Conclusion

The immediate priority for UK economic policy is undoubtedly to secure a rapid return to growth. In the past year this task has only become more urgent as fears have grown that the economy, starved of strong demand for so long, has begun to suffer long-term damage. This immediate and ongoing challenge comes on top of, and reinforces, a longer term, structural problem: how to secure steady gains in living standards for working households even once growth returns. For all its importance, this question has received little attention.

The link between economic growth and the outcomes that ultimately matter to families, from growth in disposable incomes to the affordability of essential goods, is less automatic than it once seemed. Economic growth is essential if living standards are to rise again. Without it we are nowhere. But it may not be enough.

By no means is the UK facing this challenge alone. In the US, Canada and, more recently, Germany, workers in the bottom half of the wage distribution have long found themselves missing out on much of the rising prosperity that is supposed to flow from growth. The establishment of the Commission on Living Standards was motivated in part by the fear that this experience might become a new reality in the UK.

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We were concerned that heated arguments about the proper balance of fiscal and monetary policy have not been matched by discussion about what *shape* the UK recovery might take and even less about the underlying factors that caused the pre-crisis faltering of living standards. There is too widespread an acceptance of the sanguine view that *if only we can secure growth* a return to the good years will follow. The good years weren't as good as we thought. Simply getting our economy back on the same road may mean that low to middle income Britain is failed once again.

In looking for possible solutions we have taken a hard-headed and focused approach. What are the long-term forces that really matter for real income growth for ordinary working households and how can they be strengthened? Where is future prosperity for households going to come from? Are there ways, however difficult, gradually to shift our economic model to one that better serves this group?

In this report we started by defining the problem, describing in Section 1 the way that real incomes had faltered in the run up to the crisis as wages flat-lined even as labour productivity continued to rise. Two worrying recent developments lay behind this squeeze: a falling labour share as profits rose and a fall in the share of compensation finding its way into pay-packets. Britain's workforce was getting a shrinking slice of a shrinking pie. The falling labour share echoed a worrying longer trend in a number of other mature economies, raising the prospect that this decline in the slice of GDP going to labour may resume when our economy begins to grow. Meanwhile, rising non-wage costs, mainly pension contributions, warn us that the squeeze on wages may only tighten as the costs of an ageing society are met.

We also saw that these recent developments from 2003 to 2008 were part of a longer story. The two main motors of rising living standards in the late 20th century – broad-based wage growth and rising female employment – have lost their power. Hourly wages were lagging productivity long before the crisis, and employment among women had reached a lower plateau than in other leading advanced economies. With direct state support for household incomes now severely curtailed by short- and long-term fiscal pressures, past strategies to mitigate these underlying trends in living standards are not sustainable. This makes it worryingly difficult to answer the question: where will future rises in living standards come from? This early lesson from our evidence-gathering sessions struck us as missing from our public debate.

To better understand why these trends were taking place, Section 2 looked at specific elements of Britain's economy and policy environment. The decline of broad-based wage growth is complex and, to a degree, a global phenomenon, arising from shifts in consumer demand, patterns of trade, and the pace and shape of technological change. But the UK underperforms in key areas. Our chronic failure on intermediate skills and our lack of institutions to get employers engaged in training mean that a large share of the UK workforce simply doesn't have the skills they need to compete with graduates for 21st-century jobs. A failure to think of new ways to put upward pressure on low and modest pay – over and above the minimum wage – has left millions in a weak bargaining position in the face of new pressures on wages and job security. Both shortcomings tilt the UK towards an economic model in which the quickest route to profit is too often underinvestment in people and pay.

The distribution of employment across an economy owes much to social and cultural preferences but, like the shape of wage growth, is also moulded by policy choices. As things stand in Britain, large numbers of people who could work and who want to work – and who would probably work in some leading economies – stay at home. In our slowness to recognise fully the importance of new frontier pro-employment public services like childcare and social care, and in the inefficient design of our tax and benefit system, the UK has created its own glass ceiling for employment. This waste of productive potential has a direct bearing on living standards.

If Sections 1 and 2 helped us understand the problem, Section 3 showed where Britain is heading on our current path. Its projections for living standards to 2020 – on the basis of assumptions that can only be called optimistic – are extremely challenging. On our current path, households across the bottom half in 2020 are set to have incomes lower than in 2011. For low and middle income households, we projected income falls of between 3 and 15 per cent compared with their pre-recession peak. If this comes to pass, the 21st century will have begun with two decades of no overall real income growth for low to middle income households. Yet we also saw that a different path for living standards could be possible if the UK can raise its performance on low and intermediate skills, female employment and low pay.

The evidence we have gathered leads ineluctably to some tough conclusions. There is now an imperative to rebalance income growth away from state support and towards income from employment. This presents us with a stark choice: either we are heading for an unprecedented absolute and relative decline in the position of ordinary working households during a period of growth or government will need to be far more active in helping these households to raise their incomes through work. This can only happen through higher hourly pay, more hours worked or increased overall employment – there is no other way. Only in exceptional circumstances have other advanced economies achieved the scale and shape of earnings growth that now needs to be achieved.

Section 4 turned to practical steps. What are the ingredients for strong and shared growth in a mature economy like the UK today and how can we move towards putting them in place? Our focus was on the distribution of earnings. The interesting aspect of this debate isn't the obvious insight that earnings matter greatly but the more vexed question of *how* the distribution can be changed. First and foremost, people need better chances to earn a good wage and to progress in the jobs we have today. Longer-term, we must gradually move to a different type of economy, in which the bad jobs we have today get better and in which more good jobs are created. Making this agenda work is perhaps the biggest and most important challenge facing the next generation of policy-makers. It leads directly to some new arguments that we have started to fill out.

Market economies might move in similar directions but they also come in many forms, and choices can be made that are crucial in determining who benefits from growth

While the government must keep pushing on higher education participation, today's defining challenge on education is the quantity and quality of low and intermediate skills. How can people without degrees gain access to well-paid, fulfilling careers in a polarising 21st-century jobs market? Part of the answer is that intermediate skills need to be so widespread and of sufficient quality that they give large numbers of people without degrees access to professional jobs in knowledge sectors, roles seen today as graduate-only professions. One necessary step in this direction is that our formal education system must, in time, switch its focus from attainment at 16 to the acquisition of intermediate skills by age 18.

At the lower end of our jobs market, reducing the share of people without basic skills like literacy and numeracy is equally important and could help to raise productivity and pay in personal service roles. But the near consensus view is now that expanding skills supply is not enough. Demand for skills is weak in these parts of our jobs market, particularly in large and growing non-traded sectors like care and retail. Fixing this requires direct labour market policy, including new institutions that help employers to think long term, assessing their sectors' skills needs and their collective responsibilities to train. Public authorities must also do all they can to upgrade occupations like childcare and care for the elderly, which we know are mass-employing sectors in a maturing economy and ones that are currently dominated by low skilled roles.

In the short term, such steps help to make today's jobs better and ensure that more people can share in the good jobs the UK labour market will create. In the long run the task is to tilt our economy towards creating a greater proportion of good jobs, changing the mix between sectors and occupations. An important part of both these tasks will be new institutions to combat low pay. The National Minimum Wage has introduced vital protection for the very lowest paid. But having a wage floor is a very different thing from having a strategy to reduce low pay. Just 4 per cent of people are paid around National Minimum Wage while 20 per cent are paid below the Living Wage. We propose building on the success of the National Minimum Wage and the Low Pay Commission through new mechanisms like an "affordable wage", a push to understand and address the broader drivers of low pay, and new rules on transparency. These are only the first steps in a sustained effort to ensure that pay does more to provide a decent standard of living without jeopardising employment levels.

And on employment, we are clear that securing the macroeconomic conditions for a move back towards full employment is the most important thing a government can do for living standards. But there has been too little discussion about the social infrastructure needed for broad employment in which a higher proportion of parents with dependent age children and older workers find it worthwhile to be economically active. Both government and employers have a long way to go in responding adequately to the transformation of our workforce that occurred in the late 20th century with the rise of working parents and then longer working lives.

What does this mean in practice? Our nascent childcare system all too often leaves parents barely better off in work and must be expanded. Meanwhile, the costs of our failure to secure a social care settlement fall heavily on workers in their 50s and 60s, who have to stop work early to care for their ageing parents.

For both groups our tax and benefit system aligns poorly with modern preferences for work, giving and taking away money at the wrong times. And for all but a relatively fortunate few, the words part-time and flexible turn out to be synonymous with low paid and insecure, resulting in careers that are thwarted and skills that are wasted. Shaping a jobs market and policy stance that reflects the reality of today's workforce will be vital to securing future gains in living standards.

Action on all of these fronts is restricted by short and long-term fiscal pressures. As a Commission, we haven't sought a shared view on the pace of deficit reduction, but we agree that despite all the constraints of an era of austerity, it is still possible to act. This will mean the state doing more of some things and less of others, and we have identified sources of revenue to pay for new priorities that we think could better help lift living standards. We have been clear that the UK needs a tax and benefit system that does more work for us in boosting employment, and that government must finally face up to the political difficulties of reforming some of the greatest inefficiencies in our tax system, not least Council Tax, where low to middle income households pay the costs of our timidity.

Of course enormous uncertainties are inherent in any projection about the next decade and beyond. Many of the key trends are pessimistic, as is reflected in the scenarios we have set out. Yet we should also not forget that improvements in other areas, most obviously the collapsing cost of technology both at home and in the work place, are set to continue. That may create opportunities to raise living standards in new ways.

Similarly, in the workplace, we shouldn't forget that even while poorly paid service roles expand, our traded services sector continues to create thousands of unprecedentedly well-paid and stimulating jobs. Some people who would not otherwise have done so will gain access to these jobs and will live prosperous lives as a result. The path of innovation is highly unpredictable and it is not infeasible that some of the core relationships between wages and technology could shift in a more progressive direction over time. Already, for example, technology is transforming retail, automating some roles and shifting whole product markets out of the retail sector and into distribution.

So although there aren't currently strong grounds for optimism and, as we have shown, the forces bearing down on living standards are considerable, we shouldn't be deterministic. Nor should we be fatalistic about the capacity of policy to influence what may feel like intractable trends. Even as common pressures from technology and globalisation bear down on countries, their impact on ordinary working people varies internationally and over time. Market economies might move in similar directions but they also come in many forms, and choices can be made that are crucial in determining who benefits from growth. Our research has shown us that shared growth will not come naturally in 21st-century Britain – nor is it likely to emerge by accident. But with the right steps, taken boldly across a broad range of areas, much more can be done to build it.