John Redwood visits Reading University

John Redwood visited Reading University on Friday and gave a talk on the constitutional and legal background to Brexit to a Politics class. He set out the two sides in the referendum, the positions taken by the three main parties in the 2017 General election, and the result of votes on leaving and on the Customs Union in the Commons.

UK inflation hit by energy costs

UK inflation was unchanged in January compared to December.
Housing made the largest contribution to the annual rise of 2.7% (CPIH) at 0.52%. This includes the impact of higher water, electricity and gas bills and the Council Tax. Motor fuel made the second largest contribution at 0.43% reflecting the further dollar rise in oil prices partially offset by the strength of the pound against the dollar. The third highest contributor was recreation and culture at 0.41%. These are domestic charges for entry to events and places of interest. These three items accounted for one half of the rise.

Other commentators may tell you motor fuel contributed to a fall and recreation contributed to the rise, as they compare the rate of increase this January with the rate the preceding January. This however can be misleading, as what matters most is the actual contributions of each item to the total in the month in question.

Those commentators who keep telling us the inflation is all to do with a fall in sterling should be asked why they hold this view when the three largest contributions had nothing to do with sterling, or in one case benefitted from a rise in sterling against the dollar in recent months.

Where do we want the boundary to be between the public and private sectors

Labour wants to change the current boundaries between public and private provision of public services.

They have to accept that the bulk of public service will continue to be supplied by the private sector, as they acknowledge they cannot buy up all business in the UK to provide everything from the public sector. Bread and circuses would remain privately supplied were there to be a future Labour government as they always have been.

The two most sensitive battlegrounds where they wish to change things are health and railways. It is important to understand where the current boundaries are. These are boundaries agreed by both the previous Labour governments and the current Conservative government.

In the case of health, the private sector makes and supplies all the drugs. Most GPs are private sector contractors of the NHS, some with private practises as well and many with for profit pharmacies alongside. Most pharmacies are for profit private sector businesses, dispensing over the counter medicines.

Many hospitals use private sector cleaners, caterers, computer service providers and other suppliers from the private sector. Labour introduced the idea of buying in operations from the private sector where they were good or where the NHS lacked capacity.

The public sector owns and runs most of the hospitals, but not the surgeries. It provides many of the operations, and pays for most of the care however delivered.

What do you think about these current boundaries? Are there bits which you think should be done entirely in house in public sector owned assets with public sector staff? What parts of current private sector healthcare would you want a government to nationalise?

Should GPs be made to be salaried NHS employees? Should surgeries be bought up by the state? Should all pharmacies be public sector businesses?

The costs of nationalisation

The Shadow Chancellor has come up with new economic doctrine. Apparently if you borrow money to pay for something this means it does not have a cost to you. He accepts that were a Labour government to be elected, it could nationalise say the water industry by offering government bonds to the current shareholders. The good news about this is he does recognise that in a free society and democracy the state does have to offer compensation or a price to asset owners, if it wishes to acquire their asset. The bad news is he thinks issuing government bonds to acquire the shares means taxpayers do not pay!

There are good reasons why advanced democracies do not usually elect governments that say they will confiscate assets held by private owners. Whilst in the first round of any such policy it might prove popular with those who benefit from the confiscation, the second round effects are very negative for many. Investors will be put off buying and building assets in the UK if they think a government might simply steal them. Anyone living in the Uk with savings or a pension fund will be very unhappy, because they are likely to hold some shares in the utilities or large companies the state wishes to confiscate. So one cheer for the Shadow Chancellor that he sees it would be a very bad policy to say the state will simply take companies and assets over without payment.

The idea that offering shareholders a bond in return for their shares must mean for it to work that the state would pay fair levels of compensation. The shareholders will only accept the bond as compensation if it is at a realistic level, and if the bond can immediately be converted into cash, as many may not want to hold the bond. They may wish to sell the bond on to someone else. Whichever way you look at it, the government will be in effect paying cash for the shares they buy, and borrowing all the money. That means taxpayers have two big bills to face. They have the annual interest bill on the debt incurred to buy the shares, and the repayment of the bond in due course when the entire cost of the shares falls due. This will mean higher taxes to meet these bills.

Labour may argue that they will enjoy the benefits of the profits of the companies they buy, which they hope will cover the interest cost of the bonds. Here, if we look at history, we see that unfortunately many nationalised industries in the past did not earn enough to pay the costs of their capital. There had to be frequent injections of new capital and writes off of old at the expense of the taxpayer. It is difficult to avoid the conclusion that this will be an expensive policy for taxpayers. After all, if Labour also wishes to cut prices and boost wages in these nationalised businesses, that means they will not be making profits.

Some questions for the long term forecasters

I find it difficult to believe some in the media are taking these latest economic forecasts for 15 years outside the EU seriously. They have all the hallmarks of the approach that the Treasury used to get the short term forecast for the aftermath of a Brexit vote so hopelessly wrong.

The first thing to stress is the forecasts which state the UK as a whole will lose 2% of GDP if we stay in the single market, 5% if we leave with a trade deal, and 8% if we leave without a trade deal are not saying we will be 2%-8% worse off in 15 years time. This is an estimate of slower growth, not an absolute decline. If we carry on growing on average at 2% per annum over the 15 years we will be 34.6% better off at the end of the period. These forecasts suggest that might only be 32.6% or on a worst case 26.6% better off. The 2% figure over fifteen years is little more than 0.1% per annum, or a rounding error.

The second thing to stress is that to forecast this accurately over 15 years they have to forecast two unknowns – how well would we do if we stayed in the EU, and how well will we do as we are leaving? Why do they assume that staying in is a risk free positive option? What assumptions should they make about tax levels and costs of regulation in the future? Will there be new taxes that hit UK economic activity? Will there be something like the ERM again that triggers a major recession? How much longer will the EU continue austerity policies?

The third thing to point out is there are many more issues which will have a far bigger impact on growth than Brexit. How have they modelled the risks of a Corbyn style government? What do they assume about the adoption of new technology? What will Artificial Intelligence do to UK professional business services? Will the US still be pursuing pro growth low tax policies in fifteen years time?

The fourth question to ask is why should there be any loss were we stay in the single market, compared to staying in the single market as an EU member? If, as they seem to think, the single market is the good bit of the EU, surely staying in it means no loss?

The fifth question is why have they not included a good positive gain for the UK from spending our own money at home instead of taking the strain of £12 bn going out across our balance of payments every year to be spent elsewhere? How have they modelled future increased outgoing to the EU if we stayed in?

I could go on, but feel I have asked enough to show why I think these forecasts are a nonsense. Most 15 year forecasts are likely to be wildly wrong. The longer the period of the forecast the more other things can happen that may have a big impact. In fifteen years time we might have a more integrated United States of Europe from the Eurozone, or the zone might have broken up altogether. That will be determined by voters in a range of countries, and by events and markets.