Macro-economics, local experimentation and discovery: Meeting the challenges of economic change

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Paul Ormerod June 2010
How typical has the recession been? (1)

- 224 examples of recessions (negative growth of output) in the West since the late 19th century

- Most recessions are short - 70 per cent only last 1 year, another 20 per cent last 2

- Long recessions are rare
Output profile during the 2008/09 recessions

Index, pre-recession GDP = 100

France
US
UK
Germany

Q1 2008 Q2 2008 Q3 2008 Q4 2008 Q1 2009 Q2 2009 Q3 2009 Q4 2009 Q1 2010
How typical has the recession been? (2)

- Most recessions are small
- One quarter show a fall of output less than 1 per cent
- One half show a fall of less than 2.5 per cent
How typical has the recession been? (3)

- A deep recession, in most countries the falls in output are in the top one quarter of all recessions since late 19th century

- Once recovery starts, it tends to be fast - V shaped

- After financial crises, it is more usually U-shaped

- And after financial crises, there is usually a sovereign debt crisis
Volterra

Is this time different?

- Completely different policy response from the American authorities

- Output in the US fell 2.5 per cent and is now growing again

- 1930-33 it fell 27 per cent, almost 1 in 4 Americans were jobless

- India, China etc are now big economies and have continued to grow

- Overall, cautious optimism
Historically, there seems to be a tipping point of debt as a percentage of GDP. Below this, debt rarely causes financial crises; above it, it can be does not always. This percentage is 90-100 per cent.
Why is public debt a problem? (2)

- In 1950, the percentage for the UK was around 200

- In Japan in the decade before the recession, it averaged more than 150 per cent

- The current UK figure - there are different ways to define it - is below the tipping point

- Much of the deficit - the annual addition to debt- is due to the recession and only a tiny part to ‘bailing out banks’

- When the economy recovers, the deficit will shrink
The deficit - the annual addition to debt - *is* big

Not much inflation to erode the real value of debt

Brown ran a deficit even in the good years - there is a structural imbalance

It is to a large part a matter of market sentiment rather than ‘objective reality’

But this doesn’t make the problem less real
Brown really did believe that problems could be solved by throwing money at them.

This has simply not worked - the public sector productivity record is poor.

A non-trivial part of the increases in public spending went in pay rather than to provide services.

This is why there will be serious squeezes on public sector budgets.
Volterra  Value for money and successful delivery

- 21st century approaches require economic/social systems to be thought of more from an evolutionary perspective than from the central planning mechanical approach of the 20th century.

- Diversity is important in getting the best results - local experimentation.

- ‘there is no success like failure’: Bob Dylan - public sector needs to accept that failure is an integral part of success.

- Nudge is fine but not always easy to anticipate the effects.

- Networks are the key - ‘social learning’ - to behaviour change and successful policy.

- Royal Society of Arts promoting the theme ‘21st century enlightenment’.

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