

# **The Economic Crisis and the Prospects for the UK**

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I am an accountant, not an economist, but I have done research on the current crisis. I was recently ordained, and it was during my ordination training that the economic crisis gave me a chance for reflection on it and on the ethical issues involved. My presentation will be in four parts:

- 1) What happened last year (background)
- 2) Where we are today (main part)
- 3) Where things might be heading
- 4) Some ethical/ theological thoughts from a faith perspective

## **Background: What Happened**

The background in the UK was 15 years of sustained economic expansion. Growth was particularly strong in the financial and housing sectors, which made up 60 per cent of the growth in GDP. But this growth was based on individual and corporate borrowing and easy (though not necessarily cheap) liquidity. It benefited from a benign global economy, and low-priced manufactured goods from countries such as China fed the consumer boom in the West. Commentators looking back now say this was unsustainable: that was not what they were saying at the time! We recall Gordon Brown's famous statement about the 'end of boom and bust'.

The growth was also characterised by a particular attitude to risk in financial sector in the USA and the UK. This provided the detonator for the stock market and financial crisis of 2008. The early signs of collapse came in the USA in 2006, where increases in interest rates and falling house prices led to defaults on sub-prime mortgages. These were mortgages given to poor people who had no prospect of repaying them, in the belief that the long term upward trend in house prices would enable borrowers to refinance and lenders to sell in the event of repossession.

The original lenders had repackaged the debts and sold into financial markets, often supported by insurance to enhance credit rating. Investors in the mortgage-backed securities were either unaware of their underlying financial fragility, or at least thought that by slicing and dicing the individual debts, risk could be removed! With hindsight, this was both immoral and foolish.

Like a virus, these instruments infected financial institutions worldwide. By summer 2008 major financial institutions were reporting significant losses and the drying up of inter-bank lending. The collapse of Lehmans and the stock market led to world-wide recession in 2009. This was reported as the sharpest economic downturn since the Second World War, or even the 1930s. In fact the UK's reported economic performance in 2009, with a contraction of 4.75 per cent in the first three quarters of the year, was the worst since 1921!

## **Where We Are Today**

First the basic numbers. Economists define recession as two successive quarters of negative growth. In the third quarter of 2009, whilst the rest of world was emerging from recession, GDP in the UK was still negative. Among the G7 countries France, Germany and Japan emerged from recession with quarter on quarter growth in the second quarter of 2009. The USA, Canada and Italy (and the eurozone as a whole) emerged from recession in the third quarter. The UK is the only G7 country still technically in recession, with a 0.2 per cent contraction in the third quarter, making six successive quarters of contraction since the second quarter of 2008.

The UK is the only major economy still in recession (the others are Spain and Greece). Perhaps this is because the UK was more exposed to the financial sector than most other countries, and also overindulged itself more in terms of consumer debt and property, and is now suffering a worse hangover. Consumer price inflation fell dramatically (it is now about 1.9 per cent). Unemployment rose by 1 million to about 2.5 million, or 8 per cent of the economically active population: the highest level since 1994. The Bank of England base rate has been 0.5 per cent for the past 9 months. The pound has been weak against the euro (it peaked at 1.5 in 2007, fell through 2008, then dramatically in late 2008 to a low close to parity, but has recovered to just above 1.1). Property prices rose slightly in 2010, mainly as a result of lack of supply, but are still 12.5 per cent lower than in 2007.

Action was taken by the government. It was involved in various bank rescues which were thought to cost £50 billion; this figure has proved to be more like £10 billion. The Bank of England applied quantitative easing, a form of printing money by means of the Bank purchasing government stock, which pumped £200 billion into the economy by February 2010. There were also massive cuts in interest rates.

Surprisingly, the FTSE increased from a low point last March by some 50 per cent and is now around 5,500. The strength of the stock markets may be explained by the fact that government action taken across major economies averted economic meltdown. Current indications from the financial sector are of a slow improvement in the availability of credit.

So did we have a lucky escape? Did the medication work?

## **Where Might We Be Heading?**

The *Financial Times* recently reported on an interesting survey of some 40 economists. They see a cyclical upturn in the economy as a result of re-stocking, but their general view is that the foundations are shaky. There is short-term uncertainty over the election, and some temporary measures (such as reduced VAT and the car scrappage scheme) are due to come to an end. These may cause even cyclical recovery to falter. The overwhelming view is that sustained strong recovery like that expected by the government (3.5 per cent GDP growth from 2011) is extremely unlikely.

Why is this? Households and companies will need to repair their balance sheets. But the major factor is the cost to public finances of the rescue operation. Public finances are now running at a £178 billion deficit for 2009/10, which is 13 per cent of GDP as compared with 8 per cent during the last recession in 1992/93. There is no doubt that taxes will rise and that public expenditure will have to be reduced. The main parties just differ in terms of what will have to

be cut, and then attack each other's figures. The Tories talk about a public sector pay freeze, cuts in bureaucracy, the capping of public sector pensions, raising the retirement age, scrapping the ID card scheme, and means-tested child benefit. Labour talks about a pay freeze for the higher paid, a defence review (e.g. Trident), various departmental savings (e.g. IT and consultants), and abolishing Quangos.

There seems to be no doubt that we are heading for an age of austerity. The party is over.

## **Ethical and Theological Reflections**

One positive outcome of the crisis is that it is leading people to ask questions. As Archbishop John Sentamu notes

*With the global financial crisis we have seen a sudden and traumatic impact on our banks, our businesses and in so many of the things we have taken for granted for so long. It has brought home to us in a powerful way that we have been tempted to put our trust in false securities and false gods and need to think again. Governments and individuals are both radically reassessing their priorities and values as a result and so are the religious communities. Because of this, I believe it is also a unique opportunity.*

It remains to be seen how this works out and whether people will be found to have had short memories.

I would like to focus here on two themes: idolatry and sustainability.

### ***Idolatry***

The Bible is full of texts about a concern for the poor and the idolatrous nature of money (for example: Ex 22:21-22; Job 24:3-4; Zech 7:9-10; Mk 12:41-44; Mt 6:19-24; Luke 11:34-36; Jas 1:27...). The commentator and economist Ann Pettifor, who predicted the crisis in her 2006 book *The Coming First World Debt Crisis*, says '...make no bones about it. The financial crisis is a spiritual crisis. It is the crisis of a society that worships at the temples of consumption.'

In a lecture on 'Faith in the Marketplace' Ken Costa, the investment banker, Vice-Chair of the UBS Investment Bank and Chair of Alpha International, quotes Archbishop William Temple: 'the market economy is a good servant but a poor master'. Perceptively, Archbishop Rowan Williams has said that ascribing independent reality to something man-made like the market is a perfect definition of idolatry.

Margaret Thatcher famously said 'you can't buck the market'; but clearly a totally unfettered free market would be a gangster economy. In fact I think that what we have economically – a regulated capitalist market - is probably, like democracy, the least worst system. But even the system we currently have doesn't seem able to avoid major shocks like one we have just experienced. Capital markets do not work perfectly and do not necessarily self-correct. Perhaps the financial community is more prone to temptation than had previously been thought; and also less clever.

In January 2009 Pope Benedict emphasised the Catholic doctrine of work for the common good: wealth creation is an inescapable duty in the fight against material poverty. How can a capitalist, free market system work effectively for the common good? Commentators like Ken

Costa, or Paul Vallely, the Catholic writer in the *Independent*, or Stephen Green, the Chair of HSBC, see the market as neutral and emphasise the need for virtues such as truth, honesty and trust so that it can operate properly. This theme is explored more deeply by James Featherby in his pamphlet *The White Swan Formula* about values in business, published by the London Institute for Contemporary Christianity in 2009. He points out that moral business is good business and calls for a return to trust. He argues that neither government regulation nor commercial contracts can span the chasm caused by a gap in values. The market needs morality; it is a myth that obeying the law is a substitute for morality.

But is what we're seeing a playing out of the wider moral demise in a post-modern Western society, which lacks an agreed spiritual or moral framework? Perhaps it is the general loss of these values that has worked out in a dramatic way in the financial sector. If so, at least it has made us start asking the right questions. It should serve as a warning. The financial sector should be more humble. The motto over the entrance to the Bank of England comes from Psalm 24:1: 'The earth is the Lord's and the fullness thereof'. The Lord's...not the market's!

My first point, then is a warning and reminder about the idolatrous nature of money and the market.

### ***Sustainability***

My second point is about 'sustainability', a word which is used a lot nowadays. Is the economic recovery sustainable?

Our world economy seems to rely on perpetual annual growth. We are facing a conundrum: we know we need restraint, but we also want growth and consumption, which drive the global economy. It is seen as good if individuals exercise frugality, but bad if everyone does so at once. The fact is that a return to levels of consumer spending of past decade is ultimately unsustainable ecologically. A recent (2003) Church of England Doctrine Commission report contrasted the more static economy of the Old Testament world in which material aspirations were modest. At that time any excessive accumulation of wealth inevitably led to the impoverishment of others, and hence the need for sabbatical / jubilee years to ensure release from slavery and the return of land to its original owners. There is of course a huge gulf between Old Testament times and the twenty-first century. But there are parallels: climate change is a possible limiting factor on continued economic growth. So warnings against excessive accumulation of wealth in the Old Testament are increasingly apposite.

In his 2007 book *The Economics of Climate Change: the Stern Review*, Nicholas Stern looked at economic growth forecasts and sought to predict the ecological outcomes. Perhaps there is also a need to model in the other direction: to determine the level and type of global economic growth commensurate with a sustainable planet, and then for countries and global institutions to seek to manage the world economy on such a basis.

What sort of growth is sustainable? There needs to be a linkage between repairing the financial crisis and repairing the planet. But the failure of Copenhagen shows that this link is not yet being made.

### **Conclusion**

Finally, perhaps the most difficult question is what can we do about all this?

In July I attended the National Prayer Breakfast. At a lecture by Stephen Green I asked about support and teaching from the churches for Christians in the financial workplace, particularly the City. Green agreed that this was a good point. The fact is that there are many Christians in the City, in business and finance, like Stephen Green himself, Ken Costa and many, many others. Jesus said in the Sermon on the Mount, 'You are the salt of the earth. But if the salt loses its saltiness ...it is not longer good for anything...' Why were we not salt and light in the recent crisis? As John Stott has said,

*It's no good blaming the meat and the bacteria that make meat putrefy; it's the fault of the salt that's not there to stop it going bad...It's our fault...If only we could be the salt of the earth as we were meant to be, and refine, and reform and rescue for Jesus Christ.'*

This is a challenge for me as a clergyman. The church has provided its congregations, of which we're a part, with the tools, support and encouragement and prayer necessary to be able to be the salt, which can preserve or indeed transform the structures at work. Perhaps we have a false view of relationship between the 'sacred' and the 'secular' – but that would be the subject of another session. As for me, perhaps I've been too busy over the last 33 years getting on with the job and fitting in 'church' to think deeply enough about how they should be interrelated.

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