Written evidence submitted by Professor Richard A. Werner

Introduction to me and why I am submitting my evidence

I am an internationally renowned economist with a track record for accurate economic analysis and an understanding of the relevant concepts and facts. I saw both dangers and opportunities earlier than most (in 1991, returning from Japan to Oxford, I warned of the coming collapse of the Japanese banking system and the economy; in 1995 I proposed a new post-crisis monetary policy which I called 'quantitative easing'; in my books in 2001, 2003, 2005 and 2007 I warned of the coming major banking crises and set out policies to avoid them, but also how to quickly end them once they had occurred).

I am an expert in economic development and in particular the successful high growth economics deployed by East Asian economies, among others.

Jobs, growth and productivity

- **How much difference can government policy make to economic growth?**

  The difference in economic growth rates between countries is almost entirely due to policies and policy choices taken in those countries in the past. The East Asian High Growth Economies (Japan, Korea, Taiwan, China) planned to deliver ca. 15% economic growth for several decades and did so. The low growth of many other countries is due to wrong policy choices that fail to deliver high, sustainable, equitable, non-inflationary growth without crises.

  As my quantity theory of disaggregated credit (aka the general quantity theory) demonstrated almost thirty years ago, nominal GDP growth is determined by bank credit creation for GDP transactions, and high real GDP growth can be achieved when bank credit creation is mainly used for productive business investment (e.g. to implement new technologies). See

  https://www.res.org.uk/resources-page/july-2013-newsletter-quantitative-easing-and-the-quantity-theory-of-credit.html

  https://www.sciencedirect.com/science/article/abs/pii/S1057521912000555

  https://eprints.soton.ac.uk/36569/

- **What are the causes of the gap in the UK's level of productivity compared to other advanced economies, and why has productivity growth been persistently weak in the aftermath of the 2007-09 financial crisis?**

A relevant comparison is between the UK and Germany. Until the late 19th century, the UK economy was more advanced, then Germany surpassed the UK by a number of measures around the year 1900. Post-war economic growth in Germany has been a multiple of UK post-war economic growth.

In general, potential growth is almost entirely determined by technology. Actual growth is determined by whether available high-productivity technology is actually implemented and whether monetary policy provides the new purchasing power to allow new overall growth (i.e. whether bank credit creation is deployed effectively to support economic growth or whether it is used mainly to purchase assets, as in the UK).

German productivity has been superior to UK productivity for over a century. This has been mainly due to (a) free and open education for all, including professional, tertiary and postgraduate; and (b) a decentralised banking system consisting of thousands of local community banks, while big banks play a minor role (20% of banking). These small local banks have mainly been lending to small businesses for business investment.

Small banks lend to small firms. Big banks lend to big firms. The UK has mainly big banks and thus small firms have received insufficient bank funding for the past century. In order to raise productivity, the UK needs to establish many local community banks, like the Hampshire Community Bank in Winchester (applying for authorisation presently), which enable small firms to always upgrade to the latest technologies and hence be highly competitive and productive. This explains also why Germany has by far the largest number of small firms that are such successful exporters that they hold top (first, second or third place) market share in the world in their respective market niche.

The post-2008 years have not seen any solution to the UK problem – recognised by Treasury Select Committees for over a century, at least since the Colwyn Committee of 1918 – of a concentrated banking system dominated by a small number of big banks. The existing 'Challenger Banks' are for-profit entities that will be soldsolution is to actively support the establishment of community banks following the Hampshire blueprint which ensures these banks will not be taken over in the future.

- **How successful has the Government's pandemic response been in protecting jobs to date, and how can it help reduce and mitigate the economic scarring effects of the pandemic going forward?**

  It has not been successful. The "economic scarring effects" have not been due to the pandemic, but due to government policy. Texas, Sweden, Florida and Belarus indicate the kind of approach that seems to work best, measured by health outcomes. It also delivers better economic performance.

- **Do economic statistics adequately capture growth in the modern economy, and what lessons can be learned from the pandemic about the measurement of economic activity?**

  Yes, they do, at least sufficiently for delivering high, sustainable, equitable non-inflationary growth without boom-bust cycles and crises. Attaining this goal is a more immediate priority over the more esoteric task to fine-tune measures of economic activity.

- **What policies are effective in helping people to reskill, move between occupations and sectors and take advantage of new opportunities? How could these be best implemented in the aftermath of the pandemic, and as technological developments such as artificial intelligence change the nature of work?**

  There is no evidence that the deployment of algorithm-driven and automated responses (dubbed "artificial intelligence" by its proponents) to human needs is adequate and productivity-enhancing (it is profit-enhancing for big businesses, which is the main reason why this agenda is being advanced). Instead of the concern the question seems to convey, it is more important to reform the education system to offer free education for all ages and levels of specialisation, as Germany and other countries have done.

- **Does the Government have the right mix of policies and a coherent strategy to promote long-term productivity growth and create new high-quality jobs?**

  No.

- **Is the Government doing enough to encourage corporate investment?**

  No.

- **Is the “Plan for Growth” an adequate replacement for the “Industrial Strategy”?**

  No.

- **Are we in a period characterised by long-term low economic growth (secular stagnation), and if so, what are the implications for Government economic policy?**

  No. If I was put in charge of industrial and monetary policy, I could easily deliver a sustainable 7% real GDP growth for a decade in the UK, doubling national income.

- **Is the UK well placed to take advantage of future technological breakthroughs and translate them into economic opportunities?**

  No.

Macroeconomic policy

- **What are the roles of monetary policy and fiscal policy in stabilising the business cycle and promoting growth in the post-pandemic economy?**

  The roles of monetary and fiscal policy are to stabilise the business cycle and promote growth – not just in the post-pandemic economy, but always. The empirical record thus demonstrates that monetary and fiscal policy have not achieved this goal, and hence have failed. They will likely fail again without the changes I indicated above.

- **Does the inflation target remain fit-for-purpose, especially in a world where interest rates may be ‘low for long’? Should the MPC target anything else?**

  Monetary policy has been severely misguided for many years. Using interest rates as the main monetary policy variable has been doomed to failure. Empirical research has demonstrated that interest rates are positively correlated with economic growth and in terms of statistical causation they follow it and are Granger-caused by growth. See this paper published in a peer-reviewed journal:

http://www.sciencedirect.com/science/article/pii/S0921800916307510

Thus monetary policy needs to be changed. I suggest to introduce the type of monetary policy that Deng Xiaoping introduced when he came to influence macroeconomic policy in China in 1978, and which lifted more people out of poverty in the following 40 years than anywhere before in history: he abandoned the highly centralised banking system dominated by a big bank, and instead copied the decentralised banking structure of Japan and Germany consisting of thousands of small banks headquartered across the country, in counties, provinces, cities, towns and villages. Next, monetary policy was switched from interest rate policy (which only works in the fictional theoretical dream world of equilibrium) to credit policy, which works in the real world.

- **Does the MPC have effective monetary policy tools to stimulate the economy when interest rates are low?**

Yes, the tools exist. However, possibly not the requisite insights.

- **What evidence is there on the relationship between the scale of the public debt and economic growth?**

There is no stable relationship, except that those countries able to deliver high economic growth over the long run tend to implement prudent public debt policies and thus tend to have relatively little public debt.

- **Is a return of inflation a risk to the economic recovery?**

It is a significant risk to everyone, but not to the economic recovery measured in nominal GDP.

- **Can monetary and fiscal policy improve employment, growth and/or productivity outcomes by 'running the economy hot'?**

This very much depends on how this concept 'running the economy hot' is defined. In my view this sounds somewhat risky, and unnecessarily so. Most economies, including the UKs, were far below their true potential growth rate before March 2020. As stated above, I believe ca. 7% real GDP growth is possible in the UK, if the right monetary and industrial policies are adopted, and this would not constitute 'running the economy hot', since the right policies increase both potential and actual economic growth and thus can be achieved with little inflation.

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