

Labour's Fiscal Choices

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Public Spending and Taxation

Let us assume that the next election will be within the year. The Labour Manifesto for the June 2017 election attracted enormous interest because far from being an extreme Left one, it was in line with the Labour tradition. We pledged to spend more on public services and benefits to correct years of austerity. But we also explicitly showed where the extra revenue would come from to finance the deficit.

In the Manifesto this mixture of higher spending and higher taxation should be maintained. We should reject austerity but not fiscal responsibility. Indeed, had Labour won in 2010 we would have cut the deficit but in fair way by raising taxation on those who can afford. Alistair Darling's March 2010 Budget undertook to cut the percentage deficit by half over the five years. Osborne promised to eliminate the entire deficit but managed to only halve it. But the burden fell mostly on the less well off.

The next Manifesto should raise public spending across the board. In addition to the higher income tax on those in the top 5% bracket, more can be done by removing many of the concessions (1012 according to Guy Standing) in the Income Tax code. This would raise the revenue without having to raise the tax rate.

I also believe it was wrong to promise not to raise national insurance contributions (NIC) and VAT. NIC in particular is the one tax which could be tied (hypothecated formally if necessary) to NHS spending. In the last Budget the gap between NHS spending and NIC revenue was just £10 billion. Given the category of self employment which has become a tax avoidance loophole, we have to close this loophole. If we could tie NIC to NHS (not too rigidly of course) it would be possible to raise it as and when NHS needed it.

I am most uneasy about the cancellation of student debt. This would be a regressive move regardless of its popularity. But now we are stuck with it. There can be no question of renegeing on that promise. But in fact the student loan is not a mortgage debt. Most students, 77% according to IFS, do not pay the whole debt back. It is in fact a graduate tax. Students who have had the benefit of University education pay 9% of their salary if they earn above the threshold £21,000. If we stay with the abolition of the loan, we will need to look for a new tax to finance this gap. We could levy a graduate tax on all those who graduate in the post- loan generation. We could keep it at 9% with a threshold. That would kick in three years beyond whenever the loan was replaced by free tuition.

Fiscal Rules

There are two issues in any Budget. There are the flows of spending and tax revenue that determine the balance of the revenue budget and the investment for the future. The Manifesto recognises that it is right to borrow for long run investment even though such investment may not yield a monetary income. Gordon Brown had his Golden Rule about borrowing only for long run investment but in later years (after around 2003) the investment label was indiscriminately used to justify borrowing. He also used public-private partnerships (PPP) quite a lot, creating off the balance sheet debt.

We should draw up an ambitious plan for infrastructure spending and a borrowing plan to finance it. Yields are historically low. The Argentine government has just issued a 100 year bond. Labour should do the same for social housing and health care infrastructure.

The answer to the criticism that this would make the debt-income ratio very large can be questioned. Debt-income ratio inappropriately compares a stock (debt) to a flow (Income). The correct comparison should be between flows. The annual cost of servicing the public debt should be taken as a ratio of the nominal income. This measure is sensitive to rising interest rate and by implication to inflation. It would be possible to announce targets for the ratio of debt servicing charge to Income.

A similar fiscal rule is possible for fiscal deficits. It would be reasonable that the deficit in percentage terms should be equal to the growth rate of income. Thus stabilises the Debt Income Ratio.

Final comments

Given the proximity of the election, the need is to have a winning Manifesto. We are all impatient to institute radical innovative changes. But this is not yet the time. The imperative is to win, the 2017 Manifesto was a success, Labour should reissue it with some improvements but no further surprises. There will be time enough for innovative changes after winning.

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