Consultation on April 2020 National Living Wage and Minimum Wage rates

Submission to the Low Pay Commission

Chartered Institute of Personnel and Development (CIPD)

August 2019

CIPD
Championing better work and working lives

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 over 150,000 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.

Introductory comments

Our response does not address all the questions in the Low Pay Commission's consultation, but we have indicated the questions that we are responding to.

Our submission is based largely on our Spring 2019 Labour Market Outlook survey (LMO), our quarterly survey of 1000+ employers about their recruitment and pay intentions over the next 12 months, as well as previous editions of the LMO and other CIPD research.

CIPD
Championing better
work and working lives

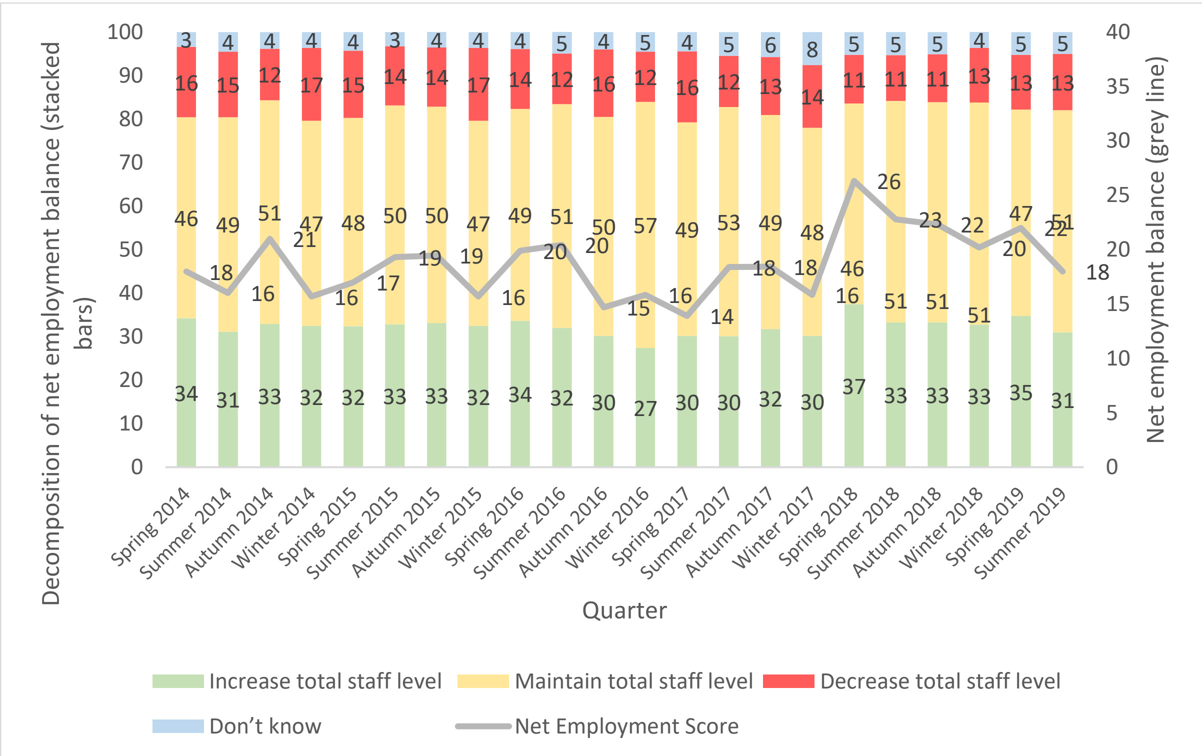
<u>Our submission</u>

Economic Outlook

What are your views on the current state of the labour market? Has the labour market tightened over the past year? If you are an employer, what has been your experience of filling vacancies?

The labour market in the 12 months to July 2019 saw very strong employment growth in the second half of 2018, followed by a softening in employment growth in the first half of 2019. This growth is consistent with the relative optimism among employers about future hiring intentions recorded in the CIPD's quarterly Labour Market Outlook (LMO), with the most recent data suggesting that employment growth will continue to soften in Q3 2020.

Figure 1: Decomposition of net employment balance over time

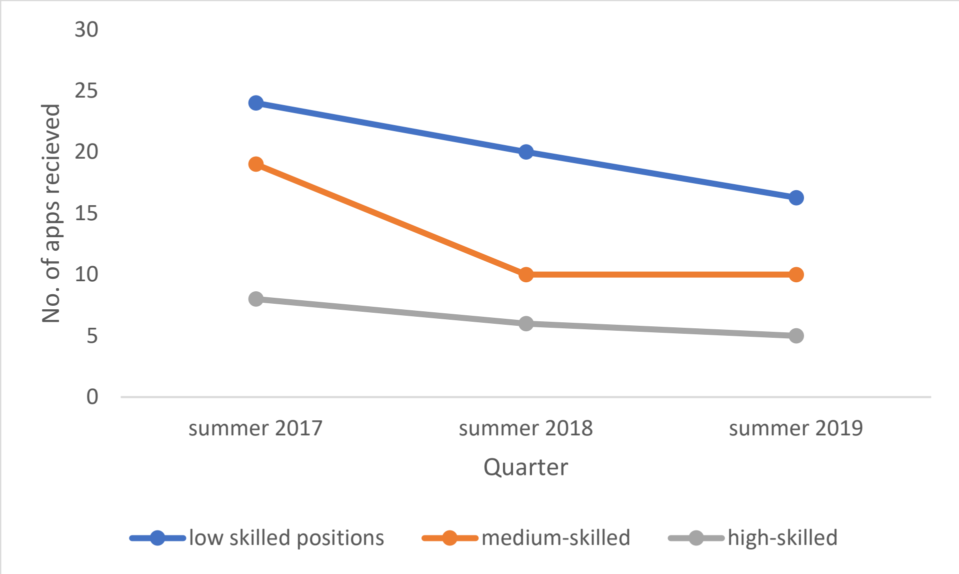


Base: Summer 2019, all employers (n=2,104).

According to the most recent LMO survey data that was carried out in June 2019[1], such employment has increased recruitment pressures on employers. More than four in ten (41%) employers say that recruitment pressures have increased during the past 12 months.

[1] [1] CIPD (2019). *Labour Market Outlook: Spring 2018*. London: Chartered Institute of Personnel and Development. Available at: https://www.cipd.co.uk/knowledge/work/trends/labour-market-outlook from 12 August 2019.

Figure 2: median number of applications received for most recently filled role by skill level, median employer



Base: Summer 2019, all employers (total n=2,104).

The LMO survey data also suggests that these pressures are partly due to labour supply constraints (see Figure 1); especially for low-skilled occupations. Where employers last filled a low-skilled vacancy, they received a median number of 16 applicants for that role. This compares with 20 applicants in the summer 2018 and 24 applicants in the summer 2017 report. It seems highly likely that the fall in applicants is partly attributable to the fall in EU net migration; especially from A8 and A2 countries.

However, employers report that the number of applications they received for medium-skilled roles is unchanged compared with the summer 2018 report. On average, employers received a median number of 10 applications for the last medium-skilled role that was advertised. Additionally, employers received a median number of five applications for the most recent high-skilled role they advertised for compared with the six applications they reported receiving in the summer 2018 report.

The resilience in skilled labour supply may come as a surprise to some commentators given that employment has increased by 274, 000 during the past year according to official data[2]; with all of the employment growth driven by medium skilled or high-skilled roles. However, it is highly likely that the 123, 000 increase in the number of non-EU born citizens in employment in the UK in the 12 months to May 2019, the vast majority of whom are subject to a skills threshold that is equivalent to graduate-level occupations, will have played an important contribution. In addition, the number of non-UK born citizens from the EU has increased by 58, 000 during the same period. Non-UK born citizens therefore account for around two thirds of the overall increase in employment during the past 12 months[3].

[2] https://www.nomisweb.co.uk/datasets/aps168/reports/employment-by-occupation?compare=K02000001

[3] https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/datasets/employmentbycountryofbirthandnationalityemp06

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

The expansion of the labour market stands in contrast with other indicators – most notably the productivity growth measured by GDP per hour worked - which fell in Q4 2018 and Q1 2019. It is therefore difficult to see how the current position of wage growth measured by average weekly earnings of 3.6 per cent can accelerate further without a hit on profits. However, the extent of movement up or down will be strongly influenced by the impact of skill and labour shortages, the final outcome of Brexit and the government's immigration policy.

Alongside the labour supply data cited earlier, the survey evidence from the CIPD LMO also shows that the share of firms reporting recruitment difficulties has steadily increased, from 49 per cent in Spring 2016 to 56 per cent in Spring 2017 and 61 per cent in Spring 2018 and 66% in Spring 2019. The survey evidence has also suggested that there has been some upward pressure on pay setting as a result. To alleviate their recruitment difficulties, more than half of employers (52%) that report rising recruitment difficulties have increased starting salaries for at least some staff. Over a quarter of organisations (27%) have increased salaries for the majority of vacancies in response to recruitment pressures, while a similar proportion (25%) say that they have increased wages for a minority of vacancies only.

At the same time, median basic pay expectations across the whole UK economy remain stuck at around 2% on average over the past year. However, there is clearly some upward movement for a significant minority of employers. Private sector pay awards have increased to 2.5% in the summer 2019 report from 2% in the LMO spring report. Additionally, more than one in three (36%) employers expect their basic pay award to increase by at last 3% in the year ahead, which compares with 28% of employers in the same period last year.

We conclude that while pressure on wages from recruitment difficulties has increased, the pressures are restricted to key staff or new hires within some firms. It also seems that overall basic pay increases are limited to a small minority of private sector firms. It is possible that basic pay awards will continue to make modest gain in response to a tighter labour market in the second half of 2019 but hampered by low productivity. It is possible that annual average earnings growth for the year ahead may settle around 3.75 per cent on average.

Impact of the National Living Wage

National Living Wage-related questions in CIPD summer 2019 LMO

In June 2019, the CIPD conducted a representative survey of 2,104 employers to ask a series of question that have been affected by the National Living Wage and how they have responded to a higher wage bill. In line with LMO summer reports since 2017, employers were given a list of potential responses and permitted to pick up to three which constituted their main reactions.
The survey two thousand sample allows us to explore the role played by firm size and industry on employer reactions.

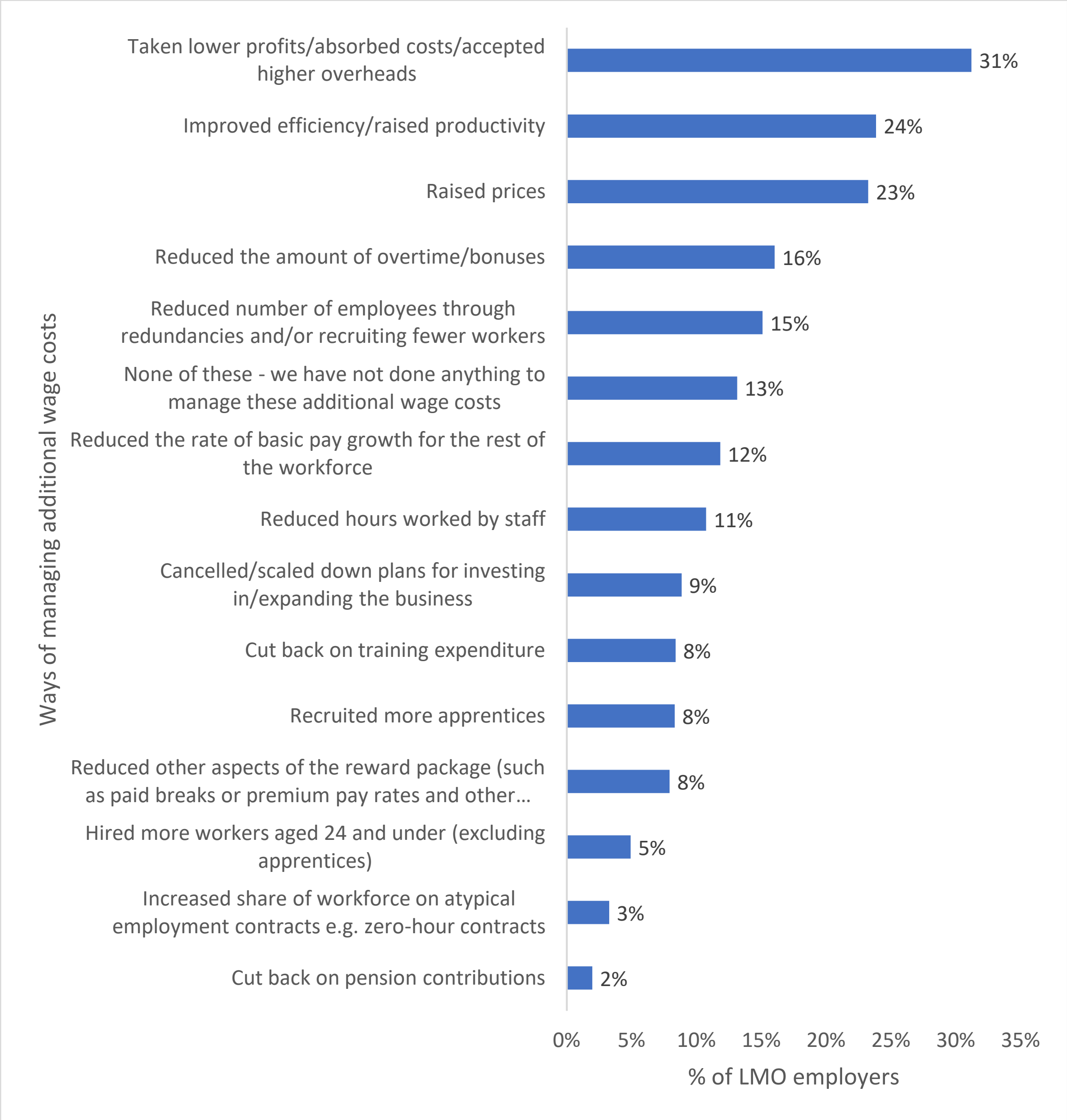
CIPD
Championing better work and working lives

Lower profits/absorbing cost

The CIPD summer 2019 LMO finds that the most popular response among employers whose wage bills have been affected by the introduction of and subsequence increases in the National Living Wage has been to absorb the costs or take lower profits (Figure 3). Almost one in three (31%) establishments report this, which is higher than in previous recent LMO surveys. In terms of sectors, more than a third (34%) of private sector firms have responded in this way, compared with a fifth (20%) of public sector organisations around a quarter (26%) of voluntary sector organisations. Among the private sector employers that say their wage bill has been impacted by the NLW, a quarter of smaller organisations (42%) say they have simply absorbed the cost compared with one quarter of large organisations (25%). This could be because smaller organisations tend to be less well informed about the NLW, have a narrower sense of what responses are available to them and are more pessimistic about the possibility of boosting efficiency. Additionally, absorbing the cost is especially prevalent in healthcare (46%), manufacturing (41%) and administrative and support service activities (38%).

It should also be noted that the share of employers that say that they have responded to National Living Wage increases by absorbing the cost has increased more sharply than other responses over the past year compared with similar questions in previous surveys.

Figure 14: Employer response to the introduction and subsequent increases in the National Living Wage (NLW)



Base: Summer 2019, those employers that have seen wage costs rise because of the NLW (n=942).

CIPD
Championing better work and working lives

Productivity improvements

Just under one quarter (24%) of those organisations that will be affected by the new higher wage floor plan to raise productivity in response to the introduction of the NLW – the second most common response across the survey. However, as per previous evidence and perhaps reflecting the greater resources and expertise they have to seek to make productivity improvements or efficiencies, larger organisations (27%) were more likely to report this than smaller organisations (19%). In terms of sub-sectors, the share of establishments reporting productivity and efficiency improvements is especially high among manufacturing (28%), hospitality (28%), retail (26%) and administrative and support services (26%) firms. This may reflect the greater scope to automate business processes in these sectors.

Worker intensification

The wider question this raises is how exactly organisations plan to achieve greater efficiency and productivity. In the LMO summer survey 2019, employers were also given a list of potential productivity responses and were invited to choose up to 3 responses. The data suggests that the National Living Wage may be leading to greater levels of worker intensification among a significant minority of employers. A quarter (25%) of employers say that they have increased the workload of National Living Wage recipients by giving them extra tasks. One in three (30%) public sector employers say that they are asking staff to work harder, compared with just under a quarter (23%) of private sector firms and just over a quarter of voluntary sector organisations (27%).

A similar proportion (23%) of employers say that they have required staff to be more flexible in their hours of work. In terms of sub-sectors, national living wage recipients are being asked to work more flexibly in around a third of organisations in hospitality (33%), healthcare (31%) and retail (31%). Additionally, around a fifth (18%) of organisations say they have raised performance standards or increased the pace of work at their organisation.

Raising productivity

On the upside, around a fifth (21%) of employers say they have sought to build on the morale boost of higher pay by seeking to improve staff motivation and just under a fifth (18%) say they have improved general business practices (e.g. quality control, supply-chain management). In addition, around one in ten (11%) establishments report automating tasks previously done by staff whereas a similar proportion (10%) say they have introduced more in physical capital.

Overall therefore, while gains are certainly being made and align with best practice, the survey responses suggest that some efforts to raise productivity may be restricting improvements and could even be counter-productive. The survey data highlights the need for more business support, and HR support in particular, to help employers improve their management practices that are key to productivity improvements in the UK. Additionally, the long-term decline in employer investment in skills can at least be reversed in part through changes to government policy that include broadening and increasing the coverage of the Apprenticeship Levy into a Training Levy, increasing FE funding and taking a closer look at Individual Learning Accounts.

CIPD
Championing better work and working lives

Raising prices

Around a quarter of employers (23%) plan to pass the cost of the NLW on to consumers through higher prices. However, reflecting the constraints on public sector and voluntary sector organisations to respond through higher prices, more than a quarter (28%) of private sector firms say they have raised prices. This option is particularly popular among hospitality firms (44%), hospitality (31%) and retail (28%). Additionally, around one-quarter of smaller private sector firms (25%) are considering this option, compared with around a third (32%) large organisations.

Employment levels

Consistent with other evidence and in line with the UK's experience of the introduction of the NMW in 1999, the survey data imply that the new rate only a modest impact on employment levels across significant swathes large of the UK economy. Fifteen per cent of organisations say that they have responded by reducing the number of employees through redundancies and/or recruiting fewer workers. However, there is some significant variation across sectors, with lower employment levels reported in public administration (24%), education (24%) and retail (19%).

Reductions in employment levels are more likely in large organisations (%) than smaller organisations (%) and among services firms (%) compared with manufacturing and production companies (%). Something of a sectoral gap emerges, with % of public sector employers likely to cut the size of their workforce because of the NLW compared with % of private sector employers

Pay differentials

In calculating the costs of the NLW, some firms may consider more than just those staff who currently earn less than the new wage floor. Because of the size of the annual increases since April 2016, a question for employers is whether to offer a similar pay rise to National Living Wage recipients.

The survey data indicate that the NLW has increased the wages of many employees already earning more than the NLW. Around one-fifth (19%) of **all** employers report that they have maintained pay differentials among employees. However, a similar proportion (20%) say that they have reduced pay differentials between those affected and their supervisors or managers. It is no surprise that there is variation across sectors, with differentials being squeezed in over a quarter of establishments in retail (28%), hospitality (28%) and healthcare (26%).

Pay

Additionally, the CIPD's Summer 2019 LMO finds that just over half of the 2,100 employers surveyed plan to increase base pay over the next 12 months (48% are unsure whether they will increase, freeze or cut pay). Among those planning to increase salaries 71% plan to increase them by 2% or more. The most common explanations amongst these are: inflation (43%), the 'going rate' of pay rises elsewhere (37%); recruitment and retention issues (29%) and movement in market rates (25%).

Just one five 20% of respondents say that the labour costs, that include the Apprenticeship Levy, the National Living/Minimum Wage and auto-enrolment are a reason why they think salaries will increase by more than 2% in the coming year.

Among those organisations planning to increase base pay by less than 2%, the most common explanations for this are: restraint on public sector pay (41%) and the organisation's inability to pay more (38%). A fifth (20%) of establishments report that the national minimum and living wages are dampening future pay increases. This explanation is more common in the private sector (26%), especially in wholesale, retail and real estate and manufacturing

Other responses

Consistent with the responses in recent LMO reports, the less popular options include:

Response	%
Reduced the amount of overtime/bonuses	16
Reduced hours worked by staff	11
Cancelled/scaled down plans for investing in/expanding the business	9
Reduced other aspects of the reward package (such as paid breaks or premium pay rates and other benefits and perks e.g. free lunch)	8
Recruited more apprentices	8
Cut back on training expenditure	8
Hired more workers aged 24 and under (excluding apprentices)	5
Cut back on training expenditure	5

In terms of sub-sectors, the key highlights include:

- More than a quarter (26%) of retail firms say they have reduced the amount of overtime or bonuses. Meanwhile, fifteen per cent of retail firms say they have reduced other aspects of the reward package e.g. paid breaks.
- Around one in seven (16%) establishments in education, retail and hospitality have reduced hours worked by staff
- Fifteen per cent of public sector employers say they have recruited more apprentices. The proportion is highest in public administration and defence (16%) and healthcare (15%).
- Almost one in five (18%) education employers say they have reduced training expenditure

The minimum wage beyond 2020

The CIPD will give its full response to this section once the current round of interviews that explore this in more detail have been completed

Effect of the minimum wage and the NLW on workers aged 21-24

Against the backdrop of our goal for good work, the CIPD already believes that there is a strong argument for abandoning the 21-24-Year-Old Rate and replacing it with an adult rate for 21-year olds and above. The CIPD's call for is based on several observations which include:

- The fear that some employers may prefer younger, cheaper workers over their older counterparts has not been reflected in either the survey findings or the qualitative data over the past couple of years. This in turn undermines the fear therefore that the labour market outcomes for young people will be affected by a new flat rate.

- Indeed, there is an argument that a new higher rate could boost the employment prospects of young people in terms of boosting labour supply. Such a policy intervention could prove particularly timely in the run-up to the introduction of migration restrictions, which looks set to provide a labour supply shock, especially for low-wage employers that employ EU citizens.

- Our qualitative data suggests that a relatively small proportion are using the 21-24-year-old rate. The qualitative data includes the current set of interviews we are currently conducting as part of the LPC-funded research that will be published in late autumn 2019.
- Many organizations who say that they pay the same National Living Wage rate to those aged between 21-24 and those aged 25 and above do so because they are performing the same tasks and therefore deem it fair to pay the same rate to all workers.

At the same time, we do not see the case for tinkering with the apprentice rate or the two respective rates. The survey data suggests that the current rates are nudging more employers into taking on apprentices. And in terms of the other two age rates, many of these workers are either students who are perhaps not fully proficient in the role and learning on the job.

Overall, the official labour market data suggests that neither the NMW nor the NLW have had an impact on the employment prospects of young people; which is reflected by lower unemployment rates across all relevant age groups since the introduction of the policy in April 2016.

2020 NLW target

Additionally, the CIPD also believes that the LPC should seek to meet the April 2020 target of £8.67 an hour, especially given that the employment effects to data seems to have been limited. However, as previously indicated, many employers will require more help with helping to meet the productivity improvements that will be required in the future to make this increase affordable. This will be achieved, at least in part, through some of the policy interventions recommended earlier.

Young people and apprentices

It is very difficult to isolate the impact of the Apprentice Rate on the pay, provision, and take up of apprenticeship places due to the substantial policy changes in the apprenticeship system. These changes - the apprenticeship levy, the new off-the-job training minimum of 20%- and 12-month minimum duration requirement, and the introduction of more challenging new standards and associated training funding bands - are likely to have played a much larger role in employers' decisions around apprenticeship take up.

International and national studies – such as Gambin L and Hogarth T (2017) - suggest that training costs (which include wage costs during non-productive training time) have a larger impact on employer's decisions around apprenticeship take-up than wages - which has implications for the introduction of the requirement of a minimum of 20% spent in off-the-job training. For younger people, the balance of employer incentives has shifted towards older apprentices and away from their younger counterparts: under the old funding regime, 100% of training costs were subsidised for 16–18-yearold apprentices, while for older apprentices subsidies were around 40–50%; under the new system, 90–100% of training is subsidised for all apprentices.

In addition, evidence from the most recent Employers Perspectives Survey (2016) suggests that cost is not the primary motive for, or barrier to, apprenticeship take-up. For example, just 8% of employers surveyed who offered apprenticeships said they did so because they were good value/cost effective and just 7% of employers who did not offer them reported that it was because they could not afford to do so.

Influence of other policies e.g. National Insurance Contributions

Soundings from employers suggest that there is a section of firms that see a connection between the NLW and other policy interventions such as the Apprenticeship Levy and auto-enrolment into workplace pensions. This is also reflected in the survey data (see Section 2). However, it seems that very few, if any, of the employers we have spoken to have not fully assessed the impact of the range of interventions and tax changes which include NICs and corporate tax reductions. It is very difficult therefore to quantify the impact of these changes overall; especially in terms of the impact on young workers or apprentices.

Compliance and enforcement

Additionally, the CIPD strongly recommends a national 'know your rights and responsibilities' campaign to improve awareness among employers about what they are required to do, and among employees about to what they are legally entitled. For instance, roadshows, webinars, tweets, etc.

CIPD

August 2019