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The chancellor's shambolic national insurance hike is based on a faulty reading of aggregate statistics

"Britain is damning itself to be a low wage, low productivity economy". How many headlines like that have we read over the past few years?

Ryan Bourne

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Certainly, the UK has performed poorly when it comes to overall real wage growth since the financial crisis, reflective of weak aggregate productivity growth. But often these average statistics are over-interpreted, and it now seems this narrative is leading to bad policy.

A Financial Times graph did the rounds online recently purporting to show that the UK was the only country in the OECD which had seen positive overall GDP growth between 2007 and 2015 coupled with a decline in median real wages. I don't doubt the veracity of the stats, but the narrative developed around it was that high immigration had flattered GDP by increasing worker numbers, but that existing workers had seen stagnant wages. "The UK is the only country in the developed world where workers are getting poorer while the country is getting richer," concluded shadow chancellor John McDonnell.

As Chris Snowdon at the Institute of Economic Affairs has shown, however, this conclusion does not follow. Median real wages rose in both 2015 and 2016 – workers right now are getting better, not worse, off.

What's more, what has happened to median real wages is heavily dependent on the composition of the labour force. It simply is not the case that workers nationwide have seen income stagnation in recent years – in fact, those 80 per cent of workers in continuous employment have, on average, seen significant real wage growth. The median real wage may well have fallen since 2007, initially due to the financial crisis, but also in part as a result of many individuals and migrants moving into low paid jobs as the employment rate has boomed.

In other words, the aggregate hides a lot of different individual stories. None of this is to downplay that productivity growth has been anaemic since the crash. Everyone wants to see more productivity-inducing innovation and business investment. Yet looking at aggregate statistics and making sweeping conclusions leads to bad policy.

Take two common ideas for supposedly moving to a higher pay, higher productivity economy. The first is the higher minimum wage for over-25s in the form of the National Living Wage. Some people genuinely believe that raising the statutory pay rate, through reducing labour turnover in low wage sectors and encouraging firms to invest in labour-saving technology, will actually improve overall average productivity.

That is more likely to come from locking low skilled workers out of the labour market altogether than anything else. But it's also not clear why "reduced labour turnover" is necessarily a good thing. Having workers work continuously in the same job is likely to improve their capacity to do those tasks in that job, but raising the minimum wage blunts their incentive to accumulate human capital to move into higher productivity, higher paying jobs. It increases the return for stasis. Over time, this could actually cause aggregate productivity to suffer.

The chancellor's shambolic policy on National Insurance also partly rests on bad reasoning from aggregate statistics. Self-employment has always faced a lower tax burden, not least because the self-employed have not historically been entitled to a range of statutory benefits. But policy wonks, not least the RSA's Matthew Taylor, tasked with reviewing this employment sector, point to these "tax advantages" as a key reason for more people being self-employed. In the view of many, because this sector tends to be lower productivity, eliminating the tax advantages will lead to more formal employment where businesses have to invest in their workers.

Again, that does not necessarily follow. Our high employment rate versus other countries with much more formal labour markets attests to that. In fact, the rise of self-employment is an important safety valve for an economy where traditional employment forms are rapidly changing.

There are certainly a range of areas where productivity could be improved through policy change. Liberalising Britain's land use planning laws is the most obvious. But the important lesson here is that policy-makers should be wary of simply basing policy on aggregate average statistical trends, rather than thinking through the underlying economics.

Productivity growth fundamentally comes from innovation and people and businesses developing new ways of doing things. When thought of this simply, it's difficult to see how this process is aided by cutting off people's options.

Ryan Bourne occupies the R. Evan Scharf Chair for the Public Understanding of Economics at Cato. He has written on a number of economic issues, including: fiscal policy, inequality, minimum wages and rent control. Before joining Cato, Bourne was Head of Public Policy at the Institute of Economic Affairs and Head of Economic Research at the Centre for Policy Studies (both in the UK). Bourne has extensive broadcast and print media experience, and has appeared on BBC News, CNN and Sky News, whilst having articles published in (among others) the Wall Street Journal Europe, The Times (London) and the UK Daily Telegraph.