

Gerard Lyons

Wanted: a demand revival



Viewpoint

A year ago the Chancellor's Budget was widely criticised. Yet one important and positive policy announced then was the personal tax cuts that will take effect this April. These was a rise in the personal allowance, which, helped by a further increase announced last December, brings it to £9,440, along with a reduction in the top rate to 45 per cent. The importance of these measures for the economy should not be overlooked.

The economy is suffering from a lack of demand and this continues to sap confidence. Tax cuts that boost disposable income are one of many necessary ingredients for the economy to pick up. The Budget may yet shock, but the signs are that there will be few surprises — perhaps an announcement of a further rise in personal allowances and even cuts in corporation and capital gains tax. Overall, it will be more of the same.

Despite a possible triple-dip recession, the jobs data and the fact that firms are hiring suggests the economy may be in better shape than other statistics suggest. But, even if it is, it is still not as good as it should be. This is a weaker recovery than any in the post-war and inter-war periods.

It's hardly surprising, then, that George Osborne is receiving plenty of advice. Yet some of it, like the case for higher taxes put by one minister, or talk of spending cuts from others, needs to be put in the bin. At this stage of the cycle, the economy needs demand.

Overall, I agree with the Chancellor's strategy for boosting growth and reducing the deficit. Furthermore, it is only when there is no deficit that the country's debt will start to fall. However, I think there is a case for some tactics to be different.

The economy needs more spending. Thus the Chancellor's tax cuts are welcome and their impact should not be underestimated. I favour more. But squeezing public spending now to provide scope for tax cuts would not provide an immediate net boost.



The current age of austerity must give way to an era of enterprise

Instead, there should be more spending on infrastructure and construction. The Chancellor is already doing some of this, but not on the scale needed. Perhaps we should expect some of this in the summer Spending Review rather than Wednesday's Budget.

While the markets want a lower deficit, they may tolerate some higher borrowing for the right reason. They would not forgive borrowing to fund tax cuts or government spending. In contrast, borrowing at low rates to fund long-term infrastructure projects and kick-start a massive building programme for affordable housing would be economically sensible and not penalised by the markets.

The economy also needs more

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Borrowing at low rates to fund infrastructure projects would not be penalised by markets

lending. In recent weeks there has been talk that some companies are afloat only because of low interest rates. Some argue that they should have the rug pulled out. I disagree.

Let's look at the data to see why. According to R3, the insolvency trade body, there are 160,000 such companies. Of these, one in three is in the hotel, catering and retail sector and one in ten in construction. The answer is not to force them out of business, with a consequent rise in unemployment, but rather to get more demand into the economy by cutting taxes and boosting confidence so that people spend. When that happens, these firms might come back to life.

The Chancellor also needs to note the concerns of small firms, which say it is the lack of demand in the economy, high business rates and prohibitive terms from banks that may be deterring them from borrowing.

There is much talk that the Chancellor will change the Bank of England's remit this Wednesday. I don't think the 2 per cent inflation target should or will change. Currently the Bank is supposed to meet its target and, subject to that, support the Government's economic policy. If there is any change, perhaps "subject to that" can go, so the Bank then has two objectives of equal weight: low inflation and supporting government policy. Whatever the words, the immediate reality is that the Bank needs to encourage banks to lend more and extend the Funding for Lending Scheme to help new firms.

Also, I think the Budget needs to change the tone of the debate. The UK had an age of excess, with much wasteful public spending and too much personal borrowing. In recent years there has been an age of austerity, focused largely on higher taxes. Now there needs to be an age of enterprise, with a Budget aimed at incentivising banks to lend, and encouraging people to spend and firms to invest. Like demand, confidence is key.

● Dr Gerard Lyons is chief economic adviser to Boris Johnson, the Mayor of London