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FISCAL STIMULUS - HOW DO WE GET OURSELVES OUT OF RECESSION?

The National Institute has called for the budget to include a stimulus to the economy. Only measures that do not have a long run impact on government borrowing should be considered. Temporary cuts in tax rates will be hard to reverse. The long term damage to the economy from the crisis means that increases in spending programmes will have to be reversed. The only wise options left are significant and immediate income tax and employers' national insurance rebates. The Institute argues there is space for a temporary £30 billion (2 per cent of GDP) stimulus of this nature in Wednesday's Budget.

Despite the Governor of the Bank of England's comments, there is no evidence that the markets are worried about the scale of debt. Market based perceptions for borrowing costs over the next decade remain below 5 per cent. Increased borrowing in the Budget would make virtually no difference to these costs.

In the medium term there must be clear plans to consolidate the budget, but the scale of debt is not so large that it must be rushed. After World War II UK government debt was 250 per cent of GDP, but it was paid off. Debts may reach 100 per cent of GDP without causing further increases in borrowing costs. The Institute argues that the deficit should be slowly scaled back in order that the government's budget is in balance or surplus by the end of the next decade. By the end of the next Parliament the public finances need to improve by around £80 billion (5 per cent of GDP) a year, if the economy is strong enough.

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Notes for editors:

Ray Barrell discussed these issues in a lecture at the National Institute on Friday 17 April 2009. A version is available on the Institute web site: <http://www.niesr.ac.uk/>

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