

THE RF EARNINGS OUTLOOK

A look beyond the headline data on the forces behind current developments in pay, how the fruits are shared, and the short- and longer-term drivers of earnings growth

The second quarter of 2016 marked both the introduction of the National Living Wage and the vote to leave the European Union. There are tentative signs that the former has led to strong shared pay growth without affecting aggregate unemployment, but more data will be needed. Referendum effects are not yet visible, but Q2 2016 – and the labour market trends up to this date – may be considered the baseline against which any impacts can be assessed.

We have seen more tightening of the labour market, with unemployment falling to a 10.5 year low. Under-employment and long-term unemployment are back to pre-crisis levels, while participation rates – including for groups with traditionally low rates – are at record highs.

Nonetheless, productivity growth has remained weak, and real employee pay growth was 1.7% in July, still below the pre-crisis average despite low inflation. With self-employment rising sharply in recent years, our ‘Spotlight’ focuses on how self-employment earnings are faring. There are signs of recovery, but rewards are still far below pre-crisis levels even accounting for large changes in the make-up of the self-employed.

In this regular briefing we use 13 key indicators to take a more detailed look at underlying trends and prospects for the future.

Our **earnings breakdown** suggests that changes in the make-up of the workforce are increasingly supporting average wage growth, and that the exclusion of the self-employed from earnings statistics continues to be a key omission.

Our analysis of **pay pressures and slack** shows that un- and under-employment fell again in Q2 2016, back to pre-crisis levels. But we also lift the lid on large differences between age groups. As a leading indicator of pay growth, job mobility has been broadly flat and remains considerably below its post-2000 peak.

Our review of **longer-term labour market health and efficiency** continues to present a mixed bag. Participation has risen still further, including for low-participation groups, but weak productivity growth and little progress on training intensity and the share of graduates doing non-graduate roles remain key long-term challenges.

Analysis from Adam Corlett:

“With further falls in unemployment, high participation rates and the introduction of the National Living Wage, the labour market looked strong overall in the second quarter of 2016.

However, productivity growth has remained weak and real wage growth has been unexceptional despite low inflation. It is hard to envision average wages returning to their pre-crisis peak any time soon, and new analysis suggests typical self-employment earnings are lower than twenty years ago.

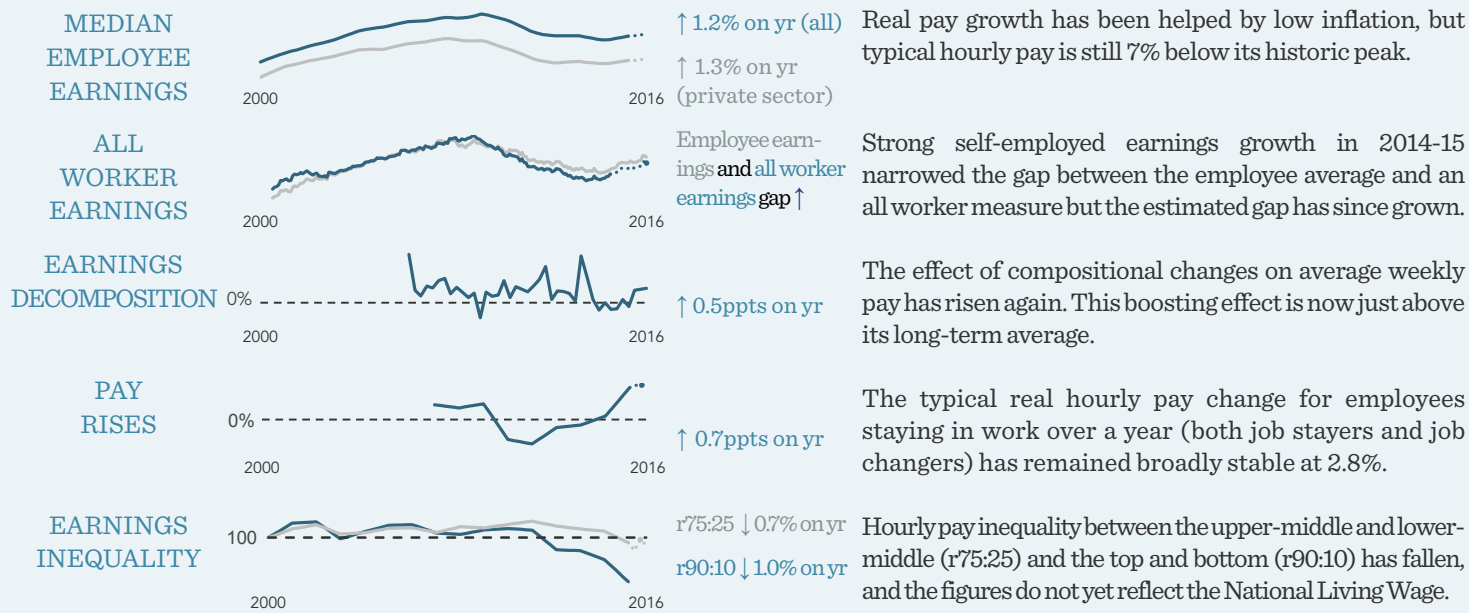
It is likely that the fall in the value of the pound following the EU referendum will feed through to higher prices, but how output, nominal earnings and employment respond will be crucial. The outlook is therefore particularly uncertain.

Big differences between different groups and areas also remain, with youth underemployment and pay in some regions still performing poorly.”

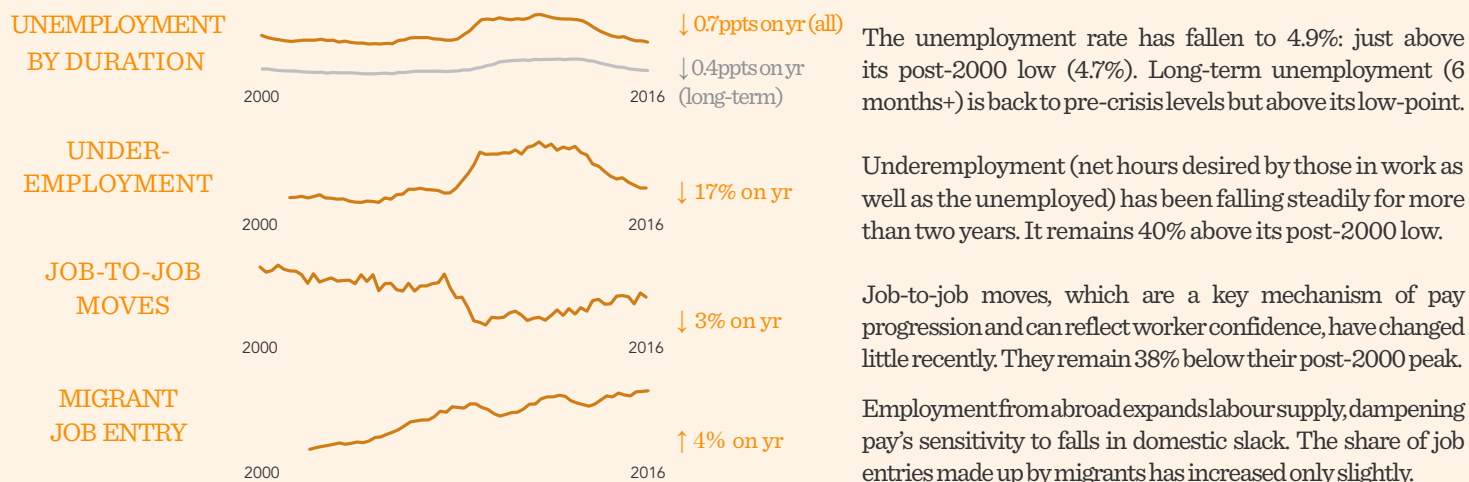
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The Scorecard: Q2 2016

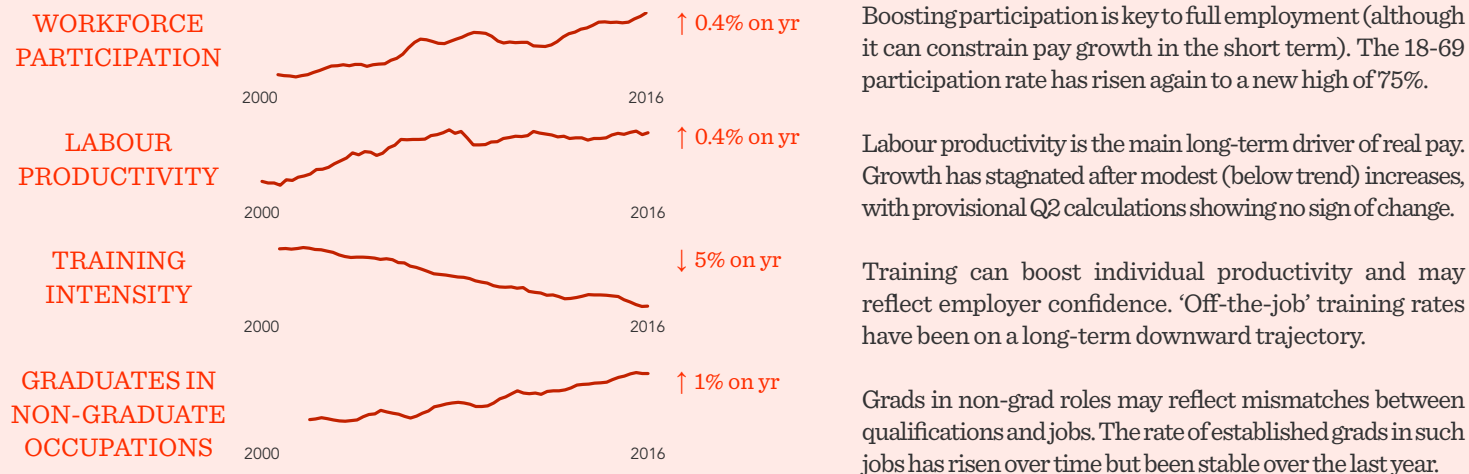
What's happened: The earnings breakdown



What's round the corner: Pay pressures and slack



What's in the pipeline: Longer-term labour market health and efficiency



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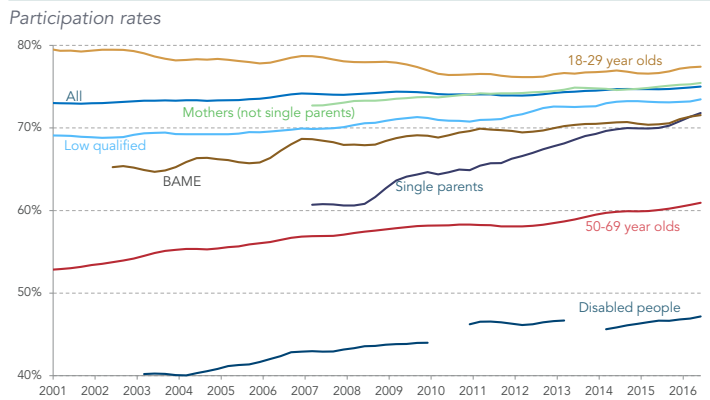
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Lifting the lid: The picture across different groups and areas

Here we explore a few of the most interesting developments for different groups of workers and different parts of the country. But there's plenty more: a comprehensive breakdown of each indicator is available on the RF Earnings Outlook website:

www.resolutionfoundation.org/earningsoutlook

Figure 1: Workforce participation rates



Notes: See notes on Indicator 10: Workforce participation at www.resolutionfoundation.org/data/sources-and-methods

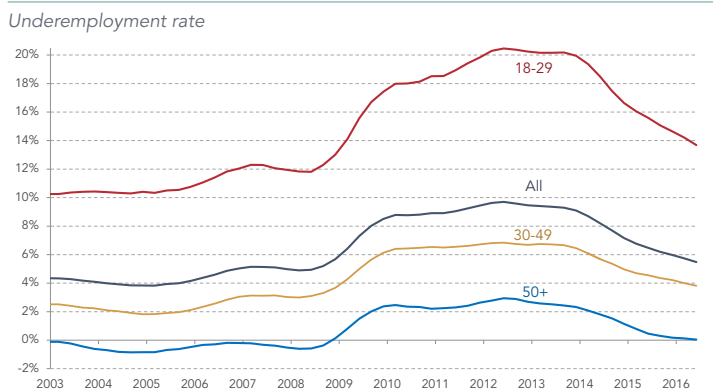
Workforce participation has continued to rise for traditionally low-participation groups

18-69 year old workforce participation hit a record high of 75% over the last year, and has continued to rise for groups that traditionally had low activity rates.

Single parents, the black and minority ethnic population and 50-69 year olds (aided by the rising State Pension Age) have recorded the largest recent increases in participation rates. These groups have converged, narrowing inequalities in participation and raising overall employment.

Differences between regions have also narrowed in general. While a lot more is needed to reach full employment, and help all those who are able to work, these are encouraging trends.

Figure 2: Underemployment rate by age



Notes: See notes on Indicator 7: Underemployment at www.resolutionfoundation.org/data/sources-and-methods

Underemployment among older workers falls to zero

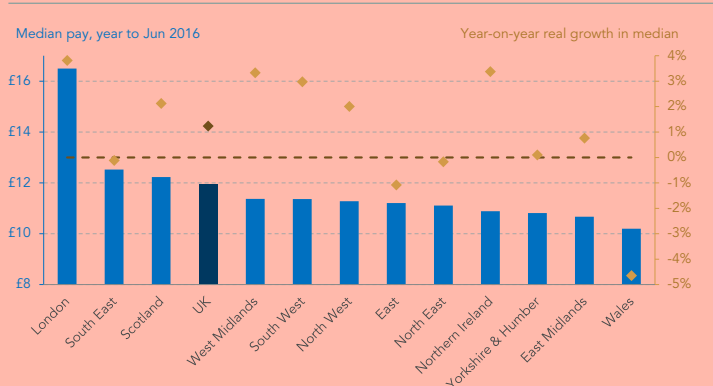
Figure 2 shows our measure of underemployment, both overall and for three broad age groups. This captures the net desired hours of the unemployed and those in work – some of whom might want fewer hours.

Among workers age 50+, underemployment has averaged zero over the past year, though negative figures (i.e. over-employment) were the norm for this age group pre-crisis.

Overall, underemployment has fallen more slowly than unemployment, and remains particularly elevated for young people relative to the 2000s. This remaining slack could be expected to weigh on pay growth for younger workers.

The regional perspective

Figure 3: Median pay and real pay growth by region



Notes: See notes on Indicator 1: Median earnings at www.resolutionfoundation.org/data/sources-and-methods

Wales now appears to have the lowest typical pay in the UK

The Annual Survey of Hours and Earnings will soon give us the best picture of 2016 pay growth. But the timelier Labour Force Survey suggests it has been uneven across the country.

Recently, Wales has become the part of the UK with the lowest median employee pay. N. Ireland, which has been at the bottom of the league table for most of the last decade, has had strong growth in the median, leapfrogging several regions.

These figures are volatile, and may be affected by compositional change as unemployment falls (as it has in Wales especially). Whether a tighter labour market, together with the NLW, will drive up typical pay remains to be seen, but regional disparities in pay and growth clearly remain large.

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Spotlight: The earnings of the self-employed

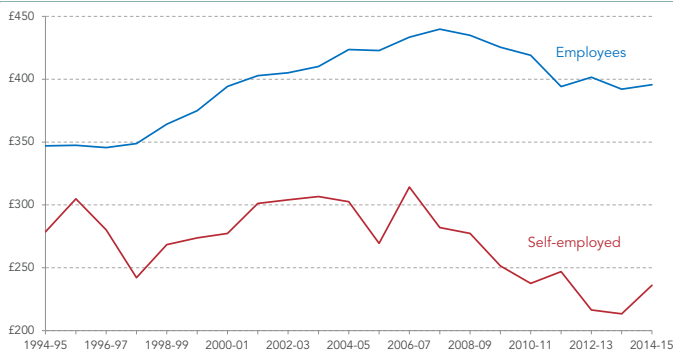
Adam Corlett, Resolution Foundation

Earnings data for the self-employed is hard to come by, a significant problem given they now make up 1 in 7 workers. New data helps shed light on their income growth up to 2014-15, and what may have driven a large decline over the past decade.

As in our all worker index (Indicator 2), we can use the Family Resources Survey to analyse the earnings of the self-employed. This data comes with a significant lag but is currently the best available.

Remarkably, this data suggests that typical earnings for the self-employed were lower in 2014-15 than in 1994-95, twenty years earlier. A fall of 15% compares to a rise of 14% in typical employee earnings, as shown in Figure 4. From their peak (2006-07) to trough (2013-14), typical self-employment earnings fell by 32% – £100 per week.

Figure 4: Median weekly earnings of the self-employed and employees, CPI-adjusted (2014-15 prices)



Notes and sources: RF analysis of FRS

Figure 5: Number of self-employed (million)



Notes and sources: RF analysis of ONS, Labour Market Statistics

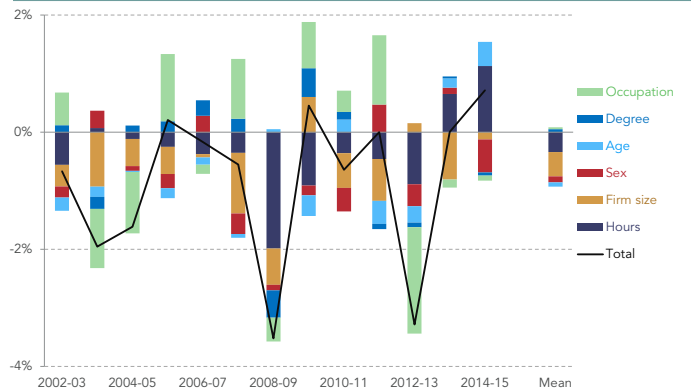
To explore why, we can look at earnings growth for different groups within the self-employed since 2001-02 – around the time self-employment started rising (Figure 5). We find that earnings have fallen across the board, but with larger falls for men than women, and smaller falls for those over 54 than for younger workers.

But as the number of self-employed has grown from 3.3m (11.9% of the workforce) in 2001-02 to 4.5m (14.7%) in 2014-15, its composition has changed too and this has affected mean and median earnings.

Just as we have looked at how the changing make-up of employees

affects mean pay (Indicator 3), we can do the same for the self-employed.¹

Figure 6: Compositional effects on average CPI-adjusted self-employment earnings, versus previous year



Notes: See notes on Indicator 3: Earnings decomposition at www.resolutionfoundation.org/data/sources-and-methods

As Figure 6 shows, the key compositional effects have been the number of hours worked – with a much smaller share now working more than 40 hours – and a large drop in the share of the self-employed who have employees. These shifts have reduced average self-employment earnings.

This analysis suggests that, over the 2001-02 to 2014-15 period as a whole, compositional effects were responsible for over 60% of the fall in average earnings (and there may be other compositional factors that we have not accounted for here),² with the remainder being a purer earnings effect.

However, this has varied over time. From 2001-02 to 2008-09, the earnings effect alone equated to growth of around 8% – with incomes rising for many sub-groups – but this was more than cancelled out by a -8% compositional effect. However, between 2008-09 and 2013-14, while there was still a negative compositional drag, the large majority (86%) of the substantial fall over this period is not explained by compositional effects.

More recently, compositional changes played a positive role and together with strong growth within groups meant a rise in average income in 2014-15. The number of self-employed workers has since increased further but whether average earnings have also risen remains to be seen.

The depth of the post-crisis earnings squeeze for the self-employed is striking, given that is not explained by compositional change. Whether the expansion and changing nature of typical self-employment is also a concern is less straightforward, and depends on the extent to which falls in hours were desirable and what kind of employee jobs they have replaced. But, whatever the reason for these shifts, the degree of change reinforces why a full picture of the labour market must include the self-employed as well as the employed.

¹ We have excluded the highest and lowest earning one per cent of the self-employed to reduce volatility.

² Industry has not been included due to discontinuities, but appears to make little difference.

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