Resolution Foundation

When does economic growth benefit people on low to middle incomes – and why?

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The Resolution Foundation Commission on Living Standards:

Improving the lives of people on low to middle incomes

This report has been prepared by Professor Lane Kenworthy for the Commission on Living Standards, an independent and wide ranging investigation into the pressures facing people on low to middle incomes in modern Britain. Professor Kenworthy is one of the world's leading experts on the causes and consequences of trends in living standards in affluent countries, with a particular expertise in international comparative work. This report contributes to a key goal of the Commission: to better understand the relationship between economic growth and gains in material wellbeing for ordinary working people.

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Introduction

For many of the world's rich countries, the most important challenge at the moment is returning to robust economic growth. At the time of writing, there remains great uncertainty about the pace and path of recovery. Eventually, though, growth will return. This report, prepared for the Resolution Foundation's Commission on Living Standards, asks a longer term question: when growth does return, to what degree will low-to-middle households benefit?

Though it isn't a foolproof guide, we can look to the recent past for clues. I examine developments in the United Kingdom and sixteen other rich countries over the period from 1979 to 2005 — the three business cycles that preceded the 2008 crash.[1] My focus is the relationship between GDP per capita and low-to-middle household income. The report asks how this relationship varies between countries, and what drives this variation.

By focusing on household income, as opposed to individual earnings, this report builds on previous work for the Commission.[2] Improvement in living standards can come in many forms, including higher income, better product quality, enhanced access to public goods and services, more free time, and others. Income is perhaps the most valuable of these, as it enables people to choose how to enjoy improvements in material wellbeing. It is a useful measure of the final material wellbeing enjoyed by households after their interaction with both the jobs market and government. Income also happens to be the indicator for which the best and most comparable data are available.

In line with the broader work of the Resolution Foundation, this report focuses on households on 'low-to-middle income'. In my analysis, 'low-to-middle' refers to households with incomes between the tenth and fiftieth percentiles (p10 to p50) of the income distribution.[3] The countries vary in the degree to which low-to-middle households have benefited from economic growth. To get a handle on why, the report then separates household earnings from net government transfers. In the nations where growth was good for the incomes of low-to-middle households, is that because earnings increased, because transfer programs passed that growth on, or both? And where earnings were important, did success stem mainly from increases in wage levels or from rising employment?

In the second part, I consider the implications of these comparative findings for policy choices, particularly in the United Kingdom. What have governments done to help ensure that economic growth benefits low-to-middle households? What strategies are likely to work going forward?

Economic growth and low to middle household incomes

Figure 1 shows the degree to which average income in low-to-middle (p10 to p50) households increased in the seventeen countries between 1979 and 2005. Because the number of years for which data are available differs somewhat across the countries, the chart shows income growth on a per-year basis. The data are for post transfer-post tax income — money from earnings, government transfers, and various other sources, with taxes subtracted. They are from the Luxembourg Income Study (LIS) Database, the best source of cross-nationally comparable income data. Incomes are adjusted for inflation using the consumer price index and converted to U.S. dollars using purchasing power parities (PPPs).[4] They also are adjusted for household size.

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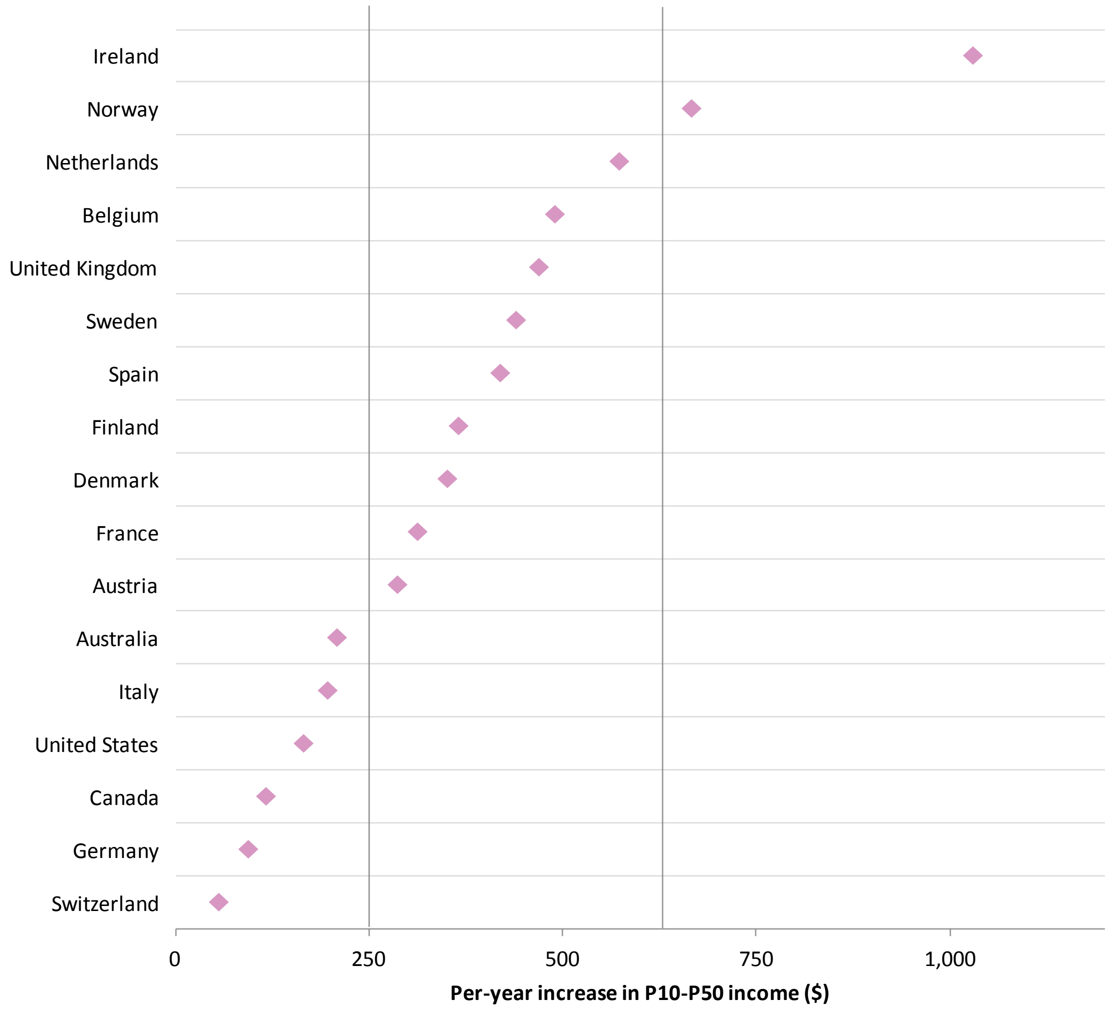
[1] The last of these business cycles ended in 2007, but cross-nationally comparable income data are available only through 2005.
[2] See in particular: Jess Bailey, Joe Coward, and Matthew Whittaker, *Painful Separation: An International Study of the Weakening Relationship between Economic Growth and the Pay of Ordinary Workers*, Resolution Foundation, 2011
[3] This is a somewhat simplified version of the Resolution Foundation's standard definition, which focuses on working-age households and filters out households that receive more than 20 percent of their income from means-tested benefits. This full definition cannot be applied to the data I am using.
[4] Throughout this report references to changes in incomes, earnings, and wages are to changes adjusted for inflation.

Figure 1 Average yearly increase in post transfer-post tax income in p10-to-p50 households, 1979-2005



Note: The actual years vary somewhat depending on the country. The data are averages for households between the 10th and 50th percentiles of the income distribution. Post transfer-post tax income, adjusted for household size. The amounts shown are for a household with four persons. Because of the way incomes are adjusted for household size, the income for a one-person household can be obtained by dividing by two. Incomes are adjusted for inflation using the consumer price index and converted to U.S. dollars using purchasing power parities (PPPs).

Source: Kenworthy calculations using income data from the Luxembourg Income Study Database and inflation and PPP data from the OECD.

The vertical lines in the chart separate the countries into three groups: very successful, successful, and not-so-successful. In the 'very successful' group are Ireland and Norway. In these two nations low-to-middle incomes rose quite rapidly. The 'successful' group consists of nine countries in which the incomes of low-to-middle households increased between $250 and $625 per year: the Netherlands, Belgium, the UK, Sweden, Spain, Finland, Denmark, France, and Austria. In the 'not-so-successful' group, low-to-middle incomes rose by less than $250 per year. These six countries are Australia, Italy, the United States, Canada, Germany, and Switzerland.

Differences in the pace of economic growth — in the degree of increase in per capita gross domestic product (GDP) — are part of the reason for these differences in household income growth. But if we set aside Ireland and Norway, economic growth accounts for only a modest portion of the variation we see in

Figure 1. What matters most is the degree to which economic growth benefited low-to-middle households.[5]

The series of charts in Figure 2 help to explain this finding. The charts in the left column have GDP per capita on the horizontal axis and low-to-middle household incomes on the vertical. As in Figure 1, the incomes shown here include transfers and subtract taxes. The data points are years for which these data are available in the LIS Database. The countries are ordered as in Figure 1, from most rapid growth of low-to-middle incomes to least rapid.

In all of the very successful and successful nations, we see a clear positive slope to the line summarizing the relationship over time between GDP per capita and low-to-middle incomes. These countries varied sharply in economic growth — movement to the right on the horizontal axis. Ireland and Norway moved quite a way to the right, the Netherlands and France far less. But in each of these eleven countries economic growth was accompanied by significant rise in low-to-middle household incomes.

In the not-so-successful countries — the last six in Figure 2 — the lines tend to look quite different. In each of these nations the line is flatter, indicating less payoff to economic growth for those on low-to-middle incomes.

What accounts for these different slopes? What, in other words, accounts for the country differences in economic growth's payoff?

There are two chief sources of income for households in the low-to-middle range: earnings and net government transfers. Earnings come from wages and salaries. Net government transfers are cash and near-cash benefits received by households less taxes paid. There are other potential sources of income — capital gains, interest and dividends, rent, gifts from family or friends, alimony and child support payments, and others — but these tend to play a small role and haven't changed over time to any appreciable degree. I ignore them here.

For twelve of the seventeen countries it is possible in the LIS data to separate earnings from net government transfers. (In the other five — Austria, Belgium, France, Italy, and Spain — earnings are reported net of taxes.) For these twelve countries, Figure 2 includes two additional charts. The first, in the middle column, shows trends over time in earnings and in net transfers for households between the tenth and the twenty-fifth percentiles (p10 to p25) of the income distribution. For ease, the remainder of the report refers to this group as 'low income'. The second, in the right column, does the same for households between the twenty-fifth and fiftieth percentiles (p25 to p50). I refer to this group as 'modest income'. These two groups are separated because, as the charts readily attest, the patterns for them differ quite a bit.

How should we read these charts? Consider the United Kingdom. The LIS database has UK data for 1979, 1986, 1991, 1995, 1999, and 2004. In the middle UK chart in Figure 2 we see trends in average earnings and average net government transfers for the 'low income' group of households. The line with the pink circles indicates average earnings of households in this income group. Average earnings in these households fell a bit in the 1980s, then stayed flat for a period, then rose between the mid-1990s and the mid-2000s. The line with the green squares shows average net government transfers received by these 'low income' households. This amount increased fairly steadily throughout the whole of the period. Some of that is unemployment insurance collected by the jobless, some is pension money, some is tax credits, some is other benefits. And some of it reflects reductions in tax payments for households in this income group. The third chart for the UK covers the 'modest income' group of households. It can be read in a similar way.

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[5] With Ireland and Norway excluded, the slopes shown in the left charts in Figure 2 explain more than twice as much of the cross-country variation in p10-p50 household income change as does GDP per capita change. Together they account for nearly all — 95% — of the variation.

It's important to note that these data are not for the same set of households followed over time. The UK data, and those for each of the other countries, are from representative samples of the population taken in each of these years, with each year being a different sample. What these charts show is a series of snapshots representing the full population, rather than the tracking of a particular set of households as they move through the life course.

Figure 3 offers a summary picture of the trends shown in the middle and right charts in Figure 2. It shows per-year increases in average earnings and in average net government transfers for the 'low income' and 'modest income' groups of households.

What do the charts tell us? Let's begin with low income households. In most of the countries we observe little or no rise in earnings among households in this group. Instead, when households on low incomes got better off, it was due most often to a rise in net government transfers.[6] Where net transfers increased, incomes tended to increase in concert with economic growth. Norway, the UK, Sweden, Finland, and Denmark illustrate this pattern. Where net transfers were stagnant, income trends were decoupled from growth of the economy. We observe this in the United States, Canada, and Switzerland. This is an important finding. It means that, as a general rule, growth has not trickled down to low income households through wages or employment. And it means that, when government transfers haven't grown, wages and employment haven't stepped in to take their place. Instead, low income households have had little or no income growth.

There are three exceptions to this pattern. One is the Netherlands, where low income households mainly saw their incomes increase due to rising earnings. Germany also is an exception: net government transfers rose, but that rise was offset by a decrease in earnings, so household incomes were flat over the period. The third exception is Ireland. In the middle chart in Figure 2 Ireland doesn't look like an exception. Net transfers increased sharply, much like in some of the other successful and very successful countries. But this hides a compositional shift that occurred during this period. Ireland enjoyed a massive economic boom in these years, which produced rising wages and work hours in many working-age households that, at the outset, had little employment and/or low wages. A number of these households consequently moved from the lower part of the income distribution into the middle. As a result, the low income group came increasingly to consist of pensioners. Pension benefit levels rose during the period, which accounts for much of the rise in net government transfers seen in the middle chart for Ireland. Naturally, though, most such households had no earnings. This explains the relatively flat line for earnings in Ireland in the low income group.

Ireland is the only country in which this kind of compositional shift occurred. All of these nations have some pensioners among their low income households, but if we were to examine only working-age households the over-time trends would look very similar to those in Figure 2.

The story is somewhat different for households in the group on 'modest' incomes, shown in the charts in the right (third) column in Figure 2. As Figure 3 confirms, here earnings have more often been the key to success. Where earnings rose, household incomes tended to rise, and where earnings were flat the same was usually true of household incomes.

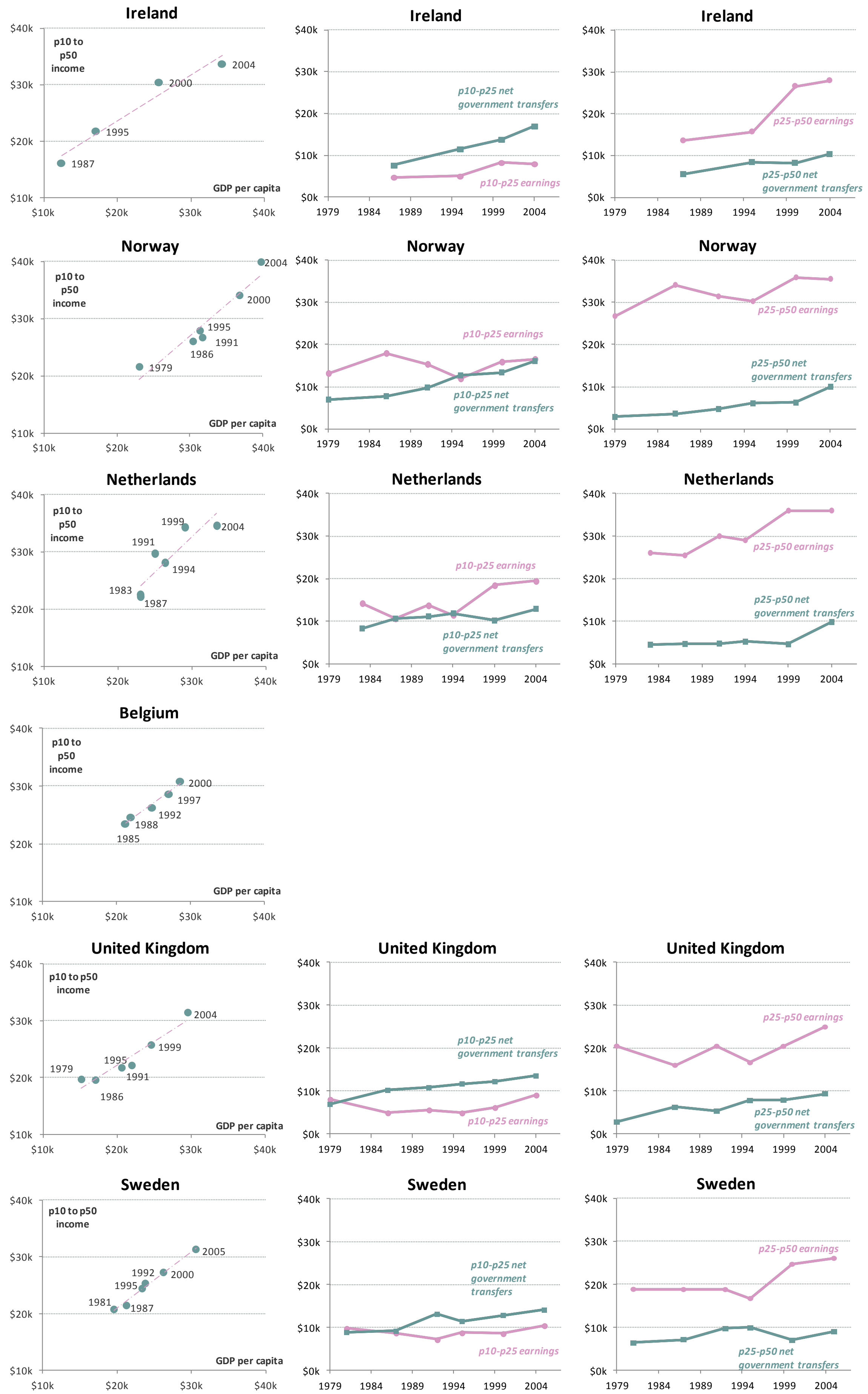
Earnings increased in these modest income households in most of the very successful and successful nations for which the calculation is possible: Ireland, Norway, the Netherlands, the UK, and Sweden. The only two exceptions are Finland and Denmark. Earnings were flat or decreased slightly in households in this group in all of the not-so-successful countries: Australia, the US, Canada, Germany, and Switzerland.

Yet net government transfers also played an important role. Among the very successful and successful nations, only in Ireland and the Netherlands were net transfers clearly secondary to earnings in accounting for household income growth. In Norway, the United Kingdom, Sweden, Finland, and

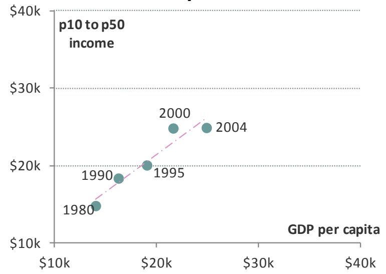
[6] This is similar to the pattern for households in the bottom income decile (below p10). See Lane Kenworthy, *Progress for the Poor*, Oxford University Press, 2011, Chapter 2.

Denmark, net transfers were as important as earnings or more so. This is an important point and bears repeating: in these countries, over the entire period from 1979 to 2005, government transfers were at least as important as wages in feeding the proceeds of growth through to even households on modest incomes.

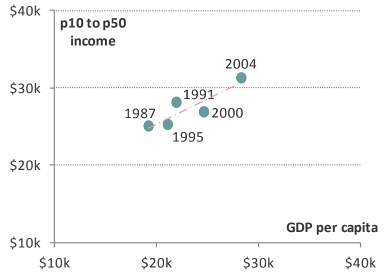
Figure 2 Average income, earnings, and net government transfers in p10-to-p50 households, 1979 to 2005



Spain



Finland



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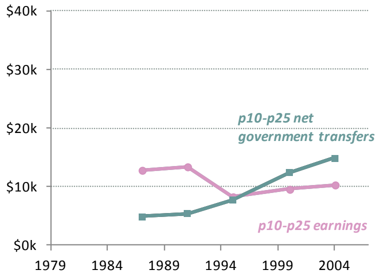

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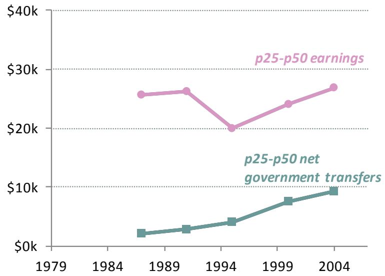
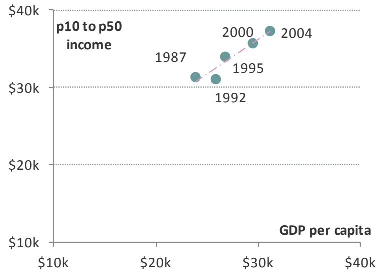


Denmark



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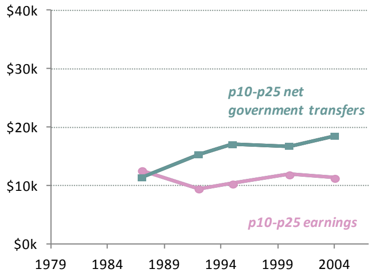

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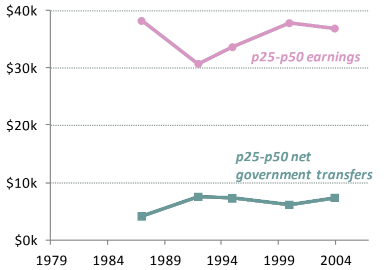
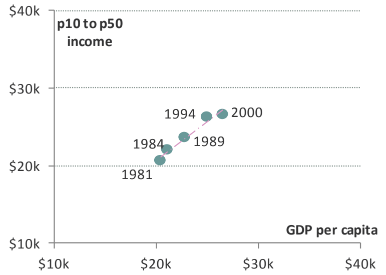
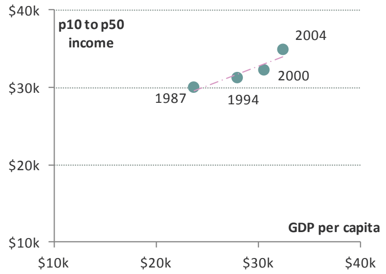


France



Austria



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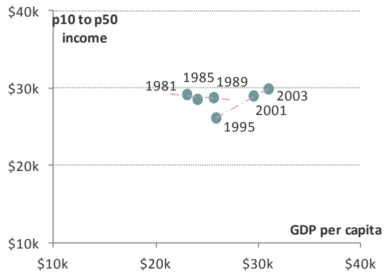

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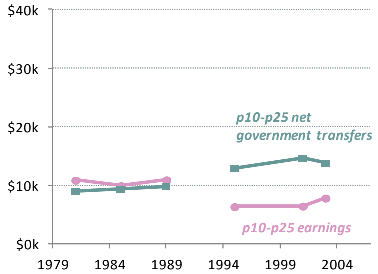

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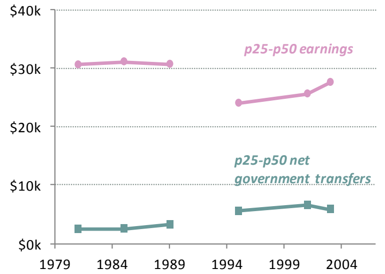
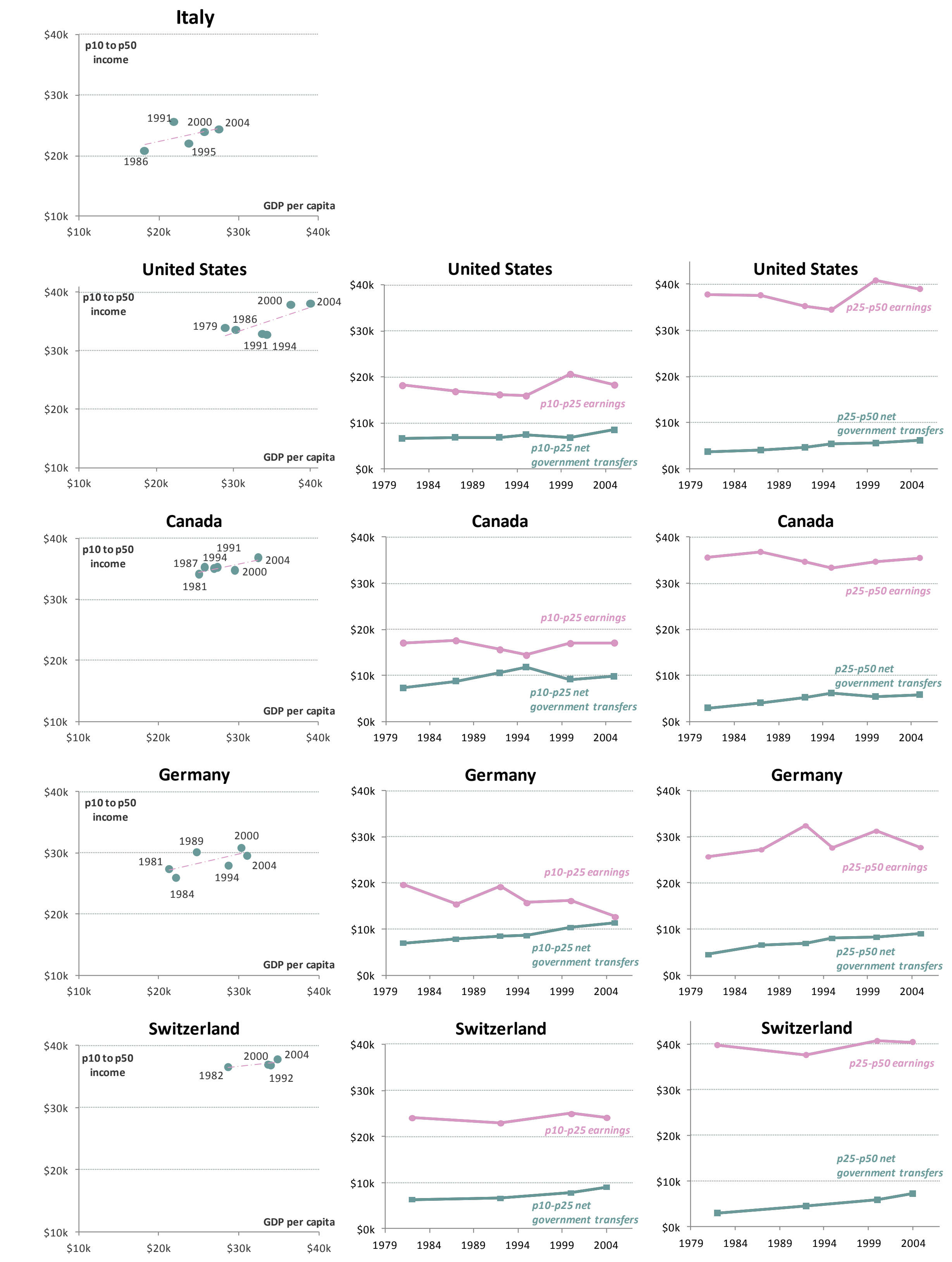
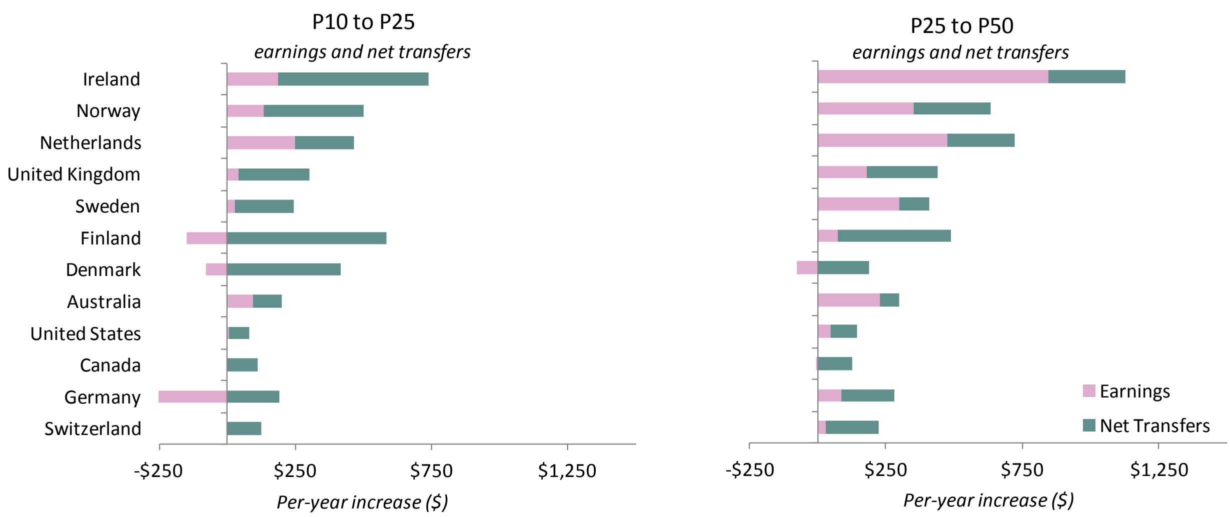




Note: The countries are ordered according to average yearly increase in income in p10-p50 households, as shown in Figure 1. The data are averages for size-adjusted household post transfer-post tax income, earnings, and net government transfers (cash and near-cash transfers received minus taxes paid). The amounts shown are for a household with four persons. Because of the way incomes are adjusted for household size, the income for a one-person household can be obtained by dividing by two. "K" = thousand. Incomes, GDP per capita, earnings, and net transfers are adjusted for inflation using the consumer price index and converted to U.S. dollars using purchasing power parities (PPPs). Average earnings and net government transfers cannot be calculated for Austria, Belgium, France, Italy, and Spain.
Source: Kenworthy calculations using income data from the Luxembourg Income Study Database and inflation and PPP data from the OECD.

Figure 3. Average yearly increase in earnings and in net government transfers in p10-to-p50 households, 1979-2005



Note: The countries are ordered according to average yearly increase in income in p10-p50 households, as shown in Figure 1. The actual years vary somewhat depending on the country. The data are averages for size-adjusted household earnings and net government transfers (cash and near-cash transfers received minus taxes paid). The amounts shown are for a household with four persons; for a one-person household, divide by two. Incomes are adjusted for inflation using the consumer price index and converted to U.S. dollars using purchasing power parities (PPPs).
Source: Kenworthy calculations using income data from the Luxembourg Income Study Database and inflation and PPP data from the OECD.

We thus have two patterns of income growth in low-to-middle households in recent decades. For the lower part of this group, from the tenth percentile to the twenty-fifth ('low income'), success has stemmed largely from net government transfers that rise in sync with GDP per capita. In countries where net transfers haven't risen, these households have seen little or no income growth. For the upper part, households from the twenty-fifth percentile to the median ('modest income'), rising earnings have been more important but net transfers again have played a significant role.

For modest income households, have rising earnings tended to come from rising employment hours or from rising wages, or both? Data limitations make it impossible to answer this question with much certainty. The problem is twofold. First, we need to know trends in average employment hours in low-to-middle-income households. No cross-nationally comparable data series exists. Second, we need to know trends in hourly wage levels in the lower half of the wage distribution. Such data do exist for some of these countries, but for many countries the data are not consistent over time and not sufficiently comparable with those for other nations.[7]

Still, there are a few countries for which it is possible to offer a tentative assessment.[8] In the Netherlands wage levels in the lower half of the wage distribution were largely flat during the 1980s, 1990s, and 2000s. Employment, by contrast, increased sharply during this period. The rise in earnings in low-to-middle Dutch households thus very likely owes to employment gains — shifts from zero earners to one, from one to one and a half or two, and so on — rather than to rising wage levels.

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[7] Jess Bailey, Joe Coward, and Matthew Whittaker, *Painful Separation: An International Study of the Weakening Relationship between Economic Growth and the Pay of Ordinary Workers*, Resolution Foundation, 2011.
[8] The wage and employment trends I refer to here are from OECD data; see Lane Kenworthy, *Jobs with Equality*, Oxford University Press, 2008, figures 3.2 and 5.6; James Plunkett, *Growth without Gain? The Faltering Living Standards of People on Low-to-Middle Incomes*, Resolution Foundation, 2011, figure 2. For the Netherlands see also Jelle Visser, "The First Part-Time Economy in the World: A Model To Be Followed?" *Journal of European Social Policy*, 2002. For Canada see also Jim Stanford, "Testing the Flexibility Paradigm: Canadian Labour Market Performance in International Context," in *Fighting Unemployment: The Limits of Free Market Orthodoxy*, edited by David R. Howell, Oxford University Press, 2005, figure 4.5. For the United Kingdom see also Jane Waldfogel, *Britain's War on Poverty*, Russell Sage Foundation,2010.

In the United States and Canada lower-half wages were stagnant for most of this period. The employment rate, on the other hand, increased in both, at least in the 1980s and 1990s. We would therefore expect some rise in household earnings. But as the third charts for these two countries in Figure 2 show, that didn't happen. It may be that, unlike in the Netherlands, the employment rise wasn't especially helpful for households on low-to-middle incomes. Or it may be that rising employment did help in households with two adults, but this was canceled out by a rise in the number of households with only one adult.

In Sweden the increase in p25-p50 household earnings seems to have been driven as much by wages as by employment. Sweden's ‘modest income’ households survived the country's deep economic downturn in the early 1990s with little drop in earnings despite a sharp decline in the nation's employment rate. After that, employment increased until 2005. Wages remained flat through the bad patch and rose beginning in the mid-1990s.

Finally, in the UK both wages and employment increased for a good bit of the 1979-2005 period. The country's most successful years were those of the late 1990s and early 2000s. Wages increased sharply throughout the lower half, due in part to the introduction of a statutory minimum wage and its steady rise. And employment hours rose in low-to-middle-income households.

To sum up: The experiences of the world's rich countries over the three business cycles from 1979 to 2005 suggest two key routes to rising incomes for low-to-middle households. For those in the lower portion of this group, with incomes between the tenth and twenty-fifth percentiles, success usually has owed to rising net government transfers. For those a bit higher in the income distribution, with incomes between the twenty-fifth percentile and the median, rising incomes typically were a function of rising earnings and/or rising net government transfers. In at least one country, the Netherlands, the rise in earnings was a function of employment growth, while for some other nations wage growth looks to have played a key role in determining success or failure.

What policy choices influence the degree to which low-to-middle households benefit from economic growth?

Low-to-middle income households can benefit from economic growth in three ways: rising net government benefits, rising employment, and rising wages. Which of these is more important depends on a household's particular circumstances, of course, but also on where the household is located in the income distribution. Net government transfers tend to play a larger role for those lower in the distribution, wages and work hours for those closer to the median. What policies can help to ensure the proceeds of growth flow through to low to middle income households?

Net government transfers

Let’s begin with government transfers. The comparative experience suggests a number of lessons about keys to success.[9]

First, most redistribution is achieved via transfer payments to households rather than via taxes. Despite their prominent role in debates about ‘progessivity’, tax systems in all affluent nations are roughly proportional: households throughout the distribution pay approximately the same share of their pretax income in taxes. Income taxes usually are progressive, but that progressivity tends to be offset by regressive payroll and consumption taxes. That is not to say that taxes don’t matter; they do. But to the extent that they serve as a redistributive mechanism, they matter mainly as the source of funds for transfer payments. It is the latter that do most of the redistributive work. For taxation it is the quantity of revenues, rather than their progressivity, that is critical for redistribution. This fact is notable in light of the not uncommon position in the UK to oppose higher VAT, which is regressive but raises very large sums in an efficient manner.

[9] The discussion in this section draws heavily on Kenworthy, *Progress for the Poor*.

Does the mix of tax sources matter? Rich nations use three principal types of taxes: income, payroll, and consumption. One common view is that consumption and payroll taxes are the key to increasing tax revenues. The comparative experience of rich countries offers no support for this notion. Another common claim is that taxes should be weighted more heavily toward consumption rather than income, in order to foster economic growth. Here too the comparative record suggests little or no impact of the tax mix. A third notion is that payroll taxes discourage employment growth, particularly in low-end services. Here the comparative experience is somewhat supportive. Apart from this impact of heavy payroll taxes on employment growth, however, the tax mix seems to not be a major determinant of either the quantity of funds a country is able to raise via taxation or macroeconomic performance.

The structure of transfer programs — in particular, their universal versus targeted design — is sometimes thought to be a significant influence on the degree to which these programs help low-end households. Because universal programs affect a broader swath of the populace, they are said to be more durable politically and therefore of greater benefit in the long run. But the evidence from the rich countries in recent decades calls this notion into question. Looking across nations, we observe little or no association between the degree of universalism in transfer programs and the amount of redistribution achieved by transfers. Nor is universalism associated with change (direction or degree) in redistribution during this period.

A particularly thorny question about transfer programs concerns the role of employment-conditional earnings subsidies such as the UK's Working Tax Credit (WTC – soon to be integrated into the Universal Credit) and the Earned Income Tax Credit (EITC) in the United States. This type of program supplements the income of households with low earnings. It implicitly presumes a low-wage segment of the labor market. A better path, some contend, is to set the wage floor at a high level so there is no need for the state to provide this kind of subsidy. There are many factors to consider in choosing between these options, including normative concerns.[10] It's worth noting, however, that even though wages for a typical low-end service employee are about three times higher in Denmark than in the US, their household incomes end up fairly similar.[11] This is due in part to America's employment-conditional earnings subsidy.

Of course, this is not to imply a wage floor is unnecessary. Indeed, to be effective, a WTC-style or EITC-style employment-conditional earnings subsidy needs to be coupled with a decent wage floor. In a nation with strong unions, the floor can be sustained via collective bargaining. But with unions weakening nearly everywhere, a number of rich countries now have instituted a statutory minimum wage, and others are likely to follow suit. Without an effective wage floor, an earnings subsidy may lead to reductions in low-end wage levels, either by pulling more people into the labor force and thereby increasing the competition for jobs or by encouraging employers to incorporate the value of the subsidy into the wages they offer.[12] Moreover, if the wage floor is too low, the subsidy would need to be quite high in order for it to ensure decent household incomes. The subsidy would then need to extend far into the middle class so that the rate at which it is reduced does not become so severe as to create work disincentives. That would increase its cost substantially.

Finally, low-end households are helped not only by transfers but also by public goods and services. Though the value of these is not included in income statistics, they expand the sphere of consumption for which the cost to households is small or nil. In doing so they boost the living standards of people on low-to-middle incomes.

What are the lessons for the UK? In one sense, much of the above should come as good news. The UK tax system is not especially progressive, the recent increase in VAT will significantly enhance revenue, and the UK welfare state makes comparatively heavy use of targeted benefits, including an employment-conditional earnings subsidy. In these respects, while the conventional wisdom would predict grounds for

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[10] Kenworthy, *Progress for the Poor*, chapter 5.
[11] Kenworthy, *Jobs with Equality*, table 7.2.
[12] See Jesse Rothstein, "Is the EITC Equivalent to an NIT? Conditional Cash Transfers and Tax incidence." NBER Working Paper 14966, www.nber.org, 2009.

pessimism, the international evidence is more optimistic. Indeed, the UK has been more successful than many other affluent nations at achieving income growth in p10-p50 households over the past generation, and increases in net transfers played a prominent role. In the 1980s and early 1990s, a big part of the story was government benefits picking up the slack for declining household earnings. Then, when earnings rose from the mid-1990s through the mid-2000s, transfer income nevertheless continued to increase.[13]

That said, recent years have seen some worrying developments, in particular the current government's plan to substantially reduce spend on the UK's tax credit system.[14] Tax credits have been a key component of the UK's success in improving employment and incomes of low-to-middle households. If they are not to play the same role in future, the government ought to identify a component of household income it believes will grow substantially faster in the coming years than it has previously.

Employment, wages, and household earnings

Employment helps households on low-to-middle income in two ways. The first is direct: it is a source of household earnings. The second is indirect: in an era in which population ageing will sap a growing share of government spending and capital mobility makes it difficult to increase tax rates, the tax revenues from additional employment can be vital to shoring up the fiscal viability of generous transfers.

Over the past generation, many policy analysts have operated under a belief that high low-end wages, generous government benefits, heavy taxes, and strict employment protection regulations impede employment growth. This is thought to be especially true for low-end service positions. Because productivity in these jobs tends to be low and difficult to increase, employers are assumed to be particularly sensitive to costs and regulations. Some say that is just as well, because rich societies should try to minimize such jobs. But low-end service positions have been a key locus of employment growth in recent decades. Employment rates surely would be lower without them. And in households with another earner, or in which the earnings are subsidized, such jobs may be far preferable if the alternative is non-employment.

The comparative experience over the period from 1979 to 2005 suggests there is some truth to the tradeoff view. But there are two important caveats.[15] First, these institutions and policies are fairly strongly correlated with one another across countries. Nations in which low-end wages are higher also tend to have more generous government transfers and higher taxes. This makes it difficult to figure out which among them has the causal effect. Second, and more important, the magnitude of the effect appears to be modest. This suggests that countries have some leeway to choose.

Education can boost employment. But its payoff comes over a relatively long period of time, and it's likely to have more influence on the quality of employment than on quantity.[16]

Family-friendly policies, such as paid parental leave during the first year and affordable high-quality child care, encourage employment, particularly among mothers. Besides that, they are vital in helping people balance work and family, and evidence is mounting that good, affordable childcare contributes to equality of opportunity, improved life chances for those at the bottom, social mobility, and perhaps also equality of outcomes.[17]

Given these considerations, the UK would seem moderately well positioned to achieve rising employment. With respect to low-end wage levels, government benefits, taxes (particularly payroll taxes), and employment protection, British policy makers probably need not be concerned that there are any serious

[13] Plunkett, *Growth without Gain?*, chapter 4.
[14] HM Treasury, *Budget 2011*, cdn.hm-treasury.gov.uk/2011budget_complete.pdf, table 2.2, p. 44.
[15] See Kenworthy, *Jobs with Equality*, part 2.
[16] Kenworthy, *Jobs with Equality*, chapter 9; Kenworthy, "Two and a Half Cheers for Education," in *After the Third Way: The Future of Social Democracy in Europe*, edited by Olaf Cramme and Patrick Diamond, I.B. Tauris, 2012.
[17] Kenworthy, *Jobs with Equality*, chapter 10; Gøsta Esping-Andersen, *The Incomplete Revolution*, 2009; Flavio Cunha and James J. Heckman, "Investing in Our Young People," Working Paper 16201, National Bureau of Economic Research, 2010; OECD, *Doing Better for Families*, 2011.

impediments to employment growth. From the late 1970s until the onset of the crisis in 2008, the UK's employment rate grew more rapidly than those of most other rich nations. In education and family-friendly programs, on the other hand, there looks to be substantial room for improvement.[18]

Because of the data limitations mentioned earlier, social scientists know far less about the determinants of cross-country differences in wage patterns. Technological change and globalization have put considerable downward pressure on wages in lower half of the distribution. But other things also have changed in many of the rich countries during this period: unions have weakened, financial systems and corporate governance practices have shifted, and so on. Where unions remain relatively strong, that probably has helped to blunt the impact of wage-depressing developments.

The UK is one of the affluent nations in which lower-half wages rose during much of the past generation. On the other hand, wage increases suddenly halted in the last four years of the pre-2008 business cycle, despite continued strong economic growth.[19] The reasons for this aren't yet clear, but it is a worrisome signal about what may lie ahead when the country finally emerges from the aftermath of the 2008-09 crisis.

Could the United Kingdom achieve earnings growth in low-to-middle households if rising wages are in fact a thing of the past? The Dutch experience suggests that it can be done, via a sharp increase in employment. That might not be feasible, though, given that the UK would be starting from a much higher employment rate than the Netherlands had back at the end of the 1970s.

The US experience suggests reason for pessimism. America's employment rate rose steadily in the 1980s and 1990s, but in only one brief period during those two decades, the late 1990s, did low-to-middle household incomes increase. That period was the lone one during the past generation in which wages rose for Americans in the lower half of the distribution. Then, in the upturn phase of the 2000-07 business cycle, the rise in the employment rate came to a halt, further reducing the likelihood of a return to income growth for low-to-middle households. The US case offers a stark warning to those who might believe employment growth in and of itself will secure rising incomes for low-to-middle households. In the absence of growth in wages and in government transfers, employment may not do enough to help. And if the employment motor slows or stops altogether, the likelihood of success is very low.

Conclusion

One hallmark of a good society is rising incomes for people in the lower part of the income distribution. When an economy grows, the benefits should be widely felt as noticeable improvements in material wellbeing. Understanding this relationship – between economic growth and the living standards of people on low-to-middle incomes – is one of the central goals of the Resolution Foundation Commission on Living Standards. This report has added to that understanding by showing that, over the past generation, the world's rich nations have differed markedly in their success at achieving this aim. This owes partly to differences in the pace of economic growth, *but more important in most countries has been the degree to which growth gets passed on to low-to-middle income households*. In successful nations, rising incomes in households between the tenth and twenty-fifth percentiles have tended to be driven by increases in net government transfers, while in households between the twenty-fifth and fiftieth percentiles both earnings and net transfers have been important.

Is there an optimal route? The results in Ireland and Norway point up the value of very strong economic growth. However, in both of these countries key contributors to rapid growth were exceptional — oil in Norway, an unsustainable bubble in Ireland — and unlikely to be replicated by other countries. The Dutch case suggests that rising employment can do quite a bit of good, but the increase in the employment rate

[18] Plunkett, *Growth without Gain?*, chapter 7; OECD, *Doing Better for Families*, 2011.
[19] Plunkett, *Growth without Gain?*; Matthew Whittaker and Lee Savage, *Missing Out: Why Ordinary Workers Are Experiencing Growth without Gain*, Resolution Foundation, 2011.

in the Netherlands was so massive that this too probably ought to be viewed as an exception. For most nations, in most circumstances, rising income in low-to-middle households is best achieved via a combination of increases in employment, wages, and net government transfers.

Over the long run, the United Kingdom has been one of the more successful affluent countries, particularly from the mid-1990s through the mid-2000s. The UK's overall policy orientation seems to have been comparatively effective at allowing and enabling economic growth to feed through to low-to-middle income households. But significant challenges loom, even if we set aside the current state of the economy and the present government's inclination to reduce public expenditure. Will employment growth continue? The US experience suggests reason for concern. Will wage growth resume? The fact that UK wage growth suddenly halted several years before the end of the mid-2000s upturn is troubling. Can taxation be increased any further? Even aside from the current fiscal squeeze, population ageing means a rising share of every pound of tax revenue will be directed toward the elderly. In this context, there is a real risk of complacency. Future growth in living standards may well not flow automatically from economic growth, but instead depend heavily on decisions made by the UK government.

The Resolution Foundation

The Resolution Foundation is an independent research and policy organisation.
Our goal is to improve the lives of people on low to modest incomes by delivering change in areas where they are currently disadvantaged. We do this by:

- undertaking research and economic analysis;
- developing practical and effective policy proposals; and
- engaging with policy makers and stakeholders to influence decision making and bring about change.

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