Osborne’s irrational economic policy and a rational alternative

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ISSUES

- Demand management (monetary and fiscal policy) vs. long-run strategy
- Key areas for concern:
  - UK financial balances
  - External position (current account; trade balance)
  - Household debt and the housing market
  - Wages and productivity
  - Inequality
  - Demographics and migration
- Open issues:
  - Supply side and “structural reform”
  - How to foster innovation and technological change
  - Corporate governance; industrial policy; finance
  - Welfare reforms, basic income?
... in terms of microeconomic policy, the ethos was generally light touch regulation, but with intervention where there was perceived to be a clear market imperfection ... There was a clear aim to reduce poverty, but again this was done through the tax and benefit system, rather than trying to directly influence market outcomes. (An exception was the introduction of the minimum wage, but that had a lot of support amongst mainstream economists). (Wren-Lewis)

- Bank of England Independence; inflation target; fiscal rules.
- GDP per capita grew 1.4% per year 1997-2010
- Strong productivity growth
- High employment
- Growth reliant on finance and property prices
- Geographically imbalanced
- Rising household debt
- Weak business investment; increasing cash balances in corporate sector
- Real median wage stagnation
- External deficits
5. If successful, the deficit reduction implemented under David Cameron will be the biggest of any government in recent history.

Source: ONS
UK national debt
% of GDP

Debt to GDP ratio
Chart 3.39: Sectoral net lending

The chart shows the sectoral net lending from 2000 to 2021, categorized into Corporate, Household, Public, and Rest of world. The forecast is indicated in the rightmost part of the chart.

Source: ONS, OBR
Household sector

Chart 3.39: Sectoral net lending

Source: ONS, OBR
HOUSEHOLD SECTOR

Household financial balance, % of GDP

March (prediction 2015 Q1)
July (prediction 2015 Q2)
November (prediction 2015 Q3)
Households & NPISH saving ratio: CP: SA

Source: Office for National Statistics
CREDIT CREATION

Loan to entrepreneur 100 100 Credit to entrepreneurs deposit account

Bank
Credit Creation

United Kingdom

Graph showing credit creation over time in the United Kingdom.
Credit creation

Lending to individuals, 12 month growth rate. Source: BoE
WAGES AND PRODUCTIVITY

Source: Hill, Thomas and Dimsdale (2015)
WAGES AND PRODUCTIVITY

Chart 25: Labour productivity, mean and median real wages in the US, since 1974

Chart 26: Labour productivity, mean and median real wages in the UK, since 1972

Source: Pessoa and Van Reenen (2013); St. Louis FED; Bank calculations

Source: Pessoa and Van Reenen (2013); Bank calculations
WAGES AND PRODUCTIVITY

Can real wages recover any of the ground lost relative to the long-term trend?
Average weekly earnings (regular pay) adjusted for CPI inflation

Wages and productivity

Figure 2: Productivity growth projection relative to pre-crisis trend

Index of non-oil output per hour (Q2 2008 = 100)

Roughly 24% 'lost growth' in output per hour sustained indefinitely

Source: RF analysis of OBR, Economic and Fiscal Outlook
WAGES AND PRODUCTIVITY

Not what it used to be
Labour-productivity growth*, per hour worked, %

Source: Conference Board

*Ten-year moving average

Economist.com
Inequality

Gini Coefficient 1961-2013/14
Inequality

Chart 16: Long run inequality

Source: Piketty (2014)
Education

Literacy profiles among 16 - 65 year olds
Percentage of adults scoring at each proficiency level

SOURCE: SURVEY OF ADULT SKILLS, (PIAAC) 2012
Figure 2. Too many teenagers in England have low basic skills
Percentage of 16-19 year-olds with low literacy and numeracy (below level 2)
Chart 27: Distribution of occupational employment in the UK by probability of automation

Source: Frey and Osborne (2013); Bank calculations
Notes: This chart shows the probability of automation based on estimates in Frey and Osborne (2013) matched against UK occupations
Demographics

Working Age Population (1950=100)

- Euro area
- United States
- Japan

Sources: United Nations; and IMF staff estimates.
EXTERNAL POSITION

![Graph showing external position with data points for Q1 2013 to Q3 2015. The graph compares trade in goods (blue line) and trade in services (orange line).]
## External position

### Table 2.2: UK Exports by Category of Goods and Services (2010)

<table>
<thead>
<tr>
<th>Category</th>
<th>UK Exports ($ Thou.)</th>
<th>Share of UK Exports</th>
<th>UK Share of World Exports</th>
</tr>
</thead>
<tbody>
<tr>
<td>Machinery / Electrical Products</td>
<td>89,470,424</td>
<td>13.9%</td>
<td>2.4%</td>
</tr>
<tr>
<td>Other business services</td>
<td>75,200,000</td>
<td>11.7%</td>
<td>8.0%</td>
</tr>
<tr>
<td>Mineral Products</td>
<td>52,831,664</td>
<td>8.2%</td>
<td>2.0%</td>
</tr>
<tr>
<td>Financial services</td>
<td>47,580,000</td>
<td>7.4%</td>
<td>17.9%</td>
</tr>
<tr>
<td>Transport Equipment</td>
<td>40,369,063</td>
<td>6.3%</td>
<td>3.1%</td>
</tr>
<tr>
<td>Chemicals / Related Industries</td>
<td>38,519,810</td>
<td>6.0%</td>
<td>4.0%</td>
</tr>
<tr>
<td>Transport</td>
<td>31,670,000</td>
<td>4.9%</td>
<td>4.0%</td>
</tr>
<tr>
<td>Travel</td>
<td>30,580,000</td>
<td>4.7%</td>
<td>3.2%</td>
</tr>
<tr>
<td>Metals / Metal Products</td>
<td>25,462,838</td>
<td>3.9%</td>
<td>2.3%</td>
</tr>
<tr>
<td>Stone / Glass / Ceramics</td>
<td>19,635,854</td>
<td>3.0%</td>
<td>3.5%</td>
</tr>
<tr>
<td>Foodstuffs</td>
<td>16,263,135</td>
<td>2.5%</td>
<td>3.7%</td>
</tr>
<tr>
<td>Precision Instruments</td>
<td>16,167,529</td>
<td>2.5%</td>
<td>3.1%</td>
</tr>
<tr>
<td>Royalties and licence fees</td>
<td>14,280,000</td>
<td>2.2%</td>
<td>5.8%</td>
</tr>
<tr>
<td>Plastics / Rubbers</td>
<td>14,139,428</td>
<td>2.2%</td>
<td>2.2%</td>
</tr>
<tr>
<td>Aerospace</td>
<td>13,605,778</td>
<td>2.1%</td>
<td>6.0%</td>
</tr>
<tr>
<td>Computer and information services</td>
<td>11,630,000</td>
<td>1.8%</td>
<td>5.4%</td>
</tr>
<tr>
<td>Insurance</td>
<td>10,380,000</td>
<td>1.6%</td>
<td>12.3%</td>
</tr>
<tr>
<td>Textiles</td>
<td>9,986,894</td>
<td>1.5%</td>
<td>1.5%</td>
</tr>
<tr>
<td>Wood / Wood Products</td>
<td>9,345,568</td>
<td>1.4%</td>
<td>2.5%</td>
</tr>
<tr>
<td>Other</td>
<td>8,194,058</td>
<td>1.3%</td>
<td>2.7%</td>
</tr>
</tbody>
</table>
Figure 2.5: UK Net Exports, Selected Sectors (2001, 2010, $bn)

Source: ITC Trade Database.
Policy: budget

Impact of key tax and benefit measures and introduction of National Living Wage announced this parliament, 2020-21

Mean change in annual income (cash)

Source: Resolution Foundation analysis using the IPPR tax-benefit model
A rational policy programme

- Borrow to invest in infrastructure (but what – Infrastructure; HS2? broadband? Low-carbon transition?)
- Fiscal rule – Balance on current budget?
- Beyond these, clear strategy needed for:
  - High-productivity jobs for decent wages
  - A functioning and stable financial system
  - “Industrial strategy”