

'Going for Growth'

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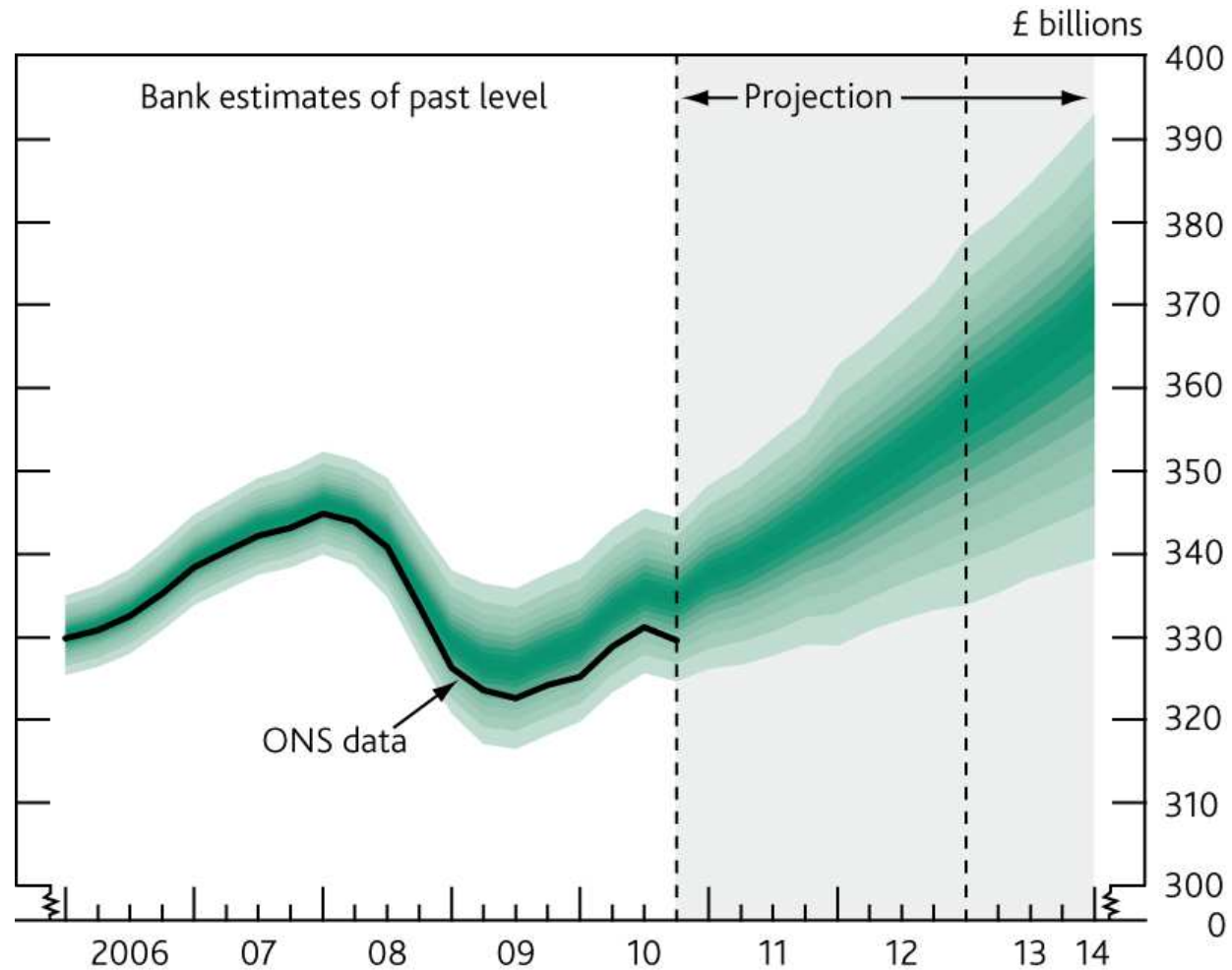
UCL & CEPR

February 2011

UK's economic predicament

- Growth is weak ... no V-shaped recovery where growth is *faster* than trend to return economy to previous growth path
- 'Double-dip' debate diverts attention from fact that *growth rate* is unlikely to be above trend

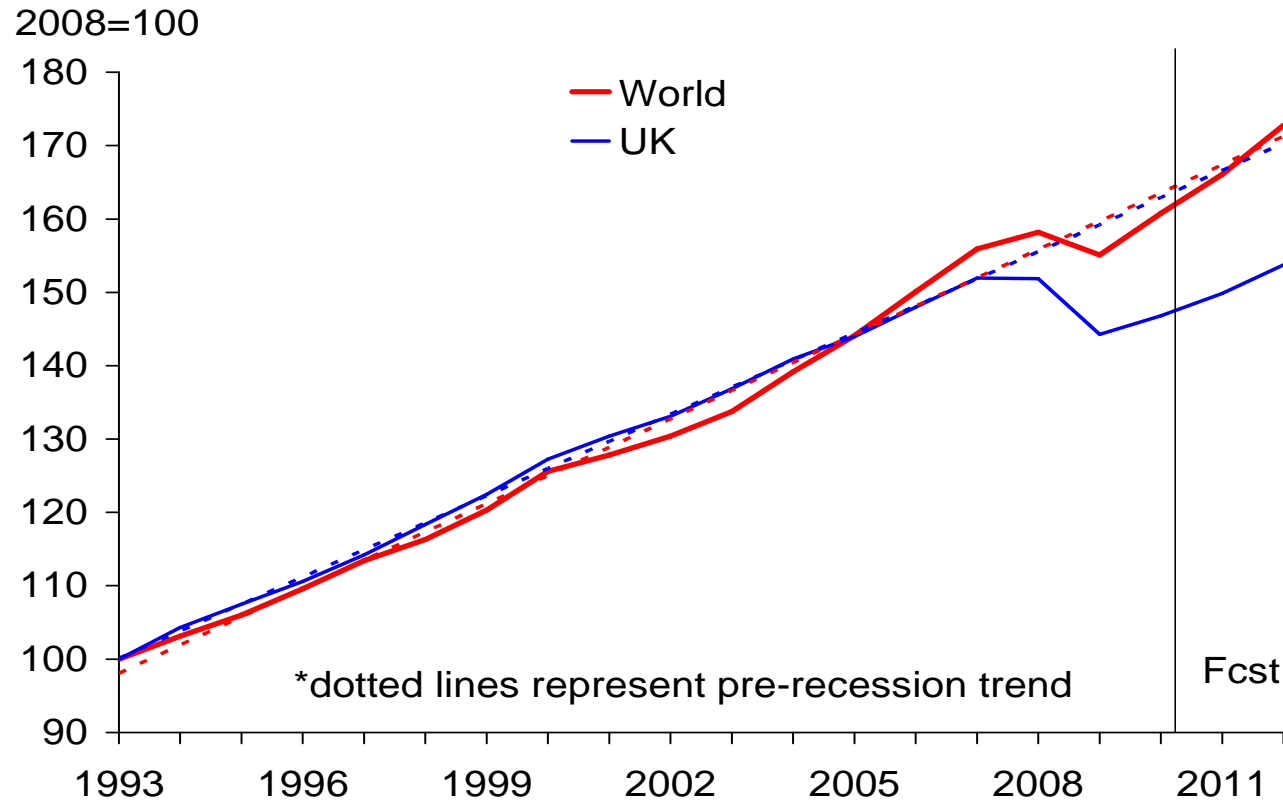
Bank of England Projection for the level of GDP



Source: BoE Inflation Report February 2011 Chart 5.11

Longer-run perspective: permanent loss of approx. 10% GDP for UK

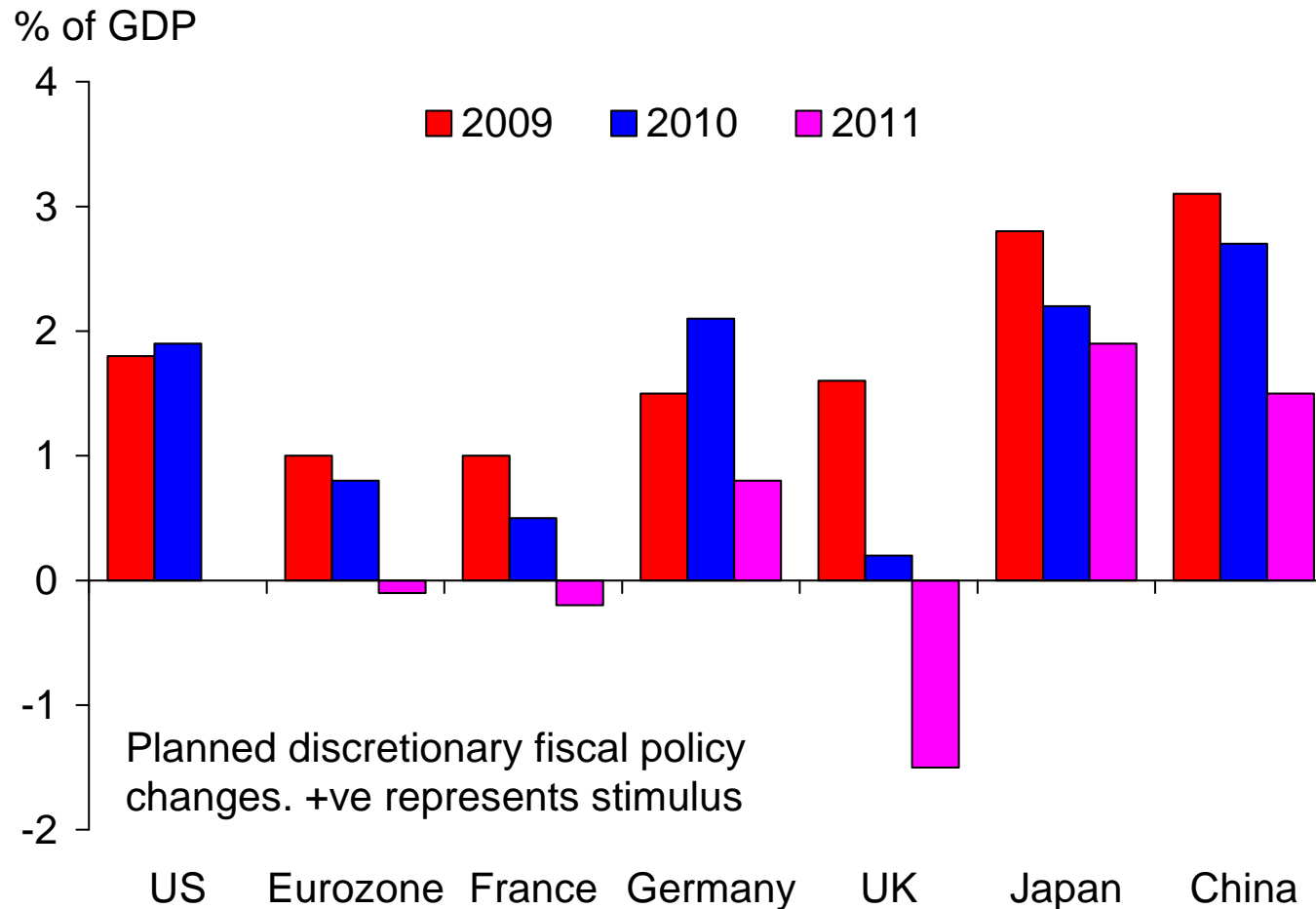
GDP: Forecast vs. pre-recession trend



Source : Oxford Economics/Haver Analytics

Source: http://www.oef.com/OE_FA_Display_Frm.asp?Pg=UKPres&Txt=UK%20Economics#

UK's front-loaded fiscal consolidation



Source : Oxford Economics

Source: http://www.oef.com/OE_FA_Display_Frm.asp?Pg=UKPres&Txt=UK%20Economics#

UK's economic predicament

- Fiscal consolidation is necessary but current plan is too front-loaded
 - If fiscal consolidation was to be expansionary, we should see front-loaded positive expectations effects on consumption & investment
 - Preferable would be to back-load the consolidation by building in commitments (legislation) to lower entitlements (e.g. higher pension age, lower public sector pensions)
 - these may not reduce aggregate demand now but secure the long-term commitment to a reasonable debt ratio

Implications for growth strategy

3 opportunities that should not be squandered

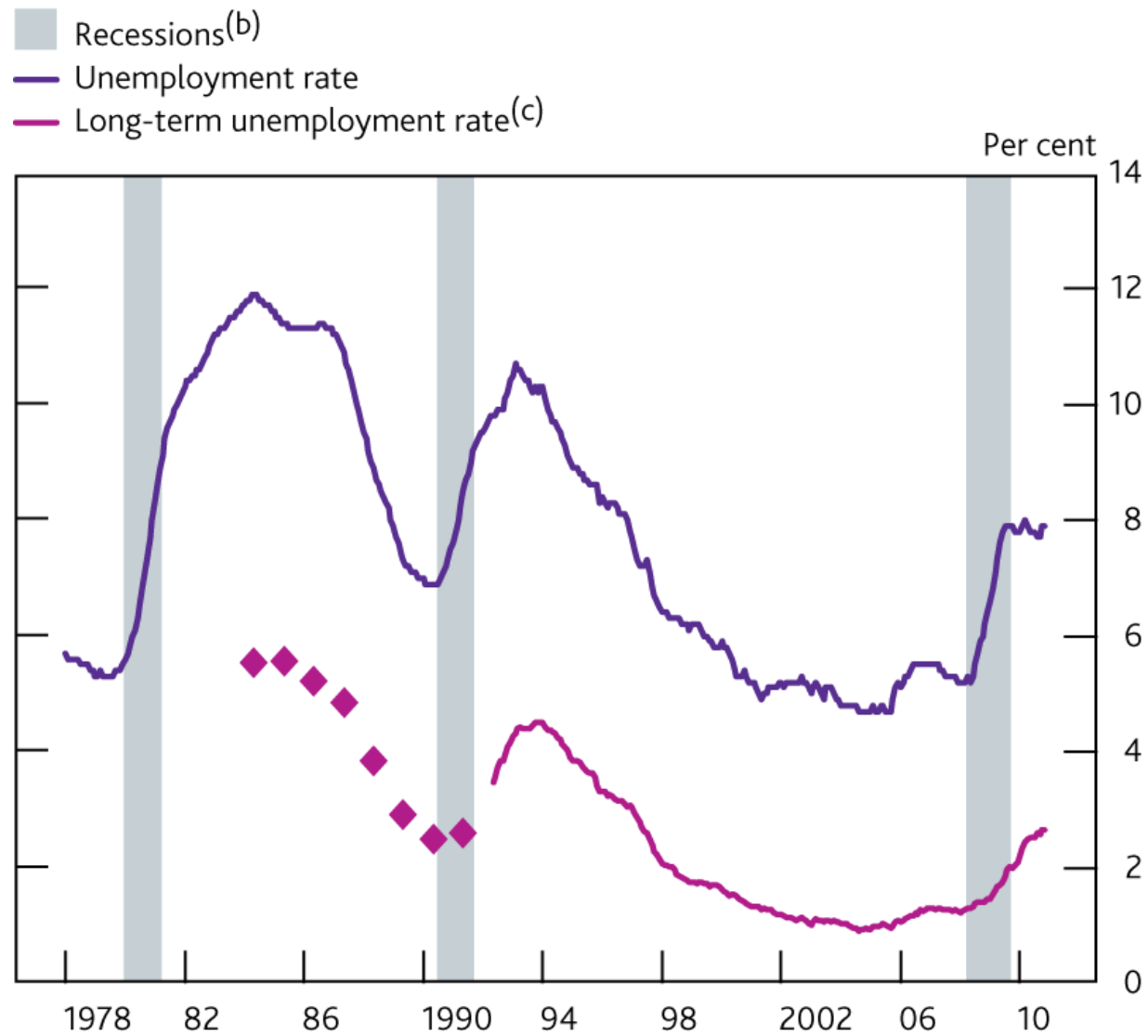
1. The labour market has performed better than in previous recessions – danger of losing this advantage in next couple of years; focus on entrants to labour market

2. Firms entered the crisis period with high profits – reflected in low bankruptcies in crisis BUT investment has been extremely low

Real interest rates are very low ... in principle, favourable conditions for private & state investment

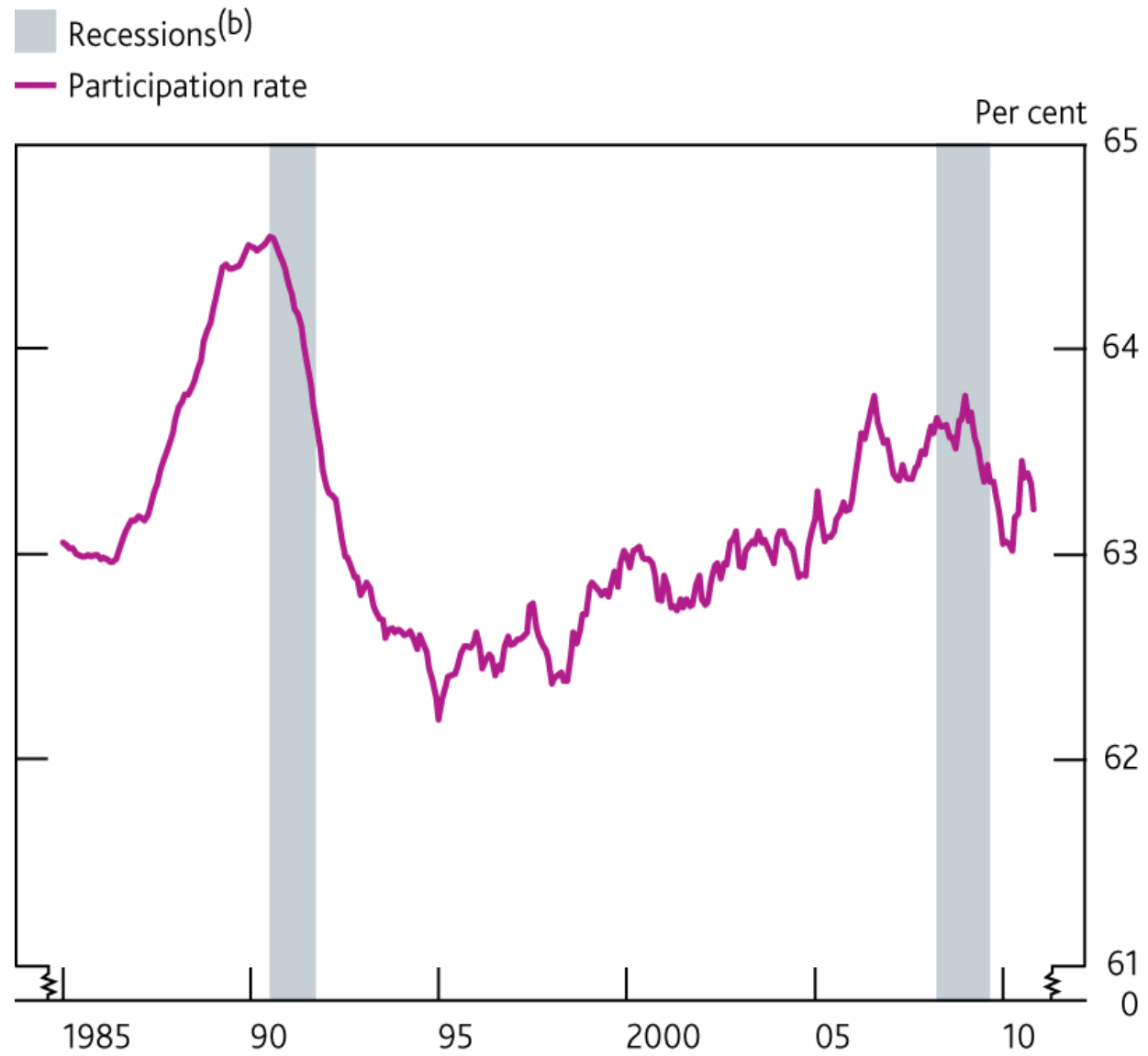
3. Large depreciation. How to capitalize on this to produce the re-balancing required?

Unemployment rates



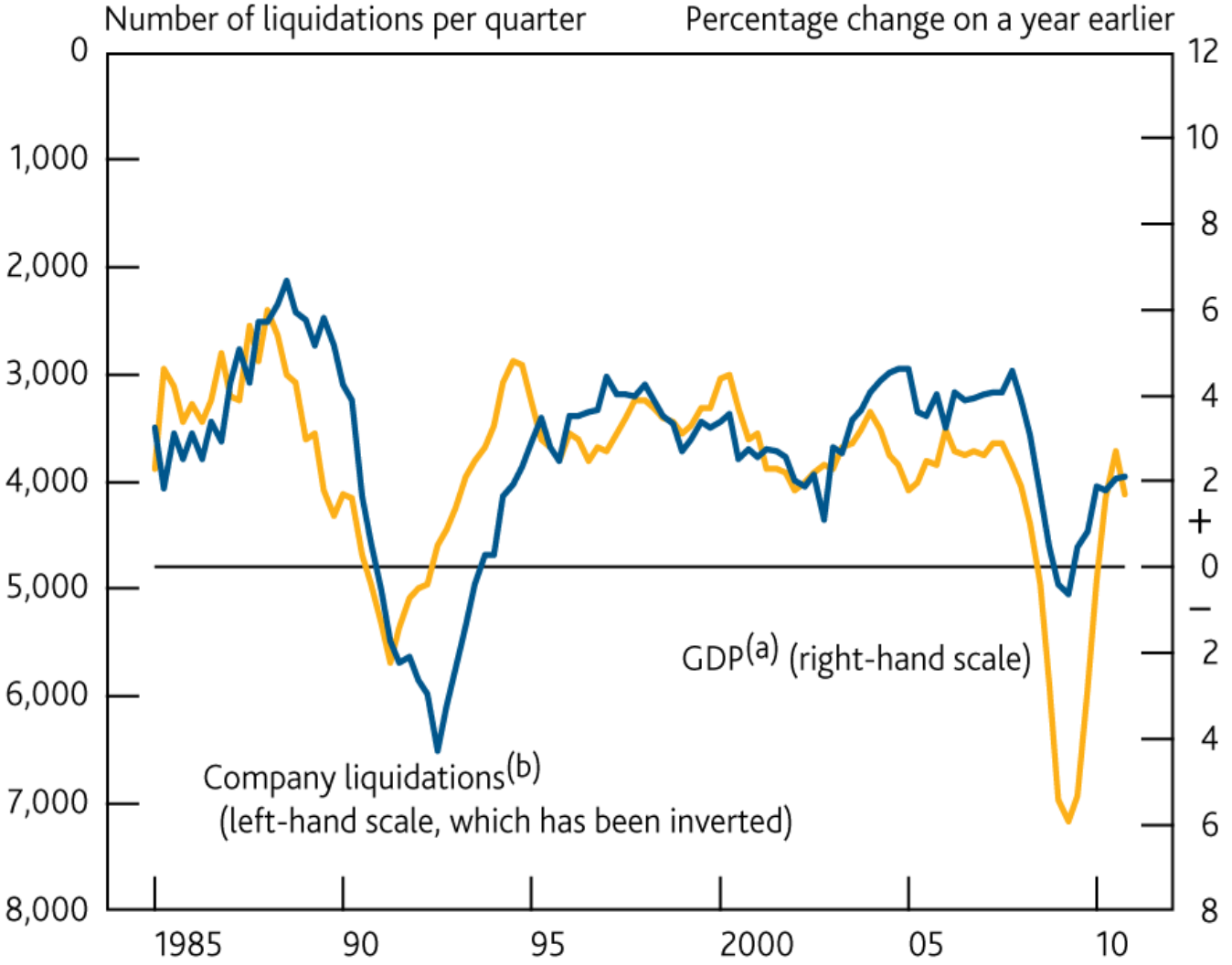
Source: BoE Inflation Report February 2011

Participation rate



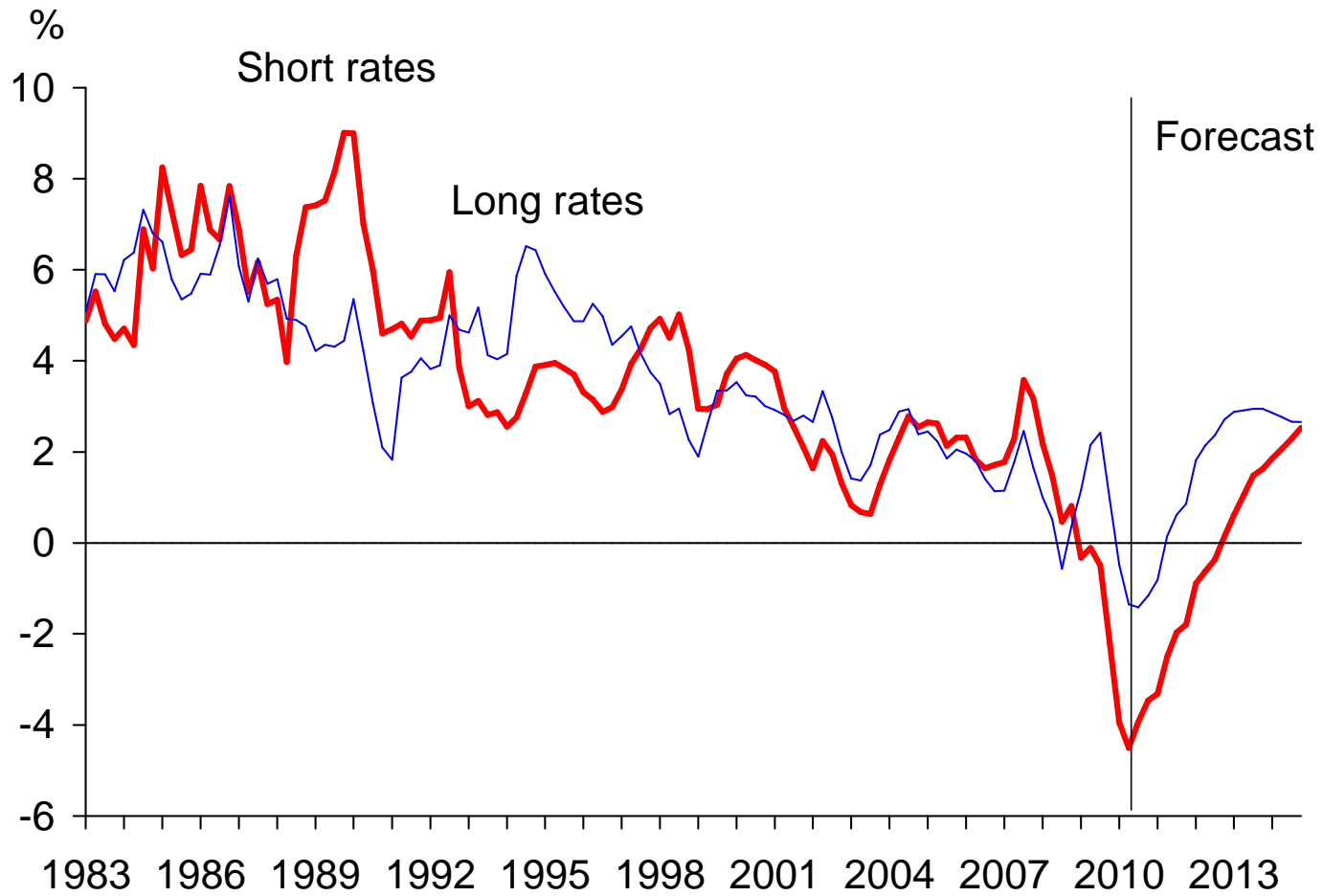
Source: BoE Inflation Report February 2011

Company liquidations in England and Wales and GDP



Source: Bank of England Inflation Report February 2011 .

UK Real interest rates



Source: Oxford Economics

Source: http://www.oef.com/OE_FA_Display_Frm.asp?Pg=UKPres&Txt=UK%20Economics#

'Rebalancing'

- Dealing with regulatory / competition issues in banking and introducing macro-prudential component into stabilization policy regime
- Shifting the balance in the contributions to the growth of demand: from consumption, housing & government expenditure to investment and net exports
- The longer term role of finance as a producer of tradeable services, i.e. as an export industry

'Rebalancing'

- Clear that the balance in the pattern of growth has to change toward investment and net exports
- Less clear that this entails a major shift in the UK's industrial specialization
- UK's high value added tradeables sectors are in finance, business services, cultural industries, education, pharmaceuticals, biotech/medicine, selected high tech engineering, ...
- Rely on excellent higher education system, international labour & capital mobility

Why do tradeables matter?

- In long run, welfare depends on productivity growth, which requires investment and innovation
- In an open economy, ability to compete in export markets is key to being able to pay for imports
- Depreciation provides a quick boost to competitiveness – but it reduces living standards
- Can only contribute to rebalancing & longer run productivity growth if the breathing space is taken advantage of by investment in tradeables
 - What is UK's comparative advantage? Radical innovation industries

Government role

- Using public debt as a buffer in face of large shock is sensible
- Growth is essential to reducing public debt ratio
- Tight constraints on traditional current government expenditure and tax cuts
- Exploit relative price changes with complementary policies that are light on the current deficit and target growth

Make use of

- Low interest rate environment to promote investment
Note the weakness of global as well as UK investment prior to financial crisis in spite of high profitability ... cannot rely on adequate rebound of private investment
- Complement behavioural changes induced by increase in oil price with policies to steer large-scale structural change to low-carbon economy
- Boost to tradeables from depreciation – use complementary not conflicting policies such as immigration controls that damage higher education & other high VA industries

There are economically sensible policies available to support growth consistent with debt stabilization – challenge is in sufficiently creative / imaginative politics