

The last thing Labour needs is another fiscal rule

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The FT has reported this morning that Anneliese Dodds is to set out plans for Labour's new economic strategy in a speech today. [They note that:](#)

Calling for a “responsible fiscal framework” based on “pragmatism, not dogmatism”, she will commit Labour to a rolling target of balancing the government’s current budget in the future, which would allow increased capital spending.

There would also be an exception to the rule for times of crisis, which would allow for a delay in budgetary consolidation while the Covid-19 recovery was continuing, but Labour is planning two defences against inevitable Tory jibes about fiscal recklessness.

The first is an idea from the Institute for Fiscal Studies that would set a “fiscal anchor”, stopping a free-for-all in public spending increases. The second is that Labour is determined to attack what it regards as Conservative waste in public spending during the crisis and put in place safeguards to prevent a repeat under a Labour government.

Any reference to the IFS in this context is unfortunate. Given that they do not understand macroeconomics and say they do not do it, using them for guidance is bound to represent misplaced faith. But I have read what they have to say fiscal anchors. [It is this:](#)

In the meantime, some fiscal anchor could be useful — not least given the prime minister’s desire to cut taxes, and next year’s spending review. Given current heightened uncertainty, rather than targeting measures of borrowing or debt, one short-term option could instead be to set a maximum amount of permanent discretionary fiscal loosening that the chancellor would be prepared to implement. If an increase in investment spending financed by borrowing was thought to be appropriate, such an anchor could apply just to the current budget. For example, the chancellor could commit to ensuring that any permanent tax cuts or further permanent increases in day-to-day spending would be entirely financed through tax rises or cuts to other spending. But because it would not constrain actual borrowing or debt, these could still increase if the underlying fiscal outlook deteriorates, or if the chancellor chooses to

raise investment spending or deliver a temporary fiscal stimulus package

What are the problems then, because I doubt I would be writing this if there wasn't one? I suggest they are threefold.

First, this is a fiscal rule, and these are hostages to fortune. As the IFS says (on this occasion with some relevance) in the same report as that just noted:

The last two decades have seen the implementation of numerous fiscal targets. Some have been quite well designed (most notably Mr Osborne's 2010 fiscal mandate, which has much in common with the first half of Labour's proposed fiscal rule). But many have been poorly designed; and many have been committed to, only subsequently to be missed or abandoned.

Let's leave aside the IFS's praise for austerity for a moment. Instead note that even they think most fiscal rules are poorly designed. The reason is one that eludes them of course.

Their report makes very clear that the purpose of any fiscal rule is to prevent the growth in government debt. In other words, the whole point of any fiscal rule is to limit the activity that government can undertake within society, even when there is need to be met.

It is not, in that case, the detail of a fiscal rule that is a problem, although such is the complexity of the economy that any rule will, inevitably be too simplistic to help. It is instead the very purpose of the rule that is the problem. Implicit in any rule are the ideas that:

- * too much government activity is a bad thing because it squeezes out the market, when there is no evidence yet found that this is true in the UK;
- * that government must be constrained from doing things that people want, and
- * that government is constrained by debt.

None of these assumptions should in any way be entertained by Labour, in my opinion. The last, in particular, is simple nonsense. QE has shown that debt is not a constraint on government so why would Labour want to suggest it is unless it wants to suggest it agrees with these other rather dangerous assumptions?

Second, the only reason for having a fiscal rule is to admit that there is a lack of trust in Labour. There were no such things before 1997. Gordon Brown believed people did not trust Labour's economic judgements, so he introduced the idea. Anneliese Dodds will, by accepting that a rule is needed, accept by implication that people still do not trust Labour. As the IFS also noted:

In the end, there is a tension between having clear and measurable short-term targets which impose real constraints and allowing chancellors full discretion to make appropriate decisions. Were governments fully rational and trustworthy — and this widely seen to be the case — rules would not be needed. The rules themselves will always be second-best. The less trust and confidence there is in a government's handling of the economy, the greater the benefits from having a transparent, measurable and constraining set of rules.

Having a rule is, then, an admission that Labour is already on the back foot economically when there is literally nothing about the last decade or so of Tory economic management that puts them in any position of authority.

Third, and most importantly, the reason to reject the idea of the fiscal rule is that it accepts the whole package of neoliberal economics. There is of course nothing new in this. John McDonnell did exactly the same thing, with a ludicrous fiscal rule that even included reference to 'maxing out the credit card'. Anneliese Dodds will, then be following in a long Labour tradition of making this mistake. But it is still a mistake.

The last decade has proved that governments do not operate at the behest of bond markets, as was once thought. Instead, bond markets operate with the consent of government, which can and will provide them with more or less debt to trade entirely at the will of government. This is a massive change in relationship. Fiscal rules pretend that this change has not happened.

Fiscal rules also pretend that government interest costs are set by the whim of markets. Again, over the last decade it has become absolutely apparent that this is not the case. So a fiscal rules is, again, misguided.

And what we now know is that the idea that deficits, tax and debt are the only variables in government finances is nonsense. Money creation is the other option available to any government. What is more it is the one that the last decade has proved must be used time and again to ensure that the economy can simply function, and yet nowhere is this idea implicit within any of the logic of fiscal rules.

I am, in that case, suggesting that Anneliese Dodds is making a political error today. She is telling the electorate that Labour cannot be trusted to manage the economy unless it shackles itself to rules that the Tories demand but would not follow. That explains why Labour cannot win with such a policy, and probably will not.

And she is making the mistake of tying Labour to neoliberal thinking that is so very obviously of no relevance now, as has been proven by events since 2008.

But worst if all, she is accepting a framework for economic management that does not reflect any of the realities of the modern macro environment. Gordon Brown may not

have known this, but both theory and practice provide no excuse for Labour not doing so now.

We live in a new era, where money creation to achieve policy goals is a key part of government economic activity. Labour is pretending that this option does not exist, and that government is still a household constrained by markets, when evidence is now very clear that government is the market maker. Offering old policy in a new era is always a recipe for disaster. I am afraid that Labour is setting itself up to fail.

And is there an alternative? Yes, of course there is. All Labour needs to say is that it will manage the economy to deliver full employment in a sustainable economy by implementing a Green New Deal to be the basis of the future real prosperity that we all deserve and the finances will literally follow and fall into place - because they always do at full employment. Unfortunately, what Labour is saying prevents that possibility. And that is really bad news.