What economic policy now? (written for Telegraph)

The abrupt decision to sack the Chancellor and to signal a 31% hike in business taxes was a bad idea. It leaves the government searching for more to fill its Growth strategy. The political debate over the growth strategy is now even more fevered and not well informed. Critics of the tax cutting plans assume the borrowing levels that result will be too high, and lasered in on wanting to hike Corporation tax to correct the elusive number they use for the alleged excessive borrowing. They should wait to see the spending plans, and to read the government's considered forecasts of what might happen to revenues and outgoings as a result of all the changes. The new Chancellor needs to work up convincing spending, taxing and borrowing numbers with OBR assessment. The OBR need to get a lot better at forecasting deficits as they are so crucial to tax judgements.

It is clear that after two years of wild pessimism about likely borrowing by the OBR, this year their forecast for borrowing was too low. I have found myself having to disagree with OBR forecasts three years running. The truth of the current situation is whether we raise Corporation tax or not, borrowing this year will be considerably higher than forecast. The main reason is the cost of the energy package. All agree we need to do enough to help hard pressed consumers and businesses. Forecasting the cost of the current scheme depends on the gas and electricity price over the winter, which could ease the costs or could escalate them. Tweaking the scheme to limit all household consumers to the controlled price for a specified amount sufficient for the average house could cut costs a bit, charge better off consumers with large houses more on the extra fuel they burn, and be a further incentive to reduce fuel use. We need to be generous to those on low incomes but careful with overall spending on this package.

The choice we are making is do we hike taxes now with the likelihood that this would intensify the downturn and lengthen a possible recession, or do we provide more offset to the downturn through a mixture of financial support and tax reductions? Arguably we will have lower overall new borrowing if we offset some of the downturn than if we rush into tax rises. The economy is going to slow whatever taxes we set, as the Bank of England is determined to drive interest rates and mortgage rates up whilst the high energy prices are like a huge tax rise on all of us. The more we pay for energy the less we have to pay for other things, and the fewer jobs and incomes there will be supplying the discretionary items that many have to give up. As mortgages are forced up so mortgage holders can afford less. Tax rises will deepen the downturn and slash the revenues as a result.

Amidst all the extreme argument there is some agreement. Most MPs agreed with cutting National Insurance as we do not need a higher tax on jobs at this juncture. Most MPs agree with the general principle of offsetting some of the impact of the energy price hikes to stop a worse downturn. The idea of a Growth strategy is still a good one. If the economy grows faster we get more revenue and have less spending on benefits as more people have better paid jobs and more are in work.

Instead of trying to undermine the Growth strategy the critics should be urging it on and demanding more action. We still await the details of the investments, regulatory changes, incentives, Enterprise Zones and the rest that it will need to boost our capacity, increase domestic energy and home grown food and expand industrial capacity. I want to see a bold set of measures, alongside a budget that tells me what the income is likely to be and what will be spent. Anyone who wishes our country well would want this too. Rushing to make the UK a less desirable place for businesses to invest and create jobs would not be a good start to such a strategy. When we know the whole package we can discuss its balance. We cannot afford tax rises, as these will worsen the downturn and cut the overall revenues.

My Speech during the Energy Prices Bill debate

Rt Hon Sir John Redwood MP (Wokingham) (Con): I welcome the Government's announcement today that this scheme should be time-limited to six months and that a different scheme should be developed against the possibility that energy prices remain very high for the months thereafter. I do not think that we can go on indefinitely at the rate of the cost of this particular scheme over the winter. If this continues, we need to target the support much more clearly on the many people and families in this country who could not afford the bills otherwise and leave those who have rather more money and are using rather more energy on luxuries to pay more of that for themselves. We have time to sort out a scheme that we can target better. I am sure that this Committee, and the dialogue that will continue, will make sure, through pressure from Back Benchers and Front Benchers, that we do not leave anybody out. It is very important that everybody has proper support one way or another so that they can afford their energy bills this winter and beyond.

I am also sure that the long-term solution is more domestic energy. We cannot carry on relying on unreliable imports, which can, at times, force our country to pay extreme prices on world markets to top up our gas or electricity because we do not have enough for ourselves. We are a fortunate country with many opportunities to produce fossil fuel and renewable energy. We have been a bit lax in recent years in not putting in enough investment, so I hope that the Secretary of State will look again at the incentives—as I am sure he will—and at the predictability of contracts and investment, so that Britain is a great place in which to invest for these purposes, and so we can exploit more of our energy and have more reliable supplies, even generating a surplus in some areas so that we can help Europe, which is very short of energy and does not have many of our natural advantages.

My concluding point is that we cannot go on for too long with a complex net of subsidies, price controls and interventions without damaging the marketplace more widely and sending the wrong signals, so I am glad that this measure will be short-term. We need a better system for the future so that there can be plenty of support for those on low incomes if energy prices remain high, but also much more investment to solve the underlying problem.

My Question to the Chancellor of the Exchequer during the Economy Statement

Rt Hon Sir John Redwood MP (Wokingham) (Con): What will the impact of these measures be on the growth rate, and will we still avoid recession?

Jeremy Hunt MP, Chancellor of the Exchequer: I will publish the economic forecasts from the OBR when I make my statement in a fortnight's time. I think it is better for me to wait until I hear that. The proper answer to my right hon. Friend's question is that what we are seeking is a long-term sustainable increase in the economic growth rate. That is a central policy of the Prime Minister, which has my wholehearted support.

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.

The Bank of England fights itself

The Bank of England has two major committees. The Monetary Policy Committee is currently wanting interest rates to climb ever higher and is willing to see mortgage and other longer term rates of interest hiked as well. They regret the big inflation that has taken place, though they blame the European war rather than their own ultra low rates and bond buying in 2021. They forget that inflation was already at 5.5% before the invasion started, 175% above target. They want to start selling the large portfolio of bonds they bought up over the last decade to take big losses on the bonds and drive interest rates higher.

The Financial Policy Committee is responsible for orderly markets and avoiding financial crises. They have had to intervene in the last two weeks to temporarily reverse the MPC’s policy of selling bonds and hiking rates. They have warned that rates have risen too far too fats and bonds have been too depressed. This has led to issues for some pension funds and other owners of government bonds that has worried them .

This big split has led to some announcements that seem contradictory. We are told the MPC has great resolve to make money dearer to get rid of inflation, and that the FPC needs rates lower to cut the losses on bonds to ensure stability. In 2021 the Bank was united in wanting rates as low as possible and bond prices as high as possible. In 2021 for a time the Bank was united in wanting to correct its 2021 errors by higher rates and ending bond purchases. More recently we have had the announcement of bond sales, promptly followed by the announcement of bond buying, to be followed by possible bond sales shortly afterwards. No wonder the market is disturbed.

We need stability of policy and clear signalling of intentions. Why not say the Bank has no plans to sell any bonds all the time they are this depressed? They should give early warning of any intent to sell should bonds rise to a more acceptable level. They could do what Japan does and give indications of what they think a sensible level of 10 year interest rates would be. As the

Bank owns around one third of all the gilts and is such a major player they can have great influence over the interest rates and bond prices. They need to use this influence for the Goldilocks rate – the rate that brings inflation down without causing a panic or deep recession.