

Ease the squeeze

This is my latest Conservative Home article.

Since March 2021 I have been telling the Treasury that their forecasts were far too gloomy. They underestimated growth, understated tax revenues and wrongly ballooned the likely level of borrowing. I was not surprised when the Chancellor had to report much better news and confess how wrong the budget forecasts had been, though even I was surprised that the latest figures just before the 2021-2 year end show that they borrowed an almost unbelievable £105,000 million less than planned! Keeping tax rates down, cutting Stamp duty and going for growth produced a much stronger economy than they expected. The extra tax revenues poured in thanks to more spending and more housing transactions.

So why change a winning formula? Why did the Chancellor fail to stress the successes and turn instead to more gloomy forecasts? Why did he think these mean he had to put National Insurance up, freeze Income tax thresholds and get ready for a huge increase in company tax rates next year? Once again we were treated to some bizarre figurework from the OBR and Treasury. Clearly upset by how much better the revenues were than expected they presented the costs of servicing the state debt in a new way designed to sensationalise it. It looked as if they hope that the government would be panicked into tax rises in the name of debt control. They decided to add to the legitimate and affordable cash costs of paying interest on the outstanding debts to savers and other investors the non cash costs of the indexation of the index linked debt. This only becomes a liability on maturity of any given bond and will simply be refinanced by rolling over the real value of the debt when it comes due. They did not put any offsetting figures into the account to show how much the state will benefit from the high inflation the Bank has now created or allowed, as it will reduce the real costs of refinancing or paying back the majority of the debt that is not index linked.

The government needs to understand that the cost of living crisis is going to be difficult for many people. It needs to do more to offset the effects of runaway energy price inflation, rising food costs and price hikes in a wide range of other goods and services. This is not the time to be taking more money off people through a National Insurance hike. It is not the time to insist on VAT on domestic fuel. It is the time to be more generous in offering a cut in petrol and diesel taxation which otherwise will rake in far more revenue than the original plans. Given the magnitude of the official forecasts for the hit to real incomes now coming the Treasury should at least have given back more than 1% of GDP. This was eminently affordable given the great performance of the public finances over the most recent year. Instead the Chancellor spent less than 0.5% of GDP in tax remission, leaving most of his revenue windfall untouched.

The danger now is of the opposite effects. The hit to real incomes will slow growth. Many people will be unable to afford discretionary goods and services after they have met the food and energy bills. The fast recovery of health

output credited to the state last year on the back of free test programmes and massive roll out of vaccines will slow dramatically. Higher taxes will knock confidence and higher inflation will worry consumers. The economy is going to slow sharply. Instead then of a revenue bonanza from better than expected growth we will experience a slowdown in extra tax receipts. More people will qualify for top up benefits and income support. The Treasury will learn the hard way that higher taxes can lead to bigger deficits and fewer good options for economic policy.

The official figures tell us that tax as a percentage of national income was at 33% in 2019 and will be at 36.2% by the end of this Parliament. That is a substantial rise in the tax proportion. It comes from the upwards movement of rates for companies, the freezing of personal allowances and the introduction of the National Insurance/social care tax proposals. It will cut the growth rate and lower average take home pay. It will damage private sector investment, which is already disappointing despite the offer of a temporary super allowance. Businesses look at the coming hike in company tax rates and are put off.

I am glad the Chancellor wants to be a tax cutting Chancellor and admires Nigel Lawson who definitely was a tax cutting Chancellor. He slashed the rates of Income Tax and company tax and the extra money rolled in as a result. It would be a great policy to follow now. People want to know the government is on their side at a time of income squeeze. They will see that external events have created strong upward pressures on oil and gas prices and may understand government cannot protect us from all such pressures. They will be less understanding of why at the same time the government shifted from a successful relatively low rate of tax policy to higher tax rates. They will blame the government for taking money away that they need to pay the higher bills.

As the Treasury needs more revenue they need to help the private sector grow the economy to deliver the extra cash. They already get a windfall tax on home produced oil and gas in the form of a doubled corporation tax rate on such activities. They should make extracting more oil and gas at home a high priority with every government assistance to get it done. That will bring in a lot of extra revenue as well more well paid jobs. Then the Treasury needs to be more positive in support of domestic process industry which is struggling to stay alive against the background of such elevated energy costs. That too could be a net win on revenues. I will urge the government again to dump the gloomy Treasury fiscal rules and substitute just two key aims and controls. One should be to take the 2% inflation target seriously. That means the Treasury helping government do more to eliminate supply bottlenecks at home. The other should be a growth target to galvanise public policy to support expansion of jobs and investment.

We need an update on the Spring Statement urgently. It would be better to head off the worst of the income squeeze before it sets in and people have to pay the high bills.

Ukraine and the great powers

Like most westerners I blame Russia for the murderous assault on Ukraine and for the violent siege tactics now being deployed to try to wrestle territory away from those who live there who wish to remain self governing. Russia's troops have been killing civilians in frustration at not being able to occupy and overwhelm as easily as they expected. Proof of this will be used as evidence of war crimes. We are all appalled at some of the scenes we are now being shown.

Like most westerners I would like to see an early truce and a negotiated settlement. I understand how difficult this will prove as the two sides have such a different view of the rights and wrongs of the situation, and neither side has yet been able to achieve enough by force of arms to enforce their settlement on the other. Ukraine has fought bravely but cannot rid themselves of Russian troops and artillery on their land. Russia has failed to capture any of the major cities on its list and has shown it lacks the ability and force to maintain control over areas it has thought it had conquered.

As peace talks continue the aims of the two sides remain incompatible with each other. Ukraine wishes all Russian troops to withdraw, to be followed by discussion of the government of those parts of Ukraine which Russia has occupied and a referendum on a possible new constitutional settlement. Russia is holding out for Crimea to become part of Russia, and for new governing arrangements for a swathe of territory from the Russian border to Crimea that would give it control or substantial influence. That is why the fighting is likely to continue.

There seems to be a bit more flexibility over the ability of Ukraine to choose its own allies and international policy. It seems unlikely NATO will offer membership to Ukraine any time soon, having notably refused to come to Ukraine's assistance with any NATO forces. Russia's aim of excluding Ukraine from NATO might in practice occur. The issue of EU membership also hangs over the conflict. The EU intervened in Ukraine to help topple the elected Ukrainian President in 2014 when he wished to walk away from the draft EU/Ukraine Association Agreement and be closer to Russia. This was the background to Russia's annexation of Crimea and civil war in Donbas. Today Ukraine has applied for formal membership and the EU needs to respond. The EU says it sees Ukraine as part of Europe and talks of Ukraine's European destiny in terms that implies in due course it does want Ukraine as a member state. This is a complication for a Russia which dislikes the expansion of the EU as well as of NATO close to its borders.

Out and about on the doorsteps

My recent sessions on the doorsteps have been of particular interest. Despite the saturation coverage of the tragic war in Ukraine no-one has raised any Ukraine related issue with me in recent visits to Earley, Shinfield, Wokingham and Winnersh. There have been some issues raised about the Spring Statement and what more the government could do to tackle the cost of living crisis. There have been no questions or suggestions about covid despite the large numbers of cases currently being reported. The occasional person has explained from a distance they are infectious and do not wish to pass it on.

Most of the conversations have been about local issues, often related to levels of development, traffic congestion, road closures and other Council matters. Emails and letters have broadly reflected the same pattern, with just three writing in on Ukrainian issues and many more on cost of living and energy matters.

Nuclear, wind and gas – the energy question

I read that the government is debating amongst itself how much additional commitment to make to new nuclear and new wind energy as it responds to the current energy crisis. As one of the few that has been advising successive governments over the last ten years of the pending energy shortage and the need for more national self sufficiency I am glad they are now actively discussing these matters. It is quite clear today we import too much and have too little spare margin to keep the lights on and the wheels of industry turning.

I have no objections to government making a substantial commitment to new nuclear . It could well make a good contribution to our needs in fifteen years time. It needs to do so understanding three crucial matters.

1. Whatever it now does nuclear will represent a considerably smaller part of our electricity output in 2030 than today because all but one of the existing stations are scheduled to close, with only one new plant coming on stream. Nuclear agreed in principle today will not be producing any power this decade.
2. To bring off this nuclear growth the UK will need to rebuild our nuclear industry and secure good intellectual property under our control. We should not want to have the Chinese or others controlling the IP and capable of using it as leverage over us.
3. The state will need to be involved in financing. A way would need to be found to ensure some competitive discipline and genuine risk for the

private sector partners to avoid the taxpayer ending up with plants that are much delayed and massively over budget bankrolled by the taxpayer.

I have no objections to the government encouraging more offshore wind farms. I would accept more onshore windfarms as long as landowners and Planning authorities had a veto over locations, and and could share in the revenues as compensation. The government needs to understand that whilst windfarms could be put in much more quickly than nuclear, they too will not solve our current energy shortage without tackling three problems they pose.

1. On Monday wind energy supplied just 1% of our electricity. On Saturday writing this wind was only supplying 5% of our electricity. If you are going to rely on more wind there has to be breakthroughs in storage technology to allow you to harvest the wind power when it is not needed and supply it when the wind is not blowing.
2. If you press ahead with more wind energy you need to understand that will still leave us short of total energy, as renewable electricity only accounts for around 5% of our total energy. Most energy is still needed as gas to heat our homes and fuel industry, and as petrol and diesel to fuel our trucks and cars. We cannot rely on more renewable electricity all the time most of our transport, heating and industrial energy is not electrified. It will take time for the electrical revolution to convert every home, factory and vehicle to allow electricity to take more of the strain away from directly used fossil fuels.
3. If you encourage more renewable power you need to allow more back up power generation for the times when the wind does not blow. All of this entails more cost.

Balance of trade affected by change of accounting

The January trade figures were disappointing, showing a marked fall in exports to the EU which has caused some concerns by those who did not study the figures. The ONS has decided to change the basis for compiling the import and export figures, and by its own admission there was a one off hit to reported exports to the EU by delaying the dates of record.

During the first year after leaving the EU customs union both exports and imports were higher for non EU than EU. In the first half of 2021 we had a welcome balance in total trade, with a strong services surplus offsetting the usual large goods and food deficit. EU trade continued to be in deficit and the rest of the world in surplus. In the second half the trade deficit we were used to in the EU returned, with a total deficit of £24 bn for the six months. The top five imports are vehicles, medicines, gas, non ferrous metals and oil.

The strains on the balance of payments will increase this year given the high oil and gas prices. It underwrites the need to extract more of our own oil and gas. The government has said it has now shifted policy on this and I look forward to the executive decisions being taken to make this a reality. The UK offsets a substantial part of the vehicles deficit by strong exports of UK made vehicles mainly to non EU markets. It will be important to invest in and retain a strong car industry as EVs become more common. It should be a welcome challenge to the UK motor sector to seek to make and sell attractive products to home consumers that can substitute for the high volumes of EU vehicles still coming in.

The balance of payments was still sandbagged in the last quarter of 2021 by a large £5.8bn payment to the EU. One of the big balance of payments wins from Brexit will be the ending of these payments. It is a pity the UK offered such an attractive deal to the EU on payments after exit, as this has slowed down getting the benefits.