In the three months to May 2019, nominal average weekly pay growth was 3.6 per cent, the fastest rate since the financial crisis. In real terms, this amounted to pay growth of 1.7 per cent, the fastest since late 2015, when inflation was near zero. In the same three months, the employment rate remained near a record high (76.0 per cent for 16-64 year olds) and unemployment at a record low (3.8 per cent). The big picture, then, is that the UK’s labour market remains tight, which continues to exert upward pressure on wage growth.

What are the prospects for future pay growth? One positive sign for the short term is on public sector pay. The pay settlement announced by the government last week gives above-inflation pay rises to several parts of the public sector including teachers (given 2.75 per cent) and police officers (2.5 per cent). These increases are below current average pay growth, but are high compared to recent pay growth in the public sector, which was frozen in 2010 and subjected to a 1 per cent cap between 2013 and 2017.

Even before this settlement was announced, the latest data shows public sector pay growth improving quickly. Average weekly regular pay in the public sector grew 1.6 per cent in real terms in the three months to May, compared to 1.1 per cent in the three months to April. Public sector pay growth is now not far off private sector pay growth (1.8 per cent in the three months to May).

However, the bigger picture on pay remains gloomy. Labour productivity – the ultimate driver of real pay - has now fallen for the last three quarters of data (the second half of 2018 and the first quarter of 2019). This continued weakness limits potential pay growth. Unfortunately, the outlook on productivity is poor – in its latest Inflation Report the Bank of England forecast zero productivity growth in 2019, improving to a still-low 1 per cent in 2020. The Bank places part of the blame on ‘elevated’ levels of Brexit-related uncertainty, which is dampening business investment.

Another note of worry is the re-emergence of self-employment as a driver of employment growth, accounting for almost half (47 per cent) of overall employment increases in the last 12 months. The self-employed are paid significantly less than employees, and so this trend might weigh on living standards improvements. In 2017-18, median annual pay for full-time workers (defined as those working at least 35 hours per week) was £20,500 for the self-employed compared to £26,400 for employees – a gap of 22 per cent.

Self-employment, and its relationship with the minimum wage, is the focus of our Spotlight piece on page 4. We challenge the idea that a higher minimum wage is pushing people into self-employment.

- Our earnings breakdown shows that real pay growth is strengthening, supported by changes in workforce composition.
- Our analysis of pay pressures and slack shows that the labour market is still tightening. Employment remains close to its record high, and underemployment is now at its lowest point this century.
- 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.
In the most recent data, real median pay grew by 1.2%. This is driven by both falling inflation and strengthening nominal pay.

The gap between employee earnings and those for all workers (i.e. including the self-employed) has remained broadly stable over the past year, at around 1.5%.

The boost to pay growth from workforce composition effects has continued to increase, mostly as a result of changes in the mix of occupations and education levels.

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

Both our headline measures of earnings inequality (r75:25 and r90:10) continue to fall. However, a measure comparing the very highest earners with the rest would see inequality increasing.

The unemployment rate continued to fall in 2019 Q1, reaching 3.8% - the lowest rate in more than 40 years. Long-term unemployment stayed flat at 1%.

Under-employment (net hours desired by those in work as well as the unemployed) has fallen by 11% over the past year. The measure is now at its lowest point in the 21st century.

Voluntary job-to-job moves (an indicator of a healthy labour market and worker confidence) regained some of the fall seen over the last three quarters. This measure remains significantly weaker than pre-crisis.

The share of jobs going to new migrants has risen slightly over the past year, to around 20%.

Labour force participation continues to rise and was up 0.6% up on the year in 2019 Q1. Increasing female participation is an important driver, with women now representing 47% of those economically active.

Labour productivity fell 0.2% on the year in 2019 Q1, a further deterioration in the already weak recent productivity data. This continues the pattern seen since the crisis.

While the proportion of people receiving 'off-the-job' training was slightly up over the past year at 6.6%, the long-term trend still shows a big fall in training intensity over the past 20 years.

The proportion of graduates in non-graduate roles remained unchanged in the last year. This suggests that labour market mismatch has not increased but remains elevated compared to previous years.
Headline wage growth continues to be supported by compositional effects

Changes in average pay depend, in part, on changes in the composition of the workforce – i.e. it’s not just about pay rises within jobs, but also the balance between high- and low-paying jobs. Over the past 10 years, the biggest compositional boost has come from the shift towards more highly qualified workers in the workforce. However, over the past three quarters, faster employment growth in higher-paid occupations has been a more important factor. In 2019 Q1, average weekly pay increased by 0.8 per cent as a result of this effect (the highest for at least 10 years), accounting for around a quarter of total nominal pay growth. Simple statistical models suggest that we should expect occupation and qualification effects to continue to support pay growth over the next year.

Unemployment to vacancy ratio suggests wage pressure, but this may be starting to ease

The ratio of the number of unemployed people to vacancies is a measure of ‘tightness’ in the labour market: if vacancies are high relative to unemployment, businesses may need to increase wages more to attract workers. The ratio’s long-term trend reflects the labour market tightening since 2014 – suggesting increasing wage pressure. But the most recent data tells a different story: the actual number of vacancies has fallen 3.9 per cent over the past five months, with particularly strong falls in sectors which are more exposed to the macroeconomic environment. For example, vacancies in construction fell by 7 per cent and in manufacturing by 12.5 per cent (both have also had weak output growth in 2019). If this picture continues, for example as a result of continued uncertainty around Brexit, and on the basis that unemployment is unlikely to fall markedly further, then wage pressure from vacancies is likely to ease.

The regional perspective

Part of the falling unemployment trend over the last five years has been a large fall in the proportion of the economically active workforce who have been out of work for more than a year. This pattern is seen across the UK, but there remains a wide gap between areas (Northern Ireland has a long-term unemployment rate almost four times higher than the South West). The trend of falling long-term unemployment has largely stopped over the past year, with the national rate flat and four UK regions/countries experiencing increases. Because those in long-term unemployment are often less well matched to available jobs, places with relatively high long-term unemployment may experience more upwards pressure on pay than headline unemployment implies. But if long-term unemployment reflects less dynamic labour markets, it might be associated with lower wage growth.
Two big changes in the labour market over the past two decades have been the rise in self-employment and the introduction and uprating of the minimum wage. Is there a connection between these trends?

Legally, of course, there is no connection - the minimum wage applies to employees only. But economically, we would expect one. A higher wage floor increases the cost of hiring employees, and makes self-employed workers relatively more attractive as a source of labour. All else equal, we would expect employers to respond by substituting employees for self-employed workers. Some have speculated that the minimum wage has contributed to the growth of self-employment. If this is true, it might be an argument against lifting the wage floor to 'ending low pay' levels, an ambition targeted by ex-Chancellor Philip Hammond.

The theory makes sense, but in practice it is hard to find much evidence of this happening (although as-yet unpublished research conducted by the Low Pay Commission indicates that there may be something going on in some areas\(^1\)). If the minimum wage was pushing up self-employment, we would expect the increase in self-employment to be greatest in the areas, occupations and industrial sectors where the minimum wage ‘bites’ the most (i.e. where the minimum wage is highest relative to average pay). But that doesn’t seem to be the case.

Figure 4: Change in self-employment as a share of all employment (2004-18) by bite of NMW in 2012

![Figure 4: Change in self-employment](image)

Notes: Bubble size corresponds to number of self-employed workers in 2018. The ‘bite’ is the minimum wage divided by median hourly pay.

Source: RF analysis of ONS, Annual Survey of Hours and Earnings; ONS, Annual Population Survey (via Nomis)

Figure 4 looks at the change in self-employment and the local bite of the minimum wage and finds no relationship. The same is true when we look at occupations and industries, and also when we look at the change in the bite as opposed to the level of the bite.

This is a surprising result. What explains it? One problem with Figure 4 is that it looks at overall self-employment growth, whereas we would not expect the minimum wage to have any effect on higher-paid self-employment (which accounts for more than half of the growth of self-employment over the last decade\(^2\)). However, repeating Figure 4 with only lower-paid occupations (caring, sales, and elementary occupations) still shows no relationship. Another explanation might be that the theory is correct but hard to observe in the presence of other, more important, factors. We have argued in the past, for example, that the most important driver of the growth of self-employment is its favourable treatment in the tax system.\(^3\)

A third explanation is that self-employed wages have risen in line with increases to the minimum wage, thereby dulling the incentive for employers to substitute. Far from firms having the power to force low-paid workers into self-employment, the availability of low-paid employment on a fast-rising minimum wage might cause self-employed wages to increase. If employers respond to the minimum wage by switching demand to self-employed workers but struggle to recruit them, or if the self-employed respond to higher wages by choosing to become employees, thereby lowering the supply of that type of lower-paid self-employed worker, their price (earnings) would increase.

There is some evidence of this happening. Figure 5 shows the distribution of hourly pay for employees and the self-employed relative to overall typical pay in 1997-99 (before the minimum wage was introduced) and in 2016-18. The effect of the minimum wage on employees is seen in the ‘spike’ in the 2016-18 data, which is the level of the minimum wage. Interestingly, there is some sign that the self-employed wage distribution is also more bunched around the level of the minimum wage.

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1. Low Pay Commission, Low Pay Commission research 2018, February 2019
3. C D’Arcy & L Gardiner, Just the job or a working compromise? The changing nature of self-employment, Resolution Foundation, May 2014
Much like employee pay growth, the result of these shifts is that earnings growth for the self-employed has been strongest for the lowest earners since the introduction of the minimum wage. Hourly real earnings have increased by 51 per cent for the bottom fifth of self-employed workers since 1998-99, compared to growth of around 15 per cent in the top half of the self-employed hourly pay distribution.

Figure 5: Distribution of workers by hourly pay relative to median, 1996-98 and 2016-18, for self-employed and employees

<table>
<thead>
<tr>
<th>Hourly pay as % of all-worker median</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employees: pre minimum wage</td>
</tr>
<tr>
<td>Employees: latest</td>
</tr>
<tr>
<td>Self-employed: pre minimum wage</td>
</tr>
<tr>
<td>Self-employed: latest</td>
</tr>
<tr>
<td>All worker median hourly pay</td>
</tr>
</tbody>
</table>

Notes: ‘Latest’ refers to the average of years 2016-17 and 2017-18. Pre-minimum wage refers to the average of years 1996-97 and 1997-98. Hourly pay is derived from positive total weekly pay from employee or self-employed earnings divided by total hours worked.

Source: RF analysis of DWP, Family Resources Survey

Of course, connecting this change to the minimum wage is speculative. Other factors, such as compositional changes, will have shaped self-employed wage growth. And the more important conclusion from Figure 5 is surely the high prevalence of low pay among the self-employed. In the FRS data, 17 per cent of employees are low paid – earning less than two-thirds of median hourly employee pay. On the same measure, 37 per cent of the self-employed are low paid. On a weekly basis, 28 per cent of employees are low paid, compared to 49 per cent of the self-employed. This suggests that, even if incentives to substitute out employees have been dulled by self-employment wage growth, they still exist.

To return to the question raised at the outset, the evidence here suggests that if there is a connection between the minimum wage and self-employment, the balance of evidence points to a positive one (improving self-employed wages) rather than a negative one (driving people into low-paid self-employment).

But despite recent improvement, the problem of low pay among the self-employed is significant. Other policies are needed to help this group.