Supertony must stop the Death of Welfare

Gerard Lyons
In my view

PARENTAL guidance is needed for the economic movie, Taxphobia. Once a US cult film, it is now on general release on both sides of the Atlantic to widespread public acclaim, although it is receiving critical reviews among many economists and those on the Left.

The plot is simple. The once good giant, Public Sector, is to be slain. The victor is the thrusting entrepreneur, Private Sector. Yet there are many sub-plots. While big business and large speculators are left untroubled, free to roam the world, local utilities and public services are subjected to a slow, painful death.

If you have not seen this movie, don't worry. You soon will. Its impact will be felt everywhere. Alas, if you think you can go to your local library to read the story you may be wrong. For a start the library will probably be shut and, even if you do get in, you may find it does not have sufficient funds to buy any recent books. Instead, walk to one of the long bus queues near the library. After a long wait catch the private bus to the end of the line. As it leaves your local Neighbourhood Watch area, you may notice a big change, particularly as you pass one of those old Victorian local schools in need of much repair.

Taxphobia is not a movie for families, whether married with children or single parents. Now a chilling sequel is planned — not Taxphobia 2, but Death of Welfare. Despite its main characters being a cross between those in *Batman* and *Superman*, this too needs parental guidance. The anti-hero is Supertony, who works for Daily Globe's newspaper magnate Rupert, while the Riddler has taken charge of Gotham UK's finances, where all must be cut, left, *left* and centre. This movie may not play so well, as the audience will be on the receiving end of many of the stunts.

How has this genre developed? There are a number of reasons. In the past two decades policy around the world has been geared to keeping inflation down, prompting fiscal conservatism. On the Continent, the Maastricht Treaty is removing fiscal flexibility. In Asia it is evident in the policy advice given by the International Monetary Fund. In Britain it is seen in the electorate's desire to avoid higher taxes. In most industrialised economies an ageing population points to rising pension and healthcare costs. High unemployment adds to this bill. Governments face three options: do nothing; shift policy to boost growth, making it easier to finance the welfare system; or take direct action through tax increases or spending cuts.

The latter has become the chosen script even in Britain and the US, which have enjoyed improving budget positions. Sustainable medium-term fiscal policies are essential. There is a danger if policies are set on auto-pilot, oblivious to current conditions, particularly given Asia's problems. Subtitles will not be needed to understand these: the story is clear.

Britain suffered two policy blunders in the last decade: the credit binge of the Lawson Boom and the pound's membership of the European exchange rate mechanism. Many Asian economies have just had both problems at the same time: a property lending bubble alongside a currency pegged to an appreciating US dollar. Hence the need to worry.

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Asian currencies have depreciated. This will help exporters, just as the fall in the pound did after it left the ERM. And just as the British economy went from Lawson Boom to bust, so too could Asia now. This will affect us. Asia accounts for more than a quarter of world exports. Devaluation will make their goods competitive, forcing British firms to keep prices and costs down in the face of severe global competition. When the crisis broke, a third of all international bank lending was to Asia. Banks around the world that write off bad loans to Asia will be forced to be cautious elsewhere.

The outcome in Asia depends on the policy response. This could be a problem. The IMF is calling for tough fiscal policies. Although there is much sense in what the IMF says, its timing is wrong. As we have seen in Europe in recent years, tight fiscal policy during economic weakness is pro-cyclical, adding to, rather than counteracting, the downturn.

The rest of Asia should heed two important lessons from Japan's recent experience. First, fiscal policy is an effective tool. After Japan's economic bubble burst in 1990 the government kept the economy afloat with huge fiscal packages. Because the Japanese economy is still weak, many have wrongly concluded that fiscal policy has been ineffective. The opposite is true. Were it not for government spending Japan would be in depression. Ironically, last spring the Japanese government made a serious mistake by raising taxes when the economy was too weak to cope.

The second lesson is the need for consistency between fiscal and monetary policy, with interest rates kept low to fight the consequences of debt inflation.

As you watch the Death of Welfare remember, as the inflationary movie of the Seventies is played in reverse, disinflation is the main global theme. This means modest growth and low inflation, implying tough policy choices.

In good times governments should run budget surpluses, not to build up a war chest to spend on tax cuts before an election but to raise sufficient savings to cope with the inevitable downswing of the economic cycle. Nothing that lasts can be bought on the cheap, and a major economy such as the UK's should have a decent and appropriately targeted health, welfare and pensions system, funded with serious money.

In a happy ending, the anti-hero Supertony can become a hero if he does not kill Public Sector but allows it to work happily ever after with Private Sector.

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Whitbread is the brewer for whom beer isn't everything. Chief David Thomas would as soon sell you a pizza

To pull in punters, you don't