

4 | EASING THE SQUEEZE

Matthew Pennycook

Ed Miliband has made the “cost of living crisis” faced by those in the squeezed middle a major theme of his Labour leadership. There remain deep questions for all party leaders to address that will need an account of what austerity means for the role of the state; clarity about who will be the distributional winners and losers from future fiscal decisions in a world of constrained public spending; and an idea of how public consent to buttress these choices can be built.

Labour must construct a coherent and detailed policy agenda of sufficient ambition, focused on the gritty steps needed to improve household finances whilst doing everything possible to generate growth and minimise the chances of prolonged stagnation.

In the aftermath of the 2010 general election, the thinking of most politicians was dominated by taxes and public spending. That focus was not misplaced. Deficit reduction and economic recovery will dominate the political agenda for the life of this parliament and beyond. Yet for all the fury witnessed during their implementation, by 2015 the clamour over cuts will have faded. Any party seeking electoral success at the next election will be forced to confront a much bigger challenge: what can be done to improve the faltering living standards of those on low to middle incomes.

In their different ways each party leader has sought to put their stamp on this agenda. David Cameron recently set out a 'fairness' agenda aimed at making sure that if people work hard and do the right thing, they get rewarded. Nick Clegg has spoken up for what he describes as "alarm clock Britain," those that rise early, work long hours for relatively little money, play by the rules and yet who are still feeling the strain.

Ed Miliband has made the "cost of living crisis" faced by those in the squeezed middle a major theme of his Labour leadership. He has spoken of the eroding nature of "the promise that if you're in work, you will do better each year"; highlighted that "[for the] first time for more than a century, the next generation will struggle to do better than the last". And he has been at pains to prove that his party is coming to terms with a world in which one cannot reach for the sake of steadily rising public expenditure.

Yet beyond the rhetoric there remain deeper questions for all party leaders to address: questions that will require an account of what austerity means for the role of the state; clarity about who will be the distributional winners and losers from future fiscal decisions; and an idea of how to build public consent for these choices. A prerequisite to answering these questions is a convincing and focused understanding of the causes of faltering living standards and a better idea of how future economic growth can be shaped to better serve the interests of the whole population, including the 10 million adults in households on low to middle incomes (broadly those who work and are in the bottom half of the income distribution).

The nature of the challenge

Expressions of sympathy from party leaders for a category of people – often vaguely presented as an all-encompassing group that includes everyone who works and is not on a

six-figure salary – that huge numbers of voters will instinctively identify with is, of course, to be expected. Political expediency demands no less. Yet beneath the signalling it is unclear whether any political party has embarked on the mental shift required to address the challenge posed by the stagnating living standards.

The onward march of living standards in the late twentieth century was driven by a series of social and economic ‘waves’ which ensured that national economic performance fed through into general prosperity. In the immediate post-war period this took the form of new technologies and widening educational opportunities, which had positive effects 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 and on modest pay. For a variety of reasons, the potency of each of these waves has diminished. As a result it has become clear that while economic growth is a prerequisite to rising living standards, it may not be enough for large swathes of the population.

Even if Office for Budget Responsibility (OBR) assumptions for GDP growth until 2016 (2.7 per cent in 2014, and 3 per cent in 2015 and 2016) are met, the immediate prospects for low to middle income households are not looking good. Disposable household income for this group is set to fall 8 per cent by 2015 (from just under £22,000 in 2007–08 to just over £20,000).¹ Strong growth in household income would see low to middle income households regain the living standards they reached in 2007–08 by 2020 – and of course unexpected factors may further improve this scenario – but policymakers cannot pin their hopes on this. A worst case scenario, in which the wage and income stagnation that occurred between 2003 and 2008 persists, would see disposable household income for this group at much the same levels in 2020 as it was in 2001.

The simple truth is that for any given household there are only a limited number of ways to achieve higher living standards: real wages (and productivity) can rise, people can work longer hours, employment levels can increase or the state can do more of the lifting. For low to middle income households each of these four potential drivers of improved living standards is under threat or in retreat. Real wage increases are not expected until 2013/14, and earnings growth will almost certainly be restrained at the lower end of the pay spectrum. Low growth and the resulting slack demand for labour makes an expansion of hours on offer unlikely, particularly in vulnerable parts of the labour market. The short-term outlook for employment remains bleak and changes to the tax and benefit system – which played such a vital role in propping up living standards over recent years as wages fell or flat-lined – are causing real pain.

Underpinning these trends in wages and employment are deeper structural shifts in the UK labour market. Along with other advanced economies, the UK is witnessing a steady polarisation of the labour market between high-skilled, white-collar and low-skilled, low-wage jobs – with little in between. The leading explanation for this phenomenon is the role of new technology in replacing repetitive ‘routine’ tasks that were previously fulfilled by middle wage labour but other factors including declining worker bargaining power have almost certainly played a strong role. UK employment forecasts to 2020 suggest that this trend will continue; add to this the potential for trends in global trade to amplify technological change and further impact on the UK jobs market, and the outlook is bleak.

With the key motors of progress for those on low to middle incomes stalled and deeper trends in wages and employment pointing the way to a more polarised UK labour market, there are good grounds for questioning

whether our established pattern of economic growth can really deliver steadily rising living standards for low to middle income households.

Mapping out a course to meet the challenge

For all the intellectual interest in the problems of the squeezed middle, there remains a glaring absence of a coherent and detailed policy agenda of sufficient ambition to address the scale of the challenge. There will be rich electoral dividends for the party that fills this void. But beginning that journey requires a move away from vague hopes of economic rebalancing toward a sharpened focus on the gritty steps needed to improve household finances; and all without neglecting the obvious need to do everything possible, particularly in terms of active macro-economic policy, to generate growth and minimise the chances of prolonged stagnation.

Fair Pay

One area that must be addressed is the growth in precarious low paid work. The success of the minimum wage has belied the apocalyptic predications of opponents prior to its introduction. Yet despite the protection afforded by the minimum wage (set at £6.08 since 1 October 2011), around 21 per cent of employees in the UK (5 million in total) still earn less than a living wage (currently set at £8.30 in London and £7.20 in the rest of the country) that would guarantee a minimum acceptable standard of living.

While there is little doubt that imposition of a mandatory living wage rate across the economy would adversely affect employment and any party leader must be cautious in viewing a living wage as a panacea for low wage work (or as some on the left have suggested, a replacement for

tax credits and welfare), living wage campaigns do have a crucial role to play in putting upward pressure on wage levels. Yet consideration will also have to be given to less cautious, but more targeted, means of increasing low pay. This should include confronting ideas hitherto seen as problematic, such as increasing the national minimum wage by means of varying rates by age, sector or region as a way of boosting pay whilst minimising employment risks.

In wider terms, sustained attention must be given to ways of tipping the balance away from the overreliance of too many UK firms on low value business strategies which rely on low paid, low productivity, poor quality jobs and in which the workforce is viewed principally as a cost driver rather than a driver of sales.²

Boosting employment

Another area requiring more thought is how employment can be boosted among low to middle income households – particularly among women and older people. This might entail prioritising available resources (funded by deeper cuts elsewhere if needs be) and reform on those public services that can serve to increase our productive potential. Childcare is an obvious case and urgent consideration should be given to a large scale expansion in, and reform of, childcare provision, starting with childcare for primary school-age children. This would help address the fact that for all the progress we've made over decades, female employment in the UK ranked just 15th in the OECD, just behind Slovenia, and second earners in the UK face some of the highest effective tax rates in the world. Solving this will involve many things, including a change in corporate culture towards greater support for quality part-time jobs, but childcare reform is one key to rapid progress.

Heading off pitfalls in housing

If stagnation, and with it our fiscal problems, persist, any party that seeks to address faltering living standards will need to provide urgent solutions to some of the structural faults in areas of Britain's housing market.

Even with interest rates as low as they are, mortgage payments still consume more than 25 per cent of the monthly incomes of more than a quarter of low to middle income families. If and when interest rates begin to rise, monthly payments will start to climb. Households with falling or stagnating incomes who stretched themselves to get on the housing ladder will find themselves in an extremely precarious financial position as a result. Thinking needs to begin immediately about what contingencies can be put in place to ensure that, if such a scenario arises, debt and mortgage distress can be managed in an orderly way that avoids triggering a rash of repossessions.

Sustained thought also needs to be devoted to the issues thrown up by a rapidly expanding, yet unreformed, private rented sector. In 1991, it would have taken a couple on a low to middle income around four years to save for a deposit on their first home. By 2011 that figure had rocketed to 22 years. Despite the recession, prices remain high and 100 per cent mortgages have disappeared from the market. These additional barriers to home ownership, coupled with the diminishing prospects of accessing social housing, have seen soaring numbers of those stuck renting privately. The vast majority of those relying on the private rented sector for shelter face a buy-to-let market characterised by steadily rising rents, insecure tenancies, and amateur management.

Surprisingly, given the insecurity that all too often accompanies private renting and the proportion of disposable income that low to middle income households in this tenure allocate to rent, there is a noticeable lack of

thinking about the social and political problems that flow from it. Those problems are particularly acute for the more than one million families with children that now rent privately, almost double the number of five years ago. While it remains crucial to increase housing supply for owner-occupation, more thought needs to be given to increasing supply in the private rented sector to ease rent pressure – including measures to attract private capital as a means of getting rental schemes off the ground – along with fresh thinking on how more certainty and security can be given to households, particularly those with children, who face the prospect of long periods in private rental accommodation.

Sharing out the pain of adjustment

If stagnation persists, any party seeking to address the challenge of faltering living standards will need to provide greater clarity about who will be the distributional winners and losers of future fiscal policy. Sustained thought needs to be given to whether the current burden of taxation is appropriate in a world of faltering living standards or whether, over time, that burden needs to be shifted away from income toward green taxes and levies on wealth. It will also require a readiness to confront more bravely the issue of generational politics which, as the furore over this year's Budget showed, is only likely to increase in prominence. At a time when younger generations are shouldering a disproportionate share of the fiscal burden, the failure to address the issue of what constitutes a fairer generational settlement (and there are obvious electoral reasons for this given the power of the 'grey vote') is only likely to aggravate underlying macroeconomic and fiscal problems.

Political parties will therefore need to think creatively about what trade-offs the older generation might accept

as the price of reform. Consideration might be given, for example, to the introduction of a proper Dilnot-esque system of social care if paid for mainly by the ageing generation itself and implemented alongside withdrawal of certain universal benefits. And of course any grand generational settlement of this nature will also require sustained strategic thought about what type of state would be required to deliver it.

Conclusion

The recent past has shown that improvements in living standards for low to middle income Britain didn't happen by accident: they required concerted policy action. In different ways each party leader has sought to capture the agenda surrounding the squeezed middle. The result has been the necessary forging of a consensus as to the existence of a problem. Yet there remains a gulf between grasping the scale of the challenge ahead and devising the concrete and unfamiliar solutions that are required to address it.

Endnotes

- 1 Using the OBR projections for average earnings (and tweaking them to reflect the historic relationship between average and lower earnings), and factoring in the Coalition Government's planned cuts to tax credits.
- 2 Zeynep Ton, *Why "Good Jobs" are Good for Retailers*, see www.hbr.org/2012/01/why-good-jobs-are-good-for-retailers/ar/1.