Progressive Economics Group (PEG)
Policy Brief

Wage Policy & public investment for sustainable development

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Policy Issue

Decades of neoliberalism leave Britain with high inequality and the worst investment and productivity performance in the developed world. Reconstructing this broken economic system requires a comprehensive policy mix based on public investment and labour market policies for equality-led growth.

What are the essential policy ingredients to tackle high inequality, low investment and poor productivity?

Analysis

High public investment is the key to achieve our multiple goals of decent jobs with decent pay for women and men, equality, and ecological and social sustainability. This requires well planned public investment in both green physical infrastructure and infrastructure linked to social care, health, education and child care.

The priorities for green physical infrastructure should be in renewable energy, public transport, social housing and insulation of the existing housing stock. However, progressive economic policy should also embrace public spending in health and social care, education and child care as investment in social infrastructure, as recommended by the Women's Budget Group. Day to day spending in these sectors indeed have long term benefits to the society as a whole, with substantial productivity impact by increasing the supply of high skilled, innovative and healthy labour force.

They will also improve gender equality, which will further increase productivity, by unleashing the hidden potential of women by increasing their participation to the paid labour force; this is why they are labelled as purple public investment by feminists. This implies that spending in universal health and social care and education and child care could be financed by borrowing in addition to tax revenues, if need be, as it adds to valuable social infrastructure. Even the OECD and the International Monetary Fund recommend borrowing for public infrastructure investment, particularly as interest rates are so low.

When the Labour Party formulated its public spending and investment priorities in its 2017 Manifesto, mainstream media organised a concerted attack with the assumption that progressive taxation of income, wealth and corporate profits to provide finance for public spending would lead to low private investment and productivity in the long term. This assessment is rather static as it totally ignores the impact of these policies on macroeconomic demand, and in return on productivity and private investment. There are two myths to debunk in this conservative discourse and open the space for progressive policy alternatives: is the conservative policy of a further decrease in the corporate tax rate the magic bullet to solve our productivity puzzle? Are low wages and labour market deregulation the key to a strong stimulus to private investment?

Empirical evidence refutes these two assertions. Despite decreasing corporate tax rates and increasing profits since the 1980s, Britain has one of the lowest productivity and private investment 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. 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, companies have exploited low labour costs.

Furthermore firms have increasingly directed their profits to financial speculation. According to 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. Large dividend payments and growth of financial activities have crowded out private investment in physical machinery and equipment. Instead of lowering corporate taxation, we need to develop corporate governance policies to create incentives for long term investment and disincentives for short-term speculation, e.g. higher rate of taxation on profits which are not invested.

Stagnant wages caused by decades of attacks to trade unions, zero hours contracts, dodgy self-employment practices, and public sector cuts and pay freeze, has led to high household debt and the shaky debt led consumption driven growth model in Britain.

Policy Framework

Growth in wages can reverse this economic fragility and improve domestic demand, which can also stimulate business investment. This requires labour market policies to decrease inequalities targeting the bottom, middle, and top of the wage distribution: improving the trade union legislation and collective bargaining coverage, banning zero hours contracts and dodgy self-employment practices and strong enforcement of gender equality at the workplaces, a minimum wage at the level of a genuine living wage to tackle low pay, enforcing a pay ratio in the public sector and companies bidding for government contracts and high top marginal income tax rate to tame the excesses at the top;

Recent research shows that such a policy mix of higher public spending, progressive taxation and higher wages would have a strong positive impact on growth and private investment as well as public budget in Britain. 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 it is combined with labour market policies improving wages and progressive taxation. All these dynamic multiplier effects of public spending, high wages and more equal income distribution are ignored in the mainstream, conservative economic policy analysis. This is shocking as our research indicates the multiplier in the UK is about 2.2; i.e. a £1 increase in demand due to public spending or higher wages would lead to £2.2 increase in GDP.

Equitable and sustainable development in the UK needs green and purple public investment, decent jobs and pay rise for both women and men. If we take care of full employment, equality, and ecological sustainability, the budget takes care of itself.

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