

SCOTLAND'S MISSING PAY GROWTH

The economic and fiscal impacts of weak wages since the financial crisis

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60-SECOND SUMMARY

While pay has performed better in Scotland than in the rest of the UK over the last five years, Scottish workers in both the public and private sectors have not been spared from the trend of below-inflation increases in earnings, with pay growth underperforming relative to expectations.

Aside from its obvious impact on household incomes and working poverty, the weakness of earnings growth has led to a smaller Scottish economy, and lower tax receipts collected in Scotland, than would have resulted from pay keeping pace with either inflation or expectations for earnings growth.

Given that the Scottish government, as a result of the Scotland bill, is set to gain greater control over income tax on earnings, how pay performs over the next five years and beyond will have an impact on the resources available to Scottish policymakers. Furthermore, in their role as setters of public sector pay, there is greater potential for some of the costs of increasing public sector pay to be offset by increased tax revenues.

PAY GROWTH IN SCOTLAND AND THE UK, 2009–2015

Pay growth in Scotland has outperformed the rest of the UK over the last five years. This pattern was particularly noticeable in the private sector, and was driven by productivity increases in Scotland relative to the rest of the UK, and a stronger link between productivity and median pay in Scotland. However, both Scotland and the UK underperformed relative to both inflation and expectations for earnings growth.

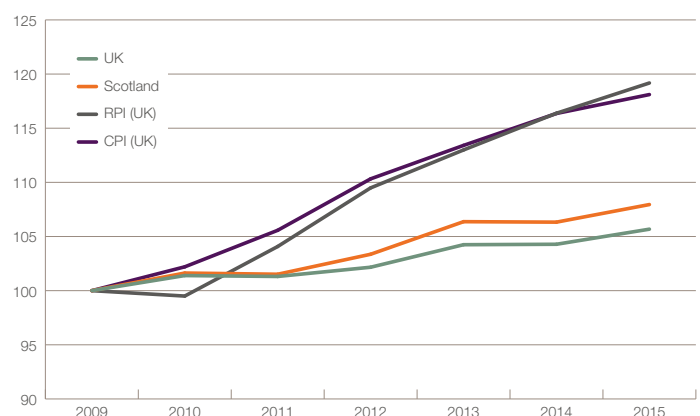
- Median gross weekly pay rose by 8 per cent in Scotland between 2009 and 2015, with growth of 7 per cent in Scotland's private sector, and 10 per cent in the public sector.
- However, prices have risen by 20 per cent over the same period (by both the RPI and CPI measures), which implies a fall in real wages of approximately 12 per cent.
- Equally, at the time of the March 2011 budget, the Office for Budget Responsibility (OBR) forecast average earnings growth of 21 per cent between 2009 and 2015.
- The subsequent weak performance of earnings relative to the forecasts means that wages in Scotland are currently 13 per cent lower in the private sector, and 10 per cent lower in the public sector, than it was predicted five years ago that they would be.

The OBR has projected strong wage growth over the next few years, with their forecast suggesting that average earnings growth will reach 3.9 per cent annually by 2020.

If wage growth were to undershoot again, however, it would not just have a negative impact on Scottish households and the size of Scotland's economy – it would also have a sizable impact on government tax revenues in both the UK and Scotland, particularly in light of the devolution of new powers over income tax and other tax revenue streams coming to Scotland over this period.

Scotland's pay growth, while stronger than the UK's, has been far outpaced by inflation

Growth in average nominal gross weekly wages and inflation indices, Scotland and UK, 2009–2015 (2009 = 100)



Sources: ONS 2016a and OBR 2015

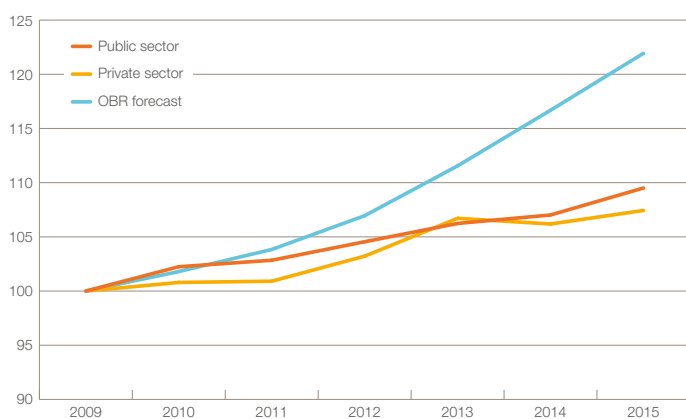
EFFECTS OF THE WAGE-GROWTH 'UNDERSHOOT' ON SCOTLAND

To assess the potential impacts of future disappointing wage growth, we have looked at the effect that the wage forecast undershoot has had on the Scottish economy over the last five years, and have found the following macroeconomic effects.

- If the OBR's 2011 wage forecast had been met, Scotland's economy would today be £11.6 billion, or 8.2 per cent, larger than it is, assuming that other economic factors had performed as they have since 2011.
- If only private sector wages had met projections, the Scottish economy would be £8.8 billion, or 6.2 per cent, larger.
- The equivalent figures for Scotland's public sector are £2.8 billion and 2.0 per cent respectively.

There is a sizeable 'pay gap' between forecast and actual pay growth

Forecast and actual nominal pay growth in Scotland, 2009–2015 (2009 = 100)



Sources: OBR 2015 and ONS 2016a

Higher private sector pay would also have led to a sizable fiscal return.

- If private sector wage growth had met the OBR's 2011 expectations, it would have led to a fiscal return totalling £2.9 billion, with £2.7 billion in additional income tax receipts, national insurance contributions and expenditure taxes, and almost £200 million of reduced benefit expenditure.
- Under the powers devolved in the Scotland bill, approximately £1.4 billion of that £2.7 billion fiscal return would directly benefit the Scottish government (as a result of the devolution of control over the income tax on earnings and the assignation of the first half of VAT revenue to the Scottish government).

One barrier to higher public sector pay has been, and will continue to be, the fiscal climate facing the Scottish government. However, with devolution of further powers to the Scottish parliament comes greater potential for some of the costs of increasing public sector pay to be offset by increased tax revenues (which will flow to the Scottish parliament rather than the UK Treasury), and for the benefits of increased pay in both the private and public sectors to be felt more directly within Scotland.

- The gross cost (before considering tax and benefit implications) of raising public sector pay in Scotland by 10 per cent would come to £1.9 billion.
- After factoring in a full suite of offsetting tax revenues to both the UK and Scottish governments, this falls to a net cost of £1.1 billion.
- By far the largest offsetting revenue increase would come from the soon-to-be-devolved income tax on earnings – at £600 million, it would mean that the net cost to the Scottish government would total £1.3 billion.

For the full report, including all references, data sources and notes on methodology, see: www.ippr.org/publications/scotlands-missing-pay-growth

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