{ ECONOMIC GROWTH }

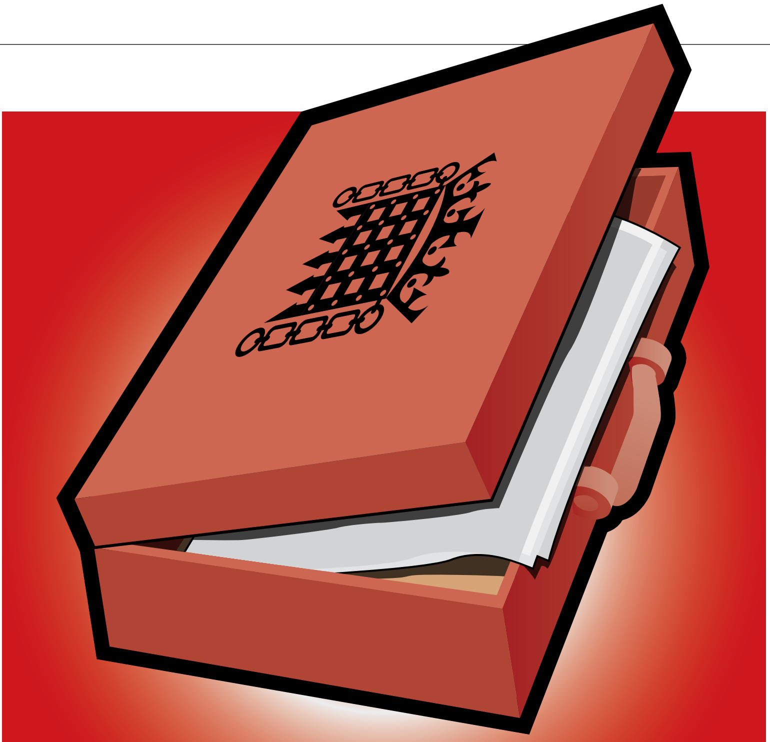
JEREMY WARNER

The economy is stuck in a rut – is it time for serious supply-side reform?

It is now nearly six years since the financial crisis began, and despite everything that policymakers have thrown at it, the economy shows few signs of healing, still less of returning to normal levels of growth.

First we bailed out the banks, but still they are deleveraging, denying the economy the lifeblood of credit expansion. We've also tried fiscal stimulus; this only succeeded in further collapsing the public finances, making the present task of fiscal consolidation more challenging still.

Zero interest rates and quantitative easing (QE) seem to have been equally ineffective in kick-starting growth. And, finally, we've tried devaluation, but that, too, given recessionary conditions in Britain's main export markets, has failed to bring about the anticipated rebalancing of the UK economy to net trade and investment.



The government's fiscal strategy is neither cutting the deficit by very much, nor is it restoring confidence

The UK economy still relies overwhelmingly on government and household demand to support output. Net trade has only marginally improved, while business investment remains firmly stuck well below pre-crisis levels.

A whole legion of credit-easing initiatives has also been tried, but so far to little avail. The economy is stuck in a rut and refuses to budge. As a result, even the government's fiscal strategy is, on its own terms, failing. It's neither cutting the deficit by very much, nor is it restoring confidence. In February, Moody's humiliatingly removed the UK's triple-A credit rating.

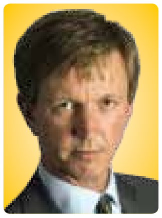
Despite the manifest failings of policy to lift the UK out of this economic funk, many cling to the belief that it can still do more. The favoured 'solution' on the left tends to favour more fiscal stimulus. Meanwhile, Britain's coalition government, still firmly committed to deficit reduction, believes monetary policy has further to go. Despite above-target inflation, the Bank of England seems largely to agree. Recently, its deputy governor, Paul Tucker, even aired the idea of a negative interest rate – that is, charging depositors for the privilege of keeping their money in the banking system. Mark Carney, the bank's new governor-in-waiting, has also made it clear that he does not believe monetary policy is 'maxed out'.

Well, possibly he is right, but experience to date of 'unconventional' monetary policy has not been supportive of this contention. Despite the monetary firepower thrown at it, the UK has suffered a deeper and longer recession than during the Great Depression. Indeed, QE is today associated more with higher inflation than higher output. The raw data is pretty damning. Since QE began, underlying inflation has averaged 2.7%, and headline inflation rather more, but GDP has remained pretty stagnant.

I'm not saying that QE was unjustified. In the early stages of the crisis, when the threat of an extreme contraction in output, money and credit was very real, something plainly had to be done, and QE was a reasonable response to it. But QE seems to have become increasingly ineffective.

So what, other than time, is the solution? The dog that has not so far barked is serious supply-side reform, a nerdy expression for a relatively simple concept, which is lowering the barriers to private sector expansion, be they regulatory or tax-related.

Undue belief in miracle, macroeconomic policy cures tends to act as an excuse for doing nothing on this front, or even a barrier to it. Why bother to indulge in genuine structural reform to make industry more productive when there is always devaluation to help with competitiveness instead? Unfortunately, there is inevitably some vested interest to deter the politician when it comes to root and branch reform. So we are stuck with more macroeconomic tweaking, however ineffective it might have become.



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