



productivity
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Shifting Regional

Labour Market Dynamics: Opportunities
for Delivering Inclusive Productivity
Growth

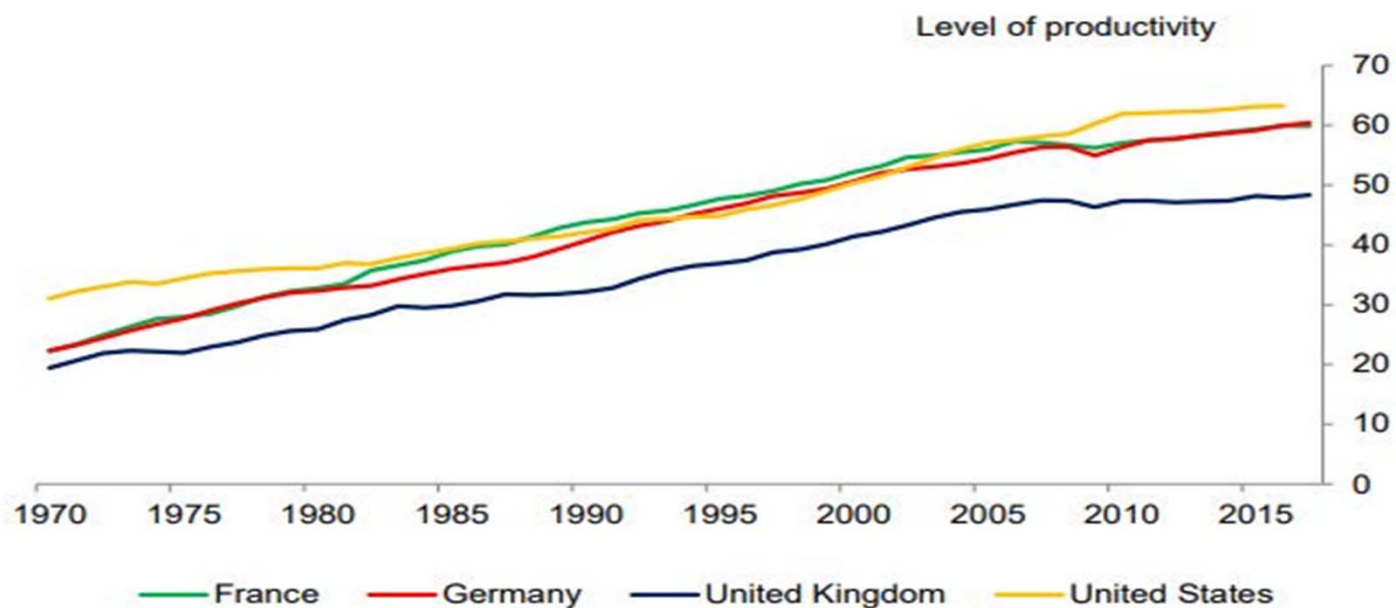
Professor Leaza McSorley, University of
Sunderland

The UK's Productivity Puzzles

- McCann (2018) three interlinked 'productivity puzzles': a 'productivity level puzzle', a 'productivity growth puzzle' and a 'regional productivity puzzle'
 - > Financial crisis => atypical recovery (Blundell et al 2014, Barnett et al 2014).
- Longer lag? - 10 years of productivity and wage stagnation
- More fundamental? Assumptions - structural and institutional underpinnings of productivity growth
- Pay and productivity
- Implications for inclusive productivity growth

Why the focus on UK productivity?

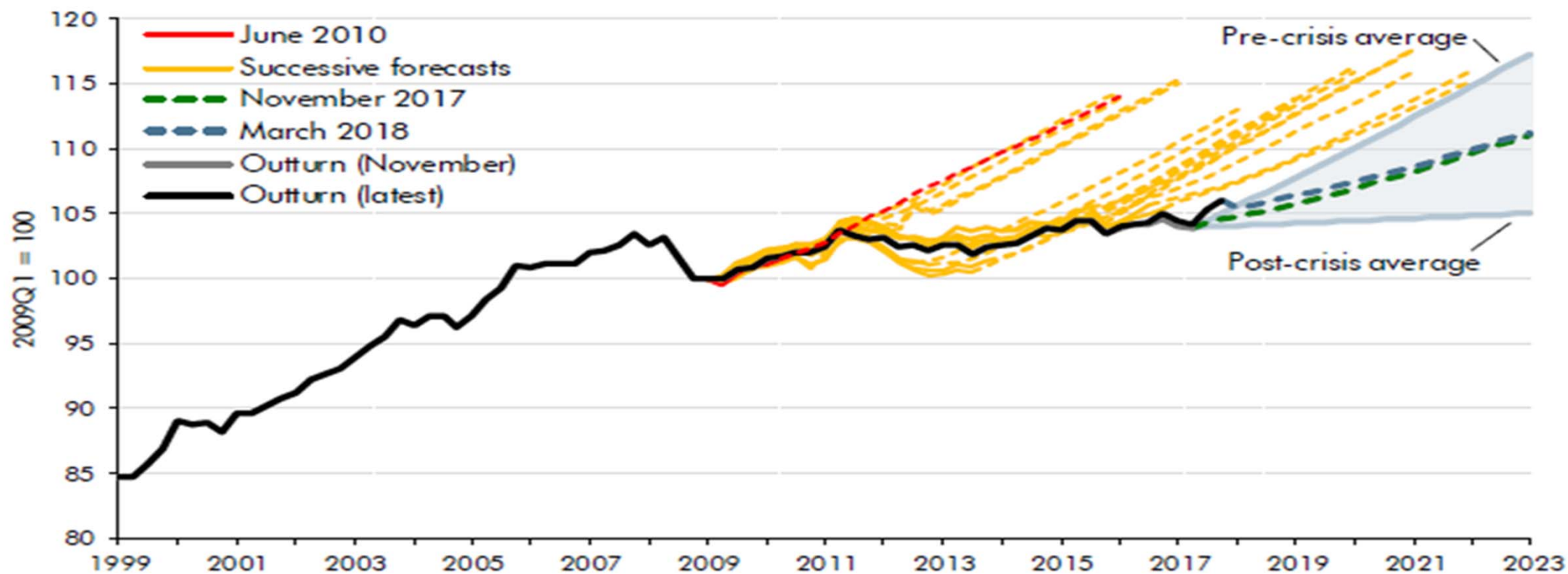
Chart 4: Productivity in UK, US, Germany and France



Sources: OECD and Bank calculations.

Notes: Productivity is output per hour worked in US\$ at constant prices, using 2010 PPPs.

Successive UK forecasts for productivity growth



Note: Solid lines represent the outturn data that underpinned the forecast.

Source: ONS, OBR

Earnings forecasts

	Per cent				
	Average earnings	Productivity per hour	Productivity per worker	Real product wage	Real consumption wage
March 2016 forecast	7.3	3.7	3.5	3.4	3.4
November 2016 forecast	5.1	2.8	2.7	1.9	0.1
March 2017 forecast	5.2	2.9	2.9	2.4	0.8
Latest data	5.0	1.9	1.4	1.3	0.7
Difference ¹					
March 2016	-2.3	-1.8	-2.1	-2.1	-2.6
November 2016	-0.1	-0.9	-1.3	-0.5	0.6
March 2017	-0.1	-1.0	-1.5	-1.1	0.0

¹ Difference in unrounded numbers.

Real earnings and real incomes

	Forecast, annual percentage change					
	2017	2018	2019	2020	2021	2022
Real disposable income per capita	-0.5	0.6	-0.1	-0.1	0.7	0.9
contributions:						
Labour income ^{1,2}	0.7	0.4	0.3	0.2	0.3	0.5
Net taxes and benefits ²	-1.0	-0.7	-0.2	-0.6	-0.1	0.0
Other non-labour income ²	-0.2	0.9	-0.2	0.3	0.5	0.4

¹ Employee compensation (including net compensation from abroad) plus mixed income less employer social contributions.

² Per capita basis, deflated by consumption deflator.

New interest in pay and productivity

- Wage stagnation => renewed focus on productivity
- New research on the links between pay and productivity
- “Is the link between productivity and pay broken?” (Stansbury and Summers 2018)
- Productivity remains a direct method of increasing wage for typical workers Stansbury and Summers (2018), although the link between productivity and pay is weakening Mishel and Bivens (2015) → due both to compensation inequality and reductions in labour’s income share

Shifting the tone of the debate

Important debate:

- questioned conventional wisdom on the direct link between pay and productivity,
 - it has challenged many prevailing assumptions, and
 - signified the role of wage inequality as an issue to be addressed if we want broad based productivity improvements
-
- Wage-led economy (Onaron et al 2015)
 - IMF - shifting to alternative models which consider inequality (Ostry, Loungani and Berg 2019)

Pay and productivity: questioning assumptions

- “great decoupling”
- co-movement (from 1945-75)
- and then divergence (1975 - ...)
- OECD countries decoupling 1995-2014 explained by declines in labour shares and also by declines in the ratio of median to average wages (a partial measure of wage inequality).
- Post crisis: Some decoupling on average but significant cross-country heterogeneity

There are large cross-country differences in macro-level decoupling

Excluding primary, housing, and non market sectors, annualised growth rates in

	Annualised growth rates			Contribution to		
	Labour productivity	Real average wages	Real median wages	Labour share	Wage inequality	Total decoupling
	(1)	(2)	(3)	(2) - (1)	(3) - (2)	(3) - (1)
Poland	4.2	2.8	2.2	-1.3	-0.6	-2.0
United States	1.8	1.2	0.5	-0.6	-0.7	-1.3
Hungary	1.9	1.5	0.6	-0.4	-0.9	-1.3
Ireland	2.5	1.4	1.3	-1.1	-0.1	-1.2
Netherlands	1.8	1.3	1.1	-0.5	-0.2	-0.7
Slovak Republic	3.8	3.6	3.3	-0.2	-0.3	-0.5
Belgium	1.4	1.1	1.0	-0.3	-0.1	-0.4
Germany	0.7	0.6	0.5	-0.1	-0.1	-0.2
Austria	1.1	1.0	0.9	-0.1	-0.1	-0.2
Norway	1.5	1.4	1.3	-0.1	-0.1	-0.2
Czech Republic	3.2	3.6	3.2	0.4	-0.4	0.0
Denmark	1.1	1.4	1.3	0.3	-0.1	0.2
Sweden	2.4	2.7	2.6	0.3	-0.1	0.2
France	1.1	1.4	1.4	0.3	0.0	0.3
United Kingdom	1.2	1.8	1.6	0.6	-0.2	0.4
Spain	0.1	0.3	0.6	0.2	0.3	0.5
Italy	-0.3	0.3	0.2	0.5	0.0	0.5
OECD (weighted av	1.3	1.0	0.7	-0.3	-0.3	-0.6

Source : OECD National Accounts database, OECD Earnings Distribution database. 1995-2013

Theory

- Hysteresis
- Lost capacity not a shock, permanent loss (Blanchard 2018, Krugman 2018)
- Structural shifts in labour markets = reflected in Philips Curve (Farmer 2018)
- Low unemployment not resulting in wage rises (Bell and Blanchflower 2018)
- Secular stagnation (Stansbury Summers 2018)
- Weakening of the link between productivity and pay

Structural and institutional factors

Established that pay inequality is important (Pessoa & Van Reenen 2013. OECD 2018)

- structural and institutional factors
- Income inequality
 - Young people have now replaced the elderly as the group most at risk of relative poverty (OECD 2016)
 - Falling or stagnating household incomes: job loss and lesser degree falling wages
- European Central Bank wage dynamics survey:
- Major reason for wage stickiness/downward nominal wage rigidity
 - “morale” => degree of strategic stability due to belief that decreasing wages in response to crisis would damage employee morale
 - “Anxiety

Efficiency Wage Theory and productivity?

- interaction between redistributive tax and benefits policies: post crisis and post austerity

Table 1: Growth in real gross value added, productivity hours and labour productivity by NUTS1 region, 2010 to 2017

NUTS1 Region	Real GVA (B)	Productivity Hours (Hours worked)	Labour Productivity
United Kingdom less extra region	15%	12%	2%
North East	7%	2%	4%
North West	11%	9%	2%
Yorkshire and The Humber	9%	8%	1%
East Midlands	13%	11%	2%
West Midlands	18%	13%	5%
East of England	16%	16%	0%
London	27%	24%	2%
South East	13%	13%	0%
South West	10%	9%	1%
Wales	13%	8%	5%
Scotland	12%	8%	3%
Northern Ireland	13%	7%	5%

Source: Office for National Statistics (2019)

- Hysteresis:
- Long term scarring - permanent scarring on earnings and types of future jobs undertaken
- May impact on employment, income inequality and productivity for decades to come
- Vicious cycle: individuals with fewer skills and poorer access to opportunities often confined to operate in low productivity, precarious jobs (OECD 2016)
- “Anxiety, Competing Narratives & the Macroeconomy: What is the Role of Policy in Stabilising Expectations?” (Ghosal, Ernst, McSorley and Miller 2019), ESRC Rebuilding Macroeconomics

Implications

- The past ten years have seen significant structural changes in the UK labour market.
- It is unlikely that productivity will return to pre-crisis levels without these structural changes being addressed (McSorley 2018)
- Productivity slowdown may well not be a 'shock' but the 'new normal', reflecting a permanent loss of productive capacity within the UK economy
- Necessitates focus on the structural and institutional underpinnings of productivity growth



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Leaza.McSorley@sunderland.ac.uk

Twitter: @leaza_mcsorley