Chapter 1

Introduction

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At the heart of the commission's work is a simple premise: Nations need to ensure both that economic growth takes place and that it is broadly shared. Nations succeed when their middle class is secure in the expectation that those willing to work are able to work and that standards of living will increase. Without that expectation, citizens lose confidence in institutions, social cohesion and international cooperation suffers, and confidence in the future erodes.

In recent decades and particularly in recent years, developed countries have experienced a toxic combination of too little growth and rising inequality. To extents that vary across countries, people are no longer confident in the expectation that hard work will be well rewarded or that their children will live better than they did. Most families find it harder to raise their living standards than they did a generation ago, and there are grounds for concern about stagnation in living standards. Those in work are working longer for less, and those out of work experience lengthy, destructive periods of unemployment. Higher incomes for working families will help avert this stagnation. In the short run, higher incomes will lead to higher demand, which will in turn increase growth. And in the longer run, a high-wage, high-productivity economy is the only route to sustained growth and opportunity for all. Indeed, shared prosperity is the challenge for our time.

Economies transformed

In the decades following World War II, the advanced industrial economies experienced rapid growth and brought an increasing share of households into prosperity. With these changes came a revolution in living standards. Hundreds of millions of people across developed countries were able to work and gain economic security through higher salaries and a series of benefits provided either directly through employers or through government social security systems. Most households came to believe that hard work and careful planning would deliver heightened levels of security for themselves and opportunity for their children, year after year. It was possible for ordinary families to enjoy better housing, and health care, and a secure retirement, and to provide their children with higher education and the prospect of economic opportunity as incomes rose broadly as the economy grew.

By the end of the 1970s, inflation and unemployment seemed out of control. In the 1980s, conservative leaders such as Ronald Reagan and Margaret Thatcher came to power with an anti-government agenda of market fundamentalism and individualism. Measures of inequality, which had been stable or declining, began to increase.

With the return of center-left governments in the 1990s, politicians such as Bill Clinton and Tony Blair sought to marry economic efficiency with social justice through their policies of the "third way." They recognized that the collapse of communism was bringing new countries into the global economy while developments in information and communications technology were bringing the world closer together. But they also foresaw that trade and technology were combining to place a premium on higher-level skills and qualifications and to reduce the number of low-skilled jobs, which could be done more cheaply by robots or workers in poorer countries.

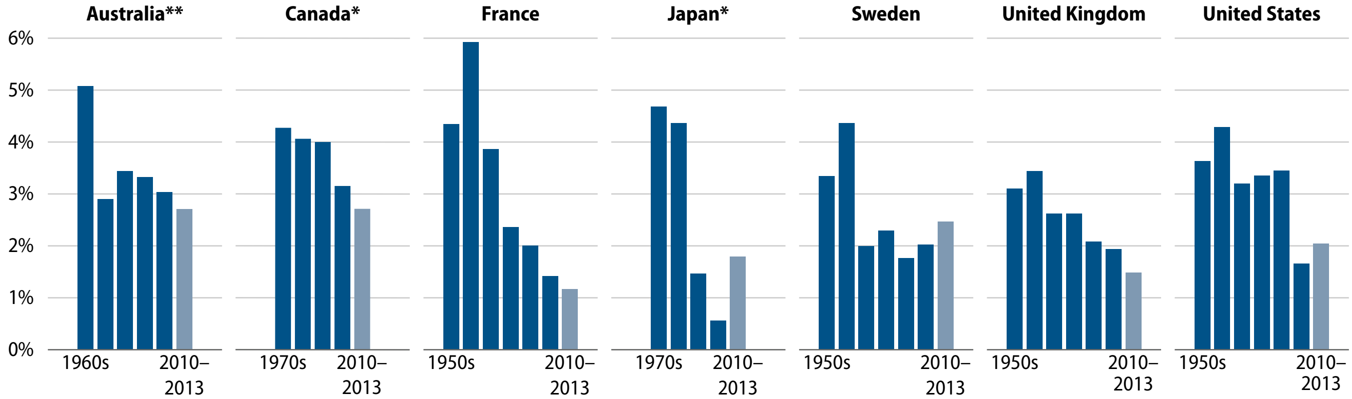
Their policy response was to put people first, emphasizing measures to develop skills and to support work because of a recognition that in a world of increased international competition and a greater and greater ability for capital and innovation to flow across international borders, the most important investments a nation could make were in what was most distinctively national—its people. Along with an emphasis on education and skill development, and greater efforts to support work through tax policy came support for a more open, globally integrated, and managed global economy.

Challenges facing developed countries

Today, developed economies face new challenges for new times. The principles of putting people first need to be updated. Global forces are operating to create new pressures on middle-class incomes and wages at the middle and bottom, and in many countries, institutions that had previously worked to mediate rising levels of inequality have been weakened, leaving families to weather these trends on their own. Therefore, even before the financial crisis and subsequent recession, some countries, such as the United States, experienced the stagnation of average wages and a decline of median household incomes, all while the real costs of important elements of most people's lives have grown more rapidly. Across the advanced economies, the underlying rates of growth have slowed. (see Figure 1.1) The income that has been generated has been distributed increasingly unequally. (see Figure 1.2)

FIGURE 1.1

Average annual GDP growth rate in select advanced economies by decade



* OECD data not available before 1970

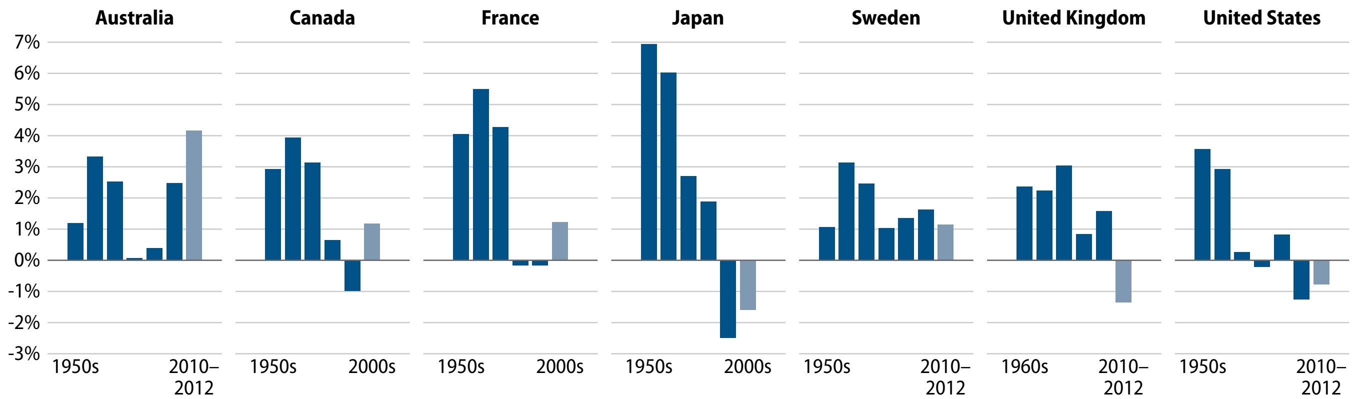
** OECD data not available before 1960

Note: Lighter shading indicates that significantly less than a full decade of data are available.

Source: Organisation for Economic Co-operation and Development, "Stat Extracts: Gross domestic product (GDP)," available at http://stats.oecd.org/index.aspx?queryid=61429# (last accessed December 2014). U.S. data from Federal Reserve Bank of Saint Louis, "Real Gross Domestic Product, Billions of Chained 2009 Dollars, Annual, Not Seasonally Adjusted," available at http://research.stlouisfed.org/fred2/series/GDPC1 (last accessed January 2015).

FIGURE 1.2

Bottom 90 percent average annual income growth rate in select advanced economies by decade



Note: Lighter shading indicates that significantly less than a full decade of data are available. Due to sporadic data availability, appropriate decades range from 9–11 years, and endpoints of decades may differ by 1–2 years.

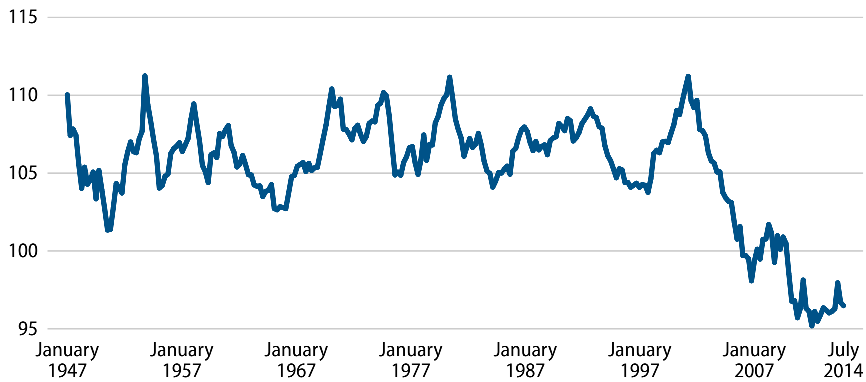
Source: Facundo Alvaredo and others, "The World Top Incomes Database," available at http://topincomes.g-mond.parisschoolofeconomics.eu (last accessed December 2014).

Middle- and low-income families across the developed world face downward pressure on wages and incomes. As growth has slowed, most economies have seen a bifurcation between growth in productivity and growth in income from labor. For example, in the United States over the past several years, firms have been profitable, but their success increasingly translates into income for shareholders and top management, not for employees. (see Figure 1.3) This was far less true 50 years ago. Dividend payments and stock-price increases are skewed to increase, not decrease, inequality. It is, therefore, entirely understandable that middle-class families feel that something is amiss when companies are profitable but wages are stagnant.

FIGURE 1.3

U.S. workers' share of income has been shrinking

Nonfinancial corporations sector: Labor share, series indexed to 2009=100, 1947–2014



Source: Bureau of Labor Statistics, "Major Sector Productivity and Costs," available at http://www.bls.gov/lpc (last accessed December 2014).

In many countries, the worst effects of the crash were exacerbated by austerity programs as premature tax increases and spending cuts sucked demand out of the economy. Countries such as the United Kingdom have seen little of the hoped-for rebalancing, with growth focused heavily on the housing market. The United Kingdom and United States are at least growing again, but wages are stagnant in both countries; the eurozone is suffering from chronically weak growth; and there is a slowdown in some emerging markets, including China, Latin America, and the Middle East. While tax-and-transfer systems—which provide income support and aid for housing, education, and health care costs, supported by government revenues—have mitigated some of these market outcomes, they have not done so everywhere.

The changing economic environment

While the immediate predicament facing most advanced economies is in large measure a result of the financial crisis and the subsequent policy response, other economic forces have played an important role in creating the challenge they confront—particularly four changes that have fundamentally reshaped the world.

First, the global economy has fundamentally changed over the past 40 years. As communism collapsed and countries gradually liberalized their economies, rapid reductions in poverty and increases in living standards have taken place in Asia and especially China, in South America, and in Eastern Europe, with growth increasingly taking off in Africa. As a result of all these changes, global trade is greater than ever before with new market opportunities opening up in many rapidly growing countries. Many goods are cheaper than ever before, giving consumers in the developed world significant increases in their living standards.

But increasing global economic integration has also meant increased competition for many workers who produce tradable goods and services. As the productive capacity of low-wage countries has increased, the level of import competition has also increased. And as Internet and computer technology has made cross-border business organization less costly and more efficient, it has become easier for businesses to outsource or relocate all or part of their operations to countries where wages, labor, and environmental standards are low.

Second, the profound technological changes that brought down the cost of many goods and services are also replacing traditional middle-income jobs. In addition to unskilled labor—which has, in some cases, been squeezed by globalization and offshoring—advances in robotics and artificial intelligence have put intermediate-skill jobs at risk in what economists call a hollowing out of the labor market. This has been common to most developed countries. Sophisticated machine tools and software are already reducing the need for routine jobs on production lines and in offices. This trend is set to continue with 3-D printers, Google's driverless cars, and Amazon's drones. This is creating an even greater premium on higher levels of skills and qualifications, making the returns from ideas, capital, and top-class qualifications greater and greater.

Third, the structure of labor markets has changed. In many advanced economies, such as the United States and the United Kingdom, employment is less likely to be stable or long term. Increasing numbers of workers find themselves in contractual relationships that do not guarantee hours worked or provide benefits such as paid vacation, sick days, or pension benefits. In the United States, unions represent a small fraction of workers, and therefore, many workers have little power to create upward pressure on wages. Major corporations have opted to use subcontracting to perform basic functions, and many workers are now classified as independent contractors, eroding basic labor-law protections.

Fourth, corporations have come to function much less effectively as providers of large-scale opportunity. Increasingly, their dominant focus has been the maximization of share prices and the compensation of their top employees. In a world where mobility is always a possibility, they have become less committed to their workforces and their communities. And their managements' attention has shifted to financial engineering, particularly with the goal of minimizing tax payments. This sea change has been facilitated by technology that has loosened the connections between top management and ordinary workers.

In summary, declining growth, the effects of the financial crisis, and increasing inequality have combined to put substantial economic stress on middle- and low-income families across the developed world. Poor policy choices have only made matters worse. These challenges are formidable, but they must be met.

Chapter 2 outlines these challenges in more detail.

Creating a better economic model

So how do we create a stronger, fairer, and more sustainable economic model in which the many and not just the few benefit from rising prosperity now and into the future? This is not just a question for governments but for companies and citizens as well.

While some on the left seek to turn away from globalization and technology, that is not a realistic option. No country can prosper in isolation. And firms that stand still and do not adapt to new technology inevitably lose out in global competition. Without successful entrepreneurs and wealth creation that finances investment, there is no possibility for progress. But if successful businesses are necessary for economic success, they are far from sufficient.

Those on the right who argue for a return to laissez-faire, trickle-down economics—cutting taxes at the top, stripping out regulation, and making deep cuts to public services—do not provide a viable alternative. Developed countries cannot succeed through a race to the bottom in which companies simply compete on cost as workers see their job security erode and their living standards decline.

A race to the top is the only route to inclusive prosperity.

How to achieve inclusive prosperity

This report analyzes the economic condition of the middle class across the developed world. The challenges outlined above are not unique to one country; indeed, globalization and technology stop at no border. Across advanced economies, middle-class households have experienced a wide range of outcomes: Some countries, such as Australia and Canada, have experienced continuing middle-income growth, while for many it has halted. Therefore, there is nothing predetermined about a country's abilities to navigate these trends and ensure shared prosperity for its people. Rather than fully embracing isolationism or laissez-faire policies, we must show—as progressives have traditionally done—that a dynamic market economy and a fair society can go hand in hand.

Creating a more-inclusive prosperity with good jobs, decent salaries, and a sustainable future is possible but requires a concerted effort and a major shift in policy across a number of areas. Powerful forces of globalization and technological change must be navigated or inequalities will continue to widen, and for many, precarious low-skill work will increasingly become the norm. The consequence is that growth will stall.

We recognize that we call for bold action at a time when institutions on all levels are deeply mistrusted by the public. However, part of that mistrust has developed precisely because both government and business have failed to offer broadly shared prosperity.

At the same time, the pace and scale of change has grown. Institutions—including governments—must respond more quickly and perhaps be more flexible and adaptive. And for those tasks they do take on, whether delivery of services or regulation, government must treat citizens like participants, customers, and clients. To build greater resilience will require reforming old laws to work in a modern era. For example, in the United States, the architecture of labor laws was created to address the industrial age; today, with the rise of technology, the structure of work has dramatically altered, but U.S. labor law, for the most part, has not.

We must focus on open, efficient government committed to addressing the concerns of its citizens. Confidence in government is at an all-time low, and consequently, the public resists intervention by a government it views as incapable of solving its problems. This forces families that could benefit from public support to face the challenges of the evolving economy on their own. It is a vicious cycle—and a cycle we can and must break by renewing confidence through a government that works effectively and efficiently for its citizens.

There are five key policy areas that need to be developed to deliver inclusive prosperity.

Raising wages: Full employment in an economy where work pays

First, we need to return to wage growth for everyone in a full-employment economy. There are still too many people who are unemployed. In the United States, for example, 16 percent of working-age men are out of work.[1] Furthermore, in the sectors in which job growth is taking place, good jobs with clear career progression must be developed. Developed countries have varying levels of institutional support for workers. In most countries in Europe, collective bargaining agreements cover many workers. However, in the United States, coverage is at a low level and middle incomes are stagnant. In the United States, we need to support the growth of unions and collective bargaining so workers can capture their share of productivity increases.

In many countries, minimum wages have lost their real value. The increase in part-time work across developed countries is associated with salaries that are often less than the living wage and with a lack of access to health care and other employment benefits. To help raise living standards and increase family incomes, there is a need to remove barriers to women's labor-force participation, such as inflexible work environments and high-cost child care. In addition, there is an important role for pro-work tax credits, but they must be used in conjunction with a strong minimum wage and substantial employment benefits to ensure that these credits are an added reward for hard work rather than a subsidy for low pay.

Finally, workers must benefit from increased productivity rather than seeing returns accrue primarily to shareholders. Profit-sharing and share-ownership schemes provide a direct way to ensure that employees have an incentive to help their company to succeed.

Educational opportunity for all

Second, in a world where technological change is increasing productivity and mechanizing jobs simultaneously in so many sectors, raising skills levels is critical to increasing growth in the long term. Focusing on early childhood education, increasing the quality of our schools, eliminating financial barriers to higher education, and providing support for apprenticeship programs are all critical to driving higher skill levels across economies in both tradable and nontradable sectors. Increasingly, a college education is similar to the high school education of the past—necessary for a prosperous life.

Different countries have approached these challenges in different ways. Countries with a more harmonious and less adversarial partnership between workers and trade associations have tended to have better on-the-job training. In some countries, there is a market failure in the provision of on-the-job training as firms fear that training will be wasted if a competitor poaches their member of staff. New institutions are therefore needed to ensure that adequate levels of work-based training take place and to bring together businesses and education providers to ensure that vocational qualifications are what employers need.

Measures to support innovation and regional clusters

Third, ensuring that workers are well skilled and able to participate in the labor market is insufficient unless developed countries remain at the technological frontier. The financial crisis continues to reverberate across advanced economies in an era of weak productivity growth. Innovation drives productivity growth and economic growth. The most innovative cities and regions tend to have higher social mobility and higher wages in lower-skilled service sectors, so there are positive consequences for most people.

It is increasingly recognized that agglomeration effects tend to cluster industries and people with similar skills in particular locations. It is, therefore, critical that cities and regions are given the tools to make their own local decisions to help drive growth.

Greater long-termism

Fourth, it is essential that markets work in the public interest and for the long term rather than focusing only on short-term returns. Corporate governance issues, therefore, remain critical. In the United States, company profits have been high relative to GDP, but this has not produced a corresponding increase in business investment in the post-recession period. There is a need to better align the incentives of corporate executives with the goals of fostering productive capital investment and long-term profitability.

Crucially, a further element of long-termism is the fulfillment of environmental commitments. Developed countries must ensure that they are sticking to their own carbon commitments in order to secure a sustainable future. That means sending clear and unequivocal signals to clean energy companies about their intentions to decarbonize the power sector and to tackle the inefficiency of the existing building stock. If we get this right and take a leadership role in international negotiations around climate change, we will help consumers and businesses reduce their own energy costs and reap the benefits of the new markets that will be created around the world.

Infrastructure investment can increase wages by creating jobs—thus tightening the labor market—and enhancing productivity. Infrastructure investments provide strong and well-paid jobs and productive assets that serve as the foundation for long-term economic competitiveness, increased prosperity, and a high quality of life. In comparison, failing to invest leads to deteriorating facilities, unpredictable service disruptions, congestion, and higher costs to businesses and households.

International cooperation on global demand, trade, financial stability, and corporate tax avoidance

Finally, we need a tougher international response to the trends outlined above—what might be called hardheaded internationalism. All countries and regions must come together in forums such as the G-20 to encourage macroeconomic coordination for sustainable global growth. While showing that they understand and can respond to voters' concerns about financial instability, immigration, and tax avoidance, governments in developed countries must stay open to the world, seek new trade deals and regional partnerships, and continue their commitment to a dynamic market economy.

On financial regulation and corporate taxation, new impetus is needed to move forward stalling efforts toward reform. On business taxation, greater international cooperation is needed to strike a fairer deal for the future and ensure that governments have a stable source of revenue to provide for a stronger, smarter, and fairer society.

Restoring the integrity of corporate taxation will require more than a simple reversal of the policies of the past 30 years. It will require governments to develop a taxation system that can withstand the pressures of a globalized economy, promote long-term investment, and provide a stable, fair, and predictable policy framework for businesses.

Chapter 3 outlines these policy responses in more detail.

Conclusion

Around the world, advanced economies are facing similar challenges as they grapple with the new realities of the global economy, technological change, and the long-term effects of a changing balance of economic power away from domestic workers and toward mobile, international corporations.

Left to their own devices, unfettered markets and trickle-down economics will lead to increasing levels of inequality, stagnating wages, and a hollowing out of decent, middle-income jobs. This outcome is morally wrong, economically myopic, and at fundamental odds with a democracy in which everyone quite reasonably asks for an equal chance to succeed.

The enduring response of progressives has been to find ways to share the gains of market dynamism broadly. To ensure that all of society's citizens have a stake in its prosperity, and therefore all of its citizens have a stake in its future. Absent a strong and effective progressive response, it is of little surprise that some countries are turning toward populism and insularity. But a better future is possible, one that combines openness with solidarity, dynamism with security, and innovation with equity.

The remainder of this report outlines these challenges and risks in more detail and sets out policy responses to secure sustainable growth by reforming our economies for the long-term, and thereby generating inclusive prosperity.

Endnotes

1 Calculation based on employment to population ratio for males ages 25–54. U.S. Bureau of Labor Statistics, "Labor Force Statistics from the Current Population Survey" (last accessed January 2015), available at http://beta.bls.gov/dataViewer/view/timeseries/LNS12300061Q.