# UK Economy: the crisis in perspective

Essays on the drivers of recent UK economic performance and lessons for the future

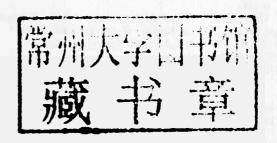
Edited by
Gabriele Giudice, Robert Kuenzel
and Tom Springbett



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**Editors Gabriele Giudice, Robert Kuenzel and Tom Springbett** 





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#### **Disclaimer**

The views expressed in this book are those of the authors and do not necessarily coincide with those of the European Commission.

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#### xvi About the authors

retirement behaviour and the adequacy of overall saving. He has also carried out a substantial amount of work on various aspects of economic statistics. Weale was appointed Commander of the Order of the British Empire (CBE) for his services to Economics in 1999 and was elected an Honorary Fellow of the Institute of Actuaries in 2001. In 2006 he was appointed to the Board of Actuarial Standards.

#### **Preface**

By Marco Buti1

In June 2010 the UK economy was in a dire condition. Over the previous year it had experienced the biggest annual decline in gross domestic product (GDP) since the Great Depression, the virtual nationalization of one the UK's largest banks and the ballooning of the government deficit to record peacetime levels.

At that time, when the European Commission held a seminar bringing together some of the UK's leading economists, analysts and policymakers to discuss the causes, consequences and lessons of the crisis, what struck me was that the mood was still broadly optimistic. While recognizing the clear failings that had helped take the UK economy down this dangerous path, there was acknowledgement of some of the UK's enduring strengths.

Most prominent among these strengths was the UK's flexible labour market, which had allowed a marked reduction in structural unemployment in the years before the crisis but also, through wage flexibility, helped prevent the recession from causing job losses in the numbers seen in the early 1980s and 1990s. Another strength that came out in the discussion was the UK's international openness. The positive commitment of successive UK governments to the EU single market agenda has been a force for good in Europe, and it is pleasing to see evidence from the discussion and in this book that this commitment to openness and unfettered trade within the EU has made a significant contribution to UK growth.

Of course there was also a lot of discussion of what went wrong. With hindsight it is clear that the UK entered the crisis with too large a government deficit and with too great a reliance on cyclical revenues. The fact that this happened in spite of the government having deemed its fiscal position to be compliant with its own fiscal framework suggests that that framework did not do its job. It is encouraging to see progress in this area in recent months which both strengthens domestic fiscal oversight and improves consistency with the Stability and Growth Pact. Financial regulation was another area where there were many lessons learned from the crisis. Again, it is a positive sign that the UK has been taking tough and radical decisions at home since our seminar, although there are clearly further challenges left to confront, as discussed in the remainder of this book.

#### xviii Preface

I am glad that the Commission has generated a deep reflection and analysis on what has been a momentous period in UK economics, which is ultimately reflected in this timely book. The fact that since the seminar took place several of the authors have been awarded high-level recognitions, such as the Nobel Prize for Economics for Chris Pissarides and membership of the Monetary Policy Committee of the Bank of England for Martin Weale, witnesses the quality of the analysis in this book. I am confident that it will prove a useful contribution to the debate.

#### Note

1 Marco Buti is Director General of the European Commission's Directorate General for Economic and Financial Affairs (DG ECFIN).

## **Abbreviations**

ABCP asset-backed commercial paper

ABS asset-backed securities
ADF Augmented Dickey-Fuller
AME annually managed expenditure
BBC British Broadcasting Corporation

BCBS Basel Committee on Banking Supervision

BIS Bank for International Settlements
BRC Budget Responsibility Committee
CBO Congressional Budget Office
CCE common correlated effects
CDOs collateralised debt obligations

CEBS Committee of European Banking Supervisors

CLG Communities and Local Government

CPB Central Planning Bureau

CPFF Commercial Paper Funding Facility

CPI consumer price index
CT corporation tax

DG ECFIN Directorate General for Economic and Financial Affairs

DELs Departmental Expenditure Limits

ECB European Central Bank
EEA European Economic Area
EFO Economic and Fiscal Outlook
EIS Enterprise Investment Scheme

EMIR European Market Infrastructure Regulation

ERM Exchange Rate Mechanism
ESM European Single Market

EU European Union

EU-27 The 27 Member States of the European Union

FCA Financial Conduct Authority
FDI Foreign Direct Investment

FISIM financial intermediation services indirectly measured

FOMC Federal Open Market Committee
FPC Financial Policy Committee

#### xx Abbreviations

FRO Financial Risk Outlook FSA Financial Services Authority

G7 a group of finance ministers from seven industrialized nations G20 a group of finance ministers and central bank governors from

20 major economies

GDP gross domestic product GVA gross value added

IFS Institute for Fiscal Studies

IIP international investment position

ILAS individual liquidity adequacy standards
ILO International Labour Organization
IMF International Monetary Fund
IZA Institute for the Study of Labor

LFS Labour Force Survey

LIBOR London Interbank Offered Rate

LSE London School of Economics and Political Science

LTV loan-to-value

MFIs monetary financial institutions

MiFID Markets in Financial Instruments Directive

MLD Mean Log Deviation

MPC Monetary Policy Committee

NAIRU non-accelerating inflation rate of unemployment

Neths Netherlands

NHS National Health Service

NIESR National Institute of Economic and Social Research

No. number

OBR Office for Budget Responsibility

OECD Organisation for Economic Co-operation and Development

OLS ordinary least squares
OMOs open market operations
ONS Office for National Statistics

OPEC Organization of the Petroleum Exporting Countries

PBRs Pre-Budget Reports
PPP Purchasing-power parity

PRA Prudential Regulation Authority
PSNB public-sector net borrowing

OE quantitative easing

R&D Research and development real house price growth

RMBS residential mortgage-backed securities

SBA Small Business Administration SGP Stability and Growth Pact SIVs Special Investment Vehicles

SMEs small and medium-sized enterprises

SMP Single Market Programme

TALF Term Asset-Backed Securities Loan Facility

TFP Total Factor Productivity

UK United Kingdom

US(A) United States (of America) VAR vector autoregressive models

VAT value-added tax

Vol. Volume

WTO World Trade Organization

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