

Our exports now go mostly to slow-growing countries. We must reboot the UK economy to focus on emerging economies, now the world's engine of growth.

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Both the UK and the Eurozone now have significant problems in achieving sustainable growth and increases in productivity. [Danny Quah](#) argues that to really understand our economic difficulties, we must analyse the positions of the UK and European economies in a global context. It is significant that the UK has ended up with most of its exports to economies showing no significant demand growth. To achieve lasting growth, we must unleash the potential of our universities and creative institutions, and most importantly, change our focus to the emerging economies which have the biggest potential for growth.



Last week, the UK's Economic Research Council invited me to represent LSE in a panel discussion on near-term prospects for the UK economy. Lord Norman Lamont, 1990-1993 Chancellor of the Exchequer, chaired. The other panelists were Prof John Muellbauer from Oxford and Prof Hashem Pesaran from Cambridge. The venue? The Royal Institution of Great Britain's Faraday Lecture Theatre, where in 1825 the first of the Royal Institution Christmas Lectures were delivered.

I argued the following:

First, the economic difficulties in the UK or the Eurozone cannot be usefully analysed without looking at these economies' positions in the world. Second, the UK and the Eurozone have an immediate problem with debt and an ongoing problem with productivity. It is unlikely that Keynesian aggregate demand management alone will lead to long-run sustained growth.

What are the facts on the UK and the Eurozone in the global economy? Time was, the night-time sky was lit up pretty much just by the Transatlantic Axis.

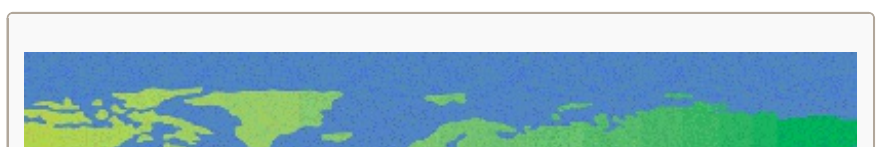
Figure 1 – The Transatlantic axis in the night time sky (via NASA)

But that was 30 years ago, and the global economy has moved on. By 2010 the world's economic centre had shifted 5,000 km — three-quarters of the Earth's radius — from the rise of the east, notably India and China.

Figure 2 - The Great Shift East

As a consequence, hundreds of millions of Asians have been lifted out of grinding poverty; soon these people will be the world's middle income class. That figure of the [Great Shift East](#) takes in grubby calculations with thousands of datapoints. But its point can be appreciated in many different ways, some more vivid than others (e.g., [view from the US](#)).

To be clear, not all Europe needs help in the same way. By the summer of 2011, a distinguished US economist had related to me how he and colleagues were surprised by German economic growth out of the 2008 Global Financial Crisis since, while keeping its traditional high-savings



habits, Germany had its export markets — the US, the rest of the EU — mired in ongoing recession. Here, however, might be part of how Germany did it:

Figure 3- Evolution of Germany's export markets, 1980-2010

The great bulk of German trade remains, naturally, with the rest of the European Union. But the EU is now deep in recession and likely to remain so for some time. Outside the EU? Germany today exports more to Developing Asia than it does to the US. And that gap continues to rise. Exports to China alone already appear as large as those to the US. Part of this obviously stems from US imports sharply falling right after 2008 — but that is exactly my point. China and Developing Asia continued to grow, continued to import from Germany (and elsewhere), and thus continued to keep parts of the global economy afloat throughout both the global financial and European sovereign debt crises.

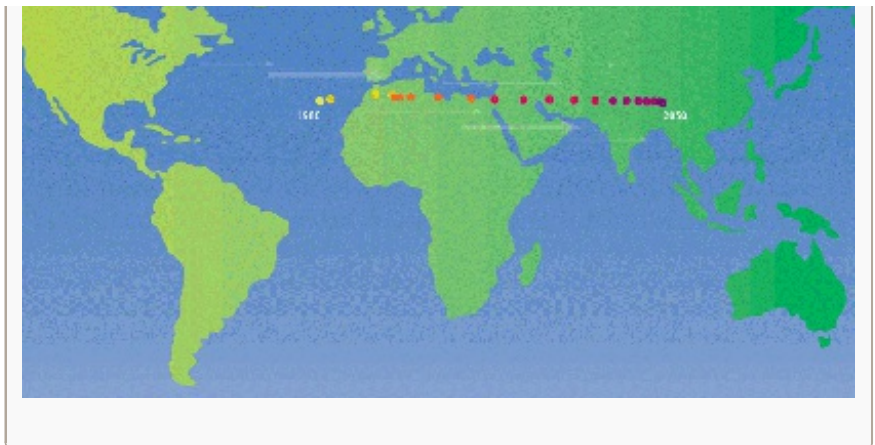


Figure 4- The Euro-sterling exchange rate, 2007-2011

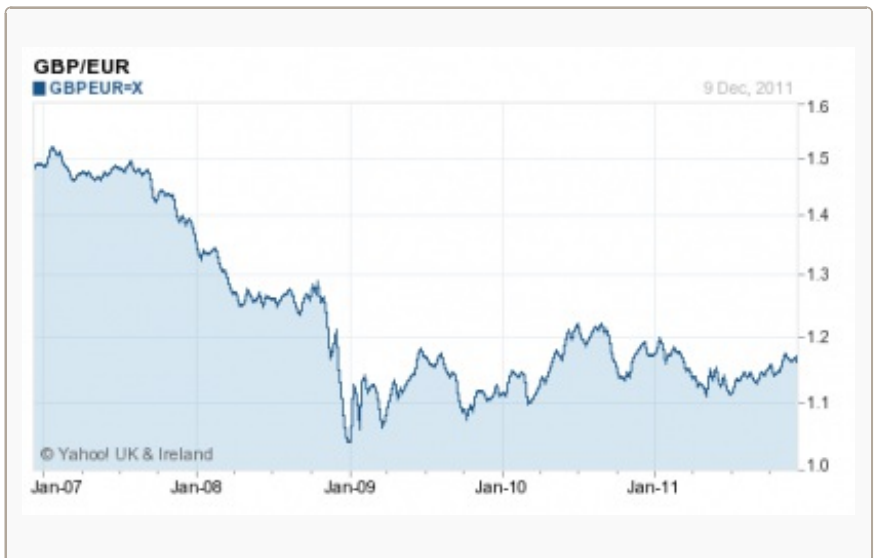
This is not just because Germany enjoyed a cheap currency. Despite the weakness of pound sterling against the Euro, the UK has not re-oriented its exports anywhere as successfully as has Germany:



Figure 5 - Evolution of UK's export markets, 1980-2010

What the UK exports to the US remain double UK exports to Developing Asia, and four times UK exports to China. The UK has simply ended up with most of its exports to economies showing no significant demand growth.

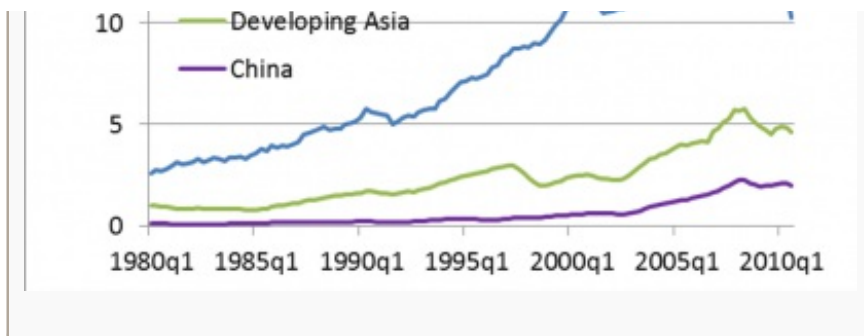
Unpack the numbers further by breaking out the UK's 50 largest trading partners in 2009: the UK had 56% of its exports go to the 10 slowest-growing economies in that group (growth measured 2000-2008). Across these 50, the correlation between exports and growth was -0.32: the UK systematically exported more to those trading partners growing slower.



The problems faced by the UK, or more broadly, by member states across the entire EU, while different in concentration, are no different in character from those in the 2008 Global Financial Crisis: Large entities



owe large amounts of debt and are likely unable to pay it all back. Previously, the entities were financial institutions; now they are sovereign states. Quick fixes that seek to get around repaying this debt will undermine institutions of trust and responsibility, those same institutions the West tells emerging economies they must build if they too want to become developed economies.



When the first round of Quantitative Easing (QE1) happened in the US, output there rose — and to a smaller extent elsewhere in the world as well. With QE2, IMF estimates show the impact multipliers everywhere had diminished sharply.

Now? There are those who hope a rescue will come when the ECB unleashes its own QE on Eurozone sovereign debt. Or some optimistically-ingenuous scheme involving different-coloured centrally issued Eurobonds, or where the discrimination occurs across member states using some other indicator might work. With luck perhaps. Longer term, some observers look to a fuller-fledged fiscal union, with Germany transferring likely more than 5% of its GDP to the Eurozone's lesser-performing periphery member states (link: [Gavyn Davies, FT, 06 November 2011](#)).

But the connection between this re-organization and member states' fiscal positions cannot be ignored. While all attention now focuses on deficit/debt figures compared to those originally given in the Maastricht Treaty, pretty much totally neglected is the nearly-contemporaneous [Copenhagen criteria](#) for EU accession. That list includes — after requiring member states be democracies that obey the rule of law, respect human rights, and protect minorities — the statement that candidate member states need to be market economies able to deal with “competitive pressure and market forces within the Union”.

I'm sorry but I don't think receiving a perpetual 5% German GDP transfer is strong evidence for that capability. (And this is just for EU accession, not even for Eurozone membership.) Monetary or other financial rescues are short-term; we need them the same way we need to kickstart an engine. But if that engine is worn out or is leaking fuel or in need of a complete overhaul, I don't see how we are going to get very far with that machine. We can't mistake a short-term boom fueled by exigent government actions for sustained long-term growth. Again, isn't this what the West tells emerging economies?

How would I propose to change matters? My suggestions at the event were general and therefore impractical. But here they are again:

1. Reboot the UK economy: Take the pain and turn around to engage fully with the emerging economies; do business with them as economic partner — no more, no less. The emerging economies are now the world's engine of growth: Deal with it.
2. Unleash our universities and other thoughtful, creative industries. This is NOT to raise government spending, but just to free up extant restrictions on their operations. UK higher education is hugely in demand by the emerging economies. If there's anything that's going to help re-balance the global economy, this is it.
3. Throw out long-standing aesthetics and principles — they're also called prejudices. Become enamoured of what works — whether it's guided capitalism under a bit of state control or anything else we previously thought completely nuts (i.e., outside the Washington Consensus). Celebrate the virtues of working hard, raising productivity, saving for the future — not revile them as many do today for Germany or used to do most obviously recently only for China (and yet might come back to doing so again soon).

This article was [first posted](#) on Danny Quah's blog on 13 December.

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Rights. He is a member of the World Economic Forum Global Agenda Council on Economic Imbalances, and serves on the Editorial Boards of *East Asian Policy*, *Journal of Economic Growth*, and *Global Policy*, and is also on the Advisory Board of OMFIF Education. He writes about the shifting global economy and the rise of the east. Danny Quah blogs at <http://dannyquah.wordpress.com/>.



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