Evidence by the Industrial Relations Committee of the Unquoted Companies Group for the Low Pay Commission's 2013 Recommendations on the National Minimum Wage

Note: *The Unquoted Companies Groups (UCG) is an informal group of some 35 UK based large family companies represented by their Chairpersons, Chief Executives or Owner-managers. The family businesses we represent are spread right around the country (not only in the prosperous South-East), and we stress continuity and long horizons. Such continuity is critical for the UK's economic and social life. Our area of particular interest is the whole of the unquoted sector of the British economy, which includes most of the UK's small and medium-sized firms.*

The Unquoted Companies Group has made a written submission in response to each of the Low Pay Commission's calls for consultation since 1999.

We are happy for this response to be made publicly available to any enquirer.

Signed:

C. D. Cracknell
Chairman, UCG Industrial Relations Committee
7 September 2012

EXECUTIVE SUMMARY

- Overall: The outlook for 2013-4 for labour markets remains poor, since real GDP growth currently appears negative (Table 1), and is likely to continue low. Moreover, continuing tax increases and EU uncertainty will destroy jobs unless real wages can fall to compensate.

- Unskilled/young workers: recent research using a broad OECD sample over 40 years has confirmed that minimum wages reduce jobs, particularly for young people in recessionary conditions. This finding, together continuing adverse developments in the youth labour market (Table 2), shows the Commission's wisdom in freezing the youth minimum (Figure 1), and we hope this policy stance continues.

- UCG experience: two member companies, both large employers of young workers have raised labour productivity and reduced employment (Figures 2 and 3). Both point to the difficulties caused by the minimum wage for employment and training.

- Pension auto enrolment: the Commission is wrong in believing that this policy mainly affects small firms in the future, since it is already affecting UCG members now. Employment will therefore have to be cut back, unless wages fall, which again points to the need for restraint in setting minimum wages.

- Welfare reform: the new Universal Credit policy has the worthy aim of reducing marginal effective tax rates faced by low-wage workers (Figure 4). Workers will be prepared to accept lower wages and price themselves into jobs (since benefit withdrawal rates will be lower), and the Commission should assist this process by allowing real wages to fall.

- In sum: the recession, particularly adverse youth labour market conditions, costly new pensions regulation and changes in welfare benefits all point to the need for restraint in setting minimum wages. We therefore recommend no increases in 2013 which will allow real wages to fall.

Introduction

1. Our evidence is in response to your consultation regarding plans for up-rating the minimum wage in October 2013. Your inquiry falls into three areas: first, the level and impact of the minimum wage; second, effects on young people and apprentices; and third, implications for the minimum wage of new pension and tax policies including pension auto-enrolment and Universal Credit. We take these areas in turn.

The level and impact of the minimum, and outlook for 2013-4

2. As in previous years (UCG, 2011), we maintain that the level of the minimum is too high, particularly for unskilled workers in small firms. We are therefore pleased that the Commission has not increased either of the youth rates in this year's up-rating, and also that the increase in the main adult rate from £6.08 to £6.19 is only 1.8%, which represents a decrease in real terms and will promote employment. However, the UK's continuing large deficit requires reduced government spending and increased taxes which will inevitably raise unskilled unemployment unless wages can adjust downwards, so continued restraint is required.

3. Evidence from the Commission's own full programme of research shows that minimum wage setting has adverse effects on unemployment of unskilled workers, particularly in recession. In particular, Dolton and Bondibene's recent (2012) analysis of international minimum wage-setting in 33 OECD countries over 1971-2009 shows especially strong adverse results for the youth (16-24) group. They state:

   "results suggest that over the 2008-2009 recessionary period when average growth was only -0.01%, then a 10% increase in the MW would reduce employment by as much as 2.6-4.1% (p 136).

   This reduction for youth is exactly our concern,

4. Adverse effects for part-time women workers in the UK – a large group - are also now becoming apparent, as shown by Dickens et al's recent (2012) report based on UK data:

   "We do find some evidence that the NMW has led to a small reduction [3 percentage points] in employment retention amongst female part-time workers, particularly upon NMW introduction and during more recent years" (pp 26 and 39)

   This result is important because a 3 percentage point reduction is in fact quite large when measured against an average retention rate (i.e. probability of remaining in employment for 1 year) of around 70%. About 10% of female part-timers are paid the minimum compared to only 2-3% for male and female full-timers, so we find it quite believable that their employment is reduced. Hence, we believe that the Commission is too sanguine in stating (2012 para 2.88) that "the general consensus of the research is that the NMW has not significantly affected employment". It has, for vulnerable groups in bad times.

5. The UK's economic outlook is almost as uncertain as when the recession began four years ago. Then we advised (UCG 2008, para 2): "The current downturn in economic conditions means there could hardly be a less propitious time to raise minimum wages", and our advice remains unchanged. The difficulties are shown in Table 1, looking forward to 2013 and 2014 which is the relevant period for the October 2013 up-rating. The first row shows that growth in 2012 is likely only to have been -0.7% according to the OECD's (2012b) latest forecast, and while the OBR forecasts an improvement to 2.0% for 2013 and 2.7% for 2014, this is probably over-optimistic. As can be seen, recent independent estimates are only half the OBR's. Thus we foresee the macro-economic environment in 2013-14 as still being unpropitious.

Table 1: The Economic Outlook

Annual % change over a year earlier	Office for Budget Responsibility forecast for 2012 (OBR, 2012)	Forecasts for 2013		Forecasts for 2014	
		OBR	Most recent independent*	OBR	Most recent independent*
Real GDP growth	0.8 (-0.7)††	2.0	1.2	2.7	1.9
Average earnings growth	2.6	3.1	2.2	4.3	
Fixed investment as % of GDP	-0.3	6.2	2.5	8.6	6.9†
RPI inflation	3.2	2.3	2.6	2.5	2.6
Claimant unemployment (m)	1.65	1.64	1.70	1.52	1.61

Memo 1: increase in adult minimum for Oct 2011 to Oct 2012 is 1.8 % (i.e. from £6.08 to £6.19). The 2 youth rates are held constant.

Memo 2: Major taxes as a percent of GDP were 34.9% in 209-10 (OBR, 2011 Table 4.6). They rose to 36.2% in 2011-12, and are forecast to rise further to 36.3% by 2013-14 (OBR, 2012 Table 4.6)

* Figures are average of most recent (June-August 2012) independent forecasts as summarised in Treasury (2012); † IFS 2012; †† latest September OECD (2012b) estimate.
Sources: Commission (2012, Table 5.1), Office for Budget Responsibility (2012, Table 3.6).

6. Other figures in Table 1 are not really more reassuring. Average earnings growth is likely to turn out to be 2.6% for 2012, and then rise to 3 or 4% in 2013-14 according to the OBR. The implication is that the NMW would have to increase by 3 or 4% in 2013 to keep pace with average earnings growth which is one of the Commission's benchmarks (too high, as we have repeatedly cautioned). However, there is uncertainty with regard to fixed investment which is an important driver of growth. In 2013, investment is forecast to increase by a respectable 6.2% by the OBR, but much less, only 2.5%, by recent independent forecasters. The picture for 2014 looks more favourable, but of course these outcomes could come to nothing given the EU crisis. At least, all forecasts appear to be in agreement that inflation will reduce to 2 or 3 % in 2013-14. Moreover, unemployment is projected to remain relatively benign at around 1.6 million claimants, despite the slump. In fact, however, such relatively low unemployment itself is difficult to explain given the depths of our recession which should surely mean more weeding out of unproductive workers. If there is a further adverse shock, will businesses suddenly lay off the unproductive workers? Finally, taxes are continuing to increase (see Memo item 2), which reduces employment.

7. We believe the uncertain outlook means a freeze in 2013 in the minimum wage for adults (just as for youth) is the only reasonable course. We have not been alone in past years in recommending a freeze, as the Commission notes (Commission 2012 para 5.37). The situation is no better this year, and we therefore maintain our position.

Effects on young people and apprentices

8. We will consider first the youth (16-24) labour market, and then apprentices. The youth labour market is performing poorly, as shown in Table 2. Admittedly, the very young 16-17 group is becoming less attached to the labourforce as the date for raising the minimum school-leaving age to 18 approaches. However, obviously the 18-24 group remains important. Hence the table gives statistics for the whole 16-24 group, and we see that their unemployment rate has almost doubled to 24.7% over the period since 1999. This performance is worse than for the working age population as a whole. In addition, as the lower panel shows, unemployment duration for the youth group has worsened, to the point where 28.2% of the unemployed have been unemployed for over one year. This figure compares with only 15.3% in 1999.

Table 2: Continuing Adverse Changes in Employment for Unskilled Workers

		All working age	No qualifications	16-24	France 15-24
Unemployment rate (%)	1999	6.3%	12.1%	13.8%	24.2%
	2011	8.1	17.0	24.7	22.1
	Change 1999-2011	1.8	7.9	10.9	-2.1
					France total
Unemployment duration (% of unemployed > 12 mons)	1999	28.7	NA	15.3	40.3
	2011	33.3	NA	28.2	41.4
	Change 1999-2011	4.6	NA	12.9	1.1

Sources: Commission (2012, Table 2.10), ONS (2012) and OECD (2000, 2012)

9. Moreover, as we noted last year (UCG 2011), the UK's youth labour market is now putting in a worse performance than France's - where youth unemployment has long been high due to the combination of high minimum wages and high taxes. This comparison is made in the last column. Our young workers are having an agonising time.

10. We are therefore relieved that the Commission acknowledges (2012 para 3.8) that a lower youth minimum is required in case it "jeopardises" young workers' employment or training opportunities. This reasoning is of course in accordance with our own. It is also in line with the recent international findings (Dolton and Bondibene 2012) noted above. It follows that we believe that the freeze should be extended to next year.

11. In fact, our analysis suggests that the Commission's freezing the youth minimum at this point in the cycle marks a break with past practice, for which we are grateful. Evidence is provided in Figure 1, which builds on our procedure last year (UCG 2011) of graphing youth minimum wage changes over the business cycle as measured by changes in GDP. However, on this occasion Figure 1 shows nominal rather than real wage changes because these give a better fit, as does a lagged rather than current GDP variable (leading GDP changes would be a more suitable guide for Commission practice, though there are

obvious uncertainties). As can be seen, both the 2012 and 2011 minimum wage increases are below the fitted line, which is in line with our desired more cautious approach.

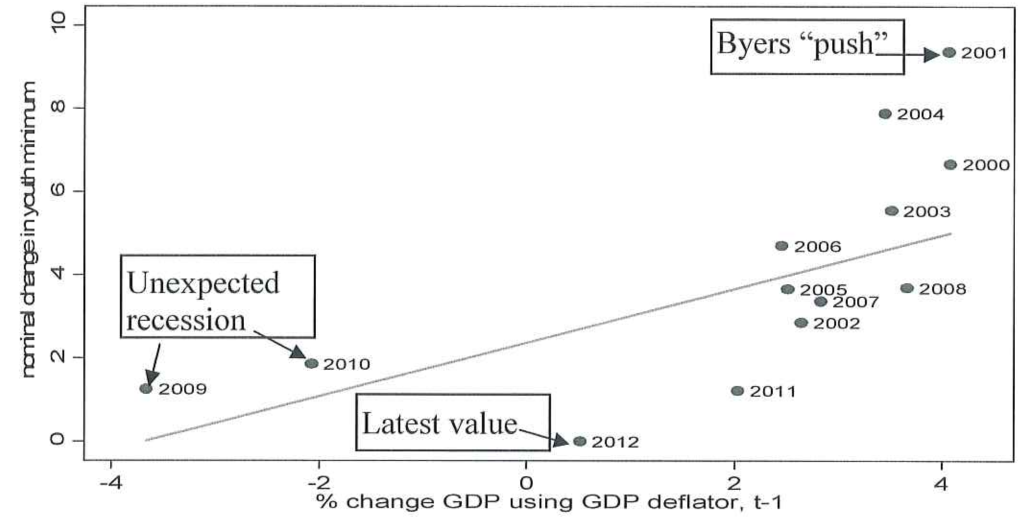

Figure 1: Changes in the Youth (18-21) Minimum Wage and in GDP
Note: labels give the date of the NMW change, the GDP change date is the year before – for example, point 2009 relates the NMW nominal increase in 2009, and the GDP change in 2008.
Source: LPC and ONS data. The GDP real growth figures deflate by the GDP deflator.

12. Evidence from two large UCG member companies employing many young workers at or near the minimum shows a downward trend in employment and increase in labour productivity in both. These trends help explain the adverse developments in the youth labour market noted above. Company I, in Figure 2, gives us a long time series, and we see how productivity in this company jumped in 1999, coinciding with the introduction of the minimum, and this higher productivity remains currently. Since the onset of the recession in 2007-8, the decline in employment and increase in productivity has been particularly marked.

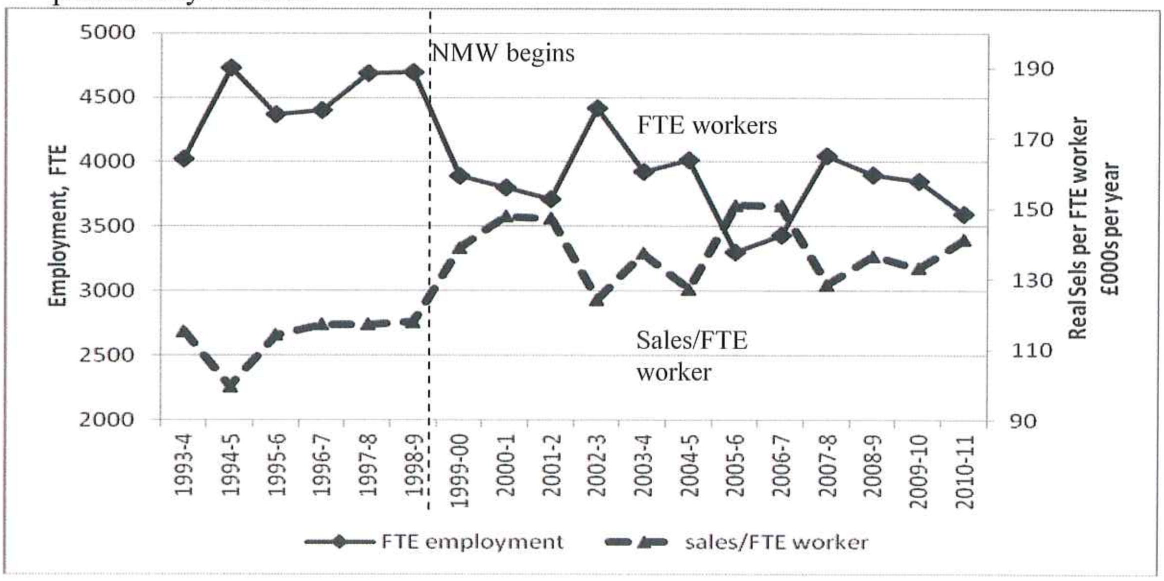

Figure 2: Employment and Productivity, National Retailer I
Source: UCG member company data
Memo: headcount employment in April 2012 is 10,419, and 6,150 of these are under age 22.

13. Company II, in Figure 3, with data since 2007 shows the same trends over this period as for company I, namely a decline in employment and rise in productivity. The Managing Director of Company II states:

"NMW policy has put a strain on retailers such as ourselves. The pressure has resulted in making sacrifices elsewhere in the business and has increased the proportion of temporary staff and non-contracted hours. NMW increases have also squeezed our capacity for training resources which ordinarily would have been more readily deployed in the training of unskilled resources" (UCG member, retail chain).

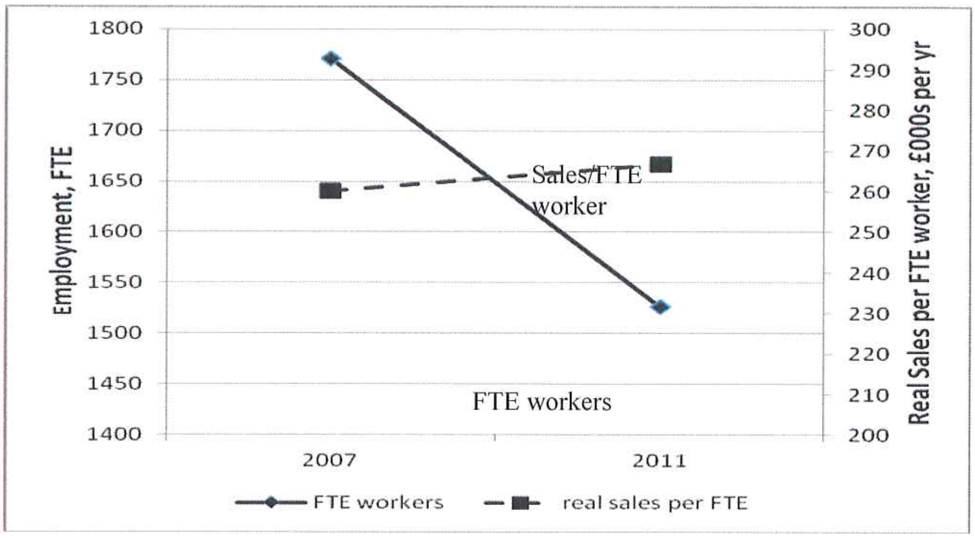

Figure 3: Employment and Productivity, National Retailer II

Source: UCG member company data

Memo: headcount employment in March 2012 is 2,440, and 422 of these are under age 22. The FTE workforce has fallen by -15% 2007-11, real sales by -12%, meaning sales per FTE worker have risen by 3% (and in fact, in calculations not shown, sales per hour worked have increased by 6%).

14. Turning to training, in past evidence we have emphasised (e.g. UCG 2009) the need for the trainee Apprentice Rate to be low in those circumstances where trainees have low productivity. Apprentices are investing in themselves, they own their training, and the company is merely the vehicle for achieving it. Hence, where there is low productivity the parties need to be allowed to negotiate low pay in order for the company training slot to be kept open. For some low productivity apprenticeships the Apprentice Rate is undoubtedly now too high. A good example is hairdressing where the National Hairdressers' Federation told the Commission (2012 para 3.6) that "training young people is now an unaffordable luxury".

15. We emphasise that apprenticeships are heterogeneous, and it is training slots for young apprentices in lower skilled industries such as hairdressing and cleaning that are at risk - not the traditional metal-bashing apprenticeships where productivity can be quite high. The Commission emphasises (2012 para 3.56) that apprentice starts have increased, but admits that most of the increase is accounted for by those aged 25 and over. Moreover, in its survey of employers of apprenticeships (2012 para 3.72), nearly one-quarter (23%) of employers in low-paying sectors had found introduction of the Apprentice Rate to be an obstacle to training. This reduction is precisely what we fear.[1] Fortunately the rise in the

[1] In fact, Chris Cracknell in evidence to the Low Pay Commission on 18 November 2011 stated in his capacity as Chair of Asset Skills, the training body for facilities management, that he was "always being asked about the

Apprentice Rate this October is only to be 5p, so not much further damage has been done, and we recommend no further increase for 2013.

16. Finally, we wish to re-affirm our support for interns remaining outside the system. Similar reasoning applies to interns as to students who are not paid for the work that they do, because they are investing in themselves. Internships offer young people an informal type of training – a chance to see and be seen, and a contribution to their CVs. The Commission is concerned (2012 para 4.44) that these are "vague promises". It is also concerned (2012 para 3.52) about the "potentially damaging impact of unpaid internships on social mobility" since only those who can afford to work for free can take them. But we have to accept that markets require discovery (assessing promises, some of which will turn out to be vague), and investing requires finance. Pursuing interns carries the real risk that this little market will be squeezed out. We need to do everything possible to improve Table 2's dire youth unemployment statistics. We therefore repeat our advice of last year: do not be drawn into pursuit of interns who are akin to students investing in themselves.

Implications of new pension and tax policies

17. We now consider pension auto-enrolment. As we noted last year (UCG 2011, para 14) auto-enrolment imposes a large cost on firms, matched by benefits to workers. We would normally expect wages then to fall to match this "mandated benefit". If wages are prevented from falling by a minimum wage, then unemployment will ensue simply because employer costs have increased.

18. We remain concerned about auto-enrolment. Our reasoning that pay will have to fall with auto-enrolment is confirmed by Commission research (Van den Ven and George 2011). We are also not convinced by the Commission argument that there is no problem in 2013-14 since the time span for any effects will be drawn out over several years. First, Van den Ven and George's (2011 p2) finding is strong:

    "To offset employer contributions required under the NEST [National Employment Saving Trust], wages would need to fall between 0.8% and 1.1% among low pay industries on average, and by 1.2% and 1.6% among private sector firms employing fewer than 25 employees".

    Second, as for the time span of the effects, it is true that the government has now decided that small firms employing less than 50 workers will not have to implement anything until after the next parliament in 2015. But larger firms will, starting with a 1% contribution soon, in 2013. Third, the Commission's belief (2012 para 5.63) that "existing qualifying pension provision is already high in large firms" is simply wrong. One UCG member with 25,000 employees has only 3,000 in the company scheme, leaving 22,000 to auto-enroll. Its Head of Reward is blunt: "auto-enrolment is a massive issue for us".

19. In 2013, then, many businesses will be facing a substantial wage cost increase of the order of 1%, for which employees will receive a pension benefit. The Commission should therefore allow the market to work and wages to flex downwards, otherwise jobs will be lost. Thus, in our view pension auto-enrolment provides a further reason, in addition to the UK's adverse economic environment, for awarding no minimum wage increases next year.

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cost of offering apprenticeships by worried managers, and clearly increases in the Apprentice Rate would not help here".

20. Finally, we turn to tax changes which are important for minimum wage workers who are close to welfare benefit levels, and so suffer high marginal effective tax rates. Figure 4 illustrates the line linking household net income and earnings. (We use DWP 2009 figures, since no more recent issue of this publication is available; however, the current situation is similar.) We see how it is scarcely worthwhile for a single earner with a family to take a minimum wage job. Such a job would pay about £240 in gross earnings a week, but – adding on benefits - the family finds itself on segment A-B of the line, receiving about £500, almost irrespective of the number of hours worked. Work is thus heavily taxed for this type of family, and the system needs to be changed.

Couple with 2 children under 11 , Private Tenant

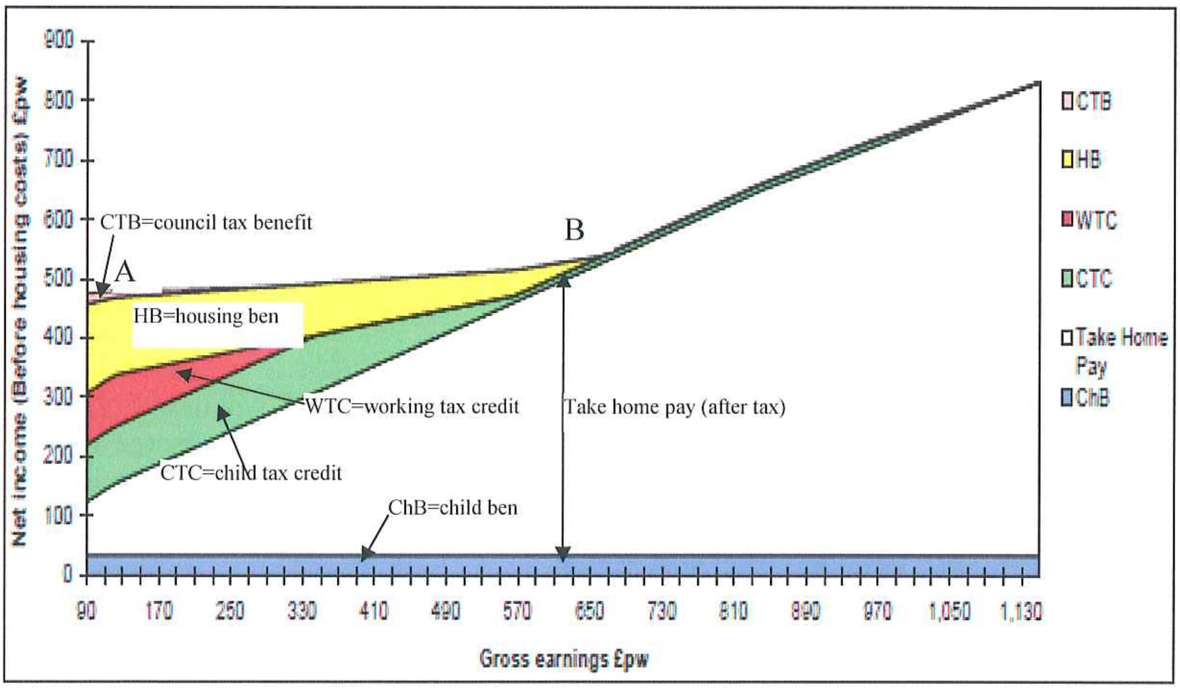

Figure 4: Example of High Marginal Effectives Tax Rates
Source; Department of Work and Pensions, Tax Benefit Model Tables, 2009. Notes: The table shows how net income including welfare benefits varies with gross earnings for a couple with 2 young children.

21. A major aim of Universal Credit is to simplify the benefit system and make the slope of the A-B line steeper, thereby reducing the tax on work. Other aims are to make monthly payments, so it is simpler and less risky for workers to transition from unemployment, and to monitor unemployment search more effectively. All of these aims should increase labour supply, and the UCG wholeheartedly supports them. There will be administrative problems in ensuring that the new computer linkages work with HMRC, but our members are sure that they can be overcome

22. The changes brought in by Universal Credit should make workers more willing to work for somewhat lower market wages than currently. (Fewer benefits will be withdrawn as more hours are worked, so the net wage will increase.) Lower market wages, if permitted, will then generate greater demand among companies for workers. The implication for the Commission is that the minimum wage should not be set so high as to prevent the newly

incentivised workers from gaining (better) jobs and enlarging the workforce. Thus, the Universal Credit provides another reason for not increasing minimum wages.

Conclusions

23. As was the case last year, we see the outlook as remaining negative. Real GDP growth will remain subdued. Taxes will continue to increase. The EU's finances, and even the US's, will remain chaotic. The worsening position of unskilled workers is shown in Table 2 for the economy, and for two large UCG retailers in Figures 2 and 3. Given these poor conditions, we are therefore pleased with the Commission's recommendation to hold the youth rates constant, and to increase the adult rate by only 1.8%, which will amount to a real fall of about 1-2%. The increase in the Apprentice Rate has also been small. These changes are lower than in the past, given economic conditions (see Figure 1).

24. Our main call is for continued restraint. Such restraint will help the economy, particularly young workers and part-timers, cope with the recession. As we have noted, recent research results show that minimum wages reduce employment of young workers, and female part-timers particularly. Restraint will also ease the introduction of the costly pension auto enrolment policy by allowing wages to flex downwards to reflect the higher pensions. Finally, lower wages will help introduction of the Universal Credit welfare system by encouraging business to generate enough new jobs to match the new workers.

Signed: C. D. Cracknell

Chairman, UCG Industrial Relations Committee
7 September 2012

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