Wage growth and productivity growth in the UK: the myth and reality of ‘decoupling’

Employees in the UK are not being denied their fair share of economic growth, according to research by João Paulo Pessoa and Professor John Van Reenen, director of the Centre for Economic Performance at LSE.

Their investigation of claims that wage growth has become ‘decoupled’ from productivity growth finds that decoupling has been overstated and cannot be used to justify redressing the balance between wages and profits.

They show that the share of UK income going to labour is basically the same now as it was 40 years ago. The real problem is inequality among employees: wage inequality has risen massively since the late 1970s. There has also been a considerable increase in non-wage labour costs, such as pension contributions and healthcare benefits.

Basic economics suggests that workers’ real hourly compensation should grow in line with GDP per hour worked over the long run. But between 1972 and 2010, UK real productivity grew by 114% while median real wages only grew by 72%. So ‘gross decoupling’ was a substantial 42 percentage points (114% minus 72%).

Is this proof that employees are being denied their fair share of economic growth? No, because what basic economics focuses on is ‘net decoupling’, which is the idea that average compensation should roughly follow GDP per hour deflated in the same way. In the UK, net decoupling is basically zero: both wages and productivity have risen by roughly the same amount since 1972.

So what explains this massive difference between gross and net decoupling? It is basically two things: inequality and non-wage labour costs. First, the UK has had growing wage inequality since the late 1970s and this means that the average wage has risen much faster than the median wage (the wage that separates the population into two halves, 50% earning more than the median earner and 50% earning less).

Second, non-wage labour costs, such as pension contributions and healthcare benefits, have risen very quickly. These are all part of what is called ‘compensation’, which is what employers care about, not just the direct cost of paying salaries.

ENDS

The paper – ‘Wage growth and productivity growth: the myth and reality of ‘decoupling’’ by João Paulo Pessoa and John Van Reenen – is available to download via the CEP’s homepage at: http://cep.lse.ac.uk/.

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