

# World Economics Association Newsletter

To *plurality*. The Association will encourage the free exploration of economic reality from any perspective that adds to the sum of our understanding. To this end it advocates plurality of thought, method and philosophy.

## Inside this issue:

<b>Greece and austerity policies: Where next for its economy and society?</b>	<b><u>2</u></b>	<b><u><a href="#">html</a></u></b>
<i>Yannis Dafermos, Marika Frangakis and Christos Tsironis</i>		
<b>Who are our allies? Who are our customers?</b>	<b><u>3</u></b>	<b><u><a href="#">html</a></u></b>
<i>David A. Westbrook</i>		
<b>A critique of Nominal and Real macro Unit Labour Costs as an indicator of competitiveness</b>	<b><u>5</u></b>	<b><u><a href="#">html</a></u></b>
<i>Merijn Knibb</i>		
<b>Macroeconomic impact of UK liberal economic policies</b>	<b><u>8</u></b>	<b><u><a href="#">html</a></u></b>
<i>Graham Gudgin and Ken Coutts</i>		
<b>1st Vienna Conference on Pluralism in Economics</b>	<b><u>12</u></b>	<b><u><a href="#">html</a></u></b>
<b>Ecological Economics—call for abstracts</b>	<b><u>12</u></b>	
<b>Contact the WEA</b>	<b><u>12</u></b>	

**WEA young economists**

**Facebook group**  
(now 2900+ members)

*Past Newsletters available at:*

**<http://www.worldeconomicsassociation.org/newsletters/>**

**World Economics Association**

**Voluntary annual membership fees:**

**<http://www.worldeconomicsassociation.org/membership/annualfees>**

## **WEA Pedagogy Blog**

**...welcomes posts about your experiences and suggestions on teaching and learning economics, with a strong focus on methods leading to deep understanding of current real world economic issues.**

## **WEA National Chapters**

**Get involved!  
Is your country listed?  
Become a contact!  
Add a link or post!**

## Greece and austerity policies: Where next for its economy and society?

By [Yannis Dafermos](#), [Marika Frangakis](#) and  
[Christos Tsironis](#), Conference Leaders

Between 20<sup>th</sup> October and 21<sup>st</sup> December 2014, the World Economic Association organised an online conference about the crisis and the austerity policies in Greece. The conference covered issues related to the social and economic effects of austerity, the 2012 haircut of the Greek public debt and the prospects of the Greek crisis. The papers of the conference, which are available [here](#), provide valuable insights into these issues, as well as useful pointers with regard to the on-going crisis one year later. Here we recap some of the main points raised during the conference and we look into the current state of affairs.

Over the period 2010-2014 the Greek economy underwent a hard austerity programme. After 5 years of implementation it became very clear that the declared targets of this programme were not achieved: the economy contracted by more than the US economy in 1929-1934 (during the Great Depression), the fiscal deficit declined at a much slower pace than expected, the public debt-to-GDP ratio was not put into a sustainable path, the exports did not rise significantly despite the sharp reduction in wages, the fragility of the financial system increased and the unemployment rate almost trebled. Moreover, Greece experienced a remarkable increase in poverty and deprivation, a widening in inequality and other adverse social developments.

But the failure of the programme was not confined to the fact that it caused significant economic and social damage in the short run. Equally important is the fact that the programme did not address two crucial long-run problems of the Greek economy: the lack of a well-organised and overall effective public sector and the low structural competitiveness linked to the de-industrialisation that has taken place since the 1980s. In the austerity programme it was assumed that the main problem of the Greek public sector is its large size, not its ineffective structure and organisation, and that the external sector suffers from low wage/price competitiveness, rather than from structural competitiveness. As a result, the measures that were taken in these areas (reduction of the number of public sector employees and wage cuts) proved counterproductive. Moreover, the 'one size fits all' approach that was adopted relegated to the sidelines the importance of the various idiosyncratic features of the Greek economy, such as the significant role of small and medium-sized enterprises in the performance of the macroeconomy.

The new Greek government that was elected on 25 January 2015 aims at putting an end to the implementation of austerity policies and bringing the economy back to growth via measures that include, inter alia, the restructuring or write-off of the public debt, the increase in minimum wages and the enhancement of the protection of socially vulnerable households. However, after many months of intense negotiations it has become clear that the European Central Bank (ECB), the European Commission and the International Monetary Fund (IMF) are not willing to accept most of the proposals of the Greek government. On the contrary, the three institutions insist on

the need for the continuation of austerity policies with virtually no change to the policy mix. The ECB and the European Commission seem also to have refused to discuss (at least in this stage) the restructuring or write-off of the public debt.

The overall result is that so far (14 June) the negotiations have not led to an agreement. The Greek government appears to have accepted certain austerity measures (e.g. tax rate increases), but insists on the need for a gradual increase in wages and the restructuring of the public debt. The three institutions have emphasised that additional austerity measures are necessary, that more privatisations need to take place and that labour market flexibility should increase. Since there are many points of disagreement, it is still uncertain whether an agreement will be reached soon, if at all.

At the same time, the liquidity of the Greek government has deteriorated significantly. On 5 June the government informed IMF that it would not make a debt repayment due on that day and that its intention was to bundle up the four June repayments to IMF in order to make them at the end of the month. The Greek government has also to make a lot of debt repayments in July and August and it is clear that its liquidity is not enough to fulfil these debt obligations.

The liquidity problems of the Greek banking sector are also serious: over the last few months the bank deposits have declined substantially and, as a result, the Greek banks rely on the liquidity provided by the Emergency Liquidity Assistance of the ECB.

Although an agreement between the Greek government and the three institutions would solve these short-term liquidity problems, much more attention should be paid to the long-run prospects of the Greek economy and the needs of the society. It is clear that a coherent long-run strategy for the Greek economy is still missing. Even if the liquidity issues are tackled via a financing agreement, no answer will have been given to the way that the Greek economy can achieve a sustainable pattern of development within the current structure of the Eurozone.

The austerity policies that are promoted both for Greece and the Eurozone cannot lead to such a sustainable development. Deep institutional transformations and government interventions that go against the idea that 'when left alone, market forces lead to optimal solutions' are essential. These include new forms of industrial policies, coordinated pro-labour wage policies, countercyclical fiscal interventions and the fundamental reconsideration of the targets of monetary policy which need to concentrate more on financial stability and employment.

Without such types of policies both the Greek and the Eurozone economies will be trapped into deflation or stagnation with significant social costs that will gradually lead to political instability. At the same time, it is fundamental for Greece to design a long-run strategy for the restructuring of its public sector and the enhancement of its productive capacity.

## Who are our allies? Who are our customers?

By [David A Westbrook](#)

In the last WEA Newsletter (Issue 5-2, April 2015), Peter Swann provocatively asked "Who Are Our Allies?" Who "from outside the heterodox economics community" (presumably meaning readers of the WEA) would help "heterodox" (or "pluralist") economists foster "substantial change in academic economics"?

Swann's provocation read clearly enough, and I think the general thrust of his suggestions sounded sensible to many readers of the WEA, including me. Readers posted interesting comments, some of which influenced this response. That said, read more closely, "Who Are Our Allies?" comprises rather difficult assumptions and intentions, a by no means

obvious sense of where intellectuals of a certain sort find themselves, and consequently, where such intellectuals should look for "allies," whatever that means in this context. What I'd like to do here is to disassemble Swann's piece a bit, and then reassemble it somewhat differently, with the intention of adding to his thinking about "allies," and who they might be.

To start simply: Swann began by identifying himself as a heterodox economist. Grazie Letto Gilles immediately amended "heterodox" to "pluralist," the WEA's now preferred usage. But no matter for present purposes: the assumption is that there is a core of economics, an orthodoxy or "normal." If there is a core, then there must be a periphery, where people holding different, non-orthodox, pluralist, etc., views are to be found. The WEA has positioned itself as an organization that provides fora for such peripheral views.

Almost by definition, normal science dominates university economics departments. That is, the core/periphery structure found at the epistemological level is replicated, and enforced, at the institutional level: relatively orthodox economists hold the vast majority of the relatively prestigious positions, from which they promulgate relatively orthodox economics to succeeding generations. Equally unsurprisingly, as Swann noted and a number of commentators emphasized, the orthodoxy has no desire to give up its privileged positions. Despite exceptions here and there, "the official mainstream response is either to ignore our criticism, or to give it a hostile reception."

So, to make the conflicts in Swann's piece graphic, the castle is held by the enemy, who has no intention of seeing the reasonableness of our demands (articles in RWER and the like), and who therefore need to be removed by force. The castle is quite strong, however, and consequently we should seek allies before we attempt an assault.

A preliminary question: why do we care? Why not just leave the castle to its own devices? Nobly, one might



care that the truth is being promulgated. Less nobly, those of us with unusual views on economic life might want prestigious positions and other emoluments for ourselves. (I know I do.) But Swann has another concern, which I share. "Mainstream economists continue to disseminate a flawed model of economics," "which can lead to serious errors," and in that case, "it is ordinary people who suffer."

Swann assumes that the university matters as the place where ways to view the economy are contested. Implicitly, if one is concerned about ordinary people being hurt by obtuse policies founded on orthodox economic thinking, one has to

care about academic economics. Hence the political desire to help ordinary people requires academic politics, specifically, to seek to diversify the economics faculty. More deeply, Swann seeks to realize populist intentions (helping "ordinary people") in what he implicitly asserts is a deeply bureaucratic society, in which the fundamental bureaucracy, the university, informs the actions of the private and public bureaucracies (corporations, regulators, etc.) that actually structure contemporary social life.

At this point, we seem to have reached a dead end. Bureaucracies are jurisdictional. So while a scientist or a sociologist might be sympathetic to a heterodox position, and a religious or community leader might be downright antagonistic to normal economics, what does that matter for bureaucratic purposes? They are not economists, and not privileged to speak *as economists*. They occupy different squares in the organogram. Thus the same argument that makes a university faculty an important objective (as the center of politics in a bureaucratic society) also make storming the walls with allies from other faculties almost unimaginable (because bureaucracies work by creating discrete jurisdictions). This is overly schematic, of course, but only slightly overstated.

To put the problem somewhat differently: at the level of general politics, of helping ordinary people, an elite's influence depends on its authority as an elite. Economists, pluralist or not, are only influential, helpful or hurtful, insofar as they are taken seriously as *economists*. Pluralist economists are outsiders, i.e., not in a position to speak for economics, and therefore taken no more seriously than ordinary citizens. Ahem. This would seem to foreclose politics, or at least make politics very difficult.

One response is to move what was "outside" to the "inside." The WEA has gone to great lengths to normalize different economic views, notably by founding peer-reviewed journals, and as recent missives from Ed Full-

brook suggest, is having some substantial success. To the same end, the very language of the community has softened, moving from the language of mental health, "autism," to "heterodoxy", to "pluralism" (after all, it's politically unsound to be against pluralism).

But these efforts at normalization are not enough, or at least not yet. As Swann notes, the WEA is still an outsider organization. The orthodoxy is secure within its battlements, despite the GFC, and inside the castle is where real politics is done, people are hurt or helped. Framed in this way, I don't think the problem is soluble, at least not within a reasonable time frame.

So let's try to reframe the question. A friendly amendment: instead of asking "who are our allies?" we might ask, "who might be interested in our thinking?" Who cares -- and frankly, who could benefit from -- a pluralist perspective on the economy?

Answering that question requires some generalization about what "a pluralist perspective" means. This is tricky: unifying the plural makes it less plural. But let me try by starting where Swann ends, with ordinary people who are hurt by bad policies founded on bad thinking. Swann's intention is, at its heart, political. His claim that economics departments need to be reformed rests on an assertion that getting it wrong in the university ultimately means getting it wrong in society.

Can we generalize, just a wee bit, about how orthodox economics gets it wrong? Notwithstanding their diverse views on many economic particulars, I think the vast majority of WEA members would (i) dispute the pretensions of orthodox economics to being a hard science, after the model of physics (with math!), and (ii) emphasize the political in what used to be called political economy. This is often expressed as a criticism of the status quo: in presenting itself as a hard science, with necessary conclusions, orthodox economics has obscured its politics, often leading to objectionable consequences not just in the university (impoverished minds) but in the world outside (impoverished people). So, to take the risky step of generalizing the pluralist positions expressed in the WEA, I think it fair to say that the vast majority of the WEAs readership would urge a more candid recognition of the political (humanistic) nature of political economy as a discipline, and the political (how do we structure our lives together?) character of markets themselves.

If this is even halfway right, then it seems likely that our "allies," i.e., the people interested in our work, would be people interested in humanist thinking about how markets structure the social. Rather than "allies" we should be looking for "customers," people who can use our thinking to further their own interests, which may be intellectual, political, or simply private. Moreover, our customers may have influence and authority of their own.

Specifically, let me suggest four contexts in which pluralist insights and approaches to economic life might be or are (in my limited experience) welcome.

#### A. Central Banking.

Central bankers encourage, or discourage, economic activity through macroeconomic policy, which is to say that the parameters of marketplace life are not given, but are subject to political contestation. Indeed, central banking law implicitly acknowledges the inherently politicized nature of the enterprise, and takes care to insulate central bankers from short term political pressures. Moreover, contemporary central banking, often under the rubric of inflation targeting, is acutely aware of the dialogic character of economic life, that is, the social contexts in which signals of various sorts are transmitted, are received, and ramify. See Douglas Holmes (2014) *Economy of Words: Communicative Imperatives In Central Banks*, Chicago, U of Chicago Press. And this is before we get to the political aspirations, constraints, and consequences of central banking in times of crisis. Thus central bankers, and those concerned with central banking (everybody), ought to be interested in what many participants in the WEA offer: economically savvy, worldly, research into and thought about policy problems, conceivable interventions, and plausible consequences.

#### B. Regulation and its *Doppelgaenger*, Lobbying.

Central banking might be considered a special case of the more general phenomenon of economic regulation, by which I mean setting the rules of the game in which marketplace activity happens. For what little it may be worth, I have long argued that just as making rules affects way games are played, regulation affects the character or output of the markets in question. See Westbrook (2010) *Out of Crisis: Rethinking Our Financial Markets*, Boulder: Paradigm Publishers. Thus deciding whether to impose or not impose this or that regulation rests on an ex ante sense of what we wish to see in a given marketplace, an aesthetics of markets.

Lawyers -- both regulators and those who appear before them, generally speaking, lobbyists -- do this unconsciously all the time. Lawyerly argument often has the form: if Rule X [is/is not] promulgated, the world will look [better or worse]. Where pluralist economics differs from orthodox economics is in insisting that such political choices are not incidental, greater or lesser deviations from "the economics." Political choices (what do we want this market to do, how and for whom?) are not sadly necessitated by imperfect information, self interest, and second-best options, but instead are integral to markets themselves, of whatever configuration, and hence are central to political economy.

#### C. Other Social Scientists.

As Swann noted, a variety of other social scientists disagree with economic orthodoxy, sometimes quite strenuously. Such disagreement, however, has its own uses within the academy, notably for setting up a "straw man" against which to structure one's own argument and text. So much social science argument is of this form: With regard to some question Q, the economists say X, and we know X cannot be true because of (Y1, Y2, Y3 . . . Yn). Instead, Z is true.

Pluralist economics can help other social scientists by

helping to understand Z. Economists, whether pluralist or orthodox, have concerns and perspectives that are different from those central to other disciplines, worries about incentives, information, structure and structural advantages, and so forth. So long as their work is good (attends to the world), pluralist economists can offer illuminating insights, that other academics can use in their own domains.

#### D. Computer scientists.

Computer scientists are used to creating and thinking about bounded contexts in which fairly autonomous actors compete and cooperate according to well defined protocols. That is, the socially constructed and multiparty nature of computer networks mirrors that of marketplaces. To make matters even more interesting, financial and other markets are computerized. Market and network not only mirror one another, they are imbricated (yet distinct, or seen as distinct). There is much work to be done here, especially concerning questions of systemic stability and operating under conditions of partial trust, about which the GFC has not yet taught us enough.

#### E. Natural scientists and scholars generally.

Swann noted that natural scientists have been some-

what suspicious of orthodox economics, in particular, of the confidence in abstract mathematics unsupported by empirical evidence. As we have seen, however, jurisdictional boundaries serve to render such misgivings ineffectual.

Pluralist economics can, however, be of use to scholars in a different way. Within the bureaucratic university, and in grantland, scholarship is a commodity. One hesitates to admit that scholars, too, are commodities, although we do not (yet) trade them in quite the cavalier fashion in which pro sports teams deal athletes and options amongst themselves. Pluralist economics could help scholars better understand, and perhaps carve spaces out from, the markets in which the business of their work, and so much of their lives, is conducted.

*To conclude:* the castle won't be stormed. At some point, the lively intellectual trade going on in the fair-ground outside the battlements simply will be too profitable for the guard to be able to stand their own gray walls. They will come forth of their own accord, leaving the drawbridge down, the keep undefended. In due course, the castle will reopen as a boutique hotel, pluralist indeed. Or so I like to think.

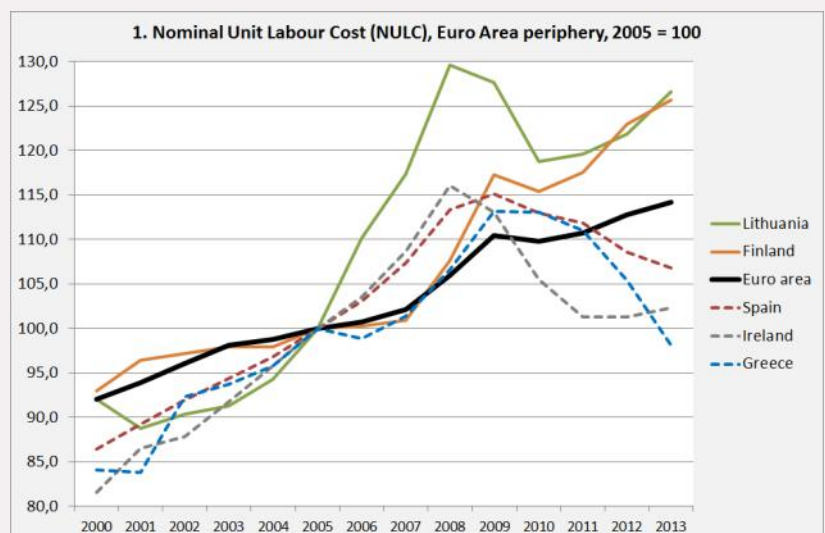
## A critique of Nominal and Real macro Unit Labour Costs as an indicator of competitiveness

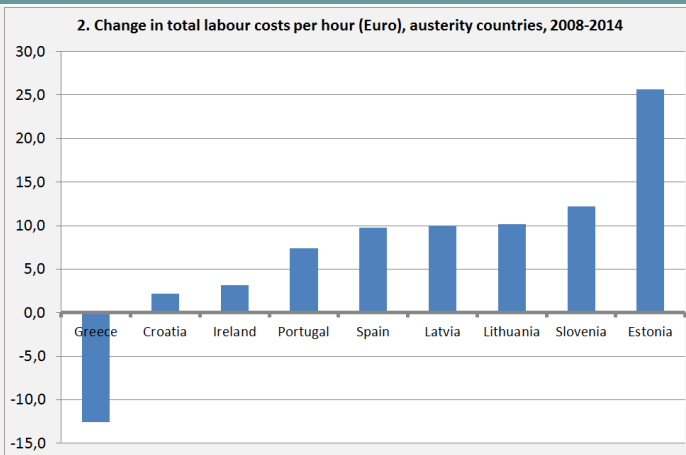
By [Merijn Knibb](#)

'Unit Labour Costs' (ULC) are a staple of macro-economic statistics. As a measure of labour costs per unit of real GDP they are calculated by the OESO, Eurostat and the Bureau of Labour Statistics and they figure prominently on the website of the ECB. They are also one of the core variables included in the [Macro-Economic Imbalance Procedure](#) of the European Union which indicates their political significance. After about 2009, Eurozone countries were under strong pressure to decrease their ULC, at least relative to other countries, as (relatively) high ULC were understood to be a sign of low competitiveness. Look [here](#) for a Draghi Speech which states this. The preferred way to decrease ULC was to moderate or halt wage increases or even to slash wages. However, there might be something wrong with this line of thinking. Graph 1 shows that after 2008 some countries indeed managed to lower ULC (in this case: Nominal ULC or NULC, see below), not just relative to other countries but even in absolute sense. But was this caused by keeping wage increases low or even by lowering wages? Graph 2 (see over) shows that Greece and Ireland, which witnessed a comparable total decrease in NULC, had a radically different development of wages.

This suggests that other factors were important, too. Might wholly different developments lead to comparable changes in NULC? If this is the case, can NULC still be understood as a valid indicator of competitiveness? Below, these factors will be investigated and it will be

argued that NULC should not be used as an indicator of macro productivity and competitiveness. On the micro level, wage costs per unit of product – such as wage costs for installing a solar panel – are indeed an important indicator of productivity. However, on the macro level this is not the case. GDP (the denominator in the formula) is an aggregate based upon the aggregation of sectors with wildly different labour costs (see graph 3 below). These sectors are aggregated using weights which, because of Schumpeterian dynamics or booms and busts, can change quite fast. This can lead to changes in NULC which are sometimes even in the opposite direction to changes in wages levels! Also, many of these sectors have next to no connection with the competitiveness of an economy. Importantly, competitiveness is on-





ly to a very limited extent dependent on the wage level (see [this ECB task group study](#) or [Felip and Kumar \(2011\)](#)). Consequently, while ULC might be useful to compare individual companies, they are not fit to compare countries. There are many reasons for this. Felip and Kumar do a good job debunking the use of this metric. However, their list of reasons is far from exhaustive and I'll try to complement it.

To do this, I first have to explain how ULC are calculated. Eurostat provides us with the following definition:

*The unit labour cost (ULC) is defined as the ratio of labour costs to labour productivity.*

*Nominal ULC (NULC) = (D1/EEM) / (B1GM/ETO) with D1 = Compensation of employees, all industries, current prices*

*EEM = Employees, all industries, in persons (domestic concept)*

*B1GM = Gross domestic product at market prices in millions, chain-linked volumes reference year 2010*

*ETO = Total employment, all industries, in persons (domestic concept)*

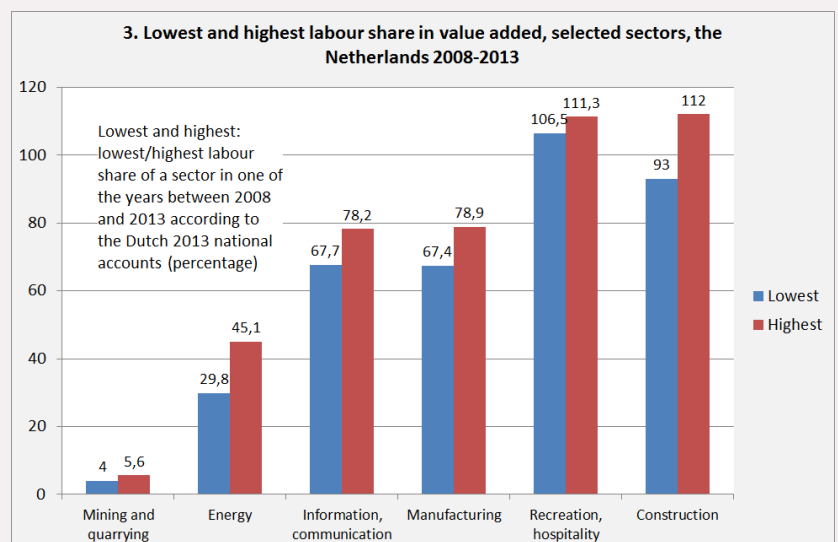
In other words, NULC are *nominal* labour costs per employee divided by *real* average value added (GDP) per worker. Eurostat continues with the caveat: "Please note that the variables used in the numerator (compensation, employees) relate to employed labour only while those in the denominator (GDP, employment) refer to all labour, including self-employed." It is a crude approximation for the share of GDP going to workers.

This definition leaves us with the following conceptual problems:

A. It is an indicator which contrary to many statements *should* increase, considering stated policy goals. Imagine a country with (like the Eurozone) an inflation target of 1.8% but which (unlike the Eurozone) does not target consumer price inflation but the GDP deflator. Such a level of inflation cannot be sustained when, in the medium run, wages do not increase by at least the same percentage (in fact: a slightly higher percentage, assuming some increase of labour productivity). The idea that NULC have to be stable is not consistent with the inflation target of the central bank – the low in-

crease of German NULC before 2010 should have been a cause for concern and sorrow for the ECB!  
B. The Eurostat caveat above is significant. The use of employees in the numerator and all workers in the denominator means that countries which had a large share of self-employed which left this status to start to work for wages which are about as high or slightly higher than their previous 'mixed income' as self-employed (e.g., a shift out of peasant farming and into tourism in Greece) might see an *increase* in NULC, because of structural *modernization*! (In extreme but conceivable cases this won't happen when, thanks to this shift, GDP (the denominator) rises relatively faster than total wage income (the nominator) because of a very rapid increase in net capital income – a case would be a shift of labour from peasant production to the extraction of natural gas (see also below)).

C. A related problem exists because of differences between economic sectors. Ireland is an example. The bust of the building boom led to the demise of lots of industries with relatively high ULC's while industries with a low ULC and a high share of capital, like the pharmaceutical industry, were much less affected by this bust. As a result, [the average ULC of Irish industry declined](#) – while the ULC's of subsectors of Irish industry barely changed. Talk about a fallacy of composition! Do not underestimate the magnitude of these differences. Graph 3 shows the labour share in value added for economic sectors in the Netherlands (which I took as I had the data at hand and also because of the exceptional low labour share in the natural gas sector). Differences are clearly very large (the 4% for mining and quarrying, aka natural gas, is real) and show large changes while for some sectors the labour share can even be more than 100%, especially in sectors with many self-employed, who, according to the formula, are assumed to earn the average wage. Often, however, they earn less. This is *because of the accounting assumption that the wage income of the self-employed is 'average'*. It means that their high labour share is compensated by negative profits (i.e. losses).



Applying such ideas: the decrease in NULC in Greece was probably caused by lower wages but the Irish decrease was to a large extent caused by the bust, which caused construction (which has high NULC) to decline. Two totally different events show up in the data in the same way!

D. Non-tradeables. Between 2000 and 2011, average German wages did not rise much. Consequently there was a low increase of the German macro ULC. But to quite some extent this was caused by stable nominal wages (and falling purchasing power) of *teachers*. Wages in industry rose a little more than average and Germany still is one of the few countries where industrial wages are higher than economy wide average wages (even despite very high wages in the financial sector). But do decreasing real wages of teachers really increase the international competitiveness and exports of a country? It might affect the current account as German teachers will have had to restrain consumption of, among other things, imported products. But at least for me the relationship with gross exports is not readily apparent.

E. [Felip en Kumar \(2011\)](#) mention the Kaldor-paradox: the empirical evidence about the ULC and competitiveness in fact suggests that high increases in ULC do not cause a decline in competitiveness but are, on the contrary, a sign of successful export performance.

F. Another fallacy of composition. An individual firm can increase its competitive position by cutting the wage

level as the wages it pays (almost) do not affect the demand for its products. But when every company decreases wages total demand will suffer. Greece (where nominal wages have decreased by about 20%) is an extreme example of this. Low rates of capacity utilization and the accompanying decrease in productivity may prevent the decline in NULC and [improved](#) competitiveness.

G. Global supply chains. The share of 'domestic' labour in the cost price of tradeable products shows sustained declines.

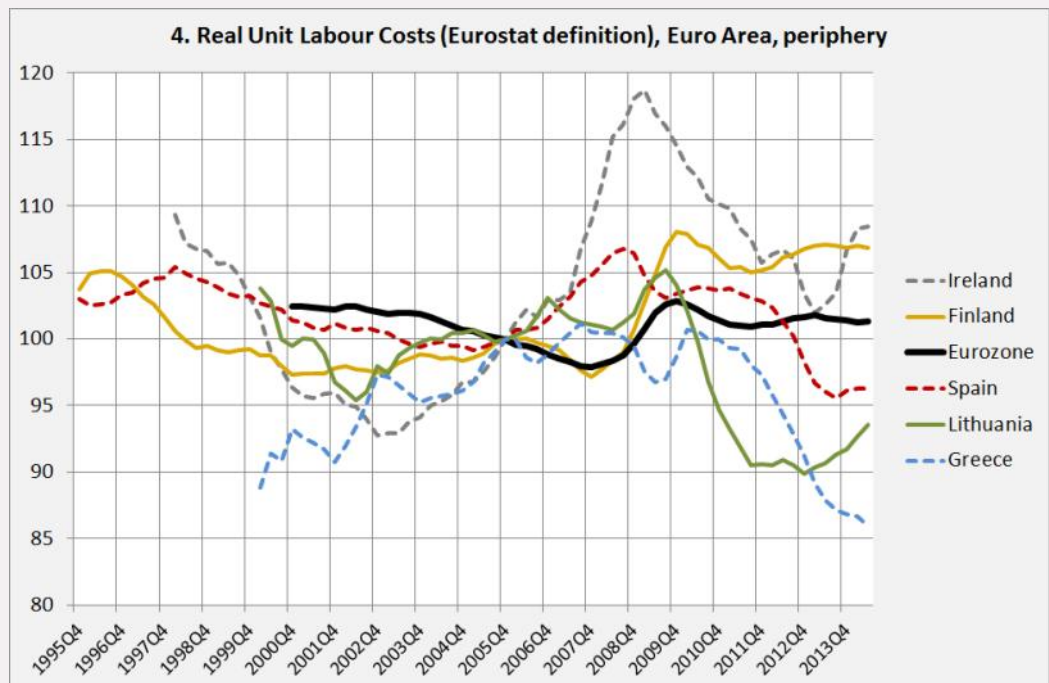
[Giordano and Zollino](#)

mention that the 'domestic labour share' of Germany declined from 27% to 21% of gross output (not the same as value added, the concept used to calculate GDP!) while the Italian share declined from 21% to 18%. This means that lowering domestic wages has a more limited effect on total production costs than it used to have.

H. Owner occupied houses are, with good reason, sup-

posed to add to total GDP. Household labour is however not counted in the GDP accounts, which means that, according to the [OESO](#) (p. 15) "*in the case of Ownership of Dwellings there are no employees, and so this component of value added has nothing to do with the relationship between output and labour costs. Consequently, it should ideally be removed from calculations of ULC indexes... If included it has the potential to distort the comparability of ULC indexes across countries, in particular where there are large differences in the level or, more importantly, changes over time across countries in the contribution of Ownership of Dwellings to value added*"

I. Aside from NULC we have RULC, Real Unit Labour Costs. According to the [IMF](#) these are defined as either: "*the ratios of real wages to productivity, labor compensation to nominal GDP or nominal unit labor costs to the GDP deflator.*" In all these cases it is (something like) the labour share in the economy. Though interesting in its own right (graph 4) this metric is of course bound to have limited variability (as is shown in the graph) while it is, as an indicator of competitiveness, prone to the same problems as the NULC (an increase of the production of natural gas in the Netherlands will lower the RULC, an increase in construction will increase RULC). Graph 4 however does show that the 'program countries' were forced to lower RULC to unnatural low levels – which however did not lead to the expected upsurge in investment.



**Summarizing:** ULC are a seriously flawed macro-indicator of competitiveness, much better ones are available, such as the composite one proposed in [this ECB](#) study. ULC cannot be used without a very thorough investigation of the actual situation and the background statistics. This has not happened post 2008.

All data: Eurostat.

## Macroeconomic impact of UK liberal economic policies

By [Graham Gudgin](#) and  
[Ken Coutts](#)

*Editor's note: This is a summary of a report co-authored by Ken Coutts and Graham Gudgin. The full study is available online. It is: [The macroeconomic impact of liberal economic policies in the UK](#). Both authors are Honorary Research Associates at the Centre for Business Research at Cambridge Judge Business School, University of Cambridge. Ken Coutts is also Emeritus Fellow of Economics at Selwyn College, Cambridge, and Graham Gudgin is also visiting Professor at the University of Ulster.*



Graham Gudgin

A sea-change occurred in the early 1980s in the way the UK economy was organised. From then on, until the present day, openness to trade, light-touch regulation of commerce and free competition have been the watchwords, alongside low income tax rates and constraints on trade union action. Most importantly, the removal of a raft of restrictions on banks and building societies, combined with the abolition of controls on the international movement of capital, allowed a huge expansion in household borrowing. These liberalisation measures extended an earlier trend including the bonfire of war-time restrictions, international trade agreements to reduce tariffs, the move to floating exchange rates between 1971 and 1973, and the switch from direct to indirect controls on bank lending in 1971. However, even by the late 1970s the UK economy was still strongly managed by government. Controls were still in place on capital movements, investment, prices and incomes. Trade unions remained powerful and the basic rate of income tax was at 30% with the top rate at 83%. Most lending to households was still undertaken by heavily controlled building societies. Government economic policies prior to the late 1970s still aimed to maintain full employment although the practice had become more difficult to achieve. After 1979 policy switched decisively towards controlling inflation, firstly through monetarism and later by using interest rates to meet inflation targets.

It is often taken for granted in media and policy making circles that more structural economic reforms, involving greater labour market flexibility, will increase the efficiency of the economy. This assumption may arise because liberal markets are linked to a political philosophy of individual freedom and responsibility. It may also be because many economists in business and academia have a presumption that private sector organisation of economic activity is superior to any state intervention. We make no such assumption. Instead, the purpose of this report is to assess the factual evidence on the macroeconomic impact liberal policies on the UK economy. In particular it is to assess their impact on the growth of GDP, productivity, employment, unemployment and inflation. The report shows that GDP and productivity have grown more slowly since 1979 than over previous decades, contrary to widespread belief. Although inflation and industrial disruption were reduced after 1980, unemployment and inequality have been higher. The volatility of the economic growth has also been much greater. The fluctuations in GDP have come in large waves in contrast to the ripples of the 1950s and 1960s.



Ken Coutts

Any support for the conventional wisdom that the liberal market regime since 1979 has had a favourable impact on growth of the UK economy thus depends on a view that economic performance would have been worse after 1979 even if the previous 'corporatist' regime had been maintained. One view is that the high inflation of the 1970s would have continued to have been a problem if a liberal market regime had not been adopted from 1979, leading to slower growth. However price inflation fell sharply from 1980 in all advanced economies irrespective of the economic policy regime.

An important post-1979 change that should be taken into account is the slowdown in growth in the volume of world trade in goods from the mid-1970s. A likely cause of the slowdown was the ending of the long recovery in the war-torn economies of Europe and Asia, but the switch to floating exchange rates may have played a role. We estimate that the growth in real per capita GDP in the UK would have slowed from 2.6% per annum to 2.2% per annum due solely to the impact of slower growth in the volume of world trade. Assessed against this more slowly growing benchmark trend, per capita GDP in the UK exceeded the trend in the late 1980s and in all years from 1994 to 2008. It then fell well below the trend and now looks unlikely to regain it for many years, if ever.

We argue that per capita GDP was maintained at levels above this trend after 1979 only by the build-up of high household debt levels. Once debt, and the rising property prices supported by rising debt, reached unsustainable levels, as it did by 2007, the banking system crashed and the level of GDP fell much further below previous trends than in any period since the Great Depression. The UK economy now appears to be developing permanently on a lower and slower long-term trajectory than for any period in the last 80 years. Our view is that the Labour Government was misled into believing that the economic growth rates of 1997-2007 could be sustained, and hence kept up a growth in public spending higher than might otherwise have been the case. A belief that the trend growth of the economy had increased during this period was held by the Treasury and by many academic economists. The politicians can hardly be blamed for accepting this professional advice.

Growth in per capita GDP is the arithmetic sum of growth in productivity (GDP per hour), hours worked per employee, employment rates and the ratio of working-age to total population. It is clear that productivity has grown at a slower rate in the post-1979 liberal market period than previously. This is associated with the



decline of manufacturing, a casualty of free market policies and globalisation. Manufacturing had, and has, consistently faster productivity growth than service sectors. The conversion of the UK economy to one based overwhelmingly on services has reduced the rate of productivity growth from around 2% per annum thirty years ago to less than 1.5% per annum today. For many years from 1982 to 2005 the falling rate of productivity growth was offset by a rising employment rate to generate a growth in per capita GDP not far below the pre-1980 trend. Even with employment rates recovering between 1982 and 2007, rates were however generally lower after 1979 than before this date and unemployment much higher. Other factors helping to maintain the growth of per capita GDP were a reduced annual decline in average hours worked, and generally favourable changes in the proportion of the population who were of working age. Without these offsetting changes in employment rates, hours worked and dependency ratios per capita GDP in the UK would have grown by 1.6% per annum on average since 1980.

### **Inflation, de-regulation and privatisation**

The main improvements in the liberal market era have been lower inflation and a greatly reduced rate of industrial disruption. More than anything else it was the huge rise in inflation during the 1970s and associated industrial disruption that stimulated the change in economic policies from 1979 onwards. UK inflation was generally a little higher than in the USA or G7 average over the 1950s and 1960s and again in the 1980s. It was in the period 1971-77 that inflation rose well above the US or G7 average levels, averaging seven percentage points above the level of inflation in the USA, and peaking at just below 25% in 1975. However UK inflation had returned to a level close to the US and G7 averages by 1978, although the subsequent breakdown of wage controls, a new oil price hike and a near doubling in the rate of VAT led to an increase in inflation in 1979 and 1980.

The main improvement relative to the G7 average came not with the Thatcher Government's monetarist policies over the 1980s but following the UK's ejection from the European exchange rate mechanism (ERM) in 1992. After 1992 UK price inflation was generally below the G7 average, due initially to high unemployment and after 1996 to a large appreciation in the Sterling exchange rate. However UK price inflation has returned to its traditional position, a little above the G7 average, since the large depreciation of Sterling in 2008. It was only in the exceptional 1993-2007 period that the UK had lower inflation than the G7 average. Otherwise inflation relative to other major economies in the post 1979 period has been similar to the 1950s and 1960s.

While the high inflation of the 1970s is often viewed as the culmination of earlier corporatist policies, it can just as easily be treated as a temporary aberration that was on its way out by the time the Thatcher government took office in 1979. Inflation was high in all major economies in the 1970s due to high deficit spending in the USA, the resulting collapse of the Bretton-Woods exchange rate system and the associated quadrupling of world oil prices in

1973. The corporatist era's policy regime of wage and price controls in a context of strong unionisation was unable to deal well with this disruptive situation and policy mistakes were made. The threshold wage agreements introduced by the Heath Government in 1973, caused prices to soar in 1974 following the oil price increase, but rises in unemployment were kept smaller than would otherwise have been the case. Inflation is likely to have been somewhat higher after 1980 than it actually was if corporatist policies had continued, but unemployment would have been much lower.

Other projected gains from liberal market policies have not been realised or not sustained. Total taxation is no lower now relative to GDP than in the 1970s. The enterprise boom in new firm formation did not outlast the 1980s and new firm formation rates are now only a little higher than in the decades prior to 1980. If business investment was expected to have risen from its low rates in the pre-1980 period, then the expectation was not realised. Nor has the record of research and development spending improved. Indeed it has worsened. Again this is likely to reflect the loss of manufacturing with the UK experiencing the largest proportional loss of any industrial nation.

Any consideration of the changes in business regulation in the post-1979 period is complex. The prices and incomes controls of the pre-1980 period did not work well and arguably had a limited impact on inflation. Such controls would in any case have become redundant as global inflation came down over the 1980s and 1990s. Regional development controls on manufacturing investment did help regions with high unemployment but were in abeyance by 1979. Although such controls were abandoned, a regime of grant-based incentives has continued up to the present albeit one regulated through EU state aids rules. The huge success of a low business tax regime in attracting multi-national firms to the Republic of Ireland shows that regional attraction measures can be very effective.

The growth of new regulations over recent decades, many EU-wide, in health and safety and other areas are part and parcel of a higher standard of living. Countries with more controls, including Germany, Austria and Sweden, do not appear to suffer a significant overall productivity penalty. OECD studies suggest that, among deregulation measures, it is free trade that has most impact. We argue that most of the tariff reductions on trade in goods had already been introduced by 1979. Nevertheless it remains true that, on average, the post 1979 period experienced much freer trade than the preceding decades. Other regulations, including labour market rules, appear to have had a limited impact. UK attempts to derogate from EU labour regulations are likely to have done little to increase economic growth or productivity over recent decades. We conclude that the regulatory regime before 1980 had little negative impact, and that the fact the UK has had a somewhat lighter regulatory regime than other EU countries since has done little to increase economic growth or productivity.

It was the de-regulation of bank lending which had

most impact after 1979. Financial de-regulation, undertaken initially in 1971 and more determinedly after 1979, led to faster growth in GDP up to 2007 but eventually left a highly indebted household sector and a devastated banking sector. Since the financial crash of 2008 the UK economy has languished further and further below the pre-2008 trend and seems most unlikely ever to regain that trend.

The impact of privatisation on industrial efficiency has been judged in most studies to have been limited. This was surprising because privatisation improved corporate governance, and freed companies from political interference and from Treasury financial controls which were likely to have constrained investment. Commercial objectives including profitability became more dominant and firms improved efficiency in marketing, innovation and finance, and were able to diversify into overseas markets, becoming large multinational companies. Even so, studies across privatised companies have concluded that either there were no long run effects on UK output or that it was tough regulation rather than privatisation per se that gave rise to welfare gains for consumers. Studies of individual privatisations show mixed results. Only some studies detected clear performance gains and a number confirmed that the main gains occurred in the run up to privatisation. In general however efficiency gains were, as expected, more likely when accompanied by competitive markets or effective regulation.

The official historian of UK privatisation concludes that 'the strident claims of ministers during the 1980s and 1990s about the benefits of privatisation were exaggerated and the true picture is more of a mixed one'. It should also be borne in mind again that any efficiency gains at company or sector level only lead to macro-economic gains if redundant labour is re-employed in productive activity. The persistently high unemployment of the 1980s and 1990s indicates that there was insufficient re-employment to growing sectors and fits our observation above that, far from improving, the trend growth in GDP per hour deteriorated substantially from the early 1980s.

It is true that the retreat of state involvement in the UK has avoided repetitions of some of the commercial failures of the corporate age including nuclear power (AGRs), Concorde and launch rockets. However other countries, and notably France, persevered longer with these technologies and now have more successful firms in these areas than does the UK. Nor was it the case that government commercial failures were confined to the corporate period. Commercial blunders were equally possible in a regime of liberal markets, as shown by the mis-selling scandal over privatising pension provision as personal pensions in 1985, and the attempt to privatise vocational training as individual learning accounts in 2000.

#### **Relative productivity performance**

Much of the support for the liberal market reforms comes from a belief that the UK's economic performance improved relative to Western European competitors although not, it should be noted, relative to the USA. Other than the support of what we regard as inappropri-

ate theories currently dominant in much of university economics, and in some quarters a philosophy of individual freedom, it has been the UK's improved performance relative to major European competitors that has underpinned the consensus around the economic benefits of market liberalisation.

In the immediate post-war years, levels of productivity and per capita GDP in the UK were well above those of most of Western Europe. The advantage had disappeared by 1979 as productivity in other EU countries improved faster than in the UK, but after 1979 the UK matched or bettered growth in per capita GDP in the original EEC members. There is however little evidence, as we have argued, that this improvement in relative growth was caused by any improvement in the actual growth of UK GDP. Rather, the improved relative performance was caused by a dramatic slowing in the growth of continental EU economies from the early 1970s onwards. GDP in the EU6 countries grew rapidly at an annual rate of 4.5% per annum from 1950-73, slowing to 2.5% per annum in 1973-79 and only 1.6% per annum from 1979-2007.

By 1980 French and German labour productivity levels were approaching 90% of US levels and had little further room to converge, while their hours worked per employee continued to fall. Moreover there was no compensating rise in employment rates, including in Germany until the Hartz labour market reforms of a decade ago. As a result, growth in per capita GDP slowed within the EU6. These conditions did not apply to the UK, where labour productivity was only 75% of the US level in 1979 and has never subsequently reached 90%. With less globalisation and hence a slower decline in manufacturing we believe that productivity growth would have slowed down less after 1979 than it actually did. On the other hand a more unionised UK is likely to have continued to reduce hours worked per employee as in the EU6 countries.

One of the proximate causes of slow productivity growth in the UK has been the low rate of investment both by businesses and government. Data from the IMF show that the UK has consistently had the lowest rate of total investment of any major economy. The investment rate in the liberal market era has been even lower than in the previous corporatist decades, but both were low. OECD data shows that business investment has been the lowest of any major economy since 1980.

Our conclusion is that UK growth in per capita GDP did not improve after 1979 and even the achievement of keeping close to pre-1980 growth rates was attained by keeping working hours from falling further. Labour productivity has remained below that of France and Germany and has fallen further behind the USA. There is little to suggest that liberal market policies in the UK contributed to convergence with other European economies.

One confidence-sapping characteristic of the pre-1980 decades was the continuous decline in the UK share of world trade in goods. This decline appeared to cease after 1980 initially due to the growing production of North Sea oil

and gas combined with high oil prices. The longer trend has been a continued decline in the UK share of world trade at much the same rate as before 1980. Once again there is little to suggest a sustained improvement in performance due to liberal policies. Instead the UK current account on the balance of payments has been continually in deficit since 1983 in sharp contrast with earlier decades. This has occurred despite a growing surplus in trade in services.

### Slow Growth in Future

The future implications of the analysis in this paper are serious. The trend in productivity growth in a UK economy heavily denuded of manufacturing by decades of globalisation is unlikely to be much above 1.4% per annum. Growth in the employment rates did offset declining productivity growth from the early 1980s, but this offset cannot be sustained in future. With the employment rate in 2014 once again close to a peak, there will be little or no future secular growth in employment rates. Even worse, projected decline in the proportion of working-age people, due to an aging population, will reduce the long-term trend in growth of per capita GDP by a further 0.5% per annum. If the average number of hours worked per employee continues to decline, even at the slow rate of recent decades, a further 0.3% per annum will be subtracted from the growth rate of per capita GDP. The trend growth rate of per capita GDP would then be only 0.6% per annum. If this sounds alarmist, we should note that observed growth over the decade to 2014 has been only 0.4% per annum. We thus expect the UK to experience the secular stagnation that Lawrence Summers projects for the USA, but the reasoning involves fundamental trends in sectoral productivity and demographics rather than the demand-side factors invoked by Summers.

### Discussion

The main contention of this paper is that financial liberalisation was the sole aspect of the liberal market reforms introduced into the UK, initially in 1971-73 and more consistently from 1979, which materially increased the rate of economic growth. The freeing up of finance led to a huge, and eventually unsustainable, expansion of household borrowing. This temporarily accelerated the growth of consumer spending and hence GDP and of house prices, but in 2008 contributed to a banking crisis and the longest recession for over a century. Other than this unsustainable boost to demand from financial liberalisation there is little evidence that other liberal market policies taken together improved the trend rate of economic growth in the UK even temporarily, although they may have been advantageous in other ways. Evidence that the growth rate was poor in the post-1979 liberal period also lies in the consistently high level of unemployment which has averaged 8% since 1979, (not including the concealed unemployed on sickness benefits), compared with 3% in the three previous decades.

The liberal market reforms were one attempt to stem the rate of decline in the UK share of world trade. Joining the EEC in 1973 in the expectation of tying the UK economy to fast growing markets had been another. While

post- 1979 liberal reforms may have had some success in improving management and industrial relations, they have also allowed UK firms to relocate production to emerging economies helping the extreme de-industrialisation of the UK economy. As far as EU membership is concerned, the UK actually joined one of the world's slower growing trade blocs, as growth slowed permanently in France, West Germany and other EEC nations just as the UK acceded.

Margaret Thatcher regarded the British in 1979 as a "a brave people who were stifled and controlled by a bureaucratic state that penalised the good and rewarded the bad, stifled innovation, while generating feckless welfare dependency". The policies designed to reduce bureaucracy, promote innovation and reduce welfare dependency clearly did not succeed in raising rates of economic growth. Even in 2007 government current spending was higher as a percentage of GDP than it had been in 1979. Welfare dependency rose by 50% during the Thatcher-Major years and remains at this level today. Attempts to reduce taxation through lower public spending were also only temporarily effective and did not survive the first post-Thatcher recession in 1990/91. Levels of business investment in the UK have remained low compared with all major competitors. Company formation rates rose only briefly and are now not much higher than before 1980. Expenditure on R&D has also remained lower than competitors and indeed the UK is the only major country in which R&D expenditure has been trending downwards relative to GDP. The erosion of manufacturing has left the UK with a permanently lower rate of productivity growth. OECD research shows that less regulated labour markets do not lead to a better economic performance. Even trade restrictions like the 11% cap placed on car imports since 1977 have served the UK well as Japanese car manufacturers subsequently set up production plants in the UK.

What was achieved by liberal economic policy was a reduced level of industrial disruption and weaker trades unions, although in part this was due to higher unemployment. It is difficult to estimate the direct economic impact of improved labour relations and lower level of industrial disputes. Common sense indicates that less disruption should be a good thing in itself but not necessarily if the result has been a weakening of wage bargaining power that has allowed a resurgence of extreme income inequality. We note that the UK economy grew consistently and well through the 1950s and 1960s even with poor industrial relations, as it did in the USA with extra-ordinarily high strike levels by British standards. Moreover, the idea that high inequality is necessary for enterprise and innovation also receives little support from the data. Recent research from the IMF suggests that increasing inequality is not associated with faster growth in GDP or higher productivity.

This report attempts to lay out the facts of UK macro-economic performance under contrasting policy regimes. It does not attempt to say much in detail about alternatives to the current liberal market regime. We can say that while we believe a framework of competition between

companies and organisations promotes productivity growth, the evidence appears to show that this is not necessarily sufficient to generate adequate growth in productivity. In complex economies like the UK, in which governments are inevitably involved in supporting the economy, the extreme assumption that free markets will generate optimal outputs is shown to be untrue. The evidence suggests that policies aimed at maintaining full employment generated better growth outcomes than policies that instead targeted inflation. The main reason is likely to be the greater certainty engendered when governments maintain demand at a high level. This encourages company investment and skill formation. Persistent tight-

ness in labour markets also promotes rapid sectoral change as low productivity sectors run short of labour which is attracted to higher paying sectors. The problem with liberal market regimes is that they leave demand management to an unco-ordinated private sector. Bank lending, chiefly to households, fills the gap vacated by governments and has negative impacts on house prices and ultimately on bank viability. Aggregate demand is usually too low, resulting in high unemployment which while depressing inflation has permanently unfavourable social effects. Our conclusion is that a wider range of varieties of capitalism are available to policy-makers than is commonly assumed.

## 1st Vienna Conference on Pluralism in Economics

This April, Vienna played host to the highly anticipated and vastly successful 1<sup>st</sup> *Vienna Conference on Pluralism in Economics*. Worldwide dissatisfaction with conventional economic curriculums and mainstream economic policy have fueled student demands for pluralism and interdisciplinarity in economic thought. As a consequence, the last few years saw the emergence of numerous organizations and events that provide a platform for marginalized economic theories as well as dialogue within the economic profession. These efforts and developments largely shaped the backdrop for the conference in Vienna.

The conference organizers, including the Society for Pluralism in Economics, the student organization Roter Börsenkrach and the collective of women in Economics, FrauWL, had developed a rather unconventional program for their conference. Rather than grouping participants and lecturers into workshops by their respective school of economic thought, they chose to group according to economic topics, such as *Living with our natural surroundings*, *Redistributing wealth & power* and *Financial markets and the role of money*. This enabled participants in each workshop to discuss their respective topic and hear questions from multiple differentiated perspectives – Marxist, Post-Keynesian, Feminist, Monetarist, Behavioral, Neoclassical, philosophical, sociological, etc.

The 300 conference participants and lecturers from all over Europe left the conference wanting more and promising to attend the 2<sup>nd</sup> Vienna Conference on Pluralism in Economics. Evidently, dialogue between different economic schools of thought is feasible, useful and in high demand. This is the message that has to be communicated to economic institutions and decision makers worldwide.

Conference HP: <http://conference.plurale-oekonomik.at/>

FB Link: <https://www.facebook.com/PluraleOekonomikWien?fref=ts>

### Ecological Economics—call for abstracts

ANZSEE, the Australasian chapter of the International Society of Ecological Economics has announced its call for abstracts for papers, workshops and panels for the 2015 *Thriving Through Transformation — Local to Global Sustainability* conference at the University of New England Business School, Armidale, NSW (Australia) in the week of 19–23 October 2015.

For details on the conference see: <http://anzsee.org/anzsee2015conference/>

The long list of themes appears here: <http://anzsee.org/2015-conference-themes/>

The call details can be found here: <http://anzsee.org/first-call-for-abstracts-or-panelsessionworkshop-suggestions/>

## Contact the Association

### Journal editors:

RWER: Edward Fullbrook [fullbrook@worldeconomicsassociation.org](mailto:fullbrook@worldeconomicsassociation.org)

Economic Thought: [ETEditor@worldeconomicsassociation.org](mailto:ETEditor@worldeconomicsassociation.org)

World Economic Review: [wereitor@worldeconomicsassociation.org](mailto:wereitor@worldeconomicsassociation.org)

### Conferences: Chair of Conference Organizing Committee:

[conferences@worldeconomicsassociation.org](mailto:conferences@worldeconomicsassociation.org)

Newsletter editor: Stuart Birks [k.s.birks@massey.ac.nz](mailto:k.s.birks@massey.ac.nz)

*The World Economics Association Newsletter is published in the UK by the World Economics Association.*