Funding the Future

The economics of deeply divided Britain

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The FT reports this morning that:

Business confidence has climbed to its highest level for at least 22 years, with optimism growing in all UK regions, a study has found.

Companies expect stronger profits, orders and sales over the next six months, raising hopes of continued economic growth, according to a survey of 1,500 businesses by Lloyds Bank.

It also notes that:

Deal frenzy, animal spirits, merger mania — call it what you like, it is back. The value of global mergers and acquisitions hit $1.75tn in the first six months of the year, a 75 per cent rise on the same period last year and the highest since 2007.

Amidst that euphoria comes the news from the Guardian that:

So many patients are facing long waits for treatment, GP appointments and diagnostic tests that the NHS is "palpably fraying at the edges", the leader of Britain's doctors warns on Monday.

Crucial services are deteriorating because the cash-strapped health service cannot cope with rising demand from patients at the same time as ministers are "attacking the overall financial viability of the service", Dr Mark Porter said.

And then there is this, from the same paper:

Bus services, libraries and leisure centres are at risk of closure over the next few years as English councils have to deal with rising demand for elderly care and a giant budget black hole, the Local Government Association has warned.

The LGA said councils in England face a funding gap of £5.8bn between March 2014 and March 2016, which could put frontline public services under threat of having their funding cut.

And the Joseph Rowntree Reform Trust has reported that:

A couple with two children needs to earn £40,600 to have an acceptable standard of living, almost 50% more than before the recession, according to a report that highlights the squeeze on families from soaring energy bills and benefit cuts.

While the amount needed to cover a family's basic needs had risen 46% since 2008, average earnings had risen only 9% in that time, the charity said. On top of that many families had lost out because of changes to tax credits and benefits.

These reports, all from this morning's news, highlight a divided Britain and a divided world. A limited few who own and control capital seem to think that they have never had it so good. Those that they employ are having a torrid time. The rich do genuinely think they are getting richer. The rest know they are not.

And yet underlying all this there are real tensions. As the FT says this morning:

The Bank for International Settlements has warned that "euphoric" financial markets have become detached from the reality of a lingering post-crisis malaise, as it called for governments to ditch policies that risk stoking unsustainable asset booms.

While the global economy is struggling to escape the shadow of the crisis of 2007-09, capital markets are "extraordinarily buoyant", the Basel-based bank said, in part because of the ultra-low monetary policy being pursued around the world.

The hype and froth of the markets that is spilling over into business confidence my all be an illusion according to BIS, fuelled by low interest rates.

But there are contrary voices on that issue. Danny Blanchflower's warnings on increasing interest rates at a time when there is real excess capacity in the economy, represented by both unemployment and undermeployment, are well reflected by Larry Elliot this morning, who says:

Underemployment will disappear, Bell and Blanchflower say, when the economy again approaches full employment. They add that the last time interest rates were raised in July 2007, the total underemployment rate stood at 5.8% — 5.5% unemployment plus 0.3% underemployment. Today the equivalent figure is 8.4% (6.6% plus 1.8%).

All of which helps to explains three things: why there has been much less wage pressure than the Bank of England has been predicting until now; why there is likely to be less wage pressure than the MPC is anticipating in the future; and why the MPC should be wary of those who say looming wage pressures justify an immediate ratcheting up in interest rates.

Yet again there is a deeply divided perception of what is important: the Bank for International Settlements, based in Switzerland, wants interest rates to rise to control capital markets. In the real world of unemployment, underemployment, low pay, a cost of living crisis and potential mortgage rate increases the exact opposite is needed.

What is apparent in each of these cases is that there is a missing link in the equation, and it is tax. There is no mention of the role of tax in these various arguments, excepting that from the Joseph Rowntree Foundation, who note that tax has added to the woes of those trying to balance the budgets of UK households. Despite this, it is tax that could solve the problem of euphoria in capital markets: a financial transaction tax would be the first step to achieving this goal. Higher corporation tax rates, especially on banks, would be a second step. A land value tax to cool property markets would obviously be of value right now. So too would more progressive income tax help: it is obvious that there is a need for significant redistribution of income and wealth in the UK and yet that is not happening. Removing National Insurance charges from those on low levels of income whilst increasing the rate for those high earners who currently make little relative contribution would be another step in the right direction. Reconsidering VAT rates on most goods and services, whilst leaving them higher on non-essentials (a policy pursued, let's remember, by Margaret Thatcher) would help this redistribution process, as would the imposition of an investment income surcharge for income tax purposes on rents, dividends, interest and other investment income over a sum of, say, £2,000 a year, to create the equivalent of a National Insurance charge.

The assumption that monetary policy has to, and even can, break the great divide in the UK economy is just wrong: it can't. Tax has to play a key role. And that's what I would really like Ed Balls to say today. But right now that message seems a long way from where it needs to be in the mainstream of economic thinking and so I can't see it happening. But that, in a nutshell, is one of the key problems that we face in the UK economy at this moment.