

Memo to an incoming PM – it's the economy stupid

The main advantage we must bring out of the leadership change is a change of economic policy. The outgoing Chancellor's policy was to correct the inflation monetary policy has brought on by a treble squeeze. He wishes to add tax rises to the current monetary squeeze to the cost of living squeeze. It is time to drop the tax squeeze. This is not something the USA and the Euro area are doing even though they too dropped the ball on money growth and triggered rapid inflations. Japan and China have inflation at 2.5% despite high energy prices, showing monetary policy matters.

The incoming PM will be told by Treasury officials that there is no money to afford tax cuts. They will argue tax rises are needed to bring the deficit down more quickly. They are wrong on both counts. On their own arithmetic there is scope in their figures for budgets to cut taxes, as the faster growth of the economy than they forecast last year delivered a deficit £100 bn lower than forecast. Nor will tax rises necessarily bring down the deficit more or at all. If the tax rises are too steep so they plunge us into recession, spending goes up and tax revenue down leading to a bigger deficit.

The new government should choose tax rates that maximise revenues, which in some cases means lower rates where tax is avoidable. It should act to offset the slowdown in the economy being brought on by the double squeeze, as only with growth will current public spending levels be affordable. Given the silly figures the Treasury uses for debt interest there is on their forecasts a big fall in those over the next two years which gives more room for tax cuts.

The Treasury should also be reminded state borrowing if properly funded is not inflationary. The state either takes money from the private sector as tax to lay its bills or as a long term loan. Either way the private sector has less money to spend and the state more. Printing money as Mr Sunak and the Bank did is usually inflationary. Only when there is huge shock as with first lockdown May it be necessary and not inflationary. A central bank allowing commercial banks to advance too much credit can be inflationary. Central Banks need to set interest rates and required capital ratios to avoid this.