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Ryan Bourne: A government that wants to Build Back Better must address supply-side constraints on the economy

Ryan Bourne

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Ryan Bourne is Chair in Public Understanding of Economics at the Cato Institute.

Well, so long, "Plan B." In jettisoning some of the most intrusive remaining Covid-19 restrictions, England (with the home nations to follow) could soon rival parts of the U.S. in being the most "normalised" policy environments in the developed world. Yes, mandatory self-isolation for those testing positive will remain, for now. But as with the vaccine rollout, Britain appears now to be leading the world into the new approach of "learning to live with the virus."

This will bring with it an economic fillip, albeit disrupted in near-term statistics by Omicron. We have certainly been in need of one. Though headline GDP figures across countries can be misleading about the impact of the pandemic given measurement differences, an analysis by *The Economist* combining five indicators – GDP, household income per person, share prices, investment, and public debt – found that through September last year Britain had been the second most adversely affected major economy from the pandemic, behind only Spain.

In its ranking of 23 OECD countries, Britain was deemed third worst for the fall in household income (behind Austria and Spain), third worst for the decline in share prices (behind Chile and Spain), worst for the fall in investment, and second worst (behind Spain) for the public debt surge. With Covid-19 deaths per capita here relatively high – above all other major European or G7 economies except for the U.S., Belgium and Italy – we suffered a pandemic double-whammy of both poor health outcomes and a big economic hit.

Does analysing the change in these variables mislead about how the UK shapes up internationally after Covid? Perhaps. It's not as if the public health crisis was the only thing happening during this time. And it's important to remember that looking at changes to economic variables in the pandemic can hide that Britain entered it with significant structural strengths too.

In mid-2019, *The FT*'s Chris Giles was able to write that incoming Chancellor Sajid Javid enjoyed unemployment at its lowest rate since 1974, with the share of 16- to 64-year-olds in work at close to record levels, inflation bang on target, average earnings growing at their highest rate for 11 years, and public borrowing modest. The biggest ongoing economic weakness then was clearly productivity – with GDP per hour worked around 15 per cent lower than seen in France or the U.S., after a decade of weak economic growth.

So the UK entered the crisis with many macroeconomic variables healthy. Even the shock of the pandemic has therefore left the country's headline statistics looking largely unremarkable in comparison with other economies.

UK unemployment is still low by international standards, for example. At 4.1 per cent for September through December 2021, the UK's rate was similar to the U.S., and bettered only by Japan (2.8 per cent) and Germany (3.2 per cent) within the G7. The employment rate for 16-64 year olds of 75.5 per cent, although still 1.1 percentage points below its pre-crisis peak, is similarly only exceeded by the Scandinavian countries, Germany, and the Netherlands within Europe and then Japan too in the G7.

Pandemic-induced disruption and rising energy prices (on the supply-side) and huge macroeconomic stimulus (on the demand-side) has left us worried about inflation and a cost-of-living crisis. But, again, this is not an affliction unique to Britain, belying the idea it is mainly caused by Brexit. At 5.4 per cent in the 12 months to December, consumer price index inflation was almost identical to EU-wide inflation (5.3 per cent), and lower than some countries within it, such as Germany. Compared to G7 countries, the UK was decisively average too, with only Japan and France with significantly lower rates.

On GDP, it's true that – putting measurement differences aside – the UK had one of the biggest headline falls in output during the pandemic. GDP in Q3 2021 was still 1.5 per cent below the pre-crisis peak, with only Japan having suffered a worse performance among G7 countries. But the OECD expects faster UK growth going forwards. And as economist Julian Jessop has noted, it's highly likely that the UK will be doing better than the eurozone in terms of GDP relative to its pre-crisis peak through 2022, although still lagging far behind the U.S.

What about the public finances? Well, up to September 2021, the IMF had calculated that the UK had the third biggest total Covid-19 fiscal support package, amounting to a massive 19.3 per cent of GDP, and so behind only New Zealand and the United States. It's therefore no surprise that public net debt has surged to new highs in peacetime. And yet, within the G7, the only country with a gross debt-to-GDP level lower than the UK is Germany and the UK is slap bang in the middle of the seven for its projected primary budget deficit this year.

The after-shocks associated with Covid-19 might be felt for years to come, through disruption to demand patterns, experiments with more home working, a spatial reallocation of activity and lingering effects on attitudes to risk. But the UK's broad macroeconomic situation is not dissimilar to that of many other comparable countries. And that should make us ponder a few lessons from elsewhere as we tackle the immediate challenges we face.

In particular, the country that has stood out in suffering a worse inflation problem than the UK is the U.S. – where households were showered with cash such that the government effectively delivered a money drop to households. So why the guys at the Social Market Foundation appear to be urging the Chancellor to introduce a £500 "Rishi Cost of Living Allowance" as if that's a cure to inflation here is beyond me.

Unemployment spiked very high and then plummeted in the U.S. below all G7 countries bar Germany and Japan – showing the long-term virtues of flexible labour markets. If Britain wants to regain its full, robust employment performance of 2019, it should beware new policies prioritising worker "security" over continuing a liberal hiring and firing environment as things normalise.

But, most of all, the UK's key economic challenge – weak growth – remains and becomes even more pertinent given Covid-19-induced constraints. The pandemic has tested to destruction the idea that macroeconomic problems can be solved by throwing more and more stimulus and "demand" at things. If the Government is serious about "Building Back Better", it needs to do the hard yards in thinking about the supply-side constraints on the economy and how to turn more demand into real growth, rather than rising prices.