[Treasury and Bank forecasts and independence.]

At last there is widespread interest in Treasury (and Bank) orthodoxy. I have been critical for sometime of the models and forecasts the Treasury and Bank provide, which do not help policy makers make good decisions. I have also been critical of the fiscal rules, which are the repackaged Maastricht rules. Under these controls and with these forecasts we have ended up with inflation five times target, and with the threat of a five quarter long recession according to the Bank. We can do better.

I have drawn attention to the Bank's confident forecasts last year that inflation this would be 2%. I queried if it was wise to continue creating so much money and keeping longer term rates so low last year when recovery was well set. I have also pointed out in answer to a Bank which says they only got it wrong because of the war in Ukraine, that inflation had already hit 5.5% in January 2022 before the war. That was some 275% of target. I disagreed with the Treasury at Budget 2021 when they forecast a huge budget deficit for 2021-2 and when Treasury advice told the Chancellor he needed to put in tax rises to plug the gap. Come the end of the forecast year they reported £131 bn less central government borrowing than estimated! I said revenue would grow faster with faster growth which we achieved. This was before any of the tax rises came in to damage it. As a result last year revenue beat forecast and model prediction by £77bn. The OBR said they did not understand why company tax had been so good, the very company tax they wanted to increase in later years by putting the rate up. It is likely the Treasury/OBR forecasts of increased revenue from higher rates next year will prove optimistic against the background of recession.

It is important to get a common understanding of OBR and Bank independence. I am not recommending less discipline or less independence. Indeed we clearly need more discipline on inflation as the current rates are unacceptable and wide of the plan and targets. Let me have another go at explaining the facts about the current control system. The Bank's MPC is independent when it comes to setting the official short term interest rate, and no-one is suggesting taking that power away. It is not independent when it comes to influencing the other key interest rates. These have been manipulated on the market by the Bank creating money and buying up large quantities of bonds to keep longer term rates down. These programmes have always required the written consent of the Chancellor, and a full Treasury guarantee against losses on the bonds. No-one can seriously claim the Bank is independent when it came to printing £895bn of new money and buying such a large portfolio of bonds. These decisions dominated money policy and interest rates for most of the last decade.

The OBR is free to publish what forecasts it wishes based on the OBR economic models at Budget time. However, the model they use is the old Treasury model they inherited. Any amendments to the model are decided jointly by the Treasury and OBR. The assumptions used to produce an official forecast run are often decided by or influenced by Treasury officials. There is much close and iterative working between Treasury and OBR officials throughout. Any government should in a free society be open to challenge over the conduct and outcomes of economic policy. It is open to any expert forecasting House to be very critical of policy or to take on official forecasts. Sensible Ministers look at outside forecasts as well as the official ones and take interest in relative success rates of forecasters.

In a later piece I will go into what may be producing poor outcomes in these official models.

Yesterday electricity prices shocked again

Yesterday U.K. wholesale electricity prices were at 414 euros a MW hour . In Germany, France and Italy they hit Euros 465 a ME hour. This is a tenfold rise on a year ago.

The U.K. has been linked into the European market by interconnectors and is often a net importer thanks to the policy of keeping us short of capacity. This summer we have a small surplus to export but the winter may well prove more difficult.

The continent is facing a damaging storm of problems. The wind often does not blow much, hobbling the windfarms when we have high pressure and no westerly winds. The low level of water in reservoirs and rivers has hit renewable power from hydro in Norway, Italy, Spain and elsewhere . The French nuclear fleet has maintenance issues at several plants and is short of cooling water to enable them to run at others. Germany has closed three of her remaining six nuclear stations and is still planning the closure of the rest by end year. The continent is racing to get Russian gas out of its system before Russia throttles the supply taps further.

Too little attention has been paid to security of supply and too much trust has been placed in renewables which do not always deliver. The U.K. has just shut one of its nuclear stations and plans to close all but one of the rest this decade. Even allowing for Hinckley C coming on stream we will end the decade with less nuclear than we began. That is why we need to keep all our gas plants and get more domestic gas out of the ground. On a bad day for wind the U.K. gets under 2% of its electricity and well under 1% of its energy from wind turbines.

Increasing capacity

Coming out of covid lockdowns we have been short of all kinds of capacity to supply goods and services. Some shortages of capacity had been building for a long time thanks to public policy and public services. Some have developed more recently. All were badly exacerbated by pent up demand during lockdown and by the impact of lockdown on the labour market.

The NHS lacked bed capacity before covid. Large extra sums were put in prior to the virus but the managers rarely managed to increase beds and provide the medical staff to deliver the extra treatments and operations needed. During covid Ministers made them put in a lot of extra Nightingale capacity. There was a reluctance to use it and then early closure of it, writing off the investment. Taxpayers also paid to take over most of the capacity of the private sector hospitals for the severe covid period. The Ministerial idea was to get much of the routine work on cataracts, hips, knees and the rest in covid free wards in private hospitals. There were reports of insufficient use being made of this capacity, so waiting lists soared. Somehow Ministers now need to direct more of the extra committed cash into providing more capacity to tackle the enlarged backlog.

Many highways authorities around the country have been busy reducing road capacity by traffic management measures and closures of lanes and through roads in the name of being green.The result is more congestion, more exhaust pollution in traffic jams, an increase in business costs, delays with deliveries and general inconvenience.

I have written recently about the water regulator, doubtless in part responding to EU directives, trying to cut individual use of water and leaving us short of reservoir and borehole capacity. The ultimate renewable resource is now scarce. No proper additional water provision has been made for the millions of migrants who have come to our country this century.

We are in the midst of a shortage of gas and electricity. Some days wind turbines only manage 2% of our electricity, well under 1% of our total energy yet the Regulators seem to think more windfarms are the answer.Ministers have now altered their line and accepted that at least for this decade we need more gas.Until there are good commercial ways of storing wind power on windy nights to use on calm days we need more reliable power. We now need to promote more U.K. gas, oil, biomass and hydro power as quickly as possible. Ministers were right to keep what little coal generating plant we have left on stand by in case the renewables produce too little.

Amidst all the talk of excessive bills there needs to be focus on solving the underlying problem of power shortage. We cannot rely on imports from a Europe even shorter of energy than us.Even friendly Norway may not have electricity to spare as low water levels mean less hydro.France is struggling to keep her big but ageing nuclear fleet going. we need more of our own power. Of course government needs to help those in need pay their bills, but we have to solve the underlying scarcity rather than press on with ever more subsidies and regulatory complexities.

No to The Venezuela model

If you want to end up with many in poverty and many fleeing your country to escape economic disaster you should follow Venezuelan policies.

They sought to control a wide range of prices below the level business needs to charge. This slashed supply and drove more businesses into bankruptcy, or stopped people trading there. Then they nationalised key industries. This drove out what remained of overseas capital and technical skill. Venezuela converted herself from being one of the most important oil producers into a country struggling to produce a small fraction of potential. The country lost big revenues.

The Starmer plan to stop energy prices going up will require taxpayers to subsidise energy companies otherwise trading at a loss, or require large sums to bail out energy companies that have gone bust. How does it help a customer to save money on the energy bill, only to have to pay more tax to deal with the corporate damage? The current price controls failed to stop prices going up and bankrupted a lot of companies. Bulb is proving a dear pensioner of the state as a result.

You can have competition in water

There is competition in water provision for businesses in our system. The householder cannot switch suppliers so most of us have to get our water from a regulated monopoly. These companies are now under the spotlight as there is an overall shortage of stored water for a dry spell so far this year. There are also too many sewage discharges into our rivers.

The nation should also be alarmed that we are constrained from doing things that need access to more water. Farmers are discouraged from irrigating more food crops, and are prevented from extracting sufficient water from rivers when flows are low for obvious reasons. The water companies have not done enough to help them find access to safe water in dry periods. Some industrial activities also need plenty of water, and the generation of power from water needs ample supply.

The competition allowed in business water provision allows choice of retailer who provides the customer interface, sends the bill and deals with issues. The retailer ,however usually has to buy the water and the waste water services from the local monopolist, so the impact of choice is limited.

The simplest model to bring more effective water competition to the many is to allow any water company to supply to any consumer using the existing pipe network as a common carrier. This will reduce the amount of regulated monopoly considerably and will allow new entrants to invest in new storage or borehole water they can provide in addition to current amounts. The pipe network will need rules on quality of water put in and on access rights to pipes given their capacities. The existing rules on water quality should suffice and are already being enforced. Where a monopoly pipe is already being used by the monopolist at full capacity then there will need to be a new pipe anyway and that might then be put in by a competitor if the monopolist refuses to make more pipe capacity available. Over time we might see new capacity to the pipe system added by new owners, or arranged by the current pipe monopolists accepting a regulated return on its use.