More efficient funding channels between investors and firms would deliver investment, innovation and growth. Romesh Vaitilingam looks at how to overcome the challenges of such a plan.
Taking a risk
Small businesses need financing from banks to flourish, but a reluctance to provide such funding to these 'riskier' enterprises is curbing potential growth.

**FUNDING SMALL BUSINESSES**

Over 80 per cent of financing for small- and medium-sized enterprises (SMEs) in Europe comes from banks. Since SMEs account for 99.8 per cent of businesses and 67 per cent of private sector employment in the EU, scarcity of bank financing is a concern. This compounds other problems facing SMEs, such as flaws in their structure and governance.

Europe’s SME funding problem arises because banks are under pressure from regulations to build up their capital and to attach increasing risk charges to riskier investments, such as SMEs. Limited competition in banking adds further to European financing costs.

Might new sources of intermediation help? There is no inherent reason to believe that banks are fundamentally any less efficient than the alternative forms of intermediation – and they certainly have strong advantages, not least through relationship banking. This would seem to give little room for the new alternatives – yet if that were true, there would be little talk of the CMU.

Because of their systemic importance, banks are increasingly required to be individually safe. Ensuring this safety is costly, which makes the Basel III regulations, with their increases in capital buffers, a primary driver of the CMU. Since the new alternatives are not yet perceived to be systemically important, they do not have to bear this insurance cost. As a result, banks’ relative inefficiency may be the raison d’être for the CMU. But the reason that the new alternatives have not been able to replace absent bank financing is that there are too many barriers in place.

There are many factors that might contrive to thwart the success of a CMU. While many are important, those that really matter are law, tax and regulations, some of which purposefully limit international flows of funding. These challenges are very sensitive and difficult to tackle, and some have been long discussed.

It seems unlikely that the CMU will attract sufficient priority from European authorities for the legislative and tax challenges to be addressed efficiently. Instead, concrete moves towards the CMU are more likely to stem from the more malleable regulatory process. There are no explicit barriers that prevent the CMU from emerging,

European firms often have a difficult time attracting funding as they depend on banks for around 80 per cent of their external financing. Yet there is no shortage of investable capital in the European Union (EU) and savers suffer from a lack of investment choices and dismal returns. The problem is that Europe lacks a unified financing system. This malaise is what the proposed capital markets union (CMU) aims to solve: to find innovative ways to channel funds efficiently from those enjoying surplus resources to those best able to make use of those funds – in other words, intermediation.

Researchers at the Systemic Risk Centre (SRC) are exploring how CMU can be achieved. They note that diverse tax regimes and national legislation pose a big challenge to its existence – and the necessary treaties and directives to solve this problem are not on the horizon. In the absence of fundamental tax and legal reforms, it is hoped that progress can be made by removing some of the myriad other obstacles that collectively form a barrier to achieving a European financing system. But, the SRC team concludes, the EU and national authorities will need to adapt their regulatory systems and embrace disruptive technologies.

As the CMU emerges, it will lower systemic risk – the threat of such financial crises leading to serious consequences for both the functioning of the financial system and the wider economy – by reducing reliance on banking or other highly concentrated funding channels, thus cutting the regulatory
but there are a large number of tiny regulatory restrictions that in aggregate stifle innovation.

The root of the problem is in those regulatory mandates that focus more on the status quo – the same status quo that is threatened by innovative technologies disrupting existing markets and creating new ones. The regulators need to have an explicit mandate to facilitate the birth of the alternative forms of intermediation that constitute the CMU. They should be removing complicated and costly micro-prudential regulations more appropriate to large banks.

They should also be developing novel regulations sympathetic to the new vehicles and structures that make up the CMU, including breaking down national barriers on clearing, settlement and custody services, and reducing the cost of raising capital. Just one example is the technical obstacles on clearing and registration invoked by some countries to keep out competition mandated by Europe’s Market in Financial Instruments Directive.

A sensible approach is that taken by Britain’s Financial Conduct Authority whose mandate – ‘ensuring markets work well for consumers and for firms’ – welcomes innovation and disruptive technologies. This may well have helped Britain to achieve its roughly 200 per cent annual growth in alternative funding models, such as crowdfunding, which amounted to over £1.74 billion in 2014 and is expected to have doubled in 2015. It is not possible to regulate a successful CMU into existence – but it is possible to redesign regulations to allow it to emerge through market forces.

**RISKY BUSINESS**

A key function of banks – and a main source of their systemic risk – is maturity transformation, where they take short-term sources of finance, such as deposits from savers and money market loans, and turn them into long-term borrowings, such as mortgages. It is the hedge against this systemic risk that creates one of the motivations for the CMU. If maturity transformation moves to alternative forms of investments, the systemic risk does not disappear: rather, it is more likely to re-emerge in the new institutions. These effects will be partially mitigated by the new technologies being more distributed, diverse and reliant on proper securitisation, without involving systemically important financial institutions.

But there will still be the danger of herding and correlated risk-taking that only becomes visible in crises. Such sudden co-ordination may be harder to detect in the emergent sectors, which is why it is important for oversight to be well funded and not be so onerous as to encourage opacity. A successful CMU will also create new risks by establishing new links between countries and entities – links with fault lines that may only manifest themselves in times of significant stress. A CMU that finances productive investment also makes it easier for speculative investments across Europe, contributing to momentum build-up and pro-cyclical systemic risk. From a systemic risk point of view, a well-functioning CMU will be a valuable addition to the existing banking-based regime, increasing the resilience of the system, provided that capital flows are monitored and the rules are robust. By expanding the range of different financing routes and decreasing dependence on banks, a CMU ought to reduce systemic risk for any given level of debt.

Europe needs the CMU because its banking system cannot adequately finance SMEs. Current regulatory, legal and tax structures favour the incumbents, and it will be almost impossible to make meaningful changes to the legal and tax regimes. Therefore, the EU and national authorities must alter existing regulatory structures, encouraging disruptive technologies and allowing market forces to match savings to investment opportunities more efficiently. If successful, the CMU will lead to improved access to finance for those firms best placed to use it – and it will deliver innovation, competitiveness, reduced systemic risk and, ultimately, growth.

Romesh Vaitilingam is a writer and media consultant. He has an MBE for services to economic and social science.
AROUND A QUARTER of homes in Britain are sold on leasehold contracts and many homeowners legally own their properties for only a fixed number of years. Reforms in the 1990s mean that most leaseholders now have the right to extend or buy a lease outright but – here’s the catch – they need to agree a price with the freeholder. A study by the Spatial Economics Research Centre (SERC) indicates that many leaseholders are paying over the odds for extensions.

The research by Philippe Bracke, Ted Pinchbeck and James Wyatt – ‘The Time Value of Housing’ – estimates how a property’s sale price varies with the remaining term on the lease. The title refers to their claim that the relationship they uncover is a measure of the discount rate – the rate at which people trade-off costs and benefits occurring at different points in time.

To illustrate, the authors contrast two identical properties, one sold as a freehold (owned forever) and the other on a 90-year lease. In the absence of any other contractual differences between the two tenure arrangements, they argue that the gap between the two sales prices must reflect the value of full ownership discounted 90 years from now.

They use this intuition to evaluate discount rates implied by more than 8,000 leasehold sales in Central London between 1987 and 1992. They find that the discount rates implied by very short leases are close to six per cent but fall to around three per cent for leaseholds of 100 years.

OVEREXTENDING

That people discount the near future at a higher rate than the distant future is no surprise and is consistent with how public sector projects are evaluated. But by providing hard evidence from real-world decisions, the research sheds light on debates about the valuation of far-off costs, such as those implied by climate change. The findings also contrast with current practices in leasehold valuation, which predominantly rely on surveyors’ opinions. Benchmarking their estimates of what surveyors call ‘relativity’ (the relationship between price and lease length) against legal decisions, the authors show that current practices underestimate the value of leases with fewer than 65-70 years left.

The implication is that many leaseholders are seriously overpaying for lease extensions. Adopting the SERC findings in the formula used by valuers to calculate lease extensions would result in savings of thousands of pounds for many leaseholders, rising to hundreds of thousands in some of Central London’s most expensive addresses.

With so much at stake, since 2013 the research has been tested in a number of tribunal proceedings covering leasehold disputes, and more are set for 2016.
Defining a new idea too broadly can benefit other inventors

THOUSANDS OF PATENTS are filed each year, each of which in principle provides their inventor with a temporary monopoly on the use of their ideas in return for disclosing them to the public. ‘Patent scope’ is supposed to reflect the protection provided to the holder – but to what extent does wider scope actually provide superior protection?

Research by Elena Novelli at Cass Business School explores how patent scope is determined and its impact on inventors and their competitors. She notes that any inventing firm wants to prevent another firm coming up with a small change to their original idea and calling it a new invention. So the former will describe all possible changes to the original idea, variations that are described in ‘patent claims’. In theory, a higher number of claims will increase the strength of patent protection, by entailing a higher risk of infringement, it will deter other inventors from building on the knowledge underlying the focal patent.

The changes described in the claims can be very marginal variations on the invention (changes in the diameter of a component) or more distant variations (completely different materials from which the same component could be made). The claims can even refer to different technological domains.

MAKING A CLAIM

Previous research has commonly assumed that patents with claims spread across many technological classes provide stronger protection to the inventing firm because they extend the protection of the patent across different technological settings. But this is not necessarily the case: if the claims are too dispersed across technological domains, the protection that they provide can actually be lower.

When an inventing firm identifies a change to the invention and publishes it in the patent, it is suggesting how that invention could be used in another technological domain, opening up a possible new trajectory of development. But the inventing firm itself might not be in the position to exploit this trajectory, and this might therefore end up giving an advantage to other parties. For example, patents with claims classified in more different classes have greater visibility and are more likely to be detected by other firms’ search processes. At the same time, it is less likely that the focal firm has the capabilities to develop the patent in so many directions. Moreover, it may be more difficult for the inventing firm to detect possible infringements across multiple technological areas.

This research shows that holding constant the number of patent claims, when they refer to very distant technological classes, other firms (rather than the inventing firm itself) tend to generate patents that build on the firm’s original invention – patents that in principle could have been developed by the focal firm itself.

An original idea needs to be protected by a patent, but infringements are rife
NEGATIVE WAVES

Economists debate whether monetary policy can go beyond the 'zero lower bound’

RISING CONCERNS ABOUT the effectiveness of monetary policy at near-zero inflation rates have stimulated a debate among economists that challenges conventional thinking about whether interest rates really have a lower bound around zero per cent. In one of its monthly surveys of leading UK-based macroeconomists, the Centre for Macroeconomics (CFM) asked for views on whether materially negative policy rates are really feasible – and whether the benefits of introducing reforms to achieve them outweigh the costs.

Some economists argue that it is perfectly possible to remove the zero lower bound (ZLB) on monetary policy. One idea is to reduce the importance of cash by withdrawing large bills and replacing them with electronic money, which can pay a negative interest rate. A second proposal is for cash to be taxed and stamped on payment to generate a negative return and so be distinguished as legal currency. A third option is that the implied unit fixed exchange rate between deposits and cash could be made variable.

Others have questioned the practical feasibility of these changes. First, there may be distributional consequences as savers receive negative returns, and the old and poor, who rely more on cash, may be disproportionately affected. Second, the financial system may be affected. Second, the financial system may be adversely affected by the removal of cash. The removal of cash could be made variable.

The first question in the CFM survey asked respondents whether they agree that it is feasible for the authorities to change the monetary system so that materially negative policy interest rates could be safely implemented. Less than a third agree or strongly agree, but of those who do so, many point to the negative policy rates in other countries. Among those who disagree, many highlight the uncertainties in the risks and benefits of the necessary reforms.

The CFM survey’s second question asked respondents whether they agree that the benefits of reforming the monetary system to allow materially negative policy interest rates outweigh the possible costs. Less than a quarter agree or strongly agree with this proposition, but of those who do so, they mostly see it as creating policy space for possible future downturns. Arguments against include fears that the costs would fall unevenly across different parts of society and concerns that monetary institutions are delicate. CFM co-director Morten Raven of University College London adds that the impact of such reforms is “sensitive to expectations traps – self-fulfilling equilibria in which a wave of pessimism takes the economy into a liquidity trap”.

Many respondents conclude that the costs of removing the ZLB are high relative to other policy measures available. Several suggest raising the inflation target as an alternative; others argue that the correct response is more active fiscal policy if monetary policy is ineffective.

cfmsurvey.org/surveys/monetary-policy-and-zero-lower-bound-zlb

UP & DOWNS

The Bank of England’s interest rates have varied from its current low of 0.5% to its highest of 17% in a long history dating back to the bank’s establishment in 1694. Here are some highlights of the last 100 years.

Source: www.bankofengland.co.uk/guardian.com
EQUALITY

PAY PUZZLES

Can female bosses really be happy to be earning less than their male counterparts?

FEMALE CHIEF EXECUTIVES of social enterprises in Britain earn 29 per cent less than their male counterparts – but these women bosses are happier with their jobs. This surprising finding of research by Saul Estrin, Ute Stephan and Suncica Vujc published by the Centre for Economic Performance (CEP) is from a study that analyses data from a unique survey called Social Enterprise as Lead Users of Service Innovation. It provides the first evidence of what they call the paradox of the ‘contented female social entrepreneur’, whose satisfaction is independent of the lower salary or revenues generated through their businesses.

GENDER GAPS
Social entrepreneurship is a growing phenomenon typically focused on addressing such challenges as poverty, discrimination and environmental degradation through market-based activities. So while social entrepreneurs have much in common with commercial entrepreneurs – for example, the central role of individual risk-bearing and organisational formation – they are also distinguished by their objectives: social wealth rather than private profit.

Entrepreneurship – and particularly social entrepreneurship – might be thought of as a way for women to circumvent organisational norms and discrimination and, as a result, that there would be little or no gender pay gap. The CEP study highlights the fact that in contrast with expectations, although social entrepreneurship may be a highly satisfying occupation, it also perpetuates gender pay inequalities.

What is not clear is whether this should be of concern to policymakers if the gender pay gap is not driven by discrimination but rather by choices of the social entrepreneurs themselves. But this has the worrying implication that women are undervaluing their contributions in business.

Since society is likely always to be concerned by income inequalities – whether or not explicable by social and economic factors – policymakers might wish to engage business support and communication campaigns to mitigate the pay gap while emphasising personal fulfilment.

The worrying implication is that women are undervaluing their contributions

cep.lse.ac.uk/_new/publications/abstract.asp?index=4531

COMMUNICATIONS

Victorian internet

How a telegraph cable boosted transatlantic trade

ONE HUNDRED AND fifty years ago, on 28 July 1866, a submarine telegraph cable between Europe and North America went live, establishing real-time communication between the two continents for the first time. Before the cable, steam ships were used to transmit information, and an average crossing took 10 days, although it could be quicker or slower depending on the weather during the voyage.

Cotton was the most important traded commodity across the Atlantic in those days, and the cable was immediately used to exchange information about the cotton markets on each side of the ocean. Research at the Centre for Economic Performance has collected data from newspapers of the time to understand the impact of this change in information technology on prices and trade flows.

The study finds that the cable led to better integration of cotton markets in New York and Liverpool, significantly boosting trade. Armed with far more up-to-date information about the demand for cotton from textile manufacturers in Britain, merchants were better able to manage their purchases of raw cotton from farmers in the American South and the volume of exports they shipped.

RESPONDING TO CHANGE

This episode illustrates how information affects the exporting behaviour of merchants and how it is necessary for market integration. According to the researcher Claudia Steinwender, the introduction of the telegraph was equivalent to abolishing a six per cent trade tariff. As a modern comparison, this is twice the average effect of the North American Free Trade Agreement (NAFTA), but it covers only half of the industry most affected by NAFTA: textiles.

The telegraph was the Victorian equivalent of today’s ‘big data’, helping firms to forecast future demand. Analysing such unique historical ‘experiments’ helps us to understand how firms and markets respond when new technology leads to a dramatic change in the availability of information.

cep.lse.ac.uk/_new/publications/abstract.asp?index=4427
RETAIL REVIVAL?

The rise of online shopping has not been bad news for all Britain’s high streets. Some retail centres are more ‘e-resilient’ than others

Britain’s retail sector has been going through a significant transformation as it adapts to both the rapid growth of online shopping and the slow recovery from the financial crisis and the recession. In recognition of this, the ESRC has supported one of the most exhaustive evidence reviews into high streets, town centres and consumer habits ever conducted in Britain for the Future High Streets Forum. The results of analysis by the ESRC Consumer Data Research Centre (CDRC), some of which are available on a highly interactive data website (maps.cdrc.ac.uk) suggest that the biggest losers may not be those centres that are dominated by big chains nor those with a variety of independent retailers – but rather those that are nestled somewhere in between.

The internet has changed the life of the consumer in an unprecedented way: access to 24/7 browsing from the comfort of our own homes, instantaneous price comparisons and shopping across continents at the click of a mouse. As a result of these trends, the Digital High Street Advisory Board 2015 concluded that the expansion of online shopping was a major cause of change to the structure of traditional high streets in Britain.

A quick glance at a typical high street or retail centre confirms this: major retailers, such as Jessops and Woolworths, have either ceased trading or pared back their retail offerings. At the same time, there has been a rise in ‘theatre’ stores from retailers including Argos, Boots and John Lewis – increasing their physical presence but using their conventional stores as showrooms for online ordering or ‘click & collect’ facilities.

Professor Alex Singleton and his colleagues at the CDRC have developed the concept of ‘e-resilience’ to provide a framework for understanding the differing fortunes of retailers and retail centres in this fast-changing world. E-resilience provides a measure of the vulnerability of retail centres to the effects of growing internet sales – and an estimate of the likelihood that their existing infrastructure, functions and management can adapt successfully. Patterns of shop openings and closures present a somewhat mixed picture of retail revival across Britain, but e-resilience provides a way of interpreting the big picture.

What will be happening five years down the line? A leading retail consultancy predicts the following, in the four largest non-food categories – Clothing & Footwear, Electricals, Furniture & Floor Coverings, and Health & Beauty:

- E-commerce will capture 34% of sales, up from 14% today, with the internet influencing 75% of sales (up from 44% today).
- Sales through stores (including those researched online) will decline to 66% (down from 86% today).
- Growth in e-commerce will be at the expense of town and shopping centre store sales especially, which will shrink by 27%. This will result in 21% less retail space and 31% fewer stores in town centre venues.

Source: Javelin Group, specialist retail and omni-channel consultancy

Working in partnership with the Local Data Company, which manages Britain’s largest database of retail facilities, the CDRC has classified every neighbourhood in England according to a variety of characteristics that might influence use of the internet for consumer purposes. Key attributes include education, employment, engagement with new innovations in information and communications technology, and locally available broadband infrastructure. Other behaviours and attitudes of consumers vary in predictable ways across the country, and this helps to anticipate changing demand for retail facilities.

Nationally, approximately 53 per cent of us use online shopping. But the research suggests that there is a seven per cent difference between those living within the most and least engaged areas. The physical attributes of the retail centre and the part of the country in which it is located also have a significant bearing on whether a retailer prospers or sinks.

Perhaps the most significant impact of online shopping is not the death of the high street, as has been predicted in the
past. Instead, it is the emergence of a new geographical pattern of shopping behaviour that has led to the creation or revival of two contrasting physical shopping experiences.

BUILDING E-RESILIENCE

On the one hand, there is a proliferation of large and attractive centres that are now hubs for shopping and leisure, and which are frequented by people in their droves. On the other hand, smaller high streets that provide everyday convenience or more specialist retail outlets seem likely to endure in some form. Between these are the least e-resilient centres mainly those located in suburban and rural areas – that do not appear to have either the infrastructure or the characteristics to attract shoppers in post-financial crisis Britain.

Of the top 10 least e-resilient centres, four are in the South East (Botley Road in Oxford, Hurstpierpoint, Oxted and Woburn Sands), three in the East of England (London Road in Leigh-on-Sea, Potton and Rochford), two in the West Midlands (Barns Green and Eccleshall) and one in the North West (Whalley). It seems that customers of these centres are now searching for an alternative shopping experience: more often than not, this is online.

Online shopping has reshaped the worlds of retailing and consumer behaviour significantly and will continue to do so as consumers use time and place in different ways to satisfy their needs and preferences. Yet the CDRC study does not suggest the death of the physical shopping experience, despite the far-reaching effects of the internet. The pace of change in some retail centres has been more rapid than in others and research suggests that some will be much more e-resilient than others.

It is crucial for retailers – in particular those that sit midway between the large centres and the locally convenient high-street stores – to engage the consumer in a far more innovative manner than has so far been explored. Without it, any retail revival that builds on the aftermath of the recession could potentially end up being very polarised.

data.cdrc.ac.uk

ONLINE ON THE RISE

While predictions of the death of the high street now seem premature, online shopping is growing inexorably as recent figures from the House of Commons Library show:

- The retail sector involves spending by consumers in shops and online. In March 2015, consumers in the UK spent around £34 billion. For every £1 spent in the retail sector (online and in shops), 42p was spent in food stores, 41p was spent in non-food stores and 11p on automotive fuel. The remainder was spent in other types of retailers, such as market stores or mail order catalogues.

- The value of internet sales as a proportion of total retail sales rose from 2.7% in January 2007 to 11.1% in January 2013. In December 2013, average weekly internet sales peaked at £1 billion.

- The increase in online sales is in part due a move towards internet-only stores and products. In 2008, online and mail-order businesses accounted for 3.4% of the total number of enterprises in the retail industry (except of motor vehicles and motorcycles). This had increased to 8.2% in 2012.

- In the music and film sector, more than half the sales of physical products (not including downloads) are already online. This has resulted in severe difficulties for retailers such as HMV, which went into administration in early 2012.

Source: The retail industry: statistics and policy (20 May 2015) by Chris Rhodes (House of Commons Library)
POOR RETURNS

Who has been affected most by tax and benefit cuts?

PREDICTING WHAT WILL happen to family incomes as a result of policy changes has become increasingly important. The EUROMOD ‘microsimulation’ model – developed by Professor Holly Sutherland and colleagues at the Institute for Social and Economic Research – is proving to be a crucial resource for policymakers and poverty campaigners across Europe monitoring fluctuating incomes at a time of uneven economic recovery.

The use of estimates of current GDP as a measure of macroeconomic conditions is long established, but until now there has been no such indicator of current income inequality or poverty. EUROMOD’s state-of-the-art modelling fills that gap by providing ‘nowcasts’ of income distribution and poverty as well as predictions of whether poverty has risen or fallen.

For example, EUROMOD predictions for Latvia show that household incomes as a whole have risen by 14 per cent during the period of recovery of the last two years. But while poverty rates are generally stable, those for older people have risen sharply (by nine percentage points) because pensions have failed to keep pace with income growth. The opposite has happened in France: pensions have been maintained but other incomes have fallen by one per cent as the economy stagnates; and pensioner poverty rates have fallen by two percentage points. Such ‘flash estimates’ combine information on the latest changes in the employment characteristics of the population and movements in market income by source with simulations of the latest changes to tax and benefit policies.

EUROMOD is financially supported by the European Commission, and the model is used to inform bilateral policy discussions with member states of the European Union (EU) and to provide comparable analysis of the distributional effects of policy changes each year. This is especially relevant in EU countries that remain affected by the economic crisis, but also those in recovery since policy changes aiming for fiscal consolidation and those aiming to relax fiscal constraints both have distributional consequences.

WHO IS FEELING THE EFFECTS?

In Britain, EUROMOD has been used to analyse the impact of the Coalition government’s tax and benefit changes. The research finds that the poor, particularly those with children, have borne the largest burden of cuts to benefits.

The poor, particularly those with children, have borne the largest burden of cuts to benefits

In 2014, EUROMOD estimated that there were 11.4 million people in low pay jobs, which was 1.6 per cent more than in 2010. The research at the University of London identified two phases of sanctions. Early sanctions did not ‘work’, but consolidated the ruling National Party regime and broadened its support base. In the second phase, in the 1980s, sanctions ‘worked’ insofar as they starved the regime of resources needed to curtail mass insurrection. In Myanmar, the study found that sanctions were largely unproductive or even counter-productive. They didn’t help the weak democratic opposition to pursue its goal and, ultimately, Myanmar’s present ‘democratic’ transition was driven by internal dynamics, not sanctions, which arguably delayed the transition to the extent they had any political effects.

www.politics.qmul.ac.uk/staff/joneslee.html

Dr Lee Jones, Queen Mary, University of London

BAD DEBT

Poor financial literacy and lack of self-control contribute to problem debt, according to a study of the relationship between self-control, financial literacy and over-indebtedness on UK consumer credit debt. Researchers at the University of Nottingham investigated how consumers’ understanding of financial information affects the way they use credit and debt including credit cards, personal loans and payday loans. They found that consumers who use credit and debt have worse financial literacy than those who save and borrowers with poor financial literacy hold higher shares of high-cost credit than those with higher literacy.

www.nottingham.ac.uk

John Gathergood
and Jorg Weber, University of Nottingham
FEARS OF A PHENOMENON called ‘secular stagnation’ have returned in the aftermath of the global financial crisis – and with good reason, at least in Europe. The idea, which originated in the 1930s, was made famous by Alvin Hansen, a well-known Harvard economist of that time. His nightmare vision was that the advanced capitalist economies would be exposed to a future of high, persistent and increasing unemployment.

There were two variants of his argument. In the first version, pessimism about future growth prospects resulting from a slowing of technological progress and adverse demography would undermine investment and create a demand shortfall. In the second version, there would be strong technological progress, but this would eliminate jobs and lead to unemployment because the labour market was unable to absorb the displaced workers. In either case, as a convert to Keynesian economics, Hansen’s eventual solution was to increase government borrowing to create employment through extra public spending. And, in fact, his fears proved totally unfounded as the US enjoyed a golden age of rapid technological progress and low unemployment in the decades after the Second World War.

ARE ROBOTS THE FUTURE?
The renewal of interest in secular stagnation has encouraged a number of organisations including the OECD to ask the ESRC Centre for Competitive Advantage in the Global Economy (CAGE) to examine the likelihood that, this time around, such a future will actually emerge – and, if so, what policy responses might be most appropriate. Our analysis suggests that the greater risk of secular stagnation lies in unemployment resulting from rapid technological progress, which will need to be dealt with by labour market policies rather than being amenable to a Keynesian approach.

Forecasting the implications of future technological progress is not easy, but there are good reasons to believe that robotics will have a very significant economic impact in the next 20 years. Indeed, a recent careful study of the US economy concluded that nearly half of current jobs have at least a 70 per cent chance of being computerised over that time period.

One key aspect is that robots have the potential to replace many low-wage jobs in the service sector. This would give a substantial boost to future productivity growth, but there would be a ‘skill bias’ towards the new technology that is very different from the 20th-century experience and which will require major labour market adjustments.

This would be a significant challenge for many European countries where labour markets have high levels of employment protection and unemployment benefits, together with relatively large shares of workers with low educational attainment. Although fiscal stimulus to support demand could be helpful to underpin the labour market where public debt levels allow some fiscal space, supply-side policies will be key if Europeans are to navigate the era of robotics successfully. These include active labour market policies to improve unskilled people’s human capital as well as reforms of welfare and regulation that improve how the labour market functions.

There are three important implications of this analysis for Britain. First, the recent weakness of productivity growth – the so-called ‘productivity puzzle’ – may be short-lived with growth prospects turning out better than recent trends might suggest. Second, the flexibility of the labour market that has been achieved over the last 30 years or so through well-designed policies will be increasingly valuable – and it should continue to be a high priority for policymakers. Third, there is even more reason to make serious efforts to raise educational standards while also providing pathways to prepare for the jobs that the robots will be unable to replace – for example, in activities that require emotional intelligence.

www2.warwick.ac.uk/fac/soc/economics/research/centres/cage

Nicholas Crafts is Professor of Economic History and Director of CAGE at the University of Warwick.
WHERE DOES ALL THE MONEY GO?
Before we go plastic, we look at the journey of a tatty old paper British banknote

ON THE ROAD
The Bank of England will be introducing polymer banknotes into circulation in 2016, which, because of the material they will be made of, will last significantly longer than a current note. Here’s a look at some figures over the life of a paper note.

HISTORY OF THE POLYMER NOTE

1980s Some early polymer notes are printed in the Caribbean and central America, followed by Australia later in the decade.

1990s The ‘plastic’ notes spread across the Far East, and reach Romania, the first European country to introduce a full set of notes.

2000 and 2010s The notes are taken up by many more countries worldwide – by 2004, an estimated 3 billion polymer notes are in circulation.

2016 The Bank of England issues the £5 polymer note featuring Winston Churchill. The £10 note will follow.

OLDEST
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MOST PROLIFIC
HOW MANY ARE IN CIRCULATION

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DIRTIEST
THE NUMBER OF EXCHANGES PER NOTE

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WHAT A CHARACTER

Sir Winston Churchill will feature on the new £5 note, with Jane Austen set to appear on the subsequent new £10 note.

£5 ELIZABETH FRY
Pioneering social reformer, renowned for her work in prisons, particularly Newgate.

£10 CHARLES DARWIN
The naturalist travelled across oceans on HMS Beagle and changed the way we view our place in the world.

£20 ADAM SMITH

£50 MATTHEW BOULTON & JAMES WATT
The engineers accelerated the production of steam engines.

CURRENT BANKNOTES

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EARLIER BANKNOTES

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