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It can be morning again for the world's middle class

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There is little hope for integration and co-operation if it is seen as benefiting a global elite

The most challenging economic issue ahead of us involves a group that will barely be represented at this week's annual Davos summit — the middle classes of the world's industrial countries.

Nothing is more important to the success of industrial democracies than sustained increases in wages and living standards for working families, as the Inclusive Prosperity Commission, which Ed Balls and I co-chaired, concludes in a report .

Amid the focus on global finance, on geopolitics and on the moral imperative of helping the world's poor, no one should lose sight of the fact that without substantial changes in policy the prospects for the middle class globally are at best highly problematic.

First, the economic growth that is a necessary condition for rising incomes is threatened by the spectre of secular stagnation and deflation. In the US, last year was to be one of rising interest rates with acceleration of growth, the end of quantitative easing, and the approach of tightened monetary policy. In Japan, prices were to start rising again. In Europe, it was to bring continued reform and normalisation.

In fact, 10-year rates have fallen by well over 100 basis points in the US and are only half as high in Germany and Japan as they were a year ago. In a number of major countries short-term interest rates are negative with lenders to governments forced to pay for the privilege. Such low interest rates suggest a chronic excess of saving over investment, and the likely persistence of conditions that make monetary policy ineffective in Europe and Japan, along with their possible re-emergence in the US. Market measures almost everywhere suggest inflation is expected to be well below target for a decade.

The world has largely exhausted the scope for central bank improvisation as a growth strategy. Excess demand, inflation, excessive credit and the need for monetary tightening should be the least of our policy concerns. Central banks will still have to do their part but it is time now for concerted and substantial measures to raise both public and private investment.

Second, the capacity of our economies to sustain increasing growth and provide for rising living standards is not assured on the current policy path. America is often held out as a model and indeed its performance has been strong by global standards. The US has enjoyed growth of about 11 per cent over the past five years. Of this, standard economic calculations suggest that about 8 per cent can be regarded as cyclical, resulting from the decline in the unemployment rate. That leaves just 3 per cent over five years as attributable to growth in the economy's capacity. Even after our recovery, the share of US men aged 25-54 who are out of work exceeds that in Japan, France, Germany and the UK.

Demand factors apart, growth prospects are worse in Europe and Japan where adult populations are shrinking and ageing, and economic dynamism is subsiding. A significant part of the sharp downward revisions in the estimated potential of industrial economies over the past seven years is the consequence of the recession conditions of recent years. In many ways strong growth is the best structural policy for promoting future growth as investment rises, workers gain experience and so forth. But more must be done.

Third, if it is to benefit the middle class, prosperity must be inclusive and in the current environment this is far from assured. If the US had the same income distribution it had in 1979, the bottom 80 per cent of the population would have $1tn — or $11,000 per family — more. The top 1 per cent $1tn — or $750,000 — less. There is little prospect for maintaining international integration and co-operation if it continues to be seen as leading to local disintegration while benefiting a mobile global elite.

The focus of international co-operative efforts in the economic sphere must shift. Considerable progress has been made in trade and investment. Less progress has been made in preventing races to the bottom, in areas such as taxation and regulation. Only with enhanced international co-operation will the maintenance of progressive taxation and adequate regulatory protection be possible. And only if ordinary citizens see benefit in an ever more open global economy will it come about.

These three concerns — secular stagnation and deflation, slow underlying economic growth and rising inequality — are real. But they are no grounds for fatalism.

The experience of many countries and many eras shows that sustained growth in middle class living standards is attainable. But it requires elites to recognise its importance and commit themselves to its achievement. That must be the focus of this year's Davos.

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