Funding the Future

If the Treasury view prevails we will be back in the 19...

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As the Financial Times has noted this morning:

Ministers will have to raise taxes sharply in the coming months to deal with an estimated £337bn deficit in the current financial year in the wake of the coronavirus pandemic, according to a leaked Treasury document.

The paper sets out a proposed "policy package" of tax rises and spending cuts which could have to be announced soon in order to "enhance credibility and boost investor confidence".

The document, revealed in the Daily Telegraph, warns that the country could face a "sovereign debt crisis" unless the economy recovers quickly.

The Telegraph provides more detail. As they note:

The document, dated May 5 and marked "Official — market sensitive", reveals that the "base case scenario" now forecasts that Britain will have a £337 billion budget deficit this year, compared to the forecast £55 billion in March's Budget.

It says tax rises and spending cuts which would raise between £25 billion and £30 billion — equivalent to a 5p increase in the basic rate of income tax — would be needed to fund the increased debt, and presents Mr Sunak with a menu of proposed measures to make up the shortfall.

They add:

In the worst case scenario — a so-called "L-shaped economic decline" — the figure would increase to a £516 billion deficit in the current financial year, rising to a cumulative £1.19 trillion over five years. This would require up to £90 billion in annual tax rises and/or spending cuts over the next few years.

Even the best-case V-shaped scenario, in which the economy falls sharply but recovers *equally quickly — described as "optimistic" in the document — would lead to a £209 billion deficit this year.*

Perhaps most tellingly the Telegraph says that:
[a] proposed "policy package" of tax increases and spending reductions ... may have to be announced within weeks in order to "enhance credibility and boost investor confidence" in the British economy.
It is hard to know where to start when commenting on these reports, so absurd do they seem. But comment, I think I must.

In that case, first note that the 'Treasury view' that the primary object of government is to balance the books does still, very clearly, persist. Nearly a century of understanding on the utter destructiveness of this idea has appeared not to permeate the Treasury's walls.

Second, note that at least they are right in appreciating that we are to face record deficits.

And third, that they are also right in dismissing as very unlikely the V shaped recoveries fancifully forecast by the Office for Budget Responsibility and Bank of England.

Fourth, they are also, apparently, suggesting that only part of the costs of a deficit need be covered. It is not apparent from what I have read as to why they have determined why that proportion might be a bit less than 20% of the total sum. That, of course, is not the cost of funding, which is negligible. Note that in the worst case (as the Treasury sees it) the Telegraph notes that:

In the worst case scenario — a so-called "L-shaped economic decline" — the figure would increase to a £516 billion deficit in the current financial year, rising to a cumulative £1.19 trillion over five years. This would require up to £90 billion in annual tax rises and/or spending cuts over the next few years.

The relationship between borrowing and the supposed cost that must be covered with tax is not clear.

Sixth, the priority that the Treasury has is apparent from this comment:

The Treasury document warns ministers that, if Britain's economy does not recover soon, the country could be thrown into a 1976-style "sovereign debt crisis", a situation that led to an international bailout.

So, we are back to the mantra that the job is the government is to keep the bond markets happy.

And seventh, it is noted that this could be done by increasing income tax by up to 5p in the pound, by ending the triple lock for pensioners, and freezing public sector (including

NHS) pay.

All of this is ridiculous. It is the economics of another era. It is as if we have learned nothing. So let's say what we have learned.

First, tax increases make economic downturns very much worse. We are facing the worst economic downturn since 1706, and the Treasury wants to make it worse. In itself that shows how absurd their thinking is. How can they think it their duty to send us further into recession, repeating the most basic error of the 1930s?

Second, we now have quantitative easing. £635 billion government bonds are now owned by the government. They will never be reissued to the market, as the Bank of England has now tacitly admitted. This is then new money, created without the involvement of the markets. We now know we can do that.

Third, we know inflation does not occur as a result if we are not at full employment. We currently have 10 million unemployed people.

Fourth, we know that this practice is commonplace: every government that can do it is doing it. And so too is the European Central Bank.

Fifth, we know as a result that the power of bond traders is broken, whether that be on rates, or deficits, or any other issue: since we now know that we are not in any way dependent upon them because if at any point they get uppity the government can simply begin another quantitative easing programme, the chance of a sovereign debt crisis is zero. And that is most especially true when every government is in the same situation.

Sixth, we know there is a massive demand for sovereign debt - including that of the UK. That is despite exceptionally low interest rates. There is not the slightest sign that there is any change in this situation, but if stock markets fell (as is likely) that demand would only increase.

Seventh, we know that the macroeconomy is not like the microeconomy: it need not balance its books.

Eighth, we know austerity killed. To be precise, it probably killed more people than Covid 19 will, and the lack of preparedness it left us with probably killed many who have died of Covid 19 as well. And no one wants to go back there.

So how to reconcile all this?

I note three things.

First, that the Treasury is simply noting cost. It is not saying what else to do, although I am sure that behind the scenes it is.

Second, to note that unless the government wants to be associated with the excess deaths (which it is clearly desperate to avoid: its whole new strategy being to blame us for it by not 'staying alert') then those costs will continue.

Third, that the Treasury is not talking about investing its way out of this. It is planning to cut out of this, which is known to never work.

And what all this means is that if the Treasury view prevails we are in deep, deep trouble.

What we need instead is a plan to deal with this.

First, markets have to be told, challenge us if you dare, but we'll nationalise you as and when you need a bailout (as will certainly be required before this is over) if you do. Take the markets on politically, in other words. Call them out, not give in to them.

Second, do not, even for a second, plan spending cuts: everyone in this country now realises how dependent we are on public services.

Third, do not think for a moment about tax rises, overall (whilst increasing wealth taxes, corporation tax reform and other measures to make sure that those who should pay do).

Fourth, do plan massive quantitative easing.

Fifth, do plan the investment needed to get the economy to working, sustainably, again. That is the Green New Deal.

And sixth, explain that the government is not constrained by a lack of money, because it can make all that is required and that none of inflation, a sovereign debt crisis or a crash will happen.

Seventh repeat six.

Eighth, repeat seven.

This can work. It will work.

But balanced budgets, tax increases and cuts are the surest way to economic and social disaster that can be imagined, and would repeat the 1930s all over again.

Unless that's what the Tories want they would be following my advice.

We'll know what they want by the decisions that they make.