BCC Submission to the 2014 Consultation on the National Minimum Wage

Summary of Recommendations

Given the fragility of the economic recovery, we would urge the Commission to act with restraint. If excessive increases are adopted based on forecasts that prove overly optimistic, this could cause higher unemployment and even bankruptcies.

We recommend:

- 2.1% increase in the Adult NMW rate (13p)
- 1.2% increase in the Development rate (6p)
- 1.3% change in the Youth rate (5p)
- 1.5% change in the Apprentice rate (4p)
- Investigate and consider the creation of an additional rate for the 21-24 age group

UK GDP forecasts: In our Q3 2013 economic forecast, issued just over a month ago, we predicted a gradual upturn in UK GDP, with full year growth of 1.3% in 2013, 2.2% in 2014 and 2.5% in 2015. **This implies growth of 2.4% in the period between October 2014 and September 2015**. It is too early to revise formally our forecast. But recent developments, notably our QES for Q3 2013, indicate a strong likelihood that our GDP growth forecast will be upgraded.

UK Inflation forecasts – prices and wages: For CPI annual inflation we are predicting, in full-year terms, 2.7% in 2013, 2.4% in 2014, and 2.3% in 2015. **This implies 2.3% CPI inflation in the period between October 2014 and September 2015**. For wages, which have risen at a consistently lower pace than prices in recent years, we assume that annual earnings growth for regular pay (excl. bonuses) will increase gradually over the next 2 years, in line with stronger economic activity, to average 1.3% in 2013, 2.4% in 2014, and 2.9% in 2015. **This implies 2.7% earnings growth in the period between October 2014 and September 2015**. Annual growth in pay is expected to stay below CPI inflation in the next 6-9 months, but is likely to rise at a rate above inflation from the middle of 2014 onwards.

UK unemployment forecasts: In our Q3 2013 forecast we predicted that **unemployment will fall from 2.514 million (7.8% of the workforce) in Q2 2013, to 2.450 million (7.5% of the workforce) in Q3 2014, and to 2.300 million (7.0% of the workforce) in Q4 2015**, a net overall fall of 214,000. Improved growth prospects, and Britain's labour market flexibility, are the main factors accounting for the expected unemployment declines in the next two years. However, the planned spending cuts will cause further public sector job losses and this will exert upward pressure on unemployment, limiting the size of any net decline.

The jobless outlook will be critically affected by what happens to inactivity and to productivity. Trends in these areas are highly uncertain, but both (particularly productivity) are key factors when considering the appropriate level of the NMW. In general, falls in unemployment will be smaller (or rises will be larger) if: 1) more people than envisaged abandon inactivity and seek work; and 2) if productivity increases more rapidly than predicted.

Youth unemployment forecasts: The UK youth unemployment rate will remain much higher than the national average. But, with total UK unemployment forecast to fall in the period to Q4 2015, youth unemployment will also decline. Our specific forecast for the 16-17 and 18-24 age groups are as follows: **Unemployment in the 16-17 age group is forecast to fall to around 180,000 (a jobless rate of 35.0%) in Q4 2015. Unemployment in the 18-24 age group is forecast to fall to around 730,000 (a jobless rate of 18.5%) in Q4 2015**.

Productivity: UK productivity has fallen sharply in recent years. In spite positive growth in recent quarters, **output per person in Q2 2013 was 4.3% lower than in Q1 2008, and output per hour 3.8% lower**. A fall in productivity is acceptable during a recession, because it limits unemployment increases, alleviates human misery and helps businesses to preserve skills. However, if productivity fails to recover as the economy returns to growth, living standards will suffer in the long-term.

Implications for the NMW: The squeeze on living standards in recent years has been an unfortunate but necessary consequence of the recession, and the consequent fall in productivity. Low wage increases have made it possible for UK firms to maintain higher levels of employment than would otherwise have been the case. As the economy recovers, there are naturally growing expectations that the squeeze on living standards will ease, as wage increases catch up with, and eventually exceed price increases. Our forecast also envisages a gradual upturn in wages at the national level. Given this background, many people will also expect a significant increase in the NMW. But, while the scale and timing of national wage rises will be determined, in the normal bargaining process, by factors such as labour demand, firms' ability to pay and productivity, fixing the NMW requires special care to avoid causing damage. At a time when what may prove a temporary spurt in growth is generating a surge in optimism, and when "cost of living" issues are at the centre of the political debate, there will be strong pressures for an unaffordable 2014 NMW rate. However, **if current reasonable expectations about continued growth and rising productivity turn out to be too optimistic, an unduly high NMW could cause higher unemployment, force businesses to stop trading, and may even result in bankruptcies. The adverse effects of an unaffordable NMW will be predominantly concentrated amongst SMEs**.

The appropriate NMW rate: Given the global and domestic risks still facing the UK economy, **there is a strong economic case for a very modest increase in the adult NMW rate of only 1.2-1.3% in October 2014, only marginally above recent increases in average earnings of 1% per year**. **This will mean an increase of 8p in the adult NMW, to £6.39**. However, given the acute political concern with the "cost of living" and the positive news about the economy, such a small increase is will probably be seen as too mean. **To have a chance of being accepted, the proposed increase in the 2014 NMW will have to be: 1) slightly higher than the 2013 increase; and 2) slightly higher than the 2% inflation target**. Since youth unemployment rate will remain much higher than the national average, **absolute levels and planned increases for younger age groups must stay lower than the adult NMW rate**. The following table summarises our proposals for the 2014 NMW rates, and compares them with the actual rates for the period 2011 to 2013. These figures satisfy the two conditions mentioned above, but also take into account that **NMW increases in recent years have been consistently higher than average wage rises at the national level**.

Year	21 and over	18 to 20	Under 18	Apprentice	% change 21 & over	% change 18 to 20	% change Under 18	% change Apprentice
2014 suggestion	**£6.44**	**£5.09**	**£3.77**	**£2.72**	**2.1%**	**1.2%**	**1.3%**	**1.5%**
2013 (current)	£6.31	£5.03	£3.72	£2.68	1.94%	1.0%	1.1%	1.1%
2012	£6.19	£4.98	£3.68	£2.65	1.81%	0.0%	0.0%	1.9%
2011	£6.08	£4.98	£3.68	£2.60	2.5%	1.2%	1.1%	4.0%

What economic conditions would justify a higher NMW rate: The following conditions would justify a higher NMW rate than we are suggesting: **1) stronger growth than now envisaged, with GDP rising by at least 0.7% per quarter in Q4 2013 and the first half of 2013; and 2) faster unemployment falls, with the rate down to 7.4% by Q2 2014, and evidence that the fall is not driven primarily by increases in inactivity**. Were these conditions to be met there would be justification for an increase to the adult rate by more than 2.1%. Depending on the margin by which these conditions are exceeded, there could be justification for an increase of as much as 2.5%.

Consider separate, lower, rate for 21-24 age group: At present the adult rate applies to those aged 21 and over. But **the very high unemployment rate amongst those aged 24 and less justifies the introduction a separate NMW rate for the 21-24 age group**. There will be strong political objections to this idea, but its acceptance is likely to help reduce unemployment significantly in the 20-24 age group.