Opinion

Neurotic mums don't need to fret about childcare
Alice Thomson, page 38

Borrow, spend ... then recoup it in energy taxes

Why taxing petrol more fiercely could plug the budget black hole, revive the economy — and help the car industry too

Anatole Kaletsky

Where will the money come from? As the US Congress prepares to vote on a multibillion auto bailout and governments around the world pledge sums running into trillions to prevent a 1930s-style economic collapse, this obvious question is being asked by taxpayers and opposition politicians everywhere, from David Cameron's Tories to Trotskyites in France.

For the next year or two, the money for the British fiscal stimulus will come from the Bank of England's printing works in Dedham. In the case of the far bigger job-creation schemes and industry bailouts planned by Barack Obama, the money will come from the Washington and Fort Worth facilities of the US Bureau of Engraving and Printing, an institution rejoicing in the most succinctly descriptive internet address I have encountered: www.moneyfactory.gov.

There is nothing wrong with printing money — and plenty of it — in a period when prices are falling, property and stockmarket values are collapsing, banks are paralysed and the only assets that savers are willing to invest in are pieces of paper issued by the government.

Printing money and spending it on public works or on tax cuts, far from being profligate or imprudent in such conditions, is the only responsible thing for politicians to do. This is what Keynes demonstrated in 1936 in his *General Theory of Employment, Interest and Money*, which is one of the main reasons why there has not been a genuine depression in any capitalist economy since he published that revelatory book.

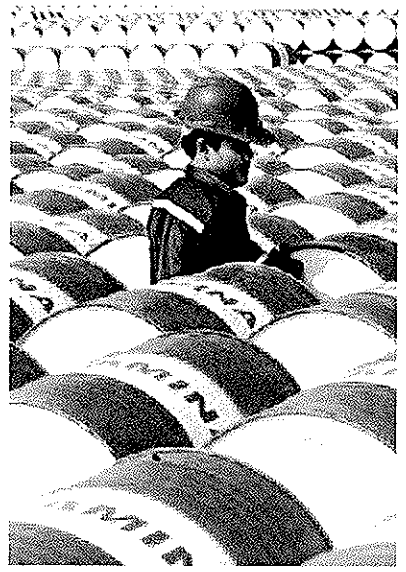
But once the threat of depression has lifted, the Keynesian calculation abruptly changes — as Keynes himself acknowledged, although many of his followers did not. When prices start rising, when financial conditions return to normal, when private businesses start hiring and consumers shopping, it is essential for the government to cut back its borrowing and for the central bank's printing presses to be switched off. Otherwise, an economy that has dodged the Scylla of depression will fall victim to the Charybdis of inflation.

It is in this sense — and in this sense only — that Mr Cameron's pre-Keynesian denunciations of Gordon Brown's "borrowing binge" could, in principle, be justified. The Tories are plain wrong to attack the increase in borrowing planned by the Government for next year. If governments do not spend and borrow during this period of private-sector weakness, nobody else will and the consequence will be much higher unemployment and more bankruptcies. The Tories are half-right, though, to point out that the money borrowed by government will have to be repaid at some point.

But there is no compelling reason why Britain's national debt should be reduced to its pre-recession level of 37 per cent of GDP — this debt burden was low by international standards. If the national debt increased in line with the Treasury's projections last month then Britain's net national debt would stabilise at 57 per cent of GDP, which would still be lower than the average figure in Europe. A similarly relaxed approach is open to the US Government, which, despite its reputation for profligacy, shares with Britain a significantly lower public debt ratio than supposedly "prudent" countries such as Germany or Japan.

While there is absolutely no compulsion for the Treasury to pay down the extra debts contracted in the next year or two, the critics of borrowing are right to point out that it will be necessary to pay interest on this increased debt burden — and that it would be a good idea to slow down the rate of borrowing once the recession is over. However, the magnitude of this challenge is not as daunting as generally believed.

An increase in the national debt from 37 to 57 per cent of GDP would add about£10 billion annually to the Government's interest bill, if financed at the present ten-year bond yield of 3.5 per cent. In reality, the cost would be smaller, since much of the borrowing could be at money market rates of 2 per cent and these are likely to fall to around zero in the months ahead. Better still, a large part of next year's public deficit could be financed at zero cost by getting the Bank of England to print more money or to lend money directly to the Treasury.



Low oil prices offer the chance to claw back money through fuel duty

The true long-run costs of Mr Brown's "borrowing binge" therefore look quite modest — maybe £5 billion to £7 billion annually in additional interest. Where could this extra money be found? It is on this point that Mr Brown deserves the criticism he suffered after the Pre-Budget Report: not for the taxes he raised, but for those he didn't. There is one type of tax crying out to be raised in the present environment because it would actually strengthen the economy. This is a tax on energy, carbon or fossil fuels.

The simplest version of such a tax is the "escalator" whereby the Treasury committed itself in the mid-1990s to raising petrol duties by 5 per cent above inflation each year. In the past three years, this escalator has been suspended to offset the effects of soaring global oil prices. Simply raising petrol duties to the level they should have reached by now, and then reinstating the 5 per cent formula, would be sufficient on its own to plug Mr Brown's budget gap. Given the recent collapse of oil prices, this would be a golden opportunity for Britain's fuel tax reductions to be reversed — and not only for fiscal reasons.

Just as importantly, tax escalation would make it harder for Opec to push the international oil price back above $100, while sending a signal that cheap energy for Western consumers was a thing of the past. Such a signal is necessary to encourage long-term investment in alternative energy and conservation. Best of all, in the context of the present slump in demand for cars, steel and other manufactured products, a commitment to rising energy or carbon taxes would encourage the replacement of inefficient car fleets, power stations, buildings, appliances and so on.

In Britain, Mr Brown missed this opportunity with his half-baked PBR. But now America has a much more exciting chance to lead a global energy transformation. If President-elect Obama wants to save the auto industry, revive US manufacturing, control government borrowing and restore US geopolitical independence, now is the time to announce a long-term increase in energy taxes.

Never again will the stars be so favourably aligned.