IRISH HOTELS FEDERATION

Submission to the Low Pay Commission

on the

National Minimum Wage in 2018

MARCH 2017

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1. Introduction

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

IHF agrees with the comment in the 2016 Low Pay Commission (LPC) report that "…. *minimum wages alone are not sufficient as a poverty alleviation strategy. Other policies may be required to deal with items such as exceptional housing and childcare costs."*

Consequently an increased focus should be placed on social policy measures and interventions as opposed to increasing the level of the national minimum wage to deal with low incomes and standards of living.

The LPC is considering what, if any, changes should be made in 2018 to the current National Minimum Wage of €9.25 per hour and the associated sub-minimum rates for young people and trainees. The current rate applied from January 2017. This followed submissions in March 2016, the LPC report in July 2016 and a Government decision accepting the recommendation resulting in a ministerial order applying the new rate from January 2017. The changes, if any, currently being discussed will apply from January 2018, or later if the IHF recommendations are accepted. Consequently, as previously argued by IHF, 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.

For reasons discussed below in the submission the IHF recommends that there should be no increase in the current rate for 2018. In addition, where increases are proposed in the future, they should apply from April of the relevant year instead of January as applied in 2017. 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 and previous submissions and in the various LPC reports, minimum wage employees have above average representation in certain industries, including the hotel/guesthouse sector. Certain sectors are also 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 particular issues the Commission is obliged by legislation to have regarded in considering its recommendation are:

(a) changes in earnings during the relevant period,

(b) changes in currency exchange rates during the relevant period,

(c) changes in income distribution during the relevant period,

(d) whether during the relevant period— (i) unemployment has been increasing or decreasing, (ii) employment has been increasing or decreasing, and (iii) productivity has been increasing or decreasing, both generally and in the sectors most affected by the making of an order,

(e) international comparisons, particularly with Great Britain and Northern Ireland,

(f) the need for job creation,

(g) the likely effect that any proposed order will have on — (i) levels of employment and unemployment, (ii) the cost of living, and (iii) national competitiveness.

The IHF recognises that it is difficult to make a direct empirical link between the supporting analysis undertaken by the LPC and the specific recommendation on the minimum wage rate. However, there should be a strenuous effort to clearly identify why and how a specific analysis leads to a particular recommendation. IHF notes that the 2016 LPC report rejects the idea of a regionally differentiated minimum wage. However, it is essential that consideration of the size of the national minimum wage should take into account regional economic circumstances which are of great significance in the hotel/guesthouse sector. Increases in the national minimum wage can also generate additional relativity type wage cost increases.

The 2016 LPC report noted that included in the main arguments presented for the "no increase in 2017" case were:

- Brexit/Sterling
- Regional differences in economic performance
- Competitiveness

These issues continue to be valid concerns of the hotel/guesthouse sector for the 2018 minimum wage level.

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 ratios. 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 2014. The sample includes indigenous manufacturing sectors such as food, 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 2014

	Turnover	GVA
Manufacturing	8.3	25.4
Food	7.5	22.4
Beverages	7.3	15.7
Chemicals	6.8	18.7
Pharmaceuticals	3.0	9.9
Computer electronic and optical products	9.9	41.7
Retail	13.1	73.5
Wholesale	6.2	48.5
Air transport	12.7	54.9
Hotels	30.3	77.9
Restaurants	35.0	83.7
Beverage serving	30.1	78.3
Computer programming, consultancy	6.8	43.3
Accounting auditing	54.0	72.3

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 8.3% of turnover. Within manufacturing, the chemicals sector is 6.8% and the pharmaceuticals sector is 3.0% and the food sector is 7.5% and the beverages sector is 7.3%. Within services the ratios also vary, wholesale is 6.2% and retail is 13.1% with hotels at 30.3%. Air transport is 12.7% and computer programming is 6.8%. Of the listed sectors hotels have one of the highest labour costs to turnover ratios. Accounting and auditing, at 54.0%, is higher than hotels. Restaurants and beverage serving activities are also high at 35% and 30.1% respectively.

This conclusion is reinforced by the labour costs share of GVA. Labour costs amount to 25.4% of GVA in manufacturing compared to 77.9% in hotels. The manufacturing figure is, of course, influenced by the accounting practices of the inward multinational sector. The food sector has a labour cost to GVA ratios of 22.4%. The other services sectors in the table are below the hotel ratio with the exceptions of the other hospitality sectors of restaurants and beverage serving enterprises. 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 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.

The regional breakdown of payroll share is shown below for 2015 using the Hotel Industry Survey data. WS refers to Western Seaboard. On this measure payroll was 36.6% of revenue or turnover nationally which is different from the CSO estimate.

The CSO estimate refers to "hotels and similar accommodation" and the Hotel Industry Survey refers to "hotels".

Table 2.2 Payroll as % of Revenue by Region

	Dublin	M & E	SW	WS	All
2015	32.5	38.3	37.9	37.3	36.6

Source: Ireland Annual Hotel Industry Survey 2016

The four regional shares range from 32.5% to 38.3%. Labour cost as a share of revenue is higher in the three non-Dublin regions than in Dublin. It is clear that the three non-Dublin regions are particularly vulnerable to increases in the national minimum wage rate.

3. National and International Economic and Labour Market situation

The latest Winter EU economic forecasts in February present a relatively optimistic picture of EU growth despite the impact of Brexit. The economies which are critical for Ireland in terms of both exports and inward tourism are all expected to grow. However, the growth rates are relatively low such as 1.8% in both 2017 and 2018 for the EU as a whole. German growth will be 1.6% and 1.8% respectively for the two years. France will grow by an average of about 1.5% in each year. The USA will grow by 2.3 and 2.2% in 2017 and 2018. However, the UK performance is a major problem for the hotel sector and the economy generally. Despite short term resilience related to Brexit the UK is expected to grow by a low 1.5% in 2017 and an even lower 1.2% in 2018. Coupled with the Sterling exchange rate this suggests a very difficult 2017 and 2018 for Ireland in the British tourism market.

Table 3.1 Current Expectations of GDP Growth% volume 2017 and 2018

	2017	2018
USA	2.3	2.2
EU	1.8	1.8
Euro area	1.6	1.8
Germany	1.6	1.8
France	1.4	1.7
Italy	0.9	1.1
UK	1.5	1.2
Ireland	3.4	3.3

Source: EU Winter Economic Forecasts 2017

On the assumption that there is not a significant worsening of the international economic environment the Irish economy will perform reasonably well over the next two years, but with a much lower growth performance than in 2016, with the EU expecting growth of 3.4% and 3.3%. The latest Irish central bank forecast is for a GDP growth of 3.3% in 2017 and 3.0% in 2018 with consumption growing by about 2.5% and 2.0% annually. 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 the lower value of Sterling.

The average wage inflation expectations are 2.3% in 2017 and 2.2% in 2018 with employment growth continuing and unemployment declining. However, as noted above, there is a substantial element of risk and uncertainty attached to these expectations.

4. Exchange Rates

The Brexit-related decline in the value of Sterling has very significant negative economic implications for the hotel sector. The sector depends heavily on the British market. Britain accounted for 41% of visitors in 2016. The decline in the value of Sterling has substantially reduced the competitiveness of the Irish hotel sector and this is a factor which is outside the control of both the Irish government and the hotel sector.

In Feb 2016 the euro was worth £0.77559. By Feb 2017 this had changed to £0.85273. This is a substantial loss in competitiveness of 9.9%. Over the same period the euro declined against the dollar by 4.1% but this is insufficient to compensate for the Sterling decline. There is no certainty about the ongoing 2017 and 2018 value of Sterling. The current Government macroeconomic projections for 2017 and beyond are made on the technical assumption of the rate staying at £0.85. The central bank is assuming a rate of £0.84 for 2017 and 2018. However, there are also grounds for expecting a further decline.

At minimum, however, it is not expected that Sterling will appreciate sufficiently to boost Irish competitiveness in 2017 and 2018. The Sterling decline has reduced Irish national and tourism competitiveness. The lower value of Sterling will also encourage a switch from Irish domestic holidays and breaks to the UK market and a switch by foreign tourists from Ireland to Britain. It may also result in British tourists spending less on their Irish trips.

The public policy aim should be to find ways to restore the lost cost competitiveness and to avoid additional reductions in competitiveness such as an increased minimum wage.

Based on Tourism Ireland market research of the impact of Brexit on British consumers travel plans, 17% would postpone a trip outside of the UK and 50% would spend less abroad.

5. HICP Inflation

The latest HICP inflation data relate to January 2017. A very small price increase of 0.2% occurred between January 2016 and January 2017. (index of 98.7 rising to index of 98.9). However, the average price level in 2016 (Jan to Dec) was 0.2% lower than the average price level in 2015 (index of 99.8 in 2016 compared with index of 100 in

2015). Taking the 12 months of Feb 2016 to Jan 2017 compared with the equivalent 2015/16 period the decline was also 0.2%.

The central bank, as of January 2017 is predicting an HICP increase of 0.8% in 2017 but excluding energy the predicted increase is only 0.1%. However, in January 2016 the central bank was predicting an HICP increase of 1.0% in 2016, which is now measured at -0.2%. The forecast price change in January 2016 for 2017 was 1.9%. The current forecast for 2017 is 0.8%. Forecast price increases have overstated the actual performance and the latest actual data show a very small increase in the year to Jan 2017.

6. Tourism and Hotel/Guesthouse Performance

Irish domestic and international inward tourism performed well in 2016. Overseas visitors to Ireland increased from 8.6431 million in 2015 to 9.5844 million in 2016, an increase of 10.9% (including same day visitors). The domestic market which supplies the bulk of demand for hotels and guesthouses had a more mixed performance. In the first three quarters of 2016 domestic trips increased by 2.4% compared with the same period in 2015. The excellent inward overseas tourism performance gives an exaggerated positive image of the overall hospitality and hotel/guesthouse performance.

The Ireland Annual Hotel Industry Survey reports that in 2015 58% of hotel business was sourced from the domestic market with 9% from Northern Ireland and 33% 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 and a substantial change of ownership has occurred reflecting the difficulties of many hotel operators.

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 2015 average room rate was €92.15 which is an increase on the 2014 average room rate of €82.29 for all hotels. However, the 2006 rate was €97.58. Room occupancy has increased from

67.8% in 2014 to 71.1% in 2015. Profit before tax (excluding financing costs) has increased from €7,347 in 2013 to €9,201 in 2014 and to €11,990 in 2015. These are average national figures and there are substantial regional variations as shown in the next section of this submission. The national figures exaggerate the strength of much of the rural and regional hotel sector.

7. Regional Issues

As noted in the 2016 IHF submission to the LPC, the economic recovery is not evenly spread throughout the country. 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 is concerned 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 for 2018.

The national unemployment rate in quarter 4 2016 was 6.7% which was a large decrease from the worst of the recession. However there is a substantial regional spread of unemployment rates. The South-East has the highest rate of 9.4%.
The Border region was next highest at 8.0% and the Midlands and the West were each at 7.9%. The lowest rate was in the Mid-East at 5.3% which was closely followed by the South-West at 5.7%. Both Dublin and the Mid-West were at 6.0%. Overall the national unemployment rate of 6.7% is accompanied by a regional range of 5.3% to 8.0%.

Over the past year to Quarter 4 2016 national employment increased by 65.1k persons or 3.3%. All regions experienced increases in employment but the rate of increase varied greatly. The lowest increase was in the Midlands region with 0.7%, followed by Border with 1.3%. The Mid-East (2.5%) and South-West (2.1%) were also below the national increase. The Dublin increase was 3.2% which was close to the national increase. At the high end of the increases, were the Mid-West region with 7.4% and the West with 5.8%. The South-East was also above average with an increase of 4.6%.

No updated data on county incomes are available since the 2016 submission. As noted in that submission, 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 2015

	Room occupancy %	Average room rate €	Profit before tax per available room €
Dublin	80.7	111.83	16,913
Midlands and East	65.0	84.20	10,628
South-West	66.8	84.71	8,370
Western Seaboard	66.9	74.20	8,058

Source: Ireland Annual Hotel Industry Survey 2016

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. These regional differences in the hotel sector clearly have implications for the regional impact of a nationally determined minimum wage rate which does not take sufficient account of the regional economic characteristics.

8. Assessment and Recommendations

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

- There should be a greater use of various social policy instruments in addition to the minimum wage mechanism to support standards of living.

- There should be no increase in the national minimum wage in 2018. The current Irish rate is already substantially higher than the UK. In light of Brexit this is an even more critical cost disadvantage.

- Public policy decisions should reflect the current and possible future negative direct and indirect economic impact of Brexit.

- The international macroeconomic outlook is reasonably good for 2017 and 2018 but there are substantial uncertainties with these expectations, especially due to Brexit. An exception to the overall picture is the expected weak performance of UK growth which is the source of 41% of our overseas visitors and is our largest market.

- While current Irish growth expectations for 2017 and 2018 are relatively good this growth performance will be lower than 2016 and there is a large degree of uncertainty attached to future performance due to Brexit.

- Prices, as measured by HICP, for the average level in 2015 compared with the average level in 2016, have decreased very slightly, by 0.2%. Consequently there has been no increase in the cost of living as measured by the HICP.

- Fundamental cost issues such as rent increases and levels should be dealt with by social policy mechanisms and not by increasing the national minimum wage.

- The decline in the value of Sterling has significantly lowered the competitiveness of the Irish economy and the hospitality and hotel sector relative to the UK. This is not expected to improve in 2017 and 2018 and may further deteriorate.

- Public policy should seek to support competitiveness and not to worsen it with an increase in the national minimum wage.

- 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. National level analysis should be supplemented by sectoral analysis in making decisions on the national minimum wage.

- 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 and is being badly hit by the decline in the value of Sterling. These factors should receive strong consideration in the LPC's deliberations.

- 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 and the need to support competitiveness 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 levels.

- There has been a substantial increase in inward tourist numbers but the domestic market, which accounts for 58% of hotel business, while growing, is not performing as well.

- 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 2015 average room rate was €92.15 for all hotels but the equivalent 2006 rate was €97.58, which is a decline of 5.6%.

- In light of the uncertain macroeconomic situation, the existing and likely exchange rate performance, Brexit, the small decrease in the price level comparing the average price levels of 2015 and 2016, the labour cost characteristics of the hotel and wider hospitality sector, the weak economic position of many rural and regional areas and the still weak position of many hotels, the IHF recommends that there should be no change in the level of the national minimum wage for 2018.

- 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.