The Opposition needs to understand the problems with UK government

The UK public sector is letting many people down and upsetting a lot of voters. Opposition parties in Parliament are good at criticising. They blame Ministers, as our system invites them to do. Opposition parties fail to ask why so many of the failures are in so called independent bodies with highly paid public sector chiefs paid many times a Minister. They claim just small extra sums – compared to the huge extra sums this government has tipped in – would make all the difference.

If only. If extra money would bring the NHS waiting lists down or would fix the Post Office and the railway things should be improving well by now. Ministers have tried this. Any Conservative MP will vote for a few extra billions of spending if it could deliver the end of waiting lists, good border control or a new railway line on time and to budget. We have often so voted.

There are three obvious flaws in our current governing structure, all undermining the power of Ministers to act whilst leaving them to blame. The first is independent bodies.

1. Independent bodies that get things hopelessly wrong. There is the Bank of England delivering 11% inflation whilst forecasting 2%. There is the Bank delivering recession and huge bond losses.

There is the nationalised Post Office putting honest sub postmasters into prison for its own bungled computer system, whilst losing taxpayers £1400 m and turning the PO into a bankrupt company surviving on big state subsidy.

There is HS 2, a nationalised company, trebling the cost of a new railway line and failing to deliver it on time.

There is the Board of NHS England denying the strikes of its employees are anything to with the highly paid managers who employ and roster them .

There is the Environment Agency and Ofwat failing to get the industry to put in enough reservoir capacity for a rising population or sufficient drainage capacity to keep us dry.

There is UK Government Investments charging us their big salaries to supervise the state ownership of the Post Office and most of the railway, who leave the huge losses and bad management unchallenged. They have approved large CEO salaries and bonuses to leave both these industries only able to trade with guaranteed payments of all the losses by taxpayers.

I have urged Ministers to insist on an annual budget meeting with each nationalised industry themselves to approve policy and targets, and an annual end of year meeting to discuss results and the draft annual report. A badly run industry, missing targets, should be put on a tougher regime of regular in year reviews. CEOs should not get bonuses for large losses and underperformance should lead to the sack where warnings are ignored and improvement plans fail.

Blame the Minister, but sort out the system

It is a crucial part of our Parliamentary democracy that we do ultimately hold government Ministers to blame for the many failings of public services and public bodies. We also expect government to intervene or to change the law when the private sector and or too many individuals miscarry.

I still believe in that system. I fully understand why government gets the blame when inflation goes too high, but note that an independent Bank of England is responsible for inflation and brought high inflation on. There are so many areas now where government is blamed but in practice the decisions and budgets rest with independent bodies, or where national and international law and judges prevent Ministers carrying out what they want to do. There are even cases where Ministers change the law but are still thwarted by activist courts.

I will explore how far this removal of power has gone, how many of the independent bodies are behaving badly or incompetently, and how courts and treaties prevent Ministers implementing the public will. As many blame Ministers, Ministers need to take back powers to solve the problems the current system fails to resolve or make worse. The doctrine of independent bodies is doing plenty of damage, from the Post Office to the railways, from Ofwat to the Bank of England. The EHCR stops us controlling our borders and the WHO which had a bad covid pandemic wants more powers to control the NHS.

Bond yields and mortgage rates

In July 2022 the UK ten year interest rate was 2%. In early September it was 3% and by the time of the Kwarteng budget on 23rd September it was approaching 4%. It peaked on 9th October at 4.38%. In July 2023 it made another new peak at 4.65% and stayed high until November. It is now just over 4%.

This pattern was similar to the pattern in the USA and the Euro area. The main cause of large rate rises in all three places was the decision of their

Central banks to go in for rapid and severe monetary tightening, as they belatedly woke up to the high inflation they had allowed or caused, depending on your view.

It is true that in the period September 26th to September 28th the UK had a bad sell off in gilts . This was mainly caused by the Liability Driven Investment crisis. The Bank has written of "severe dysfunction in the UK government bond market when distressed forced selling of gilts by liability driven investment funds led to a fire sale dynamic". The IMF also wrote how "liability driven investment funds were at the centre of the severe stress that emerged in the UK gilt (bond) market"

There are those for political reasons who claim all this was brought on by so called unfunded tax cuts in the mini budget. They overlook the fact that the increases in spending were considerably higher than the tax cuts, forget that the gilt market had fallen a long way that month before the budget because the Bank wanted a big rise in interest rates, and forget the role of LDI investors the following week in driving the market down more. The Chancellor did push the deficit up more than I suggested and could have done more to control spending. Nonetheless the pattern of rate rises and falls show that the main cause of the rate increases was Bank policy, and the main cause of the three day meltdown was LDI troubles as owners of bonds they could not afford had to sell to pay their bills. It was very difficult finding buyers when they knew the Bank was about to sell £80 bn worth and LDI investors had to sell lots of bonds as well.

Further proof of this is how the Bank turned the gilt market round. By announcing purchases of bonds and suspending the planned sales the Bank brought the ten year rate back down to 3.1% by 20th November. The fact that the following year after a series of tax rises the rate went considerably higher than in September 2022 again underlines tax cuts were not the main issue.

The Bank of England losses stop a growth policy

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The scale of Bank losses

In the budget figures we were told the Bank of England's bond buying and selling will end up losing us £102 bn. In its early phases the Bank sent the Treasury profits of £124 bn, so on these OBR estimates there are astonishing total losses coming of £226 bn. As of March 2024 the Treasury had had to pay

the Bank £49 bn to cover losses to date, so another £179 bn could become due if the OBR has got a forecast right.

These losses are huge and unacceptable. A substantial portion of the loss is avoidable. The government needs to have urgent discussions with the Bank to slash these costs. Other major Central Banks including the US are not receiving any bail outs from Treasury whilst China and Switzerland did not buy too many bonds in the first place. The ECB which made similar mistakes with bonds to the UK is now containing the losses much better with a different approach.

There are two simple changes needed.

1 Stop selling bonds in the market at low prices. The bonds repay on maturity when the Bank will get more for them than current prices, so stop selling.

2. **Copy the ECB approach to payments of interest to commercial banks on their deposits at the Central Bank . The Bank of England is losing too much on the costs of remunerating the reserves placed with it by the commercial banks compared to the interest it gets on the bonds. As the rate paid to banks is a managed rate fixed by the Central Bank cut the losses.**

These changes would lead to a good improvement in the public sector deficit x Bank of England, the measurement they use to control the economy, and to lower mortgage rates.

Bernanke needs to be radical in his review of the Bank of England

Ben Bernanke knows a lot about Central banks getting things wrong. On his watch at the Fed he saw inflation hit 5.6% in 2008 before watching it collapse along with important parts of the banking system. He was there for the banking crash and great recession of 2008-10. He pioneered the money printing and bond buying policy that lies behind the wild ride the UK has experienced in inflation and growth 2019-24.

Recommending the same people on the MPC be asked to publish their own differing forecasts will not solve the problem, as there is too much groupthink on the MPC. Telling them to publish a range of scenarios does not help much either, because what we need and want to guide money policy is a reliable base forecast. How else can they set a good interest rate if they have no idea what inflation is going to be. That is why I have set out the need to completely change their forecasting models, to take money and credit seriously, and to recruit different people to provide diversity of thought.

1.The Bank should immediately conduct an internal review into its models and forecasting to find out why it got inflation so wrong and to propose amendments that would have produced better outcomes. It should back test changes to the model to make sure they would result in material improvements.

2.The Bank should produce an analysis of the role of money and credit in inflation and discuss how this can be monitored and used in helping make policy decisions about rates and money creation going forward.

3.The Bank should ensure in its future recruitment to senior roles on the staff and to external appointments on its committee that it appoints to obtain a greater diversity of views about economics and inflation. It should wish to have representatives of the main strands of economic thought on the important topics around the table.

4.The Bank should reward staff when it hits targets for accuracy of forecasts and success of out turns to policy decisions.

5.The Bank should reconsider its attitude to Quantitative quantitative tightening. If it is unimportant as an influence on inflation as it says and the
purpose is technical or tidying up it should stop selling bonds and let maturities gradually reduce its balance sheet. It should consider whether its bond sales do depress markets in ways which can disrupt them, consider the flow across to its tasks in maintaining banking sector stability and ask whether too many bond sales might make a recession more likely. Selling bonds at huge losses and sending the bills to the taxpayer is encouraging recession and preventing a growth policy.