REAL WAGES IN THE UK: New report from the Centre for Economic Performance

Real wages in the UK continue to fall and the prospects of significant increases for typical workers remain bleak. That is the central message of a new report from the Centre for Economic Performance (CEP), the first in a series of Real Wages Updates by Professors David Blanchflower and Stephen Machin. They argue that the absence of any improvement in the UK’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.

Britain has experienced unprecedented falls in real wages since the start of the recession triggered by the financial crisis of 2008. This did not happen in previous economic downturns: median real wage growth slowed down or stalled, but it did not fall. Indeed, in past recessions, almost all workers in both the lowest and highest deciles of the wage distribution experienced growing real wages. It was the unemployed who experienced almost all the pain: they lost their jobs and much of their incomes, and many were unemployed for a long time.

But in the Great Recession and its aftermath, the economic hurt has been spread more evenly, with wages taking more of the strain this time. The real wages of the typical (median) worker have fallen by 8-10% – or around 2% a year behind inflation – since 2008. Such falls have occurred across the wage distribution, generating falls in living standards for most people, with the exception of those at the very top.

Why has this happened and what are the prospects for recovering the lost wage gains that workers experienced relative to previous recessions? Some commentators believe that significant real wage growth is coming, and that the prospects are good for a return to the real wage growth patterns seen before the downturn. At the September 2014 meeting of the Bank of England’s Monetary Policy Committee (MPC), two members voted for a rise in interest rates, arguing that ‘evidence of tightening in the labour market suggested that wage growth might pick up quite sharply as slack was absorbed’.

Speaking to the annual Trades Union Congress (TUC) in Liverpool a few days later, the Bank’s governor Mark Carney said that ‘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 5.5% over the next three years. By the end of our forecast, we see 4% nominal pay growth on average across the economy.’

Professors Blanchflower and Machin write:

‘The evidence for this turnaround seems entirely lacking. We would be very surprised if the MPC does not have to reduce its forecast for wage growth, just as it has had to do several times in the recent past. There is no compelling evidence to suggest such a rosy scenario; indeed, in the absence of productivity improvements, 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 its analysts estimate. We think that it is 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 economy appears well above the full employment level with an unemployment rate of 6.2% and the equivalent of an additional 1.8% because of underemployment.

‘Furthermore, we have seen big declines in the unemployment rate with no sign of any wage response. And despite falling unemployment, the inactivity rate has started to rise, along with the proportion of people who are inactive and want a job. The job creation rate is slowing and the majority of the new jobs created are part-time.

‘It is worth noting that when addressing the TUC, Governor Carney made no mention of the fact that membership of trade unions has declined sharply over time. In the private sector, the proportion of employees who are union members fell from 18.8% in 2000 to 14.4% in 2013, while the public sector share fell from 60.3% to 55.4%. Previous studies of ours have shown how trade unions generate a significant wage premium, 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 is unlikely to be driven by a pay explosion in the public sector. Wage growth may also be held back in part because of the potential influx of workers from Eastern Europe, as well as the possibility that firms could move their production abroad.

The latest data on average weekly earnings indicate that nominal wage growth overall and in the private sector has fallen steadily since March 2014, and it became negative in June 2014. Quarterly data from the Labour Force Survey tell an almost identical story. And OECD data show that real wage falls in Britain have been more pronounced than in France, Germany, Italy, Japan and the US.

The fundamental driver of all this is that during the recovery, the productivity performance of the economy has continued to be weak. This has not created room for wage rises, even though it has been good news for employment and unemployment. We believe that unless the division of economic growth becomes more fairly shared to offset long-run trends towards greater inequality and unless productivity can be boosted to generate wage gains for all workers, then poor real wage outcomes for typical workers may be here to stay for longer than some observers suggest.

For significant real wage growth to re-emerge, productivity would need a sharp increase of the kind experienced much earlier in the recessions of the early 1980s and early 1990s. There are few signs of this happening, and the problem has been magnified during the downturn by Britain’s dismal investment rates.

Even if productivity were to rise rapidly, the recent tendency for longer-run inequality trends to cause an unequal division of wages from productivity gains to the top (like bankers’ bonuses) would need to be addressed. Until that happens or until policy starts to address these issues seriously, it seems that the prospects of significant, rather than modest, wage increases for typical workers are bleak.

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Notes for Editors:
The first CEP Real Wages Update by David Blanchflower and Stephen Machin is published today, Monday 29 September 2014. To view, see: http://cep.lse.ac.uk/pubs/download/rwu001.pdf

The authors’ first report on Falling Real Wages was published in CentrePiece magazine: http://cep.lse.ac.uk/_new/publications/abstract.asp?index=4432

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