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24th September 2015

Consultation on the UK minimum wage rates

Dear Sir/Madam,

Thank you for giving the Institute of Directors (IoD) the opportunity to participate in this Call for Evidence review on UK minimum wage rates, published by the Low Pay Commission (LPC) on the 23rd of August 2015. Pay is an important concern for all employers. The IoD are very pleased to contribute to the current consultation on behalf of our members. This paper presents the IoD's comments on some of the key issues raised by this review and presents the views of the IoD's members on the future of minimum wage and statutory pay obligations in the UK.

About the IoD

The IoD was founded in 1903 and obtained a Royal Charter in 1906. It is an independent, non-party political organisation of approximately 35,000 individual members. Its aim is to serve, support, represent and set standards for directors to enable them to fulfil their leadership responsibilities in creating wealth for the benefit of business and society as a whole. The membership is drawn from right across the business spectrum. 71% of FTSE 100 companies and 51% of FTSE 350 companies have IoD members on their boards, but the majority of members, some 70%, comprise directors of small and medium-sized enterprises (SMEs), ranging from long-established businesses to start-up companies. IoD members' organisations are entrepreneurial and growth-orientated, and more than half (57%) export goods and services internationally.

The IoD's position: The views of our members

Since 1998, the National Minimum Wage has been set by the Low Pay Commission based on their calculation of the highest level which would not damage employment. In July 2015 the Chancellor

effectively replaced the National Minimum Wage with a new National Living Wage for those aged 25 and over. This new rate would no longer be set with regard to employment, but would instead move towards a target 60% of median income by 2020.

There are currently four National Minimum Wage rates, which change annually for all workers on an October cycle: The adult rate (for those aged 21 and over), the 16-17 Year Old Rate, the Youth Development Rate (for those aged 18-20) and the Apprentice Rate.

The Government is introducing the National Living Wage: A mandatory new rate for all workers aged 25 and above comprised of the adult rate and an initial 50 pence Living Wage Premium. The National Living Wage will apply from April 2016, at a rate of £7.20 an hour. Once introduced this will become the rate for workers aged 25 and over. Only 21-24 year olds will be paid at the adult rate of the National Minimum Wage. The Government has set out an ambition that the National Living Wage should continue to increase each April to reach 60 per cent of median earnings by 2020, with an objective to have a National Living Wage of over £9 an hour by 2020.

From the 1st of October 2015: The adult hourly rate of the National Minimum Wage will be £6.70; the hourly rate for the Youth Development Rate (covering 18-20 year olds) will be £5.30; the 16–17 Year Old hourly rate will be £3.87; the Apprentice Rate will be £3.30 per hour; and the daily limit of the accommodation offset will be £5.35 (£37.45 a week). From April 2016 the National Living Wage will be introduced at £7.20 an hour (for those aged 25 and over).

Whilst relatively high employment has been the surprising story of the recession, the flip side has been frustratingly slow wage growth during the recovery. The government are right to push for workers to share in the benefits of economic growth, but minimum wage rates must not become the subject of a political competition to see who can offer the most, irrespective of what the economy and employers can afford. The Low Pay Commission has done a good job of balancing the rate against inflation, economic growth, productivity and the effect rises would have on small businesses and job market entrants. While growth has returned to the economy, productivity remains stubbornly low, so any increase to the minimum wage must be timed carefully and be reflective of productivity growth rather than political objectives. The Low Pay Commission's independent role in determining the level of pay obligations must be strengthened to avoid the political temptation to turn wage rates into an instrument of electoral or political strategy.

Ultimately, reducing the tax burden on both employers and employees will help strengthen the position of those in low paid jobs, as they become a more attractive employment option and find themselves at less of a comparative disadvantage.

However, the Chancellor has offered business a new deal on employment. Introducing a new pay bargain and strengthening statutory pay obligations, but in return, companies have been provided with a cut to corporation tax and an increase in the employment allowance. The IoD and our members accept that deal.

The IoD's response to specific questions posed in this consultation:

Q1. Economic Outlook

The latest ONS Labour Market Statistics (August 2015) are further proof that Britain's businesses continue to power the recovery and are sharing the rewards with their employees.

In the downturn, businesses did all they could to keep people in work, taking the difficult decision to cut hours or freeze pay. Now, real pay growth has become entrenched, with average wages – not including bonuses – increasing at the fastest pace for more than six years.

The rate of unemployment has stabilised. Job security is also on the up. The proportion of people in work is now back to its joint highest level on record, suggesting the UK economy is close to full employment. The number of part-time and temporary workers who would like a full-time position is at its lowest since before the crisis and the number of long-term unemployed has fallen dramatically in the past twelve months. Even though short-term unemployment appears to be growing slightly, this is likely the result of more people starting to hunt for jobs in response to a near record number of vacancies.

It is also encouraging to see that productivity could finally be increasing. Employees are doing more with less – working fewer hours, producing more and being paid more. As firms ramp up production, and with inflation falling to zero, real wage growth will boost consumer confidence.

These are all signs that although the headline unemployment rate may have plateaued, the labour market is still tightening. Overall, the marked strengthening in earnings growth, coupled with consumer price inflation dipping to 0.0% in August, is very good news for consumers' purchasing power. With wages up 2.9% over the year and inflation low, working people have received the fastest real terms rise in over a decade.

Q3. Future Rates

The government are right to push for workers to share in the benefits of economic growth, but minimum wage rates must not become the subject of a political competition to see who can offer the most, irrespective of what the economy and employers can afford.

An increase in wage rates that is too swift or too substantial does have the potential to cost jobs. Indeed, the Office of Budget Responsibility estimates that 60,000 jobs will be lost as a result of the introduction of the National Living Wage. The potential jobs cost cannot be discounted from discussions around future wage rates. The National Living Wage will therefore need to be monitored on an ongoing basis to check that it is not having more severe negative effects than anticipated, rather than simply assuming that it will all be ok.

The Low Pay Commission has, nevertheless, done a good job of balancing the rate against inflation, economic growth, productivity and the effect rises would have on small businesses and job market entrants. While growth has returned to the economy, productivity remains stubbornly low, so any increase to the minimum wage must be timed carefully. With the National Living Wage increasing pay for entry level workers by 7.5%, this is running well ahead of private sector regular pay growth, at 3.4%. It is crucial the Low Pay Commission can make an independent judgment on the future path of this new pay floor.

Ultimately, however, it is important to remember that the only determinant of long-term wage growth is improved corporate performance, driven by productivity gains, so we welcome the government's continued focus in this area.

Q4. National Living Wage (NLW)

The IoD gave modest support to George Osborne's budget proposal for a living wage, even though it will put up employers' wage bills. We took this approach reluctantly. Employers understandably chafe at government imposing pay levels. The chancellor's flagship policy will usher in a 50p increase in the statutory minimum pay rate for the over-25s from April, to £7.20 an hour, followed by a series of stepped increases expected to take the rate above £9 an hour by 2020.

The Resolution Foundation, whose work on the future of the minimum wage was cited by the chancellor when he announced the policy in July's budget, have calculated that UK employers will see their total wage bill rise by £1.5bn, or 0.2% in April 2016, rising to £4.5bn, or 0.6%, in 2020. The report also highlights how the impact will be much bigger on certain companies – notably the hospitality, retail and care sectors - where low pay is more prevalent. Within health, the residential care sector will see a 2.8% rise in the wage bill, while employers in the hospitality and retail sectors will see their wage bill increase by 3.4% by the end of the decade. Micro businesses with fewer than 10 employees face proportionately the biggest increase in their wage bill under the new minimum pay rates announced in the summer budget, an increase of 1.5%, two and a half times the size of the increase experienced by large employers.

While some employers have warned they will have to cut jobs and hike prices to cope, past experience tells us that most absorb the pressures via some combination of passing on small increases in prices to consumers, a dip in profits and increases in productivity. Thanks to the strength of the recovery in some quarters, there are now plenty of businesses who can afford, over time, to meet this sort of wage rise without seeing a negative impact on job creation. But it must be remembered that not all companies have recovered from the recession at the same pace, with many still struggling to regain lost productivity.

The Low Pay Commission was established to assess objectively and independently the appropriate speed and extent of increases in the figure. To date, it has been regarded as successful in balancing the rate against inflation, economic growth and the effect rises would have on small businesses and job market entrants.

In the long run, however, improving the UK's productivity performance will be essential to making the national living wage affordable. The only sustainable drivers of wage growth are productivity gains and improvements in company performance. Allowing wage rates to be determined by anything other than these measures would be a risky move. Politicians should address the underlying issues holding back pay rises, and must resist the temptation of descending into a wage auction.

The good news is that economic conditions look set to drive a wage increase in the coming months. Indeed, a recent survey of IoD members revealed two thirds expect to increase pay in line with or above inflation over the coming 9 months. The same research showed that 9 in 10 IoD members already pay even their most junior staff the living wage - set at £7.65 outside London and £8.80 in London. The proposed further increase is part of a new deal offered by the Chancellor on employment. Introducing a

National Living Wage at a significantly higher level than the minimum wage was a dramatic announcement, but in return, companies have been provided with a cut to corporation tax and an increase in the employment allowance. We should not understate the boldness of this move, and many businesses will have been taken by surprise, but the IoD and our members accept this deal.

Q5. Compliance & Enforcement

The Institute of Directors has welcomed the Prime Minister's recent announcement of new penalties for employers who fail to pay their staff the minimum wage. The business community is as outraged as the prime minister at employers who skirt the law and undercut wages. Those that do so should be punished and face prosecution. David Cameron is right to focus on enforcement, and businesses will join him in condemning bad behaviour.

Tough talk about 'unscrupulous employers', however, runs the risk of portraying this as a widespread problem and betrays the fact that transgressions are beyond rare. Since 2013, only 285 employers have been found guilty of not paying staff the national minimum wage. This is of a total of 1.27 million employers in Britain – meaning just 0.02 per cent broke the rules. Ultimately, however, it is important to remember that the only determinant of long-term wage growth is improved corporate performance, driven by productivity gains, so we welcome the government's continued focus in this area.

Conclusion

Whilst relatively high employment has been the surprising story of the recession, the flip side has been frustratingly slow wage growth during the recovery. The government are right to push for workers to share in the benefits of economic growth, but minimum wage rates must not become the subject of a political competition to see who can offer the most, irrespective of what the economy and employers can afford. The Low Pay Commission has done a good job of balancing the rate against inflation, economic growth, productivity and the effect rises would have on small businesses and job market entrants. The Low Pay Commission's independent role in determining the level of pay obligations must be strengthened to avoid the political temptation to turn wage rates into an instrument of electoral or political strategy. While growth has returned to the economy, productivity remains stubbornly low, so any increase to the minimum wage must be timed carefully. Ultimately, reducing the tax burden on both employers and employees will help strengthen the position of those in low paid jobs. The Chancellor has offered business a new deal on employment. Introducing a new pay bargain and strengthening statutory pay obligations, but in return, companies have been provided with a cut to corporation tax and an increase in the employment allowance. The IoD and our members accept that deal.

Thank you once again for giving the IoD the opportunity to participate in this Call for Evidence. We hope you find our comments useful and we look forward to seeing the LPC's final report and to further engagement on ensuing policy changes. If we can provide further information on any of the issues discussed, please do not hesitate to contact me.

Yours faithfully,

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