

Much Ado About Nothing

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The budget this week was a fine balancing act between nurturing an economic recovery and recognising that the costs of the pandemic will need to be recovered. The bottom line is that tax rates will rise but not yet, to give time for the recovery from Covid to become established.

Taxes will be higher in pounds and pence for most people for a long time to come. The costs borne by the government during the pandemic will need to be repaid but unlike you and me, the government is not constrained by time. Governments can borrow over much, much longer periods and at much lower rates than ordinary individuals. The Chancellor can therefore ease the country back to balance without imposing too heavy a cost, too soon, on the economy.

Government debts can be rolled forward for generations as was the case after the two wars of the past century. The key factors are the cost of servicing this debt and the lenders' view of the solvency of the debtor: in this instance the British economy.

Unlike individuals, or even companies no matter how large, a government has the capacity to raise cash through taxation. The government is therefore a prime borrower; it cannot run out of money if it presides over a fully functioning economy. The key is to maintain and grow the size of the economic base that generate the taxes.

In Japan, which has had a shrinking real economy since the boom imploded in 1989 has had near zero borrowing rates for over 20 years, illustrating that governments can service their debts for extended periods even when the economy stagnates. In the worst case, a country's central bank can become the buyer of last resort; a powerful mechanism, and an equally powerful incentive to retain your own central bank.

The UK economy needs to enjoy a strong a period of growth to raise living standards and stabilise the ratio of debt to the gross value of what we all produce, GDP. But, even relatively modest rates of growth will erode government debt as a percentage of the economic base, as long as the growth rate is higher than the rate of interest and will, therefore, make tax rises less necessary over time.

This was in essence the Chancellor's stance this week. No major economic revolution post Brexit, just a steady as she goes approach to managing the coming five years during which time we will be asked to vote again for our elected officials. Which taxes he increased were not therefore important to those buyers of UK government debts, the big changes are in any case deferred for two years, the credibility of the economic plan was of paramount importance.

Covid has cost upwards of £400bn: few would argue that taxation needs to rise to bring the public finances back into balance. But, in the words of the sainted Augustine when he implored the Lord to make him chaste, "Not yet."

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