

# What has been driving living standards?

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# Outline

I will look (briefly) at Incomes, Earnings and Consumption

All three measures have something important to say.

1. Incomes: Working-age and Pensioners
2. Earnings: Wage Changes, Employment and Productivity
3. Consumption: Durable and Non-durable Expenditures
4. Prospects

Under each heading some summary points and supporting evidence.

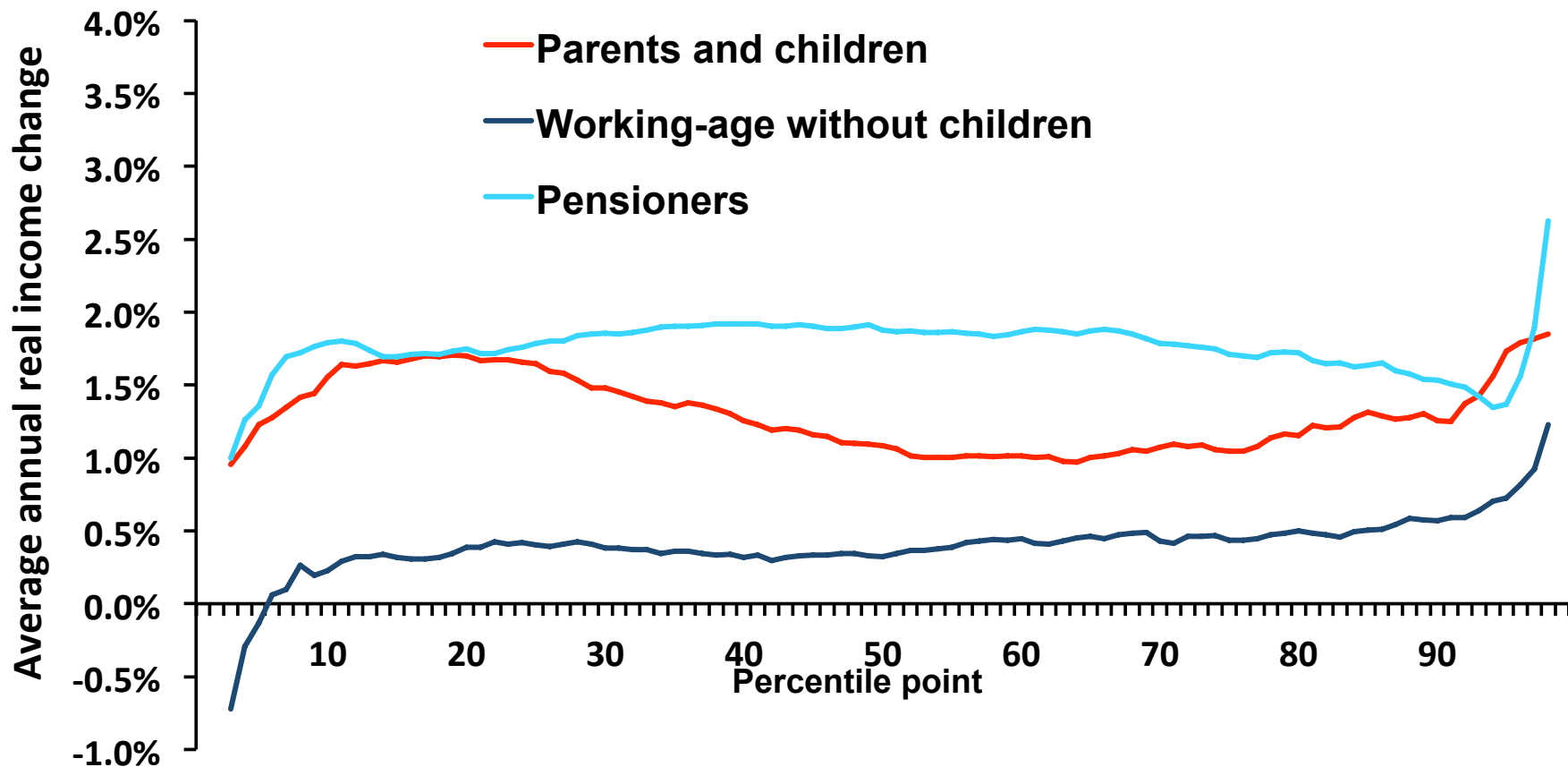
Draw on three references to recent IFS research:

- Living Standards, Poverty and Inequality in the UK.
  - *IFS Report R81*, <http://www.ifs.org.uk/comms/r81.pdf>
- What Can Wages Tell Us about the Productivity Puzzle?
  - *IFS Working Paper, W13/11*; forthcoming *Economic Journal*, <http://www.ifs.org.uk/wps/wp201311.pdf>
- Household Consumption through Recent Recessions.
  - *Fiscal Studies*, 34(2), June 2013, <http://onlinelibrary.wiley.com/doi/10.1111/j.1475-5890.2013.12003.x/abstract>

# 1. Incomes

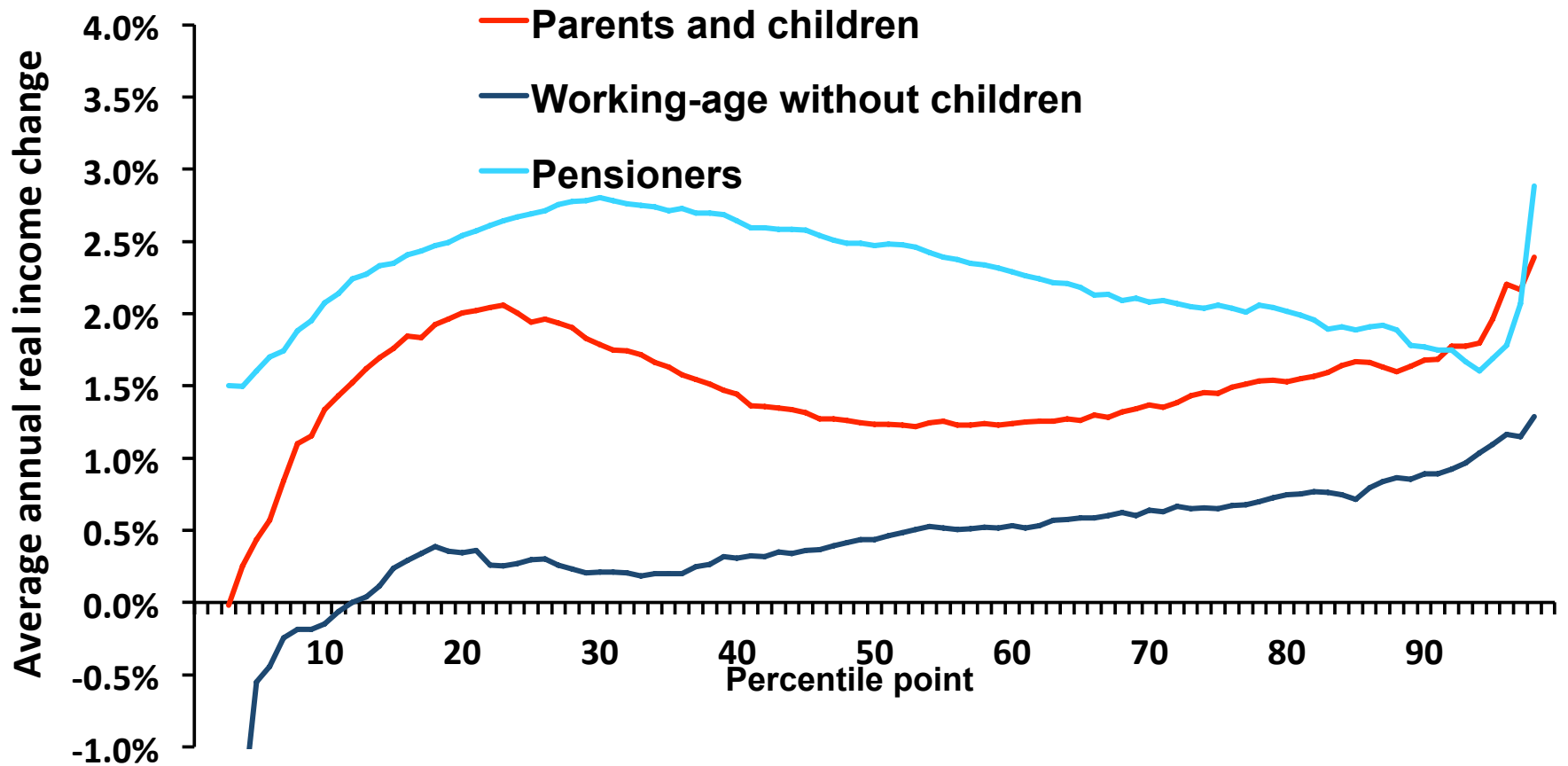
- Leading up the recession:
  - income growth had slowed in early 2000s.
  - pensioners/ working-age childless were doing relatively well/ badly
- During recession and immediately afterwards:
  - real earnings for those in work fell; benefits/tax credit incomes were robust.
  - employment rates fell for young adults but not for older ones.
  - As a result:
    - a) income inequality fell (despite rise in earnings inequality among workers)
    - b) young adults did worst; pensioners did best (again)

# 1996-97 to 2011-12: pensioners did relatively well; working-age childless relatively badly



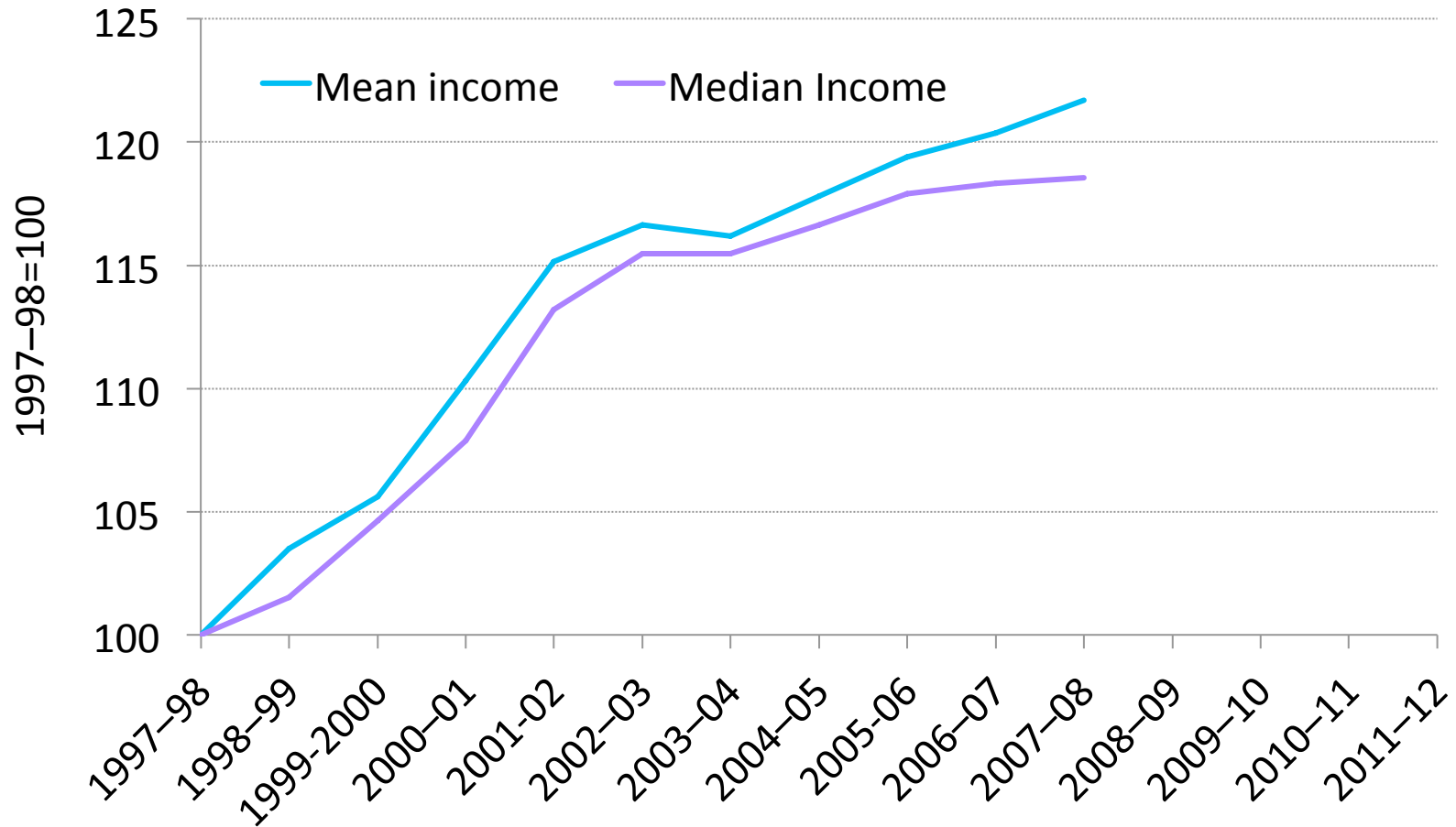
Notes and source: see Figure 5.2 of *Living Standards, Poverty and Inequality in the UK: 2013*

## ...and on an after-housing-cost (AHC) basis



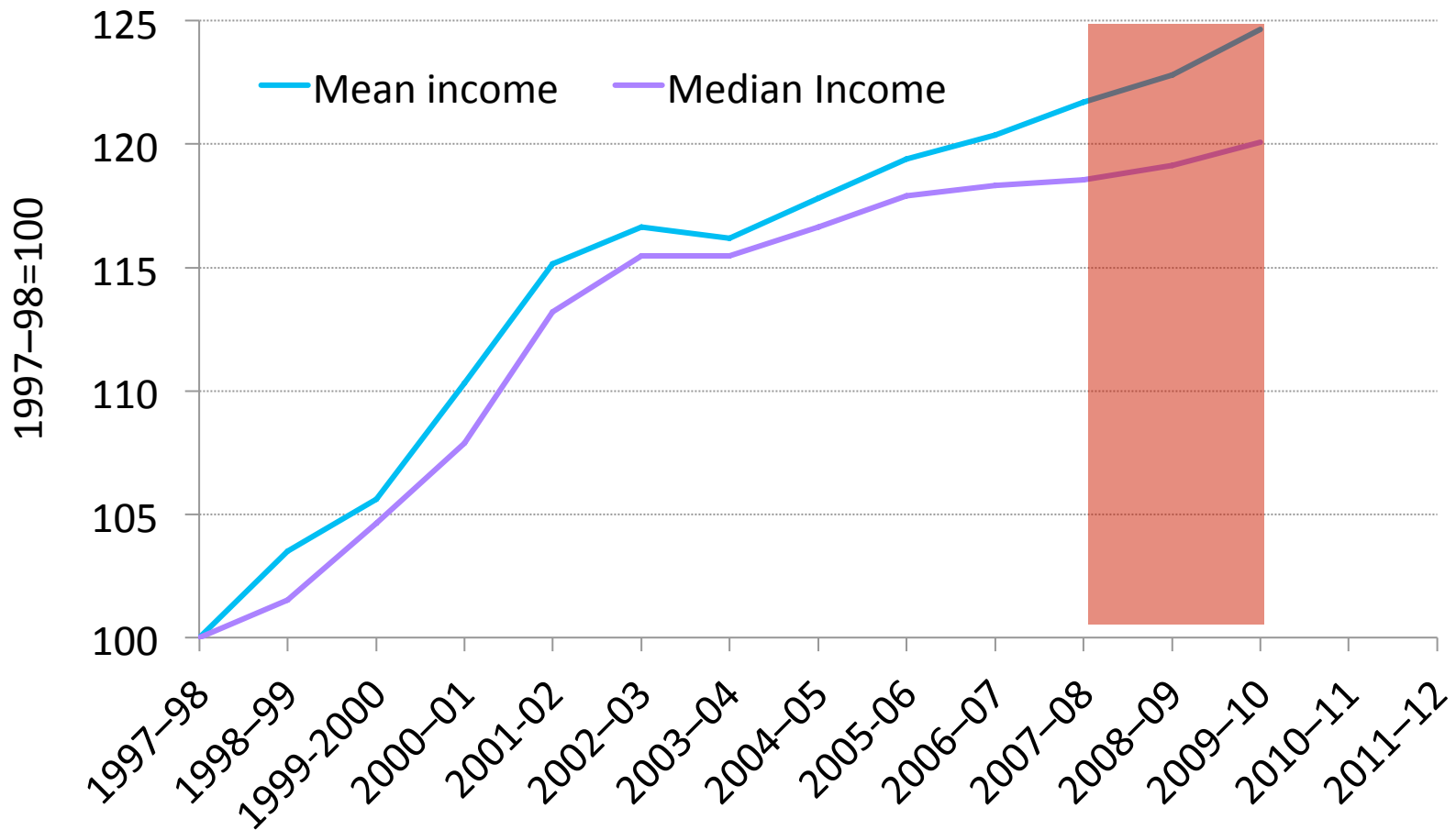
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# Trends not uniform: slower growth from early 2000s



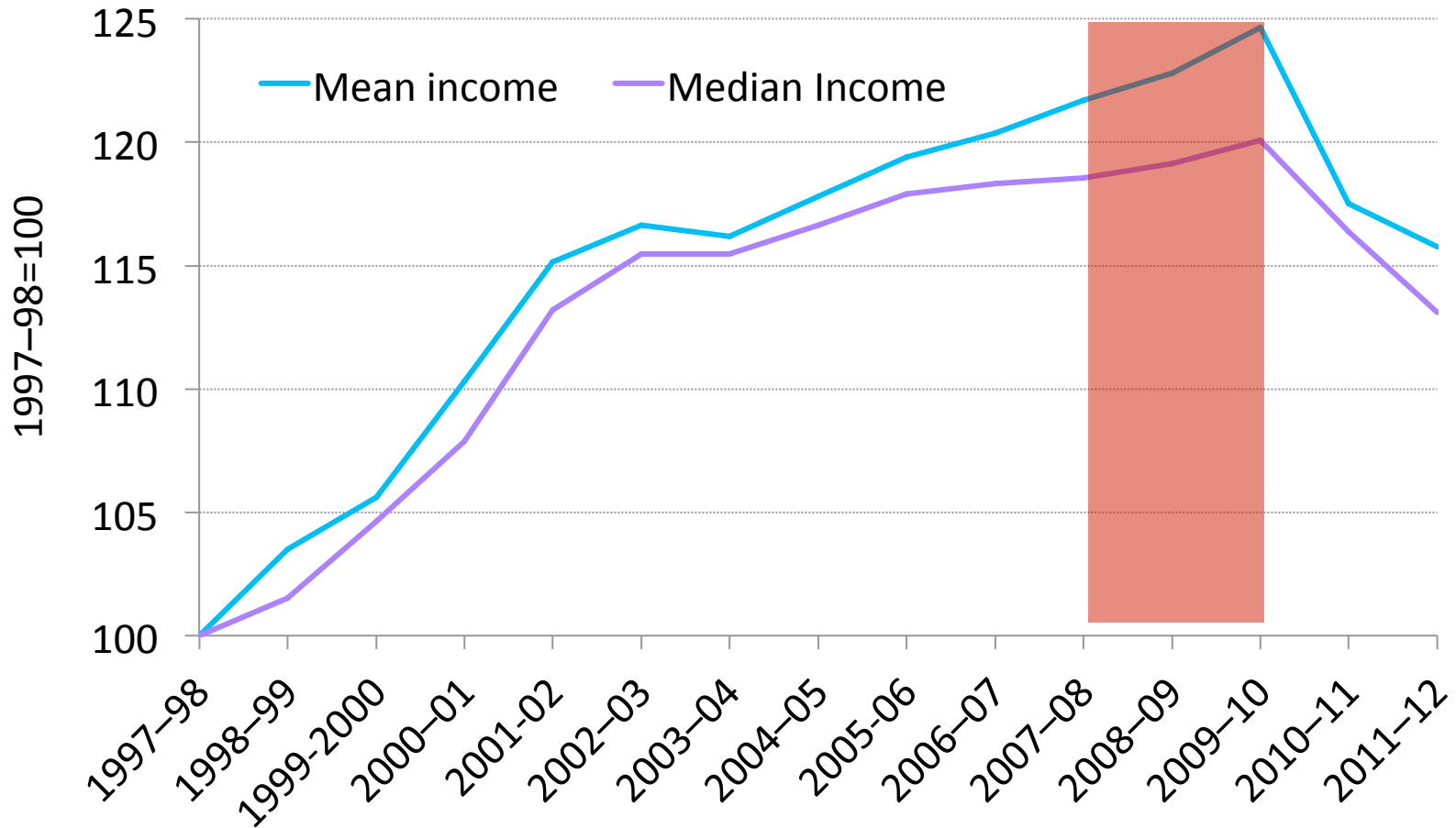
Source: Family Resources Survey, various years

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Source: Family Resources Survey, various years

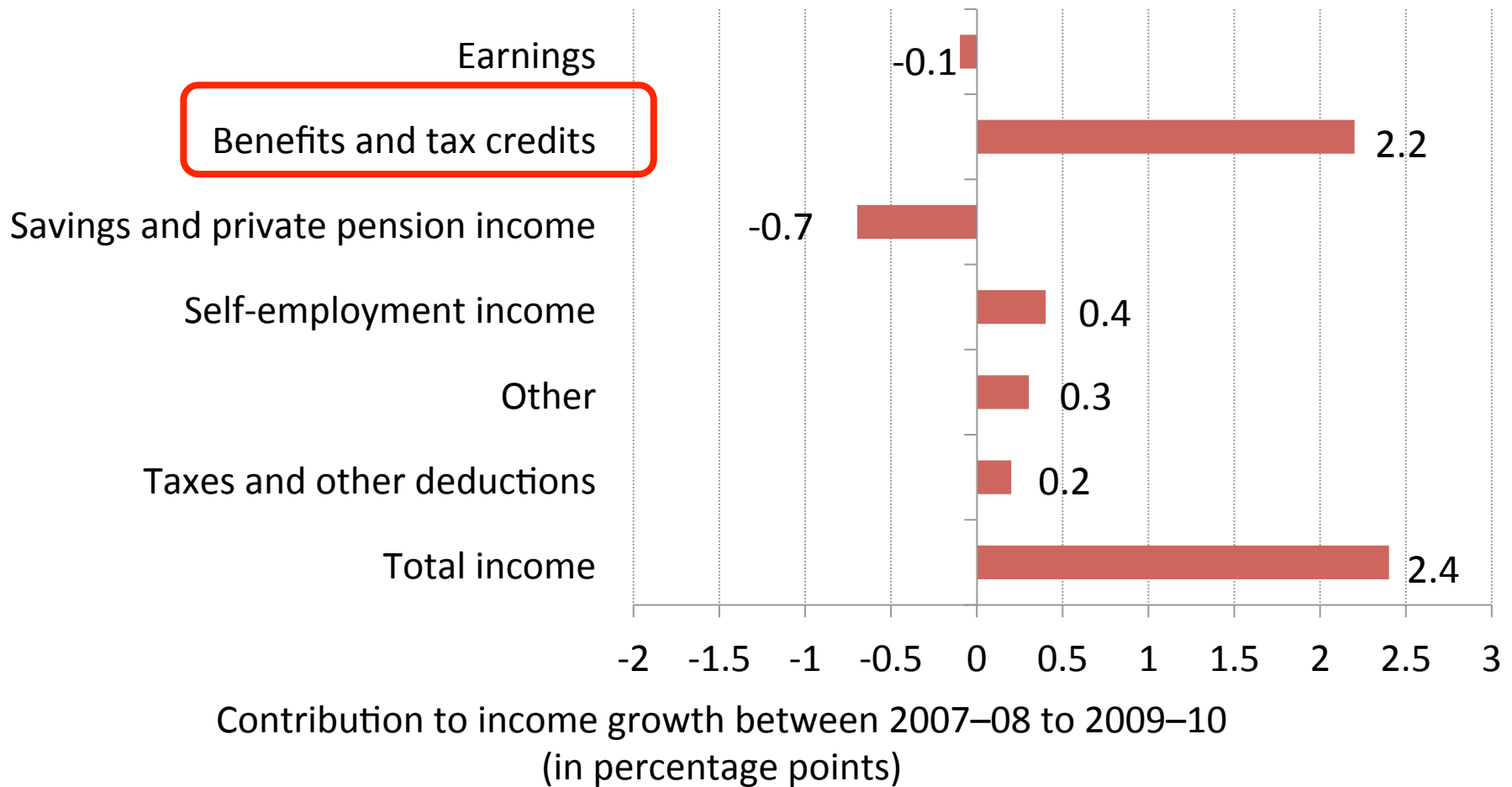
## ... and large falls after the recession



Source: Family Resources Survey, various years



# Income sources, 2007–08 to 2009–10: steady income growth due to benefits/tax credits



Source: Table 2.4 of *Living Standards, Poverty and Inequality: 2013*

Notes: This is a very slightly different sample to the overall income statistics. Households with negative incomes are dropped. This makes a small difference to falls in income

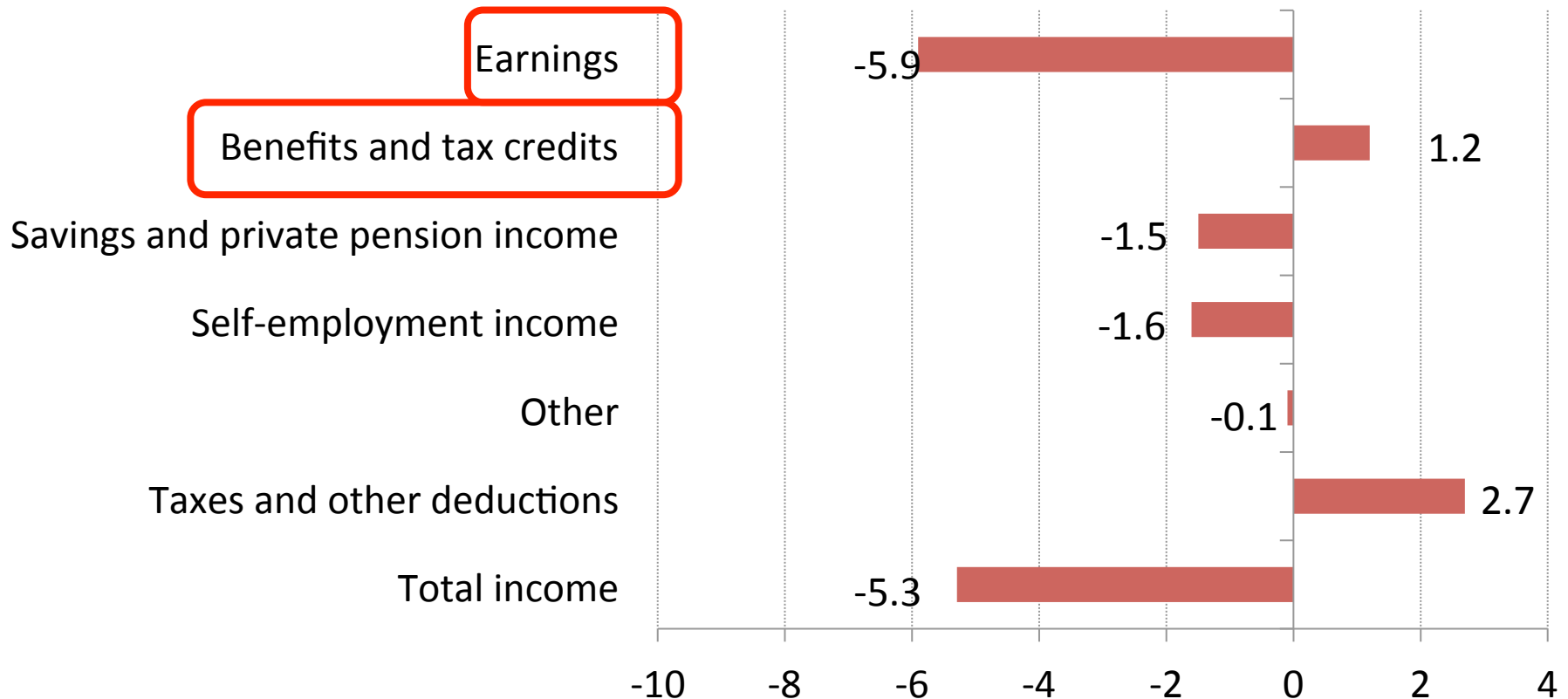
# Income sources, 2009–10 to 2011–12: large income falls due to falling earnings



Source: Table 2.4 of *Living Standards, Poverty and Inequality: 2013*

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# Income sources: 2007–08 to 2011–12

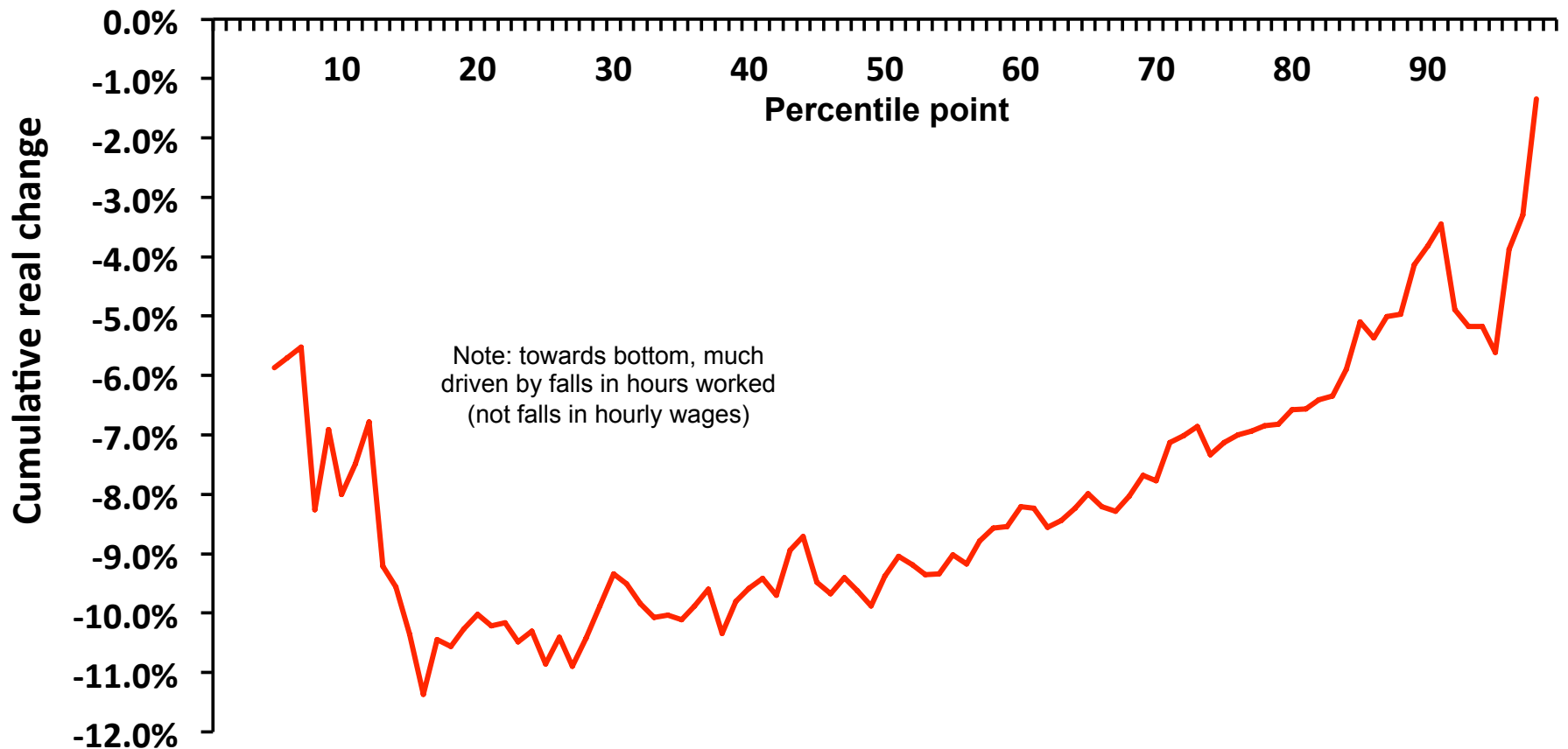


Contribution to income growth between 2007–08 to 2011–12  
(in percentage points)

Source: Table 2.4 of *Living Standards, Poverty and Inequality: 2013*

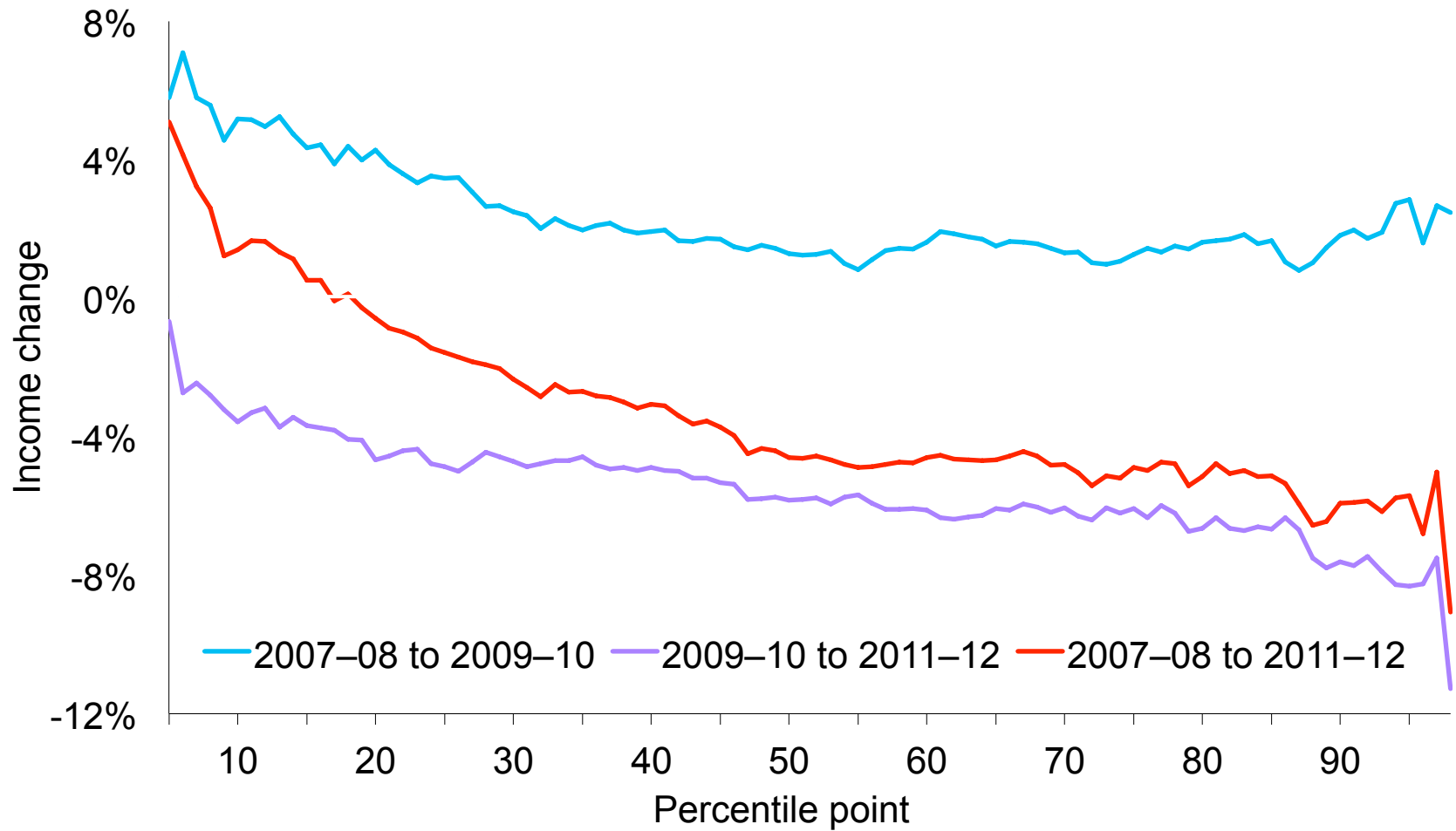
Notes: This is a very slightly different sample to the overall income statistics. Households with negative incomes are dropped. This makes a small difference to falls in income

# Weekly earnings inequality (among workers) rose between 2007-08 to 2011-12...



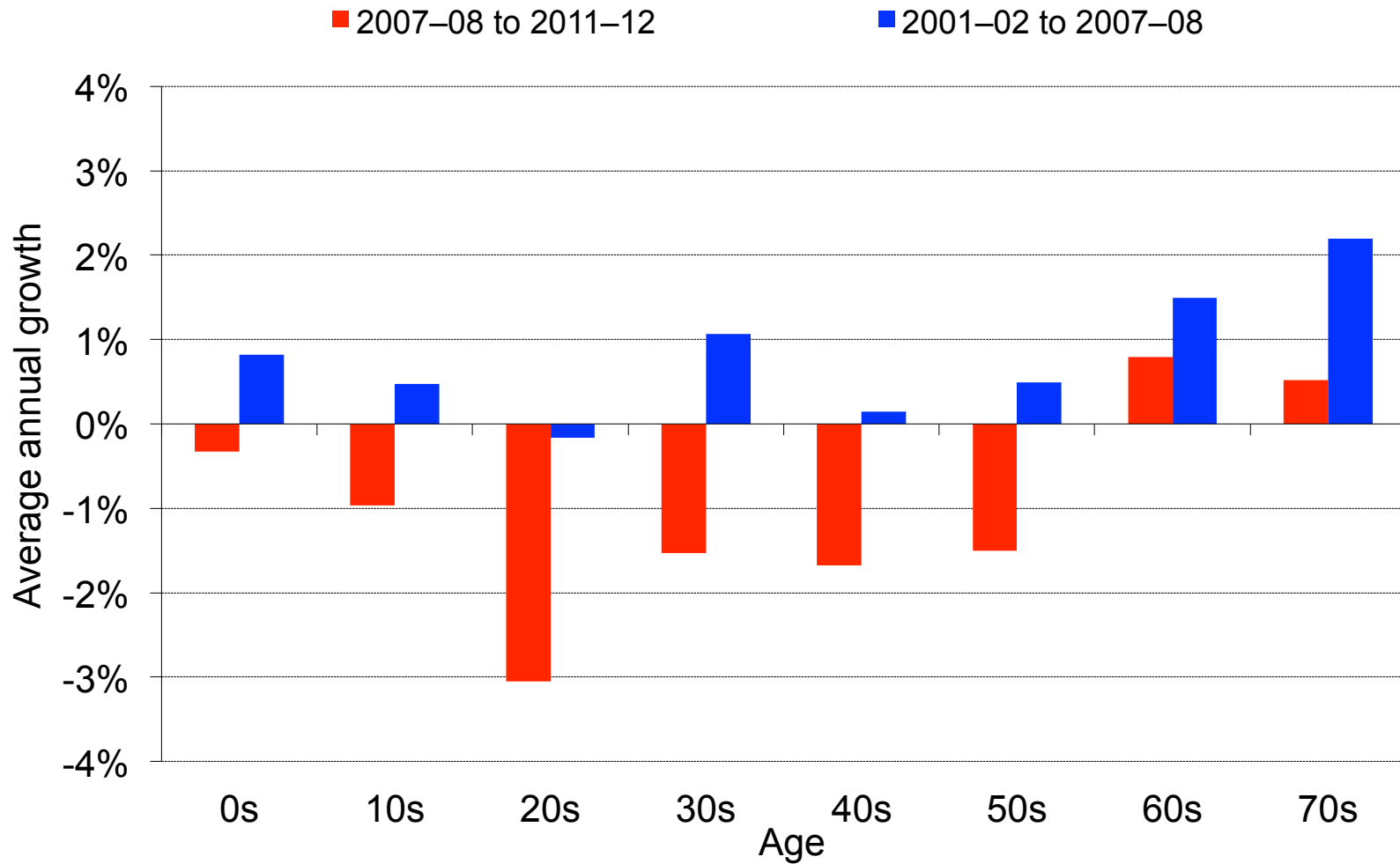
Notes and source: see Figure 3.10 of *Living Standards, Poverty and Inequality in the UK: 2013*

## ...but net result was still a fall in income inequality



Source: Figure 3.5 of *Living Standards, Poverty and Inequality: 2013*

# Median income changes by age (BHC, GB)



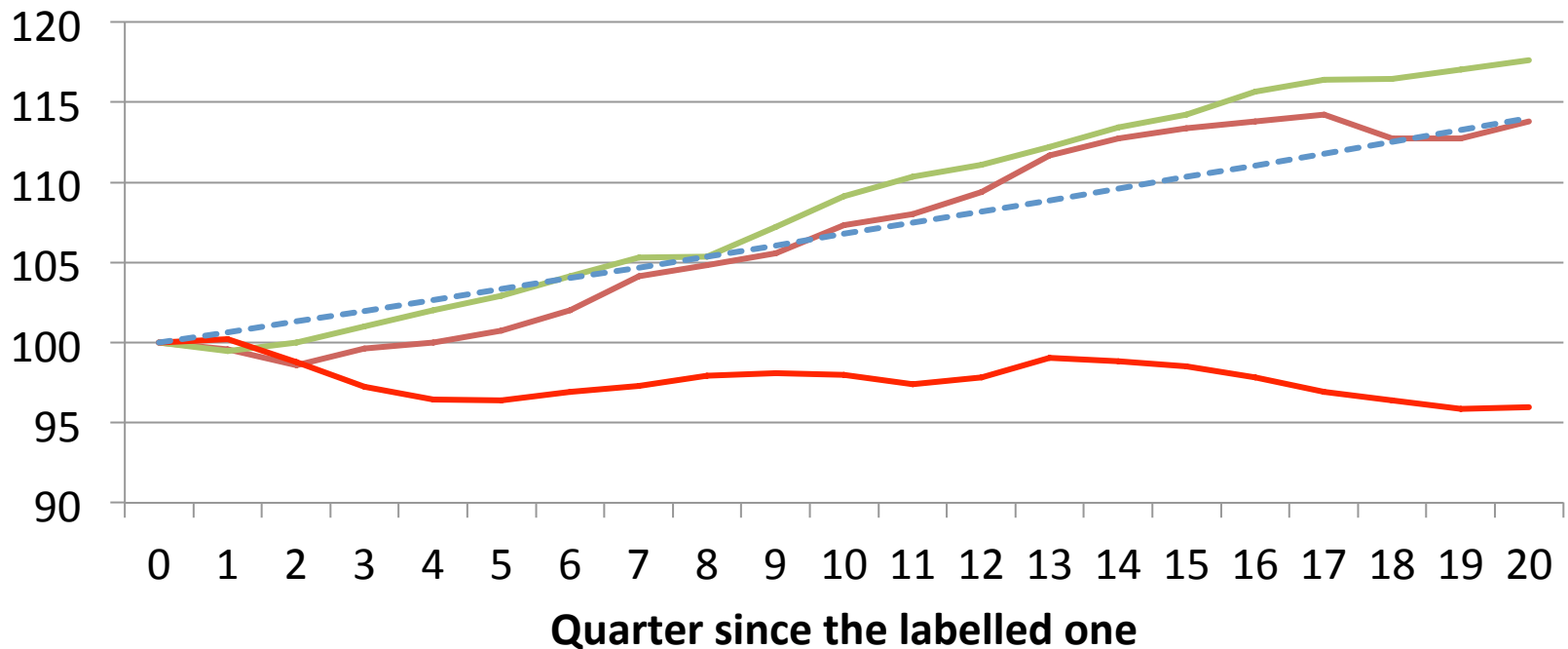
Notes and source: see Figure 5.7 of *Living Standards, Poverty and Inequality in the UK: 2013*

## 2. Earnings: Wages and Employment

- Average real hourly wages fallen since this recession began.
  - Why and will the trend continue?
- ‘Effective labour supply’ is higher now than during previous recessions, due (perhaps) to welfare policy changes and wealth shocks,
  - increasing in the long-run (due to social and policy changes) and in the short-run (due to wealth shocks and long term real wage declines).
- Workforce composition has shifted towards more productive types,
  - as in previous recessions, yet real wages have fallen.
- These real wage falls have occurred *within* individuals:
  - unprecedentedly high proportions of employees experienced nominal wage freezes,
  - especially in the lower-middle of the wage distribution and in the absence of collective agreements.

In contrast to previous recessions, real output per hour has at best been stagnant since 2008: why?

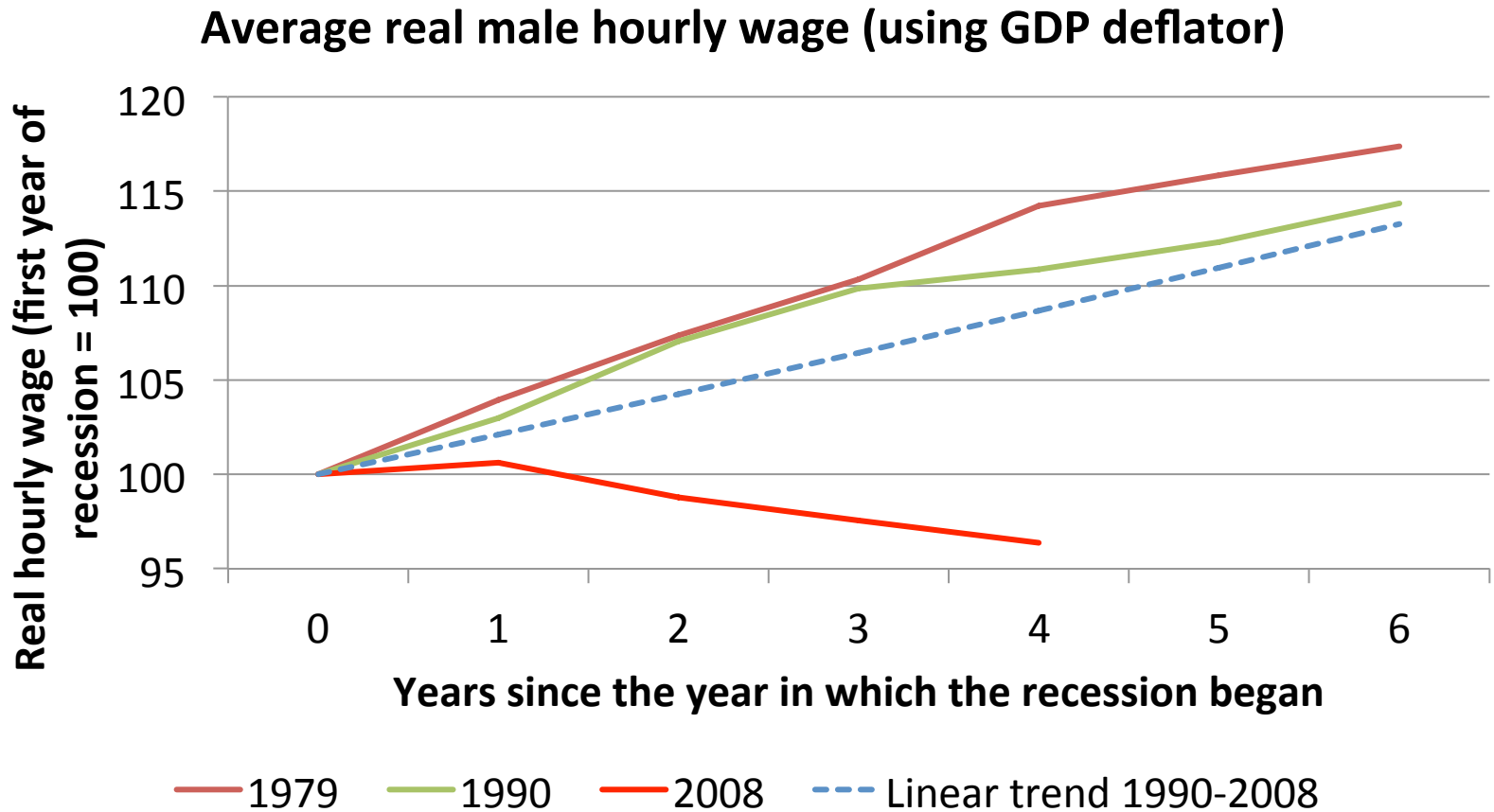
**Real output per hour**



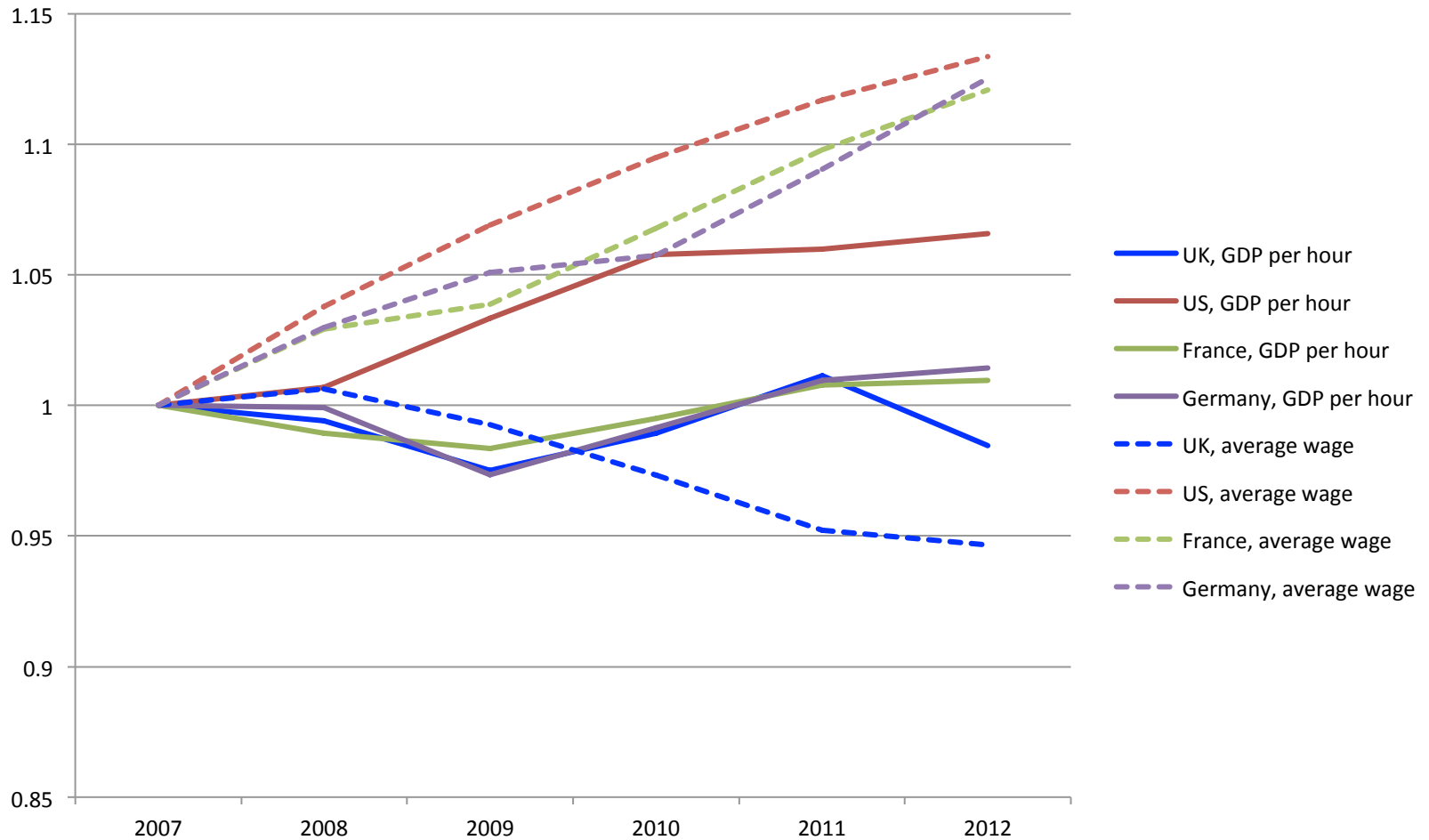
— 1979Q4 — 1990Q2 — 2008Q1 - - - Linear trend (90Q2-08Q1)



# Average real hourly wages have also been stagnant



# The UK is different.....



# Employment and labour market participation

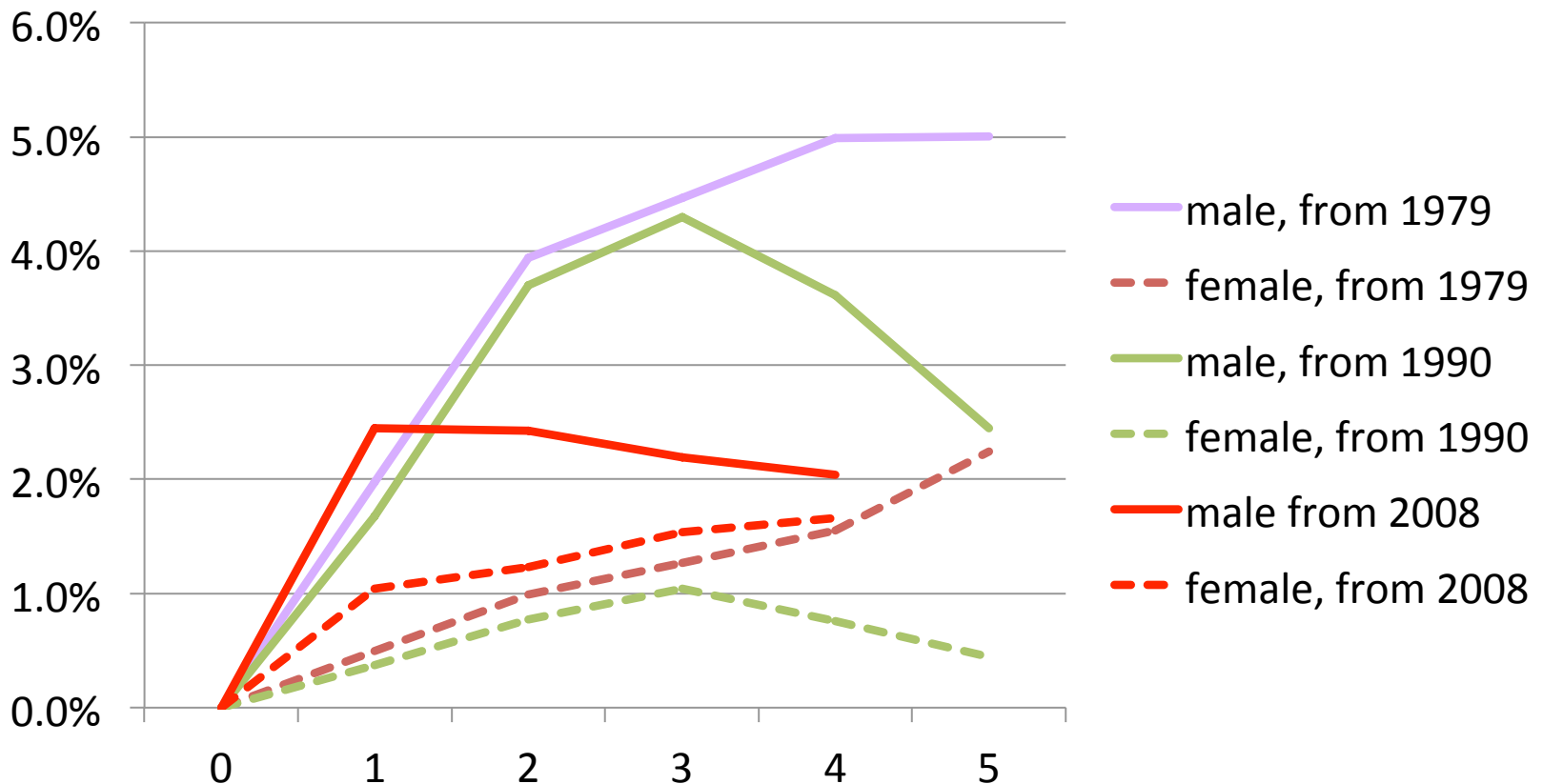
- Labour market participation has held up better during this recession than previous ones. For example:
  - Employment rates fell less (and unemployment rates increased less)

# Employment and labour market participation - employment rate of 23-64-year-olds by recession



Source: LFS every year. No data point for year 1980, 1982. Quarter 2 is used for years since 1992.

# Change to the proportion of 23-64-year-olds who are unemployed by recession

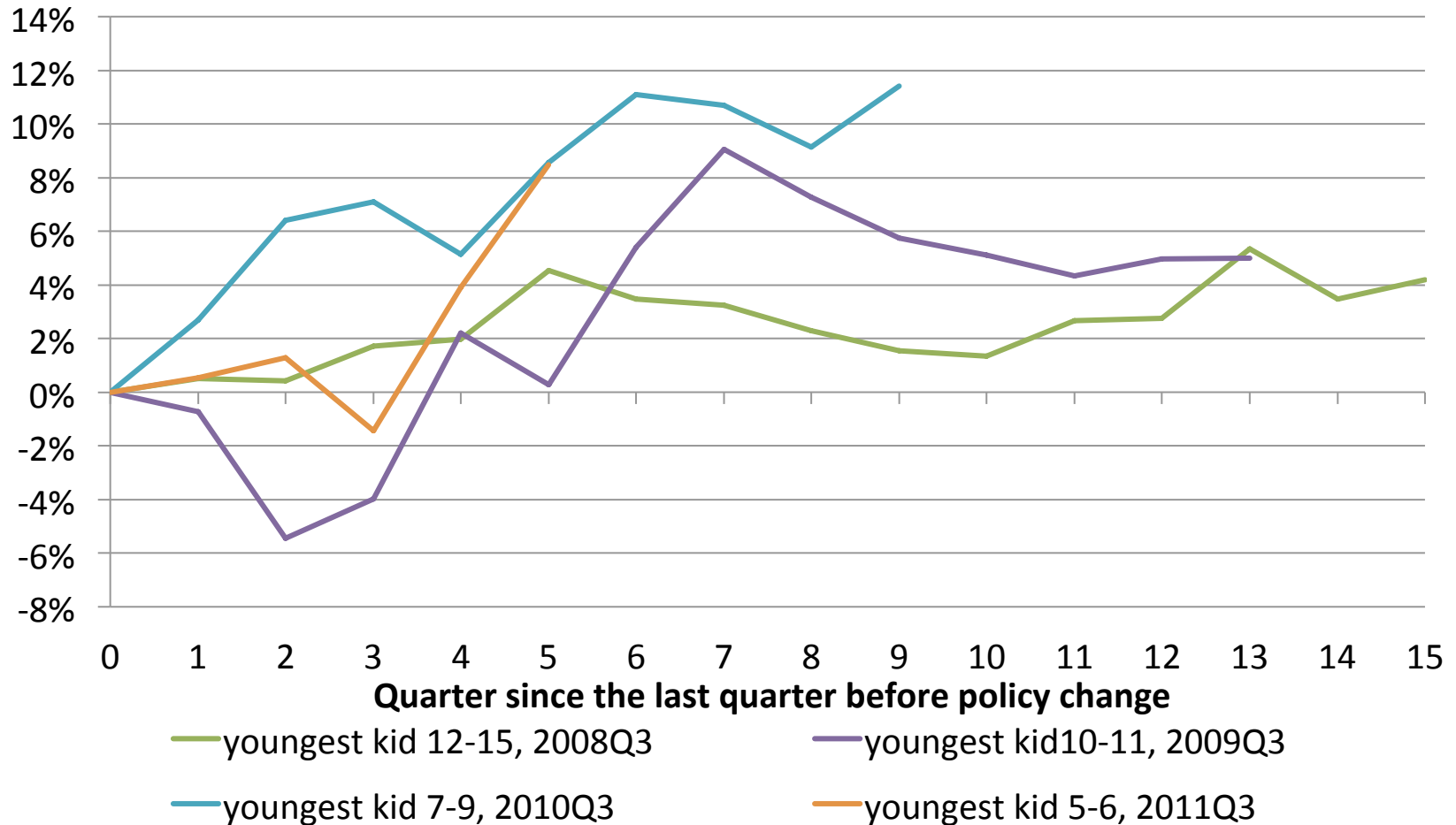


Source: LFS every year. No data point for year 1980, 1982. Quarter 2 is used for years since 1992.

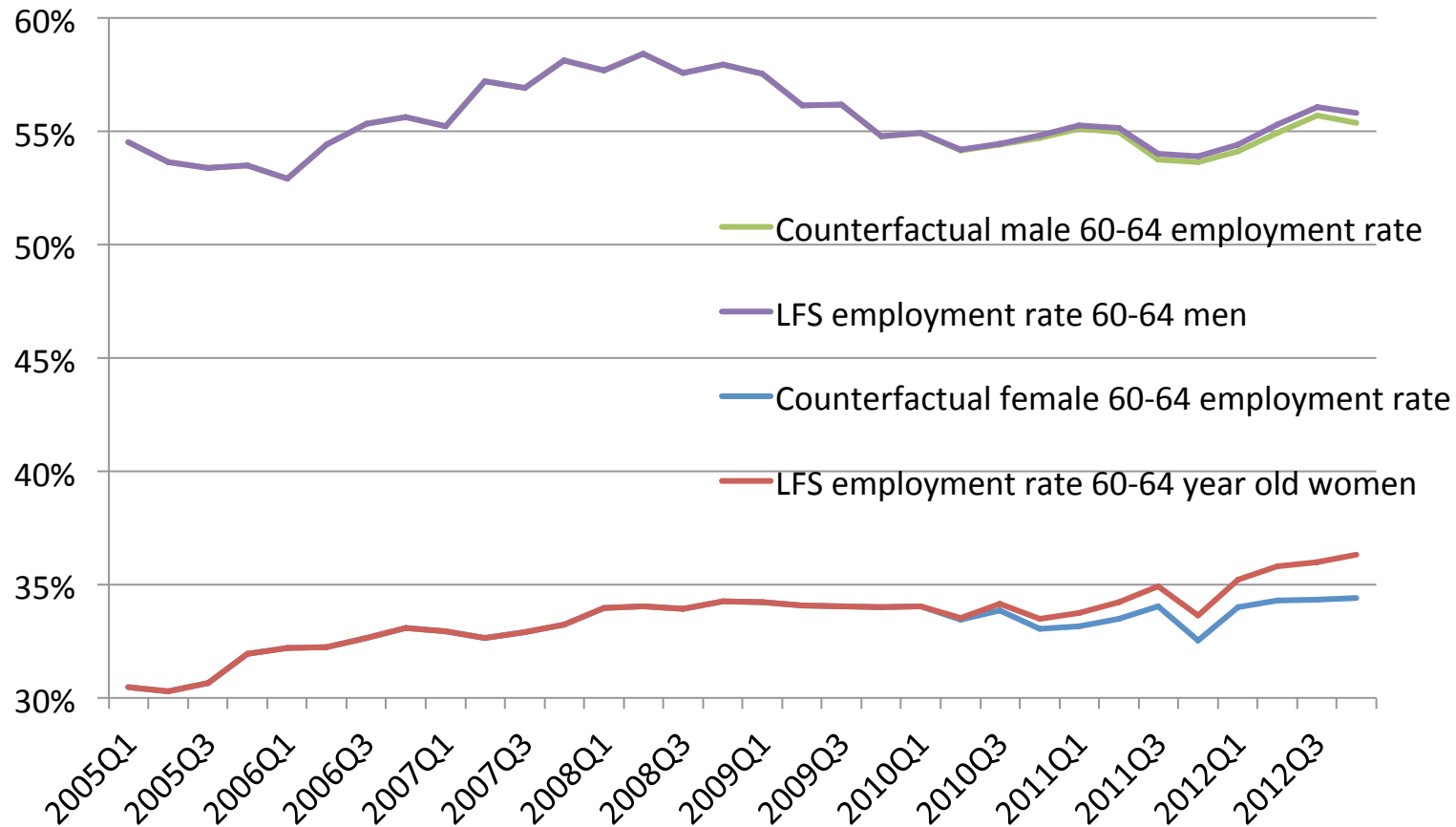
# Employment and labour market participation

- Some increase of participation can be attributed policy changes, e.g. :
  - Labour supply has increased among lone parents as a result of job search conditions attached to benefit claims
  - Older workers are retiring later as a result of increased SPA for women

# Change to lone mothers' participation rate since policy change



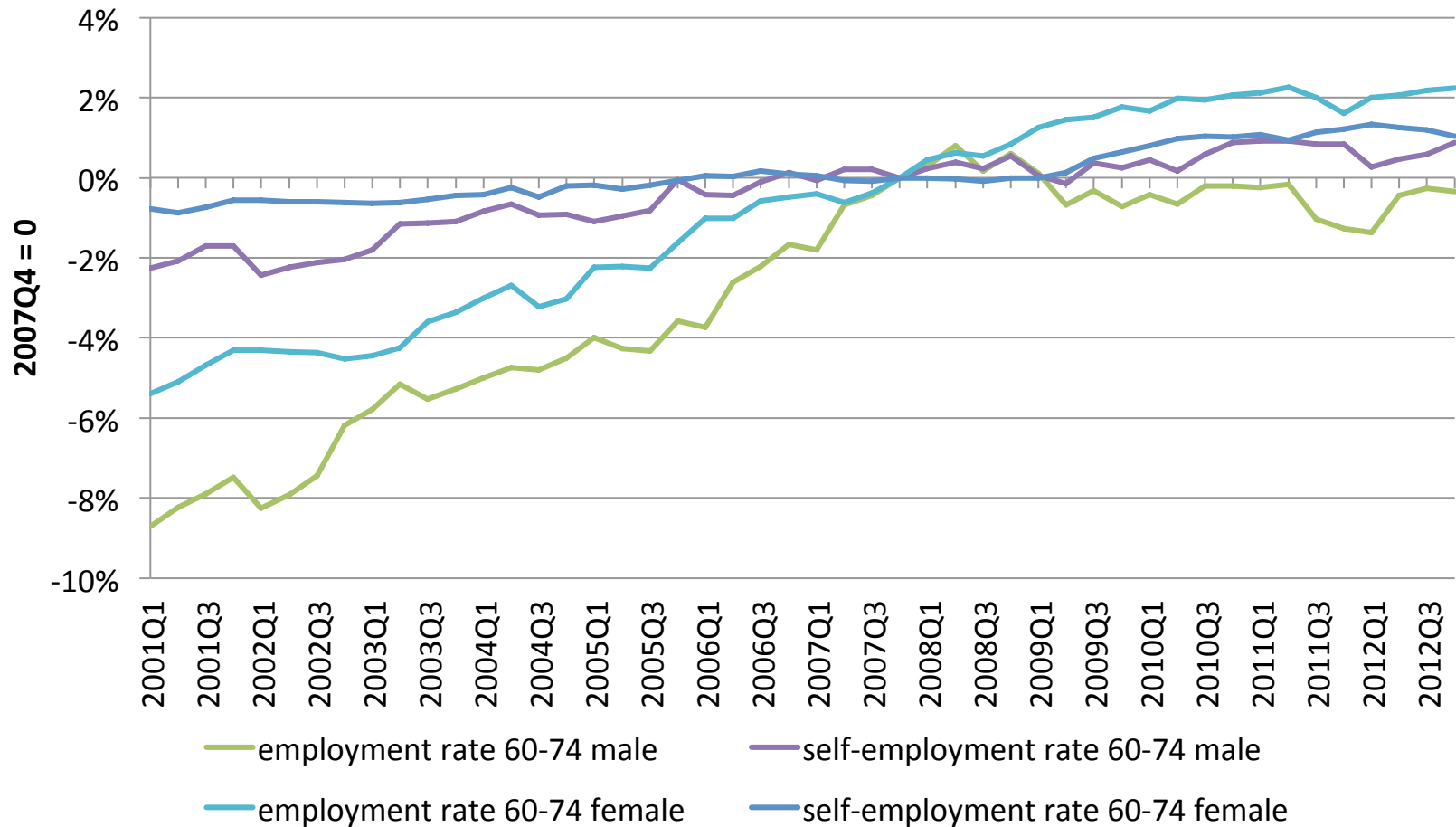
# Impact of SPA increase for women on employment



Note: counterfactual employment rates are estimated. See Cribb et al (2013) "Incentives, shocks or signals: labour supply effects of increasing the female state pension age in the UK"



# Employment and self-employment rate of older people



# Employment status of 16-22-year-olds



Source: LFS 2<sup>nd</sup> quarter every year

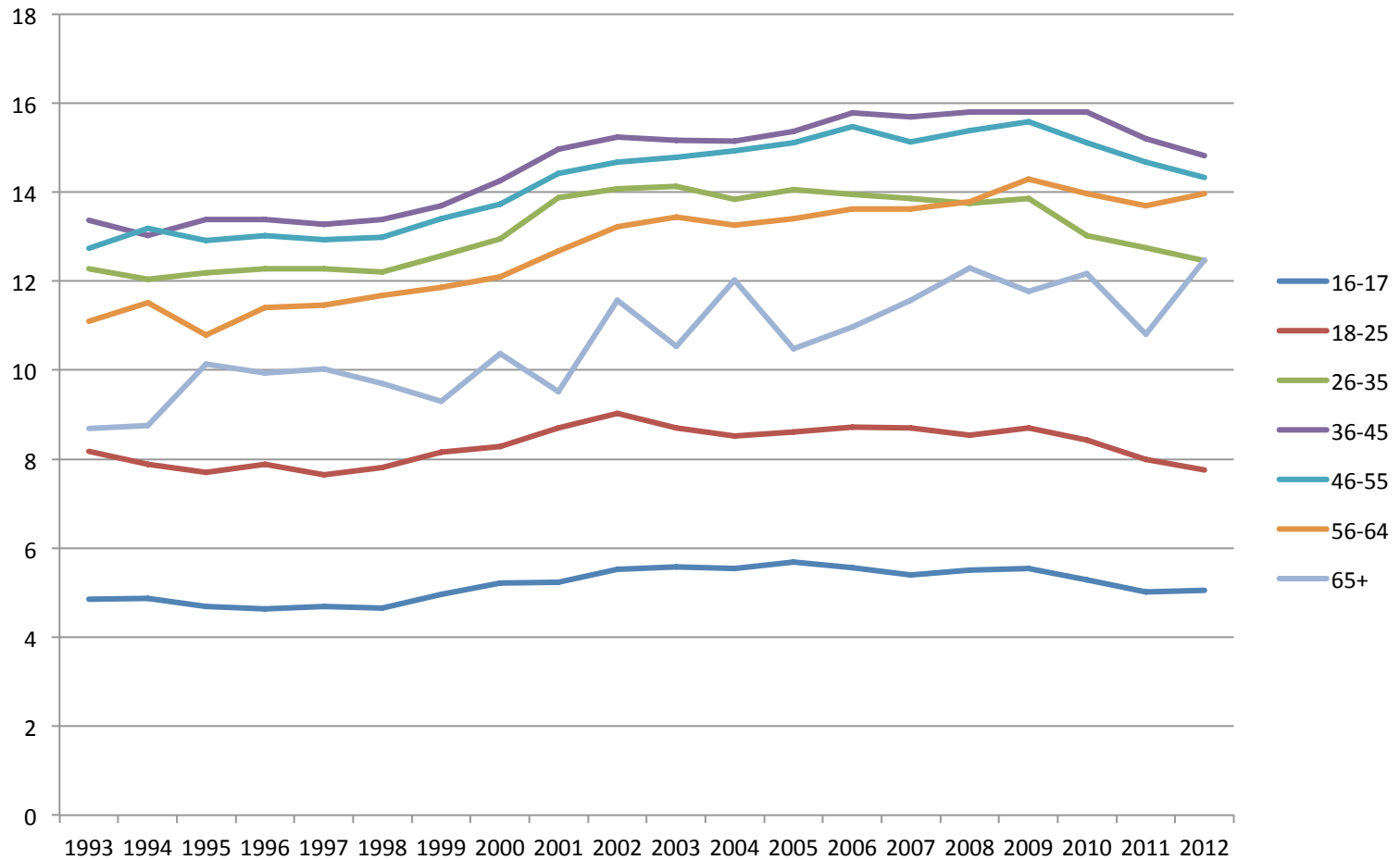
# Employment and labour market participation

- There is also some (weak) evidence that participation amongst older people has increased as a result of shocks to housing or financial wealth
  - But probably a response to falling expected real wages too.

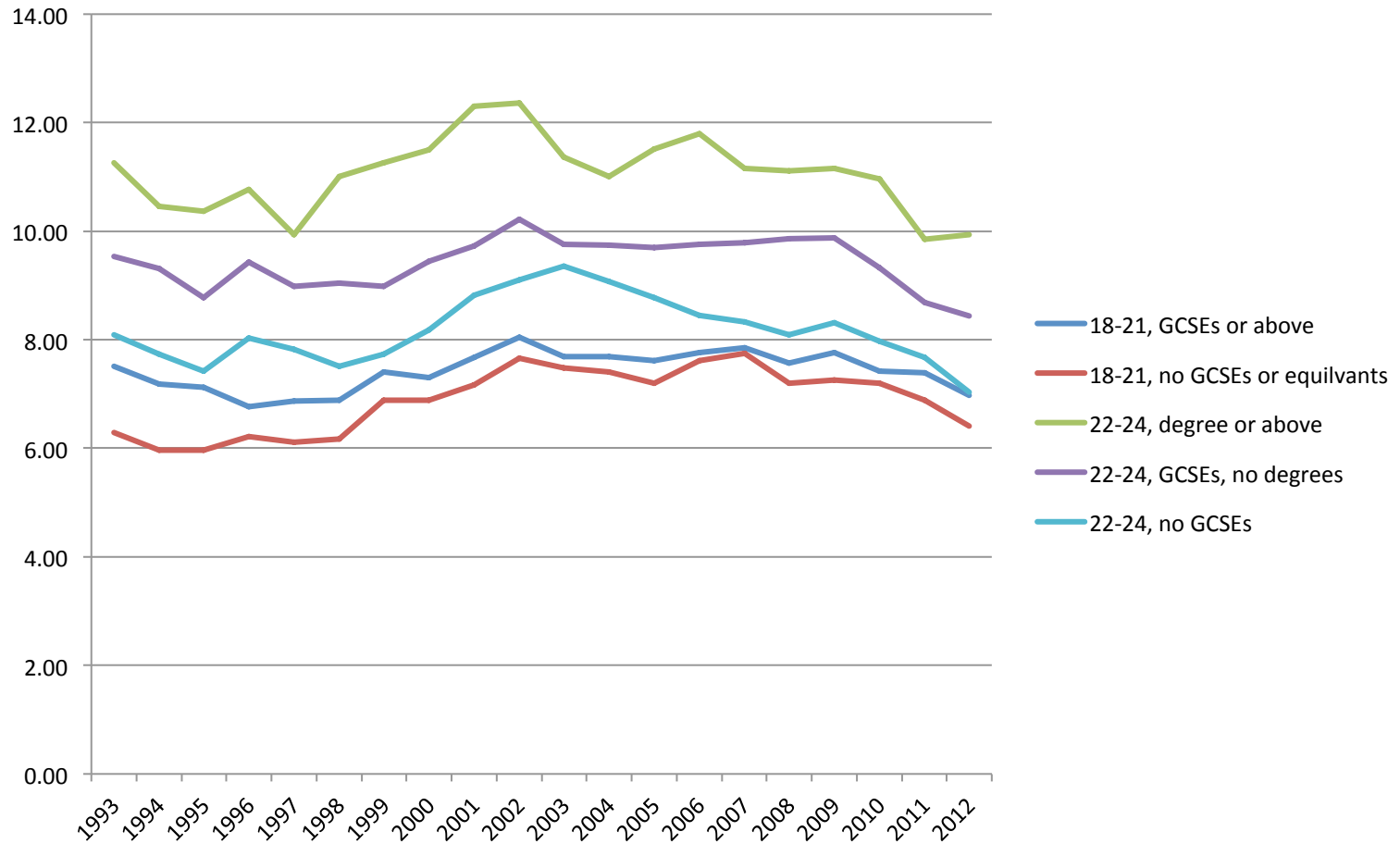
# Can changes in the composition of the workforce explain the fall in real hourly wages?

- Short answer: no
  - unlike, to an extent, in other countries.
- As in previous recessions, the composition of the workforce shifted towards more productive workers,
  - hence we would have expected the average real wage to increase (other things being equal).
- What has been different in this recession is that the returns to those characteristics have fallen substantially.
- This is true even amongst workers who keep their jobs, who have experienced nominal wage freezes/real wage falls,
  - May have been facilitated by the reduced power of labour market institutions (e.g. unions) since previous recessions.

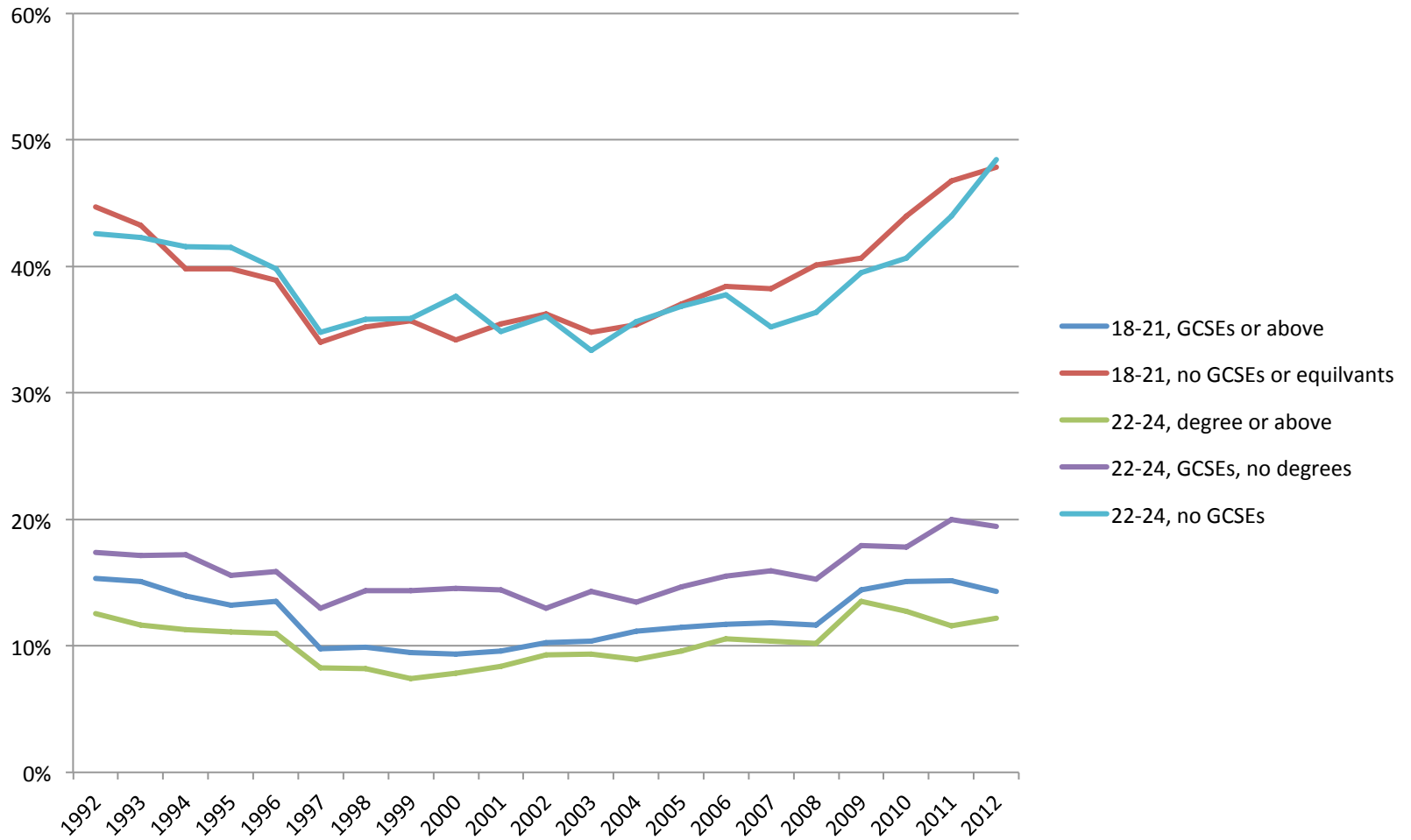
# Average real hourly wage by age group (RPI deflated)



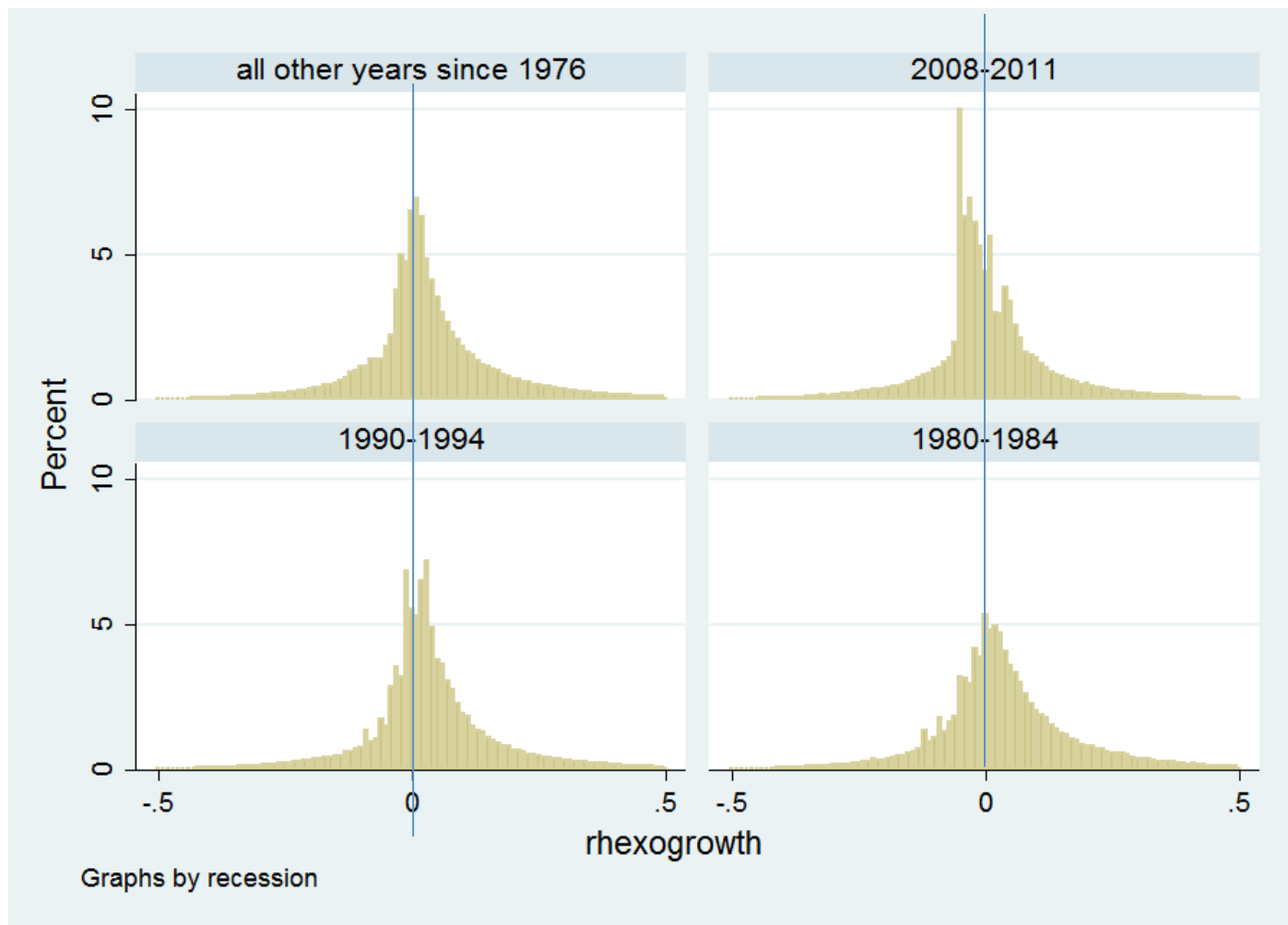
# Average real hourly wage by qualification among young people



# NEET rate among young people

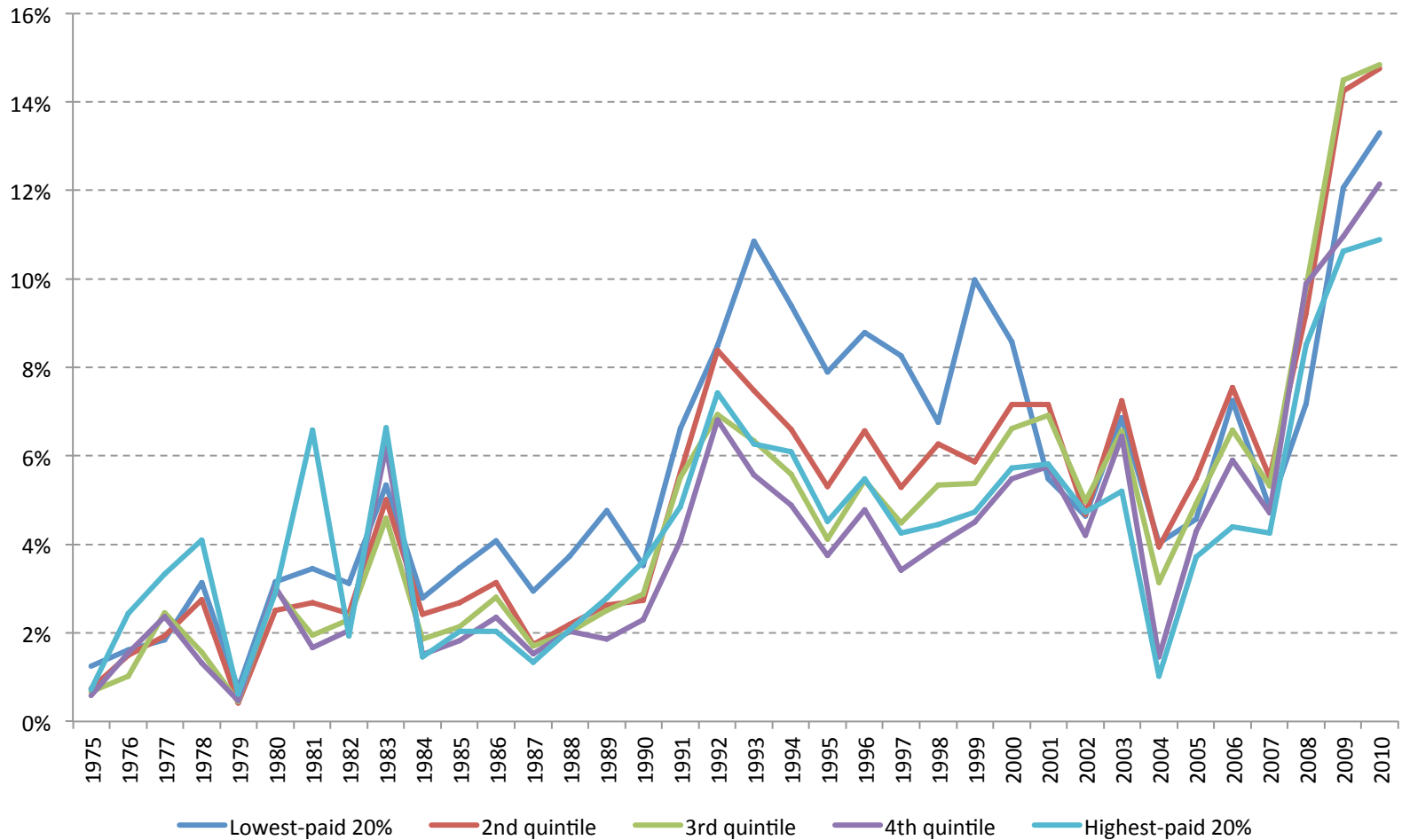


# %change to real hourly wage since last year, by period



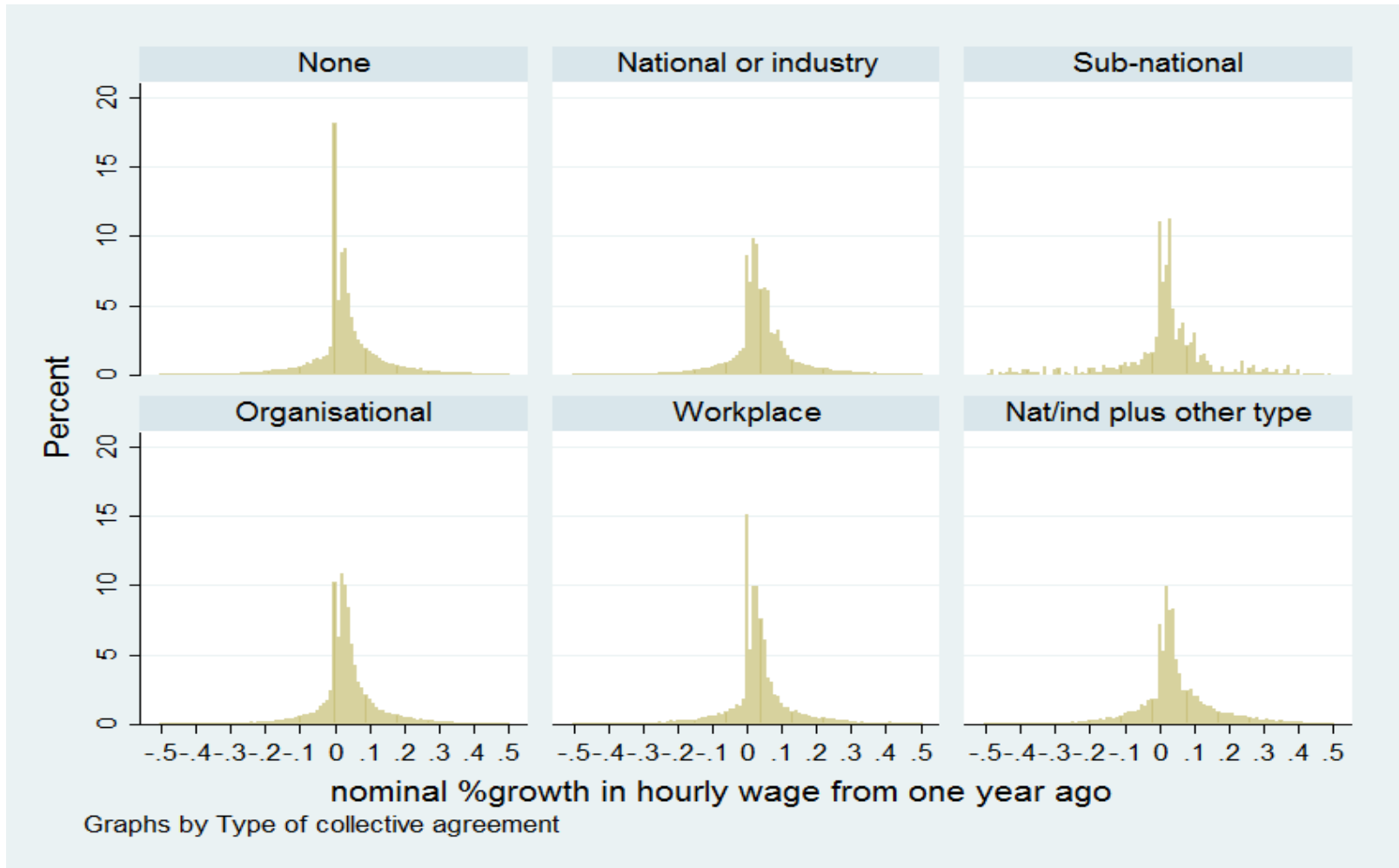


# % facing nominal wage freeze in the coming year by current wage quintile



Source: New Earnings Survey Panel Dataset 1975-2011. There are 20,000-30,000 observations underlying each data point.

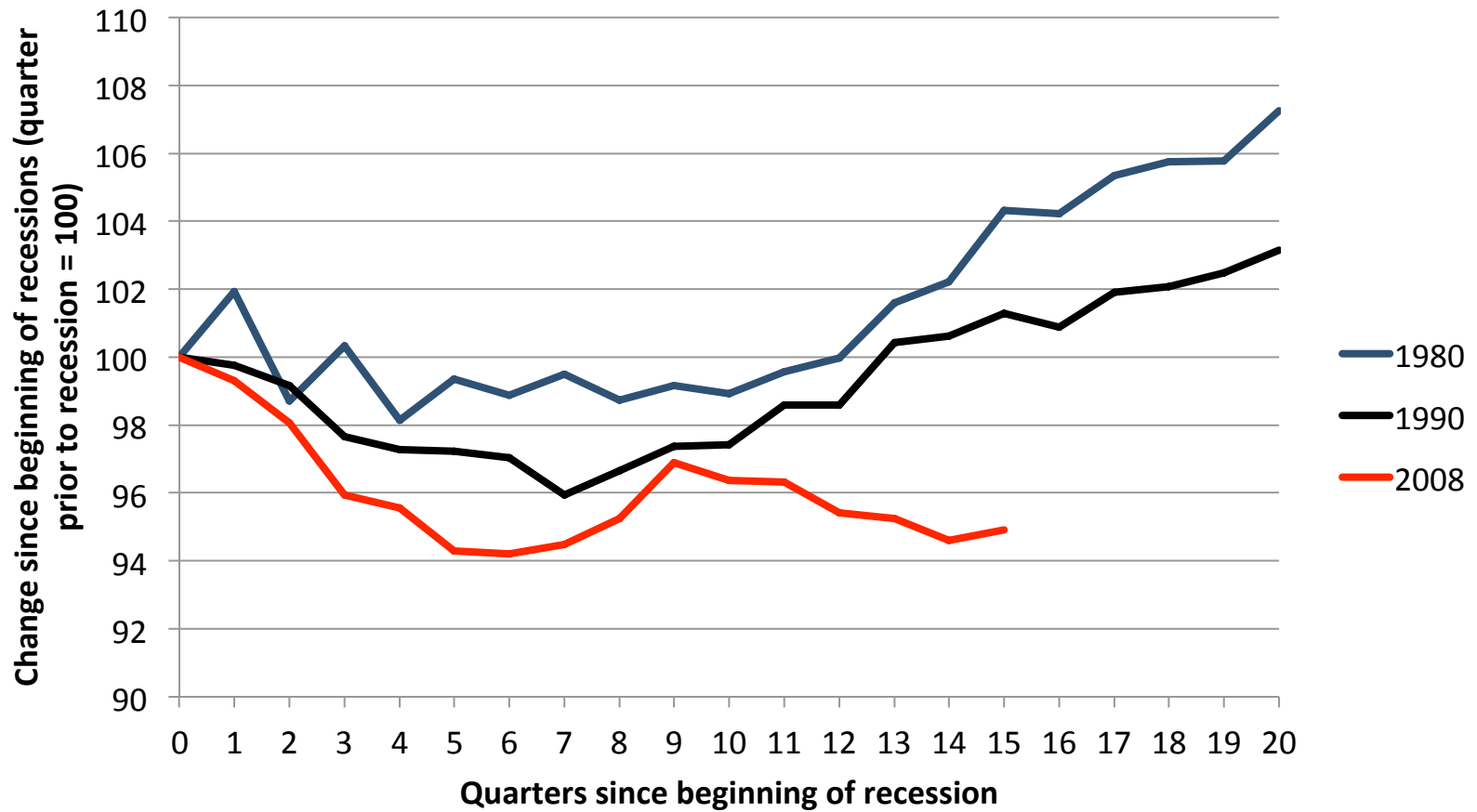
# More nominal pay freezes in the absence of collective agreement since 2008



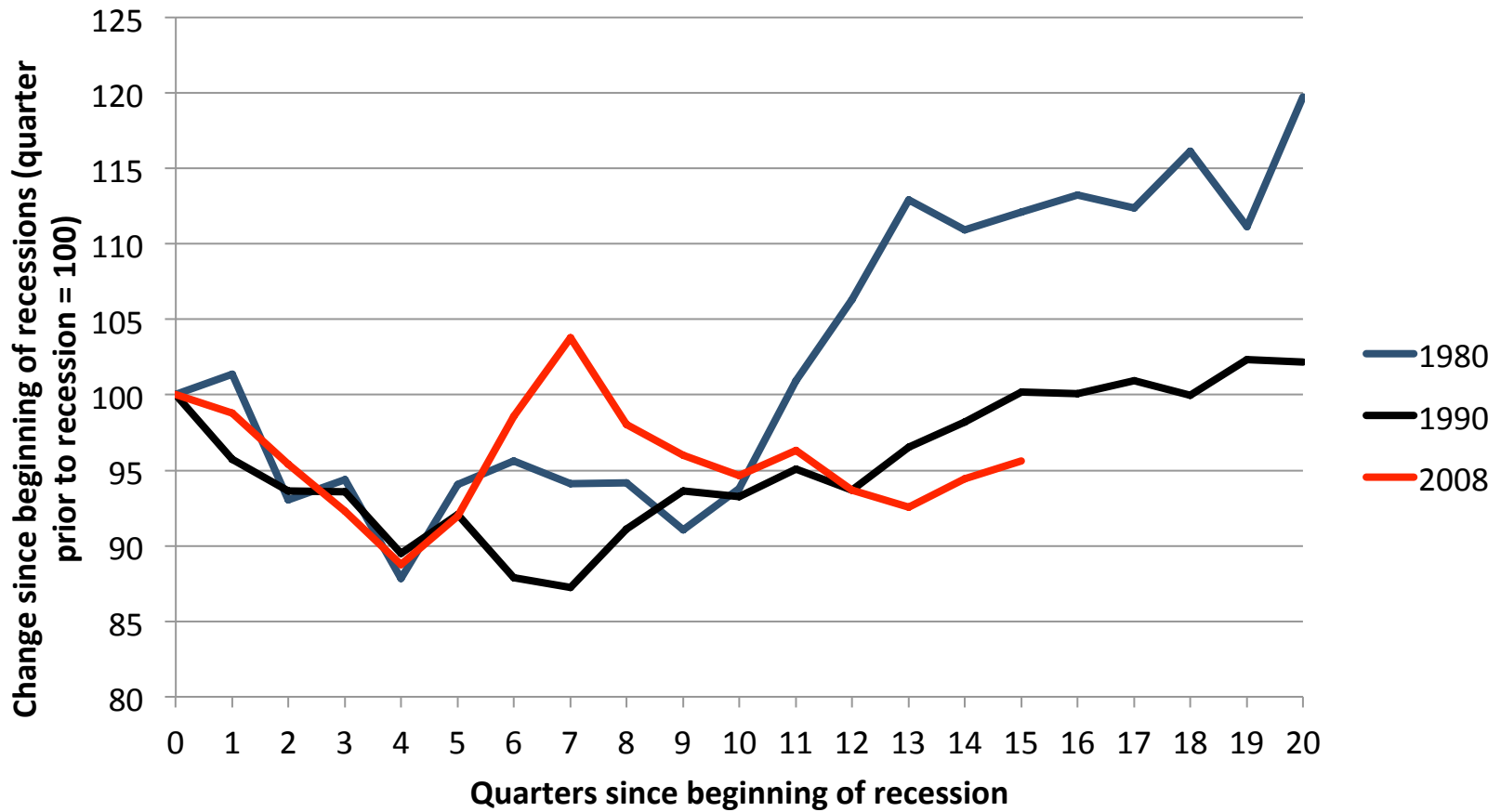
# 3. Consumption

- Expenditure falls have been deeper than in previous recessions.
  - Note that the start of the fall is coincident with the fall in GDP (not income).
- Unusually expenditure on consumer nondurables has fallen most
  - Especially among the young and to some extent among the middle aged. Less for the old.
  - Temporary VAT reduction?

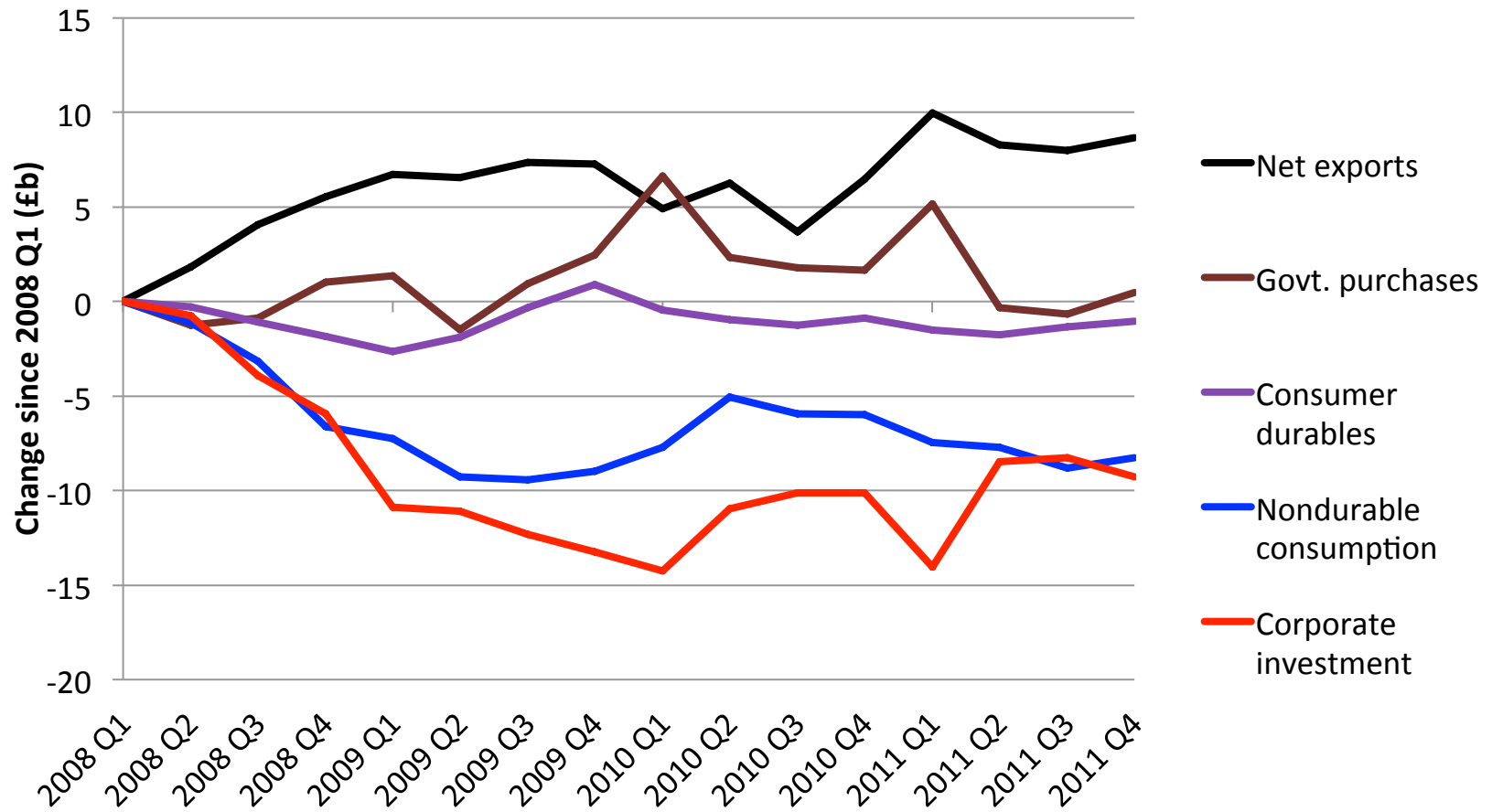
# Non- and semi-durables



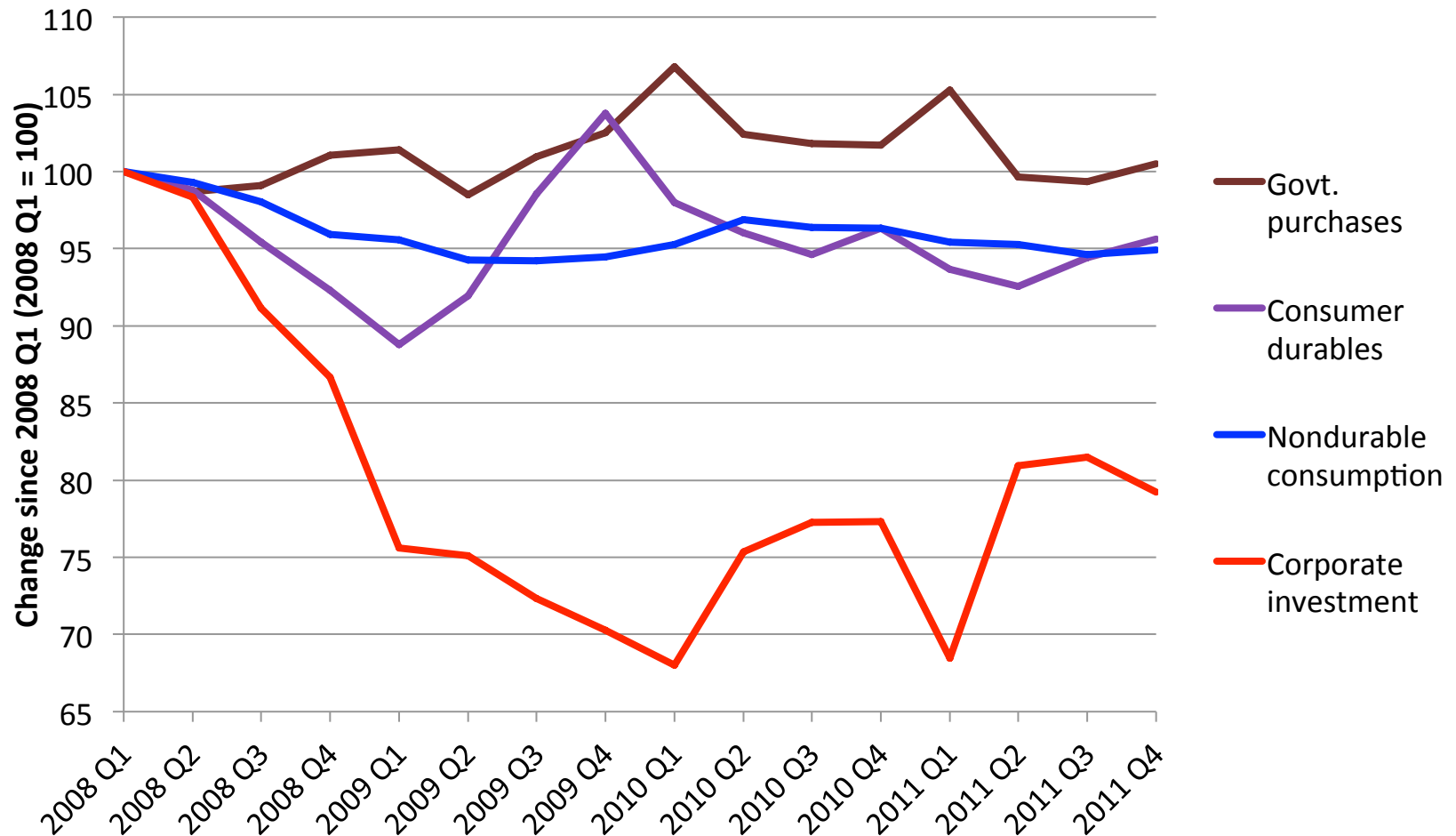
# Durables



# Components of GDP



# Proportionate Fall in Each Component



# Consumption

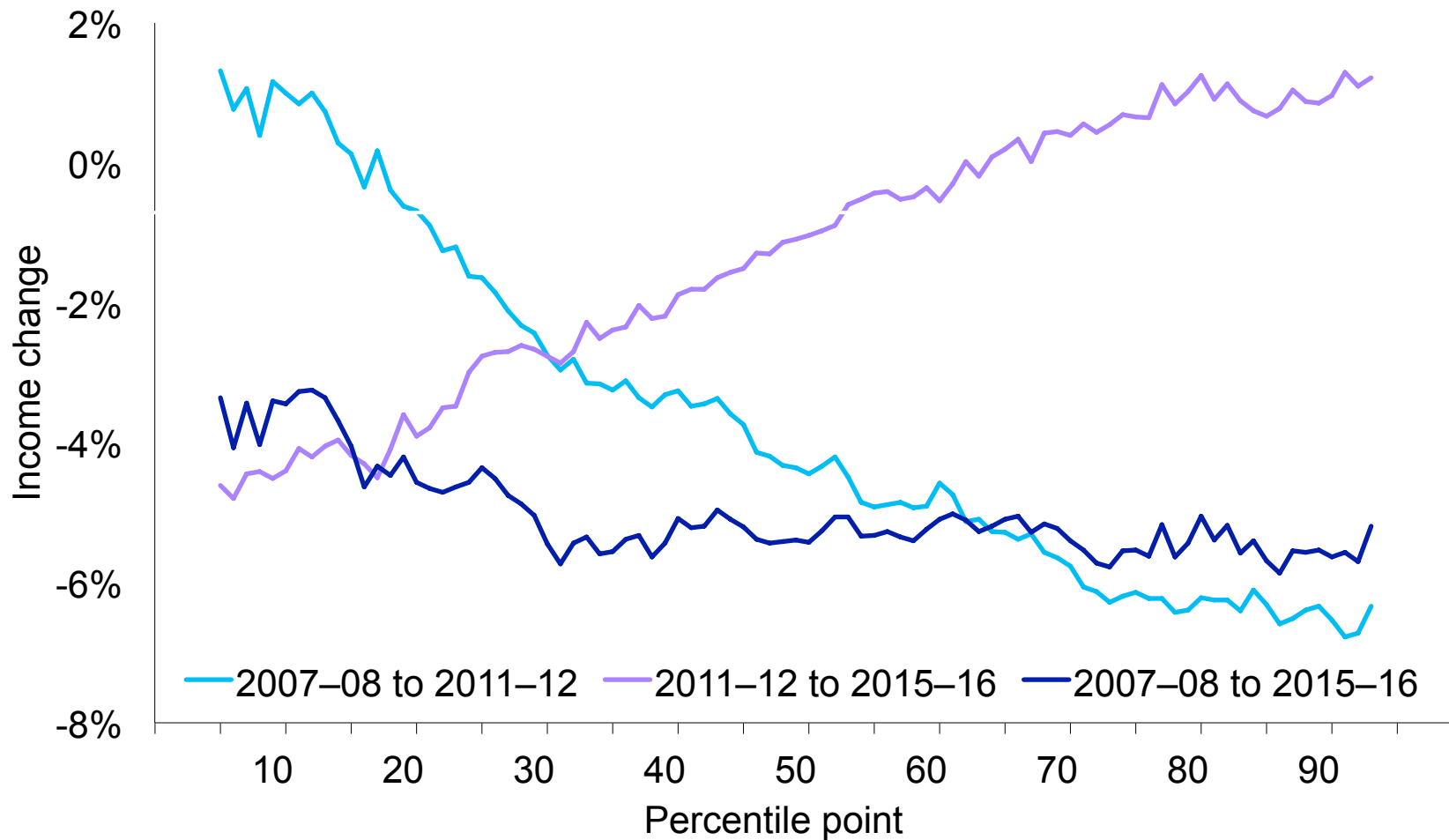
- Homeowners have made the largest cuts.
  - In past recessions there was little difference between owners and renters.
- Saving ratios are lower than during the early 1980s and early 1990s
  - but haven't risen dramatically since 2008 (and pension contributions higher).
- The data points to an expectation of a permanent fall in living standards,
  - especially among the young and middle-aged.



## 4. Summary and ... Prospects ...

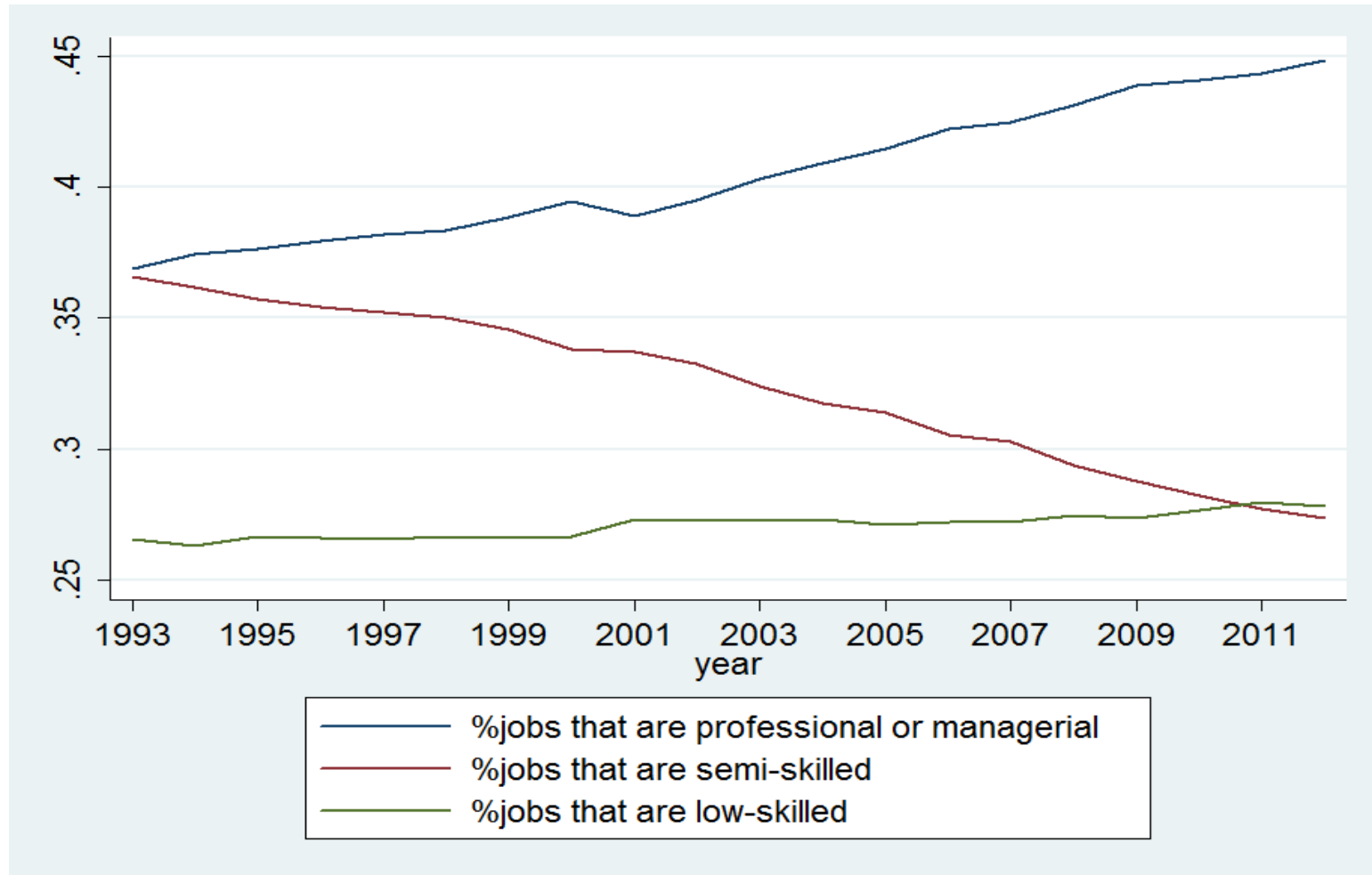
- What has driven living standards?
- Changes in the labour market are a key factor behind the changes,
  - especially for younger families/singles relative to pensioners.
- Real wages and employment tell much of the story. Benefit changes have also been important drivers.
  - the poor employment and earnings performance of young adults maps into big falls in their incomes relative to older workers.
- The continued catch-up of pensioners relative to working-age adults is in large part due to the sharp falls in real earnings and relatively robust benefit rates.

# Simulations up to 2015–16



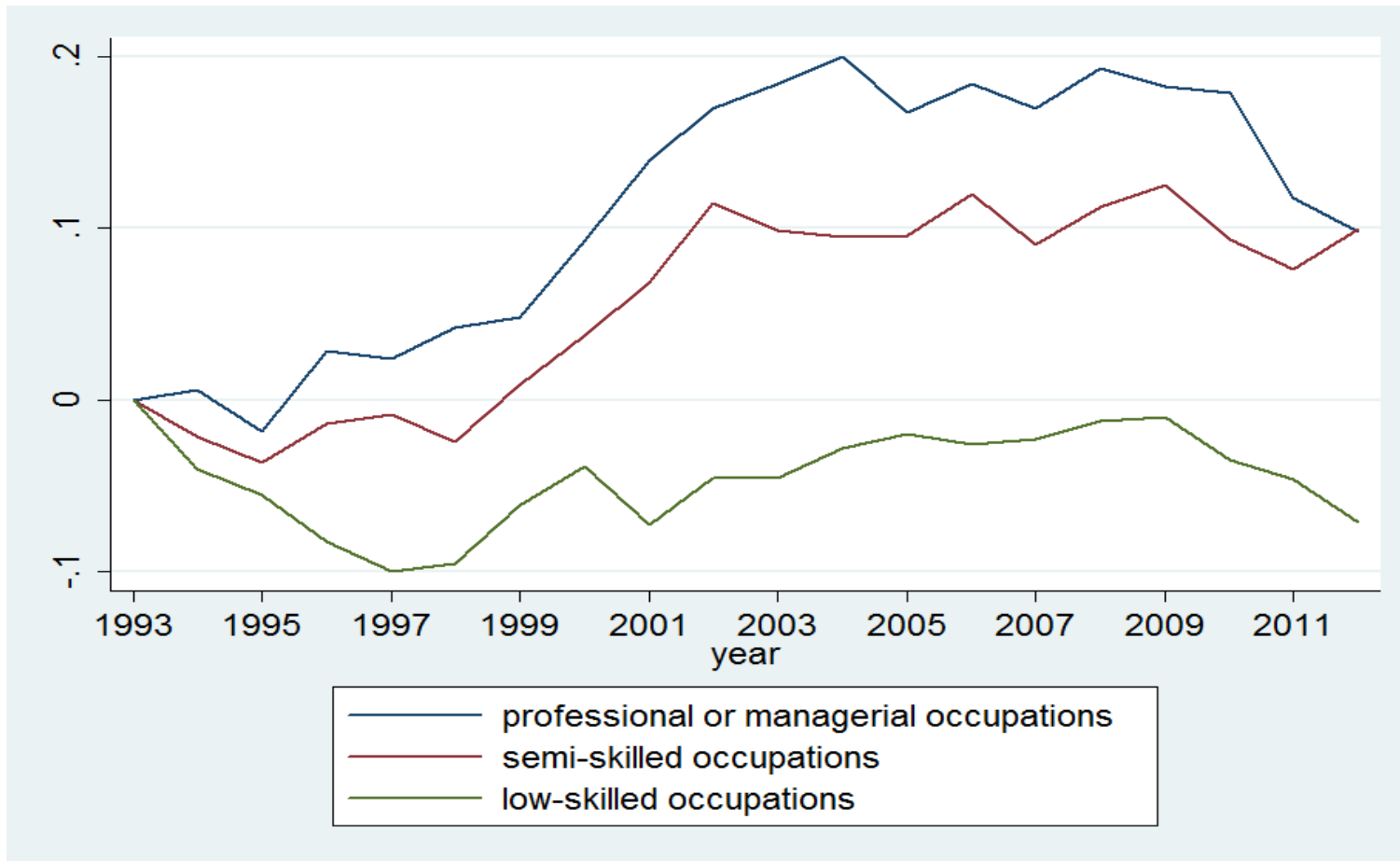
Note: Figure taken from Brewer et. al. (2013), Fiscal Studies, Vol. 34, No. 2, June 2013, Vol. 34, No. 2, pp. 179–201. Published before the latest HBAI release. The 2011–12 income distribution is therefore a simulation, but is extremely similar to the actual data.

# Employment shares of occupation groups



Note: the discontinuities in occupation classification in 2001 and 2011 have been addressed in the following way. For the conversion of SOC 1990 to SOC 2000, we look at individuals who were surveyed in 2000Q4 and 2001Q2 and stayed with the same employer and infer the transition matrix from this group. For the conversion of SOC2010 to SOC 2000, we used the ONS two-way tabulation of the LFS 2007 Q1 sample by the major occupation groups under the two SOC systems.

# (RPI deflated) Real wages by occupation group since 1993



Note: the low-skilled wage would end up around the 1993 level if we use CPI instead of RPI. Each log wage series is normalized to 0 in 1993.

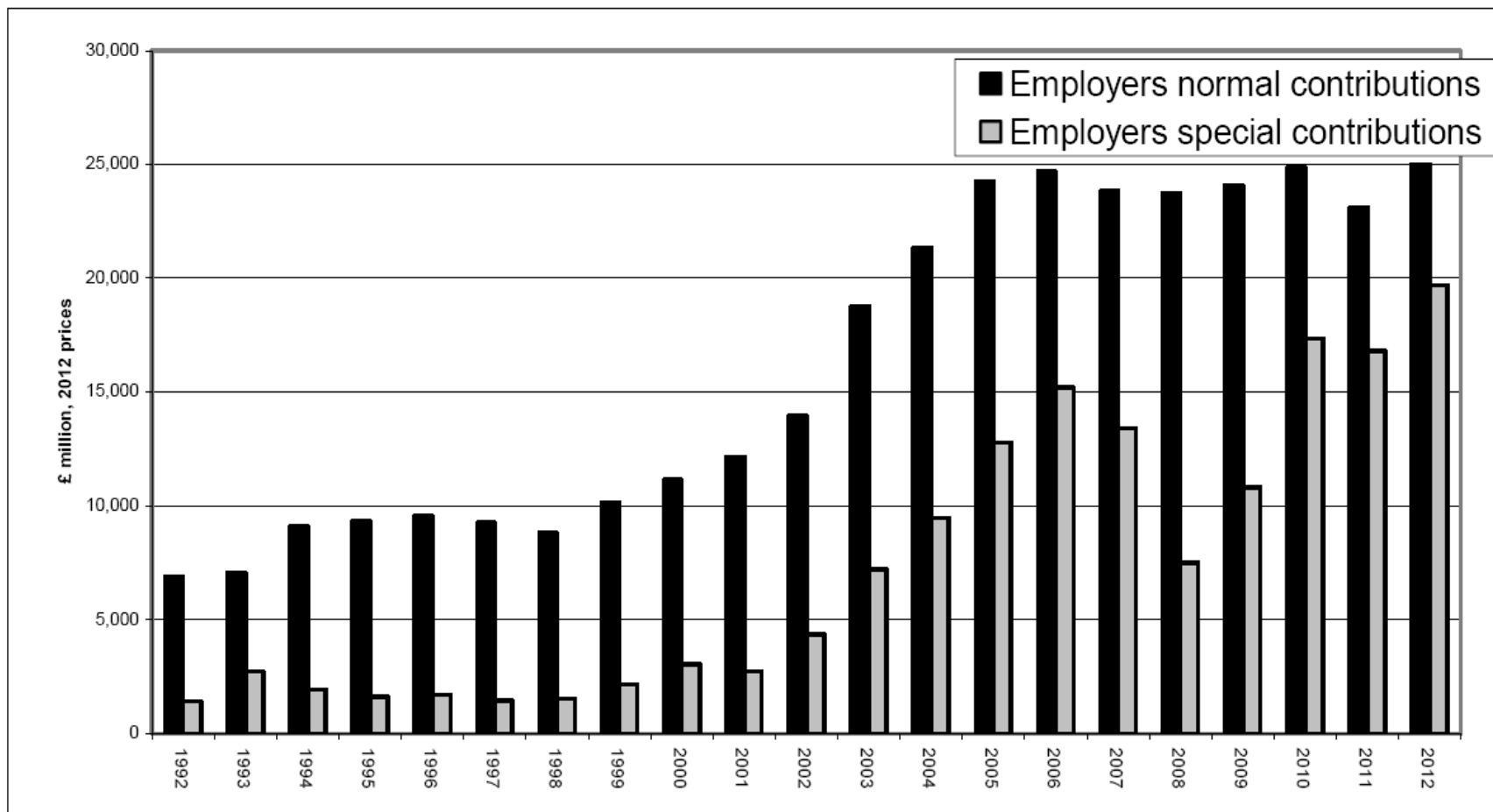
# Prospects - I

- Younger workers and families are acting as if they expect a long-run fall in relative living standards
  - evidence from consumption and saving.
- Real wages, productivity and capital investment have slow to pick up
  - we can expect the pattern of lower real wages to continue, but with fairly buoyant employment due to increased supply.
- Most *falls* in real earnings have happened (but low/no real growth)
  - fiscal contraction implies >£20 bn year of benefit cuts by end of this parliament
  - trends by age maybe more durable, e.g. pensioner benefits protected
- The number of routine jobs near the middle of the earnings distribution has declined steadily till 2009
  - more jobs are now professional or managerial. In the late 90s to early 2000s, wages grew fast for high (and mid-skilled) occupations, but this slowed down around 2003 and real wages fell since 2009.
- Suggests longer term earnings growth will mostly come from high-skilled occupations, with some at the very bottom.

## Prospects - II

- But still much to do in focussing on older workers in general, on return to work for parents/mothers, and on entry into work.
- There are still some potential big gains here,
  - for example, as (higher skilled) women age in the workforce.
- Tax/welfare reforms to enhance earnings (from *Mirrlees*):
  - refocus incentives towards transition to work, return to work for lower skilled mothers and on enhancing incentives among older workers.
- Productivity is still the key,
  - (financial) capital misallocation and potential investment returns.
- Human capital and ‘on the job’ wage/productivity complementarity
  - note the relative importance of mismatch of entry skills in the recession.
- Productivity and wages are closely related but note recent growth in the wedge between labour costs and hourly wages,
  - the growing importance of pensions and NI in the UK,
  - what will the trends in this wedge look like?

# Employer contributions to pension funds – in constant prices terms



Source: Office for National Statistics

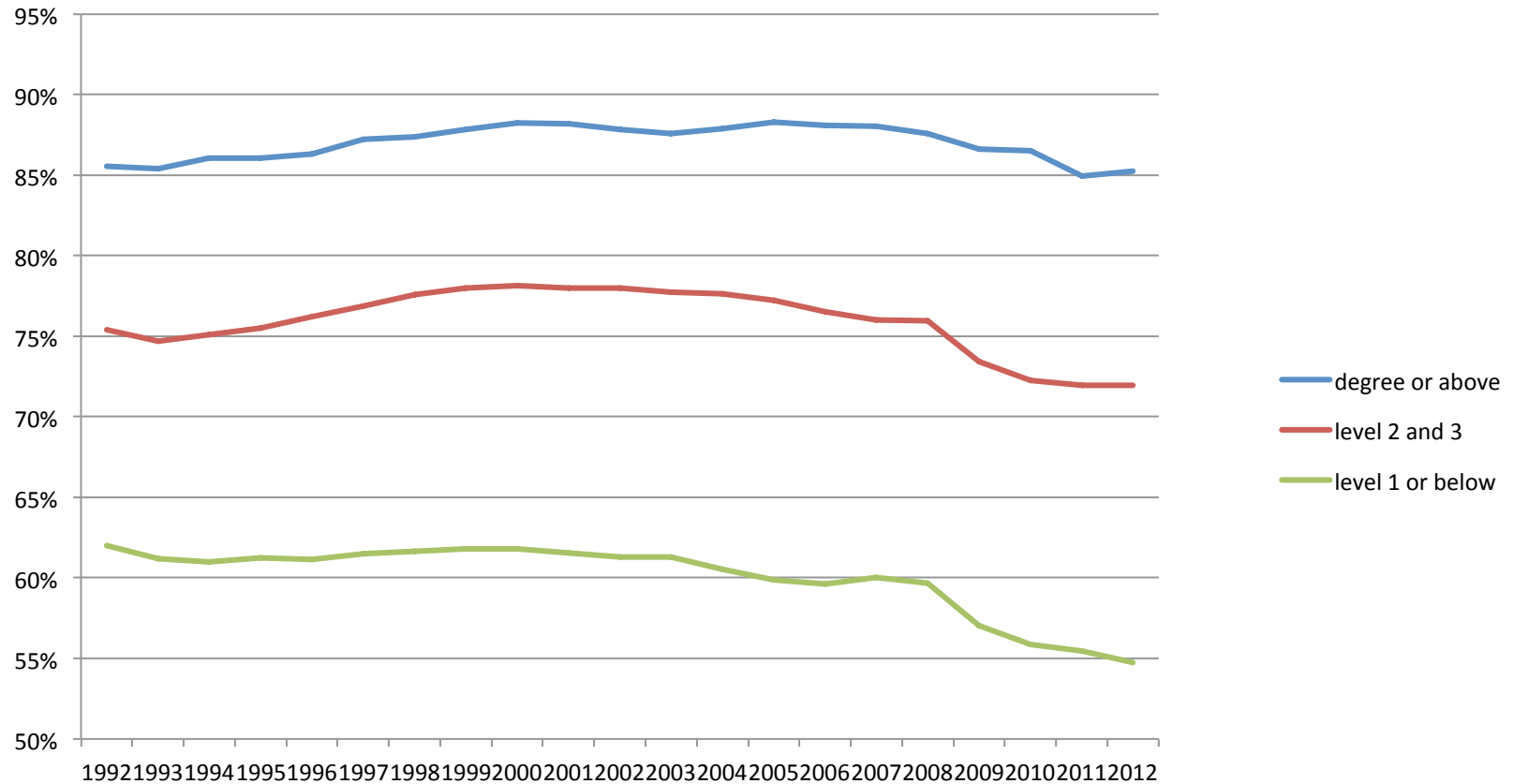
Notes: Data for Q4 2012 is not yet published so has been estimated based on Q4 2011 to Q3 2012 data

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# Employment rate by highest qualifications achieved, 16-59 year olds



Note: level 2 is GCSE grade C or above.

# Participation rates over time

