

The case again against higher National Insurance

I reproduce below my latest article for Conservative Home

Let me have another go at explaining to the Government why they must remove the National Insurance tax rise, and cut VAT, before the full cost of living squeeze hits in April.

I have no wish to see the country damaged yet again by a foolish Treasury orthodoxy, aided by a Central Bank lurching from being too loose and inflationary to being too tough.

It is too late now to head off the round of inflation they have helped create. They both need to recognise that growth will bring the deficit down and the belated ending of money printing will start to slow inflation after April/May without further action. The hit to real incomes ahead will also slow the economy.

I have seen Treasury theory do so much damage over my lifetime. I urged John Major not to push the UK into the inevitable boom bust that the European Exchange Rate Mechanism was bound to deliver. He went ahead, triggering an inflation followed by a bust which collapsed house prices and took down many small businesses. It cast the Conservatives out of office for 13 years.

I watched as Gordon Brown helped generate a Treasury orthodoxy that decided to correct a credit bubble they had created by a disastrous aggressive curtailment of cash and credit. This bankrupted large banks and brought on the predictable great recession. On the back of that, Labour have been out of office for 11 years so far.

Today inflation is too high. Tomorrow it will be higher, when the full energy price rises add to bills. Wage growth so far is below inflation. The cost of living squeeze will hit confidence and limit many people's ability to spend on discretionary items, given the big rise in the cost of the basics of food, energy and the mortgage.

Some say the inflation is the result of supply-side shortages brought on by Covid, international supply chain disruptions, and the general shortage of gas in Europe. Others point to the way the Bank of England continued creating extra money, buying up bonds, and keeping interest rates around zero long after the initial pandemic shutdown.

They were right to produce a strong positive response to offset the economic damage done by the health policies in 2020, but wrong to continue money printing in the later months of last year as recovery was well set.

Whichever explanation you prefer, it all points to a coming sharp decline in the pace of growth, a big reduction in consumer spending outside the basics, and a peak or surge in inflation. It does not look like a wage/price spiral

setting in given the deflationary impact of the huge energy price rises and the consequences of the most severe advanced country monetary tightening on offer.

The Bank of England has stopped all money printing, has raised interest rates and is even thinking of money shrinking whilst the ECB plans a further €40bn a month and the Bank of Japan carries on buying as many bonds as it takes to keep the ten year rate of interest near zero. Even the Fed, with a much bigger inflation problem than the others, is still unwisely printing more money this month. The Bank of England should give its tightening time to work before considering too much action.

The Treasury have one main argument against my proposal that we should cancel the extra National Insurance, end VAT on fuel, and cancel VAT on green products to make it cheaper to save energy at home: they say the deficit is too high so they need to hike taxes to reduce the amount we need to borrow.

I agree with them that the UK has to get the huge deficit down from the necessarily high levels to get us through lockdown. The Treasury said they could live with a deficit of £233.9bn this year. I thought that was too high, but also argued it was a very unlikely outcome in the budget debate.

Now the Treasury thinks the deficit will come in at £183bn, £50bn lower. It is currently running more than £60bn lower with just three months more to report. In that case the Treasury on its own argument can easily afford to cancel the £12bn of National Insurance increase next year and forgo around £5bn of VAT revenue. It will still be reducing the deficit by a large amount compared with its assessment of what was realistic last March.

I have a strong economic reason why they need to do this. Why has the deficit fallen so much more than they thought this year? It is because the economy has grown more than they thought. It is also because the Treasury/OBR model of the economy underestimates just how much extra tax revenue they will collect if the economy grows faster.

By the same token, if they insist on slowing the economy too much this spring they will collect less tax revenue than they thought. They could end up with a bigger deficit from too tough a squeeze. If people spend less on non essentials because they are squeezed, there will be less VAT. There will also be fewer service sector jobs so less income tax. There will be less profits tax from non energy businesses.

I do not want the Government to fall for Treasury austerity economics again and plunge us into another slowdown – which will lead to more self defeating cries from the Treasury for higher taxes and lower spending. Of course we need to get inflation down. The Bank has now taken some necessary action to start to do that in the second half of this year.

The single biggest problem is the price of energy. The Government needs to get on with licencing and encouraging more domestic production of oil and gas, and more domestic capacity for reliable electricity supply. This is the way to address the chronic domestic shortage and to start to unwind the

foolish dependence to sky-high priced imports from a continent even more short of energy than we are.