

The Analytical Foundations of the Medium-Term Financial Strategy

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1. INTRODUCTION

Since the mid-1970s macroeconomic policy in Britain has changed in two main ways. First, the Government's overriding aim has become the reduction of inflation by financial control, in contrast to the previous emphasis on full employment. Secondly, both ultimate objectives (the inflation rate) and intermediate target variables (money supply growth and the budgetary position) have been specified over a medium-term time-horizon, usually three to five years. This represents a clear break from the practice of annual adjustments to the budget deficit associated with Keynesian fine-tuning in the 1960s and early 1970s.

The two changes are related. The rationale for a medium-term policy specification is to be sought in scepticism that any worthwhile impact on the inflation rate can be achieved by monetary restraint lasting only one year. The length and unreliability of lags in monetary policy suggest that the Government should instead adhere to a programme of money supply control lasting several years. It has also been argued that, although there is no mechanical link between the PSBR and money supply growth from year to year, the two variables are related over the medium term.¹ A logical accompaniment to setting monetary targets for some years ahead is therefore to state PSBR guidelines over a similar extended period.

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¹ A. Budd and T. Burns, 'The Role of the PSBR in Controlling the Money Supply' *Economic Outlook* (Gower Publishing for the London Business School), November 1979, pp. 26-30. The subject was also considered in T.G. Congdon 'Monetarism and the Budget Deficit', paper given to the fifth Money Study Group conference at Brasenose College, Oxford, in September 1976.

These ideas were implicit in the medium-term financial strategy (MTFS) announced by Sir Geoffrey Howe in the March 1980 Budget. They remain highly relevant to the appraisal of Mr Lawson's 1984 Budget. In the Financial Statement and Budget Report (FSBR) published with the Budget the Government mentions a 3 per cent figure for the GDP deflator in 1988/89. This is not exactly a target, but it is probably intended as rather more than a working assumption. The Government's eventual goal is purportedly to establish price stability. In evidence to the Treasury and Civil Service Committee on 28th March Mr Lawson indicated that it was a ten year aim.

In this paper we shall consider, in theoretical terms, the relationship between fiscal policy and inflation. The purpose of the exercise is to provide analytical foundations for the medium-term financial strategy and a means for assessing the consistency of the Government's macroeconomic programme with its inflation objectives. The latest version of the MTFS, contained in the 1984/85 FSBR, is clearly central to this assessment, but a few passages in the Green Paper on public expenditure in the 1990s are perhaps of even greater interest. In conclusion, some remarks are ventured on where fiscal policy might go in future.

Two possible channels of linkage between fiscal policy and inflation will be examined here. The first relates to the interaction between budget deficits and the debt interest burden. It was recognised many years ago and remains logically compelling. The second, which relies on the credit counterparts arithmetic so basic to the conduct of monetary policy in Britain, may be more controversial.

2. THE MEDIUM-TERM RELATIONSHIP BETWEEN FISCAL POLICY AND INFLATION: THE PROBLEM OF DEBT INTEREST

One of the most ancient perceptions of economic science is that a nation cannot be in debt to itself. In this sense, the notion of a debt burden is a misunderstanding. However, interest has to be paid on government debt and taxation collected to meet the interest payments. Such taxation has the usual disincentive and allocation-distorting effects. If the national debt is 'too large' these effects become serious and people may be reluctant to pay their tax bills. Since difficulties in raising revenue discourage investment in government bonds, a higher real interest rate must be paid. The resulting increase in debt servicing costs further aggravates taxpayer discontent. Sooner or later the situation deteriorates into ungovernability, with open political tension between the taxpayer and rentier classes. There is no absolute criterion for deciding when the debt interest/income ratio is excessive, as much depends on the structure of taxation and taxpayer ethics. France between the wars illustrates the problem of unacceptable rentier claims with particular clarity.

The difficulties which arise from an increasing debt interest/income ratio

have been discussed in a recent paper by Sargent and Wallace.² In their work an upper bound on the public's demand for government bonds is derived from an overlapping generations model of savings behaviour. The constraint on the debt interest/income ratio therefore stems from assumptions about the savings function rather than taxpayer resistance to rentier claims. The conclusion that there is a limit to the debt interest/income ratio — and so to the debt/income ratio — is reinforced by their alternative approach.

It is important to notice that both the constraints on the debt interest/income ratio identified here are 'real'. They would apply whatever the rate of money supply growth. However, the result of excessive budget deficits must still be inflation. If a government's budget deficit is so large that debt interest is increasing faster than money national income the maximum debt interest/income ratio will eventually be reached. At that stage if the debt interest/income ratio is to remain constant, and the trend growth of productive capacity is unchanged, the rate of inflation must rise.

This argument suggests the principle that the maximum budget deficit/income ratio for a stable inflation rate (or stable prices) is one compatible with a constant debt interest/income ratio in the long run. The point was recognised in the 1944 White Paper on Employment Policy in a section which deserves to be quoted in full:

"Not only the national dead-weight debt in the narrow sense, but other public indebtedness which involves directly or indirectly a charge on the Exchequer or on the rates, reacts on the financial system. Interest and other charges thus falling on the Exchequer are often regarded as in the nature of a transfer income in the hands of the recipients and as imposing no real burden on the community as a whole. But the matter does not present itself in that light to the taxpayer on whose individual effort and enterprise acts as a drag . . . (P)roper limits . . . on public borrowing depend on the magnitude of the debt charge in relation to the rate of growth of national income".³

In the 1950s and 1960s these strictures were more or less forgotten because the budget deficit was quite low and inflation eroded the real value of the national debt. But more recently they have become important. Table A.7 in the Green Paper shows that the ratio of net debt interest to gross domestic product rose from 2.2 per cent in 1975 to 3.7 per cent in 1981 and 3.4 per cent in 1982.

A simple algebraic argument can be outlined to determine the budget deficit/income ratio consistent with a constant debt interest/income ratio. If

² T.J. Sargent and N. Wallace 'Some Unpleasant Monetarist Arithmetic' *Federal Reserve Bank of Minneapolis Quarterly Review*, Fall 1981, pp. 1-17.

³ White Paper on *Employment Policy* (London: H.M.S.O., 1944), pp. 25-26.

we assume that the interest rate is fixed, a constant debt interest/income ratio implies a constant debt/income ratio. Let a denote the constant ratio of the national debt to income. Then

$$D = aY$$

and

$$\Delta D = a\Delta Y$$

where D is the national debt, Y national income and Δ signifies changes in the variables. But the change in the debt is the same as the budget deficit (denoted by B), and so

$$\frac{B}{Y} = a\frac{\Delta Y}{Y}$$

Here $\Delta Y/Y$ is, of course, the rate of increase of money national income and is equal to the increase in prices plus the increase in real output, which may be denoted by i (inflation) and g (growth) respectively. We therefore have

$$\frac{B}{Y} = a(i + g)$$

As long as the budget deficit/income ratio is kept equal to the right-hand side of this equation year after year, the debt interest/income ratio will be constant.⁴

This is a useful result. Clearly, if the government wants to have stable prices (i.e. $i = 0$), it must keep

$$\frac{B}{Y} = ag$$

In an economy with a low underlying rate of economic growth, the message is that the government's scope for running budget deficits is very limited. The ratio of the national debt to income has never exceeded 2 for long periods in Britain. If we regard the economy's growth rate in the very long run as 2 per cent, the maximum budget deficit/income ratio consistent with stable prices and a constant debt interest burden at any stage in our history emerges as 4 per cent. At present the national debt/income ratio is about 1/2. If we follow the Treasury's suggestion in the Green Paper of 2 1/4 per cent a

⁴ The result is far from new. See p. 64 of M. Feldstein *Inflation, Tax Rules and Capital Formation* (Chicago and London: University of Chicago Press, 1983) for an alternative derivation. The similarity with the Domar model of public debt, which says that in the limit the ratio D/Y tends towards B/Y divided by $\Delta Y/Y$, is also apparent.

year growth until 1988/89 and 1 1/2 to 2 per cent a year between 1988/89 and 1993/94, the implied maximum budget deficit/income ratio would seem to be about 1 per cent. In fact, the mechanical application of the formula is not legitimate because the average rate of interest on the national debt will undoubtedly change in coming years. However, the exercise does identify variables relevant to the specification of a medium-term fiscal strategy for inflation control.

Before moving on to the relationship between the fiscal stance and monetary growth, we should note the concept of the budget deficit relevant to the debt interest problem. Government debts matched by interest-paying financial assets (e.g. claims on the private sector) or which lead to investment in profitable or self-financing enterprises (e.g. public corporations' capital spending) should be deducted from the budget deficit since they have no net effect on the interest burden. In Britain the general government financial deficit is the closest approximation to this underlying idea.

3. THE MEDIUM-TERM RELATIONSHIP BETWEEN FISCAL POLICY AND INFLATION: THE LINK WITH MONEY SUPPLY GROWTH

The general government financial deficit is not, however, the appropriate concept for tracing the link between fiscal policy and money supply growth. Here the right measure is the potential addition to the money supply attributable to the budgetary position. This measure is the public sector borrowing requirement (PSBR) since it is one item in the well-known credit counterparts identity for sterling M3:

$$\text{Change in sterling M3} = \text{PSBR} + \text{bank lending to private sector} - \text{sales of public debt to non-bank public} - \text{external items} - \text{increase in non-deposit liabilities.}$$

This identity can be expressed more concisely as

$$\Delta M = B - \Delta S + \Delta L \quad (1)$$

where S is the stock of government debt held by the non-bank public and L is the outstanding total of bank advances to the private sector. This formulation excludes the external items, the analysis of which would introduce unnecessary complications. In developing another brief algebraic argument we shall make use of the monetarist assumption, that the rates of growth of money national income and of the money supply are equal in the long run:

$$\frac{\Delta Y}{Y} = \frac{\Delta M}{M} \quad (2)$$

Now let us consider a steady-state situation in which the ratios of government debt and of the outstanding bank advances total to money national income have constant values denoted by α and β respectively.⁵ Then

$$S = \alpha Y \quad (3)$$

$$L = \beta Y \quad (4)$$

Taking differences in (3) and (4), and substituting into (1) gives, after division by Y ,

$$\frac{\Delta M}{M} \frac{M}{Y} = \frac{B}{Y} - \alpha \frac{\Delta Y}{Y} + \beta \frac{\Delta Y}{Y}$$

From (2), $\Delta M/M$ equals $\Delta Y/Y$ in long run equilibrium, and hence

$$\frac{\Delta M}{M} = \left\{ \frac{1}{(M/Y) + \alpha - \beta} \right\} \frac{B}{Y} \quad (5)$$

Equation (5) shows that the rate of money supply growth is a positive function of the PSBR/GDP ratio if

$$\frac{M}{Y} + \alpha > \beta$$

This will always be true since the money stock is higher than the outstanding bank advances total. The equation also says that an increase in the PSBR/GDP ratio can — in a long-run steady state — be accompanied by no increase in the money supply growth rate only if one or other of the following three conditions is satisfied:

- There is an increase in the ratio of the money supply to national income.
- There is an increase in the ratio of public sector debt holdings to national income.
- There is a reduction in the ratio of bank advances to national income.

As with the previous exercise, it is important to realise that the current values of the variables mentioned cannot be inserted mechanically in the equation to obtain the PSBR/GDP ratio consistent over the next few years with a particular growth rate of the money supply and money national income. The equation applies in a long-run steady state, a condition which does not prevail in the British economy today. The advantage of the

⁵ The algebraic argument is also given at the end of the third chapter of T.G. Congdon *Monetary Control in Britain* (London: Macmillan, 1982).

exercise is again that it identifies influences on the relationship between the budget deficit and money supply growth and gives analytical leverage on the theoretical issue. Real-world application is more problematic.

There are two particular hindrances to estimating the PSBR/GDP ratio consistent with a given inflation rate or price stability over the long run. First, considerable uncertainty exists about the determinants of the demand for public sector debt. It is not clear whether wealthholders are more concerned about the market value or the nominal value of the debt. The natural assumption would seem to be that they focus on the market value of debt issued in the past, but the budget deficit represents new additions to the nominal value of the debt. The successful passage of the economy from high to low inflation would reduce interest rates, increasing the market value of the national debt but having no effect on the increase in the nominal debt associated with a particular budget deficit. More fundamentally, the national debt/income ratio has varied substantially in the post-1945 period. The London Business School has shown that the nominal value of public sector debt fell from 73 per cent of GDP in 1963 to 41 per cent in 1979.⁶ The decline would have been even greater if market value had been used instead.

Secondly, the ratios of both the money supply and bank lending to national income are not immutable for all time. The ratio of broad money to money national income has varied within a relatively narrow band (from 0.35 to 0.45) over the last twenty years, but the ratio of bank advances to national income has risen steadily. The rise in the bank advances/national income ratio reflects the attractiveness of bank finance for companies relative to capital market finance throughout the 1970s. The 1984 Budget has altered the balance again, since the scope for leasing business will decline after 1986 and the need to pay deferred tax will, by eroding banks' capital adequacy, tend to restrict lending growth. At present the bank advance/national income ratio is about 0.35, a figure unlikely to be exceeded for the foreseeable future.

The provisos about the real-world application of the equation must be recognised and understood. Nevertheless, some indication of the order of magnitude of the PSBR/GDP ratio consistent with different money supply growth rates can be given. The matrix in Table 1 relies on realistic assumptions about the money supply/money national income and bank advances/national income ratios to derive possible outcomes.

4 IS THE 1984 MEDIUM-TERM FINANCIAL STRATEGY CONSISTENT WITH THE GOVERNMENT'S INFLATION OBJECTIVES UNTIL 1988/89?

In the 1984 Budget Mr Lawson decided that most of the Thatcher Government's hard work on reducing the budget deficit had been

⁶ A. Budd and T. Burns 'The Role of the PSBR', pp. 26-27.

TABLE 1
The Relationship Between the PSBR/GDP Ratio and the Growth Rate of Broad Money: Possible Outcomes

Debt/income ratio (%)	PSBR/GDP ratio (%)	1	2	3	4	5
0						
25		20.0	40.0	60.0	80.0	100.0
50		3.3	6.7	10.0	13.3	16.7
75		1.8	3.6	5.5	7.3	9.1
100		1.3	2.5	3.8	5.0	6.3
		1.0	1.9	2.9	3.8	4.8

Note: The figures in the matrix show the percentage growth of broad money associated with particular PSBR/GDP and debt/income ratios. For example, with a PSBR/GDP ratio of 2% and a debt/income ratio of 50%, broad money should grow by 3.6% a year. These calculations use equation (5) of the text.

Assumptions:

- (a) Ratio of broad money to money national income: 0.40
- (b) Ratio of bank advances to money national income: 0.35

completed. Paragraph 56 of the Green Paper on public expenditure states that, disregarding net debt interest, 'the burden for the non-North Sea sector can be reduced to the extent that public expenditure falls more than North Sea tax revenues as a share of GDP'. Success in controlling public spending other than debt interest will lead to tax cuts, not a lower PSBR/GDP ratio. This is a major change of direction from the unswerving commitment to PSBR reduction when Sir Geoffrey Howe was Chancellor of the Exchequer.

According to the medium-term financial strategy set out in the 1984/85 Financial Statement and Budget Report, the PSBR/GDP ratio is intended to decline from 3¼ per cent in 1983/84 to 2¼ per cent in 1984/85 and 2 per cent in 1985/86. Although figures of 1¾ per cent are given for 1987/88 and 1988/89, the difference between 2¼ and 1¾ per cent is less than the margin of error and for all practical purposes can be ignored. Mr Lawson is, in effect, planning to stabilise the PSBR/GDP ratio at about 2 per cent for the rest of the Thatcher Government's second term.

The stabilisation of the PSBR/GDP ratio contrasts with the aims to lower both the growth rate of broad money and inflation. The target range for sterling M3 growth is 6 to 10 per cent in 1984/85, falling by 1 per cent a year to 2 to 6 per cent in 1988/89. This is a significant deceleration. More modest are the inflation goals. The GDP deflator is put at 4¾ per cent in 1984/85, 4¼ per cent in 1985/86 and 4 per cent in 1986/87, and finally at 3 per cent in 1988/89. Curiously, these figures are assembled at no one point in the PSBR, almost as if the Government wanted to hide something or at least confuse the outsider about its intentions. The GDP deflators in the years up to 1986/87 are presented in Table 5.5, while the 3 per cent number for

1988/89 appears in paragraph 2.19. Our own Table 2 below brings together the various items in the 'programme', if such it may be called.

Whatever the reservations about applying the theoretical steady-state result to an actual situation, it is striking that the Government's fiscal plans and inflation objectives are very much in accordance with the 'ballpark' numbers given in Table 1. The national debt/income ratio is currently about ½. Moreover, the market and nominal values of the debt are not at present very different, which simplifies analysis. Table 1 shows that, with a debt/income ratio of ½, a PSBR/GDP ratio of 2 per cent would be accompanied — if realistic assumptions are made about the ratios of money and bank advances to GDP — by a rather low growth rate of broad money, about 3½ per cent a year, in long-run steady state. This is beneath the target bands for 1985/86 and 1986/87 and within them for 1987/88 and 1988/89.

An alternative approach, which is a standard technique of financial analysis in Whitehall, the Bank of England and the City, is to consider the credit counterparts arithmetic in any particular year, making guesstimates about the main components. The purpose is to find out how large official gilt sales must be if the money supply target is to be achieved. If required official gilt sales are excessive in relation to institutional cash flow, fiscal policy is deemed inconsistent with the money supply target and so with the Government's inflation objectives. There appears to be no major problem of reconciliation in 1984/85. Table 3 demonstrates that, with plausible assumptions about items in the credit counterparts identity, required official gilt sales are unlikely to have to exceed the total of £8.8b actually sold in the year to January 1984. Two qualifications to this sanguine conclusion should be mentioned. The first is that money needed for privatisation issues will represent a bigger drain on institutional cash flow in 1984/85 than in any previous year; the second is that bank lending may be significantly above the £13.5b figure assumed if the economic recovery gathers more momentum than expected.

TABLE 2
The Government's Medium-Term Financial Strategy and Inflation 'Programme'
1984/85 to 1988/89.
(All figures are percentages).

	1984/85	1985/86	1986/87	1987/88	1988/89
PSBR/GDP ratio	2¼	2	2	1¾	1¾
Growth of broad money as measured by sterling M3	6-10	5-9	4-8	3-7	2-6
Inflation rate, as measured by GDP deflator	4¾	4¼	4	3½	3

Source: 1984/85 Financial Statement and Budget Report.

TABLE 3
The Credit Counterpart Arithmetic in 1984/85:
the Consistency Between the PSBR and Money Supply Targets

EM3 growth	PSBR	£5.2b	£7.2b	£9.1b
6%		6.1	8.1	10.1
8%		4.0	6.0	8.0
10%		2.0	4.0	6.0

Note: The above matrix shows the level of official gilt-edged sales required in 1984/85, for varying PSBR totals, to achieve the sterling M3 growth stated in the left-hand margin. The figures are required official gilt sales in £b. They relate to annual periods and not the fourteen months in which the target is stated. The estimates rely on the assumptions given below.

Assumptions:

- (a) Bank lending to UK private sector: £13.5b.
- (b) Sales of other public sector debt: £3.0b.
- (c) External and foreign currency finance: -£1.5b.
- (d) Increase in banks' non-deposit liabilities: £2.5b.
- (e) Sterling M3 at mid-February 1984: £102b.

The path for the PSBR to 1988/89 set out in Mr Lawson's first Budget is, then, fully consistent with the Government's stated inflation goals. What about the general government financial deficit which, we argued earlier, is the appropriate budget concept for the debt interest problem? Is there any danger that the debt interest/national income ratio will rise even though money growth and inflation are under control? In fact, not much trouble is likely in this area. The national debt is dominated by gilt-edged securities, with the total amount in issue about £108b. Of this total £66b was issued with coupons of 10½ per cent or more. It seems unlikely that debt with a coupon much above 10½ per cent will be needed over the next four years, as long as the Government's inflation projections are met. It follows that the debt interest/national income ratio should be declining as a result of lower coupons on stock issued to match redemptions. The size of this effect is such that the increase in the debt interest burden due to persisting deficit financing should be manageable.

5. IS THE LONG-RUN FISCAL POLICY DESCRIBED IN THE EXPENDITURE GREEN PAPER CONSISTENT WITH PRICE STABILITY?

A PSBR/GDP ratio of about 2 per cent is consistent with stable inflation of 5 per cent or a little less in the period up to 1988/89. But what fiscal policy is needed for price stability?

Perhaps the first point to emphasise is that this question has clearly exercised the authors of the Green Paper. Paragraphs 53 to 56 are a brief statement of principles on 'Debt interest and public sector borrowing'. But the brevity of the remarks should not be taken as indicating that policy-makers attach little importance to them. Paragraph 56 makes the key

statement about the intention to translate successful public expenditure restraint into tax cuts. Some very interesting sentences also appear in paragraph 55. 'There is inevitably some uncertainty about the precise PSBR path which would be consistent with the government's aims on inflation. But given the aim of stable prices, the scope for varying the PSBR as a share of GDP is relatively limited. If a higher path were followed a good deal of the apparent scope for increased spending or lower taxes would be pre-empted in the event by higher debt interest payments.' The Treasury is evidently well-aware of the medium-term constraint on budget deficits imposed by the debt interest problem. Detailed work on the probable development of the debt interest/national income ratio is presented in Annex 4. Although this is the final section of the Green Paper, it takes up five pages and must have been the product of considerable thought.

Paragraph 8 of Annex 4 is optimistic about the debt interest burden over the next decade. The PSBR/GDP ratio 'is assumed to be low compared with the assumed growth of money GDP. Together with an assumed decline in both nominal and real interest rates as inflation is brought down further and pressure in financial markets eases, this implies a reduction in net debt interest payments'. Table A.8 quantifies the reduction as being from 3½ per cent of GDP in 1983/84 to 1¼ per cent in 1993/94. It is this improvement which allows the Treasury to envisage a PSBR/GDP ratio of only 1 per cent in 1993/94 despite the official intention to use any decline in the ratio of public expenditure, apart from debt interest, to national income for tax cuts. To put the point more simply, the Government has in mind a clear dichotomy between genuine public expenditure programmes and debt interest. Success in controlling programmes will lead to tax cuts; success in reducing debt interest will lower the budget deficit.

A PSBR/GDP ratio of 1 per cent would be consistent with price stability. About that there can be no doubt. Table 1 shows that a budget deficit as small as that would, with a debt/income ratio of ½, be accompanied by broad money growth at an annual rate of only 1.8 per cent. That is clearly no higher than the trend growth of productive capacity. Changes in assumptions about the debt/income and money supply/income ratios could alter the numbers, but the overall conclusion about the compatibility of such a low budget deficit with stable prices is surely robust. The general government financial deficit is usually less than the PSBR. If it were nil or a mere ½ per cent of national income there would be no worries about an increasing debt interest burden. In this respect too the Government's fiscal plans for the 1990s are consistent with price stability.⁷

⁷ A PSBR/GDP ratio of 1 per cent was given as a prescription for long-run price stability in A. Budd and G. Dicks 'A Strategy for Stable Prices' *Economic Outlook* (Gower Publishing for the London Business School), July 1983, pp. 18-23.

6. SOME COMMENTS

The Government's medium-term fiscal strategy and its long-range expenditure plans for the 1990s can be reconciled with its inflation objectives. The Treasury has clearly recognised the debt interest constraint and thought about the need to make its fiscal programme consistent with declining money supply growth.

But Mr Lawson could have done more. PSBR/GDP ratios of 1 to 2 per cent are low not only in relation to the post-1945 average; they are also very small in relation to the margin of error in PSBR estimates. The announcement of a balanced budget rule, on either the PSBR or general government financial deficit definitions, would therefore have meant little difference in practical terms. But it would have had a far more worthwhile impact on expectations than the indefinite extension of the medium-term financial strategy. Mr Lawson apparently wants to give himself as much room as possible, within financial constraints, for tax cuts. As a journalist twenty years ago his enthusiasms were tax cuts, tax reform and economic growth. He had no time for sound money nostrums. In a *Sunday Telegraph* article on 11th March 1962 he wrote against 'the Eisenhower school of economic commentators, who see mystical significance in an overall budget balance, since this is a muddled amalgam of Gladstone and Keynes without the logical consistency of either'; on 28th April 1963 he judged that 'The great social justification, to my mind, for a mildly inflationary economy is that a society in which borrowers do better than lenders of money is fundamentally more attractive than one in which the reverse is true.'⁸ The quotations might be dismissed as those of a young man trying to cut a dash. But there are two reasons for taking them more seriously. First, in evidence to the House of Commons Treasury and Civil Service Committee on 28th March 1984, the same Mr Lawson said, 'There is no particular magic about a balanced budget'. Secondly, in the first Budget he presented as Chancellor of the Exchequer he sanctioned the continuation of mild inflation for the next five years.

But tax cuts do not change the burden of public expenditure. The increase in the budget deficit they must involve means merely that the burden damages the private sector in different ways (higher interest rates, higher inflation, debt debasement) from the disincentive effects associated with overt taxes raised by the Inland Revenue or the Customs and Excise.⁹ And, more fundamentally, what is the point of perpetuating the national debt? In a long-run steady state the only beneficiaries of deficit financing are tax inspectors (who have to collect taxes to pay the interest), gilt-edged stockbrokers (who receive commission on transactions in the debt instru-

⁸ R. Shepherd 'Lawson's words for eating' *Investors Chronicle*, 9 March 1984.

⁹ The argument was developed in T.G. Congdon's 'What's Wrong with Supply-Side Economics?', *Policy Review* (Washington: Heritage Foundation), Summer 1982.

ments) and macroeconomists (who pontificate on the pros and cons of particular fiscal policies). There is more useful work for these worthy members of society to do. A really radical Chancellor would think about extinguishing the national debt by a policy of deliberate budget surpluses. Financial markets could then concentrate on the important task of channelling the nation's savings into profitable and efficient private sector investments.