Navigating the United Kingdom towards fairer weather

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The United Kingdom is sailing through troubled waters. Like other economies, the country is experiencing one of the most severe downturns in decades since the outbreak of the COVID-19 crisis. In addition, it has to manage its exit from the European Union, following almost 50 years of deep integration, and address its long-standing productivity gap. The country is at a critical juncture. Decisions made now about management of the COVID-19 crisis and future trade relationships will have a lasting impact on the country's economic trajectory for the years to come. The latest OECD Economic Survey of the United Kindgom investigates these three inter-related issues in depth and puts forward recommendations to steer towards fairer weather.

Moving from emergency to a new phase of targeted support is essential to chart a course to a sustainable recovery. The United Kingdom has been hit hard by the COVID-19 crisis. Policy reaction to limit long-term scarring of the economy has been massive. A large majority of firms applied to the Coronavirus Job Retention Scheme. Since July, the Government has moved to a new phase of support by phasing out some emergency measures, and extending and introducing others, including programmes to help people get back to work.

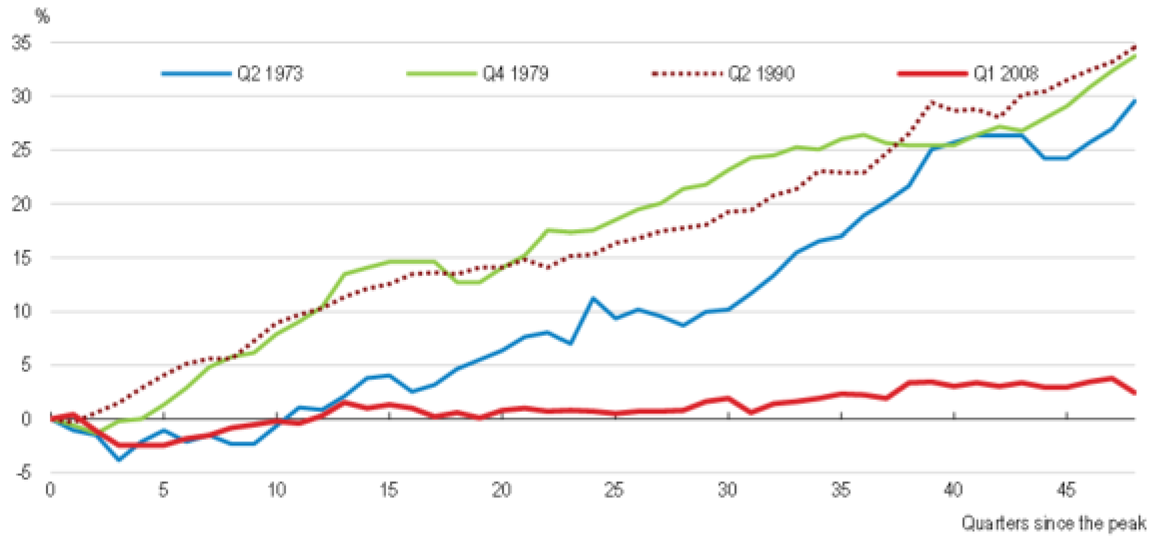
A key challenge will be ensuring that people in activities that are lastingly impacted by the COVID-19 crisis are able to move to new activities and do not become detached from the labour market. It will be important to ensure support remains available as needed given epidemiological and economic developments, and to consider introducing more targeted measures. Further increasing active labour market spending to support displaced and low-skilled workers will also help to get people back to work in good-quality jobs and to support low-income households. The crisis also provides an opportunity to move toward a greener economy and to meet the UK's ambitious target of zero net emissions by 2050 by investments that will help to lower emissions in the transport sectors.

A smooth exit from the EU Single Market and Customs Union and maintaining close trade relationships with the UK's largest trading partners will be essential to maintain on course toward a sustainable recovery. Estimates from the OECD METRO model suggest that the trade impact of entering a Free Trade Agreement with the European Union with zero tariffs and without quotas would be much less costly than an exit without a deal (Arriola et al., 2020). Firms will nevertheless have to adapt to new trading relations and the overall output loss could amount to 3.5% in the medium term compared to the present situation. About two-thirds of the cost would come from rising trade costs on goods and the remaining third stems from rising regulations on services. Keeping low barriers to trade and investment vis-à-vis EU and non EU countries and seeking high market access for services, including financial services, would help key sectors to continue to flourish.

Fostering productivity in the service sector is key to ensuring recovery and sustained growth. Productivity growth in the United Kingdom has consistently underperformed relative to expectations and has been disappointed more than in most other OECD economies since at least the global financial crisis (Figure 1). Sluggish productivity growth in the service sectors was the main factor behind this weak performance. Raising productivity will help to sustain employment and wages, but there is no silver-bullet: it will require a broad range of policies.

Figure 1. Productivity growth has been weak

Real output per hour, change from start of recession



Source: OECD calculations based on ONS (2020), Labour productivity database, July.

Data: https://stat.link/3vd4tl

Keeping low barriers to trade and competition will create a supportive environment for strong productivity performance for the UK service sectors. Prioritising digital infrastructure in the allocation of the planned increase in public investment would bring large productivity dividends. Further increasing public spending on training to develop the digital skills of low-qualified workers, who have been particularly affected by the COVID-19 crisis, will be a double-dividend policy, boosting productivity and lowering inequality.

Navigating through the current waves will be challenging, but there, policy can steer a course to a fairer, greener and more resilient economy.

References

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