

Budget Response to Corona

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It seems John Maynard Keynes is making a comeback in the unlikely form of Rishi Sunak, the new Chancellor of the Exchequer. Mr Sunak's budget is a sharp reversal of the approach taken by recent Chancellors, most obviously, George Osborne, but it is really a return to the economic orthodoxy that prevailed before the word "Austerity" entered the popular lexicon.

In the words of the Office for Budget Responsibility, "The government has proposed the largest sustained fiscal loosening since the pre-election Budget of March 1992."

One of the many seminal insights of Keynes was the notion that that the economy as a whole is not the same as a household or a corporation. Moreover, he pointed out that the government of the day has a unique capacity to add spending to an economy when the other parts of the economy; households, businesses (and net exports), are retrenching, perhaps due to fear and uncertainty. That is certainly the case today.

Mr Sunak has taken the first step down the road and, we hope, other countries, notably Germany, follow, in recognising that the "state" does have a role and responsibility for macro-economic stabilisation particularly when the Bank Rate is at zero.

One of the reasons for the very poor record of British productivity in recent years has been a lack of fixed investment. Britain has the third lowest rate of public investment in the OECD below that of Italy.

The new Chancellor has introduced new spending into health, education, infrastructure, science and research and development. He has also proposed the creation of a British version of Darpa, the US Defense Advanced Research Projects Agency to enhance and sharpen British R&D. If you use an iPhone, word processor or spreadsheet, you owe that to Darpa where the initial research was funded at public expense giving birth to both Apple and Microsoft.

As the current crisis deepens led by the Corona-virus which seems to be more serious than originally thought and worsened by poor public policy, particularly in the US, this week's budget marked a significant change in direction for the UK.

The change will lay the ground for investment in green energy, transport and health that should lead to an improvement in UK productivity in the long run but help stabilise the outlook in the short-run. There is no shortage of investment needs in the UK that should yield positive pay-offs as they are met over time.

Is it affordable? The short answer is yes. The British government can lock in borrowing over thirty years at an interest cost of 0.57%. Markets are pleading with government to take the money and put it to use. The private sector has lost the appetite for risk and, coming back to Keynes, this is exactly the time when government should step in.

Will it raise the debt ratio? Of course, in the short run; but the maturity profile of UK debt is amongst the longest in the developed world; we borrow in our own currency and more importantly there are two sides to a balance sheet.

The key question for Mr Sunak and taxpayers more generally is the quality of the assets created with the borrowed money. Will the assets created yield a positive pay-off in the future and therefore become self-financing?

At the time of writing financial markets are in a period that can fairly be described as panic. Liquidity is much thinner than is popularly understood and forced sellers who need to raise cash to cover margin calls or other borrowings are punished in these circumstances.

We have been here many times before and whilst the course of the corona-virus remains opaque and therefore more feared by markets, it is unlikely to be a repeat of the financial crisis of 2008. The basic financial global architecture is in much stronger shape today than it was then.

What seems to be different this time is that we appear to have a Chancellor who is willing to make the appropriate economic steps to lay the ground for future prosperity whilst making abundant resources available to deal with the real and present danger of Corona-virus Covid-19.

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