

We need more than a fiscal rule

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I [criticised Dan Jarvis' economic plan](#) yesterday, [and I think rightly so](#). I am hoping that John McDonnell's plan, to be announced today, makes more sense but I am not wholly optimistic. [According to the Guardian](#), who have clearly been briefed:

[McDonnell] will say that Labour would balance tax revenues and day-to-day spending over a five-year cycle; but this target would exclude long-term investment projects, allowing Labour to spend billions on projects such as housing, railways or high-speed broadband.

Thankfully there appears to be an exception clause:

Labour's new target would be suspended when interest rates were close to zero, leaving the Bank of England little firepower left to stimulate the economy. The Bank's monetary policy would make the decision about when to trigger this so-called "knock out".

In other words, the plan would not have applied in the last seven years. But this does leave big questions needing answers even if, as is obviously true, this plan accords much more closely than anything the government is offering to the obviously wise (on this occasion) wishes of the OECD and IMF, who are both demanding fiscal stimulus now.

The most obvious concern is political. This looks so much like Gordon Brown's 'golden rule' that the hark back to the Brown / Balls era is just too easy to make.

Second, like my complaint about Dan Jarvis, if this is offered as a plan without a reason it falls short of a vision and merely becomes a managerial tool. This is unfortunate, to say the least: I think people do buy vision and in this case there could be a vision people want to hear. That vision, [as I explained in the talk I gave on Monday](#), would be of fiscal expansion until such time as wage increases created the inflation that we need again, full employment at higher levels of productivity was created and the wage share of the economy had increased. That is a vision.

Third, and maybe the speech when it comes out will show I am wrong on this, but there are problems with what John McDonnell has said. The biggest, [as I have explained time and again on this blog](#), is that fiscal balance, whether it be short or long term, is beyond the gift of any Chancellor. Sectoral imbalances will persist whatever a Chancellor says. In that case to offer balance and to indicate a time scale makes no sense at all.

To elaborate, a government balanced budget depends on at least four things. The first is revenue. The second is spend. The third is the level of investment and the fourth is the balance of trade. These factors when combined decide whether the rest of the economy saves or borrows or not, and since the government is depositor (i.e, borrower) of last resort then, come what may, if everyone else in the sterling economy net saves then the government will borrow and there is little they can do about it by issuing edicts to balance the books. This is why such rules make little sense.

Instead all Chancellors can do is explain what they are going to do within the constraints under which they really operate, which would be a step in the right direction of firstly explaining their proper role as economic managers and secondly in assuming a little humility. And, I stress, there are several things they can do.

The first is they can make good decisions on spending.

Second, they can seek to boost their revenues. The only sure way to achieve this is by growth and on this issue there is a massive difference of opinion between Labour and the Conservatives that should be highlighted as the core of what Labour is saying if it wants to create electoral space for itself. The Conservatives think that cutting government spending boost the economy, even in a recession. Labour thinks that in a recession government spending boosts growth. Put technically, the Conservatives think the multiplier on government spending is less than one and Labour thinks it is more than one, as (now) do the IMF and OECD. That's all this debate is about: this is the difference in philosophy explained.

But that that means is that Labour can say training pays back in tax yield.

And investment to increase housing, business, transport, broadband and energy all pay back in tax paid.

And so these activities do not drain the Exchequer, they return money to it because they deliver growth of more than the sum that the government spends and so they boost government income and so they actually are the way to balance the books. Not maybe today, but quite emphatically over time.

And over that same time they increase national earnings and so cut the trade deficit.

And that encourages business to invest, which it is not right now.

And they also reduce dependency and so encourage spending by households who are

now saving because of fear of unemployment.

What is more, by increasing skills and productivity they increase wage share and create the inflation that we need as an economy.

And in the process they actually change the sectoral balances, meaning that the government's books could balance.

So that is a plan. And a fiscal rule is not.

I really hope we get more than a fiscal rule.

[*NB: This follow on blog may also be of interest*](#)