UK Economy Falls into Double-Dip Recession

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New Boss of the Bank of England Cannot Create Miracles. Four years after the Great Crash, UK economy falls into double-dip recession

The appointment of Mark Carney – current Head of Bank of Canada – as the first non-British governor of the Bank of England in its 300-year history has received near-universal praise. But can this 47-year-old former Goldman Sachs veteran of 13 years remedy the ills of a struggling British economy?

Four years after the collapse of Lehman Brothers sparked the greatest financial crisis and economic downturn since the Great Depression, none of the underlying contradictions of the world economic system has been resolved. Global imbalances and deep-rooted tensions have deepened even further, the financial and economic crisis and the outlook looks pretty bleak. Hundreds of billions of dollars have been made available to save the banks and financial houses around the world.

Governments and central banks took off the books of the banks, the worthless or so-called toxic assets were now transferred to the states' budgets. The bailout operation, like other similar measures like quantitative easing, has cost more than 25 percent of global GDP. This large-scale bailout rather than solve the problem, has increased the volatility of the system. World stock markets hit their lowest level in 2012 as poor US jobless figures and weak manufacturing data from Europe sparked renewed fears of a global slowdown. Recently, the World Bank warned that Europe runs the risk of sparking a Lehman-style global crisis that will have dire consequences for all Western economies.[1] Four years since the start of the economic downturn, it is becoming increasingly clear that a new period of intensified crisis is gripping the global economy.

Far from easing the dire crisis conditions and introducing careful investment policies, governments of the advanced economies, in line with the international financial institutions, are now implementing sharp austerity programmes on a scale not seen since the 1930s. Everywhere in the Western world there is unemployment, foreclosures, bankruptcies, depressed housing market, and no recovery in sight. Already, in many advanced economies the highest number of people since the 1930s are now jobless or unable to find full-time work.

Austerity measures are wrecking the UK economy

Since 2008, the British government has pumped more than 375 billion pounds into the banking system through bailouts and a series of 'unconventional' measures, but very little of this has flowed back into the real economy. This figure is almost half of the declared total public deficit.

The agreement between the Conservatives and the Lib Dems provided the government *carte blanche* to balance the budget with massive cuts in public services, jobs and wages. The scale of the Coalition government's intended austerity measures are on a scale never seen in modern Britain. What is planned here will dwarf anything that was undertaken by Thatcher in the 1980s. There is already massive unemployment in the public sector. As a realistic estimate, 750,000 public sector job losses do not look far off the mark.[2] And those still in work suffer wage freezes and cuts. Job insecurity has risen for nearly everyone. Massive unemployment and lower wages mean lower tax receipts, and even bigger budget deficits and debt loads. Austerity and high unemployment also risks social unrest. Greece has already lost control of its streets, and a number of other eurozone countries are moving in that direction.

It is very unlikely that the introduction of savage austerity measures while the economy is still on downward spiral will resolve any problems– the crisis does simply get displaced from one sphere to another. The austerity measures of the UK Coalition government are therefore damaging any potential growth prospects, and are increasing the possibility for a longer and deeper crisis. Indeed, according to the f*igures released by the UK Office for National Statistics (ONS) in May 2012, the British economy entered a "double-dip" recession for the first since the 1970s.*[3] 'Double dip' is where the economy goes back into a recession before it has had a chance to recover its previous high of economic output. *And all this is not helping the budget either– a*ccording to the National Institute for Economic and Social Research (Niesr), fiscal consolidation in the UK is increasing the UK's debt burden.

Recent and Budgeted UK Total Government Debt

Debt in billions

Click chart for briefing on Total Government Debt.
For numbers and more click here.

Debt in Percent GDP

Click chart for briefing on Total Government Debt.
For numbers and more click here.

The two charts show above show recent and planned gross debt for the UK government. On the left is a chart of the debt in current pounds sterling. On the right is a chart of the debt as a percent of Gross Domestic Product (GDP).

http://www.ukpublicspending.co.uk/uk_national_debt_chart.html

Intended massive cuts are not inevitable

It is now clear that the austerity policy in the UK is not a matter of economic necessity but of political choice. David Cameron's 'Big Society' programme offers an ideological justification for the intended massive cuts. It is obvious that the cuts of this scale are about much more than just deficit reduction. Rather, cutting public expenditure is a means to shrinking the state. The cuts are part of an agenda to transfer services from the public sector to the private sector. The pretence of 'there is no alternative' is a means for the Conservative project to radically transform the state.

If the real intention is to take the British economy out of the crisis, then the cuts are the wrong way of achieving this goal. Like any other state, the main source of British state's income is taxation of workers and businesses. If a government spends more money than it gets through taxation, there will be a budget deficit. Government spending in excess of revenue in the domestic economy creates such a deficit.

In order to justify the planned cuts the government talks about the danger of high fiscal deficits and higher national debt. However, the alleged danger comes not from the size of the deficits or debt, but from how the proceeds from them are used. When the national debt is used to expand economic production with full employment and rising wages, this will lead to positive economic results. But if the debt is used to finance non-productive speculative profits achieved through pushing down wages, or/and to structure ballooning interest payments to service old debts by getting more new debts, this will eventually drag the economy to a grinding halt. In recent times, the British economy, like the US and many other advanced economies, has suffered from such proceeds being spent on programmes that were not beneficial to sustainable economic growth or supportive to economic health.

In general, deficit financing to achieve a constructive result requires a very careful approach to spending cuts and overall fiscal policy. Reducing the overall debt/ GDP ratio is difficult by simple fiscal measures, and not always necessary. Sometimes a large fiscal deficit can be useful to actually reduce the ratio if the fiscal deficit creates a bigger GDP. The economy also must be on a growth path in order to achieve required economic and financial benefits. But if the country suffers not only low, or no growth, but also no growth in working age population, reducing the debt/GDP ratio seems unrealistic and also highly risky. Therefore in order to achieve a balanced annual budget, careful fiscal measures should be accompanied by other measures such as tax rises and growth-led investment. British government currently seems to be obsessed about the need for belt-tightening, but the real problem is inadequate spending, in other words, lack of real economic activity. Cutting government spending too soon is making the situation more drastic, and the recession more severe and lengthy. The austerity measures introduced by the UK government have so far failed to create jobs or economic growth. Just the opposite, spending cuts are reducing any chances of economic growth by hindering attempts to improve tax revenues, and hence increasing the deficit even further. Due to the lack of economic growth, the government is having to borrow much more than planned this year, the Office for National Statistics (ONS) said.[4]

The government's austerity policies are failing. They are failing to create jobs, and failing to generate economic growth. Unemployment is rising (is now at its highest for 18 years, with youth unemployment the highest on record), and living standards are falling. Despite all this, the government has pledged to cut 730,000 public sector jobs by 2017 and to cut spending by £80bn.

Austerity isn't working in other places either

Greece is the most tragic example. Greek economy has been subject to massive austerity, and its economy shrank by 7% in 2011 – leading to rioting in the streets. In Spain the unemployment rate is now 25%, while youth unemployment is over 50%, its property bubble has burst, and its banks need a €120bn bailout. The UK may not be currently facing the same grave situation as Greece or Spain, but the current government is leading the country down the same path.

There are alternatives and better decisions about stimulating economic activity could be taken, especially including job creation schemes to enable the economy to grow and overcome the deficit over a period of time. Plenty of examples exist in Latin America involving measures to encourage growth and building alternatives to austerity. For two decades all Latin American continent was a victim of unrelenting and very aggressive austerity economics, initially imposed at the barrel of a gun with the military coup in Chile in 1973. Latin America had become a laboratory for testing brutal free-market ‘shock therapy’ policies of the neoliberal model that today predominates in Europe. Over the past decade, however, the progressive alternatives implemented in many counties of the continent from Brazil to Venezuela, which offers important lessons to those looking to question austerity policies today. In Venezuela, for instance, alternative policies to neoliberal austerity includes a staggering 250,000 social houses being built in the last 18 months as part of a large scale fiscal stimulus plan that has made huge positive impact on the country’s economy. This building scheme has driven a rapid expansion in the construction sector which grew 29.6% in the first part of 2012, compared to a year earlier, and played an important role in the overall growth of 5.6%.[5] Such policies are clearly relevant to the current situation in the UK.

What needs to be done?

The most important part of the process of dealing with a problem is understanding the root causes of it: a fiscal mess is often generational or structural. Trying to put all the blame on the previous administration(s) is rather over-simplifying the issue. The current fiscal and economic problems are the consequence of deep-rooted systemic changes the world economy has been experiencing for the last three decades. A realistic understanding of this process must be the first step in dealing with the current crisis. The global financial crisis, the sharp and widespread decline in production, the contraction in world trade, the enormous budgetary deficits, the instability of national currencies – all these interconnected processes signify the opening of a new era in the organisation of the world economy, which require significantly different and much more careful and well-planned long-term policies rather than quick and reactive responses.

The current deficit is not the result of some mistakes which can be attributed to previous administrators or some individual blunder, as claimed by the Coalition government, but deep-rooted structural changes within the US-centred global economy and the serious shifts affecting all Western economies, including Britain. The Office for Budget Responsibility forecasts that unemployment will remain well above 7 per cent for the next two years and above 6 per cent for the following two. This year is particularly bad as the unemployment rate is rising from its current 8.4% to peak at around 8.7% at the end of the year.[6] Structural deficits are usually based on the notion that once you have returned to full employment (and clearly that is not +6 per cent unemployment) then you check revenues against expenditures and see if they balance. It makes little or no sense to do it before and to do it on the basis of an unemployment trend that is already well above acceptable levels of unemployment.

The right task is to find a fair and sustainable path out of crisis. Budget deficits would more or less automatically heal with economic recovery. Trying to cut the deficit quickly, in the midst of a serious recession, would damage the economy drastically and extend the crisis. This is exactly what is happening inthe UK today. The government instead should concentrate on growth and let growth reduce the deficit. During the Second World War, the UK national debt reached very high figures of up to 150 per cent of GDP.[7]

It is normal practice that countries borrow more during the time of serious national and international crises, like wars, or economic upheavals like the one currently affecting the world, and pay back the debt over a period of time. In this sense, budget deficit can be an effective way to deal with such shocks like wars, financial crashes and recessions. If anything, the problem of low economic activity is the real, and more urgent, issue than the fiscal stability.

Cuts won't reduce the deficit – investment will. Austerity policies introduced by the UK government are not working, and not producing the economic growth that the coalition government allegedly promised it would. The UK economy is experiencing an unprecedented decline in corporate tax receipts as its oil, gas and banking sectors decline. There is an urgent need to invest in replacing those sectors. To get credit flowing into productive investment is a matter of real urgency. The real challenge is to introduce constructive ways to restructure the national economy so that it can deliver strong and consistent growth. At their annual meeting in Tokyo this year, October 2012, even the IMF economists destroyed the case for austerity. While their analysis constituted a small part of the institution's routine report – the World Economic Outlook– and was generally technical in form, the devastating impact of their conclusions regarding the austerity policies adopted by a number of leading economies, including the UK, could not be ignored.[8] They have shown that austerity policies implemented by politicians and demanded by financial markets are severely damaging to what economists define as 'growth'. Ultimately, argues the IMF, these policies are self-defeating. IMF economists have now admitted that the damaging effect of austerity is far more severe than they previously advised.[9] As a result, the IMF has now urged George Osborne to prepare an emergency package of spending increases to deliver growth and boost demand as it called for further interest rate cuts and more electronic money creation from the Bank of England to lift Britain out of its double-dip recession.

Mark Carney is a central banker steeped in the culture and practices of Goldman Sachs's investment banking arm. Even though he is dynamic and youthful (he has referred to the Occupy movement as being "constructive"), there is nothing in his background which indicates that he will change the direction of current financial policies in the UK, i.e. to give Britain's productive sector the protection it needs from its over-mighty financial/ banking sector. It is therefore unlikely that he will be able to reverse the most damaging policies and practices of the current Con-Lib Coalition government. Carney may well have all the credibility of a central banker with a good reputation and experience. He may be better than all other governors of the Bank of England. He might even be considered one of the shrewdest central bankers in the world. But if the British public expect him to single-handedly save the UK economy, to manage a sort of economic miracle through central banking, they are going to be profoundly disappointed.

NOTES

[1] RT News, 17 June 2012, http://rt.com/business/news/world-bank-chief-crisisl-021/(accessed in December 2012)

[2] http://www.telegraph.co.uk/news/newstopics/spending-review/8079232/Spending-Review-2010-750000-public-sector-workers-could-lose-their-jobs.html and http://www.telegraph.co.uk/finance/budget/9159114/Budget-2012-Public-sector-jobs-cull-rises-to-730000.html (accessed in December 2012)

[3] ‘ONS figures confirm UK double-dip recession’, Money Marketing, 24 May 2012, http://www.moneymarketing.co.uk/regulation/ons-figures-confirm-uk-double-dip-recession/1051903.article (accessed in December 2012)

[4] BBC News, 21 November 2012, http://www.bbc.co.uk/news/business-20424492 (accessed in December 2012)

[5] ‘Learning from Latin America’, New Left Project, 20 July 2012, http://www.newleftproject.org/index.php/site/article_comments/learning_from_latin_america (accessed in December 2012)

[6] March 2012 Economic and Fiscal Outlook Briefing, Office for Budget Responsibility, http://budgetresponsibility.independent.gov.uk/wordpress/docs/March-2012-EFO-presser.pdf

[7] ukpublicspending.co.uk (accessed in December 2012)

[8] IMF, World Economic Outlook (WEO), ‘Coping with High Debt and Sluggish Growth’, October 2012, *http://www.imf.org/external/pubs/ft/weo/2012/02/index.htm* (accessed in December 2012)

[9] http://www.imf.org/external/am/2012/ (accessed in December 2012)

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