The British economy is experiencing its longest and deepest recession since records of quarterly economic growth and contraction began back in the mid-1950s. The comparison most frequently made is with the Great Depression of the 1930s, when employment, production, trade and stock markets plummeted across the world.

Then, the responses of economic policymakers were generally weak and ineffective, and a strong recovery only really emerged as a consequence of rearmament and war. This time, the lessons of history were learned quickly. Central banks have cut interest rates to unprecedentedly low levels and embarked on programmes of ‘quantitative easing’ – buying assets, mainly government bonds, and creating the money to do so – to increase the money supply. Finance ministries have pursued policies of ‘fiscal stimulus’ – raising public spending or lowering taxes to boost demand. And through the G20, governments have made efforts to co-ordinate their macroeconomic policies, support trade and reform the regulation of financial markets.

The results are reasonably encouraging. Global industrial production shows clear signs of recovering, global stock markets have mounted a sharp recovery and the downward spiral in the volume of global trade has abated.

In Britain, while unemployment, a typically ‘lagging indicator’ of recession, continues to rise, the contraction of national output is close to...
Chart 1, produced by the National Institute of Economic and Social Research, shows that the progress of the current recession has been worse than those of the mid-1970s, early 1980s and early 1990s, but it looks unlikely to be quite as bad as that of the 1930s.

Now comes perhaps the most difficult time for policymakers. In its World Economic Outlook of October 2009, the International Monetary Fund (IMF) explains: “The key policy requirements remain to restore financial sector health while maintaining supportive macroeconomic policies until the recovery is on a firm footing... However, policymakers need to begin preparing for an orderly unwinding of extraordinary levels of public intervention.”

For central banks, the question about unwinding – their ‘exit strategy’ – is when to start withdrawing quantitative easing and raising interest rates. Given their obligation to maintain price stability – inflation close to two per cent a year in the case of the Bank of England – this will be when there are signs of inflationary pressures. Most commentators agree that this is not an immediate threat in Britain and most other developed economies.

For fiscal policymakers, the question of exit strategy is more complex. A fiscal stimulus may encourage private spending and promote economic recovery in the short term. But longer-term, increasing public spending or cutting taxes can do more harm than good if they jeopardise the sustainability of the public finances. That happens when government borrowing and the stock of public debt get so high that it is not clear how they will be reduced. At that point, international investors in government bonds begin to worry about debt default or currency depreciation, and demand higher rates of interest.

No one knows exactly when that point would be reached. But in Britain, public sector borrowing is set to peak at a level not seen since the Second World War, and public indebtedness looks likely to climb to levels last seen in the late 1960s. So there clearly needs to be a credible plan to set aside enough resources once the recession is over to repay the additional public debt that the financial crisis and fiscal stimulus have created.

In Britain’s Fiscal Squeeze: The Choices Ahead, the Institute for Fiscal Studies (IFS) lays out the politically painful tax and spending choices that will confront the party that wins the next general election. Key decisions that need to be taken include the size of the necessary ‘fiscal tightening’, when it should begin, how quickly to try to complete it and how to spread the pain between tax increases and cuts in spending on public services.

The Treasury currently plans an eight-year tightening, beginning in the 2010/11 fiscal year and ‘front-loaded’ in its impact on spending power in the economy. But as the IFS notes, a case can be made both for accelerating the tightening – so as to reassure international investors and to get the political pain over more quickly – and delaying it – to give the economic recovery more time to get established.

Chart 2 shows the likely impact on net public debt of four alternative scenarios. The red line at 40 per cent of GDP is the ceiling on public debt according to Gordon Brown’s sustainable investment rule, which he established as Chancellor and which was shattered by the financial crisis. His second fiscal principle, the so-called ‘golden rule’ – which permitted borrowing only to invest and not to fund current spending over the economic cycle – was also a victim of the crisis. But its credibility had already been diminished by the Treasury repeatedly changing its dating of the economic cycle.
With the demise of such fiscal rules in Britain and elsewhere, the IMF recommends new rules to assist in reducing public debt: “The achievement of such reductions could usefully be supported with more robust fiscal frameworks, including suitable fiscal rules and strong enforcement mechanisms. Such frameworks and rules can play helpful roles in reining in spending pressures when good times return, thereby providing a degree of reassurance to investors that deficits and debt eventually will be rolled back.”

What might these rules look like in Britain? Chancellor Alistair Darling has proposed a Fiscal Responsibility Act, which would legally oblige the government to “reduce the budget deficit year on year, ensuring that the national debt remains sustainable in the medium term”. Carl Emmerson, Deputy Director of the IFS, says that if such an Act did boost credibility among international investors, it might be worth implementing.

But a sensible commitment to reduce borrowing would need to consider the ups and downs of the economic cycle and contain an opt-out clause in the event of an extreme unforeseen adverse shock, such as a future financial crisis. These crucial caveats could diminish the power of such an Act, just as happened with Gordon Brown’s two fiscal rules, which were enshrined in statute in the Code for Fiscal Stability in 1998.

Shadow Chancellor George Osborne has proposed an Office for Budget Responsibility to reassure markets. This institution, modelled on the Congressional Budget Office in the United States, would comprise a small number of experts producing forecasts for the public finances independently of the Treasury. Emmerson acknowledges that this would be valuable if it boosted the credibility of the Chancellor’s forecasts. But care would need to be taken to ensure that it was not hindered by lack of expertise or information compared with the current Treasury forecasting team.

Neither the Act nor the Office should be seen as a substitute for clarity on how Darling or Osborne would seek to cut borrowing. Emmerson argues. If individuals are to be made directly worse off financially, then being told sooner rather than later would enable them to plan better for the reduction in their future spending power. Similarly, setting out plans for spending on public services would allow managers more time to minimise any adverse consequences.

Professor Willem Buiter of the London School of Economics (LSE) also stresses the importance of announcing plans, though not necessarily implementing them immediately: “Sometimes the only way to gain credibility about your future intentions is to give a painful early demonstration. Certainly if, against all odds, Labour were to form the government after the next election, its fiscal credibility, and specifically its capacity to commit to future fiscal pain, would be nil.”

Professor Buiter goes on to evaluate other possible election outcomes: “The Tories are untried and untested. They did the right thing pointing out the inevitability of major fiscal pain; their apparent desire to start the fiscal tightening immediately and thus not to take full advantage of the announcement effects of future fiscal tightening may have been motivated by a recognition that they start out without a track record, without a reputation and therefore without any credibility capital to spend. A hung government might have some fiscal credibility if Vince Cable were the chancellor.”

The outcome of the general election may also have an impact on the speed with which fiscal tightening is implemented. An incoming Conservative or Liberal Democrat government would probably have a strong incentive to get the pain of tightening over as quickly as possible – preferably within a single term of government. A hung parliament might be destabilising if international investors fear that a minority or coalition government would be less able to introduce unpopular tax rises or spending cuts.

Beyond the crucial domestic issues of fiscal policy, there are important questions about future rules for international financial markets, the channel through which the recession began. Here the global policy discussion has been influenced by The Fundamental Principles of Financial Regulation by LSE’s Professor Charles Goodhart and colleagues. This urges “the coordination of ‘micro-prudential’ (bank-level) regulation by financial services authorities and ‘macro-prudential’ (system-wide) regulation by central banks”, adding financial stability to the latter’s remit alongside price stability.

One final area of rules and regulations in which national and international policymakers are having a fundamental rethink in the aftermath of the economic crisis is the multilateral trading system. “Resisting protectionism and promoting global trade and investment” has been a pledge at successive summits of the G20. It remains a vital commitment to avoid the policy errors of the 1930s recession and to ensure that this recession eventually builds into a lasting recovery.

**Chart 2: Paths of public sector net debt under different illustrative options for the timing of the fiscal tightening**

http://www.ifs.org.uk/publications/4618
EVERY SOCIETY CLINGS to a myth by which it lives. Ours is the myth of economic growth. For the past five decades, the pursuit of growth has been the single most important policy goal across the world. Economic growth is supposed to deliver higher incomes and an improved quality of life for us all. That, at least, is the conventional wisdom, but things have not always turned out that way.

Growth has delivered its benefits, at best, unequally. A fifth of the world’s population earns just two per cent of global income. Inequality is higher in the Organisation for Economic Co-operation and Development (OECD) nations than it was 20 years ago. While the rich got richer, middle-class incomes were stagnant in real terms long before the recession. Far from raising the living standards of those who most needed it, growth has let much of the world’s population down.

Fairness – or the lack of it – is just one of several reasons to question the conventional formula for achieving prosperity. The global economy is almost five times the size it was a century ago. If it continues to grow at the same rate, the economy will be 80 times that size by the year 2100.

This extraordinary expansion of economic activity has no historical precedent. It is totally at odds with our scientific knowledge of the finite resource base and the fragile ecology on which we depend for survival. And it has already been accompanied by the degradation of an estimated 60 per cent of the world’s ecosystems.

As the economy expands, so do the resource implications associated with it. These effects are already unsustainable. Global carbon emissions have risen by 40 per cent since 1990. Significant scarcity in key resources – such as oil – may be less than a decade away.

A world of ‘business as usual’ is already inconceivable. But what about a world in 2050 where nine billion people aspire to the level of affluence achieved in the OECD nations? Such an economy would need to be 80 but 200 times bigger than it was 50 years ago by the end of this century. What does such an economy look like? What does it run on? Does it really offer a credible vision for a shared and lasting prosperity?

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For the most part, we avoid the stark reality of these questions. The default assumption is that financial crises aside – growth will continue indefinitely. Not just for the poorest countries, where a better quality of life is undeniably needed, but even for the richest nations where the cornucopia of material wealth adds little to happiness and threatens the foundations of our wellbeing.

The reasons for this collective blindness are easy enough to find. When growth falters – as it has done recently – politicians panic. Businesses struggle to survive. People lose their jobs and sometimes their homes. A spiral of recession looms. Questioning growth is deemed to be the act of lunatics, idealists and revolutionaries.

But question it we must. The myth of growth has failed us. It has failed the two billion people who still live on less than $2 a day. It has failed the planet’s fragile ecological systems. It has failed, spectacularly, in its own terms, to provide economic stability and secure people’s livelihoods.

Today we find ourselves faced with the imminent end of the era of cheap oil, the prospect of steadily rising commodity prices, the degradation of forests, lakes and soils, conflicts over land use, water quality and fishing rights, and the momentous challenge of stabilising concentrations of carbon in the global atmosphere.

And we face these tasks with an economy that is fundamentally broken.

In these circumstances, a return to business as usual is not an option. Prosperity for the few founded on ecological destruction and persistent social injustice is no foundation for a civilised society. Economic recovery is vital. Protecting people’s jobs – and creating new ones – is absolutely essential. But we also stand in urgent need of a renewed sense of shared prosperity.

Delivering these goals may seem an unfamiliar or even incongruous task for policy in the modern age.

Prosperity consists in our ability to flourish as human beings – within the ecological limits of a finite planet. The challenge for our society is to create the conditions under which this is possible. It is the most urgent task of our times.
TACKLING POVERTY AND INEQUALITY

A mixed picture under Labour

The Labour Government has always been clear about its ambition to reduce poverty. It has been more ambivalent about inequality. While Tony Blair and Gordon Brown called for the eradication of child poverty within a generation, Peter Mandelson said that the government was “intensely relaxed about people getting filthy rich”.

Research by the Institute for Fiscal Studies shows that Labour’s record on both poverty and inequality has been mixed over its three terms of office. During Labour’s first term, there was robust growth of over three per cent a year after inflation in ‘median’ incomes, the incomes of people right in the middle of the income distribution.

Since poverty is usually defined as having an income below 60 per cent of the median (after taxes have been deducted and benefits added), increases in average incomes will raise the threshold and hence potentially lead to rising poverty. Indeed, this is what happened during the 1980s.

But in the late 1990s, income growth for those on relatively low incomes was also robust, partly due to increased employment and partly to various redistributive measures, such as tax credits. Low incomes more than kept up with average growth so poverty fell over this period (as shown by the blue line in the chart).

These reductions in poverty continued into Labour’s second term, with the largest falls seen for pensioners and families with children. It might have been expected for them to continue into Labour’s third term, particularly given the fact that growth in median incomes slowed to less than 0.5 per cent a year after inflation.

Poverty has actually risen during Labour’s third term, even among groups favoured by tax and benefit reforms – families with children and pensioners. The rise in poverty during Labour’s third term has almost undone the fall during the second term, though it is still lower than when the government came to power in 1997.

Following a substantial rise in the 1980s, income inequality was relatively high by historical standards in 1997. During Labour’s first term, it continued to rise, despite the poor catching up with those on middle incomes. This may seem puzzling, but is largely because incomes at the very top of the income distribution grew fastest of all.

Income inequality then fell slightly during Labour’s second term, with top incomes falling in the wake of the bursting of the bubble in shares in technology companies. The picture has changed again during Labour’s third term, with income inequality increasing once more. By 2007-08, it had risen above its previous peak in 2001-02, higher than at any point since at least the 1950s.

With the recession, there could well be another switch in poverty and inequality. The effect of the recession on inequality is uncertain. Inequality fell during the recession of the mid-1970s, rose during that of the early 1980s and was more or less unchanged during the early 1990s recession. But in all these recessions, incomes in the middle of the income distribution fell by more than those at the bottom.

The effect of the recession on poverty is also uncertain. Higher levels of unemployment are likely to increase the number of low-income households. But falls in average incomes also lower the relative poverty threshold and thereby reduce relative poverty.

In practice, relative poverty across the whole population has fallen in previous recessions, driven by big falls in pensioner poverty. Pensioners are less likely to be affected by rising unemployment or lower earnings growth than people of working age. But absolute poverty (defined against a threshold that does not decline with average incomes but is updated with inflation) has risen, particularly for families with children.

http://www.ifs.org.uk
WHAT HAVE local authorities been able to do to soften the blow of this recession? The Department for Communities and Local Government asked a team of researchers from the Spatial Economics Research Centre to look back at the recessions of the early 1980s and early 1990s, and lay out the lessons for the present.

The LSE team led by Professor Ian Gordon distinguished five roles that local authorities could play: boosting national demand; targeting demand on areas in most need; mitigating major social impacts; addressing specific forms of market and government failure; and safeguarding strategic projects with clear longer-term value.

The researchers then examined how local authorities had played these roles in past recessions. They found that councils had unexpectedly little experience of fighting an economic recession. The deep recession of the early 1980s, which was concentrated in industrial cities, was linked to a national government plan to promote restructuring by removing barriers to competitiveness. Coupled with a squeeze on local government spending, this produced polarised responses, including active resistance by a small number of councils with more interventionist agendas but little scope for action.

More strategic responses followed in the later stages of the 1980s recession. But although some Labour-run local authorities focused on investing in social housing, the situation encouraged over-politicised community responses, poorly judged business support and isolationism.

The bursting of the property bubble in the late 1980s led to negative equity and a sharp slowdown in house-building. But councils did not have the resources to act counter-cyclically. Housing associations were used to boost house-building and, in some cases, to buy up private property.

The 1990s recession was triggered by anti-inflationary policies and the bursting of a previous speculative boom. The prime effects falling more in the south-east than the previous recession. Although councils had just acquired economic development powers, local tax reform and capping had the effect of limiting interventions. There was activity to lobby central government for support, leading to the creation of ‘challenge’ funding programmes for local regeneration.

The current recession is one where local government has been a stable and financially strong part of the overall financial system.
the pattern of previous recessions. Local councils might be able to use some of their investments and reserves to boost, or at least sustain, capital spending for a period. It was suggested that the government might consider reviewing some definitional limitations on local government or public-private action.

It was expected that the demands created by homelessness would rise sharply during the recession. The government was advised to ensure there was adequate information for households and that the planning and development control systems were flexible. Land supply for new developments could inhibit recovery, as might over-zealous negotiations about ‘Section 106’ deals, which demand infrastructure contributions from developers.

Looking ahead, the researchers saw a potentially enhanced role for councils in funding mortgages if there was limited market supply. Also, once the Housing Revenue Account had been reformed, it would be possible for local government to take part more easily in partnerships to ensure private developers can once again start building houses. As it has turned out, the government was able to bring forward some capital funding, in part through local authority programmes, for 2009-10. Councils did take a number of mitigation steps, affecting households and businesses.

The current recession is one where local government has been a stable and financially strong part of the overall financial system. This stability has probably assisted the government in sustaining the economy despite a sharp contraction in national output. ■

http://www.spatial_economics.ac.uk
http://www.lse.ac.uk/collections/LSELondon/events/New_Research_June_2009.htm

### AT A GLANCE

The recession may have adverse effects on voluntary organisations in rural Scotland. Likely effects include a decline in corporate giving and volunteer schemes, causing greater vulnerability in these areas in the longer term.

http://www.crs.uhi.ac.uk

### ROUND ONE

Around one million people in Scotland, nearly one in five of the population, live in rural areas. Many of these are remote places with severe social and economic problems caused by poor transport, lack of economic opportunity and a high cost of living. The voluntary sector typically plays a pivotal role in the delivery of services in these parts of the country; at the same time, more people in rural areas give up their time to volunteer than in the rest of Scotland.

What is the likely impact of the economic downturn on Scotland’s rural voluntary sector? Predicted effects include a decline in corporate giving, the abandonment of volunteering schemes involving small businesses, and increasing pressures on advice and support agencies, which are poorly funded at the local level.

Dr Philomena de Lima, Director of the Centre for Remote and Rural Studies at the prospective University of the Highlands and Islands, is drawing on the experiences of Highlands practitioners – from large to very small organisations – to get more detailed insights into the prospects for the sector. She finds the term ‘uncertainty’ cropping up repeatedly in discussions about the downturn, accompanied by heightened anxieties as to the unpredictability of the impact on future funding.

Based on a preliminary scoping exercise, two organisations dependent on local authority funding report no immediate adverse effects, with support secured for the next two years. But there are concerns that funding in general is likely to reduce, with a detrimental impact on small voluntary organisations and their vital role in providing services in rural areas, particularly when most needed.

Individual charitable giving does not appear to be affected. But there are anxieties about the extent to which it will be sustained in the light of competing requests from charities, a downturn in local businesses and growing job insecurity.

The impact on individuals in rural communities as businesses slow down or close is another concern. It is perceived as leading to increasing social problems, such as domestic abuse associated with alcohol, stress and mental health problems.

In addition, the high costs of food, fuel and transport are cited as potentially leading to an exodus to cities. The vulnerability of rural areas to ‘depopulation’ raises serious questions about their longer-term sustainability. ■

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‘WHITE-COLLAR RECESSION’ FAILS TO MATERIALISE

In the six months after the collapse of Lehman Brothers in September 2008 and the ensuing slump in global stock markets, there were more than 26,000 jobs lost in Britain’s financial sector. These lay-offs led many to predict a ‘middle class’ or ‘white-collar recession’, one in which skilled and highly educated workers suffered more than their blue-collar counterparts.

Research by Alastair Muriel and Luke Sibieta of the Institute for Fiscal Studies suggests that this is not happening. The largest rises in unemployment have been concentrated in traditionally low-skilled occupations: elementary jobs, such as shelf-stacking, and process, plant and machinery operatives. An extra five per cent of these individuals have found themselves needing to claim unemployment benefits compared with just one per cent of those in managerial occupations.

Of course, managerial and professional workers might be less likely to claim unemployment benefits even if they do find themselves out of a job. But even using wider measures of unemployment, which take this into account, redundancies have risen fastest among workers with lower educational qualifications and among younger workers, particularly those under 25.

White-collar workers are not completely unaffected: their unemployment rate is increasing, albeit more slowly than among lower-skilled workers. And individuals on very high incomes, who are more dependent than most on financial markets for their incomes – via either earnings or returns on savings and investments – may see their incomes fall or stagnate.

While white-collar workers are feeling the pinch from the current recession, it is the low skilled, the less educated and younger workers who are being hardest hit, just as in the past. So far, at least, this is not a white-collar recession.

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One major criticism made of past job creation schemes is that they have produced rather little in the way of useful output, partly to prevent them ‘crowding out’ other jobs. Another is that they have, in some cases, actually delayed job entry rather than enhanced it. Professor Gregg believes that these risks can be overcome with intelligent design and implementation.

First, training needs to be supported by employers, including agreement to consider programme participants favourably. This can be done through guaranteed interviews, work trials or job offers on course completion. Second, there should be long-term training for recognised qualifications in shortage areas.

Dr Taylor has created a ‘financial capability index’, which measures such factors as current and previous financial situation, savings, borrowings, cutbacks and problems with housing payments. His indicators of wellbeing are people’s scores on the General Health Questionnaire, their reported life satisfaction and any health problems associated with anxiety or depression.

The results indicate that financial capability has a significant impact on wellbeing and stress levels. Moving from low to average levels of financial capability increases an individual’s psychological wellbeing by 5.6 per cent and their life satisfaction by 2.4 per cent. Health risks related to anxiety or depression are reduced by 15 per cent.

The link between finances and wellbeing is least strong for those with the worst financial problems. So, while improved finances will benefit most people, the effect on wellbeing might be lower among those who are worst off. Being unemployed or being divorced increase the negative impact of financial difficulties on psychological wellbeing, while being retired or being in good health reduce the adverse impact.

Dr Taylor concludes that improving financial capability is particularly crucial in the current recession, with increasing numbers of the population feeling under stress about managing their finances.
RECESSION & RECOVERY NEWS

PAST LESSONS FOR FUTURE PUBLIC SPENDING CUTS

FEW SERVING civil servants or politicians have direct experience of substantial public spending cuts. But we have been here before. A generation ago, the Labour government led by James Callaghan had to slam the brakes on public spending. The sterling crisis of 1976 had forced it to obtain a loan from the International Monetary Fund (IMF). In exchange, there had to be spending cuts and tax rises.

In 1922, a Liberal-Conservative coalition government led by David Lloyd George was forced by by-election losses into a programme of tax cuts and spending reductions that cut the equivalent of at least £100 billion today from government spending. That is roughly twice the level of cuts implied by the 2009 Budget projections for the period to March 2014.

Research by Carl Emmerson of the Institute for Fiscal Studies and Professor Christopher Hood and Dr Ruth Dixon of the ESRC’s Public Services Programme suggests there are two key questions prompted by these experiences. The first is whether cutbacks on the scale now being mooted can be conducted by normal Treasury processes of negotiation, given the pressures exerted by the spending departments and their interest group allies when budgets are under pressure.

In the 1920s and 1970s, Treasury’s processes were supplemented by external pressures. In 1976, the IMF made the government sign a ‘letter of intent’, which changed policy from a stance of spending stability and deferred tax rises to one of immediate spending cuts and tax increases. In the 1920s, a high-powered body of business people (the Geddes Committee) effectively doubled the cuts produced by the ‘normal’ processes.

The second question is whether the measures used to cut public spending and employment in those earlier periods can be repeated today. The 1920s cuts are arguably the last time when public spending was substantially reversed for a sustained period. They came at a time when cuts in defence spending after the First World War were feasible, and large numbers of temporary civil servants recruited in the war could be dismissed easily. Neither condition applies today.

Similarly, in the 1970s and 1980s, many of the lost civil service jobs resulted from outsourcing industrial or blue-collar jobs, mainly in the naval dockyards and ordnance factories. Now that virtually all of that work has been outsourced to the private sector, there is no equivalent scope for blue-collar public sector job cuts.

Britain’s experience since the mid-1950s suggests that the growth of public spending when the economy is growing has not been proportionately checked to compensate for extra spending in recessions. So any government aspiring to do something different now may need to learn a mixture of new and old tricks.

http://www.ifs.org.uk
http://www.publicservices.ac.uk

BANK BAILOUTS AND THE THREAT TO COMPETITION POLICY

How should we get this vital discipline back on track?

IN THE LAST DECADE, competition policy has been reinvented across Europe and introduced in many emerging economies with vigour and a new focus on economic foundations. Research consistently shows that promoting competition results in efficient businesses and benefits for consumers. The discipline of competition policy has also allowed the reduction of inefficient forms of regulation and public ownership.

But while modern competition policy is economically robust, it remains politically fragile. Professor Bruce Lyons of the ESRC Centre for Competition Policy fears that the economic crisis may lead to a weakening of competition policy: “It is still vulnerable to crude, populist and deeply flawed claims that it is an unnecessary luxury in times of recession or even that the crisis itself is due to ‘too much competition’.”

He is particularly concerned about the aftermath of governments’ responses to the threat of widespread bank failures: “The misleading ‘precedent’ of bailing out the banks should not be allowed to make competition policy another casualty of the crisis.”

The crisis had its roots in slack regulation and strategic errors by the banks. Driven by biased incentives, the banks borrowed (and lent) far too

What happens to immigration during times of recession?

IN 2008, 13 per cent of the working-age population of Britain was born overseas. This compares with 7.5 per cent at the end of the last recession. So what happens when you have an increasing number of unemployed residents in a country where migrants are playing a growing role in the labour market?

In recent years, there has been concern about abuse and exploitation of migrants. But as the recession bites, this has been replaced disturbingly quickly by fears of jobs being ‘taken’ and wages undercut, encapsulated in the phrase, ‘British jobs for British workers’. What does research reveal about the facts?

First, it demonstrates the politicised nature of definitions. Who counts as a migrant? The government and the media tend to equate the word with ‘foreign-born’. But in the year to September 2008, two in every five foreign-born residents had British nationality. And one in every 20 residents who did not have British nationality was born in Britain.

Others are nationals of the European Economic Area (EEA – the European Union plus Iceland, Liechtenstein and Norway) or permanently settled in Britain. It is illegal to discriminate against any of these people on the grounds that they are foreign-born.

Data on migrant workers are limited and can be misleading. Migrants tend to cluster in very specific occupations that are not captured in.
much given their low capital base, and were caught out when the housing price bubble burst. The global reach of this behaviour was compounded by the sale and purchase of opaque mortgage-backed securities between financial institutions.

The banks’ recklessness was facilitated by permissive monetary policy and massive international flows of funds. Like an unlimited supply of food in the animal kingdom, huge flows of funds into western banks suppressed the power of competition to select only the fittest to survive. Similarly, rapid recession, like periods of limited food, soon picks off the unfit and, if the drought is severe, many of the fit as well.

There have been two consequences. First, many of the world’s most renowned banks have been pushed close to bankruptcy. Governments across the world have stepped in to bail them out by guaranteeing loans, injecting capital, underwriting toxic assets and acquiring their shares.

Second, there has been contagion into all corners of the economy. The banks cut lending in order to rebuild their reserves. This created severe financial constraints for their business and private customers, resulting in reduced demand and a powerful negative ‘multiplier’ effect across the global economy.

Professor Lyons points out that bailing out the banks was necessary because of what he terms the unique ‘double contagion’ in banking. In addition to the impact of banking retrenchment on the rest of the economy, the crisis brought contagion between banks.

This is because banks borrow and lend to each other and are ‘counterparties’ to each other’s securities. If a large bank goes bust, this destroys the capital base of others, leading to a cascading crisis. Such contagion does not arise in other industries where survival does not depend on rivals’ ability to repay loans and insure risks.

Nevertheless, Chinese politicians, who have been lectured for years about the virtues of free markets and who have finally adopted a western-style competition policy, may be puzzled. They observe exceptional levels of government intervention in banks, including massive subsidies, direct ‘interference’ in business decisions, politicians promoting mergers and nationalisation.

Professor Lyons argues that careful analysis of the sources of the crisis and a clear understanding of the unique double contagion in banking are crucial for developing appropriate policy responses. Taxpayers’ money was needed to put the financial system on life support until it can pump sufficient finance on its own. Tighter prudential regulation of banks is self-evidently necessary. But anti-competitive mergers such as Lloyds TSB and HBOS were not necessary.

“Nevertheless, it remains true that banks and related financial institutions are a unique case,” Lyons concludes. “They do not provide a relevant precedent for adopting bailouts and abrogating competition policy for any other industries.”

http://www.uea.ac.uk/ccp

Some points-based immigration systems are being considered in Britain as a solution. Under the proposed scheme, migrants might be counted towards the government’s target of reducing immigration numbers only if they are in ‘skilled’ occupations. The idea is that bringing in migrant workers to fill gaps will not affect the level of detail of government statistics. For example, while almost a quarter of chefs employed in Britain were not born in the EEA, data do not indicate how many of them work in Indian and Chinese restaurants or others serving non-European food.

Past recessions saw the number of new arrivals in Britain fall while the number of people leaving the country increased. This certainly seems to have been the case in 2008 and early 2009. But this is about the flow of migrants, not the stock of people already in Britain. So far it seems that, unlike previous recessions, migrants (defined as ‘foreign-born’ people) are not being disproportionately hit by economic change.

Research by the ESRC Centre on Migration, Policy and Society, which has looked at the demand for migrant labour, suggests that this might in part he because migrant workers are complementary to British-born workers. In addition, some may be in ‘recession-resilient’ occupations. Many are also integrated into the economy in a way that means they are not simply an easily dismissed ‘residual’ workforce.

This suggests that simply looking at the flow of migrants is not sufficient. The employment of migrant workers is often symptomatic of issues that do not derive from immigration policy.

Take, for example, the proposed squeeze on public spending. The Department of Health and Department for Children, Schools and Families have been clear that ‘constrained public finances’ will affect salaries. But they are currently unable to attract British people to work in some low paid teaching and nursing posts.

The two departments were understandably concerned that wage levels might mean these posts would not count as ‘skilled’ for the purposes of immigration, so they would not be able to bring in migrant workers to fill them. The solution has been to treat this as a special case under the points-based immigration system. Thus, the recession might well mean more, not fewer, migrants in certain public sector jobs.

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**Business lessons from the crisis**

RISK MANAGEMENT MUST BECOME MORE PERSONAL

The recent failures in the financial services industry were largely due to a failure of management – the inability of executives running large companies to do their job properly. Management mistakes were made in several areas, not least in the development of flawed incentive systems and the lack of clarity over long-term objectives. Perhaps the area with the greatest problems was the poor risk management that lay at the heart of the subprime meltdown in 2007.

Our research on risk management points to one central conclusion: companies need to make the process of risk management more personal. Formal systems and rules, and external checks and balances will only take you so far. The real difference is made when you personalise the process: when you give responsibility for making risk judgments to those individuals closest to the action; and when they have to live with the consequences of those decisions.

So how do firms manage risk? How do they bring the necessary level of expertise to bear on difficult decisions? Historically, the answer was bureaucracy – the regulations and structures used to control activity. Bureaucracy encourages the development of formal rules and procedures that transcend individual idiosyncrasies. Bureaucracy can also make a company overly rigid and specialised and it can lead to depersonalisation and employees feeling a lack of ownership.

Depersonalisation can be a real problem, as indicated by the winners and losers in the credit crisis. While there were notable failures among smaller players like hedge funds, the major losses were borne disproportionately by the very large banks. This was partly because decision-makers in smaller companies were highly knowledgeable, closer to the action and accountable for the outcomes of their decisions.

For example, JPMorgan Chase, one of the least affected major players, had a highly cohesive top team that took ownership of its risk management agenda. Back in 2006, CEO Jamie Dimon and his team saw early warning signals of the credit risk on mortgages and the market risk on ‘collateralised debt obligations’, as a result of which they reduced the bank’s level of exposure to these complex securities, which are backed by the payments on mortgages and other loans.

Most of the large investment banks, by contrast, had hundreds of employees working in risk management, using procedures so carefully defined that well-intentioned managers could no longer see the bigger picture. The net result was that many got into deep trouble. Not only did they steer clear of promising lines of business developed by other firms, such as hedge funds and private equity houses; they also made horrendous trading losses on some lines of business.

So where did bureaucracy go wrong? In our view, it failed because it allowed individuals to detach themselves – legally and morally – from the system in which they were working. There are three basic approaches to managing risk in large firms: formal system-wide procedures and rules; external approval provided by third parties, some required by law (auditors and regulators) and others optional but widely used (credit rating agencies); and personalisation.

While all three approaches are necessary and are used to varying degrees all the time, recent evidence from banking and elsewhere suggests we need to redress the balance towards personalisation, especially in large firms.

Goldman Sachs, one of the best performers in the credit crisis, is frequently cited as the acme of personalisation, and at JPMorgan Chase, Dimon is known to have taken an active personal role in risk briefings. Goldman Sachs and JPMorgan Chase are clearly exceptions. Other firms in the sector rely heavily on bureaucratic approaches to risk management.

So how do you personalise your approach to risk management? Our research shows that there are three key elements. The first is high quality insight. Making decisions requires good quality information, effective analytical tools and the competence to interpret this information. Organisations must build systems that put the right information in the hands of those making decisions, and transform that information into insight through deep experience.

The second element is personal accountability. In many organisations, the risk manager is too far removed from the action to feel genuine responsibility. Organisations must ensure that personal accountability is appropriately rewarded, and that the individual or team with the high quality insight is also the one making the decision.

The third element is a supportive culture. An organisation’s culture must support the principles of high quality insight and personal accountability. Building a supportive culture requires transparency of purpose, a visible commitment to a set of non-financial objectives. It also requires a refusal to simplify the big picture: employees should be encouraged not to get lost in the detail but to appreciate how their work has implications for others, and how their decisions affect the wider organisation.

Personalisation of risk management does not mean throwing out the traditional systems. It means a subtle shift in emphasis: from the management of a portfolio of risks to the underwriting of individual risk decisions. This approach is relevant across all sectors of the economy, not just in the world of financial services.

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