SMF Social Market Foundation

EMPLOYMENT, SKILLS AND GROWTH

EMRAN MIAN

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While the return of economic growth to the UK has been coupled with high levels of job creation, levels of pay – linked to low productivity growth – remain a big issue. In this paper, we look at two aspects of the challenge: the interaction between skills and wage prospects; and the prospects for spreading the dividend that appears to arise from continuous as opposed to short-term employment.

1. BOOSTING THE SKILLS AND WAGE PROSPECTS OF THE LOW PAID

One in five of all workers in the UK are now in low pay.[1] This is high by international standards and it has stayed high for a long time. Of even greater concern than the mere numbers in low pay, is the fact that a large proportion is stuck in low pay.

In recent work[2], we calculated that some 2.9m workers in the UK start off in low pay and remain in low paid work for at least a year. This equates to one in every eight workers. The numbers that remain in low pay for longer periods of time are worryingly large – a quarter of the low paid remain stuck in low pay for a decade or more.

This lack of mobility is hugely problematic.

- It means that being in work often does not offer a route out of poverty;
- It necessitates large state subsidies for working households – the state expends around £21bn on tax credits for those in work; and
- It undermines the productivity of the UK economy – because potential talent in parts of the workforce remains under-utilised.

Of these three problems, it is the productivity challenge that is the most fundamental: leave it unaddressed and the social and fiscal difficulties can only persist and worsen. UK productivity lags behind comparator countries. UK productivity (in terms of output per hour) was 16 percentage points below the average for the rest of the major industrialised economies in 2012; and 24% behind comparators such as France and Germany.

The UK cannot address its low pay problem without addressing this productivity shortfall. To this end, policymakers should seek to boost the skills and productivity of those stuck in low paid work. We can make a strong case to businesses to pay their workers more if these employees are made more valuable to them.

WHY SKILLS SHOULD BE AN ANSWER

There is a strong case for investing in skills provision to boost the productivity of those stuck in low pay. Three in ten of those on low paid do not have officially-recognised qualifications; a further one in five is educated only to GCSE level. In other words, amongst the low paid workforce lie many of the poorly-skilled individuals who require assistance to progress. Meanwhile, the latest Employer Skills Survey finds that employers report significant skills deficiencies in generic skills; in the three bottom level occupations where low paid work is concentrated, employers report that 656,000 workers have insufficient skills to carry out their current role.

Our analysis shows that for those in low pay the association between training and occupational progression is strong. Those least likely to move occupational group were those on low pay who did not receive training. On receipt of training the low paid become the most likely to progress up the occupation bands. These findings complement other evidence that skills qualifications can help boost the earnings of the low paid. For instance, research by the Department of Business, Innovation and Skills has shown that on average achieving a Level 1 qualification adds about 10% to the earnings of a worker.

Despite the advantages that typically stem from training, the low paid are the least likely to receive training, to be offered it by their employer and to take it up when it is offered to them. A whole range of factors suppress take up, including cost and time constraints.

In the context of a narrowing UK skills budget and with the introduction of loans as opposed to grants for those aged above 24 seeking to access vocational education, this problem is likely to worsen rather than improve. The Government's ambitious apprenticeships policy and the proposals from all political parties to prioritise improvement in school education and support to the young are necessary steps. But, with 80% of the UK's 2020 workforce already of working age, much more needs to be done to boost their skills levels.

STACKING UP THE BUSINESS CASE FOR INVESTING IN THE SKILLS OF THE LOW PAID

Our work makes the case for adopting an approach that would encourage firms to up-skill those stuck in low pay without additional costs to the public purse. A number of schemes – including the Youth Contract – attempt to use projected savings to the Exchequer to achieve specific goals on employment and wage levels. Our research finds a strong case for using the same principle to invest in the skills and productivity of those stuck in low pay, and specifically those who typically receive less support from government, namely those over the age of 24.

So, how much might be saved to the public purse?

We estimate that under a revenue-neutral scheme the Government would be able to spend over £2,000 on each person stuck in low paid work through a mixture of training costs and financial incentives. Drawing on government and academic studies, we calculate a central estimate of 10% as an earnings premium that comes from a nationally-recognised skills qualification. Such increases could have a dramatic effect: increasing household incomes and yielding significant savings to the Exchequer. For a typical full-time low-paid worker earning £7 per hour (approximately mid-way between the National Minimum Wage and the low pay threshold), over £800 would accrue to the Treasury each year in increased tax receipts and lower benefits paid out. For some households with larger families or where housing benefit payments are high the savings are even more significant. Were the state to capture these savings over the course of a parliament, it would enable a significant pot with which to invest in training and incentivise participation so as to address the lack of skills provision and take up for those stuck in low pay. Even allowing for a more pessimistic estimate of the earnings premium of 5%, the government would still be able to invest upwards of £2,000 were the savings to be captured over the course of a parliament.

The gains to the household are also significant. A single person without dependent children living in Birmingham would take home £555 extra per year (net of tax and benefits).

In terms of delivering this new skills training, what we have called a 'Skills for Progress' agreement, employers will be free to organise themselves into partnerships. We envisage that some smaller firms – who typically have more limited progression opportunities internally as well as limited human resource capabilities – may wish not to administer the scheme themselves. For those firms that do not wish to participate in this scheme on their own, it may be that Local Enterprise Partnerships (LEPs) could take responsibility commissioning training on their behalf. These business-led sub-regional partnerships would be able to draw down funding – as part of their City Deals or Growth Deals – to invest on behalf of SMEs in their region. As with City Deals, the outcomes risks could be shared between national government and LEPs. As well as commissioning training, LEPs would be well-positioned to coordinate advice and HR support that, alongside training, could facilitate progression.

Boosting the skills of those stuck in low pay would make these individuals more valuable to UK firms and to the UK economy, unblocking the barriers to career progression.

2. THE DIVIDEND FROM CONTINUOUS EMPLOYMENT

While the recognition that the UK has a problem with high numbers of people in low pay has been growing, the value of continuous employment has had less attention, including from think tanks like ourselves. There is perhaps a 'classical' view which can be summarised as follows: the UK has chosen a more flexible labour market than many of our European neighbours, which may well mean fewer rights for workers, or lower pay, though that has in turn meant higher levels of employment, more freedom for enterprise and hence higher productivity.

We have already observed that pay growth is limited even as the economy has returned to growth after the Great Recession; and productivity is in the sink, adrift from many of our peer economies. In these conditions, the political conversation is now perhaps beginning to recognise that the 'classical' view is mistaken.

Certainly the mood has changed since the start of the Coalition. There were early moves to restrict access to employment tribunals. The Conservatives commissioned Adrian Beecroft, a venture capitalist, to suggest even more radical options for limiting employment rights. But then opposition from Liberal Democrats, specifically Vince Cable, the Business Secretary, ran those proposed changes into the ground. More recently, Cable has launched a new review into employment rights, reporting next March, which is expected to embark in the opposite direction – enhancing protections rather than diminishing them. Labour has gone on the attack over zero hours contracts and enforcement of the minimum wage. Conservative Ministers too have been commenting that wages for those in continuous employment are rising by a healthy slice above inflation, certainly more strongly than wages for the average worker.

WHAT BENEFITS MIGHT CONTINUOUS EMPLOYMENT PRODUCE?

Employees in continuous employment are likely to have a stronger bargaining position. Equally their productivity may increase as they become more attuned to their work, either as a matter of course or because the firm has provided training. Over time they may be expected to move to roles within the firm that are ever closer to an optimum fit for their skills and aspirations. If they produce more by doing so, the firm benefits; and then it looks like they get paid more, so in the end everyone wins.

Continuous employment has other more social benefits too. It's likely that workers with the certainty of long-run work are more confident about balancing work with caring for parents, children and grandchildren. They are more likely to volunteer, bringing their skills from the labour market to civil society. The big picture is this: we're living for longer, starting with our grandparents and parents - which expands the demand for care; and the state is getting smaller, already over this Parliament and perhaps further over the next one – which suggests gaps in the social safety net that active citizens may be able to fill.

All that said, observing the benefits of continuous employment is much easier than adopting policy that leads to more of it. The reality is that the decision to convert temporary into continuous employment will be made by employers – and ought to be made by them too, as they are the best placed to judge what their business requires and what workers can best support productivity improvements.

PROMOTING CONTINUOUS EMPLOYMENT

Nevertheless it is likely that a stable macroeconomic environment, good access to finance and sustainable rather than ever-increasing levels of regulation – issues on which there is a high level of all-party consensus - will give employers the confidence to retain more workers. On top of that, there are already some financial incentives from government to encourage businesses to keep people in continuous employment. The wage incentives offered since the Great Recession to employers for taking on young people do not kick in until the job has lasted six months. The incentives for taking on apprentices require that the apprenticeship is at least one year long. From 1 April, there has been a new employment allowance, reducing the National Insurance Contributions to be paid by businesses by £2,000. While the Coalition has typically spoken about this as a measure to promote new employment, it will be available to employers regardless of whether their employees are new or not. In this sense, the measure does not support new jobs directly, though it certainly reduces the cost of offering stable jobs. That is a good thing.

One change in the structure of the economy which may lead to further improvement in the proportion of continuous employment is growing the level of business diversity. The UK has lower levels of business diversity than many of its peer economies, that is to say there are fewer employee-owned firms or mutuals as a proportion of the business population. This matters because employee-owned firms may have higher levels of performance than others. A meta-evaluation of studies of the effect of employee ownership in the USA showed that, when ownership is distributed to employees, productivity improves by an average of 4.4 percent in that year, and that this higher productivity is maintained subsequently.[3] Equally there is evidence to suggest that employee-owned firms outperform other firms across the business cycle – doing almost as well during periods of growth and very significantly better during tougher times.[4] In our view, policy could be more aggressive in trying to grow the population of these businesses. We have advocated Incentivising firms to offer shares to new recruits. This could be done by guaranteeing relief from employer National Insurance Contributions for a five year period to all firms that provide shares to new hires. There would also be benefits to winning external investors over to the wisdom of employee ownership by offering a capital gains tax relief to new investors who invest at the same time as employee ownership is introduced.

ENDNOTES

[1] Calculated as two thirds of the median hourly wage.

[2] *Making Progress: Boosting the skills and wage prospects of the low paid*, SMF, 2014

[3] 'Employee Ownership, Employee Attitudes, and Firm Performance: A Review of the Evidence,' in Daniel J.B. Mitchell, David Lewin, and Mahmood Zaidi (eds.), *Handbook of Human Resource Management,* (Greenwich: 1997) 113–15

[4] *Mutually Assured Growth? Employee ownership and the UK economy*, SMF, 2013