Opinion

This modern curse that divides us from Nature

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A week of stupid politics but good economics

Claims that Britain is on the brink of bankruptcy are a misunderstanding. Every pound of savings is a pound borrowed

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Shock. Horror. VAT could go up after the next election. Or it could go down — or stay the same. The same can be said of income tax and council tax and road tax. It can also be said about public spending, government deficits, the FTSE index, the oil price and the price of fish. So what?

Britain's political debate has descended into farce. The fault for this lies largely with Gordon Brown and Alistair Darling — not because of the contents of the Pre-Budget Report, which was sensible from an economic standpoint, but because of their political failure to explain why it made economic sense. This is a case where clever economics is covered up by stupid politics — not the other way round.

Starting with the sensible economics, the Chancellor is right to cut taxes and to spend and borrow through the recession, undeterred by rising deficit projections and the build-up of public debt. The main reason comes down to a simple proposition that almost nobody in politics seems to understand: for every saver there has to be a borrower.

This means that whenever people feel like they have borrowed too much and want to increase their savings, somebody else in the economy must increase borrowing to match the extra savings, pound for pound. Because every pound of savings is a claim on a pound of somebody's wealth — and the only way to acquire such a claim is either to invest directly in a house, a factory or a business asset, or to lend money to someone else who will do this for you. Putting money in the bank is just another form of lending, in this case to the bankers.

The reason why the Government is right to borrow on a scale almost never imagined is that private citizens and businesses are in a panic and have suddenly decided — or been forced — to cut back their borrowings and increase their savings to an equally unprecedented degree. And what if George Osborne were in charge and the government refused to borrow any extra money? Then the savings in the economy would diminish instead of growing, until they matched the lower level of borrowing that the private sector was willing to undertake. How would this happen? By throwing so many people out of work and bankrupting so many businesses that the extra saving desired by the population never took place. This is what is called a depression.

So much for sensible economics; now for the incompetent politics. The Chancellor and Prime Minister have failed to convey this message to the public, despite the worldwide endorsement of the fiscal stimulus. They have not even tried to rebut the many fallacious objections to Britain's fiscal policies that have taken hold in the media and financial markets. Worst of all, political mismanagement has allowed the confidence-building benefits of the fiscal stimulus in the PBR to be overwhelmed by an irrelevant argument over future tax policies and projections of public debt.

The debate is irrelevant for a very simple reason: nobody has the faintest idea how big the public debt will be when the recession is over, still less whether taxes and public spending will need to rise, fall or remain the same. The Treasury debt numbers published on Monday are not genuine forecasts, but mechanical projections, based on assumptions about global growth, stock market levels, exchange rates and a host of other variables. It is baffling that commentators and politicians who pour scorn on the "blunders" made by the Treasury six months ago in its Budget forecasts treat its projections of borrowing five years from now as if they were gospel truth.

Because Britain's economy is today more than ever in a "path dependent" state, whereby events in the next 12 months will overwhelm any long-term plans for public finances, a brave British politician would have done what President-elect Obama is likely to do when he announces his fiscal stimulus plans: first, acknowledge that the outlook for public finances was exceptionally foggy. Secondly, admit that some changes in tax and spending may be needed in the future, depending on how the economy performs in the next two years. Finally, keep all options open until the present turmoil is over and the outlook for global and British growth is clearer than it is today.

But wouldn't such vagueness about the long-term fiscal outlook have been punished by a collapse of confidence in financial markets?

High marks for economic strategy; low marks for explaining its value

That this view is so prevalent, not only in the media and the City, but even in Whitehall, points again to a failure of political presentation, rather than economics.

Hysterical claims that Britain is on the brink of "national bankruptcy", or that the Government has "run out of money" or that the pound is going the way of the Icelandic krona may be a normal part of political banter, but they are absurd. Britain's public debt-to-GDP ratio, at around 40 per cent, is the lowest among the G7 advanced economies and if it were to rise to 57 per cent, as suggested by Treasury projections, this would not present a serious problem. Nor would it drive up interest rates and inflation, to judge by the experience of Japan, Italy, France and Germany, all of which have public debt ratios above 57 per cent.

But what, you may ask, is the relevance of such international comparisons? After all, the misfortune of other countries does not make our Government any more solvent. Actually it does. For savers to lose faith in the paper money or bonds issued by the British Government, they have to put their savings into some other asset. So where are they going to turn? Will they invest in America, where the Government is about to announce an unfunded fiscal stimulus double the size of Britain's relative to GDP? Or in Japan or Europe, where not only are government debts much bigger than Britain's, but whose pension liabilities and demographic pressures are off the scale?

British savers who are worried about "national bankruptcy" but don't fancy speculating on the dollar, the yen or the euro have just two other options. They could pull their savings out of paper money and start buying real assets — houses, shares, commodities and so on. Or they could give up on saving and increase their spending. In the present crisis, with housing, share prices and consumer spending all collapsing, either of these responses would be exactly what the doctor ordered.

If Mr Brown had any gumption he would issue a simple challenge: "If you don't trust my Government with the public finances, why put your precious savings in pieces of paper signed by the Government and the Bank of England? Either invest in shares, houses or other assets of lasting value or just go out and spend." But that would take political courage, as well as economic understanding.