WHAT SHOULD BE DONE IN THE AUTUMN STATEMENT?

NOVEMBER 2023

THE CENTRE FOR BREXIT POLICY

The Centre for Brexit Policy (CBP) is a think tank backed by cross-party voices who support the UK leaving the EU. The CBP was formed to propose the critical policy changes enabled by Brexit that will boost national prosperity and well-being in years to come, as well as help ensure that Britain fully 'takes back control' after leaving the European Union.

The CBP aspires to trigger a deep and wide debate about what Brexit should mean for the UK over the next decade or two. By providing a focus for the development of post-Brexit public policy, the CBP hopes to help formulate an overarching framework for the UK that maximises the opportunities Brexit affords. This will be promoted to government, Parliamentarians, and the public welcoming contributions from those who want to see Brexit open a new and fruitful chapter in our country's life.

The CBP has three core objectives:

- **Identify the benefits and opportunities of Brexit across the full spectrum of economic, trade, social, foreign, defence and security policy areas proposing new policies for the government's agenda**
- **Continue to make the intellectual, evidence-based case for a 'real' Brexit and provide the government with clear and constructive advice on how to deal with ongoing negotiation and implementation issues. A 'real' Brexit means regaining full control over our laws, borders, seas, trade, and courts.**
- **Check any attempts to dilute Brexit, as well as serving as a catalyst and rallying point for positive news stories that, over time, will be able to persuade and demonstrate the many substantial advantages of Brexit**

Delivery of these objectives is based on professional, substantive fact-based research by experts in their fields leading to authoritative reports, short papers, OpEds, events, and briefing meetings - both within and without government.

The CBP is supported by a cadre of expert CBP Fellows drawn from multiple disciplines to provide additional expertise and experience in developing an agenda for policy change that will ensure the British people benefit from Brexit.

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He was formerly Edward Gonner Professor of Economics at the University of Liverpool and Hallsworth Fellow at Manchester University. Prior to following an academic career, he had professional positions at THE Ministry of Overseas Development HMG, Ministry of Finance Malawi, Courtaulds, HM Treasury, and National Institute of Economic & Social Research (NIESR, London) as Editor of the NIESR Review. From 1978 onwards he was regularly consulted by Mrs Thatcher and her government on their policies of monetary and supply-side reform to conquer inflation, bring down unemployment and promote growth. His research has centred around modelling the economy, where he pioneered the application of rational expectations and more recently the use of indirect inference as an empirical estimation and testing method.

He was appointed a member of the Monopolies & Mergers Commission (1990-96), a member of HMT Panel of Independent Economic Forecasters (1993-96). Minford was appointed Commander of the Order of the British Empire in the 1996 New Year Honours for services to economics.

He has had Visiting Positions at Katholieke Universiteit of Leuven, Humbolt University, Berlin, and University of Bonn. He is a serving, and founder member of the Institute of Economic Affairs Shadow Monetary Policy Committee. In 2016, Minford was a founder-member and co-chair of the Economists for Brexit group that advocated the UK leaving the European Union.

EXECUTIVE SUMMARY

The government has a crucial opportunity to get back on track in the upcoming Autumn Statement. It faces prospects of no long term growth, with a resulting eventual ruin of the public finances, and a likely recession in the short term. These prospects have confirmed that the Truss agenda for putting the priority on growth was correct.

I. **The government should recognise that the Truss economic strategy was right and it should be continued.** A year on, it is clear that the government's present policies, which jettisoned her agenda, are running into the sand. They have been justified by the argument that they could not have been feasibly carried out, as demonstrated by the 'market meltdown' that they caused.

Yet, this meltdown argument is based largely on myths and an objective analysis of the Truss policies demonstrates they made eminent sense.

II. **It is not to late the change direction and improve the economic outlook.** The Truss economic policy was based on well-grounded economic principles: economic success is driven by growth in economic productivity that, amongst other things, is driven by innovation. Innovation, in turn, is driven by business incentives to innovate.

- **Supply-side policies in the form of low tax rates and liberal regulation provide business incentives to innovate.** Under present policies innovation is being gravely inhibited.
- **The benefits of supply-side driven growth are clear**
  - **Under a supply-side-driven growth policy**, the economy will grow providing the headroom for temporary borrowing to cover lower tax rates. Even so, because of economic growth, the percentage debt burden will decline steadily. After an initial period of say, 4 to 5 years, public sector borrowing as a percentage of GDP will become relatively lower under the growth strategy. As supply-side incentives to innovation kick in, a 'virtuous economic cycle' will result leading to the postrave outcomes.
  - **Under current government economic policy**, the economy will stagnate (as is already becoming evident) and, after a short period of debt burden reduction (in percentage terms) driven by austerity, the short-term effects of increased taxation, and the effects of high inflation reducing the real value of debt and moving taxpayers into higher tax bands, the debt burden will increase requiring even more taxation. This will lead the economy into a classical 'doom loop'.

III. **Impediments to implementing growth policies should be eliminated**

- **Ensure that the importance of fiscal policy is recognised fully so that it can play its essential role in working in tandem with monetary policy**
- **Replace short-term fiscal rules with long-term solvency targets**
- **Make structural changes so that Number 10 can provide effective economic leadership**

INTRODUCTION

The government has a crucial opportunity to get back on track in the upcoming Autumn Statement.

This paper re-examines– a year later – the lessons to be learned from the economic policies of the Truss government and applies them to what should be included in the Autumn Statement. Specifically, this paper argues that:

I. **The Truss economic strategy was right and should be continued**

II. **It is not too late to change direction and improve the economic outlook**

III. **Impediments to implementing growth policies should be eliminated**

I – THE TRUSS ECONOMIC STRATEGY WAS RIGHT AND SHOULD BE CONTINUED

The government faces prospects of low long term growth, with a resulting eventual ruin of the public finances, and a likely recession in the short term. These prospects have confirmed that the Truss agenda for putting the priority on growth was correct, for all the brickbats that continue to be thrown at her and her agenda.

A year on, it is clear that the government's present policies, which jettisoned her agenda, are running into the sand. Yet they have been justified by the argument that they could not have been feasibly carried out, as demonstrated by the 'market meltdown' that they caused.

This meltdown argument is based largely on myths and an objective analysis of the Truss policies demonstrates they made eminent sense.

MYTHS ABOUT THE TRUSS ECONOMIC POLICY COLLAPSE

In fact there was no such 'meltdown'. Market interest rates on government long term bonds rose steadily before the Truss government was formed as central banks, led by the US Fed, began to raise interest rates hastily in response to high inflation following the end of Covid. Those market rates continued to rise after Liz Truss left office, as central banks pushed rates ever higher in the face of the persistence of this inflation. The Bank of England, whose actions were reflected in UK gilt rates, was slower in reacting than the Fed and markets rightly anticipated that it would have to move more and faster. It was this that caused the crisis for UK pension funds that were following Liability-Driven-Investment (LDI) strategies.

This LDI crisis forced the Bank both to clarify its intention to raise rates and to intervene in the gilts market with purchases rather than the sales it was beginning to do – ie, renewed Quantitative Easing (QE) to push back against the premature market expectations of excessively high future crisis rates. This pushback was successful in calming the markets, with long rates falling about 100 basis points. Unfortunately, no sooner had it succeeded than it was abandoned, leaving the Truss government again exposed to market nerves. Had it continued, the threat of 'meltdown' would have been seen off as the nonsense it was.

Some economists point to the rise in Credit Default Swap (CDS) rates as another indicator of markets' loss of confidence. Yet the UK CDS rate peaked at around 40 basis points at the height of the Truss mini-budget drama. This is around the current CDS rate for Canada, which has an AAA S&P rating, hardly a basket case. The truth is quite a lot of major countries have higher public debt/GDP ratios than the UK - including the US, Canada and France, reflecting the similar pressures of the Covid episode and its similar mismanagement. It is only in the UK Treasury and the Bank of England that we see official panic in the rectification of those Covid errors - in particular, the excessive stimulus from both monetary and fiscal policy that caused the UK's high inflation. This has led to the current hair shirt policies of fiscal/monetary overkill.

The beginnings of that panic were visible in officials' reaction to Liz Truss's agenda, to which they were viscerally opposed and for which they did their utmost to frustrate, most visibly in the Bank's refusal to support the gilts market after the LDI crisis was over. Behind the scenes, Treasury officials lobbied ceaselessly for reversal of her policies in the weeks after the LDI crisis, holding the threat of a market collapse of gilts and sterling over the PM's head to force her to cave in to their demands.

Inevitably, she duly did. It was all nonsense and a tougher, more experienced Prime Minister than Liz Truss with their feet not just barely under the desk following the Queen's death might have called their bluff and survived. As it was, her fall was Rishi Sunak's opportunity to get behind the Treasury policies he had imbibed from his spell at the Treasury.

THE TRUSS POLICIES AND WHY THEY MADE SENSE

What were these frightening policies from Liz Truss that were jettisoned?

First, corporation tax was slated to be kept down at 19 per cent, possibly later to be cut further to 17 per cent. In fact, it has been raised to 25 per cent. Yet, most economic thinking emphasises the importance of this tax on entrepreneurial innovation and investment, and so on to productivity growth. And, the moves of companies to Ireland like AsraZeneca's manufacturing underscores the point. Even the Sunak/Hunt team accept this and so have attempted to blunt the blow by providing high investment allowances. But such allowances only moderate the blow and are irrelevant to innovation that requires little capital expenditure - notably in our dominant service sectors, such as the City.

Second, abolishing the 45 per cent top rate of income tax. This too is important for entrepreneurial incentives and, furthermore, is widely agreed to have no revenue cost for Laffer-Curve reasons (ie, abolition reduces tax avoidance and reduction of high-paid labour supply).

Third, indexing tax rate thresholds to inflation in line with the old Lawson-Rooker-Wise amendment. This prevents the stealth raising of marginal tax rates as people are drawn into higher tax bands - another downer for incentives.

Finally, the help given for the energy-driven 'cost of living crisis. In fact, this element was so widely accepted as necessary that in practice it has been virtually retained intact - aided as it turns out by sharply falling energy costs.

It is true that these policies would have meant lost revenue in the short term, hence more borrowing to tide them over. This in turn might have possibly violated the short term 'fiscal rules' demanding that the debt ratio fall in the short term by 2027/28. However, proper inflation accounting would question even this (see comments in Chapter III).

The critical point is that these policies would have maintained the prospects of reasonable growth, when combined with the rest of the Truss agenda - deregulation, free ports, and housing-planning reform. As it is, their jettisoning, accompanied in practice by the effective abandonment of the complementary rest of her agenda, has precipitated the zero growth prospects we now face.

This in turn ironically implies that the debt ratio will spiral out of control in the long term as revenue flattens off in the face of rising public spending needs. It is plainly better to fund a short term fall-off in revenue with borrowing and so maintain the growth prospect that will deliver long term solvency.

The next chapter will quantify the difference between these two different economic strategies. But the general point requires no quantification to be understood.

II - IT IS NOT TOO LATE TO CHANGE DIRECTION AND IMPROVE THE ECONOMIC OUTLOOK

The Truss economic policy was based on well-grounded economic principles: economic success is driven by growth in economic productivity that, amongst other things, is driven by innovation. Innovation, in turn, is driven by business incentives to innovate.

This chapter explains how supply-side policies in the form of low tax rates and liberal regulation achieve this and what we could expect if the government were to adopt such policies.

SUPPLY-SIDE BUSINESS INCENTIVES TO INNOVATE ARE KEY TO PRODUCTIVITY GROWTH

The key to a better long term outlook for growth in productivity lies in restoring business incentives to innovate. The point being that innovation requires support by supply-side policies in the form of low tax rates and liberal regulation. Under present policies innovation is being gravely inhibited.

Economic theory is clear on this: innovation requires effort and risk and to spur it on profits must result from it. Tax on this profit and burdensome regulation that increases the cost of change will then reduce innovation, as it is now doing, quite contrary to the announced intentions of this Conservative government.

There is much evidence backing this basic theory. It was carefully reviewed in an IEA report[1] and we can see it in the data on the UK Thatcher reforms and their resulting growth, as well as more widely around the world in countries or regions that embrace free market policies, such as China under Deng Xiaoping, Texas constantly among US states, and Vietnam in recent decades.

The most recent work modelling the UK and its regional growth[2] suggests that a general programme of corporate and income tax cuts could stimulate UK growth by 2 per cent per annum over the next decade.

As for deregulation, the key point is that UK common law permits innovation by controlling harms after evidence of harm is found, instead of preventing innovation in case it may cause harms, as occurs with the EU's Napoleonic Law approach.[3] This is most evident in the City, which has suffered from a huge invasion of EU regulation.

The only available work on the quantitative effects of EU regulation are in the labour market where EU regulation was found to reduce UK GDP by 6 per cent.[4] With the Labour Party in favour of moving UK labour market regulation in the EU direction, this government should grasp its opportunity to support an agenda for opposing further regulation and moving to more freedom especially among small firms for whom regulation is disproportionately costly.

1 *Sharper Axes Lower Taxes*, editor Philip Booth, IEA 2011

2 *North and South: A Regional Model of the* UK, Minford et al, *Open Economies Review*, 2022, vol. 33, pp 565-616)

3 *Restoring UK Law: Freeing the UK's Global Financial Market*, Barnabas Reynolds, Politeia, 2021

4 *Should Britain leave the EU?*, Minford et al 2015, Chapter 2, Edward Elgar

BENEFITS OF SUPPLY-SIDE DRIVEN GROWTH ARE CLEAR

What impact on the economy can one expect from supply-side economic policies?

Modelling projections are inherently uncertain. But, if used properly, and not considered to be forecasting tools, they can be helpful informing decision-making. In particular, models are useful to indicate in which direction an economy will move as a result of certain policies. Comparing the results of the Treasury orthodoxy policy with that of a supply-side driven policy is a classic comparison where models can be useful.

Therefore, we summarise in the table below the key figures from two sets of projections based on the long-established Cardiff model[5] that has been shown over time to provide a good fit with the UK economy[6].

- The 'Growth Policy' columns in the table show how a sharp tax cut programme, restoring tax to its pre-Sunak position (so reducing corporation and income tax by £85 billion a year from 2023/24 from today's levels) would work out in terms of the long term debt/GDP ratio. After rising in the short term it would fall steadily to a low and sustainable level.
- The 'Current Policy' columns in the table show how the debt ratio will move on current high-tax policies. The different profiles of the debt/GDP ratio are shown in the graph that follows. Plainly cutting tax now benefits the long term debt ratio critically.

The tables in Annex A show the detailed projections.

Comparison of Current Economic Policy with Supply-Side Driven Growth Policy

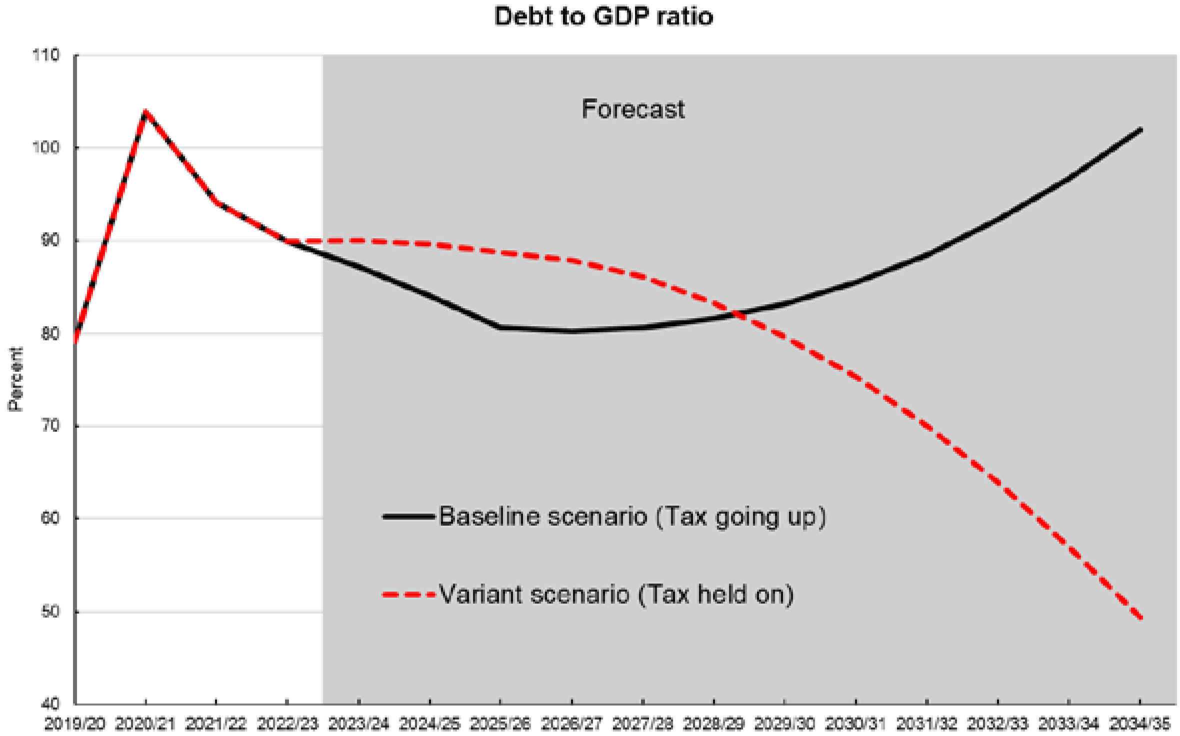
	Nominal GDP (£ bn)		PSBR/GDP (%)		Nominal Debt (£ bn)		Debt/GDP (%)	
	Current Policy	Growth Policy	Current Policy	Growth Policy	Current Policy	Growth Policy	Current Policy	Growth Policy
2019/20	2316	2316	2.8	2.8	1835	1835	79.2	79.2
2020/21	2068	2068	15.6	15.6	2148	2148	103.9	103.9
2021/22	2412	2413	5.2	5.2	2270	2270	94.1	94.1
2022/23	2695	2695	5.6	5.6	2422	2422	89.9	89.9
2023/24	2831	2832	1.6	4.4	2468	2548	87.2	90.0
2024/25	2983	2983	1.3	4.1	2507	2672	84.1	89.6
2025/26	3133	3133	0.6	3.5	2526	2782	80.6	88.8
2026/27	3196	3258	1.2	2.5	2566	2864	80.3	87.9
2027/28	3260	3389	1.9	1.6	2628	2917	80.6	86.1
2028/29	3325	3524	2.5	0.6	2712	2938	81.6	83.3
2029/30	3391	3665	3.2	-0.4	2822	2923	83.2	79.7
2030/31	3459	3812	3.9	-1.4	2959	2870	85.5	75.3
2031/32	3528	3964	4.7	-2.4	3124	2775	88.5	70.0
2032/33	3599	4123	5.5	-3.4	3320	2635	92.3	63.9
2033/34	3671	4288	6.2	-4.4	3550	2445	96.7	57.0
2034/35	3744	4460	7.1	-5.5	3814	2201	101.9	49.4

5 The projections integrate the results of the Cardiff supply-side model from tax changes (see footnote 2 above) into this Cardiff model of the economy as a whole including the demand side.

6 The Cardiff model of the UK economy has been tested on whether its simulated behaviour matches the behaviour of the UK economy using postwar data employing a robust statistical technique called indirect inference and found to do so with good statistical confidence. For details, see footnote 8 in Annex A.

Projected Debt/GDP Ratio Based On Cardiff Models from Tables in Annex A

(Kept At Low Truss Policy - Dotted Red Line)
(Current Tax Rates - Black Line)



In summary, at the end of the forecast period, the nation's finances under the Growth Policy scenario are in robust good health:

- Nominal GDP under the Growth Policy scenario is 19 per cent greater than under the Current Policy scenario
- Public sector finances are in credit at a level of 5.5 per cent of GDP under the Growth Scenario compared to a large borrowing requirement (7.1 per cent of GDP) under the Current Policy scenario (having become in credit during 2029/30)
- Nominal debt is £1.6 trillion lower under the Growth Policy scenario, having become lower as of 2030/31
- The Debt to GDP ratio is a low and declining 49 per cent under the Growth Policy scenario compared to a high and increasing 102 per cent under the Current Policy scenario.

As the graph above shows, under the Growth Policy scenario, the Debt/GDP ratio declines throughout the entire period whereas, after a short period of 4 years (reflecting austerity and the initial impact of higher taxes), the Debt/GDP ratio begins a steady increase under the Current Policy scenario, becoming greater than the Growth Policy Ratio in 2029/30.

As stated earlier, the above projections should not be regarded as detailed forecasts of how the economy may perform in future. However, they do provide – using a well-established macroeconomic model that has been proven to produce outputs that fit well with the UK economy - a robust indication of the direction in which the economy will move under each of the two policies that have been compared.

The conclusion is clear:

- **Under current government economic policy, the economy will stagnate** (as is already becoming evident) and, after a short period of debt burden reduction (in percentage terms) driven by austerity, the short-term effects of increased taxation, and the effects of high inflation reducing the real value of debt and moving taxpayers into higher tax bands, the debt burden will increase requiring even more taxation. This will lead the economy into a classical 'doom loop'.
- **Under a supply-side-driven growth policy, the economy will grow** providing the headroom for temporary borrowing to cover lower tax rates. Even so, because of economic growth, the percentage debt burden will decline steadily. After an initial period of say, 4 to 5 years, public sector borrowing as a percentage of GDP will become relatively lower under the growth strategy. As supply side incentives to innovation kick in, a 'virtuous economic cycle' will result leading to the positive outcomes listed above.

It is not too late to begin this process.

III - IMPEDIMENTS TO IMPLEMENTING GROWTH POLICIES SHOULD BE ELIMINATED

Chapters I and II explain why the attempts of the Truss government to evolve an economic growth strategy were correct and why the current government should lose no time in doing the same. However, existing institutions and procedures tend to inhibit implementation of such policies.

Three changes need to be made:

- **Ensure that the importance of fiscal policy is recognised fully so that it can play its essential role in working in tandem with monetary policy**
- **Replace short-term fiscal rules with long-term solvency targets**
- **Make structural changes so that Number 10 can provide effective economic leadership**

ENSURE THAT MONETARY AND FISCAL POLICIES WORK IN TANDEM

So far, we have considered long term policy needs. But we also should consider the short term role of policy in stabilising the economy around its inflation and full employment targets. Recent research on not merely the UK but also other major economies has found that best results are obtained by monetary policy moving interest rates to stabilise inflation while fiscal policy targets output at full employment. The reason for these results can be seen in two ways:

- First, when the economy is in a slump and inflation is low, as occurred after the Financial Crisis of 2008, fiscal policy stimulus prevents the whole burden of getting output to recover from falling on monetary policy and driving interest rates to zero thereby distorting capital markets and the economy, with reduced competition, survival of zombie firms and weak productivity growth.
- Second, when inflation is high and demands monetary tightening to bring it down, fiscal support allows the central bank to carry out these policies with less concern for the potential recession this can cause.

This combining of monetary and fiscal policy tends therefore to raise the economy's stability - as illustrated below for the UK.[7] The table shows that the loss in UK Welfare (third Line) is the lowest when fiscal policy combines with monetary policy (columns 2 and 3) versus when monetary policy acts alone (column 1).

7 The Role Of Fiscal Policy - A Survey of Recent Empirical Findings, Mai Le, David Meenagh and Patrick Minford, Cardiff Economics working paper E2023/26: https://carbsecon.com/wp/E2023_26.pdf

Welfare Results for UK Under Different Policy Rules

(Variance of Simulations)

Variance	**Baseline NGDP targeting** *Non-crisis + crisis model*	**ZLB-supressing fiscal shock** *Non-crisis + supressing fiscal shock*	**Strong fiscal feedback** *Non-crisis+crisis model + strong fiscal feedback in both models*
Var(output)	0.0103	0.0067	0.0034
Var(inflation)	0.0371	0.0282	0.0251
Welfare Loss	**0.0425**	**0.0350**	**0.0284**
Var(interest rate)	0.0186	0.0306	0.0227
Utility	-52.38	-51.03	-51.97

Compared with this ideal for short term policies, we see that monetary policy is currently destabilising, having first over-stimulated money and credit during Covid so causing high inflation and now over-tightening with money supply growth on the past year plunging to -4.2 per cent.

UK: M4 Growth

As for fiscal policy, it too is highly contractionary when properly measured, taking appropriate account of inflation. During periods of threatened recession, fiscal policy should be increasing the debt/ GDP ratio, so restoring people's wealth (including holdings of public debt) and so spending power. But inflation - when as high as it has recently been - works to reduce debt both directly by lowering its purchasing power and indirectly by raising interest rates, which reduces its market value. Furthermore the high interest rates are offset by the inflation effect in reducing its value so that real interest rates are negative.

We can see the effect of properly allowing for inflation in the following table showing the public accounts rightly measured.

PUBLIC ACCOUNTS IN REAL TERMS

Real £ billion at 22/23 Prices
(Assumes CPIH inflation 9.1% 22/23; 6.4% 23/24; 3.2% 24/25)

	2022/23	2023/24	2024/25
Govt spending	1057.3	1049.9	1145.3
T- Revenues	1020.0	1114.1	1217.0
Real Debt interest	-105.7	-109.1	35.2
Δ Real D- change in real debt	-68.4	-173.0	-36.5
Real Debt	2580	2407	2370
Adjustment Mkt Value/Par*	0.93	0.93	0.93
Adjusted Real Debt	2399	2226	2189
Real Debt/Real GDP	**84.7**	**87.6**	**75.8**

*Market Value/Par value — source ONS: series RYXY/BKPM on gilt values (respectively market value and nominal, Par, value). BoE bank reserve debt (about 800) stays at Par.

What the table shows is that the government is over-achieving its 'fiscal rule' of reducing the Debt/GDP ratio in the short to medium term. By 2024/5 it is down to 75.8 per cent truly measured versus 89.3 per cent as conventionally measured by the OBR. Ironically, this large debt/GDP reduction is the opposite of what the economy currently requires.

SCRAP SHORT-TERM FISCAL RULES IN FAVOUR OF LONG-TERM SOLVENCY TARGETS

We have seen that policy is in a mess in terms of its effects both on the long term and the short term. Monetary policy has failed on inflation, stimulating it sharply with its Covid policies and now creating overkill in bringing it down. Fiscal policy, governed by short term fiscal rules, has failed to support the economy against recession, indeed it has worsened the downturn. At the same time, it has created the prospect of zero growth and a long term fiscal crisis.

It is time for a total reset of these policies:

1. **Short term fiscal rules should be abandoned and the public finances should be managed on the basis of an approach that focuses on long-term solvency.** Such an approach should recognise the role that fiscal policy has to play in macro-economic management and the scope that the public sector balance sheet has to manage crises and the long-term challenges of investment, infrastructure planning, and managing risk generally.
2. **Government should replace the damaging short run fiscal rules with an ongoing long run solvency test based on rolling forward projections about ten years ahead.** To ensure solvency, the government must check that its spending including debt interest will over the long term be financed by taxes in such a way that the debt ratio comes down to a sustainable level. The technical condition for solvency in infinite time is that the growth rate of real debt must tend over time to be less than the real rate of interest. This in turn implies that there must in the long run be a primary surplus – namely tax must exceed spending excluding debt interest.

In practice, governments facing uncertainty in financial markets can aim to bring the debt ratio down in the long run to a sustained level of about 50 per cent being. This implies that from then onwards the primary surplus/GDP must equal the (debt ratio) times (the real interest rate minus the growth rate of GDP). In other words in the long run the tax rate must pay for direct spending and also provide a surplus to stop debt interest from raising the debt ratio.

EQUIP NUMBER 10 TO PROVIDE ECONOMIC LEADERSHIP

In recent years, there has been a serious absence of meaningful economic thought at the heart of government and, consequently, little concentration on long-term management of the economy or economic strategy. Although the Treasury has attempted to fill this gap, its initiatives have been short-term focused and blinkered. Therefore, a major institutional question is how to strengthen the capacity of the elected government to carry out government economic policy according to its policy mandate from the electorate.

The Thatcher Government dealt with this problem by importing experienced outside economists into Number 10, creating a strong policy unit with economics expertise (amongst other disciplines), and appointing like-minded strong ministers in important ministries. It should not be forgotten that the Thatcher Government had several years in opposition to prepare its policies. Even so, carrying out their programme required a huge effort of Whitehall transformation involving the removal or side-lining of numerous senior officials and the promotion of able junior civil servants who understood and implemented the programme.

Unfortunately, with the passing of the Thatcher Government and, in particular, upon establishment of the powerful Gordon Brown-led Treasury, there has been no effective institutional platform for the Prime Minister to influence economic policy and strategy effectively. This needs to change.

Today's situation is furthermore complicated by the Bank's independence and the existence of an additional body, the OBR - a private sector organisation tasked with evaluating fiscal policy. Central Bank independence generally has been a successful innovation around the world, leading on average to lower and more stable inflation. Central banks' recent mistakes are unfortunate but do not warrant rowing back on their independence.

The situation of the OBR is rather different. No other major country has set up a similar institution, which has the effect of potentially cancelling the policies of the democratically elected government on the central issues of tax and spending.

The OBR is not a policy-making body and yet it has strong influence, almost a veto, on policy from outside government in the private sector. To give any private sector body such power over policy is an invitation to private sector interest peddling. Imagine if some think tank with a well-known bias, such as IPPR, IFS or the IEA, were given such power; it would be a plainly flawed set-up, vulnerable to interest-group pressure. Yet the OBR is little different from this.

The usual Treasury set-up involves these fiscal evaluative functions being delivered inside government. Then after publication of fiscal plans, the whole spectrum of private sector think tanks, press and other commentators has freedom to comment - without privileging any one of them as the OBR now is. The Prime Minister and No 10 need to have a strong input into the planning process to ensure full democratic accountability.

How could this be achieved here?

1. **Establish a new Council of Economic Advisers responsible to Number 10**. If one looks at US economic policy institutions, potential lessons appear. The President has a Council of Economic Advisers (CEA), led by a Chair who is appointed by the President with the advice and consent of the Senate, and two members who are appointed by the President. It is an agency within the Executive Office of the President with a staff of senior economists, staff economists, research assistants, and supporting administrators, and is charged with offering the President objective economic advice on the formulation of both domestic and international policy. The Council bases its recommendations and analysis on economic research and empirical evidence, using the best data available to support the President in setting the nation's economic policy and recommending economic policies that advance the interests of the American people. The Treasury too has its own expert staff putting forward its fiscal plans. In the US the Council's staff cooperate closely with the Treasury and this cooperation should be copied here too.

   By contrast, in the UK the Prime Minister has a 'Policy Unit' that theoretically is supported by the Cabinet Office but in practice has to rely on its own 'kitchen cabinet'. Thus, it lacks the ability to get modelling and forecasting done professionally to the highest standards. It needs to be able to assess policies with a view to long term solvency - as we have argued above - in place of misconceived short term rules. Number 10 Policy Units have occasionally given highly successful assistance to the Prime Minister. However, their powers are precariously balanced against huge potential civil service opposition; hence they are a hit-and-miss solution.

   Consequently, Prime Ministers have struggled to push back against the economic direction presented to them by the Treasury. This is partly because Prime Ministers have rarely had significant economic expertise established inside Number 10, but also because they have not had an appropriate institution that is aligned with their interests and is able to push back against the policy options presented by the Treasury.

   A Council of Economic Advisors could fill this gap. The, say, three-person Council should report directly to the Prime Minister. A set-up of this sort appears both to respect the democratic will, ensure expertise in the planning process and achieve a high degree of societal oversight.

2. **Expand the remit and capability of the OBR to support the new Council of Economic Advisors.** In addition to the CEA, the President of the United States is supported by an additional unit, The Office of Management and the Budget (OMB). Its mission is to assist the President in meeting policy, budget, management, and regulatory objectives. While the US system operates differently from the UK's, this leads to the notion of reframing the UK OBR as a bureaucracy akin to the OMB, supporting a UK Council of Economic Advisers.

   The primary focus of the new OBR no longer would be primarily providing forecasts verifying that the Treasury's short-term fiscal rules had been met but rather supporting development of economic policy by the members of the Council of Economic Advisers and monitoring long-term solvency. Such a CEA/OBR set up could ensure the Prime Minister had the capability to formulate and implement economic policy in line with the UK economy's requirements.

   This would provide a more productive and fulfilling role for the OBR. In any case, if short-term fiscal rules are to be discarded, much of the existing rationale for the OBR's existence will disappear. The new role of supporting the new Council of Economic Advisers - by providing a first-class economic and analytical support capability - would require fundamental changes in the mindset of the OBR as well as major upgrading of its economics expertise and analytical capabilities, in particular, developing its own modern macroeconomic models, which it does not have today.

Finally, we need to recognise that the Treasury's expertise has been hollowed out by transfer of monetary matters to the Bank, and fiscal forecasting/evaluation to the OBR. So the Treasury needs more expert staff in these matters, such as it once enjoyed. Once more expertise can be brought to bear from the Civil Service, it will be possible to recalibrate fiscal policy in line with recent research in the way we have discussed above; with its new expertise the Treasury will soon get up to speed with the latest findings

ANNEX A
DETAILED CARDIFF MODEL PROJECTIONS8

Projection Based On Cardiff Models for Tax Levels Restored To Truss Planned Rates

	Nom PSBR[1] (£bn)	Nom GDP (£bn)	REDL Spend[2] (£bn)	Pension Spend[3] (£bn)	Welfare Spend[4] (£bn)	Other Non-debt[5] (£bn)	Total Non-debt[6] (£bn)	PSBR /GDP %[1]	Spend /GDP %	Nom Debt (£bn)	Debt Interest[7] (£bn)	Debt /GDP %	Gross Taxes[8] (£bn)	Tax Rate %
2019/20	64.3	2316.4	320.8	41.0	227.0	254.5	843.3	2.8	36.4	1835.2	49.6	79.2	828.6	35.8
2020/21	312.7	2068.0	434.5	41.9	245.4	342.9	1064.7	15.6	51.5	2147.9	41.0	103.9	793.0	38.3
2021/22	122.3	2412.6	413.8	42.8	244.3	266.6	967.5	5.2	40.1	2270.2	72.5	94.1	917.7	38.0
2022/23	152.0	2695.1	415.5	46.3	259.9	335.6	1057.3	5.6	39.2	2422.2	114.7	89.9	1020.0	37.8
2023/24	125.9	2831.6	424.7	49.1	291.3	351.9	1117.1	4.4	39.5	2548.1	114.2	90.0	1105.4	39.0
2024/25	123.8	2982.6	447.4	50.6	306.9	376.9	1181.9	4.1	39.6	2671.8	113.6	89.6	1171.7	39.3
2025/26	109.9	3133.2	470.0	51.7	322.4	396.0	1240.0	3.5	39.6	2781.7	111.9	88.8	1242.0	39.6
2026/27	82.5	3258.5	488.8	52.7	335.3	411.8	1288.5	2.5	39.5	2864.3	110.5	87.9	1316.5	40.4
2027/28	52.7	3388.9	508.3	53.7	348.7	428.3	1339.0	1.6	39.5	2917.0	109.2	86.1	1395.5	41.2
2028/29	20.5	3524.4	528.7	54.8	362.6	445.4	1391.5	0.6	39.5	2937.5	108.2	83.3	1479.2	42.0
2029/30	-14.7	3665.4	549.8	55.9	377.1	463.2	1446.1	-0.4	39.5	2922.8	107.2	79.7	1568.0	42.8
2030/31	-53	3812.0	571.8	57.0	392.2	481.8	1502.8	-1.4	39.4	2869.7	106.2	75.3	1662.0	43.6
2031/32	-94.8	3964.5	594.7	58.2	407.9	501.0	1561.8	-2.4	39.4	2774.9	105.2	70.0	1761.8	44.4
2032/33	-140.3	4123.1	618.5	59.3	424.2	521.1	1623.1	-3.4	39.4	2634.6	104.1	63.9	1867.5	45.3
2033/34	-189.9	4288.0	643.2	60.5	441.2	541.9	1686.8	-4.4	39.3	2444.8	102.8	57.0	1979.5	46.2
2034/35	-243.8	4459.5	668.9	61.7	458.8	563.6	1753.1	-5.5	39.3	2200.9	101.4	49.4	2098.3	47.1

Projection Based On Cardiff Models for Current Tax Levels As Raised By Sunak Government

	Nom PSBR[1] (£bn)	Nom GDP (£bn)	REDL Spend[2] (£bn)	Pension Spend[3] (£bn)	Welfare Spend[4] (£bn)	Other Non-debt[5] (£bn)	Total Non-debt[6] (£bn)	PSBR /GDP %[1]	Spend /GDP %	Nom Debt (£bn)	Debt Interest[7] (£bn)	Debt /GDP %	Gross Taxes[8] (£bn)	Tax Rate %
2019/20	64.3	2316.4	320.8	41.0	227.0	254.5	843.3	2.8	36.4	1835.2	49.6	79.2	828.6	35.8
2020/21	312.7	2068.0	434.5	41.9	245.4	342.9	1064.7	15.6	51.5	2147.9	41.0	103.9	793.0	38.3
2021/22	122.3	2412.6	413.8	42.8	244.3	266.6	967.5	5.2	40.1	2270.2	72.5	94.1	917.7	38.0
2022/23	152.0	2695.1	415.5	46.3	259.9	335.6	1057.3	5.6	39.2	2422.2	114.7	89.9	1020.0	37.8
2023/24	45.9	2831.6	424.7	49.1	291.3	351.9	1117.1	1.6	39.5	2468.1	114.2	87.2	1185.4	41.9
2024/25	38.8	2982.6	447.4	50.6	306.9	376.9	1181.9	1.3	39.6	2506.9	113.4	84.1	1256.5	42.1
2025/26	19.6	3133.2	470.0	51.7	322.4	396.0	1240.0	0.6	39.6	2526.5	111.5	80.6	1331.9	42.5
2026/27	39.8	3195.9	488.8	52.7	335.3	411.8	1288.5	1.2	40.3	2566.2	109.7	80.3	1358.5	42.5
2027/28	61.4	3259.8	508.3	53.7	348.7	428.3	1339.0	1.9	41.1	2627.7	108.1	80.6	1385.7	42.5
2028/29	84.7	3325.0	528.7	54.8	362.6	445.4	1391.5	2.5	41.9	2712.4	106.6	81.6	1413.4	42.5
2029/30	109.8	3391.5	549.8	55.9	377.1	463.2	1446.1	3.2	42.6	2822.2	105.3	83.2	1441.7	42.5
2030/31	136.6	3459.3	571.8	57.0	392.2	481.8	1502.8	3.9	43.4	2958.8	104.3	85.5	1470.5	42.5
2031/32	165.4	3528.5	594.7	58.2	407.9	501.0	1561.8	4.7	44.3	3124.3	103.5	88.5	1499.9	42.5
2032/33	196.2	3599.1	618.5	59.3	424.2	521.1	1623.1	5.5	45.1	3320.5	103.0	92.3	1529.9	42.5
2033/34	229.2	3671.0	643.2	60.5	441.2	541.9	1686.8	6.2	45.9	3549.7	102.9	96.7	1560.5	42.5
2034/35	264.4	3744.5	668.9	61.7	458.8	563.6	1753.1	7.1	46.8	3814.2	103.1	101.9	1591.7	42.5

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8 The Cardiff model of the UK economy is estimated by indirect inference on UK postwar data. Under this procedure, the resulting model is tested on whether its simulated behaviour matches the behaviour of the economy found in the data with good statistical confidence (indicated by its p-value, its probability, well above the 55 cutoff point). The model's p-value is 16%, showing a good match to the economy's behaviour.

Details are in Appendix A of *Modelling The Effects of Brexit on The British Economy* by Patrick Minford and Zheyi Zhu, Cardiff Economics Working Paper, 2023 No 19 - https://carbsecon.com/wp/E2023_19.pdf

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