Jobs and recovery monitor

Issue #8 Pay and the Economy Oct. 2021

TUC
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Summary

The government has said that it wants to see a 'high wage, high skill' economy.[1] This statement comes in the context of reported labour shortages in some sectors, and an expectation that these shortages could drive up pay.

This report looks at the relationship between these shortages and pay growth in the current economy, drawing on reports from trade unions who organise in these sectors, alongside analysis of the official statistics. It shows that

- While employment has recaptured lost ground, and there are high vacancy levels, the current figures come before the end of the furlough scheme, and many jobs remain at risk
- With inflation up, real wage growth is likely to be flat over the rest of the year – without action from government to improve it. In the public sector real wage growth is negative.
- Many of the sectors reporting shortages are those in which unions have been reporting poor pay and conditions for years; but
- Outside of isolated pockets, there is no evidence that high vacancies are driving up wages.

The move to a high wage high skill economy will not happen on its own. Trade unions have a central role to play. Collective bargaining across sectors delivers sustainable wage rises, and prevents the undercutting by businesses, that, rather than the existence of migrant workers, is the cause of low wages and poor conditions. Government must also act on pay and public service employment, as part of building back a stronger economy.

At the same time as calling for 'high wages', the Treasury is warning of the risks of an 'overheating' economy, and calling for a return to the tight spending settlements that sucked demand out of the economy after the financial crisis. At the start of the Spending Review process Rishi Sunak threatened "We should be clear-eyed … Covid has severely damaged our public finances … If we want to continue to meet our commitments in the future, both at home and overseas, we must act now to rebuild our fiscal resilience".[2] He renewed calls for policies that led to the lowest real wage growth for 200 years, with the wealthy enjoying soaring asset prices. While supply chain pressures are driving up prices in some sectors, notably energy, there is little evidence that the economy is 'overheating' or cannot cope with higher wages. The greater risk is an economy in the slow lane, with reduced workers' incomes holding back spending power and so restraining growth.

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[1] See, for example BBC news, 6th October 'Boris Johnson: PM promises 'high-wage, high-skill economy' at https://www.bbc.co.uk/news/av/uk-politics-58814707

[2] 'Sunak to put ministers on notice of a tough spending round, Financial Times, 14 July 2021. https://www.ft.com/content/e05b3ff5-8914-4eb8-8e68-e2af10f02331

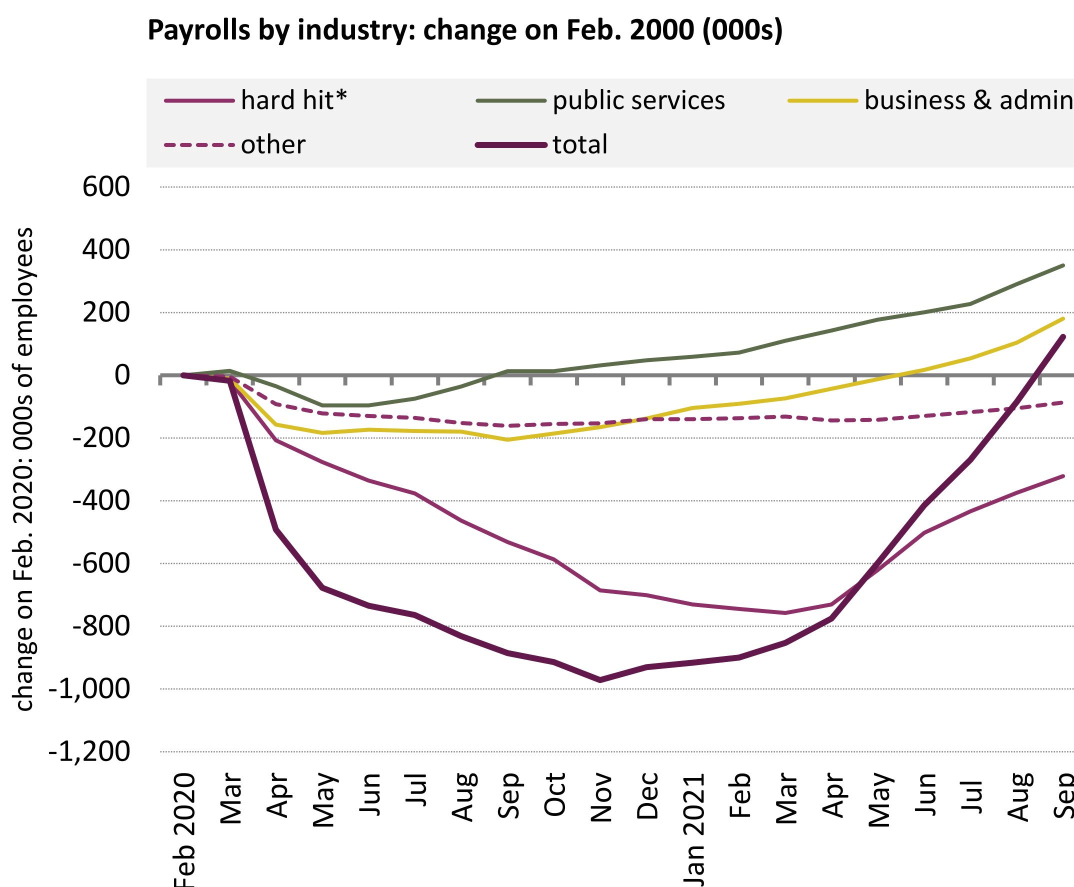
A pay rise would be good for workers, and good for the economy. Now we need a plan to deliver it.

PART 1: Jobs, shortages and real wages

1. The Labour market is recovering – but still fragile

On 12 October the ONS issued payroll figures showing the position for employees in September, the final month of the furlough scheme. While the level in August was revised down a little, the gain of 200,000 jobs in September moved payrolls 120,000 ahead of the pre pandemic position in February 2020. These payroll figures appear to tell the most plausible story over the pandemic, especially in terms of industry detail. At headline level the positive story is echoed by the unemployment rate dropping to 4.6 per cent, down from the recent peak of 5.1 per cent; the employment rate was at 75.2 per cent, up from the low of 74.7 per cent at the start of the year. However, the headline employment figure including self-employment is still down 660,000 compared to before the pandemic.

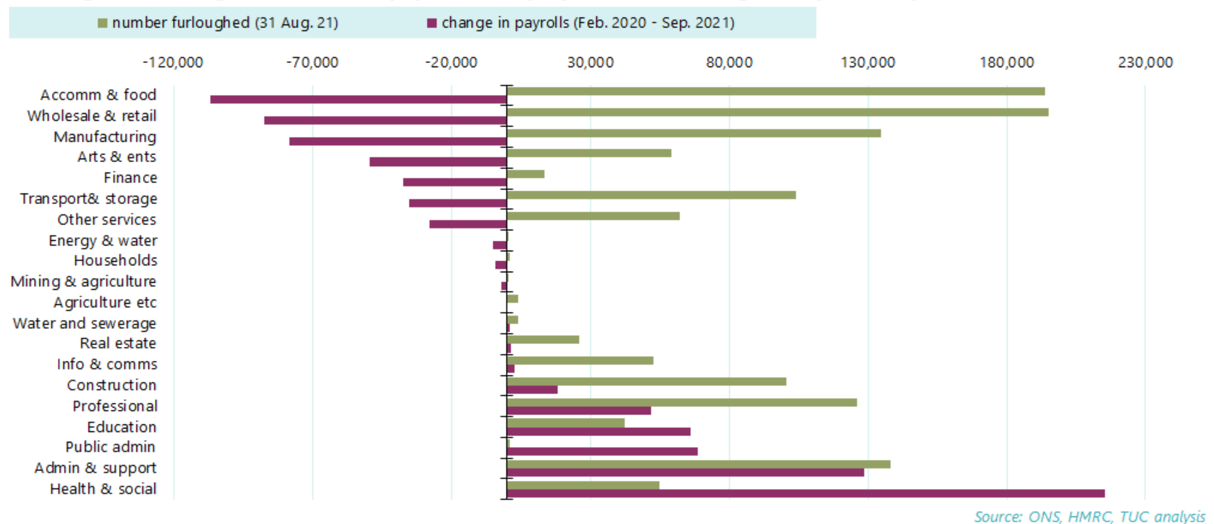
The position by industry varies greatly. A group of 'hard hit' industries remain 320,000 employees down compared to before the pandemic. This includes arts, hospitality, manufacturing and retail. Net gains in payroll jobs are confined to two main areas: public services – 60% on health and social services and 40% on education and public administration; and business services, including administrative and support services.



Source: ONS, HMRC, TUC calculations; 'hard hit': manufacturing, retail, hospitality and arts

The end of furlough

This recovery in employment figures is fragile as it covers the period before the end of furlough. At the end of August there were 1.3 million people still on furlough, with 725,000 furloughed full time. The chart below shows the number of furloughed employees by industry (grey), and compares with the change in payrolled employees since the start of the pandemic (purple). 600,000 of these furloughed employees work in hard-hit industries, where payrolled jobs are furthest behind pre-pandemic levels. Even some industries with payrolls up on pre-crisis levels still have large numbers on furlough, for example administration and support services. Despite this, the scheme ended on 30th September. The most recent ONS estimate is that between 0.9 and 1.4 million workers where still on furlough when the scheme ended at the end of September. [3]

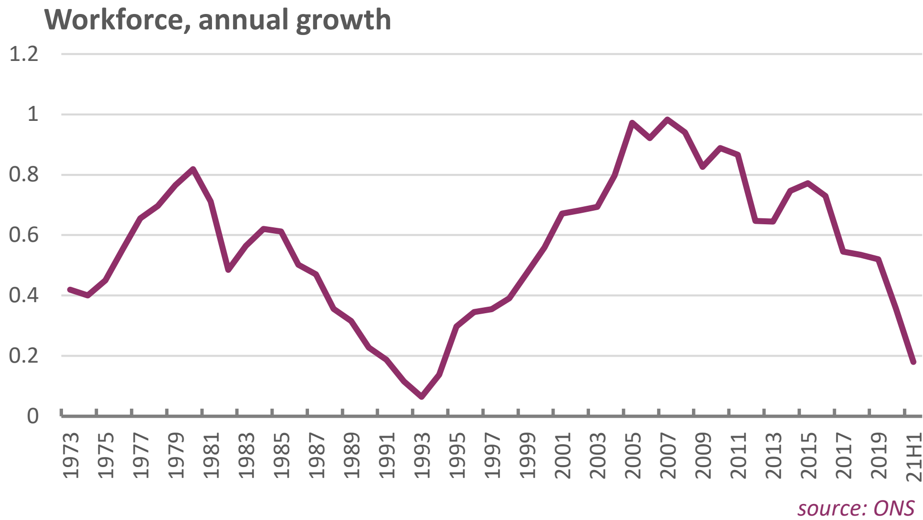


Workforce size

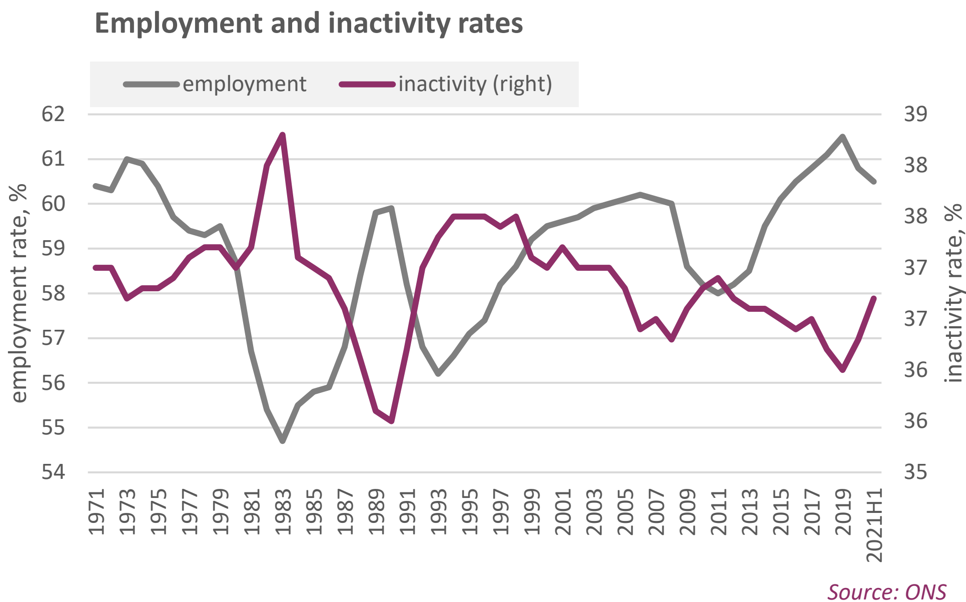
Beyond these movements in employment and furlough, growth in the size of the workforce has slowed significantly. This follows in part the intensification of longer-term trends – likely the combined effect of global recession, austerity, Brexit and the pandemic – but there is also a cyclical aspect.

The baseline for the Labour Force Survey is a measure of the population of working age and above (16+), currently at 53.6 million. The chart below shows the broad trends in the growth of the working population since the 1970s. A period of accelerating growth since the mid-1990s peaked at 0.96% a year over 2005-2007, just ahead of the global financial crisis. Some revival over the mid-2010s ended after the EU referendum in 2016; ahead of the pandemic growth was down to 0.5% in 2019. Growth into 2020 was 0.3% and is likely to fall below 0.2% in 2021.

[3] *Business insights and impact on the UK economy: 21 October 2021*, ONS. Available at: https://www.ons.gov.uk/businessindustryandtrade/business/businessservices/bulletins/businessinsightsandimpactontheukeconomy/latest



The other factor affecting the size of the workforce is the number of people regarded as inactive. There has been an increase in the size of this group by 350,000 since the start of the pandemic, with rises in the number of students (260,000), those in retirement (70,000) and the long-term sick (90,000). This is offset in part by a fall in those looking after families (-190,000), seemingly as more women have joined the workforce. However, part of this increase in inactivity overall is likely cyclical, with the chart below showing how reduced employment rates over a recession (most obviously in the early 1980s, early 1990s, late 2000s and now) coincide with increased inactivity rates.



It likely therefore that the present drop in labour supply is at least in part a result in the reduced labour demand that is the norm in a recession, though as above more women have joined the workforce. People may also perceive a shortage of jobs, and can therefore stop looking for work – but recovery can pull them back in again. And low population growth does not necessarily coincide with pressures upwards on pay and price. In 1993 when the workforce was expanding at its slowest rate, RPI inflation was 1.6%, then the lowest figure for three decades.

2. *Many sectors reporting vacancies are those where unions have been warning for years that terms and conditions are poor*

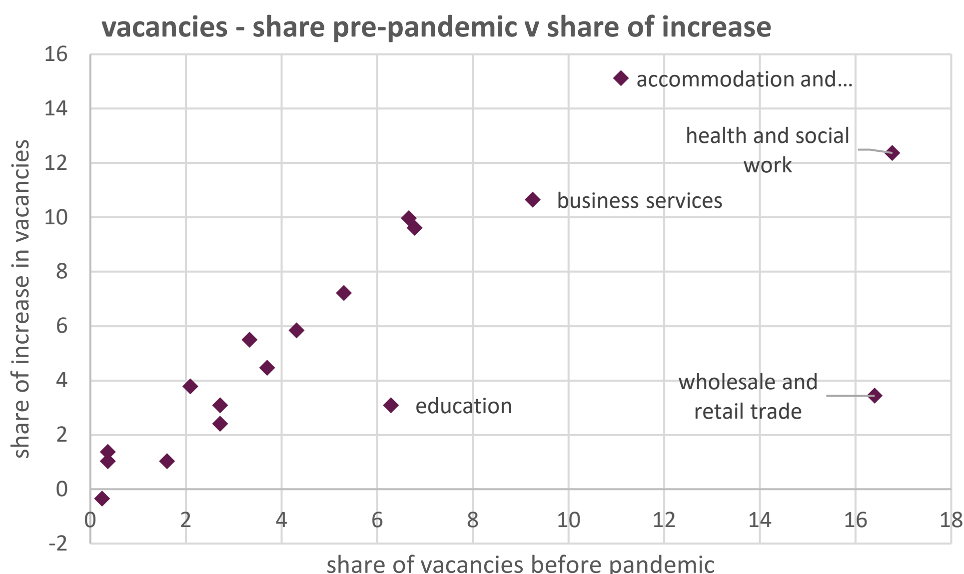
Labour shortages have been a persistent theme of labour market commentary in the past few months, leading to suggestions that the labour market is tight, on the one hand delivering pay rises, and on the other causing risks of overheating.

These shortages are meant to be indicated by the rapid increase in vacancies. Overall vacancies are at 1.1 million, a record for data extending back to 2001. Compared to the position before the pandemic they are up by 300,000.

However the rise in vacancies is seen across the board, and basically matches the share of vacancies by industry ahead of the pandemic (see the chart below, comparing by industry the share of the rise in vacancies against the share of vacancies before the pandemic). Nonetheless certain features stand out:

- vacancies in accommodation and food have increased greatly, though this is the norm in an industry that runs with high vacancies.
- The biggest change is the lower than normal vacancies in wholesale and retail vacancies, likely reflecting the changing pattern of demand to on-line and the retreat from the high street.
- Health and social work vacancies appear lower, but only marginally so given the norm of very high vacancies; lower education vacancies may reflect intense financial pressures imposed by government.

But without any obvious other pattern by industry, the suggestion is of uniform behaviour rather than a response to specific immediate pressures at an industry level. Though of course some industries have been under pressure for a long time, and there are still some real hotspots at detailed industry level.



source: ONS and TUC analysis

Workers may also be choosing not to return to sectors where pay and conditions are poor – including workers who have left the UK but have the right to return, and workers who have some form of other income to rely on (family home/pension) and are now classified as inactive. As we set out in the next section, unions report that many of the sectors reporting difficulties hiring are those where pay and conditions have long been a problem.

‘Shortage’ sectors on the ground [4]

Unions report that labour market shortages are not just the result of the pandemic or Brexit, but down to long-running problems of low pay and poor working conditions which mean that workers have been reluctant to either take up a new job in the sectors experiencing shortages, or, when given the choice, have chosen not to return. While some unions have been able to negotiate significant pay rises for some workers, this is far from a universal experience even across the same sectors. And pay rises are failing at all to materialise in some areas. such as care, that are facing severe shortages.

Speaking to relevant unions about HGV drivers, for example, a clear theme is that the problems in the sector are long-running and existed long before the pandemic. Pay has been low in the sector for a long time, and it’s a tough job with long hours and poor working conditions. Roadside facilities are poor, drivers are asked to fund their own training, and until recently, companies have been reluctant to take on younger drivers as insurance premiums are higher. This has led to long-term issues with both retention and recruitment.

Recent headlines about pay deals in the sectors exaggerate the number of big pay deals being made and do not fully represent the wider picture. There are some specific examples of large pay rises, and there have been union successes. In September, for example, GMB negotiated an 11 per cent pay rise for Wincanton HGV drivers in London.[5] In October, Unite won a similarly high pay rise (13.6 per cent) for Wincanton drivers in Wales,[6] and a £10 minimum wage for cleaners at Sheffield University.[7] However, these aren’t representative. Pay rises remain a mixed bag, with these higher rises being outliers, and some companies are going for recruitment bonuses or higher pay rates for new workers, rather than permanent pay rises for all workers. There’s a similar story in other sectors facing shortages, such as food manufacturing.

Other sectors facing shortages, such as care workers and bus drivers, are not seeing pay rises. The care sector, for example, is facing massive shortages. Pay and conditions in the sector are awful, and even before the pandemic there was a high turnover of staff. Fragmentation, outsourcing, privatisation and private equity ownership have made it harder for unions to negotiate better pay and conditions for workers. Unison reported one social care provider moving to the living wage, but under not-for-profit ownership arrangements.

When the pandemic hit, carers worked hard at a difficult job, often in unsafe conditions, on low pay. We’re now seeing absolute exhaustion and burn out. Workers have had enough and many are looking for jobs outside the sector. This has been worsened by the requirement for adult social care workers to be vaccinated (a requirement that is being expanded to other carers).[8]

While there have been rumours of isolated incidents of care providers offering bonus recruitment payments to some workers, the vast majority of the workforce are not receiving

[4] With thanks to colleagues at Unison, Unite, GMB, Community, Prospect, URTU, RMT and USDAW.

[5] https://www.gmblondon.org.uk/news/gmb-wincanton-hgv-members-secure-11-per-cent-pay-deal-in-recognition-of-their-essential-value

[6] UniteWales on Twitter: "Huge win for our members at Wincanton in Crosshands, Carmarthen, who have successfully negotiated a 13.6% pay rise, starting immediately with 3% backdated to April. Great to see an employer showing value in its workforce by working with us to deliver a fair pay rise. #UniteWin https://t.co/BDaeDrv0Pq" / Twitter

[7] Cleaning staff win campaign for £10 per hour wage at University of Sheffield - Left Foot Forward: Leading the UK's progressive debate

[8] See the TUC’s report ‘A new deal for social care, a new deal for the workforce’ for further detail on the issues facing those in the social care system: https://www.tuc.org.uk/research-analysis/reports/new-deal-social-care-new-deal-workforce

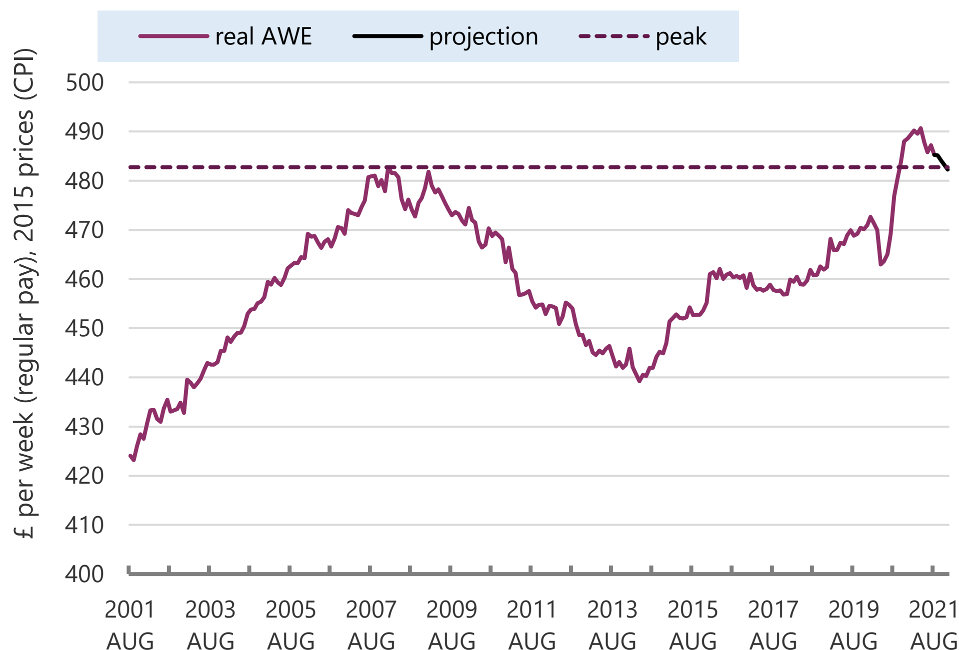
these, whether to be recruited or retained. Nor has there been widescale improvements in terms and conditions. In negotiations, national providers say they're concerned about staffing levels but also say there's no money.

Clearly, labour market shortages are not inevitably leading to pay rises. The picture is much more mixed: some workers in some sectors are seeing big pay rises or bonuses, but these are the exception rather than the rule. Pay rises do not happen on their own, with unions reporting that pay rises have been won, but often in sectors where they are well organised or as the result of disputes.

3. *Headline increases in pay and inflation*

There is a perception that the pace of the recovery and bottlenecks on the supply side of the economy – above all in logistics and more generally reflected in record vacancies - are leading to upward pressure on pay.

Certainly, workers are well overdue a pay rise. In the latest figures real wages are only £2.50 a week or ½ percent higher than their peak before the financial crisis – 13 years ago. They are likely to fall back a little further and again be below their pre financial crisis position at the end of the year.[9]



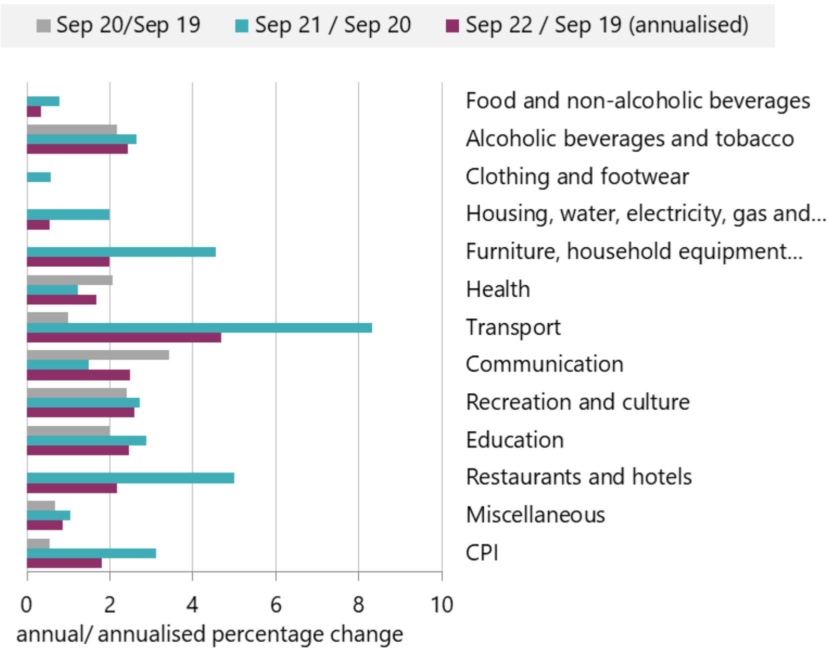
Source: ONS and TUC calculation

The projection moves downwards because of building inflationary pressures in the wider economy. Higher inflation figures this year in part reflect the extremely low figures at the peak of the pandemic last year (chart below). Most obviously the sharp rise to 3.2 per cent in August was driven in part by the 'eat out to help out' scheme in August 2020 and the small reduction to 3.1 per cent in September came as the scheme was winding down. But inflation is expected to go higher, with the Bank of England expecting a rate of above 4 per cent at the end of the year. Higher inflation is driven mainly by supply chain issues, in

[9] The projection is based on the average monthly growth for the AWE (regular pay) in the year to date, and adjusted for prices with the CPI using the Bank of England projection for 2021Q4 (pro rata on a monthly basis).

particular steep rises in the cost of freight on international markets and likely higher domestic distribution costs. Fuel inflation is also high, and energy market dysfunction is likely to feed through to domestic prices in the months ahead.

But more generally for many goods and services, higher inflation this year reflects very low inflation last year. The purple bar on the below chart shows September 2021 inflation measured from two years ago and annualised; this is set in contrast to the blue bar which is present CPI inflation, and grey, inflation a year ago. On the two-year rate, half the categories have inflation at or below the inflation target of 2 per cent; only transport really stands out as significantly higher. So while higher inflation is a material fact, this is not the generalised position across the whole of the economy.



When it comes to headline pay growth, the headline official average weekly earnings figures are distorted by the operation of the furlough scheme. The ONS explain:

> "*two reasons why headline average earnings are higher than the underlying rate at the moment. Firstly, there is something called a 'base effect'. In spring-summer 2020, many workers were on furlough or had their hours reduced. This meant that people saw their earnings fall, pushing down weekly wages. This year, with fewer people on furlough and hours returning closer to normal, weekly wages are higher … the second challenge is what we call 'compositional effects'. As we are taking a simple average, the make-up of the employees captured in Average Weekly Earnings affects that average. During the pandemic, we saw lower-paid people at greater risk of losing their jobs. Fewer lower-paid people in the workforce increased average earnings for those who remained in work. The analogy I like to use is height. If the shortest person in a room leaves, the average height of those remaining will rise. No-one has got taller, but the composition of the people in the room has changed, pushing up average height*".

Headline regular pay growth in August was at face value a still vigorous 6.0%, even though it is down from the recent peak of 7.3% in June and likely to further weaken as the compositional effects from the pandemic work out of the figures.

In the private sector pay growth is down to 6.8% from 8.4%. In the public sector pay growth has slowed more quickly to 2.6% now, from 5.5% in March, and is less likely to be distorted by furlough scheme.

The ONS offer an adjusted figure for the underlying regular earnings growth rate of between 4.1 per cent and 5.6 per cent.[10] Though the Bank of England have gone further to suggest the 'underlying private sector' pay growth is 4% in latest month, below the ONS range for the public and private sector together. Set against the Bank of England

[10] https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/bulletins/averageweeklyearningsingreatbritain/latest

expectation of 4% inflation at the end of the year this is a real pay increase of nothing for the private sector and a cut in real pay in the public sector.[11]

The broad picture is echoed in pay settlements which still remain subdued. The median pay award across the economy remained at 2.0% for the three months to August 2021, according to the latest analysis from IDR.[12] Though they note that "a larger proportion of higher-end awards worth 3% or more in the private sector has pushed the upper quartile from 2.5% in the three months to July up to 2.9% in this latest analysis period".

A fuller story is more apparent at industry level. The first chart on the next page compares a adjusted figure for pay growth now with pay growth ahead of the pandemic;[13] this partly corrects for the base effect but cannot deal with the ongoing compositional effect and so still probably overstates pay growth. Across more than half of these industries pay growth is slower than pre-crisis or remains very low; pay growth in accommodation and food slowing (almost halving) to 2% is particularly striking given widespread perceptions of shortages here and the high level of vacancies.

Of the industries where pay has accelerated, the sharp rise in ICT and administrative and support services likely correspond to increased demand as a result of the pandemic. Finance and professional services normally do well. Some of the industry increases are likely still to be distorted by still large numbers on furlough, and arts and entertainment might be treated with particular caution given the severity of the impact of lockdown in this sector. The highest furlough rates are in arts an entertainment (12%), other services (12%) accommodation and food (11%) construction (8%) and transport and storage (8%).

Translated into real terms on the second chart the story is worse, given lower inflation ahead of the pandemic than now. The chart below shows workers in mining and quarrying, construction, accommodation and food, and public administration and defence all have negative real pay, and this is before still higher inflation kicks in.

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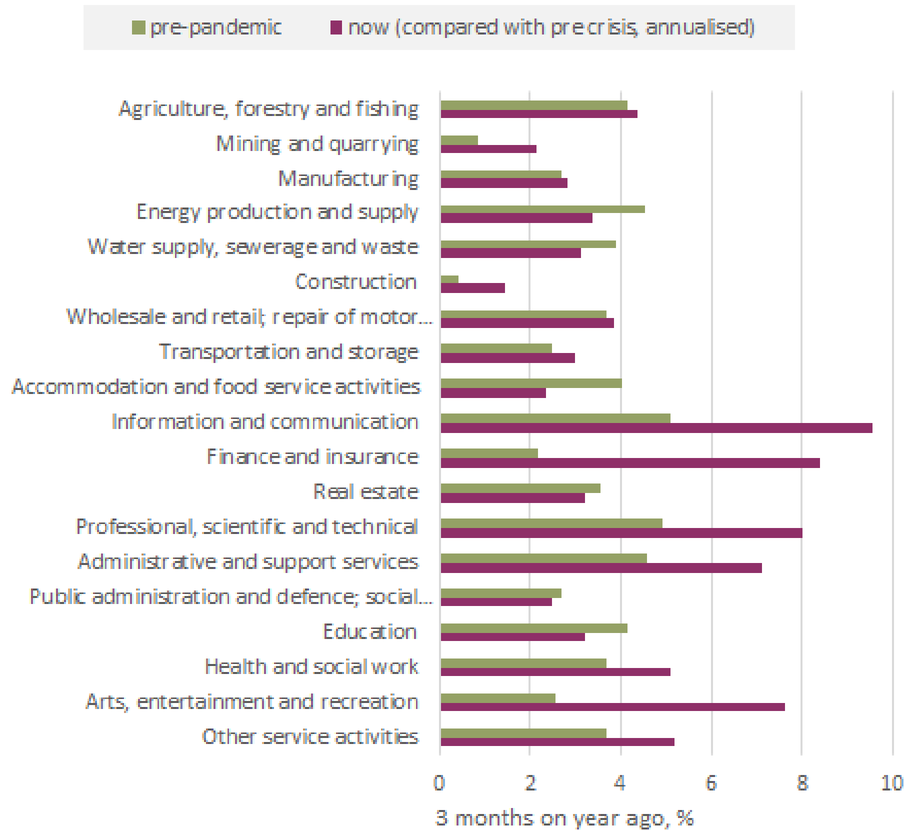
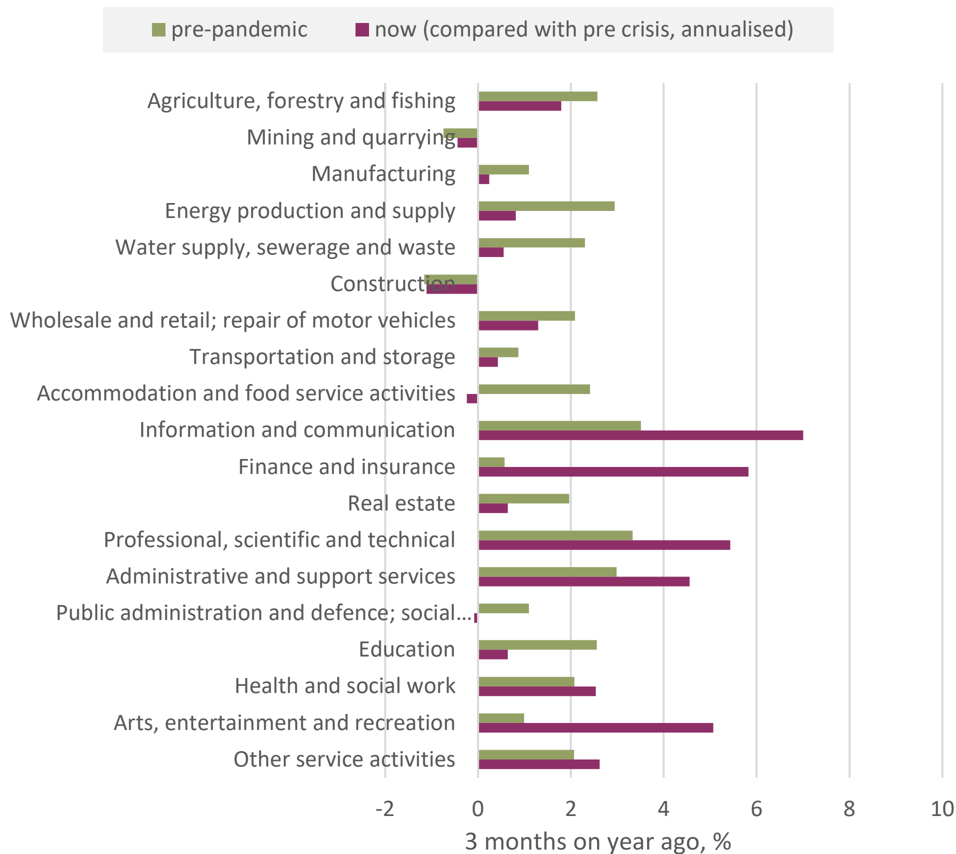
[11] https://www.bankofengland.co.uk/monetary-policy-summary-and-minutes/2021/september-2021

[12] https://www.incomesdataresearch.co.uk/resources/viewpoint/private-sector-awards-boost-upper-quartile-of-pay-outcomes

[13] The comparison is based on the payroll figures for average pay, because average earnings figures are not available on a seasonal adjusted basis by industry. Pay growth before the pandemic is measured in the year to Dec 2019 - Feb 2020; pay growth since the pandemic is from the same period to Aug. 2021 – June 2021; the latter figure is annualised by dividing by (18/12) to reflect the number of months over which the comparison is made.


Pay growth, per cent
pre-pandemic
now (compared with pre crisis, annualised)
Agriculture, forestry and fishing
Mining and quarrying
Manufacturing
Energy production and supply
Water supply, sewerage and waste
Construction
Wholesale and retail; repair of motor...
Transportation and storage
Accommodation and food service activities
Information and communication
Finance and insurance
Real estate
Professional, scientific and technical
Administrative and support services
Public administration and defence; social...
Education
Health and social work
Arts, entertainment and recreation
Other service activities
0
2
4
6
8
10
3 months on year ago, %
source: ONS, HMRC and TUC calculations


Real pay growth, per cent
pre-pandemic
now (compared with pre crisis, annualised)
Agriculture, forestry and fishing
Mining and quarrying
Manufacturing
Energy production and supply
Water supply, sewerage and waste
Construction
Wholesale and retail; repair of motor vehicles
Transportation and storage
Accommodation and food service activities
Information and communication
Finance and insurance
Real estate
Professional, scientific and technical
Administrative and support services
Public administration and defence; social...
Education
Health and social work
Arts, entertainment and recreation
Other service activities
-2
0
2
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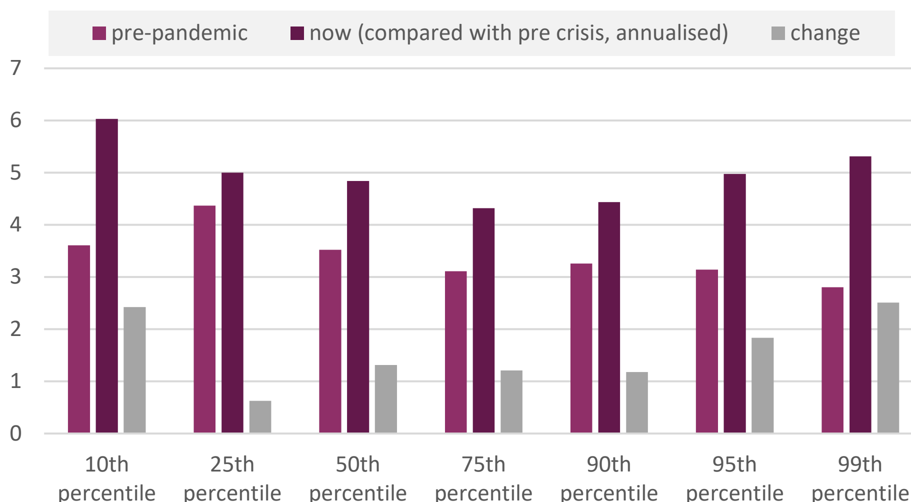
6
8
10
3 months on year ago, %
source: ONS, HMRC and TUC calculations

Lastly here, the payroll figures allow a timely snapshot of pay rises according to the income distribution. The chart below shows pay growth now (dark purple) against pre-pandemic pay growth (purple) and the change (grey). The highest increase has been for the 99th percentile, but the highest pay growth now is at the lowest decile of pay. But the same difficulties apply here too, with the lowest decile for pay likely the most distorted by compositional effects, given, as the ONS note, the lowest paid were most likely to lose their jobs, and so pushing up the average for the pay of lowest decile workers. These uncertainties caution against reading too much into any such figures.

Pay growth across the income distribution

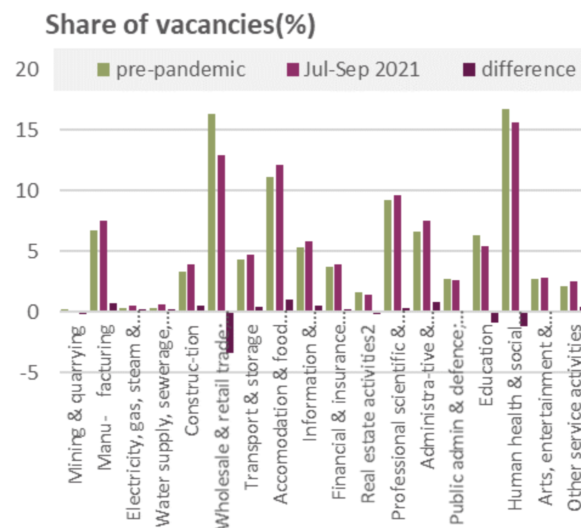


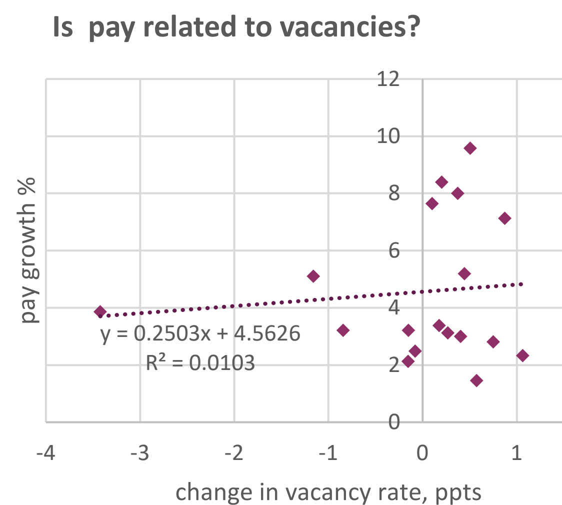
Source: ONS, HMRC and TUC caluclations

4. Are vacancies driving higher pay in certain sectors?

The obvious way for businesses to deal with vacancies would be to increase pay and improve conditions. As above, union contacts find such arrangements the exception rather than the rule. Comparing pay growth with vacancies by industry affirms what we have been told.

The first chart shows the share of vacancies ahead of the crisis (grey), vacancies now (purple) and the (small) difference (dark purple). The second chart shows pay growth against these differences, to assess whether pay growth is higher for those industries running with more vacancies than usual, and so being used to entice workers and *vice-versa*. There is almost no relationship here. A regression line is marginally positive, but basically does not explain the variation in the data.





There is therefore very little evidence that pay is rising as a result of labour shortages. To the extent activity is being held back by a lack of workers, firms are not stepping up to increase pay. The main areas of higher pay are where demand for workers is likely to be high (most obviously ICT) rather than where the supply of workers may be low.

Overall the message is that the strength of the recovery is exaggerated. There is no market led pay utopia here. It may even be that firms are using higher vacancies to try and source cheaper workers rather than increasing pay for existing workers.

5. *A plan to raise wages*

Rather than a return to the failed austerity of the last decade, we need a new economic model. Rather than dangerous, higher pay is necessary as a means to raising purchasing power and resolving the excess production (see discussion below) of the world today. Behind shortages and other disruptions in the headlines – it has been too easy to forget the precarious condition of the global economy ahead of the pandemic.

A new model must mean above all rebalancing of economic power from the wealthy few to the hard pressed many. 'From wealth to work' as President Biden has put it. As we outlined in our submission to Spending Review 2021, this must include:

- Tackling labour shortages by improving pay and conditions across industries, working with unions and business to deliver this, as well as introducing stronger laws to tackle unfair practices like zero hours contracts. Exploitative migration policies and removal of protections for workers will not address the problems created by poor conditions at work.
- Raising the minimum wage to at least £10 an hour now, and extend it to young workers.
- A policy of full employment, supported by government spending
- Investment in the economy and the just transition required to meet net zero
    - reversing the cuts to the value of public sector pay that took place over the period 2010/11 to 2020/21; creating 600,000 new jobs in public services; and large-scale investment in public services across the NHS, social care, justice and education.
    - Bringing green infrastructure spending in line with its G7 peers, by allocating £42 billion a year for the next two years to shovel-ready projects

that create jobs and deliver compliance with climate targets; and meeting wider global commitments.

- A focus on full employment by global institutions and policy makers as the best way to deliver sustainable economic growth.

PART 2. The wider context for the plan to raise wages

The desire for a high skill high wage economy is one that trade unions share. But as set out above, we have a long way to get there. The current mix of blaming migrants for exploitative employer practices, coupled with the provision of short-term visas that risk increasing exploitation will not deliver on this ambition.

One response to the current debate has been to suggest that higher wages are not currently achievable without leading to inflation; 'supply side constraints' mean that the economy cannot adapt to higher wages without increases in prices. But this ignores the role that higher wages can play in increasing demand, and helping to grow the economy. This type of argument lay behind the austerity imposed in the UK following the financial crisis, resulting in the slowest real wage growth for 200 years, as well as damaging the resilience of our public services. We must not repeat that mistake.

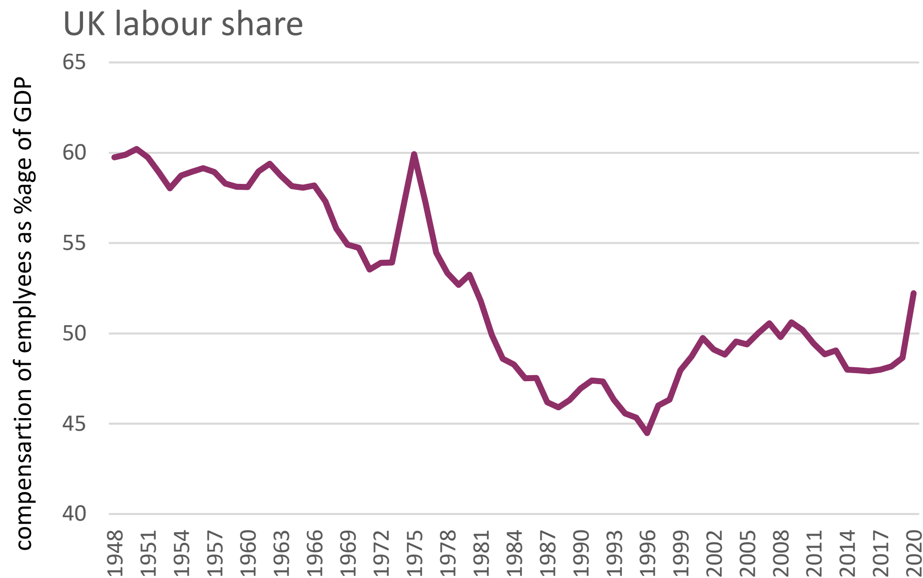
How higher pay translates to gain for workers and the economy

The Bank of England and the Treasury set policy according to a judgement about the spare capacity in the economy. If there is spare capacity (in the jargon, a negative output gap) then any increase in pay and so spending power will translate to a stronger economy.

One argument given to suggest that wages cannot rise is that the labour market is currently 'tight', and there is no spare capacity; there are not enough workers to move into jobs, even if wages are increased. Because firms are at the limits of their productive capacity, their only option will be to raise prices, and workers will be able to bargain up wages in an increasing 'wage-price spiral'.

As set out above, it is not clear that we are currently in a tight labour market. Most obviously, there are between 5 and 6 million workers unemployed, underemployed and (at the end of August) still on the furlough scheme. We have endured a decade of austerity which some – including ourselves – judge to have meant an increase in unused capacity (see below). There may be cost inflation in some markets, but this does not indicate a generalised rise in prices.

Mainstream economics does not much like issues of power relations. Even in a tight labour market, firms could increase wages by reducing the share of income they take in profits. As the chart below shows, over the last forty years labour's share of income has fallen significantly relative to the post-war decades in the UK (and worldwide).



Moreover, TUC research found that companies protect and increase payments to shareholders, even when company finances are struggling. Over 2014 to 2018, dividends to FTSE 100 shareholders rose by 58.3 per cent while average UK worker wages increased by just 8.8 per cent (in nominal terms).[14]

The history of the minimum wage shows that despite protests from business, firms have consistently been able to increase the wages of the lowest paid without leading to job losses or spiralling prices. A recent review of research from the US, UK and other developed countries found "a very muted effect of minimum wages on employment, while significantly increasing the earnings of low paid workers".[15] This was the case even for more ambitious policies including the UK's National Living Wage. This year's Nobel economics prize was awarded to David Card who used empirical research to find that employment in New Jersey restaurants increased after the minimum wage was raised, contradicting what was then mainstream economic theory.[16]

Wealth, labour and debt

Questions of power relations can also help to explain broader economic problems which have held back, rather than over-heated, economic growth.

As the Biden administration has recognised, for four decades the 'economic model' (to use the Prime Minister's language) has operated to look after the interests of the wealthy at the expense of workers across the world. Heather Boushey of the President's Council of Economic Advisers observed in an interview with the *Financial Times* "*One way of thinking about the crises that the president identified is that for the past 40 or so years we've really placed a lot of emphasis on making sure that capital had a lot of freedom*".[17]

[14] 'How the shareholder first business model contributes to poverty, inequality and climate change', 2019, A briefing note from High Pay Centre and the TUC: https://www.tuc.org.uk/sites/default/files/2019-11/Shareholder%20Returns%20report.pdf

[15] Arindrajit Dube (2019) Impacts of minimum wages: review of the international evidence https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/844350/impacts_of_minimum_wages_review_of_the_international_evidence_Arindrajit_Dube_web.pdf

[16] Nobel Prize in Economic Sciences (2021) Natural experiments help answer important questions https://www.nobelprize.org/uploads/2021/10/press-economicsciencesprize2021-2.pdf

[17] 'Heather Boushey: the guardrails have come off the US economy', 21 July 2021: https://www.ft.com/content/33a86191-3a75-452b-b3ce-d3d35ae90e06

Robert Reich Secretary of Labour under the Clinton administration, reports of the US: "*Over the past 40 years, most people's wages have basically stagnated, while worker productivity has soared. Most economic gains have gone to the wealthy – who now own more of America than at any time since the 1920s*".[18]

Not only unfair, the arrangement has dangerous macroeconomic consequences:

> *Here's the thing. The wealthy spend only a small percentage of their income – not enough to keep the economy churning. Lower-income people, on the other hand, spend almost everything they have – which is becoming very little. Most workers aren't earning nearly enough to buy what the economy is capable of producing*.

Rather than price inflation this situation leads to debt inflation. Rather than too much purchasing power chasing too few goods and services, too many goods and services are chasing too little purchasing power. Consumers take on debt to try to keep up a basic standard of living. And firms are under pressure as sales fall short of targets.

This argument can be seen beyond the US and UK. One example is the demolition of vast acres of blocks of flats in China as the developer Evergrande faces bankruptcy.[19] The World Bank and IMF are reporting a need for urgent action on poorer countries with record levels of debt, with firms having borrowed on now obviously over-optimistic expectations of high export growth.[20] Ahead of the pandemic the IMF were warning, "*global public and private debt levels were much higher going into the pandemic than they were on the eve of the global financial crisis*".[21] Earlier this year the World Bank showed the following analysis of private and public debt across 182 countries.[22]

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[18] 'The problem isn't inflation: it's that most Americans aren't paid enough', *Guardian*, 13 August 2021: https://www.theguardian.com/commentisfree/2021/aug/13/joe-biden-spending-plans-inflation-debt-fears-misplaced

[19] See discussion in James Meadway's post: https://novaramedia.com/2021/10/11/yes-chinas-debt-bubble-might-burst-but-the-government-has-far-bigger-problems/

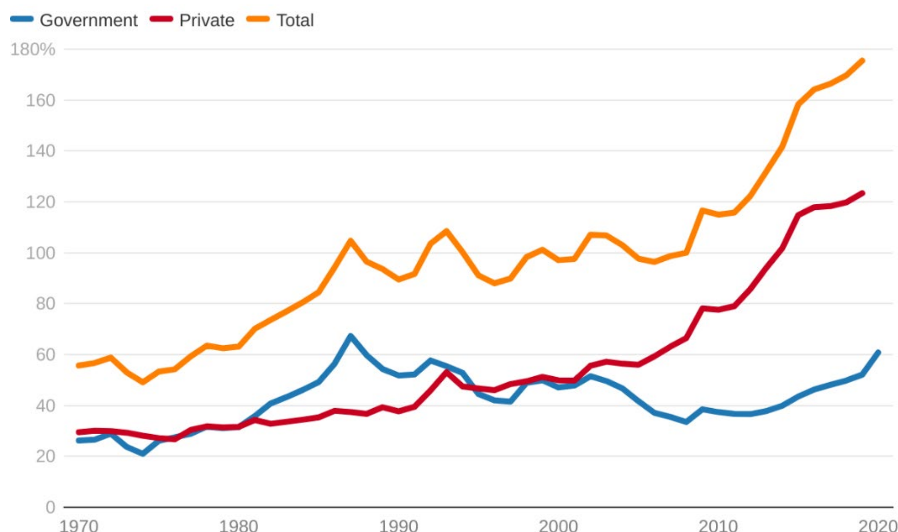
[20] 'The next global economic emergency? Deepening debt in the developing world'
Larry Elliott, *Guardian*, 7 October 2021: https://www.theguardian.com/business/2021/oct/17/the-next-global-economic-emergency-deepening-debt-in-the-developing-world

[21] 'The pre-pandemic debt landscape and why it matters', IMF blog, 1 Feb. 2021, Xuehui Han, Paulo Medas, and Susan Yang: https://blogs.imf.org/2021/02/01/the-pre-pandemic-debt-landscape-and-why-it-matters/

[22] https://blogs.worldbank.org/opendata/what-pandemic-means-government-debt-five-charts

Debt in emerging market and developing economies

Percent of GDP



Aggregates are calculated using current GDP in U.S. dollars as a weight, based on data for up to 182 countries, including up to 145 EMDEs. Data for 2020 are estimates.

Source: International Monetary Fund; Kose et al. (2020); World Bank. • Download image

So the generalised problem of the world economy has been and remains a shortfall rather than excess of spending power, with debt even ahead of the pandemic growing to repeated record highs at a very rapid rate.

Austerity

Following the financial crisis, in contrast to the above interpretation, economic policy-makers judged that the economy had lived 'beyond its means'. Across households and government spending was judged to have outstripped the capacity of the economy to produce. This led to the view that spending should be reduced in order to constrain any inflationary pressure and reduce budget deficits, in the jargon to restore 'sound finances'.

At the time, economists who focused more on the demand side of the economy, argued that the government was attempting to solve a problem of too little purchasing power and pay, and so in relative terms too much production, by further reducing incomes. Up to a point, the economic consensus has now caught up with this view. In a summary piece the *Financial Times* conceded "That consensus can be wrong was on display after the 2008 financial crisis, when many organisations — including this newspaper — advocated fiscal retrenchment".[23]

But the change in consensus has come only after in the UK we experienced the worse recovery decade for more than a century, measured across both GDP and the public debt.[24]

Supply, demand and inflation

Robert Reich's analysis shifts emphasis away from the supply side of the economy, to the broader judgement that the determining factor in outcomes has been a lack of demand.

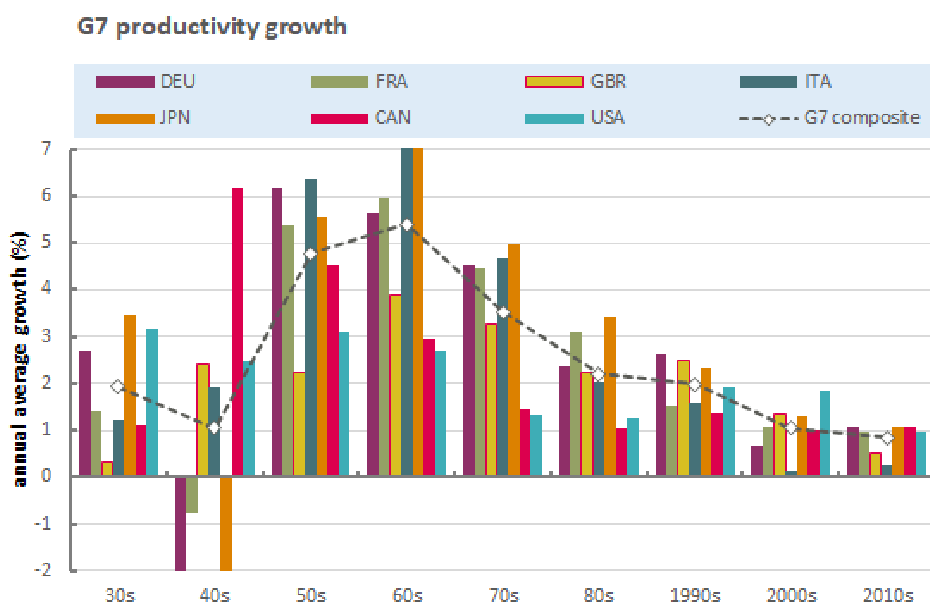
There are clearly problems with the supply side of the economy, including sharp cuts in investment in adult skills, a lack of business investment in the ongoing climate of

[23] Editorial Team, *Financial Times*, Jan. 2021

[24] See analysis of public debt and GDP in 'TUC issues call to avoid "despair of mass unemployment" with a plan to work our way out of recession, 20 May 2020: https://www.tuc.org.uk/news/tuc-issues-call-avoid-despair-mass-unemployment-plan-work-our-way-out-recession

uncertainty created by government, and a lack of worker voice that holds back innovation. But these sit alongside the problems created by a shortfall in demand. Debating the condition of the economy with Professor David Blanchflower in June 2019, MPC member Gertjan Vlieghe conceded … *"I thought he [Blanchflower] would perhaps argue that, if only there was more demand stimulus, higher productivity growth might return, i.e. that some part of the lost productivity is cyclical and reflects lower intensity of factor utilisation, not structural developments. I would have some sympathy with that idea."*[25]

Alongside the failed GDP and public debt outcomes, the same was true of productivity. Again, as the chart below shows, the past decade in the UK was the worse since the 1930s, as it was in most other major economies that followed a similar austerity approach. But according to the demand argument, productivity was following as effect not cause.



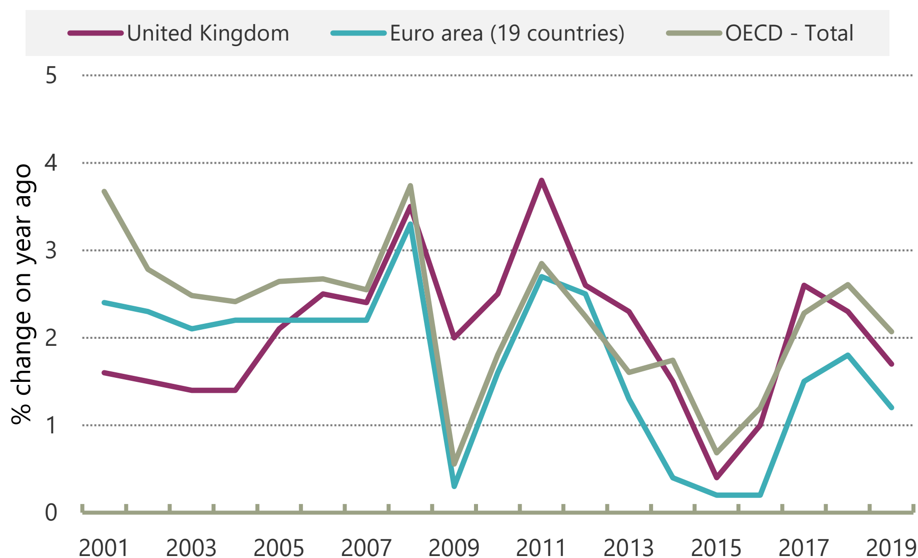
Source: BCL database; TUC calculations

Likewise, the demand argument permits setting the inflation debate in a broader context. As the below chart shows inflation has been subdued for at least 20 years. For the decade ahead of the pandemic CPI inflation averaged 2% in the UK, 1.9% in the OECD and 1.3% in the Euro area; such low outcomes would not have been possible were economies at near full capacity. Philip Turner, formerly deputy head of the monetary and economic department and a member of the senior management of the Bank for International Settlements (BIS), has recently reminded us that "Central banks have seen successive plans (in 2009, in 2013 and in 2018) to 'normalise' monetary policy frustrated by weak growth and low inflation".

Notably the latest of these episodes came just ahead of the pandemic, and as the chart shows inflation had already slowed fairly substantially into 2019. UK GDP growth in the year to the fourth quarter of 2019 had slowed to 1.2 per cent, the lowest figure for seven years. And this is relevant broader context for present inflation outcomes. There are real pressure

[25] 'Not Working - Where Have All the Good Jobs Gone?' - David Blanchflower in conversation about his latest book with Dr Gertjan Vlieghe: www.niesr.ac.uk/events/not-working-where-have-all-good-jobs-gonedavid-blanchflower-conversation-about-his-latest. In the same discussion John Llewelyn (consultant) argued productivity might be endogenous rather than exogenous, and Jagjit Chada (director of NIESR) spoke of wages adjusting in respect of a given total amount of demand. https://www.niesr.ac.uk/sites/default/files/files/GertjanVlieghe_Blanchflower%20book%20review_11%20June%202019.pdf

points in the economy because of cost pressures, especially through international supply chains and shortages of domestic workers in certain sectors. But these cost pressures are set against prolonged weakness in aggregate demand in the UK and across the word. In the UK these cost pressures are set against further reductions in take home income, as workers lose benefits and face increased national insurance payments. Most likely the recent inflation threatens reduced demand, rather than high demand in the future. And we already know that the revival in consumer spending is fizzling out, with spending in shops and on line (excluding fuel) falling by 4.5% in cash terms between April and September. These are not the conditions of a wage price spiral, and the best way to protect workers against cost of living increases is through a pay rise.



Source: ONS and OECD

A new economic model

Rather than a return to the failed austerity of the last decade, we need a new economic model. Rather than dangerous, higher pay is necessary as a means to raising purchasing power and resolving the excess production of the world today. Behind shortages and other disruptions in the headlines – it has been too easy to forget the precarious condition of the global economy ahead of the pandemic.

A new model must mean above all rebalancing of economic power from the wealthy few to the hard pressed many. 'From wealth to work' as President Biden has put it. As we outlined in our submission to Spending Review 2021, this must include:

- Tackling labour shortages by improving pay and conditions across industries, working with unions and business to deliver this, as well as introducing stronger laws to tackle unfair practices like zero hours contracts. Exploitative migration policies and removal of protections for workers will not address the problems created by poor conditions at work.
- Raising the minimum wage to at least £10 an hour now, and extend it to young workers.
- A policy of full employment, supported by government spending
- Investment in the economy and the just transition required to meet net zero

    - reversing the cuts to the value of public sector pay that took place over the period 2010/11 to 2020/21; creating 600,000 new jobs in public services; and large-scale investment in public services across the NHS, social care, justice and education.
    - Bringing green infrastructure spending in line with its G7 peers, by allocating £42 billion a year for the next two years to shovel-ready projects that create jobs and deliver compliance with climate targets; and meeting wider global commitments.
- A focus on full employment by global institutions and policy makers as the best way to deliver sustainable economic growth.