

Go for growth to get the deficit down

The government faces grave difficulties in securing a pro growth economic policy from both the OBR and Bank. The OBR regularly makes large errors in its forecasts of the future deficit yet the whole fiscal stance is based around the OBR five year forecast. The truth is no one including the OBR can get to within £50 bn of accuracy for that figure with any reliability given the huge number of variables that will affect it over a 5 year period.

Indeed, the OBR has been unable to forecast the one year figure in recent years with any accuracy. In March 2022 the budget forecast for that year was a deficit of £99 bn. Some of us said that was too low at the time. In November that was hiked to £177 bn. The current view of the outcome was just £132 bn. So since the budget of November 2022 with no further policy change the OBR has been £45 bn out! In 2021-2 the budget forecast overstated that year's deficit by £131 bn.

What should be done?

The OBR should be asked to revise its models. They should provide an honest account of why their deficit forecasting has gone so wrong. Whilst there have been some in year policy changes, the main problem seems to be the revenue forecasts on unchanged policies. Their model wrongly thinks lower tax rates raise less money and higher tax rates more, without putting in a factor for behavioural change and for the rate of underlying growth to correct. Tax revenues are very sensitive to the rate of economic growth, as a marginal pound of extra output or income is taxed highly. Recessions lower profits and incomes cutting tax inflows. The OBR's ability to forecast spend on unchanged policies is also impaired where they need to work on estimates of take up of subsidy and benefit schemes.

The government should remain committed to getting debt as a percentage of GDP and deficits down in future. It needs to explain how sensitive deficits are to growth, and explain how adopting a better pro growth strategy would assist deficit reduction. It needs to adopt a pro growth strategy and draw on past experience to show how and why faster growth will prove OBR deficit forecasts wrong if they persist with high deficit estimates.

The government needs to make the case for lower tax rates bringing in more revenue. The Thatcher cuts in income tax brought in much more revenue from higher earners. The Osborne cuts in corporation tax brought in more business tax. Above all modern Ireland shows that you can collect four times as much from business proportionate to the size of the economy by setting a 12.5% tax rate.