The UK Structural Balance of Payments Problem

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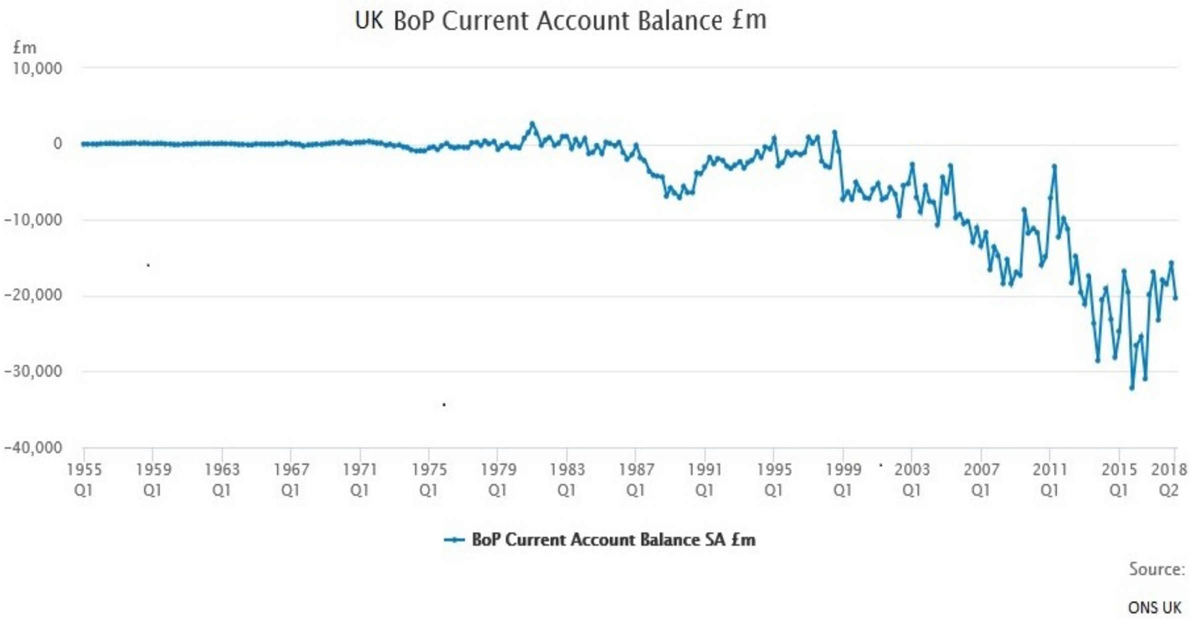
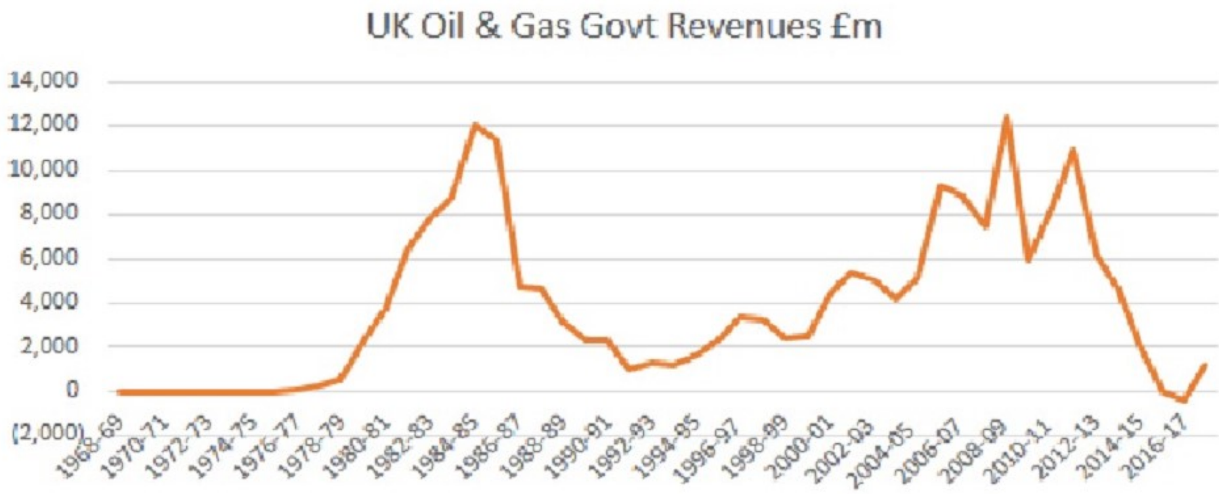
Looking at the graph below it is clear that the UK has had a BoP (Balance of Payments) problem since the late 1970s. The late 1970s coincided with the 'Winter of Discontent' and the arrival of the Conservative era of Margaret Thatcher.



Up until the 1970s any Government that failed to deliver a surplus or at least a near balance in trade was seen to have failed. This all changed after the dollar came off its gold peg in 1971 and following the formation of the OPEC oil cartel. Luckily for the UK, North Sea Oil arrived at about the same time flattering Government revenues and industrial production for the UK as a whole.

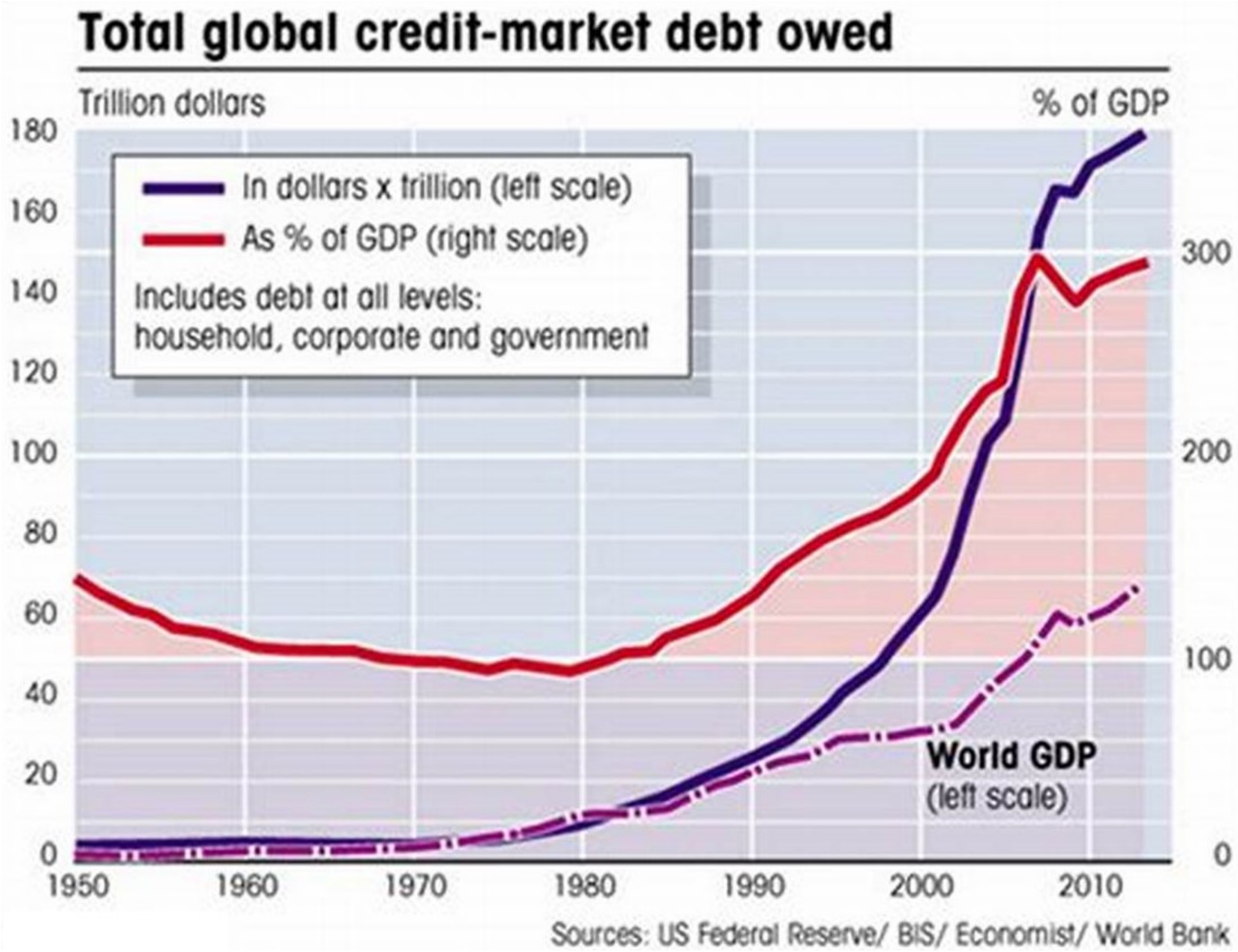
The graph below shows the Government revenues from oil and gas over the last 50 years and you can see that whilst our manufacturing exports have declined Govt revenues were being propped up by the North Sea Oil bonanza. Cumulatively this amounts to about £250bn. Much of this revenue has been used to ameliorate the transition from a manufacturing/production orientated economy to one that is now consumer led.



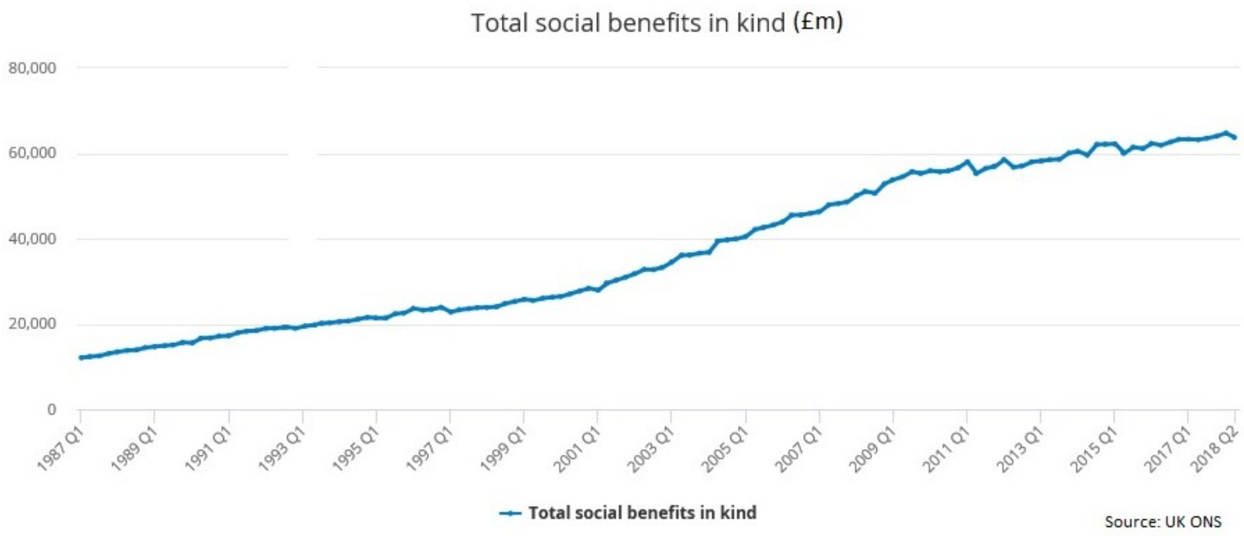
Since the financial crisis of 2007/8 we can see that Government revenues have declined sharply, partly due to the increased costs of recovering oil from mature oil fields. The UK Govt reduced PRT (Petroleum Revenue Tax) from 50% to 35% in 2015 to encourage production from these fields but it has had limited impact; more important is the market price for crude oil. In any event revenues from North Sea oil are in decline and can no longer support a consumer economy.

Of great significance to the UK structural BOP problems was the deregulation of finance by Margaret Thatcher in the 1980s which led to the 'Big Bang' in the City of London. There was a huge shift to financialization and with it the start of the modern era of debt fuelled boom bust cycles. The removal of capital controls led to the start of globalisation and an axis between the City and Wall Street.

In the chart below we can see that the dollar coming off the gold peg in 1971, deregulation of the1980s and removal of capital controls has all coincided to create not only a UK but global debt based growth. The main beneficiary was the dollar as a fiat global reserve currency.



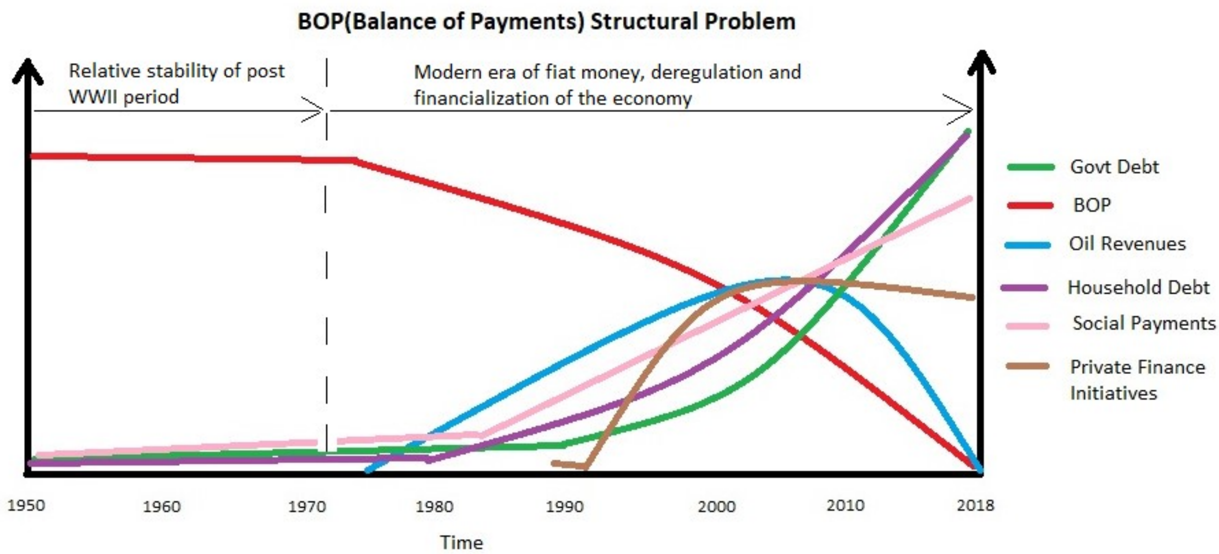
The UK BOP problems have been manufactured by successive Govts in order to fund their policies – privatisations in the case of Margaret Thatcher and to some degree welfare with a huge increase in sickness benefits. The Blair Govts continued with de-facto privatisation by vastly increasing privatisation through PFI (Private Finance Initiatives) but also hugely expensive welfare schemes such as Working Tax Credits which were really a subsidy for employers to take on low paid and largely unskilled workers. Both Labour and Conservative Govts have been guilty of failing to deal with the structural weaknesses of the UK economy and welfare benefits have risen substantially under both as in the graph below. We now have an excessively large financial sector – the tail wagging the dog – and Govt policy has no strategy for moving to a more production led economy.



The social cost of the BOP problems are the financialization of the UK economy that has led to asset inflation at the expense of wage growth. This has most widely manifested itself in the recent housing crisis with young families unable to afford their own homes and many tenants relying on housing benefit costing nearly £30bn per anum. This problem has been exacerbated by a deliberate policy of uncontrolled immigration in an attempt to keep the 'party' going with GDP growth to mask the structural Govt deficit in general revenue. The graph below shows how house price inflation coincided with the dollar coming off the global peg and excepting for the boom bust glitches have accelerated with deregulation in the 1980s.

The unprecedented level of immigration has itself affected the lower paid sections of society that have been forced to compete with immigrants willing to work for lower pay. It is not just housing but access to all forms of public service that have fuelled the desire for control of borders and the BREXIT vote.

Combining all of the above information one can produce a simplified diagram below highlighting the structural problems that date back to the dollar coming off the gold peg in 1971 to the arrival of North Sea Oil revenues in late 1970s, deregulation of finance and removal of capital controls in the 1980s. Ever since we have had evermore financialization of the economy creating evermore serious boom bust cycles. Oil revenues could have been used to build a sovereign wealth fund or to restructure the industrial base. Instead it was used to increase welfare benefits and to maintain a consumer orientated economy. I recall non means tested invalidity benefit claimant count sky rocketing in the 1990s as a way of keeping people from being registered unemployed. Household debt includes ballooning student and car loan debt.



In 1984 the former Prime Minister Harold Macmillan summed it up when he warned Margaret Thatcher against selling off the ‘Family Silver’ in response to her privatisation programme.

A similar graphic diagram could be produced for the US but with less emphasis on welfare benefits. However, there are huge similarities where Republican President Ronald Reagan deregulated the US finance and later Democrat

President Bill Clinton repealed ‘Glass-Steagal’ restrictions on banks. Student and car loans are also a huge debt problem in both countries.

There is no pain free way for the UK to escape this structural trap without the discovery of a new North Sea Oil bonanza.