The Cracks Begin to Show
A Review of the UK Economy in 2015
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By Economists for Rational Economic Policies

Contributors:
Foreword

The year 2015 has repeatedly disappointed those who had high expectations that the UK economy was back to “normal times” and destined to see significant continued economic “growth.” At the start of the year, there was a general expectation that inflation would start to rise after the sudden fall in oil prices, and that the Bank of England’s Monetary Policy Committee would start, gently, the process of raising interest rates as “slack” in the economy disappeared.

In reality, and despite some positive results (the number of those in some form of employment, for example) those expectations have gently deflated as 2015 progressed. Most economists had forecast annual GDP increase of over 2.5%. The most recent ONS estimates, up to Q3, show a continuing slide in the annual rate of change per quarter. The annual rate of real GDP change in 2014 per Quarter was 2.8%, 3%, 2.8% and 2.8%. But in 2015, a series of steps down:

<table>
<thead>
<tr>
<th>Quarter</th>
<th>Change</th>
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<tbody>
<tr>
<td>Q1</td>
<td>2.5%</td>
</tr>
<tr>
<td>Q2</td>
<td>2.3%</td>
</tr>
<tr>
<td>Q3</td>
<td>2.1%</td>
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More worryingly still, the rate of change in nominal GDP (i.e. current prices) in Q3 was also 2.1% - it is exceptionally rare for nominal GDP not to be greater than real GDP, and besides being an indicator of deflation, has a negative impact on the government finances. Indeed, we saw in the October and November public finance figures some evidence that tax receipts have slowed since the summer, with VAT in November being just 0.8% greater than in November 2014. This may make achievement of the government’s borrowing target for 2015/16 (£73.5 billion) difficult to achieve.

These recent GDP and public finance figures were published just before Christmas – and just a few weeks after the November Autumn Statement and Spending Review. The Office for Budget Responsibility had – thanks to some assumptions on GDP and tax receipts that were queried by many as being over-optimistic – helped the Chancellor to sidestep short-term political problems over working tax credit by allowing a slower path to his promised budget surplus. Those OBR and government assumptions now suffer from considerable scepticism.

Not only has GDP decelerated, but its composition has continued to disappoint. There is almost no sign of the promised “rebalancing” towards “the makers” and “the builders”. While several service industries, including real estate and food and hotels, have fared relatively well, manufacturing has seen a decline, while overall industrial production has only marginally increased over the year:

Manufacturing annual change per quarter:
<table>
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<tr>
<th>Quarter</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Q1</td>
<td>1.2%</td>
</tr>
<tr>
<td>Q2</td>
<td>0.1%</td>
</tr>
<tr>
<td>Q3</td>
<td>-0.9%</td>
</tr>
</tbody>
</table>
Industrial production, with help from a UK oil industry increasing output (but at far lower prices) has risen between 1% and 1.4% year on year, while construction – after a strong rate of annual increase in 2014, fell back from an annual rate of 6.4% in Q1 to a very modest 1% in Q3.

This imbalance is also to be seen in the UK trade and current account statistics, both of which continue to show major deficits. The current account deficit was £17.5 billion in Q3, the same as in Q2 – leaving a deficit of 3.7% of GDP. The total trade deficit widened to £8.7 billion in Q3, from £4.7 billion in Q2, with our trade in goods worsening.

Inflation, if that is the right word, remains close to zero, with some months just above (0.1% in November), and some just below. This is due not only to the continuing fall in oil prices, but to the steady fall in all commodity prices, which indicates a wider and deeper basis for sustained deflationary pressure (at least in all manufactured goods).

The economy is far short of reaching the 2% inflation target set for the Bank of England by the government, and in part explains why UK Bank-set interest rates - unlike in the US – seem likely not to rise for some time yet. But equally important, the rise in wages which earlier in the year looked as though it might top 3% per annum, meaning a real terms pay increase at last, has recently abated, with the last two months (September and October) only showing annual rises of around 2%. The only main exception is pay in construction, which is over 6% up on the year.

Despite the increase in those in some form of employment (as employee or self-employed), the wage pressures are far from strong, and real wages remain far below their peak in 2008. This trend to lower pay has weakened demand and productivity. Whilst commodity and producer deflation have enabled shoppers to buy more goods for the same money, it is notable that people are not spending much more. On the contrary, in recent months, we have seen unsecured private debt mounting, as people once again resort to borrowing to get by.

The other side of the coin is asset inflation. The reluctance of the private sector to invest in non-speculative assets, combined with QE providing liquidity for the wealthy, together help propel a property price boom which the government has done much to promote with state-aided Help to Buy and similar schemes to increase property prices.

So indeed, as the year has progressed, the economy has slowed and regressed. The public finances are built on hopes and assumptions that appear to be fragile indeed, and economic activity in many key areas has decelerated whilst the property boom helps the asset-rich. The weaknesses in the UK economy are more and more apparent, like a building with a flashy design but poor construction. The cracks begin to show. Let’s hope there’s no earthquake coming...

*   *   *
In this review of the UK economy in 2015, we have contributions on a range of themes from members of Economists for Rational Economic Policies (EREP).

John Weeks argues that the UK economy remains demand-constrained, and the government’s fiscal policy has made that straitjacket ever tighter. The depressing effect of that fiscal policy shows in GDP growth itself, which declined in current prices by 2.4 percentage points during the 12 months through 2015 Q3 compared to the previous 12 months (2013 Q3 – 2014 Q3). While noting that the Chancellor is now years behind his original ‘plan’ to cut the deficit, John argues that “to have done so would have made a bad performance worse.”

Ann Pettifor sees a discord between (radical) monetary policy and (tight) fiscal policy, with the major beneficiaries of the government’s “lop-sided approach” being big corporations and the rich - owners of assets whose value are inflated by QE. Yet due to the failure of its fiscal policy, the government has borrowed 7.5 percentage points of GDP more than expected since 2010/11. This is despite the large windfall gain to government from QE and monetary policy, with the government (through assistance from the Bank of England's Asset Purchase Fund) having access to a pool of virtually debt-free borrowing.

Richard Murphy sees the concentration of power in the hands of the Conservative Party in 2015 as accelerating the process of change in tax policy seen over the previous five years. The post-election 2015 strategy made three things clear. First, tax is at the core of whatever might be called the UK’s industrial strategy, which – based on ever lower taxation of corporate profits and international tax competition - comes down in effect to making the UK a tax haven. Second, tax is apparently to now be used to exacerbate economic inequality, with the burden of taxation being steadily transferred from business to citizens. Third, by starving HMRC of the necessary resources, the tax system reinforces the government’s strategy of shrinking the state.

Özlem Onaran argues that in 2015, the growth in GDP is based on shaky foundations. The rise in inequality and pay stagnation are among the fundamental flaws in our economic model, which were at the root of the Great Recession, and we are far from correcting this imbalance. Real pay is still 9% lower compared to its peak month in early 2008. After the longest and most dramatic period of decline in real wages since the Victorian times, wage and salary earners seem likely to have to wait till at least 2017 for a recovery in their incomes. “Financialization” is another major brake on investment and growth, with companies’ surging financial activities serving to crowd out private investment in physical assets.

Jeremy Smith looks at the development of labour productivity. Unlike the dominant supply-side approach to productivity (which remain important for the long term), data show that it is demand and economic activity that drive shorter term changes in productivity. The government is caught on the horns of a dilemma. Should it celebrate the (real but skimpily-remunerated) increase in employment over the last 3 years? Or see this as the result of a dysfunctional low productivity economy, increasingly of its own shaping? With large cuts in real wages, the ultra-flexible UK labour market has caused productivity to fall. A large,
sustained, government-driven programme of investment is the best way to combine economic activity (GDP), higher pay, and higher productivity.

Andrew Simms argues that while the politics and economics of energy and climate change dominated the year, nowhere are the full implications for economies being appreciated. Indeed, cuts to clean energy incentives were justified by the government, in a year when the Chancellor announced new fossil fuel subsidies, and a new legal obligation for the maximum use of North Sea oil and gas. As 2016 looks set to be hotter still than 2015, our greatest challenge will be to learn how to flourish within planetary boundaries. In rich countries like the UK we need to replace consumption-led growth with a new kind of materialism that respects and cares for the material world, with better distribution and a more creative approach to the art of living.

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Andrew Simms is an author, analyst and campaigner. He co-founded the New Weather Institute, and is a fellow of the New Economics Foundation.

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2015: A failing fiscal policy

John Weeks

When he became chancellor in May 2010 George Osborne pledged to eliminate the fiscal deficit, to "balance the books". In his first budget statement that summer he set a specific target, to borrow no more than £37 billion during fiscal year 2014/2015. That fiscal year ended on 31 March 2015, and borrowing for the fiscal year weighed in at a tidy £90 billion, which by simple subtraction yields an over-run of £53 billion.

The table below shows the major UK fiscal indicators for the latest available statistics, the 12 months ending 30 October 2015. Despite not meeting the target he set for himself, the chancellor has boasted of success because the overall fiscal balance (i.e. government revenues less spending) is now just over minus £50 billion compared to over £100 billion when he took over Britain’s public finances (borrowing and fiscal balance numbers in the table differ due to asset sales, almost all from bailed out banks).

UK Fiscal Indicators, 12 months through October 2015
(£billions, current prices & percentages)

<table>
<thead>
<tr>
<th>Category</th>
<th>Value Oct 2015 (bn)</th>
<th>12 month Change:</th>
<th>12 month Change:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Absolute (bn)</td>
<td>Percent</td>
</tr>
<tr>
<td>Fiscal balance</td>
<td>-51.8</td>
<td>-19.9</td>
<td>-27.7</td>
</tr>
<tr>
<td>Net borrowing</td>
<td>83.5*</td>
<td>-16.4</td>
<td>-16.4</td>
</tr>
<tr>
<td>Total revenue</td>
<td>624.0</td>
<td>25.1</td>
<td>4.2</td>
</tr>
<tr>
<td>Household YT</td>
<td>173.8</td>
<td>10.8</td>
<td>6.6</td>
</tr>
<tr>
<td>Corporate YT</td>
<td>44.4</td>
<td>3.2</td>
<td>7.8</td>
</tr>
<tr>
<td>Total Spending</td>
<td>715.6</td>
<td>4.6</td>
<td>0.6</td>
</tr>
<tr>
<td>Current Spending</td>
<td>684.5</td>
<td>4.0</td>
<td>0.6</td>
</tr>
<tr>
<td>Social Benefits</td>
<td>202.8</td>
<td>3.4</td>
<td>1.7</td>
</tr>
<tr>
<td>Local Govt</td>
<td>120.1</td>
<td>-4.3</td>
<td>-3.5</td>
</tr>
<tr>
<td>Net Investment</td>
<td>31.0</td>
<td>0.6</td>
<td>2.1</td>
</tr>
</tbody>
</table>

Net fiscal impact %GDP = -1.1

GDP growth:
2014Q3-15Q3 = 2.2%
2013Q3-14Q3 = 4.6
Change = -2.4

Source: ONS

Note: YT is income tax.

*In June 2010 Osborne announced an annual borrowing target of £37 billion for fiscal year 2014/15.

This heart-felt self-congratulation inspires scepticism for three reasons. First, the cost in human suffering of the fiscal “savings” has been enormous, felt most acutely through the devastation of local government services. Over the 12 months covered in the table, local government funding fell by over £4 billion or 3.5 percent of total spending by councils.
Though central government spending on social “benefits” (aka what we pay taxes for) increased slightly, adjustment for inflation and population increase renders the change close to zero.

Second, the reduction in the fiscal deficit and borrowing resulted from tax revenue increases not from cuts in spending. Total spending actually rose by £4.6 billion, outweighed by a revenue increase of £25 billion (almost all coming from household income taxes and VAT).

The implication of the second source of scepticism yields a third, that the budget cuts prevented a balancing of the books. A look at the chart below tells the tale. The fall in the deficit has been strongly linked with falls in the GDP growth rate (across the ten quarters a decline in the fiscal deficit of one percentage point was associated with a fall in GDP growth of 0.6 percentage points).

The causality is obvious. Tax revenues increase when GDP increases (and people’s income increases); cutting public spending reduces overall demand, depressing GDP growth. During the 12 months covered in the table the net overall effect of the chancellor’s fiscal policy was a negative 1.1% of GDP.

The depressing effect of fiscal policy shows in GDP growth itself, which declined in current prices by 2.4 percentage points during the 12 months through 2015Q3 compared to the previous 12 (2013Q3 - 2014Q3). The larger fall in GDP growth than the fiscal drag results from a slightly negative trade effect, slowdown in private investment, and the expenditure multiplier magnifying all three.

Changes in Treasury Net Borrowing (12 months) and Nominal GDP Growth Rate 2013Q1-2015Q3

Source: ONS
A review of fiscal policy for 2015 shows what we should expect. The UK economy remains demand-constrained, and the Chancellor’s policies made that straitjacket ever tighter. We should compliment the chancellor for not achieving his £37 billion borrowing target for fiscal year 2014/2015. To have done so would have made a bad performance worse.
2015: Monetary and fiscal policy discord

Ann Pettifor

The British Prime Minister declared at Davos in 2012 that he (and his Chancellor) were “fiscal conservatives but monetary radicals injecting cash into the banking system and introducing credit easing measures to make it easier for small businesses to access finance.”

Doubt can be cast over the “fiscal conservatives” claim, as well as the claim that small businesses would benefit from greater access to finance. The major beneficiaries of the government’s lop-sided approach to monetary and fiscal policy are big corporations and the rich - owners of assets whose value are inflated by QE. But the biggest victim of the ‘fiscal conservative’ approach is the government itself. For as we argued in a paper written in 2010 – The Economic Consequences of Mr Osborne – “fiscal consolidation does not ‘slash’ the debt, but contributes to it, as the extent of economic recovery becomes increasingly uncertain.”

In cumulative terms the government has borrowed 7.5 percentage points of GDP more than they expected since 2010-111. And in this year it borrowed more in the first quarter than was originally (2010) planned to borrow in the year as a whole.

This is particularly disappointing given the extremely loose monetary policies adopted by the Bank of England since the onset of the crisis in 2007-9. Lower interest rates combined with the Bank of England’s Asset Purchase Facility (APF) operations have radically reduced the cost of government borrowing – and helped to reduce the need to borrow more, now and in the future.

Thanks to what has come to be known as Quantitative Easing, the Bank of England (BoE) has become directly involved in government debt on a much larger scale and over a longer time period than before. According to the NIESR in their May 2015 Economic Review, since the Bank of England began purchasing government securities in March 2009, the government’s Debt Management Office (DMO) has raised more than £1,037 billion in cash by issuing debt “with a nominal value of £994 billion to the market.” If we assume that interest rates would have been at least 50 basis points higher, argue the NIESR authors, the DMO would have had to issue £70bn more in gilts to raise the same amount of cash.

Furthermore, the “forgone coupon payments on this unissued debt would have stood at £33bn over the life of the bonds” – a direct and additional saving to the fiscal authority. But these are underestimates as there are second-round effects. Thanks to QE the government has saved on further principal and coupon payments into the future – “because the principal

1 Source: OBR and Geoff Tily, TUC: Borrowing's in line with latest forecast, but over four times higher than originally planned http://touchstoneblog.org.uk/2015/10/government-borrowing-may-be-in-line-with-latest-forecast-but-its-over-four-times-higher-than-originally-planned/
and coupon payments on the (£70bn) unissued bonds would have been financed, for a given level of tax income, with new borrowing.” (My emphasis)

When the BoE began purchasing government securities from private debt markets in 2009, the government was obliged to pay interest on those securities to the Bank – just as it would have done to any private bondholder.

However in November, 2012 – worried about his failure to constrain public borrowing and debt – the Chancellor decided that the sums paid over to the BoE would be recycled back to the Treasury, on a regular basis. This was a handy windfall to cut the government’s Central Government Net Cash Requirement (CGNR). As a result, the government needs to borrow less. Fewer bond issues imply lower debt service payments for future generations.

While “radical” monetary policy has proved extraordinarily helpful to the Chancellor, it has done little to help him achieve his own public debt and borrowing reduction goals.

And it should come as no surprise that this one-sided monetary policy approach has failed to increase domestic demand, and with it wages and incomes. To do so would have required greater coordination of monetary and fiscal policy, and in particular the monetary authority’s support for increased public investment.

The Chancellor’s failure to use fiscal policy in tandem with monetary policy means that the timid and short-sighted private sector has lacked confidence to ratchet up investment in productive, income-generating activity – as opposed to speculative activity. This low private and public investment is causal of lower productivity levels, as Geoff Tily has argued. Wage levels in real terms are still over 7% below levels in 2007, and this has led to rises in individual and household borrowing to compensate. The result is the slowest economic recovery in this nation’s history.

Low public borrowing costs provided the ideal environment for increased public investment in, for example, the transformation of the economy away from fossil fuels, and towards more sustainable energy sources. This could be achieved through a programme of activity to increase the energy efficiency of Britain’s leaky housing stock. Such a programme would provide a stimulus to private investment in higher skills, innovation, productivity and job-creation. Such job creation would in turn generate tax income (via the multiplier) to finance the government’s very low debt service costs, and reduce public borrowing and debt.

And such a programme could easily have been financed if only fiscal policy had moved in tandem with monetary policy.
2015: A year in taxation

Richard Murphy

Taxation naturally lends itself to annual review: much of it is assessed on the basis of annual income. Tax policy is not so neatly delineated: when it comes to policy the issue is usually one of trajectories and their convergence and divergence, plus the odd significant sea-change that indicates major changes in direction. The Coalition government established a new direction for UK tax on its election in 2010. The concentration of power in the hands of the Conservative Party in 2015 has accelerated the process of change that was seen over the previous five years.

The post-election 2015 strategy made three things clear. The first is that tax is at the core of whatever might be called the UK’s industrial strategy. In 2010 the government declared that ‘the UK was open for business’ by starting to cut the UK’s large company corporation tax rate. In 2015 this downward trajectory continued with announcement of plans for the rate to be cut to 18% - which is less than the basic rate of income tax. Coupled with changes made over the last five years to reduce the scope of UK tax to ensure that no profits arising outside this country need be taxed here, this reinforces what many have felt for a long time, which is that it is the government’s plan to turn the UK into a tax haven.

It is doing that by cutting the tax rate. It is also doing that by encouraging international tax competition. This represents the second clear strategy that emerged this year: tax is apparently to now be used to exacerbate economic inequality. In the process the UK government has become deeply antagonistic towards the international process run by the Organisation for Economic Cooperation and Development to tackle what is called ‘Base Erosion and Profits Shifting’. Nowhere was this clearer than when in March 2015 the UK created the Diverted Profits Tax (or ‘Google Tax’) that directly undermines internationally agreed measures. It is also widely thought that the UK is a major opponent to EU plans to create tax harmony. That is unsurprising when it continues to support a range of captive tax havens in the Channel Islands and elsewhere.

This policy of tax competition has, however, taken on a new guise domestically. The granting of corporation tax setting powers to Northern Ireland and Scotland opens the possibility of a domestic race to the bottom in profits taxation, and the extension of this policy to business rates, that will now be set by local councils with (in most cases) downward-only adjustments allowed, does much the same thing. The intended impact is obvious in all of these policies. The aim is to reduce the tax paid by business and capital and to shift it on to working people. Office for Budget Responsibility forecasts issued in July and November confirm this plan.

Starving HMRC of resources reinforces the likelihood of this outcome, and represents the third clear strategy, which in this case is designed to reinforce the shrinking of the state. First, a shrunken HMRC will not have the resources to challenge businesses on their tax affairs. Second, a tax authority that cannot be accessed because people cannot, quite literally, get through to it is one that has a licence to make mistakes. Thirdly, newly
announced plans to ‘digitise’ personal and small business taxation undermine the personal relationships needed to make tax work and clearly signal an era when small business will be expected to pay its tax bills much sooner, which will suck them of much needed capital whilst also, perversely, encouraging more activity in the shadow economy and so an increasing tax gap that denies the state the resources needed to fund its social programmes. At a time when large companies have personal relationships with HMRC officers a clearer indication of the existence of a tax system in which everyone is very clearly ‘not all in it together’ could not be given.

Tax, then, has come to the forefront of politics. Jeremy Corbyn made my work on the tax gap part of Corbynomics for that reason, using it to indicate that other options are available in this area. Demands in the EU Parliament for action on tax abuse in December 2015 are a direct challenge to the Commission that seems likely, along with the UK government, to implement as few as possible of the OECD’s recommended measures to tackle international tax abuse.

It is said that tax need not be taxing but the reality is that tax does, in very many ways, provide any government with the best opportunity to shape the society for which it is responsible and to which it is accountable. If that is true, then I believe that this government is saying it is on the side of the wealthiest and big business and it has little care for the rest. It’s a tough message, and one that has to be challenged before the change it is promoting becomes deeply embedded in an even more divided society in 2016 and beyond.
2015: Growth based on shaky foundations without a healthy recovery in wages

Özlem Onaran

Growth in Britain is still based shaky grounds as it is driven by a massive increase in private household debt, and will remain fragile to any increase in interest rates in 2016. Just as before the Great Recession, working people are obliged to rely on debt to maintain their living standards in the absence of a healthy growth in their wages and salaries.

The rise in inequality and stagnation in wages are among the fundamental flaws in our economic model, which have been at the root of the Great Recession, and we are far from correcting this imbalance. Real pay is still 9% lower compared to its peak in early 2008. After the longest and most dramatic period of decline in real wages since the Victorian times, waged and salaried people in Britain are looking to a recovery in their incomes not much before 2017.

The share of wages in UK GDP fell from 67.7% in 2007 to 65.8% in 2015 (See Figure 1). This two percentage-point fall in labour’s share in income comes on top of a three decade long fall in the share of wages from its peak of 76.2% in 1975.

Figure 1: The share of wages in GDP in the UK, 1960-2015

Note: Labour compensation adjusted for the labour income of the self employed as a ratio to GDP at factor cost; 2014 is provisional data; 2015 is forecast. (source: AMECO).

The lack of a full recovery in wage income continues to be a drag on household confidence and demand, which in turn discourages business investment in the absence of a healthy growth in domestic demand. Our research shows that in Britain a lower share of wages in
national income leads to both a lower GDP and lower private private investment. Despite increasing profits private investment remains to be weak.

Next to wage restraint and rising inequality, financialization is the other major brake against investment and growth. According to recent research at the Greenwich Political Economy Research Centre on the investment behaviour of non-financial corporations in Britain, not only high dividend payments, but also increasing financial revenues of firms due to their surging financial activities, crowd out private investment in physical machinery and equipment. Lower wages lead to increasing profits, but bleak prospects in terms of demand, and this in turn discourages investment despite high profitability; in the meantime firms direct their profits to financial speculation.

Perversely financial activities do not provide more funds for productive activity. In the absence of strong investment performance, it is no wonder that productivity in Britain is lower than other developed countries. There is no productivity puzzle! This is also why Britain’s export performance is so weak despite falling labour costs: international competitiveness is more about productivity than labour costs, particularly in a world of race to the bottom in labour costs.

A strong recovery with decent jobs as opposed to fragile debt driven growth requires a strong recovery in wages embedded in a broader macroeconomic and industrial policy, financial regulation and corporate governance framework. Only then will investment and productivity follow. Simply improving trade union legislation could take us a long way: if the trade union density were to increase back to its level in 1980, when half of the employees were member of a trade union (as opposed to the current level of union density of 25%), the share of wages in national income could increase by up to 9%-point, and GDP per capita in the UK could increase by £444 (or 1.6%).
2015: Productivity Unpuzzled

Jeremy Smith

The fact that concerns over the UK’s low productivity are still so strong, both as a long-term international trend, and in particular since the financial crisis, speaks volumes about the nature of the UK “recovery”, based as it is on low productivity and lower real wages.

The government is caught on the horns of a dilemma. Should it celebrate the (real but skimpily-remunerated) increase in employment over the last 3 years? Or see this as the result of a dysfunctional low productivity economy, increasingly of its own shaping? Of course, it tries to gloss over their incompatibility.

In July, alongside the post-election budget, the Government issued a report on productivity, “Fixing the foundations: Creating a more prosperous nation” (a mandatory Osbornian building metaphor!). The ministerial Foreword blurs the issues:

“Productivity is the challenge of our time. It is what makes nations stronger, and families richer. Growth comes either from more employment, or higher productivity. We have been exceptionally successful in recent times in growing employment. We are proud of that. But now in the work we do across government we need to focus on world-beating productivity, to drive the next phase of our growth and raise living standards.”

The Executive Summary says

“In every member country of the Organisation for Economic Co-operation and Development (OECD) where average wages are above UK levels, productivity is also higher”

This is certainly true – and says a lot about the UK’s low wage culture and policy - but in several cases, this is because unemployment is also far higher. France (see here for my long comparison with the UK) has roughly the same population and GDP, but a far higher labour productivity – and a chronically higher unemployment rate. So we need to be careful – one can raise productivity without boosting GDP or overall living standards, and without improving the public finances - if there is insufficient aggregate demand.

The Government identifies two pillars for improving productivity – in which the government gives itself no role as “actor”, but merely as hopeful “encourager” of long-term investment, and “promoter” of a “dynamic economy that encourages innovation and helps resources flow to their most productive use”.
And when it gets down to its “fifteen-point plan”, what it mainly does is to recycle and repackage existing government policies based on laissez-faire ideology… and Top of the List:

"An even more competitive tax system, bringing business and investment to Britain... High rates of corporation tax distort incentives and stifle business investment. During the last Parliament the main rate of corporation tax was cut from 28% to 20%".

This is a very odd priority in this context. For the period during which Corporation Tax has been progressively cut coincides precisely with the period in which labour productivity has been at its lowest! Many higher productivity countries have higher corporation tax rates. This is a pure example of ideology trampling over evidence.

So let’s come to the evidence. We have tracked real GDP and labour productivity since late 1979 to the end of Q2 2015 (at the time of writing, ONS have not published Q3 labour productivity numbers). You will see from the chart that the correlation between GDP and productivity is very strong – when GDP goes up, so does productivity. And when it goes down, so does productivity, sometimes with a slight advance or delay. Increased demand tends to enhance productivity.

Since supply-side measures like better education and training take many years to feed through, and then gradually, we may fairly infer that in the short to medium term, it is demand side factors that are more important. And indeed, the periods of growth in GDP and productivity are (unsurprisingly) also tightly correlated over time with increases in overall investment. Yet the first victim of the post-2010 austerity programme was the government’s capital investment programme – a classic false economy.

The orthodox supply-side consensus is that productivity was improving gradually at a steady rate up to 2007, and has since fallen dramatically for a range of (disputed) factors. Thus
Professor Richard Jones, Pro-Vice-Chancellor, Research and Innovation, University of Sheffield (great job title):

“The UK is in the midst of an unprecedented peacetime slowdown in productivity growth. Labour productivity – the economic output produced per hour worked – has, for many decades, grown steadily at 2.3 per cent a year. All that changed in 2007, since when it has stubbornly flatlined.”

“Flat-lined” is an odd word to describe the post 2007 gyrations, including the precipitate fall in productivity at the peak of the crisis as demand and output collapsed. But the chart shows that, from 2007 to 2011, productivity tracked GDP (and vice versa) reasonably closely, but when austerity and the Eurozone crisis kicked in in 2012, GDP slowed (to 1.2%) but productivity declined more sharply. The two years that diverge somewhat from the norm are 2013 and 2014, when GDP increased at a reasonable overall rate (2.2%, 2.9%) while productivity rose only 0.4% and 0.2% respectively. But in 2015, with somewhat higher real pay finally coming through, and a modest (if slowing) rise in GDP, productivity has also risen after a poor Q1.

Behind all this, we need to recall that – in real terms – total average pay fell year on year for 6 long consecutive years, a totally new phenomenon since records began, while total employment was rising for most of the time. Only since 2014 has the process been reversed, with real pay starting to rise. As at Q3 2015, however, it still remains an enormous 7.8% below the peak Q1 of 2008.

It is really inescapable that the economy – under the government’s gaze - has evolved, since the financial crisis, in a direction of lower cost, more plentiful labour. Employment growth is concentrated in a range of service sectors (many of which are based on low pay), rather than on industrial production. Table 1 shows how growth in employment and cuts in real pay have come together since 2010 (all data from ONS):

<table>
<thead>
<tr>
<th>Employment % change y/y (Q4-Q4)</th>
<th>Real pay index % change y/y</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>1.4</td>
</tr>
<tr>
<td>2011</td>
<td>0</td>
</tr>
<tr>
<td>2012</td>
<td>1.7</td>
</tr>
<tr>
<td>2013</td>
<td>1.3</td>
</tr>
<tr>
<td>2014</td>
<td>2.0</td>
</tr>
<tr>
<td>2015 (my estimate)</td>
<td>1.8</td>
</tr>
</tbody>
</table>

Thus, the ultra-flexible UK labour market (“with employers in the driving seat”, in the government’s own charming words) – to be enhanced by the repressive new Trade Union Act – has had the effect of causing productivity to fall. And whatever government says about wanting higher productivity, this is the necessary consequence of its overall policy stance to date.
It will require a huge change in policy to achieve a high productivity UK economy. A large, sustained, government-driven programme of investment (in infrastructure, research and development, skills etc.) to enable us to prepare for our digital, post-carbon society, is by far the best way to combine increased economic activity (GDP), higher pay, and thus higher productivity.
The politics and economics of energy and climate change - two, huge, linked themes - dominated the year. And nowhere, from governments to anti-austerity oppositions on the left, are the full implications for economies being appreciated.

The Paris climate talks fell in December 2015 setting the year’s agenda so that almost all environmental issues were seen in the context of agreeing a replacement, international deal on global warming, including the process to set a new, universal Sustainable Development Goals.

Shocking compared even to the mendacity of the tobacco industry, which suppressed scientific evidence on the link between smoking and cancer, were revelations that the oil company Exxon had known for decades about the science of climate change and yet obfuscated and lobbied against action that would inconvenience the fossil fuel industries.

It then emerged that Exxon were not alone. From the late 1970s, oil majors from Shell to Texaco, Mobil, Amoco, Gulf Oil and others all knew.

For nearly 40 years, therefore, fossil fuel companies had been conducting a massive, knowing geo-engineering experiment with the planet’s atmosphere for enormous private profit, and accepted for the transitory, ancillary benefits it provided in powering a growth and high energy-based economy.

We all now live with the consequences and challenge of reversing out of the economy’s subsequent fossil fuel-powered growth dependence. Setting the scene for how to approach the challenge, the Human Development Report of the United Nations Development Programme, reminded that there is no automatic link between economic growth and human development. Countries with similar income like Chile and Equatorial Guinea can have very different human outcomes, while countries with similar levels of development like Gabon and Indonesia, can have different levels of income.

Separately, the attractive idea that technology and efficiency alone might allow the wealthy world to deal with climate change without a fundamental change in economic direction was dashed by research revealing that the long-promised (and longed for) decoupling of growth from resource use was mostly illusory and an artefact of incomplete accounting.

Research published by the US Proceedings of the National Academy of Sciences found that, “Achievements in decoupling in advanced economies are smaller than reported or even nonexistent…. As wealth grows, countries tend to reduce their domestic portion of materials extraction through international trade, whereas the overall mass of material consumption generally increases.” So, just as growth does not guarantee human development (although obviously for very poor countries it may accompany it), you cannot grow your way to reducing your environmental impact. Hence, there is no environmental Kuznets curve in a growth economy, just an upward slope of impact at the aggregate level like the rising line of
emissions and greenhouse gas concentrations in the atmosphere. Information and service
driven economies tend merely to export their environmental impact.

The Paris agreement to some extent set a new framework for these issues. For diplomats
the agreement was a resounding success and the mother of all New Year’s resolutions. For
some scientists, good presentation masked a fudge on the climate science and obscured its
economic implications.

The agreement commits signatories to act to halt temperature rises, “well below 2°C above
pre-industrial levels and to pursue efforts to limit the temperature increase to 1.5°C above
pre-industrial levels.” Inclusion of the 1.5°C figure was considered a triumph for lobbying by
the recently formed ‘climate vulnerable’ group of countries, who broke ranks from the
traditional G77 negotiating block which carried major fossil fuel interests.

Pledges made by countries are non binding, but for the 180 plus countries making
commitments they are obliged to publish and regularly ‘upward review’ their pledges such
that, and “the efforts of all parties will represent a progression over time.” An initial stock
take will happen in 2018.

However, depending on whose estimate you take, the pledges made in Paris leave the world
committed to somewhere between 2.7 – 4°C of warming. As anywhere in this range is
beyond the point that domino effects begin it means a course of potentially irreversible,
catastrophic warming.

Even then, the models used to arrive at the lower, but still dangerous levels of warming,
make assumptions that test reality. Some assume either that global emissions peaked in the
past – when they are still rising – and others that in the future non-existent, speculative
technology will be able to remove at scale vast quantities of greenhouse gases. Some
models assume both.

Other key points of Paris were: recognition of the loss and damage to vulnerable nations
from warming already locked into the climate system, but without acceptance of the need
to compensate; a modest pot of money for low income countries’ adaptation; a long term
goal of achieving net zero emissions (however meaningless if irreversible warming begins
first); and the fact that there are no sanctions for not meeting commitments.

It was in this stark context that many viewed several decisions by the UK government as
decidedly odd. Cuts to clean energy, a decision to allow fracking for gas beneath National
Parks, re-opening the previously closed book of aviation expansion via a new runway at
Heathrow, privatisation of the Green Investment Bank with a related potential dilution of its
mission, cuts to key environmental departments in government and, as severe flooding hit
several parts of the UK, an inability even to protect its own population from increasing
weather extremes of a kind set to become more common in a warming world. Indeed, cuts
to clean energy incentives were justified by the government on the grounds of opposing a
‘permanent subsidies’ model, even in a year when George Osborne, Chancellor of the
Exchequer, announced new fossil fuel subsidies, and the government introduced a new legal obligation for the maximum use of North Sea oil and gas.

But then, the mainstream Labour Party too, showed that it hadn’t really got the message either. It wasn’t a good look when, the day after the Paris climate deal was agreed, Labour MP Sadiq Khan, the Party’s candidate for London Mayor, called for UK aviation expansion. And, through effective lobbying, aviation had once again been left out of the climate agreement. Almost everyone wanted to celebrate a diplomatic success in Paris, but no one, it seemed wanted to develop a logical path for subsequent action. The Confederation of British Industry pushed for Heathrow’s third runway even as it applauded the agreement. But, as an understanding that much of our remaining fossil fuels are now unburnable spreads, and the movement for divestment from its industry grows, such voices will look increasingly anachronistic and out of touch.

More broadly an economic model of debt-fuelled overconsumption has steadily reasserted itself in the UK, with the consumer debt that has been worrying the Bank of England rising again in a pattern that preceded the 2007-2008 financial crisis.

As 2016 looks set to be hotter still than 2015, our greatest challenge will be to learn how to flourish within planetary boundaries. Those on the left of economics cannot provide a meaningful alternative to neo-liberalism by critiquing austerity for its failure to deliver growth. There needs to be a positive vision articulated for how everyone can live well respecting environmental thresholds. In rich countries like the UK that means replacing consumption-led growth for a new kind of materialism that respects and cares for the material world, and tackles human need and aspiration through better distribution and a more creative approach to the art of living.