

Before the Budget (November 2017)

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Introduction

The annual setting of the government's budget is an opportunity to review the country's economic prospects and for the administration to make policy adjustments affecting public expenditure and expected revenue. When expenditure exceeds revenue there is a budget deficit which in turn adds to the level of any existing government debt.

The Deficit

There have only been a dozen years since World War 2 that the UK government has not had a budget deficit (i.e. on only a dozen occasions has government revenue exceeded government spending). Prior to the Great Global Financial Crisis (GGFC, 2007-2010), the only time the deficit had exceeded 20% of government revenue was in the early 1990's (associated with the crisis surrounding Britain's membership of the European Exchange Rate Mechanism).

Table 1: The UK Budget Deficit 1993-2016

date	Government revenue (£billion)	Government spending (£billion)	Budget deficit (£billion)	Deficit as % revenue	Income change (y-o-y £bn)	Spending change (y-o-y £bn)
1993-94	242.1	293.7	-51.6	-21.3	7.8	12.2
1994-95	261.7	305.5	-43.8	-16.7	19.6	11.8
1995-96	284.1	319.4	-35.3	-12.4	22.4	13.9
1996-97	296.2	323.9	-27.7	-9.4	12.1	4.5
1997-98	324.3	333.2	-8.9	-2.7	28.1	9.3
1998-99	344.3	342.9	1.3	0.4	19.9	9.7
1999-00	367.1	355.9	11.2	3.0	22.8	13.0
2000-01	394.4	378.1	16.3	4.1	27.3	22.2
2001-02	399.7	404.0	-4.3	-1.1	5.3	25.9
2002-03	405.7	437.6	-31.9	-7.9	6.0	33.6
2003-04	438.6	477.4	-38.8	-8.8	32.9	39.8
2004-05	470.5	516.9	-46.3	-9.8	31.9	39.5
2005-06	504.7	546.3	-41.5	-8.2	34.2	29.4
2006-07	533.9	571.8	-37.9	-7.1	29.2	25.5
2007-08	563.5	606.3	-42.8	-7.6	29.7	34.5
2008-09	548.5	661.5	-113.0	-20.6	-15.1	55.2
2009-10	542.1	694.6	-152.5	-28.1	-6.4	33.2
2010-11	579.7	716.8	-137.0	-23.6	37.6	22.1
2011-12	600.9	717.1	-116.2	-19.3	21.2	0.4
2012-13	610.7	731.6	-120.9	-19.8	9.8	14.5
2013-14	635.4	733.8	-98.3	-15.5	24.7	2.1
2014-15	659.7	751.3	-91.7	-13.9	24.2	17.6
2015-16	683.7	756.8	-73.2	-10.7	24.0	5.5
2016-17	726.7	772.4	-45.7	-6.3	43.0	15.5

Source: OBR (with extra calculations by me)

Tax increases (extending the scope of VAT and new taxes on insurance and airlines) were combined with spending restrictions by Conservative Chancellors (Lamont then Clarke) to eliminate the deficit of the early 1990s. The fulfilment of these plans gave the incoming Labour government (1997) a balanced budget to start with. But the Blair-Brown budget was unbalanced by the shortfall in expected revenue associated with the impact of the 2001-2002 financial market disruption. Unfortunately a trajectory for return to balance only began in 2005-2006 and had not become established before the onset of the GGFC further destabilised the public finances. An increase of taxation (raising VAT to 20%) and a planned programme of spending restrictions introduced by the Coalition government after 2010 have still not reduced the deficit to pre-crisis levels.

UK Government Finances in International Context

Figures presented in Table 2 can be used to summarise the position of the UK government finances in comparison with countries of similar economic maturity. The countries chosen come from Northern Europe (France, Germany, the Netherlands), Southern Europe (Greece, Italy, Spain) and from elsewhere in the developed world (Australia, Canada, Japan, the USA).

Table 2: The State of Government Finances Before and Since the Great Global Financial Crisis

	Deficit (as % government revenue)			Debt (as % government revenue)		
	2007	2010	2015	2007	2010	2015
the UK	-7.6	-24.8	-11.3	134	232	293
France	-5.1	-13.7	-6.6	152	195	226
Germany	0.4	-9.8	1.5	149	196	174
Netherlands	0.5	-11.6	-4.4	114	158	180
Greece	-16.6	-27.1	-15.7	279	308	379
Italy	-3.4	-9.3	-5.5	245	274	330
Spain	4.9	-25.9	-13.3	102	184	302
Australia	1.9	-14.0	-8.3*	53	88	124*
Canada	4.4	-12.1	-3.3	171	220	247
Japan	-6.2	-25.6	-17.2*	534	650	688*
USA	-10.6	-38.8	-12.6	191	305	311

Source: OECD (recalculations by me)

Note: * = 2014

At the onset of the GGFC UK government debt stood at a level equivalent to 134% of its annual revenue. This represented a seemingly unthreatening level fairly similar to that elsewhere in Northern Europe: France (152%), Germany (149%) or the Netherlands (114%). Southern European countries such as Greece (279%) and Italy (245%) had higher levels of debt in relation to income, as did foreign countries such as the USA (191%) and, most notably, Japan (534%). In terms of the government's budget deficit, however, the UK was not so obviously well-placed ahead of the crisis. The deficit, at 7.6% of total revenue, was exceeded amongst the European Countries, only by Greece (16.6%). Meanwhile, of the other foreign comparator countries, the Commonwealth representatives (Australia and Canada) both had surpluses rather than deficits, but Japan (6.2%) and the USA (10.6%) had deficits more like the UK.

By the end of the crisis, in 2010, both the UK debt and deficit levels had increased significantly. Of course this was true for all the countries considered here. However, the UK's relatively large deficit in comparison with other Northern European countries meant that its relative debt position had worsened, albeit not so in relation to Japan and the USA which both had larger deficit and debt ratios. Likewise, considering the situation more recently (2015), the UK's budget deficit remains larger than other Northern European states and so UK relative indebtedness has continued to increase. Nevertheless, there are countries such as Greece and Japan (especially) which are still worse performers than the UK.

Public Spending and the Deficit

Over the whole period 2010-2015 the UK's persistent budget deficit has been a central issue of domestic political concern. But although there was an increase in VAT after the 2010 General Election the emphasis has subsequently been put on cutting expenditure rather than raising revenue by additional taxation.

Table 3 contains figures that summarise the situation of public expenditure. The data present spending under ten broad headings expressed in 2015 monetary terms (i.e. in numerically comparable or 'real' terms).

Table 3: Real Public Expenditure in the UK (£billion at 2015 Prices)

	1997-2001	2001-2007	2007-2011	2011	2012	2013	2014	2015
1. General public services	61.0	57.7	66.2	70.0	63.3	62.9	59.2	58.7
<i>of which: public and common services</i>	11.5	15.7	16.0	12.6	12.0	11.7	11.8	11.8
<i>of which: international services</i>	5.6	7.4	8.4	8.5	8.2	10.1	10.6	10.1
<i>of which: public sector debt interest</i>	43.9	34.6	41.8	48.9	43.0	41.0	36.9	36.7
2. Defence	38.2	40.6	44.4	42.5	38.7	37.6	37.1	36.6
3. Public order and safety	29.1	37.8	39.9	35.3	33.3	30.6	29.9	30.2
4. Economic affairs	34.1	46.1	53.0	40.5	37.3	39.3	38.6	45.1
<i>of which: enterprise and economic development</i>	6.6	8.4	12.2	5.3	5.3	5.9	5.1	5.3
<i>of which: science and technology</i>	2.2	3.4	4.1	4.0	3.5	4.3	4.5	4.8
<i>of which: employment policies</i>	5.0	4.5	4.3	3.5	3.1	3.8	3.1	2.4
<i>of which: agriculture, fisheries and forestry</i>	7.1	7.6	6.4	6.4	5.6	5.6	5.3	4.5
<i>of which: transport</i>	13.2	22.1	25.9	21.3	19.7	19.7	20.5	28.1
5. Environment protection	7.2	9.9	12.1	11.5	11.4	11.6	11.7	11.6
6. Housing and community amenities	8.1	11.2	17.4	11.2	10.7	10.1	10.3	10.0
7. Health	76.8	108.7	134.4	133.3	132.4	133.8	135.4	138.7
8. Recreation, culture and religion	11.5	13.9	15.2	13.7	13.5	11.8	12.5	11.4
9. Education	65.6	87.2	102.8	95.1	89.7	88.2	86.5	84.0
10. Social protection	189.6	221.4	254.3	269.1	269.9	262.6	263.5	264.2
EU transactions	-4.6	-2.9	0.6	4.7	7.1	7.4	6.3	7.7
Public sector expenditure on services	516.4	631.6	740.3	727.0	707.3	695.8	691.0	698.3
Accounting adjustments	33.9	47.8	62.7	59.1	71.2	64.9	62.9	54.8
Total Managed Expenditure	550.4	679.4	803.0	786.1	778.4	760.7	753.9	753.0

Source: Public Expenditure Statistical Analyses 2016 (HM Treasury) with recalibrations by me.

NB: Significant responsibilities for expenditure were removed from enterprise and economic development and from education (student loans) after 2010/11; whilst a significant addition to responsibility was given to transport (railways) from 2015. Also, from 2010-11 onwards VAT-based payments are no longer deducted from EU transactions.

Since the period of the GGFC the reduction of public expenditure on services in real terms (of about 6%) has fallen most heavily upon Defence (-18%), Public Order and Safety (-24%), Housing and Community Amenities (-43%, mostly non-local-authority social housing) and Recreation, Culture and Religion (-25%). “Protection” of the real value of spending given to Health, Education and Social Protection has not taken into account the increasing numbers of children and elderly people in the population. And however wasteful or profligate public expenditure may have seemed to be over the decade preceding the GGFC it is difficult to see how significant reductions can now be made without explicitly eliminating areas of government responsibility.

Government Income and Infrastructure

It is deeply engrained within our culture that the government doesn't have any 'money of its own' but only the money that it takes from us (we the people, who shalln't be taxed without representation). But this is nonsense. In fact the government fulfils a valuable economic function for which fees are not only appropriate but actually essential (thus meaning that the government does indeed earn 'money of its own'). Nor does the money paid as 'income tax' or 'national insurance' truly 'come from us' since 90% of income tax and national insurance receipts are collected via PAYE thus being unseen by the workforce and discounted by people taking decisions about work-choices.

In fact one of the easiest ways to levy a tax that is proximately in proportion to the level of activity which an individual business represents is to require payment of a transaction tax on wages and salaries (i.e. employment). And this approach is appropriate because a business's employment of workers is the best available indicator of the level of pressure on the country's infrastructure resulting from the operation of that business. Essentially this tax levied on payments to employees is a surrogate charge for the use of the infrastructure as a business input. It stands in for an explicit rent, payable for using the infrastructure (both hard and soft infrastructure: roads, traffic regulation and policing; courts, contract law and its enforcement, as examples). This is what income tax and national insurance contributions represent in practice. How the government spends the proceeds from this taxation is a decision for us to review as electors (so having, theoretically, an equal or democratic say in how the money's spent) – currently it's predominantly spent as public alms (mainly pensions). Uncoupling employment taxes from the fiction of personal contributions by instigating an Employment Transactions Tax could liberate public discussion of alternative schemes for the distribution of public alms and other elements of public spending.

From the point of view of footloose business investment, deciding where to locate their operations will involve employers considering not just the payments to workers necessary to secure their services but also the liability for associated taxes and social insurance costs. Crucial to these deliberations must be the productivity of the local workforce, and this will be directly influenced by the quality of the infrastructure within which they will be operating. And based on this understanding, getting employers to pay employment taxes, via PAYE charges linked to payments to employees, is a way of recouping the cost of maintaining that infrastructure. But it should also be recognised that the government bears a significant responsibility to assure the quality of the infrastructure in order to maximise the productivity of the workforce. This means ensuring that the infrastructure represents value-for-money to the employers who are paying for it.

Taxation in an International Context

Recognising the international context in which decisions about tax-rates have to be taken, where countries are competing as locations for business activity, it is interesting to examine the UK's relative position. Relevant data is presented in Table 4. This shows government revenue relative to

the overall national income as well as taxes levied on employment (both on workers and employers via income tax and social insurance payments) and then taxes levied on company profits (e.g. UK Corporation Tax).

Table 4: Comparative Tax Rates 2015

	Government Revenue (as % GDP)	ETT Rate Equivalent (%)	Corporate Tax Rate (%)
the UK	38.5	44.5	20.0
France	53.5	94.2	34.4
Germany	44.7	97.6	30.2
Netherlands	43.3	56.7	25.0
Greece	47.9	64.7	29.0
Italy	47.8	96.1	31.3
Spain	38.6	65.6	25.0
Australia*	33.5	39.7	30.0
Canada	39.8	46.2	26.8
Japan*	35.8	47.5	30.0
USA	33.5	46.4	38.9

Source: OECD (recalculations by me)

Note: * = 2014

The first column in the table shows the overall ‘tax take’ of the state as a proportion of national income (GDP). These figures include taxes paid by individuals and households in addition to taxes paid by organisations. Because governments in different countries have different portfolios of activities for which they act as agencies, it is difficult to assign much significance to differences amongst these figures. More pertinent, because of their potential effect upon commercial decisions about international location, are the specific taxes related to business reported in the next two columns of the table.

The system of taxation, in which levies are paid to governments by employers notionally ‘on behalf of’ the workers they employ, operates across the economically developed world. And there are usually also explicit employer payments or contributions in addition to this. The second column in the table illustrates what happens if the whole amount of employment levies (i.e. both those that are being made notionally ‘on behalf of’ their workers - as ‘income tax’ or social security/insurance ‘contributions’ – and those made as explicit payments by employers *qua* employers) is expressed as a transactions tax (an Employment Transactions Tax, something like VAT) explicitly levied on payments to workers (purchases of labour). You can see that it varies quite widely: ranging from 39.7% in Australia to 97.6% in Germany. The UK (44.5%) is towards the lower end of the range.

It’s apparent that the taxation cost of employing workers in the UK is currently very competitive (i.e. low) compared with that in other European countries. An increase in the UK’s implicit Employment Transactions Tax rate from 44.5% to nearer the Dutch level of 56.7% (and with the increase explicitly imposed on employers not workers) could be expected to eliminate the budget deficit and leave some billions over. And if the UK were remaining as a member of the Single Market and the Customs Union, this would be a straightforward recommendation.

To take account of Brexit however, we need to evaluate the UK's competitive position with reference to non-EU countries as well. Direct comparison suggests that there is less scope for increased ETT here than in the EU context, since implicit ETT rates in the group of non-EU countries considered are roughly similar to the existing UK rate (i.e. much lower than existing EU rates). But turning to comparison of corporation tax rates, shown in the third column of figures, where the UK rate is clearly lower than rates elsewhere, this suggests that there may yet be scope for the application of a higher ETT rate as a trade-off against this lower corporation tax. On the other hand a higher rate of corporation tax may be appropriate instead.

In any case, an eventual transition to explicit Employment Transaction Tax in place of national insurance and income tax would provide people with a more truthful account of economic reality and so ought to be encouraged. And I have previously prepared and presented elsewhere a more comprehensive explanation of the way that the UK tax system ought to be understood (http://www.stparsons.co.uk/files/taxation_for_fabians_march_2017.pdf).

Brexit and the Outside World

Once upon not perhaps so long ago, the world economy meant an outside world into which superfluous production (production that by accident emerged without a predetermined destination) was consigned for residual disposal. As a corollary to this, no country relied upon ad hoc purchases from the outside world as the basis for their local supply.

Nowadays all that is changed. The global market place has lost its residuary character. Prices are no longer the outcome of unrepresentative disposal sales. Instead prices are determined by the interaction of global effective demand and global availability of supply. Mobile personal information technology makes buyers and sellers well aware of market conditions, thus meaning that prices are struck which represent reality.

In this situation, when a country imposes tariffs (putting taxes on imports) it raises the price that its residents have to pay in order to get foreign produce, and thus allows its domestic producers to charge a higher price for their own output sold to residents too. (Of course these domestic producers will only get the world price for anything they sell abroad). When a group of countries agree to operate **a customs union** they all agree to charge the same tariffs on produce brought into the union from outside whilst allowing tariff-free movement of goods and services between the member countries themselves. This means that the producers in all the member countries share the benefit of the same higher prices than are being charged in the world outside; and the residents of all the member countries are equally taxed for buying stuff from countries outside the customs union. When a group of countries agree to operate as **a single market** they agree to impose the same rules and regulations regarding product quality standards and business operating procedures so as to facilitate trans-border commercial activity. **The European Union is both a customs union and a single market.** Brexit might mean the UK being automatically outside not only the political organisation of the EU but also outside both these economic institutions (the customs union and the single market). There has been a lot of discussion about how much this might or might not matter.

The Economic Consequences of Brexit

My original guesstimate was that neither EU membership nor Brexit would make a lot of difference to the country's economic prospects. And I still think this is the case.

The tradables (goods and services) part of our international accounts is pretty static. Our purchases from overseas are curbed by a lack of growth in households' real incomes (wages failing to keep up with rising prices). Whilst purchasers abroad have static incomes too, which means our export sales aren't growing either.

The non-tradables part of the accounts (financial instruments and the like) has suffered directly from the Great Global Financial Crisis (2007-2010). But the official estimates published by the ONS suggest that the impact has been matched on the credit and debit sides of the non-tradables financial account.

It now seems clear (<http://researchbriefings.parliament.uk/ResearchBriefing/Summary/CBP-7886#fullreport>) that there is £8bn of net contribution that would be available for redistribution within public expenditure following Brexit, equivalent to a 5% increase in NHS spending for example. This is not negligible.

Brexit and London

London's international status as a financial *entrepôt* had been supported by some special circumstances. The legal system of the USA has an inherited basis in English law and, as an EU member, EU law was valid in the UK too. In a world economy dominated by euro-denominated and dollar-denominated trading partners these essential underlying compatibilities, enhanced by sterling as an independent currency, gave London a solid strategic competitive advantage for facilitation of international financial transactions. And statistics from the Bank for International Settlements show that this advantage was reflected in performance.

The UK's disproportionate dependence on financial trading may have undergone a necessary correction with international dealing in financial instruments losing its attraction as part of the GGFC and the growth of such activities being muted in the aftermath.

Brexit, by most probably removing the automatic compatibility of UK and EU/euro financial regulation, could undermine London's competitive advantage to some degree.

Whether a reduction in London's economic activity would deliver a regional rebalancing of British economic activity that might not be an unwelcome development is perhaps an open question.

The Impact of Post-Brexit Trade Policy

The most important thing to bear in mind when considering the consequences of Britain adopting an independent (post-EU) international trading policy is that it will be based on the rules of the World Trade Organisation and that these rules forbid discrimination. This means that the EU cannot impose tariffs on British exports of goods and services that are more onerous than those applied to trade from any other country outside the EU. So there can be no 'punishment' for Britain in these terms.

WTO data indicate that the EU average tariff is 5%. And the simplest trade policy for the UK to adopt, when it leaves, would be to apply the same tariffs as it does already as a member of the EU. This would simply result in Britain treating EU countries the same as it already treats all other (non-EU) countries, and being treated in turn by the EU countries the same as they treat other non-member states.

The result for UK producers would be to leave existing domestic prices unchanged because they would still be defended by the same tariffs as at present. But prices received for UK exports to the

EU would now fall to the same levels as apply across the 'outside world' (i.e. 'world prices', by implication on average about 5% lower). Similarly, EU exporters would now only be able to get the 'outside world' price for their sales to the UK (and of course the UK government will now receive the proceeds of the UK's own 5% tariff on those imports).

A rough estimate of the implications for the British economy can be arrived at using data from recent years. In 2014 the value of total exports was £511,654m. At the same time the value of total output was £3,889,971m, meaning that exports represented 13% of the value of UK total economic output. According to the House of Commons Library (Briefing Paper Number 7851, 4 July 2017) UK exports are currently split 44% to the EU and 56% elsewhere. So the estimated value for UK exports to the EU therefore comes to £225,128m (44% of total exports and about 6% of UK total output). Now if, after Brexit, because the UK will be outside the customs union, UK exporters receive 5% less for their goods and services (their sales to EU countries no longer taking place inside the protection of the 5% EU tariff) that will mean a reduction in revenue of £11,256m. The total profits of UK producers in 2014 amounted to £700,923m. This means that if all the drop in revenue was taken away from profits it would mean a fall in profits of 1.6%. In fact, because only half the economic activity that takes place in the UK is potentially exportable, this probably means that the reduced profits will apply to only half of all the economic operators in the country and so amount to the equivalent of a 3% reduction for those companies engaged in these activities. The consequential fall in share values for such companies would also be 3%. Given that the FTSE100 is at record levels at the moment this seems a very small 'price to pay' for what the *chatterati* are calling 'a hard Brexit'. Any preferential trade deal between Britain and the EU would be expected to soften this impact.

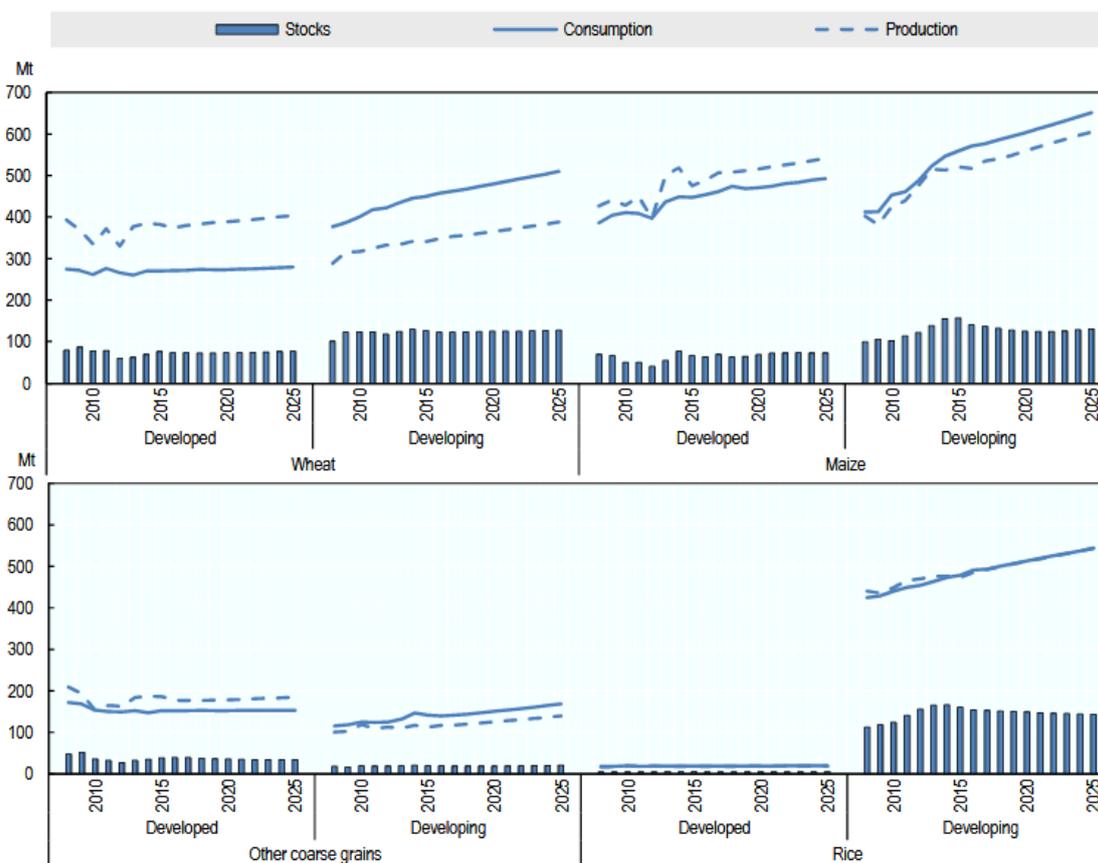
Of course, lest there be any doubt, I'm well aware that averages conceal degrees of variation: not all tariffs charged by the EU are 5%. As the House of Commons Library says: "The trade-weighted average EU tariff for non-agricultural products was 2.3% in 2014 and 8.5% for agricultural products". So because existing EU tariffs on agricultural products are often more than 5%, farmland prices might fall by more than the 3% I've mentioned for exporters' share prices. On the other hand anything currently EU-tariff-free might be completely unaffected. But the main thrust of my point is still germane: leaving the EU (single market and customs union) is not the economic big deal that it's been hyped as.

The Global Economic Context

In a situation where global income growth is slow, the discretionary purchasing power of urban populations all across the world will be significantly influenced by the prices that they have to pay for shelter, food and fuel. The availability and quality of shelter will depend inevitably upon local circumstances. But food and fuel are affected by market forces operating in the world economy. In recent years prices for these essential commodities have been much lower than for the previous decade which encompassed the Great Global Financial Crisis (2007-2010) and the less-publicised (but no less challenging for the UK) period of global trade stagnation (2011-2014) also associated with historically high commodity prices (amplified in the UK by sterling exchange rate devaluation).

The prospects for global food markets have not altered since I last prepared a detailed assessment (http://www.stparsons.co.uk/files/bleak_midwinter.pdf). The figure below illustrates the situation.

Figure 3.1.2. Supply, demand and stocks of cereals in developed and developing countries



Source: OECD/FAO (2016), "OECD-FAO Agricultural Outlook", *OECD Agriculture statistics* (database), <http://dx.doi.org/10.1787/agr-outl-data-en>.

StatLink  <http://dx.doi.org/10.1787/888933381681>

For the main food grains, increasing world consumption is matched by increases in production; whilst stocks remain at historically comfortable levels. Expected trade flows will be from developed to developing countries. A similar story can be told for oilseeds and grain-fed meats. For grass-fed meat and dairy products, income-related increases in consumption (and more expensive storage considerations) may challenge productivity growth and mean higher prices.

Whilst the FAO does emphasise the uncertainties that traditionally surround predictions of global harvests, it concludes that "current production prospects for the main grain-producing regions are optimistic despite the prevailing risk of adverse weather events such as extreme heatwaves or devastating floods evoked by climate change". But I noticed that there was no reference to the uncertainty associated with pests and diseases, particularly as these may be affected by climatic variability. Changes in the operation of currents in the upper atmosphere may mean that inter-continental movement of organisms could become more common. For instance, there was a report recently concerning the trans-oceanic migration of the fall moth from the Americas to Africa where it encountered no local evolutionarily-developed natural opposition (<http://www.fao.org/africa/news/detail-news/en/c/469532/>). This lack of local predators or of indigenous crop or livestock resistances to such long-distance invasions of pests or diseases suggests that these may be a more threatening consequence of climate-change than weather events such as droughts or floods. And historically there has not been an unbroken run of record harvests across a decade such as the FAO-OECD predictions foretell for 2015-2025. So I am less optimistic than the

FAO. And this means that one risk element affecting my outlook for the foreseeable future is an unexpected reduction in harvests leading to higher prices for food and drink.

The situation with respect to fuel-oil stocks is reported below.

TOTAL OECD STOCKS						
CLOSING STOCKS	Total	Government ¹	Industry	Total	Government ¹	Industry
		controlled <i>Millions of Barrels</i>			controlled <i>Days of Fwd. Demand²</i>	
1Q2014	4164	1585	2579	93	35	57
2Q2014	4229	1580	2649	92	34	58
3Q2014	4297	1578	2718	93	34	59
4Q2014	4285	1580	2704	92	34	58
1Q2015	4372	1583	2789	98	35	61
2Q2015	4463	1585	2878	95	34	61
3Q2015	4533	1579	2954	98	34	64
4Q2015	4573	1587	2986	98	34	64
1Q2016	4608	1593	3014	100	35	66
2Q2016	4645	1591	3054	98	34	65
3Q2016	4655	1594	3061	98	34	65
4Q2016	4583	1598	2985	99	35	65
1Q2017	4623	1598	3025	102	35	67

¹ Includes government-owned stocks and stock holding organisation stocks held for emergency purposes.

² Days of forward demand calculated using actual demand except in 1Q2017 (when latest forecasts are used).

The figures show that the number of days supply which is available from stocks had risen from 93 in the first quarter of 2014 to 102 by the first quarter of 2017 (an increase of 10%). And coinciding with this the price of oil fell from \$107.6 (in the first quarter of 2014) to \$56.7 (in the first quarter of 2017): a fall of 53%.

Unlike food, oil can be effectively stored by being left unharvested. Whilst this limits the need for stocks to be held it probably also means that the overhanging impact larger stocks have on the price will take time to erode.

The Effect of the Exchange Rate

The changing relativities of international interest rates, as well as continued fluctuations in UK-overseas non-tradables transactions, have resulted in a sustained devaluation of sterling vis-à-vis the US dollar compared with its pre-crisis level (£1 = \$US2 in 2007; £1 = \$US1.55 in 2010; £1 = \$US1.32 at present).

This fundamental aspect of our economic situation is blindly and defiantly misunderstood by 'the Establishment', their acolytes and defenders. Their conventional wisdom says that devaluation makes imports more expensive (thus curtailing our purchases of them) and simultaneously makes our exports cheaper (thus encouraging their sales). This is completely bogus. It represents a lazy quasi-imperialistic Victorian mindset in which Britain is the fulcrum of the world economy: in which global economic circumstances define themselves by reference to Britain. The people of the country at large are held hostage by their Establishment's *folie de grandeur*.

The truth is otherwise. Prices of goods and services that could be sold or bought from overseas (so-called 'tradables') are determined by the price that they would fetch in the international marketplace. This price will generally be expressed in terms of US dollars. This is basically because of the comprehensive climatic and topographical features and the complete range of organic and inorganic natural resources possessed by the United States. These mean that pretty much anything that can be produced is produced and can be bought from the United States using US dollars. And hence the \$US is the *pecunia franca* of the world economy.

This means that any 'world price' that has been established in dollars is then translated into pounds and pence by means of the exchange rate. In an age of accessible instant information the competitive pressure of entrepreneurial arbitrage keeps domestic and international prices in line. This means that sterling prices of all tradables (imports and exports alike) vary in conjunction with the exchange rate. Devaluation doesn't make imports more expensive than domestic supplies: it makes all tradables more expensive. And it doesn't make our exports cheaper than foreign alternatives: it makes all tradables more expensive.

The prices that don't change in terms of sterling when the sterling exchange rate changes are the prices of things that are determined and expressed only in sterling terms. Stocks and bonds associated with companies registered in Britain and accounted for in sterling. Government debt denominated inevitably in sterling terms.

The damaging real consequences of this established misunderstanding are felt when the Bank of England fails to match changes in US interest rates thus causing the sterling-dollar exchange rate to alter and thus change the prices of tradables in the UK arbitrarily both in absolute terms and relative to non-tradables prices.

Some Conclusions

All the evidence of economic circumstances that I have looked at indicates that externally-generated opportunities for economic growth in Britain, on the basis of contributing supplies for growing economies elsewhere, are not available. Growth on the basis of self-propulsion – borrowing from the proceeds of improved productivity to be anticipated from fresh investment in infrastructure – would be politically controversial and thus cannot be expected. Nonetheless, gradual increases in the general standard of living may come from technological improvements that result in goods and services becoming cheaper (in real terms if not in monetary values). Such benefits may not be equally distributed.

Because there have been good harvests for the last few years, world grain stocks are keeping prices relatively low. This gives scope for purchases of non-food goods and services such as the UK supplies. Less optimistically it may mean that prices have nowhere to go but up when unexpected pests or diseases or bad weather interfere with farmers' plans.

Similarly, Charlie Bean nominates one significant cause of persistent low interest rates as a population bulge that has been passing through middle age and making savings as they do so - so competition to find vehicles for savings has pushed up the prices of the vehicles, thus reducing their annual yield: the interest rate. As this bulge becomes elderly and retires it will dis-save, thus pushing the process into reverse, cutting asset prices and raising interest rates.

Taken together, there are significant chances that food prices and interest rates may increase in the near future.

The fundamental situation in global markets may be summarised as follows: stocks of food (wheat, feedgrains and soya) and fuel (oil) are high, and hence world food and fuel prices are low; interest rates around the world are also low (probably as low as they can go); nevertheless global effective demand is not growing so economic activity is not increasing.

In the UK, except for managers, directors and senior officials, average gross weekly earnings of full-time employees are lower now than they were at the end of the crisis in 2010; in real terms between 5% and 10% lower. So increases in real domestic consumption are not to be expected.

Meanwhile the British government has a persistent budget deficit. A sustained period of economic growth would generate tax revenues that might resolve this situation. Without such resolution, continuously increasing public sector debt threatens the long-term financial sustainability of the state. It is questionable whether the deficit can be addressed by substantial reductions in current spending. The alternative of increasing taxation or extending its scope is neglected.

As international interest rates increase then unless the Bank of England raises UK rates competitively the sterling exchange rate will devalue and prices of tradables will continue to increase in the UK, depressing living standards and putting further pressure on the non-tradables sector (e.g. health and social care).

Whether the recently improved conditions of the global market for manufactures (2015 to date) will be sustained and whether the UK domestic economy will be well enough adjusted to take advantage of the situation are the questions that bear down on Budget Day decisions. The OBR is widely expected to judge that productivity growth in the UK will continue to be poor. How they judge the development of the global market is unpredictable. Whether they judge that anything the Chancellor of the Exchequer does will have significant impact in itself is beyond conjecture.

I can't envisage external circumstances riding to the rescue of the UK's economic prospects. I think it's up to the government to take some steps. My own recommendations are:

- Local authorities should be instructed to commission house-building, to be retro-funded by the properties' sales.
- Implementation of road-improvement programmes should be accelerated, and cancelled rail-electrification schemes should be restored, and the Swansea tidal barrage project should be funded. This would be paid for by introduction of a 5% Employment Transaction Tax and cancellation of HS2.
- Trident renewal should be abandoned in favour of expenditure on other defence measures (e.g. putting planes on the new aircraft carrier).
- Health service funding should be enhanced by 5%, to be covered in the longer term by repatriated EU contributions.
- Improved and expanded schemes for lifewide learning should be introduced, with associated redeployment of state educational resources (reduction in the school-leaving age and redirection of university finance).

The economic crisis that is just around the corner will only be a crisis for the British state because of persistent failures of the government in terms of economic policy. In particular the failure to address the budget deficit, which emerged at the turn of the century and was accentuated by the GGFC (2007-2010). Regrettably the responsibility for this failure in government policy will be deliberately obscured, presented as the consequences of the Brexit decision and hence blamed on the result of the referendum rather than, more appropriately, on the pathetic inadequacies of the political and administrative establishment (aka 'the unaccountable élite'). The opportunity provided for this Establishment to enhance existing distractions, of the 'divide and rule' variety, in order to sustain the social status quo is unlikely to be missed. This prospect is exceedingly depressing, coming as it does at the centenary of the Great War Armistice and the 50th anniversary of the 1968 *événements*; both anniversaries associated with failures to reform 'the world order'.