

Stratis Issues Pay Guidance for Employers - Balancing Affordability Amidst Uncertainty Must Dominate Engagements on Private Sector Pay in 2021.

Where are we now?

The shock to the Irish economy from Covid-19 has had a massive impact on our economy and society.

One year on, since the pandemic took us all in its grip, the outlook for the economy is dependent on the progress of measures to contain the spread of the virus and, in the near-term, the success of the vaccination programme roll out over the coming months.

Apart from the immediate challenges from the pandemic, most commentators project a recovery of economic activity, improved compared to the prospects under a no-deal Brexit. It must of course be recognised amidst such optimism the EU-UK Trade and Cooperation Agreement (TCA) will introduce new trade frictions which will dampen those growth prospects for the Irish economy. However, recovery will not be even across all sectors, as the crisis is likely to leave longer lasting effects on parts of the domestic economy in particular such as retail, tourism, hospitality and personal services, through shifts in the delivery of services or changing consumer preferences.

The **Central Bank of Ireland** in its **first Quarterly Bulletin of 2021**, assuming successful deployment of vaccines by the second half of the year, expect a pick up in domestic economic activity and forecast domestic demand to grow by 2.9% in 2021, while GDP is projected to grow by 3.8%. Importantly, the Central Bank acknowledges that the recovery in the labour market is likely to lag until the broader economic recovery becomes more well established.

A further pick-up is expected in 2022, with modified domestic demand forecast to grow by 3.6% and GDP is projected by the Central Bank to grow by 4.6%. The **ESRI (QEC Spring 2021)** is predicting economic growth of c. 4.4% in 2021 and 5.2% in 2022. However, while the export sector is likely to continue to perform strongly in 2021(+7%) this is heavily reliant on sectors such as pharmaceuticals and computer services. Household spending dropped dramatically since the start of the pandemic. However, household incomes have generally been less affected. This is evidenced by an historic increase in the savings ratio to over 35% in Q2 2020. The unwinding of the large stock of savings accumulated during the pandemic is expected to support a recovery in consumption in 2022.

The Labour Market

The Central Bank expect to see unemployment increase to an average of 9.3% in 2021, reducing to 7.8% in 2022. The delayed impact of more than a year of closures in some sectors should mean that employment will remain below its pre-Covid levels for 2021 and 2022. However, the ESRI predict that unemployment having declined to less than 17% in quarter three 2020 is still likely to peak at 25% in Q1 2021 (including Covid adjustments) but will average 16.7% for 2021 before falling to just over 10% by the end of the year and to average c 7% in 2022. The ESRI forecast that the unemployment rate will not fall back to pre-COVID rates of 4.7% until late 2023 at the earliest.

In examining the impact on the labour market it is important to recall that, when including individuals employed by firms availing of the Temporary Wage Subsidy Scheme; at its peak in 2020, approximately 1.2 million people were in receipt of some form of income support. While every effort has been made by Government and employers to sustain as many jobs as possible, with many accessing temporary state aid measures, the reality for many has been postponed, and over the coming months, as some of those state supports are unwound, we will see more employers resize their businesses and a surge in redundancies is likely to follow.

Public Finances and Public Sector Pay

The ESRI predicts a budget deficit of just under €19 billion in 2021 or 4.7% of GDP (€18.5 billion), propelling the debt to GDP ratio from 59.8% in 2019 to over 61% in 2021. The deficit in 2020 was €23 billion as Covid-related spending and weaker tax receipts pushed the public finances into the red. This compares to a budgetary surplus of €1.85 billion in 2019. The year-on-year deterioration shows the government has spent more than €6bn on wage subsidies since the start of the pandemic and public debt is forecast to grow to €241.6 billion for 2021, up by c 10% on 2020. This amounts to €48,291, on a per capita basis, the highest in the EU and higher than the UK.

Meanwhile the newly agreed two-year 'Building Momentum' public service pay deal from 01.01.21 until 31.12.22 will cost more than €900 million (over three years). Under the deal public servants are to receive a 1% pay increase from October 2021 or €500, whichever is greater. A further 1% rise, or €500, would follow in October 2022.

A further sum of €237 million, (equivalent to a further 1% award) is allocated to a new sector fund to deal with awards, commitments and claims within particular parts of the public service or be used for a general increase for staff in specific sectors. A €150 million fund is to be established to deal with issues, such as the additional unpaid working hours for staff introduced under the Haddington Road agreement in 2013, which will be examined as part of a review due to commence in March 2021. Overtime and premium payment levels will return to those that applied prior to the cuts introduced in 2013.

We have no confidence that these estimates are accurate and we expect that sector agreements have the potential to re-introduce and drive multiple leapfrogging claims.

Private Sector Pay – Balancing Affordability Amidst Uncertainty Must Dominate Engagements.

Before the pandemic hit, the 'run rate' for private sector pay was running at c 2.5% per annum, many for up to 3 years, with a small number of agreements at even higher levels based on business performance and market outlook. Most of the agreements had some productivity element. However, even with wage adjustments being commonplace, with some sectors outstripping others, some employers in parts of the domestic economy were struggling to afford any adjustments and to maintain existing commitments.

Over 2020, for many employers, pay was off the agenda, especially for those reliant on the domestic economy. However for a minority of others in parts of the internationally traded sectors, who may not have been hugely impacted by Covid-19, or for those other employers who had entered into agreements on pay prior to the pandemic, or where negotiations had commenced, most followed through to honour commitments on pay. However, the 'run rate' percentage in Q3/Q4 2020 trended lower than in 2019 or where deals were under discussion pre Covid-19 to c 2.0% p.a amongst those businesses who were still willing to engage in discussions on pay. In other instances, some multinationals have deferred or delayed negotiations to evaluate the impact of Covid-19 on their business and trading environment.

Stratis Advice to Employers

As we now look towards the prospect of brighter times ahead and against the above background, it is now relevant to ask what will be the impact on private sector pay in 2021 as we emerge from the grip of the pandemic? The current private sector pay landscape might be summarised as follows:

- (i) Pay remains **off the agenda for most employers** reliant on the Irish domestic economy. Labour productivity in the mainly domestic sector has been substantially underperforming others in the internationally trading sectors.
- (ii) Inflation (according to the Irish Central Bank Q1, 2021, Quarterly Bulletin) is forecast to be (minus) 0.3% CPI (or +0.6% HICP) for 2021 and +0.9% CPI (or +0.6% HICP) for 2022. The ESRI in its latest Q1 2021 Bulletin, has said that price inflation does not pose a significant threat in the near term given the disinflation in many items with the CPI rate at (minus) 0.3% for 2020 and was (minus) 0.6% in January 2021. The ESRI forecast a modest CPI rise of +0.7% in 2021 and +1.2% in 2022 following a marked downward trend in inflation that coincided with the pandemic. With such benign inflation and where pay settlements are in excess of these figures they cannot be justified by reference to 'cost of living' criteria alone.

- (iii) Tactically employers should look to ensure they are securing full delivery of commitments under their existing agreements. Organisations should not be held to ransom by restrictive practices and demarcations that are well beyond their sell-by-date.
- (iv) Negotiations should seek to secure cost offsetting measures and employers should avoid paying separately for change.
- (v) Unions should be challenged on their justification for any claimed pay increases.
- (vi) Some employers may wish to delay discussions on pay until later in 2021 when they may have more certainty about trading conditions as the impact of Covid-19 crisis eases. For some employers, a position of inability to pay may be a more clear cut and credible response to any claim, especially where Covid-19 or for some where the impact of Brexit has had a significant business impact. This could involve the sharing of detailed financial information to support that assessment with independent verification.
- (vii) Others may be willing to agree a short pay deal or a lump sum payment in lieu for 12 months in view of ongoing uncertainty.
- (viii) Where pay deals have been concluded they are likely to reflect pre-existing commitments, pre-Covid19. However, for some, who entered multi-year pay agreements prior to Covid-19, these may need to be revisited.
- (ix) Where in the case of a **minority of employers**, such as a multinational operation in Ireland which has **not** been hugely impacted by Covid-19, some seem likely to conclude deals in the range of c 2.0-2.5% pa, where this is justified on productivity grounds, with a trend towards the lower end of this range.
- (x) For those employers, who are willing to conclude agreements on pay, the indications are that a term of 1-3 years remain attractive for employers, subject to price whilst duration will vary according to circumstance.
- (xi) There may also be merit, depending on the existing provisions of collective agreements, to allow for 'adjudication' of any implementation issues that might arise during the agreement term.
- (xii) Employers should take care to ensure that key clauses e.g. concerning the preclusion of cost increasing claims for the duration of the agreement and co-operation with normal ongoing change are reflected.

In our engagement with clients, we have encouraged organisations, to differentiate between the negative temporary short-term impact caused by the Covid-19 lockdown and social distancing measures on their business, and any ongoing negative impact caused by the resultant recession in addition to the losses incurred during the lockdown.

Covid-19 is requiring many organisations to re-evaluate their resourcing and work organisation models and to consider significant changes to their ways of working which will have implications for hours of work, roles, and responsibilities etc. These changes are necessary for the organisation to reopen or continue to operate. Investing in and developing people to maintain maximum relevance and career security (over job security) is essential for employers and workers. Organisations need to reflect carefully on the implications for reward as they maximise the benefits from the trends towards a more agile and resourceful workforce. A significant issue which will arise with remote working is to decide if for certain roles, there should be a movement towards pay for work done rather than for time?

With market conditions likely to remain weak for many employers they will need to strike a balance between issues of affordability in relation to pay as they assess the impact of trading uncertainties for their business and capacity to sustain jobs. As organisations look to assess and overcome the current challenges and to establish greater certainty, there are several options open to them to assess what course is best for them at this time of great uncertainty. These include:

1. Continue to focus on all necessary temporary measures in response to urgent needs and refuse to entertain any claims. In doing so it may be prudent to gauge when the business may be amenable to agree to a future time for review, but without commitment. In this scenario, the employer would be reserving its right through such future negotiations to bring about:
 - a) permanent cost reductions; or
 - b) commencement of negotiations on a new wage deal (*which could include deferrals ⁽¹⁾ or pay pauses*) considering prevailing circumstances; or
 - c) a combination of the two.

¹ A deferral could allow retrospection to be sought at a later date rather than where a pay pause is agreed which would not create a liability on pay retrospection for that period.

2. Decide to proceed now to secure more permanent cost and headcount reductions as necessary to include an agreement which delivers wage certainty for a defined period of time by way of a combination of pay pauses, suspension of regular incentive payments (if applicable) and/or a modest adjustment at a future date where the business sees this as affordable.
3. Continue to use temporary relief measures such as recourse to temporary lay-offs and/or short time working, or temporary pay reductions as required.
4. For those employers where agreements expired they may need to pause the commencement of discussions and review matters later in 2021. Here they may wish to consider the merit of providing a 'non-consolidated' lump sum payment on an interim basis.
5. For those employers who are willing to proceed to conclude an agreement on pay, they should do so having regard to both their own commercial and economic circumstances but also for the impact of their actions on other employers.
6. For those increasing numbers of employers with market based pay models, they will also need to do more to bring greater transparency to the model and to the comparative benchmark data being used to inform decision making on reward outcomes.

Throughout the Covid-19 crisis, employers have had to deploy active communications with employees to keep them informed of work and business developments. There has never been a more compelling time for employees to be kept fully up to date with what is happening and why. The organisation must also ensure that its processes are effective to allow it to understand the concerns of staff. Even amidst the growing optimism, that the end of the pandemic may be in sight, in the current uncertain environment, effective communications will be vital and employers should act with caution and only enter into agreements which are in the best interests of the organisation where the timing is right.

If you would like to talk to us about any of these issues, or about engaging your people through the period ahead, please get in touch with me at brendan.mcginity@stratis.ie or any one of our [Partners](#).

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