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Contents | Page No.

Commentary on the economic situation 1

Research paper -
Topic: Old and new in British fiscal policy 3

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A dull Budget would be no bad thing

Will the new rules constrain fiscal activism?

Shift from the PSBR to new concepts of the Budget balance

For over 25 years the public sector borrowing requirement (or PSBR) was the favoured measure of the UK's fiscal position. In 1997 the present Government introduced two new rules for fiscal policy. As a result, the attention of policy-makers and financial markets should be on different measures of the fiscal position. The first rule (the so-called "golden rule") is that the public sector should not borrow except to finance capital expenditure. The implied target measure of fiscal policy is the "public sector current budget" (PSCB), to be kept close to zero in the course of the business cycle. (Deficits are allowed when output is beneath trend.) The golden rule could be abused, if too much capital spending led to vast cash deficits and an excessive growth of debt. This justifies a second rule, "the sustainability rule", that net public sector debt should not exceed 60% of GDP. The relevant measure of fiscal policy here used to be called the public sector's financial deficit (or surplus), but is now relabelled "public sector net borrowing" (PSNB).

Official press releases to encourage greater awareness of new concepts

Much comment on the public finances continues to focus on the PSBR, which has been renamed the "public sector net cash requirement". The persistence of old habits may partly reflect the regular monthly publication of the PSNCR figure, as well as its connection with the programme of official gilt sales. But the Treasury and the Office for National Statistics have started to focus on the Labour Government's preferred measures of the budgetary position. On 19th January they issued a press release with the first monthly figures for public sector net debt and borrowing. (The data had previously been available quarterly; they were buried in the specialist publication, Financial Statistics.) On 26th February they published a new press release on Public sector accounts: provisional results. It gave prominence to the PSCB, emphasizing that this is an "important statistic...used to monitor the Government's success in meeting the Golden Rule".

The fiscal position under the new rules is alright, but tax cuts must be limited because of higher spending

Neither of these releases received significant attention in the financial press. Nevertheless, Mr. Brown and his advisory team take the rules very seriously. Since the "Budget judgement" is now to be subordinated to them, analysts need to check what is happening to the PSCB, the PSNB and the debt-to-GDP ratio. As far as the PSNB and debt-to-GDP ratio are concerned, Mr. Brown has room for manoeuvre, because the PSNB is in approximate balance and the debt-to-GDP ratio is well beneath 60%; on the PSCB, the position is also satisfactory, with a deficit of only £1.6b. in the nine months to December 1998. But - given his commitments on extra public spending - Mr. Brown will have to eschew tax cuts on 9th March if his rules are to be met in 1999 and 2000.

Professor Tim Congdon 5th March, 1999

Summary of paper on

"Old and new in British fiscal policy"

Purpose of the paper

New fiscal rules have been introduced by the Labour Government. This research paper asks how they relate to previous fiscal rules practised by British Governments.

Main points

* **Until the Second World War British fiscal policy was dominated by the principle of the balanced Budget, expressed in terms of a complex above-the-line/below-the-line distinction. This rule had no clear basis in macroeconomic theory.**

* **Keynesian economists tried to introduce macroeconomic concepts into fiscal policy in the 1940s and 1950s, and they believed that they had done so. In fact, pre-Keynesian concepts and principles survived until the late 1960s.**

* **After excessive fiscal (and monetary) stimulus in the early 1970s and the consequent macroeconomic anarchy of the mid-1970s, new fiscal rules - relating the PSBR to targets for money supply growth - were adopted. But money supply targets were dropped in 1985.**

* **Both the "Keynesian revolution" and the "monetarist counter-revolution" amounted to less in practice than they did in the media propaganda of their heydays, although they shared a belief in the relevance of macroeconomic theory to the design of fiscal policy.**

* **The late 1980s saw a return to the balanced Budget principle, now expressed as a zero PSBR over the cycle. In 1997 New Labour took the rehabilitation of old ideas further, by announcing the Golden Rule and the "sustainability rule", and relabelling the terms used to describe fiscal policy.**

* **New Labour's rules have almost nothing to do with traditional macroeconomic theory, but should instead be interpreted as the recovery of old principles of sound finance stated in contemporary terms.**

This research paper was written by Professor Tim Congdon. A slightly different version is to be published in the Institute of Economic Affairs' journal *Economic Affairs*.

Old and new in British fiscal policy

Macroeconomics vs. sound finance as policy guidelines

Changing approaches to fiscal policy

The conduct of British fiscal policy has changed during the post-war period, reflecting both the pressure of events and the evolution of thinking about macroeconomic policy. The purpose of this paper is to review the changes in policy approach and to see how they relate to the ultimate objectives of macroeconomic policy. These objectives are usually recognized to be high (or full) employment and price stability, although equilibrium in external payments and economic growth need also to be mentioned.

In 1940s and 1950s new macro-economic ideas gained ground compared with old sound finance precepts, but recently these precepts have returned

The argument will be that in the 1940s and 1950s attempts were made to replace atheoretical Treasury orthodoxies with policy approaches clearly grounded in macroeconomic analysis. Unhappily, the two main approaches - Keynesianism and monetarism - were in conflict. Indeed, the differences between them were radical in principle and led to bitter disputes in practice. Despite these tensions all economists involved in the debates on fiscal policy between the 1950s to the 1980s appealed to macroeconomic theory and analysis to support their positions. However, in the 1980s - and more particularly in the 1990s - the debates fizzled out, while the fiscal ground rules became disconnected from the understood objectives of macroeconomic policy. Indeed, the new ground rules - despite their authors' insistence on their modernity - had many echoes to those espoused in the Treasury before the 1940s.

Above-the-line and below-the-line distinction crucial until post-war period

The key precept in fiscal policy until the post-war period was that the Government should balance its Budget. The concept of budget balance depended on a distinction between "above-the-line" and "below-the-line" items, with the aim being to maintain the balance (or even achieve a small surplus) above-the-line . The distinction was related, but not identical, to that between current and capital expenditure. In essence, recurrent items of capital expenditure were deemed to be "above-the- line" and so had to be covered from current revenue, which would predominantly be taxation. Borrowing was legitimate to cover the cost of exceptional, non-recurrent items of capital expenditure, but that was all. Continuous borrowing to meet the cost of recurrent capital expenditure was rejected, as it "would only increase the costs over the years by unnecessary payments of interest".(1) Implicitly, high levels of debt interest were regarded as misguided, even dangerous.

and had originated in the late 19th century

These definitions and conventions originated in the era of Gladstonian sound finance in the late 19th century. They were affiliated to distinctions between the Consolidated Fund and the National Loans Fund set out in the Exchequer and Audit Departments Act of 1866. To macroeconomists who had absorbed Keynes' ideas in his *General Theory* of 1936 they were old-fashioned hocus-pocus. The Keynesians believed instead that the budget balance should be varied to influence the level of demand in the economy and, at a further remove, the number of people in work. While Keynes' own prescriptions for fiscal policy were never stated with much precision, most Keynesians thought

Keynesians derided old rules

that the right concept of the budget balance was that which measured the net "injection" or "withdrawal" of demand from the economy. In their writings this can be most readily interpreted as the change in the public sector's financial deficit (or surplus), where the financial deficit is the net incurral of financial liabilities to other agents. The PSFD has no clear or necessary connection with the budget balance above-the-line.

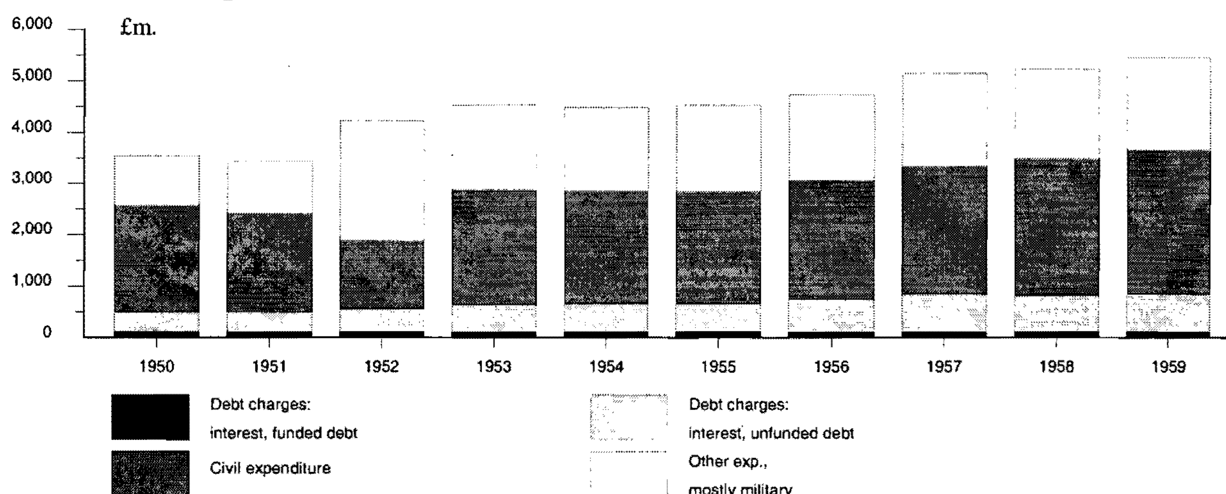
Debate in the 1940s and 1950s was between old Treasury traditions and Keynesian demand management

So the debate about fiscal policy in the 1940s and 1950s can be viewed as being between the guardians of old Treasury traditions and the apostles of Keynesian theories of demand management. The debate ran partly in terms of definitions, but it was also, more substantively, about the purposes of policy. The Keynesian theorists portrayed themselves as more rigorous, scientific and modern, partly because they were focussed on a standard aim of macroeconomic policy, namely to sustain high employment. A familiar textbook account of the period is that enlightened Keynesianism vanquished benighted Treasury orthodoxies. According to Dow in his well-known study on *The Management of the British Economy 1945 - 60*, "Since 1941 almost all adjustments to the total level of taxation have been made with the object of reducing excess demand or repairing a deficiency."(2)

In practice, the Treasury was able to preserve the above-the-line surplus

The debate between the Treasury mandarins and the Keynesian evangelists was in reality far more even-handed than the textbook story suggests. An important study by Matthews, published in 1968, emphasized that "throughout the post-war period the Government, so far from injecting demand into the system, has persistently had a large current account surplus...[G]overnment saving has averaged about 3 per cent of the national income".(3) The persistence of a "large current account surplus" may have been due to the application of the old Treasury rules, because it would be the logical by-product of financing a significant proportion of capital spending (i.e., the recurrent element) from taxation. Indeed, public sector accounts continued to refer to the distinction

Composition of public expenditure in the 1950s



Note the continuing distinction between funded (i.e., undated) and unfunded debt, and the prominence of debt charges in the presentation, showing the Treasury's concern about undue growth in debt interest.

Source: B. R. Mitchell *British Historical Statistics* (Cambridge University Press, 1988), p.592.

between above-the-line and below-the-line items until the 1960s. These notions survived, despite repeated criticism - and even outright mockery - from academic Keynesians.

Introduction of the concept of the PSBR, under IMF auspices, ended old Treasury principles

The final abandonment of the Victorian accounting framework came in the late 1960s, but it did not occur in particularly glorious circumstances. The Labour Government under Mr. Harold (later Sir Harold) Wilson from 1964 to 1970 was plagued by a weak balance-of- payments position and was obliged to devalue the pound in November 1967. As the balance of payments did not improve quickly, the British Government borrowed from the International Monetary Fund in 1968. In addition to imposing certain conditions for its loan, the IMF introduced new measures of both monetary and fiscal policy. Its target for the British authorities was stated in terms of "domestic credit expansion", which can be regarded as the sum of new bank credit extended to all UK domestic agents (i.e., to the public and private sectors combined).

PSBR was part of an accounting framework geared to control of the payments deficit,

The thinking was that the balance-of-payments deficit would be roughly equivalent to DCE minus the growth of the money supply. (Bank credit would create new money balances, unless the expenditure it financed went to foreign suppliers.) So - for any given rate of money supply growth - control over DCE would strengthen the balance-of-payments position. As bank credit to the public sector was part of DCE, the IMF guidelines implied some limit on the total of public sector borrowing which might be financed from the banks. This total was known as "the public sector borrowing requirement" or PSBR for short.

and the new concepts of the PSBR and DCE began to infiltrate monetary concerns into fiscal policy

The acceptance of IMF restrictions on Britain's public finances implied that satisfactory balance-of-payments outcomes had a higher policy priority than the achievement of full employment. This was undoubtedly a setback for the Keynesians. However, the IMF's involvement in policy- making in the late 1960s had another and rather different long-term significance. The vocabulary and form of macroeconomic policy shifted, giving more scope for monetary variables such as money supply growth, domestic credit expansion, bank credit to the private sector, non-bank financing of the budget deficit and, crucially for the future, the PSBR. It was this shift - not the Keynesians' ridicule in the 1940s and 1950s - that finally expunged the Victorian notions of above- and below-the-line deficits from the copybook maxims of British public finance.

Excessive fiscal expansion of the early 1970s

The move to a floating exchange rate in the early 1970s gave policy- makers a new freedom from the external balance-of-payments constraint on fiscal and monetary expansion. They abused their freedom totally. DCE and money supply growth ran at fantastic rates in 1972 and 1973, far higher than anything previously recorded in the post-war period. The PSBR, which had been in small surplus in the 1968/9 fiscal year, recorded a deficit equal to 9 per cent of GDP (at market prices) in the 1974/5 fiscal year. The annual rate of retail inflation exceeded 25 per cent in early 1975, in conjunction with a vast current account deficit on the UK's balance of payments. In the autumn of 1976 the Government again sought assistance from the IMF, which - as in 1968 - spelt out its targets in terms of DCE and the PSBR.

caused macroeconomic anarchy and stimulated "monetarism" as new body of policy thinking

In this environment of macroeconomic anarchy, a number of British economists rejected the Keynesian principles held by the majority of their profession and advocated monetary control as the right answer to inflation. A new body of thought, conventionally known as "monetarism", began to influence policy thinking. The Government had already introduced a target for money supply growth in July 1976, a few months before seeking IMF help, and refined them in conjunction with IMF officials in the closing months of the year.

UK monetarism particularly associated with the London Business School

Monetarism was - and remains - a rather disparate set of ideas. But, according to one very influential strand of British monetarist analysis in the late 1970s, control over money supply growth is essential to the control over inflation, while quantified targets for the PSBR facilitate control over money supply growth.(4) This strand of analysis had received an obvious impetus from the two IMF visits, but its basis was in a large corpus of theoretical work on monetary economics from American universities, particularly the University of Chicago. In the UK the most influential analysis was carried out in London, notably at the London Business School, but also with important inputs from City stockbroking firms.

and led to PSBR targets in the Medium-Term Financial Strategy

When the Thatcher Government came to power in 1979, the central themes of macroeconomic policy were avowedly monetarist. Money supply growth was to be reduced gradually in order to combat inflation, while fiscal policy was specified in terms of the PSBR in the belief that the budget position must be subordinated to the monetary agenda. In the Budget of 1980 the Medium-Term Financial Strategy was announced, with multi-year targets for both the PSBR and money supply growth. This was the sunny high noon of British monetarism.

Linking of PSBR and money supply targets heavily criticized in the early 1980s

But clouds soon appeared on the policy-makers' horizon. In the summer and autumn of 1980 the money supply target was exceeded by a wide margin, and yet economic activity deteriorated and inflation started to fall sharply. Monetarist theory, with its emphasis on the link between money growth and inflation, looked silly. Meanwhile opponents of monetarist thinking assembled an array of expert opinions about macroeconomic theory and policy for the Treasury and Civil Service Committee of the House of Commons. Their report was damning in its repudiation of the relationship between the PSBR and money supply growth, which was the analytical kernel of the MTFS. According to officials active at the time, the role of money supply targets in policy was downgraded as early as late 1980. While monetarism's sunset is best dated as October 1985 with the ending of broad money targets, its ideas had been fading in a rather murky intellectual twilight for some years.

So there were two main battles of ideas from 1945 to mid-1980s, both involving acknowledged macroeconomic objectives

The development of post-war British fiscal policy until the mid-1980s can now be provisionally summarized. There had been two main battles of ideas. The first had been between Treasury orthodoxies and Keynesianism. Whereas Treasury orthodoxies could be fairly characterized as having no clear meaning for any of the ultimate policy objectives, Keynesianism's ultimate objective was - very explicitly - the achievement of full employment. According to the textbooks, this battle had been resolved in favour of the Keynesians at some point between 1940 and 1970. Further, the textbooks judge that - whatever the

ambiguities about the exact date of its adoption by officialdom - Keynesianism was a success. Crucially, the application of its ideas was reputed to have been the dominant reason for the impressively low unemployment recorded in the 1950s and 1960s.(5)

The second battle was between the Keynesians and monetarists in the 1970s, as policy-makers and economists close to them grappled with double-digit inflation. The monetarists urged that macroeconomic policy as a whole concentrate on lowering inflation and that, by means of PSBR targets, fiscal policy be made subsidiary to money supply targets. Plainly, Keynesians and monetarists had divergent views about the best way of formulating fiscal policy, about the manner of fiscal policy's interaction with the rest of policy-making and about the effects of fiscal policy on the economy at large. These divergences were deeply felt and publicly disputed. But, equally plainly, both the Keynesians and monetarists validated their views on fiscal policy by reference to understood macroeconomic objectives. They were a long way apart, as the Keynesians stressed the goal of full employment whereas the monetarists were concerned almost exclusively with inflation. Nevertheless, their discourse was recognizably macroeconomic in structure and intention.

Protagonists in the debates appealed to macroeconomic theory and objectives

Both "the Keynesian revolution" and "the monetarist counter-revolution" less substantial than claimed

A strong argument can be made that neither "the Keynesian revolution" nor "the monetarist counter-revolution" amounted to all that much. The Keynesian revolution was far less substantial in actual fiscal praxis than it was as a set of nostrums and aspirations shared by a large number of university dons; the monetarist counter-revolution was retrospectively dismissed by the media as a temporary political fad, since it had never had a serious hold on the long-term policy-making establishment in the Treasury and the Bank of England. Subsequent narrative accounts of the period by the key players suggest that the media's characterization of the official attitude towards monetarism was accurate.(6) Perhaps the most noteworthy Budget on monetarist lines was that in 1981, which raised taxes sharply in the midst of a bad recession.

In the late 1980s Lawson reintroduces the balanced Budget principle, in the sense of a zero PSBR

However, this leaves a vacuum. If neither Keynesian nor monetarist approaches to fiscal policy held sway by the late 1980s, then what set of ideas did influence policy? The question may not have seemed particularly pressing during the boom in the final years of Mr. Nigel (later Lord) Lawson's period as Chancellor of the Exchequer. The public finances recorded large surpluses, as tax revenue was boosted by excessive domestic expenditure. At any rate, in the 1988 Budget Lawson took the opportunity to spell out a new rule for fiscal policy, that "henceforth a zero PSBR would be the norm". The rationale for this apparent restoration of the principle of a balanced Budget was that it provided "a clear and simple rule, with a good historical pedigree". Further, the balanced Budget rule would - according to Lawson in his memoirs - give the Treasury "a useful weapon in the unending battle to control public spending". Among other considerations which favoured balancing the Budget he referred to "the burden of debt service and therefore the tax level in years to come".(7)

But Lawson's attempt to validate his principle by its "historical pedigree" was curious

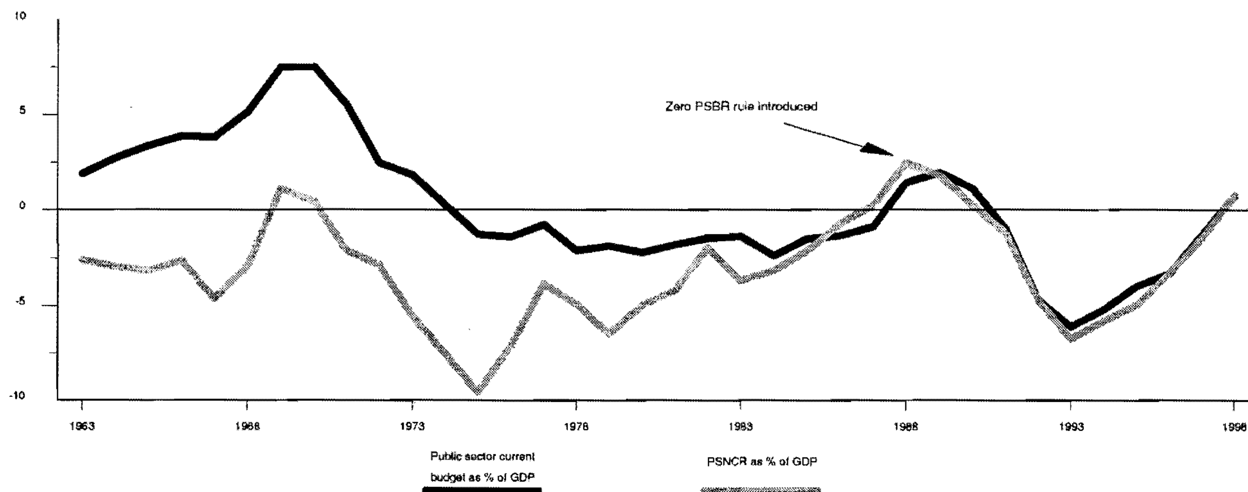
Lawson's discussion of the zero PSBR rule - in both the Budget speech of 1988 and his memoirs - referred only tangentially to the debate between the Keynesians and monetarists which had raged in the 1970s and early 1980s. Indeed, the comment on debt interest and the virtues of expenditure restraint echoed many statements from senior Treasury officials in the 1930s and 1940s, almost as if the Keynesian/monetarist debate had never been. But one of Lawson's claims - that the zero PSBR rule had "a good historical pedigree" - was misinformed. Even in 1988 the PSBR was hardly an historical concept. It had been introduced to the UK as recently as 1968, while at no point in the following 20 years had a zero PSBR been the main guideline for fiscal policy. The PSBR is an altogether different measure of the fiscal position from the balance above-the-line, which had in fact been the focus of Treasury attention in the early and middle decades of the 20th century.

Debate about broader purposes of fiscal policy became less heated in the late 1980s, as criticism was transferred to the validity of the PSBR in itself

The policy tendency of Lawson's years was therefore away from the macroeconomic objectives over which the Keynesians and monetarists had fought so furiously. Instead there was a return to rather old notions, such as the need to deliver long-run fiscal solvency and tight expenditure control. One item of expenditure in particular, the debt interest burden, was mentioned quite often in official speeches. The Conservatives remained in office for almost seven years after Lawson's resignation in October 1989 and kept his zero PSBR rule. The aim of maintaining a balance was not particularly controversial. Economists with a monetarist background were happy with a zero PSBR, while many Keynesian economists had come to accept the goal of full employment could no longer be pursued merely by means of demand management. However, the concept of the PSBR came under increasingly sceptical scrutiny. Embattled Treasury politicians and civil servants routinely relied on the PSBR target as their principal obstacle to more public spending. The concept of the PSBR was therefore reviewed and questioned. The critics seemed to think that the definition of the term, rather than the sequence of political choices being made

Old vs. new measures of fiscal solvency

Chart shows the PSNCR (the old PSBR) and the PSCB, which is relevant to the Golden Rule, as a % of GDP at market prices. Note that the improvement in the PSNCR/GDP ratio from the 1970s was much greater than that in the PSCB/GDP ratio. (Source: ONS)



by ministers, was to blame for the lack of particular kinds of public spending. For example, the PSBR was attacked by supporters of more public housing. They thought it was anomalous that extra capital spending by public corporations increased the PSBR, as the public sector had another asset (i.e., public housing) to match increased debt. A report in 1995 from the Chartered Institute of Housing and Coopers & Lybrand considered "whether there are alternatives to the current emphasis on the PSBR which would avoid undue constraints being imposed on investment by public corporations".(8)

This criticism of the PSBR was the prelude to two new fiscal rules set by Labour Government in 1997,

The election of a Labour Government in 1997 aroused high expectations of a change in the fiscal rules, including the demotion of the PSBR from its pivotal role. In a sequence of statements in late 1997 and 1998 Mr. Gordon Brown, the Chancellor of the Exchequer, did indeed greatly alter the framework for fiscal policy. Building on proposals in the Labour Party's election manifesto, in June 1998 the Government published a paper on *Stability and investment for the long term*. The PSBR had already been renamed "the public sector net cash requirement". As widely hoped, it was now downgraded in the list of fiscal concepts and ceased to be the subject of any policy rule. Instead the Government set two new rules for fiscal policy. The first - the so-called "golden rule" - said that, over the business cycle, the Government would borrow only to invest and not to fund current spending; the second - termed "the sustainable investment rule" - intended that "net public debt as a proportion of GDP will be held over the economic cycle at a stable and prudent level".(9)

with a shift of concern to the public sector current budget and to an overall limit on public sector debt

One consequence was that the critical variable for control purposes became the balance on the current budget or "public sector current budget". The golden rule implied that this should be nil or even in surplus. Of course, if the PSCB were balanced and yet capital spending financed by borrowing were on an enormous scale, the PSNCR (or PSBR, to use its old title) would explode. The purpose of the second rule was therefore to limit the public sector debt. However, the words first chosen to defend the rule - "stable" and "prudent" - were mealy-mouthed. Neither of the Government's two rules had an obvious link with macroeconomic theory, as conventionally understood. Indeed, *Stability and investment for the long term* contained almost nothing about the relationship between fiscal policy and employment on Keynesian lines, and no mention whatsoever of any measure of the money supply. The silence on the money supply contrasted sharply with similar statements 15 or 20 years earlier. Plainly, the Treasury no longer had much interest in the relationship between fiscal policy and money supply growth. Its political masters - and presumably its officials - seemed to have forgotten entirely the theoretical rationale for the initial programmes of PSBR reduction in the late 1970s.

New rules were interested in the distinction between current and capital items, inter-generational

So what were the arguments for the Labour Government's new rules? According to *Stability and investment for the long term* the new spending control regime was to be "based on the distinction between current and capital spending" (p. 20). Spending on capital items "creates assets which support services and benefits taxpayers in future years as well as now" (p.20). The golden rule was therefore "fair", because "those generations that benefit from

equity and the burden of debt interest

public spending should also meet the cost"; it would help "to match the costs and benefits of public spending across generations" (p. 21) and so ensure inter-generational equity. What about the second rule, that total debt should be kept under control, even if borrowing were to finance investment? In the crucial paragraph a reference to sustainability was tacked on to the emphasis on stability and prudence. Fiscal policy settings were then described as "sustainable" if "on the basis of reasonable assumptions, the government can continue to meet its current spending and taxation policies indefinitely while continuing to meet its debt interest obligations" (p. 22).

New Labour's leaders believe in the modernity of their rules

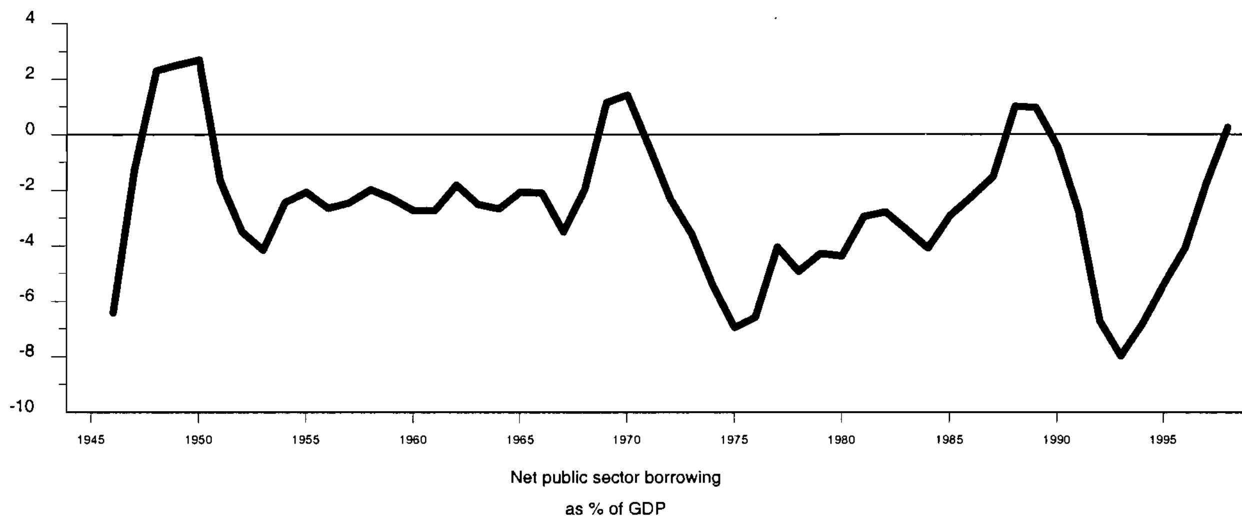
In short, the golden rule was concerned with inter-generational equity, while the "sustainable investment rule" would clearly be breached if debt interest were rising much more rapidly than national income. New Labour politicians undoubtedly believed that they were entering new territory. The White Paper on the *Comprehensive Spending Review* - published in July 1998 - was replete with references to modernity. In his foreword, the Prime Minister, Mr. Blair, insisted on a "new principle" which he termed "money for modernisation"; the first chapter said the overall spending plans would result in "a modern and flexible role for the Government, while the Treasury would "oversee a capital modernisation fund to provide for additional innovative projects"; and the National Health Service would have its own "modernisation fund". Rarely has the jargon of novelty been extended so close to the limits of platitude.

In fact, the new rules hark back to old pre-Keynesian orthodoxies

But how modern are the new fiscal rules? It is interesting to compare the present Government's views in *Stability and investment for the long term* with the thoughts of Sir Herbert Brittain, an old-style Treasury knight, in his book on *The British Budgetary System* published in 1959. The present Government claims that, under the golden rule, borrowing - and the associated increase in the national debt - can be justified if it is for investment purposes; Brittain observed that "[a] good deal of borrowing below-the-line may be offset by

Public sector net borrowing since 1945

Chart shows ratio of public sector net borrowing (formerly known as the "public sector financial deficit") to GDP at market prices. Note the sharp improvement since 1993 after a record deficit in 1992/3. (Source: ONS)



productive assets and to that extent...the increase in the national debt on this account need not cause undue alarm".(10) New Labour and Sir Herbert Brittain are clearly thinking is much the same way. The Government's "sustainable investment rule" is partly addressed to the danger of an ever-rising debt interest bill; Brittain noted that borrowing to finance current spending might stimulate the economy, but "in future years...the general taxpayer will have to find the interest which has to be paid to the holders of the newly-created debt".(11) Again, the thinking is similar.

Even inter-generational equity was of concern to the Treasury, especially in the context of war finance

Brittain was also quite eloquent about inter-generational equity, particularly in the context of debt-financed war expenditure. He doubted that borrowing did in fact shift the burden between generations. As he noted, "[w]ar borrowing - like any other borrowing - means that various members of the public lend to the State...the unspent portions of their incomes in return for some form of claim on the State in the future; and that claim is satisfied out of the taxation or borrowing of future years. But all this amounts to is that, in those future years, value is being transferred within the country from one set of people to another from one generation."(12) *Stability and investment for the long term* refers to the recent academic fashion for calculating "generational accounts", which "estimate each generation's net tax and benefit position over their respective remaining lifetimes", and says that the Treasury is working with others to produce such accounts for the UK. This sounds new and forward- looking. In fact - as is evident from the Brittain quote - the Treasury had been thinking about the subject 40 years ago.

New Labour's fiscal rules have no connection with received concerns of macroeconomics

In conclusion, the new fiscal rules introduced by the present Labour Government resemble a number of old fiscal rules which prevailed before the so-called "Keynesian era". They cannot be easily related to the received concerns of macroeconomics. More specifically, they have no direct relevance to either the maintenance of high employment or the control of inflation. Their rationale instead runs in terms ("stability", "prudence", limiting the debt interest burden, matching new debt with productive assets) which Treasury officials of the 1930s and 1940s would recognize, understand and approve. Macroeconomic theory and analysis had some influence on fiscal policy between the 1950s and late 1980s, although the precise nature of that influence can be disputed. But macroeconomics has little or no relevance to the fiscal rules now in force. This conclusion may appear to be critical and negative. It is not intended to be so. The squabbles of macroeconomists in the 20 years to the mid-1980s were not particularly edifying and did not reach satisfactory, widely-accepted answers. Further, a case can be made that - in terms of results - fiscal policy was better before the 1960s and after the mid-1980s than it was in intervening period of macroeconomic debate and confusion. But New Labour must not pretend that its fiscal framework is innovative and modern. Such claims ignore the long- standing emphasis on sound finance in Britain's historical record. The golden rule and the sustainable investment rule are best interpreted not as new departures, but as the latest footnotes to that record.

This is not intended as a negative conclusion

Notes

(1) Sir Herbert Brittain *The British Budgetary System* (London: George Allen & Unwin, 1959), pp. 53 - 4.

(2) J. C. R. Dow *The Management of the British Economy 1945 - 60* (Cambridge: Cambridge University Press, 1964), p. 178.

(3) R. C. O. Matthews 'Why has Britain had full employment since the War?', *Economic Journal*, September 1968, vol. LXXVIII, pp. 555 - 69. The quotation is from p. 556.

(4) T. G. Congdon *Monetary Control in Britain* (London and Basingstoke: Macmillan Press, 1982), pp. 35 - 45.

(5) For a sceptical assessment of the Keynesian revolution, see T. G. Congdon 'Did Britain have a Keynesian revolution?: fiscal policy since 1941', pp. 84 - 115, of John Maloney, (ed.) *Debt and Deficits: an Historical Perspective* (Cheltenham: Edward Elgar, 1998).

(6) Nigel Lawson *The View from No. 11* (London and New York: Bantam Press, 1992), pp. 447 - 60.

(7) Lawson *The View*, p. 811 - 2.

(8) John Hawksworth and Steve Wilcox *Challenging the Conventions: Public Borrowing Rules and Housing Investment* (Coventry: The Chartered Institute of Housing, 1995), p. 3.

(9) H. M. Treasury *Stability and investment for the long term* (London: The Stationery Office, 1998), p. 20.

(10) Brittain *Budgetary System*, p. 53.

(11) Brittain *Budgetary System*, p. 53.

(12) Brittain *Budgetary System*, p. 175.