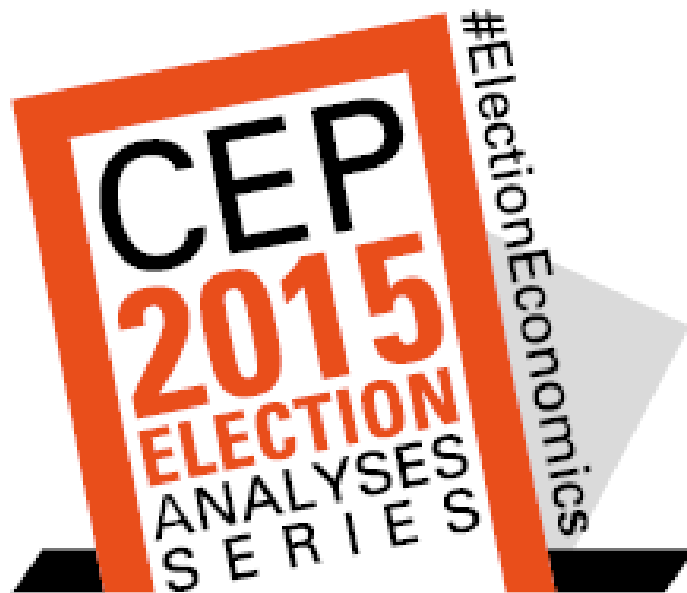


The Election & the Economy

John Van Reenen (Professor of Economics, LSE & Director Centre for Economic Performance)

CASE Election Series, April 29th 2015



Introduction

- Economy major election issue
- CEP Election Analysis <http://cep.lse.ac.uk/election2015/>
15 briefings. Main themes:
 - **Austerity**
 - **Britain's Place in the World** (EU, Immigration)
 - **Long-run growth** (Productivity, housing, energy/environment)
 - Public services (health, schools, HE, police)
 - Living Standards (incomes, inequality, cities, gender, top tax)
- Major differences, but many things unclear & not discussed in media

Economic background

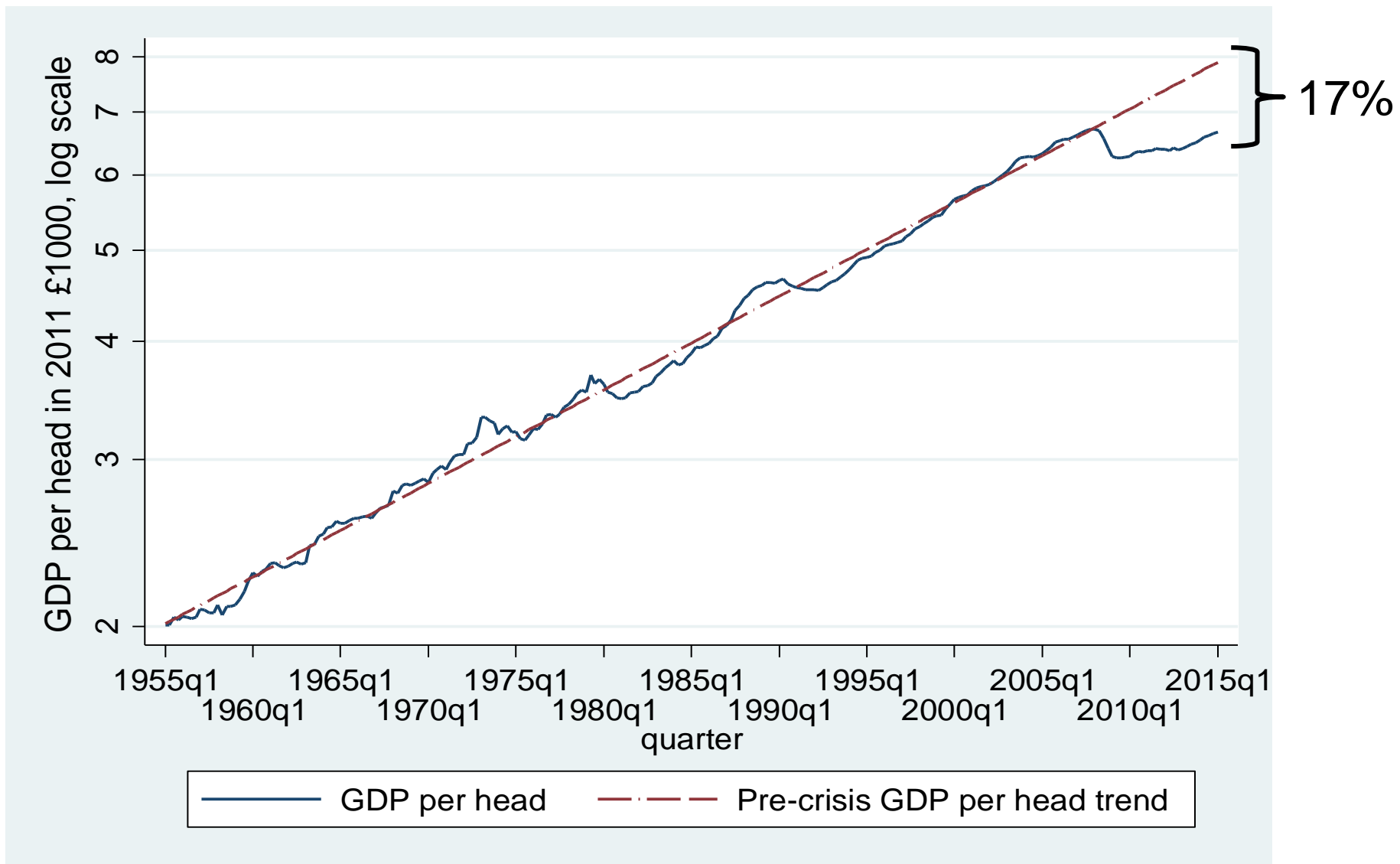
Austerity

Brexit

Immigration

Long-term growth

A DISMAL ECONOMY? GDP PER PERSON, 1955-2015



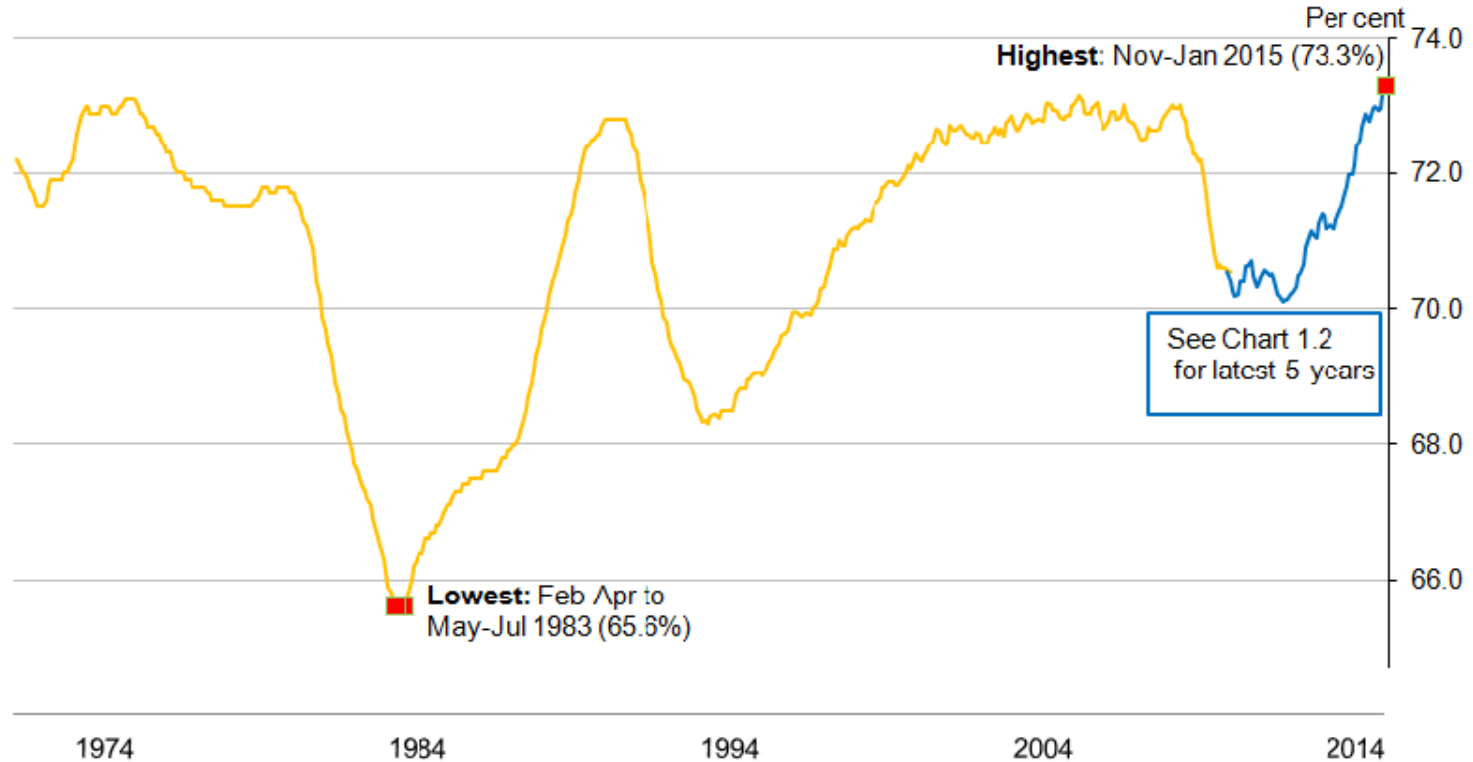
Notes: Trend line at 0.57% per quarter (linear trend from 1955Q1 to 2008Q1 when recession began). Quarterly GDP (in £1000) per head on log scale (ONS series IHXW, downloaded April 28th 2015)

<http://www.ons.gov.uk/ons/datasets-and-tables/data-selector.html?cdid=IHXW&dataset=ukea&table-id=X11>.

2015Q1 estimated using GDP growth http://www.ons.gov.uk/ons/dcp171778_402219.pdf

A HAPPY ECONOMY? EMPLOYMENT RATE AT RECORD HIGH

Chart 1.1: Employment rate (aged 16 to 64) from January-March 1971, seasonally adjusted

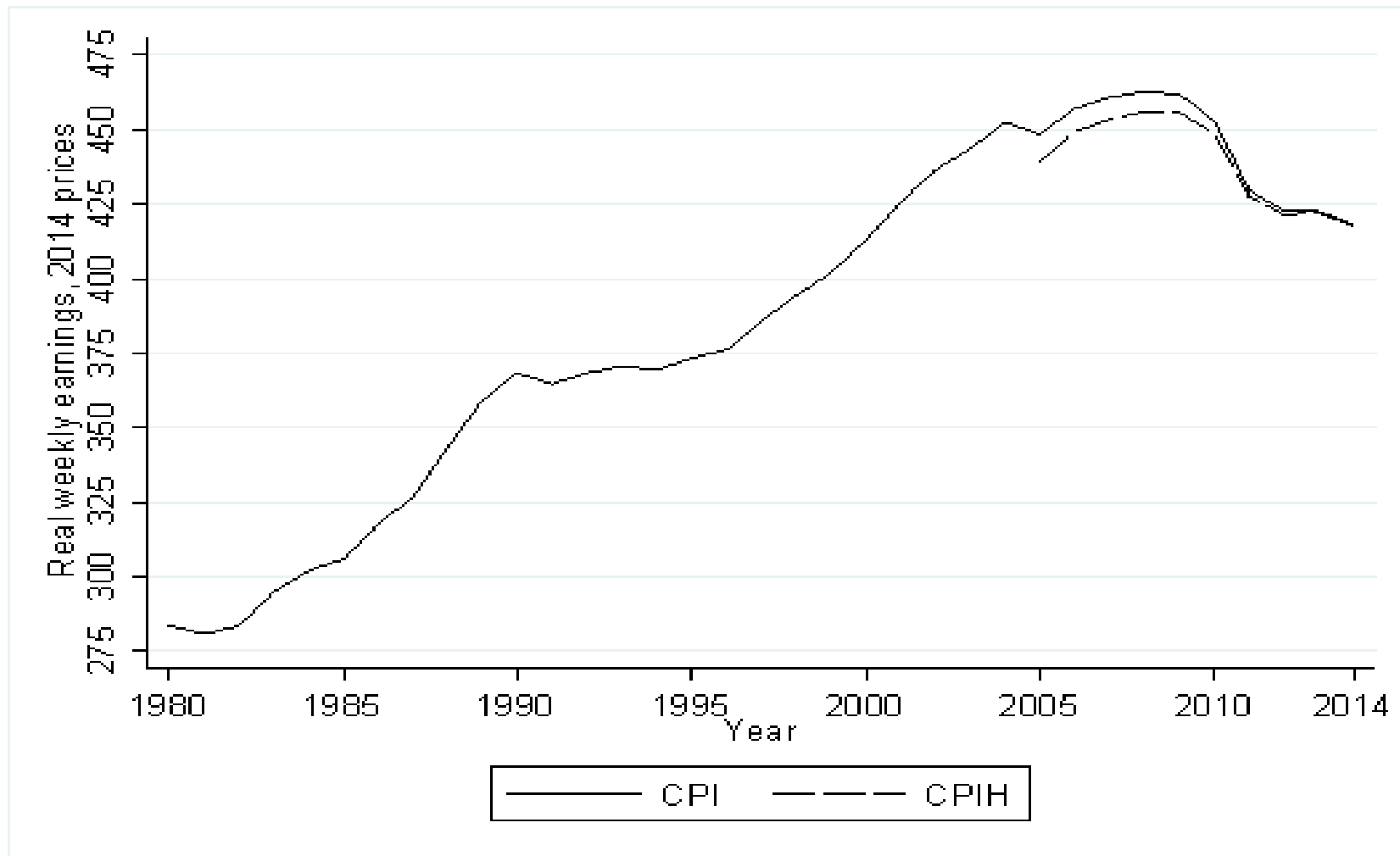


Source: Labour Force Survey - Office for National Statistics

Source: ONS LFS (2015, March) <http://www.ons.gov.uk/ons/dcp171>

CENTRE for ECONOMIC
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THE EXPLANATION? FALLING REAL WAGES



Notes: Annual Survey of Hours and Earnings (ASHE) weekly earnings numbers, updated from Gregg et al (2014a, 2014b), deflated by CPI and CPIH (from 2005).

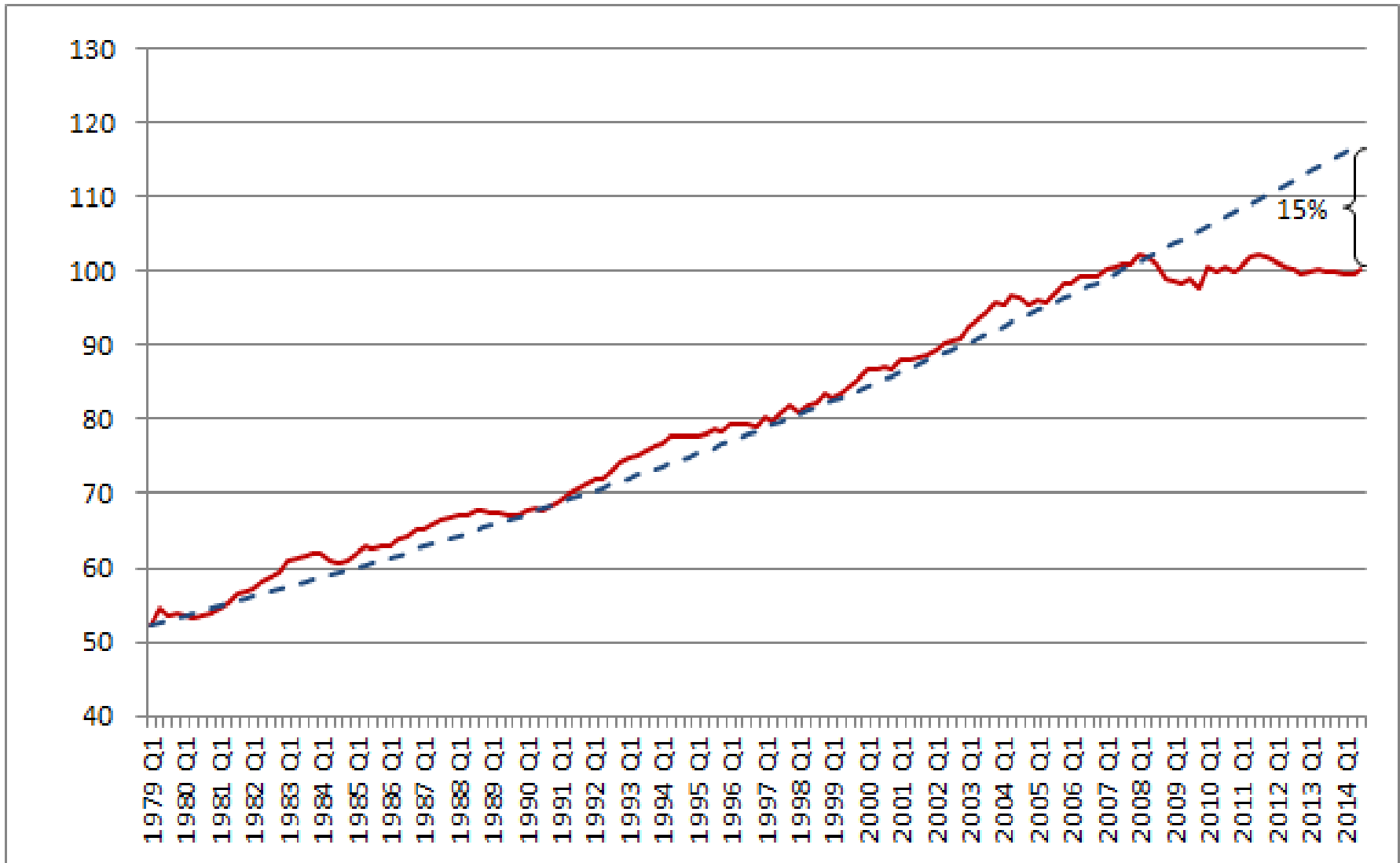
FALLING REAL WAGES: GROUP VARIATIONS

Percentage falls in median real wages by group
since 2008, ASHE

All	-10%
Men	-12%
Women	-7%
Age 18-24	-16%
10 th Percentile	-10%
90 th Percentile	-11%

Notes: Machin (2015) Updated CPI deflated numbers from Gregg et al (2014b).

THE UK PRODUCTIVITY GROWTH PUZZLE

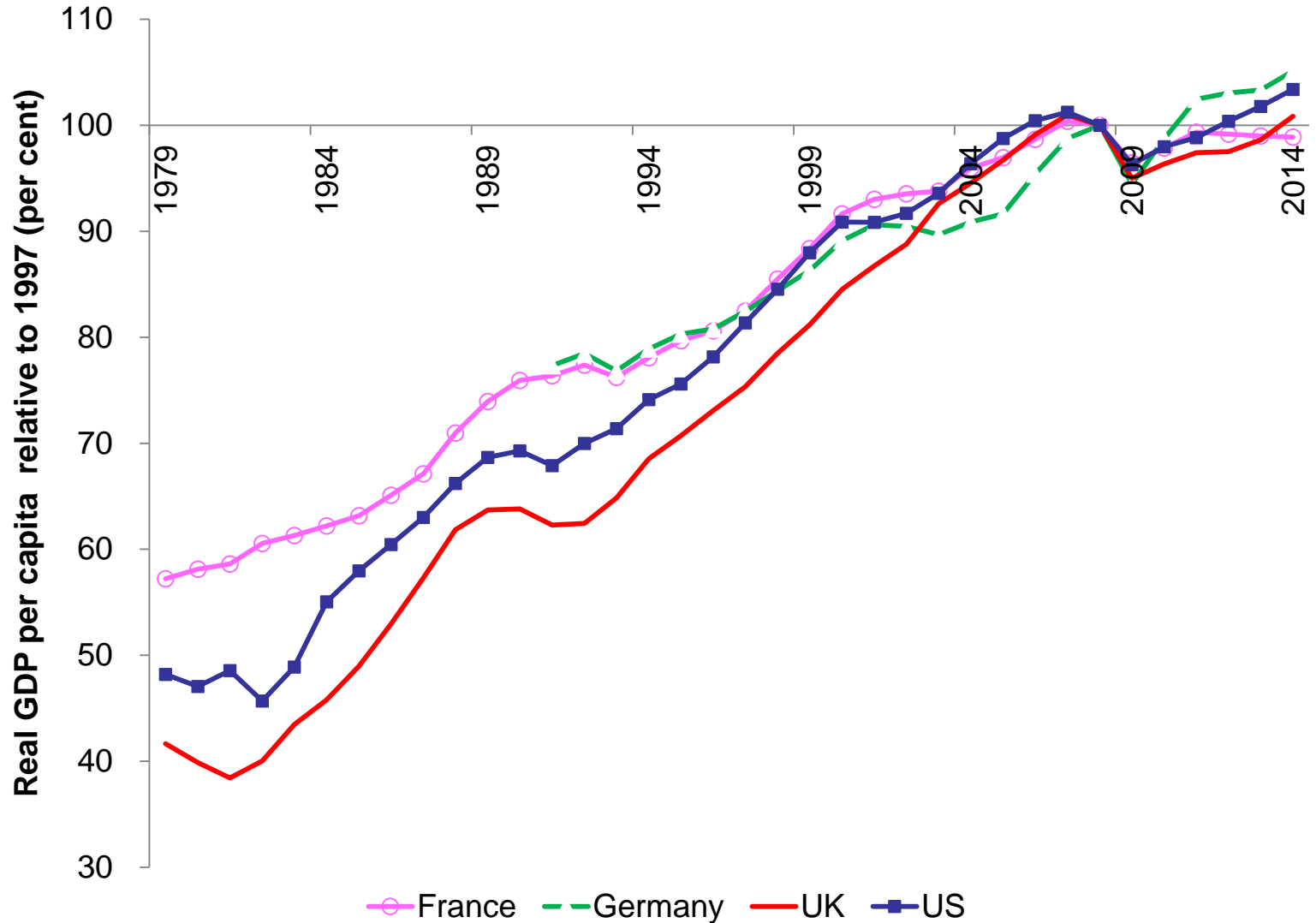


Source: ONS Statistical Bulletin, Q3 2014, extracted 6 February 2015

Notes: Whole Economy GDP per hour worked, seasonally adjusted (Q2 2010=100).

Predicted value after 2008 Q2 is the dashed line calculated assuming a historical average growth of 2.3% per annum (the average over the period 1979 Q1 to 2008 Q2).

UK REVERSES A CENTURY OF RELATIVE DECLINE IN THE 30 YEARS TO 2008, BUT UNDER-PERFORMED SINCE



Source: Conference Board (2015)

Economic background

Austerity

Brexit

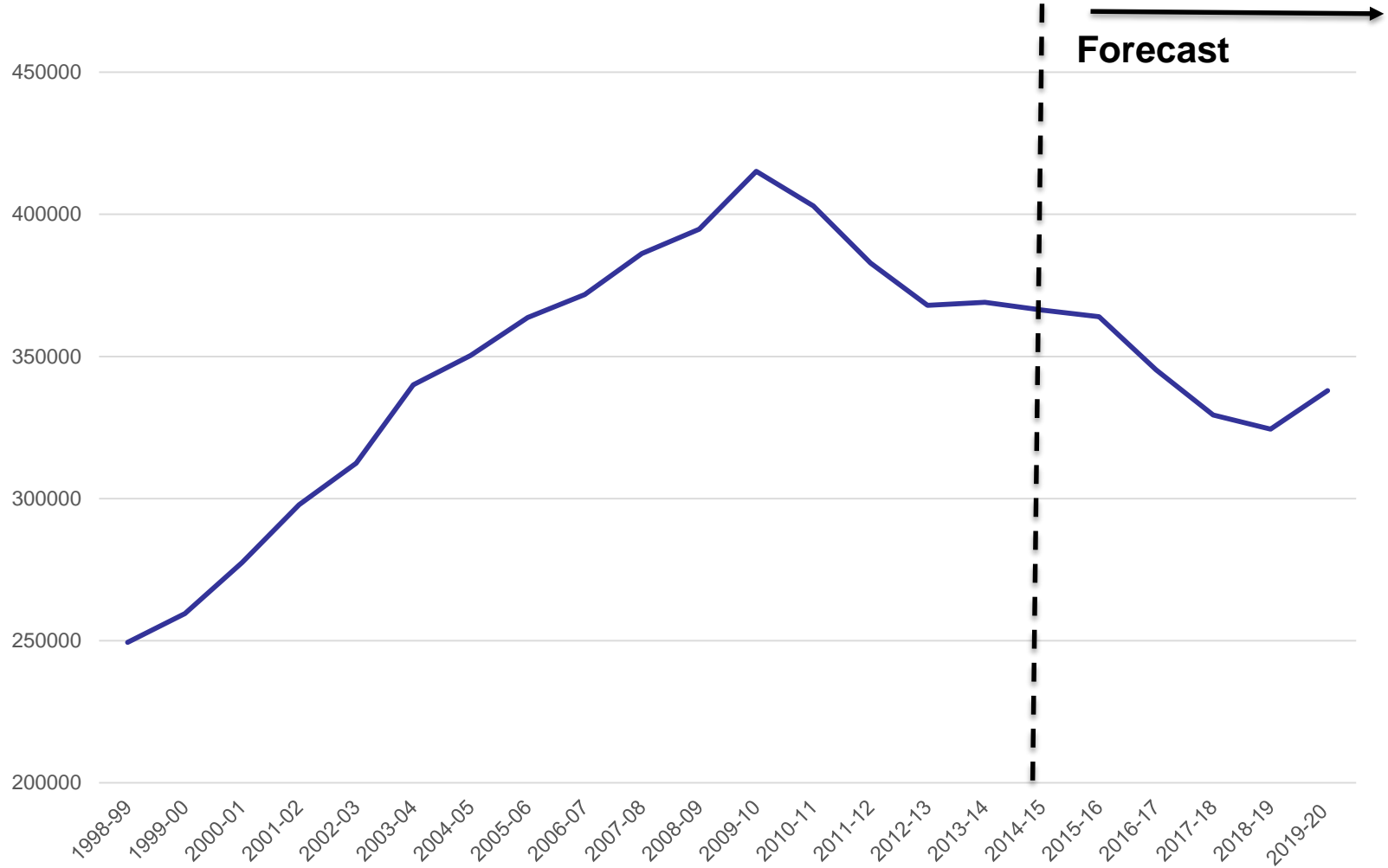
Immigration

Long-term growth

Austerity Past

- Budget deficit 10.2% of GDP in 2010-11 & fell to 5% 2014-15
- Acceleration in fiscal consolidation since 2010 (included a 40% cut in public investment over next 2 years)
- OBR estimate this knocked 2% off economic growth (2010-11 and 2011-12)
 - Likely to be underestimate as impact of austerity much greater in downturn when interest rates near zero
- Justifications based on (i) confidence; (ii) Greek style debt crisis; (iii) MPC response. Rejected.
- Slowdown in austerity in 2nd half of parliament & some recovery

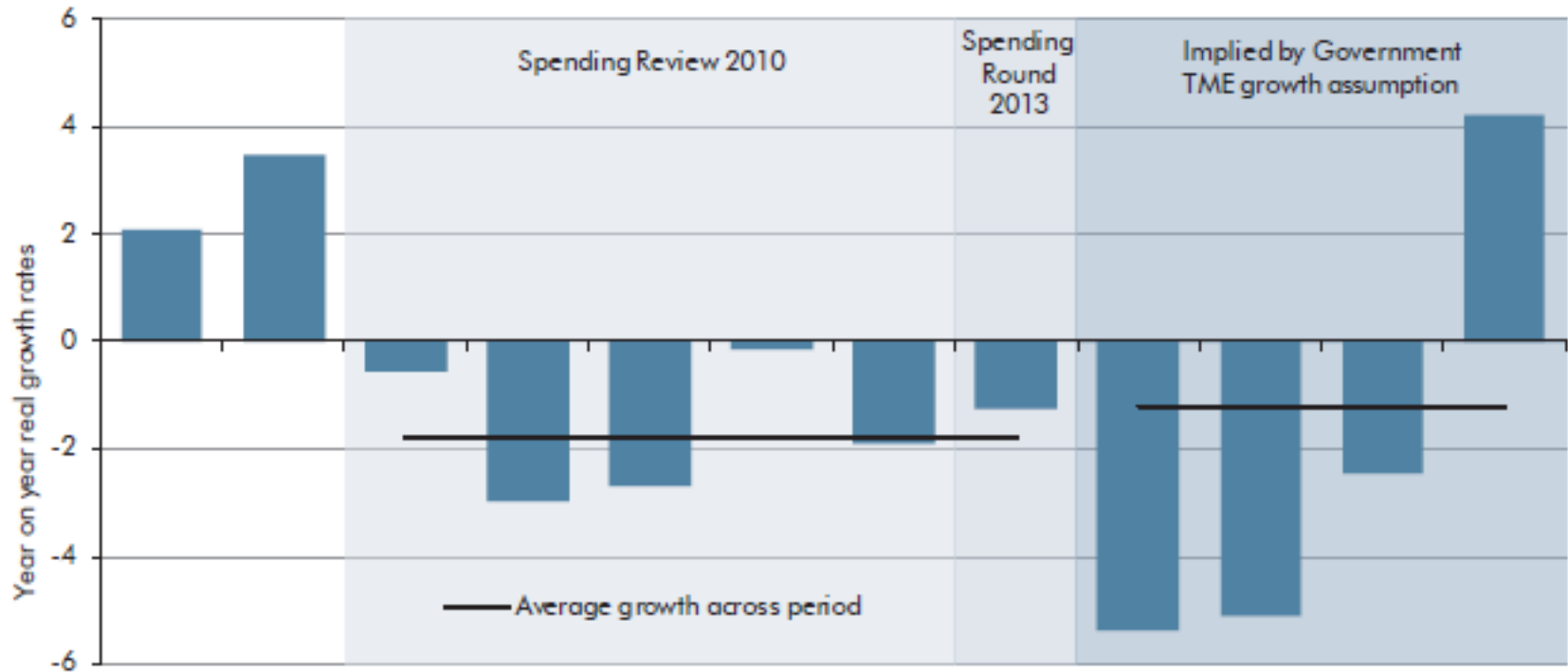
DEPARTMENTAL SPENDING PLANS IN BUDGET 2015, £M



Source: PESA (various years), 2015-16 prices, Budget 2015 plan

THE “ROLLERCOASTER” PATTERN OF SPENDING ON PUBLIC SERVICES

Chart 1.3: Year-on-year growth in real resource DEL spending



Note: RDEL series excludes major historical switches with AME as well as switches with AME in forecast years. Details are available in the supplementary fiscal tables on our website.
Source: OBR

Source: OBR (March, 2015)

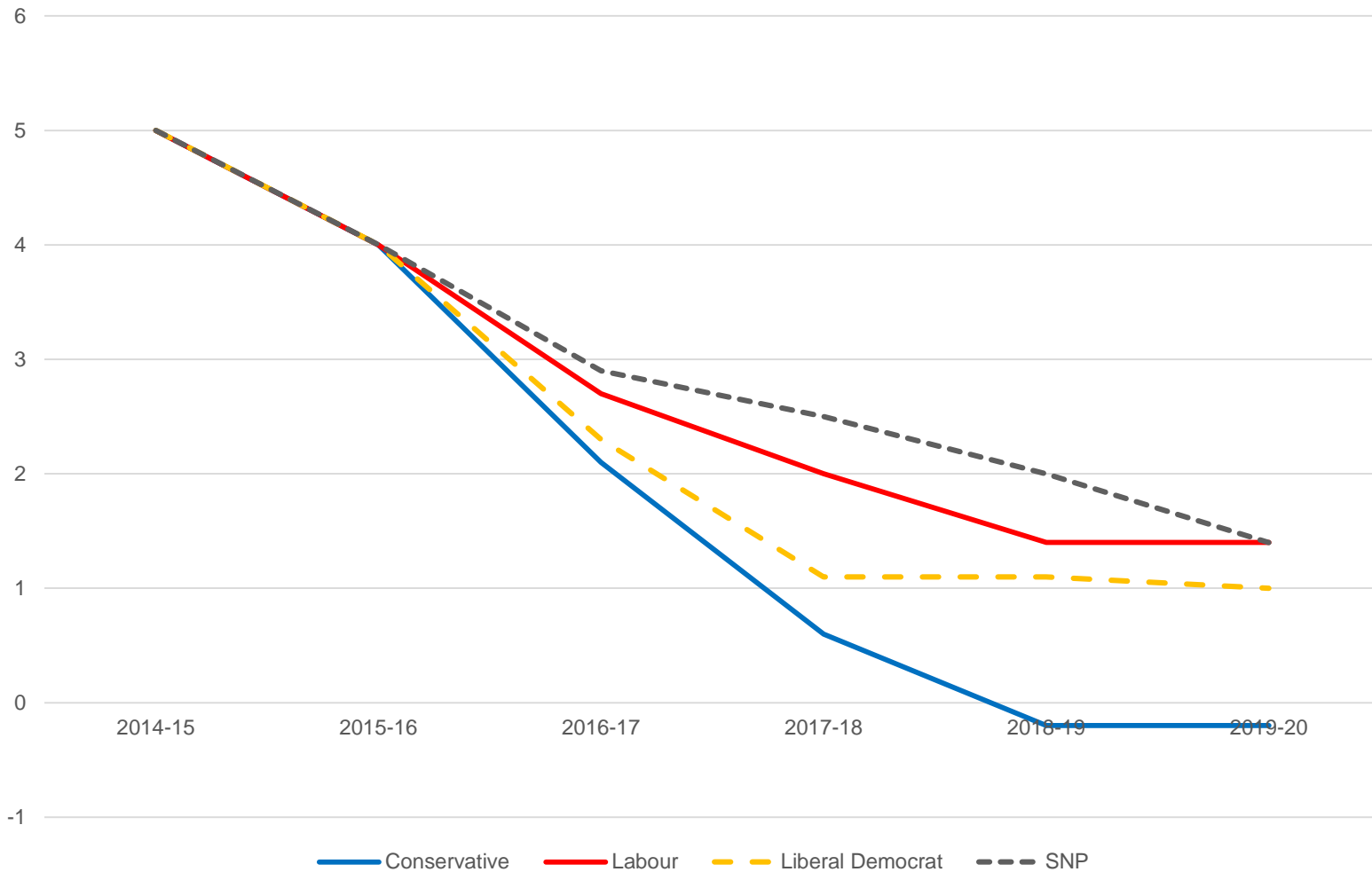
http://cdn.budgetresponsibility.independent.gov.uk/March2015EFO_18-03

CENTRE for ECONOMIC
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Austerity Present & Future: Overall Consolidation

- Given manifestos & statements can estimate fiscal stance across party plans
- Budget 2015 Coalition Plan aiming for a surplus on total budget 2018-19
- Conservative Plans similar
- Liberal democrat: balance *current* budget by 2016-17
- Labour balance *current* budget by 2018-19
- Difference is that Lab & Lib allow borrowing for investment (or “productive investment in Lib case). So could meet plan & still spend more (PNI 1.4% of GDP)

PUBLIC SECTOR NET BORROWING (% GDP) PLANS

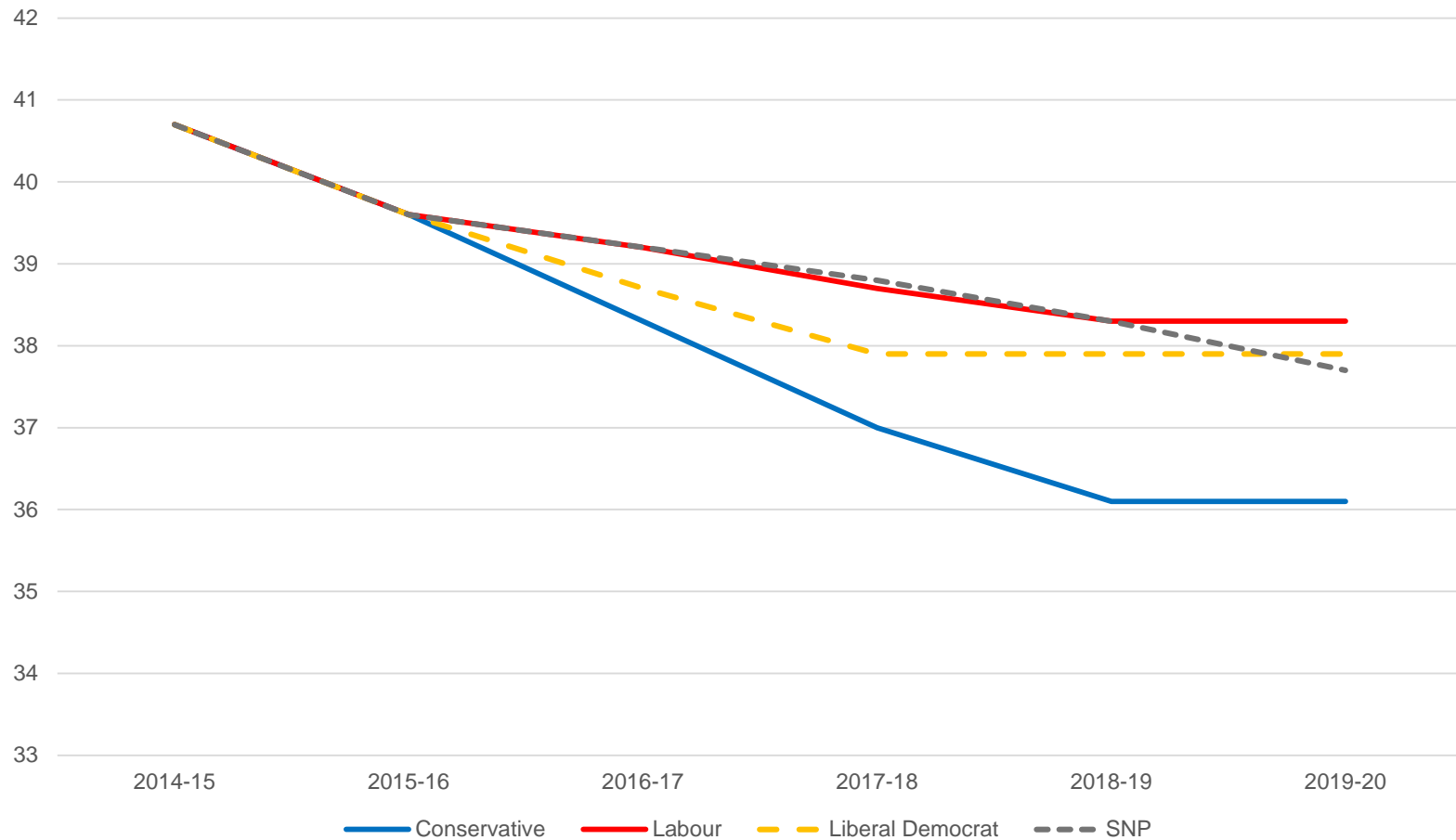


Source: IFS (2015) based on OBR, Economic and Fiscal Outlook: March 2015 and Election 2015 Manifestos from each of the parties.

Austerity Present & Future: Overall Consolidation

- Tax & spending profile
- Conservatives net tax giveaway of £0.1m (tax thresholds)
- Labour takeaway of £0.3m (e.g. Mansion tax, 50p rate)
- So much faster cuts under Tories, but also quicker reduction in public debt (£90bn difference by 2019-20)
- “Unprotected departments” bear brunt. 2014-15 to 2018-19 17.9% real cut (7.1% overall)

PUBLIC SPENDING (% GDP) PLANS



Source: IFS (2015) based on OBR, Economic and Fiscal Outlook: March 2015 and Election 2015 Manifestos from each of the parties.

Unanswered questions on austerity

- Savings on tax avoidance (By 2019-20 pa £10bn Lib Dems; £7bn Lab; £5bn Cons)
- Savings on non-pensioner welfare (£2bn Lib Dem; £10bn Cons)
- Efficiency savings in public services (e.g. NHS)
- How are cuts to unprotected departments going to be made
- Bottom line: if deficit reduction targets to be met more taxes will have to rise for majority (NOT just “rich”)
 - As they have done in each of past 5 elections

Economic background

Austerity

Brexit

Immigration

Long-term growth

“Brexit” from the European Union

- Conservatives & UKIP promise an In/Out Referendum on EU by 2017
- Lib Dems haven't ruled out being in coalition with this
- Lab & SNP against
- Economic effects of leaving EU
 - Save net transfer to EU (0.53% of GDP, but Norway says 83% of this to be in EEA)
 - Foreign Investment (e.g. HSBC)
 - Migration
 - Uncertainty
 - **Trade**

Trade effects of Brexit

<http://cep.lse.ac.uk/pubs/download/ea022.pdf>

- Dhingra et al (2015)
- Just under half of all UK exports to EU, single biggest market in world
- Higher tariff barriers; non-tariff barriers (e.g. different regulations); non-participation in future trade deals
- Use (static) quantitative trade model. Welfare loss of 1.1% to 3.1% (£50bn) of GDP
- Dynamic productivity losses approximately double these
- Future trade deals lost – e.g. US & Jap deals gain £6bn

Economic background

Austerity

Brexit

Immigration

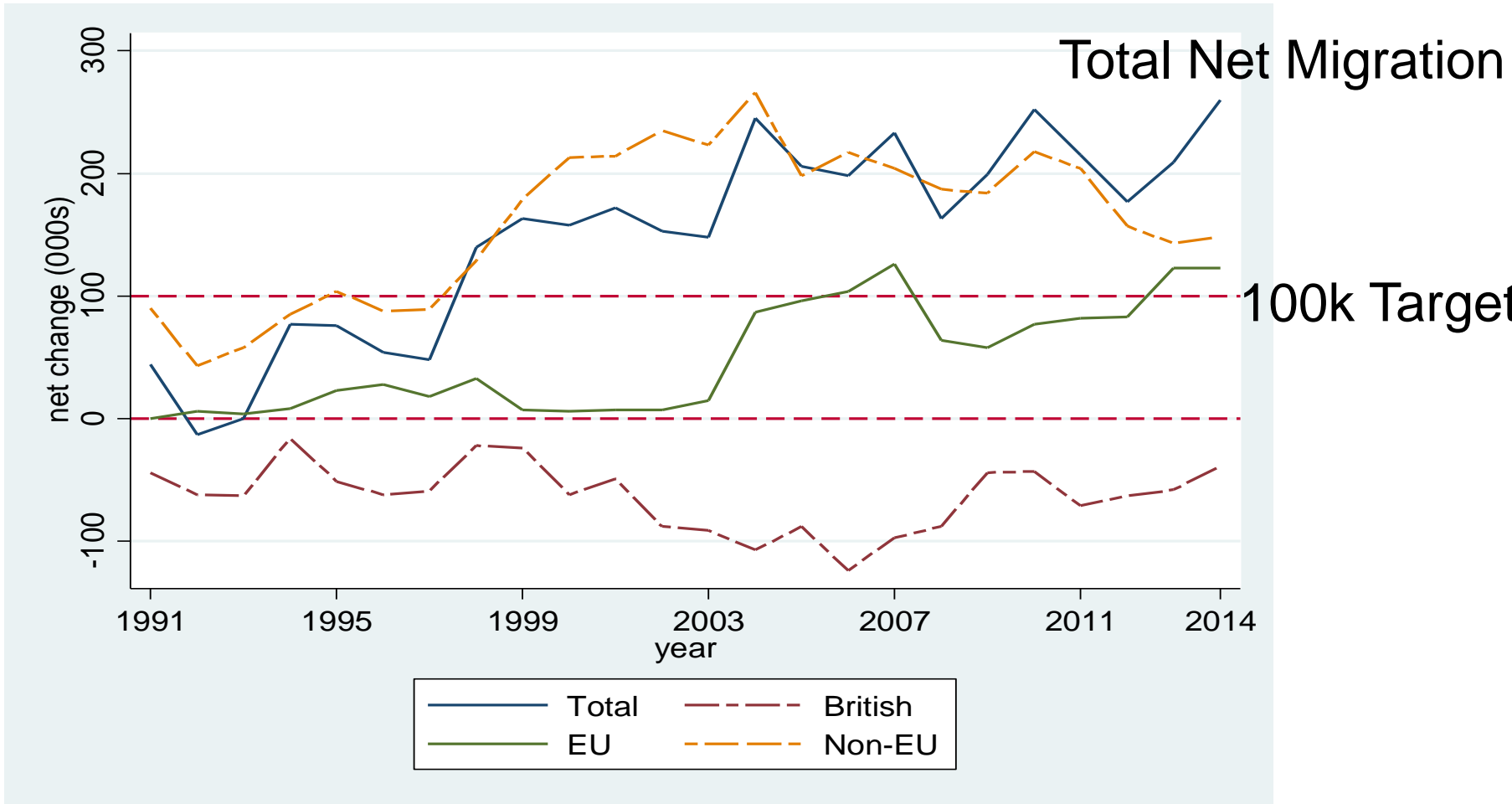
Long-term growth

Immigration

<http://cep.lse.ac.uk/pubs/download/ea019.pdf>

- Target of reducing net migration to under 100,000 (renewed “aspiration”. UKIP 50k)
- Latest figures show it running at 298,000
- Restrictions on students & highly skilled (as unskilled already strictly controlled via MAC)
- Proposals to restrict ability of EU migrants to access in-work benefits for 2 years (Lab) and 4 years (Cons)
- Effects of immigration on economic outcomes either positive or neutral
 - Wages
 - Jobs
 - Inequality
 - Public Finances
 - Public Services

Net Migration

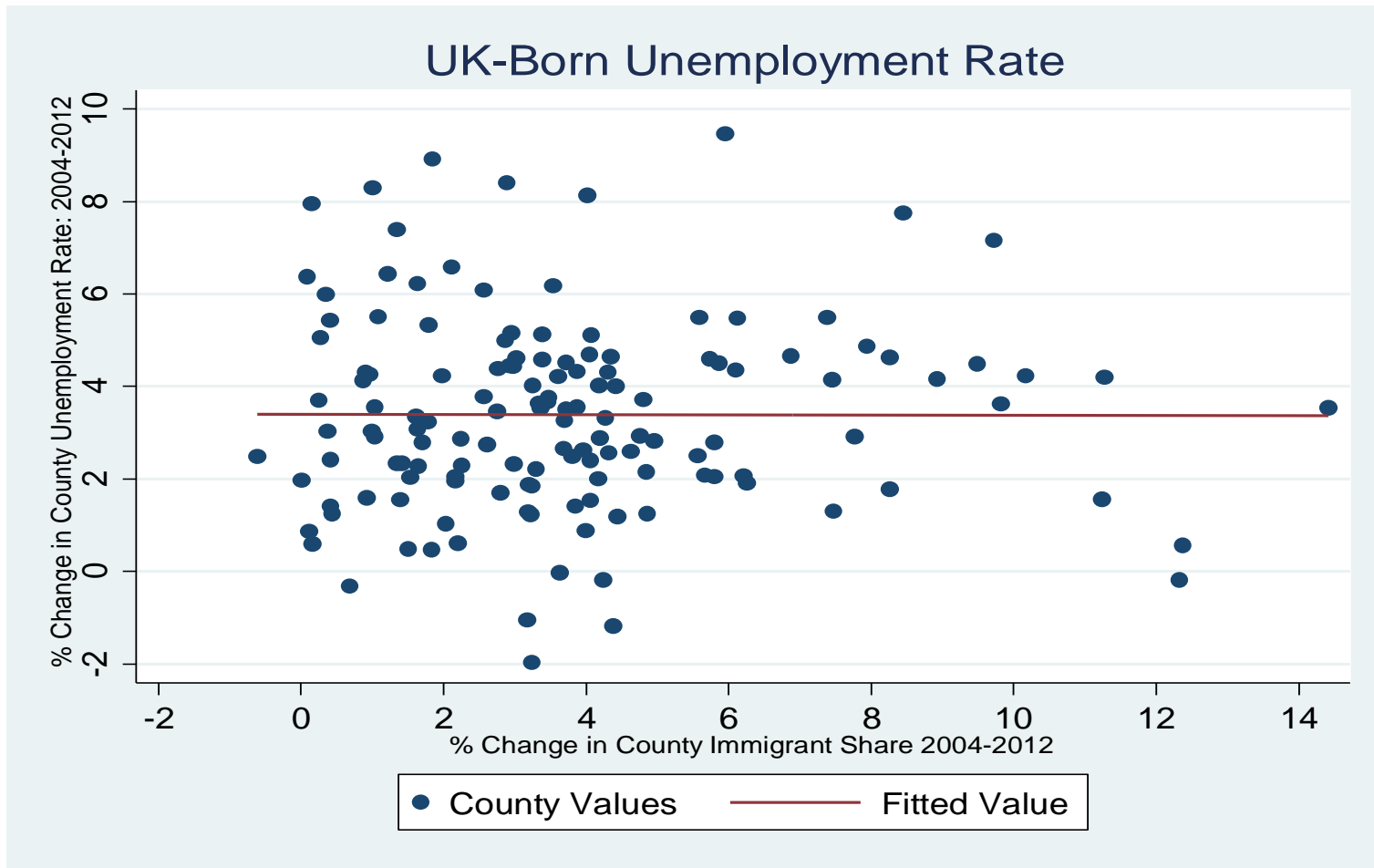


Source: Labour Force Survey; Wadsworth (2015)

Economic effects of Immigration

- Ambiguous as immigrants create demand
- They are on average younger & more educated (more very skilled & very unskilled)
- Empirical effects of immigration on outcomes either positive or neutral
 - **Jobs (over)**
 - Wages
 - Public Finances
 - Public Services (crime, health, social housing, etc.)

No effect of increases in immigrant share on unemployment rate of UK born



Source: Annual Population Survey; Wadsworth (2015)

Economic background

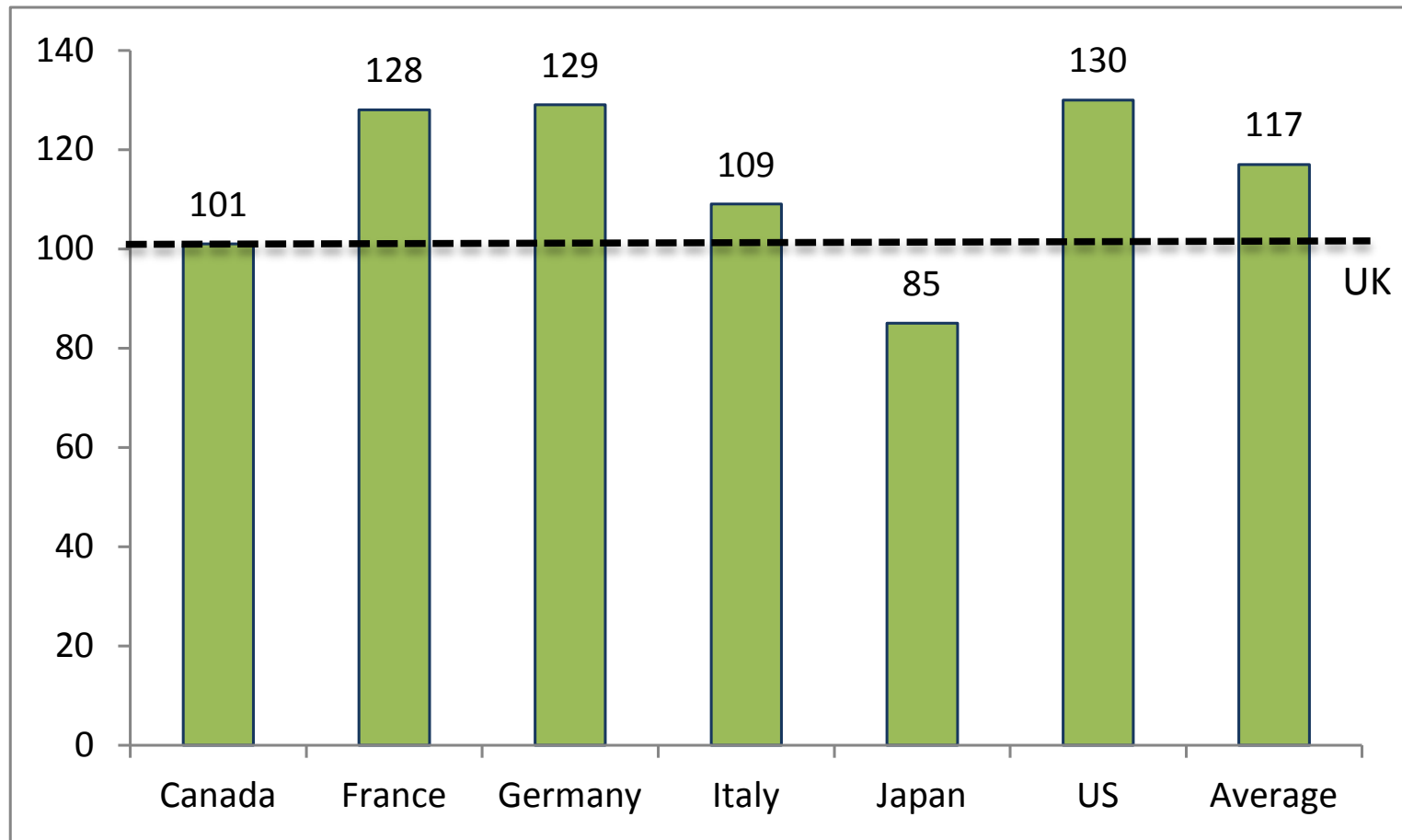
Austerity

Brexit

Immigration

Long-term growth

PRODUCTIVITY IN LEVELS: THE GAP



Source: ONS International Comparisons of Productivity, First Estimates, 2013

Notes: Current price GDP per hour worked from ONS data. Average refers to G7 average, excluding UK

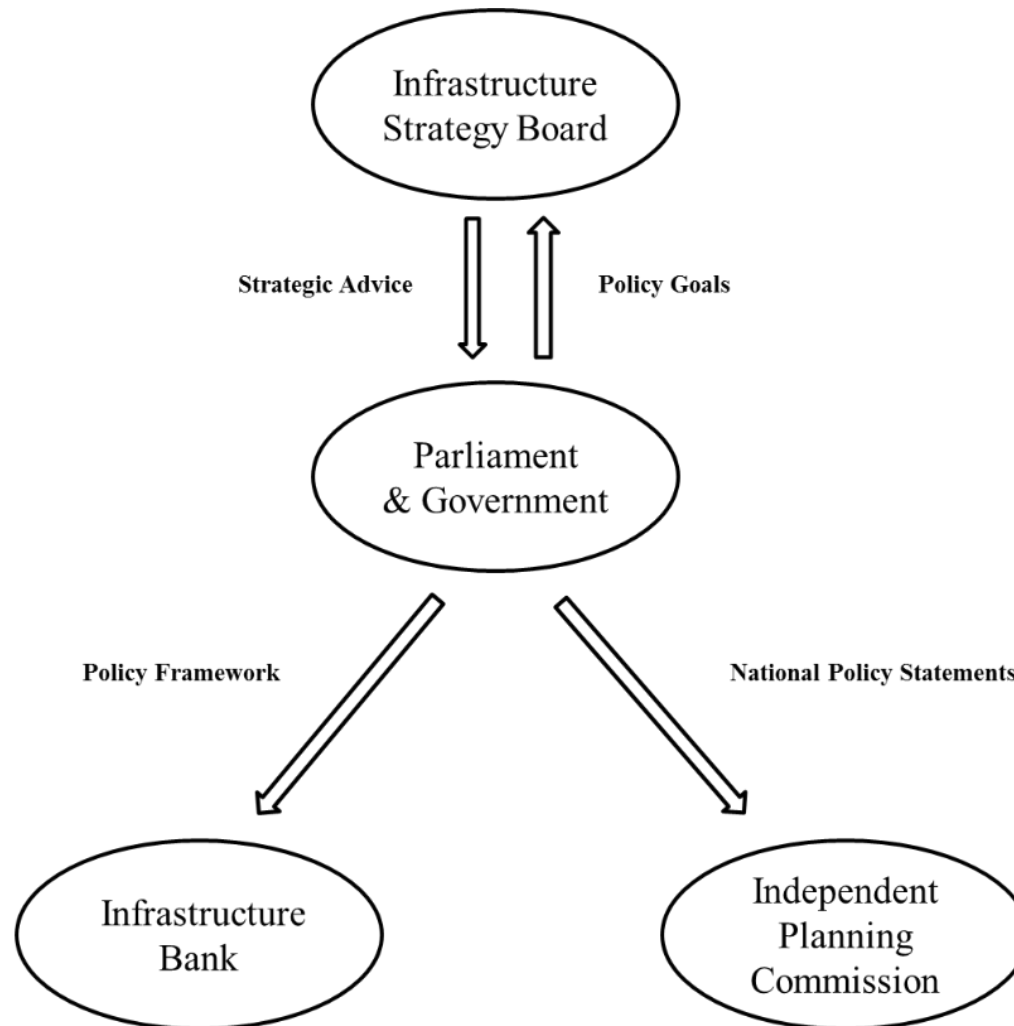
WHAT DO WE KNOW?

- Productivity gap, long term causes (LSE Growth Commission). Weak long-run investment (helps explain recent problems too)
 - Infrastructure (transport, energy & housing)
 - Innovation
 - Human capital

WHAT WORKS AND WHAT DOESN'T?

- ✓ Gov R&D support (science budget & R&D tax credits)
- ✓ Product market competition
- ✓ Human capital
- ✓ Bridging gap between academia and business (Catapult)
- ? Targeted SME support
- ✗ Dysfunctional banking sector
- ✗ Short termism in business and markets
- ✗ Debt bias and complexity in tax system
- ✗ Patent box
- ✗ Lack of stable infrastructure institutions

PROMOTING CONFIDENCE AND TRANSPARENCY



WHERE DO THE PARTIES DIFFER ON BUSINESS?

- Consensus in many areas
- Emphasis on productivity? Budget 2015 omitted issue
- Differences emerging on:
 - Corporate tax rate
 - Measures for long-termism (governance and tax)
 - Small business administration
 - Economic regulation
 - Transparency over tax havens & non-doms
 - Banking sector reform
- No party has committed to protecting science budget in real terms

Public sector productivity

- How to get more productivity from the public services, in an era of severe cutbacks?
- NHS, Schools, HE, Police
- Example of NHS – even if extra £8bn as promised by coalition materialises, Forward View assume 2%-3% efficiency improvements needed
- This hasn't been done and will be harder
 - Demand pressure will still rise
 - Efficiency increases over last few years because of wage restraint
 - Competition reforms in 2000s were successful, but Labour rejects; Lib Dems row back & Tories in damage limitation after disaster of 2012 Health Act

CONCLUSIONS

- Consensus on some **austerity**, but ~£30bn difference by 2019-20 & tax raising. Investment concern & lack of clarity
- **Brexit** defining issue & probably most important
- **Immigration** has highest sound/importance ratio
- **Productivity** most important economic issue that dare not speak it's name. Needs supply side reform that parties are dodging

FURTHER READING

- CEP Election Analysis Series

http://cep.lse.ac.uk/_new/publications/series.asp?prog=CEPEA

- World Management Survey

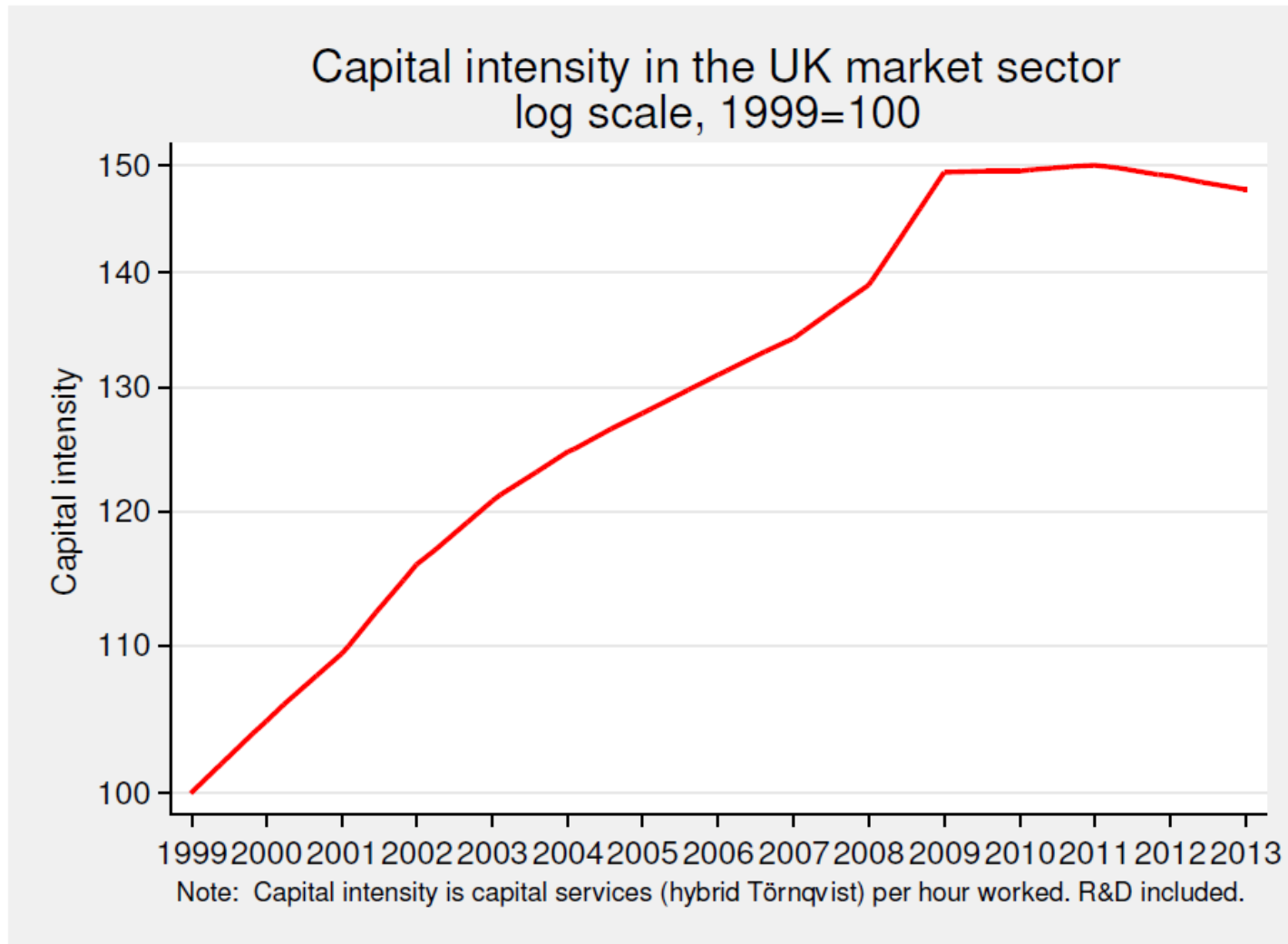
<http://worldmanagementsurvey.org/>

- LSE Growth Commission Final Report

<http://www.lse.ac.uk/researchAndExpertise/units/growthCommission/documents/pdf/GCReportSummary.pdf>

POST 2009 STAGNATION OF CAPITAL SERVICES PER HOUR

Chart 8



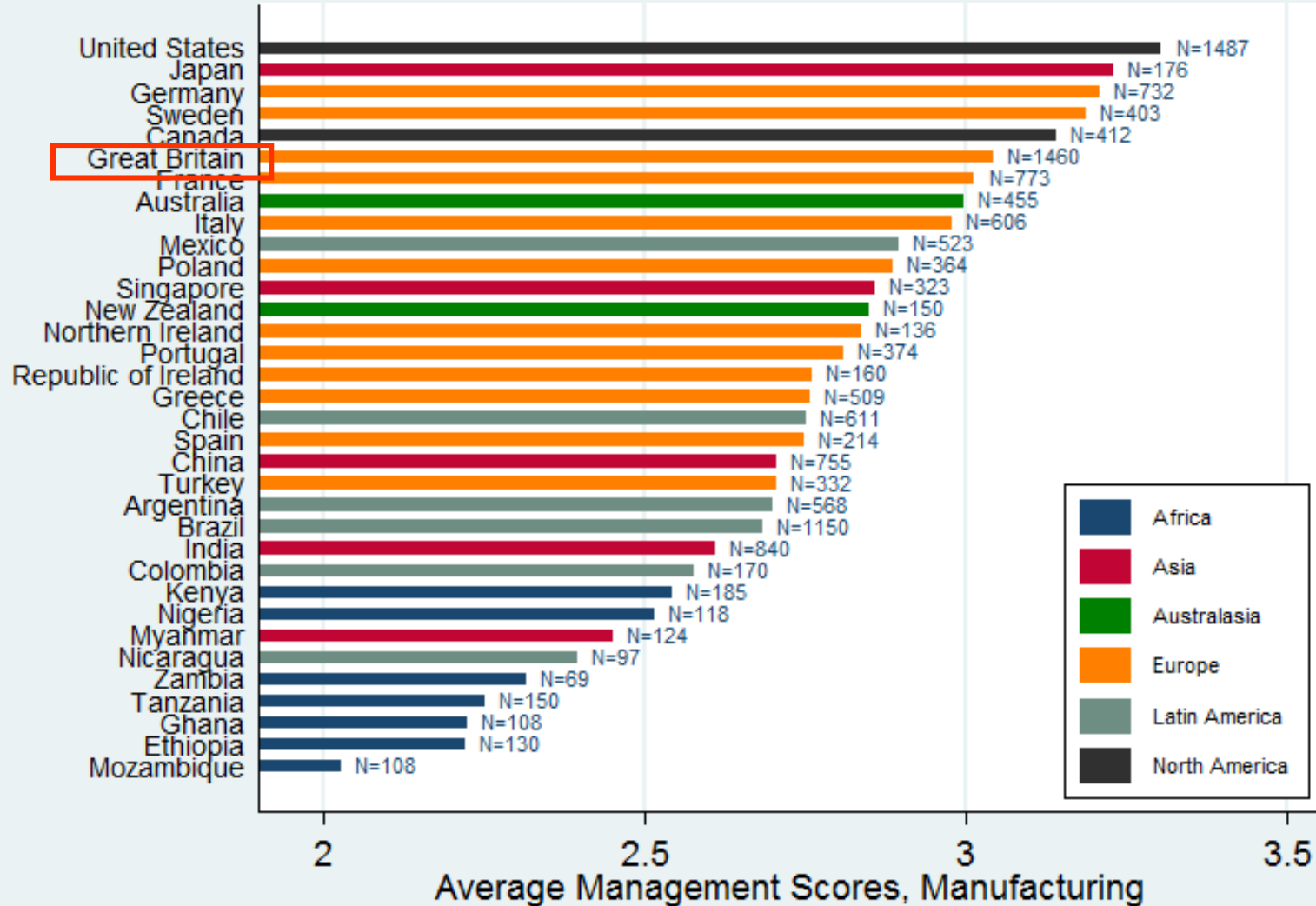
Economic context

Figure 2: GDP (£ billion) and quarter-on-quarter growth(1), Quarter 1 (Jan to Mar) 2015

UK, 2003 to 2015



Average Management Scores by Country



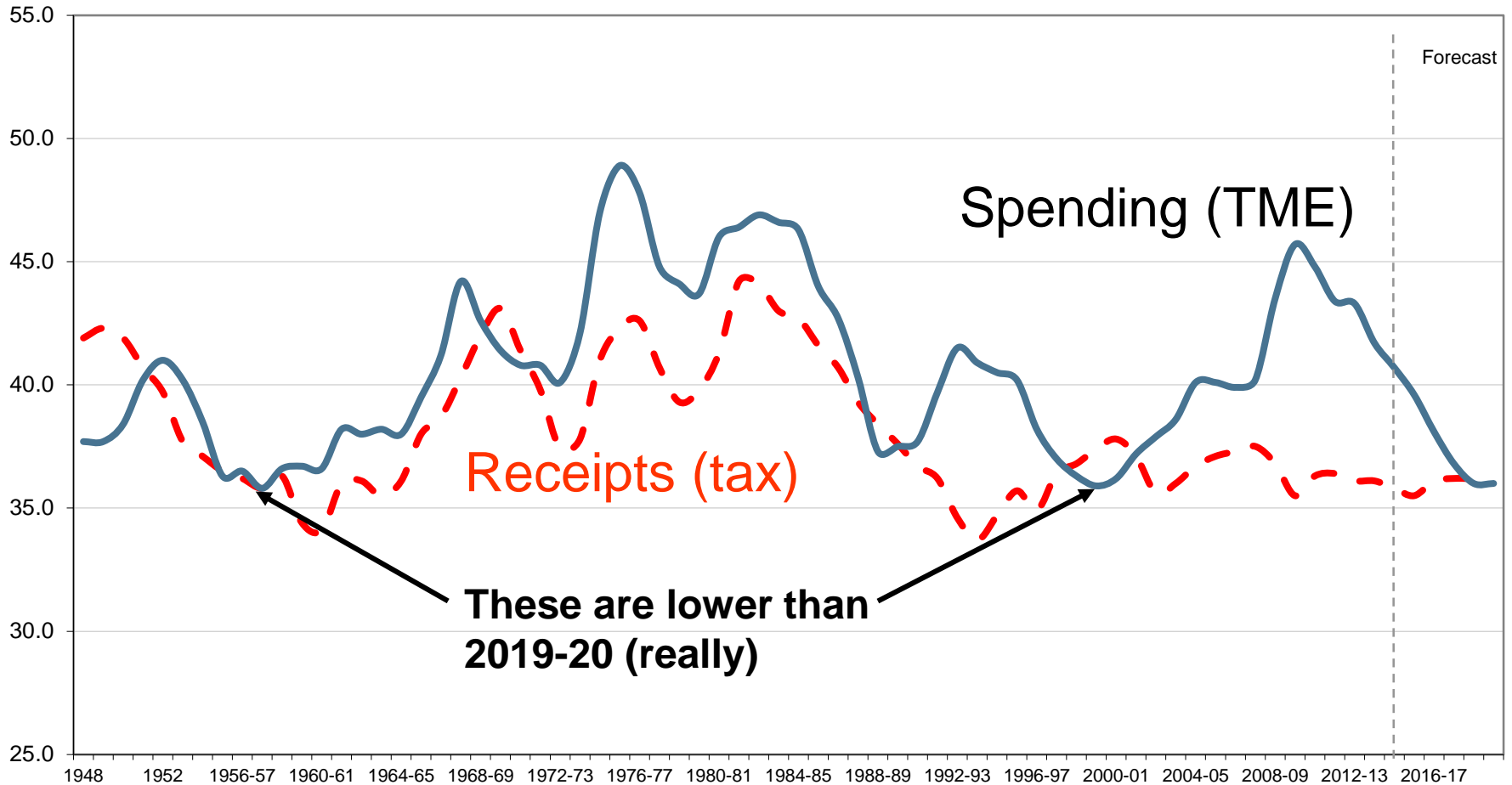
Note: 14772 interviews with firms between 50 and 5000 employees,

Note: Unweighted average management scores (raw data) with number of observations. All waves pooled (2004-2014)

Falling debt/GDP in 2015-16

- Supplementary fiscal target
- Achieved from bring forward sale of government assets (mainly shares in financial institutions from 2008)
- Not a genuine reduction in government indebtedness
- Classic example of HMT financing fiddles. When investment creates an asset no benefit to finances from sale (LSE Growth Commission warning)
- Like ignoring one side of company balance sheet

FIG 4: THE POLITICAL REASON FOR ROLLERCOASTER: GOV SPENDING & RECEIPTS (% OF GDP), 1948-2020



Source: OBR Public Finance Database (March, 2015)
<http://budgetresponsibility.org.uk/category/data/>

TABLE 1: BIG CHOICES - SPENDING PLANS 2015-16 TO 2019-20

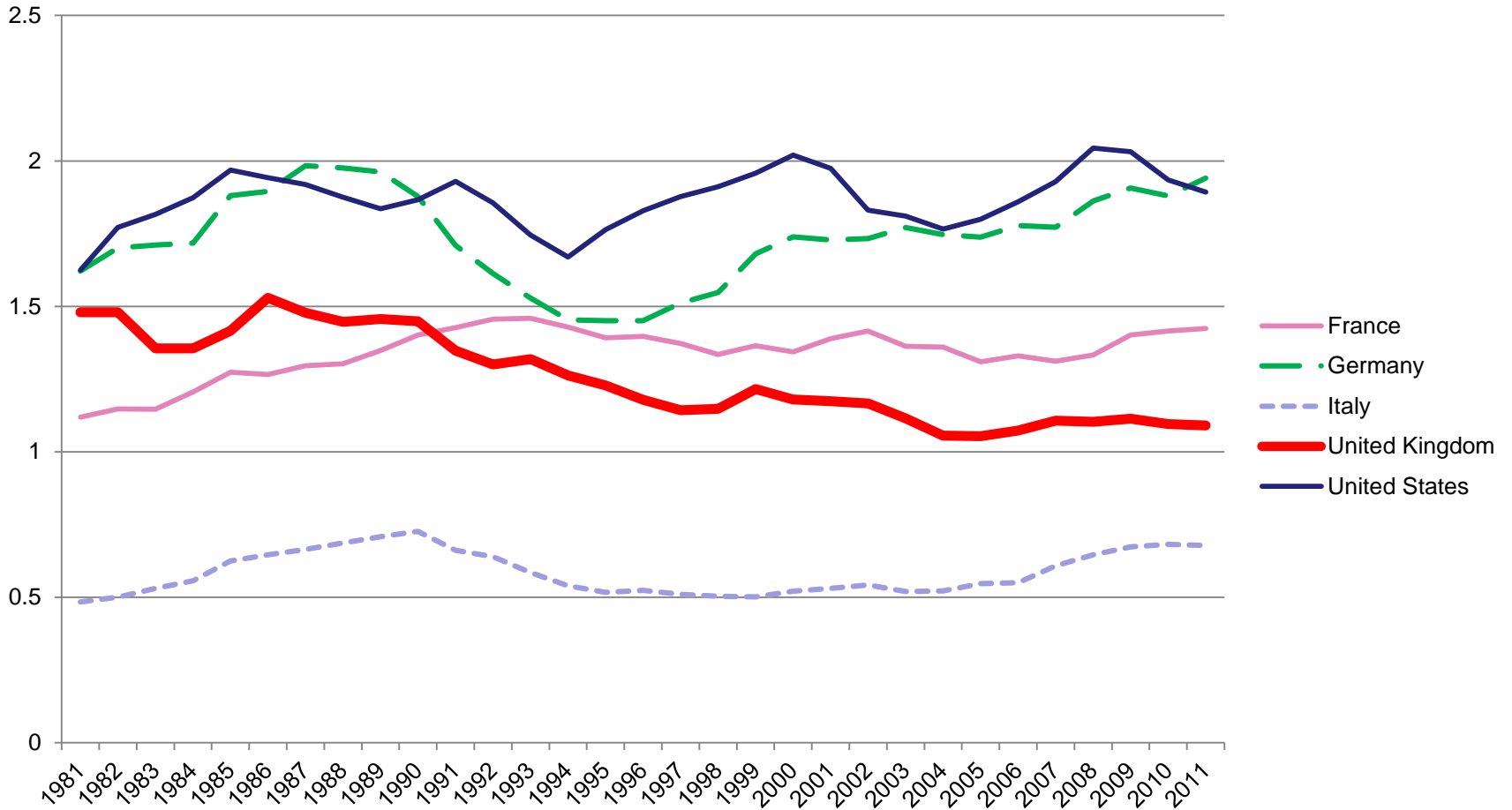
£billion real (% change)	Coalition plans	Conservatives	Labour
DEL (public services)	-26.0 (-7.2%)	-13.6 (-3.7%)	9.2 (2.5%)
<i>of which:</i>			
“protected”	4.7	4.7	5.0
“unprotected”	-30.8 (-15.7%)	-18.3 (-9.4%)	4.3 (2.4%)

Source: OBR & IFS calculations, http://www.ifs.org.uk/uploads/budgets/budget2015/budget2015_sk.pdf

Notes: Conservative plans are £13bn lower than coalition because (i) instead of a £7bn surplus 2019-20 assume zero surplus (just meet mandate); (ii) raise £12bn in (largely unspecified) welfare cuts and spend £6bn on tax cuts raising thresholds. Labour plans to be balanced in current budget (i) so could keep to coalition investment plans and borrow more (thus less pressure on DEL – PNI is £28.6bn in 2019-20); (ii) protect all of education budget – not just schools; (iii) tax rises (like mansion tax)

Motivation

Business conducted R&D (BERD) to GDP ratio, 1981-2011, selected countries



Source: OECD, 2013