

## CEP REAL WAGES UPDATE – September 2014

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### Real wages continue to fall in the UK

Real wages continue to fall – in the UK and elsewhere – yet despite this striking feature of the labour market, some commentators anticipate resurgent pay growth in the near future. This report, the first in a new series of *CEP Real Wages Updates*, argues that the absence of any improvement in the country's productivity performance – together with evidence that nominal wage growth is flatlining and real wage growth is falling – make it highly unlikely that wage growth is about to explode upwards.

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## Real wages continue to fall in the UK

Real wages continue to fall – in the UK and elsewhere (Jowett et al, 2014). Yet this striking feature of the labour market still fails to register properly with some commentators. On 9 September 2014, Mark Carney, the Governor of the Bank of England, gave a speech at the 146<sup>th</sup> annual Trades Union Congress in Liverpool, where he argued as follows:

‘Specifically, the Bank’s latest forecast expects real wage growth to resume around the middle of next year and then to accelerate as the unemployment rate continues to fall to around 5½% over the next three years. By the end of our forecast, we see 4% nominal pay growth on average across the economy.’<sup>1</sup>

The evidence for this turnaround seems entirely lacking. We would be very surprised if the Bank’s Monetary Policy Committee (MPC) does not have to reduce its forecast for wage growth, once again as it has had to do so several times in the recent past. There is no compelling evidence to suggest such a rosy scenario; it seems far more likely that nominal wage growth will once again disappoint on the downside.

We believe that the MPC’s over-optimism arises because there is more slack in the economy than the MPC estimates. Following Bell and Blanchflower (2014), we think it singularly inappropriate for the MPC to reduce the amount of slack arbitrarily as they are doing with both the level of long-term unemployment and the amount of underemployment. The UK economy appears well above the full employment level with an unemployment rate of 6.2% and the equivalent of a further 1.8% or so on top of that because of underemployment. Furthermore, we have seen big declines in the unemployment rate with no sign of any wage response.

One point of interest is the fact that Governor Carney nowhere made mention of the fact that trade union membership has declined sharply over time. According to the Trade Union Membership, 2013 Statistical Bulletin, published by the Department for Business Innovation and Skills, the proportion of employees who were union members has fallen from 29.8% in 2000 to 25.6% in 2013. The proportion of employees who were union members fell in the private sector from 18.8% in 2000 to 14.4% in 2013, while in the public sector they fell from 60.3% to 55.4%.

In earlier work, the two of us have shown how trade unions generate a significant wage premium (Blanchflower, 1986; Gregg and Machin, 1991, 1992). So the continuing decline in union density is likely to have a downward effect on sustainable wage growth in the future. A similar story applies in the public sector where we have seen pay freezes. Wage growth in the UK economy is unlikely to be driven by a wage explosion in the public sector. Our view is also that wage growth may be being held back, in part, because of the potential influx of workers from Eastern Europe (Blanchflower and Shadforth, 2009) as well as the possibility that firms could move their production abroad.

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<sup>1</sup> Speech given by Mark Carney at the 146th Annual Trades Union Congress, Liverpool, 9 September 2014, <http://www.bankofengland.co.uk/publications/Pages/speeches/2014/754.aspx>

## The recent facts

Table 1 shows the change in Average Weekly Earnings (AWE), the UK's national statistic on pay, published monthly in the Labour Market Statistics Release. The data are collected from the Monthly Wages and Salaries Survey, which excludes all workers in firms with fewer than 20 employees. Adjustments are made annually based on data from the Annual Survey of Hours and Earnings (ASHE), which is clearly a potential source of bias in the data within a year.

The latest data show that far from a wage acceleration, there has been an obvious deceleration in wage growth.<sup>2</sup> Nominal wage growth overall and in the private sector has fallen steadily since March 2014, and became negative in June 2014. Average weekly pay in July 2014 was £478 and has essentially been flatlining for some time.<sup>3</sup> Looking at Chart 1 makes it difficult to see any signs in the recent data of any significant wage growth coming; it also seems unlikely that wage growth is going to mean-revert to the pre-recession mean any time soon.

We now also have recently published quarterly data from the Labour Force Survey (LFS), a random sample of employees, which tell an almost identical story.<sup>4</sup> Table 2 presents data on full-time employees, which confirm the evidence from the AWE that nominal weekly wage growth is decelerating and has gone negative in the latest available quarter. Chart 2 provides a longer-term trend. It appears that the fall in earnings is even greater in the LFS than in the AWE, which may be explained by the former's broader coverage of workers in small firms.

## The international picture

The Office for National Statistics (ONS) recently produced a publication drawing on OECD data showing that real wage falls in the UK have been more pronounced than in other countries (Jowett et al, 2014). Chart 3 shows the numbers on a comparable basis from 2000 to 2012 for six countries – France, Germany, Italy, Japan, the UK and the US. The poor real wage performance for UK workers since 2008 is very clear in the chart. Very evidently real wage growth in the UK has been weak in comparison with our international competitors.

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<sup>2</sup> Care should be taken comparing the private and public sectors because of four recent major classification changes. 1) From July 2009 Royal Bank of Scotland Group plc is classified to the public sector; for earlier time periods it is classified to the private sector. 2) Between July 2009 and March 2014 Lloyds Banking Group plc is classified to the public sector; it is classified to the private sector for earlier and later time periods. 3) Between June 2010 and May 2012 English Further Education Corporations and Sixth Form College Corporations are classified to the public sector. Before June 2010 and after May 2012 they are classified to the private sector. 4) From October 2013 Royal Mail plc is classified to the private sector; previously it is in the public sector.

<sup>3</sup> There was a drop in earnings in March 2013 and then a rise in April 2013 because of changes in the tax code, but there is little evidence since then of any growth. The last 18 weekly earnings numbers (for total pay) from February 2013-July 2014 were as follows £469; £466; £485; £477; £475; £475; £475; £475; £475; £475; £478; £477; £478; £475; £482; £479; £477; £478.

<sup>4</sup> The LFS earnings data also excludes the self-employed.

## **The self-employed**

Recent data provided by the ONS shed some light on the earnings of the self-employed that are excluded from both the AWE and the LFS. This is especially important given that from April-June 2010 to April-June 2014, total employment is up by 1.622 million, of which 666,000 or 41% were self-employed. Currently 15% of workers are self-employed. It is well known that the earnings of the self-employed are below those of a typical employee, even though the reverse is the case with the means because of the high right-hand tail for the self-employed (Murphy, 2014; Blanchflower and Shadforth, 2007).

Table 3 shows that nominal and especially real incomes of the self-employed are down sharply in the most recent year for which we have data, 2012-13, falling from £236 to £207 or by an astonishing 12.1%. This confirms recent research from the Resolution Foundation by D'Arcy and Gardiner (2014) using the same data source, the Family Resources Survey.

They found that the weekly earnings of typical self-employed people was hit far harder than those of employees, who themselves have experienced unprecedented falls. In 2011-12, the earnings of the median self-employed worker were 20% lower than in 2006-07. Over the same period, employee earnings fell by 6%. Self-employed earnings, the authors found, were already falling in 2006-07 and continued to do so until 2010-11. This differs from the experience of employees at the median, where earnings were flat between 2006-07 and 2009-10 before falling. As a result of these trends, the typical self-employed person earned 40% less than the typical employed person in 2011-12; in 2006-07, the gap was 28%.

## **Conclusion**

In the minutes of its meeting of 3/4 September, the two members of the MPC who voted for a rate rise, Martin Weale and Iain McCafferty, were reported as arguing that this was because 'evidence of tightening in the labour market suggested that wage growth might pick up quite sharply as slack was absorbed'.

We simply cannot see that there is any credible evidence to support such a contention. The absence of any productivity pick-up, together with evidence that nominal wage growth is flatlining and real wage growth is falling just cannot form any solid (or sensible) basis for determining that wage growth is about to explode upwards. The majority agreed arguing that 'increases in Bank Rate well ahead of any prospective pickup in wage and income growth risked increasing the vulnerability of highly indebted households'.

Oil prices and commodity prices are falling and the CPI fell again to 1.5% in the latest ONS data release. Despite the fall in the unemployment rate to 6.2%, the inactivity rate has started to rise, along with the proportion of the inactive that want a job.<sup>5</sup> The

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<sup>5</sup> In the latest ONS UK Labour Market release for September 2014 over the last three months, between April (March-May) and June (May-July) 2014 unemployment fell by 103,000 and the rate fell from 6.5% to 6.2%. Employment fell by 34,000 and full-time jobs were down 66,000 while part-time jobs were up 32,000. Inactivity for those ages 16-64 rose by 151,000 with the inactivity rate up from 21.7% to 22.1%; there was a fall in the

job creation rate is slowing and the majority of the new jobs created are part-time. Real wages continue to fall and show no likelihood of picking up any time soon. The MPC appears to have underestimated the large amount of slack still remaining in the UK labour market.

Last time we wrote on falling real wages earlier this year (Blanchflower and Machin, 2014), we took a relatively bleak position on where significant wage growth could come from, and it seems we were right then. As real wages continue to fall, and productivity performance remains weak, we see no reason to alter that viewpoint right now.

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number of students by 33,000 and a rise in those out of the labour force who wanted jobs by 43,000. The claimant count dropped by 37,000 while the number of long-term sick rose by 36,000; the concern is these are the same people, moving from one benefit to another. This does not look like a tightening labour market.

[http://www.ons.gov.uk/ons/dcp171778\\_374770.pdf](http://www.ons.gov.uk/ons/dcp171778_374770.pdf)

## Further reading

Bell, David and David Blanchflower (2014) 'Labour Market Slack in the UK', *National Institute Economic Review* 229: F4-11.

Blanchflower, David (1986) 'What Effect Do Unions have on Relative Wages in Great Britain?', *British Journal of Industrial Relations* 24: 196-204.

Blanchflower, David and Stephen Machin (2014) 'Falling Real Wages', <http://www.voxeu.org/article/falling-real-wages-uk>

Blanchflower, David and Christopher Shadforth (2007), 'Entrepreneurship in the UK', *Foundations and Trends in Entrepreneurship* 3(4): 257-364.

Blanchflower, David and Christopher Shadforth (2009) 'Fear, Unemployment and Migration', *Economic Journal* 119(535): F136-182.

D'Arcy, Conor and Laura Gardiner (2014) 'Just the Job – or a Working Compromise?', Resolution Foundation, <http://www.resolutionfoundation.org/wp-content/uploads/2014/05/Just-the-job-or-a-working-compromise-FINAL.pdf>

Gregg, Paul and Stephen Machin (1991) 'Changes in Union Status, Increasing Competition and Wage Growth in the 1980s', *British Journal of Industrial Relations* 29: 603-12.

Gregg, Paul and Stephen Machin (1992) 'Unions, the Demise of the Closed Shop and Wage Growth in the 1980s', *Oxford Bulletin of Economics and Statistics* 54: 53-72.

Jowett, Andre, Ciaren Taylor, Michael Hardie and Zuhair Khan (2014) 'An International Perspective on the UK – Labour Market Performance', ONS.

Murphy, Richard (2014) 'Disappearing Fast: The Falling Income of the UK's Self-employed People', Tax research LLP, <http://www.taxresearch.org.uk/Documents/SEI2013.pdf>

**Table 1:**  
**Three-month averages of the annual growth rate (%) of Average Weekly Earnings (AWE) and Consumer Price Index (CPI)**

	All	Private	Consumer Price Index
January 2013	1.2	1.1	2.7
February 2013	1.0	0.9	2.7
March 2013	0.6	0.5	2.8
April 2013	1.6	1.6	2.7
May 2013	1.9	2.0	2.6
June 2013	2.3	2.6	2.7
July 2013	1.2	1.4	2.7
August 2013	0.8	1.1	2.8
September 2013	0.8	1.1	2.7
October 2013	0.9	1.3	2.5
November 2013	0.9	1.2	2.3
December 2013	1.2	1.5	2.1
January 2014	1.3	1.7	2.0
February 2014	1.7	2.0	1.9
March 2014	1.9	2.1	1.7
April 2014	0.8	0.8	1.7
May 2014	0.4	0.3	1.6
June 2014	-0.1	0.0	1.7
July 2014	0.6	0.9	1.7

**Notes:**

- 1) From ONS UK Labour Market Statistical Bulletin, September 2014.
- 2) Month is last year of 3-month averages.
- 3) CPI numbers also 3-month averages to match AWE.

**Table 2:**  
**Annual growth in full-time LFS weekly earnings (%)**

	All	Private
Oct-Dec 2010	1.3	1.2
Jan-Mar 2011	1.5	2.4
Apr-Jun 2011	0.4	0.0
Jul-Sep 2011	1.9	2.6
Oct-Dec 2011	0.4	-0.5
Jan-Mar 2012	0.3	-0.2
Apr-Jun 2012	1.6	2.4
Jul-Sep 2012	2.3	1.9
Oct-Dec 2012	2.7	3.8
Jan-Mar 2013	2.8	3.4
Apr-Jun 2013	2.9	3.1
Jul-Sep 2013	0.8	2.5
Oct-Dec 2013	0.4	0.4
Jan-Mar 2014	1.1	1.2
Apr-Jun 2014	-0.6	-1.5

**Notes:**

1) From ONS EARN04 series.

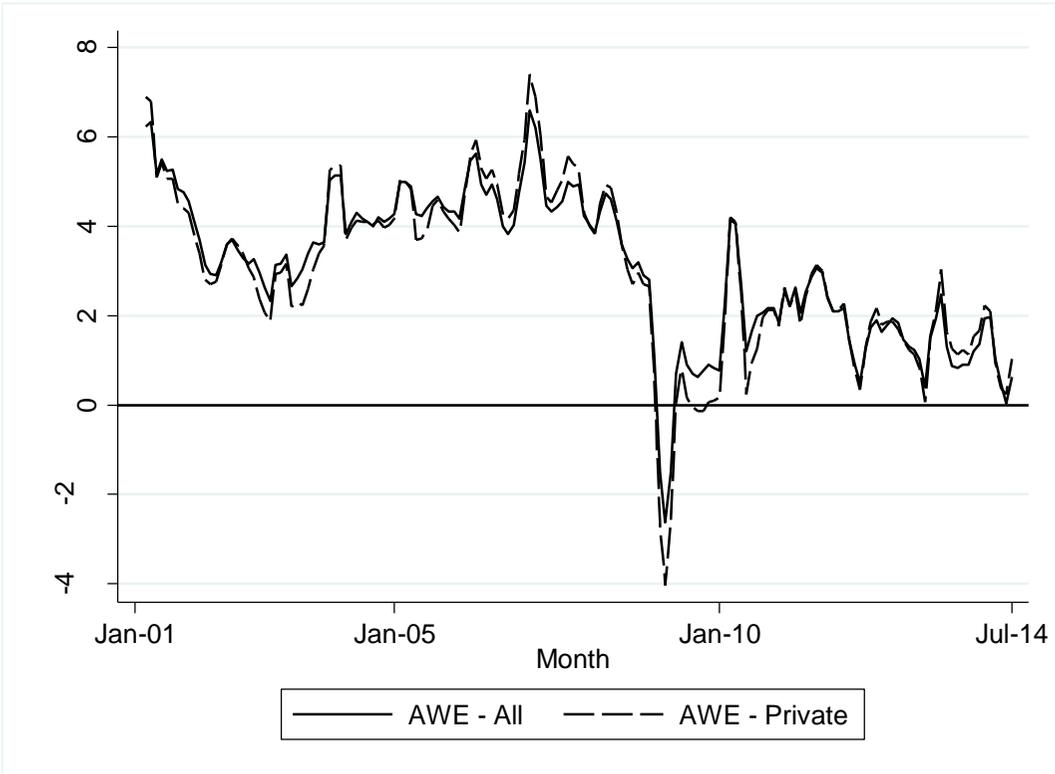
**Table 3:**  
**Median income of the self-employed, 2002/03-2012/13**

	Adjusted for inflation	Not adjusted for inflation
2002/03	290	223
2003/04	296	230
2004/05	290	230
2005/06	256	207
2006/07	301	250
2007/08	269	230
2008/09	266	233
2009/10	238	216
2010/11	221	210
2011/12	236	230
2012/13	207	207

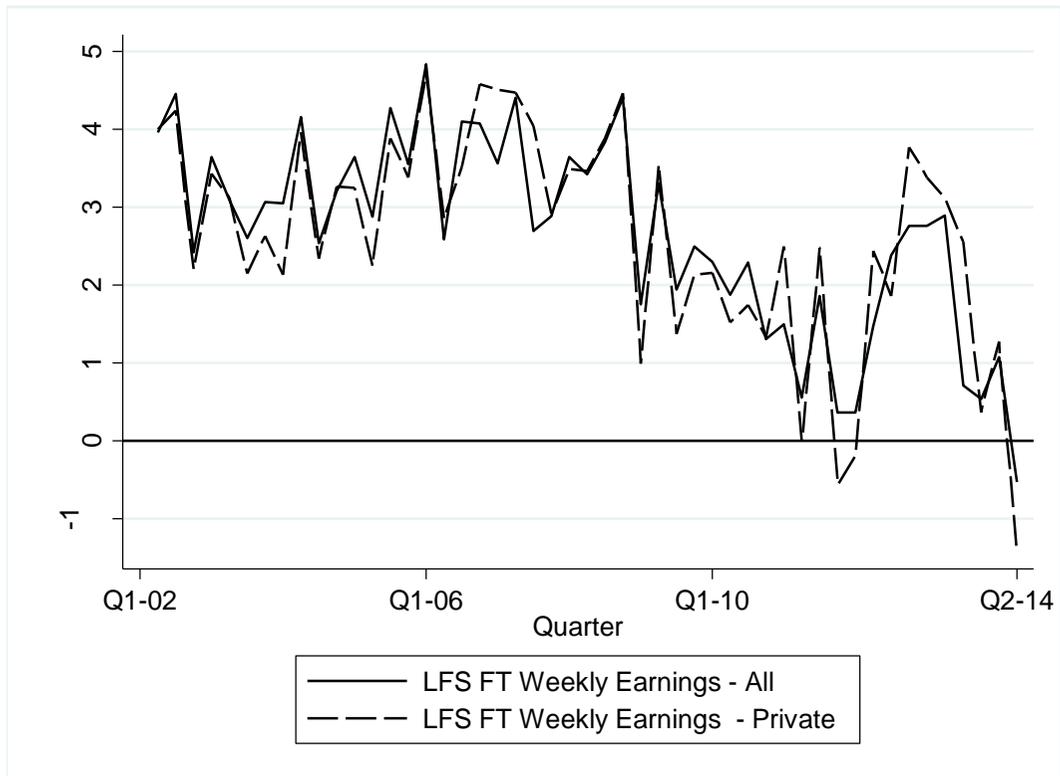
**Notes:**

- 1) Source: DWP, Family Resource Survey.
- 2) Self-employed and employees are aged 16 and over.
- 3) Income figures are in 2013 prices.

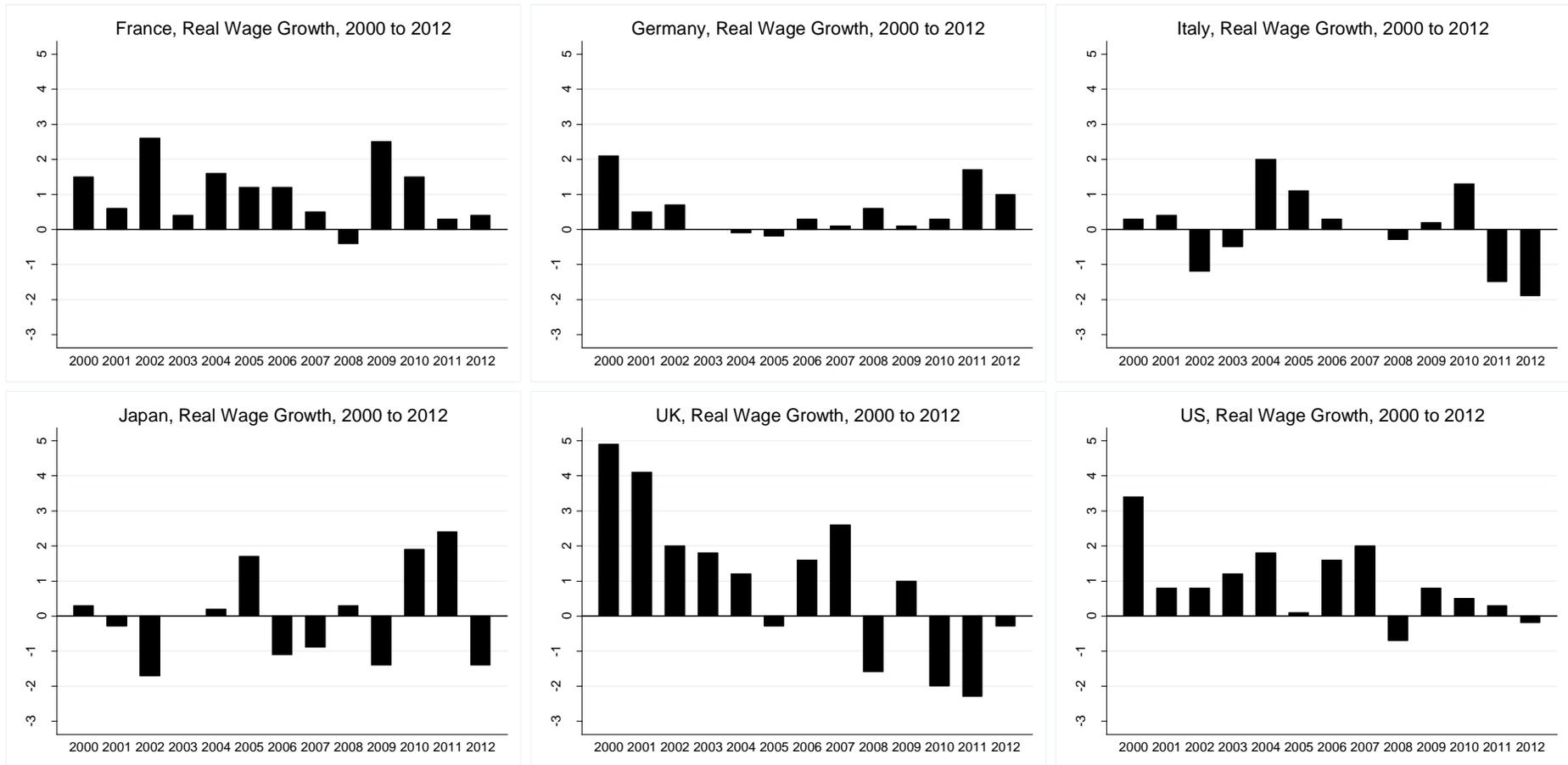
**Chart 1:  
Three-month nominal AWE growth**



**Chart 2:  
LFS Annual Weekly Earnings Growth**



**Chart 3:  
Real wage growth for six countries, 2000 to 2012**



**Notes:**

- 1) From Jowett et al (2014).
- 2) Real wages are from OECD and defined as average annual wages per full-time and full-year equivalent employee in the total economy, adjusted for all items consumer prices.