

National Minimum Wage

Low Pay Commission
Report 2014



National Minimum Wage

Low Pay Commission Report 2014

Presented to Parliament
by the Secretary of State for
Business, Innovation and Skills
by Command of Her Majesty

March 2014



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Introduction

Since we submitted our 2013 Report there has been an upsurge of public interest in the National Minimum Wage (NMW), often in the context of a broader discussion of living standards. Several independent bodies have initiated reviews of aspects of the NMW. The value of the minimum wage to those who receive it, the ability of employers to afford it, and strengthening the arrangements for enforcing it, have all been very widely discussed among politicians and in the media.

The economic climate has also changed since we submitted our last report. The context then was one of acute financial pressures on employers and their employees in tough business conditions, as it had been when we submitted our 2012 Report. This year we have also seen and heard evidence about difficult economic circumstances, but we have also heard that, at least for some, conditions have eased in the last twelve months as the economy has grown more strongly.

Our recommendations are again based on an extensive examination of the evidence. This has included written and oral submissions from stakeholders, meetings with employers and workers in low-paying sectors and small firms, a programme of commissioned external research and detailed in-house analysis of labour market and other economic data.

Remit

This is the 15th Low Pay Commission report. Our remit from Government stated the Government's aim of having NMW rates that help as many low-paid workers as possible, while making sure that we do not damage their employment prospects. It asked us to:

- monitor, evaluate and review the levels of each of the different NMW rates and make recommendations on the levels which should apply from October 2014; and
- review the contribution the NMW could make to the employment prospects of young people.

In making recommendations in these areas we were asked to take account of the state of the economy, and employment and unemployment levels. We were asked to report to the Prime Minister, Deputy Prime Minister, and the Secretary of State for Business, Innovation and Skills by the end of February 2014.

In September we were also asked to carry out an additional assessment. The Secretary of State for Business, Innovation and Skills requested that we take a longer-term view of the NMW, and consider the conditions that need to be in place to allow a faster increase in the minimum wage, taking into account the implications on employment. This year our report contains an extra chapter which provides this assessment, which is also available as a separate document.

Evidence

We are again very grateful to those organisations and individuals that provided evidence about the NMW. We received 61 written responses to our consultation, some of which were helpfully extended at short notice to comment on the additional assessment mentioned above. Eight organisations presented to us at our regular meetings, and in November last year 35 came to our oral evidence sessions. Our Secretariat held more than 40 meetings with stakeholders. Appendix 1 lists those who responded to our call for evidence.

We have also visited employers, workers and others affected by low pay in the four countries of the UK. Eight visits took place during our work for this report, during which we had a total of 40 meetings. We visited Birmingham and Wolverhampton; Gloucester and Newport; Dundee and Perth; London; Middlesbrough and Saltburn; Belfast and County Down; Nottingham and Mansfield; and Lincoln and Boston. These visits again gave us a valuable insight into the effects of the NMW and the issues associated with it that other forms of evidence cannot provide. We would like to record our gratitude to everyone who gave up their time to meet us.

We commissioned ten external research projects. Seven of these were completed for this report, and these are outlined in Appendix 2 together with a summary of the projects' findings. We also commissioned three projects to run over two years. The report draws on initial findings from these, and the final projects will inform our 2015 Report. In 2013 we brought academic experts and policy makers together for the first annual Low Pay Commission Research Symposium to explore the findings of work we had commissioned and insights from other experts too. We have again examined the best available economic evidence very carefully, and worked closely with the Office for National Statistics to obtain a comprehensive and consistent database on earnings and employment.

We met formally as the Low Pay Commission eight times since our previous report, including an all-day meeting in December to take presentations from a number of government and other organisations on economic and labour market issues, and an extra meeting in January to consider the additional assessment. We received presentations from those carrying out the research we commissioned, to understand and explore implications for our report. We met in January for two days to review and assess the evidence relevant to our remit and to agree all of the recommendations contained in this report.

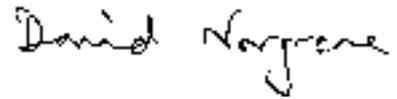
Conclusion

We have again aimed to produce a report which is detailed enough to explain the reasons for our conclusions and recommendations, while also being of manageable length. Our conclusions and recommendations represent the unanimous view of all Commissioners.

The Commissioners

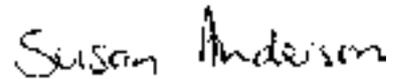
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Chair, PensionsFirst and the Family Justice Board



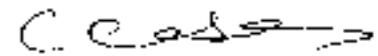
Susan Anderson

Consultant to the CBI on Employment Issues



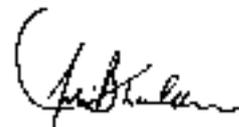
Kay Carberry

Assistant General Secretary, TUC



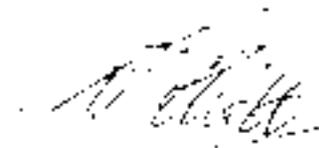
Peter Donaldson

Managing Director, d5 Consulting Limited



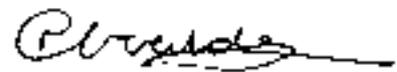
Professor Bob Elliott

Professor of Economics, University of Aberdeen



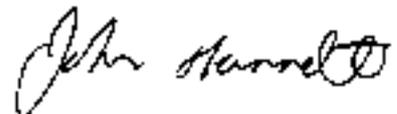
Neil Goulden

Director, Neil Goulden Consulting Limited



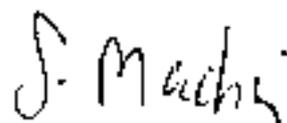
John Hannett

General Secretary, Usdaw



Professor Stephen Machin FBA

Professor of Economics at University College London and
Research Director, Centre for Economic Performance,
London School of Economics



Heather Wakefield

National Secretary for UNISON's Local Government Service Group



The Secretariat

Robin Webb, Secretary

Nicola Allison

Jay Arjan

James Brennan (to September 2013)

Tim Butcher

Helen Connolly (from October 2013)

Gerry Franks (to January 2014)

Rosalind Hands (from July 2013)

Tony Studd

Yi Zhang

Executive Summary

- 1 This is the fifteenth Low Pay Commission report. Our remit from the Government stated its aim of having National Minimum Wage (NMW) rates that help as many low-paid workers as possible, while making sure that it does not damage their employment prospects. It asked us to monitor, evaluate and review the levels of each of the different NMW rates and make recommendations on the levels which should apply from October 2014, and review the contribution the NMW could make to the employment prospects of young people. In September the Secretary of State for Business, Innovation and Skills asked us also to carry out an additional assessment, as part of our work this year, to consider the conditions that need to be in place in order to allow a faster increase in the minimum wage taking into account the implications on employment. This report is provided in response to the remit and the additional assessment request and, as in previous years, we set out the detailed evidence on which we have based our conclusions and recommendations.

Chapter 1: The Economic Context to the October 2013 Rates

- 2 Since we met to discuss and agree our recommendations in January 2013, the Office for National Statistics has again revised the data for economic output. These revisions have shown the recession was deeper than had previously been thought but there were some upward revisions to growth in recent quarters, implying a slightly stronger recovery. However, in the third quarter of 2013, gross domestic product was still 2 per cent below its level in the first quarter of 2008.
- 3 After the weak growth from the middle of 2011 to the end of 2012, the economy has at last picked up, growing by around 1.9 per cent in 2013. The strong jobs performance that we observed in 2011 and 2012 has continued into 2013. Total employment and total hours worked have fully recovered and are now well above their pre-recession peaks. However, population growth has meant that the working age employment rate has not yet recovered to its pre-recession levels. It should also be noted that although there was strong growth in the number of employees, especially full-time and permanent ones, over the last year, the numbers of full-time employees and permanent employees are still below their May 2008 levels.
- 4 This strong labour market performance combined with the weakness in output has led to a very sluggish productivity performance. Indeed, whether measured by output per hour or output per worker, the level of productivity is around 4 per cent below its level in the first quarter of 2008. A prominent feature of the recovery has been the subdued nature of wage

growth, with real wage reductions for much of the period. When adjusted for Consumer Price Index (CPI) inflation, median hourly earnings have fallen 7.5 per cent since April 2009.

- 5 In our 2013 Report, we recommended that the adult rate of the minimum wage be increased by 1.9 per cent to £6.31 an hour in October 2013. We thought that this would likely be close to maintaining the relative earnings of the lowest paid but recognised that it was also likely to lead to a reduction in their real earnings. As expected the rate of inflation has turned out above the increase in the adult rate but the data on average earnings growth were more mixed. The increase in average earnings measured by Average Weekly Earnings (AWE) at around 1 per cent was below the increase in the NMW but the annual earnings data from the Annual Survey of Hours and Earnings (ASHE) suggested that over the year to 2013 there had been much stronger growth, at around 2.2-2.6 per cent.
- 6 Median pay settlements by award were around 2.0-2.5 per cent but the median when weighted by employee numbers was lower at 1.5-1.8 per cent. If earnings turn out to be as measured by AWE, then the bite of the NMW (its value relative to the median or mean) will have increased. If, on the other hand, the picture shown by ASHE and pay settlements is a more accurate description of the labour market, then the bite of the NMW will have fallen. In the past, we have tended to give greater weight to the findings from ASHE, though these data are only available annually. However, using our most common measures of price inflation, the real value of the NMW has fallen. Thus, our recommendation for the adult rate was approximately in line with the growth in some measures of wages but was below the increase in prices.

Chapter 2: The Impact of the National Minimum Wage

- 7 The adult rate of the NMW has increased by around 75 per cent since its introduction at £3.60 an hour in April 1999. This is greater than the increase in average earnings or prices over the same period. However, in recent years the real value of the NMW has fallen as the increase in the NMW has been lower than the increase in both CPI and Retail Price Index (RPI) inflation. Using CPI to calculate the value of the NMW in real terms its value in October 2013 was similar to that in 2004 and much less than it was worth in 2007. Using RPI, the real value of the NMW in October 2013 was less than it was in October 2004. In contrast, the value of the NMW relative to average earnings had never been higher than it was in October 2012 and it remained close to that value in October 2013. As a consequence, the bite of the NMW (its value relative to the median) – broadly stable in the economy as a whole between 2007 and 2010 – is now close to its highest level since the NMW was introduced.
- 8 Between 1999 and 2007, wage growth was similar across all sizes of firm, all age groups and broad sectors. Between 2007 and 2011, this changed. Small firms had lower employee earnings growth than large firms, and the smaller the firm the lower the growth in employee earnings. Similarly, wage growth among the low-paying sectors was lower than in the rest of the economy; and wage growth among the youngest workers was much lower than for those aged 21 and over. Since 2011, we have seen some reversal of this divergence. Wage growth between 2011 and 2013 was similar across all firm sizes and between low-paying

sectors and the rest of the economy. However, wage growth among young workers has remained below that of older ones.

- 9** According to ASHE the increase in hourly wages in 2013 was greater than the increase in the NMW. This led to the bite of the NMW, its value relative to the median, falling in 2013 in the economy as a whole and across many industries and all sizes of firm. The bite for the whole economy, however, remained historically high at 52.4 per cent, though 0.4 percentage points below its peak in 2012. The bite remained just under 80 per cent in the low-paying sectors as a whole and was still over 65 per cent for micro firms and close to 60 per cent for other small firms.
- 10** Despite the increased level of the bite of the NMW, total employment has continued to grow in the economy as a whole and in the low-paying sectors. Moreover, although the bite in the low-paying sectors has grown even more than in the economy as a whole since 2007, the number of jobs in the low-paying sectors has increased at a faster rate than the number in the whole economy. Over the last year, growth in both the low-paying sectors and the rest of the economy has been strong with both growing by 2.1 per cent. Further, the employment performance of those groups of workers most affected by the minimum wage – women, older workers, disabled workers, ethnic minorities, and migrants – has generally been better, since the onset of the recession, than that of others not so affected by the NMW. However, there are two groups whose experience has been worse: young people and those with no qualifications, although it is important to note that the employment rates of the latter group have increased over the last twelve months.
- 11** The research we have commissioned to inform our decisions has shown that, though the lowest paid had received higher than average wage increases, there remains little evidence of significant adverse effects of the minimum wage on employment, whether analysing aggregate employment; individual employment probabilities; relative employment shares of low-paying sectors; or regional employment differences. It reveals that employers have adopted a number of strategies to cope with the minimum wage. These have included adjusting pay structures; reducing non-wage costs; small reductions in hours; increases in productivity; some increases in prices; and that there has been some squeezing of profits although insufficient to lead to an increase in business failure. We have now commissioned over 130 research projects from external organisations that have investigated various aspects of the impact of the NMW. Our most recent research has not altered these conclusions but has helped provide a clearer understanding of the processes at work.

Chapter 3: Young People and Apprentices

- 12** The earnings of 18-20 year olds saw relatively strong growth in 2013 compared with the previous year and the bite of the Youth Development Rate fell, due in part to the freezing of the Youth Development Rate in October 2012. While the 16-17 Year Old Rate was also frozen in October 2012, the bite of the 16-17 Year Old Rate increased in 2013 as median earnings for 16-17 year olds fell between 2012 and 2013. Although, it should be noted that median earnings for 16-17 year olds have remained more or less at £5.00 an hour since 2008.

- 13** After rising in recent years, commissioned research and stakeholder evidence reported a reduction in employers' use of the youth rates in the last twelve months or so. Our own analysis of earnings found the use of the 16-17 Year Old Rate fell in 2013, although an increasing proportion of 16-17 year olds was paid at the focal point of £5.00 an hour. There was no change in the proportion of 18-20 year olds paid at the Youth Development Rate. The proportion paid at the Adult Rate fell slightly. We also noted a rise in the proportion of young people paid below their age-related NMW rate although this may be due to the increased number of apprentices and greater use being made of the Apprentice Rate.
- 14** The labour market position of young people showed signs of improvement over the last year. Since 2011 we have recommended lower increases in the Youth Development Rate and 16-17 Year Old Rate than the adult rate. In this period they have risen by 2.2 per cent, while the adult rate has risen by 4.1 per cent. In 2013 the overall proportion of 18-20 and 16-17 year olds in employment stabilised, following a long-term decline. There were also signs of labour market improvement among young people not in full-time education and the proportion of young people not in education, employment or training. Although youth employment remains below its pre-recession level, this is largely due to the increasing number of young people staying in full-time education.
- 15** Apprenticeship starts in the UK on the other hand fell in 2012/13 for the first time since 2005/06 and the fall was greatest among 16-18 year olds. We noted in our 2012 Report that median gross apprentice pay was significantly above the Apprentice Rate in 2012, although there was evidence of lower pay, and non-compliance, among younger apprentices. An international comparison of apprenticeships commissioned for this year's report found that median apprentice pay was higher in the UK than in many other countries including Germany and Switzerland. At the same time, the ratio of vocational to academic enrolments, apprenticeship duration and level of funding was higher in other countries despite having lower apprentice pay.

Chapter 4: Compliance and Operation of the National Minimum Wage

- 16** Over the past year there has been progress in improving the compliance and enforcement regime. This includes revision of the naming scheme, which should lead to public naming of more employers who flout the requirement to pay the minimum wage, and an increase in the penalties where employers failed to pay at least the NMW. We will monitor the operation of these arrangements.
- 17** Other areas of the compliance and enforcement framework still require improvement, namely the depth of official guidance, awareness of the NMW among employers and workers, and a need to increase the use of prosecutions for the most serious infringers. The Government has indicated it is considering what further information was required to improve the NMW guidance and is undertaking work to review its prosecutions policy. It remains important to maintain sufficient resource for HMRC and BIS to support and deliver the compliance systems.

- 18** The evidence suggests that some groups are at greater risk than others of not receiving their entitlement to the NMW. Of particular concern is social care: HMRC's report on their recent investigations supported other evidence which had indicated that NMW non-compliance in this sector was higher than average. Government commitments to develop tougher measures to deter non-compliance and support compliance in this sector have been slow to materialise. We urge the Government to take further action, including that promised statutory guidance on commissioning should include a requirement for local authorities to take into account the actual costs of care, including the NMW.
- 19** Migrant domestic workers have faced difficulty in enforcing their right to the NMW. The courts have sometimes judged that they are not entitled to the minimum wage, under the family worker exemption. We are concerned that the exemption has been applied where it is not intended to operate, and recommend that the Government looks again at this area of law and takes the next available opportunity to legislate and clarify the entitlement of migrant domestic workers to the NMW.
- 20** Other areas of concern include the inappropriate use of unpaid interns; and non-compliance among employers of apprentices. We support the action the Government is taking to improve compliance in both areas.

Chapter 5: The Rates

- 21** The prospects for the UK economy in the short to medium term are much better than those in January 2013. Then forecasts for growth in the coming year or so were being revised down. This time they are being revised up. That optimism has carried through to the labour market, and into the forecasts for employment and unemployment in 2014 and 2015. Despite the weakness in output growth, the labour market continued to perform well in 2013.
- 22** However, wage growth and pay settlements continue to be subdued and remain well below the increases recorded before the recession. Real wages have continued to fall. Looking forward, inflation expectations are subdued and the CPI is forecast to be around target over the next year or so. Most economic commentators expect productivity to pick up and forecast that an increase in real wages will follow.
- 23** Differing views of the likely speed, strength and extent of economic recovery were at the heart of our discussions this year. The outlook for growth has improved since last year and the labour market, including the low-paying sectors, had performed strongly. On the other hand the economy was recovering rather than recovered, and the bite of the minimum wage remained at historically high levels in the low-paying sectors and among small firms.
- 24** Because the economic outlook is more optimistic, the labour market has performed strongly, and the NMW has fallen a little as a proportion of median earnings, we see headroom to recommend a larger increase than in recent years. At the time of our decision it is too early to know how strong and sustained the recovery will turn out to be, or how far it will spread across all of the economy and the country. We have had to balance the risk of recommending more than business and the economy can afford against the risk of doing too little to start to restore the real value of the earnings of the lowest paid.

- 25** We believe that the first step towards restoring the real value of the minimum wage can now be taken. We recommend that the adult rate of the National Minimum Wage be increased by 3 per cent, or 19 pence, to £6.50 an hour, from 1 October 2014. This will increase the real value of the minimum wage for the first time in five years through the biggest percentage increase since 2008. We expect this to increase the number of jobs covered by the minimum wage by over a third to around one and a quarter million and it to lift NMW workers' pay relative to others' earnings too.
- 26** Because of the improved economic and labour market conditions we believe that employers will be able to respond in a way which supports employment. However, we are concerned about the extra pressure the increase will place on the largely government-funded care sectors. We have made recommendations in previous reports, and comment again in Chapter 4 this year, on the mismatch between funding of social care in particular and the obligations, including the NMW, which providers must meet. We urge the Government to ensure funding is available to meet the extra pressure the NMW rise will place on the care sectors.
- 27** Our aim is to continue to restore the real value of the minimum wage as the economy improves, and we intend to build on this year's recommendation in 2015, provided that the economy and earnings take the upward path that is widely expected.
- 28** Last year we conducted a review of the accommodation offset. As a result we said that it was our intention to recommend staged increases towards the value of the adult rate of the NMW when economic circumstances mean that the real value of the NMW is tending to rise. As indicated above we are recommending an increase in the NMW that should cause its real value to rise. As we foreshadowed a year ago we are therefore making a start on the process of raising the offset's value, by recommending that it increase by a larger percentage than the increase in the NMW. We recommend that the accommodation offset be increased by 3.5 per cent, to £5.08 a day, from 1 October 2014.
- 29** In 2011 and 2013 we recommended smaller increases for young people than for adults and in 2012 we reluctantly recommended freezing their rates, because the labour market position of young people has been worse than that of adults. We aimed to increase their relative attractiveness to employers as a result. We have also noted that employment of young people is more sensitive than that of adults to the economic cycle, and that we expected to be able to recommend larger increases for them when economic conditions have eased. Their labour market position has yet to improve to match that of adults, and, despite a fall in 2013, we continue to see greater use of the youth rates than in earlier years. However, the employment position of young people does now appear to have stabilised. The lower increases in the youth rates that we have recommended in recent years may have played some part in this. This year we are recommending increases which should broadly protect the rates' real value, though less than the increase we recommend for adults. We continue to believe that the youth rates should increase by more than the adult rates when economic circumstances permit. A strengthening economic recovery and labour market performance of young people over the next twelve months will enable us to explore the scope to recommend such increases next year. We recommend an increase of 2 per cent in the Youth Development Rate to £5.13 an hour and in the 16-17 Year Old Rate to £3.79 an hour from 1 October 2014.

- 30** No apprentice pay survey has taken place in 2013 which meant there was little new evidence about apprentice pay to inform our recommendation. Last year we expressed our concern about the extent of non-compliance with the Apprentice Rate and recommended that it should be frozen. The Government decided to increase the rate in order to maintain its relativity with the youth rates, and has since then announced a number of measures to support compliance. A new survey of apprentice pay will take place later this year which will inform next year's decision. At this stage we are recommending an increase in the Apprentice Rate which will maintain its position relative to the youth rates. We recommend an increase in the Apprentice Rate of 2 per cent, or 5 pence, to £2.73 an hour from 1 October 2014.

Chapter 6: The Future Path of the National Minimum Wage

- 31** In September the Secretary of State for Business, Innovation and Skills asked us to carry out an additional assessment as part of our work this year, to consider the conditions that need to be in place in order to allow a faster increase in the minimum wage taking into account the implications on employment. He added that he would be keen to understand how government policies that affect the labour costs and take-home pay of people on the National Minimum Wage have influenced our conclusions.
- 32** The minimum wage has shown its worth during the economic slowdown. It has continued to rise faster than median earnings since the onset of recession in 2008, thus increasing the relative pay of the lowest paid. This is quite different from what happened in earlier recessions going back at least to the 1970s, when the pay of those at the bottom tended to fall behind that of other people.
- 33** The wages of the lowest paid are now higher relative to those of other workers than they have been for several decades. However, during the slowdown the value of the minimum wage to those receiving it has fallen, even as it has risen faster than other wages, because the increases in both the NMW and average wages have been exceeded by inflation. The bite has continued to rise in recent years and is now at or near its highest level ever.
- 34** We have found no numerical indicator available which would go further forward than the 21-month time period of our recommendations in order to signal the longer-term path of the NMW, while also being reliable enough to be useful. However, it is possible to set out the conditions for a faster increase in the National Minimum Wage.
- 35** We share the generally held view that a sustained increase in real wages depends on increased productivity: for wage increases to be sustainable they must be affordable, which generally requires an overall increase in output per head. The Commission will continue to base its assessments on the prospects for wages generally (both as a guide to changes in productivity in the economy and for the relationship between the minimum wage and other wage levels); on the outlook for employment, particularly in low-paying sectors and in small firms; and on expectations for economic growth. For significantly faster increases in the minimum wage to be achievable without risk to the employment of the low paid we believe it

would be necessary to see rising real wages in the economy more generally; stable or rising employment, particularly in low-paying industries and small firms; and an expectation of sustained economic growth.

- 36** The scope for higher pay is affected by government policies, especially those which affect employer costs. The Commission considers the effects of particular government policies on business, as an important element, but one among many, on the financial position of employers. For the purposes of the minimum wage the effects of government policy are often felt more at a sectoral level, for example through local authority spending on social care and/or through regulation in many industries. Government measures can also have a substantial impact on encouraging productivity in low-paying industries. The Commission does not take impacts on take-home pay into account: they do not affect employer affordability and ability to pay.
- 37** This year economic conditions have enabled us to recommend an adult rate from October 2014 which should increase the real value of the NMW. The Commission aims to recommend progressive real increases in the value of the minimum wage, restoring and then surpassing its previous highest level. Provided economic circumstances continue to improve we expect that process to continue, so that 2014 will mark the start of a new phase – of bigger increases than in recent years – in the work of the Commission.

Recommendations

National Minimum Wage Rates

We recommend that the adult rate of the National Minimum Wage be increased by 3 per cent, or 19 pence, to £6.50 an hour, from 1 October 2014 (paragraph 5.103).

We recommend an increase of 2 per cent in the Youth Development Rate to £5.13 an hour and in the 16–17 Year Old Rate to £3.79 an hour from 1 October 2014 (paragraph 5.107).

We recommend an increase in the Apprentice Rate of 2 per cent, or 5 pence, to £2.73 an hour from 1 October 2014 (paragraph 5.108).

Accommodation Offset

We recommend that the accommodation offset be increased by 3.5 per cent, to £5.08 a day, from 1 October 2014 (paragraph 5.106).

Migrant Domestic Workers

We recommend that the Government should review the law, and take the next available opportunity to legislate and clarify the entitlement of migrant domestic workers to the National Minimum Wage (paragraph 4.89).

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Chapter 1

The Economic Context to the October 2013 Rates

Introduction

- 1.1** In our 2013 Report, we recommended that the National Minimum Wage (NMW) should increase by 1.9 per cent for those aged 21 and over and by 1.0 per cent for young people. These recommendations came into effect on 1 October 2013. We start this report, our fifteenth, by considering how the economy has performed in 2013 and comparing it with the forecasts available and our expectations when we agreed those recommendations in January 2013. As well as those forecasts, our recommendations also took account of the impact of the NMW to date; the state of the economy at the time; international comparisons and developments; and the likely impact of current and forthcoming government legislation. Our recommendations in this report again take account of the same considerations and are detailed in this and subsequent chapters.
- 1.2** In Chapter 2, we look at the impact of the minimum wage on earnings; the distribution of earnings; pay structures; employment; hours; and business competitiveness. As the recent changes in the rates of the minimum wage only took effect in October 2013, it is too early to adequately assess their impact. We thus consider the whole period since the introduction of the NMW in April 1999, but focus much of our analysis on the most recent upratings, in particular those that came into effect on 1 October 2012. The labour market for young people and recent developments concerning apprenticeships are reviewed in Chapter 3. The workings of the NMW, including issues concerning compliance and enforcement, are then discussed in Chapter 4. Chapter 5 brings together an overview of the prospects for the economy; stakeholder views; international developments; and consideration of other relevant government legislation, before concluding with our recommendations for the various minimum wage rates from October 2014 and an assessment of their likely impact. In this report we make use of the evidence available to us up to 24 January 2014, when we met to agree our recommendations.
- 1.3** In addition this year, we have responded to a request from the Secretary of State for Business, Innovation and Skills for an assessment of the conditions that would need to be in place for faster increases in the minimum wage in future. Our analysis of these issues is set out in Chapter 6.

2013 National Minimum Wage Upratings

- 1.4** In arriving at our recommendations for October 2013 we considered the economic outlook, and its implications for wages and earnings, very carefully. We were conscious that recent gross domestic product (GDP) forecasts had tended to be too optimistic and that the performance of the economy in 2012 had been disappointing. However, we agreed with most forecasters in expecting some improvement in the period to be covered by our recommendations, albeit with GDP growth still below its long-term pre-recession trend. We noted the strong employment performance of the low-paying sectors, where employee jobs grew at more than double the rate of the economy as a whole; and that the real value of the minimum wage had again fallen because of inflation, with increases in prices of essentials such as energy and food hitting the lowest paid especially hard. But we were concerned that the economy remained weak, and the bite of the adult minimum wage had reached its highest ever level (in April 2012) as the minimum wage increased by more than median earnings. These increases in the NMW had intensified pressures on affordability for some employers, particularly those in small firms. We discussed how far the resilience of the labour market might in part be attributable to falling real wages and thus entail a risk of adverse consequences for employment if real wages started to rise.
- 1.5** During the economic downturn we have taken a prudent approach to NMW rates. We noted that, in practice, our recommendations had approximated very closely to what has proved to be the path of average earnings growth since 2009. Over that period forecasts of average earnings have turned out to be too high, and this experience suggested that our recommended adult rate for October 2013, when we were again cautious, might be closer to actual average earnings than forecasts available at the time of our meeting. We commented that the economic environment was not markedly different in January 2013 compared with January 2012, and thus our recommendation for the adult rate was similar to the one we made in our 2012 Report. That is, we expected the recommended NMW increase to maintain the relative incomes of the lowest paid, while recognising that, in common with other workers, they would be likely to see some reduction in their real incomes.
- 1.6** Our position on the rates for young people was different. In 2011 we recommended increases in the two young people's rates of the NMW below that for adults, and in January 2012 we reluctantly recommended a freeze, because of the worsening labour market position of young people. Since the beginning of 2012 their position had stopped deteriorating. Rises in their median pay in 2012 meant that the bites of young people's minimum wage rates had fallen; but employers were paying more young workers the youth rates. There continued to be debate about the role of pay in the labour market outcomes of young people. In these circumstances, we did not believe another freeze in these rates was necessary, but we remained mindful that employment of young people was more sensitive than that of adults to the economic cycle, and we recommended increases in these rates that were around half those of the increase in the adult rate.
- 1.7** The evolution of the rates of the National Minimum Wage is shown in Table 1.1. The adult rate rose by 1.9 per cent from £6.19 an hour to £6.31 an hour from October 2013, while the

Youth Development Rate increased by 1.0 per cent to £5.03 an hour; the 16-17 Year Old Rate by 1.1 per cent to £3.72 an hour; and the Apprentice Rate by 1.1 per cent to £2.68 an hour.

- 1.8** The adult rate of the minimum wage has increased by 75.3 per cent since it was introduced in April 1999. Over the same period, the Youth Development Rate has increased by 67.7 per cent. The 16-17 Year Old Rate was introduced in October 2004 and has increased by 24 per cent. Between October 2004 and October 2013, the adult rate increased by 30.1 per cent and the Youth Development Rate by 22.7 per cent. The Apprentice Rate was not introduced until October 2010 and has increased by 7.2 per cent from £2.50 an hour to £2.68 an hour in October 2013. Its value relative to the youth rates and the adult rate has increased as the youth rates have risen by 2.2 per cent and the adult rate by 6.4 per cent in this period.

Table 1.1: National Minimum Wage Hourly Rates, UK, 1999-2014

	Adult rate		Youth Development Rate		16-17 Year Old Rate		Apprentice Rate	
	Rate	Change	Rate	Change	Rate	Change	Rate	Change
	£	%	£	%	£	%	£	%
Oct 2013-	6.31	1.9	5.03	1.0	3.72	1.1	2.68	1.1
Oct 2012-Sept 2013	6.19	1.8	4.98	0.0	3.68	0.0	2.65	1.9
Oct 2011-Sept 2012	6.08	2.5	4.98	1.2	3.68	1.1	2.60	4.0
Oct 2010-Sept 2011	5.93	2.2	4.92	1.9	3.64	2.0	2.50	-
Oct 2009-Sept 2010	5.80	1.2	4.83	1.3	3.57	1.1		
Oct 2008-Sept 2009	5.73	3.8	4.77	3.7	3.53	3.8		
Oct 2007-Sept 2008	5.52	3.2	4.60	3.4	3.40	3.0		
Oct 2006-Sept 2007	5.35	5.9	4.45	4.7	3.30	10.0		
Oct 2005-Sept 2006	5.05	4.1	4.25	3.7	3.00	0.0		
Oct 2004-Sept 2005	4.85	7.8	4.10	7.9	3.00	-		
Oct 2003-Sept 2004	4.50	7.1	3.80	5.6				
Oct 2002-Sept 2003	4.20	2.4	3.60	2.9				
Oct 2001-Sept 2002	4.10	10.8	3.50	9.4				
Oct 2000-Sept 2001	3.70	2.8	3.20	0.0				
Jun 2000-Sept 2000	3.60	0.0	3.20	6.7				
Apr 1999-May 2000	3.60	-	3.00	-				

Source: Low Pay Commission (LPC).

Notes:

a. From October 2010, those aged 21 have been covered by the adult rate. Previously they had been covered by the Youth Development Rate.

b. '-' denotes not applicable.

The UK Economy in 2013

- 1.9** At the time of our deliberations in January 2013, the HM Treasury Panel of Independent Forecasts for GDP growth in 2013 again revealed little consensus, ranging from 0.2 per cent to 2.0 per cent. The median of these forecasts had been revised down sharply since June 2012 from 1.7 per cent to 1.0 per cent in January 2013. Similarly, the Office for Budgetary

Responsibility (OBR) had revised its forecasts from 2.0 per cent in March 2012 to 1.2 per cent in December 2012. In spite of this expectation of below-trend growth, both forecast employment to grow in 2013 albeit both thought it would be too weak to prevent unemployment increasing.

- 1.10** As we noted above, we recommended an increase of 1.9 per cent in the adult rate of the NMW from October 2013. As is evident from Table 1.2, this recommendation was lower than the forecasts for average earnings growth in 2013 by the OBR or the median of independent forecasts compiled by HM Treasury. It was also below the forecasts for inflation, which remained above 2.0 per cent for both the Consumer Price Index (CPI) and Retail Price Index (RPI) measures. We judged that our recommendation would turn out below inflation but be closer to the actual increase in average wages than the forecasts. We now turn to look at what has actually happened.

Table 1.2: Economic Forecasts Available in January 2013, UK, 2013-14

Per cent	Forecasts for 2013		Forecasts for 2014	
	Median of independent forecasts (January 2013)	OBR forecasts (December 2012)	Median of independent forecasts (November 2012)	OBR forecasts (December 2012)
GDP growth (whole year)	1.0	1.2	1.8	2.0
Average earnings growth (whole year)	2.2	2.2	-	2.8
Inflation RPI (Q4)	2.7	2.5	2.6	2.6
Inflation CPI (Q4)	2.4	2.3	2.0	2.2
Employment growth (whole year)	0.5	0.3	-	0.3
Claimant count (millions, Q4)	1.62	1.69	1.61	1.70

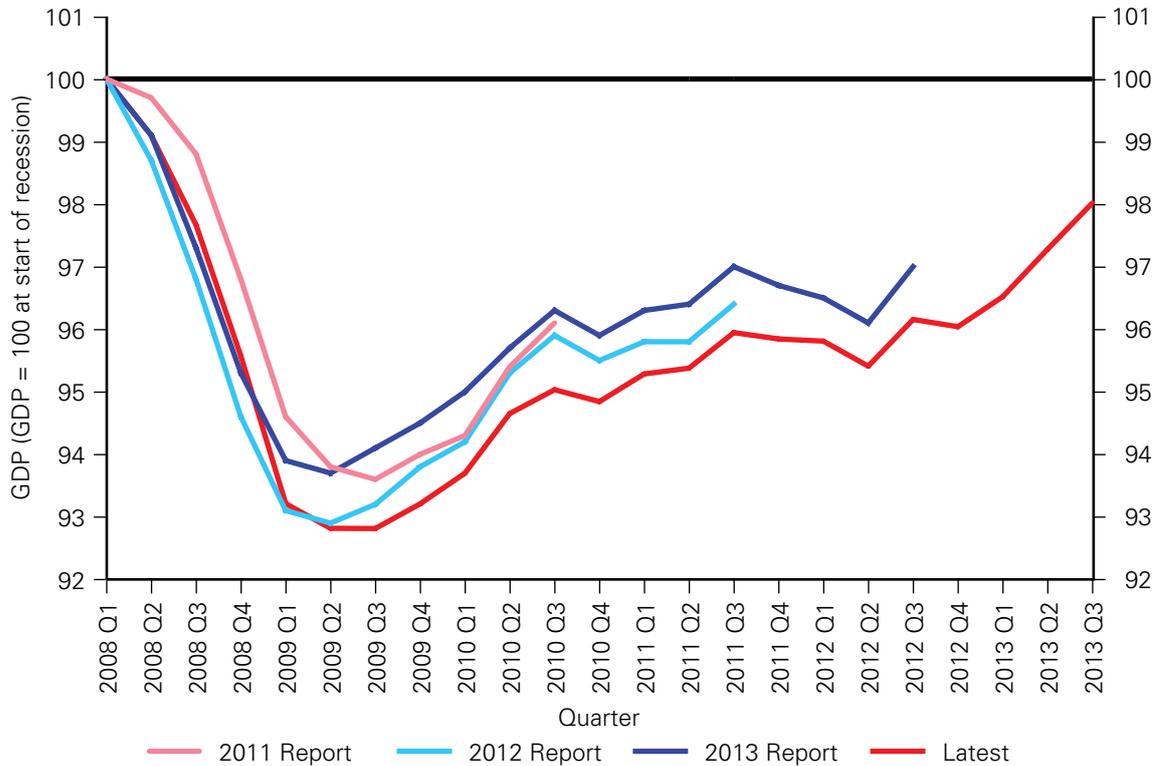
Source: HM Treasury Panel of Independent Forecasts (2012 and 2013a) and OBR forecasts (2012) based on ONS data: GDP growth (ABMI), total employment measured by workforce jobs (DYDC) and claimant unemployment (BCJD), quarterly, AWE total pay (KAB9), monthly, seasonally adjusted; RPI (CZBH) and CPI (D7G7), quarterly, not seasonally adjusted, UK (GB for AWE); 2013-14.
Note: '-' denotes not available.

Gross Domestic Product

- 1.11** When we wrote our 2013 Report, official data suggested that the recession, which began in the second quarter of 2008, had lasted five quarters and that the resultant fall in real GDP had been 6.3 per cent. The recovery had been weak with GDP still around 3 per cent below its pre-recession peak by the third quarter of 2012. Since January 2013, the Office for National Statistics has again revised its GDP data. The latest data, released in December 2013 and shown in Figure 1.1, still suggested that the recession lasted five quarters (or possibly six if we include a negligible decline in output in the third quarter of 2009 – 0.004 per cent) but was much deeper than was thought at this time last year, with output now estimated to have fallen by 7.2 per cent.
- 1.12** The revised data show the economy was slightly stronger prior to the recession with GDP growth averaging 3.1 per cent a year from 2004 to 2007 (revised up from 3 per cent); the recession was deeper; and the subsequent recovery a little stronger. The economy grew by 2.4 per cent in the initial stage of recovery from the third quarter of 2009 to the third quarter

of 2010 but then stalled, growing by just 1.1 per cent from the third quarter of 2010 to the fourth quarter of 2012. However, since the beginning of 2013, growth has been much faster than most forecasters had expected in early 2013. As recently as April 2013, the median of independent forecasts for GDP growth in 2013 had fallen to 0.7 per cent. It has since rebounded to expectations of growth around 1.4 per cent as the economic news has improved.

Figure 1.1: Effect of Recent Revisions to Gross Domestic Product, UK, 2008-13



Source: ONS, quarterly change in GDP (IHYQ), quarterly, seasonally adjusted, UK, Q1 2008-Q3 2013.
 Note: The data are those that were available in January of each year.

1.13 However, the latest revisions to the data in 2012 and the first three quarters of 2013 suggest much stronger growth in 2013 than previously thought. GDP growth in 2012 was revised up to 0.3 per cent from 0.1 per cent and the cumulative growth in the first three quarters of 2013 has been revised up to 2.1 per cent from 1.8 per cent. These data suggest that growth in 2013 will be much higher than was forecast at the time we prepared our 2013 Report. Indeed, if growth in the fourth quarter of 2013 is 0.7-1.0 per cent, which seems likely according to most forecasters, then GDP growth in 2013 will turn out to have been 1.9 per cent. This is close to more optimistic forecasts made a little earlier: 1.8 per cent was the median forecast as recently as June 2012.

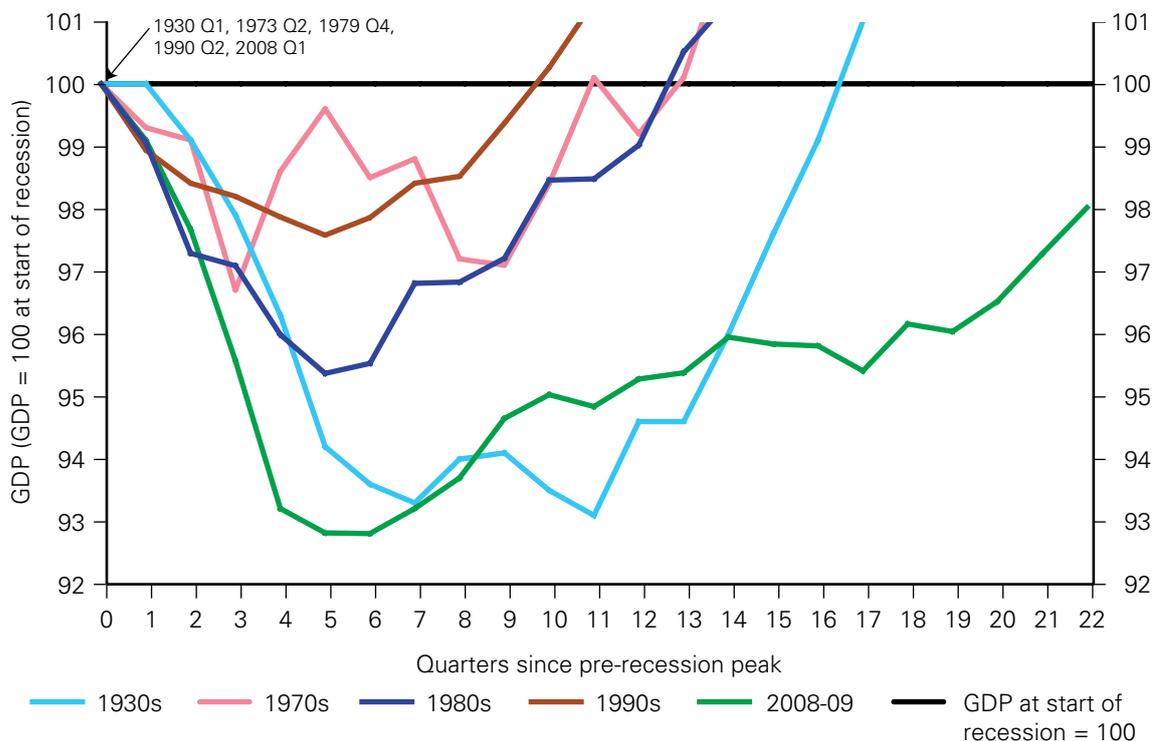
1.14 As noted, cumulative growth in the first three quarters of 2013 was stronger than forecast, supported by unexpected increases in household spending (with consumers running down savings and spending the windfall from compensation for mis-selling of financial products); a pick-up in housing investment (boosted by the Bank’s Funding for Lending scheme and supplemented by the Government’s Help to Buy schemes) and a reduction in the pace of the austerity measures (although these are planned to pick up again in 2015). There has been

some recovery in consumer confidence and credit conditions have eased but business investment, trade and earnings growth have remained weak.

1.15 In general, the recovery has been sluggish so far. While the service sector, the bulk of the economy, has returned to its pre-recession level of output, that only occurred in the third quarter of 2013. Even within services, the performance is mixed. While real estate (up nearly 9 per cent); professional and technical services (up 8 per cent); education (up nearly 2 per cent); and health and social services (up over 13 per cent) have recovered, many service sectors remain below their pre-recession levels, including wholesale and retail (just under 2 per cent below); hotels and restaurants (over 4 per cent below); and finance (nearly 14 per cent below). Output in other sectors such as construction, agriculture and manufacturing remains around 10 per cent below the level of output produced in the first quarter of 2008.

1.16 The recent recession remains the deepest that the UK has experienced since the 1920s and, as shown in Figure 1.2, the recovery is one of the slowest on record. Not surprisingly, the recovery after the milder recession of the 1990s was quicker than that in the 1980s although the latter only needed two years to make up the lost output. In contrast, over four years after the end of the most recent recession, real GDP was still 2 per cent below what it was in the first quarter of 2008. The recession of the 1930s was longer, lasting 10 quarters, but then it took only a further 5 quarters for the economy to fully recover.

Figure 1.2: Gross Domestic Product in Recession and Recovery, UK, 1930-2013



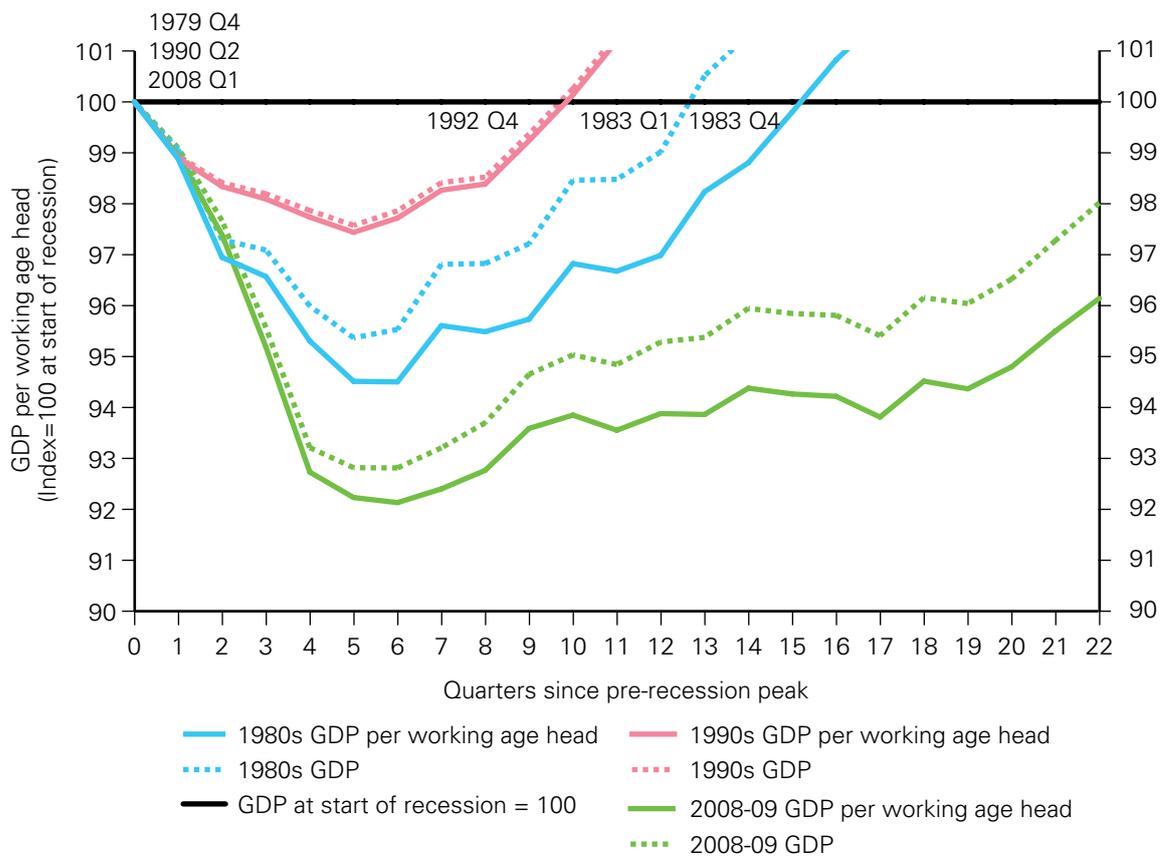
Source: LPC estimates based on ONS data: GDP (ABMI), quarterly, seasonally adjusted, UK, Q2 1973-Q3 2013; and data from Mitchell, Solomou and Weale (2012): Q1 1930-Q2 1935.

Note: Quarter 1 is the first quarter of the recession (1930 Q1 for the 1930s, 1973 Q2 for the 1970s, 1980 Q1 for the 1980s, 1990 Q3 for the 1990s, and 2008 Q2 for the 2008-09 recession).

1.17 The population has grown strongly throughout the period of recovery, resulting in an even more sluggish recovery when measured by GDP per head (of working age population). The working age population grew by over 0.77 million between the first quarter of 2008 and the

third quarter of 2013. This was weaker than in the 1980s when the working age population grew by over 1.3 million between the fourth quarter of 1979 and the second quarter of 1985, but much stronger than in the 1990s when the working age population increased by just 0.22 million between the second quarter of 1990 and the fourth quarter of 1995. Figure 1.3 shows that the recent recession and the one in the 1980s experienced even slower recoveries when considering GDP per head. In contrast, there was little difference in the 1990s. In the recent recession, GDP per head fell by nearly 8 per cent and, in the third quarter of 2013 (over five years after the onset of recession), was still nearly 4 per cent below its level in the first quarter of 2008. In the 1980s, despite the much stronger population growth, GDP per head had fully recovered within four years.

Figure 1.3: Gross Domestic Product per Head in Recession and Recovery, UK, 1979-2013



Source: LPC estimates based on ONS data: GDP (ABMI) and working age population (LF20), quarterly, seasonally adjusted, UK, Q4 1979-Q3 2013.

Note: Quarter 1 is the first quarter of the recession (1980 Q1 for the 1980s, 1990 Q3 for the 1990s, and 2008 Q2 for the 2008-09 recession).

1.18 In summary, at the time we wrote our 2013 Report the independent forecasts and those from the OBR had suggested that growth would be around 1.0-1.2 per cent in 2013. The out-turn looks as if it will be stronger, with growth for 2013 now expected to be around 1.9 per cent, though GDP remains below its pre-recession peak.

Prices, Settlements and Earnings

1.19 The latest inflation data available to us at the time of our 2013 Report related to December 2012. The CPI inflation rate at that time was at 2.7 per cent and the RPI rate was at 3.1 per

cent. All inflation rates had been pushed up in October 2012 by the increase in undergraduate tuition fees to £9,000; rising food prices; and higher gas and electricity bills. Inflation was expected to fall back in the second half of 2013, as these factors fell out of the 12-month comparison, and productivity started to recover. The CPI rate of inflation was forecast to be 2.3-2.4 per cent in the fourth quarter of 2013, with the RPI rate at 2.5-2.7 per cent.

1.20 After several years of under-forecasting inflation, the forecasts for 2013 have been broadly accurate and may even have slightly over-estimated the rate of inflation. Figure 1.4 shows that CPI inflation was around 2.7 per cent between January and September 2013. It fell sharply to 2.2 per cent in October as the effect of the increase in undergraduate tuition fees fell out of the 12-month rate, and as a result of falling petrol prices and air fares. RPI inflation followed a similar pattern, falling from 3.2 to 2.6 per cent between September and October 2013, where it remained in the fourth quarter of 2013. With interest rates broadly unchanged, the RPIX measure of inflation followed RPI.

Figure 1.4: Price Inflation, UK, 2006-13



Source: ONS, annual change in CPI (D7G7) and RPI (CZBH), monthly, not seasonally adjusted, UK, 2006-13.

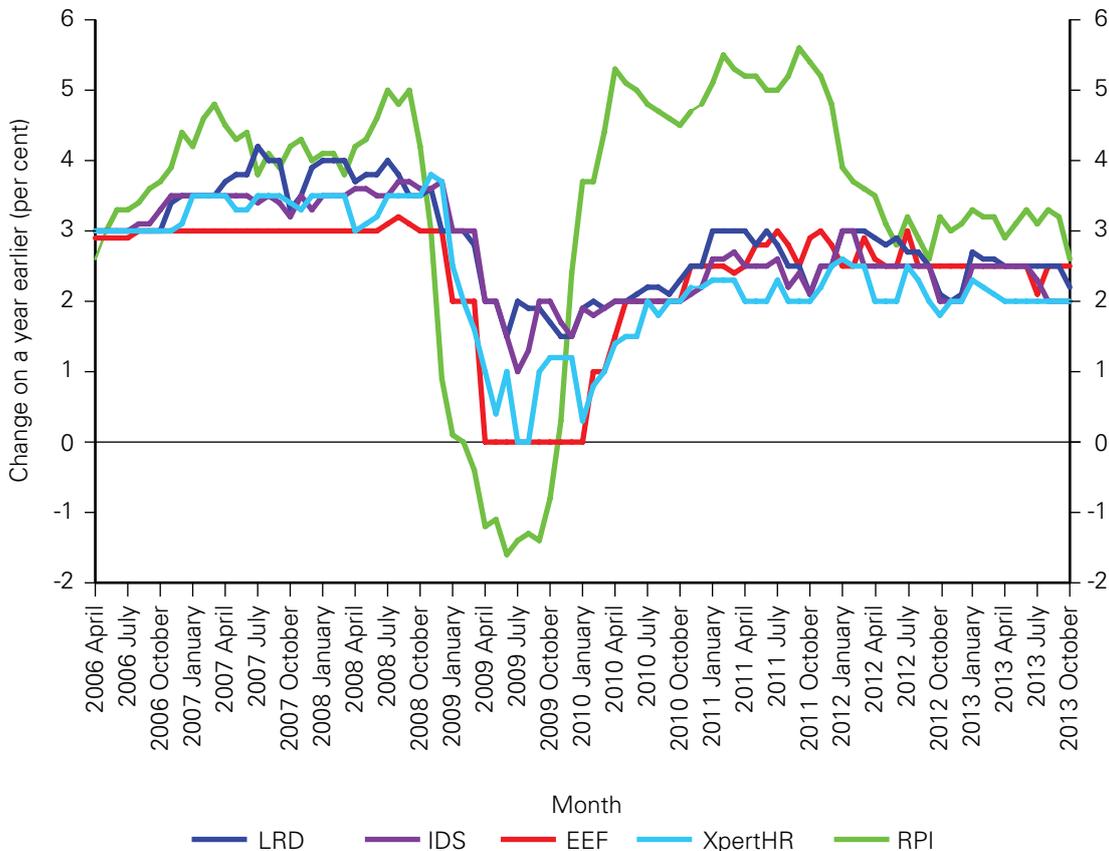
1.21 The ONS undertook a consultation in autumn 2012 on options for making changes to the way in which the RPI is calculated, in order to reduce or eliminate the ‘formula effect’ which accounts for a substantial part of the difference between the RPI and the CPI. The resulting recommendation was that, while the arithmetic formula used for the RPI does not meet international standards, the RPI would continue unchanged because of the value to users of a consistent long time series. A new version of the RPI – RPIJ – has been published alongside the RPI since March 2013, which uses the geometric rather than the arithmetic mean. A consequence of the new method is that RPIJ will always be lower than, or equal to, the RPI rate (lower by 0.4 percentage points on average over the last 16 years, with the

monthly differences ranging from 0.2 to 0.8 percentage points). The RPI group of inflation measures were downgraded in March, and are no longer considered 'National Statistics'.

1.22 A further new measure of inflation was introduced in March 2013, CPIH, to introduce an element of housing costs into the CPI. This measure of inflation has been 0.2 percentage points lower than the CPI rate over the last 12 months, as housing inflation has been lower than average inflation. While we will monitor these new measures of inflation, we will continue to focus on the RPI and CPI rates of inflation as these offer consistency over the longer-term; are the measures used by the major forecasters, including the OBR; are the most commonly used measures of inflation in pay negotiations; and are showing similar trends to the new measures.

1.23 The link between inflation and pay settlements has weakened in recent years, with affordability and the business outlook becoming more important factors, in addition to an absence of wage pressures. Pay settlement medians, as shown in Figure 1.5, were around 2.0-2.5 per cent in 2013, just below inflation, and broadly in line with that expected at the time of our 2013 Report. Outside the public sector, there was a small degree of variation by sector, with pay reviews in manufacturing centred on 2.5 per cent and private services at 2.0 per cent. Figure 1.6 illustrates that, while the number of pay freezes fell slightly between 2012 and 2013, there was also a smaller proportion of pay reviews at 3.0 per cent and above, with an increasing share in the 2.0-2.9 per cent range.

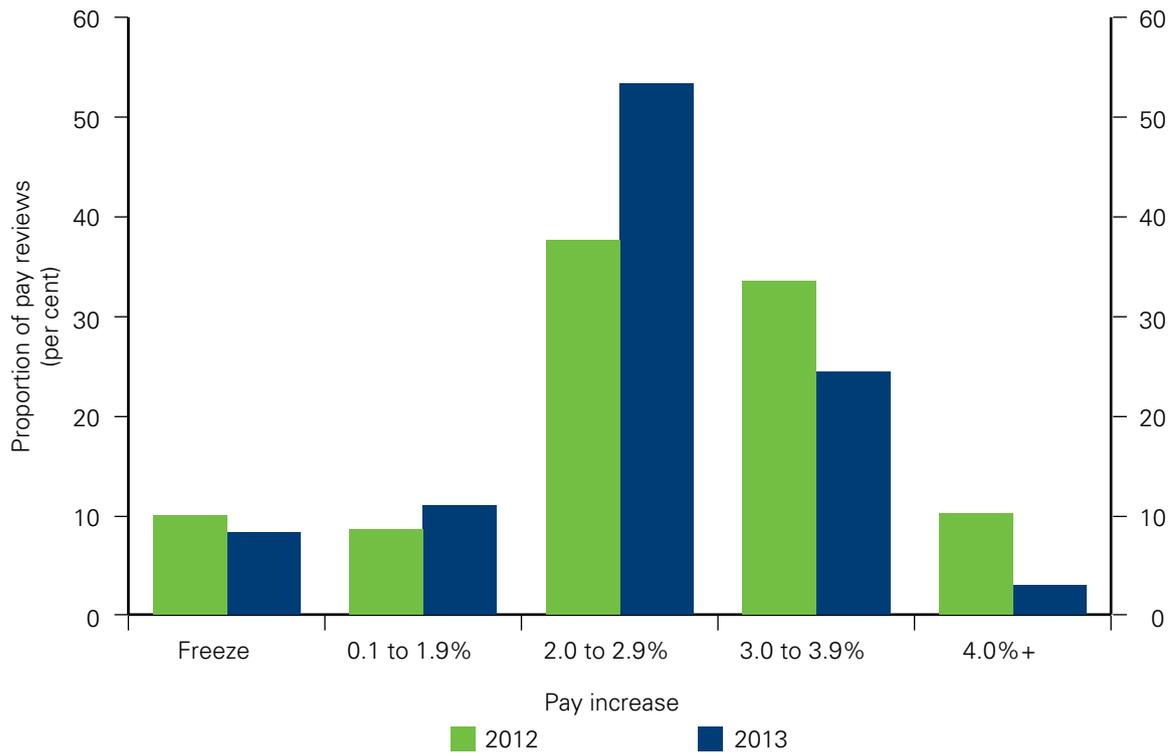
Figure 1.5: Median Pay Settlements and Price Inflation, UK, 2006-13



Source: XpertHR (previously Industrial Relations Services), Incomes Data Services (IDS), Labour Research Department (LRD), and EEF, the manufacturers' organisation (EEF), pay databank records, three-month medians; ONS, annual change in RPI (CZBH), monthly, not seasonally adjusted, UK, 2005-13.

Note: Pay settlement medians for the three months to the end of month shown.

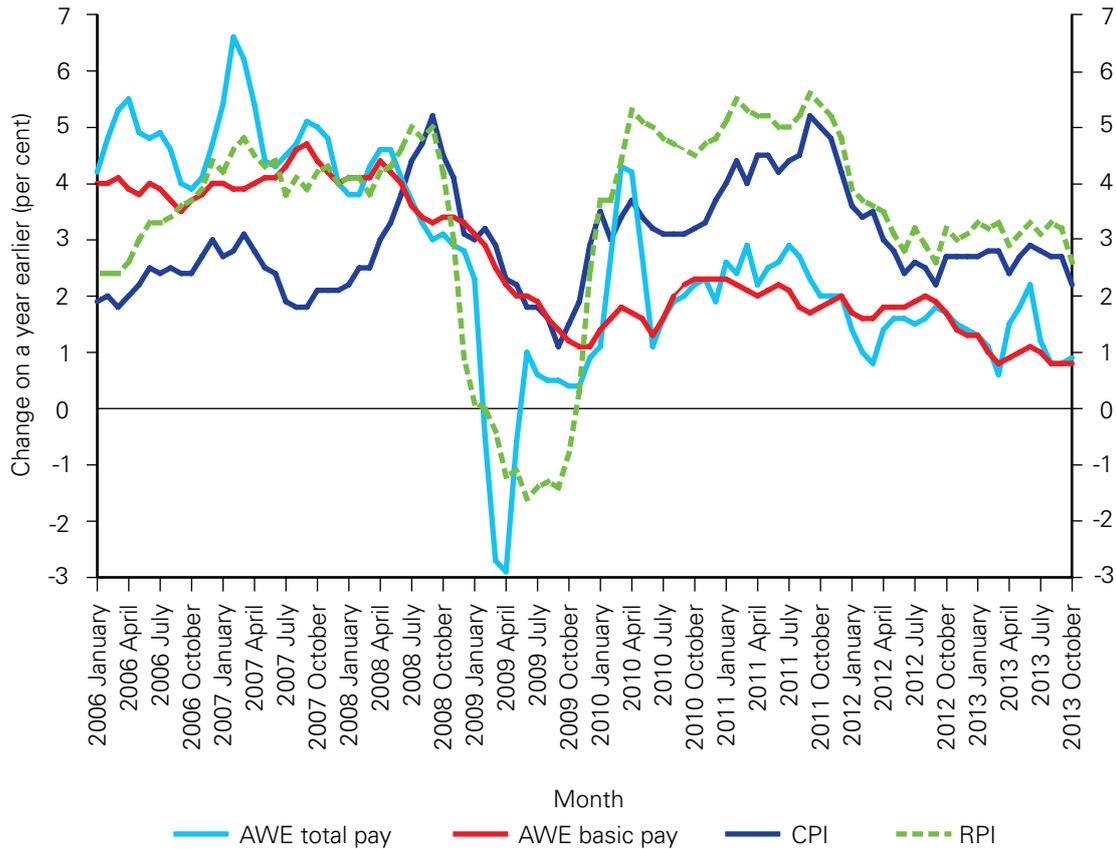
Figure 1.6: Distribution of Private Sector Pay Settlements, UK, 2012-13



Source: IDS, UK, 2012-13.

- 1.24** Average earnings growth in the economy as measured by Average Weekly Earnings (AWE) remained subdued throughout 2013 and consistently below inflation, as shown in Figure 1.7. The three months to October 2013 saw whole economy annual average weekly earnings growth of 0.9 per cent. Average weekly earnings growth was 1.3 per cent in the private sector and 0.0 per cent in the public sector (the latter excluding financial services). This was well below the modest forecasts of 2.2 per cent average earnings growth contained in our 2013 Report.
- 1.25** The data on bonus pay for the first half of 2013, and consequently average weekly earnings growth overall, are misleading: the payment of bonuses was delayed (and this appears to have been across the board in the private sector, and not confined to finance) in the early months of 2013, to attract the lower income tax rate (45 rather than 50 per cent) from April onwards. The annual growth in bonus pay in the month of April alone was 62 per cent across the whole economy and 83 per cent in the finance and business services sector. This meant that total private sector average earnings growth fell to 0.2 per cent in the three months to March, but bounced back to 2.8 per cent in June, as the full effect of the delayed bonus payments was seen. Private sector earnings growth excluding bonuses was stable at around 1 per cent throughout 2013.

Figure 1.7: Average Weekly Earnings Growth, GB, and Price Inflation, UK, 2006-13



Source: ONS, AWE basic pay (KAI9) and total pay (KAC3), annual three-month average change for the whole economy (KAI9), monthly, seasonally adjusted, GB, 2006-13; and annual change in RPI (CZBH) and CPI (D7G7), monthly, not seasonally adjusted, UK, 2006-13.

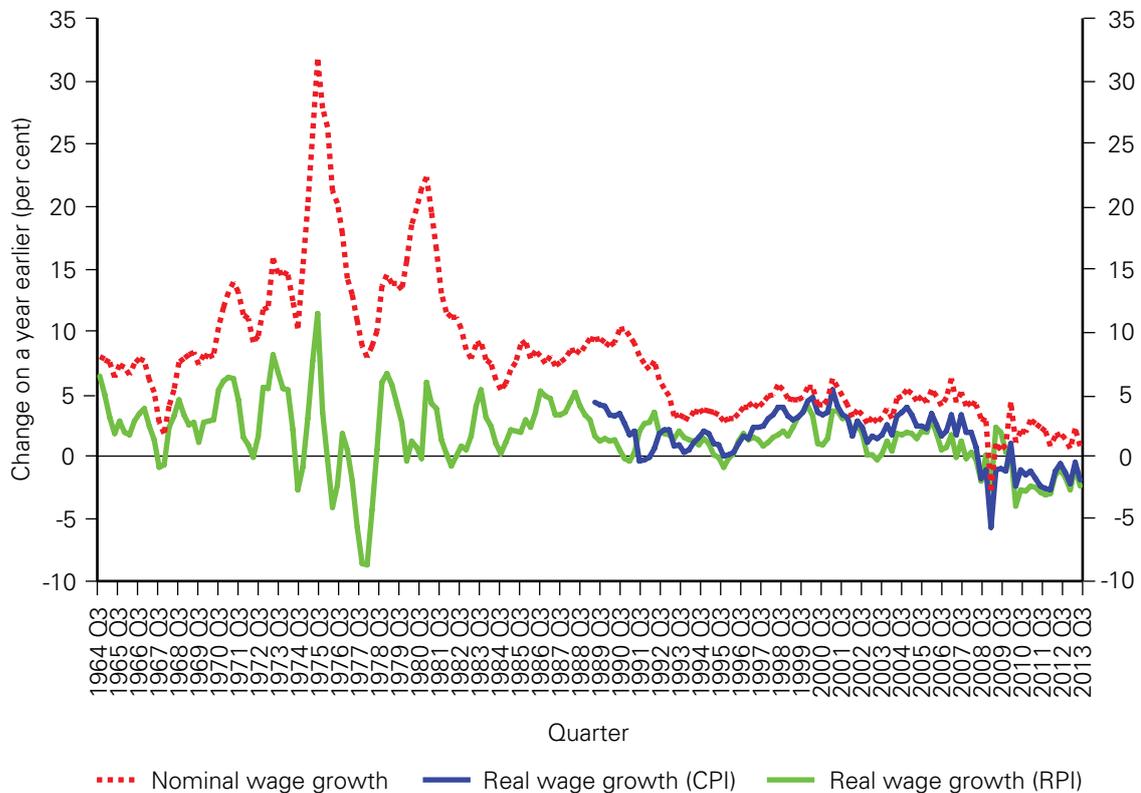
1.26 This raises the question of why average earnings growth across the whole economy has been so persistently low, and below pay settlements. A number of possible explanations have been offered. It may be that new employees have been recruited on lower salaries than incumbent staff, given the ease of recruitment. Furthermore, there may have been a restructuring of the reward package for the highest-paid employees away from cash bonuses towards longer-term incentives, which has skewed the average. It should be noted that data from the Annual Survey of Hours and Earnings (ASHE) indicated a much faster rate of pay growth, 2.6 per cent, in median weekly earnings between April 2012 and April 2013, which is closer to the measure of pay settlements. That measure was higher than forecast average earnings growth, though it was still below the increase in price inflation over that period (2.8 per cent for CPI and 3.3 per cent for RPI over the year to the first quarter of 2013).

Real Wages

1.27 A consequence of this weak nominal wage growth is that the UK has experienced an unprecedented period of falling real wages. Other than a short period in 2009 when the RPI recorded a fall in prices, price inflation as measured by the two most commonly used indices (CPI and RPI) has generally been higher than both pay settlements, since 2006 as shown in Figure 1.5, and average earnings growth, since the onset of recession in 2008 as shown in Figure 1.7. This is very different to what has happened previously. As shown in Figure 1.8, this period of real wage falls is unprecedented. Until 2010, the UK had not experienced any

continuous period of more than five quarters of negative real wage growth since records began in 1964. On both measures of consumer price inflation, real wages have been falling since the second quarter of 2010, and, save for one quarter when wages and bonuses were brought forward for tax purposes, real wages on the CPI measure have been falling continuously since the third quarter of 2008.

Figure 1.8: Growth in Nominal and Real Wages, UK, 1964-2013

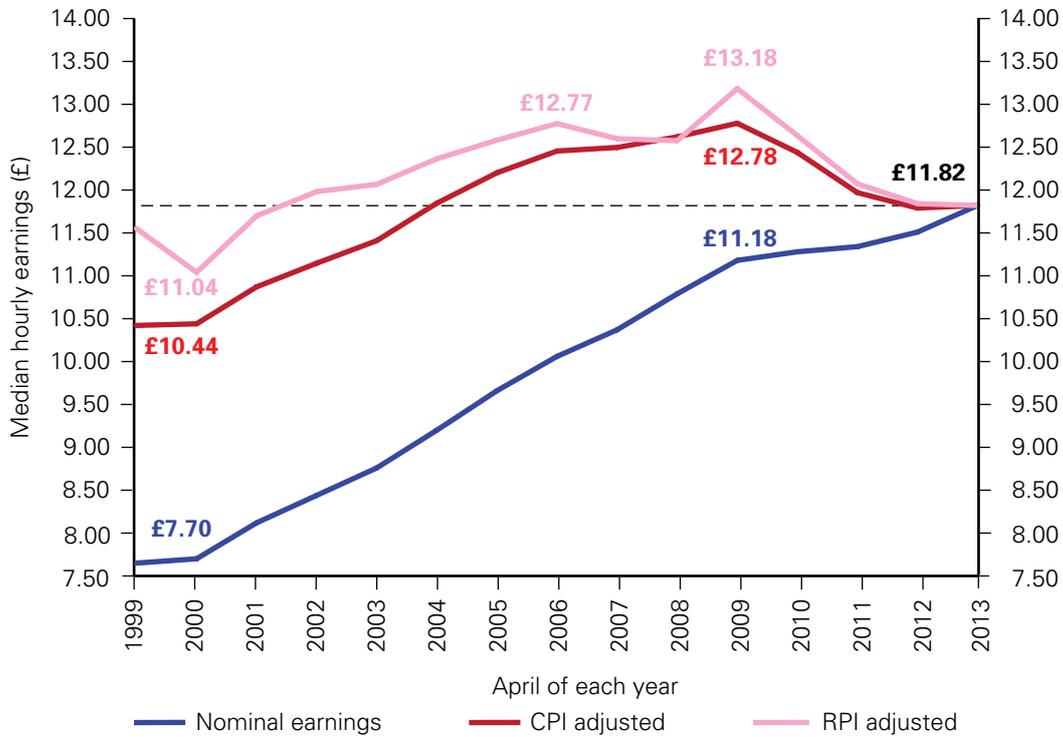


Source: LPC estimates based on ONS data: annual change in CPI (D7G7), Q1 1989-Q3 2013, and RPI (CBZH), Q1 1964-Q3 2013, quarterly, not seasonally adjusted, UK; annual change in AEI inc bonuses (LNNC), Q1 1964-Q4 2000, and AWE total pay (KAC3), Q1 2001-Q3 2013, monthly, seasonally adjusted, GB.

1.28 Another way to look at real wages is to look at the relationship between price changes and median hourly wages over time. This is shown in Figure 1.9 where data from ASHE are used to measure wages. Between 1999, when the adult rate of the National Minimum Wage was introduced, and April 2009, median hourly earnings for those aged 22 and over grew at a similar rate each year (over 4 per cent in nominal terms). Since then increases in median hourly earnings have been much more modest, growing on average by just 1.2 per cent a year between 2009 and 2013. Figure 1.9 shows that in real 2013 price terms, adjusted for RPI price inflation, median hourly earnings increased from £11.04 an hour in April 2000 to £12.77 in April 2006, an increase of around 2.5 per cent a year. They then fell back by 1.6 per cent over the next two years (to £12.57 an hour in 2008) before rebounding strongly to £13.18 an hour in April 2009, as the RPI fell. Over the following four years, real earnings in 2013 RPI terms have fallen back by 10.3 per cent, albeit by only 2 pence (0.17 per cent) in the last year to £11.82 in April 2013. The pattern is similar in CPI terms, with real median earnings increasing on average by about 2.3 per cent a year from £10.44 an hour in April 2000 to £12.78 an hour in April 2009. Since then, real median hourly earnings have fallen by 7.5 per cent. It should be noted that over the last year real median hourly earnings in CPI terms

actually increased by 3 pence an hour (an increase of 0.25 per cent). However, this would not have been the case if we had used AWE instead of ASHE.

Figure 1.9: Growth in Nominal and Real Median Hourly Wages for those Aged 22 and Over, UK, 1999-2013



Source: LPC calculations based on ONS data: RPI (CZBH) and CPI (D7G7), monthly, not seasonally adjusted, UK, 1989-2013. ASHE median hourly pay: without supplementary information, April 1997-2004; with supplementary information, April 2004-06; 2007 methodology, April 2006-11; and 2010 methodology April 2011-13, standard weights, UK.

Note: ASHE data have been adjusted to take account of methodology changes to provide a consistent time series.

1.29 The fall in real median earnings since 2009 has meant that the value in CPI terms of median hourly earnings in April 2013 was below what it was in April 2004. In RPI terms, the real value of median hourly earnings in April 2013 was lower than in April 2002. Median hourly earnings have increased by nearly 55 per cent since 1999 while RPI has increased by 51 per cent. However, since 2002, median hourly earnings have increased by 40 per cent, while RPI has increased by 42 per cent. Thus, the rise in median earnings between 2002 and 2013 has been less than RPI inflation.

Employment and Unemployment

1.30 We noted in our last report that the absence of real wage growth appeared to have aided the labour market which had shown remarkable powers of recovery in light of the sluggish GDP performance. In our 2013 Report, we noted that forecasters were expecting the weakness in output to lead to falls in employment in 2012. The weakness in output was realised but there was strong growth in employment. In January 2013, forecasters were again expecting weak below-trend growth but this time they expected some employment growth albeit weaker than that observed in 2012. The OBR and the median of independent forecasters expected employment growth of 0.3-0.5 per cent in 2013. However, this increase in employment was not forecast to be sufficient to prevent unemployment from increasing. The claimant count

was expected to increase from 1.57 million to 1.62-1.69 million. The expected upturn in growth in 2014 was also forecast to lead to further employment growth but again was expected to be too weak to enable unemployment to fall.

- 1.31** As GDP growth has turned out higher than expected, we might therefore expect the labour market to have performed better than forecast. Indeed, workforce jobs have increased by 0.8 per cent between 2012 and 2013 and claimant count unemployment has fallen to 1.39 million in the third quarter of 2013.
- 1.32** The apparent strength of the labour market, whether measured by the number of people in work or the total number of jobs, can be seen in Table 1.3, which shows total employment and the number of workforce jobs at record levels. Between October 2012 and October 2013, total employment increased by 485,000 or 1.6 per cent to 30.1 million workers. The increased employment mainly came from employees (up 429,000 or 1.7 per cent) rather than the self-employed (up 53,000 or 1.3 per cent). Among employees, the increase was mainly full-time (up 2.2 per cent) and permanent (up 2.0 per cent) rather than part-time (up only 0.2 per cent) and temporary employees (down 2.2 per cent).
- 1.33** We can also see a similar picture if we look at the number of jobs rather than the number of people in employment. Between September 2012 and September 2013, the number of workforce jobs increased by 598,000 or 1.9 per cent to a record high of 32.35 million. Employee jobs increased by more (2.1 per cent) than the increase in self-employed jobs (1.3 per cent). Alongside the increase in the number of jobs and people employed, there has been an increase in hours worked. The total numbers of hours worked rose by 1.9 per cent between October 2012 and October 2013, and the growth in hours worked was mainly driven by increases in full-time employment as well as an increase in hours worked in second jobs.
- 1.34** Another sign of the improved labour market is the growth in the number of vacancies, up by 15 per cent to 562,000 in the three months to October 2013, compared with the same period a year ago. In addition, the number of redundancies has also fallen by more than 18 per cent over the year to October 2013.
- 1.35** As well as increases in employment, there has been a reduction in unemployment on both the ILO measure (available and seeking) and the claimant count. The working age level of unemployment was 2.37 million in October 2013, down 5.0 per cent on a year previously. The claimant count saw even larger reductions with the number of unemployment benefit claimants falling by 268,000 to 1.31 million in the year to October 2013.

Table 1.3: Change in Employment, Jobs, Hours and Unemployment, UK, 2008-13

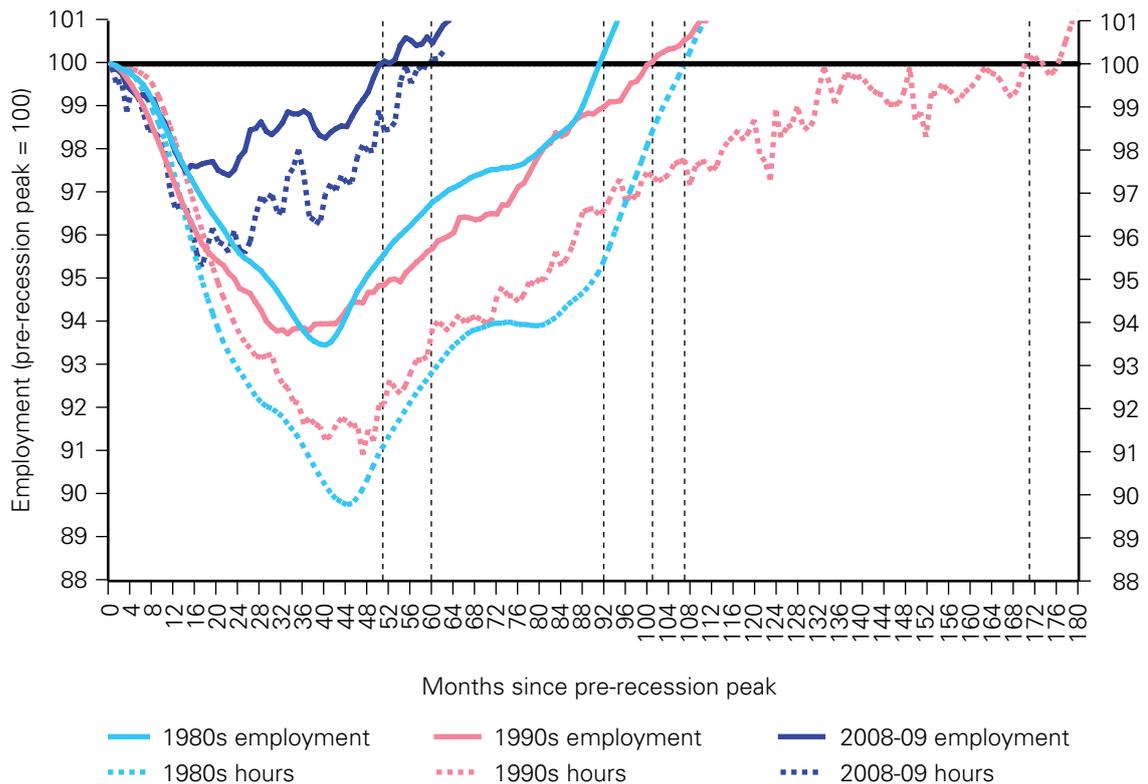
	(October 2013)	Change		Change	
		(Oct 2012-Oct 2013)		(May 2008-Oct 2013)	
	000s	000s	%	000s	%
LFS Employment					
Employment	30,086	485	1.6	514	1.7
Full-time employment	21,942	460	2.1	-135	-0.6
Part-time employment	8,144	25	0.3	650	8.7
Number of employees	25,547	429	1.7	44	0.2
Full-time employees	18,789	413	2.2	-295	-1.5
Part-time employees	6,758	15	0.2	339	5.3
Contract type					
Permanent employees	23,963	465	2.0	-120	-0.5
Temporary employees	1,584	-36	-2.2	164	11.5
Self-employment	4,253	53	1.3	417	10.9
Full-time self-employment	3,065	55	1.8	141	4.8
Part-time self-employment	1,188	-1	-0.1	276	30.3
ONS Workforce Jobs					
Workforce jobs	32,351	598	1.9	189	0.6
Employee jobs	27,908	565	2.1	-315	-1.1
Hours worked					
Total hours worked	966,700	17,700	1.9	21,300	2.3
Full-time hours in main job	825,000	15,148	1.9	5,962	0.7
Part-time hours in main job	131,189	1,214	0.9	14,212	12.2
Unemployment					
ILO unemployment	2,365	-125	-5.0	766	47.9
Claimant count	1,305	-268	-17.0	491	60.2

Source: LPC estimates based on ONS data: workforce jobs (DYDC) and employee jobs (BCAJ), quarterly; total employment (MGRZ), full-time employment (YCBE), part-time employment (YCBH), employees (MGRN), full-time employees (YCBK), part-time employees (YCBN), self-employment (MGRQ), full-time self-employment (YCBQ), part-time self-employment (YCBT), total weekly hours worked (YBUS), ILO unemployment for 16-64 year olds (LF2I) and Claimant count (BCJD), monthly, seasonally adjusted, UK, 2008-13.

Note: ONS workforce jobs data are for September 2013, change on September 2012 and change between June 2008 and September 2013.

- 1.36** Although, the level of GDP is still below that in the first quarter of 2008, total employment and total hours worked have now risen above their pre-recession peaks. As Figure 1.10 shows, this is in marked contrast to the two immediately previous recessions. It took about 7.5 years for employment to fully recover after the 1980s recession and around 8.5 years in the 1990s. It has taken just over four years this time.

Figure 1.10: Hours and Employment in Recession and Recovery, UK, 1979-2013

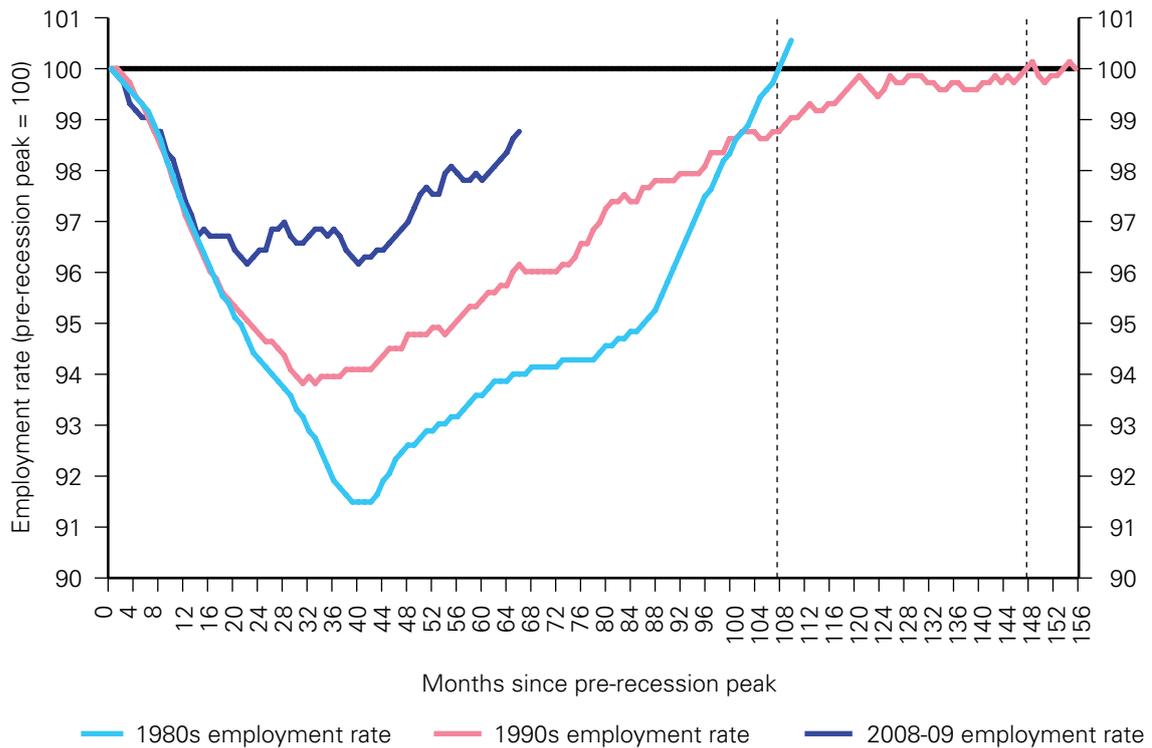


Source: LPC estimates based on ONS data: total employment (MGRZ), and total weekly hours (YBUS), monthly, seasonally adjusted, UK, 1979-2013.

Note: Month 0 is the pre-recession peak for each measure (December 1979 for the 1980s, July 1990 for the 1990s and May 2008 for the 2008-09 recession for employment; and August 1979 for the 1980s, December 1989 for the 1990s, and March 2008 for the 2008-09 recession for hours).

- 1.37** Further, total hours worked are also above their pre-recession level but they took even longer than employment to recover in those previous two recessions. It took nearly 9 years for the total hours worked to reach their pre-recession level after the 1980s recession, and over 14 years after the 1990s recession.
- 1.38** Despite this recovery in total employment, the working age (16-64) employment rate has not recovered as quickly. The potential supply of labour has become larger through natural population growth, increases in net migration and an increase in the number of older, post-State Pension Age, workers. As shown in Figure 1.11, the working age employment rate reached its peak in May 2008 at 73.0 per cent, and then fell throughout the recession and the start of the recovery to 70.2 per cent in March 2010, picked up but fell back again to 70.2 per cent in September 2011 before gradually recovering to 72.0 per cent in October 2013, still substantially below its pre-recession peak. But the employment rate for those aged 25-64 has returned to its pre-recession peak. It is the employment rate for those under the age of 25 that has yet to recover.

Figure 1.11: Working Age Employment Rate in Recession and Recovery, UK, 1979-2013



Source: LPC estimates based on ONS data: working age employment rate (LF24), monthly, seasonally adjusted, UK, 1979-2013.
 Note: Month 0 is the pre-recession peak (December 1979 for the 1980s, July 1990 for the 1990s, and May 2008 for the 2008-09 recession).

1.39 It would require a further 378,000 people of working age to be employed to reach an employment rate of 73.0 per cent. However, it should be noted that the fall in the working age employment rate has not been as great as in the two previous recessions and recovery looks to be happening more quickly. It took 9 years for the employment rate to return to its previous peak after the 1980s recession and it took over 12 years for it to do so after the onset of the less severe 1990s recession.

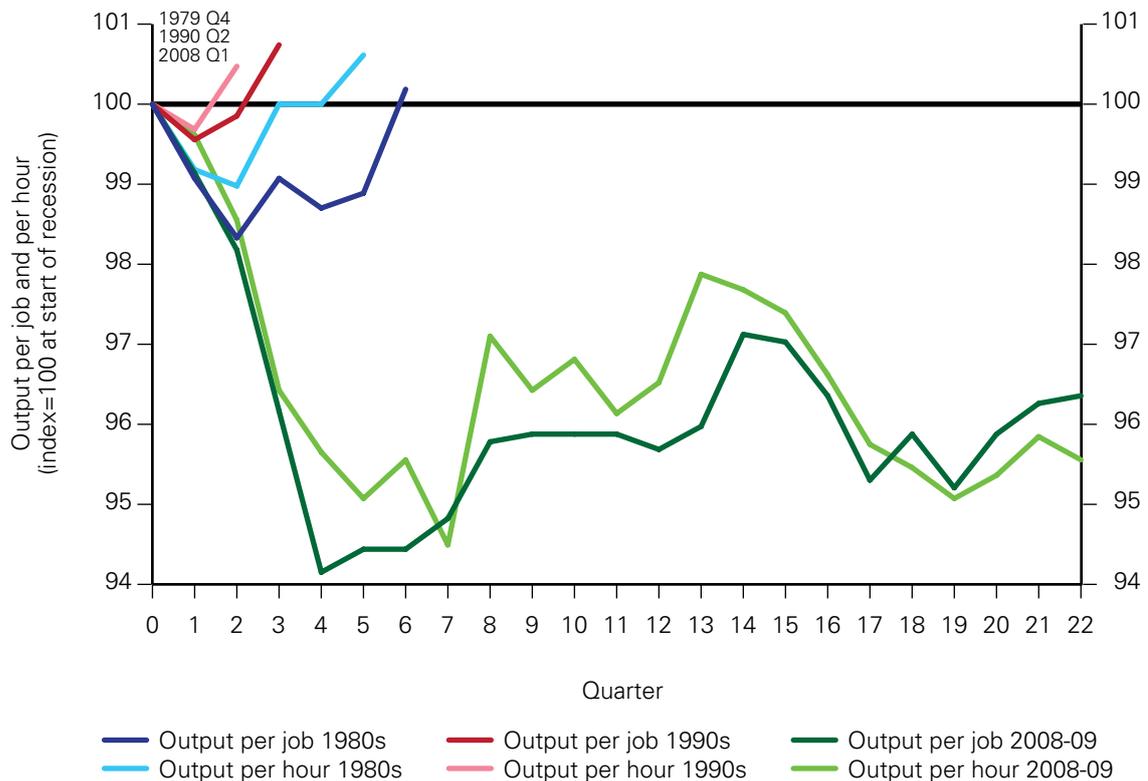
1.40 In summary, the labour market has again performed better than the forecasts predicted with stronger employment growth and much larger falls in unemployment. In light of what has happened regarding output, the employment performance looks remarkable. However, it does have important implications for productivity.

Productivity

1.41 The relationship between output and employment has been very different in this recession compared with previous ones. In the recessions of the 1980s and 1990s, employment and hours fell by more than the fall in output. GDP fell by 4.6 per cent in the 1980s and by 2.4 per cent in the milder recession of the 1990s. The falls in employment and hours were similar in both recessions and much greater than the fall in output. Employment fell by 6.5 per cent in the 1980s and 6.2 per cent in the 1990s, while the number of hours worked fell by 10.2 per cent in the 1980s and 9.1 per cent in the 1990s. The most recent recession was very different. The fall in output was 7.2 per cent but the fall in employment was only 2.5 per cent and the fall in hours was 4.7 per cent. Further, the recoveries in output were stronger after

the recessions of the 1980s and 1990s, while this time the recovery in employment and hours has been stronger. This has led, as shown in Figure 1.12, to a more sluggish productivity performance this time, measured as either output per job or output per hour. In the 1990s, productivity barely fell on either measure. Even in the 1980s, productivity had returned to its pre-recession levels within six quarters of the start of recession. This time, 22 quarters after the onset of recession, productivity is still around 4 per cent below what it was in the first quarter of 2008.

Figure 1.12: Productivity in Recession and Recovery, UK, 1979-2013



Source: ONS: output per job (LNNN) and output per hour (LZVB), for the whole economy, quarterly, seasonally adjusted, UK, Q4 1979-Q3 2013.
 Note: Quarter 0 is the pre-recession peak (1979 Q4 for the 1980s, 1990 Q2 for the 1990s, and 2008 Q1 for the 2008-09 recession).

1.42 The long-run quarterly average productivity growth in the UK, whether measured using output per worker or per hour, has been about 0.6 per cent.¹ If those trends had continued, productivity per worker and per hour would have been around 14 per cent higher in the third quarter of 2013 than in the first quarter of 2008. However, as we noted above, both measures are around 4 per cent below their pre-recession levels. That is, on these measures productivity is around 18-19 per cent below what it would have been had it followed previous trends.

¹ This quarterly average of 0.6 per cent is the average output per worker between the first quarter of 1962 and the first quarter of 2008; the average output per hour between the first quarter of 1973 and the first quarter of 2008; and the average output for both per worker and per hour between the first quarter of 1997 and the onset of recession.

Revised Forecasts for 2013 and 2014

- 1.43** We have noted above that forecasters have been revising their growth forecasts upwards since the spring of 2013. We also noted that these forecasts were likely to be underestimates after the significant revisions to the GDP data series by ONS in December 2013. We now estimate that GDP growth in 2013 will be around 1.9 per cent. Forecasts for growth in 2014 have also been revised up over the year. This improvement has led to substantial upward revision to the growth forecasts for employment and downward revisions to claimant count forecasts. We now know that workforce jobs grew by 0.8 per cent in 2013 and that jobs growth was even stronger in the third quarter, up 1.9 per cent on the year. We also know that the claimant count had already fallen to 1.25 million in December 2013 and has been falling continuously since October 2012.
- 1.44** As we noted above, inflation has turned out broadly similar to the forecasts made in January 2013 and thus there have been few revisions to the inflation forecasts for 2013 and 2014. However, average earnings growth, as measured by the monthly Average Weekly Earnings series, has been much weaker than had been forecast, though the earnings data from the 2013 Annual Survey of Hours and Earnings were similar to the forecasts for 2013 made in January 2013.

Table 1.4: Revised Economic Forecasts, UK, 2013-14

Per cent	Forecasts used in 2013 Report (January 2013)				Latest forecasts available (January 2014)			
	Median of independent forecasts (November 2012 and January 2013)		OBR forecasts (December 2012)		Median of independent forecasts (January 2014)		OBR forecasts (December 2013)	
	2013	2014	2013	2014	2013	2014	2013	2014
GDP growth (whole year)	1.0	1.8	1.2	2.0	1.4	2.4	1.4	2.4
Average earnings growth (whole year)	2.2	-	2.2	2.8	1.3	2.5	1.5	2.6
Inflation RPI (Q4)	2.7	2.6	2.5	2.6	2.7	3.0	2.8	3.0
Inflation CPI (Q4)	2.4	2.0	2.3	2.2	2.3	2.4	2.2	2.3
Employment growth (whole year)	0.5	-	0.3	0.3	1.2	1.0	1.2	1.1
Claimant count (millions, Q4)	1.62	1.61	1.69	1.7	1.30	1.30	1.31	1.26

Source: HM Treasury Panel of Independent Forecasts (2012, 2013a and 2014a) and OBR forecasts (2012 and 2013c) based on ONS data: GDP growth (ABMI), total employment measured by workforce jobs (DYDC) and claimant unemployment (BCJD), quarterly, AWE total pay (KAB9), monthly, seasonally adjusted; RPI (CZBH) and CPI (D7G7), quarterly, not seasonally adjusted, UK (GB for AWE); 2013-14.

Note: '-' denotes not available.

Conclusion

- 1.45** Since we met to discuss and agree our recommendations in January 2013, ONS has again revised the data for economic output. These revisions have shown that though the recession was deeper than had previously been thought, growth in recent quarters had been revised upwards, revealing a slightly stronger recovery. However, in the third quarter of 2013, GDP was still 2 per cent below what it was in the first quarter of 2008.
- 1.46** After the weak growth from the middle of 2011 to the end of 2012, the economy grew by around 1.9 per cent in 2013. The strong jobs performance that we observed in 2011 and 2012 continued into 2013. Total employment and total hours worked recovered and are now well above their pre-recession peaks. However, the increase in population has meant that the working age employment rate has not yet recovered to its pre-recession level. It should also be noted that although there was strong growth in the number of employees, particularly full-time and permanent over the last year, the numbers are still below their May 2008 levels.
- 1.47** This strong labour market performance combined with the weakness in output has led to a very sluggish productivity performance. Whether measured by output per hour or output per worker, the level of productivity is around 4 per cent below its level in the first quarter of 2008. An important feature of the period since 2008 has been the subdued nature of wage growth, with real wage falls for much of the period.
- 1.48** In our 2013 Report, we recommended that the adult rate of the minimum wage be increased by 1.9 per cent to £6.19 an hour. We judged that this would likely be close to maintaining the relative incomes of the lowest paid but recognised that it would likely lead to a reduction in their real incomes. The rate of inflation was forecast to be above the increase in the adult rate and this is what happened. However, the out-turn for average earnings has been more mixed. The increase in average earnings measured by AWE (around 1 per cent) was below the increase in the NMW but the annual earnings data from ASHE suggested much stronger growth, at around 2.2-2.9 per cent, depending on the measure of earnings used. Median pay settlements by award were around 2.0-2.5 per cent but when the median was weighted by employee numbers it was lower at about 1.5 per cent. If earnings growth was as suggested by AWE, then the bite of the NMW (its value relative to the median or mean) would have increased. If, on the other hand, the picture shown by ASHE and pay settlements is a more accurate description of the labour market, then the bite of the NMW will have fallen. In the past, we have tended to give greater weight to the findings from ASHE but we note that these data are only available annually. However, using our most common measures of price inflation, the real value of the NMW has fallen. Thus, our recommendation for the adult rate was approximately in line with the growth in many measures of wages but was below the increase in prices. We now consider the impact of the adult rate of the National Minimum Wage in Chapter 2.

Chapter 2

The Impact of the National Minimum Wage

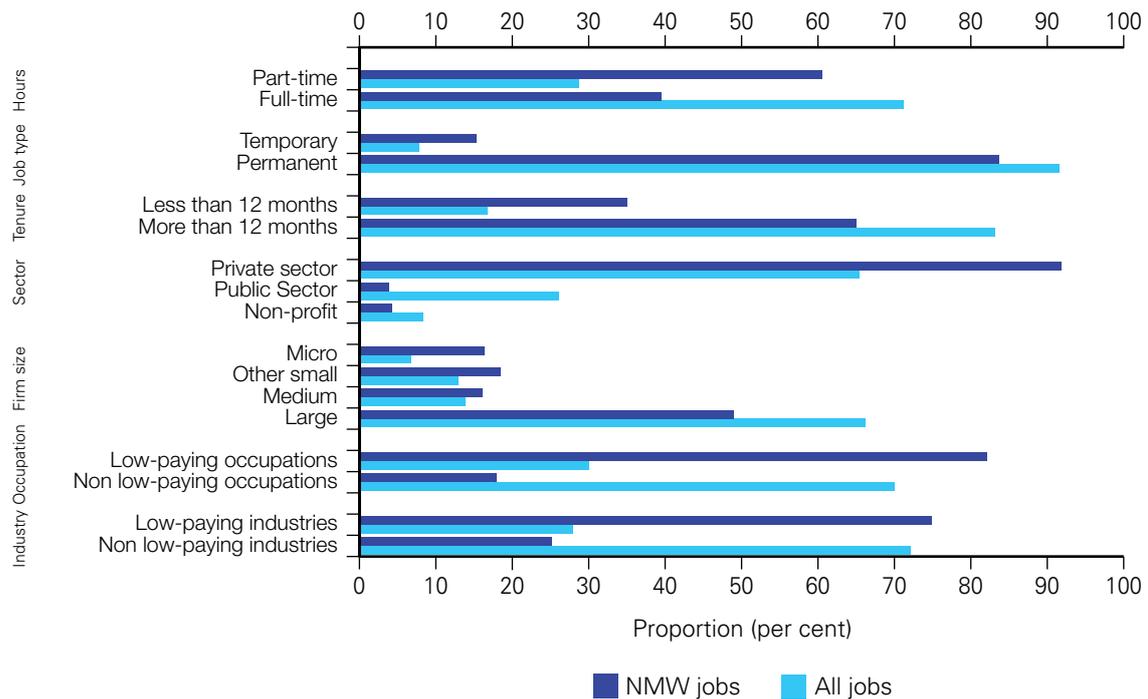
Introduction

- 2.1** The economic context to the most recent upratings to the National Minimum Wage (NMW) was considered in Chapter 1. We now examine the impact of the minimum wage so far. Since the minimum wage was introduced, we have monitored and assessed its impact in a series of reports. In these reports, we have presented the evidence collected by undertaking in-depth analysis; commissioning research; consulting our stakeholders; and visiting employers and workers around the UK. We have again used information gathered from these sources to inform our deliberations and make our recommendations for the rates of the NMW from October 2014 onwards. We review and summarise that evidence in this and subsequent chapters.
- 2.2** As we noted in Chapter 1, it is still too early to assess the impact of the minimum wage increases that took effect on 1 October 2013. However, we now have enough information to undertake an initial evaluation of the changes to the NMW that took effect a year earlier, on 1 October 2012. The adult rate of the NMW was then increased by 1.8 per cent from £6.08 an hour to £6.19 an hour. We recommended that the two youth rates were frozen and, indeed, they remained at £4.98 an hour for those aged 18-20 on the Youth Development Rate and £3.68 an hour for those on the 16-17 Year Old Rate. We also recommended that the Apprentice Rate should increase from £2.60 to £2.65 an hour. This chapter focuses on the impact of the adult rate of the NMW. The following chapter considers the impact of the youth rates and the Apprentice Rate.
- 2.3** In this chapter, we start by looking at minimum wage jobs, investigating the types of jobs and the people that are employed to undertake them. We then investigate the impact of the adult rate of the NMW on individual earnings; pay settlements; and pay structures. The impact on employment and hours is then assessed before concluding the chapter by looking at the impact on profits, prices, productivity and business start-ups and failures. As well as examining the consequences of the NMW in aggregate, we explore the impact on those firms and groups of workers that are most likely to be affected by the minimum wage. We start by looking at those jobs and workers.

National Minimum Wage Jobs

- 2.4** The Office for National Statistics (ONS) regards the Annual Survey of Hours and Earnings (ASHE) as the best source of information on individual earnings in the UK. We thus use this as our main source for analysis. ASHE is an annual survey of employee jobs based on a 1 per cent sample of all employees on HM Revenue & Customs' Pay-As-You-Earn register. The earnings and hours information collected in the ASHE survey is reported by employers from their records and covers the individual's gender, age, industry, occupation, home postcode, work postcode and size of firm. Unfortunately, ASHE does not contain information on ethnicity, qualifications or disability. For analysis of these, we use the Labour Force Survey (LFS), which is a survey of households. LFS data on earnings are regarded as less reliable than ASHE data because ASHE is based on employer records, whereas the LFS is self-reported and based on smaller sample sizes. More information on ASHE and the LFS is given in Appendix 4.
- 2.5** The latest available ASHE data were collected in April 2013, when the adult minimum wage was £6.19 an hour (1.8 per cent higher than in April 2012). We use hourly pay excluding overtime as our basic measure of earnings, as that is the wage measure closest to the legal definition of the minimum wage.
- 2.6** In this section we have defined a minimum wage job as one that, in April 2013, paid up to five pence above the minimum wage. That is any job that: paid less than £6.24 an hour held by an adult aged 21 and over; paid less than £5.03 an hour held by a young person aged 18-20; and that paid less than £3.73 an hour held by a 16-17 year old. Using this definition, we estimate that around 5.1 per cent of all jobs were minimum wage jobs, totalling 1.3 million jobs. Figure 2.1 shows that a higher proportion of part-time jobs; temporary jobs; jobs held for less than a year; jobs in smaller firms; and in the low-paying occupations and industries were minimum wage jobs.
- 2.7** Despite accounting for just under 30 per cent of all jobs, part-time workers held over 60 per cent of minimum wage jobs. Around 11 per cent of part-time jobs were minimum wage jobs compared with 3 per cent of full-time jobs. Fewer than 8 per cent of all jobs were temporary, but they constituted 15 per cent of all minimum wage jobs. About 10 per cent of temporary jobs were minimum wage jobs, twice as high as that of permanent jobs. Compared with 4 per cent of jobs held for a year or over, 11 per cent of jobs held for less than a year were minimum wage jobs, making up 35 per cent of all minimum wage jobs, but only 17 per cent of all jobs. The private sector accounted for around 65 per cent of all employee jobs (with 26 per cent in the public sector and 8 per cent in the not-for-profit sector), but more than 90 per cent of minimum wage jobs were in that sector. Minimum wage jobs accounted for around 7 per cent of all jobs in the private sector, but fewer than 1 per cent of all jobs in the public sector. Non-profit organisations accounted for 8 per cent of all jobs and 4 per cent of minimum wage jobs. Around 3 per cent of jobs in this sector were paid at or below the minimum wage.

Figure 2.1: Proportion of All Jobs and Minimum Wage Jobs, by Hours, Job Type, Tenure, Sector, Firm Size, Industry and Occupation, UK, 2013



Source: Low Pay Commission (LPC) estimates based on ASHE, 2010 methodology, low-pay weights, including those not on adult rates of pay, UK, April 2013.

Notes:

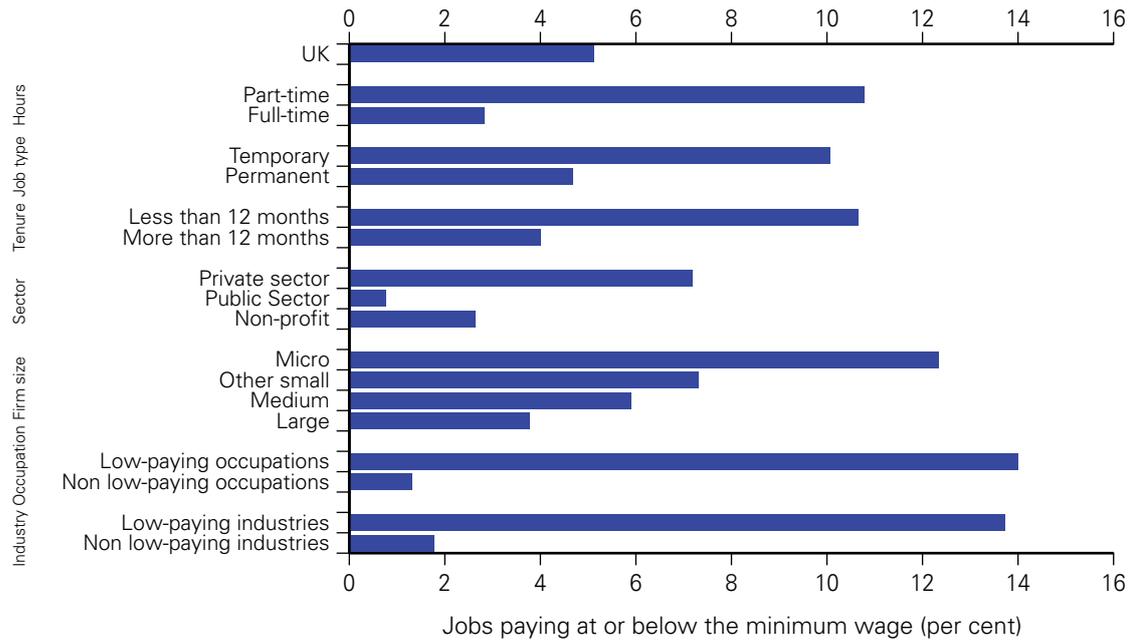
a. Minimum wage jobs defined as adults (aged 21 and over) earning less than £6.24, youths (aged 18-20) earning less than £5.03, and 16-17 year olds earning less than £3.73 in April 2013.

b. About 0.1 per cent of all jobs had unknown firm size and 0.7 per cent of all jobs had unknown job type.

2.8 Figure 2.1 also shows that smaller firms were more likely to pay their employees at or below the minimum wage. Micro (1-9 employees) and other small firms (10-49 employees) together only accounted for around 19 per cent of all employee jobs, but they made up over 35 per cent of minimum wage jobs. There is a clear relationship between the proportion of minimum wage jobs and size of firm – the proportion of minimum wage jobs decreases as the firm size increases. As shown in Figure 2.2, minimum wage jobs accounted for just under 4 per cent of jobs in large firms (with 250 or more employees); about 6 per cent of jobs in medium-sized firms (those with 50-249 employees); 8 per cent of jobs in other small firms; but 13 per cent of jobs in micro firms.

2.9 As in previous reports, we define low-paying sectors as those with a large number or high proportion of minimum wage workers. We would prefer our earnings and employment analyses to be based on occupational definitions as they would exclude high-paid managerial and professional jobs in a given sector. However, policymakers and stakeholder groups tend to be industry-focussed. Furthermore, the main ONS data series that are released monthly or quarterly are only disaggregated by industry. We therefore tend to make greater use of our low-paying sector definitions based on industries. Full definitions of each low-paying occupation and industry can be found in Appendix 4.

Figure 2.2: Characteristics of Minimum Wage Jobs, UK, 2013



Source: Low Pay Commission (LPC) estimates based on ASHE, 2010 methodology, low-pay weights, including those not on adult rates of pay, UK, April 2013.

Note: Minimum wage jobs defined as adults (aged 21 and over) earning less than £6.24, youths (aged 18-20) earning less than £5.03, and 16-17 year olds earning less than £3.73 in April 2013.

- 2.10** Unsurprisingly, jobs are more likely to be paid at or below the minimum wage in low-paying industries and occupations, as shown in Figure 2.2. Table 2.1 shows that the low-paying industries, as defined in Appendix 4, contained 74.9 per cent of minimum wage jobs (997,000), compared with 25.1 per cent in the non low-paying industries (335,000).
- 2.11** When broken down by sector, the low-paying industries with the most minimum wage jobs were hospitality and retail, which between them accounted for about 45 per cent of minimum wage jobs. Social care, cleaning, and employment agencies each accounted for between 6 and 7 per cent of minimum wage jobs. A further 10 per cent of minimum wage jobs were in the other low-paying industries. Just under a third of all jobs in hairdressing and cleaning, and about a quarter of jobs in hospitality were minimum wage jobs. Agriculture and textiles accounted for the smallest proportions of minimum wage jobs, fewer than 1 per cent in each sector.
- 2.12** Table 2.1 also shows that the LPC-defined low-paying occupations covered over four-fifths of all minimum wage jobs. Again we found minimum wage jobs were concentrated in hospitality, retail and cleaning. Together these three occupational sectors made up about 54 per cent of minimum wage jobs in the UK. The other LPC-defined low-paying occupations accounted for about 28 per cent of all minimum wage jobs. Around 238,000 (or 18 per cent) of minimum wage jobs were not classified in one of our low-paying occupational sectors.

Table 2.1: Number and Proportion of Minimum Wage Jobs, by Low-paying Industry and Occupation, UK, 2013

Industry/occupation	SIC 2007			SOC 2010		
	Number (000s)	Proportion of total NMW jobs (%)	Proportion of jobs in sector (%)	Number (000s)	Proportion of total NMW jobs (%)	Proportion of jobs in sector (%)
All	1,332	100.0	5.1	1,332	100.0	5.1
Non low-paying sectors	335	25.1	1.8	239	17.9	1.3
All low-paying sectors	997	74.9	13.7	1,093	82.1	14.0
Hospitality	331	24.9	24.9	289	21.7	25.2
Retail	278	20.9	9.7	249	18.7	11.8
Cleaning	88	6.6	30.6	183	13.7	22.4
Social care	87	6.6	8.8	66	5.0	8.8
Employment agencies	75	5.7	13.5	-	-	-
Leisure, travel and sport	45	3.4	10.8	26	1.9	10.3
Hairdressing	26	2.0	29.7	26	2.0	29.3
Food processing	25	1.9	6.8	48	3.6	14.6
Childcare	24	1.8	14.9	44	3.3	12.7
Agriculture	9	0.7	7.8	11	0.8	6.8
Textiles and clothing	7	0.6	11.4	7	0.5	12.2
Office work	-	-	-	33	2.4	7.3
Non-food processing	-	-	-	25	1.9	6.5
Storage	-	-	-	51	3.8	10.1
Transport	-	-	-	38	2.8	8.7

Source: LPC estimates based on ASHE, 2010 methodology, low-pay weights, including those not on adult rates of pay, UK, April 2013.

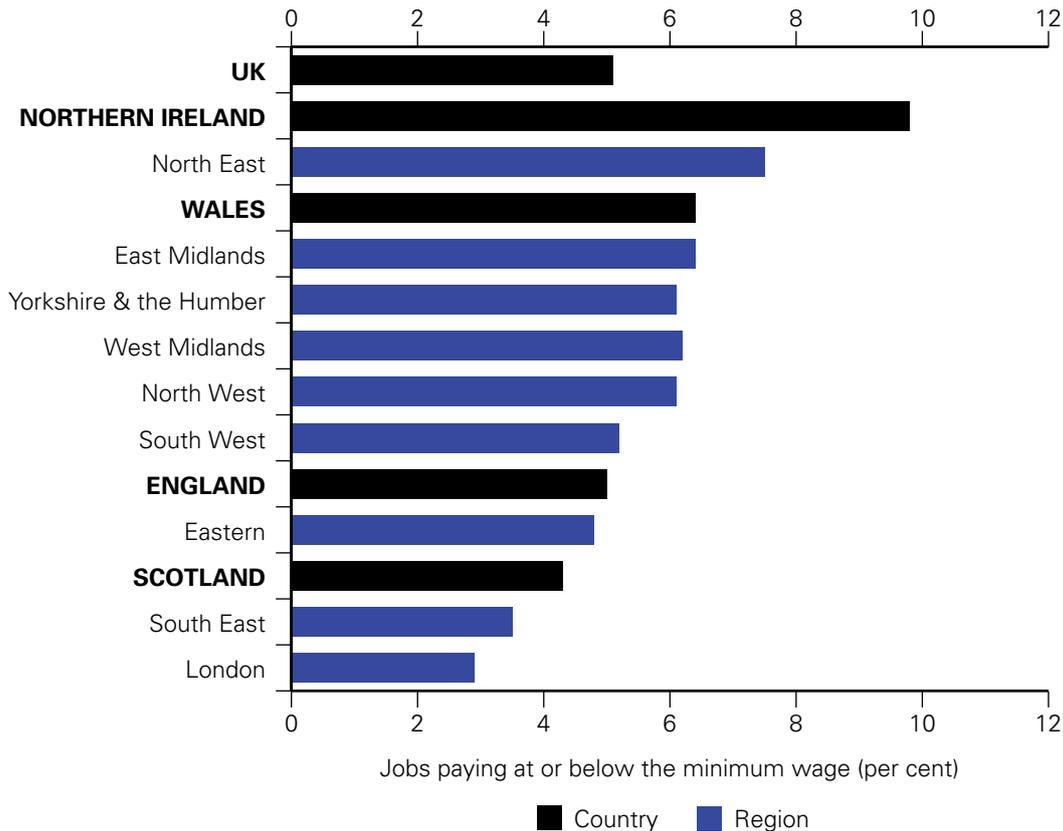
Notes:

a. Minimum wage jobs defined as adults (aged 21 and over) earning less than £6.24, youths (aged 18-20) earning less than £5.03, and 16-17 year olds earning less than £3.73 in April 2013.

b. '-' denotes not applicable.

2.13 When looking at the distribution of minimum wage jobs geographically, Figure 2.3 shows the variation in the distribution of minimum wage jobs across the UK, while Table 2.2 shows that significant variation also occurs within countries and regions.

Figure 2.3: Minimum Wage Jobs, by Country and Region, UK, 2013



Source: LPC estimates based on ASHE 2010 methodology, low-pay weights, including those not on adult rates of pay, UK, April 2013.
 Notes:
 a. Minimum wage jobs defined as adults (aged 21 and over) earning less than £6.24, youths (aged 18-20) earning less than £5.03, and 16-17 year olds earning less than £3.73 in April 2013.
 b. The geographic areas are work-based.

- 2.14** Minimum wage jobs accounted for 9.8 per cent of all jobs in Northern Ireland, the highest proportion across the countries of the UK, followed by Wales (6.4 per cent). Scotland was the country with the lowest proportion of minimum wage jobs (4.3 per cent), with around 5.0 per cent in England.
- 2.15** However, England accounted for 82.0 per cent of all minimum wage jobs in the UK, and Scotland 7.5 per cent. These were lower than the proportions of all jobs accounted for by England and Scotland (84.0 and 8.9 per cent respectively). The remaining minimum wage jobs were split between Wales (5.5 per cent) and Northern Ireland (5.0 per cent). The latter two countries accounted for smaller proportions of total jobs (4.4 per cent and 2.6 per cent respectively) than minimum wage jobs.
- 2.16** There is significant variation between the English regions, where the proportion of jobs paid at or below the minimum wage ranged from 2.9 per cent in London to 7.5 per cent in the North East. However, because many more people work in London than in the North East, there were more minimum wage jobs there (about 111,000) than there were in the North East (76,000) in April 2013. There were slightly more minimum wage jobs in the North East than in Wales (73,000) or Northern Ireland (67,000). The North West is the English region with the highest number and share of minimum wage jobs (169,000 or 12.7 per cent), followed by the West Midlands (138,000 or 10.4 per cent) and Yorkshire and the Humber

(129,000 or 9.7 per cent). Although London has 14.7 per cent of all employee jobs (3.8 million), more than anywhere else, it only accounted for 8.3 per cent of minimum wage jobs. The broader south eastern part of England including the South East, Eastern and London together accounted for more than a quarter of minimum wage jobs (around 350,000 or 26.3 per cent).

2.17 Table 2.2 shows that the proportion of jobs that were minimum wage jobs also varied a lot within regions. For example, 5.3 per cent of all jobs in the South West were minimum wage jobs, but this ranged from 2.6 per cent in Cotswold to 14.4 per cent in West Somerset. London also had a wide spread, varying from 0.8 per cent in the City of London to 7.3 per cent in Waltham Forest. The biggest variation, however, was in the East Midlands, where the proportion of jobs that were minimum wage jobs ranged from 1.0 per cent in the small county of Rutland to 18.2 per cent of jobs in Bolsover, Derbyshire. At the other extreme, Scotland had the smallest variation ranging from 1.9 per cent in Aberdeen City to 7.7 per cent in Angus.

Table 2.2: Minimum Wage Jobs, by Country and English Region, Highest and Lowest Local Authority within Each Area, GB, 2013

Country/Region	Percentage of jobs that were NMW jobs(%)	Highest (%)	Lowest (%)
England	5.0	Bolsover (18.2)	Test Valley (0.7)
Scotland	4.3	Angus (7.7)	Aberdeen City (1.9)
Wales	6.4	Carmarthenshire (10.3)	Torfaen (3.0)
North East	7.5	Hartlepool (13.2)	Sunderland (4.8)
East Midlands	6.4	Bolsover (18.2)	Rutland (1.0)
West Midlands	6.2	Cannock Chase (10.1)	Wyre Forest (2.9)
Yorkshire & Humber	6.1	Hambleton (11.0)	Calderdale (3.7)
North West	6.1	West Lancashire (17.9)	Barrow-in-Furness (3.0)
South West	5.2	West Somerset (14.4)	Cotswold (2.6)
Eastern	4.8	Castle Point (10.0)	Cambridge (2.1)
South East	3.5	Reigate and Banstead (8.8)	Test Valley (0.7)
London	2.9	Waltham Forest (7.3)	City of London (0.8)

Source: LPC estimates based on ASHE 2010 methodology, low-pay weights, including those not on adult rates of pay, UK, April 2013.

Notes:

a. Minimum wage jobs defined as adults (aged 21 and over) earning less than £6.24, youths (aged 18-20) earning less than £5.03, and 16-17 year olds earning less than £3.73 in April 2013.

b. The geographic areas are work-based. No regional breakdown is available for Northern Ireland.

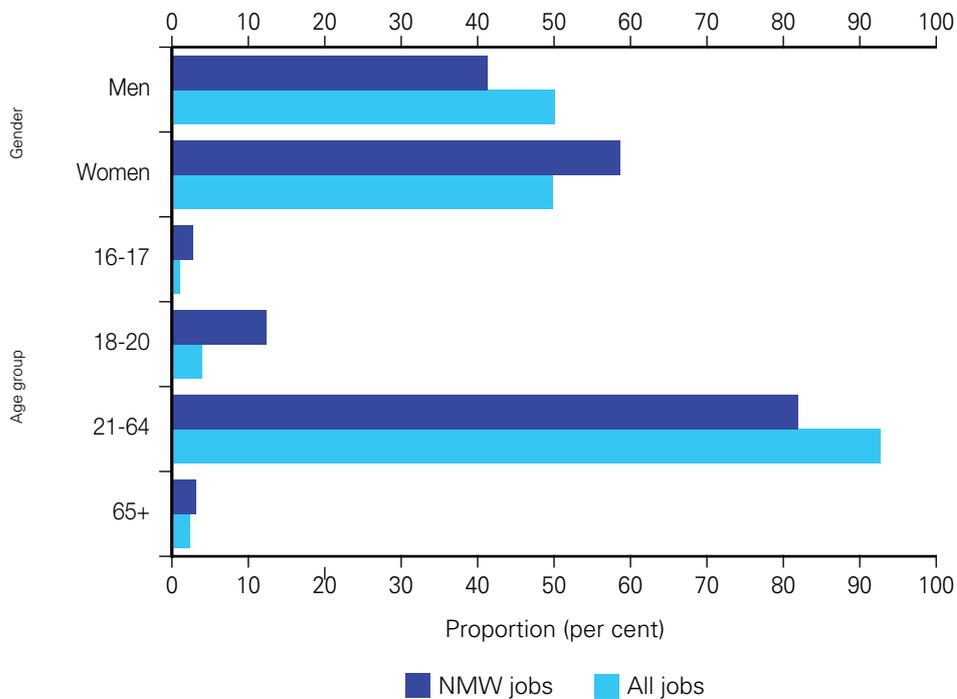
National Minimum Wage Workers

2.18 In the previous section we looked at characteristics and locations of minimum wage jobs. Now, we move on to explore the characteristics of those people who work in these jobs. We focus on those groups that contain high proportions of minimum wage workers, including: women, young workers, older workers, disabled people, ethnic minorities, migrant

workers and those with no qualifications. Earnings data from ASHE are only available for age and gender, so we need to use another data source for information on the other groups. The LFS contains such data but it should be noted that LFS data on earnings are not regarded as having the same reliability as those derived from ASHE: ASHE is based on employer records whereas the LFS is self-reported and based on smaller sample sizes.

2.19 We start this section with an overview looking at the distribution of minimum wage jobs by gender and age. Figure 2.4 shows women, younger people aged 16-20 and older workers aged 65 and over are more likely to be in a minimum wage job compared with men and those aged 21-64. Making up just a half of all employee jobs, women accounted for 59 per cent of total minimum wage jobs. When broken down by age group, we can see those aged under 21 only held around 5 per cent of all jobs, but they made up 15 per cent of minimum wage jobs. Older workers aged 65 and over accounted for around 2 per cent of all employee jobs but 3 per cent of all minimum wage jobs.

Figure 2.4: Proportion of All Jobs and Minimum Wage Jobs, by Gender and Age, UK, 2013

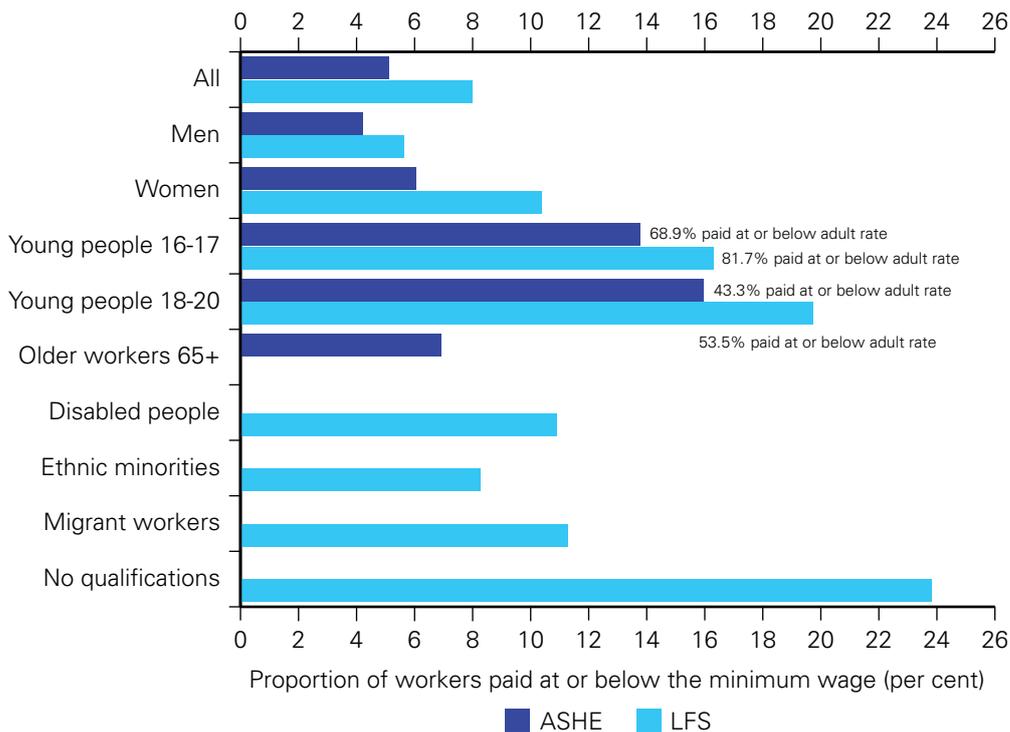


Source: LPC estimates based on ASHE 2010 methodology, low-pay weights, including those not on adult rates of pay, UK, April 2013. Notes: Minimum wage jobs defined as adults (aged 21 and over) earning less than £6.24, youths (aged 18-20) earning less than £5.03, and 16-17 year olds earning less than £3.73 in April 2013.

2.20 Figure 2.5 shows those groups of workers that had a higher proportion of minimum wage jobs compared with the overall working population. LFS estimates of minimum wage jobs tend to be higher than those from ASHE: around 8 per cent of workers are recorded by the LFS as being in minimum wage jobs, compared with 5 per cent in ASHE. Young people and those with no qualifications were more likely than other groups to have minimum wage jobs in the second quarter of 2013. According to ASHE, around 69 per cent of jobs held by those aged 16-17 paid at or below the adult rate of the minimum wage. This figure was even higher using the LFS (about 82 per cent). The proportion of young people aged 18-20 in jobs that paid at or below the adult rate of the minimum wage was also high, at around 43 per cent

according to ASHE and up to 54 per cent using the LFS. Even if we restrict our analysis to the age-related minimum wage rates, young people still had higher likelihoods of being in those age-related minimum wage jobs than those aged 21 and over. According to ASHE, around 16 per cent of 18-20 year olds and 14 per cent of 16-17 year olds were in minimum wage jobs. Using LFS, the proportions were a bit higher (nearly 20 per cent and just over 16 per cent respectively). The coverage of older workers aged 65 and over was much lower than for young people, although with around 7 per cent in minimum wage jobs estimated by ASHE, was still higher than the national average.

Figure 2.5: Minimum Wage Workers, UK, 2013



Source: LPC estimates based on ASHE 2010 methodology, low-pay weights, including those not on adult rates of pay, UK, April 2013 and LFS Microdata, income weights, quarterly, not seasonally adjusted, UK, Q2 2013.
 Note: Minimum wage jobs defined as adults (aged 21 and over) earning less than £6.24, youths (aged 18-20) earning less than £5.03, and 16-17 year olds earning less than £3.73 in April 2013.

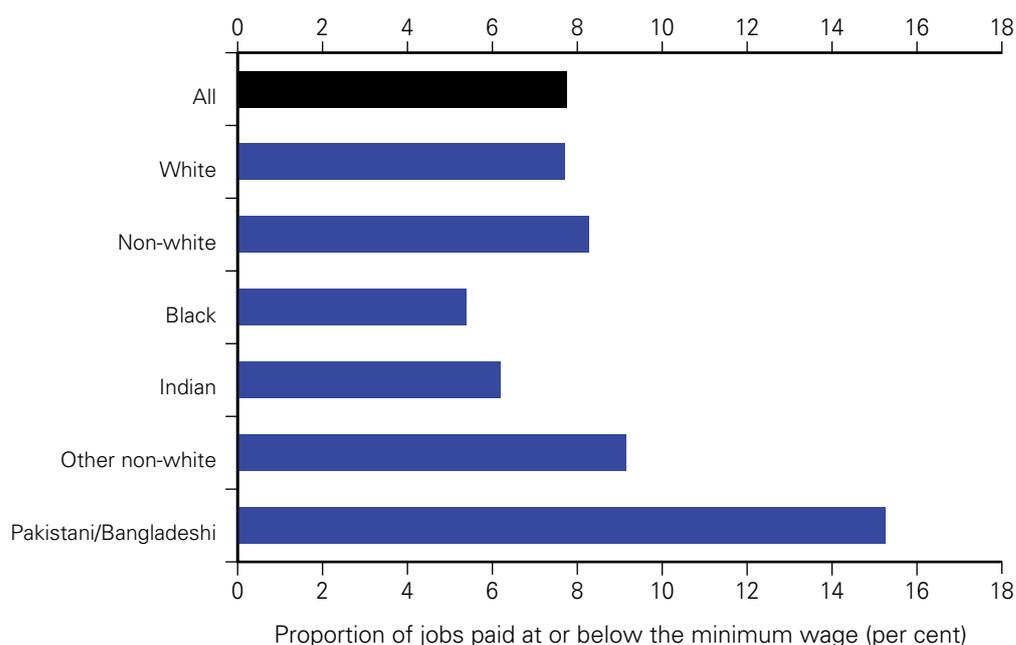
2.21 These vulnerable groups of workers tend to have a higher proportion of minimum wage jobs compared with their respective comparator. Not surprisingly, there is a large difference in coverage of minimum wage jobs between people with no qualifications and those with qualifications: according to the LFS, the proportion of minimum wage jobs among people with no qualifications was 23.8 per cent compared with 7.1 per cent of such jobs held by those with qualifications. People with no qualifications held 15.2 per cent of minimum wage jobs, although they only accounted for just 5.1 per cent of all jobs. Accounting for 8.1 per cent of total employee jobs, disabled workers held 10.2 per cent of all minimum wage jobs. Around 10.9 per cent of jobs held by disabled workers were minimum wage jobs compared with 7.8 per cent for non-disabled workers.

2.22 The proportion of all minimum wage jobs held by ethnic minorities stood at 10.8 per cent, slightly higher than the proportion of all jobs held by the same group (10.1 per cent). Minimum wage jobs accounted for 8.3 per cent of jobs held by ethnic minorities as opposed

to 7.7 per cent for White workers. Around 11.3 per cent of migrant workers' jobs were paid at or below the minimum wage, compared with 7.4 per cent of jobs for UK-born workers. The proportion of minimum wage jobs held by migrant workers (21.4 per cent) was also disproportionately higher than their share of the workforce (15.2 per cent).

2.23 Presenting ethnic minority and migrant worker groups as an aggregate hides large variation among them. Figure 2.6 shows that the proportions of Black workers (5.4 per cent) and Indian workers (6.2 per cent) in minimum wage jobs were lower than that of White workers (7.7 per cent). In contrast, 15.3 per cent of Pakistani/Bangladeshi workers earned the minimum wage, the highest proportion among all ethnic groups.

Figure 2.6: Minimum Wage Workers, by Ethnicity, UK, 2013



Source: LPC estimates based on ASHE 2010 methodology, low-pay weights, including those not on adult rates of pay, UK, April 2013 and LFS Microdata, income weights, quarterly, not seasonally adjusted, UK, Q2 2013.

Note: Minimum wage jobs defined as adults (aged 21 and over) earning less than £6.24, youths (aged 18-20) earning less than £5.03, and 16-17 year olds earning less than £3.73 in April 2013.

2.24 We have shown that a higher proportion of minimum wage jobs are part-time, temporary, in small firms, in the private sector and in the low-paying occupations and industries. Further, this section has shown that a higher proportion of women, young workers, older workers, ethnic minorities, migrant workers, disabled people and those with no qualifications are minimum wage workers. We now assess the impact of the minimum wage at the aggregate level, and on these types of jobs and groups of workers in particular.

Impact on Earnings and Pay

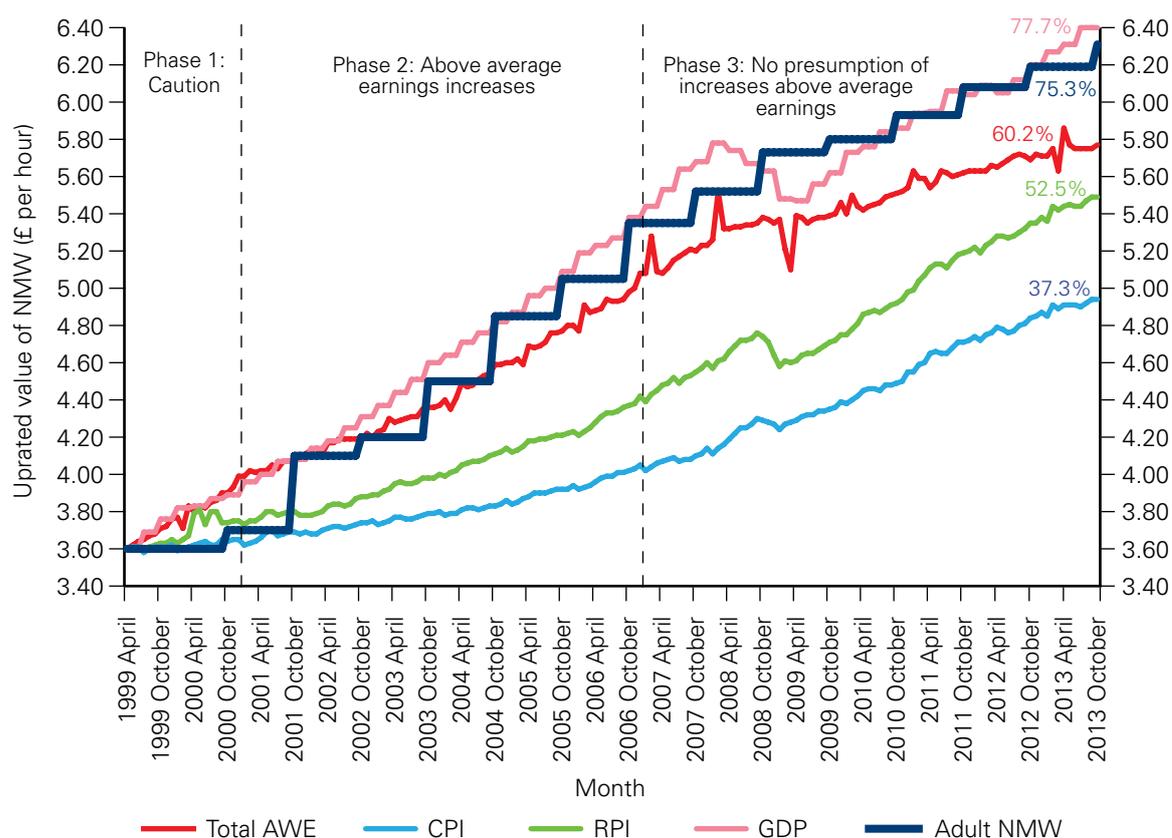
2.25 In this next section, we investigate the impact of the minimum wage on earnings; pay settlements; and pay structures. Although we consider the impact of the NMW since it was introduced in April 1999, we focus much of our analysis on the most recent changes. We mainly use official data sources such as the Annual Survey of Hours and Earnings (ASHE) and the Labour Force Survey (LFS), but we also consider information from various pay research organisations as well as findings from our commissioned research and that of other organisations.

National Minimum Wage Relative to Prices and Earnings

2.26 The adult rate of the NMW has increased by over 75 per cent since it was introduced, from £3.60 an hour in April 1999 to £6.31 an hour in October 2013. Figure 2.6 shows the increases that we recommended and were accepted by the Government, and also how the NMW would have changed, if instead of increasing in line with our recommendations, it had increased in line with average earnings, price inflation or the general growth in the economy. If the NMW had increased in line with average earnings growth, it would have risen by just over 60 per cent and have been £5.77 an hour in October 2013, 54 pence lower than its actual level. If the NMW had tracked price increases, it would have increased by 52.5 per cent to £5.49 an hour using the Retail Price Index (RPI), or by just 37 per cent to £4.94 an hour, using the Consumer Price Index (CPI). That is, it would have been 82 pence an hour lower using the RPI or £1.37 an hour lower using the CPI than the actual increase in the NMW. If on the other hand, the NMW had risen in line with nominal Gross Domestic Product (GDP), then it would have increased by nearly 78 per cent to £6.40 an hour, 9 pence above its actual level.

2.27 There have been three distinct phases in the path followed by the adult rate of the minimum wage. From 1999-2001 the introductory minimum wage was set at what might, in hindsight, be considered a cautious level and was then raised in line with price inflation, while the Commission awaited the outcome of research investigating the impact on employment and wages. Those early research studies suggested that the minimum wage had raised the wages of many workers but that it had not greatly affected differentials nor led to an adverse impact on employment or hours worked. Between 2001 and 2007, the second phase, the Commission recommended a series of increases that were above average earnings growth. The end of this phase coincided with more uncertain economic circumstances and the onset of recession. Since then, in the third phase, increases in the adult rate of the NMW have broadly kept pace with average earnings growth.

Figure 2.7: Increases in the Real and Relative Value of the Adult National Minimum Wage, UK, 1999-2013

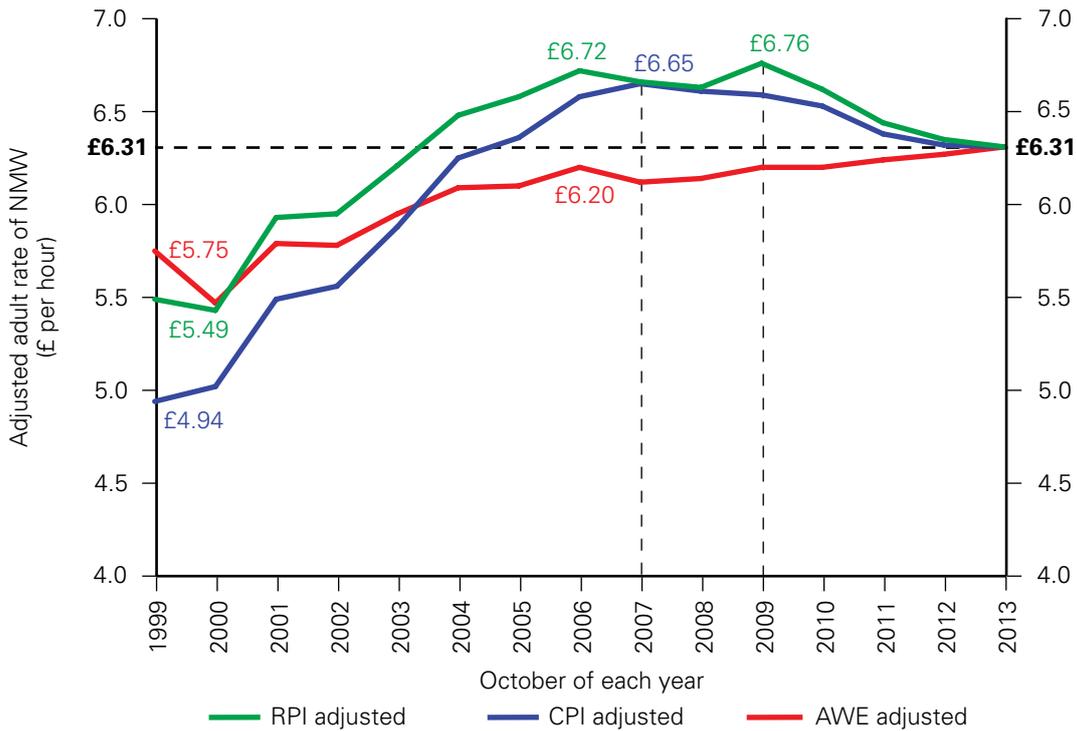


Source: LPC estimates based on ONS data: AEI including bonuses (LNMQ), 1999, AWE total pay (KAB9), 2000-13, CPI (D7BT), 1999-2013, and RPI (CHAW), 1999-2013, monthly; and nominal GDP (YBHA), 1999-2013, quarterly, seasonally adjusted (AWE, AEI and GDP only), UK (GB for AWE and AEI).

Note: The AWE series began in January 2000 and the AEI series ended in July 2010. Our earnings series is estimated using AEI (including bonuses) from April 1999-January 2000 and AWE (total pay) from January 2000-October 2013.

2.28 These distinct phases can also clearly be seen in Figure 2.8 which presents the level of the minimum wage in real and relative terms since its introduction. It shows that the adult rate of the NMW was at its highest relative to average earnings growth in October 2013, with sharp increases between 1999 and 2004, and increases broadly in line with average earnings since 2006. When taking into account RPI inflation, the adult minimum wage of £6.31 an hour in October 2013 was lower in real terms than at any point since 2003. The RPI-adjusted adult rate had increased between 2000 and 2006 before stabilising and peaking in 2009, when it was worth £6.76 an hour at October 2013 prices. It then fell sharply between 2010 and 2012. Adjusting for CPI shows a similar trend, with the adult rate in 2013 the lowest in real terms since 2004, although significantly higher than the CPI adjusted rate in 1999 of £4.94 an hour. By October 2013, the real CPI value of the NMW was 5.0 per cent lower than at its peak in 2007 and the NMW was 6.7 per cent below its real RPI value in 2009. Despite these large falls in the real value of the NMW, the falls in the real value of median wages have been even greater, as shown in Figure 1.9 in the previous chapter, with the real RPI value of median hourly earnings falling by 10.3 per cent and the real CPI value falling by 7.5 per cent since 2009.

Figure 2.8: Real and Relative Value of the Adult National Minimum Wage, UK, 1999-2013

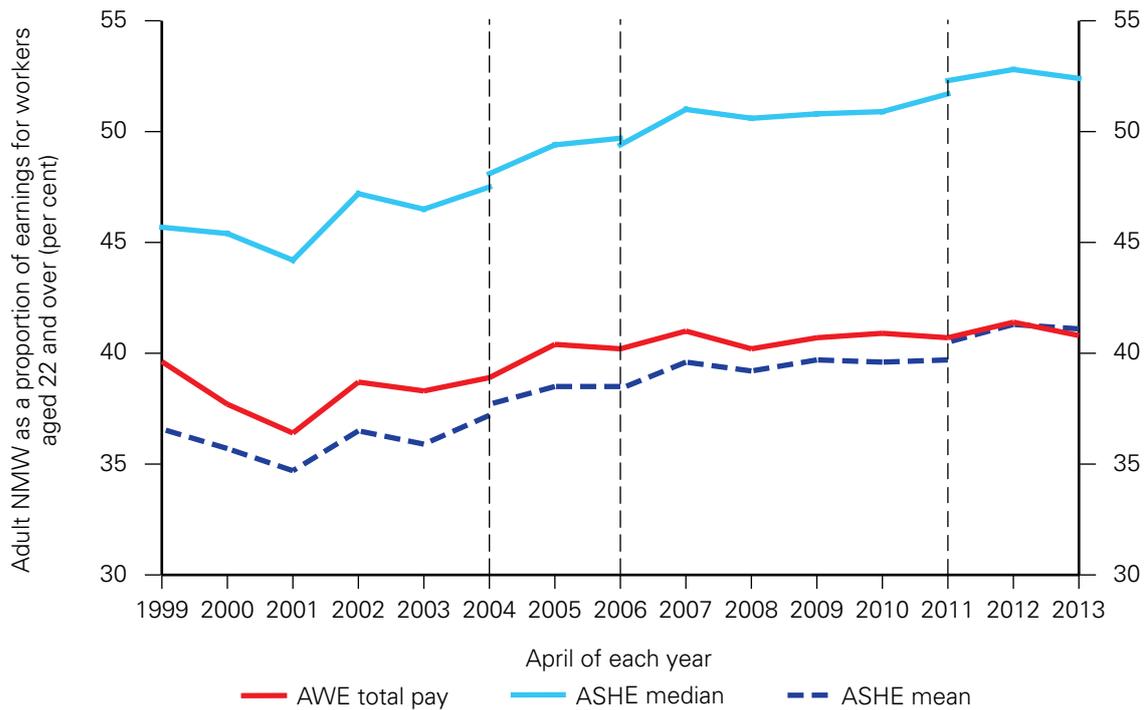


Source: LPC estimates based on ONS data: AEI including bonuses (LNMQ), 1999, AWE total pay (KAB9), 2000-13, CPI (D7BT), 1999-2013, and RPI (CHAW), 1999-2013, monthly; and nominal GDP (YBHA), 1999-2013, quarterly, seasonally adjusted (AWE, AEI and GDP only), UK (GB for AWE and AEI).

Note: The AWE series began in January 2000 and the AEI series ended in July 2010. Our earnings series is estimated using AEI (including bonuses) from April 1999-January 2000 and AWE (total pay) from January 2000-October 2013.

2.29 In consequence, Figure 2.9 shows that the bite of the minimum wage (its value relative to median or mean earnings) has increased since the introduction of the NMW whether we use Average Weekly Earnings (AWE) or ASHE data. The AWE weekly data are converted into an hourly rate by dividing by the average weekly hours worked for all workers from the LFS. Although the bite at the median is the measure we tend to focus on, because the mean may be moved by changes in the pay of small numbers of high earners, we consider comparisons of both measures. Both ASHE and AWE data show that from 2001, the bite of the minimum wage at mean and median earnings rose steadily, before initially peaking on all three measures in 2007. The bite at the mean rose from 36.4 per cent in 2001 to 41.0 per cent in 2007 using AWE; and from 34.7 per cent to 39.6 per cent using the ASHE mean, while the bite at the median rose from 44.2 per cent in 2001 to 51.0 per cent in 2007.

Figure 2.9: Bite of the Adult National Minimum Wage Using Different Earnings Measures, UK, 1999-2013



Source: LPC estimates based on ONS data: AEI including bonuses (LNMQ), 1999-2000, AWE total pay (KAB9), GB, average actual weekly hours of work (YBUV), UK, monthly, seasonally adjusted, April, 2000-13, and ASHE: without supplementary information, April 2000-04; with supplementary information, April 2004-06; 2007 methodology, April 2006-11; and 2010 methodology, April 2011-April 2013, standard weights, including those not on adult rates of pay, UK.
 Note: The AWE total pay series is not available before January 2000 on a consistent basis, so AEI is used for 1999-2000.

2.30 Between 2007 and 2010 the bite of the minimum wage at the mean was broadly flat before peaking in 2012 on both mean measures at 41.3-41.4 per cent. It then fell back to 40.8 per cent using AWE and 41.1 per cent using ASHE in 2013. The fall in bite using AWE is almost certainly due to the delaying of bonuses in early 2013 until after April for tax purposes. This caused AWE to rise sharply in April 2013 before falling back. If we ignore this one-off bonus effect, the bite would have risen to 41.7 per cent, its highest ever level. The bite at the ASHE median was also broadly flat between 2007 and 2011; however, it rose sharply in 2011 and 2012, reaching its highest ever level, 52.8 per cent, before falling back a little in 2013 to 52.4 per cent. Although slightly lower than at their peaks in 2012, the bites of the minimum wage on all measures in 2013 were far higher than they were when the NMW was introduced and are higher than they were in 2009.

2.31 Table 2.3 shows that the bites at other points on the earnings distribution, including the mean, have followed a similar trend to the bite at the median: rising steadily between 1999 and 2007; remaining broadly flat between 2007 and 2010; rising again in 2011 and 2012; before falling back slightly in 2013.

2.32 The bite at the lower decile increased from 81.3 per cent in April 2000 to 89.6 per cent in April 2008, it remained at roughly that level until April 2011 when it jumped to 91.2 per cent. The bite of the NMW at the lower decile is now 91.6 per cent, just below its level in April 2012, 91.7 per cent, the highest it had been. The bite at the mean has increased from

34.6 per cent in 2001 to reach 41.1 per cent in 2013, just below its peak of 41.3 per cent in April 2012.

- 2.33** Unlike earlier years, where rises in the bite have generally followed similar trends across the earnings distribution, the bite of the minimum wage in 2013 fell across much of the bottom of the earnings distribution but the bite remained the same relative to the upper quartile and upper decile. In 2013, wages at the bottom of the earnings distribution grew faster than wages at the top of the distribution.

Table 2.3: Bite of the Adult National Minimum Wage at Various Points on the Earnings Distribution for Those Aged 22 and Over, UK, 1999-2013

	Data year (April)	Adult NMW (£)	Adult minimum wage as % of					
			Lowest decile	Lowest quartile	Median	Mean	Upper quartile	Upper decile
ASHE without supplementary information	1999	3.60	83.9	65.1	45.7	36.6	30.4	21.1
	2000	3.60	81.3	64.2	45.3	35.7	29.8	20.6
	2001	3.70	80.3	63.0	44.3	34.6	29.0	19.9
	2002	4.10	85.2	67.5	47.2	36.5	30.8	21.0
	2003	4.20	82.4	65.8	46.5	35.9	30.5	20.8
	2004	4.50	84.9	67.6	47.5	37.2	31.3	21.4
ASHE with supplementary information	2004	4.50	85.6	68.3	48.1	37.7	31.6	21.7
	2005	4.85	88.0	69.9	49.4	38.5	32.4	22.1
	2006	5.05	87.5	69.9	49.4	38.3	32.3	22.1
ASHE 2007 methodology	2006	5.05	87.5	70.0	49.7	38.5	32.5	22.3
	2007	5.35	89.2	71.6	51.0	39.6	33.6	22.9
	2008	5.52	89.6	71.6	50.6	39.2	33.2	22.8
	2009	5.73	89.7	71.7	50.8	39.7	33.3	22.9
	2010	5.80	89.6	72.0	50.9	39.6	33.2	22.9
	2011	5.93	91.2	73.4	51.7	39.7	33.9	23.2
ASHE 2010 methodology	2011	5.93	91.2	74.1	52.3	40.5	34.0	23.3
	2012	6.08	91.7	74.7	52.8	41.3	34.7	24.0
	2013	6.19	91.6	74.3	52.4	41.1	34.7	24.0

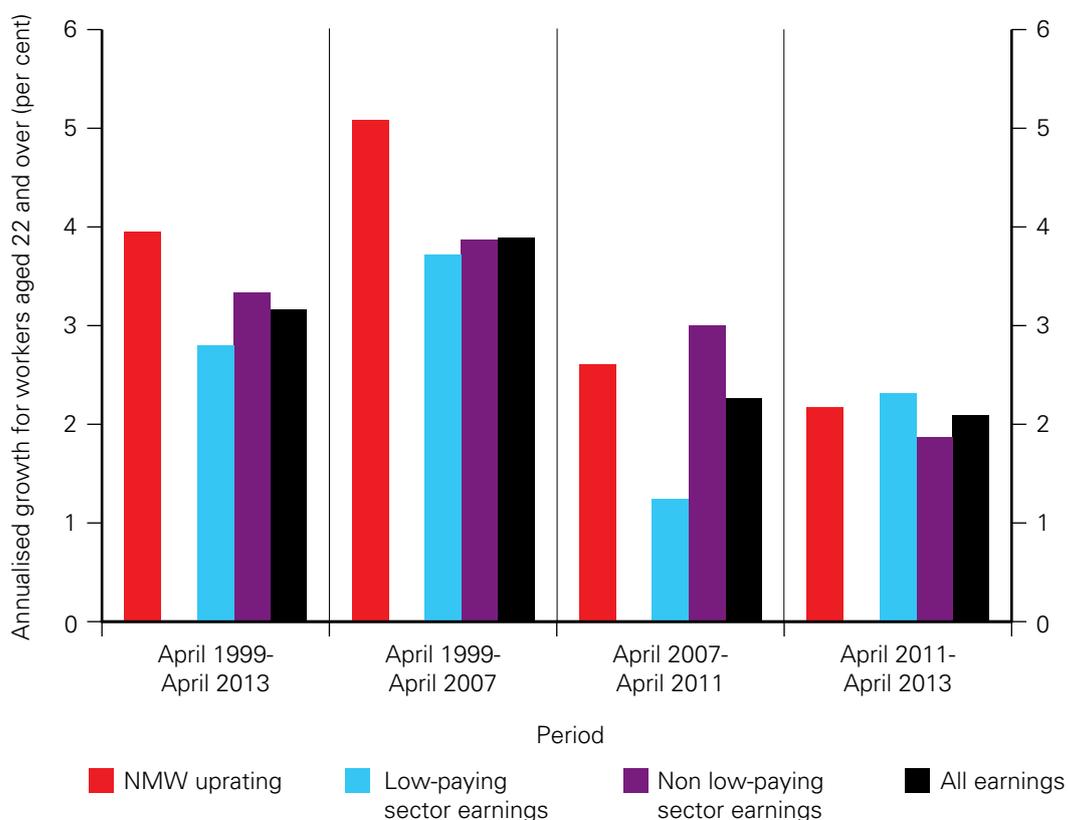
Source: LPC estimates based on ASHE: without supplementary information, April 1997-2004; with supplementary information, April 2004-06; 2007 methodology, April 2006-11; and 2010 methodology April 2011-13, standard weights, including those not on adult rates of pay, UK.

Note: Direct comparisons before and after 2004, before and after 2006, and before and after 2011 should be made with care due to changes in the data series.

- 2.34** As shown at the start of this chapter, a higher proportion of jobs in small firms (micro and other small firms), and in the low-paying occupations and industries are minimum wage jobs. The minimum wage has a higher bite in smaller firms and the low-paying sectors than elsewhere in the economy. Although, as Table 2.2 and Figure 2.8 have shown and we have discussed above, the bite was broadly flat in the economy as a whole between 2007 and 2010, it continued to rise in the low-paying sectors and in small firms, increasing further in 2011 and 2012, albeit then falling back a little in 2013.

2.35 Figure 2.10 shows that annualised earnings growth between 1999 and 2007 was similar in the low-paying industries and the rest of the economy, both growing by around 3.9 per cent a year. But there was considerable divergence between 2007 and 2011, when annualised earnings growth in the low-paying industries was 1.2 per cent a year, compared with 3.0 per cent a year in the non low-paying industries. However, this trend has reversed in the past two years. Between 2011 and 2013, low-paying industries saw annualised earnings growth of 2.3 per cent, compared with a 1.9 per cent increase in median earnings in non low-paying industries. Over the whole period of the minimum wage, 1999-2013, earnings growth in the low-paying industries (2.8 per cent a year) has been a little lower than that in other industries (3.3 per cent a year).

Figure 2.10: Annualised Growth in the Adult National Minimum Wage and Median Earnings for Those Aged 22 and Over, by Sector, UK, 1999-2013



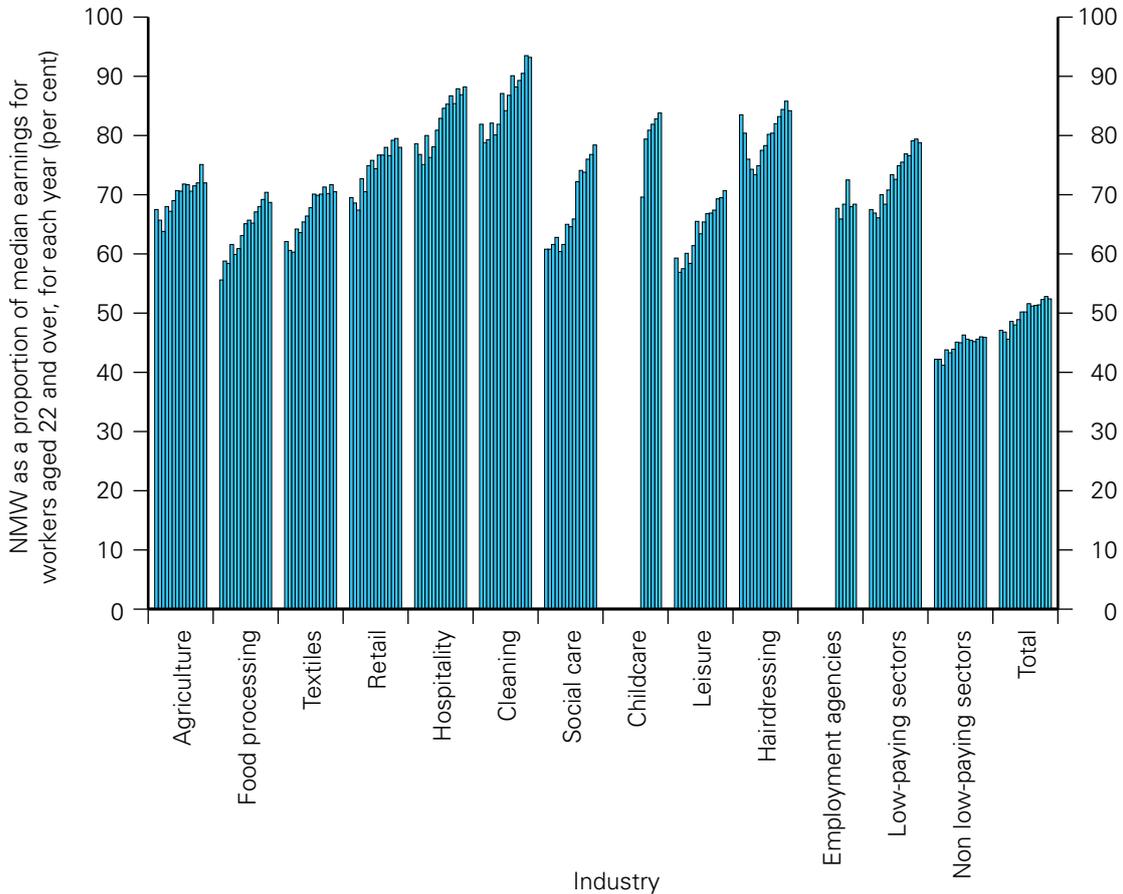
Source: LPC estimates based on ASHE: without supplementary information, April 1997-2004; with supplementary information, April 2004-06; 2007 methodology, April 2006-11; and 2010 methodology April 2011-13, standard weights, including those not on adult rates of pay, UK.

Note: ASHE data have been adjusted to take account of methodology changes to provide a consistent time series.

2.36 Figure 2.11 shows that the bite has been steadily rising for adult workers in the low-paying industries, from 67.5 per cent in 1999 to 78.8 per cent in 2013. The bite for the non low-paying industries increased from 42.2 per cent to 45.9 per cent over the same period. The lower earnings growth between 2007 and 2011 in the low-paying industries resulted in the bites of the minimum wage in the low-paying industries and the other industries diverging. Annualised earnings growth in the low-paying industries was, on average, 2.1 percentage points lower than the uprating in the NMW between 2007 and 2011, which increased the bite from 74.9 per cent in 2007 to 79.1 per cent in 2011. After peaking in 2012 at 79.4 per cent, the bite in the low-paying sectors dropped back to 78.8 per cent in 2013 but it was still

more than 13 percentage points higher than it had been in 2001. In contrast, over this period earnings growth in the non low-paying industries more than matched the annual upratings in the NMW, so the bite fell from 46.3 per cent in 2007 to 45.6 per cent in 2011. However, the bite rose in 2012 to 46.0 per cent and remained elevated in 2013 at 45.9 per cent in the non low-paying sectors.

Figure 2.11: Bite of the Adult National Minimum Wage for Workers Aged 22 and Over, by Low-paying Industry, UK, 1999-2013



Source: LPC estimates based on ASHE: without supplementary information, April 1997-2003; with supplementary information, April 2004-05; 2007 methodology, April 2006-10; and 2010 methodology April 2011-13, standard weights, including those not on adult rates of pay, UK.

Notes:

a. Definitions for the low-paying industries are based on Standard Industrial Classification (SIC) codes. Data from 1999-2007 are based on SIC 2003 codes. Data from 2008-12 are based on SIC 2007 codes. Because of this change in methodology direct comparisons before and after 2007 should be made with care.

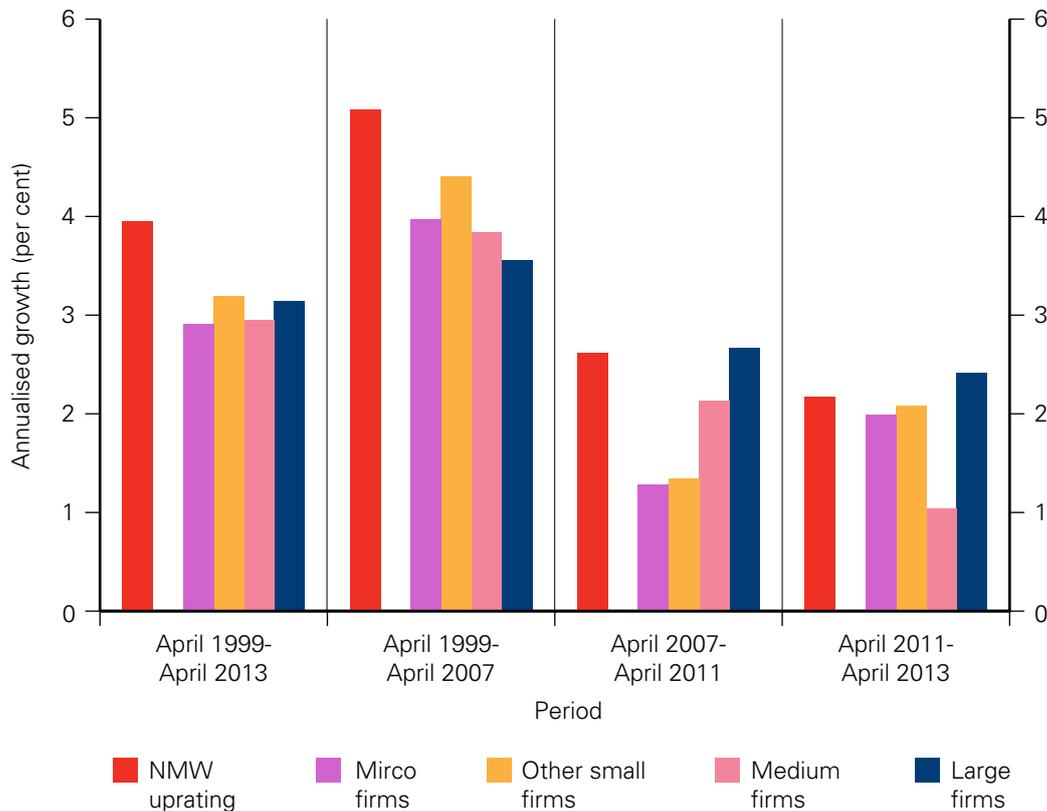
b. Data on childcare and employment agencies industries were not available before 2008.

c. ASHE data have been adjusted to take account of methodology changes to provide a consistent time series.

2.37 There were differences among the low-paying sectors. In 2013, the highest bites were in the cleaning industry (93.2 per cent), followed by hospitality (88.2 per cent), hairdressing (84.2 per cent) and childcare (83.8 per cent). The lowest were in employment agencies (68.4 per cent) and food processing (68.7 per cent), but these were still much higher than for the non-low-paying sectors (45.9 per cent). Although the bite in the low-paying sectors as a whole fell in 2013, it increased in hospitality, leisure, childcare and employment agencies.

2.38 Figure 2.12 shows that, like those in the low-paying industries, employees in smaller firms have also experienced lower earnings growth since 2007. The positive relationship between size of firm and average annual earnings growth is clear. Over the whole period from 1999 to 2013 earnings growth across firms of different sizes was similar, at around 3 per cent on average a year. But this disguises two distinct periods.

Figure 2.12: Annualised Growth in the Adult National Minimum Wage and Median Earnings for Those Aged 22 and Over, by Firm Size, UK, 1999-2013



Source: LPC estimates (adjusted earnings) based on ASHE: without supplementary information, April 1997-2004; with supplementary information, April 2004-06; 2007 methodology, April 2006-11; and 2010 methodology April 2011-13, standard weights, including those not on adult rates of pay, UK.

Note: ASHE data have been adjusted to take account of methodology changes to provide a consistent time series.

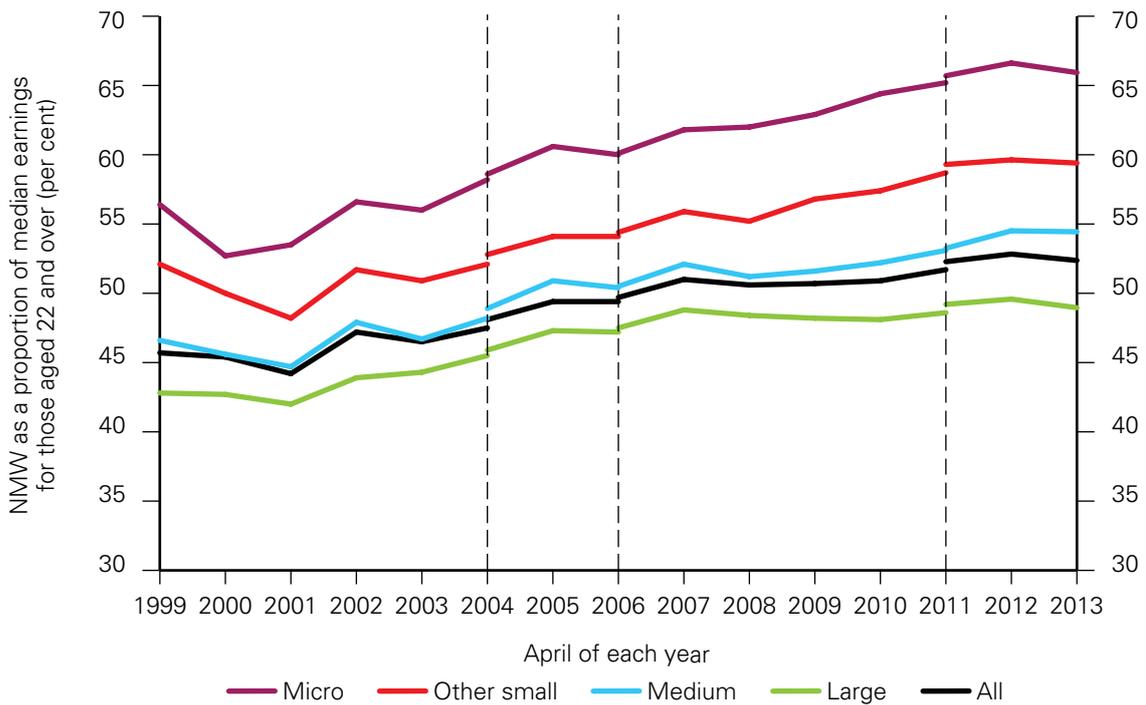
2.39 Between 1999 and 2007, employees in micro and other small firms saw higher earnings growth than medium-sized and large firms, although still below the average upratings in the NMW of 5.1 per cent. However, between 2007 and 2011 this trend reversed, with smaller firms having lower earnings growth than larger firms, and the smaller the firm, the lower the growth in employee earnings. Between 2007 and 2011 workers saw an average growth in median earnings of around 1.3 per cent a year in micro firms and in other small firms, 2.1 per cent in medium-sized firms, and 2.7 per cent in large firms. The minimum wage increased by an average of 2.6 per cent a year over the same period.

2.40 In the most recent period since 2011, things have changed again. Although wage growth in large firms has continued to be relatively strong, wage growth has also picked up among small firms. It is medium-sized firms that have seen the smallest average growth. Between 2011 and 2013 workers saw an average growth in median earnings of just 1.0 per cent a year in medium-sized firms compared with around 2 per cent average growth in micro firms

(2.0 per cent), other small firms (2.1 per cent) and large firms (2.4 per cent). These were similar to the minimum wage increases of 2.2 per cent over the same period.

2.41 Figure 2.13 shows that the bite in micro firms has increased more or less continuously since 2000 from 52.7 per cent to 65.9 per cent in 2013. Similarly, other small firms experienced an increase in the bite from 48.2 per cent in 2001 to 59.4 per cent in 2013. Among medium-sized firms, the bite has increased from 44.7 per cent to 54.4 per cent. Although the bite for large firms increased at a similar pace to that for other sizes of firm between 2001 and 2007, there has been a noticeable difference since then.

Figure 2.13: Bite of the Adult National Minimum Wage at the Median for Those Aged 22 and Over, by Firm Size, UK, 1999-2013



Source: LPC estimates based on ASHE: without supplementary information, April 1997-2004; with supplementary information, April 2004-06; 2007 methodology, April 2006-11; and 2010 methodology April 2011-13, standard weights, including those not on adult rates of pay, UK.

Notes:

a. Direct comparisons before and after 2004, before and after 2006, and before and after 2011 should be made with care due to changes in the data series.

b. There were fewer responses to the question on size of firm in the 2002 ASHE than in other years.

2.42 Since 2007, median wage growth in large firms has been similar to that of the minimum wage, and hence the bite remained at around 49 per cent for large firms. In contrast the bite for all other sizes of firm increased between 2007 and 2012. Wage growth among all sizes of firm was greater than the increase in the NMW in the year to April 2013. Thus, the bite fell for all sizes of firm in 2013. The strongest wage growth in 2013 was among micro firms (2.9 per cent) and large firms (3.1 per cent).

2.43 Turning next to low-paid workers, we again observe a rise in the bite in recent years as the increase in the minimum wage has outpaced the growth in wages. Unfortunately, ASHE does not record many characteristics of workers. We therefore use LFS data to consider the impact of the minimum wage on certain groups of workers. For those aged 22 and over the

bite at the median was 58.3 per cent and the bite at the lowest decile was 93.8 per cent. These are a little higher than those estimated using ASHE (52.4 per cent and 91.6 per cent respectively). Figure 2.14 shows that the bites at the median for low-paid workers are much higher than those for the working population as a whole and these bites generally increased between 2007/08 and 2011/12.

Figure 2.14: Bite of the Adult National Minimum Wage at the Median for Those Aged 22 and Over, by Groups of Workers, UK, 2007/08-2012/13



Source: LPC estimates based on LFS Microdata, income weights, quarterly, four-quarter averages, UK, Q4 2007-Q3 2013.
 Note: Due to changes in the data series, the estimates from 2011/12 onwards are not directly comparable with estimates for earlier years.

2.44 Overall, the bite increased from 55.9 per cent in 2007/08 to 58.5 per cent in 2011/12. This bite was 58.3 per cent in 2012/13. This fall in the bite in the last year was also observed for ethnic minorities and those with no qualifications, but the bite continued to increase for migrant workers and women. In 2012/13, those with no qualifications had the highest bite (85.0 per cent), then women (64.3 per cent), disabled people (63.2 per cent), migrants (62.2 per cent) and ethnic minorities (60.3 per cent).

2.45 Since the onset of recession in 2008, the bite has generally increased for White workers (from 55.7 per cent to 58.1 per cent) and those from ethnic minorities as a whole (from 57.9 per cent to 60.3 per cent). But the bite for ethnic minorities disguises variations among different ethnic groups. The bite at the median for Indian workers is lower than that for White workers, and has increased from 50.3 per cent in 2007/08 to 51.3 per cent in 2012/13. The increase in the bite for Black workers over the same period, from 56.9 per cent to 61.4 per cent, was much larger. The bite for Bangladeshi workers also increased, from 74.0

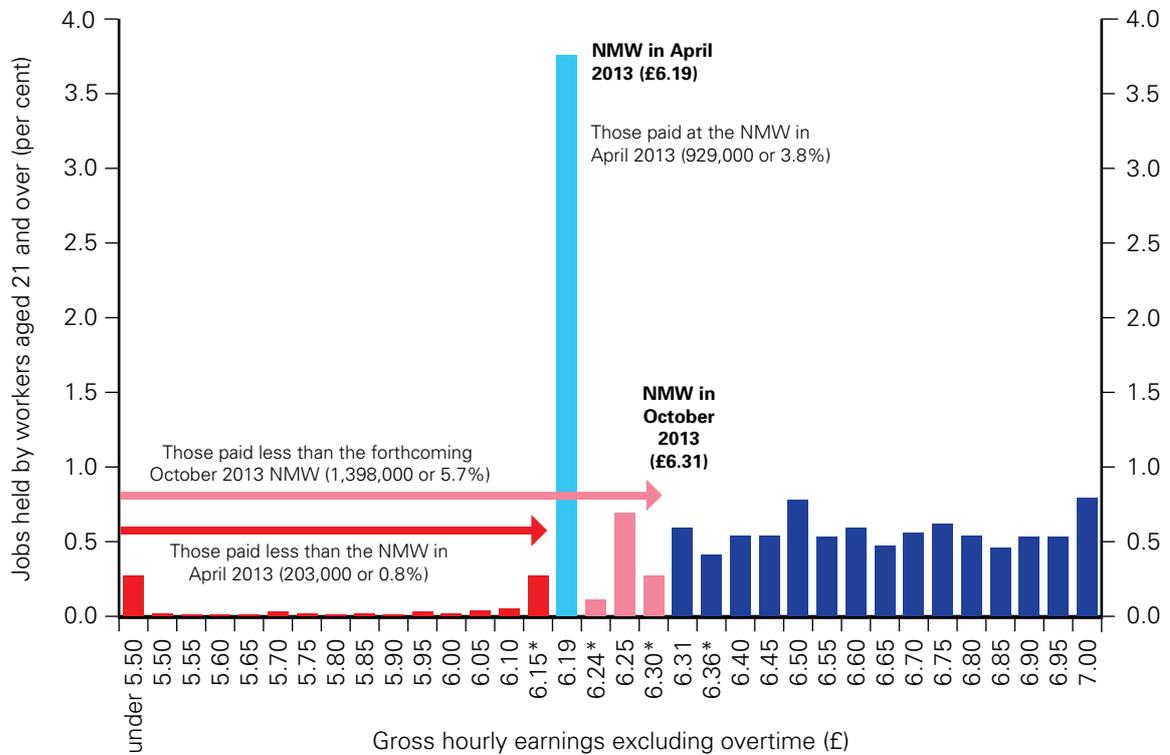
to 77.1 per cent. In contrast the bite for Pakistani workers has fallen from 73.5 per cent to 71.1 per cent, but remains high. Over the last year, there was a fall in the bite for White workers and all other ethnicities, except for Pakistani workers.

Earnings Distributions

2.46 We now turn to the impact of the minimum wage across the earnings distribution.

The impact of the minimum wage can clearly be seen in Figure 2.15 which shows a spike in the hourly earnings distribution at £6.19 in April 2013, the adult rate at that time. Around 929,000 employees (nearly 3.8 per cent) were paid at the minimum wage. This number was below that in April 2012 (around 961,000 or 3.9 per cent) but was substantially above that in April 2011 (about 737,000 or 3.0 per cent).

Figure 2.15: Hourly Earnings Distribution for Employees Aged 21 and Over, by Five Pence Band, UK, 2013



Source: LPC estimates based on ASHE, 2010 methodology, low-pay weights, including those not on adult rates of pay, UK, April 2013. Note: * Five pence bands except where stated otherwise (bands labelled by minimum pay amount).

2.47 Although not necessarily evidence of non-compliance, a further 203,000 employees (about 0.8 per cent) were paid less than the minimum wage in April 2013. This was similar to the number observed in 2012 (around 207,000 or 0.8 per cent). Those who may legitimately be paid less than the adult rate of the minimum wage include apprentices; those living in accommodation provided by their employer; and in some circumstances those on Fair Piece Rates. We consider the extent of non-compliance in Chapter 4.

- 2.48** Figure 2.15 also shows that in April 2013 there were about 1.40 million employees aged 21 and over (around 5.7 per cent) paid less than the then forthcoming minimum wage rate of £6.31 an hour, which was implemented in October 2013. A similar number was estimated in both 2011 and 2012, with around 5.5-5.8 per cent paid less than the then forthcoming rate of the minimum wage.
- 2.49** The analysis above was based on 5 pence bands of the minimum wage and the earnings data used were for those aged 21 and over. Table 2.4 shows the trends since the minimum wage was introduced in the numbers of those paid less than the NMW, at the NMW, and below the forthcoming rate of the NMW. For consistency with years prior to 2004, the numbers are given in ten pence pay bands and are for those aged 22 and over. There are concerns about the quality of the data for smaller pay bands prior to 2004. Those aged 21 were not entitled to the adult rate of the minimum wage until October 2010. Around 183,000 jobs held by those aged 22 and over (0.8 per cent) were paid less than the NMW in April 2013. This was similar to the previous year. Indeed, since 2002, the numbers paid less than the minimum wage have fluctuated around 200,000 (or 0.8-1.0 per cent) each year. There was a considerable increase (to 290,000) after the large (10.8 per cent) uprating in October 2001, and a higher figure still at the introduction of the NMW.
- 2.50** When the ten pence pay band includes a focal point on the earnings distribution (such as £6.00 in April 2011) the effect is clear. The numbers paid at the minimum wage rose from around 700,000 (3.0 per cent) between 2007 and 2010 to about 1 million (around 4.0 per cent) thereafter. It remained over 1 million in 2013. These are the highest numbers recorded over the lifetime of the NMW. However, in April 2013, 1.29 million (about 5.3 per cent) were paid below the then forthcoming October 2013 rate of £6.31, fewer than those paid below the then forthcoming October 2011 rate in April 2011.

Table 2.4: Jobs Held by Those Aged 22 and Over, Paid At and Below the Existing National Minimum Wage and the Forthcoming National Minimum Wage, UK, 1999-2013

	Data year (April)	Adult minimum wage rate in April	Jobs held by adults paying less than the adult rate in April		Jobs held by adults paying the adult rate (ten pence band) in April		Forthcoming October adult minimum wage rate	Jobs held by adults in April paying less than the forthcoming October rate	
		£	000s	%	000s	%	£	000s	%
ASHE without supplementary information	1999	3.60	460	2.1	723	3.3	3.60	458	2.1
	2000	3.60	190	0.9	551	2.5	3.70	746	3.3
	2001	3.70	210	0.9	394	1.8	4.10	1,326	5.9
	2002	4.10	290	1.3	630	2.8	4.20	920	4.1
	2003	4.20	210	0.9	445	2.0	4.50	1,022	4.5
	2004	4.50	230	1.0	558	2.5	4.85	1,399	6.2
ASHE with supplementary information	2004	4.50	233	1.0	408	1.8	4.85	1,209	5.3
	2005	4.85	233	1.0	484	2.1	5.05	1,147	5.0
	2006	5.05	239	1.0	544	2.4	5.35	1,289	5.6
ASHE 2007 methodology	2006	5.05	238	1.0	544	2.4	5.35	1,289	5.6
	2007	5.35	231	1.0	696	2.9	5.52	1,215	5.1
	2008	5.52	212	0.9	731	3.1	5.73	1,245	5.2
	2009	5.73	181	0.8	726	3.1	5.80	846	3.6
	2010	5.80	203	0.9	698	2.9	5.93	981	4.1
	2011	5.93	208	0.9	971	4.0	6.08	1,297	5.4
ASHE 2010 methodology	2011	5.93	187	0.8	1,007	4.2	6.08	1,315	5.5
	2012	6.08	186	0.8	992	4.2	6.19	1,204	5.0
	2013	6.19	183	0.8	1,017	4.2	6.31	1,286	5.3

Source: ONS central estimates using ASHE without supplementary information and LFS, UK, 1999-2004; LPC estimates based on ASHE: with supplementary information, April 2004-06; 2007 methodology, April 2006-11; 2010 methodology, April 2011-13, low-pay weights, including those not on adult rates of pay, UK.

Notes:

a. Prior to 2004, all our analyses were conducted in ten pence pay bands using the ONS central estimate methodology. In contrast to elsewhere in this report, where five pence pay bands are used, we use ten pence pay bands in this table.

b. Direct comparisons before and after 2004; those before and after 2006; and those before and after 2011, should be made with care due to changes in the data series.

2.51 There are differences in the proportion of jobs paid at or below the existing NMW and those paid below the forthcoming NMW by low-paying sector and firm size. Table 2.5 shows that, in April 2013, about 4.3 per cent of all employees were paid at or below the NMW of £6.19 an hour.

Table 2.5: Proportion of Jobs Held by Those Aged 22 and Over, Paid At or Below the Adult National Minimum Wage, by Sector and Firm Size, UK, 2012-13

Per cent Industry/ Occupation/Size of firm	April 2012					April 2013				
	Paid < NMW (£6.08)	Paid at NMW (£6.08)	Paid < £6.19	Paid < £6.50	Paid < £7.00	Paid < NMW (£6.19)	Paid at NMW (£6.19)	Paid < £6.31	Paid < £6.50	Paid < £7.00
Retail	1.4	7.2	10.5	20.8	37.5	1.3	7.6	11.5	16.5	33.8
Hospitality	3.1	21.6	27.2	37.7	50.3	2.5	22.4	29.1	34.9	47.9
Leisure, travel & sport	1.4	8.4	11.6	18.8	27.6	1.4	7.2	11.3	16.4	24.4
Cleaning	2.1	32.4	37.0	47.3	61.0	2.4	29.4	36.5	43.5	57.9
Social care	0.9	7.2	10.0	19.1	32.2	0.8	7.9	11.7	18.3	32.3
Childcare	2.6	9.5	14.5	26.7	41.6	2.8	9.4	16.0	22.5	41.3
Agriculture	1.5	6.7	8.8	14.4	24.2	1.2	5.7	8.7	10.9	20.9
Textiles & clothing	0.3	10.7	13.3	18.9	28.2	0.8	9.8	12.0	15.5	23.8
Hairdressing	3.0	18.8	23.9	33.2	44.9	3.5	17.9	25.3	29.3	41.8
Employment agencies	0.6	12.7	14.5	19.9	26.5	0.7	12.6	15.0	17.9	24.4
Food processing	0.2	6.5	8.6	16.9	26.3	0.6	6.0	8.4	12.1	22.7
Office work	1.1	5.7	7.5	13.5	22.4	0.8	5.5	7.3	11.1	20.4
Non-food Processing	0.4	7.5	9.0	14.2	23.5	0.4	5.8	7.7	11.2	20.5
Storage	0.9	6.6	8.6	15.0	25.3	0.9	8.3	11.1	14.4	24.8
Transport	1.6	6.8	9.3	14.9	23.8	1.3	6.0	8.9	11.3	20.1
All low-paying industries	1.5	11.2	14.7	24.1	37.6	1.4	11.4	15.7	20.9	34.9
Micro	2.3	8.3	11.7	16.9	24.3	2.7	8.0	12.8	15.2	22.4
Other small	0.9	5.3	7.1	11.0	17.2	0.8	5.0	7.1	9.3	15.6
Medium	0.6	4.5	5.9	9.3	14.9	0.6	4.3	5.9	8.0	13.4
Large	0.7	2.6	3.8	7.1	12.2	0.6	2.6	4.1	5.9	11.0
Whole economy	0.8	3.6	5.0	8.5	14.0	0.8	3.5	5.3	7.3	12.7

Source: LPC estimates based on ASHE, 2010 methodology, low-pay weights, including those not on adult rates of pay, UK, April 2012-13.

Notes:

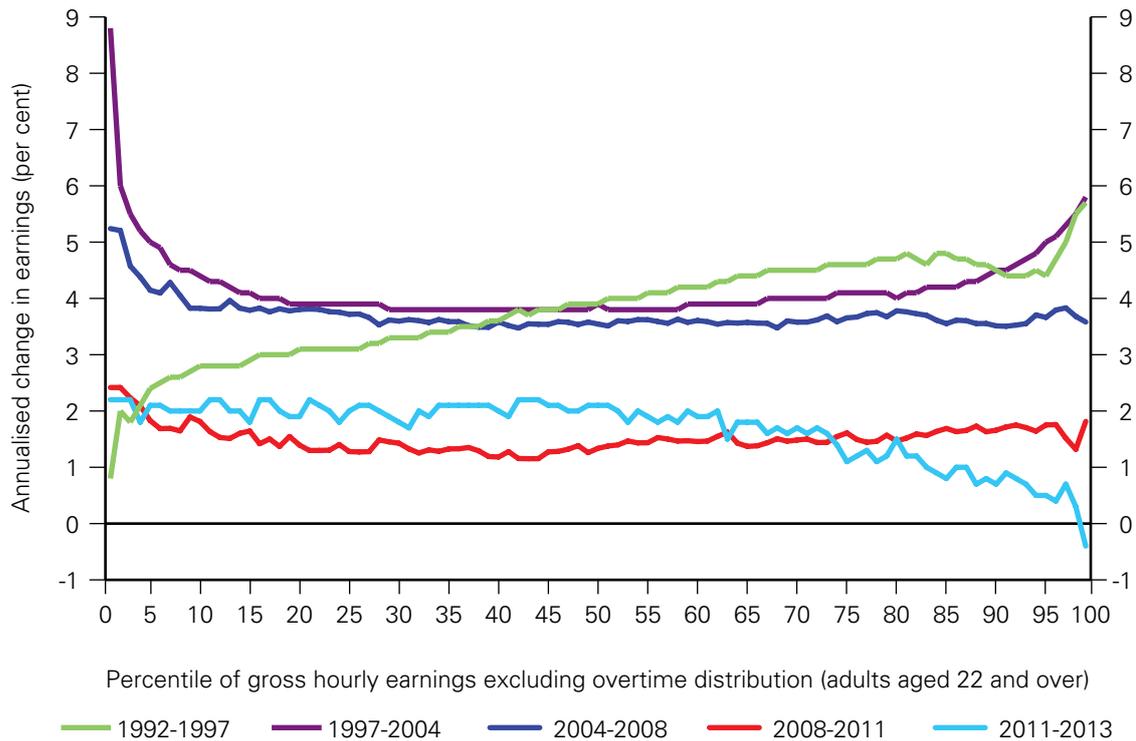
a. Based on a five pence band.

b. This sector is defined using Standard Occupational Classifications (SOC) 2010. The other sectors are based on SIC 2007.

2.52 This proportion was higher in the low-paying sectors (12.8 per cent) and ranged from 6.2 per cent in non-food processing, through 8.9 per cent for retail, 21.4 per cent for hairdressing, and 24.9 per cent for hospitality, to 31.8 per cent in cleaning. There was little difference to the year before when 12.7 per cent of workers in the low-paying sectors were paid at or below the NMW rate of £6.08 an hour. There was little change within many low-paying sectors between 2012 and 2013. However, there was a fall of 2.7 percentage points in cleaning. Other low-paying sectors with falls included non-food processing; agriculture; leisure, travel and sport; and transport. In contrast, minimum wage jobs increased in storage (up 1.7 percentage points) and social care (up 0.6 percentage points).

- 2.53** The proportions in the low-paying sectors paid below the forthcoming NMW increased from 14.7 per cent in April 2012 to 15.7 per cent in April 2013. This pattern differed across the low-paying sectors. Similar increases were experienced in retail and hospitality among others but the proportions were fairly stable in cleaning; leisure, travel and sport; and agriculture. There were falls in textile manufacturing and storage. Not surprisingly, the sectors with the largest proportions paid less than £7.00 an hour tended to be those with the highest proportions paid at the NMW. Nearly 58 per cent of workers aged 22 and over in cleaning were paid less than £7.00 an hour. The next two highest sectors were hospitality (48 per cent); hairdressing (42 per cent); and childcare (41 per cent). Although fewer than 8 per cent of employees in retail and social care were paid at the NMW, around a third were paid less than £7 an hour. In stakeholder consultations, trade bodies from these low-paying sectors have often emphasised the impact of the NMW on differentials. In contrast, almost 13 per cent of staff in employment agencies and 10 per cent of staff in textile manufacturing were paid at the NMW, but fewer than a quarter were paid less than £7 an hour.
- 2.54** In our 2013 Report, we noted that the proportions paid less than £6.50 in agriculture had increased between 2011 and 2012 and we said that we would monitor this in light of the announced abolition of the Agricultural Wages Boards in England and Wales. In 2013, the proportions paid less than £6.50 an hour and those paid less than £7.00 an hour have fallen by similar percentages to other low-paying sectors.
- 2.55** By size of firm, a similar picture emerges with regards to the proportions paid at or below the NMW and those paid below the then forthcoming NMW. In April 2013, the proportions paid at or below the NMW ranged from 3.2 per cent in large firms, through 4.9 per cent in medium-sized firms to 10.7 per cent in micro firms. These were falls on the year before for all but the smallest firms. In contrast, the proportions paid less than the then forthcoming rate increased for the smallest and largest firms compared with the previous year. There was a relationship between size of firm and those paid less than £7.00 an hour with micro firms having the largest proportions (around 22 per cent) and large firms the lowest (11.0 per cent).
- 2.56** We can rank employees by their earnings, by splitting them into 100 equally sized groups (percentiles), and ordering them from the lowest paid to the highest paid. We can then track how the wages of each percentile changes over time. Figure 2.16 shows that, before the introduction of the minimum wage, those at the lowest end of the hourly earnings distribution had the lowest wage rises. Between 1992 and 1997, those in the bottom decile had increases in line with price inflation (between 1 and 3 per cent), whereas those in the upper part of the distribution had higher wage rises (about 5-6 per cent). Those in the middle, around the median, received pay rises of around 4 per cent.

Figure 2.16: Annualised Growth in Hourly Earnings for Employees Aged 22 and Over, by Percentile, UK, 1992-2013



Source: LPC estimates based on New Earnings Survey (NES), April 1992-1997, and ASHE: without supplementary information, April 1997-2004; with supplementary information, April 2004-06; 2007 methodology, April 2006-11; and 2010 methodology April 2011-13, standard weights, including those not on adult rates of pay, UK.

Note: Direct comparisons before and after 1997, before and after 2004, before and after 2006 and before and after 2011, should be made with care due to changes in the data series.

- 2.57** Since 1997, that picture has changed. Those at the bottom of the earnings distribution have had much higher increases than those in the middle of the distribution. Between 1997 and 2004, increases for all of the bottom decile were above 4 per cent a year, as were those for the top two deciles. For the rest, pay growth was just below 4 per cent a year. However, the increases at the bottom have moderated significantly since 2004 (and especially since 2008), growing on average by 3-4 per cent a year, although this is greater than for the rest of the distribution which has experienced annual average wage growth of less than 3 per cent.
- 2.58** Figure 2.16 also shows a remarkable outcome over the last two years. Between 2011 and 2013, the earnings of the bottom half of the distribution grew by around 2 per cent but pay increases have been weaker for those in the top 15 percentiles. In other words real wages fell right across the earnings distribution as inflation was higher than 2 per cent, whether measured using CPI or RPI. At the top end, very unusually, the falls in real pay were greater than for the rest. Between 2011 and 2013, those in the bottom half of the earnings distribution have tended to have done better than those in the top half.

Pay Gaps

- 2.59** As we showed earlier (and highlighted in Figure 2.5), particular groups of workers are more likely to be in minimum wage jobs. We can use pay gaps (the proportional difference between the earnings of one group and those of a comparator group) to measure the extent of the difference in pay between these groups and their counterparts who are less likely to be in minimum wage jobs. In order to avoid picking up differences due to hours worked, official statistics tend to focus comparisons on hourly earnings of full-time employees. Since the introduction of the NMW, the gender pay gap at the lowest decile has been generally falling. Indeed, it has more than halved from 12.9 per cent in 1998 to 5.8 per cent in 2013. Similarly, the gender pay gap at the median has fallen from 15.9 per cent in 1998 to 9.4 per cent in 2013. Changes at the upper decile have been less noticeable with the gender pay gap the same in both 1998 and 2013.
- 2.60** In 2011, there was a change in the methodology and weighting used to take account of ONS's new occupational classifications, SOC 2010. Table 2.6 shows that the resulting revisions to the data led to a large downward revision of female earnings, but had little effect on estimates of male earnings. Thus, the measured gender pay gap at the median in 2011 increased from 8.3 per cent to 9.6 per cent. In 2013, the growth in male earnings has been higher than the growth in female earnings across the earnings distribution. This has resulted in increases in the gender pay gap at the lowest decile, the median and the upper decile. The gender pay gap at the lowest decile was 5.8 per cent in 2013, up from 5.0 per cent in 2011. Although the median gender pay gap in 2013 rose by nearly 1 percentage point to 9.4 per cent and the upper decile gender pay gap rose to 20.5 per cent, these gender pay gaps were below those in 2011.

Table 2.6: Hourly Gender Pay Gap of Full-time Workers Aged 22 and Over, UK, 1997-2013

	Data year (April)	£ per hour				Per cent			
		Men		Women		Gender pay gap			
		Median	Mean	Median	Mean	Lowest decile	Median	Mean	Upper decile
ASHE without supplementary information	1997	8.51	10.38	7.17	8.38	13.1	15.8	19.2	19.6
	1998	8.84	10.93	7.43	8.73	12.9	15.9	20.1	20.5
	1999	9.15	11.37	7.78	9.17	11.8	15.0	19.4	19.7
	2000	9.21	11.66	7.97	9.47	10.7	13.4	18.8	19.7
	2001	9.65	12.39	8.38	10.05	11.1	13.2	18.9	20.7
	2002	10.07	13.05	8.76	10.55	11.1	13.0	19.1	20.6
	2003	10.41	13.43	9.09	10.91	10.0	12.7	18.7	20.1
	2004	10.89	13.88	9.64	11.50	8.9	11.5	17.1	19.8
ASHE with supplementary information	2004	10.75	13.63	9.51	11.35	8.3	11.5	16.8	18.8
	2005	11.22	14.33	9.98	11.96	7.8	11.1	16.5	18.6
	2006	11.65	14.96	10.42	12.41	7.3	10.6	17.1	20.2
ASHE 2007 methodology	2006	11.56	14.86	10.26	12.26	7.7	11.2	17.5	20.5
	2007	12.02	15.39	10.72	12.77	7.8	10.8	17.0	20.5
	2008	12.56	16.11	11.13	13.26	7.3	11.4	17.7	21.6
	2009	13.01	16.49	11.59	13.75	7.3	10.9	16.6	20.5
	2010	13.00	16.64	11.89	14.08	6.0	8.6	15.4	19.3
	2011	13.13	16.84	12.04	14.27	4.7	8.3	15.3	19.8
ASHE 2010 methodology	2011	13.13	16.82	11.87	14.07	5.0	9.6	16.3	21.1
	2012	13.25	16.84	12.12	14.32	5.6	8.5	14.9	19.0
	2013	13.55	17.24	12.28	14.48	5.8	9.4	16.0	20.5

Source: ONS central estimates using ASHE without supplementary information and LFS, UK, 1999-2004; LPC estimates based on ASHE: with supplementary information, April 2004-06; 2007 methodology, April 2006-11; 2010 methodology, April 2011-13, low-pay weights, including those not on adult rates of pay, UK.

Notes:

a. Prior to 2004, all our analyses were conducted in ten pence pay bands using the ONS central estimate methodology. In contrast to elsewhere in this report, where five pence pay bands are used, we use ten pence pay bands in this table.

b. Direct comparisons before and after 2004; those before and after 2006; and those before and after 2011, should be made with care due to changes in the data series.

2.61 Table 2.7 uses LFS data in order to present the pay gaps for other groups of workers at the median. It suggests that the gender pay gap is greater than estimated using ASHE, because the LFS analysis used here includes part-time workers. This measure of the gender pay gap rose to 18.6 per cent in 2012/13, up from 17.4 per cent in 2011/12, when it was at its lowest since 2007/08. Other than for those with no qualifications (where the pay gap was 33.7 per cent in 2012/13), the pay gaps for other groups of workers were generally smaller (less than 10 per cent) than the gender pay gap. The disabled pay gap and the migrant worker pay gap also increased in 2012/13. In contrast the pay of those with no qualifications rose relative to those with qualifications in 2012/13. Ethnic minority pay also rose relative to that of White workers in 2012/13.

Table 2.7: Hourly Pay Gaps for Particular Groups of Workers Aged 22 and Over, UK, 2007/08-2012/13

Per cent	Median					
	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13
No qualifications	34.4	35.3	34.9	34.6	34.3	33.7
Women	19.5	19.5	17.6	19.1	17.4	18.6
Disabled people	11.1	11.7	9.9	9.5	8.9	9.1
Migrant workers	3.9	5.5	8.2	7.8	6.1	7.2
Ethnic minorities	3.9	5.3	5.0	3.4	4.0	3.6
of which						
Indian	-10.6	-13.2	-6.7	-8.1	-12.6	-13.1
Other non-white	4.4	5.3	5.5	2.9	3.3	2.8
Black	2.2	8.9	3.3	4.3	8.4	5.4
Pakistani	24.3	22.1	26.8	18.0	10.2	18.3
Bangladeshi	24.8	24.3	31.8	26.6	23.2	24.6

Source: LPC estimates based on LFS Microdata, income weights, quarterly, not seasonally adjusted, UK, Q4 2007-Q3 2013.

Note: Comparators for the groups are respectively those with qualifications, men, those not disabled, non-migrants, and the White ethnic group. Individual ethnic groups are all compared with the White ethnic group.

2.62 Table 2.5 also shows that the pay gap for migrant workers is higher (7.2 per cent) than that for ethnic minorities as a whole (3.6 per cent). But the latter disguises large differences within the ethnic minority population, with Indian workers earning more than White workers but Black workers earning less, and both Pakistani and Bangladeshi workers earning much less than White workers. There had been substantial reductions in the pay gaps between Pakistani and White workers, and to a lesser extent Bangladeshi and White workers up to 2011/12 but these pay gaps increased to over 18 per cent for Pakistani workers and over 24 per cent for Bangladeshi workers in 2012/13.

Pay Settlements and Pay Structures

2.63 In addition to investigating the impact of the minimum wage on individual earnings, we can also look at its effects on pay-setting and pay structures. We start by looking at pay settlements and consider whether the NMW influences pay settlements in the economy as a whole or in low-paying sectors in particular. The Workplace Employment Relations Study (2013) found that 31 per cent of private sector employers considered the NMW as an influence on pay settlements, while CIPD (2012) found that 7 per cent regarded the NMW as the most important influence on increasing salaries. There are no official data sources on pay settlements, so it is necessary to use data from various pay organisations. As discussed in Chapter 1, we use four such organisations – EEF, the manufacturers' organisation (EEF), Incomes Data Services (IDS), the Labour Research Department (LRD), and XpertHR. These data sources tend to under-represent smaller firms. All four generally gave a similar picture on pay awards across the economy over the last year (as shown in Figure 1.4 in Chapter 1). The median of pay settlements for all four organisations began the year in the range 2.5-3.0 per cent but weakened through 2013 to finish the year at around 2.0 per cent (although it was 2.5 per cent for EEF).

2.64 Using IDS data, we are able to break down pay settlements by low-paying sector. In general, as shown in Table 2.8, pay settlements in the low-paying sectors have tended to broadly track pay settlements in the whole economy. However, pay settlements have been lower in the low-paying sectors than in the whole economy since 2010. Median pay settlements in low-paying sectors were 2.0 per cent in 2013, slightly ahead of the 1.9 per cent increase in the NMW. This is similar to 2012, when the 2.0 per cent median in low-paying sectors was ahead of the 1.8 per cent increase in the NMW.

Table 2.8: Annual Median Pay Settlement, by Sector, UK, 2000-2013

Per cent	Whole economy	Low-paying sectors	Care services & housing	Children's nurseries	Hotels, restaurants, pubs & leisure	Retail
2000	3.0	3.0	-	-	-	-
2001	3.2	3.0	-	-	-	-
2002	3.0	2.8	-	-	-	-
2003	3.0	3.0	-	-	-	-
2004	3.0	3.0	-	-	-	-
2005	3.2	3.0	-	-	-	-
2006	3.0	3.0	-	-	-	-
2007	3.5	3.0	-	-	-	-
2008	3.5	3.0	3.0	3.0	3.2	3.0
2009	2.0	2.0	2.0	3.0	2.3	1.5
2010	2.0	2.0	1.0	2.5	2.0	2.0
2011	2.5	2.1	2.0	..	2.5	2.0
2012	2.5	2.0	1.5	..	2.3	2.0
2013	2.5	2.0	2.0	..	2.3	2.0

Source: IDS.

Notes:

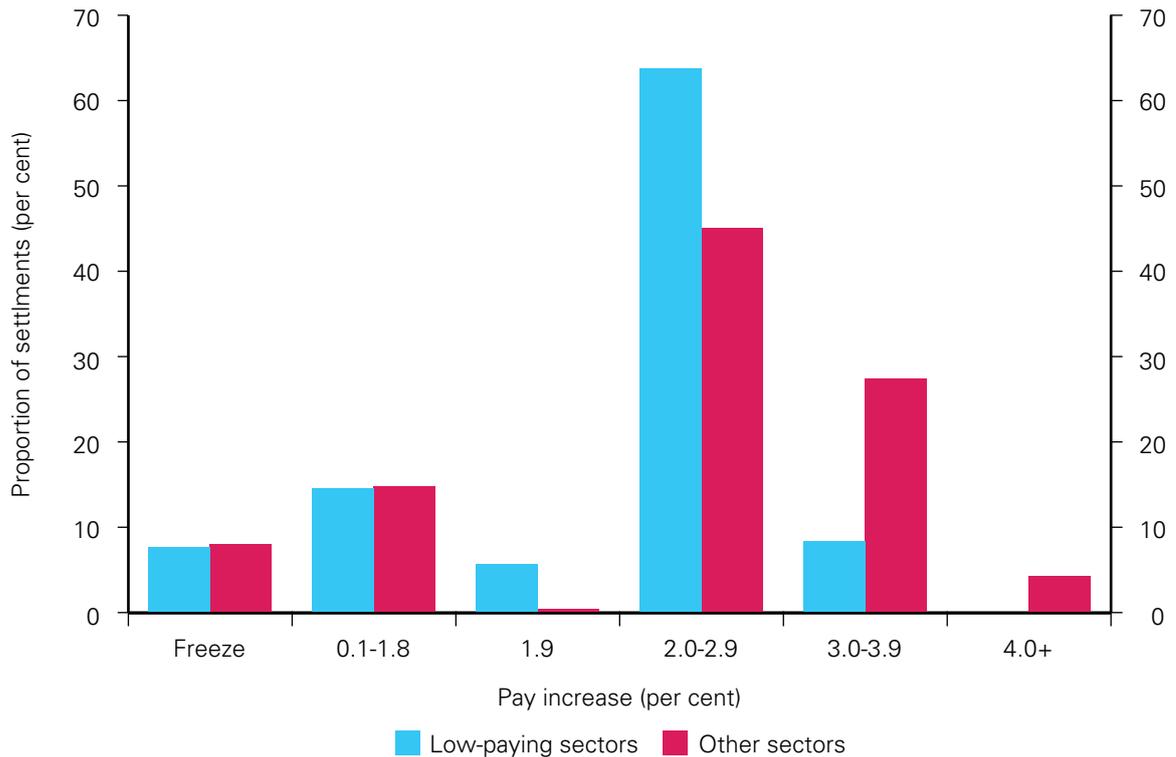
a. The annual data are for the calendar year from 1 January to 31 December. IDS did not disaggregate pay settlement by individual sector prior to 2008.

b. Where the sample size is too small to produce an estimate it is denoted by '..'.

c. '-' denotes not available.

2.65 There continue to be some differences across low-paying sectors, with firms in hospitality (hotels, restaurants, pubs and leisure) awarding higher pay settlements than those in retail or care services since 2008. This is despite the fact that, as noted by IDS (2014c), the NMW is most commonly used by employers in the fast food, pubs and restaurants sector (55 per cent) compared with 41 per cent of non-food retailers and 18 per cent of food retailers.

2.66 As Figure 2.17 shows, pay settlements in low-paying sectors in 2013 were just as likely as in other sectors to be freezes, or in the 0.1-1.8 per cent range. Even though only 6 per cent of pay reviews in low-paying sectors were at exactly 1.9 per cent, the increase in the NMW in 2013, this was much higher than in other sectors, where less than half a per cent of pay reviews were at 1.9 per cent. It seems that lower-paying employers were most likely to opt for a 2 per cent pay rise in response to the NMW uprating: a third of low-paying employers gave a pay rise of exactly 2 per cent, compared to 14 per cent of other employers.

Figure 2.17: Distribution of Pay Settlements in Low-paying and Other Sectors, UK, 2013

Source: idspay.co.uk, 24 January 2014.

- 2.67** IDS (2014c) looked in detail at 90 pay settlements covering over 1.43 million employees in the retail sector. It reported that, in the year to the beginning of November 2013, the median pay settlement in retail was 2.0 per cent, below the 2.5 per cent observed for the economy as a whole, but similar to the increase in the NMW, 1.9 per cent. There was a lack of variation in pay settlements. Over two-thirds of the pay awards in the retail sector in 2013 were 2.0-2.5 per cent. Only 8 per cent were higher than this range. The proportion of pay freezes was unchanged on last year at 4 per cent, fewer than in the economy as a whole. In a matched sample of 61 retailers, there was little sign that employers were being less cautious between 2012 and 2013. Around 44 per cent gave the same increase in both years, just over a fifth paid higher rises than last year, while over a third paid lower rises.
- 2.68** Only 9 per cent of the retail organisations monitored awarded a settlement exactly in line with the NMW increase but the NMW remained influential, with 72 per cent citing it as 'quite' or 'very' important in setting pay.
- 2.69** From the onset of recession up to 2012, pay settlements in food retail were higher than in non-food retail. However, as in 2012, median pay settlements in both sectors were the same in the year to the beginning of November 2013 but the range of pay settlements was wider in non-food than in food. This reflected a greater number of pay freezes and a few higher settlements in non-food retail. Similar to a year ago, pay settlements were slightly stronger in the fast food, pubs and restaurants sector, at 2.2 per cent over the year to November 2013.

Research on Earnings and Pay

- 2.70** Many research studies have investigated how the National Minimum Wage has affected earnings; pay settlements; pay structures; and household and family incomes. They have included both quantitative and qualitative research. In our various reports (for example, LPC 2013) and earlier in this chapter we have clearly demonstrated that the NMW has affected the earnings distribution. There is a notable spike in the hourly earnings distribution at the exact rate of the NMW and there is clear evidence that the left-hand tail of the earnings distribution has exhibited a clear cut-off since the NMW was introduced.
- 2.71** Several studies have been commissioned by the LPC to look at the impact of the NMW on pay settlements and pay structures. In a series of studies (including IDS, 2007, 2009 and 2011a), the relationship between pay rates and the NMW has been examined. From the introduction of the minimum wage up to 2010, IDS (2011a) showed the median of pay settlements in the low-paying sectors had followed similar trends to those in the economy as a whole, albeit slightly weaker. Indeed, the only notable difference appeared to be the use of pay freezes since the onset of the recent recession, with pay freezes far more common in the whole economy than in the low-paying sectors. That, however, may be due to the minimum wage continuing to increase throughout the period, leaving little scope for low-paying sector employers to freeze pay at the bottom of the distribution. Figure 2.17 showed that was not the case in 2013 with pay freezes covering similar proportions of pay awards in the low-paying sectors and the rest of the economy. Building on that previous analysis, IDS (2014a) found that increases to pay rates at the bottom end of pay structures continued to be influenced by the size of the increase in the NMW. It reported that the median pay settlement was 2.0 per cent in 2012, which was slightly higher than the increase in the NMW, 1.8 per cent.
- 2.72** Using the 2011 Workplace Employment Relations Survey, Bryson and Lucchino (2014) investigated the influence of the NMW on pay-setting. They found that as many as 30 per cent of workplaces, covering around 23 per cent of all employees, mentioned the NMW as an influence on pay settlements. This appears to be much greater than might be expected from our estimated coverage of the NMW, up to 5-6 per cent of workers affected. They conjectured that this evidence was suggestive of the NMW uprating being interpreted by managers as some sort of benchmark for adequacy. The most influential factor in setting pay was financial performance, but the NMW was cited as the third most influential factor just behind changes to the cost of living. Not surprisingly, having a high share of workers paid at or near the NMW had the strongest association with the NMW influencing pay-setting. Even still, around 15 per cent of workplaces where median pay was above £7.50 an hour cited the NMW as an influence on the latest pay settlement but these higher-paying workplaces tended not to increase pay by as much as the NMW. This suggested that for these firms, it was part of a broader range of factors. It was also consistent with some compression of differentials.
- 2.73** The paper has improved our understanding of the nature of the workplaces where the NMW was an influence on pay settlements. In the private sector, these were positively associated with a higher share of women, part-time and non-British workers. Industry, occupation and geography lost most of their significance once they took account of the level of pay and

market competition. Other than the share of employees paid the NMW, very few other factors were an influence in the public sector.

- 2.74** Bryson and Lucchino (2014) found that the NMW played a stronger role in the private sector when the management set pay unilaterally, and where trade unions were absent or were not involved in pay-setting. The researchers conclude that this is important as it demonstrated that the NMW is 'providing a minimum standard of pay protection in pockets of the labour market where such protection would otherwise be absent'.
- 2.75** As well as influencing pay-setting, there is also clear evidence that the minimum wage has affected the timing of pay reviews in the low-paying sectors. IDS (2011a and 2011c) showed that October had become a more common settlement date among the low-paying sectors. In 1999, fewer than 5 per cent of pay settlements in either the low-paying sectors or the whole economy were in October, however, that proportion had increased to nearly 20 per cent of pay reviews in the low-paying sectors in 2010, but had risen to just 6 per cent in the whole economy. This trend had continued. IDS (2014a) found that around 28 per cent of the pay reviews monitored in the low-paying sectors in 2013 were effective in September or October, compared with just 2.7 per cent across other sectors.
- 2.76** We have commissioned several studies to investigate how firms have attempted to cope with the minimum wage through their pay structures. IDS (2011a) summarising its previous work on pay-setting since 1994, found that many companies had anticipated the introduction of the minimum wage and had to some extent prepared beforehand. Its introduction thus had little impact but the subsequent large upratings between October 2001 and October 2006 had led to further adjustments. Pay structures were changed with the number of hierarchies or geographic pay zones reduced. Pay differentials had narrowed, as those paid above the minimum wage received smaller pay increases than those on the minimum wage. In addition, firms also looked at ways to reduce labour costs by reducing pay premia for overtime and unsocial hours; and by restricting non-wage benefits such as subsidised meals and transport, annual leave, pensions, and staff discounts. Grimshaw and Carroll (2002); Cronin and Thewlis (2004); Denvir and Loukas (2006); and various Commission surveys of employers and stakeholder evidence found similar effects on the remuneration package and pay structures.
- 2.77** In its most recent study, IDS (2014a) also investigated changes in premia pay and non-wage benefits. It found that low-paid employees continued to receive premium payments for working unsocial hours, although they monitored a trend away from paying premiums on Sunday and reducing premiums for bank holidays. This trend had begun before the recession but continued through 2007-2012. Sunday working was increasingly paid at basic pay, while bank holidays still attracted premiums but these were generally less generous than previously. This was particularly the case in the retail sector. Premia payments for night working have undergone fewer changes and continue to be paid in many cases.
- 2.78** The reward package for low-paid workers also includes non-wage benefits. These were mostly low cost and were less generous than the non-wage benefits given to higher-paid colleagues. They commonly included staff discounts, employer pensions, and enhanced paid holidays. Company sick pay also featured. There were sectoral variations, particularly relating

to free meals and staff discounts. Higher paid employees typically had better packages including healthcare, larger pension contributions, more holidays and access to salary sacrifice schemes. The research found that employers used non-wage benefits for recruitment and retention and believed they were worth around 3-5 per cent of the overall reward package.

- 2.79** IDS (2014a) found that the minimum wage had caused only 4 per cent of employers to decrease the benefits package in 2013, lower than the 6 per cent recorded in a previous survey in 2005. A quarter of respondents to its survey had made changes to benefits since the start of the recession and only one third of these had reduced their benefit packages. Reductions in benefits had come in the form of reduced sick pay; changes to pensions; a move from free transport to subsidised transport; and lower sales bonuses. However, nearly two thirds of employers had improved the benefits package though take-up rates were not supplied. Some of these, especially those using salary sacrifice schemes, will likely have a low take-up among low-paid employees. It also found the impact of pensions auto-enrolment less than expected but it was early days and many smaller employers had yet to begin the process.
- 2.80** Using econometric methodology, Gregg and Papps (2014) also explored the impact of the minimum wage on pay premia and non-wage benefits. They found no statistically significant evidence that the minimum wage had affected workers' levels of incentive pay; shift pay; or overtime pay. They also found no evidence that eligibility for a pension had been reduced.
- 2.81** As well as investigating the impact of the NMW on the composition of the pay package, Gregg and Papps (2014) also looked at the impact of the minimum wage on hourly, weekly and annual pay. They found that employers responded to increases in the minimum wage by raising the wages of affected workers to be compliant. This occurred before and after the recession and across the three minimum wage age groups. However, for those who remained with the same employer, increases in the minimum wage did lead to a statistically significant but small reduction in hours. A ten pence increase in the NMW led to a fall in the average working week by 8 minutes. They also found that increases in the minimum wage were offset by reductions in weeks worked when considering annual pay.
- 2.82** In a descriptive analysis comparing 1992-1997 with 1998-2003, Butcher (2005) showed that there was a change in the relative pay of the lowest paid compared with pay at the median when the minimum wage was introduced and that the relative improvement had continued with subsequent upratings in the NMW. He also suggested that there was an impact on differentials but that this appeared weak and did not reach far up the earnings distribution. This issue of the impact of the NMW on the wages of those paid just above the minimum wage, known in the literature as spill-over effects, has been investigated using more sophisticated econometric techniques. Covering the period up to 2007, Stewart (2009) explored various methodologies to assess the impact of the NMW on differentials. Although, when using wage distribution functions or wage quantile regression, he found some evidence of more significant spill-over effects than the previous descriptive analysis, his findings were very sensitive to assumptions about the counterfactual (how wages would change in the absence of a minimum wage). However, his analysis of individual wage changes found little evidence of any effects and he concluded that spill-over effects were

generally small and limited, typically reaching no further up the earnings distribution than the 5th percentile.

- 2.83** Dolton, Rosazza Bondibene and Wadsworth (2010), using data up to 2009, found evidence that the minimum wage had squeezed differentials at the bottom of the earnings distribution. Using individual and spatial data from 1994-2010, Dickens, Riley and Wilkinson (2012) found that the minimum wage had led to significantly higher wage growth for low-paid workers, particularly when the NMW was introduced. They found a large impact on pay inequality across areas as the NMW compressed wages at the bottom of the distribution, especially in the period prior to the recession. Those areas with the lowest pay prior to the introduction of the NMW had the greatest reductions in inequality. More recently, Butcher, Dickens and Manning (2012) found that the NMW had affected wage inequality, and developed a model based on imperfect labour markets that is able to explain a considerable part of the evolution of wage inequality between 1998 and 2010. In contrast to many previous studies, they found evidence of more significant spill-over effects that reached up to the 25th percentile, about 40 per cent above the NMW. These spill-over effects were larger in low-paying sectors and regions. On the other hand, analysing pay data from 1977-2011, Dolton, Makepeace and Tremayne (2012) found no association between a minimum wage and earnings growth or pay settlements and concluded that this was consistent with previous research that had found limited spill-over effects on earnings higher up the wage distribution.
- 2.84** Dickens, Riley and Wilkinson (2012) also found that during the recession years, 2008-2010, there had been some restoration of wage differentials. This was consistent with the findings of earlier research, such as Swaffield (2009) and Dolton, Lin, Makepeace and Tremayne (2011) that when minimum wage increases were lower than average earnings, low-paid workers tended to get smaller pay rises than the average, and vice versa. In their analysis of company level pay, IDS (2011a), also found that there had been some slight restoration of differentials between 2008 and 2010, when minimum wage increases were much smaller than in the years of the large upratings. Extending this previous analysis, IDS (2014a) found that the differential between the established adult rate and the NMW had increased over the period from the onset of the recession (2007-2012) but that there was much variation across companies, sectors and years. Over the latest year, 2012, it found that more organisations than previously had been able to widen differentials, while fewer had reduced them.
- 2.85** It has been argued that the minimum wage is not particularly well-targeted at the lowest income households. Indeed, NMW workers tend to be in the 3rd to 6th deciles of the household income distribution but those households in the lowest deciles tend to have few workers, as they comprise mainly of pensioners and those on out-of-work benefits. IFS (2003), Bryan and Taylor (2004 and 2006), and Brewer, May and Phillips (2009) among others, showed that if the sample was restricted to working age households, removing pensioner households, then NMW workers were concentrated in the second to fourth deciles. Further, if workless households were also excluded, the NMW was targeted on those households in the bottom two deciles. Brewer and De Agostini (2013) found a similar picture when analysing family income distributions. The families for whom the NMW was the main source of income were concentrated in the bottom two deciles of the income distribution for working families.

Views on Earnings and Pay

- 2.86** The impact of the minimum wage on wage structures was a common concern raised by employers and their representatives. The CBI said within the low-paying sectors the NMW typically acted as a benchmark for business, meaning it had a greater impact than just on those earning the NMW. Given that the NMW had been uprated by more than average earnings in recent years the CBI told us the low-paying sectors had experienced more pay growth and fewer freezes than other parts of the economy – notably in wholesale; retail; and hotels and restaurants. This had, it said, caused a reawakening of issues with pay differentials as businesses were faced with either passing on pay rises to a wider group of staff or the erosion of pay structures and rewards for skills development.
- 2.87** We heard from a number of other employer stakeholders representing businesses in the low-paying sectors about the impact of the NMW on pay and earnings. The British Hospitality Association, British Beer & Pub Association, Business In Sport and Leisure and the Association of Licensed Multiple Retailers (ALMR) thought the main impact of the NMW on hospitality and leisure businesses was, as they had considered for many years, the compression of differentials.
- 2.88** The National Day Nurseries Association said many nurseries will pay their unqualified staff, such as nursery assistants and support staff, at or around the NMW. Employers structured pay scales to reflect qualifications and responsibility, therefore increases in the NMW meant a review of pay for the entire workforce to maintain differentials and incentivise and reward attainment. It said that the NMW had reduced the discretion nurseries had to set their own pay structure to reward performance. It was difficult for nurseries to afford any increase in their staffing budgets, and this was predominantly spent on response to the NMW, limiting discretionary awards.
- 2.89** In the hairdressing sector, the National Hairdressers' Federation highlighted the compression of differentials as an issue, particularly between trainees and junior staff. In the adult social care sector a number of employer associations advised our Secretariat that an increase in the NMW had an impact on recruitment and retention of staff. As available monies are used to pay increases for those on the NMW the ability to incentivise staff is reduced, including the ability to provide incentives to train and take on responsibilities. In retail, the British Independent Retailers Association reported that a recent survey of its members showed 58 per cent had to increase rates of pay to comply with an increase in the NMW and this had affected differentials. It also said that the gap between starting wages and the NMW had closed dramatically in many sectors.
- 2.90** On a visit to Newport, Crystal Group, operating in the cleaning sector, told us how the NMW had drastically eroded differentials between junior and supervisory staff, which made supervisory staff feel less valued.

“The area where it has had the most impact has been in wage differentials, with businesses now having to pay those with more senior jobs the same or just slightly more than workers with little responsibility or experience. Increases affect the whole pay structure, not just those earning the NMW. ”

Federation of Wholesale Distributors' evidence

Clients were not willing to pay for higher wages beyond the legal minimum. Three years ago supervisors were on £6.50 an hour but now were almost on the NMW, with the differential reduced from around 50 to 20 pence.

- 2.91** The Rural Shops Alliance said new staff may be paid at or near the NMW, however, the pay scales above them have contracted. More senior and experienced staff, including supervisors, were being paid much less of a premium than used to be the case in many stores. It said that this flattening of pay structures was not fair on those with additional skills/ experience and made work in their sector less attractive. While the British Retail Consortium (BRC) told us of the markedly different distribution in hourly wages between food and non-food from its survey of large retailers: non-food had a far higher proportion of employees paid at, or close to, the adult rate of the NMW (16 per cent are paid between the NMW and £6.39 compared with 3 per cent of food sector employees). It said the proportion of non-food employees earning within 20 pence of the NMW rose from 9 per cent in 2012 to 16 per cent in 2013. Upratings in the NMW have had a much larger impact on the wage profile of non-food retailers compared with food retailers.
- 2.92** ALMR reminded us that its recent submissions had focused on the fact that the NMW had become the average wage within the bar sector. This trend was less marked in its latest survey with a third of respondents paying current NMW rates of between £6.19 and £6.31 per hour, down from over 50 per cent in 2010. A similar proportion were paying an average bar wage below the rate of the adult NMW, however, continuing a trend the ALMR first identified last year towards exploiting the lower rates of NMW; finding ways to alleviate the ever increasing cost burden associated with payroll without having to sacrifice staff or cut back on investment. Respondents from small businesses confirmed their greater probability of being affected by the NMW. A Federation of Small Businesses survey of members found 23 per cent employed one or more staff on the NMW. While this was a 4 per cent fall on the position in 2012, small firms in hospitality (43 per cent) retail (36 per cent) and leisure and entertainment (31 per cent) were more likely to have staff on the minimum wage.
- 2.93** The UK Fashion and Textiles Association explained to our Secretariat that there were a number of member companies which used the NMW as the base point on their wage scales. Others utilised bonus and other incentive payments for pay above this level. Increases in the NMW had eroded pay differentials where companies used production incentive schemes.
- 2.94** Some employer groups had a different perspective on the impact of the NMW on pay and earnings. The Recruitment and Employment Confederation told us that the NMW has had a positive impact on workers at the lower end of the labour market both in terms of earnings and through encouraging more people into work. The impact of the NMW was more profound in

“Wage differentials with the NMW had closed in recent years, with a 2 per cent pay rise this year and no pay increase in the previous couple of years. The company had to ‘make-up’ pay to the level of the NMW for those not earning at least this amount through the company incentive scheme. Prior to the NMW workers had to improve to enhance their pay, but now there was less incentive to get better and learn new skills.”

Textiles company, Commission visit in England

those sectors where pay rates are normally on or around the minimum wage. Having a minimum wage helped recruiters supplying labour to these sectors as it provided a price floor and levelled the playing field.

- 2.95** Trade unions continued to be concerned that increases in the NMW over recent years had not been sufficient for it to retain its value. Unite said the 1.9 per cent increase in October 2013 would not keep pace with inflation and this would see workers' spending power reduced, which would ultimately have a negative effect on the economy. The Communications Workers' Union said that the gap between inflation and NMW increases in recent years had been pronounced. In the three years between July 2010 and July 2013, RPI increased by 11.6 per cent while over the same period the NMW increased by just 6.7 per cent.
- 2.96** Some unions also pointed to evidence that suggested to them that a number of businesses could afford to pay more. The Union of Shop, Distributive and Allied Workers (Usdaw) reported that retailers who had settled with it in 2013 had generally settled at 2.0-2.5 per cent. Settlements outside of retailing had been slightly higher. This, it said, showed that the Commission was not setting the going rate or leading to a freeze or erosion of differentials. In its oral evidence the TUC said it believed employer concerns about differentials were overstated and that it could see no evidence of problems in filling supervisor vacancies.

Summary on Earnings and Pay

- 2.97** In summary, the earnings of the lowest paid have increased faster than average wages and inflation since the NMW was introduced in 1999. Since 2007 and the onset of recession, the increases in the NMW have been lower. But, between 2007 and 2013, the adult rate of the NMW has more than maintained its relative value compared with median or average earnings. Indeed, the bite (its value relative to the median) has increased over this period and in 2013 was just below its value in 2012, when it reached its record high. However, in line with other wages across the earnings distribution, the real value of the NMW (its value relative to price inflation) has fallen. It is now only worth the same as in 2004 and is well below its peak value in 2009, when compared with RPI (in CPI terms, it peaked in 2007).
- 2.98** The research shows that the National Minimum Wage has affected hourly and weekly pay, as well as the timing of pay reviews in the low-paying sectors. It also demonstrates evidence that firms have adjusted their pay structures and altered their total reward packages in response to minimum wage increases.

Impact on the Labour Market

2.99 Having demonstrated that the minimum wage clearly affects earnings, we can go on to investigate how firms have coped with the introduction and subsequent increases in the NMW. In response to increases in wages, firms can alter employment by adjusting the extensive margin (the number of workers employed) or the intensive margin (the number of hours worked). Firms can also respond by trying to pass increased costs onto customers through higher prices; or by absorbing those costs in reduced profits. Alternatively, they may try to improve productivity in order to make the increases affordable. The remainder of this chapter investigates how firms have coped with minimum wage increases.

Employment and Employee Jobs

2.100 As we noted in Chapter 1, the labour market has been remarkably resilient considering the depth of the recession and the subsequent sluggish growth. Output (in the third quarter of 2013) was still 2 per cent below its pre-recession level (in the first quarter of 2008) but total employment and total hours worked have fully recovered. In light of what happened to employment and hours in the recessions of the 1980s and 1990s, this seems quite remarkable. After those less severe recessions, it took around eight years after the onset of recession for employment to return to its pre-recession level and even longer for hours. In this recession, employment and hours have taken less than five years to return to their pre-recession levels.

2.101 In assessing employment, we can consider two main official data sources: the Labour Force Survey (LFS) and the ONS Workforce Jobs series (WFJ). The LFS surveys households and estimates employment by counting the number of people in employment. The WFJ series, on the other hand, surveys businesses and counts the number of jobs in the economy. LFS can also be used to estimate the numbers in second jobs but it does not ask about those with more than two jobs. These employment counts differ as they are derived from different samples and a person can have more than one or two jobs (official statistics would count a job share as two jobs). Further, due to the sampling frame, the LFS is less likely to pick up jobs performed by migrant workers who have been in the UK for less than a year. Ware (2012) gives a more detailed explanation of the differences between the two data sources.

2.102 Since the minimum wage was introduced in April 1999, real GDP has grown by nearly 29 per cent. This growth has been reflected in the labour market. Table 2.8 shows that between the introduction of the minimum wage and September 2013, the number of workforce jobs in the UK and the number of people in employment had increased by around 11 per cent. The number of workforce jobs had grown by more than 3.2 million and there were an additional 2.0 million people in work. Ignoring those unlikely to be directly affected by the minimum wage (the self-employed, unpaid family workers and those on government training schemes), employment growth among employees was not quite as strong but still considerable. The number of employee jobs increased by 9.3 per cent, nearly 2.4 million, while the number of employees increased by almost 2 million, or 8.5 per cent. At 8.4 per cent the increase in total hours worked was slightly weaker. Together, these suggest that the aggregate labour market has been strong taken over the whole 14 year period, 1999-2013.

2.103 However, the recession caused employment to fall, most noticeably in 2008 and 2009. The recovery between September 2009 and September 2011 was weak, with much of the employment growth among the self-employed. There was little recovery among employees. Since September 2011, the recovery in the jobs market has taken hold with employee jobs, number of employees, and total hours worked growing strongly. In the last year, between September 2012 and September 2013, aggregate job growth was strong across the board with the number of employee jobs up by 1.8 per cent and 1.4 per cent more employees. The strong growth in hours between September 2011 and September 2012 continued into 2013, albeit at a slightly slower rate.

Table 2.9: Change in Employment, Jobs and Hours, UK, 1999-2013

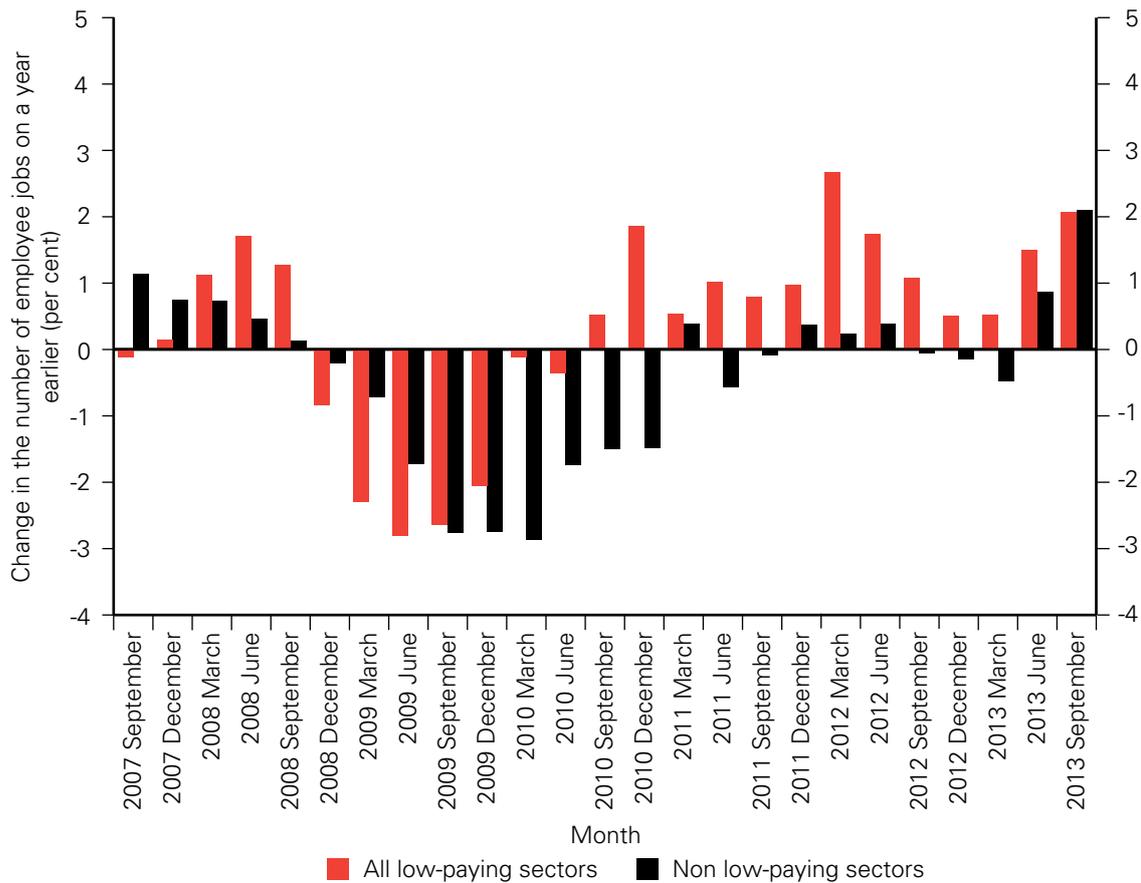
	September 2012-September 2013		September 2011-September 2012		September 2010-September 2011		September 2009-September 2010		September 2008-September 2009		March 1999-September 2013	
	000s	%	000s	%	000s	%	000s	%	000s	%	000s	%
Workforce jobs	598	1.9	188	0.6	243	0.8	-127	-0.4	-678	-2.1	3,227	11.1
Employee jobs	565	1.8	82	0.3	44	0.2	-228	-0.8	-768	-2.7	2,382	9.3
Employment	377	1.3	513	1.8	-110	-0.4	306	1.1	-519	-1.8	2,917	10.8
Employees	361	1.4	319	1.3	-132	-0.5	92	0.4	-563	-2.2	1,995	8.5
Hours worked (000)	17.4	1.8	23.8	2.6	0.8	0.1	11.7	1.3	-29.8	-3.2	74.4	8.4

Source: ONS, workforce jobs (DYDC) and employee jobs (BCAJ), quarterly; total employment (MGRZ), employees (MGRN) and total weekly hours (YBUS), monthly, seasonally adjusted, UK, 1999-2013.

2.104 The increase in the adult rate of 1.8 per cent in October 2012 from £6.08 to £6.19 an hour would be expected to have most effect on firms in the low-paying sectors. Although this turned out to be a relative increase, as average wage growth remained subdued, it was still a fall in the real value of the NMW as the uprating in October 2012 was again less than both CPI and RPI inflation.

2.105 There were around 27.2 million employee jobs in Great Britain in September 2013.² About 34 per cent of them, 9.3 million, were in what we define as our low-paying industries. Since September 1998, just prior to the introduction of the NMW, the number of employee jobs across the whole economy in Great Britain has increased by 2.5 million, or 10.1 per cent, but the number of employee jobs in the low-paying industries has increased more, by 11.5 per cent. Figure 2.18 shows that, going into the recession, between March and September 2008 the annual growth in employee jobs was much stronger in the low-paying industries than in the rest of the economy. However, this then quickly reversed with the low-paying industries being more adversely affected as consumption spending fell and world trade collapsed.

² In this and following paragraphs we use data for GB rather than UK as a detailed sector breakdown of employee jobs is not available for Northern Ireland. Further, the GB data are not seasonally adjusted and therefore comparisons should only be made by comparing a quarter with the same quarter in previous years.

Figure 2.18: Annual Change in Employee Jobs, by Sector, GB, 2007-2013

Source: LPC estimates based on ONS employee jobs series, every three months, not seasonally adjusted, GB, 2006-13.

- 2.106** Between June 2008 and June 2009, the number of employee jobs in the low-paying industries fell by 2.8 per cent from 9.2 million to 8.9 million. This compared with a fall of 1.7 per cent in the rest of the economy. Over the two years to June 2010, the number of employee jobs in the low-paying sectors fell by 288,000 or 3.2 per cent. The fall in the rest of the economy was greater. Between September 2008 and September 2011, the number of employee jobs in the non low-paying sectors fell by 785,000 or 4.3 per cent.
- 2.107** However, jobs in the low-paying industries recovered much more quickly in the aftermath of the recession and subsequent stagnation. Between September 2010 and September 2013, the number of jobs in the low-paying industries increased by around 4.0 per cent, compared with just 2.0 per cent in the whole economy. Over the year to September 2013, the number of employee jobs grew by around 2.1 per cent in both the low-paying sectors and the rest of the economy. By September 2013, jobs in the low-paying sectors exceeded their pre-recession (September 2007) level by 3.1 per cent, whereas employee jobs in the rest of the economy were still 2.2 per cent below their levels in September 2007. Overall, as shown in Table 2.10, the number of employee jobs in the whole economy is still 0.5 per cent below what it was in September 2007.
- 2.108** Using the ONS employee jobs series, we can also look in more detail at some of the individual low-paying industries, aggregating them into four main groups: consumer services, such as retail and hospitality; business-to-business services, such as cleaning and employment agencies; international trade-dependent – those that produce goods and face

international competition, such as food processing, textile manufacturing and agriculture; and government-dependent services – those that are to some extent dependent on government spending, such as social care and childcare. Unfortunately, the ONS employee jobs series do not allow us to separate childcare from education or some social work activities, so our analysis of government-dependent jobs using employee jobs data combines domiciliary care with non-primary school childcare activities. Residential social care is identified separately.

2.109 Between September 1998, just before the NMW was introduced, and September 2013, notwithstanding the recession, there was strong growth in employee jobs across nearly all of the low-paying sectors with the exception of those where international trade is important. Growth was strongest in social care (up 44 per cent), followed by business-to-business services (up 34 per cent), and then those dependent on consumers (up 10 per cent). Those industries facing international competition saw jobs fall by over 41 per cent over the same period. However, these industries had experienced a long-term decline in employment well before the minimum wage was introduced.

Table 2.10: Change in Employee Jobs, by Low-paying Industry, GB, 1998-2013

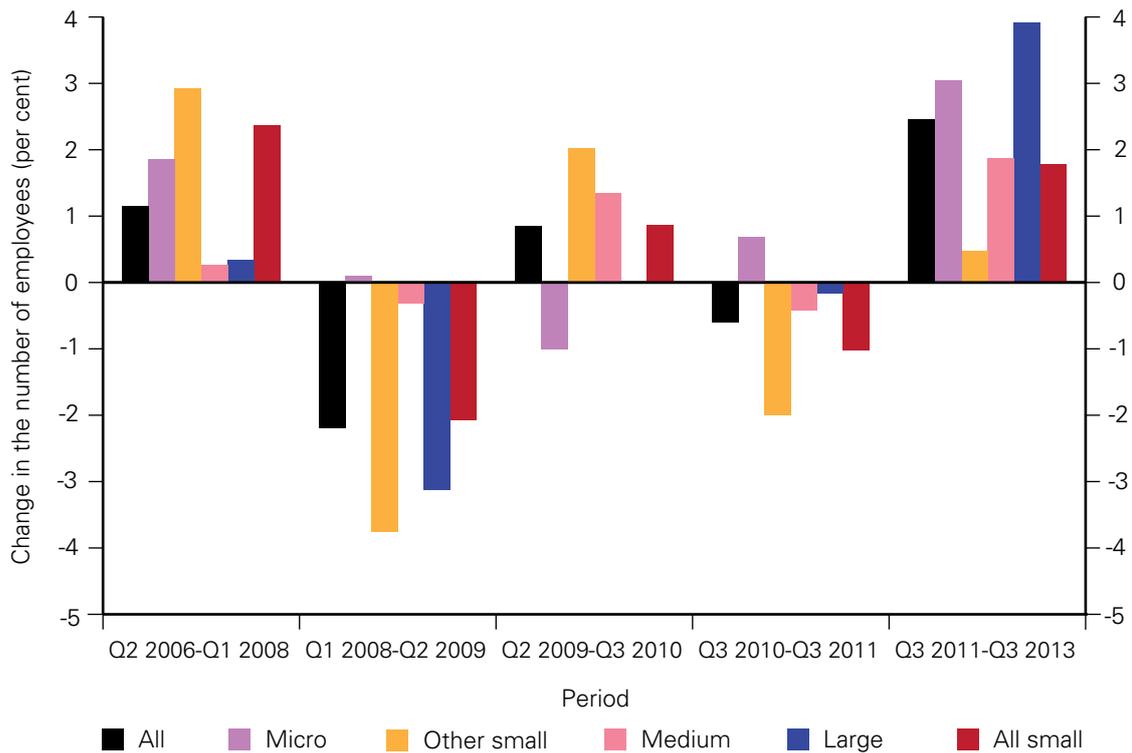
	2013	Change on 2012		Change on 2007		Change on 1998	
	September	September	%	September	%	September	%
	000s	000s	%	000s	%	000s	%
All industries	27,204	557	2.1	-126	-0.5	2,502	10.1
All low-paying industries	9,300	188	2.1	276	3.1	957	11.5
Consumer services	5,652	41	0.7	-56	-1.0	514	10.0
Retail	3,225	39	1.2	-82	-2.5	99	3.2
Retail (excluding motor)	2,743	16	0.6	-60	-2.1	124	4.7
Hospitality	1,825	4	0.2	3	0.2	239	15.1
Leisure, Travel and Sport	494	0	0.0	36	7.9	147	42.4
Hairdressing	108	-2	-1.8	-13	-10.7	29	36.7
Business-to-business services	1,439	102	7.6	188	15.0	364	33.9
Cleaning	718	49	7.3	113	18.7	122	20.5
Employment agencies	721	53	7.9	75	11.6	242	50.5
International trade-dependent	587	-17	-2.8	-78	-11.7	-416	-41.5
Food processing	332	1	0.3	-25	-7.0	-98	-22.8
Agriculture	180	-17	-8.6	-29	-13.9	-88	-32.8
Textiles, clothing	75	-1	-1.3	-24	-24.2	-230	-75.4
Government-dependent services	1,622	62	4.0	222	15.9	495	43.9
Residential care	690	7	1.0	45	7.0	184	36.4
Domiciliary care/childcare	932	55	6.3	177	23.4	311	50.1

Source: LPC estimates based on ONS employee jobs series, three-monthly, not seasonally adjusted, GB, 1998-2013.

- 2.110** As we noted above, many employee jobs were lost in the recession, with the low-paying sectors initially faring worse before recovering first. Despite the reasonably strong recovery in employee jobs in the low-paying sectors as a whole, those sectors dependent on consumer spending or international trade have not fared as well. Table 2.10 shows that there were still 56,000 fewer employee jobs in the consumer services low-paying sectors in September 2013 than there were before the recession, in September 2007. The strong growth observed in 2012 had weakened in 2013, with only 41,000 net jobs created. And most of those were in retail, confined mainly to motor sales, with the number of jobs stagnant in hospitality; leisure, travel and sport; and hairdressing.
- 2.111** In September 2013, there were also 78,000 fewer employee jobs in the international trade-dependent low-paying sectors than in September 2007. But as we have noted, there has been a long-term decline in such jobs, with 416,000 fewer jobs in September 2013 than in September 1998. However, there has been strong growth in the last year in business-to-business services and government-dependent services. An extra 50,000 net jobs were created in both the cleaning and employment agencies sectors between September 2012 and September 2013. In addition, a further 62,000 were added to government-dependent services, mainly in the domiciliary care and childcare sector. Between the onset of recession, September 2007, and September 2013, the number of employee jobs in business-to-business services and government-dependent services have increased by around 15-16 per cent. There were 113,000 more cleaning jobs, 75,000 more employment agency jobs, 177,000 more domiciliary care and childcare jobs and 45,000 more residential care jobs.
- 2.112** The figures in Table 2.10 aggregate both full-time and part-time jobs. Of the 2.5 million additional employee jobs created in the whole economy between September 1998 and September 2013, around 1.3 million were part-time and the other 1.2 million were full-time. In striking contrast, over the same period, nearly all of the net jobs created in the low-paying sectors were full-time (926,000). Just 31,000 were part-time jobs.
- 2.113** Over the year to September 2013 the number of full-time jobs increased slightly faster than the number of part-time jobs in the whole economy. Full-time employee jobs increased by 2.2 per cent (up 390,000) while part-time jobs increased by 1.9 per cent (up 167,000). Job growth in the low-paying sectors was similar across both job types, albeit with slightly stronger growth in full-time than part-time. Full-time employee jobs grew by 2.5 per cent (up 120,000) and part-time jobs by 1.7 per cent (up 71,000). This picture was similar in retail and employment agencies, where full-time jobs grew at a much faster pace than part-time jobs. However, in cleaning and social care, the growth in jobs was more equally shared between full and part-time.
- 2.114** We examined the evidence for any effect of increases in the minimum wage on overall employment in the low-paying sectors, and found little evidence of employment loss except in those sectors, such as agriculture, textiles and food processing, which have been shedding labour for a period that started well before the introduction of the minimum wage.

- 2.115** We turn now to the impact on small and medium-sized firms. According to the LFS, over the year to the third quarter of 2013 about one in five employees worked in a micro firm (one with 10 or fewer employees). Just over one in four worked in other small firms (those with 11-49 employees). In other words, around 48 per cent of all employees worked in small firms. A further quarter worked in medium-sized firms (those employing 50-249 employees) and the remaining 27 per cent in large firms (those with 250 or more employees).³
- 2.116** The growth in employment by size of firm as shown in Figure 2.19 appears quite volatile. However, certain patterns do emerge. Prior to the onset of recession in 2008, employment was growing across all sizes of firm although the strongest growth was among small firms. During the recession, employment in micro firms initially held up while employment in other small firms and large firms fell sharply. In the initial period of economic recovery, employment growth was led by other small firms and medium-sized firms with micro firms shedding some workers. The stagnation from the third quarter of 2010 to the third quarter of 2011 saw a reversal of those trends, as other small firms and medium-sized firms shed jobs while micro firms increased employment. Employment in large firms was generally flat in these two periods of recovery.
- 2.117** Over the last two years the UK has experienced strong employment growth, led by micro and large firms but also aided by medium-sized firms. Other small firms experienced weaker increases in employment. Our analysis of earnings from ASHE had suggested that the strongest growth in wages had been among micro and large firms.
- 2.118** Our analysis in an earlier section of this chapter suggested that the minimum wage had a greater effect in micro firms than others. These employment data suggest that those micro firms are coping with burdens that may have been placed on them. However, the employment performance of other small firms has not been as strong.

³ Respondents to the LFS are asked the size of their workplace. It is self-reported and will not be the as other measures of firm size from different data sources. This is likely to underestimate the size of firm as firms can consist of many workplaces. Indeed, LFS estimates of employment in small firms (48 per cent) are much higher than the 35 per cent reported in the BIS Business Population Estimates (BPE) or the 20 per cent in ASHE.

Figure 2.19: Change in Employment, by Firm Size, UK, 2006-2013

Source: LPC estimates based on LFS Microdata, quarterly, not seasonally adjusted, UK, Q2 2006-Q3 2013.

- 2.119** As well as looking at the low-paying sectors and small firms, we can also analyse the impact of the introduction and subsequent increases in the minimum wage on the employment of those groups who were expected to be most affected by it. Table 2.11 shows that generally, taking the period as a whole from 1999-2013, those groups who are most likely to have been minimum wage workers have performed better in terms of employment than others.
- 2.120** Employment rates for working age females have increased (up 1.8 percentage points) while those for males fell over the same period (down 2 percentage points). Older workers increased their employment rates by 4.4 percentage points, compared with a fall of 0.1 percentage points for all those of working age. The ethnic minority group as a whole experienced a 4.0 percentage point increase in their employment rates compared with an increase of 0.6 percentage points for the White group. Similarly, migrants have also experienced higher employment rate growth (up 5.7 percentage points) compared with counterparts born in the UK (down 0.3 percentage points).
- 2.121** Employment rates for disabled people have risen strongly, up by 4.4 percentage points, and fallen for those without disabilities, down 1.4 percentage points. However, young people and those without qualifications have not done as well. Employment rates for those without qualifications, admittedly an ageing and shrinking group, have fallen by over 8 percentage points to just 42.6 per cent. The employment rates for 16-17 year olds have fallen by 26.0 percentage points and for 18-20 year olds by 14.2 percentage points since the first quarter of 1999, although much of this is directly related to the increased participation of young people in full-time education. A more detailed analysis of the impact of the NMW on young people is presented in Chapter 3.

Table 2.11: Employment Rates, by Groups of Workers, UK, 1999-2013

(Rates: per cent; changes: percentage points)	2013 Q3	Change on:		
		2012 Q3	2008 Q2	1999 Q1
Working age	71.6	0.7	-1.3	-0.1
Men	76.5	0.5	-2.4	-2.0
Women	66.7	0.9	-0.2	1.8
16-17 year olds	22.0	-1.9	-12.1	-26.0
18-20 year olds	47.0	-0.1	-9.6	-14.2
Older workers (65+)	9.5	0.6	2.3	4.4
White	73.2	0.8	-1.3	0.6
All ethnic minorities	60.0	0.4	-0.5	4.0
Black	61.5	1.5	-2.2	0.4
Indian	71.1	1.4	2.4	8.0
Pakistani/Bangladeshi	49.5	-0.8	3.7	11.1
Other non-white	58.5	0.3	-3.2	1.5
UK born	72.3	0.7	-1.3	-0.3
Non-UK born	68.0	1.2	0.0	5.7
With qualifications	74.9	0.6	-3.3	-3.5
No qualifications	42.6	0.8	-5.1	-8.2
Not disabled (16-59/64)	78.6	0.5	-2.0	-1.4
Disabled people (16-59/64)	42.1	0.1	1.9	4.4

Source: LPC estimates based on LFS Microdata, quarterly, four-quarter moving average, UK, Q2 1998-Q3 2013.

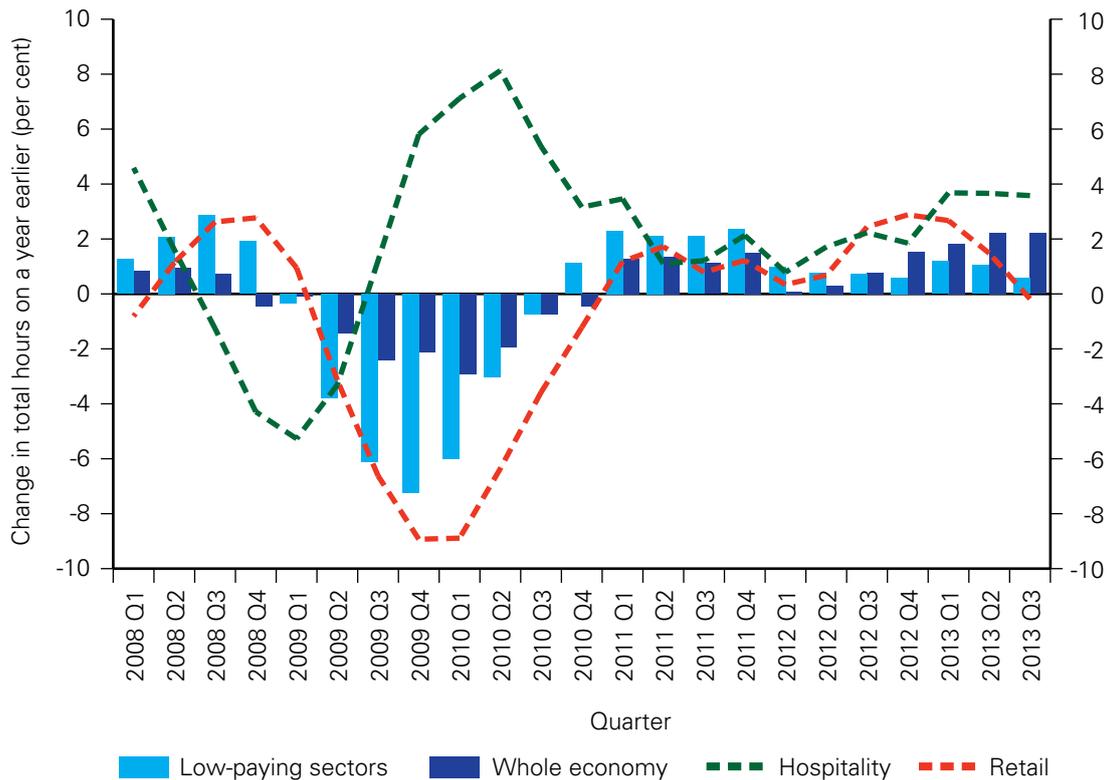
Note: Working age, unless otherwise stated.

- 2.122** Taking the period since the recession began (the second quarter of 2008), a similar picture emerges with women, ethnic minorities, and migrants suffering smaller than average falls in employment rates while employment rates actually rose for older workers and disabled people. In contrast, employment rates continued to fall sharply for young people and those with no qualifications.
- 2.123** Over the year to the third quarter of 2013 employment rates for 16-17 year olds have continued to deteriorate. For 18-20 year olds, their employment rate was more or less the same as a year ago. However, these overall data disguise a more positive performance in both groups among those not in full time education. There had been an upturn for those with no qualifications, with employment rates rising by 0.8 percentage points to 42.6 per cent. Ethnic minorities and the disabled had not performed as well over the last year as those outside of these groups, with the exception of migrants born outside the UK. Although ethnic minorities as a whole performed worse than their White counterparts, there was some divergence, with strong increases in the employment rates of the Black and Indian ethnic groups, but a fall in the employment rate of the Pakistani/Bangladeshi group to below 50 per cent.

Hours

- 2.124** As we noted above, instead of adjusting the extensive margin by changing employment, it is also possible for employers to try to cope with the minimum wage by adjusting hours. The number of hours worked in the UK economy as a whole increased by around 7 per cent between the introduction of the minimum wage and the onset of recession (from 888.3 million in March 1999 to 949.3 million in March 2008). It then fell in the recession by over 4 per cent, reaching a nadir of 904.5 million in August 2009, before recovering and by the spring of 2013 it had returned past its previous peak (950.3 million in March 2013). In October 2013, 966.7 million hours were worked in the UK each week, nearly 9 per cent more than when the minimum wage was introduced.
- 2.125** Figure 2.20 shows that during the recession the fall in hours was greater in the low-paying sectors than for the economy as a whole. But it also shows that as the economy began to recover, hours worked picked up faster in the low-paying sectors than in the economy as a whole. Using quarterly data, total hours worked were 1.4 per cent higher in the third quarter of 2012 than in the first quarter of 2008. For the low-paying sectors total hours worked were about 1.5 per cent lower.
- 2.126** However, between the fourth quarter of 2010 and the third quarter of 2012 hours rose by 3.0 per cent in the low-paying sectors compared with 1.9 per cent in the whole economy. The pick-up in the economy in 2013 is highlighted by the strong growth in hours over the year to the third quarter of 2013, up 2.2 per cent. However, the growth in hours has been much weaker in the low-paying sectors, with hours just 0.5 per cent higher in the third quarter of 2013 than a year previously. The low-paying sectors accounted for about 26.5 per cent of all hours in the first quarter of 2008, falling to 25.7 per cent in the fourth quarter of 2009, but rising to 26.3 per cent by the fourth quarter of 2011 before falling back to 25.8 per cent in the third quarter of 2013.
- 2.127** There is a noticeable contrast between the hospitality and retail sectors where movements in hours tended to mirror each other before and during the recession. In hospitality hours actually increased during the recession, rising by 3.4 per cent between the first quarter of 2008 and the second quarter of 2010. In retail hours fell by 8.1 per cent over the same period. However, hours increased by 3.0 per cent in retail and by 7.2 per cent in hospitality between the third quarter of 2010 and the third quarter of 2013. This compares with an increase of 4.1 per cent in the whole economy.

Figure 2.20: Annual Change in Hours Worked, by Sector, UK, 2008-13



Source: LPC estimates based on LFS Microdata, quarterly, four-quarter moving average, UK, Q2 2006-Q3 2013.

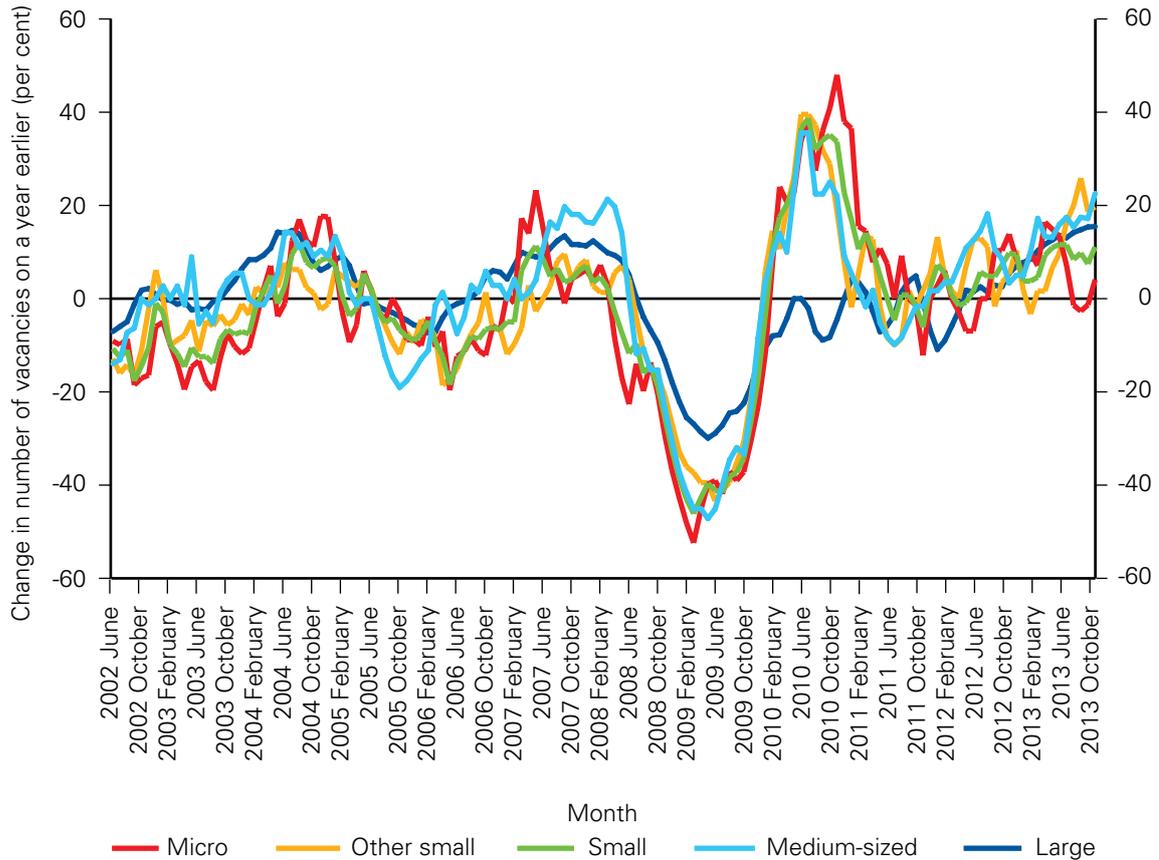
Vacancies and Redundancies

2.128 The strength, or otherwise, of the labour market can also be measured by looking at the number of new jobs created, vacancies, and the number of jobs being lost, redundancies. The stock of unfilled vacancies peaked in February 2008 at 695,000 but then fell sharply before bottoming out at 430,000 in May and June 2009. Since then vacancies have recovered to 562,000 in October 2013, up 73,000 on the previous October but still well below its pre-recession peak.

2.129 A similar picture appears for the hospitality and distribution (which comprises the wholesale and retail) sectors. Vacancies in both low-paying sectors peaked in February 2008 (at 135,000 in distribution and 67,000 in hospitality) before falling throughout the recession (to lows of 76,000 in April 2009 in distribution, and 40,000 in hospitality in May 2009). Vacancies in both sectors have since grown moderately, reaching 119,000 and 62,000 respectively in October 2013, still below their pre-recession levels.

2.130 Figure 2.21 shows that numbers of vacancies by size of firm follow a similar general trend albeit that the pattern for large firms differs somewhat from the trends for small and medium-sized firms. During the recession, vacancies fell first among micro firms, then other small and medium-sized firms and last among large firms. The fall in vacancies was of a similar magnitude in micro, other small and medium-sized firms. Large firms were the least affected.

Figure 2.21: Annual Change in Vacancies, by Firm Size, UK, 2002-13



Source: LPC estimates based on ONS data: vacancies in firms with 1-9 employees (ALY5), 10-49 employees (ALY6), 50-249 employees (ALY7), 250-2,499 employees (ALY8) and 2,500+ employees (ALY9), monthly, seasonally adjusted, UK, 2001-13.

2.131 However, in 2010 the growth in vacancies among small and medium-sized firms was much stronger than in large firms. Across all sizes of firm the level of vacancies had generally been flat between the end of 2010 and the beginning of 2012, but it has turned upwards since the spring of 2012 and this upturn has continued into 2013 for the larger firms. It should be noted that the growth in vacancies has been weak in micro firms since spring 2013.

2.132 Redundancies had fallen gradually from over 207,000 in the three months to February 1999 to fewer than 120,000 in the three months to April 2008. During the recession they rose to 310,000 in the three months to April 2009 then fell to 116,000 in the three months to April 2011. The sluggishness of the economy in 2011 and redundancy programmes in the banking and public sectors then led to redundancies climbing to reach 174,000 by the three months to February 2012, but have since fallen back as the economy has started to recover. There were 120,000 redundancies in the three months to October 2013, similar to the numbers prior to the recession. There appeared to be similar trends among hospitality and retail to those observed for the whole economy.

Unemployment and Inactivity

2.133 It might be that the impact of the minimum wage is reflected in increased unemployment or inactivity. We showed earlier in this chapter that employment rates for many of the groups expected to be most affected by the minimum wage have increased since its introduction. Table 2.12 shows that older workers, ethnic minorities, disabled people and migrants have also experienced reductions or less than average increases in their unemployment and inactivity rates since the introduction of the minimum wage. With the exception of some ethnic minorities, these groups have also coped well since the start of the recession.

2.134 In contrast to the rise in inactivity rates for men, those for women have fallen since 1999, while changes in unemployment rates have been similar for both genders. Again, it is a different story for young workers and those with no qualifications who have generally seen their unemployment and inactivity rates rising.

2.135 Over the last year, the picture has reversed a little with unemployment rates falling less for women than men, but rising among ethnic minorities and disabled people. Unemployment rates fell for those with no qualifications and for 18-20 year olds but only the former saw their inactivity rates fall. Older workers and migrants followed similar trends to the average but those aged 16-17 experienced above average unemployment and inactivity rates.

Table 2.12: Unemployment and Inactivity Rates, by Groups of Workers, UK, 1999-2013

	Unemployment				Inactivity			
	2013 Q3	Change on:			2012 Q3	Change on:		
		2012 Q3	2008 Q2	1999 Q1		2012 Q3	2008 Q2	1999 Q1
Working age	7.9	-0.3	2.6	1.6	22.3	-0.5	-0.8	-1.3
Men	8.4	-0.4	2.7	1.4	16.5	-0.2	0.2	0.9
Women	7.4	-0.2	2.5	2.0	28.0	-0.8	-1.7	-3.4
16-17 year olds	37.2	0.8	11.1	17.2	65.0	2.6	11.2	25.0
18-20 year olds	24.2	-1.3	8.1	9.5	38.0	1.3	5.4	9.7
Older workers (65+)	2.1	-0.4	0.4	-0.7	90.3	-0.6	-2.4	-4.5
White	7.2	-0.4	2.3	1.3	21.1	-0.5	-0.6	-1.7
All ethnic minorities	13.8	0.2	3.2	0.4	30.4	-0.7	-2.0	-5.0
Black	16.8	-0.8	4.0	2.0	26.1	-1.1	-0.9	-2.2
Indian	9.1	-0.3	2.2	0.0	21.8	-1.2	-4.4	-8.8
Pakistani/Bangladeshi	18.9	2.8	4.5	-1.4	39.0	-1.0	-7.5	-12.8
Other non-white	12.2	-0.2	2.5	-0.1	33.3	-0.2	1.7	-1.7
With qualifications	7.3	-0.4	2.5	1.8	19.2	-0.4	1.3	2.2
No qualifications	18.2	-0.6	6.4	5.8	47.9	-0.6	2.0	6.0
Not disabled (16-59/64)	7.2	-0.4	2.4	1.5	15.3	-0.2	-0.1	0.1
Disabled people (16-59/64)	15.7	0.4	3.8	2.6	50.1	-0.3	-4.2	-6.6
UK born	7.7	-0.3	2.6	1.6	21.7	-0.4	-0.7	-1.1
Non-UK born	9.1	-0.4	2.2	0.5	25.2	-1.0	-1.7	-6.6

Source: LPC estimates based on LFS Microdata, quarterly, four-quarter moving average, UK, Q2 1998-Q3 2013.

Note: Working age, unless otherwise stated.

Research on Employment, Hours and Unemployment

- 2.136** Most of the research that has been conducted on the minimum wage has looked at some aspect of its impact on employment and hours. This is true of both the literature in the United States and here in the UK. It is difficult to summarise all of the studies that have been conducted, however, two meta-studies (studies of studies) in the United States and one in the UK have attempted to do this. Doucouliagos and Stanley (2009) looked at 64 US minimum wage studies published between 1972 and 2007 that looked at the impact on teenage employment. The results were weighted by statistical precision. They concluded that their results found “an insignificant employment effect (both practically and statistically) from minimum wage raises”. Belman and Wolfson (forthcoming) also conducted a meta-study of US research but looked at the impact on employment more generally. They also found no statistically significant negative employment effects. Using results from 16 UK studies in their meta-regression analysis, De Linde Leonard, Doucouliagos and Stanley (2013) found no overall practically significant adverse employment effect although they did find employment effects in some of their analysis. In particular, they noted that adverse employment effects could be found in the residential home care industry. Neumark and Wascher (2006) concluded from a qualitative review of the international research since the 1990s that “in our view, the preponderance of the evidence points to disemployment effects”. However, their study did not adopt the robust methodology employed by the three meta-studies that generally found no employment effects.
- 2.137** The research that we have previously commissioned in this area has also generally found little or no effect on employment. Researchers have adopted a number of different methods and approaches. These have included the analysis of: aggregate and sectoral time series data; individual data; the geographic variation in bite and coverage; industry and business data; and case studies. We provide a summary of the findings of these studies below.
- 2.138** The analysis of time series data across samples of countries has generally found that minimum wages have a statistically negative impact on employment (OECD 1998; Neumark and Wascher, 2004 and 2008). However, research undertaken in the UK has questioned these findings. Dolton and Rosazza Bondibene (2011 and 2012) found that the results were dependent on the specification of the model and definition of the minimum wage, though they did find a consistent and strong negative impact on the employment of young workers. Using time series analysis of industries, Dickens, Machin and Manning (1999) and Dickens and Dolton (2011) found no evidence of a negative impact of (Wages Council set) minimum wages on employment in the UK in the 1980s or 1990s.
- 2.139** Researchers have also used data on individuals to assess the impact of the minimum wage on employment and unemployment but these studies have also generally found little adverse impact of the minimum wage on employment. Stewart (2001, 2003, 2004a and 2004b) investigated the impact of the introduction of the minimum wage; Dickens and Draca (2005) assessed the 2003 and 2004 upratings; Dickens, Riley and Wilkinson (2009) looked at the 2003-2006 minimum wage increases; Mulheirn (2008) also investigated the 2006 upratings; and Bryan, Salvatori and Taylor (2012 and 2013) and Dolton, Rosazza Bondibene and Stops (2012) looked at the more recent upratings covering the period including and since the 2008-09 recession. Bryan, Salvatori and Taylor (2013) analysed the unemployed using

predicted entry wages and estimating job entry probabilities. All of these studies found no significant and consistent adverse effects on employment. Where negative employment effects have been found, these have generally been insignificant or not robust, for example, Dickens, Riley and Wilkinson (2012) found negative effects on the employment of female part-time workers on introduction of the minimum wage and during the recession in some specifications of their econometric modelling.

- 2.140** Spatial analysis, taking advantage of variations in pay across the country, has also been used to investigate the impact of the minimum wage on employment. The probability of employment or employment growth in the lowest wage areas has been compared with the probability of employment or employment growth in slightly higher wage areas. In general this research has found very little impact of the minimum wage on employment. Stewart (2002) found some weak but not statistically significant evidence of a fall in employment as a result of the introduction of the minimum wage. Dickens, Riley and Wilkinson (2009) found no effect of the upratings between 2001 and 2006. Dolton, Rosazza Bondibene and Wadsworth (2009) found no effect on employment over the period 1997-2007. Indeed those last two studies found evidence that unemployment had fallen in particular as a result of the large upratings between 2003 and 2006. Using data from 1999-2011, Dolton, Rosazza Bondibene and Stops (2012) and Dickens, Riley and Wilkinson (2012) also found no adverse effects on employment. In the most recent study, using data up to 2012, Bryan, Salvatori and Taylor (2013) found evidence that the NMW had increased job entry rates in the mid-2000s with some weak evidence that this had reversed during the recession. The pre-recession results were consistent with previous findings from Dolton, Rosazza Bondibene and Wadsworth (2009), and Dickens, Riley and Wilkinson (2012).
- 2.141** In contrast to all these previous findings, and using data on firms and industries rather than individuals, Galinda-Rueda and Pereira (2004) found that the minimum wage had adversely affected employment growth in the lowest-paying areas. Experian (2007), also using industry data, found no adverse employment effects of the 2003 and 2004 upratings of the NMW. Although their research was focused on the impact of the minimum wage on competitiveness, Riley and Rosazza Bondibene (2013) using data on firms found little evidence that the introduction of the NMW had any effect on employment, and this was also the case during the recession.
- 2.142** As well as employment, researchers have also investigated the impact of the minimum wage on hours. There appears to be more evidence of effects with regards to hours than employment, although the estimated reductions in hours have not been sufficient to reduce weekly earnings. Stewart and Swaffield (2004) found significant reductions in hours as a result of the introduction of the minimum wage, although an earlier study by Connolly and Gregory (2002) found no such strong effects. Nor did Robinson and Wadsworth (2007) in their study of second jobs and hours worked. Dickens, Riley and Wilkinson (2009 and 2012) and Bryan, Salvatori and Taylor (2012) found reductions in hours, particularly among young workers. However, Bryan, Salvatori and Taylor (2013) updated their earlier analysis and concluded that they could find no systematic effect of the NMW on hours worked by adults across time or even during the recession.

- 2.143** Several case studies of various industries have investigated the introduction of the National Minimum Wage. These have also, in general, concluded that there had been no employment effects from minimum wage increases. Georgiadis (2013) investigated the impact of the minimum wage in residential care homes, building on previous research in this area. Machin, Manning and Rahman (2003), Machin and Wilson (2004) and Georgiadis (2006) had all found that the wage structure had been affected by the NMW, but only moderate employment effects had resulted. The lack of employment effects might be explained by the findings of Draca, Machin and Van Reenen (2011) that the minimum wage had reduced the profitability of care homes. Georgiadis (2013) found evidence to suggest that the NMW may have acted as an efficiency wage, in that increases in the minimum wage had been partly offset by reductions in supervisory staffing.
- 2.144** Recent research in the United States has added to the debate about minimum wage effects on employment. Meer and West (2013a and 2013b) found that raising the minimum wage may have had little or no effect on the level of employment but it did hurt employment growth over time. They found very large effects, where a 10 per cent increase in the minimum wage led to a reduction in annual job growth of a quarter (from 2 per cent to 1.5 per cent). Schmitt (2013b) questioned their results as these estimates were 'outside the range of almost all earlier research'. Further, other recent US studies which take account of local area effects found no such strong results. Allegretto, Dube, Reich and Zipperer (2013) looked at the impact of the minimum wage on teenagers and fast food workers. They used four data sets and six approaches and all suggested that the employment effects are small. Dube, Lester and Reich (2013) found a sizable negative effect on flows but not on stocks. They found a significantly negative impact on separations, hires and turnover rates for teenagers and restaurant workers; however, they found no impact on the level of employment.
- 2.145** For this report, we commissioned two research projects that investigated the impact of the minimum wage on employment and the use of flexible types of employment. Gregg and Papps (2014) used individual data from the Labour Force Survey (LFS) to assess the impact of the minimum wage on employment. They found significant negative effects on job retention but failed to take account of increased job entry as a result of higher wages. In their analysis of weekly pay using ASHE, they also found that the minimum wage reduced work hours among those who remained with their employer, albeit this reduction was small and not sufficient to reduce weekly pay.
- 2.146** Bewley, Rincon-Aznar and Wilkinson (2014) also investigated the impact of the minimum wage on flexible employment using the Workplace Employment Relations Survey as well as the LFS. They found that the use of flexible employment over time was largely due to factors other than the minimum wage. Employers that were most affected by the minimum wage had not tended to respond to minimum wage increases by adjusting their use of flexible working practices. There was also only limited evidence that the impact of the minimum wage during the recession was in anyway related to the use of flexible employment. They concluded that the ability of low-paying workplaces to weather the recession did not depend on the use of flexible employment practices.

Views on Employment and Hours

- 2.147** The CBI argued that the encouraging job creation in the low-paying sectors had not been uniform. In oral evidence it gave the example of the retail sector, where employment growth was weaker for small retailers, who were the minimum wage employers in the sector, not the big supermarkets. It referred to survey evidence that 16 per cent of small retailers were citing the minimum wage as a major business issue in 2014 compared with 10 per cent in 2013.
- 2.148** The Association of Convenience Stores pointed to evidence from its annual survey of members which it said showed there was a clear correlation between increases in the minimum wage and a reduction in staff hours and changed pay structures from 2010 to present. This was also true of delays to expansion and investment, with 75 per cent indicating they had delayed plans. The British Retail Consortium's survey of members found that the 1.8 per cent increase in the NMW in October 2012 directly caused one in twenty five retailers to either reduce the number of staff they employ or reduce hours worked – but all were non-food retailers, indicating again the differential impact of the NMW on the retail sector. One in eight retailers expected to reduce staff levels or hours worked as a direct result of the October 2013 NMW increase (all non-food retailers).
- 2.149** The British Chambers of Commerce said the squeeze on living standards in recent years had been an 'unfortunate but necessary' consequence of the recession, and the consequent fall in productivity. Low wage increases have made it possible for UK firms to maintain higher levels of employment than would otherwise have been the case.
- 2.150** During a Commission visit to Nottingham, a member of the Federation of Wholesale Distributors with a medium-sized firm told us how with 60 per cent of its staff on the NMW, every 10 pence increase in the NMW directly cost it £50,000-£60,000, but it also needed to increase the pay of those above that level to maintain differentials, so overall, £100,000 would be added to the wage bill. In reality the company said it had to employ fewer people in order to 'keep a lid on wages'.
- 2.151** The Institute for Family Business said that studies showed that rises in minimum wages which were faster than the rise in average wages had an adverse impact on employment. It claimed that such rises had occurred in the UK which suggested that the level of the NMW was now too high.
- 2.152** The evidence from trade unions emphasised there was little evidence that the NMW had a detrimental effect on employment, and that the sectors most affected by the NMW were performing better than other parts of the economy. Indeed, Unite believed that the evidence continued to show that a NMW in the UK has had a positive effect, pointing to an increase in employment in the low-paying sectors of 16 per cent since its introduction.
- 2.153** The TUC referred to the number of employee jobs in the low-paying sectors as a whole having increased since the economic downturn began. This it contrasted with the broader economy, where employee numbers had still not recovered. On the same point the Communication Workers' Union said four in five jobs created since June 2010 had been in industries where pay was generally low. It said unemployment was not driven by the NMW,

it was a more complex picture that encompassed low demand, lack of confidence, reduced investment and the stockpiling of capital. Within retail, the largest low-paying sector, Usdaw pointed to the latest available official figures (at the time of submission) which showed employment in retailing had gone up by 19,000 over the last year. The union thought the level of the NMW was clearly not having a detrimental impact on employment levels in the sector.

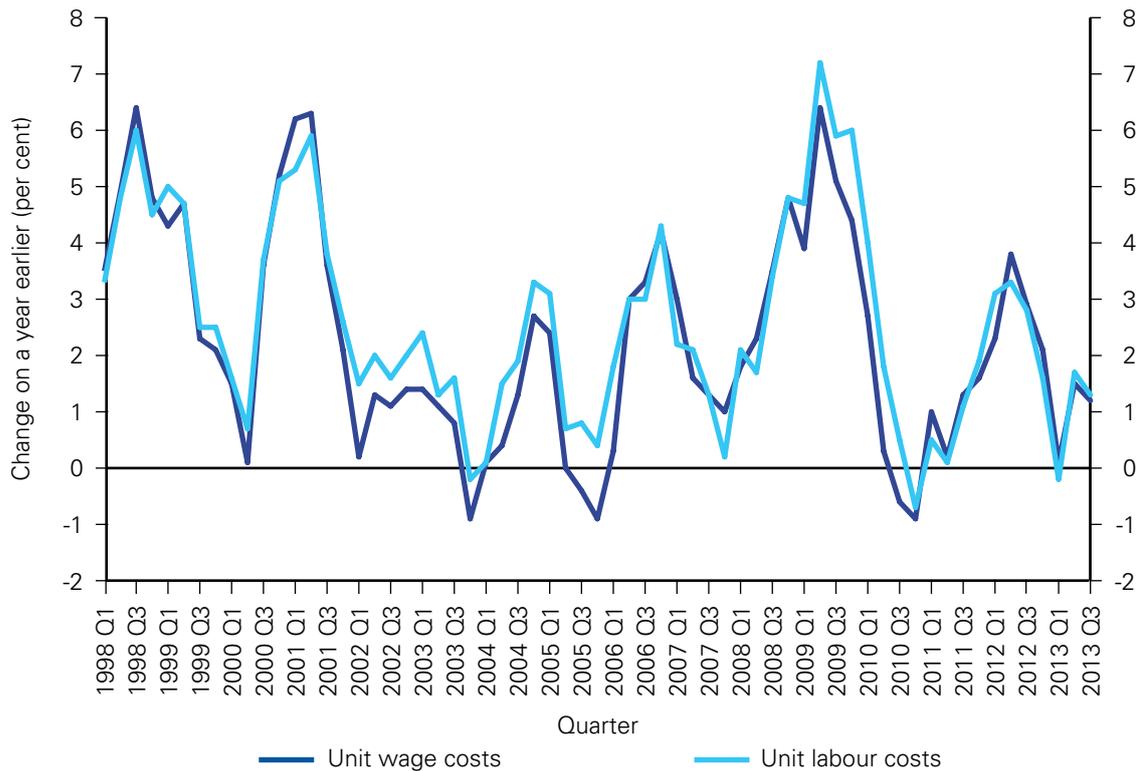
Impact on Competitiveness

2.154 Instead of reducing employment or cutting hours, firms may attempt to cope with minimum wage increases by seeking to absorb them within their costs; pass on increases in prices to customers; absorb them by reductions in profits; or raise the productivity of their workforce. Before considering each of these, we next look at labour costs.

Costs

2.155 As we noted above, pay settlements and average earnings growth have been relatively subdued since the onset of recession in 2008. Real earnings have fallen over this period. However, this had not been reflected in the annual change in unit costs of wages and labour, as productivity had also fallen. Figure 2.22 shows that during the recession the annual change in unit wage costs increased from about 1-2 per cent (in early 2008) to around 6-7 per cent (in the middle of 2009), as the fall in employment was less than the loss of output. As output recovered at the end of 2009 and into 2010, growth in unit wage costs slowed, becoming negative through much of 2010. The stagnation in output since the third quarter of 2010, combined with the increase in employment, led to an increase in unit wage costs, with annual growth reaching around 4 per cent in the third quarter of 2012. Since then, the economy has shown signs of recovery with output increasing. Alongside this pick-up in growth, wage growth has also remained subdued leading to falls in the growth of unit wage costs to around 1 per cent.

Figure 2.22: Annual Change in Unit Wage and Labour Costs, UK, 1998-2013



Source: ONS, unit wage costs (LOJE) and unit labour costs (DMWN), quarterly, seasonally adjusted, UK, Q1 1998-Q3 2013.

2.156 The annual change in unit labour costs has followed a similar pattern. From the end of 2008 to the end of 2010, annual changes in unit labour costs slightly exceeded those in unit wage costs, suggesting that employers were experiencing increasing non-wage costs, such as higher pension and National Insurance contributions. Since the end of 2010 to early 2013 increases in unit wage and labour costs have been similar, suggesting no such additional contributions through this period. However, in the second and third quarters of 2013, unit labour costs appeared to have grown faster than unit wage costs. This could reflect the pension reforms and the introduction and roll out of auto-enrolment. These data do not allow detailed sectoral analysis.

2.157 As well as labour costs, businesses have experienced increases in other costs in recent years. These have included index-linked business rate rises, above-inflation increases in energy costs and increased import costs (as a result of the depreciation of sterling since 2007). However, increases in the costs of business-to-business services have by and large been smaller than the general increase in prices.

Prices

- 2.158** Firms affected by increases in their labour costs as a result of the minimum wage might try and pass their costs on to customers in the form of higher prices. There are three main sources of detailed information on consumer and business-to-business prices. The CPI and RPI collate information on prices to consumers, while the Services Producer Price Index (SPPI) collects information on business-to-business transactions. Since the introduction of the minimum wage in April 1999, SPPI has increased by 33 per cent, while CPI and RPI have risen faster, by 38 and 53 per cent respectively. For the most part, it appears that firms may have found it easier to increase the prices of minimum wage goods and services (those produced by firms in low-paying sectors with a high proportion of minimum wage workers) to consumers rather than to other businesses. Table 2.13 suggests that since the introduction of the minimum wage the prices of selected consumer goods and services have risen much faster than prices in general. Between 1999 and 2013, prices in restaurants and cafes; canteens; hairdressers; and dry cleaners had all increased faster than CPI. Similarly, the prices of restaurant, canteen, and takeaway meals; wine and beer; and personal services had all increased faster than the general level of RPI.
- 2.159** In contrast, prices for many business-to-business minimum wage goods and services had typically increased much less than general price rises. An exception to this was employment agencies, where prices to business had gone up slightly more than the general increase in business-to-business prices. The price rises to businesses for industrial cleaning, dry cleaning and hotels had been much lower than the general increase in prices since 1999. However, considering increases over the whole period from 1999-2013 disguises changes that have occurred within this period.
- 2.160** Since the onset of recession in 2008, firms appear to have been much less able to pass on price rises to consumers although there is a difference between the CPI and the RPI. Between 2007 and 2012, the price rises in selected minimum wage goods and services for consumers were generally below the general increase in CPI prices, and the relative growth in these prices continued to weaken in 2013. The price rises in selected minimum wage goods and services using the RPI continued to increase faster than the general increase in the RPI. However, over the last year, this has reversed and we can see that prices in those selected goods and services grew more slowly than the general price rise. Over the last year, only prices in personal services and canteens had increased faster than consumer prices in general, and these increased only just above the general increase. Price rises for business-to-business transactions still appear much more constrained than price rises to consumers. Business-to-business prices were particularly weak in 2013, apart from in canteens and catering, which were possibly affected by an increase in food prices.

Table 2.13: CPI, RPI and SPPI Price Inflation for Selected Goods and Services, UK, 1999-2013

		Percentage change				
		1999 Q1- 2004 Q3	2004 Q3- 2007 Q3	2007 Q3- 2012 Q3	2012 Q3- 2013 Q3	1999 Q1- 2013 Q3
CPI	All items	7.0	6.7	17.6	2.8	38.0
	Restaurants and cafes	17.2	10.0	19.7	2.7	58.4
	Canteens	28.8	11.6	14.2	3.0	69.2
	Dry cleaning	18.0	13.8	14.2	1.8	56.2
	Domestic and household services	38.5	14.4	12.2	1.5	80.6
	Hairdressing	31.1	12.2	13.4	1.3	68.9
RPI	All items	14.5	10.5	17.4	3.2	53.3
	Restaurant meals	19.1	9.0	18.9	2.9	58.9
	Canteen meals	32.0	11.9	14.2	2.4	72.6
	Take-aways and snacks	18.2	9.2	18.4	2.5	56.6
	Beer on-sales	16.4	11.4	21.6	2.0	60.8
	Wine and spirits on-sales	18.0	9.3	23.0	3.1	63.6
	Domestic services	35.0	15.5	15.7	1.8	83.6
	Personal services	32.7	14.3	20.4	3.4	88.9
SPPI	Net sector	10.6	8.7	9.8	0.3	32.9
	Hotels	9.7	13.1	-5.3	-1.9	15.2
	Canteens and catering	8.1	9.2	8.9	2.1	31.2
	Employment agencies	20.9	7.5	5.2	-1.4	34.7
	Industrial cleaning	4.2	8.0	6.1	1.5	21.2
	Commercial washing and dry cleaning	8.3	5.7	3.2	1.5	19.8

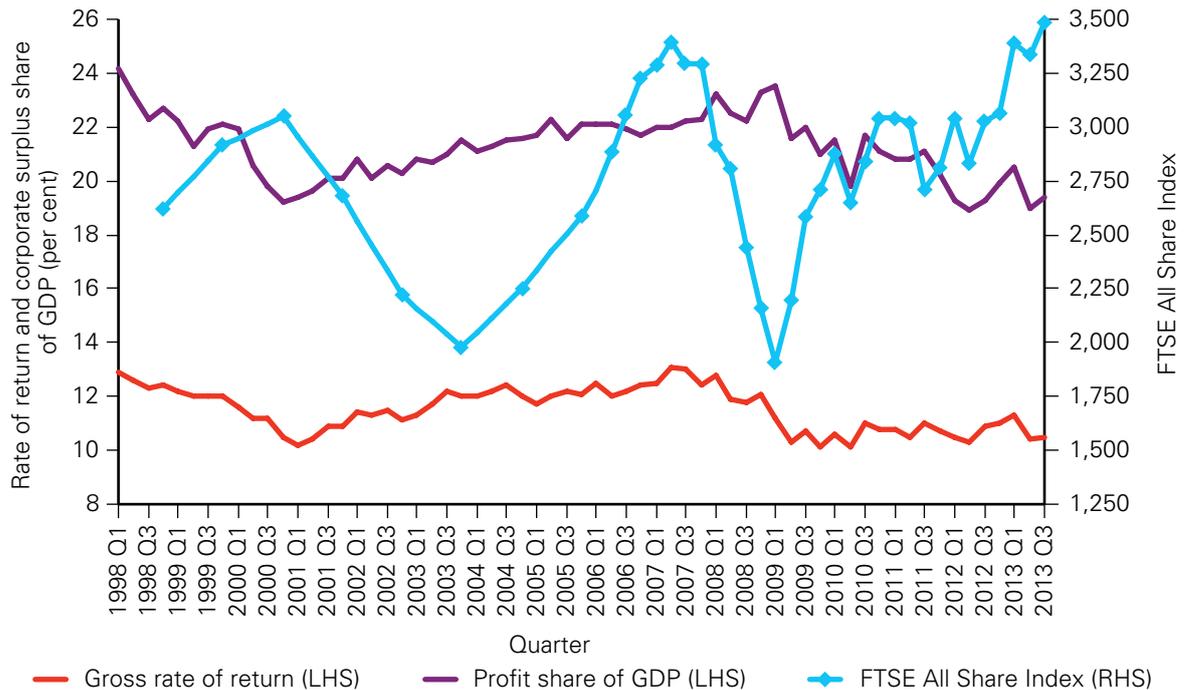
Source: LPC estimates based on ONS data: CPI all items (D7BT); restaurants and cafes (D7EW); canteens (D7EX); dry-cleaning, repair and hire of clothing (D7DM); domestic services and household services (D7E6); hairdressing and personal grooming establishments (D7EY); RPI all items (CHAW); restaurant meals (DOBE); canteen meals (DOBF); take-aways and snacks (DOBG); beer on sales (DOBI); wine and spirits on sales (DOBL); domestic services (DOCI); personal services (DOCR); SPPI aggregate net sector SIC 2003 basis (I5RX) and SIC 2007 basis (K8ZW); hotels (K8TE); canteens and catering (K8TP); employment agencies (K8XZ); industrial cleaning (K8YQ); commercial washing and dry cleaning (K8ZM), quarterly, not seasonally adjusted, UK, Q1 1999-Q3 2013.

Note: SIC 2007-based SPPI net sector (transactions between business services and other sectors excluding business services) data are only available from Q1 2003 onwards. On the SIC 2003 basis they are available from Q1 1998-Q3 2010. Data provided here use the SIC 2003 basis and assume it would have grown at the same rate as the SIC 2007 data from Q2 2010-Q3 2013. All other SPPI figures are on the SIC 2007 basis.

Profits

- 2.161** If firms are unable to pass increased costs on to their customers in the form of higher prices, they may have to try and absorb those costs by accepting reduced margins. At the aggregate level, we can measure profits in many ways, which generally give similar indications of what is happening to profits in the economy. From the National Accounts, we can measure profits by using gross trading profits or gross operating surplus of corporations. After falling by 0.7 per cent in 2008 and a further 10.1 per cent in 2009, gross trading profits for UK non-oil and non-financial corporations increased by 4.0 per cent in 2010 and 5.9 per cent in 2011. However, they did fall in the final quarter of 2011 and remained below this level until the third quarter of 2012, but have since recovered with gross trading profits 2.6 per cent higher in the third quarter of 2013 than in the third quarter of 2011, and 0.7 per cent higher than a year ago.
- 2.162** Gross operating surplus has followed similar trends. When expressed as a proportion of GDP, it is often referred to as 'the profit share'. Figure 2.23 shows that the profit share fell at around the time of the introduction of the minimum wage from around 22 per cent of GDP to about 19 per cent at the end of 2000, before embarking on a general upward trend that peaked at 23.5 per cent at the beginning of 2009. It has since fallen back to around 19 per cent in 2013.
- 2.163** The gross rate of return on capital employed can also be used as a measure of profits. Using this measure, Figure 2.23 suggests that the profit rate has increased since the second quarter of 2012, peaking at 11.3 per cent in the first quarter of 2013. It is, however, well below its pre-recession mid-2007 peak of 13.1 per cent. The net rate of return has followed a similar path. Although a detailed sectoral breakdown of these data is not available, ONS does provide figures for manufacturing and services separately. Having fallen from 12.4 per cent to 8.4 per cent between the second quarter of 2008 and the last quarter of 2010, profits in manufacturing recovered to 9.4 per cent in mid-2011, but have since fallen again, dipping below 9.0 per cent in the third quarter of 2011 and remaining between 7.6 and 8.8 per cent in 2012 and 2013. Profits in services fell by less during the 2008-09 recession (from 16.2 per cent in the first quarter of 2008 to 13.2 per cent in the second quarter of 2010), but have since picked up and stood at 14.2 per cent in the third quarter of 2013.
- 2.164** Share prices offer an alternative measure of (future) profitability. Figure 2.23 also shows how the FTSE All Share Index has changed over time. Prior to the recession it peaked at about 3,400 in the second quarter of 2007, before falling sharply through the recession and bottoming out in the first quarter of 2009 at around 1,900. A sharp rebound carried it back to 3,000 in the fourth quarter of 2010 where it stood in the third quarter of 2012. In the period preceding our meeting in January 2014 it had again risen, to 3,500 in the third quarter of 2013, above its pre-recession peak.

Figure 2.23: Selected Profit Measures, UK, 1998-2013



Source: ONS, Gross rate of return (LRX0) and profit share of GDP (IHXM), quarterly, seasonally adjusted and BoE, FTSE All Share Index, UK, Q1 1998-Q3 2013.

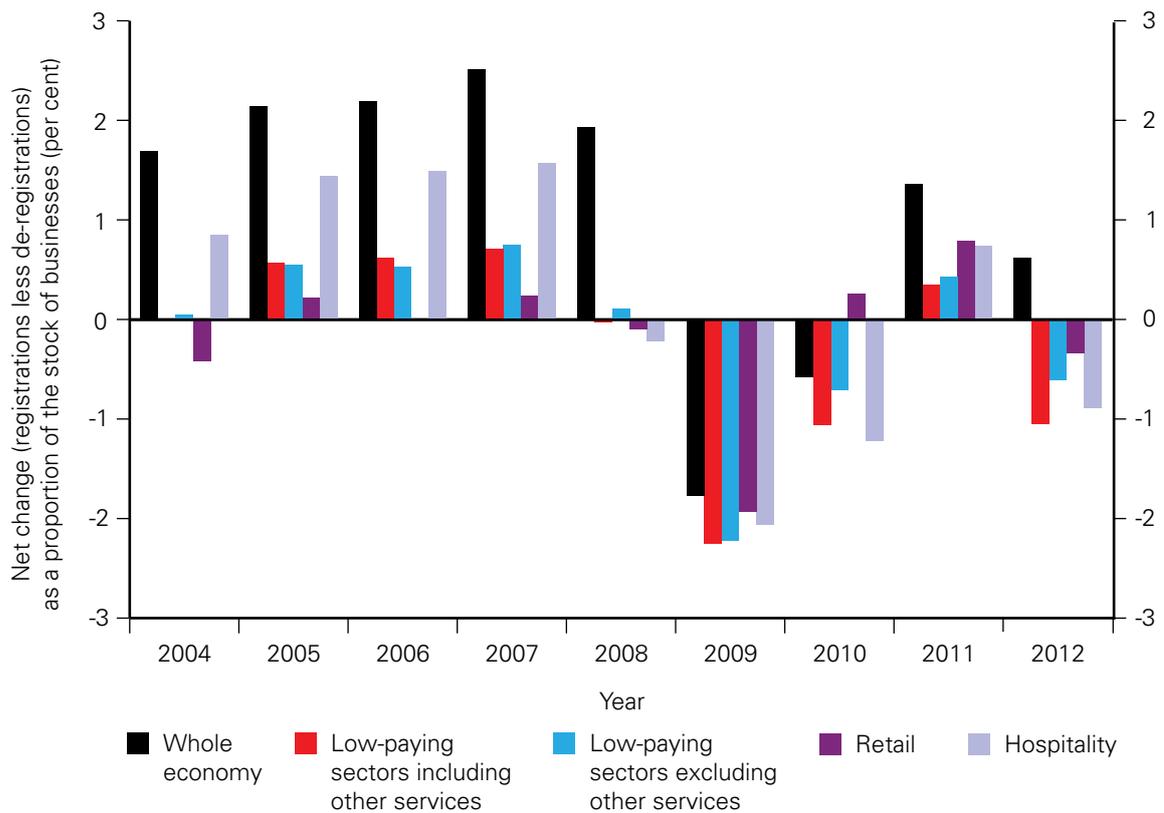
2.165 However, we should note that it is difficult to get information on profits at a more disaggregated level. Most of the information set out above relates mainly to the behaviour of large firms. Our anecdotal evidence suggests that profitability varies considerably by sector and by size of firm. Small firms and certain low-paying sectors appear to have faced far smaller profit margins than large firms. This seems to be supported by evidence that is available, including accounts we heard during our visits around the UK. In a survey of small businesses conducted in 2012, BIS (2013c) found that 72 per cent of small and medium-sized enterprise (SME) employers generated a profit or surplus in their last financial year. Medium-sized businesses were more likely to have done so (86 per cent), compared with 75 per cent of other small firms and 71 per cent of micro firms. The survey also found that slightly more businesses made a profit than in the previous survey undertaken in 2010 (up 1 percentage point overall).

2.166 Business Population Estimates for the UK showed that between the start of 2011 and start of 2012, annual turnover of all firms increased by about 3 per cent. Turnover in micro firms increased by over 3 per cent and nearly 7 per cent for medium-sized firms. However annual turnover continued to fall for other small firms (down over 1 per cent). Between the start of 2010 and the start of 2012, annual turnover fell in both micro and other small firms (as well as large firms) but there had been an increase overall for medium-sized firms. However, annual turnover rebounded a little in 2013. Between the start of 2012 and start of 2013, annual turnover rose for all sizes of firm in the private sector, by about 5 per cent. However, annual turnover for micro firms fell 7 per cent, whereas other sizes of firm saw turnover increase between 2012 and 2013. Turnover was up 4.9 per cent in other small firms and 9.1 per cent in medium-sized firms.

Births and Deaths of Firms

- 2.167** Another indicator of how well businesses are able to cope with the minimum wage is to look at its impact on the levels and changes in both the creation of new businesses (start-ups) and the deaths of existing businesses (failures). It should be noted that many factors can affect this, in particular consolidation due to mergers and acquisitions, which is likely to be important in the low-paying sectors. An increase in wage costs, caused by a rise in the minimum wage, might make it less attractive to start a business. Further, increases in the minimum wage might squeeze profits enough to lead firms to exit the market. In this section, we look at the aggregate and, where possible, sectoral picture of business start-ups and failures, and company insolvencies.
- 2.168** The stock of enterprises registered for VAT increased in every year from 1995 to 2008 but the recession prompted falls in 2009 and 2010. The latest data, for 2012, suggested that the stock of enterprises has now increased for two consecutive years, albeit the growth was weaker in 2012 than 2011. The number of births, firms registering for VAT, fell from 281,000 in 2007 to around 235,000 in 2009 and 2010, but bounced back strongly in 2012 to 270,000. The number of firm deaths, businesses de-registering from VAT, rose sharply from 223,000 in 2008 to 277,000 in 2009 but then fell back to 250,000 in 2010 and 230,000 in 2011. However, the number of firm deaths rose to 255,000 in 2012. This suggested a weaker recovery in 2012, although the number of business births was still lower, and the number of business deaths higher, than their pre-recession levels.
- 2.169** Although the stock of firms in the whole economy increased by nearly 2 per cent in 2008, Figure 2.24 shows that it fell marginally in the low-paying industries. In 2009, as the economy suffered its worst recession since the 1930s, the percentage reduction in the number of firms was greater in the low-paying industries (2.2 per cent) than in the economy as a whole (1.8 per cent). This pattern, albeit with fewer net firms lost, continued in 2010. Hospitality appeared more affected than retail, which experienced net growth.

Figure 2.24: Net Change in Stock of Firms, by Selected Low-paying Industry, UK, 2004-12



Source: LPC estimates based on ONS data; business demography, enterprise births, deaths and survivals, annual, not seasonally adjusted, UK, 2004-12.

Note: From 2008 onwards these data are based on SIC 2007, before 2008 they are based on SIC 2003. Care should be taken in comparisons between 2007 and 2008.

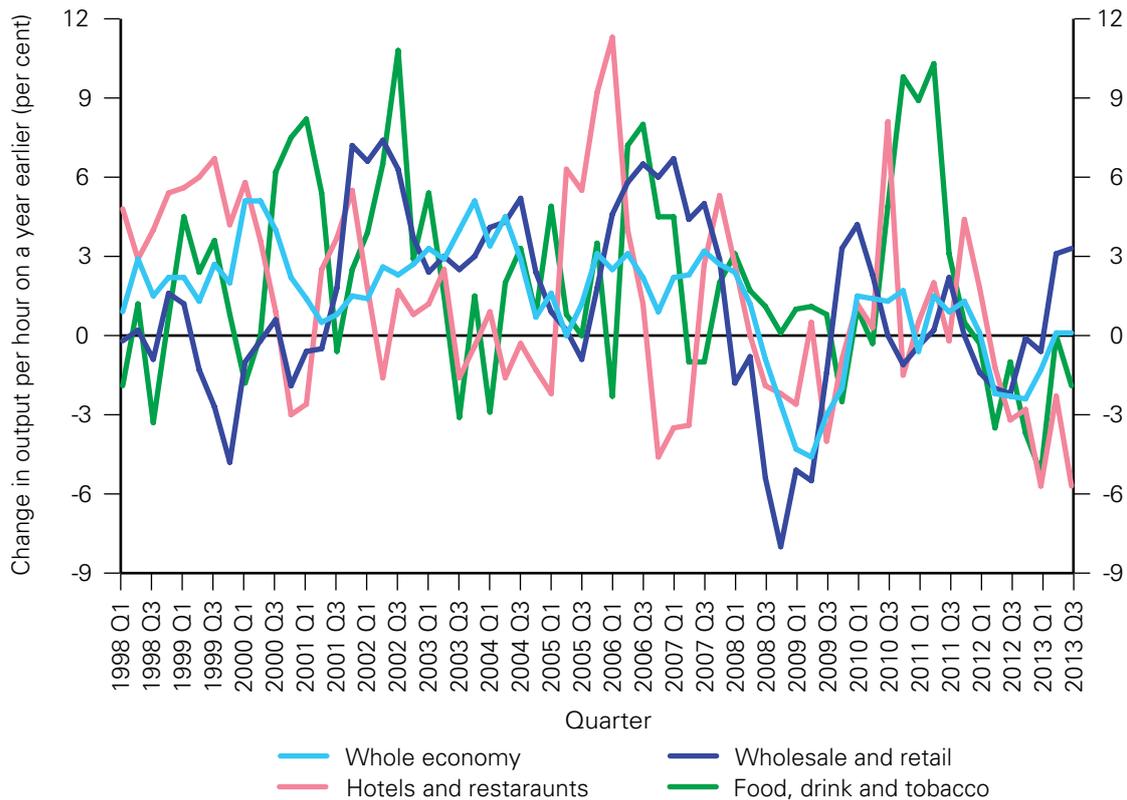
2.170 In 2012 the net change in the stock of firms across the whole economy grew by 0.6 per cent, compared with a 0.6 per cent fall in the low-paying industries. The net change in the stock of firms has fallen more sharply in hospitality (down 0.9 per cent) than in retail (down 0.3 per cent) and in the low-paying industries as a whole (down 0.6 per cent). These data on business creation and destruction contrast with our findings on employment. When assessing employment, we found net job growth had been greater in the low-paying industries than in the overall economy between 2011 and 2012.

2.171 We can also analyse the stock of businesses by size of firm. Business Population Estimates suggest that the number of micro firms in the UK economy increased in most years between 2000 and 2013, and over the whole period increased by over 8 per cent, rising to 987,000 firms by 2013. The picture for other small firms has been more mixed, with a large increase in the number of other small firms in 2002 but falls in 2004 and 2010. Over the whole 13 year period, the number of other small firms has increased by 15 per cent to 187,000 firms. The number of medium-sized firms has increased at a similar pace to other small firms, rising by close to 14 per cent over the period, to 31,000 firms by 2013. Finally, and in contrast to the findings for other sizes of firm, the number of large firms in the UK economy has decreased over the period, largely due to significant falls between 2002 and 2004, and between 2009 and 2010. Overall, between 2000 and 2013, the number of large firms fell by 8 per cent to 6,600.

Productivity

- 2.172** Other than reducing employment and hours; passing on costs in higher prices to customers; or absorbing costs through a squeeze in profits, businesses can look at ways to improve the productivity of their workforces. There are a number of ways that firms can do this. They could monitor or motivate workers to put in extra effort; adjust the work organisation to improve the capital-labour mix; invest in new equipment to replace existing workers; invest in new technology to improve the quality of capital; and/or invest in improving the quality of labour through education and training. Each of these would lead to an increase in labour productivity.
- 2.173** As noted in Chapter 1, official data showed productivity (whether measured per hour or per job) falling throughout the 2008-09 recession as losses in output were greater than the reductions in hours or employment. Output grew with economic recovery from mid-2009 and into 2010, and productivity per hour and per job also picked up. But since the end of 2010, as output has stagnated and employment and hours have risen, productivity on both measures has weakened. Indeed productivity per job was flat or falling and productivity per hour fell in each of all four quarters of 2012. Output per hour has remained weak in 2013 but output per job has increased since the beginning of 2013.
- 2.174** No clear picture emerges when looking at productivity by sector. Figure 2.25 shows that productivity in the food, drink and tobacco manufacturing sector held up reasonably well during the recession, but that productivity in retail and hospitality fell as it did in the economy as a whole. Productivity picked up strongly in retail towards the end of 2009 and, with a lag, in hospitality; and food, drink, and tobacco manufacturing. Figure 2.25 also shows that the general weakness in productivity since the end of 2011 was observed across much of the economy, but particularly in hospitality. Although manufacturing productivity held up well during the recession and markedly improved in 2010, reflected in the productivity performance in the food, drink and tobacco manufacturing sector, this dissipated in 2012 with productivity falling, as in much of the rest of the economy. However, productivity in the food, drink and tobacco manufacturing, and hospitality sectors continued to be weak in 2013. In contrast, productivity in retail has risen strongly since the beginning of 2013.

Figure 2.25: Productivity per Hour, by Selected Low-paying Industry, UK, 1998-2013



Source: ONS, output per hour for the whole economy (LZVD); wholesale and retail (DJQ6); hotels and restaurants (DJR4); food, drink and tobacco (DJL3); quarterly, seasonally adjusted, UK, Q1 1998-Q3 2013.

Research on Competitiveness

2.175 As we noted above, as well as changing pay structures, employment and hours, employers can attempt to cope with minimum wage changes through raising prices, reducing profit margins or improving productivity. The NMW may also affect the ability of firms to start new businesses or remain in business. Unfortunately, the data available to investigate many of these issues are not as comprehensive as those available to investigate employment and hours. However, researchers have used a variety of means and sources to attempt to assess the impact of the minimum wage on these competitiveness variables.

2.176 The findings of previous research on prices; labour costs; profits; business start-ups and failures; and productivity are summarised below. Wadsworth (2007 and 2008) investigated the impact of the minimum wage on prices. He found some evidence that firms had been able to increase prices above the general price rise for those goods and services which were produced by a high proportion of minimum wage workers and were not internationally traded.

2.177 Riley and Rosazza Bondibene (2013) investigated the impact of the minimum wage on firm behaviour since the introduction of the NMW and during the recession using data from the Annual Respondents Database (ARD) and Financial Analysis Made Easy (FAME). They explored wage effects for firms in all industries and for firms in low-paying industries as well as by size of firm. They showed that, using either data source (FAME or ARD), average labour costs rose significantly more among low-paying firms than among firms with higher pay when the minimum wage was introduced. They noted no such relationship before its

introduction. These effects were also evident among firms of all sizes in the low-paying industries. Initial findings from Riley and Rosazza Bondibene (ongoing) confirm these results.

- 2.178** In line with previous research using the same data source (FAME), Riley and Rosazza Bondibene (2013) also found some evidence that the NMW may have reduced firms' profitability. These effects were more evident over the longer term (1999-2007). Their more recent analysis has found no effects on profits. A few other studies have also investigated profits. These have generally found that the minimum wage has led firms to absorb increases through squeezed profits. Draca, Machin and Van Reenen (2011) found that the minimum wage had significantly reduced profits, particularly those in industries with less competition. A previous study by the same authors (2005) had found that profits had fallen in the low-paying industries as a result of increases in the minimum wage. Forth, Harris, Rincon-Aznar and Robinson (2009) also found significant negative effects of the minimum wage on the return on capital employed. They also found adverse effects on profit margins but these were not robust. Experian (2007), however, found no effects on profits resulting from the 2003 and 2004 upratings.
- 2.179** Any squeeze in profits may restrict investment and affect the long-run viability of a business. Crawford, Jin and Simpson (2013) found that there was no strong evidence of differences in investment responses by firms of different sizes, and also little evidence of any differences in investment according to the long-term coverage of the NMW. Riley and Rosazza Bondibene (2013) also found no robust evidence to indicate that the NMW changed the investment behaviour of low-paying firms; upon introduction, over the longer term, or during recession.
- 2.180** A sufficient reduction in profits may lead to an enterprise closing down with subsequent impact on employment. Draca, Machin and Van Reenen (2005 and 2011) found that the reduction in profits had not led to business closure. Riley and Rosazza Bondibene (2013) also found no evidence to suggest that the NMW had led to a change in company exit rates. However, Forth, Harris, Rincon-Aznar and Robinson (2009) found some weak evidence that the minimum wage may have led to higher exit rates of firms.
- 2.181** Riley and Rosazza Bondibene (2013) found some evidence to suggest that the NMW resulted in productivity improvements among low-paying firms in low-paying industries. These productivity increases occurred in the initial years of the NMW and were apparent using both data sources (FAME and the ARD). Initial findings from Riley and Rosazza Bondibene (ongoing) that extends the analysis to include the recession confirms these results. In general, previous research has found a small positive association between productivity and the minimum wage. Galinda-Rueda and Pereira (2004) using plant level data; Forth and O'Mahony (2003) using industry data; Machin, Manning and Rahman (2003) using care home data; and Draca, Machin and Van Reenen (2005) and Croucher and Rizov (2011) using company account data from Financial Analysis Made Easy (FAME) all found evidence of a positive association of the minimum wage with productivity. In contrast, Forth, Harris, Rincon-Aznar and Robinson (2009) and Georgiadis (2006) found no such effects. Additionally, Arulampalam, Booth and Bryan (2004) found a positive effect of the introduction of the minimum wage on both the incidence and intensity of training but Dickerson (2007) was unable to replicate this finding using a different data set. He found no relationship between training and the minimum wage using data covering the introduction and first two upratings.

2.182 The introduction of a minimum wage (and its subsequent increases) may reduce the attractiveness of starting a new business. There is some evidence that the minimum wage may have adversely affected entry rates. Draca, Machin and Van Reenen (2011), Experian (2007) and Galinda-Rueda and Pereira (2004) all found evidence that business creation may have been slower as a result of the minimum wage.

Views on Competitiveness

2.183 A number of employer organisations advised us how increases in the NMW added to the cost pressures they faced, which in many cases for low-paying sector employers included a substantial employment bill. Many of them faced difficulty in passing on additional costs to their customers through higher prices for their goods and services. Others said increases in the NMW had squeezed margins and reduced profits.

2.184 One example of the difficulties some employers faced was in social care where providers are often heavily dependent on local authority purchasing of their services. During oral evidence organisations representing adult social care providers – National Care Association, Registered Nursing Home Association and the United Kingdom Home Care Association, told us that the real issue was not the NMW per se, but the lack of recognition of the actual costs of care by local authorities exercising their monopsony purchaser power, thereby making it difficult to keep pace with the NMW. This sector is covered in further detail in Chapter 4. They felt there was no way to bring local authorities to account and pointed out that the Office of Fair Trading’s remit did not extend to considering monopsony purchasers.

2.185 A Federation of Small Businesses (FSB) member survey showed that 23 per cent of businesses said the October 2013 NMW uprating would have a negative impact. Of these, 75 per cent said that it would reduce their firm’s profitability; 35 per cent would be reluctant to take on new staff; 34 per cent said they would have to increase prices; and 9 per cent suggested that they would have to reduce staff numbers.

2.186 National Day Nurseries Association said that the average fee increase reported to it by child nurseries last year was 1.5 per cent, often with comments that they were moderating or freezing fees to help parents. But this meant increases in wages squeezed margins further and other income streams were also under pressure. For example, there was also a long-standing issue with the level of local authority funding for free early years education, with many nurseries saying it did not cover their costs.

“The adverse effects of an unaffordable NMW will be predominantly concentrated among SMEs. The impact of the NMW also varies across sectors and regions. Businesses have been concerned with rising wage and employment costs amid many other increasing costs of doing business.”

British Chambers of Commerce, FSB, Forum of Private Business oral evidence

2.187 UK Fashion and Textile Association told our Secretariat that it was difficult to attract new workers into the industry, given that the NMW is the base level for pay. It was also difficult to pay workers more given that retailers would not tolerate higher prices from producers. However, companies needed to pay staff more in order to maintain pay differentials and keep production incentives. It had been easier to achieve this when the general level of pay rises in the industry were around RPI (and higher than increases in the NMW).

2.188 In retail, an Association of Convenience Stores' members' NMW focus group found that in response to increased employment costs retailers reduced staff hours; removed bonuses; or did not replace staff who left, instead of closing stores or losing jobs. Other costs (e.g. energy) were important and had to be met, but other tactics could be used by retailers to reduce employment costs. The BRC said the recent increase in the NMW was felt across the entire wage structure for shop workers and was estimated to have cost the sector around £120 million. It said there was a clear trade-off between growth in employment (and other forms of investment) and NMW increases, particularly for small and independent retailers.

"The salon faced strong competition, including from mobile hairdressers, and the business could not charge clients more for fear of losing them. In reaction to the October 2013 increase we will have to seriously look at the possibility of cutting hours or reducing staffing."

Hairdressers, Commission visit in England

2.189 The Rural Shops Alliance said the NMW had also reduced profitability to the extent that owners are unable to fund capital investments in the business. It argued the potential for improving staff productivity was limited. The pressure for longer opening hours was spreading the same amount of consumer spending over more trading hours; some retailers were now closing for a late lunch, when customer numbers were fewest, with the key driver for change being to save on wages. The Association of Licensed Multiple Retailers (ALMR) said that within the pub sector gross employment and payroll costs now accounted for just over a quarter of business turnover (26 per cent) and this had increased from 18 per cent when the NMW was introduced. It said that net profit margins were slim and cushions to absorb cost increases from Government measures or suppliers remained stretched. ALMR said that the recent NMW increase would have cost the industry in the region of £44 million and this would have a direct impact on profitability; ability to invest; employment patterns; and prices to consumers.

2.190 EEF, the manufacturers' organisation, said that the main impact of the NMW was on its members that used outsourced services. Many of these, for example, security, catering, cleaning, were labour-intensive services, more often than not supplied by organisations where increases in the NMW were directly linked to workers' pay and where increases were then passed on to customers. This indirect impact, according to EEF, made companies less competitive at a time when manufacturers were competing both on quality and cost.

- 2.191** Trade unions saw more room for businesses to afford an increase in the NMW. The TUC and some unions pointed to stronger economic growth and the emerging recovery as indicators that trading conditions were likely to improve strongly during the next minimum wage year. The TUC also noted that the number of small businesses in the UK now stood at a record level.
- 2.192** Unite said despite the recent difficulties, UK corporations made profits of £82.8 billion in Q1 2013, up by £5.9 billion or 4.1 per cent from £76.9 billion in Q1 2012. The TUC told us the companies we should be most interested in were those in the service sector, since they were likely to have higher concentrations of low-paid workers. Although the average net rate of return for these companies was still below the pre-recession high point, the TUC said that the latest figures showed that the bottom line was still healthy in the first quarter of 2013 at 15.1 per cent, which was the best result for four years. Service sector profitability was now close to full recovery.

Summary of Research

- 2.193** A common finding across the myriad of research that has investigated the impact of the minimum wage on earnings, in this country and elsewhere, has been that increases in minimum wages have statistically significant and substantive effects on the wages of the lowest paid. But, as Schmitt (2013a) in his recent survey of the literature in the United States highlighted, it is striking, that despite such increases in wages, how often it is that ‘the weight of the empirical evidence is either inconclusive (statistically insignificant or positive in some cases and negative in others) or suggestive of only small economic effects.’ This is similar in spirit to the conclusions reached by us in previous reports (for example, Low Pay Commission, 2013).
- 2.194** Schmitt (2013a) noted that the most likely reason for the lack of employment effects was that minimum wage increases were generally modest relative to the wages paid to low-paid workers, and that the cost increase to employers was small relative to most firms’ overall costs. He concluded, in a similar vein to the research summaries of the evidence on the impact of the minimum wage in the UK by Metcalf (2008), Butcher (2012), and Butcher and Metcalf (forthcoming), that employers can respond to increases to minimum wages in many ways. Although much of the research has focused on employment outcomes, employers can reduce hours, non-wage benefits or training. They can increase prices to consumers or accept lower profit margins. They can also adjust pay structures and try to increase productivity. Workers may respond to higher wages by putting in more effort. These are adjustments that we have highlighted previously in our reports. He finished his article by suggesting that the most important channel of adjustment was through reductions in labour turnover, which he argued led to significant cost reductions for employers.

Conclusion

- 2.195** The adult rate of the National Minimum Wage increased by 1.8 per cent in October 2012, from £6.08 to £6.19, and by 1.9 per cent in October 2013 to £6.31 an hour. The adult rate of the NMW has increased by around 75 per cent since its introduction at £3.60 an hour in April 1999. This is greater than the increase in average earnings or prices over the same period.
- 2.196** However, the real value of the NMW has fallen in recent years as the increase in the NMW has been lower than the increase in both Consumer Price Index (CPI) and Retail Price Index (RPI) inflation. In real terms using CPI, the value of the NMW in October 2013 was similar to its value in 2004 and much less than it was worth in 2007, while using RPI the real value of the NMW in October 2013 was less than it was in October 2004. In contrast, the value of the NMW relative to average earnings had never been higher than it was in October 2012 and remained close to that value in October 2013. As a consequence, the bite of the NMW (its value relative to the median) – broadly stable in the economy as a whole between 2007 and 2010 – is close to its highest since the NMW was introduced.
- 2.197** Between 1999 and 2007, wage growth was similar across all sizes of firm, all age groups and broad sectors. Between 2007 and 2011, this was not the case. Small firms had lower employee earnings growth than large firms, and the smaller the firm the lower the growth in employee earnings. Similarly, wage growth among the low-paying sectors was lower than in the rest of the economy; and wage growth among the youngest workers was much lower than for those aged 21 and over. Since 2011, we have seen some reversal of this divergence. Wage growth between 2011 and 2013 was similar across all firm sizes and between low-paying sectors and the rest of the economy. However, this divergence remained for young workers.
- 2.198** The increase in hourly wages in 2013, according to ASHE, was greater than the increase in the NMW. This led to the bite of the NMW, its value relative to the median, falling in 2013 in the economy as a whole and across many industries and all sizes of firm. The bite, however, remained historically high in the whole economy at 52.4 per cent, just 0.4 percentage points lower than its peak in 2012. The bite remained just under 80 per cent in the low-paying sectors as a whole and was still over 65 per cent for micro firms and close to 60 per cent for other small firms.
- 2.199** Despite the increased level of the bite of the NMW, total employment has continued to grow. Moreover, although the bite in the low-paying sectors has grown even more than in the economy as a whole since 2007, the number of jobs in the low-paying sectors has increased faster than the number in the whole economy. Over the last year, growth in both the low-paying sectors and the rest of the economy has been strong with both growing by 2.1 per cent. Further, generally the employment performance of those groups of workers most affected by the minimum wage – women, older workers, disabled workers, ethnic minorities, and migrants – has been better, since the onset of the recession, than their less affected counterparts. However, there are two groups whose experience has been worse: young people and those with no qualifications, although the employment rates of the latter group have picked up over the last year.

2.200 The literature on the impact of the National Minimum Wage has been further extended by our research programme for this report. We have now commissioned over 130 research projects from external organisations that have investigated various aspects of the impact of the NMW. We conclude from this work that the lowest paid have received higher than average wage increases but that there remains little evidence of significant adverse effects of the minimum wage on employment, whether analysing aggregate employment; individual employment probabilities; relative employment shares of low-paying sectors; or regional employment differences. The research does find that employers have adopted a number of strategies to cope with the minimum wage. These include adjusting pay structures; reducing non-wage costs; small reductions in hours; increases in productivity; some increases in prices; and some squeezing of profits although insufficient to lead to an increase in business failure. Our most recent research has not altered this conclusion but has helped provide a clearer understanding of these findings. We will continue to monitor the impact of the National Minimum Wage and have recently invited tenders for a range of research projects that we hope will enhance further our evidence base. We now go on to discuss the impact of the minimum wage on young people and apprentices in Chapter 3.

Chapter 3

Young People and Apprentices

Introduction

- 3.1** In our remit this year the Government asked us to review the contribution that the National Minimum Wage (NMW) could make to the employment prospects of young people. It asked us to take account of the state of the economy, and employment and unemployment levels in doing so, as it did in our consideration of the adult rate. Our recommendations for the youth and apprentice rates are covered in Chapter 5, and we consider enforcement issues including those relating to young people, such as internships and apprenticeships, in Chapter 4.
- 3.2** This chapter first looks at: young people; their earnings; and their labour market position, and how they have fared since the beginning of the recession from 2008. We then explore the change in apprenticeship volumes and pay over recent years, and assess the impact of the introduction of the Apprentice Rate from 1 October 2010.

Young People

- 3.3** The labour market position of young people has undergone a long-term deterioration, particularly since the start of the 2008-09 recession. We noted in our 2013 Report that it showed some signs of improving, with unemployment and employment rates of those not in full-time education (FTE) levelling off. We also noted that the bites of the minimum wage for young people fell in 2012 as young people's median hourly earnings growth exceeded the upratings in the youth rates. However, the earnings data also suggested that more employers were using the youth rates (and the adult rate) to pay young workers.
- 3.4** This section of the chapter looks at the latest data, research and stakeholder evidence on young people. We consider the earnings and labour market position of young people to assess the effects of the minimum wage. We also look at those young people not in education, employment or training (NEET), and assess whether the number or proportion has changed over the last year.

Youth Rates

- 3.5** There are two youth rates of the minimum wage: the Youth Development Rate and the 16-17 Year Old Rate. The Youth Development Rate was introduced in April 1999 at £3.00 an hour and originally covered 18-21 year olds. Between 1999 and 2010, as shown in Table 1.1 in Chapter 1, the Youth Development Rate rose broadly in line with the adult rate of the NMW,

National Minimum Wage

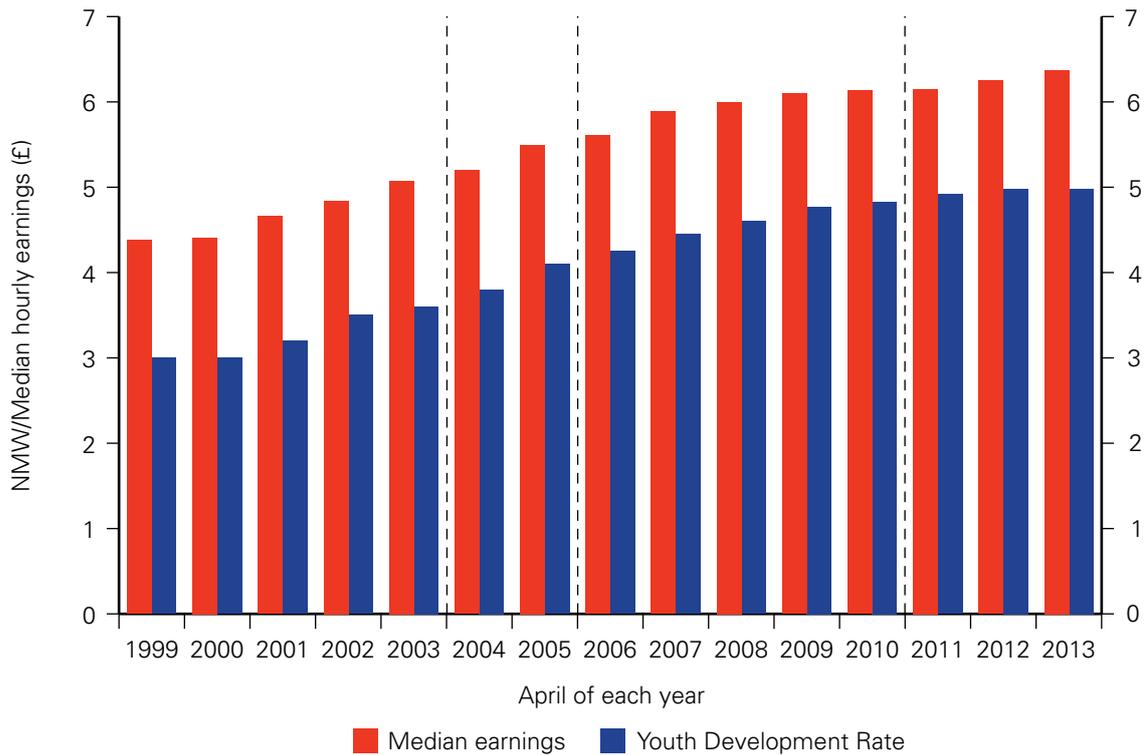
but since then it has not risen as much, as we have been concerned about the relative worsening in the employment prospects of young people. On 1 October 2013 the Youth Development Rate (now applying to 18-20 year olds) increased from £4.98 an hour to £5.03 an hour, about 80 per cent of the adult rate. The 16-17 Year Old Rate was introduced on 1 October 2004 at £3.00 an hour, and like the Youth Development Rate it rose broadly in line with the adult rate between 2004 and 2010, but has not risen as much from 2010. On 1 October 2013 the 16-17 Year Old Rate increased from £3.68 an hour to £3.72 an hour, around 59 per cent of the adult rate.

- 3.6** Since the formation of the Commission, we have believed that the minimum wage should be set at a lower level for young people. The evidence continues to show that they are more vulnerable in the labour market, and the threat of unemployment is greater for younger workers. When in employment, young people should of course be protected from exploitation, but we do not want the level of the minimum wage to jeopardise their employment or training opportunities.

Earnings

- 3.7** We use data from the Annual Survey of Hours and Earnings (ASHE) to look at the level and growth of earnings for employees. The latest ASHE data relate to April 2013, and cover the minimum wage rates introduced in October 2012. The Youth Development Rate and the 16-17 Year Old Rate were frozen in October 2012 at their respective 2011 rates of £4.98 and £3.68 an hour, something we recommended reluctantly because of concerns about the vulnerability of young workers to unemployment during periods of economic instability.
- 3.8** Figure 3.1 shows that earnings for 18-20 year olds continued to increase in 2013 despite the freezing of the Youth Development Rate. Median hourly earnings stood at £6.37 an hour in 2013, an increase of 12 pence (1.9 per cent) from 2012. They have continued to rise year-on-year during and after the 2008-09 recession, although the rate of increase has slowed since 2008.

Figure 3.1: Median Hourly Earnings and the Minimum Wage for 18-20 Year Olds, UK, 1999-2013

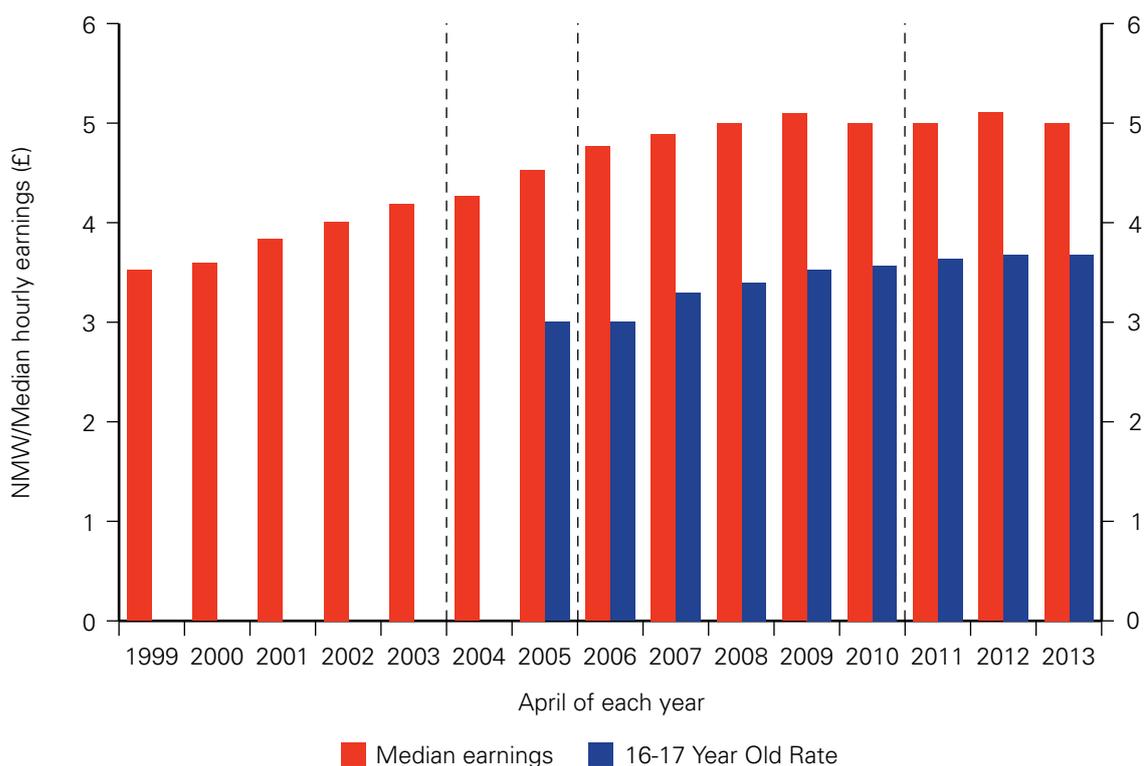


Source: Low Pay Commission (LPC) estimates based on ASHE: without supplementary information, April 1999-2003; with supplementary information, April 2004-05; 2007 methodology, April 2006-10; and 2010 methodology, April 2011-13, standard weights, including those not on adult rates of pay, UK.

Note: Direct comparisons of median earnings between 2003 and 2004, 2005 and 2006, and 2010 and 2011 should be made with care due to changes in the data series.

3.9 However, the earnings picture for young people aged 16-17 has deteriorated. Figure 3.2 shows that, between 2012 and 2013, 16-17 year olds’ median hourly earnings fell by 11 pence (2.2 per cent) to £5.00 an hour. Their median earnings have fluctuated from £5.00 to £5.11 an hour since 2008. In summary, with a focal point of £5.00 we consider the median to have been flat from 2008-13 at £5.00 an hour.

Figure 3.2: Median Hourly Earnings and the Minimum Wage for 16-17 Year Olds, UK, 1999-2013



Source: LPC estimates based on ASHE: without supplementary information, April 1999-2003; with supplementary information, April 2004-05; 2007 methodology, April 2006-10; and 2010 methodology, April 2011-13, standard weights, including those not on adult rates of pay, UK.

Note: Direct comparisons of median earnings between 2003 and 2004, 2005 and 2006 and 2010 and 2011 should be made with care due to changes in the data series.

- 3.10** Despite the stronger earnings growth of 18-20 year olds (1.9 per cent) in 2013, Figure 3.3 shows that since 2007 both 18-20 year olds and 16-17 year olds have, on average, seen lower median earnings growth than adults. Since the introduction of the NMW in 1999 the Youth Development Rate has risen by slightly less than the adult rate, at 3.7 per cent a year compared with 4.0 per cent a year. The 16-17 Year Old Rate has risen by significantly less, at 2.6 per cent a year on average over the period since it was introduced in 2004.
- 3.11** Between 1999 and 2007 there was little difference in the average annual increase in the NMW for each age group, with average annual increases for the three groups ranging from 4.9 per cent to 5.1 per cent. In this period 16-17 year olds saw slightly higher earnings growth, around 4.2 per cent at the median, compared with 3.8 per cent for 18-20 year olds and 3.9 per cent for adults. However, since 2007 there has been a clear change in median earnings growth across each age group. Median hourly earnings for 16-17 year olds increased, on average, by just 0.4 per cent a year between April 2007 and April 2013, compared with 1.4 per cent for 18-20 year olds and 2.2 per cent for adults. Over the same period, annual minimum wage upratings have been higher than this, averaging 1.8 per cent for 16-17 year olds, 1.9 per cent for 18-20 year olds and 2.5 per cent for adults.

Figure 3.3: Growth in the Minimum Wage and Median Earnings, by Age, UK, 1999-2013



Source: LPC estimates based on ASHE: adjusted earnings without supplementary information, April 1999-2003; with supplementary information, April 2004-05; 2007 methodology, April 2006-10; and 2010 methodology, April 2011-13, standard weights, including those not on adult rates of pay, UK.

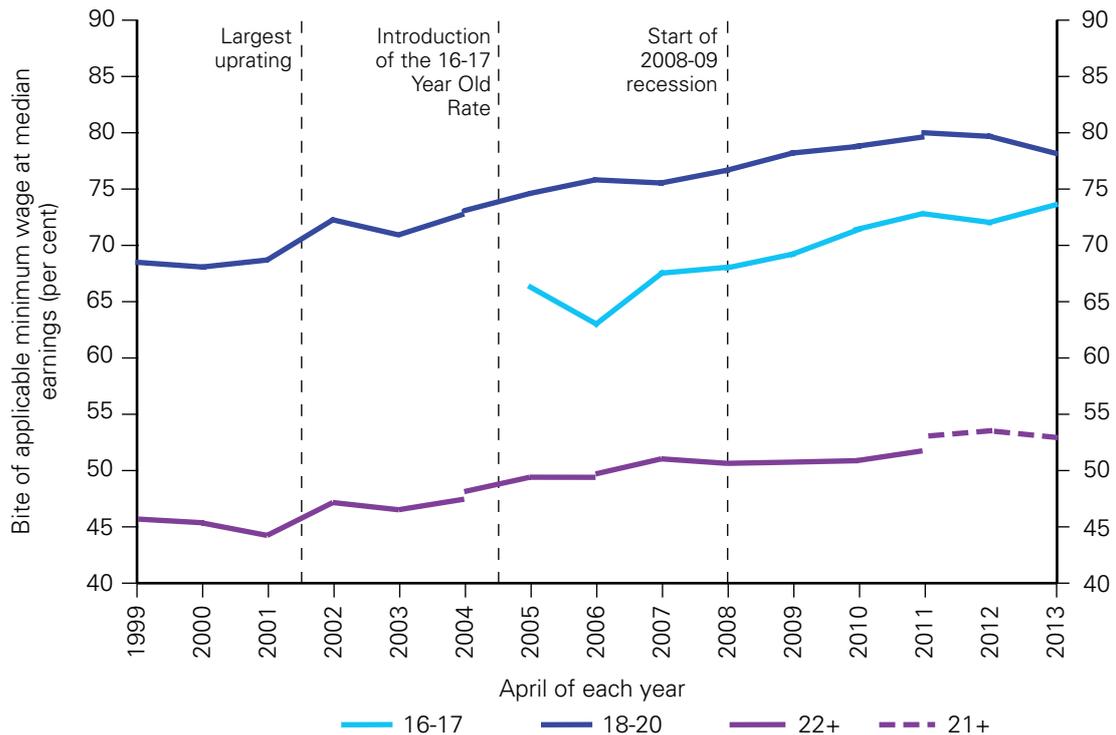
Notes:

- a. Earnings data have been adjusted to account for discontinuities in the data sets.
- b. The National Minimum Wage growth for 21 year olds and above is based on the adult minimum wage rate, which applied only to those aged 22 and over between 1999 and 2010.
- c. The 16-17 Year Old Rate was introduced in October 2004. The NMW for 16-17 year olds covers the period from 2004 to 2013, whereas median earnings cover the whole period.

3.12 The relatively strong median earnings growth of 18-20 year olds between 2012 and 2013, alongside the freezing of the Youth Development Rate, meant that the bite of the Youth Development Rate (its value relative to median earnings) fell in 2013, and has now fallen in two consecutive years, returning it to its level in 2009. Figure 3.4 shows that, as we had intended, in 2013 the bite of the Youth Development Rate fell by 1.5 percentage points, from 79.7 per cent to 78.2 per cent. The bite of the adult rate of the minimum wage also fell, by around 0.5 percentage points to 53.0 per cent, returning the adult bite to its level in April 2011, when eligibility for the adult rate been lowered from 22 to 21 years of age.

3.13 In contrast, the fall in median hourly earnings for 16-17 year olds has meant that, despite freezing the 16-17 Year Old Rate in October 2012, the bite has actually increased by 1.6 percentage points to 73.6 per cent, more than reversing the fall that had occurred in 2012. It is now at its highest level since it was introduced in 2004.

Figure 3.4: Bite of the Minimum Wage at the Median, by Age, UK, 1999-2013

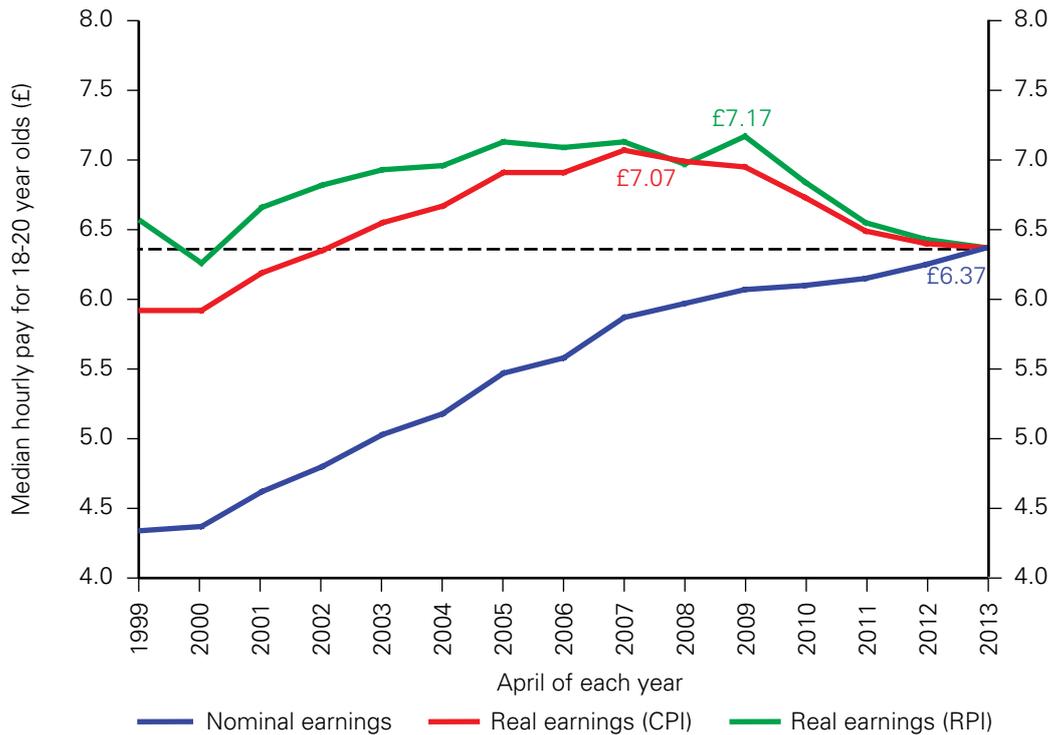


Source: LPC estimates based on ASHE: without supplementary information, April 1999-2004; with supplementary information, April 2004-06; 2007 methodology, April 2006-11; and 2010 methodology, April 2011-13, standard weights, including those not on adult rates of pay, UK.

Notes:

- a. At the introduction of the NMW the adult rate applied only to workers aged 22 and over. From October 2010 eligibility for the adult NMW was extended to 21 year olds.
- b. Direct comparisons before and after 2004, 2006 and 2011 should be made with care due to changes in the data series.

3.14 Figure 3.5 shows the nominal increase in the median hourly earnings of 18-20 year olds, alongside real hourly earnings, adjusted to take into account either Retail Price index (RPI) or Consumer Price index (CPI) inflation. Adjusting median earnings to take RPI inflation into account shows that in real terms median hourly earnings for 18-20 year olds are at their lowest level since 2000 and lower than they were when the Youth Development Rate was first introduced in April 1999. Adjusting instead for CPI inflation shows real median hourly earnings in 2013 at about the same level as in 2002. The fall in real median earnings between 2012 and 2013 was relatively small compared with that seen in 2010 and 2011, when CPI and RPI were above 3 per cent and 4 per cent respectively for a sustained period.

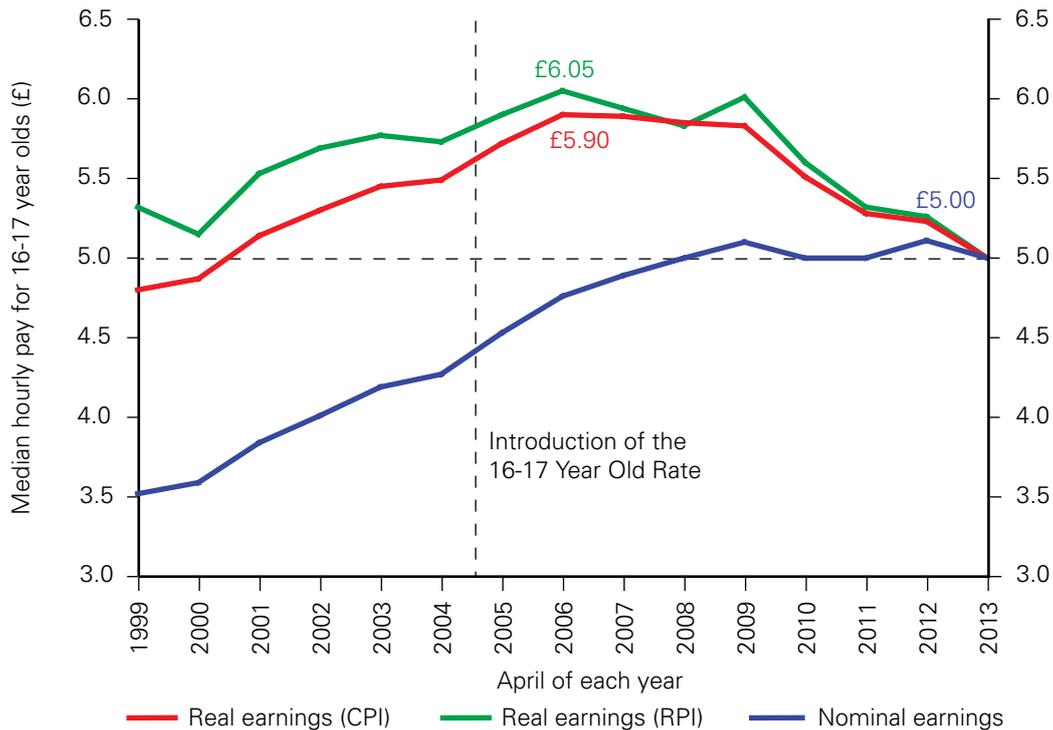
Figure 3.5: Nominal and Real Median Earnings for 18-20 Year Olds, UK, 1999-2013

Source: LPC estimates based on ONS data, CPI (D7BT) and RPI (CHAW), April 1999-2013, monthly, and ASHE: without supplementary information, April 1999-2003; with supplementary information, April 2004-05; 2007 methodology, April 2006-10; and 2010 methodology, April 2011-13, standard weights, including those not on adult rates of pay, UK.

Note: ASHE data have been adjusted to take account of methodology changes to provide a consistent time series.

- 3.15** Figure 3.6 shows that in 2013 the median hourly real wage for 16-17 year olds of £5.00 an hour was at its lowest level since 2000 when earnings are adjusted by CPI inflation, and lower than at any point since the minimum wage was introduced in 1999, when adjusted for RPI inflation.
- 3.16** Figures 3.5 and 3.6 show that real median earnings of young people fell sharply between 2009 and 2013. Among 18-20 year olds, real earnings fell by around 12 per cent when deflating by RPI and around 8 per cent when deflating by CPI. Real earnings of 16-17 year olds fell by around 17 per cent when deflating by RPI and around 14 per cent when deflating by CPI.

Figure 3.6: Nominal and Real Median Earnings for 16-17 Year Olds, UK, 1999-2013

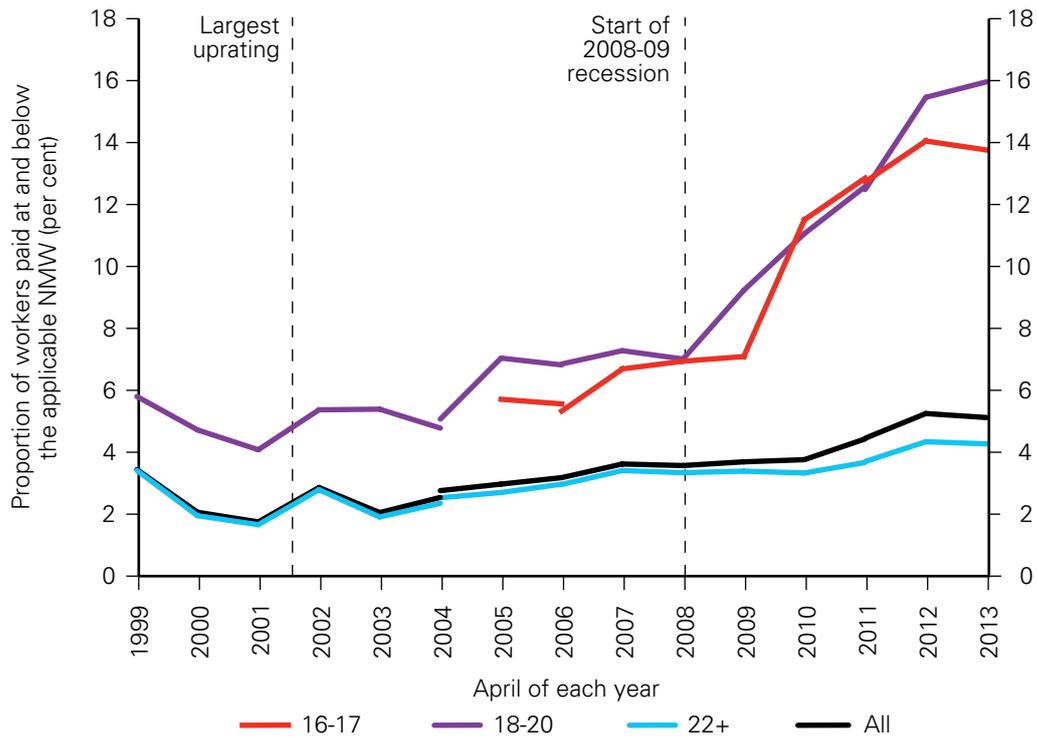


Source: LPC estimates based on ONS data, CPI (D7BT) and RPI (CHAW), April 1999-2013, monthly, and ASHE: without supplementary information, April 1999-2003; with supplementary information, April 2004-05; 2007 methodology, April 2006-10; and 2010 methodology, April 2011-13, standard weights, including those not on adult rates of pay, UK.

Note: ASHE data have been adjusted to take account of methodology changes to provide a consistent time series.

3.17 We noted in our 2013 Report that more young workers were falling within the coverage of the youth rates of the minimum wage. Figure 3.7 shows that the proportion of young workers paid below or at (including those paid up to five pence above) their age-related minimum wage rate increased in 2013 for 18-20 year olds, from 15.5 per cent to 16.0 per cent. However, it fell slightly for 16-17 year olds, from 14.0 per cent to 13.8 per cent. The proportion of adults paid at the adult rate of the minimum wage was stable at 4.3 per cent in 2013, having previously increased between 2010 and 2012.

Figure 3.7: Percentage At or Below Minimum Wage Rates, by Age, UK, 1999-2013



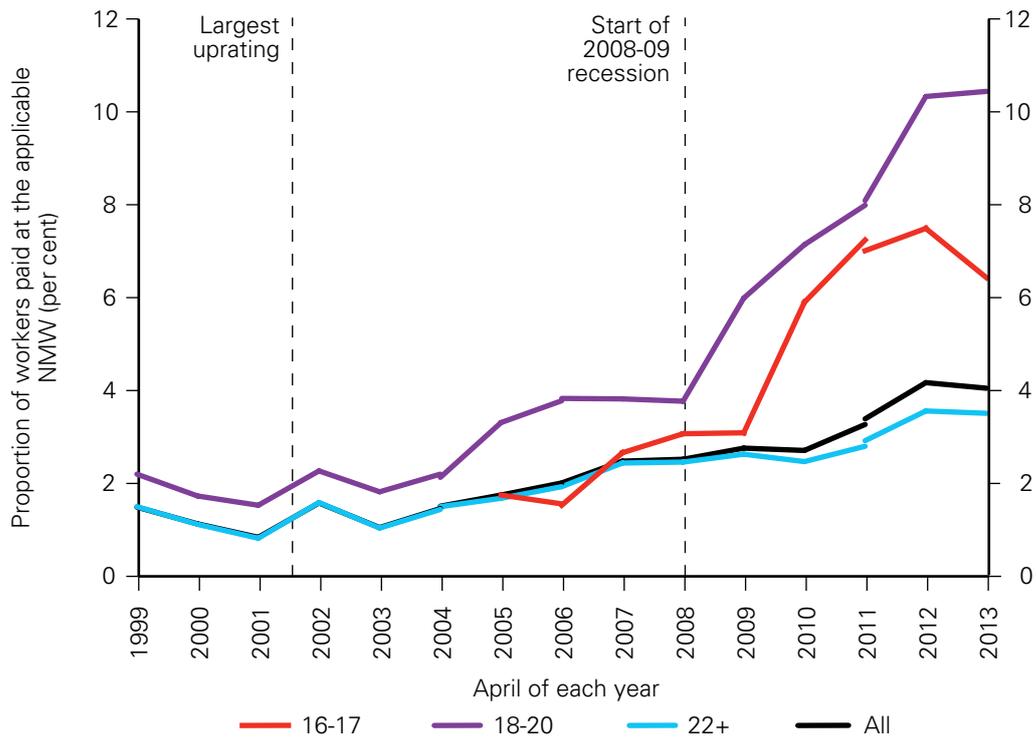
Source: LPC estimates based on ASHE: without supplementary information, April 1999-2004; with supplementary information, April 2004-06; 2007 methodology, April 2006-11; and 2010 methodology, April 2011-13, standard weights, including those not on adult rates of pay, UK.

Notes:

- a. Based on a 5 pence band.
- b. Direct comparisons before and after 2004, before and after 2006 and before and after 2011 should be made with care due to changes in the data series.

3.18 When we separate out those paid at the minimum wage and those paid below the minimum wage we see a clear difference between 16-17 year olds and 18-20 year olds in their coverage of the minimum wage. Using a 5 pence band, Figure 3.8 shows that the percentage of 16-17 year olds paid at the 16-17 Year Old Rate fell sharply, from 7.5 per cent to 6.4 per cent, between 2012 and 2013. The percentage of 18-20 year olds paid at the Youth Development Rate remained stable at 10 per cent over the same period.

Figure 3.8: Percentage Paid At their Age-related Minimum Wage Rate, by Age, UK, 1999-2013



Source: LPC estimates based on ASHE: without supplementary information, April 1999-2004; with supplementary information, April 2004-06; 2007 methodology, April 2006-11; and 2010 methodology, April 2011-13, standard weights including those not on adult rates of pay, UK.

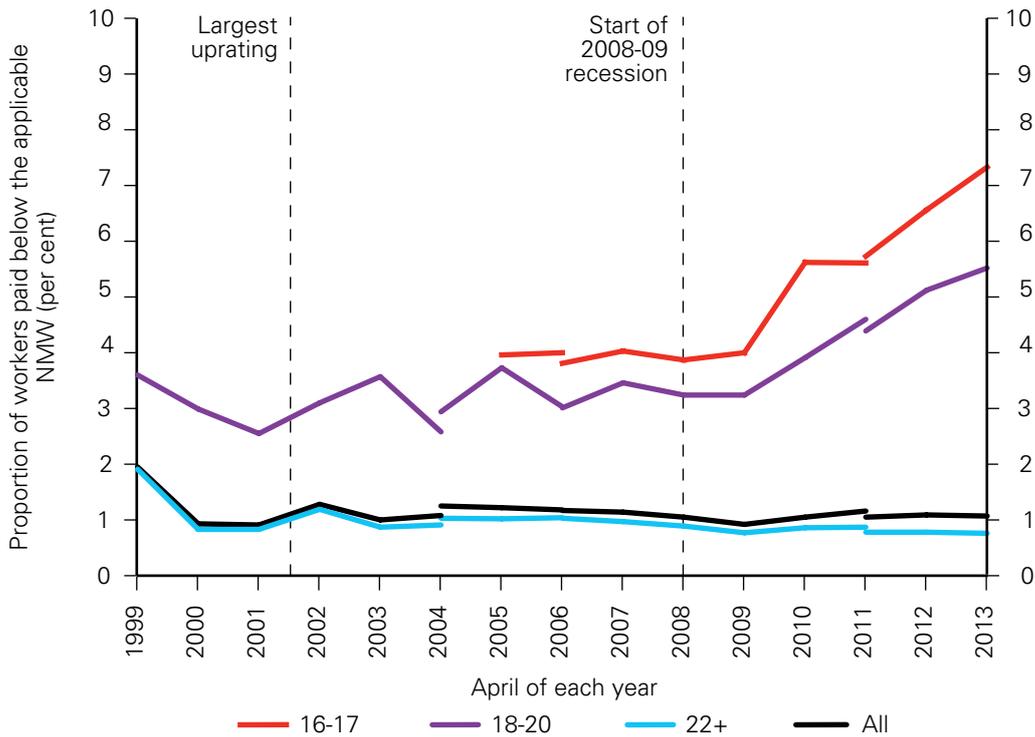
Notes:

a. Based on a 5 pence band.

b. Direct comparisons before and after 2004, before and after 2006 and before and after 2011 should be made with care due to changes in the data series.

3.19 However, the percentage of young employees paid below their age-related minimum wage rate has increased for both groups of young workers. Figure 3.9 shows that since 2009 there has been a continuing sharp increase in the percentage of 16-17 and 18-20 year olds being paid below their age-related minimum wage.

Figure 3.9: Percentage Paid Below their Age-related Minimum Wage Rate, by Age, UK, 1999-2013



Source: LPC estimates based on ASHE: without supplementary information, April 1999-2004; with supplementary information, April 2004-06; 2007 methodology, April 2006-11; and 2010 methodology, April 2011-13, standard weights including those not on adult rates of pay, UK.

Notes:

a. Based on a 5 pence band.

b. Direct comparisons before and after 2004, before and after 2006 and before and after 2011 should be made with care due to changes in the data series.

3.20 The increase in the percentage of young people paid below their age-related minimum wage rate followed the onset of the recession in 2008 but might also be related to increases in the number of apprentices and the introduction of the Apprentice Rate in October 2010. It is possible therefore that some of the increase reflects growing use by employers of the Apprentice Rate. Table 3.1 shows the percentage of young employees paid at the Apprentice Rate in the year immediately before, and then following, its introduction in October 2010. The earnings data suggest a gradual increase in the percentage of young people paid at the Apprentice Rate but the overall proportions are still very small. Allowing for a 5 pence band, those paid at the Apprentice Rate accounted for 2 per cent of 16-17 year olds and just over 1 per cent of 18-20 year olds in April 2013. It is currently not possible to establish how many of these young people are on an apprenticeship scheme but the data suggest that the introduction of the Apprentice Rate may not fully account for the increasing proportion paid below the minimum wage. However, we know from analysis of young people’s earnings that employers often choose to pay employees at focal points and it is possible that employers may be paying apprentices at rates slightly above the Apprentice Rate but below the youth rates, for example at the focal points of £3.00 or £4.00 an hour.

Table 3.1: Percentage of Young Employees Paid At the Apprentice Rate, UK, 2010-13

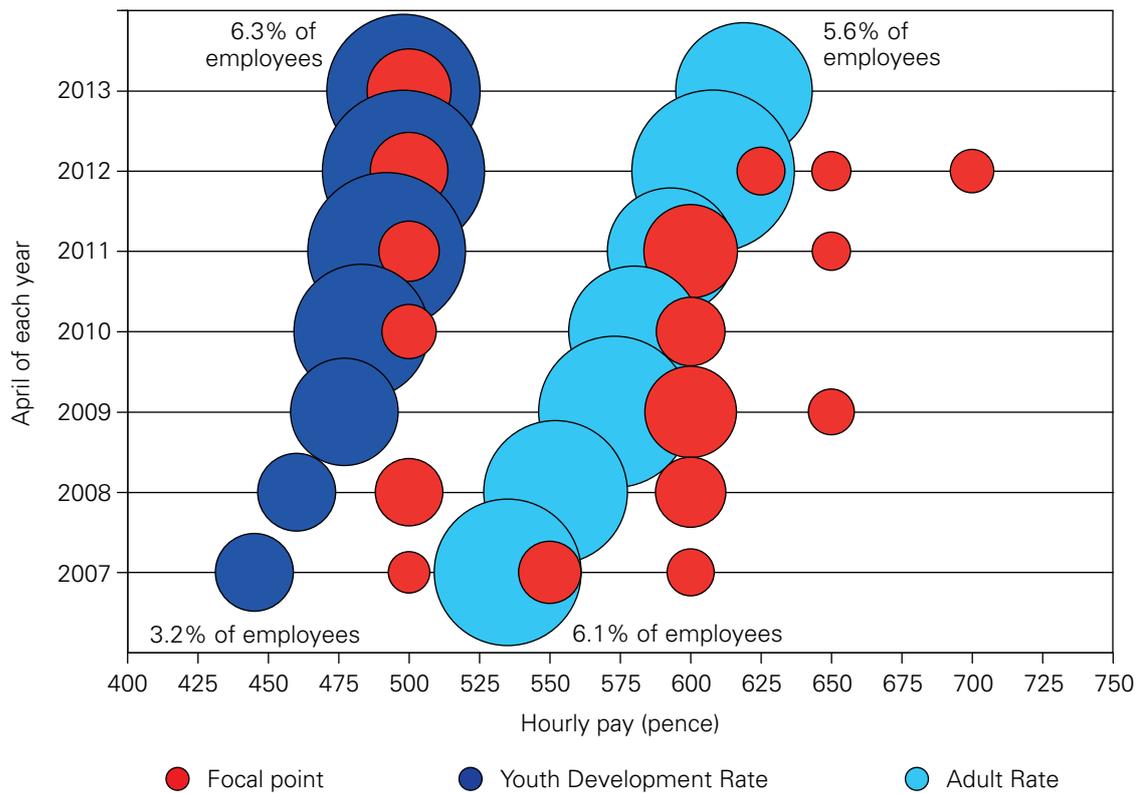
	16-17 years		18-20 years	
	Exact Rate	5p Band	Exact Rate	5p Band
Before the introduction of the Apprentice Rate:				
Percentage paid at the forthcoming £2.50 rate:				
April 2010	0.2	0.3	0.0	0.2
Following the introduction of the Apprentice Rate:				
Percentage paid at Apprentice Rate:				
April 2011	1.3	1.7	0.3	0.4
April 2012	1.6	2.1	0.7	0.8
April 2013	1.7	2.0	0.9	1.3

Source: LPC estimates based on ASHE: without supplementary information, 2007 methodology, April 2010; 2010 methodology, April 2011-13, low pay weights including those not on adult rates of pay, UK.

Note: The Apprentice Rate was introduced at £2.50 in October 2010; increased to £2.60 in October 2011; and increased to £2.65 in October 2012.

- 3.21** In 2013 ONS included new apprentice questions in the Annual Survey of Hours and Earnings. These will enable us to identify apprentices in the data and gain a better understanding of the extent to which they account for the increasing proportion of young workers paid below the 16-17 Year Old Rate and the Youth Development Rate. The new data were not available at the time of this report but we will undertake analysis and present the findings in our 2015 Report. Later in this chapter we discuss the increase in apprenticeship starts since 2009-10, particularly among those aged 19 and over, and the current evidence relating to apprentice pay.
- 3.22** Previous research found that employers tended to set wages at focal points. This behaviour was persistent over time and most noticeable in small firms in the private sector. In relation to this Figure 3.10 shows the use of each of the minimum wage rates, and other key focal points in the earnings distribution for 18-20 year olds. In this type of chart, the size of each circle represents the proportion of the population paid at that point on the earnings distribution. In other words, a larger circle represents a larger proportion of the workforce. The charts show the points on the earnings distribution with more than 1.5 per cent of workers, for both 16-17 and 18-20 year olds, in order to compare the key characteristics of the earnings distribution over time and the extent of earnings variability at the lower end of the earnings distribution.
- 3.23** Figure 3.10 shows that the use of both the Youth Development Rate and the adult rate to pay 18-20 year olds decreased slightly in 2013. The proportion of 18-20 year old workers paid at exactly the Youth Development Rate (the dark blue circles) increased from 3.2 per cent to 6.7 per cent between 2007 and 2012 but fell back slightly to 6.3 per cent in 2013. The use of the adult rate of the minimum wage to pay 18-20 year olds (the light blue circles) increased between 2011 and 2012, from 5.3 per cent to 6.7 per cent, but then fell back to 5.6 per cent of employees in 2013, albeit remaining higher than in 2010 or 2011. In 2012 we observed small proportions of employees paid at the focal points of £6.25, £6.50 and £7.00, but these disappear in 2013 as fewer young people were paid at these focal points.

Figure 3.10: Earnings Distribution for 18-20 Year Olds, by Minimum Wage Rate and Focal Point, UK, 2007-13

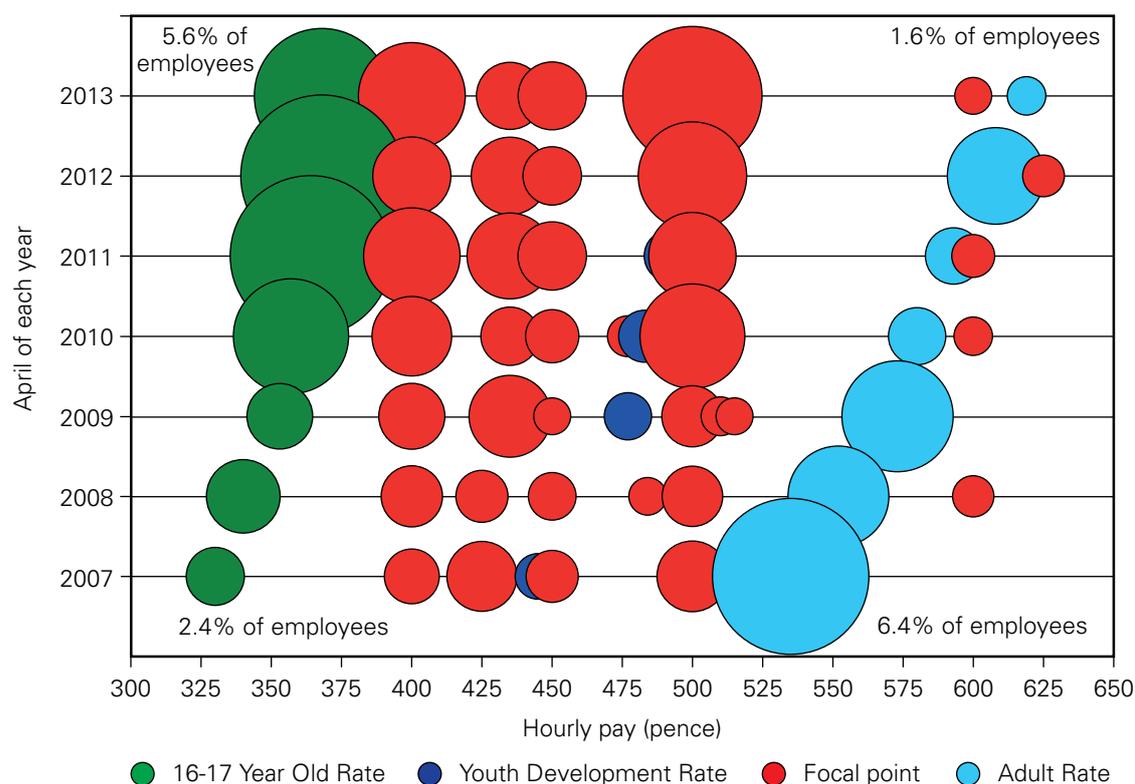


Source: LPC estimates based on ASHE: 2007 methodology, April 2007-10; and 2010 methodology, April 2011-13, low pay weights, including those not on adult rates of pay, UK.

Note: Direct comparisons before and after 2011 should be made with care due to changes in the data series.

3.24 Figure 3.11 shows a mostly similar picture for 16-17 year olds, with decreasing proportions paid at any of the minimum wage rates in 2013. The proportion of 16-17 year olds paid exactly at the 16-17 Year Old Rate (the green circles) increased significantly between 2007 and 2012, from 2.4 per cent to 6.7 per cent, and although it fell back to 5.6 per cent in 2013, it remained much higher than it had been before 2011. Use of the adult rate of the minimum wage (the light blue circles) has fallen for 16-17 year old workers, from 6.4 per cent in 2007 to 1.6 per cent in 2013. However, it did increase in 2012 to 4.0 per cent, but this may be due to the adult rate of the NMW passing through the £6.00 threshold. The proportion paid at the adult rate of the NMW is now lower than at any point in the last seven years. Use of the Youth Development Rate to pay 16-17 year old workers is relatively rare, with just 2 per cent receiving the Youth Development Rate between 2009 and 2011 and even fewer in subsequent years. However, Figure 3.11 also shows that 16-17 year olds have become much more likely to be paid at focal points and, increasingly, at £4.00 or £5.00 an hour. In 2013, 4.4 per cent were paid at £4.00 an hour and 5.7 per cent were paid at £5.00 an hour.

Figure 3.11: Earnings Distribution for 16-17 Year Olds, by Minimum Wage Rate and Focal Point, UK, 2007-13



Source: LPC estimates based on ASHE: 2007 methodology, April 2007-10; and 2010 methodology, April 2011-13, low pay weights, including those not on adult rates of pay, UK.

Note: Direct comparisons before and after 2011 should be made with care due to changes in the data series.

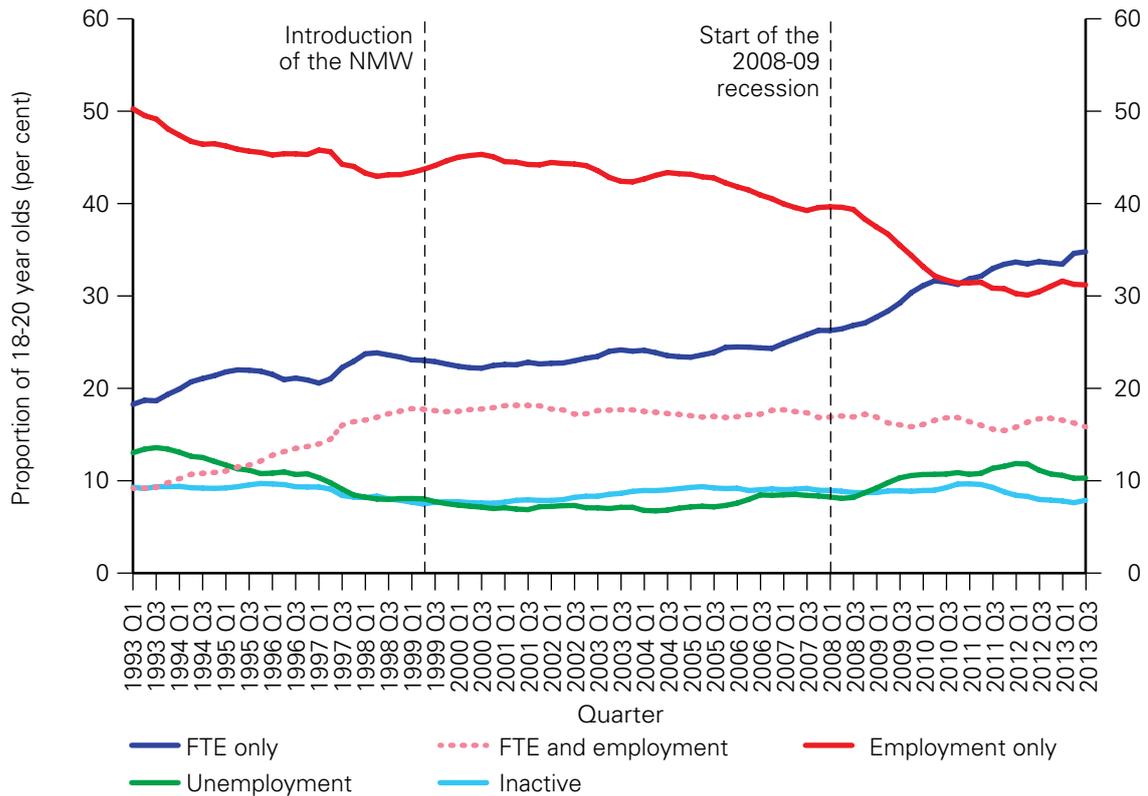
- 3.25** Taken together, Figures 3.8 to 3.11 show a reduction in the use of minimum wage rates to pay young workers in 2013. In particular, the previously observed increase in the use of the adult rate of the minimum wage to pay both 16-17 year olds and 18-20 year olds in 2012 reversed in 2013.
- 3.26** Having considered the earnings of those young people in work, we now look at the labour market position of young people, and assess the impact of the minimum wage on their labour market activity.

Labour Market Position

- 3.27** Young people were hit harder than older workers during the 2008-09 recession as youth employment fell and youth unemployment rose by relatively more than that of older workers. Since 2008 an increasing proportion of young people has remained in full-time education (FTE), with fewer choosing to enter the labour market. However, these trends should be placed in context alongside changes in the population of young people, to provide an accurate overview of how young people are engaging with the labour market. The Office for National Statistics (ONS) has forecast that the population of young people will fall relative to the whole working age population between 2013 and 2020, which may improve the relative job prospects of young people in the labour market, through reduced competition for vacancies.

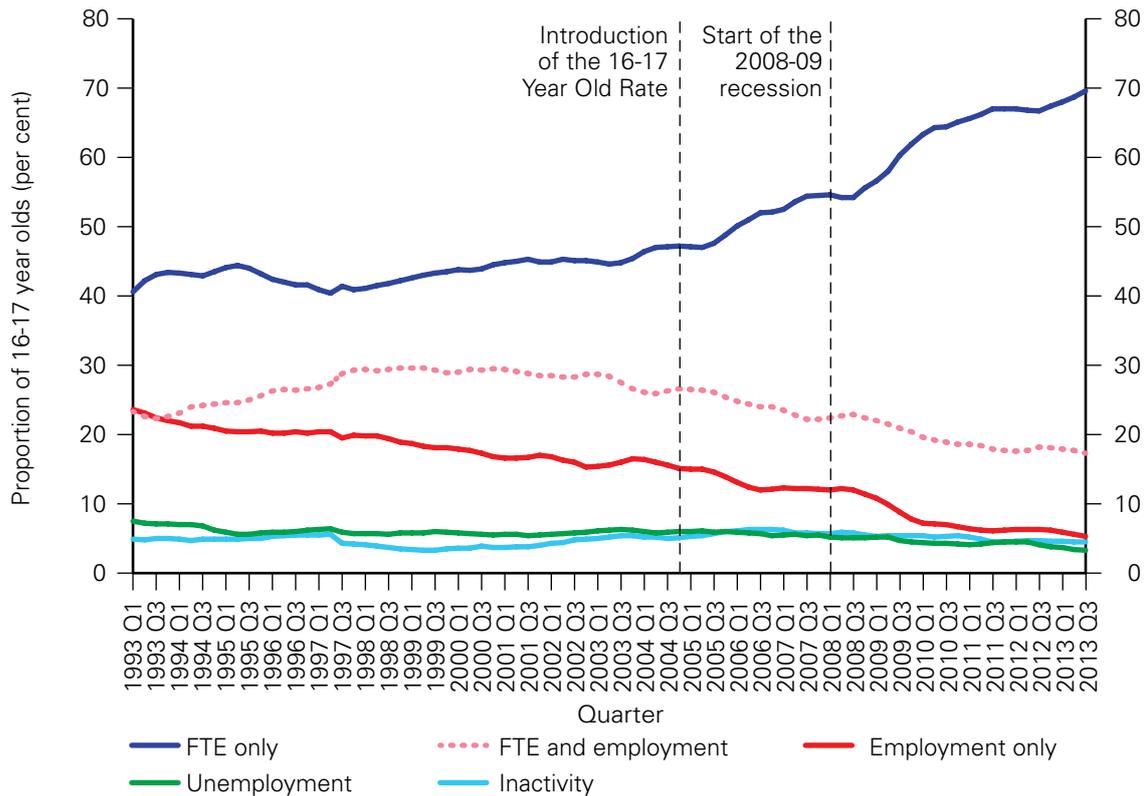
- 3.28** In this section we investigate the change in economic activity, using data from the Labour Force Survey (LFS). Our classifications of economic activity differ in one respect from those published by the ONS. That is in the way that we classify those individuals in FTE who are seeking employment. ONS classify all individuals as unemployed if they are looking for a job, even if they are in full-time education and are only seeking part-time employment to supplement their studies. We are less concerned about students' participation in work, and more concerned about young people that are not in education, employment or training (NEET). We therefore classify individuals in FTE as either in FTE and employed if they also have a job, or in FTE only if they do not have a job. In our definitions, an individual cannot therefore appear as unemployed if they are in FTE. Because of this, our estimates of the level of unemployment for young people are significantly lower than those of the ONS. Further, the population weights in the LFS microdata, which we use in our analysis, lag those available on ONS website (and may thus understate slightly the levels of employment and unemployment). However, trends and proportions should be less affected.
- 3.29** Figure 3.12 shows that the proportion of 18-20 year olds in FTE only (that is they have no job alongside their education or training), continues to rise, from fewer than one in five 18-20 year olds in 1993 to over one in three (35 per cent) by the third quarter of 2013 (representing about 798,000). The proportion of 18-20 year olds in both FTE and employment has remained broadly flat since the introduction of the NMW in 1999 at 16-17 per cent (around 363,000 in the third quarter of 2013). The proportion of 18-20 year olds in employment only, by comparison, has been declining, linked to the increasing numbers choosing to remain in FTE, with a further steep decline following the 2008-09 recession. However, the proportion in employment has been fairly stable at around 31 per cent since 2010 (around 716,000 in 2013). The proportion of inactive 18-20 year olds has fluctuated at just below ten per cent of the population throughout the period (around 181,000 in 2013), while the proportion unemployed rose from 8.1 per cent at the start of the recession in mid-2008 to 11.9 per cent in the first quarter of 2012, falling steadily since then to 10.3 per cent in the third quarter of 2013 (around 236,000).

Figure 3.12: Economic Activity of 18-20 Year Olds, UK, 1993-2013



Source: LPC estimates based on LFS Microdata, quarterly, four-quarter moving average, UK, Q2 1992-Q3 2013.

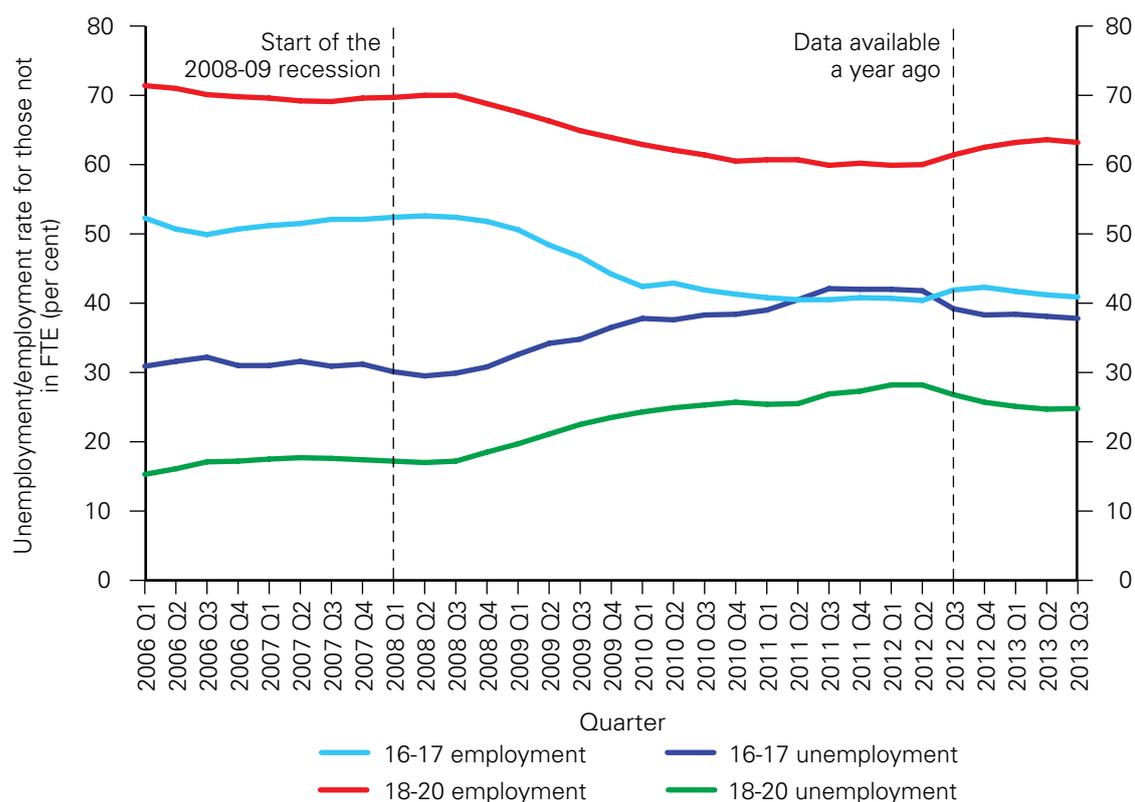
3.30 Figure 3.13 shows that the proportion of 16-17 year olds in FTE only has risen since the start of 1998, although there were particularly sharp increases that coincided with the introduction of the Education Maintenance Allowance in September 2004, and the onset of recession in 2008. Over the whole period, the number of 16-17 year olds in FTE only has risen from 529,000 to 989,000. In contrast, the proportion of 16-17 year olds in FTE who also have a job has fallen steadily since 1998, and was less than 20 per cent of all 16-17 year olds by the third quarter of 2013 (around 246,000). The proportion of 16-17 year olds in employment only has fallen steadily across the period, from just under 25 per cent at the start of 1993 to just over 5 per cent by the third quarter of 2013 (around 76,000). The proportion of 16-17 year olds that is inactive has been fairly static since 1993, fluctuating around 5 per cent (around 63,000 in the third quarter of 2013). The proportion of 16-17 year olds unemployed had also remained fairly static throughout the period but has shown signs of improvement recently, falling from 4.1 per cent in the third quarter of 2012 to 3.3 per cent in the third quarter of 2013 (representing a fall from 59,000 to 46,000).

Figure 3.13: Economic Activity of 16-17 Year Olds, UK, 1993-2013

Source: LPC estimates based on LFS Microdata, quarterly, four-quarter moving average, UK, Q2 1992-Q3 2013.

3.31 Figures 3.12 and 3.13 show that an increasing proportion of young people are remaining in FTE, particularly since the start of the 2008-09 recession. However, there is some evidence that the position of young people, particularly 18-20 year olds, who choose to leave education and enter the labour market is improving. Figure 3.14 shows the employment and unemployment rates for those 16-17 and 18-20 year olds who are not in FTE. Between the start of the 2008-09 recession and the third quarter of 2011 the unemployment rates of both 16-17 and 18-20 year olds not in FTE rose sharply, and their employment rates fell. However, over the year to the third quarter of 2013, employment and unemployment rates for 18-20 year olds have improved, while they have stabilised for 16-17 year olds. Among 18-20 year olds not in FTE, unemployment rates fell by 2.0 percentage points and employment rates increased by 1.8 percentage points over the year to the third quarter of 2013.

Figure 3.14: Employment and Unemployment Rates for Young People Not in Full-time Education, by Age, UK, 2006-13



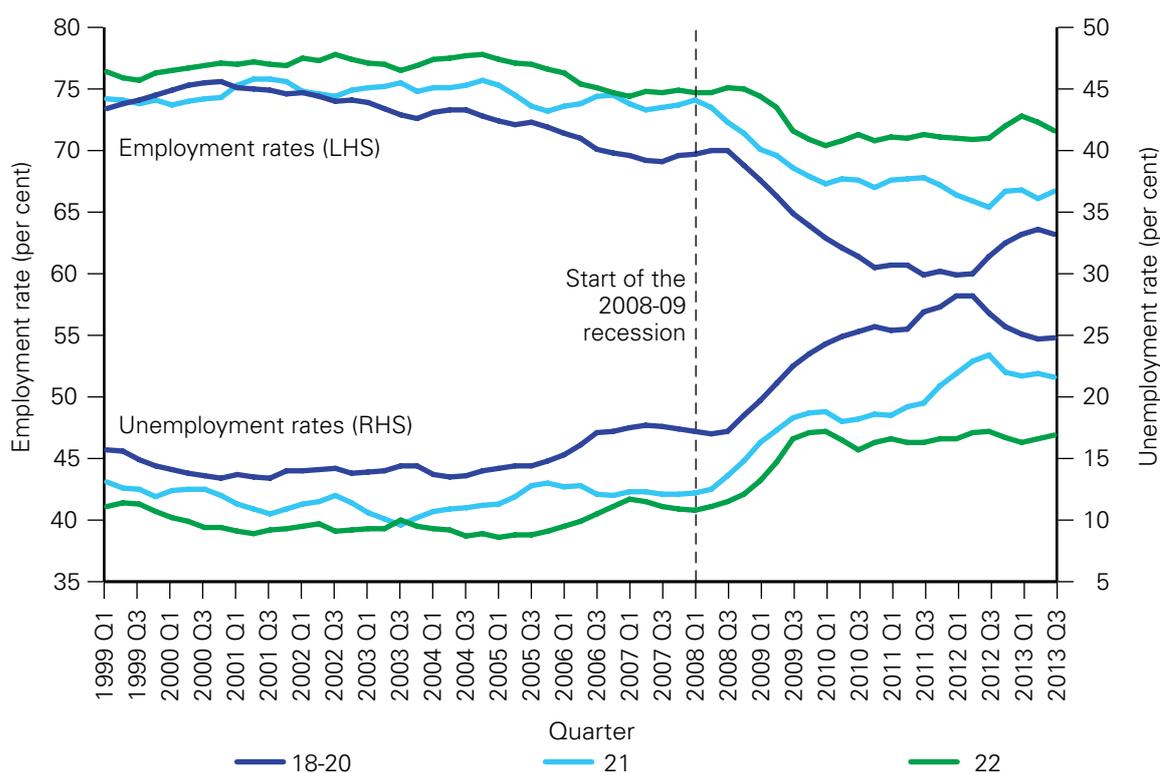
Source: LPC estimates based on LFS Microdata, quarterly, four-quarter moving average, UK, Q2 2005-Q3 2013.

- 3.32** It is worth noting that the employment and unemployment rates of young people have largely been driven in recent years by the increasing proportion of young people who have remained in FTE, as we showed in Figures 3.12 and 3.13. As the unemployment rate is based only on the economically active population (those that are employed or seeking employment and available to start), a move into full-time education, especially by some of the more employable or employer-ready young people, will change the composition of the economically active population. In a recent government review the Department for Business, Innovation and Skills (BIS, 2013b) noted that young people with low or no qualifications accounted for 39 per cent of all young people not in education and unemployed, and 47 per cent of their inactive counterparts. The proportionate increase in the unemployment rate within this population is a consequence to some extent therefore of the decision by other young people, those possibly with greater chances of obtaining employment, to remain in FTE.
- 3.33** It is clear that those young people who did not continue in FTE were seriously affected by the 2008-09 recession, but the deterioration in employment and unemployment rates has stopped and there are tentative signs in the most recent period that the labour market may now be improving for these young people, particularly for 18-20 year olds.

21 Year Olds

- 3.34** From 1 October 2010, 21 year olds have been entitled to the adult rate of the minimum wage. With the adult rate then rising to £5.93 an hour, this was an effective increase of 23 per cent in the minimum wage entitlement for 21 year olds, from the previous Youth Development Rate of £4.83 an hour. Since introducing this change we have monitored the earnings and labour market position of 21 year olds relative to 20 year olds and 22 year olds to ensure that the change in NMW entitlement did not have an adverse effect on their labour market outcomes.
- 3.35** The latest evidence shows that median hourly earnings of 21 year olds increased by 2.5 per cent in 2013. This increase was only slightly below that of workers aged 22 and over (2.7 per cent). In 2013 the hourly earnings of 21 year olds at the median (£7.04) remained closer to those of 20 year olds (£6.63) than 22 year olds (£7.50) but their earnings have seen improvement relative to 20 and 22 year olds in 2013. In 2012, 21 year olds were paid 5.7 per cent more at the median than 20 year olds, but this increased to 6.1 per cent in 2013. The gap between 21 and 22 year olds fell from 8.7 per cent in 2012 to 6.5 per cent in 2013.
- 3.36** Turning to their labour market position, we noted in our 2013 Report that since the end of 2011 the unemployment and employment rates of 21 year olds not in FTE appeared to have diverged from those of 22 year olds, having previously closely followed them. Figure 3.15 shows that, from the end of 2011 to the end of 2012, unemployment rates rose sharply for 21 year olds not in FTE while employment rates fell. By the end of 2012, the unemployment and employment rates of 21 year olds not in FTE were closer to 18-20 year olds than 22 year olds. The latest data suggest that the sharp rise in unemployment and fall in employment observed between the third quarters of 2011 and 2012 has not continued and the gap between 21 and 22 year olds has narrowed in 2013. Unemployment rates for 21 year olds not in FTE fell to around 22 per cent, and employment rates picked up to around 67 per cent by the third quarter of 2013. In 2013, the relative closeness of employment and unemployment rates of 21 year olds to those of 18-20 year olds reflects more the improvement in labour market outcomes for 18-20 year olds rather than any deterioration for 21 year olds.

Figure 3.15: Employment and Unemployment Rates for 18-22 Year Olds Not in Full-time Education, by Age, UK, 1999-2013



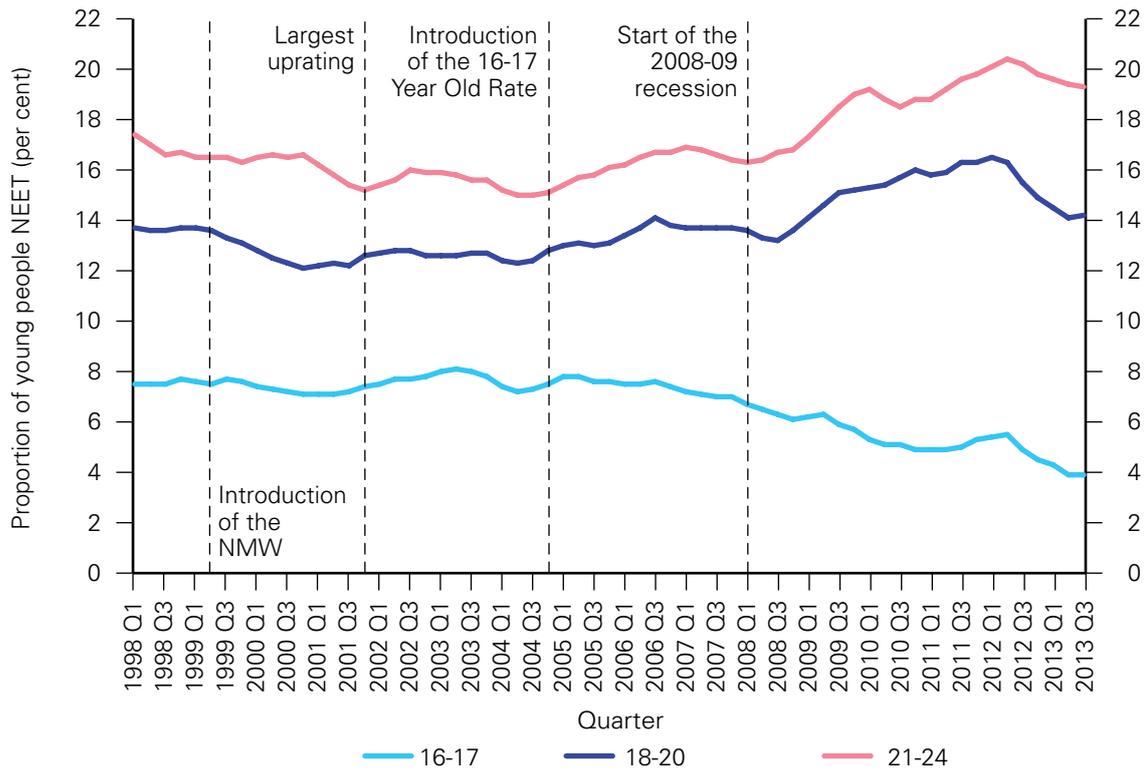
Source: LPC estimates based on LFS Microdata, quarterly, four-quarter moving average, UK, Q2 1998-Q3 2013.

Young People Not in Education, Employment or Training

3.37 To complete the overview of how young people are engaging with the labour market, we look at those young people who are not in education, employment or training (NEET). We use data from the Labour Force Survey to define a person as NEET if they are unemployed or inactive but are not: a student; on a course; working towards a qualification; or undertaking an apprenticeship. In 2013 ONS produced the first official NEET time series for the UK from 2001 onwards.⁴ Our NEET estimates differ a little from ONS estimates due to slightly different definitions of NEET and different approaches to the treatment of cases with missing data. One example is that people who are enrolled at an educational institution, but not currently attending, are counted as NEET (if they also meet other criteria) by ONS but not counted as NEET in our definition. The NMW was introduced in April 1999 and our NEET series begins in 1992. For the following analysis we have therefore retained our approach in order to make use of the longer time series that we have produced for our previous reports.

3.38 Figure 3.16 shows that NEET Rates fell between the first quarter of 2012 and the third quarter of 2013. The fall occurred across all age groups and represents the first significant decline since the start of the 2008-09 recession, when the proportion of 18-20 and 21-24 year olds who were NEET rose sharply. The proportion of 16-17 year olds NEET was lower in the third quarter of 2013 than at any time previously, reflecting the increasing participation in FTE discussed above.

⁴ The NEET time series became a National Statistic in May 2013. See Barrett and Chandler (2013) for further details.

Figure 3.16: NEET Rates by Age, UK, 1998-2013

Source: LPC estimates based on LFS Microdata, quarterly, four-quarter moving average, UK, Q2 1997-Q3 2013.

Research on the Impact of the Minimum Wage on Young People

- 3.39** For this report we commissioned two research projects specifically related to young people and apprentices. Incomes Data Services (IDS, 2014a) explored the impact of the NMW on pay, non-wage benefits and the pay of young people; and London Economics (2013) undertook an international comparison of apprentice pay. We also commissioned research for our 2015 Report from London Economics (ongoing) on the impact of the NMW on young people and have access to some preliminary findings. The main findings from these research projects on young people are summarised here alongside findings from other commissioned research which, while not specifically focused on young people, provided evidence related to them. Research on apprentices is discussed later in the chapter.
- 3.40** IDS (2014a) found that around a third of employers have pay rates specifically linked to age but noted a trend away from paying youth rates. Evidence from stakeholders also suggested that many employers preferred to pay their young workers the adult rate of the NMW, perceiving the youth rates to be too low to provide sufficient incentive for young workers, although employers from the hospitality sector indicated a preference for use of the youth rates. However, IDS also found that the freeze on youth rates may have influenced some employers' decisions on pay, with a stall in the trend away from youth rates in 2012.
- 3.41** London Economics (ongoing), in their preliminary analysis, has found weak evidence of a positive effect of lowering the age of eligibility for the adult rate to 21, with an increased likelihood of 21 year old men being employed compared with 20 year old men. The research also found a significant fall in the likelihood of being inactive when comparing 21 year old men to either 20 or 22 year old men. However, they also found weak evidence of an increase

in unemployment of 21 year old men. They noted that the increase in the labour force, that is, the reduction in economic inactivity associated with eligibility to the adult rate may have increased both employment and unemployment for young men. The effects were not significant for young women. The research also found some evidence that eligibility for the adult rate had reduced the number of hours worked by all 21 year olds on average.

- 3.42** London Economics (ongoing) also conducted initial research to explore the impact of larger, compared with smaller, upratings in the NMW on employment, unemployment and hours worked. As part of this research they also considered the impact on young workers as they became eligible for the adult rate of the NMW. In contrast to some previous research findings (for example, Fidrmuc and Tena 2011 and 2013), but in line with the findings of Dickens, Riley and Wilkinson (2010 and 2011), they found no evidence of negative employment outcomes for workers one year below the eligibility age. In contrast to their other analysis, London Economics (ongoing) found no evidence of an impact on hours worked by young people at the threshold age in this part of their study.
- 3.43** Le Roux, Lucchino and Wilkinson (2013) explored the issue of non-compliance with the NMW. Their research confirmed previous research which had found that non-compliance was more prevalent among young people. They also found higher levels of non-compliance for part-time employment which may disproportionately affect young people, particularly those young people who are engaged in part-time work to supplement their income while in further education.
- 3.44** Having considered earnings; the economic activity of young people; the proportion NEET; and research on the impact of the NMW, we now move on to look at new government policy. In particular, Raising the Participation Age in England may affect the proportion of young people NEET, and increase the proportion which remains in FTE or enters the labour market.

Raising the Participation Age in England

- 3.45** The Raising the Participation Age (RPA) policy came into effect on 28 June 2013. The policy means that all young people who left year 11 in summer 2013 should continue in education or training until the end of the academic year in which they turn 17 and all young people who are in year 11, or below, from September 2013 should participate until their 18th birthday. A young person can meet this obligation by remaining in FTE, undertaking an apprenticeship, or doing some part-time education or training while working full-time. There is no obligation on employers to provide training.
- 3.46** We noted in our 2013 Report that the RPA policy will only have a direct impact on those young people who are in full-time employment and are not undertaking any education or training, or those who are NEET, as all other young people will already meet its requirements. Based on the latest official statistics from the Department for Education (DfE, 2013), there were 33,600 16-17 year olds in England in employment and not in education or training (out of a total population of 1.3 million), and 85,800 16-17 year olds who were NEET at the end of 2012. Since, by definition, young people NEET are not working this means that the population of young people who would be entitled to the NMW but who would not, in the absence of RPA, be undertaking any training or education will number around 33,600.

- 3.47** Alongside the introduction of RPA, the Government launched the Youth Contract in England in April 2012.⁵ In its interim evidence to us (BIS, 2013f) the Government advised that the Youth Contract is worth almost £1 billion over three years, of which £126 million is reserved for 16-17 year olds. The Youth Contract provides a programme of additional, individualised support focused on young people who are NEET and aims to meet the needs of 70,000 16-17 year olds with low levels of attainment (no GCSEs at A*-C). By the end of the 2012/13 financial year, 4,364 16-17 year olds had enrolled on the Youth Contract, 1,202 of whom had re-engaged successfully into education, training or employment with training.
- 3.48** More recently, the Government has announced a number of new measures to improve labour market outcomes for young people. These include a cross-government review, led by the Cabinet Office. Following initial findings from the review a number of initiatives were announced to provide support for 16-24 year olds, including focused support for 16-17 year olds. These include a new work preparation scheme, Traineeships, which was introduced in August 2013. Traineeships combine an education and training programme with work experience for a maximum of six months, and are focused on giving young people the skills and experience they need to help them compete for apprenticeships or other jobs. We will monitor the progress of the Traineeships programme for any impact on the NMW, including indirect effects for example through increasing the demand for apprenticeships and improving the labour market outcomes of young people.
- 3.49** The Government has also announced changes to apprenticeship policy in response to a review by Doug Richard in November 2012. These are discussed later in the chapter.

Employment Prospects of Young People

- 3.50** This year, as last year, the Government asked us to review the contribution the NMW could make to the employment prospects of young people. We have conducted extensive analysis to examine the relationship between the youth rates, young people's earnings and their labour market outcomes. We have also consulted with stakeholders, including employers, and commissioned research to explore the relationship between the NMW and young people's employment, hours and earnings.
- 3.51** Research commissioned for this report has explored whether there were any negative employment effects associated with lowering the eligibility age for the adult NMW from 22 to 21. The research has found little or no negative employment effects and initial research by London Economics (ongoing) has tentatively found some positive effects for young men, including a reduction in economic inactivity and an increase in employment. The latest research findings build on previous research which has found no evidence that the NMW had a systematic effect on the evolution of relative employment (that is, in terms of the employment size of younger worker age groups relative to the employment size of older worker age groups). Previous research has also suggested that the minor changes to the differences in the NMW between age groups since its introduction have not affected the composition of the labour force.
- 3.52** The evidence collected this year has not suggested any further measures which would enable the NMW to support young people's employment prospects, other than to continue

⁵ See www.dwp.gov.uk/youth-contract/ for further information.

to examine closely all the features of the labour market for young people and to recommend rates for young people which reflect those labour market conditions.

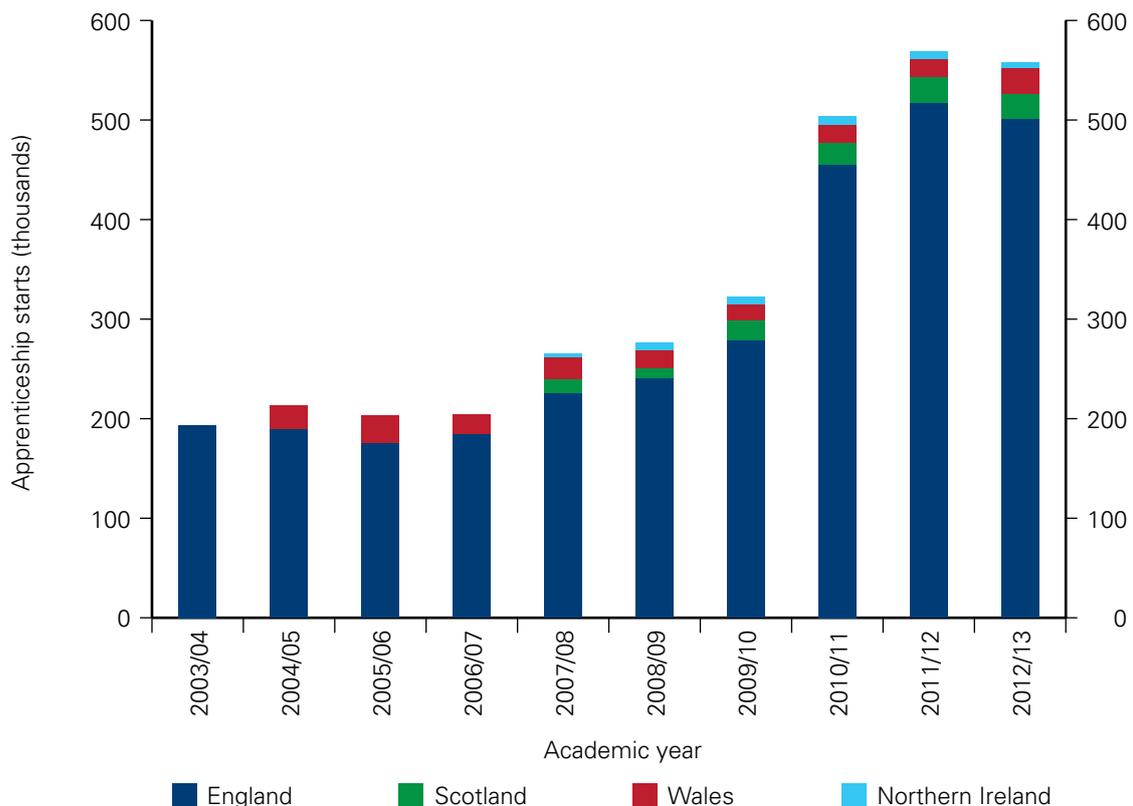
3.53 Having considered the impact of the youth rates on the earnings and labour market position of young people, we now go on to consider the impact of the Apprentice Rate.

Apprentices

3.54 This section first looks at how the volume of young people undertaking an apprenticeship has changed since our last report, placing it in the context of the change in overall apprenticeship numbers. We consider the evidence on apprentice pay using data from the BIS 2012 Apprentice Pay Survey (BIS, 2013e) and then report the findings from commissioned research, including an international comparison of apprenticeships. Finally, we highlight policy changes which may affect the volume of apprenticeships going forward.

3.55 We present the latest data on apprenticeship starts across the UK, using data provided by each of the administrations. Figure 3.17 shows that the total volume of Level 2 and Level 3 apprenticeship starts in the UK fell by just over 10,000 between 2011/12 and 2012/13. While the overall reduction was relatively small at 2 per cent, it was the first fall since 2005/06.

Figure 3.17: Apprenticeship Starts (Levels 2 and 3), by Country, UK, 2003/04-2012/13



Source: UK administrations, 2003-13.

Notes:

- England and Wales figures are for the academic year; Northern Ireland and Scotland figures are for the financial year. Data for Wales are available from 2004/05, and for Scotland and Northern Ireland from 2007/08.
- England data for 2012/13 are provisional, and may be subject to small revisions.
- Data exclude apprenticeship starts above Level 3.
- Estimates for Northern Ireland have been revised and will differ from those published in the 2013 Report.
- Figures for Scotland are only available for Modern Apprenticeships, which will not include all those at Level 2.

3.56 Table 3.1 shows that the fall in the volume of starts occurred in all countries of the UK with the exception of Wales. Apprenticeship starts fell in England by 16,400 (3 per cent) between 2011/12 and 2012/13 but the fall was only among Level 2 starts, which fell by 11 per cent (around 36,000); conversely, Level 3 starts increased by 11 per cent (around 20,000) over the same period. In Scotland the number of apprenticeship starts also fell by 3 per cent, but the greatest percentage fall occurred in Northern Ireland where apprenticeship starts fell by 20 per cent, from 7,800 in 2011/12 to 6,300 in 2012/13. In stark contrast, the number of apprenticeship starts increased by 45 per cent in Wales over the same period.

Table 3.2: Number of Apprenticeship Starts (Levels 2 and 3), by Country, UK, 2003/04-2012/13

Thousands	UK	England	Northern Ireland	Scotland	Wales
2003/04	-	193.6	-	-	-
2004/05	-	189	-	-	24.6
2005/06	-	175	-	-	28.1
2006/07	-	184.3	-	-	19.6
2007/08	265.2	224.8	4.1	14.7	21.6
2008/09	276.4	239.8	7.9	10.6	18.1
2009/10	322.5	278.2	7.7	20.2	16.4
2010/11	503.9	455.0	8.8	21.5	18.6
2011/12	568.7	516.9	7.8	26.4	17.6
2012/13	558.1	500.5	6.3	25.7	25.6

Source: UK administrations, 2003-13.

Notes:

a. England and Wales figures are for the academic year; Northern Ireland and Scotland figures are for the financial year. Data for Wales are available from 2004/05, and for Scotland and Northern Ireland from 2007/08.

b. England data for 2012/13 are provisional, and may be subject to small revisions.

c. Data exclude apprenticeship starts above Level 3.

d. Estimates for Northern Ireland have been revised and will differ from those published in the 2013 Report.

e. Figures for Scotland are only available for Modern Apprenticeships, which will not include all those at Level 2.

f. '-' denotes data not available.

3.57 In our 2013 Report we noted that the number of 16-18 year olds starting an apprenticeship in England had fallen for the first time since 2008/09. Provisional data for 2012/13 indicate that the number of apprenticeships for 16-18 year olds has fallen further, and more steeply, since. Table 3.3 shows that the number of 16-18 year olds in England starting an apprenticeship in 2012/13, was the lowest in four years, at around 114,000. This suggests that there were around 15,500 (12 per cent) fewer apprenticeship starts among 16-18 year olds in 2012/13 compared with 2011/12. Scotland experienced a small reduction in 16-18 year old apprenticeship starts over the same period (5 per cent) but the number of young apprentices increased in Wales (23 per cent) and, to a lesser extent, in Northern Ireland (4 per cent).

Table 3.3: Total Apprenticeship Starts (Level 2 and 3), by Age and Country, UK, 2005/06 to 2012/13

Thousands	England		Northern Ireland		Scotland		Wales	
	Under 19	19+	Under 19	19+	Under 19	19+	Under 19	19+
2005/06	99.5	75.4	-	-	-	-	6.9	21.2
2006/07	105.6	78.7	-	-	-	-	4.9	14.7
2007/08	107.5	117.3	2.2	1.9	-	-	4.9	16.7
2008/09	99.2	140.5	2.0	5.9	7.5	3.1	4.5	13.6
2009/10	116.7	161.5	1.4	6.2	7.0	13.2	3.8	12.6
2010/11	131.5	323.5	1.0	7.8	9.9	11.6	3.6	15.0
2011/12	129.5	387.3	0.9	6.9	10.2	16.2	3.7	13.9
2012/13	114.0	386.4	1.0	5.3	9.7	16	4.6	21.1

Source: UK administrations, 2003-2013.

Notes:

a. England and Wales figures are for the academic year; Northern Ireland and Scotland figures are for the financial year. Data for Wales are available from 2004/05, and for Scotland and Northern Ireland from 2007/08.

b. England data for 2012/13 are provisional, and may be subject to small revisions.

c. Data exclude apprenticeship starts above Level 3.

d. Estimates for Northern Ireland have been revised and will differ from those published in the 2013 Report.

e. Figures for Scotland are only available for Modern Apprenticeships, which will not include all those at Level 2.

f. '-' denotes data not available.

3.58 Apprenticeship starts for those aged 19 and over also fell slightly in England in 2012/13. While this fall was relatively small compared with the fall in 16-18 year old apprenticeship starts, it was the first fall in Level 2 and 3 apprenticeships for the older age group in recent times. However, it should be noted that apprenticeships for those aged 19 and over in England increased by around 5,000 between 2011/12 and 2012/13 once apprenticeships at Level 4 and above are included; the inclusion of higher level apprenticeships does not however change the pattern for 16-18 year olds.

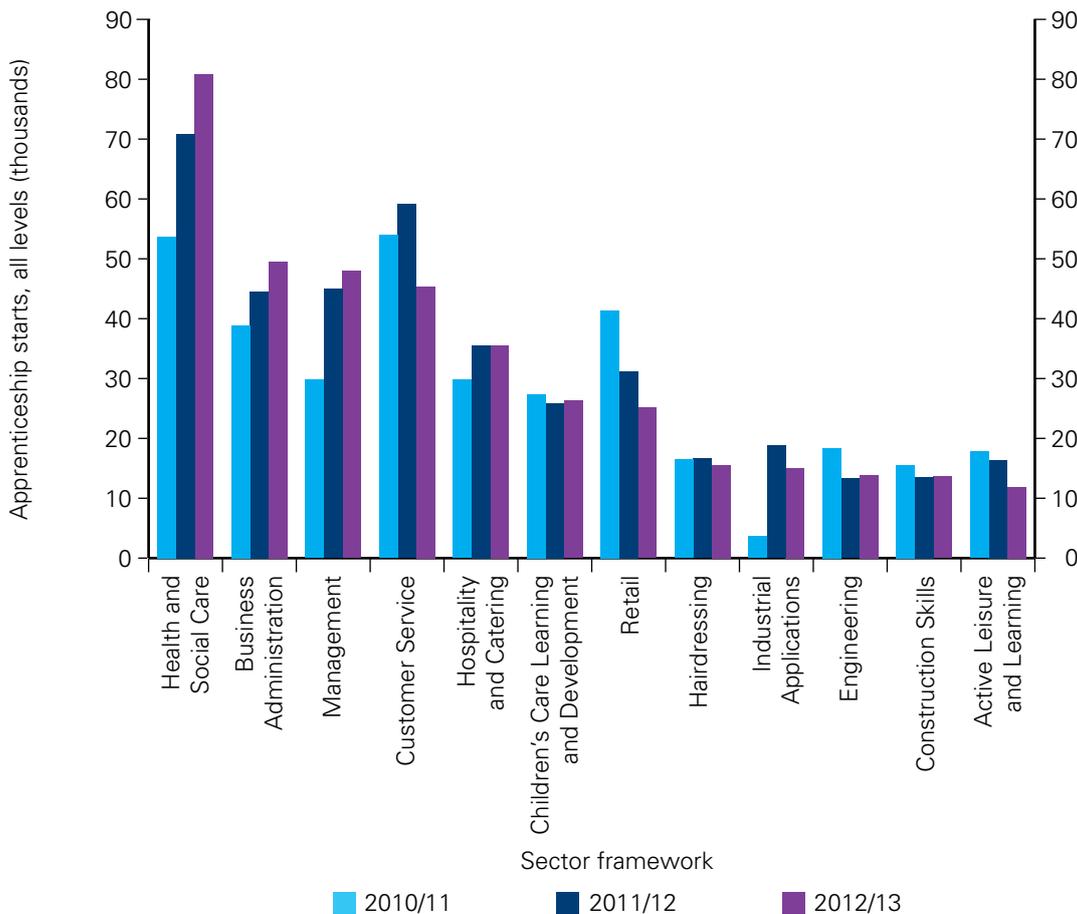
3.59 Table 3.3 also shows a fall in apprenticeship starts for those aged 19 and over in Northern Ireland. This may be due to changes to the funding of apprenticeships from September 2012. Between 2008 and 2011 apprentices aged 25 and above were eligible for 100 per cent funding from the Northern Ireland Administration. From September 2011 to September 2012, the level of funding was reduced from 100 per cent to 50 per cent for over 25s for all apprenticeship frameworks. However, since September 2012, the 50 per cent funding has been restricted to a small number of selected frameworks that the Administration regards as being key to rebalancing the economy. These frameworks include business services; financial services; advanced manufacturing and engineering; creative industries; and any other important emerging sectors. None of these are traditionally low-paying sectors. For learners aged 25 and above all other apprenticeship frameworks will no longer be eligible for any government funding.

3.60 In addition, Table 3.3 illustrates the trend towards older apprentices. In recent years this trend has been most pronounced in England and Scotland. Over the last five years, 16-18 year olds have almost halved as a proportion of apprenticeship starts in England, making up 41 per cent

of all starts in 2008/09 but just 23 per cent in 2012/13. In Scotland they have fallen from 71 per cent to 38 per cent of apprenticeship starts over the same period.

3.61 In our 2013 Report we noted the increase in ‘non-traditional’ apprenticeship frameworks in England, Scotland and Northern Ireland. Figure 3.18 shows that apprenticeship starts in the ‘non-traditional’ sectors of health and social care; business administration; and management have continued to increase between 2011/12 and 2012/13 but apprenticeships in customer service, and retail have fallen over the same period. Apprenticeships in traditional sectors such as hairdressing; construction; and engineering have also seen small reductions in recent years.

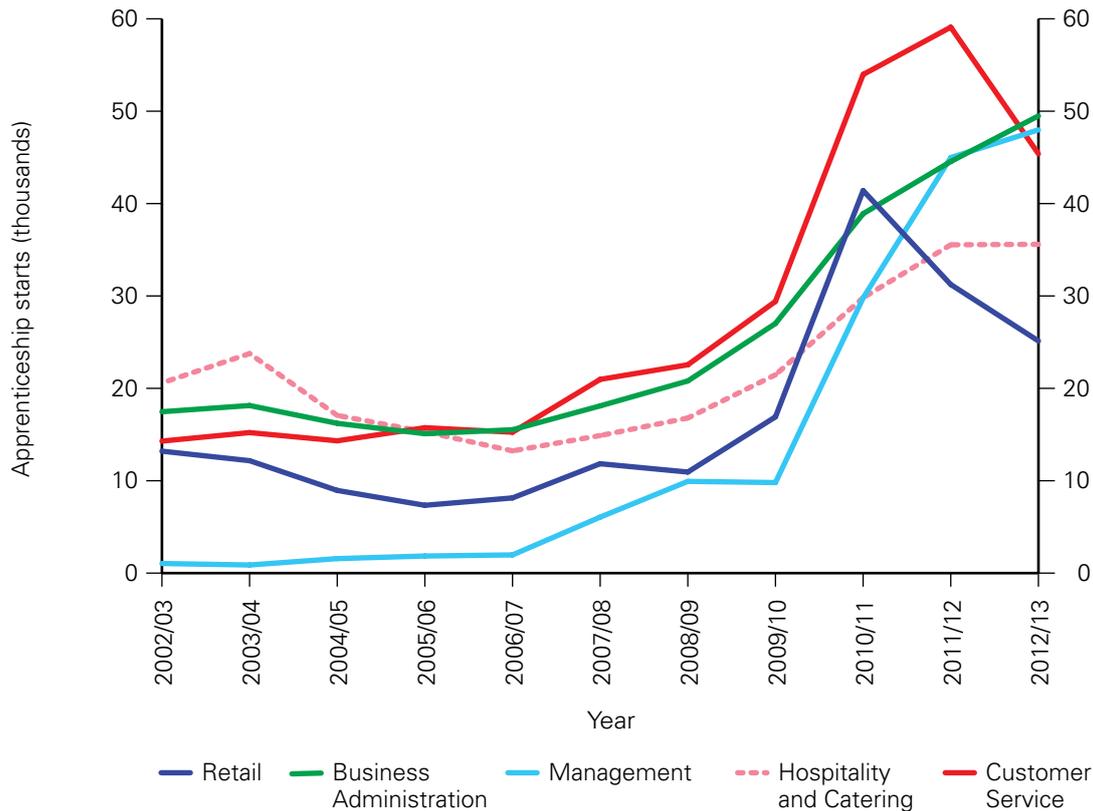
Figure 3.18: Apprenticeship Starts, by Framework, England, 2010/11-2012/13



Source: Individualised Learner Record, England, 2010/11-2012/13.
 Note: Data for 2012/13 are provisional and may be subject to minor revisions.

3.62 Figure 3.19 shows the growth in some of the main ‘non-traditional’ apprenticeship frameworks in England over the past decade. Management apprenticeships have seen the greatest increase, growing from around 1,000 to 48,000 in the ten years between 2002/03 and 2012/13. There were also substantial increases in Business Administration apprenticeships over the same period, from around 17,000 to 49,000. These two frameworks together saw a fivefold increase over the decade, accounting for almost 100,000 apprenticeships, or just under one in five (19 per cent), in 2012/13. Apprenticeships in the Retail, and Customer Service frameworks have also seen substantial growth over the decade although, unlike Management, and Business Administration, they have declined over the last year.

Figure 3.19: Apprenticeship Starts, by Framework, England, 2002/03-2012/13



Source: Individualised Learner Record, England, 2010/11-2012/13.
 Note: Data for 2012/13 are provisional and may be subject to minor revisions.

Apprentice Pay

- 3.63** For our last report we presented an analysis of apprentice pay based on the 2012 Apprentice Pay Survey. We were disappointed that the Government did not commission a further survey of apprentice hours and pay in the summer or autumn of 2013. However, we welcome its intention to conduct a UK-wide apprentice pay survey in the spring of 2014. We also welcome the introduction of questions about apprentices and their pay in the 2013 Annual Survey of Hours and Earnings (ASHE) and future surveys, although quality assurance issues mean that we are unable to use these data in our report this year.
- 3.64** The main findings of the 2012 Apprentice Pay Survey are summarised below. For more information readers are directed to our 2013 Report. In the period since we reported our findings last year BIS (2013e) has published a comprehensive report which provides further detailed findings from the survey.
- 3.65** In 2012 the level of apprentice pay in England and Wales varied substantially with the age of the apprentice. For all age groups, mean (average) pay was higher than median pay, due to a small number of apprentices in each age group being paid significantly more than the average wage. Median gross pay was £6.19 an hour overall but was significantly lower for apprentices aged 16-17 (£2.88) and 18-20 (£4.50) than their counterparts aged 21 and above (£6.83).

- 3.66** The proportion of apprentices paid below their NMW entitlement appeared to have increased between 2011 and 2012 but we noted that the timing of the 2012 Pay Survey in early October 2012, shortly after the Apprentice Rate had increased, may have contributed to this as some apprentices would not have been paid since the uprating.
- 3.67** We noted that just over 40 per cent of 16-17 year old apprentices were estimated to be paid less than £2.65 an hour, the Apprentice Rate from October 2012, but this figure fell to about 32 per cent if we instead looked at the proportion paid below the Apprentice Rate prior to October 2012, £2.60 an hour. Among 18-20 year old apprentices, around 42 per cent were paid less than their minimum wage entitlement and a quarter were paid less than £2.65 an hour. These estimates fell to 38 per cent and 18 per cent respectively when looking at the rates before the October uprating. However, even allowing for possible timing effects, the proportion of apprentices receiving less than their NMW entitlement remained higher in 2012 than 2011.
- 3.68** We also noted that close to 5 per cent of all apprentices in 2012 were paid an hourly rate of either £2.50 or £2.60 an hour, which were the levels of the Apprentice Rate of the minimum wage from October 2010 and October 2011 respectively. We suggested that employers may have initially been compliant with the minimum wage, but over time had become non-compliant, either intentionally or through ignorance of the upratings to the Apprentice Rate. We also suggested that many employers may have been unaware that for apprentices aged 19 and above, their NMW entitlement rises to their age-related rate in the second year of their apprenticeship. Non-compliance with the minimum wage was more prevalent, and worryingly high, in frameworks with lower apprentice pay, including Hairdressing, Construction Skills, and Children and Young People's Workforce.
- 3.69** In the absence of new data we are unable to assess whether non-compliance is a continuing, or growing, problem. In our 2015 Report we hope to use the results of the 2014 Apprentice Pay Survey, and the findings from the ASHE 2013 and 2014 apprentice questions, to update and strengthen our understanding of non-compliance with the Apprentice Rate. In addition we have also commissioned a research project to investigate the impact of the Apprentice Rate on apprentice pay and non-compliance.
- 3.70** We have noted previously that the minimum wage requires widespread compliance and have suggested that the Government take further action to address non-compliance. In our 2013 Report we recommended a communications campaign and a targeted enforcement initiative to ensure that the Apprentice Rate is known to employers and apprentices. We welcome the commitment that the Government has since made to putting in place a package of measures to improve compliance, including focused communications and targeted enforcement by HMRC.

Research on Apprenticeships

- 3.71** Previous research has explored the impact of the introduction of the Apprentice Rate on apprentice pay. Behling and Speckesser (2013) found that apprenticeships in the growing 'non-traditional' segment of the service sector, and those in small firms, had pay levels closer to the Apprentice Rate than more 'traditional' apprenticeships. Overall, however, they did not

find any impact on young people's pay from the introduction of the Apprentice Rate although they suggested that the Apprentice Rate may have prevented wages decreasing further in sectors paying close to the apprentice minimum wage.

- 3.72** For this report, London Economics (2013) undertook a comprehensive international comparison of apprenticeships in 14 countries, including English-speaking, Scandinavian, Francophone, and southern, northern and central European countries. The research compared the levels, characteristics and funding of apprenticeships; and the relationship between apprentice pay, the 'fully qualified' rate and the minimum wage.
- 3.73** There was considerable variation in the duration of apprenticeships, with apprenticeships in England at the lower end of the spectrum. The researchers estimated average apprenticeship durations of between 36-48 months in the majority of countries compared with a typical duration of 12-30 months in England. Only Spain had apprenticeships of shorter duration than England, with average durations of 24 months.
- 3.74** Levels of funding per full-time equivalent learner were also lower in the UK than almost all of the comparison countries with the exception of Italy and New Zealand. In Austria, France and Ireland the average funding at upper secondary level was approximately 25-30 per cent higher per annum than in the UK, while in Denmark, Spain and the Netherlands the average funding level was between 10 and 20 per cent higher than in the UK. The researchers noted that the majority of the 14 countries provided larger levels of funding for vocational qualifications than academic qualifications, in contrast to the UK. Switzerland had the highest levels of funding per FTE learner, where funding for vocational training was 65 per cent higher than funding for academic studies.
- 3.75** The average value of an apprenticeship – measured by the average earnings of someone whose highest qualification is an apprenticeship – also varied across countries. The average fully qualified rate across all countries was approximately £12.26 an hour. After adjusting for differences in purchasing power, the fully qualified hourly rate ranged from approximately £10.50 in Spain to the equivalent of £16.66 in Germany. The average value for the UK was towards the lower end of the spectrum, at £11.89 an hour, with some variation between the countries of the UK, ranging from £10.50 in Northern Ireland to £12.84 in Scotland.
- 3.76** However, apprentice pay was generally higher in the UK than in many other countries. The researchers estimated that apprentices in the UK earned on average £6.05 an hour (ranging from £5.92 in Northern Ireland to £6.87 in Wales). This was equivalent to around 50 per cent of the 'fully qualified' rate for the UK, that is, around half of the average hourly rate earned by workers whose highest qualification was an apprenticeship. UK apprentices earned between 90 and 110 per cent of the adult rate of the NMW on average. The researchers noted however, that average earnings and their relationship to the fully qualified rate and adult rate of the NMW varied considerably by age of apprentice. Specifically, although average apprentice pay across the UK was approximately £6.05 per hour, for those apprentices aged less than 19 the average pay rate was approximately £3.88 an hour (compared with an average apprentice pay rate of £8.15 an hour for those aged 25 or above). This implied that younger apprentices earned approximately 63 per cent of the full adult minimum wage on average over the course of their apprenticeship.

- 3.77** Apprentice pay was particularly low in Germany, Austria and Switzerland. Depending on year of study, apprentices were paid the equivalent of between £3.47 and £4.64 an hour in Germany; £2.67 and £5.60 in Austria and between £1.39 and £3.01 in Switzerland, all of which were below the average rates received in the UK and often below the rates for young apprentices.
- 3.78** Finally, there were very different patterns of vocational learning with extensive variation between countries in terms of the relationship between academic and vocational learning and take-up of apprenticeships. Among young people in upper secondary and post secondary non-tertiary education, Switzerland had the highest proportion of vocational enrolments, with more than 60 per cent of young people studying apprenticeships. It was followed by Germany and Denmark (both 45 per cent). The equivalent figure for the UK was 32 per cent. The lowest levels of vocational enrolment were in Spain, Belgium and Ireland, with fewer than 5 per cent of young people in further education enrolled on an apprenticeship.
- 3.79** Consistent with other research in the field, this study found that those countries that achieve high rates of transition to 'combinations of vocational training and work' by the end of lower secondary education were associated with the lowest youth unemployment rates, and that those countries that had failed to achieve a similar integration of young people into the labour market (for example, the UK and Sweden) were associated with higher youth unemployment rates.

Apprenticeship Policy

- 3.80** Apprenticeship starts across the UK slowed in 2013, possibly due to changes to apprenticeship funding arrangements in England and Northern Ireland. From August 2013, government funding for further education courses in England (including apprenticeships) was removed for learners aged 24 and above, on a Level 3 or higher course. To mitigate this, the Government introduced new 'Advanced Learning Loans', which are available to those learners who are no longer eligible for government funding.
- 3.81** These loans work on the same basis as Higher Education student loans, with repayments on an income-contingent basis and any outstanding loan amount written off after 30 years. Individuals only begin to repay the loan when their earnings reach £21,000 or more a year, at which point 9 per cent of all earnings above this threshold is collected as repayment.
- 3.82** BIS completed an impact assessment of the removal of funding and introduction of fees for this age group, and estimated that around 55 per cent of learners who would have previously been eligible for funding would still undertake learning under the new fee and loan system. This implies that there may be a reduction of about 45 per cent in the number of apprenticeship starts for those apprentices aged 24 or above on an Advanced Level apprenticeship (equivalent to Level 3) from August 2013. Based on current volumes this would imply a significant reduction of apprenticeship starts for people aged 24 and over in England from 2013/14.
- 3.83** More recently, the Government announced a radical overhaul to the organisation, structure and funding of apprenticeships in England following a review by Doug Richard (Richard, 2012). The Government's response to the Richard Review was published in October 2013

and proposes a new approach which will begin in 2015/16 leading to full implementation in 2017/18 (BIS, 2013i). Changes include greater involvement by employers in setting requirements and standards; practical competency testing at the end of the apprenticeship rather than throughout the placement; grading of apprenticeships to pass, merit or distinction; and the inclusion of English and Maths competency tests.

- 3.84** Other important changes include a requirement for all apprenticeships to last at least twelve months and changes to funding, which have yet to be determined but which may include providing funding directly to employers. The aim of the changes is to improve the quality and value placed upon apprenticeships by both apprentices and employers. It is too early at this stage to estimate the impact of these changes on the volume of apprenticeships.

Conclusion

- 3.85** There was a mixed picture on earnings growth for young people. Earnings growth improved for 18-20 year olds but 16-17 year olds median earnings have remained around £5.00 an hour since 2008. Median earnings growth for 18-20 year olds in 2013 exceeded the uprating in the youth rates which were frozen in October 2012. Consequently, as we had intended, the bite of the minimum wage for 18-20 year olds fell by 1.5 percentage points, from 79.7 per cent to 78.2 per cent. In contrast, the fall in median hourly earnings for 16-17 year olds has meant that, despite the freezing of the 16-17 Year Old Rate, the bite increased by 1.6 percentage points to 73.6 per cent in 2013, more than reversing the fall that had occurred in 2012.
- 3.86** There was also a mixed picture in terms of employers' use of the minimum wage rates for young employees. The proportion of 18-20 year olds paid at the Youth Development Rate was stable at 10 per cent through 2012 and 2013, halting the increase which had been observed from 2008. At the same time the proportion paid at the adult rate fell slightly between 2012 and 2013, but remained higher than in 2010 or 2011. For 16-17 year olds, the proportions paid at both the 16-17 Year Old Rate and the adult rate fell between 2012 and 2013. However, an increasing proportion of 16-17 year olds were paid at the focal point of £5.00 in 2013. Research also noted a trend away from paying youth rates among employers in retail and this was echoed by the evidence provided to us by employers through our stakeholder consultation process.
- 3.87** The labour market position of young people was deteriorating before the start of the recession in 2008, and worsened in the period after, but there are signs of improvement over the last year. In 2013 the overall proportion of 18-20 and 16-17 year olds in employment stabilised, following a long-term decline. This was accompanied by an improvement in unemployment for both groups of young people in 2013. There were also signs of improvement among young people not in full-time education. Among 18-20 year olds not in full-time education, both employment and unemployment rates improved slightly through 2012 and 2013. Employment and unemployment rates have stabilised among 16-17 year olds not in full-time education, halting the deterioration that followed the recent recession. Although the level of youth employment remains significantly lower than its pre-recession level, this is in large part due to the increased number of 16-17 and 18-20 year olds staying in full-time education.

- 3.88** We also noted an increase in the proportion of young people paid below their age-related NMW rate. Research found that non-compliance was more prevalent among young people, and more prevalent for part-time employment, which may also disproportionately affect young people. It is also possible that some of those paid below the age-related rates were paid at the Apprentice Rate or paid at focal points above the Apprentice Rate but below the youth rates. We expect to have new data on apprentices for the 2015 Report which will help us to establish whether the increase in the proportions paid below the age-related rates is related to apprenticeships.
- 3.89** The total number of Level 2 and Level 3 apprenticeship starts in the UK fell by just over 10,000 in 2012/13, marking the first fall since 2005/06. The fall was greatest among 16-18 year olds, with the number of apprenticeship starts falling in England by 12 per cent in 2012/13.
- 3.90** The 2012 Apprentice Pay Survey showed that median gross apprentice pay was significantly above the Apprentice Rate, at £6.19 an hour, although there was substantial variation by age and evidence of significantly lower pay, and non-compliance, among younger apprentices. An international comparison of apprentices found similar average apprentice pay rates and the same variation by age but also found that apprentice pay was higher in the UK than in many other countries. Apprentice pay was particularly low in Germany, Austria and Switzerland. However, the UK performed less well, in comparison with other countries, on a range of factors including the level, duration, funding and value of an apprenticeship. Despite the relatively low rates of apprentice pay in Switzerland and Germany they had the highest proportion of vocational enrolments. Switzerland also had the highest levels of funding, with vocational studies receiving 65 per cent more funding than academic studies. And the value of an apprenticeship – measured by the average earnings of someone whose highest qualification is an apprenticeship – was greatest in Germany. While there was considerable variation between the 14 countries in the duration of apprenticeships, only Spain had average durations which were shorter than those in the UK.
- 3.91** In general the research we commissioned for this report, like earlier research, found little effect of the minimum wage on the employment of young people. It found mixed evidence on the effect of lowering the age of eligibility for the adult rate from 22 years to 21 years. Lowering the age of eligibility to 21 was associated with an increase in employment and a reduction in inactivity for 21 year old men. Conversely, using a different methodology, the researchers found weak evidence of an increase in unemployment for 21 year old men and a reduction in hours worked by 21 year olds on average. They noted that the fall in inactivity may have both increased employment and unemployment levels for 21 year old men. However, in contrast to some previous research, they found no evidence of negative employment outcomes for workers one year below the eligibility criteria. This research builds on a long series of research which has found very little evidence of negative labour market effects associated with the NMW.
- 3.92** We aim to ensure that the minimum wage rates prevent the exploitation of those in work, or undertaking an apprenticeship, while not providing an incentive for young people to leave valuable education or training which will improve their long-term economic position. In this chapter we have considered the contribution that the youth rates and the Apprentice Rate of

the NMW could make to the employment prospects of young people, including those in apprenticeships. We have reviewed evidence on young people's earnings and labour market outcomes alongside the findings from commissioned research and evidence from stakeholders. The evidence collected this year has not suggested any further measures which would enable the NMW to support young people's employment prospects, other than to continue to examine closely all the features of the labour market for young people and to recommend rates for young people which reflect those labour market conditions. Our recommendations for the youth and apprentice rates for October 2014, alongside stakeholder views and other evidence that influenced our conclusions, are presented in Chapter 5. We now go on to consider the operation of the National Minimum Wage in Chapter 4, including an assessment of the non-compliance issues we highlighted that affect young people such as internships and apprenticeships.

Chapter 4

Compliance and Operation of the National Minimum Wage

Introduction

- 4.1** In past reports we have made clear the importance we attach to having widespread compliance with the National Minimum Wage (NMW) together with a respected and effective enforcement regime to tackle any breach of the rules. Issues of NMW compliance and operation form a significant part of the evidence we receive from stakeholders through our written consultation, oral evidence sessions and visits around the country. Compliance is necessary if the minimum wage is to be the wage floor for the UK labour market in practice as well as in statute. Compliant employers need to be assured that they will not be undercut by unscrupulous businesses, and workers, particularly those vulnerable to exploitation, need to be assured that they will receive the promised wage protection.
- 4.2** This chapter first looks at the arrangements for promoting compliance and delivering an effective enforcement regime. It then goes on to consider some aspects of the operation of the NMW which our consultation and other evidence has suggested require further consideration: either in respect of the risk that particular groups of workers may not in practice receive at least the NMW (for example, those working as interns); or where employers have told us that the way the rules work has caused problems to them and in some instances to their workers as well (for example, with respect to the way the accommodation offset operated).

Developing the Compliance and Enforcement Regime

- 4.3** Over the lifetime of the NMW we have made a number of recommendations and suggestions to government about how arrangements for the NMW could be improved in order to raise compliance and make enforcement more effective. These have included measures to: target enforcement in problem areas; revise guidance; make greater use of prosecutions; name and shame those who disregard the rules; and to increase resources for enforcement. Most of our proposals on these issues have been accepted and, on a number of them, our Secretariat has worked with officials to help take matters forward.
- 4.4** We are pleased to report below on some improvements during the past year in the compliance and enforcement regime. In addition the Government is taking steps to consolidate the 18 sets of NMW Regulations into a single set. This exercise will also update the drafting of the Regulations so that it complies with current drafting conventions, which have changed considerably since 1999. We understand that the Government will shortly launch a public consultation on the draft consolidated regulations. We will provide our own

input to this consultation process and hope the outcome is a set of statutory NMW rules that are as clear as possible and that further assist minimum wage compliance.

- 4.5** One of our major concerns has been that the compliance and enforcement regime should reflect a strategic view on the best deployment of resource, against an assessed risk of NMW non-compliance. We were pleased therefore that the Government introduced a Compliance Strategy in 2010, and in this section we first look at how this has operated and what impact it has had, before going on to consider other recent developments in the regime as well as areas which we consider require further enhancement.

Implementing the Compliance Strategy

- 4.6** A five-year National Minimum Wage Compliance Strategy was introduced by the Government in March 2010. The Government's vision contained in the strategy is that everyone who is entitled to the NMW should receive it. While all complaints are investigated, the approach is informed by intelligence and data to ensure best use is made of the available tools and resources. The strategy also seeks to ensure it has the most effective balance of civil and criminal enforcement action.
- 4.7** It takes a multi-faceted approach, including targeted communications to raise awareness; helping employers to comply; and targeted enforcement action in sectors or areas where there is a higher risk of NMW non-compliance. The strategy uses a 'suite of interventions' to help achieve the Government's vision. These include: face-to-face meetings; correspondence with employers to 'nudge' them into compliant behaviour; health checks to help businesses better understand what they need to do to comply with the NMW; and targeted enforcement, sometimes involving multi-agency operations, to address the higher risk sectors/areas. The Government's evidence to us illustrated the type and range of operations it has undertaken using each of the 'suite' of interventions. Some of these operations have been in response to recommendations we have made and are reported in more detail in the second half of this chapter, such as in relation to apprentices and interns. Other action has been based on intelligence received by HM Revenue and Customs (HMRC) and its risk assessment of where to target enforcement resource (such as in social care).
- 4.8** During 2013 a number of stakeholders expressed views about non-compliance and HMRC's role and work. Recent reports by researchers and think tanks have suggested further action is needed. Pennycook (2013) reported that non-payment of the NMW was high in social care and Hull (2013) claimed that the compliance and enforcement regime was not fit for purpose and required radical overhaul, including taking away primary responsibility for enforcement from HMRC. In addition some stakeholders, while welcoming the reforms to the enforcement regime over recent years, have sought other measures.
- 4.9** Given that enforcement of the NMW legislation in Equity's sector (entertainment) was bound up with employment agency law it was disappointed that the Department for Business Innovation and Skills (BIS) had not recommended that the Employment Agencies Standards Inspectorate (EAS) be given similar powers to HMRC in order to 'properly investigate'. A number of trade unions, such as Unite, again called for unions to be able to take a 'representative action' on behalf of a group of workers to an Employment Tribunal. Unions

have also called for their complaints to trigger full investigations by HMRC. The Broadcasting Entertainment Cinematograph & Theatre Union (BECTU) reminded us of its concerns that HMRC's enforcement activities were hampered by perverse confidentiality rules, which prevented HMRC from drawing regular attention to its activities and successes. The Public and Commercial Services union (PCS), which represents Compliance Officers, once again asked us to consider the possibility of giving HMRC the power to enforce holiday pay rights alongside the NMW.

- 4.10** On occasion we too have been critical in our reports where we have seen shortfalls in the compliance and enforcement regime, and we have made a number of recommendations. However, we also think that it is important to acknowledge the steps taken and the achievements made so far in what we hope is a continuing pathway towards ensuring all entitled to the NMW receive it. This year's figures showed a marked increase in the strike rate – the proportion of investigated cases where non-compliance is found – by HMRC in finding non-compliance (up to 43 per cent from 35 per cent in 20011/12) and an increase in total NMW underpayments (up to nearly £4.0 million from £3.6 million in the previous year). These may be indicators that the Government is becoming more effective in targeting non-compliance. Of course it is difficult to get a true measure of the extent of non-compliance (considered later in the chapter) from looking only at the level of complaints and activities undertaken by the enforcement body.
- 4.11** However, in its submission to us this year the Government pointed to other enforcement data which it thought showed increased success for HMRC in identifying NMW arrears for workers. It highlighted improved performance since 2009/10 (i.e. the year before the Compliance Strategy was introduced) on a number of key measures including the number of penalties charged, the amount of such penalties, and the average arrears per case, and that HMRC was doing the work with less than it spent in 2009/10 – we comment on resources later in the chapter. The Government maintained this improvement in performance reflected an improved focus on risk and risk governance; improved targeted enforcement; improved depth and scope of investigations; and improved internal processes.
- 4.12** In its evidence the Government said it would be undertaking an evaluation of the Compliance Strategy, and this should be completed by the time of our next consultation in summer 2014. We will welcome the opportunity to contribute to that review. Our judgement is that progress has been made, both in terms of the overall Compliance Strategy, taking a proactive approach to enforcement, and in the work being done on the ground by HMRC local compliance officers and central teams. There is, however, further work to be done. Later in the chapter we set out areas where there is a higher risk of non-payment of the NMW and where enforcement resource should focus. First, however, we look at other aspects of the compliance and enforcement regime, including where changes have taken place or are pending.

Reviewing Penalties and Fair Arrears

- 4.13** The Compliance Strategy commenced shortly after another major change in the enforcement regime: Penalties and Fair Arrears. From April 2009, this introduced fines for breaches of the NMW and repaid workers' arrears of the minimum wage at the current rate(s) rather than the

rate(s) which applied at the time of the breach. The fines were set at half of the amount of arrears identified up to a maximum fine of £5,000.

- 4.14** Since 2009 we have reported differing views on these arrangements: on whether workers should receive arrears at the current rate or the rate which operated when the breach occurred; on whether it was fair to penalise an employer who made a genuine mistake; and whether the maximum £5,000 penalty was high enough. We have previously said that changes should only be made following a full review of the arrangements and in both our 2011 and 2012 Reports we suggested the time was right to conduct one.
- 4.15** In evidence for the 2013 Report the Government advised us it was undertaking a review of the Penalties and Fair Arrears regime and this would be completed by September 2013, although for this report it informed us this work would not now be concluded until summer 2014. However, the Government announced in January this year that it was increasing the penalties where employers had failed to pay at least the NMW. The financial penalty percentage would increase from 50 per cent to 100 per cent of the unpaid wages owed to workers, and the maximum penalty would increase from £5,000 to £20,000. It expected these new limits, subject to Parliamentary approval, to be in force by 1 March 2014. The Government said it also wanted to go further and would bring in legislation at the earliest opportunity so that the maximum penalty could apply in relation to each underpaid worker. We welcome measures to strengthen the penalty regime and will closely monitor the operation of these new arrangements.

Revising the Naming Scheme

- 4.16** In 2009 we recommended that the Government introduce a 'name and shame' policy to expose employers who show a wilful disregard for the NMW. The Government accepted our advice and introduced a new policy in January 2011. However, between January 2011 and January 2013 only one employer had been named. The Government acknowledged this was disappointing and we said the position was untenable. In evidence for our 2013 Report the Government told us it intended to undertake a review of the Naming Scheme and we indicated our willingness to participate in such a review.
- 4.17** The Government subsequently reviewed the scheme and in August 2013 it announced reforms to make it simpler to name employers who break NMW law. The new arrangements, which have operated since October 2013, replaced the previous requirement to meet two financial criteria (a minimum of £2,000 total arrears and an average of at least £500 owed per worker) and at least one of seven other criteria. These included evidence that the employer knowingly or deliberately failed to comply with their NMW obligations, and evidence that the employer had previously received advice from HMRC about the steps they needed to take to ensure future compliance and had not taken them. Under the reformed scheme employers who have been issued with a Notice of Underpayment by HMRC (setting out owed wages and the penalty for non-compliance) will be named. There is a mechanism for the employer to appeal (as previously) against the Notice of Underpayment or to make representations to BIS outlining whether they meet any of three criteria to prevent them being named: naming carries a risk of personal harm to an individual or their family; there are national security risks

associated with naming; or there are other factors which suggest that it would not be in the public interest to name the employer/company.

- 4.18** Both trade union and employer stakeholders which commented on these reforms generally welcomed them, including the Trades Union Congress (TUC) which thought we should monitor the new scheme to ensure that it delivers what it promises. The CBI told us in oral evidence that it was content with the Government's intention to name and shame. It thought that the NMW was clear, and business should comply, although the process should include an opportunity for businesses to set things right. However, while welcoming removal of the restrictive criteria, PCS thought that the reason only one employer had been named was due to reductions in the number of staff in BIS. This, it said, meant there had been insufficient resource to consider which employers should be named. It thought that unless this funding issue was addressed, the new naming scheme would run into similar problems.
- 4.19** The new arrangements should lead to more employers being named. We welcome the changes and hope that more naming of those not meeting their obligations will send a stronger signal to other infringers. We will look closely at how these reforms work in practice as offending employers should start to be named under the scheme in early 2014, and we look forward to receiving evidence from the Government about this for our 2015 Report.

Reviewing the Prosecutions Policy

- 4.20** In our 2013 Report we reiterated our long held view that serious infringers of the NMW should be prosecuted, and that this action should be publicised to deter others. While the Government has always supported prosecutions as one part of its tool kit for addressing non-compliance, there have been only eight prosecutions since the introduction of the NMW with the last case in February 2013.
- 4.21** While fully recognising the high resource cost of bringing each prosecution, we have always regarded them as having the potential for a high impact on employers contemplating not paying the NMW. The TUC has also recognised that prosecutions were resource-intensive, but thought HMRC needed to take more of the aggravated cases to court, including repeat offenders. It thought the Commission should argue for more prosecutions, higher penalties and higher fines. PCS said it would welcome more prosecutions for NMW offences, but cautioned that this should not be at the expense of HMRC working on securing wage arrears for workers. It thought priority should be given to prosecuting employers with insufficient records where this was preventing calculation of NMW arrears.
- 4.22** In evidence for this report the Government told us that since March 2013, eight cases have been referred by HMRC officers for consideration of prosecution. The decision on whether to prosecute or not is made by the Crown Prosecution Service which considers the evidence and whether it is in the public interest to prosecute. The Government has reiterated that prosecutions continue to be resource-intensive, in terms of time and money and it explained to us the thresholds which need to be met for a case to be prosecuted. However, it also said that it was reviewing its policy on prosecutions to ensure that it continues to be consistent with its overarching Compliance Strategy for the minimum wage. We welcome its decision to review this policy and we hope that it may lead to greater use of this part of the

enforcement tool kit, which we continue to believe can have a very substantial impact on those contemplating not paying their workers the NMW.

Raising Awareness

- 4.23** In past reports we have highlighted the links between the extent of awareness of the NMW and the level of minimum wage compliance. This was supported by both research (BIS, 2011b) and stakeholder evidence. In its evidence for our 2013 Report the Government told us that a priority was raising the profile of NMW enforcement to ensure that workers and employers were aware of their rights and obligations. To that end it was producing a communications plan to increase compliance through raising awareness of the NMW and enforcement of it. We welcomed that intention, although the plan has not yet been published.
- 4.24** We have also encouraged HMRC to take opportunities to publicise more widely NMW compliance and enforcement activities, and the outcome for those who flout the law. HMRC has told us that, where opportunities have arisen, it has sought to gain publicity, such as where it has pursued debts on behalf of workers to County Court and has obtained a County Court Judgement. Also HMRC regularly 'push' SMS messages to over 2,000 recipients and it used national and regional news releases on 30 May 2013 to highlight the amount of National Minimum Wage arrears secured in 2012/13.
- 4.25** BIS holds a modest communications budget for the NMW, however, as part of the Government's 'marketing freeze' there has been a restriction on Whitehall departments using such funds to pay for publicity. We are pleased that at least some general awareness-raising, such as that relating to apprentices, has taken place. In our 2012 Report we recommended that communications activities about the NMW should not be subject to the 'marketing freeze'. While it is of course appropriate to make full use of low and no cost routes in raising awareness of the NMW, we believe that expenditure on publicity would be cost-effective for the public purse, particularly for NMW upratings and for sectors and groups where there is higher risk of non-compliance. In addition, we would encourage BIS to produce the promised communications plan to ensure activities in this area are contributing to a strategic approach in raising awareness of the NMW.

Improving NMW Guidance

- 4.26** As part of our work for the 2012 Report we were asked to consider whether the NMW could be made even simpler and easier to administer. We recommended that the Government put in place and maintain effective, clear and accessible guidance on all aspects of the minimum wage, particularly where there was significant evidence of ignorance or infringement. As a first step we asked the Government to undertake a review of all existing guidance.
- 4.27** The Government accepted the recommendation. However, work to progress this was overtaken by the introduction of GOV.UK, the replacement government website for information previously hosted on businesslink and directgov. The NMW guidance on the new site lacked the depth and breadth of that previously available, and despite concerns registered with the Government, by both us and stakeholders, at the time of our last report little progress had been made in improving the available guidance. We remained keen to

assist with a review of the guidance and hoped that in the near future the Government would achieve the improvement in the NMW guidance which it agreed to make following our recommendation in 2012.

4.28 This matter was again raised by stakeholders in their evidence for this report, particularly in sectors which may have complex working arrangements (such as in social care or agriculture). Better guidance is needed to ensure employers and workers clearly understand how to calculate NMW pay. The Association of Labour Providers said businesses in its sector needed more advice and guidance on the NMW, particularly on the more challenging and complex issues. The United Kingdom Home Care Association (UKHCA) told us that to try and address the shortcomings in official guidance it had spent substantial sums on developing material for its members. The TUC and Unite were among the trade union organisations which told us of the concerns raised with the Government, but that the faults had not yet been rectified. BECTU regarded GOV.UK as a step backwards and in some areas actively misleading. Equity referred to sector-specific guidance which was promised for its industry following a recommendation in our 2010 Report, and thought it may be time for us to repeat our advice.

4.29 We have discussed the issue of NMW guidance on GOV.UK with government. The Government accepts that there should be guidance on GOV.UK that enables employers and workers to easily understand their rights and responsibilities. A fifty page guidance document on ‘calculating the minimum wage’ (covering much of the information that was previously on directgov and businesslink e.g. deductions, what counts as pay, and what counts as working hours) has now appeared on GOV.UK. We understand that the Government is keeping this guidance under review and considering what further information is required.

We are closely interested in the work to bring the official guidance to the point where it properly meets user needs and will continue to provide assistance to the Government in progressing this. A later section covering interns highlights one area where further work on the official guidance is required.

“Information regarding the NMW and other business-related issues on GOV.UK needs improving.”

**Federation of Small Businesses,
Forum of Private Business and
British Chambers of Commerce
oral evidence**

Resourcing and Ensuring Access to the Enforcement Regime

4.30 We have previously recommended that the Government maintain (in real terms) the budget for enforcement. The Government noted this recommendation. In recent years the budget has remained steady in cash terms at between £8.0 and £8.3 million, at a time when generally government budgets have faced substantial pressure. Going forward there are some other sources of additional resource.

4.31 Following a recent review of the law regulating employment agencies (BIS, 2013d), the Government has said resource will focus on helping the most vulnerable workers who need protection, particularly those on the NMW, by moving staff resources from the BIS Employment Agency Standards Inspectorate to HMRC’s NMW team. Some further additional

resource for HMRC enforcement will also result from a transfer from the Department for Environment, Food and Rural Affairs following abolition of the Agricultural Wages Board for England and Wales. But along with these extra funds have come extra responsibilities.

- 4.32** However, as we identify later in this chapter, there remain areas where further enforcement action is needed, and there may also be pressure on resources for other reasons. Some stakeholders, such as PCS, have raised a concern that the introduction of tribunal fees may lead to more cases that would otherwise go to an Employment Tribunal (ET) being referred to HMRC, with knock-on resource implications. Trade unions generally have once again pressed for additional resources for enforcement, with increases in real terms. Unite, while welcoming HMRC's success in identifying NMW arrears, thought this warranted increased funding for enforcement, especially with growing numbers of apprentices and workers previously covered by the Agricultural Wages Board coming within the NMW framework. PCS also referred to new challenges and an increased workload, pointing to the changed arrangements in agriculture where it said there was a prevalence of low pay at or below the NMW. The TUC thought the budget for enforcement should be increased. It questioned whether the current budget, which had declined in real terms, could cover all the tasks HMRC and BIS needed to carry out and ensure the low paid could enforce their rights.
- 4.33** It is too early to know what impact the introduction of fees for ET claims may have on the number of complaints made to HMRC. Complaints involving the NMW form only a small proportion of total annual claims to ETs (around 500, or 0.2 per cent, of all claims by jurisdiction), compared with about 1,400 NMW complaints received by HMRC. However, where a case involving a claim for non-payment of the NMW progresses to an ET hearing the fee would total £390, compared with average wage arrears of £150 per worker achieved by HMRC in its casework in 2012/13. Given that much work still remains to be done, in raising compliance and enforcing the minimum wage, it is important that the Government maintains sufficient resource, both in BIS and HMRC, so that there can be continued progress towards ensuring that the National Minimum Wage is always the floor under wages in practice as well as in statute.

Addressing Compliance and Enforcement Issues

- 4.34** As stated above, the Government's vision contained in the Compliance Strategy is that everyone entitled to the NMW should receive it. This obviously implies ensuring that in practice all workers entitled to the NMW receive at least this wage rate, and later in this part of the chapter we look at particular sectors, groups of workers, or aspects of the NMW where issues have arisen over whether and how this is achieved. The vision contained in the strategy also implies establishing how close we are to its attainment, and understanding the overall nature and extent of NMW non-compliance. In the next section we consider what we know about this, including what our most recent commissioned research has been able to add to our knowledge base on compliance.

The Nature and Extent of Non-compliance

- 4.35** One way of measuring the success of the compliance and enforcement regime is to measure the extent of non-compliance, and any changes to this. Although it is very difficult to get an accurate picture of non-compliance, we have continued to try to obtain an assessment of how widely the minimum wage is being observed and where it is not to gain a better understanding of the reasons for this.
- 4.36** There are no official data that indicate reliably the level of non-compliance. Official data show that in April 2013 around 203,000 adults (those aged 21 and over) were paid less than the adult rate of the minimum wage, compared with 207,000 the previous April. If we look at these numbers over a longer period and on a comparable basis there were 183,000 adults aged 22 and over (the previous age threshold for the adult rate) who were paid less than the adult rate of the minimum wage in April 2013. The number has been at around this level in recent years, lower than in the mid-2000s but similar to a low point in 2009. However, there are of course legitimate reasons why some workers are exempt from the wage or can be paid a lower rate (e.g. an adult apprentice in the first twelve months of training) and so these data do not provide a true measure of non-compliance. We explained in our last report that based on the data we had on apprentices and the accommodation offset our working assumption is these reasons account for less than half of the number reported in official data as paid below the NMW. In addition we felt there was almost certainly under-reporting of unlawful non-payment of the NMW.
- 4.37** We have also looked at enforcement data from HMRC. Although data show that the number of enquiries completed and the number of complaints of non-compliance to HMRC decreased in 2012/13 – the continuation of a trend since 2007/08 – it is not clear what this may mean. Fewer completed cases may reflect the impact of changes to enforcement arrangements on casework capacity or that arrangements are now picking up more complex and time-consuming cases. Fewer complaints may not necessarily mean compliance has improved since the number of complaints may be affected by other factors such as workers being aware of their NMW rights and being prepared to come forward with a complaint. We have therefore tried to better understand what is happening to non-compliance through other routes as well, including commissioned research.
- 4.38** Research for the 2013 Report included that by le Roux, Lucchino, and Wilkinson (2013), which suggested that between 2000 and 2011 around 6 per cent of the bottom decile of adult earners (i.e. those most at risk of underpayment of the NMW) did not receive their minimum wage entitlement. While the research had not been able to provide precise estimates of non-compliance across the UK, if non-compliance remained at this sort of level – and our sense from more recent evidence we had received was that if anything it is more likely to have increased than reduced – then it was a significant problem. Other research commissioned for our last report (Bessa, Forde, Moore and Stuart, 2013) investigated the impact of the NMW in social care, a sector thought to be at higher risk of non-compliance. The researchers suggested that a relatively small but possibly rising proportion of domiciliary care workers were paid under the NMW. As the research did not make any assumption about the inclusion of travel time in workers' hourly rates, the researchers regarded their estimates of the proportion paid at or below the NMW as a conservative or lower bound.

- 4.39** For this report we conducted our own analysis of non-compliance in the social care sector. We found that as there is no agreed estimate of unpaid work time (e.g. for travel time) it is not possible to derive a definitive estimate of NMW non-compliance. However, based on the assumed level of unpaid hours derived from recent independent research (Hussein, 2011), we estimated that up to 10.6 per cent of workers in social care may not be paid their NMW entitlement. This estimate was in line with those derived by other researchers. However, it should be noted that estimates of compliance are very sensitive to the assumptions used as there are many social care workers employed at or just above the NMW. Thus any additional estimated unpaid hours will reduce the estimates of hourly pay and lead to an increase in the measure of non-compliance.
- 4.40** We also commissioned research to look at the changing use of flexible employment and any implications for the NMW, including non-compliance. (Bewley, Rincon-Aznar and Wilkinson (2014) found evidence that non-compliance was more likely where there was some use of shiftworking or employees worked part-time, and lower where some employees were agency workers, worked compressed hours or worked at home (although of course homeworkers can include both salaried staff and piece rate workers, the latter being more likely to be lower paid and affected by the NMW). The findings suggested that some flexible employment practices may be a risk factor which should be taken into account in NMW compliance and enforcement. The researchers' estimates of overall NMW non-compliance (for 2012-13) were broadly in line with estimates by le Roux, Lucchino and Wilkinson (2013) for the period 2008-11.
- 4.41** We now go on to look at some aspects of the operation of the NMW which our consultation evidence suggested required further consideration: either in respect of the risk that particular groups of workers may not in practice receive the protection of being paid at least the NMW, or where employers have told us the way the rules work caused problems.

Apprentices

- 4.42** Chapter 3 looked at how the volume of young people undertaking apprenticeships has changed since our last report and considered the available evidence in relation to apprentice pay including the findings from research. The Government has not undertaken an Apprentice Pay Survey since 2012 and the results of that survey were included in our 2013 Report.
- 4.43** We reported that the proportion of apprentices paid below the NMW had risen when compared with a year earlier, across many of the low-paying sectors, in particular hairdressing, construction and childcare. Non-compliance appeared most prevalent among employers of young apprentices: 40 per cent of 16-17 year old and 25 per cent of 18-20 year old apprentices were estimated to be paid less than £2.65 an hour. The problem was particularly acute in hairdressing where, in 2012, around 64 per cent of 16-17 year old and 70 per cent of 18-20 year old apprentices were estimated to be paid below their entitlements.
- 4.44** We were extremely concerned about what these data were showing. It was clear that non-compliance appeared to be increasing and action was necessary to tackle this. We stated that non-compliance was so widespread that the Apprentice Rate was not functioning as the floor under apprentice pay. The Government did not agree with us that the Apprentice Rate

should be frozen because of the extent of non-compliance. It did however accept our recommendation that it should combine a communications campaign and a targeted enforcement initiative to ensure that the Apprentice Rate was known to employers and apprentices, and that infringers were caught, punished, and wherever appropriate, named. The Employment Relations Minister stated that the Government shared our concerns about non-compliance with the Apprentice Rate and was clear that employers must pay their staff at least the minimum wage. The Government said that as from July 2013 all calls from apprentices made to the Pay and Work Rights Helpline were being prioritised for action. In addition, it would be stepping up its communications activity to increase the level of awareness of the minimum wage rules, and it was improving guidance and information more generally to ensure there was clear, comprehensive and consistent information on the minimum wage rules. It had already issued NMW posters to relevant organisations asking them to display them where employers and workers could see them, to raise awareness of the NMW.

- 4.45** In addition, the Government told us that, in England, it was taking steps to ensure all training providers deliver on existing obligations to inform employers and apprentices of the NMW requirements. It would be including information on the NMW rules in the employers' information packs that the National Apprenticeship Service issues to prospective apprentice employers, and in the information given to apprentices by training providers. In Northern Ireland Compliance Officers were already engaging with relevant parties to offer help and guidance on compliance with the NMW. The Government's decision to change the criteria for naming employers who do not comply with the NMW rules (as reported earlier in this chapter) will apply to employers of apprentices.
- 4.46** In written evidence this year, the National Hairdressers' Federation said it believed reputable businesses were fully aware of the NMW requirements and it did not condone any deliberate non-compliance. It said it recognised that the rules were complex, particularly those relating to the apprentice minimum wage and it believed a more lenient approach would be helpful where any non-compliance was due to interpretation, if it was voluntarily corrected as soon as it came to light.
- 4.47** The TUC said that anecdotal evidence from union representatives suggested that compliance with the NMW had declined quite sharply in the past two years. It said that some non-compliance may result from careless mistakes, but in many other cases, it was caused by deliberate cheating by the employer. The TUC said this was not acceptable and should lead to penalties, fines, naming and, after due consideration, exclusion from the apprenticeship programme. It said the Government needed to act urgently to tackle non-compliance otherwise there was a real danger that exploitation would become rife and the quality of the apprenticeship brand would be seriously undermined.
- 4.48** We welcome the focus that the Government is giving to the rights of apprentices, in terms of enforcement and awareness-raising activities. Only time will tell whether the actions already announced are enough to reverse the increase in non-compliance. We would urge the Government to continue with its efforts in this area and we look forward to seeing the results of the 2014 Apprentice Pay Survey.

Care Workers

- 4.49** In our 2013 Report we reported our concern at evidence of a growing risk of non-compliance with payment of the NMW to workers in adult social care. Although central Government was allocating additional funds to adult social care, the general reduction in local authority expenditure and an absence of ring-fencing of care budgets meant that at the local level the experience was of reducing public resources for adult care. In many instances local authorities froze or reduced fees paid to care providers, paying increasingly for very short care visits and linking payment to user contact time only – often with no recognition in care fees of travel time or travel costs. Increasingly contracts did not guarantee providers a particular volume of business, with representatives of care providers pointing to instances of care fees too low to enable their members to discharge their statutory responsibilities, including payment of the NMW.
- 4.50** We formed the view that the compliance issue was only likely to be satisfactorily resolved when action was taken to address commissioning practices. We recommended that contracts issued by public bodies which commissioned the provision of social care should contain a clause requiring at least the NMW to be paid and that the Government should take responsibility for bringing this about. We were disappointed that the Government noted rather than accepted this recommendation saying it believed there were more effective ways to achieve a reduction in NMW non-compliance. It told us that the Department of Health and Department for Communities and Local Government would work together to develop tougher measures to deter non-compliance as well as support improvements in compliance.
- 4.51** However, since then it has taken some time for any of the promised action to materialise. At the same time we received further evidence confirming our concerns about the level of NMW non-compliance in the sector. Indeed the Government's own evidence for this report acknowledged that there had been a lack of progress in taking forward our recommendation. It was looking to name and shame employers who broke the NMW rules, but only recently has the naming scheme been reformed to facilitate this. It has also told us it was looking to allocate resources to this important area of work and would seek to address our recommendation. And it was encouraging all social care employers to sign up to a code of practice, the Social Care Commitment, which incorporates an ambition to provide a quality service by ensuring a positive culture and working environment is created. However, the evidence we received for this report confirmed the severe financial pressures the sector was under and the risk care workers faced of not being paid the NMW. An Association of Directors of Adult Social Services survey reported that by March 2014, over a three year period, £2.68 billion of savings will have been made from adult social care budgets.

- 4.52** Laing & Buisson (2013), using its latest market data for care home fees, found councils giving an average uplift of 1.8 per cent, close to the 2.0 per cent it estimated was needed to keep pace with care home inflation. It contrasted this with ‘the chasm’ in 2012/13 (an average 1.6 per cent uplift against the 2.5 per cent needed to keep margins neutral). However, it pointed out that there had been no ‘catch-up’ for ground lost over recent years, and there continued to be variation in the level of uplifts: of 133 councils providing data 62 gave below ‘standstill’ uplifts (where the standstill band was considered to be 2.0-2.9 per cent), including 31 which froze fees (although none reduced them); 56 gave an uplift in the standstill band; and 15 gave a rise at a margin-enhancing rate (3 per cent or above). 74 councils had not yet set baseline fees or did not respond to the survey.
- 4.53** In respect of home care the Equality and Human Rights Commission (EHRC, 2013) conducted a follow-up investigation to its 2011 report on human rights and home care in England (EHRC, 2011) to see what action councils had taken in response to its recommendations, including that local authorities should ensure that care providers can pay at least the NMW, including payment for travel time. This found that a fifth of local authorities responding to its survey paid providers £11.00 an hour or less for day-time home care, with the lowest at just £8.98. We question whether all statutory responsibilities, including payment of the NMW, can be met by providers when local authorities pay such very low hourly fees. For our last report UKHCA estimated at least £14.95 an hour was needed to meet all costs and provide a profit margin. In oral evidence UKHCA advised that it thought it would now be above £15.00, and has subsequently calculated the rate as £15.19 an hour. It told us that at £11.00 an hour it would not be possible to provide home care without cutting training or some other item, such as payment for travel time. Indeed we heard from one major care provider, Sue Ryder, that it had taken the decision to exit entirely from the provision of home care when faced with very low fee payments from local authorities (see box below).
- 4.54** Evidence from representatives of care providers also confirmed these pressures. The Registered Nursing Home Association (RNHA) told us how the adult social care sector was under severe cost and occupancy pressure as a result of continuing public spending cuts and that it was left between a ‘rock and a hard place’: authorities had not increased fees while the NMW had risen. In oral evidence the National Care Association advised that a large number of care home businesses were looking to exit the supply of care to local authorities and it was beginning to see care home closures. The UKHCA said that increasingly its members were struggling to meet their statutory obligations, including paying the NMW. UKHCA explained how the financial climate and local authority commissioning (calculating fees by contact time and a move away from guaranteed volume) compounded the current use of zero hours contracts; although it did not believe there was any evidence that zero hours contracts created a disposition to NMW non-compliance. They enabled flexible working patterns which responded to the demands and needs of service users.

Case Study: Sue Ryder

In March 2012 the company was providing domiciliary care through a large number of contracts across the UK but had a number of serious concerns.

- It was losing money across the entire portfolio of contracts and did not believe that charity money should be funding care which is the responsibility of government.
- In a given locality its business model required 1000 hours of care to make it work financially given the need for proper governance and quality assurance. While local authorities were issuing tenders in excess of these hours they were then putting a number of suppliers onto a framework agreement. In practice what this meant was the company was lucky if it got more than a few hundred hours in any given locality and at the same time some authorities started to only pay for hours in attendance and not the travelling time between visits. In addition, some authorities were starting to request 15 minute calls.
- Sue Ryder was only paying its care staff the National Minimum Wage, but was paying for travelling time, which meant that where local authorities were not paying for travelling time Sue Ryder was absorbing that cost as the company was not prepared to pay staff only for visit times.

Taking all these facts into consideration Sue Ryder was seriously concerned that the quality of care that it could give in, say, a 15 minute visit, would be seriously compromised. It took the view that the market would get worse as local authorities were continually looking at ways to cut costs further. It was concerned that any further increase in the National Minimum Wage would not be matched by increased funding thereby increasing its losses further. Most importantly it believed that its reputation as a quality care provider was seriously at risk. As a result Sue Ryder concluded that it should exit domiciliary care in England.

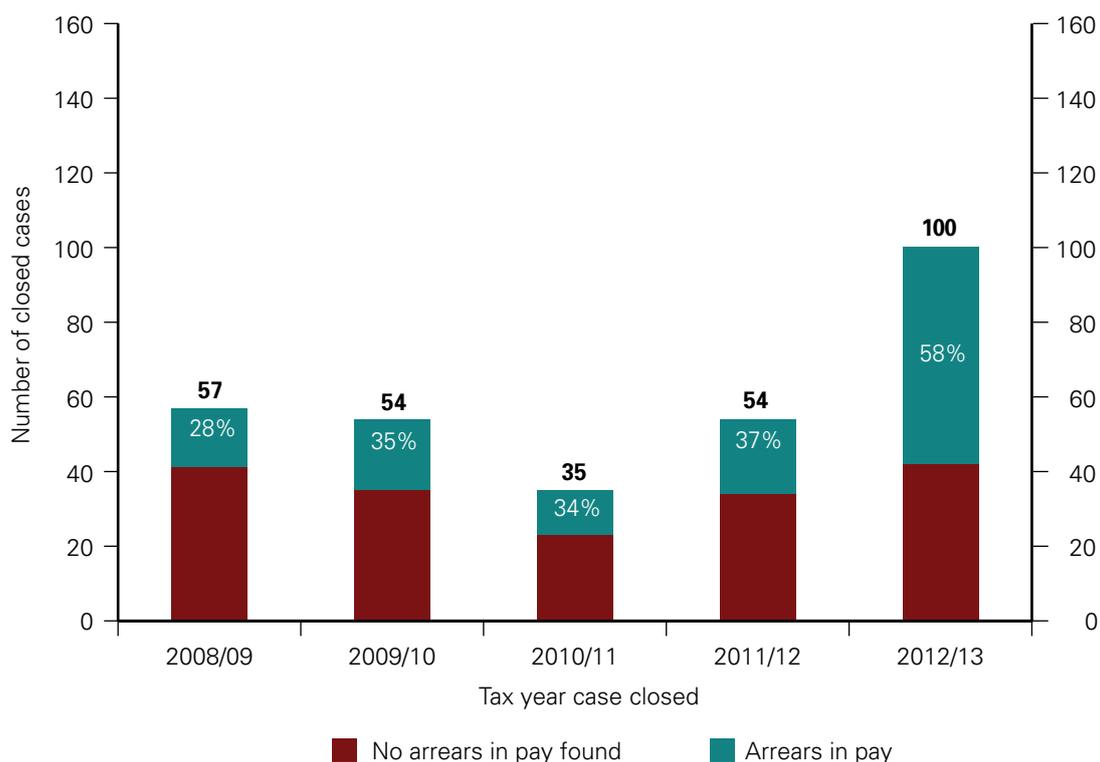
- 4.55** Trade unions were also concerned about council commissioning which did not guarantee work for providers and paid them for contact time only. This, they argued, drives care providers in turn to pay their staff for contact time only, and staff are not paid for travel time. Unlike representatives of care providers, they saw from their members' experiences a link between zero hours contracts and NMW non-compliance. A UNISON survey of care workers reported that 12 per cent of respondents said they were sometimes not paid the NMW with almost a third not paid for travel time. The union said that on average workers spent nearly seven hours a week travelling between visits, with implications for wrongly identifying staff as paid at or above the NMW. UNISON asked for the Low Pay Commission to investigate zero hours contracts, including the link between zero hours contracts and the NMW. The TUC also asked the Commission to investigate abuse of zero hours contracts and considered the sector as one for targeted enforcement. It was concerned at the rapid rise of zero hours contracts in recent years and their relationship with only paying for particular parts of a working day, and not for example paying for travel time or time spent waiting for work.

- 4.56** Our concerns, and those of others, that care workers were at higher risk of not being paid their entitlement to the NMW were confirmed by HMRC's report on its investigations into the sector over the past couple of years. The most common reasons for non-compliance related to deductions from workers' pay; and payments by the worker for items deemed to be a business expense (purchased for the employers' benefit and use in their business). Such deductions and payments brought workers' pay below NMW rates. Other issues identified by HMRC as causing underpayment of the National Minimum Wage to workers in domiciliary care included unpaid training time; unpaid travelling time between appointments; hourly pay rates below the NMW rate; and incorrect use of apprentice rate(s). In residential care, issues identified by HMRC included a failure to pay workers for all working time; unpaid training time; hourly pay rates below the NMW rate; a lack or awareness of the accommodation offset rules and their effect on NMW pay calculations; and incorrect use of apprentice rate(s). HMRC investigations also found many employers had failed to keep sufficient records of working time to demonstrate that workers were paid at least the NMW.
- 4.57** HMRC (2013), covering the two years from 1 April 2011 to 31 March 2013, reported on 224 investigations into the sector. In 183 completed cases HMRC found non-compliance in 88 (48 per cent). The incidence of non-compliance was also found to be rising in the sector. It was higher in 2011/12 and 2012/13 than in any year since April 2008. The strike rate of 58 per cent in 2012/13 compares with 43 per cent non-compliance in all HMRC investigations in the same year. Figure 4.1 shows this rise.

"I estimate that 70 per cent of local care providers are not complying with the NMW. The impact of local authority commissioning arrangements will be either: NMW non-compliance; less capacity in the system; companies 'take a hit'; or service users will not receive their due care."

**Local care provider,
Commission visit in England**

Figure 4.1: Number of Completed HMRC Enquiries and Proportion with Arrears of National Minimum Wage Pay in Social Care, UK, 2008/09–2012/13



Source: HMRC (2013).

4.58 As well as providing an analysis of its compliance findings, HMRC (2013) explained how the NMW should be calculated, particularly with respect to payments likely to occur in the sector such as for travel time and accommodation. We think it is necessary to disseminate the document to care providers and care workers across the UK. We understand that BIS is working with HMRC to identify communication action necessary to promote the information and the next steps to help mitigate non-compliance in the sector.

4.59 The Government has acknowledged the findings of HMRC from its targeted care sector work and told us it will commission Skills for Care to develop and publish guidance for employers with regard to how they maintain worker records (for example, for travel time) and how this affects the NMW. We welcome this. We were also pleased to learn that the Department of Health will develop statutory commissioning guidance for local authorities which refers to employment law and to BIS guidance on payment of travel time, so local authorities can assure

“Contracts should not be let where the expectation was providers would not be able to comply with the NMW, however, local authorities would baulk at the requirement for NMW contract clauses with the expectation they would have a monitoring role where other bodies (HMRC) already had this duty. There would need to be clear accountability and clarity of rules and responsibilities if more than one body performed a NMW monitoring role.”

Association of Directors of Adult Social Services oral evidence

themselves that the care companies they contract with comply with the NMW Regulations. We understand that subject to parliamentary approval and public consultation, the guidance will be published in the autumn of 2014.

4.60 On the basis of its further investigations into the sector EHRC, which supports our recommendation for the inclusion of a clause in care contracts requiring at least the NMW to be paid, has also recommended that local authorities use costing models which incorporate all essential elements of the actual costs of care, including the NMW, and demonstrate transparency by putting these costing models on their websites.

UKHCA told us of its costing model which was freely available to the sector. EHRC (2013) also advised that, as part of next steps to its work, it will convene a round table with stakeholders to discuss ways of promoting commissioning practices that most effectively support payment of at least the NMW to care workers. Again, these are actions to be supported in helping to raise NMW compliance.

“We would like to see more light shone on the issue of non-payment for care workers’ travel time, and more local authorities using costing models.”

EHRC oral evidence

4.61 The adult social care sector continues to be under severe financial pressures stemming from the reductions in local authority budgets and the related constraints on the level of fees paid to independent care providers. On our visits around the country and in written and oral evidence, we were given many examples of very low levels of care fees. In our judgement providers will be faced in such circumstances with either being NMW non-compliant or failing to meet some other duty. We were told frequently on our visits by those operating in the care sector that NMW non-compliance was occurring, and that even compliant providers were being pushed towards such choices.

4.62 Care workers remain at a high, and possibly increasing, risk of non-compliance with the NMW. Unfortunately, the Government’s promises to develop tougher measures to deter non-compliance and support compliance have been slow to materialise. We urge the Government to take the promised action; build on the work by HMRC and EHRC; create better guidance; maintain enforcement action; and support the use of fee-costing models/ transparency. The promised statutory guidance on commissioning provides an opportunity to include a requirement for local authorities to take into account the actual costs of care, including the payment of the NMW, and we urge the Government to ensure this is part of the guidance.

Unpaid Work: Interns, Work Experience and Volunteering

4.63 Over the last few years, we have reported on the substantial volume of evidence we have received which suggested a growth in situations where the terms ‘internship’, ‘work experience’ or ‘volunteer’ were applied to unpaid activities that looked like work and to which the NMW should be applied. In our 2012 Report, we noted that new guidance had been prepared and was going to be issued and that time should be allowed for this to have an effect, and also that targeted enforcement would be taking place.

- 4.64** In our 2013 Report, we reported on the evidence again received concerning abuse of the NMW rules and also on the work the Government had done to improve enforcement in this area. HMRC had undertaken a targeted enforcement campaign in the fashion industry and, at that point, a number of employers had been investigated with wage arrears of £137,000 being recovered.
- 4.65** We have for this report received evidence that unpaid or low-paid work (below the NMW) continues to occur in many positions which appear to be work and for which the minimum wage should be paid, particularly in the entertainment and media industries. Nearly a quarter of all responses to our written consultation covered this issue to some extent.
- 4.66** The Broadcasting Entertainment Cinematograph & Theatre Union (BECTU) said some employers continued to take advantage of new entrants by offering them unpaid entry-level posts which were clearly work. A survey of young people's experience of work had found that a third of jobs undertaken were unpaid. A third of these were in the informal production sector and a quarter were in the commercial sector with broadcasters or established film and television production companies. BECTU said the widespread problem of unpaid entry-level positions gave a clear advantage to those who could support themselves or fall back on private resources. Equity said young workers were expected to take unpaid positions for a number of years and that cultural factors and perceptions of the industry needed to be tackled. It said in areas such as fringe theatre, the amount of unpaid work was growing. A number of organisations that spoke to us at oral evidence said that the use of interns was entrenched in their industries and was seen as the only way in which young people could get a foot onto the career ladder.
- 4.67** Unite said unpaid internships were on the increase and they were becoming the fastest source of abuse under the NMW. The TUC also highlighted concerns over the use of interns by businesses as a means of getting free work. Intern Aware said that there were still many employers that routinely advertised for internships that were unlawful. It said there were not enough complaints to the Pay and Work Rights Helpline to make a difference to behaviour in the labour market overall.
- 4.68** However, Inspiring Interns said that existing employment law, when applied properly, was sufficient protection against abuse of the internship system by a small minority of companies. It said a large number of internships were predominantly learning experiences and could correctly be classified as volunteering positions. The Textile Services Association said its industry had experienced occasional problems with the application of the NMW to volunteers and interns, but that the quality and clarity of official guidance had improved greatly, especially from HMRC, which had reduced significantly the number of problems that had occurred in the past.
- 4.69** The Government has said that it has worked very constructively with the British Fashion Council (BFC), BECTU and others to tackle the exploitation of interns and to change employer behaviour. It recognised that there was still much to do but it said it was committed to tackling potential non-compliance at the advertising stage as well as fast-tracking all complaints that it received.

- 4.70** HMRC advised that it has worked with the BFC to educate employers around the use of interns and volunteers. This, it told us, had resulted in the BFC beginning to design a selection of products, including apprenticeships, to provide an alternative to the use of interns. HMRC wrote to 100 fashion houses and designers offering guidance on the payment of and entitlement to NMW. BFC also wrote to around 400 UK fashion-related companies, enclosing HMRC-approved guidance on entitlement to the NMW. HMRC has also written to 20 agencies that were advertising on-line for interns, highlighting that they needed to let employers know of their obligations under the NMW Act. Further action had identified a number of employers advertising on-line for interns and in November 2013, BIS issued a press release stating that HMRC would be contacting 200 employers advertising for unpaid interns and then following this up with checks in 2014.
- 4.71** All complaints to the Pay and Work Rights Helpline which relate to interns are fast-tracked and referred to the HMRC's Dynamic Response Team. To the end of September 2013, there had been 95 intern complaints since the fast track process started in August 2012 and arrears of pay for 171 workers totalling £193,873 had been identified in 12 cases.
- 4.72** Stakeholders also commented on the work of HMRC in tackling non-compliance in this area. Intern Aware recognised improvements in the enforcement regime, namely: the expansion of naming and shaming; a poster campaign to communicate issues; increased support from the Employment Minister; and some enforcement success. The TUC also recognised some progress had been made in relation to enforcement. At oral evidence, a number of organisations cautiously welcomed the actions being taken by HMRC but noted that HMRC's work would only be classed as successful if employers changed their behaviours and there were no more abuses.
- 4.73** Stakeholders put forward a number of views on how the situation with regard to unpaid interns could be improved. These included: a new legal definition of an internship; continued targeted enforcement; enforcement activity being publicised more widely; penalties for non-compliance being increased; and better advice being made available.
- 4.74** In our 2013 Report, we noted that the guidance had been cut back on the Government's new website (GOV.UK) and we said we would like to see effective, clear and accessible guidance put in place and combined with vigorous and targeted enforcement. If this was not done, we said we would expect the Government to consider other measures to secure compliance, possibly including changes to the law.
- 4.75** A number of stakeholders commented on the guidance. BECTU was concerned over the reduction of advice available as a result of moving to GOV.UK. It said the content had been reduced so much that in some instances what was there was actively misleading. Equity said the advice previously available on businesslink was barely adequate and that the new advice available on GOV.UK was even worse. Mark Watson, a freelancer in the television industry, said the official advice from the BIS site was not fit for the purposes of interns. It was not written in a way that young people understood and it should be rewritten and include detailed guidance for interns. EEF, the manufacturers' organisation, said that there was confusion around 'what an internship was' and that employers found it difficult to differentiate between an internship, work experience and work shadowing.

- 4.76** In evidence for this report, the Government said that since HMRC had started tackling abuses in this area, it was clear that the issue of interns was not as straightforward as it at first appeared. There was a blurring of the distinctions between voluntary work and work which attracts the NMW. HMRC had requested legal advice from BIS, with a view to providing some clarity for interns and employers alike. The Government has already taken some steps to improve official guidance available on interns, including guidance published in September 2013 on calculating the minimum wage. It has subsequently said that given the further work it is undertaking in this area, which aims to provide greater clarity for employers and young people, it was not intending to seek legal advice at this stage. It would, however, seek legal advice if the steps it is currently taking do not provide the clarity required.
- 4.77** In summary, we have once again heard concerns from stakeholders over the number of unpaid internships (which appear to be work) being advertised and how in some instances this is the accepted form of entry into a number of industries. This is an issue on which we have received a considerable amount of evidence for a number of years now.
- 4.78** The Government is making some headway in tackling the issue, and this has been welcomed by stakeholders. We also support what has been done, which we would encourage the Government to treat as a basis for intensifying its efforts in order to make real headway in tackling non-compliance. There are two ways this should be done.
- 4.79** First, the Government should address the issue of making clear and accessible guidance readily available. There is now some guidance on the issue of volunteers, but clearly there is scope for this to be much more comprehensive. We would urge the Government to work with interested parties in designing and publishing clear and comprehensive guidance. Second, the Government should continue with targeted enforcement, concentrating on areas where the issue is most acute and reports of non-compliance are widespread. We will continue to monitor over the coming year the actions taken by the Government in the area of unpaid work, and how far the situation appears to be improving.

Migrant Domestic Workers

- 4.80** Some of our recent reports have featured evidence on the minimum wage experiences of migrant domestic workers; that is, migrant workers who enter the UK on overseas domestic worker visas to work in private households, sometimes those of diplomats. Around 15,000 overseas domestic worker visas are issued each year, although not all eventually come to the UK. Evidence we received included the abuse some migrant domestic workers had incurred at the hands of their employer, often physical, and going well beyond just non-payment of the NMW. Some employers of migrant domestic workers had cited the family worker exemption from the NMW (NMW Regulations 1999 Section 2(2) (a)) as the basis for not paying them the minimum wage, despite their being here on a domestic worker visa and often working long hours for low pay.
- 4.81** As well as covering family members, the family worker exemption allows for people who live as part of a family (but are not members of that family) and who share in the work and leisure activities of the household to be exempt from the NMW. Living as part of the family means in particular sharing in tasks and leisure activities on the same basis as other family members.

The primary reason this exemption was inserted in the NMW Regulations in 1999 was to address concerns that households may have had to pay their au pairs the NMW with the possible impact this may have had on the future availability of such opportunities. Au pairs will typically visit the UK on a cultural exchange and while they may help with light housework and childcare and receive 'pocket money' they would usually also attend English language classes and be allowed time to study and practise English with the host family.

- 4.82** Evidence for the 2013 Report has again highlighted the difficulties migrant domestic workers experienced in establishing their right to the NMW. Kalayaan, a charity which provides advice and support to migrants who come to the UK as domestic workers, told us that changed visa conditions for overseas domestic workers introduced in April 2012 had significantly reduced domestic workers' access to support and protection. In particular the removal of the right to change employer and limiting their stay for a maximum of six months, had led to increased abuse with no real possibility of seeking redress. Since the introduction of the new visa it had noticed a lower proportion of migrant domestic workers had taken a case against their former employer and that its clients on the new visa were also more likely to claim experience of exploitation in their workplace than those on the old visa – 32 per cent received no salary as opposed to 1 per cent on the old visa, and greater numbers worked in excess of 16 hours a day on the new visa.
- 4.83** Despite visa entry measures intended to ensure that migrant domestic workers and their employers understood their respective rights and responsibilities (such as an information leaflet for migrant domestic workers; a statement of written terms and conditions of employment for employers to sign; and a declaration that the worker will be paid in accordance with the NMW), Kalayaan told us that many migrant domestic workers were ignorant of these arrangements. It said the vast majority it dealt with had never been given information on their rights and were not called for interview for visa entry clearance. It had also noticed a large proportion of applications for further leave to remain did not comply with the NMW, yet were still approved.
- 4.84** The Anti Trafficking and Labour Exploitation Unit (ATLEU), a charity providing legal help to victims of trafficking and labour exploitation, called for the family worker exemption to be reviewed, and either restricted to apply only to those who were actually members of the employer's family or if the intention was to exclude from the NMW those who were genuinely au pairs, amended to define this group. It said migrant domestic workers travelled overseas not for the purposes of cultural exchange or language learning but to support dependent children in their home countries.
- 4.85** ATLEU pointed to its migrant domestic worker client casework in which many employers invoked the family worker exemption when their domestic workers sought to claim their right to the NMW. It highlighted a Court of Appeal case in

"I started to work at age 12 and was driven by poverty to travel half way across the world to work in the UK...however I was treated badly by my employers in the UK, including sexual harassment, physical abuse, extremely long hours and low pay, far below the NMW."

Migrant domestic worker's evidence, Commission visit to London

November 2012 where, despite the Court acknowledging that the family worker exemption should be narrowly applied, found it nevertheless applied in cases where, for example, a migrant domestic worker normally worked over 75 hours a week and sometimes as many as 95 hours; was required to share a bedroom with two children and slept in the dining room on a fold-away mattress; and was paid on average £155 a month (equivalent to an hourly rate of 46 pence). Given the Court of Appeal's decision, ATLEU's current reading of the law meant it could be possible for the exemption to apply in wider circumstances than previously envisaged, such as even where there was an absence of parity of treatment between the worker and other family members; the worker performed the majority of the household tasks, with only some tasks outside the workers' contractual tasks being shared; and that despite the accommodation offset, a migrant domestic worker receiving free accommodation and meals may be expected to perform more household duties for the family than other family members.

4.86 Trade unions have also raised their concerns about the family worker exemption being used to exempt migrant domestic workers from the NMW. The TUC said in its evidence that it was still deeply concerned about the position of those domestic workers who were exempt from the NMW because they were said to be living as part of the family. It thought that in many cases this was completely unwarranted and amounted to a licence to exploit these workers. The TUC called for the exemption to be abolished or at least greatly tightened, and for there to be targeted enforcement using a multi-agency approach.

4.87 While some of the existing visa arrangements should help to clarify the status of migrant domestic workers (for example, a requirement for a prior employment relationship and stated terms and conditions on visa documentation) evidence from stakeholders representing them was that in some cases visas may be granted despite stated rates of pay falling below the NMW. We have also heard claims by these groups that employers use fraudulent documentation to obtain visas for their workers with, it is claimed, little checking of the real circumstances by the visa authorities.

4.88 It is difficult to know the true scale of the problem, but it is unsafe to assume that the absence of high levels of complaints by migrant domestic workers means that it is small. Under-reporting is likely given that these workers are typically new to the UK; will often be ignorant of their employment rights; and may be especially reluctant to complain about their employer since their visas are conditional on remaining in employment with the employer who has

"A large proportion of fraudulent documentation is submitted by employers to gain entry clearance to the UK and for visa renewals...It is not uncommon to see applications where a domestic worker is required to work 40 hours a week for pay of £200 a month, yet the application for the visa is still granted."

Kalayaan evidence

"Overseas domestic workers are only allowed visas if they are coming to the UK to work, so should not be exempt from the NMW for being family workers. The law was not working in a cohesive manner."

TUC oral evidence

brought them to the UK. We are also aware that changes to rules for access to legal aid and the introduction of fees for Employment Tribunal claims may also mean that relatively few breaches of the NMW with respect to migrant domestic workers come to the attention of the authorities. While HMRC should provide the route of choice for reporting NMW non-compliance, stakeholder evidence suggests that enquiries through that route may have been choked off as they have also been met with the need to consider the possible application of the family worker exemption.

- 4.89** We suggest the Government looks again at the law in this area. While we recognise that any effective action may require a change to primary legislation and necessitate the availability of a suitable legislative vehicle, **we recommend that the Government should review the law, and take the next available opportunity to legislate and clarify the entitlement of migrant domestic workers to the National Minimum Wage.** We also urge the Government to take action to increase awareness of the NMW entitlement of this group of workers; undertake appropriate enforcement; and ensure the process undertaken for the UK visa arrangements involves an effective check that the legal obligation to comply with the NMW is met by their employer.

Fair Piece Rates: Homeworkers and Hotel Cleaners

- 4.90** People who work from home, including those who perform low-skilled manual work, sometimes do so on a piece-rate basis. Where an employer cannot control a worker's hours of work, there are arrangements under the NMW Regulations for compliance with the NMW to be measured against an output-based pay arrangement (i.e. payment by the piece). This arrangement is called Fair Piece Rates (FPRs). Homeworkers can face particular difficulties in enforcing their rights to the NMW.
- 4.91** For a number of years we have received evidence of homeworkers being paid below the NMW. But as we have previously reported, it is very difficult to get information on homeworkers, because they are spread out across different sectors and there are few organisations directly representing them. We have also received accounts of hotel cleaners, engaged through agency and contract cleaning companies, and paid on a 'per-room' basis and not receiving their entitlement to the NMW. In 2010 we recommended that HMRC investigate whether these workers were receiving their entitlement under the NMW for their hours worked. This recommendation was accepted and HMRC subsequently reported on the outcome of its targeted enforcement campaign.
- 4.92** This campaign involved visiting a number of hotel chains as well as cleaning businesses that supplied workers to hotels and in evidence for the 2013 Report, HMRC advised that a number of investigations had been undertaken, including as a result of worker complaints, and in one case £40,000 in arrears were identified for 100 workers. HMRC said it planned to undertake a number of further investigations at large cleaning businesses. The 2013 Report noted that continued enforcement action was necessary along with detailed and clear guidance.
- 4.93** In its written evidence this year, Unite has said that the issue of agencies abusing the FPR system in the hotel sector by underpaying the NMW had not improved. It again said that

piece rates have been set at unattainable levels which made it impossible for workers to achieve the NMW and called for the removal of the FPR system from the hotel sector because room cleaning did not constitute output work. In its evidence the Government said that its targeted enforcement work in the hotel-cleaning sector was continuing. It was making enquiries into a number of contract-cleaning businesses and to date it had recovered just over £3,000 in arrears. HMRC also advised it was in discussion with the Equality and Human Rights Commission which was looking at the protection of employment rights of cleaning workers.

- 4.94** During a Commission visit we met with a knitwear manufacturer who told us that wage differentials with the NMW had narrowed in recent years. The company had to 'make up' pay to the level of the NMW for those not earning at least this amount through the company incentive scheme. Prior to the NMW, workers had to improve to enhance their pay, but now there was less incentive to get better and some were deterred from learning new skills. UK Fashion and Textile Association highlighted that the erosion of differentials was an issue across the industry.
- 4.95** We have not received any evidence this year in relation to homeworkers. This is disappointing as we said in our 2013 Report that our understanding of the impact of the NMW on homeworkers would certainly benefit from more evidence about this group of workers. The guidance now available on GOV.UK includes sections on output work and on Fair Piece Rates (and how they should be calculated). This guidance clearly shows that if a worker's hours are being controlled, it is not output work. This is what HMRC's targeted enforcement campaign in the hotel-cleaning sector showed; employers were controlling workers' hours and Fair Piece Rates did not apply. We will continue to monitor the evidence received and consider if further enforcement action is necessary in light of this.

Accommodation Offset

- 4.96** As part of our remit for the 2013 Report we reviewed the accommodation offset, whereby employers may reduce the NMW entitlement by a daily maximum amount if they provide their workers with accommodation. Following a detailed exercise we concluded that: the offset should remain the only permitted benefit-in-kind that can count towards payment of the NMW; there should be only one rate; and that it should apply irrespective of whether the worker has a choice over taking the accommodation.
- 4.97** We also noted that the evidence indicated that the provision of accommodation by employers had decreased. Although this was a result of several factors, we believed a higher offset would help to encourage mutually beneficial provision of accommodation. However, we did not want to reduce the take-home pay of the lowest earners when they were experiencing erosion in the real value of their wages. We stated that it was our intention to recommend staged increases in the offset towards the value of the hourly adult rate of the NMW when economic circumstances mean the real value of the NMW is tending to rise. For October 2013 we recommended, and the Government accepted, a 1.9 per cent increase in the level of the offset (in line with the rise in the adult rate) to £4.91 a day. Our recommended level of the offset for October 2014 is set out in Chapter 5.

4.98 We received reaction from both employer and worker organisations to the position we reached on the offset. Employer reaction fell into two broad camps: those which welcomed our approach (some with qualification), and those which were disappointed and still called for the offset to apply only to tied accommodation and not to circumstances where a worker was able to exercise choice over whether to take the employer-provided accommodation.

4.99 Among employer groups welcoming the Commission’s position were those representing the hospitality sector (British Hospitality Association, British Beer & Pub Association, Business In Sport and Leisure and the Association of Licensed Multiple Retailers – BHA, BBPA, BISL and ALMR). Their consistent position had been for the offset to be retained, but for it to be increased to a more economic level. The National Farmers’ Union (NFU) also welcomed the approach of increases in the value of the offset towards the hourly adult rate of the NMW. It said an increase to the hourly rate would represent around a 25 per cent rise in the offset; this would reduce employer subsidies, which might in turn encourage employers to increase the supply and standard of accommodation. However, as this would take place when there was an increased real value of the NMW, the NFU balanced support with its view that the bite of the NMW should not be increased.

4.100 Some employer groups highlighted compliance and enforcement issues. The Federation of Small Businesses and National Hairdressers’ Federation told us of a lack of awareness about the offset arrangements in their sectors and the need for greater awareness. While the Recruitment and Employment Confederation (REC) broadly supported the concept of staged increases in the offset, it thought the existing level was far too low for it to be a financially viable option for those looking to house temporary workers. It was concerned this led to workers having to find their own accommodation and therefore being open to exploitation from landlords offering sub-standard or over-crowded housing.

4.101 Some of the trade unions which welcomed maintenance of the offset arrangement expressed concern at our signalled intention to increase its value when circumstances allow. Usdaw said it was wary of the Commission’s intention to increase the level of the offset towards the value of the hourly adult rate when the real value of the NMW was tending to rise. While Usdaw acknowledged this could be seen as showing a commitment to clawing back the real value in the NMW which had been lost through below inflation increases, for the union it also pointed to the offset heading towards market rates. Usdaw thought this would open up the issue of the quality of accommodation, which had not been seriously addressed by the Commission so far. However, for this year, the union thought the offset should rise by the same percentage as the adult rate. Unite also saw no evidence for why we should change from our original approach to the offset when it was established, and would support an increase that did not exceed projected RPI or average earnings.

“We support the current offset arrangements and what the Commission said last year... we don’t believe there is a test which can be used to show genuine choice.”

BHA, BBPA, BISL, ALMR oral evidence

4.102 Other unions, and other worker groups, continued to call for no deductions for accommodation to be allowed, or for the offset level not to rise. The Rail Maritime and Transport Workers' Union and PCS were opposed to the offset and would like to see the law changed so that employers were not allowed to deduct any accommodation costs from workers' wages. UNISON thought the offset should not be increased, particularly where the worker had no choice about taking up the accommodation. Kalayaan, which represents migrant domestic workers, while recognising the protection the offset gave, recommended no deduction from the NMW should be made for accommodation or food; only from earnings in excess of the NMW.

4.103 The Association of Labour Providers (ALP) was very disappointed with the outcome of our review. It thought our review had made only a ' cursory reference to seeking to find a test to distinguish between tied and free choice accommodation' and that our report contained no exploration or consideration of alternative tests to distinguish between accommodation required to be taken and that where there is free choice; it had expected to see evidence of a 'proper exploration' of the options available. The ALP continued to recommend that the offset be applied only to tied accommodation (i.e. required to be taken) and asked us to consider and evaluate mechanisms for establishing whether or not a worker's accommodation is 'voluntary'. It proposed that accommodation should be considered tied whether or not let by the employer or third party if: it is provided in connection with the contract of employment; or the worker's continued employment is dependent upon occupying it; or the worker's occupation of accommodation is dependent upon remaining in a particular job. ALP acknowledged the challenge of enforcing arrangements, but noted that this existed for many aspects of the NMW.

4.104 We can assure all stakeholders that our recent review explored all available avenues to gather information and carefully considered all options. We thank stakeholders who have again contributed to the evidence base on this matter. However, we have not seen any new evidence which leads us to a different conclusion on the way forward to the one that we reached in our 2013 Report, in particular that there is no robust test of whether a worker had 'voluntarily' taken accommodation out of 'free choice'. We will continue to adhere to the position we adopted in our last report – our stated intention to increase the level of the offset towards the value of the adult hourly rate of the NMW once the latter is tending to rise in real terms – and our recommendation on the level of the offset in October 2014 in Chapter 5 should be read in that context.

"We have seen a rise again of slum landlords. It would be better if labour providers could afford to supply accommodation but the level of the offset means this is not economically viable. So we ask again for the offset not to apply to accommodation which isn't tied to a worker's employment."

ALP oral evidence

Transport Costs

4.105 We received evidence this year on a couple of issues relating to transport costs, both of which have featured in past reports. One concerned where an employer provides transport for its workers and seeks to claw back the cost through deductions from the workers' pay. Such action reduces pay and if it drives the hourly rate below the NMW then there is a breach of the minimum wage. For some employers this leads to collection of payment for transport through alternative methods which are more inconvenient and costly, such as taking payment in cash. The ALP questioned HMRC's interpretation of the rules in not allowing employers to deduct transport costs from a worker's wages without this lowering the level of payments which count towards meeting the NMW. It regards this as causing labour providers and their workers to incur considerable additional costs and making it more difficult for the poorest workers to obtain work. It also said it had difficulty in getting clarity from Government on the matter and thought the Commission had failed to consider this issue properly in the past and asked for the matter to be fully considered in this report.

4.106 The other transport cost issue on which we received evidence was travel and subsistence (T&S) schemes, which concern arrangements whereby workers give up a certain amount of their salary and are then given T&S payments that are tax free. Their pay is reduced, but they pay less tax and National Insurance, and the value of their pay plus T&S payments is higher than what their original take-home pay would have been. However, workers can lose out in the long term through paying reduced National Insurance contributions, thereby lowering entitlement to contributory benefits. The employer is usually the main beneficiary through a reduction in its National Insurance contributions.

"It would give greater accountability, safety, transparency and be easier to administer if transport costs could be legitimately taken from wages as you would know exactly what had been deducted from the pay packet."

**Total Labour Solutions
evidence, Commission visit
to Scotland**

4.107 In 2011 the Government changed the NMW Regulations so that tax-free travel and subsistence payments would not count towards pay for NMW purposes, but the agency sector representative body REC told us that these types of scheme were still operating, sometimes affecting those on the NMW, and this interaction was a major concern. REC said unregulated 'intermediary' businesses had grown up over the past three years, marketing ever-changing T&S models that constantly pushed the boundaries of what was compliant. These practices challenged HMRC's guidance, and all sorts of indemnities and guarantees were offered to agencies and workers that use these services. REC's members did not want to go down this route, but then faced the prospect of being at a competitive disadvantage. REC found the lack of enforcement action from HMRC, and of publicity which linked instances of NMW non-compliance to the abuse of T&S arrangements, meant it was unable as an industry body to point definitively to such cases as examples of non-compliant models that members should strictly avoid. We also heard evidence on this matter from the Gangmasters Licensing Authority during our Commission visit to Nottingham. It advised us

the operation of these schemes was very widespread across the temporary work industry and that there needs to be strong enforcement in this area.

4.108 We have previously considered representations on allowing employer deductions for transport costs to count towards the NMW. We have taken the view that deductions from a worker's pay (other than for accommodation) that take pay below the minimum wage should not be allowed. This is to protect vulnerable workers because there is no sufficiently robust test to prove that acceptance of employer-provided transport is a genuine free choice.

In addition, limiting allowable deductions to the accommodation offset avoids adding to the complexity of the minimum wage regulations. While we have again carefully considered the matters raised, we find no new or compelling evidence to change our view.

4.109 The abuse of the NMW rules and T&S schemes is an enforcement matter for HMRC. The law was changed in 2011 to outlaw such schemes in making up NMW pay. We noted above that HMRC were to receive additional staff resource from the Employment Agency Standards Inspectorate which should allow greater focus on the activities of employment agencies. We urge HMRC to look at investigating the compliance issues raised with us on this matter, and if greater clarity is needed in the law on the NMW and use of T&S schemes we would be interested in hearing evidence on HMRC's experience of this for our next report.

"There are still too many illegal travel and subsistence schemes designed to reduce payroll costs."

**Employment agency evidence,
Commission visit in England**

Conclusion

4.110 In this chapter we looked at recent developments in the NMW compliance and enforcement regime, noting both the improvements that have taken place as well as where change is either coming or current arrangements are under review. Progress in improving the compliance and enforcement regime included revision of the naming scheme, which should lead to public naming of more employers who flout the requirement to pay the minimum wage, and an increase in the penalties where employers failed to pay at least the NMW. We will monitor the operation of these arrangements.

4.111 Other areas of the compliance and enforcement framework still required improvement, namely the depth of official guidance, awareness of the NMW among employers and workers, and a need to increase the use of prosecutions for the most serious infringers. The Government has indicated it was considering what further information was required to improve the NMW guidance and is undertaking work to review its prosecutions policy. It remains important to maintain sufficient resource for HMRC and BIS to support and deliver the compliance systems.

- 4.112** The evidence suggests that some groups are at greater risk than others of not receiving their entitlement to the NMW. Of particular concern is social care: HMRC's report on their recent investigations supported other evidence which had indicated that NMW non-compliance in this sector was higher than average. Government commitments to develop tougher measures to deter non-compliance and support compliance in this sector have been slow to materialise. We urge the Government to take further action, including that promised statutory guidance on commissioning should include a requirement for local authorities to take into account the actual costs of care, including the NMW.
- 4.113** Migrant domestic workers have faced difficulty in enforcing their right to the NMW. The courts have sometimes judged that they are not entitled to the minimum wage, under the family worker exemption. We are concerned that the exemption has been applied where it is not intended to operate, and recommend that the Government looks again at this area of NMW law and takes the next available opportunity to legislate and clarify the entitlement of migrant domestic workers to the NMW.
- 4.114** Other areas of concern include the inappropriate use of unpaid interns; and non-compliance among employers of apprentices. We support the action the Government is taking to improve compliance in both areas. We turn in the next chapter to our recommendations on what the rates of the NMW should be in October 2014.

Chapter 5

The Rates

Introduction

- 5.1** The meeting to discuss and agree our recommendations that are set out in this report was held towards the end of January 2014. These deliberations were based on data and information available up to 24 January 2014. The preliminary estimate of gross domestic product (GDP) for the fourth quarter of 2013 was released on 28 January 2014. That estimate was for growth in the whole of 2013 to have been 1.9 per cent, which was in line with what we and many others had expected.
- 5.2** In the previous four chapters we have set out the evidence base used in making our recommendations. Our understanding of the economic context to the October 2013 upratings of the National Minimum Wage (NMW) was set out in Chapter 1, where we discussed the current state of the economy, particularly recent trends in pay and employment. In Chapter 2, we investigated and summarised the impact of the adult rate of the minimum wage. The youth labour market and the impact of the youth rates of the NMW and the Apprentice Rate were considered in Chapter 3. The workings of the NMW, including compliance and enforcement, were assessed in Chapter 4.
- 5.3** In addition to that evidence base, our rate recommendations which are set out in this chapter take account of the prospects for the economy; the evidence provided by stakeholders; international comparisons; and recent and proposed Government legislative changes. After setting out our recommendations, we then consider the implications of those recommendations for the bite of the minimum wage, the coverage of the minimum wage, and its effect on take-home pay. We first consider the prospects for the economy in 2014 and 2015.

Economic Prospects

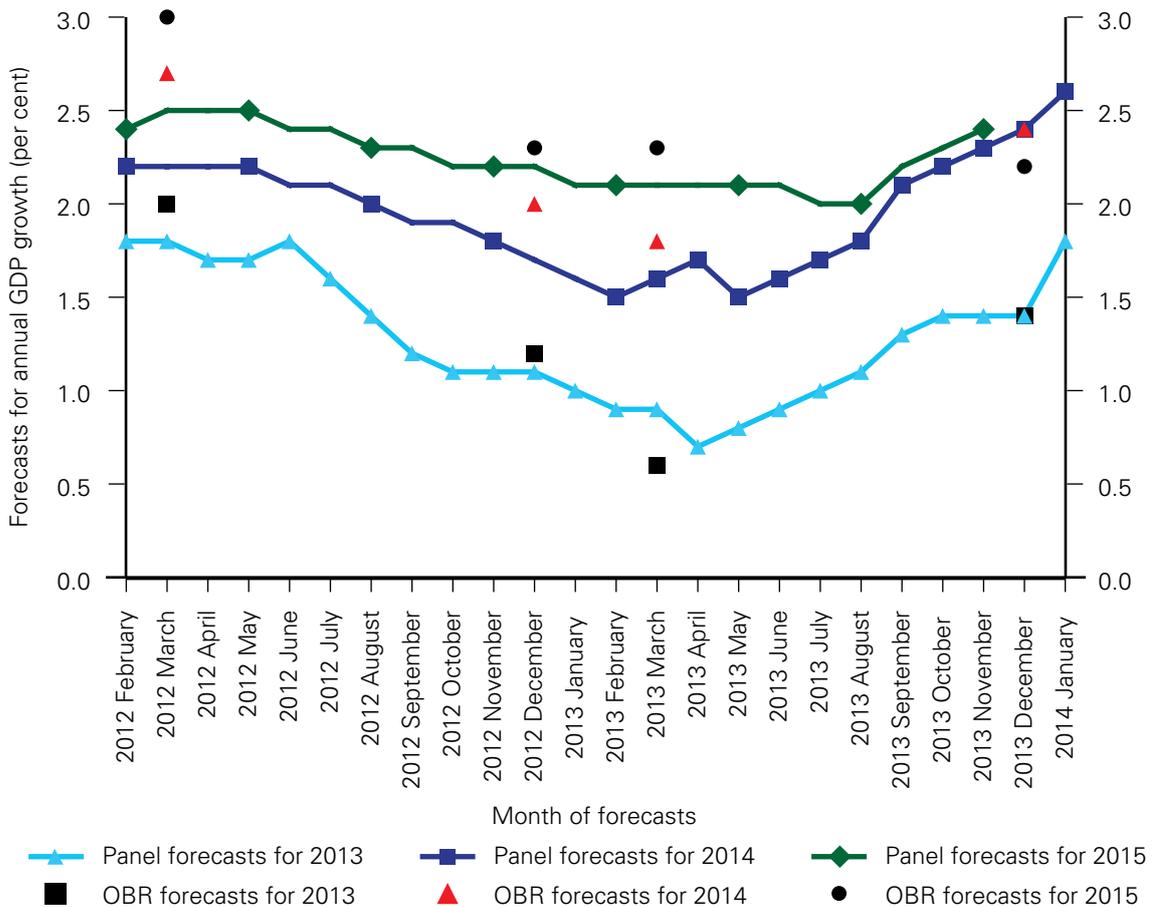
- 5.4** If accepted by the Government, our recommended rates will become effective on 1 October 2014 and will not be amended until October 2015. Therefore, it is important that we consider the prospects for the economy, particularly the likely future path of economic growth, employment, unemployment, earnings growth and price inflation. The backdrop to our discussions was formed by the likelihood that the recent improvement in the economy would prove durable and that the strength of the labour market would continue. Future affordability, particularly in the low-paying sectors and among small firms, was an important determinant in our recommendations. In assessing that we look at the prospects for growth in the economy as a whole and among low-paying sectors and small firms in particular. Consideration of the

value of the NMW (that is, its real value after taking account of inflation and its value relative to average or median earnings) was also an important factor in our recommendations. We therefore look at the prospects for inflation, pay settlements and earnings before we consider how employment and unemployment might be affected.

Prospects for Growth

5.5 As we discussed in Chapter 1, the performance of the economy improved throughout 2013, with growth much stronger than had been forecast at this time last year. Up until the spring, the forecasts for the UK economy had generally been revised down. But since April, as shown in Figure 5.1, those forecasts have been revised up.

Figure 5.1: Gross Domestic Product Forecasts, UK, 2012-14



Source: HM Treasury Panel of Independent Forecasts (median, monthly, February 2012-January 2014), OBR Forecasts (biannual, March 2011-December 2012), based on ONS data: GDP growth (ABMI), quarterly, seasonally adjusted, UK, 2012-14.

Note: Forecasts for growth in 2013 were made before the first estimate of Q4 2013 growth was available.

5.6 After the pick-up in the economy in the third quarter of 2012, driven in part by the London Olympics, the economy then fell back in the fourth quarter and poor economic indicators at the start of the year triggered concerns about returning to recession. However, those concerns were not realised when, in April 2013, the preliminary estimates of growth in the first quarter of 2013 turned out to be 0.3 per cent. Revisions to the data, erasing the double dip recession at the end of 2011, suggested that the recovery, albeit still weak, had been stronger than initially thought. As such, forecasters' views of the medium-term economic outlook have become more optimistic since April 2013.

- 5.7** In recent months, the Office for Budgetary Responsibility (OBR, 2013c), the Bank of England (2013b), the International Monetary Fund (2014), the Organisation for Economic Cooperation and Development (OECD, 2013b) and various independent forecasts (HM Treasury, 2014b) have all revised their estimates for UK output growth in 2014 upwards to around 2.4-2.6 per cent and most expect similar growth in 2015 with the OECD (2.5 per cent) slightly stronger than the IMF and OBR (2.2 per cent). These forecasts suggest that the UK will return to its pre-recession level of GDP at some point in 2014.
- 5.8** The economic outlook for the low-paying sectors will depend not only on the general level of, and growth in, GDP but also on the difference among the components of growth – consumer spending, government spending, investment and trade. The largest component is consumer spending which accounted for about 62 per cent of GDP in the third quarter of 2013. Government spending on consumption accounted for about 22 per cent and investment 14 per cent, more than half of which was business investment. Imports and exports both accounted for just under a third of GDP, with net trade being no more than around 2 per cent of GDP. Thus, the economy is mainly dependent on the level and character of consumer spending.
- 5.9** The prospects for consumer spending will affect low-paying sectors such as retail; hospitality; leisure, travel and sport; and hairdressing. Indirectly, cleaning will also be affected. The level of, and growth in, government spending will be an important determinant of prospects for companies in the social care and childcare sectors, which rely heavily on government funding of places. Cleaning; hospitality; and leisure, sport and travel will also be affected by changes in government spending. The outlook for trade will be a significant factor for many low-paying sectors, such as agriculture; food processing; textiles and clothing; and non-food processing. Tourism is also important for retail; hospitality; and leisure, sport and travel. Investment will help determine the long-run outlook for the UK economy and the path of real wage and productivity growth. We now turn our attention to look at the prospects for consumer spending, investment, trade, and government spending.
- 5.10** There had been hopes that there would be a rebalancing of the economy towards trade and investment and away from consumer and government spending. Indeed, many forecasters are still relying on such re-balancing and continue to expect trade and investment to pick up in the coming years. However, to date, as shown in Table 5.1, there has been little sign of that in this economic recovery. Table 5.1 also shows the weakness of the recovery this time: quarterly growth has averaged just 0.3 per cent, compared with growth of 0.8-0.9 per cent a quarter in the recoveries following the two previous recessions. Although consumer spending has been weaker than after the two previous recessions, in the latest recovery it has been the main driver of growth, along with government consumption spending. Investment and trade have made negligible contributions, although investment has picked up in 2013. After the two previous recessions, investment played a much greater role.

Table 5.1: Components of Gross Domestic Product Growth in Recession and Recovery, UK, 1980-2013

Per cent	Average growth per quarter						Growth on previous quarter			
	Recession			Recovery			Latest			
	1980	1990	2008	1981	1991	2009	2012		2013	
	Q1-1981 Q1	Q3-1991 Q3	Q2-2009 Q2	Q2-1985 Q2	Q4-1995 Q4	Q3-2013 Q3	Q4	Q1	Q2	Q3
Household consumption	0.0	-0.6	-1.2	0.7	0.7	0.3	0.7	0.7	0.3	0.8
Government consumption	0.2	0.8	0.3	0.1	0.1	0.2	0.4	-0.8	1.1	0.7
Investment	-3.5	-1.6	-4.3	1.3	1.0	-0.1	-4.5	0.7	1.7	1.5
Business investment	-2.4	-2.8	-4.1	1.3	0.8	-0.1	-7.8	3.1	-2.3	2.0
Dwellings investment	-7.1	-2.9	-5.7	1.2	0.9	1.0	0.4	3.0	4.7	0.0
Change in inventories	-3.4	-3.3	-0.7	-0.4	0.6	0.4	1.7	-0.5	1.3	2.3
Domestic demand	-1.2	-0.9	-1.7	0.9	0.8	0.4	0.4	-0.0	0.6	1.9
Exports	-1.3	0.4	-2.2	1.2	1.6	0.8	-1.9	-0.2	3.3	-3.0
Imports	-3.4	-1.1	-2.9	1.9	1.4	0.8	-0.2	-1.7	2.5	0.7
Real GDP	-0.9	-0.5	-1.5	0.8	0.9	0.3	-0.1	0.5	0.8	0.8

Source: LPC estimates based on ONS data: household final consumption expenditure (ABJR), general government final consumption expenditure (NMRY), total gross fixed capital formation (NPQT), business investment (NPEL), investment in dwellings (DFEG), change in inventories (CAFU) minus alignment adjustment (DMUM), total domestic expenditure (YBIM), total exports (IKBK), total imports (IKBL) and GDP (ABMI), chain volume measures, quarterly, seasonally adjusted, UK, Q4 1979-Q3 2013.

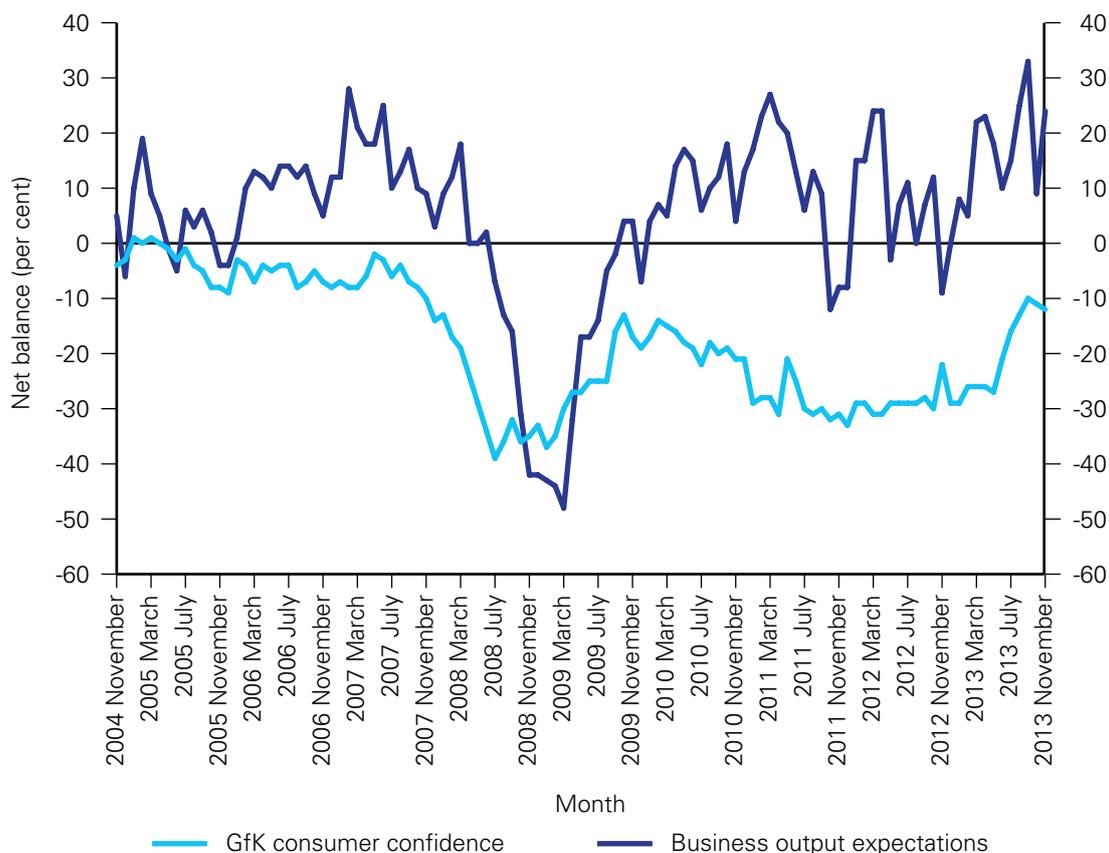
5.11 Household spending on consumption will depend on current and future income. In the immediate aftermath of the recession, real consumer spending remained flat, held back by declining real incomes; household indebtedness; austerity measures; the weak housing market and tight credit conditions. Many of these factors started to ease in 2012 with consumer spending picking up and maintaining momentum in 2013. Indeed, Ernst & Young (2014) estimates that GDP growth in 2013 was entirely dependent on consumer spending and the housing market. Although pay settlements and average wage growth have remained subdued, inflation did fall back to target by the end of 2013. Despite a continued fall in real average incomes, total real household income has increased (up by 0.3 per cent over the year to the third quarter of 2013) as employment growth has been very strong. But the main driver behind consumption spending has been households running down savings. The households' saving ratio has fallen from around 8 per cent in the first half of 2012 to just 5.4 per cent in the third quarter of 2013.

5.12 In addition, as noted by Peston (2014), over the 18 months to December 2013, around £12 billion has been paid out by the financial industry for mis-sold credit insurance (Payment Protection Insurance (PPI)), with a further £4-8 billion still expected to be paid. As the PPI payments are transfers from banks to consumers, they have depleted banks' capital reserves and may have further suppressed lending, but this effect may have been marginal as there

seemed little appetite by banks to lend, at least to smaller firms. It thus seems likely that these compensation payments have enabled spending to be brought forward. And the evidence is that consumers have been spending, mainly on luxury items such as new cars and holidays, rather than reducing debts or building up savings. In addition, consumer spending has also been boosted by the pick-up in the housing market, aided by the Government's Funding for Lending (FLS) and Help to Buy schemes.

- 5.13** These factors behind consumption growth are unlikely to be sustained for much longer. Indeed, the mortgage lending incentive has already been removed from FLS and the boost from PPI payments will ease. It is also unsustainable for consumers to continue to run down savings for a lengthy period of time. Thus future consumption spending growth will depend on rising real incomes and the confidence that consumers have in the recovery. We discuss the prospects for real wage growth by analysing the outlook for inflation, pay settlements and earnings growth in the next section. We note that inflation has fallen back to target; the housing market has improved; and there has been renewed optimism that the recovery can be sustained. This has led to a marked improvement in consumer confidence, as shown in Figure 5.2. Between the end of 2010 and the beginning of 2013, apart from a couple of 'false dawns', consumer confidence had been at similar levels to those experienced in the depths of recession. However, since the beginning of 2013 and particularly after fears of a return to recession had been erased in April, consumer confidence has grown.

Figure 5.2: Consumer and Business Expectations, UK, 2004-13



Source: GfK consumer confidence index, and CBI output expectations, monthly, not seasonally adjusted, UK, 2004-13.

- 5.14** Business investment depends not only on the pick-up in demand but on the expectation that it will be sustained. It will also depend on the cost and accessibility of finance, both internal and external. Table 5.1 suggests that four years in to previous recoveries, investment has been a driver of growth. Investment in dwellings has been similar to that in previous recoveries but business investment has been very sluggish this time. Although business investment increased by 2.7 per cent between the fourth quarter of 2012 and the third quarter of 2013, it is still about 23.7 per cent lower than it was in the first quarter of 2008. Large firms account for about 65 per cent of net capital expenditure and improvements to credit conditions have been greatest for these firms. But large firms have held back on investment despite many of them having healthy balance sheets with substantial financial reserves and relatively easy access to finance as they have been able to raise funds through issuing corporate bonds. Uncertainty about future demand and the need to tackle pension deficits have been suggested to be important factors preventing large firms from investing.
- 5.15** On the other hand, credit conditions for small firms remained restrictive and SMEs account for around a third of total business investment. They rely much more than large firms on bank credit as they have limited access to capital markets and internal financing. There have been some reductions in the cost of credit to SMEs and availability of credit improved in 2013 but net lending by banks to all UK businesses continued to contract. McCafferty (2014) suggested that the unwillingness to invest had been due to the economic uncertainty and constrained access to finance, but that the conditions were now finally in place for a recovery in business investment.
- 5.16** Stockbuilding has been an important contributor to growth since 2010 and again contributed significantly to growth over the last year. After running down stocks in the first quarter of 2013, when demand was stronger than expected, companies have rebuilt their stocks in the second and third quarters. However, surveys have suggested that those stock levels are now close to their long-run averages. Changes in inventories are therefore unlikely to provide much of a boost to growth going forward.
- 5.17** Overall, business expectations for growth picked up strongly in 2013, as shown in Figure 5.2, with investment intentions and profit forecasts improving. Businesses were expecting a consolidation of the recovery, with credit conditions likely to ease further. Improved prospects for growth might be expected to encourage firms to finally increase investment.
- 5.18** As well as investment, it was also hoped that the economy would rebalance with more emphasis placed on exports of goods and services. The trading performance of the UK will be affected by the value of its currency and the economic prospects in its main trading nations. Despite the large depreciation in sterling between 2007 and 2009 of over 25 per cent against the dollar, the euro and a trade-weighted basket of currencies, the contribution of net trade to growth has continued to disappoint. Exports grew by 14.3 per cent between the second quarter of 2009 and the third quarter of 2013, but imports grew by more (15.1 per cent). Although sterling remained around 20 per cent lower than its value pre-recession, it appreciated in 2013. Recession in the euro area, the UK's main trading partner, in both 2012 and 2013 had not helped. And to some degree the export performance reflected both of these factors as, between the third quarter of 2012 and the third quarter of 2013, exports fell

by 1.3 per cent while imports rose by 1.2 per cent. This acted as a drag on growth of around 1.2 percentage points in the third quarter of 2013.

- 5.19** Recently the IMF (2014) has reported that global economic activity and world trade picked up in the second half of 2013 as the easing in financial conditions aided recovery in many advanced countries. Growth in world output was now expected to be around 3.0 per cent in 2013. It forecast global growth and world trade to increase in 2014 and 2015. The OECD (2013b) also noted that the recovery was gaining momentum and that global activity and trade were projected to strengthen in 2014 and 2015 but cautioned that the recovery was likely to remain modest. Both organisations had world output growing by 3.6-3.7 per cent in 2014 and 3.9 per cent in 2015, with world trade growing by 4.2-4.5 per cent in 2014 and 5.2-5.9 per cent in 2015. Growth was also expected to pick up in the UK's two main trading partners – the EU and the US. The euro area appeared to be moving out of recession with both the IMF and OECD forecasting growth, albeit modest, of 1.0 per cent in 2014 and 1.4-1.6 per cent in 2015. The recovery in the US was expected to continue with growth of 2.8-2.9 per cent in 2014 rising above 3.0 per cent in 2015. Growth in the emerging economies was also expected to be maintained, with growth in India and China of 6-8 per cent, although both were expected to start to rebalance their economies away from investment towards consumption. On the other hand, growth was forecast to be flat in Japan in 2014 before increasing to 1.0 per cent in 2015.
- 5.20** However, the IMF reported that there were still notable risks in the system. Inflation is low and falling in many advanced economies, particularly in the euro area. Any further adverse shocks would increase the possibility of deflation. Low inflation (or deflation) raises real debt burdens and this would exacerbate the debt problems in many euro countries. The announcement in December 2013 that the US Federal Reserve would begin tapering (reducing the size of its asset purchases) led to increased financial market and capital flow volatility. There have already been sharp capital flows and exchange rate adjustment in some emerging countries, particularly Turkey and Argentina.
- 5.21** Since the end of the recession, government current spending has been one of the main contributors to growth, holding up while other components such as trade and investment have been weak. Indeed, over the year to the third quarter of 2013, it grew by 1.4 per cent. With economic growth lower than expected between the autumn of 2010 and the end of 2012, public sector finances had not improved as quickly as the Chancellor had hoped. In December 2013 the Institute for Fiscal Studies told us that the annual deficit remained at 8.2 per cent of national income. The plans set out by the Chancellor in his Autumn Statement (HM Treasury, 2013d) would be equivalent to a fiscal consolidation of 10.1 per cent of real national income over eight years. The fiscal consolidation was set to continue, although the overall consolidation planned by 2015/16 was slightly smaller (less tightening in 2013/14 almost offset by more tightening in 2015/16) but with additional tightening in 2016/17 and 2017/18. Most of the tax increases had already been implemented or announced but the UK was only half of the way through its fiscal consolidation with most of the spending cuts to come. Among other things, this is likely to add further to concerns about adequate funding for social care and childcare. Local authorities are also likely to find it increasingly difficult to maintain the pay of their lowest-paid workers above the NMW.

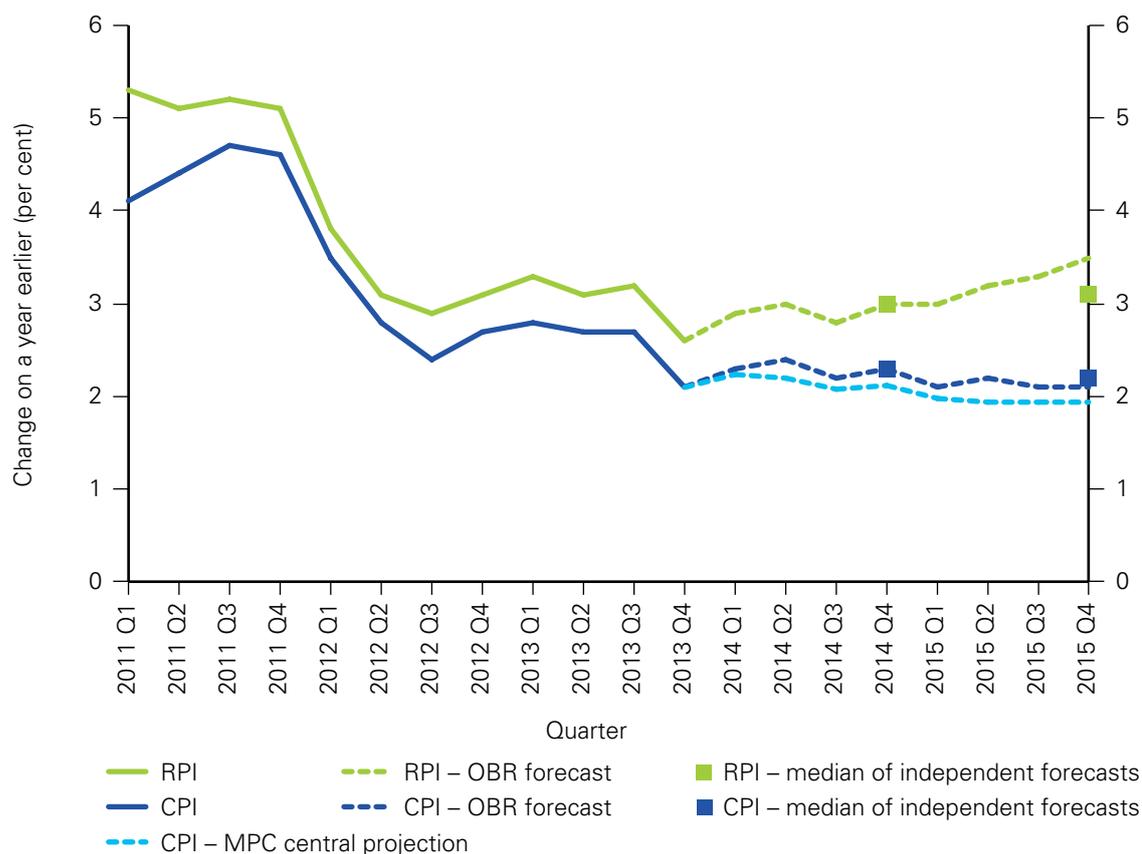
- 5.22** The OBR (2013b) estimated that these fiscal consolidation measures would have a substantial impact on GDP. It noted that fiscal measures (including the reduction in VAT) boosted the level of GDP by about 0.6 per cent in 2009/10 but that thereafter fiscal measures reduced GDP. By 2015/16, it estimated that the current Government's measures will have reduced the level of GDP by nearly 8 per cent, with the reduction being 5.2 per cent between 2010/11 and 2013/14. It also found that the effects in 2013/14 were less (1.4 per cent) than in 2012/13 (1.6 per cent) leading to a positive impact on growth in 2013/14 and causing Robert Chote, the head of OBR, to note that 'deficit reduction appears to have stalled'. The OBR does not extend this analysis to take account of the additional fiscal measures up to 2017/18. Bagaria, Holland and Van Reenen (2012), Portes (2013) and Wren-Lewis (2013) believe that these estimates might be underestimates of the impact but their own forecasts are of a similar magnitude.
- 5.23** Overall, the recovery has been much slower than forecast but growth had picked up in 2013 and this is likely to be sustained into 2014 and 2015. There has as yet been little contribution to the recovery from investment but conditions were now in place that should encourage businesses to invest in new plant and machinery. World trade growth should boost exports but the recent appreciation of sterling may dampen that. As discussed above, government spending was not expected to provide a boost, leaving the consumer as the main determinant of the future growth path. As we discussed earlier consumer spending was likely to depend on real incomes. We now go on to look at the prospects for inflation and wage growth.

Prospects for Inflation, Pay Settlements and Earnings

- 5.24** In the latest data available to us, for the twelve months to December 2013, the CPI inflation rate was 2.0 per cent, its lowest for four years, and the RPI rate was 2.7 per cent. Inflation fell sharply in October 2013, having been at a steady rate since October 2012 (with CPI around 2.7 per cent and RPI around 3.2 per cent), when it was pushed up by the introduction of undergraduate tuition fees. In the October 2013 figures, however, the initial increase in tuition fees to £9,000 dropped out of the 12-month calculation. The extension of the £9,000 fee level to another year of students in October 2013 resulted in a lower average increase than in 2012, so the inflationary impact was much less.
- 5.25** The CPI and RPI measures of inflation have followed a similar pattern through the last 12 months, with roughly 0.7 percentage points difference between the two. The formula effect reduces the CPI inflation rate by around a percentage point compared with the RPI rate, while other differences in weights and coverage, notably the exclusion of housing costs from the CPI, partially offset this effect.
- 5.26** The Bank of England (2013) revised its inflation forecast down in its most recent report, reflecting unexpectedly low out-turns and the recent appreciation of sterling. The Bank reported that CPI inflation was set to remain around the 2 per cent target over the next year or so as the impetus from past increases in import prices faded and a gradual revival in productivity growth, together with a persistent margin of spare capacity, curbed domestic price pressures. As shown in Figure 5.3, its central forecast was for CPI inflation of 2.1 per cent in the fourth quarter of 2014.

- 5.27** The OBR expects a slightly higher CPI inflation rate of 2.2-2.4 per cent through 2014, held above target by utility price increases. It forecasts RPI inflation at around 3 per cent through 2014, pushed further above the CPI rate by house price rises.
- 5.28** The median of independent forecasts gives a very similar picture to the OBR, with the CPI rate of inflation expected to be 2.3 per cent in the fourth quarter of 2014, and the RPI rate 3.0 per cent. A small minority of these forecasters expect a rise in the base rate this year, which would have a direct upward effect on the RPI inflation rate.

Figure 5.3: Annual Change in RPI and CPI, and Forecasts, UK, 2011-15



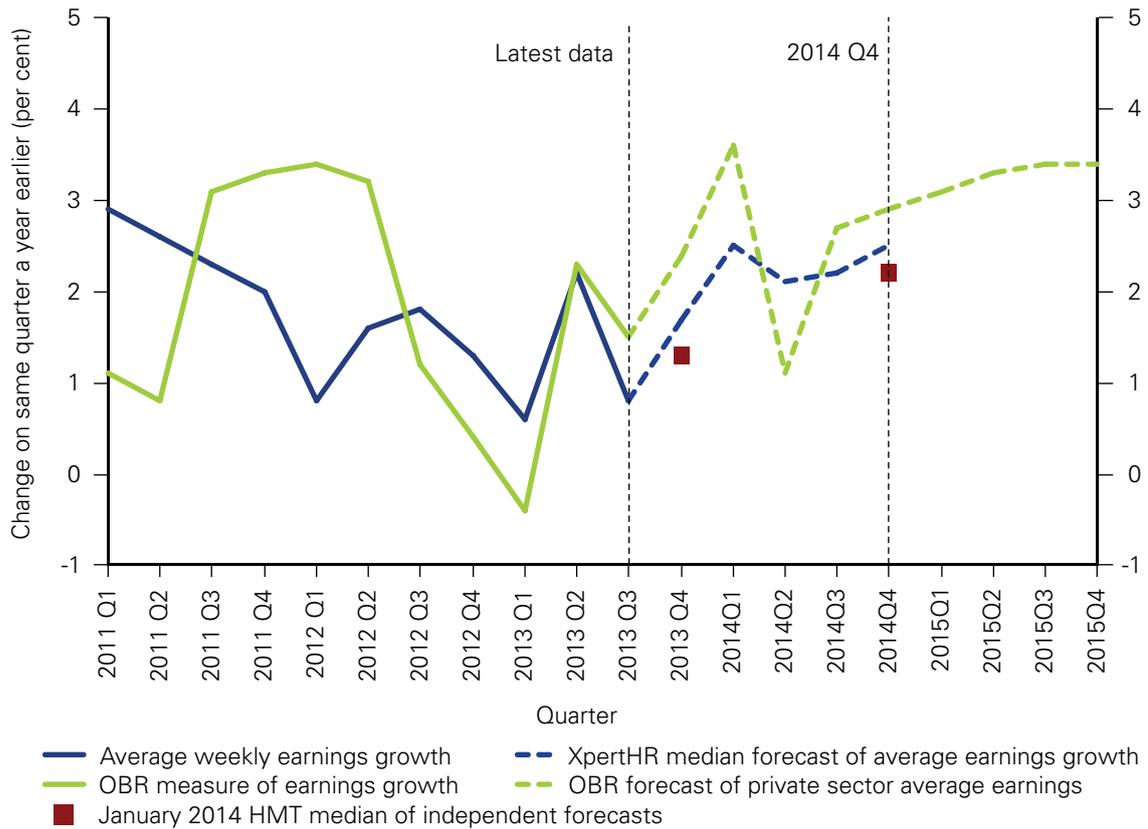
Source: ONS: CPI (D7G7), RPI (CZBH) quarterly, not seasonally adjusted, UK, Q1 2011-Q4 2013; Bank of England Inflation Report, November 2013, Office for Budgetary Responsibility December 2013; HMT Panel of Independent Forecasts, November 2013 and January 2014.

- 5.29** There is a clear consensus that CPI inflation will remain close to, but just above, 2 per cent over 2014. We note that the 2013 inflation forecasts were the most accurate for some time, whereas previous years had seen persistent under-forecasting of inflation due to unforeseen shocks. But we also note the inevitable uncertainty around these forecasts. The RPI inflation rate is sensitive to the growth in house prices and potential increase in mortgage interest rates over the medium term.
- 5.30** In previous reports we have noted the weakening of the relationship between the RPI inflation rate and the level of basic pay increases during and since the recession. Pay settlement medians have been persistently below the RPI rate of inflation for four years, leading to a substantial cumulative fall in real rates of basic pay.

- 5.31** In the current labour market, inflation is only a secondary influence on pay-setting. In a recent survey of employers' reward strategies, IDS (2013) found that 100 per cent of respondents considered affordability an important (or very important) factor determining the level of pay awards, higher than future business outlook (87 per cent), recruitment and retention (66 per cent) or productivity (63 per cent). Inflation, or the cost of living, was considered an important factor by under half (45 per cent) of respondents. XpertHR (2013), however, found inflation to still be a significant factor influencing pay awards. While 93 per cent of respondents indicated that organisational performance/ability to pay was a factor influencing pay awards, as many as 72 per cent cited inflation, or the cost of living, ahead of recruitment and retention (67 per cent) as a factor influencing pay-setting. Bryson and Lucchino (2014) also found that the NMW was an important influence on pay-setting for many low-paid workers, and for some others too.
- 5.32** We looked at pay settlement measures published by IDS, XpertHR, the Labour Research Department and EEF, the manufacturers' organisation. The latest available published data related to the three months to December 2013, and showed the whole economy median pay settlement at 2.0-2.5 per cent, depending on the pay researcher. There was a slight fall in median pay settlements reported by most pay researchers during 2013, from around 2.5 per cent at the start of the year to 2.0 per cent at the end of the year. IDS recorded that pay freezes made up 8 per cent of private sector pay reviews in 2013, down slightly from 10 per cent in 2012. Similarly, EEF indicated that 10.5 per cent of pay reviews in manufacturing were freezes in 2013, down slightly from 12.3 per cent in 2012.
- 5.33** Manufacturing pay settlements (2.5 per cent median) were higher than private sector services (2.0 per cent median), while there was a 1.0 per cent median pay settlement in the public sector. Median pay settlements in the low-paying sectors were in line with private sector services, at 2.0 per cent according to IDS.
- 5.34** Early indications of 2014 pay reviews have been given by XpertHR and IDS. January pay reviews disproportionately cover the manufacturing sectors and, in recent years, have been higher than those for other sectors. Reviews early in the year are often long-term deals linked to inflation so have also been higher than the median pay review in recent years. XpertHR (2014) reports a median of 2.5 per cent, based on 63 deals in January 2014. IDS (2014b) also reports a provisional median of 2.5 per cent (based on 34 pay reviews in January 2014).
- 5.35** Some surveys of employers' intentions can give an indication of the level of pay reviews in 2014. XpertHR (2013), published in October, indicated that private-sector employers expected to award a median pay rise of 2.5 per cent in 2014. This was the same for both manufacturing and private-sector services. Pay freezes were expected to affect just 6.4 per cent of pay settlements.
- 5.36** CIPD (2013) reported in November that the expected mean basic pay settlement, among those employers that were planning a pay review in the twelve months to September 2014, was 1.6 per cent. This was 1.9 per cent in the private sector (down from 2.6 per cent a year ago), 1.0 per cent in the voluntary sector, and 1.0 per cent in the public sector. Excluding those employers planning a pay freeze or a pay cut, the average expected private sector pay rise was 2.8 per cent.

- 5.37** This evidence suggests continuity in pay-setting, with settlements centring again on 2.5 per cent in 2014. We are conscious, however, that aggregate pay settlement data do not necessarily reflect the experiences in many small firms that are not covered by these surveys.
- 5.38** Pay settlements can provide a timely measure of changes in basic pay, and can pick up short-term changes in pay pressures in specific sectors. The broader official measure of earnings growth, Average Weekly Earnings (AWE), includes progression, variable pay, working time and changes in the labour market, such as workforce restructuring. Over the long term, improvements in productivity and wage drift have meant that average earnings growth has generally been ahead of basic pay settlements. Throughout 2012 and 2013, however, average earnings growth has been below 2 per cent and below median pay settlements, meaning that other factors, such as a restructuring towards lower paid jobs or changes in the make-up of the reward package have been keeping earnings growth down.
- 5.39** Annual average earnings growth as measured by AWE across the whole economy was 0.9 per cent in the three months to November 2013. Average earnings growth was 1.2 per cent in the private sector and 0.5 per cent in the public sector (excluding financial services). If bonus payments are excluded, the growth figures are little different: 1.1 per cent in the private sector and 0.6 per cent in the public sector (excluding financial services). The data on bonus pay for the first half of 2013, and consequently on average earnings growth overall, were particularly misleading: the payment of bonuses was delayed in the early months of 2013 until April, to attract the lower income tax rate (45 rather than 50 per cent). This meant that total private sector average earnings growth fell to 0.6 per cent in the three months to March 2013, but bounced back to 2.8 per cent in the three months to June 2013, as the full effect of the delayed bonus payments was revealed, before falling back towards the end of the year to 0.9 per cent. Private sector average earnings growth excluding bonuses has been stable at around 1 per cent all year.
- 5.40** Average regular pay fell in the (relatively high-paid) finance and business services sector through 2013, while earnings growth was strongest in the relatively low-paying wholesale, retail, hotels and restaurants sector, at around 2.7 per cent.
- 5.41** The median independent forecast for average earnings growth of 2.2 per cent for the whole of 2014 suggests average earnings growth may pick up this year. The OBR forecasts average earnings using a National Accounts measure of total compensation per employee, rather than Average Weekly Earnings. The OBR expects the weakness of real wage growth (i.e. wage growth adjusted for inflation) to persist into 2014 before picking up gradually to match productivity growth. It does not expect real take-home pay to reach its pre-crisis peak until late 2015, mainly reflecting the slow recovery in productivity growth. The OBR expects whole economy wages to grow by around 2.9 per cent in the year to the fourth quarter of 2014.

Figure 5.4: Average Earnings Growth and Forecasts, GB, 2011-15



Source: ONS, AWE total pay (KAC3), quarterly, seasonally adjusted, GB, 2011-13; OBR (December 2013); XpertHR (November 2013); and HM Treasury Panel of Independent Forecasts (January 2014).

Note: The median of HM Treasury Panel of Independent Forecasts is for the whole year, but these have been plotted in Q4.

Prospects for Employment

5.42 As we noted in Chapter 1, one of the most notable things about this recovery has been the resilience and the strength of the labour market in terms of jobs and employment. Although output fell by over 7 per cent in the recession and the level of GDP in the third quarter of 2013 was still 2.0 per cent below what it was in the first quarter of 2008, total employment and total hours worked are now greater than then. This is in stark contrast to the two previous recessions (in the 1980s and 1990s) when employment and hours took much longer than output to recover. Usually in a recovery growth in employment, and falls in unemployment, will be accompanied by real wage growth but this time has been different. The labour market resilience has been accompanied by low productivity growth and falling real wages.

5.43 As a consequence of the recession total employment fell to a low point of 28.8 million in March 2010, 2.6 per cent below its pre-recession peak of 29.6 million in May 2008. It then started rising gradually before falling back in the second half of 2011. Since 2011 employment has increased, rising above its pre-recession peak in August 2012 and continuing upwards into 2013, reaching 30.2 million in November 2013, around 580,000 higher than the pre-recession peak.

- 5.44** The picture is similar, although not quite as strong, when looking at jobs. The number of workforce jobs rose to 32.16 million in June 2008 before falling by 2.7 per cent to 31.30 million in December 2009 as the recession took hold. The number of jobs then picked up through 2010 and 2011 before falling back throughout 2012. However they have increased strongly in 2013, reaching a record of 32.35 million in September 2013.
- 5.45** The record employment and job levels reflect a growing labour force, enlarged by later retirement, immigration, and benefit cuts. The working age employment rate (72.1 per cent in November 2013) has also risen over the last two years but remains below its pre-recession level (73.0 per cent). Over the last two years (September 2011-September 2013), employment of those aged 65 and over has increased by about 180,000, with an extra 375,000 people aged 50-64 becoming employed. In addition, around an extra 320,000 people born outside the UK have become employed. Between May 2011 and May 2013 (the latest data available), a further 262,500 people stopped claiming various out of work benefits. In total, that is an additional 877,000 people (2.9 per cent) being absorbed by the labour market. But the situation is even more remarkable when considering that over the same period, September 2011-September 2013, the public sector has shed about 196,000 jobs. Therefore, nearly 1.1 million people have joined the labour market and have been absorbed by it, as unemployment, measured on both the ILO unemployment basis or the claimant count, and working age inactivity have fallen.
- 5.46** In the two years to November 2013, the number of people looking for work and available to start within two weeks has fallen by around 350,000 to 2.30 million, a working age unemployment rate of 7.3 per cent. The unemployment rate for all workers, used by the Monetary Policy Committee in its forward guidance, fell to 7.1 per cent. The more timely claimant count has also seen a fall of 350,000 in the two years to December 2013, when it stood at 1.25 million. The falls in both measures in recent months have been marked. Over a similar period (November 2011-November 2013), working age inactivity has also fallen by 350,000 to 8.93 million.
- 5.47** These extra workers appear to have priced themselves into jobs. Ernst & Young (2014) believes that similar forces will continue to bear on labour supply and estimate that between 2013 and 2015 a further 1.3 million workers will be seeking work. That estimate consists of 300,000 migrants, 150,000 people above the State Pension Age, 250,000 people approaching that pension age (aged 50-64) and a further 300,000 as a result of benefit cuts. It also estimates that there will be 300,000 public sector redundancies. Ernst & Young (2014) projects strong employment growth and believes that real wages and productivity will recover slowly as the demand for labour picks up and earnings growth overtakes inflation.
- 5.48** The OBR and the median of independent forecasters expect a further strong increase in employment in 2014, with growth of 1.1-1.4 per cent, and unemployment is also expected to fall. OBR (2013c) noted that it had tended to under-forecast employment over the past few years (and over-forecast earnings growth). Its latest forecast therefore indicates stronger employment growth, above that implied by the upward revision to the near-term GDP forecast. The OBR expects unemployment to continue to fall relatively quickly in the short term, to around 7.2 per cent in the first quarter of 2014, as spare capacity in the economy is

taken up. Thereafter, it expects the decline in unemployment to slow as the current momentum in GDP growth eases and productivity growth picks up.

- 5.49** These forecasts are supported by employer surveys. The Chartered Institute of Personnel and Development (CIPD, 2013) reported a significant improvement in employment intentions in its latest Labour Market Outlook in November 2013. The net balance of employment intentions, which measures the difference between the proportion of employers who expect to increase staff levels compared with those who expect to decrease staff levels in the next quarter, was +24 in autumn 2013, up from +14 in summer 2013. This is the highest level since the report was introduced in 2005. The positive net employment intentions are driven by the private sector. The net balance for the private sector was +38 for autumn 2013, up from +26 in summer 2013. The net balance for the public sector was -19 in autumn 2013, itself the highest level for a year.
- 5.50** The Recruitment and Employment Confederation/KPMG (2013) reported that employers were more optimistic going into 2014 and were planning to recruit both permanent and temporary workers. A fifth of surveyed employers reported that they had increased headcount in 2013 (up from just 4 per cent in 2009) while only 12 per cent had made redundancies (down from 22 per cent in 2009). Only 8 per cent of employers planned to reduce headcount in the first quarter of 2014 with a quarter maintaining current employment levels. Nearly two-thirds were looking to recruit permanent workers and just under a half were intending to increase their use of agency workers. Looking further ahead to the rest of 2014, nearly 60 per cent predicted they would end 2014 with a larger permanent workforce and just 5 per cent forecast a slight decrease. The survey also highlighted concerns that about a third of employers had no spare capacity to take on more work without creating new jobs. Around a half only had a little spare capacity. This suggested that if the economy continued to pick up then this could lead to greater employment. However, some employers cautioned that shortages of suitable candidates in some skill areas could hamper growth. These included driving and distribution jobs.
- 5.51** Having prospered in 2012, despite the weakness in output growth, the labour market continued to perform well in 2013, helped this time by a pick-up in demand. This optimism has fed through into the forecasts for employment and unemployment in 2014 and 2015. However, wage growth and pay settlements continue to be subdued and remain well below the increases recorded before the recession. And real wage growth has continued to fall.

Summary of Forecasts for 2014 and 2015

- 5.52** In summary, the prospects for the UK economy in the short to medium term are much better than those that we faced in January 2013. Then forecasts for growth in the coming year or so were being revised down. This time they are being revised up. That optimism has carried through to the labour market. The latest forecasts are shown in Table 5.2. Inflation expectations are subdued and CPI is expected to be around target. Most forecasters are expecting productivity to at last pick up and are forecasting an increase in wages to follow.

Table 5.2: Actual Out-turn and Independent Forecasts, UK, 2013-15

Per cent	Actual data 2013	Median of independent forecasts (November 2013 and January 2014)		OBR forecasts (December 2013)	
	(Actual to Q4/whole year or latest)	2014	2015	2014	2015
GDP growth (whole year)	1.9^a	2.6	2.4	2.4	2.2
Average earnings AWE (whole year)	1.2^b	2.2	-	2.6	3.4
Inflation RPI (Q4)	2.6	3.0	3.1	3.0	3.5
Inflation CPI (Q4)	2.1	2.3	2.2	2.3	2.1
Employment growth (whole year)	0.8	1.4	-	1.1^c	0.3 ^c
ILO unemployment rate (Q4)	7.6	6.9	6.8	7.1	6.8
Claimant count (millions) (Q4)	1.27	1.13	1.26	1.26	1.21

Source: HM Treasury Panel of Independent Forecasts (2013c and 2014b), OBR Forecasts (2013b) and LPC estimates based on ONS data: GDP growth (ABMI), total employment as measured by workforce jobs (DYDC) and claimant unemployment (BCJD), quarterly, and AWE total pay (KAB9), monthly, seasonally adjusted; RPI (CZBH) and CPI (D7G7), quarterly, not seasonally adjusted, UK (GB for AWE), 2012-15.

Notes:

- a. Estimate of economic growth based on latest ONS data and LPC estimates of likely Q4 out-turn.
- b. Estimate of average earnings growth based on January-November 2013 compared with the same period a year earlier.
- c. OBR forecasts employment levels rather than growth. Growth forecasts shown here reflect the percentage differences between these forecast levels.
- d. '-' denotes not available.

Stakeholder Views

5.53 A number of stakeholders have provided us with views on the rates of the minimum wage which should apply from October 2014. We have received these views through our written consultation, oral evidence sessions and during one of our visits around the UK. A list of those who have provided evidence to us is shown in Appendix 1, but it should be noted that not all of those who provided evidence gave views on what the rates should be from October 2014.

The Adult Rate

5.54 As in previous years, opinions on the adult rate which should apply from October 2014 fell roughly into two camps. Those representing businesses pointed out that it was early days in terms of the UK's economic recovery and that the path and sustainability of the recovery were far from assured. Now, they argued, was not the time to be significantly increasing costs to businesses. On the other hand, those representing workers pointed to the much publicised squeeze on living standards and how recent below-inflation increases to the minimum wage had led to declining incomes for those at the bottom of the earnings distribution. They argued that with the economy on an upward trajectory, and many large companies having strong financial reserves, now was the time to give a real increase to the wages of the low paid.

5.55 Around 25, just under half of the responses to our consultation, were from employers or employers' organisations which expressed a view on what the adult rate should be from October 2014. Some gave specific figures, others a more general guide on the magnitude and pace of any change in the adult rate. Many counselled us to maintain a cautious approach. The CBI was among this group and it suggested we must set a minimum wage that supports investment necessary for a robust recovery. The British Hospitality Association (BHA), British Beer & Pub Association (BBPA), Business In Sport and Leisure (BISL) and the Association of Licensed Multiple Retailers (ALMR) argued that as the recovery was still uncertain caution was still required. The Forum of Private Business (FPB) said that until it was sure of recovery it could not condone above-inflation increases. In the adult care sector, the United Kingdom Home Care Association told us it would be premature to allow the NMW to rise more than current conditions allow without consequent higher care fees paid by local authorities to independent sector providers.

5.56 Around half a dozen called for a freeze in the NMW. These were largely from the retail and distribution sectors, including the British Independent Retailers Association and the Federation of Wholesale Distributors. The Association of Convenience Stores had urged caution and said the steer from its small business members was for a freeze. The Institute for Family Business argued for a freeze or only a token rise, ensuring any increase was less than average earnings.

"77 per cent of members do not want to see any increase in the NMW and 84 per cent do not want to see any increase in the Apprentice Rate. We call for all rates to be frozen next year."

National Hairdressers' Federation oral evidence

5.57 The remainder, around ten, suggested a specific rate of increase or referenced a particular metric to determine one. Where a specific figure was put forward this was typically in the 1-2 per cent range: National Day Nurseries Association (NDNA) favoured 1-2 per cent; British Retail Consortium's position was that it should not exceed long-term average earnings growth (1.5 per cent by its definition at the time of submission); UK Fashion and Textiles Association wanted to limit a rise to the increase in average earnings (1 per cent at its time of writing) and the British Chambers of Commerce (BCC) proposed a rise of 2.1 per cent. Others referred to limiting any increase to measures of inflation: Rural Shops Alliance suggested a rise in line with or marginally below inflation; Federation of Small Businesses (FSB) wanted an increase no higher than CPI. Some proposed a formula approach: the EEF favoured linking NMW increases to the average of basic pay settlements over the previous twelve months; and the Food and Drink Federation (FDF) wanted to link to the change in basic rates of pay across the economy.

5.58 Organisations representing workers highlighted the very difficult plight of low-paid workers, who were faced with falling real incomes and rising costs. They commented on the NMW's loss of value and the impact of this on the living standards of the poorest. They pointed to the healthy economic outlook and predictions for the UK's economy going forward and suggested that this meant a reasonable increase was affordable. Inflation was also forecast to fall and earnings growth expected to pick up so there was no need for the wages of the

low paid to continue to fall. They again pointed out that employment in the low-paying sectors remained buoyant and a number saw a living wage as the ultimate goal.

5.59 The Trades Union Congress (TUC), supported by the Broadcasting, Entertainment, Cinematograph & Theatre Union (BECTU) said the recovering economy would be able to support a considerably more substantial increase by October 2014 and that this would provide some help needed by low-paid workers, who had seen the real value of their wages fall in recent years. They wanted to see, as a minimum, the adult rate increase by more than inflation and average earnings, whichever was the higher. BECTU also said that a significant increase was required to reduce the number of low-paid workers who were receiving in-work benefits.

“Union policy is for the NMW to be a living wage... We recognise there may need to be steps on the way to getting there and a £1 an hour increase would be a bold step.”

Unite oral evidence

5.60 The Union of Shop, Distributive and Allied Workers (Usdaw) drew our attention to the fact that there continued to be strong performance in the retail sector and settlements it had agreed in 2013 with organisations in the sector were above 2 per cent. Given this and the improved economic outlook, it believed that the adult rate could be increased by more than RPI. The Public and Commercial Services union wanted to see a single adult rate of £8.25 an hour.

5.61 A number of unions saw harmonisation with the living wage as the ultimate goal, with differing views on how long it should take to get there. UNISON highlighted the current crisis of low wages and living standards and pointed out the benefit to local economies of increases to the minimum wage through increased spending. It wanted to see the minimum wage increased substantially in 2014 and, after that, it should move in stages towards a living wage for all workers. The National Union of Students wanted the adult rate set at the level of the living wage and the Communication Workers’ Union wanted to see staged NMW increases to bring it in line with the living wage. The GMB said the adult rate should increase in line with average earnings or RPI, with a view to moving towards £8 an hour, making the NMW a living wage.

“Raising the NMW to £7.00 an hour would be fair. Friends and colleagues often have multiple jobs as their earnings are low... people on the NMW often work excessive hours to make ends meet.”

UNISON members, Commission visit to Wolverhampton

The Youth Rates

5.62 Views on the youth rates were again roughly divided into two groups. Some were in favour of a freeze or cautious increase as this was necessary to maintain and increase the attractiveness of young people to employers. Others argued that the minimum wage had little or no impact on the labour market position of young people, so there was no need for them to be treated differently from adults.

- 5.63** Where employers expressed caution, or proposed a freeze, with respect to the adult rate, they tended to at least maintain this approach for the Youth Rates. The BHA, BBPA, BISL and ALMR, for example, thought their suggested cautious approach to the adult rate would perhaps be easier for us to justify for the Youth Development Rate and 16-17 Year Old Rate. The National Farmers' Union, which had urged caution in setting the NMW thought any increase over 2 per cent may limit job growth and affect job prospects for young people. The CBI believed we should give primacy to ensuring that young people had the ability to enter the labour market and that constraining the Youth Rates was sensible.
- 5.64** BCC suggested specific increases for the Youth Rates. It proposed a lower increase than for the adult rate, with a 1.2 per cent increase in the Youth Development Rate and a 1.3 per cent increase in the 16-17 Year Old Rate. BCC also proposed a new age category for the NMW, with a graduated rate for the 21-24 age group. In contrast, the increases proposed by the NDNA and the FSB were the same as they had put forward for the adult rate.
- 5.65** Unite said youth rates should increase by more than the adult rate in real terms to help close the gap between them and the adult rate. A number of worker representative bodies wanted to see youth rates abolished, if necessary over time, with larger increases now in preparation for harmonisation. The TUC, supported by BECTU, wanted to see the adult rate eventually paid at age 18, and called for the Youth Development Rate to increase by at least the same percentage as the adult rate. It argued there wasn't any persuasive evidence that young people should not continue to see their minimum wage rates increase in real terms. Usdaw wanted to see the 16-17 Year Old Rate and Youth Development Rate increase by the same percentage as the adult rate and ultimately it too wanted to see the adult rate paid at 18.
- 5.66** UNISON, like others, pointed out that paying young people lower rates did not accurately reflect the value of the work they undertook and resulted in real hardship. It said that the NMW had not caused or exacerbated the weakness of the youth labour market. It therefore wanted to see the Youth Development Rate brought in line with the adult rate from 2014; and 16-17 year olds entitled to the existing Youth Development Rate, with a view to harmonising it with the adult rate over time.

The Apprentice Rate

- 5.67** Views on the appropriate level for the Apprentice Rate were less clearly divided than those on the adult and youth rates. A number of employer organisations said their members did not use the Apprentice Rate as they paid above this. Some of these questioned the necessity for the rate while others supported its retention, and at a modest level, as a means to encourage employers to take apprentices on. Organisations representing workers wanted to see the rate increased to at least the level of the youth rates, or possibly the adult rate
- 5.68** Most employer submissions to us either did not specifically refer to the level of the Apprentice Rate or either applied, directly or by inference, their views on the other rates to this wage. The Apprenticeship Ambassadors Network, one of the employer groups which did express a specific view on the Apprentice Rate, thought for October 2014 the rate should be adjusted for the cost of living, and supported migrating it to the level of the youth rates over a three-year period. Some employer organisations saw a need to treat the Apprentice Rate

differently from the other rates. BCC proposed a 1.5 per cent increase, higher than for the youth rates. EEF suggested increasing it in line with the adult rate (noting that it had little impact in the manufacturing sector) as opposed to urging caution in reviewing the youth rates. The FSB thought there was a case for enhancing the Apprentice Rate, to help boost the apprenticeship brand, potentially to the level of the 16-17 Year Old Rate (based on existing government funding support being maintained). The FDF told us very few members used the Apprentice Rate and questioned if it was necessary.

- 5.69** Those concerned at the impact of the Apprentice Rate included the National Hairdressers' Federation (NHF). It told us that an even higher proportion of its members opposed any increase in the Apprentice Rate than in the other minimum wage rates. NHF advised that employers had concerns about the cost of training apprentices, that apprentices do not generate income for the salon, and that the owner often has to take time out of the business to carry out training.
- 5.70** The TUC, supported by BECTU, wanted to see the Apprentice Rate increased to the level of the current youth rates as soon as possible. It said that it was currently far lower than was necessary and as the recovery continued, it would become even more unattractive for young people to take up an apprenticeship. Unite said it should increase by more than the adult rate to help close the gap between it and the adult rate. Usdaw said that apprenticeships needed to be made a truly viable alternative to education or full-time employment. Also, it said that apprenticeships paid at the Apprentice Rate were most likely to be in one of two sectors and that these sectors should not be a drag on the attractiveness of apprenticeships. Consequently, it would like to see an increase significantly above the general increase.

Implications of Other Government Legislation

Pension Reforms

- 5.71** In our previous two reports we have commented on the introduction of pensions auto-enrolment, and what this could mean to both workers and employers in terms of costs. We were commenting on predicted impact, drawing on a number of surveys and information from stakeholders, along with research we commissioned for the 2012 Report. The reforms were introduced from October 2012, and have now been in place for over twelve months. This report is the first opportunity to look at what has happened in practice.
- 5.72** Under the reforms, all eligible workers have to be enrolled into a qualifying pension scheme. Eligible workers are those aged 22 years and above, below State Pension Age, and earning more than £9,440 per year as of 1 October 2013. Contributions would be based upon earnings between £5,668 and £41,450 (the lower and upper earnings limits for National Insurance (NI) contributions). The arrangements are being implemented in stages, depending on the size of firm. For the period October 2013 to September 2014, those firms employing more than 60 employees will join the scheme. Contribution rates are also being phased in. Between October 2012 and September 2017, both the worker and employer will contribute a minimum of 1 per cent each. By October 2018 the total minimum contribution will be 8 per

cent: made up of 4 per cent from the worker, 3 per cent from the employer and 1 per cent tax relief. A worker can choose to opt out of the arrangements.

- 5.73** There have been a number of surveys published, along with some official research, on the impact of the reforms. To date, in excess of 2 million workers in over 3,500 firms have joined the scheme. The level of opt-outs has been much lower than was originally predicted. Initial estimates suggested that 20-30 per cent of workers would choose to opt out, although in practice on average only around 10 per cent have done so. It would appear that inertia has played a large part in this lower opt-out rate, although the initial low level for contributions may also have been a factor in workers' decisions to stay in the scheme. A full-time worker paid at the NMW will currently be paying around £73 per year in contributions (about £1.40 per week). When the reforms are fully implemented (October 2018), a full-time worker paid at the NMW would be paying around £220 per year (£4.23 per week) based on today's earnings and thresholds.
- 5.74** There has been very little published information about the costs of the reforms. We have heard from stakeholders in the retail sector that start-up costs varied between £54,000 and £1.7m, which included advice, change to payroll systems, etc. But we have not obtained any information on the impact on the paybill. In our previous reports we estimated that in the initial phase, for large firms the cost would, on average, be no more than 0.2 per cent of the total wage bill and for medium-sized firms the cost would be no more than 0.4 per cent. Although the reforms started in October 2012, many firms have taken advantage of the three-month deferral period available before they have to start auto-enrolling. At the time of writing this report, there will have been a limited number of firms who will have actually been in the scheme for over twelve months. By the time of our next report we may have additional information to better estimate the impact on those who have auto-enrolled.
- 5.75** Stakeholders have again raised concerns this year about the additional costs on businesses as a result of these reforms. A number of business representatives highlighted the reforms that were taking place, pointing out the published percentage costs to businesses as the contribution levels increased. The BHA, BBPA, BISL and ALMR said in its joint submission that as the threshold was increasing to £10,000, the impact of the reforms on hospitality employment was becoming less significant as half of all hospitality workers were part-time and the average wage cost per employee in 2011 was £10,680. The Forum of Private Business said it supported the roll out of auto-enrolment but this was a sizeable cost increase, and the Government should show more understanding in mitigating other costs. It said a typical micro business employing nine staff on the NMW could expect to pay an additional £3,476 towards pensions when the scheme has fully rolled out. The National Day Nurseries Association said the reforms were of concern because existing take-up of pensions with employer contributions was relatively limited in the sector, so it would be a new cost for many businesses.
- 5.76** In December 2013, the Government announced that it would be changing the thresholds for those qualifying for auto-enrolment. From April 2014, a worker would be automatically enrolled if they earned more than £10,000 and contributions would be based on earnings between £5,772 and £41,865. Our estimates show that a worker paid at the National Minimum Wage (£6.31 an hour) as of April 2014 would have to work in excess of 30.4 hours

a week to be automatically enrolled. This has increased from 25.2 hours a week, when using the threshold in place at October 2012.

- 5.77** Using data from the Annual Survey of Hours and Earnings, around 39 per cent of those aged between 22 and 65, and paid at the NMW, worked in excess of 30 hours per week in April 2013. These figures do not take into account workers already in a pension scheme, but give an initial indication of the proportion of minimum wage workers that will fall within the scope of auto-enrolment when it is fully rolled out, in the absence of significant changes in thresholds or hours worked by minimum wage workers.
- 5.78** For the period of our recommendations on rates for the National Minimum Wage (i.e. October 2014 to September 2015), small firms – those employing fewer than 50 workers – will start joining the scheme. A number of surveys have highlighted concerns over what could happen when small firms start to auto-enrol. Many large employers already had pension schemes that met the auto-enrolment criteria as well as access to specialist pension advice in-house. There are concerns that small firms do not have the expertise, or resource, to deal with the changes and having to employ consultants to advise will impose additional costs on them. Also, many small firms may not pro-actively communicate the changes to their workers at an early stage. This is something that has been highlighted as very important by the research undertaken on large firms which have joined. Pension providers and firms which provide administration processes have said that it takes many months to get new customers up and running and that small firms needed to be thinking about this now. Workplace Law (2013) reported that 32 per cent of SMEs planned to ignore auto-enrolment and 66 per cent had little or no knowledge about what the legislation involved. Centre for Economics and Business Research (2013) estimated that getting ready for auto-enrolment would cost small businesses £8,900 each.
- 5.79** As stated above, in previous reports we have estimated the cost to large and medium-sized employers in the first year of auto-enrolment. Our estimate for small firms (who join from June 2015) is that the cost will be around 0.5 per cent of their total wage bill, on average. This has been estimated on the basis of the original predictions for opt-outs (20-30 per cent) because the published information suggests opt-out rates will be higher for small firms than for large or medium-sized ones.
- 5.80** We have again carefully considered the likely impact of the new arrangements in reaching our recommendations on the minimum wage this year. It is clear from what we have seen that auto-enrolment has had an impact on firms in terms of the start-up costs. Although there is very limited information about the impact on the wage bill, it is likely to have been slightly higher than originally envisaged given the lower opt-out rate. But as we have previously stated, the majority of workers on the minimum wage will earn too little to fall within scope and the low initial contribution rates until 2017 will also affect the impact. We will continue to monitor the reforms next year and beyond as more data become available.

Changes to Personal Tax and Benefits System

- 5.81** The 2014/15 tax year will again see changes to the tax and benefits regime that will affect minimum wage workers. The personal tax allowance for those aged under 65 is again to

increase by more than inflation. From April 2014, it will rise to £10,000, an increase of £560 on the previous allowance. The main tax rate remains at 20 per cent. In the Autumn Statement (HM Treasury, 2013d), the Government announced that the primary threshold for National Insurance contributions would increase from £149 to £153 in 2014/15. The main Class 1 rate remains at 12 per cent for employees and 13.8 per cent for employers. However, the Government also announced that from April 2015 it will abolish employer National Insurance contributions for under 21 year olds earning less than £813 a week. There will also be changes to the benefits system, but the full roll-out of Universal Credit has been delayed until the end of 2017.

Abolition of the Agricultural Wages Board for England and Wales

- 5.82** The Agricultural Wages Board (AWB) was abolished in June 2013, although the Agricultural Wages (England and Wales) Order 2012 stayed in force until 30 September 2013. The NMW has operated in the agricultural and horticultural sectors in England since 1 October 2013. However, in July the Welsh Assembly passed legislation which would carry forward wages board functions in Wales. On 9 August the Attorney General gave notice that he had decided to refer the measure to the Supreme Court. He was not convinced it was within the National Assembly's competence (i.e. it covered employment matters) and sought a ruling from the Court. Pending that judgement, amendments were made to legislation to preserve the Agricultural Wages Order in Wales beyond 30 September 2013. A court hearing was to take place early in 2014.
- 5.83** In the 2013 Report, Commissioners highlighted two concerns in response to the (then) proposed abolition: if abolition went ahead there should be a communications campaign to ensure both workers and employers were aware of the change; and that sufficient resources should be allocated to HM Revenue & Customs (HMRC) to extend its enforcement work into the agricultural sector. The Government has subsequently revised the official guidance for the sector published on GOV.UK and we understand that a transfer of some resource from the Department for the Environment, Food and Rural Affairs to HMRC with respect to enforcement was agreed.
- 5.84** Employer and union stakeholders have continued to hold different views on the impact of these changes. The National Farmers Union (NFU) has welcomed the abolition of the AWB, seeing this as simplifying arrangements in the sector and giving farmers greater flexibility to set wage arrangements above a single minimum. Unite, however, has voiced its concerns. It noted that from October 2013 around a quarter of a million rural workers (its estimate of those both directly covered and those whose pay was benchmarked against the AWB order) who are 'hard to reach' would come under the enforcement regime of HMRC. Unite invited us to monitor the situation, and whether HMRC had the resources to accommodate these additional responsibilities.
- 5.85** Other changes have also been recently introduced in the sector, with the Seasonal Agricultural Workers Scheme (SAWS) – which allowed UK farmers and growers to recruit low-skilled, overseas workers for short-term agricultural work, up to a maximum of six months – closed at the end of 2013. NFU has voiced concern that this could lead to a labour shortage in the sector, given the particular seasonality in labour needs and the freedom of

workers from Bulgaria and Romania (previously allowed entry to work in the UK through SAWS) to work in other sectors in future. The Association of Labour Providers has appealed to all horticultural sector representative bodies to work together to secure an adequate seasonal labour supply for the industry.

- 5.86** We continue to monitor developments in this sector and take appropriate account of them. When there has been sufficient time to fully assess any implications for the NMW we will also consider commissioning further independent research on the sector.

Changes to Other Regulations

- 5.87** As in previous years we received evidence from some organisations asking us to consider the impact of other regulations during our deliberations. This is apart from the changes mentioned above to pensions and in the agricultural sector.
- 5.88** BHA, BBPA, BISL and ALMR raised concerns over proposed reforms to the Licensing Act, such as the introduction of a late-night levy and restrictions on opening hours. They said that a number of councils had consulted, or were in the process of consulting, on introducing these powers which they said would have a pronounced economic impact on late-night operators and increase the costs associated with running a business: the levy is four times the cost of the current annual licence fee.
- 5.89** A number of employer organisations, particularly in the retail sector, mentioned the impact of business rates on costs. The BRC told us that business rates continued to form a significant cost to retailers and in some parts of the country business rates are higher than rents paid to landlords. ACS highlighted the rising financial burden on retailers from business rate increases in the past two years. In the Autumn Statement (HM Treasury, 2013d), the Government committed to cap the rise in business rates to 2 per cent in 2014/15. It also extended Small Business Rate Relief until April 2015.
- 5.90** In the care sectors we were reminded how the regulatory frameworks, to which they are each subject, can generate additional costs to business and inhibit their possible range of responses to new business pressures. In the childcare sector the National Day Nurseries Association referred to the limited action nurseries can take in relation to staffing to reduce costs, given they need to comply with statutory adult:child ratios. And, as highlighted in Chapter 2, there continues to be debate about how far entitlement to free early education for two, three and four year olds is matched by sufficient funding to nurseries from local authorities. In the care sector the Registered Nursing Home Association told us that businesses had to absorb costs associated with registration of staff.
- 5.91** We again heard evidence about the impact of the introduction of Real Time Information – the requirement on employers each time they pay a worker to submit details about employees' pay and deductions to HMRC using payroll software. The FPB said with the introduction of this requirement businesses had reported an increase in the use, and cost, of external support.

Other Government Announcements

5.92 The Government has also committed to provide more support for the young unemployed and announced a new Help to Work scheme targeted at the long-term unemployed. It also provided some additional funds for higher apprenticeships and enhanced the Start Up Loan scheme that aims to support young entrepreneurs.

International Comparisons

5.93 We have looked at the level and arrangements for minimum wages in a number of other countries, including any changes which have been made since the end of 2012. We have monitored the situation in the 12 comparator countries (besides the UK) we have looked at since the minimum wage was introduced in the UK. The information we have considered is set out in Appendix 3.

5.94 There has been little change in the position of the UK's minimum wage over the last twelve months relative to other countries we consider. It should be noted that countries have different mechanisms and timings for making changes to their minimum wages. Since the end of 2012 six of the 12 countries we monitor had not increased their minimum wages, and three of these Ireland, Portugal and the United States, had not seen any increases in the preceding year either. As well as economic conditions, relevant terms of international loan agreements will have influenced some countries' decisions as to whether or not to increase their minimum wages.

5.95 Of the 13 countries we look at, Australia had the highest increase in terms of national currency at 2.6 per cent, followed by Japan (2.0 per cent) and then the UK (1.9 per cent). In our 2013 Report, we noted that five countries had implemented higher percentage increases in their minimum wages than the UK during 2012.

5.96 When exchange rates are taken into account, the UK is again in the middle of this group of comparator countries. The same can be said in terms of purchasing power, which adjusts for inflation as well as exchange rates. We are also ranked in the middle of these countries when considering the bite, the value of the minimum wage relative to full-time median earnings. The bite of the UK's minimum wage has remained in a similar position to last year. The growth in the bite of the UK's minimum wage was, as last year, higher than in most other countries, apart from France, Japan, Portugal and New Zealand. In 1999, only Canada, Japan and the US had bites below the UK's bite. By 2012 Greece, the Netherlands and Spain also had lower bites than the UK.

Recommended Rates

5.97 Differing views of the likely speed, strength and extent of economic recovery were at the heart of our discussions this year. Arguments for a substantial increase in the adult rate included:

- the improvement in the outlook for growth since we met a year ago. At that time forecasts had been lower, and when they were revised it was usually downwards. Now they were higher, and tending to be revised upwards;
- the performance of the labour market had exceeded all expectations and the employment rate of adults (25-64 year olds) had passed its pre-recession peak, while absorbing a significant increase in labour supply;
- importantly the employment performance of the low-paying sectors had continued to match or surpass that of the economy as a whole, and pay in these sectors had risen faster than the minimum wage, suggesting that the NMW had not had adverse effects on employment among the low paid;
- the bite had fallen a little from its 2012 peak as median earnings rose more than the NMW in 2012-13; and
- inflation had again eroded the real value of the minimum wage so that it was worth appreciably less than it was several years ago.

5.98 However, other arguments suggested caution:

- the economy was in recovery rather than now recovered, and growth to date had relied too heavily on consumers reducing their savings to command confidence in its sustainability. Not only had investment and trade yet to pick up, but the recovery was also patchy in its coverage of sectors and geographic regions;
- although the bite of the minimum wage had fallen back a little it remained at historically high levels in the low-paying sectors and among small firms, which continued to face very difficult financial conditions;
- an incautious increase at this stage risked burdening a still-fragile economic recovery, and contributing to wage increases that would risk job losses, insofar as labour market resilience had depended on falling real wages; and
- a bold increase would be unwise given uncertainties about aspects of the labour market position arising from conflicting official sources of data.

The Adult Rate

5.99 Two trends have characterised the National Minimum Wage since the onset of recession in 2008. It has tended to rise as a proportion of median earnings, and it has tended to lose real value. The lowest paid have done relatively better than other workers: although their wages have fallen in value, others' real wages have fallen faster.

- 5.100** In this period our recommendations have been close to the out-turn path of average earnings, though not to forecasts for average earnings available to us when we made our recommendations, since those forecasts have repeatedly been too high. Increases in the minimum wage have meant that the lowest paid have fared better than in previous recessions, while adverse employment effects have been avoided. In several reports we have described our approach in this period as cautious, as we have sought to protect these gains in a time of pressures on many businesses, particularly small businesses.
- 5.101** When we met last year conditions were not very different from the previous year. GDP forecasts had repeatedly tended to prove over-optimistic and economic growth had remained well below its long term pre-recession trend. We expected some improvement in the period to September 2014, i.e. the period covered by the 2013 rate recommendation. That expectation appears likely to be proved correct.
- 5.102** This year the economic outlook is more optimistic, the labour market has performed strongly, and the NMW has fallen a little as a proportion of median earnings. For these reasons we see headroom to recommend a larger increase than in recent years. At the time of our decision it is too early to know how strong and sustained the recovery will turn out to be, or how far it will spread across all of the economy and the country. We have had to balance the risk of recommending more than business and the economy can afford against the risk of doing too little to start to restore the real value of the earnings of the lowest paid.
- 5.103** We believe that the first step towards restoring the value of the minimum wage can now be taken. When we met to agree our recommendation the minutes of the most recent meeting of the Monetary Policy Committee put expected CPI inflation at around 2.0 per cent. **We recommend that the adult rate of the National Minimum Wage be increased by 3 per cent, or 19 pence, to £6.50 an hour, from 1 October 2014.** This will increase the real value of the minimum wage for the first time in five years through the biggest percentage increase since 2008. We expect this to increase the number of jobs covered by the minimum wage by over a third to around one and a quarter million, (partly because the new rate would be at a round number which is already paid to many workers), and to lift NMW workers' pay relative to others' earnings too.
- 5.104** Because of the improved economic and labour market conditions we believe that employers will be able to respond in a way which supports employment. However, we are concerned about the extra pressure the increase will place on the largely government-funded care sectors. We have made recommendations in previous reports, and comment again in Chapter 4 this year, on the mismatch between funding of social care in particular and the obligations, including the NMW, which providers must meet. We urge the Government to ensure funding is available to meet the extra pressure the NMW rise will place on the care sectors.
- 5.105** Our aim is to continue to restore the real value of the minimum wage as the economy improves, and we intend to build on this year's recommendation in 2015, provided that the economy and earnings take the upward path that is widely expected.

The Accommodation Offset

5.106 Last year we conducted a review of the accommodation offset. As a result we said that it was our intention to recommend staged increases towards the value of the adult rate of the NMW when economic circumstances mean that the real value of the NMW is tending to rise. As indicated above we are recommending an increase in the NMW that should cause its real value to rise. As we foreshadowed a year ago we are therefore making a start on the process of raising the offset's value, by recommending that it increase by a larger percentage than the increase in the NMW. **We recommend that the accommodation offset be increased by 3.5 per cent, to £5.08 a day, from 1 October 2014.**

The Youth Development Rate, 16-17 Year Old Rate and Apprentice Rate

5.107 In 2011 and 2013 we recommended smaller increases for young people than for adults and in 2012 we reluctantly recommended freezing their rates, because the labour market position of young people has been worse than that of adults. We aimed to increase their relative attractiveness to employers as a result. We have also noted that employment of young people is more sensitive than that of adults to the economic cycle, and that we expected to be able to recommend larger increases for them when economic conditions have eased. Their labour market position has yet to improve to match that of adults, and we continue to see greater use of the youth rates than in earlier years. However the employment position of young people does now appear to have stabilised. We are recommending a rise in their rates which should broadly protect their real value, though less than the increase we recommend for adults. We continue to believe that the youth rates should increase by more than the adult rates when economic circumstances permit. A strengthening economic recovery and labour market performance of young people over the next twelve months will enable us to explore the scope to recommend such increases next year. **We recommend an increase of 2 per cent in the Youth Development Rate to £5.13 an hour and in the 16-17 Year Old Rate to £3.79 an hour from 1 October 2014.**

5.108 No apprentice pay survey has taken place in 2013 which means there is little new evidence about apprentice pay to inform our recommendation. Last year we expressed our concern about the extent of non-compliance with the Apprentice Rate and recommended that it should be frozen. The Government decided to increase the rate in order to maintain its relativity with the youth rates, and has since then announced a number of measures to support compliance. A new survey of apprentice pay will take place later this year which will inform next year's decision. At this stage we are recommending an increase in the Apprentice Rate which will maintain its position relative to the youth rates. **We recommend an increase in the Apprentice Rate of 2 per cent, or 5 pence, to £2.73 an hour from 1 October 2014.**

Implications of the Recommended Rates

5.109 In assessing the likely impact of our minimum wage recommendations, we have looked at various factors, including the bite (the value of the minimum wage relative to average or median earnings) and the coverage, as well as likely changes to household income. We also consider the likely impact on wage bills and the Exchequer.

Position Relative to Average Earnings

5.110 The bite of the minimum wage is one way of assessing the impact of the minimum wage on the earnings distribution. In April 2013, according to ASHE, the median gross hourly earnings (excluding overtime) of all employees aged 21 and over (full and part-time) were £11.69 an hour and the adult rate of the NMW was £6.19 an hour. Thus the bite of the NMW (its value relative to the median) was 53.0 per cent. In order to compare this bite with the bite for the recommended adult rate from October 2014, we need to make some assumptions about how median earnings will change by April 2015, when the earnings data become available to estimate the actual bite. That is, we need to forecast how wages are likely to change between April 2013 and April 2015.

5.111 In recent years the forecast average earnings available when we have made our recommendations in January have turned out to be higher than the out-turn. Further, there still seems little pressure on wages in the economy and the forecasts may again turn out to be over-estimates. Indeed, the latest AWE data suggest that earnings growth was only 0.9 per cent in the year to November 2013, although the data from ASHE in April 2013 suggested much stronger wage growth. The OBR forecast for earnings growth (an average of 2.2 per cent from the second quarter of 2013 to the first quarter of 2014 and 3.0 per cent between the second quarter of 2014 and the first quarter of 2015) is above the median of the Treasury Panel of Independent Forecasts (2.2 per cent for the whole of 2014). If average wages grew by only 2 per cent, this would still be twice as fast as currently suggested by AWE. In this section, we therefore estimate the bite in April 2014 and April 2015 using a range of earnings growth estimates from 2 per cent to 3 per cent.

5.112 Using the OBR forecast for average earnings the adult rate of £6.50 would be about 52.8 per cent of estimated median earnings for those aged 21 and over (£12.31) in April 2015. This is the same as the estimated bite at the median (£11.95) for employees aged 21 and above in April 2014, when the adult rate was £6.31 an hour. The OBR forecast earnings growth between 2014 and 2015 is the same as the recommended rate increase.

5.113 However, using our assumption of 2.0 per cent annual growth in median earnings between April 2013 and April 2015, we estimate that the adult rate of £6.50 would be 53.5 per cent of estimated median earnings for those aged 21 and over (£12.16) in April 2015. This is higher than the estimated bites at the median in April 2014 (52.9 per cent) and April 2013 (53.0 per cent). It would return it to its level in April 2012 and match the highest bite to date.

5.114 As well as considering the bite at the median, we can also consider the bite at the mean. The mean in April 2013 was £14.95 for those aged 21 and over. Based on the OBR forecast for average earnings, the bite at the mean in April 2015 is estimated to be around 41.3 per

cent for employees aged 21 and over. This is the same as the bite in April 2014 and a little below the bites in 2012 and 2013. However, if we assume annual increases in average earnings of 2.0 per cent between April 2013 and April 2015, the bite at the mean would remain at 41.4 per cent in April 2014, but rise in April 2015 to its highest yet, 41.8 per cent (above its previous high of 41.6 per cent in April 2012).

- 5.115** In order to compare the estimated bite with the historic time series we need to exclude those aged 21 from the analyses. For those aged 22 and over, median hourly pay was £11.82 and mean hourly pay was £15.07 in April 2013. Using the OBR forecast for average earnings, the NMW is expected to be about 52.2 per cent of median earnings in April 2015, a little below the bite in 2013. It would be more than half a percentage point higher at 52.8 per cent based on annual increases in average earnings of 2.0 per cent between April 2013 and April 2015.
- 5.116** We now look at the mean. Using the OBR forecast for average earnings, we estimate the bite at the mean for those aged 22 and over in April 2015 would be around 41.0 per cent, the same as in April 2014 and marginally lower than in April 2013 and April 2012. Using average earnings growth of 2.0 per cent instead, the bite would be 41.5 per cent in April 2015, its highest yet.
- 5.117** Assuming wages of low-paid workers were to increase in line with the OBR forecast for average earnings, the bites at both the median and mean for those aged 22 and over are expected to fall slightly between April 2013 and April 2014 (forecast growth of 2.2 per cent is greater than the 1.9 per cent increase in the NMW), and stabilise between April 2014 and April 2015 (the increase in the NMW matches that of the OBR forecast). However, assuming annual increases of 2.0 per cent in average earnings over the same period would lead to a higher bite at both mean and median earnings in April 2015 than those in April 2013 and in April 2014.
- 5.118** The increases in the youth rates are below those of the adult rate in both October 2013 and October 2014. They are also below most of the earnings forecasts used in the analysis set out above. Although forecasts of young people's earnings are not available, and they have not followed the same path as those of adults in recent years, we would expect the bite for young people to fall in April 2014 and remain at a similar percentage in April 2015 if earnings turn out slightly weaker than those forecast by the OBR or the HM Treasury Panel of Independent Forecasts.

Coverage

- 5.119** Another way of looking at the impact of the NMW is to try and assess the number of people that are covered by the minimum wage. According to ASHE data, in April 2013 there were around 1.60 million jobs that paid less than the minimum wage rates that became effective in October 2013, and around 2.13 million jobs paid less than the minimum wage rates we are recommending for October 2014. Of those jobs paid below the recommended rates for 2014, 1.91 million were held by those aged 21 and over (7.7 per cent of jobs in the age group), 183,000 jobs by 18-20 year olds (17.8 per cent of jobs in the age group), and 39,000 jobs held by 16-17 year olds (14.7 per cent of jobs in the age group).

5.120 We expect that most workers will have received a pay rise between April 2013 and October 2014. Thus we should attempt to account for increases for those paid less than £6.50 an hour in order to estimate the coverage of the recommended upratings. We therefore make assumptions about how the wages of the low-paid would change in the absence of any minimum wage increases. In other words, in order to estimate the coverage of the recommended upratings in April 2015, we need to downrate the recommended rates using predicted wage growth to April 2013 (the date of the latest earnings data). Unlike the bite analysis above, where we needed to forecast average and median wage growth, for the analysis that follows we need to forecast the earnings growth for low-paid workers. Prior to the introduction of the NMW, there was some evidence that the wages of the low paid increased in line with inflation. However, that has certainly not been the case in recent years and we do not replicate their use here. We instead focus on the average earnings forecasts that we used in the analysis of the bite.

5.121 It should be noted that the methodology we have used in previous reports to estimate coverage will only produce sensible estimates of coverage when the downrated value of the future minimum wage is at least its current value. That is, in other words, when the increase in the NMW is greater than the increase in wages suggested by the forecasts.

5.122 By its nature, this is not an exact science and there is much uncertainty about the future path of earnings. We have produced estimates under three scenarios: assuming that the wages of the low paid increase according to the earnings growth forecasts of the OBR (2.6 per cent) and the median of the HM Treasury Panel of Independent Forecasts (2.2 per cent); or that they increase by 2.0 per cent. Under these scenarios the number of people affected by the new rate (£6.50) for those aged 21 and over ranges from 1.1 million (4.5 per cent of jobs in the age group), to 1.3 million (5.2 per cent of jobs in the age group) using the assumption that wages would grow at 2 per cent, more than twice the current increase in annual average earnings growth suggested by AWE. We think the number is more likely to be at the upper end of this range, because of our view given above about the expected path of average earnings, and because the recommended rate is a round number. Fry and Ritchie (2012a and 2012b) and Dawson, Ritchie and Whittard (2014) suggested that employers, particularly those in small firms, use focal points to set wages. The new recommended rate is a focal point and currently just under 200,000 workers are paid at this wage.

5.123 Our recommendations for the youth rates are again below those for the adult rate. Using the coverage methodology adopted for adults would lead to the downrated values of their 2014 minimum wage rates being lower than their values in April 2013. We therefore cannot adopt this approach to estimate their coverage in October 2013. The recommendations for the youth rates are a little below the earnings forecasts. If those forecasts are realised, it is likely that the minimum wage coverage of young people would fall a little but they could remain at similar levels. It is also possible that coverage could increase, as in recent years pay increases for young people have been lower than for adults. Indeed, last year the median pay of 16-17 year olds actually fell. Further, employers may continue to make increased use of the youth rates (as they have generally done since the onset of recession in 2008) and this would also affect coverage.

Impact on Household Income

- 5.124** When the adult minimum wage increased to £6.31 in October 2013, gross weekly income would have been £220.85 for a 35-hour week. Using HM Treasury estimates for the 2013/14 tax year, this gross income would have been equivalent to a net income of £216.28 for a single person working full-time with no children (a net wage of £6.18 an hour for a 35-hour week). The corresponding amount for a couple with two children (one partner working and the other not) would have been around £402.65 (equivalent to a wage of £11.50 an hour for a 35-hour week).
- 5.125** Again assuming a 35-hour week, gross weekly income would increase by £6.65 to £227.50 following the minimum wage increase to £6.50 an hour in October 2014. Taking into account the minimum wage uprating and the 2014/15 tax year, the net weekly income for a single person would rise by £4.98 to £221.26. For a two-children family, net income would rise by £6.87 to £409.52. The effective hourly rate for the single person would be £6.32 (14 pence higher than in October 2013), and for a two-children family would be £11.70 (20 pence higher than in October 2013).

Wage Bills

- 5.126** Given the size of our recommended increase we expect that the direct impact of our recommendations on the wage bill is likely to be limited. We expect a very small direct impact on the public sector wage bill as very few jobs in the public sector are paid at the minimum wage. We have noted above that our recommendation will create some cost pressure on the care sector, which is largely government-funded.

Exchequer Impact

- 5.127** An increase in the minimum wage can also affect the public sector through an impact on the Exchequer resulting from changes in tax receipts and benefit payments. In our previous reports, we tended to focus on the immediate impacts in a static analysis, consisting of changes to direct tax and benefit expenditure. However, this static impact did not take into account wider employment effects and further adjustments that were likely to take place in the economy as a result of increases to the NMW. This year HM Treasury⁵ (2014a) provided us with a dynamic analysis of the overall fiscal impact of increasing the NMW, including the wider effects mentioned above. This suggested that we should expect a neutral fiscal impact from increasing the NMW, given the size of our recommended increase.

⁵ HM Treasury provided us with estimates of fiscal impacts for an increase in the adult rate of the NMW to £7 in October 2015, taking into account employment effects and adjustment effects, and concluded that it is unlikely there will be a significant positive fiscal impact from increasing the NMW.

Conclusion

5.128 Our recommended rates for the National Minimum Wage reflect a careful assessment of the outlook for the economy and the labour market. The economy has grown more in 2013 than in recent years and there are grounds for expecting the recovery to strengthen further. The performance of the labour market in creating jobs has continued to exceed many forecasters' expectations. The youth labour market has stabilised, although it has not yet really started to show the benefits from economic recovery. After a very careful review of a wide range of evidence we have made recommendations for the year from October 2014 which we believe are appropriate to a strengthening economy and a resilient labour market. In the next chapter we consider the outlook for the National Minimum Wage beyond that time horizon.

Chapter 6

The Future Path of the National Minimum Wage

Introduction

6.1 In September 2013 the Secretary of State for Business, Innovation and Skills wrote to our Chair requesting that we undertake an additional task. He said that: “alongside signs of an emerging recovery, I am keen to ask the Commission to take a longer term view of the minimum wage and the necessary conditions for higher increases in the National Minimum Wage. In addition to the remit that I sent you in June, I would like you to:

- consider the conditions that need to be in place in order to allow a faster increase in the minimum wage taking into account the implications on employment.

Included amongst these conditions, I would be keen to understand how government policies that affect the labour costs and take-home pay of people on the National Minimum Wage have influenced your conclusions.”

6.2 We welcome this request. Since our 2013 Report there has been an upsurge of interest in the part the National Minimum Wage (NMW) may play in supporting the incomes of the lowest paid, often in the context of wider discussion of living standards. In this chapter we set out the Commission’s view of the contribution that the NMW has made, particularly during the period of generally falling real wages since the economic downturn began in 2008, and our view on the conditions needed for the minimum wage to increase faster in future.

6.3 This chapter comprises three parts as well as this introduction, and a conclusion. The remainder of the Introduction outlines the roles of the National Minimum Wage (paragraphs 6.11-6.16) and of the Low Pay Commission (paragraphs 6.17-6.21).

6.4 Part 1, The National Minimum Wage to Date, covers:

- the path of the NMW since its introduction, outlining the different policy phases in the Commission’s approach to recommending rates (paragraphs 6.23-6.25);
- the impact of the recommended increases on employment and the real value of the NMW, including:
 - what it has meant for the pay of the lowest earners in periods of recession and recovery (paragraphs 6.26-6.30);
 - measures of the impact of the NMW, including the minimum wage as a proportion of median earnings, and numbers of workers covered by it (paragraphs 6.31-6.35); and

National Minimum Wage

- the findings of research investigating evidence of adverse employment effects (paragraphs 6.36-6.37).
 - the general context we judge important for understanding the impact of our recommendations, including:
 - the decline over time in the wage share of national income experienced in the UK and other developed countries (paragraphs 6.38-6.40); and
 - movements in labour costs and take-home pay, and their place in Low Pay Commission deliberations (paragraphs 6.41-6.50).
- 6.5** Part 2, Conditions Needed for Faster Increases in the National Minimum Wage, covers:
- stakeholders' views on the conditions needed for faster NMW increases (paragraphs 6.55-6.64);
 - the general conditions in the economy conducive to faster NMW increases, including:
 - inflation and the role of the Monetary Policy Committee of the Bank of England in determining the real value of the NMW (paragraph 6.68);
 - the importance of productivity (paragraphs 6.69-6.74);
 - the role of increased demand in the economy (paragraph 6.75); and
 - previous experiences of faster increases in the National Minimum Wage (paragraphs 6.76-6.78).
- 6.6** The next section, from paragraph 6.79, discusses the sectoral conditions for faster increases in the NMW, which focuses on the low-paying sectors and includes the significance of:
- labour costs (paragraphs 6.82-6.85);
 - short-term market adjustments (paragraphs 6.86-6.87);
 - market characteristics (paragraphs 6.88-6.91);
 - impact on differentials (paragraph 6.92);
 - non-labour costs (paragraphs 6.93-6.94) and
 - statutory requirements (paragraphs 6.95-6.96).
- 6.7** Part 2 ends with comments on implications of a higher bite for the low-paying sectors (paragraphs 6.97-6.101).
- 6.8** Part 3, Scope to Affect the Conditions Needed for Faster Increases in the National Minimum Wage, examines:
- the scope to influence general economic conditions which would enable a faster NMW increase (paragraphs 6.104-6.107);
 - conditions directly affected by government policies, including tax and National Insurance contributions (paragraphs 6.108-6.110);

- productivity in the low-paying sectors (paragraphs 6.111-6.115);
 - small firms and the NMW (paragraphs 6.116-6.120);
 - other considerations, including the living wage (paragraphs 6.121-6.122);
 - young people (paragraphs 6.123-6.127); and
 - apprentices (paragraph 6.128).
- 6.9** Part 3 ends by discussing options for clarifying the forward path of the NMW, including the idea of forward guidance from the Commission on the minimum wage (paragraphs 6.129-6.136).
- 6.10** The Conclusion (paragraphs 6.137-6.151) then summarises the conditions which would enable the Commission to recommend faster increases in the minimum wage. For significantly faster increases in the minimum wage to be achievable without significant risk to the low paid we believe it would be necessary to see:
- rising real wages in the economy generally;
 - stable or rising employment, particularly in low-paying industries; and
 - an expectation of sustained economic growth.

The Role of the National Minimum Wage

- 6.11** The purpose of the NMW is to provide a wage floor, in order to protect low-paid workers against exploitation, without causing job losses. Many economists have been wary of statutory minimum wages: unless they raise the price of labour at the bottom of the wage distribution above what it would otherwise be they are pointless; but if they raise it then the fear is that they will curb demand for labour, and curb it to the particular detriment of the least skilled – those whom a wage floor is intended to help.
- 6.12** However, others have pointed out that labour markets are not perfectly competitive. There are costs and risks for workers who want to change jobs, and some employers enjoy a degree of monopsony power in local labour markets. As a result workers may be paid at levels below the market-clearing rate. The implication is that a statutory wage floor may raise the pay of the lowest earners without adverse employment effects. Of course, even under these conditions, if the minimum wage is set too high then adverse effects on employment will appear. So the challenge is to set the level as high as possible short of causing people to lose jobs.
- 6.13** The minimum wage is not a living wage: a living wage aims to assess needs and to provide enough for an employee and their dependants to live on, whereas the NMW aims to provide a wage floor which is affordable for business. It may need to be supplemented by other policy measures, principally in the tax and benefits fields, to produce enough for a family or household to live on. The tax and benefits systems, unlike wages (whether the NMW itself or indeed a living wage that is set across family types), are able to take into account household characteristics such as number of children, family size and number of earners in the household, all of which are closely correlated with household need.

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- 6.14** The UK minimum wage is relatively simple. There are only four rates: three age-related rates, and a rate for apprentices. It is a single hourly rate across the UK for all industries, occupations, sizes of firm and regions. It is cash, and does not include benefits-in-kind, apart from accommodation. It is comprehensive as it covers nearly all workers and types of employment, with few exemptions. We regard this simplicity as a strength because it makes the NMW easily understandable for employers and workers, which promotes support for it and compliance with it; it makes enforcement easier; it minimises the regulatory costs of compliance for business; it avoids the 'boundary issues' regional or sectoral rates would entail; and it simplifies the process of determining the rates.
- 6.15** The Low Pay Commission's founding principles have been unchanged since the Commission was created in 1997. The First Report set out the Commission's intentions for the minimum wage: that it should support a competitive economy; be set at a prudent level; be simple and straightforward; and make a difference to the low paid. We continue to support these guiding principles, underpinned by a strong, evidence-based, analytical approach.
- 6.16** Accordingly our overarching aim in recommending minimum wage levels has, like our predecessors on the Commission, been to help as many workers as possible, without adversely impacting employment prospects. In its interim evidence to us in September 2013 and in its final evidence in January the Government encouraged us to retain this focus in making our minimum wage recommendations for 2014.

The Low Pay Commission

- 6.17** This overarching aim embodies the objectives of both employers, that the minimum wage should be affordable for business, and of unions, that as many workers as possible should benefit from as generous an NMW as is achievable. As such it reflects the composition of the Low Pay Commission, which includes three Commissioners from employer backgrounds, three from employee representative backgrounds, and three independents (the Chair, and two labour market experts).
- 6.18** To date all the recommendations made by the Commission have been unanimous. This is central to the effectiveness of the Commission: what the Government receives are not competing arguments from different standpoints but recommendations which are supported by business, by unions and by independent experts.
- 6.19** The Commission's recommendations are shared judgements rather than the mechanistic products of an economic model. They are strongly based in evidence, gathered through: commissioned research; visits to low-paying employers and employees around the country; extensive analysis of labour market and economic data, written and oral evidence from representative organisations and review of international comparisons. They involve careful assessment of the past impact of the NMW, and of the future prospects for the economy. However, despite this grounding in substantial evidence and analysis, in the end the Commission's recommendations necessarily remain judgements, and are not the arithmetical output of a formula.

- 6.20** This has proved a successful model. In 2010 members of the Political Studies Association voted the minimum wage the most successful government policy of the preceding 30 years. It is supported by all the main political parties, and has survived a change of government, and a prolonged economic slowdown which has put acute pressures on both the living standards of the lowest paid and the margins of many businesses. In our view simplicity and universality are key to this success.
- 6.21** Of course it is important that we examine factors which are not universal in arriving at rate recommendations, and later in this chapter we consider the role of constraints on increasing wages which operate at sectoral level. Each year the Commission looks closely at the different low-paying sectors and occupations in order to understand the actual and likely impact of previous and possible future increases in the minimum wage. Alongside our recommendations for minimum wage rates we have from time to time made recommendations calling for changes to policy or practice relating to specific sectors. However, while we take account of sectoral features and differences in arriving at our rate recommendations we cannot, and should not, react to each industry and occupation. In this sense it is fair to say that the attributes that have contributed to the success of the minimum wage – particularly its simplicity and universality – mean that it is by necessity a blunt instrument.

Part 1: The National Minimum Wage to Date

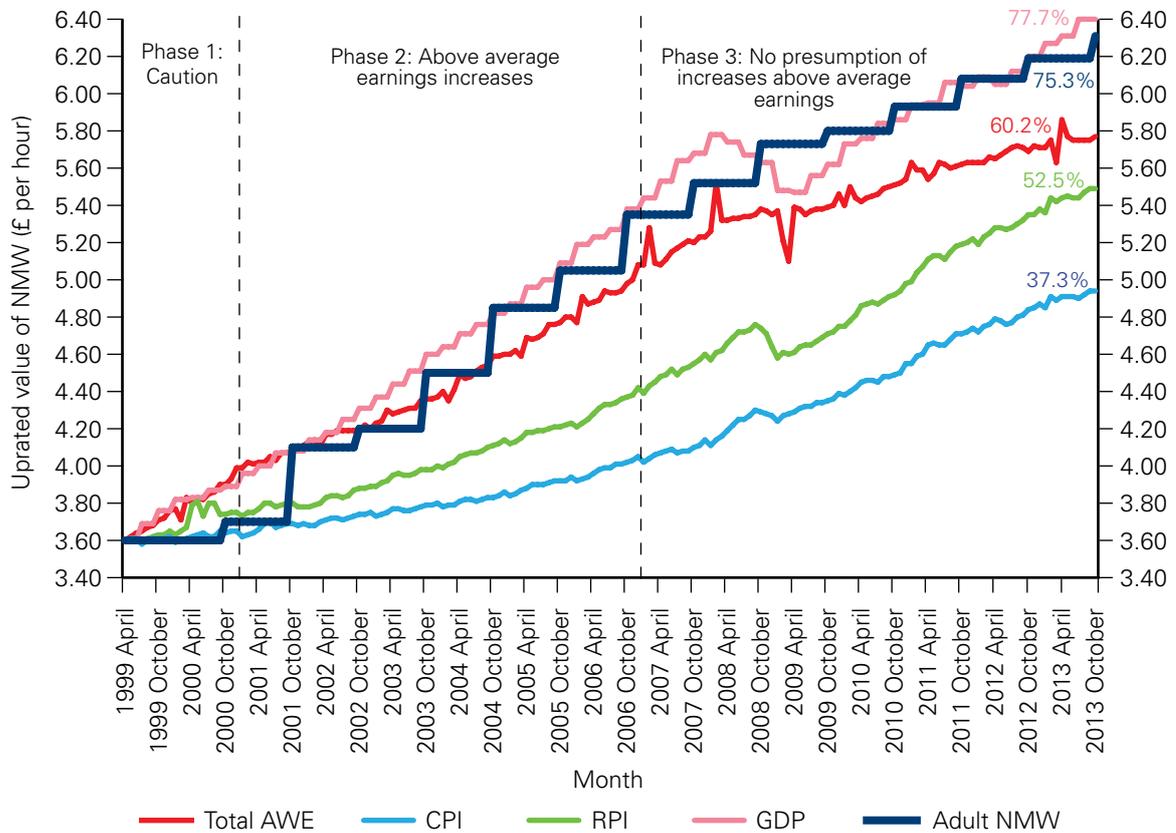
6.22 This part covers:

- the path of the NMW since its introduction, outlining the different policy phases in the Commission’s approach to recommending rates (paragraphs 6.23-6.25);
- the impact of the recommended increases on employment and the real value of the NMW, including:
 - what it has meant for the pay of the lowest earners in periods of recession and recovery (paragraphs 6.26-6.30);
 - measures of the impact of the NMW, including the minimum wage as a proportion of median earnings, and numbers of workers covered by it (paragraphs 6.31-6.35);
 - the findings of research investigating evidence of adverse employment effects (paragraphs 6.36-6.37);
- the general context we judge important for understanding the impact of our recommendations, including:
 - the decline over time in the wage share of national income experienced in the UK and other developed countries (paragraphs 6.38-6.40); and
 - movements in labour costs and take-home pay, and their place in Low Pay Commission deliberations (paragraphs 6.41-6.50).

The Path of the National Minimum Wage Since its Introduction

6.23 The NMW was introduced in April 1999 at £3.60 an hour for those aged 22 and over. Figure 6.1 shows that it has increased in nominal value each year, reaching its current £6.31 an hour in October 2013, an increase of 75.3 per cent since 1999. This increase is similar to the increase in nominal gross domestic product (GDP) over the period, and significantly more than the increases in average earnings (around 60 per cent) and in prices, which have risen by about 52 per cent measured using the Retail Price Index (RPI) and by around 37 per cent using the Consumer Price Index (CPI). In other words the minimum wage is worth more now than when it was introduced and, while its relationship to average earnings has shifted from time to time with changes in economic conditions and in the policy of the Commission (see below), the hourly earnings of workers receiving it are a substantially higher percentage of average earnings than they were in 1999.

Figure 6.1: Increases in the Real and Relative Value of the Adult National Minimum Wage, UK, 1999-2013



Source: LPC estimates based on ONS data, AEI including bonuses (LNMQ), 1999, AWE total pay (KAB9), 2000-13, RPI (CHAW), 1999-2013, and CPI (D7BT), 1999-2013, monthly; and GDP (YBHA), 1999-2013, quarterly, seasonally adjusted (AWE, AEI and GDP only), UK (GB for AWE and AEI).

6.24 Figure 6.1 also shows the three distinct phases in the Low Pay Commission’s approach to recommending the rate since the NMW was introduced in 1999. It was initially set at a cautious level and was then raised in line with price inflation, while the Commission awaited the outcome of research investigating the impact on employment and wages. The Commission reviewed its approach in the light of those early research studies which suggested that the minimum wage had raised the wages of many workers, but that it had not covered as many workers as expected and it had not greatly affected differentials or led to an adverse impact on employment or hours worked.

6.25 Informed by these findings and in a climate of continuing economic growth the Commission followed a policy of recommending increases that were above average earnings growth and inflation between 2001 and 2007. The Commission adjusted its approach again after 2007, with the arrival of more uncertain economic conditions. Since then, increases in the adult rate of the NMW have been much closer to average earnings growth.

The Impact of the National Minimum Wage

The Level of Low Pay

6.26 Table 6.1 shows relative changes in the hourly wages of the lowest-paid since 1975, broken down into phases of the economic cycle. In the earlier recessions of 1979-82 and 1989-92 the wages of the lowest paid fell relative to the median. In the 1979-82 recession the pay of those at the median rose by 6 percentage points more than that of workers in the lowest 5th and 10th percentiles. Table 6.1 also shows that during the recoveries of the 1980s and 1990s the pay of those at or above the median rose faster than that of the lowest paid.

6.27 Since the introduction of the NMW the picture has changed radically. The lowest paid have received the largest increases in earnings relative to the median. The strongest relative growth was between 1997 and 2004 (although that growth was not shared by those in the second quartile, particularly those between the 25th and 40th percentiles – not shown).

“... revised statistics show that the number of workers directly affected by the minimum wage are smaller than the Commission originally forecast.... All the signs are therefore that the minimum wage can now be increased as a percentage of average earnings – benefiting more workers – without producing damaging economic effects.”

Chairman’s Foreword to the Fourth Report of the Low Pay Commission, 2003.

“... we do now consider that the phase in which the Commission is committed to increases in the minimum wage above average earnings is complete and, looking forward, we have no presumption that further increases above average earnings are required.”

Low Pay Commission Report, 2006

Table 6.1: Earnings Growth by Selected Percentile, UK, 1975-2013

Hourly wage growth relative to the median (percentage point difference)	Mean	Percentile					Median total hourly wage growth (%)
		5th	10th	25th	70th	90th	
1975-79	0.1	5.0	-3.0	-0.7	0.8	2.5	65.7
1979-82	1.0	-6.3	-6.0	-3.6	4.3	7.7	53.0
1982-89	0.8	-9.1	-8.7	-6.3	5.1	12.1	67.7
1989-92	0.7	-3.0	-1.0	-0.4	2.2	4.2	27.2
1992-97	-0.1	-4.6	-2.8	-2.4	1.8	2.7	17.3
1997-04	5.3	12.4	6.3	-0.1	1.3	5.9	27.2
2004-08	1.2	2.9	0.5	0.3	0.2	-1.0	19.8
2008-13	-0.2	1.9	0.1	-0.1	-0.3	-2.6	7.6

Source: LPC estimates based on NES and ASHE, UK, 1975-2013.

Notes:

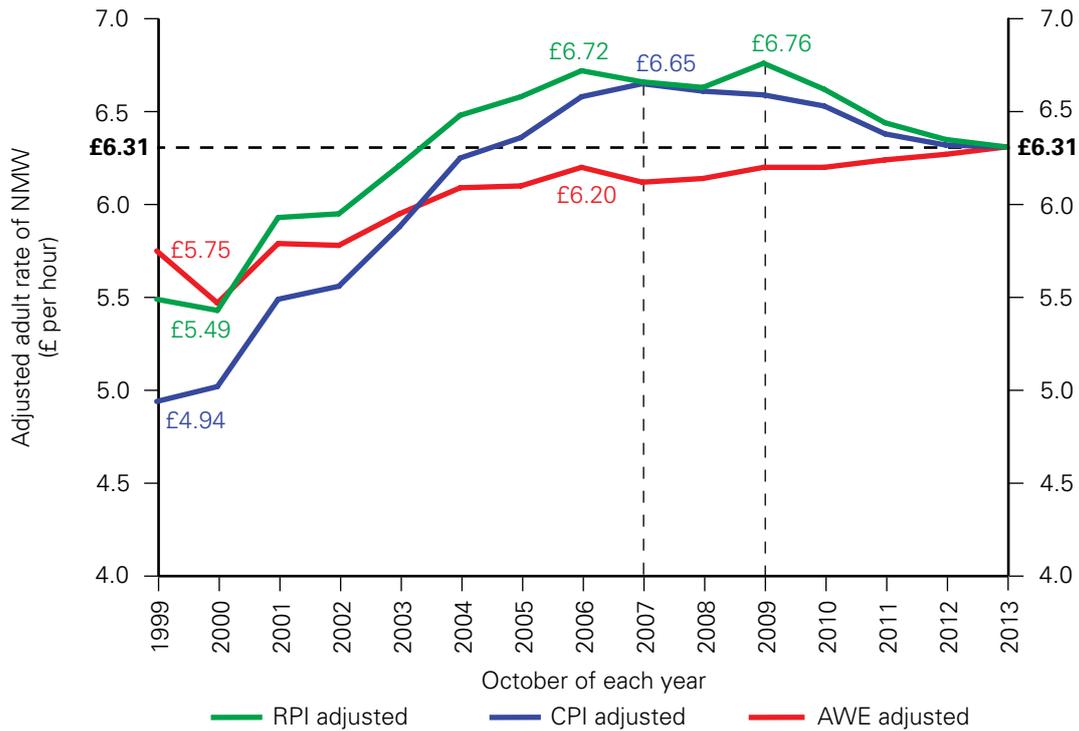
a. Shaded periods are recessions.

b. The 5th percentile generally has covered those on the NMW since 1999.

6.28 Since the onset of recession in 2008 the lowest paid have again made the greatest relative gains. In other words the trend whereby the wages of the lowest paid used to rise slowest has been reversed since the introduction of the NMW, and they have fared relatively better than their peers. Figure 6.2 below shows that the value of the NMW was at its highest ever level relative to Average Weekly Earnings (AWE) in October 2013.

6.29 However, although NMW increases have kept pace with the growth in average earnings since 2007, along with wages in general they have failed to keep up with price inflation. Figure 6.2 shows that using the RPI, the real value of the NMW peaked in 2009 (at £6.76 in 2013 prices), and in 2007 using the CPI (at £6.65 in 2013 prices). Thus, in October 2013, the NMW was 45 pence an hour lower in real RPI terms than it was in October 2009 and 34 pence lower than it was in October 2007 in real CPI terms. Were it decided to recover the lost value of the minimum wage through one uprating in October 2014, it would need to increase by 10.3 per cent in RPI terms (from £6.31 to £6.96) or by 7.8 per cent in CPI terms (to £6.80).

Figure 6.2: Real and Relative Value of the Adult National Minimum Wage, UK, 1999-2013



Source: LPC estimates based on ONS data, AEI including bonuses (LNMQ), 1999, AWE total pay (KAB9), 2000-13, RPI (CHAW), 1999-2013, and CPI (D7BT), 1999-2013, quarterly, seasonally adjusted (AWE and AEI only), UK (GB for AWE and AEI).

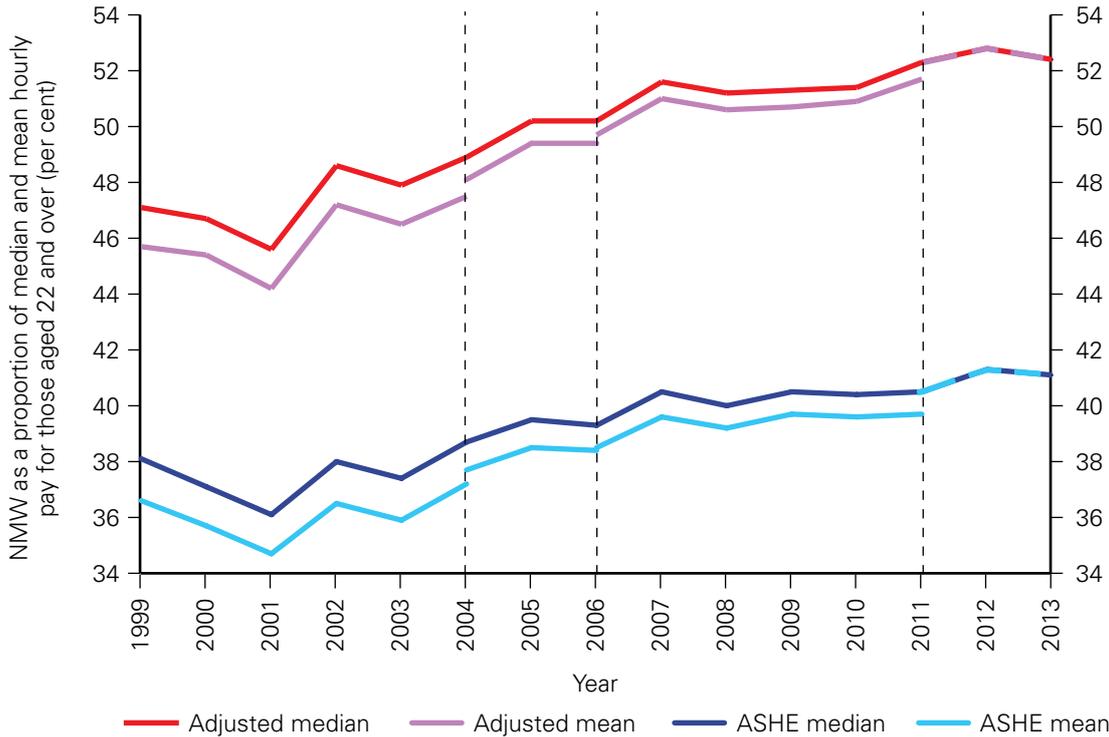
6.30 To put the trends another way, while the real value of the minimum wage has declined in this period, the real value of wages generally has declined faster. But this is little consolation to low wage workers, who are often those least able to absorb reductions in income. On our visits around the UK low-paid workers have told us about growing difficulties in making ends meet, and their struggles to afford what many people would regard as necessities.

Measures of the Impact of the National Minimum Wage

6.31 The increase in the value of the NMW, relative to average earnings, is often expressed in terms of the bite – the minimum wage as a proportion of median earnings.⁶ We closely monitor the bite because a high or growing bite means that employers are more likely to be affected by the NMW. It may indicate an increased risk that the minimum wage will reduce demand for labour – that it will cost jobs – because of wage bill impacts on employers. Figure 6.3 shows that in 1999 when the NMW was introduced the bite was 45.7 per cent (or 47.1 per cent using an adjusted-ASHE series). Since 2007 it has increased from 51.6 per cent to 52.4 per cent in 2013 on the adjusted-ASHE basis (or 53.0 per cent if 21 year-olds, who were not entitled to the adult rate until 2010, are included). If average earnings grow as much as the OBR forecast for the year to the first quarter of 2014 (2.4 per cent), we would expect the bite to fall, to around 52.1 per cent when the 2014 ASHE data become available.

⁶ The bite is defined as the National Minimum Wage as a proportion of a particular point on the earnings distribution. In our reports, we tend to focus on the bite in terms of median earnings or average (mean) earnings, although we also consider the bite at the lowest decile, lowest quartile, upper quartile and upper decile. The bite can only range from 0-100 per cent.

Figure 6.3: Bite of the Minimum Wage, UK, 1999-2013



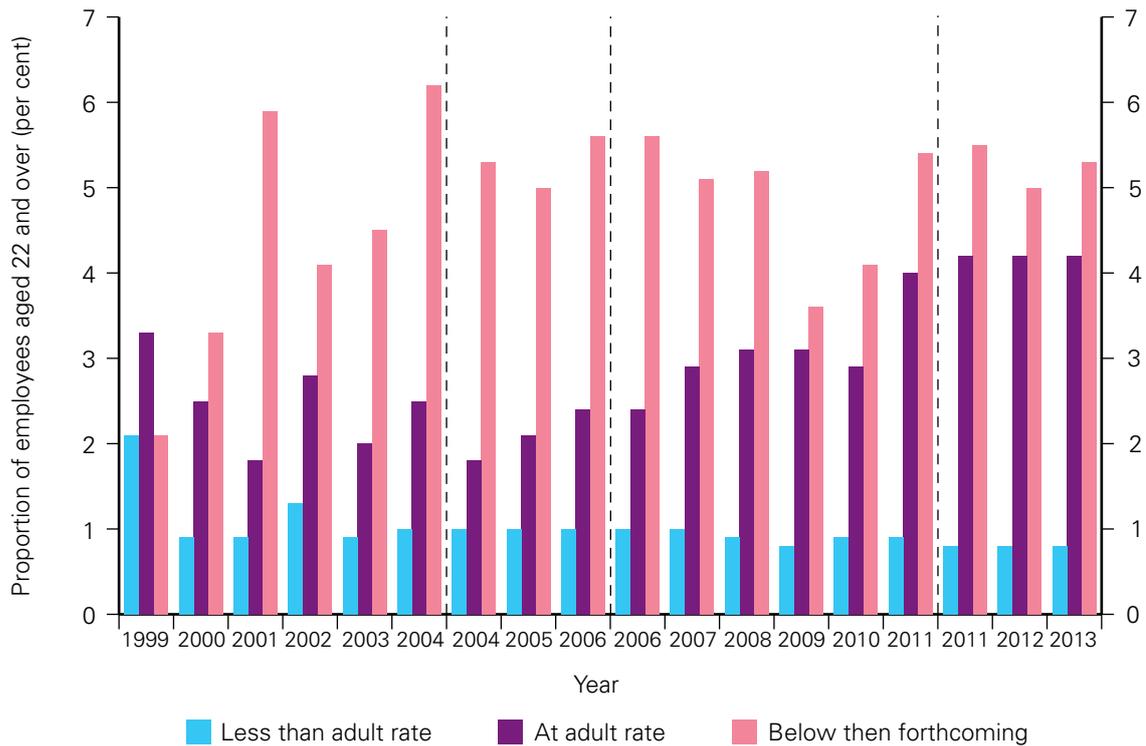
Source: LPC estimates based on ASHE: without supplementary information, April 1997-2004; with supplementary information, April 2004-06; 2007 methodology, April 2006-11; and 2010 methodology April 2011-13, standard weights, including those not on adult rates of pay, UK.

Note: ASHE data have been adjusted to take account of methodology changes to provide a consistent time series. The raw data are shown with distinct breaks to show the discontinuities in the four ASHE series.

6.32 The bite can be expressed sectorally, being the minimum wage as a proportion of median earnings for a given sector or group of sectors. For the low-paying sectors as a whole it is just under 80 per cent. The data, and evidence we have received through our consultations and visits, suggest that in some areas, such as cleaning and hairdressing, the minimum wage is increasingly often the going rate for the job. (See Annex A for details of the bite in low-paying sectors over time.)

6.33 In its evidence to us for this additional assessment the Government asked us what other measures of the impact of the NMW we take into account, besides the bite. As well as considering the bite at the median we examine the bite at the lowest decile, lowest quartile and mean. We also review the number of jobs covered by the minimum wage. Figure 6.4 shows how many jobs have been covered since 1999. We expect our recommended 2014 rate rise to increase the number of jobs covered by the NMW by over a third, to around one and a quarter million, partly because the new rate would be at a round number – £6.50 an hour – which is already paid to many workers. All of these measures indicate that the impact of the NMW on earnings is at or near its highest point to date.

Figure 6.4: Coverage of the Minimum Wage, UK, 1999-2013



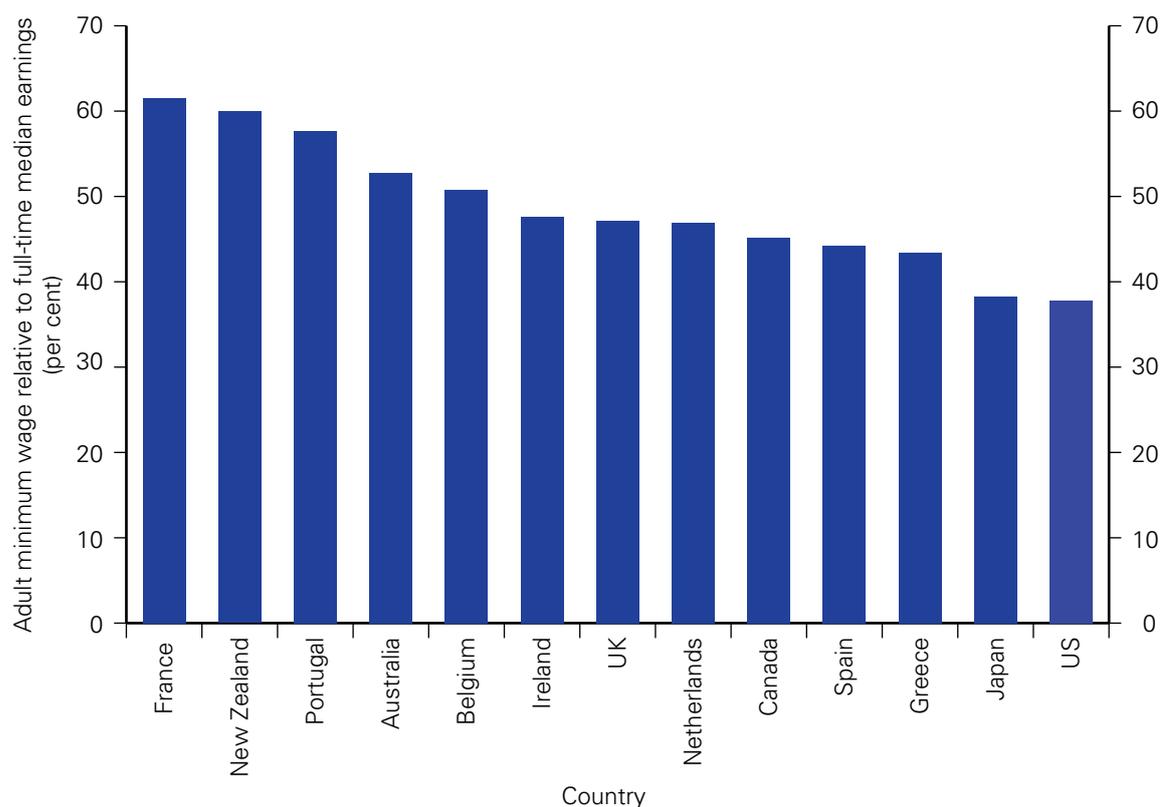
Source: ONS. Source: ONS central estimates using ASHE without supplementary information and LFS, UK, 1999-2004; LPC estimates based on ASHE: with supplementary information, April 2004-06; 2007 methodology, April 2006-11; 2010 methodology, April 2011-13, low-pay weights, including those not on adult rates of pay, UK.

Notes:

- a. Prior to 2004, all our analyses were conducted in ten pence pay bands using the ONS central estimate methodology. In contrast to elsewhere in this report, where five pence pay bands are used, we use ten pence pay bands in this table.
- b. Direct comparisons before and after 2004; those before and after 2006; and those before and after 2011, should be made with care due to changes in the data series.

6.34 We also consider the relationship of the NMW to median earnings in an international context. Figure 6.5 shows that the UK bite sits broadly in the middle of the bites in the OECD comparator countries that we have tracked since 1999.

Figure 6.5: Adult Minimum Wages Relative to Full-time Median Earnings, by Country, 2012



Source: OECD estimates based on OECD minimum wage database and median earnings for full-time workers, 2012.
 Note: Average value of minimum wage in each year.

6.35 To summarise the changing value of the NMW, two trends – superficially though not actually divergent – have occurred during the economic slowdown of recent years: on the one hand the worth of the minimum wage to those receiving it has fallen, even as, on the other hand, the minimum wage has risen faster than other wages. The Commission is concerned by both of these trends. Neither of them is sustainable indefinitely, but one or both is inevitable for as long as inflation exceeds average earnings growth.

Employment Impacts of the National Minimum Wage

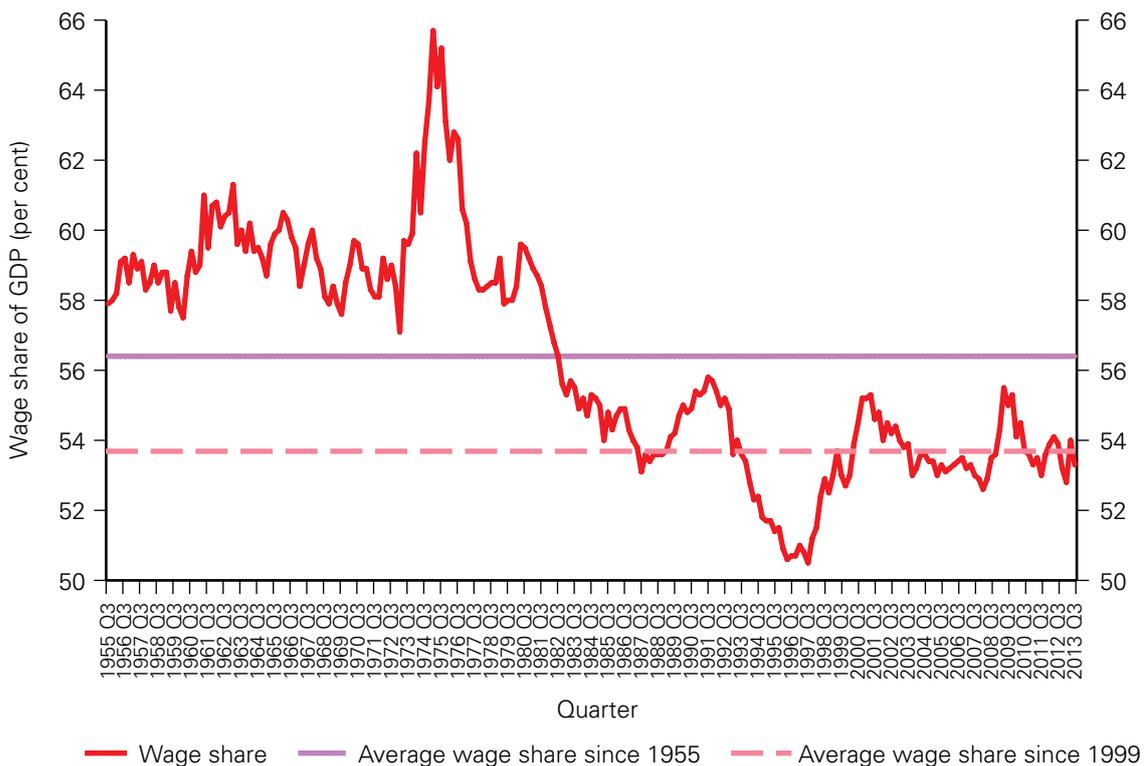
6.36 Since 1999 the Low Pay Commission has commissioned over 130 research projects that have covered various aspects of the impact of the National Minimum Wage on the economy. In that period the low paid have received higher than average wage increases but the research has, in general, found little adverse effect on aggregate employment; the relative employment shares of the low-paying sectors; individual employment or unemployment probabilities; or regional employment or unemployment differences. The research suggests that employers have coped with the minimum wage by adopting a combination of strategies. Pay structures may have been adjusted or non-wage costs reduced. There may have been small reductions in hours worked and increases in productivity. We monitor hours worked in order to understand how rises in the hourly NMW rate feed into weekly wages. To the extent that there may have been small reductions in hours worked these have not been enough to leave affected NMW workers no better off.

6.37 In addition some prices may have been increased and profits squeezed but these reductions in profits have not been sufficient to lead to an increase in business failure. Business creation may also have slowed. Our most recent research has not altered these findings although it has refined our understanding, for example of the propensity of some employers to set wage rates at round numbers. However, adverse employment effects have been found by research into the experiences of other countries (such as Neumark and Wascher, 2008), where minimum wages have represented a higher proportion of median earnings than here; or where they have not had separate rates for young people.

The Wage Share of Income

6.38 Part of the context for these changes is a longer-term fall in the share of national income which goes in wages. At around 54 per cent the wage share of GDP, shown in Figure 6.6, is lower now than it was in the 1960s and 1970s, when it averaged around 59 per cent. It rose sharply in the mid-1970s, reaching over 65 per cent, before falling back. It then fell sharply to just above 50 per cent before rebounding after 1997. It has fluctuated at around 54 per cent since 1999.

Figure 6.6: Wage Share of GDP, UK, 1955-2013



Source: LPC estimates of the wage share calculated using ONS data: Total compensation of employees (DTWM) as a proportion of GDP (YBHA), seasonally adjusted, quarterly, UK, 1955-2013.

6.39 The decline in the wage share is not restricted to the UK. It is a common feature across most economically advanced countries. The TUC (2013) showed that the wage share had generally fallen across many countries between 1970 and 2007. Using available data from the OECD, we estimate that the labour share across OECD countries fell from an average of over 70 per cent in the 1970s to around 67 per cent in the 1980s, 64 per cent in the 1990s and under 62

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per cent in the 2000s. It has slightly increased since the global downturn in 2008 to around 63 per cent.

- 6.40** Within that falling wage share, there have been significant differences across earnings groups. Between 1975 and 2000 those in the bottom decile saw their wages rise much more slowly than those at the median, who in turn had smaller increases than those in the top decile. The introduction of the NMW has helped stabilise the gap between the top and bottom deciles since that period. It should be noted that it is the top 1 per cent, or more specifically, the top 0.1 per cent, that have had the greatest increases in earnings and income over the last twenty years.

Labour Costs and Take-Home Pay

- 6.41** The Secretary of State has asked us to consider in our assessment government policies that affect the labour costs and take-home pay of people on the National Minimum Wage. Impacts on take-home pay are complex and we set out in Annex B our analysis of the effect that these have had since 2001 as context for the role they might play in future, which we consider later in this chapter. Our findings are below, before our examination of the impacts on labour costs for employers.

Take-Home Pay

- 6.42** Take-home pay represents an employee's net pay – what is left after deductions for income tax and National Insurance contributions (NICs). On average, NMW workers worked around 26 hours per week in April 2013. The hourly distribution of minimum wage workers is very different to that of more highly-paid workers. It has a bimodal structure with 23 per cent of minimum wage workers working 9-16 hours and about 19 per cent working 36-40 hours per week. In contrast, over 52 per cent of non-minimum wage workers work 36-40 hours a week with only 21 per cent working 25 hours or fewer. This influences the extent to which changes in income tax and NICs thresholds affect minimum wage workers.
- 6.43** Around a third of minimum wage workers work 16 hours or fewer. Those working these hours do not earn enough to pay income tax or make National Insurance contributions. Another 10-11 per cent of workers, working around 20 hours a week, were drawn into the income tax and NI system between 2004/05 and 2010/11. The raising of the personal tax and NI thresholds since 2010/11 means that those now working up to around 25 hours a week no longer pay income tax but those working 25 hours a week do make small contributions to NI. Thus, by the 2013/14 financial year, around 54 per cent of NMW workers no longer paid any income tax or National Insurance. Our analysis assumes that all NMW workers work 52 weeks a year, which means that it may overstate to a degree the impact of income tax on NMW workers.
- 6.44** Take-home pay (cash in the pocket) is likely to matter most to workers. Between 2001/02 and 2006/07 the increase in the hourly take-home pay of NMW workers rose faster than both measures of inflation (RPI and CPI) but was generally similar from 2006/07 to 2009/10, except for the anomaly produced when RPI inflation was briefly negative. Although recent increases in the NMW have been below inflation, the changes in income tax and National

Insurance since 2010 have resulted in the effective take-home pay of many NMW workers (those working more than 25 hours a week) increasing faster than inflation. However, 45 per cent of NMW workers have not benefited from income tax and NI changes because they work 20 hours or fewer a week. Another 11 per cent do not work enough hours to have benefited from the most recent increases in personal tax allowances in 2013/14. Therefore around 56 per cent of NMW workers received a cut in real take-home pay in 2013/14, but for around 44 per cent it maintained or increased its value.

6.45 However, real take-home pay is not the same as real disposable income, which may be affected by tax credits and other in-work benefits as well as the impact of changes in other forms of taxation and regulated prices. Benefits are generally assessed at the household level, whereas our analysis above has been limited to individuals. An assessment of the impact of changes including those to in-work Tax Credits, eligibility for Council Tax and Housing Benefit, and indirect taxes such as VAT would be necessary to draw conclusions about changes in the real disposable income of the lowest paid. The complexity of the tax and benefits system and the availability of appropriate data sources make it very difficult to assess the impact of these changes on NMW households. Research from the Joyce (2012), Joyce and Phillips (2013) and Brewer and De Agostini (2013) tends to suggest that for those at the bottom of the income distribution such changes have negatively affected real disposable income. This is also indicated by analysis that supplemented the Autumn Statement. HM Treasury (2013e) showed that the cumulative impact of the tax and benefit changes would have a net negative effect on the bottom four deciles of household income. Brewer and De Agostini (2013) concluded that, after the changes to Universal Credit and personal tax allowances had been included, a ten per cent rise in the minimum wage would lead on average to a 3 per cent increase in net income.

6.46 We aim to understand the effect of government measures on take-home pay to improve our overall understanding of the position of the low paid. These measures may also affect incentives to find work, and hence labour supply. However, we do not take account of the effect of employees' tax and National Insurance on take-home pay in recommending minimum wage rates, because they do not alter what employers can afford to pay or the level of the minimum wage the economy can bear without employment impacts.

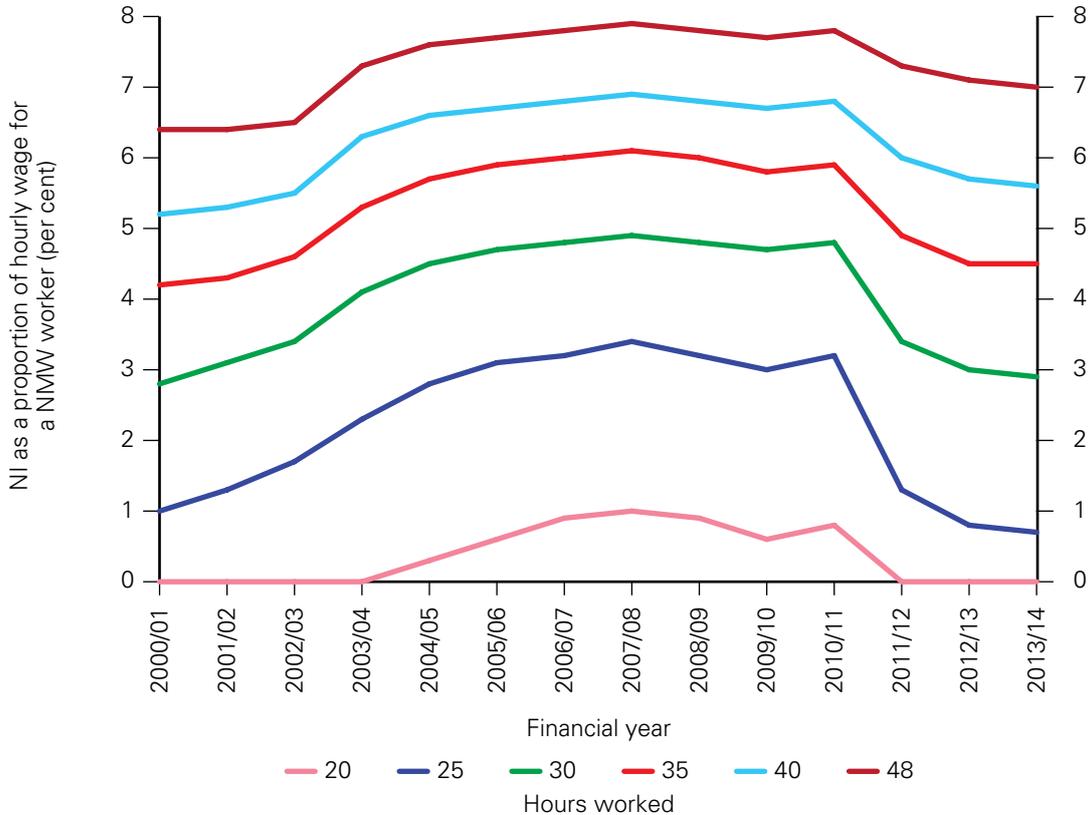
Labour Costs

6.47 We are, however, concerned about labour costs. National Insurance is levied on workers and employers. The thresholds have a similar structure but the rates differ. They are higher for employers. Figure 6.7 shows that the direct costs to employers of employing a NMW worker rose during the mid-2000s but have fallen back since 2010/11. It also shows that, in terms of National Insurance, it is more costly per hour to an employer to employ a full-time NMW worker than a part-time one. Recent changes to the NI thresholds have taken those working 20 hours or fewer out of the system and reduced the cost of employing those working between 25 and 35 hours a week back to similar rates as in 2000/01. The recent reductions in NI for full-time NMW workers have not been sufficient to reduce the costs back to those experienced in 2000/01. They may however have had some positive impact on the employment of lower-paid workers. It should be noted that this analysis does not take

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account of indirect costs such as annual leave entitlement and pension contributions. However, these indirect costs are not trivial and appear to have increased over time.

Figure 6.7: Labour Costs for Minimum Wage Workers by Hours Worked, UK, 2000-14



Source: LPC calculations based on Employer NI thresholds and rates, in nominal terms, UK, 2000-14.

- 6.48** Government measures that affect employer costs are of interest to the Commission in that they affect affordability. They are, however, exceedingly difficult to assess in aggregate, and in terms of how they bear on or support businesses in different sectors or by size of firm.
- 6.49** The employer is concerned about real as well as nominal costs. For an employee, the real wage should be considered in terms of consumer inflation, measured using the CPI or RPI. This will determine what the wage earner can buy with their wage. We call this the real consumer wage. However, consumer prices are not necessarily the appropriate prices to consider for an employer. Not all firms sell direct to consumers. Employers are concerned about the price of their outputs, and they are concerned about how these costs are changing relative to the costs of the output produced by the labour employed. Changes in the price of output can be measured using the GDP or gross value added (GVA) deflators, and used to express the wage in real terms for the employer, the real product wage. It makes little difference to this analysis which deflator we use. For the section that follows we use the GDP deflator.

6.50 As well as the wage, employers will also consider the non-wage costs of labour. This can be measured using compensation of employees (that includes other labour costs such as NICs and pensions). Figure 6.8 shows how consumer and product wages have changed over the last 14 years. Since the introduction of the NMW in 1999, the real product wage has generally increased faster than the real consumer wage. Both the product and consumer wage increased up to the end of 2007, but since the onset of recession, the real product wage has remained around 13 per cent higher than it was in 1999. In contrast the real consumer wage increased by around 10 per cent between 1999 and 2009 but has since fallen back and is now only 1.5 per cent above its level in 1999. Over the same period, real product compensation (taking account of employers’ social contributions as well as wages) has risen by nearly 20 per cent. This shows that although the real consumer wage has fallen since 2009, the real product wage has been relatively constant and real product compensation has risen slightly, which would tend to reduce the scope to increase wages.

Figure 6.8: Real Consumer and Product Wages, UK, 1999-2013



Source: LPC estimates based on ONS data: Real RPI consumer wage is Wages and Salaries (ROYJ) per employee job (BCAJ) deflated by RPI (CHAW), the real product wage is Wages and Salaries (ROYJ) per employee job (BCAJ) deflated by the GDP deflator (YBGB), and the real product compensation is total compensation of employees derived from wages and salaries (ROYJ) and employers’ social contributions (ROYK) per employee job (BCAJ) deflated by the GDP deflator (YBGB), UK, 1999-2013.

Note: The product wage and product compensation are deflated by the GDP deflator.

Part 2: Conditions Needed for Faster Increases in the National Minimum Wage

6.51 Part 2 covers:

- stakeholders' views on the conditions needed for faster NMW increases (paragraphs 6.55-6.64);
- the general conditions in the economy conducive to faster NMW increases, including:
 - inflation and the role of the Monetary Policy Committee of the Bank of England in determining the real value of the NMW (paragraph 6.68);
 - the importance of productivity (paragraphs 6.69-6.74);
 - the role of increased demand in the economy (paragraph 6.75); and
- previous experiences of faster increases in the National Minimum Wage (paragraphs 6.76-6.78).

6.52 The next section, from paragraph 6.79, discusses the sectoral conditions for faster increases in the NMW, which focuses on the low-paying sectors and includes the significance of:

- labour costs (paragraphs 6.82-6.85);
- short-term market adjustments (paragraphs 6.86-6.87);
- market characteristics (paragraphs 6.88-6.91);
- impact on differentials (paragraph 6.92);
- non-labour costs (paragraphs 6.93-6.94); and
- statutory requirements (paragraphs 6.95-6.96).

6.53 Part 2 ends with comments on implications of a higher bite for the low-paying sectors (paragraphs 6.97-6.101).

6.54 First we set out below the views we have received from stakeholders. When we received the Secretary of State's request that we carry out this additional assessment we extended the deadline for responses to our consultation on the 2014 minimum wage to allow stakeholders to let us have their views on the request. We are grateful to all who commented.

Stakeholder Views

6.55 A number of business representatives commented on the additional assessment and several common themes emerged. Businesses were clear that there would have to be a real and sustained recovery of both productivity and employment across the economy, including within the sectors most affected by the minimum wage. Some argued that there were other policies which should be brought into play to help increase living standards, not just increases in the minimum wage.

6.56 The CBI said there were three essential economic outcomes which had to be prioritised ahead of increases in the NMW. Addressing these would lead to a wider recovery in wage growth and it would expect the NMW to keep in step with this. The three outcomes were: a broad-based economic recovery; evidence of material productivity improvements; and a significant reduction in the unemployment rate. UK Fashion and Textiles also said unemployment should be falling dramatically (to well below 7 per cent) and it also wanted to see strong evidence that average earnings were rising faster than basic rate earnings.

6.57 British Chambers of Commerce said stronger growth and faster falls in unemployment were needed – and not just falls in unemployment driven primarily by increases in inactivity. The Textiles Services Association said there would have to be consistently higher levels of economic growth and consistently lower levels of RPI inflation. EEF, the manufacturers’ organisation, said the NMW should be increased in line with basic rates of pay across the economy. It said there may be occasions when businesses could afford a stronger increase, but for this to happen, there would need to be broad-based sustainable growth in both employment and productivity.

6.58 EEF also said there should be a broad-based approach to improving living standards and that government policy should take steps to create a more productive and more flexible workforce. The CBI said that skills needed to be addressed. It said the low skilled were more likely to be unemployed and earn less and it wanted to see the education system achieve academic rigour and once in work, individuals maintain and develop skills that supported progression.

The owner believed the recent recession was worse than in the 1990s...he wanted to give more to staff but the business couldn't afford to in difficult times.

Meeting with hospitality business, Commission visit, 2013

6.59 Representatives from the hospitality sector said there had to be a clear and stable trend in the economy over at least a year; there had to be confidence about economic circumstances two years ahead; and job creation in the low-paying sectors attributable to increased business activity. The Association of Convenience Stores said wages were determined by the profitability of businesses and general performance and retention of staff. Attempting to set them by any external monetary indicator did not meaningfully reflect the performance of a business and the wage rates they could afford. Those representing businesses in sectors which rely on public funding (e.g. social care and childcare) said increases in the fees paid to service providers would be necessary to enable wages to be increased.

6.60 There was a degree of overlap between employer and union representatives in the key economic indicators each thought we should take into account when judging the scale and pace of recommended future NMW upratings. However, unions generally interpreted these data as indicating there was more room than employer groups saw for higher increases in the NMW. In addition, unions thought our assessment should be more responsive to recent

They reiterated the fragility of the recovery and that they could not accommodate sharp increases in the NMW.

Meeting with hospitality businesses, Commission visit, 2013

changes in household needs, which had been increased by falling real wages. They also thought the exchequer saving from a higher minimum wage, resulting from a reduced subsidy to low-paying employers, should be considered.

6.61 The Union of Shop, Distributive and Allied Workers (Usdaw), in line with evidence we received from other union bodies, thought the case for significant improvements in the NMW was currently supported by improvements in key economic indicators, referring to forecasts of employment growth, the level of unemployment and GDP growth. It suggested that we focus on these and then we may well agree that the NMW could rise by more than current conditions allow. Usdaw suggested that as the economy picked up our cautious approach could be lifted.

6.62 The Trades Union Congress (TUC) also thought the strength of the existing recovery already provided significant scope for the NMW to increase more quickly than in recent years, and that the additional assessment task aimed to allow us to consider the conditions which would allow a faster increase than would currently be feasible within the current terms of our remit, i.e. than would be possible even as a strong recovery unfolds. The TUC looked at ways which could enable higher NMW rises, and would like to see the Government take a more proactive role in supporting low-paid industry to secure productivity

gains by, for example, helping to raise skill levels. In sectors where increases in productivity were neither attainable nor desirable (care provision for example), the Government could help in other ways, by identifying new sources of public funding or taking new approaches to public sector contracting. The TUC did not accept that take-home pay should be taken into account when considering the scope for faster increases in the NMW, because it did not capture the impact of other factors like rises in indirect taxes or benefit reductions, and so was not an appropriate measure of household incomes. However, it thought some sectors could already pay a higher NMW and that there may be a case for charging the Low Pay Commission with overseeing a process for setting additional NMW premia (to apply to particular sectors), or for us consulting on the pros and cons of introducing an appropriate London weighting to the NMW.

6.63 A number of unions thought we should take into account the effect of relatively small upratings, in the context of rising prices, leading to falls in real income. GMB's call for fair wages in order to close the gap between pay and the cost of living was typical of the approach of many unions. UNISON told us that the current level of the NMW was failing workers across the UK and a significantly higher NMW, raised in stages towards the living wage, was the right thing to do in moral terms, and to boost the economy. It was affordable and would produce savings to the Treasury. Unite supported such a move towards the living wage level, better reflecting real living costs.

They explained that for people receiving the NMW it was important that their pay should not lose real value as they have less scope to accommodate that."

Meeting with trade union members, Commission visit, 2013

6.64 The Communication Workers Union also called for the NMW to be transformed into a living wage. In examining which longer-term conditions would allow for further increases in the NMW, it believed we should look not only to sector profitability and medium and longer-term economic forecasts, but also to projections for in-work poverty rates, the real value of the NMW in relation to inflation and qualitative evidence of the experiences of families living on low wages.

He thought the Commission should be bold. The NMW had started at a low level and now was the time to 'experiment upwards'. Companies in his sector were making large profits but paying staff low wages 'because they can'.

**Meeting with union officer,
Commission visit, 2013**

General Economic Conditions for Faster Minimum Wage Increases

6.65 We distinguish between increases in the real value of the NMW which take place when the NMW and wages generally are rising faster than inflation, but broadly in line (and when the bite remains more or less constant); and increases in the real value of the NMW greater than increases in average wages, so that the bite rises. In this section of the chapter we focus on increases that would not raise the bite, and examine the general economic conditions conducive to such increases.

6.66 We start by noting the significance of inflation, and then outlining the conceptual framework within which we consider the scope for real increases in the minimum wage. Productivity, i.e. how much workers produce, is central to this assessment and we set out our approach to that below. Of course we also take into account factors affecting the supply and demand for labour since movements in either of these may tend to put upward or downward pressure on wages.

6.67 We consider demand factors later in the section. Those affecting the supply of labour include: population growth influencing the working age population (which also increases demand for goods and services); changes in inward and outward migration; and alterations to the ages at which workers enter or leave the labour market, for example through changes in the ages at which younger workers leave education, or at which older ones retire. We take account of all of these, through consideration of the employment rate, in arriving at our recommendation for the rate of the NMW.

Inflation and the Monetary Policy Committee

6.68 The real value of the minimum wage is a function of inflation as well as of the level of the NMW. Therefore an objective of supporting real increases in the NMW engages both minimum wage policy and policy towards the management of inflation. The Bank of England's Monetary Policy Committee (MPC) has responsibility for managing inflation. The MPC has published forward guidance outlining the circumstances in which it may raise the Bank Rate. The forward guidance has only an indirect relationship to our recommendations for future NMW rates, as a factor bearing on expectations for inflation. We discuss the scope for forward guidance in relation to the minimum wage at paragraphs 6.129-6.136 below.

Productivity

- 6.69** We share the widely held view, expressed by many stakeholders from both employer and worker standpoints, that a sustained increase in workers' compensation depends on increased productivity – for increases in compensation to be sustainable they must be affordable, which generally requires an increase in overall output (and revenue) per head at a given level of employment.

Wages and Productivity

"...The MPC's November Inflation Report reiterates the link between wages and productivity, and the Governor of the Bank of England has stated that "ultimately the growth in real wages is going to be determined by recovery in productivity in this economy" ... The OBR in their Economic and Fiscal Outlook December 2013 also state that "productivity growth is the only sustainable source of real income growth in the long term"..."

The Chancellor's Autumn Statement, 5 December 2013, paragraph 1.27

- 6.70** The theory of labour demand underpinning this view states that the number of workers in a firm will be determined by the point where the value of additional output produced by workers (the value of their marginal productivity) equals their wage. In competitive labour and product markets, when wages equal the value of marginal productivity firms would not want to adjust employment and the labour market will be in equilibrium (labour supply equals labour demand). If wages are lower than the value of marginal productivity, firms can make profits from hiring additional workers and so would take on more workers until the point where there is no gap between wages and the additional value of output. Conversely, when wages are above the value of marginal productivity, they will shed labour until they return to the point where wages equal the value of what the marginal worker can produce.
- 6.71** Of course, this theoretical relationship between productivity and workers' compensation carries several caveats. It assumes perfectly competitive labour and product markets, which in practice are imperfect. Indeed the NMW itself represents a recognition of this, as we noted at paragraph 6.12 above, and while productivity determines what an employer can pay, market power may enable him or her to retain an excess share. Moreover, while it may be generally true that productivity increases are necessary for sustainable rises in compensation, exceptions are not hard to find and behaviours may follow different patterns in the short term. It is however the case that, at the level of the economy and viewed over the long term, a sustainable increase in real compensation in the economy depends on productivity gains – as the Bank of England and Office of Budget Responsibility observe, in the box above.

The company had a number of concerns if the NMW was increased in 2014...it would reduce further the level of spare cash for investment.

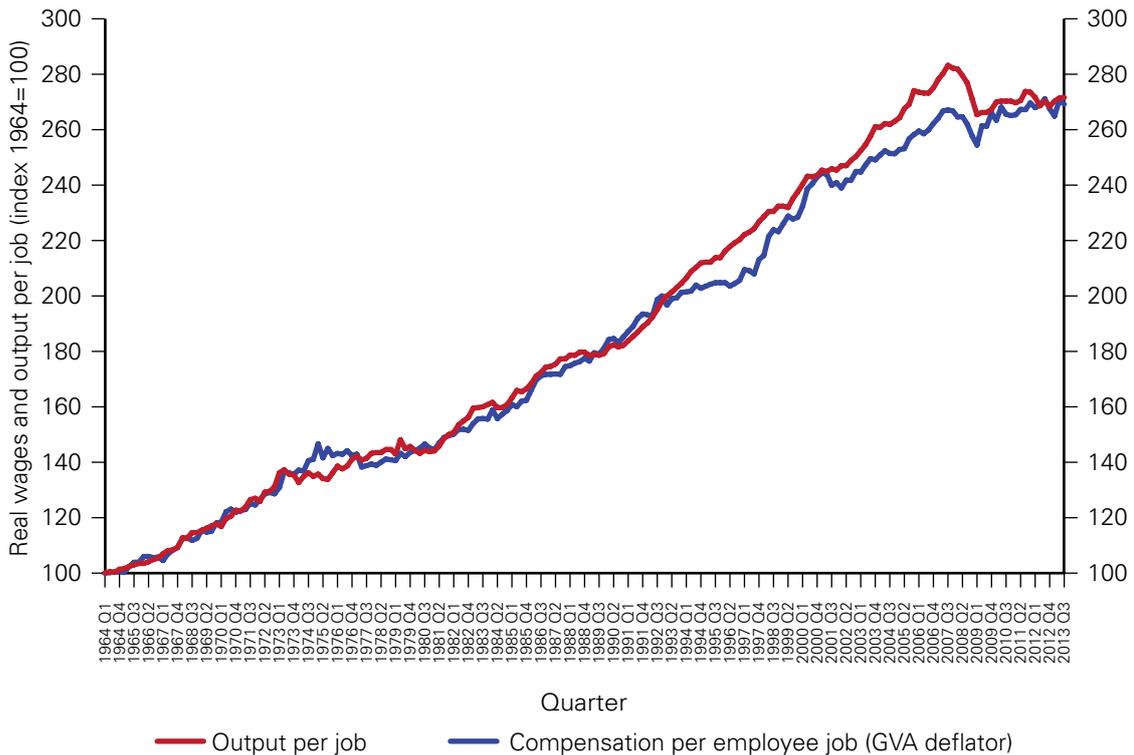
Meeting with manufacturing business, Commission visit, 2013

- 6.72** Over the long run it is therefore important to monitor changes to wages in seeking to understand changes in productivity in the economy. Moreover a key consideration in recommending the level of the minimum wage is the relationship between the NMW and wages elsewhere in the economy. By giving close attention to the path of average wages we gain insight into labour productivity across the economy, while also placing the minimum wage in the context of wages more broadly.
- 6.73** However, while increased productivity (properly measured or recognised) is a necessary condition for sustained increases in the real value of the minimum wage, it is not a sufficient condition. As indicated above, our aim is to help as many workers as possible without an adverse impact on employment prospects. It is possible for firms to increase productivity per worker by shedding less productive workers – the ‘batting-average effect’ whereby output is lower and fewer people have jobs, albeit that those in jobs have higher productivity. Gains in productivity per worker of this sort would not prompt us to recommend corresponding increases in the minimum wage because we would not thereby meet our aim of helping as many workers as possible, or of avoiding adverse employment effects.
- 6.74** In other words it is increases in productivity in the context of stable or rising employment that matter. Data on and forecasts of employment are central to our judgement of the optimal NMW rate. We examine not only headline data, but those relating to the employment performance of the low-paying sectors to understand the labour market affecting the lowest paid, and we pay close attention to forecasts for changes in employment.

Productivity and Wages: Recent History

We have suggested that over the longer term and at the level of the economy wages are determined by productivity. While productivity increases are a prerequisite for sustained real wage growth, some economists have argued that wages have failed to match rises in productivity in recent years. Our assessment is that much of the difference disappears when total employee compensation, i.e. all elements of remuneration including non-wage items such as pension contributions, are included, as Figure 6.9 shows. However, workers have not seen their real wages increase proportionately with productivity, for several reasons. One is that an increase in the non-wage component of compensation, principally increased employer pension contributions, is not received in the current pay packet. A second is that consumer price inflation, which determines the real spending value of wages, has exceeded product price inflation, which is used to determine the real cost of wages to employers. Third, increased inequality means that although average (i.e. mean) compensation in the economy has tracked productivity, over the life of the NMW a bigger share of the overall growth in compensation has gone to the highest earners. The implication is that average compensation for the economy as a whole has risen more than the compensation of lower-paid workers.

Figure 6.9: Employee Compensation and Productivity Growth, UK, 1964-2013



Source: LPC estimates based on ONS data: Output per job (LNNN); and compensation per employee job (DTWM divided by BCAJ) and deflated by the GVA deflator (CGBV), quarterly, seasonally adjusted, UK, 1964-2013.

Increased Economic Demand

6.75 We of course pay close attention to the prospects for overall growth in the economy, which depend critically on the stage of the business cycle, and also on world economic conditions. A general increase in the level of demand in the economy will likely necessitate an increase in domestic output to meet that demand. In turn, firms will utilise more inputs to generate that output. One of those inputs will be labour. An increase in the demand for labour will put upward pressure on wages. Similarly, increased demand in certain sectors can lead to increased demand for labour and thus increases in wages in these sectors.

Previous Experience of Faster Increases in the National Minimum Wage

6.76 In the preceding paragraphs we have summarised the conceptual framework which we have in mind when assessing the scope for real increases in the minimum wage. Here we briefly set the above-inflation increases in the NMW between 1999 and 2007 in the context of these considerations.

6.77 Many of the factors we have highlighted above as conducive to real increases in the NMW were in place between 1999 and 2007, a period when the NMW not only rose in real terms, it also grew faster than median wages so that it was a period when the bite increased:

- average labour productivity rose: output per filled job increased 2.2 per cent a year between 1999 and 2008 (see Figure 6.9 above), while output per hour increased at 2.5 per cent a year;

- real wages rose, as pay settlements and average earnings growth in general exceeded inflation over the period. Between 1999 and 2006, the median of pay settlements was around 3 per cent, picking up to 3.5 per cent between 2006 and mid-2008. Positive pay drift saw average earnings growing at around 4-4.5 per cent between 2000 and mid-2008. Price inflation rose on average by 1.4 per cent (CPI) and 2.5 per cent (RPI) between 1999 and the end of 2006. Although inflation picked up in 2007 it remained below the increases in average earnings. Thus 1999 to 2007 was characterised by a period of real wage growth, an average of 2.8 per cent a year (in CPI terms) and 1.7 per cent (in RPI terms). Moreover pay growth was similar across different sectors, sizes of firms and age groups;
- employment rose – employment increased by over 2.5 million (around 9.4 per cent) between April 1999 and May 2008. Over the same period the working age employment rate increased from 71.8 to 73.0 per cent – growth in employment outstripped the growth that took place in labour supply; and
- GDP grew relatively strongly. Growth averaged 3.1 per cent a year between the second quarter of 1999 and the first quarter of 2008.

6.78 In this section we have commented on the general economic conditions conducive to increases in the real value of the NMW which take place when wages generally are rising faster than inflation, emphasising the centrality of productivity gains to sustainable real wage increases. The presence of many of these conditions enabled the Commission to follow a policy of recommending increases above inflation in the period up to 2007, which meant that the lowest paid shared in the gains of economic growth at the time.

Sectoral Conditions for Faster Minimum Wage Increases

6.79 We distinguished above between the minimum wage increasing alongside other wages, and increases in the real value of the NMW which exceed any increases in average wages, so that the bite rises.

6.80 Sector-specific factors are an important dimension in considering the conditions which need to be in place for the minimum wage to increase faster in both senses. Some of the constraints on increasing wages reflect the characteristics of particular sectors, their markets, and their low-paying occupations. These constraints vary in significance from one sector to another, and also in the extent to which they might be eased by government policy measures. Taken together they are critical to the capacity and potential of the low-paying sectors – on which the majority of low-paid workers depend for employment – to accommodate faster rises in the NMW without adverse employment effects.

6.81 In this part of the chapter we examine the nature of these constraints, focusing on those affecting low-paying industry sectors which employ 4 per cent or more of minimum wage workers (childcare, cleaning, hospitality, retail, social care) or where minimum wage workers account for a third of the employees in a sector (hairdressing). We recognise that other low-paying sectors may also be affected by

Paying above the NMW was important to the business to help retain staff.

Meeting with day nursery, Commission visit, 2012

National Minimum Wage

specific constraints. Furthermore, it should be noted that around a quarter of minimum wage workers do not work in the low-paying sectors but are distributed across the whole economy. In addition, there are parts of the public sector, in particular local government, where several years of pay restraint has meant the minimum wage has now started to meet the bottom points on pay scales. Without employer action, the NMW would have recently caught up with the lowest hourly rates paid by some local authorities.

Significance of Labour Costs

6.82 Other things being equal, sectors where labour costs account for a larger share of business turnover will tend to be proportionately more affected by increases in those costs than other sectors. The data shown in Table 6.2 below are indicative rather than definitive because the composition of costs varies from firm to firm within a sector according to factors such as the extent of automation, and because there are no authoritative official data on the share of turnover spent on labour costs. Nonetheless they do illuminate the importance of labour costs, and by extension the minimum wage, in these low-paying sectors. Other data for these costs are available from other sources, in particular from trade associations, and these may differ from the ONS Annual Business Survey figures given in the table, and are often higher.

Table 6.2: Labour Costs in Low-paying Sectors, UK, 2013

	Labour costs as share of turnover (ABS) (%)	Proportion of total minimum wage jobs (%)	Minimum wage jobs in sector (000s)	Proportion of jobs in sector paid at minimum wage (%)
Hospitality	29	25	331	25
Retail	11	21	278	10
Cleaning	48	7	88	31
Social Care	61	7	87	9
Childcare	62	2	24	15
Hairdressing	37	2	26	30

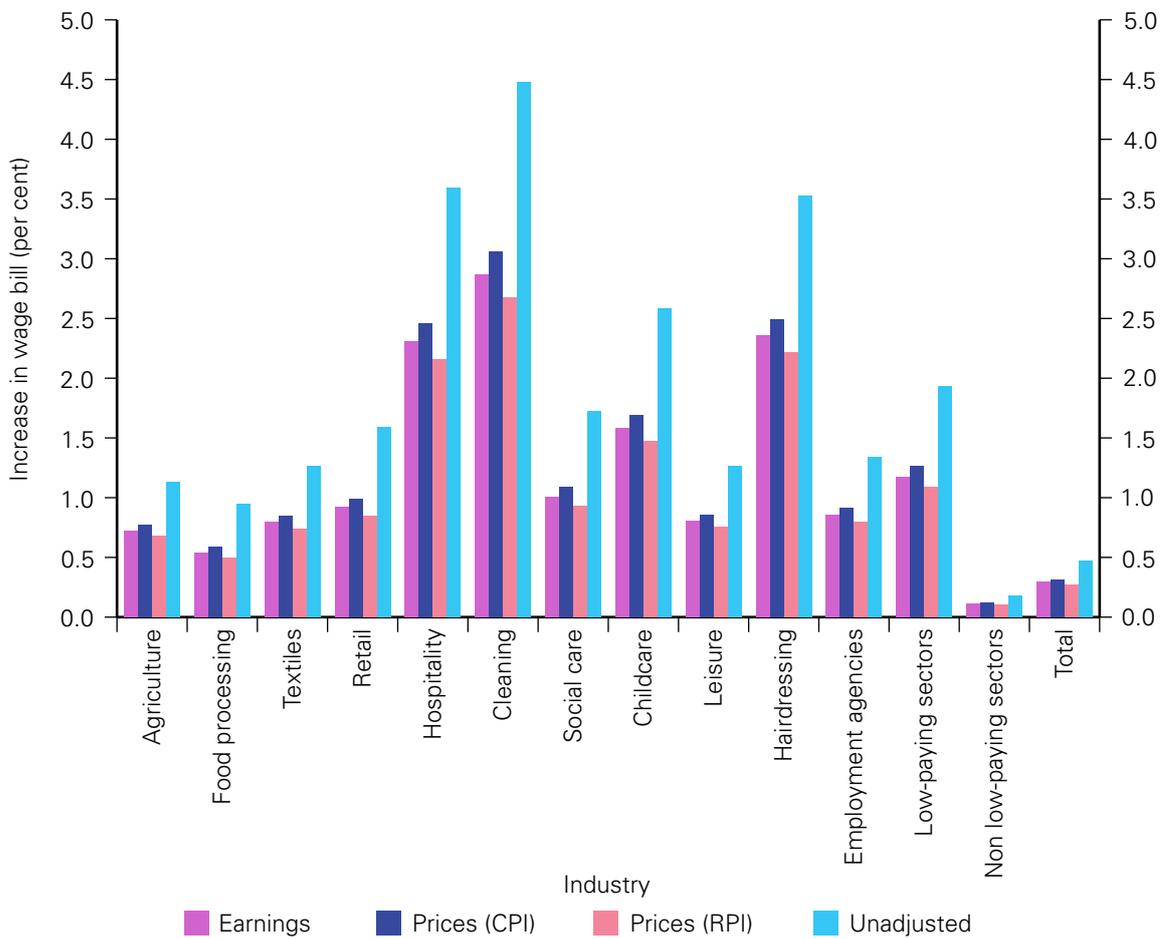
Source: LPC estimates are based on the ONS Annual Business Survey (ABS), 2012, UK; and ASHE 2010 methodology, low-pay weights, including those not on adult rates of pay, UK, April 2013

6.83 In all the sectors discussed here minimum wage jobs account for at least 10 per cent of jobs (with the exception of social care at 9 per cent, which may be subject to reporting error⁷ – estimates derived from other data sets put the figure considerably higher and our own internal Low Pay Commission estimate is that it could be up to 12 per cent). This means that, in general, minimum wage jobs are likely to be too large a part of the cost base for wage rises to be affordable without material increases in a firm's revenue, particularly as such increases are likely to create pressures to increase the pay of other workers in order to protect differentials (see paragraph 6.92 below).

⁷ Domiciliary care workers are typically paid an hourly rate for client contact time, which employers may report in the Annual Business Survey as the hourly rate they pay to employ their carers. However the unpaid time these carers spend travelling between clients needs to be factored in to determine their actual hourly pay, and this will be closer to the NMW (or below it) for many of these workers.

6.84 We can estimate the impact of restoring the real value of the NMW on changes in the wage bill for each sector. In order to do this, we need to make an assumption about the counterfactual – how wages might change in the absence of any increase in the NMW. To provide a range of estimates we use the median of HM Treasury Panel of Independent Forecasts for CPI, RPI and average earnings growth. We set this alongside an assumption that wages have not changed since April 2013. As shown in Figure 6.10, irrespective of our counterfactual wage assumption, the estimated impact of the restoration of the real NMW is, not surprisingly, greater for the low-paying sectors (over 1 per cent of the wage bill) than the rest of the economy (around 0.1 per cent). The increase in wage bills would be particularly large in cleaning, hospitality, hairdressing and childcare. Further, these estimates do not include any impact on differentials and thus may underestimate the full impact.

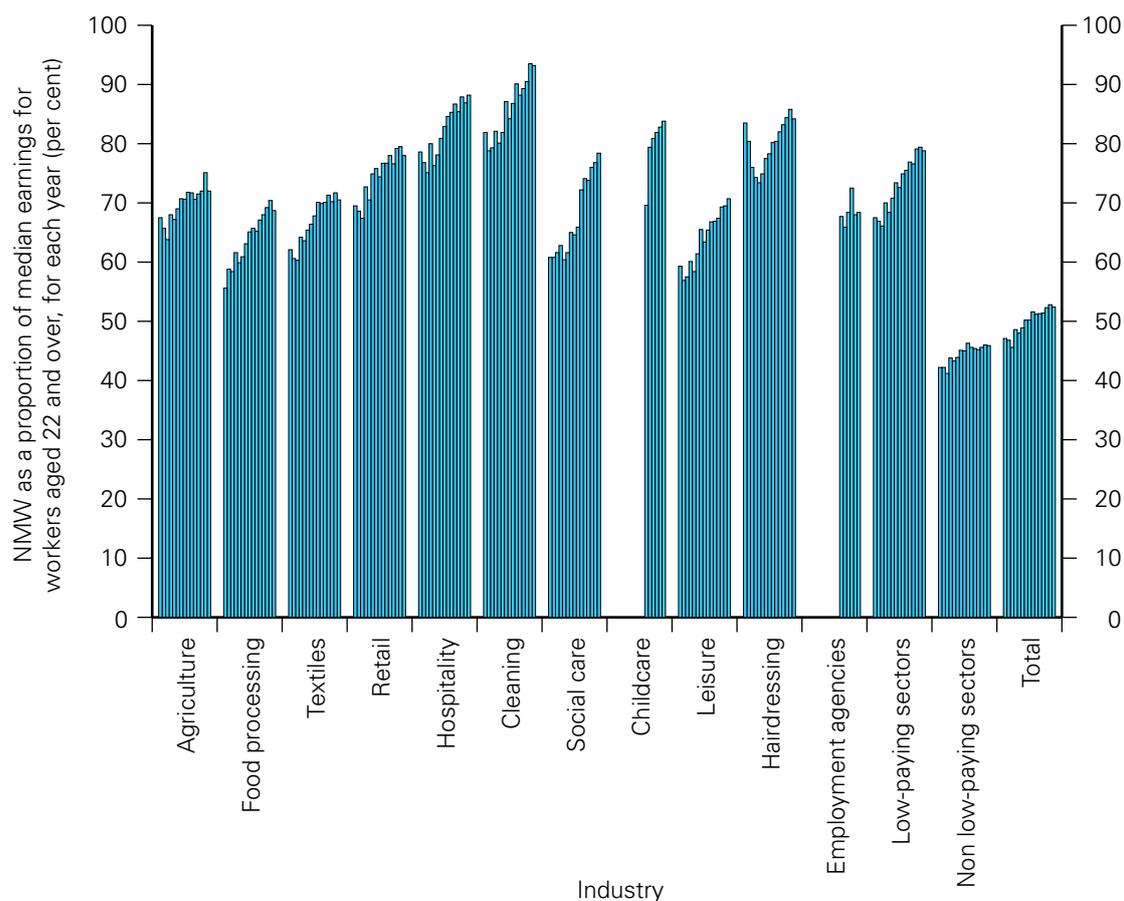
Figure 6.10: Estimated Impact on Wage Bills of Restoring Real Value of the National Minimum Wage, UK, 2013



Source: LPC estimates based on ONS ASHE 2010 methodology data, UK, April 2013 and HM Treasury Panel of Independent Forecasts for CPI, RPI and average earnings growth (January, 2014).

6.85 The size of the sectoral bite – the NMW as a proportion of the median wage for each sector – is one way to understand the impact of the minimum wage in these sectors. This is shown in Figure 6.11. The bite in low-paying sectors has increased steadily in recent years, with a small fall in 2013 for some.

Figure 6.11: Bite of the Adult National Minimum Wage for Workers Aged 22 and Over, by Low-paying Industry, UK, 1999-2013



Source: LPC estimates based on ASHE: adjusted earnings without supplementary information, April 1997-2004; with supplementary information, April 2004-06; 2007 methodology, April 2006-11; and 2010 methodology April 2011-13, standard weights, including those not on adult rates of pay, UK.

Notes:

- a. Definitions for the low-paying industries are based on Standard Industrial Classification (SIC) codes. Data from 1999-2007 are based on SIC 2003 codes. Data from 2008-12 are based on SIC 2007 codes.
- b. Data on childcare and employment agencies industries were not available before 2008.
- c. ASHE data have been adjusted to take account of methodology changes to provide a consistent time series.

Short-term Market Adjustments

- 6.86** Hospitality, retail and hairdressing are heavily reliant on consumer spending, and sensitive to shocks affecting consumers. They experience an immediate impact when consumers curtail discretionary spending as a result of factors that reduce, or consumers fear will reduce, their income. For example, ONS data for the wholesale and retail sectors indicate that between the second and fourth quarters of 2008, Gross Value Added for the sectors fell almost 8 per cent. The next biggest change across two quarters in the period since 2008 was an increase of 3.9 per cent between the fourth quarter of 2012 and the second quarter of 2013.
- 6.87** The cleaning sector is vulnerable to shocks which also affect businesses, or are transmitted to businesses by reduced consumer spending. It is affected when businesses cut back on non-core activity. Since the onset of recession in 2008 we have heard repeated accounts from firms in the cleaning sector of reduced demand from clients, or the re-negotiating of

contracts, responding to reductions in income. In childcare, the economic downturn has affected parents' use of childcare and ability to afford fees.

Market Characteristics

6.88 Hairdressing is characterised by low barriers to entry, so that competition is intense, inhibiting the scope to raise prices and create headroom for wage increases. In the four years from 2008 the number of hairdressing enterprises increased 8 per cent, while industry turnover increased by only 4 per cent. This means that over the industry as a whole income per business fell. Further, the employed workforce is only around 100,000 but the industry trains 28,000 apprentices a year, a much higher proportion of the workforce than any other comparable industry.

6.89 The markets for provision of social care (4 per cent of minimum wage jobs, accounting for 7-12 per cent of jobs in the sector) and childcare (4 per cent of minimum wage jobs, and 14 per cent of jobs in the sector) services are distinctive in that providers are heavily dependent on public sector purchasers, who exercise a degree of monopsony power. Social care providers have faced static or falling prices paid by local authority commissioners, and have been unable to pass on higher costs. Laing & Buisson (2013), found councils giving an average uplift of 1.8 per cent, compared with the 2.0 per cent it estimated was needed to keep pace with care home inflation. For 2012/13 it gave figures of 1.6 per cent and 2.5 per cent respectively. These averages concealed significant variations between local authorities (for further details see Chapter 4).

The care business was struggling because care was no longer an attractive industry to finance. The collapse of Southern Cross had made it even more difficult to raise finance, banks were reluctant to lend, and as a result some care homes were struggling to survive or had gone to the wall.

Meeting with social care business, Commission visit, 2013

6.90 The Association of Directors of Adult Social Services (ADASS) in England told us that around £2.8 billion of savings had been taken out of local authority social care spending over the past three years. In its Children's Nurseries UK Market Report, Laing & Buisson (2011) showed that the average local authority early years (3 and 4 year old) funding per hour was £3.68. Nearly two-thirds of nurseries said that this level of funding did not cover the cost of providing care (although we might note that most continue to provide this care).

6.91 As well as strength of competition and power of purchasers, the ability to raise prices (in order to afford wage rises), is affected by increased costs of other inputs such as rent, rates, fuel, energy, transport and raw materials. It will also be affected by the sensitivity of consumers to changes in prices.

Impact on Differentials

6.92 The implications for the pay of those above the NMW – the cost of pay rises for them consequent on minimum wage increases, and/or the erosion of differentials between these workers and those on the minimum wage – are significant considerations in a number of

low-paying sectors. Around a third of all jobs in the low-paying sectors are paid less than £7.00 an hour. In some sectors much more of the workforce is paid less than £7.00 an hour, including: childcare (41 per cent); hairdressing (42 per cent); hospitality (48 per cent); and cleaning (58 per cent). Evidence since the introduction of the minimum wage, from official and independent research, showed how during certain periods differentials in the low-paying sectors narrowed, particularly at times of relatively larger increases in the NMW (2002-06), and how higher NMW increases were also accommodated through changes to pay structures (merging of grades in retail), changes to pay premia, and restrictions on non-wage benefits (IDS 2011a, Cronin and Thewlis 2004, Denvir and Loukas 2006). Later research found evidence of a restoration of differentials when there were relatively smaller increases in the NMW between 2008 and 2010 (IDS 2011c, Dickens, Riley and Wilkinson 2012). Further detail about each low-paying sector is provided in Annex A.

Non-labour Costs

6.93 Non-labour costs can be a significant component of firms' overall costs, but there can be limited scope for controlling them, or mitigating increases. The widely publicised increases in utility costs (gas, electricity, water) over recent years will have affected industries for which premises are an important factor for their business, for example hospitality (pubs, restaurants), retail and hairdressing (shops), and manufacturing (factories). Many firms have had to fund making good deficits on their pension obligations – not strictly a non-labour cost, but nonetheless a cost reducing scope to fund wage rises. The Input Price Indices produced by the ONS measure the changes in the prices of materials and fuels bought by UK manufacturers. These showed fuel prices increased by 4.7 per cent and imported food prices by 7.8 per cent, in the year to October 2013.

Increased costs included not just the NMW, but also building costs, energy costs, taxes... it was difficult for the company to pass additional costs onto customers.

Meeting with wholesale distribution company, Commission visit, 2013

6.94 Increases in business rates are linked to RPI and in 2012 they increased by 5.6 per cent (following a 4.6 per cent increase in 2011). In addition, significant increases in food inflation over the last few years have increased the input costs for hospitality businesses and general increases in inflation will have affected input costs for the retail and non-food processing industries. The British Furniture Manufacturers reported that between 2009 and 2012, direct labour and material costs as a proportion of turnover increased from 53 per cent to 61 per cent. The ability to control, or reduce, these costs (and therefore allocate funds to wage increases) may be limited.

The cost of raw materials had increased significantly over the past two years, impacting on profitability.

Meeting with knitwear manufacturers, Commission visit, 2012

Statutory Requirements

- 6.95** A number of the low-paying sectors are subject to requirements for particular levels and/or age of staff, minimum qualifications and service standards. In the security sector regulatory requirements have contributed to raising wages (see case study in ‘Sector Productivity’ section below). However, statutory requirements can limit firms’ room for manoeuvre in coping with minimum wage rises. Care homes are required under statutory regulations to meet minimum staffing requirements so that at all times there are sufficient numbers of suitably qualified, skilled and experienced workers. In the childcare sector, nurseries need to conform to statutory staff:child ratios (and staff have to be of at least a certain age to count towards the ratio). Providers in both sectors are currently being asked to raise qualification levels and service standards in their workforce. These place limits on the scope to change staffing level or mix, or alter service standards, in order to find savings to fund higher minimum wages.
- 6.96** In hospitality and retail, requirements include alcohol-licensing regulations (including minimum staff age), health and safety rules (e.g. food hygiene) in restaurants, and costs of licences for provision of, and limits on, operating facilities for gambling.

Implications of a Higher Bite for Low-paying Sectors

- 6.97** In this section, together with Annex A, we have drawn attention to the significance of the NMW as a component of the cost base in the low-paying sectors, to the bites in these sectors, and we have discussed the constraints and pressures on wages in them. As we noted at paragraph 6.32 above, in areas such as cleaning and hairdressing the minimum wage is increasingly often the going rate for the job.
- 6.98** We have outlined the pressures affecting each sector. The key considerations are:
- labour costs as a share of turnover, which varies by sector but is significant in all of the sectors and means that (partly through impact via differentials on staff paid above the NMW) the minimum wage is a material cost;
 - sensitivity to short-term market adjustments, particularly through shocks affecting consumers (notably in retail, hospitality and hairdressing, and also in cleaning and childcare);
 - market characteristics such as low barriers to entry (which has given rise to intensified competition in hairdressing) or dependence on public sector contracts (which have left many social care and childcare providers struggling to afford to pay the NMW);
 - the cost implications of particular statutory requirements in care, in hospitality and in retailing; and
 - intensifying pressures from other costs, such as utilities (affecting all sectors, but especially retailing, hospitality and hairdressing) and making good pension deficits.
- 6.99** The bite is at or near its highest ever level in these sectors. Against that background our view is that in these conditions an increase in the NMW such as to cause a large rise in the bite would run a high risk of adverse employment effects.

6.100 That risk would be more acute if an increase were to take place very quickly: the evidence from past increases in the NMW is that time to adjust business practice in order to manage additional wage costs has been important in enabling employers to cope. We continue to receive advice from employers that a very big rise that takes place in one go would be the hardest for them to absorb.

6.101 We say this on the basis of the existing relative productivity of the low-paying sectors and other parts of the economy. Earlier in the chapter we emphasised the centrality of productivity to sustainable real increases in the minimum wage. It follows that, were the productivity of the low-paying sectors to increase relative to others, then that would help to create the conditions in which a significant increase in the bite could take place without material adverse employment effects. We discuss the considerations affecting this productivity gain in the next part of the chapter, which addresses the scope to influence conditions needed for faster increases in the minimum wage.

Part 3: Scope to Affect the Conditions Needed for Faster Increases in the National Minimum Wage

6.102 Part 3 examines:

- the scope to influence general economic conditions which would enable a faster NMW increase (paragraphs 6.104-6.107);
- conditions directly affected by government policies, including tax and National Insurance contributions (paragraphs 6.108-6.110);
- productivity in the low-paying sectors (paragraphs 6.111-6.115);
- small firms and the NMW (paragraphs 6.116-6.120);
- other considerations, including the living wage (paragraphs 6.121-6.122);
- young people (paragraphs 6.123-6.127); and
- apprentices (paragraph 6.128).

6.103 Part 3 ends by commenting on options for clarifying the forward path of the NMW, including the idea of forward guidance from the Commission on the minimum wage (paragraphs 6.129-6.136).

Scope to Influence General Economic Conditions

6.104 We have commented above on the general economic conditions which would enable a faster increase in the NMW. The Government has a significant influence on these framework conditions, although some of the timescales for impact are longer term, and where it may influence them many other considerations besides the minimum wage typically come into play, meaning that weighing the benefits of different policy objectives is necessary.

- 6.105** We have highlighted higher productivity as a central issue. The strategic challenge for employers, employees and government in achieving a sustainable longer term increase in real wages is to support the creation of a high productivity economy. For government, key policy fields include skills development, infrastructure, and supporting access to finance for capital investment. We consider below the scope to support productivity improvements in the low-paying sectors in particular.
- 6.106** We have also emphasised the importance of economic growth. Important public policy levers include those affecting interest rates, inflation and fiscal conditions, as well as establishing regulatory frameworks which are conducive to growth.
- 6.107** In paragraph 6.67 above we noted the role of labour supply factors. Some of these, such as the legal frameworks governing educational participation, migration and the retirement age, are shaped to some extent by government policy, and would thus need to be considered if a comprehensive examination of policy affecting wages were undertaken.

Conditions Directly Created by Government Policies

Tax and National Insurance Contributions

- 6.108** Paragraphs 6.41-6.50 above and Annex B present the impact of changes in the income tax and NICs regimes since 2000. They show that around half of NMW workers, those working fewer than 25 hours a week, have not been affected by recent income tax and NI changes but that the other half had experienced real increases in take-home pay as a result of these changes. They also show that the relative costs of employing NMW workers had fallen but the hourly costs of full-time NMW workers were higher than for those working fewer than 30 hours a week.
- 6.109** Changes already made mean that for over half of NMW workers there is limited scope for further improvement in take-home pay through adjustments to the income tax and NI regimes. We estimate that 56 per cent of NMW workers already earn less than the appropriate thresholds and would thus experience no benefit from their going up (unless it is argued that increasing employer NI thresholds would make it more likely that employers would offer more hours to part-time minimum wage workers, thereby increasing their weekly pay although not their hourly rates). The Government has already announced an increase in the personal tax allowance to £10,000 in 2014/15. This would currently take all those working 30 hours or fewer out of the income tax system. That would be around 65 per cent of NMW workers. However, the increase in the NI threshold is only sufficient to take those working 24 hours or fewer out of the NI system. Scope therefore remains to adjust the income tax and NI regimes so as to increase the take-home pay of a substantial minority of the lowest paid, and also to remove disincentives to employers to offer full-time work to minimum wage workers. In relation to young people (discussed at paragraphs 6.123-6.127 below) the Government has recently announced that it will reduce National Insurance payments for under 21 year olds.

Other Statutorily Determined Parts of the Reward Package

6.110 We have noted already that as well as tax and National Insurance, a number of other statutory provisions apply to all employers and affect labour costs and the value of the reward package to the worker. These include minimum annual, and maternity and paternity, leave entitlements, and pension auto-enrolment. Although significant in their own terms these are not central to the terms of the Secretary of State's request, and for the purposes of our assessment we have assumed that they are currently out of scope.

Sector Productivity

6.111 If improvements in the productivity of workers in low-paying sectors exceed those of workers elsewhere in the economy then, as we noted at paragraph 6.101, prospects for increasing the minimum wage faster than average wages are enhanced. The constraints on increasing wages in the low-paying sectors which we have described above in the section on 'Sectoral Conditions for Faster Minimum Wage Increases' help to illuminate some of the challenges involved in achieving increases in productivity in these sectors.

6.112 These challenges differ from sector to sector, and a multi-strand approach would be necessary if action was to be taken to increase productivity across the low-paying sectors. Measures could be expected to include raising the skill levels of managers and workers, developing and utilising technology (and facilitating the access to finance to invest in it), introducing new business methods and practices, and so on, but the balance between them, and the specific challenge, will vary in each case.

6.113 In sectors such as social care and childcare it may be difficult to raise productivity within statutory constraints without an unwanted adverse effect on services. The scope to substitute technology appears limited, and statutory requirements (for example, in relation to staff:child ratios in childcare) limit freedom to alter delivery models. Unless desirable productivity improvements can be identified within these parameters it would be necessary to increase funding for care, specifically for financing wage rises for the lowest paid, if these sectors were to be included in a programme of sectoral measures to support increases in the minimum wage.

6.114 In evidence provided to us and on our visits around the country we have heard the argument that in social care in particular there is an issue not so much of productivity as of the value society attaches to providing care, and of a failure to reward the skills that are required. A policy objective of funding higher wages for the lowest-paid care roles might need to be accompanied by other measures, formally recognising the skills involved, and requiring carers to demonstrate possession of them, for such a policy objective to be attained. The experience of raising wages in the security sector may offer some pointers (see box below).

6.115 It is beyond the scope of this chapter to rehearse the detailed circumstances of each sector, but the general point is that an agenda of raising productivity to help enable increases in the minimum wage would require action targeted at each sector and differentiated to reflect the challenges of each sector.

Case Study: the Security Sector

Following a review of the characteristics of the low-paying (minimum wage) sectors in 2012, we ceased to classify the security sector as low-paying because of the small proportion of workers in the sector who were paid at or near the NMW. The actual number of workers in the sector had increased since the introduction of the NMW; in June 2012 there were 179,000 employee jobs in the security industry (an increase of 57,000 compared with June 1998), but the proportion (in April 2011) paid at or below the adult NMW rate then in force was just over 5 per cent.

The security sector has changed over a number of years, with the impact of the minimum wage lessening, mainly driven by the introduction of a statutory licensing system. Security guarding is the part of the sector where jobs are more commonly paid at or around the NMW. The compulsory licensing of individuals undertaking designated activities within the private security industry came into being from 2003. This has increased the training and professionalism within the industry, and raised wages. At the same time, there has been a switch by companies to make better use of electronic technology. In 2006, we were told that the earnings within the sector had risen strongly, largely because of the introduction of the statutory licensing system. At that time, when the adult rate of the NMW was £5.35, official data showed a clear spike in the earnings distribution at £6.00 and stakeholders told us the 'going rate' for the industry was around £6.40. Over time upskilling and training brought about by compulsory licensing, and increased use of technology, has increased wages in the sector, shrinking the proportion of security workers paid at or near the NMW.

Small Firms and the National Minimum Wage

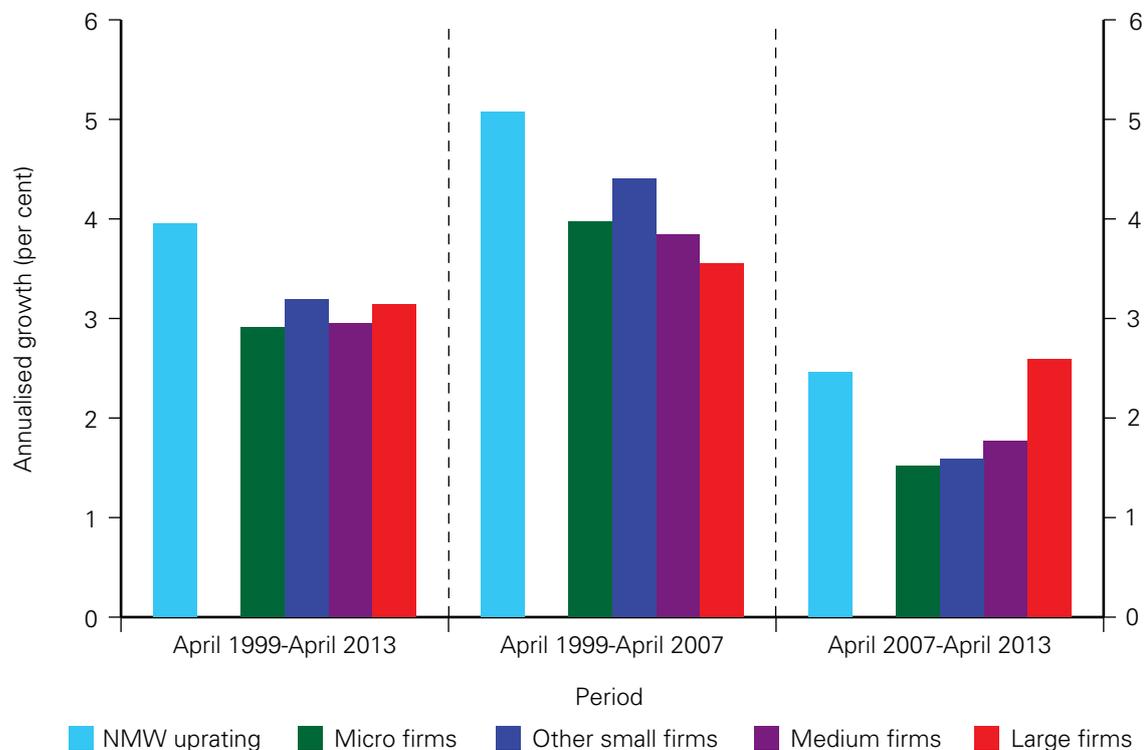
6.116 Any programme of measures intended to create conditions conducive to faster increases in the NMW would need to address constraints on small firms. In our 2013 Report we noted, as we had in our previous reports, that there was a clear relationship between the proportion of minimum wage jobs and the size of firm. In April 2013, minimum wage jobs accounted for fewer than 4 per cent of jobs in large firms (with 250 or more employees), about 6 per cent of jobs in medium-sized firms (those with 50-249 employees), 7 per cent of jobs in other small firms (10-49 employees), and 12 per cent of jobs in micro firms (1-9 employees). Small and micro firms employ 20 per cent of the adult workforce, but employ around 35 per cent of minimum wage workers.

With labour costs 45 per cent of turnover, the NMW made it very difficult for the company to compete with low-wage countries.

Meeting with small manufacturer, Commission visit, 2012

6.117 Figure 6.12 shows that employees in smaller firms have also experienced lower earnings growth since 2007. The positive relationship between size of firm and annualised earnings growth is clear. Over the whole period from 1999 to 2013, earnings growth across firms of different sizes was similar, at around 3.0 per cent. But this disguises two distinct periods.

Figure 6.12: Annualised Growth in the Adult National Minimum Wage and Median Earnings for Those Aged 22 and Over, by Firm Size, UK, 1999-2013



Source: LPC estimates based on ASHE: adjusted earnings without supplementary information, April 1997-2004; with supplementary information, April 2004-06; 2007 methodology, April 2006-11; and 2010 methodology April 2011-13, standard weights, including those not on adult rates of pay, UK.

Note: ASHE data have been adjusted to take account of methodology changes to provide a consistent time series.

6.118 Between 1999 and 2007, employees in micro and other small firms saw higher earnings growth than medium-sized and large firms, although still below the average upratings in the NMW of 5.1 per cent. However, since 2007, smaller firms have seen lower earnings growth than larger firms, and the smaller the firm, the lower the growth in employee earnings. Between 2007 and 2013 workers saw an annualised growth in median earnings of just 1.5 per cent a year in micro firms, 1.6 per cent in other small firms, 1.8 per cent in medium-sized firms, and 2.6 per cent in large firms. The minimum wage increased by an average of 2.5 per cent a year over the same period.

The family business owner highlighted the long hours the family worked...it was likely as the self-employed owner he earned below the NMW.

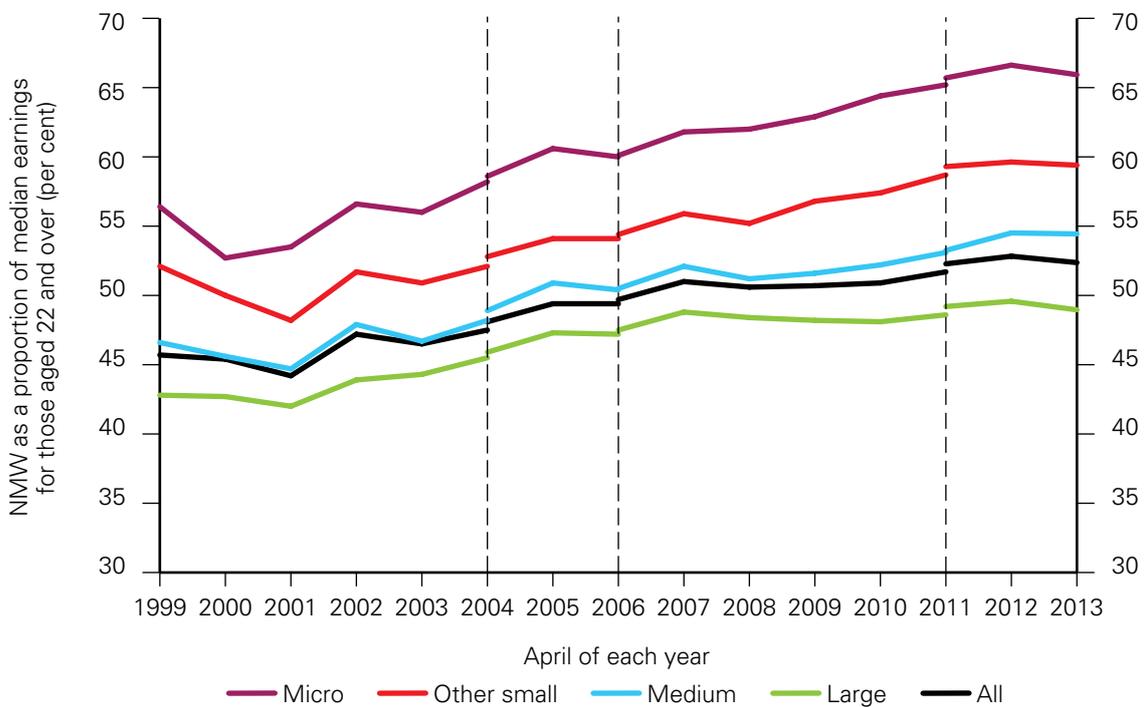
Meeting with rural business, Commission visit, 2013

6.119 This pattern of earnings growth in small firms has increased the bite of the NMW in these firms since 2001. Figure 6.13 shows that the bite in micro firms had increased more or less continuously since 2000 from 52.7 per cent to 67.0 per cent in 2012 and 66.0 per cent in 2013. Similarly, other small firms experienced an increase in the bite from 48.2 per cent in

2001 to 59.4 per cent in 2013. Although the bites for medium-sized and large firms increased at a similar pace to that for small firms between 2001 and 2007, there has been a noticeable difference since then.

6.120 From 2007 to 2010, median wage growth in medium-sized and large firms was similar to that of the minimum wage, and hence the bite remained at around 52 per cent for medium-sized firms and 48 per cent for large firms. Since then wage growth in these larger firms has not matched increases in the NMW and the bite has again risen. In April 2013, the bite for large firms had risen to 49.0 per cent and for medium-sized firms to 54.4 per cent. These were, however, considerably below those for micro firms (66.0 per cent) and for other small firms (59.4 per cent).

Figure 6.13: Bite of the Adult National Minimum Wage at the Median for Those Aged 22 and Over, by Firm Size, UK, 1999-2013



Source: LPC estimates based on ASHE: without supplementary information, April 1997-2004; with supplementary information, April 2004-06; 2007 methodology, April 2006-11; and 2010 methodology April 2011-13, standard weights, including those not on adult rates of pay, UK.

Notes:

- a. Direct comparisons before and after 2004, before and after 2006, and before and after 2011 should be made with care due to changes in the data series.
- b. There were fewer responses to the question on size of firm in the 2002 ASHE than in other years.

Other Considerations

6.121 The discussion above has explored the role of national and sectoral economic and business conditions, and the scope for government to affect these. These factors have an important bearing on what workers can be paid, but ultimately the actual decisions as to specific rates of pay are taken by employers. Depending on their circumstances employers retain more or less room for manoeuvre in adjusting the wages of their lowest-paid employees.

The Living Wage

6.122 The Living Wage Foundation campaigns to persuade employers who can afford to do so to pay at least the wage rates specified by the Foundation. These are calculated by estimating the needs of each of a range of household types, and then arriving at a single number by taking an average of the estimates for the different household types. A number of employers have increased the pay of their lowest-paid employees as a result. We noted at the start of this chapter that the NMW is a pay floor for individual workers, which is not the same as a living wage. We believe that employers who are not driven by business pressures to pay the minimum wage should be encouraged to pay more. Around a quarter of minimum wage workers are not employed in the low-paying sectors, and may be working for employers for whom their wages are a relatively small element in their cost base.

A housing group advised that at the beginning of 2013 it had taken the decision to make the living wage its lowest pay point. This decision affected fewer than 30 employees (mainly cleaners) and the impact on its pay bill was around £10,000, which the Group described as "minimal" when looked at as a proportion of its total wage bill.

Meeting with a housing group, Commission Visit 2013

Young People

6.123 So far this chapter has concentrated on the adult rate of the NMW. We have noted in previous reports that employment of young people is more sensitive than that of adults to the economic cycle, and during the economic slowdown the labour market position of young people deteriorated more than that of adults. In addition there is evidence of change in the structure of the labour market for young people. This means that recommending the youth rates involves a judgement year-by-year which assesses both these factors. In 2011 and 2013 we recommended lower increases for young people than for adults, and in 2012 we recommended freezing the youth rates.

6.124 As the youth rates have risen less than the adult rate since the onset of recession in 2008 they have also undergone a larger fall in real value. Using the RPI, the real value of the youth rates of the NMW peaked in 2009 (at £5.63 and £4.16 in 2013 prices), and in 2007 using the CPI (at £5.54 and £4.10 in 2013 prices). Thus the youth rates of the NMW today are 60 and 44 pence an hour, or 10.7 and 10.6 per cent, lower in real RPI terms than they were in October 2009 (and 51 and 38 pence, or 9.2 and 9.3 per cent, lower than they were in October 2007 in real CPI terms).

6.125 However the value of the youth rates compared with median earnings for 16-17, and 18-20 year olds has increased significantly over the period 2007-13. The annualised increase in the 16-17 Year Old Rate (1.8 per cent) and Youth Development Rate (1.9 per cent) exceeded the annualised increase in median earnings over the period, for both 16-17 year olds and 18-20 year olds (0.4 and 1.4 per cent respectively). The bite of the Youth Development Rate has however fallen slightly in the last two years partly as a result of our cautious youth rate recommendations already mentioned, though the bite of the 16-17 Year Old Rate increased in April 2013 as median earnings for this age group fell.

- 6.126** The general conditions necessary for us to recommend faster rises in the adult rate in future also apply to the youth and apprentice rates. However the greater sensitivity of young people's employment to the economic cycle means we would expect to be able to recommend larger increases for young people when economic conditions have eased.
- 6.127** That recommendation would also of course be influenced by our view of the characteristics of the labour market for young people at the time. There are reasons to believe these characteristics may be changing. In its evidence to us the Government noted that the number of young workless people that have never had a paid job has been increasing since the early 2000s, and that there appears to be a structural issue in the youth labour market relating to the transition between education and employment. If the Government wishes us to conduct a fuller examination of the conditions necessary for faster increases in the youth rates we would expect to include that in our 2015 Report, informed by an up-to-date assessment of how far the labour market for young people has experienced structural as well as cyclical change.

Apprentices

- 6.128** The Apprentice Rate was introduced in 2010 and has risen more than any other rate of the NMW since then. While, as noted above, the general economic conditions which inform our recommendation for the adult rate are also the context for recommending youth and apprentice rates, the labour market for apprentices has a number of distinct features. It is shaped to a significant extent by the evolution of the learning and qualifications frameworks, and of government support for training apprentices. The apprentice framework is continuing to evolve as the Government implements the recommendations of the Richard Review of Apprenticeships. Moreover it is clear that the impact of the Apprentice Rate differs greatly from sector to sector (its bite by sector ranges from 98 per cent in hairdressing in England, to 25 per cent in management in Wales). We have been very concerned by the widespread non-compliance with the Apprentice Rate suggested by the Department for Business, Innovation and Skills' Apprentice Pay Survey 2012 (BIS, 2013e). We understand that in 2014 the Government intends to conduct another apprentice pay survey, the third since the rate was introduced. This should provide an important data source for a fuller assessment of the conditions needed for us to recommend a faster increase in the Apprentice Rate, should the Government wish us to include that in our 2015 Report.

Clarifying the Forward Path of the National Minimum Wage

- 6.129** The Secretary of State has asked us to take a longer-term view of the minimum wage, and in its evidence to us the Government said that it wanted us to provide forward guidance on the NMW. It also asked us for our views on phasing planned increases over two or more years to ease adjustment, and on whether we would be looking to restore the relative position of NMW workers, i.e. to restore the fall in the bite that took place in 2013.
- 6.130** To an extent the Commission already provides forward guidance. We meet in January to agree recommended rates for the year beginning 9 months, and ending 21 months, after our decision. This contrasts with the Monetary Policy Committee, whose decisions take immediate effect.

National Minimum Wage

- 6.131** In taking our decision this year we have considered the outlook for the minimum wage. We believe an abrupt increase at this stage of the recovery would put employment at risk. But we will aim to recommend progressive real increases in the value of the NMW, restoring and then surpassing its previous highest level. The Conclusion below summarises the conditions that will be needed to achieve this.
- 6.132** The scope to give greater clarity on future levels of the minimum wage, including the option of two-year recommendations, was something we examined in our 2012 Report. Our conclusion then was as follows.

“...We previously gave two-year recommendations in our Third, Fourth and 2005 Reports for the upratings of the minimum wage between 2001 and 2006. We moved to annual recommendations in our 2007 Report as we felt the increasing bite of the minimum wage and greater economic uncertainty meant it was important that our recommendations were based on the most timely data.

Some stakeholders supported two-year recommendations in their responses to our consultation. The FSB thought that two-year recommendations would aid business planning, and the Association of Convenience Stores (ACS) reported that two-year recommendations would allow retailers to budget further ahead and restructure staff with a longer-term perspective in mind. Some stakeholders in favour of two-year rates, including the ACS and Scottish Licensed Trade Association (SLTA) felt it was important that we retain an ability to review and change the second year rates to reflect the economic climate.

A few stakeholders called for even longer-term recommendations. The Cinema Exhibitors' Association felt that knowing the increases three to five years ahead would help planning of financial and human resources, while members of the Cleaning and Support Services Association reported that they would be able to factor the increases into their tenders if they were known up to three years in advance.

However, most stakeholders thought that we should continue to make annual recommendations, particularly given the current economic conditions. These stakeholders included the TUC, Unite, CBI, the BCC, and other representative organisations of both employers and employees. Many of these stakeholders cited the importance of basing the recommendations on timely information, and a need for us to retain flexibility to respond to volatile economic conditions.

We have examined a number of ways of indicating what rate recommendations might be expected in the second year. A substantial majority of consultees, from across the spectrum of employers and workers, opposed these ideas. We agree with them that the disadvantage of constraining the Commission to a position which by definition cannot be based on timely evidence outweighs any benefit in increased clarity, particularly in the present uncertain business environment. We have also considered whether the implementation date for our recommendations could be moved in order to give increased notice of upratings, but again this would mean the data informing our recommendations would be less timely than at present.”

Low Pay Commission Report, 2012

- 6.133** This remains our view. We have also considered the Government's question about restoring the fall in the bite, which might imply making an intended level of the bite an explicit goal, which could be another way to provide stakeholders with greater certainty about the future path of the NMW.
- 6.134** However, we do not favour this. The Commission reviews all the evidence and weights it according to our assessment of it. Targeting a given level for the bite would make the Commission's task more formulaic, and less a weighing of all the evidence, than it has been to date. In addition we see serious practical difficulties:
- it would mean making assumptions at our January meeting about median earnings in the April, 15 months later – further into the future than any available forecasts of median earnings, and two years forward from the starting point in the most recent ASHE;
 - given the poor record of past independent forecasts of earnings any assumed median earnings figure would be highly likely to be inaccurate;
 - even when forecasts of average earnings are available, they are prone to error, and they forecast the Average Weekly Earnings series (AWE) which is liable to diverge from ASHE in a given year (in two of the past three years there has been a marked difference between the increases in earnings measured by ASHE and AWE);
 - the year-on-year volatility of the principal data series, and their tendency to diverge in a given year would make it very risky to treat the most recent ASHE or AWE as a baseline from which to take a formulaic approach to recommending the NMW.
- 6.135** None of this is to say that we do not take best estimates of the impact on the bite into account in recommending rates. We do. Our 2014 recommendation will bring the bite back to around its 2012 peak if median earnings increase 2 per cent per year between April 2013 and April 2015, which is plausible. But we would not favour making a given level of the bite a target because the numbers are not robust enough for the purpose.
- 6.136** For the reasons given above we think that – while we can and do give our view on prospects for a faster increase in the minimum wage – there is no numerical indicator available which would go further forward than the 21-month time period of our recommendations, while being reliable enough to be useful. However it is possible to set out the conditions for a faster increase in the National Minimum Wage, as the Secretary of State has requested, and we do this in the Conclusion of this chapter below.

Conclusion

- 6.137** There have been three phases in the Low Pay Commission's approach to recommending the adult rate since the NMW was introduced in 1999: initial caution (1999-2001); increases above average earnings growth and inflation (2001-07); and rises closer to average earnings (2007-13).

National Minimum Wage

- 6.138** The minimum wage has done its job well. Before its introduction the lowest paid fared worse than other workers; since 1999 they have done better, including since the onset of recession in 2008. This has happened without evidence of adverse employment effects.
- 6.139** But since 2007 the NMW has not kept pace with inflation. It is worth less now than it was then. At the same time the NMW has continued to increase as a proportion of average earnings, since wages generally have experienced an even larger loss of real value.
- 6.140** This year however we have recommended an increase which should start to restore the real value of the NMW. Provided economic circumstances continue to improve we expect that process to continue, so that 2014 will mark the start of a new, fourth phase – of bigger increases than in recent years – in the work of the Commission.

Conditions for Faster Increases in the National Minimum Wage

- 6.141** We set out below the general economic conditions we believe are needed for faster increases in the NMW which would materially increase its real value.
- 6.142** We share the widely held view that a sustained increase in real wages depends on increased productivity. We look closely at movements in average wages because over the longer term they are a guide to changes in productivity at the level of the economy, and because of the importance of the relationship between the NMW and other wages.
- 6.143** However, because we aim to help as many workers as possible without an adverse impact on employment prospects we also require a context of stable or rising employment, and an expectation of economic growth, so that there is likely to be steady or growing demand for labour. At the macro level the key considerations that would lead to recommendations for higher increases are:
- an expectation that real wages generally will rise and continue to do so in a sustainable way;
 - stable or rising employment; and
 - an expectation of sustained economic growth (itself the basis for the first two conditions).

We would also take into account evidence of conditions affecting the low-paying sectors, such as the level of and outlook for consumer spending.

- 6.144** Even without these conditions being met we have, since the downturn began, recommended increases in the minimum wage that were modestly larger than the increases in median earnings in the economy as a whole. This has led to an increase in the bite for the economy generally, but so far without evidence of an adverse effect on employment.
- 6.145** The bite faced by low-paying sectors and small firms, where minimum wage workers are employed disproportionately, has increased faster than for the wider economy. By definition, wages of low-paid workers tend to be a material part of the cost base of firms in the low-paying sectors so this is particularly relevant to our recommendations. And in some sectors the bite has risen to an extent that the minimum wage has become the wage determinant for the industry.

- 6.146** We have however judged that these increases, necessary to limit the erosion of the incomes of the lowest paid, could be accommodated without an adverse effect on employment when introduced in regular steady increments, and this appears to have been true.
- 6.147** But because of the increased pressure the NMW now places on small firms and low-paying sectors we believe that a dramatic increase (for example to recover most of its lost value in one uprating) would be very risky in current conditions. For the same reason we would expect to recommend any rises that would cause further longer-run increases in the bite only in gradual steps, and only where the evidence shows that the low-paying sectors have accommodated preceding steps without material employment effects.
- 6.148** These are necessarily matters of judgement: the effects of NMW increases cannot be known in advance, though they can be estimated. Rate recommendations are also judgements in the sense that they are shared assessments of the evidence, written, oral, and from our discussions around the country with employers and employees, rather than the outcomes of a mechanistic formula. Setting the level of the minimum wage can never be wholly a science. It means working with economic forecasts that are always uncertain, and – at least in recent years – more often wrong than right. Moreover expectations themselves, and the climate of economic confidence, affect what the economy will bear.
- 6.149** The Government influences the employment of the low paid and the value of their wages. It has an influence on general economic conditions including through the management of inflation, and economic management and policy in support of growth. Government also has a direct impact on the cost of employing low-paid workers through the National Insurance framework, and through regulatory requirements such as pension obligations.
- 6.150** We take these into account in arriving at our recommendations. We do not take account of the effect of tax and National Insurance on take-home pay because these do not alter what employers can afford to pay or the level of the minimum wage the economy can bear without employment impacts. We do though note here that 44 per cent or so of NMW earners work enough hours to incur deductions from pay, and it is open to the Government to raise their take-home pay by increasing these thresholds.
- 6.151** Lastly, we have noted that around a quarter of minimum wage workers are not employed in the low-paying sectors. For many of them it may be affordable for employers to raise their wages without adverse impacts on their businesses as a whole. We believe that employers who are not driven by business pressures to pay the minimum wage should be encouraged to pay more.

Annex A

The Bite of the National Minimum Wage in Low-paying Sectors

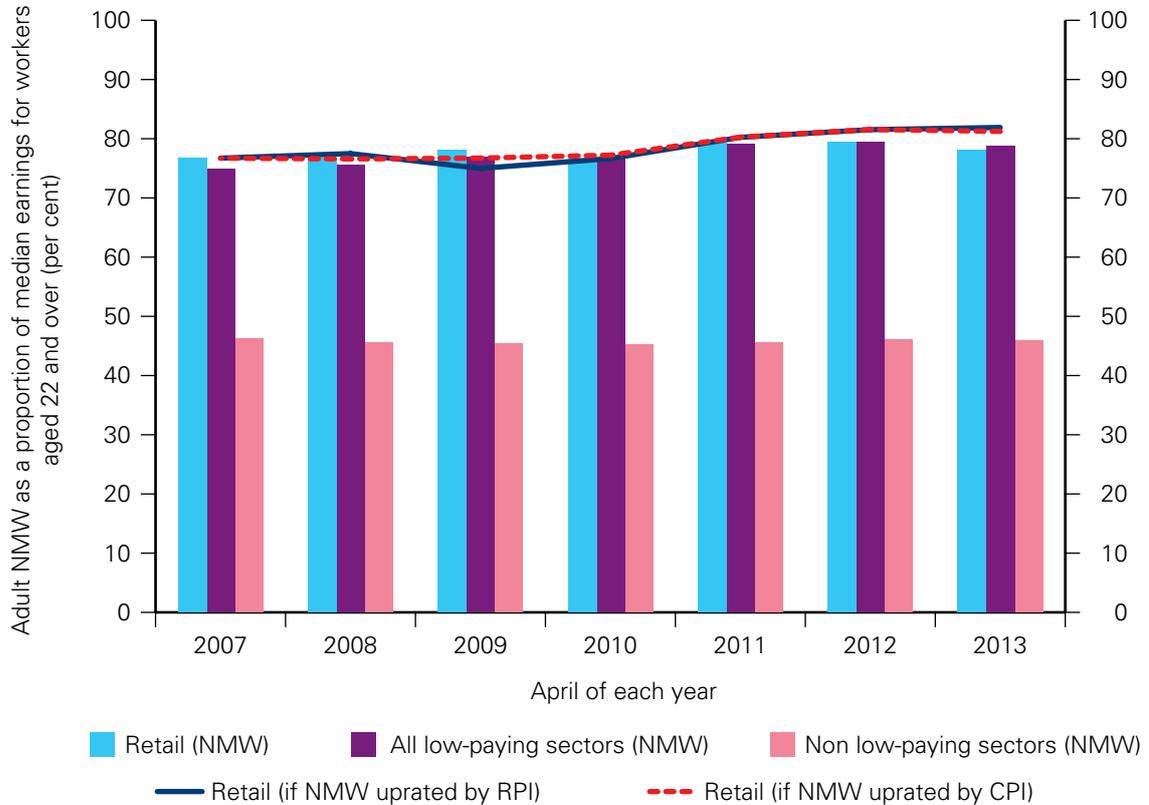
- The bite is the National Minimum Wage (NMW) as a proportion of a particular point on the earnings distribution. In this annex we look at the bite of the minimum wage (the NMW against median earnings) from 2007 onwards. We focus on six low-paying sectors – those which employ 4 per cent or more of minimum wage workers (childcare, cleaning, hospitality, retail, social care) or where minimum wage workers account for a third of the employees in a sector (hairdressing). We compare the bite in each with that for all low-paying and all non low-paying sectors. We also look at what the bite would have been if the NMW had been uprated in line with inflation (both Consumer Price Index (CPI) and Retail Price Index (RPI)) and consider what stakeholders have told us about the impact of the NMW in these sectors, in particular on differentials.

Retail

- Figure 6A.1 shows how the bite of the NMW in the retail sector had reached 78 per cent by 2013, up from around 75 per cent in 2007. However, if the value of the NMW had been maintained in real terms between these years the bite would have been higher by 2013, at just over 81 per cent (if uprated in line with CPI) or nearly 82 per cent (if uprated in line with RPI). Retail is a very differentiated sector in terms of pay. While in the major supermarkets in 2013, sales assistants' basic hourly rates at age 18 were well above the adult NMW (ranging from around £6.60 to £7.28 an hour) we are told by those representing small rural retailers that the cost pressures mean that proprietors often pay themselves considerably less than the minimum wage.
- Jobs in retail paid at or around the NMW include retail assistants, cashiers, and other basic sales occupations. Over the years we have often heard from retailers and organisations representing them that a consequence of increases in the NMW has been to narrow differentials between grades, particularly between basic retail and supervisory roles, with implications for the motivation, and recruitment and retention, of staff. The response to this has varied across the sector. In some parts this has meant a compression of points on pay scales as retailers cannot afford to or choose not to restore the wage differential. For example, the British Retail Consortium informed us that the proportion of employees in non-food retailers earning within 20 pence of the NMW almost trebled to 9 per cent in 2012 compared with 2011, and in 2013 rose again to 16 per cent. The British Independent Retailers Association also told us that some parts of the sector in particular face wage compression from NMW upratings, such as in department stores and certain geographical regions. The Association of Convenience Stores has often raised with us the squeezing of differentials between average wage rates paid by its members and the NMW. In addition,

research has found that employers have sometimes absorbed NMW upratings by reducing pay premia or restricting non-wage benefits.

Figure 6A.1: Bite of the National Minimum Wage, Retail, Low-paying and Non Low-paying Sectors, Actual and If Uprated in Line with CPI or RPI, UK, 2007-13



Source: LPC estimates based on ASHE: 2007 methodology, April 2007-11; and 2010 methodology April 2011-13, standard weights, including those not on adult rates of pay, UK; and ONS data: CPI (D7BT) and RPI (CHAW), monthly, UK, 2007-13.
 Note: ASHE data have been adjusted to take account of methodology changes to provide a consistent time series.

- 4 We have, however, also heard that in some parts of the retail sector the NMW has either had less effect, or has led to what might be regarded as a more positive development in pay structures. For example, our commissioned research has told us that the impact from a squeezing of differentials has sometimes prompted sector employers to revise their pay and grading structures: instead of separate grades for trolley-collecting, shelf-stacking and cashiering these were often merged into one grade. Usdaw, which represents retail workers, told us that the increase in the NMW in October 2013 was lower than the level of sector settlements Usdaw was achieving (2.0-2.5 per cent, with some at 2.8 per cent). The NMW, it maintained, was not reducing differentials, but allowing the lowest paid to fall further behind the rest of the labour market.

Hospitality

- 5 The bite of the NMW in the hospitality sector, as shown in Figure 6A.2, reached just over 88 per cent by 2013, an increase from just over 84 per cent in 2007. However, if the value of the NMW had been maintained in real terms in this period the bite would have been just under 92 per cent (if uprated in line with CPI) or just over 92 percent (if uprated in line with RPI).

Figure 6A.2: Bite of the National Minimum Wage, Hospitality, Low-paying and Non Low-paying Sectors, Actual and If Uprated in Line with CPI or RPI, UK, 2007-13



Source: LPC estimates based on ASHE: 2007 methodology, April 2007-11; and 2010 methodology April 2011-13, standard weights, including those not on adult rates of pay, UK; and ONS data: CPI (D7BT) and RPI (CHAW), monthly, UK, 2007-13.

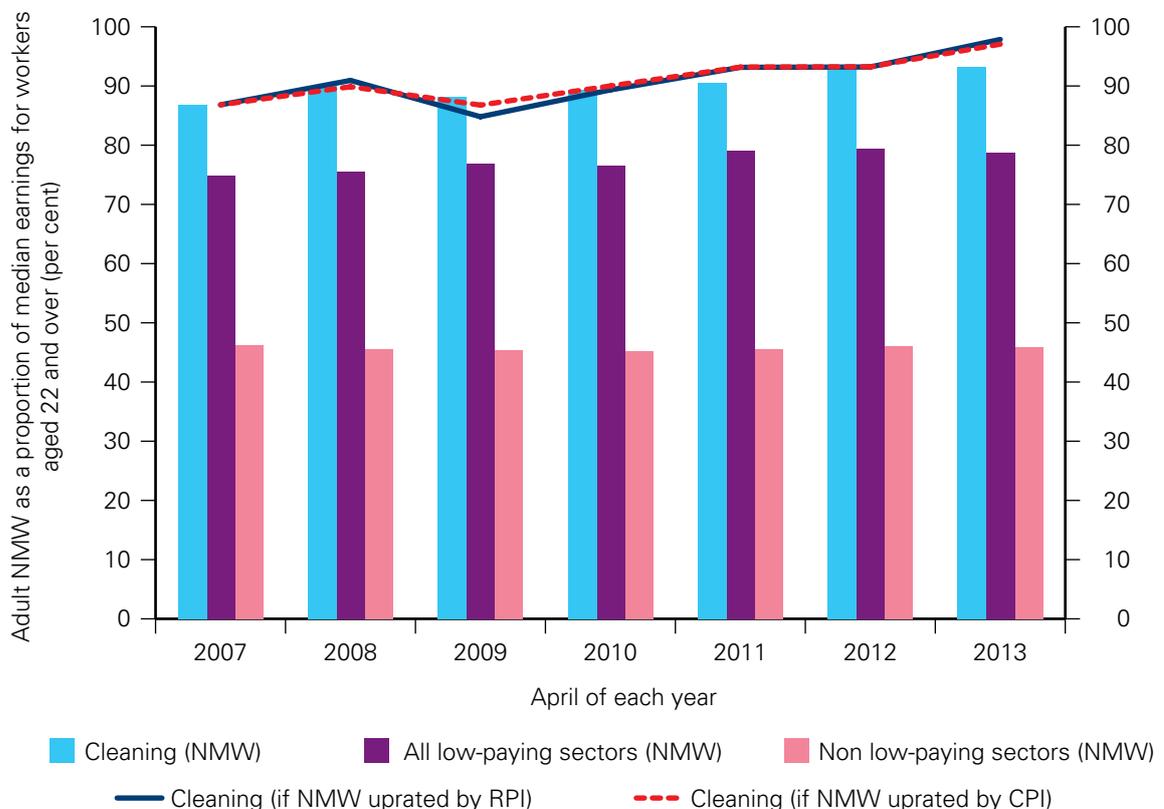
Note: ASHE data have been adjusted to take account of methodology changes to provide a consistent time series.

- 6 A large proportion of jobs in hospitality are paid at or around the minimum wage. These include waiting staff, bar staff, hotel cleaners, etc. In hospitality, unlike retail, there is an increasing use of the Youth Development Rate, i.e. the minimum wage for 18-20 year olds. Employees aged under 21 make up around 22 per cent of the sector's workforce.
- 7 Sector representatives tell us that the main impacts of the minimum wage are on the compression of differentials and the scope for employers to maintain non-pay benefits. Over recent years these concerns have grown as input prices (food, utilities, etc) have increased substantially. As a result of this compression, job layers have gradually been removed, causing disgruntlement among those affected (reducing opportunities for promotion and squeezing differential pay for those with greater responsibilities). They expect this situation to carry on if the minimum wage continues to increase. In recent years the pub sector has advised us that the adult rate of the National Minimum Wage has become the average wage in the sector.

Cleaning

- 8 The cleaning sector has the highest bite of all low-paying sectors. Figure 6A.3 shows it reached just over 93 per cent in 2013, an increase from just under 87 per cent in 2007. However, if the value of the NMW had been maintained in real terms between these years the bite would have been nearly 97 per cent (if uprated in line with CPI) or just under 98 per cent (if uprated in line with RPI).
- 9 The majority of the jobs in this sector could be described as cleaning operatives. Although official data show that around a third are paid at the minimum wage, an industry survey in 2012 reported that 62 per cent of cleaners were paid at the NMW (then £6.08) with a pay rate of £6.25 proving an effective ceiling. Around 76 per cent of workers were paid less than this.
- 10 Business representatives report that successive increases in the minimum wage have forced employers to reduce hours and the quality of the service they provide, as they have little scope to renegotiate contract prices (and during the recent economic downturn service users have tried to renegotiate prices down to reflect pressures they were under). Consequently differentials continue to be squeezed and further minimum wage increases would only exacerbate this situation and flatten pay structures. We have been told by business representatives that the squeezing of differentials reduces the incentive for workers to take on extra responsibilities, for example by becoming supervisors.

Figure 6A.3: Bite of the National Minimum Wage, Cleaning, Low-paying and Non Low-paying Sectors, Actual and If Uprated in Line with CPI or RPI, UK, 2007-13



Source: LPC estimates based on ASHE: 2007 methodology, April 2007-11; and 2010 methodology April 2011-13, standard weights, including those not on adult rates of pay, UK; and ONS data: CPI (D7BT) and RPI (CHAW), monthly, UK, 2007-13.
 Note: ASHE data have been adjusted to take account of methodology changes to provide a consistent time series.

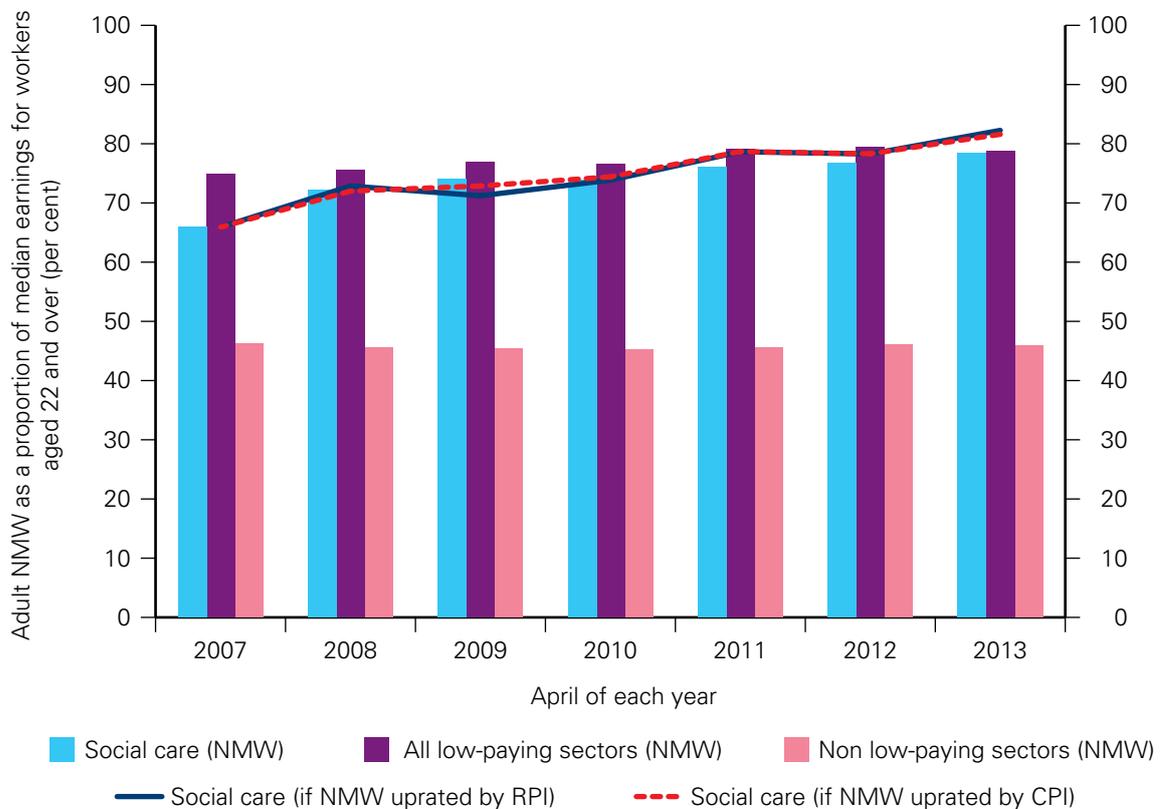
National Minimum Wage

- 11** But Asset Skills (2013) found that while pressures on cleaning businesses remained significant, a number of businesses were managing these challenges effectively and a significant number of respondents reported relatively healthy profitability. Asset Skills reported that even though challenges remain, businesses had put in place structures which allowed them to operate more effectively and efficiently.

Social Care

- 12** Figure 6A.4 shows that the increase in the bite of the NMW in the social care sector was one of the sharpest in the low-paying sectors, rising from 66 per cent in 2007 to reach over 78 per cent by 2013. However, if the value of the NMW had been maintained in real terms between these years the bite would have been even higher, at nearly 82 per cent (if uprated in line with CPI) or just over 82 per cent (if uprated in line with RPI).
- 13** Independent providers in the social care sector tell us that the key factor they face in affording increases in the minimum wage, and in managing the impact of the NMW on their pay structures, is whether local authorities (LAs) pay care fees at a level which reflects the actual cost of care – providers are often heavily dependent on LA purchasing of their services. Care associations have advised us that NMW upratings add significant financial pressure to providers with a substantial proportion of provider expenditure on staff costs.

Figure 6A.4: Bite of the National Minimum Wage, Social Care, Low-paying and Non Low-paying Sectors, Actual and If Uprated in Line with CPI or RPI, UK, 2007-13



Source: LPC estimates based on ASHE: 2007 methodology, April 2007-11; and 2010 methodology April 2011-13, standard weights, including those not on adult rates of pay, UK; and ONS data: CPI (D7BT) and RPI (CHAW), monthly, UK, 2007-13.

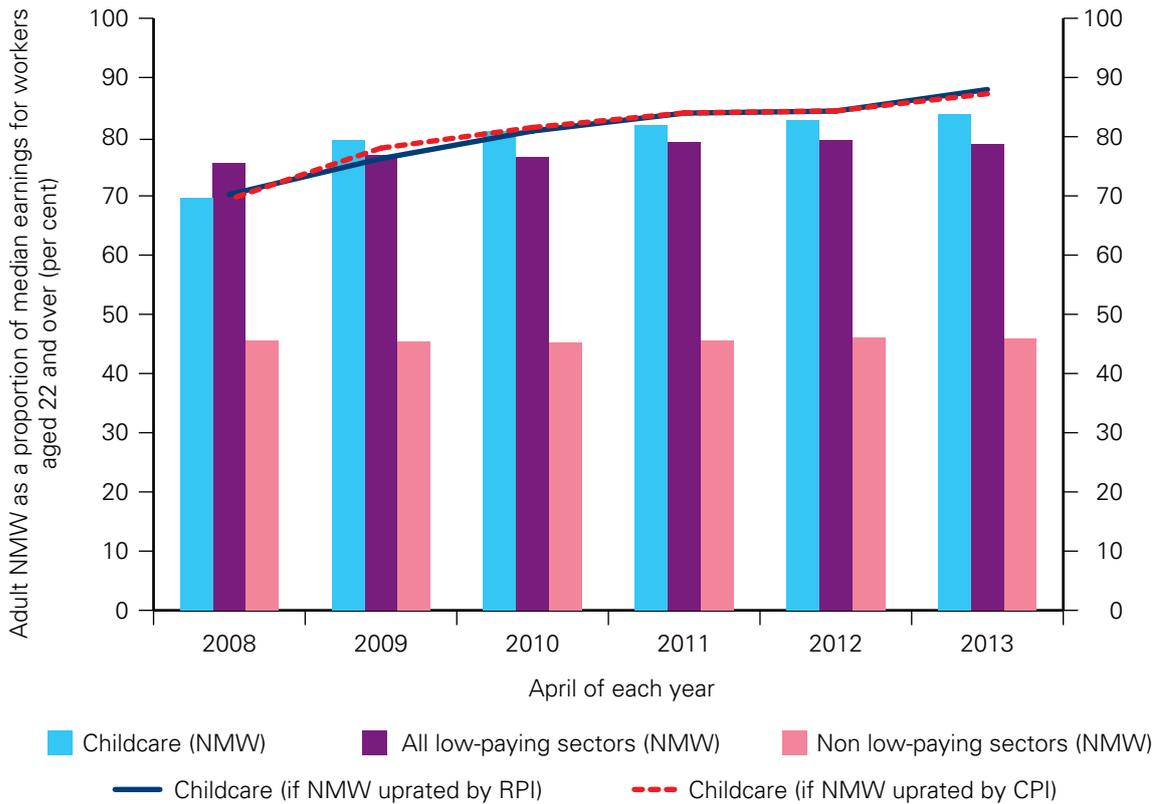
Note: ASHE data have been adjusted to take account of methodology changes to provide a consistent time series.

- 14** Jobs in social care paid at or around the level of the minimum wage include care assistants in residential care and home care workers, as well as those in support service functions. Although ASHE data suggest that social care, compared with some other low-paying sectors, does not appear to have a very high proportion of jobs paid at the NMW, we have found from our own analysis (supported by other research) that unpaid time (such as for travel) and failure to factor in deductions (such as for accommodation) may mean a far higher proportion are actually paid at or near to the NMW. In addition, care sector representatives tell us that without care fees reflecting care costs, an increase in the NMW has an impact on recruitment and retention of more senior workers. Available monies would be used to pay increases for those on the NMW rather than reward higher-paid staff. This also affects incentives for existing staff to train and take on higher responsibilities. As it gets harder to retain and recruit permanent staff, more use would be made of expensive agency staff, which would add further pressure to the pay bill.

Childcare

- 15** The bite of the NMW in the childcare sector has grown even more sharply than the bite in social care. Figure 6A.5 shows that the bite reached nearly 84 per cent in 2013, a substantial increase from just over 69 per cent in 2008. However, if the value of the NMW had been maintained in real terms between these years the bite would have been just over 87 per cent (if uprated in line with CPI) or just under 88 per cent (if uprated in line with RPI).
- 16** Many nurseries pay their unqualified staff, such as nursery assistants and support staff, at or around the NMW and structure pay scales to reflect qualifications and responsibility. The body representing day nurseries reported that the average increase in nursery fees in 2013 was 1.5 per cent and fee increases had moderated, or been frozen, in response to pressure on parents to afford them. A key concern for the sector is funding, whether it be from parents (many of whom are struggling to pay) or from government for free nursery places (where the majority of nurseries claim that this funding does not cover the cost of provision).
- 17** Businesses report that increases in the NMW have affected the sustainability of many nurseries. Increases in the NMW mean a review of pay for the entire workforce if they are to: maintain differentials; incentivise staff; and reward attainment. Continued increases in the NMW, and funding pressures, have reduced the discretion owners have to set their own pay structures. Many nurseries report that any increase in budgets is predominantly spent on responding to NMW increases, thus limiting discretionary awards. This will affect the sector's ability to maintain qualified and motivated staff, who may look for alternative careers.

Figure 6A.5: Bite of the National Minimum Wage, Childcare, Low-paying and Non low-paying Sectors, Actual and If Updated in Line with CPI or RPI, UK, 2008-13



Source: LPC estimates based on ASHE: 2007 methodology, April 2008-11; and 2010 methodology April 2011-13, standard weights, including those not on adult rates of pay, UK; and ONS data: CPI (D7BT) and RPI (CHAW), monthly, UK, 2007-13.

Notes:

- a. ASHE data have been adjusted to take account of methodology changes to provide a consistent time series.
- b. Data in childcare were not available before 2008.

Hairdressing

- 18** Figure 6A.6 shows that the bite of the NMW in the hairdressing sector had increased to just over 84 per cent by 2013 from below 80 per cent in 2007. However, if the value of the NMW had been maintained in real terms between these years the bite would have been even higher at just under 88 per cent (if updated in line with CPI) or just over 88 per cent (if updated in line with RPI).
- 19** Hairdressing is a labour-intensive industry. It has the sector workforce with the largest proportion of apprentices and it has the highest proportion of workers paid at or below the age-related minimum wage. The industry reports that increases in the minimum wage have continued to erode pay differentials. This is mainly an issue between trainees and junior staff (as senior staff are more likely to earn commission (tips) or benefit from incentives or performance-related pay). Businesses in the sector have limited scope for dealing with increases in the NMW if they want to maintain differentials. Managing increasing costs in a highly competitive market is very difficult.
- 20** However, Habia (2012) reported that 60 per cent of owners had said that the NMW had not affected their business, with only 20 per cent saying it had. Habia reported that the reason

fewer businesses were being affected was because they were now used to the legislation and were factoring it into their budgets.

Figure 6A.6: Bite of the National Minimum Wage, Hairdressing, Low-paying and Non Low-paying Sectors, Actual and If Uprated in Line with CPI or RPI, UK, 2007-13



Source: LPC estimates based on ASHE: 2007 methodology, April 2007-11; and 2010 methodology April 2011-13, standard weights, including those not on adult rates of pay, UK; and ONS data: CPI (D7BT) and RPI (CHAW), monthly, UK, 2007-13.

Note: ASHE data have been adjusted to take account of methodology changes to provide a consistent time series.

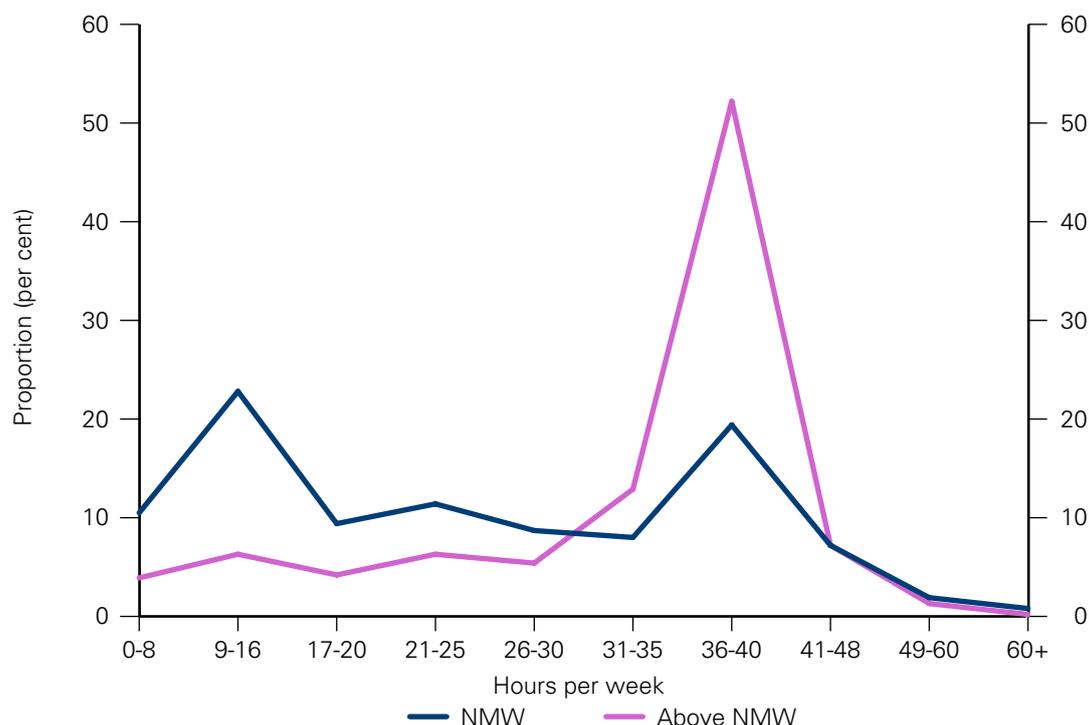
Annex B

Take-home Pay

- 1 Several steps are necessary in order to reach a judgement about the effects of changes to the income tax and National Insurance regimes on the take-home pay of minimum wage workers. This is mainly because the minimum wage is an hourly rate whereas National Insurance contributions (NICs) are payable on weekly or monthly earnings and income tax is payable on annual income. It is therefore necessary to divide the population of NMW earners into bands according to how many hours they work in order to derive estimates of the weekly and annual earnings of minimum wage workers, to which NICs and income tax apply. Since these factors may vary over time we have made these calculations separately for each of the financial years since 2000/01. Further, income tax and NI thresholds and rates are set for financial years (April-March) but the NMW changes on 1 October each year. Thus, we need to take account of the change in the NMW in the middle of each tax year.

- 2 On average, NMW workers worked around 26 hours per week in April 2013 (the latest available data). Figure 6B.1 shows that the hourly distribution of minimum wage workers is very different to that of more highly-paid workers. It has a bimodal structure with two peaks, at 9-16 hours per week (23 per cent of minimum wage workers) and 36-40 hours per week (19 per cent). In contrast, the hours worked by non-minimum wage workers have only one peak, at 36-40 hours a week (over 52 per cent of non-minimum wage workers), with only 7 per cent working 9-16 hours or fewer.

Figure 6B.1: Distribution of Hours Worked for Minimum Wage Workers, UK, 2013



Source: LPC estimates based on ASHE: 2010 methodology April 2013, low-pay weights, including those not on adult rates of pay, UK.

- 3** We now turn to look at the take-home pay of an average NMW worker. We should note that the Annual Survey of Hours and Earnings (ASHE) is conducted after the start of the new financial year and yields information on gross hourly and weekly pay in the latest pay period as well as gross annual earnings but the latter will cover the previous financial year, whereas the former is likely to relate to the current financial year.
- 4** Tables 6B.1 and 6B.2, and Figure 6B.2 below, show how government policies regarding income tax and NI have affected the take-home pay of minimum wage earners and the labour costs of their employers since 2000/01, differentiating these effects to take account of the factors mentioned above. Table 6B.2 shows that the average weekly wage for a minimum wage worker in 2013 was about £158.50, with the median minimum wage worker earning £146.60 per week. Over the year to April 2013, the average annual wage for a minimum wage worker was £7,233, with the median wage at £6,342. The NI threshold was £149 a week in the 2012/13 financial year. That means that an average NMW worker would pay 52 pence a week in NI and, if they earn on average £7,233 a year, they would not have paid any income tax (as the threshold in the 2012/13 financial year was £8,105). A median NMW worker would not have paid any income tax or NI. In order to assess weekly and annual take-home pay, we have taken some account of the fact that many NMW workers work fewer than 52 weeks a year on average, by dividing average annual earnings by average weekly earnings.

Table 6B.1: Gross and Net Earnings of Minimum Wage Workers Aged 22 and Over, UK, 2001-13

ASHE Year	Gross weekly earnings		Gross annual earnings		Take-home (net) weekly earnings		Take-home (net) annual earnings	
	Mean	Median	Mean	Median	Mean	Median	Mean	Median
2001	90.0	81.4	4,784	4,150	87.6	80.5	4,768	4,150
2002	98.3	88.4	5,277	4,565	89.7	81.4	5,160	4,565
2003	107.6	98.4	5,587	4,785	96.2	88.4	5,383	4,717
2004	114.9	104.0	5,381	4,618	103.7	97.0	5,194	4,554
2004	116.7	107.5	5,576	4,745	110.9	102.5	5,358	4,666
2005	123.0	114.1	5,758	4,727	112.2	105.6	5,522	4,635
2006	128.9	116.2	5,799	4,780	118.0	111.8	5,565	4,693
2006	128.5	115.5	6,238	5,334	123.7	114.0	5,949	5,240
2007	138.7	127.3	6,450	5,408	122.6	113.5	6,129	5,280
2008	143.3	129.7	6,854	5,700	131.8	124.3	6,488	5,581
2009	146.4	131.8	6,951	5,988	135.7	127.0	6,666	5,879
2010	147.3	133.4	6,740	5,767	140.4	129.4	6,499	5,656
2011	149.5	134.9	6,833	5,815	142.0	130.8	6,776	5,815
2011	151.1	136.4	7,134	6,032	148.2	134.9	7,065	6,032
2012	153.4	140.0	7,233	6,342	149.7	136.4	7,191	6,342
2013	158.5	148.6			152.5	140.0		

Source: LPC calculations based on ONS ASHE data: without supplementary information, April 1997-2004; with supplementary information, April 2004-06; 2007 methodology, April 2006-11; and 2010 methodology April 2011-13, low-pay weights, including those not on adult rates of pay, UK.

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- 5 Figure 6B.1 showed that around a third of minimum wage workers work 16 hours or fewer. Table 6B.2 shows that these workers have never earned enough money to pay income tax or make National Insurance contributions. Another 9 per cent of workers, working around 20 hours a week, were drawn into the income tax and NI system between 2004/5 and 2010/11. The raising of the personal tax and NI thresholds since 2010/11 means that those working up to around 25 hours a week in 2013/14 no longer pay income tax but those working around 25 hours a week do make small contributions to NI. Thus, by the 2012/13 financial year, around 53 per cent of NMW workers no longer paid any income tax or National Insurance. The analysis in Table 6B.2 assumes that all NMW workers work 52 weeks a year, which means that the analysis is likely to overstate the extent of the impact of income tax on NMW workers.

Table 6B.2: Effective Hourly Take-home Pay for Minimum Wage Workers Aged 22 and Over, UK, 2000-14

ASHE Year	Financial Year NMW	16 or fewer hours	20 hours	25 hours	30 hours	35 hours	40 hours	48 or more hours
Approximate Share (%)		33	9	11	9	8	27	3
2000/01	3.65	3.65	3.65	3.56	3.45	3.33	3.22	3.10
2001/02	3.90	3.90	3.90	3.82	3.70	3.57	3.46	3.32
2002/03	4.15	4.15	4.15	4.03	3.91	3.76	3.64	3.51
2003/04	4.35	4.35	4.35	4.18	4.04	3.88	3.76	3.62
2004/05	4.68	4.68	4.65	4.46	4.29	4.12	4.00	3.85
2005/06	4.95	4.95	4.90	4.70	4.51	4.34	4.21	4.06
2006/07	5.20	5.20	5.12	4.92	4.71	4.54	4.41	4.25
2007/08	5.44	5.44	5.34	5.13	4.91	4.73	4.60	4.44
2008/09	5.63	5.63	5.58	5.27	5.04	4.87	4.75	4.60
2009/10	5.77	5.77	5.74	5.46	5.21	5.03	4.90	4.75
2010/11	5.87	5.87	5.83	5.52	5.28	5.10	4.97	4.82
2011/12	6.01	6.01	6.01	5.90	5.60	5.38	5.22	5.03
2012/13	6.14	6.14	6.14	6.10	5.79	5.56	5.39	5.18
2013/14	6.25	6.25	6.25	6.22	6.05	5.80	5.60	5.38

Source: LPC calculations based on income tax and NI thresholds and rates, UK, 2000-14.

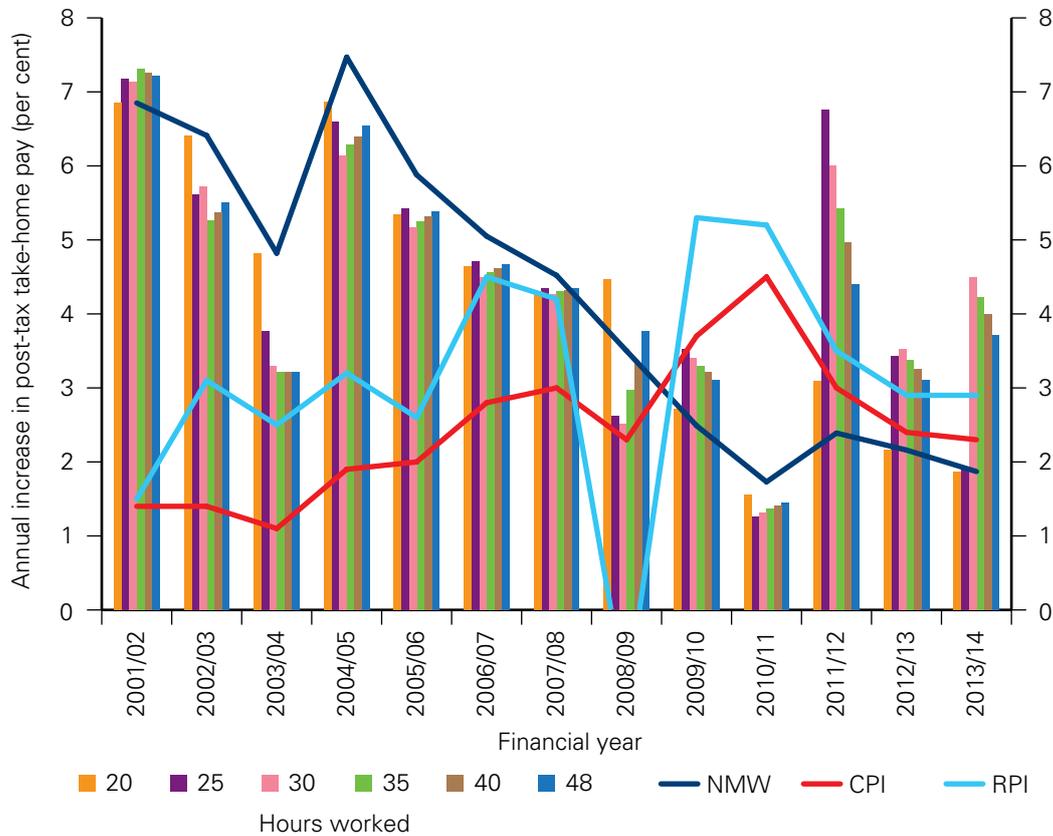
Notes:

- a. The financial year NMW is the average of the adult rates of minimum wages in the Octobers before and after the start of the financial year.
 b. Approximate shares are 17-20 for 20 hours; 21-25 for 25 hours; 26-30 for 30 hours; 31-35 for 35 hours; and 36-47 for 40 hours.

- 6 It is take-home pay (cash in the pocket) that is likely to matter most to workers. Table 6B.2 suggests and Figure 6B.2 shows that between 2001/02 and 2006/07 the increase in the hourly take-home pay of NMW workers increased faster than both measures of inflation (RPI and CPI) but was generally flat from 2006/07 to 2009/10, except for the anomaly produced when RPI inflation was briefly negative. Although recent increases in the NMW have been below inflation, we can see that the changes in income tax and National Insurance have resulted in the effective take-home pay of many NMW workers (those working more than 25 hours a week) increasing faster than inflation. However, 42 per cent of NMW workers work 20 hours or fewer a week and have thus not benefited from those recent income tax

and NI changes. Further, those who work around 25 hours (around 11 per cent) did not benefit from the most recent changes in the increase in personal tax allowances. Around 53 per cent of NMW workers received a cut in real take-home pay in 2013/14, and for around 47 per cent it maintained or increased its value.

Figure 6B.2: Annual Increase in Take-home Pay for Minimum Wage Workers, by Hours Worked, UK, 2001-14



Source: LPC calculations based on income tax and NI thresholds and rates, UK, 2001/02-21013/14 and ONS data: CPI(D7BT) and RPI (CHAW), monthly, UK, 2001-13.

7 However, real take-home pay is not the same as real disposable income, which may be affected by tax credits and other in-work benefits as well as the impact of changes in other forms of taxation and regulated prices. Benefits are generally assessed at the household level, whereas our analysis above has been limited to individuals. An assessment of the impact of changes including those to in-work Tax Credits, eligibility for Council Tax and Housing Benefit, and indirect taxes such as VAT would be necessary to draw conclusions about changes in the real disposable income of the lowest paid. The complexity of the tax and benefits system and the availability of appropriate data sources make it very difficult to assess the impact of these changes on NMW households. Research from the Joyce (2012), Joyce and Phillips (2013) and Brewer and De Agostini (2013) tends to suggest that for those at the bottom of the income distribution such changes have negatively affected real disposable income. This is also indicated by analysis that supplemented the Chancellor’s Autumn Statement. HM Treasury (2013e) showed that the cumulative impact of the tax and benefit changes would have a net negative effect on the bottom four deciles of household income. Brewer and De Agostini (2013) concluded that, after the changes to Universal Credit and personal tax allowances had been included, a ten per cent rise in the minimum wage would lead on average to a 3 per cent increase in net income.

Appendix 1

Consultation

We are grateful to all those people and organisations that contributed to the preparation of this report. We would like to thank in particular those who provided evidence, either written or oral, and those who organised or participated in Low Pay Commission visits and meetings. All such individuals and organisations are listed below, unless they expressed a wish to remain unacknowledged.

Accord Housing Ltd
Agnew Group
Amey Price
Anti Trafficking and Labour Exploitation Unit
Apprenticeship Ambassadors Network
Association of Convenience Stores
Association of Directors of Adult Social Services
Association of Employment and Learning Providers
Association of Labour Providers
Association of Licensed Multiple Retailers
B&CE Insurance Ltd
Balhousie Care Group
Bank of England
Blagdon Post Office & Stores
Blockley Community Shop and Café, Gloucestershire
British Beer & Pub Association
British Beer & Pub Association (Midlands)
British Chambers of Commerce
British Furniture Manufacturers
British Growers Association
British Hospitality Association
British Independent Retailers Association (bira)
British Retail Consortium
British Youth Council
Broadcasting Entertainment Cinematograph & Theatre Union (BECTU)
Business In Sport and Leisure
CBI
Chartered Institute of Payroll Professionals
City of York Council
Communication Workers Union
Councillor Elspeth Maclachlan
Crystal Group Ltd
Domestic Care Group
Dundee Citizens Advice Bureau

National Minimum Wage

Dundee College
EEF, the manufacturers' organisation
English Community Care Association
Equality and Human Rights Commission
Equity
Euro Foods Group Ltd
Everards Brewery
Fabric Housing Group
Federation for Industry Sector Skills & Standards
Federation of Small Businesses
Federation of Wholesale Distributors
Food and Drink Federation
Forum of Private Business
Frederic Robinson Brewery
Gangmasters Licensing Authority
GMB
Hair Razor
HM Government
Home Instead Senior Care
Incomes Data Services
Independent Parliamentary Standards Authority
Inspiring Interns
Institute for Family Business with UCG
Institute of Fiscal Studies
Intern Aware
Jamie Pirie
John Smedley Ltd
Joseph Rowntree Foundation
Kalayaan
Keinton Stores
Labour Research Department
Lilian Faithfull Homes
Lincolnshire Care Association (LinCA)
London Borough of Merton
London Youth
Mark Watson
Mash Direct Ltd
National Association Pension Funds
National Association of Master Bakers
National Care Association
National Care Forum
National Day Nurseries Association
National Farmers' Union
National Hairdressers' Federation
National Institute of Economic and Social Research

National Union of Journalists
National Union of Students
Newcastle Youth Council
Norwich City Council
One Parent Families Scotland
Orieton PO & Stores, Herefordshire
Premier Community Care Ltd
Public and Commercial Services Union
Punch Taverns
Rail, Maritime and Transport Workers' Union
Recruitment & Employment Confederation
Red Recruitment 24/7
Red Squirrel Day Nursery
Registered Nursing Home Association
Resolution Foundation
Ringlink Scotland
Rosemary Goodenough
Rural Shops Alliance
Scottish Enterprise
Scottish Government
Seren Group
Social Futures Institute, Teeside University
SPAR, Saltburn-By-The-Sea
Staffline Group Plc
Sue Ryder
Sunnybank Day Nursery
Textiles Services Association
TLC Private Home Care Services
Total Labour Solutions
Trades Union Congress
UK Fashion & Textile Association
Union of Shop, Distributive and Allied Workers
UNISON
Unite
United Kingdom Home Care Association
Villa Italia
Village Shop, Hooky
Walnut Care At Home
Welsh Government
West Midlands Homebased Care Ltd
White Horse Child Care Limited
XpertHR

Appendix 2

Low Pay Commission Research

Overview

- 1 The Low Pay Commission has now been established for 17 years. Over that time, we have commissioned over 130 research projects. We have been fortunate to engage with many of the leading researchers in this area and have made great use of their expertise. We are grateful to all those who have contributed over the years. In each of our previous reports we have provided a summary of the findings of our commissioned research. We do so again.
- 2 In our 2013 Report, we again concluded that the research in general found little adverse impact of the minimum wage on employment. It concluded that since the introduction of the National Minimum Wage (NMW), the low paid had received higher than average wage increases but that the research had, in general, found few adverse effects on aggregate employment; the relative employment shares of the low-paying sectors; individual employment or unemployment probabilities; or regional employment or unemployment differences. The research suggested that employers have coped with the minimum wage by adopting a combination of strategies. Pay structures may have been adjusted or non-wage costs reduced. There may have been small reductions in hours worked and increases in productivity. Some prices may have been increased and profits squeezed but these reductions in profits had not been sufficient to lead to an increase in business failure. Business creation may also have slowed. We noted that we would continue to monitor the impact of the NMW and had invited tenders for a range of research projects that we hoped would enhance further our evidence base. We now summarise the findings of that research.
- 3 Seven research reports were commissioned for this report. They cover the reliability of official statistics; the impact of the minimum wage on earnings, pay and type of employment; the impact of the minimum wage on prices, consumption and debt; and international comparisons of apprentice pay. For our 2015 Report, we have already commissioned research on the impact of the NMW on young people; the impact of the Apprentice Rate; and the impact of the NMW on businesses by size of firm. These three projects have already provided some initial insights in time for this report. In addition, we have recently commissioned two other projects for our 2015 Report, on the impact of the minimum wage on employment and hours, and on the interaction of the NMW with the tax and benefits system. We also hope to issue another invitation to tender for research in the spring of 2014.
- 4 Dawson, Ritchie, and Whittard (2014) assessed the reliability and usefulness of official data sources. Previous research by Fry and Ritchie (2012a and 2012b) had raised some issues concerning the data and these were investigated in this study. It covered six areas; an overview of existing data sources; an extension of the previous research by Fry and Ritchie

(2013b), to investigate reliability and rounding in the Annual Survey of Hours and Earnings (ASHE) and Labour Force Survey (LFS); a comparative analysis of the British Household Panel Survey (BHPS)/Understanding Society and the LFS; an investigation into the imputation process used for the earnings data in the LFS; a study of how wage rates relate to household and family earnings; and a brief review of other potential data sources.

- 5 They provided an overview of the different data sources used by the Commission in its analyses. This descriptive summary included coverage, timing, sample sizes, variables available, and a view on the usefulness of the data in Low Pay Commission research and analysis.
- 6 The investigation into rounding and measurement error in ASHE and the LFS built on previously commissioned work by Fry and Ritchie (2012b). Similar to the previous research, the new research found evidence that employers set wages at focal points (round numbers). This finding was persistent over time and was most noticeable among small, private sector firms. Rounding by occupation was more likely than by industry. These findings suggested that small variations in the minimum wage were absorbed by business. Rounding by employers was predictable and did not appear to be random.
- 7 The potential for measurement error was more severe using household data (the LFS in this case) than individual data from employers (ASHE). There was much greater divergence between stated and derived earnings in the LFS and the regression analysis suggested that it was more prevalent among proxy responses. This strong result had not been found in the previous work.
- 8 Rounding was investigated further by analysing the BHPS/Understanding Society. The researchers found that when the pay information was exact (taken from a pay slip) the data were similar to that from ASHE, but that when the data were not 'exact', they were more like the LFS. Thus, there appeared to be lessons for ONS to improve the accuracy of data collection. In general, they concluded that rounding of earnings data by employers was dependent on the pay period and was stable over time. In contrast, rounding by employees appeared to be measurement error; but although significant, noticeable and predictable, this error was largely unrelated to employee characteristics. Hence, the errors seem unlikely to bias statistical analyses of the LFS.
- 9 The LFS is essential for understanding low pay by certain personal characteristics. A review conducted by ONS in 2003 had found that the derived hourly earnings data in the LFS suggested much lower hourly wages than those estimated using ASHE. To correct for this, ONS introduced imputation to fill some of the data gaps caused by small cell sizes and missing information in order to enable the distribution of earnings data to more closely resemble ASHE. This study investigated this imputation process. The new analysis raised some concerns about spurious accuracy and its sensitivity to low-pay thresholds, and hence the way in which any findings should be interpreted. However, it also found that simpler alternatives, such as scaling up results for different ethnic groups, were equally likely to present misleading statistics. The researchers recommended that the use of imputation be reviewed, and that the code be rewritten to allow for sensitivity analysis and greater information on the quality of estimates.

- 10** Their study also gave a brief overview of other potential data sources. Generally, the data sources investigated appeared reliable and robust. We now go on to see how these data sets have been used to assess the impact of the minimum wage.
- 11** Two of the research projects investigated the impact of the NMW on pay settlements and structures. Using data from the 2011 Workplace Employment Relations Survey (WERS) and ASHE, Bryson and Lucchino (2014) investigated the importance of the minimum wage in setting pay in British workplaces. WERS is a nationally representative linked employer-employee survey of 2,680 workplaces with more than 5 employees. The research made use of the employer survey and the responses to questions about how pay is set. They used the more robust ASHE earnings data to adjust the pay data in WERS to reduce their variance and the estimates of the numbers paid below the NMW. The study found that the NMW was the third most important factor in setting private sector pay, cited by just under a third of employers (it was cited by fewer than 15 per cent of public sector employers). They also showed evidence of potential knock-on effects further up the wage distribution.
- 12** Bryson and Lucchino (2014) also explored relationships between the characteristics of workplaces and employees and the incidence of the NMW as an important factor in determining pay. The results suggested that the impact of the minimum wage was greatest in hospitality; in those workplaces with more NMW workers; in workplaces with more women, migrants and part-time workers; and in those firms where demand was sensitive to price. They also found limited effects of recession on the influence of the NMW in pay-setting. But those mentioning the NMW as an influence had responded differently to the recession from those that did not. There was evidence to suggest that they were more likely to have absorbed the demand shock by adjusting hours rather than employment.
- 13** In the other research project on pay settlements and pay structures, Incomes Data Services (IDS, 2014a) investigated the impact of the minimum wage and recession on pay and reward for low-paid employees. It explored the relationship between the NMW and the rates paid at the bottom of pay structures as well as examining the use of age-related pay rates, pay premia and non-pay benefits. It used an employer survey to augment its usual pay database. It found that the lowest pay rates had increased at similar rates to the NMW and that differentials had been restored to an extent in 2012 after some compression in the recession. When analysing the use of age-related pay rates, it found some convergence to the use of 18 and 21 as the starting age for the adult rate rather than a continuum. Youth rates were also more prevalent among small employers. There had continued to be a general move away from age-related pay in retail although a pause had appeared in 2012 when many firms froze youth rates, in line with freezes in the NMW. The move away from age-related pay or reducing age differentials had continued in 2013 among some large retail employers.
- 14** Previous IDS research (IDS, 2005) had suggested that firms were moving away from paying premiums for unsocial hours, particularly in retail for weekend and bank holiday work. The latest data suggested that this trend had continued with less generous unsocial hours payments in 2011 and 2012 than in previous years. However, night rates continue to be paid. Low-paid employees were less likely to receive non-wage benefits than their higher-paid colleagues with employers claiming that benefits were offered mainly for recruitment and retention purposes. However, some rewards had improved since the onset of recession as

firms looked for alternatives to general pay increases. The study's early findings on pension auto-enrolment suggested that opt-out rates had been much lower than expected, at just 7 per cent. However, firms not yet affected expected much higher opt-out rates, at around 44 per cent on average.

- 15** In an alternative way of looking at the pay package, Gregg and Papps (2014) used ASHE data to assess how changes in the minimum wage had affected workers' hourly, weekly and annual earnings; earnings from overtime, shift or incentive pay; and type of pension scheme or employee contract (whether permanent or temporary). The study also used longitudinally-matched quarterly LFS data for 1998-2011 to examine the effect of the minimum wage on different non-wage components of workers' total compensation. In line with much previous research, they found that the minimum wage had decreased weekly work hours but that this decrease was small and had not led to falls in weekly income. But they found no impact on annual wages. There was no evidence that the minimum wage affected the amount of incentive or shift pay received. The minimum wage was also found to have no significant effects on overtime pay or pension provision.
- 16** As well as looking at the impact of the NMW on earnings and now-wage elements of the pay package, the research also looked at the impact of the NMW on employment and the use of flexible employment arrangements. Previous research had found little adverse impact on employment but had not considered in any great detail the impact on the type of employment contract. In contrast to some of those previous studies, this study exploited individual panel data to examine effects of the minimum wage. Their results suggested larger negative employment effects than previously reported in other research (such as Bryan, Salvatori and Taylor 2013 or Dickens, Riley and Wilkinson 2011), particularly in the post-2008 period. However, these negative effects provide only part of the picture as they only capture exit probabilities. The research takes no account of any increased entry probability as a result of higher wages. Only when the two effects are taken together can we identify the impact from the NMW on employment. They found little effect on other aspects of employment, such as the use of zero-hours contracts, although they noted that there were identification problems using the LFS.
- 17** Bewley, Rincon-Aznar and Wilkinson (2014) also investigated the impact of the NMW on the changing use of flexible employment. Their study used WERS to assess changes in flexible working practices between 1998, 2004 and 2011. It used employee data from WERS to identify NMW workers and workplaces, and then used the management surveys to look at flexible working. This was supplemented by analysis of LFS over a similar time period.
- 18** They found that the use of flexible employment in both low-paying and slightly higher-paying workplaces increased following the introduction of the NMW. While there was some evidence that the increase was greater in low-paying workplaces, this might have reflected the higher incidence of flexible employment practices in higher-paying workplaces in 1998. Since 2004, the patterns were broadly similar in low-paying and higher-paying workplaces, suggesting that the increase in the use of flexible employment by employers over time was due to factors other than the introduction of the NMW.

- 19** There were notable increases in the use of a range of flexible working arrangements between 1998 and 2004 in both low-paying and slightly higher-paying workplaces. In low-paying workplaces, the use of zero-hours contracts increased between 1998 and 2004 (albeit weakly significant), and increased significantly between 2004 and 2011, whereas this was not the case in workplaces which offered slightly higher pay-levels.
- 20** Between 1998 and 2004 workplaces which used flexible working arrangements were as likely to close as those without flexible working arrangements, even when the likelihood that the workplace was affected by the NMW was taken into account. For the period from 2004 to 2011, the association between the use of flexible working and workplace closure appeared slightly stronger for higher-paying workplaces than lower-paying ones, but whether the relationship was positive or negative depended on the type of flexible working considered. Generally speaking then, there was little evidence that since the introduction of the NMW the survival prospects of low-paying workplaces had been affected by the use such workplaces had made of flexible working arrangements. There was also little evidence to suggest that the impact of the recession on low-paying workplaces was related to the use of flexible working arrangements.
- 21** The LFS analysis focused on the use of flexible working arrangements: flexitime, annual-hours contracts, term-time only working, job-sharing, compressed-hours and zero-hours contracts; the use of flexible employment: part-time employment, self-employment, homeworking and temporary employment; and different types of temporary employment: seasonal work, fixed period/fixed task work, agency work, casual work and other types of temporary employment.
- 22** The multivariate local area analysis focused on 136 areas used in previous work for the Commission. Their estimates found no evidence of a relationship between the bite of the NMW and the use of any of the flexible working arrangements, but the shares of part-time employment and agency workers were higher when the bite of the NMW was higher. There was no evidence that low-paying workplaces varied their use of flexible working practices during the recession.
- 23** Further analysis considered whether flexible working arrangements were related to the extent of non-compliance with the NMW. Using WERS, they found that the use of shiftworkers was associated with a lower likelihood of complying with the NMW, while compliance was more common where compressed hours, homeworking or agency workers were used. These associations were evident in both 2004 and 2011. No other associations were sustained over time. Using the LFS, their estimates of non-compliance confirmed previous work by le Roux, Lucchino and Wilkinson (2013), which showed higher non-compliance when part-time employment was high.
- 24** As well as considering the impact on employment and earnings, we also commissioned research on the impact of the NMW on prices, consumption, savings and debt. Aitken, Dolton and Wadsworth (2014) investigated the effects of the NMW on the consumption patterns, and savings and debt behaviour, of NMW workers and NMW households relative to others. This work built on previous work that we have commissioned (Wadsworth 2007 and 2008; and Brewer, May and Phillips 2009). They used the Family Expenditure Survey (FES)

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and its successors, the Expenditure and Food Survey (EFS) and the Living Costs and Food Survey (LCF) to update that previous analysis. They used different definitions to identify NMW individuals and households, and these were used to provide robustness checks.

- 25** They found that NMW households were generally poorer than other working households but that consumption patterns were similar. As a result of these similar budget shares, price changes were broadly in line for NMW and other working households, so a finding of change in consumption patterns because of any differential price changes should not be expected. They did, however, find that price rises appeared to have been lower for workless households. They found little evidence of any significant change in the spending patterns of households in receipt of a minimum wage income relative to other households over time.
- 26** A recent US study by Aaronson, Agarwal and French (2012) found that consumption increased significantly following a minimum wage hike, along with greater indebtedness. Comparing the behaviour of minimum wage households in states that raised wages with minimum wage households in states that did not, they found that positive NMW income shocks boosted debt-financed purchases of consumer durables (mainly cars). Aitken, Dolton and Wadsworth (2014) attempted to apply a similar analysis to the UK, using panel data on individual and household incomes, consumption, spending and debt. Using the BHPS/ Understanding Society, and the Family Resources Survey, the research attempted to identify any effects from the NMW. They found that indebtedness and deprivation were worse for NMW households than for other working households, although the situation was even worse for non-working households. The ability to heat ones home and save regularly appreciably worsened over the years of recession. Savings declined by about 20 per cent for NMW individuals between 1999 and 2010 (the decline for non-working households was even greater, at 40-50 per cent). There was evidence that the financial situation disadvantage of NMW households improved between 1998 and 2003 before re-emerging at the onset of recession.
- 27** The final research project for this report looked at apprenticeships. London Economics (2013) produced a very comprehensive study of apprentice pay across 14 different countries. It found that there was substantial variation in the nature of apprenticeship characteristics across countries, in terms of both how apprenticeships are structured, funded and governed; the incidence of apprenticeships (and the extent of academic and vocational training more generally); the level of apprenticeship qualification; the main sectors of apprenticeship training; and the personal characteristics of apprentices. The nature of the labour market; and the education and training system in each of the jurisdictions made cross-country comparisons difficult.
- 28** Enrolment in the different educational paths at upper secondary level varied substantially by jurisdiction, with vocational qualifications dominating in Northern European countries, while the opposite was the case in Spain, Ireland, the UK and New Zealand. Within vocational training, work-based learning dominated in Switzerland, Germany and Denmark, while it was substantially less prevalent in Ireland, France, Belgium and Spain. Apprenticeships in the UK were generally of shorter duration than elsewhere (other than Spain).

- 29** Using a range of data sources, the study assessed average apprentice pay in the various jurisdictions compared with the adult minimum wage (where it existed), the weighted average of sectoral/regional minimum wages (where appropriate) or the average wage among the unskilled (as a proxy). In the case of the fully qualified rate, it used the rate of pay achieved by those with the relevant apprenticeship qualification or the point on the salary scale at which apprentice pay is calculated. Across all apprentices, apprentice pay in the UK (with some variation by country) ranged between 50 and 60 per cent of the fully qualified rate irrespective of year of training. However, there was significant variation in pay by age, which was especially important given that the recent expansion of apprenticeships in the UK was concentrated among those aged 25 and over. For those apprentices aged under 19, the average apprentice pay rate was around 32 per cent of the fully qualified rate, compared with 70 per cent for those apprentices aged 25 and over. Apprentice pay in the UK was quite concentrated compared with other countries and may reflect the multiple levels of apprenticeship qualification available in the UK compared with the single path of apprenticeship attainment in most other countries. Evidence also suggested that there may be a relatively high level of non-compliance with the Apprentice Rate, the minimum wage for apprentices.
- 30** Some countries (Switzerland, Germany and France) offered very low headline pay to apprentices with limited progression across training years (less than 40 per cent of the fully qualified rate). In contrast, some countries (Scandinavia and Australia) offered steep earnings progression to apprentices (from 35 per cent in the 1st year and 70 per cent in the 4th year) with a similar style of pay progression in Austria and the Netherlands. Other jurisdictions (Ireland and Italy) offered relatively high apprentice pay as a proportion of the fully qualified rate by time of completion (up to 95 percent).
- 31** The study concluded that in the UK, apprentice pay was on average around the full adult minimum wage for the duration of the apprenticeship – and about 10-20 per cent higher on completion (of the third year of training). These relativities were generally comparable with Australia, Italy, Denmark, the Netherlands, and Austria (though with the exception of Austria, these countries have higher minimum wages than the UK). In Ireland, apprentice pay (determined by the social partners by apprenticeship sector) exceeded the national minimum wage in the first year and was almost double the national minimum wage by completion. At the other end of the spectrum, in Belgium and Germany, apprentice pay reached approximately 50 per cent of the national minimum wage or sectoral minimum (again with relatively limited variation in terms of the year of training). Switzerland has an apprenticeship structure that aims to be cost neutral to employers over the duration of the apprenticeship, with very low rates of apprenticeship pay reflecting this objective (about 20 per cent of the minimum wage). In the UK, as noted above, apprentice pay varied considerably by age. Average apprentice pay for apprentices aged under 19 was approximately 63 per cent of the adult rate of the National Minimum Wage, compared with 132 per cent for apprentices aged 25 and over.

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- 32** In addition to the research commissioned specifically for this report, we have also already commissioned three research projects for the 2015 Report: Riley and Rosazza Bondibene (ongoing) are undertaking a project investigating the impact of the NMW on UK businesses; London Economics (ongoing) is assessing the impact of the minimum wage on young people; and Drew, Ritchie, Veliziotis and Webber (ongoing) are looking at apprentice pay and compliance with it. We have received some early findings from these studies. These are summarised in Table A1 below. We will present these results in full on completion of the projects in time for our 2015 Report.
- 33** In conclusion, in general the research commissioned for this report has not altered the overall conclusion suggested by previous research, that there has been little adverse impact of the minimum wage on employment.

Table A2.1: Low Pay Commission Research Projects for this Report

Project Title and Researchers	Aims and Methodology	Key Findings and Results
<p>Understanding Official Data Sources</p> <p>Chris Dawson (University of Bath), Felix Ritchie, and Damian Whittard (University of the West of England)</p>	<p>This study built on previous work by Fry and Ritchie (2012a and 2012b) and had three elements:</p> <ol style="list-style-type: none"> A qualitative summary of micro and macroeconomic data resources. It focused on those data sources that have been used to assess the impact of the NMW, including: coverage; variables available; timing; and sample size, as well as how key measures of low-wage activity differ. It provided an overview of the limitations of official data sources for the analysis of low pay; An analysis of the 'core' LPC data sets, Annual Survey of Hours and Earnings (ASHE) and Labour Force Survey (LFS), with the main focus on refining the general results from Fry and Ritchie (2012b) to assess rounding behaviour and establish sources of measurement error more precisely. This section also included an extension to analyse rounding behaviour in the British Household Panel Survey/Understanding Society in order to investigate whether the characteristics of the LFS were unique to that survey or generic to employee responses; and An investigation into the imputation process used in the LFS in order to account for missing data as a result of small cell sizes and missing information. 	<p>The key findings from the research were:</p> <ul style="list-style-type: none"> ● Rounding of pay was evident in both employer and employee data sets. ● For employers, rounding behaviour was to some degree predictable and showed that many low-paying employers were not constrained by the NMW but had some flexibility over pay. This indicated that wages could be set according to characteristics other than measurable productivity. This was most evident in small firms and private sector companies. The occupation of the employee appeared to be a more important factor than industry. ● For employees, they found measurement error in the LFS but it was largely unrelated to personal characteristics. This meant that multivariate analyses using LFS should not be biased by measurement error. But proxy responses and failure to check pay slips were both consistently associated with measurement error. The BHPS/Understanding Society data supported the view that measurement error of pay from household data was largely random. The most important finding was that there was firm evidence in the value of checking whether respondents' answers were 'exact' (taken from pay slips). ● Three potential problems with the imputation of data in the LFS were identified: not recognising the asymmetry caused by the existence of the NMW; small numbers of observations; and the choice of interventions available to the analyst. ● The imputation methodology and statistical model had been developed in 2002-03 and had not been refined since. It found that there were sources of potential errors and difficulty in updating and allowing for alternative scenarios. The methodology was not efficient and did not provide statistical information on the accuracy of the estimates. They recommended that the LPC consider having the code reviewed and updated. ● Despite concerns about imputation in the LFS, the study concluded simpler alternatives (such as using a different hourly earnings measure) were also unsatisfactory, and hence recommended improvement of the imputation code.
<p>The Influence of the National Minimum Wage on Pay Settlements in Britain</p> <p>Alex Bryson and Paolo Lucchino (National Institute for Economic and Social Research)</p>	<p>This project attempted to identify the impact of the NMW on pay settlements using the 2011 Workplace Employment Relations Survey (WERS) and ASHE.</p> <p>The aims of the project were:</p> <ol style="list-style-type: none"> To investigate the factors influencing pay settlements, including the NMW; To establish the nature of pay settlements that were affected by the NMW, including the frequency pay is reviewed or negotiated and the outcome; To establish whether the NMW played any role in pay settlements for employees paid above the NMW level; To establish the nature of pay determination arrangements in place at workplaces where the NMW influenced the pay settlement; To identify what was distinctive about workplaces that mentioned the NMW as an influence on the latest pay settlement; and To identify what role the recession may have played in amplifying (or limiting) the role of the NMW in affecting pay settlements. 	<p>The key findings from the research were:</p> <ul style="list-style-type: none"> ● Around 30 per cent of all establishments, covering 23 per cent of all employees, mentioned the NMW as an influence on the pay settlement of their largest occupational group. ● The NMW was the third most quoted factor out of a possible nine, ranked well behind 'financial performance', but only slightly behind 'cost of living' changes. ● When the NMW was cited as an influence on the pay settlement of the largest occupational group there was strong evidence of bunching in the size of the settlement around the size of the NMW increase. ● Around 15 per cent of establishments where the median wage was above £7.50 per hour mentioned the NMW as an influence on the latest pay settlement. The researchers interpreted this as evidence of the NMW having potential knock-on effects further up the wage distribution. ● Higher-paying establishments that cited the NMW as an influence on pay settlements tended not to pass through the full uprating. This was consistent with the possibility of the NMW compressing wage differentials. ● In the private sector, the share of women, part-time and non-British workers were all positively associated with the NMW being mentioned as an influence on pay settlements (even conditioning on pay). The positive association with firm size disappeared when controlling for pay levels. ● In the private sector, the NMW appeared to have a stronger role when other forms of pay protection, such as collective bargaining, were absent. ● In the public sector, very few characteristics in the setting of pay emerge as positively correlated with the NMW. ● There was little association between establishments' experience of the recession and whether they mentioned the NMW as an influence on the pay settlement of the largest occupational group.

Project Title and Researchers	Aims and Methodology	Key Findings and Results
<p>Pay, Non-pay Benefits, Young People and the Minimum Wage</p> <p>Laura James, Ken Mulkearn, Lois Wiggins, and Louisa Withers (Incomes Data Services)</p>	<p>Using internal pay data and a survey of small firms, this project attempted to address the following key questions:</p> <ol style="list-style-type: none"> Have increases in the level of the minimum wage had an impact on pay-setting for employees at the bottom end of pay structures? What has happened to differentials between pay rates and the minimum wage during recession? Have employers made changes to the treatment of, and associated premia for, unsocial hours, overtime and bank holidays? Has the minimum wage had an impact on the provision of non-pay benefits to low-paid employees in low-paying sectors? Has the recession led to an increase in the use of age-related pay rates? Have there been any changes in employers' age-related reward practice since the reduction in the age at which the adult statutory minimum wage applies? What has happened to levels of pay for young workers versus that for adult workers at company level? 	<p>The key findings from the research were:</p> <ul style="list-style-type: none"> Increases to pay rates at the bottom end of pay structures have continued to be influenced by the size of the increase to the National Minimum Wage, however, the trend in differentials has been more unpredictable since the onset of recession. Around a third of employers operated age-related pay but the vast majority set their own youth rates, usually at round numbers, rather than making use of the statutory youth rates. IDS had previously monitored a trend away from paying different rates to younger workers in the retail sector and this trend had continued in the latest period. Over the longer period there had been a convergence in the age at which adult rates were paid to either 18 or 21, with 21 being the most common. Low-paid employees often received premium pay for working unsocial hours, although IDS has monitored a trend away from paying premiums on Sundays and reducing premiums for bank holidays which began before the recession and had continued in the latest period. Sunday working was increasingly paid at basic pay, while most bank holidays still attracted premiums, albeit at lower levels than previously. Premiums for night working had been more resilient and continued to be paid in many cases. The reward package for low-paid workers included other non-wage benefits, however, these were mostly low-cost and generally less generous than for higher-paid staff. During the recession some employers had enhanced their benefits offering. The impact of pensions auto-enrolment may have been more than expected as employers reported lower opt-out rates among low-paid workers than anticipated.
<p>Beyond the Wage: Changes in Employment and Compensation Patterns in Response to the National Minimum Wage</p> <p>Paul Gregg and Kerry Papps (University of Bath)</p>	<p>The aim of this project was to examine how the NMW had changed aspects of individuals' work arrangements, including the composition of low-paid workers' total compensation and employment retention.</p> <p>The study followed a similar empirical approach, using the construction of a wage gap variable, to that adopted by Stewart (2004), Dickens, Riley and Wilkinson (2012), and Papps (2012). It used individual-level longitudinal data from both the ASHE and LFS.</p> <p>Specifically, it explored whether workers who were affected by a minimum wage increase were more likely to experience reductions in: weekly working hours (or weeks over the year); the rewards for overtime or shift work; or entitlements to pensions and different forms of leave. It also investigated employment retention and the use of flexible employment arrangements.</p>	<p>The key findings from the research were:</p> <ul style="list-style-type: none"> Most previous research has focused on the possible negative employment effects associated with the minimum wage. This study found that there were statistically significant but small negative effects on employment retention (or increased exits from employment). The relationship between job separations and the minimum wage appeared stronger after the onset of recession in 2008. Compared with adults, young people were not significantly more likely to exit their jobs. The minimum wage was found to reduce work hours and weeks among those who remained with the same employer, reducing the overall positive effect of the minimum wage on their annual pay. There was no evidence that the minimum wage affected workers' levels of non-basic pay (incentive pay; shift or premium pay; and overtime pay) There was also no evidence that the NMW affected the likelihood of shifting from a permanent contract to a temporary contract or of losing eligibility for a pension. The minimum wage was also not found to have a significant effect on the use of various types of flexible work arrangements, such as zero-hours contracts. <p>However, this study did not account for any entry effects. Only when we consider both can we identify the impact of the NMW on employment.</p> <p>Further, the researchers noted that the limitations in the availability of data in the LFS and of its structure are a hindrance to obtaining accurate estimates of these relationships.</p>

Project Title and Researchers	Aims and Methodology	Key Findings and Results
<p>An Assessment of the Changing Use of Flexible Employment and Implications for the National Minimum Wage, Including Compliance</p> <p>Helen Bewley, Ana Rincon-Aznar and David Wilkinson (National Institute of Economic and Social Research)</p>	<p>The aims of the project were to:</p> <ol style="list-style-type: none"> Examine changes in the use of flexible employment and the relationship with the NMW; Explore how the use of flexible employment changed during the recession and whether there were any implications for the NMW; and Investigate the extent to which non-compliance with the NMW varied with the type of flexible employment. <p>The study used the 1998, 2004 and 2011 WERS to explore changes in the incidence of flexible working over time in those workplaces most likely to be affected by the NMW. It also examined the LFS, which provided information on the incidence of various forms of flexible work in the UK. Flexible working arrangements included: self-employment; permanent or temporary jobs (including casual, seasonal, agency, or work based on a fixed-period or fixed-task contract); part-time or full-time jobs; homeworking; shiftworking; the pattern of working hours; and the type of agreed work arrangement (flexi-time, annualised hours contract, term-time contract, job sharing, zero-hours contract, on-call working).</p> <p>The study also considered the implications of flexible working for compliance with the NMW. They built on previous work by le Roux, Lucchino and Wilkinson (2013) and looked at whether the increased variation in hours worked, related to some types of flexible working such as zero-hours contracts, made it more difficult to comply with the NMW.</p>	<p>The key findings of the research included:</p> <ul style="list-style-type: none"> Low-paying sectors were less likely to use annual-hours contracts, job sharing, term-time only and fixed-term or temporary contracts but were much more likely to use zero-hours contracts. Temporary work was more prevalent among the lowest paid but not in the low-paying sectors. The rise in the use of flexible working arrangements has been due to factors other than the NMW, but NMW-affected workplaces were more likely to adopt these between 1998 and 2004. The results suggested there was little evidence that since the introduction of the NMW survival prospects of low-paying workplaces have been affected by their use of flexible working arrangements. Estimates of non-compliance using LFS confirmed previous work, showing higher non-compliance when part-time employment was high. Analysis of WERS found that the use of shiftworking was associated with a lower likelihood of NMW compliance, but that compliance was more common where homeworking, compressed hours or agency workers were used.
<p>Did the Minimum Wage Change Consumption, Saving and Debt Behaviour?</p> <p>Andrew Aitken (Royal Holloway College, University of London), Peter Dolton (University of Sussex and Centre for Economic Performance, London School of Economics) and Jonathan Wadsworth (Royal Holloway College, University of London and Centre for Economic Performance, London School of Economics)</p>	<p>The aim of this study was to provide an assessment of the impact of the minimum wage on the consumption spending of low-paid workers and the interaction with indebtedness.</p> <p>Using the Family Expenditure Survey (FES), the Expenditure and Food Survey (EFS) and the Living Costs and Food Survey (LCFS), this study updated the previous work by Wadsworth (2007 and 2008), which had concluded that minimum wage households, while notably poorer than average, had similar spending patterns. However, that study did not take into account to what extent consumption in low-pay households was debt-financed.</p> <p>There has been little academic work on debt responses to minimum wages, although a recent US study by Aaronson, Agarwal and French (2012) explored this issue. This study attempted a similar analysis for the UK, using panel data from the BHPS/ Understanding Society, as well as the Family Resources Survey (FRS) to investigate the impact on individual and household incomes, consumption, saving and debt. This attempted to provide a more complete understanding of indebtedness among the low paid and how it has changed over the last 20 years.</p>	<p>The key findings of the research included:</p> <ul style="list-style-type: none"> Minimum wage households were generally poorer than non-minimum wage working households. The average disposable income was around 50 per cent lower in NMW households than in other working households. There was considerable heterogeneity of income among minimum wage households. Around 10 per cent of working households relied on minimum wage workers as their main source of wage income. Only 1 per cent of all working households had more than one minimum wage worker. Around 30 per cent of minimum wage workers lived in households with an aggregate income less than 60 per cent of the median household income for all households with at least one employee. There were few significant differences in expenditure patterns across household types, although adult NMW households appeared to spend a slightly larger fraction of their income on food, compared with other households with non-NMW workers. Using a variety of measures, indebtedness and deprivation were worse for NMW households than they were for other working households but that the position of the non-working households was significantly worse still. Using BHPS/Understanding Society, the biggest effect on NMW individuals had been the decline in saving of around 20 per cent over the 1999-2010 period. This had been mirrored in the decline in saving of non-working households of around 40-50 per cent over the same period. The financial disadvantage of NMW households improved between 1998 and 2003 before re-emerging at the onset of recession.

Project Title and Researchers	Aims and Methodology	Key Findings and Results
<p>An International Comparison of Apprentice Pay</p> <p>Claire Benard, Cecilia Caliendo, Gavan Conlon, Rasmus Flytkjaer, Maike Halterbeck, Daniel Hearn, David Innes, Marguerita Lane (London Economics) and Steve McIntosh (University of Sheffield)</p>	<p>The aim of this study was to investigate the level of apprentice pay across countries. Essentially, this project updated the work of Steedman (2010) and extended the analysis from 8 to 14 countries. It conducted international comparisons across 5 distinct groupings of nations: English-speaking (UK, Australia, NZ, Ireland); Scandinavian (Denmark, Sweden); Francophile (France, Belgium); southern European (Spain, Italy); and central European (Germany, Netherlands, Austria, Switzerland).</p> <p>It provided detailed descriptions of:</p> <ol style="list-style-type: none"> the nature of the educational structure in each country; the incidence of vocational training and apprenticeships; apprenticeship structure; funding arrangements; and apprentice pay. <p>In analysing apprentice pay, the study looked at absolute pay; pay relative to the relevant minimum wage; and pay relative to the 'fully qualified' rate.</p> <p>They also provided comparisons across countries using purchasing power parities.</p>	<p>The main findings of the research include:</p> <ul style="list-style-type: none"> ● There was substantial variation in the nature of apprenticeship characteristics across the 14 countries, in terms of both how apprenticeships are structured and governed and the incidence of apprenticeships. ● The nature of the labour markets in each country added to the complexity of the comparison of pay. ● The (median) duration of apprenticeships in the 14 countries considered varies considerably. Across most countries, apprenticeships lasted for at least 36 months. Only Spain had shorter median durations than the UK. ● The majority of the 14 countries were associated with higher levels of funding for vocational qualifications than academic qualifications – sometimes significantly so. ● Countries operating a highly integrated, high-quality apprenticeship system were associated with lower youth unemployment rates. ● Across all apprentices, the analysis suggested that the level of apprentice pay was higher in the UK than in those countries operating an established (Dual) apprenticeship system (for example Austria, Germany, and Switzerland). Apprentice pay in the UK was also significantly higher than in France and Belgium. UK apprentice pay is at generally comparable levels with apprentices in Denmark and Sweden (although there were more structured pay increments as training progressed in these countries). ● There is significant variation in the level of apprentice pay by age in the UK, with apprentices aged under 19 earning less than half that of apprentices aged 25 and over. ● Even considering apprentice pay among younger apprentices only, the levels of UK apprentice pay were higher than in those central European countries operating the Dual Apprenticeship system. <p>The study concluded that the level of pay was low in Dual Apprenticeship system countries because: the quality (and cost) of training was high; there were strong returns once qualified; and the integrated nature of vocational training enabled better transition into apprenticeships from school.</p>

Table A2.2: Low Pay Commission Research Projects for our 2015 Report

Project Title and Researchers	Aims and Methodology	Progress to Date and Any Key Findings
<p>The Impact of the National Minimum Wage on UK Businesses</p> <p>Rebecca Riley and Chiara Rosazza Bondibene (National Institute of Economic and Social Research)</p>	<p>This project, to be completed for our 2015 Report, aims to build on previous evidence to answer the following questions:</p> <ol style="list-style-type: none"> How has the distribution of average labour costs across businesses developed since the introduction of the NMW? How can treatment and control groups be best defined when analysing NMW impacts using firm-level data?; and How has the NMW affected the behaviour of smaller and larger firms and firms in the low-paying sectors? In particular, how have these impacts changed since 2008 and with recent NMW upratings? <p>They will examine the impacts of the NMW taking a similar approach to that taken by Draca, Machin and Van Reenen (2005 and 2011) and in their previous work (Riley and Rosazza Bondibene, 2013). They will use a difference-in-differences approach applied in the main to firm-level data. They will analyse two business data sets: the record of UK company accounts provided in Financial Analysis Made Easy (FAME) and the Annual Respondents Database (ARD) held by the ONS. They will consider wages, productivity, profitability and probability of exit. They will distinguish any impacts by firm size.</p> <p>In comparison with Riley and Rosazza Bondibene (2013) they aim to make several improvements to the data analysed:</p> <ol style="list-style-type: none"> a more comprehensive database using annual historical FAME extracts; make the analysis of the ARD and FAME more comparable; use post-recession data from the ARD; and provide more up-to-date analysis including data to 2012. 	<p>This project will not be finalised until our 2015 Report. However, the researchers have undertaken some initial analysis for us for this report. Their preliminary findings include:</p> <ul style="list-style-type: none"> Workers paid at or below the NMW are concentrated in establishments with low average labour costs. This pattern has persisted over time and is evident within small and medium enterprises (SMEs), larger companies, and among low-paying sectors. Average labour costs per head increased among low-paying firms (the treatment group) compared with less low-paying firms (the control group). This was clear across firm size (SMEs and large firms), and across sectors (for firms in low-paying sectors and other market sectors). The magnitude of these average labour cost effects was greatest upon introduction of the NMW and smallest during the recession. This was in line with changes in the NMW over time, which were relatively much larger prior to the onset of recession. As yet no robust evidence has been found to suggest that trends in profit margins differed substantially between lower and higher average labour cost businesses over any of the periods analysed. Some evidence was found to suggest that GVA per head increased among low-paying firms, compared with firms with higher average labour costs. This was particularly evident upon the introduction of the NMW but was less clear during later periods. The analysis so far suggests results may be sensitive to the inclusion of additional control variables.

Project Title and Researchers	Aims and Methodology	Progress to Date and Any Key Findings
<p>The Impact of Minimum Wages on Young People</p> <p>Gavan Conlon, David Innes, Rohit Ladher, Patrice Muller, Pietro Patrignani (London Economics) and Steve McIntosh (University of Sheffield)</p>	<p>This project, to be completed for our 2015 Report, should provide a comprehensive overview of the impact of minimum wages on young people and give important insights into the youth labour market. The study has five main aims:</p> <ol style="list-style-type: none"> Provide a literature survey to gain a clear understanding of the use of the youth rates of the minimum wage in the UK; their evolution, and their relativities to each other and the adult rate; Investigate, using econometric analysis, the impact of the introduction and subsequent upratings of the youth rates of the minimum wage. This will include assessing the impact of the recent freeze in youth rates as well the impact of reducing the age of entitlement to the adult rate to 21; Consider an international perspective on the impact of minimum wages on young people; Attempt to provide a clear understanding of the extent of unpaid internships; and Explore the implications for the NMW of raising the participation age in England. <p>The researchers will use data from the LFS, ASHE, and BHPS/Understanding Society in order to achieve these aims and identify the determinants that influence young people's decisions to enter the labour market using binary and multinomial models.</p>	<p>This project will not be finalised until our 2015 Report. However, the researchers have undertaken some initial analysis for us for this report. Their preliminary findings include:</p> <ul style="list-style-type: none"> Assessing the impact of the minimum wage on young people using a regression discontinuity approach, the researchers found a statistically positive effect for low-skilled men prior to September 2011. For women, the positive effect was not statistically significant. However, they found large and statistically significant negative impacts on employment after October 2011 in some specifications but these were not robust. In both periods, the changes in employment appeared to be the result of changes to unemployment. They also found no effect on hours at the age threshold. Investigating the impact of the recession, they found some evidence of an increase in employment probabilities for low-skilled women on becoming eligible for the adult rate in the pre-recession period. They found no effects in the recession period. The results for men were not statistically significant, however, they did find some evidence of a positive impact on hours for low-skilled men in the recession period. Looking at reducing the age of entitlement to the adult rate to age 21, they found weak evidence of a positive effect on 21 year olds being employed when compared with 20 year olds but there is also evidence that this has reduced the number of hours worked by 21 year olds. They found a significant fall in the likelihood of being inactive when comparing 21 year olds with either 20 or 22 year olds and this was due to increases in both employment and unemployment. The effects on inactivity and unemployment were significant for men but not for women.
<p>Apprentice Pay</p> <p>Hilary Drew, Felix Ritchie, Michalis Veliziotis and Don Webber (University of the West of England)</p>	<p>This project, also to be completed for our 2015 Report, builds on the work conducted for us by Behling and Speckesser (2013) for the 2013 Report. That study provided a detailed analysis of the impact of the introduction of the Apprentice Rate. This study will provide a detailed analysis of the position of apprentices vis-à-vis other labour market participants, particularly studying distributive effects before and after the introduction of the Apprentice Rate. It will extend the analysis up to 2013.</p> <p>The research will:</p> <ol style="list-style-type: none"> Provide a descriptive analysis of the characteristics of apprentices; Assess the impacts of the Apprentice Rate on labour market choices of young people; and Investigate the extent of non-compliance. <p>For the quantitative analysis, both the LFS and the BIS Apprentice Pay Surveys will be used. The LFS has information on apprentices, their pay and their demographic and job characteristics. Moreover, apprentices and non-apprentices can be compared before and after the introduction of the Apprentice Rate. Data up to the first quarter of 2014 will be used. The BIS Apprentice Pay Surveys 2011 and 2012 will be analysed thoroughly. They will also use the 2014 BIS Apprentice Pay Survey if it is made available in time.</p>	<p>This project will not be finalised until our 2015 Report. However, the researchers have undertaken some initial analysis for us for this report. Their preliminary findings include:</p> <ul style="list-style-type: none"> In preliminary analysis of the 2012 Apprentice Pay Survey, they found that there was a difference of nearly 13 percentage points in non-compliance between individuals that report an hourly pay rate and individuals that do not. Thus, non-compliance calculated using a derived hourly rate for apprentices may be overstated. However, they still found a non-compliance rate of almost 21 per cent among hourly paid workers. This was still substantial and a reason for concern, but the design of the survey made it impossible to distinguish between genuine non-compliance and measurement error. In their preliminary regression analysis, they found that the apprentice framework (sector) was important but that demographic factors, other than age, were not. Age was important for those in their first year of apprenticeship (being under 19). Younger apprentices were more likely to be paid less than the appropriate minimum wage. But, for those in the second year or above of their apprenticeship, non-compliance increased with age. They also noted the importance of the timing of surveys to assess pay and that many employers used focal points at rounded hourly and weekly pay rates. Their initial analysis has also considered measurement errors related to pay as well as the inclusion of off-the-job training hours.

Future Research

34 We have commissioned the following research projects to inform our next report:

- **The Impact of the National Minimum Wage on UK Businesses.** Rebecca Riley and Chiara Rosazza Bondibene (National Institute of Economic and Social Research)
- **The Impact of Minimum Wages on Young People.** Gavan Conlon, David Innes, Rohit Ladher, Patrice Muller, Pietro Patrignani (London Economics) and Steve McIntosh (University of Sheffield).
- **Apprentice Pay.** Hilary Drew, Felix Ritchie, Michalis Veliziotis, and Don Webber (University of the West of England)
- **The Impact of the National Minimum Wage on Employment and Hours.** To be commissioned.
- **Taxes, Benefits and the National Minimum Wage.** To be commissioned.

Appendix 3

Minimum Wage Systems in Other Countries

- 1** As in previous years, information in this section allows a comparison to be made between the UK's National Minimum Wage (NMW) and the minimum wage in a number of other countries featured in our earlier reports. We are, as ever, grateful to British Embassies, High Commissions and the Organisation for Economic Co-operation and Development (OECD) for supplying much of this data. Caution is needed when making comparisons between countries because arrangements differ in terms of what counts towards the minimum wage, the age(s) at which the rate(s) apply, exemptions and overall coverage.
- 2** We again present information on the monetary value of the respective wage rates in terms of local currency, exchange rates and purchasing power parities (PPPs). This measures the monetary amount needed to buy the same representative basket of goods and services in each country (taking into account price inflation) and gives a more accurate comparison of standards of living across countries than exchange rates. We have compared the increase in the respective minimum wage rates between 2012 and 2013.
- 3** In our 2013 Report we set out in more detail some of the policy and economic context to changes in minimum wages across the countries we look at. We have not looked at this in detail this year, but there are still strong economic factors affecting countries' decisions about revisions to their minimum wages. It should be noted that countries have different uprating timetables and mechanisms and do not necessarily uprate their minimum wages annually.
- 4** Table A3.1 shows that nearly half of the countries we looked at experienced no increase in their minimum wage rates between 2012 and 2013. Some of these, Ireland, Portugal and the US, have not increased their minimum wages since before 2012. For those countries that did increase their minimum wages, the increases were much more modest than have been seen in previous years. Of the thirteen countries we compare, Australia had the highest increase at 2.6 per cent and the UK's increase of 1.9 per cent was the third highest.
- 5** In terms of both exchange rates and PPPs, the UK remains in the middle of the pack of these comparator countries. In exchange rate terms countries' minimum wages ranged from £2.36 an hour in Portugal to £9.58 an hour in Australia. In PPP terms minimum wages ranged from £2.91 an hour in Portugal to £7.79 in Australia.

National Minimum Wage

Table A3.1: International Comparison of Adult Minimum Wages, by Country, December 2013

	In national currency expressed as hourly rate ^a	In UK £, using:		Date of last uprating	% Increase in national currency from 2012-13	Age full minimum wage usually applies ^b
		Exchange rates	PPPs			
Australia^c	AUS\$16.37	9.58	7.79	Jul-13	2.6	21
Belgium	8.67	7.30	7.02	Dec-12	0.0	21
Canada^d	C\$10.24	6.24	5.89	^e	1.4	16
France	9.43	7.93	7.77	Jan-13	0.3	18
Greece	3.52 ^f	2.96	3.40	Feb-12	0.0	25
Ireland	8.65	7.28	6.80	Jul-11 ^g	0.0	20
Japan^h	JPY764	4.85	4.80	Oct-13	2.0	15/18 ⁱ
Netherlands	8.53 ^j	7.18	6.97	Jul-13	1.5	23
New Zealand	NZ\$13.75	7.05	6.35	Apr-13	1.8	16 ^k
Portugal^l	2.80	2.36	2.91	Jan-11	0.0	16
Spain^l	3.72	3.13	3.48	Jan-12	0.0	16
UK	£6.31	6.31	6.31	Oct-13	1.9	21
US	US\$7.25 ^m	4.57	5.31	Jul-09	0.0	20

Source: British Embassies and High Commissions. LPC calculations of country minimum wage rates in pounds sterling using exchange rates and PPPs. PPPs derived from Comparative Price Levels (CPLs), OECD Main Economic Indicators, September 2013. Exchange rates, Bank of England monthly average spot exchange rate, September 2013.

Notes:

- For countries where the minimum wage is not expressed as an hourly rate, the rate has been converted to an hourly basis assuming a working time of 8 hours per day, 40 hours per week and 173.3 hours per month.
- Exemptions and special rules apply in many cases. For example, in France and the US the full adult rate applies to young workers with a tenure of more than six and more than three months respectively.
- The Australian Federal National Minimum Wage Order, effective from first pay period on or after 1 July 2013.
- Weighted average of provincial/territorial rates.
- Date of last uprating varies between provinces.
- Minimum hourly rate for 'employees'. Different hourly rate operates for 'blue collar' workers.
- The hourly minimum rate was reduced from 8.65 to 7.65 for adult workers on 1 February 2011. That reduction was reversed and the hourly rate went back up to 8.65 on 1 July 2011.
- Weighted average of prefectural rates.
- Age 15 to receive the regional minimum wage. Age 18 to receive the sectoral minimum wage.
- Excludes 8 per cent supplement for holiday pay. Minimum wage based on a 40 hour working week. There are different minimum rates for those working a 38 or 36 hour week.
- For all employees aged 16 and over, who are not either on the training minimum wage or the starting out minimum wage.
- Not including annual supplementary pay of two additional months of salary for full-time workers.
- Federal minimum wage. Tipped employees receive a lower minimum wage depending on state laws, the lowest being \$2.13 per hour in direct wages.

6 Figure A3.1 shows how minimum wage rates have grown in each country since the NMW was introduced in 1999, and also how this varied before and after 2007. In national currency terms, the UK's minimum wage has grown faster since 2007 than six of these countries. Since 1999 in national currency terms only New Zealand has increased its minimum wage more than the UK, and in PPP terms only France, Japan and New Zealand have had larger increases than the UK.

Figure A3.1: Annualised Growth in Adult Minimum Wages, by Country, 1999-2013

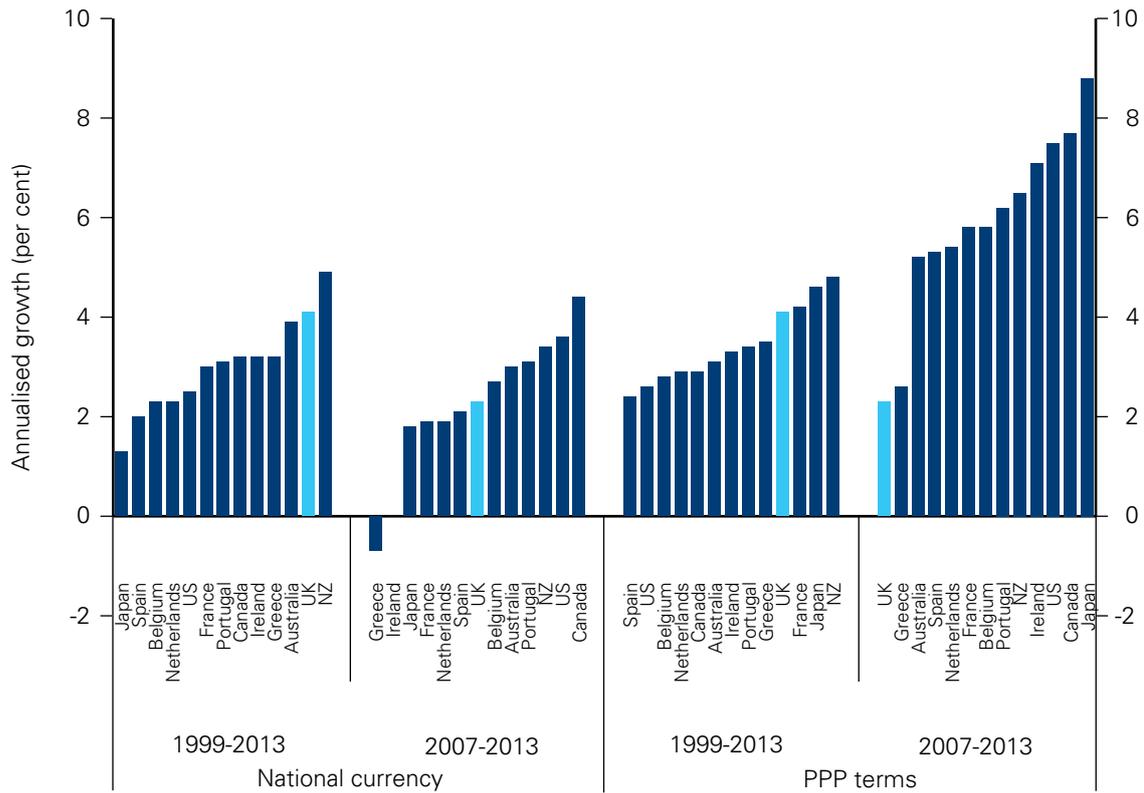
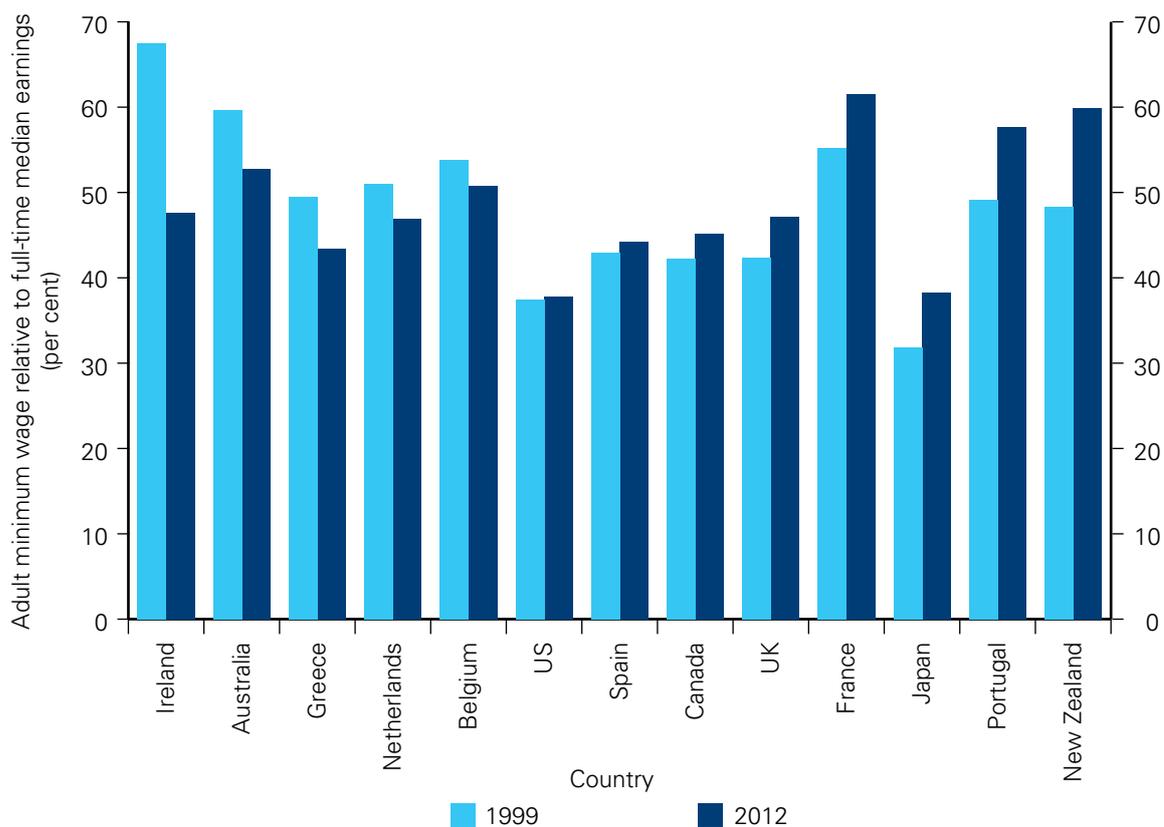


Figure A3.2: Adult Minimum Wages Relative to Full-time Median Earnings, by Country, 1999 and 2012

Source: OECD estimates based on OECD minimum wage database and median earnings for full-time workers, 1999 and 2012.

Notes:

a. Average value of minimum wage in each year.

b. Figures for Ireland are from 2000 when its minimum wage was introduced.

c. Countries ranked according to the change in the bite of their minimum wage rates.

- 8** Table A3.2 shows the minimum wage rates for young people aged, 16, 17 and 18-20, as a percentage of the full adult rate. Of the 13 countries, 7 made no distinction between the three groups of young people; giving 16, 17 and 18-20 year olds the same minimum wage rate. These included Spain, Portugal, Japan and Canada, all of which entitled their young people to 100 per cent of the adult rate. The UK and Ireland were the only two countries that distinguished between 16-17 year olds and 18-20 year olds, both countries giving a higher minimum wage to 18-20 year olds (80 per cent and 85 per cent of the adult rate respectively) than 16-17 year olds (59 per cent and 70 per cent respectively). Australia, Belgium, France and the Netherlands went further still, distinguishing between 16, 17, and 18-20 year olds and increasing the minimum wage with age.
- 9** The UK minimum wage for 16 and 17 year old workers was in line with the US; both countries made no distinction between 16 and 17 year olds and their minimum wage rates were 59 per cent of the adult rate. Only Australia and the Netherlands had lower rates for 16-17 year olds than the UK (and US) as a proportion of the adult rate; both of these countries distinguished between 16 and 17 year olds but the rates at both ages were lower than the UK or US rates as a proportion of the respective adult rate.

- 10** The increased minimum wage rate for workers aged 18-20 years (relative to 16-17 year olds) in the UK – at 80 per cent of the adult rate – brought the UK closer to the other comparator countries, with 11 of the 13 countries giving 18-20 year olds around 80-100 per cent of the adult rate. The US and the Netherlands were the exceptions, entitling their 18-20 year olds workers to, respectively, 59 per cent and 48 per cent of the adult minimum wage.

Table A3.2: Youth Minimum Wage Rates as a Percentage of Adult Minimum Wage Rates, by Country, 2013

Country	Percentage at age 16	Percentage at age 17	Average percentage at ages 18/19
Australia^a	47	58	68-83
Belgium	70	76	90
Canada	100 ^b	100 ^b	100
France^c	80	90	100
Greece	87	87	87
Ireland	70	70	85
Japan	(regional) 100 (sectoral) 0	(regional) 100 (sectoral) 0	(regional) 100 (sectoral) 100
Netherlands^d	34.5	39.5	48
New Zealand^e	80	80	80
Portugal	100	100	100
Spain	100	100	100
UK	59	59	80
US^c	59	59	59

Source: OECD Minimum Wage Database, British Embassies High Commissions, and LPC.

Notes:

- a. These percentages apply to juniors only. Apprentices and trainees have different rates.
- b. All provinces except Ontario. Ontario's youth minimum wage is 94 per cent of the adult minimum wage.
- c. For France and the US, the reduced rates apply to young workers with a tenure of fewer than six months and three months, respectively.
- d. Based on a working week of 40 hours. Different percentages apply for a 38 or 36 hour week.
- e. The starting out minimum wage only applies to employees aged 16 and 17, who have not completed six months' continuous employment with their current employer. Employees aged 18 and 19, who have received unemployment benefit for more than six months, will receive the starting out minimum wage until they have completed six months work for a single employer, after which they will be paid the adult minimum wage rate. The starting out minimum wage also applies to 16 to 19 year olds, who are required by their employer to undertake industry training.

- 11** In addition to reviewing and comparing the rates in other countries we also take an ongoing interest in any changes to minimum wage policy, where they occur in our comparator countries. New Zealand changed its youth rate structure in 2013 and we provide an overview of those changes below.
- 12** In 2008 New Zealand replaced youth rates with a 'new entrant's' wage. But in 2013 it introduced a 'starting out' wage which replaced the new entrant's wage and modified the existing training wage. Both the starting out wage and training wage are set at no less than 80 per cent of the adult minimum wage. The training wage is now only for employees aged

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20 or over who are undertaking recognised industry training (such as an apprenticeship) and the starting out wage applies to:

- 16 and 17 year olds who have not completed six months' continuous employment with their current employer;
- 18 and 19 year olds who have received unemployment benefit for more than six months. After six months work for a single employer the adult minimum wage rate applies; or
- 16 to 19 year olds required by their employer to undertake industry training.

The New Zealand Government has said its aim in introducing a starting out rate is to encourage young people to enter the workforce and to make them more attractive for employers to take on.

Appendix 4

Main Data Sources

Introduction

- 1** In this appendix we document the main data sources used in our analyses and outline any major changes that have been made since our 2013 Report. There are three main sources of data that we use in this report to measure earnings: the Annual Survey of Hours and Earnings (ASHE), Average Weekly Earnings (AWE), and the Labour Force Survey (LFS). These are all published by the Office for National Statistics (ONS). There are two main sources of employment information: the LFS and the ONS employee jobs series. The LFS captures the number of people in employment, whereas the employee jobs series measures the number of jobs in the economy. This is an important distinction as a person can have more than one job.
- 2** In addition to employment and earnings data, we also look at a variety of macroeconomic data and statistics. This appendix outlines the two main macroeconomic series that we use, which report inflation and gross domestic product (GDP), as well as summarising the revisions that ONS has recently made to GDP estimates.
- 3** In 2011 ONS revised the Standard Occupational Classification (SOC) that defines occupations. The new classification, SOC 2010, replaced the previously used SOC 2000 in ONS outputs including ASHE and the LFS, and it is not possible to make exact comparisons between data on the old and new classifications. In our 2013 Report, we reviewed and updated our definitions of the low-paying sectors based on the latest SOC 2010 codes. The detailed methodology and results of the review were outlined in Appendix 6 of the 2013 Report. The final section of this appendix sets out full definitions of each low-paying occupation and industry.

Annual Survey of Hours and Earnings

- 4** ASHE is the main source of structural earnings data in the UK and is regarded by ONS as the best source of earnings information for cross-sectional analysis. It provides information on the levels, distribution, and make-up of earnings, as well as on hours, gender, age, geography, occupation and industry. It is a survey of employees completed by employers and conducted in April each year. Results are based on a 1 per cent sample of employee jobs in Pay-As-You-Earn income tax schemes obtained from HM Revenue & Customs (HMRC). The self-employed are excluded. Employees not on an adult rate of pay are excluded from ASHE earnings estimates used by ONS, but are included in our own analysis of earnings from ASHE. This means that our earnings estimates will be different to ONS estimates.

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- 5 From 2011, ASHE data have been reweighted to SOC 2010 codes. This means that earnings estimates for 2011 onwards are not directly comparable with those prior to 2011. In light of these changes to occupation codes, we reviewed and updated our definition of the low-paying occupations in our 2013 Report. This review was similar to the re-assessment of the definition of low-paying industries we undertook when the Standard Industrial Classification (SIC) codes changed from SIC 2003 to SIC 2007 (see Appendix 4 of our 2010 Report for more information). The results and methodology of our latest review were outlined in Appendix 6 of the 2013 Report.
- 6 There is no official, consistent, long-run time series of structural earnings in the UK. The best source available now consists of five overlapping New Earnings Survey (NES)/ASHE data sets: NES, 1975-2003; ASHE without supplementary information, 1997-2004; ASHE with supplementary information, 2004-2006; ASHE 2007 methodology, 2006-2011; and ASHE 2010 methodology, 2011 onwards. In order to produce a consistent series over time, we have used the annual increases in the older data series to adjust the level of earnings to make the previous series compatible with the current series. This generally has the effect of reducing the estimates of the mean and median in years prior to 2011, which increases our estimates of the bite (the NMW relative to the median or mean) for that period.

Average Weekly Earnings

- 7 AWE is a short-term measure of the level of average weekly earnings per job in Great Britain which is based on data from the Monthly Wages and Salaries Survey. It replaced the previous measure of short-term changes in earnings, the Average Earnings Index (AEI). AWE is available monthly, showing regular pay, bonus pay and total pay. AWE uses current industry weights that are updated each month to take account of the distribution of jobs across sectors. ONS also produces a decomposition of the growth rates to show how much growth is due to wage growth, and how much results from changes in employment across sectors. Apart from the standard regular revisions as new information and weighting becomes available, ONS conducts an annual review of the seasonal adjustment process and revises estimates of AWE back to the start of the time series in 2000.
- 8 During 2013, ONS released three AWE historic time series, all of which are monthly in frequency and include bonus payments: the whole economy series runs from January 1963 to 2010, while public and private sector series are available from January 1990 to 2010. The method used to compile these time series takes into account the observed relationship between AEI and AWE, in particular that AWE increased faster than AEI for most of the period between January 2000 and July 2010. Therefore, these new AWE historic time series show more growth than the AEI. The differences are relatively small between 1990 and 1999, but larger when earlier periods are considered. The difference between the AEI and AWE wage growth should not be over-interpreted, as there is considerable uncertainty introduced by the estimation process. As these historic time series are only available up to 2010, when the AEI was discontinued, there is no fully consistent complete time series for these data sets up to the present time.

Labour Force Survey

- 9** The LFS is the official data source used to measure employment and unemployment. It is a quarterly survey of around 60,000 UK households conducted on a rolling monthly basis and provides information on employment; unemployment; earnings; and personal and socio-economic characteristics, including gender, ethnicity and disability.
- 10** In our report, analyses of aggregate employment, unemployment and hours worked use seasonally adjusted monthly and quarterly LFS data published by ONS. For detailed analyses of the labour market by age, ethnicity, disability and other personal characteristics, we use the non-seasonally adjusted LFS Microdata. We take the four-quarter moving average of these outputs to take account of seasonality, which is different from the seasonality adjustment method used by ONS. Consequently our analyses based on LFS Microdata produce estimates of levels that differ from the headline aggregates published by ONS.
- 11** ASHE contains no information on disability, ethnic background, country of birth, nationality or education level. The LFS is, therefore, our only timely source of data on earnings for disabled people, ethnic minorities, migrants and people with no qualifications. However, data on pay and hours in the LFS tend to be less reliable than in ASHE. Reasons for this include: a smaller sample; people often answering the earnings questions without reference to pay documentation (although they are prompted to consult available documents); and some information being provided by proxy respondents. ASHE collects information from employers about employees' paid hours, whereas the LFS collects information from individuals about their actual and usual hours of work, which might include unpaid hours. This generally means that the derived hourly earnings variable in the LFS is lower than the derived hourly pay rate recorded in ASHE. Where a stated hourly rate of pay is unavailable from the LFS, ONS has developed an imputation method using a nearest-neighbour regression model, which also takes account of information on second jobs in estimating the median earnings of various groups of workers. This methodology reduces the differences between hourly earnings estimates from the LFS and ASHE, and we use it to estimate earnings in our LFS analyses.
- 12** Dawson, Ritchie and Whittard (2014), in research we commissioned, assessed the reliability and usefulness of official data sources. One of the key project elements was to investigate the imputation process used in the LFS in order to account for missing data. The researchers identified three potential problems with the imputation methodology applied to the LFS data: not recognising the asymmetry caused by the existence of the NMW; small numbers of observations; and the choice of interventions available to the operator. The researchers suggested that the model could be improved in the light of the following factors: there had been no recent development of the statistical model; the aforementioned problems with the imputation methodology; and the difficulty in updating the data. They recommended that the Low Pay Commission consider having the code reviewed and updated.
- 13** In this report the estimates we present on disabled people use the old definition of working age (men aged 16-64 and women aged 16-59), rather than all aged 16-64, in order to allow for consistency across time. The LFS changed the way it asked questions on disability in 2010, which caused a discontinuity in the time series. Prior to 2010 most women aged 60 or over were not asked whether they had a work-limiting disability. Since the state pension age for

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women started to increase (in April 2010) the question has been asked of all women aged 60-64. Men were not affected by this change. Until there are sufficient data on the new basis to form a substantive time series, we will continue to use the old working age definition for analyses of disabled people. In April 2013 the disability questions on the LFS were harmonised to other ONS social surveys. This was to bring these questions in line with the Equality Act. But this change does not appear to have led to noticeable discontinuity in the time series data for employment of disabled people (those with a work-limiting disability).

- 14** LFS Microdata are usually revised on an annual basis, resulting from reviews of the seasonal adjustment process and reweighting to new population estimates. The latest revision undertaken by ONS was in 2012, when the LFS Microdata were revised back to the third quarter of 2009. Our consistent back-series of estimates takes account of this revision. ONS has planned a major revision of the LFS Microdata back to 2001 to account for the 2011 Census population estimates. This revised dataset is scheduled for release in 2014 and should be available for our next report.

Employee Jobs

- 15** The employee jobs series provides a timely breakdown of jobs in the UK. A number of Short Term Employer Surveys, which collect data from businesses across the economy, are used to compile the employee jobs series. Figures at a more detailed industry level, however, are available only for Great Britain and are not seasonally adjusted. This makes quarter-on-quarter comparisons problematic, particularly as much of the employment in the low-paying sectors is of a seasonal nature, for example, Christmas trading in the retail sector. Comparisons between one quarter and the same quarter a year earlier, however, help to alleviate this problem.
- 16** In the latest release in December 2013 for data up to September 2013, ONS has revised estimates of workforce jobs including the employee jobs series back to 1981. There have been substantial downward revisions to the time series data since 2012 and smaller revisions to earlier time periods back to 1981. These revisions have been caused by benchmarking to the latest estimates from the annual Business Register and Employment Survey (BRES), updating the seasonal factors and taking on board late information such as later responses to the survey. A consistent back-series, based on SIC 2007, is also available back to the second quarter of 1978.

Inflation

- 17** ONS publishes monthly inflation indices which reflect changes over twelve months in the cost of a 'basket' of goods and services on which people typically spend their money. We use three main inflation measures: the Consumer Price Index (CPI), Retail Price Index (RPI), and Retail Price Index excluding mortgage interest payments (RPIX).
- 18** Each measure uses the same basic price data, but the CPI (which follows international definitions) excludes Council Tax and a number of housing costs faced by homeowners that are included in the RPI. Other differences include: the methodologies used to combine

individual prices at the first stage of aggregation; the sources used to derive the weighting that each component contributes; and the population whose spending the 'basket' is designed to represent. The RPI is never revised and the CPI, although revisable in theory, has only ever been revised in exceptional circumstances.

- 19** In early 2013, the RPI was assessed against the Code of Practice for Official Statistics and found not to meet the required standard for designation as a National Statistic due to the formulae not meeting internationally-recognised best practices. However, ONS also noted that there was significant value to users in maintaining the continuity of the existing RPI's long time series without major change, so that it may continue to be used for long-term indexation and for index-linked gilts and bonds in accordance with user expectations. Therefore, while the current methodology for producing the RPI remains unchanged, ONS has constructed a new price index (known as RPIJ) which is based on a new methodology and has been published since March 2013. The only difference between the methodologies used to compile the RPI and RPIJ arises from different formulae used in calculating the average of price changes relative to a different period. This results in the RPIJ measure of inflation being lower than or equal to the RPI. Since its introduction, RPIJ has also been lower than CPI.
- 20** The RPI measure continues to be used by forecasters; it is still the main measure of inflation used in wage negotiations; and the time series goes back to 1948. Until RPIJ or another measure of inflation becomes as widely used as RPI, we will continue to use RPI and RPIX, along with CPI, as our main measures of consumer price inflation.

Gross Domestic Product

- 21** GDP provides a measure of total economic activity. It is often referred to as one of the main 'summary indicators' of economic activity and is used to measure growth in the economy.
- 22** In 2011 ONS implemented significant methodological changes in the production of GDP figures, which brought the UK into line with international standards. The details of these changes and their impacts were outlined in Appendix 4 of our 2012 Report. These changes included: adopting the 2007 SIC; using a revised classification of products; changing the method of calculating inflation; and revising the base and reference years. Following these changes the data indicated that the 2008-09 recession was shorter (five quarters instead of six) but deeper (7.1 per cent loss of output instead of 6.4 per cent) than previously thought.
- 23** During 2012, ONS again revised the GDP data, reflecting methodological changes in the way insurance services are measured; new HMRC earnings data; and other revised data including those from the ONS Annual Business Survey. The GDP data used in the 2013 Report showed that the recession was not as deep as previously thought (resulting in a 6.3 per cent loss of output), but it was still the deepest since the recession of the 1930s.
- 24** The latest GDP data, released in December 2013, showed that the recession was longer than previously thought with no positive growth for six consecutive quarters, albeit growth in the third quarter of 2009 was very close to zero. The data also suggested that the recession was deeper, with GDP falling by 7.2 per cent, the deepest recession since the 1920s. By the third

quarter of 2013 GDP was estimated to be 2.0 per cent below its peak in Q1 2008, compared with the 2.5 per cent below peak that was suggested by the previous data.

Definitions of Low-paying Sectors

25 Throughout this report, and particularly in Chapter 2, we refer to the low-paying sectors. We define these as occupations or industries which contain a high number or proportion of low-paid workers based on the SOC and SIC codes published by ONS. We have two distinct definitions of low-paying sectors, one based on industries and one on occupations. Table A4.1 sets out a list of low-paying sectors defined by SIC 2007 and SOC 2010 respectively. These definitions are used when conducting detailed analysis of low-paying sectors using ASHE or the LFS.

Table A4.1: Definitions of Low-paying Industries and Occupations, by SIC and SOC Codes

Low-paying industry/ occupation	Old industry definition	New industry definition	Old occupation definition	New occupation definition
	(SIC 2007)	(SIC 2007)	(SOC 2000)	(SOC 2010)
Retail	45, 47, 77.22, 95.2	45, 47, 77.22, 95.2	1234, 5496, 711, 7125, 721, 925	1254, 5443, 7111,7112,7114, 7115, 7123-7125, 7130, 7219, 925
Hospitality	55, 56	55, 56	5434, 9222-9225	5434, 5435,9272-9274
Social care	86.10/2, 87, 88.1	86.10/2, 87, 88.1	6115	6145, 6147
Employment agencies	78.10/9, 78.2	78.10/9, 78.2	-	-
Food processing	10	10	5431-5433, 8111	5431-5433, 8111, 9134
Leisure, travel and sport	59.14, 92, 93	59.14, 92, 93	6211, 6213, 6219, 9226, 9229	3413, 3441, 3443, 6131, 6139, 6211, 6212, 6219, 9275, 9279
Cleaning	81.2, 96.01	81.2, 96.01	6231, 9132, 923	6231,6240, 9132, 9231, 9233- 9236, 9239
Agriculture	01, 03	01, 03	5119, 9111, 9119	1213, 5112-5114, 5119, 9111, 9119
Security	80.1	-	9241, 9245, 9249	-
Childcare	85.1, 88.91	85.1, 88.91	6121-6123, 9243, 9244	6121-6123, 9244
Textiles and clothing	13, 14	13, 14	5414, 5419, 8113, 8137	5412-5414, 5419, 8113, 8137
Hairdressing	96.02, 96.04	96.02, 96.04	622	622
Office work	-	-	4141, 4216, 9219	4129, 4216, 7213, 9219
Non-food processing	-	-	-	5211, 5441, 8112, 8114-8116, 8125, 8131, 8134, 8139, 9120, 9139
Storage	-	-	-	9260
Transport	-	-	-	5231, 8135, 8212, 8214

Note: '-' denotes not applicable.

- 26** Industry definitions will capture many workers, such as managers and supervisors, who will not necessarily be low-paid while occupational definitions can be more focused on specific low-paid jobs. Ideally we would like our earnings and employment analyses to be based on occupational definitions. However, official employment data using these definitions are not available although we can estimate them quarterly using LFS Microdata and annually using ASHE. There is no regular, official data series on employment by occupation but ONS does provide one on employment by industry, the ONS employee jobs series. In addition, policymakers and stakeholder groups tend to be industry-based. Therefore, we tend to focus our analysis on industries.
- 27** Unfortunately, the ONS employee job series does not have a detailed break-down of sectors up to four-digit SIC codes. We therefore use broader industry-based classifications when considering the ONS employee jobs series. Table A4.2 contains SIC2007 codes used to define low-paying sectors in our analysis of the ONS employee jobs series. In the 2013 Report and reports prior to 2013, we only used the SIC code '87' to define social care in our analysis of employee jobs. However, this definition only covers social care workers who undertake residential care activities. In this report, we also add SIC code '88' to our definition of social care in order to include a large number of domiciliary care and childcare workers.

Table A4.2: Definitions of Low-paying Industries by SIC 2007

Low-paying industry	SIC 2007
Textiles, clothing	13, 14
Retail	45, 47
Hospitality	55, 56
Cleaning	81, 96.01
Hairdressing	96.02
Agriculture	01, 03
Food processing	10
Leisure/Travel/Sport	92, 93
Employment agencies	78.2-3
Residential care	87
Domiciliary care/childcare	88

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