

George Osborne should change course on the economy and loosen the austerity programme

Danny Quah signed a letter with a number of other leading economists in 2010 backing George Osborne's austerity programme. Here he explains why shifts in the international environment and UK monetary policy now require a change of policy.



Discussion of appropriate UK debt reduction policy cannot occur independently of, in this case, at least two other large factors: first, the international environment; second, the stance of UK monetary policy. In my view, dramatic swings in the both of these have occurred since I joined the group that signed the letter supporting Chancellor Osborne's austerity programme.

We need to remember that in February 2010 the UK's debt and deficit position was not dramatically different from those of the Eurozone countries now experiencing considerable sovereign debt distress. It doesn't take a lot of imagination to see how, all else equal, UK government borrowing could easily have become just as expensive and as difficult as in those economies. In the event, however, the Eurozone economy went into free fall much faster and much further than I expected. This has had two effects on the UK fiscal position: on the one hand, UK debt has turned out looking, well, not so bad after all relative to comparable advanced TransAtlantic economies. The fear that UK borrowing would become overly costly has become much less relevant.

On the other hand, the continued inability of both sides of the Atlantic to resume economic growth means a dramatic drag on UK economic performance. Unlike, say, Germany, the UK has historically consistently exported mostly to the slowest-growing advanced economies, and so this TransAtlantic slowdown has considerably depressed the UK exports and thus the UK economy. [Germany, by contrast, today exports more to Developing Asia than it does to the US.]

So, the international environment has shifted in such a way so that the urgency for rapid debt reduction has lessened.

The other large factor is how market perception on the stance of UK monetary policy too has shifted. For most observers now, the Bank of England has made clear how it is willing to put considerable resources into monetary easing. That has also reduced the pressure for dramatic debt reduction, compared to the perceived monetary stance at the time I signed the letter.

So, have I changed my mind since signing the letter? Yes. Because circumstances have changed: not just because the UK economy is in recession. By itself, that latter wouldn't be enough to fight excessive debt. But because of shifts in the international environment on the one hand, and UK monetary policy on the other.

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