

A series of background briefings on the policy issues in the December 2019 UK General Election

The Labour Market

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The Labour Market

CEP ELECTION ANALYSIS

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Summary

- UK employment growth has been strong in the last few years, reflecting a jobs boom, with employment and unemployment rates respectively at record highs and lows.
- But at the same time, wage growth has been extremely weak with real wages stagnating or falling for most workers since the late 2000s. Low wage workers have done better due to mandated minimum wage increases outpacing inflation.
- The UK's recent wage growth compares poorly internationally. Out of 34 OECD countries, only Greece experienced lower real wage growth between 2007 and 2018.
- The low measured unemployment rate masks that labour market slack is higher than it suggests as average hours have fallen and under-employment has risen.
- Solo self-employment has risen very sharply and is the main source of jobs growth in the UK labour market.
- Insecure employment is on the rise via more low wage positions, including zero hours contracts and new forms of alternative work arrangements (frequently being experienced by the solo self-employed).
- Key policy options for discussion include: proposed sizable increases in minimum wages; the tax and social insurance treatment of the solo self-employed; and the need for productivity to increase to get wages up across the board.

Introduction

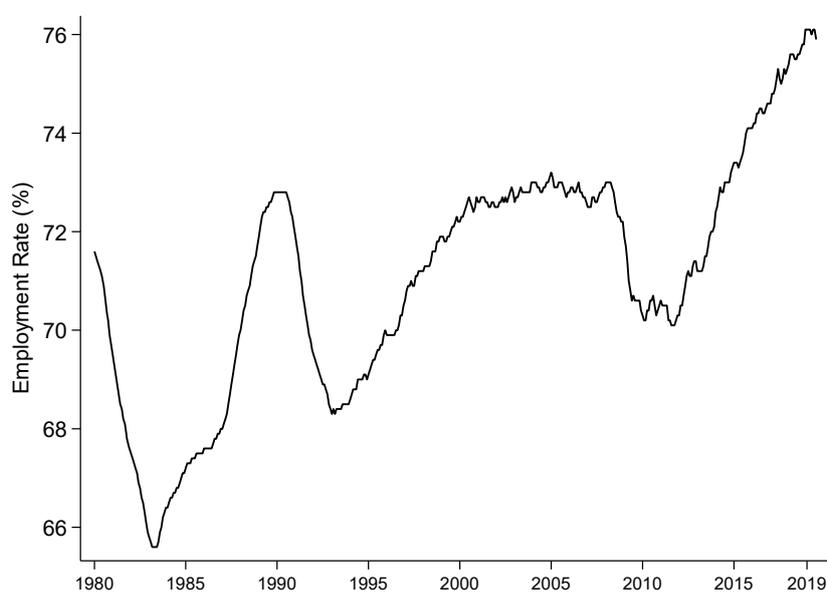
The UK labour market, at first glance, seems to be playing at Dr Jekyll and Mr Hyde. Employment (in terms of both levels and rates) is at record highs, yet wage growth has been extraordinarily weak. One view is that these are opposite sides of the same coin. Another, more nuanced standpoint is that record employment is hiding a number of serious concerns about the changing composition of work as poor quality jobs, often with little employment protection, have permeated the labour market.

Employment and unemployment

The employment performance of the UK labour market has been strong, in the wake of the global financial crisis and through the austerity years. Figure 1 plots the employment to population ratio from 1980 to 2019: this shows both a distinct cyclical pattern and, very notably, a rapid pick-up with employment rates growing strongly since 2013.

Indeed, the UK labour market has experienced record high employment since January 2015 when the previous record of 73.2% was superseded. The sustained growth in employment has continued since, reaching a new high of 76% in work (employment or self-employment), according to the latest figures for July-September 2019.

Figure 1: Employment rate in the UK, 1980-2019



Source: ONS employment series.

The unemployment rate has also come down to record levels. Figure 2 shows the time series, again from 1980 to 2019, with each successive downturn (the early 1980s, the 1990s and the late 2000s/early 2010s) characterised by a lower peak unemployment rate (11.9% in 1984, 10.7% in 1993 and 8.7% in 2011). This has led many commentators to argue that the natural rate of unemployment has fallen and, even more provocatively, that the UK labour market is operating at full employment.

Figure 2: Unemployment rate in the UK, 1980-2019

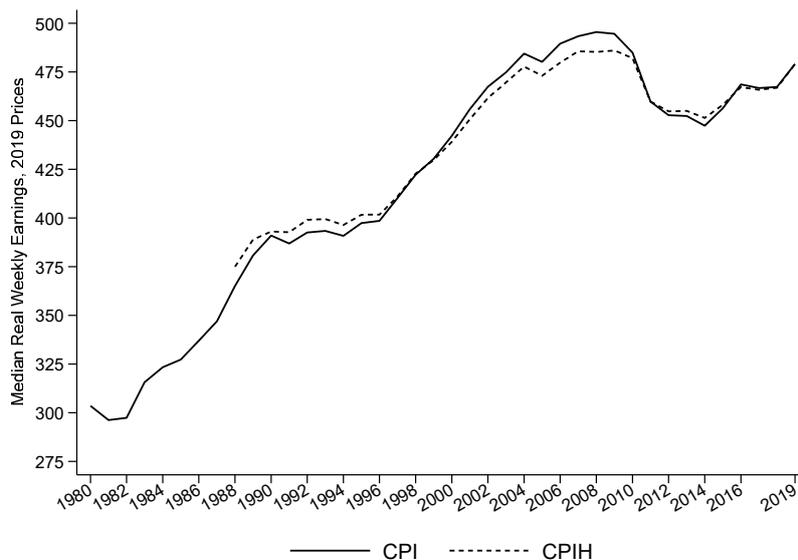


Source: ONS unemployment series.

Real wages

On the wage side of the labour market, things are not as rosy. Median real weekly wages have still not returned to the values observed before the start of the recession in 2008. This is shown in Figure 3, which plots median real weekly earnings from 1980 to 2019. In April 2019, the median real weekly wage in the UK was £479. Depending on which price deflator is used to convert the wages to real terms, this is around 1-3% lower than in 2008.

Figure 3: Median real weekly earnings, ASHE, 1980 to 2019



Notes: Weekly earnings deflated by CPI or CPIH.

Source: New Earnings Survey (NES) and Annual Survey of Hours and Earnings (ASHE). 2019 figures are based on the provisional ASHE estimates published by the ONS in October.

This amounts to a striking turnaround compared with earlier times. It reflects unprecedented weakness in modern history and the extended period of real wage stagnation is the longest since Victorian times (TUC, 2014). What was in broad terms a norm of 2% annual growth in real median wages experienced from 1980 to the mid-2000s is a distant memory. In fact, real wages are a huge 22% below the expected trend if that norm had continued.

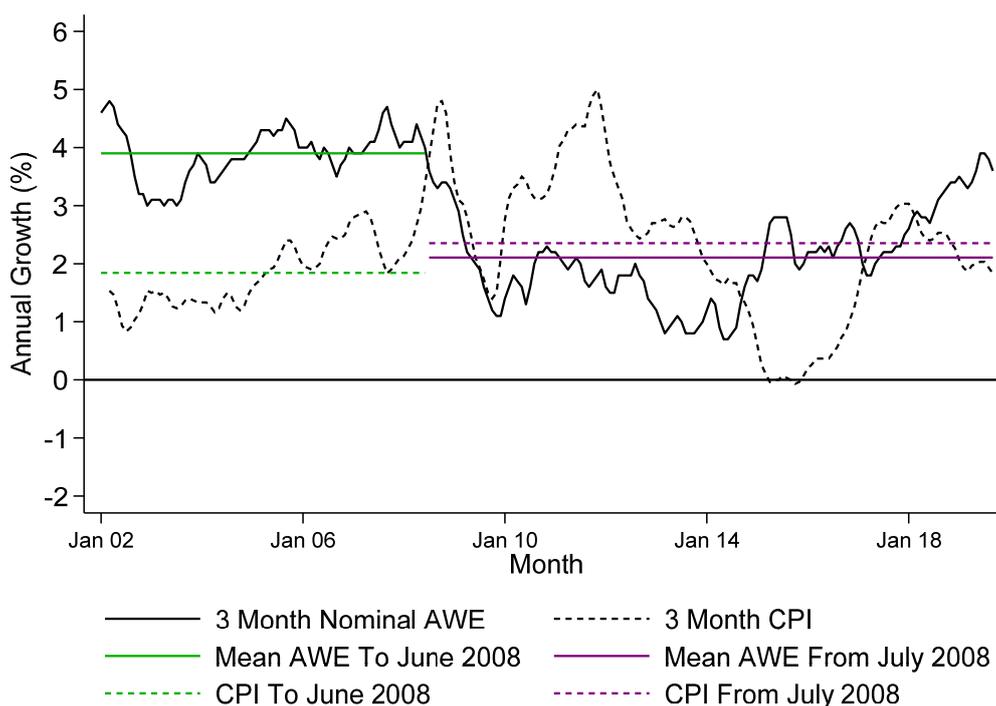
The monthly official average weekly earnings (AWE) series pulls out illustrates the recent weakness in wage growth very clearly.¹ With inflation measured using the consumer price index (CPI), Figure 4 shows the systematic 2% real wage growth of the early 2000s and the subsequent departure from that norm.

There have been five phases of real wage growth and decline since the early 2000s:

- Real wage growth of 2%, resulting from around 4% nominal wage growth and 2% price inflation, through most of the period from 2001 to 2008.
- After the onset of the global financial crisis, real wages fell sharply with inflation outstripping AWE nominal growth consistently until September 2014.
- This was followed by period of positive real wage growth anchored on low price inflation.
- The low inflation trajectory suffered a significant shift in the aftermath of the June 2016 referendum on the UK's membership of the European Union. An overnight fall in the pound of 8% against the dollar has since persisted and intensified. Facing higher import costs, inflation climbed steadily (Breinlich et al, 2019) overtaking AWE growth by February 2017, hence ending the previous phase of real wage growth (Costa et al, 2019).
- As the referendum-induced price increases dropped out of the CPI index, inflation dropped again and, with something of a pick-up in nominal terms, modest real wage growth has returned.

¹ AWE is the headline average weekly earnings index produced by the Office for National Statistics (ONS).

Figure 4: Monthly nominal AWE and CPI growth, 2002 to 2019



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

Table 1 shows real wage growth for different groups over the period from 2008 to 2019. Real wages have evolved differently between genders: men have seen a fall in real wages of approximately 7%, whereas women have seen a rise in their real wages of 2% as of April 2019.

Focusing on different points of the wage distribution, the 10th percentile (the worker 10 percent from the bottom of the wage distribution) has experienced real wage growth of 4% in line with the strong real wage growth (12%) of the National Minimum Wage (NMW) and National Living Wage (NLW) rates. By contrast, workers at the median and 90th percentile have suffered real wage falls of 3% and 7% respectively. This shows a modest recent contraction in wage inequality, compared to the long-run upward trend that occurred since 1980 (Machin, 2011).

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

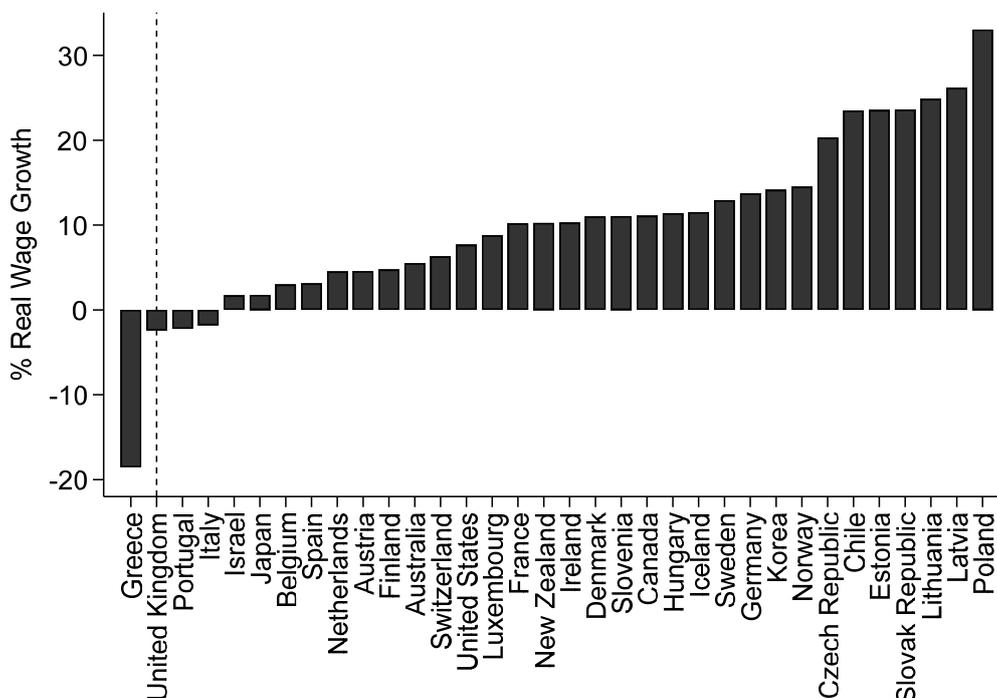
Changes in real hourly wages (CPI deflator)	
Median	-3%
Men	-7%
Women	+2%
10 th percentile	+4%
90 th percentile	-5%
NMW/NLW adult rate	+12%

Notes: Using CPI deflator.

Source: ASHE. 2019 figures are based on the provisional ASHE estimates published by the ONS in October.

Figure 5 places the UK experience into international context by showing real wage growth across developed economies (OECD) between 2007 and 2018. The UK's performance relative to other countries is extremely poor. With the second worst performance (the worst being Greece), the UK is in the group of four out of thirty four countries that have experienced negative real wage growth during this period (together with Greece, Portugal and Italy).

Figure 5: International average real wage growth, 2007-18



Notes: Average real wages defined by the ratio between total wage bill and average hours worked. *Source:* OECD Stats, 2019 (<https://stats.oecd.org/>).

The bottom line on real wage growth is that it has been exceptionally weak for most workers. Only those workers benefitting from mandated minimum wage increases have experienced significant real wage growth since the global financial crisis.

Changes in the nature of work

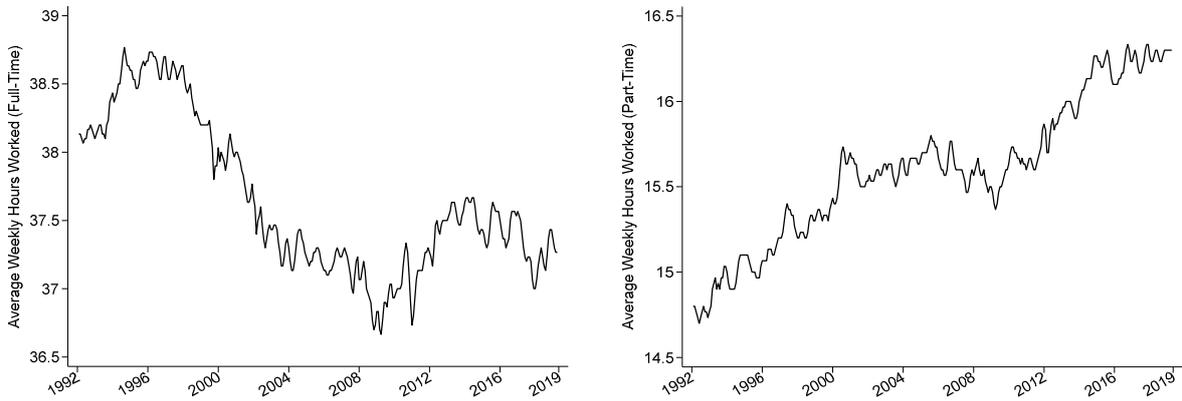
The nature of work has changed and that is a key factor behind the strong employment growth seen in the recent past. There are several dimensions: falling hours and associated increases in under-employment; a big rise in solo self-employment; and the emergence of new forms of work and contract types, as typified by the alternative work arrangements of the ‘gig economy’.

Each of these are considered in turn:

Falling hours

Full-time weekly hours have dropped, and part-time hours have increased, as shown respectively in the left-hand (full-time) and right-hand (part-time) charts in Figure 6.

Figure 6: Full-time (left) and part-time (right) average hours per week



Source: ONS Hours series

Rising under-employment

The percentage of people saying that they would like more hours and of part-time workers who are involuntarily part-time have risen. These changes suggest more slack in the labour market than is picked up in the ILO unemployment rate (see also Blanchflower and Bell, 2019; Boeri et al, 2019). Figure 7 shows higher rates if the under-employed and involuntary part-timers are added, bringing into question claims that the labour market is operating at full employment.

Figure 7: Labour market slack



Notes: The Bell and Blanchflower (2019) measure is the unemployment rate plus the difference between more hours wanted by the under-employed and less hours wanted by the over-employed converted to unemployment equivalents using average hours. Source: ONS Hours and Employment series

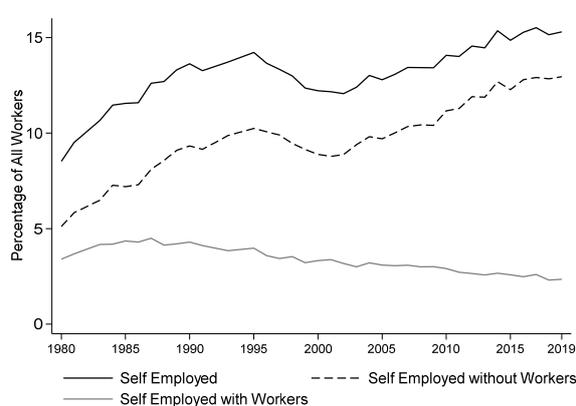
Solo self-employment

One of the most pronounced changes in today's labour market has been the sizable increase in self-employment. The left-hand chart of Figure 8 shows that around 14% of jobs are now done

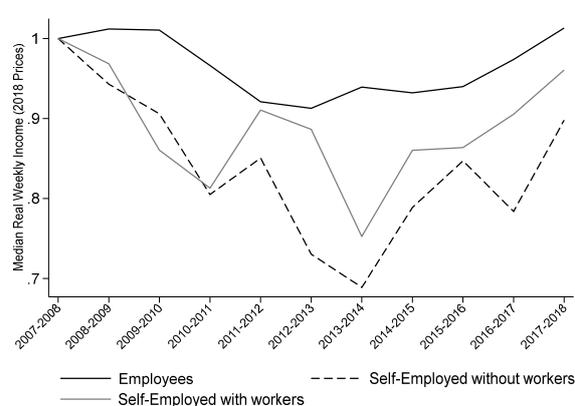
by self-employed people, and that all of the increase is in job positions classified as solo self-employment (self-employed people who do not have any employees). According to the latest figures available for 2019, this category alone accounts for 85% of the total number of self-employed workers.

The right-hand chart of Figure 8 shows that many of these are low wage jobs, and that people doing them have suffered much more than employees in terms of real income losses. Between 2007/08 and 2017/18, solo self-employed people have seen the biggest drop in their real weekly income: in the order of 10% in contrast with a total recovery of real income levels for traditional employees and a milder decline of 4% for self-employed people with employees.²

Figure 8: Self-employment rates (left) and weekly incomes (right)



Source: QLFS, ONS.



Source: Family Resources Survey (FRS)

Alternative work arrangements

Today’s labour market features the use of ‘atypical’ work arrangements. Some of these – such as self-employment and agency work – have emerged in their current format as an evolution of previous work structures. Others – such as short hours and zero hours contracts – reflect the work demands of the modern age, with their introduction driven by technical and social change. The classically cited example is ‘gig economy’ work, but other forms of insecure work have permeated the modern labour market.

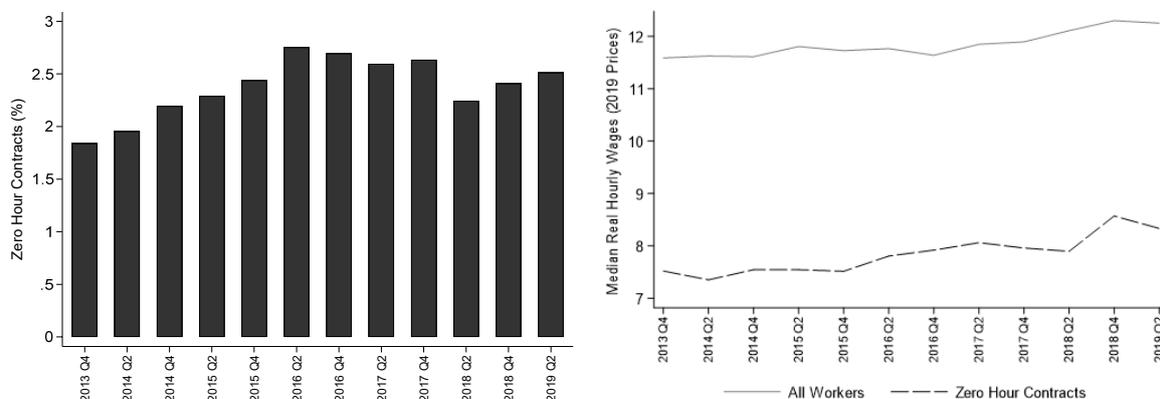
The UK labour market now has around 2-2.5% of people working in zero hours contract positions. The left-hand chart in Figure 9 shows the recent trend in the incidence of zero hours contracts. These are employees. Many of these positions are prominent in the low wage sectors of employment (Datta et al, 2019). They are very low paid, as the right-hand chart of Figure 9 makes clear.

Many alternative work arrangements involve the solo self-employed. These are positions that have limited access to the safety net to which traditional employees are entitled: sick pay,

² See Cribb et al (2019) for a detailed analysis of solo and non-solo self-employment trends and earnings.

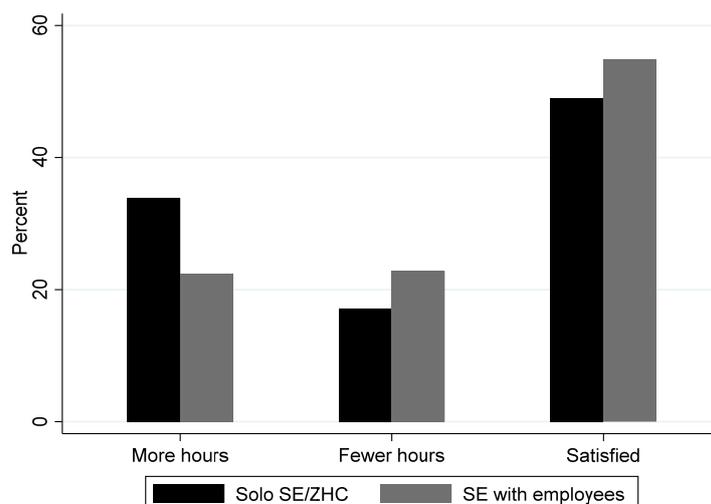
holiday pay, employment security, pensions and coverage by the National Living Wage. Their low pay levels have already been noted. Figure 10 shows that, in addition, the solo self-employed would like to work more than self-employed people who have employees.

Figure 9: Incidence of zero hours contracts and wages



Source: QLFS, ONS.

Figure 10: Desired hours of work among the self-employed



Notes: The graphs show the distribution of responses to the question ‘Would you have preferred to work more or fewer hours last week at your current wage rate? Or were you satisfied with the number of hours you worked?’. Answers are reported separately for solo self-employed and zero hours contract workers (black bar) and self-employed with employees (grey bar).

Source: LSE-CEP Survey of Alternative Work Arrangements.

Policy issues for the election

The labour market is not in as good shape as some assert. While employment growth has been strong, behind it are some big concerns to do with the changing composition of work and low (sometimes very low) wages. The Resolution Foundation’s (Bell and Gardiner, 2019) argument that people want to work more because they are not earning enough rings true, but many cannot achieve such an aim because extra work is not available.

This should make policy options for the labour market a key election issue. So what is on – or could be on – the table?

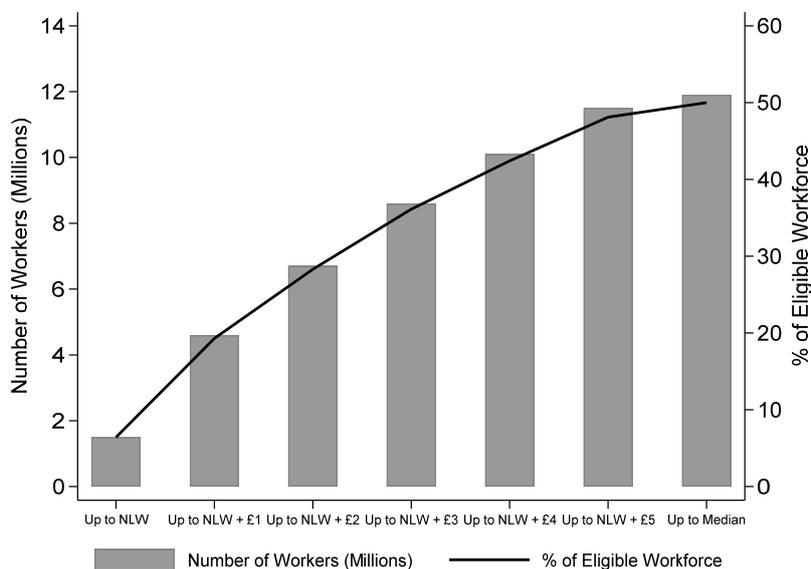
Minimum wages

Raising the minimum wage has become popular, irrespective of political colour. This is in part because accumulated evidence shows that progressively raising the minimum wage has not caused job losses. It may also be because raising minimum wages is one of the few levers available to governments to boost pay levels directly.

If minimum wage increases continue their prior pattern of not harming employment, then raising the minimum is a good thing to boost the pay of low wage workers. It should be noted, though, that proposed big increases – possibly as far as two thirds of the median wage, as discussed in the recent Dube (2019) report for the Treasury – mean that many more workers would be covered by minimum wages.

Figure 11 shows minimum coverage for hypothetical NLW increases. As coverage increases and so the minimum wage becomes the established rate in more sectors, it is important that career development and promotion are not harmed as would be the case if workers become stuck on the pay floor for longer.

Figure 11: Minimum wage coverage for hypothetical increases in National Living Wage



Notes: Calculation are made following Dube (2019) methodology. The eligible workforce includes those entitled to the NLW (aged 25 and over) and paid below or within 5 pence of the NLW. Results are weighted using the ASHE survey low pay weights. *Source:* ASHE 2018

Solo self-employment

The increased incidence of this kind of work, and alternative work arrangements more generally, has led to discussions of a trade-off between additional flexibility and the emergence

of low wage, dead end jobs that function outside the job legislation offered in conventional forms of employment. These jobs have limited access to the safety net to which traditional employees are entitled: sick pay, holiday pay, employment security, pensions and coverage by the National Living Wage. There are, of course, also different tax treatments of the self-employed that favour employees (for example, those gaining work through agencies) as labelling such workers self-employed.

Policy levers could affect both of these. Tax treatment of the employed and self-employed should be equalised, and already has been discussed at various times in policy circles and government reports (for example, the 2017 Taylor Review).

In addition, the increasingly hazy distinction between who is an employee and who is self-employed (for example, highlighted in the Uber and Pimlico Plumbers court cases) needs to be clarified and addressed, together with whether (and how) social insurance benefits could be extended beyond those in traditional employment to offer a safety net to those in precarious work.

How to get wages up across the board?

The billion dollar question. In the long run, the key driver of wages is productivity. For all workers to get pay increases, and for all to have decent living standards, productivity needs to improve. With no return to wage increases from collective bargaining in sight as unionisation rates get lower and lower, this is important.

Employers repeatedly warn of skill shortages, especially outside the South East of England. Research and development (R&D) is low compared with international competitors. Productivity remains sluggish and has taken a hit following the vote to leave the European Union (Bloom et al, 2019). Of course, this speaks to complementary policies that start to go beyond the labour market: skills, innovation and human resources policies are all critical for this goal.

Further reading

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