

National Minimum Wage

Low Pay Commission Report 2006





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Low Pay Commission Report 2006

Presented to Parliament by the
Secretary of State for Trade and Industry by
Command of Her Majesty

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Chairman's Foreword

When the National Minimum Wage was first introduced in April 1999, the adult rate set (£3.60 per hour) reflected the Commission's deliberately cautious approach. As a result, about one million low-paid workers benefited with no measurable adverse effects on employment or inflation.

From 1999 to 2002 the minimum wage increased roughly in line with average earnings, and again no adverse effects were observed. The number of beneficiaries, however, appeared fewer than originally intended. That was the background that led the Commission in its Fourth Report, in March 2003, to conclude that it would be appropriate to increase the minimum wage faster than average earnings for a number of years. As a result, between October 2002 and October 2004 the adult minimum wage was increased by 15.5 per cent while average earnings increased by 8 per cent.

In the 2005 Report, published in February 2005 and making recommendations for October 2005 and October 2006, we concluded that some further increase above average earnings remained appropriate, but also recommended that we should review the October 2006 rate in January 2006 to check whether economic conditions had changed in a way that made the level proposed inappropriate. This report sets out the conclusions of that review, along with an analysis of issues relating to 16–17 year olds, salary sacrifice schemes and the accommodation offset.

Our review of economic conditions revealed some factors which could argue for a slight reduction in the October 2006 increase. These are described in Chapter 2 of this report. In particular we noted that, since average earnings growth has been slightly less than anticipated, the 2005 and 2006 increases together will result in slightly faster progress towards raising the minimum wage relative to average earnings than was anticipated at the time of the 2005 Report. The Commission concluded, however, that the divergence of economic outcomes from those anticipated was not sufficient to justify a

reduction in the recommended 2006 increases. We therefore confirm our original recommendation. We do, however, consider that the phase in which the Commission is committed to increases in the minimum wage above average earnings is complete and, looking forward, the Commission will start with no presumption that further increases above average earnings are required.

Over the four years 2002 to 2006, the adult minimum wage will have increased by 27.4 per cent while (on latest forecasts) average earnings will have increased by 17 per cent. This has been an appropriate upward adjustment from the cautious level at which the minimum wage was originally set, but the Commission has always recognised that the minimum wage cannot increase faster than average earnings indefinitely.

When the minimum wage was initially introduced it did not apply to 16 and 17 year olds. At the time of our Fourth Report (2003), however, the Commission was struck by evidence that a minority of 16–17 year olds were paid extremely low wages unaccompanied by training, and in February 2004 we recommended the introduction of a minimum wage for 16–17 year olds at a level of £3.00. We have seen no evidence to suggest that the introduction of the wage has had any adverse effects on employment or created incentives for young people to leave full-time education. It has, however, benefited some young people by outlawing clearly exploitative wages. The Commission continues to believe that the 16–17 year old rate should be focused on the prevention of very low wages, and that caution should be exercised in any increases. However, given that it was introduced at a cautious level and that it was not uprated at all in 2005, we recommend that the rate can and should be increased to £3.30 in October 2006.

Two other issues have been the focus of detailed Commission attention over the last year. One is 'salary sacrifice schemes'. Here we have concluded, for reasons set out in Chapter 4, that it is not appropriate to change the minimum wage regulations so as to allow cash earnings to fall below the level of the minimum wage.

The other issue concerns the accommodation offset, on which the Commission has deliberated at length. The fact that we have needed to do so reflects the significant changes within the UK labour market being caused by increased inward migration. This migration has created issues relating to accommodation provision by labour providers ('gangmasters') which were not

even considered in the first six years of the Commission's work. Our proposed resolution of the issues raised is set out in Chapter 4. More widely, however, the Commission is aware that the impact of migration on the UK labour market may be an increasingly important factor for it to consider as it develops future recommendations.

On those and other issues, however, it will be for the new Chairman, Paul Myners, to lead the Commission. My own four years as Chairman have been hugely interesting, and I have been proud to play a role in the development of the minimum wage. Since its introduction in 1999 the minimum wage has been a major success. It has significantly improved the wages of many low earners; it has helped improve the earnings of many low-income families; and it has played a major role in narrowing the gender pay gap. But it has achieved this without significant adverse effects on business or employment creation.

That success reflects the excellent hard work which the Commission Secretariat put into our analysis, and the commitment of Commission members to constructive and fact-based debate, seeking to arrive at a consensus. I have greatly enjoyed working with my fellow Commissioners and the Secretariat over the last four years, and wish them and the new Chairman all success as they guide the future development of the National Minimum Wage.



March 2006

From left to right standing:

Ian Hay
Paul Gates
Lord Turner of
Ecchinswell
William Brown
David Metcalf

From left to right seated:

Ian Brinkley
Heather Wakefield
John Cridland
Angie Risley

The Commissioners



The Secretariat

Chris Dee, OBE, Secretary
Jay Arjan
Graham Boyd
Tim Butcher
Hazel Hector
Sema Kardas
Nikos Tsotros
Joanne Willows
Sonia Wilson

Lord Turner of Ecchinswell (Chairman)

Vice-Chairman,
Merrill Lynch Holdings Ltd

Ian Brinkley

Chief Economist and Head of Economic and
Social Affairs Department,
Trades Union Congress

Professor William Brown, CBE

Professor of Industrial Relations and
Master of Darwin College,
University of Cambridge

John Cridland, CBE

Deputy Director-General,
CBI

Paul Gates, OBE

Deputy General Secretary,
Community

Ian Hay, OBE

Chairman,
Food Trade Association Management

Professor David Metcalf

Professor of Industrial Relations,
London School of Economics

Angie Risley

Board Member,
Whitbread Group PLC

Heather Wakefield

National Secretary for UNISON's
Local Government Service Group

Executive Summary

Chapter 1: Introduction

In our remit the Government invited us to review our recommendations for uprating the adult and development minimum wage rates in October 2006 in the light of present economic circumstances. The Government also asked us to review the level of the minimum wage rate for 16–17 year olds, the operation of the accommodation offset and the treatment of benefits-in-kind, including those offered as part of a salary sacrifice arrangement.

Chapter 2: Review of the Rates

In our 2005 Report, which made recommendations for October 2005 and October 2006, we said that we believed it was appropriate to increase the minimum wage slightly faster than average earnings over that two-year period. We also recommended that we should review the October 2006 rate in January 2006 to check whether economic conditions had changed in any way that made the proposed increase inappropriate.

Our review of economic conditions revealed some factors which could argue for a slight reduction in the October 2006 increase: economic growth in 2005 was less dynamic than we anticipated in January 2005, and forecast growth for 2006 has also been shaded down. Consumption spending was relatively subdued, with negative implications for low-paying sectors, in particular retail. Average earnings increased somewhat less than we anticipated over the last year (by 4.1 per cent not 4.5 per cent) and forecasts for 2006 suggest a similar shortfall. And the slowdown in average earnings growth appeared greater if we focused on the private sector alone, and particularly on some of the most affected sectors.

Conversely, we noted that employment continued to grow, both in the overall economy and in the low-paying sectors, and that corporate profitability

continued its cyclical improvement. The latest data showed that, although total employment fell by 22,000 in the quarter to November 2005, it increased by 221,000 over the year to November. While some groups, such as young people, did less well, the employment rates of others, older workers for example, rose. Between September 2004 and September 2005, 38,000 net new jobs were created in the low-paying sectors, including 22,500 net new jobs in the retail sector. In 2005, private sector employment grew at its fastest rate since 2000.

By our latest calculations, 0.9 million jobs benefited from the 2005 upratings, and 1.3 million jobs are scheduled to benefit from the 2006 upratings. The percentage of jobs benefiting is 3.6 per cent in 2005 and slightly greater than 5 per cent in 2006. These numbers are similar to those of previous upratings.

Pending employment legislation will have implications for subsequent reviews of the minimum wage. The Government intends to extend statutory holiday entitlement to include bank holidays, giving a typical full-time worker 28 days annual leave. The timing of the introduction of this entitlement and, in particular, whether it is phased over a number of years or introduced in one, may have implications for the appropriate level of increase in the minimum wage rates over subsequent years. The nature of UK implementation of the Equal Treatment Directive is also relevant to the setting of the minimum wage rates, but the Commission is satisfied that the Government intends to introduce the legislation in such a way that the rates for young people retain their viability.

In response to our consultation exercise, employer groups tended to emphasise the downturn in the economy and the adverse impact this was having on businesses. They stressed both the impact of energy price hikes and likely forthcoming changes in employment legislation on employers' costs, and argued that the proposed increase in the minimum wage should be reduced or delayed. In contrast, union groups tended to focus on the strength of the labour market and employment creation. They pointed out that, while the economy was growing more slowly than in recent years, it continued to expand. Evidence from the Government highlighted the success of the minimum wage, and noted no untoward effects arising from the ongoing increases.

Given the above, we acknowledge that a case could be made to shave the 2006 increase by a small amount. In particular, we noted that, since average earnings growth had been slightly less than anticipated, the 2005 and 2006

increases would (if followed through) result in slightly faster progress towards raising the minimum wage relative to average earnings than had been anticipated at the time of the 2005 Report recommendation.

Although some Commissioners believed that this overshoot was sufficient to justify a reduction in the 2006 rate to, for instance, £5.30 or £5.25, we concluded that the divergence of economic outcomes from those anticipated was not a sufficient basis on which to agree a reduction in the 2006 increase. We therefore confirm our original recommendations. However, we do now consider that the phase in which the Low Pay Commission is committed to increases in the minimum wage above average earnings is over. Looking forward, we have no presumption that further increases above average earnings are required. In addition, we note that it will be particularly important over the next year to look in detail at trends in average earnings by sector, analysing, for instance, whether private sector average earnings growth continues to lag behind that in the public sector and reviewing, in the light of that analysis, the appropriate average against which to consider increases in the minimum wage which primarily affects private sector employees.

Chapter 3: 16–17 Year Olds and Trainees

In October 2004 a minimum wage for 16–17 year olds was introduced to prevent the exploitation of young people in very low-paid jobs providing minimal training and few development prospects. The data and evidence we have gathered indicate that the introduction of this minimum has not encouraged young people out of full-time education (FTE) or training, nor has it damaged their prospects in the labour market.

The labour market position for 16–17 year olds not in FTE has been weakening over a number of years, and we are concerned by the rise in the number that are not in education, employment or training. We do not believe, however, that the minimum wage has been a factor in this development, rather that the trends that were apparent prior to its introduction have continued.

We have no doubt that there continues to be a need to protect the position of 16 and 17 year olds in the labour market and we believe that to do this it remains appropriate to have a separate minimum wage rate set at a lower level than that for older workers. We see the main purpose of the 16–17 year old minimum wage as providing a wage floor to prevent exploitation, but we

want to guard against the risk that young people may feel disillusioned with the world of work due to very low wages. We recommend, therefore, that the minimum wage for 16–17 year olds be increased to £3.30 per hour from October 2006. In arriving at this recommendation, we took account of the absence of any uprating in October 2005. We recommend that future reviews of the 16–17 year old rate be carried out in line with the timing of the reviews of the rates for older workers.

We also reviewed the use of the older workers' Development Rate and the 12 months exemption for apprentices under the age of 26. It was evident that the Development Rate remains little used and that it would be difficult to justify objectively an age limit on the apprenticeship exemption given forthcoming legislation to outlaw discrimination on the grounds of age. We believe, therefore, that the evidence is strongly in favour of abolishing the older workers' Development Rate and, simultaneously, of extending the 12 months apprenticeship exemption to cover all apprentices aged 19 and over. We submitted our findings to a review of these matters carried out by the Government in late 2005.

We also considered the other apprenticeship exemptions currently in place, but came to the view that it was too soon for a full-scale review. Instead, we recommend that the Government invite the Commission to carry out a full review of the apprenticeship exemptions and report in 2008.

Chapter 4: Benefits-in-kind, Salary Sacrifice Schemes and the Accommodation Offset

Since the introduction of the National Minimum Wage, accommodation has been the only benefit-in-kind that may count towards the calculation of minimum wage pay. For this report, we reviewed the operation of the accommodation offset and considered whether the provisions remain appropriate. We also considered whether there was a case for allowing other benefits-in-kind, including those offered by means of a salary sacrifice arrangement, to count towards the minimum wage.

We received evidence from employer representatives who argued that low-paid workers should be able to participate in salary sacrifice schemes, even if it caused their cash wages to fall below the minimum wage. They suggested it was unfair that these workers were denied the opportunity to exchange some

of their pay for an attractive benefit with a preferential tax and national insurance treatment. Trade unions argued, however, that employers should not be able to offset benefits such as childcare vouchers against minimum wage pay. In their view, it would erode the value of the minimum wage and undermine its simplicity.

We acknowledge that some low-paid workers would benefit from participating in a salary sacrifice arrangement. But the evidence indicated that most low-paid workers would be better off claiming support for childcare through the Working Tax Credit system than by joining a company salary sacrifice scheme for childcare vouchers. We found that salary sacrifice schemes for home computers, bicycles to work and other benefits were less common and less well developed, and employee take-up rates in firms that offered these benefits were often quite low. In addition, many part-time low-paid workers would gain no advantage from these schemes. We conclude that allowing further benefits-in-kind to count towards minimum wage pay would undoubtedly complicate the National Minimum Wage while only benefiting a small number of workers. It would also introduce new risks: some workers might see their wages reduced in return for a benefit of little or no value. We recommend that salary sacrifice schemes should not count towards the minimum wage.

Our review of the accommodation offset found that, although many employers in sectors where accommodation has traditionally been provided were aware of the offset, awareness and understanding could still be improved. We recommend that the Government take greater steps to publicise the offset and to improve the scope and quality of existing guidance. There was a range of views about the appropriateness of its current level, but we continue to believe that an offset of £3.90 per day (rising to £4.15 in October 2006) represents a fair balance between the interests of workers and those of employers.

We received evidence that accommodation charges in excess of the maximum permitted under the offset provisions were common in agriculture and food processing. Employer representatives and trade unions both reported that an increasing number of migrant workers were employed in these sectors, often on the minimum wage, and were typically charged £40–60 per week for accommodation provided by their employer. Until recently the Department for Environment, Food and Rural Affairs (Defra) had advised agricultural employers that, based on its reading of the Agricultural Wages Order for England and Wales, the accommodation offset rules did not apply

to agricultural workers when accommodation was provided under a stand-alone agreement. Following a review by the relevant government departments, Defra has now revised that view and confirmed that no worker may be paid less than is due under the National Minimum Wage accommodation offset provisions.

Some respondents from the agriculture sector argued, however, that the offset should only apply to workers who were required to occupy accommodation under the terms of their employment contract. They suggested that, in most cases, migrant workers were offered accommodation because of the difficulties they faced securing the deposits and documents required by most landlords. In their view, accommodation provided by employers in these circumstances was an optional service that workers could choose to decline, and therefore the two parties should be free to agree a rent between them. Trade unions, on the other hand, cited cases of severe overcrowding combined with high accommodation charges, and called for a greater emphasis on enforcement of the existing provisions.

We accept that there is a distinction in principle between accommodation that is offered to workers as an optional service independent of the job offer, and accommodation that workers are required to occupy as a condition of their employment. But we are not convinced that such a distinction could work effectively in practice due to the difficulty of establishing whether the worker had been given a genuine choice. We are also concerned that some employers have been exploiting vulnerable migrant workers by applying high charges for poor quality, overcrowded accommodation – in excess of the maximum allowed under the accommodation offset rules. We recommend that the offset provisions should continue to apply to all workers housed by their employer in all circumstances and that the Government should ensure that employers are fully aware of the legal requirements. We would also like to draw the Government's attention to evidence that existing housing standards are not being enforced consistently at a local authority level. We propose to continue to keep the accommodation offset under review, in particular the treatment of housing offered as an optional service not tied to the job.

Our consultation also revealed that some employers have deliberately sought to circumvent the existing offset rules by setting up a separate company to arrange accommodation for their workers. We recommend that the Government take the steps necessary to avoid abuse of such arrangements.

Employers may make a variety of other arrangements with third party landlords, and in some cases there may be some doubt whether the accommodation offset applies. We believe that the employer should be regarded as the accommodation provider where a worker's ability to remain in a particular job, or to remain in particular accommodation, is dependent one upon the other. We believe that the offset should also apply if the employer receives a financial benefit from an accommodation arrangement. We recommend that the Government provide further guidance on these matters.

In our view there is a need to tackle overcharging for accommodation and evasion of the accommodation offset as part of a more concerted effort to ensure that migrant workers receive the minimum wage to which they are legally entitled. We recommend that the Government take action to prioritise targeted enforcement of the minimum wage in those sectors that employ significant numbers of migrant workers.

Recommendations

National Minimum Wage Rates

We confirm our original recommendations that in October 2006 the adult rate of the minimum wage should be increased to £5.35 and the youth Development Rate should be increased to £4.45. (Paragraph 2.81)

16–17 Year Olds

We recommend that the minimum wage for 16–17 year olds be increased to £3.30 from October 2006. We also recommend that the Government ask us to review the rate in line with the timing of the reviews of the rates for older workers. (Paragraph 3.54)

Trainees

We recommend that the Government invite the Commission to carry out a full review of the apprenticeship exemptions and report in 2008. (Paragraph 3.88)

Salary Sacrifice

We recommend that childcare vouchers should not count towards the National Minimum Wage. (Paragraph 4.50)

We recommend that salary sacrifice schemes should not count towards minimum wage pay. (Paragraph 4.52)

Accommodation Offset

We recommend that the accommodation offset provisions should continue to apply to all workers housed by their employer in all circumstances.

(Paragraph 4.114)

We recommend that the Government update existing guidance on the accommodation offset so that it is as clear and comprehensive as possible, and ensure that information is available on relevant websites. We also recommend that the Government take action to raise awareness of the offset, with a particular emphasis on employers and workers in agriculture and other sectors affected by the overlap between the Agricultural Wages Orders and the National Minimum Wage provisions. (Paragraph 4.119)

We recommend that the Government should implement legislative measures to prevent employers using the device of a separate accommodation company to evade the accommodation offset. We also recommend that it should make available guidance on the types of circumstances in which it will deem the employer to be the accommodation provider, taking account of the principles we have set out in paragraph 4.126. (Paragraph 4.127)

Enforcement

We recommend that the Government should step up enforcement of the minimum wage in low-paying sectors that employ significant numbers of migrant workers, particularly agriculture and food processing and packing, and that these sectors are targeted as a priority within HM Revenue and Customs' rolling programme of targeted enforcement. (Paragraph 4.133)

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Introduction



In our remit the Government invited us to review our recommendations for uprating the adult and development minimum wage rates in October 2006 in the light of present economic circumstances. The Government also asked us to review the level of the minimum wage rate for 16–17 year olds, the operation of the accommodation offset and the treatment of benefits-in-kind, including those offered as part of a salary sacrifice arrangement.

Terms of Reference

- 1.1 On 11 July 2005 we received our new terms of reference from the Government which asked us to:
- consider whether the October 2006 upratings of the adult and development rates recommended in our 2005 Report remained appropriate in the light of economic circumstances and the other factors identified as relevant in that report, and if not to make any recommendations for change;
 - review the level of the 16–17 year old rate, keeping in mind the position of the youth labour market and the incentives for young people to participate in education and training;
 - review the operation of the accommodation offset and, if appropriate, make recommendations for any changes needed to the regulations; and
 - review the treatment of benefits-in-kind, including where those benefits are offered as part of a salary sacrifice arrangement.
- 1.2 We were asked to report to the Prime Minister and the Secretary of State for Trade and Industry by the end of February 2006.

- 1.3 At the same time the Government announced that it would itself review the position on the older workers' Development Rate and the way the minimum wage exemption applied to older apprentices, working closely with the Commission, in time for these issues to be addressed in the forthcoming age discrimination regulations.

Consultation and Research

- 1.4 As we have done for previous reports, we have consulted widely during the preparation of this report and our consultations have provided us with valuable input. We carried out two formal written consultations in July and August: the first covering the non-economic issues in our remit and the second focused on our macroeconomic review. Our website also helped us to reach interested parties and encouraged individuals, firms and organisations to submit their written evidence to us. Overall, we received over 90 responses from employer organisations, trade associations, unions, voluntary organisations, pressure groups, academics and the Government.
- 1.5 We also heard oral evidence from a number of organisations, including the TUC, CBI, the British Retail Consortium and a youth delegation. We continue to find these sessions very productive, providing an invaluable opportunity to expand on points that had been made in written evidence.
- 1.6 For this report we commissioned one research project specifically tailored to focus on a key part of our remit. On our behalf Incomes Data Services Ltd (IDS, 2005a) conducted a survey of the non-cash benefits offered by employers in four low-paying sectors. A summary of the findings is provided in Appendix 2.
- 1.7 We continue to be keen to hear first hand the views of all groups with an interest in the minimum wage. Talking with and listening to those directly affected often provides insights that cannot be found in learned papers or formal submissions of evidence. In England, we visited Cumbria, Doncaster, Gateshead, Hastings, Lincolnshire, London, Manchester, Newcastle upon Tyne, Nottingham, Reading and Worksop. In Northern Ireland we had the opportunity to visit Coleraine and Derry and in Scotland we travelled to Aberdeen and Peterhead. We also visited Colwyn Bay and Llandudno in North Wales. The visits gave us

the opportunity to meet employers and workers from many affected parts of industry at local level.

- 1.8** We are very grateful to all of those people and organisations who assisted us in the arrangement of these visits and who gave their time in order that they might share their views with the Commission.

Review of Minimum Wage Rates for 2006

- 1.9** In our 2005 Report, we recommended that the adult rate of the minimum wage should be increased to £5.35 in October 2006 and the youth Development Rate should be increased to £4.45. In making our original recommendations, we prepared an extensive report on the minimum wage.
- 1.10** Our review of the rate for October 2006 has focused on the current economic circumstances and prospects; we did not re-open all of the associated issues. We considered whether the broad economic outlook had changed to the extent that might require or make advisable a modification of the rates we had recommended for October 2006. In addition to examining the overall economic picture, we looked at the circumstances affecting those groups and sectors in which low pay was most prevalent and asked whether their circumstances had changed sufficiently to warrant the modification of our original recommended rates. Our analysis and conclusions are described in Chapter 2.

Review of 16–17 Year Olds and Trainees

16–17 Year Olds

- 1.11** In our 2004 Report we recommended the introduction of a new minimum wage rate of £3.00 an hour for 16 and 17 year olds from October 2004. The Government accepted this recommendation. Our aim in recommending a minimum wage for 16–17 year-olds was to prevent exploitation of young people without encouraging them to leave education or training. In our 2005 Report we made no recommendation for uprating the 16–17 year old rate as it had only just been introduced and there was insufficient evidence to assess its

impact. Accordingly, we recommended that a full assessment be carried out and reported on in 2006.

- 1.12** In order to inform our deliberations on the 16–17 year old minimum wage, we consulted and received evidence from a range of interested parties including employers and their representative organisations, trade unions, youth organisations, voluntary organisations and others. A summary of their views and of related evidence for our conclusions and recommendations can be found in Chapter 3.

Trainees

- 1.13** In our 2005 Report, we reviewed the older workers' Development Rate and the 12 months minimum wage exemption for apprentices. We concluded provisionally that the older workers' Development Rate should be abolished from October 2006, and that, simultaneously, the 12 months exemption from the minimum wage should be extended to cover all apprentices aged 19 and over. We noted that the current 'below age 26' threshold applied to the exemption might no longer be justifiable, in particular given the Equal Treatment Directive (2000/78/EC) due to be implemented outlawing age discrimination at work. We also noted that take-up of the older workers' Development Rate continued to be very low and the consultation responses we received had suggested near unanimous support for abolishing it. We proposed that the remit for our 2006 Report include a review of our provisional conclusion.
- 1.14** However, the Government decided that it would be more appropriate for it to carry out its own review, liaising closely with us, to fit in with the timing of its work on the Equal Treatment Directive. We consulted with stakeholders on this as part of our written consultation exercise for this report and provided feedback to the Government late in 2005. Our deliberations and conclusions on these issues are also given in Chapter 3.

Review of Benefits-in-kind, Salary Sacrifice Schemes and the Accommodation Offset

- 1.15** At present, benefits-in-kind (with the exception of accommodation up to a specified daily offset limit) may not count towards the calculation of the minimum wage. Salary sacrifice schemes depend upon employees voluntarily forgoing a part of their pay in order to take advantage of a benefit provided by their employer such as childcare vouchers or a home computer. However, if a worker's cash pay were to fall below the minimum wage as the result of a salary sacrifice scheme, the employer concerned would be acting unlawfully. It was becoming clear at the time of our 2005 Report that this was causing problems for some employers. In order to allow us sufficient time to consider this issue, we suggested that the Government include a review of salary sacrifice schemes in our remit for this report. The Government accepted our recommendation, but broadened the review to cover the minimum wage treatment of all benefits-in-kind, including where they are provided by means of a salary sacrifice arrangement.
- 1.16** We looked carefully at the benefits typically offered under salary sacrifice schemes, including the savings on tax and National Insurance Contributions that they offered to employers and workers. We compared the childcare benefits offered through a childcare voucher salary sacrifice scheme with those that were available to low-paid workers through the Working Tax Credit system. The evidence for our conclusions and recommendations can be found in Chapter 4.
- 1.17** The accommodation offset is designed to recognise the significance of the provision of accommodation in certain sectors and the benefit it offers to both employers and workers. The level of the accommodation offset aims to retain a balance between providing employers with a reasonable amount to be deducted in respect of accommodation without making severe reductions in the cash value of the minimum wage to workers. The offset rate is currently £3.90 per day, and is set to rise to £4.15 per day from October 2006. The Government invited the Commission to review the operation of the accommodation offset and, if appropriate, to make recommendations for any changes. Details of our review and recommendations can also be found in Chapter 4.

Conclusion

1.18 Finally, we would like to declare our gratitude for the valuable input we have received from many different organisations and individuals; some of them are named in the report or its appendices, others preferred to remain anonymous. Their views helped to inform the work that we do and, hopefully, they have helped us make this report more relevant, accurate and well informed.

Review of the Rates



In our 2005 Report, which made recommendations for October 2005 and October 2006, we said that we believed it was appropriate to increase the minimum wage slightly faster than average earnings over that two-year period. We also recommended that we should review the October 2006 rate in January 2006 to check whether economic conditions had changed in any way that made the proposed increase inappropriate.

Our review of economic conditions revealed some factors which could argue for a slight reduction in the October 2006 increase: economic growth in 2005 was less dynamic than we anticipated in January 2005, and forecast growth for 2006 has also been shaded down. Consumption spending was relatively subdued, with negative implications for low-paying sectors, in particular retail. Average earnings increased somewhat less than we anticipated over the last year (by 4.1 per cent not 4.5 per cent) and forecasts for 2006 suggest a similar shortfall. And the slowdown in average earnings growth appeared greater if we focused on the private sector alone, and particularly on some of the most affected sectors.

Conversely, we noted that employment continued to grow, both in the overall economy and in the low-paying sectors, and that corporate profitability continued its cyclical improvement. The latest data showed that, although total employment fell by 22,000 in the quarter to November 2005, it increased by 221,000 over the year to November. While some groups, such as young people, did less well, the employment rates of others, older workers for example, rose. Between September 2004 and September 2005, 38,000 net new jobs were created in the low-paying sectors, including 22,500 net new jobs in the retail sector. In 2005, private sector employment grew at its fastest rate since 2000.

By our latest calculations, 0.9 million jobs benefited from the 2005 upratings, and 1.3 million jobs are scheduled to benefit from the 2006

upratings. The percentage of jobs benefiting is 3.6 per cent in 2005 and slightly greater than 5 per cent in 2006. These numbers are similar to those of previous upratings.

Pending employment legislation will have implications for subsequent reviews of the minimum wage. The Government intends to extend statutory holiday entitlement to include bank holidays, giving a typical full-time worker 28 days annual leave. The timing of the introduction of this entitlement and, in particular, whether it is phased over a number of years or introduced in one, may have implications for the appropriate level of increase in the minimum wage rates over subsequent years. The nature of UK implementation of the Equal Treatment Directive is also relevant to the setting of the minimum wage rates, but the Commission is satisfied that the Government intends to introduce the legislation in such a way that the rates for young people retain their viability.

In response to our consultation exercise, employer groups tended to emphasise the downturn in the economy and the adverse impact this was having on businesses. They stressed both the impact of energy price hikes and likely forthcoming changes in employment legislation on employers' costs, and argued that the proposed increase in the minimum wage should be reduced or delayed. In contrast, union groups tended to focus on the strength of the labour market and employment creation. They pointed out that, while the economy was growing more slowly than in recent years, it continued to expand. Evidence from the Government highlighted the success of the minimum wage, and noted no untoward effects arising from the ongoing increases.

Given the above, we acknowledge that a case could be made to shave the 2006 increase by a small amount. In particular, we noted that, since average earnings growth had been slightly less than anticipated, the 2005 and 2006 increases would (if followed through) result in slightly faster progress towards raising the minimum wage relative to average earnings than had been anticipated at the time of the 2005 Report recommendation.

Although some Commissioners believed that this overshoot was sufficient to justify a reduction in the 2006 rate to, for instance, £5.30 or £5.25, we concluded that the divergence of economic outcomes from those anticipated was not a sufficient basis on which to agree a reduction in the 2006 increase. We therefore confirm our original recommendations.

However, we do now consider that the phase in which the Low Pay Commission is committed to increases in the minimum wage above average earnings is over. Looking forward, we have no presumption that further increases above average earnings are required. In addition, we note that it will be particularly important over the next year to look in detail at trends in average earnings by sector, analysing, for instance, whether private sector average earnings growth continues to lag behind that in the public sector and reviewing, in the light of that analysis, the appropriate average against which to consider increases in the minimum wage which primarily affects private sector employees.

Introduction

- 2.1** Following increases significantly above average earnings growth in 2003 and 2004, we recommended in our 2005 Report that the adult minimum wage should increase by more than the predicted increase in average earnings over the next two year period (2005 and 2006). However, our recommendations were designed to keep the adjustment above average earnings small and to concentrate the increase in the second year so that businesses would have time to absorb the impact of previous increases. We said that we thought further increases above the growth in average earnings would be required in subsequent years before the adult minimum wage had been brought to an appropriate long-term level. We recommended that the adult rate and youth Development Rate be increased in October 2005 and again in October 2006. However, our recommendations for October 2006 were conditional on a review of the prevailing economic conditions in early 2006.
- 2.2** We based our recommendations for 2005 and 2006, made in our 2005 Report, on our assessment of the impact of the minimum wage to that point and an assessment of the future prospects for the economy as a whole. We also took account of the views expressed by interested parties. This Chapter reviews the upratings recommended for October 2006 in the light of the economic circumstances prevailing at the beginning of 2006.
- 2.3** First, we look at the performance of the macroeconomy and the labour market since the 2005 Report before reviewing trends in inflation and

pay settlements. We then assess the impact of the 2004 minimum wage upratings on earnings. We also note any differences in earnings and employment growth between the public and private sectors. We then summarise the views of interested parties who responded to our consultation exercise in the Autumn of 2005. We revisit our estimates of the number of beneficiaries of the 2005 minimum wage upratings in light of the economic outcomes in 2005, before reviewing the economic prospects for 2006 and beyond. The prospects for growth in average earnings and price inflation, which constitute important benchmarks against which to assess proposed upratings to the minimum wage, are then used to revisit our estimates of the likely number of beneficiaries of the proposed 2006 upratings. Finally, we set out our recommendations, taking into account the likely impact of the planned new legislation on age discrimination and the extension of statutory annual leave entitlement to include bank holidays.

Review of the Macroeconomy

Independent Forecasts for 2005

2.4 In general the UK economy has not performed as well as had been predicted at the time of our 2005 Report but it did continue to grow in 2005, albeit more slowly than anticipated. Consumer price inflation, as measured by the Consumer Price Index (CPI), has been higher than expected mainly due to increasing oil and fuel prices, but this has not been reflected in increased wage inflation as average earnings, measured by the Average Earnings Index (AEI) including bonuses, have increased more slowly than forecast. Table 2.1 sets out these changes, comparing the actual 2005 data with the forecasts for 2005 we used when we arrived at our recommendations for the 2005 Report.

Table 2.1 Independent Forecasts and Actual Outcomes of Growth in Gross Domestic Product (GDP), Prices, Employment and Average Earnings for 2005

Annual percentage increases (median of forecasts)	Forecasts used in 2005 Report	ONS actual outcome 2005	Difference between outcome and forecast
GDP	2.6	1.8	-0.8
Prices (RPIX)	2.3	2.3	0.0
Prices (CPI)	1.8	2.1	+0.3
Average earnings	4.5	4.1	-0.4
Employment	0.3	0.8	+0.5

Source: HM Treasury (2005a) and Office for National Statistics (ONS).

Notes:

1. Forecasts used in the 2005 Report were the medians taken from the HM Treasury February 2005 'Forecasts for the UK Economy'.
2. Gross domestic product (GDP) is measured by ONS code ABMI but this is not yet available for 2005. Actual GDP growth for 2005 is therefore taken from the preliminary GDP estimate (ONS code IHYP).
3. Retail Price Index excluding mortgage interest payments (RPIX) is measured by ONS code CDKQ and the Consumer Price Index (CPI) is measured by ONS code CJYR.
4. Average earnings are measured using Average Earnings Index (AEI) including bonuses for GB (ONS code LNNC). Actual average earnings growth in 2005 is for the year to the third quarter of 2005.
5. Employment is defined as workforce jobs and is measured by ONS code DYDC.

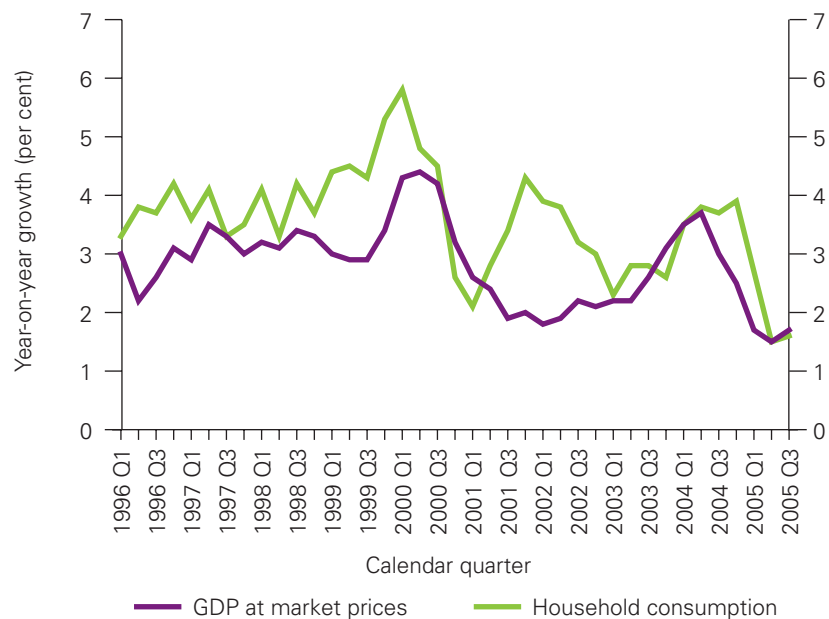
2.5 When we deliberated last year on our recommendations for an increase to the adult rate and the youth Development Rate, we referred to the Treasury Panel of Independent Forecasters. It can be seen from Table 2.1 that the outcome for 2005 is not now thought to have been as favourable as was forecast at the time of our deliberations. Expected growth in UK output, as measured by gross domestic product (GDP), has been reduced by about a third from 2.6 per cent to just 1.8 per cent. In spite of this, employment growth has been much stronger than anticipated.

GDP and Consumption

2.6 Examining GDP growth more closely, Figure 2.1 shows that after strong growth in 2003 and early 2004, GDP growth declined sharply before bottoming out by the middle of 2005 and picking up thereafter. The latest data show that the economy continued its recovery by growing at 0.6 per cent in the fourth quarter of 2005, up from 0.4 per cent in the third quarter. This recovery was led by distribution, hotels and catering, which grew by 1.2 per cent in the fourth quarter, up from 0.2 per cent in the third quarter of 2005. However, GDP growth for the whole year in 2005 was 1.8 per cent, the slowest annual increase since 1992. But the consensus among independent forecasters is that the economic prospects for 2006 and beyond look more encouraging and the UK economy is expected to return to trend growth by 2007.

2.7 Figure 2.1 shows a similar pattern for household consumption, although the decline in growth started about six months later than the decline in GDP. Growth of household consumption expenditure slowed to an annual rate of growth of 1.6 per cent in the third quarter of 2005, lower than the long-run trend of around 2.7 per cent established since 1960. However, this constitutes a slowdown in the rate of growth, not the outright contraction that would occur during a period of economic recession. Moreover, data for the second and third quarters of 2005 suggest that this fall in consumer spending has also bottomed out and there are signs of recovery, albeit gradual. The recent data on retail sales and firmer housing market offer support for the view that consumer spending is reviving.

Figure 2.1
Growth in GDP and Consumer Spending, UK, 1996–2005



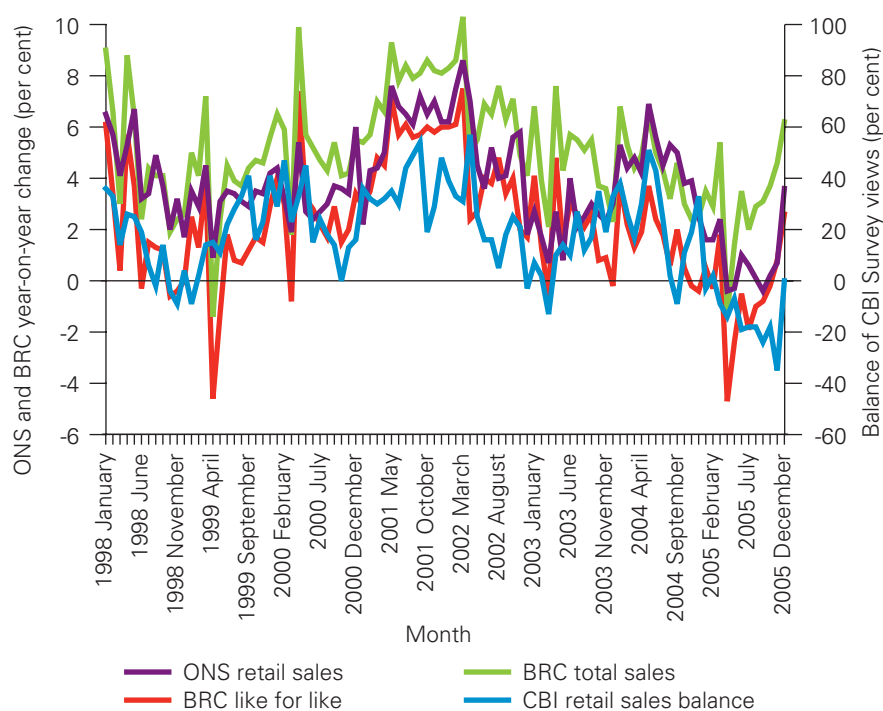
Source: ONS, UK GDP at market prices chained volume measure (ONS code ABMI) and household consumption expenditure (ONS code ABJR), quarterly, seasonally adjusted, UK, 1996–2005.

2.8 As much of the debate on falling output in the UK has centred on retail sales, we have examined a number of measures of retail sales growth. Figure 2.2 shows that on all four measures considered here, retail sales growth is weaker than it has been since early 1999. This is not indicative of outright recession, although few analysts are expecting a rebound to the previously high levels of activity in the near-term. Data from the Office for National Statistics (ONS), the CBI and the British

Retail Consortium (BRC), whether using total sales or like-for-like sales, show similar trends, although data from the CBI did not initially show the same recovery that the other measures appear to find since April 2005. The CBI data did, however, show a significant 'bounce' in December 2005, indicating that Christmas sales were reasonably firm. The large increase in year-on-year sales in March 2005 followed by a larger drop in April 2005 is likely to be the result of the fact that Easter (when retail sales are normally relatively high) was in April in 2004 but in March in 2005.

Figure 2.2

Comparison of ONS, BRC and CBI Retail Sales Data, UK, 1998–2005



Source: ONS retail sales (value of retail sales, not seasonally adjusted, ONS code EAIH), BRC Retail Sales Monitor (value of retail sales) and CBI Distributive Trades Survey (retail sales volumes; balance of views), monthly, UK, 1998–2005.

Note: The growth rates presented are percentage changes in the latest month compared with the same month a year ago.

2.9

Initial indications from various retail organisations suggest that Christmas 2005 sales have been higher than expected. Indeed, retail sales data from ONS have confirmed that some recovery has been taking place. In the three months to December 2005 retail sales, after stripping out the effect of price rises, rose by 1.6 per cent compared with the previous three months. Compared to the same period of the previous year, sales volumes increased by 2.8 per cent. However, this

recovery towards the end of the year was not sufficient to prevent a low rate of growth being recorded for the year as a whole. The total value of retail sales only rose by 1 per cent during 2005, which was the lowest annual increase recorded since the Second World War. The previous record low rate of increase was 2.6 per cent, recorded in 2003.

- 2.10** The data showing the value of sales do not, however, tell the whole story. One reason the value of retail sales grew so slowly was because of the increasing market share of cheap imports from countries such as China and India, which had the effect of lowering prices for some goods. It does not follow, of course, that profits fell as a consequence. Because of falling retail prices for some goods, the volume of retail sales may be a better guide to conditions in the sector. In 2005, the volume of retail sales rose by 2 per cent, down from 6 per cent in 2004. At the same time, however, retailers probably also lowered prices in order to support volumes during the difficult trading conditions encountered during part of 2005.
- 2.11** Data from the other large low-paying sector – hospitality – show that the sector grew strongly in 2003 and 2004. During 2005 the rate of growth declined in each of the first three quarters, but, unlike the rest of the economy, the rate of growth only dipped below the sector's long-term trend rate of growth during the third quarter (almost certainly as a response to the bombings in July 2005 in London) before rebounding strongly again in the fourth quarter.

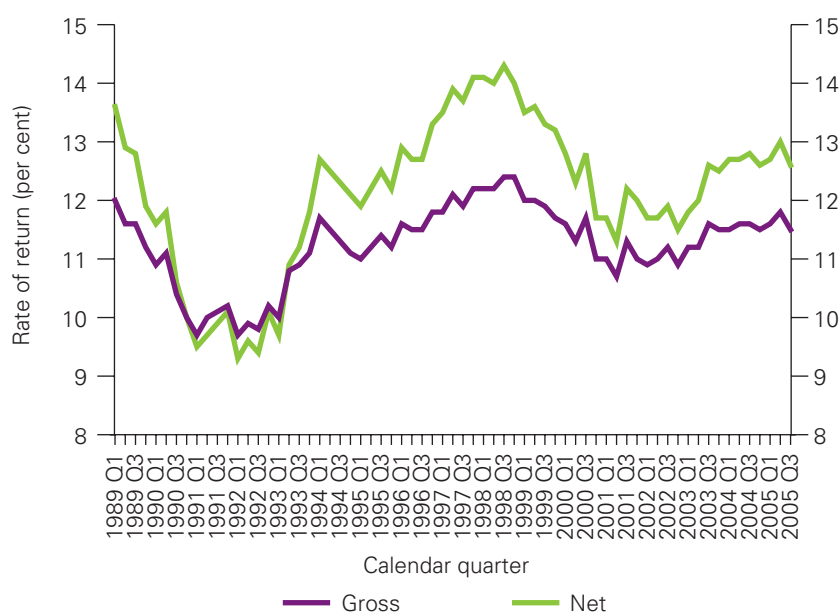
Profits and Investment

- 2.12** Despite the downturn in the economy, profits do not appear to have been adversely affected and have generally been growing since the first quarter of 2001. Figure 2.3 shows the gradually improving rate of return (both gross and net) for non-financial companies, excluding the volatile oil sector. However, it should also be noted that during 2005, the financial and oil sectors were in fact the best performing sectors of the UK economy, thus Figure 2.3 understates the upswing in profitability currently taking place in the UK economy as a whole.
- 2.13** It is not possible to deduce from such broad movements in profitability what effect the minimum wage has been having on particular sectors of the UK economy, still less the effects on individual firms. However,

there is no evidence to suggest that a generalised profits squeeze of any form has been taking place. Current fluctuations in profits seem to be consistent with the largely trendless cycles in profits that have been taking place over the last two decades.

Figure 2.3

Gross and Net Rates of Return on Capital Employed of Non-oil Private Non-financial Corporations, UK, 1989–2005



Source: ONS, gross and net rates of return of non-oil private non-financial corporations (ONS codes LRXO and LRXP), quarterly, seasonally adjusted, UK, 1989–2005.

Notes:

1. The rates of return presented are ratios of operating surpluses compared to capital employed, expressed as percentages.
2. Intuitively, the reader might expect the gross rate of return to be greater than the net rate of return. However, in the net rate of return calculations, net operating surplus is derived by subtracting capital consumption (depreciation) from the gross operating surplus and net capital is net of accumulated capital consumption (depreciation). The latter depreciation is much greater than the former leading the net rate of return to exceed the gross rate of return.

2.14 Despite healthy levels of profitability, the level of investment, or new capital formation by firms, has recently been very low, even compared with previous periods of below-trend growth. This is a phenomenon that is by no means confined to the UK economy, but one the UK shares with other developed economies. There is currently an abundance of savings, or funds available for investment, and since these are not being absorbed by firms wishing to borrow to invest, real interest rates¹ have fallen to the lowest levels for a generation. To a

“ The conditions for business investment over the next two years remain favourable. ”

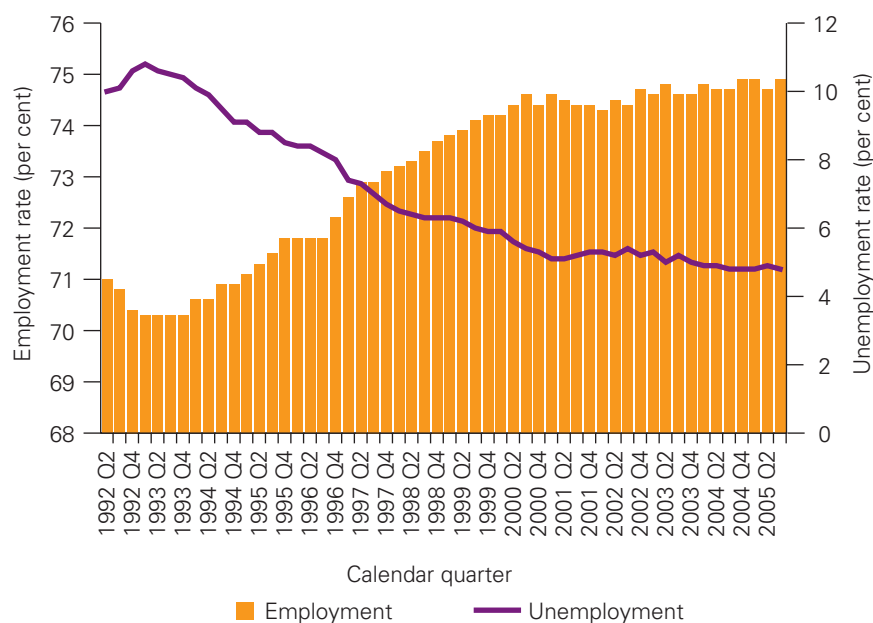
NIESR, National Institute Economic Review, January 2006

¹ Real interest rates are defined as the difference between nominal interest rates and inflation.

certain extent it is firms themselves doing the saving, as they attempt to make provision to shore up deficits in their pension funds, deficits which are, in turn, exacerbated by low interest rates.

Labour Market – Employment

- 2.15** Despite the slowdown in consumption and retail sales and the disappointing data on output growth, particularly in manufacturing, the labour market remained remarkably robust in 2005. However, it should be noted that employment is often a lagging indicator of the state of the economy. Since the adult minimum wage was uprated to £4.85 in October 2004, total employment has risen and currently stands at near record levels. Employment rates, on the other hand, are broadly flat as the working age population has also grown, mainly as a consequence of the large increases in net migration. Unemployment, whether measured in levels or rates, by job seekers or benefit claimants, also continues to be low but has increased during 2005.
- 2.16** By the end of the third quarter of 2005 there were 27.8 million working age people in employment. Between the October 2004 and October 2005 minimum wage upratings, total working age employment increased by 281,000, an increase of 1.0 per cent, which is similar to the growth reported in recent years. The working age employment rate increased marginally from 74.7 per cent in the third quarter of 2004 to 74.9 per cent in the third quarter of 2005, as shown in Figure 2.4. The most recent data, however, show a slight downturn in the labour market. Although total employment for all those aged 16 and over increased by 221,000 over the year to November 2005, it fell by 22,000 in the quarter to November 2005. The fall in employment, coupled with the migration-led increase in population, led to a fall in the working age employment rate to 74.5 per cent in the three months to November 2005.

Figure 2.4**Working Age Employment and Unemployment Rates, UK, 1992–2005**

Source: ONS, Labour Force Survey (LFS), employment rate (ONS code MGSU) and unemployment rate (ONS code YBTI), quarterly, seasonally adjusted, UK, 1992–2005.

2.17 Claimant unemployment has now risen for 11 consecutive months. The rise has been gradual, but over the year to December 2005 the cumulative increase was nearly 85,000 bringing the total to just under 0.91 million. Headline unemployment (using the International Labour Organisation (ILO) definition) was up to 1.53 million in the three months to November 2005 – the biggest increase since the three months to February 1993. In the three months to November 2005, it was also up 121,000 on a year earlier and was at its highest level since February 2003. Increasingly, however, government economists do not draw a strong distinction between the unemployed and those on incapacity benefits, but instead view both categories as containing people who could be drawn into work under the right circumstances. Hence the Government's preferred indicator of the state of the labour market is employment.

2.18 The robustness of the labour market is confirmed by another measure of labour market activity – the total number of hours worked in the economy. The total number of weekly hours worked in the third quarter of 2005 was 942.8 million, an increase of nearly 15 million on the third quarter of 2004. The latest data confirm this robustness with total weekly hours worked at 942.7 million in the quarter to November 2005.

The owner of a small business in the Reading area told us that migrant workers are becoming more and more important because “people round here wouldn’t get out of bed for the minimum wage”.

**Low Pay Commission
visit to Reading**

The decline in average hours worked per week appears to have bottomed out at around 32 hours (increases in part-time hours have offset the decline in full-time hours in recent quarters).

- 2.19** The number of job vacancies is a potential leading indicator of the demand for labour. The data indicate that the trend is generally downwards. However, the number of vacancies in the three months to December 2005 was up 6,300 on the three months to November 2005. The level of job vacancies has been declining since reaching a peak in the three months to January 2005 but remains slightly higher than throughout 2001 to 2003. The fact that vacancies remain at a relatively high level, despite the surge in inward migration (according to ONS there was a net inward migration to the UK of 223,000 in 2004), is testimony to the ongoing strength of the UK labour market. There were 606,500 job vacancies on average in the three months to December 2005, down 12,700 from the three months to September 2005 and down 40,000 from the same period a year earlier. These falls have been concentrated in manufacturing and services (down 20 and 5 per cent respectively since the 2004 minimum wage upratings). In the service sector, the recent softening in consumer spending is reflected in the vacancy data for wholesale, retail and hospitality, where vacancies were down 21,300 in the three months to December 2005 compared to the same period in the previous year (a fall of nearly 11 per cent). However, they were higher than for most of 2003.

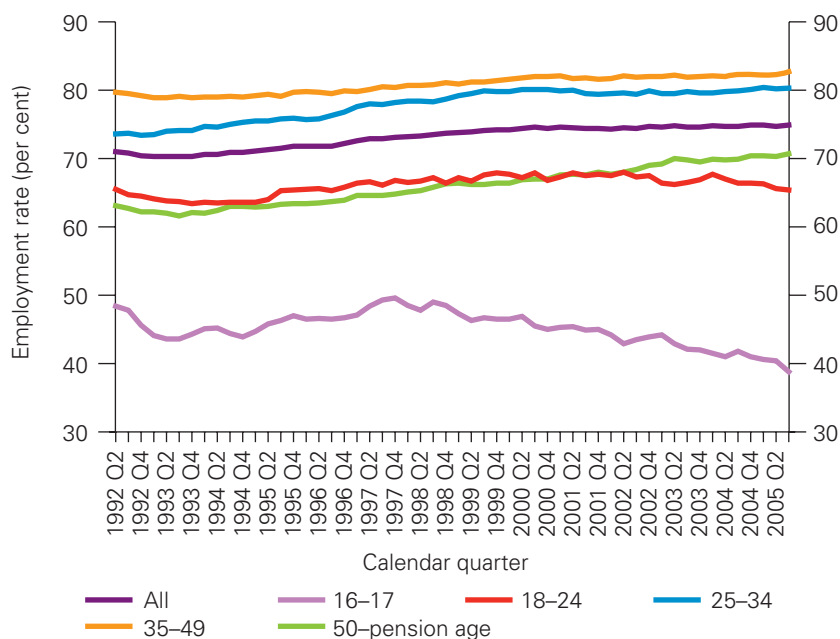
Low-paid Groups

- 2.20** Turning our attention to those groups of workers most affected by the minimum wage, we find that in the period since the October 2004 minimum wage upratings some of these groups appear to have experienced a slight deterioration in terms of their employment and unemployment outcomes. In particular, young people have continued to experience the toughest time in the labour market.
- 2.21** Figure 2.5 shows employment rates for different age groups. Since the October 2004 upratings and in the year to the third quarter of 2005, employment rates for those aged under 25 have fallen, as inactivity rates, particularly among students, have risen. Unemployment rates for those under 25 have also increased over the last year. In contrast, the employment rates of older workers have been rising. We discuss the

position of 16–17 year olds in the labour market in more detail in Chapter 3.

Figure 2.5

Working Age Employment Rates for Different Age Groups, UK, 1992–2005

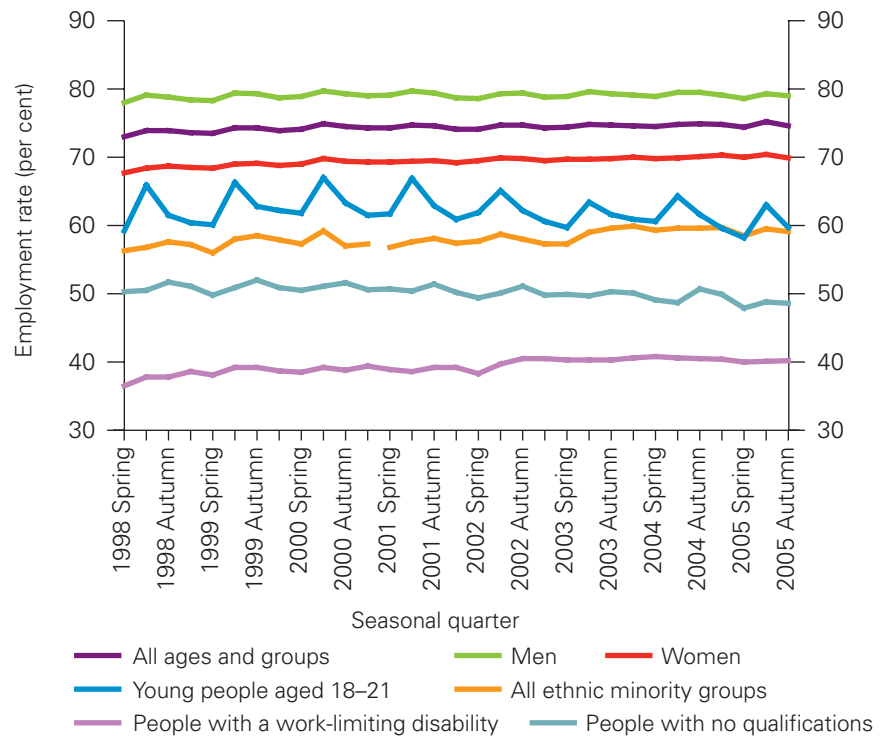


Source: ONS, LFS, employment rates by age series (ONS codes MGSU, YBUA, YBUD, YBUG, YBUJ and YBUM), quarterly, seasonally adjusted, UK, 1992–2005.

2.22 Figure 2.6 shows recent changes in the working age employment rates of women, ethnic minority groups, those with a work-limiting disability, young people and those without any educational or training qualifications. The employment rate for women fell between Autumn² 2004 and Autumn 2005 by 0.1 percentage points to 69.9 per cent, while the employment rate for men fell by 0.4 percentage points to 78.9 per cent.

² Autumn covers the months September to November.

Figure 2.6
Working Age Employment Rates for Different Groups, UK, 1998–2005



Source: LPC estimates based on ONS LFS Microdata, seasonal quarters, not seasonally adjusted, UK, 1998–2005.

Note: The definition of ethnic groups in the LFS changed in Spring 2001 in line with the 2001 Census classifications; thus direct comparisons before and after should not be made.

2.23 Between Autumn 2004 and Autumn 2005 there were significant falls in employment rates for young people and those with no qualifications. Although employment rates for those without any qualifications were stable between Summer³ 2004 and Summer 2005, they fell by 2.1 percentage points between Autumn 2004 and Autumn 2005. Employment rates of young people aged 18–21 fell by 1.9 percentage points between Autumn 2004 and Autumn 2005, which continues the downward trend observed since the Summer of 2001. Employment rates for people with a work-limiting disability actually increased in the Summer and Autumn quarters of 2005 but are still below the peak of 40.8 per cent observed in Spring 2004. Employment rates for ethnic minorities have fallen slightly since the 2005 minimum wage upratings but have been fairly constant since Summer 2003.

2.24 Although inactivity rates for those with work-limiting disabilities have fallen since Autumn 2004, their employment rates have also fallen.

³ Summer covers the months June to August.

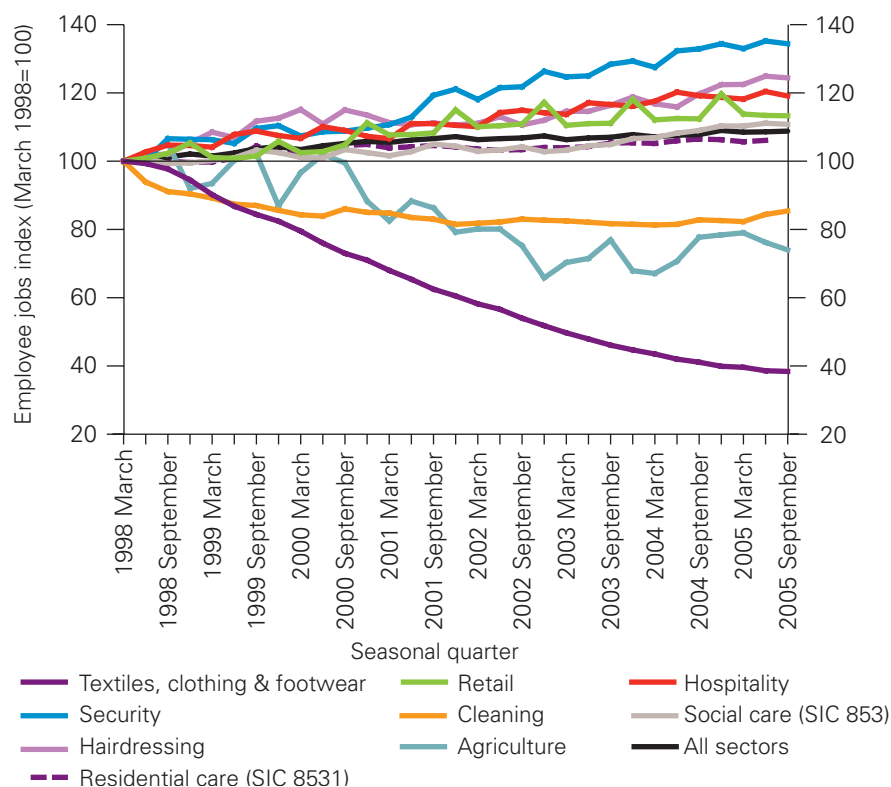
Recent changes to the benefits system have been designed to induce more people with disabilities to seek work and thus their unemployment rates may have risen as a result.

Low-paying Sectors

2.25 As discussed in previous reports, were there to be an adverse employment impact as a result of the minimum wage, in all likelihood it would be more evident in the low-paying sectors than in the economy as a whole. Figure 2.7 shows how the number of employee jobs has changed in the main low-paying sectors since 1998.

Figure 2.7

Change in Employee Jobs in Low-paying Sectors, GB, 1998–2005



Source: ONS Employee Jobs series, seasonal quarters, not seasonally adjusted, GB, 1998–2005.

Note: The ONS series on residential social care was discontinued in June 2005. Available data for the social care sector covers both residential and non-residential care.

2.26 In general the number of employee jobs has increased over time in most of these sectors. Only in three industries has the number fallen – the manufacture of textiles, clothing and footwear; cleaning; and agriculture. The declines in employment in agriculture and textiles are well-documented and stem from reasons unrelated to the minimum

wage. The decline in the number of cleaning jobs occurred mainly before 2000, bottomed out in 2002 and 2003 and has started to reverse in the last two years.

2.27 These changes are shown in more detail in Table 2.2. It can be seen that since the introduction of the minimum wage, there has been growth of over 10 per cent in the number of jobs in both retail and hospitality. There is no strong evidence in the labour market to support the contention that recent increases in the minimum wage have had a detrimental effect on the number of jobs.

Table 2.2 Number of Employee Jobs in Low-paying Sectors, GB, 1998–2005

	Number of employee jobs			
	September 2005	Change on September 2004	Change on March 1999	Change on September 1998
All sectors	25,948,686	+231,304	+1,742,258	+1,802,604
All low-paying sectors	6,740,643	+38,404	+429,610	+337,738
<i>Of which:</i>				
Retail	2,829,694	+22,552	+305,018	+275,999
Hospitality	1,781,258	-1,624	+224,027	+215,721
Social care	1,076,382	+17,812	+103,252	+112,037
Cleaning	434,793	+13,426	-19,010	-28,765
Agriculture	214,008	-10,696	-56,500	-89,789
Security	161,914	+1,789	+33,840	+33,422
Textiles, clothing and footwear	130,069	-9,091	-175,436	-201,056
Hairdressing	112,525	+4,236	+14,419	+20,169

Source: ONS, employee jobs series, not seasonally adjusted, GB, 1998–2005.

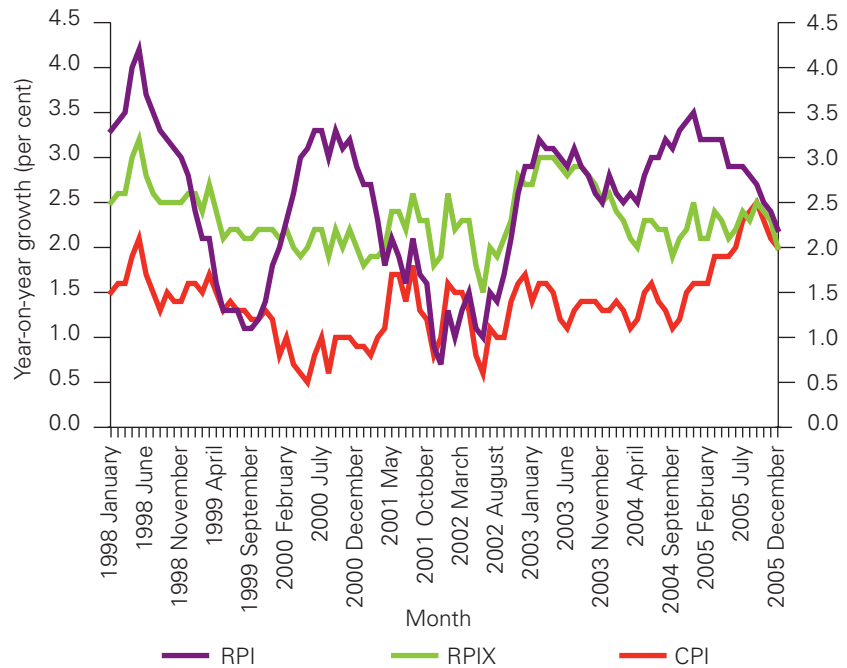
Note: The ONS series on residential social care was discontinued in June 2005. The social care sector data given here covers both residential and non-residential care.

2.28 ONS data show that over 38,000 net new jobs have been created in the low-paying sectors since September 2004. The data also indicate that, despite the many negative stories about recent difficulties in the retail sector, there has been no net job loss. On the contrary, around 22,500 net new jobs have been created in that sector since September 2004.

2.29 The net reduction of about 1,600 jobs in the hospitality sector is small but conceals a big shift from part-time to full-time working. Growth in net full-time employee jobs of 48,800 was accompanied by a loss of just over 50,000 net part-time jobs. Moreover, about 216,000 net employee jobs have been created in the sector since September 1998. This constitutes a rise of 13.8 per cent in the number of jobs in hospitality since September 1998.

Inflation

- 2.30** The evidence suggests that the labour market has not contributed towards inflationary pressures in the economy. There are three commonly used measures of price inflation, and although these can differ quite markedly, Figure 2.8 shows they are all presently sending similar messages about inflation. In December 2005, annual growth in the Retail Price Index (RPI) was 2.2 per cent; the Retail Price Index excluding mortgage payments (RPIX) was 2.0 per cent, as was the CPI, which was at the Bank of England's target of 2.0 per cent.
- 2.31** Where the measures have produced different inflation rates in the past, the differences have been largely the result of different treatments of housing costs. The CPI excludes all housing costs, whereas the RPI includes them and the RPIX excludes only those related to mortgage interest payments. The differences are thus driven by items such as Council Tax bills, interest rates, housing depreciation and buildings insurance. Pay settlements tend to be more closely geared towards RPI than the other measures, and this has been less responsive than CPI to higher energy costs.
- 2.32** At the same time that GDP growth has slowed in response to higher energy costs, these have also pushed up inflation, as measured by the CPI, but only from around 1.6 per cent in June 2004 to 2.0 per cent in December 2005. The encouraging inflation picture is also reflected in the fact that the key retail price index, RPIX, rose more slowly than expected despite the energy price rises. This suggests that the degree of slack that opened up in the economy as a result of slower than expected output growth served to dampen down any inflationary pressures that might have arisen.

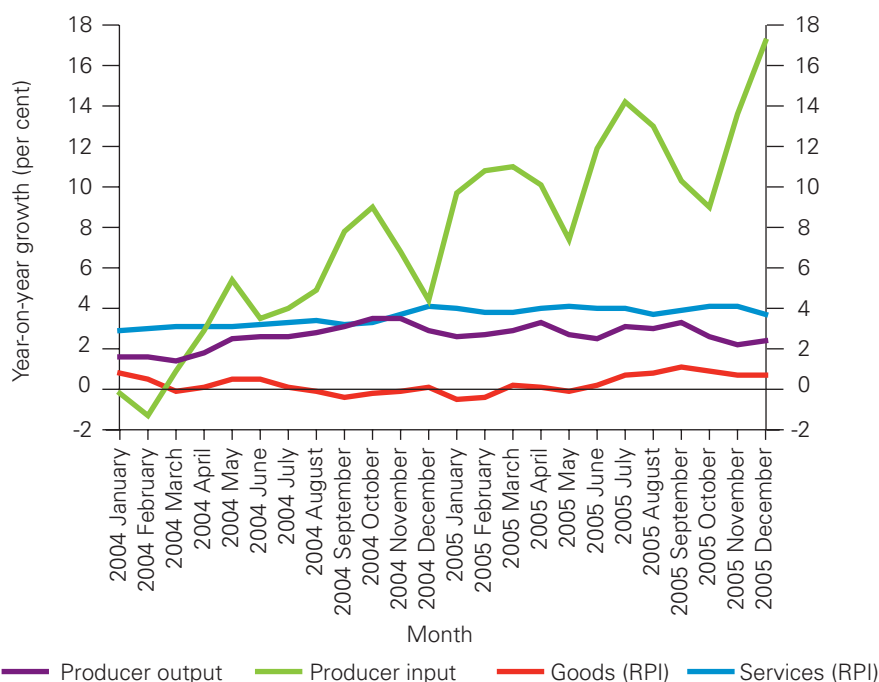
Figure 2.8**Consumer Price Inflation – A Comparison of Measures, UK, 1998–2005**

Source: ONS, CPI (ONS code CJYR), RPI (ONS code CZBH) and RPIX (ONS code CDKQ), UK, 1998–2005.

2.33 Figure 2.9 illustrates that prices of producer inputs, spurred on by energy costs, have risen substantially faster than the prices of producer outputs, or consumer goods prices. This indicates that firms lack pricing power in the current economic environment, and are unable to pass cost increases along the production chain. This is principally the result of the drag exerted by the growing output gap as growth in economic activity has fallen below trend. Consequently, forecasters are largely agreed that inflation will remain well contained within the region of the Bank of England's current target of CPI inflation of 2 per cent. Reflecting this, and that there has been little or no pass-through from energy prices to consumer prices to wages, growth in average earnings fell below consensus expectations in 2005.

Figure 2.9

Price Inflation – Manufacturing Input and Output Prices, RPI Goods and Services, UK, 2004–2005



Source: ONS, RPI for consumer goods (ONS code DOGD) RPI for services (ONS code DOGE), producer input prices (ONS code RNNK) and producer output prices (ONS code PLLU), monthly, not seasonally adjusted, UK, 2004–2005.

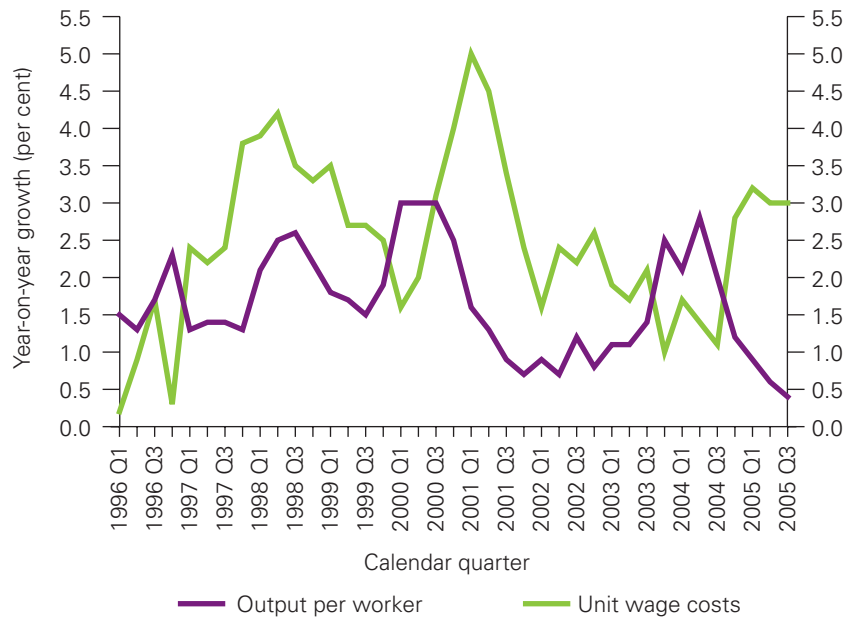
Productivity and Unit Wage Costs

2.34 While inflation has remained subdued despite the pressures from energy price hikes, there has been some acceleration in labour costs. Slow growth in GDP combined with high employment has led to a decline in productivity growth, which in turn has led to an increase in unit wage costs over recent quarters. Figure 2.10 shows that productivity has fallen significantly since the second quarter of 2004 and, combined with steady growth in real earnings (earnings relative to price inflation), has resulted in a rise in unit labour costs of 3.0 per cent in the third quarter of 2005, up from a rise of just 1.0 per cent in the previous year. It should, however, be noted that productivity growth often falls sharply when growth slows at the start of a downturn, as GDP growth falls faster than employment growth. This productivity fall might be exacerbated if employers believe that the downturn is only short-term and hold on to workers they might otherwise let go.

A hotel manager told us that being made to pay more forced managers to manage better. In his hotel they had recently stripped out layers of hierarchy, as they had found that too many layers were not only unnecessary but also tended to reduce individual initiative. He concluded by saying, "After all, cooking breakfast is not rocket science and I don't see why we have to call someone who fries egg and bacon a 'chef'".

**Low Pay Commission
visit to Northern Ireland**

Figure 2.10
Growth in Labour Productivity and Unit Wage Costs, UK, 1996–2005



Source: ONS, output per worker (ONS code A4YN) and unit wage costs (ONS code LOJE), quarterly, seasonally adjusted, UK, 1996–2005.

Note: Output per worker is the ratio of Gross Value Added at basic prices and LFS total employment. Unit wage costs are defined as average wages and salaries for employees divided by output per worker.

Pay

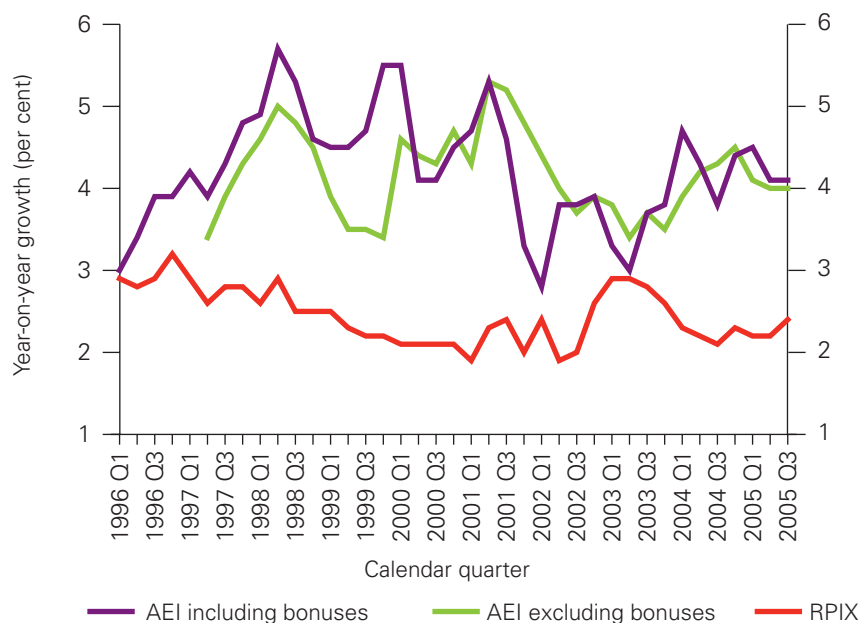
2.35 The influence of the disinflationary forces in the economy is reflected in the level of wage increases in the economy. The increase in unit labour costs is not the result of any acceleration in the pace of pay increases. Figure 2.11 depicts the annualised increase in average earnings (including and excluding bonuses), as measured by the AEI, and inflation, as measured by RPIX.

2.36 Average earnings growth (with and without bonuses) has moderated in recent months and is currently below the 4.5 per cent level forecast in our 2005 Report. The rising net inflow of migrant workers to the UK, particularly from Eastern Europe, may have played a significant role in subduing wage inflation. In the third quarter of 2005, annualised average earnings grew by 4.1 per cent including bonuses and by 4.0 per cent if bonuses are excluded. The latest data, for the three months to November, show a further deceleration in annual average wage growth. The measure including bonuses fell to just 3.4 per cent while the measure excluding bonuses fell to 3.8 per cent. However,

independent forecasters' consensus prediction remains that average earnings including bonuses will grow by 4.2 per cent in 2006.

Figure 2.11

Comparison of Growth in Average Earnings (GB) with Price Inflation (UK), 1996–2005

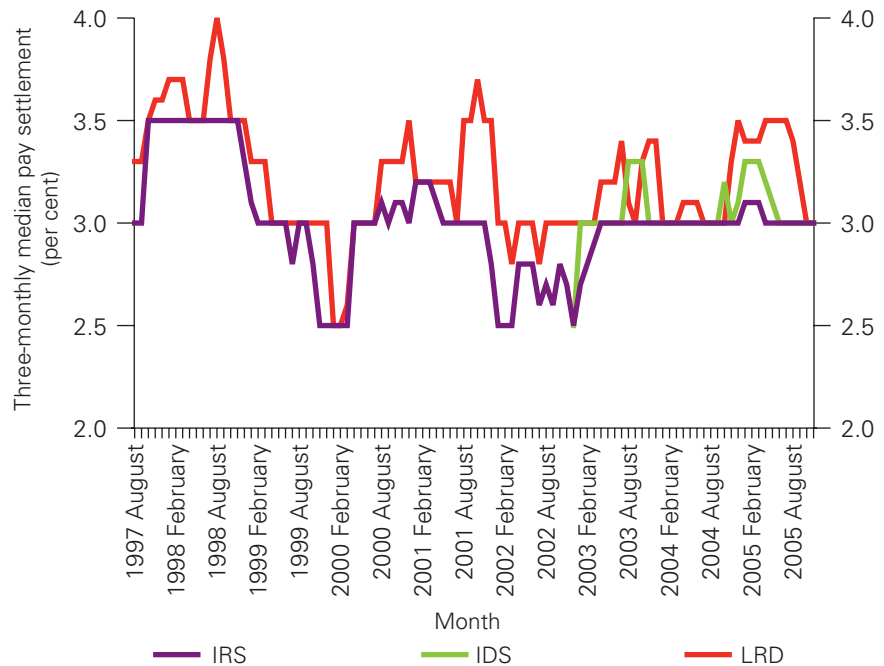


Source: ONS, AEI including and excluding bonuses (ONS codes LNNC and JQDY), and RPIX (ONS code CDKQ), quarterly, seasonally adjusted, GB (UK for RPIX), 1996–2005.

Notes:

1. The AEI excluding bonuses series began in 1997.
2. The AEI growth rates presented are 3-month average percentage changes; the 3-month average change is the change in the average seasonally adjusted index value for the last 3 months compared with the same period a year earlier.
3. The RPIX growth rates are percentage changes over a year earlier.

2.37 Although the data indicate that actual earnings growth turned out to be slower in 2005 than was forecast in the 2005 Report, especially in the private sector, data on pay settlements do not generally reflect this. Pay settlement data from Incomes Data Services (IDS), Industrial Relations Services (IRS) and the Labour Research Department (LRD) show that, for most of 2004, median pay settlements were stable at 3 per cent, as shown in Figure 2.12.

Figure 2.12**Pay Settlements – A Comparison of Median Measures, UK, 1997–2005**

Source: IRS, IDS and LRD pay databank records, UK, 1997–2005.

Note: The IDS monthly series began in December 2002.

2.38 Indeed, the level of pay settlements picked up in the early part of 2005, although the IRS and IDS measures had returned to 3 per cent by August 2005. The LRD measure gives greater weight to the public sector than the other measures, so it is perhaps not surprising (given that public sector average wage growth has been higher than in the private sector throughout 2005) that this measure is currently running slightly higher than the other two measures.

2.39 Some respondents to our consultation reported that recent increases in the minimum wage had forced firms to give larger than planned increases to low-paid workers on the minimum wage and to those earning slightly more in order to maintain differentials. However, we have uncovered no evidence to suggest that recent increases in the National Minimum Wage have fuelled inflation in general or wage inflation in particular.

A common view expressed at a meeting with a hospitality association was that the minimum wage was no longer just a wage floor that protected people from poverty, but was now driving the level of wages in the sector.

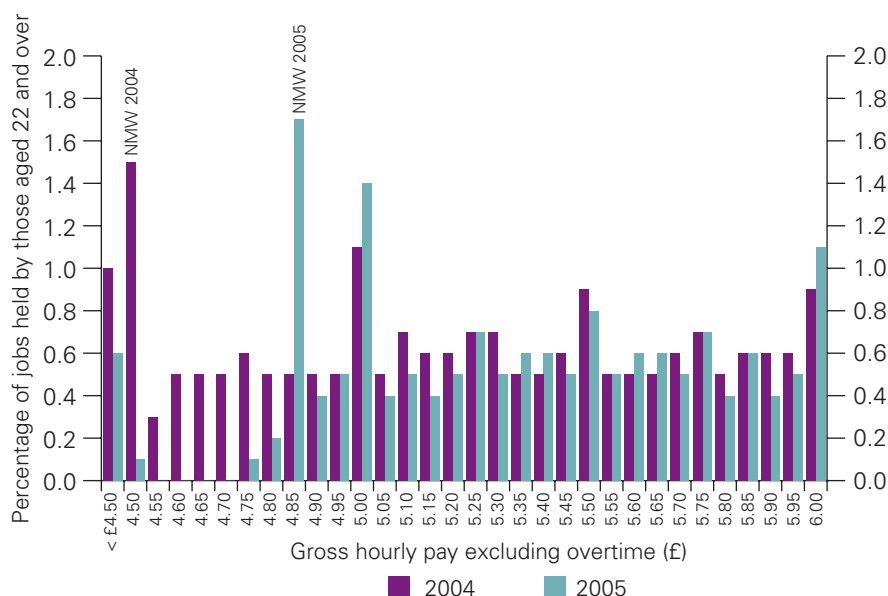
**Low Pay Commission
visit to Manchester**

Earnings

2.40 The impact of the adult minimum wage can clearly be seen in Figure 2.13. There are spikes in the distribution of hourly earnings excluding overtime at the applicable adult minimum wage rates in both April 2004

(£4.50) and April 2005 (£4.85). In previous reports we found that the concentration of the workforce at the minimum wage was greater after a large increase in the minimum wage. The increase in the adult minimum wage between April 2004 and April 2005, 7.8 per cent, was greater than the 7.1 per cent increase between April 2003 and April 2004 and we can see that the proportion of employee jobs paying the minimum wage was slightly higher in April 2005 than in April 2004.

Figure 2.13
Distribution of Gross Hourly Earnings Excluding Overtime for Employees Aged 22 and Over, UK, 2004–2005



Source: ASHE with supplementary information, UK, 2004–2005.
 Note: NMW label shows the adult NMW rate in April of the given year.

2.41 In our 2005 Report, we demonstrated that the minimum wage had increased the hourly wages of those at the bottom end of the earnings distribution, particularly in the period around the introduction of the minimum wage (1998–2000) but also as a result of subsequent upratings (2000–2004). Figure 2.14 shows that this improvement in the hourly wages of those at the bottom of the earnings distribution, compared with the median, has continued. However, at the lower end of the earnings distribution, only those in the bottom four percentiles appear to have had hourly wage increases significantly greater than the median between April 2004 and April 2005. For the fifth to the seventy-fifth percentiles, hourly wage increases over this period were similar to

The HR manager of a retail firm said that while a minority of staff benefited from the minimum wage (i.e. those at the bottom of the pay ladder) the majority of staff (i.e. those higher up the pay scale and those in higher-paying areas of the UK) had not seen their wages rise by the same amount and so could be seen as worse off.

Low Pay Commission visit to Grimsby

the median. However, the hourly earnings of the top 25 percentiles rose faster than the median.

Figure 2.14

Increase in Hourly Earnings Excluding Overtime Minus the Increase in Median Earnings by Percentile for Employees Aged 22 and Over, UK, 2004–2005



Source: ASHE with supplementary information, UK, 2004–2005.

“ A key indicator of inflationary pressures in the labour market is private sector regular pay.... The subdued pace of regular pay growth is likely to reflect demand conditions. But supply factors may also have been important... higher levels of net migration have boosted labour supply and eased the degree of tightness in the labour market over the recent past. ”

Bank of England, Inflation Report, November 2005

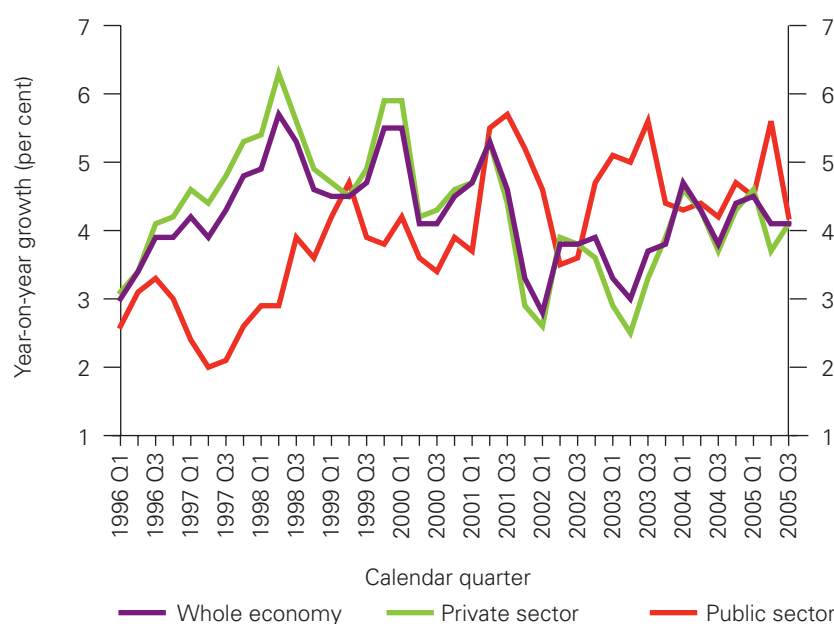
The Public and Private Sectors

2.42 Few employees in the public sector are paid at wages close to the minimum wage, particularly since the implementation of improved pay rates under the Agenda for Change in the NHS. It might be argued that we should therefore concentrate our analyses on the impact of the minimum wage on the private sector. This section looks at the differences in earnings and employment growth between the two sectors.

2.43 It can be seen in Figure 2.15 that average earnings growth in the public sector has generally been higher than in the private sector since 2001, although apart from the second quarter of 2005, average wage growth has been similar in both sectors since the end of 2003. In the third quarter of 2005, average earnings grew by 4.1 per cent in the public sector compared with 4.0 per cent in the private sector.

Figure 2.15

Growth in Average Earnings Including Bonuses, Public and Private Sectors, GB, 1996–2005



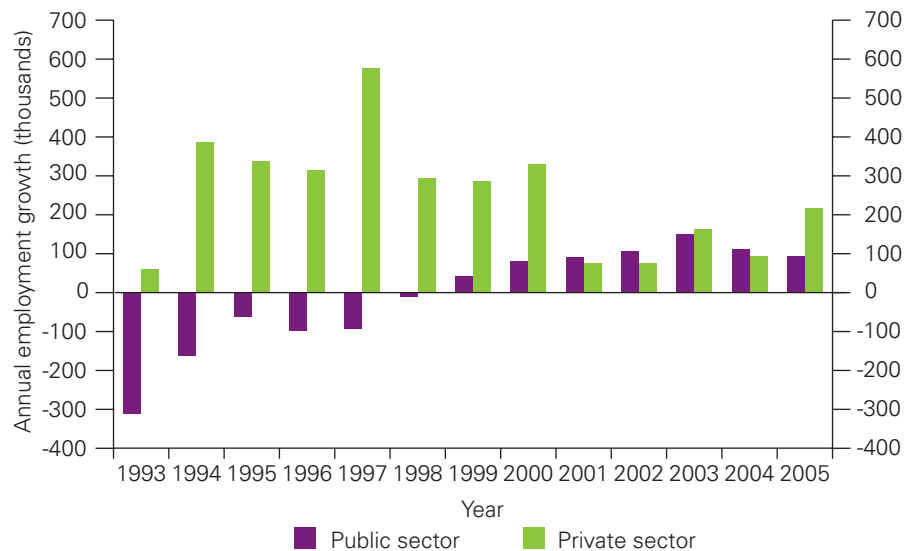
Source: ONS, AEI including bonuses for the whole economy (ONS code LNNC), private sector (ONS code LNND) and public sector (ONS code LNNE), quarterly, seasonally adjusted, GB, 1996–2005.
Note: Growth shown is for the quarter compared with the same period a year ago.

2.44 More recently, however, average earnings growth in the private sector has been markedly slower than in the public sector – growing at just 3.3 per cent compared to 4.1 per cent in the three months to November 2005. The evidence also suggests that average wage growth in retail and hospitality has also been particularly subdued in the latter half of 2005.

2.45 Employment in the private sector, as shown in Figure 2.16, has grown in every year since 1993. Recent increases in government expenditure have led to an increase in the size of the public sector workforce. Indeed, most of the increase in jobs in the UK labour market between 2001 and 2004 was in the public sector. However, the increase in the number of private sector jobs in 2005 was more than twice the increase in public sector employment. But the growth in public sector employment in 2005 was faster than the growth in private sector employment as the public sector accounts for only a fifth of all jobs.

Figure 2.16

Annual Changes in Public and Private Sector Employment, UK, 1993–2005



Source: ONS, public sector employment (ONS code C9KD) and private sector employment (ONS code CZG8), annual, not seasonally adjusted, UK, 1993–2005.

Note: Changes based on mid-year estimates.

- 2.46** At an overall level, there is no evidence to suggest that the minimum wage has significantly affected wage inflation or employment growth in the private sector.

Stakeholders' Views

- 2.47** In the Autumn of 2005, we conducted a written consultation exercise asking a selection of interested parties to send us their views on the state of the economy and whether there had been sufficient change since the 2005 Report to warrant a revision to our recommended rates for 2006. We asked them to focus on sectoral data and other information that would not otherwise be available to us.
- 2.48** Not surprisingly, the responses were mixed. Trade unions, on the whole, believed that the proposed October 2006 increases could be absorbed without harmful effects to the economy. In general, they emphasised the strength of the labour market in their arguments. The TUC argued that although the economy was growing more slowly than in recent years, there was no sign of recession. It also noted that the recent slowdown had not adversely affected profits. The Union of Shop, Distributive and Allied Workers (Usdaw) pointed out that, despite the

Before the minimum wage was introduced, employers warned of dire consequences, none of which happened. Now the LPC must stand firm.... The views of employers, who are unable to put the brakes on their own boardroom pay and pensions, should carry little weight with the Commission.

TUC evidence

downturn on the high street, employment in retail had actually increased since October 2004. It argued that aggressive competition in retail was responsible for some of the sector's difficulties, although it conceded that there had been a decline in the growth of consumer spending.

2.49 In contrast, employers' groups emphasised the downturn in the economy and the impact this was having on particular sectors, especially those in the consumer-related service sector. In general, they did not support the proposed increase and called for it to be reduced or at least delayed. Most employer organisations stressed the adverse impact of increased costs on businesses, particularly those arising from energy use and business rates. The CBI warned that we should be very cautious in proceeding with an above-average earnings increase in the minimum wage. It concentrated its arguments on the lower forecasts for growth in 2005 and 2006; the level of profits and how these were below those normally expected at this point in the business cycle; the performance of the consumer-related service sector; and increases in non-labour input costs.

2.50 The BRC concentrated on the downturn in the retail sector and the inability of retailers to raise prices despite a backdrop of increased labour and non-labour costs. The Association of Convenience Stores also drew on these issues but emphasised the potential impact of other legislation, in particular the proposed extension to statutory annual leave entitlement and the possible introduction of compulsory employer pension contributions, and argued that these be taken into account when reviewing the rates. BUPA Care Services also picked up on this theme, emphasising the burden of increasing paid holiday entitlement, along with higher energy costs and the inability to pass on many of its costs to its customers. Manufacturers, on the other hand, tended to stress the impact of the minimum wage on differentials and incentive pay systems.

2.51 The Government stressed how successful the National Minimum Wage had been. It noted that output had slowed, reflecting a decline in housing market activity and consumer spending as a result of interest rate rises earlier in the year. The Bank of England has also noted (for example, in its November 2005 Inflation Report) that discretionary spending had reduced due to increases in taxation and utility bills, as well as fuel prices.

“The CBI is concerned that in the worst case scenario, for those companies whose profits will be particularly squeezed by the proposed NMW increase, ...companies would cut back on employment in order to save costs, and those employed at the minimum wage would probably be the first to suffer job losses.”

CBI evidence

A manager of a small general store commented, “In general, I’m not hostile to the minimum wage but I have struggled to cope with the most recent annual upratings. The business faced labour shortages a few years ago for the first time, which led to pressure on wages. Although I think that wages would have risen anyway, the minimum wage has begun to have a huge impact on pay differentials and staffing levels. I am particularly concerned about how far it will rise in the future.”

**Low Pay Commission
visit to Lincolnshire**

2.52 The Government noted that, despite the slowdown, profits remained fairly strong and the labour market robust. Unemployment had risen marginally and earnings had been broadly stable. It noted that the bite of the minimum wage (its level relative to average earnings) had increased, but that coverage remained at around 5 per cent of all jobs. In international comparisons of minimum wages relative to average wages, the UK minimum wage was roughly in the middle. The Government found little adverse impact of the minimum wage on the low-paying sectors.

Review of 2005 Upratings – Beneficiaries and Coverage

2.53 The rate of growth of average earnings is a crucial input into the estimation of the number of beneficiaries of the minimum wage. Estimating the number of beneficiaries, as a way to gauge the impact of the minimum wage, is not altogether straightforward, and we begin by looking at the latest ONS estimates of those paid below the minimum wage. The scale of the impact of the minimum wage will be related to the number of workers affected. A larger than expected number of beneficiaries would indicate that the effect had been greater than we had anticipated.

2.54 We start, however, by looking at potential coverage – the maximum number of jobs that could possibly be affected. We can see from Table 2.3 that in April 2005, 327,000 jobs paid below the minimum wage. This total consisted of 249,000 jobs held by adults (aged 22 and over), 57,000 held by youths (aged 18–21) and 20,000 held by 16–17 year olds.

Table 2.3 Estimates of Jobs (in Thousands and Percentages) Paid Below the Applicable National Minimum Wage and the October 2005 Upratings

Jobs paying less than	16–17		18–21		22 and over		Total	
	000s	(%)	000s	(%)	000s	(%)	000s	(%)
NMW (April 2005)	20	4.0	57	3.2	249	1.1	327	1.3
NMW (October 2005)	20	4.0	127	7.1	1,172	5.1	1,319	5.2

Source: ASHE with supplementary information, UK, 2005.

Notes:

1. The minimum wage for 16–17 year olds was £3.00 in April 2005 and October 2005.
2. The minimum wage for 18–21 year olds was £4.10 in April 2005 and £4.25 in October 2005.
3. The minimum wage for those aged 22 and over was £4.85 in April 2005 and £5.05 in October 2005.

- 2.55** In April 2005, around 1.2 million jobs held by adults aged 22 and over (or just over 5 per cent of the workforce) were paid below £5.05 an hour, the adult minimum wage rate implemented in October 2005. Nearly 130,000 young workers (aged 18–21) were paid below the October 2005 youth Development Rate of £4.25 an hour. We made no recommendation on the uprating of the 16–17 year old rate for October 2005 and it remained at £3.00.
- 2.56** The coverage estimates provide a fairly crude measure of how many jobs were likely to benefit from the October 2005 upratings. In order to estimate more accurately how many workers actually benefited from the minimum wage increases in October 2005, we need first of all to estimate what would have happened to the wages of the low-paid if the minimum wage had remained at its October 2004 rate of £4.85 an hour for adults and £4.10 for young workers aged 18–21.
- 2.57** It is likely that low-paid workers would have experienced at least some increase in their hourly wages in the absence of a minimum wage increase. We cannot know precisely how much their wages would have increased in the absence of the minimum wage, so we use two assumptions for the counterfactual growth in earnings. We assume either that wages would have grown in line with average earnings or that they would have grown in line with price inflation⁴. We consider the beneficiaries of the 2005 upratings to be those who would otherwise have gained a smaller pay rise between April 2005 (when the pay data was collected) and October 2005, when the new minimum wage rates came into effect.
- 2.58** Table 2.4 compares our latest estimates of beneficiaries, using the 2005 ASHE and the latest information on earnings and prices, with those made at the time of the 2005 Report using the information then available. These estimates follow the familiar pattern explained in the 2005 Report. As we use data closer to the implementation date of the minimum wage upratings, we find that the estimated number of beneficiaries is revised downwards.

⁴ A recent article (Butcher, 2005) showed that the earnings of the lowest-paid rose considerably less than those of the better paid in the period (1992–1997) immediately prior to the introduction of the National Minimum Wage. Indeed, between 1992 and 1997, wage growth for the lowest decile (13.9 per cent) was closer to the growth in retail prices (12.6 per cent) than the growth in average earnings (19.0 per cent).

Table 2.4 Estimates of Jobs (in Thousands and Percentages) Benefiting from the October 2005 National Minimum Wage Rates

Hourly rates October 2005		Estimated number (thousands) and percentage of jobs benefiting			
		Earnings basis		Prices basis	
		Latest estimates ⁵	2005 Report estimates ⁶	Latest estimates ⁷	2005 Report estimates ⁸
Adult rate	£5.05	740 3.2%	1,090 4.7%	850 3.7%	1,470 6.3%
Youth Development Rate (18–21s)	£4.25	110 6.2%	120 6.3%	110 6.2%	150 7.9%
16–17 year old rate	£3.00	20 3.9%	40 7.5%	20 4.0%	40 7.5%
Total		900 3.6%	1,300 5.2%	1,000 4.0%	2,100 8.4%

Source: LPC calculations based on ASHE with supplementary information, UK, 2004 and 2005.

Notes:

1. The estimates of beneficiaries made at the time of the 2005 Report assumed 21 year olds would be entitled to the adult rate. In these estimates they are assumed to qualify for the youth Development Rate.
2. The 2005 Report estimates are based on ASHE 2004 data and assumptions used in that report. Latest estimates are based on ASHE 2005 data.
3. Estimates of adult jobs and the total number of beneficiaries are rounded to the nearest 100,000. Estimates of youth (18–21) jobs and 16–17 year old jobs are rounded to the nearest 10,000.
4. Estimates of the percentage of gainers are rounded to the nearest 0.1 per cent.
5. Estimates in December 2005 based on average earnings growth including bonuses of 2.05 per cent between April 2005 and October 2005.
6. Estimates in February 2005 based on average earnings growth including bonuses of 2.1 per cent between April 2004 and October 2004 and forecast increase of 4.5 per cent in 2005.
7. Estimates in December 2005 based on RPIX price inflation of 1.2 per cent between April 2005 and October 2005.
8. Estimates in February 2005 based on RPIX price inflation of 1.2 per cent between April 2004 and October 2004 and forecast increase of 2.3 per cent in 2005.
9. If all 16–17 year olds had been paid the minimum wage in April 2005, there would not be any beneficiaries among this age group as the minimum wage did not increase in October 2005 for 16–17 year olds. However, we estimate that up to 20,000 16–17 year olds have benefited from the £3.00 rate in 2005 as they were paid below the minimum wage in April 2005.

2.59 Using the earnings assumption, we now estimate that 0.9 million jobs benefited from the 2005 upratings compared to the 1.3 million estimated at the time of the 2005 Report. This apparent fall, however, probably reflects the fact that some employers will have anticipated the forthcoming October 2005 minimum wage prior to the ASHE survey date in April 2005 and that workers who benefited prior to April 2005 do not show up in these estimates.

2.60 If no employers had anticipated the forthcoming October 2005 upratings, we would have estimated that more low-paid employees would have benefited from the upratings to the minimum wage than was anticipated at the time of the 2005 Report, as a consequence of average earnings growing more slowly than expected at the time of the 2005 Report.

Economic Outlook for 2006 and Beyond

2.61 Looking forward to the prospects for the economy in 2006, the revisions to the consensus forecasts we used in our 2005 Report have been much smaller than our revisions for 2005. The GDP growth rate is forecast to increase to 2.2 per cent in 2006, still below the 2.5 per cent anticipated at the time of our 2005 Report, but less of a shortfall than in 2005 itself. Inflation expectations are little changed and average earnings are forecast to grow more slowly than was anticipated in February 2005.

2.62 The consensus forecasts anticipate that the composition of growth will shift towards exports and investment and away from household consumption spending. This could have consequences for low-paying sectors such as retail and hospitality. The National Institute of Economic and Social Research, in their latest forecast (NIESR, 2006), argue that the fall-off in productivity growth in 2005, which pushed up unit wage costs, will likely act as a spur to higher investment spending by firms. While growth in world trade is not likely to rebound back to the elevated level achieved in 2004, there are hopes of a recovery in the UK's main export markets in Europe, from the lacklustre growth that has been a factor constraining UK export growth thus far. Overall, however, world economic growth is expected to remain strong, led by China and India. And while the economy is expected to grow more slowly than trend in 2006, growth is expected to rise above trend by 2007.

“ In our medium term projections employment rises a little less quickly than the labour force, allowing for small increases in unemployment. ”

**NIESR, National Institute
Economic Review,
January 2006**

Table 2.5 Independent Forecasts of Growth in GDP, Prices, Employment and Average Earnings for 2006

Annual percentage increases (median of forecasts)	January 2006 forecasts for 2006	Forecasts for 2006 used in the 2005 Report	Change since the 2005 Report
GDP	2.2	2.5	-0.3
Prices (RPIX)	2.2	2.3	-0.1
Prices (CPI)	1.8	1.9	-0.1
Average earnings	4.2	4.5	-0.3
Employment	0.5	0.3	+0.2

Source: HM Treasury (2005a, 2006).

Notes:

1. Forecasts for 2006 used in the 2005 Report were the medians taken from the HM Treasury February 2005 'Forecasts for the UK Economy'.
2. GDP is measured by ONS code ABMI.
3. RPIX is measured by ONS code CDKQ.
4. CPI is measured by ONS code CJYR.
5. Average earnings are measured by AEI including bonuses for GB using ONS code LNNC.
6. Employment is defined by workforce jobs and is measured by ONS code DYDC.

Impact of 2006 Upratings

2.63 Our estimates of the likely impact of the upratings⁵ of the minimum wage recommended for 2006 are based on the same methodology as that described for 2005 above. We can see from Table 2.6 that in April 2005, around 2.1 million jobs (or about 8 per cent of jobs) held by those aged 18 and over were paid below the minimum wage rates recommended for October 2006. This consists of about 1.9 million jobs held by adults (aged 22 and over) and around 170,000 held by youths (aged 18–21).

Table 2.6 Estimates of Jobs (in Thousands and Percentages) Paid Below the Applicable National Minimum Wage and Forthcoming 2006 Upratings

Jobs paying less than	18–21		22 and over		Total (18 and over)	
	000s	(%)	000s	(%)	000s	(%)
NMW (April 2005)	57	3.2	249	1.1	306	1.2
Forthcoming NMW (October 2006)	171	9.6	1,886	8.2	2,057	8.3

Source: ASHE with supplementary information, UK, 2005.

Notes:

1. The minimum wage for 18–21 year olds was £4.10 in April 2005, £4.25 in October 2005 and was recommended to be £4.45 in October 2006.
2. The minimum wage for those aged 22 and over was £4.85 in April 2005, £5.05 in October 2005 and was recommended to be £5.35 in October 2006.
3. Beneficiaries of the 16–17 year old rate are discussed in Chapter 3.

⁵ In this section we concentrate on those employees aged 18 and over. 16–17 year olds are discussed in Chapter 3.

- 2.64** In order to estimate how many workers stand to benefit from the minimum wage increases in October 2006, we need first of all to estimate what would have happened to the wages of the low-paid were the minimum wage to have remained at its October 2004 rate of £4.85 an hour for adults and £4.10 for 18–21 year olds. We again use two assumptions for the counterfactual growth in earnings – that they would otherwise have risen in line with average earnings or that they would have risen in line with consumer price inflation.
- 2.65** In contrast to our estimates of beneficiaries for the 2005 upratings, we can see from Table 2.7 that the number of beneficiaries estimated for 2006, using the average wage assumption, has not fallen. Indeed, our estimates for 2006, compared with those published in our 2005 Report, have been revised upwards slightly. This reflects the fact that average earnings increases which occurred in 2005, and are now forecast for 2006, are lower than those we assumed at the time of our 2005 Report. Between October 2004 and September 2005, average earnings including bonuses grew by 4.1 per cent compared with a forecast of 4.5 per cent. The Treasury Panel of Independent Forecasters' median forecasts of average earnings growth in 2006 have also been revised down from 4.5 per cent to 4.2 per cent. We now estimate that 1.28 million employees aged 18 and over will benefit from the 2006 upratings. This compares with 1.25 million employees aged 18 and over using the data available when our 2005 Report was published.
- 2.66** Using the prices assumption, we have revised our estimates of the number of beneficiaries, aged 18 and over, from the 2006 upratings to 1.63 million, down from the 2 million estimated using data available at the time of our 2005 Report.

Table 2.7 Estimates of Jobs (in Thousands and Percentages) Benefiting from the Recommended October 2006 National Minimum Wage Rates

Hourly rates October 2006		Estimated number (thousands) and percentage of jobs benefiting			
		Earnings basis		Prices basis	
		Latest estimates	2005 Report estimates	Latest estimates	2005 Report estimates
Adult rate	£5.35	1,170 5.1%	1,130 5.0%	1,490 6.5%	1,820 8.0%
Youth Development Rate (18–21s)	£4.45	110 6.2%	120 6.3%	140 7.9%	180 9.7%
Total		1,280 5.2%	1,250 5.1%	1,630 6.6%	2,000 8.2%

Source: LPC calculations based on ASHE including supplementary information, 2004 and 2005.

Notes:

1. The estimates of beneficiaries made at the time of the 2005 Report assumed 21 year olds would be entitled to the adult rate. In these estimates they are assumed to qualify for the youth Development Rate.
2. The 2005 Report estimates are based on ASHE 2004 data and assumptions used in that report. The latest estimates are based on ASHE 2005 data.
3. Estimates of adult jobs and the total number of beneficiaries are rounded to the nearest 100,000. Estimates of youth (18–21) jobs are rounded to the nearest 10,000.
4. Estimates of the percentage of gainers are rounded to the nearest 0.1 per cent.
5. Estimates in February 2005 based on AEI growth including bonuses of 2.1 per cent between April 2004 and October 2004 and forecast increase of 4.5 per cent in 2005 and 2006.
6. Estimates in February 2005 based on RPIX price inflation of 1.2 per cent between April 2004 and October 2004 and forecast increase of 2.3 per cent in 2005 and 2006.
7. Latest estimates based on AEI growth including bonuses of 2.05 per cent between April 2005 and October 2005 and forecast increase of 4.2 per cent in 2006.
8. Latest estimates based on RPIX price inflation of 1.2 per cent between April 2005 and October 2005 and forecast increase of 2.2 per cent in 2006.

The Impact of Other Labour Market Legislation

2.67 Pending employment legislation on bank holidays and age discrimination may impact on the wage costs of some firms, and therefore have implications for the appropriate level of future increases in the minimum wage beyond 2006.

Bank Holidays

2.68 The Government intends to extend statutory holiday entitlement to include bank holidays, thereby giving a typical full-time worker 28 days annual leave. At present, some employers include bank holidays as part of the annual leave entitlement. Thus, some full-time workers receive 20 days leave including the eight bank holidays. The Government has not yet announced a date for implementation or indicated whether it

will be staged. It is our belief that the necessary arrangements are unlikely to have passed through Parliament and into law before we consider the minimum wage rates for 2007 and 2008 in early 2007. Although we are aware of the implications of this change, we have not therefore taken them into account in reviewing our recommendations for 2006. We will, however, need to review the situation before making any future recommendations for 2007 and beyond. The timing of the introduction of bank holiday entitlements and, in particular, whether those entitlements are phased over a number of years or introduced in one, may have implications for appropriate increases in the minimum wage over subsequent years.

- 2.69** As regards impact, we have little additional information to that available at the time of our 2005 Report. We concluded then that the proposed change was unlikely to have such a large or widespread impact as to make our recommendations for 2005 and 2006 inappropriate. However, we also noted that some firms would be adversely affected and that the pace of introduction would determine the severity of the adjustment faced by these firms.

Age Discrimination Legislation

- 2.70** We stated in our 2005 Report that we would review our recommendations for October 2006 in the light of UK implementation of European Union wide age discrimination legislation. We noted that the ability to increase the adult rate by more than average earnings growth depended on the continued existence of the youth Development Rate. We stated that our recommendation of an adult rate of £5.35 rested in part on the assumption that UK implementation of the Equal Treatment Directive would allow employers continued straightforward use of the minimum wage youth rates.
- 2.71** Since publication of our last report in February 2005, we have monitored progress toward implementation of the age discrimination legislation. In July 2005 the Government initiated public consultation on its proposals on age discrimination. The exercise entitled 'Coming of Age' ended on 17 October 2005. Subject to Parliamentary approval, the legislation is scheduled to come into force on 1 October 2006.

Members of a hospitality association expressed concern that the new bank holidays legislation would have a huge impact when it is introduced. It was not just the additional pay bill but also finding the flexibility to cover the additional leave. This problem would be particularly acute for small firms.

**Low Pay Commission
visit to Llandudno**

2.72 In August 2005 we responded to the formal consultation on the draft Employment Equality (Age) Regulations 2006. We wrote:

'The Commission's view is that the provisions of the age discrimination legislation should ensure that employers continue to be able to make routine and straightforward use of the age related rates of pay set out in National Minimum Wage legislation. To do this the regulations and the advice accompanying them need to be clear and explicit on the continuing legitimacy of the National Minimum Wage's age related provisions.'

2.73 In our response we pointed out what we regarded as a few ambiguities in the text, but we welcomed the overall thrust of the consultation paper. The Government's intentions appeared entirely consistent with the Commission's view. For example, the consultation documents explained that the draft regulations allowed for certain exemptions 'to ensure that the Age Regulations do not discourage employers from using the development rates of the NMW'.

2.74 In October 2005 the Commission made further representations to the Government prompted by consideration of the wider implications of the proposed legislation. We were concerned that a narrowly defined exemption for youth rates of pay might have unintended consequences and that the guidance about the extent of the exemptions proposed would need to be clear and unambiguous.

'The Commission's long held view is that a lower minimum wage for younger workers is justified for reasons set out in detail in several previous reports. The Government has accepted that view and enshrined it in legislation. Whether employers who, while abiding by minimum wage regulations, pay young workers less than adult workers should be afforded the same protection as those employers who have a pay scheme that mirrors the NMW's age bands is, strictly speaking, outside the LPC's remit. However, it seems strange to treat a company that pays its workers an adult rate at 21 more harshly than a firm that makes its workers wait until they are 22.'

'Moreover, a reading of DTI consultation papers and associated guidance would be unlikely to alert companies in this position to the fact that they were likely to be affected by the new age regulations. The guidance needs to spell out more clearly that reward systems

that determine pay according to age will not be covered by the NMW exemption unless they adhere to the NMW age profile.

'Some of the complications identified above could be resolved were the Government to adjust the age at which the youth Development Rate is payable from 18–21 to 18–20. As you know, this is a course of action that the Low Pay Commission has repeatedly recommended on other grounds....'

- 2.75** We understand that the Government will not be publishing the revised Age Regulations incorporating changes made as a result of consultation before this report is published. However, the Commission is satisfied that the Government remains committed to maintaining the youth Development Rate of the National Minimum Wage.
- 2.76** In our 2005 Report we also recommended a change in the upper age limit for the youth Development Rate from the 22nd to the 21st birthday. The Commission is disappointed to record that the Government has decided not to accept this recommendation.

Conclusion and Recommendations

- 2.77** In our 2005 Report, which made recommendations for October 2005 and October 2006, we stated that we believed it appropriate to increase the minimum wage slightly faster than average earnings growth over that two-year period, but we also recommended that we should review the October 2006 rate in January 2006 to check whether economic conditions had changed in any way that made the previous level proposed inappropriate.
- 2.78** Our review of economic conditions has revealed some factors which could argue for a slight reduction in the October 2006 increase: economic growth in 2005 has been less dynamic than we anticipated in January 2005, and forecast growth for 2006 has also been shaded down. Consumption spending has been relatively subdued, with negative implications for low-paying sectors, in particular retail. Average earnings have increased somewhat less than we anticipated over the last year (by 4.1 per cent not 4.5 per cent) and forecasts for 2006 now suggest a similar shortfall. And the slowdown in average earnings

appears to be greater if we focus on the private sector alone, and particularly on some of the most affected sectors.

- 2.79 Conversely, we noted that employment continues to grow, both in the overall economy and in the low-paying sectors, and that corporate profitability continues its cyclical improvement.
- 2.80 Given these facts, we acknowledge that there could be a case to shave the 2006 increase by a small amount. In particular, since average earnings growth has been slightly less than anticipated, the 2005 and 2006 increases will result in slightly faster progress towards raising the minimum wage relative to average earnings than was anticipated at the time of the 2005 Report recommendation.
- 2.81 Although some Commissioners believed that this overshoot was sufficient to justify a reduction in the 2006 rate to, for instance, £5.30 or £5.25, we concluded that the divergence of economic outcomes from those anticipated was not a sufficient basis on which to agree a reduction in the 2006 increase. **We therefore confirm our original recommendations that in October 2006 the adult rate of the minimum wage should be increased to £5.35 and the youth Development Rate should be increased to £4.45.**
- 2.82 However, we do now consider that the phase in which the Commission is committed to increases in the minimum wage above average earnings growth is complete and, looking forward, we have no presumption that further increases above average earnings are required. In addition, we note that it will be particularly important over the next year to look in detail at trends in average earnings by sector, analysing for instance, whether private sector average earnings growth continues to lag behind that in the public sector and reviewing in the light of that analysis the appropriate average against which to consider increases in the minimum wage, which primarily affects private sector employees.

16–17 Year Olds and Trainees



In October 2004 a minimum wage for 16–17 year olds was introduced to prevent the exploitation of young people in very low-paid jobs providing minimal training and few development prospects. The data and evidence we have gathered indicate that the introduction of this minimum has not encouraged young people out of full-time education (FTE) or training, nor has it damaged their prospects in the labour market.

The labour market position for 16–17 year olds not in FTE has been weakening over a number of years, and we are concerned by the rise in the number that are not in education, employment or training. We do not believe, however, that the minimum wage has been a factor in this development, rather that the trends that were apparent prior to its introduction have continued.

We have no doubt that there continues to be a need to protect the position of 16 and 17 year olds in the labour market and we believe that to do this it remains appropriate to have a separate minimum wage rate set at a lower level than that for older workers. We see the main purpose of the 16–17 year old minimum wage as providing a wage floor to prevent exploitation, but we want to guard against the risk that young people may feel disillusioned with the world of work due to very low wages. We recommend, therefore, that the minimum wage for 16–17 year olds be increased to £3.30 per hour from October 2006. In arriving at this recommendation, we took account of the absence of any uprating in October 2005. We recommend that future reviews of the 16–17 year old rate be carried out in line with the timing of the reviews of the rates for older workers.

We also reviewed the use of the older workers' Development Rate and the 12 months exemption for apprentices under the age of 26. It was evident that the Development Rate remains little used and that it would

be difficult to justify objectively an age limit on the apprenticeship exemption given forthcoming legislation to outlaw discrimination on the grounds of age. We believe, therefore, that the evidence is strongly in favour of abolishing the older workers' Development Rate and, simultaneously, of extending the 12 months apprenticeship exemption to cover all apprentices aged 19 and over. We submitted our findings to a review of these matters carried out by the Government in late 2005.

We also considered the other apprenticeship exemptions currently in place, but came to the view that it was too soon for a full-scale review. Instead, we recommend that the Government invite the Commission to carry out a full review of the apprenticeship exemptions and report in 2008.

Introduction

- 3.1** A statutory minimum wage for 16–17 year olds was introduced in October 2004 in line with the recommendation in our 2004 Report. It applies to those below age 18 but above compulsory school age. In our 2005 Report, we decided against recommending any increase to the 16–17 year old rate due to the lack of evidence on its initial impact. Accordingly, it has remained at its introductory level of £3.00 per hour. At our suggestion, the Government invited us to review the operation of the 16–17 year old rate and report in February 2006, with recommendations suitably adjusted to take account of the absence of any uprating in 2005.
- 3.2** In our 2004 Report we re-examined the case for 16–17 year olds to be provided with the protection of a minimum wage. We had previously recommended that 16–17 year olds should not be entitled to a statutory minimum wage as we considered that this age group formed a distinct segment of the labour market. We took the view that 16–17 year olds should be strongly encouraged to remain in education or training at least until the age of 18 and therefore should not be regarded as fully participating in the labour market. While we still believed this to be the case, the evidence gathered for our 2004 Report indicated that a number of full-time jobs for this age group offered extremely low rates of pay while providing minimal training and few development prospects. In the light of evidence of this kind of

exploitation, we felt it appropriate to recommend the introduction of a minimum wage for 16–17 year olds from October 2004.

- 3.3** The introductory rate for the 16–17 year old minimum wage was set cautiously and well below that of the youth Development Rate. Our aim was to strike a balance between stopping exploitation and avoiding any action that might encourage young people out of education or training to the detriment of their longer-term prospects. In recommending the introduction of the £3.00 minimum wage rate, we noted that it should be reviewed periodically, but said that we saw no reason to link its level to increases in the youth Development Rate.
- 3.4** In our 2005 Report, we reviewed the minimum wage exemptions covering apprenticeships and accredited training, focusing in particular on the older workers' Development Rate and the 12 months minimum wage exemption for apprentices aged 19 or over, but under the age of 26. These exemptions were two of the measures put in place when the minimum wage was introduced in 1999 to ensure that it was sufficiently adaptable to encourage employers to increase the provision and quality of training opportunities.
- 3.5** However, we have questioned the value of the older workers' Development Rate over recent years as all the evidence suggests it is little used. We have also questioned the appropriateness of the current 'below age 26' threshold which applies to the 12 months apprenticeship exemption in the light of the Equal Treatment Directive (2000/78/EC) due to be implemented in the UK in 2006. The legislation will outlaw discrimination at work on the grounds of age. This led us to the provisional conclusion that the older workers' Development Rate should be abolished from October 2006, and that, simultaneously, the 12 months exemption from the minimum wage should be extended to cover all apprentices aged 19 and over, with no upper age threshold.
- 3.6** We are pleased that the Government has acted upon our provisional conclusion by carrying out its own review of these exemptions to the minimum wage, working closely with us, in good time for both issues to be addressed appropriately in the context of the forthcoming Equal Treatment Directive legislation.
- 3.7** In this Chapter we look first at the operation of the 16–17 year old minimum wage. We consider the impact of its introduction, looking at

participation in education and the labour market performance of this age group. We review the impact on earnings and estimate the number of beneficiaries of the £3.00 minimum wage rate. We then consider the views of stakeholders on the introduction of the rate and on its future level. We conclude with our recommendation on the uprating of the 16–17 year old rate for October 2006.

- 3.8** We then focus on developments in relation to the older workers' Development Rate and the 12 months minimum wage exemption for apprentices. We outline the background to the exemptions, stakeholders' views and the current status of these exemptions following the Government's review. Lastly, we examine other trainees and consider the case for a full review of the minimum wage exemptions that apply to them.

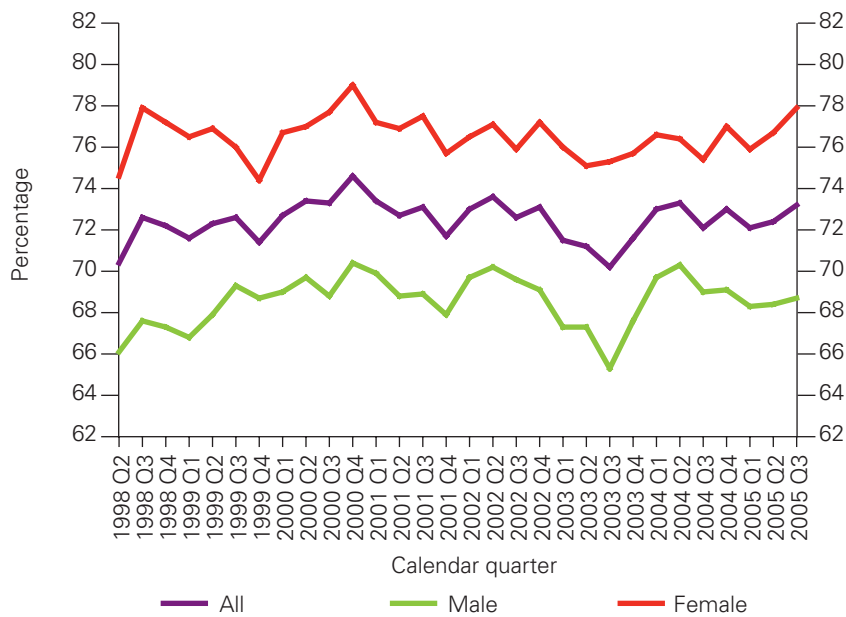
The Minimum Wage for 16–17 Year Olds

Assessing the Impact

- 3.9** When considering whether it was appropriate to introduce a minimum wage for 16–17 year olds, one of our main concerns was to ensure that it did not encourage young people out of full-time education (FTE) or training. In assessing the impact of its introduction we have therefore looked carefully at what has happened to young people's participation in FTE and training since October 2004.
- 3.10** According to the Labour Force Survey (LFS), in the third quarter of 2005 the UK population of 16–17 year olds was around 1.58 million (0.81 million males and 0.77 million females). Just over 73 per cent were in FTE – over two-thirds of males and three-quarters of females – as shown in Figure 3.1. The rate of participation in FTE has been fairly stable for a number of years. However, due to the increase in the population of 16–17 year olds, the actual number in FTE increased by 109,000 between the second quarter of 1998 (a year prior to the introduction of the National Minimum Wage) and the third quarter of 2004 (the period before the 16–17 year old rate was introduced), and by a further 26,000 between the introduction of the 16–17 year old rate in October 2004 and the third quarter of 2005.

Figure 3.1

Proportion of 16–17 Year Olds in Full-time Education by Gender, UK, 1998–2005



Source: LFS, calendar quarters, seasonally adjusted, UK, 1998–2005.

3.11 The data suggest that the introduction of the 16–17 year old minimum wage rate in October 2004 has not had an initial negative impact on participation in FTE. Indeed, the number of 16–17 year olds in FTE increased by 42,000 if we compare the fourth quarter of 2004, the period immediately after the introduction of the minimum wage, with the same period in 2003. However, we note that there was a particular dip in participation in FTE in the third quarter of 2003 and therefore care needs to be taken when using this comparison.

3.12 However, the minimum wage cannot be considered in isolation from other influences on young people’s decisions about participation in education, training or employment. Establishing the extent of any impact of the minimum wage for 16–17 year olds is complicated because the timing of its introduction closely coincided with the initial roll-out of the Education Maintenance Allowance¹ (EMA) to 16 year olds in August 2004 in Scotland and in September 2004 in England, Wales and Northern Ireland. The roll-out of the EMA is being staged over a three year period. Sixteen year olds were eligible to apply in year one

¹ The Education Maintenance Allowance is a weekly payment directly to a young person of £10, £20 or £30 a week depending on household income (which must be below £30,000 per year to qualify). The funding is available during term time for any academic or vocational course (up to level 3) which involves at least 12 hours of guided learning per week.

(2004/05), 16 and 17 year olds were eligible in year two (2005/06) and 16 to 18 year olds will be eligible from year three (2006/07). Take-up of the EMA by 16 year olds in its first year of being available across the UK was 255,435, but information on the impact it has had on the level of participation in FTE is not yet available. However, the Department for Education and Skills (DfES) commissioned an evaluation of the EMA pilot projects run in England in 2004 which estimated that the EMA increased participation in FTE at ages 16 and 17 by 6.1 percentage points (Maguire and Maguire, 2004).

Trainees

- 3.13** The vocational training available to young people can take a variety of forms, including apprenticeships, preparatory schemes such as Entry to Employment (in England), National Vocational Qualifications (NVQs) or Scottish Vocational Qualifications (SVQs). Assessing the impact the minimum wage for 16–17 year olds might have had on those in training is difficult due to the lack of reliable data on the number of 16–17 year olds who have left school and are undertaking vocational training. The information we have gathered on government-supported vocational training suggests that in the 2004/05 academic year there were just under a quarter of a million² 16–17 year olds undertaking vocational training in the UK, a similar number to that in the same period in the previous year and prior to the 16–17 year old minimum wage being introduced.
- 3.14** The Learning and Skills Council (LSC) has announced that the EMA will be extended in England from April 2006 to replace the current Minimum Training Allowance (MTA) available to unwaged apprentices. It will also be available to young people on its Entry to Employment programmes, which aim to prepare ‘hard to reach’ young people for apprenticeships, employment and further education, and to participants on Programme Led Pathways. A key benefit from this change is that, unlike the MTA, the EMA will not affect other family benefits (such as Housing Benefit) and will therefore increase the financial support for young people from lower income households and those living independently to the same level as is available for those who chose to remain in FTE.

² The 2004/05 figure for 16–17 year olds in vocational training is provisional.

3.15 The extension of the EMA in England and the LSC's introduction in August 2005 of a contractual requirement for waged apprentices in England to receive a minimum of £80 per week from their employer should provide further incentives to young people to take up vocational training. We do not believe that the minimum wage will discourage them from this course and entice them into employment that offers little or no training. During our consultation we met a group of 16 and 17 year olds living independently at Forest YMCA who expressed the view that most young people would not be encouraged to abandon their long-term career goals and leave education or training even if they were entitled to the adult rate of the minimum wage.

Labour Market Position of 16–17 Year Olds

3.16 In this section we look in detail at the labour market status of those in FTE and those not in FTE, considering any changes that have occurred between the periods prior to and after the introduction of the 16–17 year old minimum wage, as well as looking at the trends that have emerged over a longer period.

3.17 It is important to note, however, that small sample sizes and a high proportion of proxy responses for this age group mean that the data used in our analysis need to be treated with caution. For example, in the LFS, our main source of information on economic activity, there is a sampling error of around $\pm 40,000$ in the number of 16–17 year olds in FTE (which is about ± 2.5 percentage points of the proportion in FTE). Small deviations from trends should be treated with particular caution, so we concentrate more on broad trends.

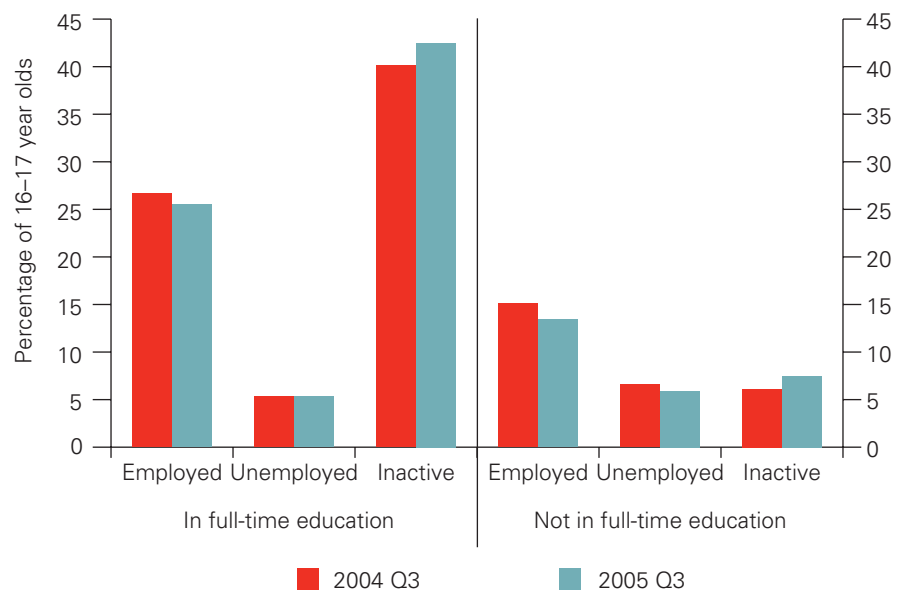
3.18 In 2005 the population of 16–17 year olds reached 1.58 million and accounted for about 4 per cent of the total working age population. The Government Actuary's Department predict that the population of this age group will rise by a further 100,000 up to 2008, after which it will start to decline.

3.19 Half of all 16–17 year olds were economically active in the third quarter of 2005 (around 822,000), as shown in Figure 3.2, with a similar proportion of males and females. (The term 'economically active' includes those who are employed and those seeking and available for work but excludes non-working students.) Fewer than three in ten

16–17 year olds were not in FTE. Around 40 per cent of the 16–17 year olds who were in FTE were economically active. Since the introduction of the 16–17 year old rate, employment rates for all 16–17 year olds have fallen slightly as inactivity rates have risen marginally, but these changes are part of a longer running trend.

Figure 3.2

Labour Market Status of 16–17 Year Olds by Education Status, UK, Third Quarter 2005 Compared With Third Quarter 2004

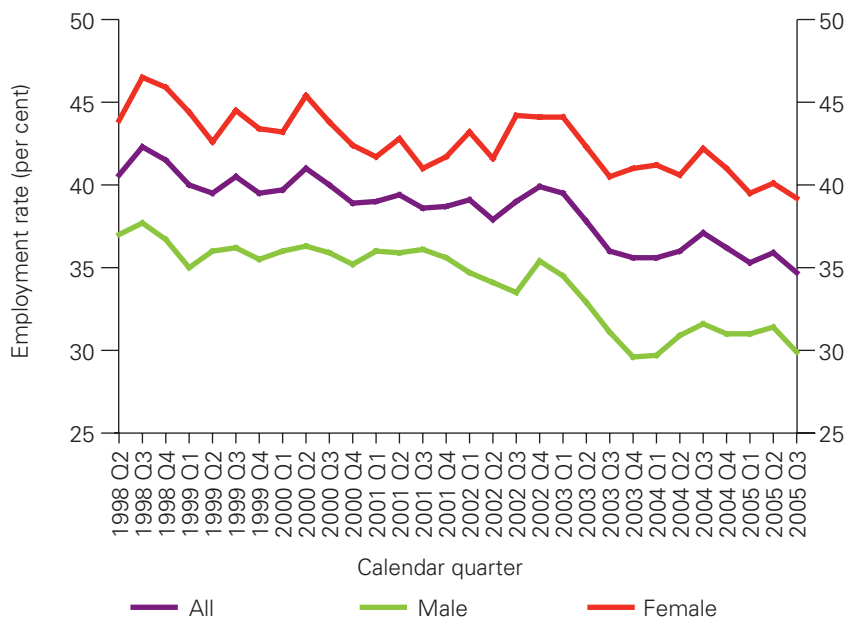


Source: LFS, calendar quarters, seasonally adjusted, UK, 2004–2005.

3.20 Around 35 per cent of those in FTE are employed, with young females in FTE more likely to have jobs than young males (just under 40 per cent of female 16–17 year olds compared to 30 per cent of males). In Figure 3.3 we see that there has been an overall downward trend in employment rates for 16–17 year olds in FTE since the second quarter of 1998, with a particularly sharp decline between the fourth quarter of 2002 and the fourth quarter of 2003, after which they picked up slightly. However, in terms of the level of employment this accounts for only 13,000 fewer 16–17 year olds in FTE who were employed in the third quarter of 2005 than in the second quarter of 1998.

Figure 3.3

Employment Rates of 16–17 Year Olds in Full-time Education by Gender, UK, 1998–2005

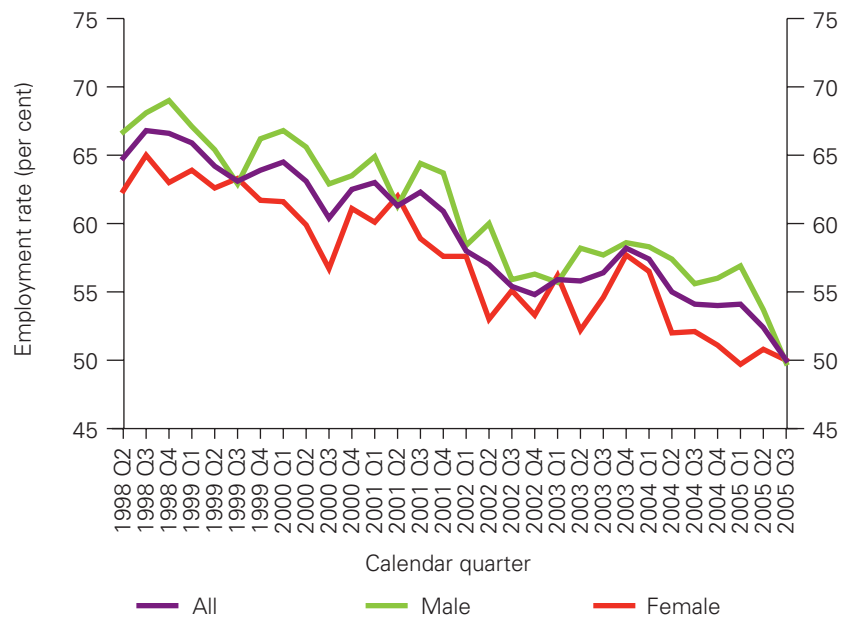


Source: LFS, calendar quarters, seasonally adjusted, UK, 1998–2005.

3.21 We now turn to look at the labour market position of 16–17 year olds not in FTE. The population of this age group not in FTE has stayed reasonably constant at around 430,000 since the second quarter of 1998. Figure 3.4 shows that between the second quarter of 1998 and the third quarter of 2005, the employment rate for 16–17 year olds not in FTE has fallen by around 15 percentage points, with the level of employment down by some 67,000 (40,000 males and 27,000 females). This downward trend began in the late 1990s.

Figure 3.4

Employment Rates of 16–17 Year Olds Not in Full-time Education by Gender, UK, 1998–2005



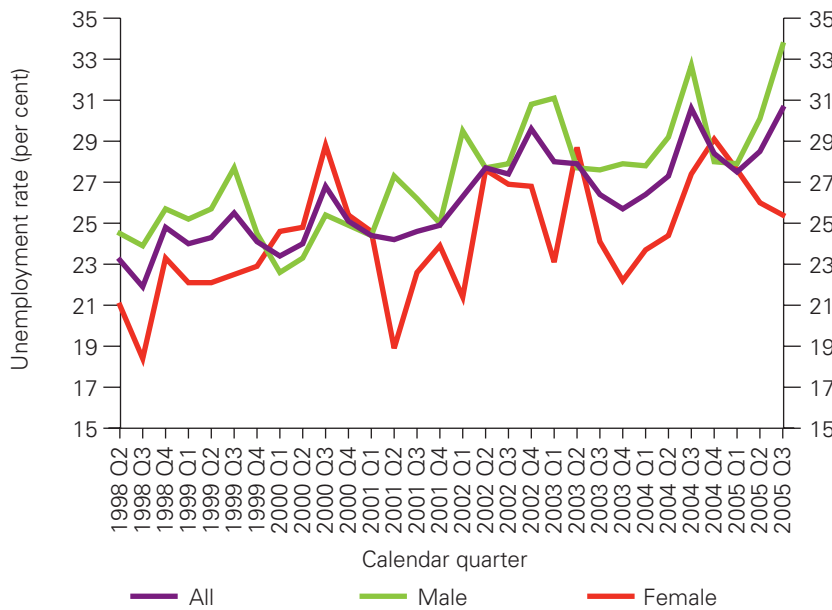
Source: LFS, calendar quarters, seasonally adjusted, UK, 1998–2005.

3.22 Although the unemployment rates for male and female 16–17 year olds not in FTE have fluctuated considerably since 1998 (as seen in Figure 3.5), the overall trend has been upward. Young males not in FTE are significantly more likely to be unemployed than young females. Since the introduction of the 16–17 year old minimum wage and the third quarter of 2005 the overall rate of unemployment for 16–17 year olds not in FTE rose by 2.2 percentage points. However, during this same period the unemployment rate for females decreased by nearly 4 percentage points, but increased for males by nearly 6 percentage points.

3.23 It is interesting to note that although all economically active 16–17 year olds form a relatively small proportion of the total economically active people of working age – only about 2.6 per cent – they comprise over 10 per cent of the unemployed. This highlights their particular vulnerability in the labour market.

Figure 3.5

Unemployment Rates of 16–17 Year Olds Not in Full-time Education by Gender, UK, 1998–2005

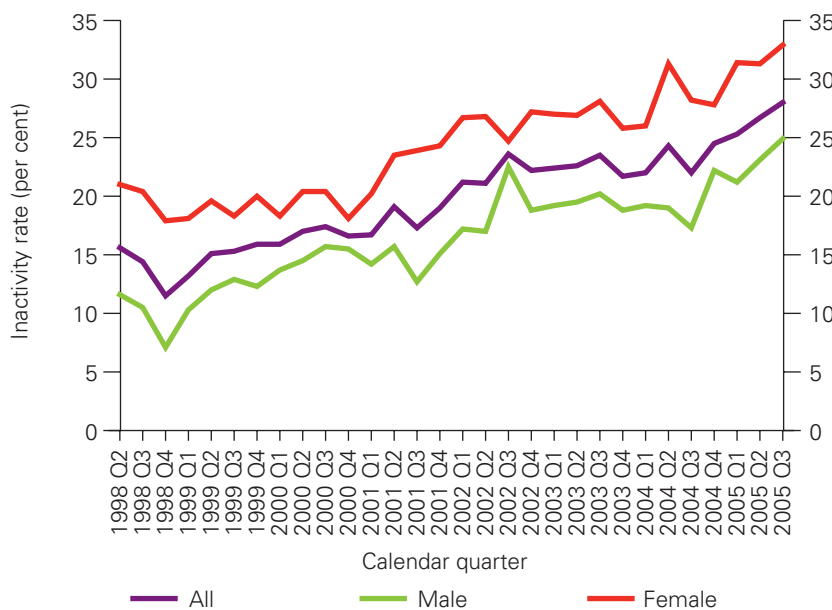


Source: LFS, calendar quarters, seasonally adjusted, UK, 1998–2005.

3.24 The inactivity rate for 16–17 year olds not in FTE is also increasing, a trend which began in the fourth quarter of 1998, as shown in Figure 3.6. Overall, 28 per cent of 16–17 year olds not in FTE are inactive, a quarter of males and a third of females.

Figure 3.6

Inactivity Rates of 16–17 Year Olds Not in Full-time Education by Gender, UK, 1998–2005



Source: LFS, calendar quarters, seasonally adjusted, UK, 1998–2005.

3.25 Table 3.1 shows the percentage breakdown of 16–17 year olds not in FTE and inactive by the reason they have given for inactivity. Over a third of inactive 16–17 year olds are students doing part-time studies, with the proportion in this group increasing significantly since 1998. However, there is a further third that state their reason for inactivity as that they ‘would not like work’. We are concerned about this group as, although not large, it has been growing. The remainder of the inactive are made up of those who have caring responsibilities, those who are sick or disabled and those who would like work but are not classified as unemployed (i.e. not actively seeking work or are unavailable to start work within two weeks).

Table 3.1 Proportion of Inactive by Reason Among 16–17 Year Olds Not in Employment or Full-time Education, UK, 1997–2005

Percentage of inactive	Winter 1997– Autumn 1998	Winter 1998– Autumn 1999	Winter 1999– Autumn 2000	Winter 2000– Autumn 2001	Winter 2001– Autumn 2002	Winter 2002– Autumn 2003	Winter 2003– Autumn 2004	Winter 2004– Autumn 2005
Inactivity reason								
Students	24.9	22.3	29.1	27.0	33.2	39.3	37.0	38.9
Carers	21.4	18.6	13.1	12.7	10.2	6.4	6.1	6.8
Sick/disabled	7.8	8.7	7.0	8.6	9.7	8.1	7.2	6.1
Looking for/want work	16.7	23.7	19.3	19.5	16.8	16.4	16.4	15.1
Would not like work	29.2	26.7	31.6	32.2	30.1	29.8	33.3	33.1

Source: LPC estimates based on LFS Microdata, seasonal quarters, not seasonally adjusted, UK, 1997–2005.

Notes:

1. Four quarter averages.
2. Inactive are defined as those not in paid work or full-time education.

3.26 The circumstances that have led to the increase in the ‘would not like to work’ category are unclear despite efforts to investigate this further. But we can gain a better insight into the reasons given by some young people in this category by looking at the research we commissioned by Dickerson and Jones (2004) for our 2004 Report. The research obtained details of the main reasons for unemployment or inactivity among 16–17 year olds not in education or training, based on data from sweep 1 of the 2002 Youth Cohort Study (YCS). The main reasons given by respondents were that they needed more qualifications and skills to obtain a job, education or training place; they had not yet decided what sort of job or course to do; and/or they had not found a suitable job or course. DfES commissioned research by the Centre for Research in Social Policy (2005) supported the Dickerson and Jones findings on the

reasons why some young people are not in education, employment or training. Given these findings, we would expect the time spent by young people in this category to be short, and that they would return to education to obtain the necessary qualifications or go into employment, probably with a training element.

- 3.27** To assist us to understand the relationship between the labour market status of 16–17 year olds and their particular circumstances and characteristics, we look to other data sources for information. Table 3.2 provides information on the main activities of 16 and 17 year olds in England and Wales by their individual characteristics, using data from the 12th Cohort of the YCS (DfES, 2005b, 2005d). The results are from the survey of 16 year olds carried out in Spring 2004 (eight months after respondents had completed compulsory education), with the same respondents being surveyed a year later aged 17.
- 3.28** According to the YCS, around 72 per cent of 16 year olds and two-thirds of 17 year olds were in FTE. About another 16 per cent of 16 year olds and a fifth of 17 year olds were in government-supported training or full-time employment. The remainder were in part-time employment (4 per cent), out of work (6 per cent) or doing something else, for example looking after family or home (3 per cent). Young females were more likely to be in FTE than young males at both ages. However, young males were much more likely to be in government-supported training. Of those who were out of work at 16, a third were in employment by the age of 17, 12 per cent were in government-supported training and a further 19 per cent had re-entered FTE.
- 3.29** Participation in FTE at ages 16 and 17 was strongly linked to performance in year 11. At age 17 more than nine in ten of the cohort group who achieved eight or more GCSE grades A*–C were in FTE at age 17, compared with less than a third of those who achieved fewer than five GCSE grades D–G. Low achievers were more likely to be out of work than other groups.
- 3.30** The YCS showed that 9 per cent of both 16 and 17 year olds were not in education, employment or training. The rates were similar for males and females of both ages. Young people whose parents had routine occupations were over four times more likely to not be in education, employment or training than those from higher professional families.

Table 3.2 Main Economic Activity by Characteristics of 16–17 Year Olds, England and Wales, 2004–2005

Percentage of the group defined at each row	Full-time education		Government-supported training (GST)		Full-time job (excluding GST)		Part-time job		Out of work		Other/not stated	
	16	17	16	17	16	17	16	17	16	17	16	17
Age												
All	72	66	9	10	7	11	4	4	6	6	3	3
Male	67	61	6	13	9	13	3	4	7	6	2	2
Female	77	71	0	6	5	10	4	5	5	5	3	4
Ethnic origin												
White	70	64	10	10	8	13	4	5	6	6	3	3
Black	83	88	4	3	3	3	2	–	7	4	2	–
Asian	85	82	3	4	1	3	2	2	5	5	14	4
Other	81	78	4	4	4	6	2	4	6	6	7	–
Not stated	65	64	12	10	8	10	2	–	7	6	6	7
Parental occupation												
Higher professional	85	81	5	6	5	6	2	3	2	2	1	1
Lower professional	79	72	7	8	5	10	3	3	4	4	1	2
Intermediate	71	63	10	11	8	13	4	4	5	6	3	3
Lower supervisory	61	54	15	15	10	15	5	5	6	7	3	3
Routine	57	51	12	13	11	15	6	7	11	9	4	4
Other	63	60	9	8	7	11	4	4	12	9	5	7
Parents' qualifications												
At least one with degree	85	81	4	5	4	6	3	3	3	4	1	2
At least one with A Level	77	70	7	8	6	11	4	4	4	4	2	2
Neither with A Level	64	57	12	12	9	14	4	5	8	7	4	4
Year 11 qualifications												
5+ GCSE Grade A*–C	89	87	3	4	3	5	2	2	1	1	1	1
1–4 GCSE Grade A*–C	60	49	15	16	11	17	5	6	7	8	3	3
5+ GCSE Grade D–G	48	36	17	18	12	20	7	9	11	11	5	6
1–4 GCSE Grade D–G	32	30	21	13	17	28	4	7	20	14	6	7
None reported	26	31	11	9	11	11	9	7	28	24	15	18

Source: DfES estimates based on the Youth Cohort Study, England and Wales, 2004–2005.

Note: '–' represents a non-zero quantity of less than 0.5 per cent, a cell size of less than 5 or an insufficient base.

3.31 The overall picture of the labour market position of 16–17 year olds shows that the trends in employment, unemployment and inactivity of those in and those not in FTE that were apparent before the introduction of a 16–17 year old minimum wage in October 2004 have continued since its introduction. However, the data highlight that the labour market position for those not in FTE has been weakening over a number of years. Employment rates have continued on a downward trend and the rates of unemployment and inactivity have continued to increase. It is difficult to explain the reasons for these trends, but the introduction of the minimum wage for 16–17 year olds does not appear to have further adversely affected their position in the labour market.

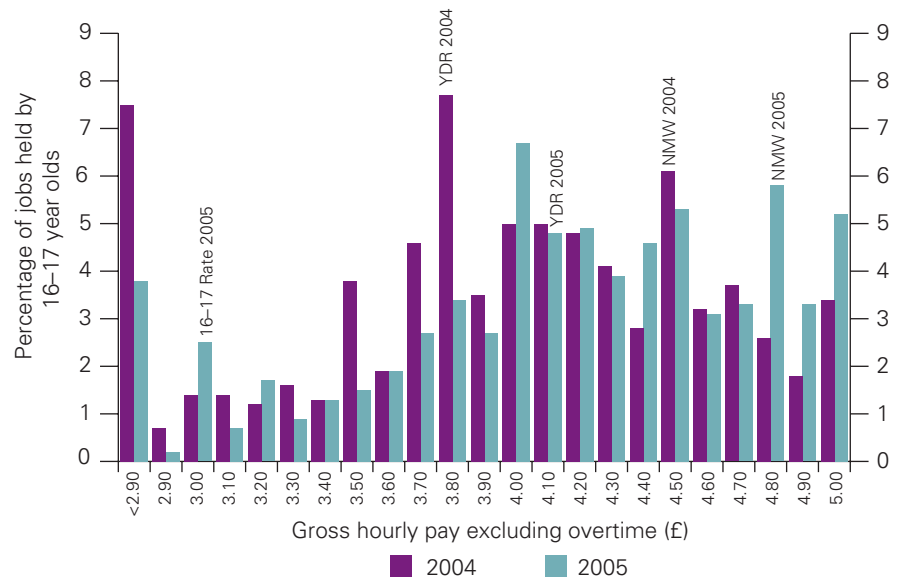
3.32 This view is supported by the earnings data that we examine next, and by the testimony of the majority of respondents to our consultation who indicated that the minimum wage has had little or no negative impact and that it has not created a substitution effect in favour of older workers. We consider the views of stakeholders later in this Chapter.

Earnings

3.33 The April 2005 Annual Survey of Hours and Earnings (ASHE) shows that the most common rate of earnings for 16–17 year olds was between £4.00 and £4.50 per hour. It can be seen in Figure 3.7 that in Spring 2005 around 4 per cent (20,000) of 16–17 year olds were paid below £3.00 per hour. These estimates should not, however, be used as a measure of non-compliance. It is not possible to determine from the ASHE data whether an individual is eligible for the minimum wage. For example, it is not possible to identify those on apprenticeships or on certain accredited training who are exempt from the National Minimum Wage, or those who are in receipt of accommodation for which an employer is entitled to deduct an offset.

3.34 Figure 3.7 illustrates the hourly earnings distribution for 16–17 year olds in April 2004 (prior to the introduction of the £3.00 minimum wage rate) and April 2005 (after its introduction). We can see there was an upward shift in the distribution over this period. In April 2005 the most pronounced peak in the 16–17 year olds' earnings distribution was at £4.00, with a number of further spikes between £4.10 and £5.00. It highlights that most 16–17 year olds earn well above £3.00.

Figure 3.7
Distribution of Gross Hourly Earnings Excluding Overtime for
16–17 Year Olds, UK, 2004–2005



Source: ASHE with supplementary information, UK, 2004–2005.

Notes:

1. NMW label shows the adult NMW rate in April of the given year.
2. YDR label shows the youth Development Rate in April of the given year.
3. 16–17 label shows the 16–17 year old rate in April 2005.

3.35 The median hourly earnings for 16 year olds in April 2005 was £4.32 and for 17 year olds it was £4.64, an increase of 8 per cent and 6.7 per cent respectively compared to April 2004. Looking at both ages together, the median hourly earnings was £4.55 in April 2005, an increase of 6.2 per cent when compared to April 2004.

3.36 Table 3.3 shows the distribution of pay for 16 and 17 year olds. The proportion of 16–17 year olds earning less than the youth and adult minimum wages grew between 2004 and 2005. Just under 30 per cent of 16–17 year olds earned less than the youth Development Rate in 2005 (£4.10), up from just over a quarter in 2004 (£3.80). In both years, around 60 per cent of 16–17 year olds earned less than the adult minimum wage – slightly above in 2005 and below in 2004.

Table 3.3 Distribution of Gross Hourly Earnings Excluding Overtime for 16–17 Year Olds, UK, 2004–2005

Distribution of pay (percentage)	16		17		16–17	
	2004	2005	2004	2005	2004	2005
Less than £3.00	10.7	4.7	7.3	3.7	8.3	4.0
Less than £3.80	33.8	20.4	22.0	15.6	25.6	17.1
Less than £4.00	46.0	27.7	32.7	21.2	36.8	23.2
Less than £4.10	52.6	35.4	37.2	27.3	41.9	29.9
Less than £4.25	60.5	44.8	45.7	33.4	50.2	37.0
Less than £4.45	65.5	55.1	53.3	41.4	57.1	45.7
Less than £4.50	66.6	57.5	55.1	43.7	58.7	48.0
Less than £4.85	78.6	70.4	70.4	57.0	72.9	61.2
Less than £5.00	81.0	76.6	73.7	65.2	75.9	68.8
Less than £5.05	82.6	80.8	76.7	69.1	78.5	72.8
Less than £5.35	86.6	86.1	80.6	76.2	82.4	79.3
Less than £6.00	92.2	91.8	88.3	86.6	89.5	88.3
Less than £7.00	95.1	95.7	92.8	92.8	93.5	93.7
£7.00 or more	4.9	4.3	7.2	7.2	6.5	6.3

Source: ASHE with supplementary information, UK, 2004–2005.

3.37 A research survey commissioned by the Department of Trade and Industry (DTI) early in 2005 (Continental Research, 2005) provides some further information on the earnings of 16–17 year olds. Although the main aim of the survey was to ascertain the level of awareness of the minimum wage for 16–17 year olds, it included some questions on the minimum wage more generally. A few questions sought information on current rates of pay for 16–17 year olds. Of the 216 workers aged 16–17 surveyed, 65 per cent of whom were working students, 2 per cent said they were being paid less than £3.00 per hour, while the most common hourly rate of pay was between £4.00 and £4.99 per hour. All the 75 employers employing 16–17 year olds said they were paying them a minimum of £3.00 per hour. Some employers reported paying different rates for 16–17 year olds depending on the job and skills required. The most common rate of pay for 16–17 year olds used by these employers (83 per cent) was between £5.00 and £6.00 per hour, while 40 per cent said that they had a pay rate of between £3.00 and £4.00 per hour and 27 per cent said they had a pay rate for 16–17 year olds of over £8.00 per hour.

3.38 The British Hospitality Association advised us that in August 2005 it had carried out a survey of 50 of its members, who collectively had a total of 7,650 employees. Thirty-seven of the 50 firms employed at least one 16 or 17 year old. Of these, two paid a lowest rate of £3.00 per hour, but most paid £3.25 or more, with 21 paying a lowest rate of £4.00 per hour or more. In a survey carried out by the Union of Shop, Distributive and Allied Workers (Usdaw) of 800 of its 16–17 year old members, the average wage of the 92 respondents who gave pay details was £4.25 per hour.

Beneficiaries of the Introduction of the 16–17 Year Old Minimum Wage

3.39 Based on the revised 2004 ASHE data, we now estimate that up to 37,000 jobs benefited from the introduction of the £3.00 per hour minimum wage for 16–17 year olds in October 2004 (6 per cent of all jobs held by this age group). However, this figure is the upper estimate as it includes those on apprenticeships and on pre-apprenticeship programmes who were exempt from the minimum wage and, taking these into account, is likely to reduce significantly the actual number of beneficiaries. Our latest estimate of beneficiaries is lower than the estimates given in our 2004 and 2005 Reports. This downward revision is in line with what we have found when calculating the number of beneficiaries for upratings of the adult rate and youth Development Rate. The reasons for this revision are explained in Chapter 2 (paragraphs 2.59 and 2.60), but it is also important to note that, although we have used the same methodology in calculating the number of 16–17 year old beneficiaries that we use for the adult and youth Development upratings, the 16–17 year olds estimates have to be treated with extra caution due to the small sample sizes.

Employment of Young People by Occupation and Industry Sector

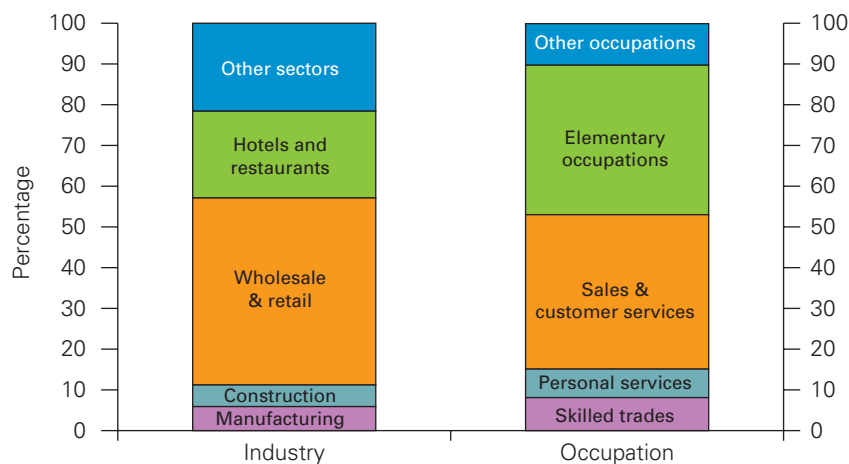
3.40 We look next at the industry and occupational structure of employment for 16–17 year olds which is fairly heavily concentrated in low-paying sectors. Analysis we carried out for our previous reports showed that nearly 80 per cent of full-time students with jobs were employed in either the retail or hospitality sectors. These sectors are also important

employers of 16–17 year olds who are no longer in full-time education, as is the construction industry.

3.41 Analysis of the industries and occupations employing young people in 2005 shows that employment of 16–17 year olds in the retail sector exceeds by far that of any other sector, accounting for 45 per cent of all employed 16–17 year olds. The hospitality sector is the next largest employer of this age group (at over 21 per cent). Sales and retail assistants alone accounted for nearly 37 per cent of 16–17 year old employees. The views of employers in these sectors about the impact of the minimum wage on their recruitment and training of young people were therefore particularly relevant. During the year we consulted widely and met a number of employers in these sectors during our Commission visits. The predominant view expressed during our meetings with such employers was that the 16–17 year old rate has had very little impact as most were paying young workers significantly above £3.00 per hour.

Figure 3.8

Employment of 16–17 Year Olds by Industry Sector and Occupation, UK, Winter 2004–Autumn 2005



Source: LPC estimates based on LFS Microdata, seasonal quarters, not seasonally adjusted, UK, Winter 2004–Autumn 2005.

Note: Four quarter averages.

3.42 We now consider the views of those who responded to our consultation on the minimum wage for 16–17 year olds.

So far there has been no discernible adverse impact of the National Minimum Wage on the participation of young people aged 16–17 years in education or training.

Government evidence

SBC is pleased that the rate will not increase in 2005. Low skilled young people are already struggling to be attractive to employers.

Small Business Council evidence

Stakeholders' Views

- 3.43** We sought written and oral evidence from employers and their representative organisations, trade unions, youth organisations and others in the preparation of this report. The vast majority of respondents said that there had been little or no negative impact. Most employers already paid workers of this age group substantially above £3.00 per hour. One exception was a company in the care sector which advised that it had ceased to employ 16 and 17 year olds as a result of the introduction of the minimum wage for this age group. No other respondent noted a change in employers' willingness to take on 16–17 year olds and none suggested any move by employers to substitute this age group in favour of older workers. The Association of Licensed Multiple Retailers advised that a survey of its members had indicated that the 16–17 year old rate had not affected the demand for labour or the provision of training in the sector and a similar point was made by other organisations, including Business in Sport and Leisure.
- 3.44** There was a range of views expressed by respondents to our consultation regarding future increases to the 16–17 year old minimum wage rate. Employer organisations urged caution, taking the view that further time was needed to gather more evidence before making any significant adjustment to the rate. The CBI noted that the full effects of the initial 16–17 year old rate were not yet clear and that it was imperative that we did not offer incentives to young people to opt out of education or training. A few respondents suggested that the rate should be frozen in 2006, while others sought a modest increase. The British Chambers of Commerce stated that it would support an increase of approximately 3 per cent in 2006.
- 3.45** Some employer respondents expressed the view that the rate should be increased by a reasonable amount, but most wanted the differential between the 16–17 year old rate and the youth Development Rate to remain substantial. The Royal College of Midwives noted that a low minimum wage for this age group defeated the object of a minimum wage in preventing exploitation. However, it accepted that an overpriced National Minimum Wage for 16–17 year olds might encourage them to leave further education or training and that this would have to be taken into account when establishing a revised rate

for this age group. It suggested a percentage increase of no less than the Retail Price Index.

- 3.46** Of the fifty-two respondents to our consultation who offered a view on the 16–17 year old minimum wage, around a third sought for it to be substantially increased. These were mainly, but not exclusively, trade unions and other organisations representing workers. The Federation of Licensed Victuallers Association suggested that an increase to £3.50 would be acceptable. A joint response from the Children’s Rights Alliance for England and the British Youth Council described the present arrangements as discriminatory and suggested that employers could use young workers as a source of cheap labour. They argued for parity with 18–21 year olds as a first step towards a single minimum wage rate for all workers. They suggested that such a rate would improve, not impair, the ability of young people to participate in education and training as it might result in them being able to afford to work fewer hours and dedicate more time to their studies. Such comments were echoed by most union respondents, all of whom stressed a commitment to the same rate of pay for the same work. The TUC called for the 16–17 rate to be increased by a series of steps above increases in average earnings in order to narrow significantly the gap between the rate for 16–17 year olds and minimum wage rates for older workers.
- 3.47** The Scottish Low Pay Unit welcomed the introduction of the 16–17 year old minimum wage, but thought it had been set far too low. It also suggested that a higher minimum wage would lead to better education outcomes as students would be better able to combine their education and part-time work if they could reduce their hours as a result of a higher rate of pay.
- 3.48** A number of organisations commented that the introduction of the minimum wage had been successful in halting the worse excesses of low pay. However, there was concern that awareness and enforcement needed to be strengthened. We consider this later in this Chapter.

“ Most members pay 16 and 17 year olds above £3 an hour because of competition from other retailers and to retain the goodwill of a trained member of staff who may return to the store during university holidays etc. Pay rates range from £3.50 to the adult minimum wage rate. ”

British Shops and Stores Association evidence

“ Significant numbers of students are struggling with their studies because of their hours of work. If you take into account that the survey was done in September, these problems will exacerbate as exams approach, and many young people will do less well in their education because of the hours they are working. ”

Usdaw survey of 16–17 Year Old Members

Conclusion: Uprating the 16–17 Year Old Rate

- 3.49** Over the last year we have carefully assessed the available evidence on the impact of the introduction of the 16–17 year old minimum wage rate. We have analysed the statistical data provided by the Office for National Statistics (ONS) and other sources on the labour market position and earnings of 16–17 year olds, although we note the limitations to this data cited earlier. We have also received a range of other evidence to supplement our understanding of the impact of the 16–17 year old minimum wage and to enable us to recommend an uprating of the rate in October 2006 that is appropriate and fair.
- 3.50** We conclude that the labour market conditions for this age group have not been adversely affected by the introduction of the minimum wage. We also received no evidence to suggest that it may have encouraged young people out of FTE or training. Indeed, the evidence we received during our consultation for this report and the research we previously commissioned both show that the vast majority of 16–17 year olds are earning in excess of the current minimum wage rate of £3.00 per hour.
- 3.51** Trade unions and organisations representing young people argued that the rate should be increased to bring it in line with the youth Development Rate or the adult rate. Conversely, a number of employer organisations called for the rate to be frozen at £3.00 in 2006, or increased at a rate significantly lower than the 2006 percentage increases recommended for older workers.
- 3.52** We firmly believe that there continues to be a need to protect the position of 16 and 17 year olds in the labour market and to do this it remains appropriate to have a separate minimum wage rate set at a lower level than that for older workers. And we continue to see the main purpose of the 16–17 year old minimum wage as providing a wage floor to prevent exploitation. As noted in our 2004 Report, there is evidence of the scarring effect of unemployment on young people throughout their working lives (e.g. Stewart, 2002) and international evidence that any potential adverse effects of minimum wages are more likely to be felt by young people than adults (e.g. Organisation for Economic Co-operation and Development, 1998).

- 3.53** We confirmed in our 2004 Report that we saw no reason to link the 16–17 year old rate to the youth Development Rate and we continue to hold this view. But we believe that the current rate of £3.00 is too low. We consider that young people in the workplace need to receive a fair rate of pay and feel valued as members of the workforce. We want to guard against the risk that young people may feel disillusioned with the world of work due to very low wages.
- 3.54** We need to strike a balance. Taking all the evidence into account, including the fact that the rate for this group of young people was not increased in 2005, **we recommend that the minimum wage for 16–17 year olds be increased to £3.30 from October 2006.** This represents an increase of 10 per cent on its introductory rate of £3.00 in October 2004. In our 2004 Report we commented that the 16–17 year old rate should be reviewed periodically. We believe that it is appropriate for such reviews to be carried out on a biennial basis, and **we recommend that the Government ask us to review the rate in line with the timing of the reviews of the rates for older workers.** But we emphasise our view that the purpose of the 16–17 year old minimum wage rate is primarily to prevent the exploitation of young people and we see no correlation between it and the youth Development Rate.
- 3.55** We estimate that up to 32,000 jobs are likely to benefit from the recommended increase in the 16–17 year old rate in October 2006, which represents 6.5 per cent of all jobs for this age group. But estimating the number of beneficiaries for 16–17 year olds is significantly more difficult than for older workers due to the data limitations highlighted earlier in this Chapter. We believe that the actual number of 16–17 year old beneficiaries will be markedly reduced when apprentices and those on pre-apprenticeship programmes who are exempt from the minimum wage are taken into account.

Awareness and Enforcement

- 3.56** Some organisations responding to our consultation registered a concern that awareness of the minimum wage among 16–17 year olds was low, and that those who were aware of its existence did not know the actual rate, nor where to go to for help if they thought they were

being underpaid. The Children's Rights Alliance and the British Youth Council advised that there was still considerable ignorance among this age group about their entitlement and suggested a campaign to increase awareness.

- 3.57** As well as the need to improve awareness among young people, a few of our stakeholders thought that awareness among employers was not as good as it should be. Citizens Advice commented that many employers either were not aware of their obligation to pay the rate to young workers or were deliberately not complying with this obligation. It called for more enforcement activity. Other organisations also made this point.
- 3.58** The DTI commissioned a research survey in early 2005 (Continental Research, 2005) to ascertain levels of awareness of the minimum wage among 16–17 year olds and employers. The results showed that all 207 employers in the survey were aware of there being a National Minimum Wage, as were 89 per cent of the 216 16–17 year old workers who participated. However, significantly fewer participants in both groups were aware that there were different minimum wage rates for different age groups – 85 per cent of employers and 53 per cent of 16–17 year old workers. Two-thirds of employers were aware that there was a 16–17 year old minimum wage rate, rising to 74 per cent among those who employed 16–17 year olds. There was no single widely recognised source of information and advice on the minimum wage. Employers reported advertising (e.g. press and television) as a key source of information, whereas 16–17 year old workers relied predominantly on word of mouth, particularly family and friends. Employers' and workers' awareness of the HM Revenue and Customs (HMRC) Minimum Wage Helpline was extremely low.
- 3.59** We are encouraged that general awareness of the minimum wage is high for both employers and 16–17 year old workers, but more needs to be done to raise awareness of the rates, and a much greater effort is needed to ensure that both young people and employers are aware of the role of the HMRC Minimum Wage Helpline as a source of advice and as a means to report non-compliance. We continue to encourage the Government to promote awareness of the minimum wage and the HMRC Minimum Wage Helpline and to seek effective ways to reach young people.

3.60 We now turn to consider trainees and the minimum wage exemptions that apply to this group.

Older Workers' Development Rate and the Extension of the 12 Months Apprenticeship Exemption

3.61 In our 2005 Report, we reviewed the older workers' Development Rate and the 12 months minimum wage exemption for apprentices and concluded provisionally that the older workers' Development Rate should be abolished from October 2006, and that, simultaneously, the 12 months exemption from the minimum wage should be extended to cover all apprentices aged 19 and over. We were pleased that the Government decided to take forward its own review of both issues in good time for them to be addressed appropriately in the context of the forthcoming Equal Treatment Directive legislation. We also re-examined our provisional conclusions and provided input to the Government's review. Our considerations and conclusions are detailed below.

Older Workers' Development Rate

3.62 The older workers' Development Rate applies to workers aged 22 and over in a new job with a new employer and who are doing accredited training on at least 26 days (not necessarily full days) during the first six months of employment.

3.63 At the outset of the minimum wage, we wanted to ensure that older workers returning to the labour market or seeking to acquire new skills and develop their career were not disadvantaged by the minimum wage. We recognised that the acquisition of skills was not simply an issue for the young, but that people of all ages may need access to training and development. We did not want the minimum wage to become a barrier to the provision of structured training for older workers.

3.64 To provide an incentive for employers to take on older workers and provide good quality training, an older workers' Development Rate was included in the National Minimum Wage provisions from the outset. Its purpose was to strike a balance between the interests and productivity

expectations of both employer and worker. To date the rate has been set in line with the youth Development Rate.

- 3.65** However, take-up of the older workers' Development Rate has been consistently low and since our Third Report (2001) we have questioned the value of maintaining it if it remained little used. In preparing our 2005 Report, it was clear that the position had not changed and that only a small minority of employers were making use of the rate. We also found little support from stakeholders to maintain the rate, with the complexity and costs associated with operating accredited training schemes a principal deterrent to its use. This led us to make our provisional recommendation that the rate should be abolished.
- 3.66** It is not possible to tell from the official data how many employers use the older workers' Development Rate or how many workers it applies to. We have, however, ascertained that in April 2005 there were about 162,000 workers aged 22 or over paid between the then older workers' Development Rate (£4.10) and the adult rate (£4.85) who were not in the same job as in the previous year. Some of these workers could have been on the older workers' Development Rate. However, the reason for these workers being paid below the adult rate of the minimum wage could also be due to a variety of other factors, such as use of the accommodation offset or the apprenticeship exemption. We therefore relied on our consultation with stakeholders to gain a better understanding of the extent to which the rate is used. We look at stakeholders' views next.

Stakeholders' Views

- 3.67** In our consultation this year, we asked stakeholders to comment specifically on the Commission's provisional conclusion to recommend the abolition of the older workers' Development Rate. Overall there was virtually no support for it to be maintained.
- 3.68** We also asked about use of the rate during our visits to meet individual firms throughout the UK. None of the firms we met made use of the rate, and some did not know of its existence, suggesting awareness continues to be low. No firms indicated that they would be likely to make use of the rate in the future and their general view was that they would find it difficult to recruit older workers at a rate below the adult rate of the minimum wage. The problems associated with operating

accredited training schemes were also cited as a key reason for the low uptake.

- 3.69** The trade unions that submitted evidence to us, including the TUC and Usdaw, were generally in favour of abolishing the older workers' Development Rate. The reasons they cited included the low use of the rate and that it would cut off a potential avenue for abuse.
- 3.70** The majority of employer organisations responding to our consultation that gave a view on the older workers' Development Rate were also in favour of it being abolished, with the exception of the CBI, The Newspaper Society and BUPA Care Services. It was clear from the responses that take-up of the rate continues to be extremely low. The Association of Licensed Multiple Retailers, who were previously advocates of the rate, advised that no responses to its survey of members suggested the use of, or the need for, a specially reduced rate for older workers undergoing training and that it would be content if it were abolished. The Small Business Service noted that the rate was used so infrequently that it saw no difficulty arising if it were abolished. The CBI, while accepting that use of the rate was low, was concerned that abolishing it would be a loss of an important flexibility for employers. The Newspaper Society also noted that the rate was rarely used, but that their members would prefer to see it continued. BUPA Care Services argued that historical use of the rate was not an indicator of its future use and that the proposed extension of the 12 months apprenticeship exemption did not offer a suitable replacement for the rate.
- 3.71** These consultation responses are in line with the findings of research we commissioned from Incomes Data Services (2004) and Cronin and Thewlis (2004) for our 2005 Report. The IDS research on the impact of the October 2003 upratings found no reported use of the older workers' Development Rate and the Cronin and Thewlis research on firms' adjustments to the minimum wage found only one company using the Development Rate.

Extension of the 12 Months Apprenticeship Exemption

- 3.72** The 12 months minimum wage exemption for apprentices was introduced for those aged 19 and over but under the age of 26 to encourage employers to continue to offer good quality apprenticeships

“ We join with the TUC and other unions in requesting that the Adult Development rate is abolished as it is too easily abused by some employers. ”
T&G evidence

“ ... we have been unable to trace any member using the older workers' Development Rate. ”
British Hospitality Association evidence

to this age group following the introduction of the minimum wage. The age limit on the exemption was in line with government apprenticeship schemes at the time, which were only available to those aged 25 or under. The minimum wage exemption recognised that pay for apprentices was often low in the first year, reflecting the extent to which the apprentice is in training rather than productive work during this early stage of the apprenticeship. Wages often increase to well above the applicable minimum wage level in subsequent years.

- 3.73** We noted in our 2005 Report that the current ‘below age 26’ threshold applied to the exemption might be open to challenge in terms of the forthcoming implementation of the Equal Treatment Directive (2000/78/EC) outlawing age discrimination at work. Moreover, the Government was itself making changes to the age limits that applied to apprenticeship schemes. These factors led us to review the exemption. We remained of the view that there was a need to exempt apprentices in the first 12 months of employment to take account of their lower productivity, and concluded that it was appropriate for the current upper age limit for the 12 months apprenticeship exemption to be removed. However, we made our recommendation provisional to allow time to consult and consider the issue further.
- 3.74** The key driver for change to the apprenticeship exemption remains the absence of any obvious objective justification for the retention of the requirement for apprentices to be aged below 26 for the 12 months exemption from the minimum wage to apply. We, and the Government as stated in its evidence to us, continue to believe the current upper age limit is incompatible with the Age Directive legislation due to be implemented in 2006.
- 3.75** It is not possible to tell accurately from the official data how many apprentices are over the age of 25. However, our best estimate is that there are no more than 10,000 such apprentices. This suggests that the impact of removing the 26 year old threshold would be minimal.

Stakeholders’ Views

- 3.76** The majority of trade unions were against extending the 12 months apprenticeship exemption to older apprentices. The TUC and the Transport and General Workers’ Union were concerned that the exemptions could lead to exploitation of apprentices with very low

wages being paid during the exemption period. They were also concerned about the high drop out rate for apprentices and believed that the exemption from the minimum wage acted as a disincentive for apprentices to complete their training. They proposed that we should instead undertake a wider review of all apprenticeship exemptions to check whether they were still justified.

- 3.77** Some unions, including the Northern Ireland Public Service Alliance and Unison, suggested that the apprenticeship exemption be abolished altogether, not extended. The GMB advocated the abolition of the apprenticeship exemption in favour of a single development rate to cover all apprentices, regardless of age, for the first six months. Usdaw did not consider there to be a need to extend the exemption to cover older apprentices, and was concerned that it could lead to older workers with family responsibilities being paid less than the adult minimum wage rate.
- 3.78** Employers and their representative organisations were in favour of the extension of the apprenticeship exemption, although a few, such as the British Hospitality Association, advised that the use of the apprenticeship exemption in their sectors was low. The Scottish Grocers Federation commented that they were operating in a competitive labour market and that low pay rates only hindered recruitment. Conversely, Business in Sport and Leisure and the Employers' Organisation for Local Government believed the exemption would help encourage recruitment of older workers. During our Commission visits some employers also made this point.
- 3.79** The hairdressing sector in particular sought to have the exemption further extended. The National Hairdressers' Federation argued that apprentices and those on accredited training programmes, verifiable by a relevant sector body, should be treated in the same way irrespective of age and be exempt from the minimum wage for the duration of their apprenticeship or accredited training. It stressed that the current exemption periods for apprentices were too short and that they acted as a deterrent to employers to take on and train new staff.
- 3.80** The Scottish Low Pay Unit and Citizens Advice Scotland were both against the extension of the apprenticeship exemption. A primary concern was that exemptions to the minimum wage could lead to

“ NIPSA supports the abolition of both the Older Workers' Development Rate and the 12 month apprentice exemption. There is no justification for either exemption. All workers entering apprenticeships for skilled trades and crafts or professions should be receiving wages in excess of the statutory minimum wage. ”

Northern Ireland Public Service Alliance evidence

“ Our members consider that, to coincide with the changes taking place in the provision of apprenticeship schemes, the 12-month exemption should be extended to those aged 25 and over, in order to reduce the risk of litigation and support in the employment of this age group. ”

The Newspaper Society evidence

exploitation and abuse of the rules. The Scottish Low Pay Unit believed that the minimum wage should be the absolute minimum which no worker's pay should fall below, even in training. The Equal Opportunities Commission was concerned that such exemptions could lead to inequalities in pay between men and women.

- 3.81** In conclusion, the consultation responses suggested near unanimous support for abolishing the older workers' Development Rate. But the views on extending the apprenticeship exemption were mixed, with employers and employer organisations largely in favour of extending the exemption, while trade unions and voluntary organisations were pressing for a reduction or abolition of the exemption period.

Conclusion: Development Rate and Apprenticeship Exemption

- 3.82** Our review has shown that the position on the older workers' Development Rate and the 12 months apprenticeship exemption has not changed since we reported our provisional conclusions in our 2005 Report. Take-up of the older workers' Development Rate remains very low and the consultation responses suggest near unanimous support for abolishing it. The suggestion by some stakeholders in previous years that the older workers' Development Rate would be used more intensely as the level of the minimum wage increased does not appear to be borne out. Consultation responses on the apprenticeship exemption were more mixed. But we have received no evidence to alter our view that it would be difficult to justify an age limit on the apprenticeship exemption objectively in terms of the forthcoming age discrimination legislation.
- 3.83** Taking all these factors into account, we conclude that the evidence is now compellingly in favour of the older workers' Development Rate being abolished in October 2006 and, simultaneously, the 12 months apprenticeship exemption being extended to cover all apprentices aged 19 and over. We submitted our findings to the Government in November 2005. The Government's own assessment concurred with our view and it has advised that it will be proceeding on this basis. We understand that it will be introducing the necessary provisions before Parliament shortly.
- 3.84** We now turn to consider other trainees and the minimum wage exemptions that apply to them.

Other Trainees

- 3.85** During the preparation of our 2004 Report, we looked carefully at the position of trainees and reviewed the minimum wage exemptions that were in place at that time in relation to the introduction of the minimum wage for 16–17 year olds. We concluded by recommending that the exemption from the minimum wage for apprentices aged 19 and under should be retained following the introduction of the 16–17 year old minimum wage, but said then that we would wish to look at the position of apprentices and participants on pre-apprenticeship programmes in a few years.
- 3.86** Such a review would also enable us to take account of other developments relating to apprenticeships in recent years. These include the Foundation Modern Apprenticeships and Advanced Modern Apprenticeships being replaced with ‘Apprenticeships’ (level 2) and ‘Advanced Apprenticeships’ (level 3) in England and the abolition of the arbitrary 25 year old upper age limit for starting apprenticeships in Scotland and Wales, and the review of the age limit in England and Northern Ireland. In addition, as noted earlier, in August 2005 the LSC introduced a contractual requirement for waged apprentices in England to receive a minimum of £80 per week from their employer. It has also announced that the EMA will be extended from April 2006 to replace the current MTA in England and will be available to young people on pre-apprenticeship programmes.
- 3.87** Some consultation responses received from trade unions and other organisations for this report raised concerns about the apprenticeship exemptions. They were concerned that the exemptions were being abused by some employers who offered little or low quality training. They asked that we carry out a review of them.
- 3.88** We believe that it is too soon to carry out a review for our next report which we expect will be due in 2007, but **we recommend that the Government invite the Commission to carry out a full review of the apprenticeship exemptions and report in 2008.** This timing will also enable us to assess the impact of the abolition of the older workers’ Development Rate and the extension of the 12 months apprenticeship exemption in 2006.

Benefits-in-kind, Salary Sacrifice Schemes and the Accommodation Offset



Since the introduction of the National Minimum Wage, accommodation has been the only benefit-in-kind that may count towards the calculation of minimum wage pay. For this report, we reviewed the operation of the accommodation offset and considered whether the provisions remain appropriate. We also considered whether there was a case for allowing other benefits-in-kind, including those offered by means of a salary sacrifice arrangement, to count towards the minimum wage.

We received evidence from employer representatives who argued that low-paid workers should be able to participate in salary sacrifice schemes, even if it caused their cash wages to fall below the minimum wage. They suggested it was unfair that these workers were denied the opportunity to exchange some of their pay for an attractive benefit with a preferential tax and national insurance treatment. Trade unions argued, however, that employers should not be able to offset benefits such as childcare vouchers against minimum wage pay. In their view, it would erode the value of the minimum wage and undermine its simplicity.

We acknowledge that some low-paid workers would benefit from participating in a salary sacrifice arrangement. But the evidence indicated that most low-paid workers would be better off claiming support for childcare through the Working Tax Credit system than by joining a company salary sacrifice scheme for childcare vouchers. We found that salary sacrifice schemes for home computers, bicycles to work and other benefits were less common and less well developed, and employee take-up rates in firms that offered these benefits were often quite low. In addition, many part-time low-paid workers would gain no advantage from these schemes. We conclude that allowing further benefits-in-kind to count towards minimum wage pay would undoubtedly complicate the National Minimum Wage while only benefiting a small number of workers. It would also introduce new risks: some workers might see

their wages reduced in return for a benefit of little or no value.

We recommend that salary sacrifice schemes should not count towards the minimum wage.

Our review of the accommodation offset found that, although many employers in sectors where accommodation has traditionally been provided were aware of the offset, awareness and understanding could still be improved. We recommend that the Government take greater steps to publicise the offset and to improve the scope and quality of existing guidance. There was a range of views about the appropriateness of its current level, but we continue to believe that an offset of £3.90 per day (rising to £4.15 in October 2006) represents a fair balance between the interests of workers and those of employers.

We received evidence that accommodation charges in excess of the maximum permitted under the offset provisions were common in agriculture and food processing. Employer representatives and trade unions both reported that an increasing number of migrant workers were employed in these sectors, often on the minimum wage, and were typically charged £40–60 per week for accommodation provided by their employer. Until recently the Department for Environment, Food and Rural Affairs (Defra) had advised agricultural employers that, based on its reading of the Agricultural Wages Order for England and Wales, the accommodation offset rules did not apply to agricultural workers when accommodation was provided under a stand-alone agreement. Following a review by the relevant government departments, Defra has now revised that view and confirmed that no worker may be paid less than is due under the National Minimum Wage accommodation offset provisions.

Some respondents from the agriculture sector argued, however, that the offset should only apply to workers who were required to occupy accommodation under the terms of their employment contract.

They suggested that, in most cases, migrant workers were offered accommodation because of the difficulties they faced securing the deposits and documents required by most landlords. In their view, accommodation provided by employers in these circumstances was an optional service that workers could choose to decline, and therefore the two parties should be free to agree a rent between them. Trade unions, on the other hand, cited cases of severe overcrowding combined with

high accommodation charges, and called for a greater emphasis on enforcement of the existing provisions.

We accept that there is a distinction in principle between accommodation that is offered to workers as an optional service independent of the job offer, and accommodation that workers are required to occupy as a condition of their employment. But we are not convinced that such a distinction could work effectively in practice due to the difficulty of establishing whether the worker had been given a genuine choice. We are also concerned that some employers have been exploiting vulnerable migrant workers by applying high charges for poor quality, overcrowded accommodation – in excess of the maximum allowed under the accommodation offset rules. We recommend that the offset provisions should continue to apply to all workers housed by their employer in all circumstances and that the Government should ensure that employers are fully aware of the legal requirements. We would also like to draw the Government's attention to evidence that existing housing standards are not being enforced consistently at a local authority level. We propose to continue to keep the accommodation offset under review, in particular the treatment of housing offered as an optional service not tied to the job.

Our consultation also revealed that some employers have deliberately sought to circumvent the existing offset rules by setting up a separate company to arrange accommodation for their workers. We recommend that the Government take the steps necessary to avoid abuse of such arrangements. Employers may make a variety of other arrangements with third party landlords, and in some cases there may be some doubt whether the accommodation offset applies. We believe that the employer should be regarded as the accommodation provider where a worker's ability to remain in a particular job, or to remain in particular accommodation, is dependent one upon the other. We believe that the offset should also apply if the employer receives a financial benefit from an accommodation arrangement. We recommend that the Government provide further guidance on these matters.

In our view there is a need to tackle overcharging for accommodation and evasion of the accommodation offset as part of a more concerted effort to ensure that migrant workers receive the minimum wage to

which they are legally entitled. We recommend that the Government take action to prioritise targeted enforcement of the minimum wage in those sectors that employ significant numbers of migrant workers.

Introduction

- 4.1** Our 2005 Report recorded that a number of large retailers had raised concerns that, as a result of the requirements of the minimum wage, their lowest-paid employees were prevented from taking up some of the non-cash benefits that were available to their higher-paid colleagues. Employees in these companies were offered the opportunity to take childcare vouchers, home computers or other benefits in exchange for an agreement to give up part of the pay normally due to them. This is generally known as a ‘salary exchange’ or ‘salary sacrifice’. The difficulty arose because participation in this type of arrangement would have caused the wages of lower-paid employees to fall below the National Minimum Wage. The British Retail Consortium (BRC) called for a change to the regulations to enable salary sacrifice schemes to form part of the minimum wage calculation.
- 4.2** In the run-up to our 2005 Report, the Government became aware of the difficulties that some employers had encountered arising from the treatment of salary sacrifice schemes under the minimum wage. In October 2004 the Government had asked us to advise, by the end of 2004, whether salary sacrifice schemes involving childcare vouchers should be allowed to count towards minimum wage pay. We felt that this timescale was too short to consult, consider the issue properly and take full account of a number of complex factors (which we will go on to examine in this Chapter). Instead, we proposed in our 2005 Report that the Government invite us to review the issue of salary sacrifice in depth and report back by February 2006. The Government accepted our recommendation, but widened the scope of our review to cover the minimum wage treatment of all benefits-in-kind. We welcomed the opportunity to examine salary sacrifice schemes within this broader context.
- 4.3** Our consultation over the last year revealed that, while there were significant concerns from employers in some sectors with respect to salary sacrifice, there was very little pressure for change to the

treatment of benefits-in-kind more generally (with the exception of accommodation which we consider separately later in this Chapter). Consequently, our review focused on the interaction between salary sacrifice schemes and the minimum wage. We looked in particular at the provision of childcare vouchers and home computers because these were the salary sacrifice schemes that caused the most concern for the employers and trade unions who responded to our consultation.

4.4 The Government also asked us to look at the treatment of accommodation and to consider if any changes to the regulations governing the accommodation offset were necessary. Since the introduction of the National Minimum Wage in 1999, accommodation has been the only benefit-in-kind that may be counted towards minimum wage pay¹, and even then only up to a specified maximum amount. This is known as the accommodation offset. We have concluded in previous reports that the offset was working reasonably well, particularly following the implementation of a simplified daily calculation in 2003. However, our most recent consultation revealed that there were problems with its operation when applied to the housing of migrant workers by employers operating in agriculture and related industries such as food processing. We consider accommodation in detail in the second half of the Chapter.

The Definition of the National Minimum Wage

4.5 In our First Report (1998), we considered in detail the definition of earnings that should count towards the National Minimum Wage. Our overriding concern was to recommend a definition that would be ‘...simple and fair, easily enforceable and consistent with the needs of business and the low-paid’. The First Report concluded that most low-paid workers received only a basic rate of pay with few additional benefits (although the payment of tips and gratuities has continued to feature in certain sectors such as hospitality). In line with the principle of ‘simplicity and enforceability’, as well as a concern about the

¹ No benefit-in-kind other than accommodation may be taken into account for the purposes of the minimum wage calculation. However, employers may make certain deductions from pay that do not reduce pay for minimum wage purposes (for example employee pension contributions and the purchase of company shares by the employee). Employers may also charge an amount equivalent to the accommodation offset where accommodation is not provided as a benefit-in-kind.

difficulty of estimating and monitoring the value of many benefits, we recommended – and the Government accepted – that all benefits-in-kind with the exception of accommodation should be excluded from the calculation of the National Minimum Wage. We believed that if the value of the minimum wage was to be preserved, workers should be remunerated in money not in kind. We look at the reasons for the particular treatment of accommodation later in this Chapter.

- 4.6 The Government accepted our recommendations and the principles we set out in our First Report have continued to guide our thinking. We have found that, in general, the minimum wage definition we recommended in our First Report has worked well. However, as we noted above, consultation with the retail sector in the run-up to our 2005 Report revealed that a few large retailers were experiencing problems because the definition of National Minimum Wage pay excludes non-cash benefits provided under salary sacrifice schemes. In the next section, we describe how salary sacrifice arrangements operate and look at some of the more popular schemes.

The Minimum Wage and Salary Sacrifice Schemes

- 4.7 Sometimes known as a salary exchange, a salary sacrifice is an arrangement whereby a worker agrees to forgo a portion of their pay in exchange for another benefit. Her Majesty's Revenue and Customs (HMRC, undated) defines it as follows:

'A salary sacrifice happens when an employee gives up the right to receive part of the cash pay due under his or her contract of employment. Usually the sacrifice is made in return for the employer's agreement to provide the employee with some form of non-cash benefit. The "sacrifice" is achieved by varying the employee's terms and conditions of employment relating to pay. Salary sacrifice is a matter of employment law, not tax law. Where an employee agrees to a salary sacrifice in return for a non-cash benefit, they give up their contractual right to future cash remuneration.'

- 4.8 Workers who participate in salary sacrifice arrangements are required to give up their contractual right to a portion of their pay for an agreed period, in some cases for a year or longer. However, if their gross pay

were to fall below the National Minimum Wage as a consequence, their employer would be acting unlawfully. The non-cash benefit received instead – for example, a childcare voucher or home computer – has no value for the purposes of calculating minimum wage pay. (We have already noted that the only benefit-in-kind that may be offset against the minimum wage is accommodation. In addition, no vouchers may count towards the minimum wage.) While employers are free to offer childcare vouchers and other benefits on top of normal pay if they wish, many have found it more cost-effective to offer them as a replacement for part of an employee's existing pay package via a salary sacrifice arrangement.

- 4.9** Salary sacrifice schemes are generally designed to take advantage of the fact that, unlike cash wages, in certain circumstances some non-cash benefits offered by employers are exempt from liability for income tax and National Insurance Contributions (NICs). The exemption applies whether the benefit is offered via a salary sacrifice arrangement or on top of pay. These benefits include childcare vouchers, loaned home computer equipment, loans for bicycles to travel to work, employer contributions to occupational pensions and mobile telephones for personal use. By 'sacrificing' part of their gross pay, workers can receive a benefit that has a greater value than the net cash pay they would have received, after tax and NICs, if they had retained their original salary. However, part-time workers who do not earn enough to be liable for tax and NICs will not make these savings through a salary sacrifice arrangement.
- 4.10** Salary sacrifice schemes are also attractive from an employer's perspective as they offer savings through reduced employer NICs. There are also less tangible benefits. These schemes can be a useful tool to distinguish a company from its competitors and enhance the overall employee benefits package at little or no additional cost to the employer. This can be attractive for employers operating in a tight labour market. There may also be advantages in terms of reduced staff turnover, particularly in the case of home computer loans which typically require employees to sign an agreement which lasts for two or three years.
- 4.11** The concept of salary sacrifice is not new: pension arrangements, which take advantage of the more generous NICs treatment afforded to employer pension contributions compared to employee

contributions, have existed for some time. Similarly, the Government introduced measures to boost 'green' transport and reduce reliance on cars for travel to work in 1999. Often known as 'cycle to work' schemes, employers can loan their staff a bicycle as a tax and NICs-free benefit-in-kind.

- 4.12** However, salary sacrifice schemes appear to have gained greater impetus since 2004 due to two recent government initiatives. In January 2004, the Government issued guidance to promote a £500 annual exemption from the taxable benefit on loaned home computing equipment. The exemption, designed to boost home computer ownership and improve computer literacy, was introduced in 1999 but employer take-up had been low. The 2004 Home Computing Initiative (HCI) guidance promoted the use of salary sacrifice by employers, which offers a direct cost benefit through savings in NICs (estimated at about £64 per annum per employee). In April 2005, the Government introduced reforms to encourage employers to offer childcare vouchers as part of its strategy to increase the availability of affordable childcare and remove barriers to work for parents. Employers are able to offer childcare vouchers worth up to £50 per week per employee, free of income tax and NICs. Basic rate taxpayers can save up to £858 per year and higher rate taxpayers up to £1,066 per year. Again, employers can also save on their NICs.
- 4.13** We are also aware of other salary sacrifice schemes, for example mobile phones and car parking spaces at the workplace, but the evidence indicates that these are less common and, unlike some of the other schemes, we are not aware of a direct link with a specific government initiative.

The Evidence

- 4.14** Our 2005 Report established that the interaction between salary sacrifice schemes and the National Minimum Wage was causing difficulties for a few large retailers. In the preparation of this report, we have sought to investigate the extent of the problem within the retail sector and to discover whether other low-paying sectors are similarly affected. We invited written evidence from interested parties and heard oral evidence from employer representatives and trade

unions covering a number of sectors. We visited companies in different parts of the country including retailers in Hastings, Manchester, Lincolnshire, Northern Ireland and Nottingham. We invited a group of retailers that had implemented salary sacrifice schemes to give a presentation to the Commission. The group included House of Fraser, the John Lewis Partnership and Tesco. Dixons had also been involved in the preparation. We received a separate presentation from Whitbread on its benefits package and salary sacrifice schemes.

- 4.15** We also wanted to investigate whether there had been a change in the pattern of provision of non-cash benefits to low-paid workers that might be linked to an increase in the prevalence of salary sacrifice schemes or to increases in the level of the minimum wage. Our First Report (1998) and the subsequent occasional paper, *Pay Structures and the Minimum Wage* (Low Pay Commission, 1999b), concluded that low-paid workers tended to receive few additional benefits-in-kind from their employer (although it was also noted that government statistics and commercial surveys collected little relevant information). During our meetings with employers in recent years, some had suggested that successive minimum wage upratings were driving them to review their benefits packages with a view to identifying possible savings. We look next at the data available to us from statistical sources and research, before considering the evidence we received from our consultation.

Employer Provision of Non-cash Benefits

- 4.16** Official data on non-cash benefits are limited and there is almost no information available on the prevalence of salary sacrifice schemes. However, the Department for Work and Pensions' Family Resources Survey (FRS) asks respondents about the non-cash benefits received from their present employer in the last six months. As shown in Table 4.1 below, 76 per cent of jobs paying less than £4.60 per hour² offered no benefits-in-kind in 2003/04, compared with 56 per cent of jobs paying more than £10.00 per hour. Apart from a slight decline in the provision of free or subsidised meals, or other meal provision, across all the hourly wage bands we examined, there has been very little

² The National Minimum Wage for workers aged 22 and over was £4.50 per hour in the period October 2003 to September 2004. The additional ten pence is to allow for those respondents who were paid marginally above the minimum wage and for the effects of rounding.

variation in the provision of benefits-in-kind in the surveys undertaken between 1997/98 and 2003/04 (the latest year available). More detail is shown in Appendix 3. This suggests that the minimum wage has had little impact on the provision of non-cash benefits. The FRS indicates that most low-paid workers continue to receive few non-cash benefits on top of basic pay and that they are less likely to receive them than higher-paid workers.

Table 4.1 Proportion of Jobs Providing Any Payments-in-kind by Gross Hourly Pay, UK, 2003/04

Percentage of jobs	Gross hourly pay, £				All paybands
	£4.60 or less	£4.61 to £6.00	£6.01 to £10.00	More than £10.00	
Luncheon vouchers	–	–	–	1	0
Free meals	9	7	5	5	6
Free or subsidised canteen	5	8	9	14	10
Free or subsidised goods	7	8	4	4	5
Childcare provisions/vouchers	–	–	–	1	0
Free/subsidised medical insurance	1	1	3	15	7
Shares or share options	2	3	4	10	6
Payment of school fees	–	–	–	–	0
Phone for personal and work	2	2	4	13	6
Company vehicle	2	2	4	13	7
Any other payments-in-kind	2	1	1	3	2
No payments-in-kind	76	75	73	56	68
Total jobs in pay band (000s)	3,016	3,839	8,656	8,120	23,631

Source: Department for Work and Pensions, Family Resources Survey, UK, 2003/04.

Notes:

1. Some jobs may provide more than one payment-in-kind, or none at all, so the categories are not mutually exclusive and will not add up to 100 per cent.
2. '–' denotes grossed cell sizes below 30,000.

4.17 The FRS gives no indication of the frequency with which salary sacrifice schemes are offered, although it does show that childcare vouchers were received by very few workers in any of the income bands (the 2003/04 survey predates the introduction of new tax rules in April 2005 designed to boost uptake of the vouchers). The data also show that very few non-cash benefits other than those specified were received.

4.18 Commercial surveys of pay and benefits tend to focus on larger companies (partly because they are more likely to respond and because they tend to offer more benefits) and are not well-targeted at low-paying employers. Small sample sizes mean that the outcomes vary considerably. It is difficult to draw firm conclusions, but surveys such as the Employee Benefits/Halifax survey of voluntary benefits (Centaur

Communications Ltd, 2005c), as well as articles in the press, suggest that interest in salary sacrifice schemes is increasing and that childcare vouchers is the most popular scheme, followed by pensions and home computers, with few employers offering bicycle loans or mobile phones. This is consistent with the other evidence presented to us.

- 4.19** The Government was not able to provide conclusive information on take-up of salary sacrifice schemes in its evidence because these data are not collected. It estimated that around 600 organisations have adopted HCI schemes and that about half a million individuals have taken up the offer in the UK. A snapshot survey undertaken in November 2005 by the HCI Alliance (established by BT, Intel and Microsoft to promote the initiative to employers) suggested that over 1,250 organisations implemented HCI schemes between January 2004 and November 2005 and just over 475,000 computers were loaned to employees who participated. The average employee take-up rate in the organisations surveyed was just over 10 per cent. We met two large retailers who reported similar take-up rates for the home computer schemes that they had implemented.
- 4.20** The Government's evidence noted that the largest Cycles to Work provider estimated that it would issue at least 30,000 certificates for new cycles in 2006. Taking into account other providers, it is estimated that around 100,000 people will be in a cycle scheme in 2006. The Government does not know how many childcare vouchers have been issued, although HMRC plans to conduct surveys to evaluate the impact of the changes implemented in April 2005.
- 4.21** In view of the lack of official information on the extent to which salary sacrifice schemes are being offered by employers, we commissioned Incomes Data Services Ltd (IDS, 2005a) to undertake research on this topic. A summary of the project is contained in Appendix 2. IDS examined the provision of non-cash benefits and salary sacrifice schemes in four low-paying sectors: retail, hospitality, leisure and care homes. These sectors were chosen because we judged that they were most likely to offer non-cash benefits, including accommodation, as part of the remuneration package. Three thousand postal questionnaires were distributed to firms of different sizes in the UK, resulting in 341 responses. Nearly half of the respondents were from the retail sector and the median number of employees in each firm was

200. Ninety per cent of respondents said that they had employees who earned £6.00 per hour or less, confirming that the survey had been successful in targeting low-paying employers.

- 4.22** The main postal survey found that three in ten respondents offered at least one kind of salary sacrifice scheme, rising to four in ten retailers. Nearly half of large organisations (with 500 or more employees) offered a scheme. The most popular types were childcare vouchers (offered by 15 per cent of respondents), pension contributions (13 per cent of respondents) and home computer loans (6 per cent of respondents). Very few offered mobile phones or bicycles. A follow-up telephone survey with 29 employers that offered a salary sacrifice scheme established that employee take-up varied considerably from firm to firm and scheme to scheme, but overall the median take-up rate was just under one per cent.
- 4.23** The proportion of respondents operating a salary sacrifice scheme in the IDS survey seems high when compared to the evidence we gathered from other sources. We think these results are unlikely to be representative, and may reflect the high proportion of firms in the retail sector in the survey (which we believe are more likely to offer these schemes than firms in other low-paying sectors), or indicate that companies offering salary sacrifice schemes were more likely to respond. In particular, the administrative burden associated with operating a salary sacrifice scheme would suggest that far fewer small firms will offer them to staff. Nevertheless, the IDS findings do support other evidence that the most significant salary sacrifice schemes are those for childcare vouchers and home computers.
- 4.24** Pension salary sacrifice schemes were also found to be relatively common in the IDS survey. However, they were referred to infrequently by respondents to our written consultation, and seemed to cause few problems for employers in low-paying sectors. This may reflect the fact that these schemes have been around for some time and so firms may have been able to adjust to any impact of the minimum wage. In addition, workers who participate in a pension salary sacrifice scheme tend to sacrifice an amount which is fixed in direct proportion to their total pay, making it less likely that participation will cause their wages to fall below the minimum wage.

- 4.25** Although not specific to salary sacrifice schemes, it is notable that 86 per cent of respondents to the IDS survey said that the minimum wage had not caused them to make any changes to their overall non-cash benefits package. Six per cent said it had led to a decrease in the level of benefits provision, while seven per cent said it had led to an increase. This supports evidence from the FRS, which suggested that the minimum wage has not had a significant impact on benefits provision.
- 4.26** In summary, it is difficult to draw firm conclusions about the prevalence of salary sacrifice schemes in low-paying sectors. Nevertheless, commercial surveys and our own research suggest that these schemes are being offered by firms with low-paid employees and that interest is increasing, particularly in large firms and in the retail and leisure sectors. However, employee take-up rates in individual companies generally appear to be low.

Our Consultation

- 4.27** We received opposing views on the question of whether salary sacrifice schemes should count towards the minimum wage in future. In general, employers' representatives were in favour of change, particularly in the retail sector. Most of those employers who commented on the issue argued that specific salary sacrifice schemes, particularly those for childcare vouchers and home computers, should count towards minimum wage pay. A smaller number advocated a greater relaxation of the rules, either in relation to particular non-pay benefits or other salary sacrifice schemes. Conversely, three hospitality associations were not in favour of changing the definition of the minimum wage to accommodate salary sacrifice schemes. Trade unions and other worker representatives were generally opposed to allowing any benefits-in-kind other than accommodation to count towards minimum wage pay. Both sides of the debate presented persuasive arguments to support their position, which we considered carefully.
- 4.28** A number of trade unions were concerned that allowing salary sacrifice schemes to count towards the minimum wage would complicate the definition of minimum wage pay. They argued it would open up the potential for abuse by allowing employers to replace cash pay with benefits of less transparent value. The TUC's evidence argued that the enforceability of the minimum wage depended largely on its simplicity

Although there would be potential benefits for workers in that they may be able to access goods and services at lower prices, the system would be open to abuse in that employers could be passing these goods and services on at a profit in an attempt to offset wage bills.

Scottish Low Pay Unit evidence

The minimum wage is based on simplicity. It is easy to understand because, apart from the accommodation offset, no other benefit-in-kind is allowed to be deducted and we believe this should remain the case.

Usdaw evidence

and it was concerned that a change would 'make it harder for workers to know their rights and to enforce them'. The TUC also noted that salary sacrifice schemes could tie a worker into an arrangement for a number of years and concluded that 'the problems of allowing these schemes to cut below the minimum wage would be very likely to outweigh any benefits'.

4.29 Others feared that allowing salary sacrifice schemes to count towards the minimum wage could open the door to further allowable deductions in future, thus eroding the value of the minimum wage. The Union of Shop, Distributive and Allied Workers (Usdaw) pointed out that many low-earners would be better off receiving support for childcare through the Working Tax Credit (WTC) system than by taking part in a childcare voucher salary sacrifice scheme. It was also concerned that some Usdaw members who had taken childcare vouchers had unwittingly built up large overpayments of WTC that they then had to pay back, causing financial hardship. The available literature had not made clear that workers who received childcare vouchers should report this to HMRC so that their entitlement to the childcare element of the WTC could be adjusted. The GMB was concerned that workers could find their entitlement to other state benefits reduced as a result of a salary sacrifice arrangement if they were not advised properly about the implications. We look at the impact that salary sacrifice schemes can have on entitlement to WTC support and other state benefits later in this Chapter.

4.30 In contrast, employers responding to our consultation emphasised that low-paid workers could be better off financially by 'sacrificing' part of their salary, because of the preferential tax and NICs treatment of the benefit in comparison with cash. Retailers provided examples illustrating the significant savings that could be made by participating in a HCI scheme, compared to the purchase of a home computer on the high street. They also noted that participation in a HCI scheme allowed employees to purchase a computer package from a trusted source and pay for it over an extended period, without being subject to a credit check (which may be attractive in itself, even without the associated tax and NICs savings).

4.31 Employer representatives also argued that low-paid workers should be entitled to dispose of their wages as they chose and on the same basis

as any other worker. Some suggested that it was illogical for one government policy – the National Minimum Wage – to prevent employers offering benefits that the Government itself had been seeking to encourage through the introduction of tax and NICs exemptions.

- 4.32** Some employers told us that they had decided not to introduce salary sacrifice schemes at all rather than offer them only to higher-paid workers as they felt this was unfair to those who were excluded and contrary to their company ethos. However, we also came across examples of employers who had decided to introduce salary sacrifice schemes that were restricted to higher-paid employees.
- 4.33** The CBI wrote that the most significant problems arose with childcare vouchers and pointed out that non-cash benefits enabled employers to offer a distinctive package to attract and retain employees in a tight labour market. It also suggested that this flexibility was threatened by the rising level of the minimum wage. The Association of Convenience Stores, representing smaller retailers, stated in its written evidence that salary sacrifice schemes were not generally used by its members at present, although it was in favour of allowing them to count towards the minimum wage.
- 4.34** The BRC argued strongly for change, and that at the very least, it should be possible to count childcare vouchers and home computer schemes towards the minimum wage. Its written evidence, based on a detailed analysis of three large retailers, suggested that many retail employees were excluded from participating in salary sacrifice arrangements and that part-time workers, who make up the majority of the retail workforce, were particularly affected.
- 4.35** Our own analysis of retail sector pay supported the BRC's findings, although it is important to note that most low-paid part-time workers would gain little or no benefit from a salary sacrifice arrangement because they pay little or no income tax or NICs. To participate in a home computer salary sacrifice scheme over three years involving the loan of equipment worth £1,000 in total (requiring a 'sacrifice' of about £6.40 per week), a worker would need to earn 16 pence per hour more than the minimum wage (based on 40 hours per week) or 32 pence per hour above the minimum wage (based on 20 hours per week).

Participation in these schemes is entirely voluntary and the decision not to participate should be through individual choice rather than statutory exclusion. ”

BUPA Care Services
evidence

Employers are frustrated that in complying with one area of Government policy in relation to the National Minimum Wage they must then disadvantage their staff in respect of different policy initiatives designed to increase the provision of good quality childcare, get more mothers back into the economy, protect the environment and improve computer literacy. ”

Institute of Payroll and Pensions Management
evidence

“ The impact of successive NMW increases is effectively denying many low-paid employees access to salary sacrifice schemes from which they could benefit. ”

British Retail Consortium evidence

According to the Annual Survey of Hours and Earnings 2005, 20 per cent of employees (391,000) aged 22 and over in the retail sector earned less than 32 pence above the minimum wage in April 2005. (Of these, 54,000 earned less than the then adult minimum wage of £4.85, although some of these are likely to have been apprentices or subject to the accommodation offset deductor.) Many more retail employees would not earn sufficient to sacrifice the maximum £50 per week in return for a childcare voucher.

- 4.36** While the main pressure for change came from the retail sector, we did receive evidence from employers in other sectors, including Sanctuary Housing Association, Nestor Healthcare Group and the charity Rethink. BUPA Care Services estimated that 20 per cent of its 21,000 workforce would be unable to participate in the salary sacrifice schemes that it was looking to introduce. In its evidence, the Institute of Payroll and Pensions Management wrote that ‘many of our public sector members employ large numbers of workers subject to these restrictions. Feedback from our members is that this issue predominantly affects the provision of childcare’. Within the hospitality sector, views were mixed. Some employers were in favour of change, but three major hospitality employer associations – the British Beer and Pub Association, British Hospitality Association (BHA) and Business in Sport and Leisure – were not. They were concerned about the potential administrative burden for employers associated with demonstrating continued compliance with the minimum wage and questioned whether it would lead not only to employees expecting more benefits, but also to a demand for a higher minimum wage to compensate for employers’ ability to offset part of the costs through a salary sacrifice scheme. The BHA found little demand for change from members.
- 4.37** The Government’s evidence to the Commission recognised the value of benefits provided under a salary sacrifice arrangement and the opportunities these schemes offered to employers, but stated that it did not believe that there was a strong enough case for allowing them to count towards the minimum wage at the present time. It was concerned about ‘complicating the rules and potentially undermining enforcement’ of the minimum wage.
- 4.38** We examined carefully the arguments presented both for and against allowing salary sacrifice schemes to count towards minimum wage

pay. We paid particular attention to childcare vouchers because the evidence suggested that this was the most common form of salary sacrifice arrangement. It was raised most frequently by employers as something that was causing difficulties for them. We also recognised that childcare support was an extremely valuable benefit for some families. But as we have indicated, there were further complicating factors to consider. Participation in a salary sacrifice scheme may affect a worker's entitlement to government WTC support and we look at this next, before considering the effects that salary sacrifice schemes can have on entitlement to state benefits.

Childcare Vouchers and Working Tax Credits

4.39 Many low-paid workers, and particularly those with children, will be entitled to Working Tax Credit (WTC), an in-work benefit paid by the Government to people on low-incomes. WTC is made up of a number of distinct elements, including a specific element designed to subsidise childcare costs for working families. Participation in any salary sacrifice scheme may actually increase a worker's entitlement to the main element of WTC. Because the worker has agreed to accept a reduced wage in return for a non-cash benefit, the income on which they are assessed for WTC purposes is also reduced, which may result in a higher award. But a worker with children taking childcare vouchers from their employer is likely to find that their entitlement to the childcare element of the WTC is reduced, as the rules stipulate that they may not claim support for the same childcare costs twice over. Therefore a key question for the Commission in deciding whether to recommend that salary sacrifice schemes for childcare vouchers should count towards the minimum wage was: how many low-paid workers would actually benefit?

4.40 The Government told us in its evidence that ‘...for the vast majority of low-paid workers, accepting a childcare benefit from their employer in return for a salary sacrifice will not provide any advantage over claiming the childcare element of WTC’. During the year to April 2006, the childcare element of the WTC enabled those who were eligible to save up to 70 per cent of their childcare costs, up to a maximum limit. Precisely the same percentage saving was available by taking childcare vouchers, due to the combined effects of reduced income tax and NICs payments and increased entitlement to other elements of WTC support. However, the Government has announced that from April 2006 the maximum subsidy available through the childcare element of the WTC will rise to 80 per cent of childcare costs (up to the maximum limits of £175 for one child and £300 for two or more children), which will mean that childcare vouchers will be less attractive for many low-paid workers. Table 4.2 illustrates the effect on family income of participation in a childcare voucher salary sacrifice scheme, compared with support for childcare through the WTC system. In families with parents who earn around the level of the minimum wage, WTC childcare support usually offers greater assistance.

Table 4.2 Childcare Voucher Salary Sacrifice Schemes Compared with Working Tax Credit Support for Childcare: Effect on Income for Low-earners with Children, April 2006–April 2007

Family circumstances	Family income before and after childcare costs
Example 1: A lone parent with one child working 16 hours per week on the NMW. The parent incurs £30 of childcare costs each week.	<p>The parent's original income¹ is £231.99 per week.</p> <p>Paying for a childcare voucher to the value of £30 through salary sacrifice would lower income to £227.49² per week, after childcare costs. The tax and NICs saving would be £0.00 as the parent is a non-tax payer. By claiming support for the childcare costs through WTC, the parent's income after childcare costs would be £231.09.</p> <p>The claimant is therefore £3.60 per week better off with tax credit support than by participating in a childcare voucher salary sacrifice arrangement.</p>
Example 2: A lone parent with one child working 40 hours per week on the NMW, incurring £50 of childcare costs each week.	<p>The parent's original income is £272.83¹ per week.</p> <p>Paying for a childcare voucher to the value of £50 through salary sacrifice would lower income to £257.78² per week, after childcare costs. The tax and NICs saving would be £16.50. By claiming support for the childcare costs through WTC, the parent's income after childcare costs would be £262.83.</p> <p>The claimant is therefore £5.05 per week better off with tax credit support than by participating in a childcare voucher salary sacrifice arrangement.</p>
Example 3: A couple both working 30 hours per week on the NMW, two children, incurring £50 of childcare costs each week.	<p>The parents' original income is £385.82¹ per week.</p> <p>Paying for a childcare voucher to the value of £50 through salary sacrifice would lower income to £366.37² per week, after childcare costs. The tax and NICs saving would be £12.10. By claiming support for the childcare costs through WTC, the parents' income after childcare costs would be £375.82.</p> <p>The claimant is therefore £9.45 per week better off with tax credit support than by participating in a childcare voucher salary sacrifice arrangement.</p>
Example 4: A couple both working 35 hours per week on £7.00 per hour, three children, incurring £100 of childcare costs each week.	<p>The parents' original income is £487.76¹ per week.</p> <p>Paying for a childcare voucher to the value of £50³ through salary sacrifice, with the remaining £50 of costs being claimed through tax credits, would lower income to £462.71² per week, after childcare costs. The tax and NICs saving would be £16.50. By claiming support for the full value of the childcare costs through WTC, the parents' income after childcare costs would be £467.76.</p> <p>The claimant is therefore £5.05 per week better off with tax credit support than by participating in a childcare voucher salary sacrifice arrangement.</p>

Source: HM Treasury calculations for the LPC.

Notes:

1. In each example, 'original income' represents income after tax and NICs and the value of entitlement to the main (non-childcare) element of WTC support have been taken into account, and before childcare costs. In Example 1 original income also includes the typical value of Housing Benefit and Council Tax Benefit awards for a family in these circumstances.
2. In each example, income after childcare costs includes adjustments to (a) tax and NICs due (b) entitlement to the main element of WTC (c) any entitlement to the childcare element of WTC. Thus 'post-sacrifice income' plus 'amount sacrificed' do not add to 'original income'.
3. There is a £50 per week limit on the tax and NICs exemption for childcare vouchers.
4. Calculations are effective from April 2006–April 2007.

4.41 Nevertheless, there are some groups of low-paid workers who could benefit from a childcare voucher salary sacrifice scheme, including those with a higher-paid partner whose earnings make the family ineligible for WTC support. We believe that the number of families in this category who have childcare costs is likely to be fairly small. From April 2006, a family with one child incurring £50 of childcare costs each

week would not gain from participating in a childcare voucher salary sacrifice scheme over claiming support through the WTC system until the family's income reached £21,500. This figure would rise to around £26,300 if there were two children and to around £31,100 if there were three children. A further group of low-paid workers that could benefit from the childcare vouchers are those with high childcare costs in excess of the WTC limits. Those who work less than 16 hours per week and are thus ineligible for WTC might also benefit, although they would need to earn over £6.00 per hour in order to start to make tax or NICs savings through a salary sacrifice arrangement.

- 4.42** There are clearly some important considerations that low-paid workers need to weigh up before agreeing to give up part of their pay in exchange for a childcare voucher. But there are also some more general implications arising from all salary sacrifice schemes that are likely to affect low-paid workers in particular. We look at these next.

Salary Sacrifice Schemes and the Lower Earnings Limit

- 4.43** The Government's evidence noted that many people on the minimum wage work part-time and thus will pay very little, if any, income tax and NICs. A worker aged 22 or over who earns the National Minimum Wage must work nearly 19 hours per week in order to become a taxpayer (based on the adult minimum wage of £5.05 per hour in October 2005 and the Lower Earnings Limit (LEL) of £94 per week in 2005/06). Thus many low-paid part-time workers would make little or no savings by sacrificing salary in return for childcare vouchers, or indeed for any other benefit under a salary sacrifice scheme.
- 4.44** Even for those workers who do earn enough to be liable for tax and NICs, there are complications. As entitlement to some state benefits is based on the amount of NICs paid or on earnings, a salary sacrifice could affect a worker's current or future entitlement to these state benefits. In many cases, entitlement will be protected as long as the worker's earnings remain above the LEL, but some benefits such as the State Second Pension may be affected by a salary sacrifice arrangement even above this level. Work-related payments such as Statutory Maternity Pay, which is based on average earnings over a

fixed period before the payment is received, may also be reduced. However the effect is likely to be small, unless a worker chooses to sacrifice a substantial proportion of pay, particularly over an extended period.

- 4.45** A salary sacrifice arrangement may also affect a worker's terms and conditions of employment. Some employers will use a 'notional' pre-sacrifice level of salary to calculate contributions to occupational pension schemes and other entitlements such as holiday pay, while others will base these on the lower post-sacrifice level of pay. This is a matter for individual employers to agree with their staff and is not just an issue for those on the minimum wage. But it does demonstrate that there are a number of complex factors that workers need to consider before deciding whether to give up part of their pay in return for another benefit under a salary sacrifice scheme.
- 4.46** Having reviewed the evidence from our consultation and other sources and considered some of the implications of participation in a salary sacrifice scheme, we now draw together our conclusions on whether there is a case for recommending that these schemes should count towards the minimum wage.

Childcare Voucher Salary Sacrifice Schemes

- 4.47** The evidence we received indicated that childcare voucher salary sacrifice schemes were the most prevalent and were causing the most difficulty for employers. There are probably a number of reasons for this. Childcare costs are rarely an optional item of expenditure for working parents and it follows that providing support to meet existing costs is an attractive benefit for employers to be able to offer. There was considerable publicity surrounding the introduction of new rules for childcare vouchers in April 2005 and the tax and NICs savings are potentially significant. In addition, the maximum amount of salary that may be sacrificed each week or month is much higher than for a typical home computer or bicycle scheme. This means that employees earning rather more than the National Minimum Wage may be affected by the current minimum wage rules, particularly if they work part-time. For these reasons, and because we recognised that the vouchers were an

important and valuable benefit for some families, we considered very carefully whether to recommend that they should count towards minimum wage pay.

4.48 We note the low take-up rates of salary sacrifice schemes in individual firms indicated in the IDS research (IDS, 2005a). Evidence from our oral hearings and meetings with individual employers suggested that take-up rates of between 0.5 and 2 per cent were typical for childcare vouchers and that take-up rates for HCI were typically around 10 per cent. Two large retailers told us that although a small number of their employees would benefit, take-up rates for their childcare voucher and home computer schemes were not expected to increase significantly even if the minimum wage rules were changed. This was because these companies had put in place their own hourly pay thresholds to ensure that the earnings of their employees did not fall below the LEL as a result of a salary sacrifice. We believe that similar restrictions are likely to affect many more low-paid workers. We have also noted that many part-time workers, who make up the majority of those on the minimum wage, would not benefit from salary sacrifice arrangements even if the minimum wage rules were changed, because their earnings already fall below the LEL, making them non-taxpayers.

4.49 The interaction between the two forms of government childcare support – childcare vouchers and the childcare element of the WTC – is complex and we are concerned that less responsible employers might fail to ensure that their staff receive the information they need to make the most appropriate decision in the light of their own personal circumstances. This may be because some employers do not fully understand the implications themselves. The IDS research project provides some evidence that the level of advice offered by employers varies considerably, although the results were based on a small number of firms.

4.50 We have stated that some people on low wages would benefit from childcare voucher salary sacrifice schemes. But the evidence shows that the majority would be at least as well off getting support through the childcare element of the WTC. In the case of childcare vouchers, we do not believe there is sufficient justification to complicate the minimum wage for all workers in order to benefit a small number.

Low Pay Commission Research

Part of the telephone survey focused on advice given to employees... and, specifically, if they were advised whether they would be better off claiming tax credits than taking [childcare] vouchers.... Seven out of 29 employers ... said it was the individual's responsibility, while 13 employers...provided advice help-line numbers, put a ready reckoner on the company intranet, or referred employees to the organisations running the scheme. Two further respondents said they did not know what the situation was....

IDS, 2005a.

Non-pay Benefits in Low-paying Organisations

We recommend that childcare vouchers should not count towards the National Minimum Wage.

4.51 The Government wrote in its evidence that it is ‘considering issuing some best practice guidance [for employers] as part of the detailed guidance on the childcare vouchers’. While this falls outside our remit, our consultation points to significant confusion and we would strongly support any moves to help workers fully understand the implications of opting to participate in a childcare voucher scheme and to help employers to advise them appropriately.

Other Salary Sacrifice Schemes

4.52 We recognise that the Home Computing Initiative (HCI), cycle to work schemes, pension salary sacrifice arrangements and some of the other schemes mentioned in this Chapter could be beneficial to some low-paid workers. But the evidence we received indicates that these salary sacrifice schemes are less common or are causing fewer difficulties for employers (partly because the sums sacrificed are usually smaller). The HCI has presented problems for some employers but we believe that it is in its early stages of development. It was not until the Government issued new guidelines in 2004 that significant employer interest was generated. We have concluded that a compelling case for changing the composition of minimum wage pay to include salary sacrifice schemes has not been made. **Therefore we recommend that salary sacrifice schemes should not count towards minimum wage pay.** We set out the reasons for our conclusion below.

4.53 We have already stated that one of our guiding principles from the early days of the Commission has been that of simplicity. We strongly believe that the minimum wage should be as simple as possible for employers and workers to understand, and for HMRC to enforce. We believe that this is one of the reasons why the National Minimum Wage has been effective as a wage floor. It is clear to us that allowing salary sacrifice schemes to count towards the minimum wage would depart from the principle and would complicate the definition of the minimum wage.

“ We understand that the Government is worried that, because some employees are better off claiming the childcare element of the working tax credit, allowing childcare vouchers to count towards the NMW will encourage employers to offer them and therefore leave some families worse off. CBI members believe that it is Government’s responsibility to ensure that the policy measures it puts in place are properly communicated to families. ”

CBI evidence

- 4.54** We want to ensure that the value of the minimum wage is protected and believe that, with the exception of accommodation, it should not be possible to substitute benefits-in-kind for cash pay to make up the minimum wage. We are in no doubt that the vast majority of employers would offer salary sacrifice schemes in good faith. But we remain concerned that if non-cash benefits offered through salary sacrifice schemes were to be allowed to make up minimum wage pay, a minority of employers might attempt to misuse this flexibility by reducing the cash wages of employees and offering a non-cash benefit of dubious or no value instead, or might offer staff little or no choice to participate in a salary sacrifice arrangement.
- 4.55** Some employers have suggested to us that it would not be possible to exploit salary sacrifice schemes to the detriment of workers because the schemes are in some way approved or monitored by HMRC. However, this is not an accurate reflection of the position. According to HMRC, salary sacrifice arrangements are an entirely contractual matter between a worker and an employer. In this context HMRC's concern is solely directed to ensuring that the correct tax and NICs treatment is applied to the benefit-in-kind. Employers are not required to seek approval for their salary sacrifice schemes from HMRC or to submit details of their schemes. Indeed, HMRC will not comment on draft proposals. In practice, many employers are concerned that they might set up their schemes incorrectly so they may choose to set up a pilot scheme which HMRC inspectors are then willing to comment on.
- 4.56** We know that some employers have put in place measures to ensure that their employees understand fully the implications of participation in a salary sacrifice scheme, including the potential impact on entitlement to WTC support, state benefits and their individual terms and conditions of employment. But we are concerned that other employers may not ensure that their employees are able to take such a fully informed decision, or that employers themselves may not fully understand the complex interactions and consequently give poor advice. Of course, some of the issues we have raised could apply to any worker who participates in a salary sacrifice scheme and not just to the low-paid, but we believe that low-paid workers are more vulnerable to exploitation by unscrupulous employers and more at risk of reducing their entitlement to state benefits. Any negative consequences of

opening up the definition of minimum wage pay to accommodate salary sacrifice schemes would fall hardest on the lowest-paid.

- 4.57** We have some particular concerns in relation to the HCI. This scheme involves the loan of home computer equipment, normally over a three-year period, although sometimes two years is offered. As noted by the Public and Commercial Services Union in its evidence, a worker is tied into an agreement for the duration of the loan, and may have to pay back any remaining instalments immediately if he or she moves to another employer. In addition, the value of computer equipment is less transparent than that of other benefits such as childcare vouchers (which are a close substitute for cash), thus there is a greater potential for abuse.
- 4.58** We are also aware that the Treasury has instigated a review of the HCI in response to a report on the Government's digital strategy (Cabinet Office Prime Minister's Strategy Unit and Department of Trade and Industry, 2005), which might lead to reform of the scheme. *Connecting the UK: the Digital Strategy* contains a commitment to bridge the 'digital divide' and encourage wider take-up of computer equipment and internet access, particularly among low-income groups. According to the report, the Treasury review will consider the 'impact and cost of the Home Computing Initiative to ensure that it is targeted most effectively at those with the lowest take up'.

Conclusion: Salary Sacrifice Schemes

- 4.59** We have listened to the views of employers, trade unions and other interested parties and made careful note of the benefits and drawbacks of allowing salary sacrifice schemes to form part of minimum wage pay. We considered childcare vouchers to be the most important scheme for us to examine because the availability of affordable childcare can be central to an individual's ability to enter or remain in the workforce. But we have concluded that most low-paid workers have access to an equally good, if not better, form of childcare support through the WTC system. Therefore we believe that the case for changing the minimum wage rules on childcare vouchers in order to benefit a small group is weak.

- 4.60** The evidence suggested that salary sacrifice arrangements for home computers, cycles to work and other benefits were of a smaller scale and that employee take-up levels were, on the whole, low. We have noted that many part-time low-paid workers would derive no benefit from participating in a salary sacrifice scheme, even if the minimum wage rules were changed, as they pay little or no tax or NICs. Indeed, they might actually be worse off if they joined a scheme. In our view, the advantages that these schemes would offer to some low-paid workers do not outweigh the disadvantages associated with complicating the definition of minimum wage pay. It is important that workers know what they are entitled to, employers are easily able to demonstrate that they have met their legal obligations, and that HMRC is able to enforce the National Minimum Wage effectively.
- 4.61** In addition to the salary sacrifice schemes that have been brought to our attention, there may well be other arrangements that develop in the future, particularly if the Government were to change the tax or NICs treatment of other benefits-in-kind. Furthermore, we made our recommendation on childcare vouchers in the context of the current system of support and this too could change. The fact that the tax and NICs treatment of non-cash benefits and the state benefits system do change relatively frequently is perhaps one reason not to alter the minimum wage rules to fit the current circumstances. But equally we think that it is important to keep the issue of salary sacrifice and the minimum wage under review.
- 4.62** If new salary sacrifice schemes affecting low-paid workers develop in the future, we would want to consider them on their individual merits, while bearing in mind the views we have expressed in this Chapter. And if evidence emerges to indicate that salary sacrifice schemes are becoming significantly more widespread, we would want to review the position. Should these circumstances arise, we suggest that the Government ask us to return to this topic in a future report to check if the conclusions we have reached remain valid.
- 4.63** We now turn to the one benefit-in-kind that can already count towards minimum wage pay and to our review of the operation of the accommodation offset.

The Accommodation Offset: Introduction

4.64 We recommended an accommodation offset when the minimum wage was first introduced and we have continued to review it in subsequent reports. We were pleased that the Government asked us to look at it in detail, alongside our broader review of the treatment of benefits-in-kind and salary sacrifice arrangements. We were asked to examine the operation of the accommodation offset and to consider whether any changes to the relevant regulations were necessary. During our consultation we asked employers, trade unions and other interested parties – particularly those with knowledge of the low-paying sectors where accommodation is most commonly provided by employers – to tell us how the offset was working in practice. We asked if the provisions and guidance were sufficiently straightforward to understand and comply with, and whether there was any evidence that they were not being interpreted in a consistent manner or not being complied with.

4.65 In the course of our analysis of the evidence it became apparent that there were two distinct issues to be addressed:

- the operation of the accommodation offset in the circumstances which the Commission had in mind at the time of our First Report (1998) (i.e. when accommodation is provided as an integral element of the employment package); and
- whether and how the accommodation offset should be applied in cases where the provision of accommodation by an employer, and its acceptance by the employee, is not an explicit condition of employment. This issue has arisen in particular in relation to the provision of accommodation to migrant workers in agriculture and in the food processing and packing industries.

4.66 We begin by reviewing the decision made in our First Report (1998) to recommend the introduction of an accommodation offset, and we comment briefly on consideration of the offset in our subsequent reports. Next we examine the data available on accommodation provision in low-paying sectors, drawing on the Labour Force Survey (LFS). We then discuss the evidence received during our most recent consultation and we consider the provision of accommodation in both sets of circumstances highlighted above. Finally, we examine

enforcement of the accommodation offset and of the minimum wage more broadly, particularly in relation to migrant workers.

Discussion in Previous Reports

4.67 When the Commission considered which elements of pay should count towards the National Minimum Wage in its First Report (1998), it recommended one exception to the general principle that benefits-in-kind should not form part of the definition of minimum wage pay. We believed that a special case should be made for accommodation because of its significance as a benefit-in-kind in particular low-paying sectors such as hospitality and agriculture. A special report on accommodation (LPC, 1999a) noted that the former Wages Councils allowed an accommodation offset and that the Agricultural Wages Boards continued to do so. We took account of these and industry practices at the time in determining an appropriate offset level. We were concerned that not allowing an offset could disadvantage low-paid workers should employers choose to introduce high cash charges for accommodation. Accordingly, a weekly maximum offset of £19.95 was introduced in 1999. Since then, we have reviewed the level of the offset in the light of evidence submitted to our consultations and it has generally increased in line with upratings of the adult minimum wage.

“...there has been a widespread acceptance of the existing accommodation offset by both employers and workers in the formal economy.”

TUC evidence

4.68 Most recently, our 2005 Report noted that we continued to receive calls for a significant increase in the offset from some employer representatives, while some trade unions, concerned about the poor standards of some accommodation, argued for no increase. On the basis of the evidence received, we concluded that the offset was working well, was generally understood by employers and represented a reasonable balance between the interests of employers and workers. The report stated that we continued to believe that our approach to the offset was a fair one and we recommended that it should increase in line with the adult rate of the minimum wage in October 2005 (to £3.90 per day) and in October 2006 (to £4.15 per day). The Government subsequently accepted our recommendation.

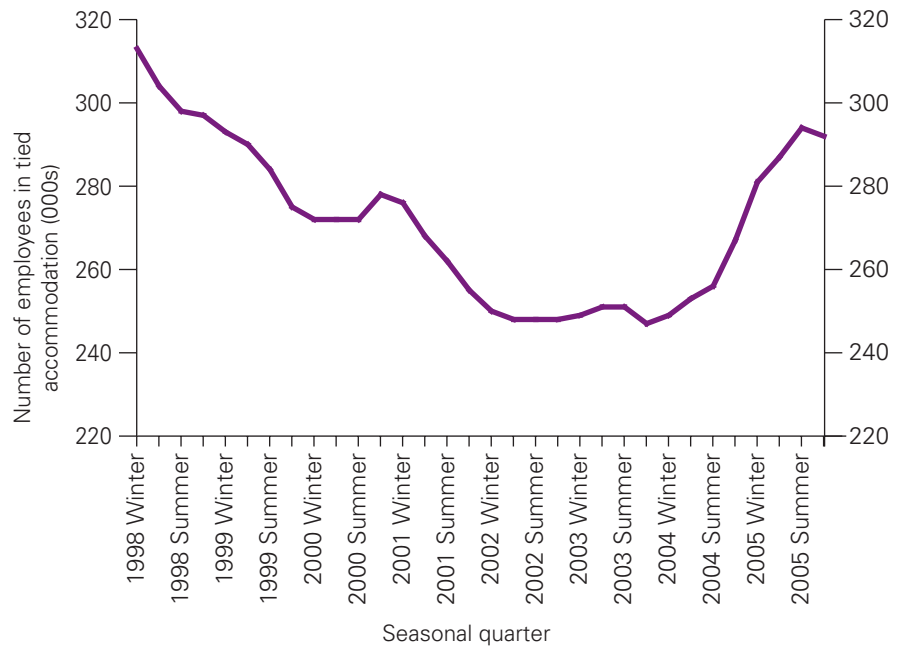
Provision of Accommodation by Employers

- 4.69** Information about the provision of accommodation by employers is limited. The LFS asks employees if their accommodation is tied to their job and it can give us an indication of the number of workers who may be affected by the accommodation offset, but there are problems with the data³.
- 4.70** Figure 4.1 below illustrates that the total number of employees in tied accommodation has been falling for some years, although the numbers levelled off in 2002 and 2003 (at around 250,000) and have since risen (by 44,000 between Autumn 2003 and Autumn 2005). This was largely driven by increases in sectors outside those we would normally consider as low-paying. However, there were small increases in agriculture, hunting and forestry; wholesale and retail; and hospitality between Autumn 2003 and Autumn 2005, contrary to the long-term trend in these sectors. Over half of the total number of employees in tied accommodation are employed in public administration and defence; health and social work; education; or real estate, renting and other business activities.
- 4.71** The low-paying sectors where accommodation is most significant are hospitality and agriculture, hunting and forestry. According to the LFS, about 24,000 workers (15 per cent) in agriculture, hunting and forestry were in tied accommodation in Autumn 2005. Although far more people are employed in the hospitality sector, both the number and proportion of workers in tied accommodation are significantly smaller. Later in this Chapter we consider evidence of an increase in the number of migrant workers taking up low-paid and often temporary employment in the UK, some of whom will have been provided with accommodation by their employer. We do not know how many of these workers are captured by the LFS tied accommodation data, particularly as some are likely to be employed on a temporary basis.

³ Because this survey is based on individual responses, there may be genuine confusion between rent-free and rented accommodation. For this reason in the following statistics the numbers of employees living in tied accommodation, either rented or free, are given. The LFS data may also underestimate the numbers of staff in tied accommodation because: (i) the LFS excludes addresses which receive on average 25 or more items of mail per day (which may be larger hotels); and (ii) even smaller hotels which are included may inadvertently omit such staff because they are not perceived as part of the household.

Figure 4.1

Number of Employees in Tied Accommodation, UK, 1998–2005



Source: LFS, 1998–2005.

Note: Four quarter moving average.

4.72 We also asked IDS to examine the provision of accommodation as part of the research project on non-pay benefits referred to earlier in the Chapter (IDS, 2005a). The research targeted low-paying sectors that were thought likely to provide benefits, including accommodation, and so is not representative of all employers. The average proportion of firms providing accommodation to their employees across the 303 firms that responded to the survey question was 12 per cent, with little variation by firm size. IDS found that 13 per cent of care homes, 42 per cent of hotels and hospitality firms and 21 per cent of leisure firms in the sample provided accommodation.

Our Consultation

4.73 Our consultation on the accommodation offset raised a number of issues, including the offset level and whether the amount allowed at present was too much or too little. Respondents also raised points about the interpretation of the offset regulations and accompanying guidance, both in terms of some quite specific technical questions about calculating the offset and more general questions about the circumstances in which the offset does and does not apply. We also

received comments concerning awareness of the offset and the effectiveness of enforcement. Some of the topics raised were new, while others have been considered in previous reports.

- 4.74** We begin by reviewing the evidence we received on the accommodation offset level, before going on to consider understanding and awareness of the offset rules and guidance. We then examine the provision of accommodation to migrant workers employed in agriculture and the food industry, where problems were reported to us that related to the offset level, understanding and awareness of the provisions, and the effectiveness of enforcement of the offset. In particular, we received evidence that some employers in these sectors were charging workers on the minimum wage more than the maximum offset for accommodation. In some cases, this may have been due to confusion about the legal requirements.
- 4.75** We also look at the application of the accommodation offset where it is not immediately evident if the employer or a third party has provided accommodation, including evidence that some employers have deliberately sought to circumvent the offset provisions by setting up a separate company to provide accommodation to their workers. We conclude by examining some more general issues relating to the enforcement of the minimum wage for migrant workers.

The Offset Level

- 4.76** As in previous years, we received a number of comments about the level of the offset, particularly from the hospitality and leisure sector. In general, employers in these sectors favoured a significant increase in the level of the offset, with some commenting that it represented only half of the actual costs of provision. Two charities also expressed concerns that the offset did not reflect the value of the accommodation provided to their employees. We visited a hotel chain that operates across the UK and were told that the company offered accommodation to workers in locations where it was otherwise difficult to find, but that it was becoming increasingly difficult to continue this practice as costs were outstripping the offset limit. A small number of employers suggested a system of variable offset levels, depending on the quality or value of the accommodation. On a Commission visit to Manchester, a group of pub companies suggested a distinction should be made

“ In our opinion, employers are expected to subsidise any live in staff by at least 50 per cent of the real costs involved, a situation which is totally unacceptable. ”

The Scottish Licensed Trade Association evidence

‘...as we have said in previous submissions, we believe the time is right for a freeze to the level of the deductor....’

GMB evidence

between a self-contained flat or house (which in the pub sector often becomes the pub manager’s family home) and a room in a house or hotel with shared facilities. Others were wary of introducing a more complex system.

- 4.77** In contrast to other employer representatives, the CBI recommended that the offset should continue to increase in line with adult minimum wage upratings and the British Holiday & Home Parks Association regarded the offset as a reasonable measure that balanced the employer’s need for a residential presence and the employee’s need for reasonably priced accommodation. Trade unions were opposed to any increase, citing evidence of poor standards of accommodation and overcrowding.
- 4.78** Much of the evidence we have reviewed so far was from employers in sectors that have traditionally offered accommodation to employees because they are needed on site or at a convenient location nearby in order to perform their duties effectively – the first category of accommodation provision that we identified in the introduction to this topic. Typically these workers are required to live in the employer’s accommodation as part of their terms and conditions of employment. There are usually advantages to both worker and employer. While the worker may have no choice but to live in a particular place, the accommodation is often subsidised by the employer in some way. The package might also include council tax, water rates, or other utility payments.
- 4.79** We have always maintained that in these circumstances the offset is not intended to reflect the full costs of providing accommodation or rents on the open market, since this would fail to recognise the advantages to the employer of housing workers at, or close to, their place of work. Rather the offset has provided a mechanism to reflect employers’ costs in part, while also ensuring that low-paid workers who are housed by their employer are not subject to high charges for accommodation that could reduce their cash pay substantially. We believe that the accommodation offset works well in this context and that it is set at an appropriate level. Furthermore, we continue to believe that the simplicity of the minimum wage is crucial to its success and so we do not see a case for more than one offset level. This would inevitably be more complicated for employers and workers to understand and more difficult to enforce.

Awareness, Understanding and Guidance

- 4.80** A few employers raised some technical issues in relation to the calculation of the offset, for example where a worker is sick or, in the context of care services, a worker living long-term with a service user. Within the hospitality sector, some employers felt that the guidance was unclear and short on examples. They also suggested that publicity was insufficient and that the offset level should be displayed more prominently on the Department of Trade and Industry (DTI) minimum wage website, particularly before new rates come into effect each October. On the other hand, the British Beer & Pub Association, British Hospitality Association and Business in Sport and Leisure felt the offset rules were reasonably clear and did not need to be changed and similarly the CBI wrote that ‘...members believe that, for those employers that use the offset, it works well and should not be changed’.
- 4.81** Citizens Advice Northern Ireland, which runs the minimum wage helpline for Northern Ireland, wrote that it had received no specific calls complaining about deductions for accommodation, but callers enquiring about their wages in general sometimes revealed a lack of understanding of the deductions for accommodation which had been made. Similarly, the results of a small number of telephone interviews conducted by IDS (IDS, 2005a) suggested that awareness of the offset was not as high as it could be. The GMB called for greater publicity to encourage compliance and the Small Business Service stated that it would be happy to help improve the quality of guidance available to employers on the offset.
- 4.82** The GMB also highlighted the question of what is and is not included within the term ‘accommodation’. The offset provisions do not contain a specific definition of accommodation. The GMB argued that employers should not be able to apply separate charges for utilities in addition to the accommodation offset deductor.
- 4.83** In our view it would not be sensible or feasible to set out exhaustively in regulations exactly what is and is not included within the definition of accommodation and thus what provision would fall within the scope of the accommodation offset. But the official guidance could be clearer and more helpful with respect to deductions or payments – such as

‘...we do not think that the NMW [accommodation offset] regulations require amendment...’

British Hospitality Association evidence

‘The accommodation offset regulations would benefit from clarification and better publicity – even to the point that the rate is not mentioned on the main NMW page of the DTI Employment Relations website.’

National Trainers Federation evidence

Low Pay Commission Research

From our telephone survey, eight of the 14 employers...said that the NMW offset did not apply in their organisation. Three further employers...indicated that the accommodation offset did apply, although only the leisure organisation specified the previous £26.25 maximum. For the remaining employers, one in the hotels and hospitality sector did not know whether the offset applied in their organisation and two others in the care and leisure sectors did not respond, which perhaps suggests that these respondents were similarly unsure.

IDS, 2005a.

Non-pay Benefits in Low-paying Organisations

utility charges or other charges for services – that are connected to the provision of accommodation. Furthermore, in our view, employers ought to be able to demonstrate that, where workers are subject to any deductions for services connected to accommodation, these have not been applied by the employer for his or her own financial benefit.

- 4.84** We believe that there is a reasonable level of awareness and understanding of the offset in low-paying sectors such as hospitality, leisure and social care and that the offset has provided an important protection for low-paid workers who are provided with accommodation as part of the overall employment package. Our consultation has indicated, however, that some employers were not clear how to apply the calculation to some more complex or unusual situations. Some of these issues might be resolved by a call to the National Minimum Wage helpline, but further examples of the offset calculation in the DTI guidance would probably be welcomed by some employers.
- 4.85** However, this level of understanding was not consistent across all low-paying sectors affected by the accommodation offset. Our consultation revealed that there was significant confusion about the amount employers could charge for accommodation in those sectors that lie across the interface between the National Minimum Wage and the separate system of agricultural minimum wages. We received evidence that some low-paid workers employed in agriculture and food processing were being charged significantly more than the maximum offset of £3.90 per day (equivalent to £27.30 per week) that has been effective since October 2005. In some cases, employers may have believed that the offset provisions did not apply in their particular circumstances. We examine some of the reasons for this confusion, and the impact it has had on workers – particularly migrant workers – in these sectors next.

The Accommodation Offset, Free Choice and Migrant Workers

- 4.86** In this section, we describe the new issues relating to the accommodation offset which have emerged as the role of migrant workers, particularly in agriculture and related sectors such as food processing, has increased. We describe first the guidance which has

until recently been provided to agricultural employers by the Department for Environment, Food and Rural Affairs (Defra), relating to the provision of accommodation where the employee can exercise a choice as to whether or not to accept it. We then describe the growing role of migrant workers in these sectors, the new pattern of accommodation provision which has emerged, and the case put forward by relevant employer groups for a change to the existing regulations in the face of these new developments. Our conclusion on the appropriate way forward is followed by comments on the enforcement of the accommodation offset, particularly in those low-paying sectors where migrant workers are concentrated, and comments on the wider issue of the enforcement of the minimum wage itself in relation to migrant workers.

Accommodation Charges in the Agriculture Sector: Past Government Guidance

- 4.87** The Agricultural Wages Boards for England and Wales, Scotland, and Northern Ireland respectively are responsible for determining statutory minimum pay rates and other conditions of employment for workers in the agricultural sector. The National Minimum Wage underpins the system of agricultural minimum wages such that the Agricultural Wages Boards cannot set an agricultural minimum pay rate which is below the National Minimum Wage. Agricultural employers are in a unique position in that they must comply with the provisions of the Agricultural Wages Orders as well as the National Minimum Wage.
- 4.88** During 2005 we were made aware of inconsistencies in the advice and guidance issued by different government departments concerning the amount that employers could charge workers for accommodation. The Agricultural Wages Order for England and Wales contains its own provisions relating to accommodation which differ in some respects from those contained within the National Minimum Wage legislation. We were informed that, until April 2005, Defra had advised agricultural employers that they could deduct more than the accommodation offset from the pay of agricultural workers, as long as accommodation was provided under a stand-alone agreement separate from the employment contract and the worker could choose whether to occupy the accommodation concerned. Many temporary and seasonal workers

– and the labour providers who supply workers to farmers, producers and other labour users – operate across agriculture and other sectors such as food processing. This means that the Defra advice is very likely to have reached employers active in other sectors, even though the Agricultural Wages Order for England and Wales only applies to agricultural employers.

- 4.89** DTI guidance based on the National Minimum Wage regulations makes no such distinction, however, and states that employers who provide accommodation cannot reduce the wages of those on the National Minimum Wage by more than the accommodation offset. The guidance notes that employers may deduct an amount from wages or charge a specific amount once wages have been received, or may offer accommodation on an uncharged basis; in each case, the offset rules apply.
- 4.90** Once this discrepancy in advice was recognised, all involved parties in government reviewed the position early in 2005. Following a re-examination of the relevant provisions, all government departments concerned agreed that, regardless of the sector of employment and regardless of whether the worker has agreed to take accommodation under a stand-alone agreement, the present National Minimum Wage regulations provide that a worker must not receive a wage that is less than the National Minimum Wage, minus the maximum accommodation offset where applicable. Employers are free to charge workers more for accommodation if they earn more than the National Minimum Wage. This includes workers on the higher agricultural minimum rates that apply to more skilled or experienced workers. Although the Government had clarified the legal position, its subsequent decision to include a review of the accommodation offset in our remit in July 2005 recognised that the issues that had come to light were complex – as we will discuss below – and merited further investigation by the Commission.
- 4.91** One consequence of Defra’s interpretation of the Agricultural Wages Order for England and Wales, and the advice it had previously given to agricultural employers, was that some students coming into the UK under the Seasonal Agricultural Workers Scheme (SAWS), who signed stand-alone contracts for accommodation, might have been charged more than the maximum allowed under the National Minimum Wage

provisions. Others may have received their legal entitlement to the National Minimum Wage despite the higher accommodation charges because they were paid at a higher agricultural minimum pay rate. According to the Government's evidence, accommodation charges for SAWS workers averaged £30–40 per week, with a minority charged £55–£75 per week. SAWS temporary work permits are issued by scheme operators under the auspices of the Home Office and according to the Government's evidence, some 16,250 foreign students came into the UK under the 2005 scheme.

- 4.92** Evidence from the Association of Labour Providers (ALP), trade unions and other organisations indicated that accommodation charges that are significantly higher than the maximum offset permitted under the National Minimum Wage provisions are common in agriculture and related sectors such as food processing. We were informed that employers in these sectors typically charge low-paid workers around £40–60 per week (often inclusive of utility bills) for a shared room in a shared house. Of course, some of these workers will be earning more than the National Minimum Wage, but Defra-sponsored research that examined the use of temporary and gang labour in agriculture and food processing (Precision Prospecting Ltd, 2005a, 2005b) suggests that many will not. In addition, accommodation charges at these levels are less likely to apply to some permanent members of the agricultural workforce – such as skilled farm labourers – who have been provided with a traditional tied cottage on the farm for many years.
- 4.93** Consultation responses suggested that many of those affected by accommodation charges in excess of the accommodation offset were migrant workers. Some employer respondents from the agriculture sector argued that the position that had been taken by Defra was the most logical approach and was helpful to both employers and workers. They suggested that the offset was set at an uneconomic level and that migrant workers would benefit if restrictions on the deductions that employers were able to make for accommodation were removed in certain circumstances. Trade unions and worker representatives, however, were concerned about cases of overcrowding and poor housing conditions combined with high rents. They urged a greater focus on enforcement of the existing offset provisions, particularly in relation to migrant workers. We consider the arguments put to us on both sides of

the debate. As background, we begin by examining the increasing role of migrant workers in agriculture and the food industry and the problems that some have faced in finding suitable accommodation.

The Growing Role of Migrant Labour

- 4.94** There has been a significant increase in the employment of migrant workers in the UK, particularly Eastern Europeans who have had the right to work in the expanded European Union since May 2004. A number of trade unions and employer representatives commented on this trend in their evidence. According to the *Accession Monitoring Report May 2004–September 2005*⁴ (Home Office *et al.*, 2005), there were 293,000 applicants to the Workers Registration Scheme between 1 May 2004 and 30 September 2005. Twenty-three per cent of registered workers were employed in hospitality and catering, 13 per cent in agriculture, 8 per cent in manufacturing and 5 per cent in food, fish and meat processing.
- 4.95** There has always been a need for seasonal and temporary workers in sectors such as hospitality and agriculture, but research commissioned by Defra (Precision Prospecting Ltd, 2005a, 2005b) suggests that over the past few years native workers have increasingly withdrawn from the labour market in agriculture and related sectors such as food processing and packing. The ALP stated in its evidence that labour providers⁵ and other employers operating in the agriculture and food industries were increasingly recruiting workers directly from Eastern Europe, particularly Poland, so that their clients – labour users – could be sure of a reliable and highly efficient workforce, with very low absence rates and a strong work ethic.

⁴ Workers from eight of the ten countries that joined the European Union on 1 May 2004 (known as the 'Accession 8' or 'A8') are required to register with the Home Office Workers Registration Scheme (WRS) for the first 12 months of employment in the UK. Workers may register more than once, and are not required to de-register if they leave the UK, so WRS data represent a cumulative figure rather than the total number of A8 workers in the UK. Workers who are self-employed are not required to register.

⁵ We have used the term 'labour provider' to cover the spectrum of businesses engaged in supplying workers to other businesses, often on a temporary or casual basis. We include employment agencies and gangmasters within the term. References to employers in this Chapter are intended to include labour providers, employment agencies and gangmasters.

Provision of Accommodation to Migrant Labour

4.96 We met employers in the hospitality and social care sectors who had recruited significant numbers of overseas workers and found it necessary to offer them accommodation. We are also aware that some migrant workers have found employment in other low-paying sectors such as retail. However, reported difficulties with the accommodation offset in this context primarily came from employer representatives in agriculture and the food industry. This may reflect a significantly greater reliance on temporary overseas labour, and the more rural locations in which some workers in these sectors are based. According to research for Defra, 18 per cent of sampled labour providers operating in agriculture and on-farm primary food processing provided accommodation (Precision Prospecting Ltd, 2005b) and in a separate survey of workers, 23 per cent of seasonal workers engaged in secondary food processing used labour provider accommodation (Precision Prospecting Ltd, 2005a).

4.97 Evidence submitted to our consultation revealed that many migrant workers find it difficult to save enough money to supply a deposit and a month's rent in advance when they first arrive in the UK. They may also struggle to provide the references, proof of identity and bank details required by most landlords. Labour providers and other employers who wish to take on migrant workers to fill gaps in the labour force have therefore found it necessary to provide them with accommodation. Both the ALP and the National Farmers' Union (NFU) drew our attention to this development in their evidence and argued that the accommodation offset provisions should recognise the particular circumstances in which accommodation is offered to migrant and temporary workers by employers.

Proposals for Redefining the Scope of the Accommodation Offset

4.98 In its evidence, the NFU noted the wording used in the Agricultural Wages Order for England and Wales, which suggested that the accommodation offset applied only to accommodation provided in accordance with the worker's contract of employment. The NFU suggested that it was unhelpful that the National Minimum Wage

Foreign workers...find it difficult to seek private rented accommodation independently because they have come from a country in which incomes are much lower than in Britain and therefore are unlikely to have accumulated the deposit (typically one month's rent) that landlords require...they cannot provide references acceptable to landlords...have difficulty establishing their identity and...may well not have a bank account. ”

Association of Labour Providers evidence

regulations referred only to accommodation provided by the employer, with no further clarification. It argued that accommodation offered under a separate stand-alone agreement (i.e. where the employee did not have to take the accommodation in order to be employed) should not be subject to the restrictions of the accommodation offset.

4.99 Similarly, the ALP drew a distinction between two categories of accommodation provision: the traditional model of tied accommodation that we discussed earlier in the Chapter, and accommodation offered as an optional service to workers. In the traditional model, workers normally had no choice but to live in the employer's accommodation as it was a requirement of their terms and conditions of employment. The ALP argued that the provision of accommodation by employers in these circumstances was very different from the situation of labour providers who offered workers a choice to take up an offer of accommodation if they wished.

4.100 The ALP suggested that labour providers supplied accommodation – sometimes at considerable inconvenience to themselves – as a service that workers were free to accept or decline, because of the difficulties that migrant workers would otherwise face in securing accommodation on the open market. The ALP proposed that the offset should not apply in such cases. Instead, it argued that accommodation provided in these circumstances should be treated like other goods and services under the minimum wage. Under the National Minimum Wage provisions (Regulation 35(e)), workers may choose to purchase goods and services other than accommodation from their employer with no reduction in pay for the purposes of the minimum wage calculation, provided that there is no obligation placed upon the worker concerned and it is a completely free choice.

“Where an employee has freedom of choice as to where he can live, the rental arrangements and the amount of rent charged should be left free for negotiation between the parties.”

**National Farmers' Union
evidence**

4.101 The ALP and NFU argued that not only was it more logical and consistent that the offset should not apply where accommodation was offered as an optional service independent of the employment contract, but that workers would also benefit if employers were able to charge a rent closer to the market rate. They suggested it would make employers more likely to provide accommodation and provide an incentive to improve its quality. The NFU wrote that it would encourage workers to take jobs in sectors with labour shortages and reduce the risk that workers would be given notice to quit their accommodation in

future because employers would be unwilling to provide it at a rate that they considered to be uneconomic.

4.102 Similarly, the ALP argued that greater flexibility would reduce the risk that migrant workers would be forced into the hands of unscrupulous landlords who might exploit their limited access to alternative sources of accommodation by offering overcrowded and substandard housing. We were told by another interested party that migrant workers' interests might not be best served by a growing reluctance by their employers to provide them with accommodation as this would lead to a division of responsibility for their welfare. We met one labour provider who told us that his company carried out checks to ensure its accommodation was of a good standard because his clients were concerned about their reputation. These clients did not want to risk losing contracts to supply the major supermarkets as a consequence of evidence of poor treatment of workers.

4.103 However, we also received evidence from a number of trade unions and worker representative bodies expressing concern about the charges applied for accommodation by some employers and calling for greater enforcement activity, particularly in the agriculture and food processing and packing sectors. The TUC and other organisations were particularly concerned that high charges for accommodation were sometimes combined with poor standards and overcrowding. The Transport and General Workers' Union (T&G) cited an example of ten migrant agency workers sharing three rooms who were paying on average £57 per week for accommodation, despite being on the National Minimum Wage. The GMB described cases of up to six people sharing a room, and deductions of £120 per week for accommodation. The T&G suggested these practices were becoming more common among employment agencies that specialised in providing migrant labour and proposed that a detailed study was needed, as did Citizens Advice Scotland. However Citizens Advice Scotland acknowledged that it was not always clear if such charges were 'due to lack of knowledge or blatant exploitation'.



4.104 The TUC argued that employers should only be able to apply the offset to accommodation that met minimum housing standards and that HMRC should, having consulted local authority officers, have 'the clear

“ If labour providers do not provide accommodation then workers may have difficulty in obtaining accommodation and will be paying substantially more than £26 a week [the then offset] unless they are prepared to accept overcrowding. ”

Association of Labour Providers evidence

“ We understand that there are concerns over the abuse of the accommodation offset and would support any enforcement activity which would prevent this. However we believe that these cases are isolated.... ”

CBI evidence

 Anecdotal evidence from CAB managers suggests that, since 2004, the number of employment-related advice enquiries being made to Citizens Advice Bureaux (CABx) by migrant workers has continued to increase, to the point where, for example, migrant workers now account for more than 25 per cent of all the advice enquiries made to some CABx in East Anglia. And the making of excessive (and in most cases patently unlawful) deductions in respect of poor standard and/or overcrowded accommodation remains a key theme of this strand of advice work. 

Citizens Advice evidence

power to disallow the accommodation offset in cases where accommodation does not meet legal standards’.

Scope of the Accommodation Offset: Our Conclusions

- 4.105** We concluded earlier in the Chapter that, on the basis of the evidence we received, there was no strong reason to recommend changes to the offset provisions for workers who are required to occupy accommodation provided by their employer as part of the conditions of their employment or for the effective performance of their duties. As we have noted in previous reports, the offset is intended as a measure to recognise both the advantages an employer derives from having workers housed in a convenient location, and the benefits to the worker.
- 4.106** However, we recognise that employment conditions in some sectors have changed since the Commission first recommended an accommodation offset. Recent increases in the employment of migrant workers in low-paying sectors, and their consequent need for suitable housing, have meant that some employers are offering accommodation in circumstances that differ from the traditional model of tied accommodation. We accept that there is a distinction in principle between the type of situation we envisaged when we first recommended an accommodation offset, and that described by the ALP and NFU in their evidence.
- 4.107** Accepting such a distinction between accommodation that is provided as an integral part of the employment package – often as a benefit-in-kind – and accommodation provided as an optional service that a worker is free to accept or decline with no consequences for the job offer, we considered carefully whether this distinction should be recognised within the accommodation offset provisions. We considered whether accommodation provided in the latter circumstances should be treated in the same way as goods and services under Regulation 35(e) of the minimum wage legislation.
- 4.108** We noted the arguments put forward by the ALP and NFU that employers would be more likely to offer accommodation to migrant workers (who would find it difficult to obtain reasonably priced housing of their own accord) if they could apply charges that would cover the

costs of renting, furnishing and maintaining the property on behalf of their workers. It might also provide an incentive to improve the quality of the housing offered and to reduce overcrowding. We also considered the risk that, due to difficulties in accessing alternative accommodation, migrant workers might have no choice but to take poor housing from unscrupulous landlords willing to overlook deposits and references in return for high rents. We balanced these arguments against the evidence put forward by worker representatives who were concerned that, despite the offset rules, some employers were taking advantage of the weak bargaining position of some migrant workers by charging high rents for overcrowded accommodation of poor quality, leaving these workers with very low net cash wages on which to live.

4.109 Having weighed the options carefully, our conclusion is that, while there is a case in principle for distinguishing between workers who are given a free choice about accommodation and those obliged to accept housing from their employer, there are significant practical difficulties associated with any such distinction.

4.110 Our consultation revealed that many low-paid migrant workers face significant problems when they first arrive in the UK in finding accommodation on the open market, and that there is a shortage of affordable rental accommodation in certain areas of the UK. It is likely that a good number of migrant workers will have little real choice but to accept accommodation from their employer in order to work in the UK. This is a very different situation from a worker who chooses to buy goods such as clothes or groceries from his or her employer, but could just as easily walk down the high street to purchase similar items elsewhere. Having considered the issue at length, we came to the conclusion that it would be very difficult to devise a simple, robust test of choice to apply where an employer has provided accommodation to a worker. Signatures on an employment contract and on a separate accommodation agreement do not necessarily demonstrate that the worker has been offered a meaningful choice and that the job and accommodation offer are genuinely independent of each other, particularly if these documents were signed prior to arrival in the UK.

4.111 We have described the concerns of trade unions and Citizens Advice with respect to high charges for often substandard and overcrowded accommodation. The fairness or otherwise of an accommodation charge is dependent to a significant extent on the quality of the accommodation. This is not something that can be controlled effectively through the minimum wage. Under housing legislation there are minimum standards already in place designed to prevent overcrowding and poor conditions, but the evidence we have received suggests that they are not being enforced consistently by local authorities.

‘ The last several years have seen a dramatic increase in the employment of migrant workers throughout Northern Ireland.

Generally such workers are employed through an increasing number of local employment agencies.... Many employment agencies will recruit their migrant workforce in Europe and fly them directly to Northern Ireland.

The control exerted by the agency is total in that workers have no option but to use the agency’s transport and accommodation. ’

Citizens Advice Northern Ireland evidence

4.112 We acknowledge that there are good employers who would charge a fair rent for decent accommodation if the offset restrictions were not applied to cases where free employee choice could be demonstrated. But we are concerned that without effective enforcement of minimum housing standards, and better enforcement of the minimum wage for migrant workers, any relaxation of the offset rules would introduce a greater risk of exploitation of some of the most vulnerable workers. Workers who are housed by their employer – and may also use their employer’s transport for travel to work – are in an unusually dependent position. They are more vulnerable than most, since they may risk losing their home and their employment too if they try to exercise their legal rights. In addition, in such circumstances it is usual for employers to require a worker to leave the accommodation if they find a new job.

4.113 Without the protection of a maximum deduction for accommodation afforded by the offset, it is possible that some employers could use high accommodation charges as a means to undercut the minimum wage, thus undermining the principle of a wage floor for all workers. In the light of these considerations, we believe there remains a strong case for treating accommodation differently to other goods and services.

4.114 **We therefore recommend that the accommodation offset provisions should continue to apply to all workers housed by their employer in all circumstances**, regardless of whether accommodation is provided in an agreement separate to the employment contract and regardless of whether the employee is offered a choice about whether to occupy the accommodation. This is consistent with the current National Minimum Wage legislation and the guidance now being provided by both the DTI and Defra. It means that employers and

workers alike should be in no doubt about the maximum deduction that an employer may make for accommodation in all circumstances.

- 4.115** If, however, a simple and robust test of choice could be devised that could be applied in a straightforward and effective manner, and if our concerns about cases of exploitation were allayed, we would be prepared to review the case for an amendment to the offset arrangements. In such circumstances we could see potential benefits of an approach which reflected the ability of some workers to make a free choice to accept an offer of accommodation from their employer, independent of their contract of employment. A mechanism to ensure that the length of the employment contract and that of the housing tenure were completely independent of the other might prove conclusive in deciding whether a worker had a genuine choice with respect to living in the employer's accommodation.
- 4.116** We will therefore continue to monitor closely developments relating to migrant labour, and to the provision of accommodation. We note that the Gangmasters Licensing Authority (GLA), which came into being in April 2005, has consulted on the licence conditions that should apply to labour providers. The consultation included a proposal that, as one element of their licence to operate, labour providers must ensure that any accommodation they provide meets legal requirements and is not overcrowded. We will monitor the impact of the licensing of gangmasters on the employment conditions (including the standards of employer-provided accommodation) of those who are employed in sectors covered by the new arrangements.

Enforcing the Accommodation Offset: the Need for Clear Guidance

- 4.117** We welcome the fact that a consistent position on the accommodation offset has been agreed between Defra, the DTI and HMRC and it is vital that this is maintained and communicated effectively. But it is clear that the offset has not been applied or enforced consistently in the past, due in part to confusion about the legal requirements. This must change. It is important that SAWS operators and employers in agriculture and related sectors are aware that stand-alone accommodation agreements do not override the requirement to ensure that workers receive pay of no less

than the National Minimum Wage – minus the accommodation offset deductor where applicable – regardless of the sector of employment. The Home Office is reviewing its guidance for SAWS operators in the light of the discussions that took place between government departments in 2005. We have been assured that new guidance will be available as early as possible within the 2006 SAWS season.

4.118 Clear enforcement of the existing rules is indeed in the interests of those employers who have been acting in accordance with the existing rules, and it is important that they are not undercut by companies charging higher levels of rent for accommodation. The first step in effective enforcement is to ensure that all employers understand the provisions.

4.119 We have already suggested earlier in the Chapter that the guidance on the accommodation offset could be clarified and improved in a number of areas and that there is a need for greater publicity to increase awareness and understanding of the provisions. Accordingly, **we recommend that the Government update existing guidance on the accommodation offset so that it is as clear and comprehensive as possible, and ensure that information is available on relevant websites. We also recommend that the Government take action to raise awareness of the offset, with a particular emphasis on employers and workers in agriculture and other sectors affected by the overlap between the Agricultural Wages Orders and the National Minimum Wage provisions.**

4.120 The next section considers a specific issue of enforcement: the provision of accommodation by ‘third parties’ who are linked to but legally separate from the employer.

Enforcing the Accommodation Offset: Third Party Accommodation Providers

4.121 Comments submitted to our consultation revealed uncertainty about the application of the offset where it was not immediately evident if the employer or a separate party had provided accommodation to a worker. The National Minimum Wage regulations governing the offset refer to accommodation provided by the employer but are not any

more specific about what this means. In practice, employers may make a variety of arrangements with third parties.

- 4.122** We were informed by the Government, trade unions and the ALP that some employers have set up separate companies to provide accommodation to their workers as a way to circumvent the restrictions imposed by the offset. The employer is no longer the same legal entity as the accommodation provider, even if the two companies share the same directors, and thus there is some doubt about whether the offset provisions apply. According to the T&G, some employers then deduct ‘unreasonable amounts of money for often poor standard accommodation’, although the union acknowledged that in some cases arrangements of this kind may be convenient for some workers and the accommodation is not always of poor quality.
- 4.123** We have no reason to believe that the practice of setting up a separate accommodation company to evade the offset is widespread. The evidence suggested that this activity was largely confined to a minority of employers operating in agriculture and the food processing and packing sectors. As the Government noted in its evidence, it is not clear what view an employment tribunal or court would reach on this matter. Nevertheless, we do not believe it is right for employers to seek to evade the offset rules by the device of a separate accommodation company set up specifically for the purpose, when in any meaningful sense, the employer and accommodation provider are one and the same. We believe that the Government should seek to close this loophole.
- 4.124** In addition to this type of evasion of the offset, the Government drew our attention to other arrangements with third parties where it is unclear whether the employer has effectively provided the accommodation.
- 4.125** Defra guidance for agricultural employers indicates that an employer may make deductions from pay for accommodation in excess of the offset, provided they are passed to a third party and the employer derives no benefit from the transaction. This kind of practice can be helpful to some workers, such as those who are on temporary contracts or others who might have difficulty securing the references and deposits normally required by landlords. It enables the employer to guarantee that rent is paid and then recover this money via the payroll.

“ The fundamental question here is whether changes may be needed to the legislation to maintain the policy and to prevent employers from seeking to circumvent the restrictions of the offset by using other vehicles or third parties to provide the accommodation. This is an area that has not been tested by the courts and it seems preferable to ensure that the legislation here is completely clear. ”

Government evidence

In other cases, an employer might receive commission payments or some other financial benefit from an arrangement with a landlord, thus establishing a relationship between the accommodation provider and the employer. It may not always be clear if the worker has entered into a genuinely separate agreement with a separate party, with the employer simply facilitating the transfer of rent money, or if the employer is effectively the accommodation provider. In the absence of specific legislation or tribunal decisions on these types of circumstances, the Government was concerned that some employers might seek to bypass the offset rules by making arrangements with third party landlords.

4.126 Because of the complexity of arrangements that may exist involving third parties, it would be difficult to draw up legislation that could define whether an employer is indeed the provider of accommodation – and therefore the offset should apply – in every possible combination of circumstances. Some of these issues may only be resolved through case law and the tribunal process. However, it is not helpful to employers or workers if there is significant confusion about what constitutes provision of accommodation by the employer. In our view, the fact that an employer makes deductions from payroll for accommodation that have been agreed by the worker in advance and then passes them to a genuinely separate third party does not of itself demonstrate that the employer is providing accommodation to his or her workers. However, we do believe that the employer should be regarded as the provider of accommodation and that the offset should apply in any of the following circumstances:

- a worker's occupation of accommodation is effectively dependent on fulfilling a particular employment contract or remaining with a particular employer; or
- a worker's continued employment is effectively dependent on occupying a particular place of accommodation; or
- the employer derives a financial benefit from the worker occupying particular accommodation.

4.127 We recommend that the Government should implement legislative measures to prevent employers using the device of a separate accommodation company to evade the accommodation offset.

We also recommend that it should make available guidance on the types of circumstances in which it will deem the employer to be the accommodation provider, taking account of the principles we have set out above.

Enforcing the Minimum Wage For Migrant Workers

- 4.128** Our review this year was focused on the operation of and compliance with the accommodation offset, but the evidence we have received has shown that problems associated with accommodation are often symptomatic of a wider issue: that of enforcing the rights of migrant workers to receive the minimum wage. A TUC report *Below the Minimum: Agency Workers and the Minimum Wage* (TUC, 2005) found evidence of very poor employment practices in relation to agency workers and particularly migrant workers, including deductions for transport, equipment and uniforms. The report noted that these workers were particularly vulnerable due to language difficulties and a lack of knowledge of UK employment law.
- 4.129** Migrant workers who take up unskilled employment in the UK represent a pool of workers who may be willing to accept low pay – perhaps even below the minimum wage in the informal economy – and poor employment conditions because of the comparatively lower wages in their country of origin. The potential impact of migrant labour on wages across the economy is an issue that warrants further investigation and we have commissioned a research project on this topic to inform our next report.
- 4.130** We received evidence from the T&G demonstrating high charges applied by employment agencies not just for accommodation, but for other services as well. This included an example of an employment contract that required workers to pay a £45 per week management fee to the employment agency (which is legal provided that the worker has agreed to the charge), plus a separate accommodation agreement with rent at £70 per week. Following these deductions, a worker earning £5.00 an hour for 40 hours per week received just over £50 net pay for the week.
- 4.131** The ALP told us that there are labour providers who are willing to agree contracts to supply labour to packhouses and suppliers in the food

“...our case evidence demonstrates the need for the enforcement of pay and employment rights for migrant workers.”

Citizens Advice Scotland evidence

“ The real abuse is not by people with detailed records that can be examined but rather by people with no records, no tax returns, no accounts, no fixed premises but rather a phone, a white van and a great deal of cash. ”

Association of Labour Providers evidence

industry at an hourly rate which is below the absolute minimum required to meet all the legal requirements of an employer – which it estimates at around £6.30 per hour. This implies that either the worker is not receiving the minimum wage, or that tax and NICs are not being paid, or possibly both; in some cases there may be collusion between the employer and worker. Although many of these issues fall outside our remit, they suggest a worrying trend in the exploitation of vulnerable low-paid workers, which may lead to their take-home pay falling significantly below the minimum wage.

- 4.132** The Government has prepared leaflets in other languages including Portuguese, Lithuanian and Polish in conjunction with the relevant Governments. These provide information on workers rights under UK legislation and list key contact numbers. We welcome this development. As we have noted, there may also be some positive impact as a result of the activities of the GLA, although its scope is presently limited to a few sectors – agriculture, shellfish gathering and some associated processing and packaging activities. Nevertheless we remain concerned about enforcement of the minimum wage, particularly in sectors that will not come under the remit of the GLA.
- 4.133** We believe that the evidence of exploitation of migrant workers warrants a greater focus on enforcement, particularly in low-paying sectors where significant numbers are employed. Ideally, a greater focus on enforcement of the minimum wage and the accommodation offset would be combined with action by the relevant authorities to address poor standards of accommodation. **We recommend that the Government should step up enforcement of the minimum wage in low-paying sectors that employ significant numbers of migrant workers, particularly agriculture and food processing and packing, and that these sectors are targeted as a priority within HM Revenue and Customs’ rolling programme of targeted enforcement.** The timing of this activity will need to be considered carefully to take account of our recommendations on raising awareness of the offset and on new measures with respect to employers who set up separate accommodation companies.

Conclusion: The Accommodation Offset

- 4.134** We have looked closely at the operation of the accommodation offset and whether there was any need to amend the existing regulations. We have concluded that the offset is working reasonably well in a number of sectors where accommodation has traditionally been offered as part of the employment package, although we have recommended that the Government should make greater efforts to publicise the offset and should improve the existing guidance. As in previous consultation exercises, some employers have argued for a substantial increase in the level of the offset, but we believe that this would fail to strike a fair balance between the interests of employers and low-paid workers, who, without the protection of the offset, might face significant reductions in their take home pay.
- 4.135** We have examined the application of the accommodation offset to migrant workers in agriculture and other sectors such as food processing and packing. We have concluded that the accommodation offset should continue to apply to all workers in all sectors, regardless of the circumstances in which accommodation is provided. In our view, it would be very difficult, in practical terms, to establish an effective, workable and enforceable distinction between accommodation provided as part of the terms and conditions of employment and accommodation that is offered as a service which workers are free to accept or decline with no negative consequences for their employment. However, we will continue to keep the accommodation offset under review.
- 4.136** We were also concerned about evidence that some migrant workers are being exploited and are faced with high charges for poor quality, overcrowded accommodation that in some cases would not meet existing housing standards. We have recommended a greater focus on enforcement of the accommodation offset and of the minimum wage more broadly in those low-paying sectors where migrant workers are concentrated. We have also recommended that the Government should bring forward measures to prevent employers deliberately evading the offset by setting up a separate accommodation company.

4.137 In reviewing the treatment of benefits-in-kind under the minimum wage, and the accommodation offset and salary sacrifice schemes in particular, one of our overriding concerns has been to avoid further complicating the minimum wage. A system that is as simple as possible to understand and work with is of benefit to employers and workers alike.

Consultation

We are grateful to all the people and organisations that helped us by providing oral and written evidence, and by organising or participating in visits and meetings. All organisations which participated, and gave consent for us to publish their names, are listed below according to the nature of their contribution.

Oral Evidence to the Commission

Association of Labour Providers
British Beer & Pub Association
British Hospitality Association
British Retail Consortium
Business in Sport and Leisure
CBI
Forest YMCA
GMB
Trades Union Congress
Trades Union Congress Youth Forum
Transport and General Workers' Union
Union of Shop, Distributive and Allied Workers
UNISON

Written Evidence to the Commission

Aktfast Ltd
Association of Convenience Stores
Association of Labour Providers
Association of Licensed Multiple Retailers
British Activity Holiday Association Ltd
British Beer & Pub Association
British Chambers of Commerce
British Dental Association
British Footwear Association
British Holiday & Home Parks Association Ltd
British Hospitality Association
British Retail Consortium
British Shops and Stores Association
British Youth Council (joint submission with Children's Rights Alliance for England)
Brownes Hospital, Stamford
BUPA Care Services
Business in Sport and Leisure
Business Services Association
CBI
Children's Rights Alliance for England (joint submission with British Youth Council)
Church of Scotland
Citizens Advice
Citizens Advice Northern Ireland
Citizens Advice Scotland
Cleaning and Support Services Association
Communication Workers Union
Community
Dyfed Cleaning Services Ltd
East Riding of Yorkshire Council
EEF The manufacturers' organisation
Employers' Organisation for Local Government
Equal Opportunities Commission
Federation of Licensed Victuallers Association
Forum of Private Business

GMB
Greater Manchester Low Pay Unit
Her Majesty's Government
Leicester City Council
MHA Care Group
National Council for One Parent Families
National Day Nurseries Association
National Farmers' Union
National Hairdressers' Federation
National Trainers Federation
Nestor Healthcare Group PLC
Northern Ireland Public Service Alliance
Public and Commercial Services Union
Rethink
Royal College of Midwives
Sanctuary Housing Association
Scottish Grocers' Federation
Scottish Licensed Trade Association
Scottish Low Pay Unit
Small Business Council
Small Business Service
Tesco Stores Ltd
Textiles Services Association
The Cinema Exhibitors' Association
The Institute of Payroll and Pensions Management
The Newspaper Society
Trades Union Congress
Transport and General Workers' Union
Union of Shop, Distributive and Allied Workers
UNISON
Universities and Colleges Employers' Association
Unquoted Companies' Group
Wadworth and Company Ltd
Wales TUC Cymru
White Horse Child Care Ltd
Winchelsea Little Shop Association Ltd
Working Men's Club & Institute Union Ltd

Visits and Meetings

Agricultural Wages Board for England and Wales
Aktfast Ltd
Angel HR
Association of Convenience Stores
Association of Labour Providers
Boots PLC
British Beer & Pub Association
British Beer & Pub Association Midlands Region
British Beer & Pub Association North of England
British Hospitality Association
British Retail Consortium
British Shops and Stores Association
British Youth Council
Business in Sport and Leisure
CBI
Children's Rights Alliance for England
City Hotel Derry
Coleg Llandrillo–Hospitality & Tourism
Connexions Tyne and Wear
Cophorne Tara Hotel
Daisy's Day Nursery
David Graham Hairdresser
Dixons
English Lakes Hotels Ltd
Ethical Trading Initiative
Gangmasters Licensing Authority
GMB
Goldstar Cleaning Services
House of Fraser
Incomes Data Services Ltd
Independent Retailers Confederation
James Cropper Plc
John Lewis Partnership
Lyndhurst Rest Home
MacDuff Shellfish (Scotland) Ltd
National Association of Masterbakers

NEXT PLC
 Nisa Today's
 Northern Counties Club
 Princess Road School
 Provista Recruitment Ltd
 Robinson's Cleaning & Support Services Ltd
 Rural Shops Alliance
 Small Business Council
 Small Business Service
 Summerhill Nursing & Residential Homecare
 Tesco Stores Ltd
 Trades Union Congress
 Transport and General Workers' Union
 Union of Shop, Distributive and Allied Workers
 UNISON
 Whitbread PLC
 Wilkinson Consultancy
 Wilkinson Hardware Stores Ltd
 Youth Hostel Association

Low Pay Commission Research Project

A2.1 We asked Incomes Data Services Ltd (IDS, 2005a) to conduct a survey of the non-cash benefits offered by employers in four low-paying sectors to inform our review of benefits-in-kind, salary sacrifice schemes and the accommodation offset. Our review is described in Chapter 4. A summary of the research project is provided in Table A2.1 below.

Table A2.1 Non-cash Benefits in Low-paying Sectors, 2005

Contractor	Incomes Data Services Ltd.
Aims and objectives	To examine the provision of non-cash benefits in a selection of low-paying sectors and in particular, the prevalence of salary sacrifice schemes.
Methodology	Postal survey of 3,000 firms in the care home, leisure, hospitality and retail sectors. Questions were asked about the number of low-paid employees (defined as those earning less than £6.00 per hour); the non-cash benefits they received and the approximate value of these benefits; use of salary sacrifice schemes; the provision of accommodation and use of the accommodation offset; and the influence of the National Minimum Wage on the provision of non-cash benefits. Follow-up telephone survey with a selection of organisations that offered a salary sacrifice scheme or accommodation.
Results	<p>341 employers responded to the postal questionnaire, a response rate of 11 per cent. The most common non-cash benefits offered to low-paid staff were paid holidays, staff discounts and sick pay. The retail sector was more likely to offer non-cash benefits, as were larger companies. Non-cash benefits were typically worth 0–2 per cent of the overall reward package, although around 20 per cent of respondents said that non-cash benefits were worth 11 per cent or more.</p> <p>Around three in ten respondents offered at least one type of salary sacrifice scheme. The most popular scheme was childcare vouchers (15 per cent), followed by pensions contributions (13 per cent) and home computer loans (6 per cent). 12 per cent of respondents offered accommodation. 86 per cent said that the minimum wage had had no impact on the provision of non-cash benefits.</p>

Jobs Offering Selected Non-cash Benefits by Gross Hourly Pay, 1997–2003

Table A3.1 Proportion of Jobs Offering Luncheon Vouchers, Free Meals, or Free or Subsidised Canteen by Gross Hourly Pay, 1997–2003

Percentage of jobs	Year					
	1997/98 ²	1998/99 ²	1999/00	2000/01	2001/02	2002/03
Gross hourly pay, £						
NMW+10p ¹ or less	17	16	15	15	13	13
More than NMW+10p to £6.00	19	18	17	16	17	16
£6.01–£10.00	23	22	19	18	18	17
More than £10.00	29	26	24	24	22	21
All	21	21	19	19	18	18

Source: Department for Work and Pensions (DWP), Family Resources Survey (FRS) 1997–2002 (GB), 2002/03 (UK).

Table A3.2 Proportion of Jobs Offering Free or Subsidised Goods by Gross Hourly Pay, 1997–2003

Percentage of jobs	Year					
	1997/98 ²	1998/99 ²	1999/00	2000/01	2001/02	2002/03
Gross hourly pay, £						
NMW+10p ¹ or less	7	6	7	6	6	7
More than NMW+10p to £6.00	8	9	8	7	8	8
£6.01–£10.00	5	6	5	6	5	5
More than £10.00	6	6	5	5	4	5
All	7	7	6	6	5	6

Source: DWP, FRS 1997–2002 (GB), 2002/03 (UK).

Table A3.3 Proportion of Jobs Offering Shares or Share Options by Gross Hourly Pay, 1997–2003

Percentage of jobs	Year					
	1997/98 ²	1998/99 ²	1999/00	2000/01	2001/02	2002/03
Gross hourly pay, £						
NMW+10p ¹ or less	1	1	2	2	2	2
More than NMW+10p to £6.00	4	4	3	4	4	3
£6.01–£10.00	7	8	7	7	6	5
More than £10.00	13	14	14	14	13	11
All	6	7	7	7	7	6

Source: DWP, FRS 1997–2002 (GB), 2002/03 (UK).

Table A3.4 Proportion of Jobs Offering Mobile Phone for Personal or Work Use by Gross Hourly Pay, 1997–2003

Percentage of jobs Gross hourly pay, £	Year					
	1997/98 ²	1998/99 ²	1999/00	2000/01	2001/02	2002/03
NMW+10p ¹ or less	N/A ³	2	2	2	2	2
More than NMW+10p to £6.00	N/A	3	3	3	2	2
£6.01–£10.00	N/A	5	5	6	5	4
More than £10.00	N/A	10	11	11	12	12
All	N/A	5	6	6	6	6

Source: DWP, FRS 1997–2002 (GB), 2002/03 (UK).

Table A3.5 Proportion of Jobs Offering No Payments-in-kind by Gross Hourly Pay, 1997–2003

Percentage of jobs Gross hourly pay, £	Year					
	1997/98 ²	1998/99 ²	1999/00	2000/01	2001/02	2002/03
NMW+10p ¹ or less	76	76	76	78	78	78
More than NMW+10p to £6.00	74	71	74	74	73	74
£6.01–£10.00	68	65	68	69	69	70
More than £10.00	54	50	53	55	53	55
All	69	65	67	67	66	67

Source: DWP, FRS 1997–2002 (GB), 2002/03 (UK).

Notes:

1. The National Minimum Wage (NMW) rates for workers aged 22 and over in the period 1999–2002 were: £3.60 (1999), £3.70 (2000), £4.10 (2001), £4.20 (2002). The additional 10 pence is to allow for those employees who were paid marginally above the NMW and for the effects of rounding.
2. The FRS variables 'dvuhrhd' and 'dvuhrsp' measuring total weekly hours in the 1999–2004 datasets are not available in the 1997/98 and 1998/99 datasets. The 1997/98 and 1998/99 analyses use the 'tothouhd' and 'tothousp' variables.
3. No questions on mobile phones were asked in the 1997/98 survey (Table A3.4).
4. Notes apply to Tables A3.1–A3.5 unless otherwise specified.

Abbreviations

AEI	Average Earnings Index
ALP	Association of Labour Providers
ASHE	Annual Survey of Hours and Earnings
BHA	British Hospitality Association
BRC	British Retail Consortium
CAB(x)	Citizens Advice Bureau(x)
CBI	Confederation of British Industry
CPI	Consumer Price Index
Defra	Department for Environment, Food and Rural Affairs
DfES	Department for Education and Skills
DTI	Department of Trade and Industry
DWP	Department for Work and Pensions
EMA	Education Maintenance Allowance
FRS	Family Resources Survey
FTE	Full-time Education
GB	Great Britain
GCSE	General Certificate of Secondary Education
GDP	Gross Domestic Product
GLA	Gangmasters Licensing Authority
GST	Government Supported Training
HCI	Home Computing Initiative
HMRC	Her Majesty's Revenue and Customs
IDS	Incomes Data Services Ltd
ILO	International Labour Organisation
IRS	Industrial Relations Services
LEL	Lower Earnings Limit
LFS	Labour Force Survey
LPC	Low Pay Commission
LRD	Labour Research Department
LSC	Learning and Skills Council

MTA	Minimum Training Allowance
NFU	National Farmers' Union (England and Wales)
NHS	National Health Service
NICs	National Insurance Contributions
NIESR	National Institute of Economic and Social Research
NIPSA	Northern Ireland Public Service Alliance
NMW	National Minimum Wage
NVQ	National Vocational Qualification
ONS	Office for National Statistics
Q	Quarter
RPI	Retail Price Index
RPIX	Retail Price Index excluding mortgage interest payments
SAWS	Seasonal Agricultural Workers Scheme
SBC	Small Business Council
SVQ	Scottish Vocational Qualification
T&G	Transport and General Workers' Union
TUC	Trades Union Congress
UK	United Kingdom
Usdaw	Union of Shop, Distributive and Allied Workers
WRS	Workers Registration Scheme
WTC	Working Tax Credit
YCS	Youth Cohort Study
YDR	Youth Development Rate

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