

**THE UK ECONOMY
IN THE
LONG EXPANSION
AND ITS
AFTERMATH**

EDITED BY

Jagjit S. Chadha, Alec Chrystal,
Joe Pearlman, Peter Smith
and Stephen Wright

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The UK Economy in the Long Expansion and its Aftermath

Edited by

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The 1990s to 2000s period has been a time of remarkable economic growth and stability in the UK. This book examines the economic performance of the UK during this period, and the challenges it has faced. It also discusses the impact of the 2008 financial crisis and the subsequent recovery. The book is written for a general audience and is accessible to non-economists.

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Series editors

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The 2007–10 financial crisis has asked some very hard questions of modern macroeconomics. The consensus that grew up during ‘the Great Moderation’ has proved to be an incomplete explanation of how to conduct monetary policy in the face of financial shocks. This series brings together leading macroeconomic researchers and central bank economists to analyse the tools and methods necessary to meet the challenges of the post-financial crisis world.

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Preface

As the Series Editors of *Modern Macroeconomic Policy Making*, one of our purposes in this series was to encourage more work on and examination of the UK economy. The academic incentives to study macroeconomic developments in the UK have become somewhat limited, so there is only a dwindling band of those with a strong home bias to continue this important work of following the story of the First Industrial Nation. Between the conjunctural analysis of City scribblers and policy-oriented work at the Bank of England, there is room for some answers to the question of what happened to the UK economy after the end of the 1990–92 recession that left it so vulnerable to financial crisis. The conference that preceded this volume was held at Clare College, Cambridge, in September 2013, mirroring another conference held 10 years earlier in the same venue at which it was suggested that there might even be an end to monetary history. Given that we are all subject to the vagaries of fashion, in intellectual activities just as much as anything material, these new research papers allow us to set in print many of the views about the period immediately prior to the financial crisis, in the shadow of which we continue to live. We took the unusual step of having many editors, as each of Alec Chrystal, Joe Pearlman, Peter Smith and Stephen Wright acted as discussants at the conference and helped frame the set of chapters that we now hand over to posterity. We thank them, the authors and the anonymous referees of the chapters.

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JAGJIT S. CHADHA AND SEAN HOLLY

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Introduction

*Jagjit S. Chadha, Alec Chrystal, Joe Pearlman,
Peter Smith and Stephen Wright*

In the aftermath of the inflation and recessions of the 1970s and early 1980s, from the early 1990s onwards there was a major upswing in most advanced countries. In the UK it was the longest period of economic expansion on record. But it came to an abrupt end in 2007, with the freezing of the interbank markets and the collapse of Northern Rock, followed in 2008 by Bear Stearns and Lehman Brothers.

Before the crisis, many economists had begun to call this period of upswing the Great Moderation; and, echoing developments in other disciplines, such as political thought, some openly wondered whether we had found the answer to the questions that had perennially been posed by ‘boom and bust’. But given the magnitude of the shocks that hit the global economy in the crisis period of 2007–08 (and since then in a number of countries) the apparent reduction in macroeconomic volatility of the earlier period now appears, with the benefit of hindsight, to have been largely illusory. We therefore argue that the period 1992–2007 can more accurately (and less ambitiously) be described as the Long Expansion – hence the title of this volume.

It is now clear that many of the problems that have occupied policy-makers during the global financial crisis were being incubated during this period. And so with the twin aims of encouraging more policy-focused research on the UK, and to encourage policy debate, in the aftermath of the financial crisis and the prolonged economic recession, we commissioned 10 papers from leading UK-based researchers to look at the issues that arose during the Long Expansion and its aftermath.

The chapters in this collected volume originate in papers presented at a conference held at Clare College, Cambridge on 19–23 September, 2013.¹ The papers have been peer-reviewed and thoroughly revised since the initial versions presented at the conference. They offer a

¹ The papers and previous three conferences can be viewed at: <http://www.econ.cam.ac.uk/MMPM/>.

comprehensive overview of the UK economy over this period in a form that we hope will offer an authoritative and enduring perspective on the British economy in the early years of the twenty-first century. We are grateful to the Bank of England, the INET Fund and the Money, Macro, Finance Research Group for support in hosting this conference. We thank Chris Harrison and Phil Good for sponsoring the modern macroeconomic policy-making series, published by Cambridge University Press. Finally, we thank Jagjit Chadha for his support in organising and thinking of this conference and book.

The volume opens with 'Prospects for UK growth in the aftermath of the financial crisis', by Nicholas Oulton (London School of Economics). This chapter starts by documenting the remarkable performance of the UK economy during the period 1990–2007 – the 'Long Expansion'² of the title of this book. By any standards – but particularly relative to what came before (and afterwards) – the productivity performance of the UK economy during this period was excellent, and looked set to continue. On the basis of pre-crisis data, using a two-sector growth model, Oulton argues that a plausible projection of the future growth rate of GDP per hour in the market sector would have been around 2½% p.a.

However, since the onset of the financial crisis and the Great Recession in the UK in spring 2008 such an optimistic projection has looked increasingly unlikely to be fulfilled. At the time when the chapter was finalised (in early 2014) both GDP and GDP per hour had fallen, and the latter was still below the level reached at the peak of the boom. The chapter shows that this fall in productivity was pervasive throughout a broad range of sectors of the UK economy. In the rest of the chapter Oulton investigates competing explanations for how this can have occurred, and then reflects on the implications for the future.

The chapter examines a wide range of hypotheses that have been proposed as an explanation of the productivity collapse: sectoral shifts; mismeasurement of banking output; overheating during the boom (with consequent overstatement of potential output); lower inputs of both physical and/or human capital input; hoarding of labour and capital; so-called "zombie firms";³ and fiscal austerity (the impact of which Oulton concludes has been overstated). Indeed, the common feature of each of these

2 With thanks to Jagjit Chadha for this phrase to describe the period from the early 1990s to the Great Financial Crash.

3 This popular term has come to refer to firms that are just about able to meet their debt obligations to banks but are not investing.