp fall in aggregate demand causing deflation, exceptional measures that tolerate or temporarily even increase deficits can be justified and may even be desirable. It is only when debt repayment is higher than a country’s economic growth that the debt is considered unsustainable.

To ascertain whether this is the case, it is necessary to examine the figures, although even this can be challenging as there are many definitional issues to be taken into account and the relevant data are often buried in the minutiae of complex reports. Deficits can occur at different levels of government (local, state, central, and, in the case of the UK, including social security funds). General government estimates reflect the sum of all of these sectors deficits or debts. By varying the way in which the fiscal stimulus is factored into the calculations, whether different sectors of government are included, the calendar or fiscal year or month being reported and the timing of the nominal debt calculation (as exchange rates fluctuate), it is possible to make the figures look better or worse.

Turning first to the headline general government figures, the UK has seen the general government deficit-to-gross domestic product (GDP) ratio rise from 0.4 to 11.4% between 2007/08 and 2009/10 fiscal years,⁹ while the debt-to-GDP ratio increased from 43.0% before the bank bailouts in spring 2008 to 68.2% in May 2010.⁹ Taken in isolation, these figures seem alarming, so it is necessary to look at how they compare with other countries, how they have changed over time and why. Table 1 shows the most recent internationally comparable data for the UK and some other industrialized nations.¹⁰ Reflecting the dominance of

Table 1 Summary of deficit, debt and debt repayment, selected countries

Country	Deficit as a percentage of GDP	Gross debt level as a percentage of GDP	Maturity (average of government debt, years)
Germany	–5.7	72.5	6.0
USA	–11.0	83.2	4.4
France	–8.2	77.4	6.5
UK	–11.4	68.2	12.8
Greece	–8.1	115.1	7.4
Japan	–9.8	217.7	5.2
Italy	–5.2	115.8	6.7
Portugal	–8.8	77.1	6.2

Source: IMF Fiscal Monitor.¹⁰

the financial sector in the economy, the UK has spent more than any other European country on bank bailouts (variously expressed as £850 billion,¹¹ or £14 000 per person or over 30% of GDP)^{11,12} This is an important contributor to the relatively large UK deficit, which is now slightly higher than that of the USA. However, these bailouts involve investments that at some point will be repaid (potentially at a large profit, as happened in Sweden in the 1990s).

Understandably, politicians in favour of large-scale budget cuts have focused on the deficit, rather than the underlying debt (although when interviewed they often seem confused themselves). The figures on the debt (which, as we have noted, can be considered analogous to a mortgage) suggests that the UK is in a rather more favourable position. Its total debt is somewhat smaller, as a percentage of GDP, than many otherwise comparable countries while, crucially, the average maturity of its debt (the time at which it must be refinanced) is very much longer than in other countries. Although the level of debt has increased (Fig. 1), to place it in context the 'free-market' policies pursued during the Reagan presidency in the USA increased government debt as a share of GDP rose from 33% in 1980 to 56% in 1990. By 2007, before the recent economic crisis, general government debt in the USA reached almost 70% of GDP,¹³ nearly 20 percentage points higher than the current level in the UK.¹⁴

It is next necessary to ask whether the structural debt is due to lower income or increased expenditure. Although spending by Western governments has slowly risen, the

major source of the continued rise in government debt is falling tax revenue.¹⁵ Between April 2008 and August 2009, expenditure rose by £11.7 billion, but revenues fell by £23.6 billion (Table 2). Thus the structural budget deficit seems less a matter of 'out-of-control government spending' than of substantial falls in tax revenues. This view is supported by the successive reductions in estimates of the deficit for 2009/10 as tax revenues picked up at the end of the financial year.

What do these findings mean for the future? The Institute for Fiscal Studies estimates that, if these exceptional conditions remain unchanged, public debt/GDP will reach 180% by 2040. However, the possibility that governments of any persuasion would fail to act in such circumstances is extremely implausible. The projection is actually based on pessimistic assumptions about current interest rates in the immediate recovery period (4% instead of the current 0.5%, which may or may not be reasonable in the long run) as well as unrealistic assumptions about continued extremely low tax revenues. The experience of some American states, such as California, shows that a persisting tax shortfall is possible, but only because those states have enacted constitutional amendments that require 'supermajorities' (typically two-thirds majorities in their legislatures) to raise taxes; this is not the situation in the UK.

This takes us to the crux of the matter. Paradoxically, while current increases in government borrowing will increase the headline debt further, raising questions about sustainability, projections by commentators such as the

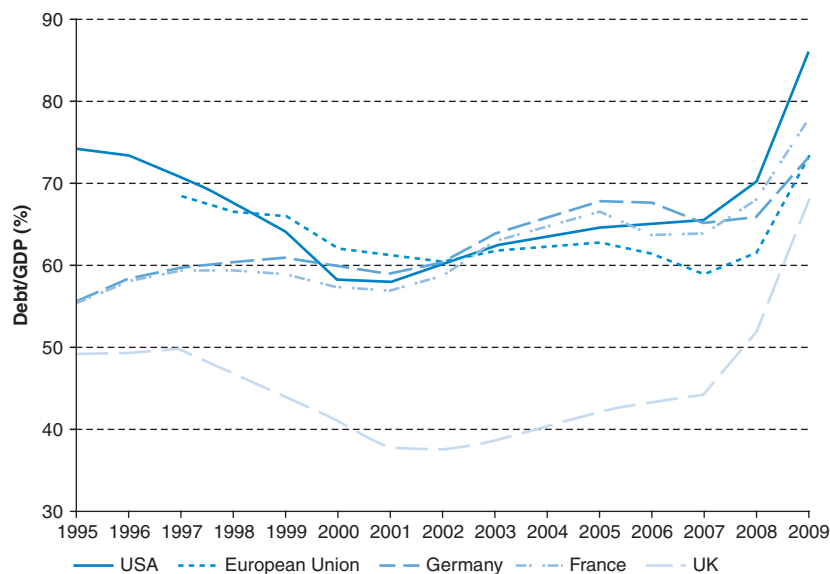


Fig. 1 Trends in Government Debt/GDP, 1995–2008. Sources of data: UK debt apart from the financial intervention in 2009 was 43% of GDP, lower than in 1995. Public debt is defined in the Maastricht Treaty as consolidated general government gross debt at nominal value, outstanding at the end of the year. The general government sector comprises central government, state government, local government and social security funds. EU data from European Commission EuroStat dataset 2010 edition; US data from the Office of Management and Budget, 2009.

Table 2 Central government deficit structure, receipts and expenditures, April 2008/09 and August 2009/10 (billions)

<i>Current receipt</i>	<i>April 2008/09</i>	<i>August 2009/10</i>	<i>Current expenditure</i>	<i>April 2008/09</i>	<i>August 2009/10</i>
Taxes on production	74.3	65.9	Interest	15.2	11.2
Taxes on income and wealth	79.4	66.6	Net social benefits	62.2	68.1
Compulsory social contributions	40.1	38.7	Other current expenditure	145.4	155.2
Total current receipts	206.1	182.5	Total current expenditure	44.3	45.6
Difference in receipts		–23.6	Difference in expenditure		+11.7
Net borrowing	29.2	69.1			

Notes: Data are not seasonally adjusted.

Total includes other taxes and interest and dividends categories. Social contributions are divided into actual social contributions and imputed social contributions. Actual social contributions include employers' actual social contributions, employees' social contributions and social contributions by self-employed and non-employed persons. Imputed social contributions represent the counterpart to social benefits (less eventual employees' social contributions) paid directly by employers.

CentreForum think tank indicate that this may actually be necessary to reduce future debt.^{16,17} To understand whether the debt will be sustainable, it is necessary to examine further the consequences of public debt.

What are the consequences of public debt?

Those concerned about high public spending cite fears that it will crowd-out the private sector or increase interest rates, reducing investment and future economic growth.¹⁸ They also suggest that credit agencies could punish high public debt-to-GDP ratios by downgrading the country's credit rating, so increasing the costs of borrowing and repayment. Higher debt also requires increased repayments, which could divert resources from other forms of government spending. More immediately, the European Union's 'Excessive Deficit Procedure' set out in the Maastricht Treaty threatens economic sanctions against member states whose public debt-to-GDP ratios are greater than 60% ('excessive debt') or annual public deficit is greater than 3% ('excessive deficit'). Yet on critical analysis against available data, these claims seem highly questionable.

First, economists debate how much deficits matter for the economy. Indeed, the economic historian Niall Ferguson has asked 'do public debts matter?' and, after quoting principles expounded by those who have sought to constrain debt, from Dickens' Mr. Micawber to Gordon Brown, concludes that 'the long-run experience—and especially that of Britain—would seem to fly in the face of all such rules'.¹⁹ Supporting this view,²⁰ a considerable body of empirical research finds that public deficits do not increase future inflation, reduce private investment or decrease economic growth in high-income countries such as the UK (indeed, greater deficits seem

to boost subsequent growth in the USA).^{21–24} This research supports Adam Smith's observation, in 1776, that 'Great Britain seems to support with ease a debt burden which, half a century ago, nobody believed her capable of supporting'.²⁵

Few economists question the need for temporary, significant deficits in a situation such as the current one. Especially in times of crisis provoked by too low aggregate demand and pervasive loss of consumer confidence, fiscal stimulus may be the key to bringing the deficit back to its previous levels. Timing is crucial; cutting public spending too early could prolong a crisis, as with the protracted recession that followed Japan's decision to cut spending in the mid-1990s.^{5–7}

The argument that investors would disinvest as a result of public debts is not supported by historical evidence^{22,26} and seems even less so now. Since the 1980s, the private sector has been a major beneficiary of government spending programmes, attracting often lucrative contracts to undertake what were once core government activities.²⁷ Neither are fears about credit ratings supported by the observation that they are not being marked down in major economies facing greater debt than the harshest projections for the UK.¹⁵ In Canada in the 1990s, elements of the media and investment community characterized public spending levels as disastrous, casting doubt on the country's AAA credit rating, even though later assessments revealed that the country's finances had been healthy.²⁸ (It should also be noted that the credit agencies are themselves coming under considerable scrutiny given evidence of incestuous links with financial institutions given AAA ratings just as they are about to fail, leading to calls in continental Europe for greater transparency and a European credit rating agency.) Further, the concern that debt repayment will rise as a fraction of current government spending in subsequent years depends

on assumptions about the sustainability of the debt and, as some argue, the stimulus contributing to the deficit is itself crucial for restoring growth and ensuring debt sustainability. There is an emerging consensus that government actions in the first months of the downturn have been vital to prevent a severe depression, and this increased spending should not be cut prematurely. Finally, the levels of debt and deficit written into the Maastricht treaty are now accepted as arbitrary; there is no evidence that these levels predispose countries to worse economic outcomes and, while they reflect a widespread view among macroeconomists, there is also evidence that higher public spending during recessions can promote recovery.^{29,30} The criteria set out in the Maastricht treaty are consequently being reconsidered as so many countries have breached them, but they may previously have taken their toll on public spending programs, including public health budgets. Major declines in public spending occurred after the Maastricht criteria were agreed upon in the early 1990s.^{29,30}

As this brief analysis shows, the current debate on public debt is greatly simplified, and its consequences likely overstated; perversely, it could nevertheless be self-fulfilling. If consumers worry about out-of-control government spending, they may save money instead of spending due to fears of a further downturn, ironically delaying recovery.

If we are to reduce budget deficits, how might we do it?

Reducing government deficits is, in principle, simple: cut costs or free up money. Governments should always spend money efficiently, but there are also at least five ways in which their finances can be increased.

One short-term measure is the sale of government assets (i.e. privatization). This is risky; governments may fail to recoup their assets in a depressed market. Russia's rapid privatization programmes sold assets at a small fraction of their actual value. In one of the worst examples, an oil company with assets worth \$8000 million was auctioned for \$101 million. However, Britain has experience with case-by-case sales of assets, and has begun selling assets to attempt to raise £16 billion, with more on the way, such as the channel tunnel rail link and the National Air Traffic Control Service. It is important to get the timing right; the Swedish government made a substantial profit when it resold ailing banks that had been partially nationalized in the early 1990s in response to a banking crisis³¹ and the British government is already sitting on profits of many billions of pounds as a result of its investments in part-nationalized British banks.

Governments can alternatively stimulate the economy by increasing the money supply because, when a country faces the risk of deflation, demand reduces as people wait for prices to fall. Governments have, however, been anxious about doing this since Germany's experience in the inter-war years, when printing money to pay war debts led to spiralling inflation and ultimately World War II. This sequence of events is now recognized as an extreme case, and many economists argue that inflation does not impede growth as long as it does not rise above about 8–10%,^{32–35} leading to 'hyper-inflation.' The options are, however, limited because when interest rates are already close to zero, it is not possible to stimulate the economy by cutting such rates further. Instead, central banks increase the supply of money to financial institutions to encourage them to lend even greater sums (an approach known as 'quantitative easing', especially relevant when there is risk of deflation which could lead consumers to save in anticipation of further price drops). Thus this measure has been employed by the Bank of England, the US Federal Reserve and the European Central Bank, although there is now considerable pressure for further structural reform of the British banking sector to ensure that the money is lent to businesses. Although primarily intended to increase the money supply, quantitative easing will tend to increase inflation and thus reduce the value of debt held in the national currency (but simultaneously put pressure on interest rates to rise).

A third option is to borrow more money. Most governments have taken this approach, issuing long-term government bonds. The rationale is that the resulting investment helps countries to grow out of debt, as long as the economy grows faster than interest rates (which are currently at record lows).

A fourth option is to increase taxes. Taxing the rich has considerable populist appeal, as many hold those involved with the bank system responsible for the crisis and believe they should pay its price. As we have noted, a key problem with the current debt crisis is less increased public spending than decreased tax revenue. However, some commentators argue that taxing bonuses and high incomes may stifle incentives for entrepreneurship and innovation. Enforcing a more progressive tax system is politically challenging in light of the lobbying strength of the wealthy, but may most directly address the current debt crisis. While more progressive taxation is a less viable option in countries with already highly progressive systems, like Sweden, there is scope for raising revenues in the UK.^{16,17} In fact, the current government has adopted a quite different approach, increasing VAT, a regressive indirect tax whose burden falls disproportionately on the poor.

There are also some simple, albeit politically difficult, changes that would bring British corporate taxation into line with many other countries, to yield very large sums for continued government spending.³⁶ Increasing taxes on alcohol, tobacco and sugary drinks further could be viable revenue-generating options, benefiting both health and the economy. In the short run, these options may disproportionately hurt the poor (although there are disputes about the net effect on their overall welfare), and Keynesian economists have worried that such taxes will diminish aggregate demand and slow the recovery. Thus, in Roosevelt's New Deal, prohibition on alcohol was lifted not only because it was popular, but mainly because it would reinvigorate consumer spending and increase tax revenues. The health costs of this aspect of his policy (and, in turn, subsequent downstream costs) were never assessed. Further limitations include the scope for tax evasion due to imports from other EU countries, as well as smuggling of goods such as cigarettes, an activity in which the tobacco industry has been complicit. Another option is the proposed Tobin Tax, which would take a very small percentage of capital flows. This was proposed by Gordon Brown at the recent G20 but elicited a lukewarm response and was dismissed by the International Monetary Fund. This could generate significant revenue, but would require agreement and implementation by all major countries to be effective.

The final option, and that being adopted by the government, is to cut public spending. This was done in Japan in the 1990s, but backfired. Cutting public spending removed money from the economy just at a time when a fiscal stimulus was needed, resulting in a further loss of revenue.

The implications for public health may be considerable; those calling for public spending cuts focus not only on the bank bailouts that caused the problem but rather also on public services. Such cuts are likely to impact on those without means to buffer themselves from economic shocks, and who are least likely to live in the marginal constituencies that are crucial for a party to win power under the first-past-the-post political system. They effectively redistribute resources from the poor to the wealthy^{37–39} and there is now clear evidence from historical data that lower spending on social welfare costs lives.²

How to cut public spending if deemed necessary?

As the government moves towards the autumn spending review, there will be a debate about which services should be cut. There is always scope to cut spending on services, which do not provide value for money. However, the

services that are cut are often those which lack a strong advocacy base, such as mental health, rather than those lacking a strong evidence-base for improving health. It cannot be assumed that cuts will selectively target inefficiencies, and may actually make the system less efficient.

Ideally, policymakers will identify the sectors in which investments have the greatest multiplicative effects on economic growth to guide such decisions. It is to be hoped that they are aware of the growing evidence supporting appropriate investment in both health⁴⁰ and education⁴¹ as means of increasing human capital, and the evidence compiled by NICE and others identifying what investments in health and health care are most cost-effective, recognizing that this must be coupled with policies to disinvest in those that are not. In this light, the government's response to the excellent report on homeopathy by the House of Commons Science and Technology Committee is alarming, signifying a rejection of basic scientific principles.⁴²

In the health-care provision there is merit in looking at future liabilities to see whether they might be restructured. Of most relevance to the NHS are the commitments entered into for hospitals to be built using the Private Finance Initiative—now widely viewed as inefficient and costly, and with the added irony that some of the banks that have been rewarded by the government for assuming risks of investing have themselves been bailed out by the government. As happened in Australia, it may be appropriate to take these hospitals back under public ownership, increasing spending in the short run but potentially reducing future liabilities.⁴³

Further, there is now known to be significant waste associated with the high transaction costs of running a competitive market-style system with its emphasis on consumer choice. Rather than encourage further competition, wasteful of public funds with little demonstrable gain, arguably the need now is for greater collaboration and joining-up across government at all levels. One example is Total Place Pilots, which appears to generate significant savings by looking at the needs (health and other) of an entire place or community rather than focusing on the separate organizational silos in those places. Seeking to reduce costs through ending duplication and waste also create potential for freeing up funds without sacrificing essential services or quality—indeed, such measures could enhance delivery and quality. There are also the huge sums of money spent with dubious effect on management consultants in the NHS, as reported by the House of Commons Health Committee in 2008–09.⁴⁴

In developing evidence-based investment reforms, NICE now provides guidance to demonstrate 'best buys' and where investment might be made to most effective together with disinvestment. It remains to be determined whether

GP commissioning groups will use such guidance or will simply adopting a familiar 'slash and burn' approach to balancing their books.

Budget cuts also offer opportunities to investors who are eager to clear room for private sector development in a number of choice industries. Some large corporations, such as the Virgin group, are already positioning themselves to take advantage of these opportunities, explaining Richard Branson's pre-election calls for large reductions in public services. Health care is a major target, as many of the other public services have already been passively privatized over the years (including long-term care).²⁷ Policymakers may select evidence that justifies their decisions that benefit vested interests, illustrated by the Audit Commission's descriptions of the case for some Private Finance Initiative projects as 'pseudoscientific mumbo jumbo'.⁴⁵

What is happening in the rest of Europe?

Are other countries choosing to cut spending on health? In a survey of experts from 18 European countries,⁴⁶ there was little evidence of explicit cuts in health budgets at this point in the crisis, with the exception of Spain, the Baltic states and other eastern European countries. These latter countries borrow from the International Monetary Fund, which has demanded such cuts, causing some health ministers to resign rather than implement what was demanded of them.⁴⁷ Health budgets in some countries are, however, being allowed to wane by avoiding updating of budgets in line with inflation, creating an effective reduction in the health budget rather than explicitly cutting them. When budgets have been cut, the focus has been on salaries of health workers (including Slovenia, Latvia and Lithuania) or pharmaceutical expenditure (Spain). In most cases, efforts have been made to protect spending for the most vulnerable, although some countries report threats to already low mental health budgets (such as Hungary). In the Czech Republic and Estonia, health insurance funds have benefited from accumulated reserves, while in others, such as Austria, governments have topped up insurance funds from tax revenues. A number of countries, including Sweden, France and Austria, have also increased spending on health care and labour market protections, explicitly to mitigate negative health impacts of the financial crisis and stimulate economic recovery.¹

Summary

The argument that the UK's current debt is unsustainable is based on assumptions that are questionable given current

and plausible future levels of interest rates, inflation and economic growth; however, the spectre of politicians continuing to trigger public anxieties, talking public spending down, could bring real economic and public health risks. Given the evidence indicating that good health is good for the economy (and, in turn, poor health hurts the economy), as well as evidence (such as the two Wanless reports) that investment in health will reduce the long-term cost of delivering health care)^{48–52} and that public spending can make a positive difference to health,⁵³ we caution that the 'savage cuts' being implemented should not be seen as inevitable. The potential long-term health, economic and welfare harms from cutting health spending could outweigh any potential short-term financial gains, a view seemingly accepted by other European countries with even greater debt than the UK. As the recent Marmot review on health inequalities in England argued,⁵⁴ it is essential that sustainable investment in health and social justice is not sacrificed in the quest for short-term economic gains (Box 1).

Box 1. Debates on public debt

'Probably more uninformed statements have been made on the issue of public sector debt and deficits than on any other topic in macroeconomics. Proof by repeated assertion has frequently appeared to be an acceptable substitute for the more conventional methods of proof by deduction or by induction.' Buiter, 1985²⁶

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