Even before the cost of living crisis, a toxic combination of slow growth and high inequality was threatening UK living standards, particularly for families on low and middle incomes. The Economy 2030 Inquiry is examining how to move beyond the past decade and a half of stagnation to create a stronger and fairer economy.

Whether through rising wages, higher employment, the provision of public services or support for those who fall on hard times, the UK state and economy have delivered in the past. Between the Second World War and the turn of the millennium, real wages nearly quadrupled, while state spending on healthcare as a share of the economy almost trebled.

But that progress – and the strength it gives to our society and democracy – should not be taken for granted. There are periods when this underpinning of our social contract comes under pressure. When a clear route to a better tomorrow is lacking, the improvements that people expect dry up and some groups are left wondering whether the country works for them. Britain in 2022 is in this undesirable position.

The UK was meant to have started on the road to recovery this year following the ravages of Covid-19. Instead, our anxious focus on fast-rising case rates has, almost instantaneously, been replaced by one on surging prices: the first global pandemic in 100 years has been followed by the arrival of inflation not seen for four decades. Inflation has risen from close to zero at the start of 2021 and by July was at double digits and set to rise further.

But as pressing as today’s issues are, policymakers must also lift their sights to broader challenges to ensure our shared prosperity. UK households went into this crisis with low levels of financial resilience and are expected to experience a sluggish recovery in living standards coming out of it: despite support that has been announced to date this year, median incomes are set to fall in 2022/23 and 2023/24 by the highest or near-highest rates on record.

The shocks to the global economy that have hit our shores are the driver of the economic pain that the whole country is enduring this year, but the challenges the UK faces are compounded by the low growth of the past 15 years and high inequality of the past four decades, which pose risks not only for our economy, but for our society and democracy too. This makes the UK a “stagnation nation”.

On the eve of the financial crisis, GDP per capita was just 6% lower than in Germany, but this gap had risen to 11% by 2019. Our GDP performance would have been even weaker were it not for strong employment growth, with hours worked having increased by more than two and a half times the rate in France (11% compared with 4%).

This reflects a productivity slowdown far surpassing those seen in similar economies. Labour productivity grew by just 0.4% a year in the UK in the 12 years following the financial crisis, half
the rate of the 25 richest OECD countries (0.9%). Having almost caught up with the economies of France and Germany from the 1990s to the mid-2000s, the UK’s productivity gap with them has almost tripled since 2008: from 6% to 16% – equivalent to an extra £3,700 in lost output per person.

Claims that these measures of economic progress mean little for ordinary workers are common but painfully wide of the mark. Weak productivity growth has fed directly into flatlining wages and sluggish income growth: real wages grew by an average of 33% a decade from 1970 to 2007, but this fell to below zero in the 2010s. The result is that by 2018, typical household incomes were 16% lower in the UK than in Germany and 9% lower than in France, having been higher in 2007.

Low growth, productivity disparities and high inequality

While Britons have been living with low wages for the last 15 years, inequality has been a problem for more than twice as long. The persistence of income inequality comes despite the success of the national minimum wage in reducing hourly wage inequality between the bottom and the middle. This reflects the top (largely men)
continuing to pull away from the middle, lower earners working shorter hours and housing costs rising for poorer households even as interest rate falls boosted living standards at the top.

Income and productivity gaps between places matter and both are high and persistent in the UK. Income per person in the richest local authority – Kensington and Chelsea (£52,500) – was 4.5 times that of the poorest – Nottingham (£11,700) – in 2019. And productivity disparities are larger still, with that between the leading city and potential high-performing others greater than in peer countries such as France. For example, London is 41% more productive than Manchester, whereas Paris is 26% more productive than Lyon.

The twin challenges that the UK faces – low growth and high inequality – are substantial issues on their own, but together they create a toxic combination.

Slow growth is always a problem, but even more so when lower-income households lack financial resilience: over one in four adults went into the pandemic saying they would not be able to manage on their savings for a month if their income stopped. Inequality seems to matter more when the economic music stops: the share of the public citing poverty and inequality as one of the most important issues facing the country rose from 7% in 2010 to 19% pre-pandemic (see Figure 1).

Countries can go through phases of relative stability, but the UK in the 2020s is clearly not such a country. A lot has happened already this decade, and longstanding demographic and technological shifts will continue and combine with Brexit and the net-zero transition in the years ahead. These will bring significant disruption for some, but not the radical reset for our economy or large job losses that many predict. Instead, rather than solving our stagnation, change risks reinforcing it.

These changes are the context within which the badly needed attempt to renew the country’s path to economic success needs to be placed.

Renew the UK’s economic strategy and end stagnation

Relying on supposed silver linings or silver bullets is part of a wider problem: the belief that a policy shift in one area holds the answer to stagnation. It won’t. Instead, the task for the 2020s is to renew the UK’s economic strategy – its route to shared economic success.

Important elements of a more comprehensive approach are visible, from the government’s focus on science, to the Labour Party’s green investment plans or the Welsh government’s prioritisation of social partnership. But the test for a broader economic strategy is that it requires:

- Goal orientation: being clear about the problem a strategy is trying to solve.
- Clarity about context: understanding the type of country we are and the opportunities and constraints this brings.
- Realism about trade-offs: recognising the tensions that always exist in setting strategy.
- Policies of sufficient scale that will plausibly move the dial.
- And finally, staying power: because change takes time.

Understanding our country: the starting point to providing a renewed economic model

The Economy 2030 Inquiry is now at its half way point, having analysed the issues that dominate the UK’s economic performance – both for ill and for good – and set out the broad components of what a comprehensive economic approach could plausibly look like. In the coming year, we will provide a suite of policy proposals that together provide a route towards a renewed economic model for the country.

These policies will seek to rectify the fundamental weaknesses present in our economy – from low growth to high inequality – and will also build on the country’s clear strengths.

For example, although commentators often talk of the UK economy as being narrowly built on banking, the reality is that the UK is a broad-based services economy built on successful musicians and architects as well as bankers. We’re about culture, marketing and information and communications technologies, as well as finance (whose fraction of total exports fell from 12% to 9% in the pre-pandemic decade). No one celebrates it, but the UK is the second largest exporter of services in the world.

Recognising the nature of our economy is not the same thing as welcoming all aspects of it. But an economic strategy that fails to understand it is no strategy at all. It will leave us without a clear view of how growth is achieved, exposed to policy mistakes and failing to address the challenges that being a services-led economy brings: upward pressure on inequality between people and places.

Jobs in tradable services are 80% more likely than average to pay in the top 5%, while services exports are concentrated in the highest-wage areas. Wrestling with this is essential and possible. France is services-focused like us but has much lower inequality.

Wrestling with these sorts of trade-offs is the job of creating a successful economic strategy. And is the task to which the project now turns as we delve deeper into policy solutions.

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This article summarises ‘Stagnation Nation: Navigating a Route to a Fairer and More Prosperous Britain’ published by CEP and Resolution Foundation (https://economy2030.resolutionfoundation.org/reports/stagnation-nation/). Some of the analysis presented has been slightly updated to account for changes in the UK economy since publication in July.

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