The manufacturers' organisation

EEF response to the Low Pay Commission consultation – 2014 report

Overview

1. EEF, the manufacturers' organisation, is the voice of manufacturing in the UK, representing all aspects of the manufacturing sector including engineering, aviation, defence, oil and gas, food and chemicals. With 6,000 members employing almost one million workers, EEF members operate in the UK, Europe and throughout the world in a dynamic and highly competitive environment.

2. Whilst EEF members have continued to find NMW rates have limited direct impact on their businesses, the indirect impacts involved, such as on outsourced services, can have an overall impact on manufacturers' ability to maintain a flexible workforce, and lead to demands for increased pay in the rest of the sector.

3. The NMW rate for Apprentices has again had little impact on manufacturers. Many manufacturers pay above the NMW rates to attract young people into the industry to begin with and retain the talent they invest in throughout the apprenticeship and completion of the training. Since its introduction employers have continued to offer apprenticeships and the number of apprenticeship starts have increased, therefore the NMW rate for Apprentices does not present a demand or supply problem.

4. The co-existence of high levels of youth unemployment and significant recruitment problems for manufacturing is a real cause or concern. However the Youth Development Rate is not the main barrier to employers recruiting young people – instead it is a lack of technical skills, experience and relevant qualifications of young people – these should be the Government's focus. Until this addressed, the Commission should act cautiously in terms of increasing the Youth Development Rate.

5. EEF continues to call for a new model of formulating NMW rates. We maintain that this should be a retrospective analysis of the movement of basic rates of pay across the economy. The average level of basic pay settlements that has been reached across the economy over the previous 12 months would be a real approximation for this measure. Moreover, this approach would give a good indication both of firms' ability to pay, and the general trend in living standards across the economy.

6. Although pro-cyclical, over the longer term basic pay has risen more strongly than inflation and therefore provides a stronger support of living standards. Tying the NMW to basic pay allows those on low income to share in improvements in living standards while also seeing more moderate rises in pay, along with the rest of the population, during tougher times.

7. Prior to the recession the NMW rose faster than basic pay, but there is no guarantee that it could continue to do so without having a detrimental impact on employment. While we do believe the NMW should increase in line with basic pay, it should not be increased at a faster rate, especially at present, as current economic conditions remain challenging and uncertain.

8. Although we would continue to advocate a predictable annual increase in the NMW based on basic pay growth, there might be times when businesses would be better able to afford a stronger increase. We believe that for this to happen, we would need to see a combination of broad-based sustainable growth in both employment and productivity.

9. For businesses, sustainable pay rises are based upon productivity improvements in their workforce. Therefore rising productivity across the economy is likely to be associated with an increased ability to pay higher basic wages. However, sometimes businesses will be driving productivity in response to weak demand, and may therefore not be in a position to take on more employees or pay higher wages.

10. It is therefore important that employment is growing too. The reason this must be linked to productivity growth is highlighted by employment trends since the 2008 recession. Employers have held on to employees, and may have taken on new employees as an alternative to investment in new capital, and this has led to falling productivity in a number of sectors. This is not an increase in employment that is consistent with employers being able to afford large pay rises.

OUTLOOK FOR THE UK ECONOMY – October 2014-September 2015

11. The UK's economic recovery has been slow and unsteady, but while growth has been weak, the labour market has been remarkably resilient. Unemployment rose considerably less than in previous recessions and much of this resilience was down to flexibility on the parts of both employers and employees, marked by wage restraint and flexible hours.

12. Recent data suggest that unemployment has now fallen below 2.5m and our forecasts suggest the ILO rate of unemployment should start to fall slowly from the beginning of 2014. Manufacturing sector employment bucked its long-term trend in 2012, with the number of jobs in the sector increasing BY 2.8%, and while we do expect employment in the sector to fall in 2013, this is likely to be at a much smaller rate than we have seen historically.

13. However, these forecasts are contingent on limited wage inflation. In the last two years our Pay Settlements surveys have shown that annual pay increases have remained at fairly modest level between 2.1% and 2.5%. **Any increase in the NMW should reflect the movement in basic pay rates we have seen across the whole economy**.

IMPACT OF THE NATIONAL MINIMUM WAGE (NMW)

What has been the impact of the NMW?

14. EEF's previous submissions to the Low Pay Commission have continued to highlight the fact that since the NMW was introduced, it has been increased by a rate in excess of both the rate of inflation and the average level of pay settlements reported by EEF members. This is discussed in more detail in response to questions on the economic conditions that would need to be met to accelerate increases in the NMW rate.

15. Whilst the NMW continues to have little direct impact on manufacturers, with employees earning above NMW, as highlighted in EEF's Professional and Workforce Pay Benchmark surveys. However, the NMW rate does indirectly impact EEF members that use outsourced services. Many of these – security, catering, office cleaning – are labour intensive services, more often than not supplied by organisations where increases to NMW directly linked to the actual pay of workers and where such increases are then passed onto customers. This indirect impact can then make companies less competitive, at a time where manufacturers are competing both on quality and cost.

16. Where changes to NMW rates do have direct impacts for manufacturers is in terms of business planning. They would benefit from greater certainty about the impact of future cost increases and any action needed to be taken by the business to alleviate any potential negative impacts. As such, **the NMW rate must be set by a formula that looks retrospectively at the movement of basic rates of pay across the economy. We consider the average level of basic pay settlements that has been reached across the economy over the previous 12 months to be a real approximation of this measure**.

YOUNG PEOPLE

What has been the impact of the minimum wage on young people?

What effect do you think it has on their employment prospects?

17. Manufacturers are concerned about the high levels of youth unemployment. The fact that youth unemployment remains high at a time where four in five manufacturers are saying they are experiencing recruitment problems demonstrates a real mismatch of skills[1]. However, a notable increase to the Youth Development Rate will not alleviate this problem; it in fact risks exacerbating the issue further by deterring employers from recruiting young people with low skills. We therefore urge the Commission to strike a balance between increasing the Youth Development Rate and ensuring employers are incentivised to recruit young people.

18. The Government's Youth Contract is a clear demonstration that youth unemployment goes far beyond the wage associated with hiring a young person. Under the Youth

[1] EEF, the manufacturers organisation, Skills for Growth: A more productive and flexible labour market (2012)

Contract employers can offer an eight-week work experience to a young person, without pay, or recruit them for a minimum period of 26 weeks whilst receiving a £2,275 subsidy (sufficient to cover NMW costs). However the take up of such initiatives has been extremely low, with less than 1% of EEF members using the wage subsidy.[2]

19. The focus for young people should be instead on giving them the skills, experiences and qualifications required by employers. Two-thirds of manufacturers said that recruitment problems stemmed from candidates lacking technical skills, six in ten said experience and almost half said relevant qualifications.[3] Pay is not the dominant problem, and this is supported by the fact that youth unemployment has remained high even when the Youth Development Rate has been frozen. **However, until the Government puts effective measures in place to tackle these issues, the Commission should act cautiously when setting the NMW rates for the year ahead not to deter employers from recruiting young people further.**

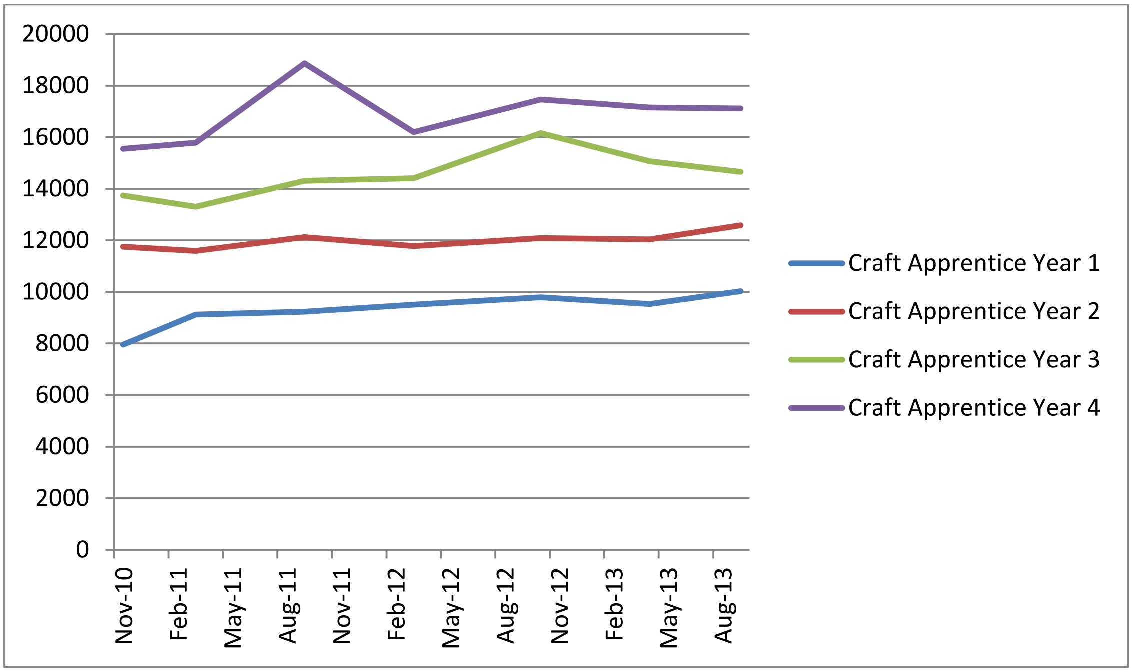
THE APPRENTICE RATE

What has been the impact of the Apprentice Rate of the NMW?

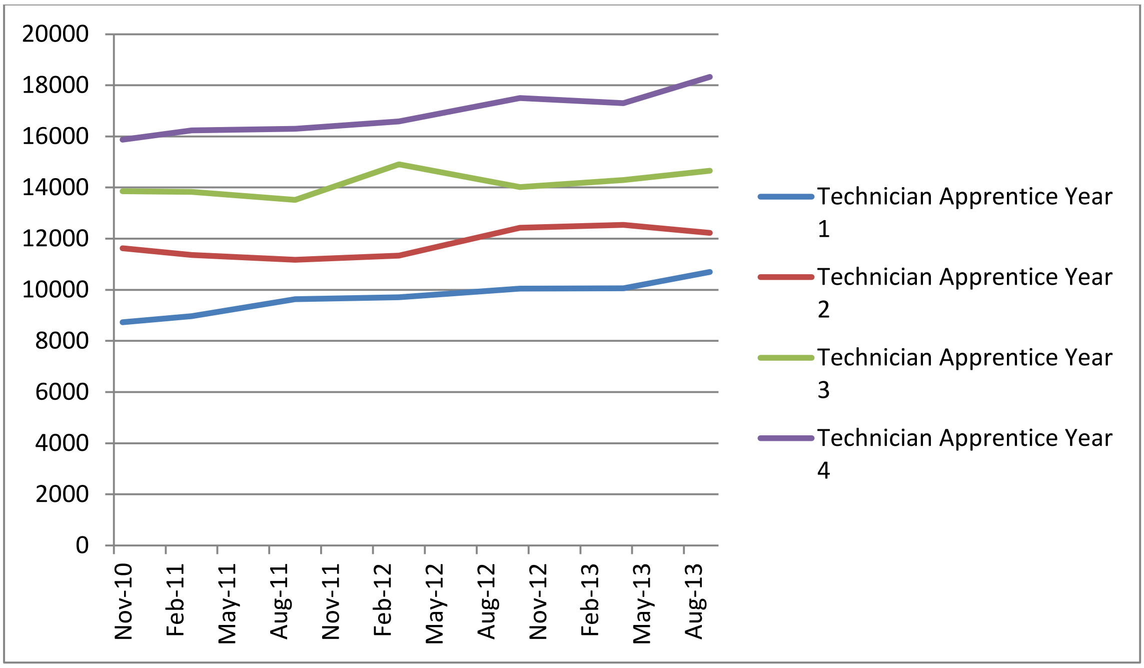
20. The Apprentice Rate of the NMW has had very limited impact on manufacturers. In fact, EEF's 2012 Skill Survey showed that only 1% of companies considered the National Minimum Wage for Apprentices as a barrier to taking on apprentices.[4] In addition, since the introduction of the NMW rate for Apprentices, the numbers of apprenticeship starts have increased (457,200 starts in 2010/11 – 520,600 in 2011/12). **Therefore the introduction of a NMW rate for Apprentices has not affected supply of apprenticeship programmes by employers.**

21. Moreover, EEF's Workforce Pay Benchmarks from 2010 to 2013 reveal the average basic pay for both craft and technician apprenticeships within EEF's members was considerably above and beyond the Apprentice rate of the NMW. This supports other findings including the BIS Apprentice Pay Survey 2011.

[2] Ibid
[3] Ibid
[4] Ibid



Source: EEF Workforce Pay Benchmark 2010 – 2013



Source: EEF Workforce Pay Benchmark 2010 - 2013

22. Since its introduction in 2010 the Apprentice rate of the NMW has increased from £2.50 to £2.65 (as of October 2013), this has increased approximately 1.9% each year. The October 2013 rate will reflect a 5.7% increase from its introductory rate.

Year	2010	2011	2012	2013
Apprentice NMW Rate	£2.50	£2.60	£2.65	£2.68
% Increase	-	3.8%	1.9%	1.1%

23. On average the Craft and Technician Apprentice rate for EEF members has increased by 10.6% over the same period – higher than the 5.7% NMW rate for Apprentices. Much of this is driven by increases in wage rates for first and final year apprentices. The increase in final year apprentices is likely to reflect the productivity gains associated with the apprentice at this point. Manufacturers will be gaining returns from investing in their apprentices and are therefore rewarding their apprentices to reflect these additional gains. The reason behind the increase in first year apprentices is likely to reflect the demand from employers to attract the best talent into their industry. Moreover, manufacturing employers will often offer Apprenticeships with enhanced pay packages to attract young people into the industry to begin with, and then continue this in order to retain these skills during and upon completion of the training.

24. Whilst this is a positive news story, we would remind the Commission when determining the NMW rate for Apprentices for 2014 that the above figures represent Craft and Technician Apprentices within manufacturing. This does not take into account other frameworks that manufacturers may use. As Craft and Technician Apprenticeships have a proven track record in being rewarded generously, it is not representative of Apprenticeships as a whole. Moreover, the Commission should note that the Apprentice NMW rate has had little impact on the demand from learners for Apprentices – indeed statistics released from the National Apprenticeship Service reveals there were 239,900 apprenticeship starts in 2008/09 (before the introduction of the NMW rate for Apprentices), and 520,600 in 2011/12. **Demand from learners then has not been affected by rises in the NMW rate for Apprentices. Given the fact that movements in demand and supply for apprenticeships have not been affected by current trends, we believe that they should continue to increase in line with the adult NMW.**

COMPLIANCE

How far is there compliance with the NMW? Do particular groups experience *problems with NMW compliance (Apprentices, interns, work experience)*

The Apprentice NMW Rate first to second year jump

25. Manufacturers are active in offering Apprenticeships, internships and work experience opportunities. Two-thirds of companies we surveyed said they offer Apprenticeships, seven in ten work experience and a third internships.

26. BIS Apprentice Pay Survey 2011 revealed strong indicators that the rules which dictate how much an Apprentice should earn are not understood by all employers particularly that pay in the second year of an Apprenticeship increases from the Apprentice NMW Rate to the relevant age related rate for those apprentices aged 19 or older. We are concerned that there could therefore be some element of unintended non-compliance.

27. For example a 21 year old Apprentice in their first year has a NMW rate of £2.65, however in their second year this increases to £6.19 – reflecting the Adult NMW rate. Whilst this information is well communicated via websites such as the National Apprenticeship Service and gov.uk, we are concerned that some providers and colleges are not communicating this to employers at the start of the Apprenticeship, and therefore they fall foul of the NMW regulations.

Overwhelming number of Government initiatives leave employers confused

28. EEF's 2012 Skills Survey revealed that a third of manufacturers currently offer internships. Some of these will be a compulsory component of a degree and as such employers are under no legal obligation to pay the intern. However, those internships that fall outside of a degree are within scope of NMW regulations. Whilst this is now relatively understood by employers, the confusion still lies in 'what is an internship'.

29. Employers will often find it difficult to differentiate between an internship, work experience and work shadowing. When offering work experience or work shadowing, the employer does not have to pay as they are not setting out work hours, responsibilities, job tasks and so on. However, they are legally obliged to pay when the intern is considered to be a worker. H owever the wording around this is not clear. Take for example the gov.uk website which states:

    An intern's rights depend on their employment status. If an intern is classed as a worker, then they're ***normally*** *due the National Minimum Wage.*[5]

30. There is then still a need for legal definitions of the terms 'intern' and 'internship'.

31. Further difficulties have come from the number of Government initiatives introduced to reduce youth unemployment. Employers can offer work experience placements up to 8 weeks without paying NMW and a traineeship with a work placement element up to 5 months without paying NMW. An employer recruiting a young person under the Youth Contract must pay NMW but receives a subsidy of £2,275 which covers NMW costs. Given the ever increasing number of youth unemployment initiatives, it is important that the Government clearly sets out the legal obligations for employers under each initiative that has been introduced.

ECONOMIC CONDITIONS FOR INCREASING THE NMW ABOVE AND BEYOND BASIC PAY

[5] Gov.uk – Employment rights and pay for interns https://www.gov.uk/employment-rights-for-interns

Why do we have a NMW?

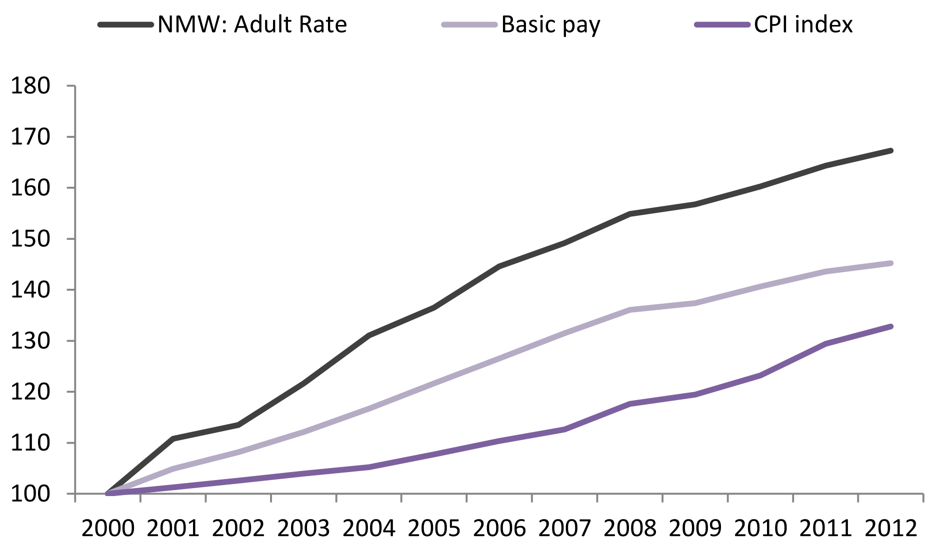
32. The NMW was introduced as a protection against very low rates of pay, and it is important that it continues to do this, without having a detrimental impact on employment.

33. While there were concerns when the NMW was introduced that employment might fall, as a wage floor could price some people out of the labour market, these concerns did not materialise. The NMW was set a proportionate level that did not hurt employment.

34. It remains important that the NMW should reflect economic conditions in order that it does not have a disproportionate effect on employment and firms' ability to take on new employees. Since its inception the NMW has risen more strongly than either basic pay or inflation.

The National Minimum Wage has risen faster than inflation or basic pay[6]

(Index, 2000 = 100)



Sources: Low Pay Commission and ONS, 2013

35. EEF has long argued the case that the NMW should be increased in line with the movement of basic rates of pay across the economy, which gives a good indication both of firms' ability to pay, and the general trend for living standards across the economy.

36. Although pro-cyclical, over the longer term basic pay has risen more strongly than inflation and therefore provides a stronger support of living standards. Tying the NMW

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[6] Average weekly earnings, regular pay

to basic pay allows those on low income to share in improvements in living standards while also seeing more moderate rises in pay, along with the rest of the population, during tougher times.

37. Prior to the recession the NMW rose faster than basic pay, but there is no guarantee that it could continue to do so without having a detrimental impact on employment. While we do believe the NMW should increase in line with basic pay, it should not be increased at a faster rate, especially at present, as current economic conditions remain challenging and uncertain. One of the key reasons employment remained resilient during the recession was flexibility on the parts of both employers and employees, marked by wage restraint and flexible hours.

There is currently not a strong case for increasing the NMW a rate above and beyond earnings growth

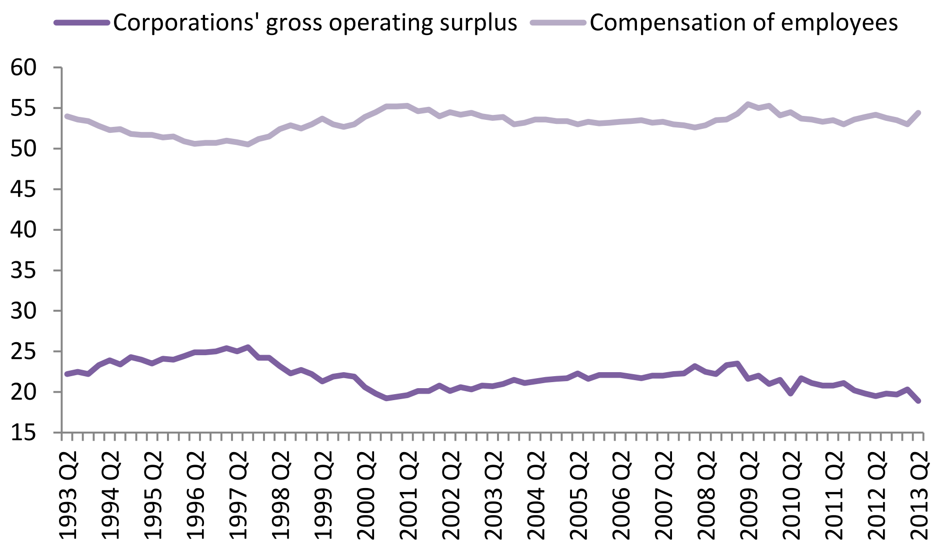
Labour's share of income was stable during the recession:

38. While basic pay growth did slow during the recession, the wage share of national income was more or less unaffected by the recession, in fact, it rose 0.7 percentage points between 2007 and 2012. At the same time corporations' gross operating surplus as a percentage of GDP fell from 22.1% in 2007 to 19.7% in 2012.

39. Although there has been discussion about the falling share of national income accounted for by wages, much of this relates to the US and not the UK. The UK's wage share did fall in the late 70s and early 90s but it rose in the late 90s and has since been stable for nearly two decades, suggesting there is little case for additional policy intervention.

Labour and business share of GDP has remained relatively stable for two decades

(% of GDP)



Source: ONS, 2013

40. Nonetheless, living standards have fallen since the recession began, as basic pay has risen by less than inflation. But if the Low Pay Commission was looking to make up some of this lost ground it would be critical to first ensure that economic conditions were strong enough to make such a rise sustainable.

There is not yet strong-enough economic growth to justify increases above average wage growth:

41. **Although we would continue to advocate a predictable annual increase in the NMW based on basic pay growth, there might be times when businesses would be better able to afford a stronger increase:. We believe that for this to happen, we would need to see a combination of broad-based sustainable growth in both employment and productivity**.

Employment and productivity should both be growing

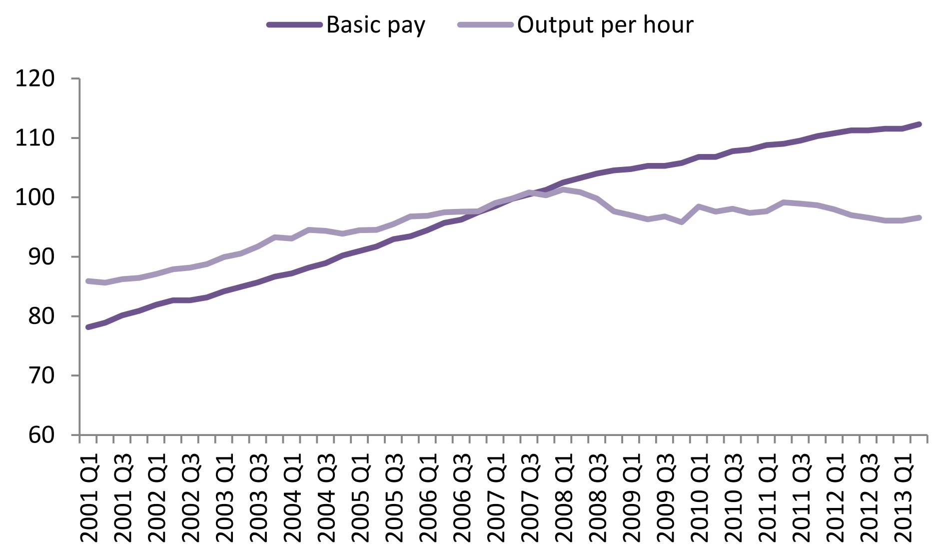
42. For businesses, sustainable pay rises are those based upon productivity improvements in their workforce. Therefore rising productivity across the economy is likely to be associated with an increased ability to pay higher basic wages.

43. However, sometimes businesses will be driving productivity in response to weak demand, (for example by process improvements that may imply a reduction in the size of their workforce) and may therefore not be in a position to take on more employees or pay higher wages.

44. It is therefore important that employment is growing too. The reason this must be linked to productivity growth is highlighted by employment trends since the 2008 recession. Employers have held on to employees, and may have taken on new employees as an alternative to investment in new capital, and this has led to falling productivity in a number of sectors. This is not an increase in employment that is consistent with employers being able to afford large pay rises.

Productivity growth has fallen below growth in basic pay

(Index, 2000 = 100)



Source: ONS 2013

45. For this reason – in order to be sure that an increased NMW would not adversely affect employment – **the Low Pay Commission should not consider increasing the NMW at a faster rate than movements in basic pay unless productivity and employment were both rising at the same time.**

46. If we were to see a period when both of these indicators were rising across the economy, this would provide a case for opening up a dialogue about a different approach to setting the NMW. We would not advocate an automatic acceleration in the NMW, however, as there are a range of other factors that would need to be taken into account such as growth rates in those sectors most exposed to the minimum wage.

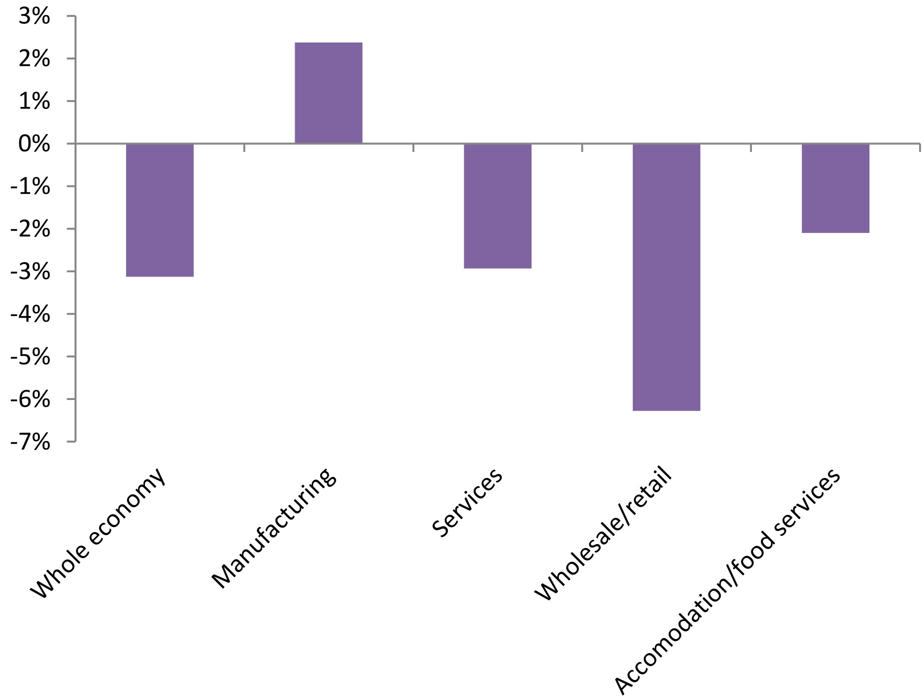
Growth must be broad based

47. While manufacturers generally pay more than the NMW, its use tends to be more prevalent in some sectors such as retail and hospitality. These sectors are also labour-intensive, and therefore less likely to see the kind of productivity gains that can improve the affordability of pay rises. As a result, employment in these sectors is more vulnerable to increases in the minimum wage.

48. This means it is important to see productivity growth in a wide variety of sectors – and not just to look at the whole economy rate – before raising the NMW above and beyond basic pay.

In most sectors, productivity remains below pre-recession levels

(Output per hour, % change 2007 – 2012)



Source: ONS, 2013

49. We do not believe that it would be appropriate to develop sector-specific minimum wages as this would reduce the transparency and simplicity of the current minimum wage; these characteristics are beneficial to both employers and employees.

The NMW is not the only tool

50. Finally, increasing the NMW is not the only way to increase the earnings of the lowest paid. There should be a broad-based approach to improving living standards. Policy should take steps to create a more productive and more flexible workforce; ensuring that individuals have the skills that enable them to secure well-paid jobs in companies that are working in highly competitive global markets.

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