IRISH HOTELS FEDERATION

Submission to the Low Pay Commission

on the

National Minimum Wage in 2017

MARCH 2016

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1. Introduction

As noted in our submission last May the Irish Hotels Federation (IHF) supports a national minimum wage for all workers but such a rate must be appropriate, competitive and affordable.

The Low Pay Commission (LPC) is considering what, if any, changes should be made in 2017 to the current National Minimum Wage of €9.15 per hour and the associated sub-minimum rates for young people and trainees. The current rate applied from January 2016. This followed submissions in March 2015, the LPC report in July 2015 and a Government decision accepting the recommendation resulting in a ministerial order in October 2015 applying the new rate from January 2016. The changes, if any, currently being discussed will apply from January 2017, or later if the IHF recommendations are accepted. Consequently the LPC should give a strong emphasis to future expectations about the national and international economy, other factors such as exchange rates and the labour market performance in its deliberations. The IHF acknowledges the difficulties of having a very up to date and projected empirical assessment in light of the time lags associated with data availability. In addition, the evidence presented by the LPC on the impact of minimum wage increases on both the overall economy and specific sectors is weak, depending as it does on a review of the international literature.

For reasons discussed below in the submission the IHF recommends that there should be no increase in the current rate for 2017. In addition, where increases are proposed in the future, they should apply from April of the relevant year instead of January as applied in 2016. The IHF also recommends that the sub-minimum rates should be retained at their current relativities. The IHF acknowledges that the current implementation of the minimum wage is as a "national" rate. The IHF argues below that specific regional and rural economies and hotel/guesthouse activities and other specific sectors operate in a fundamentally different economic and business environment to the national economy and the economies of the large cities and traditional strong tourism locations. These weaker geographic areas and specific sectors should receive increased emphasis in deliberations and decisions on minimum wage rate fixing.

In addition, as argued in this submission and in the 2015 LPC report, minimum wage employees have above average representation in certain industries, including the hotel/guesthouse sector. In addition certain sectors are characterised by relatively low earnings primarily because of their business and economic circumstances. Such industries are more vulnerable to labour cost increases than high earnings sectors. The LPC should pay particular attention to these industries when deciding on the appropriate minimum wage rate rather than depending on economy wide assessment. A focus on specific sectors would produce better analysis of the effects of minimum wage increases. For example, national productivity levels and international comparisons present Ireland in a good light but this is heavily due to the impact of multinational enterprises. A different picture emerges at the more detailed sectoral level.

The IHF recognises that it is difficult to make a direct link between the supporting analysis undertaken by the LPC and the specific recommendation on the minimum wage rate. However, there should be a greater effort to clearly identify why and how a specific analysis leads to a particular recommendation. In the opinion of the IHF the 2015 July LPC report does not make a specific link between the supporting economic analysis and the recommendation. Consequently, the basis and justification for last years recommended increase is unclear.

2. Labour and Earnings Structure of Hotel Sector

The average economy labour and costs situations do not adequately represent the hotel sector. The hotel sector in Ireland and internationally is characterised by high labour intensity and very high labour cost to revenue. These factors should be borne in mind by the LPC. The hotel and wider hospitality sector is particularly vulnerable to changes in labour costs. The higher the labour share of overall production costs the greater the burden felt by a sector from a labour cost increase, other things being equal. The role of labour costs in turnover and gross value added is shown below for a sample of sectors. Official CSO data is used first as this allows a comparison between hotels and other sectors and supports transparency. This data illustrates the fundamental difference between the hotel/hospitality sector and several other sectors. The latest CSO data is for 2012. The sample includes indigenous manufacturing sectors such as meat and dairy, high technology manufacturing sectors such as chemicals and computers and a range of services sectors including retail, wholesale, computer services and accounting.

The CSO sectoral comparative data are shown below and labour costs relative to gross value added and turnover are shown. Gross value added (GVA) refers to the value added generated by the sector. In effect it is turnover less bought in materials. GVA is a more accurate measure of the economic contribution of a sector than turnover. However, the payroll to turnover ratio is also an important business and economic indicator.

Table 2.1 Labour Costs as percentage of Turnover and Gross Value Added 2012

	Turnover	GVA
Manufacturing	7.7	22.4
Meat	8.3	61.5
Dairy	6.5	58.6
Beverages	8.6	18.7
Chemicals	5.6	16.8
Pharmaceuticals	3.2	8.0
Computer electronic and optical products	8.3	32.7
Retail	13.5	74.9
Wholesale	6.7	47.4
Air transport	11.9	55.6
Hotels	38.0	87.2
Restaurants	32.3	84.2
Beverage serving	23.8	76.9
Computer programming, consultancy	8.5	50.8
Accounting auditing	42.6	63.7

Source: CSO CIP and Annual Services Inquiry

The vulnerable position of the hotel sector arising from labour costs is clearly illustrated by the above official CSO data. In manufacturing labour costs amount to 7.7% of turnover. Within manufacturing, the chemicals sector is 5.6% and the pharmaceuticals sector is 3.2% and the three indigenous sectors range between 6.5% and 8.6%. Within services the ratios also vary, wholesale is 6.7% and retail is 13.5% with hotels at 38.0%. Of the listed sectors hotels have one of the highest labour costs to turnover ratios. Accounting and auditing, at 42.6%, is higher than hotels.

This conclusion is reinforced by the labour costs share of GVA. Labour costs amount to 22.4% of GVA in manufacturing compared to 87.2% in hotels. The manufacturing figure is, of course, influenced by the accounting practices of the inward multinational sector. The meat and dairy sectors have labour cost to GVA ratios of around 60% which are still well below the hotel ratio. The other services sectors in the table are below the hotel ratio with retail, restaurants and beverage serving enterprises relatively close to the hotel figure. The hotel sector is a very labour intensive industry and is very vulnerable to wage induced cost increases. The data indicate the very large role of labour costs in the hotel business model.

The regional breakdown of payroll share is shown below for 2014 using the Hotel Industry Survey data. WS refers to Western Seaboard. On this measure payroll was 38% of revenue or turnover nationally.

Table 2.2 Payroll as % of Revenue by Region

	Dublin	M & E	SW	WS	All
2014	34.2	39.9	39.8	38.6	38.0

Source: Ireland Hotel Industry Survey 2015

The four regional shares range from 34.2% to 39.9%. Labour cost as a share of revenue is higher in the three non-Dublin regions than in Dublin.

The hotel sector provides many highly skilled jobs such as managers, accountants marketing executives, HR executives and IT specialists. However, to provide the required level of service, it also employs large numbers of lower skilled occupations. Consequently it has a higher proportion of lower paid persons than other sectors. This means that wage cost is a significant business issue for hotels, unlike many other sectors.

The hospitality sector is of significant strategic importance in the Irish economy and in economic development policy. Ireland in 2014 was ranked fifth in the EU in the relative importance of hospitality employment to total employment after Greece, Spain, Cyprus and Malta. The Irish share of accommodation and food services in total employment was 7.3% compared to the highest Greece at just over 8%. The overall EU share was 4.6%. Government has ambitious growth targets for the hospitality sector.

3. National and International Economic and Labour Market situation

The latest OECD international macroeconomic forecasts published in February present a more pessimistic view of future economic performance than the earlier November forecasts. Expectations of growth in both 2016 and 2017 have been reduced. Currently the OECD expects a world GDP growth of 3% in 2016 which is lower than the previous 3.3% expectation. For 2017 a growth of 3.3% is expected compared to 3.6% previously. The economies which are critical for Ireland in terms of both exports and inward tourism have all had their growth expectations revised downwards. The revised expectations are summarised in Table 3.1.

As shown, while growth is still expected in Ireland's main markets the growth rate has been revised downwards. In addition there are concerns about financial markets with increased levels of volatility and recent falls in equity prices. The projected global growth rate for 2016 is now expected to be the same as 2015 which was itself the lowest of the past five years. Declines in commodity and oil prices while beneficial for importing economies will also reduce economic prospects in the producing economies. OECD describes the financial market instability risks as substantial. There are substantial risks that the 2016 and 2017 forecasts will be revised down further as the year progresses.

Table 3.1 Current Expectations of GDP Growth% volume 2016 and 2017

	2015	November 2015 forecast for 2016	February 2016 forecast for 2016	November 2015 forecast for 2017	February 2016 forecast for 2017
World	3.0	3.3	3.0	3.6	3.3
USA	2.4	2.5	2.0	2.4	2.2
Euro area	1.5	1.8	1.4	1.9	1.7
Germany	1.4	1.8	1.3	2.0	1.7
France	1.1	1.3	1.2	1.6	1.5
Italy	0.6	1.4	1.0	1.4	1.4
UK	2.2	2.4	2.1	2.3	2.0
Canada	1.2	2.0	1.4	2.3	2.2
China	6.9	6.5	6.5	6.2	6.2

Source: OECD Interim Economic Outlook. Feb 2016

On the assumption that there is not a significant worsening of the international economic environment the Irish economy will perform well over the next two years. The latest forecast from DKM (Feb 2015) is for a GDP growth of 4.4% in 2016 and 3.7% in 2017 with consumption growing by about 3% annually. The average of thirteen 2016 forecasts, is for growth of 4.7%. The average of nine 2017 forecasts is a growth of 3.9%. However, there are significant uncertainties associated with these forecasts. In addition to the general international macroeconomic risks the economy will have to cope with Brexit and possibly short to medium term political instability.

The average wage inflation expectations are 2.1% in 2016 and 1.9% in 2017 with employment growth continuing and unemployment declining. However, there is a substantial element of risk and uncertainty attached to these expectations.

4. Exchange Rates

As noted in the July 2015 LPC report, Irish businesses are “highly susceptible to currency fluctuations”. (Page 11) It noted the substantial fall in the value of the Euro relative to both the Dollar and Sterling and that this helped competitiveness and inward tourism performance. It also noted that such a continuing benign exchange rate scenario was not certain. This has been borne out with respect to Sterling. The 2015 LPC report reported a Euro exchange rate for 1/7/2015 of 1.11 for the Dollar and 0.7905 for Sterling and noted that since July 2011 there had been a decline of 22% relative to Sterling and a decline of 23% relative to the Dollar. This has improved the financial position of Irish firms trading in these markets and improved the flow of tourists from these two markets. There have been fluctuations since July 2015. For example, the Euro weakened relative to Sterling and reached £0.73235 in January 2016. However, since then Sterling has weakened and the Euro was worth £0.77483 on March 4 2016. The Dollar was valued at $1.0970 to the Euro on the same date.

Between July 2015 and March 2016 exchange rate movements have contributed to competitiveness but Sterling has been weakening over the recent past. This is likely to continue amid concerns about Brexit. Exchange rate expectations after the UK referendum and for 2017 are uncertain but it they are unlikely to provide the improvement to competitiveness as for the last review period for the national minimum wage.

5. HICP Inflation

The LPC July 2015 report measured inflation up to May 2015 using the HICP indicator. A price increase of 3.3% occurred between July 2011 and May 2015. Using the same indicator prices decreased between May 2015 and the January 2016, which is the latest data available. The rate of decrease was 1.7% (index of 100.4 declining to index of 98.7).

6. Tourism and Hotel/Guesthouse Performance

Irish domestic and international inward tourism performed well in 2015. Overseas visitors to Ireland increased from 7.11 million in 2014 to 7.90 million in 2015, an increase of 11.1%. The domestic market which supplies the bulk of demand for hotels and guesthouses had a more mixed performance. In 2015 domestic tourism expenditure increased by 3% compared with 2014 but domestic bed nights decreased slightly by 0.7%. The excellent inward tourism performance gives an exaggerated positive image of the overall hospitality and hotel/guesthouse performance.

The Ireland Hotel Industry Survey reports that in 2014 67% of hotel bed nights were sourced from the domestic market with 4% from Northern Ireland and 29% from overseas. In addition to bed nights the hotel industry depends greatly on the domestic market for a wide range of revenue generating functions. Many hotels are still recovering from the financial difficulties of the economic collapse.

Overall, the industry has performed well over the recent past but in some significant respects it has not yet regained the pre-recession situation. The 2014 average room rate was €82.29 for all hotels but the 2006 rate was €97.58, a decline of 15.7%. The 2014 rate is an increase from the 2013 rate of €77.49. Room occupancy has increased from 65.9% in 2013 to 67.8% in 2014. Profit before tax (excluding financing costs) has increased from €7,347 in 2013 to €9,201 in 2014. It is unlikely that such a rate of increase has been continued into 2016. These are average national figures and there are substantial regional variations as shown later in this submission. The national figures exaggerate the strength of much of the rural and regional hotel sector.

7. Regional Issues

The economic recovery as measured by GDP growth, employment increases and lower unemployment has not been felt evenly throughout the country. This is particularly the case in tourism and the hotel sector. Dublin is performing very well, followed by some other urban centres and traditionally strong tourism locations but there are many hotels and locations in the third group where there has been very limited recovery and where hotels and guesthouses struggle. The IHF's concern is that the LPC will not pay sufficient attention to the weak regional and rural economies within the national economy in deciding on the appropriate rate for the national minimum wage.

The national unemployment rate in quarter 4 2015 was 8.7% which was a large decrease from the 11.8% of two years previously. However there is a substantial regional spread of unemployment rates. The South-East has the highest rate of 11.9%, followed by the Midlands at 10.9% and the West at 10.6%. The lowest rate was in the South-West with 7.4% which was closely followed by Dublin and the Mid-East both on 7.6%. The Border region had an unemployment rate of 8.7% and the Mid-West was at 8.5%. Overall the national unemployment rate of 8.7% is accompanied by a regional range of 7.4% to 11.9%.

Over the past year to Quarter 4 2015 national employment increased by 44.1k persons but two regions experienced decreases in employment. The West declined from 181.1k to 178.0k. The Mid-East declined from 237.9k to 235.8k. The Mid-West had a small increase from 152.8k to 153.1k.

Disposable income per person in 2014 in the State as a whole was €19.3k. Dublin had an average disposable income of €21.6k while Donegal was at €15.6k. Monaghan was at €16.6k and Roscommon was at €16.8k. Dublin's disposable average income was 38% greater than Donegal.

There is also a substantial regional variation in hotel performance as noted above. The Ireland Hotel Industry Survey divides the country into four regions, Dublin, Midlands and East, South-West and Western Seaboard. A range of indicators is presented for the four regions in Table 7.1.

Table 7.1 Regional Variation in Hotel Performance 2014

	Room occupancy %	Average room rate €	Profit before tax per room €
Dublin	77.2	97.25	13,797
Midlands and East	62.4	79.36	7,393
South-West	65.7	79.43	7,140
Western Seaboard	65.2	67.50	6,791

Source: Ireland Hotel Industry Survey 2015

Room occupancy is much higher in Dublin than elsewhere. The Dublin average room rate greatly exceeds those of the other three regions. Profit before tax per room in the Western Seaboard is less than half of the Dublin level.

8. Assessment and Recommendations

- The IHF supports a national minimum wage for all workers but such a rate must be appropriate, competitive and affordable.

- The international macroeconomic outlook is very uncertain with particular concerns about financial markets. Growth projections are being revised downwards. The LPC should take account of this uncertainty in its decision-making.

- While current Irish growth expectations for 2016 and 2017 are good there is a large degree of uncertainty attached to future performance.

- Prices, as measured by HICP, have declined between May 2015 and January 2016. Consequently there has been no increase in the cost of living.

- Exchange rate changes will not provide the impetus to competitiveness that arose over the past few years and in the short term may decrease competitiveness due to the weakness of Sterling.

- The hotel sector is a very labour intensive industry and is very vulnerable to wage induced cost increases given the very large role labour costs play in the hotel business model.

- The hotel and wider hospitality sector, as is the case internationally, has very high labour cost to revenue and value added ratios which make it vulnerable to minimum wage increases. In addition, the hotel sector it is open to severe international competition both for domestic tourism and international inward tourism. These factors should receive strong consideration in the LPC's deliberations.

- As a general rule the LPC should provide detailed analysis of the impact of a higher national minimum wage on those sectors where it is a significant element as well as the analysis of the national economic situation.

- The hospitality sector is of substantial strategic importance. It accounts for a very high share of total employment compared to other EU economies. Measured by share of hospitality employment in total employment Ireland is fifth highest in the EU.

- The hospitality sector is of strategic importance in terms of future economic development and the Government has set ambitious targets for the sector. Its strategic role should be recognised in the LPC's deliberations.

- Specific regional and rural economies and very many hotels/guesthouses operate in a fundamentally different economic and business environment to the national economy and the economies of the large cities and traditional strong tourism locations. These weaker areas should receive increased emphasis in deliberations and decisions on minimum wage rate fixing.

- In the opinion of the IHF the 2015 July LPC report does not make a direct link between the supporting economic analysis and the recommendation. Consequently, the basis and justification for last years recommended increase is unclear. The LPC must make clear the rationale and economic justification for its decisions.

- There has been a substantial increase in inward tourist numbers but the domestic market, which accounts for two thirds of hotel bed nights, is not performing as well.

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- The excellent inward tourism performance gives an exaggerated image of the overall hospitality and hotel/guesthouse performance and economic position.

- The hotel sector has performed well over the recent past but in some significant respects it has not yet regained the pre-recession situation. The 2014 average room rate was €82.29 for all hotels but the equivalent 2006 rate was €97.58, a decline of 15.7%.

- In light of the uncertain macroeconomic situation, the possible exchange rate performance, the decline in the price level, the labour cost characteristics of the hotel and wider hospitality sector, the weak economic position of many rural and regional areas, the still weak position of many hotels and the 2016 very large increase in the minimum wage of 5.8%, the IHF recommends that there should be no change in the level of the national minimum wage for 2017.

- The IHF also recommends that the sub-minimum rates should be retained at their current relativities.

- Where increases are proposed in the future the LPC should clearly show the link between its economic and other analysis and its recommendation.

- Where increases are proposed in the future, they should operate from April of the year in question instead of January.

- Where increases are proposed in the future they should take account of income tax/usc and employee and employer PRSI implications.