Will Hutton and the battle of the Economists

Thursday 18th February 2010

The Gladstone Club
1 Whitehall Place London SW1A 2HD

A 6% fall in production is the biggest blow to enterprise since 1921. The question is, says Will Hutton, how much is lost forever and won't be coming back? He measures an average growth rate between 1991 and 2009 troughs at 2.1%. That is well below the 2.6% forecast informing the Government's plan to halve the deficit by 2013-14. At Hutton's pessimistic growth rate he doubts this can be achieved. He sees little hope of returning to 2007 output levels before 2015 and predicts unemployment will reach 10 or even 15% of the workforce.

Using aggregate demand analysis, as Keynes predicts, most contraction has come from a massive 50% reduction in firms' capital investment expenditure. He points to shop closures on high streets outside London and particularly in small and medium-sized towns in the North and the Midlands as evidence of a drop in consumer demand, the result of rising (+2%) unemployment. To cut government expenditure at this time would be foolish. In the most effected regions 50k jobs in the private sector have been lost over the last ten years but replaced by 150k jobs in the public sector, without which we would have had disaster and likely social unrest.

Knowledge workers keep jobs
The burden of the collapse in output has fallen on manual and unskilled labour. London has been less effected because of its strength in the 'knowledge economy'. Firms don't like to lose their knowledge workers. They are high value adding, know the business, are expensive to replace and new hiring notoriously difficult to get right. Hence sabbaticals, part time working, extended holidays etc.

Battle of the economists
In a letter[1] to the Sunday Times (14th Feb) 20 economists backed the Tories call for action in 2010-11 toward paying off the structural part of the deficit in 5 years. Part is the temporary effect of increased welfare payments and decreased tax revenues, opinions vary on how much is 'structural' but around 70%. That pace of pay back has never been attempted before. He calls it armchair economics having no sense of the effect on real lived lives.

By the following morning, his critique was echoed in Friday's FT in a contrary letter[2] signed by 60 economists. 9 more signed another adding: *"History is littered with examples of premature withdrawal of the government stimulus, from the US in 1937 to Japan in 1997"*. Premature withdrawal or just didn't work? It adds that net debt peaking at 78% of GDP is *"lower than in the majority of peacetime years since 1815"*. Will Hutton agrees. The deficit is a tool we should be prepared to use for a longer period and not worry providing it is below 100% of GDP and the trajectory is downward. If you find dry rot in the cellar you borrow to fix it or the house falls down.

Credit for industry
Apart from the stimulus, we need to ensure firms get the credit they need. This is part of the need for reform of banking. Of £1.8tr bank created debt, two thirds is domestic mortgages, then there is unsecured consumer debt, credit cards etc, commercial property but a paltry 5.5% goes in working capital to industry for productive use. This illustrates banks' lending inclinations. We need to make more credit available for production.

Regulators concern should be for the availability of supply at a reasonable price not, like the FSA, the international competitiveness of the utility companies. Banks have shown no will for reform beyond increasing capital. There should be reform of bonuses, gearing, reserves, a formal exchange for CDSs and CDOs and the biggest should be broken up.

Did he favour Glass-Steagall? the US's 1933 post-crash act enforcing separation of retail banking (granting credit, taking deposits) from investment banking (using credit, investing in 'securities'). The argument for repeal in 1999 was that the securities activities would spread risk. Hutton finds the Glass-Steagall split overly restrictive but supports Obama and chair of his Economic Recovery Board, Paul Volcker. The Volcker Rule splits off proprietary trading, private equity and hedge fund activities. Obama has got it right but he won't get it through congress.

Banks warn that if over regulated or taxed then they will go elsewhere. Hutton asks Where? Rekjavic? We have seen the importance of the State's ability to underwrite them. Will high net worth individuals entrust their money to a bank domiciled in some small island state? Our big four are among the biggest in the world and the reality is that the only places that could cope with them are London, New York and Frankfurt. He agrees with the Bank of England's Andy Haldane – let them form an orderly queue at Terminal 4.

Pensions silver bullet
The older generation scooped windfalls on their houses and enjoy generous final salary pensions. When Asquith bought in the state pension in 1910 the average man died at 61 and the pension age was 60. Now life expectancy for men is 85. You can't expect to work for 35 years and be supported by others for another 35, to be a burden on our children paid through high mortgages. These things are all connected, inter-generational equity, Osborne is right about that.

Taxation
Entrepreneurs who build successful companies, innovations, should get rich, very rich. Should earn a handsome dividend. Not bankers! But there are some things that if left to the private sector wouldn't get done, that only governments can do. Apart from Keynes, Hutton's other Social Liberal hero is L T Hobhouse argument that government also deserved a dividend, taxation, for its contribution.

Although willing to mix freely the technical and economic with his political philosophy elsewhere, Will Hutton seems to have no appetite to discuss the incidence of taxation. Wearisome. Perhaps in the end that is the difference between Liberal and Liberal Socialist implicit in it the worrying possibility that misallocation of the incidence may be the cause of the difficulties. He knows that growing public sector jobs alone cannot solve unemployment, he believes that SMEs (small and medium-sized enterprises) are vital, but does not seem to have a policy to liberate their energies – other than more help from the State?

China
Some fear China will come to dominate or else might somehow bring economic salvation. Will Hutton dismisses both prospects. China is economic giant but financial pygmy. According to him its 8% growth is all built on debt, one big Ponsi scheme, 98% of exports are by foreign companies and the 5th generation of communist leaders will have zero legitimacy. It is difficult he says to be too pessimistic of China's prospects. See his latest book *'The Writing on the Wall'*.

---

1 http://www.timesonline.co.uk/tol/comment/letters/article7026234.ece

2 http://www.ft.com/cms/s/0/75b2481e-1cb5-11df-8d8e-00144feab49a.html?nclick_check=1