FINANCE AND CONSTITUTION COMMITTEE

AGENDA

9th Meeting, 2019 (Session 5)

Wednesday 24 April 2019

The Committee will meet at 10.30 am in the Robert Burns Room (CR1).

1. **Earnings in Scotland:** The Committee will take evidence from—
   
   Anna Ritchie Allan, Executive Director, Close the Gap;
   
   John Gallacher, Scottish Organiser, Unison;
   
   Torsten Bell, Director, Resolution Foundation;
   
   Professor David Bell, Professor of Economics, University of Stirling;
   
   Helen Martin, Assistant General Secretary, STUC;
   
   Hazel Brown, Leader of Exceptional Service (Quality), Cornerstone;
   
   Russell Gunson, Director, IPPR Scotland.

Jim Johnston
Clerk to the Finance and Constitution Committee
Room T3.60
The Scottish Parliament
Edinburgh
Tel: 0131 348 5215
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The papers for this meeting are as follows—

**Agenda item 1**

Cover note  

FCC/S5/19/9/1
Finance and Constitution Committee  
9th Meeting, 2019 (Session 5), Wednesday 24 April 2019  

Earnings in Scotland-roundtable discussion

Introduction

1. At its meeting on 6 February 2019, the Committee agreed to undertake some work on earnings in Scotland and agreed its approach to this work at its meeting on 27 February 2019. This paper provides some context for the Committee’s roundtable discussion on earnings in Scotland.

Background

2. Employment in Scotland comprises of public sector employment (20.9 %) and private sector employment (79.1 %) as of December 2018.¹ In March 2019, the unemployment rate in Scotland fell over the quarter to 3.4% whilst for the UK as a whole it is 3.9%. Employment increased to 75.3%, just below the UK wide figure of 76.1%.²

3. The Committee is interested in how earnings in Scotland compare to the rest of the UK and how public sector pay compares with private sector pay. In addition, the Committee has had an ongoing interest in the gender balance of the Scottish income tax base.

4. The Committee’s Adviser, David Eiser, has produced a briefing paper on earnings in Scotland which is attached at Annexe A.

Roundtable

5. The witnesses taking part in the roundtable discussion are:

   • Anna Ritchie Allan, Executive Director, Close the Gap;
   • John Gallacher, Scottish Organiser, Unison;
   • Torsten Bell, Director, Resolution Foundation;
   • Professor David Bell, Stirling University;
   • Helen Martin, Assistant General Secretary STUC;
   • Hazel Brown, Leader of Exceptional Service (Quality), Cornerstone;
   • Russell Gunson, Director, IPPR.

6. Professor David Bell has provided a written submission in advance of the roundtable discussion and this is attached at Annexe B.

7. The discussion will be based around the following themes:

• how public sector pay compares with the private sector;
• how pay in Scotland compares with the rest of the UK;
• changes in the labour market and impacts on earnings;
• distribution of earnings and implications for revenues.

Next steps

8. The Committee will hear from the Cabinet Secretary at a future meeting on issues raised during discussion.

Committee Clerks,
April 2019
INTRODUCTION
In advance of the Committee’s evidence session on earnings in Scotland on 24 April, this paper outlines a number of trends and issues which the Committee may want to raise with the panel.

The paper draws out five broad issues that seem particularly relevant to ongoing policy debates:

- Recent trends in wage growth, and the debate over causes of recent wage stagnation
- Trends in the gender pay gap
- Earnings trends in the public and private sector
- Trends in earnings in Scotland relative to those in the UK – relevant now in the context of the fiscal framework
- Trends in earnings growth across the earnings distribution (i.e. earnings inequality).

The data in this paper is drawn from the Annual Survey of Hours and Earnings (ASHE). ASHE is a random 1% sample of employees. It is widely recognised as the best source of employee earnings data, although it does not include the self-employed.

LONGER-TERM TRENDS IN WAGES: WAGE STAGNATION AND ITS CAUSES
The period since the Great Recession has seen an unprecedented stagnation in wages. In Scotland, real terms median hourly pay in 2018 remained 1.6% below the 2009 level. Among women the story is slightly more positive – real hourly pay in 2018 matched that in 2009, whilst for men real wages are 3.5% lower than at their peak (Chart 1).

Chart 1: Median hourly pay of male and female employees

Source: ASHE
Stagnation or decline in real pay over such a long period is unprecedented. The causes of pay stagnation have been extensively debated. One set of explanations relates to a decline in the bargaining power of workers relative to firms. This could result from a combination of: a rise in labour supply (as a result of later retirement, a more coercive welfare system, and immigration); and a rise in the monopsony power of firms (i.e. if there are fewer employers, those employers have relatively greater power in the wage-setting process). Somewhat relatedly, it may also reflect increases in the non-wage elements of firms’ labour costs (such as pension contributions).

Perhaps more strikingly, real wage stagnation is likely to reflect the stagnation in productivity growth. The causes of this ‘productivity puzzle’ are in turn debated, but probably relates in part to the UK’s historically low levels of investment, a trend which has been accentuated since the recession, possibly combined with weak management practices and weak levels of innovation. Real wage stagnation is likely to have been further accentuated since the financial crisis by sterling depreciation which puts upward pressure on prices (thus reducing real wages).

Stagnation in weekly earnings has been even more marked than is the case for hourly pay, reflecting a small decline in average hours worked. Compared to 2009, weekly earnings in 2018 were 3.9% lower for men and broadly unchanged for women.

THE GENDER PAY GAP

On 3 April 2019, the Scottish Government published its latest report on the gender pay gap (looking at employer perceptions and methods for reducing the gap), and this included an analysis of the latest pay gap data.

The gender pay gap refers to the difference in hourly earnings between men and women, expressed as a percentage of men’s average hourly earnings. The gender pay gap can be calculated as the difference in either the mean or median hourly earnings. Pay gaps may be calculated by comparing full-time workers, part-time workers or all workers. The official measure of the gender pay gap excludes overtime.

Chart 2 shows the evolution of the pay gap for median wages for full-time workers. The pay gap in Scotland had been falling reasonably quickly until 2011, but the gap has closed relatively more slowly since then. It should be noted that the pay gap is larger if average rather than median pay is considered, and larger too if all employees rather than full time employees only are considered (as women are more likely to undertake part-time work).
Chart 2: Gender pay gap (median hourly wages for full-time workers)

Source: Scottish Government, analysis of ASHE 2018

It remains unclear to what extent the reporting requirements of the Equality Act 2010 (Gender Pay Gap Information) Regulations 2017 (whereby private sector companies employing more than 250 employees have to report their gender pay gaps) will contribute to further reductions in the gap.

It will be interesting to hear participants’ views of the causes of the decline in the pay gap – to what extent does it reflect changes in the occupational structure of male and female employment, changing attitudes in relation to childcare responsibilities, or reduced forms of discrimination.

WAGE GROWTH IN SCOTLAND AND RUK

Under Scotland’s new Fiscal Framework, the Scottish budget will be better off than it would have been without tax devolution if revenues per capita grow more quickly in Scotland than in rUK. One of key determinants of growth in income tax revenues is earnings – faster earnings growth should equate to faster revenue growth.

Chart 3 shows Scottish average weekly earnings as a percentage of average UK earnings. Between 2002 and 2013 there was a remarkable convergence of Scottish earnings to the UK – average Scottish earnings were 91.5% of the UK average in 2002 (i.e. 8.5% below UK earnings) but were just 3% below UK earnings by 2013.

In other words, Scottish wages grew more quickly than UK wages during this period, although remain slightly lower than the UK on average.

Between 2013 and 2016 there was no further convergence of Scottish earnings to the UK average. Moreover in 2017 and 2018 Scottish average wages grew less quickly than in the UK. This relative slowdown in Scottish wage growth is also reflected in a relative slowdown in ‘real time’ PAYE tax data published by HMRC.

Understanding the causes of the relative Scottish earnings slowdown is an ongoing priority – as is determining what the Scottish Government’s policy response should be.
PUBLIC AND PRIVATE WAGE GROWTH

In Scotland and in the UK, average earnings are higher in the public as opposed to the private sector, reflecting differences in the average skill/qualification level in the two sectors. The public sector premium is higher in Scotland than in the UK as a whole, although the shape of the premium over time follows a similar pattern. The public sector premium rose during the recession and its aftermath, perhaps reflecting greater flexibility in private sector wages and hiring decisions, but has been declining in recent years, reflecting public sector wage restraint (Chart 4).

Chart 5 shows that Scottish private sector earnings have tended to converge towards those in the UK (other than in the most recent couple of years), whilst public sector earnings in Scotland are now above those in the UK (whilst having been below the UK pre-recession).
RECENT CHANGES IN EARNINGS INEQUALITY

How has earnings inequality evolved in recent years? It is useful to distinguish inequality in hourly pay from inequality in weekly earnings. For men, we can make the following observations (Chart 6):

- Inequality in hourly pay has declined slightly in recent years, and particularly so in 2016. The decline in wage inequality in 2016 reflected a substantial rise in wages at the tenth percentile relative to the median (a decline in the 50/10
Since the national living wage was introduced in April 2016, it seems reasonable to hypothesise that this fall in hourly pay inequality was driven by that introduction.

- However, despite falling inequality of hourly pay, inequality of weekly earnings has increased quite substantially. This largely reflects an increase in an increase in the 50/10 ratio.
- The rise in inequality of weekly earnings in the ‘lower tail’ is consistent with the rise in part-time working among men. In other words, despite the narrowing of the dispersion of hourly pay, this is offset by the greater dispersion of working hours. In particular, what seems to have been happening in recent years is that, whilst average hours worked by men is declining, the decline in hours worked has been proportionately greater among men working in relatively low paying jobs than among more highly paying jobs.

**Chart 6: Pay and earnings inequality for males in Scotland**

Source: ASHE. Notes: the 90/10 line shows the ratio of wages at the 90th percentile to wages at the 10th percentile. The 50/10 line shows the ratio of wages at the median to wages at the 10th percentile; and the 90/50 ratio shows the ratio of wages at the 90th percentile to wages at the median. In all cases, a larger number means greater dispersion, i.e. higher inequality.

For females the story on hourly wage inequality is the same as for men – hourly wage inequality has been declining, particularly in the last few years. However, what is different from the male story is that weekly earnings inequality has not tended to increase as much – hours worked by women have become less rather than more polarised, so reductions in hourly pay inequality have not been offset by hours changes (although weekly earnings inequality remains higher for women than men, given the larger proportion of part-time working).
The broad trends described here – a slight narrowing of hourly pay inequality, offset for men by a greater dispersion in hours worked – are not unique to Scotland but reflect similar trends across the UK (Clarke and Bangham 2018; Belfield et al. 2017; Blundell et al. 2018). Moreover the trend towards widening weekly earnings inequality among men, driven by increased part-time working, is not specific to the post-recessionary period but reflects the continuation of a trend that has been observed for at least the last 20 years.

A challenge for future research is to understand the extent to which the rise in male part-time working reflects supply-side or demand-side factors. In other words, does it reflect a tendency for men to choose to work fewer hours – perhaps to balance work with study, family life or a transition into retirement – or does it reflect greater difficulty in accessing the hours of work that they desire?

The increase in part-time working among males, particularly those in relatively low-paid jobs, also contrasts with the US experience. Unlike the UK, the US has not seen increases in male part-time working, although the overall male employment rate in the US has declined, whilst it has been increasing in the UK.

David Eiser
April 2019
Annexe B

Written submission from Professor David Bell

Recent Developments in Wages in Scotland

Introduction

Movements in wages provide an important guide to the understanding of a wide range of economic issues, many of which also have a social dimension. The understanding of why wages vary across different groups of workers owes a great deal to Adam Smith, Scotland's most influential thinker. Data on the levels and evolution of wages is central to an appreciation of:

- the evolution of real living standards of individuals and households;
- the incentives to move between occupations, locations or industries;
- the growth in inequality, between or within generations;
- the rewards for investing in education;
- the balance of attraction between working in the public rather than the private sector and
- the “pay gap” between groups (defined by characteristics such as gender or race) that cannot be explained by differences in observable characteristics such as skill, trustworthiness or experience.

This paper does not go into the detail of these issues. Instead it provides an overview of a number of issues relating to wages and their evolution. It does this through a series of figures which largely relate to trends in pay levels in Scotland. These can only give a broad understanding of recent trends: they cannot capture the complex interactions that determine wage levels in different labour markets. But hopefully they give some context for recent debates on the issues listed above.

The data sources on which the figures rely are the Annual Survey of Hours and Earnings (ASHE) and the Labour Force Survey (LFS), both of which are collected by the Office for National Statistics (ONS). The ASHE data is based on employer payroll records. Though it has some drawbacks, this survey is generally thought to give the more accurate estimates of employee earnings. LFS estimates of earnings are based on the responses of individuals (or their proxies) in a household survey. The LFS can relate earnings to a wider range of employee characteristics than can ASHE. Thus, for example, ASHE does not include data on education, so cannot be to estimate the “graduate premium”. So there are advantages and disadvantages in both of the major surveys of earnings in the UK.

This paper focuses solely on the earnings of employees. Estimates of the earnings of the self-employed (which comprise around 13% of the workforce) tend to be less reliable than those for employees, partly because they may only be known to the self-employed themselves after they make their tax return. Nevertheless, the self-employed are an important group who are often overlooked in debates on the state of the labour market.
1. Trends in Real Wages in Scotland and the UK 1997-2018

Figure 1 shows the evolution of real weekly wages in Scotland and the United Kingdom as a whole over the period 1997-2018. Money wages are adjusted by the consumer price index (CPI) to remove the effects of price inflation. This allows valid comparisons over time of the amount of goods and services that the wage can buy.

Figure 1 shows median real earnings which implies that 50% of employees earn less than this value while 50% earn more. Average earnings tend to be higher than median earnings because a relatively small number of people with extremely high earnings can significantly increase the average wage of the whole population. This can mean that only a relatively small proportion of employees earn at or above average earnings. The median has the advantage that it captures the earnings of the person in the middle of the income distribution.

There are two notable lessons from Figure 1. First, the gap between median earnings in Scotland and those in the UK as a whole has tended to narrow since 1997. This is true even though the Scottish economy suffered disproportionately from the drop in the oil price in 2014. Second, real earnings in Scotland are still lower than they were in 2008, which implies that workers have not seen their real spending power increase for a decade. However, the drop in Scotland has been less severe than that in the UK as a whole.


Figure 2 illustrates one of the key explanations of the slow growth in real earnings - the equally slow growth in productivity. Since 2008, productivity growth in Scotland has stalled. Scotland is not alone: many advanced countries have experienced productivity slowdowns, some preceding the recession.

An important question is whether slow productivity growth is the “new normal”. For example, Gordon\(^3\) argues that demography, inequality and lack of opportunity to expand education will limit productivity growth for the foreseeable future. In turn, this would limit the growth of both private and public consumption. This implies less resource would be available to fund public services.

Against this argument, technological change in the form of artificial intelligence, new materials and biomedical advances may reinvigorate productivity growth. However, even if productivity growth is rebooted, there is an important question of whether the benefits of this will accrue to workers in the form of higher wages or to the owners of capital in both its tangible and intangible forms.

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Figure 1: Median Real Weekly Wage: Scotland and UK 1997-2018

Source: ASHE

Figure 2: Productivity per Hour and Real Hourly Pay: Scotland 1997-2017

Source: Scottish Government and ASHE
3. Wages as Indicators of Inequality

Wages are an important barometer of inequality since they are the principal source of household income. However, income inequality can be measured in many different ways. Figure 3 shows the ratio of those whose earnings are greater than 90% of other workers to someone whose earnings are only greater than 10% of other workers. Thus, in 2018 in Scotland, the worker at the 90th percentile earned 3.1 times more than the worker at the 10th percentile. The figure shows that on this measure, income inequality in Scotland is lower than in the UK as a whole and has been falling since 2012. The difference between Scotland and the UK as a whole largely stems from the relative scarcity of very high earners in Scotland. The fall in this ratio over this period is likely to have been partly driven by above inflation increases in the minimum wage which have improved the relative position of low-paid employees.

Although there may have been a recent decline, compared to other European countries the UK has very high levels of inequality. Note that the ratio shown here does not account for the share of income captured by the highest earners - for example, the top 1%. These are difficult to assess in Scotland because survey data typically does not capture a sufficient number of very high income respondents to enable robust conclusions to be drawn.

Note that the measure shown here captures market inequality - that which results from the operation of supply and demand in the labour market. It does not measure inequality of living standards because it does not take into account effects of taxes or benefits which tend to reduce income inequality by redistributing income from high earners to those on low incomes. Neither does it account for household structure (whether individuals are living alone or in a family) which will also affect living standards.

4. Private and Public Sector Wages

Figure 4 shows recent trends in public sector and private sector pay in Scotland. Typically those working in the public/voluntary (or non-profit) sector earn more than private sector workers. This is largely because they are better qualified and are engaged in more skilled work - for example, many are employed in health and education and required advanced qualifications in order to practice.

The recession had a more adverse effect on private sector pay. The private sector was more exposed to the immediate effects of the Great Recession. However, a prolonged period of pay restraint in the public sector has almost returned the public-private differential to its pre-recession level.

When considering differences in pay, Adam Smith would remind us that pay is only one component of a job. Other conditions of employment may be as, or more, important than wages. Hours of work, physical and mental pressures of the job and other rewards all influence the types of jobs that workers are willing to take. Thus, for example, comparisons of private and public sector weekly pay do not capture the much greater generosity of pensions in the public sector compared to the private sector. When other factors are taken into account, the evidence suggests that public sector wages tend to be more generous for the low paid and for women - or alternatively that the private sector is more generous towards the high-paid and men. However, this results in public sector wages being less competitive for highly skilled workers. This may have important implications for retention and recruitment of the highly skilled in the public sector. The issue is more prevalent where private sector
wages are high and is most acute in London. Such pressures do not exist in the more remote parts of Scotland, but there are acute recruitment crises for some public sector jobs in these areas because relatively high wages do not offset what are perceived to be the disadvantages associated with taking jobs in such locations - such as reduced advancement prospects or lack of employment opportunities for partners.

**Figure 3: Wage Inequality: Ratio of 90th to 10th Percentile for Full-Time Workers**

![Graph showing wage inequality ratio](image)

Source: ASHE

**Figure 4: Private v Public/voluntary sector (non-profit) weekly pay**

![Graph showing weekly pay](image)

Source: Labour Force Survey
5. Wages within the Public/Voluntary Sector

Figure 5 shows the evolution of money wages within different parts of the non-profit part of the Scottish economy from 2003 to 2018 based on the LFS. Growth in pay in central government, local government and health authorities has been broadly similar during this period. In contrast, wages in universities and other grant funded institutions have grown slightly more rapidly than other sectors, whereas employment in the charity and voluntary sector has largely flatlined since 2010.

Note that these medians reflect not only pay rates for specific time periods, but also the changing composition of the different workforces. A switch towards more part-time working will reduce weekly pay, whereas changing the balance towards more qualified and senior staff will have the opposite effect. Employers in these sectors are constantly trying to adjust to the demands placed upon them by finding the best staff within their available budget. Always bearing in mind that potential recruits may have other opportunities inside or outside the public sector.

6. Wages by Age Group

An issue that has gained increased traction in recent years is the intergenerational divide: this is a different take on inequality seeing it through the perspective of different generations rather than across all households at a single point in time. One symptom of this issue is the relative decline in the earnings of the young. This is illustrated in Figure 6, which is drawn from the LFS and shows how the ratio of median pay of those aged 25 to 34 to those aged 45 to 54 in Scotland over the period 2001 to 2018. This ratio is quite erratic due to the relatively small numbers of employees in these age groups in the LFS, but the trend line through the data slopes distinctly downward. Thus, whereas in 2001 the younger workers earned around 91% of the older group, by 2018 this ratio had fallen to 84%. This is prima facie evidence that labour market prospects for successive cohorts of younger people has been declining relative to older workers during this century. Scotland does not differ from other parts of the UK in this respect. And wages are only one symptom of the growing intergenerational divide. The wealth of the young has also been growing less rapidly than that of older people, as has their access to the housing market.
Figure 5: Median Weekly Earnings within the Public/Voluntary Sector

Source: Labour Force Survey

Figure 6: Ratio of Hourly Pay of Those Aged 25-34 To Those Aged 45-54

Source: Labour Force Survey
7. The Graduate Pay Premium

One reason why individuals invest in higher education is to receive a pay “premium” compared with other forms of education or training. For a long time, it has been the case that graduates earn considerably more than non-graduates in Scotland. However, the evidence suggests that this premium is slowly declining. Figure 6 shows the ratio between the hourly pay of graduates and that of non-graduates between 2001 and 2018. Again, the trend is gradually downward from a premium above 90% in 2001 to around 65% in 2018. Over this period, the share of graduates in Scottish labour market has increased significantly, due to historic increases in participation rates. Other things being equal, increases in the supply of graduate labour, could be expected to reduce the graduate premium through market forces. However, again, the reasons for the change are likely to be more complex. On the demand side, employer requirements for graduates will change through time as sectors grow and contract and business processes change. And there is strong evidence that choice of institution and subject at university affects labour market outcomes. Changes in these balances will affect the relationship between graduate and non-graduate pay.

8. Hours of Work

The length of the working week has been on a long-term downward trend. Figure 8 shows that this trend has continued during this century. Differences in weekly hours between Scotland and the UK as a whole are relatively small. This is shown in Figure 8. There was a relatively sharp dip in weekly hours during the recession, particularly in Scotland and the subsequent recovery in Scotland has been less strong. This may be due to increases in employment in Scotland since the recession being more weighted to part-time jobs than in the rest of the UK.

Some may opt for part-time work because it suits their lifestyle. However, part-time workers are more likely than full-timers be “underemployed”. They would like to increase their hours even without an increase in the hourly rate of pay.

It is a truism that the weekly wage is the product of the hourly pay rate and hours worked. However, it may not be the case that all working hours are equally productive. Some employers are currently experimenting with a four-day week schedule. The success of such an approach is bound to vary by the nature of production so that it is unlikely that it would be universally welcomed by employers.
Figure 7: Graduate v non-Graduate Hourly Pay

Source: Labour Force Survey

Figure 8: Usual Weekly Hours of Work

Source: Labour Force Survey
9. Worker Representation

Worker representation is an important countervailing force in the labour market. Improving wage rates it invariably part of their mission. There has been a gradual decline in such representation over time with only around 25% of workers in Scotland being represented in 2017 (see Figure 9). Trade unions have becoming increasingly concentrated in the public sector. Part of their decline in the private sector has been the growth of the service economy which does not have the same tradition of unionisation as did the industrial sectors which used to form a much larger part of the Scottish economy.

There is some debate about how the other side of the labour market has evolved. In an influential contribution, Krueger (2018)\(^4\) suggested that worker bargaining power has been declining not simply through the decline in trade unions but also because of the changing structure of the labour market. One of his key arguments is that employment has become more concentrated, particularly for job openings in rural areas. This gives employers greater bargaining power which they may exercise by offering new hires poorer wages and conditions.

10. Wage Variation within Scotland

The implications of the effects described in previous paragraphs suggest that it would be surprising not to find major differences in wage levels across Scottish local authorities. Indeed this is the case: Figure 10, which is based on ASHE data, shows variations in weekly wages for full-time workers in 2018 both by where they work and where they live.

Differences in productivity are a key determinant of weekly wage variation across Scotland. In turn, these will reflect the qualifications of the workforce, whether they are in the private and public sector and what age they are. The extent of local or national worker representation will also have an effect. Thus weekly earnings at the workplace vary between a maximum of £663 in Inverclyde and £470 in Dumfries and Galloway.

However, earnings at the workplace differ from earnings where workers live. Where commuting is feasible, workers may choose to live in a different local authority from the one in which they work. Nowhere is this more evident than in East Renfrewshire where median earnings for residents, at £744 per week, exceed those who work in East Renfrewshire by nearly £250 per week. Similar, but less extreme patterns are found in East Dunbartonshire, Angus and the Scottish Borders. On the other hand, workers tend to earn more that residents in Inverclyde, Falkirk, Dundee, Argyll & Bute and Clackmannanshire. While these variations provide interesting evidence on where employees choose to work and live when they have commuting options, they also have important implications for local taxation, since a local income tax based on place of work would clearly result in a quite different distribution of revenues to some local authorities compared with one based on place of residence.

Figure 9: Share of Workers That Are Members of Trade Unions or Staff Associations

Source: Labour Force Survey

Conclusion

This paper has touched on a number of issues which a study of wages in Scotland can help shed light on. There are many others which could not be accommodated within a short paper. And general trends usually conceal a host of other factors that determine their trajectory. Nevertheless, this analysis hopefully provides highlights some recent developments in the Scottish labour market that are perhaps worthy of more detailed examination.
Figure 10: Median Weekly Earnings of Full-Time Workers 2018: Scottish Local Authorities

Source: ASHE