

The Resolution Foundation Earnings Outlook

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As we come to the end of a year like no other, the outlook for the labour market remains uncertain. At the beginning of this month, the second national lockdown came to an end, non-essential retail and hospitality businesses (in most of the country) were allowed to reopen, and recent weeks have brought official approval and rollout of the first coronavirus vaccine. The outlook for the economy and the labour market remains bleak in the medium term, however, with unemployment [continuing to rise](#) in the latest data, Covid-19 cases increasing, and social distancing restrictions expected to continue into the middle of next year.

November was a big month for official economic forecasts. At the beginning of the month, the Bank of England's Monetary Policy Report [projected](#) that employment would peak at 7.75 per cent in 2021 Q2 – later than it expected in August due to the extension of the Job Retention Scheme, but still reflecting significant outflows from employment to come when Government support is wound down. In late November, the Office for Budget Responsibility (OBR) [published](#) its latest Economic and Fiscal Outlook, which painted a far less pessimistic picture than their July scenarios, when the central scenario had unemployment reaching 12 per cent in the middle of next year. They now expect a very similar peak to the Bank (7.7 per cent in 2021 Q2), but with unemployment falling more slowly. The OBR have also [revised down](#) their pay expectations compared to their March forecast, with inflation-adjusted earnings now expected to be 3.4 per cent (or £1,200) lower by 2025 than the March forecast.

The Chancellor also [announced](#) three key labour market policies in November's Spending Review. The welcome (though ambitious) new Restart scheme will help the long-term unemployed find work. The National Living Wage will rise by 19p next April – its smallest rise since 2013, though still leaving it on track to reach two-thirds of typical hourly pay by the middle of the decade – and extended to over-23s. And finally – the focus of this Outlook's spotlight – the Chancellor announced a pay freeze for some public sector workers.

Our Lifting the Lid section looks in more detail at how much of the recent pay growth is due to compositional effects, the rise in young people in full-time education since the start of the crisis, and regional changes in economic activity.

Spotlight | Public sector pay

To protect the lowest earners, the freeze excludes those with a salary below £24,000 (who will receive 'at least £250'), as well as NHS workers in recognition of their work throughout the pandemic – although small increases will represent a [real pay cut](#) for many. This echoes the 2011-2013 pay freeze, when the newly-elected coalition government set pay awards to zero for all but the lowest-paid: over that period, full-time public sector workers staying in the same organisation saw average pay growth of just 1.8 per cent a year (in cash terms) over that period, compared to 4.3 per cent a year on average between 2005 and 2010.¹ Despite the exemptions, many non-NHS key workers are set to have their pay frozen next year ([all qualified teachers](#), for example, will be subject to the freeze), as well as part-time workers whose full-time equivalent salary is over £24,000 but who earn less in practice (8 per cent of all those affected by the freeze).

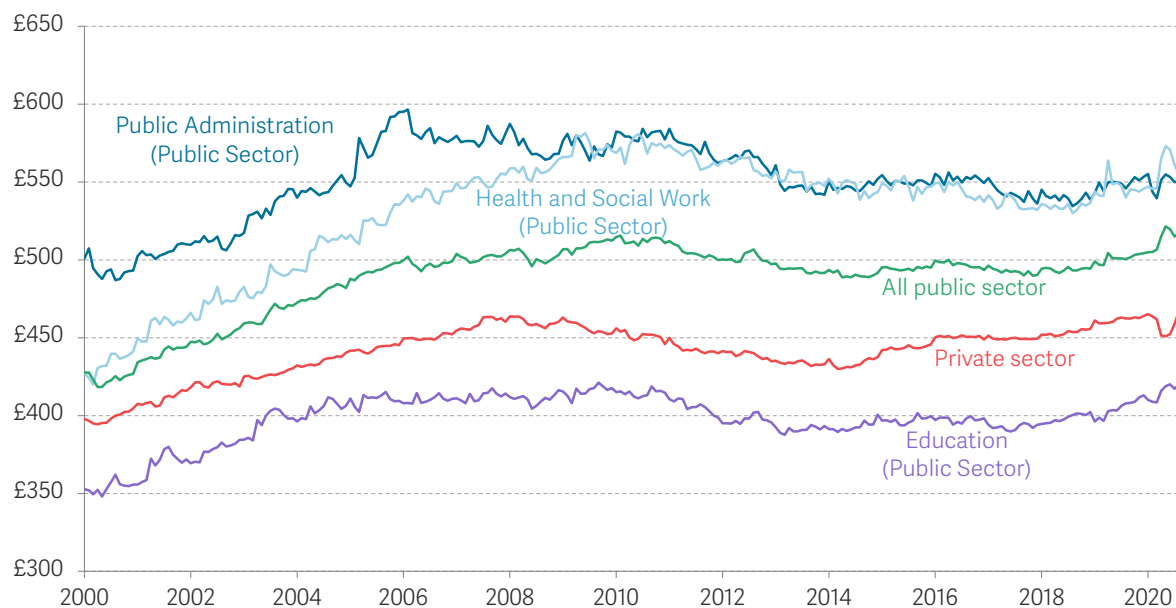
Since comparable data began in 2000, average weekly earnings in the public sector have been higher than in the private

¹ This figure tracks changes from the second quarter of one year to another and includes employees who worked in the public sector and worked full time in both periods. It excludes public sector workers who moved organisations but includes those who got promoted within the same organisation. Source: RF analysis of ONS, Five-Quarter Longitudinal Datasets.

sector – although as Figure 1 shows, higher pay is not a feature of all public sector industries, with education lower-paid than the private sector average. Both the public and private sectors have faced a decade of lost earnings growth: while pay restraint held back public sector earnings, real pay in the private sector reflected a weak labour market. More recently, however, public and private sector pay have responded very differently to the coronavirus crisis. While real private sector earnings fell by as much as 2 per cent year-on-year when millions of workers were furloughed during lockdown, public sector weekly pay increased, driven by the health and social care sector (analysis of the Labour Force Survey suggests that this was largely due to more hours worked rather than any change in hourly pay). Private sector pay has since recovered, however, reaching pre-crisis levels in August and growing by 2.4 per cent in the year to October.²

FIGURE 1: Average weekly earnings are higher in most of the public sector than in the private sector

Average weekly earnings (regular pay), adjusted for CPIH inflation: GB



NOTES: Three-month averages.

SOURCE: RF analysis of ONS, Average Weekly Earnings.

Does this gap justify the pay freeze? Some of the pay difference between the public and private sectors is [explained](#) by differences in the types of workers that work in each sector. The exact value of the remaining public sector pay premium, after adjusting for observed characteristics, depends on how it is calculated, but on all measures the premium has declined over the past decade, and the Institute for Fiscal Studies [estimates](#) that it fell to zero in 2019. And those that are affected by the pay freeze actually face a public sector pay penalty: the average worker in this group earns close to 8 per cent less than comparable workers in the private sector, as Figure 2 shows.³ On the other hand, those not affected by the pay freeze receive a pay premium of 6.7 per cent, which is almost entirely driven by the lower earners in the group (likely linked to [the fact that](#) the private sector employs far more people at the wage floor and on very low pay). Non-wage benefits also have a part to play, though. Public sector pensions are [much more generous](#), and public sector workers have benefited from greater job security during the pandemic: in September, public sector workers were around half as likely as private sector workers to say they were worried about losing their job or for their employer to have announced redundancies (16 per cent and 30 per cent respectively).⁴

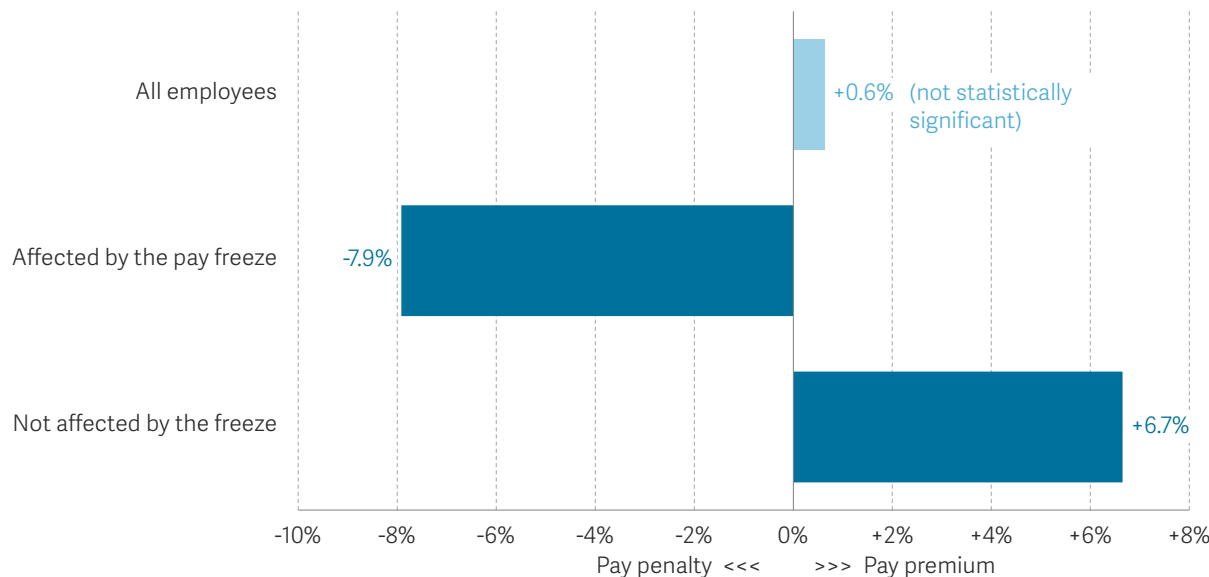
² It is worth noting that pay growth in the private sector may be less positive than it appears: rather than workers getting pay rises, it may reflect compositional changes in the labour market if lower-paid workers are more likely to lose their jobs, leaving the average employee still in work higher-paid. See: N Cominetti & H Slaughter, [Low Pay Britain 2020](#), Resolution Foundation, September 2020.

³ This is consistent with previous findings from the Institute for Fiscal Studies that higher earners face a public sector pay penalty, while lower earners experience a public sector pay premium. See: J Cribb, C Emmerson & L Sibietta, [Public sector pay in the UK](#), Institute for Fiscal Studies, October 2014.

⁴ Refers to the share of respondents saying they were anxious that they will lose their job over the next three months, whose employer has announced that they are considering making redundancies or a that a redundancy consultation is happening, or who have been told that they will be made redundant. Base = all UK adults aged 18-65 years with an employee job (n=3,645). Base by categories: private sector n=1,755; public sector n=1,515. Fieldwork was carried out online by YouGov Plc between 17-22 September 2020. The figures have been weighted and are representative of all UK adults (aged 18-65) according to age, gender and region. These figures have been analysed independently by the Resolution Foundation. Source: RF analysis of YouGov, Adults Age 18 to 65 and The Coronavirus (COVID-19) - September wave.

FIGURE 2: Those affected by the pay freeze earn less than comparable workers in the private sector

Public sector pay differential after adjusting for observed characteristics, by whether affected by the public sector pay freeze: 2019-20



NOTES: Aged 16-64. We control for age, age-squared, region, education and experience, following the same broad methodology as outlined in: J Cribb, C Emmerson & L Sibieta, Public sector pay in the UK, Institute for Fiscal Studies, October 2014. For our analysis of those affected by the pay freeze, we restrict our sample to those earning at least £24,000 a year and exclude public sector employees who work for a health authority or the NHS; to apply the former condition, we calculate the full-time equivalent salary of part-time workers based on their usual hours worked relative to an assumed full-time week of 35 hours. For those not affected, we include only those who earning less than £24,000 (full-time equivalent) or work in the human health industry (to include a reasonable comparison group with NHS workers).

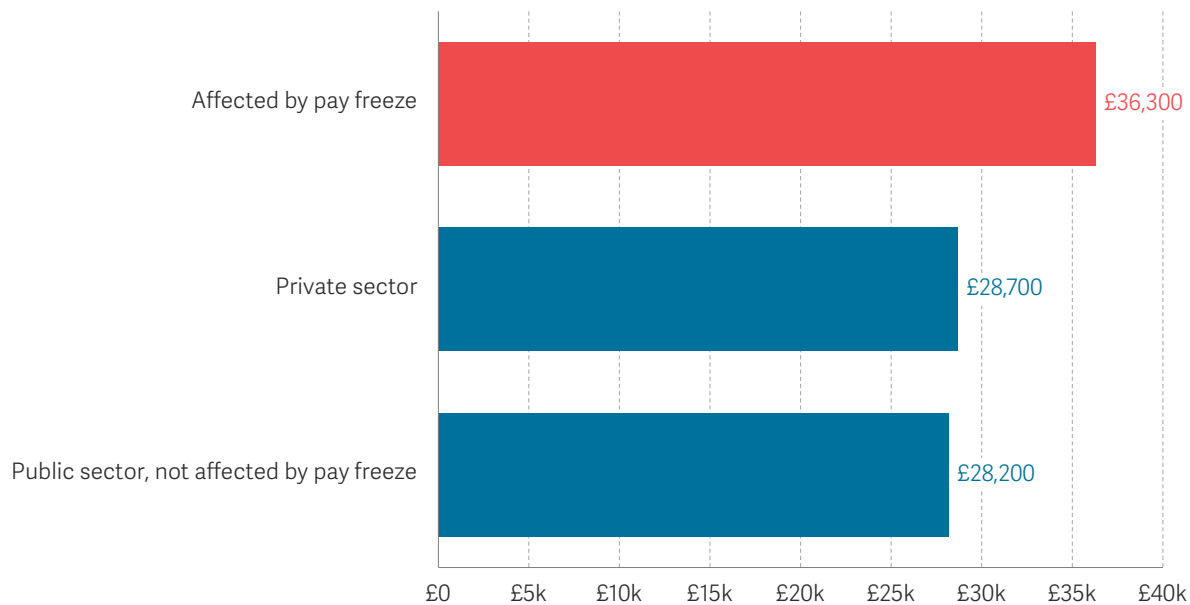
SOURCE: RF analysis of ONS, Labour Force Survey.

The exemption for the lowest earners also goes some way to soften the impact of the pay freeze on living standards. Although earnings do not always correlate with household income, Figure 3 shows that those affected by the pay freeze have a typical household income 28 per cent higher than either workers in the private sector or those impacted by the freeze. Similarly, the pay freeze will have a relatively small impact on low-to-middle income households: just 4 per cent of low-to-middle income families contain someone whose pay will be affected by the freeze, compared to 12 per cent of higher-income families.⁵

⁵ Low-to-middle income families defined as in Annex 1 of D Tomlinson et al., [The Living Standards Audit 2020](#), Resolution Foundation, July 2020. Source: RF analysis of DWP, Households Below Average Income.

FIGURE 3: Those affected by the pay freeze have relatively high household incomes

Median annual equivalised household income after housing costs, by whether affected by the public sector pay freeze: UK, 2018-19



SOURCE: RF analysis of DWP, Family Resources Survey.

Looking ahead, the crisis has driven two key changes that make the case for public sector pay restraint over the next year. First, pay in much of the private sector looks set for stagnation next year. In its recent [report](#), the Low Pay Commission shows that there has been a significant increase in pay freezes, increasing from 5 per cent to 20 per cent between 2019 and 2020; similarly, [data](#) from Incomes Data Research suggests that pay freezes have become five times more common in 2020 compared to last year. And second, in the face of higher public spending on Covid-19 support measures, the Chancellor has [announced](#) a £10 billion reduction in normal (non-Covid-19-related) public service spending next year. With pay making up [more than a fifth](#) of total public spending, it is perhaps unsurprising that a pay freeze has been proposed as a way to cut costs – effectively transferring money back to taxpayers, who are poorer, on average, than those affected by the freeze (Figure 3).

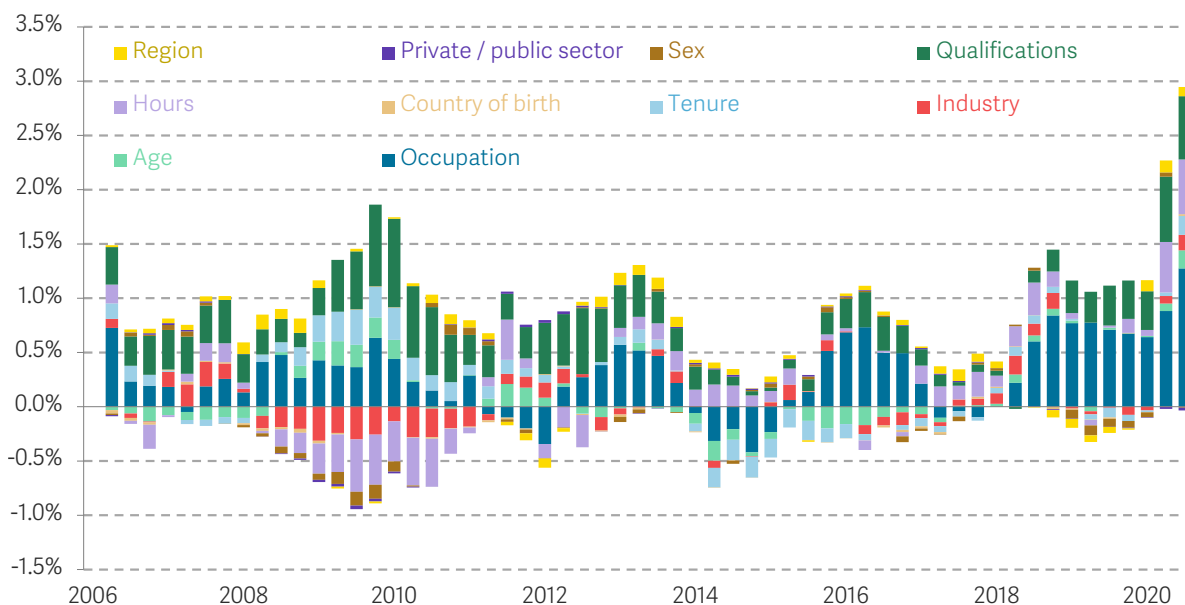
Decisions about public sector pay, however, should take account of the wider economic context. While public and private sector pay do tend to move together in the longer term (and it is right for that trend to continue), April may not be the right time to bring public sector pay back in line with the private sector given ongoing weak economic conditions. From a fiscal policy perspective, the Government [should be increasing spending power](#) to boost demand during the recovery, rather than reducing it.

Any longer-term public sector pay restraint could also exacerbate existing recruitment difficulties, and so the quality of public services: the Government needs to set public sector pay to recruit both the number and quality of staff they need. Recruitment challenges may well be smaller in the aftermath of the crisis while unemployment remains high – but pay is nonetheless important for attracting the right people. And there are already recruitment difficulties in some parts of the public sector, such as [education](#), as well as the publicly funded social care sector. (While the majority of social care workers are employed by private sector contractors, and so are out of scope of this pay freeze, their pay is nonetheless determined by Government policy.) Less than half of frontline care workers [are paid the real Living Wage](#), contributing to a vacancy rate of [over 7 per cent](#). Looking ahead, the Government will need to improve pay (and conditions) in social care, alongside other parts of the public sector, to resolve longer-term recruitment issues.

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. A comprehensive breakdown of each indicator is available online: resolutionfoundation.org/earningsoutlook

FIGURE 4: Compositional contributions to year-on-year growth in nominal weekly earnings in the Labour Force Survey

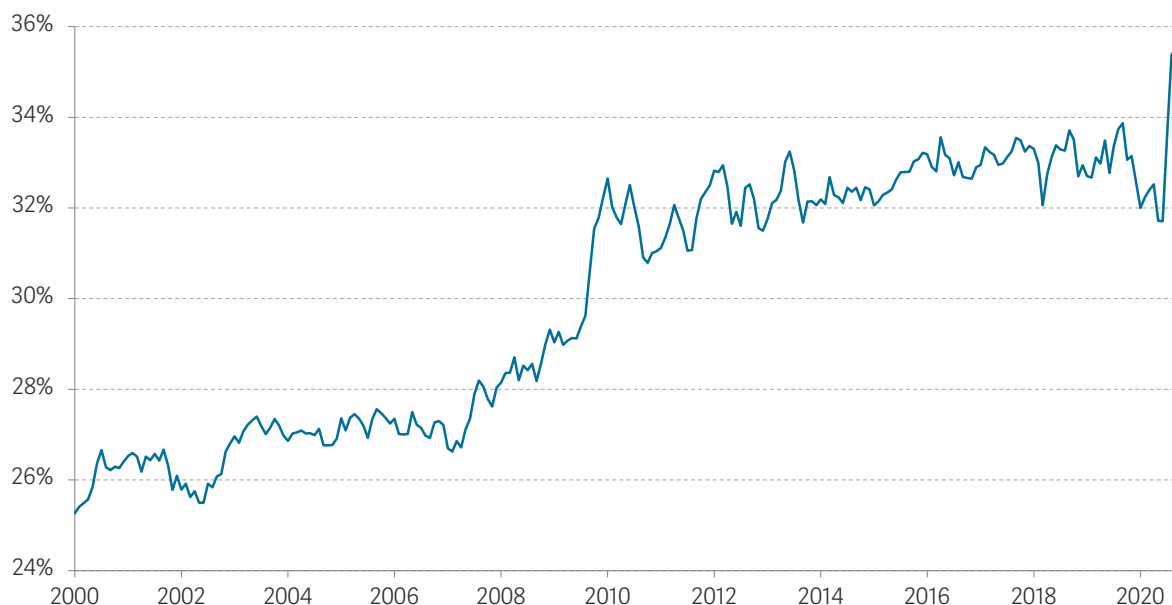


NOTES: This analysis uses data from the Labour Force Survey rather than the headline Average Weekly Earnings series.

SOURCE: RF analysis of ONS, Labour Force Survey.

Earnings growth during the crisis has been extremely variable. On the ONS' Average Weekly Earnings measure, pay fell in the spring as many furloughed workers (who are included in the data) moved onto 80 per cent of their pre-crisis earnings. But real earnings have actually been higher in recent months than they were pre-crisis. Figure 4 provides an insight into the compositional factors that may explain this growth, using data from the Labour Force Survey (LFS). It shows that the biggest drivers of LFS earnings growth in the year to Q3 2020 were occupation, hours, and qualifications: as the relative number of employees in lower-paying occupations, with fewer qualifications, and working part-time has declined, the average employee still in work is now higher-paid. Rather than the rise in wages representing good news, much of it reflects the fact that low-paid workers have been [much more likely](#) to have lost their jobs during the crisis.

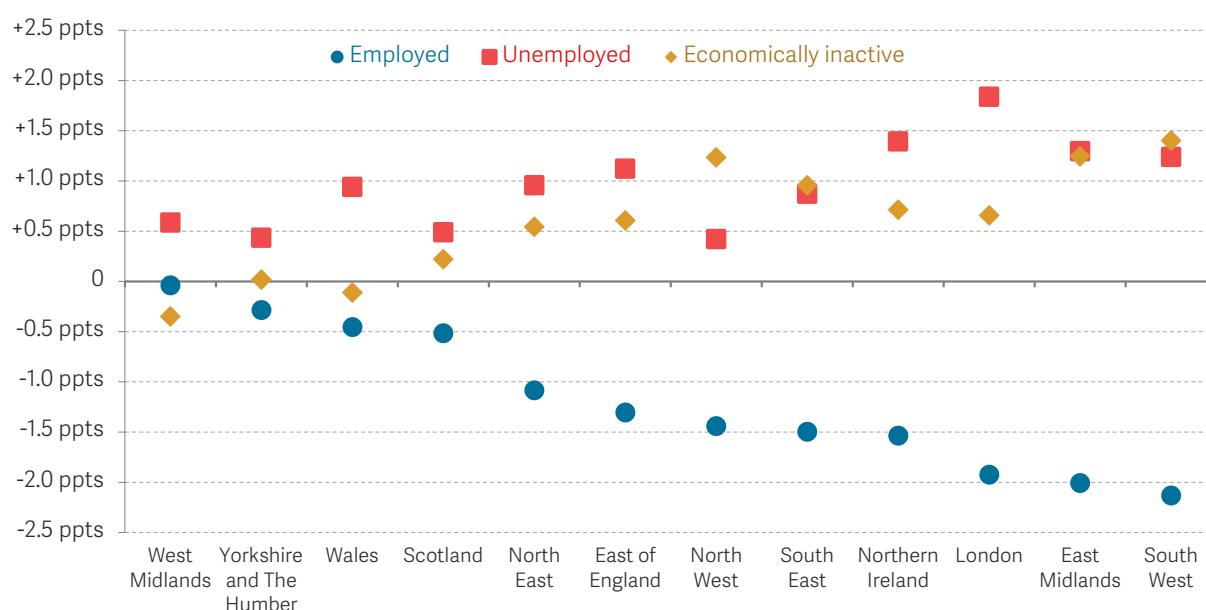
FIGURE 5: Proportion of 18-24-year-olds in full-time education: UK



SOURCE: RF analysis of ONS, Labour Market Statistics.

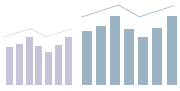
One way that young people can ‘ride out the storm’ of an economic downturn is by staying on in education. And it appears that many 18-24-year-olds are doing just that: Figure 5 shows that the share of young adults in full-time education reached a record high of 35.5 per cent in September, dipping slightly in October but remaining higher than any point before the crisis. This trend may also be linked to [higher university admissions](#) this year after A-Level results were awarded based on predicted grades – but whatever the cause, more people staying in education is good news, since entering the labour market in the middle of a crisis is [associated with](#) long-term scarring of young people’s pay and employment prospects.

FIGURE 6: Change in employment status between Dec-Feb 2020 and Aug-Oct 2020, by UK region and nation

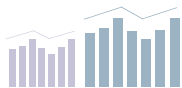


SOURCE: RF analysis of ONS, Labour Market Statistics.

Figure 6 shows how the labour market impact of the crisis has impacted the different regions and nations of the UK. Successive lockdowns and social distancing restrictions to control the virus have taken their toll on employment across



the country, with every area seeing a rise in unemployment and a fall in the employment rate. But the impact has not been evenly spread. London has faced the biggest rise in unemployment over the course of the crisis, and the biggest fall in the employment rate was in the South West (possibly linked to [its reliance on tourism](#)). On the other hand, the West Midlands, Yorkshire and The Humber, and Wales have seen a very limited employment impact so far – the employment rate in the West Midlands is almost unchanged compared to the beginning of the year.



The Scorecard | Quarter 4 2020

<p>Median employee earnings</p>		<p>↑ 3.1% on yr (all) ↑ 2.1% on yr (private sector)</p>	<p>In the most recent data, real median pay grew by 3.1%. Pay growth has picked up in the latest data, in part due to workers returning from furlough when many received 80% of their normal earnings.</p>
<p>All worker earnings</p>		<p>Employee earnings and all worker earnings gap ↓ 11%</p>	<p>Our all worker earnings measure is based on pre-pandemic data, so the falling gap reflects the hit to employee weekly pay thanks to furloughing in the crisis.</p>
<p>Earnings decomp.</p>		<p>↑ 1.0ppts on yr</p>	<p>Pay growth was 1.5 ppts higher as a result of compositional effects, as low-paid workers have been more likely to lose their jobs in the crisis. The 'Lifting the Lid' section explores these compositional effects in more detail.</p>
<p>Annual pay rises</p>		<p>↑ 1.3ppts on yr</p>	<p>Median year-on-year real hourly pay growth for employees in work over a year (both job stayers and changers) stood at 1.4% in April 2019, 0.6 ppts higher than the previous year.</p>
<p>Earnings Inequality</p>		<p>r75:25 ↓ 1.7% on yr r90:10 ↓ 1.6%</p>	<p>Our headline measures of earnings inequality continue to fall, but low paid workers have been more likely to face reductions to hours and pay or to have lost work.</p>
<p>Unemployment by duration</p>		<p>↓ 0.9 ppts on yr (all) ↑ 0.1 ppts on yr (long-term)</p>	<p>The headline unemployment rate rose to 4.9% in the latest data, and there are signs that long-term unemployment is starting to increase.</p>
<p>Under-employment</p>		<p>↑ 41% on yr</p>	<p>Under-employment has risen significantly in the crisis, likely due to employers making hours reductions in the face of weak demand and supply constraints.</p>
<p>Job-to-job moves</p>		<p>↓ 59% on yr</p>	<p>The proportion of workers voluntarily moving job (an indicator of worker confidence) was down by more than half on the previous year. This will have a negative effect on pay growth.</p>
<p>Migrant job entry</p>		<p>↓ 7% on yr</p>	<p>The proportion of jobs going to new migrants fell by 7 per cent over the past year.</p>
<p>Workforce participation</p>		<p>↑ 0.5% on yr</p>	<p>The labour force participation rate of 18-69-year-olds reached 76.8% in Q3 2020, but the crisis has caused recent growth to plateau.</p>
<p>Labour productivity</p>		<p>↑ 2.9% on yr</p>	<p>Hourly productivity rose sharply in Q3 2020, possibly for compositional reasons (people in lower-productivity sectors losing their jobs).</p>
<p>Training intensity</p>		<p>unchanged on yr</p>	<p>The long-term trend in falling 'off-the-job' training has flattened out, but the proportion of workers receiving such training remains low – a potential drag on productivity.</p>
<p>Graduates in non-graduate occupations</p>		<p>↓ 3% on yr</p>	<p>The proportion of graduates in non-graduate roles (a measure of mismatched demand and supply of skills) has fallen over the past year, and stands at 35.3%.</p>