Budget 2016

TUC budget statement

Budget 2016: a TUC budget statement

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Section one

Introduction

In 2010, as the economy was emerging from what the Chancellor described as the "longest and deepest recession in living memory" George Osborne set out[1] his analysis of the challenges facing British policy makers. He described a UK economic model based on debt (in his view both public and private) and imbalance, and made the case for change.

While the TUC has consistently opposed the Chancellor's assertion that public debt was a cause rather than a consequence of the financial crash, we also recognise that his wider analysis identified a number of significant economic concerns: soaring asset prices, low investment and saving, high private debt, low exports, a persistent current account deficit, a fall in living standards and regional and industrial imbalances.

However, our key point of disagreement is with the Chancellor's view that government stands in the way of delivering balanced and sustainable growth. Contrary to his position, the TUC understands that government has a vital role to play in securing such a recovery, through more supportive fiscal policy as well as wider supply-side policy measures.

In the years since 2010 the global and UK economy alike have moved forward only fitfully; no decisive momentum has been achieved. The Budget approaches against the backdrop of a slowing world economy and resumed volatility in financial markets. The OECD and IMF have both recently sounded the alarm and called for an urgent policy response.

Fiscal consolidation aimed at reducing the role of the state has also proved detrimental to overall economic conditions. Economic expansion over the past five years has fallen around £140bn – nearly a third – short of expectations.

Productivity and wages have been depressed, and expansion has been heavily reliant on the same imbalances as under the pre-crisis model. The cumulative effects of restrained activity is now obvious in price data, with the economy experiencing disinflation for four years.

[1] In his 'Mais' lecture of February 2010. http://www.totalpolitics.com/print/speeches/35193/george-osborne-mais-lecture-a-new-economic-model.thtml

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The consequences for working people have been significant, both in terms of the quality and security of work, reduced standards of living and withdrawn public services and welfare support. And our fear is that rather than long-awaited improvements, the years ahead will hold even greater concerns. Given the latest weakening of economic conditions, projected improvements in the public finances once more are unlikely to materialise in full and the Chancellor has in the meantime indicated that he will review existing spending plans. But in spite of repeated rounds of public spending cuts, the public debt crisis is further than ever from resolution. There is now a danger that persistent disinflation turns into outright deflation, bringing even poorer prospects for living standards in the period ahead.

Seemingly discarding policy doctrine that they have previously supported, the OECD now argue that increasing public investment will support future growth and improve the sustainability of public finances. The broader implication is that a new policy approach would not only be fairer and better for working people, but for economic conditions more generally, including for the public finances.

The TUC Budget Statement therefore sets out an interpretation of current economic events and social conditions (Section 2), and then makes a series of recommendations for a stronger economy (Section 3). We hope the Chancellor will take this opportunity to recognise that delivering against his aspirations for a better balanced economic model will need both more supportive fiscal policy alongside wider policy change.

Summary of recommendations

The Budget is set against the backdrop of growing fears in financial markets and worries about the strength of the global economy going forward. The OECD in particular is calling for expansionary policies coordinated across countries to revive demand, as protection against deflationary forces. In line with previous TUC reports, the OECD now emphasise not only that spending cuts might be harmful to the public finances, but that spending increases should improve the public finances by strengthening the economy.

The policies outlined in this submission therefore seek to act on supply and demand in tandem. They set out proposals for targeted increased government spending aimed to lift economic activity, alongside wider actions aiming to ensure that UK industry is well positioned for sustainable, balanced growth and to compete internationally in the future. Likewise actions aimed at improving the conditions of employment seek also to improve activity and prosperity.

The recommendations, which set out TUC priorities for action, are summarised below.

Infrastructure

- Commit to an immediate infrastructure boost on the basis of a re-appraisal of the level of capacity in the economy and a clear target based on increasing investment as a share of GDP.
- Use expanded infrastructure investment to fulfil the Government's commitment to providing three million apprenticeships by 2020

Wages

- Equalise the national minimum wage for young people aged 21-24 and ensure that minimum wage rates for workers under 21 grow at least as fast as rates for adults.
- Lift the one per cent public sector paybill cap.

Public services

- Reverse the planned cut to local government grants.
- Lift the cap on the Housing Revenue Account spending in order to revitalise social housing stock.
- Commit to sufficient funding of health and care services.
- Municipalise local bus services, along the lines of the London model.

Industrial strategy

- Introduce an urgent, comprehensive rescue package for British steel.
- Deliver a long-term roadmap to increase UK investment in research and development to three per cent of GDP.
- Implement a sustainable, modern industrial strategy, with responsibility shared between both the Department for Business, Innovation and Skills and the Department for Energy and Climate Change.
- Develop industrial roadmaps that both meet the UK's economic and industrial needs, at both regional and sectoral level, and put the UK on track to meet its commitments to CO_2 reduction under the Paris Agreement.
- Introduce vital borrowing powers for both the British Business Bank and the Green Investment Bank and roll back on privatisation of the Green Investment Banks.
- Give specific consideration to how best to pursue the development of Carbon Capture and Storage technology.
- Allow biomass to compete in this autumn's Contracts for Difference (CfD) auction, to award CfDs on a whole system cost basis and to give biomass conversion the same length contracts as other renewable technologies.

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- Ensure sufficient funding for further education, and pay attention to the needs to the needs of industry, and the value of involving employees in planning skills training.

Banking reform

- Conduct a review of the implementation of the ICB's proposals to ensure that the UK develops a strong and robust banking system capable of servicing the wider economy.

Corporate governance

- Reframe directors' duties so the promotion of long-term success is the primary aim. Serving the interests of investors should be secondary to this central aim, as is the case for the other stakeholder groups included in Section 172 of the Companies Act 2006 (employees, suppliers, customers and local communities).
- Legislate so that shareholders' corporate governance rights in companies should be subject to a minimum period of shareholding of at least two years.

Pension saving

- Move to a system of flat rate tax relief at around 33 per cent in order to support low and middle income earners to save.

Opportunities for young people

- Introduce a Job Guarantee for long-term unemployed young people.
- Consult on the development of a new youth employment and skills service.
- Introduce a right to fixed hours contracts for workers who work regular hours and mandate that workers on irregular or intermittent hours be paid an allowance to reward the flexibility they provide to employers.

Fairness in the workplace

- Abolish employment tribunal fees so that statutory employment rights are effective in delivering the intended benefits for individuals, the economy and wider society.
- Provide a significant increase in funding for labour market enforcement to prevent exploitative working practices and to ensure core labour standards like paying the national minimum wage are observed.
- Withdraw the Trade Union Bill.

Section two

The shape of the UK economy

Introduction

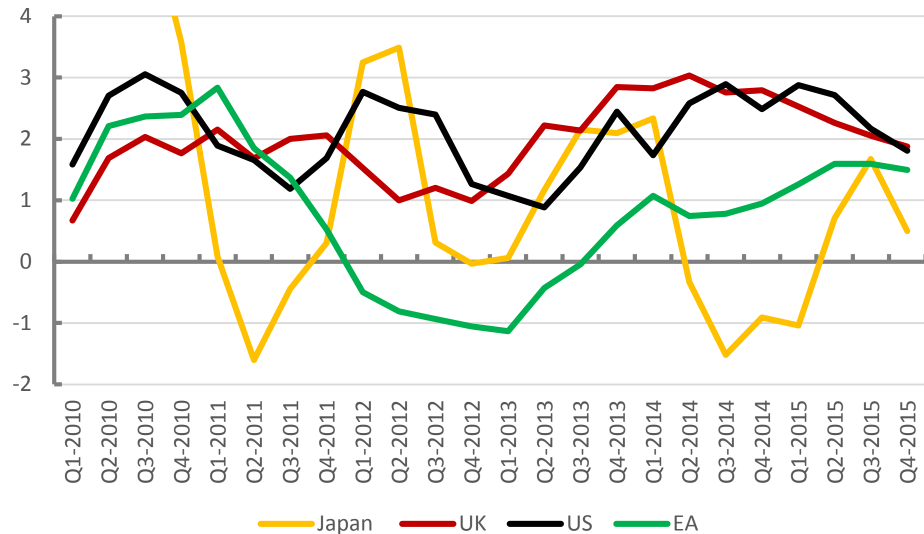
After a brief revival over 2014 and 2015 economic conditions have deteriorated. This is particularly apparent on the nominal economic figures that express outcomes in current prices (i.e. not adjusting for inflation). Weak growth in these aggregate incomes is already feeding back to resumed lower earnings growth for workers. What's more, lower corporate and household incomes mean lower tax revenues and consequently projected gains in the public finances are unlikely to materialise. Despite evidence to the contrary, domestic policymakers continue to interpret these outcomes as driven by flaws on the supply side of the economy rather than as a result of reduced demand, and hence hold back expansionary actions (in particular government spending). But in doing so they risk allowing disinflationary conditions to continue, which looks set to weaken future growth.

GDP growth and the world economy

Over 2015 GDP growth slowed in most countries, and a renewed downswing is now evident. Chart 1 shows how fitful and erratic growth has been across the whole post-crisis period in major economies. Newly issued OECD forecasts for 2016 show global growth no stronger than 2015, "itself the slowest pace in the past five years … Growth is slowing in many emerging economies with a very modest recovery in advanced economies and low prices depressing commodity exporters".[2]

[2] *OECD Global economic outlook and interim economic outlook* http://www.oecd.org/eco/outlook/economicoutlook.htm., February 2016

Chart 1: Major economies, four quarter percentage growth

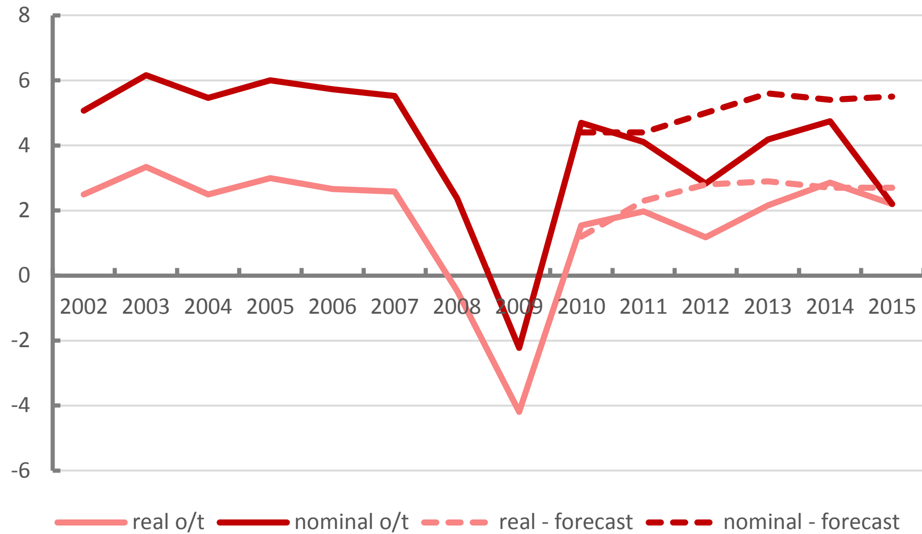


These dynamics correspond broadly to policy setting. The financial and economic crisis of 2008-09 was brought to an end through expansionary policies; when these were withdrawn, the economy slowed. From 2012 policymakers again applied stimulus, not least the Federal Reserve's third programme of quantitative easing in the US, and the various monetary initiatives and then later increased government spending in the UK. With this stimulus withdrawn, renewed weakness is unsurprising.

In the UK, outcomes have fallen well short of the expectations set out in the June 2010 Budget, when the government's strategy was announced.[3] Chart 2 shows outcomes for GDP growth against Office for Budget Responsibility (OBR) forecasts in both real and nominal terms. With official figures for 2015 recently published for the first time, outcomes can now be compared with the full span of the original OBR forecast which extended to 2015.

[3] Usually outcomes are assessed in real terms, with distortions from price change removed. This is done with the GDP deflator that captures price change across the economy as a whole rather than the CPI that is based only on consumer prices. Under present conditions it is useful also to look directly at nominal figures that are not adjusted for price.

Chart 2: UK GDP, four quarter percentage growth



The dotted lines show the OBR originally forecasting growth in 2015 recovering to pre-crisis rates. But outturns (o/t) fell short, especially over 2012 and 2013; in 2014 real growth was marginally higher than expected, before the gentle slowdown into 2015 (leaving actual performance a little below forecast). In nominal terms the differences are more marked, especially in 2015. Nominal GDP growth has only been slower on two occasions since the Second World War; through the recent financial crisis and a one-off occasion in 1958.

The difference between the two measures of GDP results from the wider and ongoing reduction in price inflation pressures, i.e. 'disinflationary' tendencies. In 2015 the GDP deflator was 0.3 per cent, echoing the behaviour of consumer prices (prices are discussed more fully in section 6).

The result of this divergence is GDP in cash terms has increasingly fallen short of the expected path. The cumulative effect is a shortfall of nearly £140 billion or one third; GDP was expected to rise by £447 billion between 2010 and 2015; instead it rose by only £308bn.[4] Nominal growth rates matter, both for secure living standards and government revenues. It is only with cash gains that households achieve greater security over the future value of their wages. Similarly, in the medium-term government certainty over its ability to fund services requires higher cash revenues. Exceptionally low inflation is not a secure basis for protecting living standards or government spending going forwards.

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[4] These figures are derived on the latest definitions of GDP, and so the expected figure is projected using 2010 growth estimates with the current estimate of the level of GDP in 2010.

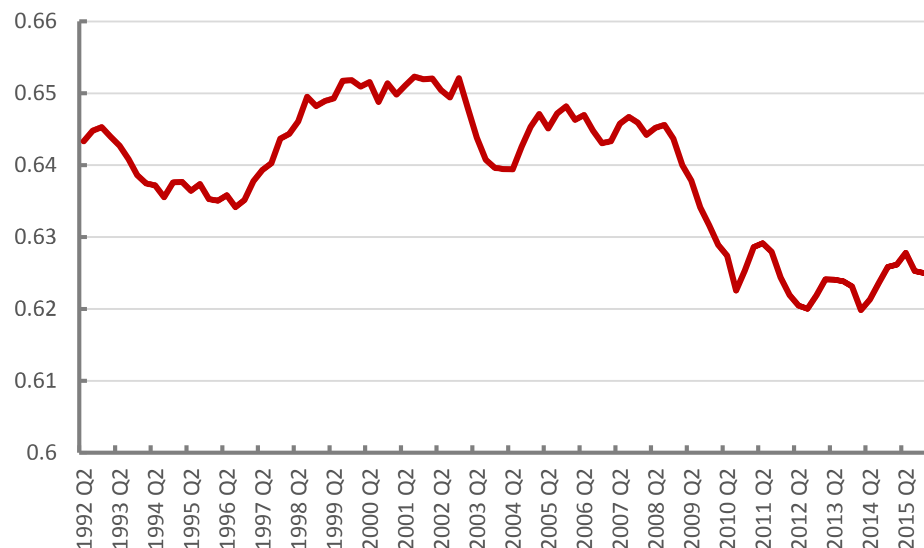
Employment, earnings and income

The response of the labour market to these economic conditions is both unprecedented and paradoxical. At face value employment gains have been strong, but these are set against a severe and prolonged fall in real wages. Normally strong growth in jobs is associated with rising earnings.

The employment rate in 2015 was 73.7 per cent, the highest on ONS figures that extend (in present form) back to 1971. At 5.4 per cent the unemployment rate is just above the rate in 2007 ahead of the crisis.

While these headline figures are positive, a deterioration in the quality of work is apparent on a number of measures. Chart 3 shows the share of jobs that are full-time employee posts.

Chart 3: Share of full-time employee posts



The shortfall of around two percentage points corresponds to around 600,000 full-time jobs. While the share improved a little over 2014, this improvement came to an

end from the middle of 2015.[5] The TUC also estimate underemployment at 3.3 million, up 900,000 on the position ahead of the crisis, and ONS statistics continue to report the prevalence of zero hours contracts increasing rapidly; for October-December 2015 the number of workers on zero-hours contracts had increased by 15 per cent to 801,000 over the previous year. [6]

Conditions in the public sector are obviously even tougher. A total of 337,000 posts have been lost over 2010 to 2015 (excluding the effects of major reclassifications), a total drop of seven per cent.[7] TUC analysis has also shown how these losses have been disproportionately light in London. The North East and Wales have seen the largest (relative) falls in public sector employment, and have also faced the lowest gains in private sector jobs.

The other side of the headline gains in employment is the seven year decline in real earnings over 2008 to 2014. The modest revival in 2015 was driven as much by the reduction in inflation as rises in nominal earnings; real earnings still stand 6 per cent below pre-crisis level (discussed further below).

The behaviour of the labour market needs to be understood in the context of the economy as a whole. On the income perspective, GDP is derived as the sum of compensation of employees and profits[8] – corresponding to the payments to labour and capital as the factors of production.

Using the same approach as previous TUC work,[9] growth rates and the composition of nominal GDP are compared across pre-and post-crisis episodes.[10] Average annual GDP growth declined to 3.9 per cent after the crisis from 5.7 per cent before. This

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[5] TUC *TUC economic quarterly, June 2014* https://www.tuc.org.uk/sites/default/files/June%20Economic%20Quarterly-%20final%20pdf_1.pdf , 2014

[6]ONS *Contracts with no guaranteed hours 2015* http://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours/articles/contractswithnoguaranteedhours/2015-09-02 , 2016

[7] ONS *Public sector employment September 2015* *http://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/publicsectorpersonnel/bulletins/publicsectoremployment/september2015#total-uk-public-sector-employment* , 2016

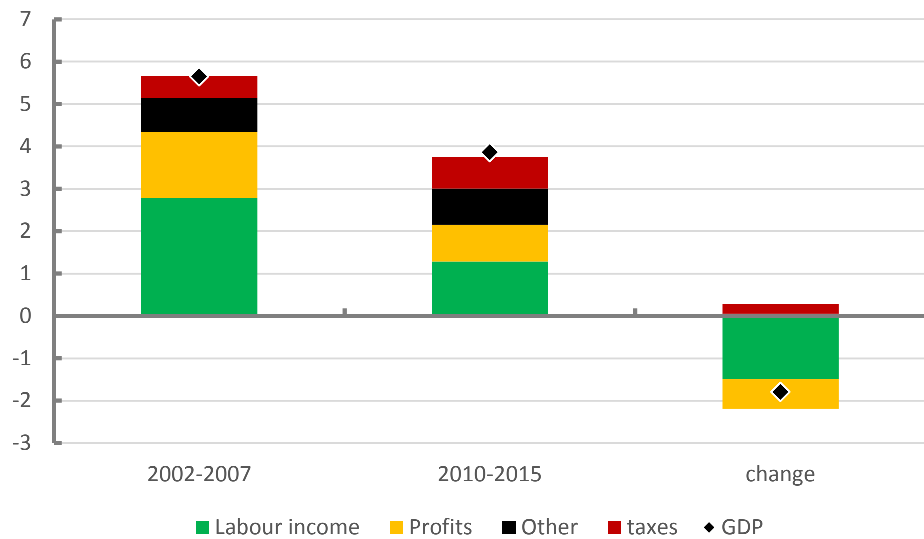
[8] Strictly wages and salaries, employers' contributions in to pension schemes, gross operating surplus and rental income of corporations, mixed income (including earnings from self-employment) and taxes.

[9] e.g. 'The price of austerity', https://www.tuc.org.uk/sites/default/files/ThePriceofAusterity.pdf

[10] This decomposition is published only in nominal terms, but this is also the relevant perspective when considering for example the public finances, with tax revenues depending on the strength of the economy in nominal or cash terms. 'Pre' is defined as the six years over 2002 to 2007, and 'post' the six years over 2010 to 2015.

reduction of 1.8 percentage points a year was shared relatively evenly between labour income (two thirds) and corporate income (a third). (Though labour was marginally disadvantaged given it actually accounts for 60 per cent of the economy.)

Chart 4: GDP income, average annual growth percentage points



Rather than a significant shift in how the rewards of growth are shared, the main action has been within the labour income component. Labour income corresponds to the total amount of earnings from employment, so the growth in labour income can be approximated as the sum of employment and earnings growth. This is shown in Chart 5, which shows that the whole of the shortfall in labour income is seen to be accounted for by earnings, with employment growth ahead of and after the crisis virtually unchanged at one per cent a year. The labour market has adjusted to lower economic growth wholly through price (wages) rather than quantity (employment).

Chart 5: Labour income, average annual percentage growth

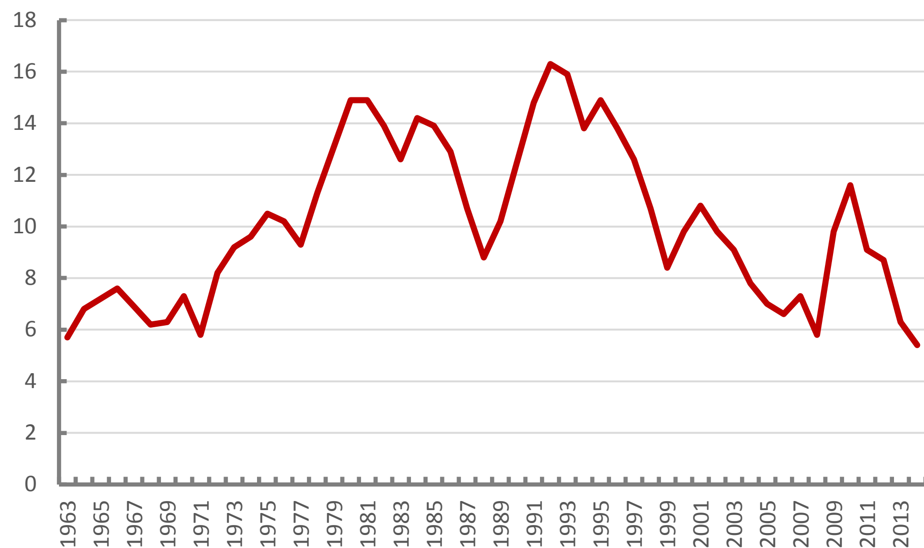
Overall, the sum of the parts of employment gains and the earnings shortfall is a net loss: annual growth in total labour income has been reduced.

Living standards and household finances

The scale of these changes should not be underestimated. From the perspective of earnings alone, TUC analysis has shown that the falls in real earnings are unprecedented on records that extend back to the 1850s. Even if real earnings expand at the pace expected by the OBR in November (now very unlikely), real earnings will have been below their pre-crisis peak for a total of eleven years; the only episode that is remotely comparable is through the 1920s into the great depression.

This sustained fall in earnings has meant obvious additional financial pressures on households. In their June 2010 Budget document, the Treasury warned that "By 2008, the household saving ratio had fallen to the lowest levels since the 1950s". On present trends the saving ratio in 2015 is likely to come in at the level of 2008 or potentially lower.

Chart 6: saving ratio, per cent of income



Ahead of the crisis, while income growth fell short of spending growth the difference was modest and the prolonged reduction in the saving ratio fairly gradual. Since the crisis, even though consumer spending growth has been lower, very low disposable income growth has meant a sharp and rapid reduction in the saving ratio.[11] The table contrasts the two most recent episodes of saving ratio reduction shown on the chart, and also the brief reversal during the crisis period.

Table 1: Household spending, income and saving

	1991-2007	2007-09	2010-14/15	*Post–pre* crisis
	Average % change p.a.			
Income	5.4	3.9	3.0	*-2.4*
Spending	5.7	0.8	4.1	*-1.6*
difference	*-0.3*	*+3.1*	*-1.1*	*-0.8*

The effects are two-sided. On one hand households are putting less aside for the future, on the other there is now evidence of resumed higher borrowing on credit. Bank of England figures show consumer credit growing at its fastest rate for a decade. Work for the TUC by the Centre for Responsible Credit shows significant pressures from debts on unsecured borrowing. The burden of indebtedness is highest for those on the lowest income, with 3.2 million or one-in-eight households reckoned to be over-indebted.[12]

[11] The figure for 2015 is based on a projection for income into Q4.
[12] TUC *Britain in the Red provisional report,*https://www.tuc.org.uk/economic-issues/britain-red-provisional-report, 2015

Productivity, supply and demand

The unprecedented behaviour of the labour market is an important factor in the exceptional behaviour of productivity over recent years. In its simplest terms, productivity growth is measured as economic output over employment. As chart 6 shows, with post-crisis economic growth lower than pre-crisis growth, but employment growth holding up, productivity has been reduced.

Chart 7: annual average productivity growth, per cent

The position is often presented by comparing the level of recent outcomes with pre-crisis trends; on this basis productivity has been as far as 17 per cent down (see e.g. TUC, 2015a). [13]

Government approaches to date have broadly regarded the figures as indicative of structural or 'supply' weaknesses with the economy. Undoubtedly there are a number of such shortcomings, most obviously a financial sector that is orientated towards speculative rather than productive activity and an absence of any strategic approach to industry, investment, regions and skills. Given persistent economic underperformance since 2010, it is also likely that existing problems have been exacerbated.

But in large part, productivity is consequence rather than the cause of wider economic outcomes. TUC (2015b)[14] explained this result in two stages, first the higher-than-expected impact of spending cuts on economic growth, and second (as above) the way the labour market adjusted to reduced growth.

When they outlined their consolidation plans, HM Treasury recognised that "*direct and indirect effects*, from reduced public spending or increased taxation … will tend to reduce demand growth in the short term" (Budget, June 2010, Box 1.3). But they argued that "*wider economic effects*, which depend on the reaction of the private sector and monetary policy to the changed fiscal environment … will tend to boost demand growth, could improve the underlying performance of the economy and could even be sufficiently strong to outweigh the negative effects". But in reality the rebound of private sector activity was insufficient to compensate for the reduction in public spending.[15] As a result, GDP growth slowed.

As discussed in section (3), the labour market adjusted to weaker economic growth through earnings. So the productivity calculation sets weaker GDP growth against disproportionately strong employment growth.[16] Productivity is therefore a symptom of the wage adjustment, rather than its cause. The same outcome is common to

[13] TUC (2015a) *Building a secure high productivity economy*, p. 2. https://www.tuc.org.uk/economic-issues/public-spending/budget/spending-review-must-focus-bigger-economy-not-smaller-state, 2015

[14] TUC (2015b) *Productivity: no puzzle about it.* https://www.tuc.org.uk/sites/default/files/productivitypuzzle.pdf

[15] Alternatively stated, the OBR assumed a too small multiplier effect of government spending on the economy. While the supply side has been debated *ad nauseam*, debate about multipliers remains virtually non-existent.

[16] The demand argument has become synonymous with the implausibility of prolonged labour hoarding; this neglects the point that labour hoarding has only been made possible by wage adjustment.

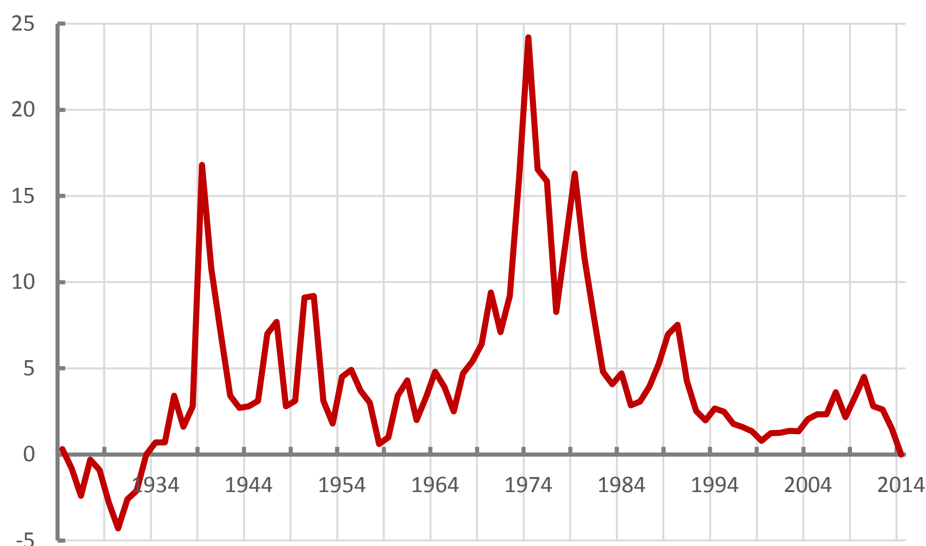
nearly all OECD countries that made spending cuts, with most also seeing a disproportionate adjustment on wages (TUC, 2015b).

The policy implication is that sustained action to revive demand should also result in an increase in productivity (as labour market performance strengthens and earnings rise more strongly in response). But the same analysis has a wider bearing on the interpretation and outlook for inflation outcomes.

Disinflation

If the economy had been subject to a material deterioration on the supply side, upwards pressure on prices would surely by now be apparent (as reduced capacity would limit output and drive up prices). Indeed in the early years of the coalition government, above-target inflation was deployed to dismiss demand arguments. But higher inflation was short-lived and from 2012 the economy has been on a permanently disinflationary trajectory.

Chart 8: CPI inflation on a long historic view



On a calendar-year basis, inflation was zero per cent in 2015, the lowest annual rate since 1933, towards the end of the great depression. This outcome corresponds straightforwardly with the view that there has been a sustained and material deficiency of demand. This has meant that capacity has been left under-utilised, a process that is cumulative in effect. (In technical terms, there is now a large negative output-gap.)

But policymakers continue to avoid this perfectly standard and conventional conclusion, explaining disinflation instead as a result of oil and other commodity prices and also the sterling exchange rate. These conditions however reflect deflationary forces on a global basis, which are increasingly widely understood as driven by demand.

For as long as demand-driven weakness is attributed to supply, policymakers rule out expansionary action. The risk is of disinflation turning into outright deflation. Already short-lived increases in earnings growth have been reversed, likely as a result of lower inflation factored into earnings settlements. The repercussions look set to feed through again to living standards, government revenues and price inflation.

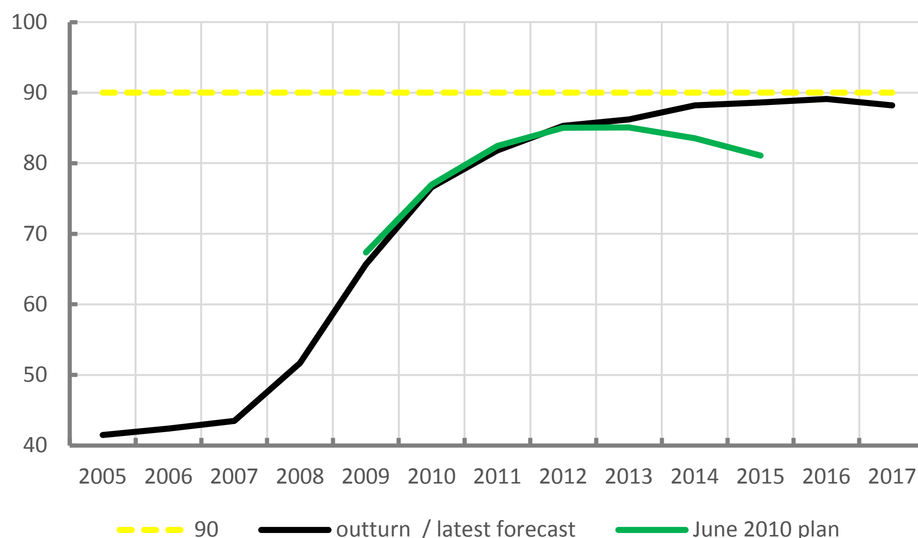
The public finances

Even in the brief period since the spending review, it is likely that the outturn for public borrowing in the current financial year will fall short of the latest OBR forecast. Once more government revenues have weakened as incomes have fallen short of expectations. Total revenues grew by 7.6 per cent in the year to 2014Q4, but slowed to 0.9 per cent in the year to 2015Q4.

In terms of public sector finance aggregates, the central goals of policy have not been achieved. Whatever the exact outcome for the deficit this year, at around £80bn it is basically four times higher than expected in 2010. The cumulative shortfall in the budget deficit against June 2010 plans is likely to be around £170bn. This shortfall has meant that public debt has continued to rise to a roughly corresponding extent. On the Maastricht definition, for which consistent and up-to-date figures are available, debt was meant to fall into 2013; instead on the basis of the latest EU projections of UK public debt, rates do not fall until 2017.[17]

Chart 9: Public debt, per cent of GDP

[17] The June 2010 OBR forecast for financial years has been pro-rated onto an annual basis.



After the financial crisis policymakers around the world took their cue from the work of Kenneth Rogoff and Carmen Reinhart. Their 'growth in the time of debt' analysis set an explicit threshold of 90% of GDP above which a significant deterioration in economic conditions was observed.[18] But the results of practical experience are the reverse of their theory.[19] With public debt in 2016 forecast at 89.1 per cent of GDP, the actions aimed at bringing the public finances under control have instead caused economic conditions to deteriorate so that debt has ended up virtually at the threshold that motivated policy in the first place.

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[18]The National Bureau of Economic Research *Growth in a time of debt* http://www.nber.org/papers/w15639, 2010

[19] The empirical analysis has also been refuted, see e.g.: Bloomberg Business *FAQ: Reinhart, Rogoff, and the Excel Error That Changed History* http://www.bloomberg.com/bw/articles/2013-04-18/faq-reinhart-rogoff-and-the-excel-error-that-changed-history

The impact of public spending cuts

The impact of spending cuts on public services has been significant. The IFS has calculated that spending across unprotected areas (i.e. outside health, schools, overseas aid and defence) will have fallen by about a third in real terms between 2010-11 and 2019-20[20]. Local government has borne a particularly heavy burden, with a 37 per cent funding cut in real terms between 2010/11 and 2015/16[21] and a further real terms cut in grant funding of 24 per cent over the spending review period to 2019/20[22].

Even in 'protected' areas such as the health service, funding has failed to keep pace with demand arising from a growing and ageing population with increasingly complex health needs and escalating costs of treatment. The Nuffield Trust estimates that cost pressures in the NHS are growing at around 4 per cent a year, yet government funding increased at around 0.9 per cent a year under the coalition and is set to rise by slightly over 1 per cent over the next five years, a sharp contrast to historical annual increases closer to 4 per cent.[23] This has led to a growing financial crisis within the NHS.

While many public sector providers have demonstrated great agility under pressure and public service workers have worked hard with management to maintain service quality, the 'achieving more for less' mantra cannot disguise the impact that cuts are having on service quality. In a survey by the Kings Fund, over half (53 per cent) of NHS Finance Directors claim that services have worsened in the last 12 months as a result of financial pressures. And performance metrics across the health service support this, with negative impacts in key target areas such as waiting lists, A&E waiting times, cancer treatment times and delayed discharges.

[20]The Institute of Fiscal Studies, *Summer Budget 2015,* http://www.ifs.org.uk/tools_and_resources/budget/505, 2015
[21] National Audit Office *Impact of funding reductions on local authorities*, p6, 2014
[22] Local Government Association, *LGA responds to 2015 spending review,* http://www.local.gov.uk/spending-review/-/journal_content/56/10180/7586753/NEWS, 2015
[23] Roberts, Marshall and Charlesworth *A Decade of Austerity – the funding pressures facing the NHS from 2010/11 to 2021/22*, The Nuffield Trust,2012

New research by Howard Reed of Landman Economics (commissioned by the TUC), shows cuts having the biggest impact on those on low and middle incomes.[24] Chart B1 shows that the total impact of spending cuts is largest in cash terms for the 4th and 5th deciles, amounting to over £1,500 per year. Average cuts in cash terms are smallest for the top two deciles (at less than £1,000) mainly because these richer households receive relatively little publicly funded social care.

[24] The analysis shows the distributional impact of spending cuts announced in the Spending Review for 2015 - 2020 (excluding social security measures) expressed in annual cash-equivalent terms, across the distribution of net income (by household income decile).

Chart B1: Annual cash value impact of cuts to spending on public services 2015-2010 by household income decile

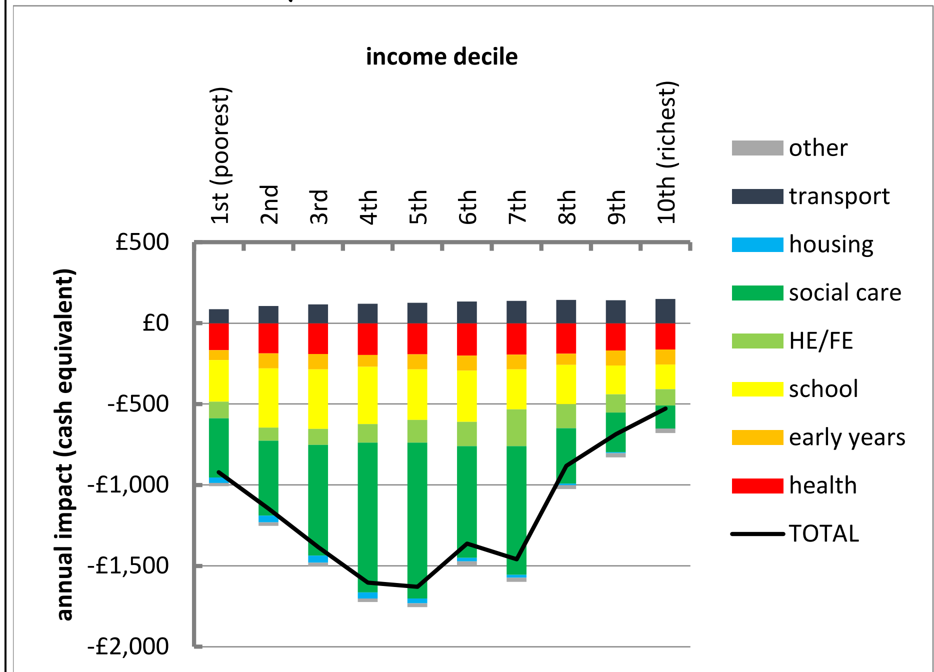
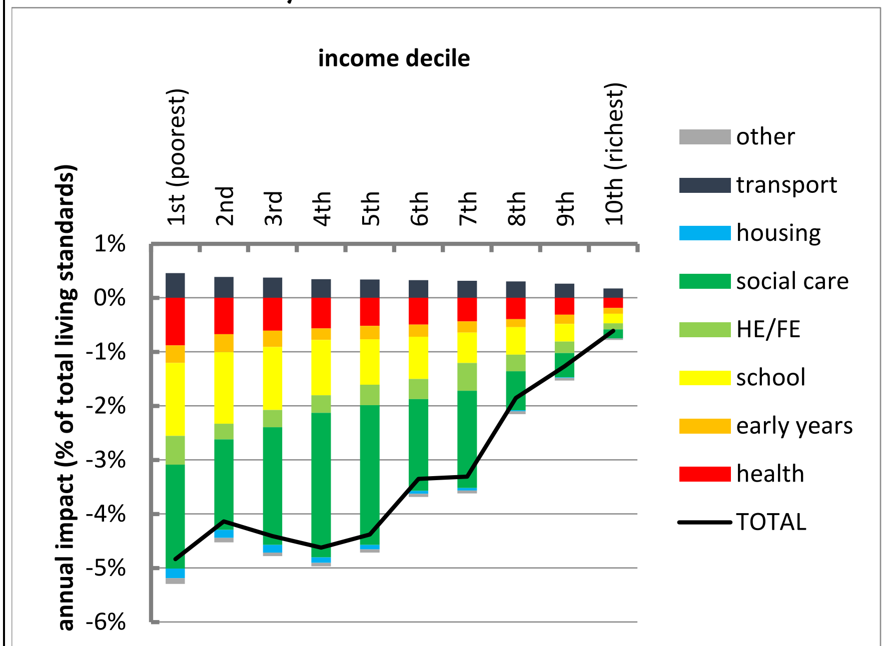


Chart B2 below shows the same information as a proportion of total household living standards.[25] These figures show spending cuts are *regressive*: the lowest income decile are set to experience an average reduction in living standards of around 5 percent, while the 2nd, 3rd 4th and 5th deciles experience reductions of around 4.5 percent. Meanwhile, average losses for the top decile are less than 1 percent of living standards. This regressive impact is seen for all of the spending categories.

[25] Defined as household disposable income after taxes and social security payments, *plus* the value of in-kind public services.

Chart B2: Annual cash value impact of cuts to spending on public services 2015-2010 by household income decile



Cuts have also exacerbated regional inequalities. Councils in the top 10 per cent most deprived areas have had an average cut of £228 per person compared to £45 per person in the top 10 per cent of least deprived councils.[26] The government's proposals to reform local authority funding through the replacement of grant funding with 100 per cent retention of business rate and council tax growth may lead to even greater inequalities.

Private debt and other imbalances

[26] University of Sheffield Political Economy Research Institute, *Study examines impact of local authority budget cuts on election results*, https://www.sheffield.ac.uk/news/nr/budget-cuts-election-impact-1.387712, 2014

In the private sector there has been renewed reliance on the imbalances that the government sought to resolve. Most obviously, growth has remained severely skewed to the service sector. Over 2010 to 2015 manufacturing has been virtually stagnant, growing by only 0.1 per cent a year and still 5.9 per cent below its pre-crisis peak. In contrast the service sector grew by 1.9 per cent a year and is 12.5 per cent above the previous peak. Correspondingly, while all regions and nations have benefitted from growth in the economy and the expansion in employment, activity has become increasingly skewed towards London – which now accounts for 22.5 per cent of the UK economy, up from 20.4 per cent in 2010.

On specific macroeconomic factors, in the June 2010 Budget the Treasury identified a number of imbalances around excessive reliance on consumption and deteriorating productive activity. But these imbalances have generally worsened and are at best unchanged. The Treasury observed that "between 1997 and 2007 business investment fell from 11¾ to 10 per cent of GDP". In 2015 business investment was 9.6 per cent of GDP. Likewise: "The current account deficit was 2¾% in 2007, a figure that was flattered by a 2 ¼ per cent surplus in financial services". In 2014 current account deficit was 5.1 per cent of GDP, flattered by a 2.5 per cent surplus on financial services.

On household excess, the Treasury warned of a lack of saving and reliance on debt. They observed "By 2008 … household debt had risen to 100 per cent of GDP, as households borrowed heavily to purchase increasingly expensive property" (para 1.2). In spite of this, the government's main expansionary initiatives have been aimed at the housing market. House prices have been re-inflated even though they are already out of reach of many, with the situation in London rightly described as a crisis and there have been associated repercussions on rental prices. While there was a revival in housing construction, growth rates hit a peak in 2014 and activity flat-lined over much of 2015.

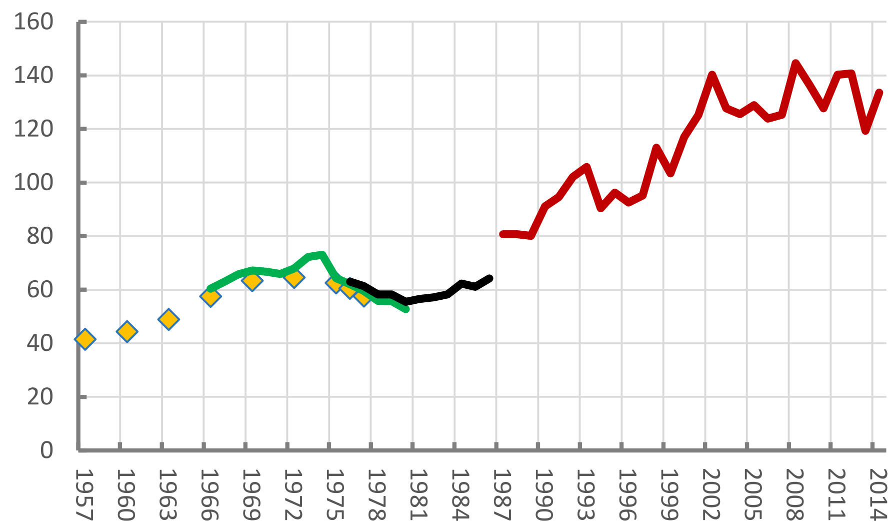
Conversely while bank lending to housing and property-related initiatives have been relatively vigorous, lending to the rest of the economy has remained stagnant really since the financial crisis.[27]

And fundamentally the problem of private indebtedness that the Chancellor identified as the critical factors behind the economic crisis does not appear to have been resolved. While the household debt burden was reduced to 92.5 per cent of GDP in 2014, it rose again in 2015 and, as is widely recognised, the OBR have it breaching 100 per cent again in 2019 to end up at 102 per cent of GDP in 2020.

[27] The new economics foundation show the credit stock of non-financial firms falling steadily as a share of GDP since 2009.See New Economics Foundation *Why you can't afford a home in the UK*, https://medium.com/@neweconomics/why-you-can-t-afford-a-home-in-the-uk-44347750646a#.q00kkjvpq, 2016

Equally debts of corporations have remained seriously elevated. Again the Treasury observed “companies took on rising levels of debt, reaching 110 per cent of GDP by 2008”. Chart 9 shows the latest ONS figures in newly published historical context, with revisions seemingly moving figures for recent years well above 110 per cent and no real evidence of any deleveraging.

Chart 10: Corporate debt as % GDP



In their most recent (February) *Inflation Report*, the Bank of England discussed a widening of corporate bond spreads (the compensation that investors require for holding risky corporate bonds, instead of government bonds), especially for high-yield bonds (those issued by companies with lower credit ratings). The Bank report "Market contacts also report that concerns about the resilience of corporate balance sheets more broadly, given the increases in leverage in recent years, may have contributed to wider spreads" (p. 5).

Immediate prospects

These rising corporate interest rates follow as part of a broader deterioration in financial markets. While fears intensified in January, really markets turned in the middle of 2014. This shift coincided with the withdrawal of the Federal Reserve's third programme of quantitative easing; the recent volatility with the Fed's effort to start to normalise interest rates at the end of 2015. In the UK, FTSE is down around 13 per cent on its peak. Under disinflationary conditions, any turn around in interest rates is seriously amplified in real terms.

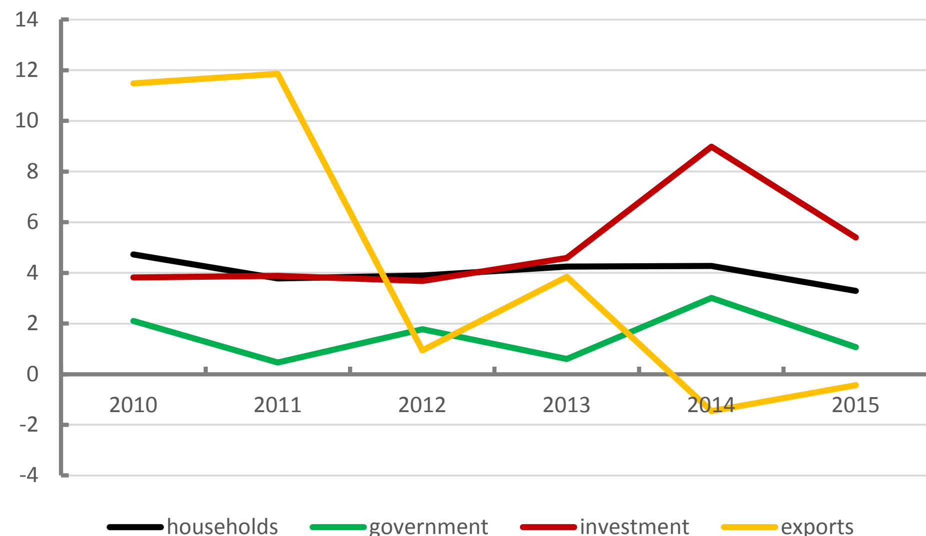
As discussed above, a slowdown in economic growth was apparent over 2015. In the labour market, however, employment growth continued to rise rapidly and for a while earnings growth began to gain pace. Employment growth has continued at an annual rate of around 2 per cent. But the revival in earnings has proved very short-

lived, peaking at only 3.1 per cent in 2015Q3 and down to 1.9 per cent in Q4. Moreover, given the slowdown in nominal GDP growth to 2 per cent, the implied labour income growth of close to 4 per cent seems unsustainable. For the moment profit growth has fallen sharply by 3.6 per cent in 2015Q4, but it is unlikely that firms will take a hit indefinitely before wider labour market impacts become apparent.

Pressures go beyond abstract figures to the real world. The UK steel industry has been crushed by low commodity prices and the consequent dumping of cheap product on the UK market by China. North Sea oil is under acute pressure. These industries are victims to a global deflation, at root caused by a severe deficiency of demand. In the meantime there must be wider pressures on banks' balance sheets, as domestic and foreign asset values deteriorate.[28] If the impact is large there will be repercussions on domestic lending conditions, and hence implications for the domestic real economy.

Even ahead of any such developments, it is difficult to see where forward momentum will come from. While the Bank of England argue that "private domestic demand growth is projected to remain resilient" (Feb. *IR*, p. 10), nominal figures suggest a fairly broad-based slowdown. Chart 5 of annual figures shows consumer demand slowing gently, the contribution from trade negligible, and investment and government demand slowing materially.

Chart 11: GDP expenditure breakdown, percentage growth



[28] In their December *Financial Stability Report*, the Bank of England observe "UK owned banks have material exposures to EMEs via direct lending to households and firms". See Bank of England *Financial Stability Report December 2015*, p18 http://www.bankofengland.co.uk/publications/Documents/fsr/2015/dec.pdf, 2015

Government demand, however, is particularly difficult to interpret and anticipate. The chart shows a clear surge in spending over 2014, and hence moderation in the government's original consolidation plans. Table 12 shows the outturn against plans for the last five years and then the evolution of the plans over the coming five years. [29]

Table 2: Government spending projections / policy: annual growth

	JUN10	OUTTURN		MAR15	JUL15	NOV15
2010	4.7	1.7	2015	0.4	-0.1	0.3
2011	-0.5	-0.1	2016	-1.6	1.3	1.3
2012	-0.4	1.0	2017	-2.0	1.1	2.0
2013	0.2	0.2	2018	-0.3	1.0	0.9
2014	0.1	3.5	2019	5.1	1.6	1.7
2015	0.9	0.3	2020		5.5	4.6
average	-0.2	1.2		0.3	1.2	1.5

Some clear moderation of spending cuts is evident, to the extent that there will be an increase in spending in each year of the current parliament (the figures however do not incorporate changes to benefit spend). But these are still very small annual increases relative to longer-term norms, and likely to be inadequate to arrest the ongoing disinflationary conditions let alone the threat of a more severe crisis.

[29] Averages are calculated excluding the last year as likely to be a fiction.

Section three

Recommendations for a stronger recovery

The following section sets out the TUC's recommendations in response to the recent weakening in growth, and ongoing imbalances in the recovery.

Infrastructure

With public spending now necessary to support aggregate demand, the most obvious priority is infrastructure spending. As the OECD recognises such spending has a high multiplier, so that there are major repercussions through the whole economy. While the government has expanded investment spending, as a share of GDP this type of spending will be lower this parliament than the last. The setting up of the National Infrastructure Commission is also a positive development, but there are real concerns about its scope and potential ambition.

Infrastructure spending operates both in the short-term through boosting demand, but also in the longer term through strengthening the supply side of the economy. Previous studies have shown the potential to create a permanent increase in GDP of up to 0.5 per cent.[30] The government should commit to an immediate infrastructure boost on the basis of a re-appraisal of the level of capacity in the economy and a clear target based on increasing investment as a share of GDP.[31]

There are many vital projects such a fiscal boost could support. These include:

- widening the government's investment in HS2 to better support regional regeneration;
- community energy projects and home energy efficiency schemes;

[30] National Institute of Economic and Social Research, *Macroeconomic impacts of infrastructure spending – report to Trades Union Congress,* p6, https://www.tuc.org.uk/sites/default/files/tucfiles/infrastructure_spending.pdf

[31] This should be based on a retrospective assessment of the output gap using more realistic estimates of multipliers for government current and investment expenditures.

- a full scale carbon sequestration programme for power and industry, focussed on CCS pipeline and storage infrastructure in key industrial regions;
- rolling-out ultra-fast broadband across the UK.

Housing could be another key areas for greater support. The commitment by the Government to creating 200,000 new homes over the next five years is welcome. However, the housing charity Shelter have estimated that 250,000 new homes are needed each year to address the current crisis. Shelter have estimated that every £1 spent on housing contribute around £3.50 to the economy.[32] An expanded program of house building would provide employment and skills to thousands, while also helping alleviate the housing crisis that is currently having a severely deleterious effect on families' lives, and impeding a more robust economic recovery. With local authorities likely to be in the lead, grants from central government should be supplemented by lifting the relevant borrowing caps.

Apprenticeships and infrastructure

In August of 2015 the Government made a commitment that any government contracts above £10 million would entail a clear commitment to apprenticeships.[33] A firm commitment to investment in infrastructure would therefore be the ideal way to secure the fragile recovery and improve the prospects of young people in keeping with the government's commitments.

The TUC has argued for decades for training levies and has consistently called on ministers to use levies to increase the number of apprenticeships in the UK. The government's target of creating three million apprenticeships is also a welcome move. But it will be important that investment in these new places does not come at the expense of wider further education services and that quality is given as much focus as quantity. The government has said it "will establish a new independent body, led by employers – the Institute for Apprenticeships – to regulate the quality of apprenticeships within the context of reaching three million starts in 2020." An independent Chair will be appointed to lead a small Board "made up primarily of employers, business leaders and their representatives."[34] The TUC is calling on the government to ensure that the interests of apprentices and the wider workforce are given a voice on this new body through the role of trade union Board members, as is the case with similar bodies in other European countries.

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[32] Shelter, *What are the solutions?* http://england.shelter.org.uk/campaigns_/why_we_campaign/the_housing_crisis/building_more_homes [last accessed 04/03/2016]

[33] Department of Business, Innovation and Skills, *PM unveils plan to boost apprenticeships and transform training,* https://www.gov.uk/government/news/pm-unveils-plans-to-boost-apprenticeships-and-transform-training, 2015

[34] Department of Business, Innovation and Skills, *English apprenticeships, our 2020 vision*, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/482754/BIS-15-604-english-apprenticeships-our-2020-vision.pdf p42, 2015

Wages

As discussed above, real earnings have seen an unprecedented decline. It is usual for wages to improve alongside economic growth, but pay growth has continued to lag behind forecasts.

It is obviously in the government's interest to ensure that earnings do not continue to undershoot their optimal path. A higher rate of sustainable pay growth would benefit employers as well as workers by strengthening demand – businesses need customers – and help the Treasury by improving the tax/benefit ratio.

The TUC supports the government's decision to implement a higher minimum wage. The negative effects predicted by some industries are overstated, since they take no account of the boost in spending power generated by the increase.

In recent years the government has also increased the budget for enforcing the NMW, but more will be needed in order to protect the greatly increased coverage of the statutory pay floor.

In addition, it will be important to ensure that younger workers are not left too far behind as the new rate rises. The National Living Wage rate should be extended to all workers aged 21 and above, and minimum wage rates for workers under 21 should grow at least as fast those for older adults.

More broadly, part of the key to improving wages for middle income workers in the private sector must be found in increased productivity. One shortcoming of the Government's 15-point productivity plan is that it does not engage with employees and their representatives. The TUC calls on the government to pilot a new initiative for employers, staff and their trade unions to work together to improve both productivity and pay.

Real earnings growth in the public sector has stagnated ever since the financial crisis, and living standards moved behind most private sector equivalents. This is the result of government pay policy, subjecting workers first to a pay freeze from 2010, and then to a one per cent paybill cap which is planned to continue for the life of the current parliament. In the meantime a number of public sector activities have been outsourced, often with a great reduction in expertise and experience.

Increasing public sector wages would be among the fastest ways to revive demand and also to restore some fairness for those who have had their pay held back for nearly a decade.

Public services

Increased investment in public services should be another government priority.

A productive economy requires high quality public services, and local authorities are well placed to take a lead in delivering innovative and high quality public services. However, their ability to provide these services has been hamstrung by the scale of cuts to local government. We are also particularly concerned that reforms to the

collection of business rates will lead to a race to the bottom and damage councils' ability to deliver vital services. Plans to replace the local government grant with council tax receipts risk penalising the poorest local authorities, who have a lower tax base. Reversing these cuts should be a fiscal priority.

Committing to sufficient funding for health and social care services is another area where a looser fiscal stance would pay dividends. Reliable healthcare is also key to economic success, with a direct impact on the ability of the population to participate in the workforce. While the front-loading of a significant proportion of the government's planned £10bn investment in the NHS announced in the Spending Review was welcome, it is becoming increasingly clear that funding over the course of the next five years is likely to fall far short of what is required.

The health service's ability to find the £22bn in efficiency savings in order to close the remaining funding gap, without hindering service quality, is questionable. Around three-quarters of savings found in the last five years have come through cuts to tariffs (the price paid to hospitals for treatments) and capping NHS workers' pay. But neither are sustainable in the long run.

Average yearly increases in NHS spending amount to around 0.9 per cent across this spending review period, compared to an historical average of 3.7 per cent[35]. Furthermore, the Kings Fund states that spending as a proportion of GDP will likely fall by 1 per cent by 2020[36].

Likewise, the ability for councils to add a two per cent precept to fund social care will raise much needed short term revenue but it is expected to raise £2bn by 2020, against a predicted funding gap twice that size[37].

To deliver an effective and integrated health and social care system that meets the needs of our changing population, the government needs to undertake a step change in investment bringing funding as a proportion of GDP in line with leading EU nations such as France and the Netherlands.

Poor quality housing also impacts on education and overall health, but in January the Local Government Association predicted that up to 80,000 council houses could be lost by the year 2020. By 2014 the number of people on local authority waiting lists was 1,368,312.38 Increasing reliance on the weakly-regulated private rental sector has

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[35] Nuffield Trust, King's Fund, Health Foundation, *The Spending Review: what does it mean for health and social care*, December 2015

[36] Appleby, J, *Response to the Spending Review,* King's Fund, 25 November 2015

[37] Local Government Association and Association of Directors of Adult Social Services, *Social care funding: 2014 state of the nation report*, October 2014

[38] DCLG *Live Table 600 Rents, lettings and tenancies: numbers of households on local authorities' housing waiting lists* www.gov.uk/government/statistical-data-sets/live-tables-onrents-lettings-and-tenancies, 2014

meant higher housing costs, insecure tenancies and more people living in housing that does not meet the official Decent Homes minimum standard.[39]

We therefore recommend for the government to lift the Housing Revenue Accounts cap, to allow local authorities to borrow more against their current stock in order to invest in the housing we need.[40]

Local economies rely upon bus networks that are essential for lower paid workers' to commute. However, in 2014 the National Transport Survey found that 63 per cent of local authorities had cut funding for local bus services. The Government's proposed Buses Bill is an opportunity to allow local authorities to set some or all of the fares and ticketing structures, specify a broad network or all elements of it, and determine the timetable and service standards. This could enable restoration of services cut under austerity and fund investment in new services.[41]

Industrial strategy

The UK urgently needs a modern, sustainable industrial strategy. An understanding of the UK's industrial strengths is essential. This needs to be coupled with a shared agenda for developing those sectors where the UK can remain competitive – sectors that are rich in research and development, have great export potential and can provide the well-paid, highly skilled jobs of the future.

An urgent, comprehensive rescue package for British steel should be a particular priority. This should include opposing Market Economy Status for China in the light of the alleged dumping of cheap Chinese steel in European markets, ensuring that steel companies in the UK pay business levies and energy costs that are comparable with competitor European nations, and using procurement policy to intelligently support UK steel within European rules. Large scale infrastructure projects, such as HS2 and Hinkley Point, should be required to use British steel

A long-term roadmap to increase UK investment in research and development to three per cent of GDP should be another priority, as recommended by the Business, Innovation and Skills Select Committee. Countries with strong industrial policies recognise that a sustainable industrial strategy should link to an overarching mission to strengthen science and innovation capability. For example, wind turbines in the North Sea can withstand wind speeds of 300km/h thanks to specialised plastics developed in the German chemical sector.

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[39] DCLG *A decent home, definition and guidance for implementation*, p14, www.gov.uk/government/uploads/system/uploads/attachment_data/file/7812/138355.pdf, 2006

[40] Trades Union Congress, *Addressing the housing crisis,* p16 www.tuc.org.uk/sites/default/files/Addressing%20the%20housing%20crisis%20-%20the%20next%20five%20years%20May%202015_0.pdf, 2015

[41] Transport for quality of life *building a world-class bus system for Britain,* p4 http://www.transportforqualityoflife.com/u/files/160120_Building_a_world-class_bus_system_for_Britain_FINAL1.pdf, 2016

Throughout economic history, industries have died and new ones have been born. The rise of the BRIC economies and players like Mexico and Indonesia means that in the future some UK sectors will no longer be viable, while others provide exciting new opportunities. Increased R&D investment is vital to allowing the UK to stay ahead of this curve.

Britain's banks do not effectively meet the industrial challenges of the UK faces. We are concerned that plans for privatisation of the GIB will water down the possibility of channelling sufficient funds to vital environmental initiatives, and should be rolled back. Within the public sector, granting the bank vital borrowing powers is essential.

Further education and industrial strategy

A successful economy will require well trained, skilled workers. A comprehensive and coherent policy on further education is therefore essential. Currently there are limited opportunities for adults to access subsidised training to upskill as a result of the contraction of courses offered by colleges following the substantial cuts since 2010. In the Spending Review the government announced an extension of these FE Loans so that from this August they will be available to anyone aged 19 and above (they were previously only for people aged 24 and above). The government's approach of involving introducing HE-style loans for FE adult students, is simply putting the financial burden on individuals, many of whom will be more debt-averse than young people heading off to university.

In November the Government took the welcome decision not to implement cuts to further education in the Comprehensive Spending Review. As highlighted in the Select Committee research paper, the scale of the UK's productivity challenge also means that we need to empower the existing workforce to improve their skills. However, government funding for adult FE and skills has been cut back heavily since 2010, while the decision not to impose further cuts is a sensible one; Government also needs to pay much more attention to how training and skills are influenced by other external factors in the workplace, especially the impact of employee engagement in maximising skills take-up and improved utilisation. For example, a recent research report from Leeds University showed that union members are a third more likely to receive regular training, and that union engagement in learning and skills in the workplace is directly associated with higher wages, better job security and improved organisational performance.

Green industry

Industrial policy is not simply a matter for the Department for Business, Innovation and Skills; the Department for Energy and Climate Change has a shared agenda in the development of this industrial strategy.

The Paris Agreement will require progressive moves towards decarbonisation. Some governments, such as those of Germany and Denmark, are embracing this, for example through Germany's '*energiewende*' programme and Denmark's specialisation in wind power. This also needs to happen in the UK. A first step should be the introduction of industrial roadmaps that both meet the UK's economic and

industrial needs, at both regional and sectoral level, and put us on track to meet our commitments to CO2 reduction under the Paris Agreement. Business organisations and trade unions, which are long-standing supporters of industrial strategy, should be included in policy development, as is common in countries such as Germany and Denmark.

Investment in new green technology development is also a vital step in this area. The position in the UK suffered a major setback in the 2015 Autumn Statement when the £1bn capital budget for a Carbon Capture and Storage (CCS) competition was reversed. CCS technology is vital to fossil fuel companies seeking to combat global warming. Indeed, the Energy and Climate Change Committee has warned that it will be much more difficult to meet national and internationally-agreed targets on reducing greenhouse gases without CCS. The extra cost could run into billions. Furthermore, successful CCS could prove to be a vital British export, given the ongoing, widespread use of coal fired power stations in such locations as Eastern Europe and China. Giving full consideration to how best to pursue CCS development in the future should be a government priority.

Separately, the conversion of coal power stations to burn biomass in place of coal offers great potential for renewable energy. Biomass has no new grid connection costs, makes the most of existing assets, and has no hidden transmission or balancing costs. DECC estimates that it would cost £44bn more to meet our 2050 carbon targets without biomass. Allowing biomass to compete in this autumn's Contracts for Difference (CfD) auction, to award CfDs on a whole system cost basis and to give biomass conversion the same length contracts as other renewable technologies, would be an important step forward for the green industrial policy agenda.

Banking

Strong banks are essential as safe homes for savers' deposits, sources of credit to homebuyers and businesses and providers of secure employment for workers. But eight years after the last financial crisis, worries are emerging again about the health of the banking system. Bank share prices were hit particularly hard in the market declines at the start of 2016. On a wider view, bank lending remains excessively skewed to the property market, with lending to other businesses in long-standing decline.

The TUC is worried about several developments that suggest appetite for reform is waning:

- the abandonment of plans for a reverse burden of proof for banking regulatory failures;
- the dropping of a Financial Conduct Authority investigation into banking culture.

Of particular concern to the TUC is the lack of momentum behind full implementation of the key pillars of the Independent Commission on Banking's proposals to enhance strength and stability of the UK banking system, namely:

TUC

- ringfencing of banks' crucial retail banking activities;
- additional capital requirements to ensure banks can withstand future crises.

Ringfencing, the separation of deposit-holding retail banking from investment banking, aims to protect retail banking from risks unrelated to the provision of those services. The ambition is to avoid taxpayer liability and ensure the continuous provision of vital banking services. Details of banks' final ringfencing plans have yet to be published. But there are worrying reports of attempts by banks to effectively lower the ringfence – for instance by seeking to make the retail bank a subsidiary of its investment bank. The TUC believes the spirit of these proposals has been lost as we move towards implementation from 2019.

Our concerns are exacerbated by the detailed rules being published by regulators which will:

- Allow cross-selling within banking groups. This could leave ringfenced banks dependent on income from other parts of their business.
- Permit ringfenced banks to pay dividends to their parents which could weaken the stability of these entities.
- Allow banking group to retain excessive influence on ringfenced entities, for instance by permitting them to hold board seats.

Linked to this, we are concerned that Bank of England proposals for equity buffers to be held by ringfenced banks, and are the key element that allows them to absorb losses, are substantially weaker than set out by the ICB. It has proposed:

- The exemption of banks with assets of less than £175 billion from systemic risk buffer requirements.
- Applying the ICB's suggested three per cent increment only to ringfenced banks with assets of more than £755 billion – of which there will be none.

The effect will be to leave UK banks holding little more capital than required by international standards.

The TUC appreciates that a balance has to be struck between allowing banking institutions the flexibility to thrive and expand and ensuring they remain safe and secure. But watering down measures governing stability of the banking system is not pro-business. Businesses, and those who work for them, require certainty and stability. A first step towards ensuring that we have this balance right would be for government to undertake a review of the implementation of the ICB's proposals, with a view to assessing whether the current regulatory framework provides the UK with a robust banking system capable of servicing the wider economy.

Corporate governance and pensions' reform

Corporate governance

Reform of corporate governance is an essential part of creating an economy where long-term investment, high productivity and fair wages provide the basis for sustainable growth.

Company law requires company directors to prioritise the interests of shareholders over those of other stakeholders and indeed the company itself. Shareholders are the only stakeholder group with significant rights in terms of governance: shareholders elect company directors, vote on remuneration reports, vote on resolutions at company AGMs and can file shareholder resolutions and convene EGMs.

But in a context where many shareholders rely increasingly on share trading, rather than long-term share ownership, to generate returns, the interests of shareholders can diverge from the long-term success of the company. In addition, fear of hostile takeover and, in many cases, share-linked remuneration for company directors, combine to create an incentive to focus on mergers and acquisitions and strategies to raise the company's share price at the expense of organic growth. This creates a conflict of interests at the very heart of our corporate governance system.

As a first step directors' duties should be therefore reframed so the promotion of the long-term success is the primary aim. Serving the interests of investors should be secondary to this central goal, as is the case for the other stakeholder groups included in Section 172 of the Companies Act 2006 (employees, suppliers, customers and local communities).

There is also a strong case for shareholders' corporate governance rights in companies to be subject to a minimum period of shareholding of at least two years. As Bank of England Chief Economist Andy Haldane has argued, shareholder primacy has negative economic consequences: "If power resides in the hands of one set of stakeholders, and they are short-termist, then we might expect high distribution of profits to this cohort, at the expense of ploughing back these profits (as increased investment) or distributing them to workers (as increased real wages). To some extent, this matches the stylised facts on rising inequality – rising executive and shareholder compensation and faltering real wage growth."[42]

Pension saving

Given the need to improve the level of pensions saving in the UK, and ensure the most effective use of taxpayer funds, it is appropriate that HM Treasury has been considering the role of tax relief. The TUC believes that improvements could be made to the current system and more support provided to lower and middle earners.

The net cost of tax relief, after allowing for tax paid on pensions in payment, was estimated to be £21.2 billion in the 2013/14 tax year. While basic rate taxpayers make 50 per cent of total pension contributions, they benefit from only 30 per cent of pension tax relief. In contrast, 50 per cent pension tax relief goes to higher rate

[42] Bank of England, *Speech: Unfair shares, p7,* http://www.bankofengland.co.uk/publications/Documents/speeches/2014/speech732.pdf, 2014

taxpayers and 20 per cent goes to additional rate taxpayers. These groups make 40 per cent and 10 per cent of total contributions respectively.

It is however important that any changes avoid a shift away from the important principle of providing up-front relief. It is vital that the government supports, and is seen to support, pension saving in partnership with employers and individual workers. The best way to foster responsibility is to ensure it is easy for an individual to make good decisions by placing them within a system of decent value, well-governed workplace pensions. An essential part of this is up-front tax relief that provides an incentive to save for some, and support in building retirement savings for many.

Similarly, we believe that moving to a system where contributions were paid from taxed income with the intention of making payments tax-exempt would be a mistake. Implementation would be complicated and costly. It is also potentially regressive. Currently, 48 per cent of pensioners pay no income tax in retirement.

Equally important is that any reform should not undermine defined benefit schemes, including funded and unfunded public service pensions, which remain key recruitment and retention tools for the state sector.

Given these concerns, the TUC would support flat rate tax relief of around 33 per cent. This would be revenue neutral compared to the existing system of relief based on a worker's marginal income tax rate. But it would target those low and middle earners who most need support to secure decent levels of savings for their later years, while maintaining vital support for higher earners whose continued participation is important for the viability of many pension schemes.

Given the importance of supporting pensions saving, the overall level of tax relief used to support pension saving should be maintained. Using reform as a revenue saving measure would send a signal that the government does not value pension saving. It would also make it harder for workers to amass pension savings and make it more likely that they suffer hardship in later years.

Opportunities for young people

The TUC is concerned that young people who become long-term unemployed are insufficiently supported by the current welfare-to-work system. Long-term youth unemployment risks scarring effects across young people's careers, limiting their opportunities as well as their future economic contribution. But at present little support is in place for this group. A "youth obligation" requires young people to take part in an apprenticeship or traineeship, gain work based skills, or participate in unpaid work experience from six months into their claim, but it is far from clear that this type of support is effective for those furthest from the jobs market. Given the very welcome announcement in the Comprehensive Spending Review about the end to Mandatory Work Activity and Community Work Placements, the Budget presents an opportunity for the Chancellor to commit to a new approach through the introduction of a Job Guarantee scheme.

Job guarantees should be real jobs, paid at least the minimum wage and with full employment rights to avoid exploitation and minimise the risk of displacing other workers. They should be limited to six months, so that participants are not trapped in a low value-added ghetto. At the same time, they should allow at least half a day a week for job search – applicants are far more likely to get another job if they apply whilst still working on their job guarantee job than after they have returned to unemployment. Because they are real jobs, the same benefit rules that apply to other jobs should also apply; claimants who turn down a job guarantee job without good cause should face benefit sanctions. Investment even only on the scale set aside for the previous government's Youth Contract would soon produce the strong results we saw with the successful Future Jobs Fund.

Furthermore, the issue of youth worklessness extends far beyond those claiming Jobseeker's Allowance. Latest figures show that 848,000 young people (aged from 16 to 24) in the UK are not in education, employment or training (NEET), the vast majority of whom are women. In the short term, the TUC believes that jobcentre support should be available to all young people, regardless of whether they are claiming benefits. But we also need a more innovative approach. With this in mind the government should consult on the development of a new Youth Employment and Skills Service that would bring together the job-related support provided through Jobcentre Plus with skills and careers provision to provide comprehensive support for all those aged under 25.

Young people in particular are more likely than older workers to be stuck in temporary, insecure and precarious work. For example, young people are three times more likely to work under a zero-hours contract than the working age population in general. We know that casualised workers are paid significantly less, have no job security and limited career development opportunities. Given this, all workers should receive a written statement on their first day of employment setting out terms and conditions, including expected hours of work. Workers should have a right to notice before work is allocated or cancelled and to be paid for transport costs and lost earnings where a shift is cancelled at short notice. There should also be a right for those workers who work regular hours to a fixed-hours contract reflecting their normal hours. And those whose work is irregular or intermittent should be paid an allowance rewarding the flexibility they provide employers. These measures would improve job quality for all, but would bring particular benefits to young people.

Fairness in the workplace

Fairer productive workplaces are essential to a strong economy. Statutory employment rights help ensure decent standards of living, stability of income, job security and equality of opportunity. They can also contribute to a committed and engaged workforce, help reduce sickness absence and support the retention of skilled workers, all of which boosts productivity

TUC

Ensuring compliance with employment rights

In practice, the economic benefits of employment protection depend upon effective enforcement procedures to ensure the rights are observed. Most employment rights depend upon individuals who are mistreated at work being willing and able to hold their employer to account, ultimately at an employment tribunal if all other reasonable means of resolving a dispute have failed. But since the introduction of employment tribunal fees in July 2013, the number of cases going to tribunal has fallen by 70 per cent. This fall has been sustained and it has affected all types of claims. This is bad for the individuals who have had their rights violated, but it also undermines wider compliance and good practice. If rogue employers are allowed to get away with flouting the law they will do so and they will undercut those who are striving to meet or exceed their legal obligations. It is in the interests of both businesses and their workforces for employment tribunal fees to be abolished.

Enforcement also depends on government funding. The government's plans to tackle labour market exploitation by creating a Director of Labour Market Enforcement, expanding the remit of the Gangmasters Licensing Authority (GLA) and creating new labour market enforcement orders and penalties, depend critically on significant new funding being made available for this work. The resources of the three main labour market enforcement bodies have been seriously stretched for a number of years. Compared to 2010/11 there are now 25 per cent fewer frontline staff at the GLA inspecting labour providers in the agriculture and food processing sectors. So far there has been no commitment to increase resources to match the much wider remit of the new Gangmasters and Labour Abuse Authority, which will be charged with tackling exploitation across the whole economy.

The TUC and other stakeholders such as the British Retail Consortium, the Food and Drink Federation and the Association of Labour Providers have raised concerns about the return of rogue operators and a decline in labour standards in these sectors if these reforms result in existing resources becoming more thinly spread.

Diverting resources from the seriously understaffed Employment Agencies Standards Inspectorate or from the HMRC's National Minimum Wage (NMW) enforcement team is not therefore the answer. New funding must be made available.

Trade union bill

Trade unions provide a vital role bringing people together in the workplace to promote their interests and protect them from abuse. Unions are the bodies through which employers can most effectively consult with their workforce on a collective basis and negotiate over terms and conditions. At national level, unions represent all working people, whether or not union members, in their role as advocates for rights and protections at work and their contribution to economic policy debate. Without unions, many vital employment rights that people and parties across the political spectrum now take for granted, including the national minimum wage, would probably not exist.

The development of union learning representatives shows how unions have developed their role in recent years to help working people access learning and develop their skills. Unionlearn - the learning and skills organisation of the TUC – has trained more than 30,000 union learning representatives (ULRs) who act as a focal point for training and learning in their workplace. Through ULRs, over 220,000 people are being given training and learning opportunities through their union every year. In a 2010 survey of 400 employers with a total of 6 million employees, 87 per cent said that they wanted to continue to support union learning, with two-thirds saying that it benefited the organisation and 81 per cent saying it benefited the individual. Union learning representatives have proved particularly successful in reaching the lowest skilled workers who are generally under-represented in workplace training – thus addressing a vital piece of the challenge of raising productivity.

However, the current government, rather than embracing this role and working with unions to enhance it, has chosen to seek to weaken it with its Trade Union Bill. But the introduction of tighter restrictions on the right to strike is likely to damage constructive employment relations in the UK, which generate extensive benefits for managers, employees and wider society.

Unionised workplaces are more likely to have family-friendly policies. According to the latest Worklife Balance Employer Survey, published by BIS in December 2014[43] seventy-seven per cent of unionised workplaces had a written policy on flexible working arrangements compared with 43 per of non-union workplaces. Such negotiated agreements provide clear benefits for those with caring responsibilities but also assist managers and businesses. They have a positive effect on recruitment and retention. They enable employers to recruit from a wider talent pool and lead to increased loyalty amongst staff.

Union workplaces are safer workplaces, largely due to tens of thousands of union health and safety reps being trained each year to internationally-recognised standards. Unions raise safety concerns through health and safety committees and collective bargaining arrangements and this leads to far fewer workplace accidents.[44] According to research commissioned by the Department of Trade and Industry (DTI, now BIS) in 2007, by reducing lost time from occupational injuries and work-related illnesses, union safety reps save taxpayers between £181m and £578m (2004 prices) every year.[45]

Negotiations between employers and unions also facilitate innovation and change. In a recent article a leading academic, Professor David Bailey from Aston Business

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[43] BIS *Fourth Worklife Balance Employer Survey BIS Research Paper No. 184*, available at: www.gov.uk/government/uploads/system/uploads/attachment_data/file/398557/bis-14-1027-fourth-work-life-balance-employer-survey-2013.pdf, 2014

[44] Nichols, Walters and Tasiran, *Trade Unions mediation and industrial safety*, Journal of Industrial Relations, 2007

[45] DTI *Workplace representatives: A review of their facilities and facility time, 2007*

School, acknowledged the important role which unions play in improving the performance and competitiveness of the UK motor industry:

> *"I would also add in another factor for the industry's success - the flexibility and hard work of workers and unions in pulling out all the stops to help make the UK a competitive place in which to assemble cars and source components (something the media all too often fails to recognise)."*[46]

Following the economic crisis of 2008, there have also been extensive examples of unions and managers engaging in constructive negotiations with a view to saving jobs and retaining skilled employment. For example:

- During the economic downturn, unions worked with employers at Jaguar Land Rover to avoid serious job losses and to protect the future of the company. Following a lengthy consultation, unions and their members agreed a one year pay freeze and a shorter working week. The unions also agreed to move labour between two plants to save jobs.
- At Bombardier, following the loss of the Thameslink contract to Siemens in 2011, the company announced mass redundancies, the closure of the Derby site and a review of their UK operations. Management met on at least a weekly basis with recognised trade unions. The consultation period provided unions and management with the opportunity to identify and win new contracts, to review shift patterns and staffing structures. The company, unions and government departments (including DWP and BIS) invited appropriate agencies to visit the site to assist in job searching. As a result of the ongoing discussions, all compulsory redundancies were avoided.

The BIS-commissioned Macleod Report,[47] endorsed by the current Prime Minister,[48] also suggests that managers should listen to the concerns expressed by employees and their representatives. It concludes that addressing these concerns will increase levels of employee engagement, thereby helping to deliver sustainable economic growth. Similarly, research undertaken by the Advisory, Conciliation and Arbitration Service (ACAS)[49] found that union representatives play an important role in improving workforce engagement and morale, by helping to ensure employees' concerns regarding their working conditions are listened to and addressed. This in turn can improve workplace productivity, the quality of services provided, and ultimately the financial performance of organisations.

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[46] Birmingham Post, *UK car output up, and down* www.birminghampost.co.uk/business/business-opinion/uk-car-output-up-down-9902855#ICID=sharebar_twitter, 2015

[47] Department for Business, Innovation and Skills *Engaging for success – enhancing performance through employee engagement,*p121, http://dera.ioe.ac.uk/1810/1/file52215.pdf, (2009)

[48] Government announcement *New taskforce for employee engagement,* www.gov.uk/government/news/new-task-force-for-employee-engagement, 2011

[49] ACAS *Information and Consultation at Work: from challenges to good practice. Research Paper,* 03

The evidence base is clear: by engaging with trade unions, rather than by seeking to undermine them, the government will boost the economy. It is still not too late for the Trade Union Bill to be withdrawn.

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