**Liberal Democrat Leader, Vince Cable, sets out the Liberal Democrat approach to the Budget.**

The full text is below.  
  
As Leader of the Liberal Democrats, it is one of my responsibilities to give a serious Lib Dem analysis of the economics around the Budget, and to present an alternative.  
  
I have recently been returned to Parliament and one of my regrets, however, is that the previous competition between the parties on economic competence no longer exists. The likes of Gordon Brown, George Osborne, Ed Balls and Oliver Letwin were all serious players and thinkers even if I often disagreed with them.  
  
Now, the economy – pivotal still to people’s lives – has been relegated to the margins of political debate and the June election produced minimal discussion of economic policy. The Conservatives didn’t produce any economic numbers in their manifesto. Labour did, but as the IFS caustically pointed out at the time, there was a strong element of fantasy.  
  
My Party did much better than our rivals at the hands of the IFS and serious commentators at the FT and The Economist but few noticed. And, now, economic debate is drowned out by the politics of Brexit and an unstable government. Yet this is an unusually important and difficult budget.  
  
The Chancellor has foresworn the use of a second budget, traditionally used to correct the mistakes in the first, and the potential for a massive, if unquantifiable, economic shock from an unsatisfactory deal – or, even, ‘no deal’ is palpable. Brexit hangs over the forecasts. The environment of radical uncertainty is already spooking business investment and depressing growth, including the growth in government revenue.  
  
I want, then, to set out some analysis of where we are and some ideas for where the Liberal Democrats think Britain could and should go.  
  
Our focus is on freeing up capital spending to build the homes and infrastructure the country needs, on reviving the NHS with a targeted injection of cash, and on giving a leg up to young people with a learning account as they begin their working lives. To do all this, we need a Government which prioritises economic competence over political dogma.  
  
Neither the ‘no deal’ Brexit extremism of the Conservative Party nor the ‘socialism in one country’ dreamed of by Labour will deliver a successful economy.  
  
**Fiscal Rules**  
  
I have long held the view that governments must subject themselves to the discipline of fiscal rules which have first, sufficient independent, non-political, oversight to prevent arbitrary and populist tax and spending policies and, secondly, which dovetail with independently managed monetary policy. In the last two decades, however, good intentions and consistency have been undermined by the massive shock and dislocation caused by the 2008 banking crisis and by the temptation of successive governments to redefine and politicise the fiscal targets while paying lip service to them.  
  
Gordon Brown introduced two rules which were broadly accepted as sensible: to balance the current – ie non capital – budget over the economic cycle; and to permit borrowing for investment subject to meeting a rule that government net debt to GDP should be under 40%.  
  
To complicate matters the Government also shadowed the Maastricht target of an overall deficit (current and capital) of 3% GDP subject to a (gross) debt ratio of 60%.  
  
After almost a decade of sustained growth the Labour Government claimed that it was still meeting the fiscal rules, though it was widely believed that this was achieved by defining the cycle in a statistically convenient but economically dubious manner. The collapse of the banking system destroyed the fiscal framework. Enormous temporary deficits (with overall government borrowing of 10% in 2009) made the current deficit and overall debt rules meaningless.  
There was a massive structural rather than cyclical deficit.  
  
I wrote about these issues in both my book *The Storm* and its sequel, *After the Storm*.  
  
The Coalition set the fiscal objective of eliminating the structural current deficit ratio over the first four years of the 2010-2015 Parliament. The Office of Budget Responsibility was set up to provide independent monitoring.  
  
But the four year objective was allowed to slide to five, then seven, years and attempts to separate the structural and cyclical became increasingly difficult. Gradually, Osborne’s objective became one of simply eliminating government borrowing – current and capital – over a specified time period. The present objective is to balance the overall budget by the end of the decade (followed by surpluses). In practice, this means running a surplus on current spending by the end of the decade. The justification for doing so is to build in resilience in the event of a future shock.  
  
What it does not acknowledge is how challenging reaching a surplus position may be, and the other risks it poses to economy – particularly if capital spending continues to be constrained. The current position as set out in scenarios proposed by the IFS, is that the Government may come close to achieving the OBR estimate of ‘structural’ borrowing of under 1% of GDP in 2019/20 in a “moderate” benign environment, falling further in subsequent years (from 3% in 2017/18). But it is also possible that in a “very poor” environment the ‘structural’ deficit could fall to only 2% in 2019/20 and then rise again to over 3% in 2021/22.  
  
In the latter case, government net debt could rise to over 90% in 2021/22 as opposed to falling below 80% in the benign environment. The IFS concludes that a firm commitment to running a budget surplus from the mid 2020s (for resilience reasons) “is no longer sensible”. I agree.  
  
What should be done? The public is tiring of “austerity” though the Government is some way short of realising its targets, which may well have to be allowed to slide to accommodate the clamour for spending on health, schools, welfare reform, policy, defence and prisons; lifting the public sector pay cap; and accommodating Brexit contingencies. The IMF (like the IFS) recommends a “gradual” approach to reducing the deficit.  
  
Our priority now must be to prioritise capital spending.  
  
One damaging practical consequence of the Government’s existing, unachievable targets is that productive investment is being squeezed, choking off the prospect of the long-term economic benefits it brings.  
Despite this month’s rate rise, government borrowing can be financed very cheaply at present, with continuing very low interest rates available to us on long term debt.  
  
My preferred model would be to return to the Golden Rule which will be more credible now there is an independent OBR.  
  
There also needs to be an independent check on the economic impact of government financed capital projects. I discuss how this can be done in a recent paper for the LSE.  
  
In parallel with a reform of fiscal targeting I would want to see a reform of the monetary policy framework. I was a strong supporter of the MPC set up and continue to defend its independence. But post-crisis economics has made its role in setting interest rates of secondary importance and also deeply confusing not least to itself: a ship with defective radar, damaged steering and ancient maps.  
  
It would make more sense to give the MPC the role of targeting (nominal) GDP, which is what it has appeared to do in any event and also to have some agreed rules around QE including variants which merge into fiscal policy since this is likely to be the main policy mechanism in future recessions.  
  
**Economic Fundamentals**  
  
Underlying the more pessimistic forecasts for economic growth and the budget are negative assessments of UK productivity performance. UK productivity in terms of output per man hour and total factor productivity lag well behind other Western economies such as Germany and France.  
  
Moreover, productivity has stagnated since the financial crisis: the flip side of a positive story of rising employment and falling unemployment.  
  
The two sides of this phenomenon come together in the form of stagnating real wages.  
The budget cannot solve the productivity problem but it can address it properly and point to the steps needed to counter it.  
  
The first is the need for increased business investment which incorporates innovative technology and better work practices. However, a long-standing dearth of investment is now compounded by the radical uncertainty surrounding Brexit.  
  
Long term studies by the LSE have shown that the two main determinants of poor UK performance on productivity are lack of innovation (R&D as opposed to basic science where the UK is strong) and low levels of skills.  
  
The former problem is being addressed by R&D tax credits and by the work of Innovate UK, in particular the Catapult network, which Liberal Democrats launched in government as part of the Industrial Strategy.  
  
The latter is a far less tractable problem and despite the progress we made in the Coalition in raising the number and quality of apprenticeships, especially Higher Apprenticeships, the programme is now slipping backwards largely because of clumsy implementation of the apprenticeship levy and the neglect of careers advice and guidance. There is an immediate need to ensure that the apprenticeship levy rebates reach the supply chains of larger companies.  
  
The industrial strategy is the right framework. After I introduced it in 2011, as a way of cementing long term decision making, there was a revival of confidence in industries as varied as cars, aerospace, creative industries, and railway supply chains. With the current uncertainty over Brexit and doubts about the durability of the government, that confidence has begun to evaporate. Yet a budget built around the industrial strategy, prioritising education and skills, R&D and infrastructure would, at the very least, send the right signals.  
  
  
**Lib Dem Priorities**  
Given the constraints surrounding the budget I would advocate the following:  
  
1. A freeing up of government capital spending, separate from decisions around the day-to-day budget.  
  
Two main areas suggest themselves.  
  
One is greater operational freedom for Network Rail and devolved transport authorities like Transport for London to finance their investment programmes, where they can raise capital cheaply. That would mean faster decisions to press ahead with projects like Crossrail 2, and the potential to move on bringing about a rail revolution in the North with HS3.  
  
The second is to use the Government’s balance sheet to finance large scale housebuilding by a government agency operating on the Development Agency model, used in different ways in the Docklands and Liverpool and for the New Towns.  
  
The Communities Secretary has partially backed a plan originally put forward by Respublica for a £100bn programme over ten years, to build homes for sale or rent. Such a programme could be complemented by greater freedom for councils to borrow to build, and by assisting smaller private builders by boosting the small builders’ credit scheme operated by the British Business Bank.  
  
One way of improving the overall economic effectiveness of public investment would be to channel it through our independently managed institutions on the lines of the Green Investment Bank (now, regrettably, privatised).  
  
If Brexit happens, Britain will need to replace the admirable European Investment Bank, based loosely on the model of the German KfW(Kreditanstalt für Wiederaufbau). A British Investment Bank would have responsibility for selecting and, then, overseeing public investment.  
  
2. There is an urgent need for additional funding for key public services but this must be financed on a tax neutral basis.  
  
3. My party’s policy is to raise 1p in the pound on each rate of income tax, to provide an extra £6.5bn for the NHS and social care. This proposal has the dual merit that it addresses the immediate gap identified by NHS professionals and the NHS Chief Executive (though not the longer term issue of funding sustainability) and acknowledges explicitly that revenue has to be identified to pay for spending commitments.  
  
There are other current spending priorities and, in particular, to relieve the harshness of welfare changes notably arising from the freezing of benefit levels, especially housing benefit, and the introduction of the universal credit. The June Lib Dem manifesto explains how those could be funded - essentially by cancelling several tax cuts since 2015, notably to Capital Gains Tax and Inheritance Tax.  
  
4. By common consent, young people have been left behind for too long. There now has to be some form of redistribution between generations to restore the implicit contract in every society between young and old. In ours, the spiralling price of property has radically shifted the balance making home ownership unaffordable for large numbers of younger people. Taken together with diminished job security, pension availability and the costs of post-school education, an issue of intergenerational equity has arisen.  
  
A better proposal than populist gestures like cuts in tuition fees and freezing rents is to create an endowment or learning account for young people on their 16th or 18th birthday which they can draw down at any time in life all to pay for further and higher education (a post graduate course, for example), reskilling and adult learning, as they choose.  
  
The Director of the IFS has written favourably of this approach. The principle of intergenerational transfer would be sustained by the imposition of a modest tax on personal wealth.  
  
Let us consider, notionally, a generous and ambitious learning account of, say, £18,000.  
This would cost just over £14bn per annum for each new age cohort. This is worth roughly 1/3 of 1% of net household financial and property assets.  
  
It is not difficult to see how a modest tax on personal net wealth, above a certain threshold, could generate substantial sums. We shall investigate how best to do this.  
  
**Wider Tax Reform**  
  
My party, in coalition, promoted one of the more far reaching tax changes in modern times by radically lifting the threshold for basic rate income tax, lifting four million people out of income tax altogether. We also promoted an aggressive approach to tax avoidance, leading to the introduction of the General Anti Avoidance Rule.  
  
Now I want us to apply that same radicalism to land values, to business taxation and to tax avoidance.  
  
First, led by the entrepreneur, Andrew Dixon, we have a group investigating the feasibility of Land Value Taxation. Authoritative analysis of the British tax system, notably the Mirlees Report, makes it clear that the taxation of land is the most economically efficient and rational form of taxation, the least open to evasion and avoidance and the most relevant to contemporary needs such as better utilisation of land for housing. The Lib Dems are committed as a first step to replacing business rates with site value taxation.  
  
Secondly, a group of tax specialists, on our Corporation Tax Panel, has been reviewing business tax. Its interim conclusions are that the system is over complicated and full of unintended incentives.  
  
They suggest:  
• A stable and predictable corporation tax reform with a competitive rate of around 20%. Britain should not be aiming to be a corporate tax haven.  
• All companies bidding for government contracts must be clearly seen to be subject to tax in the UK and preclude the use of offshore tax havens.  
• Rapid progress on limiting tax deductibility of corporate interest  
• Recognising the special problems presented by digital companies which currently find it easy to shift profits to low tax jurisdictions. One argument for “exit from Brexit” is that the European Commission is currently an effective enforcer.  
• The complex capital allowances regime must be reformed to incentivise and not penalise capital investment.  
  
Thirdly, The ‘Paradise Papers’ scandal underlines the scale of systematic tax avoidance.  
In fact, the introduction by the Coalition of the General Anti-Avoidance Rules and an open register of beneficial ownership put the UK among the tighter jurisdictions and the estimated ‘tax gap’ between actual and potential receipts is now one of the lowest – 6% of revenues. This still, though, amounts to a large sum.  
One necessary step is firm action against dependent territories and crown colonies which encourage aggressive tax avoidance. This should include the blacklisting of firms which utilise abusive schemes operating from those territories and the reserve power of direct rule.  
There are precedents for such action. The Turks and Caicos Islands were subject to direct rule because of corruption in 2009.  
  
**Conclusion**  
  
Getting this Budget right is more important than the Chancellor realises.  
Disillusionment with our current economic performance, and the model which underpins it is acute. Any Brexit would make the problem worse, and a ‘no deal’ Brexit would cause severe destabilisation.   
  
The danger is that this provokes a further growing appetite both for populist fiscal policy – sometimes described as the magic money tree – and for retreating to a much more state controlled and inward looking model.  
  
Both could be catastrophic for our country.  
  
So what is needed is a serious strategy for growth and prosperity, and in today’s politics only the Liberal Democrats are offering it.