

The changing pattern of earnings: employees, migrants and low-paid families

Findings
Informing change

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This study explores the assumption that individuals can work their way out of poverty, by examining the changing earnings of employees, the integration of migrants and the progression of low-paid families in Britain since the late 1970s.

Key points

Employees

- Since the late 1970s, inequality of annual earnings among employees has grown considerably. Increases in inequality have been greater for men but there is evidence that inequality started to fall among women after 1997.
- Between 1979 and the mid-1990s, the lifetime earnings of men became more unequal.
- In the late 1970s, earnings mobility was lower among women but by 2005 it was generally higher than among men.
- Wage mobility generally has risen since 2000.

Migrants

- When migrants first find work in Britain, they typically earn less than their British-born counterparts: over 30 per cent less for men and 15 per cent less for women. This pay gap reduces as their stay in Britain lengthens.
- For migrant men it takes, on average, 20 years to close this gap. For migrant women, it takes no more than 6 years.
- Different nationalities experience different rates of wage convergence, with Europeans catching up the fastest. Asian men show little signs of catching up at all.
- More recent groups of migrants have fared better but this is largely due to smaller pay gaps on entry into Britain rather than faster wage growth.

Families

- Working Families Tax Credit (WFTC) seems to have increased employment retention among men.
- WFTC did not appear to lead to pay increases in the first year after the start of a claim, relative to Family Credit.
- There is no evidence that employers have used the more generous WFTC to keep pay increases down.

The research

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Introduction

The 1980s and early 1990s saw sharp increases in the inequality of earnings and income and the distribution of work across households. These factors contributed to large increases in child poverty, so that by 1997 about a third of all British children lived in relative poverty. Important contributory factors were low skill levels, high unemployment, and benefit levels which were insufficient to lift families out of poverty.

The current government has focused on tackling poverty through employment, complemented by increases in benefit levels for some groups, mainly parents and pensioners. There is an expectation that individuals can work their way out of poverty, and this study looks at how progression in the labour market has changed over time to assess how easily an individual can achieve this. Recent migrants are known to be disadvantaged in the labour market, both in terms of finding work and the wages they receive when in work. The study examines this group to assess changes in the pay penalty across different migrant groups and over time. It looks at the time it takes for migrants' earnings to catch up with those of their British-born counterparts and how this has changed since the late 1970s. One of the Labour Government's flagship policies, the Working Families Tax Credit (WFTC), was designed to increase the incentive to find and stay in work for individuals in low-income families. This research looks at the impact of WFTC on the extent to which individuals remain in employment (retention) and wage growth.

Earnings inequality/mobility

The study examines changes in the inequality of annual earnings and earnings mobility for those with secure patterns of work and for a wider group of individuals who experience some years without any earnings. This makes it possible to assess the impact of the unequal distribution of work and the unequal distribution of earnings for those who are in work. The term 'inequality of annual earnings' is used to mean the variation that exists in the amount individuals earn over a year. If everybody earned the same amount there would be no inequality. There are very many different measures of inequality and they all have different strengths and weaknesses. For example, some measures place greater importance on differences between those on very high incomes and those on very low incomes, while others put more weight on variation around

average earnings. It is normal to use a number of different measures, and this study uses four measures to provide a better understanding of how differences between individuals' earnings change over time. The term 'long-run inequality' is used to mean the inequality of individuals' earnings when they are added up over a number of years, and 'earnings mobility' refers to how individuals' earnings change when their earnings are compared over a number of years.

Changes in the inequality of annual earnings 1979–2005

Inequality in annual earnings increased in the period 1979–2005. It was higher among women than men, which is likely to be due to a greater variation in annual hours worked. However, inequality in earnings increased by more among men than among women during the time period.

A number of different measures of inequality show increases in inequality in annual earnings since 1979. There is some evidence that inequality has been gradually falling among women since 1997.

The inclusion of individuals with no earnings from employment in a given year increased measured inequality during the 1980s and 1990s. Increases in unemployment in the 1980s and 1990s recessions translated into higher levels of inequality up to 1997. As employment increased in the late 1990s, inequality fell. Increases in employment among women further reduced inequality.

'Long-run inequality' in earnings and employment

Over time, individuals' earnings change in absolute terms and relative to other employees, so their longer-run prospects are not necessarily well represented by a snapshot of their earnings at a single point in time. A simple way of looking at the longer-run picture is to compare the employment status and earnings of the same individuals at two points in time. This analysis reveals that:

- People with low annual earnings are more likely than those with higher earnings to have no earnings and receive benefits in subsequent years.
- People with no earnings and receiving benefits are more likely to have low annual earnings in the future.
- There is some variation in different time periods and among men and women, but overall there is a high degree of persistence in low earnings and benefit receipt, with limited long-range upward mobility and very little downward mobility for high earners.

A more complete picture was gained by using a more sophisticated measure of earnings mobility. The methodology used summarises individuals' earnings over a number of years, measures inequality in earnings

averaged over these years, and compares it to a single year measure. This provides a measure of how much mobility offsets any increase in cross-sectional inequality and can be used to assess how long-run inequality has changed.

The results show that mobility among male earners fell between 1979 and the mid-1990s. This fall is indicative of an increase in the inequality of lifetime earnings. There is also evidence that earnings mobility for men has started to rise a little since 2000.

For women earners there was less variation in mobility than for men over the same time period. While there were some changes over time, mobility rates were quite similar in the late 1970s and the mid-2000s. Again, there is some evidence that mobility has started to increase since 2000.

Figure 1 shows mobility measured over four- and eight-year periods for men and women using the Gini measure of inequality (four measures of inequality were used).

Figure 1 Changes in earnings mobility among male and female employees

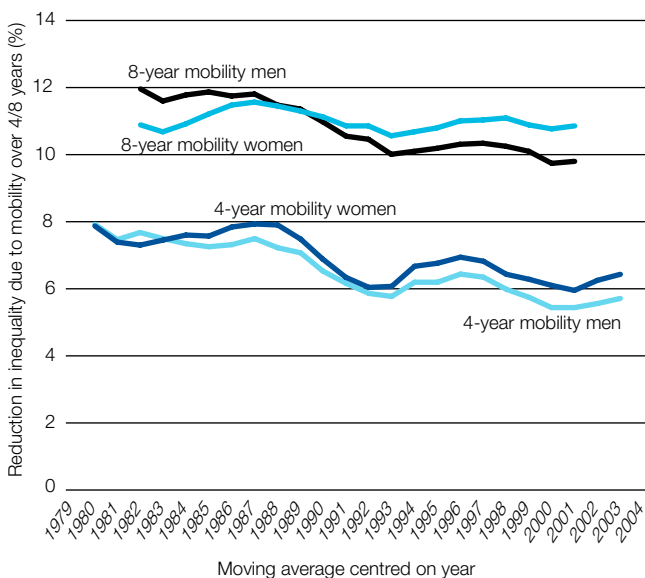


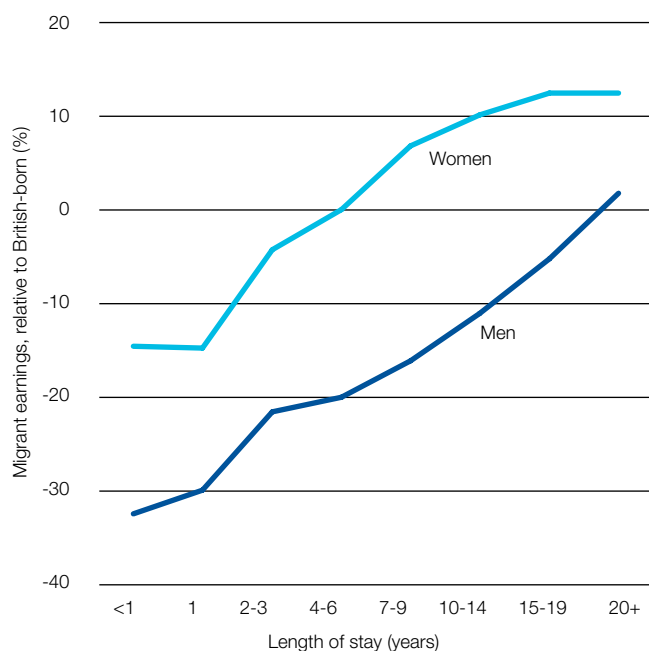
Figure 1 shows that mobility among all individuals, including those without earnings from employment, fell until 2000, with increases since then. There was greater turbulence in mobility among men but an overall downward trend until the mid-1990s, followed by an increase in mobility from 2000.

Migrant pay gaps

Migrants have lower rates of employment and, when in employment, attain lower average wages. This places migrant families at greater risk of poverty. In terms of exploring routes out of poverty, this study looks at entry wages relative to migrants' British-born counterparts (the pay gap) and patterns of convergence in this pay gap for different groups of migrants, men and women at different ages and by country of origin. The key findings are:

- Not only has there been a big increase in migration into Britain over the last 25 years, but patterns of migration have also changed over time. Since the late 1970s there has been an increase in the proportion of migrants from Africa and Central Asia and large increases from the EU Accession states in recent years.
- Using a statistical model of wages and controlling for age and current year provides estimates of the entry pay gap and rates of convergence. When migrant workers first arrive, they experience a weekly pay gap relative to their British-born counterparts of over 30 per cent for men and 15 per cent for women.
- For migrant men it takes, on average, 20 years to eradicate this difference; for migrant women it takes no more than 6 years (see Figure 2). The greater rate of convergence in pay and lower average pay gap in the latter group may be due to higher relative weekly hours of work among migrant women compared with their British-born counterparts.

Figure 2 Earnings of migrants relative to British-born employees, by length of stay



- Separate model estimates for migrants from different regions of the world show that different nationalities experience varying rates of wage convergence, with Europeans catching up the fastest but Asian men showing little signs of catching up at all. They also have a higher initial pay gap, at 45 per cent.
- More recent entry groups of migrants, arriving in Britain 1985–90 and 1995–2000, have fared better than migrants arriving 1975–80 but this is largely because they entered with a smaller pay gap rather than experiencing faster wage growth.

The impact of tax credits on job retention and advancement

The introduction of tax credits in 1999 represented an evolution of in-work benefit policy in the UK. The Working Families Tax Credit (WFTC) was designed to supplement the incomes of low-income families and so help to reduce child poverty, increase transitions from welfare to work, reduce the number of households without work, improve job retention in low-paying jobs and assist with advancement to higher-paying jobs.

More families qualified for WFTC than Family Credit and it was more generous than its predecessor. This led to an increase in the number of families receiving in-work benefits and an increase in the average value of awards.

A statistical analysis of job retention among individuals entering work and claiming WFTC, compared with their counterparts who had claimed Family Credit, showed that WFTC increased job retention among male recipients after controlling for differences in age and entry wage.

An analysis of wage growth a year after in-work benefit recipients entered employment revealed that WFTC did

not appear to increase earnings compared with Family Credit.

There is no evidence that the more generous WFTC has been used by employers to keep wage growth down. This may have been helped by the simultaneous introduction of the National Minimum Wage, which established a wage floor in the low-wage labour market.

Conclusion

After a very long period of increase, there is some evidence that earnings inequality is finally falling due to increases in employment and a reduction of inequality among women in particular. Earnings mobility also appears to be on the increase after a long period of decline. Migrants remain disadvantaged in the labour market and rates of convergence in wages have not improved, but more recent groups of migrants have entry wages which are more on a par with their British-born counterparts. Tax credits have led to increases in employment and job retention, increasing the incomes of many low-income families.

About the project

This study was by Richard Dickens, Centre for Economic Performance at the London School of Economics and the University of Sussex, and Abigail McKnight at the Centre for Analysis of Social Exclusion at LSE. The analysis was based on a unique administrative data source which has tracked the same large random sample of individuals since the late 1970s to the present day. The Lifetime Labour Market Database (LLMDB) contains a wealth of information on individuals' labour market status, their annual earnings and receipt of a range of benefits. It includes information on personal characteristics, including migrant status.

For further information

Three background working papers by Richard Dickens and Abigail McKnight, are published by the Centre for Analysis of Social Exclusion at LSE. The working papers will be available through the CASE website: <http://sticerd.lse.ac.uk/case/>

This Findings is available to download as a free PDF at www.jrf.org.uk

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