BBC RADIO 4

RADIO CURRENT AFFAIRS

ANALYSIS
PROFITS BEFORE PAY

TRANSCRIPT OF A RECORDED DOCUMENTARY

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Broadcast Date: 20.02.12 2030-2100
Repeat Date: 26.02.12 2130-2200
CD Number: PLN208/12VT1008
Duration: 27.40

Taking part in order of appearance:

Unnamed worker

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James Plunkett
Secretary to the Commission on Living Standards, The Resolution Foundation

Stewart Lansley
Research fellow at Bristol University and the author of *The Cost of Inequality*

Matt Oakley
Head of economics at the think tank Policy Exchange

Jacob Hacker
Professor of Political Science at Yale University and co-author of *Winner Take-All Politics*

DeAnne Julius
Economist and chair of Chatham House

Roger Bootle
Managing director of Capital Economics

WORKER: I've been working for a finance company for the past four years now, since I graduated. It's a great job, we're hitting targets on a yearly basis. We're looking to expand within the next few years. At the moment my salary has stayed the same since I started, hasn't increased at all.

WELDON: This worker's experience of frozen wages is far from unique. He earns £25,000 a year – very close to the median, or middle, wage in the UK. Since the financial crisis of 2008 many of us have been suffering a wage squeeze and falling living standards. But this isn't a programme about the recession. It's about how things were going wrong just as we thought things were alright.

MUSIC – Things can only get better

WELDON: We tend to think of the early 2000s as a time of relative prosperity – "Things can only get better" was still fresh in the memory, house prices were rising, credit flowed easily and people generally felt better off. But underneath this rosy surface, wages for many actually stopped rising – years before the recession hit.

KELLY: I think to some extent we were kind of blinded by growth in this period.

WELDON: Gavin Kelly is the chief executive of the Resolution Foundation think thank and before this he worked as an advisor in Downing Street under both Tony Blair and Gordon Brown.

KELLY: We thought if the economy was growing things would look after themselves, and of course what we've learnt is that isn't always the case.

WELDON: My name is Duncan Weldon and I'm a senior economist at the Trades Union Congress. In this programme I'll be investigating why wages stopped rising in the years before the crash. What were the driving forces for the squeeze? It's an issue that's seizing the attention of think tanks on both the left and the right – as fuel prices, rail fares, food bills and the general cost of living rise but pay packets, for most of us, refuse to budge. We're feeling poorer by the month. It's something that politicians simply can't ignore.

MILIBAND CLIP: Over the past few decades, less of what our economy produces has been paid out in wages and more in profits. Gains in productivity have not been reflected in higher earnings.

CAMERON CLIP: Too many people found they couldn't count on their savings growing. They couldn't afford to buy a home. They worried about how they would pay their bills in old age.

CLEGG CLIP: In just three years, real household disposable incomes have fallen by some 5% - one of the biggest squeezes since the 1950s, since the records began.

WORKER: Circumstances at the moment, it's understandable but within a year or so, if things haven't changed then you know, I'll sort of be knocking on my boss' door and saying you know "what's going on, you know, we're hitting profits for you but you're not, you're not sort of rewarding us back."

WELDON: While much of the focus today is on those losing their jobs, there are important questions to ask about those still in employment. The Resolution Foundation is a think tank which focuses on those on low and modest incomes. James Plunkett is the secretary to its Commission on Living Standards.

PLUNKETT: This is a thing that's not widely known. In the lead up to the recession: from about 03 to 08 we saw almost no wage growth in the middle and below in the UK economy despite the fact the economy grew by 11 per cent in that period. Then clearly the recession hits and you see people's wages fall, but that fall that has happened post the recession is really a problem on top of a problem.

WELDON: Whilst wages for those in the middle and at the bottom of the earnings ladder began to stagnate in 2003, this was the just the culmination of a much longer shift in the economy. Since the 1980s median wages (the wages earned by those in the middle) have been failing to keep up with productivity. That is to say, as the economy has become better at producing output over the last three decades, the gains from this efficiency haven't fed through to those in the middle and below.

One way to think about this is to consider the so-called "wage share". Stewart Lansley is a research fellow at Bristol University and the author of The Cost of Inequality.

LANSLEY: The wage share is basically the share of the total output in the economy that goes to the workforce in the form of wages. And essentially what has happened over the last 30 years is that share, the wage share, has been shrinking, so the share of the economic pie if you like that's going to the workforce as a whole is smaller now than it was 30 years ago. This is in contrast to what happened in the immediate post-war decades when that share stayed roughly constant, so you know the gains from growth in 30 years after the war were divided more or less equally. Since then, essentially the workforce have been separated from the proceeds of growth. They haven't shared equally in the proceeds of growth and at an accelerating rate.

WELDON: This idea, that ordinary people have become separated from the proceeds of growth is hugely important. If economic growth doesn't benefit ordinary working people, then many will ask – what's the point?

Compounding this problem, alongside a change in the wage share, there has been a change in how it is divided up between different employees. James Plunkett:

PLUNKETT: Obviously in the 80s it's kind of widely known that we saw rising inequality across the spectrum, so if you like the kind of middle are moving away from the bottom and people at the top are moving away from the middle - really a kind of fanning out if you like of people's wages across the economy. What has changed recently, which is quite a big change really, is since the late 90s really the top 1 to 3% have detached from the rest and so it's really become a kind of very, very top against the rest if you like.

WELDON: Currently someone in the top 3% earns over £65,000 a year. For the top 1%, it's over £117,000. And of course some earn a lot more.

The interaction of these two factors – the amount of the economy going into the wage share and the way that share is divided up have both contributed to a long trend whereby those in the middle and below have seen their earnings rise by a lot less than those at the top. And that pattern has become more extreme over the last decade.

You'd expect people like me, on the left, to be worried about workers getting a smaller slice of the economic pie. But the centre right has also become concerned, though they suspect that it's the welfare state itself which may have been partly responsible for the wage squeeze. Matt Oakley is head of economics at the think tank Policy Exchange.

OAKLEY: The tax credit system spanned households with incomes of up to around I think £55,000, so a large, large chunk of households actually taking tax credits home with them. The worry I have is that there's been some evidence that actually it can have a adverse effect, so actually by giving tax credits, this allows firms to actually pay less wages than it would do otherwise. It acts as a kind of firm subsidy - reducing wages.

WELDON: Concerned as he might be about the role of welfare payments on wages, Matt Oakley believes that they should also be included in any meaningful picture of household income.

OAKLEY: Look at things like the benefit system, the tax credit system, which of course redistributes money from people with higher earnings, people with higher abilities, people without disadvantage, to those people we're trying to support in society - low earners, people with disadvantages, those sorts of things, and of course you know you see a very, very different picture again where actually incomes - so earnings, plus redistribution, plus benefits and tax credits - are very, very different. And I think that's what we should be looking at, not just this perhaps quite simplistic measure of wages from employment.

WELDON: This is an important insight. Wages, or earnings, are of course just one type of income. Earnings from work are an important part of the picture but they don't tell us the whole story.

Especially when we are thinking about households rather than just individuals. A two earner couple with children will be receiving income from two sets of wages, from child benefit, possibly from various tax credits and possibly from savings.

Indeed over the past two decades, wage increases have not been the key driver of household incomes for most.

James Plunkett of the Resolution Foundation:

PLUNKETT: We saw in those post-war decades very positive changes in technology and some other kind of things that drive job growth in the economy, effectively kind of creating the modern middle class if you like - so people shifting out of unskilled factory jobs into quite skilled white collar jobs. So that was really the first wave. Then we saw women entering the labour market throughout the 80s, really pushing up household income - again a huge new source of income for households - and then later we saw tax credits and the Labour Government getting involved a bit more in directly supporting some of the income of these households that were struggling. And if you look at each of those waves, in fact they've either kind of slowed down or broken, so the question is what is the next wave and is there anything else that's going to drive up household income in the next 10 years?

WELDON: Whilst these trends are just starting to capture attention in the UK they have long been apparent in the United States. President Obama even referred to this debate in his state of the union address last month.

OBAMA CLIP: Long before the recession, jobs and manufacturing began leaving our shores. Technology made businesses more efficient, but also made some jobs obsolete. Folks at the top saw their incomes rise like never before, but most hardworking Americans struggled with costs that were growing, pay cheques that weren't, and personal debt that kept piling up.

WELDON: The US has seen middle incomes stagnate since the late 1970s. Hourly median wages have been flat for 30 years. As in Britain, the changing distribution of wages has also played a key role in the US. Jacob Hacker is a professor of Political Science at Yale University and the co-author of Winner Take-All Politics.

HACKER: Between 1979 and 2007 the incomes of the middle fifth of Americans, after taxes and benefits, the average incomes of this middle group rose by around a quarter, 25%. The incomes of the top 1%, the average income of this group in the top 1% of the distribution rose by around 250% or ten times as much in percentage terms. And what that means is that over this period fully 40% of all household income gains went to the richest 1% of Americans; whereas about the same proportion, slightly less, went to the bottom 90% combined.

WELDON: The US stands as a stark example of how bad these problems can become if left unchecked. The picture in the UK is not yet as extreme. But it's getting there, just look at the increases those at the very top have enjoyed in recent years.

So, what's behind this pressure on wages for most of us, while the rich have got richer? The two most common explanations from economists are globalisation and technology. Initially, in the post-war years, in the 1950s and 1960s, new technology freed up the workforce, drove up employment and led to generally higher wages as productivity rose. Then the 1970s promised even more rapid technological change.

HORIZON CLIP: Inside here is a silicone chip with all the important components of the computer etched onto its tiny surface.

WELDON: This time, though, the gains brought by new technology were much more narrowly focused.

HORIZON CLIP: Such chips will totally revolutionise our way of life. They are the reason why Japan is abandoning its ship-building and why our children will grow up without jobs to go to.

WELDON: That rather alarmist warning came from the Horizon programme in 1978. Clearly the microchip hasn't destroyed all jobs and for DeAnne Julius, an economist and chair of Chatham House, it's really a question of what skills you have.

JULIUS: I think the recent technological shifts, which have been largely driven by the information technology revolution - internet, all of the advances in IT - I think they have disproportionately benefited higher skilled people, which means the higher end of the income distribution. And in addition to providing a lot of new jobs which are not really available to people without appropriate skills, they've also killed off a lot of the old jobs - the secretarial positions, the admin positions which a lot of semi-skilled people in earlier decades filled.

HORIZON CLIP: There's a new machine coming into use – it's called a word processor and it's probably a more important step than the invention of the typewriter.

WELDON: Back in the days before the word processor, every solicitor, accountant, manager had his or her own secretary. That's clearly not the case nowadays. Meanwhile a financial trader, equipped with a high speed internet connection can make masses more money, compared to his or her counterpart in the 1970s, armed with just a telephone.

Many of the gains from increased productivity and economic growth have disproportionately gone into company profits and the pockets of top earners. This challenges those who believe that improving productivity is the best way to ensure higher wages for all.

JULIUS: It's a fallacy to think that increasing productivity automatically leads to increasing wages. if you look at manufacturing productivity, it's gone up much faster globally than service productivity, but that doesn't mean that manufacturing wages have gone up in the West because those jobs are now often done by people earning much less in East Asia.

WELDON: Alongside technology, the other major structural change in the economy since the 1970s has been the impact of globalisation.

DYSON CLIP: Newsreader: The manufacturer of one of the most famous British inventions in recent years is set to be switched from Wiltshire to Malaysia with the loss of up to 800 jobs. James Dyson who…

DYSON CLIP: Newsreader: Eight hundred workers in Malmesbury heard this morning that their future is under threat.

DYSON CLIP: Employee: Gutted. I live in Malmesbury. I live on my own. I can't drive. And er…

BOOTLE: Essentially what's occurred as a result of the opening up of world economy is that something like a couple of billion workers have just joined the world economy.

WELDON: Roger Bootle is the Managing Director of Capital Economics.

BOOTLE: The result of that, not surprisingly, is downward pressure on real incomes and again downward pressure on particular sorts of real incomes of people who are in competition effectively with unskilled or lowly skilled people in emerging markets.

JULIUS: Well there was a good study recently by the OECD that showed that it wasn't really trade flows that seem to affect wages. It was more the dispersion of supply chains - the outsourcing, the fact that many labour-intensive industries actually shifted from European countries to China, to Asian countries. So it was more the flow of capital that affects where companies are investing rather than trade itself, and both of those of course are an element of globalisation.

WELDON: The outsourcing of certain jobs – first in manufacturing and later in services like call centres, affects the economy much like technological change. It might make the UK more productive and give us cheaper goods but it also destroys some jobs. But is globalisation as important a factor as some claim it is?

PLUNKETT: I think people often go straight to globalisation as the kind of key driver of a lot of these trends. I think it can be overstated.

WELDON: James Plunkett from the Resolution Foundation.

PLUNKETT: For example, I'd point to the fact that a lot of the jobs in Britain that we're really worried about in these kind of conversations are in actually non-traded sectors. These are sectors where we're not really talking about competing with China and India. You know jobs aren't being outsourced to India. So …

WELDON: You can't get your haircut in China.

PLUNKETT: You can't get your haircut in China. Likewise hotels - you can't … An Indian worker from India cannot change a bed in a hotel room in London.

And so these jobs aren't really jobs that are being outsourced to India and China and yet are huge jobs, very badly paying jobs. Similarly social care is a big example. Care for the elderly in Britain is not going to happen from China. And so this is a really big part of the picture and it's not really just down to globalisation, I think.

WELDON: Globalisation and technology have been major drivers of what has happened to wages but they seem to have affected different countries to a different extent.

PLUNKETT: In the US and Canada we've seen in fact much longer stagnation in middle wages for about 30 years. Even in Germany, which people often hold up as a good example, we've seen stagnation for about 10 years or so. But then other economies like France, like Australia have seen much stronger growth at the bottom, so there does seem to be something that governments can do to change these trends.

WELDON: That's interesting. So if France and Australia have you know managed to alleviate some of these trends, how have they done it?

PLUNKETT: What you see in countries like France and Australia is they have not just a minimum wage but a kind of more complicated system of mechanisms to push up wages. So, in France for example, workers above the minimum wage have their pay linked to the minimum wage, so that when the minimum goes up, they go up as well. So they have kind of more mechanisms in place to make sure that when the economy grows people's wages kind of rise in line with that growth.

WELDON: Technology and globalisation are factors that one would expect to impact upon all developed countries in a broadly similar manner. But if the trends in wages have varied, then some other factor or factors could be behind this. For Stewart Lansley, politics is one missing ingredient.

LANSLEY: There were a series of acts in the 1980s that weakened the power of unions; and regulations were taken off business, particularly in relation to the labour market, which gave business more power. So effectively what, what happened was that balance shifted. Industry had a lot more power - you know the concept of countervailing power - was greatly undermined. You know, the checks and balances that used to exist in the economy were removed in favour of one group against another.

WELDON: The American economist J K Galbraith coined the term "countervailing power" in the early 1950s. He thought that in the years before the Second World War the US economy had been dominated by big business to the detriment of employees, but in the post-war world this power would be balanced by a stronger role for trade unions and a more activist government.

The argument is that the weakening of trade unions and their countervailing power in the UK since the 1980s has played a part in driving down the share of the economy that reaches those in the middle and below.

But back in the mid-1970s Britain experienced the exact opposite of the current squeeze on wages – a profit squeeze.

WELDON: Through the 1950s and 1960s the wage share of the economy, the proportion of its output going directly back to workers, was around 58 to 60%. In the mid-1970s it began to rise quickly, briefly hitting a peak of 65%. Corporate profits came under pressure, investment began to fall and the UK found itself in serious economic problems culminating in a bail out from the IMF in 1976.

The Labour Prime Minster Jim Callaghan found himself calling for wage restraint.

CALLAGHAN CLIP: By mid-1975 both earnings and prices were rising at about 25% a year. I cannot forebear to remind you of this. I need hardly dwell on the damage that continued inflation on this scale would have inflicted on British industry and on our level of unemployment.

JULIUS: This country had gotten itself into a very difficult economic situation during the 70s.

WELDON: DeAnne Julius.

JULIUS: We all read about or some remember the strikes and so forth in those days. So Britain had a real economic structural transformation during the 80s and that's probably why some of these trends sped up during that period when we lost a lot of the manufacturing base and a lot of those jobs of course

WELDON: After the wage share peaked in 1975, seemingly over-powerful labour has since been replaced by what many, including myself, feel is over powerful capital. The balance of countervailing power has been removed, and the wage share is now in the low 50s. Throughout the 1950s and 60s some right-leaning economists had begun to argue that the post-war economic model had made labour too strong relative to capital, or businesses. And whilst these voices were generally marginalised until the 1970s, things rapidly began to change.

THATCHER CLIP: Mr Chairman, this government is pursuing the only policy which gives any hope of bringing our people back to real and lasting employment.

WELDON: Another phrase that keeps cropping up to explain what has happened to wages is the concept of "shareholder value", this idea suggests that in the 1980s the way corporations were run changed, as they became more exposed to pressure from financial markets and concerned by their share price. Stewart Lansley again:

LANSLEY: In the 1950s and 1960s, we had a very, very different model of capitalism in which the share price and profit were both key drivers of business activity but only one of them. So relationships with the staff, relationships with the community, the role they played in society worked hand in hand. But what happened then – a lot of those extra responsibilities and social responsibilities that companies accepted were all ditched.

JULIUS: I think there's always been a very important focus on shareholder value, and indeed unless one creates shareholder value in a private company the company disappears. So I don't think that's a new focus.

BOOTLE: I think there has been a shift in corporate behaviour. Essentially so much about publicly quoted companies doesn't actually work very well.

WELDON: Roger Bootle isn't just talking about inflated executive pay but also shrinking company investment levels and unrealistic expectations from today's shareholders.

BOOTLE: It's perverse really it seems to me, that you've got very low interest rates in both the United States and the UK. The British government can borrow at a negative real interest rate and yet we've still got British companies and in America, American companies demanding huge returns – 10%, 15%, in some cases 20% - from prospective investment. This is where I think there's a major failure of the system that needs to be grappled with. I often think to myself what would have happened in the 19th century? What would the great Victorian entrepreneurs and businessmen have done confronted with these very low rates of interest? Well the answer is they'd have rebuilt the world.

WELDON: Whether the driver was politics, a change in corporate behaviour, globalisation, technology or some combination of them all, the pattern of wage earning in Britain today is certainly very different to how it was 30 years ago.

There are competing views on how wages will develop over the next few years. The finance worker, who we heard from at the beginning, is hopeful that his personal four-year wage freeze might be nearing its end.

WORKER: I'm sort of questioning why, why my salary is still the same. Hopefully it will sort of go up in the next year or so but I think, sort of based on the financial difficulty at the moment, I'm not really complaining. So if anything, I'm sort of lucky that I've still got the job and you know, I'm still on the actual salary that I am.

WELDON: Sadly, independent forecasters are less optimistic. The respected Institute of Fiscal Studies believes the squeeze on living standards will continue until at least 2016.

Even allowing for uncertainty, it seems that the factors that have put wages under pressure, such as globalisation and technological change are here to stay, whilst the factors that helped alleviate the weakness of earnings to drive incomes higher, such as the growth of two earner couples or transfers through the tax system, have slowed down.

In the past two decades wage growth has not been a major driver of incomes for a lot of people in the middle and below. But for a typical family that might now be changing – if both members of the household are already in work and tax credits and other benefits are unlikely to be increased, then the future driver of incomes can only be wages.

MUSIC – Things can only get better.

WELDON: Any government serious about relieving pressure on the "squeezed middle" and making things better will have to take questions of wages more seriously than in recent years.

But Gavin Kelly, who spent 11 years working as an adviser in Whitehall and Downing Street under Labour, says that the government machine isn't really set up to deal with this properly.

KELLY: Because at the heart of this is the truth that no department in Whitehall really sees it as their job to worry about big trends in living standards facing the working population of this country. Obviously everyone has in interest in it but no-one really owns it. And I think that is a problem which will still exist today because you don't change the nature of Whitehall departments quickly.

WELDON: The Treasury, understandably, focuses on growth and the public finances while the Department of Work and Pensions is more concerned with unemployment and issues like child poverty. Finding out how a typical household's budget is playing out can prove difficult.

KELLY: There's not much data on that which actually informs key decision making. If you want to have a debate about a particular tax change or a particular spending cut, you will be inundated with analysis; you can have as much analysis as you could possibly want to have on that particular question. If you say how in the round is this type of household faring from all the wider sort of trends which could impact on the plight of the household, you'll find it quite hard to get that information.

WELDON: No one can deny that technology, whether the invention of the microchip or the word processor, and globalisation, whether through outsourcing or trade flows, have had a major impact on wages in Britain. But for me they simply cannot explain why the trend has moved further in the US and the UK than elsewhere.

If we want living standards to start rising for ordinary people and if we want economic growth to mean something for those in the middle and at the bottom then we need to see wages rising again. If we don't then the 2010s will resemble the 2000s but without the alleviation of cheap credit, rising house prices and generous tax credits. People will get poorer, something that no modern generation has experienced on this scale.

Economists and policy-makers occasionally say that Britain might experience a "lost decade" of low to zero growth as Japan did after its own financial crisis in 1990. For many ordinary people this debate is irrelevant – they have already experienced a lost decade of stagnating living standards, even if the first part was camouflaged by mitigating factors.

I struggle to see how we can talk about economic recovery in any meaningful sense unless the rewards from growth are more evenly shared.

KELLY: Even if we do get growth back, based on previous trends and given how far we have fallen in terms of living standards of working people over the last few years, it will take a long time - we're looking towards 2020 - for many households to recover the position that they had previously attained prior to the recession. So this debate and the politics of this debate is set to run and run, and that's assuming that the economy actually does recover. So I'm afraid we'll be talking about this for a long time to come.