

## Executive Summary

This is the first report for the Resolution Foundation's *Commission on Living Standards*. Its purpose is to set the scene for the Commission's work by providing an overview of the long-term trends that are shaping the living standards of people on low-to-middle incomes. It doesn't intend to set out definitive answers, but simply to bring definition to current concerns about living standards, and to frame the key questions that will guide the Commission in the course of its work.<sup>1</sup>

### The global context

Recent trends in several of the world's advanced economies are prompting leading thinkers to reappraise the link between national economic growth and personal gain. These trends are most stark in the United States, where median earnings have now been stagnant for a generation. The median American worker in 2009 earned no more than an equivalent worker in 1975.<sup>2</sup> Over the same period, US GDP more than doubled.

There is now evidence that American workers are not alone in having failed to benefit from a long period of economic growth. Similar trends, though far less chronic and less acute, are now in evidence in leading economies such as the UK, Germany and Canada.<sup>3</sup> In all three countries, median wages were stagnant or falling during long periods of growth, prior to the 2008-09 global recession.<sup>4</sup> The phenomenon is by no means universal. Other OECD economies appear to have experienced better wage performance, including Australia, France, Sweden and Norway.<sup>5</sup>

In the US, the phenomenon of median wage stagnation is being interpreted by some leading economists as a 'decoupling' of growth from gain.<sup>6</sup> The productivity of labour – commonly understood as the key driver of rising wages – has continued to grow, but these gains have failed increasingly to feed through into pay packets. The effects of this 'decoupling' on households have not been trivial; if US median household earnings had continued to track GDP per capita since the mid 1970s – as they had from 1945 to 1973 – the average household would not have earned \$50,000 in 2008 but around \$80,000, or 60 percent more.

In search of explanations, many economists point to inequality.<sup>7</sup> Skewed by strong increases in wages at the top, mean wages have performed better than median wages across the world's developed economies.<sup>8</sup> The balance of proceeds between wages and profit has also shifted, with labour receiving a shrinking slice of the pie in recent decades. But evidence is also emerging of a deeper shift – a change in the way that technology drives jobs growth in advanced economies. Rather than displacing jobs at the bottom and creating them higher

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1. In line with the academic consensus, we define living standards as *the kind of life that people can afford to live*. Our focus is material wellbeing. As a concept, this makes living standards broader than income, because it also includes other determinants of the goods and services that people can afford; and it is a narrower concept than 'quality of life', not including less tangible aspects of wellbeing, such as culture. See page 13 for a fuller explanation.

2. Source: OECD Stat – in constant 2009 prices, controlled for the US Consumer Prices Index.

3. *Real wages in Germany: Numerous years of decline*, German Institute for Economic Research, No. 28/2009; *The relationship between labour productivity and real wage growth in Canada and OECD countries*, Centre for the Study of Living Standards (CSLS), Sharpe et. al, (2008)

4. p.1, CSLS (2008); p1, GIER (2009)

5. OECD Stat Database. For an account of wage trends in France see Howell and Okatenko (2009)

6. See, among others, Professor Tyler Cowen (<http://bit.ly/cmy8VG>), Professor Lane Kenworthy (<http://bit.ly/fXO2QD>), Professor Mark Thoma (<http://bit.ly/fnCN6f>).

7. Frank (2011)

8. OECD, *Growing Unequal?* (2008)

up, as happened in the post-war decades, today's technologies are displacing jobs in the middle, with poor consequences for those on low-to-middle incomes.<sup>9</sup> There is compelling evidence that this shift, to what might be considered a new phase of growth, has taken place across many OECD economies.<sup>10</sup>

### The UK picture

These global developments set a worrying context for the UK. So what has happened to living standards in the UK over the last thirty years? In absolute terms, UK earnings growth was strong from 1977 to 2003 but from 2003-08 – before the 2008-09 recession, and despite GDP growth of 11 percent in the period – wages in the bottom half flat-lined.<sup>11</sup> There is emerging evidence that wage growth has fallen behind growth in labour productivity. After a sharp fall as the result of the downturn, wages are now set to recover only very slowly. Based on current government forecasts, we expect that average wages will be no higher in 2015 than they were in 2001.<sup>12</sup> In relative terms too, the position of the UK's 11 million people living on low-to-middle incomes has deteriorated. The stark increases in inequality that took place in the 1980s and 1990s have now levelled off – *but only within the bottom half of the distribution*. The earnings of those at the top have continued to move away from those in the middle, while the wage-characteristics of the bottom half have coalesced.<sup>13</sup>

These trends in earnings have transformed government's relationship with people on low-to-middle incomes. The group's share of national income has declined – households between the 10th and 50th percentiles of income (40 percent of the total) accounted for 30 percent of national original income in 1977; in 2009, the group's share dropped to 22 percent. The group's share of wages has fallen more quickly.<sup>14</sup> In 1977, the tax-benefit system 'topped up' this group's share of national income by one percentage point; by 2008-09 the system was lifting their share almost four times as much, by 3.7 percentage points.<sup>15</sup> A system of tax-credits has been created to boost incomes, particularly targeted at low-to-middle income people in work and with children. This has raised living standards, but has also meant higher marginal tax rates, with many people on low-to-middle incomes now taking home less of every additional pound they earn.<sup>16</sup>

### New pressures affecting the character of life on low-to-middle income

Although real income is the most important determinant of living standards, other trends can transform the reality of people's lives. Headline inflation may have been low from 1993 to 2009 but, even in this time, changes in the relative prices of different goods altered the profile of households' living costs beyond recognition. Transport costs rose 115 percent from 1988 to 2010 while clothing costs fell by 50 percent.<sup>17</sup> A generation rich in housing and relatively poor in consumer goods has been replaced by one that is relatively rich in consumption and housing-poor. More recently, inflation has hit people on low-to-middle incomes disproportionately. A full picture of living standards cannot ignore the effect of these trends.

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9. Goos and Manning (2008)

10. Autor (2010)

11. See Figure 13, Chapter 3 below. Source: ONS and the Annual Survey of Earnings and Hours, full-time employees

12. Resolution Foundation analysis, based on ONS ASHE and Office for Budget Responsibility forecasts for average weekly earnings and RPI inflation

13. See Figure 16, Chapter 4 below. Resolution Foundation analysis based on ONS ASHE data for the 50:10 and 90:50 income ratios.

14. Resolution Foundation analysis, based on ONS The distribution of household income series, UK Data Archive

15. See Figure 24, Chapter 4 below. Resolution Foundation analysis, based on ONS The distribution of household income series, UK Data Archive

16. See Figure 27, Chapter 4 below.

17. See Figure 31.

Nor can it ignore assets and debt, and in particular housing. In 1988, 58 percent of young people in the low-to-middle income group owned a home and 14 percent rented privately.<sup>18</sup> By 2008, those figures had flipped to 29 percent (owning) and 41 percent (repetitively). This change took place in spite of a dramatic loosening of credit. In 2007-08, just prior to the financial crisis, 30 percent of people on low-to-middle incomes buying their first home relied on 100 percent mortgages, a higher proportion than in the income groups either above or below.<sup>19</sup> *Despite falling interest rates*, the burden of mortgage repayments on people on low-to-middle incomes has been rising, not falling over time.<sup>20</sup>

The report concludes by looking at new working patterns, and in particular the rise in female economic participation. This trend has been a significant contributor to rising living standards in the past three decades,<sup>21</sup> but new working patterns have also changed the *kinds* of support on which workers depend. The UK childcare market quadrupled in size from 1990 to 2006.<sup>22</sup> Now ageing is adding further pressure; by 2040, one in ten people will be over 75.<sup>23</sup> People will need to stay productive in work into later life. Public services have long had a significant impact on people's living standards in the sense that they provide significant 'benefits-in-kind'. Now services like childcare and elderly care look set to have a more direct impact than ever on people's ability to raise their earnings through work.

### The nature of the challenge

Today, in the UK economy, the prospects for growth remain unclear. Historically, recessions characterised by credit crises have often led to long periods of anaemic performance. For good reason, today's defining political challenge is framed simply in terms of securing a steady recovery. Nothing in this report undermines the significance of that task. Growth is a prerequisite to rising living standards. But an additional lesson does emerge from these pages: growth is necessary, *but it may not be enough*.

The late twentieth century rising tide of living standards did not fall out of a simple formula: 'growth leads to gain'. Instead, the period was characterised by a series of social and economic 'waves' that ensured that national economic performance fed through into widespread prosperity. In the post-war decades, new technologies and the widening of educational opportunity had an overall positive impact on skill- and pay-levels. In the 1970s and 1980s, female economic participation rose rapidly. From the late 1980s, financial deregulation resulted in the wider availability of credit. Into the 2000s, tax credits boosted the incomes of those in work on modest pay.

As set out in this report, for a variety of reasons, each of these waves is no longer boosting the living standards of ordinary workers to the same degree. The upward march of living standards for people on low-to-middle incomes had already started to falter prior to the recession. In this sense, we have entered a new phase. Today, a singular focus on growth obscures a more difficult question: what sort of growth should we be seeking? What other conditions will be required to ensure that economic recovery feeds through into widespread prosperity – and how can they be attained? This report sets the scene for a major programme of work on those questions over the next 18 months.

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18. See Figure 38, Chapter 6 below. Based on Resolution Foundation analysis of the Family Resources Survey and the Family Expenditure Survey.

19. The equivalent figure for those who are heavily reliant on benefits was 27 percent, and for those on higher incomes 18 percent. Resolution Foundation analysis, Survey of English Housing, 2007-08 'People on higher incomes' are defined here, and throughout this report, in line with the Resolution Foundation's standard definition as: people living in households with above median income, based on an equivalised household income distribution for working-age households.

20. Resolution Foundation analysis, British Household Panel Survey.

21. See Figures 20 and 21.

22. Source: Laing & Buisson, 2007

23. Resolution Foundation analysis, ONS UK Census