

# Opinion

Pietersen was the loose cannon all too likely to be fired

John Woodcock, page 26



## Punish savers and make them spend money

Near-zero interest rates and even a tax on bank deposits are necessary to force those with cash to use it productively

Anatole Kaletsky



The battlelines are drawn. On one side we have the Labour Government and the Liberal Democrats, the Bank of England, the US Federal Reserve Board and the vast majority of Keynesian economists in every country — plus Barack Obama. On the other side, the Tory Opposition, the German Socialists, the European Central Bank, the Church of England and the vast majority of Marxist economists in every country — plus the British public. The question, of course, is what to do about the recession. Specifically whether the way out is “to spend, spend, spend or to save, save, save” — as David Cameron has so clearly put it.

I believe, in line with the vast majority of non-socialist economists, that Mr Cameron’s campaign for savings is completely wrong; that “borrowing our way out of debt”, paradoxical as it sounds, is exactly the right prescription for our present problems. This paradox is easily explained: if governments or wealthy individuals increase their borrowings they replace weak debtors — bankrupt hedge funds, struggling businesses or repossessed homeowners — with strong ones and this helps to stabilise the financial system and sustain economic activity and employment. The country can borrow its way out of debt.

But what I think is of little importance, especially as I have been

wrong about so many aspects of this crisis — as have most conventional economists and policymakers, whose views I broadly share. Of equally little importance is what Mr Cameron and the Tories think. Only two opinions matter: on one side, that of the Obama Administration and the Brown Government; on the other, US and British consumers.

It may seem parochial to combine the US and Britain, but there are several reasons to believe that events in the two economies will be closely linked. First, both countries face similar problems of collapsing housing markets, overdeveloped financial sectors and higher than average mortgage debt.

Second, both have complete freedom of action on interest rates and monetary policy, as they are not locked into a single currency like so many European countries.

Third, the US and British governments, despite their reputations for reckless borrowing and fiscal imprudence, have managed their finances better than most other countries and entered this crisis with substantially lower public debt levels than Germany, France, Italy or Japan.

Fourth, Britain and (very soon) the US have decisive governments with clear majorities and proactive economic philosophies, in contrast to the slow-moving, reactive governments of Europe and Japan, where policy changes, if and when they eventually happen, will have little impact until 2010 and beyond.

Finally, there is the flow of ideas across the Atlantic, most of it one way. British public opinion will be strongly swayed by the policies of President Obama — even if no one in Wichita pays any attention to what is happening in the UK.

What then is the outlook for

economic policies in the US and Britain? And how will consumers, businesses and voters react? The second question is imponderable — and may depend on whether Mr Obama and Keynes look more credible to voters than Mr Cameron and Marx — but the answer to the first is quite clear. Governments and central banks on both sides of the Atlantic will do whatever they can to increase spending and borrowing.

The Brown Government has cut consumer taxes, accelerated public spending and increased public borrowing by roughly 2 per cent of GDP, on top of £500 billion in bank guarantees — and more guarantees can be expected for loans to business and homeowners in the weeks ahead.

Tomorrow, in his first important speech since the election, Mr Obama will promise a similar programme of borrowing and spending on a far grander scale: \$800 billion of tax cuts and new public spending over two years, equivalent to 5 per cent of GDP, financed by a federal government deficit that may well exceed \$1 trillion.

Meanwhile, the central banks in both countries are trying as hard as they can to make people save less. In the US, interest rates on bank deposits have been cut to zero and the Fed has just announced that it may buy long-term government bonds to squeeze five-year and ten-year rates as close as possible to zero. The result is that US mortgage rates are falling to the lowest level on record and banks, which can no longer earn risk-free returns by placing money with the Government, have no alternative but to lend to businesses and consumers. Britain is also pursuing the same monetary logic, if a few months late.

At noon today the Bank of



David Cameron has lined up with Marx and the Church of England

England will almost certainly cut its base rate to the lowest level in its 300-year history — my hunch is that the cut will be at least a full percentage point, to 1 per cent, or even below.

Inflation gives no further reason for procrastination and all economic indicators continue to weaken, if at not quite the catastrophic rate that some headlines suggest. The pound has stabilised and its weakness can no longer be seen as a constraint, as arguably it was last month.

The faster interest rates approach zero the sooner the Bank and the Treasury can start co-ordinating the programme of government-guaranteed borrowing and monetary expansion that Mervyn King, the Governor of the Bank of England, has suggested as the next logical step to sustain credit and boost demand.

Assuming interest rates are reduced to about 1 per cent today, it will make little difference to savers if they fall all the way to zero. To all intents and purposes, income from bank accounts will be reduced to nil.

The next logical step, although it may be politically controversial, would be to do the opposite of what the Tories suggest. Instead of reducing taxes on interest payments, the Government could tax all bank deposits and other risk-free savings. This would create a negative risk-free interest rate, encouraging savers either to invest in property, shares and other productive assets — or simply to save less and consume more. In either case, the result would be more consumption and physical investment, less unemployment and faster recovery from the slump.

In the absence of a savings tax — and even Mr Obama would probably balk at anything so controversial — there are plenty of other measures to boost consumption and investment. Most obvious are direct government spending on infrastructure; public guarantees and subsidies for business loans or home mortgages; or tax cuts and handouts, especially for those on low incomes who tend to spend all their money. The beauty of such policies in a world of zero or near-zero interest rates is that they are effectively cost free. In the present environment, extra public borrowing does not displace private employment or “crowd out” business investment.

There are plenty of objections to ever-increasing public borrowing, not just fairness and efficiency but also the moral hazard of creating a culture of state-dependence. But in a slump, when the alternative is business bankruptcies and longer dole queues, these objections make little sense.