Why We Recommend Uprating the 2009 GHRs

Introduction

Our recommendation for the 2010 GHRs involves no substantive changes from the 2009 GHRs because we have yet to complete our analyses of the issues raised in our paper "The Derivation of New Guideline Hourly Rates" which accompanied our recommendations for 2009. Thus our 2010 recommendation simply involves uprating the 2009 by a suitable index following our practice in previous years.

Why Index the GHRs?

The purpose of indexation is to ensure that the real level of what is being uprated remains unchanged. It thus represents a neutral change. Failure to uprate for inflation ensures that there is a real fall in the level of the relevant variable so long as inflation is positive. This is a substantive move which should only be introduced if there are good reasons for believing that the pre-existing level of the relevant variable is wrong. In the particular case of GHRs, there is no intention on our part to instigate such a real shift because, as we indicated above, we have yet to complete our analysis of the outstanding issues.

Why use a Wage Index rather than a Price Index?

The GHRs essentially reflect the wages of solicitors. When uprating recommended rates of pay, it is both natural and correct to make use of a wage index rather than a price index. Over the long term, wage indices tend to rise more rapidly than a price indices because real wages in the economy tend to rise over time at a rate corresponding to the growth of national productivity. So if a price index is used for indexation purposes in this context, the pay levels will, over the long term, fall continuously relative to general levels of pay thereby steadily reducing the relative pay rates of solicitors. Unless there is a good reason for believing that the relative pay of solicitors should be reduced over the longer term, then a wage index should be used for indexation.

Of course, in the short run, it may be that in certain periods the general level of wages grows more slowly than prices and the general level of real wages falls. Using a wage index for uprating then ensures that the pay of the relevant group also rises more slowly than prices and that the group shares in the general pain.

Why use the Wage Index Associated with Private Sector Services?

When uprating GHRs, it is important to use an index based on private sector pay, because wages in the private sector directly reflect market forces. Thus they will respond directly to market conditions, so in bad times they will tend to grow more slowly. The service sector is the obvious comparator because legal services are a part of this sector.

National Wage Indices do not Reflect the Whole Picture

In fact national private sector wage indices precisely do reflect the whole market picture. Thus our recommended uprating of 1.7% reflects the entire economic picture in private sector services. The tough economic conditions have generated a recommended rise in GHRs which is well below current RPI inflation and so will lead to a significant fall in the real pay of solicitors operating in this area. This is a natural consequence of the recession.

Of course, uprating is based on past rates of inflation in the relevant wage index because current and future rates of inflation are not observed. This one year lag means that GHRs can never exactly reflect current market conditions but that is an inevitable consequence of the fact that information cannot be collected and transmitted instantaneously.

Can the Market Bear the Rise in the GHRs?

Typically, the companies which pay the GHRs are those operating in general insurance. Insurance companies were badly hit by the recession in 2008 with trading profits falling from £5.5bn to £4.5bn (IFSL Research, Insurance 2009, December 2009, p.9). The complete 2009 picture is not yet available but survey evidence and some published results for the first half of the year (eg. Aviva) suggest improvement relative to 2008. The overall economy stopped contracting towards the end of 2009 and modest growth is expected in 2010. Uprating GHRs by 1.7%, exactly two percentage points less than current RPI inflation, seems unlikely seriously to damage the market.

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