Stratis CONSULTING
Leading People Strategies

Affordability Will Inform Private Sector Pay Amidst Covid-19

A Quick Recap

The unprecedented shock to the Irish economy from Covid-19 has impacted on all aspects of Irish society. Whole swathes of business activity shuddered to a halt, with a collapse in employment levels, when the lock-down commenced on 28th March and is only now beginning to reemerge as part of the Governments Roadmap for the Reopening of the Economy.

The July Stimulus package was designed to help get Ireland's businesses back on their feet and get as many people as possible back to work quickly. It is now clear that public policy is not to subsidise low-productivity employment where demand has permanently shifted and that the focus of Government is to provide supports to enable workers to move between sectors.

However, while every effort is being 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 final months of 2020 we will see employers take hard decisions to resize their businesses and a surge in redundancies will follow.

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 some agreements at even higher levels based on business performance and market outlook.

Against this background, it is now relevant to ask what will be the impact on private sector pay as we navigate these unprecedented difficulties?

Three Scenarios

The level of uncertainty is borne out by the fact that the ERSI in its summer commentary (20.05.20) presented three different scenarios, whilst recognising that the negative impact varies from sector to sector with hospitality and transport hit hardest.

The **ERSI "benign" scenario** is the most optimistic, with a recovery commencing in the second half of the year and the economy returning to pre-Covid conditions in Q4. This, most optimistic, forecast would result in a 9% decline in the economy. This is the only scenario that sees a return to pre-Covid conditions in 2020.

The **ERSI "baseline" scenario** (which it regards as most likely) with lockdown restrictions gradually lifted but operating at below its 'pre-pandemic' level due to ongoing measures such as physical distancing would see the economy entering a recovery phase until the end of the year, resulting in a 12.4% decline in real GDP for 2020. Investment is predicted to decline by 28% and in terms of international trade, imports expected to decline by 12% and exports by 8%.

In the worst case the **ERSI "severe" scenario**, with a return to lock-down in Q4 the real GDP decline would be 17%.

The Labour Market

The unemployment rate peaked, so far, at 28% in April (up from 4.8% in February), and as of 24.08.20 there were 230,400 claiming the Pandemic Unemployment Payment (PUP). This represents a 61% drop on the 598,000 paid at its peak on 5 May 2020. In addition, 370,000 were availing of the Temporary Wage Subsidy Scheme (TWSS)[1] which does not form part of the unemployment figures with 69,500 employers registered under the scheme. Latest figures reveal the unemployment rate due to Covid-19 stood at 23.1% at the end of June when there were 531,412 people out of work. The rate has since dropped to 16.7% in July with 386,935 people out of work.

The top three sectors in which employees are returning to work are Accommodation and Food Services; Wholesale and Retail Trade, Repair of Motor Vehicles and motorcycles; and Construction. While unemployment will decline as the economy reopens, under the ERSI "baseline" scenario, the unemployment rate is predicted, to average 17.4% for 2020. The "benign" scenario would be 15.2% and the "severe" at 19.4%.

Meanwhile, the **Central Bank in its Quarterly Bulletin** (03.07.20), projects a recovery in employment in the third quarter as businesses reopen. As a result, it believes the unemployment rate will fall to around 15% in Q3 and 12.5% in Q4. It forecasts an average COVID-adjusted unemployment rate of 14.5% for 2020.

During the period of economic recovery between 2012 - 2019, GNI growth was 4% on average mainly due to more work rather than productivity. Average growth per hour worked was only 0.6% and so underscores our productivity challenge which is particularly acute across indigenous industry.

[1] To be renamed as the Employment Wage Subsidy Scheme (EWSS) from September 2020

Public Finances

The initial forecasts for 2020 forecast a deficit of 0.3% for the year. In the ERSI "baseline" scenario this is now predicted to be 9% of GDP or €27.5bn. This is based on loss of revenue coupled with the additional costs associated with health and social welfare spending.

A fiscal deficit is expected to continue in 2021, which is likely to result in continued government borrowing which is much more sustainable than was the case in 2008 recession. It must also be remembered too that full impact of Brexit, in the absence of a trade deal with the EU by the end of 2020, will make all these scenarios more uncertain for businesses, workers and Government.

Consumer Prices Gives No Justification For Pay Increases In 2020

The consumer price index (CPI) for July 2020 was 0.4% lower than the corresponding month in 2019. That was the fourth consecutive month to be lower than the previous month in 2019. The average change in the annual CPI rate is minus 0.4% or using the HICP measure is minus 0.6%.

Headline HICP inflation is projected to decline from 0.9% in 2019 to just 0.1% in 2020. Core inflation, excluding food and energy prices, is expected to turn negative both this year and next, at -0.2% for 2020 and -0.5% for 2021. Most of the impact will be on services prices, as these sectors are hit hardest by declines in demand and increase in costs.

Prior to the lockdown in March 2020 wage inflation (where increases were negotiated) was averaging 2.5% per annum with most of the deals for a period of 3 years. This varied by sector with those most likely to be impacted by Brexit doing deals at the lower end, around 2% per annum. 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.

Post the 2008 recession wages in the public sector were cut by between 5 and 10.5% and a three year pay freeze was agreed. Overall, in the private sector, average gross earnings decreased by 4% in the period 2008 to 2011 (CSO, EHECS). The level of decrease in the private sector varied significantly from sector to sector with 62% of employers indicating that they implemented cuts (23% involved cuts in pay and 34% in staff numbers) in 2009.

While many economic commentators may be predicting that recovery will be quicker this time around compared with 2008, nevertheless, the future business and operating environment (including the costs of compliance with public health guidance) for many employers is extremely uncertain. This will vary from sector to sector, therefore, the response in terms of reorganisation (including cuts in staffing numbers and wage rates) or the capacity to enter into wage negotiations is likely to be much more varied than it was post 2008.

The public service pay bill will increase by a staggering €330m in 2021, excluding the potential cost of any follow-on deal to the Public Service Stability Agreement (PSSA). The public service pay bill has increased from €16.5 bn in 2017 to €19.7 billion in 2020 or by €3.2 billion (20%) over the lifetime of the PSSA. and is unsustainable.

The public sector now employs 337,000 and has gone through a prolonged process of pay restoration of cuts from the previous recession and given the forecast deficit in Government finances of €27.5bn, and the impact on overall debt levels, any new agreement with the public service unions will prove very difficult.

Affordability Is Now The Key Determinant For The Private Sector

In our engagement with clients, we have encouraged organisations, in the first instance, 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.

This differentiation is of significance while temporary Government supports remain in place.

Temporary or short-term problems can be overcome, in some cases, by way of temporary lay-offs or short time working. Whereas longer term problems may require reduction in employment numbers and/or wage rates. Given the current level of uncertainty for many organisations, it may be difficult to differentiate at this time.

Covid-19 is already 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.

Past trends in wage inflation, prior to the lockdown, are less relevant to how individual organisations should now respond to pay claims, where they arise. We expect to see large swathes of businesses being unable to make any commitments to increase pay in 2020, with 2021 being uncertain. 'Inability to pay' issues will be more commonplace whilst we also know that labour productivity in the mainly domestic sector has been substantially underperforming others in the foreign sector. For some, who entered multi-year pay agreements prior to Covid-19, these may need to be revisited. For a minority of others in parts of the internationally traded sectors, who may not have been hugely impacted by Covid-19, some modest adjustments on pay may be possible.

Affordability is now the key determinant with market conditions likely to remain weak for many high job dependent sectors for some time to come. Organisations are postponing wage negotiations for a period to allow them to assess and overcome the current challenges and to establish greater certainty. There are several options open to the employer and it is up to each individual organisation to consider and assess which is best, 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[2] or pay pauses) considering prevailing circumstances; or
   c) a combination of the two.

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. Put everything on hold for 2020 and 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 and were in the middle of talks and/or may have made an offer on pay, they may need to pause discussions and review matters in 2021.

5. Similarly, for those employers where agreements are due to expire in Q3/4 of 2020, they may need to defer any discussions pending assessment of the full impact of Covid-19 on their business and trading environment and to review matters in 2021.

6. For those minority of employers who may be willing to proceed to conclude an agreement on pay, they should do so having regard for the impact of their actions on other employers and amongst the options available they may consider provision of 'non-consolidated' lump sum payments on an interim basis as an alternative to ongoing consolidated rate increases.

Throughout the Covid-19 crisis, employers have had to deploy regular and active communications with employees to keep them informed of all relevant work and business developments. There has never been a more compelling time to ensure that employees continue to be kept fully up to date and understand what is happening and why. The organisation must also ensure that its processes are effective to allow it to understand the concerns of staff. Effective communications will be vital to what is achievable in any pay

[2] 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.

negotiations at the appropriate time. In the current environment, employers should act with caution and only enter into agreements which are in the best interests of the organisation where the timing is right, and a better deal will not be achievable in the future.

If you would like to talk to us about any of the above issues, or about engaging your people through the period ahead, please get in touch with me at brendan.mcginty@stratis.ie or any one of our Partners.

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