

2017-8 Lecture Series

Blueprint for Brexit Britain

The British Economy: can we build a successful future?

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GRESHAM COLLEGE



YEARS OF RESEARCH INTO POLICY • 1938 - 2018

NATIONAL INSTITUTE OF ECONOMIC AND SOCIAL RESEARCH



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The Economic Landscape of the UK

“The major fluctuations in the rate of growth of demand and output in the years after 1952 were thus chiefly due to government policy. This was not the intended effect; in each phase, it must be supposed, policy went further than intended, as in turn did the correction of those effects. As far as internal conditions are concerned then, budgetary and monetary policy failed to be stabilising, and must on the contrary be regarded as having been positively destabilising.”

J. C. R. Dow, *The Management of the British Economy 1945-1960*,
(1964).

To what extent has short-term demand management led to supply-side failures?



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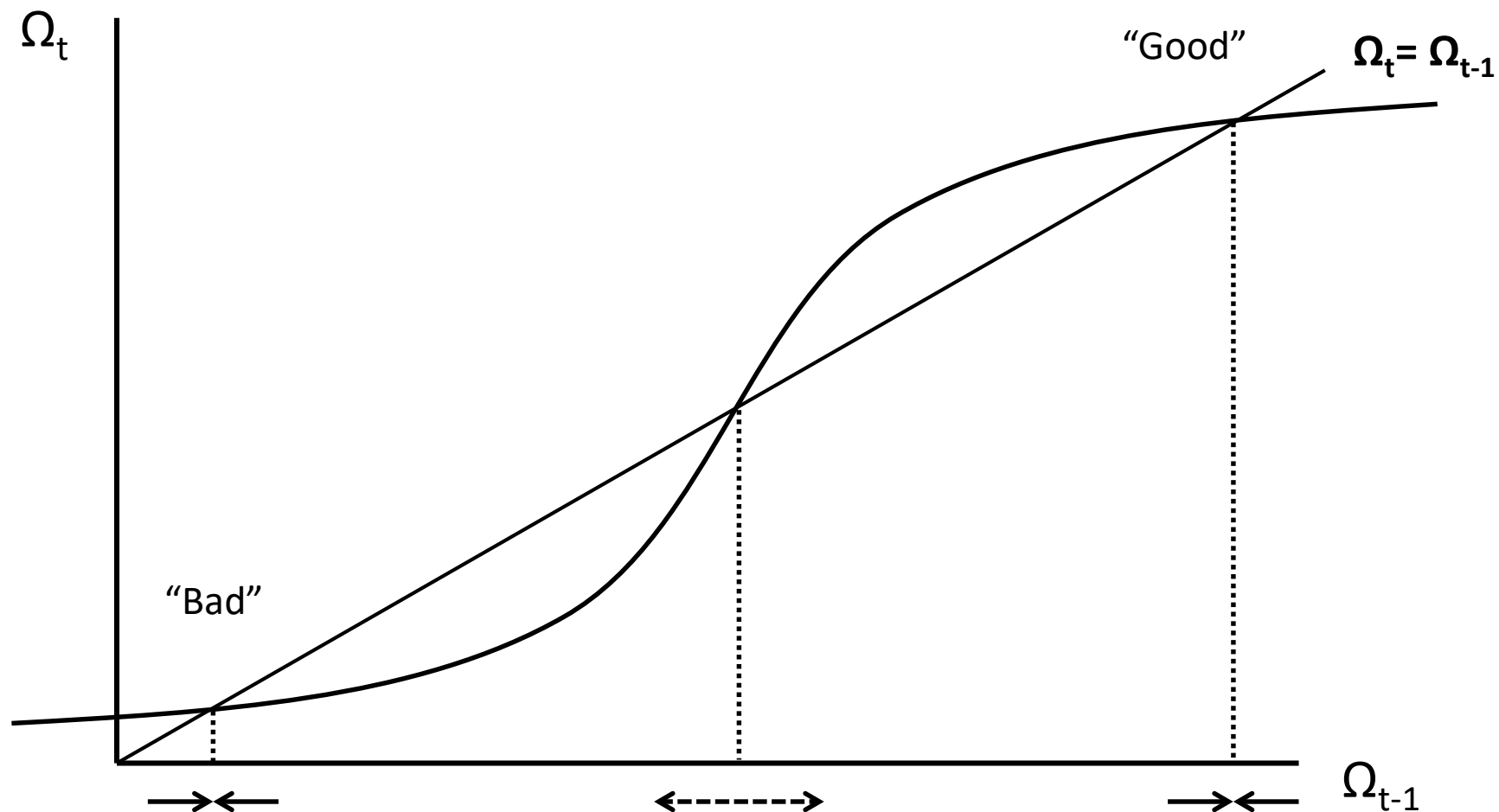
The Policy Landscape

“I have been deliberately as neoclassical as you can get. Some part of this rubs off on the policy side. It may take deliberate action to maintain full employment. But the multiplicity of routes to full employment, via tax, expenditure, and monetary policies, leaves the nation some leeway to choose whether it wants high employment with relatively heavy capital formation, low consumption, rapid growth; or the reverse, or some mixture. I do not mean to suggest that this kind of policy (for example: cheap money and a budget surplus) can be carried on without serious strains. But one of the advantages of this more flexible model of growth is that it provides a theoretical counterpart to these practical possibilities. ”

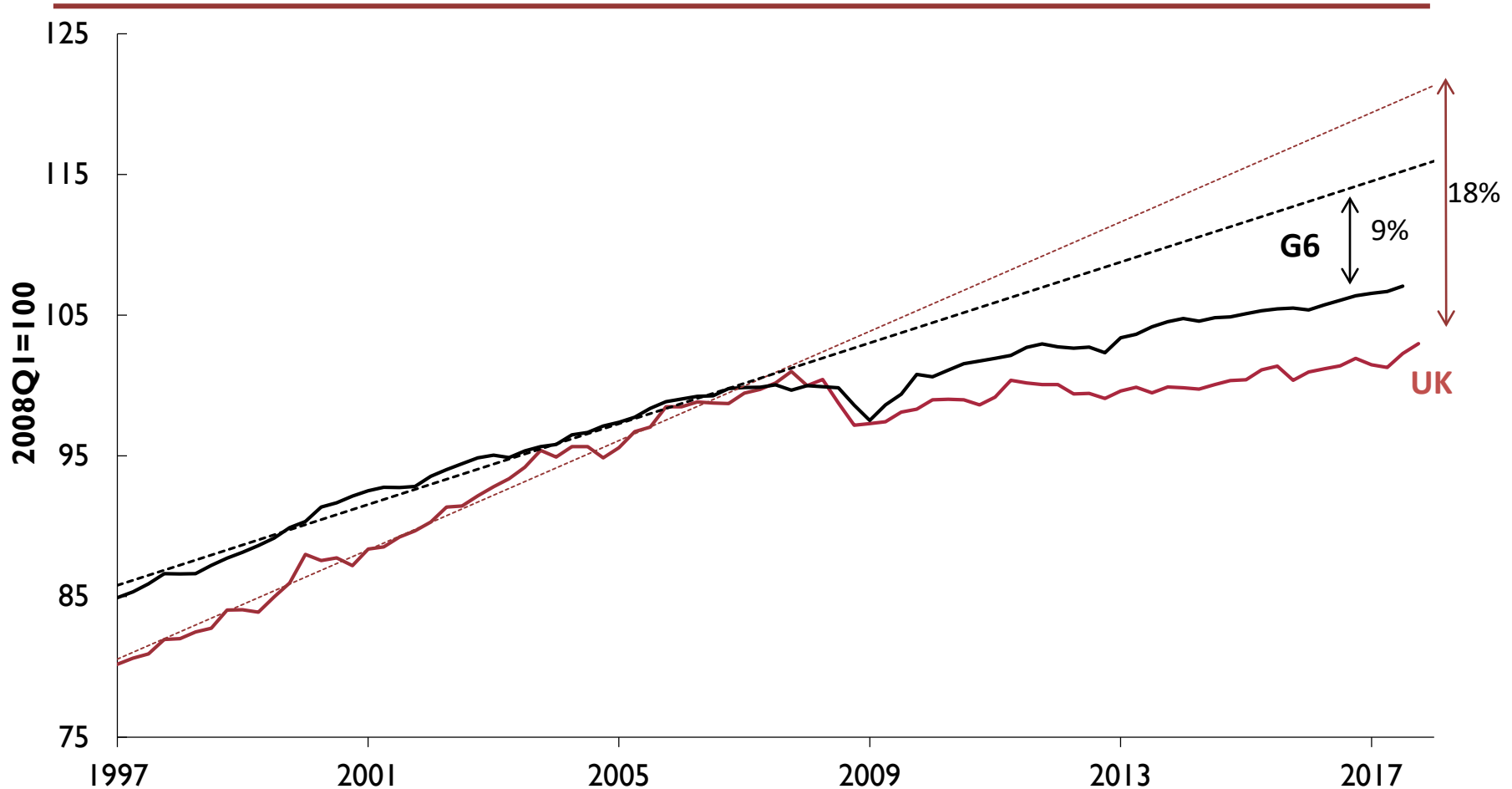
R. M. Solow, *A Contribution to the Theory of Economic Growth*, (1956).



Good and Bad Outcomes



Productivity Trap: UK compared to rest of G7

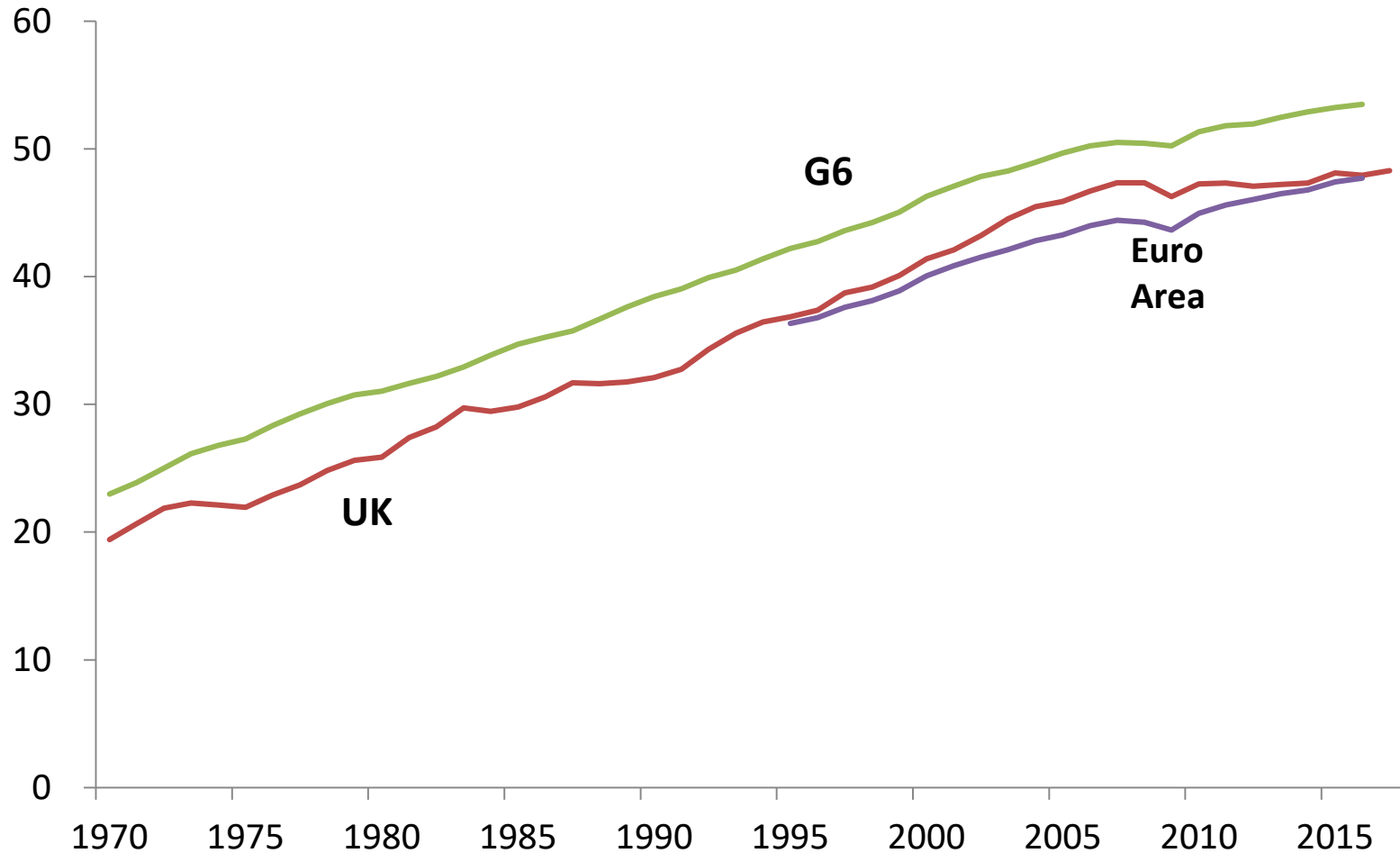


Source: NIESR

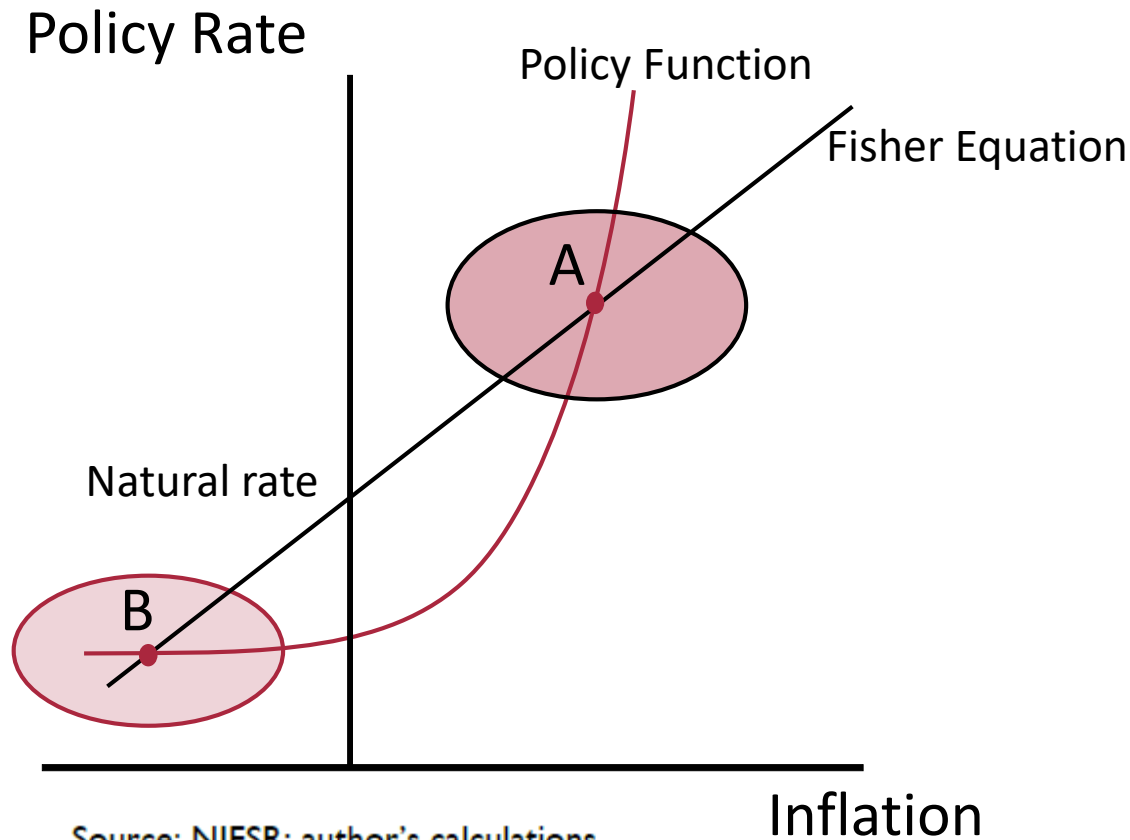


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GDP per hour worked (USD constant prices 2010 PPP)

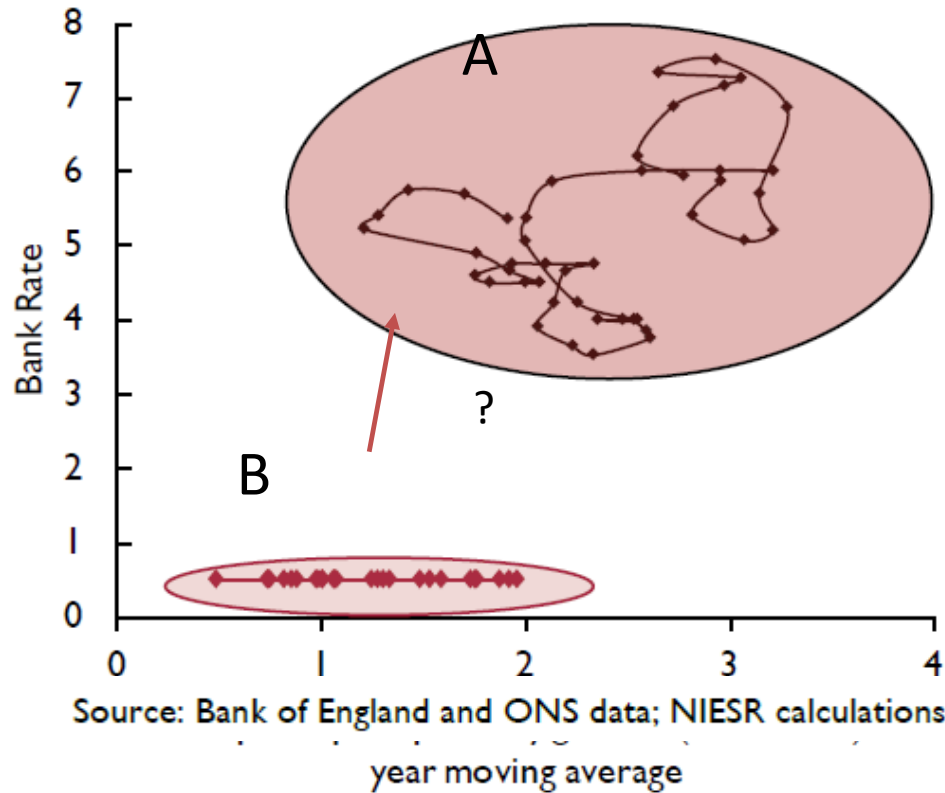


Good Times (A)...Bad Times (B)...

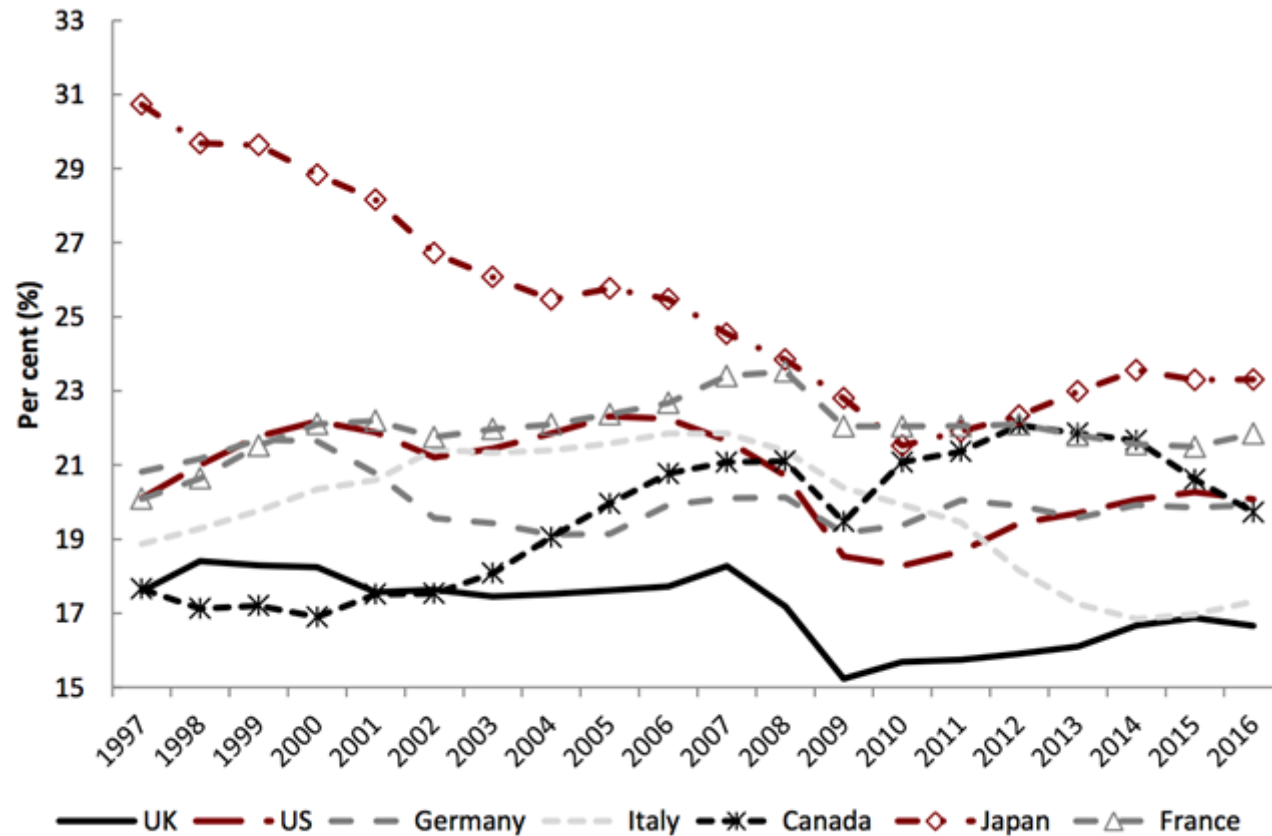


How to get back to normal?

Cyclical GDP growth versus Bank Rate



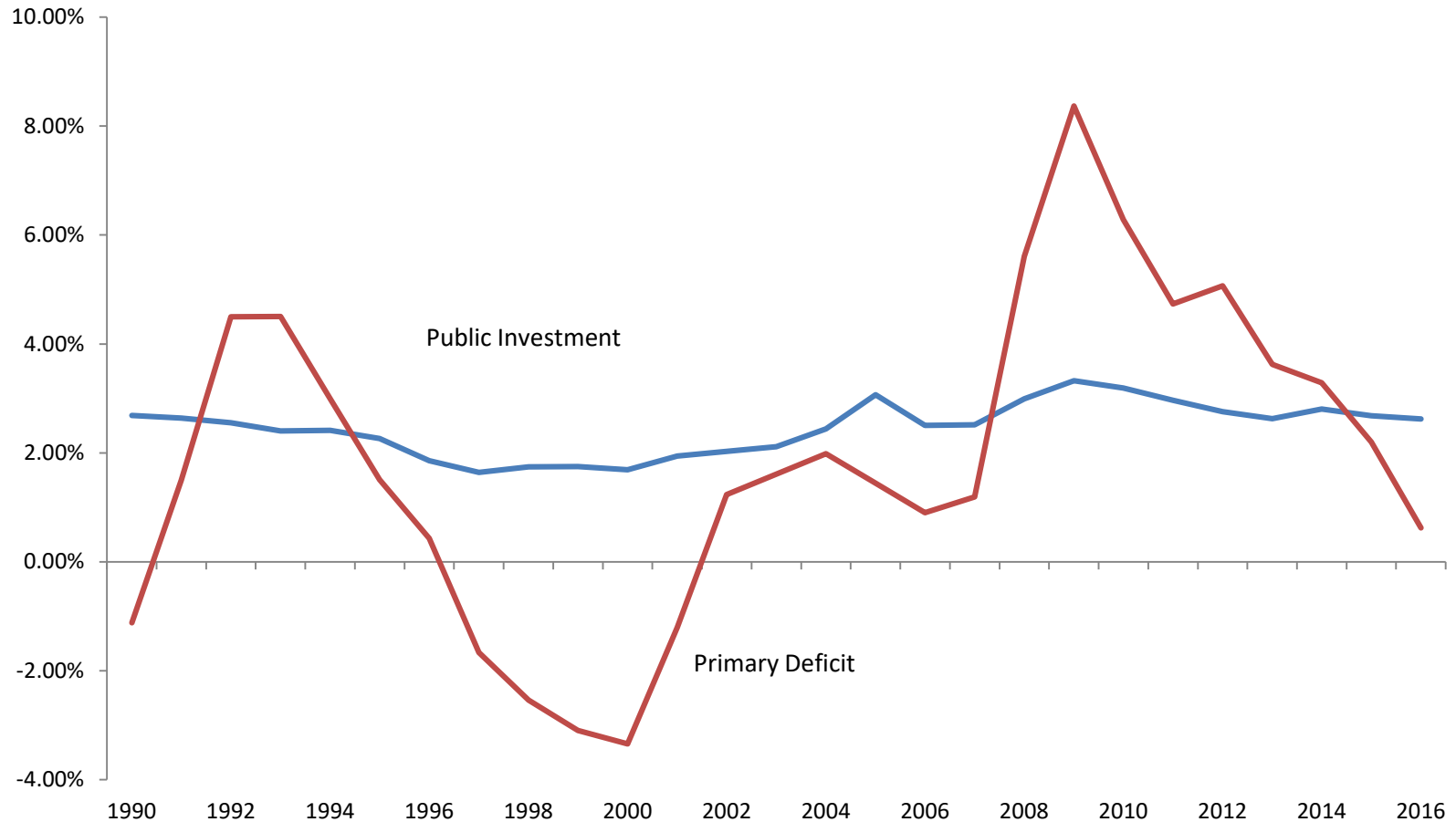
Investment to GDP in G7



Source: Source: NIGEM database



Public investment and Primary Deficit (as % of GDP)

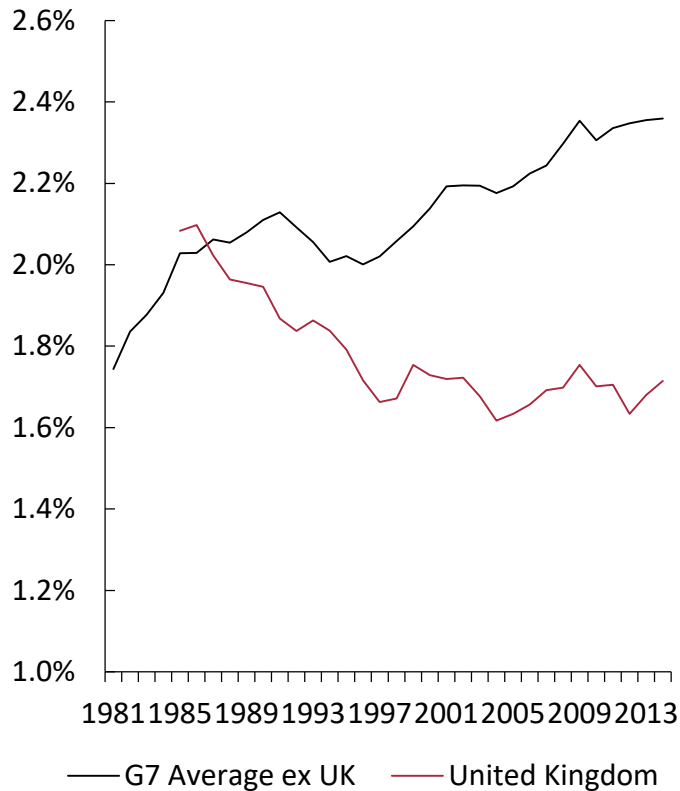


Source: European Commission, OBR

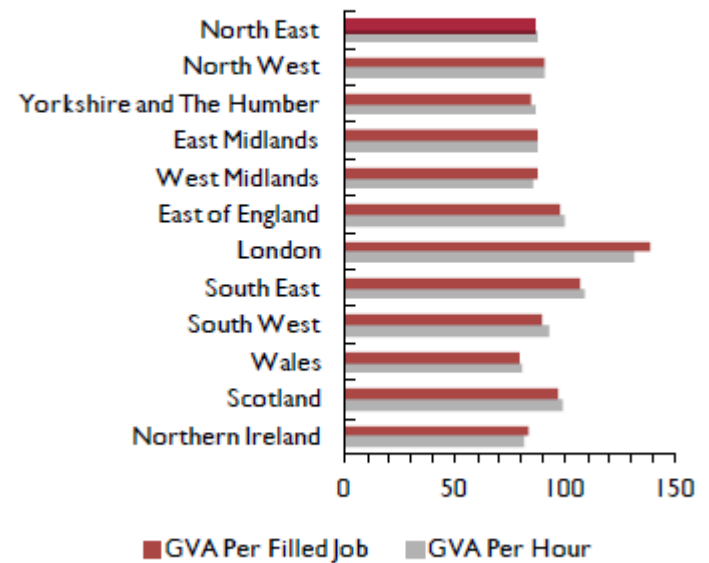


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R&D and Regional Productivity



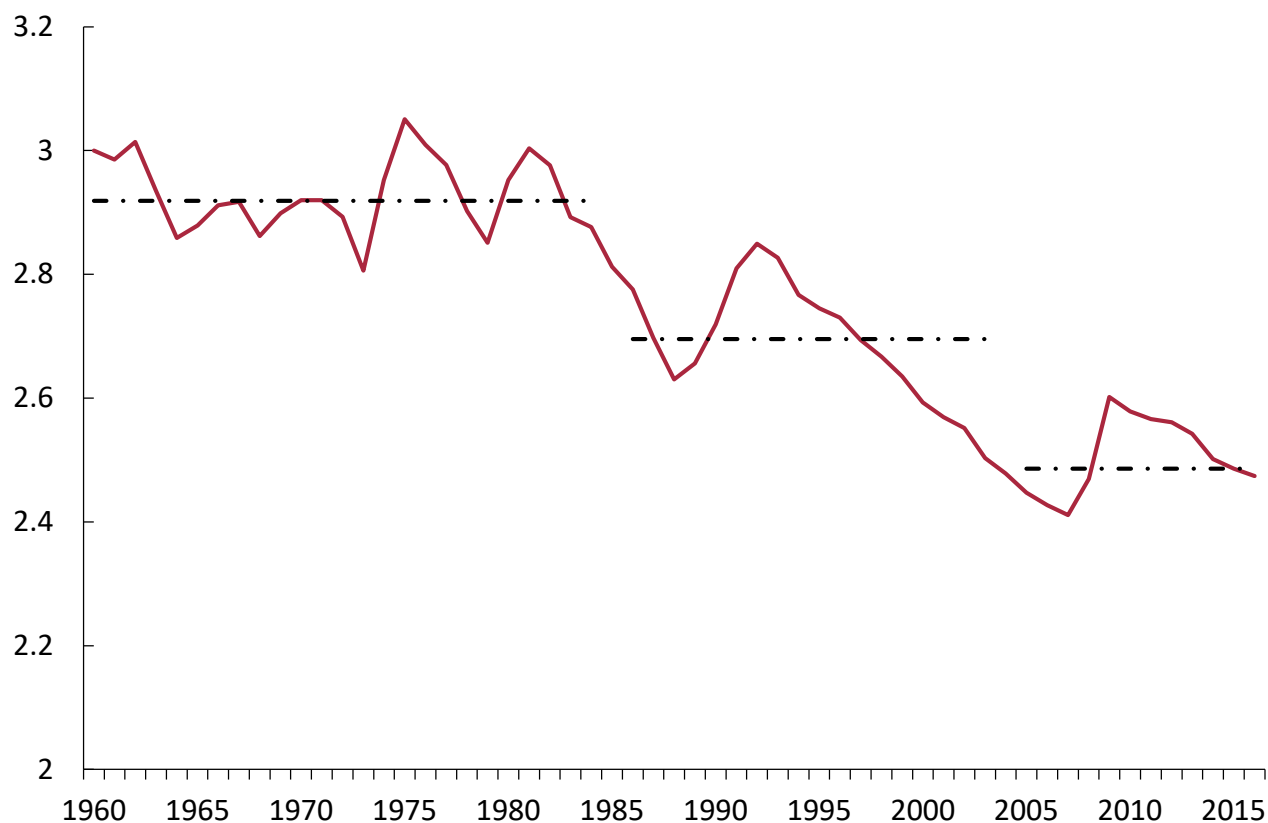
Labour productivity by NUTS I region or country, 2015



Source: ONS and NIESR, UK=100.



Capital–output ratio at constant prices 1960–2016



Source: European Commission and NIESR.



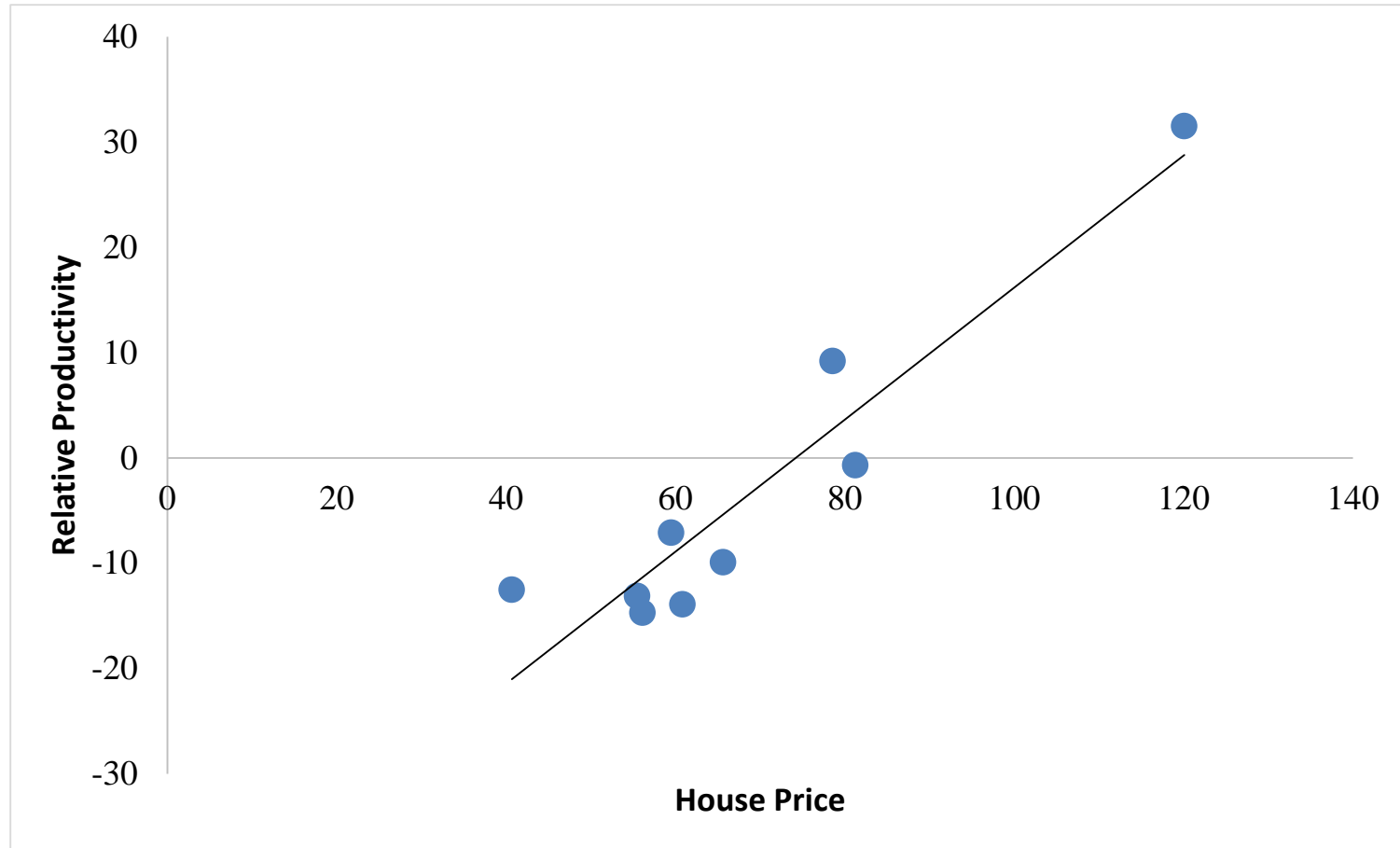
Growth in Net Capital per Employee



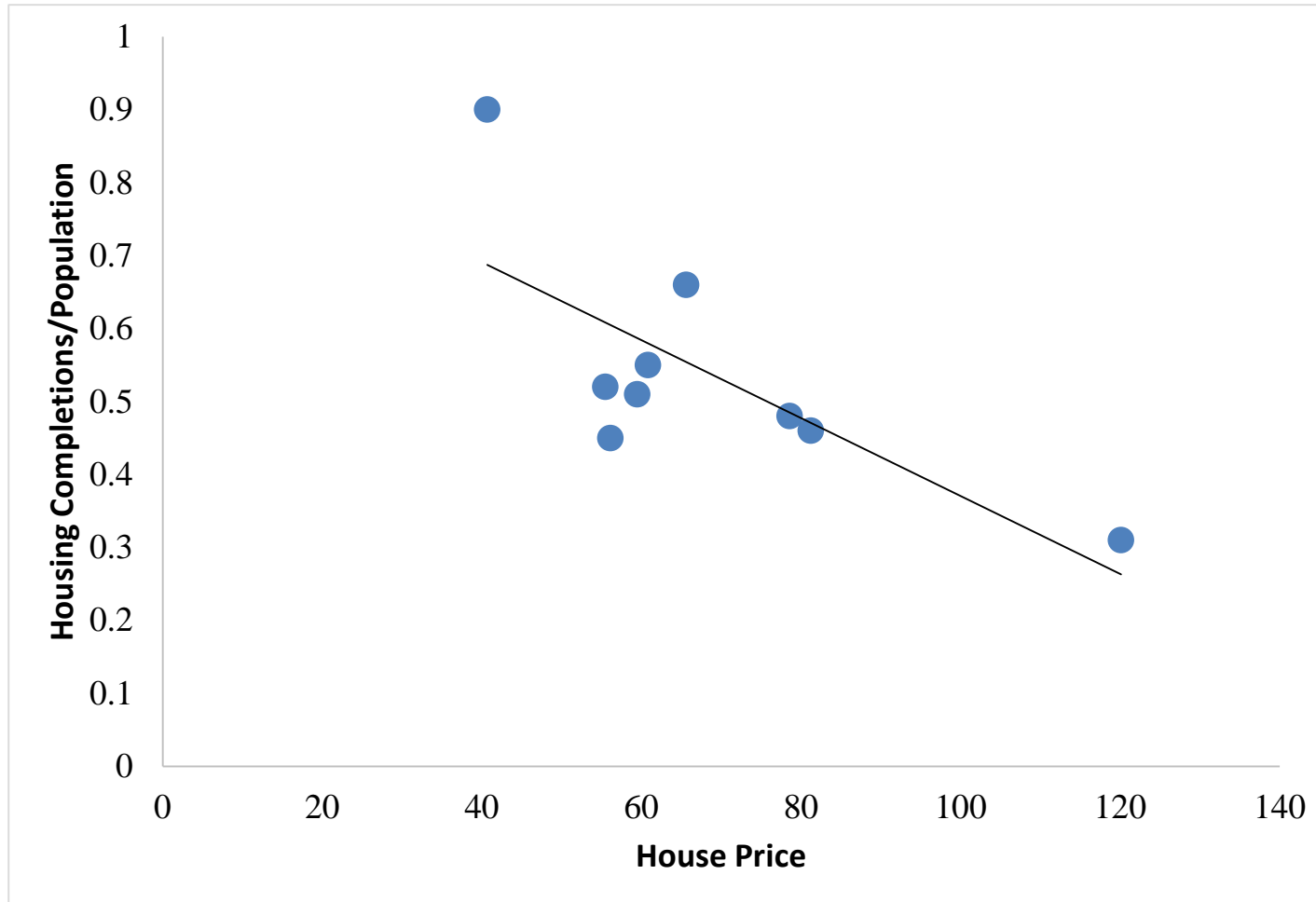
Source: ONS.
Note: Reference year: 2013



English House Price Rises versus Relative Productivity: Nine Regions

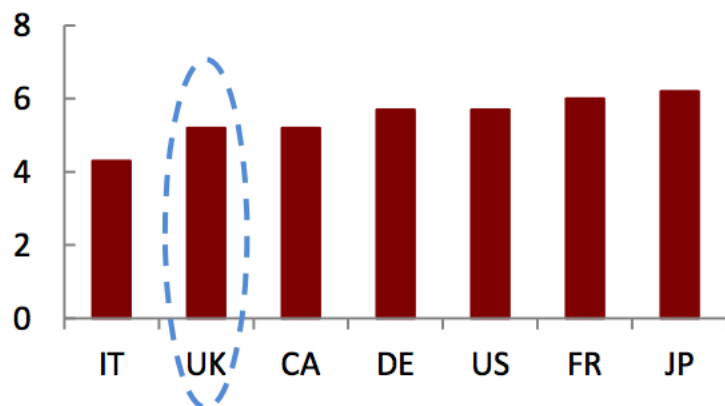


English House Price Rises versus Housing Completions/Population: Nine Regions



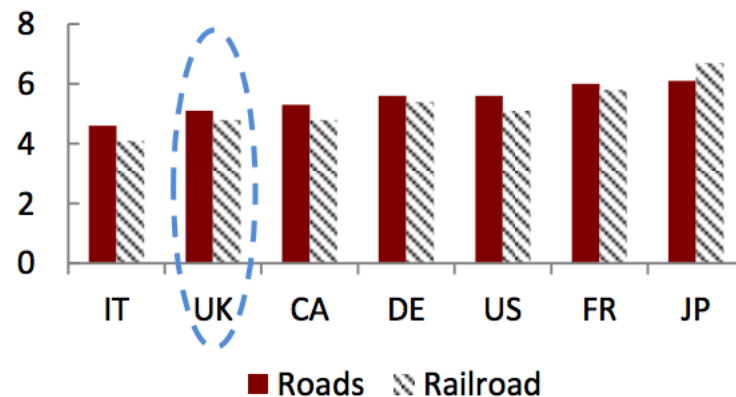
Quality of Infrastructure

Figure 1: Perceived quality of infrastructure spending



Source: The Global Competitiveness Report, 2016-2017
Notes: The scale ranges from 1 to 7, with 1 denoting the worst outcome and 7 the best.

Figure 2: Perceived quality of roads and railroad infrastructure

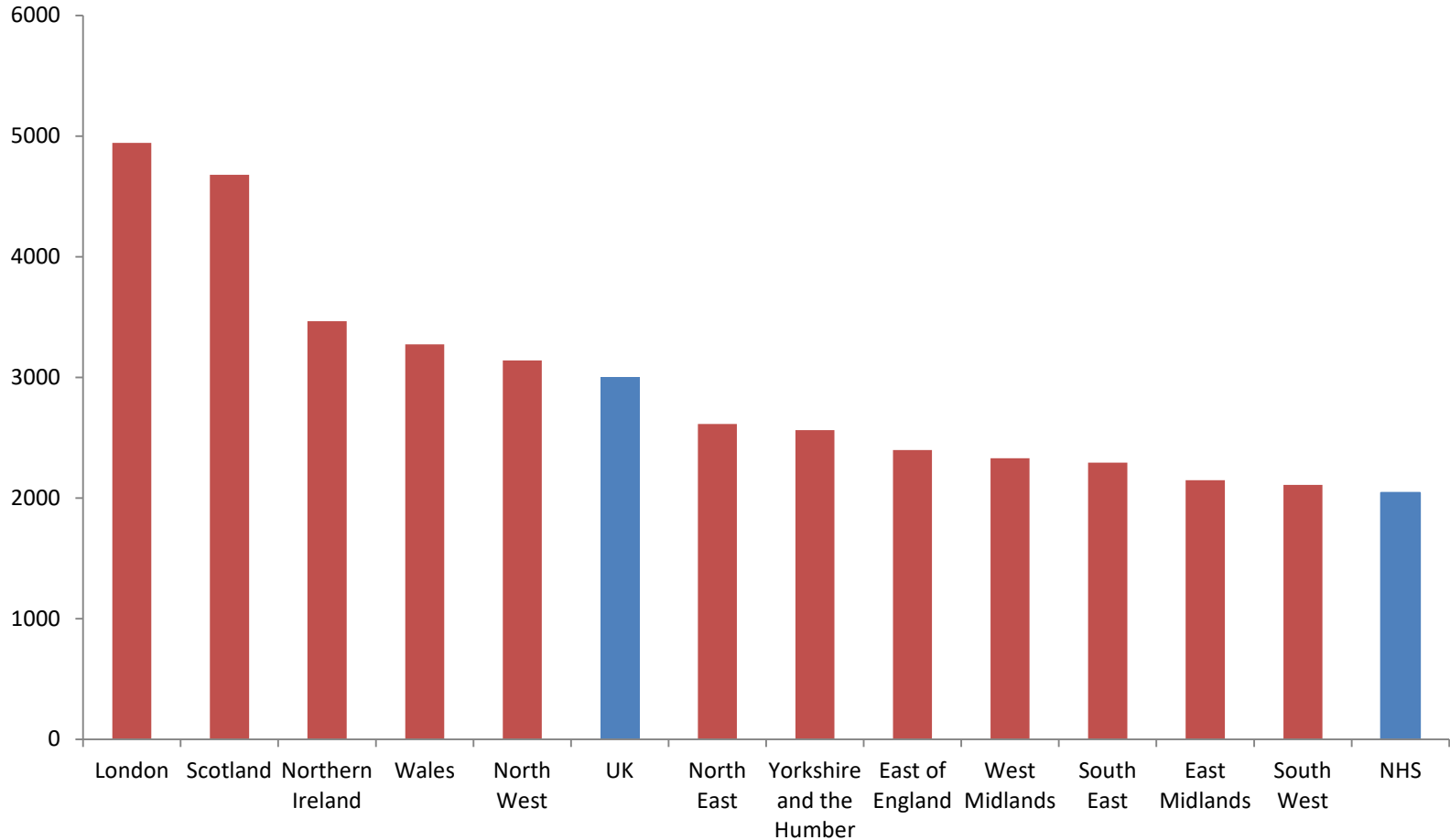


Source: The Global Competitiveness Report, 2016-2017
Notes: The scale ranges from 1 to 7, with 1 denoting the worst outcome and 7 the best.



Public Spending on Infrastructure by Country and Region

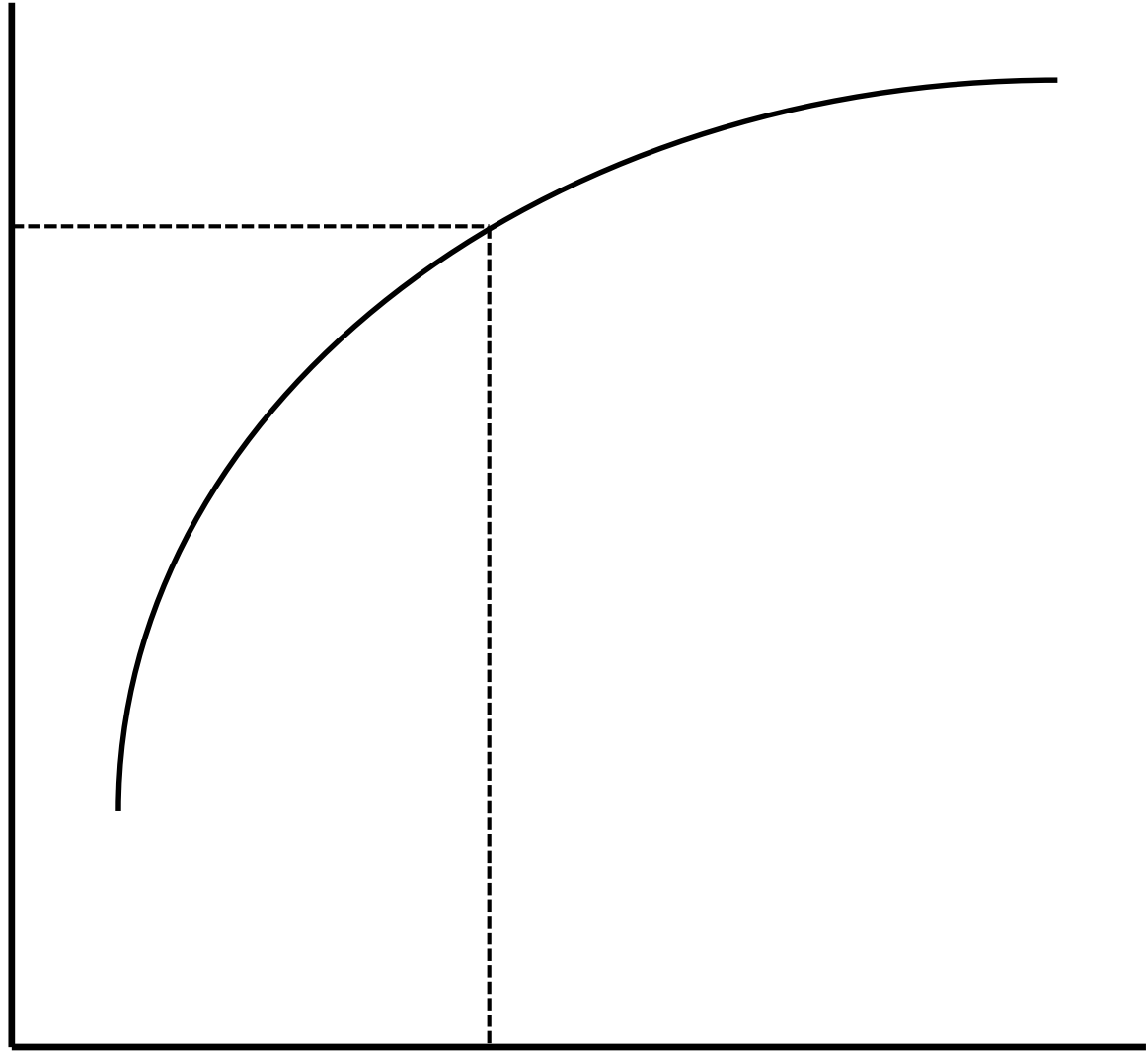
£ per head, average of 2011-12 to 2015-16, excludes spending incurred for UK as a whole



Firm Decision

Profits

$F(K)$



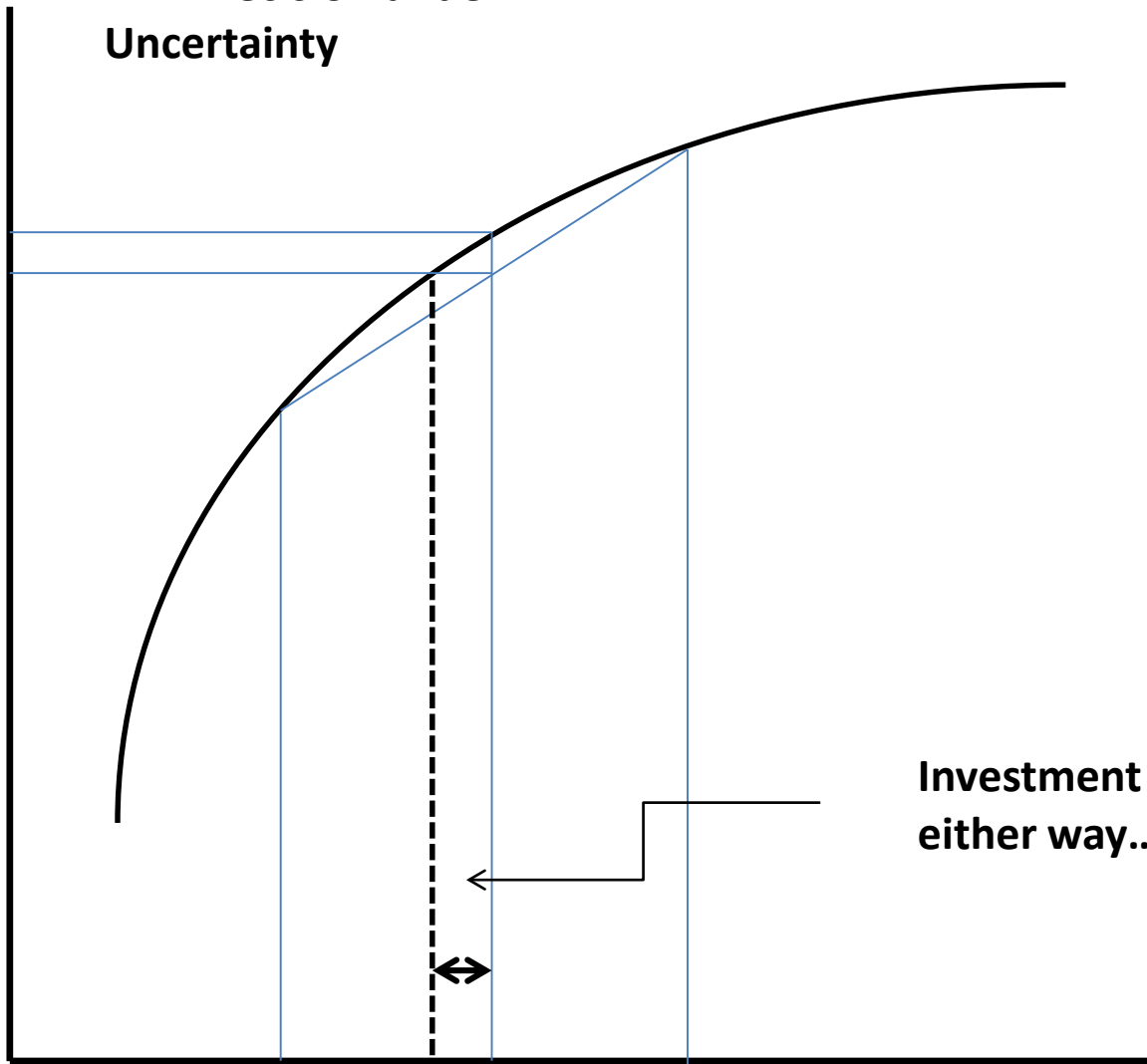
EU

Investment

Firm Decision under Uncertainty

Profits

$F(K)$



“Fear”

EU

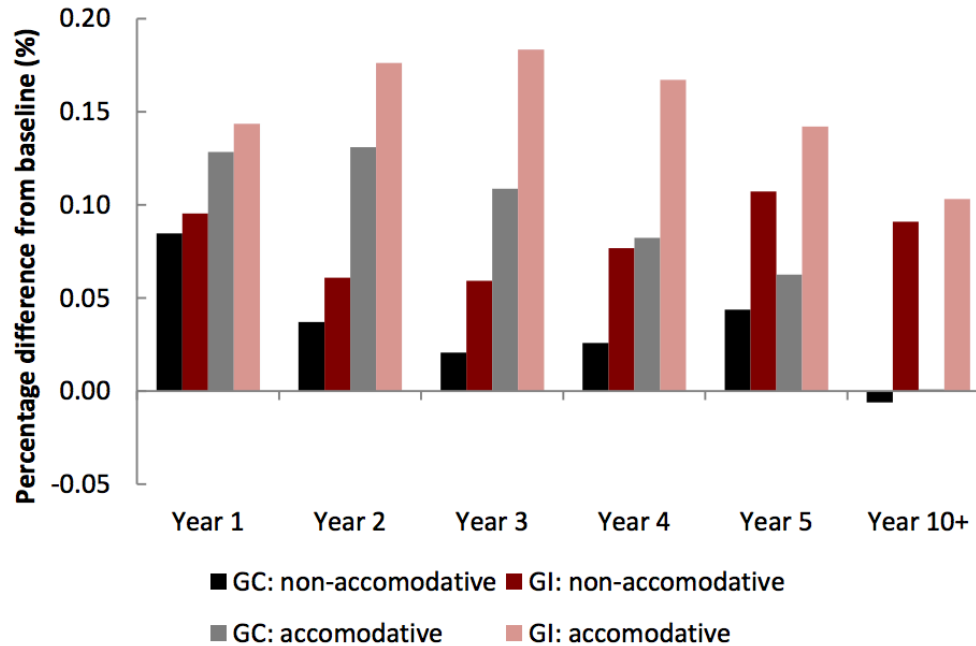
“No Fear”

Investment

Investment falls either way...

Government Investment Impact: NiGEM

Figure 5: Response of UK output to a fiscal expansionary shock

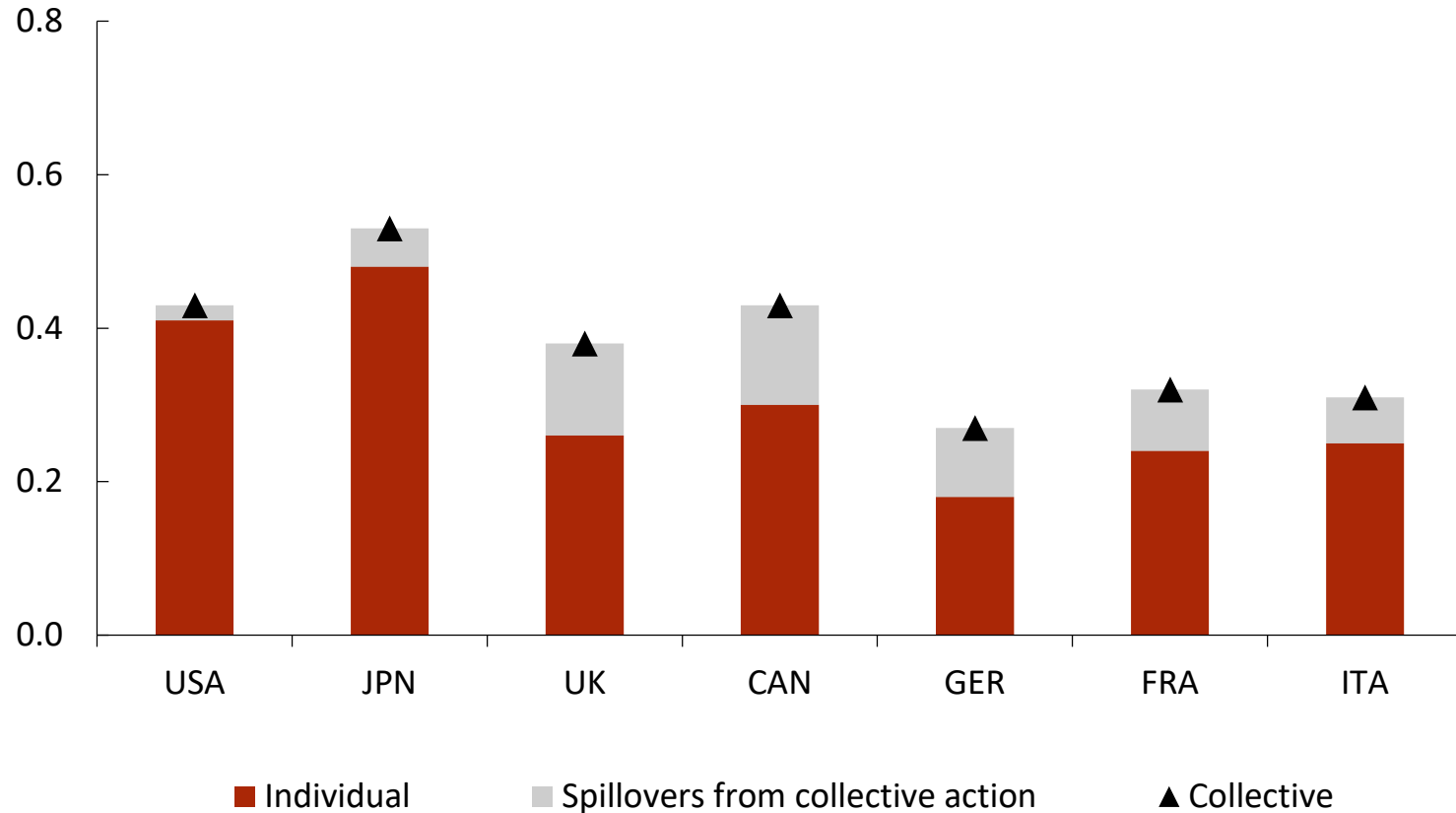


Source: NiGEM simulations.

Note: GC denotes government consumption; GI denotes government investment. Accommodative denotes that the central bank does not change interest rates for the first five years of the simulation, while non-accommodative denotes that the central bank reacts immediately to developments in the economy.



Public Investment (OECD estimates using NiGEM, Pain *et al*)

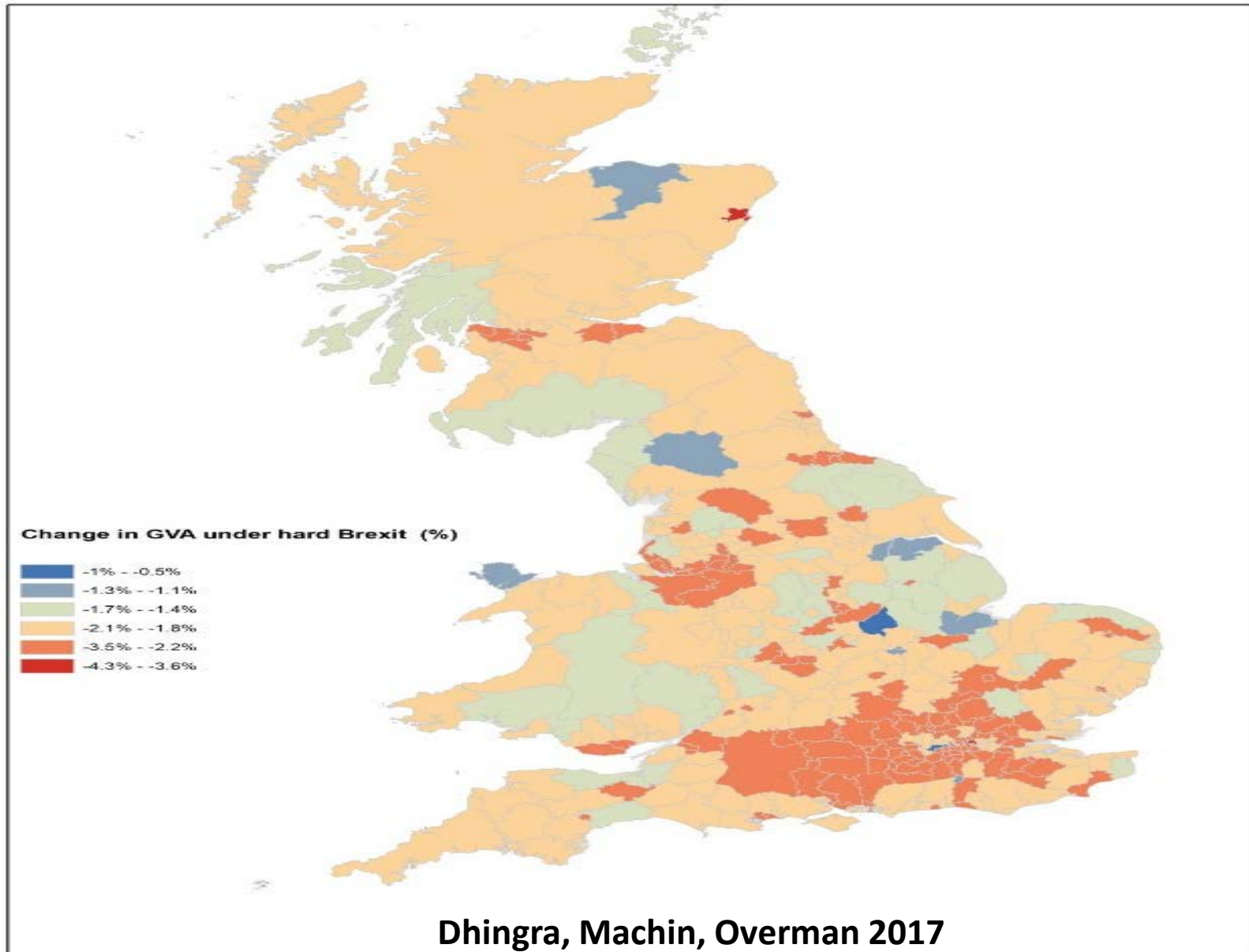


- Impact of ½% of GDP of investment on GDP individually or collectively

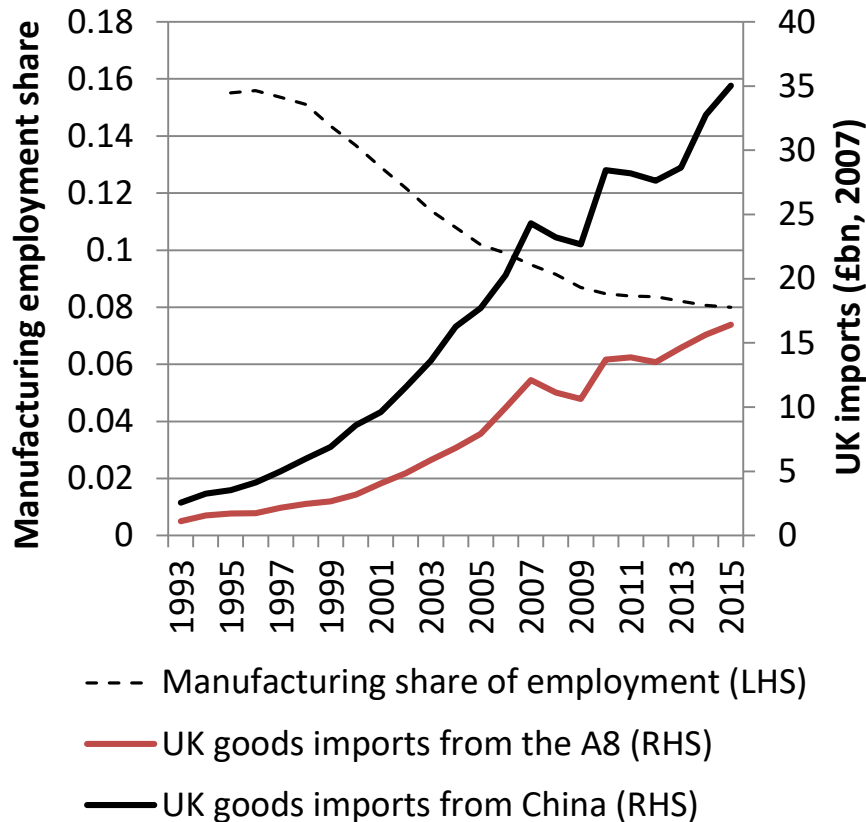


Estimated Impacts of Brexit across Regions

National Institute Economic Review, November 2017



Goods Imports from Low Wage Countries: National Institute Economic Review, November 2017



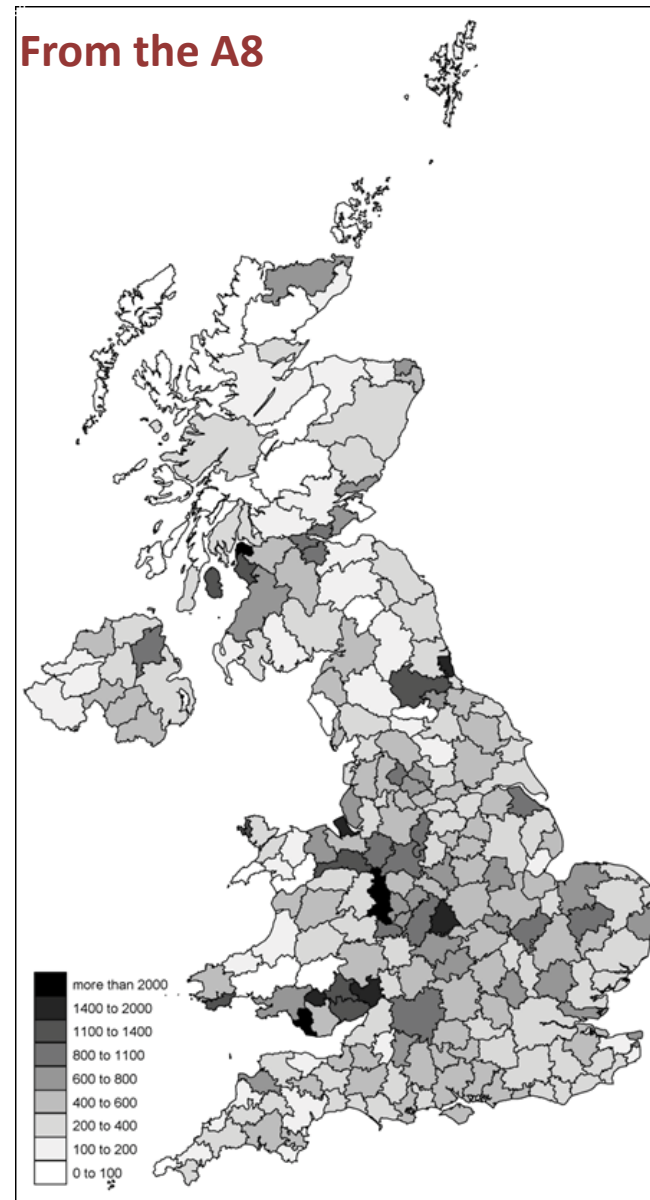
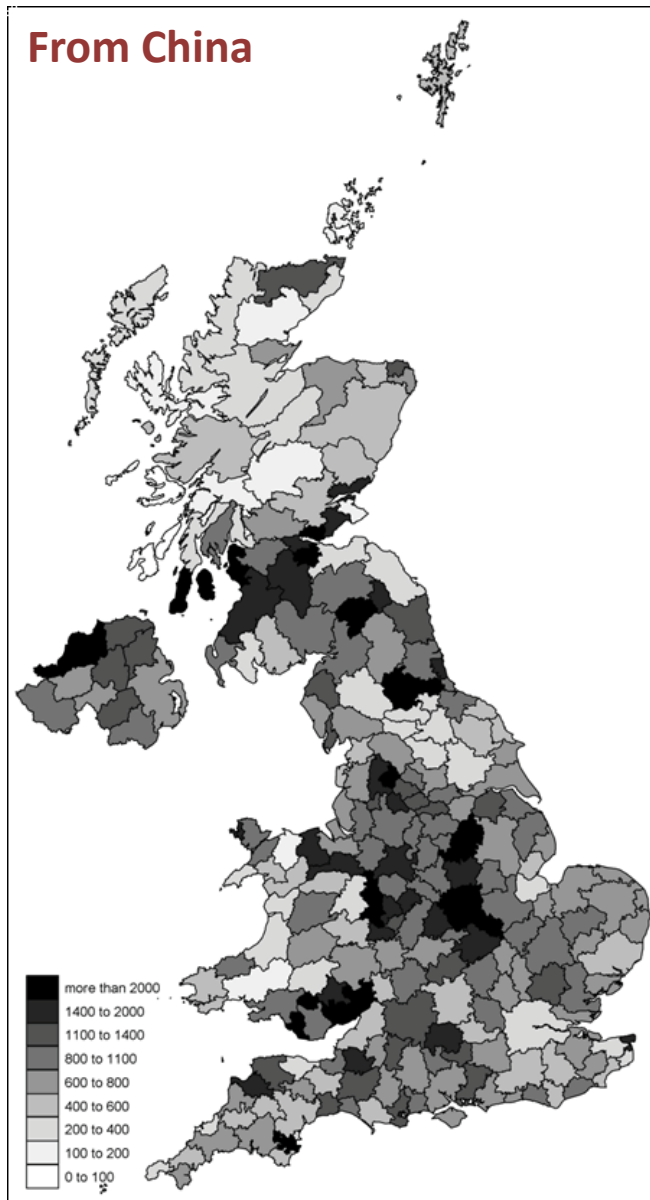
Source: OECD Structural Analysis Database and EUKLEMS.

- Between 2000 and 2015 the nominal value of UK goods imports has risen:
 - from China by a factor of 5
 - from the A8 by a factor of 6
 - from the world by a factor of 2
- Over the same period, we calculate that 40% of the rise in import penetration in UK manufacturing can be attributed to imports from China and the A8.



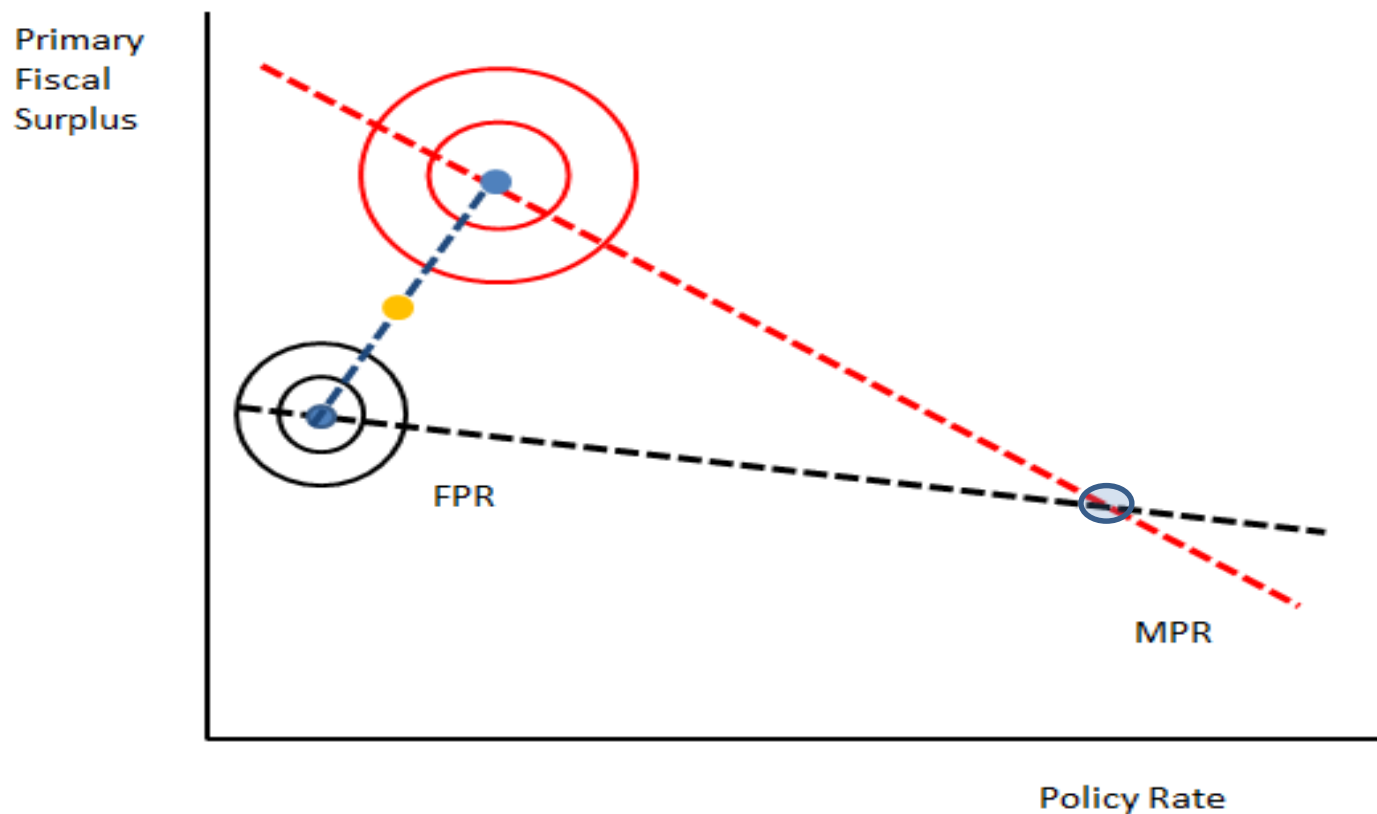
Geography of Import Changes

Change 2000/01 to 2014/15 in UK imports of manufacturing goods per job (£, 2007 prices)

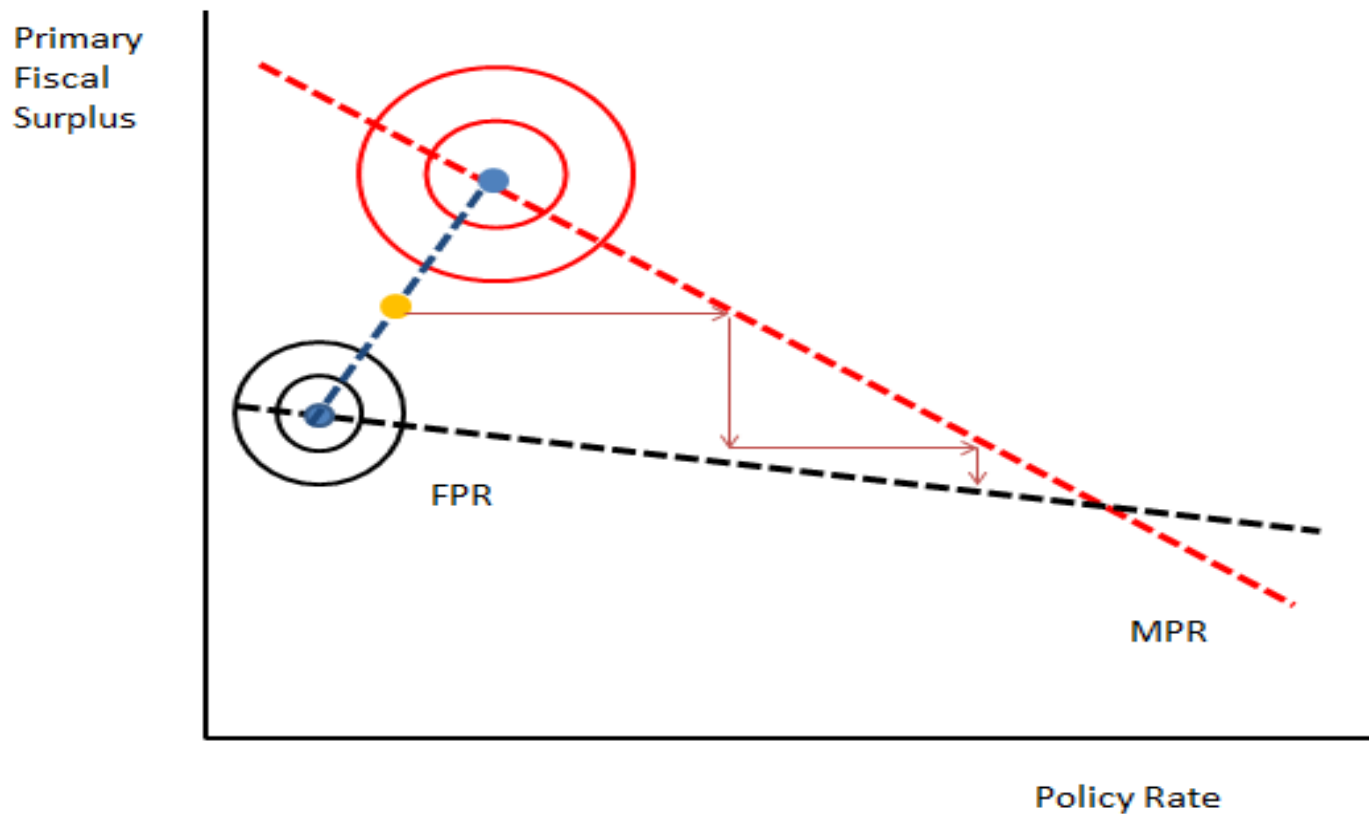


Source:
Business Structure
Database, COMTRADE,
authors' calculations.
Note: 24
TTWAs 2001 definition.

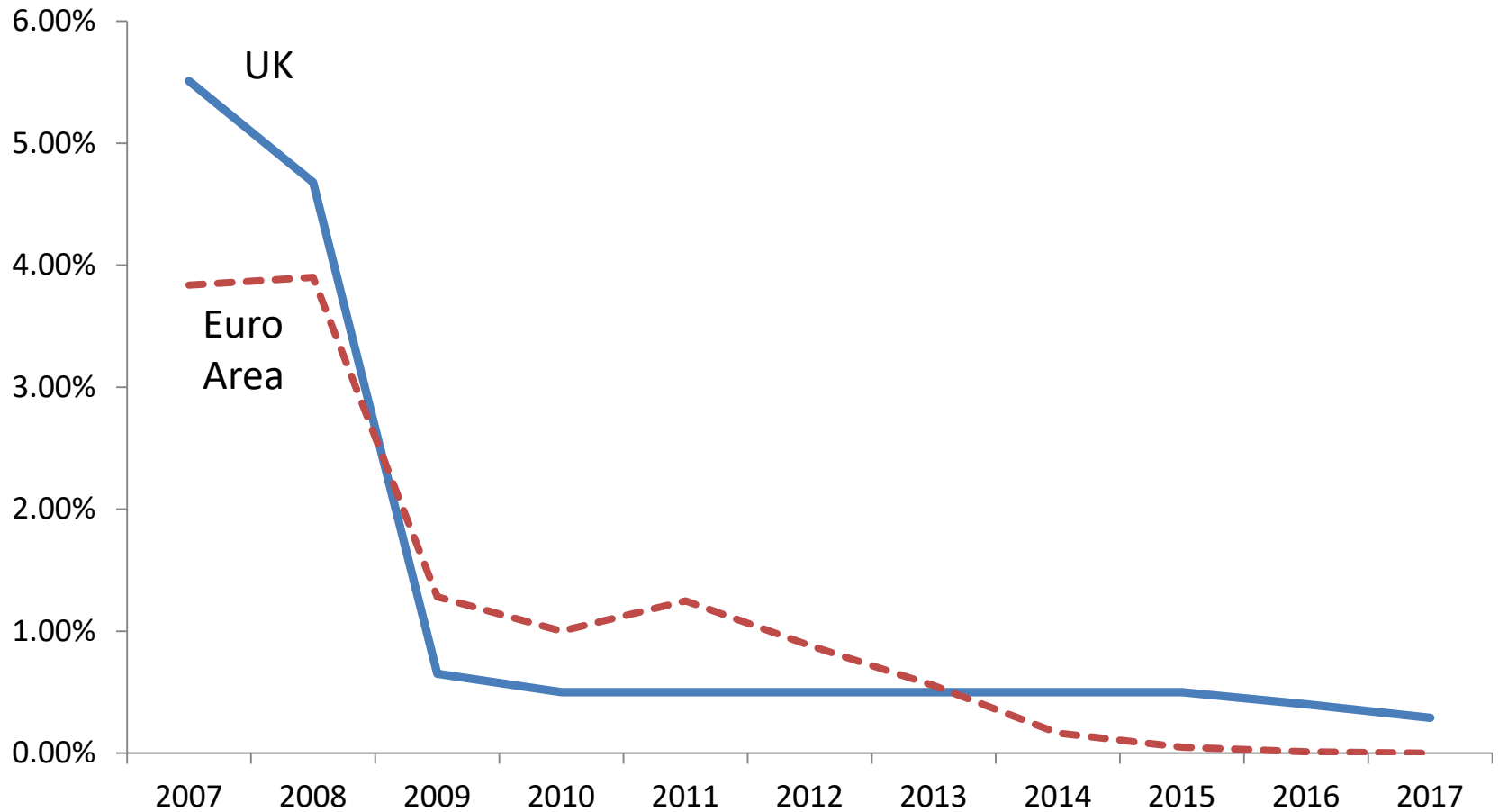
Contract Curves beat Mr. Nash



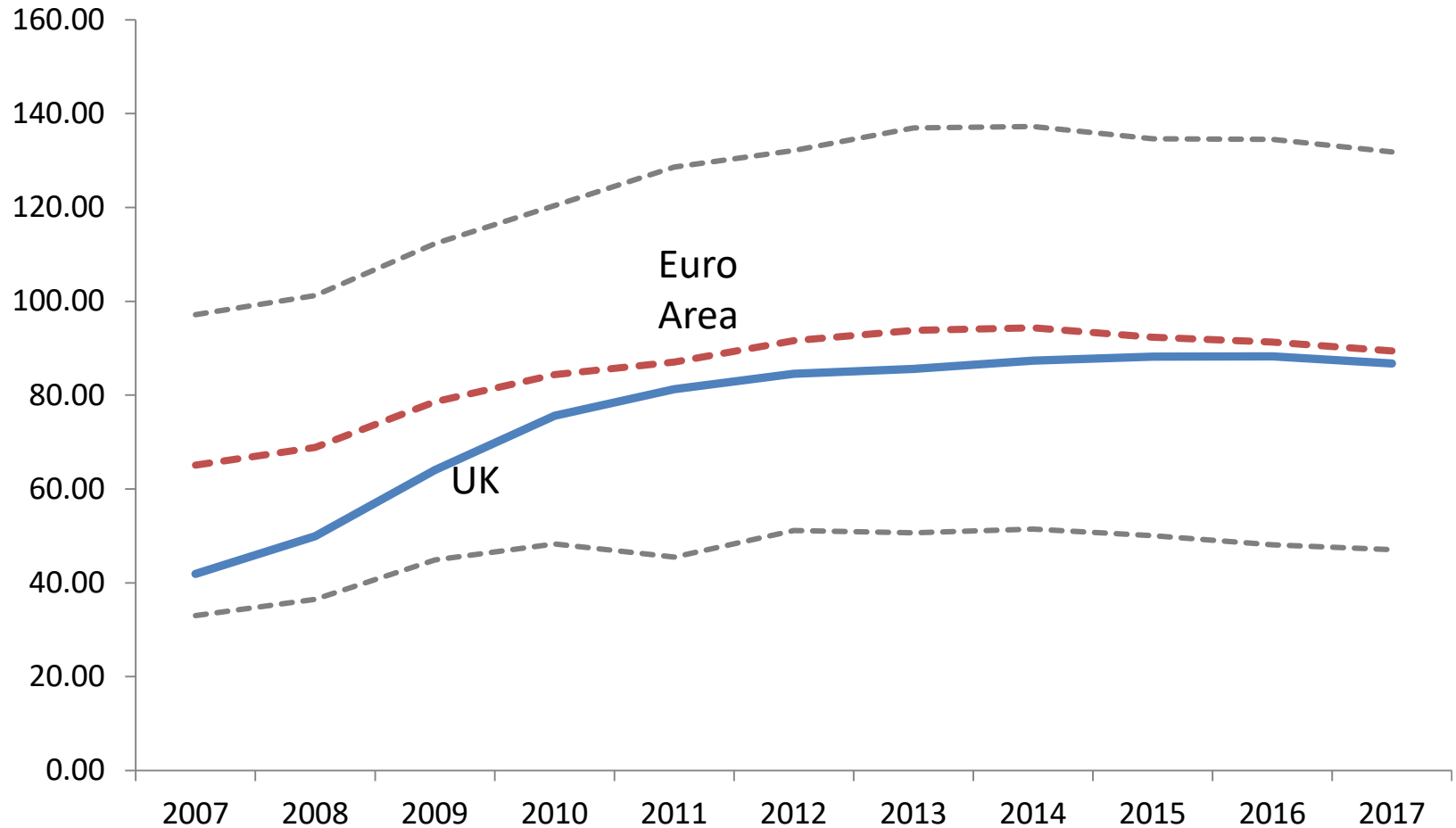
But Instability draws us to Nash



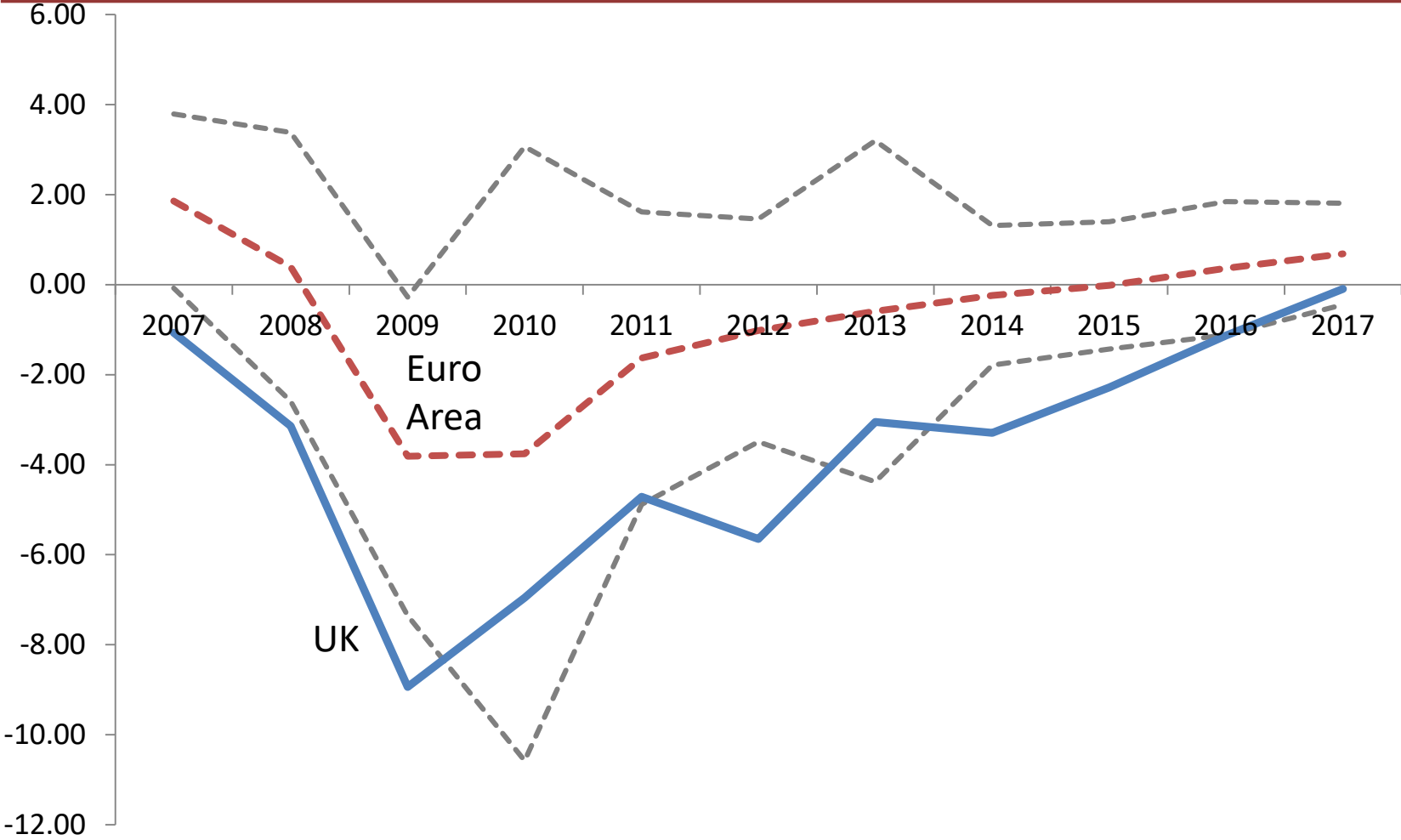
Policy Rates – post crisis



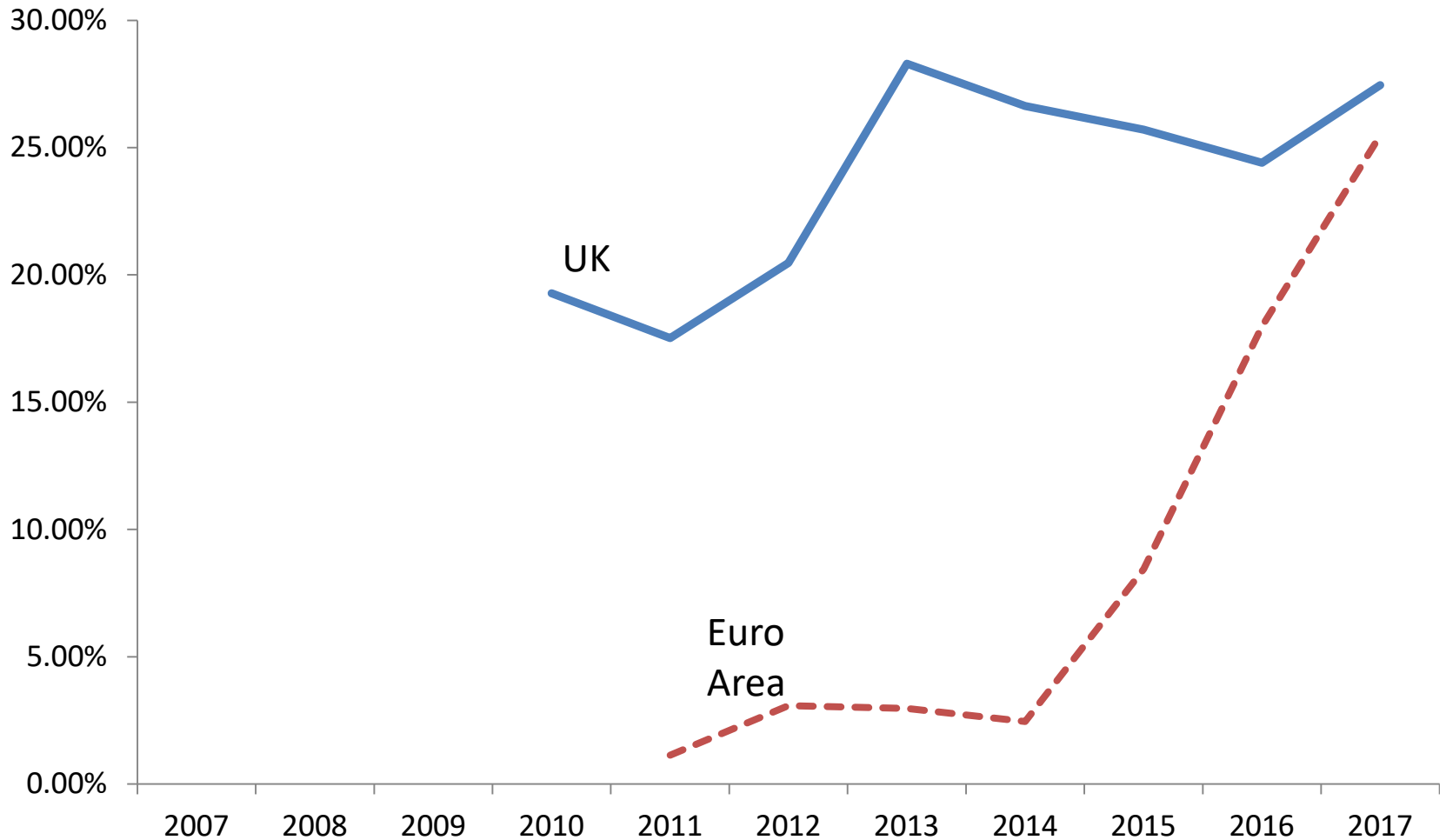
Gross public debt (percentage of GDP)



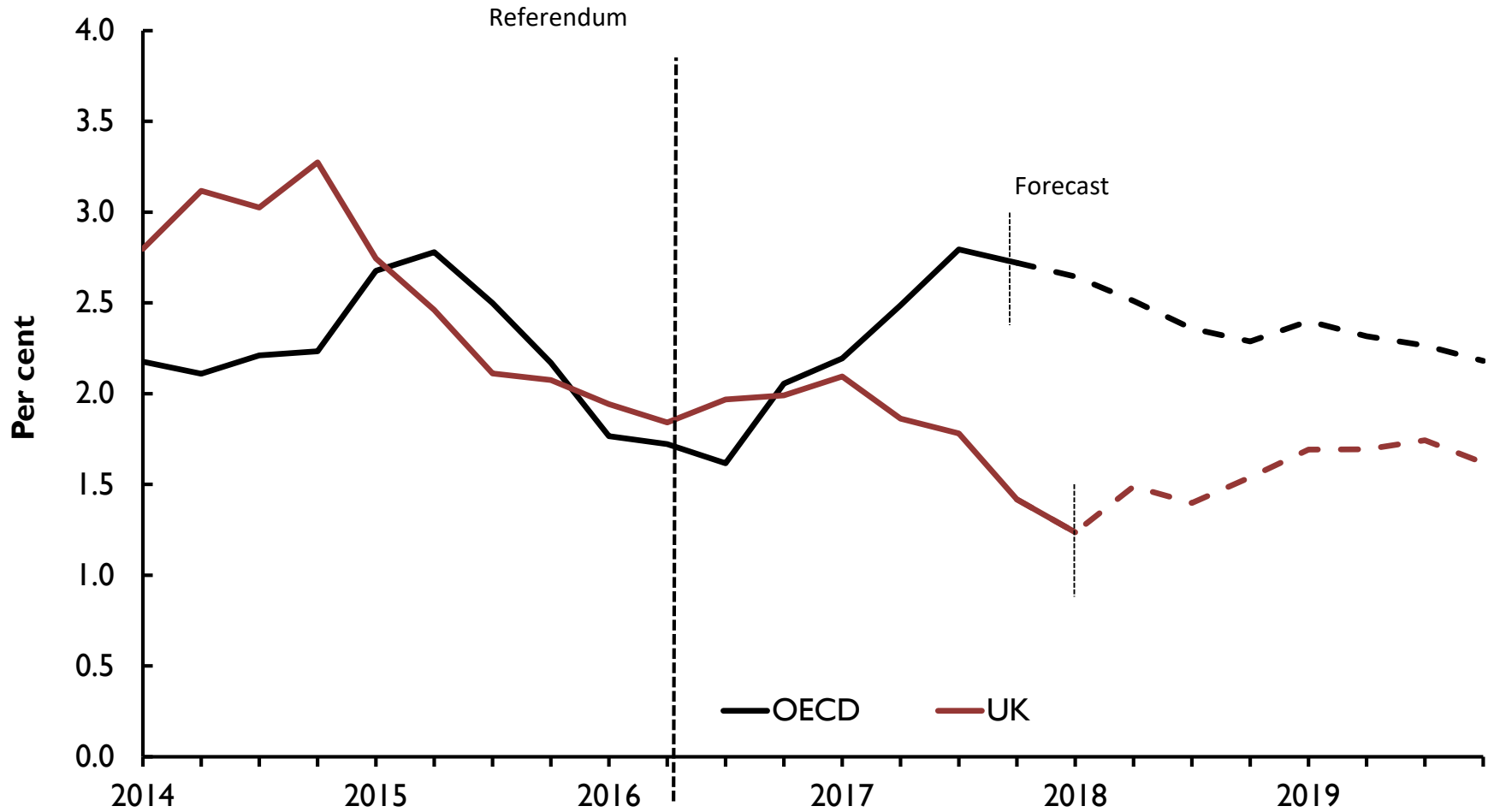
Government primary balance (percentage of GDP)



Percentage of public debt held by Central Bank



UK growth Vs OECD

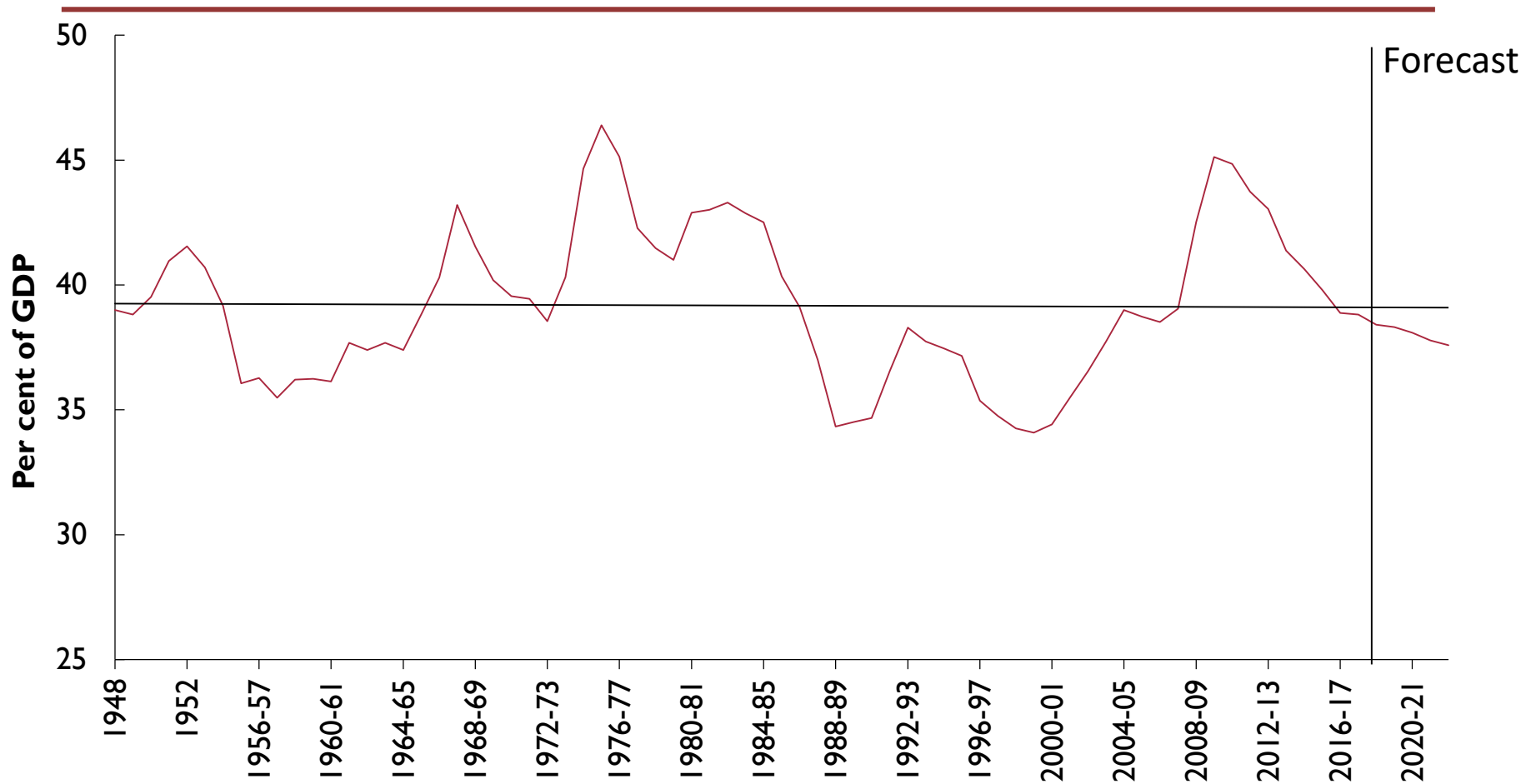


Fiscal targets and rules since the creation of the OBR

Year	Rule	Definition
2011	Fiscal mandate	Achieve cyclically-adjusted current balance by the end of forecast period (2015-16)
	Supplementary target	PSND as a % of GDP to be falling at a fixed date of 2015-16
2012	Fiscal mandate	Achieve cyclically-adjusted current balance at the end of the forecast period (2016-17)
	Supplementary target	PSND to fall as a % of GDP between 2014-15 and 2015-16
2013	Fiscal mandate	Achieve cyclically-adjusted current balance, five years ahead
	Supplementary target	Reduce PSND as a % of GDP in 2015-16
2014	Fiscal mandate	Achieve cyclically-adjusted current balance, five years ahead
	Supplementary target	Reduce PSND as a % of GDP in 2015-16
2015	Fiscal mandate	Borrow only to pay for investment- in the third year of the rolling five-year forecast period (2017-18)
	Supplementary target	Reduce PSND as a % of GDP in 2016-17
2016	Fiscal mandate	Achieve budget surplus in 2019-20 and beyond
	Supplementary target	PSND to fall as % of GDP each year
	Welfare cap	Spending below cash limits set in July 2015
2017	Fiscal mandate	Structural deficit below 2% of GDP in 2020-21
	Welfare cap	Spending below cash limit in 2021-22
	Supplementary target	Public sector net debt to fall as a percentage of GDP in 2020-21
	Fiscal objective	Achieve fiscal balance ASAP in next parliament (2022 or 2025?)



Total managed expenditure



Source: NIESR



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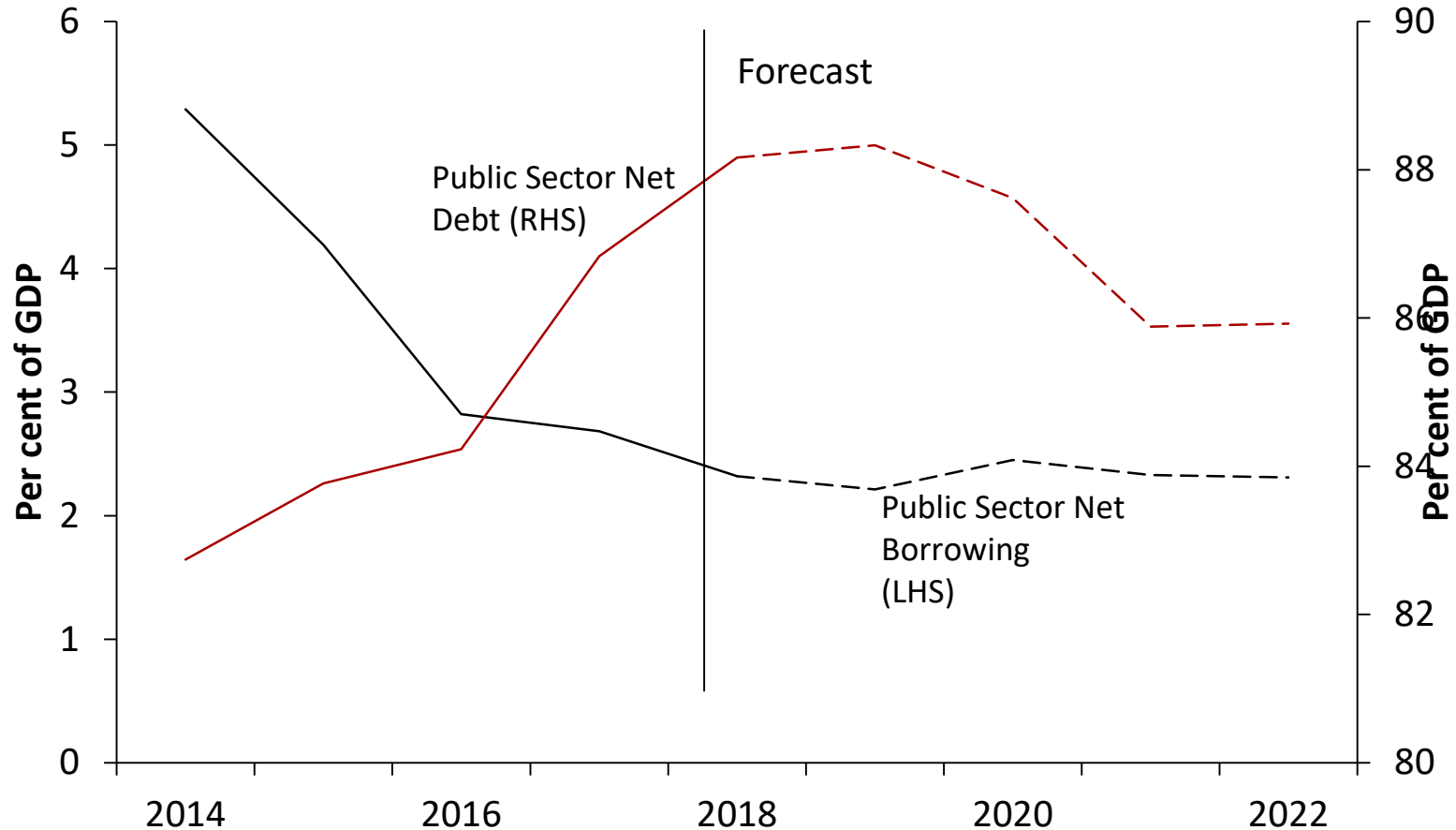
Government consumption: nominal



Source: NIESR, OBR



Public sector debt and deficit



Source: NIESR



Policy Conclusions

- Addressing the Productivity Trap requires the recognition that we have entered a "bad" equilibrium in the transition to new forms of production
- Monetary and Fiscal tools have concentrated on stabilising the economy and creating smoother aggregate responses but they have not helped this transition: lending is too property-oriented and fiscal policy needs to support public investment
- Regional, industrial and financial policies must balance support for fading industries and those vulnerable to a compression in EU trade against increasing opportunities for new firms
- The physical infrastructure of roads, rail as well as national broadband capabilities are in need attention and do not fear the building of more housing
- Bring forward plans to develop technical further education and work-related apprenticeships
- Institutional reform of government departments to meet the democratic deficit posed by globalisation
- Re-consider the question of corporate governance and the ongoing development of employees when in work.



The End.

"The British are absorbent, we put our own inventive stamp on all that we encounter. The British are open to all influences, we are a fusion of the best of many languages, cultures and philosophies with which we have come into contact over the centuries. In the age of globalisation, most countries are open to outside influences. So why are we different? More flexible, more pragmatic? Is it our geographical position, politics, monarchy? It is all of these things and yet none of these. We are actually British in a very subtle way: nationalistic but rarely demonstrating nationalism. We know we are British and so do not have to show it. However, being British there will be a multiplicity of opinion on being British about which we will have the right to disagree."

Anonymous, Pavement (outside Home Office), Marsham Street, London SW1

