A fiscal policy for all seasons

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13 janvier 2021

Opinion The FT View

Spending approaches should be ready for a change in circumstances

The editorial board

Robert Rubin and others rightly stress that economists frequently make mistakes and things may change very quickly, in either direction © David Paul Morris/Bloomberg

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Fiscal orthodoxy has changed. Organisations such as the IMF and the OECD have told governments that, with low interest rates seemingly here to stay, the costs of excessive borrowing are much lower for advanced economies than previously thought. The benefits, too, are greater, given the need for governments to take some of the burden off central banks in supporting crisis-hit economies. In these circumstances, the aim of balancing the budget can, at least temporarily, be dropped.

This thinking can command support across the political spectrum. On Wednesday Anneliese Dodds, shadow chancellor in Britain's leftwing Labour party, and Christine Lagarde, the ECB president and a former centre-right politician, both said that governments should avoid prematurely removing support they have provided to economies in the pandemic.

A paper from the Peterson Institute for International Economics is both further testament to the degree of consensus and a warning of the dangers in assuming the future will resemble the present. The goal, it argues, should be a policy suitable for all seasons.

That the authors — Peter Orszag, former director of the Congressional Budget Office; Robert Rubin, the Treasury secretary who ran budget surpluses under Bill Clinton; and the leftwing Nobel Prize-winner Joseph Stiglitz — all agree is notable in its own right. The authors rightly stress, however, that economists frequently make mistakes and things may change very quickly, in either direction.

That consensus can be wrong was on display after the 2008 financial crisis, when many organisations — including this newspaper — advocated fiscal retrenchment. The facts have changed and economists have, sensibly, changed their minds. Inflation, economic growth and interest rates failed to recover as anticipated after the financial crisis. This not only kept borrowing costs down but demonstrated that cutting spending may have had a bigger negative impact than expected.

This is not a reason to abandon the goal of fiscal sustainability. Governments can, usually, simply roll over their debt stock at reasonable interest rates. There is, however, an ever-present risk that the market will move against governments and the cost of borrowing will rise to such an extent that the choice will be between a painful default or vicious austerity. Keeping a watchful eye on the public finances can prevent societies from ever having to make such a choice.

As Messrs Orszag, Rubin and Stiglitz point out, the reasons behind the fall in interest rates are not well understood and are critical to the long-term path of debt. Top-down "rules of thumb" are usually flawed too: a 3 per cent deficit limit in the eurozone was arbitrarily invented by two French civil servants. Instead they advocate a programme that is adaptable: extending debt maturities, a greater role for automatic stabilisers such as unemployment benefits, and "semi-autonomous infrastructure" spending that rises when growth falls.

Either way, a looser fiscal approach must not change the role of central banks. Inflation-targeting central banks should only "print" money to hit their inflation targets and not finance government spending: quantitative easing is justified by low inflation and not high deficits. Interest rates should be set based on the needs of the economy and not finance ministers. UK investors are already questioning whether the Bank of England is simply offsetting government borrowing. Central banks must even more jealously guard their credibility when debts are high. The facts have changed, but not everything else should.

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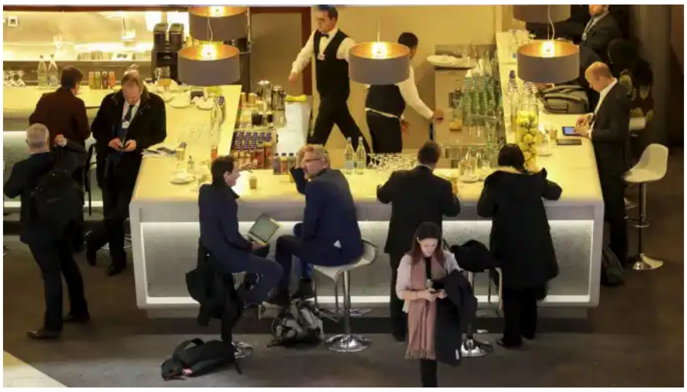

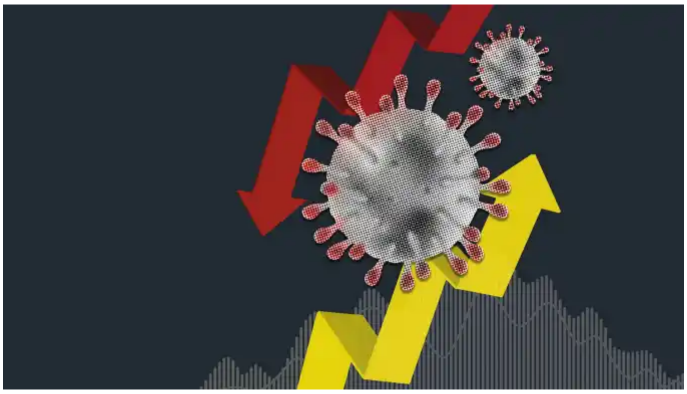

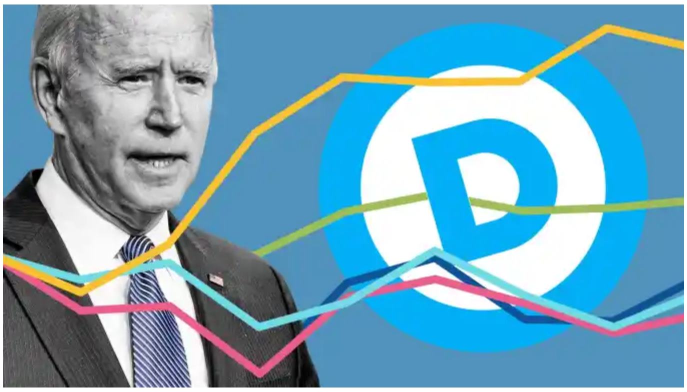

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