

Conservative Home article on managing the economy

The Treasury and the Bank put out a wrong narrative on the economy. The Bank claims it is independent and responsible for counter inflation, but denies any blame for the great inflation that we are living through. It belatedly and at slow pace is reviewing why it got its inflation forecasts so wrong. You would expect it to move more quickly as how can it control inflation properly going forward if it does not know what it is likely to be? The Treasury and OBR are so far unrepentant for their wildly wrong forecasts of the deficits in recent years, yet still full of themselves in telling us we cannot afford any tax cuts. How can they know this when they cannot forecast tax revenues at all accurately, and have a model which does not seem to understand that tax revenues tend to rise with more growth and fall with more austerity?

Of course the Ministers and Shadow Ministers must defend officials in public and work with them in private to get a good answer. It is not, however, the Minister or Shadow Minister's role to pretend all is well when big mistakes are being made. It is certainly not a good idea to accept advice which is wrong, based on models, forecasts and economic theories that have done much damage in the past. The Minister needs to institute reform from within whilst declining the advice in the meantime if it visibly depends on things that have done harm recently. The Shadow Minister should be critical from without, blaming the Minister for a bad scheme or wrong forecasts or bad advice if the Minister is relying on them. It is the Minister's job to look for and take good advice, not to accept bad advice because of who put it forward. The media should not be reverently presenting every OBR and Bank forecast and statement as the gospel when it has been so wrong in the recent past. It should be shining a critical light on how the Bank forecast 2% inflation and we got 11%, and how the OBR was more than £100bn out on deficits when they claimed to be able to pin point the need for £10bn or £20bn of more tax revenue.

Instead, both the main parties now are telling us we need to accept an iron financial discipline designed by the OBR. Labour wants to double up on the OBR discipline the government accepts, apparently oblivious of the huge errors in deficit forecasting in a control system that relies on forecasts of the deficit to determine spending and taxes. The Chancellor briefs the press that there is no scope for tax cuts based on strange forecasts for five years time, when the only thing we should all agree about is the five year forecast is bound to be wrong. So many things might have changed by five years time, whatever the result of the next election. Few professional forecasters would wish to give you a spot forecast for the government deficit that far forward, but would reluctantly give you a range based on varying scenarios.

Don't get me wrong. I do not want the state to spend and borrow more. I am all in favour of getting the deficit down, but do not think high tax rates and austerity achieve that. More often in the past that approach has put the economy into recession, cutting tax revenues, boosting the costs of economic failure and so increasing the deficit. What we need is better

spending control, a vigorous assault on the unprecedented 7.5% large fall in public sector productivity this decade, and a combined monetary and fiscal policy that takes inflation seriously. We have lived through several years of both parties agreeing a policy of spending huge extra sums on covid relief and public services, with Labour usually complaining that the very large rises are not sufficient in some important areas. No party queried the printing of huge sums of money to keep rates low and bond prices high, powered by a Bank of England that paid ever more expensive prices to buy bonds. In 2021 those of us who warned of the dangers of the Bank extending bond buying and money creation too far into recovery after a necessary offset to lockdown were ignored. It proved inflationary, as we feared and as they denied. Now the Bank has lurched to a very tight monetary policy and is dumping the very bonds it paid too much for at ever lower prices, maximising the losses it is making.

Over the last year the Treasury has followed a policy they told us would stabilise the bond markets. Instead bonds have fallen further, pushing interest rates up a bit more. The ten year and the thirty year rates of interest hit new highs recently, above the level of last autumn which attracted so much criticism. So the higher taxes did not bring the rates down or save the value of the bonds. This should not surprise anyone. Throughout the last year the Bank of England has been threatening higher bank rates, raising rates and selling loads of bonds at ever lower prices, driving the market down. It was the Bank of England's announcement of higher rates and the plan to sell £80bn of government bonds on the eve of the Kwarteng budget that sped the fall last autumn, at a time when the Fed and ECB were doing the same to their bond markets. The Bank engineered a rally last autumn in prices by a temporary reversal of the bond selling. The Bank realised late that bond prices were destabilising some pension funds who held too many bonds and showed it could get the market up if it wanted. Surely those experiences should lead people to see the Bank had an important role and still has an important role in driving rates higher and bonds lower? The recent sell off in bonds clearly wasn't the fault of Mr Kwarteng and I don't think Mr Hunt had anything to do with it either.

The UK economy can perform better. The covid lockdowns were a bad economic blow agreed to by all front benches in Parliament. The bitter Ukraine war gave energy prices a savage twist, though the general inflation was well set before the war. Inflation in the UK was three times target on the eve of the hostilities. Today the economy needs more growth as well as lower inflation. It should not be a case of getting inflation down with a recession first, then thinking about monetary stimulus to cheer things up. What is needed is a successful drive to boost public sector productivity, to at least get it back to 2019 levels, a reining in of some nice to have but not essential spending, and some tax reductions and incentives to boost investment and output. Ending the HS 2 scheme where it can be cancelled and spending on better cheaper transport links that can come in sooner is a good step. Granting permissions to extract more of our own oil and gas from the North Sea down half empty pipelines is very positive, boosting output and tax revenues. It also needs lower taxes on small business, the self employed and company profits. These can be afforded within a sensible deficit reduction strategy, with models that realistically capture how more output delivers more revenue.