Fiscal rules

We await new fiscal rules to guide the economy. According to the IFS we have had 12 fiscal rules from 1997 until 2017 and have broken or ditched ten of them. Labour's aim to keep state debt below 40% of GDP was blown away by their Great Recession and the idea that they would balance the current budget over the cycle with it. Osborne's aim to get state debt falling as percentage of GDP every year so that actual debt fell from 2014-15 was relaxed when he did not hit target.The 2019 aim of getting the current budget in balance within three years was binned by the pandemic.

All the fiscal rules have been variants of the Maastricht requirements that the deficit should be under 3% and state debt should be under 60% of GDP or declining as a percentage of GDP to get closer to that target. The formal rules are currently in suspension pending new rules. However the Spring 2021 OBR and Red Book was based around getting the budget deficit down to slightly under 3% by 2024-5 and getting state debt falling as a percentage of GDP by the end of the period. It is all very familiar.

The government is still reporting our progress against the Maastricht rules as if we were still under the EU reporting system and in their semester control. The OBR assures us there are still guides and it still clearly likes the state debt and deficit controls. The rules that the current budget should on average across the cycle be in balance, and capital spending should be no more than 3% of GDP is just another way of expressing the EU budget deficit ceiling. The way spending growth is constrained in the later years of this Parliament and taxes planned to go up shows just what a grip on policy the state debt controls have.

I am urging a new approach. The government should stop monitoring the U.K. economy against the EU debt and deficit rules, and stop budgeting as if they ruled the future. Instead it is a good idea to have a limit on debt interest as a percentage of revenues. The current limit of 6% is generous and could be brought down to 5%.

There then could be targets for growth and inflation . We already have a 2% long term inflation target which is fine. To produce a balanced policy where there is scope to invest and grow we should set a stretching but achievable growth target. This should be above 2% for the long term average and should be much higher for this year and next given the need to recover from the pandemic recession.