The UK labour market: Out of Rehab?

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Resolution Foundation
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Worst Recession ever? Cumulative GDP change from start of downturn

Source: NIESR, downloaded October 2014
Wage Blues

Jobs boom

Productivity puzzle

Putting it all together
The longest real wage squeeze ever?

UK real wages Change over previous seven years

1862


1862

Sources: Bank of England, FT Research

Observer Graphic
Nominal Annual Wage Growth (AWE), smoothed

Source: Manning (2014)
Source: Blanchflower and Machin (2014)
Wage Blues

Jobs boom

Productivity puzzle

Putting it all together
The UK jobs miracle?

Source: RF analysis of ONS, Labour Market Statistics
Wage Blues

Jobs boom

**Productivity puzzle**

Putting it all together
The Productivity Puzzle

Chart 1 Whole-economy labour productivity per hour

- **Output per hour**
- **Continuation of pre-crisis trend**
- **May 2014 Inflation Report**

Index: 2008 Q1 = 100

Sources: ONS and Bank calculations.

(a) Pre-crisis trend growth is calculated between 1997 and 2008 Q1, and is projected forward from 2008 Q1.
OVER LONG-HAUL COMPENSATION (WAGE + NON-WAGE BENEFITS) GROWTH TRACKS PRODUCTIVITY GROWTH, 1972-2012

Source: Pessoa and Van Reenen (2014), 1972=1
BUT WAGE INEQUALITY HAS RISEN DRAMATICALLY (PERCENTAGE DIFFERENCE IN PAY BETWEEN TOP AND BOTTOM 10% OF EARNERS)

Great Britain, 1975 to 2012

Notes: UK data, 1968-96 (NES) 1997-2012 (ASHE); 90-10 log weekly earnings ratios, full-time, 1975-2012

For more see CEP video, https://www.youtube.com/watch?v=tvN8zvovDrY
MEANING MEDIAN WAGES DIVERGE FROM AVERAGE WAGES & PRODUCTIVITY GROWTH

Source: Pessoa and Van Reenen (2013), Resolution Foundation & CEP
http://cep.lse.ac.uk/pubs/download/dp1246.pdf
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SUPPLY SIDE PESSIMISTS

- Financial crisis caused/revealed a much lower level of structural UK productivity
- Real wages have to fall to reflect this
- Recessions generally cause some permanent loss of output (relative to pre-recession output)
  - The issue is how big is the fall of potential output and hence the equilibrium wage adjustment
- Related story is that the long-run steady state rate of productivity growth has fallen, so real wage growth must be lower than it was historically
  - Not just UK – an international malaise of advanced economies (Robert Gordon; Larry Summers; etc.)
Average Labour Productivity (GDP per worker)
Growth before and after the Global Financial Crisis

Pre-crisis 1997-2007
Post-crisis 2007-2014

Source: Conference Board (2014), TED Table 9 derived
https://www.conference-board.org/retrievelfile.cfm?filename=SummaryTables_Jan20141.pdf&type=subsite
Average Labour Productivity (GDP per worker)
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Average Labour Productivity (GDP per worker) Growth before and after the Global Financial Crisis

Source: Conference Board (2014), TED Table 9 derived
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PROBLEMS FOR THE PESSIMISTS

- Market economies have usually bounced back after recessions (even after big downturns like 1930s): productivity growth rates pretty steady
- In fact, UK bridged a fair bit of productivity gap with peers like US, France & Germany in the 1980-2007 period (see LSE Growth Commission)
  - This wasn’t just finance (only 14% of measured productivity growth 1997-2007 due to fin. services)
- So why should this time be so radically different?
  - Evidence from financial crises mainly LDCs
- Pessimism an (understandable) psychological reaction to worst recession since inter-war period
A MORE OPTIMISTIC STORY: DEMAND SHOCKS IN A FLEXIBLE LABOUR MARKET

• Global financial Crisis 2008-2009
• Premature austerity after 2010 (e.g. 50% cut in public investment only partially reversed post 2012)
• Euro-crisis
• Different response of UK labour market to previous recessions because of flexible labour markets
  – Steady fall in union power
  – Welfare reforms keep people looking for jobs
• So in this recession real wages took brunt of adjustment instead of unemployment
• But flipside is low capital investment because people cheaper than machines & therefore low labour productivity (GDP per hour)
  – Not a big fall in structural productivity (“TFP”)
NEGATIVE OUTPUT SHOCK & RIGID WAGES – LABOUR PRODUCTIVITY STABLE (“NORMAL RECESSION”)

![Graph showing Labour Demand and Labour Supply](image)

- **Real Wage, W/P**
- **Labour Supply**
- **Labour Demand**

**MRP=W/P**

0

$L^*$

Jobs
NEGATIVE OUTPUT SHOCK & RIGID WAGES – LABOUR PRODUCTIVITY STABLE ("NORMAL RECESSION")

![Graph showing labor demand and supply with a recession shock]

- Real Wage, W/P
- Lab Supply
- Lab Demand
- $MRP = W/P$
- 0
- $L'$
- $L^*$

Recession shock
NEGATIVE OUTPUT SHOCK & RIGID WAGES – LABOUR PRODUCTIVITY STABLE ("NORMAL RECESSION")

MRP=W/P

Unemployment

Recession shock
NEGATIVE OUTPUT SHOCK & FLEXIBLE WAGES – LABOUR PRODUCTIVITY FALLS ("NEW NORMAL")

\[ MRP = \frac{W}{P} \]

\[ MRP' = (\frac{W}{P})' \]

Recession shock
Note: TFP = “Total Factor Productivity” (productivity after controlling for capital and hours) whole economy; 1970s recession is 1973-1978 (so 1 = 1973, 2 = 1974, etc); 1980s recession is 1979-1984; “Current” is 2007-2012. 1970s and 1980s TFP data from EU KLEMS. 2000s authors’ estimates from ONS data.

POLICY IMPLICATIONS

• As UK economy recovers, so will productivity and so will average real wages
• Keep demand strong
  – Loose monetary policy
  – Support public investment
  – Expand demand in Eurozone
• Inequality issue still remains – but this is long run issue of rising demand for more skilled workers
• Big increases in wages prior to a recovery in productivity will lead to inflation
• Whichever party wins in 2015, very tough times ahead for public sector spending (& public sector wages)
FURTHER READING


• “Has ICT Polarized Skill Demand? Evidence from Eleven Countries over 25 Years” (with Guy Michaels and Ashwini Natraj), Review of Economics and Statistics (2014) 96(1) 60–77
  http://cep.lse.ac.uk/pubs/download/dp0987.pdf


• “Decoupling of wage growth and productivity growth: myth and reality” (with Joao Pessoa), CEP Discussion Paper 1246
  http://cep.lse.ac.uk/pubs/download/dp1246.pdf
BRITAIN NEEDS A PAY RISE
MOTIVATION

• World is still suffering hangover from global financial crisis. EU growth particularly weak
  – Needs more Draghi/Abe treatment
• UK has very slow recovery
• But mixed news from labour market
RISING GRADUATE WAGE DIFFERENTIALS IN UK: DEGREE PREMIUM RISES FROM 39% TO 56% 1980-2011

Rising Graduate Wage Differentials (Full-Timers)

FT Graduate Wage Premium, Percent

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MEDIAN WAGE GROWTH DIVERGES FROM PRODUCTIVITY GROWTH BECAUSE OF INEQUALITY & PENSIONS

Source: Pessoa and Van Reenen (2013), Resolution Foundation & CEP
http://cep.lse.ac.uk/pubs/download/dp1246.pdf
BofE August Inflation Report

Chart 3.4 Job-to-job flows below pre-crisis rates

Job-to-job flows\(^{(a)}\)

Sources: Labour Force Survey and Bank calculations.

\(^{(a)}\) Number of people who reported being in a private sector job three months ago, and report being in a private sector job for less than three months. Two-quarter average. Seasonally adjusted by Bank staff.
Decline in job-to-job flows in the US

Figure 3: Job-to-job Flows 1995:Q4 – 2012:Q3, LEHD and CPS quarterly data. LEHD data are from Hyatt and McEntarfer (2012b). CPS national monthly data were downloaded from the Federal Reserve website and converted to a quarterly frequency. All data are seasonally adjusted.
Three month nominal wage growth in AWE: consistently below the rate of inflation since crisis.
A REVERSAL OF MISFORTUNE? GDP PER CAPITA, 1980=100

Source: LSE Growth Commission
PRODUCTIVITY GROWTH (GDP PER HOUR): IT WASN’T ALL FINANCE

Source: LSE Growth Commission
EMPLOYMENT RATE, 16-64

LF24

[Graph showing the employment rate from 1971 to 2013]