

The two deficits

Let me have another go at explaining why I think we should be more worried about the balance of payments deficit than about the state deficit which seems to attract all the attention.

The state deficit will be financed primarily by UK savers. It means the state can spend a bit more and individuals choose to spend a bit less as they save. The state can always repay the state debt as it is issued in pounds and the state through its Central Bank decides how many pounds to create. Usually the state just rolls the state debt over when it matures. Of course I wish to see good value for money spending on national priorities, and to leave plenty of room for personal and business consumption and investment. There is always a political argument to be had over the total tax take, tax rates, and the growth rate of personal real incomes. There are important arguments over how much the state can and should do, and how much is best done through a competitive private sector.

The OBR forecasts a large balance of payments deficit of 6% of GDP. This will also need financing. It needs paying for in foreign currency, as it represents the excess of imports of goods and services over exports and the excess of payments abroad to incoming payments of dividends and interest. The two main ways in which it is paid for is through the sale of UK assets to foreign buyers, and the assumption of foreign debt by UK businesses and individuals. These foreign debts cannot be repaid by the Bank of England creating the necessary foreign currency as it can only create pounds. The debts can only be rolled over if the lenders agree. If we sell too many of our productive assets we may see an outflow of jobs and activity from the UK, as some of the foreign buyers want to buy UK capacity to reduce it or relocate it elsewhere. They may also wish to acquire great intellectual property in order to earn the rents and licence fees on that in some other jurisdiction.

The government has passed legislation giving it stronger powers to resist foreign takeovers of companies with important technology and capacity in the UK that we should wish to keep. The best way to keep more capacity and good ideas in the UK is to narrow the payments gap to reduce the need to sell assets to overseas buyers. It is an important part of national security and defence to have sufficient capability at home. This capability should not just be in weapons manufacture, but also in food and basic materials necessary during a time of crisis to be easily accessible. The US is scrambling to restore rare earths capacity given the troubles with trade with China, reminding us there are things you need to do for yourself.