

Resolution
Foundation

Commission
on Living Standards

Executive Summary:

Missing out

*Why ordinary workers are
experiencing growth without gain*

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Executive summary

It is a central assumption of modern, democratic economies that economic growth leads to rising living standards for the great majority of people. Now, evidence is emerging that questions that assumption. Median wages in the UK were stagnant from 2003 to 2008 despite GDP growth of 11 per cent in the period. Similar trends are evident in other advanced economies from the US to Germany. For some time, the pay of those in the bottom half of the earnings distribution has failed to track the path of headline economic growth.

If a central goal of government is to secure a new period of rising living standards then these trends point to one of the great economic challenges of our time: the need to restore the link between economic growth and the pay of ordinary working people. That challenge raises a number of immediate questions. Which factors decide whether the pay of ordinary workers rises when the economy grows? How have these factors changed over time in the UK? How have changes in the UK's industrial make-up affected these trends?

This paper builds on our earlier work¹ by considering these questions in more detail. We use the wages of those in the bottom half of the earnings distribution as a proxy for the earnings of people on low-to-incomes.² Our focus is specifically on *earnings* and the outcomes of the jobs market before the redistribution that is carried out by government through taxes and benefits.³ As with all of the work of the *Commission on Living Standards*, our concern is not the immediate fallout from the recent recession but longer term trends.

Where does the value generated by the UK economy go?

Economic growth is most commonly reported in terms of gross domestic product (GDP), which measures the value produced – in terms of goods and services – by all firms and workers in the nation. Therefore, if all else remains equal, the pay of ordinary workers rises in line with the value generated by economic growth. But if the *distribution* of the added value changes over time – if it moves from one group of recipients to another – that relationship may weaken.

Over the past three decades, this is precisely what has happened in the UK. **In 1977, of every £100 of value generated by the UK economy, £16 went to the bottom half of workers in wages; by 2010 that figure had fallen to £12, a 26 per cent decline.**⁴ Indeed, the trend may be even starker: inclusion of bonus payments reduces the bottom half's share to just £10 in 2010.⁵

In simple terms, the value generated by an economy feeds through into wages for the bottom half in three steps. Those three steps help us to understand the nature of the decline in the share going to ordinary workers:

¹ Plunkett, James, Resolution Foundation, *Growth without gain? The faltering living standards of people on low-to-middle incomes*, May 2011

² See Box 1 for a full explanation.

³ The Commission will be examining the impacts of the tax-benefit system later in the course of its work.

⁴ Of the remainder in 2010, £39 went to the top half of workers, £11 was paid by employers in the form of social contributions and £39 went to businesses and owners in the form of profits.

⁵ No comparable figure is available for 1977 but, over the period for which comparable data is available (1999-2008), the share of value accounted for by the bottom half declined more quickly when bonuses were included than when they were excluded.

- ✦ First, the value generated by the economy accrues either to employees in the form of remuneration (labour share), or to corporations and shareholders in the form of profits (capital share). Over the period considered in this paper, the share of value that goes to employees declined, while the share going to profits increased. **This shift explains one-seventh (14 per cent) of the decline in the share of overall value accruing to the wages of the bottom-half of workers.**
- ✦ Secondly, within the share of value that goes to workers, a portion is paid out in the form of wages and salaries (wage share) and a portion is taken up by the social contributions of employers (from employer National Insurance payments to pension contributions). **The decline in the former over the period, and the increase in the latter, explains one-sixth (16 per cent) of the fall in share experienced by the bottom half of employees.**
- ✦ Thirdly, wages and salaries are shared out between employees across the earnings distribution. In the years analysed here, growing wage inequality meant that a smaller share found its way to employees in the bottom half. **These changes in the distribution of wages explain the majority – 70 per cent – of the decline in the share of value added accounted for by the bottom half of earners.**

It is important to note that wages are not the only form of income; the tax-benefit system and public services also play an important role. Some of the trends we outline, for example rising employer National Insurance contributions (NICs), serve to both shrink the wage-pot and boost other aspects of well-being; for example by funding investment in public services. Earnings though remain by far the largest component of household income – on average comprising three-quarters of gross income among low-to-middle income households⁶ – and are the focus of this paper.

What has changed in the UK economy to account for these trends?

In the past 30 years, important cross-cutting trends, such as technological advances and the wage-returns to education and skills, have driven changes in the distributions of rewards *within* all sectors of the UK economy. At the same time, significant changes in the nation's industrial structure have produced shifts *between* sectors.

In the case of the growing share of value that goes to profits rather than to workers, the trend was driven primarily by the shift in the economy from *industry* (covering manufacturing jobs in the main), where a relatively high share of value is distributed to workers, to the *finance & business activities* sector, where more value is retained as profits rather than being distributed to workers.

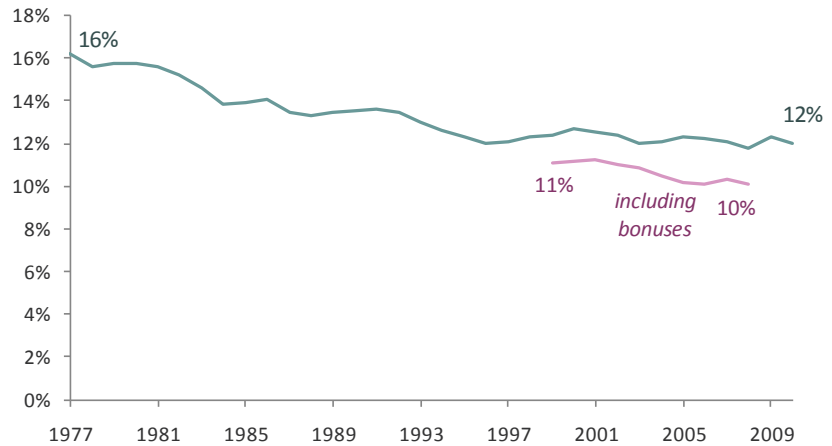
When it comes to the second factor, the proportion of labour's 'pie' that goes to salaries rather than to employer NICs or pension contributions, the overall growth in employer social contributions occurred largely because of government policies that affected all industries, not because of shifts in the underlying sector mix.

Finally, in the case of the third and most important trend – the **rise in wage inequality** – the aggregate level **picture was driven by growth in pay dispersions across all sectors**, with the *finance*, *business activities* and *retail* sectors recording particularly high levels of wage inequality in 2010.

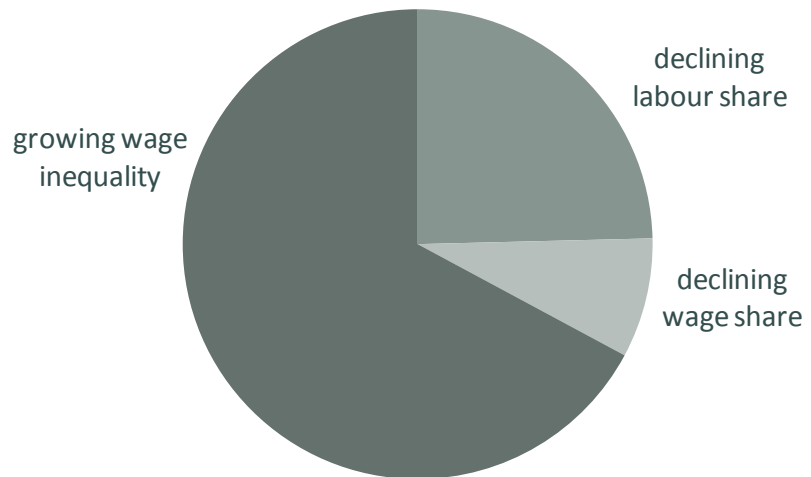
⁶ See Section A1 of the Technical Appendix.

Summary of findings

The share of national income associated with growth that is accounted for by the wages of workers in the bottom half of the earnings distribution has declined by one-quarter over the past 30 years...



One-third of the decline can be explained by an overall reduction in the size of wage pie associated with falling labour share and wage share; however, growing wage inequality has been much more influential...



Which in turn has been driven primarily by changes in inequality within all sectors of the economy - rather than shifts in the industrial structure; the trend in inequality in recent years has been dramatically more pronounced in the finance sector.

