Number 7 July 2015

This quarterly TUC report provides an analysis of UK economic developments over recent months; focuses on the current labour market compared to pre-recession levels; and includes a spotlight feature on productivity since 2008.

Summary

- Economic activity appears to have weakened a little from the end of 2014 and into 2015.
- Historic imbalances have not been repaired, with manufacturing back in decline.
- Household and corporate savings have been reduced over the past years, and deleveraging may have stalled.
- As a share of GDP, the current account deficit is at an all-time high.
- Public sector deficit reduction has fallen far short of expectations, and government cuts have made no impression on public debt.
- Since 2008 there has been a major shift in employment towards part-time work, self–employment and insecure work.
- Underemployment remains high.
- Young people have not benefitted from the recovery in the labour market.
- From a longer standing view, real earnings remain greatly below pre-crisis outcomes.
- Only an increase in productivity will bring sustained wage increases in the medium term, but low productivity has been one of the characteristics of the labour market recovery.

Economy

Economic growth

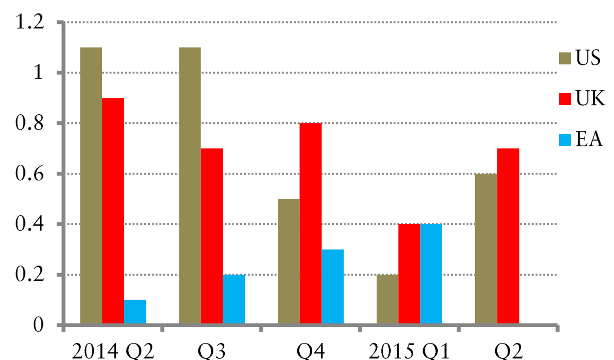
Evidence that economic activity has weakened a little is not going away. GDP growth picked up to 0.7 per cent in 2015Q2 from 0.4 per cent in Q1. But growth in Q2 may be exaggerated by erratically strong energy figures. Underlying the headline figures, both manufacturing and construction weakened into the second half of 2014 and slowed to a standstill in the first half of 2015.

Any weakness goes beyond the UK; in their June *Economic Outlook*, the OECD reported that globally Q1 was the weakest quarter since the financial crisis, and while it had been attributed "mainly to a confluence of special factors, [it] may in reality be signalling some persistent underlying weakness".

Global backdrop

A number of tensions in the global economy are apparent, not least the Greek/euro crisis and a major deterioration in Chinese financial markets. Moreover the weakening in GDP coincides with upheavals to global quantitative easing programmes.

GDP quarterly growth, per cent



We have stressed in previous reports that the revival in UK GDP coincided with a global

monetary stimulus that began at the end of 2012 when the US announced its third programme of quantitative easing and the UK also made financial interventions, not least 'funding for lending' and 'help to buy' (as well as easing up on austerity). Over 2014 the US began to reduce the amount of stimulus, and the programme ended in October. The reduction in growth in a number of economies may therefore be rooted in the withdrawal of stimulus. In 2015 Q2 quarterly growth in US GDP was still subdued at 0.6 per cent, though up on 0.2 per cent in Q1. In the meantime the ECB has set in motion its QE programme, and growth in the Euro area is making modest gains, moving up to 0.4 per cent in 2015 Q1 (see chart on preceding page).

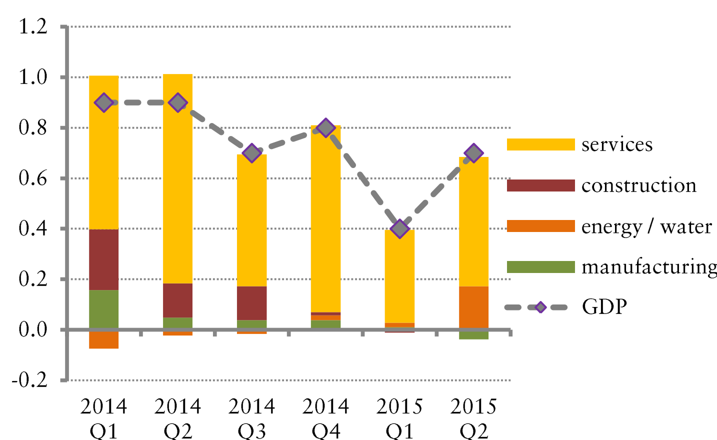
Outcomes for the UK and the rest of the world seem poised between opposing forces of monetary expansion, fiscal contraction and wider financial risks. The former may provide bursts of forward momentum, though not without disturbing side-effects in asset markets (e.g. house price inflation), and is set against the downward pressures from austerity. Looking ahead, downward pressures from departmental spending cuts will be around the same in this parliament as the last, even in spite of the reduced extent of austerity announced in the July 2015 Budget. On this basis it seems premature to judge that economic outcomes are moving onto a more even keel.

Output

The main reasons for the increased growth in Q2 were a surge in energy extraction and a rebound in service activity. Acting in the opposite direction was the first fall in manufacturing output for over two years and flat construction activity.

'Mining and quarrying' (primarily oil extraction) grew by 7.8%, likely boosted by the reduction in the 'supplementary charge' oil and gas companies pay on their profits announced in the March 2015 Budget. Services grew by 0.7% in Q2, up from 0.4%, mainly as business services bounced back from a low Q1 – perhaps reflecting a pause and revival in business on either side of the election. Manufacturing output fell by -0.3%, the first decline for more than two years. Flat (0.0%) growth in construction in Q2 follows a decline of -0.2% in Q1, and the suggestion is that activity here has also seriously weakened. The chart below shows the contribution of the various headline industries to quarterly GDP growth.

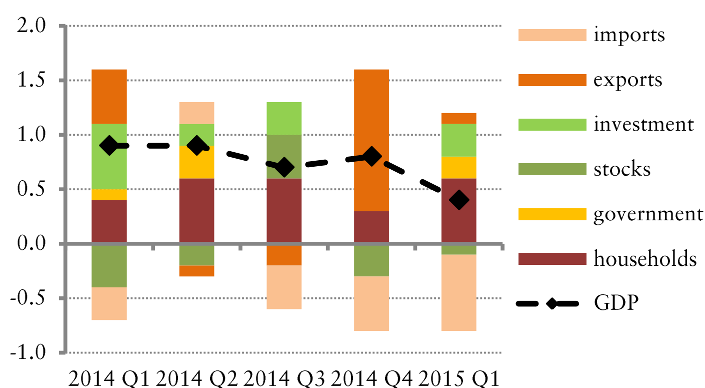
Contributions to GDP growth, percentage points



Demand

On a short horizon the demand view has recently been reasonably balanced. In Q1 (the last quarter for which comprehensive figures are available) household spending, government spending, capital investment were all relatively robust (with a significant contribution from housebuilding), but net trade dragged as imports outstripped exports to a significant degree.

GDP quarterly growth, per cent



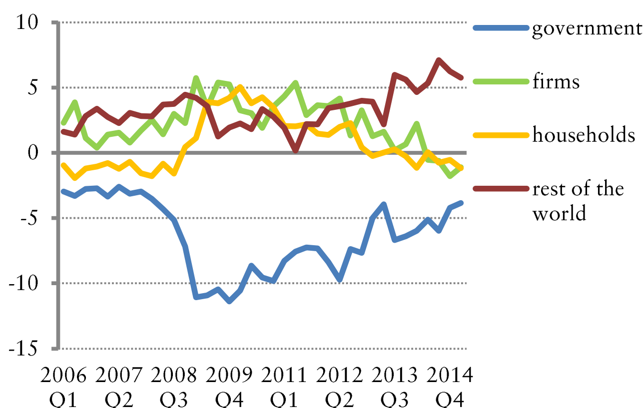
On a year ago, the story is similar with strength across all categories of demand. There is some evidence of household consumption speeding up (although this is mainly the result of falling prices leading to rises in consumption volumes, rather than an acceleration in the total amount of cash expenditure), but investment is slowing a little. Government demand strengthened into 2014 as the government relaxed its austerity policies, though this may be tailing off now. Exports have been very volatile in recent quarters as the chart indicates, but are consistently outweighed by stronger imports.

While investment has seen some growth in recent years, as a share of the economy it remains at historically low levels and towards the bottom of OECD countries. Trade performance is also poor, in spite of the reduction in the exchange rate in the aftermath of the crisis. Overall, there is still excessive reliance on household consumption.

Income, borrowing and debt

GDP growth is at the expense of increased borrowing across all sectors of the domestic economy, except for government where borrowing has reduced – though by far less than the Chancellor originally planned. The 'financial balances' measure the balance of all spending and revenues for each sector, as on the chart below (note that they add to zero at each point in time).

Sectoral financial balances, % of GDP



Households

In the household sector, with the prolonged crisis in earnings incomes have been increasingly outstripped by expenditures. The sector balance has moved from a 5 per cent surplus in 2010Q1 to -1.2 per cent deficit in 2015Q1. While there has been much stronger growth in wages and salaries in recent figures (the rise of 5.5 per cent in the year to 2015Q1 was highest since the start of the crisis) the sector balances depend on cumulative changes and recent gains have not been sufficient to outstrip the scale of past losses.

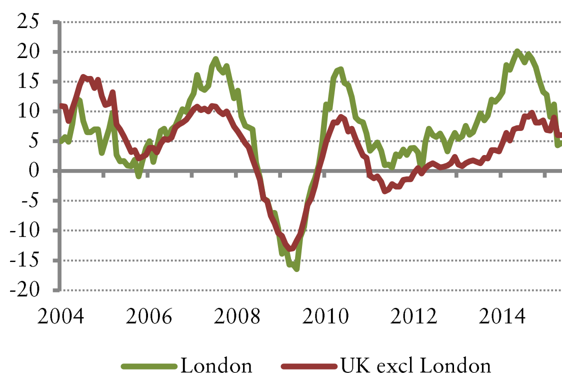
As the financial balance has moved into deficit, household debt figures are beginning to rise again relative to income. Bank of England figures show personal credit use increasing by 7.2 per cent on the year, the highest rates of growth for eight years.

Set against this though are some signs of weakening in the housing market. Mortgage approvals bounced back in April and May, though are still down by around 10,000 from the recent peak of 75,000 in January 2014.

Moreover there was a hefty fall in house price inflation in the latest two months, with the annual rate of growth down materially to 5.7 per cent in May from 9.6 per cent in March. This was mainly driven by London, where inflation fell to 4.7 per cent in May from 11.2 per cent in March, but the UK excluding London also fell to 6.0 per cent from 9.0 per cent.

The chart overleaf shows the recent experience of house price inflation through both the upswing and the apparent downswing as no less vigorous than the two previous episodes in 2007 and 2010.

House price inflation, annual percentage growth



Corporate sector

The corporate sector (including financial and non-financial firms) has also moved into deficit. Here incomes have been falling over the past five years; in spite of some growth in profits, UK firms have been increasingly paying high dividends, including to overseas owners while overseas payments to UK owners have moved in the opposite direction. In the meantime business investment has grown steadily over the past five years (although at roughly 5 per cent a year this was around half the pace the OBR expected), with a particular surge in house-building into 2014 (up 14.3 per cent). This means that the sector has moved from a surplus of around 5 per cent of GDP to a deficit of -1.1 per cent in the latest quarter. Total net borrowing of -£10bn in 2014 is the first annual negative since the corporate dot.com expansion in 2000.

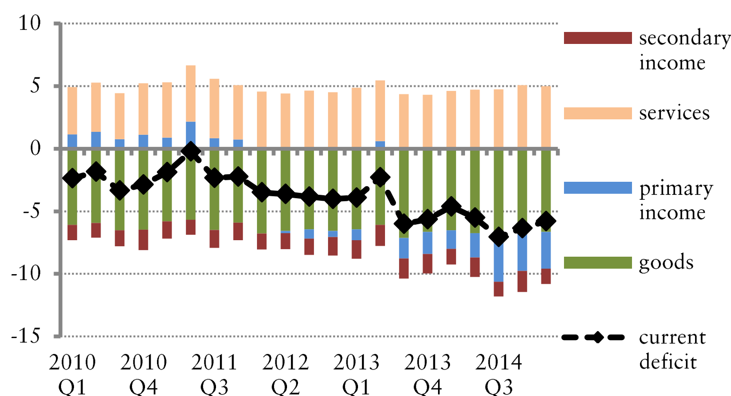
Higher borrowing in the corporate sector has taken the form of new corporate bond issuance, as bank borrowing has reduced. The National Accounts show corporate bond issuance of £30bn in 2014, around double the average annual issuance since 2000, when issuance had peaked at £40bn. Corporate sector indebtedness remains very elevated as a share of income.

Relations with the rest of the world

The flip side of UK firms' high payments of dividends are major gains to other countries from dividend recepits; adding these to the UK's ongoing trade deficit means the rest of the world now shows a record surplus with the UK. In general terms, the UK has become increasingly reliant on funds from the rest of the world (with investors overseas funding a significant share of UK corporate and government borrowing).

The chart below breaks down the UK current account deficit over recent quarters (note these figures correspond to the rest of the world surplus on the above, but from the UK point of view). Over recent quarters as a share of GDP, the UK has been in deficit to a unprecedented extent. In 2014 the current account deficit was 5.9 per cent of GDP, the highest annual figure on record.

UK current account, % of GDP



The goods deficit and services surplus have been relatively stable as a share of GDP, likewise the deficit on 'secondary income' (mainly net payments to the EU). The move to increased deficit has followed movements in primary (mainly investment) income. In the past an investment surplus used to cover for the weaker trade position, as earnings on UK investments abroad outstripped overseas earnings on their investments in the UK. But this position has now reversed, in particular on direct investment and debt securities.

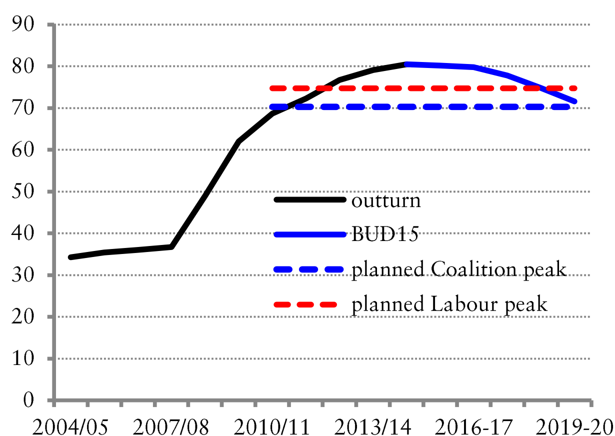
UK public sector finances

As on the financial balances chart, the government has broadly halved the deficit on this definition (which is a little different to the one used by the OBR) from around 10 per cent to 5 per cent of GDP. However the scale of this reduction falls *far* short of the government's

plans: in cash terms in June 2010 the OBR expected public sector net borrowing in 2014-15 to be £37bn; the outturn was £89bn. In 2015-16, data for April and May show borrowing to date of £16.4bn, an improvement on last year, but again far above original expectations.

More importantly the Chancellor has failed on the basis of his own goal of reducing public sector net debt. Instead public debt has been much higher than projected when he took office. Under Labour's pre-2010 election plan debt was set to rise to a peak of 74 per cent of GDP in 2014-15; the Chancellor aimed to reduce that peak to 70 per cent, but instead in 2014-15 public debt was 80 per cent of GDP. It is projected to remain higher than Labour's forecast peak until 2018-19.

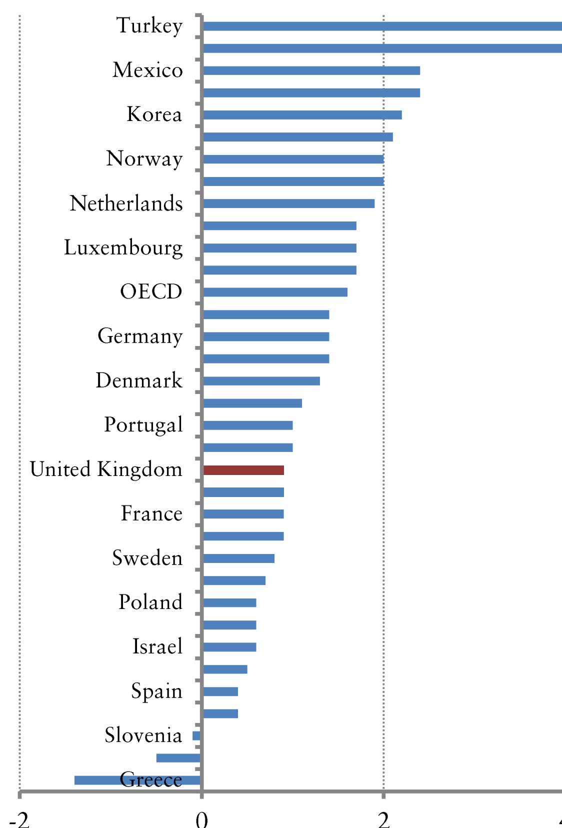
Public sector net debt, % of GDP



While a limited reversal in oil price falls is now feeding through to headline figures, inflation remains unprecedentedly low and in negative territory for many countries. In the UK the April CPI at -0.1 per cent fell negative for the first time since 1960 (according to newly devised ONS historical estimates). After a rise to 0.1 per cent in May, it fell back to zero in June.

Underlying pressures might be better shown by 'core inflation', which excludes energy, food, alcohol and tobacco. These figures have been on a downwards trend for two years, and showed annual inflation of 0.9 per cent in May 2015 and 0.8 per cent in June. The UK is one of fourteen countries with core inflation of less than one per cent, the same rate as the euro area and well below the OECD average of 1.6 per cent.

Core inflation, annual change (figures in chart are for May 2015)



On one hand low inflation has meant rising real wages, and low fuel prices mean more to spend elsewhere. But low inflation might also be a cause for concern, as it could be indicative of a low growth/low productivity recovery that has left substantial spare capacity in its wake.

Labour market

Our quarterly TUC Economic releases have been providing updates on recent developments in the labour market. In this edition however we focus on the current labour market compared to the pre-recession level of early 2008.

While it is welcome that we are seeing record levels of employment, is everyone gaining from the improvements in the labour market? Has the composition of the labour market changed since 2008? And has there been any change to the unprecedented fall in wages?

Employment

The employment rate in the most recent data is 73.3 per cent; this is slightly above the pre-recession rate of 73 per cent. However the male employment rate has still not returned to the pre-recession level while the employment rate for women is now 1.7 percentage points higher over the same period. The 68.7 per cent employment rate for women is the highest since comparable records began in 1971.

Employment rates 2008-15 by gender

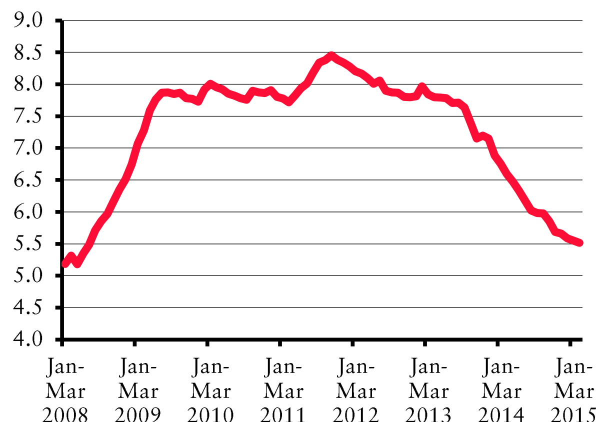
Men	Jan-Mar 2008	79.1%
	Mar- May 2015	78.1%
Women	Jan-Mar 2008	67.0%
	Mar- May 2015	68.7%

Unemployment

While we have been seeing healthy improvements in unemployment, this fall has come to halt as the latest data show a rise of 15,000 in the unemployment level. This is the first quarterly increase since early 2013.

The unemployment rate still remains higher than pre-recession levels for both men and women. This is currently 5.6 per cent, 0.4 percentage points higher than early 2008.

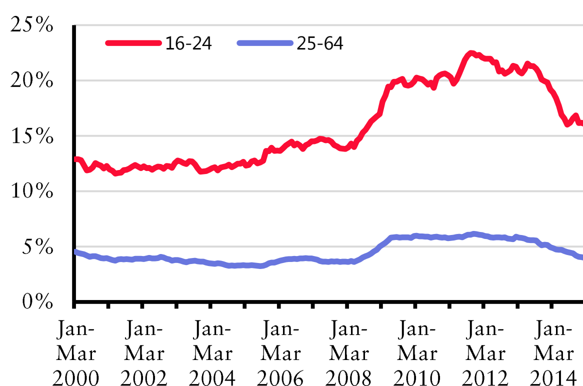
Unemployment rate 2008-15



Experiences of different age groups

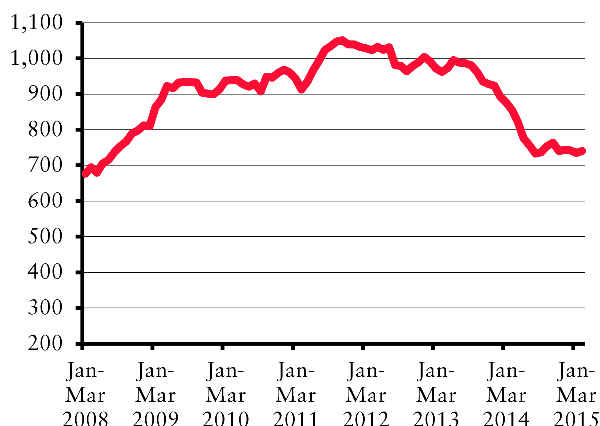
Young people have been hit hard during the recession and have not gained in the recovery compared to other age groups. This age group has the highest unemployment rate. Although unemployment was rising for young people before the recession improvements have not yet been sufficient to get back to even pre-recession rates.

Unemployment rates compared: 16-24 to 25-64



The graph above illustrates the much higher rates of youth unemployment compared to the 25 and over group, and that the gap between the two rates is larger than before the recession. Currently unemployment among those aged 16-24 is 15.9 per cent compared to 4.1 per cent for adults aged 25-64. While all age groups experienced a fall in the number of unemployed people during the recovery, this stopped last summer for young people when the level essentially flat-lined.

Youth unemployment levels (000s)



So who has been gaining from the employment growth? All age groups apart from the 16-24 year olds have, with the 50+ group gaining higher net increases than any other age group.

Employment rates by age groups 2008–15

	Aged 16-24	Aged 25-34	Aged 35-49	Aged 50-64	Age 65+
Jan-Mar 2008	57.9	80.6	82.4	65.7	7.2
Mar-May 2015	53.3	80.7	83.6	69.1	10.1
change	-4.6	0.1	1.2	3.4	2.9

When looking at the older age groups by gender it is noticeable that among the 50-64 year old age group women's employment rate has increased much faster than men's - by 5.6 percentage points compared to 1.3 points. This will be partly due to ongoing changes to the state pension age for women resulting in fewer women retiring between the ages of 60 and 65. For the 65+ group the percentage increases for both men and women are similar, just under 3 percentage points.

Employment rates – 50-64 by gender

Men	Jan-Mar 2008	73.3
	Mar-May 2015	74.6
	Change	1.3
Women	Jan-Mar 2008	58.3
	Mar-May 2015	63.9
	Change	5.6

To add to the difficulty young people face in employment, recent analysis by the Institute of Fiscal Studies (IFS)[1] singled out younger workers as among the hardest hit by the fall in living standards post 2008. During the 2009-11 period, when wage declines were more pronounced median weekly earnings for 22 to 29 year olds fell by 10.6 per cent, compared with just under 7 per cent for older age groups.

In addition they will see no benefit from the NMW supplement the Chancellor announced in his most recent Budget, as this new NMW rate will only apply to those aged over 25.

Composition of the workforce

There have been significant changes in the shape of the labour market since the recession, as the following table shows.

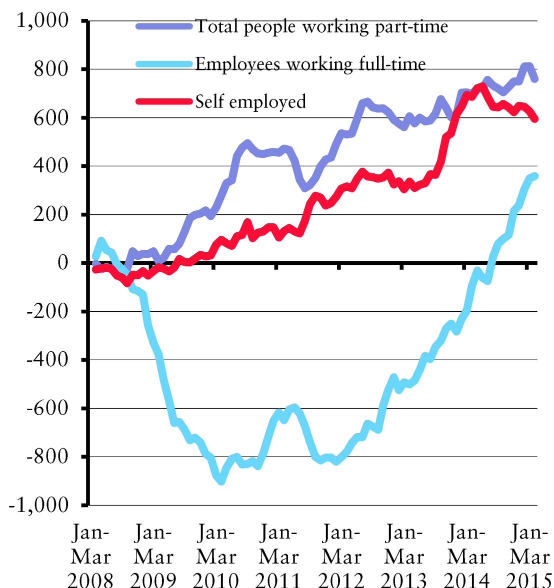
Composition of growth in jobs 2008–15 (000s)

(000s)	Jan-Mar 2008	Feb-Apr 2015	% change	As a % total change
Employees	25,582	26,307	3	55.9
Self employed	3,878	4,468	15	45.5
Working FT	22,134	22,718	3	45
Working PT	7,549	8,264	9	55
Emp'ees working FT	19,123	19,474	2	27
Emp'ees working PT	6,459	6,832	6	29
FT Self-employed	2,946	3,160	7	17
PT Self-employed	932	1,291	40	29

It is only in the last year that the majority of the gains in employment have been from full-time employee posts; previously they were from self-employment and part-time jobs.

1 www.ifs.org.uk/publications/7543

Composition of growth in jobs 2008–15 (000s)



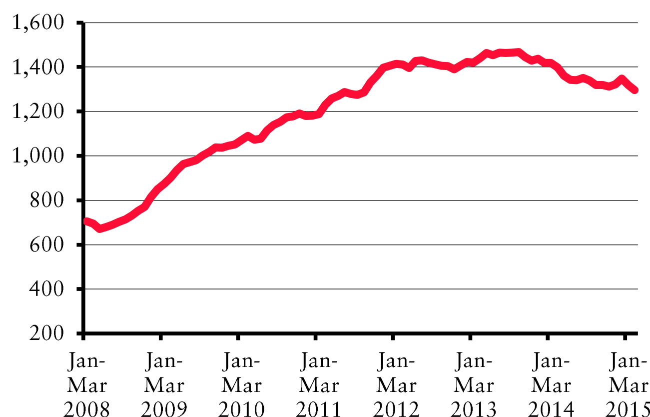
Despite this recent reversal it is still true that the share of employment taken by full-time employee jobs (many people's first choice) remains below pre-recession levels. The share of UK jobs accounted for by full-time employees fell from 64.4 per cent in Jan–May 2008 to 62.9 per cent in Mar- May 2015. Achieving the equivalent share today would require just under half a million more full-time employee jobs.

Self-employment

Growth in self-employment has accelerated in recent years, however it is a trend that was established before the recession. Numbers have been rising since the early 2000s; in early 2001 there were 3.2m self-employed people, by the end of 2007 this had reached 3.8m. After the downturn, self-employment accelerated and cushioned overall employment falls. It is currently at 4.5m after peaking at 4.6m in spring 2014. Whilst self-employment is now falling it still forms 14.4 per cent of employment, up from 13.1 per cent in early 2008.

The TUC has previously[2] set out our concerns around the growth in self-employment, as while some move into self-employment out of choice others may have been forced into self-employment as they were unable to find alternative opportunities. Previous TUC analysis[2] of self-employment has also shown that self-employed workers often earn less, are more likely to be underemployed and have less job security than employees.

Self employment 2008–15 (000s)

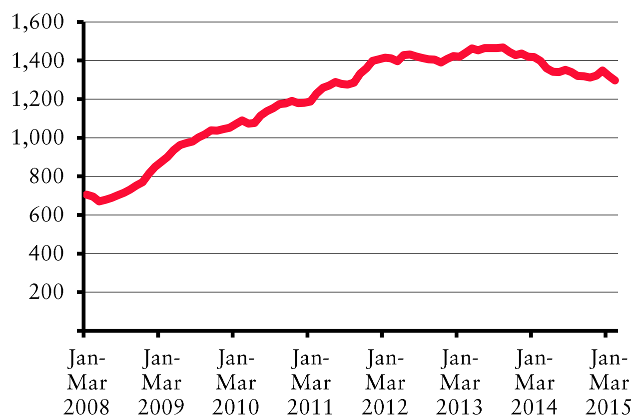


Underemployment

Any recent gains in the labour market must also be set against large-scale underemployment.

In early 2008, part-time work comprised of 25.4 per cent of employment and is currently 26.7 per cent. While many choose to work part-time out of choice a significant number are forced to do so as they cannot find full- time work. There are almost 1.3m people working part-time involutarily; while there have been small falls in this type of work the level is still 80 per cent higher than in early 2008, when it was around 700,000.

Involuntary part-time work (000s)

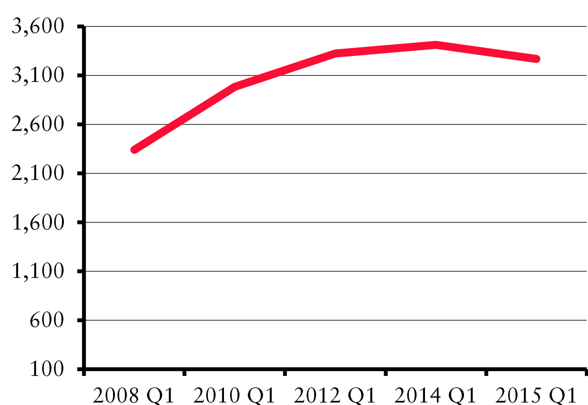


2 www.touchstoneblog.org.uk/2014/06/tuc-economic-quarterly-report-4/

The TUC has also analysed[3] the wider scale of the underemployment problem by looking at how many workers across the economy want more hours in their existing jobs as well as the regularly published measure of the number of workers in part-time jobs who want to work full-time. This shows that around 1 in 10 people are underemployed.

There were 2.3m people underemployed in early 2008, however underemployment rose rapidly following the recession and reached 3.4m in early 2014. It has fallen slowly in the last year to reach just under 3.3m in early 2015; but this is still over 900,000 higher than it was before the recession.

Underemployment levels 2008–15 (000s)



The UK needs a much lower rate of underemployment. Otherwise levels of in work poverty will remain high and the economy will continue to fail to achieve its full potential.

ONS analysis[4] shows that those finding part-time jobs are less likely to leave poverty. Those taking up full-time jobs were more likely to move out of poverty when entering employment (76 per cent) compared with those who moved in to part-time employment (62 per cent). Looking at part-time workers, those leaving poverty work more hours per week on average (18 hours) than those remaining in poverty (15 hours).

Temporary work

The number of temporary workers has also increased since early 2008, along with the proportion working on a temporary contract as they could not find permanent work. Involuntary temporary work has increased from around a quarter to a third of temporary workers.

Temporary work 2008–15

Data in 000s	Total	Total as % of all employees	Could not find permanent job	% that could not find permane nt job
Jan-Mar 2008	1,430	5.6	363	25.4%
Mar-May 2015	1,672	6.4	552	33.0%

Zero hour contracts

The rise in the use of zero hour contracts (ZHCs) has been widely reported.
An ONS survey of businesses undertaken in August 2014 found that there are around 1.8m contracts in the UK that do not guarantee a minimum number of hours. The figure previously released (which considered the position in January 2014) estimated there were 1.4m contracts of this type. The ONS has recommended some caution with the statistics, as a greater public recognition of ZHCs and some seasonal factors could have affected the final number. The important issue here is that the numbers working on zero hour contracts are rising rather than falling. It may not be possible to compare this data directly to 2008; however it is widely accepted that a higher proportion of the workforce find thesmselves in this position.

Pay

In his speech[5] to TUC Congress 2014, the governor of the Bank of England confirmed that real wages had fallen by around a tenth since the

3 www.touchstoneblog.org.uk/2015/06/high-levels-of-underemployment-still-remain/

4 http://visual.ons.gov.uk/in-work-poverty/

5www.tuc.org.uk/congress/congress-2014/mark-carney-governor-bank-england-speech-congress-2014

onset of the crisis, unprecedented since the early 1920s. The latter came in the wake of austerity after the first world war, and while similar in magnitude it lasted only two years; now in its seventh year, this squeeze has no historical precedent.

The latest data does show that regular pay grew by 2.8 per cent on the year. This is the highest annual growth rate since early 2009, though this is still well below the pre- recession norm of nominal earnings growth of around four percent. It is only because of the exceptionally low rate of inflation we are seeing real earnings growth approaching three per cent, above historic norms.

From a longer standing view, real earnings remain greatly below pre-crisis outcomes. A brief period of real earnings gains does not make up for years of losses.

Real earnings, index 2008=100

With price inflation set to return to its 2 per cent rate at some point, in order to secure real wage growth, nominal earnings need to rise by pre-recession levels.

Only an increase in productivity will bring sustained overall wage increases, and low productivity has been one of the characteristics of the labour market recovery. (The fall in productivity is discussed in detail in our special spotlight feature on productivity).

Conclusion

While there has been a lot of commentary to the effect that the labour market has been more resilient than in previous recessions and that employment has held up relatively well, this may over-simplify the picture.

It may be too soon to say where there have been structural changes in the labour market, but it is now in a very different place than before the crisis. Underemployment is high, and there has been a shift towards part-time work, self-employment and higher numbers of insecure jobs. While there has been recent growth in full-time employee positions, half a million more jobs are needed just to get the proportion of these positions back to where it was in 2008.

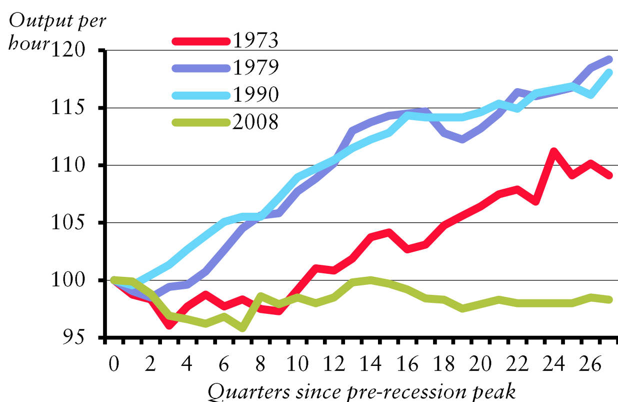
The gap between young people's employment and the rest of the population has widened; we are in danger of seeing some young people left behind. A brief period of real earnings gains does not make up for the years of losses, it is still extremely premature to say that wages have recovered as there is a substantial living standards gap still to make up.

Spotlight feature – trends in productivity since 2008

For nearly five years economists have been talking about the UK's "productivity puzzle", which could equally be called the "employment puzzle". This is that employment fell less than was expected given the large loss of output (as measured by GDP) in the recession and has grown faster than the recovery of GDP would seem to justify. Labour productivity measures the amount of output for a given unit of labour input, so another way of interpreting these impressive employment figures is that UK productivity was hit hard by the recession and has not fully recovered since.

The commonest ways of measuring productivity are in terms of output per worker and output per hour.[6] The chart below shows the large fall that followed the recession.

Productivity since the turn of the century

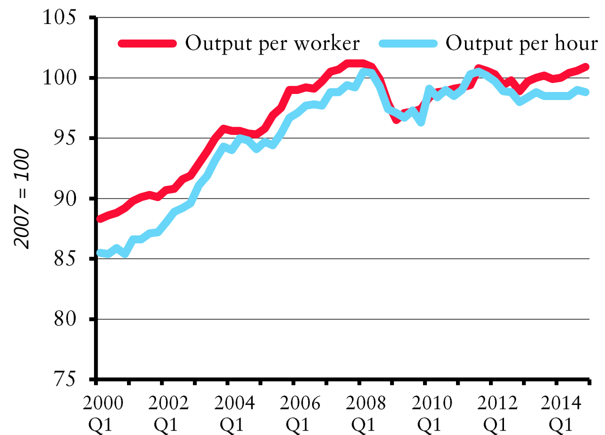


The chart also shows that output per hour began to improve in 2009, when the recession ended, but this was cut off in 2011 when the UK nearly entered a double-dip recession. It has not recovered since. Output per worker *has* recovered, but has only just matched the pre-recession peak.

The comparison with previous recessions for half a century is marked.

6 See: www.ons.gov.uk/ons/rel/productivity/labour-productivity/q3-2013/info-labour-productivity.html

Productivity per hour in four recessions[7]



By this stage – more than six years since the start of the recession – previous recessions had long since seen productivity surpass pre-recession levels. The lack of movement over the past three years matches the period of record-breaking employment growth.

The UK has for a long time had serious difficulties matching productivity levels in other countries. For anyone unfamiliar with these data it can come as a surprise to see how much better the performance is of economies often derided in the British press as hopelessly inflexible and out-of-date. The table below presents productivity figures for 2013, the most recent available.

International comparisons of productivity, UK=100, 2013

	Per hour worked		Per worker
Netherlands	148	US	140
US	131	Ireland	136
Belgium	131	Belgium	123
Germany	128	Netherlands	122
France	127	Italy	115
Ireland	125	France	113
Italy	109	Spain	109
Spain	109	Germany	106
Canada	101	Canada	103
UK	100	UK	100
Japan	85	Japan	89

7 Sources: www.ons.gov.uk/ons/rel/productivity/labour-productivity/q1-2015/stbq115.html, www.ons.gov.uk/ons/rel/naa2/quarterly-national-accounts/q1-2015/tsd.html

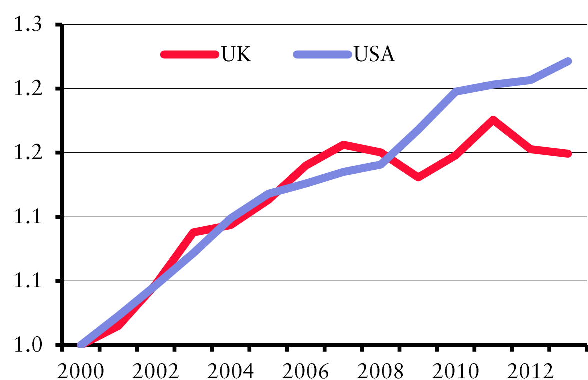
The UK's relative performance is slightly better if we turn to changes in productivity between 2008 and 2013, but this country is still among the poorer performers:

Changes in productivity, constant prices, 2008–13

	Per hour worked			Per worker
Ireland	11.7%		Spain	10.4%
Spain	10.3%		Ireland	10.0%
Netherlands	9.9%		Netherlands	8.9%
US	7.1%		US	6.9%
Japan	5.5%		Canada	3.7%
Canada	5.3%		Japan	3.4%
France	3.1%		France	1.9%
Belgium	0.4%		UK	0.5%
UK	-0.1%		Belgium	-0.1%
Germany	-0.2%		Germany	-2.6%
Italy	-0.4%		Italy	-3.3%

The contrast with the country with the highest productivity, the USA, is especially striking. Before the recession, UK productivity growth was matching America's but since 2008 we have fallen well behind:

Productivity per hour in the UK and the USA, indexed to 2000



In our recent report, *Productivity: no puzzle about it*[8], the TUC argued that the 'productivity puzzle' is simply the way the economy has responded to inadequate demand. In previous recessions, worse output produced lower levels of employment; in the most recent recession it instead led to stagnant and insecure incomes.

Lower productivity is the necessary consequence and it will not recover until demand is restored, which relies upon a less extreme fiscal position. Given the damage that will inevitably have been done to the economy by the crisis (and the long period of economic staganation that followed it) we also need significant structural change to boost capacity. This needs to involve active supply side measures including investment in skills and industrial policy and genuine corporate governance reform.

As we noted, talk about a productivity puzzle is often linked to calls for further labour market de-regulation, lower benefits and weaker unions. But there are signs that the OECD and the IMF have both started to realise that weak demand, not over-regulation, underlies low productivity. Recent economic literature has instead emphasised that labour market regulation, collective bargaining and decent unemployment benefits encourage workers to accept capital investment, innovation and other productivity enhancing measures that might otherwise be seen as threats to their employment. Employers are more likely to invest in equipment and training when labour is expensive and these policies tend to encourage long-term employment relationships that allow firms to get the most out of investments and innovation. (The literature is well summarised in this[9] report.)

An important recent paper from the National Institute for Economic and Social Research[10] used the Annual Respondents Database (a large and detailed business survey) to study productivity growth. The authors found that over half the gap between productivity after the crisis and before was due to a fall in productivity *within* firms and this happened "across main industry groups and is evident for both small and large firms." This is surprising because economists often assume that, at a national level,

8 www.tuc.org.uk/sites/default/files/productivitypuzzle.pdf

9 http://rfs.oxfordjournals.org/content/27/1/301.full

10 http://bit.ly/1K1qkmp

productivity is driven by the allocation of resources *across* firms, rather than within them.

In fact, as the *Financial Times*[11] commented, “changes in the composition of corporate Britain actually boosted output per worker” because “businesses that died off in 2008 were of lower average quality than those that died off in previous years.” The NIESR authors’ suggested explanation is significant:

“This is unlikely to be directly related to credit restrictions which would not have prevented businesses from laying off workers. It is more likely to be associated with the lack of cost pressures, including low nominal wage growth, that allowed businesses to survive in a low-demand environment.”

In other words our weak low pay recovery is directly related to poor productivity performance, which in turn is a result of a lack of sufficient demand.

Unions have repeatedly emphasised the macroeconomic problems caused by low wage growth. The conclusion that lower productivity within firms is a major cause of the UK’s productivity problem suggests that this element of the productivity problem may be resolved when growth is re-established on a broader basis and firms can no longer rely on the effective “subsidy” provided by low wages and cheap credit. As the NIESR authors conclude:

“More importantly, we conclude that other common factors, which we do not explore in this article, for example general demand weakness coupled with flexible wages, are likely to have been central in explaining the stagnation in UK productivity growth”.
Of course some capacity will have been lost over the recession and the slow recovery that has followed. But there is also significant evidence of ongoing capacity underutlisation – ie for a stronger recovery to be achivede without us hitting inflationary pressures. And as well as delivering immediate productivity improvements stronger demand is needed to create the conditions that will allow the investment in skills and industry which will be vital for long medium term economic health.

The UK’s productivity puzzle remains unsolved, but a substantial demand boost could well provide a significant part of the answer.

11 http://ftalphaville.ft.com/2015/06/08/2131096/banks-businesses-or-the-bust-deeper-into-the-uk-productivity-puzzle/