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Policy Brief

Forgotten macroeconomics in the manifesto debate

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Abstract: The assessment of the impact of the policies in the election manifestos in the media is rather static as comments mostly ignore their positive impacts on growth, investment and productivity. This policy brief brings in the forgotten macroeconomic principles into this debate: Policies proposed in the Labour manifesto to provide a decent physical and social infrastructure, patient, long-term finance via the National Investment Bank, stable macroeconomic environment, incentives to remove new plant and machinery from business rate calculations and disincentives for speculation via broadening the financial transaction tax can lead to higher private investment and productivity and help to rebalance the economy. Policies encouraging a healthy growth in wages could reverse the shaky growth model in Britain driven by a massive increase in private household debt, decrease economic fragility, improve household confidence and domestic demand, which can stimulate business investment.

Keywords: inequality, investment, productivity, National Investment Bank

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Forgotten macroeconomics in the manifesto debate

Labour Party manifesto offers a feasible alternative in this election to the government's continued austerity, welfare cuts, low wages and insecure jobs. It addresses the key challenges of 21st century prioritizing decent jobs with decent pay for all women and men, equality, and ecological and social sustainability by a comprehensive policy mix: higher public investment in both physical and social infrastructure embedded in a broad industrial policy; long-term finance for investment via the National Investment Bank; progressive taxation of income, wealth and corporate profits and broadening of financial transaction tax; corporate governance policies to create incentives for long term investment and disincentives for short-term speculation; and labour market policies to decrease inequalities targeting the bottom, middle, and top of the wage distribution -a minimum wage at the level of a genuine living wage, enforcing 1:20 pay ratio in the public sector and companies bidding for government contracts and an excessive pay levy for the rest of the private sector to tame the excesses at the top, banning zero hours contracts, improving collective voice and collective bargaining coverage, and closing gender wage gaps.

The assessment of the impact of these policies in the media is rather static as comments mostly ignore their positive impacts on growth, investment and productivity. If anything, mainstream media and think-tanks claim that measures such as the rise in corporate tax rate will, in the long run, decrease private investment and productivity.

However, despite the low corporate tax rate and increasing profits since the 1980s, Britain has one of the lowest productivity and private investment rates as a ratio to GDP among the developed countries. There is a missing link between profits and investment. Rising inequality and financialization have been the main reasons behind this missing link. Private investment responds to both demand and public infrastructure, and not just to profitability. Britain's reliance on low public spending and low wages has led to a fragile, unstable growth model based on high household debt, which has also discouraged investment. Rather than investing, firms have exploited low labour costs. Furthermore firms have increasingly directed their profits to financial speculation. According to our research, the non-financial corporations' profits devoted to real investment declined from about 80% in the 1980s to less than 50% in the last decade, while their financial assets increased substantially (Onaran and Tori, 2017). High dividend payments and surging financial activities in Britain crowd out private investment in physical machinery and equipment.

Policies to provide a decent physical and social infrastructure, patient, long-term finance via the National Investment Bank, stable macroeconomic environment, incentives to remove new plant and machinery from business rate calculations and disincentives for speculation via broadening the financial transaction tax can lead to higher private investment and productivity and help to rebalance the economy. Policies encouraging a healthy growth in wages could reverse the shaky growth model in Britain driven by a massive increase in private household debt, decrease economic fragility, improve household confidence and domestic demand, which can stimulate business investment.

Higher wages accompanied by high investment would not hurt Britain's export performance either, as international competitiveness is more about productivity than low labour costs in the league in which Britain is competing. Decent public and private investment and a comprehensive industrial policy, not low wages, are crucial in reducing the trade deficit.

Our recent research shows that such a policy mix that would include an increase in public spending, progressive taxation and an increase in wages would have a favourable impact on not only growth and private investment but also public budget in Britain (Onaran, Nikolaidi, Obst, 2017). Higher economic growth leads to further increases in tax revenues beyond the impact of tax increases and more than offset the impact of higher public spending on the budget. An increase in public spending alone would also increase GDP and finance itself by about 15%; because it leads to higher GDP and tax revenues for a given tax rate. The positive impact of public spending on economic growth is further enhanced, when they are combined with labour market policies improving wages and progressive taxation.

If anything, Labour Party manifesto is cautious, as the fiscal credibility rule limits public borrowing only to financing physical infrastructure spending under normal circumstances, while day-to-day spending is financed by tax revenues. Even the OECD and the International Monetary Fund recommend borrowing for public infrastructure investment, particularly as interest rates are so low. However, the vast majority of the day-to-day spending pledges in the manifesto is composed of health and social care, education and child care, which indeed have long term benefits to the society as a whole, with substantial potential productivity impact by increasing the supply of high skilled, innovative and healthy labour force. They will also increase productivity by improving gender equality and unleashing the hidden potential of women by increasing their participation to the paid labour force. The necessity of such spending is praised by even the critiques of the manifesto. Indeed social spending can be regarded as investment in social infrastructure, as recommended by the Women’s Budget Group, and therefore could be financed by borrowing, if need be.