National Living Wage and National Minimum Wage: 2016 evidence

Submission to the Low Pay Commission

Chartered Institute of Personnel and Development (CIPD)

July 2016

Background

The CIPD is the professional body for HR and people development. The not-for-profit organisation champions better work and working lives and has been setting the benchmark for excellence in people and organisation development for more than 100 years. It has 140,000 members across the world, provides thought leadership through independent research on the world of work, and offers professional training and accreditation for those working in HR and learning and development.

Our membership base is wide, with 60% of our members working in private sector services and manufacturing, 33% working in the public sector and 7% in the not-for-profit sector. In addition, 76% of the FTSE 100 companies have CIPD members at director level.

Public policy at the CIPD draws on our extensive research and thought leadership, practical advice and guidance, along with the experience and expertise of our diverse membership, to inform and shape debate, government policy and legislation for the benefit of employees and employers, to improve best practice in the workplace, to promote high standards of work and to represent the interests of our members at the highest level.

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Introduction

This submission draws on the CIPD's most recent Labour Market Outlook (LMO) for Summer 2016, a survey of 1,050 CIPD member employers carried out in the second half of June. This means that some respondents will have competed the questionnaire before the result of the EU referendum, while others will have competed it after the result was known. The full Summer LMO will be published next month, and we will forward this to the Commission as soon as it becomes available.

The Summer LMO includes a set of questions on the impact of the first increase in the National Living Wage (NLW) in April 2016. Within the overall survey we separated out responses from employers made before the Brexit vote and responses made after the Brexit vote, with the latter subset boosted by further interviews with CIPD member employers to ensure adequate and representative samples.

The CIPD's quarterly *Labour Market Outlook* provides a set of forward-looking labour market indicators, highlighting employers' recruitment, redundancy and pay intentions.

Please note that, at the time of writing, the *Labour Market Outlook* results for Summer 2016, which we have cited, have not been published.

Our response is to questions 1, 2, 4, 5, 11, 12, 16, 17 and 18 from the LPC's consultation document, and concludes with our recommendations.

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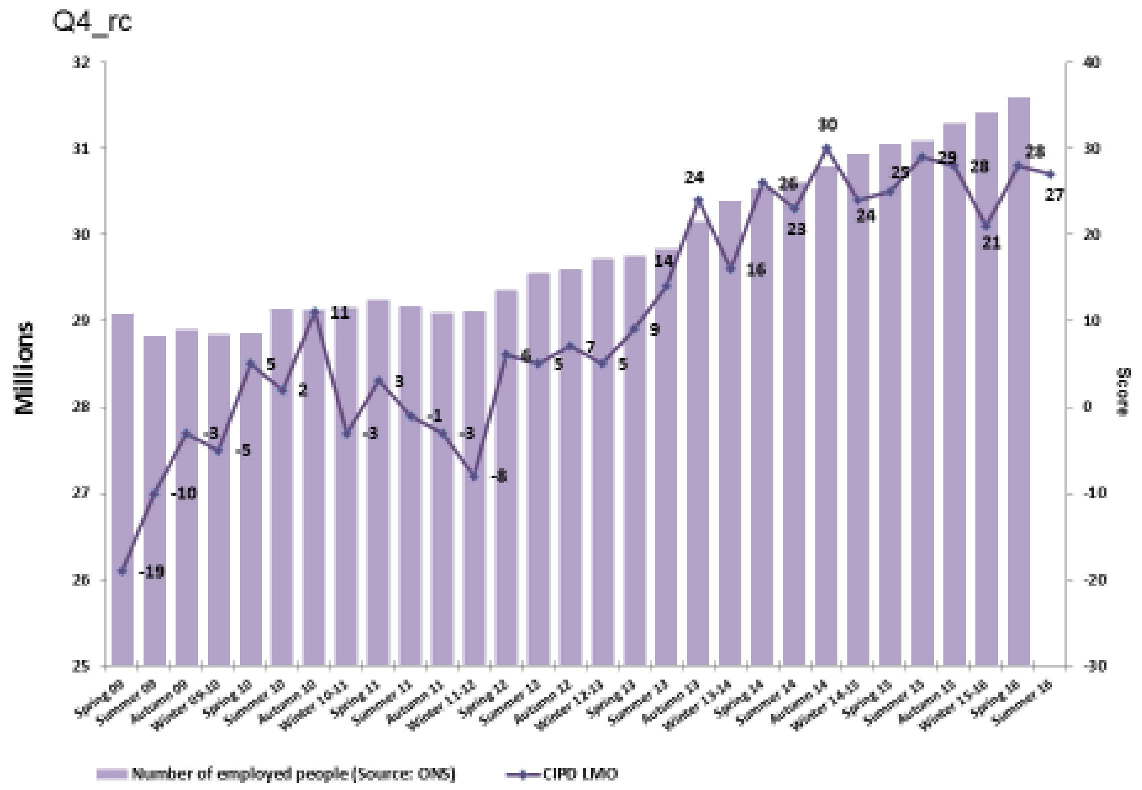
Our response

Economic Outlook

Question 1: What are your views on the outlook for the UK economy, including employment and unemployment levels, for (a) the period up to April 2018 (b) the period up to April 2019?

The survey suggests that, in the short term, there is still a great deal of stability in the labour market but with higher than usual levels of uncertainty among employers about immediate prospects. The net employment balance – the difference between employers who say they expect to increase staff and the share of employers who say they will decrease staff over the next three months – generated a positive score of 27, very similar to the score in Spring 2016, and not significantly different to the score in Summer 2015.

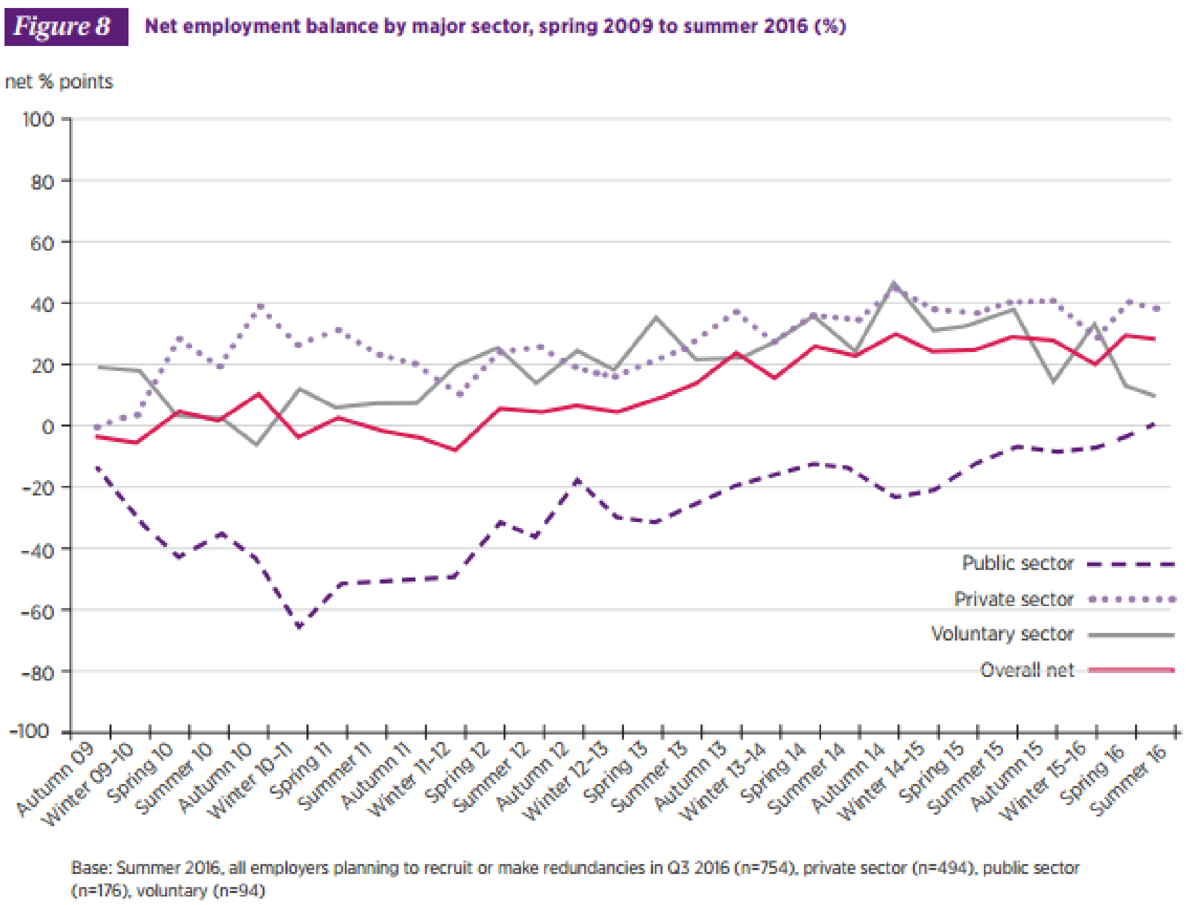
CHART 1: NET EMPLOYMENT INTENTIONS 2009-2016



Q4_rc. Thinking about the next THREE months_, what will be the overall effect of recruiting new staff and/or making redundancies?
Base: All employers who are planning to recruit and/or make employees redundant in the next three months (Total n=764)

Looking in more detail across sectors, private sector services is a little down compared with the Spring results and, in line with previous surveys, the public sector has improved, recording net employment balances of 40 and zero respectively compared with 42 and – 5 in the previous survey. This reflects the slowing rate of job loss in parts of the public sector. However, there has been a significant fall in the net balance for manufacturing and production, albeit the score is still positive, from 31 in Spring 2016 to 23 in Summer 2016.

CHART 2 EMPLOYMENT INTENTIONS BY MAJOR SECTOR 2009-2016

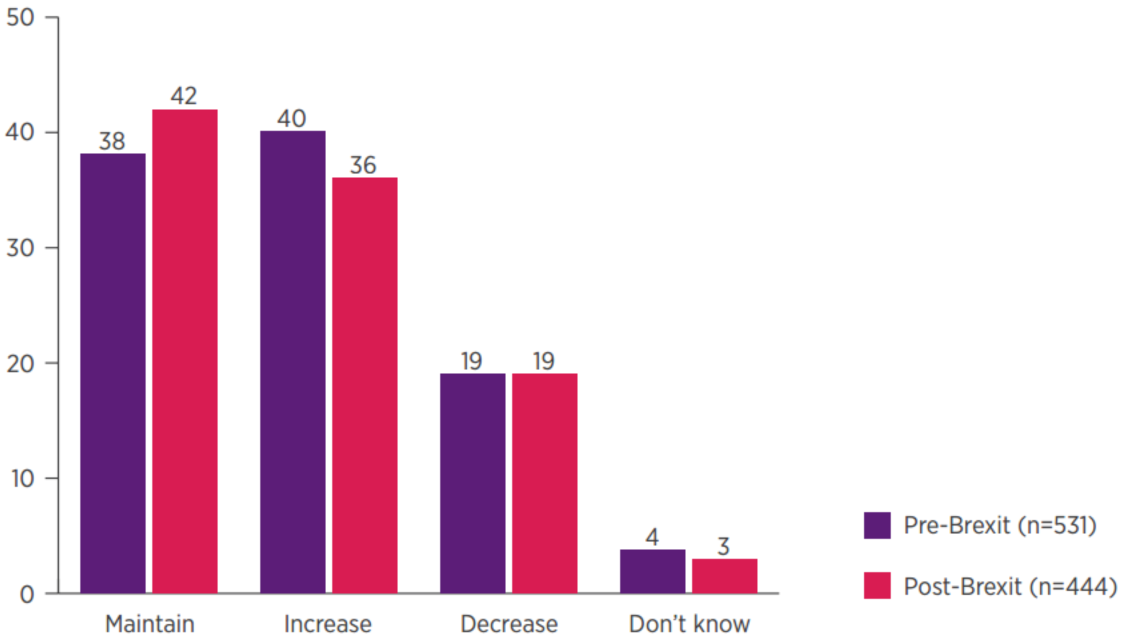


Impact of Brexit on the labour market outlook

Comparison of the pre and post-Brexit survey results shows that significant minorities of employers expect adverse impacts from the vote to leave the EU. They highlight weaker recruitment intentions, higher costs, and weaker investment in equipment and training and development. We find relatively little net impact on exports. A small proportion of employers are considering relocating outside the UK, but others are likely to focus future expansion on their UK locations.

We found a significant change for the worse in recruitment intentions post-Brexit, mainly driven by employers becoming more cautious about expanding their workforces. As a result, the net "score" based on the difference between the share of employers expanding their workforce and the share of the workforce reducing their workforce dropped from +21 pre-Brexit to 17 post-Brexit.

CHART 3: EXPECTED CHANGE IN STAFFING LEVELS OVER THE NEXT THREE MONTHS



The latest Bank of England's monthly survey by the Bank's Agents[1] of businesses is consistent with our survey findings on relocation, investment and costs. The Bank's Agents noted that many businesses had not yet reformulated their business strategies in the light of the result and were adopting a business as usual approach in the short term. However, a third of respondents expected some negative impact as a result of Brexit.

The latest employment figures[2] – published 20 July 2016 – show a remarkably resilient labour market, with strong job growth and falling unemployment comparing the three

[1] http://www.bankofengland.co.uk/publications/Pages/agentssummary/2016/jun.aspx
[2] http://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/bulletins/uklabourmarket/july2016

months to May 2016 with the previous three months. However, our survey and the Bank of England's survey reinforce the widespread expectation that the labour market will deteriorate significantly in 2017.

HM Treasury compiles a list of independent economic forecast each month. Comparing the forecast made in June (pre-Brexit) with the forecasts made in July (post-Brexit) indicates a significant turn-around, with post-Brexit forecasts showing falling employment and rising unemployment in 2017, whereas the pre-Brexit forecast showed the opposite (see Table 1 below).

The forecasted fall in employment for 2017 is likely to be between 50,000 to 100,000, but this is in contrast to a gain of between 200,000 and 250,000 implied by the pre-Brexit forecast. Unemployment is expected to rise from 4.9 per cent to 5.7 per cent, roughly where it was in mid-2014.

Table 1: Impact of Brexit on economic forecasts for the labour market for 2017

	Pre-Brexit (June 2016)	Post Brexit (July 2016)
GDP growth	2.1%	0.5%
Employment growth	0.7%	-0.2%
Unemployment rate	4.9%	5.7%
Inflation (CPI)	1.9%	1.3%
Average earnings	3.2%	2.3%

Notes: annual growth rates. CPI = consumer price index. Average of forecasts published in June and July 2016.

Source: HM Treasury https://www.gov.uk/government/collections/data-forecasts#2016

Question 2: What has been the experience of wage growth and inflation in the last year and what do you forecast for the next couple of years?

Last year

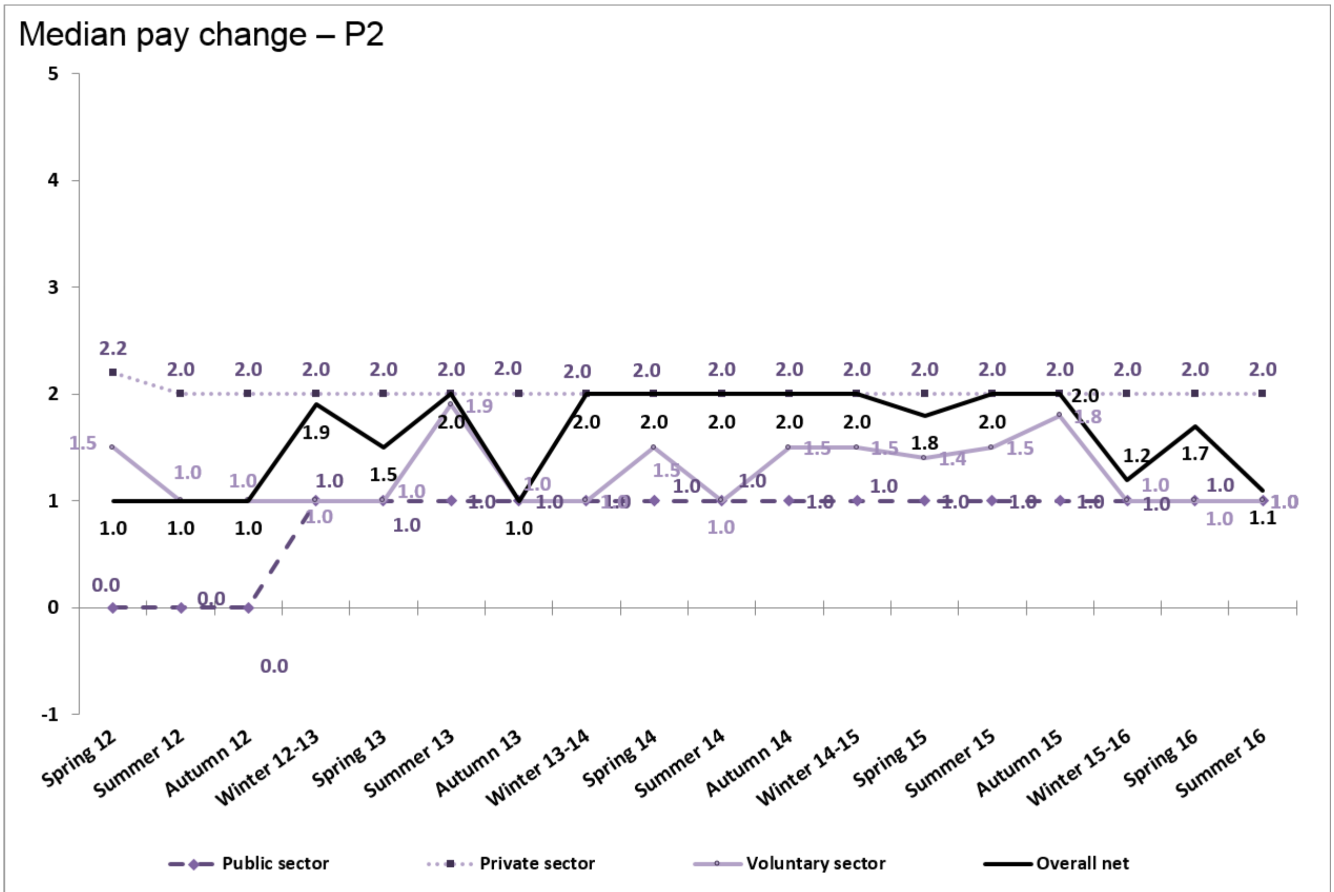
The CIPD's June 2016 Labour Market Outlook finds that in the 12 months to June 2016:

- 72% of employers have conducted an annual pay review (by sector: private 76%; public 59%; and voluntary 76%)

- 70% of those that have conducted a pay review have increased pay, while 17% have frozen it and 2% have cut salaries (11% are unaware of the outcome)
- Overall, the median pay increase for this period is 1.1% (2.21% mean). If we look at just pay rises, the median increase is 2% (2.92% mean)
- According to the median, overall pay rises have been higher in the private sector (2%) than in the public (1%) or voluntary sectors (1%).

See Table 2 below for more LMO information about median pay increase from previous years

Table 2: Median pay change March 2012 to June 2016



P2. How much will your organisation's average basic pay increase or decrease by as a result of the next pay decision? (excluding bonuses, incremental increases, overtime and impact of a re-grading exercise)
Base: All employers who report an expected increase, decrease or pay freeze in the next 12 months (Total n=437; Private n=240; Public n=137; Voluntary n=60)

The year ahead

The CIPD's quarterly Labour Market Outlook for June 2016 finds in the 12 months to June 2017 employers predict that:

- 85% of them will carry out a pay review, while 15% will delay it
- among those planning to delay their pay review, 35% predict a pay freeze, while 63% are unable to forecast the final outcome
- of those planning a pay review, 37% will increase wages, 8% will freeze them, while 1% will decrease them. The remainder, 53%, either don't know (15%) or say that it will depend on the how their organisation is performing at the time of the pay review (38%)
- by sector, 50% of public sector employers predict that they will increase pay in the next 12 months, followed by 41% of voluntary sector organisations and 33% of private sector firms. By contrast, 47% of private sector employers report that the outcome of the pay review will depend on organisational performance at that time, compared with 31% of voluntary sector employers and 9% of public sector employers
- the overall median increase will be 1.1% (2% mean), ranging from 1% in both the public and voluntary sectors to 2% in the private sector
- if we exclude pay freezes and cuts, the median salary rise will be 2% (2.64% mean) ranging from 1% in the public sector and 1.2% in the voluntary sector to 2% in the private sector.

Further comment

We expect relative stability in basic pay awards, continuing the underlying stability, whereby the median increase in basic pay in the private sector has been consistently at 2 per cent and, for the public sector, 1 per cent. Our latest results appear to show a fall in the median, but we think this is explained by a higher share of employers than usual being unable to put a figure on their next pay award.

We look in more detail at what employers who said they expect to pay more than 2 per cent and those who said they expect to pay less than 2 per cent or impose a pay freeze or pay cut said were the most important factors behind those decisions (see Table 3 below).

Note that this analysis is confined just to those employers who said they could give a figure for expected changes in basic pay over the next twelve months.

Employers who thought they would offer 2 per cent or more were more likely to cite the ability to pay more and the need to remain competitive against pay rises elsewhere than in the previous survey, but significantly less likely to cite the introduction of the National Living Wage in April 2016 (down from 29 per cent to 15 per cent). It may be that a significant number of employers have already made adjustments to pay to accommodate the rise in the Living Wage. We report on the NLW in more detail below.

At the other end of the scale, employers who said they would offer less than 2 per cent or impose a pay freeze or cut showed little change in the factors they thought were most important, with public sector pay restraint the obvious factor for public sector organisations and inability to pay the most important for about 40 per cent of all organisations (46 per cent private, 27 per cent public). The importance of the National Living Wage has also dropped somewhat, from 21 per cent to 16 per cent.

The historic series also confirms that basic pay awards in the past have been unresponsive to changes in the rate of inflation. We also find in the Summer LMO that current and future inflationary expectations are not a key influence on future pay awards. They are more likely to be cited by employers making pay awards above 2 per cent (where 16 per cent say the current rate of inflation and 15 per cent the anticipated rate of inflation has had an influence). Only 7 per cent of employers making awards below 2 per cent said that future inflationary expectations had an influence while 12 per cent said it was current rates. However, the question assumes that the current rate of inflation continues, so may not be entirely reliable a guide to employer reaction if inflation were to move significantly higher than at the time of the survey in late June.

TABLE 3: WHY BASIC PAY AWARDS ARE BEING MADE ABOVE AND BELOW 2 PER CENT

Pay more than 2 per cent		**Pay below 2 per cent, freeze or cut**	
Ability to pay	40%	Restraint on public sector pay	42%
Pay rises elsewhere	37%	Ability to pay	39%
Recruitment and retention	28%	National Living Wage	16%
Improved productivity and performance	27%	Other non-wage labour costs	15%
Pay catch up	23%	Pension auto-enrolment	12%
Increase in NMW in Oct 2016	17%	Increase in the NMW Oct 2016	12%
Current rate of inflation	16%	Current rate of inflation	12%
Increase in LW in April 2016	15%	Wage movement elsewhere	9%
Anticipated rate of inflation	15%	Apprenticeship levy	8%
Ripple effect of higher salaries	11%	Anticipated rate of inflation	7%

Base: all employers who think their basic pay award will increase by more than 2 per cent (N=180) and those who expect it to be less than 2 per cent (n=234) over the next twelve months.

Many employers find it hard to say what their basic pay award will be over the next twelve months, especially in the private sector, where nearly 60 per cent said it was hard to know because it depended on organisational performance or said they did not know. This compares with 50 per cent in the Spring survey. In contrast, public sector organisations were much more likely to be able to predict future pay growth, with just 33 per cent saying it was hard to know or they did not know what their basic pay award would be. This is a not significantly different result to the Spring survey.

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Impact of the NMW and the NLW

Question 4: What has been the impact of the NLW (from April 2016)? We are interested in any views or data on the initial effects on employment, hours, earnings, pay structures (including premium pay) and benefits, outsourcing differentials, progression, job moves, training, contract type, business models, prices or profits.

Although the NLW has declined in importance as a general factor in driving basic pay both up and down over the next twelve months, it has still had a considerable impact on current wage bills. Moreover, there still remain a significant minority of employers – especially in the low pay private sector industries - for whom it is a continued important factor over the next year. The survey looked at the impact of the NLW on wage-bills and what actions employers had taken to mitigate those impacts.

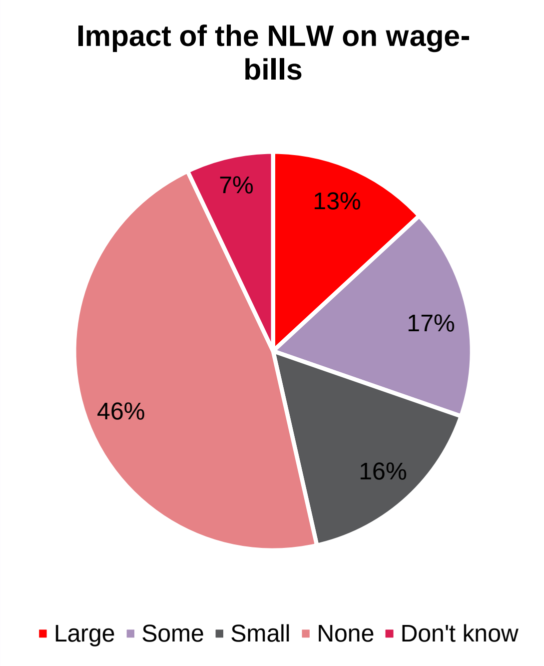
Nearly half of all employers reported that the NLW had had some impact on their wage bill (see Chart 4 below). Around one in seven (13 per cent) said it had had a large impact and another 17 per cent said it had some impact. A further 16 per cent said it impacted to a small extent. These results do not vary greatly between the public and private sectors.

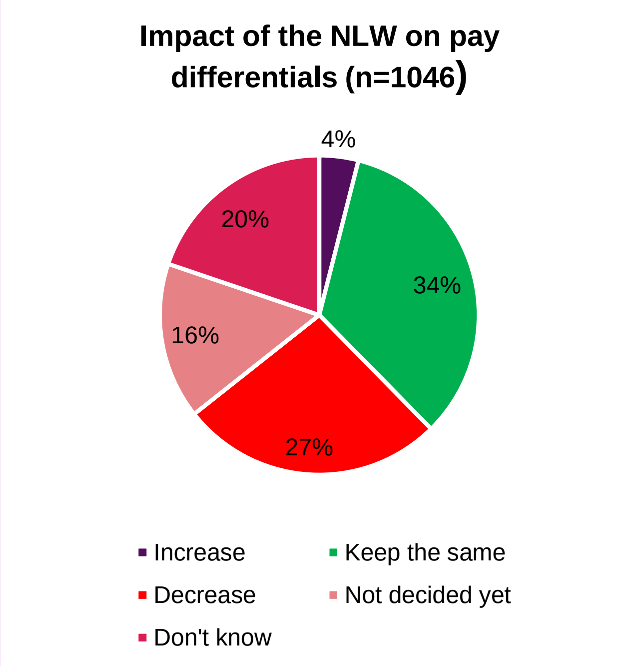
National minimum wages can cause a “ripple” effect whereby an increase in the wages of the lowest paid pushes up wages of supervisors and more skilled workers in order to sustain differentials. They can also cause compression of differentials as employers try and mitigate the overall impact on the wage-bill by increasing the wages of those paid above the NLW by less than those on the NLW. We found evidence for both effects from the recent increase in the NLW, with 34 per cent of employers saying they had kept differentials the same and 27 per cent saying they had decreased differentials. However, significant minorities had either not decided at the time of the survey or did not know the impact on differentials.

Moreover, those organisations who faced increases in pay-bill from the NLW were more likely to have squeezed differentials (47 per cent), while 23 per cent maintained differentials and 4 per cent increased them. Differentials were also more likely to be squeezed in some low pay industries, notably hospitality and arts, creation and entertainment where 47 per cent reported reducing differentials compared with 34 per cent of wholesale and retail organisations.

While this may have helped firms and organisations cope with the April 2016 rise, it is clearly not sustainable to go on reducing differentials without organisational and other changes, otherwise the differential between supervisors and front line managers will effectively disappear, creating difficulties in filling these posts.

CHART 4: IMPACT OF THE NLW ON WAGE BILLS





Base: all employers (n=1050) Summer 2016

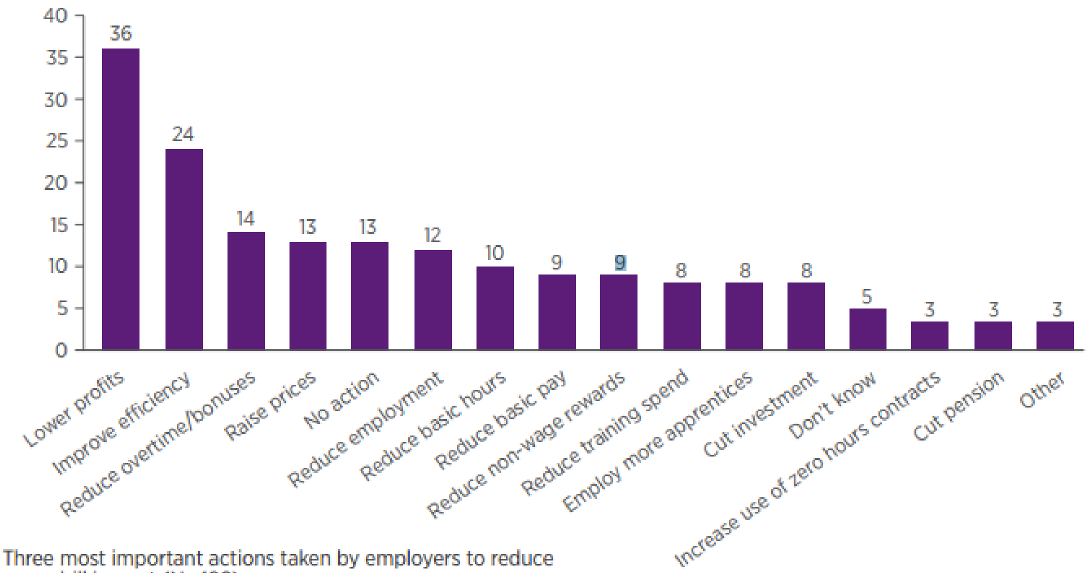
Employers who said it had some impact were then asked to select the three most important from a list of options. Previous studies of the Minimum Wage and much of the estimates about the impact of the Living Wage have suggested that employers will either absorb the costs; increase productivity (especially in the face of a big increase); pass the costs on through higher prices, or reduce costs elsewhere by reducing hours and non-wage benefits or cutting back on investment[3]. There has been significant concern expressed at the potential employment impact of the Living Wage, which increased the minimum wage significantly in April 2016, and is likely to exceed average earnings growth next year.

The LMO survey shows that the commonest response was to take a hit on costs or profits by absorbing the increase (36 per cent), followed by improving efficiency and raising productivity (24 per cent) – see Chart 5 below. Businesses have otherwise embraced a variety of options, none of which has been adopted by more than a relatively small share of organisations. About 13 per cent said they had increased prices. A small number of

[3] http://www.niesr.ac.uk/media/press-release-impact-national-minimum-wage-productivity-business-performance-and-employment#.V5TUrI-cHfA

organisations said they cut back on investment (8 per cent). Hours and some premium payments had been cut back, with 14 per cent cutting overtime and 10 per cent reducing basic hours. Reducing other aspects of the reward package or reducing basic pay for the rest of the workforce was selected by less than 10 per cent of organisations. Relatively small shares of employers (12 per cent) had cut back on employment.

CHART 5: HOW EMPLOYERS ARE RESPONDING TO INCREASED WAGE-BILLS FROM THE RISE IN THE NLW



Three most important actions taken by employers to reduce wage-bill impact (N=498)

These results compare pretty well with a joint survey between the CIPD and the Resolution Foundation published in November 2015 which asked employers to try and anticipate the impact of the NLW[4]. The main differences are that the share of employers who said they would cope by taking lower profits and absorbing the cost is higher and the share of employers who said they would improve efficiency is lower. In the November 2015 survey about 22 per cent of employers said they would absorb the cost, whereas the 2016 Summer survey showed 36 per cent of employers actually did. In the November 2015 survey the most common response that employers anticipated making was to increase efficiency (30 per cent), but in Summer 2016 the share of employers citing this response was pushed into second place and the share was somewhat less (24 per cent).

We should expect some differences between survey responses made before and after first increase in the NLW. However, the new survey result reinforces the conclusion of the 2015 survey that improving workplace productivity remains an urgent priority. Employers may

[4] https://www.cipd.co.uk/publicpolicy/policy-reports/weighing-up-wage-floor-employer-responses-national-living-wage.aspx

have absorbed the cost so far by taking a hit on profits, but this process is not sustainable, especially if cost pressures are rising from other sources such as Brexit. A significant increase in the share of employers saying they are dealing with the increase in the Living Wage by improving efficiency will be required if future adverse consequences of NLW increases are to be minimised.

Those employers who said they had improved productivity to cope with the rise in the NLW were most likely to say they had changed management practices (61 per cent); redesigned work (38 per cent); or changed organisational design such as adopting a different business strategy (37 per cent). They were less likely to say they had redesigned jobs (27 per cent) or improved progression (22 per cent) or invested in new technology or training (24 and 22 per cent respectively). They were least likely to say that the NLW had boosted productivity by improving morale (19 per cent). These responses suggests that the NLW has had a very modest net impact in increasing investment in new technology and training.

Question 5: Has the impact varied, and if so (for example, by sector, type and size of business, nation and region, or groups of workers – including women, ethnic minorities, migrant workers, disabled people, older workers, and those who have no or few qualifications)?

As might be expected, the impacts are much larger on the low pay industries, with over 70 per cent of employers in the wholesale and retail, hospitality, and arts, entertainment, and recreation industries reporting an impact. Just over a third (34 per cent) of organisations in wholesale and retail said there had been a large impact, as did 29 per cent of firms in hospitality, arts, entertainment and recreation.

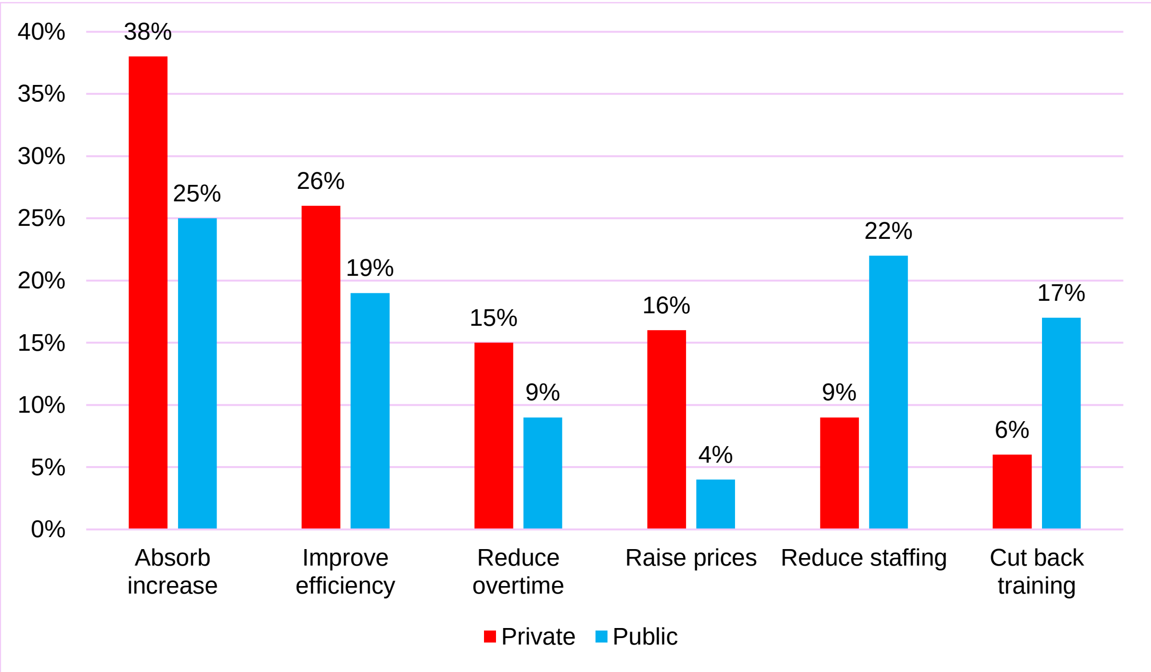
Large vs small employers

We also find that large organisations were more likely to say it had had some impact than small organisations (56 per cent of those employing 250 or more (large firms) and 35 per cent among those employing less than 250 (SMEs). There were some significant differences between large and small organisations – SMEs were more likely to say they had absorbed the increase (46 per cent) compared with large organisations (31 per cent). In contrast, very few SMEs said they had improved efficiency (9 per cent) compared with 31 per cent of large organisations.

Sectors

There are some important differences between the private and public sectors. The private sector is more likely to absorb the increase or improve productivity and efficiency than the public sector. The public sector was more likely to say it was reducing staff (22 per cent of organisations compared with 9 per cent in the private sector) and cutting back on training. Overall it appears that some adverse impacts of the NLW are showing up more strongly in the public sector.

CHART 6: RESPONSES TO THE NLW BY PRIVATE AND PUBLIC SECTORS Private n=379, Public n=91)



Young people

The survey found modest impacts from the NLW on the employment of young people. Overall, only 6 per cent of employers said they were hiring more workers under 24 in response to the NLW, implying they were shifting the composition of their workforce towards cheaper workers. In contrast, about 8 per cent of employers said they were taking on more apprentices, which can be interpreted as part of efforts to improve workforce skills.

<u>Setting the NLW and the other rates</u>

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Question 11: Do you agree that we should focus on the bite path? Do you agree that, in the absence of economic shocks or other strong evidence, our default should be a straight-line profile?

The decision to leave the EU could result in an economic shock, though we are unsure as yet when the shock will feed through into the labour market, how big it will be, how long it will last and whether it will be negative or positive. Hopefully, it will become easier to assess the situation in the coming months.

If the shock is initially negative, then earnings growth will decline, and earnings could potentially decline. This may mean that the 60% relative earnings objective could be achieved without a significant uplift.

Those employers that have seen the biggest increase in their pay-bills (such as retail) due to the NLW could be more impacted by a negative Brexit shock.

We would recommend that the LPC should adopt a cautious approach in suggesting increases in the NLW until the situation becomes clearer and consider back loading the glide path, rather than spreading out the increases relatively equally. We would also add that it would be prudent to adopt a longer timescale to achieve the NLW policy goal as it is very difficult to predict now the impact of Brexit on the economy in 2018 and 2019.

Question 12: Do you agree with the technical basis (using ASHE and the latest OBR forecast supplemented by other data like the Treasury panel of Independent Forecasts)?

Yes, although the basis may have to be revised in light of Brexit.

April 2017 Rates of the NLW and Other Minimum Wage Rates

Question 16: At what level should the NLW be set in April 2017?

It’s hard to give a figure because we will not know what the impact of the EU referendum has been on the UK economy for a number of months, by which time the LPC will have had to make its recommendation. If the impact is negative, it may be advisable to adopt a cautious approach in the first couple of years, followed by a period of catch up as and when the economy recovers.

Question 17: The projected 'on course' rate for April 2017 is around £7.60 or 5.6 per cent increase over the introductory rate. The exact figure will change between now and the autumn as new pay data and forecasts are published and is subject to LPC deliberations – but nonetheless provides a rough guide, what do you estimate would be the effect of an increase of this approximate level?

The impact of an increase to £7.60 on employment will depend on the impact that Brexit is having on the economy. The increase will have the largest impact on retail, hospitality, care and education sectors and their ability to absorb, pass on, or reduce the additional cost will influence their response.

Question 18: The LPC has been asked to provide 'indicative' second year rates for 2018 for the NLW. At what level should the NLW be set in April 2018 (the 'on course' rate is currently projected to be £8.05)?

We think that it is important to give 'indicative' rates because it gives employers the ability to plan and budget for the 2018 increase. However, the LPC should stress that these rates are only indicative and that they could be adjusted in light of subsequent economic data.

Our recommendations

The key recommendation from the CIPD to the Low Pay Commission is to adopt a more cautious approach to increasing the National Living Wage (NLW) in 2017 and beyond, including, if necessary, a longer timescale to achieve the desired policy goal.

The original suggested level for the NLW of £9 an hour by 2020 was always likely to be ambitious. Our survey suggests that while firms have coped relatively well with the initial increase in April 2016, many have responded in ways which will be difficult to sustain such as taking a hit on profits and costs and squeezing differentials rather than becoming more efficient.

These responses may change for the better over time, with more organisations putting in place measures to improve efficiency as other options are exhausted. But it is just as possible that more organisations will start to cut jobs and hours and reduce investment in training, especially in areas where greater efficiency is hard to achieve. Moreover, we know from our pre and post-Brexit survey that a large share of organisations anticipate rising costs as a result of the vote, making it even harder to absorb further cost increases from the NLW.

Our survey and others, and most economic forecasts, suggest that the labour market will deteriorate significantly in 2017 with rising unemployment and falls in employment. This is very different from the economic background the Commission could have reasonably anticipated in 2017 before the Brexit vote. Our survey also brings out large areas of uncertainty for employers, not least on the future employment of migrant workers where they report significant minorities are considering leaving the UK.

It would have been reasonable for the Commission to have followed the default position of a straight-line profile in achieving the 2020 target NLW rate in the absence of a macro-economic shock or other evidence that the NLW was adversely affecting employment. However, if the Commission accepts our recommendation to deliver a lower increase in the NLW in 2017 than the straight-line profile would suggest, logic says the Commission would then have to indicate bigger increases in 2018 and 2019 to achieve the desired outcome by 2020.

This would be risky. Firstly, the economic outlook for 2018 and beyond is unusually uncertain. It is quite possible the Brexit slowdown shown in the current forecasts will be short-lived, with the economy recovering strongly in 2018 and 2019. But it is also possible that the slowdown could be deeper and persist longer if the global economy also cools. It would be a brave forecaster who could say today with any confidence which of these scenarios is most likely. Secondly, our survey suggests that organisations will need more time and support to adjust to the NLW in sustainable ways that minimise any adverse impacts on the labour market. Both these considerations suggest that adopting a longer timescale to achieve what is still a very ambitious goal would be prudent.

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