Resolution Foundation

THE RF EARNINGS OUTLOOK | Q4 2018

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

In the three months to January 2019, average nominal pay growth was 3.4 per cent, where it had been for the last three months. However, with inflation falling below its 2 per cent target, real pay growth strengthened to 1.4 per cent, the highest since June 2016. Improving pay growth is being driven by a tighter labour market. In the three months to January employment rose to a record high (hitting 76.1 per cent for the first time since the Second World War) and unemployment fell to a 40 year low.

Analysis from Nye Cominetti

"The minimum wage is turning 20 on Monday, and is celebrating with a bang – a pay rise for two million workers. This policy, condemned as a jobs killer when it was first introduced, has turned out to be one of Britain's biggest-ever policy successes for living standards.

The Chancellor is right to be signalling now where it should go after 2020. However, he should also ensure that the next phase of minimum wage rises are done so with the evidence carefully examined."

More good news on pay is found at the wage floor. On Monday (the 1st April) the National Living Wage (the higher minimum for those age 25+) will go up by 38p, or 4.9 per cent – above the rate of average pay growth. It will also mark twenty years since the minimum wage was introduced in the UK – and it is a true policy success story. The minimum wage has increased pay for low earners. In the Spotlight section (page 4) we show that, over the past two decades, earnings growth has been strongest at the bottom of the wage distribution. Average annual growth in real hourly pay has been 2.1 per cent for the bottom tenth of the distribution, compared to 0.9 per cent in the middle.

And this has been achieved while avoiding the much-predicted negative employment effects. Because of this track record, and thanks to the evidence base collected by the Low Pay Commission (LPC), the minimum wage now enjoys a political consensus unimaginable in 1999. Moreover, we have in recent years seen a political bidding war to further increase its level, spurred on by the 'fight for $15' in the US.

However, despite these successes, the minimum wage has its limitations as a tool for increasing incomes. By its nature the minimum wage affects hourly pay, not necessarily weekly pay – a more important driver of living standards. As we document in the Lifting the Lid section (page 3) in 2018 weekly pay fell at the bottom of the distribution. This could be because the lowest paid are working fewer hours or this group could contain more young workers or apprentices.

Furthermore, the minimum wage only affects pay at the bottom of the distribution – those on the wage floor. Beyond this, the LPC estimates that 'spillover' effects (where people earning just above the minimum are paid more as employers protect pay differentials), only extend to the 20th-30th percentile. Different tools are needed to improve middle incomes, including those that improve labour market outcomes by raising productivity and workers' bargaining power.

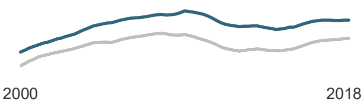
- Our **earnings breakdown** shows that real pay growth is strengthening, but still remains low by historical standards.
- Our analysis of **pay pressures and slack** shows that the labour market continues to tighten. Employment has hit a new record, and underemployment is below pre-crisis levels. One dark spot is job mobility, with voluntary job-to-job moves falling in the last two quarters.
- Our review of **longer-term labour market health**, as usual, shows areas of concern. Productivity growth is very low, as is the level of workplace training (which could improve productivity).

 Source: RF analysis of ONS/DWP datasets. Notes: all real-terms series are CPI-adjusted; for further details of data sources and methods go to www.resolutionfoundation.org/data/sources-and-methods. A full breakdown of each indicator is available at www.resolutionfoundation.org/earningsoutlook. This project was funded by the Nuffield Foundation, but the views expressed are those of the authors and not necessarily those of the Foundation.

The Scorecard: *Q4 2018*

What's happened: *The earnings breakdown*

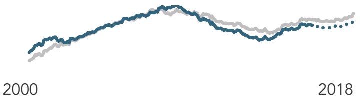
Median employee earnings



↑ 0.5% on yr (all)
↑ 1.5% on yr (private sector)

The most timely pay data showed median real pay growth continued to strengthen into 2018 Q4, partly because inflation ticked below its 2 per cent target.

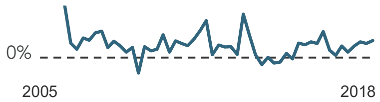
All worker earnings



No change on yr

Strong self-employed earnings growth in 2014-15 narrowed the gap between the employee average and the all worker measure, with the estimated gap staying the same since then.

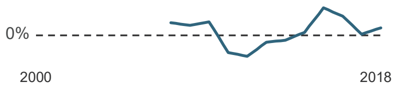
Earnings decomposition



↑ 0.5ppts on yr

The compositional boost to pay associated with a changing workforce has been increasing in recent months, with the main contributor in recent quarters occupation.

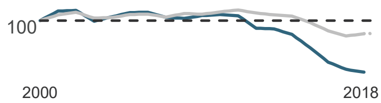
Pay rises



↑ 0.6ppts on yr

Median year-on-year real hourly pay rises for employees in work over a year (both job stayers and changers) stood at 0.8 per cent in April 2018, an increase on 2017.

Earnings Inequality

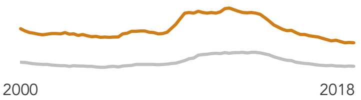


r75:25 ↓ 0.3% on yr
r90:10 ↓ 0.6%

While both our headline measures of earnings inequality continue to fall, a measure comparing the very highest earners with the rest would see inequality increasing.

What's round the corner: *Pay pressures and slack*

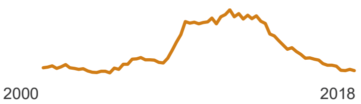
Unemployment by duration



↓ 0.3 ppts on yr (all)
↓ 0.1ppts on yr

The unemployment rate continued to fall in Q4 2018, reaching a record low of 3.9 per cent in January 2019. Long-term unemployment also continues to fall, but with signs that levels are plateauing.

All worker earnings



↓ 10% on yr

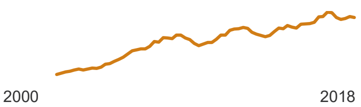
Under-employment is down on the year but relatively unchanged over the past three quarters. It is below levels seen immediately pre-recession but not quite as low as it was in the mid-2000s.

Job-to-job moves

↓ 20% on yr

Voluntary job-to-job moves (an indicator of a healthy labour market and worker confidence) fell sharply in Q4 2018 for the second quarter in a row, bucking the trend of recent years.

Migrant job entry

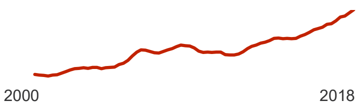


0% on yr

In 2018 Q4 the share of job entries made up by migrants was unchanged on the year. Since the post-referendum fall, net migration to the UK has stabilised at just below 300k per year.

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

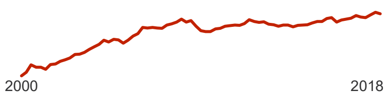
Workforce participaton



↑ 0.7% on yr

Labour force participation continues to rise, as it has for the every quarter since summer 2012. In Q4 2018 the rate was 0.7 per cent up on the year.

Labour productivity



↑ 0.9% on yr

In Q3 2018 labour productivity was up on the quarter and year (by 0.9%). However in the latest data (for November) productivity growth slowed to just 0.2%.

Training intensity

No change on yr

'Off-the-job' training was unchanged on the year. Longer term, the big picture is a large fall in training intensity over the past 20 years.

Graduates in non-graduate occupations

↑ 1% on yr

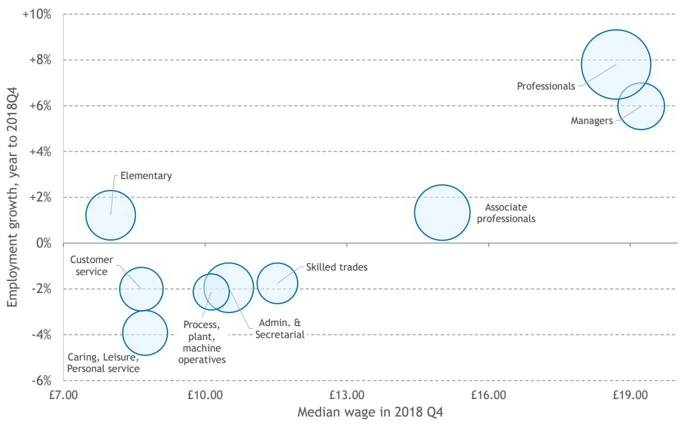
Grads in non-grad roles reflect mismatches between qualifications and jobs, and may constrain productivity. This measure has risen over time and ticked up over the past year.

 Source: RF analysis of ONS/DWP datasets. Notes: all real-terms series are CPI-adjusted; for further details of data sources and methods go to www.resolutionfoundation.org/data/sources-and-methods. A full breakdown of each indicator is available at www.resolutionfoundation.org/earningsoutlook. This project was funded by the Nuffield Foundation, but the views expressed are those of the authors and not necessarily those of the Foundation.

Lifting the lid: *The picture across different groups and areas*

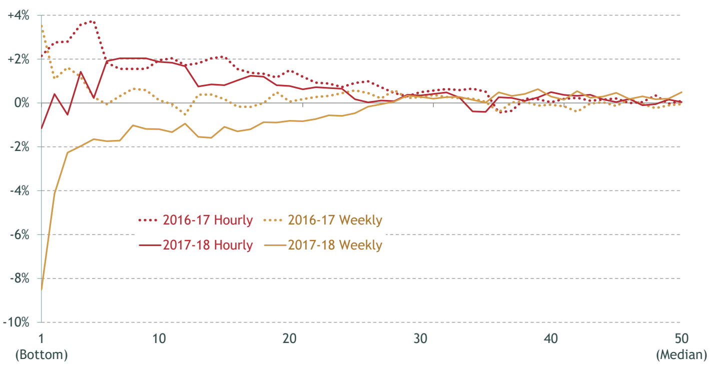
Here we explore a few of the most interesting developments for different groups of workers and different parts of the country. But there's plenty more: a comprehensive breakdown of each indicator is available on the RF Earnings Outlook website: www.resolutionfoundation.org/earningsoutlook

Figure 1: Employment growth and median wage by broad occupation group



Source: RF analysis of *Labour Force Survey* (ONS).

Figure 2: Earnings growth at the bottom of the earnings distribution



Source: RF analysis of *Annual Survey of Hours and Earnings* (ONS), accessed via UK Data Service

Employment growth in higher-paid occupations

Changes in average pay can be decomposed into the effect of changes in the composition of the workforce, and a wage effect. In 2018 Q4, average weekly earnings growth was 3.2 per cent, of which 0.8 per cent was compositional. Changes in the occupations people are working in are currently making the biggest contribution to the positive compositional effect, with recent employment growth weighted towards higher-paid occupations. Managers, and Professionals, the two highest paid occupation groups, saw employment growth of 6 and 8 per cent over the past year. Meanwhile employment fell in the lower-paid occupations. Our method for calculating compositional effects is similar to the Bank of England's, and the same occupational effect was noted in Monetary Policy Committee's March meeting.

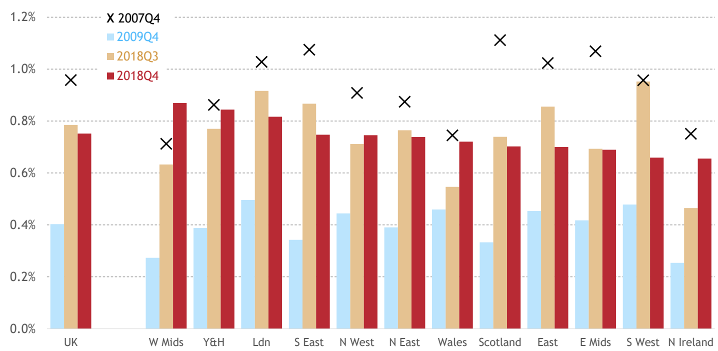
Strong wage growth for low earners

The rising National Living Wage is driving strong hourly wage growth for most low earners. Figure 2 shows that in both 2017 and 2018 hourly wages increased faster towards the bottom of the earnings distribution (with the bottom 5 per cent an exception in 2018). However, we are not seeing the same trends in weekly pay. This is important because weekly pay is a better measure of living standards. Low earners have seen low and negative weekly earnings growth in the last two years. The data for 2018 is particularly striking – it shows a significant reduction in weekly earnings at the bottom. For example, weekly pay for the bottom 10 per cent fell by an average of 2.5 per cent on the previous year. It is not yet clear what is driving these trends. The obvious explanation is that the lowest paid are working fewer hours. Another possibility is that there has been a change in the composition of the low-earning group, perhaps containing more young workers or apprentices, who are subject to lower minimum wage rates. These are questions we will be investigating in our 2019 Low Pay Britain report.

The regional perspective

Job mobility is important for individual pay progression, but is also a leading indicator of overall pay growth. Not only do those who move tend to see higher pay growth, but moves put pressure on employers to increase pay for fear of losing staff. In 2018 Q4, in the UK overall, over a quarter of people voluntarily moved jobs. This is down on the previous year, and still some way short of the pre-recession rate, of close to 1 per cent. Looking across the regions, the job mobility picture is a varied one. In 2018 Q4, job mobility in the West Midlands, the region with the highest rate, was a third higher than in Northern Ireland, the place with the lowest mobility. Some parts of the country are closer to their pre-recession peak than others. The largest gap is in Scotland, where the rate of job mobility is 40 per cent below its pre-crisis peak.

Figure 3: Voluntary quarterly job-to-job moves by region



Source: RF analysis of ONS, *Labour Force Survey*

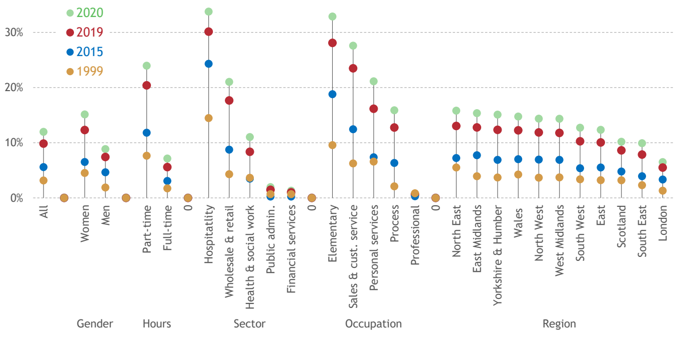
Spotlight: *On the minimum wage*

This Monday, the 1st April, 2 million people working minimum-wage jobs will start the week with a pay rise. The National Living Wage (NLW), the rate that applies to 25+ year olds, will rise by 38p, from £7.83 to £8.21. We project that this will increase the number of people paid at the wage floor to 2.7 million workers. In this article we chart the increasing reach of the minimum wage, and its impact on hourly wages at the bottom since its introduction in 1999.

First, who are the minimum wage employees?[1] In 2019, 1.7 million are women (62 per cent of the total), and 1.6 million are working part-time (60 per cent of the total). Of course, there is significant overlap here - women working part time comprised more than two-in-five (43 per cent) of all minimum-wage workers in 2019. Minimum wage workers are also predominantly in the private sector (2.4 million in 2019 – 87 per cent of the total) and in three sectors in particular. In 2019, hospitality, wholesale and retail, and health and social Care together contain 3three-in-five minimum wage workers (58 per cent of the total).

On Monday the NLW enters its fourth year. The NLW is rising in value so that by October 2020 it will be equal to 60 per cent of median earnings (for those aged 25+), whereas in April 2015 it was worth 52 per cent. These increases are serving to extend the reach of the wage floor. In 2020, in just five years, the NLW will have doubled the proportion of employees paid the minimum from 6 per cent (representing 1.5 million workers) to 12 per cent (3.3 million workers).

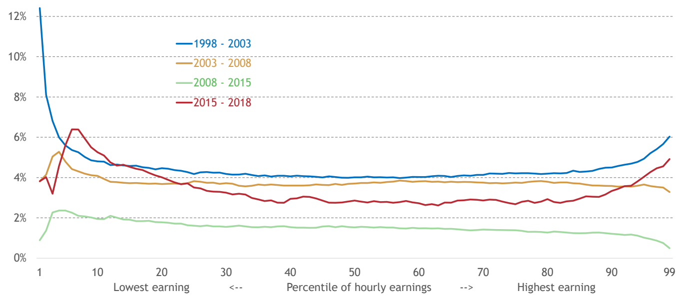
Figure 4: Proportion of employees paid at the wage-floor, 1999 to 2020 – select breakdowns



Source: RF analysis of ONS, *Annual Survey of Hours and Earnings*

Figure 4 charts the reach of the minimum wage across sub-groups of employees. It compares the coverage in 2015 (pre-NLW) with our projection of the reach in 2019 and 2020. Since Monday also marks the twentieth anniversary of the minimum wage's introduction in the UK, we also look back to 1999. Perhaps most startling is the impact the minimum wage is now having in the three largest low-paying sectors (those mentioned above). By 2020, one-in-three workers in hospitality will be paid the minimum wage. The policy is having a dramatic effect in that sector. In others, such as the public sector and finance, where pay is higher, the minimum wage has barely had any effect at all, and even the recent rises aren't changing that.

Figure 5: Average annual growth in real hourly pay, by percentile, for select periods



Source: RF analysis of ONS, *Annual Survey of Hours and Earnings*

The point of the minimum wage, of course, is to increase the wages of the lowest paid. Figure 5 shows that this goal has been achieved. Over the last twenty years, hourly pay growth has been strongest at the bottom of the distribution. The period after the policy's introduction (1999 to 2003), is particularly striking, as is the impact of the recent NLW increases, with strong hourly wage growth for lower earners in the last three years. Monday's uplift will see the NLW increase by 4.9 per cent, well above the current growth in average pay (in January the annual growth in average nominal weekly earnings was 3.4 per cent).

The debate has now turned to post-2020, with the Chancellor mooting an even more radical policy of 'ending low pay', which, based on the most widely used definition, would mean the minimum wage being set at 66 per cent of median earnings. This 66 per cent 'bite' would represent a leap into the unknown. Arin Dube's review of minimum wages will help, but he will have scant international evidence to draw on for such a high bite. Of rich countries only France's bite is comparable, and that's only 62 per cent. What's more, the differences between the two countries will make it hard to learn lessons directly. For example, in France most jobs are covered by collective bargaining arrangements, and there are extensive subsidies for employers hiring the low skilled and the young.

Still – the Chancellor's ambition is laudable, and a far cry from back in 1999 when the Conservatives opposed the minum wage's introduction. Today's political consensus on the minimum wage is highly welcome. On its twentieth birthday, it is pleasing to reflect on how far the minimum wage has come. Where once it was seen as a job-killer, now the only question is 'how high?'.

1 We define this group as those paid at or near (within 1 per cent) of the relevant minimum wage.

 This project was funded by the Nuffield Foundation, but the views expressed are those of the authors and not necessarily those of the Foundation.