

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.

Debt Interest

We read that the Chancellor is being told there is no scope for tax cuts in the budget because debt interest continues to leap upwards.

I do agree the government needs to reduce the deficit and control state debt in future. The best ways to do that are to control public spending better, and to grow the economy faster to increase tax revenues. Tax cuts are essential to a growth strategy. The decision to cut HS 2 is an important first step in controlling public spending. This blog has identified plenty more.

The debt interest figures being used to terrify the Chancellor are a muddle of three very different things.

There are the payments actually being made in cash on all the past government borrowings. These are going up a bit as a result both of the increase in debt, and the increase in interest rates meaning that when some of the debt matures the replacement borrowings are at higher rate. These are still affordable.

There is the payment being made to the commercial banks for holding reserves at the Bank of England. This is a new torture for taxpayers introduced as part of the Bank's ill advised Quantitative Tightening policy familiar to readers of this blog. Money deposited at the Bank by commercial banks as reserves used not to attract interest, then attracted a reduced amount of interest based on a weighted calculation. The European Central Bank has recently announced they are going back to no payments on required reserves. Why doesn't the Bank of England resume its old policy to save the taxpayer some money? Interest paid to commercial banks has soared as the Bank has hiked interest rates and passed it all on to them, a direct gift from taxpayers.

Then there is the real killer in the figures, the inflation cost on the indexed part of the debt. Around one quarter of the state debt has been borrowed offering the lenders reimbursement for inflation on the income and capital they are owed. The main capital enhancement is not paid as a cash sum each year as inflation mounts. At the maturity of the debt which may be 10 or 20 years away then the inflation is added to the sum to be repaid. In practice the state just borrows the extra sum as it rolls over the debt. It is wrong to treat this as an annual cost affecting the running deficit as the current accounts do. This gives alarming figures for debt interest when inflation is high. In June debt interest was said to be £13.6bn but £9.3bn of this was inflation provisions where no cash was paid out.

Why make people buy things they do not want?

The row over what kind of car led to the Luton car park fire reveals a deep divide over what cars people want to buy and which they think are good. I have not posted items from people who claim the car was an EV or was a diesel as clearly this is an important contested fact. Some assumed it was an EV, some countered it was a diesel and some now say it was a hybrid with a lithium ion battery. Let us have the truth from some independent authority.

The reason for the row is of course the fact that the establishment wants people to love electric cars, whilst many people do not want one for all sorts of reasons. They are looking for any more bad news to try to put the establishment off its huge support for EVs. If cars with lithium ion batteries do self immolate more often than petrol or diesel then that would be a big negative. Bringing down a whole new car park is not a good look. We must be thankful no one died in the fire. There are worries about newsworthy vehicle fires and about the difficulty in putting out a battery fire, and issues over how common these disasters are.

The underlying problem is the insistence of net zero governments that we should buy or accept products we do not want because we think they are dearer, less convenient, not so fit for purpose. Indeed in one case government wants us to accept a product, the smart meter, which is offered free. We all of course are paying heavily for this through our tax and energy bills. Despite the free offer, years on half of us refuse one. Huge money and effort is being expended on trying to get us to take one. They will not take No for an answer. They should try instead to understand the wide disagreement with these products and produce better ones we do want.

Too many people see EVs as dear, with too limited a range posing big problems to recharge. The refusal of government to say how lost petrol tax will be replaced is also a major worry. Too many people think heat pumps are far too expensive even after a subsidy, and worry they would be dear to run and let us down on temperature on cold days. Smart meters are thought to be a change designed to overcharge or switch off power if supplies become too irregular.

The green revolution needs to take consumers with it to make faster progress. That will require improved products and services that people can afford.

Labour's policy approach

Much has been written and spoken about Labour this week as they met for Conference. I will today give one of my rare critiques of the leading Opposition party's policy approach.

It is difficult to square their analysis which wrongly claims public services have been starved of money in recent years, with their proposal that there should be an iron discipline against more spending, taxing and borrowing save for a very few limited changes paid for by VAT on school fees, and an extra tax on Non Doms. They ignore the £350 bn increase in annual cash spending this Parliament so far, an increase well above inflation. They ignore the collapse of public sector productivity.

Were they to win office they would soon be subject to many spending pressures from the public sector Unions and some of their own MPs to tear up the iron rules and go for a higher taxing, higher spending, higher borrowing model. They have no ideas for getting productivity back to even 2019 levels. Their attack on waste centres on getting back more of the wrong claims on covid relief monies, where the present government's policy is to maximise the repayments. Labour would be using the same officials to pursue the same policy. Savings on private planes will be tiny in a £1.1 trillion budget and many Ministers will doubtless still be flying around the world in expensive seats on commercial flights.

Their views on migration favour making faster decisions on applications,. The danger is they will allow or encourage flagging many more people through. The safest and quickest thing to do for the official is to say Yes. This avoids criticism from the applicant and legal challenge and means they could rush the weighing of the evidence or skip the need for proper documentation seeing the Ministerial imperative to get a fast time for processing. Putting on more safe routes of entry and speeding consideration could be similar to offering an amnesty to all who are here in the queue, and is closer to having open borders. The wish to do a deal with the EU to try to get more co-operation from France would come at the cost of accepting more migrants from the EU. The EU are keen to spread the large numbers coming across their southern and eastern frontiers through as many states as possible.

The policy of wanting to force through more planning permissions to build homes and new towns whatever the local view of the desirability and feasibility of this policy is at least consistent with a migration policy likely to boost numbers of newcomers. The housing shortage is partly the result of up to 600,000 additional people coming to the UK and needing homes in a single year, when the homes build rate has never been anywhere big enough to cope with such arrival numbers on top of domestic demand. The planning policy is not a good idea. Communities have been asked to take a lot of new homes in many parts of the country, and have seen homes built before the extra roads, hospitals, schools, utility provision has been completed. It is also very difficult to hit CO2 targets for reduction if the country invites in many more people and needs to build many more homes for them, as this is

bound to increase the CO₂ output substantially.

Contacts for Pauline Jorgensen and the new Earley and Woodley constituency

Pauline Jorgensen is doing a great job as Leader of the Opposition on Wokingham Borough and is also the prospective Conservative candidate for the new Parliamentary seat of Woodley and Earley.

She keeps people informed and keeps in touch through her website paulinejorgensen.uk which residents of Earley and Woodley will find interesting.