STUC Budget Submission 2015

Introduction

The past year has been dominated by increasingly optimistic rhetoric about the scale and pace of the recovery from years of economic recession and stagnation. The UK is, we are consistently told, now growing at the fastest pace of any G7 nation. The merits of the UK flexible labour market are supposedly revealed in the historically high headline level of employment. Welfare reform measures are now providing the right incentives for people to leave benefits and move into work. The supply side reforms introduced by the Government have set the UK on course to win the 'global race'.

The STUC is profoundly sceptical of this dangerously naïve and self-serving account of the current state of the UK economy. Some of the Coalition Government's claims are exaggerated, others demonstrably wrong. The economy emerging from the 'great recession' is one characterised by low wages, rising insecurity for those in and out of work, rising household debt and a failure of 'rebalancing' at all levels.

And the sustainability of the recovery is also under threat: the Government and Bank of England are much too relaxed over the prospects of sustained deflation and the low oil price could have a significantly detrimental impact on growth and jobs in Scotland (although we accept the net impact of lower oil prices is likely to be positive for the UK as a whole).

In this submission, the STUC will outline its assessment of the current state of the Scottish economy and labour market, the impact of the Coalition Government's policies and propose policies for a fairer, more robust and sustainable economic strategy; one that leads to a more stable, resilient and fairer economy.

STUC assessment of current economic conditions

Any assessment based on headline employment and GDP statistics – often assumed to provide a comprehensive overview of the state of the economy - would be justifiably positive at this time. The recovery as measured by GDP growth is now firmly embedded and the labour market has outperformed expectations throughout the last seven years of recession and stagnation.

In Scotland the employment rate has now almost recovered to its pre-recession peak and there has been nine consecutive quarters of economic growth.

Yet there are a number of reasons why the STUC is cautious about ongoing economic recovery:

Deflation: CPI inflation grew by only 0.3% in the year to January 2015 mainly driven by falling prices for motor fuels and food. While falling inflation (rather than strong nominal wage growth) is behind the recent return to real wage growth, the STUC believes that the Government is complacent about the nature and potential impact of deflation. It is also somewhat ironic that the Government is lauding inflation falling to 0.3% while, presumably for a reason, it sets the Monetary Policy Committee a target of 2%.

The key point is that inflation is at a historic low while debt levels are high: debt deflation – the rising real value of debt fixed in nominal terms - tends to make debtors cut back spending without compensatory spending by creditors.

Oil and gas: the STUC tends to believe that Mark Carney[1], Governor of the Bank of England is correct in his assessment of the impact of lower oil prices: the net impact at UK level is likely to be positive as consumers and sectors which rely on oil as an input benefit but that the net impact for Scotland, a net exporter of oil, is likely to be negative. Indeed, Scotland – the north east in particular – is already suffering from arbitrary pay cuts and redundancies. The situation is unlikely to improve substantially while prices remain around $60 a barrel.

Eurozone: the Eurozone, Scotland and the UK's biggest trading partner, continues to suffer from low growth and deflation. At the time of writing it remains plausible that Greece could exit the Eurozone in 2015. If a Greek exit transpires, the consequences for the Eurozone, the UK and Scotland are almost certainly negative.

Global economy: despite the fall in oil prices which, as a massive shift in income from producers to consumers has/ provided a significant global stimulus, the global institutions have actually revised down their forecasts of growth in 2015. The World Bank[2] has argued that 'the global economy is still struggling to gain momentum as many high-income countries continue to grapple with legacies of the global financial crisis and emerging economies are less dynamic than in the past'. China is, 'undergoing a carefully managed slowdown'.

Similarly, the IMF[3] argues that 'new factors supporting growth—lower oil prices, but also depreciation of euro and yen—are more than offset by persistent negative forces, including the lingering legacies of the crisis and weak investment as many countries adjust to lower potential growth'.

[1] In evidence to Treasury Select Committee, 13 January 2015

[2] Global Economic Prospects, World Bank, January 2015

[3] World Economic Outlook, IMF, January 2015

The Chancellor's Autumn Statement

As the Chancellor announced his statement on 3 December the OBR's simultaneously published its Economic and Fiscal Outlook[4]. There was much in the latest publication to challenge the Chancellor's unreasonably optimistic assessment.

The OBR:

- while raising growth forecasts for 2014 and 2015, actually cut its forecasts for 2016 onwards;
- cut its forecasts for wage growth;
- spelled out the extent to which tax revenues have failed to recover with employment – a manifestation of the crisis of low wages;
- forecast an economy that looks nothing like the 'rebalanced' economy promised by the Coalition in 2010;
- has, once again, implicitly criticised the Government's spending plans beyond the next election. With NHS, schools and international development all 'protected', the spending cuts on other departments are widely considered to be undeliverable. Of course, because the NHS and schools receive real terms increases in funding doesn't mean that they're 'protected' in any genuine sense given that inflation in these sectors – especially health - tends to be higher than for other services.

Failure of Austerity

It is true that growth in both GDP and employment has been higher over the past 24 months than the STUC or many others anticipated at the time of the Budget 2013. However, this growth came at a time when the Chancellor significantly slowed the pace of austerity. The stronger recovery also failed to bring with it the benefits promised by Coalition ministers:

- despite the stronger than anticipated growth through 2013 and 2014, output remains far below its historical trend and exports, manufacturing and construction remain below pre-recession levels;
- workers are not feeling the benefit of recent growth: real wages have continued to decline at a rate without precedent in modern times and real household disposable income has also been affected by regressive tax rises and benefit cuts; the return to a cycle of real terms wage rises forecast by the Government and many others has simply failed to materialise. The very recent return to real wage growth has been attributable to falling inflation rather than strong nominal wage growth. As things stand, the OBR's forecasts for real wage growth in 2015 will almost certainly prove too optimistic;

[4] Economic and Fiscal Outlook December 2014, OBR

- the composition of growth through 2014 continues to be a concern. Although business investment has started to revive (though it fell again in Quarter 3 2014) the consumer continues to drive growth. This won't be sustainable if rising real wages don't return. The OBR also forecasts that 1) household debt to income ratio will through this forecast period soar above the pre-recession levels which are now widely considered to have been unsustainable and 2) net trade (exports minus imports) will make zero positive contribution to GDP growth throughout the forecast period.

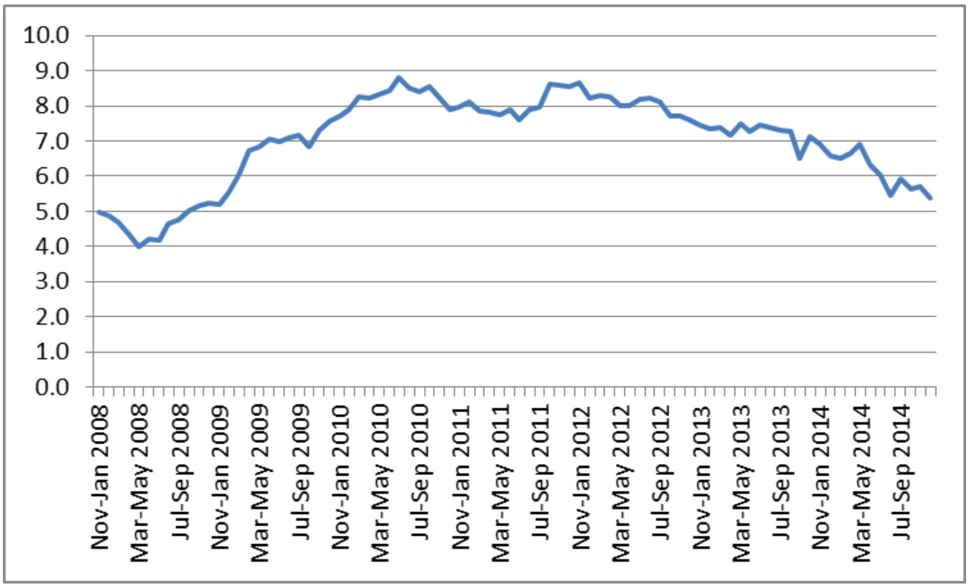
Therefore, the economy at the end of this Parliament will exhibit many of the features of the pre-2008 economy: an unsustainably high household debt to income ratio, an economy unbalanced towards finance, the south-east and domestic consumption.

Labour Market

Encouraging employment growth through 2014 continues to mask very worrying developments in the labour market. The period since 2008 has seen the further embedding of a number of adverse labour market trends, often obscured by a relentless political focus on the headline level of employment.

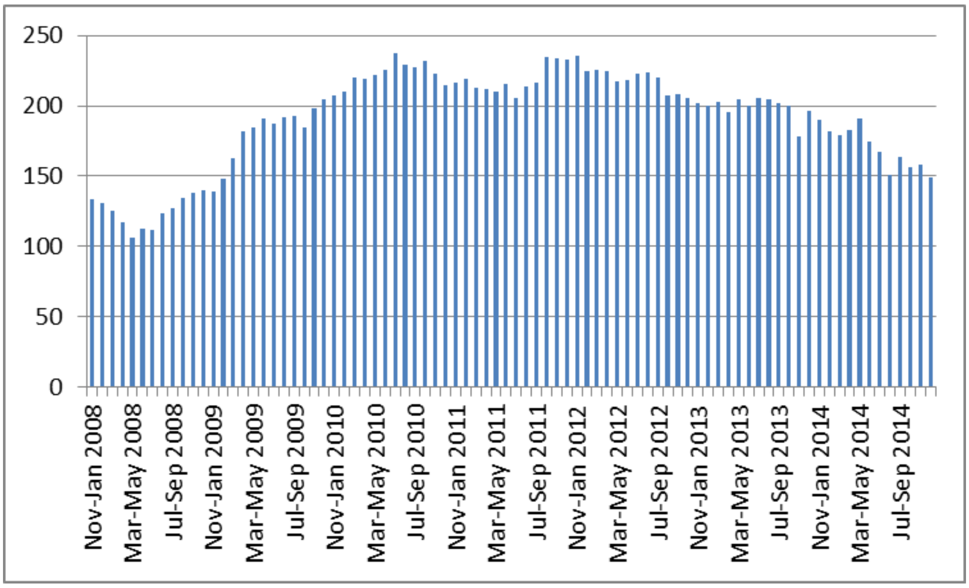
The first point to stress is that unemployment in Scotland as measured by both the level and rate remains much higher now than on the cusp of the recession; the rate is 1.4% higher which corresponds to an additional 42,000 unemployed people[5].

Chart 1 ILO Unemployment rate (%) Scotland, 2008 to Oct-Dec 2014



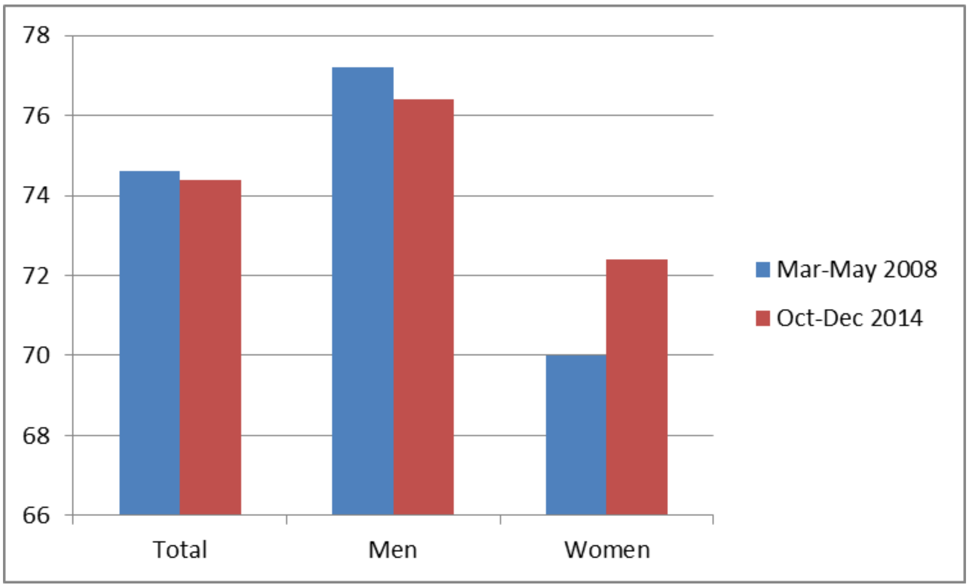
[5] ONS Regional Labour Market, February 2015 – all labour market statistics in this paper are drawn from the same release unless otherwise stated.

Chart 2 ILO unemployment (000s), Scotland, 2008 to Oct-Dec 2014



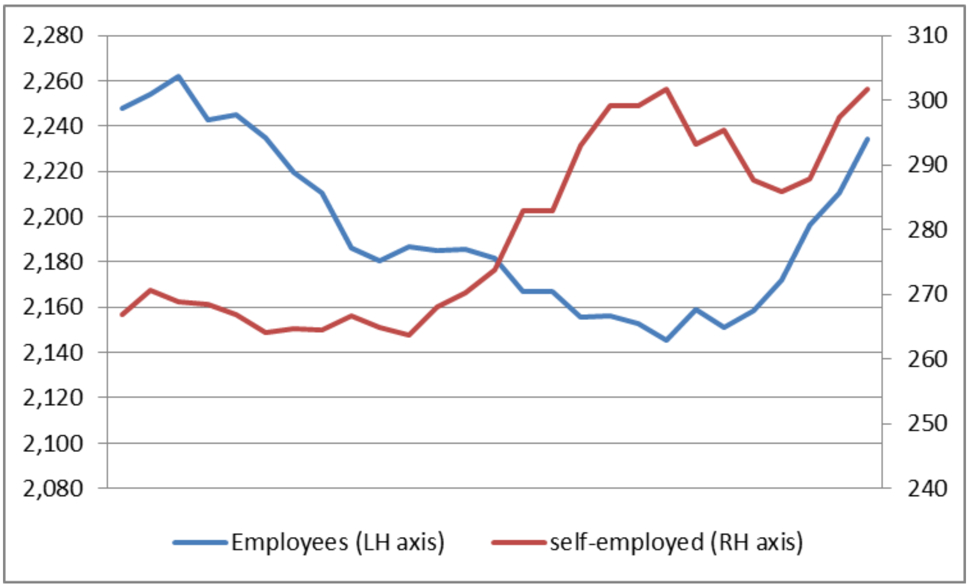
Employment has performed better, having reached its pre-recession level and getting closer than unemployment to attaining its pre-recession rate. It is striking that the improvement in the employment rate is wholly attributable to rising employment among women.

Chart 3 16-64yrs Employment rate (%), Scotland



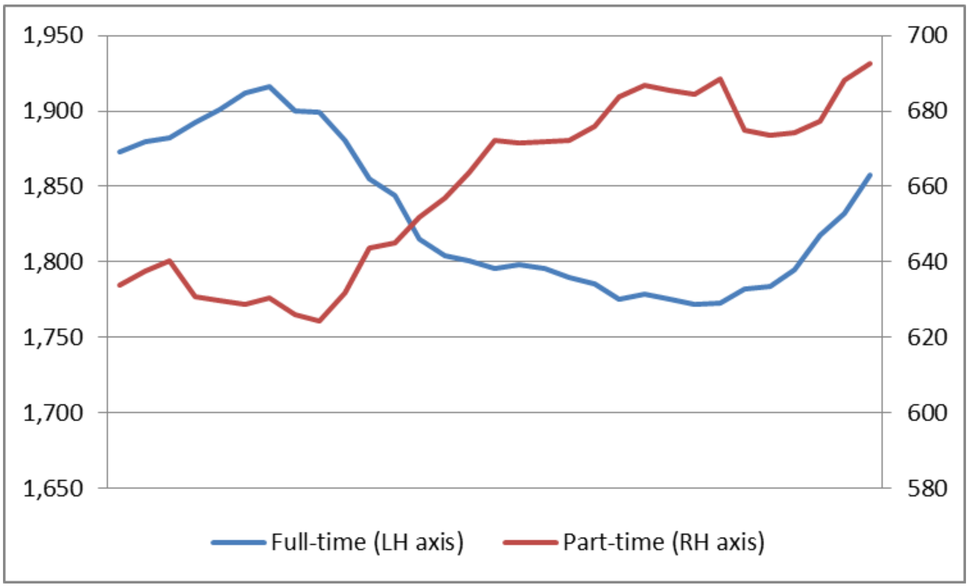
Of course, the salient feature of the post crisis labour market is the shrinking relevance of the headline statistics to how people actually experience a labour market characterised by low pay, insecure forms of employment, rising self-employment and falling number of full-time jobs.

Chart 5 No.s of employees and self-employed (000s), Scotland, 2008-2014



While the number of employees is still 1% down on 2008, the number of self-employed has increased by over 14%. While detailed information on the nature of these new self-employed jobs in Scotland is scarce, it is reasonable to assume on the basis of UK wide surveys that the new self-employed are earning less, working less hours and paying less tax than they did as employees.

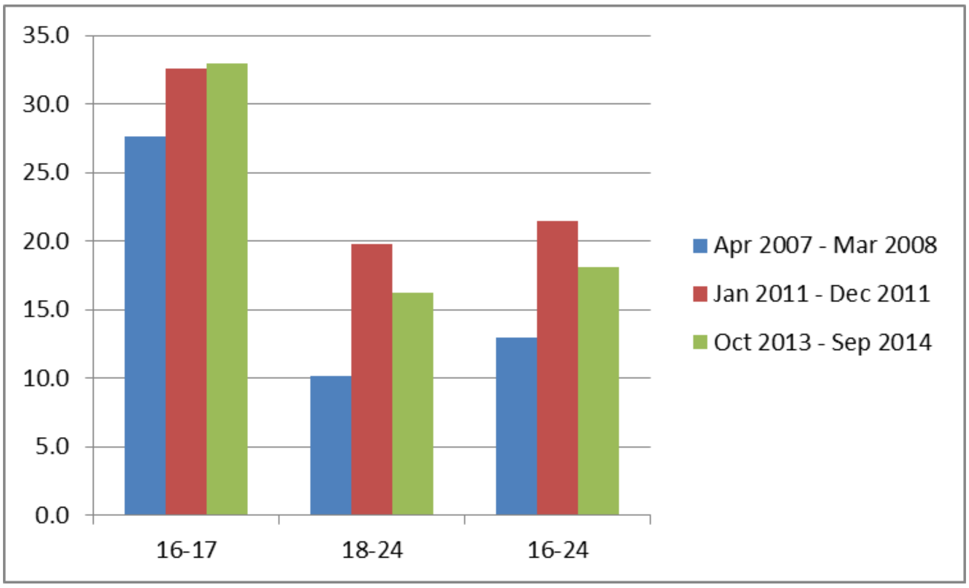
Chart 6 Full-time and part-time employment (000s), Scotland, 2008-2014



One of the positive aspects of the past year is the increase in full-time employment of 4.1% in the year to September 2014. However this is still 60,000 or 3% below pre-recession peak. Part-time employment has increased by over 11% since 2008. While women have always accounted for the majority of part-time workers (around 80%) it is worth noting that women accounted for all the additional 19,000 new part time jobs in the past year.

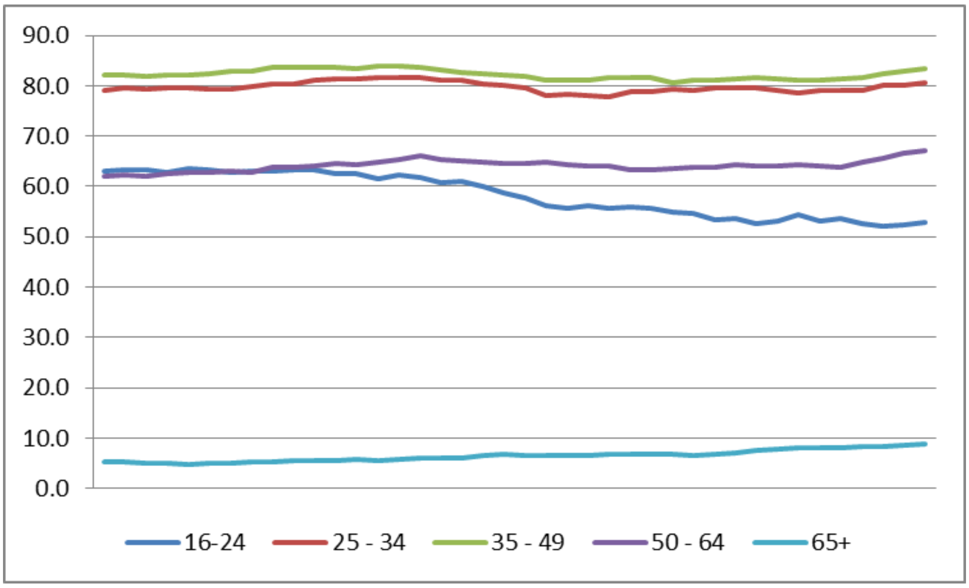
One of the most worrying aspects of the labour market has been the stubbornly high levels of youth unemployment which have not fallen with the all age rate. This has started to correct over the last year but youth unemployment (16-17 year olds, 18-24 and 16-24) remains significantly higher than pre-recession rates.

Chart 7 Youth unemployment, Scotland, 2007-2014



One possible reason for higher youth unemployment might be the increasing employment rates for older age groups. Indeed the only age categories to surpass their pre-recession peak employment rates are the 50-64 and 65 plus. The 65 plus age group has the fastest rising employment rate of all (although it is still way below that for other groups).

Chart 8 Employment rate (%) by age group, Scotland 2004-2014



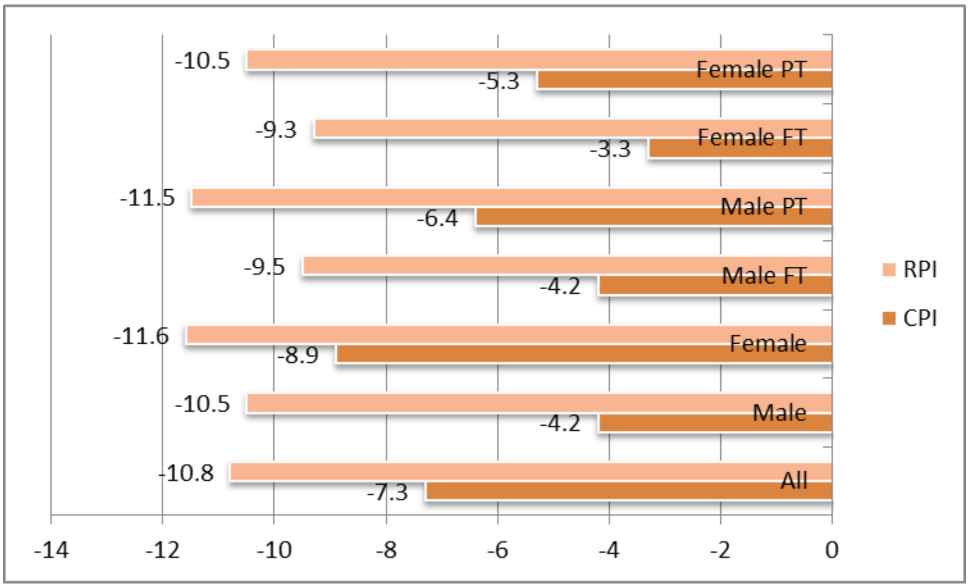
Wages

The collapse in real wages since 2009 is without precedent in modern times. It is necessary to go back till the mid-19th century to find a comparable period of sustained falling wages.

Recent Annual Survey of Hours and Earnings (ASHE) data confirm that the real median wage in Scotland fell for the fifth consecutive year in the year to April 2014. If wages had kept pace with CPI inflation since 2009, the median worker in Scotland would have earned £1,670 more in the year to April 2014. This rises to £2,048 for the median women full-time worker. The biggest percentage loss is for part-time women workers who earn 11.6% less than if wages had kept pace with CPI (or £693 annual loss)[6].

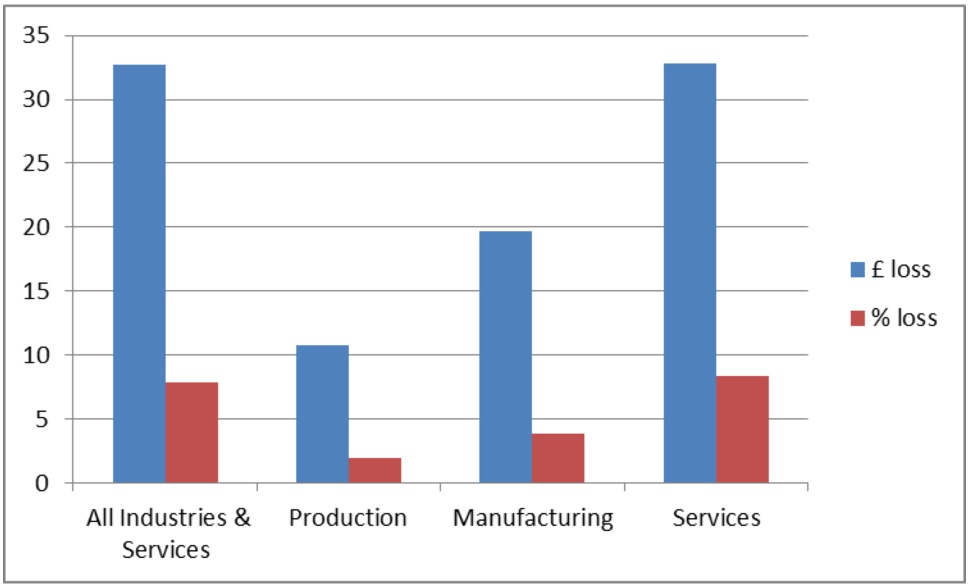
[6] STUC analysis of ASHE 2014 (ONS November 2014) statistics

Chart 9 Real median wage (gross weekly earnings adjusted by both CPI and RPI inflation) by gender and job type, Scotland, 2009-2014



The fall in real wages has been apparent across all industries although the service sector has begun to recover over the past year:

Chart 10: Real weekly income loss, Scotland, 2009-2014



Although falling wages have affected all sectors of the economy the distribution of pain is highly uneven. For instance, over the last year, the biggest increase went to financial sector directors and managers who earned a massive real terms increase of 23%. However, low pay occupations such as ‘retail cashiers and check out operators’ (-12%) and ‘elementary sales occupations’ (-9.4%) continue to suffer significant real terms cuts.

Public finances

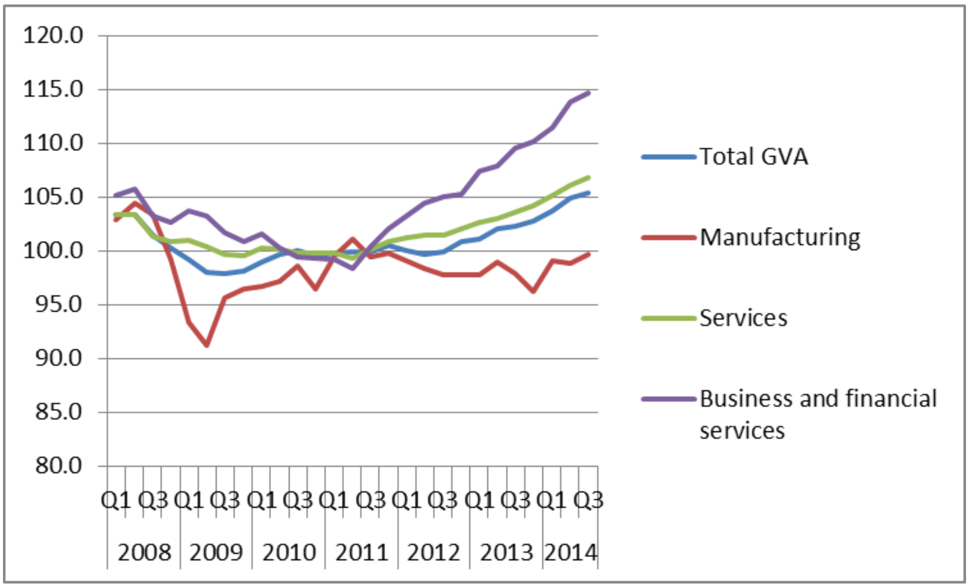
Austerity has failed on its own terms as the STUC always argued it would: current deficit is much higher than anticipated in 2010 and stock of debt has risen much faster. Austerity has had to be extended and the Chancellor has missed again his target for debt beginning to fall by 2015. Despite better than anticipated income from self-employed tax returns in January 2015, revenues have persistently under-performed against forecast and the OBR is poor at explaining why it thinks they will now recover strongly (although rising real wages are clearly the key contributory factor). Indeed, revenues were low even before the crisis. The Government has failed to address this crisis in revenue collection.

Prospects for growth/GDP performance

In 2010 the Chancellor promised the Coalition would rebalance the UK economy: from finance to manufacturing, from London to the nations and regions, from domestic consumption to exports and from debt to investment. The progress, if indeed there has been any at all, has been minimal.

In Scotland, the recession in manufacturing was much deeper than that in services and the recovery, such as it is, significantly slower. Remarkably in light of the rebalancing rhetoric, it is business and financial services which are driving the recovery in Scotland:

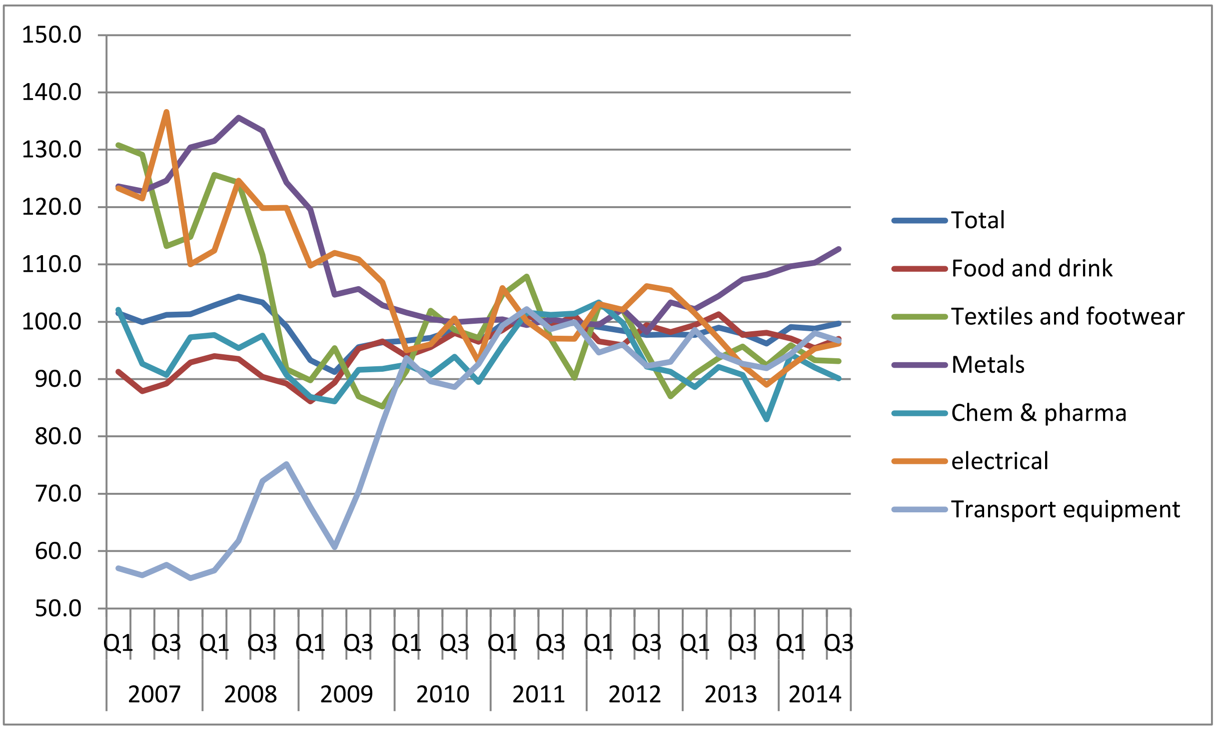
Chart 11: Output by sector (2011=100), Scotland, 2008-Q3-2014[7]



[7] STUC analysis of Scottish GDP Q3 2014 published by the Scottish Government, January 2014

Worse, the slow and uneven recovery in manufacturing is being driven by only two sub sectors: food and drink and transport equipment:

Chart 12: Manufacturing output by sub-sector, Scotland, 2008-2014



There is a similar story in other aspects of the rebalancing agenda: GDP and employment growth has been stronger in London and the South East, the public finances haven't improved as forecast, household income to debt ratio is forecast to rocket and net trade will make no positive contribution to growth over the forecast period.

What passes for an economic strategy isn't working and, worse than that, is actually undermining sustainable long term growth. The last thing the UK needs is corporation tax cuts, further deregulation and, most importantly, policies which deliberately seek to inflate another housing bubble.

There is also the ongoing failure to deal with the source of the current crisis: the banking sector. Weak reforms to be implemented by 2019 is not a credible response to immediate and huge problems.

Tax

Due to the appalling behaviour of HSBC and other major companies, the issue of tax avoidance and evasion - a major feature of STUC Budget Submissions since 2008 - is now firmly back on the political agenda.

The STUC believes that, despite encouraging rhetoric, the Government has singularly failed to introduce robust measures. Worse, some tax 'reforms' introduced since 2010 have actually facilitated additional avoidance.

The STUC believes that:

- genuine progressivity must be reintroduced into the taxation framework;
- the first step should be the reintroduction of the 50p rate. The STUC notes that serious academic research[8] has shown that the optimum top rate of tax in the UK is probably significantly higher and that there is no link between the top rate of tax and growth. Indeed, the US and UK – the countries that have cut the top rate more over the past four decades – have been middle performers in terms of growth. These countries have however seen the largest increase in inequality over this period;
- the UK must seek to sustainably increase total tax revenues as a percentage of GDP if the key demographic and climate change challenges are to be met successfully. It is possible that some trade-off will be necessary between scale and progressivity (i.e. we will all have to contribute more);
- Recognise that the Autumn Statement did include welcome commitments to tackle tax avoidance by banks and multinational firms but that these measures need to be properly resourced – it isn't possible to develop a credible anti evasion and avoidance strategy whilst HMRC continues with staff cuts.

Welfare Reform

The Government's desire to make rapid and deep cuts to the social security/welfare budget meant that bad decisions were inevitably made. Policies such as the bedroom tax have saved little or no money while causing profound hardship. The consequences are apparent in the rapidly increased use of food banks. The IFS recently concluded that:

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[8] See for instance 'The Top 1% in International and Historical Perspective' Piketty, Atkinson, Saez, Alvaredo *Journal of Economic Perspectives—Volume 27, Number 3—Summer 2013—Pages 3–20*

"Low-income working-age households have lost the most as a percentage of their income from tax and benefit changes introduced by the coalition, mainly as a result of benefit cuts"[9].

The Government has pencilled in significant cuts for the next Parliament but has thus far refused to specify where they will fall. It will be unacceptable if the Chancellor refuses to provide some clarity in advance of the election.

The NIESR sets out the extent of the challenges and scope for regressive decisions within the next Parliament:

"*The next Government faces important decisions on whether or not to proceed with Universal Credit and on how to avoid the reassessment of DLA claimants turning into a repeat of the Workplace Capability Assessment disaster of 2011-14. There will be fewer options available to make retrenchments less regressive, especially if pensioner befits continue to be protected, and the consequences of continued below inflation uprating would be highly regressive. The next government will also be faced with continuing problems which retrenchment policy has failed to contain: housing benefit costs for working families in the private rented sector and the cost of in-work tax credits. This welfare reform, in a different form from that envisaged by the Coalition, may well be on the agenda for the next parliament*"[10].

It is essential that the Chancellor starts to set out the Government's approach in Budget 2015.

STUC priorities/policy alternatives

As outlined earlier in the submission, the STUC is very sceptical on both the strength and durability of the current recovery. GDP and employment growth may have improved but the recovery has been transparently insufficient to bring about a general recovery in living standards.

In order to sustain employment and GDP growth, increase living standards and improve the quality and security of work, the STUC calls for:

- Postponement of fiscal consolidation until three conditions have been satisfied: monetary policy is no longer constrained by the zero lower bound, real wages have grown for a sustained period and productivity has started to improve;

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[9] The effect of the coalition's tax and benefit changes on household incomes and work incentives, IFS, January 2015

[10] National Institute Economic Review, February 2015

- When these conditions have been satisfied, fiscal consolidation should be rebalanced towards tax cuts for those individuals and firms who can afford them;
- Taking advantage of low long-term borrowing costs, public investment to be increased in order to provide quality employment and create the conditions for future sustainable growth;
- Wider promotion of the living wage through public contracts at all levels;
- A new 50p higher rate of tax as the first move towards a more progressive system; and,
- A reinvigoration of industrial policy to meet the rebalancing challenge: an essential first step is to bring Business Bank to sufficient scale in order to provide the patient capital required by manufacturers and exporters.

Oil and gas

The industry's response to the recent dramatic oil price fall has been to impose swingeing pay cuts and redundancies. This is neither fair nor sustainable.

The STUC does recognise that the industry must seek to control rising costs. ***Implementation of the Wood Review recommendations - with full participation by all stakeholders including trade unions – will be a sensible starting point***.

It is important to stress that there is every bit as much onus on the industry to get the response to Wood right as there is on the Government. Key recommendations (on, for example, collaboration) rely on a mature and properly resourced industry effort.

Tax cuts may help stabilise the industry, increase investment and safeguard jobs. Given the costs pressure associated with a mature and hostile environment like the north sea, it is also highly likely that the UK exchequer will have to become acquainted with a significantly lower tax take from the industry even if the oil price recovers and new investments yield forecast output.

The STUC therefore supports calls made by the industry and the Scottish Government for an immediate reduction in the supplementary charge and increased incentives for exploration and new development. A shift to a tax regime which is more stable and levels a lower overall tax on profits is now unavoidable.

However, given that producers are taxed on profits which are likely to be non-existent in the current year and perhaps for a period beyond, it is important to be realistic about the potential stimulatory impact of tax cuts at this time.

STUC
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