

# The UK labour market: Out of Rehab?

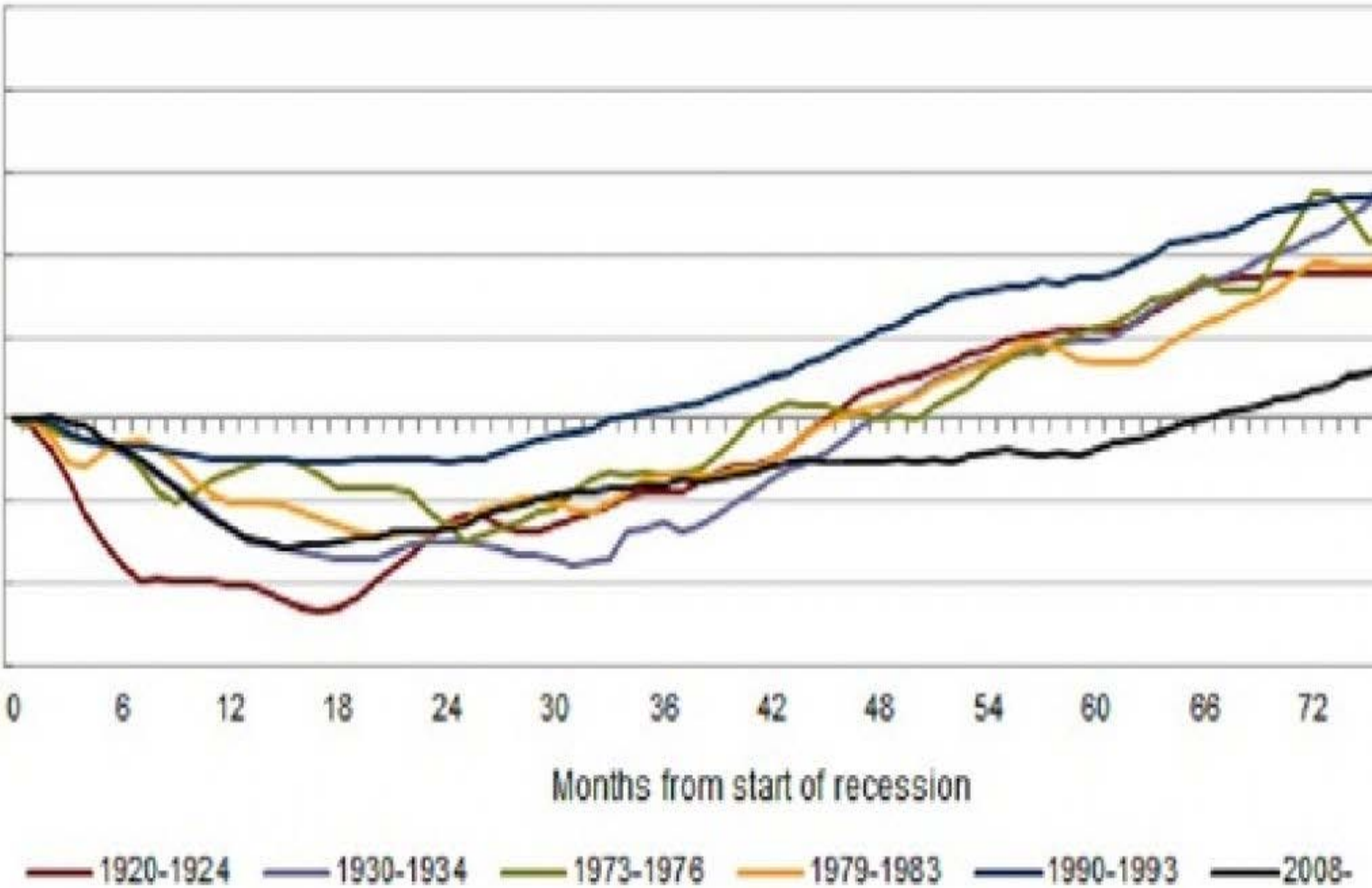
John Van Reenen

Resolution Foundation

October 19<sup>th</sup> 2014



# Worst Recession ever? Cumulative GDP change from start of downturn



Source: NIESR, downloaded October 2014

# **Wage Blues**

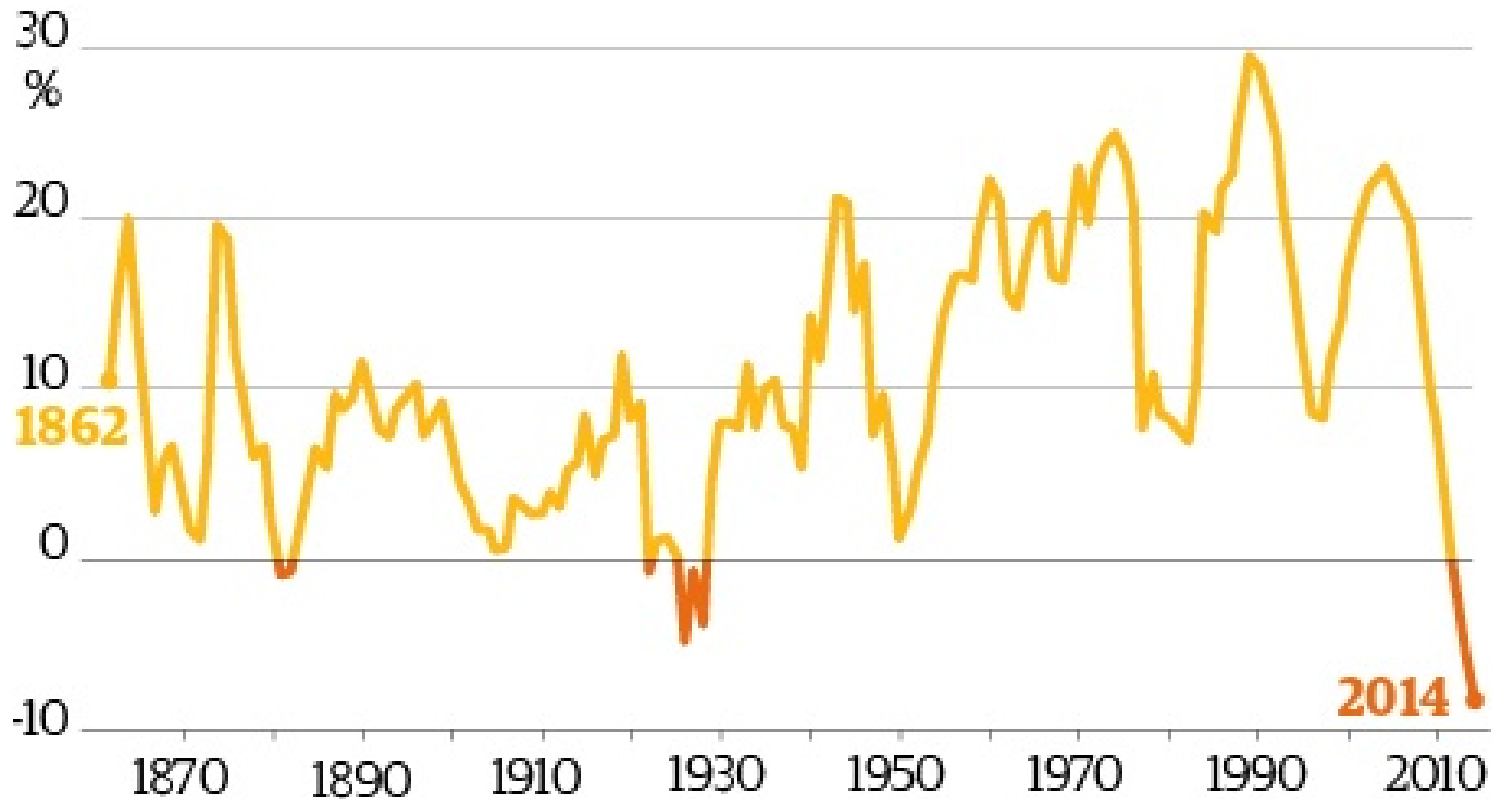
Jobs boom

Productivity puzzle

Putting it all together

# The longest real wage squeeze ever?

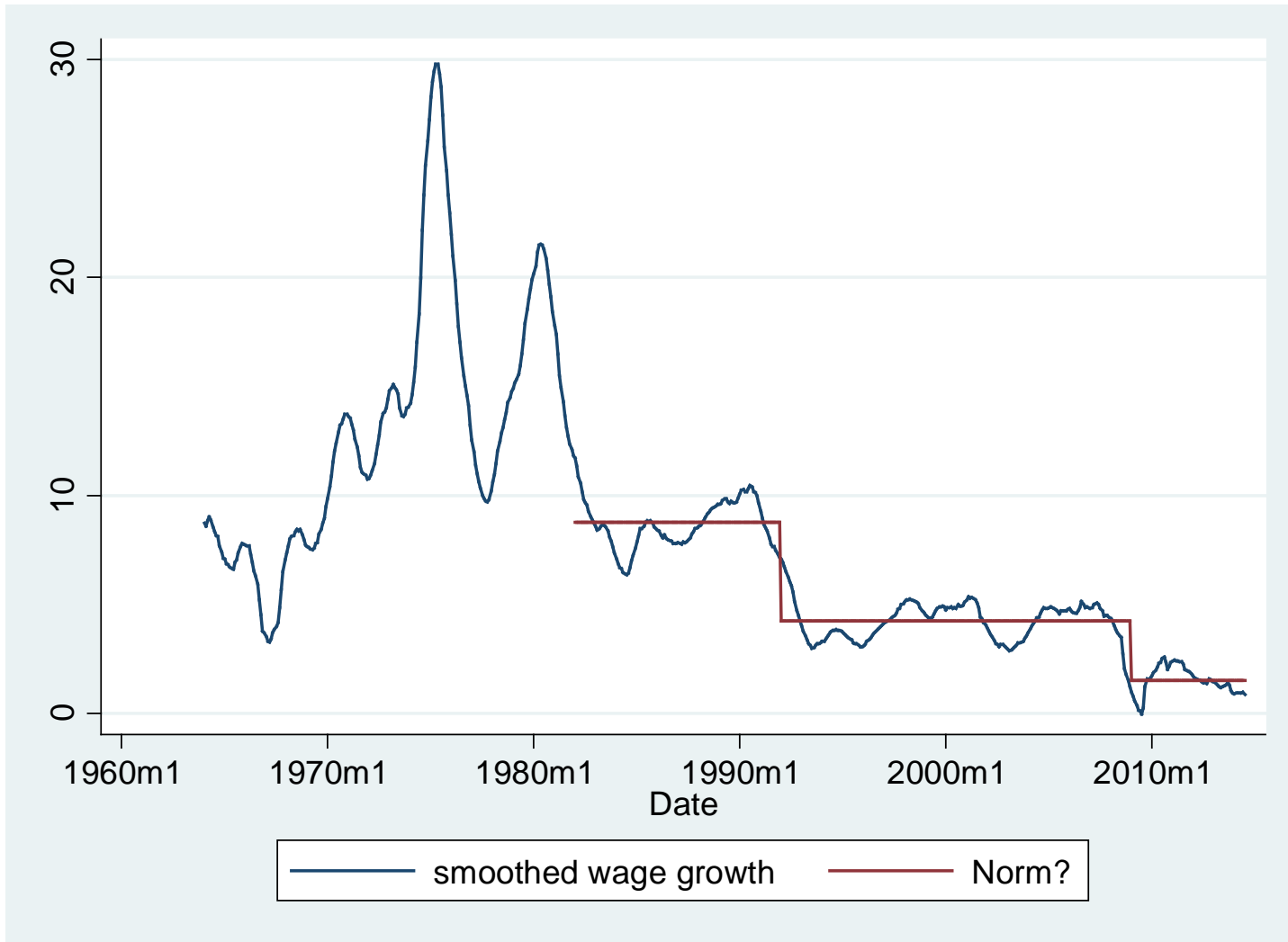
## UK real wages Change over previous seven years



OBSERVER GRAPHIC

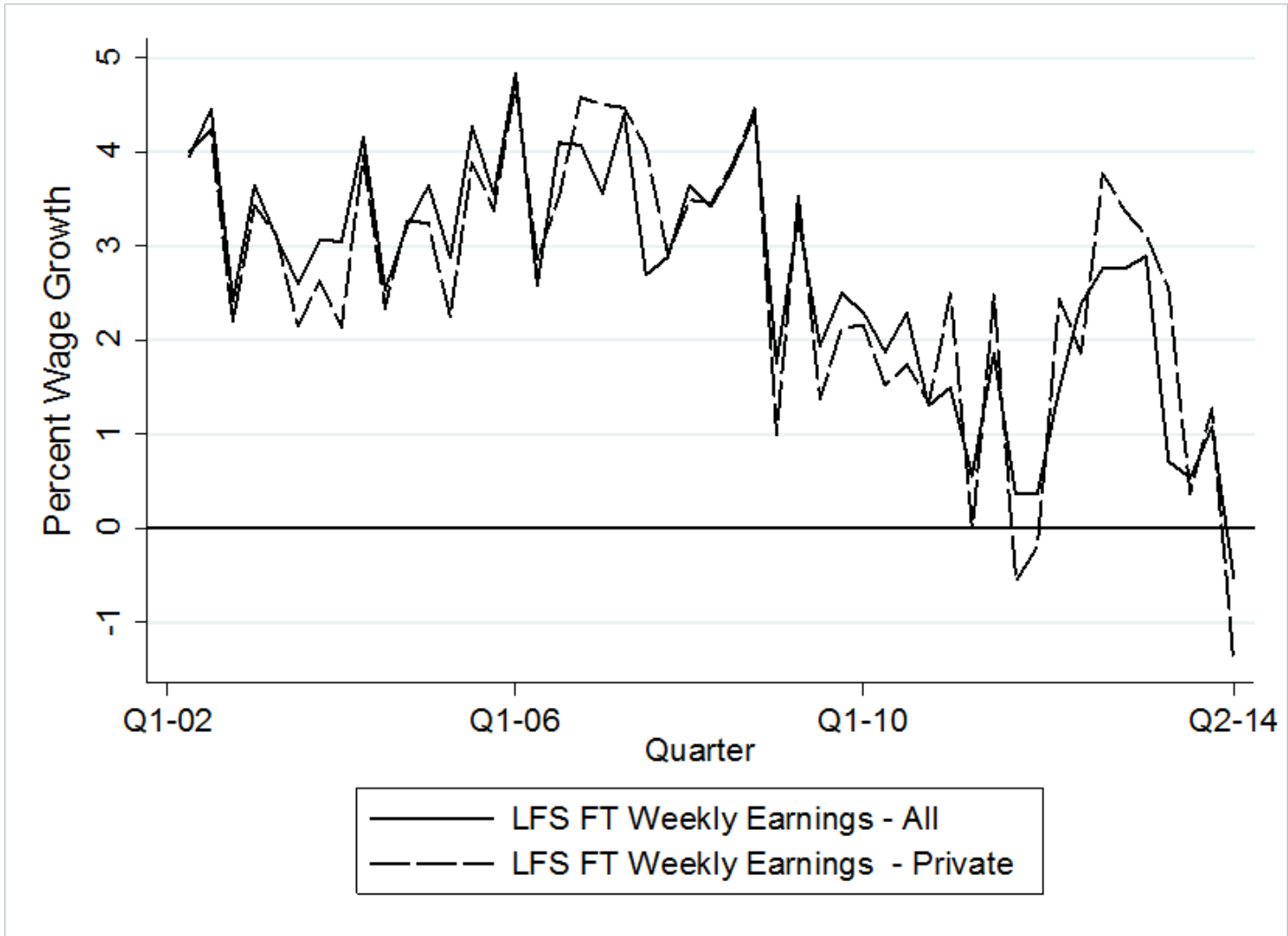
SOURCES: BANK OF ENGLAND, FT RESEARCH

# Nominal Annual Wage Growth (AWE), smoothed



Source: Manning (2014)

# LFS Annual Weekly Earnings Growth



Source: Blanchflower and Machin (2014)

Wage Blues

**Jobs boom**

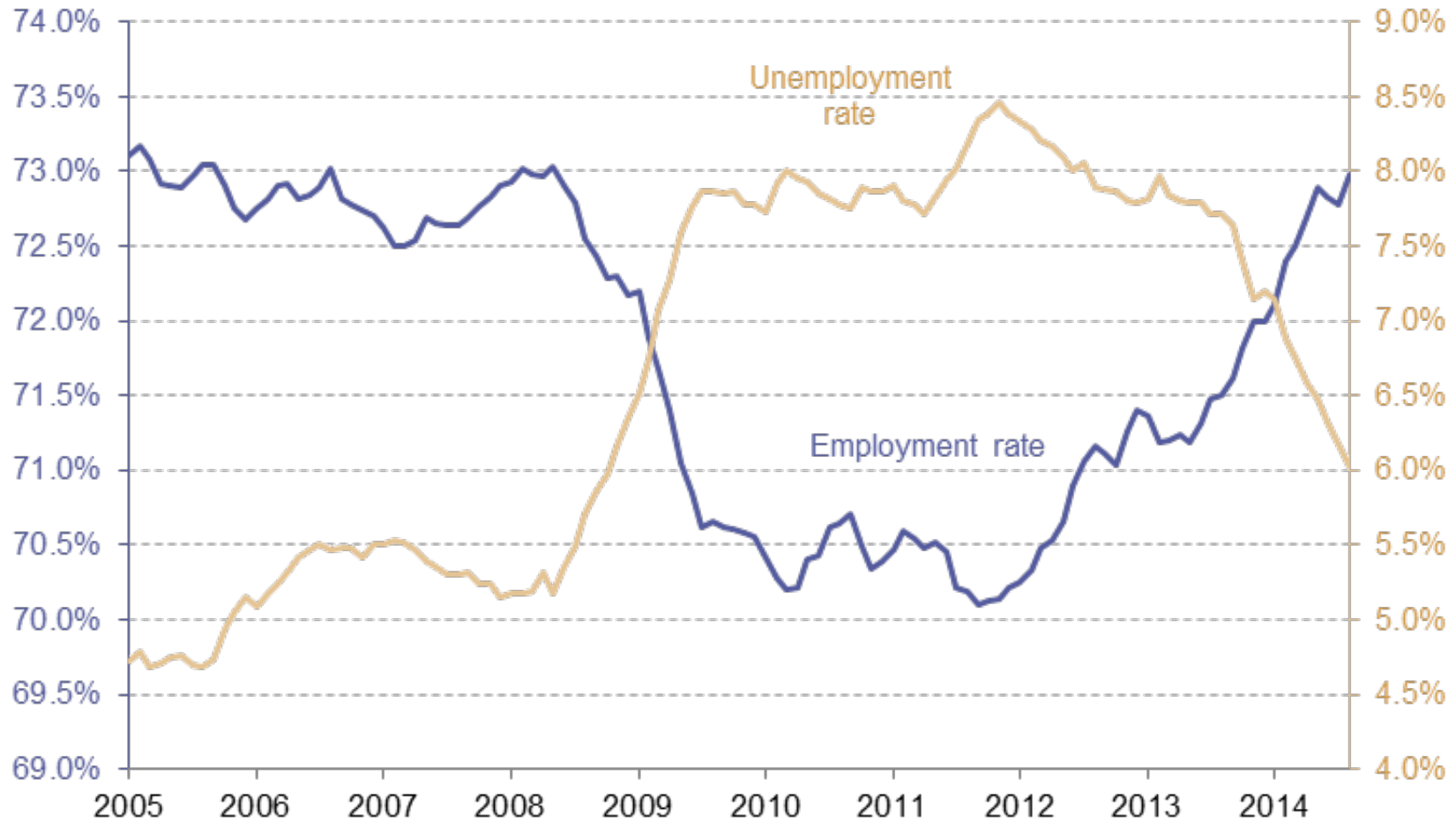
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# The UK jobs miracle?

Employment rate: 16-64 year-olds

Unemployment rate: 16+ year-olds



Source: RF analysis of ONS, Labour Market Statistics



Wage Blues

Jobs boom

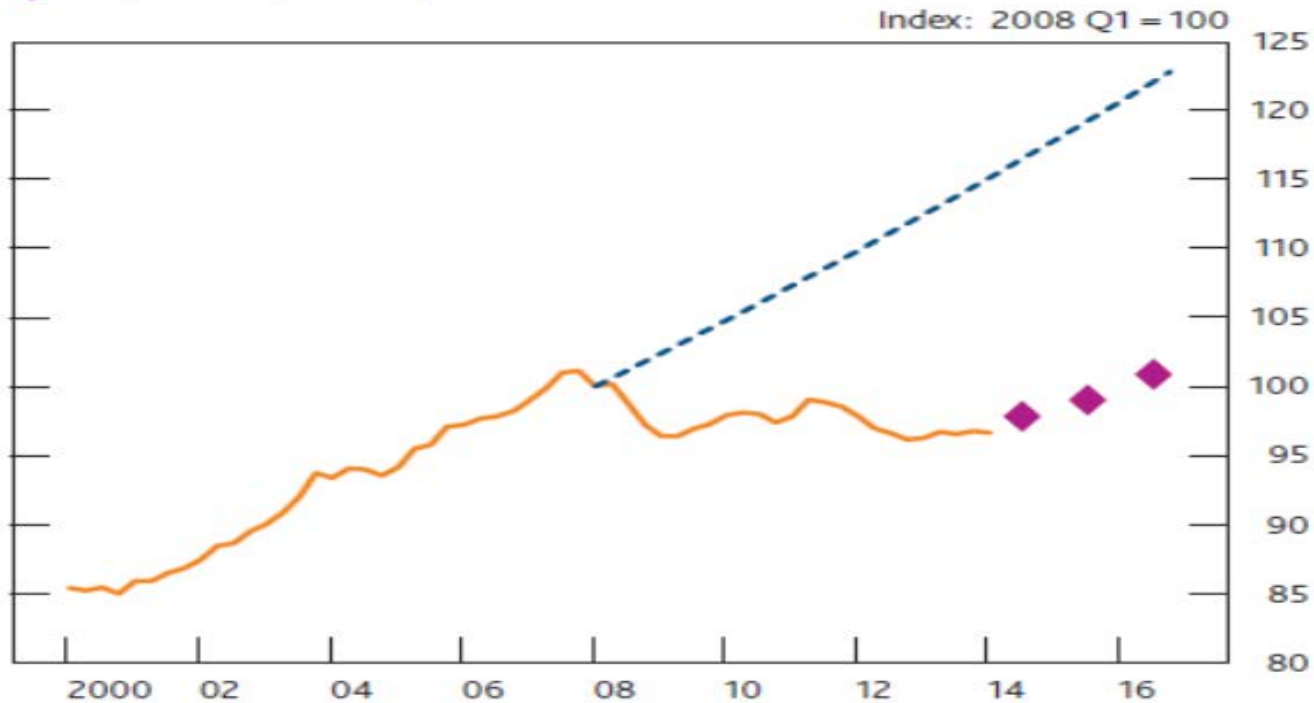
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# The Productivity Puzzle

Chart 1 Whole-economy labour productivity per hour

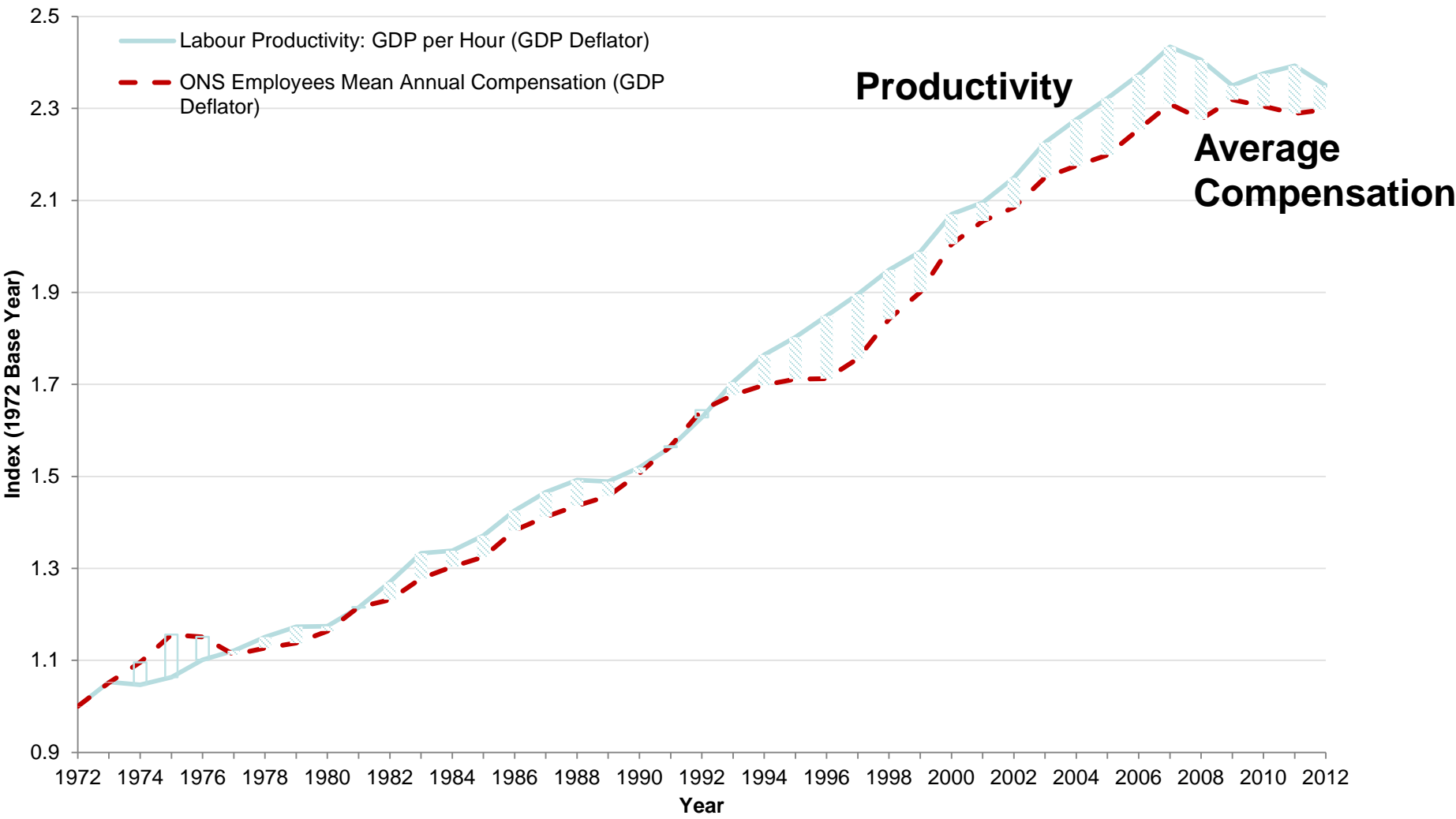
- Output per hour
- - Continuation of pre-crisis trend<sup>(a)</sup>
- ◆ May 2014 *Inflation Report*



Sources: ONS and Bank calculations.

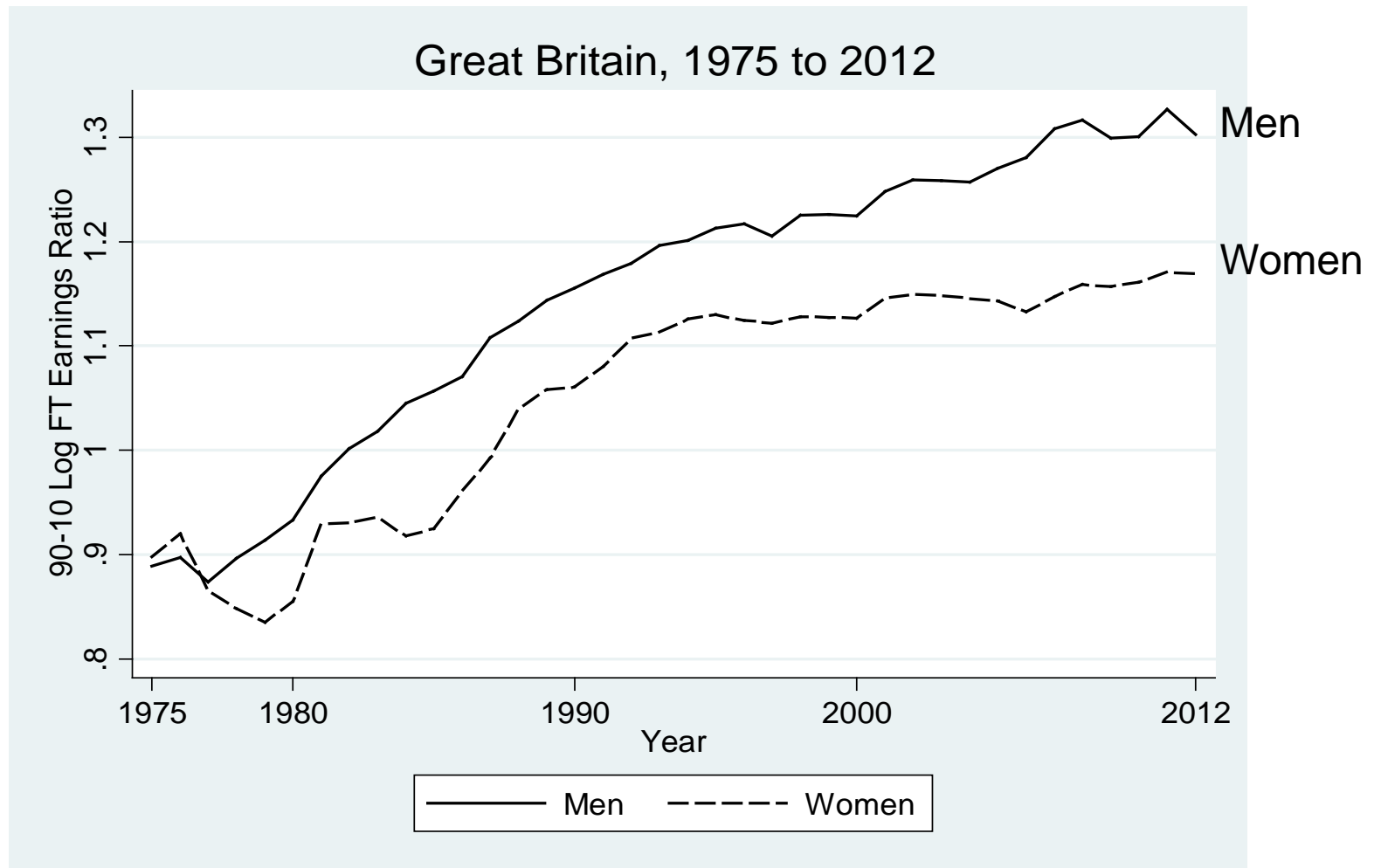
(a) Pre-crisis trend growth is calculated between 1997 and 2008 Q1, and is projected forward from 2008 Q1.

# OVER LONG-HAUL COMPENSATION (WAGE + NON-WAGE BENEFITS) GROWTH TRACKS PRODUCTIVITY GROWTH, 1972-2012



Source: Pessoa and Van Reenen (2014), 1972=1

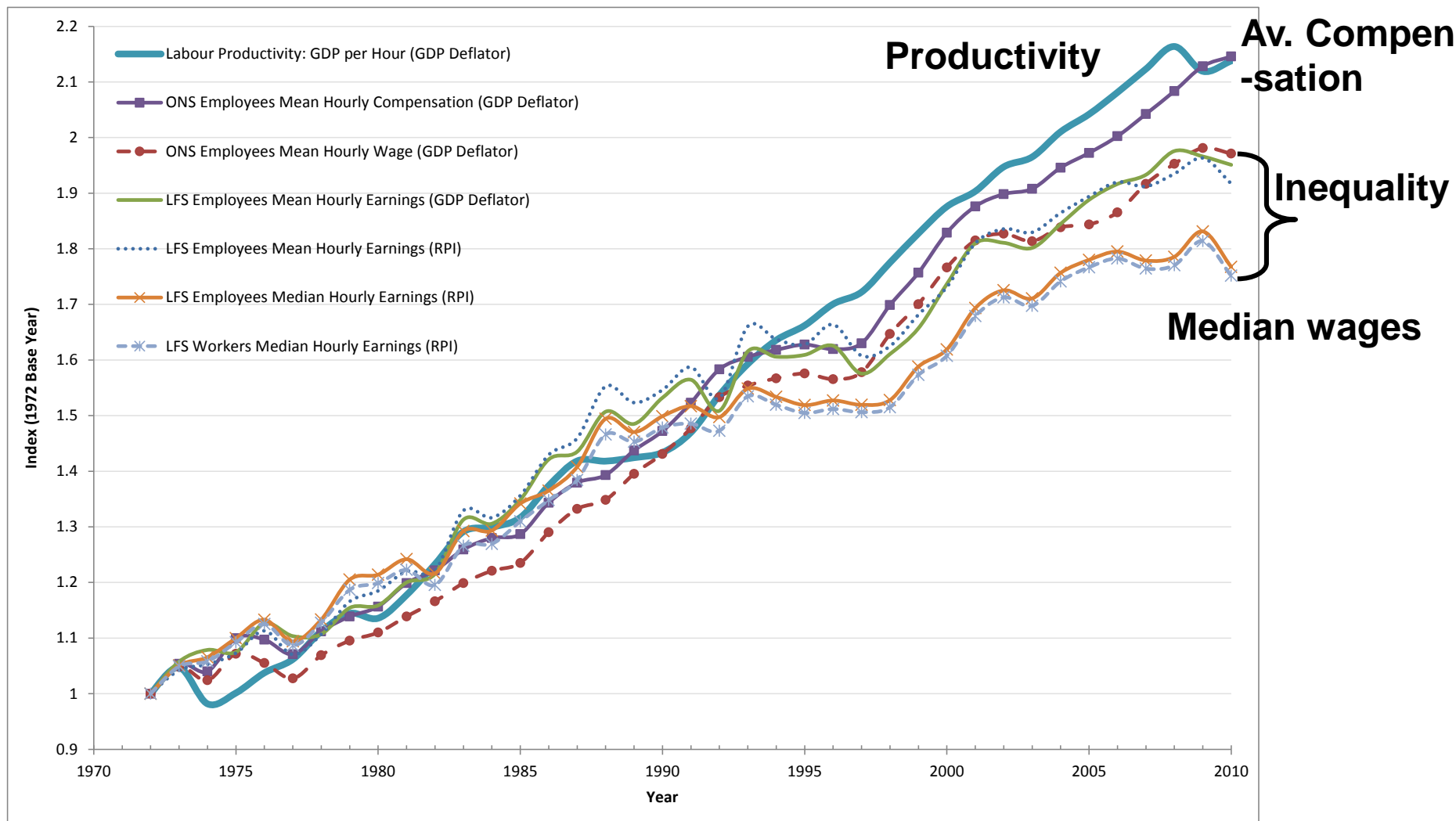
# BUT WAGE INEQUALITY HAS RISEN DRAMATICALLY (PERCENTAGE DIFFERENCE IN PAY BETWEEN TOP AND BOTTOM 10% OF EARNERS)



**Notes:** UK data, 1968-96 (NES) 1997-2012 (ASHE); 90-10 log weekly earnings ratios, full-time, 1975-2012

For more see CEP video, <https://www.youtube.com/watch?v=tvN8zvovDrY>

# ....MEANING MEDIAN WAGES DIVERGE FROM AVERAGE WAGES & PRODUCTIVITY GROWTH



**Source:** Pessoa and Van Reenen (2013), Resolution Foundation & CEP

<http://cep.lse.ac.uk/pubs/download/dp1246.pdf>

Wage Blues

Jobs boom

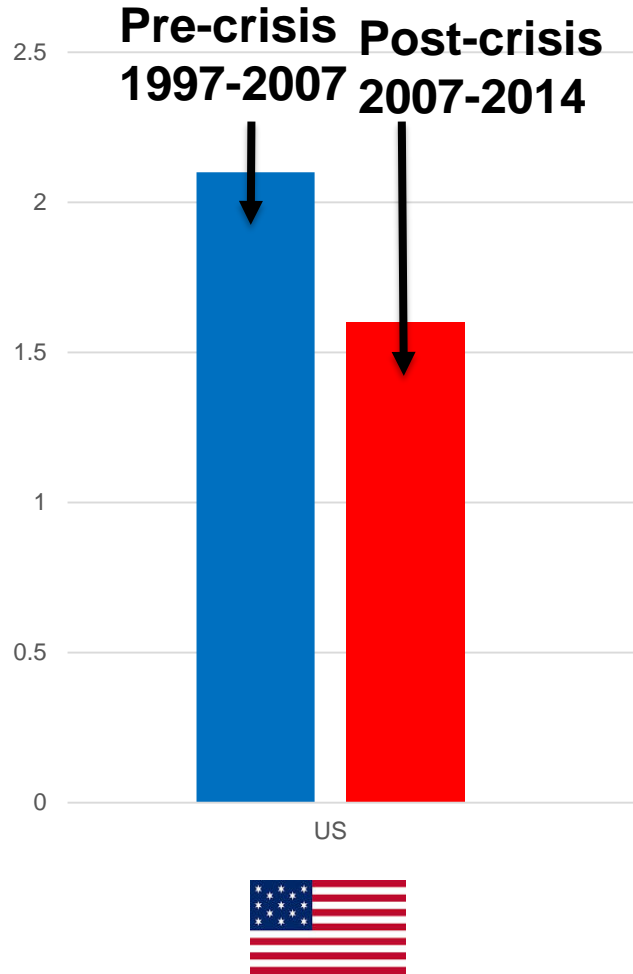
Productivity puzzle

**Putting it all together**

# SUPPLY SIDE PESSIMISTS

- Financial crisis caused/revealed a much lower level of structural UK productivity
- Real wages have to fall to reflect this
- Recessions generally cause some permanent loss of output (relative to pre-recession output)
  - The issue is how big is the fall of potential output and hence the equilibrium wage adjustment
- Related story is that the long-run steady state rate of productivity growth has fallen, so real wage growth must be lower than it was historically
  - Not just UK – an international malaise of advanced economies (Robert Gordon; Larry Summers; etc.)

# Average Labour Productivity (GDP per worker) Growth before and after the Global Financial Crisis

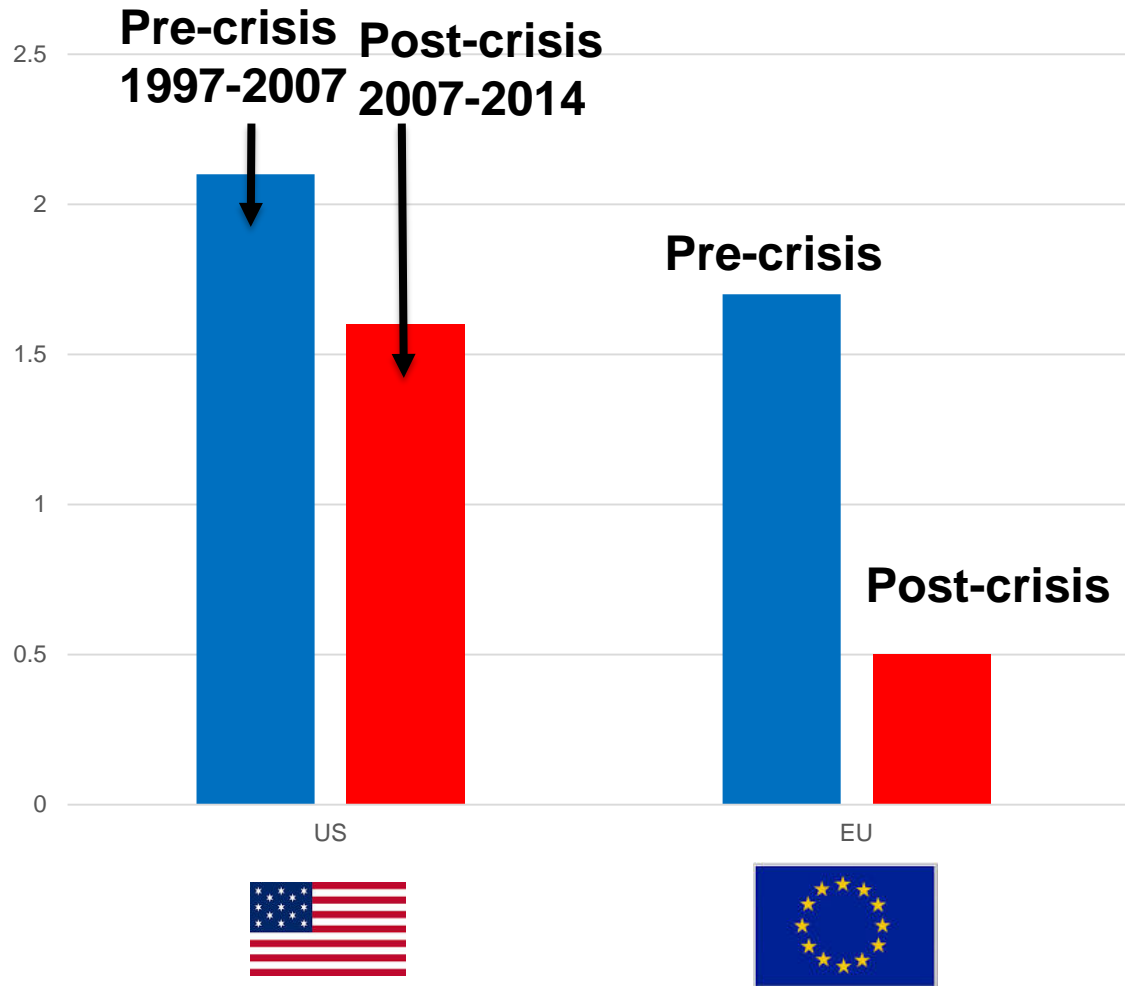


**Source:** Conference Board (2014), TED Table 9 derived

[https://www.conference-board.org/retrievefile.cfm?filename=SummaryTables\\_Jan20141.pdf&type=subsite](https://www.conference-board.org/retrievefile.cfm?filename=SummaryTables_Jan20141.pdf&type=subsite)



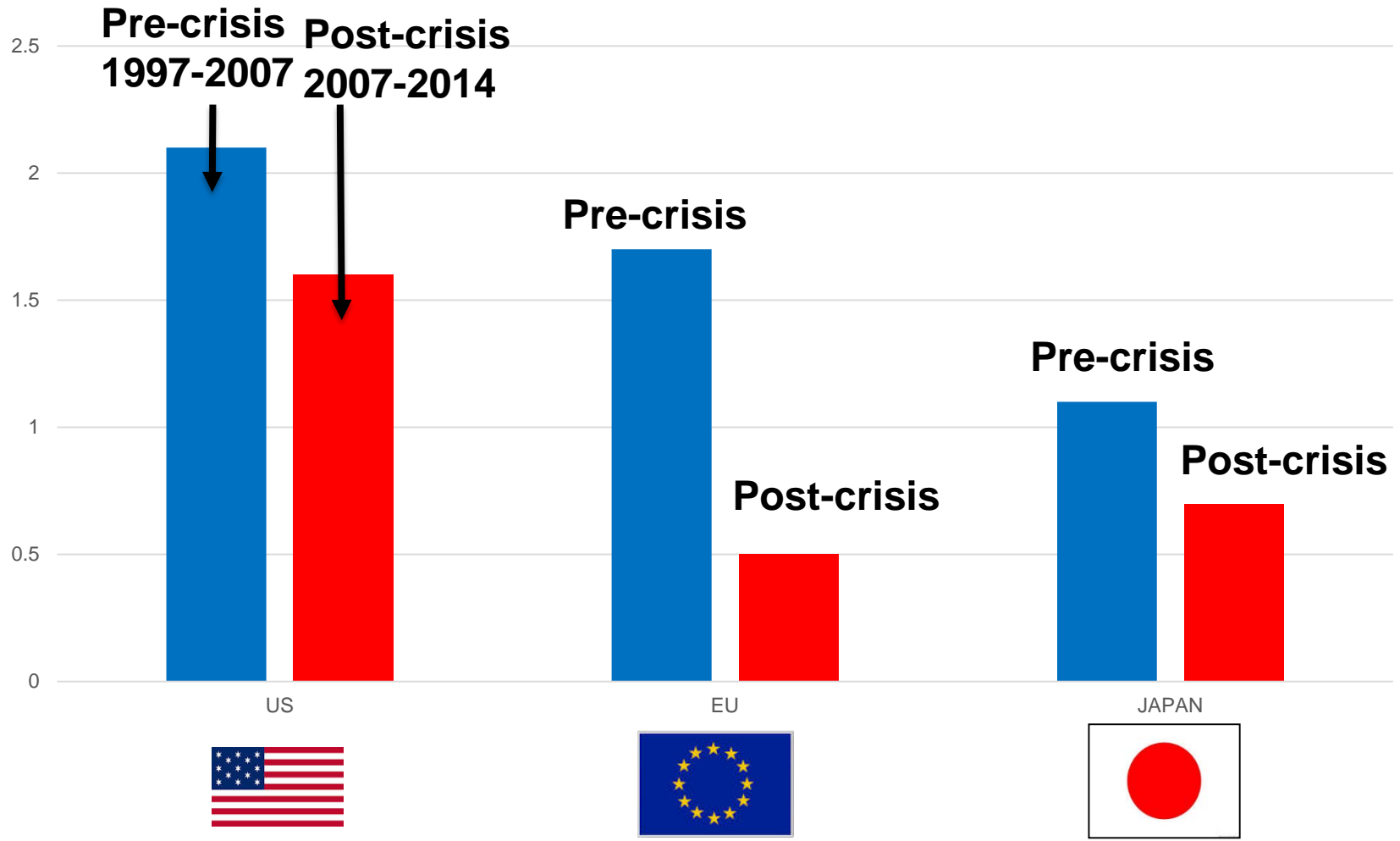
# Average Labour Productivity (GDP per worker) Growth before and after the Global Financial Crisis



**Source:** Conference Board (2014), TED Table 9 derived

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# PROBLEMS FOR THE PESSIMISTS

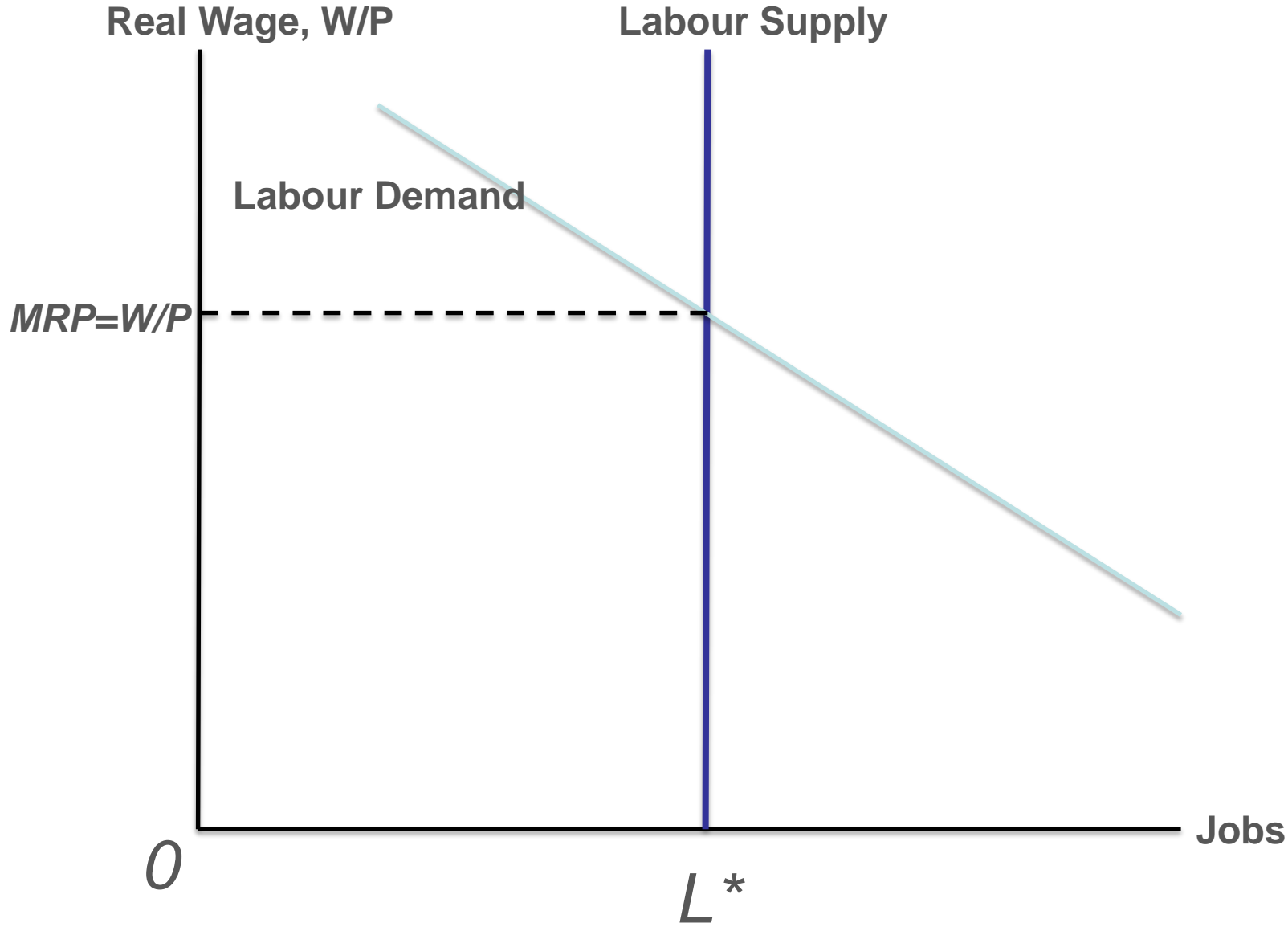
- Market economies have usually bounced back after recessions (even after big downturns like 1930s): productivity growth rates pretty steady
- In fact, UK bridged a fair bit of productivity gap with peers like US, France & Germany in the 1980-2007 period (see LSE Growth Commission)
  - This wasn't just finance (only 14% of measured productivity growth 1997-2007 due to fin. services)
- So why should this time be so radically different?
  - Evidence from financial crises mainly LDCs
- Pessimism an (understandable) psychological reaction to worst recession since inter-war period



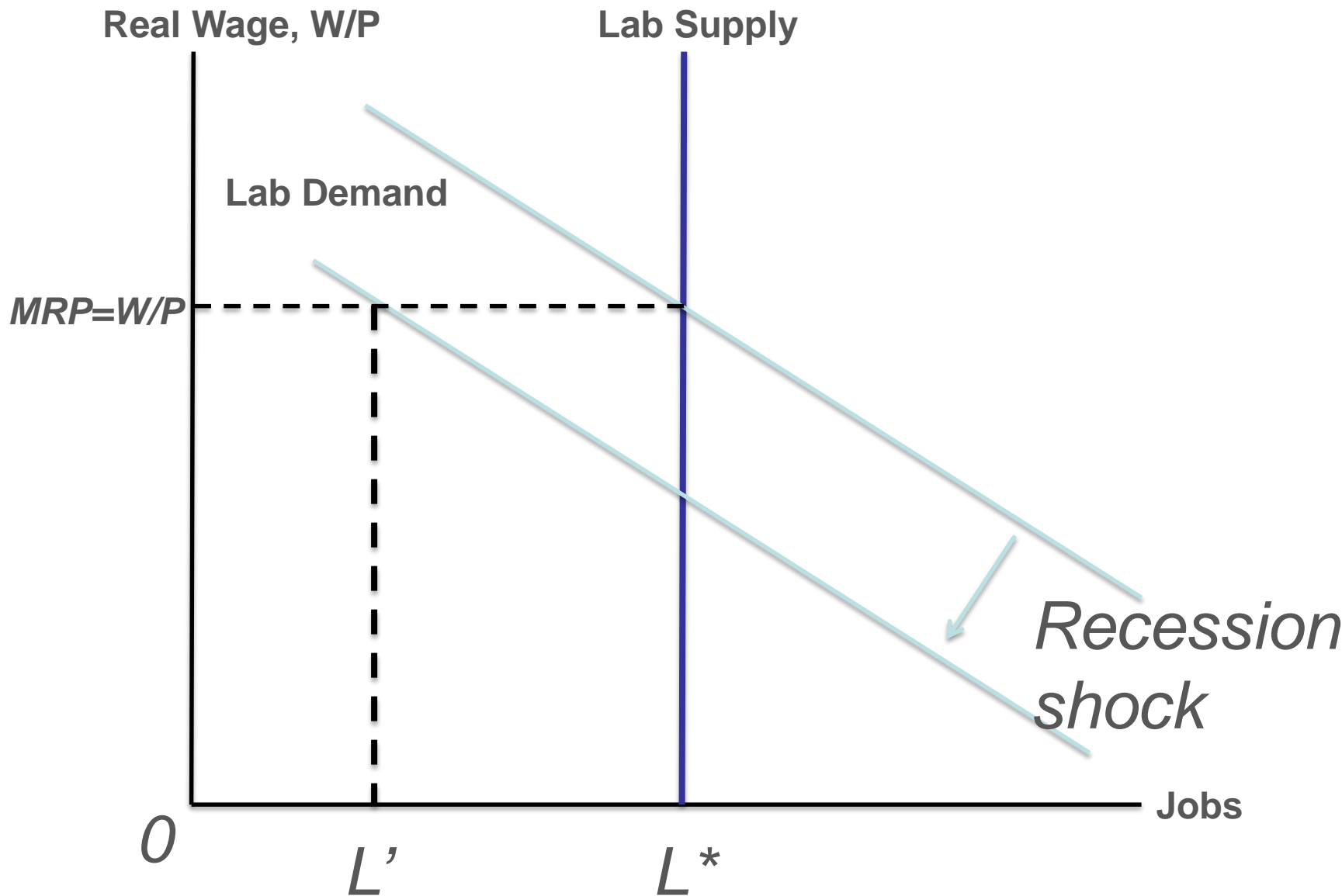
# A MORE OPTIMISTIC STORY: DEMAND SHOCKS IN A FLEXIBLE LABOUR MARKET

- Global financial Crisis 2008-2009
- Premature austerity after 2010 (e.g. 50% cut in public investment only partially reversed post 2012)
- Euro-crisis
- Different response of UK labour market to previous recessions because of flexible labour markets
  - Steady fall in union power
  - Welfare reforms keep people looking for jobs
- So in this recession real wages took brunt of adjustment instead of unemployment
- But flipside is low capital investment because people cheaper than machines & therefore low labour productivity (GDP per hour)
  - Not a big fall in structural productivity (“TFP”)

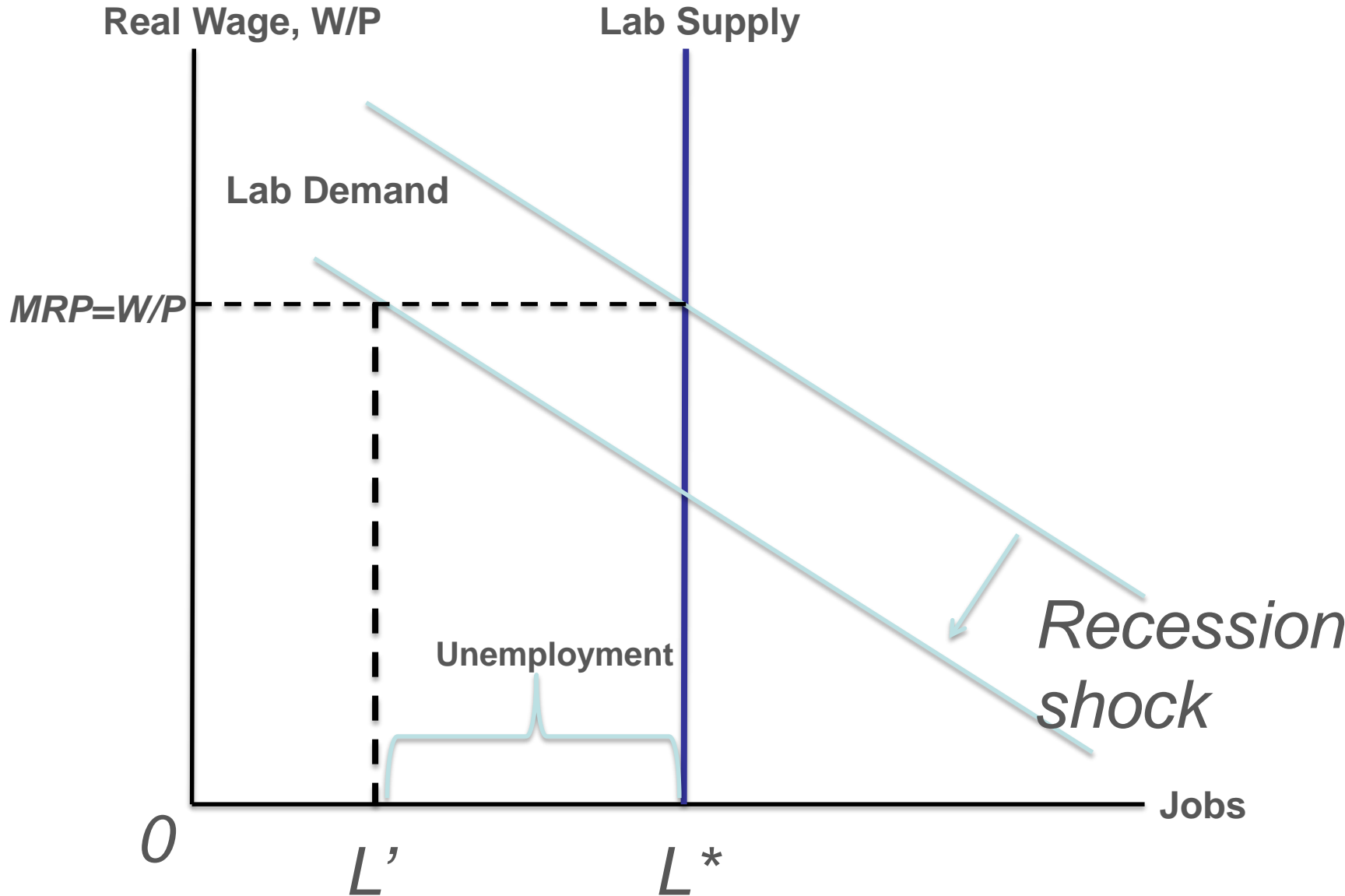
# NEGATIVE OUTPUT SHOCK & RIGID WAGES – LABOUR PRODUCTIVITY STABLE (“NORMAL RECESSION”)



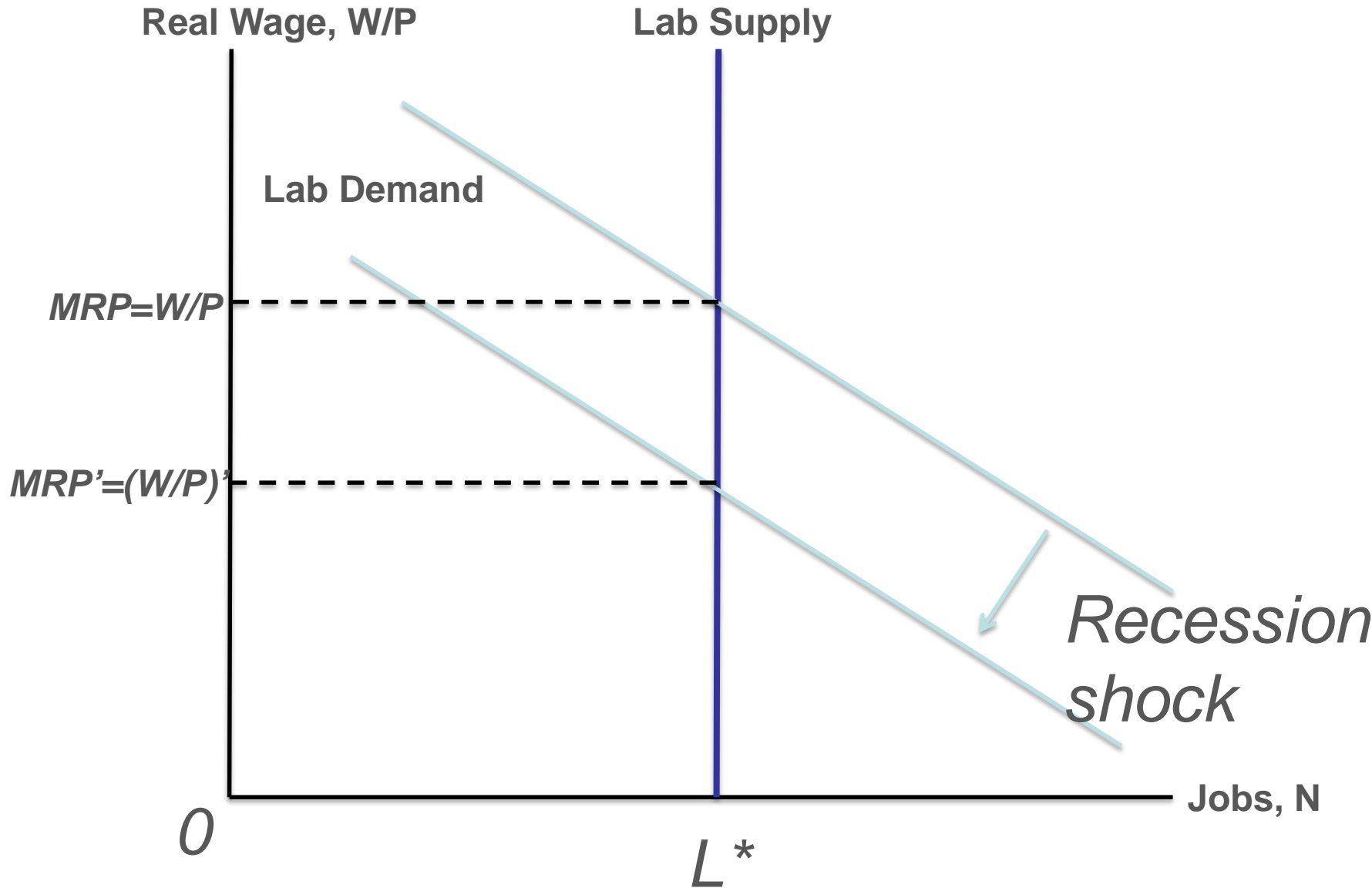
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# NEGATIVE OUTPUT SHOCK & RIGID WAGES – LABOUR PRODUCTIVITY STABLE (“NORMAL RECESSION”)



# NEGATIVE OUTPUT SHOCK & FLEXIBLE WAGES – LABOUR PRODUCTIVITY FALLS (“NEW NORMAL”)





**FIGURE 11: THE COLLAPSE OF REAL INVESTMENT,  
2008-2012 (2008Q2=100)**



Source: ONS (August, 2013), GFCF chained volume 2010 reference year series NPQT

# CHANGE OF TFP IN THREE RECESSIONS



**Note:** TFP = “Total Factor Productivity” (productivity after controlling for capital and hours) whole economy; 1970s recession is 1973-1978 (so 1 = 1973, 2 = 1974, etc); 1980s recession is 1979-1984; “Current” is 2007-2012. 1970s 1980s TFP data from EU KLEMS. 2000s authors’ estimates from ONS data

**Source:** Pessoa and Van Reenen (2014), <http://cep.lse.ac.uk/pubs/download/special/cepsp31.pdf>

# POLICY IMPLICATIONS

- As UK economy recovers, so will productivity and so will average real wages
- Keep demand strong
  - Loose monetary policy
  - Support public investment
  - Expand demand in Eurozone
- Inequality issue still remains – but this is long run issue of rising demand for more skilled workers
- Big increases in wages prior to a recovery in productivity will lead to inflation
- Whichever party wins in 2015, very tough times ahead for public sector spending (& public sector wages)

# FURTHER READING

- “The UK Productivity and Jobs Puzzle: Does the Answer Lie in Wage Flexibility?” (with Joao Pessoa), *Economic Journal* (2014), 124, 433-452  
<http://cep.lse.ac.uk/pubs/download/special/cepsp31.pdf>
- “Has ICT Polarized Skill Demand? Evidence from Eleven Countries over 25 Years” (with Guy Michaels and Ashwini Natraj), *Review of Economics and Statistics* (2014) 96(1) 60–77  
<http://cep.lse.ac.uk/pubs/download/dp0987.pdf>
- “UK Productivity under Labour” *Oxford Review of Economic Policy* (2013) 29 (1): 113-141  
[http://cep.lse.ac.uk/conference\\_papers/15b\\_11\\_2011/CEP\\_Report\\_UK\\_Business\\_15112011.pdf](http://cep.lse.ac.uk/conference_papers/15b_11_2011/CEP_Report_UK_Business_15112011.pdf)
- “Decoupling of wage growth and productivity growth: myth and reality” (with Joao Pessoa), CEP Discussion Paper 1246  
<http://cep.lse.ac.uk/pubs/download/dp1246.pdf>



# MOTIVATION

- World is still suffering hangover from global financial crisis. EU growth particularly weak
  - Needs more Draghi/Abe treatment
- UK has very slow recovery
- But mixed news from labour market

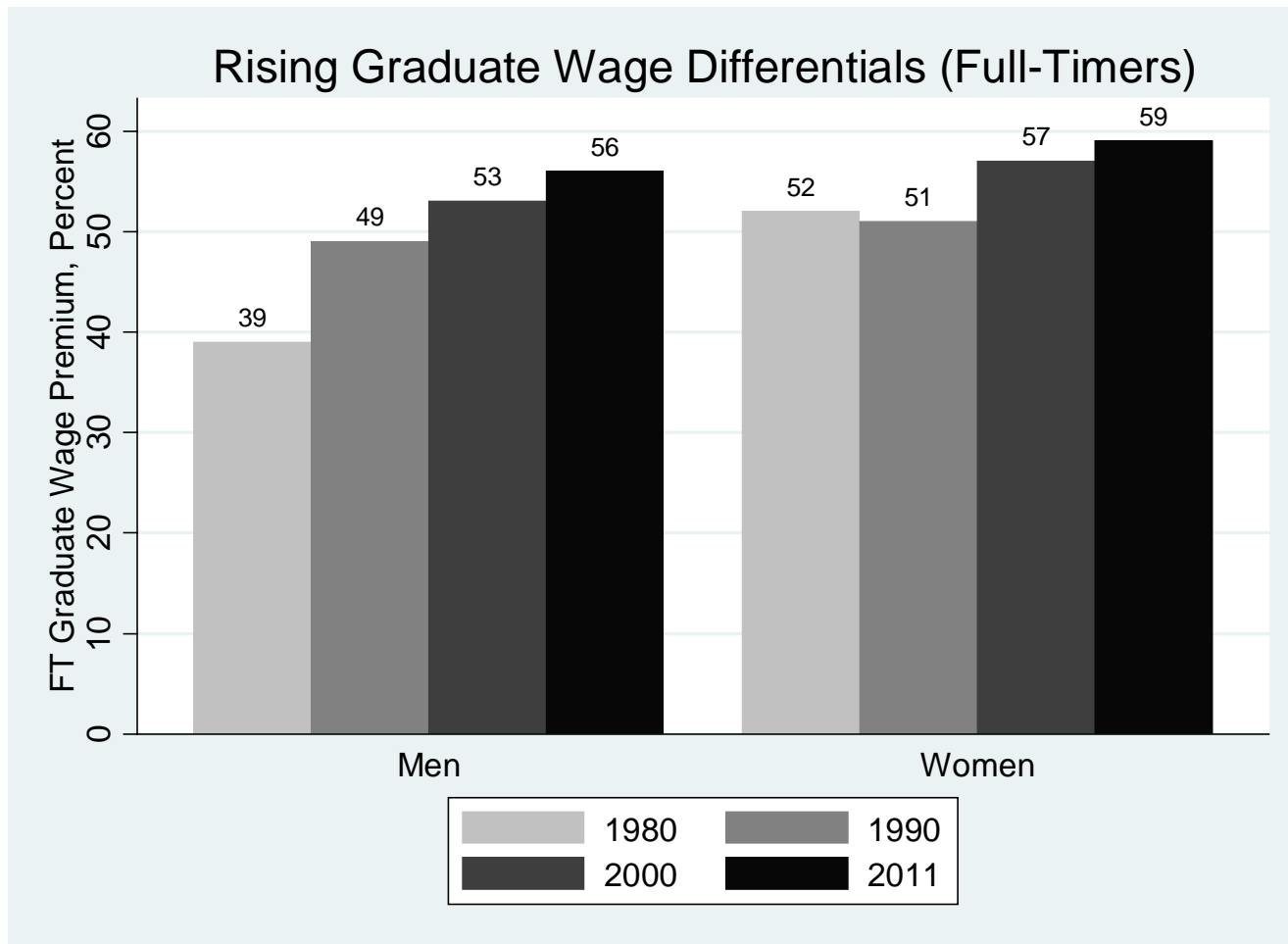


Mario Draghi

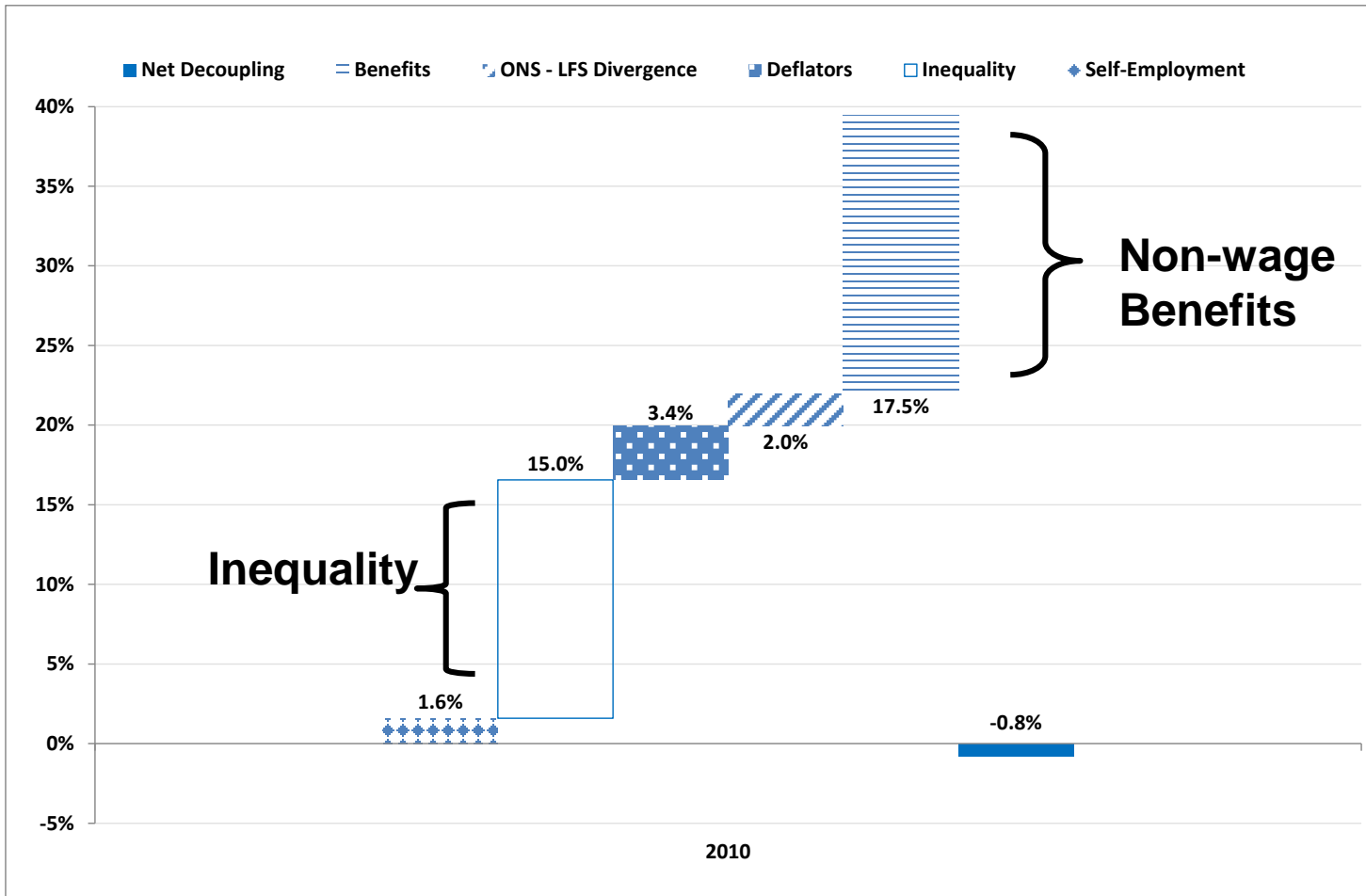


Shinzō Abe

# RISING GRADUATE WAGE DIFFERENTIALS IN UK: DEGREE PREMIUM RISES FROM 39% TO 56% 1980-2011



# MEDIAN WAGE GROWTH DIVERGES FROM PRODUCTIVITY GROWTH BECAUSE OF INEQUALITY & PENSIONS



Source: Pessoa and Van Reenen (2013), Resolution Foundation & CEP

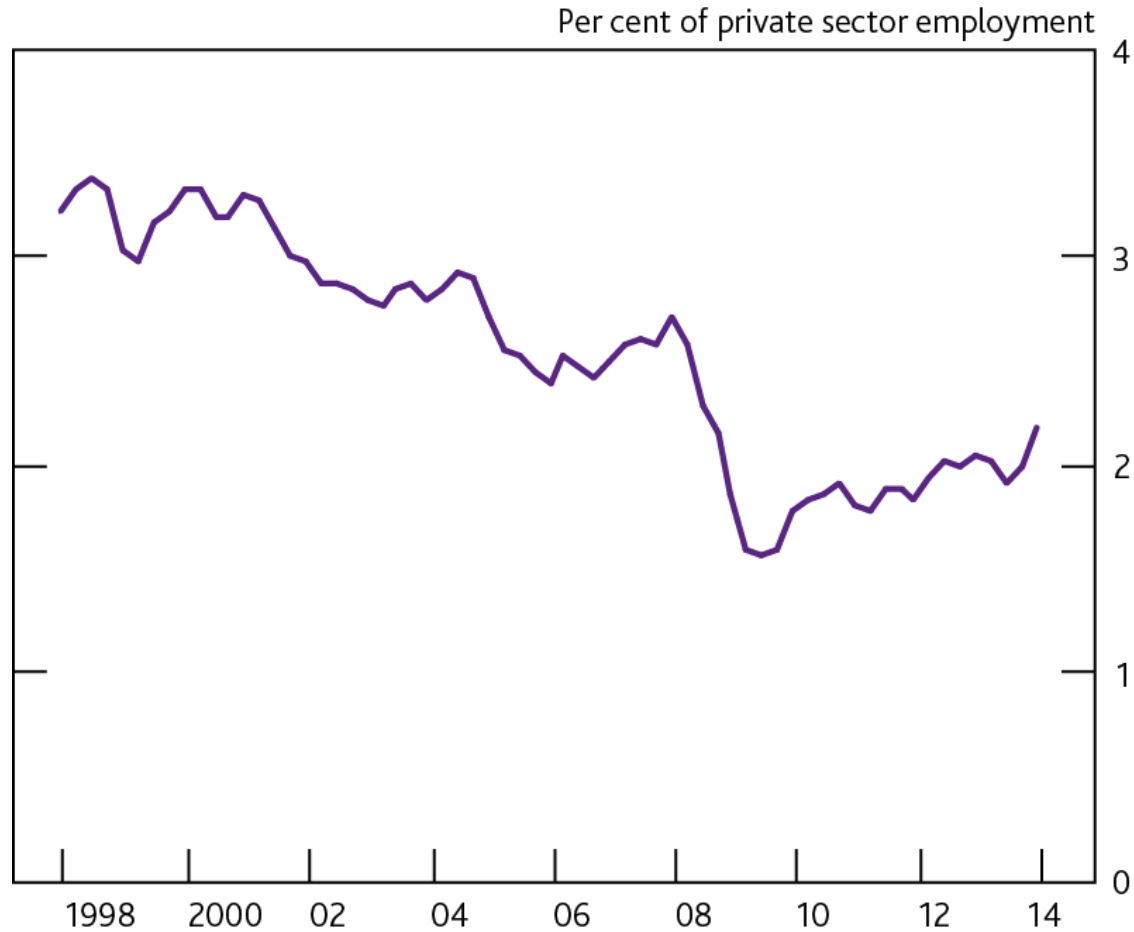
<http://cep.lse.ac.uk/pubs/download/dp1246.pdf>



# BofE August Inflation Report

## Chart 3.4 Job-to-job flows below pre-crisis rates

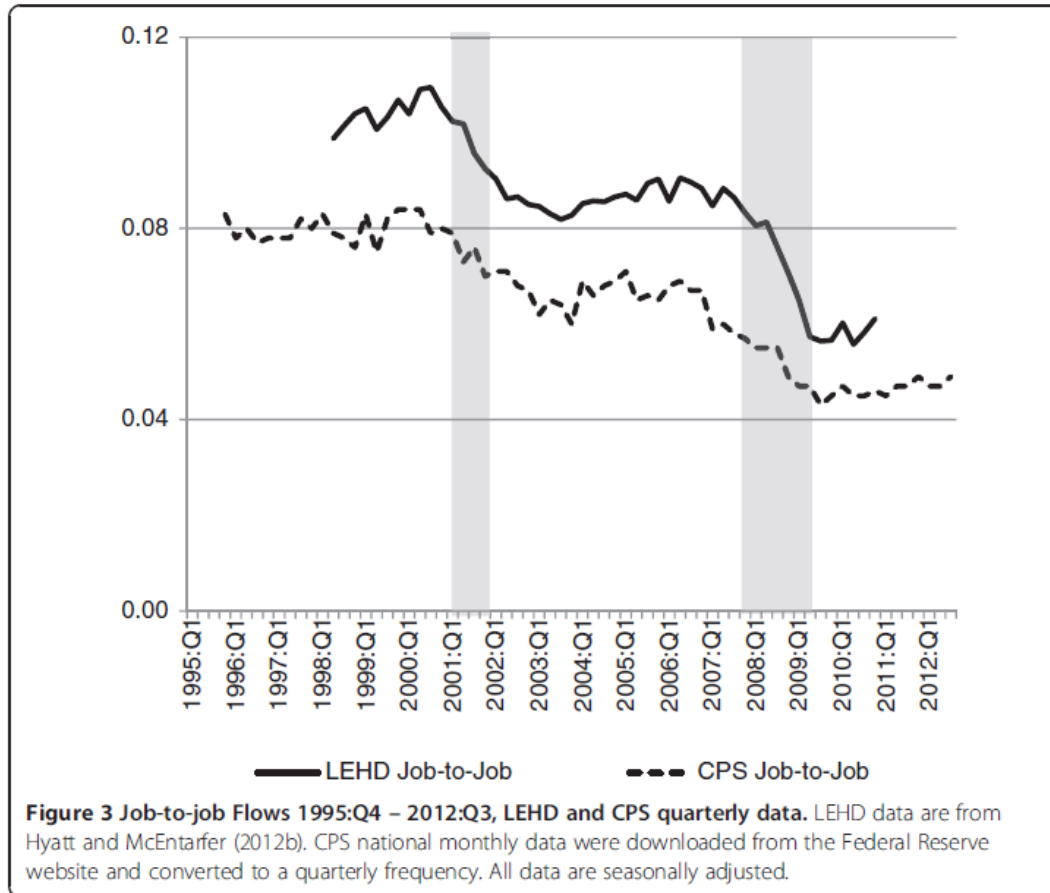
Job-to-job flows<sup>(a)</sup>



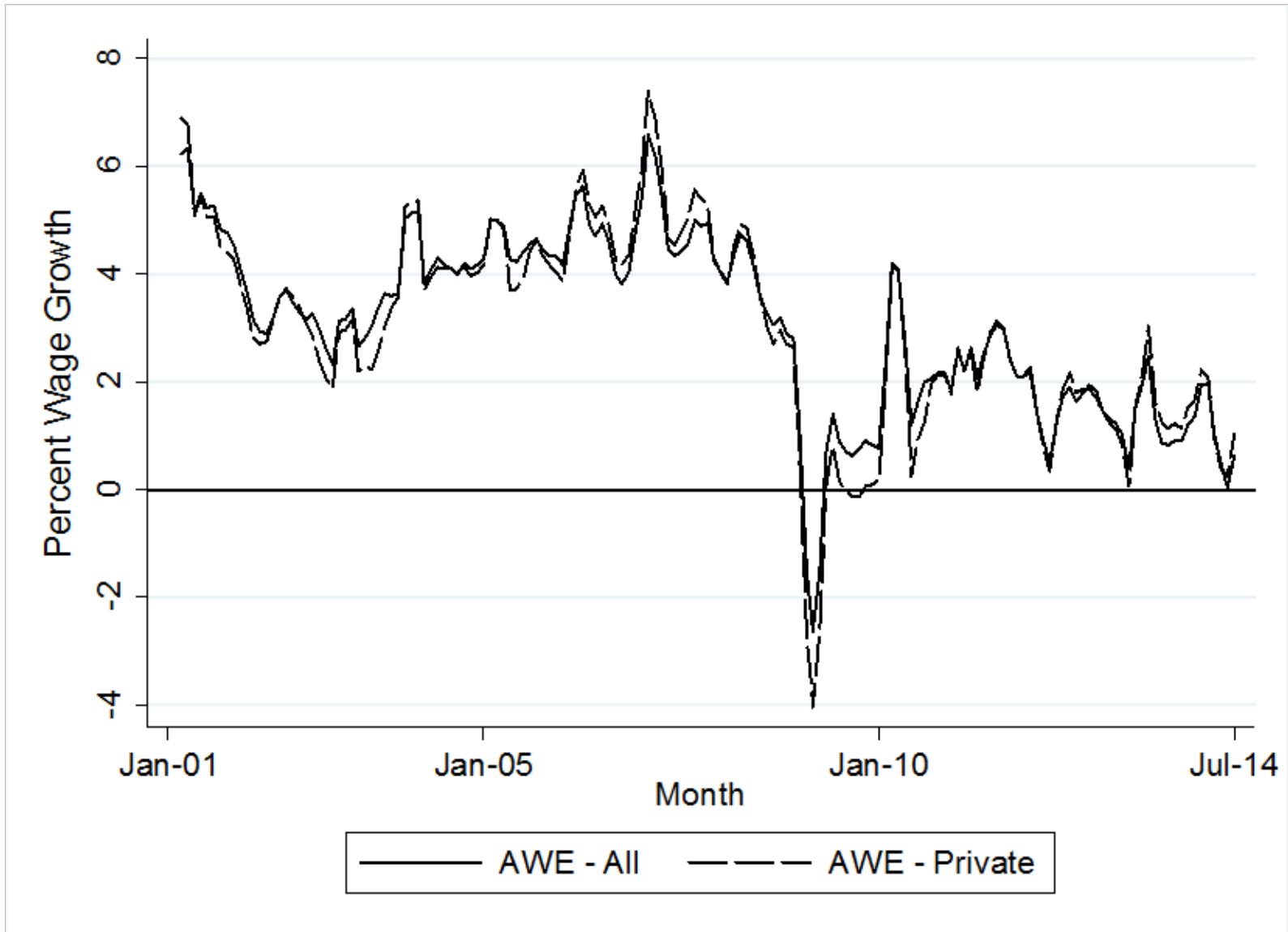
Sources: Labour Force Survey and Bank calculations.

(a) Number of people who reported being in a private sector job three months ago, and report being in a private sector job for less than three months. Two-quarter average. Seasonally adjusted by Bank staff.

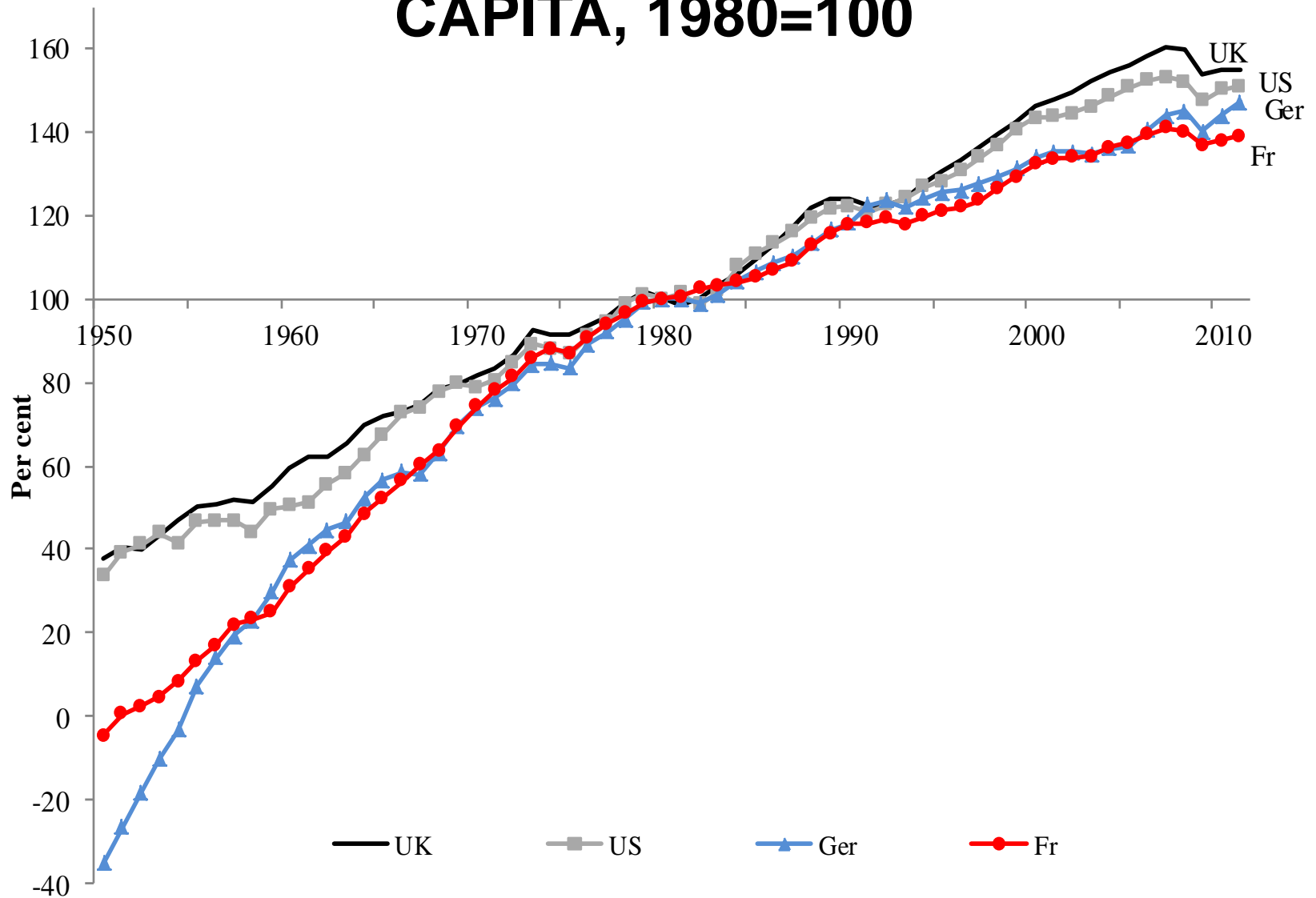
# Decline in job-to-job flows in the US



# Three month Nominal wage growth in AWE: consistently below the rate of inflation since crisis

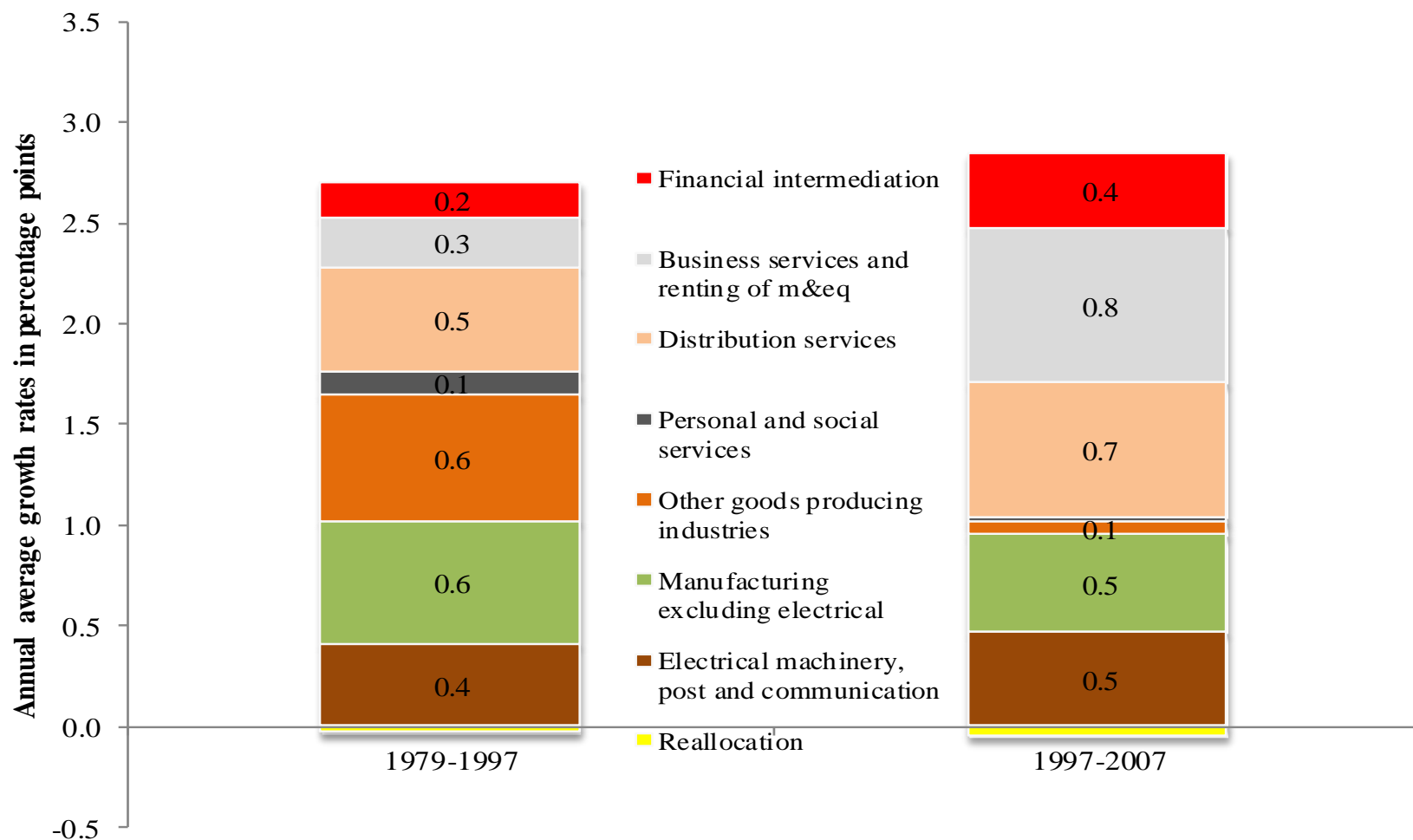


# A REVERSAL OF MISFORTUNE? GDP PER CAPITA, 1980=100



Source: LSE Growth Commission

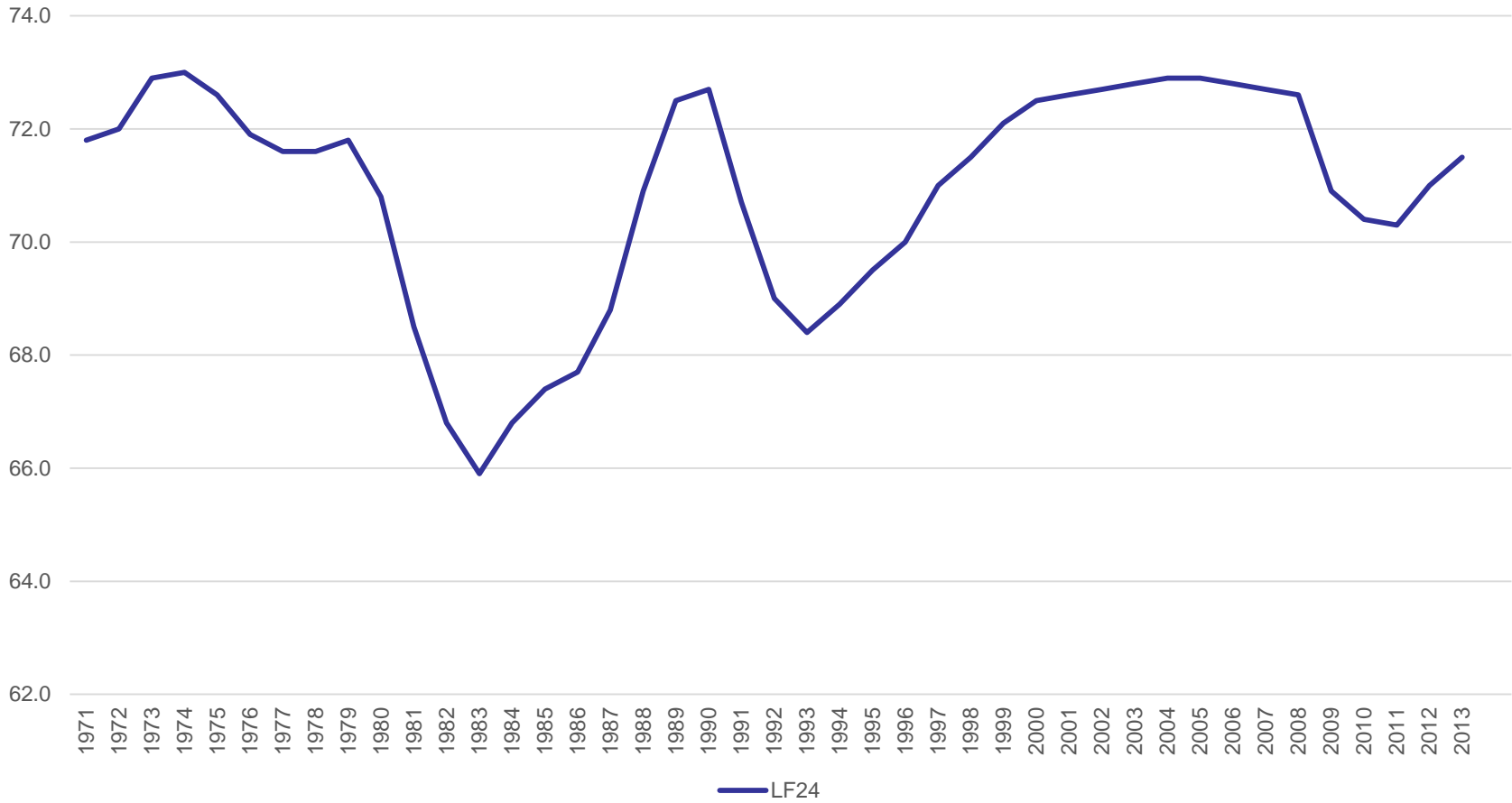
# PRODUCTIVITY GROWTH (GDP PER HOUR) : IT WASN'T ALL FINANCE



Source: LSE Growth Commission

# EMPLOYMENT RATE, 16-64

LF24



# UNEMPLOYMENT RATE, 16+

