Pay Trends in 2016 and Outlook for 2017

A TUC report

Contents

Section one

Using the outlook for pay to negotiate rises in 2017

A message from the TUC

“Britain needs a pay rise” remains a key campaign for the TUC.

We have made some gains, including persuading the government to increase the national minimum wage for over 25s, which delivered a pay increase for 1.5 million people in April last year.

Former chancellor George Osborne even adopted our language for his 2015 summer budget speech, saying “Britain deserves a pay rise and Britain is getting a pay rise.”

But while we have moved the national debate some way towards fairer pay increases, there is still a very long way to go, especially for the vast majority of workers who make up the “squeezed middle” who, in Chancellor Philip Hammond’s phrase, they are “just about managing”.

In fact, the UK is still experiencing the longest pay squeeze since records began. The average UK employee still earns £1,000 per year less than they did in 2008, once price increases are taken into account.

The impact is particularly extreme in the public sector, which has been facing pay freezes and caps for nearly a decade, but pay parsimony also bites hard across many parts of the private sector.

Squeezing pay is obviously bad for working people and the families. The TUC also believes that the long-running pay constraints have been bad for the economy, leading to greater personal indebtedness and lower demand. Put simply, businesses need customers with money to spend.

We asked IDR to produce this report on the current state of pay and prospects for 2017 for trade unions and their members.

Trade union negotiators will want to bear in mind many of the points made in the report. Average salaries have still not recovered to pre-recession levels, once inflation is taken into account. Economic uncertainty means that there is a real danger that inflation will once again increase faster than earnings during the next year, which would put real pressure on both individual workers and the economy as a whole.

From a trade union perspective, there are many facts in the IDR report that point towards the need for higher pay increases. For example, too many employers plan to give the same pay rise as they did last year, clustering around 2 per cent, and few seem to have factored in the widespread predictions of higher inflation throughout the coming year.

It is also very likely that the triggering of the process for the UK's exit from the EU will also generate more uncertainty, so negotiators will need to keep a close eye on the economic indicators this year as well as looking at the usual issues like the employer's ability to pay.

In addition, the report highlights how growing recruitment pressures in some parts of the public sector may be leading the government to tweak their policy on pay. Public sector negotiators will want to make full use of any opportunities that arise during the coming year.

It is ever more important that working people do not get left behind. Our goal must be to endure that real pay growth strengthens during the coming year. Britain still needs a pay rise.

Section two

Introduction

This report has been prepared by IDR for the TUC and it examines trends in pay and conditions in 2016, and how these trends might develop in 2017. It takes into account what employers have told us about their priorities for the coming year in respect of pay and conditions.

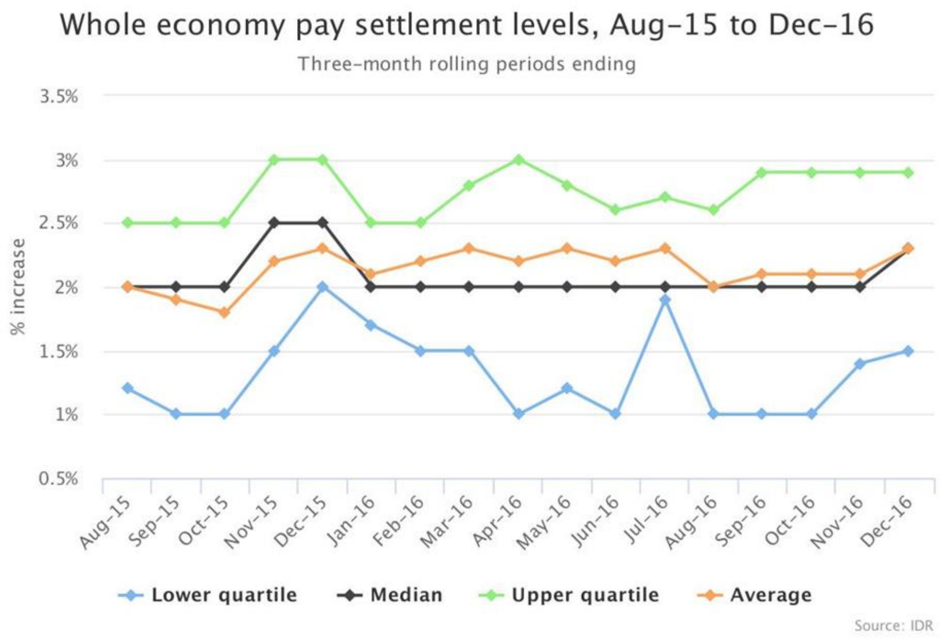
IDR monitors hundreds of pay settlements across all sectors of the economy. It collects this data directly from employers. We use the data to produce an overview of trends in basic pay awards, so that employers and anyone concerned with pay setting can make decisions on pay increases. We also conduct regular surveys of reward practitioners in company, asking them about what has guided their recent decisions and what might influence their future intentions

The report also takes account of forecasts for inflation, the economy and the labour market. Regarding the latter, we comment on how the labour market might be shaped by the post-referendum situation and the prospects of a so-called ‘hard’ Brexit.

Section three

Pay trends in 2016

The median pay settlement for the whole economy in 2016 was 2%. This was slightly lower than the median settlement in 2015, which was 2.2%. The fall indicates the extent to which pay growth has been muted, even though the economy continued to grow and unemployment fell over the course of the year. The main factor in this was low inflation, which made for little upward pressure on prices and therefore on pay. This meant that in real terms, pay rises remained positive, though by the end of the year, as inflation began to rise, this was only just about the case. The vote to leave the EU was not a factor affecting pay awards, since most settlements in most years – and 2016 was no exception – take place in January and April. Indeed, the median in our series rose slightly in the autumn under the influence of higher-than-average awards in retail, as firms responded to the increase in the National Minimum Wage.



Definitions
Median - the middle point when pay awards are ranked by size of increase.
Quartiles – the pay increases at the one-quarter and three-quarter points in the ranking by size of pay increase

Table 1: IDR pay settlement levels, three months to end August 2015 to December 2016

	Lower quartile	Median	Upper quartile	Average	Total*
Aug-15	1.2%	2.0%	2.5%	2.0%	72
Sep-15	1.0%	2.0%	2.5%	1.9%	62
Oct-15	1.0%	2.0%	2.5%	1.8%	46
Nov-15	1.5%	2.5%	3.0%	2.2%	54
Dec-15	2.0%	2.5%	3.0%	2.3%	42
Jan-16	1.7%	2.0%	2.5%	2.1%	43
Feb-16	1.5%	2.0%	2.5%	2.2%	61
Mar-16	1.5%	2.0%	2.8%	2.3%	71
Apr-16	1.0%	2.0%	3.0%	2.2%	104
May-16	1.2%	2.0%	2.8%	2.3%	168
Jun-16	1.0%	2.0%	2.6%	2.2%	162
Jul-16	1.9%	2.0%	2.7%	2.3%	47
Aug-16	1.0%	2.0%	2.6%	2.0%	56
Sep-16	1.0%	2.0%	2.9%	2.1%	55
Oct-16	1.0%	2.0%	2.9%	2.1%	36
Nov-16	1.4%	2.0%	2.9%	2.1%	33
Dec-16	1.5%	2.3%	2.9%	2.3%	24

*Total number of settlements recorded in the three-month period | *Source: IDR*

Sectoral variations

Importantly, there were differences between the various sectors of the economy when it came to pay settlements. While in manufacturing and production, the median increase was also 2% (as was the average or mean rise), in private services the median was 2.2% and the average or mean increase was even higher at 2.6%. As mentioned already, the main influence here was retailers' pay awards, which tended to be above average as they sought to maintain pay rates in line with a higher National Minimum Wage.

In the public sector, the median award remained at 1%, in line with the Government's cap on basic increases. However, the upper quartile was 1.5%, indicating that some public sector awards were above 1%, mainly in areas where recruitment and retention has been made more difficult by the policy limit and slightly higher increases were therefore permitted. We discuss the public sector pay policy in more detail further on in this report.

Distribution of awards

The distribution of pay awards shows that the largest proportion of awards in 2016 were worth between 2.0% and 2.9%, however the proportion of awards worth between 0.1% and 1.9% was almost as great, with the distribution almost showing a bi-modal (twin peak) distribution overall. This is because of the preponderance of awards at 1% - the level of the Government's pay cap – in the public sector, in contrast to the relatively high frequency of awards at 2% or 2.5% in the private sector.

While pay freezes still make up part of the overall picture, they constitute just 6% of the awards monitored by IDR las year. At the other end of the distribution, awards worth more than 4% made up just 9% of all awards monitored by us last year. These include settlements at retailers, responding to the introduction of the National Living Wage, and at some car manufacturers, where pay settlements continue to register above the median for the whole economy.

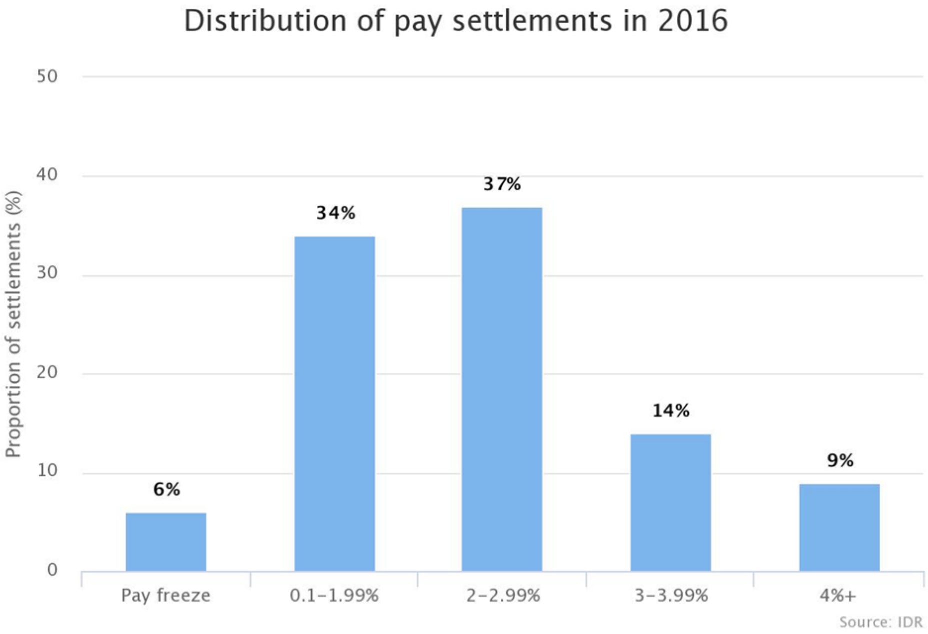


Table 2: Distribution of pay awards in 2016

	IDR pay awards	
	Count	**Proportion %**
Pay freeze	29	6
0.1-1.99%	157	34
2.0-2.99%	173	37
3.0-3.99%	63	14
4.0%+	41	9
Total	*463*	*100*

Source: IDR

Impact of inflation

Inflation plays an important role in pay negotiations and the all-items Retail Prices Index (RPI) while no longer classified as an official statistic largely remains viewed by pay negotiators as the most complete measure of changes in the costs of living. The relationship between pay settlement levels and inflation is a retrospective one, with settlement levels broadly following movements in the RPI, though in the recent period since 2004 settlement levels have tended to peak at around 3% when inflation moved significantly upwards and not fall below 2% when inflation was negative (although we did witness a bi-modal distribution of awards due to a significant increase in the number of pay freezes recorded during that period).

The chart below tracks the whole-economy median, as monitored by IDR, against both the RPI and CPI It shows that the median pay increase has been below RPI inflation each year between 2007 and 2014, with the exception of 2009 when inflation fell into negative territory. Our median moved ahead to 2.2% in 2015 against a backdrop of RPI at 1% and to 2.0% in 2016 against a backdrop of RPI at 1.4%. The median pay settlement has fared slightly better against rises in the CPI – the Government’s preferred measure of inflation and the measure which excludes housing costs – although our median has still lagged behind CPI inflation between 2009 and 2013.

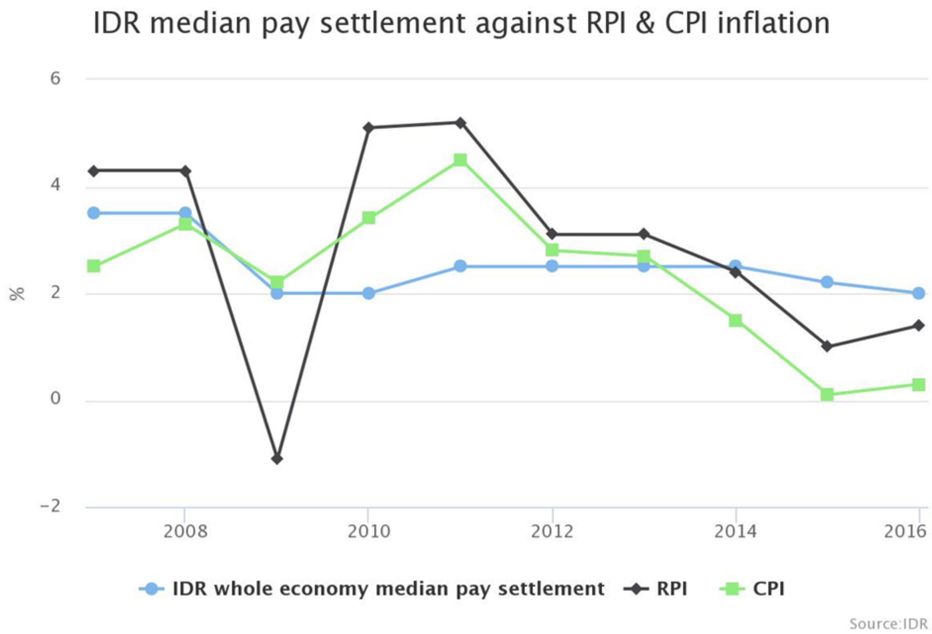


Table 3: IDR whole-economy median pay increase versus RPI and CPI

Year	IDR whole-economy median pay increase %[1]	Inflation[2]	
		RPI	CPI
2007	3.5	4.3	2.5
2008	3.5	4.3	3.3
2009	2.0	-1.1	2.2
2010	2.0	5.1	3.4
2011	2.5	5.2	4.5
2012	2.5	3.1	2.8
2013	2.5	3.1	2.7
2014	2.5	2.4	1.5
2015	2.2	1.0	0.1
2016	2.0	1.4	0.3

[1] IDR settlements cover from 1 January to 31 December

[2] Inflation in the year to May

Source: IDR

Real-terms pay rises

In order to measure the impact of this on real-terms pay increases we have adjusted the whole-economy median increases in each year since 2004 by RPI. The chart below illustrates the gap between the basic award and the real-terms adjusted award, with adjusted awards worth less in each year except 2009, when prices measured by RPI actually fell.

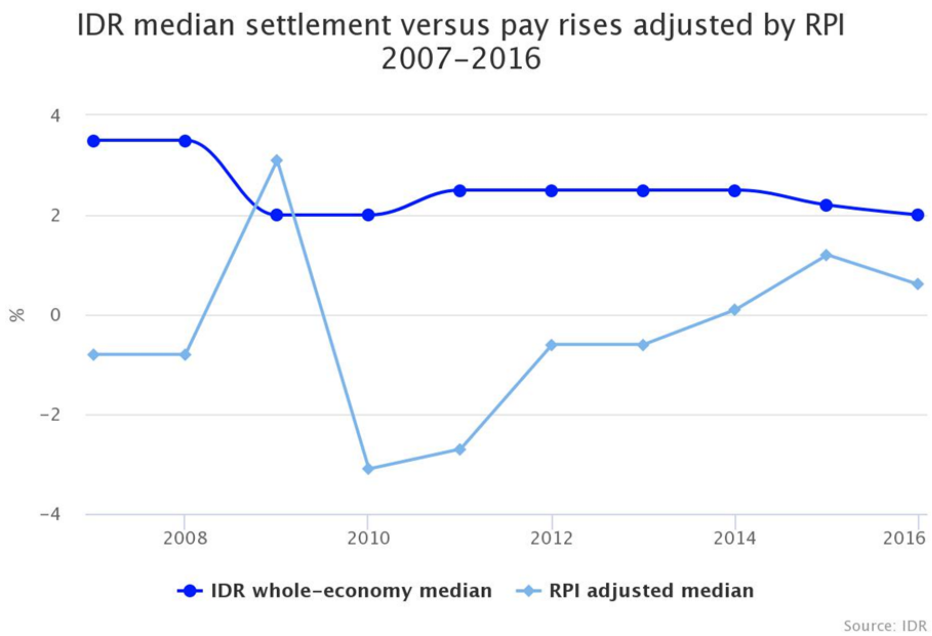


Table 4: IDR whole-economy median pay increase adjusted for RPI inflation, 2007-2016

Year	IDR whole-economy median pay increase %[1]	RPI inflation[2]	IDR median pay increase adjusted for RPI
2007	2.4	4.3	-1.9
2008	2.5	4.3	-1.85
2009	1.3	-1.1	2.35
2010	0.0	5.1	-5.1
2011	0.0	5.2	-5.2
2012	1.0	3.1	-2.1
2013	1.0	3.1	-2.1
2014	1.0	2.4	-1.4
2015	1.0	1.0	0
2016	1.0	1.4	-0.4

[1]IDR settlements cover from 1 January to 31 December.
[2]Inflation in the year to May
Source: IDR

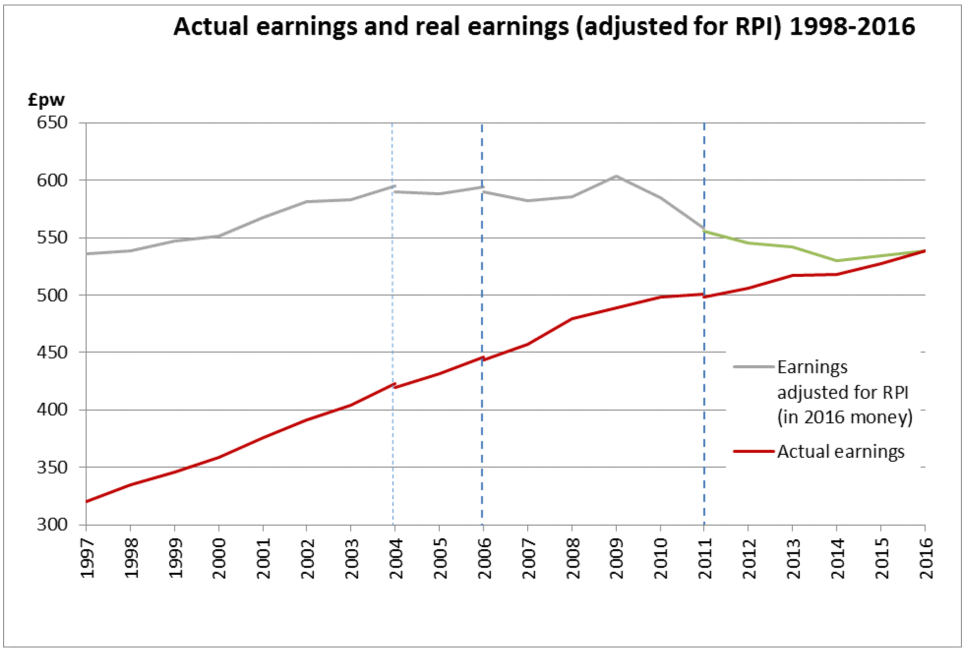
Earnings growth

The Government's Average Weekly Earnings (AWE) series, which is released every month, showed relatively weak earnings growth in the first part of 2016, with total earnings only growing at around the same level as basic pay awards. In the three months to June however, earnings growth strengthened somewhat, to 2.5%, and has remained around those levels.

These figures are different to data on basic pay settlements, since they indicate changes in company pay bills and as such, include all elements of pay, such as bonuses and overtime. Therefore, one might normally expect them to produce higher figures than those for basic pay awards. In particular sectors, such as construction and retail, this has indeed been the case at particular times. However the fact is that for the whole economy the earnings growth figures are lower than pay awards, reflecting changes in the composition of the workforce and hours worked.

Another official indicator of earnings growth is the Annual Survey of Hours and Earnings (ASHE). This is a snapshot of earnings for a 1% sample of employee jobs across the economy. It showed that earnings grew by 2.2% at the median in April 2016, which was broadly in line with the figures shown by the AWE series. The equivalent figure for those who remained in the same full-time job between 2015 and 2016 – around two-thirds of the ASHE sample – was much higher, at 4.6%, an indication of the impact of the new 'National Living Wage' and progression increases in addition to annual pay reviews.

In real terms however, pay growth was weaker: 1.9% using the Government's favoured CPI measure of inflation, and just 0.9% using the RPI, which is more commonly used for pay setting. The graph below shows actual earnings from ASHE compared with real earnings, adjusted by the RPI. Real weekly earnings in April 2016 remained almost 11% down on the peak figure of £604 (as adjusted for 2016) prices in April 2009. So while real earnings growth has returned, some years after the recession, this trajectory will need to be maintained for a number of more years before real earnings catch up with the rates of earnings growth seen before the economic crisis began.



Section four

Impact of the 'National Living Wage'

The Government introduced a new age-related top-up to the National Minimum Wage (NMW) with effect from 1 April 2017. Set at an initial rate of £7.20 an hour for employees aged 25 and over, it was termed the 'National Living Wage' (NLW). The title appeared to appropriate the terminology of the campaign being conducted by the Living Wage Foundation. It is however lower than the £8.45 which the latter organisation currently estimates to be the hourly rate necessary for a socially acceptable standard of living outside of London (the 'London Living Wage' is estimated to be £9.75 an hour).

The new rate was almost 7.5% higher than £6.70 an hour, the then NMW rate for employees aged 21 and over. As such, it had an immediate impact in low-paying areas of the economy. For example, our survey of pay in the retail sector in the winter of 2015/16 found a median rate for front-line staff of £6.84. This year, we have found that the median is £7.20, identical to the NLW rate. This is a result of many large employers in the sector paying all staff at least £7.20, regardless of age. And many retailers now pay basic rates significantly ahead of the NLW. For example, our monitoring of pay rates across the retail sector show food retailers with rates as high as £8.40, and in non-food retail the highest rate is £8.25.

However in order to boost basic rates of pay like this, many large employers also made changes to other elements of their reward packages. In a number of cases, premiums for working overtime, or for weekends and bank holidays, have been reduced[1]. And other elements of pay have been cut back as well. The result was that the initial expected impact of the NLW on earnings growth failed to materialise, as these measures offset the boost to basic rates

In particular, the AWE series for wholesale, retail, hotels and restaurants failed to register much of an effect from the new higher minimum in the months immediately after its introduction. For example, in the three months to the end of April 2016, year-on-year earnings growth in this sector was just 1.3% (later revised upwards to 1.5%), up a little on the previous three-month figure of 1% for January to March. The

[1] These premiums are not under the same sorts of pressures in other parts of the economy. For instance, our research in call centres and engineering shows that in both these areas, premium pay for unsocial hours working remains common, with little evidence of downward pressure on the amounts on offer. Rises in the NMW and now, the NLW, have added to the pressure on these elements of earnings in a sector like retail where the growth in the number of students working part-time provided employers with an opportunity to reduce premiums for working periods that for other workers, e.g. those with dependents, would be seen as unsocial.

single-month figures for the sector showed stronger growth, of 2.3% in the year to April, up from a negative -1.4% in the year to March. But in terms of actual pay there was little movement in the sector between February and April: in February average weekly earnings were £338, in March £336 and in April £339.

The likely explanation for this is that cost-offsetting measures to minimise the impact of the NLW, such as the reduction or removal of premium payments, might have had the effect desired by employers, countering the increase in basic rates. Earnings grew a little stronger over the subsequent months, however, reaching a peak of 3.8% in the three-month average for the year to the end of October. The NMW was raised by 3.7% in October and this, together with relatively higher percentage rises under annual pay reviews at many companies in the lower-paying areas of the economy, is likely to have influenced the rate of increase. For example, one large supermarket raised pay for all staff by 4% for the second year running, with effect from 28 August 2016. A number of other retailers raised pay for retail staff by 3%.

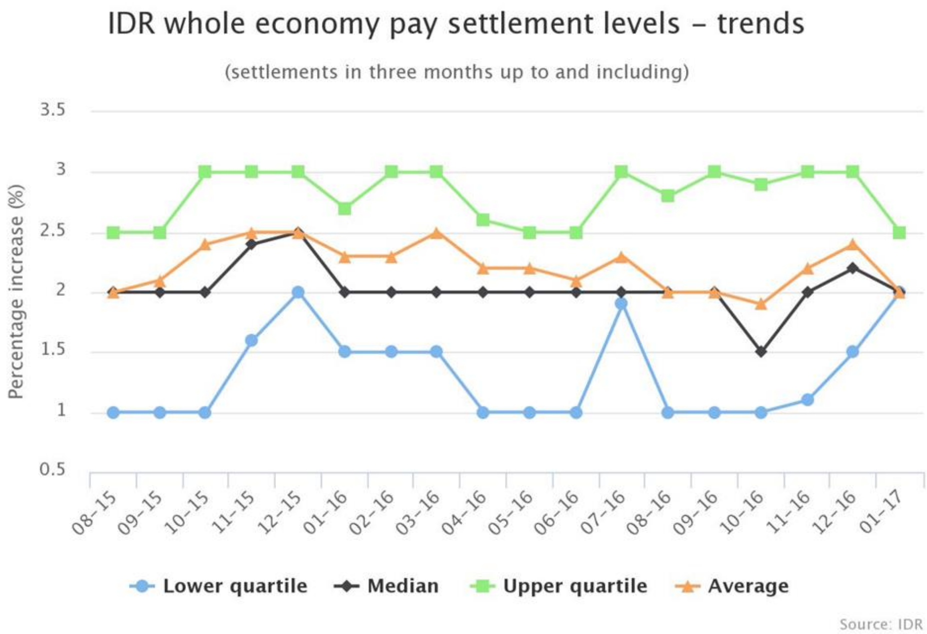
The NLW produced a modest impact on the ASHE pay figures[2] , helping to raise earnings growth at the median from 1.8% to 2.2%. It made for the fact that the greatest increase in earnings was seen at the bottom of the distribution – hourly earnings for full-time jobs increased by 5.9% at the fifth percentile from £6.86 to £7.26 between 2015 and 2016, compared with a rise of 2.5% at the 95th percentile, the top end of the distribution. The advent of the NLW also made for an increased concentration of pay at the bottom of the earnings distribution, with a sharp spike around the £7.20 an hour mark

Prospects for 2017

The median pay award across the whole economy was 2% in the three months to January 2017, according to the latest monitoring figures from IDR. The median had ticked up to 2.2% in the period to December 2016, driven in part by pay awards in those sectors most influenced by increases in the National Minimum Wage.

Now these awards have dropped out of the reference period, the median has returned to the level recorded during much of 2015 and 2016. The latest figures are based on 45 pay awards, covering 138,358 employees in total. Notable January pay reviews include the deal at one major car manufacturer, where employees received a basic rise of 2.75%, plus a £750 lump sum, in the first year of a new two-year agreement at the car maker where some staff, those not at the top of their pay band, are also eligible for additional merit-based pay rises.

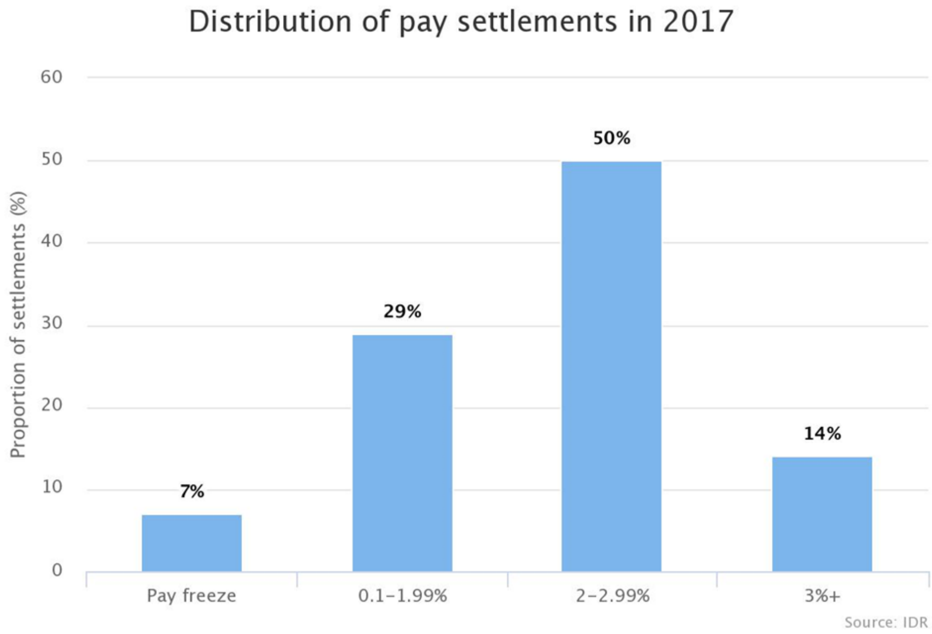
[2] Note that ASHE may not have recorded all the NLW effect, as the new rate applied to the first pay period after 1 April, so some weekly paid staff may not have received the increase until after the ASHE survey was compiled.



The interquartile range, where half of the awards are set, has contracted to between 2% and 2.5%. This reflects a much narrower variety of pay outcomes than in the three months to October, when half of all settlements fell between 1% and 2.9%. The proportion of awards worth less than 2% has fallen from 42% to 25% in the latest quarter, partly due to the absence of public sector pay deals during this period.

While very few employers are agreeing deals below 2%, we have not detected a corresponding rise in higher-end deals. Less than a tenth of settlements in our sample were worth 3% or more, compared to a quarter in the three months to October 2016. As a result, more than two-thirds of deals are being recorded between 2% and 2.99%. The most common settlement across every sector of the economy was 2%, with close to a third of deals in our sample worth 2% exactly. The effect of deals clustering around the median figure of 2% mirrors the trend recorded throughout much of the past two years, although it is too early at this stage to predict whether 2017 will continue along the same lines.

So far, however, the picture on pay for this year looks very much like that for last year. This is in line with what HR practitioners told us when we surveyed them last summer about their pay intentions for the year ahead. Then, the majority (two-thirds) indicated that they were likely to award the same pay rises as in 2016. However, we also surveyed engineering employers, most of whom awarded lower increases in 2016 than they had in 2015. When we asked them about their future intentions on pay, nearly two-thirds said they were likely to reach a higher pay settlement in 2017 than they had in 2016.



We conducted our main survey of employers' pay intentions shortly after the vote to leave the EU. We asked companies about the effect that Brexit was likely to have on their employment and pay policies. The responses indicated that, at that point, the vote was having little direct impact on firms' plans. However, economic concerns following the vote may have added to the existing emphasis on affordability when it comes to pay rises. With most employer's also predicting little change in their headcounts, the referendum result probably heightened employers' caution. Further to this, when we asked engineering employers about the likely impact of Brexit on their employment strategy, almost a third said they were unsure, indicating that at this stage at least, it was too early to tell.

But what has altered since we conducted the survey? Are there any countervailing upward pressures on pay? The main change is that inflation has begun to rise, mainly as a consequence of the fall in the exchange value of sterling and the effect that it is having on import prices. Higher inflation is likely to place upward pressure on pay settlements, but with a time lag, and this potential upward pressure will only be realised if the economy and labour market both remain in robust shape.

The annual uplifts in the NMW and NLW will be aligned in April from now on, and on 1 April 2017 the NMW rate (for 21 to 24-year olds) is set to rise from £6.95 to £7.05 an hour, while the NLW rate for those aged 25 and over will rise to £7.50. This will place additional upward pressure on pay in retail and other low-paying areas of the economy. As long as economic growth continues, the NLW is set to rise by a similar amount each year until it reaches 60% of median earnings in 2020. This could be £8.60, according to estimates from the Low Pay Commission, the body nominally responsible for recommending the level of the statutory minimum.

The new regulations on reporting gender pay gaps don't constitute a pressure as such, since they're aimed at trying to gently encourage employers to equalise pay between genders and ethnicities, which may lead to pay rises for some, though not in every case, since it is possible to equalise down as well as up. Whether they have sufficient teeth to achieve their aim is another matter.

At least though, the regulations have already encouraged many large employers to calculate their gender pay gaps – over half of the employers in our survey had calculated theirs, well ahead of the required publication date of 1 April 2018, and the remainder said they would tackle this in 2017. However, a lower proportion of our survey respondents, 27%, had gone further and carried out full gender pay audits, and one question is whether and by how much this proportion might rise, and what the results might be for employees.

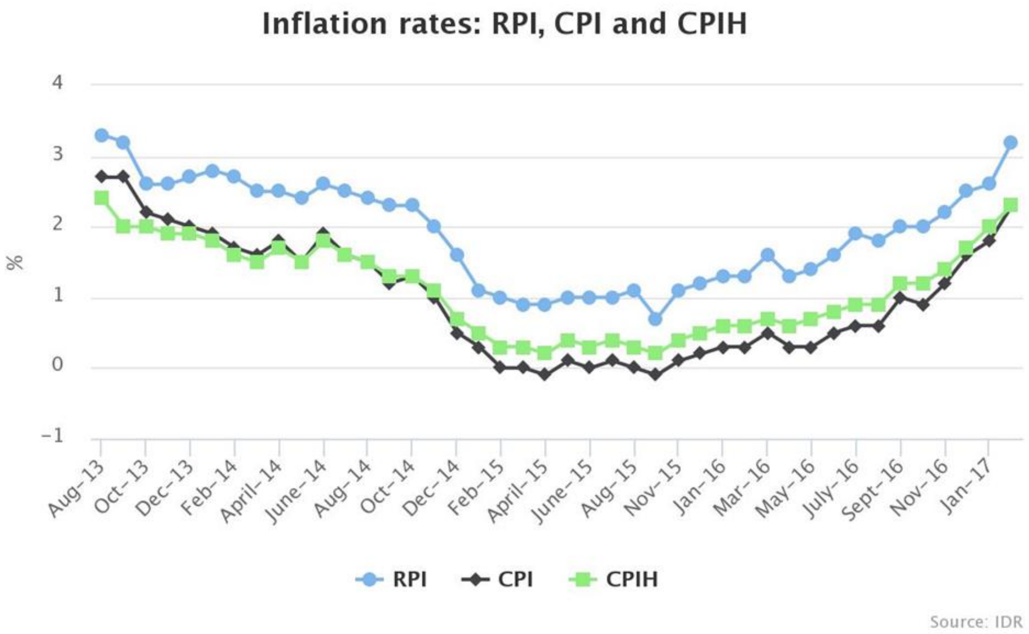
Inflation

Employee aspirations have assumed greater importance in pay reviews, according to employers. Some 42% of this reported it as a 'very important' or 'important factor' when it comes to setting pay, up from 20% in our previous survey. This is likely to come into greater focus if inflation continues to rise (see chart below), since employees will hope that their wages can remain sufficient to maintain their living standards.

Inflation itself remains a prominent factor when it comes to pay reviews. Some 64% of employers in our survey rated the cost of living as 'very important' or 'important'. Pay settlements are likely to respond to higher inflation, but with a lag. And given that most pay reviews take place in either January or April, most employers will want to settle quickly for 2017 before inflation rises further.

When it comes to the cost-of-living figures used for decisions on pay, the RPI is no longer a 'national statistic' but continues to be produced and published by the Government, and remains the pre-eminent measure for inflation when it comes to setting pay increases, although the Government's preference for the CPI means that employers are also taking this measure into account, though to a lesser extent than with the RPI.

However the Office for National Statistics has made the currently experimental 'CPIH' figure its preferred measure of inflation. What effect might this have on pay-setters' practice in respect to their choice of inflation indicator? The CPIH represents an attempt to overcome the shortcomings of the CPI, which does not include any measure of housing costs, unlike the RPI. In this respect the CPIH could be more useful than the CPI. However the CPIH's use of private sector rental values as the basis for its estimate of owner-occupier housing costs has been criticized as an inadequate way of assessing changes in house prices and the costs associated with mortgage payments.


Inflation rates: RPI, CPI and CPIH
4
3
2
1
0
−1
%
Aug-13
Oct-13
Dec-13
Feb-14
April-14
June-14
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Aug-15
Nov-15
Jan-16
Mar-16
May-16
July-16
Sept-16
Nov-16
Jan-17
RPI
CPI
CPIH
Source: IDR

Section five

Inflation forecasts

After the sharp rise in RPI inflation in the year to February, economic forecasters have had to revise their assumptions about the likely path of inflation. Inflation rose to 3.2% in the year to February, up from 2.6% in the year to January. The increases were higher than predicted, and were due to increases in prices for oil and petrol on the one hand, and food on the other. In the case of food prices, increases are mainly caused by the impact of sterling's depreciation.

Averaging all the predictions from our panel of City economists produces a forecast that sees the RPI rising to around 4% in the year to August, and peaking shortly after at around 4.2%. After that, most economists think that inflation will subside slowly.

The predicted increase in the cost of living is based on the relatively rapid transmission of effects on import prices from the fall in sterling's value to items like food. In addition, the higher-than-expected electricity price rises announced recently have played a major role in economists' assessment of the outlook.

Further ahead, possible factors involved in inflation falling back slowly in early 2018 include slower GDP growth (see below) and lower house price inflation. And some economists think that services inflation should remain muted as consumer purchasing power is squeezed by rising goods prices. Finally, oil prices have not risen as sharply as predicted and look to be holding steady, though recent events in the Middle East could have the opposite influence.

An important factor in the medium- to longer-term outlook for inflation will be whether or not economic growth slows, for instance as a result of Britain leaving the EU. So far the economy has continued to grow, despite predictions that it would falter. But the actual break with the EU is yet to take place. If the economy does weaken, then this could mute the effects from the drop in sterling and higher energy prices; if inflation remains high in these circumstances, then the economic situation could be characterised by 'stagflation', a combination of low or no growth and high inflation, something the Bank of England and the Government, as well as most other economic actors, will wish to avoid.

All the analysts predict that CPI inflation, which does not include a measure of housing costs or other associated elements, is likely to rise further above the Government's target of 2%, and might only return to target in 2019. Most economists have not moved to produce estimates for the alternative CPIH measure, which does include an indication of housing prices – via imputed rents. The Office for National Statistics made CPIH its preferred measure of inflation in March. However this measure remains 'experimental' and the CPI is still the Government's target for macroeconomic purposes

Inflation forecasts

Section six

Brexit and the labour market

The vote to leave the EU was predicted by many analysts and economists to have immediate negative effects on the UK economy. So far, however, those effects have yet to be realized, with most of the data relating to the economy continuing to indicate a positive picture. The main negative effect has been the fall in the value of sterling, which is prompting inflation to rise. These predictions have, nevertheless, been an important factor in conditioning the responses of many economic actors. In some ways, forecasts represent an attempt to influence the future, even if, by definition, this is impossible to achieve.

But the negotiations to leave the EU have only just begun, and in such circumstances, it is reasonable to conclude that the potential effects of Brexit are unlikely to materialise until these get under way, and further ahead, until the UK's departure is finally concluded. This is where predictions about what could happen are important.

In June 2016, just before the referendum, the National Institute of Economic and Social Research (NIESR) modelled the short-term and long-term effects of Britain's leaving the EU[3]. In the short term, NIESR predicted that the UK economy could be around 2½ per cent smaller two years after what turned out to be a vote to leave the Union. The same report correctly predicted the rise in inflation resulting from a depreciation of sterling.

It also predicted a sharp fall in business investment, of just over 10% in the third quarter of 2016. But the actual picture has been less dramatic, and more mixed. On the one hand, private sector investment indeed fell in the third quarter of 2016 compared with the same period in 2015, by 2.2% according to the latest data from the ONS. And importantly, this marks three consecutive periods of negative growth in business investment when compared with the same quarter a year earlier.

But compared to the previous quarter, business investment in the third quarter increased by 0.4%, and this was the second consecutive period of positive quarter-on-quarter growth following a 1.2% increase in the second quarter of 2016. According to the ONS, business investment is now 7.5% above its pre-economic downturn peak in the first quarter of 2008.

This more mixed, and in some ways positive picture on investment is one of the reasons why employment remains stable and high, unemployment remains comparatively low (though not in every area of the UK – there are 'cold spots' with

[3] 'Modelling events: the short-term economic impact of leaving the EU', Baker et al, June 2016 and 'Modelling the long-run economic impact of leaving the European Union', Ebell et al, June 2016.

high joblessness in a number of places) and earnings growth has risen a little on the latest figures (2.8% in the year to November 2016).

Given this, the longer-term outlook is the more important one. Also, as the NIESR long-run report points out, any short-run shocks as a result of the vote itself are likely to fade out in the run-up to Brexit. Indeed, they have begun to do just that, to the extent that they materialised at all. According to NIESR, only in 2017 are economic actors likely to begin to anticipate any long-run shocks.

In the longer term, NIESR (along with the Treasury) is most concerned about the prospect of a permanent reduction in the size of the UK's export market share in EU member countries. It predicts that if this comes to pass, then this would be the main mechanism by which the UK leaving the EU could lead to a decline in both consumption and GDP. If this does happen, then there is likely to be an impact on the labour market, with negative effects on employment and wages.

Brexit raises a number of questions about the labour market in particular areas of the economy. In the public sector, the Government's requirements for the Brexit negotiations may make for a short-term positive effect on the recruitment and retention of trade lawyers and negotiators, and associated specialists and support staff. But an important question here will be whether there is any direct financial penalty to the Treasury for leaving, and whether and to what extent this can be offset against current Treasury contributions to the EU.

In the private sector, the Government will hope to minimise the effects resulting from Brexit on the terms of trade affecting such key sectors as engineering and finance. These are areas where access to EU markets is very important: for parts and raw materials on the one hand, and exports on the other in the case of UK engineering, while the City of London is the EU's main source of investment finance. Will companies that have manufacturing bases in both the EU and the UK be subject to tariffs on UK-produced goods entering EU markets? And will the City be able to maintain its pre-eminent position in financial markets? Answers to both these questions will have significant implications for employment and reward in these sectors and the other parts of the economy to which they are connected. If the costs of conducting business with Britain's main markets are increased, employers are likely to look to balance these increases with costs reductions in other areas. This could involve reducing unit costs by raising productivity, or by reducing labour costs, or perhaps both.

Finally, many parts of the economy depend on migrant workers. The NHS, construction, food processing and finance are just four of the different areas that do so. Controls on immigration, and/or a rise in xenophobia, could reduce these flows and make it more difficult for organisations to recruit and retain key staff.

Therefore the question that arises here is the extent to which any change in migration patterns affects recruitment and retention. While some might hope that this could raise wages in these industries, the relationship between the two is not straightforward. In the NHS, pay is set according to an interplay between

Government policy and national negotiations between the health service unions and the national employers’ body; wages in construction have been rising strongly in any case; and while in food processing wages are comparatively lower, there is little evidence that this is mostly due to migrants. While migration has had a small effect, other pressures, such as technological change and crucially, the decline in collective bargaining, are likely to have had a greater effect. While employers have most power to influence the former, trade unions have a crucial role in the latter

Section seven

Public sector pay

Government policy on pay appears to be shifting slightly. The formal policy remains a low limit on basic pay awards of 1%, the main context for which is the Government's position on the funding of public services. While the recent autumn statement dropped the previous time scale for deficit elimination it retained the principle of austerity and spending restraints. However, with employment in the private sector continuing to rise and after a number of years of strict pay restraint, evidence is beginning to emerge that recruitment and retention pressures in parts of the public sector are increasing, particularly but not exclusively in those areas where competition with the private sector is sharpest. And future skill needs, as the UK moves towards leaving the EU and renegotiating the terms of its trade with both Europe and other international partners, are an important aspect of the situation in parts of the civil service.

As a result, some changes in the application of the policy are taking place. In the civil service, the Government has signalled its intention to utilise the limited flexibility inherent in its policy on pay to provide special treatment to a number of groups: commercial specialists, 'digital, data and technology' specialists, science and engineering roles, technical specialists (including data analysts), and senior civil servants.

The Government's emerging requirements may also be a factor behind an apparent softening of the policy in relation to pre-set quotas for performance-related pay increases in the civil service. Widely disliked by staff, these meant that managers were compelled to place pre-determined proportions of staff in the different performance categories of 'expected' (65% of staff), 'exceeding' (25%) and 'poor performance' (10%), with those in the latter receiving no pay increase. New arrangements will be based on principles that no longer require departments to operate these quotas.

There is already some evidence of variations from the letter of the policy in the civil service. For example, the latest pay award at the Oil and Pipelines Agency was 1.3%, while marine surveyors recently secured a pay deal worth 2% many staff, and increases for staff at both the Scottish Government and Scottish Parliament were higher than 1%, with 1.5% on all scale maximums at the former and 2% on scale maximums at the latter (though all other points were increased by just 1%). Progression pay also remains in place in these bodies, something that has been under pressure and in some instances has gone by the board south of the border. (For example the new deal at the DWP pays above-average increases in return for a phasing out of progression and a move to spot rates of pay for the main clerical grades.) The Scottish context is perhaps unique however, with the SNP administration ensuring that the effects of austerity are more muted for public servants there – this has also been a factor behind higher pay rises in local government in Scotland, with increases of 1.5% and the implementation of a minimum wage of £7.97.

Last year teachers in England and Wales saw their scale maximums increased by 2% on the back of recruitment and retention pressures, though the outcome reverted in 2016 to 1% for all. Another group set to receive 'special treatment' as a result of recruitment and retention issues are NHS paramedics. This group are to be re-banded nationally from band 5 (currently eight points from £21,909 to £28,462) to band 6 (nine points from £26,302 to £35,225). A new job profile for band 6 has been agreed and salary moves resulting from matching paramedics' jobs to the new profile will take effect from 31 December 2016.

There is less pressure in respect of staff morale (apart from perhaps the moves on ending quotas for performance-related pay rises mentioned earlier and moves in the prison service to rise pay and boost staffing numbers), though this may emerge as more of an issue in respect of the second influence on Government pay policy – the prospects for higher inflation, already discussed. There is also the possibility that the Government could return to the issue of public sector pensions. Improving base pay could well be important to public servants in the light of any future moves to worsen pension provision further.

The Government's pay policy appears to be under a certain amount of strain. However the extent to which this affects application depends on a combination of the economy and the labour market. These remain broadly healthy for the moment, with economic growth positive and unemployment low. If growth falters, however, an even tighter policy might be in prospect.

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