

Chapter 1

Introduction

1a A crisis on top of an underlying problem

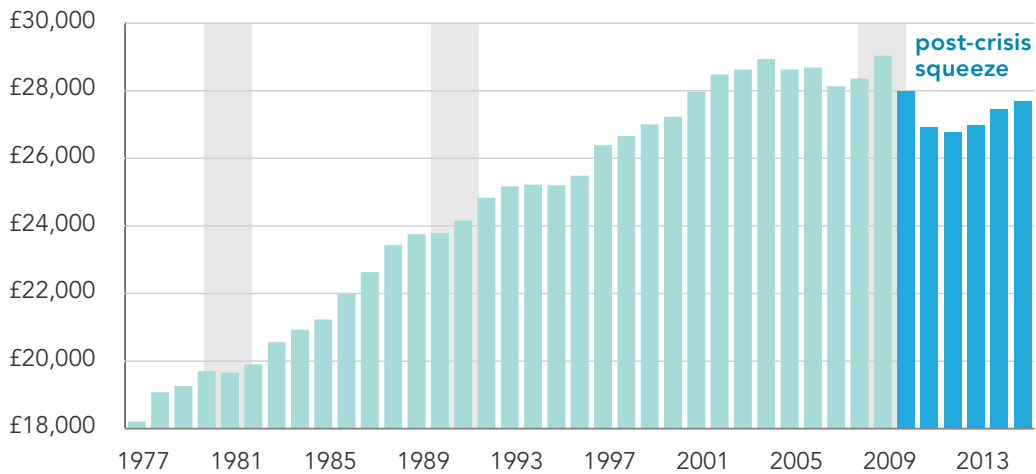
The current focus of UK political and policy debate is – rightly – securing a return to sustained economic growth. UK GDP is more than 4 per cent below its pre-recession peak and central forecasts for short- and medium-term growth are low and still routinely being downgraded. For the first time in living memory, serious commentators are discussing the possibility that the UK will experience a sustained period of no or very low growth. Avoiding this is, without question, the most important thing that could be done for the living standards of low to middle income Britain. Right now, it overshadows everything else.

Yet there is also growing recognition of a longer-term, structural problem for living standards in the UK economy. Since 2008, real incomes have seen some of the steepest declines in living memory. But even in the run up to the crisis, when GDP growth was strong, living standards for low to middle income households were, at best, broadly stagnant and, at worst, had eroded over

time (Figure 1.1). Overall employment was relatively high and inflation was moderate. Yet median wages were flat-lining, disposable incomes were falling outside London, and sharp spikes in the price of essential goods were piling pressure on ordinary working people.

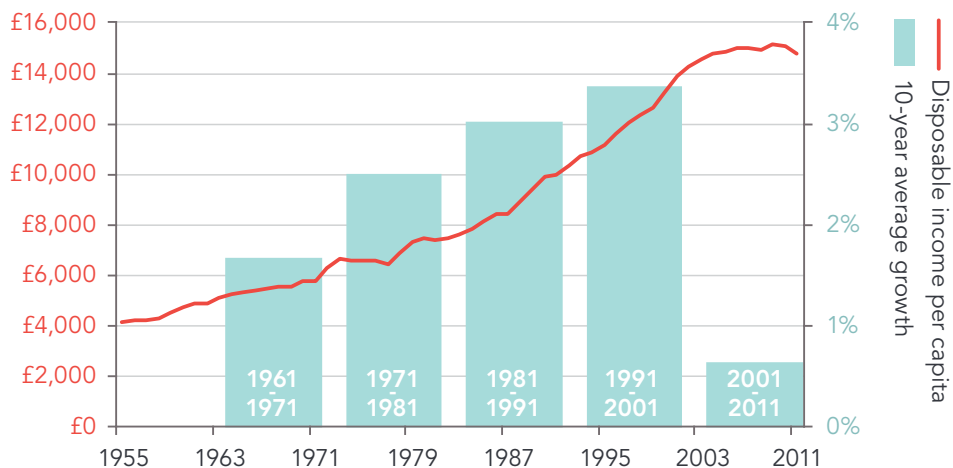
Stagnation followed by crisis has already taken us to uncharted territory. The past decade has seen by far the weakest growth in disposable incomes of any on record (Figure 1.2). The squeeze is still ongoing and there remains great uncertainty about what will happen next. There is ongoing turmoil in the global economy, making growth forecasts very unreliable. Historically high levels of debt overhanging the UK private and public sector will take years to pay down. There is growing evidence that the UK economy’s long-term growth rate has been damaged. This uncertainty needs to inform how we interpret our projections as to what might happen to living standards over the next decade. But one thing is clear: on our current path, the outlook is not good.

Figure 1.1: Gross median weekly earnings, male employees, constant 2010 prices



Notes: Controlled for RPI inflation. Post-crisis projections calculated on the basis of OBR March 2012 forecasts for RPI and average earnings. Source: ONS ASHE and OBR

Figure 1.2: Long-term trends in UK real household disposable income per capita, 1955–2011



Source: Office for National Statistics (ONS), ONS data series CDID

Beyond the overall economic gloom, pre-crisis trends in incomes raise concerns of a dangerous and puzzling disconnect between headline economic indicators like GDP and the financial health of ordinary working households. They are given added salience by developments in a number of other advanced economies, including the US, Canada and, more recently, Germany, where ordinary working people have become no better off over time, even in periods of growth. Although much of the intensity of the current UK squeeze is explained by unique, post-crisis factors, the bleak trajectory for living standards arises as much from this more established, pre-crisis, direction of travel.

This unprecedented position raises the bar for action in many ways. Certainly we need to fight hard to stem falling incomes and for a return to growth and productivity. But economic policy makers also need to recognise that this is only half the story. Growth makes rising living standards possible – but it doesn't guarantee it. This means being hard-headed in identifying the ways in which economic growth flows through into income growth for ordinary working households, and it means admitting where our labour market falls short and

taking steps to ensure that we eke out every possible gain for ordinary working households. Our success will decide whether much of the population makes a difficult but steady climb back to economic health when growth resumes, or walks a long, flat road in which a full generation of rising living standards is lost.

The hard truth is that the UK has yet to wake up fully to this challenge, let alone answer it. In the US, where the stagnation of living standards is far deeper and longer running, an informed debate is taking place at the highest level of politics about the links between growth, productivity and broader trends in the labour market – colloquially speaking, a debate about the demise of the American “middle class”. US academics and policy experts from Tyler Cowen to David Autor have written eloquently on the challenge. Major research institutions have taken up the task. Serious journalism has put the issue centre-stage. Politicians including President Obama have put the question at the forefront of political debate.^[1]

Here in the UK our own debate on these issues is starting but it is far less developed. That must change now if we are to secure shared prosperity.

1b Low to middle income Britain – too rich, too poor

The issues and trends examined in this report have impacted on the vast majority of households in Britain to a greater or lesser extent. Few escaped the pre-crisis faltering of living standards or the impact of the recession itself. As ever, in tough times like these, life is hardest for those on the lowest incomes,

Life on low to middle income in modern Britain is hard and getting harder

many of whom struggle with complex disadvantages, finding themselves in need of significant external support.

But our main focus as a Commission is the large swathe of the UK population living on low to middle incomes. They are not the poorest households in Britain and are not the main focus of debates about poverty and the socially excluded. They are mostly in work and so rely less heavily on our main systems of state support than the very poorest. But those in this group – living on incomes below the median, often trying to raise a family – also find life a struggle. Life on low to middle income in modern Britain is hard and getting harder.

Any definition of a socioeconomic group is to some degree arbitrary, and low to middle income Britain is

not static. Only one-third remain in the group after 10 years. But for the purposes of analysis it is important to be specific. We therefore define this group – at once too rich and too poor – as working-age people living in households with incomes below the median but above the bottom 10 per cent. (See Annex B for more details.) This is not to deny that many households with incomes below this group will share its characteristics or that many with incomes above it will also be struggling, nor of course that there is substantial hardship in our pensioner population.

We focus on a group that makes up roughly one-third of the UK population and yet too often gets overlooked in our national policy debate. It is a group whose members are in work but on low pay; who work across all sectors, especially those – like retail and hospitality – that are rarely discussed in relation to policy; and who struggle to get on the housing ladder, to secure promotion and to save. These households are on the front line in turbulent times, acutely vulnerable to knocks that would seem modest to high income households, from a big electricity bill to car repairs. Life's running expenses, from food to work-related costs like childcare and transport, leave no room for manoeuvre.

[1] See for example the White House Middle Class Task Force, “a major initiative targeted at raising the living standards of middle-class, working families in America” established by President Obama and chaired by Vice President Joe Biden: www.whitehouse.gov/strongmiddleclass/about (accessed 27 August 2012). The phrase “middle class” has traditionally been defined more broadly in the US than in the UK although there is some evidence that the two have been converging. The proportion of Americans identifying as middle class is now around 49 per cent, having fallen in recent years, while the proportion of people in Britain self-identifying as middle class is now around 44 per cent, having risen significantly in recent decades (Pew Social Trends, Lost Decade of the Middle-Class, 22 August 2012; Ipsos MORI, Perceptions of Social Class, 19 March 2008).

1c Our approach as a Commission

Our concern as a Commission is the living standards of this group and the way in which long-term trends in our economy are eating away at the kind of life they can afford to live. As in any Commission, we have had to make some difficult judgements about scope. Living standards can be defined

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in many ways and we have taken an unashamedly direct approach, focusing on the financial aspects of life, and in particular household earnings and incomes, rather than broader and less tangible aspects of wellbeing.

In all of our work, we have followed standard practice and been careful to talk about real incomes over time adjusted for inflation. But we have also looked at how headline inflation can understate the pressures on lower income households, who spend more of their income on some essential goods. We also take into account the importance of household size, recognising that a family with children will struggle far more than

a single person on the same income.

There are many issues that, though clearly highly relevant to living standards, we have simply had to rule out of scope. For example, public services play a critical role in supporting living standards and were responsible for many tangible improvements in the past 10 years, but questions of spending on, or reform of, health and education have not been our primary focus. Other similarly important issues such as housing policy, youth unemployment and the structure of energy markets have also been beyond our scope.

Finally, we are clear that our focus is long term. We are not here to comment on the impact of this or that spending cut. Our arguments about policy also focus on the big picture. That will disappoint some people. This report contains no simple remedy and no headline grabbing policy initiative. Nor do we provide a long list of policies or a manifesto. Instead, we have taken big judgements on the direction of reform that will matter, illustrated by some practical, funded, incremental steps.

The structure of this report

Section 1 sets out the most detailed account to date of living standards in the run up to the crisis. Chapter 2 explores the period 2003–2008 in detail, explaining how incomes and earnings stagnated even as the economy grew. We also describe how soaring household debt and spikes in the prices of essential goods affected households. Chapter 3 looks at Britain in an international context within the same period, finding that the country's recent performance carries worrying echoes of longer running stagnation in other countries, while some countries have maintained a stronger link between growth and personal gain, suggesting they have a degree of choice.

It is important not to dwell too heavily on one short period. In Section 2 we therefore put the period 2003–2008 into perspective. Over the long term, people get better off for three reasons: rising wages, growth in employment or working hours, and rising support from

the state. We examine each of these factors in turn. We look first at how much of growth reaches wages for those in the bottom half of the wage distribution (Chapter 4); second at how the distribution of employment and working hours has changed, in particular through the rise of women's work (Chapter 5); and third at how the role of the state has grown and will need to adapt to a new fiscal climate (Chapter 6). Although the period since 2003 brought a perfect storm for living standards, the UK had long been storing up trouble.

Section 3 looks forward to sketch out the prospects for low to middle income Britain in the coming decades according to a range of different scenarios. Underpinning this section is a major new piece of analysis, carried out for the Commission, which gives a sense of what the future might be if we maintain our current direction (Chapter 7), of possible optimistic and pessimistic circumstances, and of the

scale of difference that can be made by ambitious interventions (Chapter 8).

Section 4 describes what we call the ingredients for shared growth. First, we make the case for a more active role for government and public policy in creating broader-based wage growth in the labour market (Chapter 9). We then turn to employment and participation, arguing that there is significant economic potential in raising employment levels among groups that want to work but who are currently economically inactive in the UK (Chapter 10). Finally, we consider the role of the tax and benefit system (Chapter 11). Rather than proposing greater redistribution, we ask how we could do more to boost employment incomes by reprioritising current spending and tax reliefs into more productive forms of support.

We argue for new ways of thinking in each of these areas, and demonstrate each case with practical, funded first steps.