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THE LIVING WAGE: STATING THE CASE

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FOREWORD

This piece of research was originally undertaken in 2015 to review the available evidence surrounding the business case for paying a Living Wage as defined by the Living Wage Foundation, and thus to consult with our members in determining what our position on the issue should be. In the latter stages the research overlapped the announcement of the National Living Wage by George Osborne, which complicated an already confused debate around the official Living Wage and the National Minimum Wage. Therefore, the research was expanded to include some clarification on the matter, as well as a wider debate about statutory wage rises, the nature of this policy in particular and the general impacts of increasing employee pay. Whilst this broadened the research, setting out the Chambers' message to business regarding the official Living Wage remained the objective. Led by the evidence, the report was presented to members at an assembly meeting in October 2015, where 91% of members voted in favour of supporting an official Living Wage campaign backed by the Chamber. Our position is on the basis that the push for increased adoption of Living Wage policies is achieved through progression rather than regulation, and we aim to communicate that it is a good business decision thanks to the benefits it can ultimately provide in terms of aspects such as productivity and retention of staff. We aim to make businesses enthusiastic about this opportunity, and we are in no way arguing for statutory policy change.

Throughout the research it became clear that businesses in particular sectors such as Health and Social Care operate in a more heavily restrained market making pay rises of this nature extremely difficult if not impossible to implement, and there was vocal concern over this issue at the assembly meeting. To this end, the Chamber's recommendation comes with significant caveats, and we will continue to lobby in support of the needs of those businesses in sectors particularly sensitive to these issues.

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Alex joined Greater Manchester Chamber of Commerce in April 2015 after completing Undergraduate and Master's degrees in economics at Manchester Metropolitan University. As a passionate researcher and writer of behavioural economics and social policy, Alex's Master's dissertation took a look at negative income taxation as a replacement for the UK tax and welfare system. Alex currently works as a research analyst at GMCC and has penned reports on the Living Wage and flexible working policies. Since joining Alex has honed his skills in database manipulation and statistical analysis, working on various large projects including the North West Construction Pipeline and a number of individual research pieces. **Alexander Davies** *November 2016*

EXECUTIVE SUMMARY

- The Living Wage Foundation aims to raise the living standards of low-paid workers by providing a wage that supports a minimum acceptable standard of living.
- The Living Wage (LW) calculation takes account of the cost of living, taxes and benefits. It is calculated for the UK with an additional LW for London, and currently sits at £8.25 and £9.40 an hour respectively.
- The national campaign seeks to increase pay by having firms accredited as official Living Wage Employers, with 2861 firms having been accredited across the UK, including GMCC – the first Chamber of Commerce to do so.
- Becoming accredited means an increased wage bill for those firms with low-paid workers, and due to the vast differences between business models the LW may not be practical for many firms, so no blanket statement of endorsement can be made.
- Aside from any ethical or moral case for the LW, enough anecdotal evidence exists surrounding living wages and the effects of increasing pay to form a picture of the implications for business.
- Firms in traditionally low-paid, low-skilled and high staff-turnover sectors such as retail, healthcare, bars and restaurants etc. will likely face relatively larger wage bill increases and have less scope to absorb said increases than sectors such as IT, banking and finance, and construction.
- Sector also determines how prices are likely absorbed. Some sectors have scope to increase prices, whilst others may have to remove inefficiencies or reduce the number of staff or hours worked.
- Across all the available evidence, which primarily stems from the UK and the USA, three main areas in which paying higher wages can have a significant beneficial impact are evident: productivity, ease of recruitment and staff retention.
- The evidence is almost entirely supportive of the idea that paying higher wages can improve production and quality, although the long-term nature of the benefits make them harder to quantify against the immediate cost increase. Wider beneficial economic spill-over effects have been observed following pay increases in select cases.
- The Conservatives' plan to increase the NMW, introduce a National Living Wage and increase the tax-free allowance will increase tax revenue for the Treasury, whilst planned cuts to tax credits will increase the cost of living and therefore the need for a higher official Living Wage.
- George Osborne's National Living Wage is not a "true" Living Wage, it confuses the conversation, and may hinder the LW campaign as a result.
- If, after careful consideration a particular business is determined to have adequate scope for paying higher wages, the evidence overwhelmingly suggests it is beneficial to do so.

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INTRODUCTION

"Paying the Living Wage is not only morally right, but makes good business sense too. What may appear to be an unaffordable cost in a highly competitive market should more often be viewed as a sound investment decision. I believe that paying decent wages reduces staff turnover and produces a more motivated and productive workforce." **— Boris Johnson 2009**

With roots stretching as far back as the second industrial revolution, since its reincarnation in 2001 the Living Wage (LW) is an idea that has gained significant traction in both the public and political spectrum. The intention is clear: to provide low-paid workers with a wage that supports a minimum acceptable standard of living. What may be unclear to businesses however, is whether paying the LW to employees is an achievable idea in practice.

The result of a combined effort between the Joseph Rowntree Foundation and the Centre for Social Policy research at Loughborough University, the 2016 UK LW is £8.25 per hour, with an additional calculation made for London, where the LW is currently £9.40 per hour. The LW Foundation seeks to raise the living standards of the low-paid through accreditation of firms as LW Employers. 2861 firms are currently accredited across the UK, with Greater Manchester Chamber of Commerce being the first Chamber to become accredited. Unfortunately, aside from the moral and ethical incentive, there is a lack of evidence regarding the experiences of accredited firms from a business perspective, making it difficult for others to comprehend if they can accommodate the extra cost and exactly what the effects of accreditation will be. Evidence from the UK is limited but it is out there, and by consolidating this with the more abundant evidence from the USA (some cities of which have toyed with various LW implementations since the early 1990s) an outline of the business impacts begins to take shape.

From the outset one thing is clear: the LW may not be for everybody. Despite George Osborne's announcement of a "National Living Wage" in 2015, a statutory LW is not the intention of the campaign or any current political party, nor is it necessarily desirable, although that is another discussion altogether. The business world is so varied and nuanced that a blanket statement of endorsement would be naïve, and it is precisely this variation that makes it difficult for any single firm to adequately assess how accreditation may be of benefit not just to the employees, but to the business as a whole. Certainly, the headline names of the campaign (KPMG, Google, Burberry, HSBC and Goldman Sachs to name but a few) will do little to convince SMEs that accreditation is a worthwhile and practical pursuit, but the rising number of accredited firms is increasingly facilitating analysis that can serve a more general application to the business community.

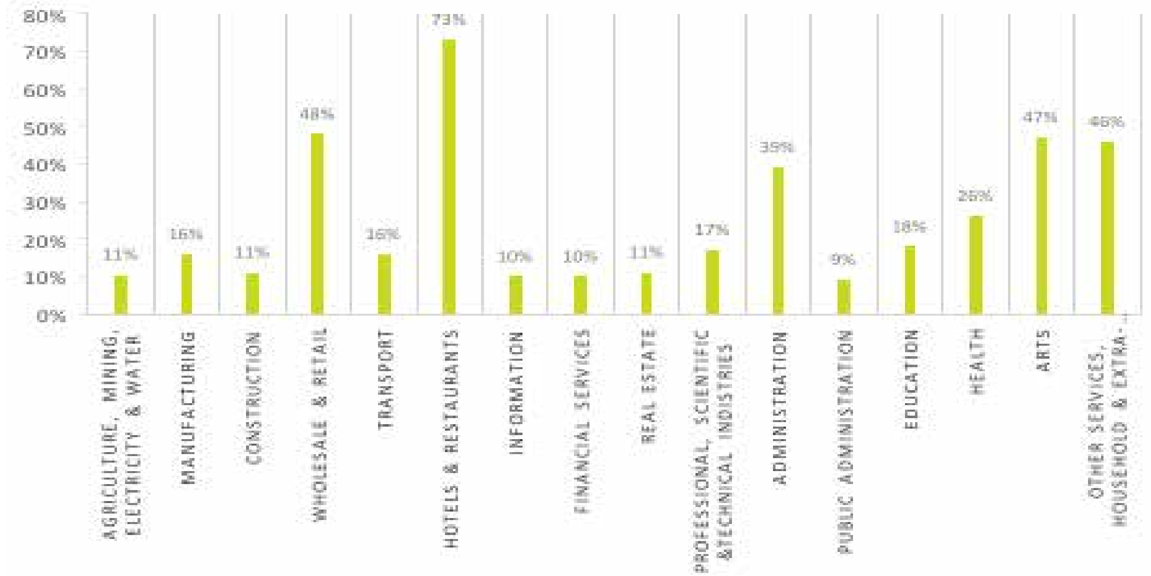
In the North West, 28% of the 2,710,000 strong workforce were being paid less than the £8.25 LW at the end of 2015, compared to a UK average of 25% and a London average of 21%. Within the North West the three districts with the highest percentage of workers being paid less than the LW are West Lancashire at 38%, and Blackpool and Rossendale at 36%. Of the 2861 accredited firms across the UK, 229 are based in the North West, including Greater Manchester Chamber of Commerce[i]

SECTOR ANALYSIS

Alongside willingness, sector and business size is a major determinant of the possibility of paying a LW. As seen by the headline companies of the campaign, accredited firms tend to be large and employ mostly well-paid and highly-skilled workers. This is reflected in the sectoral analysis which finds that it is predominantly firms that hire relatively few, but relatively highly skilled employees that will suffer the lowest overall wage bill increase following accreditation. Generally these sectors include IT, banking and finance, and construction, all of which would see an estimated overall wage bill increase of between 0.2% - 1.1%. Conversely, businesses in traditionally low-paid and low-skilled sectors such as bars, restaurants and general retailers would see an estimated increase of 4.7% - 6.2% of their overall wage bill[ii]. The nature of firms in such sectors adds further to the difficulty of paying a LW: profits tend to be lower, costs tend to be more variable, there is less wiggle-room in terms of prices, and employee turnover tends to be high. The differences in firm size and business models within each sector determine the available scope for absorbing extra costs and reaping any benefits the LW may provide.

Larger firms may be able to promote productivity by removing inefficiencies or by re-structuring, but those that are constrained may struggle to find other acceptable methods of offsetting extra costs outside of increasing prices. Whilst this will depend on the particular competition and price-sensitivity within the sector, the available evidence shows that a majority of firms felt no need to alter prices following accreditation[iii]. However this may be a mere reflection of the type of firms to which paying a LW is achievable, as contrasting evidence shows that almost 70% of firms increased prices following the introduction of the NMW, with around 30% deemed to have made significant increases[iii]. Certainly, we would expect firms in highly competitive sectors to rule-out price increases, with data showing that textile companies are least likely to increase prices. Similarly, businesses facing high price sensitivity such as pubs, cafés and cleaning services will not be able to increase prices without affecting demand, whereas hotels and restaurants may be more able to pass the costs onto customers through price increases. Firms with little scope to raise labour productivity however (hairdressing being a textbook example), may have little choice but to raise prices, and would therefore need to improve quality to retain customers.

PERCENTAGE OF EMPLOYEES BELOW LW, BY SECTOR, NORTH WEST.



PRODUCTIVITY, RECRUITMENT AND RETENTION

Anecdotal evidence from both the UK and USA highlights a number of benefits experienced by LW firms, with the most prevalent improvements across the board being in labour productivity, recruitment and retention of staff. A recent report from Oxford Economics[iv] stresses the cost of replacing established workers, separating the costs into logistical recruitment costs, lost revenue during the required time for an employee to reach full productivity, and wages spent on the initial under-productive labour. They find that for a small firm in some sectors it can take up to ten weeks for a new employee to reach optimum productivity, and that this time increases for larger firms. Overall the report suggests that recruitment costs are generally underestimated, particularly when replacing skilled labour. A US study[v] shows that employers in the retail sector grossly underappreciate the benefits of investing in the workforce. In a cross-section of comparable retailers, the performance of the best store was 43 times better than that of the worst. A large part of this variation could be traced to labour practices, as stores with labour "gaps" – through poor training, low labour budgets, high employee turnover etc. – consistently had to deal with the most operational problems.

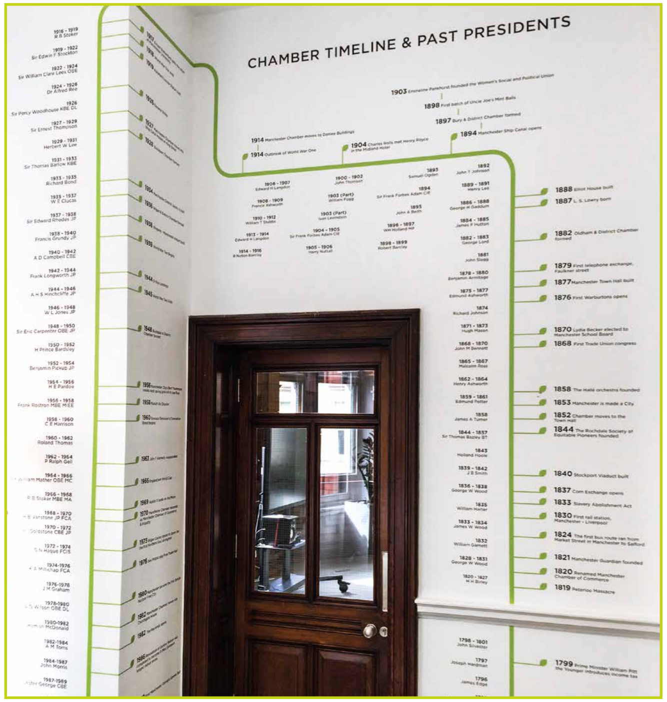
Survey results[vi] show that following uptake of the LW, a majority of London firms reported decreased turnover of staff, cost savings in recruitment and training, and increased employee morale and motivation. The research from the Greater London Authority also showed that five in six employers experienced enhanced quality of work, two thirds saw increased output per employee, and half reported intensified work effort. All but one firm surveyed confirmed positive impacts on recruitment and retention of staff in general, with two thirds reporting a significant positive impact. Analysis of the experience of the 5400 workers at San Francisco Airport who were affected by the implementation of a LW showed a large beneficial impact in a similar fashion[vi]. Across several low-paid occupations staff turnover fell from 95% to 19%; morale, customer satisfaction and overall performance were improved; and there was a significant reduction in employee absenteeism, sick leave and disciplinary hearings. Research covering a number of cleaning firms of various sizes in London[vii] shows an average reduction in staff turnover of 25% relative to comparable non-LW firms, although the impacts differed greatly across the sample. Following a trial period of improving its cleaners' pay and benefits package, Barclays Bank deemed the increased costs to be commercially viable thanks to a fall in employee turnover and absenteeism from 30% to 4%, and increased performance and customer satisfaction. Barclays extended the LW to all its cleaners in 2007[viii]. KPMG had a similar experience, as employee turnover was halved following accreditation, along with reduced training costs and increased motivation[viii]. A study that compared 75 LW firms to 210 others in Los Angeles[ix] found that accredited firms on average saw turnover averaging 17% lower than non-accredited firms. A 60% turnover of its least-skilled employees is estimated to cost Walmart $1billion a year[x], and large companies are increasingly desperate to keep their least-valued workers. A report from 2006[xi] showed that, despite being direct competitors, US retailer Costco could pay its workers almost double that of Walmart subsidiary Sam's Club thanks to the lower turnover and increased number of applications the higher wage encouraged. After all, if an employee stays twice as long, the cost of recruiting and training that person is halved. As Costco co-founder Jim Sinegal put it: *"This is not altruistic, it is good business."* This further highlights the point that the costs and benefits of paying a LW are entirely sensitive to business characteristics, and that whilst the costs are easily accounted for, the benefits may be less obvious in the short run.

PRODUCTIVITY, RECRUITMENT AND RETENTION (CONT)

Evidence suggests[xii] that many firms see productivity increases following increases in the National Minimum Wage (NMW), and such gains should be of particular emphasis amidst current turmoil over the lack of action to combat the UK's seven-year productivity sleepwalk. It is suggested that firms achieve this by removing inefficiencies or introducing different managerial structures following a cost increase. It is also likely that the productivity gains come from increased employee satisfaction and effort, or through reductions in staff turnover allowing firms to retain more experienced and skilled workers. Evidence from many US cases[vii] show that productivity gains primarily stem not from substitution of labour but from existing labour increasing work effort in response to a wage increase. It could also be the case that firms explicitly change operating practices or invest more heavily in training to achieve higher productivity, rather than the gains arising exclusively as a result of wage increases. Whilst it tends to be larger firms that see the highest productivity gains, there is growing support for the idea that productivity gains can be achieved by firms in traditionally low-pay dominated sectors, with evidence showing that US firms in low-paid sectors have seen improved customer experience and cost reductions solely by investing in staff[v]. Furthermore, many LW firms cite the ability to attract better quality staff, although there is evidence suggesting that firms in low-paid sectors may face external barriers to productivity gains such as lack of available skilled workers, lack of managerial expertise or increasing competition. Another concern is that a LW may encourage the substitution of younger, less-skilled labour for older, more highly-skilled labour, having a disproportionate effect on youth unemployment.

There is mounting evidence to suggest that LW policies can benefit the broader economy by stimulating consumer spending. A report from Goldman Sachs showed that increasing the incomes of the lowest paid has a proportionally larger stimulating effect on the economy than increasing wages of those on higher incomes. This is due to the fact that low-paid workers face more essential spending needs, and so tend to spend a greater amount of the extra income. Furthermore, higher wages for the lowest paid can affect the market such that other firms follow suit by increasing pay, further stimulating the economy. In the aforementioned San Francisco Airport study, after introducing a LW the number of jobs at the airport increased, and spill over effects were seen in rising wages of similar professions in the area. This may also be due to the effects accreditation has on corporate social responsibility and firm reputation.

70% of London LW firms stated that being a recognised LW employer had increased consumer awareness of their commitment to be an ethical employer[vii]. Whilst the financial benefits of this are hard to quantify, evidence shows that people want to work for organisations that show values consistent with their own, and that young people in particular believe in responsible business practice as a method of increasing profitability[i]. Likewise, companies that show strong corporate responsibility are more likely to form business connections with others that share the same values.



GMCC has been a Living Wage Employer since September 2014

POLICY IMPLICATIONS

There are a few final points to consider. Firstly, what are the tax and National Insurance Contributions (NICs) implications of paying a LW? A person working 37.5 hours a week on Minimum Wage will earn £13,936 in 2015 before tax, the same person on a LW earns £16,328. The extra income is all subject to both NICs and auto-enrolment pension contributions by the employer. Interestingly, for someone working part-time for 20 – 24 hours a week, the jump from the NMW to the LW will move them over an NICs threshold, wherein employers' NICs rise from between 0 – 3.4% (with a rebate) depending on their status, to 10.8 – 13.4% outright. This is a significant disincentive to firms with many part-time employees, which may explain why 43% of part-time positions offer pay below the LW, versus 13% of full-time roles[i].

It has been pointed out repeatedly over the past few years that the post-tax income of someone earning a LW is "within pennies" of the pre-tax income of a person working the same number of hours on the NMW. In other words, a policy that takes all those on the NMW out of tax and NICs completely, would essentially be equivalent to paying them a LW. This raises some interesting thoughts. Promoting the LW is one thing that all the major political parties stand together on, and it is easy to see why; the increased tax revenue and reduction in benefit payments makes the Treasury the biggest beneficiary. The Conservatives have announced plans to lift those on minimum wage out of tax (but not NICs) by 2020, by raising the personal allowance to £12,500, and are committed both to increasing the NMW to at least £8.00 and the new NLW to at least £9.00 by 2020. Whilst incomes will be increased, those who currently just break the tax-free allowance threshold will step much further over the line and see a higher proportion of their income subject to tax than they do now[1]. This may also discourage moves from part-time to full-time work as the income tax threshold is crossed at a reduced number of hours.

The announcement of cuts to corporation tax was pushed as a sort of relief to counteract the increased costs to businesses of the NLW. In reality the numbers do not add up. Any firms with many workers on low-pay can expect to see the cost of their employees increase quite dramatically with the uptake of the NLW. In fact, an employee on the NMW will cost their employer thousands of pounds more to employ by 2020 through policy changes alone. Simple arithmetic butchers the idea that a 2% fall in corporation tax could offset the price rise for such firms: an employee being £1000 more expensive per year would require £50,000 of new profit to be offset by the move. The tax cut will benefit many businesses with well-paid employees who will not struggle with the NLW, but for many firms and particular sectors it will offer barely any relief.

How beneficial these policies will be to workers in real terms is dependent on the economic performance of the next five years, and so it is difficult to determine whether the net effects of these policies will be sufficient in improving living standards. However the Conservatives have also planned to cut tax credits for working families, which is problematic for a number of reasons. Unless the lost income is fully compensated at the cost of employers, such a policy will likely see a decline in living standards for the lowest paid, increasing the gap between actual pay and an effective LW. Furthermore, the LW calculation itself takes account of tax credits, meaning any tax credit cuts will increase the LW by definition alone.

POLICY IMPACT

In 2020, a full-time employee over the age of 25, working 40 hours a week on minimum pay will earn £18,720 annually, that's £5,200 more than they earn in 2015.

They will pay £1,244 in income tax, which is £714 more than they pay now, and is 6.6% of their total salary rather than the 4% they pay currently. Such an employee may cost their employer a maximum of £5,063.51 more per year in 2020 than in 2015.

In 2020, a full-time employee over the age of 25, working 25 hours a week on minimum pay will earn £11,700 annually, which is £3250 more than they earn in 2015.

They will still pay no tax, and may cost their employer a maximum of £3,111.17 more per year in 2020 than in 2015.

Key Dates:

April 2016:
The NLW is introduced at £7.20 for over 25s.

The Personal tax-free Allowance rises to £10,800

Employment allowance up to £3,000

2017:
Corporation Tax cut to 19%.

October 2017:
Employers' Pension Contribution rises to 2%.

October 2018:
Employers' Pension Contribution rises to 3%.

2020:
The National Living Wage hits at least £9.00, targeting 60% of UK median income.

Corporation Tax falls to 18%.
The National Minimum Wage is at least £8.00

The Personal tax-free Allowance hits at least £12,500

THE NATIONAL LIVING WAGE

In the first all-Conservative budget for 19 years on the 8th of July 2015, George Osborne muddled discussions somewhat by announcing his "National Living Wage". To be clear, Osborne's NLW is not a living wage as we know it, nor does it replace the current NMW outright, and so the first impact of this announcement is to make discussions of either of these concepts unnecessarily cumbersome. Osborne's NLW is set at £7.20 in 2016 rising to target 60% of the national median wage by 2020, or around £9.00 according to estimates. To be eligible for the new NLW workers must be aged 25 or above, making it a new band of NMW rather than a replacement[2]. This is also an attempt to avoid exacerbating unemployment for those under 25 by keeping their labour relatively cheap, although replacement of older workers with younger, cheaper ones may be a side-effect. The Office for Budget Responsibility announced that they expected the increase to cause a loss of 60,000 jobs by 2020, which over the span of five years and amongst new job creation may seem insignificant, but who bears the brunt of this is a major concern. The low-pay sectors previously mentioned such as retail, restaurants, hotels etc. might have the scope to pass the extra cost on to consumers rather than take a hit on their already low profits. Particular sectors like healthcare however, are constrained in ways that could make the cost increase very painful indeed, they may have quotas on the number of staff required per patient for example. With margins already low they may well be disproportionately hit by the rise, and adjustments in employers NICs could pale in comparison to the wage bill increase.

Perhaps more frustrating however, is that the move could be viewed as a political one, potentially at the expense of inflicting damage to all low-pay debate and likely the LW campaign along with it. The Low Pay Commission's Annual Report on the NMW traditionally suggests the maximum increase to the NMW that can be made without causing an unacceptable decrease in employment. In other words, the LPC's work on the NMW is rooted in careful economics and reason. The same can be said of the true LW, being determined by a calculation that takes into account the cost of living, welfare, taxes, inflation etc; everything one would expect it to be based on. Whilst not a replacement for either of these, Osborne's NLW could be viewed as undermining both the work of the LPC and the LW Foundation by throwing the tried and tested methods to the wayside in favour of a much less dynamic one. The estimated 2020 figure of £9.00 is lower than the actual LW in London in 2016. In fact, if we use the ratio of the NMW to the LW since 2012 as a future trajectory, the LW for the UK and London in 2020 would equal roughly £10 and £11.50 respectively, and that admittedly crude calculation takes no account of inflation converging on the 2% target, or the reductions in tax credits that will increase the LW by very definition, or any other unforeseen economic changes over the next 5 years. The target of 60% of the median wage was suggested by the LPC itself, but such a rise in such a short time, being unprecedented at least in the UK, is a big gamble and takes us into uncharted territory. The effects of such wage increases on unemployment is perhaps the most debated and divisive topic within the economics profession, making the policy an important social experiment if nothing more.

The LW Foundation itself may hail the wage increases but ultimately the new NLW could harm their cause. Simply by calling his policy a "living wage" Osborne scratches away at any meaning the term held, and obfuscates the objectives of the campaign itself.

By confusing the two the push for firms to become accredited is likely weakened and so too the benefits seen by those who are already signed up. Once employers start paying the NLW, they may equate this with accreditation from the LW Foundation, and those who are officially accredited may lose their recognition for doing so. Of course, the implications will depend upon how much the two terms become conflated, but it is hard to not suspect that Osborne - ever the pragmatic politician, used this to his advantage in full awareness. Either way, a wage increase is a wage increase, but when confusion lays waste to reason in policy decisions we are all worse off for it.

[1] In 2015, workers who only-just broke the tax-free allowance threshold by working 35 hours a week, 52 weeks a year on NMW (Earning £11,860 with a £10,600 allowance), will see a higher proportion of their income subject to tax (Earning £14,560 with a £12,500 allowance). In other words, the tax threshold will be crossed at around 31 hours a week rather than 35.

[2] It is unclear how the new NLW interacts with the 1% cap on public sector wage

CONCLUSION

So where does all this leave us? If anything can be taken away from the research on the LW, it is that under the right conditions, paying a LW can make good business sense. It can increase productivity, improve morale, reduce staff turnover and absenteeism and improve the quality of work. Whether these benefits are attainable for firms without unacceptable cost increases or other changes however, is entirely dependent on the nature of the business. It is impossible to argue for or against changing wages in any way except for on a case-by-case basis, and the same goes for recommending a LW. This report is admittedly a business-focused one, leaving out any ethical or moral arguments, but when considering all aspects in tandem only one recommendation can be made: if, after careful consideration your business is determined to have adequate scope to cope with increasing wages, there is a strong case to be made for paying a LW. In a business sense all anecdotal evidence points to the cost increases being much more modest and easier to accommodate than expected, and the benefits are overwhelmingly championed by those that have become accredited. The work effort gains should be of particular emphasis amidst current turmoil over the lack of action to combat the UK's seven-year productivity sleepwalk. In the short-term, the benefits are difficult to quantify relative to the immediate financial impacts, making cost-benefit analysis an issue, but the message from accredited firms suggests that implementation of a LW should be viewed as a long-term change management programme to be phased in over a period of 1 – 2 years[xiii]. The tenuous recommendation can unfortunately not become much more than just that due to the endless business characteristics that must be considered. The LW is a moral pursuit that can be recommended to some, but the ethical argument alone is not enough. As the number of accredited firms increase, the available evidence will become more abundant and the case studies will extend to more varied business models, allowing for a more comprehensive business case. This may pave the way for businesses to stop considering higher wages a mere cost, rather than a method of improving production and quality.

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[3]It is unclear how the new NLW interacts with the 1% cap on public sector wage increases.

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