CBI
THE VOICE OF BUSINESS

CBI submission to the Low Pay Commission – September 2012

The UK economy is in recession, with the recovery yet to be secured. GDP is more than 4 percent lower than it was in 2008 with output per capita now 14 percent below its pre-crisis trend. As a result of this stalled recovery, confidence remains weak and uncertainty high. The CBI forecast for growth has been revised down to minus 0.3 percent in 2012 and 1.2% in 2013. Given the significant downside risks from the Eurozone – which now seems to be acting as a drag on the broader global economy – uncertainty continues to dampen business confidence.

Although the labour market has continued to outperform expectations, overall fragility persists, with the performance we have seen in recent quarters expected to deteriorate. The CBI forecasts unemployment to continue to rise, averaging 8.4 percent, or 2.69 million people, in 2013. Productivity levels are yet to recover, with the risk that if productivity continues to fall employers will look to cut back on jobs in order to stem further declines.

Pay restraint continues to play an important role in supporting employment and slack in the labour market is set to continue to bear down on wage growth meaning a cautious approach to the rate of the NMW will reflect wider labour market practice, with NMW earners unlikely to fall further behind. Pay restraint will continue to characterise the labour market in 2013, with the CBI forecasting growth in average weekly earnings at 1.7 percent and the latest consensus forecast (median) showing 2.2 percent earnings growth in Q4 2013. Inflation is set to continue to fall back towards target in 2013, helping to ease the pressure on household income. In this environment **it is vital that a highly cautious approach is taken when setting the 2013 NMW** rate as without a sustained upturn, we will continue to see slow wage growth and a sluggish labour market owing to a weak economy.

Young people continue to bear the brunt of unemployment, with the disproportionate impact of the recession adding to existing structural challenges. With the youth unemployment rate at over 20 percent or over 1 million young people, and 968,000 NEETs in England alone, **freezing the youth rates will allow their bites to continue to fall to more sustainable levels**, helping young people make progress in the labour market and safeguarding their access to jobs.

The CBI recommends:

- **In the face of economic and labour market pressures an extremely cautious approach to the 2013 NMW rate remains vital:**

INVESTORS IN PEOPLE

CBI Centre Point 103 New Oxford Street London WC1A 1DU
T: +44 (0)20 7379 7400 **F:** +44 (0)20 7240 1578 **W:** www.cbi.org.uk
Director-General: John Cridland CBE President: Sir Roger Carr

- **The rate of the NMW must be considered in light of an economy in recession which continues to face significant downside risks**

- **Unemployment and inactivity rates remain very high, and with economic risks impacting on the labour market it is vital that entry costs are restrained**

- **Freezing the youth rates and cautiously approaching the apprentice rate will help support the position of young people in the labour market**

- **Effective operation and enforcement is vital to the success of the NMW.**

A. In the face of economic and labour market pressures an extremely cautious approach to the 2013 NMW rate remains vital

1. Given the high degree of uncertainty resulting from the inconsistent economic and labour market figures, alongside significant economic risks, **the CBI believes that an extremely cautious approach to the 2013 NMW rate is essential. With more than a million young people out of work, and 968,000 16-24 year olds in England Not in Employment, Education, or Training (NEET), freezing the youth rates will help support the employment prospects of those aged under 21.**

2. Explaining the divergent labour market and output data continues to pose a challenge for economists, with the Bank of England describing the phenomenon as a 'genuine economic puzzle.' The inconsistency between the essentially flat labour market figures – since the start of the recession employment has fallen by less that 1 percent – and the GDP data – showing that GDP has fallen by approximately 4 percent over the same period – has not been fully explained. As a consequence labour productivity has fallen, and is lower than levels seen in 2008 at the outset of the recession.[1]

3. This inconsistency and the resulting uncertainty, coupled with the serious economic downside risks we continue to face, means that unemployment – which remains unacceptably high – is forecast to increase over 2013. On-going pay restraint – which has helped to characterise the recession by supporting employment – will persist. As such, supporting employment growth and moving people into work must be a priority.

The rate of the NMW must be considered in light of an economy in recession which continues to face significant downside risks

- **The economic recovery is not secure with disappointing GDP figures showing contraction in the first half of 2012**
- **Serious uncertainty remains around the prospects for growth and the timing and strength of the upturn**
- **Consumer-facing sectors, where the NMW has a major impact, are particularly challenged by the weak economic outlook**

The economic recovery is not secure with disappointing GDP figures showing contraction in the first half of 2012

4. The UK economy has been broadly flat over the past two years with the economic recovery by far the slowest of the post-war period. The result is that output per capita is now 14 percent below its pre-crisis trend and 6 percent below its pre-crisis level.[2] As a result of this stalled recovery, confidence remains weak and uncertainty high. The fall in real GDP growth in Q2 2012 of 0.5 percent is the third-consecutive quarterly decline in GDP. As a result GDP growth is 4.2 percent smaller than its peak in Q1 2008 and at broadly the same level it was in Q2 2010.[3]

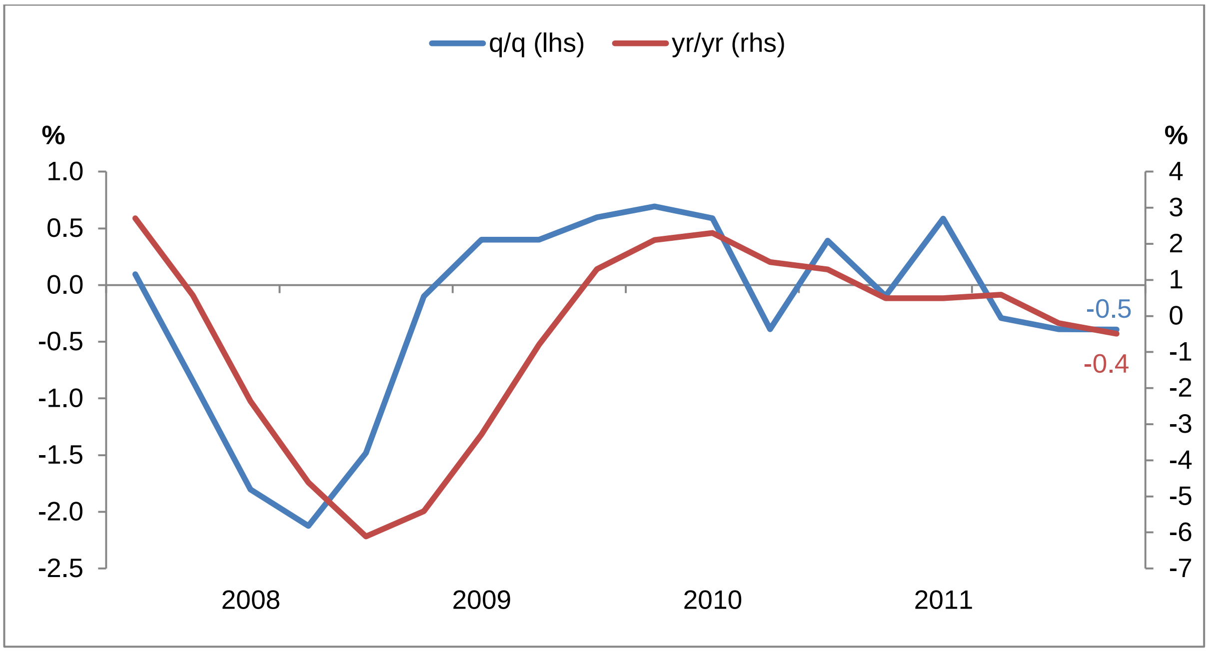
5. When setting the October 2012 rate in mid-January 2012 the LPC was presented with large downwards revisions of projected GDP growth in 2012 from most forecasters, with the median forecast falling to 0.4 percent.[4] Despite these revisions the

[1] ONS The productivity conundrum, interpreting the recent behaviour of the economy, August 2012
[2] IMF United Kingdom 2012 Article IV Consultation, July 2012
[3] ONS Second Estimate of GDP, Q2 2012
[4] Low Pay Commission Report 2012

performance of the economy has been worse than expected, with the consensus forecast now averaging -0.3 percent GDP growth in 2012 and 1 percent in 2013.[5] Given that the economy still faces major downside risks, the 2013 rate must be set in a way which continues to consider this sustained weakness and uncertainty.

6. At the time of setting this October's rate the median of forecasts showed average weekly earnings total pay growing by 2.4 percent in 2012. In the three months to July 2012 total pay across growth stood at just 1.5 percent on the year.[6]

Exhibit 1 – Real GDP growth
Source: ONS



<u>Serious concerns remain around the prospects for growth and the timing and strength of the upturn</u>

7. While we continue to expect a gradual recovery, it is yet to be secured, with the economy remaining exposed to significant risks. As a result the outlook for growth remains 'unusually uncertain.'[7]

8. The CBI forecasts UK growth to gradually pick up, as global growth improves and the squeeze on real wages eases further as inflation falls, but progress is likely to be slow for some time. The CBI's forecast has been revised down, and we expect an increasing sense of unease to continue to build through the remaining months of this year. Our 2012 GDP forecast for the UK has been cut to minus 0.3 percent, from plus 0.6 percent previously. We expect the UK economy to grow by just 1.2 percent in 2013, down from 2.0 percent in our earlier forecast.[8] This is based on our expectation of a smaller contribution from net trade over the next year – given a slower pace of global growth than previously forecast—and a more modest contribution from business investment, reflecting the elevated level of uncertainty.

9. In addition to relatively muted domestic demand, the primary risk stems from the Eurozone crisis, which is yet to be resolved and constitutes a significant headwind. As

---

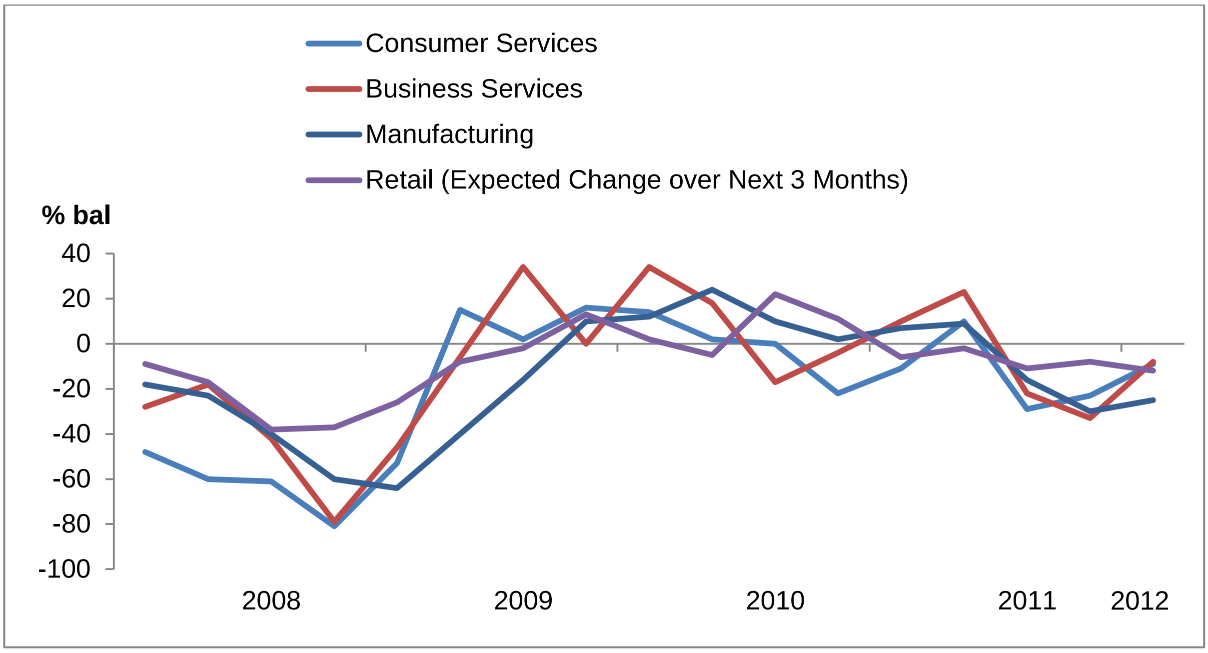
[5] HM Treasury Forecasts for the UK economy: a comparison of independent forecasts, September 2012
[6] ONS Labour Market Statistics, September 2012
[7] Bank of England Inflation Report, August 2012
[8] CBI Economic and Business Outlook, August 2012

a result of the continuing crisis, growth in the euro area – the UK's main export market – is low, and the future path of this growth and corresponding UK export growth, will be strongly influenced by the extent and pace of the recovery. Any further deterioration of the euro area crisis remains the most significant and immediate risk to the global outlook.[9]

10. The on-going Eurozone crisis now also seems to be acting as drag on broader global economic momentum with a wider uncertainty surrounding demand in the rest of the world. Weak rates of activity in the euro area are already acting as a particular drag.[10] The global economy has weakened since the spring, with the OECD revising down their forecast of G7 economic growth to 1.1 percent in Q4 2012.[11] In the three months to June the global recovery has shown signs of further weakness, with growth in a number of major emerging markets weaker than forecast.[12]

11. This uncertain backdrop continues to impact on business confidence, with the latest CBI business surveys showing a sustained lack of business optimism. Low business confidence and resulting sluggish investment growth risks further damaging economic and employment prospects. We take the view that the risks to the UK economy delivering in line with expectations are large, and heavily weighted towards the downside. With the economic environment fraught with uncertainty, we expect growth in business investment to remain modest, at around 5 percent this year and 3.8 percent in 2013.[13]

Exhibit 2 – Business optimism compared to 3 months ago
Source: CBI business survey data
A balance is the difference between the percentage of respondents reporting an increase and those reporting a decrease.



[9] IMF World Economic Outlook Update, June 2012
[10] CBI Economic and Business Outlook, August 2012
[11] OECD What is the near-term global economic outlook, September 2012
[12] IMF World Economic Outlook Update, July 2012
[13] CBI Economic and Business Outlook, August 2012

Consumer-facing sectors, where the NMW has a major impact, are particularly challenged by the weak economic outlook

12. Economic weaknesses continue to hit areas of the economy impacted by the NMW. Real private consumption has declined at a 1 percent annual rate, being held back by balance sheet repair, weak household income and low consumer confidence.[14]

13. Output has fallen among the UK's small and medium-sized manufacturers, and optimism about the general business situation has deteriorated, with investment intentions for the next 12 months softening.[15]

14. Constrained consumer spending continues to present a serious challenge to the consumer-facing sectors, which face a particular exposure to the NMW, over the coming period. Weak household demand has resulted in the contraction of household consumption expenditure in Q2 2012 which, at minus 0.4 per cent, is 0.3 percentage points lower than the contraction in the first quarter of the year.[16] Spending on consumer goods and services has slowed and become increasingly volatile, with 'nominal demand now only moderately higher than a year earlier, entirely due to higher prices.'[17] Households are likely to remain relatively cautious, given a weak labour market, an on-going process of deleveraging, and the elevated level of uncertainty.

15. Sales on the UK high street were flat in August compared to a year ago, broadly in line with retailers' expectations, but sentiment about the business situation has deteriorated sharply. Retailers report a slowdown of sales growth (-3%), with orders placed with suppliers falling at their fastest rate since January 2012 (-11%). They also expect the business situation to deteriorate over the next three months, with sentiment weakening more than at any time since February 2009. [18] As a result the balance of investment intentions for the year ahead remains negative (-13 percent, below the long-run average of 0 percent).[19]

16. Consumer service firms – comprising significant lower paying sectors such as hotels, bars and restaurants, travel and leisure – responding to the latest CBI service sector survey reported a continuing fall in business volume and value, alongside a continued decline in profitability and in the value of business. Optimism regarding the business situation (-23%) was significantly lower than three months ago (-2%). A balance of firms reported a fall in volume and value of business, while total costs per employee continued to rise sharply. As a result the number of people employed in Consumer Services fell (-8%) and training/re-training expenditure was reduced (-16%). With profitability expected to fall more sharply next quarter (-26%), due to expectations of falling business volumes combined with faster growth in total costs per employee (+37%) the rate of job shedding is also expected to increase (-19%).[20]

[14] IMF United Kingdom 2012 Article IV Consultation, July 2012
[15] CBI SME Trends Survey, August 2012
[16] ONS Economic Review, August 2012
[17] Bank of England Agents' summary of business conditions, August 2012
[18] CBI Distributive Trades Survey, August 2012
[19] CBI Economic and Business Outlook, August 2012
[20] CBI Service Sector Survey, August 2012

Unemployment and inactivity rates remain very high, and with economic risks impacting on the labour market it is vital that entry costs are restrained

- **Slack remains in the labour market with data suggesting a slowdown in the rate of job creation**
- **Unexpectedly robust labour market performance has not been shared equally across the country**
- **Productivity continues to fall, increasing unit labour costs**
- **Growth in pay remains subdued, with pay restraint continuing to play an important role in supporting employment**
- **Pension auto-enrolment and the introduction of Universal Credit will push up employment costs for large numbers of firms in 2013-14**

<u>Slack remains in the labour market with data suggesting a slowdown in the rate of job creation</u>

17. Although the UK labour market continues to perform relatively robustly in the face of a challenging economic environment, unemployment is up on the year and stands at 2.59 million people or 8.1 percent, only slightly down from the 8.4 percent peak in the final quarter of 2011. While up on the year, the number of people in employment in the UK – at 29.56 million in the three months to July[21] – this strength is not forecast to persist, with the average (median) of independent forecasts made in the past three months pointing to just 0.3 percent employment growth in 2013.[22]

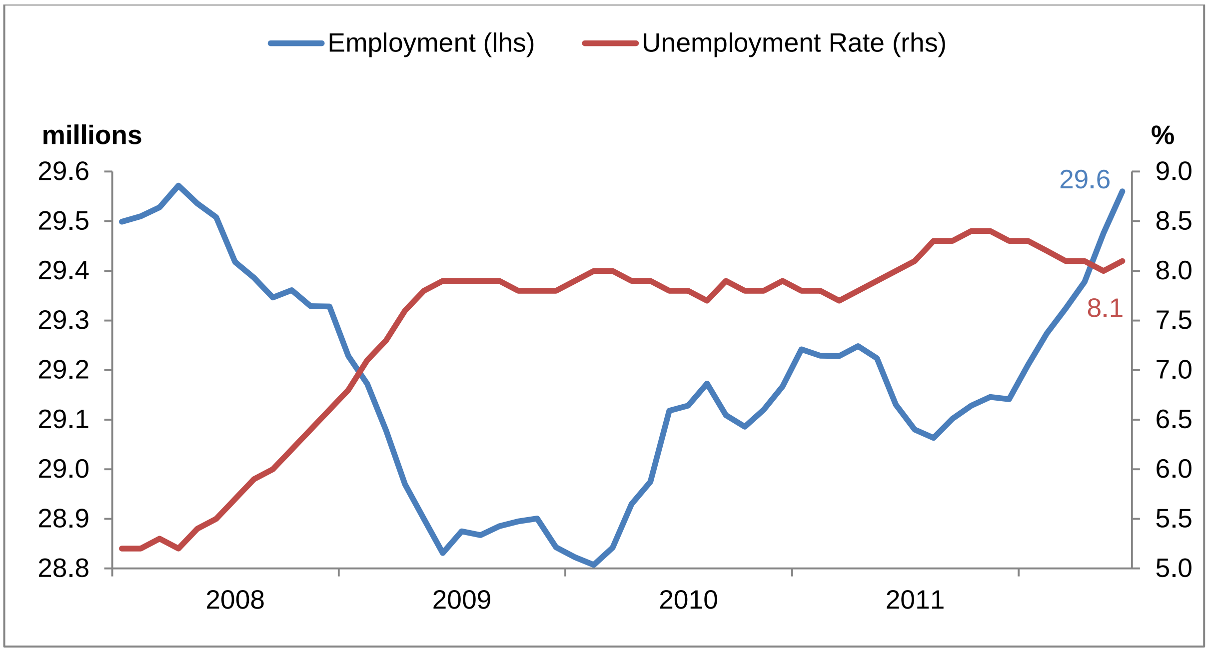
18. Most of the additional employment created in the three months to July was part-time rather than full-time employment. The number of employees and self-employed people working part-time because they could not find a full-time job now stands at 1.42 million, the highest figure since comparable records began in 1992.[23] The number of economically inactive people dropped by 181,000 in the three months to July and while it is encouraging that more people are re-entering the labour market to either take up or actively look for work, the sheer number of labour market entrants, alongside those reporting that they are underemployed, highlights that there is still considerable slack within the labour market, with the road to recovery likely to be long. The NMW can form a barrier to employers offering as many hours as they might otherwise be able to, therefore reducing people's ability to move to full-time hours.

19. Private sector employment growth continues to outstrip public sector job losses with private sector employment rising by 275,000 in the second quarter of this year, while public sector employment fell by 39,000 (excluding the reclassification of educational bodies to the private sector). Despite this good news from the private sector, the workforce jobs data shows that compared to the first quarter of the year job creation has slowed, with notably fewer employee jobs created in the second quarter of the year (93,000) compared to the first quarter (258,000). [24] While public sector job losses have been more than offset by private sector job creation the impact of public sector spending cuts is significant, with general government investment forecast at -3.6 percent on the year in 2013, and general government consumption -1.1 percent on the year.[25]

[21] ONS Labour Market Statistics, September 2012
[22] HM Treasury Forecasts for the UK economy: a comparison of independent forecasts, September 2012
[23] ONS Labour Market Statistics, September 2012
[24] ONS Labour Market Statistics, September 2012
[25] OBR Economic and Fiscal Outlook, March 2012

20. Most of the increase in employment is also accounted for by those in occupations which are relatively highly skilled[26] suggesting that challenges remain for employment growth in lower paying sectors. Specific sectors are also facing a squeeze. The biggest losses in workforce jobs in the second quarter of this year include the wholesale and retail trade (-27,000) and human health and social work activities (-60,000),[27] sectors which both support significant numbers of lower paying jobs.

Exhibit 3 – UK labour market: Employment and unemployment
Source: ONS, Labour market statistics, monthly data

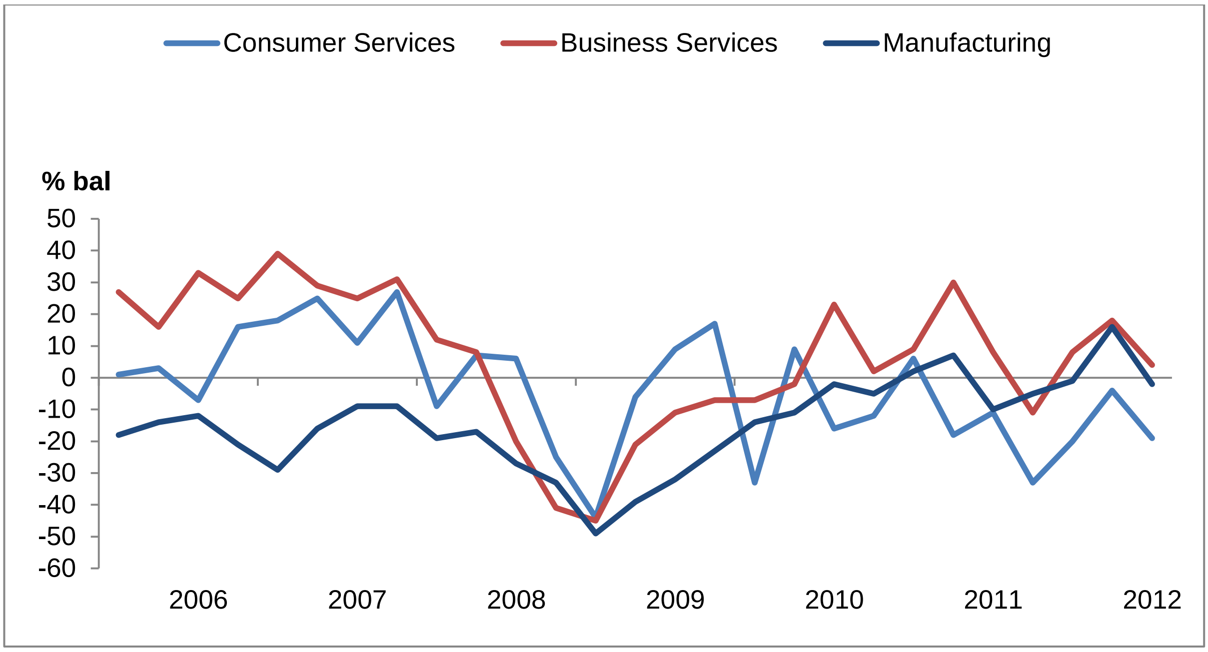


21. Survey data suggests that employment – a lagging indicator – will weaken over the next few months. Respondents to CBI surveys point to the likelihood of renewed falls in employment in major parts of the economy. The CBI's latest quarterly Distributive Trades Survey reports that the number of people employed in the retail sector was down on a year ago (a balance of -25 percent), with retailers expecting to reduce headcount further in the coming months (-12 percent).[28] The number of people employed in Consumer Services fell for the tenth consecutive quarter (-12 percent).[29] With jobs in these significant lower-paying sectors already falling, any revision to the NMW must be approached with extreme caution.

22. As a result, the unexpectedly robust labour market performance we have seen in recent quarters – with additional employment of 431,000 over the last year – is not expected to continue. The independent consensus forecast puts claimant count unemployment at 1.69 million in Q4 2013,[30] up 130,000 on the July 2012 figure of 1.57 million.[31] The CBI forecasts unemployment continuing to rise, averaging 8.4 percent in 2013. ILO unemployment is forecast to rise to 2.7 million in Q2 2013, before falling back to 2.69 million in Q4[32] - a figure which is unacceptably high, six years after the beginning of the recession.

[26] Bank of England Inflation Report, August 2012
[27] ONS Labour Market Statistics, September 2012
[28] CBI Distributive Trades Survey, August 2012
[29] CBI Service Sector Survey, May 2012
[30] HM Treasury Forecasts for the UK economy: a comparison of independent forecasts, September 2012
[31] ONS Labour Market Statistics, September 2012
[32] CBI Economic and Business Outlook, August 2012

Exhibit 4 – Expected employment change over the next three months
Source: CBI survey data



23. With 5.9 million working age benefit claimants,[33] 2.9 million workless households[34] (excluding fully retired and student households), and over a million unemployed young people, supporting employment requires well targeted interventions to ensure that people can move from out-of-work benefits and into the workplace. Ensuring our education and welfare systems support skills, employment and work incentives is vital. Equally, the cost of hiring also has a key role to play.[35]

24. At the time of setting the 2012 rate, growth in 2013 was forecast to lead to increased employment in 2013. With the upturn failing to materialise and the labour market likely to deteriorate in 2013, the NMW must not become a further dampener on employment prospects.

> A trade association said: *"The economic climate makes it difficult for businesses to invest in new labour. Firms are focused on increasing performance to weather the storm, by re-organising and optimising their workforce rather than considering expansion."*
>
> A construction firm: "*Any employment change over the months ahead is unlikely. It's very much a wait and see situation."*

[33] DWP Statistical Summary, August 2012
[34] ONS Workless households, 29 August 2012
[35] CBI Getting the UK working, 2011

Unexpectedly robust labour market performance has not been shared equally across the country

25. With the NMW operating on a national basis, it is vital that it does not act as a further dampener on areas which are currently experiencing weaker than average labour markets.

26. Although the labour market is holding up better than expected at a national level regional performance varies substantially, with London contributing almost half of the national growth in employment in the three months to July (91,000). A substantial amount of this employment growth is expected to have been due to the increase in economic activity in the run up to and during the Olympics. With the Olympics providing a temporary and short term boost – with some likely to struggle to remain in work as Olympic hiring is withdrawn – we may see a narrowing of the gap between output and employment over the coming months.

27. Meanwhile, in the last quarter unemployment rose in half of the UK regions – with the largest absolute increase in unemployment at 23,000 in Yorkshire and Humber, followed by the West Midlands (16,000) and Northern Ireland (10,000).[36]

> A small manufacturing business in Scotland, said: *"increases in the minimum wage are biting – it must not continue to be increased annually. A freeze must be considered to allow this area of the country to continue to be able to compete."*

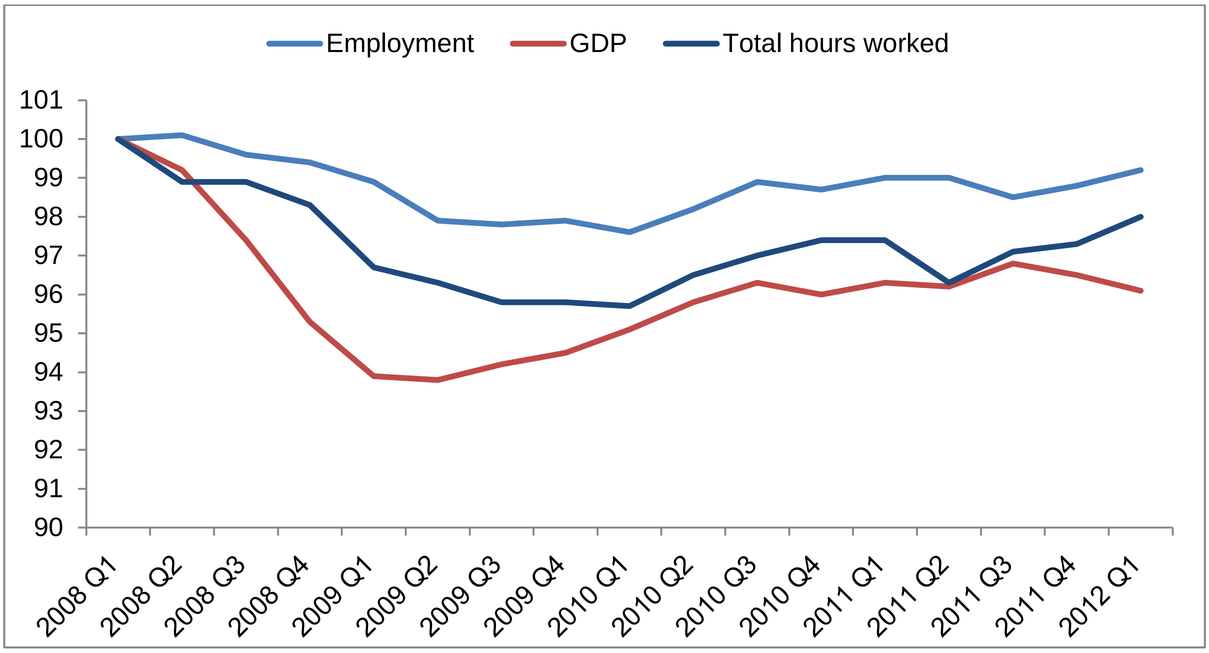
Productivity continues to fall, increasing unit labour costs

28. Productivity remains well below the pre-recession trend as a result of the large divergence between growth and employment, with many employers and workforces safeguarding jobs as far as possible. This labour market resilience, with fewer employment losses than in the aftermath of previous major UK recessions, has left labour productivity well below its pre-crisis trend[37] as output per hour worked fell, and continues to fall. In the first quarter of this year worker productivity declined by 0.7 percent.[38] Although output has increased from the low level it reached during the recession, at the end of 2011 it remained below 2007 levels, while unit labour costs increased by 13.7% over the same period.[39]

29. Caution is required to ensure that increases to paybill costs through a NMW rise do not push employers – particularly those in the service sector who are facing a particular decline in productivity[40] – to cut back on jobs in order to stem further productivity decreases.

[36] ONS Labour Market Statistics, September 2012
[37] IMF United Kingdom 2012 Article IV Consultation, July 2012
[38] Bank of England Agents' summary of business conditions, August 2012
[39] CBI/Harvey Nash Facing the future: Employment Trends Survey, 2012
[40] Bank of England Agents' summary of business conditions, August 2012

Exhibit 5 – Output, Employment and Total Hours Worked
Source: ONS, Index (2008 Q1=100)



Growth in pay remains subdued, with pay restraint continuing to play an important role in supporting employment

30. On-going pay restraint accounts for some of the discrepancy between the output and labour market figures, helping to support job growth despite the challenging economic climate. Throughout the recession pay restraint has played an important role in supporting employment. This is set to continue with containing labour costs cited as the second highest workforce priority for businesses in the next 12 months, with half of respondents to the CBI Employment Trends Survey citing this as a workforce priority.[41]

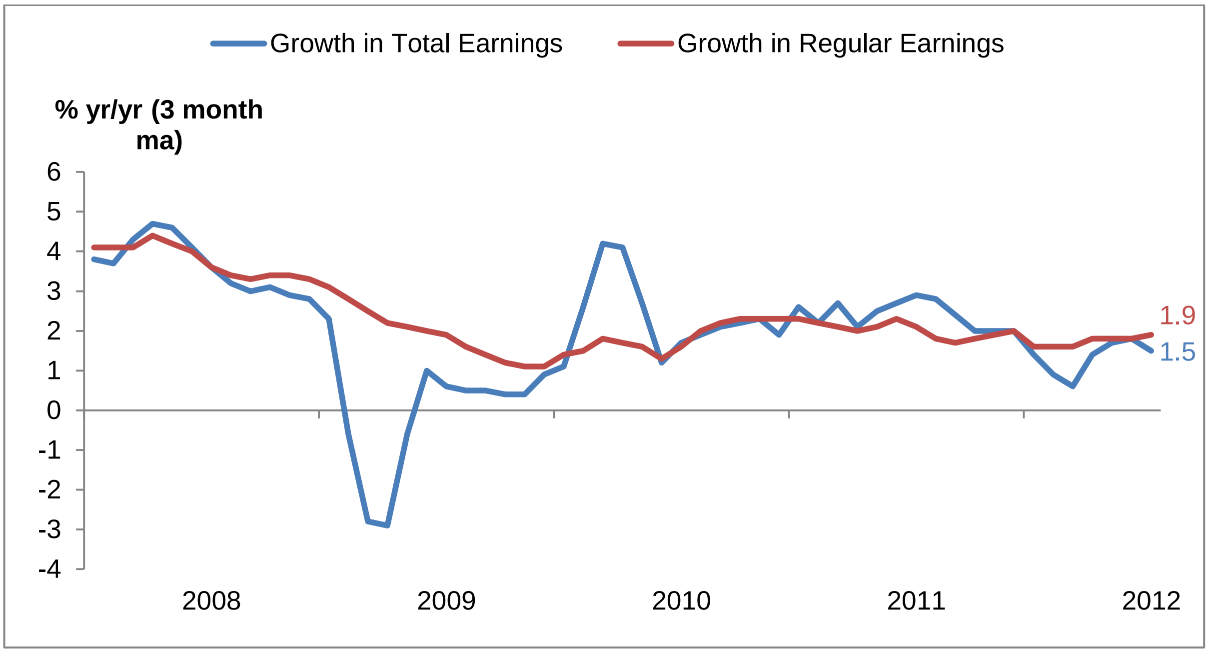
31. Earnings growth remains substantially below pre-recession levels and below inflation, with total pay (including bonuses) growing by a modest 1.5 percentage points year on year, down from 1.8 percent in June. Regular pay (excluding bonuses) growth was 1.9 percent year on year in July, in line with the consensus expectations of year on year growth of 1.9 percent (3 month average).[42] Slack in the labour market is set to continue to bear down on wage growth[43] with the CBI forecasting average weekly earnings (including bonus) growth of 1.7 percent in 2013.[44] The consensus forecast puts median average earnings growth at 2.2 percent in 2013.[45]

[41] CBI/Harvey Nash 'Facing the future – employment trends survey', July 2012
[42] ONS Labour Market Statistics, September 2012
[43] Bank of England 'Inflation Report', August 2012
[44] CBI Economic and Business Outlook, August 2012
[45] HM Treasury Forecasts for the UK economy: a comparison of independent forecasts, September 2012

In relation to this prolonged period of wage restraint, a small, specialist manufacturer said: *"It's important that wage levels are able reflect the 'new' economic reality... Small but ambitious companies like ours must be able to compete and grow."*

A retailer said *"we would hope the LPC take into consideration the affordability and continued uncertainty over the business outlook to ensure any NMW rates are held at modest levels this year. Our wage bill continues to be one of our highest operating costs, representing over 40% of our annual turnover. Therefore any increases in wages have a significant and disproportionate effect on our business compared to others in the same sector."*

Exhibit 6 – Growth in Average Weekly Earnings
Source: ONS



32. Businesses report that they remain reluctant to commit to changes in reward until the macroeconomic outlook becomes clearer.[46] As a result, differentiated pay rises within workforces continue to play an important role, with businesses reporting moves towards the use of bonuses and individual performance-related pay to avoid permanent pay-bill increases.[47] One in six businesses intend targeted pay increases for some key employees – responding to individual pay pressures without an across-the-board increase in labour costs.[48] As part of a move towards more flexible forms of pay almost half of employers are also looking at reviewing their total bonus and benefit packages.[49] The rigidity of the NMW clearly prevents this kind of pay flexibility and differentiation at the bottom of the pay-scale.

33. This poses a particular difficulty for lower-paying sectors, where an NMW increase places an across-the-board pressure at the bottom of the pay-scale, reducing the scope for using targeted reward or non-pay benefits as part of the total reward strategy. Added to the fact that in both 2010 and 2012 the median rise in low-paying sectors was

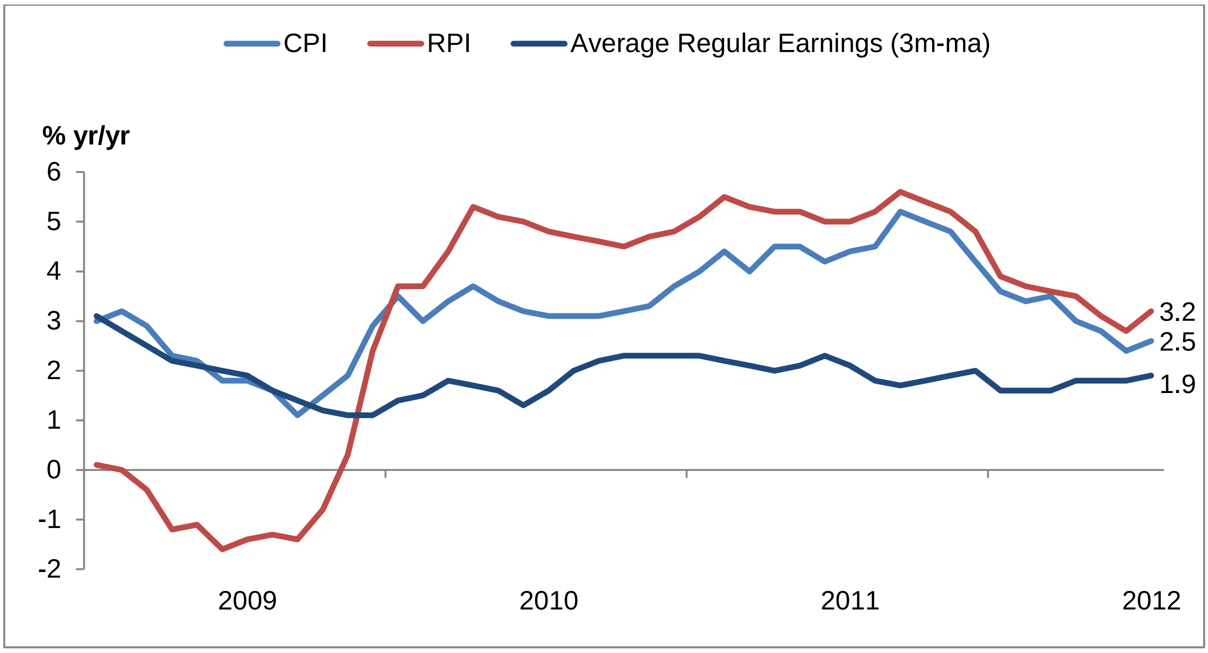
[46] Bank of England Agents' summary of business conditions, August 2012
[47] Bank of England Agents' summary of business conditions, August 2012
[48] CBI/Harvey Nash 'Facing the future – employment trends survey', July 2012
[49] Income Data Services 'Impact of economic recovery on pay settlements'. March 2012

lower than the NMW uplift,[50] managing both cost control and individual pay pressures has becoming increasingly difficult. Consumer service employers report that total costs per employee rose sharply and at a faster rate than expected in the last quarter.[51]

34. A growing number of pay freezes has added to this pressure – with one in five firms planning a general pay freeze at their next pay review.[52] With the increasing number of pay freezes in retail[53] and small and medium businesses – where 31% of SMEs are planning a freeze[54] – the NMW rate is of particular concern, as the combination of extended pay freezes and increases in the NMW has eroded pay differentials, forcing some employers to consider an across-the-board rise in order to preserve distinct pay scales.[55] This reduction in individual flexibility in targeting pay can come at the cost of both staff morale and incentives, and company ability to target reward in line with their individual pay strategy, for example only providing merit-based rises.

> A CBI member in the services sector said "*Year-on-year, the number of staff employed on the NMW is increasing as a result of successive increases in the rate. The erosion of differentials has a negative impact on staff morale and incentives to up-skill and to take on additional responsibilities.*"
>
> A retailer said "*Our employees continue to be paid above the national minimum wage level – both adults and young people. The differential however between our established hourly rate and the NMW will be just above 8% in October 2012. This has halved from the 16% differential we had in September 2000.*"

Exhibit 7 – Inflation and Earnings Summary
Source: ONS



[50] Income Data Services 'Impact of economic recovery on pay settlements'. March 2012
[51] CBI Service Sector Survey, August 2012
[52] CBI/Harvey Nash 'Facing the future – employment trends survey', July 2012
[53] Bank of England Agents' summary of business conditions, August 2012
[54] CBI/Harvey Nash 'Facing the future – employment trends survey', July 2012
[55] Bank of England Agents' summary of business conditions, August 2012

35. The overall drop in inflation over 2012 has eased some of the pressure on real earnings, with the CBI forecasting CPI inflation to fall back to 2.1% in Q4 of this year.[56] After a period of high inflation adding further pressure to restrained income growth inflation should continue on a downwards trend, with real disposable income recovering as inflation continues to ease in 2013. The CBI forecast 2 percent CPI inflation in 2013, with RPI inflation at 2.8 percent.[57] Falling inflation means that pressure on household spending is easing, despite wage growth remaining weak. During 2013 real disposable incomes should begin to rise again, for the first time since 2010, giving something of a modest boost to consumer spending, although households are likely to remain cautious given the weak labour market.

Pension auto-enrolment and the introduction of Universal Credit will push up employment costs for large numbers of firms in 2013-14

36. The CBI supports two significant reforms to welfare and pensions – pension auto-enrolment and the introduction of Universal Credit. While these reforms will have major benefits for businesses and individuals in the medium term, they will push up employment costs in 2013.

37. From this October, companies will begin automatically enrolling staff aged between 22 and state pension age and earning over £8,105 into a pension scheme. From October 2013 firms with between 800-1,249 workers will have to enrol their workers into a scheme and by October 2014 all employers with more than 60 workers will be required to auto-enrol their workers. Employers' contributions will rise from one to three percent of qualifying earnings over the transitional period to 2018.

38. Lower-paying industries are disproportionately impacted by the introduction of auto-enrolment both because their employees are currently much less likely to already contribute to a pension and to take advantage of employer contributions than those on higher incomes[58], and because the NMW reduces wage-flexibility at the lower end of the labour market. Data shows that to offset the cost of new employer contributions, pay would need to fall by, on average, between 0.8% and 1.1% in lower-paying industries, compared with between 0.6% and 0.8% across all sectors.[59] The NMW clearly places a significant restraint on the ability of companies to absorb this increased cost elsewhere in the pay bill. During this NMW year, 2013-14, the reforms will expand from large businesses who typically have pensions in place, to many smaller firms for whom this will be the first time they have provided such benefits.

39. In addition to contribution costs the estimated annual administrative cost of compliance will be £444m in year one with an annual on-going cost of £127m[60]. CBI members and respondents to the latest Bank of England Agents' Report frequently report that significant management time and effort is being spent preparing for auto-enrolment.[61] Administrative costs extend to workers earning below the income threshold, with companies having a duty to provide information to staff on their rights to either 'opt-in' or to 'join' a pension scheme. Lower-paying industries, which face a higher than average turnover of staff and small companies are particularly hit by these administrative costs.

[56] CBI Economic and Business Outlook, August 2012
[57] CBI Economic and Business Outlook, August 2012
[58] Pensions Commission, A New Pension Settlement for the Twenty-First Century; The Second Report of the Pensions Commission, November 2005,
[59] NIESR Financial Implications of the National Employment Savings Trust, 2011
[60] DWP Workplace Pension Reform Regulations – Impact Assessment, 12 January 2010
[61] Bank of England Agents' summary of business conditions, August 2012

40. The CBI supports auto-enrolment as a key part of developing a sustainable pension system in light of the longer, healthier lives we are enjoying, where we will all need to work for longer and, crucially, save more. It is therefore essential that the significant cost and impact of auto-enrolment is taken into account when setting the level of the NMW.

> A retailer said: *"Pension reform is vital to support changing demographics, but as a business we cannot afford to fund both this increased cost and continued rises in the NMW."*

41. The CBI also supports the introduction of the Universal Credit as a way to simplify the benefit system and increase claimants' labour market incentives. Universal Credit will come into force nationally for new claimants from October 2013. To work effectively, Universal Credit needs to have access to good-quality, up-to-date claimant data. For the majority of claimants this will be sourced from HMRC, through its new Real Time Information (RTI) system.

42. Providing this information will constitute a significant cost to businesses as they are required to provide clean and accurate data to HMRC. HMRC must minimise the additional burden on businesses through RTI and clarify and streamline what information employers will be required to submit as soon as possible. Lower-paying sectors often face higher staff turnover and therefore will face an additional burden in providing information.

43. The DWP also needs to devise mechanisms for getting up-to-date data for those Universal Credit claimants for which no RTI data will be available. A potentially large number of businesses do not currently use PAYE because they pay their employees cash or they fall under the income tax and National Insurance threshold. These companies' employees are highly likely to be eligible to claim Universal Credit, but as a result of the way in which their employers operate there will be no real time information available for them.

44. While the wider impact of the Universal Credit on individuals' work-incentives and employment choices remains unclear at this stage but is likely to be positive, the administrative cost of businesses complying with RTI, particularly in 2013 as employers begin using the system, is set to be significant and should be taken into account, as part of the significant challenges businesses are currently facing. It should be noted that NMW workers are likely to be Universal Credit claimants, and many will have the highly variable patterns of weekly hours and cash wages that will pose the greatest issues for the new RTI system.

B. Freezing the youth rates and cautiously approaching the apprentice rate will help support the position of young people in the labour market

- **Freezing the youth rates will help to support the employment prospects of young people**
- **With more than a million young people out of work in the UK, and 968,000 NEETs in England alone, 16-24 year olds continue to bear the brunt of unemployment**
- **The bite of the youth rates should continue to fall to more sustainable levels to help safeguard jobs**
- **Businesses remain committed to supporting apprenticeships, but young people must not be priced out of them**

Freezing the youth rates will help to support the employment prospects of young people

45. Given the particularly challenging outlook for young people, CBI members very strongly welcomed the Commission's decision to freeze the 2012 youth rates. Freezing the minimum wage helps to lower one barrier to hiring facing young people, by ensuring they are not priced out of jobs and encouraging employers to take a risk on a relatively inexperienced candidate. **With youth unemployment at its highest for a generation, the youth rates should once again be frozen to safeguard the employment prospects of young people.** In this very challenging economic climate we cannot afford to put barriers in the way of those starting out or we risk losing a generation to worklessness.

With more than a million young people out of work in the UK, and 968,000 NEETs in England alone, 16-24 year olds continue to bear the brunt of unemployment

46. Young people have been particularly exposed to the negative impact of the recession, with their labour market position continuing to deteriorate. With the economic recovery stalling young people will continue to face challenges in 2013 and beyond, as unemployment remains high and older people – with greater experience of work – likely to be the initial beneficiaries of any upturn.

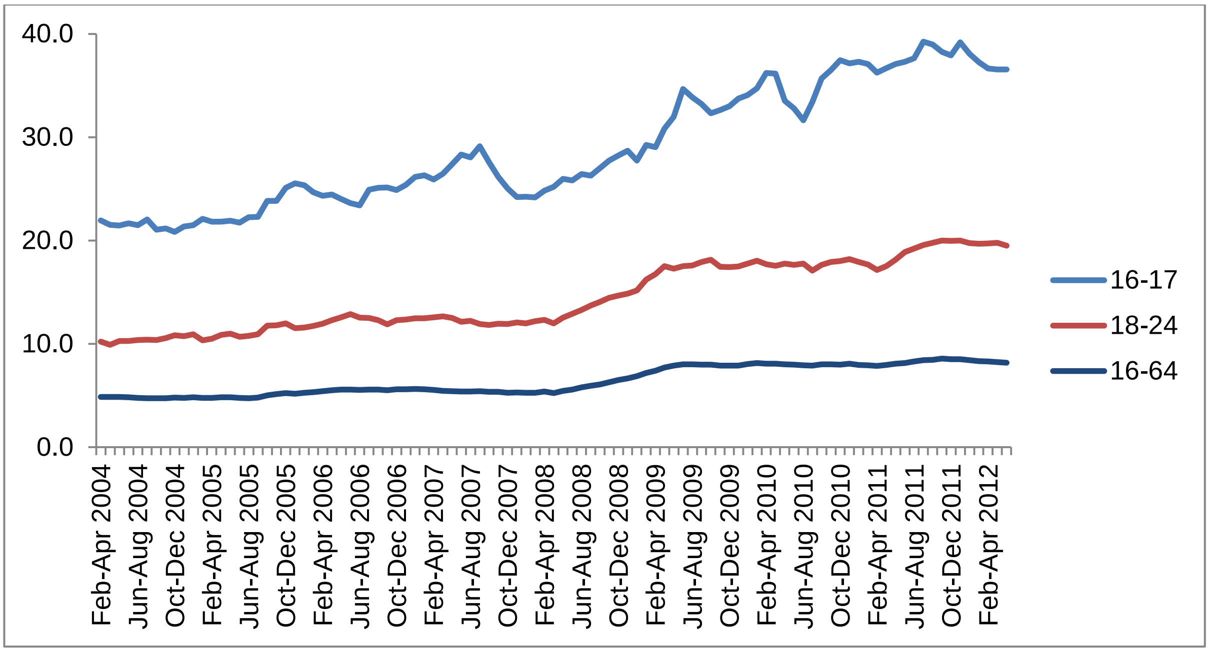
47. In the three months to July 2012 there were 1.02 million unemployed 16 to 24 year olds, up 7,000 from the three months to April, or 21.6 percent. After removing full-time students the youth unemployment rate stands at 20.3 percent, up 9,000 young people to stand at 716,000.[62]

48. Young people also continue to suffer the disproportionate effects of exposure to the long term scarring effects of youth unemployment,[63] with harmful social and economic costs. Many of the 16 percent, or 968,000, 16-24 year olds in England not in employment, education or training (NEET) will find it particularly challenging to return employment or training even as the recovery strengthens, resulting in both long and short term personal and societal costs. [64, 65] The 10.3 percent NEET rate for those aged 16-18 is up 0.5 percentage points on the year.[66]

[62] ONS Labour Market Statistics, September 2012
[63] Duval, Eris and Furceri The Effects of Downturns on Labour Force Participation: Evidence and Causes *OECD Economics Department Working Papers*, No. 875, 2011
[64] Audit Commission Against the odds, 2010
[65] Gregg and Tominey The Wage Scar from Youth Unemployment, *CMPO working paper series* No. 04/097, 2004
[66] Department for Education NEET Statistics – Quarterly Brief, Quarter 2, 2012

49. The gap between the unemployment rate of young and older people remains of particular concern. Alongside the cyclical and structural challenges facing young people and damaging their labour market position, the number of older workers has rapidly increased – with 1.4 million people working beyond state pension age, a figure which has almost doubled since 1993.[67] While there are many factors influencing the decision of older people to continue to be active in the labour market, and this increased participation can benefit both individuals and the wider economy. But at a time of very high youth unemployment the NMW for young people must be set very cautiously, and be allowed to reflect the lower productivity levels of younger workers to safeguard opportunities to enter the labour market, to ensure that the participation of older workers does not come at a cost of excluding young people from the workplace

Exhibit 8 – Unemployment by age group
Source: ONS, Labour Market Statistics, August 2012



The bite of the youth rates should continue to fall to more sustainable levels to help safeguard jobs

50. The key to preventing a 'lost generation' remains helping young people access their first job. Reforms to education, training and the welfare system to improve employability and work incentives play a key role in supporting young people in transitioning into and succeeding in work. We have set out our wider recommendations on supporting young people into jobs – and sustainable jobs in particular – in our 'Getting the UK Working' reports.[68]

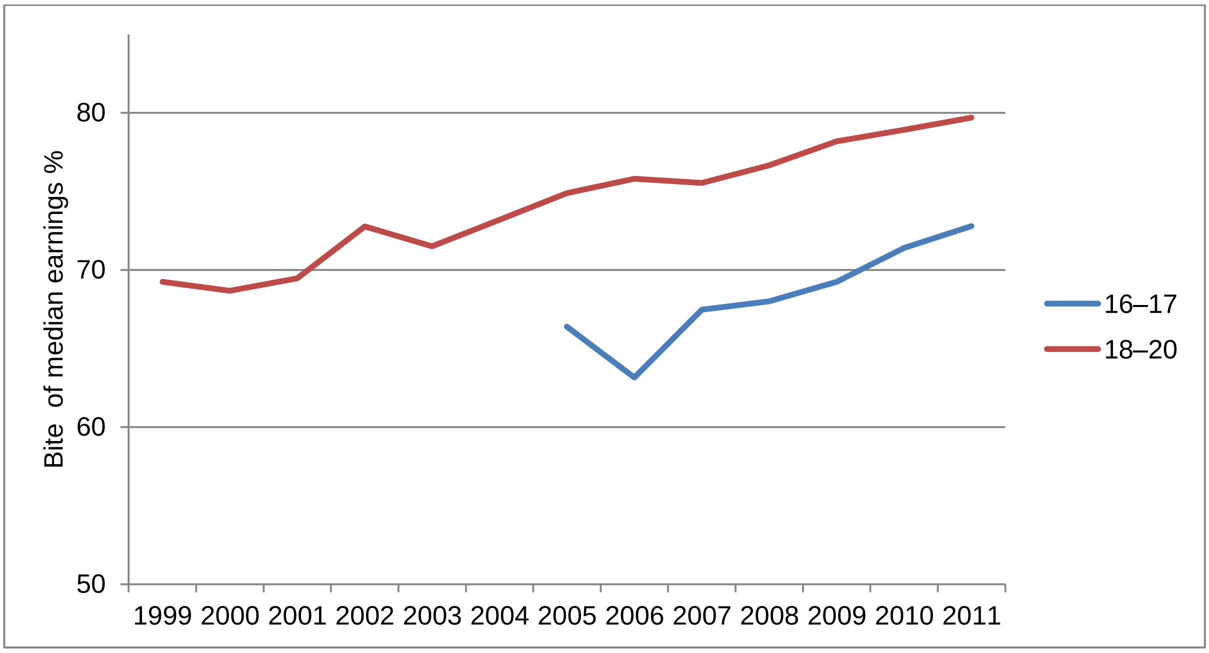
51. The youth rates play an equally important role, helping to allow employers to achieve a balance between the cost of employing and training young people and their productivity as they gain in experience and skills. With young people facing particular exposure to adverse employment impacts from a minimum wage[69] mitigating any negative effects by setting the rate at the appropriate level remains vital. Evidence of NMW upratings resulting in reduced weekly hours for 18-21 year olds, which correspond to an overall

[67] ONS Older Workers in the Labour Market, 2012
[68] CBI Getting the UK working, 2011
[69] Fidrmuc and Tena Horrillo The impact of the national minimum wage on the labour market outcomes of young workers, 2011

reduction in weekly earnings,[70] suggests that the case for restraint applies from the perspective of both employees and employers. Contradictory trends show some businesses using and introducing youth rates, while others move away from their use by reducing the number they use or removing them altogether.[71] The absence of a dominant trend suggests that individual flexibility for businesses in setting the appropriate rate for their young workers remains vital.

52. Notwithstanding the welcome freeze in the youth rates for 2012 the bites relative to the median remain much higher for the Youth Development Rate and 16-17 year old rate than for the adult rates. Since 2007 the bites of the Youth Development rate and 16-17 year old rate relative to the median have continued to increase, rising to around 80 percent and 73 percent respectively, while in the same period the bite of the adult rate has remained roughly stable at around 51%.[72]

Exhibit 9: Bite of the youth rates by age, 1999-2011
Source: ONS, ASHE
Minimum wage as a per cent of median earnings



53. Since 2007 pay growth for young people has failed to keep pace with that of adults. In April 2011 the median full-time gross weekly earnings of 16-17 year olds fell by 7.9 percent, while 18-21 year olds saw no change on the year. Across all employees the same figure was up 0.4 percent. Across all age groups total pay has grown by 1.5 percent in the year to July 2012.[73] The trend of young people seeing lower than average pay growth is likely to have continued and therefore while the freeze in the youth rates was welcomed, the reduction in the bite is likely to have been slight. Further restraint is therefore necessary to allow the bite of the youth rates to fall to more sustainable levels.

54. Given their labour market position, young people are likely to continue to see their earnings growing at a slower pace than the adult workforce in 2013. A further freeze in

---

[70] Institute for Social and Economic Research The Impact of the National Minimum Wage on Earnings, Employment and Hours through the Recession , February 2012
[71] Income Data Services An Examination of the Trend in Earnings Growth for Young Workers, March 2012
[72] Low Pay Commission Report 2012
[73] ONS Annual Survey of Hours and Earnings, 2011

the youth rate will help support the employment prospects of young people while fairly reflecting their lower productivity, with the evidence suggesting that young workers receive greater pay relative to their productivity compared with workers in their 30s.[74] This is particularly acute in low paying sectors, suggesting that the youth rates have played a role in supporting wages to an extent not reflected in productivity with "young people's relative wage gains within sectors in the post-recession period not justified in terms of their relative productivity performance."[75]

A service provider said *"we recognise the importance of helping young people to get on to the first rung of the career ladder. The freeze in the youth NMW rates has assisted us in providing these opportunities."*

Businesses remain committed to supporting apprenticeships, but young people must not be priced out of them

55. **The CBI urges caution in the apprentice NMW rate in order to support the provision of apprenticeships in this challenging jobs market.**

56. Apprenticeships combine work and training, providing an invaluable route into employment, helping to develop the skills that employers and employees need to succeed. Government has taken the right approach so far to boost apprenticeship numbers and make some early cuts to bureaucracy to help employers provide more places. And businesses remain committed to apprenticeships, with 25 percent of firms responding to the CBI's latest education and skills survey reporting that they plan to increase their recruitment of apprentices in 2012. This falls to just one in six for SMEs.[76] Many smaller employers remain apprehensive about the costs and bureaucracy of getting involved in apprenticeships. With SMEs responsible for creating the majority of jobs in the economy[77] we cannot be complacent – supporting smaller firms in providing apprenticeships remains vital.

57. The official data shows an impressive 63 percent increase in apprenticeship starts, but much of this increase can be attributed to those ages 25 and over starting an apprenticeship. This group saw a 271 percent increase on the previous year, compared to a 26 percent increase for those aged 19-24 and just 13 percent for those under 19.[78] To ensure that younger apprentices are also attractive to companies it is vital that the apprentice rates are set at a level that helps businesses to take on these younger and less experienced apprentices.

58. While the evidence to date suggests that the introduction of the Apprentice Rate has had limited impact on businesses' decisions to offer apprenticeships, over a third of employers agree that the Apprentice Rate is appropriate for the work that apprentices do[79] and overall apprentices themselves report that access to an apprenticeship and career is more valuable to them than an increase in the Apprentice Rate.[80]

[74] Dickerson and McIntosh Further Investigation into the relationship between productivity, earnings and age in the early years of a working life, January 2012
[75] Dickerson and McIntosh Further Investigation into the relationship between productivity, earnings and age in the early years of a working life, January 2012
[76] CBI/Pearson Learning to grow: what employers need from education and skills, June 2012
[77] CBI 'Think small first', March 2011
[78] BIS statistical first release, January 2012
[79] Ipsos MORI and Cambridge Policy Consultants An Assessment of the Introduction of the Apprentice Rate, February 2012
[80] Ipsos MORI and Cambridge Policy Consultants An Assessment of the Introduction of the Apprentice Rate, February 2012

59. While the apprentice rate looks to have had limited impact so far, further increase in the rate risk deterring employers from taking on younger, less productive apprentices, particularly given the tough economic outlook.

> A trade association: *“Firms are doing what they can to keep existing labour in place but the outlook for new training is not positive.”*

C. Effective operation and enforcement is vital to the success of the NMW

- **The accommodation offset is a valuable measure which should be retained and the CBI supports the gathering of further evidence to ensure its rate is set appropriately**
- **CBI members support appropriate enforcement action against employers who fail to comply with the NMW**
- **The NMW regulations are relatively straightforward to comply with and where complexities exist – such as in the case of salaried-hours workers – additional regulations are accepted**

The accommodation offset is a valuable measure which should be retained and the CBI supports the gathering of further evidence to ensure its rate is set appropriately

61. The accommodation offset plays a valuable role, particularly in encouraging the provision of accommodation in rural areas where alternative accommodation is non-existent or cost-prohibitive. It is therefore vital that that the offset is set at a level which encourages employers to provide accommodation which can support people in undertaking work that might otherwise be prohibitive, while also preventing the NMW from being undermined. As there is a lack of evidence on the appropriate level of the offset we support the LPC's efforts to try and gather further information on the appropriate level.

CBI members support appropriate enforcement action against employers who fail to comply with the NMW

62. The success of the NMW depends on it being widely known and accepted and we believe that it is. Clear accessible advice and guidance can help businesses understand their obligations. To support this HMRC must continue to take action against unscrupulous businesses who fail to pay workers their due, and in the process undercut compliant businesses. We endorse a risk-based approach to enforcement and the prioritisation of resources to 'at risk' areas.

The NMW regulations are relatively straightforward to comply with and where complexities exist – such as in the case of salaried-hours workers – additional regulations are accepted

63. The Low Pay Commission have been asked by the government to evaluate the NMW regulations for salaried-hours workers, and consider whether there are any measures which could be taken to make arrangements as simple and easy as possible for employers and individuals. We have been clear that we believe the NMW legislation to be relatively straightforward for businesses to comply with and generally well understood. Therefore we do not recommend any changes in pursuit of simplification. Where parts of the regulations are more complex - for example in relation to salaried-hours workers – the additional rules are valuable and wanted.

64. Keeping up-to-date with changes to employment law can be onerous for businesses, especially small business. Addressing the areas of regulation which genuinely concern business should be prioritised in favour of minor drafting changes which have attracted no criticism from business.

References

Audit Commission Against the odds, 2010
Bank of England Agents' summary of business conditions, August 2012
Bank of England Inflation Report, August 2012
CBI Distributive Trades Survey, August 2012
CBI Economic and Business Outlook, August 2012
CBI Getting the UK working, 2011
CBI SME Trends Survey, August 2012
CBI Service Sector Survey, August 2012
CBI 'Think small first', March 2011
CBI/Harvey Nash Facing the future: Employment Trends Survey, 2012
CBI/Pearson Learning to grow: what employers need from education and skills, June 2012
Department for Education NEET Statistics – Quarterly Brief, Quarter 2, 2012
Dickerson and McIntosh Further Investigation into the relationship between productivity, earnings and age in the early years of a working life, January 2012
Duval, Eris and Furceri The Effects of Downturns on Labour Force Participation: Evidence and Causes *OECD Economics Department Working Papers*, No. 875, 2011
DWP Statistical Summary, August 2012
DWP Workplace Pension Reform Regulations – Impact Assessment, 12 January 2010
Fidrmuc and Tena Horrillo The impact of the national minimum wage on the labour market outcomes of young workers, 2011
Gregg and Tominey The Wage Scar from Youth Unemployment, *CMPO working paper series* No. 04/097, 2004
HM Treasury Forecasts for the UK economy: a comparison of independent forecasts, September 2012
Institute for Fiscal Studies Releasing Jobs for the Young?, July 2009
IMF United Kingdom 2012 Article IV Consultation, July 2012
IMF World Economic Outlook Update, July 2012
Income Data Services An Examination of the Trend in Earnings Growth for Young Workers, March 2012
Income Data Services 'Impact of economic recovery on pay settlements'. March 2012
Institute for Social and Economic Research The Impact of the National Minimum Wage on Earnings, Employment and Hours through the Recession , February 2012
Ipsos MORI and Cambridge Policy Consultants An Assessment of the Introduction of the Apprentice Rate, February 2012
Low Pay Commission Report 2012
NIESR Financial Implications of the National Employment Savings Trust, 2011
OBR Economic and Fiscal Outlook, March 2012
OECD What is the near-term global economic outlook, September 2012
ONS Annual Survey of Hours and Earnings, 2011
ONS Economic Review, August 2012
ONS Labour Market Statistics, August 2012
ONS Older Workers in the Labour Market, June 2012
ONS Second Estimate of GDP, Q2 2012
ONS The productivity conundrum, interpreting the recent behaviour of the economy, August 2012
ONS Workless households, 29 August 2012