New fiscal rules?

I read that the Treasury is getting round to reconsidering their fiscal rules. That is a necessary and urgent task.

There are two key rules affecting the conduct of economic policy that are in place today that I think should continue.

The first is the 2% inflation target that is meant to guide Bank of England interest rate decisions. It also needs to guide the Treasury as they make decisions on levels of money creation and bond buying with the Bank of England, and as through fiscal policy they have a substantial impact on inflation.

The second is the debt interest rule, that the interest charges on government debt should not exceed 6% of revenues. They are under half that at the moment, thanks to very low interest rates and to Quantitative easing. This is a sensible target to continue, and could be toughened to 5% of revenues.

There are two rules over the deficit. The first is it should be brought back to balance on current spending within a three year horizon. This is a bizarre target, as the government/OBR hits it by forecasting favourable changes three years out which might never take place. The second is capital spending in the public sector should be limited to 3% of GDP. It has been running below this for some years. Capital spending levels should primarily be judged on prospective returns and ability to be self funding over time. Add these two targets together and we return to the Treasury's much loved Maastricht target of keeping the deficit down to 3%. The OBR/Treasury are also still wedded to the idea that state debt as a percentage of GDP should be brought down, so they encourage ministers to impose tax rises and spending cuts to get state debt as a proportion of GDP falling. This reflects the Maastricht requirement to get state debt down to 60% of GDP sometime.

It is high time we cancelled the Maastricht austerity targets. The Treasury still reports how we are doing against them as if we were still governed by the EU Treaty that made that necessary. Instead we should have a growth target. Like the Fed the Bank of England should have the twin targets of low inflation and faster growth. A growth target would stimulate more thought and action in government to raise living standards and follow policies that boost UK jobs, incomes and business. A suitable growth target would be to aim to return to 2.5% per annum growth from the more anaemic levels of this century under Maastricht austerity.