



A series of background briefings on the policy issues in the June 2017 UK General Election

# Real Wages and Living Standards in the UK

Rui Costa and Stephen Machin

#GE2017Economists



## CEP ELECTION ANALYSIS

### Real Wages and Living Standards in the UK

Rui Costa and Stephen Machin

- Real wages of the typical (median) UK worker have fallen by almost 5% since 2008, reflecting a sizable fall from 2008 to 2014, and a modest bounce back in the following two years. Compared with the trend of 2% annual growth of real wages from 1980 to the early 2000s, this represents around a 20% shortfall.
- The recent pattern of real wage growth in the UK is weaker than in the majority of other OECD countries.
- The modest real wage recovery that started in 2014 has recently been eroded by two factors: first, higher price inflation as a consequence of the depreciation of sterling following the vote to leave the European Union (EU) in the 2017 referendum; and second, nominal wage growth becoming stuck at a 2% norm.
- Low-wage workers have benefited from minimum wage increases, especially the 2016 introduction of the National Living Wage. They have done better than workers higher up the wage distribution, thus leading to a modest decrease in wage inequality.
- Young workers have been the ones most affected since the crisis, experiencing a sharp fall in real weekly wages (of the order of 16% for workers aged 18-21), linked to lower hours, part-time work and self-employment arrangements.
- Self-employment has been on the rise, but only for individuals without employees. Many of these individuals receive low incomes, and are often employed in ‘gig economy’ positions, with little access to some of the non-wage benefits that employees receive.
- Family incomes have recovered to pre-crisis levels and done better in growth terms than wages, largely due to the tax and benefit system. In particular, pensioners have fared significantly better due to the ‘triple lock’ policy and the tax and benefit system.
- Three sets of manifesto promises are of particular relevance to UK real wages and living standards: proposed changes to minimum wages; classifications of employees and the self-employed, and proposals on insecure work; and amendments to the ‘triple lock’.

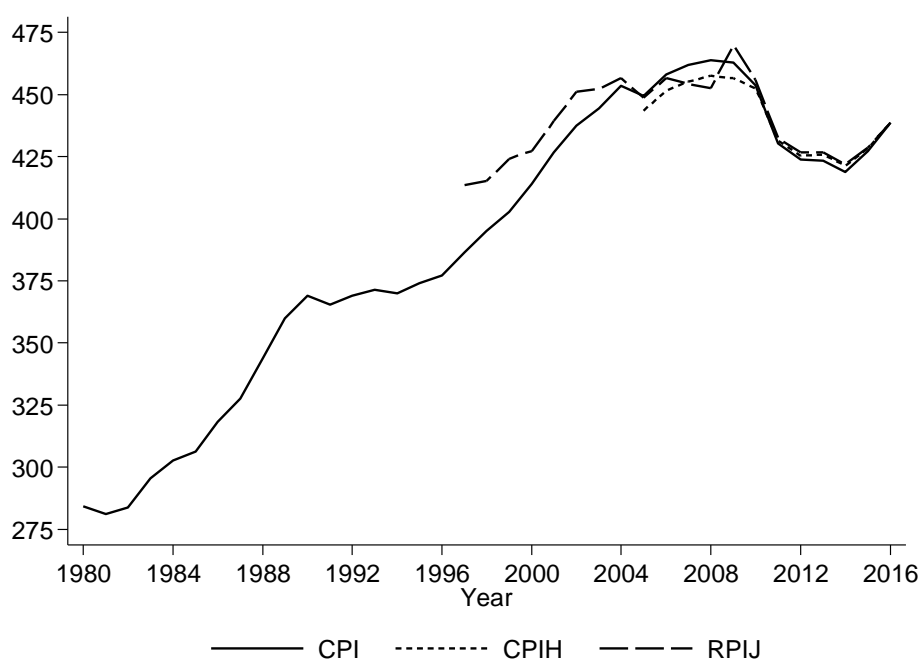
## Introduction

Since the global financial crisis of 2007/08, workers' real wages and family living standards in the UK have suffered to an extent unprecedented in modern history. Real wages of the typical (median) worker have fallen by almost 5% since 2008, while real family incomes for families of working age have just about recovered to pre-crisis levels. But almost all groups of individuals and families – with the exception of pensioner households – are no better off on average than in 2008. In particular, there is an important generational shift, with young people doing considerably worse.

## Falling real wages

Figure 1 shows that median real wages grew consistently by around 2% per year from 1980 to the early 2000s. What followed was something of a slowdown, after which real wages fell dramatically when the economic downturn started in 2008. Since then, real weekly wages of the median worker have fallen by around 3-5% (depending on which measure of inflation is used as a deflator – the consumer price index, CPI, the housing cost augmented version, CPIH, or the retail price index, RPIJ). This corresponds to almost a 20% drop<sup>1</sup> relative to the trend in real wage growth from 1980 to the early 2000s.

**Figure 1: Annual ASHE median real weekly earnings, 1980 to 2016**



*Notes:* Weekly earnings deflated by CPI, CPIH and RPIJ.  
*Source:* Annual Survey of Hours and Earnings (ASHE).

Figure 2 focuses on the very recent experience, using the most up to date monthly official average weekly earnings (AWE regular) numbers deflated by CPI.<sup>2</sup> Growth in AWE

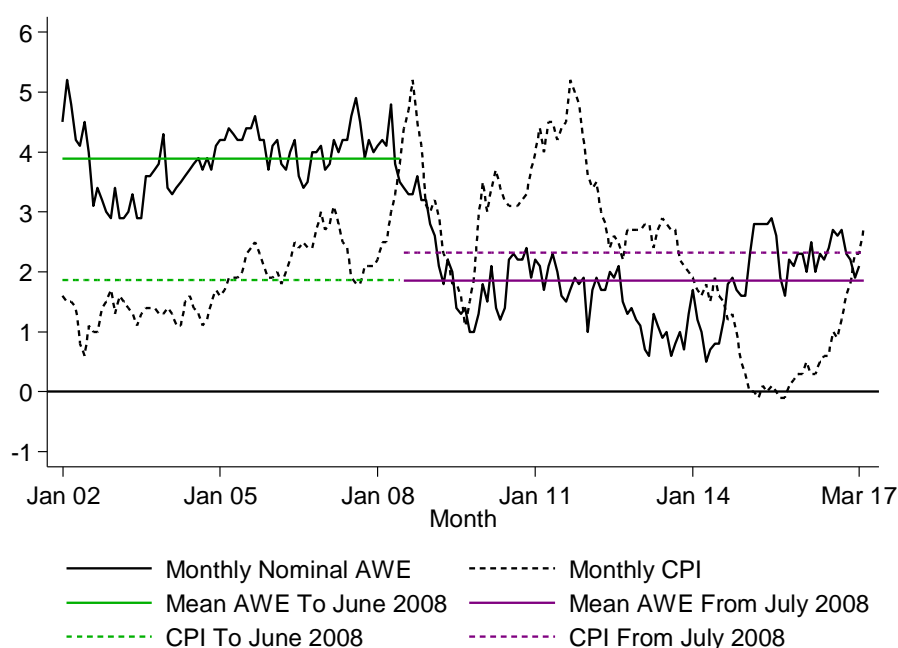
<sup>1</sup> This calculation is made assuming a counterfactual 2% growth per year trend in real wages since 2008.

<sup>2</sup> AWE is the average weekly earnings index produced by the Office for National Statistics (ONS).

outstripped consumer price inflation until June 2008. From July 2008 onwards, real wages did not grow until a modest bounce back began in September 2014. Growth in real wages since then was mainly due to a decrease in price inflation, rather than a significant increase in nominal wage growth, which appears to have become stuck at a norm of 2% per year.<sup>3</sup>

Since the June 2016 referendum on the UK’s membership of the EU, real wages have again been weakened by rising inflation. Sterling has fallen by 15% against the dollar since the vote and according to the Bank of England’s most recent *Inflation Report*, the depreciation will lead to higher import costs, raising consumer price inflation some way above target.<sup>4</sup> With the current 2% nominal wage growth norm, as Figure 2 shows, real wage falls have therefore returned to the UK labour market.<sup>5</sup>

**Figure 2: Monthly nominal AWE and CPI growth, 2002 to 2017**



Source: Average weekly earnings (AWE regular) and CPI from ONS.

Table 1 shows variations in real wage growth across different groups of workers over the period 2008 to 2016. Men have seen larger falls in real wages (7%) compared with a fall of 1% for women.

Real wage falls have occurred in the top half of the wage distribution, dropping by 6% at the 90th percentile and 4% at the median. The mild increase in the 10th percentile (2%) relative to the median and 90th percentile means that inequality has not gone up during the downturn; if anything, it has decreased slightly. This contrasts with long-run wage inequality trends since 1980, which peaked at the start of the downturn (Machin, 2011).

<sup>3</sup> See Blanchflower and Machin (2016).

<sup>4</sup> *Inflation Report*, Bank of England, May 2017.

<sup>5</sup> See Blanchflower et al (2017).

**Table 1: Percentage falls in median real wages across distribution since 2008, ASHE**

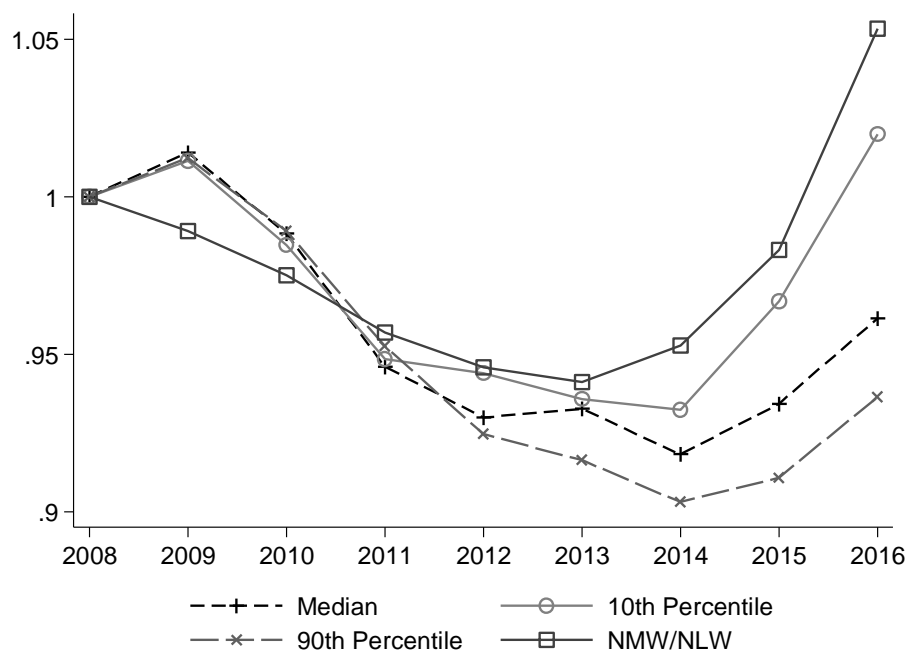
Changes in Real Hourly Wages (CPI Deflator)	
Median	-4%
Men	-7%
Women	-1%
10 <sup>th</sup> Percentile	+2%
90 <sup>th</sup> Percentile	-6%
NMW Adult Rate	+5%

*Notes:* Using CPI deflator. Updated CPI deflated numbers from Gregg et al. (2014a, 2014b).

*Source:* ASHE. 2016 figures are based on the provisional ASHE estimates published by the ONS in October.

A closer look at the evolution of real hourly wages at different points in the wage distribution is presented in Figure 3. It shows a close relation between the relatively stronger real wage growth at the 10th percentile and the significant recent developments in minimum wage setting in the UK. In particular, the introduction of the National Living Wage (NLW) in April 2016 has contributed to a significant drive upwards at the bottom of the wage distribution (Bell and Machin, 2018). In fact, workers who were on the National Minimum Wage (NMW) and the NLW when it came in experienced 5% real wage growth between 2008 and 2016.

**Figure 3: Percentiles of real hourly wage and NWM/NLW, indexed to 2008**

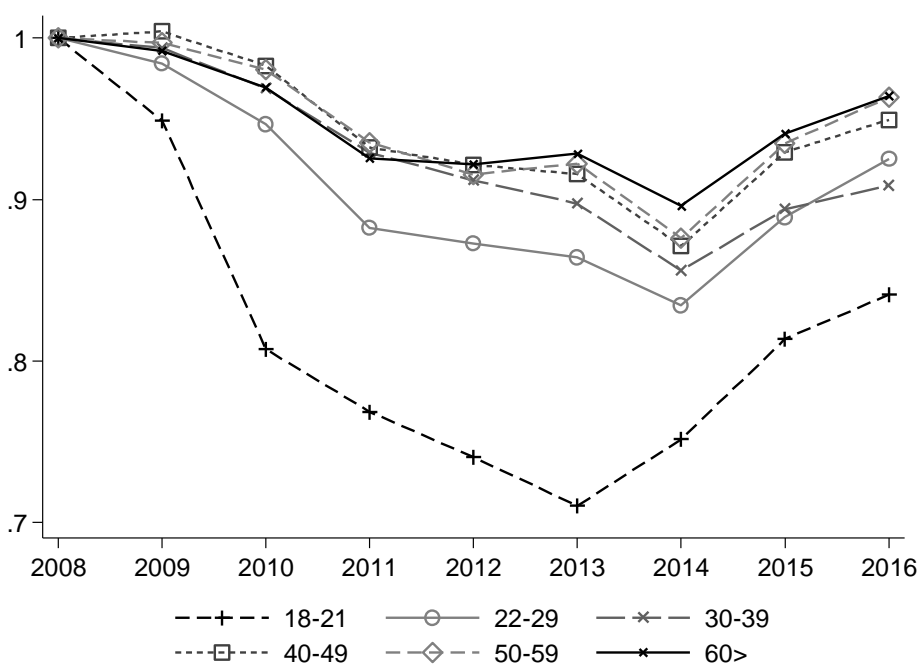


*Notes:* NMW stands for National Minimum Wage and NLW stands for National Living Wage.

*Source:* Annual Survey of Hours and Earnings (ASHE) hourly earnings, all workers. 2008=100.

There are big differences by age. Young workers (those aged 18-21) have suffered a considerable loss in their wages – of the order of a huge 16% fall in real weekly earnings. A significant fraction of this change can be attributed to falls in hours worked and full-time status given that, for this same group, real weekly wages of full-time workers decreased by substantially less (around 3%). The increased prevalence of self-employment arrangements among young workers also contributes to worsening the position of this age group as discussed below (LSE Growth Commission, 2017).

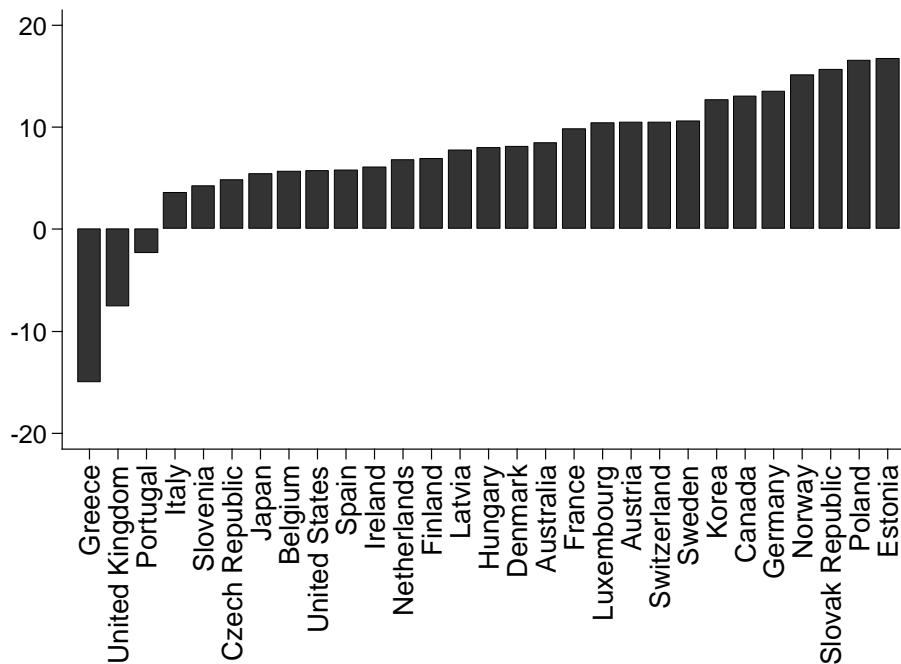
**Figure 4: Median real weekly wage by age groups**



*Source:* Annual Survey of Hours and Earnings (ASHE) weekly earnings, all workers. 2008=100.

Since the global financial crisis, UK wages have fallen by more than in other OECD countries. Figure 5 reports comparable wage growth numbers from the OECD between 2007 and 2015 for 28 countries. The UK's relative performance is very poor, placing 27th above only Greece.

**Figure 5: International average real wage growth, 2007-15**



*Notes:* Average real wages defined by the ratio between total wage bill and average hours worked.  
*Source:* OECD Stats, 2016 (<https://stats.oecd.org/>).

## The recent rise in self-employment

The composition of the UK labour market has been affected by a substantial increase in self-employment and alternative working arrangements since the economic downturn.

As Figure 6 shows, the proportion of self-employed individuals has risen significantly. But all the increase is in terms of individuals in self-employed positions who do not have any employees. This has been steadily increasing since the 1980s, but since 2000 the proportion has increased from 9% to 13% of all those in work. This group are sometimes employed in ‘gig economy’ positions, with little access to the non-wage benefits that employees receive – the right to be paid the NLW, sick pay, holiday pay, employment security and pensions.

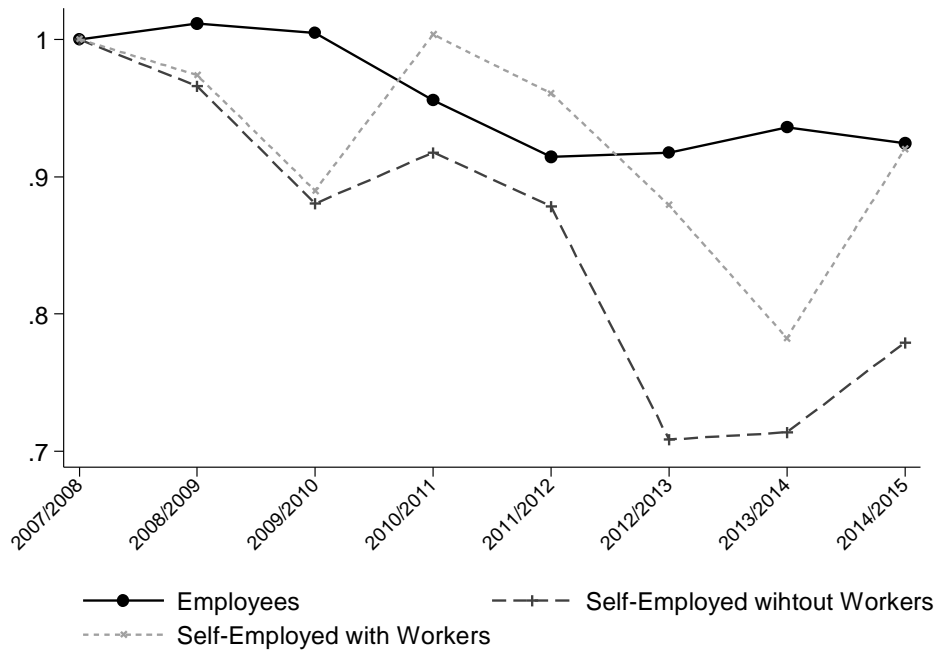
Some of the self-employed, especially in more specialist skilled positions where pay is high (for example, consultants and programmers), do very well in terms of earnings from their self-employed status. Others, including sizable numbers of the new self-employed, have fared very badly in terms of earnings. Figure 7 confirms that self-employed people without employees have seen their median real weekly income drop significantly since 2007/08, experiencing close to a 20% loss in real terms by 2014/15. Both employees and the self-employed with workers have had milder drops compared with individuals in independent self-employed work arrangements.

**Figure 6: Percentage of self-employed individuals in the workforce**



Source: QLFS, ONS.

**Figure 7: Real weekly income growth by employment/self-employment status**



Notes: 2007/08=100. Source: Family Resources Survey (FRS).



## Family income

Overall, median family incomes have recovered considerably faster than median wages. Table 2 shows that median real (after-tax) income increased by 2.2% in real terms between 2007/08 and 2014/15. The better performance of income is partly due to the tax and benefit system's automatic stabilisers (at the start of the downturn), to tax changes that increased the annual personal allowance (which in turn has reduced income tax receipts) and, most importantly, because pensioner households have actually fared much better than working age households.

Looking at the breakdown between working age families and pensioner families shows significant differences. Pensioners' real median incomes grew by 10.5%, while those of working age families are only just back to their 2007/08 levels. The real income gains of pensioners arise from three factors: first, state pensions were linked to inflation under the 'triple lock'<sup>6</sup>; second, older workers were largely unaffected by the rise in NICs (national insurance contributions); and third, most of the austerity policies on benefits have not been focused on this age group.<sup>7</sup>

**Table 2: Percentage changes in median real family income by group, 2007-08 to 2014-15**

---

Changes in real median family income, 2007/08 to 2014/15 (CPI deflator)	
All	+2.2%
Working age families	-0.3%
Pensioner families	+10.5%

---

*Notes:* Based on Family Resources Survey, from Belfield et al (2016) with additional numbers provided by Robert Joyce. Calculations of the percentage falls in median real income are after tax and before housing costs.

It is important to note the difference in recovery between income and earnings/wages in the economy, with income recovering to its pre-crisis level whereas earnings still lag behind. The explanation lies in the tax and benefit system, which has been relatively successful in compensating for the fall in earnings.

## The election context

The concern over lack of real wage growth is common across the political spectrum, and all parties have stated ambitions to try to improve the situation in their manifestos.

---

<sup>6</sup> The 'triple lock' policy, introduced in 2010 by the Conservative-Liberal Democrat coalition government, guarantees that state pensions are updated by maximum of the three: inflation, average earnings growth or 2.5%.

<sup>7</sup> See Hood and Waters (2017).

But other than the proposals on minimum wages, which would raise wages at the lower end of the wage spectrum, it is not straightforward to see how proposed policies contained in the manifestos of all parties could enable future pay growth for all workers.

On minimum wages, Labour advocate a £10 minimum for all workers aged 18 and over; the Conservatives commit to their plans already in place where the NLW (for workers aged 25 or more) is targeted to reach 60% of the median wage by 2020.

In the current climate of weak wage growth, these plans may place additional pressures on employers to adjust their operations. The precise margin of adjustment is not clear, but the evidence on UK minimum wages so far is that employment has not been adversely affected. Whether this would occur for the level as high as Labour proposes is uncharted research territory for the UK, but it is a very sizable increase. It would generate increased cost pressures that would be likely to require employers to adjust in some way. This, and the ability of employers to cope, is likely to differ across sectors.

A second set of relevant issues addressed in the manifestos is the increasingly hazy distinction around people working as employed or self-employed, and those in relatively insecure work. Labour and the Liberal Democrats propose banning zero hours contracts – our view is that such a blanket ban is unwise and that regulating such jobs would be better.

Labour go further on the self-employment question by arguing that the burden of proof needs to be shifted so that workers are classified as employees unless an employer can prove otherwise. Obviously, there are difficult legal issues associated with this, but to the extent that the policy is trying to protect workers' rights, this seems a good strategy. The Conservatives simply propose a Commission that will publish recommendations in a report in due course.

Finally, a double lock for pensioners – removing the 2.5% rule, and keeping the wage and price growth components of the triple lock currently in place – is proposed by the Conservatives. This is likely to make very little difference relative to the triple lock, although in the current era of weak real wage growth, it may seem more equitable for family incomes across the age spectrum. This would be less relevant if wage growth returns to the labour market.

May 2017

***For further information, contact:***

Rui Costa: [uctprmv@ucl.ac.uk](mailto:uctprmv@ucl.ac.uk)

Stephen Machin: [s.j.machin@lse.ac.uk](mailto:s.j.machin@lse.ac.uk)

Or Romesh Vaitilingam on 07768-661095 ([romesh@vaitilingam.com](mailto:romesh@vaitilingam.com))

## Further reading

- Belfield, C, J Cribb, A Hood and R Joyce (2016) 'Living Standards, Poverty and Inequality in the UK: 2016', *Institute for Fiscal Studies Report* R117.
- Bell, B and S Machin (2018) 'Minimum Wages and Firm Value', *Journal of Labor Economics*, forthcoming.
- Blanchflower, D and S Machin (2016) 'The Current 2% UK Wage Growth Norm', CEP Real Wage Update (<http://cep.lse.ac.uk/pubs/download/rwu005.pdf>).
- Blanchflower, D, R Costa and S Machin (2017) 'The Return of Falling Real Wages', CEP Real Wage Update (<http://cep.lse.ac.uk/pubs/download/rwu006.pdf>).
- Gregg, P, S Machin and M Fernández-Salgado (2014a) 'Real Wages and the Big Squeeze', *Economic Journal* 124: 408-32.
- Gregg, P, S Machin and M Fernández-Salgado (2014b) 'The Squeeze On Real Wages – And What It Might Take To End It', *National Institute Economic Review* 228, R3-16.
- Hood, A and T Waters (2017) 'The Impact of Tax and Benefit Reforms on Household Incomes', *Institute for Fiscal Studies Briefing Note* BN196.
- LSE Growth Commission (2017) 'UK Growth: A New Chapter' (<http://www.lse.ac.uk/researchAndExpertise/units/growthCommission/documents/pdf/2017LSEGCReport.pdf>).
- Machin, S (2011) 'Changes in UK Wage Inequality Over the Last Forty Years', in P Gregg and J Wadsworth (eds) *The Labour Market in Winter*, Oxford University Press.