

The Economic establishment's errors

During my adult life so far I have witnessed three major UK recessions which did great damage to businesses and individuals, all from predictable policy errors. I have also lived through the false forecasts of a large rise in unemployment and fall in activity in the first two years after a Leave vote, where despite unhelpful policy the UK economy did not fall into a recession in those two years.

So we need to ask why has the UK economic establishment at the Treasury and Bank had such a bad time of it?

One of the recessions occurred under a Conservative government and two under a Labour government. Clearly none of the Chancellors and PMs involved set a policy to have a recession, and in each case they relied on the professional advice at the time. They were told right up until the recession had started that there would be no recession.

It is the case the Labour Ministers made the 1975-6 crisis worse by insisting on very high levels of spending and borrowing, which led to the run on the pound and the visit to the IMF to force a change of economic policy. In 2007-9 Labour Ministers seemed to be in lock step with official opinion, with both arguing for the wrong approach to managing banks cash and capital at a time of overextended balance sheets. Conservative Ministers willingly implemented the European Exchange Rate Mechanism policy which led to the humiliation of sterling, basing their case on the official and business advice in favour of membership. Ironically they called the ERM "the golden scenario", stating it would bring low inflation and growth. Instead it brought an expensive spike in inflation and recession.

So we do need to ask if senior officials specialising in economies should be under any pressure to get their forecasts right and to correct their positions if they are going wrong? I do not recall anyone in the Treasury or Bank apart from Ministers losing their job as a result of the disasters which hit the UK economy, though many hundreds of thousands of other people lost their jobs as a result of bad policy.

In each case the errors were mainly monetary. In the 1970s the UK lurched from too fast a build up of credit and bank lending to too hard a landing, leading to a property crash and a general recession. In the ERM again as I predicted the mechanism encouraged too rapid a build up of credit, triggering inflation, and then forced too rapid a correction, bringing the economy down. In the banking crash the same thing happened. Bank policy was too accommodating in the run up, as the Parliamentary opposition and various commentators warned. Then the authorities switched to too fast a correction, causing a great recession as I feared.

Tomorrow I will look at more recent Treasury and Bank thinking on the economy and ask if it is fit for purpose, and question why we have cut ourselves off from what Central Banks in the rest of the world are doing. Meanwhile we are

looking at another Establishment error, as they watch and do nothing about the current problems.

UK state debt levels are fine

Some people tell me UK state debt is too high and we need to take tougher and more urgent action to bring it down. I disagree.

According to the ONS at the end of the last financial year UK state borrowing was £1821bn or 84% of GDP. This is well below Japan, Italy, Belgium and some other advanced countries and not very different from the USA and France.

It is not, however, a very meaningful figure. The Bank of England has bought up £435bn of the debt. As the UK state owns the Bank of England and receives dividends from its interest receipts we should deduct this part of the state debt from the total. That brings it down to £1387bn or 64% of GDP actually owed to people and institutions outside the state. This is a perfectly manageable figure.

Today the UK government can borrow at 0.5% for 10 year money and at below 1% for 30 year money. These are very low rates, showing markets think there is little risk in lending to the UK state. In the 1970s when the Labour government was spending and borrowing too much they had to pay more than 15% to borrow. They ignored these warnings and ended up at the IMF begging for a loan. The IMF demanded spending cuts and a lower deficit.

Today's problem worldwide in advanced countries is fighting deflation and economic slowdown. Markets are telling governments, companies and individuals they can borrow more for decent projects. There is too much saving and not enough investment going on.

It would be quite wrong as the rest of the world fights recession and the economic impact of the virus for the UK to tighten fiscal policy hastening a bigger downturn. Yesterday we learned that Hong Kong is offering helicopter money. Every adult citizen will be given HK\$10,000 to spend, to try to fight recession. That is how bad it is in Asia.

Fighting recession

Much of the world is in recession fighting mode. They need to be so, because the advent of the corona virus and the severe responses to it by governments makes recession more likely without action.

The virus has hit international travel and tourism hard, has disrupted Chinese output, slashed the demand for oil and other raw materials, brought freight rates well down and is now disrupting supply chains around the world. It has damaged confidence, and led to investments and orders being put off. Japan had a sharp fall in GDP last quarter thanks to a tax rise, whilst Germany is struggling to grow at all thanks to the anti car policies being followed.

This week the Stock markets of the world have suddenly woken up to the threat that comes from these events. For the first month of serious virus news gold, oil and bonds signalled trouble ahead, and share markets decided it would be short lived and they could look through it. Now they are not so sure.

What can governments and Central Banks do? They can take offsetting action to promote more economic activity, and provide more money to offset cash shortfalls by businesses hit by interruptions to their production and sales.

Taiwan has announced a stimulatory package. China has produced some tax cuts and bank lending at low rates. The Fed, the Peoples Bank of China, the ECB and the Bank of Japan have all put money into markets in various ways to increase liquidity and available funds. China has started to cut interest rates. So far the UK has taken no action to help.

These moves will ease some of the worst features of a slowdown brought on by the virus, but do not deal with the root cause. The best way out is to turn the tide in the battle against the virus by a combination of treatments, vaccinations and reducing the spread. That is not easy and we all wish them well in doing so.

As China is discovering, if you go in for lock down and isolation of whole cities after cases have been found you do not stop the spread as some people will already have carried it out of the area, but you do considerable damage to output and activity.

The Home Office and Immigration

In the 1980s and 1990s Ministers and officials in the Home Office administered a relatively successful Immigration Policy. It typically ran at 50,000 net migrants joining the UK population each year. It was never above 100,000, and was at 48,000 in 1997 when the Conservatives were replaced by Labour in government. This level enabled us to be generous over refugees, and to meet the business requirements for special skills or seasonal workers.

The new Labour government wanted policy change to boost numbers. The civil service and the EU were very helpful. It soon rose substantially. Between 2004 and 2007 it ran above 250,000 in each of the four years, some five times higher than the previous government's preferred level.

The newly elected Coalition government in 2010 appointed a Conservative Home Secretary who made clear her wish to bring numbers down from over 250,000 to below 100,000. Home Office officials were asked to work on various ways to help achieve this. After an early fall to 176,000 in 2012 it accelerated away again to well over 250,000 in each of the years 2015 to 2017.

In the 2017 election the former Home Secretary had her chance to review this policy and targets as Prime Minister. She reconfirmed them, stating in the Manifesto that “our objective (is) to reduce immigration to sustainable levels, by which we mean annual net migration in the tens of thousands rather than the hundreds of thousands we have seen over the last two decades”. She also made clear she wished to control EU as well as non EU migration, thus ending freedom of movement.

We need to ask why was it that the Home Office did not implement policies that met these Manifesto pledges? They had shown how it was possible to run such a policy in the 1980s and 1990s. They could have been in no doubt about the wishes of their Home Secretary, nor of the new Prime Minister in 2017. This failure raises interesting questions about the relative responsibilities of senior officials and elected politicians. Whilst I of course defend the constitutional principle that the Home Secretary has to take the public blame for failing to implement her own policy, we do also need to ask about the wider departmental failure.

Today we read of problems for the current Home Secretary to get her policies implemented in a timely and helpful way. I would urge officials in the Home Office to see that they had had years to get ready to cut migrant numbers, and soon will have full powers over EU migrants as well as from the rest of the world. Surely they can draw on their experiences in recent years, and on the new powers they can create, to succeed this time round? If not the Prime Minister would be right to allow new senior officials who can.

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The role of Permanent Secretaries

The Permanent Secretary in a department is the most senior civil servant. He or she is responsible for supervising, promoting and disciplining the civil servants and for ensuring timely advice to the Secretary of State. He or she is the Accounting Officer responsible for controlling agreed budgets, for spending regularity, legal conformity and financial reporting of the department's affairs.

The Secretary of State is the Head of the Department as policy maker, chief spokesman, and decision taker. Ideally the Secretary of State after discussion with officials sets out the policy, agrees a budget with Cabinet and Treasury and expects the civil servants in his or her department to get

on with implementing any changes and administering the wider corpus of departmental actions and policies.

The Permanent Secretary has no independent voice other than when reporting to the Public Accounts Committee as Accounting Officer or to a Select Committee when it is making an Enquiry into matters of implementation rather than government policy. In return for having no direct voice the Permanent Secretary expects the Secretary of State to defend the department and the actions of officials when reporting to Parliament or appearing on the media.

There are occasions when relations are strained because officials have made substantial mistakes which the Secretary of State warned them against or knew nothing about. It is best in such a situation for the politician and the senior officials to agree the way for the matter to be reported to Parliament. The Minister has to take the main hit, but it may also be agreed that there needs to be disciplinary action with an honest account made of where the mistakes or wrongdoing occurred and by whom.

It is much more difficult if relations are strained because senior officials do not like the policy being followed. This should not in theory happen. Assuming the policy decided by the Minister is not illegal or dangerous officials should accept and implement with good grace, especially if it was part of the governing party's Manifesto or it was the result of a referendum. The price of anonymity and protection from too much public scrutiny is to accept properly made Ministerial decisions and implement them in the best way even if you have reservations about them.

If a Minister disagrees strongly with an important government policy they usually have to resign. It is difficult to see why it should be different for a senior civil servant who feels so strongly that a government policy is wrong yet he or she is called upon to implement it. When I was the Prime Minister's chief Policy Adviser I had to judge on the few big issues where she and I disagreed when she had finally decided and was not going to change, and end my attempts to change her mind. Once she was committed in public to a course of action I would never do or say anything negative about the policy I was worried about. I disagreed with the Community Charge or Poll Tax and with the decision to sacrifice the veto in various single market areas.

I will be looking at issues around the performance of Permanent Secretaries in crucial departments in future posts.