The Iran war UK budget opportunity

The fallout from the Iran war is not the UK's fault, but it is the UK's problem. With 30-year borrowing costs hitting multi-decade highs, the markets are worried about stagflation. Chancellor Reeves deep-seated fear of the bond market has understandably seen the government focus on fiscal discipline. Yet that discipline has myopically been achieved through taxation that has tended to be both growth unfriendly, and more tactical than structural. This government's policy mix has exacerbated the UK's debt vulnerability. At a time of so much global uncertainty, it is a mistake the UK cannot risk repeating. The time is ripe to introduce a structurally positive minimum pump price that kicks in at much lower levels than consumers are seeing today. This will allow for huge future windfalls for the Treasury when oil is flowing normally again, and more still as the energy transition progresses. The only question is, does the UK government have the courage to be the first country in the world to introduce this policy?

The government's refusal to join the Iran war is bandied about as a reflection of PM Starmer's good judgement. This crisis offers more than a character endorsement for a Prime Minister under siege. It also offers the opportunity to break the Chancellor's damaging fiscal rut with a big-ticket structural win for the UK Treasury. The Iran war driven spike in oil prices should be viewed as an opportunity to fund discretionary cyclical budget support, with the introduction of a permanent minimum price at the pump that is far enough below current pump prices to avoid consumer backlash. If calibrated to a level that is historically viewed as normal for petrol prices, the electorate won't bat an eye, but the Office of Budget Responsibility (OBR) and Market will immediately understand the future and permanent implications on Treasury revenue. The Government will finally have some leeway for growth oriented fiscal policy.

The idea is to introduce a minimum price in the UK has precedent in Scotland’s existing minimum price for alcohol. Unlike Scottish alcohol policy, the intention is not to raise the price for consumers, only to stop it from falling. Also, unlike Scottish booze, the windfall, when it occurs, will go to the government rather than industry. The idea is to establish a mechanism that allows the gains from a lower sterling-based Brent Crude price (driven either via a falling $ price for crude, or £ strength) to accrue to the Treasury, rather than consumers. While consumers will effectively be funding this, they will scarcely notice as they will see a stable pump price when the mechanism kicks in. For every £10 fall per barrel of brent oil, this should raise in excess of £5bn annually for the Treasury. As oil prices tend to fall and occasionally crash when the global economy is weaker, this mechanism will also be a counter-cyclical source of windfall revenue for the Treasury. As an added plus Ed Miliband and indeed all of us…it would be environmentally positive.
As this is not a traditional tax, there will be no inflationary cost of living impact on consumers when the oil price is higher than the threshold. Yet even if cash is not immediately flowing to the Treasury, the OBR can take a view on the likelihood of through-the-cycle future oil price falls. This will allow the Treasury to maintain fiscal rules while increasing borrowing capacity today.

Beyond Treasury inflows, the government’s environmental credibility would rise. A minimum petrol price policy will support greater demand for electric vehicles than would happen when consumers see lower petrol prices as the energy transition progresses. While voters often resist mandates that mean they must buy more expensive products for environmental reasons, they respond to market pricing. The removal of the cyclical and structural falls in pump prices will sustain demand for the EV transition. The environmental gain would be politically palatable. Importantly, this policy will create a partial longer-term hedge to the inevitable decline in petrol tax revenues as EVs become more prevalent. This will avoid the need for the government to overly tax EV's for road use, a policy which the government has prematurely embraced.

With the current conflict over Hormuz, it is entirely possible that household gas prices will be uncomfortably high for consumers next winter. A similar mechanism could also be applied to household gas (although not for industrial users as this will reduce competitiveness). The government could then use the future windfalls from a price floor for household gas, to fund subsidies to reduce the shorter term pain.

In both cases, petrol prices and gas prices in the UK will become less cyclical and more "utility" like. Has this been done before? No, but this is just the inverse of fairly common policies for countries to cap the oil price. And let's be honest: minimum prices supporting agricultural prices have existed for an eternity in many countries. In that case farmers are supported with consumers none the wiser. With this proposal, it won't be the producers that benefit, it'll be the Treasury. Or put another way, taxpaying consumers will be the ultimate beneficiaries.

The Chancellor's reluctance to break with market orthodoxy is likely to mean she won't give this proposal any serious thought. That would be a shame for the UK economy, taxpayers, the environment…and probably her career prospects.