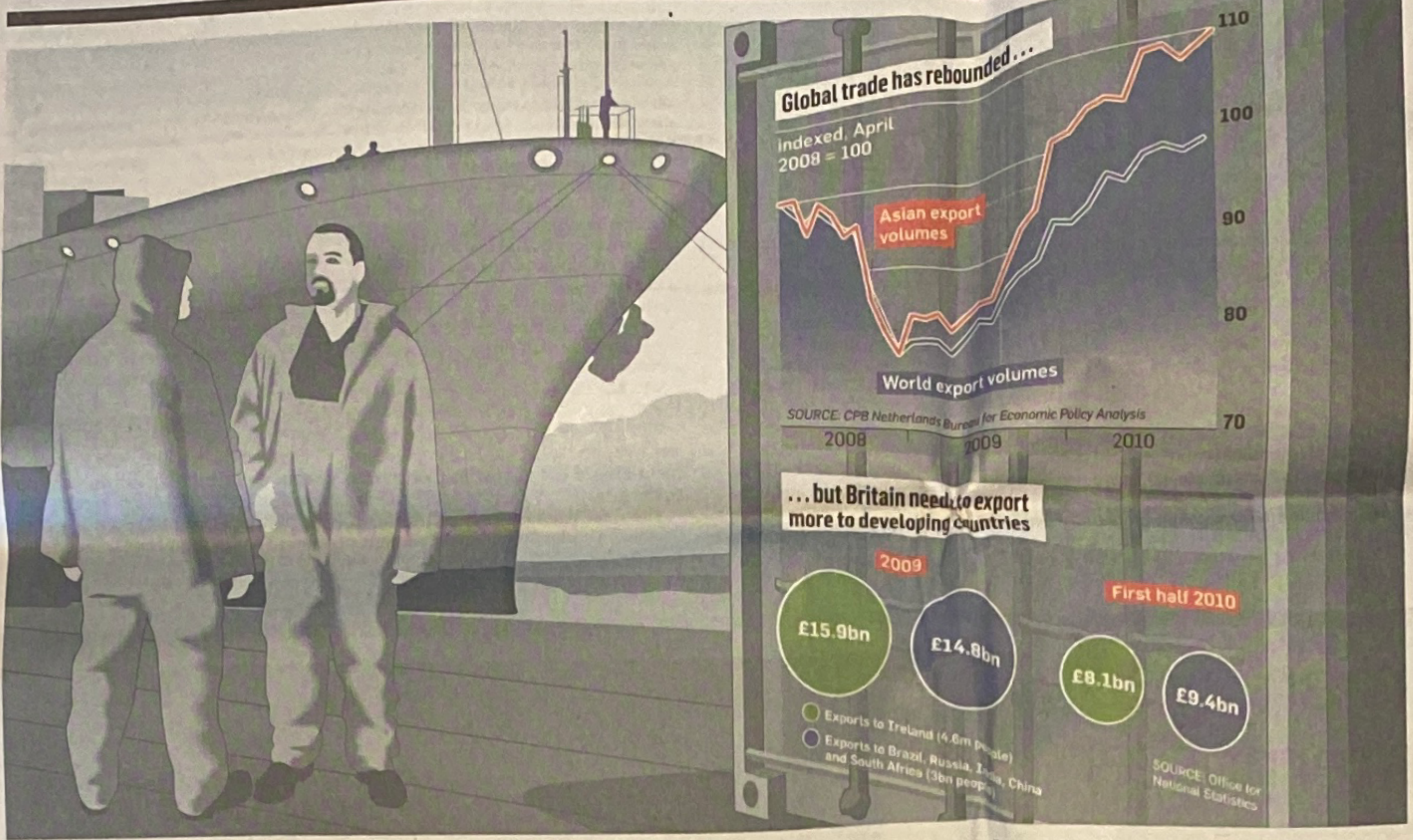

Britain needs to think global or we will wilt

GERARD LYONS
ECONOMIC OUTLOOK

Cash, commodities and creativity. These are the key ingredients needed for a country to succeed in the changing global economy. Britain does not have the cash or the commodities. The question is, does it have the creativity to adapt and change to be competitive? I think it does, but it's not clear-cut.

The global economy is recovering but it is a tale of two worlds. Emerging markets account for one-third of the world economy but two-thirds of its growth. And it is not just a China story. Solid growth is being seen in a long list of nations, from Brazil to Nigeria and India.

This is in sharp contrast to the West, where economies are sluggish as the impact of last year's policy stimulus wears off. Across Europe, recession on the periphery — as in Greece and Ireland — contrasts with solid recovery at the centre, as in Germany. Youth unemployment is shockingly high. In Spain, it is 45%. In Britain one in three 16-17 year-olds and one in five 18-24 year-olds are unemployed.

Meanwhile, in America, large firms and big banks are in good shape, with improving balance sheets, but small firms and regional banks are in a fragile state.

Amazingly, the world is now a $62 trillion (£39 trillion) economy, bigger than before the financial crisis and twice the size of a decade ago. Global trade has recovered too — it is almost back to its pre-recession peak.

Current developments reflect a profound shift. There is an industrial revolution in China. India is opening up. Intra-Asian trade is rising and an increasing number of countries across Africa, the Middle East and Latin America are becoming connected through rising exports, increasing investment and new trade corridors.

Little wonder the biggest growth markets for most western firms are in Asia, where populations are growing and getting richer, confidence is high and there is much technological change and innovation. In previous recoveries these western firms would have invested at home, creating jobs. Not now. European and American firms, it seems, have no allegiance to the West. So, talk of trade wars and protectionism is premature — the biggest investors in China are American firms.

This changing outlook is creating deep fissures at the heart of global policy — France versus Germany, America versus Asia. The lack of global leadership on economic issues is stark. It is the last thing the world needs.

Over the past year, global policy has been co-ordinated. Countries acted together to prevent the common threat of depression. It worked. Now, policies are being set to suit domestic needs. This is understandable but has dangerous consequences.

Fears of a double-dip in the West contrast with worries about inflation and financial bubbles in the East. A double dip could be triggered by a policy mistake, another shock such as high oil prices, or by a loss of confidence.

The biggest policy danger in the West is regulatory overkill, which limits banks' ability to lend. Add in the tightening of fiscal policies — in Europe and perhaps even in America after the mid-term elections — and it is easy to see why interest rates in the West need to stay low. They certainly will in America, but in Europe the Germans seem keen on a rise and even some in Britain are calling for one. That would be a big mistake.

The trouble is that, while low rates are needed in the West, they lead to problems elsewhere, as money flows to emerging markets: there is deep resentment that printing more money in America could cause inflation in Asia.

China and other Asian countries were successful before the recession, using macro-prudential measures to limit lending and borrowing. Now they need higher interest rates. But they fear this could attract hot speculative money from the West. Expect more countries to implement controls on capital, as Brazil and Thailand have done.

Given these pressures, there has been talk of the need for a "grand bargain" to redress the balance between savers and borrowers. The worry is that too much of the burden of adjustment falls on borrowers, making them spend less. That still happens. But, in addition, the savers should spend more. For Germany this is akin to asking the good to become like the bad. They will resist it, already feeling they have put their hands in their pockets enough to help the profligate Greeks.

The other part of the bargain is to address the problem of currency disputes. Having seen sterling plunge in 2008, Britain is keeping quiet on this topic. The focus is on China, yet Beijing would say that it is already contributing to global recovery through its strong growth. The Chinese will let their currency appreciate, but at a gradual pace.

The G20 is thus facing an uphill battle when world leaders meet in Seoul in two weeks. Some fear the organisation is simply too big to succeed. The French, who preside over the G20 next year, have hinted at a smaller, unspecified group of countries to resolve the currency issue.

What does this mean for Britain? We certainly need to punch our weight at global meetings. After all, we have shown decisive action on some key policy challenges. Sometimes, Britain's biggest export seems to be its pessimism. Yet, in many areas we still shine — the creative industries, pharmaceuticals, design, fashion, comedy, the environment and our top universities, among others. Also, despite the crisis, much in the City of London did not break. We need to be conscious of our strengths, but nothing should be taken for granted.

In fact, we can't blame a global crisis and the banks for our current problems — they are more deep-rooted. Four times since the second world war Britain has indulged in a collective boom and bust. The Maudling, Barber, Lawson and Brown booms were all followed by economic busts. While we need low interest rates now to help the economy deleverage, once we recover we will need to avoid the lethal combination of cheap money, rising debt and leverage and one-way expectations, particularly on house prices.

Moreover, we need to think global. Last year we exported more to Ireland than to the three billion people in China, India, South Africa, Russia and Brazil combined. At least there is upside potential, and we should welcome the rise in exports to these economies in the first half of this year. But there is a long way to go.

All this should reinforce the need to change fundamentally Britain's way of thinking. One global lesson is that an economy can only have a public sector that the private sector can afford. Even after the comprehensive spending review, if one were starting afresh, welfare benefits would be neither as high nor as widely available as they are, discouraging work.

Where the state has a vital role is in building the right infrastructure. It is disappointing that higher education and infrastructure receive such a raw deal. Better road, rail and air transport help attract firms to Britain and encourage the private sector to invest in the regions.

Boris Johnson, mayor of London, should be encouraged to proceed with his plans for a new airport. It is needed and would send a clear message of intent that, contrary to popular perception, Britain can improve its infrastructure, move with the times and be creative.

Gerard Lyons is group head of global research and chief economist at Standard Chartered Bank

David Smith is away