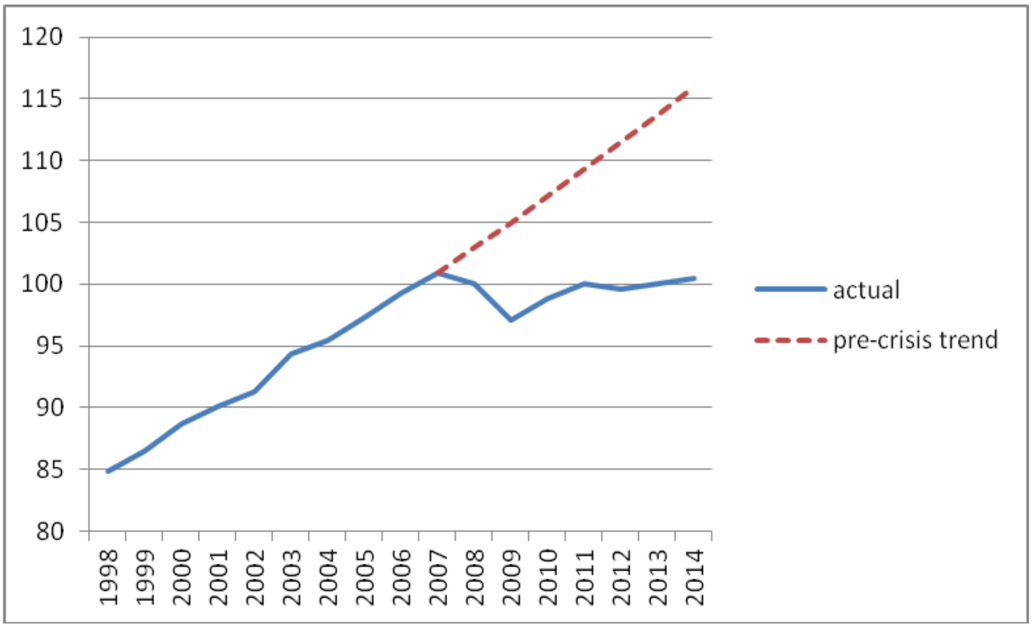
TUC Budget statement

June 2015

With productivity stagnating, and gains from growth still unfairly shared, future living standards are not secure

UK productivity has virtually failed to recover at all since 2008, and is 16% below where it would have been had pre-crisis trends been maintained.[1]

Output per head 1998 – 2014 actual and pre-crisis trend



Productivity growth is not just a 'nice to have' - without it our economy will lack the conditions for sustained growth in pay and profits in the decades ahead. While evidence from the past shows us that productivity gains are not automatically fairly shared, without them there is no medium term scope for higher returns to be generated at all.

The UK faces two urgent economic challenges – securing stronger productivity growth and acting to ensure that working people share fairly in these improvements.

Our productivity shortfall has been accompanied by a failure to deliver fair pay

The Chancellor is keen to present a positive story on recent UK economic performance as real wages have started to rise and adult unemployment continues to fall.

But the reality is that despite long awaited employment gains, all is not well.

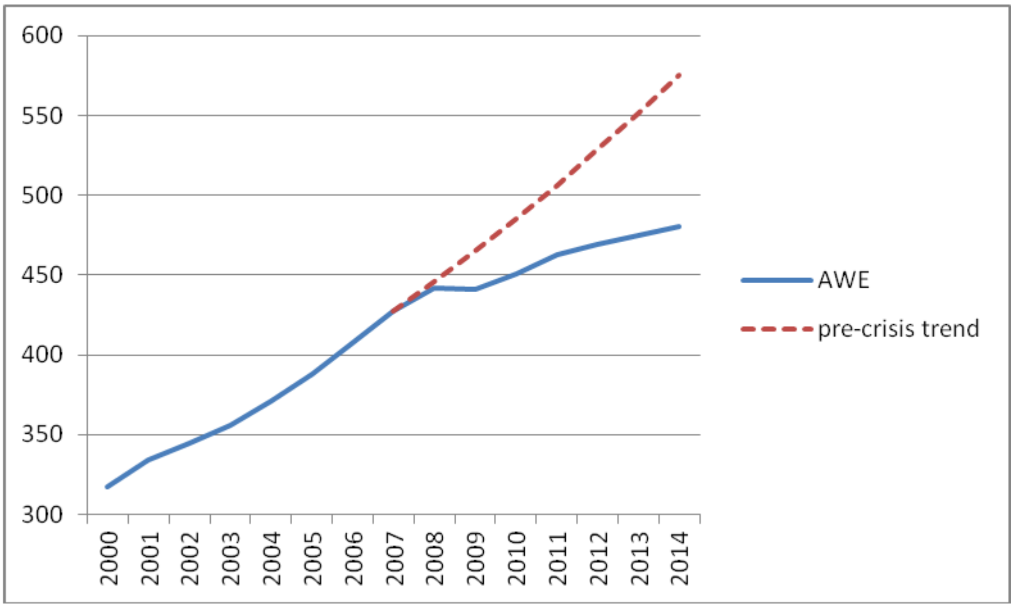
---

[1] This is 16 per cent below trend on an output per head basis and 17 per cent below on an output per hour basis.

On pay, real wages are still around eight per cent below where they were before the crisis. Even on the government's preferred inflation measure this means the average earner is £50 a week worse off.

What's more, if recent years had seen nominal pay grow at the same rate as before the crash, the average worker would be taking home £100 per week more (with average weekly earnings 20 per cent higher than they currently are).

Average weekly earnings 2000–2014 actual and pre crisis trend



Even at current rates it's set to take until 2018 for average earnings just to get back to the real value they held in 2008. That's a lost decade on wages and remains the worst performance on pay since Victorian times.

As concerning is that the real wage growth we have is still dependent upon exceptionally low inflation (a consequence both of poor domestic demand and international factors) - nominal earnings are still growing below their pre-crisis norm.

Our low productivity economy is also failing to deliver enough decent quality jobs for working people

Our low productivity economy is not only holding back the potential for higher wages, it also means poorer job quality. Years of economic underperformance have seen an increase in the proportion of our jobs which are lower skilled with the potential of too many workers underutilised. The Bank of England has observed a particular increase since mid-2013 in "disproportionately in lower-skilled jobs". There are over three million people in the economy who say they want more hours than they can get. Youth unemployment remains four times as high as the adult rate.[2] A better recovery would provide the basis for resolving these challenges with high productivity growth maximising the full potential of our workforce.

What's more, there is a genuine risk that prolonged poor productivity is beginning to permanently damage our labour market, leaving us with less scope for high paid decent quality employment growth than we had before the crisis. If low value working models become entrenched and employers continually invest in low skilled jobs rather than the technological innovations which will create better employment, we will be stuck on a low road approach to growth. If we lose the skills, knowledge and opportunities to invest in high value sectors with potential to generate better productivity outcomes, it will be even harder to recover the living standards that have been lost. And if we do not address the productivity challenges that parts of our economy faced even before the crisis, we will lose the opportunity to learn from our past mistakes and create a more resilient economy for the future.

The government should not be satisfied with a jobs market where our productivity gains are non-existent and where so many people are still struggling to achieve the living standards they want and need for their families. The TUC believes that we can do better.

Wider economic challenges also remain unaddressed, and new risks are building for the future

Behind the topline economic data there is much to remain concerned about, with wider economic trends offering some explanation for our stagnant productivity performance.

The UK's long overdue recovery remains the weakest on historic record, and growth has slowed continuously over the past year, alongside a wider slowdown in global performance.

GDP per head has only recently returned to its pre-crash position, which was close to eight years ago. Manufacturing, construction and energy extraction industries are still smaller than they were before the recession. The Chancellor talked about the march of the makers, but it has failed to emerge. Consumer spending continues to power our economy. Our overreliance on the financial sector remains a systemic risk.

The recovery is not only weak, but as structurally unbalanced as the economy that went before it.

Our trade deficit has failed to close - despite years of currency depreciation, our export growth has (honourable exceptions aside) been among the weakest in the OECD. On top of this, a sharp reduction in interest, dividend and direct

[2] Unemployment among those aged 16-24 is 16.1% compared to 3.9% for adults aged 25-64.

investment income flows from overseas has meant that the current account is in record deficit.

Business investment growth is weak and again UK investment is amongst the lowest of OECD countries as a share of GDP.

Bank lending other than to the financial and housing sectors remains non-existent, and has declined almost without interruption since the crisis.

Levels of household debt are predicted to return to where they were before the recession hit, with a particularly big increase in the use of consumer credit.

Despite all the talk of northern powerhouses the gaps between London and everywhere else are now larger than ever.

These outcomes mean that the Chancellor's primary stated economic objective, to pay off the deficit, has not been met as slower than expected growth (along with poor policy choices) has meant disappointing tax revenues and borrowing that in 2014-15 was £50bn above his target.

They also mean that the wider challenges working people face remain unaddressed.

In the jobs market, significant worries about falling pay and conditions are matched with new concerns, as too few jobs allow families to balance work and care and too many graduates find they are not able to utilise their skills.

The UK's housing market remains a drag on growth with high cost housing bearing down on living standards, driving up debt and preventing the labour market mobility that we need – as well as capping too many young people's ambitions.

An increasingly unequal society prevents us making best use of everyone's talents and abilities.

It is only with stronger, better balanced, fairer growth that we can turn productivity performance around, and in turn deliver an economy that truly meets working people's needs.

But the Chancellor's fiscal and economic policies are holding us back and failing to deliver productivity improvements and a secure recovery

The Chancellor's strategy is failing to address these problems – doing little to secure a stronger, more equitable, higher productivity recovery.

The TUC has persistently argued that extreme government spending cuts have weakened our economic potential, and continues to do so. We are concerned that growth is at even greater risk from the heighted pace of austerity that the Chancellor is planning for the years ahead. The recovery was knocked off course by spending cuts in 2010 and although it has been a little stronger since 2013, it's inevitable that such a large reduction in government demand will again damage growth going forwards.

With productivity growth still non-existent and GDP weakening extreme cuts are the last thing our economy (along with the working people whose living standards depend upon its performance) needs. As NIESR recognised “common factors....for example general demand weakness coupled with flexible wages, are likely to have been central in explaining the stagnation in UK productivity growth”.[3] With capacity still underutilised we need a stronger recovery to deliver productivity gains and this requires a boost to government demand as well as greater business investment and active supply-side reform.

Even those areas of spending which have the greatest impacts on wider demand remain depressed and look set to be hit hard, with public sector net investment (including infrastructure spending and house building) cut by nearly 50 per cent over 2009-2013 and (under current plans) stagnating going forward. Investment in areas vital for a better balanced and high productivity economy – further education, innovation and science – are also set to feel the weight of the Chancellor’s spending axe. Public services, which also have a vital role in play in supporting our economy (keeping our population healthy and educated as well as closing social inequalities), are being run into the ground. The childcare services which help so many families move into work are being closed down. Cuts in tax credits and in-work support, which redistribute the gains for growth to those on lower incomes, are leaving those on low pay even worse off with their spending power further depressed.

Within the constraints that government has set it, many feel the Bank of England has done what it can – keeping interest rates at rock bottom for years and retaining its quantitative easing programme. But by relying on monetary support for growth impacts have been less significant and more poorly targeted than a fiscal package would have allowed for. Prolonged access to cheap credit has also helped create asset bubbles which risk bringing little genuine benefit for the real economy, but are creating substantial future risks, particularly in the housing and financial markets.

As well fiscal policy which leaves too much of our economic capacity wasted, our economy is also hampered by the government’s failure to put in place the supply-side policy changes that would lead to genuine increases in our productive potential and to better balanced growth. Our industrial policy looks set to be pulled apart. The Green Investment Bank is left without borrowing powers, and is being sold off. Instead of measures to improve workforce engagement and boost collective bargaining, trade unions are attacked. Rather than reforming corporate governance to boost long-term investment, weak governance codes remain in place. Welcome increases in apprentice numbers are not matched by the quality guarantees that young people need. Young unemployed people are left without

[3] Riley et al, NIESR, 2015

the programmes that would give them a genuine chance of moving into paid work.

There is so much more that could be done to make sure that the productivity gains from growth maximised and that ongoing structural weakness are addressed, but too much of the government's plans take us back to the 1980s rather than towards the high investment, high value business models being followed by our international competitors.

With the right fiscal policy and better economic policies we could raise our productivity performance and create a sustainable basis for shared growth with better jobs and higher earnings. Inflation could get back to target with average pay growing well above it and action could be taken to make sure that as gains are generated working people receive their fair share.

The Chancellor thinks the solution to our economic problems is a new law requiring an annual surplus. But he is missing the point. On the biggest challenges we face – strong, sustainable, shared, high productivity growth - he has little to say.

We need a better plan that delivers high productivity, sustainable and shared growth

So what are the answers?

An immediate challenge is a better response to the public finances - the Chancellor's approach remains economic masochism. But the best and most effective way to balance the books is strong growth and a high productivity economy. We need to get debt falling as a proportion of GDP - but we need to do so in a way that doesn't remove our ability to address any of the wider, significant challenges we face and that doesn't undermine our capacity to grow strongly. Getting debt falling is reliant on sustained growth, and many voices (including the OECD) now argue this needs higher investment and a better fiscal approach.

The government also needs to recognise the key role that the right economic (as well as fiscal) policies can play in delivering vital productivity gains. All the evidence shows us that this needs very much more than simply getting out of the way. Cutting employment rights doesn't deliver productive workforces (indeed it may damage productivity outcomes[4]) - particularly when the challenges of competing globally across the next century will depend on us recognising that employees really will be businesses' greatest assets. Some of our greatest industries have some of the county's strongest union agreements – the UK's automotive sector is in the ascendency because of its workforce, not in spite of it, and unions within the automotive companies have contributed to the success the sector has enjoyed. We need fair treatment at work and increased employee voice, not reductions in vital employee protections.

[4] http://cep.lse.ac.uk/pubs/download/special/cepsp31.pdf

Well funded public services also have a key role to play. Enabling parents to undertake decent jobs relies upon high quality and flexible childcare. Making sure that young people – whether they go to university or not – have the skills they need to deliver productivity gains needs increased investment in education. Excellent health services support more disabled people to get into and stay in work.

Action is further needed to ensure that when gains are achieved they are fairly shared.

Firstly this means doing more to create more better quality jobs. Active industrial strategy can help grow our high value industries. Setting higher standards can incentivise employers to create higher skilled positions. Significant increases in the NMW, and acting to secure higher minimum rates in sectors where they can well be afforded, can improve pay and drive productivity gains, as can decent employment rights.

We will also always need action to redistribute growth's gains across society. Where high value industries generate significant wealth, we need to make sure that tax system shares those fairly. Where pay alone cannot provide the basis for decent living standards, the state needs to step in and support incomes.

These measures – more better jobs and fair taxation - are not just a matter of social equity. As IMF research has shown, rampant inequality is bad economics. Without stable and growing household incomes, a society where everyone's talents can be put to best use, and an economy where we maximise the share of high productivity jobs available, future growth will remain at risk.

The government could act now to deliver the jobs and living standards that working people need. But the current plan is not working. With a different fiscal and economic policy approach high productivity, fairly shared growth can be achieved. Now is the time for the Chancellor to change direction and make sure it is delivered.