

Why we need a new macroeconomic strategy

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Executive summary

Four years on from the financial crisis, the UK economy is still a mess. The government's economic strategy is not only failing on its own terms, it is damaging our fundamentally weak economy. The roots of our current problems lie beyond the credit crunch; in the UK's dangerous dependence on a large financial sector, poor current account, low productivity and uneven regional development. It is time for a new macroeconomic strategy – one that is more equal, provides employment for those who want it, minimises our impact on the planet, and maximises our well-being.

Our approaching triple-dip recession was a direct result of the government's flawed economic strategy. The case for austerity rests on two false premises: that the previous government had been spending excessively, and the government debt and deficit are the main threat to our economic stability. But the real threat to stability lies in our financial system – which, following the crash, led the UK into recession, decreasing tax revenues while pushing up government debt

The government's austerity strategy was founded on two other incorrect beliefs. First, the Coalition assumed that the private sector would fill the gap created by public spending cuts. In fact, business investment has grown by less than a third of the rate the government forecast in 2011 and 2012 and shows no sign of rising to the levels required to prompt an economic recovery.

Second, the strategy relied on export-led growth. Despite the pound falling over 20 per cent in value since 2007, exports have been volatile, reflecting global uncertainties, and the trade deficit shows few signs of closing. We have little chance of attracting more European export sales, and our import dependency is increasing.

Austerity is the wrong response to a demand-led recession. With both households and firms reigning in their expenditure the multiplier effect makes it foolish for a government to behave likewise, particularly given the economic uncertainty abroad.

A longer term analysis of the overall state of the UK economy finds it to be fundamentally weak:

- **It is overly dependent on finance.** Our uniquely large, globalised, and poorly regulated finance system makes us particularly vulnerable to external shocks.
- **It is heavily indebted.** The UK's total indebtedness is continuing to rise, with the bulk of the UK debt burden arising from the private rather than the public sector.
- **Relative to other large developed countries, the UK is in a poor position to deliver future growth.** productivity growth in the private sector collapsed in the recession and failed to recover.
- **Britain is the most geographically unequal economy in the European Union.** Growth over the last decade has been heavily biased towards the South East. While Inner London is now the richest space in the EU, the Welsh valleys are poorer than Slovakia.

- **The UK's chronic trade deficit has been paid for by flows of finance from abroad.** The mutual reinforcement between demand for finance and demand for imports has turned into an economic deadlock.
- **Growth alone is not the best economic objective.** Better metrics for assessing economic policy based on work created, real median incomes, well-being and environmental damage would help shape economic policy better.

We live in a high-carbon, high-debt economy. It used to deliver growth. Now it cannot even manage that. There are clear barriers to growth, and, worse, growth itself is unlikely to deliver for the majority. But “Keynesianism” alone – boosting government spending – will not reverse the course when debts remain high and the underlying economy is weak.

It is essential we carve a new path, though it will take significant effort and expenditure to do. A successful new macroeconomic strategy must recognise the path dependency of our current situation and shift to a completely new mode of operating. The first steps to ensure this will require us to:

- **End austerity and sustain demand.** When no one else is spending, government has to. The government must act to create jobs, boost demand and redistribute wealth to the regions. Rising inequality and a falling share of wages in output are direct drivers of economic stagnation and must be reversed.
- **Shrink and reshape the financial system.** The UK's financial system is unsustainably large and requires shrinking: its balance sheets reduced relative to GDP, its employment reduced as a share of the workforce. Breaking up major banks would help them to operate differently, with a greater variety of financial institutions spreading risks and managing complexity better. Localising banks, diversifying ownership structures, and placing greater democratic and public control over banking functions will all help to transform the financial system for the better. Some debt cancellation is likely to be necessary.
- **Introduce capital controls.** By making movements of capital in and out of the UK more expensive, they become less desirable, reducing speculation. Measures like an emergency tax on capital inflows; unremunerated reserve requirements; legal restrictions on derivatives positions and restrictions on overseas ownership of residential property could manage the flows of capital to attract more stable investments.
- **Use Quantitative easing for productive activity.** The effects of QE so far have been to support the existing financial system. If, instead of piling new financial assets onto bank balance sheets, QE was used to inject cash directly into the economy, it could start to act to break our economic deadlock.

Introduction

Nearly five years after government bail-outs propped up the financial system to prevent total economic collapse, there has been no return to normality. Debts, accumulated during the years of apparent boom, remain high. Growth is stagnant or faltering. Further financial panic looms. All the while, the deterioration of the environment grows more evident daily.

No single policy can unpick this tangle of mutually reinforcing weaknesses, formed over decades. We need an economic *strategy*: a set of policies designed to break open the deadlock and set us on a better track.

Transfixed on reducing the debt and the deficit, the Coalition's current macroeconomic strategy is all too clear: austerity, extended far into the future.

This paper proposes a major change of course. It shows not just that austerity is counter-productive on its own terms, leading to widening deficits and rising debts, but that far from overcoming the UK's deep economic weaknesses, it builds on them.

Starting from the gloomy state Britain is in now, this report charts a path towards a new, and better, economy: one that is more equal, provides employment for those who want it, minimises our impact on the planet, and maximises our well-being.

It aims to show how the global features of this crisis have had their particular, national impact on the UK – and how, then, it can develop a particular, national response.

The failure of the government's economic strategy

Since its formation after the election of May 2010, the Coalition government has stuck ruthlessly to its central economic case: that austerity is the only route back to financial stability for the UK.

Austerity isn't working

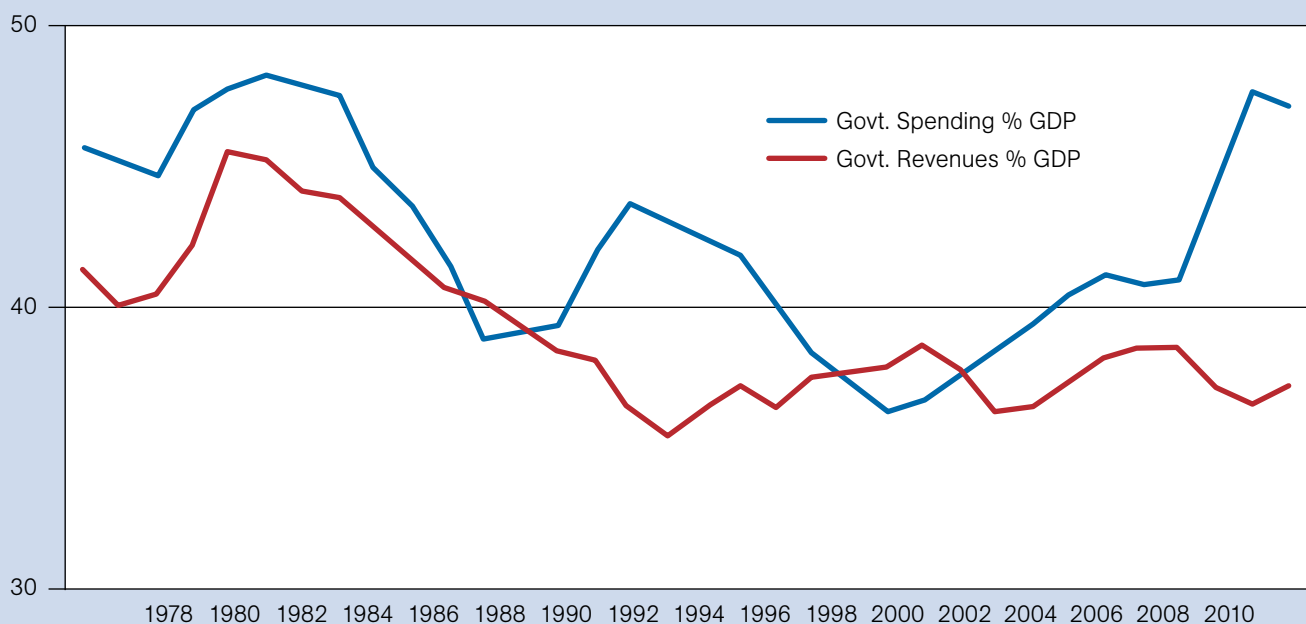
Austerity is the Coalition government's big-picture solution to the crisis. It argues that during the boom years, everyone (the government especially) spent too much, and so borrowed too much – resulting in a gaping national debt and deficit that we can apparently no longer sustain. The government must therefore repay its debts as quickly as it can or face economic calamity; and austerity – sharp cuts in government spending backed up by moderate tax rises – is how it proposes to do this.

This is arguably the worst single economic argument that any British government has ever been taken in by, let alone enacted into policy. On its own terms, it is close to economically illiterate, ignoring 80 years or more of theory and experience.

First off, the argument is built on the false premise that our previous government had been spending excessively, and in doing so increasing public debt and widening the deficit. In fact, as Figure 1 shows, the Labour government of 1997–2010 on average spent less (and taxed less) as a share of GDP than the two preceding Conservative governments.² Moreover, public expenditure has been falling relative to GDP ever since the 1970s. So quite contrary to the myth, New Labour was by historic standards a low expenditure, low taxation government.

Second, the Coalition's argument frames debt and deficit as public enemy No. 1, when the main threat to our economic stability lies in the structure of our financial system. Last time this system unravelled, the fallout was disastrous:

Figure 1. Government spending and revenues as % of GDP, 1978–2010.



Source: HM Treasury

- Following the collapse of Lehman Brothers in 2008, the government was faced with total disintegration of the financial system. It believed it had to take on immense new liabilities and borrowing and offer support to a stricken financial sector. The total cost of propping up the banking system, according to the Bank of England, was £1.278 trillion, including both direct and indirect support.
- By panicking banks and others into cutting back on their lending, the financial crash triggered an immediate and very sharp recession. Box 1 explains how this 'credit crunch', through the multiplier effect, led to severe stagflation and rising public costs. The collapse, incidentally, had nothing to do with 'excessive' public spending: as Figure 1 shows, rising spending from 2001 had levelled off by 2006.

Third, austerity is no way to end a recession, and has failed. In fact, in the circumstances, it is the worst possible course of action that the government could have followed. With both households and firms reining in their expenditure, it is plainly foolish – given the multiplier effect – for government to behave likewise.³ And with economic uncertainty prevailing globally, exporting abroad can be by no means relied upon to deliver a boost at home, as claimed for those dubious austerity 'success stories' of Canada in the 1990s, and the Baltic states today.⁴

The unprecedented triple-dip recession was a direct result of government policy. Right up until the Coalition began to ratchet up austerity measures, the UK was beginning to recover from the immediate shock of 2008 (Figure 2).⁵ Now, estimates by the National Institute of Economic and Social Research (NIESR) suggest 5 per cent will be wiped off UK GDP by 2013 as a result of austerity, while the IMF's chief economist now admits that 'stronger planned fiscal consolidation has been associated with lower growth than expected'.^{6, 7}

Box 1. The recession: What happened?

By panicking banks and others into cutting back on their lending, the financial crash produced an immediate and very sharp recession. This 'credit crunch', and accompanying economic uncertainty, caused both households and firms to rein back their spending. Household consumption fell by more than in any previous post-war recession, while investment spending fell by more than £40 billion in real terms since its 2007 peak.

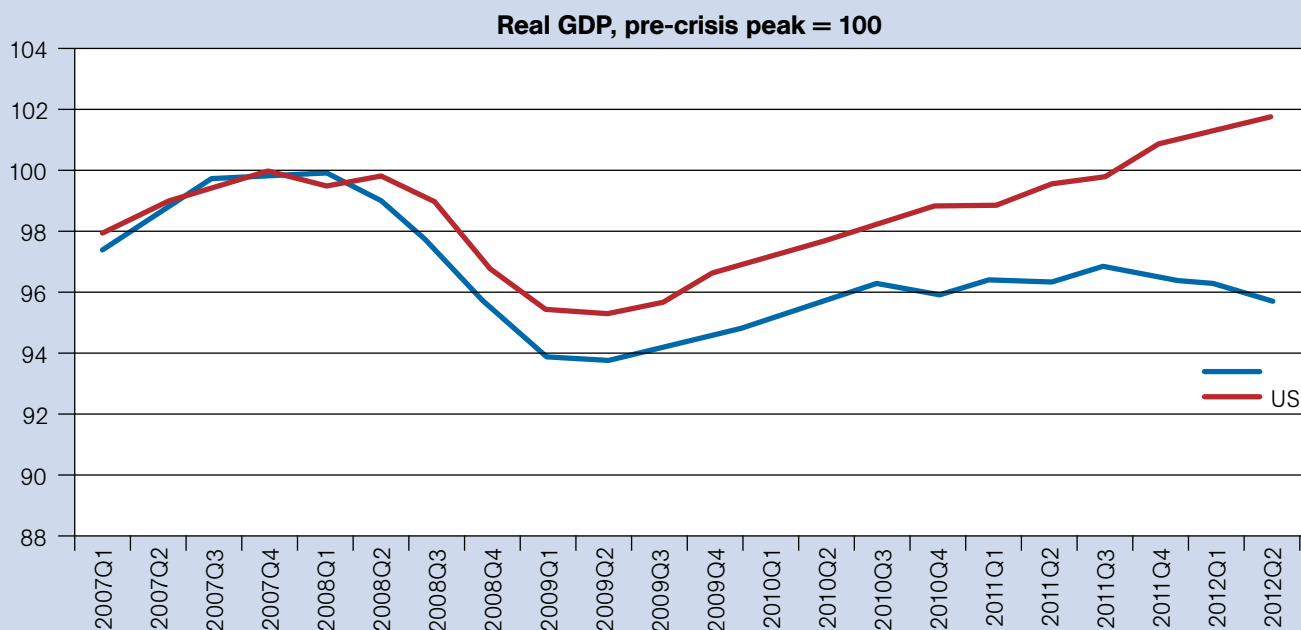
This feature of the recession is essential to understanding what happened next. Both firms and households, as we have seen, had become increasingly indebted during the boom years. When credit conditions turned sharply against further borrowing, preventing firms and households continuing to roll over their debts as they had done, they looked immediately to pay down their debts. They did this by reducing their spending, and paying off their creditors as best they could.

While it makes some sense for an individual household or firm to pay off their debt, it is disastrous for the economy as a whole. Across the whole economy, what one individual spends is necessarily what another individual earns – money spent has to be earned somewhere. So if someone cuts their spending to repay a debt, it means someone else is earning less. If they are earning less, they, too, will cut their spending. The effect of the initial fall in spending is magnified by this process, known as the multiplier effect.

This multiplier effect means that if both firms and households are cutting their spending, others are earning less, and so the whole economy is pulled backwards. A sharp recession broke out, of a kind that had been seen before. Richard Koo, investigating Japan's recession of the 1990s, called this a 'balance sheet recession', when heavily indebted firms and households look to shrink their debts, cut their spending, and so produce a shrinking of the economy overall. The UK is going through the same process today, resulting in 'prolonged stagnation'.

Its impact on public finances has been dramatic. The sharp increase in government spending as a share of GDP in 2009 is the direct impact of a recession both shrinking real economic activity and pushing up necessary spending on unemployment benefits.

Figure 2. Real GDP.



There has been no private sector led recovery

So what did the Coalition *think* would happen as a result of austerity? We can draw some clues from the first set of forecasts and accompanying economic commentary produced by the Office for Budget Responsibility (OBR) in 2010, set up shortly after the general election by George Osborne, purportedly to overcome the politicisation of official economic forecasts.⁸

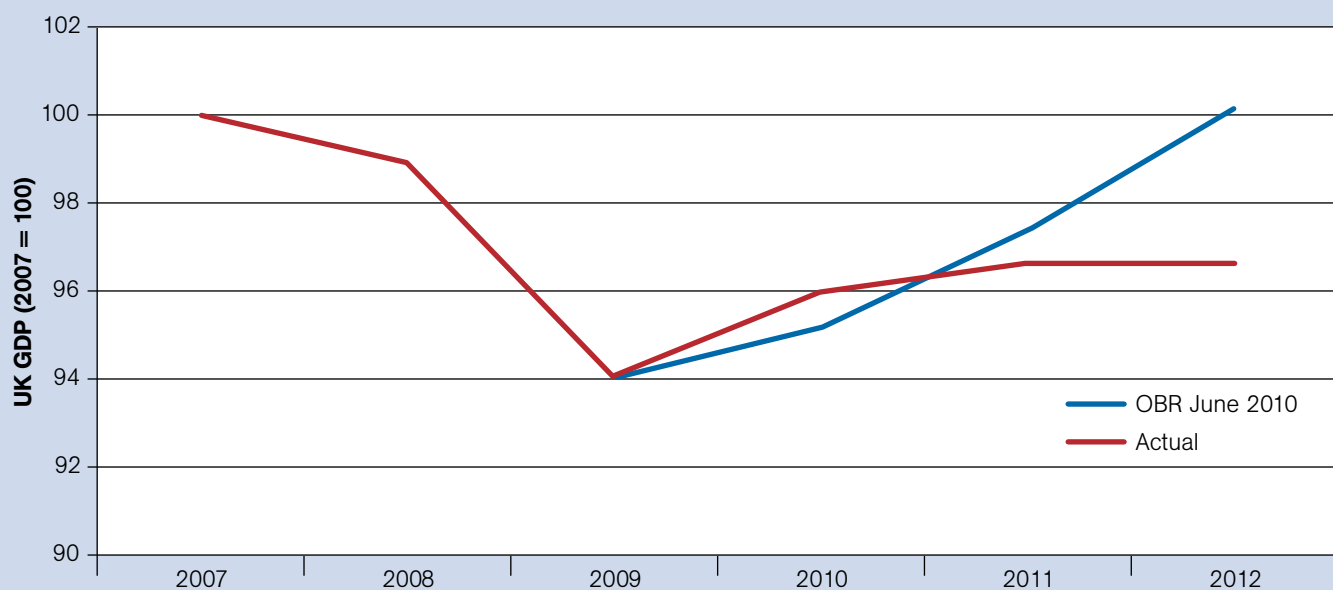
These now make for ironic reading. While acknowledging the demand-shrinking effect of sharp government spending cuts, the OBR proposed that these were nothing to be feared. In the place of government spending, its forecasters confidently expected a rebound in the private economy. The private sector would roar ahead, driven by an investment boom so great that it would overwhelm the depressive effects of the spending cuts. All this would be assisted by a steep recovery in exports. By 2011, the OBR predicted, the whole economy would be growing by 2.3 per cent, rising to 2.8 per cent in 2012 (driven by a business investment growth rate of 8 per cent in 2011 and 10 per cent in 2012). In short, the recovery rate would be faster than that achieved after any recession since the Second World War.

All this would drive a rapid return to economic growth in which the private sector, not the public, would dominate: just the economic 'rebalancing' that the Coalition wanted. The economy would be weaned off public spending and private consumption, with investment and exports leading the way. That would mean a few squeezed years on real living standards for the majority, but with the compensation of a healthier, more competitive economy by 2014, driving average earnings growth of 4.3 per cent in that year.⁹ The share of national income taken by labour would continue to decline, as it had done for decades, but a faster-growing economy would compensate the workforce.¹⁰ Shaking out and restructuring driven by austerity in the public sector, although painful for most, would be glossed over by a rapid return to boom conditions.

This was an implausible story even at the time. It now looks risible. Business investment in 2011 grew by just 0.8 per cent, and is expected for 2012 to be around 3.5 per cent – around one-third of the rate predicted. The whole economy, far from rebounding to health, flopped back into recession and continues to flounder. Figure 3 shows the prediction – and the reality.

The government's core narrative, as expressed in the OBR reports, has failed. There has been no significant private sector recovery. That failure, in turn, is driving the failure of its stated core economic objective: to reduce the national debt and the deficit through a programme of severe austerity measures.

Figure 3. Official forecasts vs. reality of GDP recovery.



Export-led growth has floundered

The other driver in the Coalition's forecast was international trade. The key to its story was a recovery in international competitiveness, driven by a reduction in the UK's relative costs: the pound has fallen around 30 per cent in value since 2007, making UK exports cheaper for those abroad.

The Coalition predicted this would lead to the UK selling more abroad, helping shrink our trade deficit – the gap between what an economy imports, and what it exports. This has not happened. Exports have been volatile, reflecting global uncertainties, and the trade deficit reached record levels over the summer. It has since closed, the deficit falling from £4.8 billion in June to £1.5 billion at the end of July – largely as a result of the good, if declining, fortune of North Sea oil. Nonetheless, the general pattern of stagnation is clear, as demonstrated by Figure 4, which shows the UK current account (defined in Box 2) as a percentage of GDP, since 1979. The deficit is clearly chronic, and shows few sustained signs of closing.

The trade deficit in goods alone reached an all-time high over last year, at £100.3 billion in real terms, partially compensated for by a surplus of service exports.

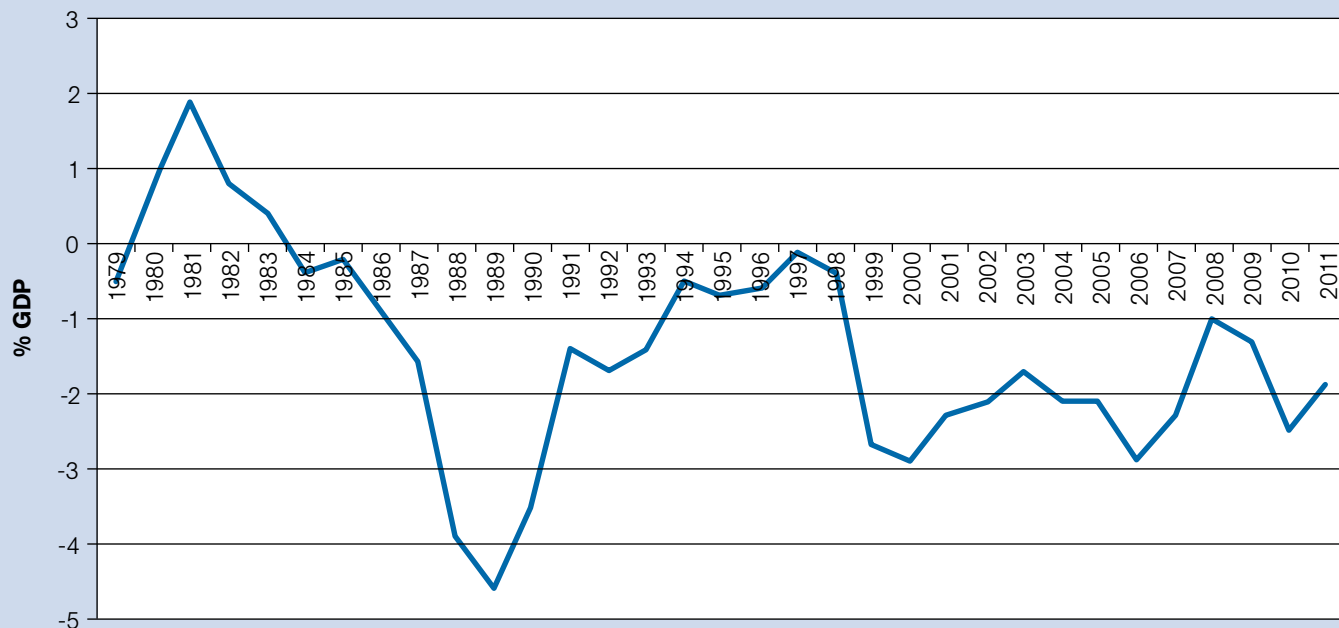
So why didn't the devaluation of the pound bring about a boom in exports, as expected? The answer is simple: the flip side of UK goods costing less abroad is that imports from abroad cost much more here in the UK. Although we may sell more exports, they will not earn enough to cover the increased costs of the imports we are consuming at home. After all, in response to the changing prices of internationally traded goods and services, those consuming imports at home will in general carry on buying them, while those buying UK exports abroad may take time to switch to buying cheap UK exports.

The result of this is a widening deficit. When supply chains are internationalised, the effect can be simply to immediately increase the price (due to the falling pound) of necessary imports for producers, while overseas sales take far longer to adjust to falling prices.

Box 2. What is the UK current account?

The current account measures trade in both goods and services. It is the sum of the balance of trade (export earnings minus purchases of imports), factor income (income from foreign investments minus payments to foreign investors), and cash transfers.

Figure 4. UK current account, as share of GDP.



And this is nothing new: currency devaluations have led to worsening current account deficits several times before. Harold Wilson’s 1966 devaluation, for instance, worsened the trade situation decisively.¹¹

This deficit should, all things being equal, gradually close over time as consumers adjust their spending away from (expensive) imports and those abroad buy more (cheaper) UK exports.¹² The September 1992 devaluation, following the UK’s exit from the Exchange Rate Mechanism (ERM), had this impact – as can be seen in Figure 4 – with the current account deficit starting to head back towards a balance.

This gradual closing of the trade gap is not guaranteed, however, and has in the past been problematic. Since the Second World War, when governments have attempted to boost the domestic economy either by relaxing credit controls and setting low interest rates or (less often) deliberately loosening fiscal policy, the result has also been to force the current account still further into deficit. With increased disposable incomes, firms and households in the UK have simply chosen to buy more from abroad – increasing imports and worsening the deficit. As a result, governments have then reined in activity again by tightening monetary policy and pulling back on spending.

This swing between loose and tight policy has been dubbed the ‘stop-go’ cycle, in which successive governments have aimed for domestic expansion but run up hard against constraints imposed by the UK’s position internationally.¹³

But what is truly unique about the UK government’s current strategy is that, committed to the exact reverse of a domestic expansion in spending, it is managing to produce the same results as post-war governments while aiming at precisely the opposite target. We have precluded the stop-go cycle but instead arrived at a stop-stop: a government committed to austerity in a recession that finds its clampdown on domestic activity reinforced by the UK’s international position. That failure to improve the UK’s international position in turn places further pressure on domestic real incomes.

The UK’s largest trading bloc, the Eurozone (covering around 40 per cent of our international trade) is also in worsening recession and pushing hard at austerity. As a result, we have little chance of attracting more European export sales. Finally, the UK is also a growing net importer of energy and of food, with import dependency from all energy sources rising to 36 per cent of total domestic availability last year.¹⁴ As North Sea oil and gas supplies decline, this situation will worsen – notwithstanding the dubious benefits of expensive shale gas.¹⁵

The state of the UK economy

The UK, possessor of a uniquely large, globalised, and poorly regulated financial sector, was the worst affected by the crash of any major economy.¹⁶ Its recession was the sharpest and its bailout was the largest, relative to GDP.

Dependent on the financial system

During the crash, financial systems everywhere turned in on themselves. Financial flows into the UK economy, which had been critically responsible for sustaining the apparent prosperity of the boom years, reversed sharply, falling from an inward investment of £1074 billion in 2007 to a *disinvestment* of £490 billion in 2008, as those resident elsewhere ditched UK financial assets in enormous volumes.¹⁷ These outflows, driven by depositor withdrawal from UK banks and the disposal of financial assets held in UK accounts, were matched by a similar withdrawal from abroad by depositors and institutions based in the UK.

The fact that UK domestic consumption is so dependent on international flows is dangerous: it means that sharp shifts in international financing act as a direct constraint on the domestic economy.

But aside from the vulnerability to external shocks (or, for that matter, shocks arising entirely from the financial system's own baroque practices) there is a longer-term problem: external financing will continue to flow into the UK for as long as it can offer acceptable rates of return, relative to elsewhere. For nearly two decades, assisted by complaisant politicians and the seeming ability of the UK's financial sector to offer high rates of return for low degrees of risk, this has been the case. Finance has willingly flowed into the UK, and flowed out only when subjected to a major shock in 2008. Otherwise, since 1991, the UK has been a net recipient of financial flows, resulting in those abroad piling up financial claims against the UK economy.

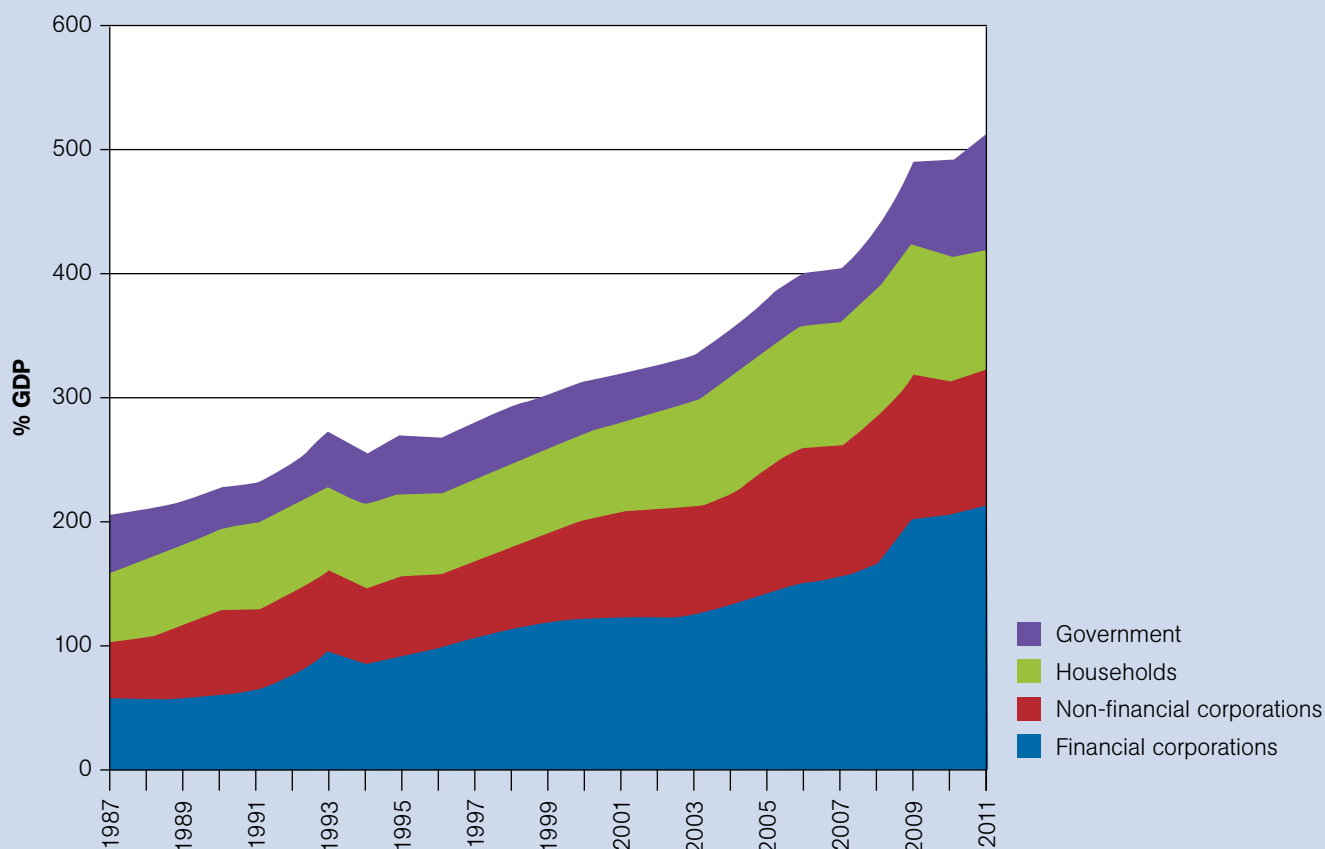
But if, for instance, it becomes apparent that the stock of claims held by those abroad is now too large to be supported by economic activity that flow will dry up. This will leave the whole economy deeply exposed, because the most likely response of our financial system will be to drag up interest rates in an effort to draw in capital – hitting households and firms in the process. Should growth not recover, it will become increasingly apparent that the UK cannot sustain the huge volume of external claims now held against it. As rising interest rates further choke off growth, a vicious circle will be set in train.

As long as the UK remains dependent on external financing, it is vulnerable to a long-term decline in that financing; and as long as the UK retains a major financial centre, it is permanently and excessively exposed to fluctuations in the global economy. Either option is troubling. The capacity of financial activity to exaggerate rather than dampen shocks is a further cause for concern, particularly if we believe that the general picture for at least the next few years is likely to contain significant international financial uncertainty. The Eurozone remains the single biggest risk in this respect, and is likely to do so for some time.¹⁸

Heavily indebted

The UK's *total* indebtedness is continuing to rise. Indebtedness is about more than the so-called national debt, which covers only the debt of the government. Households, corporations, and financial companies are all enormously in debt. The total debt of these different sectors of the economy has risen unstoppably in the last two decades and at an accelerating rate over the 2000s. It stood at 310 per cent of GDP in 2000, already higher than any other major economy with the exception of Japan. By 2008 (before the crash) the UK's total debt had climbed to 487 per cent of GDP – higher than Japan.

Figure 5. UK debt liabilities by sector, 1987–2011.



Source: National Statistics (2012) Blue Book.¹⁹

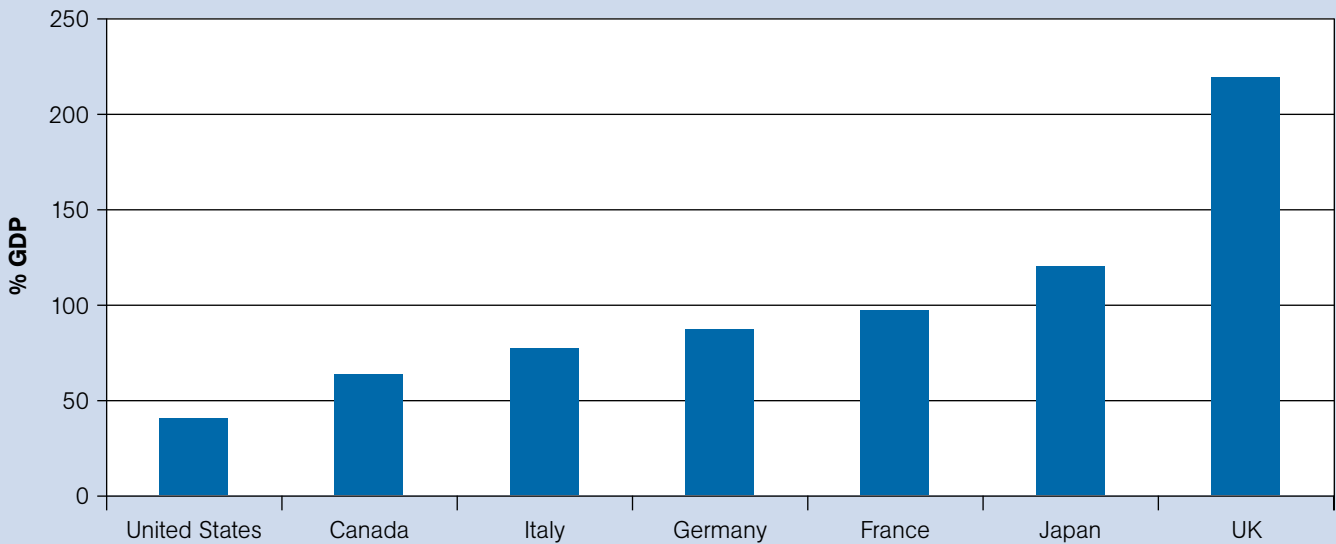
Since the crash, and despite the efforts of households, firms, and government to remove their debt, this burden has actually continued to rise, hitting 511 per cent of GDP. Britain vies with Japan as the most highly indebted major developed economy in the world.

This is not, however, as a result of government debt. The UK's public debt is around 81 per cent of GDP – higher than has been typical in the last few decades, but significantly lower than the G7 average of 105 per cent of GDP. It is only slightly above the USA, on 80 per cent, and below Germany on 83 per cent. It is currently below Reinhart and Rogoff's widely cited figure of 90 per cent, above which (it claims) economies will start to experience difficulty in financing growth.²⁰

The bulk of the UK debt burden, instead, arises from the private sector. UK households are the most heavily indebted of any major economy, holding debt to the value of 98 per cent of GDP. Its non-financial corporations are second only to Italy in their debt holdings, on 109 per cent of GDP. But truly spectacular is the debt held by the UK's financial corporations. Banks and other financial institutions hold debt to the value of an eye-watering 219 per cent of GDP. This increased from 47 per cent in 1987 (at the beginning of the period of deregulation) to 122 per cent in 2000, and then accelerated upwards to today's figure. The crash of 2008 made little difference to this: UK financial corporations' debt has risen from 209 per cent of GDP that year by a further 10 percentage points.

To put this in perspective, a recent IMF paper found robust evidence, from a range of countries, that private sector debt above a threshold of 80–100 per cent of GDP had a directly negative effect on growth.²¹ Even without including the financial sector, the UK's private debt is currently 205 per cent of GDP. Meanwhile its financial sector debt alone is the highest of any G7 economy, and by some distance.

Figure 6. Financial sector debts, G7 economies, 2011 Q2.

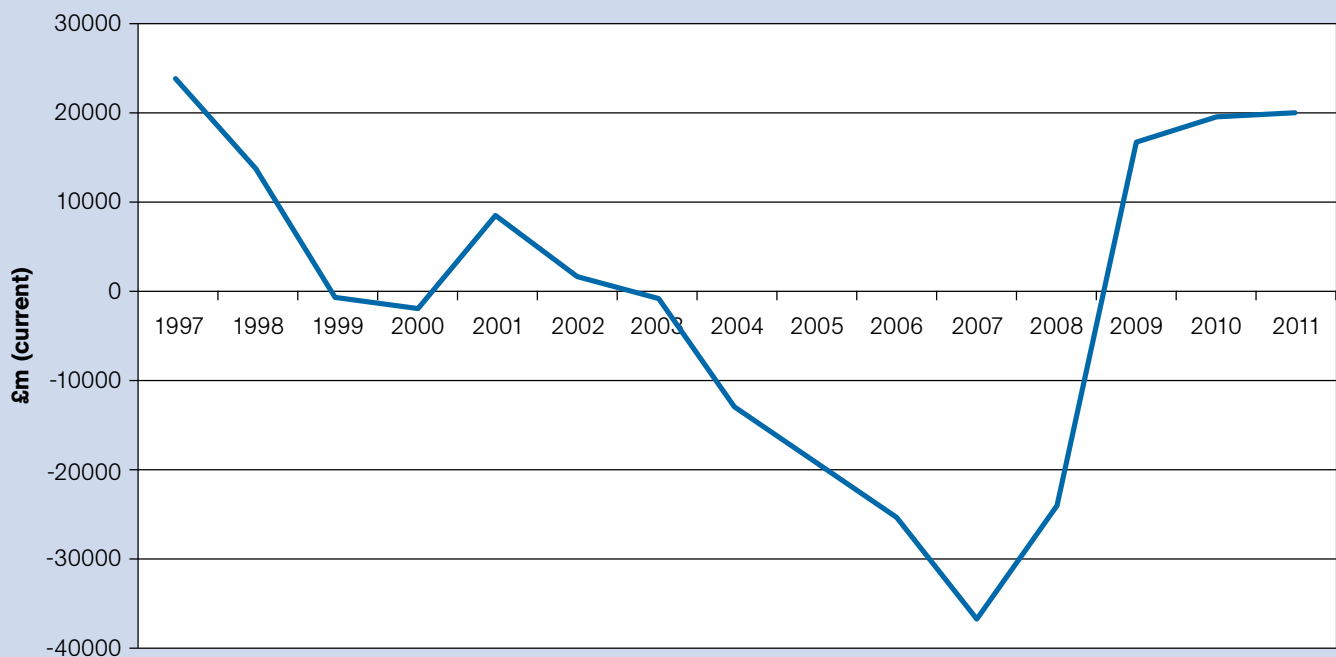


Source: McKinsey Global Institute (2012) Exhibit E4

Government debt, too, is still growing. Because the deficit – the gap between what the government spends, and what it takes in, in taxes – is still wide, and because the Coalition is failing to close this gap, the UK's public debt burden will continue to grow into the future. But it is not rising as fast as *total* debt, which is being pushed upwards by the financial sector.

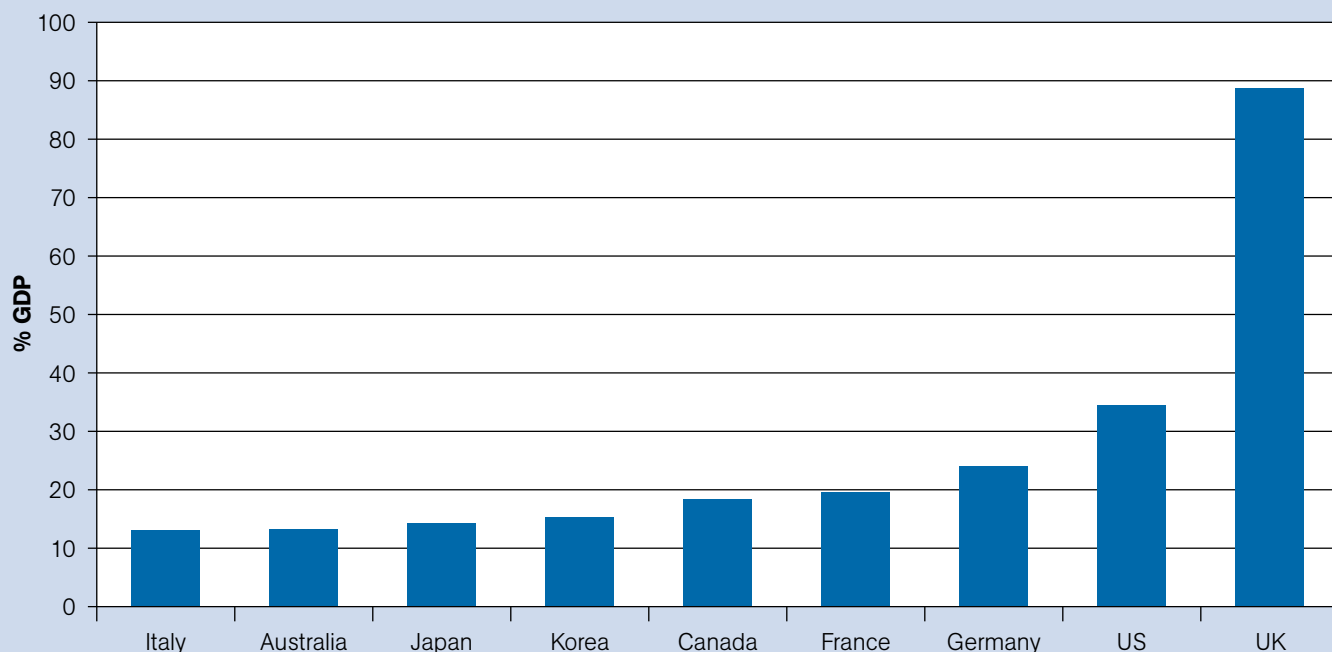
Households are attempting to repay their debts. Figure 7 shows the very sharp swing by households from negative net savings (borrowing, in the aggregate) to positive savings, as heavily indebted households attempt to repay their debts. But since the aggregate effect of this flow of repayments is to undermine the economy, their debt position is barely improving, with household debt (unlike that of other heavily indebted countries) scarcely declining, relative to GDP.

Figure 7. UK net household savings, 1997–2011.



Source: ONS (2012), Blue Book 2012, Table 6.1.6

Figure 8. Support pledged to the banking sector, 2009.



Source: IMF (2010) A fair and substantial contribution by the financial sector: final report for the G-20, Table A1.4

Our country's *total* debt burden matters because, as 2008 proved, governments may be forced to bail out heavily indebted financial institutions to enable them to continue functioning.

The IMF estimate the total cost to the UK of bailouts during the credit crunch to be £1.28 trillion – about 88 per cent of GDP. To put this in perspective, The Fund's estimate for the global costs of government bailouts is £6.8 trillion. The UK figure, more than twice the US equivalent, is the highest cost, relative to GDP, for any large developed country.²²

This exceptional cost of our bank bailouts was a direct result of the size and reach of the UK's financial sector. The crisis both pushed up national debt, through the bailouts, and led to a widening of the government deficit as a result of the recession. A crisis of *private* finance, emerging in the financial system itself, was not ended but transformed into a burden for *public* finance; and through austerity, the immense cost of the transformation is now imposing itself on society.

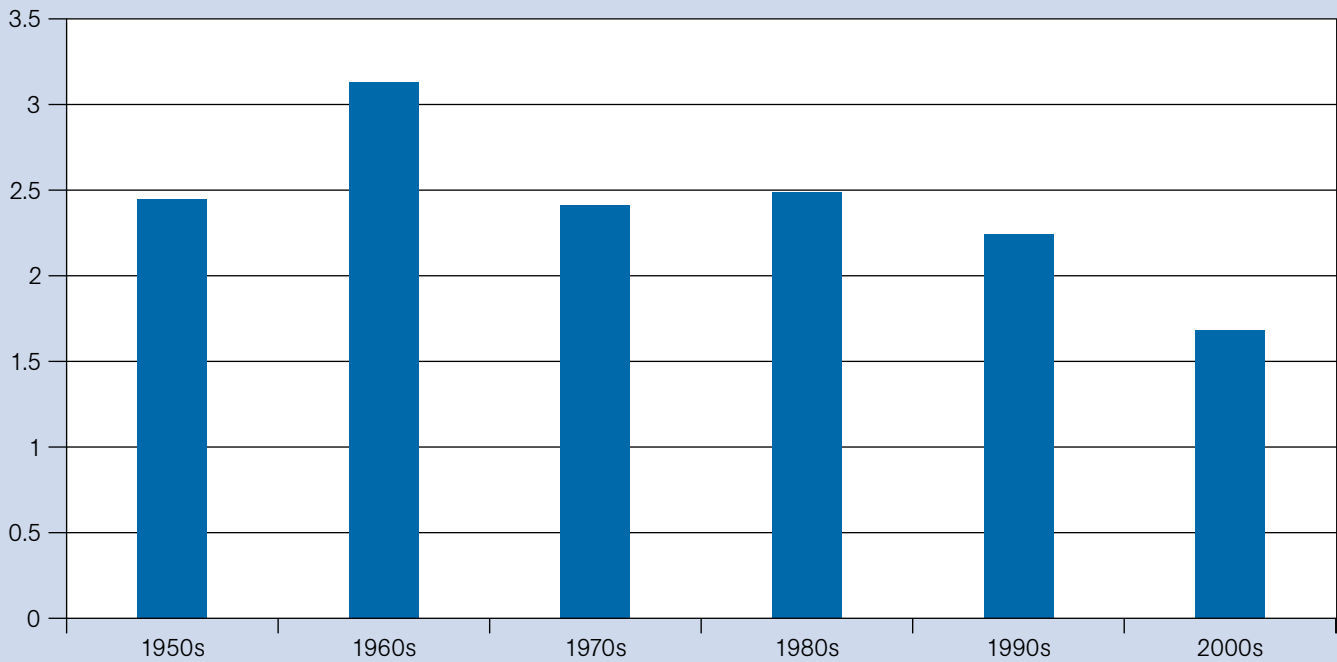
What the bailouts revealed, in dramatic fashion, is that risks apparently residing with private institutions can suddenly present themselves on the public balance sheet. What previously might have been considered an immutable barrier between private and public sector finances can suddenly disintegrate; debt created by the private sector and held outside of direct government control can be forced onto the public.

What is more, the apparently private (but essentially public) risks are amplified by the size of our financial system. Empirical evidence suggests a direct correlation between the size of a financial sector and financial volatility.²³ So as the financial system grows, it becomes more unstable.

Despite the fact that this ever more precarious pile of debt is a threat to the whole of society, it is not subject to the same standards of management or control as public sector debt. And while the UK public sector has a long history of successful debt management (the UK is one of only six countries in the world to have not defaulted on its public debt in modern times), the UK private sector has not, with private financial crises having occurred on a regular basis.²⁴

As it stands, UK financial corporations are exposed to at least one major source of external risk. They have lent £198 billion to the crisis-hit countries of Portugal, Ireland,

Figure 9. UK GDP growth rate, by decade since 1950.



Source: Bank of England figures

Italy, Greece, and Spain (a figure that excludes the potentially large contingent liabilities from the Eurozone that may reside in UK institutions, like credit default swaps and other forms of insurance against financial events). Only France has a larger direct exposure to high-risk euro debt.²⁵

Any future crisis in private finance can lead rapidly to an expansion in our public, sovereign debt. The burden of the crisis last time, now imposed on wider society through austerity, was huge, but not unbearable. Further crises will impose further burdens on a weakened economy.

It is highly unlikely that the UK economy, and therefore the UK state, would have the capacity to cope with another financial crisis of anything near the scale we have seen recently. It would not be able to summon up the resources needed to do so without creating exceptional additional costs. Researchers at the IMF have suggested that its 'fiscal space' (the capacity of the government to expand borrowing if needed), while bigger than Japan and crisis-hit euro members, is limited, and its size very sensitive to future interest rate increases.²⁶

Slowing down

Decade by decade, the British economy is slowing down (Figure 9).

This slowdown is common to the developed world, and has been exacerbated everywhere by the crisis.²⁷ The possibility of the slowdown becoming permanent – that the 250-year burst of economic growth that accompanied capitalism was just an historic anomaly – is now being openly entertained in mainstream economics.²⁸ Robert Gordon's recent paper on experience of growth since 1300 pointed to the paltriness of current innovations in driving current economic expansion, and to the likelihood that growth will continue to dwindle as time goes by.²⁹

Capitalism without growth would be redder in tooth and claw than the capitalism we know today. Each individual firm's restless drive to expand and accumulate would remain, but the impossibility of system-wide growth would push deeper and deeper redistribution against labour and society, assisted by the nation-states. Gordon entertains this possibility in his description of a future USA in which the poorest 99 per cent are held further and further away from a 1 per cent accelerating into the stratosphere.

Box 3. Growth is no golden bullet

'Growth' is not an end in itself, as the underlying conditions of the early 2000s show. These years were once labelled by Mervyn King, who presided over most of them as Governor of the Bank of England, as the 'NICE' decade, meaning 'Non-Inflationary, Continual Expansion'. Everything seemed to go right. Inflation was low, growth (if not especially rapid) was continuous, unemployment was low. In economic theory the 'New Macroeconomic Consensus' prevailed: the touching belief that all the major problems of the macroeconomy had been essentially solved, both theoretically and in policy practice, by a combination of technical wizardry, modelling prowess, and good governance.

This happy prognosis turned out a little inaccurate. But even during the years of hubris, it was – or should have been – clear that all was not well. Growth, considered since at least the 1950s as the panacea for all economic problems, was not delivering. The real incomes of low-to-middle-income households stagnated or even fell during the boom, with median weekly earnings falling by 0.3 per cent over 2002–2008. Both have, of course, fallen sharply since the onset of the crisis, and are widely expected to fall further.

During the NICE decade, rising consumption was sustained by growing indebtedness. At the peak of the boom, UK households were the most heavily indebted of any major economy, with 163 per cent of average household disposable income held as debt. And the environmental damage this boom was inflicting – most notably in its greenhouse gas emissions – showed no signs of abating. The energy efficiency of the UK economy has improved sharply over time. But these improvements have not been enough to cut back on total carbon emissions and biodiversity loss, given economic growth. The so-called boom produced no real prosperity for most and caused real damage for all. Growth definitely did not deliver.

Of course, growth is not an end in itself (Box 3), but the major factor in the health of the system as a whole. Growth makes improvements in living standards and widening prosperity easier to achieve, but, as we shall see, does not guarantee them. A lack of growth, however, makes life much harder for most. This helps explain why, since the Second World War, economic growth has assumed such prime importance for governments.

Relative to other large developed countries, the UK is in a poor position to deliver future growth. Rising productivity is the critical determinant of overall growth in a developed country. Increasing productivity means that for each hour worked, more is produced, and so the economy grows – even if hours worked stay the same, or (if productivity growth is fast enough) even fall. In the UK, however, productivity growth has been historically weak relative to comparable nations, with anxiety about our sliding productivity stretching right back to the nineteenth century.³⁰

The sources of the slide have been debated continuously. Low rates of domestic capital investment, poor education, and antagonistic workplace relations have all been popular explanations at one point or another. Nonetheless, the period since 1979 appears – at least at first glance – to look like one of recovery. The initial shock of deindustrialisation, with manufacturing employment falling more than two million from 1978 to 1987 was driven by a shaking-out of British industry: under intense competitive pressure, less efficient plants and factories closed, leaving the more efficient still standing and so driving up reported average productivity.³¹

Under Labour, this process of shaking out in manufacturing continued, albeit at a slower pace. Researchers at the London School of Economics have claimed, in addition, that the economy under New Labour was relatively successful at sustaining productivity increases in the now-dominant service sector. They attribute this to improved skills and technological advances, particularly in business services and distribution, and note that GDP per capita grew faster than Germany, France, and the USA, while productivity grew second only to the USA itself.³²

Since the crisis, however, productivity growth has collapsed, and failed to recover.³³ This is highly unusual: the more usual pattern, following a recession, is for productivity to rebound strongly and recover rapidly to its trend levels.

Breaking the figures down, while UK manufacturing productivity is above its pre-crash levels, productivity in the services sector remains below its peak.³⁴ Since services account for around 70 per cent of the whole economy, productivity growth overall is therefore weak or even negative.³⁵

This unusual pattern points to deeper problems within the economy. A heavy dependence on finance and services, apparently a benefit during the boom years, has now turned into a major drag.

One problem, of course, is the measure of productivity used. By treating productivity as solely the contribution to Gross Value Added (GVA), a measure only of output sold, a sector or industry can look hugely productive when in fact it is doing little more than capturing value created elsewhere. Much of our financial services activity now appears to have been of this character.

Moreover, if productivity growth in services is now weak, after a curiously exceptional decade, it is returning to a long-run trend: lagging productivity growth in services now appears central to the UK's relative economic decline in the post-war years. Existing productivity problems in manufacturing back then were exacerbated by a loss of a productivity lead over other countries in services traded internationally.³⁶ Services, too, have been consistently poor at creating jobs, with only 60 000 net jobs created in finance over 1979–2007, compared to four million lost in manufacturing over the same period. Government spending took up the slack, under both Conservative and Labour administrations, with fully 57 per cent of new jobs created since 1979 funded by the public sector.³⁷

The recession we are in is something like a mirror of that of the early 1980s. The recession then provoked sharp increases in unemployment and the closure of less competitive plants and producers in manufacturing, driving *up* reported productivity. The recession now has seen far more muted rises in overall unemployment and declining productivity in the services sector, driving *down* reported productivity.³⁸ This is the so-called productivity conundrum: that falling GDP has not produced a collapse in employment, but instead has led to a slide in productivity.

The fall in productivity growth imposes another constraint on the recovery. The 'output gap' measures the distance between what an economy actually produces, and what it *could* produce – a measure, in effect, of spare capacity throughout the whole country. If this gap is wide, there is obvious scope for immediate government action, through increasing expenditure that brings spare capacity into use. If the gap closes, conventional economic theory would predict a risk of increased inflation. But the longer measured productivity continues to flag, the more the output gap will shrink, of necessity.³⁹ Should the productivity paradox continue to hold, the scope for Keynesian solutions, dependent only on boosting government expenditure, will close.

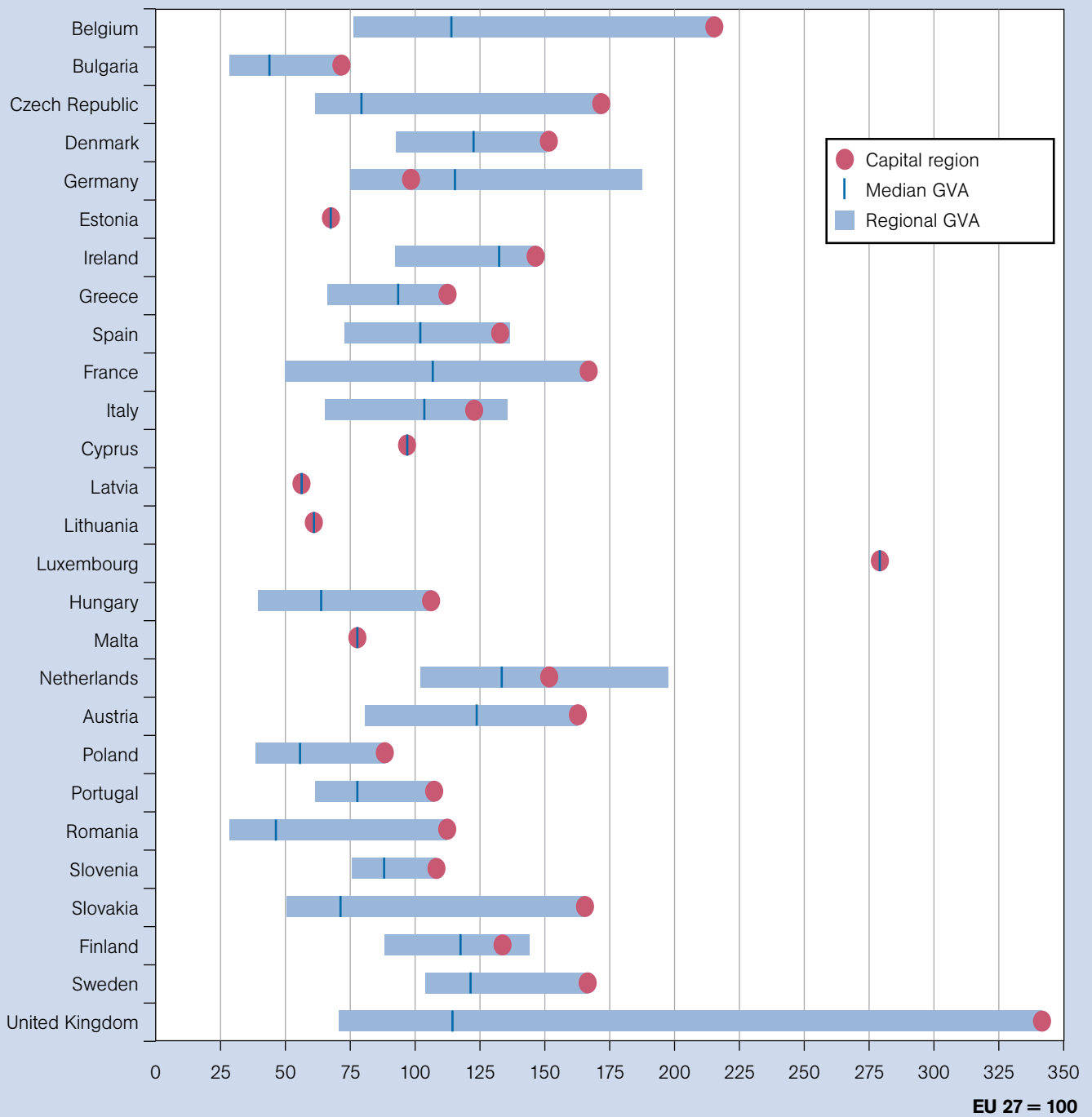
Unless either a dramatic recovery in services productivity growth occurs, or a significant shift is made out of services and into manufacturing, the prospects for a convincing, sustained economic recovery must remain bleak. The former is frankly unlikely. The latter implies a '1980s' for the service sector, with job losses on a very wide scale as less productive firms shut up shop.

At present, precisely the opposite movement is happening: high-productivity manufacturing is shrinking, while low-productivity services continue to expand their output. The whole economy is moving further away from a secure recovery. Growth, under these circumstances, is a chimera.

Unbalanced

Britain's economic landscape is notoriously uneven. That unevenness has worsened over time; today, it has the most geographically uneven distribution of economic activity of any EU member state. As Figure 10 shows, the spread between its poorest and its richest region is much larger than elsewhere in Europe. Inner London is the richest space in the EU; but the Welsh valleys are poorer than Slovakia. London itself is, notoriously, the most unequal city in the OECD.

Figure 10. Variance in Gross Value Added (GVA) across regions within EU members, 2008.



Growth over the last decade has not helped close this gap. It was, crudely put, growth of the wrong sort, concentrated in the wrong sectors. Forty-five per cent of the financial sector's output is produced in London, for example. Expansion of financial services necessarily tends to favour London and the south-east.⁴⁰

One way the previous government tried to combat this was through Regional Development Agencies (RDAs), established in 1998 to promote growth within the English regions. Although these Agencies – now abolished – had some local impacts, their comparatively limited budgets, aligned with a belief that the role of public authorities was limited to fostering markets and promoting 'clusters', did not do enough to tap into the flow of wealth rushing to London – or, more accurately, to the prosperous within London.⁴¹

Market-led growth meant, in practice, the continuation and deepening of a pattern of development heavily biased towards the south-east that had been in train since at least the close of the First World War. Despite governments

Figure 11. Percentage variation from national average Gross Value Added (GVA) per capita, 2011.

	1989	1999	2009
North East	-18.2	-22.7	-23.5
North West	-10.5	-11.7	-15.6
Yorkshire and Humber	-12.3	-12.1	-17.4
East Midlands	-7	-9.2	-12.4
West Midlands	-10	-10	-17.0
East of England	-6.6	-3.9	-7.3
London	53.8	60.1	73.9
South East	-1.8	6.1	6.3
South West	-9.9	-8.2	-9.1
Wales	-17.2	-23.3	-26.7
Scotland	-5.9	-5.7	-1.2

Source: ONS

apparently committed to regional policy (and despite at least the patina of success in some older inner cities and urban areas) the 2000s accelerated the flow of wealth southwards.

Regional development spending has more than halved since the formation of the Coalition government, with weaker local bodies replacing the RDAs. If the weak efforts of the previous administration could not prevent regional disparities yawning wider, the still more limited efforts of this government will have no discernible impact. Market-led growth, untrammelled by serious public action, spells London-centred growth – and the continuing decay of the rest.

Trapped in trade deficit

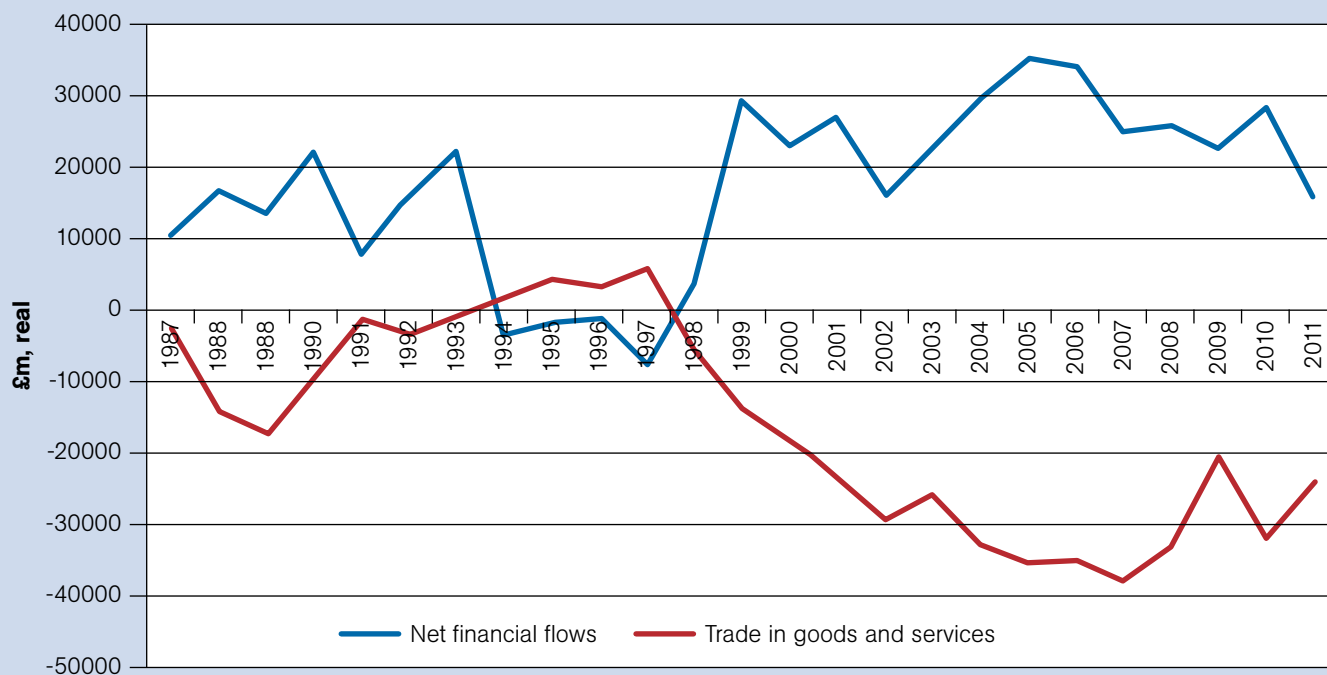
All trade deficits require financing. And over the last 20 years, the UK's chronic trade deficit has been financed by a similarly chronic flow of financial investment (and accumulation of debt) from abroad.⁴² Our well-established inability to export sufficiently is compensated for by our exceptionally large financial services industry, with banking activity dominating the bulk of transactions between 2000 and 2008.

The two sides are mutually reinforcing: the weakness of the UK economy, being unable to export in sufficient volume, created a permanent demand for financing. Our desire to purchase from abroad was, unsurprisingly, matched by the willingness of those abroad to finance these purchases. During the boom years, this fostered an illusion of prosperity.

Researchers at the IMF recently used a simulation exercise to model this situation for the UK. They found that rising inequality between the richest 5 per cent of our population and everybody else is being exacerbated as ordinary households, who – in an attempt to maintain living standards – borrow from the top 5 per cent. The top 5 per cent mobilise savings from abroad to finance this borrowing, leading to a worsening of the UK current account. The IMF's econometric estimates suggest that almost the entire UK current account deficit since the 1970s has come about as a result of this process, which has been further exaggerated by financial liberalisation.⁴⁴

But with the collapse of the boom and no realistic prospects for its return, this mutual reinforcement between demand for finance and demand for imports has turned into an economic deadlock. 'Rebalancing' the economy – shifting

Figure 12. UK current and financial accounts, 1987–2011.



Source: National Statistics (2012), Pink Book 2012⁴³

it away from financial services – will be all but impossible when our trade position is so profoundly weak. Alternatively, shifting the chronic trade imbalance will be all but impossible with the immense weight of financial claims that now exist against the UK economy. The entire economy is deeply exposed to changes in international sentiment, as the immense reversal of financial flows in the aftermath of the crisis helped demonstrate.

It is this lack of space for future manoeuvre that helps explain the drive to austerity now. Unlike the economies of southern Europe, the UK does not belong to a single currency and is not compelled to adopt severe austerity measures. It is, instead, chained to a dysfunctional, overexposed financial system that is symbiotically linked to a weak real economy. A weak economy sucks in imports, requiring finance; a continual demand for financing helps support a bloated financial system; the permanent risk of financial crisis produces austerity. The key to breaking the grip of austerity is to undermine the financial sector. The key to undermining the financial sector is, in turn, to reinforce the real economy – creating jobs and supporting meaningful economic activity.

This twin approach must be at the heart of a viable new economic strategy. Having described both the recession we are in, and the barriers to ending it, we are in a position to describe the steps that must be taken to clear a path to a new economy. The critical barriers, on this analysis, are:

1. A commitment to austerity that cripples real economic activity.
2. A real economy that is inefficient and import-dependent, demanding financing.
3. A financial system that is bloated with debt and over-exposed to risk.

We can envisage a new, more socially just and efficient economy that does not harm the environment. But getting there requires policy moves made today that will clear the barriers.

Towards a new macroeconomic strategy

It is always easier to do tomorrow what you did today. The costs of moving to a different way of working or living are significant. This problem is magnified in the whole economy, since many of the costs of moving to a different mode of life are dependent on others' actions. If they do not act the same way as you do, with everyone co-ordinating their behaviour over time, the costs of change can be so great that no one will make the shift.⁴⁵

Path dependency

For the whole economy, it is always easier to return to a familiar path of growth than it is to shift to a different mode of operating. For the environment, this produces a situation of 'carbon lock-in': institutions and markets evolve in such a way as to trap the whole economy on a high-carbon path. It is only with significant effort and expenditure that this path can be convincingly broken, and a new one carved.⁴⁶

Path-dependency makes much current discussion of rebalancing the economy singularly idle.⁴⁷ There will be no rebalancing without a clear break with the past – quite the opposite: as is now happening, in the absence of this break many of the dysfunctional features of the UK economy, like its dependence on financial services, are becoming more, not less pronounced. And even if by some miracle a return to the levels of growth seen in the 2000s was made, there are no real reasons to anticipate they will be anything other than as illusory as they were back then. We live in a high-carbon, high-debt economy. It used to deliver growth. Now it cannot even manage that. There are clear barriers to growth, and, worse, growth itself may not deliver the economic goods – not, at least, for the majority.

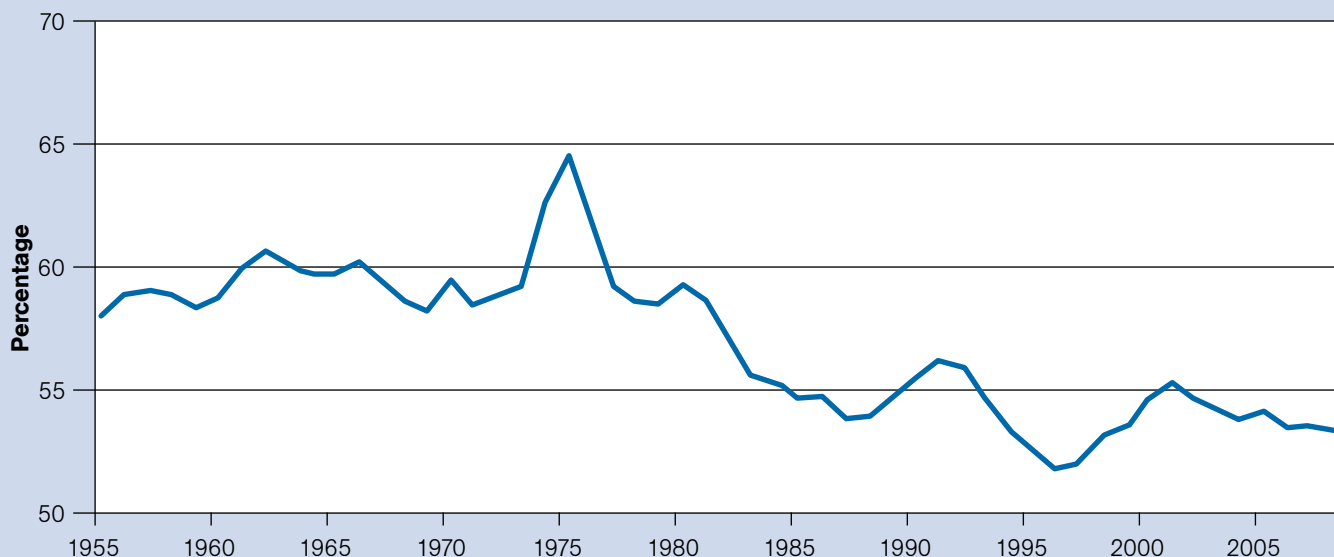
The economic problem, then, is not one that can easily be solved through tinkering of the kind that dominated during the boom years. Back then, with macroeconomic problems apparently resolved, successive governments concentrated on microeconomic questions, informed by a peculiarly ingrained belief in the efficacy of free markets: competition would drive productivity, deregulation would free up entrepreneurs. None of this is appropriate in dealing with a crisis on the scale we are confronted with. The macroeconomy, its deep problems smothered in the smug years of the credit bubble, has returned with a terrible vengeance.

Ending austerity, sustaining demand

The Coalition's own economic strategy has failed. It was, at best, based on a series of deep misconceptions about the nature of the crisis. Austerity cripples weak economies. The starting point in any new economic strategy must be to end austerity. Quite apart from its social effects, and the obvious injustices involved, it is economically foolish. When everybody else is not spending, government must. There is no credible macroeconomic case for cuts 'almost without historical or international precedent', as the Institute for Fiscal Studies put it, under present economic circumstances.⁴⁸ Even the IMF now admits this much.

This is a distinct argument from that about the supposedly 'ideal' size of government spending. The arguments about reforming the state and provision of public services should be disentangled from the macroeconomic argument about spending cuts. They should not become entangled with an argument

Figure 13. Wages as a proportion of GDP, 1955 to 2008, percentages.



about 'excessive' benefits, or 'skivers', however much Coalition ministers have attempted to do just that. We could all agree that spending on social security is too high. But that is precisely why government must act to create jobs and boost demand, so that those now languishing on benefits can find work.

That will mean thinking more carefully about the objectives of economic policy. Chasing GDP alone, as we have seen, is no longer appropriate – if it ever was. We need instead to think in a more nuanced way about what we expect our economy to do: sustaining well-being, ensuring a reasonable distribution of life chances, delivering secure, decent work, and doing so within clear environmental limits. GDP tells us very little about this and, worse, no longer delivers on its blunt promise of rising real incomes. Better metrics for assessing economic policy – a sharper focus, for example, on work created, real median incomes, and environmental damage – would help shape economic policy better.⁴⁹

Capitalism in the UK has been bad at providing jobs, and singularly poor at offering work of a decent standard. Since the 1970s, it has destroyed middle-income, generally more secure jobs in manufacturing to gain instead a thin crust of well-paid white-collar jobs that cover up a growing mass of poorly paid, insecure, service sector employment. Low levels of job creation overall have been compensated for by a sharp expansion of state or state-funded work. Labour markets have polarised sharply, a key feature in rising inequality, and the share of national income going to labour has declined precipitously.

A detailed comparative study by the International Labour Organization found that growth internationally is 'wages-led': it is pushed along by rising average incomes and significant labour share in national income, rather than being pulled along by the alleged virtues of entrepreneurs and profits.⁵⁰ If real incomes continue to decline, and household debt burdens remain threatening, prolonged general stagnation will result. There is a critical role here for government in both creating decent, secure work, and in redistribution. The case becomes still stronger should productivity remain weak, since earnings will not rise without it. Redistribution, on a wide scale, will be necessary to secure continued prosperity.

For the regions, redistribution is now an iron necessity. There is no plausible prospect of regions lagging behind the prosperous parts of the south-east ever catching up without it. Take Wales: if London grows at just 2 per cent a year – below its average since 1979 – Wales will have to grow at 2.5 per cent for

the next 30 years to close the gap. In other words, it would have to repeat the experience of the entire post-war boom, but at a higher and more sustained rate of growth. This is a fantasy scenario. Wealth needs to be drawn out from the great pools held and controlled not so much by the 1 per cent, but a still tinier fraction, the 0.1 per cent, and applied to the reconstruction of regions and nations.

That reconstruction, across the country, cannot be led by the market. The market will attempt to follow the path of least resistance – the same path we followed into the mire: high debt, high carbon, and low wages. We can see, under the Coalition, precisely this route opening out in front of us.

Decisive public action, instead, is needed. After all, industrial strategy is back in fashion: former Conservative minister Michael Heseltine recently presented a strong business case for government intervention. David Cameron has in the past spoken of ‘investing in industries of the future’. But this should not be industrial strategy tied to the failed metrics of the past, such as boosting GDP, or to the immediate demands of business. Instead, national and regional schemes need to think more closely about meaningful measures, creating secure, sustainable jobs, and protecting the environment.⁵¹

The strategy will need a clear goal to reduce the UK’s dependence on imports, for both environmental reasons and – as we have seen – to break its dependence on the City. Local and regional economies, supported by financial resources and national government, can act to break their carbon dependencies and drive local recovery. Two obvious contenders for localisation are food and energy production: both impose heavy environmental burdens; both are net contributors to the trade deficit.

But what about the markets?

The continual retort, from those insisting on self-defeating austerity, is that the financial markets would turn against a government committed to increasing its spending. Interest rates would soar, as bond markets became concerned about the government’s ability to meet the additional liabilities it was taking on. The answer to this falls in two parts.

First, government spending can increase without widening the deficit. Over the last two years, the obscenity of tax avoidance by Britain’s wealthiest individuals and corporations has become a political scandal, thanks in no small part to the activities of protest group UK Uncut and dogged tax justice campaigners. A serious clampdown on avoidance would deliver billions in additional revenue, with even HMRC’s very conservative estimate suggesting £35 billion is lost annually – other, credible estimates, range much higher.⁵² But we can move beyond merely closing existing loopholes, and do something to reverse the decades-long rise of inequality. The Green New Deal group has proposed a suite of taxes for the wealthiest that could immediately raise £26.4 billion in additional revenue, and potentially a further £21.9 billion after consultation.⁵³ Since Britain’s rich and its major corporations are not spending their wealth, this is economic good sense: by taking money out of the hands of the hoarders, and ensuring it is spent on productive activities – invested, for example, to create sustainable jobs – the whole economy will benefit.⁵⁴

Second even if wholly or partly financed by borrowing, government spending made on productive assets – such as public transport improvements or renewable energy – will not substantially alter Britain’s *net* debt position. Although we will have increased our public liabilities through borrowing, adding to gross debt, we will have gained an asset of the same value. Of course, it is *gross* debt that requires continual financing, since it is the total debt that demands interest payments (and assets cannot be disposed of easily or quickly to meet these repayments); but an investment plan producing steady, long-term returns would meet this requirement.

A third argument against financial doom greeting the end of austerity is more distinct. Britain, as many commentators have argued, is not Greece or some other now heavily indebted Eurozone member. For a start, it retains its own currency and its government can therefore always repay debt denominated in

pound sterling – even by printing money, in extremis. If anything, it suffers from the opposite problem: that of being perceived as a ‘safe haven’, with possible consequences we consider briefly below.⁵⁵

However, the constraints imposed on the UK’s domestic economy by its international position are, as we have seen, binding. A programme for recovery, and especially one built around an increase in government spending, is liable to very rapidly run up against both its current account deficit and its dependence on financial flows. A financial system choosing to panic in response to a serious effort at reflating and restructuring could provoke capital flight and undermine the government. The next element in the strategy therefore must consider the UK’s peculiar relationship to the financial system.

Shrink and reshape the financial system

It should be obvious from the above that the UK’s financial system is unsustainably large. At this size, it constitutes a direct barrier to economic recovery. It therefore requires shrinking: its balance sheets reduced relative to GDP; its employment reduced as a share of the workforce.⁵⁶ But shrinking also implies restructuring, as Andrew Haldane has recently argued.⁵⁷ Increases in the system’s size have, over the years, delivered a deepening complexity of operations, particularly associated with the management of risk. Disentangling that complexity will allow the system to be safely deflated and brought into effective public control.

One particular aspect of that complexity is the extent to which different forms of financial transactions have been brought under the control of single institutions. At the same time, enormous pressures to increase the complexity of their operations are brought to bear, through competition globally for business. Financial ‘innovation’, the deliberate pursuit of complexity, is compelled on the banks and the major financial institutions by their participation in global financial markets. The creation of new and more complex financial instruments can generate short-term returns, but at the price of rising systemic complexity and risks. Those risks, still poorly understood and managed, remain hidden inside giant financial institutions.

The arguments for a greater variety of financial institutions, to spread risks and better manage complexity, are clear. Breaking up the major banks would require also that they transform how they operate. At root, a bank should do little more than provide somewhere safe to place savings, and create some credit. Localising banks, diversifying ownership structures, and placing greater democratic and public control over banking functions will all help lead them towards that ideal.

Nonetheless, the liabilities of the whole system remain vast. An immense pile of debt, equating to 214 per cent of our GDP, has now developed inside UK financial institutions.⁵⁸ (And even this is a conservative estimate, having excluded financial derivatives and more complex instruments. Including these would push the ratio of liabilities to GDP within the financial system to nearly 750 per cent of GDP.)

There are three ways to remove a debt:

- **Repay it** – but as we have seen, this creates a self-defeating spiral of stagnation and decline. Trying to repay a debt can make the real debt burden worse.
- **Allow inflation to whittle it away** – but, even if this were politically possible for the government debt, the total debt burden is too great to make it a convincing prospect. Even if we assume exceptionally low, economy-wide, nominal interest rates of 1 per cent, inflation at 5 per cent and an immediate return to a trend rate of growth of 2.5 per cent, the UK’s total debt-to-GDP ratio will not reach even its 1996 level until 2026. Any deviation from steady growth and low interest rates pushes that date still further into the future.⁵⁹ To reach the current US debt-to-GDP ratio, under these assumptions, would take until 2025. Effective repayment through inflation is not a plausible scenario.

- **Cancel it** – If debts can neither be repaid, nor inflated out of existence, that leaves only one option: cancellation. Without a high (and sustained) rate of growth, high (and sustained) inflation, or low (and sustained) interest rates – or some combination of all three – the debt burden will not diminish. For households and businesses, it will be a permanent drag on activity; for the financial sector, it is a permanent exposure to risk. Of all the sectors, government is the least directly burdened by debt, but instead is caught between the others – receiving diminished tax receipts on one side, and expected to support finance on the other.

Yet cancellation would impose severe political challenges. The burdens of cancellation would fall on creditors within the financial system. However well managed, and it is critical that it is done so fairly, cancellation would impose great strains on financial institutions. Some of these would not cope, and could require nationalisation. But should a sustained recovery fail to materialise, the demand to write off debts will become more insistent.

Capital controls

The danger of a financial crash remains very real. The most recent IMF Global Financial Stability report suggests the risks are as high now as they were prior to the crash of 2008.⁶⁰ As we have seen, the UK's exceptionally large financial sector exposes the whole economy to fluctuations and crises happening right across the world. And the dependence the UK now has on financial inflows to compensate for chronic trade imbalances creates a further uncertainty, with volatile flows of capital able to reverse very rapidly in the event of a crisis.

The biggest danger here is contagion, where chaos spreads from country to country through our tightly connected international financial system. As one economy fails, those in financial markets start to believe other, similar economies will fail. Perhaps those economies nearby, or those with similar industrial structures come under attack. Speculators move in, sensing weakness, looking to profit from the collapse, perhaps through financial devices like derivatives. More risk-averse investment rushes out, with former investors dumping their holdings of the economy's currency and financial assets. Meanwhile, economies seen as strong can suffer the opposite effect: a panicked inflow of capital, fleeing turmoil elsewhere, can be just as destabilising as a panicked outflow. Contagion can work both ways.

We know from previous recent episodes of financial panic that contagion can be devastating. When market sentiment turned against East Asian economies over 1997/1998, a recession of exceptional severity erupted across the region. None of the economic fundamentals had changed – the economies were much the same the day before the panic, as when it started. But when beliefs shifted rapidly following the unplanned devaluation of the Thai bhat, liberalised, electronic markets were able to move fast; hot money pulled fast out of economies, as speculators gambled on further devaluations.

Something similar could happen as a result of deepening crisis in the Eurozone, with contagion spreading in two ways. First, because banks across Europe have loaned each other immense sums of money, they are all exposed to each other. Should a bank or a government default on its loan repayments, its creditors will all get hit. French banks, for example, still have a very major exposure to Greece. A Greek default would hit them hard. UK banks have dropped most of their Greek holdings, but since they still have a large exposure to French banks, they could still suffer.

The other route is through the capital markets themselves. The UK is exposed precisely because it is *not* in the Eurozone and is seen as a safe haven for investors looking for low-risk investments. This is, in part, why the borrowing rate for the UK government is so low. Those in financial markets believe to be low risk, and will not ask for high interest rates to compensate when lending money to the government here.

In the event of a crisis, capital could rush into the UK, seeking safety. This

Box 4. Capital controls in action

Malaysia

Malaysia was engulfed by the East Asian financial crisis. But its government defied the IMF position at the time to introduce sharp restrictions on the ability of investors to withdraw capital. The amount of the currency, the ringgit, that could be taken abroad was restricted and investors in the country were subject to a one-year 'stay period' during which they could not remove funds. Measures like these are now widely credited as having helped Malaysia weather the storm.

Brazil

To prevent its exchange rate rising too rapidly as the economy expanded, in 2009 Brazil introduced a 2 per cent tax on foreign purchases of stocks and bonds, later backed up with a tax on the sale of foreign deposits, and an increase in the original tax to 4 per cent. These were estimated, by the IMF and others, to have slowed the rate of Brazilian currency appreciation, reducing the value of its currency by around 1.2 per cent.

South Korea

Economic expansion after the crash of 2008/2009 has led to speculation on the rising value of the South Korean won, which was appreciating rapidly. In response, the Korean government fixed limits on the value of foreign-exchange derivatives that banks can hold – no more than half their capital base for local banks. Although the won continued to rise in value, the rate of increase slowed and was lower than the regional average.

would be enormously destabilising: the exchange rate would appreciate, further worsening the UK current account position, and money flooding into speculative assets would promote further expansion of property and financial bubbles. The net result would be to further undermine real economic activity, while promoting financial activity – in other words, to shift the whole economy still further away from a rebalancing.

Alternatively, we might face a rapid outflow of funds – similar to that of 2008. This could occur without any change in policy: the mere combination of a continued recession, a poor current account, and low productivity growth could be enough to promote an old-fashioned sterling crisis, as has happened five times since 1945.⁶¹ Speculators would ditch sterling and sterling denominated assets, fearing that the economic fundamentals were now too weak to sustain activity. While in the long term this may, as after the devaluation of the ERM crisis in 1992, promote a recovery in exports, in the first instance it would create an immediate financial crisis and sharp rises in real interest rates. And given the slow response of imports to exchange rate changes, the most likely immediate effect would be to perversely *widen* the deficit on the current account. Again, the damage to the economy could be substantial.

The introduction of direct controls on the movement of capital in and out of the economy would help prevent either possibility. Growing empirical evidence, recently summarised by the IMF itself, suggests that, despite the rhetoric of globalisation, well-applied controls can work in a range of different economic circumstances. The examples in Box 4 back this up.

By making movements of capital in and out of the UK more expensive, they become less desirable. While in theory capital markets should allocate capital efficiently, in practice this does not apply – and, in conditions of financial contagion, it applies even less, as market signals are drowned out in the melee. European law, otherwise strongly in favour of free capital movement, allows the implementation of capital controls by non-euro members, in the event of emergency, without prior EU-wide approval.⁶² There is, as we have indicated, a serious risk of financial crisis – either externally, most likely via the Eurozone, or internally, as the weaknesses of the UK economy reveal themselves. The Treasury is reported to have already drawn up plans for the emergency introduction of capital controls, in the event of a financial collapse. But it would be sound policy to design these with a view to retaining long-term restrictions on the free movement of capital.

There should be no domestic legal barriers to imposing controls, and recent UK governments have acted to restrict international financial activities – for instance in combating terrorism. Notoriously, anti-terrorism legislation was used by Gordon Brown’s government to freeze Icelandic financial assets held in the UK when it became apparent its economy was imploding in October 2008. The Landsbanki Freezing Order was drafted to prevent the repatriation of funds held by Landsbanki’s UK subsidiary back to Iceland, and, while the merits of the action are contested, it illustrates the ease with which a determined government can regulate financial activity through legislation.

For the UK, measures to consider could include, but are not limited to:

- **An emergency tax on capital inflows**, similar to that levied in Brazil against purchases of UK financial assets. Existing stamp duties could be increased.
- **Unremunerated reserve requirements**, requiring those buying financial assets to also place an amount in foreign currency, equal to a proportion of the capital flow, with the Central Bank. Successfully used in Chile and Columbia to break capital surges, these work to increase the cost of holding financial assets in a country.
- **Legal restrictions on derivatives positions**, similar to those implemented in South Korea, as a means of dampening speculation in foreign exchange.
- **Restrictions on overseas ownership of residential property**, particularly via offshore companies based in tax havens.

By managing the flows of capital we can structure a suite of controls so as to attract longer-term, more stable investments. Controls that affect the *quality* of capital flows invested are, IMF and other evidence suggests, generally more effective than those seeking only to impact on quantity – although these can also be important. The type of flow matters: we might want to attract Foreign Direct Investment into new plant and machinery, in line with the priorities of a green investment plan, but deter more speculative investments in financial derivatives. Capital controls can allow this degree of discrimination to be imposed.

Quantitative easing

The case for a State Investment Bank, either by transforming an existing institution (like majority state-owned RBS) or boosting the Green Investment Bank, has been well made, and is increasingly accepted. The need to provide finance for investment to meet clear public objectives, after years of suffering clearly dysfunctional private banking, is now obvious. There remains, however, a set of arguments over how such an institution should itself be funded, and where its liabilities should sit. Mobilising finance on the scale needed to transform the economy implies the creation of significant liabilities for the state. Yet the government has, for nearly three years, been creating liabilities on a huge scale.

Since early 2010, the Bank of England has delivered £375 billion through its quantitative easing (QE) programme. Often referred to as ‘printing money’, the operation is slightly more nuanced than simply firing up the presses. The Bank of England uses its powers to create money in order to buy back government bonds from financial institutions. These bonds then sit on its own balance sheet, while – in return for parting with the bonds – the banks receive cash. There is a certain sleight of hand involved here, since if the government-owned Bank of England is buying government bonds, there is no change in the total liabilities of the public sector: instead of sitting on private banks’ balance sheets, they sit on the central banks. The government is, in effect, lending money to itself.

Elsewhere, the European Central Bank (ECB), in defiance of European law, has been issuing liquidity since November 2011 through the Long-Term Refinancing Operation (LTRO), with ECB President Mario Draghi more recently committing the ECB to buying Eurozone debt without limit. Bank of Japan head Maasaki Kirashawa has announced an extension to the BoJ’s monetary easing scheme. And Federal Reserve Chair Ben Bernanke is launching an open-ended asset purchasing programme for the Fed. The details differ, but the general intent and

mechanism is the same – the use of unconventional policies to release flood-tides of liquidity into the world’s banking systems.

The net effects of these operations are, despite their scale, not well understood. They were motivated originally by the belief that, with interest rates at or near a zero bound, only unconventional monetary policy would operate.⁶³ Empirical research has suggested that over the last 18 months, QE in the UK has helped maintain asset prices (like property) at the expense of some slight increases in inflation. The net result has been strongly to the benefit of those who hold financial assets – which means principally those at the very top of the income distribution.⁶⁴ It is also likely that the immense purchases of existing government debt through QE, by supporting demand for debt, have helped drive down interest rates. In other words, the effects of QE so far have been to *support* the existing system of widening inequalities sustained by the financial system. The economic deadlock is maintained, not broken, by current QE.

But it could, just as easily, be used to *undermine* the system, breaking the deadlock. If, instead of piling new financial assets onto bank balance sheets, QE was used to inject cash directly into the economy, it could start to act to break the deadlock. Because at present the UK is so critically dependent on large financial flows from abroad to sustain its weak domestic economy, it cannot successfully rebalance. The flows from external sources result in large external claims against the economy, which themselves then become further barriers to recovery.

But if those financial flows came instead from a domestic source, and went directly into domestic economic activity, the deadlock would be at least circumvented. And to the extent that continuing flows of finance, mobilised *ab nihilo* by the Central Bank, move into domestic activity and remain distinct from the private financial system, that system is undermined. With domestic banks unwilling to lend, and with the great tide of QE doing little more than to help fragile banks rebuild their own balance sheets, there is a clear role for more direct government intervention.

This is how QE could play a central role in rebalancing and repositioning the entire economy. Were the Bank of England to mobilise its capacity to create new financial assets, and push them towards real economic activity, investments could be made and economic activity restarted without running immediately into the barrier of the financial system. ‘Green QE’ has been proposed as an ideal means of raising financing for long-term investments in sustainability. These will need to be very substantial: at the upper end of the scale, Dieter Helm has estimated that £500 billion of investment in infrastructure will be needed over the next ten years to upgrade it to a more sustainable basis.

The objection conventionally raised to the use of QE for any purpose other than the purchase of government debt is that to behave otherwise is to break down the important distinction between fiscal and monetary policy: that without a government clearly able to maintain the distinction between the two, markets will assume the government to have no sense of fiscal or monetary discipline, and will start driving up interest rates. Further, at present, QE has limited market impact – it has driven up some asset prices, but to a very great extent has got no further than banks’ balance sheets. Were it to be released into the economy, there is at least a plausible chance that it would lead directly to increased inflation, as extra volumes of money in circulation acted to bid up prices without substantially affecting output.

These two objections stem from a similar source, which is a theoretical misunderstanding of how money operates in the economy. In both cases, the underlying assumption is that a basically fixed stock of cash is used and circulated at a regular pace that is determined largely by the rate of economic activity. Attempting to add to this fixed stock – for instance, through QE – does not increase the pace of activity, and therefore leads only to increases in prices. The distinction between fiscal and monetary policy is critical, since changes in fiscal policy are (in this world) simply attempts to alter the flow of an existing stock of cash, shifting it from one purpose to another. Without a clear distinction

between fiscal and monetary operations, all expansionary fiscal policy can start to look suspiciously like illicit attempts to expand the money supply, pushing up inflationary expectations and so beginning to drive up interest rates. Productive QE would appear doubly bad: the money supply is directly increased by QE itself, and then the effect is reinforced through its use as a substitute for fiscal policy.

This is, in general, an incorrect description of the functioning of money in an economy.⁶⁵ But it is particularly poor in present circumstances. One of the defining features of a balance sheet recession is precisely that balance sheets are shrinking, with the result that the money supply contracts rapidly as spending shrinks. Money, in effect, is hoarded – taken out of circulation and held dormant, being used to pay down debts, or, especially in the case of banks, to shore up reserves. This effect has been substantial, and will continue to be so, with the IMF expecting a £2.6 trillion contraction in European bank balance sheets over the next 18 months.⁶⁶ It accounts for the reason why the observed money supply, despite QE, has moved so little.

So it is precisely in the kind of recession that we are now in that the case for productive QE is strongest: it stokes up real economic activity, as will many other kinds of interventions and it can act against the contraction of the money supply. Because this is a strictly and completely domestic source of financing, QE can begin to undermine the UK's dependence on external sources of financing. It can act as a major blow against the domination of private finance over public, economic outcomes, democratising the role of finance in the economy as a whole. Used wisely and sparingly, alongside more conventional mechanisms, it can act to help kick-start the transition to a fairer and more sustainable economy.

Conclusion

This document has attempted to provide, in outline, a summary of the particular challenges facing the British economy in conditions of global economic malaise.

It has attempted to demonstrate that these challenges are so great that there is no realistic prospect of a return to more stable conditions without a very sharp break with the past. The constraints of weak domestic demand, high private debts, and an exposed international position – all now bolstered by low or falling productivity – will prevent any repeat of the 2000s. Neoliberalism, the belief in a market-led solution to all economic questions, has failed and will continue to fail.

Given these constraints, it is necessary to think through the steps needed to make that break with the past. Shopping lists of desirable reforms are no longer enough. We need, instead, to understand the economic logic of the situation we are in, and to arrange our demands to meet it. This outline sketches the four demands that meet the most pressing issues. It has not touched on the political or institutional barriers to achieving them: from political parties wedded to neoliberal myths, to a Treasury historically opposed to all serious efforts at reform, to a financial sector that retains immense lobbying power and a pet local authority in the Corporation of London. It is concentrated only on the bare-bones economics. It has, deliberately, left to one side critical questions about democracy and popular control of the economy of the kind Occupy raised.

Transitions from neoliberalism are being attempted elsewhere. We can learn from elements of all of them. Iceland, worst hit by the financial crisis of any developed country, taking on the bankers; South Korea, investing to create nearly a million sustainable jobs over the next decade; the experience of public investment banks in Germany. Much can be adapted to local and national conditions. But transforming the entire economic system will require more than the repetition of good examples, or appeals to existing power structures: it will require the mobilisation of the creative energies of millions of people and the formation of a movement able to make a decisive break with the past.

Endnotes

- 1 'Public' or 'national' debt is the debt owed by the government. It is a *stock* of debt, built up over time. The deficit (or public sector deficit) is the gap between what the government receives in taxes and what it spends. It is a *flow* of borrowing, which adds over time to the *stock* of national debt.
- 2 *Ibid.*
- 3 An argument that applies with more force when interest rates are at a zero bound. The OBR's initial estimates for the value of the government multiplier were taken from the IMF, and implied that the effects of government spending cuts would be limited. The IMF, in light of recent experience, has now revised its own estimates significantly upwards, leaving the OBR forecasts high and dry.
- 4 For the Baltics, see Katell, R. and Raudla, R. (2012). *Austerity that never was? The Baltic states and the crisis*. Levy Economics Institute of Bard College, policy note 2012/5. The authors note also EU assistance (20 per cent of Latvia's national budget, for example) and mass emigration, particularly of the young, in promoting an apparent 'success'.
- 5 An apparent improvement in the most recent quarter (July-September 2012) was driven very largely by the one-off effects of the Olympics and a slight 'rebound' from the additional bank holiday in the preceding quarter.
- 6 Holland, D. and Portes, J. (2012). Self-defeating austerity? *National Institute Economic Review* 222.
- 7 Blanchard, O. and Leigh, D. (2013)., 'Growth forecast errors and fiscal multipliers. IMF working paper WP13/1.
- 8 Office for Budget Responsibility. (2010). *Fiscal Sustainability Outlook*. OBR: London
- 9 *Ibid.*, Table 3.3.
- 10 *Ibid.*, Chart 3.11.
- 11 There is a longstanding economic literature on contractionary devaluations, from Krugman and Taylor onwards. See Krugman, P. and Taylor, L. (1978). Contractionary effects of devaluation. *Journal of International Economics* 8.
- 12 A familiar result in economics known as the J-curve.
- 13 Middleton, R. (2002). Struggling with the Impossible: sterling, the balance of payments, and British economic policy, 1949-72 in Arnon, A. and Young, W. (eds.). *The Open Economy Macro Model: past, present, and future*. Boston: Kluwer.
- 14 Department for Energy and Climate Change. (2012). *Digest of United Kingdom Energy Statistics 2012*. London: HMSO, Table 1B.
- 15 Simms, A. (2012). *We can't afford to invest in fracking*. London: **nef** (new economics foundation) blog
- 16 Relative to GDP, of any developed country. See for example US Dept of the Treasury. (April 2012). The financial crisis in charts, Chart 15. Washington, D.C.: US Department of the Treasury.
- 17 National Statistics. (2012). *Pink Book*, Table 7.1.
- 18 See Lapavistas, C. *et al.* (2012). *Eurozone in Crisis*. London: Verso.
- 19 *National Statistics (2012), Blue Book* To avoid double-counting, the figure for the financial sector excludes loans secured on dwellings (series NLKZ in the Blue Book), and loans by major financial institutions (NLKQ). Financial derivatives (NLKK) are also excluded due to the uncertainties involved in their status as assets or liabilities. Inclusion of all three would push the reported liabilities of the financial sector for 2011 to 985 per cent of GDP.
- 20 Reinhart, C. and Rogoff, K. (2010). *Growth in a time of debt*. National Bureau of Economic Research working paper 15639.
- 21 Arcand, J.-P., Berkes, E. and Panizza, U. (2012). Too much finance? IMF Working Paper WP/12/161. See also Rousseau, P., and Wachtel, P. (2011). What is happening to the impact of financial deepening on economic growth? *Economic Inquiry* 49, which finds a dwindling effect of financial depth on growth as depth increases.
- 22 IMF. (2010). *A fair and substantial contribution by the financial sector: final report for the G-20*, Table A1.4.
- 23 Easterly, W., Islam, R., and Stiglitz, J. (2000). *Shaken and stirred: explaining growth volatility*. Annual Bank Conference on Development Economics. (Washington D.C: World Bank.
- 24 More or less. An agreement was struck between the UK government and its US creditors in 1931 to write down some of the UK's existing war debts. UK gilts are otherwise reckoned to be an exceptionally safe bet.
- 25 McKinsey Global Institute. (January 2012). 'Debt and deleveraging: uneven progress on the path to growth', Exhibit 11, p.24. Other calculations of the UK's debt burden have produced far bigger estimates for the financial sector's total debt – perhaps, as we have seen, more than 950 percent of GDP. We have followed MGI and deliberately provided a relatively conservative estimate.
- 26 Ostry, J.D., Ghosh, A.R, Kim, J.I, Qureshi, M.S. (September 2001). *Fiscal space.*, IMF Staff Position Note SPN/10/11, Washington DC: International Monetary Fund, p.24.

- 27 But not, of course, to the developing.
- 28 It has long formed part of more heterodox traditions: in environmental economics, citing physical limits to exponential growth; in Marxist terms, citing the ability of capital accumulation to undermine the conditions for its future accumulation through the falling rate of profit. Mike Kidron saw the connections between both: see Kidron, M. (1974). *Capitalism and Theory*. London: Pluto, chs. 2 and 4 especially.
- 29 Gordon, R.J. (2012). Is US economic growth over? Faltering innovation confronts six economic headwinds. *CEPR Policy Insight* 63, London: Centre for Economic Policy Research.
- 30 A somewhat sceptical review is provided by Tomlinson, J. (1996). Inventing 'decline': the falling behind of the British economy in the post-war years. *Economic History Review* 49:4.
- 31 For example, Barnes, M. and Haskell, J. (2000). 'Productivity, competition and downsizing'. Paper prepared following HM Treasury Growth Seminar, London.
- 32 Corry, D., Valero, A., and Van Reenan, J. (2011). *UK economic performance since 1997: growth, productivity, and jobs*. London: Centre for Economic Performance.
- 33 Measured on an output per hour basis. The most recent data points to an absolute decline in productivity over the third quarter of 2012 of 0.2 per cent, with productivity down 2.4 per cent compared to the third quarter of 2011. Office for National Statistics. (2012). 'Labour productivity Q3 2012'. *Statistical Bulletin*.
- 34 Over 1997–2007, services productivity rose by 2.3 per cent per year. Since 2008, it has risen by only 0.8 per cent. Hughes, A. and Saleheen, J. (2012). UK labour productivity since the onset of the crisis – an international and historical perspective. *Bank of England Quarterly Bulletin* Q2:2012. The last set of ONS data suggests that the disparity between manufacturing and services productivity may be closing, with sharp declines in manufacturing output per hour over the second and third quarters of last year.
- 35 Hughes, A. and Saleheen, J. (2012). UK labour productivity since the onset of the crisis – an international and historical perspective. *Bank of England Quarterly Bulletin* Q2:2012.
- 36 Broadberry, S.N. (1997). *The productivity race: British manufacturing in international perspective, 1850–1990*. Cambridge: Cambridge University Press.
- 37 Froud, J., Johal, S., Law, J., Leaver, A., Williams, K. (January 2011). Rebalancing the economy (or the buyer's remorse). *CRESC Working Paper Series no.87*. Manchester: Centre for Research on Socio-Cultural Change.
- 38 Although we should note that the picture varies substantially beneath the aggregate.
- 39 The 'output gap' is dependent on $Y^* - Y$, where Y is reported output and Y^* is potential output. If productivity is growing more slowly than the economy as a whole, it must be the case that this gap is closing, since Y (observed GDP) would be rising at a faster rate than Y^* , which is directly dependent on productivity.
- 40 As measured by Gross Value Added (GVA). See Froud, J., Johal, S., Law, J., Leaver, A., Williams, K. (January 2011). Rebalancing the economy (or the buyer's remorse). *CRESC Working Paper Series no.87*. Manchester: Centre for Research on Socio-cultural Change.
- 41 See National Audit Office. (2010). *Independent Supplementary Reviews of the Regional Development Agencies*. London: HMSO.
- 42 See summary in the Pink Book 2012. National Statistics, *Pink Book*, London: HMSO, ch 7.
- 43 Trade in goods and services shown only, excluding transfer payments and incomes. Inclusion of these would pull the balance further into negative territory for every year shown.
- 44 Kumhof, M., Lebarz, C., Ranciere, R., Richeter, A.W., Throckmorton, N.A. (2012). Income inequality and current account imbalances. *IMF Working Paper WPI/12/08*. Washington, DC: International Monetary Fund.
- 45 This is an argument from standard, neoclassical economic theory, based on the existence of externalities to economic activity – additional costs and rewards to economic activity which cannot be captured by an individual agent, and which the market cannot price properly. Since it cannot price properly, it produces less than optimal outcomes. For an economy as a whole, a co-ordination failure can exist in which a better outcome is known about, but impossible to achieve since the costs of any individual moving are too great relative to the anticipated rewards.
- 46 Foxon, T. (2002). Technological and institutional 'lock-in' as a barrier to sustainable innovation. *ICCEPT Working Paper*. London: Imperial College Centre for Energy Policy and Technology.
- 47 See, for example, the remarks of David Cameron in BBC News, 'Cameron urges economy to 'rebalance' to restore growth'. 7 March 2011.
- 48 For an impeccably orthodox case against fiscal austerity in depressed economies, see De Long, J. and Summers, L. (2012). Fiscal policy in a depressed economy. *Brookings Papers on Economic Activity* 2012. Washington, D.C.: Brookings Institute.
- 49 Abdallah, S., Mahoney, S., Marks, N., Michaelson, J., Seaford, C., Stoll, L., Thompson, S. (2011). *Measuring our Progress: the power of well-being*. London: **nef** (new economics foundation).
- 50 The authors find that a decrease in the labour share in national income reduces growth in the euro area, Germany, France, Italy, UK, USA, Japan, Turkey, and South Korea, while Canada and a few others show the opposite effect. For the whole globe, the effect of falling labour share is unambiguously negative. Onaran, O. and Galanis, G. (2012). Is aggregate demand wage-led or profit-led? National and global effects. *Conditions of Work and Employment* 40. Geneva: International Labour Organization.
- 51 Greenham, T., Johnson, V., Meadway, J., Seaford, C., Wallis, S. (2011). *The Good Jobs Plan: a new approach to industrial strategy*. London: **nef** (new economics foundation).

- 52 One recent, thorough assessment suggested that a total of £13 trillion has now been hoarded through tax avoidance schemes globally. Henry, J.S. (2012). *The Price of Offshore*. London: Tax Justice Network.
- 53 Green New Deal group. (2012). *The Great Tax Parachute: how to save the public finances and keep the economy afloat*. London: **nef** (new economics foundation).
- 54 The well-known 'balanced budget multiplier' holds that, even if increased taxes entirely pay for the cost of additional government spending, the net effect on the economy is still positive.
- 55 At least for gilts (loans to the UK government) and property.
- 56 This is mainly an argument about *relative* size – a shrinking of financial sector employment as a proportion of total employment, with other sectors growing. In addition, many banking jobs provide something akin to a public utility – operating local branches, for example – and should be maintained or even expanded. There ought, however, to be few tears shed for job losses at the apex of the financial system.
- 57 Haldane, A. (October 2012). 'On being the right size'. 2012 Beesley Lecture at the Institute of Directors, London.
- 58 Figures from ONS Blue Book.
- 59 Figures from ONS Blue Book. UK 1987 total debt: GDP ratio is 269 per cent; 2012 is 511 per cent. Debt dynamic calculation derived from Escolano, J. (2010). *A Practical Guide to Public Debt Dynamics, Fiscal Sustainability and the Cyclical Adjustment of Budgetary Aggregates*. Washington, D.C.: IMF. We have assumed for simplicity that no net debt repayment or accumulation takes place. Including aggregated net debt repayment makes little difference to the picture: an all-economy repayment rate of 30 per cent of GDP per year (implausibly high) brings the date to 2039. Increasing the assumed rate of inflation to 10 per cent brings the date to 2023; more plausible, but it is unlikely that such a high sustained rate of inflation would be politically acceptable, and more unlikely that markets would accept low nominal interest rates under permanently high inflation.
- 60 International Monetary Fund. (October 2012). *Global Financial Stability Report*, Washington, DC: IMF, ch.3 especially.
- 61 These being 1947, 1967, 1976, 1992 and 2008-9. In all five instances sharp declines in the value of pound sterling were forced on the economy.
- 62 Article 120 of the Treaty Establishing the European Community, updated by Article 144 of the Treaty on the Functioning of the European Union, contains provisions to allow unilateral action by member states ahead of Commission approval.
- 63 The 'zero bound' here refers simply to the fact that interest rates cannot, in nominal terms, fall below zero. If more loose monetary policy is required beyond this point (implying further declines in target interest rates), governments must look to more unconventional policies, like QE.
- 64 Bridges, J. and Thomas, R. (2012). The impact of QE on the UK economy – some supportive monetarist arithmetic. *Bank of England working paper 442*.
- 65 Greenham. Ryan-Collins, J., Greenham, T., Werner, R. and Jackson, A. (2011). *Where Does Money Come From?* London: **nef** (new economics foundation).
- 66 Ryan-Collins, J. (2012). *Credit is as credit does*. London: **nef** (new economics foundation) blog.

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