Good Morning. Welcome to the National Institute of Economic and Social Research for the release of our February 2020 Review. The UK’s exit from the European Union on Friday 31st January means that a near-sixty year process of pivoting our external relations on trade, migration and capital through the European continent has come to an end. The question now facing the UK is whether the break with Europe and provide the fillip to address domestic failings in economic policy or whether it will be yet another step on the path to continued relative decline.

The prospects for the global economy suggest less source of comfort, at least in the short run. Global economic growth slowed again last year as tariffs and portents of a trade war acted to slow industrial production. The weaker outlook though did prompt timely responses by several central banks and their actions have supported growth this year. With service sector activity looking robust, global growth seems likely to be around its trend of 3% or so this year and next. The key change since the final decade of the 20th century is that we have come to depend more on growth from emerging economies. This means we are more vulnerable distant economic dislocations.

The outstanding such example is the risk that climate change poses significant risks to the well-being of people throughout the world. Recent extreme weather events have highlighted that these risks are already uncomfortably high. Sir David Attenborough described the Australian bushfires as the moment of crisis to address climate change. Moreover, he lamented the lack of action in addressing the issue, arguing that “this is an urgent problem that has to be solved and, what’s more, we know how to do it – that’s the paradoxical thing, that we’re refusing to take steps that we know have to be taken”.

1
The risks posed by climate change are widely recognized and have led to promises of action. More than 190 countries have signed the 2015 Paris Agreement and set a goal to limit average global temperature rises to well below 2 degrees above pre-industrial levels. Significantly though, the United States has embarked on the process of withdrawing from the Paris Agreement because it is deemed to impose an unfair economic burden on domestic workers, businesses, and taxpayers.

The articles in this issue of the Review, edited by Garry Young (NIESR) and Dawn Holland (UN) highlight some of the economic issues involved in acting to cut greenhouse gas emissions to a level consistent with the ambition to limit global temperature increases. Together they help explain why progress in tackling this “urgent problem” is likely to be slow even though “we know how to do it”.

Turning to the UK. While the decisive result in last month’s election has reduced political uncertainty, as it has delivered a majority large enough for the government to work through a whole Parliamentary term, elevated economic uncertainty is likely to persist while we work through a number of trade deals. The first of which, with the EU, is unlikely to be able to progress much beyond trade in goods by the end of this year and will therefore leave many significant issues unresolved.

Domestic economic policy should thus be targeted with addressing the uncertainty. And so the first question to confront with next month’s Budget is the parlous state of economic growth. Just as with the immediate aftermath of the Great Slump after WW1, the British economy has been in the doldrums since the Great Financial Crisis. Then again stoking up the economy to encourage a faster rate of growth in income and well-being has been a constant occupation of British policy-makers since WW2. Indeed almost as soon as we worked out how to measure the size of the economy in the 1940s we found ourselves dissatisfied with what we found. The current administration, highlighted by the 2 3\% target recently adopted by the Chancellor, is no different but I doubt success.

There are two separate problems. First action to boost demand through tax cuts or public expenditure will quickly discover capacity constraints.
Current estimates of trend capacity growth are barely much over 1% and, given little estimated slack in the economy, a demand surge is likely to be inflationary and hence met with a response from the Monetary Policy Committee of the Bank of England. Secondly, even if policies were implemented that did create the conditions for faster non-inflationary growth by expanding supply, these policies simply cannot lay down that extra supply all that quickly. Our estimates are that even 1% of GDP of government investment would increase long run supply by around 0.5% in a decade or so.

The determination to boost activity therefore carries two separate risks. The first that it brings forward a monetary policy tightening cycle that the real economy cannot yet bear. This would leave the MPC with the problem of either acting flexibly and hoping the inflation pressures will not persist or risk a severe stress of the financial system as we suspect the sensitivity of output to interest rate changes is relatively high given the level of private and public debt.

The second is that having promised the electorate both faster growth and a “levelling up” in the economy, it simply cannot be delivered very quickly. And that may further frustrate a population that demands a significant improvement in economic prospects. And yet free trade deals will open up the economy to the gales of competition that will seek to drive down prices in tradeable industries and may in the short run further accelerate job losses in those industries.

The problem with raising living standards is that it implies huge improvements in productivity and a need to exploit the kind of technological opportunities offered by the digital revolution. Our first Prais lecture by Bart van Ark (Conference Board) last November made this point forcefully and followed up on the key issues outlined in my own Gresham lecture in 2017. There is no single answer and an improvement will require a series of connected strategic plans at local, regional and national level. And these are likely be beyond the scope of a single Budget.

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