My Conservative Home article on Treasury orthodoxy

So why did Kwasi Kwarteng and Liz truss campaign against Treasury orthodoxy? And why did Liz truss then give a win to that same Treasury orthodoxy by sacking her Chancellor and imposing a business tax rise just as the fans of Treasury orthodoxy had always said?

We cannot be sure. One of the strangest things was the absence of a definitive speech by either on what Treasury orthodoxy was, or why it was wrong. I think I know what they meant, but maybe my view was more conventional and restrained than theirs. The problem with challenging the establishment without explaining why or what you replace it with was you could end up losing, devoid a clear alternative. Nor was it any good sacking a High Priest of Treasury 0rthodoxy , the Permanent Secretary ,without having a ready replacement who did know what you meant and what changes you wished to make.

I have argued for some time that the Treasury and Bank are necessary institutions to impose discipline. The Treasury should do a better job at securing value for money in the many public services we do want, and at resisting demands for those extensions of state services which we cannot afford. The Bank needs to concentrate on its prime aim of keeping inflation down to 2%. Both need to sharpen their models and forecasting abilities, as in recent years they have given bad policy advice based on worse numbers.

The Treasury/OBR overstated the central government deficit by £121 bn last year. The very high number was used by Mr Sunak to justify unhelpful tax rises we did not need. Watching their model and forecasts over the years it has always had a tendency to understate revenues in an upswing and overstate them in a downswing, allied with an inability to see turning points in good time. They also do not credit revenue forecasts for some of the taxes with sufficient Laffer effect when rates are lowered, inducing more taxable activity. How can a Chancellor make good decisions when revenue can be so wrongly forecast from existing taxes? They need to amend their models to recognise the sensitivity of revenues to rates of growth and to allow that some taxes provide more revenue at lower rates.

The Treasury was at its worst over social care. It needed to make the case that the state cannot afford to take on all the costs of residential stays for elderly people who can afford to pay for them out of their savings or money released from selling their old home they no longer need or use. That has been our system for many years. Of course all healthcare is and should be free, but board and lodging is for most people with means a cost on their own resources. Instead the Treasury reached a compromise which did not guarantee to protect the full inheritance for the children whilst entailing extra costs for taxpayers which led to the hated NI rise and social care tax. These were also insufficient to pay for all the potential liabilities being unleashed.

The Bank was far too optimistic about inflation. For much of 2021 as it was busy creating £150bn more to spend on depressing interest rates on bonds the Bank assured us inflation would stay within the 2% target. Then as the year wore on it said any uptick would be transitory. As inflation prepared to hit 10% or five times target this year the Bank told us this was because of the unexpected Ukraine war hitting energy prices. So why then was inflation already at 5.5% or 2.75 times target before the war broke out? The Bank needs to take an interest in rates of change in money and credit. It does not believe that creating more money leads to more inflation, pointing out velocity of circulation or how frequently the stock of money is used can change as well. It should nonetheless be required to tell us if money and credit is growing quickly and provide a commentary if they think this is not inflationary to avoid them making the same mistake again.

Which brings us to the question what should be the controls? There are currently three. There is the inflation control. This is crucial and needs to be better enforced. The government needs to adopt it as well as the Bank. As the government spends so much in the economy it needs to take the impact on inflation into account in all its actions. There is the target to keep interest charges down as a percentage of GDP or public spending. We need this, which should be based on the cash cost of interest payments made regularly to service the bonds. It should not include the extra eventual repayments on index linked bonds which will in practice just be rolled over , nor should there be any credits for the big devaluation of repayments of nominal bonds brought on by the current high levels of inflation . Cash is what matters. There is then the Maastricht left over, debt as a percentage of GDP. This leads to bizarre decisions. As it relates to later years the figures will doubtless be well out given the poor forecasting record. Instead of this the tough inflation requirement which will constrain public spending and borrowing should be complemented by a growth target. I think 2% would be stretching compared to where we currently are, though this government has gone for 2.5%.

What the PM and Chancellor seemed to be saying was they wanted to break out of the debilitating cycle of low growth brought on by low taxes, heavy regulation and an anti enterprise culture. The world does not owe us a living and finally last year the proponents of the Orthodoxy discovered their luck had run out in simply printing more money and keeping interest rates too low. We certainly need a new orthodoxy to replace that and to get on top of the inflation it has delivered. Growth is the way out. Growth does need lower tax rates, more investment, and a stronger spirit of enterprise. It also needs more control over spending, whilst ensuring great quality core services like health and education.