NEWS

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Clarke is not Santa Claus or Scrooge, but he is Goldilocks

Mr Clarke said during his Budget speech that he was not going to be Santa Claus, or Scrooge. And so it proved, as he presented a relatively tight Budget but still found room to cut income tax.

Instead the Chancellor is more like Goldilocks, presiding over a recovery that is not too hot to trigger inflation and not too cold to prompt fears of recession.

The Budget has received too much criticism, because of misplaced fears the economy is overheating, when it is not.

It was not a bad Budget. The Chancellor was right to be cautious, announcing a credible cut in next year's Public Sector Borrowing Requirement, limiting the scale of the tax giveaway and constraining the growth in spending. With a General Election on the horizon it would have been tempting for Clarke to have given more away, but he is not engaging in a dash for growth and that is welcome.

Despite this, the Budget does not disguise the inappropriateness of the current policy stance. Two wrongs do not make a right. It is wrong for the authorities to have given a green light to the foreign-exchange markets to push sterling aggressively higher to an uncompetitive level. It is wrong that the Chancellor used the Budget to give a further boost to consumption through a reduction in income tax.

It is important to help those on low incomes by raising allowances and widening the lower-tax band, but in view of how strong the Chancellor expects consumption to be, on economic but not on political grounds, such income tax cuts could have waited until next year.

One cannot criticise the net tax giveaway. It was small. Last year the Chancellor gave away £3.1 billion. This year, economic recovery and the high budget deficit tied the Chancellor's hands and he limited the tax giveaway to £735m in the next fiscal year and £590m in 1998/99. This is because he has robbed Peter to pay Paul, raising taxes in a number of areas so he can lower income taxes and raise allowances by £2.23 billion during the next year.

For the run-up to a General Election there is tight control on public spending. This fiscal year the public spending control total is set to fall by 0.3% in real terms, after adjusting for inflation. Last year it rose only 0.5%. Future plans are tough. Compare this with the three years before the last General Election when spending rose 4.9%, 2.4% and 3.5%, respectively.

Thus the Government is controlling the growth of spending. Some of the recent cutback has been due to greater efficiency in the public sector.

And, as usual, the contingency reserve, which is set aside for unanticipated events such as BSE, is being raided in the next two years to keep spending down. Also, the increasing reliance on the Private Finance Initiative has allowed the Government to curb public sector capital investment. If the PFI works this is a good thing. However, cutting capital investment is the soft option for the Government. It is the last area that should be cut.

Whilst the recent trend is welcome it should not disguise the future need to control spending in areas such as social security, ensuring that money is spent on those most in need. Social security spending is set to rise from 29.5% to 30.7% of the control total by 1999-2000.

The financial markets will be wary of a new Labour Government's ability to keep to these tight spending controls.

The economy appears in good shape, particularly when compared with the continental Europe. Growth is set to accelerate next year and inflation should remain low. But there are two problems.

First, growth is unbalanced, being too reliant on consumption. For strong growth to be sustainable requires a rebound in exports and investment and a more balanced recovery.

Higher consumption may be necessary for a recovery in investment, but the fear of a stronger pound and higher interest rates may limit the scale of any rebound in investment.

Second, the tight monetary stance may slow the economy by the second half of next year.

The Budget should prevent interest rates from rising, but it probably won't. The Bank of England and the financial markets are not convinced the economy can grow strongly without triggering higher inflation.

Improving consumer confidence and an abundance of interest-free deals is releasing pent-up demand for high-ticket, expensive items that people have not bought for some time. This should be welcome, not frowned upon. But because of misplaced inflation worries it could trigger the Chancellor to raise rates to 6.25% in February, after strong fourth-quarter GDP figures are released. If Labour wins the General Election, Gordon Brown may also wish to raise interest rates to 6.5% to prove he is tough.

Such interest rate increases will not only be less than the financial markets expect but they may not be sustained. As these rates hikes will not be justified they will probably be reversed by the end of next year, as the economy slows.

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The reaction to the Budget displays too much pessimism about inflation, says **Gerard Lyons**