

How on earth will Brown pay it all back?

The markets have more confidence in the debt of Unilever, the soaps-to-soup group, than in that of the British state," observes the *Financial Times* after the post-PBR rise in the cost of insuring government debt. With reason, but not the reason most analysts ascribe to the increased doubts about the ability of Brown & Co to pay back the huge sums it is borrowing.

It is not the stimulus package that has investors on edge. The Tories and Labour might squabble about the near-term effects of packages financed by borrowing (Brown-Darling), or cuts in other spending (Cameron-Osborne).

The simple fact is that the most important determinant of the real future burden of current spending is whether it will help the economy dig out of the hole into which it is descending. If the spending results in a shallower, shorter recession than now seems to be in store for the country, the Government's decision to finance the stimulus by borrowing will seem a triumph of pragmatism over monetarist theology. If Britain is still wallowing in recession at the end of next year, the spending will be deemed wasted, a tribute to the Government's refusal to heed Keynes's warning not to rely on

"some academic scribbler of a few years back". No matter that Keynes was the scribbler whose voice they heard as they attempted to pump up demand by cutting VAT and taking from the rich to give to the poor, whom they deem more likely to spend than the already sated rich.

Here is a not-so-secret secret. The science of economics is not capable of predicting with any certainty who will have the better of the argument. We just don't know whether Labour's plan to borrow and spend will so drive up interest rates as to prolong – rather than end – the recession, or whether the Tories' plan to fund new spending with other spending cuts will gut the stimulating effect of the new spending.

But we do know what has the markets so nervous: it is not the immediate stimulus package; it is the fact that the public ledger will continue to be splattered with red ink even when stimulus spending stops. Not even a rapid recovery can restore the public finances to the condition that the Prime Minister once claimed to be his target.

There are only five ways that the public finances can be put right once this crisis is over. The first would be to raise taxes. No, not on the rich, a group too small and too mobile to provide the



Irwin Stelzer
identifies five ways in which Britain's Budget could be brought back into balance

Exchequer with more than the odd billion. And no, not on the poor – these over-taxed masses haven't got enough money to support themselves and the army of public sector employees that purports to serve them.

The middle class is the only group Labour can tap for funds, and even Labour suspects it would be electoral suicide to suck the aspirational class dry to appease the class warriors in its midst. Business is an inviting target, but, as the Government's reluctantly forced climb-down over taxing foreign dividends

shows, businesses are in no mood to accept taxes that can be avoided by pulling up stakes and moving to more welcoming jurisdictions.

The second way the deficit eventually can be cut would be to curtail spending on the swollen public sector. Anyone who believes that is a possibility for a Labour government is forgetting that public sector employees constitute almost half the workforce in several areas, and are the party's largest client group, with the possible exception of those receiving disability and other benefits bestowed on non-workers. One rule of politics is that you don't antagonise those voters who put you in power, and who can force MPs to seek honourable employment in the cruel, cold world where value for money rules. No one understands this better than the Labour Party, which is one reason why Brown broke repeated promises not to plough one farthing into the public services until work and spending practices had been reformed.

With increased taxation that might yield significant sums off the table, and spending cuts impossible for a Labour government, the country will still have three choices. It might pass the torch to the Conservatives,

some hoping they will get their fingers burnt, others in the belief the newcomers will be able to do what the class warriors could not, and pare down the client state.

Or it might ready the country for a return of the International Monetary Fund after a 32-year absence: being beyond the reach of Britain's voters, the IMF can again impose spending cuts that will bring Britain's finances into some semblance of order.

Finally, the Government can repudiate its debts. No, not by defaulting: too obvious a confession of failure. Simply allow the billions in circulation to trigger wild inflation and a depreciation in the value of the pound. Then, pay creditors in depreciated pounds, to the cheers of those with excessive mortgages, who will follow suit. Since investors have short memories, Britain would be forced out of world markets only for a while. Or so inflation-lovers hope.

There you have it: higher taxes, a shrunken welfare state, a courageous new government, the IMF or the opiate of inflation. Your guess is as good as mine as to which of these will prove to be the path taken.

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