The Chancellor has finally shifted towards stimulating growth

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Commenting on the Chancellor's budget, ***Linda Yueh*** *sees a lot of positive stimulus measures that are better late than never, such as increased infrastructure spending and measures to cut corporate taxes. However, the Chancellor could have done more to boost confidence by setting out a convincing vision instead of knitting together disparate pieces of stimulus.*

Subtly, quietly and not billed as such, the UK Budget has shifted towards stimulating growth. It may not be enough and should have been more strongly emphasised, but the Budget has reconstituted tax cuts and government spending to generate a limited fiscal stimulus targeted at jobs, businesses, and homeowners.

The Budget is fiscally neutral, so the tax cuts are offset by spending cuts of some £2.5 billion and an increased levy on banks of 0.142%, among others. And the targeted tax cuts aim to support the right areas of the economy.

The surprise is perhaps the exemption from National Insurance of the first £2,000 for firms which should help employment. As the Chancellor says, it is equivalent to hiring four minimum wage workers, and would help small businesses. Although employment has recovered to 2008 levels, supporting employment is always worthwhile as it helps to avoid hysteresis that embeds short-term output loss into a permanently slower growth rate. Indeed, unemployment is still creeping higher as seen in the latest figures and the rate is still undesirably high at 7.8%. Raising the income tax threshold to £10,000 also provides some support for workers.

The second is a cut in the corporation tax to 20% from 2015, down from 28% when the government came to power. It is indeed among the lowest tax rates, especially for a major economy. As an economy recovering from a financial crisis should rely on investment and not consumption, it is the right move. Further support for R&D spending also places the right emphasis on innovation. This is also particularly important because one of the lessons from Japan is that firms hoarded cash because they were reluctant to invest due to low TFP. And, another positive is £15 billion for new infrastructure from 2015-2020, which is needed but rather late in the game.

Finally, the government is extending its shared equity scheme with interest-free loans up to 20% of the value of new homes. There will also be bank guarantees to support £130 billion of new mortgage lending for three years from 2014. This is more controversial as some worry that it will entangle the government in the mortgage market and is reminiscent of the Fannie Mae/Freddie Mac system in the U.S. which ran into problems with the housing bust. However, the other side of the argument is that a significant part of the deleveraging process in Britain relates to household debt, so this is helping with the balance sheet recession – which is important as another lesson from Japan. Indeed, the Fed intervened in the mortgage-backed securities market which may have helped the recovery of the U.S. housing market.

The big question is whether or not these measures are enough. Critics will point to the lack of a larger vision for growth for Britain. This is particularly as the weak growth has been attributed largely to disappointing net trade. Indeed, the Chancellor pointed to trade to explain the continual downgrade of growth, down to just 0.6% this year. Even if a triple dip recession is avoided (which is predicted by the OBR as Q1 should eke out 0.1% GDP growth), the slow and uneven growth path is the biggest challenge and should have been tackled much earlier. As such, a vision – such as one that encompassed seeking new markets, addressing the credit crunch and providing other supportive policies to improve the business environment – would have been more convincing instead of knitting together disparate pieces of stimulus.

This is particularly important as the context was tough as usual. The budget deficit may have been cut by one-third since the crisis but it is still 7.4% of GDP, then estimated to fall to 6.8%, 5.9% in 2014/15 at the end of this Parliament, 5%, 3.4%, and only reaching 2.2% in 2017/18. As a result, the debt target has "deteriorated" and will peak at 85.6% of GDP in 2016/17 – one of the factors that triggered Moody's downgrade of the UK's AAA credit rating.

Thus, as growth is ultimately premised on confidence, this may have been the largest missed opportunity in the Budget.

Note: This article gives the views of the author, and not the position of the British Politics and Policy blog, nor of the London School of Economics. Please read our comments policy before posting.

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