National Minimum Wage

Low Pay Commission Report 2011

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Presented to Parliament by the Secretary of State
for Business, Innovation & Skills
by Command of Her Majesty
April 2011

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Introduction

The National Minimum Wage is now generally accepted as one of the cornerstones of the UK labour market. This was not the case when it was launched 12 years ago. Then it was highly controversial; now it is endorsed by all major political parties. Shortly after it took office in May 2010, the Coalition Government declared its support for the National Minimum Wage and accepted all of the main recommendations in our last report. Members of the Political Studies Association recently voted the minimum wage the single most successful government policy of the last 30 years and it has recently withstood the test of the most sustained economic downturn since the 1930s. Many regard it as an unqualified success.

However, as our annual consultation exercise has again reminded us, there are aspects of the minimum wage that still give cause for concern. While generally content with the modest scale of recent increases, many employers continue to express concern about previous larger increases and about the impact of the minimum wage on their ability to maintain differentials. On the other hand, there is no shortage of trade union representatives or poverty action groups calling for more significant and substantial increases, especially for young workers, and there have been a growing number of calls for the introduction of a living wage.

For our own part, while we are pleased that the National Minimum Wage is widely accepted, we would be wary of claiming it as an unqualified success. We believe it is still too early for such pronouncements. It has been successful to date, but there are dangers in complacency and we see the minimum wage as a policy that needs ongoing monitoring and constant attention. For this reason we were pleased by the Coalition Government's recent decision, in the context of its review of all UK-wide non-departmental public bodies, to retain the Low Pay Commission in its present form as a separate, stand-alone source of advice to government on the National Minimum Wage.

Remit

This is the 12th Low Pay Commission report. Our remit from Government asked us to monitor, evaluate and review the National Minimum Wage and to report to the Prime Minister and the Secretary of State for Business, Innovation and Skills by the end of February 2011 on the following matters:

- the level of each of the different rates of the National Minimum Wage with recommendations on the appropriate levels from October 2011;
- the effect of the minimum wage on pay, employment and competitiveness in the low-paying sectors, with particular reference to the competitiveness of small firms; and

- the effect of the minimum wage on the pay structures and employment of different groups of workers.

We were also asked to review the labour market position of young people, including those in apprenticeships and internships, and the arrangements for the apprentice minimum wage.

Evidence

In order to deliver a report that meets this remit we have, as in previous years, consulted widely, seeking written and oral evidence from those most affected by the National Minimum Wage. We would like to offer our thanks to all those individuals and organisations who gave evidence. Without their contributions it would be impossible to make recommendations with any confidence. A list of those who responded to our call for evidence can be found in Appendix 1.

As is our usual practice, we commissioned several new pieces of research to inform our consideration of this year's remit. Details of the research projects and a summary of the findings are set out in Appendix 2. Our recommendations also draw on the best available economic evidence and we have worked closely with the Office for National Statistics to obtain a comprehensive and consistent database on earnings and employment.

We undertook a programme of visits around the United Kingdom. We met some of the employers and workers with a direct interest in the minimum wage, listened to their views and discussed various aspects of the policy with them. This year we visited Ayr, Barnstaple, Derry, Ipswich, London (twice), Middlesbrough, Newcastle, Taunton and Wrexham.

We met formally as the Low Pay Commission seven times during the year. We also participated in a research workshop at which the research commissioned for this report was presented and discussed. In addition we met in January for two days to review and assess the evidence relevant to our remit and to reach a decision on all of the recommendations contained in this report.

Conclusion

As a commission, our aim is to arrive at recommendations only after weighing carefully all of the available evidence. This report attempts to set out that evidence for the reader so that the key factors (data, research findings, stakeholder representations) that led to our recommendations can be set against the recommendations themselves. The conclusions and recommendations in this report represent the unanimous view of all Commissioners.

Throughout the year we were ably assisted by our Secretariat. We are grateful to them for the commitment and expertise they have brought this year, as in every year, to support us in preparation of this report. The Commission's Secretariat is now among the country's leading experts in its understanding of the UK's labour market.

The Commissioners

David Norgrove (Chair)
Chair of the Family Justice Review Panel

Susan Anderson
Director of Public Services and Skills, CBI

Peter Donaldson
Managing Director, D5 Consulting Limited

Professor Bob Elliott
Professor of Economics and Director of the Health Economics Research Unit, University of Aberdeen

Neil Goulden
Chairman (emeritus), The Gala Coral Group

Katja Hall[1]
Director of Employment Policy, CBI

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

Frances O'Grady
Deputy General Secretary, TUC

Heather Wakefield
National Secretary for UNISON's Local Government Service Group

The Secretariat

Katy Cornish Secretary (to September 2010)
Chris Dee Secretary (from September 2010)
Jay Arjan
Kim Brinkworth
Tim Butcher
Jessie Evans
Gerry Franks
Jennifer Oxley
Steve Palmer
Tony Studd

1 With the Low Pay Commission's agreement, Katja Hall represented Susan Anderson during Susan's unavoidable absence due to ill health in late December and January. We would like to record our appreciation for Katja's contribution to this report.

Executive Summary

Chapter 1: The National Minimum Wage in an Economic Recovery

1 Our remit this year asked us to monitor and evaluate the impact of the minimum wage, to consider its effect on small firms, low-paying sectors and different groups of workers, and to make recommendations for the minimum wage rates. We were also asked to review the arrangements for the Apprentice Rate, following its introduction in October 2010. As ever, in fulfilling our remit we have benefited from the evidence presented to us by employers, workers, their representatives and interested parties, including Government. We believe that these responses, our analysis of official data and our specially commissioned research projects have provided a sound evidence base for our deliberations.

2 Following the deepest recession since the 1930s, the UK economy started to recover in the fourth quarter of 2009 and continued to grow during each of the first three quarters of 2010. Indeed, it grew more strongly than had been predicted when we wrote our last report in January 2010. Recovery was particularly evident in business investment, construction and manufacturing. The depreciation of sterling since mid-2007, along with the pick-up in world trade, contributed to a strong recovery in exports, although imports grew even more strongly. Profits and productivity also improved. The labour market continued to show the resilience it had shown during the recession. Data for the third quarter of 2010 revealed some weakening in the labour market position but unemployment remained below the levels anticipated by the median forecasts in January 2010.

3 The National Minimum Wage was increased by 2.2 per cent from 1 October 2010 as we had recommended. This was broadly in line with the median level of pay settlements and the growth in whole economy average earnings, both of which had shown some increase compared with the previous year. It was also in line with the median of earnings forecasts for the year published in January 2010. However, the increase was below the rate of inflation as measured both by the Consumer Price Index (CPI) and the Retail Prices Index (RPI). These showed increases of 3.1 per cent and 4.6 per cent respectively in the year to September 2010. Both figures were well ahead of the forecasts for inflation available in January 2010 and were the result of stronger than expected upward pressures from increased commodity and other import prices, and from changes in indirect taxation, notably the restoration in January 2010 of the earlier reduction in VAT.

Chapter 2: The Impact of the National Minimum Wage to Date

4 We assessed the impact of the adult rate across low-paying sectors, firm size, and groups of workers. The minimum wage increased by nearly 65 per cent between its introduction in April 1999 and October 2010. Over that period, the increase was much higher than price inflation or average earnings growth.

5 The bite of the minimum wage (its value relative to median earnings) increased from just under 46 per cent when it was introduced to around 51 per cent in April 2007. Since the end of 2006, however, the National Minimum Wage has risen broadly in line with both average earnings growth and price inflation. As a result the bite of the minimum wage in general has not increased since then. But it has increased for micro and other small firms, some low-paying sectors, young people and those with no qualifications. All of these saw wages rise more slowly than the average in the last few years.

6 Analysis of the earnings distribution shows that a clear spike has been observed at the minimum wage in every year since 1999. In recent years, even though the minimum wage has increased no more than average earnings, that spike has become larger. This clearly demonstrates that the minimum wage has affected earnings and their distribution.

7 Our own analysis, commissioned research, evidence submitted in our consultation and anecdotal evidence from visits and meetings have found that some employers have responded to the change in earnings (and consequent increase in labour costs) by adjusting non-wage costs and changing pay structures. Overtime and unsocial hours premia may have been reduced; pensions and annual leave entitlement made less generous; pay zones (geographic and hierarchical) merged; or differentials may have been squeezed. Further, there is also evidence to suggest that some firms may have coped with minimum wage increases by reducing hours, raising prices, or by accepting lower profits. However, the evidence available to date suggests that minimum wages do not appear to have cut employment to any significant degree. Further, the reduced hours do not appear to have reduced weekly earnings and the lower profits have not led to business closures.

8 Between 1999 and the start of the recession, aggregate employment rose and unemployment fell. Employment growth in the low-paying sectors was slightly lower than in the whole economy. Although, in terms of the proportion of employee jobs lost, the low-paying sectors performed in line with the whole economy during the recession (March 2008–September 2009), they have recovered more quickly and have outperformed the whole economy since September 2008. Since the end of the recession, the number of jobs in the low-paying sectors has increased while those in the economy as a whole have continued to fall. However, the two largest low-paying sectors – retail and hospitality – have not performed as well as the whole economy. The employment picture also differed by size of firm. Micro firms appeared to be able to hold on to their labour for longer during the recession but, in contrast to large firms, have not yet experienced a pick-up in jobs in the recovery.

9 Analysis of the labour market outcomes of different groups of workers found that the employment rates of women, ethnic minorities as a group, disabled people and older workers held up better than average during the recession. Their unemployment rates also rose by less on average. In contrast, the employment rates of young people and those with no qualifications fell by more than average during the recession and have continued to fall as the economy has recovered. Throughout the recession and subsequent recovery, their unemployment rates have also increased more than those of the working age population in general.

10 We were concerned by evidence indicating that the level of fees paid by public sector bodies when purchasing care services from the independent social care sector did not reflect minimum wage costs. We recommend that the commissioning policies of local authorities and the NHS should reflect the actual costs of care including the National Minimum Wage. This is a recommendation we have made before.

11 The consensus of the research findings on the impact of the National Minimum Wage in the UK is that it has not significantly adversely affected employment but that it may have had a small negative effect on hours. Much of that research was conducted when the economy was performing strongly. The research we commissioned for this report continued to show that, in general, the minimum wage has affected earnings but has had no robust or statistically significantly adverse effects on employment. However, it did find some evidence to suggest that young people may have been adversely affected by the minimum wage. We intend to commission further research into the impact of the National Minimum Wage during the recent recession.

Chapter 3: Young People, Interns and Apprentices

12 As we noted in our 2010 Report, the labour market position of young people has been deteriorating for some time. It became much worse in the recession. Although the employment rate for 16–17 year olds has deteriorated since the late 1990s and the unemployment rate has increased (especially during the recession), much of this can be explained by an increase in education participation. The proportion of 16–17 year olds unemployed or inactive has remained fairly constant since 1998. For 18–20 year olds there has been an increase in the proportion unemployed since the start of the recession. There has also been some increase in education participation among this age group and, as a consequence, their employment rate fell sharply at the start of the recession. Their employment rate continued to fall and unemployment rate continued to rise even as the economy recovered.

13 Between 1999 and 2007, average earnings of young people rose roughly in line with those of adults, as did their minimum wages. Since then, it has become evident that the wages of young people have increased at a slower pace than those of adults, even though their minimum wages rose roughly in line with the adult rate and the general rise in average wages. As a result, the bites of the Youth Development Rate and 16–17 Year Old Rate, relative to the median, have continued to increase to 79 per cent and 71 per cent respectively, while the bite of the adult rate relative to the median has remained stable at around 51 per cent. There has also been evidence this year that employers have made further use of their ability to pay below the adult minimum wage rate.

14 Much of the commissioned research for this report had a focus on the labour market performance of young people. The research found that the youngest workers had lower productivity and lower earnings and suggested that young workers were overpaid relative to their productivity. This relationship was not exacerbated by the minimum wage. However, the research found evidence that, in difficult economic circumstances, the level of the minimum wage may have had an impact on the employment of young people. The evidence also suggested that these effects were mitigated to some extent where there were separate rates for younger workers. This research confirms previous international research findings that influenced the original decision to incorporate youth rates into the UK National Minimum Wage system.

15 There has been a growth in internships since the start of the recession. While internships provide a valuable opportunity for young people entering the labour market to gain work experience, we are concerned that a number of employers appear to be ignoring minimum wage rules by hiring interns to undertake unpaid work. This practice effectively excludes many young people from such opportunities.

16 Apprenticeships continue to be an important source of training for young people with expansion in numbers supported by the Government. There has been a rise in the overall number of apprenticeships across the UK, with England and Scotland driving this increase. We found that the recession had an impact on the sectoral distribution of apprenticeships, but that Government apprenticeship policy and funding played a key role in increasing places and influencing patterns of provision.

17 Although we have not yet been able to assess fully the impact of the new Apprentice Rate at this point, we judge on the basis of available evidence that it has been introduced at a level which is unlikely to have adversely affected overall apprenticeship provision. While some stakeholders were concerned about aspects of the wage arrangements, we do not propose any changes to the arrangements at this early stage. We are keen to see the available information on apprentice pay improved and are pleased that the Government is to commission a UK-wide apprentice pay survey in 2011.

Chapter 4: Compliance and Operation of the National Minimum Wage

18 Ever since the introduction of the National Minimum Wage, the Commission has maintained a close interest in compliance and enforcement, and the actions taken by the Government to raise awareness among workers and employers of their rights and obligations. The Government has in the past, on the whole, responded positively to our recommendations in this area.

19 We are pleased that there has been good progress this year in a number of areas in relation to the enforcement regime. The introduction of a new compliance strategy is welcome. In particular the move to a more flexible enforcement approach, allocating resources according to risk and making better use of intelligence are, we believe, positive developments that should enhance the effectiveness of the enforcement of the National Minimum Wage.

20 The new penalties and fair arrears regime and the introduction, in January 2011, of a new policy on naming have the potential to significantly strengthen the enforcement regime. But it will be important to review both initiatives at the right time to ensure they are having the desired effect. We are, however, very concerned this year about the effect of cuts already made to the budget for publicising the minimum wage and the likely impact of possible further cuts as a result of the Spending Review. It is imperative for the credibility of the National Minimum Wage that it is rigorously enforced and that upratings and other changes to the rules are known and fully understood. We will monitor closely the impact of any reduction in funding for enforcement of the minimum wage.

21 We have again received evidence that certain groups of workers are more vulnerable to exploitation than others and more at risk of being denied their entitlements under National Minimum Wage legislation. In previous years we have made several recommendations with such groups in mind. Last year we made a recommendation, which the Government accepted, concerning those working in hotels as contract and agency cleaners and we look forward to seeing the result of the Government's actions. This year, in response to persuasive evidence, we recommend that the Government raises awareness of minimum wage rules relating to internships and other forms of work experience placements and ensures that the rules are effectively enforced.

Chapter 5: Setting the Rate

22 The data available at our meeting in January 2011 showed that the economy had recovered in the first three quarters of 2010, and faster than had been previously forecast. Looking ahead, a range of forecasters expected growth to continue in 2011. Although they had varying views of its likely strength there was some consensus around 2 per cent growth for the year as a whole. These prospects are largely dependent on private sector consumption and trade, and there are some significant downside risks to growth in 2011. Consequently, the growth rate could turn out closer to that experienced in 2010, estimated (given the growth in the first three quarters of the year) to be around 1.7 per cent.

23 Economic growth will also be affected by any increases in interest rates taken to combat higher than target inflation. The outlook for inflation in 2011 has hardened over time, with further rises in the shorter term before turning down later in the year. Even so, the consensus forecast for the fourth quarter of the year had CPI inflation at 2.9 per cent and RPI inflation at 4.0 per cent. In terms of the implications for pay, there was no evidence of a marked pick-up in settlement levels, although median pay settlements had risen in the latter months of 2010. Average earnings growth remained muted, and was likely to be constrained to an extent by the Government's pay policy for the public sector and the existence of excess capacity in the labour market. Forecasts for the year as a whole centred on 2.6 per cent, only marginally higher than the rate in 2010.

24 The labour market showed great resilience during the recession and continued to improve through much of 2010, albeit employment growth was largely at the expense of full-time and permanent positions. Towards the end of that year latest data suggested that the improvement had stalled. While there will be some pressure on employment costs in 2011, surveys are showing that private sector employers are expecting to take on more staff, certainly during the early part of the year. The public sector, however, is forecast to lose jobs, as are private sector employers reliant on government contracts, but private sector job creation overall is expected by the Office for Budget Responsibility and other forecasters to generate sufficient new employment opportunities to more than offset job losses elsewhere.

25 In international terms our analysis shows that, on a variety of measures, the level of the UK minimum wage is currently somewhere in the middle of the pack of the Organisation for Economic Co-operation and Development and the European Union comparators suggesting it is neither too generous nor too parsimonious.

26 Views from stakeholders on the appropriate level of the adult rate of the minimum wage for October 2011 fell roughly into two camps. Those representing employer organisations cited the uncertain economic situation and urged caution. Others, mainly unions, argued that increases to the minimum wage should protect the lowest-paid workers at a time of rising inflation. Several employer organisations called for the adult rate to be frozen, although some significant employer organisations saw room for a modest increase.

27 Worker representatives all supported an increase. Many wanted the forecast increase in average earnings to be reflected in the minimum wage. Others called for a rise above the forecast level of price inflation. A few organisations and some unions saw a living wage as the ultimate goal. Several respondents referred to recent Joseph Rowntree Foundation research on a living wage.

28 Employers generally wanted to retain youth rates. A few called for a freeze; most suggested they be increased in line with the adult rate. A number of other respondents, including many unions, called for the youth rates to be phased out. Some saw them as discriminatory and proposed a single minimum wage. Views on the Apprentice Rate for October 2011 were divided with some favouring a freeze; some a rise in line with other minimum wage rates or in line with inflation; while others sought a far higher increase.

29 We discussed respondents' views and other evidence at length and weighed the data and advice carefully. After much discussion, we concluded that our recommendation should take account of the continued economic uncertainty while protecting the lowest-paid workers from falling further behind the average. Accordingly, we recommend that the adult rate of the National Minimum Wage be increased by 15 pence to £6.08 an hour from 1 October 2011.

30 We received no new evidence to convince us of the need to adjust the relative position of the accommodation offset. We therefore recommend that the accommodation offset should increase from £4.61 to £4.73 per day from 1 October 2011.

31 There has been a continuing decline in the labour market position of young people. The bite of the minimum wage for young people has continued to increase while the bite of the adult rate has remained stable. Recent research has found evidence that in difficult economic circumstances the level of the minimum wage may have had an impact on the employment of young people. Against this background, we decided that it would be imprudent to recommend an uprating of the youth rates that would be likely to further increase its bite. We therefore recommend that the Youth Development Rate be increased by 6p to £4.98 an hour and that the 16–17 Year Old Rate be increased by 4p to £3.68 an hour from 1 October 2011. We make this recommendation reluctantly. If new evidence shows that the minimum wage has not contributed to the employment difficulties of young people, we will recommend that their relative earnings be restored.

32 It appears that the initial Apprentice Rate has had little or no negative effect on the supply of apprentice places and the initial rate was cautious, broadly equating to the rate that had been set by the Learning and Skills Council in August 2009. We recommend that the Apprentice Rate be increased by 10p to £2.60 an hour from 1 October 2011.

Recommendations

National Minimum Wage Rates

We recommend that the adult rate of the National Minimum Wage be increased by 15 pence to £6.08 an hour from 1 October 2011 (paragraph 5.61).

We recommend that the Youth Development Rate be increased by 6p to £4.98 an hour and that the 16–17 Year Old Rate be increased by 4p to £3.68 an hour from 1 October 2011 (paragraph 5.64).

We recommend that the Apprentice Rate be increased by 10p to £2.60 an hour from 1 October 2011 (paragraph 5.66).

Accommodation Offset

We recommend that the accommodation offset should increase from £4.61 to £4.73 per day from 1 October 2011 (paragraph 5.62).

Social Care

We recommend that the commissioning policies of local authorities and the NHS should reflect the actual costs of care, including the National Minimum Wage (paragraph 2.74).

Compliance

We recommend that the Government takes steps to raise awareness of the rules applying to payment of the National Minimum Wage for those undertaking internships, all other forms of work experience, and volunteering opportunities. In addition, we recommend that these rules are effectively enforced by HMRC using its investigative powers (paragraph 4.38).

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Chapter 1

The National Minimum Wage in an Economic Recovery

Introduction

1.1 Our terms of reference for this report, our 12th, asked us to monitor, evaluate and review the National Minimum Wage and its impact, looking in particular at the low-paying sectors, the competitiveness of small firms and the effect on different groups of workers. We were also asked to review the labour market position of young people, including apprentices and interns. Finally, our terms of reference asked us to make recommendations for each of the different minimum wage rates and consider the arrangements for the apprentice minimum wage.

1.2 In fulfilling this remit, we commissioned research, consulted widely, visited employers and workers around the country, and conducted our own economic and statistical analysis. This report sets out the wealth of information which we gathered to inform our recommendations. In this chapter we look at the current state of the economy and discuss the minimum wage recommendations we made in our last report in the context of subsequent economic events. In Chapter 2 we assess the impact of the minimum wage since its introduction, before going on in Chapter 3 to review the labour market position of young people, interns and apprentices. We also investigate the impact of the minimum wage rates for young workers and discuss the introduction of the Apprentice Rate. Chapter 4 discusses the Government's actions with regard to compliance and enforcement, as well as looking at particular aspects of the operation of the minimum wage. Finally, in Chapter 5, we conclude our report by setting out and explaining our main recommendations concerning the rates of the National Minimum Wage from October 2011.

1.3 At its introduction in 1999, the National Minimum Wage provided a minimum wage for all adults aged 22 and over, as well as a lower rate, called the Youth Development Rate, for 18–21 year olds. Young people who were aged under 18 and apprentices aged under 19 were exempt. Apprentices aged 19–25 in the first year of an apprenticeship were also exempt. In October 2004, the National Minimum Wage was extended to those aged under 18 who had reached the compulsory schooling age with the introduction of the 16–17 Year Old Rate. In October 2006, the upper age limit for apprentices was removed. The National Minimum Wage was further extended in October 2010, when the Apprentice Rate (set at £2.50 an hour) was introduced for all employed apprentices aged under 19 as well as those aged 19 and over in the first year of their apprenticeship. In addition, the qualifying age for the adult rate was reduced to 21.

1.4 Table 1.1 sets out how the minimum wage has changed since its introduction and shows that recent increases in the minimum wage have been more modest than some of the earlier increases. Since its introduction the adult rate has increased by over 64 per cent: from £3.60 in April 1999 to £5.93 in October 2010. Though the pattern of increases has varied, the Youth Development Rate has increased roughly in line with the adult rate, as has the 16–17 Year Old Rate since its introduction in October 2004.

Table 1.1: National Minimum Wage Hourly Rates, UK, 1999–2011

	Adult rate			Youth Development Rate			16–17 Year Old Rate		
	Rate	Increase		Rate	Increase		Rate	Increase	
	£	Pence	%	£	Pence	%	£	Pence	%
Oct 2010–	**5.93**	**13**	**2.2**	**4.92**	**9**	**1.9**	**3.64**	**7**	**2.0**
Oct 2009–Sept 2010	5.80	7	1.2	4.83	6	1.3	3.57	4	1.1
Oct 2008–Sept 2009	5.73	21	3.8	4.77	17	3.7	3.53	13	3.8
Oct 2007–Sept 2008	5.52	17	3.2	4.60	15	3.4	3.40	10	3.0
Oct 2006–Sept 2007	5.35	30	5.9	4.45	20	4.7	3.30	30	10.0
Oct 2005–Sept 2006	5.05	20	4.1	4.25	15	3.7	3.00	0	0.0
Oct 2004–Sept 2005	4.85	35	7.8	4.10	30	7.9	3.00		
Oct 2003–Sept 2004	4.50	30	7.1	3.80	20	5.6			
Oct 2002–Sept 2003	4.20	10	2.4	3.60	10	2.9			
Oct 2001–Sept 2002	4.10	40	10.8	3.50	30	9.4			
Oct 2000–Sept 2001	3.70	10	2.8	3.20	0	0.0			
June 2000–Sept 2000	3.60	0	0.0	3.20	20	6.7			
April 1999–May 2000	3.60			3.00					

Source: Low Pay Commission.

Emerging from Recession

1.5 Last year, the immediate economic context for our recommendations was a pronounced worldwide recession in which the UK experienced its longest and deepest recession since the 1930s. We now know that during the recession the economic output of the UK fell for six consecutive quarters and by over 6 per cent in total. The latest official UK output data available to us at the time we made our last recommendations related to the third quarter of 2009. The data showed the UK economy still in recession, although the rate of decline in output was slowing. However, other more up-to-date indicators suggested that the economy had started to grow again in the fourth quarter of 2009 and that it would continue to grow throughout 2010, albeit many forecasters expected this growth to be weak and below trend.

1.6 At the time we noted a remarkable resilience in the labour market with employment holding up well both in terms of the overall fall in output and when compared with previous post-war recessions. This resilience had been accompanied by very low rates of inflation and pay growth. But the modest fall in employment, compared with output, had led to a fall in productivity and an increase in unit wage costs, suggesting that firms might still need to make adjustments to their workforces. When we made our last recommendations there had been recent, though modest, improvements in employment and unemployment.

We concluded that firms had been able to shelter employment through real wage flexibility and by running down inventories and cutting investment. We also noted the expected pick-up in settlement levels reported by private sector employers and the restoration of bonuses and therefore we predicted that average earnings would grow faster in 2010 than they had in 2009. This analysis informed our October 2010 recommendations that the adult rate increase by 2.2 per cent with a slightly lower increase for the youth rates.

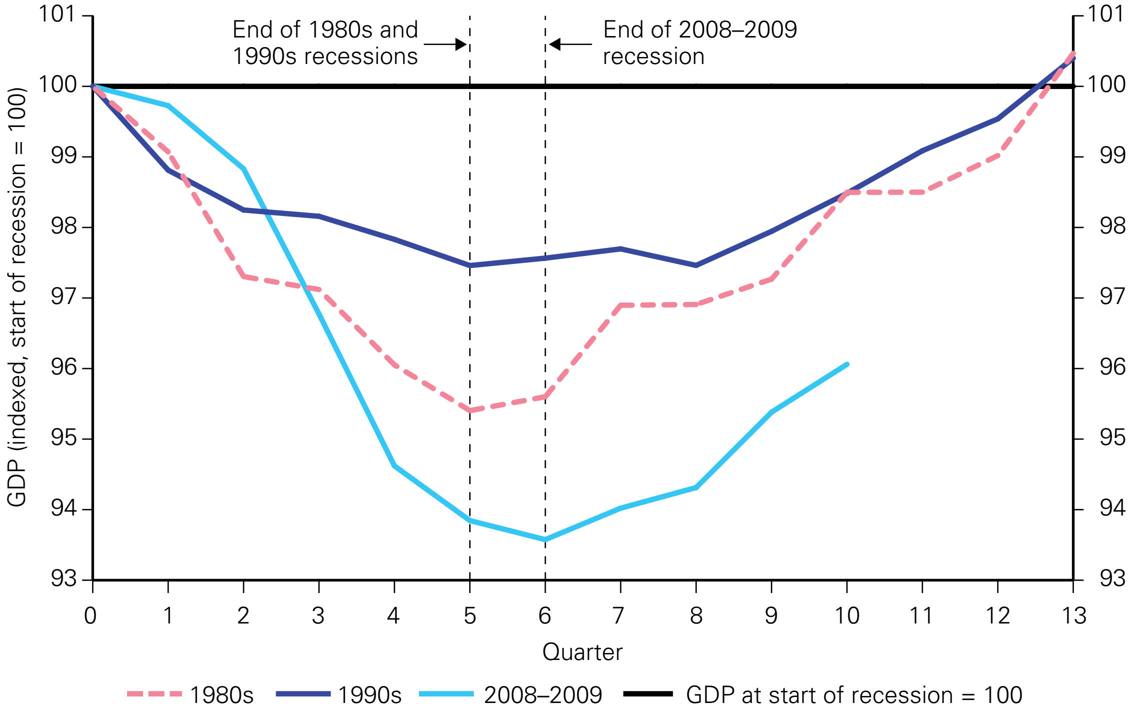
1.7 In this chapter we look at how the economy has developed from the end of 2009 to the point at which our last recommendations took effect in October 2010. We focus on changes to output, inflation, pay and employment. In subsequent chapters, we look at the impact of the National Minimum Wage on particular areas of the economy.

Economic Growth

1.8 At the time we made our last set of recommendations, the consensus forecast was that economic output, gross domestic product (GDP), would grow by 1.3 per cent in 2010 and 2.0 per cent in 2011. So far, the economy has recovered more quickly than was expected with growth of 2.1 per cent in the first three quarters of 2010. At the time of writing, data for the fourth quarter of 2010 had not been published. If fourth quarter growth were to be, as forecast, weak but positive, the economy would have grown by around 1.6–1.7 per cent in the whole of 2010 compared with the 1.3 per cent forecast. This would be stronger than expected and similar to the strength of the recovery in the 1980s.

1.9 Further, Figure 1.1 shows that the recessions in the 1980s and 1990s lasted five quarters and it took a further two years (or eight quarters) for the economy to return to its previous level of real output. As the most recent recession was longer and much deeper than either of the previous two, we should perhaps be cautious about calculating the likely recovery time but it is probable that real output will not return to its pre-recession level until the third quarter of 2011 at the earliest.

Figure 1.1: Gross Domestic Product in Recession and Recovery, UK, 1979–2010



Source: LPC calculations based on ONS data, GDP (ABMI), quarterly, seasonally adjusted, UK, Q4 1979–Q3 2010.
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 2008–2009 recession).

1.10 Having noted the experience of previous recessions in the UK, we briefly examine how other economies have fared in the recent global recession. The recessionary experience in the UK was slightly deeper and longer than the average in the Organisation for Economic Co-operation and Development (OECD), where the recession lasted four quarters and output fell by 5.1 per cent. It was also more severe than the average in the European Union, where the recession lasted five quarters and output fell by 5.4 per cent. The fall in output, however, was not as large as in Germany (6.6 per cent), Japan (10.1 per cent), the Baltic States (between 15 and 25 per cent), and Iceland or Ireland (both suffering output losses of around 15 per cent so far). The recovery in the UK has lagged that of the OECD as a whole, the United States, Japan and Germany but has been slightly stronger than in the European Union as a whole.

1.11 During the recent recession, consumer spending fell, investment collapsed and inventories were run down but government spending held up and imports weakened more than exports. The recovery in the UK economy, as shown in Table 1.2, appears to have been led by investment. After falling by 23.3 per cent between the fourth quarter of 2007 and the fourth quarter of 2009, investment picked up strongly in 2010, growing by 12.1 per cent, making up some of that earlier loss. Much of that rebound has been in investment in housing and other buildings and in business investment. The fall in business investment was much greater in the recent recession (over 28 per cent from peak to trough) than in the two previous recessions (falls of around 13 per cent and 18 per cent in the recessions of the 1980s and 1990s respectively). In contrast, the run down of inventories has been similar, around 11.5 per cent, in all three recessions.

Table 1.2: Breakdown of Growth in Gross Domestic Product, UK, 1991–2010

Per cent	Average	Recession		Growth on previous quarter			
				2009	2010		
	1991 Q4–2008 Q1	2008 Q2–2009 Q3	Peak to trough	Q4	Q1	Q2	Q3
Household consumption	**0.7**	-4.9	**-4.9**	1.0	-0.1	0.8	**0.3**
Government consumption	**0.4**	2.6	**n/a**	0.4	0.7	0.6	**-0.4**
Investment	**1.0**	-18.0	**-23.3**	-1.5	3.1	1.0	**3.4**
Business investment	**1.4**	-21.5	**-28.2**	-2.9	7.9	0.7	**3.1**
Dwellings investment	**0.8**	-28.9	**-35.5**	-2.8	0.8	6.8	**3.8**
Change in inventories	**0.7**	-8.1	**-11.7**	-2.1	-0.7	-0.5	**0.2**
Domestic demand	**0.8**	-7.6	**-7.7**	0.7	1.2	0.9	**0.8**
Exports	**1.3**	-11.7	**-12.9**	3.7	-0.9	3.1	**1.5**
Imports	**1.5**	-15.3	**-16.9**	4.1	2.1	2.0	**1.7**
Real GDP at market prices	**0.7**	-6.4	**-6.4**	0.5	0.3	1.1	**0.7**

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), total domestic expenditure (YBIM), total exports (IKBK), total imports (IKBL) and GDP (ABMI), chain volume measures, quarterly, seasonally adjusted, UK, Q4 1991–Q3 2010.

1.12 Consumer spending has increased by 2 per cent since the end of the recession, during which it fell by 4.9 per cent. This pick-up is slightly lower than trend growth between 1991 and 2008. Government spending, however, rose during the recession by 2.6 per cent but weakened considerably in the third quarter of 2010. The Bank of England, among others, had expected the weaker pound to provide a major stimulus to exports. Although there are signs that exports have picked up as world trade has recovered, imports have grown more strongly leading to a net drag on growth in 2010.

1.13 Table 1.3 shows that the recession was broad and affected most sectors of the UK economy. Construction and manufacturing suffered most but services also endured a decline in output. The upsurge in housing and other property investment noted above, however, led to a sharp rise in construction output. Since the spring of 2010, construction has grown by 11.2 per cent, regaining most of the loss (14.2 per cent) experienced during the recession. The pick-up in world trade and the increase in UK exports has helped manufacturing rebound strongly, growing by 5.2 per cent since the third quarter of 2009. But manufacturing output is still over 10 per cent below its pre-recessionary levels.

Table 1.3: Sectoral Growth in Gross Domestic Product, UK, 1991–2010

Per cent	Average	Recession		Growth on previous quarter			
				2009	2010		
	1991 Q4–2008 Q1	2008 Q2–2009 Q3	Peak to trough	Q4	Q1	Q2	Q3
Whole economy	**0.7**	**-6.4**	**-6.4**	**0.5**	**0.3**	**1.1**	**0.7**
Agriculture, forestry & fishing	**0.0**	-5.5	**-9.4**	-1.0	-1.8	2.9	**-0.2**
Construction	**0.5**	-12.9	**-14.2**	-1.0	-0.6	7.0	**4.0**
Manufacturing	**0.2**	-14.5	**-14.5**	0.9	1.4	1.7	**1.1**
Total services	**0.9**	-4.5	**-4.5**	0.8	0.3	0.6	**0.5**
Wholesale & retail trade; motors & repairs	**0.7**	-5.8	**-7.8**	2.4	-0.5	0.4	**0.8**
Hotels & restaurants	**0.6**	-7.9	**-8.0**	0.3	-0.5	1.9	**0.8**
Finance	**1.2**	-5.1	**-8.0**	-1.1	0.3	-0.4	**0.1**

Source: LPC estimates based ONS data, GDP (ABMI), and output indices for: agriculture, forestry & fishing (GDQA); construction (GDQB); manufacturing (CKYY); total services (GDQS); wholesale & retail trade (GDQC); hotels & restaurants (GDQD); and financial intermediation (GDQI); chain volume measures, quarterly, seasonally adjusted, UK, Q4 1991–Q3 2010.

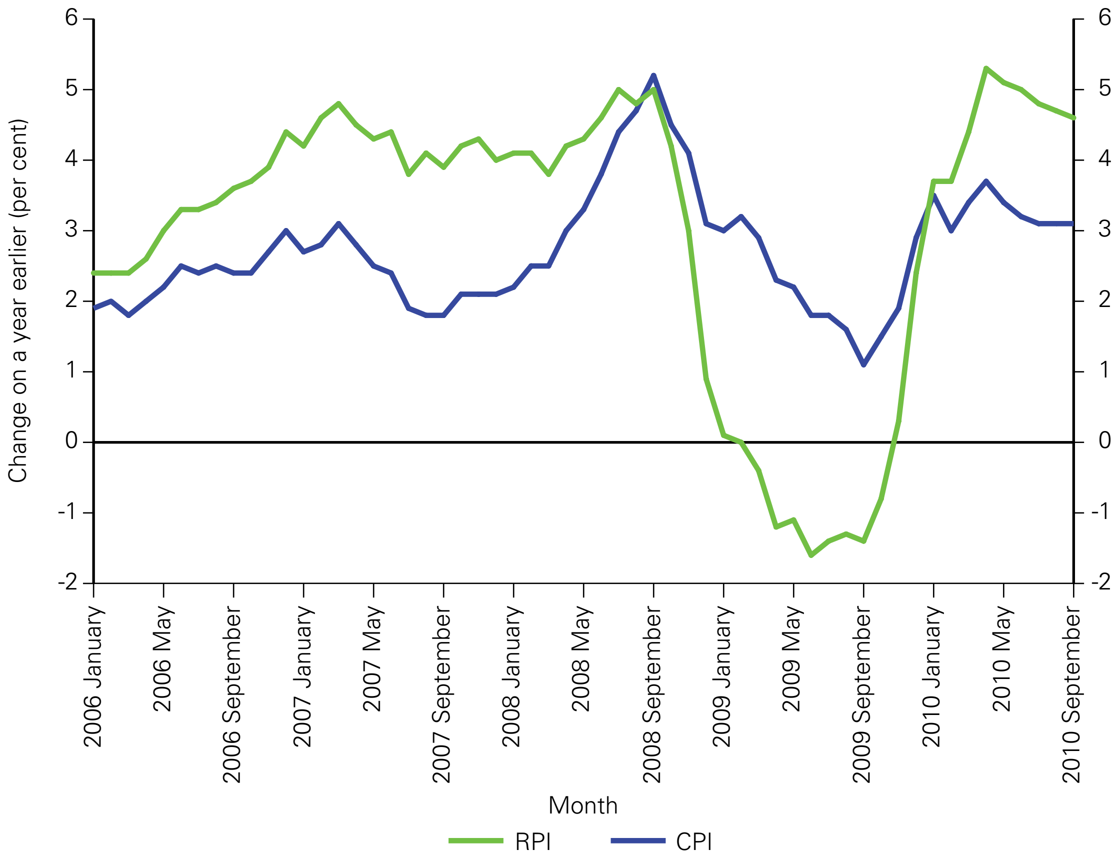
1.14 Manufacturing and construction are not large employers of minimum wage labour. Two sectors that employ many workers paid at or near the minimum wage, retail and hospitality, were also badly affected by the recession with output falling by around 8 per cent in both distribution (wholesale & retail trade; motors & repairs in Table 1.3) and hospitality (hotels & restaurants in Table 1.3). On this output measure, retail appeared to start picking up in the third quarter of 2009 and has grown by 3.1 per cent since the end of the recession. In contrast, the recovery in hospitality did not start until the second quarter of 2010 but has been very similar to the whole economy, both growing by around 2.7 per cent since the end of the recession. Evidence from the industry itself, however, suggests that this growth has mainly been confined to London and other major tourist cities as the weak pound has attracted more tourists.

1.15 In contrast, retail output – as measured by retail sales – held up surprisingly well throughout the recession. Official measures of retail sales growth were reasonably robust with the headline three-month retail sales growth averaging over 2 per cent and never falling below 0.6 per cent (March 2009). The volume measure was weaker, averaging 1.3 per cent, with falls registered between March and May of 2009. Retail sales estimates from BRC-KPMG were slightly weaker than the official estimates, with growth in total sales averaging just under 2 per cent, recording a fall only in December 2008. The CBI Distributive Trades Survey tracked similar trends but was generally more pessimistic than the other two measures.

Prices, Settlements and Earnings

1.16 The recession exerted downward pressure on inflation and pay. By the same token, the economic recovery since the third quarter of 2009 might be expected to have implications in the opposite direction. Figure 1.2 shows that the rates of growth in the two key measures of inflation reached their nadir in mid-2009 when the effects of a combination of technical issues and actual price falls resulted in the all items Retail Prices Index (RPI) falling to -1.6 per cent in June 2009 and the Consumer Price Index (CPI) falling to 1.1 per cent in September 2009. The downward pressures were sufficient to push the RPI into negative territory for the first three quarters of 2009 while inflation as measured by CPI had also fallen back during this period. The waning of these downward pressures on the indices, in the case of RPI amplified by the effects of previous large cuts in mortgage interest payments (not included in CPI), meant that both measures started to rise again later in 2009, and both were positive and over 2 per cent in December 2009, the latest figures available to us when we made our recommendations last year. Forecasters at that time expected inflation to keep rising through the first half of 2010 as the earlier downward pressures continued to fall from the indices, the cut in the level of VAT was reversed and price pressures emerged in a range of goods and services.

Figure 1.2: Price Inflation, UK, 2006–2010



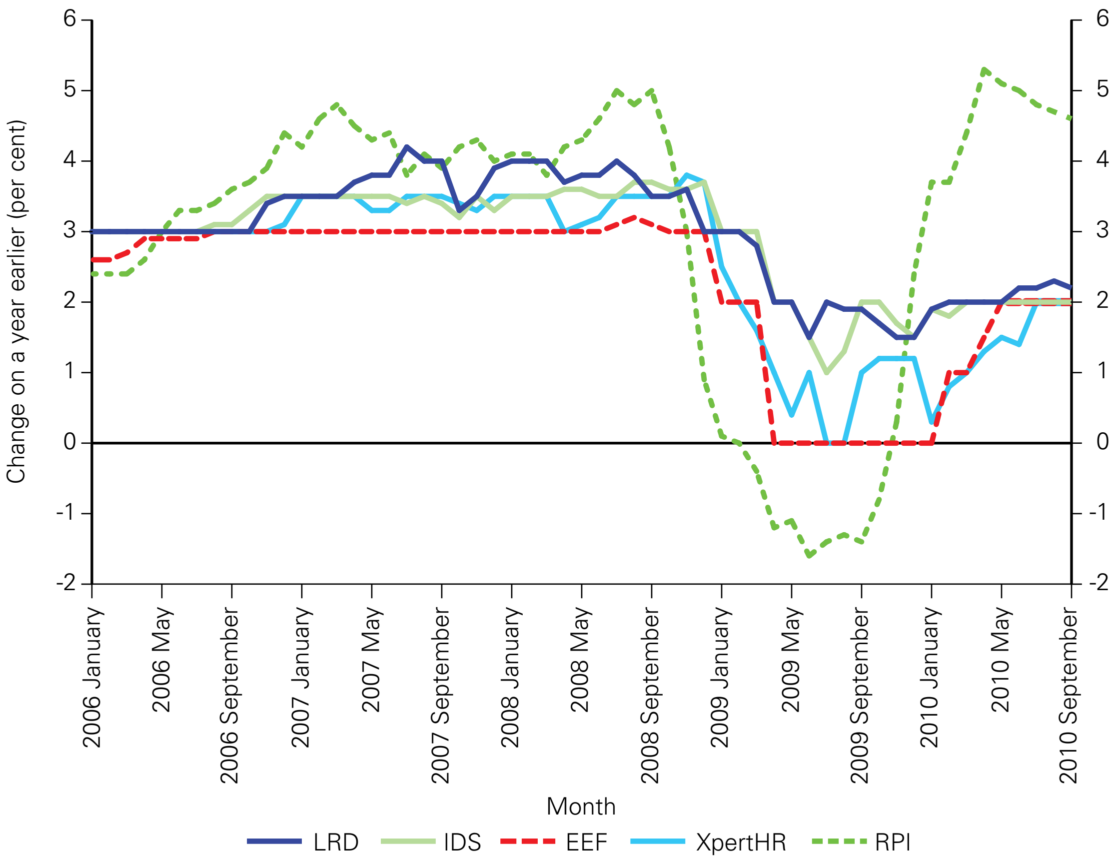
Source: ONS, CPI (D7G7), RPI (CZBH), monthly, not seasonally adjusted, UK, 2006–2010.

1.17 Even so, the expectation was that inflation would fall back later in the year, with the median consensus of independent forecasts in January 2010 putting CPI at 1.8 per cent in the fourth quarter of 2010, and RPI at 2.9 per cent. These forecasts reflected assumptions that the effects of then prevalent upwards pressures would themselves fall from the indices from the summer of 2010 onwards. For our own part, we drew attention to recent price volatility and the lack of clarity around the effects of the Bank of England's quantitative easing programme, and felt that forecasting inflation in 2010 would be particularly difficult. We were right to be concerned. As Figure 1.2 shows, CPI was above 3 per cent for the first nine months of 2010, well above its target rate of 2 per cent, and which resulted in several explanatory letters from the Governor of the Bank of England to the Chancellor of the Exchequer. It was 3.1 per cent in September 2010. RPI has been above 4 per cent for most of the period and was 4.6 per cent in September 2010. These rates of inflation are much higher than those of the consensus forecasts from January 2010.

1.18 Inflation is one factor that influences pay settlements – the periodic, usually annual, adjustments to basic pay rates within organisations. The key inflation measure used is the RPI, as it captures all items including housing costs. As Figure 1.3 shows, settlement levels fell sharply from late 2008, with a large increase in the proportion of pay freezes and with another large proportion of awards around 2 per cent. This introduced an unusual bi-modality into the settlement distribution. Consequently, the median of awards in 2009 typically lay in the range of 0–2 per cent depending on data source, and could be heavily influenced by a very small number of awards. However, even at these relatively low levels, the median of settlements – that is, the midpoint of the pay settlement distribution – had been well above RPI during all of 2009 bar December, resulting in regular, and sometimes historically large, increases in real base pay.

1.19 Surveys of employers' 2010 pay award intentions variously suggested an increase in the median to 2–3 per cent, but with a continuing high percentage of pay freezes. At the time of writing our 2010 Report there were few pay settlement data available for us to assess how 2010 would actually pan out.

Figure 1.3: Median Pay Settlements and Price Inflation, UK, 2006–2010



Source: XpertHR (formerly IRS), IDS, LRD, and EEF, pay databank records, three-month medians; ONS, RPI (CZBH), monthly, not seasonally adjusted, UK, 2006–2010.
Notes:
a. EEF covers manufacturing only.
b. Pay settlements in the three months to end of month shown.

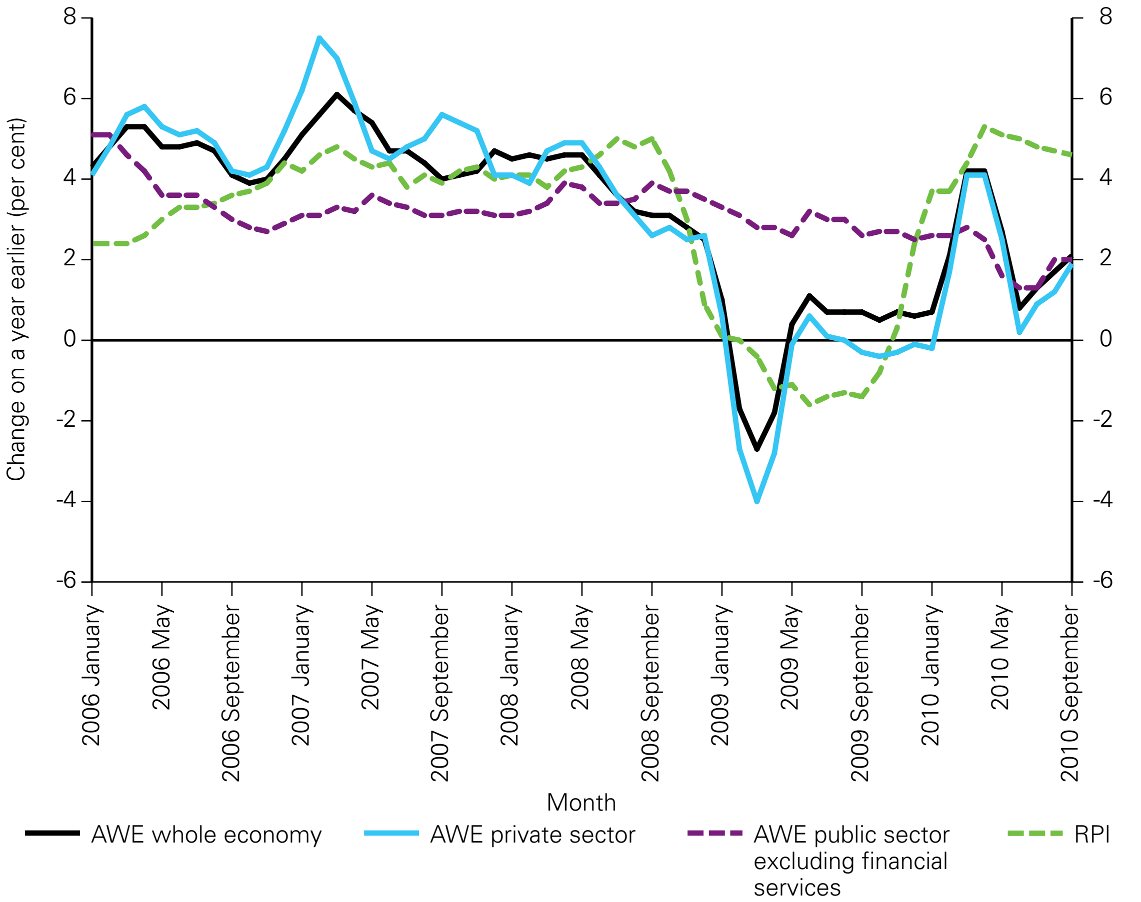
1.20 While there has been some slight variation in the different medians, there was a clear centring on 2 per cent as 2010 progressed, with the medians in September 2010 in the range 2–2.2 per cent. This is towards the lower end of employer expectations from the earlier surveys and in relation to inflation shows a marked fall in real base pay levels in 2010 in contrast to 2009. There has been a large decline in the number of pay freezes in the whole economy in 2010. Most of the databases showed pay freezes in around half of all awards in the early months of 2010, similar to the proportions recorded in 2009, but this proportion fell steadily during the year and was around one tenth of all awards in the three months to September 2010. As a result, at the end of 2010 the settlement distribution had returned to a more 'normal' shape.

1.21 Average earnings are a broader indicator of pay growth than settlements as they include adjustments, such as location allowances, incremental progression, or overtime and shiftwork payments, which are not included in basic pay rates and therefore not picked up in settlement data. In January 2010 the Office for National Statistics (ONS) adopted Average Weekly Earnings (AWE) as its preferred measure of short-term earnings growth. For a number of specific and technical reasons ONS believes that AWE is a more accurate measure of earnings movements than the traditional Average Earnings Index (AEI) that it replaced, with the latter discontinued from July 2010. We understand, however, that forecasters had no difficulty adjusting to the new measure and their expectations for 2010 were unaffected by the change.

1.22 The latest data available to us at the time of our 2010 recommendations were based on the AEI and related to November 2009. They showed earnings growth in the public sector higher than in the private sector, a picture unaffected by the inclusion or exclusion of bonus effects. We noted that this relationship was not unusual during periods of economic downturn and was expected to reverse as the economy improved. There were likely to be downward pressures on public sector pay awards from policies aimed at fiscal constraint. On the other hand, private sector pay awards were expected to pick up and there was also expected to be some restoration of bonuses in the finance sector. Taken together, these pointed to a slowdown in earnings growth in the public sector, and some pick-up in the private sector rate of growth. Overall, the median forecast was for whole economy earnings to grow by 2.2 per cent in 2010, slightly higher than the expected outcome for 2009. We said that we would not be surprised if the rate of growth in 2010 turned out higher than expected.

1.23 Figure 1.4 shows the movements in total pay in the whole economy and public and private sectors. The data for the year to September 2010 show that whole economy total earnings growth averaged 2.2 per cent, broadly in line with forecasts for the full year. As we expected, total earnings growth in the public sector, excluding the nationalised banks, has slowed since the beginning of 2010 as settlement levels have declined. It was 2.0 per cent in the three months to September 2010. Again, as we expected, there was a sharp pick-up in private sector earnings growth in early 2010 as bonus payments were restored, particularly in the finance sector. Although the rate has settled back as those effects have fallen from the index, growth at 1.9 per cent was considerably higher in September 2010 than 12 months earlier and was very close to that in the public sector. As in the case of pay settlements, earnings growth throughout the year to September 2010 was generally well below the rate of RPI inflation resulting in substantial falls in real earnings over the period.

Figure 1.4: Growth in Average Weekly Earnings Total Pay, GB, and Price Inflation, UK, 2006–2010



Source: ONS, AWE total pay, three-month average growth for: the whole economy (KAC3), the private sector (KAC6), and the public sector excluding financial services (KAE2), monthly, seasonally adjusted, GB, 2006–2010; and RPI (CZBH), monthly, not seasonally adjusted, UK, 2006–2010.

Employment and Unemployment

1.24 The consensus forecasts in January 2010 expected sluggish output growth to have an adverse effect on employment with the number of workforce jobs falling by 0.7 per cent in 2010 and claimant count unemployment rising from around 1.60 million at the end of 2009 to 1.82 million in 2010 and 1.88 million in 2011.

1.25 Official measures of employment, as shown in Table 1.4, give a mixed picture on the performance of the labour market in 2010. Data derived from employer surveys continued to show employment falling with workforce jobs and employee jobs both lower in September 2010 than a year earlier, down 0.6 and 1.0 per cent respectively. Looking over the whole year, between 2009 and 2010, workforce jobs fell by 1.0 per cent, which was more than forecast. On the other hand, data derived from household surveys (Labour Force Survey (LFS) employment and employees in Table 1.4) paint a more positive picture. These show that employment has actually grown over the last year, with the numbers in employment up 1.0 per cent and the number of employees up 0.3 per cent. Hours increased by 1.3 per cent.

Table 1.4: Change in Employment and Unemployment, UK, 2007–2010

	September 2007–September 2008		September 2008–September 2009		September 2009–September 2010	
	000s	%	000s	%	000s	%
Workforce jobs	76	0.2	-856	-2.7	-170	-0.6
Employee jobs	132	0.5	-964	-3.5	-277	-1.0
Employment	133	0.5	-496	-1.7	286	1.0
Employees	158	0.6	-553	-2.2	80	0.3
Hours worked	2,000	0.2	-30,000	-3.2	12,000	1.3
ILO unemployment	179	10.9	625	34.4	-12	-0.5
Claimant count	123	14.6	649	67.1	-148	-9.2
Vacancies	-69	-10.2	-173	-28.5	27	6.2
Redundancies	27	21.1	49	31.6	-59	-28.9

Source: LPC estimates based on ONS data, workforce jobs (DYDC) and employee jobs (BCAJ), quarterly; total employment (MGRZ), employees (MGRN), total weekly hours (YBUS), ILO unemployment (LF2I), claimant count unemployment (BCJD), vacancies (AP2Y) and redundancies (BEAO), monthly, seasonally adjusted, UK, 2007–2010.

1.26 Unemployment appears to have fallen during 2010, with headline unemployment (the ILO measure which is derived from a household survey) down 0.5 per cent over the year and the claimant count (derived from administrative records) falling by 9.2 per cent. The fall of 148,000 in the claimant count to 1.47 million was much better than expected by the consensus forecasts.

1.27 Although employment growth, as measured by the LFS, appears strong, it has mainly been in part-time and temporary jobs. In the year to September 2010, the number of full-time employees fell by 126,000 while there was an increase in part-time employees of 207,000. Similarly, the number of permanent employees fell by 49,000 compared with an increase of 129,000 temporary employees. Reflecting the state of the labour market, many workers taking these new jobs appear to be doing so through the lack of available full-time and permanent jobs. Between the start of the recession (May 2008) and September 2010 there was an increase in the number of part-time workers who would prefer to work full-time from 667,000 to 1.16 million – a rise from around 9 per cent of part-timers to about 15 per cent. Similarly, the number of temporary workers who would prefer to work in a permanent job rose from 354,000 in May 2008 to 597,000 in September 2010, an increase from about 25 per cent of temporary workers to over 38 per cent.

1.28 Although unemployment has generally been falling throughout 2010, there has been a notable rise in the proportion unemployed for more than a year. The number of long-term jobless, however, is much below the levels experienced during the previous two recessions. It should also be noted that, although vacancies have picked up and redundancies have fallen over the year to September 2010, these measures have started to worsen since the summer of 2010.

Productivity

1.29 Although the employment picture is mixed, various economic measures still suggest that the fall in output was greater than the fall in employment (or hours) during the recession. In our last report, we showed that productivity had fallen sharply and there had been steep rises in unit wage costs. We said at the time that this was unsustainable and that further reductions in labour input might be necessary unless there was a pick-up in output and productivity. That rise in output appears to have occurred with productivity rising in 2010, particularly in manufacturing, and unit wage costs have fallen as the recovery has gathered momentum.

1.30 We also noted in our 2010 Report that, as a consequence of reducing investment and running down stocks, firms had continued to build up their financial balances throughout the recession. This has continued during the recovery. Profits also began to recover in 2010.

Profits

1.31 We use three measures of profits that are available at the aggregate level – rates of return on capital, stock market indices and gross operating surplus – to assess profitability. We first consider the rate of return on capital employed and the stock market. Although the gross and net rates of return on capital both fell during the recession, bottoming out at 11.0 per cent in the first quarter of 2010, they remained above the rates of return obtained in the recession of the 1990s. They also increased strongly in the second quarter of 2010, reaching their highest rates of return for over a year in manufacturing and the economy as a whole. Stock market indices, which can be interpreted as measures of expected future profits, also experienced some recovery in 2010. According to EcoWin, the FTSE-All share index fell by 17.6 per cent in 2008 and lost a further 14.5 per cent in 2009, but it regained 12.9 per cent in 2010.[2]

1.32 We next consider our preferred measure of profits, gross operating surplus of corporations. This fell by nearly 14 per cent for non-financial corporations during the recession but has picked up by 8 per cent since the last quarter of 2009. The gross operating surplus of financial corporations fell almost 40 per cent between the fourth quarter of 2008 and the second quarter of 2010.

1.33 The profit share (gross operating surplus as a share of GDP) rose steadily, from 19.5 per cent in the fourth quarter of 2001 to 24.0 per cent in the fourth quarter of 2008. It then fell sharply, reaching 20.1 per cent in the second quarter of 2010 as the recession took hold before recovering to 21.4 per cent in the third quarter of 2010. Despite the fall, the profit share remained above its long-run average share (since 1955) and was considerably above the profit share experienced during the two previous recessions.

1.34 In contrast, the wage share (compensation of employees as a share of GDP) rose during the recession from 53.0 per cent in the second quarter of 2008 to 56.1 per cent in the second quarter of 2009 before falling back below 54 per cent in the third quarter of 2010. It remained well below its long-run average share (since 1955) but was similar to the share observed during the 1990s recession.

2 Based on averages over the year.

Revised Forecasts for 2010 and 2011

1.35 Since we wrote our last report, the Government has established the Office for Budget Responsibility (OBR) to make independent assessments of the public finances and the economy. The Government now uses forecasts from the OBR in its budget reports. The OBR forecasts are more detailed than those previously produced by HM Treasury. We will use these forecasts alongside those of the panel of independent forecasters, still collated by HM Treasury on a monthly basis.

1.36 As we noted above, at the time of writing our 2010 Report the consensus forecasts (shown in Table 1.5) were that the economy was expected to grow by 1.3 per cent in 2010 and 2.0 per cent in 2011. The speed of the recovery has led to the forecasts being revised so that growth is now expected to have been much stronger, at about 1.7–1.8 per cent, in 2010. Despite the forthcoming fiscal consolidation, the consensus forecast is still growth of 2.0 per cent in 2011. OBR's forecast is slightly higher at 2.1 per cent.

1.37 As a consequence of higher than expected growth in 2010 and the apparent continued resilience of the labour market, the forecasts for employment have been revised up and the forecasts for claimant unemployment revised down.

1.38 Inflation forecasts have been continually revised upwards as a result of increases in energy, food and commodity prices, as well as the reversal of the VAT cut. Inflation in 2010 turned out to be nearly double the rate forecast in January 2010 and it is expected to remain at elevated levels in 2011, reflecting the VAT increase to 20 per cent in January 2011. Despite higher than forecast inflation, the consensus forecasts and the OBR at the time of writing say they do not expect this to feed into inflationary expectations and cause wage pressures to increase substantially, as they expect average wage growth to increase only marginally in 2011. These inflation forecasts may reflect views formed a while ago. Some city commentators are much less sanguine about the prospects for inflation. Indeed, past experience suggests that sustained higher inflation may well result in higher wage settlements and stronger earnings growth than are presently being forecast.

Table 1.5: Actual Outturn and Revised Forecasts Compared with 2010 Report Forecasts, UK, 2010–2011

Per cent		Forecasts used in 2010 Report: Median of independent forecasts (November 2009 and January 2010)		Actual outturn (data for Q4 unless stated otherwise)	Latest forecasts for 2010 and 2011: Median of independent forecasts (January 2010)		Latest forecasts for 2010 and 2011: OBR (November 2010)	
		2010[a]	**2011[b]**	**2010[c]**	**2010[d]**	**2011[d]**	**2010[e]**	**2011[e]**
GDP growth[f]		**1.3**	2.0	**1.7[g]**	**1.7**	2.0	**1.8**	2.1
Employment growth[f]		**-0.7**	–	**-1.0**	**0.0**	0.4	**-0.0[h]**	0.3[h]
Claimant unemployment (millions)[i]		**1.82**	1.88	**1.46**	**1.47**	1.56	**1.47**	1.49
Average earnings growth (AWE total pay, GB)[j]		**2.2**	–	**2.3[k]**	**2.3**	2.6	**2.3**	2.2
Price inflation	**CPI[i]**	**1.8**	1.6	**3.4**	**3.2**	2.9	**3.0**	2.8
	RPI[i]	**2.9**	2.6	**4.7**	**4.6**	4.0	**4.0**	3.4
	RPIX[i]	**2.4**		**4.7**	**4.6**	3.7	**4.1**	2.7

Source: HM Treasury (November 2009, January 2010 and January 2011); OBR (November 2010); and LPC estimates based on ONS data, GDP growth (ABMI), total employment as measured by workforce jobs (DYDC), and claimant unemployment (BCJD), quarterly, AWE total pay (KAB9), monthly, seasonally adjusted; RPI (CZBH), RPIX (CDKQ) and CPI (D7G7), quarterly, not seasonally adjusted, UK (GB for AWE); 2009–2011.

Notes:

a. Forecasts for 2010 were from the HM Treasury Panel of Independent Forecasts (January 2010).
b. Forecasts for 2011 were from HM Treasury Panel of Independent Forecasts (November 2009).
c. Data available up to 19 January 2011.
d. Latest forecasts for 2010 and 2011 are from HM Treasury Panel of Independent Forecasts (January 2011).
e. OBR forecasts from 29 November 2010.
f. Actual data and forecasts are for whole year growth.
g. Estimate of economic growth based on current ONS data, latest forecasts and LPC extrapolations.
h. The OBR forecasts employment levels rather than growth. Growth forecasts here reflect the percentage differences between forecast levels.
i. Data and forecasts are for Q4.
j. The forecast made in January 2010 was for average earnings growth measured by AEI (including bonuses) (ONS code LNNC). Since January 2010, the AEI has been replaced by AWE (total pay). AWE is used for actual data and more recent forecasts.
k. Estimate of average earnings growth based on January–November 2010 compared with the same period a year earlier.

Conclusion

1.39 The UK economy has emerged reasonably strongly from the longest and deepest recession since the 1930s. As we noted in our last report, the labour market had been particularly resilient in the recession. In contrast to the two previous recessions in the 1980s and 1990s, employment and hours worked fell by much less than the fall in output. Unemployment also did not rise to the levels seen in either of the previous two recessions. The available data continue to support this resilience in the labour market, although data derived from employer surveys suggest that the labour market has been more adversely affected than data derived from household and administrative records.

1.40 Wage growth has turned out as expected but inflation has been much higher than forecast, the relatively subdued wage growth leading to cuts in the real wages of many workers. The minimum wage increases in the last two years, 1.2 per cent in October 2009 and 2.2 per cent in October 2010, have been in line with median pay settlements and average wage growth but have been below the rise in prices. We now go on to consider these increases as we look at the impact of the minimum wage to date on earnings, competitiveness and employment.

Chapter 2

The Impact of the National Minimum Wage to Date

Introduction

2.1 The previous chapter set out the economic context surrounding last year's minimum wage upratings. This chapter reviews the impact of the National Minimum Wage since its introduction in April 1999 with an emphasis on recent years. As it is too early to gauge the impact of the most recent October 2010 upratings, we focus mainly on the minimum wage rates as uprated in October 2009.

2.2 The increases in October 2009 were around 1.2 per cent for all three minimum wage rates prevailing at that time. Our analysis in this chapter concentrates on the impact of the adult rate, although we also refer to increases in the minimum wages for young workers and comment on some aspects of the impact by age. The analysis covers those aged 22 and over as the adult rate was not extended to cover 21 year olds until October 2010. The impact on young workers is covered in more detail in Chapter 3.

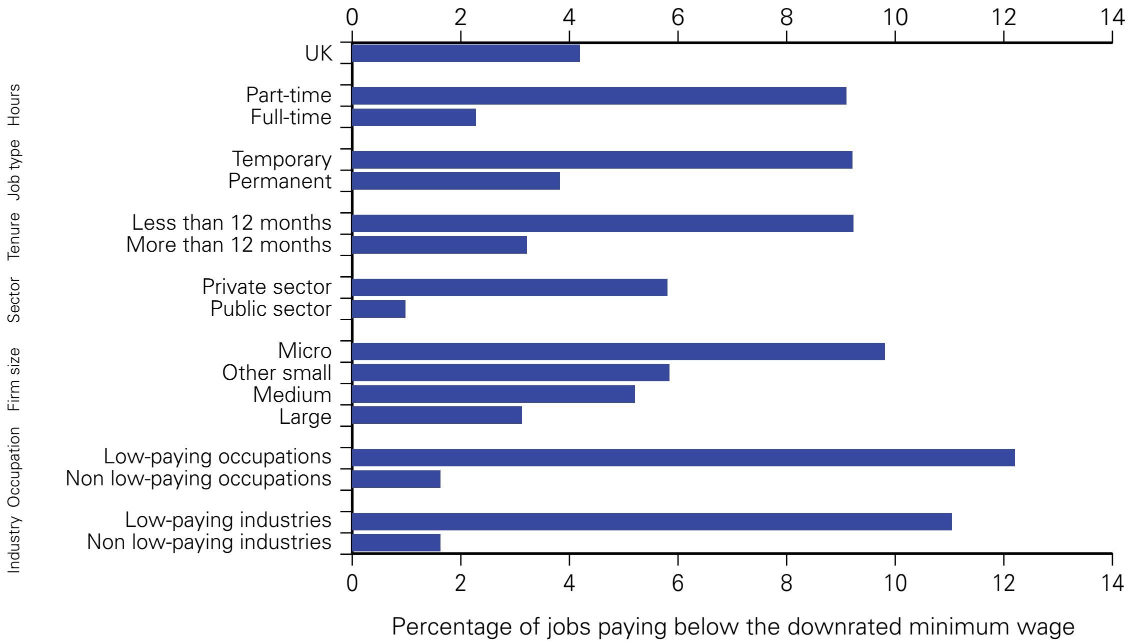
2.3 Before looking in detail at the impact of the minimum wage, we briefly review those areas where we might be most likely to find evidence of impact. We know that certain jobs in particular locations and industries are more likely to be low-paid. We also know that specific groups of workers are more likely to be low-paid because they suffer from skill deficits, limited experience or other constraints. We start by looking at these low-paying jobs and low-paid workers.

National Minimum Wage Jobs

2.4 We use the Annual Survey of Hours and Earnings (ASHE) as the main data set with which to assess how the minimum wage has affected the distribution of earnings. The latest available ASHE data are from April 2010, when the adult minimum wage was £5.80 an hour (1.2 per cent higher than in the previous year). We use hourly pay excluding overtime as the basic measure of earnings. It should also be noted that the earnings distribution in April 2010 may already, to some extent, reflect the then forthcoming increases to the minimum wage in October 2010, as some employers may have pre-empted some or all of the increase.

2.5 For the purposes of analysing minimum wage jobs in this section, we define a minimum wage job to be one that, in April 2010, paid less than the equivalent of the forthcoming October 2010 minimum wage. We do this by first observing the average earnings growth between April and October 2010. The October 2010 minimum wage rates are downrated (deflated) by this amount. We then use these downrated values to determine whether a job in April 2010 was a minimum wage one or not. On this basis, we estimate that about 4.2 per cent of all jobs are minimum wage ones. Figure 2.1 shows that such jobs are more likely to be: part-time; temporary; held for less than a year; in the private sector; in small and medium-sized firms; and in certain low-paying industries and occupations. Around 9 per cent of jobs that are part-time, temporary, or have been held for less than a year are minimum wage jobs, compared with 2–4 per cent of jobs that are full-time, permanent or have been held for more than a year. In private sector organisations nearly 6 per cent of jobs are minimum wage ones but only 1 per cent of jobs in public sector organisations are.

Figure 2.1: Characteristics of Minimum Wage Jobs, UK, 2010



Source: LPC estimates based on ASHE 2007 methodology, low-pay weights, including those not on adult rates of pay, UK, April 2010.
Note: Minimum wage jobs defined as adults (aged 21 and over) earning less than £5.86, youths (aged 18–20) earning less than £4.86, and 16–17 year olds earning less than £3.60 in April 2010.

2.6 Figure 2.1 shows that there is a clear relationship between the proportion of minimum wage jobs and the size of firm. Workers in large firms (those with 250 or more employees) are much less likely to be in minimum wage jobs than those in small firms (those with fewer than 50 employees), especially micro firms (those with 1–9 employees). Nearly 10 per cent of jobs in micro firms are paid at the minimum wage compared with around 3 per cent in large firms. Nevertheless, according to ASHE, the majority of minimum wage workers work in large firms. Around 51 per cent of minimum wage workers work in large firms compared with around 17 per cent in micro firms and a further 17 per cent in other small firms (those with 10–49 employees). The remaining 16 per cent work in medium-sized firms (50–249 employees).

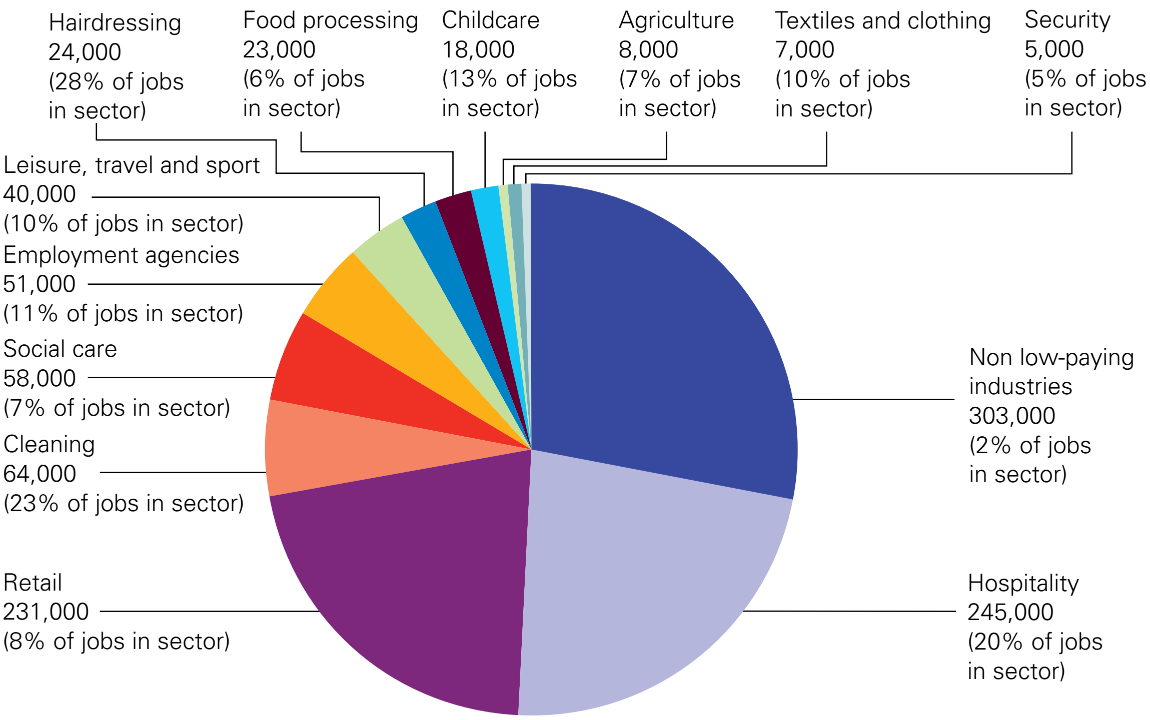
2.7 Figure 2.1 also shows clear differences between those industries and occupations that we consider to be low-paying and other occupations and industries. As in previous reports, we define low-paying sectors as those industries or occupations with a large number or high proportion of minimum wage workers. By this definition the low-paying industries are: retail; hospitality; social care; employment agencies; food processing; leisure, travel and sport; cleaning; agriculture; security; childcare; textiles and clothing; and hairdressing.[3] When defining our occupation-based low-paying sectors, we group low-paying occupations under

3 Full definitions of these low-paying industries are given in Appendix 4 of the 2010 Report.

the same headings (for example, retail includes trolley collectors, shelf stackers, till cashiers and sales assistants) and add office work.[4] However, we are not able to do this for employment agencies.

2.8 Looking at the low-paying industries in greater detail, Figure 2.2 shows that 303,000 minimum wage jobs (just under a third) are not in any of the identified low-paying industries. The greatest numbers of minimum wage jobs are in hospitality (245,000) and retail (231,000), which together account for around 44 per cent of all minimum wage jobs. Cleaning (64,000), social care (58,000) and employment agencies (51,000), each represent between 4 and 6 per cent of minimum wage jobs, while the remaining low-paying industries account for 125,000 jobs (or around 12 per cent). Figure 2.2 also shows that hairdressing (28 per cent), cleaning (23 per cent) and hospitality (20 per cent) have the highest proportions of minimum wage jobs, whereas only 8 per cent of jobs in retail and 7 per cent of jobs in social care are minimum wage ones.

Figure 2.2: Number and Proportion of Minimum Wage Jobs, by Low-paying Industry, UK, 2010[ab]



Source: LPC estimates based on ASHE 2007 methodology, low-pay weights, including those not on adult rates of pay, UK, April 2010.
Notes:
a. Minimum wage jobs defined as adults (aged 21 and over) earning less than £5.86, youths (aged 18–20) earning less than £4.86, and 16–17 year olds earning less than £3.60 in April 2010.
b. Percentages in parentheses are the proportion of jobs in each industry that are minimum wage jobs.

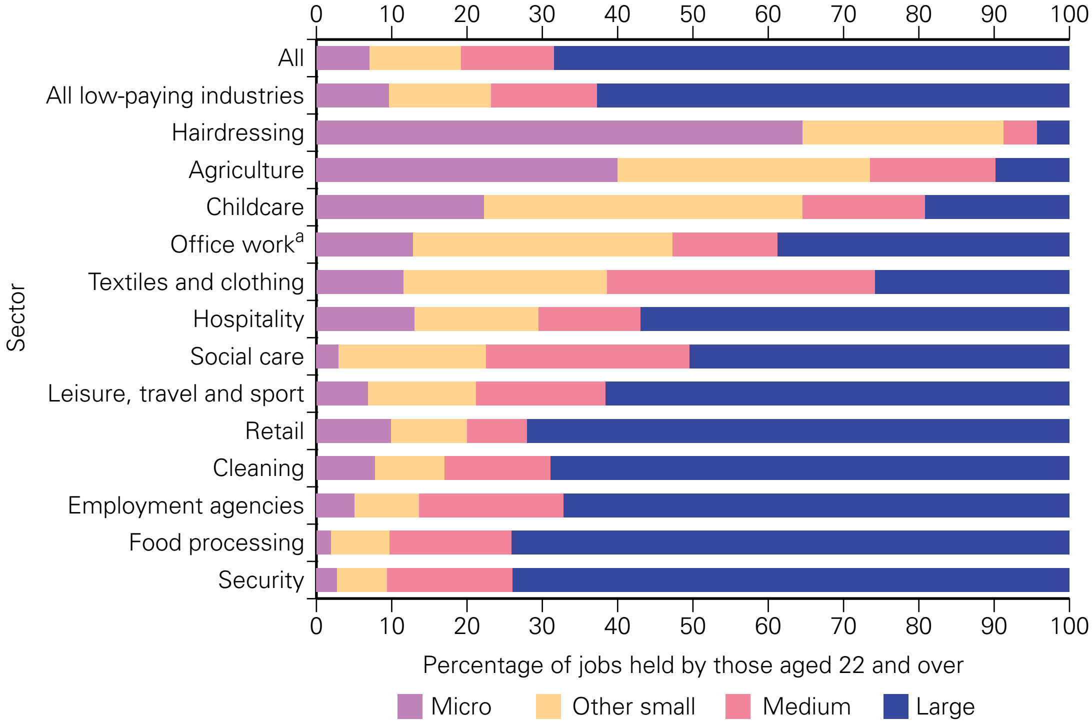
2.9 We find a similar pattern in the low-paying occupations. Just under a third of minimum wage jobs are not to be found in any of our defined low-paying occupations. The largest numbers of minimum wage jobs are in hospitality (222,000) and retail (212,000), and together they account for around 40 per cent of minimum wage jobs. Using our occupational definition, cleaning accounts for about 14 per cent of all minimum wage jobs (around 151,000). This is much larger than the numbers covered by the industry definition in Figure 2.2, as cleaners are

4 Full definitions of our occupation-based low-paying sectors are given in Appendix 4 of the 2010 Report.

to be found in most industries across the whole economy. That leaves just 16 per cent of minimum wage jobs in our other low-paying occupation groups. Those occupation groups with the highest proportions of minimum wage jobs are hairdressing (25 per cent), hospitality (21 per cent) and cleaning (19 per cent).

2.10 Figure 2.3 shows that, according to ASHE, micro, other small and medium-sized firms account for a greater proportion of employment in the low-paying sectors than in the economy as a whole. But there is much variation across sectors. Micro and other small firms account for over 70 per cent of employment in hairdressing and agriculture compared with just over 19 per cent in the whole economy. Of all the low-paying sectors, only cleaning, food processing, employment agencies and security account for a lower proportion. Employment in medium-sized firms is much more common in textiles and social care than in the whole economy. Employment in large firms, however, is more common in security, cleaning, food processing and retail.

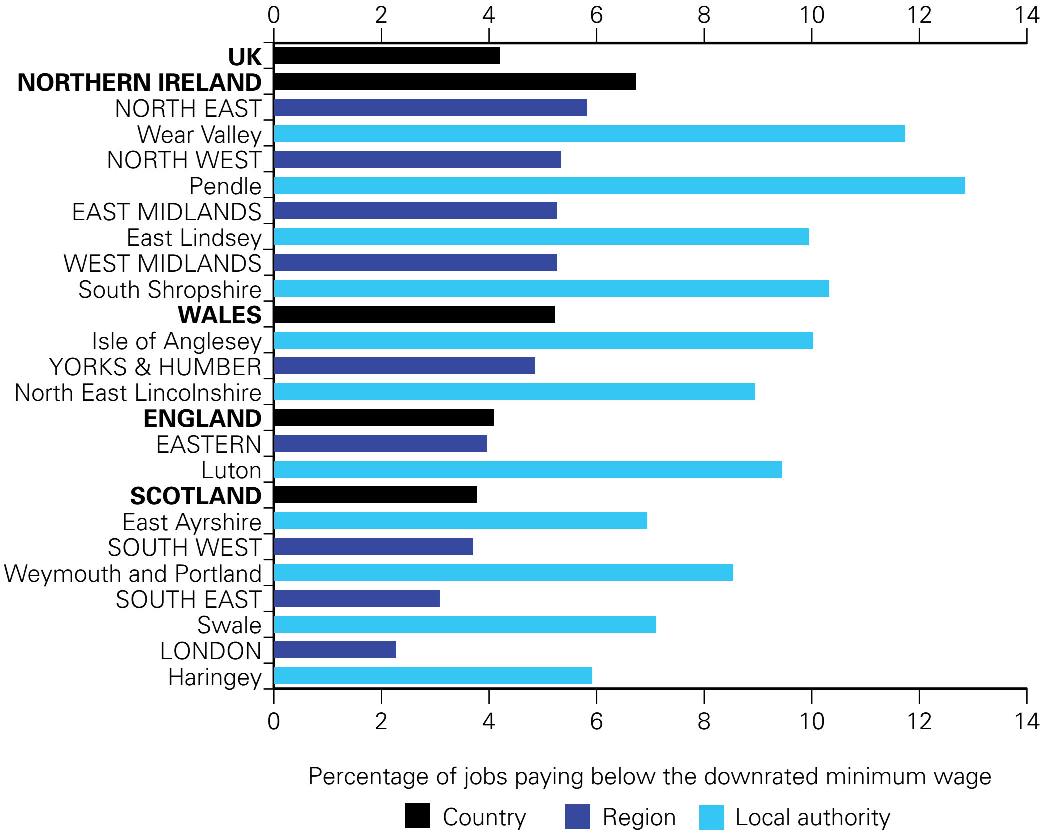
Figure 2.3: Jobs, by Size of Firm and Low-paying Sector, UK, 2010



Source: LPC estimates based on ASHE 2007 methodology, low-pay weights, including those not on adult rates of pay, UK, April 2010.
Note:
a. This sector is defined using Standard Occupational Classifications (SOC) 2000. The other sectors are based on the Standard Industrial Classification (SIC) 2007.

2.11 Just as they are distributed unevenly across sectors, so minimum wage jobs are spread unevenly throughout the UK. Figure 2.4 shows that Northern Ireland is the country with the highest proportion of minimum wage jobs (6.7 per cent), followed by Wales (5.2 per cent) and England (4.1 per cent), while Scotland has the lowest (3.8 per cent). Looking at regions within England, we can see that the North East has the highest (5.8 per cent) while London has the lowest (2.3 per cent). In contrast, the largest numbers of minimum wage jobs are found in the North West, the West Midlands and the South East, each accounting for around 10 per cent or more of all minimum wage jobs. Although London has the largest number of employees (14 per cent of all employees), it has only 8 per cent of all minimum wage jobs.

Figure 2.4: Minimum Wage Jobs, by Country, Region, and Highest Local Authority Within Each Area, 2010



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

a. Minimum wage jobs defined as adults (aged 21 and over) earning less than £5.86, youths (aged 18–20) earning less than £4.86, and 16–17 year olds earning less than £3.60 in April 2010.
b. The geographic areas are work-based. No regional breakdown is available for Northern Ireland.

2.12 There is also significant variation among local authorities within regions. For example, within the North East just under 6 per cent of all jobs are minimum wage jobs but nearly 12 per cent of jobs in Wear Valley are minimum wage ones compared with only 2 per cent of jobs in Gateshead. The spread is even wider in the North West, where the proportion of minimum wage jobs ranges from 2 per cent in Trafford to just under 13 per cent in Pendle. Minimum wage jobs account for 5.3 per cent of all jobs in the North West.

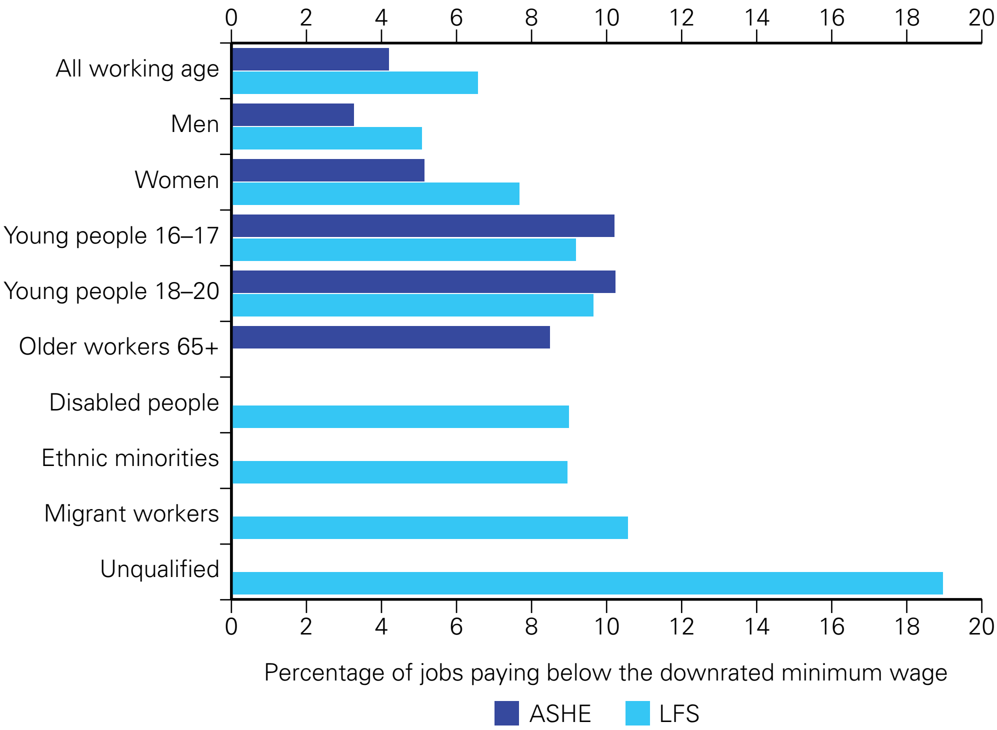
2.13 So far, we have looked at the characteristics of minimum wage jobs and their employers. We now turn to the people who work in these jobs. Our remit asked us to monitor the impact of the minimum wage on various groups of workers including, in particular, different age groups, women, ethnic minorities, disabled people and migrant workers. Earnings data from ASHE are only available by gender and age, so

"The impact of the NMW remains a regional matter. Companies within the South East consistently pay above the NMW whereas companies within the North West, North East, Scotland, and Northern Ireland may be more influenced by the NMW. Clearly as the minimum hourly rates are national, consideration must be given to the different regional effects of a single rate."

British Security Industry Association evidence

for the other groups we use earnings data from the Labour Force Survey (LFS). LFS data are, however, more liable to error than ASHE data. This is because ASHE data are based on employer records, whereas LFS data are self-reported and based on smaller sample sizes. LFS estimates of minimum wage coverage tend to be higher than ASHE. Figure 2.5 shows the coverage of the October 2010 upratings using these two datasets. It shows that the groups covered by our remit, along with those who have no qualifications, contain higher proportions of minimum wage workers than the overall working age population.

Figure 2.5: Minimum Wage Jobs, by Group of Worker, UK, 2010



Source: LPC estimates based on ASHE 2007 methodology, low-pay weights, including those not on adult rates of pay, UK, April 2010 and LFS Microdata, income weights, quarterly, not seasonally adjusted, UK, Q2 2010.
Note: Minimum wage jobs defined as adults (aged 21 and over) earning less than £5.86, youths (aged 18–20) earning less than £4.86, and 16–17 year olds earning less than £3.60 in April 2010.

2.14 Caution should be exercised when considering the data concerning migrant workers and those from ethnic minority groups. The ethnic minority and migrant worker categories in Figure 2.5 are the aggregates of many different ethnicities and countries of birth and presenting them in this form hides significant variation between the constituent groups. For example, among the ethnic minorities, the proportion of black people who are minimum wage workers is lower than that of white people (5.8 per cent compared with 6.1 per cent), whereas the proportions are much higher among workers of Bangladeshi and Pakistani origin (11.2 and 12.7 per cent respectively).

Impact of the National Minimum Wage

2.15 We now look at the impact of the minimum wage on earnings and labour costs. If we can show that the minimum wage has affected earnings, then it is likely to have affected labour costs. This in turn will lead firms to adopt different strategies to cope with these increased costs. Employers might, for example, decide to adjust their pay structures or reduce non-wage benefits.

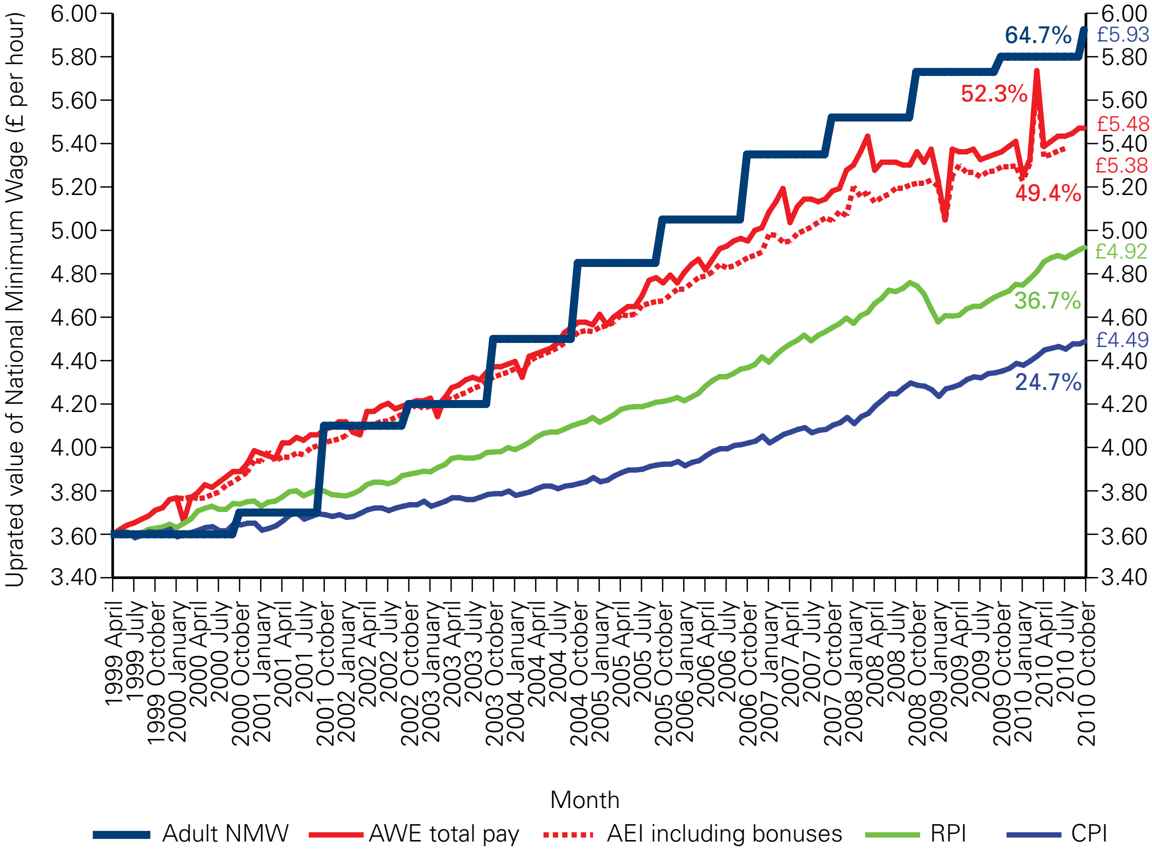
2.16 Alternatively, firms may not be able to absorb these additional costs within their pay bill. In that case, businesses might try to pass on these extra costs to their customers in the form of price rises (or reductions in quality) or attempt to absorb them through reduced profit margins. Furthermore, employers may have to adjust the hours of work or the numbers employed. They might also seek ways to increase productivity as a means of affording the increases. At the extreme, excessive rises in the minimum wage could lead to business failure and insolvencies. The minimum wage could also affect the ease with which businesses are able to start up. We look at each of these in turn to assess the impact of the minimum wage to date.

2.17 We start by assessing how the increases in the minimum wage compare with increases in average earnings (the relative increase) and the general level of price inflation (the real increase). As noted in the previous chapter, our previous measure of average earnings growth, the Average Earnings Index (AEI), has been replaced as the National Statistic by Average Weekly Earnings (AWE). AWE (total pay) rose slightly faster than AEI (including bonuses) between January 2000 and July 2010[5] (44.2 per cent compared with 42.7 per cent respectively).[6] We can see from Figure 2.6 that both have risen at a slower pace than the National Minimum Wage. There has, therefore, been an increase in the relative value of the National Minimum Wage since its introduction. Had the minimum wage been uprated in line with average earnings growth (AEI to January 2000 and AWE from then on), it would have been £5.48 in October 2010. That is 45 pence less than the current level of the minimum wage.

5 The AWE series began in January 2000. Prior to that time, for comparative purposes, we use the AEI to measure earnings growth. The AEI series ended in July 2010.

6 Over the same period, AWE (regular pay) and AEI (excluding bonuses) both rose by about 43.5 per cent.

Figure 2.6: Increases in the Real and Relative Value of the Adult National Minimum Wage, UK, 1999–2010



Source: LPC estimates based on ONS data, AEI including bonuses (LNMQ), AWE total pay (KAB9), CPI (D7BT) and RPI (CHAW), monthly, seasonally adjusted (AWE and AEI only), UK (GB for AWE and AEI), 1999–2010.
Note: AEI was replaced as a National Statistic by AWE in January 2010. The AEI series ended in July 2010.

2.18 Figure 2.6 also shows that the real value of the National Minimum Wage has risen whether we use the Consumer Price Index (CPI) or the Retail Prices Index (RPI) as a measure of price inflation. Since April 1999, the minimum wage has risen by nearly 65 per cent. In the same period the RPI rose by only 37 per cent and the CPI by less than 25 per cent. Had the minimum wage risen in line with price inflation it would have been £4.92 (using RPI) or £4.49 (using CPI) in October 2010. That is £1.01 or £1.44 less than its current level. Thus, the minimum wage has increased sharply in both real and relative terms since its introduction in 1999.

2.19 Since October 2006, however, the increases in the minimum wage have been more modest, growing less than the increase in price inflation and no faster than average wage growth. Between October 2006 and October 2010 the adult rate increased by 10.8 per cent (from £5.35 to £5.93 an hour). Over the same period, AWE total pay grew by 10.7 per cent while basic pay increased by 11.1 per cent. Inflation rose faster, with CPI increasing by 11.6 per cent and RPI by 12.7 per cent. This suggests that the relative value of the minimum wage has remained reasonably constant since October 2006 while the minimum wage has fallen slightly in real terms.

Impact on Earnings

2.20 In this section we investigate the impact of the minimum wage on earnings, concentrating particularly on the October 2009 upratings. We look first at how the bite (the value of the minimum wage relative to some point on the hourly earnings distribution, such as the mean, median or lowest decile) has changed over time. We then look at how the distribution of earnings has been affected by the minimum wage before considering changes to pay structures and differentials.

Bite

2.21 We start by considering the bite of the minimum wage and look at how it has changed over time. As we noted above, since its introduction the minimum wage has increased faster than average earnings. But recent increases have been more or less in line with average earnings growth. We can see from Table 2.1 that the bite relative to mean hourly pay for adults rose from under 35 per cent in April 2001 to 39.6 per cent in April 2007, and has remained around this level since. The bite at the median has followed a similar pattern, rising from 44.2 per cent in 2001 to 51.0 per cent in 2007. It has remained just under that level since. The bite at the lower end of the distribution, however, has increased since 2007, reaching 89.7 per cent of the lowest decile and 72.0 per cent of the lowest quartile in April 2010. This might suggest that the minimum wage has led to some compression of earnings at the bottom of the distribution, but that this has not been extended much beyond the lowest quartile in recent years.

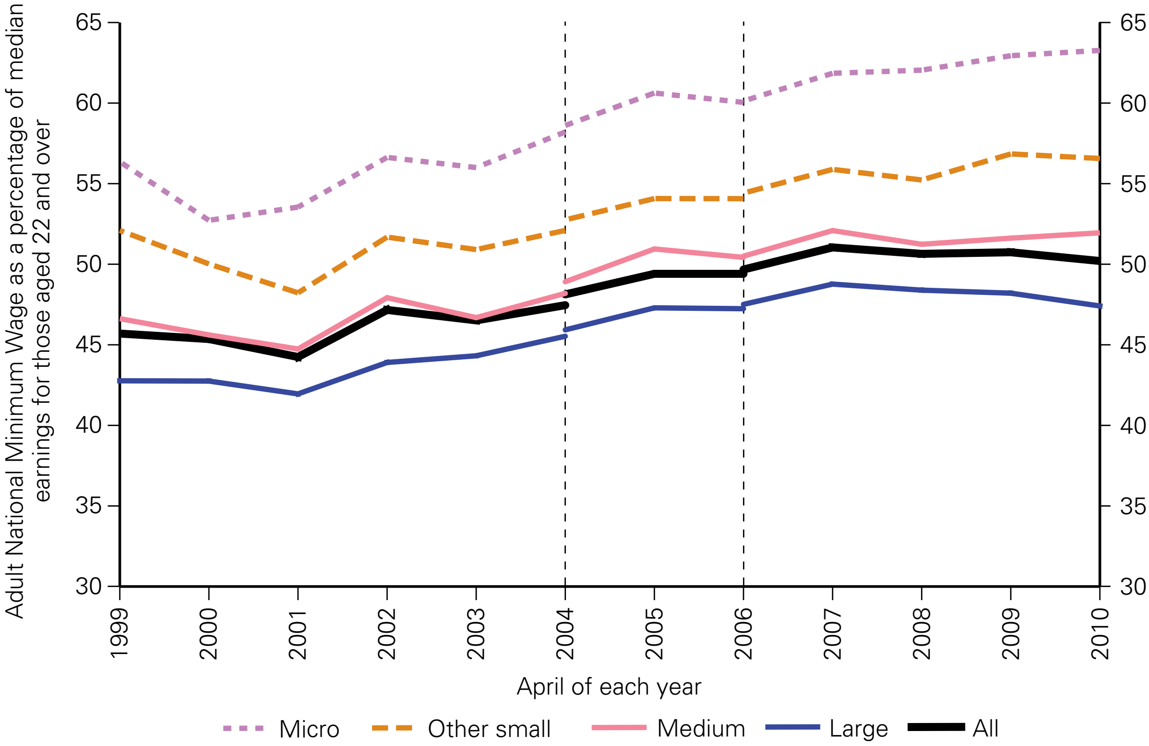
Table 2.1: Bite of the Adult National Minimum Wage at Various Points on the Earnings Distribution for Those Aged 22 and Over, UK, 1999–2010

	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**	81.2	64.2	**45.4**	35.7	29.8	20.6
	2001	**3.70**	80.3	63.0	**44.2**	34.7	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	32.3	22.1
	2006	**5.05**	87.5	69.9	**49.4**	38.4	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	71.7	**51.0**	39.6	33.6	22.9
	2008	**5.52**	89.7	71.6	**50.6**	39.2	33.2	22.8
	2009	**5.73**	89.6	71.7	**50.7**	39.7	33.3	22.9
	2010	**5.80**	89.7	72.0	**50.8**	39.6	33.2	23.0

Source: LPC estimates based on ASHE without supplementary information, April 1999–2004; ASHE with supplementary information, April 2004–2006; and ASHE 2007 methodology, April 2006–2010, standard weights, including those not on adult rates of pay, UK.
Note: Direct comparisons before and after 2004, and those before and after 2006, should be made with care due to changes in the data series.

2.22 The bite varies by firm size. It is much greater, at every point of the earnings distribution, for smaller firms than for large ones. In April 2010, the bite relative to the median was 63.3 per cent for micro firms (with fewer than 10 employees), 56.6 per cent for other small firms (10–49 employees), 51.9 per cent for medium-sized firms (50–249 employees) and just 47.4 per cent for large firms (250 or more employees). Figure 2.7 shows that the bite relative to the median increased for all sizes of firm between 2001 and 2007. Although the minimum wage has increased in line with average earnings growth since October 2006, the bite relative to the median has continued to rise for micro and other small firms. For medium-sized and large firms, the bite relative to the median has fallen over the same period (2007–2010 in Figure 2.7).

Figure 2.7: Bite of the Adult National Minimum Wage at the Median, by Size of Firm, UK, 1999–2010



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

a. Direct comparisons before and after 2004, and those before and after 2006, 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.

2.23 Table 2.2 shows that the bite in the low-paying industries is, not surprisingly, much greater than the bite in the economy as a whole. In the low-paying industries, the minimum wage is nearly 76 per cent of the median compared with under 45 per cent for the rest of the economy. In hospitality, cleaning, and hairdressing the minimum wage already covers at least 10 per cent of the adult workforce and the bite at the median is over 80 per cent.

2.24 Due to changes in the Standard Industrial Classification (SIC) in 2007, there is a discontinuity in the definitions of low-paying industries in ASHE between 2007 and 2008. We therefore limit our analysis of industries in this section to the period 2008–2010. Table 2.2 also shows that the bite fell over these years for those in the non low-paying industries. In contrast, the bite relative to the median in the low-paying industries peaked during the recession (in 2009) and then fell back in 2010, although there are some sectoral variations. The bite continued to rise in textiles and clothing, food processing, and hairdressing. The bite in cleaning, agriculture and employment agencies did the opposite to that of the low-paying industries in general (falling in recession and rising in the recovery).

Table 2.2: Bite of the Adult National Minimum Wage at the Lowest Decile and Median for Those Aged 22 and Over, by Low-paying Sector, UK, 2008–2010

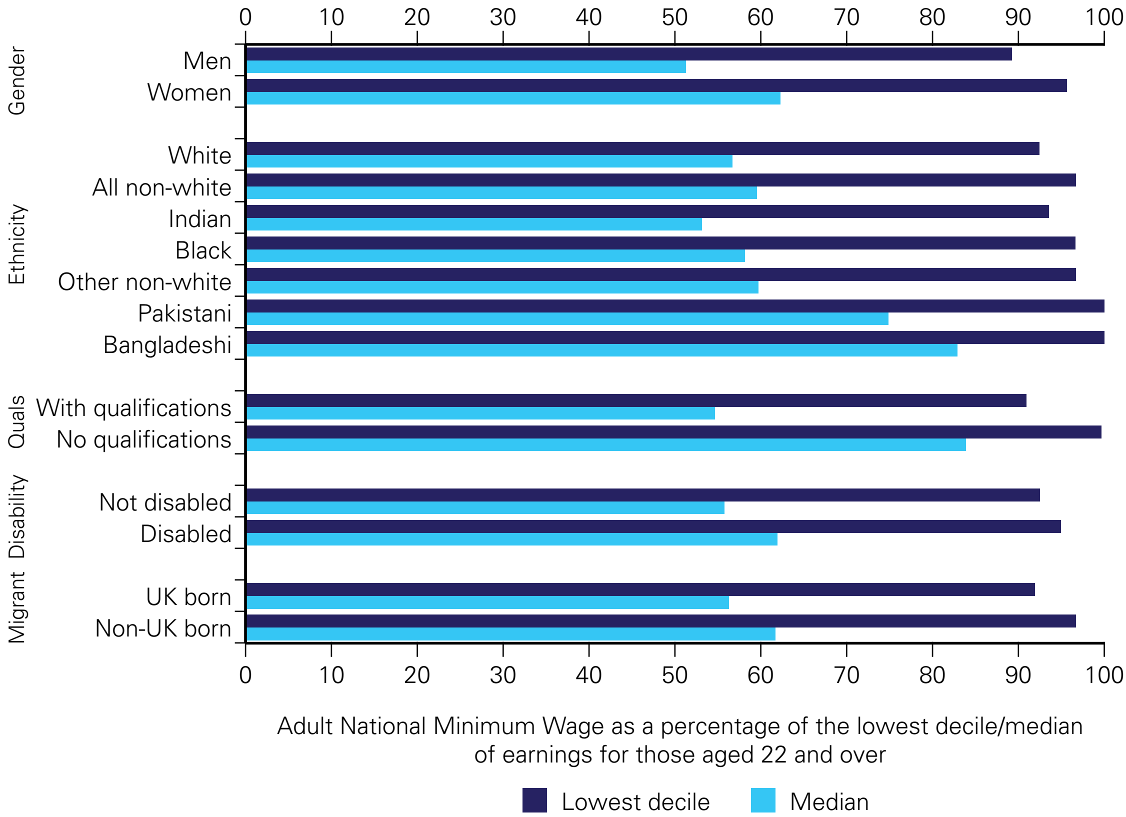
Per cent	Bite at lowest decile			Bite at median		
Sector	**2008**	**2009**	**2010**	**2008**	**2009**	**2010**
Retail	97.6	98.0	**97.3**	75.5	76.8	**75.4**
Hospitality	100.0	100.0	**100.0**	84.9	86.3	**85.3**
Cleaning	100.0	100.0	**100.0**	90.0	88.2	**89.3**
Social care	96.9	97.1	**97.2**	72.5	74.4	**73.8**
Childcare[a]	98.2	99.2	**98.6**	69.3	79.0	**79.4**
Hairdressing	100.0	100.0	**100.0**	80.0	81.6	**82.9**
Employment agencies	99.3	99.2	**99.8**	66.9	65.2	**67.1**
Textiles and clothing	97.4	98.5	**99.1**	69.7	69.9	**71.1**
Security	92.0	93.2	**93.5**	70.4	70.7	**71.1**
Leisure, travel and sport	96.8	98.3	**97.0**	66.4	66.6	**66.9**
Agriculture	94.0	94.2	**93.5**	71.8	70.7	**71.7**
Food processing	94.2	95.5	**95.7**	64.9	66.8	**67.8**
All low-paying sectors	**98.9**	**99.4**	**99.1**	**74.8**	**76.7**	**75.8**
Non low-paying sectors	79.5	79.2	**78.9**	45.2	45.1	**44.8**
Whole economy	**89.7**	**89.6**	**89.7**	**50.6**	**50.7**	**50.8**

Source: LPC estimates based on ASHE 2007 methodology, standard weights, including those not on adult rates of pay, UK, April 2008–2010.
Note:
a. The large increase in bite at the median for childcare in 2009 was caused by a sharp fall in median pay.

2.25 In order to look at specific groups of workers, we need to use LFS earnings data. For those of working age, the bite at the median is 57 per cent and at the lowest decile is 93 per cent. These bites are higher than those estimated using ASHE (51 per cent and 90 per cent respectively). Figure 2.8 shows that the bite is highest for those with no qualifications (84 per cent at the median and 100 per cent at the lowest decile). Women, disabled people, migrant workers and ethnic minorities all have a considerably higher bite than men. However, grouping all ethnic minorities together hides variation between them. At 53 per cent, the bite at the median is lower for Indians than for white people (57 per cent), whereas it is significantly higher for Bangladeshis (83 per cent).

2.26 Most groups saw their median bite fall between 2009 and 2010, having seen a rise between 2008 and 2009. Migrant, unqualified and Bangladeshi workers, however, saw two consecutive increases, while the median bite for Indian and Pakistani workers fell in 2009 and rose in 2010.

Figure 2.8: Bite of the Adult National Minimum Wage at the Median and Lowest Decile, by Group of Worker, UK, 2009/10

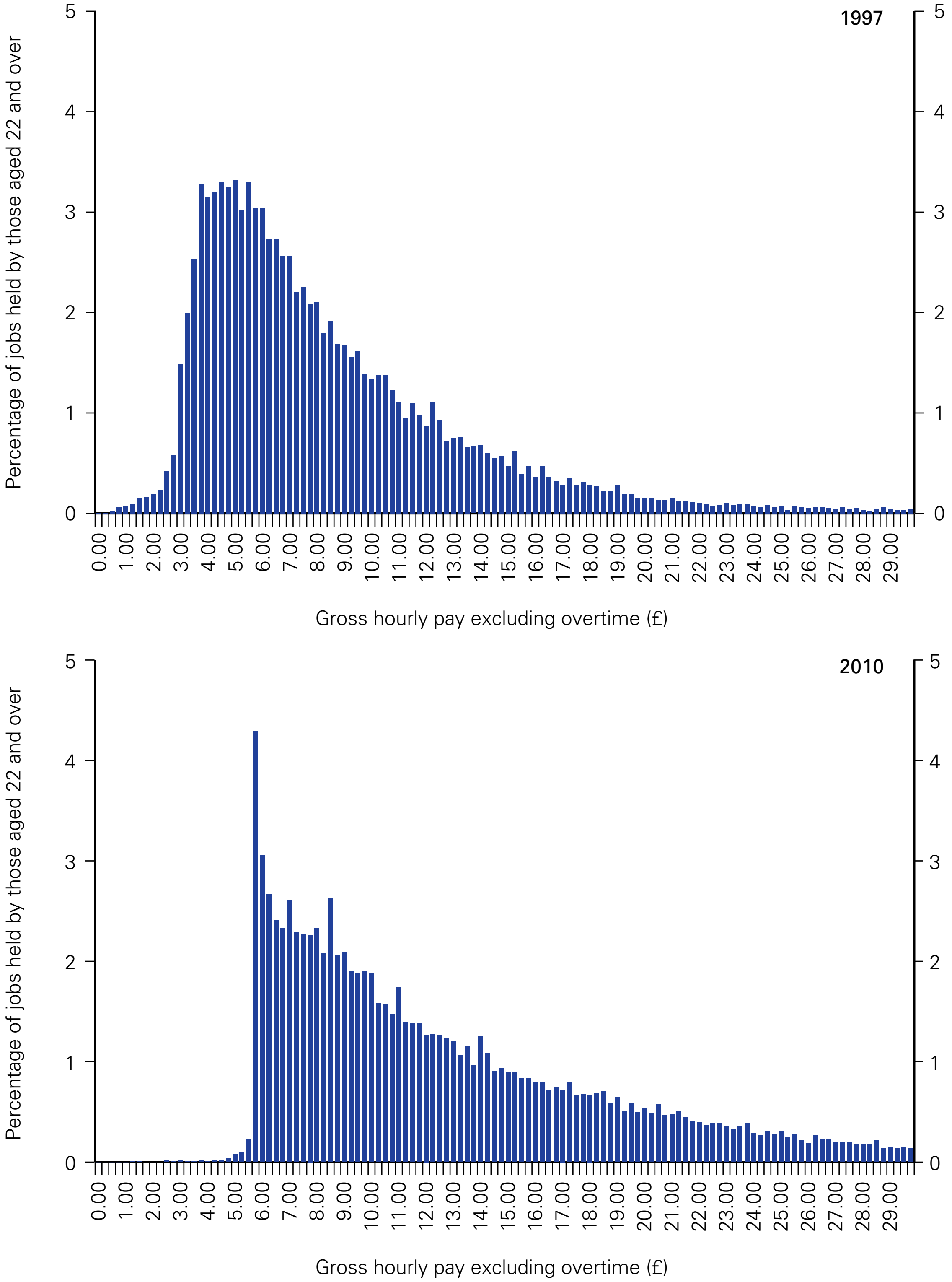


Source: LPC estimates based on LFS Microdata, income weights, quarterly, not seasonally adjusted, UK, Q4 2009–Q3 2010.

Distribution of Earnings and Coverage

2.27 We can clearly see from Figure 2.9 how the minimum wage has affected the distribution of earnings. Prior to the introduction of the minimum wage, in 1997, there was no abrupt cut-off in the earnings distribution. The minimum wage, introduced in 1999, has effectively removed the left hand tail of the earnings distribution. In 2010, there was a clear spike at the minimum wage. The clarity of the cut-off at the bottom of the earnings distribution has become more apparent over time as the minimum wage has increased.

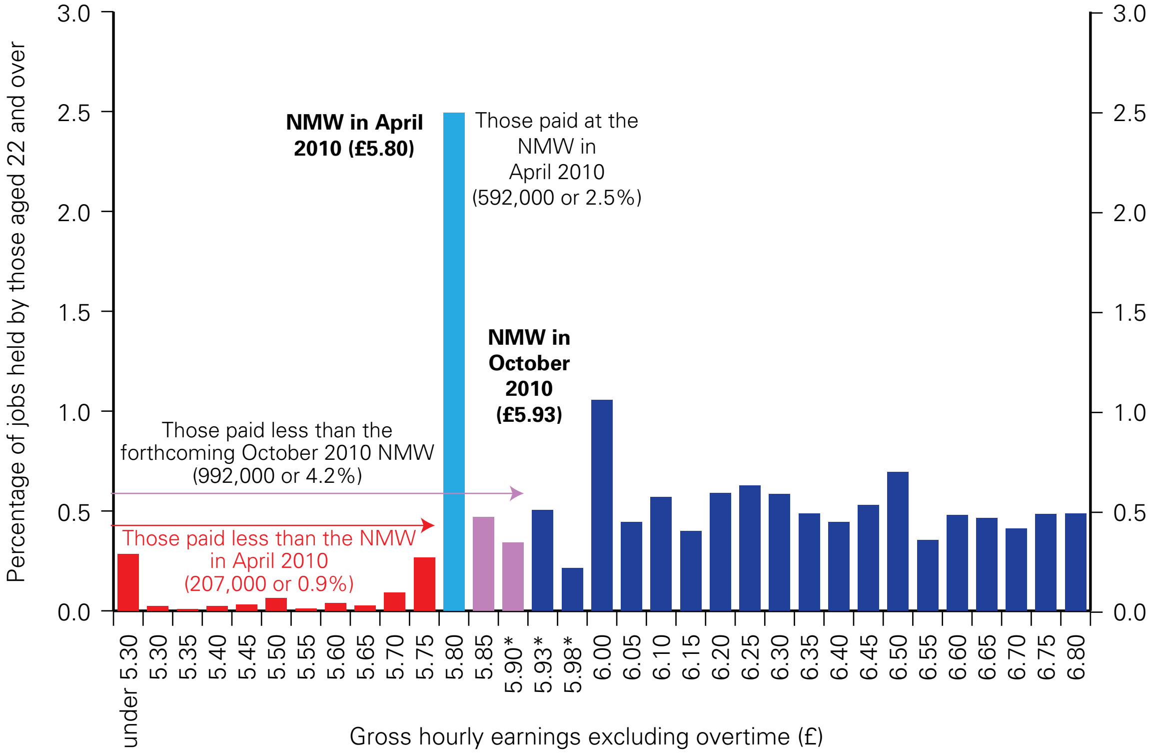
Figure 2.9: Hourly Earnings Distribution for Employees Aged 22 and Over, by 25 Pence Band, UK, 1997 and 2010



Source: LPC estimates based on ASHE without supplementary information, April 1997, and ASHE 2007 methodology, April 2010, low-pay weights, including those not on adult rates of pay, UK.

2.28 The impact of the minimum wage on the hourly earnings distribution in April 2010 can also clearly be seen in Figure 2.10 where there is a distinct spike at the adult rate of the minimum wage. There are also smaller spikes at rounded numbers, such as £6.00 and £6.50. In April 2010, around 2.5 per cent of all adult employees (592,000) were paid at the minimum wage with around 0.9 per cent (207,000) paid below. This latter figure should not be interpreted as a measure of non-compliance. Some workers may legitimately be paid below the minimum wage. These include those who are paid piece rates, those who have accommodation provided by their employer and those who are exempt from the minimum wage because they are apprentices. It is not possible to identify such workers from available data sources. A further 193,000 workers (0.8 per cent) were paid an hourly rate above the then current minimum wage (£5.80) but below the then forthcoming minimum wage (£5.93).

Figure 2.10: Hourly Earnings Distribution for Employees Aged 22 and Over, by 5 Pence Band, UK, 2010



Source: LPC estimates based on ASHE 2007 methodology, low-pay weights, including those not on adult rates of pay, UK, April 2010.
Note: * Five pence bands except where stated otherwise (bands labelled by minimum pay amount).

2.29 Table 2.3 shows that the number of jobs paid less than the minimum wage in April 2010 was in line with the number observed in recent years. The proportion paid at the minimum wage (ten pence pay band) was also similar to recent years (at around 2.9 per cent). However, the latest available data do show an increase in the number paid below the then forthcoming rate. There were 992,000 (4.2 per cent) paid less than £5.93 an hour in April 2010. This compares with 846,000 (3.6 per cent) in the previous year who were paid less than £5.80 an hour (the then forthcoming rate in October 2009). This is not surprising given that the increase in the adult rate in October 2010 was 13 pence an hour, compared with just 7 pence in October 2009. These numbers are much below those observed between 2003 and 2008 (1.0–1.4 million), but the increases in the minimum wage in the last two years have been much smaller than those during that earlier period.

Table 2.3: Jobs Held by Those Aged 22 and Over Paid At and Below the Existing National Minimum Wage and the Forthcoming National Minimum Wage, UK, 1999–2010

	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**	**207**	**0.9**	**684**	**2.9**	**5.93**	**992**	**4.2**

Source: ONS central estimates using ASHE without supplementary information and LFS, UK, 1999–2004; LPC estimates using ASHE with supplementary information, April 2004–2006, and ASHE 2007 methodology, April 2006–2010, 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, and those before and after 2006, should be made with care due to changes in the data series.

2.30 Across the economy as a whole, 3.4 per cent of jobs were paid at or below the minimum wage in April 2010. Table 2.4 shows that there were substantial differences across industries and by size of firm. For the low-paying sectors, nearly 10 per cent of jobs were paid at or below the minimum wage, ranging from 3.9 per cent in office work through 8.7 per cent in childcare to 20.3 per cent in hospitality and 23.5 per cent in cleaning. By size of firm this ranged from 2.6 per cent in large firms to 8.3 per cent in micro firms. The proportions paid at or below the minimum wage were in general similar to those observed in 2008 and 2009, although the proportions had risen in 2009 during the recession for the low-paying sectors. They had also continued to rise for micro firms and for jobs in a handful of low-paying sectors – textiles and clothing, employment agencies and security.

Table 2.4: Proportion of Jobs Held by Those Aged 22 and Over Paid At or Below the Adult National Minimum Wage, by Sector and Size of Firm, UK, 2008–2010

Per cent	April 2008			April 2009			April 2010		
Industry/Occupation/ Size of firm	**Paid at or below £5.52**	**Paid below £5.73**	**Paid below £6.50**	**Paid at or below £5.73**	**Paid below £5.80**	**Paid below £6.50**	**Paid at or below £5.80**	**Paid below £5.93**	**Paid below £6.50**
Retail	**6.8**	13.7	38.1	**7.7**	8.7	34.3	**6.8**	9.0	30.0
Hospitality	**22.0**	28.8	51.3	**23.3**	25.0	48.6	**20.3**	23.7	45.4
Leisure, travel and sport	**7.3**	11.3	28.3	**9.0**	9.6	25.3	**6.8**	9.7	21.2
Cleaning	**24.7**	31.3	60.6	**21.9**	23.0	50.8	**23.5**	27.0	53.1
Security	**3.4**	6.0	21.7	**4.4**	4.7	18.1	**5.0**	5.5	17.7
Social care	**6.6**	11.5	30.7	**6.2**	6.8	26.5	**6.5**	9.1	24.7
Childcare	**7.3**	12.0	35.4	**10.3**	11.2	35.3	**8.7**	12.2	34.9
Agriculture	**5.1**	7.1	24.3	**4.7**	5.3	19.9	**5.3**	5.7	17.9
Textiles and clothing	**7.9**	12.8	24.1	**8.3**	9.0	23.3	**10.1**	13.0	24.2
Hairdressing	**16.3**	20.8	43.8	**15.3**	16.7	38.2	**18.1**	19.4	37.5
Employment agencies	**10.3**	12.7	27.5	**10.3**	11.0	24.6	**11.0**	12.7	24.5
Food processing	**4.4**	7.5	23.8	**5.7**	6.4	22.0	**5.7**	7.3	20.8
Office work[a]	**3.2**	5.2	19.6	**4.4**	4.8	19.1	**3.9**	5.0	16.2
All low-paying industries	**9.9**	**15.5**	**37.1**	**10.5**	**11.5**	**33.4**	**9.9**	**12.3**	**30.8**
Micro	**7.4**	9.9	23.1	**7.9**	8.5	21.2	**8.3**	9.5	21.3
Other small	**4.2**	6.0	15.8	**4.8**	5.3	14.4	**4.3**	5.3	13.0
Medium	**3.6**	5.2	13.8	**4.0**	4.4	12.0	**4.1**	5.1	11.7
Large	**2.7**	4.6	12.7	**2.6**	2.9	10.2	**2.6**	3.3	9.4
Whole economy	**3.3**	**5.2**	**13.9**	**3.4**	**3.7**	**11.7**	**3.4**	**4.2**	**10.9**

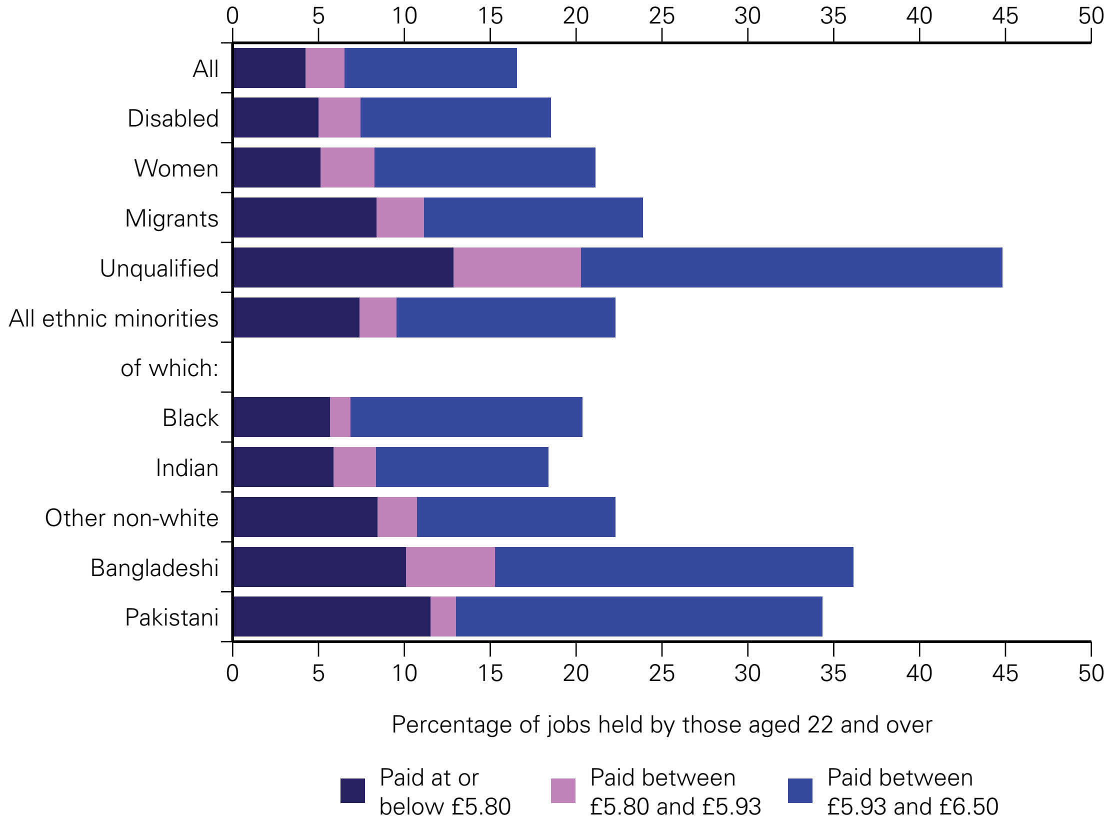
Source: LPC estimates based on ASHE 2007 methodology, low-pay weights, including those not on adult rates of pay, UK, April 2008–2010.
Note:
a. This sector is defined using Standard Occupational Classifications (SOC) 2000. The other sectors are based on the Standard Industrial Classification (SIC) 2007. Industry data by SIC 2007 are available from 2008 in ASHE.

2.31 Table 2.4 also shows the proportions paid just above the minimum wage (up to £6.50 an hour) across low-paying sectors and by size of firm. Around 11 per cent of jobs in the economy were paid less than £6.50 an hour in April 2010, compared with 31 per cent in the low-paying industries.

2.32 Around 53 per cent of jobs in the cleaning industry, 45 per cent in hospitality, 38 per cent in hairdressing and 35 per cent in childcare were paid less than £6.50 an hour in April 2010, while fewer than 18 per cent were paid such wages in agriculture, security and office work. Over 21 per cent of jobs in micro firms were paid less than £6.50 an hour, compared with fewer than 10 per cent in large firms. This suggests that differentials in many low-paying industries and in micro firms are already quite narrow.

2.33 We can see from Figure 2.11 that certain groups of workers are more likely to be low-paid. Nearly 45 per cent of those with no qualifications were paid less than £6.50 an hour in April 2010. Around 35 per cent of those from Pakistani or Bangladeshi origin also earned less than £6.50 an hour. Disabled workers are less likely to be low-paid than women, migrants or ethnic minorities as a whole.

Figure 2.11: Proportion of Jobs Held by Those Aged 22 and Over, by Pay Band and Group of Worker, UK, 2010



Source: LPC estimates based on LFS Microdata, income weights, quarterly, not seasonally adjusted, UK, Q2 2010.
Note: This analysis covers both main and second jobs held by employees.

Pay Gaps

2.34 We saw in Figures 2.5 and 2.11 that particular groups of workers (women, disabled people, ethnic minorities, migrants, and those with no qualifications) are more likely to be in minimum wage jobs. The extent of the difference in pay between these groups and their counterparts who are less likely to be in minimum wage jobs can be measured by looking at pay gaps (i.e. the proportional difference between the earnings of two groups). We tend to focus on the median pay gaps for full-time workers, as they more closely compare like-with-like and are less affected by outliers in the earnings distribution than the mean.

2.35 Table 2.5 shows that the median gender pay gap has gradually closed from nearly 16 per cent before the introduction of the minimum wage to under 9 per cent in April 2010. The gender pay gap at the lowest decile is smaller and has fallen by more than half over the same period. It is now just 6.1 per cent. In contrast, the gender pay gap at the upper decile has remained close to 20 per cent for the last decade.

Table 2.5: Hourly Gender Pay Gap of Full-time Workers Aged 22 and Over, UK, 1997–2010

	Data year (April)	£ per hour						Per cent		
		Men			Women			Pay gap		
		Lowest decile	Median	Upper decile	Lowest decile	Median	Upper decile	Lowest decile	Median	Upper decile
ASHE without supplementary information	**1997**	4.71	8.51	17.62	4.10	7.17	14.16	13.1	15.8	19.6
	1998	4.91	8.84	18.45	4.28	7.43	14.68	12.9	15.9	20.5
	1999	5.10	9.15	19.19	4.50	7.78	15.42	11.8	15.0	19.7
	2000	5.20	9.21	19.85	4.64	7.97	15.93	10.7	13.4	19.7
	2001	5.46	9.65	21.38	4.86	8.38	16.95	11.1	13.2	20.7
	2002	5.68	10.07	22.48	5.06	8.76	17.85	11.1	13.0	20.6
	2003	5.90	10.41	23.03	5.31	9.09	18.41	10.0	12.7	20.1
	2004	6.12	10.89	23.99	5.57	9.64	19.25	8.9	11.5	19.8
ASHE with supplementary information	**2004**	6.03	10.75	23.52	5.53	9.51	19.09	8.3	11.5	18.8
	2005	6.31	11.22	24.77	5.82	9.98	20.16	7.8	11.1	18.6
	2006	6.55	11.65	25.94	6.07	10.42	20.70	7.3	10.6	20.2
ASHE 2007 methodology	**2006**	6.50	11.56	25.76	6.00	10.26	20.49	7.7	11.2	20.5
	2007	6.80	12.02	26.75	6.27	10.72	21.26	7.8	10.8	20.5
	2008	7.00	12.56	27.93	6.49	11.13	21.91	7.3	11.4	21.6
	2009	7.28	13.01	28.72	6.75	11.59	22.84	7.3	10.9	20.5
	2010	7.32	13.01	28.79	6.88	11.88	23.28	6.1	8.7	19.1

Source: LPC estimates based on ASHE without supplementary information, April 1997–2004, ASHE with supplementary information, April 2004–2006 and ASHE 2007 methodology, April 2006–2010, standard weights, including those not on adult rates of pay, UK.
Note: Direct comparisons before and after 2004, and those before and after 2006, should be made with care due to changes in the data series.

2.36 In its written evidence Unite said that, since its introduction, the National Minimum Wage had helped to close the gender pay gap, although it was not the only factor that had played a role. Both Unite and the Equality and Human Rights Commission (EHRC) said that the National Minimum Wage was a key weapon in reducing the gender pay gap.

2.37 Unite and EHRC also referred to the pay gaps for ethnic groups and disabled people in their written evidence. These pay gaps, along with those for migrant workers and those with no qualifications, can be calculated using LFS data. These LFS-based calculations include all workers so are not comparable with the gender pay gaps shown in Table 2.5 which are for full-time workers only using ASHE. Table 2.6 shows that the median pay gaps for ethnic minorities, migrant workers and disabled people are much lower than the gender pay gap, whereas the median pay gap for people with no qualifications is almost twice as high as that for women. While the median gender pay gap has been falling, the other median pay gaps have not shown such a consistent picture. The median pay gap for ethnic minorities and migrant workers has increased since 2007/08, while the median pay gap for disabled people rose between 2007/08 and 2008/09 then fell in 2009/10.

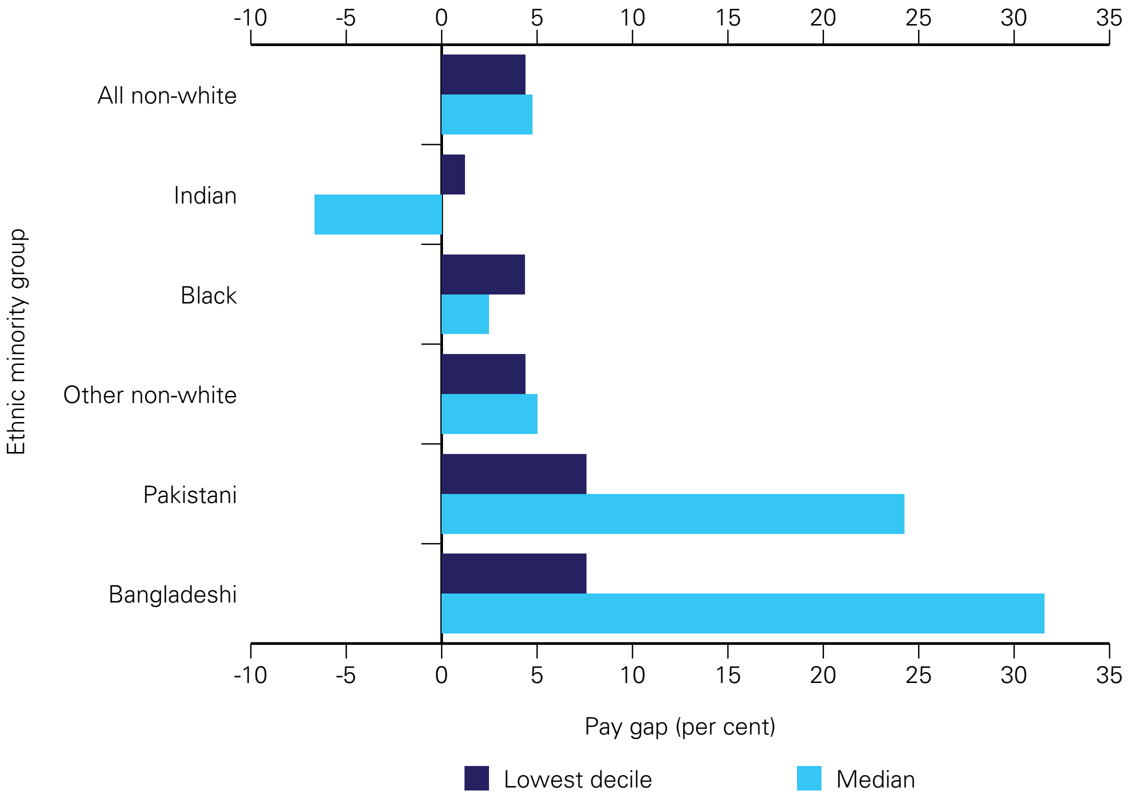
Table 2.6: Hourly Pay Gaps for Particular Groups of Workers Aged 22 and Over, UK, 2007/08–2009/10

Per cent	Lowest decile			Median		
	2007/08	2008/09	2009/10	2007/08	2008/09	2009/10
Ethnic minorities	2.5	3.2	4.4	4.1	4.9	4.8
Migrant workers	3.5	3.5	4.9	4.0	5.7	8.8
Disabled people	3.0	3.5	2.5	11.5	11.6	9.9
Women	9.4	8.0	6.7	19.6	19.4	17.7
Unqualified	9.5	9.2	8.8	34.3	35.1	34.8

Source: LPC estimates based on LFS Microdata, income weights, quarterly, not seasonally adjusted, UK, Q4 2007–Q3 2010.

2.38 Looking in more detail at the pay gaps for ethnic minority workers, Figure 2.12 shows that there is considerable variation between the different ethnic groups. For ethnic minorities as a whole, the pay gaps at both the lowest decile and the median were similar in 2009/10. The median pay gap for workers of Indian ethnicity was negative and suggested that median pay for these workers was around 7 per cent higher than the median pay for white workers. By contrast the median pay gaps for workers of Pakistani and Bangladeshi ethnicities were both over 20 per cent.

Figure 2.12: Hourly Pay Gaps Between White and Ethnic Minority Workers Aged 22 and Over, UK, 2009/10



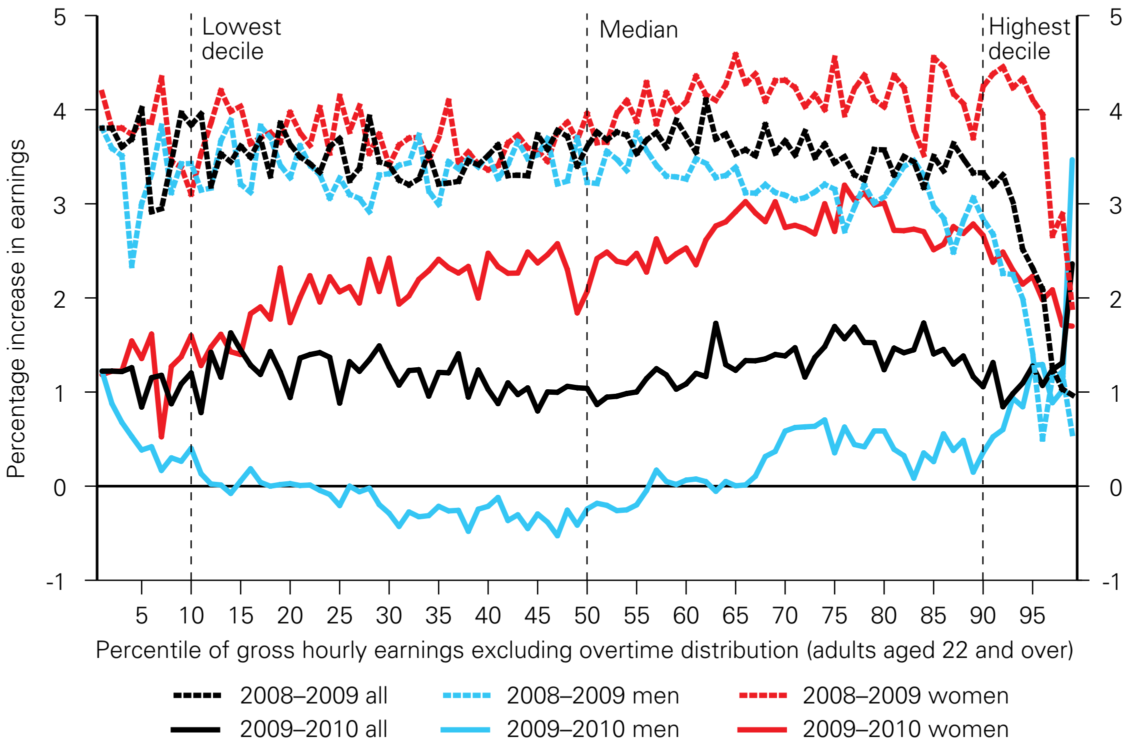
Source: LPC estimates based on LFS Microdata, income weights, quarterly, not seasonally adjusted, UK, Q4 2009–Q3 2010.

Pay Structures and Differentials

2.39 We noted above that employers might decide to adjust their pay structures (by narrowing differentials or removing some pay bands) or reduce non-wage benefits (such as pension provision, annual leave or company perks e.g. subsidised canteen and staff discounts) in response to the National Minimum Wage. We now look in more detail at the impact of the minimum wage on the distribution of earnings and differentials.

2.40 Dividing employees into 100 equally sized groups (percentiles) and ranking these groups by their hourly earnings from the lowest paid on the left to the highest paid on the right, Figure 2.13 shows how the earnings at each of these percentiles have changed on average each year for the last two years (2008–2009 (covering the 3.8 per cent uprating) and 2009–2010 (covering the 1.2 per cent uprating)). Between 2008 and 2009, the hourly wages of those at the bottom of the earnings distribution grew roughly in line with the growth experienced by most other workers (around 3.5 per cent). Those in the highest decile, however, had much lower growth (between 1 and 3 per cent). There was a divergence between men and women. In general, men had slightly lower wage growth than women below the median, but the difference was much greater above it, with women experiencing much larger increases in wages.

Figure 2.13: Annual Increase in Hourly Earnings for Employees Aged 22 and Over, by Percentile and Gender, UK, 2008–2010



Source: LPC estimates based on ASHE 2007 methodology, standard weights, including those not on adult rates of pay, UK, April 2008–2010.

2.41 This gender pattern continued in 2009–2010 but the gap was evident across the entire distribution of wages. In general, wages had increased by between 1 and 1.5 per cent along the entire earnings distribution. But, apart from the lowest paid, men paid below the median had pay freezes or even cuts. For men above the median, pay rises had generally been no more than 0.5 per cent. Those men at the very top had pay increases above 1 per cent. In contrast, the pay increases for women were generally 2 per cent or more for all those above the bottom two deciles. In those lowest-paid deciles, the increases were much greater than for men but averaged around 1–1.5 per cent. These differences in earnings explain some of the reduction in the gender gap discussed above. They also suggest that businesses have restored differentials between the lowest paid and the rest in the last year, although only for women.

2.42 In research we commissioned this year, Incomes Data Services (IDS, 2011) looked at the impact of the National Minimum Wage on pay-setting since 1994, focusing on four distinct periods: immediately before the introduction of the National Minimum Wage (1994–1997); the early years of its operation (1998–2000); the period of relatively large increases (2001–2006); and the years of more modest uplifts (2007–2010). The research showed that many employers made changes to pay structures before the minimum wage was introduced which made adjustment to its introduction fairly straightforward. During the period of relatively high awards the minimum wage was increasingly adopted as the lowest rate in companies in some low-paying sectors, partly as a response to the uplifts but also because of the extension of Sunday trading and longer opening hours. Employers also reviewed the level of allowances and premia as possible offsets to increases in the minimum wage. In the final period, there was evidence of some employers re-establishing a lead between their lowest rate and the minimum wage, and restoring differentials further up the pay structure.

2.43 IDS (2011) also found that the gap between the minimum wage and the lowest rate of pay for an established worker varied between the low-paying sectors, but that the differential was narrowest in the fast food, pubs and restaurant sector. Pay pressures in this sector tended to be weaker, with a large number of casual staff and relatively high turnover rates.

2.44 In aggregate, pay settlement medians in low-paying sectors since 2000 have broadly matched those of the whole economy. During the recession, however, there has been a lower proportion of freezes in low-paying sectors than in the rest of the economy. IDS (2011) noted that awards in these sectors were, as in the rest of the economy, more likely to be influenced by inflation and general economic factors than determined solely by changes in the minimum wage. There has been some impact on settlement practice, however. The proportion of companies in low-paying sectors who have an October pay settlement date has nearly doubled since the introduction of the minimum wage, and some other employers have also begun to use October as the settlement date for their low-paid staff, while retaining a different settlement date for the bulk of their employees.

2.45 Using similar data to IDS, but taking a more econometric approach, Dolton, Lin, Makepeace and Tremayne (2011) described how recessions had affected the distribution of pay and earnings. They found evidence that unemployment was negatively related to wage settlements, consistent with much of the previous literature. In contrast, they also appeared to find a counter-cyclical impact on growth but, as they note, this was almost certainly due to the lagged nature of pay settlements. Unsurprisingly, they found a clear positive effect of inflation on wage settlements. More pertinently, they also found slightly higher increases in wage growth in years when minimum wages had been in force.

2.46 In previous research conducted for the Commission that looked at differentials, Swaffield (2009) found that low-wage employees had experienced significantly higher pay increases in the period since the introduction of the National Minimum Wage than previously. Wage growth was greater than it would otherwise have been in years in which the minimum wage increase was higher than average earnings. But employers managed to give lower pay rises in years when minimum wage increases were smaller.

2.47 Using three different methods to identify whether increases in the National Minimum Wage had effects on wages beyond those paid the minimum wage, Stewart (2009) found that there was little evidence of any effects when analysing individual wage changes. However, when using wage quantile analysis he did find evidence of significant but limited spill-overs up to the 11th percentile in 2001 as well as spill-overs up to the 20th percentile for the October 2002 upratings. He completed his analysis by estimating wage distribution functions and again found evidence of significant spill-overs from the October 2002 minimum wage upratings. Although this might seem surprising, as it was the smallest percentage increase there had been until October 2009, it might be explained by employers using the years of low increases to restore differentials. He noted that the evidence of the impact of the minimum wage on differentials depended on the assumption of the counterfactual wage distribution. He concluded that in general spill-over effects from the minimum wage were small and typically did not reach above the 5th percentile.

2.48 In an extension of work that we had previously commissioned, Dolton, Rosazza Bondibene and Wadsworth (2010) found that the minimum wage was associated with a significant fall in inequality in the bottom half of the earnings distribution. They concluded that geographic areas where pay was lowest, and thus the bite of the minimum wage highest, had experienced larger declines in inequality than elsewhere. This suggested that the minimum wage may have squeezed differentials at the bottom of the earnings distribution. Further, Butcher, Dickens and Manning (2009), in their analysis of differentials, found that areas most affected by the minimum wage had the largest spill-overs, with effects evident up to the 25th percentile. In contrast to the findings of Stewart (2009), they concluded that spill-over effects may be larger than previously thought.

"As the minimum wage has increased so differentials in the sector have been eroded. When trying to develop staff to become managers this erosion has destroyed incentives. The spill-over effect from the minimum wage in larger breweries was also to reduce differentials with those staff further up the pay scales."

BBPA Members, Commission visit to Wrexham

Views on Pay Structures and Differentials

2.49 As well as analysing the data and considering research findings, we also considered stakeholders' representations on pay. Some stakeholders drew attention to the impact of the minimum wage on the pay differentials between those on the lowest rates and higher-paid staff. The English Community Care Association (ECCA) said that an increase in the National Minimum Wage usually had an effect on differentials as it often exceeded any increase in fees employers in social care received from state purchasers of care. In the hospitality sector, the British Hospitality Association (BHA), British Beer and Pub Association (BBPA), and Business In Sport and Leisure (BISL) told us their members were convinced that the minimum wage had squeezed differentials and reduced the scope for non-pay benefits. They pointed out that in sectors where employment costs can be 30–40 per cent of turnover, pay was bound to be a pressure point. In oral evidence, these hospitality associations told us that the minimum wage had reduced differentials in managed pubs, which adversely affected employers' ability to attract or retain staff. Accordingly, they told us licensees would typically take on more work themselves.

"When rates of pay are compressed, career progression and skill development are disincentivised, so NMW rates typically have a much wider effect than simply raising the pay of the very lowest paid."

CBI evidence

2.50 The CBI told us that a recent member survey found a cumulative impact of successive minimum wage increases on differentials in affected firms. Of the 24 per cent affected by the 2010 uprating, 41 per cent said they expected the rise to have an impact on differentials within their organisation – a significant increase on the 27 per cent who responded similarly in the previous year and a departure from past trends.

2.51 The problems of recruiting and retaining staff in the face of financial difficulties were discussed by those representing nursery sector employers. The National Day Nurseries Association (NDNA) told us that financial pressures often made it difficult for nurseries to reward staff when new qualifications were obtained. It also told us that nurseries needed to remain competitive by paying wages above the minimum wage, and it was increasingly common to find nurseries searching for new ways to reward staff other than through pay (for example, using discounts, insurance, extra holidays etc).

2.52 The National Hairdressers' Federation (NHF) pointed out that employment costs formed a high proportion of total costs faced by salons, and the sector was made up of many micro businesses. It said that the minimum wage and VAT were the two most significant causes of concern among its members, and the impact of the minimum wage upratings had been to reduce the scope of salons to reward performance. The NHF told us in a Secretariat meeting that the impact of the minimum wage on differentials would often vary by size of establishment. The larger employers were still driven by the search for quality stylists able to offer a premium service which attracted clients willing to pay accordingly. As the fiscal tightening took hold smaller, less sophisticated, salons were likely to be facing the prospect of lower demand and thus less income, resulting in a squeeze on wage premia.

"The furniture industry is traditionally not a low paying sector but the continual large upratings in the adult NMW are having more of an effect. Because of the perilous state of the furniture industry we agreed with the GMB not to implement any increase for 2010, however, as our unskilled rate has now become equivalent to the NMW, that rate has to rise by 2.24% from October, while the skilled rate remains unchanged."

British Furniture Manufacturers evidence

2.53 In evidence, the BHF-BSSA group reported that 43 per cent of retail employers in its survey had to increase their minimum pay rates in order to comply with the minimum wage and a further 43 per cent had to increase the rates of more senior staff in order to maintain differentials. In a survey of its members, the Association of Convenience Stores (ACS) found that the majority of the responding firms (53 per cent) said that their pay structures had been squeezed as a result of increases to the minimum wage. Retailers expressed frustration at their inability to reward their most valued employees with pay increases, which made retaining them more difficult. The ACS reported that some retailers had often removed supervisor positions from their staffing structures to reduce costs.

2.54 The Food and Drink Federation (FDF) reported that the minimum wage was now having a direct impact on pay levels and the structure of remuneration for its members. It said that its members reported pressure to maintain differentials for basic rates of pay against the National Minimum Wage.

2.55 In oral evidence the Trades Union Congress (TUC) said that although there had been some compression of differentials, unions had generally accepted this and that it had not proved a major problem. Indeed, an increasing number of unions had recently attempted to negotiate bottom-loaded pay deals which gave larger rises to those at the bottom of the pay scales.

Summary on Pay

2.56 Prior to October 2006, the bite of the minimum wage (its value relative to median earnings) increased sharply from just under 46 per cent when it was introduced to around 51 per cent in April 2007. Since the end of 2006, however, the National Minimum Wage has risen broadly in line with both average earnings growth and price inflation. As a result the bite of the minimum wage in general has not increased since then. But it has increased for micro and other small firms, some low-paying sectors, young people and those with no qualifications. All of these have seen wages rise more slowly than the average in the last few years. Analysis of the earnings distribution shows that a clear spike has been observed at the minimum wage in every year since 1999. In recent years, despite the minimum wage increasing only in line with average earnings, that spike has become larger. This clearly demonstrates that the minimum wage has affected earnings and their distribution. Given that, we now assess whether this has affected the competitiveness of firms and the employment of workers.

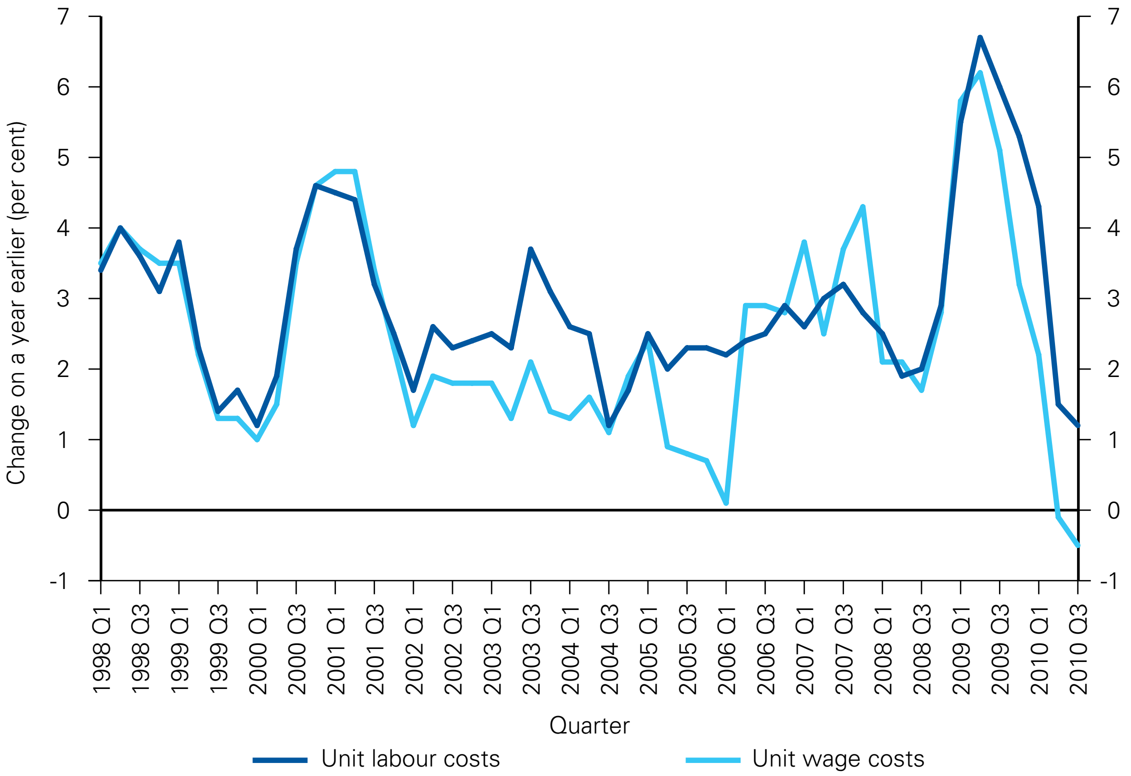
Impact on Competitiveness

2.57 As part of our remit, the Government asked us to look at the competitiveness of low-paying sectors and small firms. In this section, we look at costs, prices, profits, productivity, and business start-ups and failures.

Costs

2.58 Pay settlements and real average earnings growth have been relatively subdued throughout 2009 and 2010. Figure 2.14 reflects this trend, showing that the annual change in unit wage costs for the whole economy has fallen back sharply since the end of the recession (third quarter of 2009). During the recession, the annual change in unit wage and labour costs both increased from about 2 per cent (in early 2008) to around 6 per cent (in the middle of 2009), as the fall in employment was less than the loss of output. Since the end of the economic downturn, as output has recovered, growth in unit wage and labour costs has slowed. But unit labour costs have fallen by less, suggesting that non-wage costs have increased relative to wage costs. The annual change in unit wage costs actually fell in the second and third quarters of 2010, reflecting the subdued nature of earnings growth, while unit labour costs were still rising by just over 1 per cent. Data on these costs are not available at a more disaggregated level.

Figure 2.14: Unit Wage and Labour Costs, UK, 1998–2010



Source: ONS, unit wage costs (LOJE) and unit labour costs (DMWN), quarterly, seasonally adjusted, UK, Q1 1998–Q3 2010.

2.59 Hospitality sector organisations told us that pubs continued to face pressures through increased costs (such as higher duty, VAT, business rates, and food prices) and fewer customers (which the industry claimed was mainly a result of the smoking ban and the price discounting of supermarkets). In their oral evidence the BHA, BBPA and BISL told us that it was difficult to tease out the impact of the minimum wage from the impact of other costs and regulatory changes.

2.60 The ACS said that increasing employment costs affected the competiveness of its members' businesses. In addition, its members faced increases in other costs, such as business rates, the cost of borrowing, flexible working regulations and compulsory pension contributions which would all have an impact on business competitiveness.

2.61 During a visit to Northern Ireland the Ulster Farmers' Union told us that farmers were being squeezed, with rapidly rising input prices, increasing costs of environmental and welfare standards and high land rents on one side and a downward pressure on prices received from supermarkets on the other side. On a visit to Taunton we met a company that designs and produces cosmetics, personal care and household goods for leading retailers. The Chief Executive told us that increases to the minimum wage were one (but not the only) factor that had influenced its decisions to move some jobs offshore.

2.62 Access to finance continued to be a widely reported problem, particularly for small firms. This was borne out by numerous surveys. The SME Business Barometer (February, 2010) found that of those SMEs (small and medium-sized enterprises) who tried to obtain finance, 38 per cent had difficulties doing so. Of these, 30 per cent were unable to get any finance from the first source they approached. Bank loans and overdrafts were the types of finance where difficulties were most likely to be encountered, with insufficient security or a poor credit history the main reasons for being turned down. The ACS told our Secretariat that it was not only access to finance that was an issue for its members, but also the cost of finance. The Bank of England's Agents' Report in November 2010 noted that, for firms with robust balance sheets, usually larger firms, access to finance was back to normal. However, it noted that banks remained risk-averse with regard to those with less robust balance sheets and there were a number of reports of small firms having overdraft facilities either reduced or withdrawn. In these instances, such firms had to rely on more expensive means of finance.

Prices

2.63 As noted previously, firms affected by the minimum wage might increase prices as a way of dealing with increased costs. Looking at selected goods and services that are produced by workforces with a high proportion of minimum wage workers, Table 2.7 suggests that inflation for many of these may have been greater than for the economy in general. Since 1999, when the minimum wage was introduced, the CPI and Services Producer Prices Index (SPPI) which measures the price of business to business services, have recorded rises of about 25 per cent for all goods and services. The RPI has risen by more, at 37 per cent.

2.64 It appears that firms have found it easier to pass on costs for many minimum wage goods and services to consumers rather than to other businesses. The price of take-away meals, restaurant meals, domestic and personal services, and bar sales of beer, wine and spirits have all increased much faster than the general rate of RPI inflation between 1999 and 2010. Similarly, the prices for hairdressing and dry cleaning have risen faster than CPI inflation.

Table 2.7: CPI, RPI and SPPI Price Inflation for Selected Goods and Services, UK, 1999–2010

		Percentage change			
		1999 Q1–2004 Q3	2004 Q3–2007 Q3	2007 Q3–2010 Q3	1999 Q1–2010 Q3
CPI	**All items**	**7.0**	**6.7**	**9.7**	**25.2**
	Restaurants and cafes	17.2	10.0	10.6	42.5
	Canteens	28.8	11.6	7.7	54.8
	Dry cleaning	18.0	13.8	7.6	44.6
	Domestic and household services	38.5	14.4	8.4	71.8
	Hairdressing	31.1	12.2	8.2	59.1
RPI	**All items**	**14.5**	**10.5**	**8.4**	**37.1**
	Restaurant meals	19.1	9.0	10.4	43.2
	Canteen meals	32.0	11.9	8.7	60.5
	Take-aways and snacks	18.2	9.2	10.5	42.6
	Beer on sales	16.4	11.4	11.4	44.6
	Wine and spirits on sales	18.0	9.3	11.3	43.6
	Domestic services	35.0	15.5	10.4	72.1
	Personal services	32.7	14.3	12.0	70.0
SPPI	**Net sector**	**10.6**	**8.7**	**4.5**	**25.7**
	Hotels	9.7	13.1	-10.1	11.6
	Canteens and catering	8.1	9.2	5.9	25.0
	Employment agencies	20.9	7.5	2.9	33.7
	Security services	23.3	10.2	0.3	36.2
	Industrial cleaning	4.2	8.0	3.8	16.9
	Commercial washing and dry cleaning	8.3	5.7	2.1	16.8

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); security services (K8YH); industrial cleaning (K8YQ); commercial washing and dry cleaning (K8ZM), quarterly, not seasonally adjusted, UK, Q1 1999–Q3 2010.
Note: SPPI net sector data are only available on the SIC 2007 basis from Q1 2003 onwards. On the SIC 2003 basis they are available from Q4 1997 to Q2 2010. Data provided here use the SIC 2003 basis and assume it would have grown at the same rate as the SIC 2007 data between Q2 2010 and Q3 2010. All other SPPI figures are on the SIC 2007 basis.

2.65 Only services producer prices in catering, cleaning (both industrial and dry) and hotels have risen by less than the general services producer price rise, suggesting that firms producing these services have found it more difficult to pass on their costs to other businesses. However, this may not be entirely due to the minimum wage. Most minimum wage goods and services are relatively labour intensive and it may just reflect that.

2.66 Between 2007 and 2010, price rises for CPI minimum wage goods and services tended to be less than the general increase in CPI, although prices in restaurants and cafes continued to increase at a faster rate. This may reflect the more modest increases in the minimum wage over this period. In contrast, RPI minimum wage goods and services have generally risen faster than the all items RPI, but this is entirely due to the latter being subject to significant downward pressures from mortgage interest payments and falls in house prices. Services producer prices have again risen more slowly than those for consumers.

2.67 Although we did not commission any specific research on prices for this report, we can summarise two recently commissioned projects that shed light on whether employers have been able to pass on the costs of minimum wage increases to their customers in the form of higher prices. In two separate projects, Wadsworth (2007 and 2008) found some evidence that the introduction and subsequent uprating of the minimum wage may have led certain minimum wage industries and services (those in which the workforce contained a high proportion of minimum wage workers) to raise prices. Although there was no evidence of significant price changes in the month in which the minimum wage changed, he concluded that prices in several minimum wage industries had risen relatively faster than prices in non-minimum wage sectors in the period after the minimum wage was introduced.

2.68 A number of stakeholders told us how businesses in their sector had been unable to increase their prices to fund increases in the minimum wage. NDNA told us that, in the childcare sector, between 65 and 80 per cent of all fees paid by parents went directly on staff salaries. This meant that an increase in staff wages was likely to be followed by a rise in fees. However, concern about affordability and a rise in parental debts to nurseries, had caused many nurseries to refrain from raising fees to the desired level. As a result, many had decided to freeze fees or deny staff a pay rise in order to retain business. In their oral evidence, BHA, BBPA, and BISL told us that the scope to raise prices in the hospitality and leisure sectors was similarly limited, with owners concerned that increases could price businesses out of the market, particularly in parts of the pub and health and fitness sectors.

2.69 In the cleaning sector, the Cleaning and Support Services Association (CSSA) told us that as a result of the tough trading climate, its members were reporting an inability to pass on increased costs to clients. Instead businesses had to absorb these costs in order to safeguard contract retention and, in an industry where margins were already low, this had an impact on profitability.

2.70 In the social care sector we continued to hear of difficulties providers faced when attempting to negotiate any increase in the price paid for their services by public sector commissioners of care services. The majority of adult social care is funded by the state but delivered through independent sector providers. It is on these independent suppliers of care that the minimum wage has the most impact. We have made repeated recommendations to the Government that the commissioning policies of local authorities and the NHS should reflect the actual costs of care, including the minimum wage. While the Government has always accepted these recommendations, industry stakeholders have repeatedly claimed that the uplift in fees paid by many authorities did not match either the increase in the National Minimum Wage or the general increase in their costs.

2.71 Laing & Buisson data for 2009/10 (Laing & Buisson, 2009) showed that the average uplift in baseline fees paid by local authorities across the UK was 2.6 per cent. This exceeded the increase in the minimum wage in October 2009 (1.2 per cent) and the estimated care home inflation rate (2–2.5 per cent). But there continued to be a notable geographical variation in the size of the uplift. Laing & Buisson also argued that, even in areas where higher rises occurred, such increases only started to address issues of underfunding of care judged against their fair price models. The latest information from Laing & Buisson (Laing & Buisson, 2010) showed the average uplift in baseline fees paid by local authorities across the UK was 0.8 per cent for 2010/11 – the figure for England alone was lower at 0.5 per cent. Of the authorities in England responding to the survey, 63 per cent said there would be no increase in fees, up considerably from the 4 per cent who froze fees between 2008/09 and 2009/10. The increase in the adult minimum wage in October 2010 was 2.2 per cent, while Laing & Buisson estimated the standstill inflation rate for the sector as 2.1 per cent.

2.72 Independent care providers have continued to highlight what they regard as the inappropriately low level of fees paid by local authority and NHS commissioners of care provision. ECCA told us that this should be considered in the light of the local authorities' requirement to contribute 20 per cent to government spending reductions in the coming year. In oral evidence ECCA and the United Kingdom Homecare Association (UKHCA) told us that local authorities had, once again, not found the money to increase fees in line with the increased costs faced by employers in the sector, including the increase in the minimum wage. UKHCA told us that, following council spending cuts, insolvencies in the health and social care sector were up 49 per cent in the first half of 2010 compared with the previous year.

"We pressed the Government for details of its plans to ensure that commissioners in both local authorities and the NHS recognise the true costs of service provision…we see no evidence to suggest that the Government is moving to implement the Commission's recommendation."

UKHCA evidence

2.73 The Government reminded us in its evidence that it did not directly employ care workers. Rather, it allocated resources to local authorities who made decisions on what proportion of their budgets was spent on adult social care. It also said that it regarded the terms and conditions of social care workers, including pay, as a matter for local employers within the existing requirements of employment legislation. However, the Government also assured us that the Department of Health would continue to work with local authorities to ensure that the providers from whom they commission services would offer fair terms and conditions, including payment of at least the minimum wage.

2.74 We recognise that commissioning of social care is a local matter. We are also aware that the Government has established the Dilnot Commission, which we understand is due to report in the summer of 2011, to consider the future funding of adult care in England. But given the current level of fee increases and the financial stringencies likely to be faced by the sector in the coming year, we consider it timely and appropriate to repeat our recommendation on commissioning. We again **recommend that the commissioning policies of local authorities and the NHS should reflect the actual costs of care, including the National Minimum Wage.**

Margins and Profits

2.75 As we have said above, firms faced with increased labour costs resulting from an increase in the minimum wage may be forced to accept a squeeze on profits. There is little evidence that the minimum wage has had a major impact on profits at the whole economy level, but some research evidence suggests that it may have affected profits in certain low-paying sectors, such as care homes.

2.76 In Chapter 1 we noted that profits at the aggregate level, measured in various ways, picked up in 2010. The net rate of return on capital employed fell over the recession from 13.2 per cent in the first quarter of 2008 to 10.0 per cent in the first quarter of 2010, but picked up to 10.6 per cent in the third quarter of 2010. Over the same period, the fall in manufacturing profits, from 11.8 to 5.0 per cent, was greater than that for services, 17.4 to 12.8 per cent, but the net rate of return in manufacturing rebounded to 8.7 per cent in the third quarter of 2010 compared with 13.9 per cent in services.

2.77 Several research papers have recently investigated the impact of the minimum wage on profits. In an extension to work that we had previously commissioned, Draca, Machin and Van Reenen (2011) found that minimum wage rates had raised wages and also significantly reduced profitability, especially in those industries with relatively high market power (those with less competition). Their previous research (2005) had also found some significant and robust evidence that increases in the minimum wage had reduced profits in the care home sector, although Georgiadis (2006) found no such relationship in a follow-up study. Experian (2007) also found no statistically significant effect for any industries in their analysis of the impact of the minimum wage on profits.

2.78 Forth, Harris, Rincon-Aznar and Robinson (2009) examined the impact of the minimum wage on the rate of return to capital employed and on price-cost margins. In those sectors with the highest proportions of workers affected by the minimum wage, they found a significant negative impact of the minimum wage on the rate of return on capital employed. They also found a negative effect of the minimum wage on price-cost margins, but it was not statistically significant or robust. In all, these results suggest that minimum wages may have reduced profits in those sectors most exposed to the minimum wage and which are unable to pass on costs in other ways.

2.79 In the course of our consultations, a number of employers spoke of the pressure on profits for businesses in their sector. According to NDNA, this was the case in many parts of the childcare sector. It told us that a number of nurseries had been obliged to keep fees in check in order to retain business, a position it saw as unsustainable for any significant period of time. NDNA also told us that around one in three providers were merely breaking even and another fifth were making a loss. It claimed that a significant proportion of nurseries were losing money by providing 'free' government-funded nursery care. NDNA also reported that Ofsted had, for the first time, recorded that childcare places had fallen as nursery businesses had been forced to close.

2.80 CSSA reported that its 2010 survey showed that some of its members had seen their turnover fall by between 3.2 per cent and 16.3 per cent since 2009. This had resulted in depressed margins, which made it difficult for such businesses to make sufficient capital investment to purchase new equipment and provide training.

2.81 In response to a survey conducted by the BHF-BSSA Group, 43 per cent said that the National Minimum Wage had affected their profits, rising to 72 per cent in Scotland. When looked at in relation to size of firm by turnover, 54 per cent of those with a turnover of up to £200,000 and 22 per cent with a turnover in excess of £3 million said the minimum wage had had an adverse impact on their profits.

2.82 On the other hand, stakeholders representing workers cited evidence which suggested that many businesses in the low-paying sectors continued to make a healthy profit. The TUC, while recognising that hotels in the provinces had struggled in the past year, noted that in London the average revenue per available room had climbed by 9.2 per cent. Unite said that, according to the latest Hotstats Hotel Confidence Monitor, 72 per cent of hotel general managers were either optimistic or very optimistic about their hotel's trading performance, and 78 per cent expected to maintain staffing levels during the third quarter of 2010 compared with the previous year. The union also maintained that the majority of the top 50 hospitality employers in the UK were profitable, particularly notable given that results for the financial year reported included at least part of the recessionary period. Unite also noted that UK corporations overall had made profits of £77.6 billion in the first quarter of 2010. This has now been revised down to £75.9 billion but increased to £78.1 billion in the third quarter of 2010.

2.83 The TUC pointed out that the service sector, which contains the greatest concentration of minimum wage workers, continued to enjoy an average rate of profitability of 14.4 per cent, which was higher than the 11.1 per cent general rate of profitability for the whole economy.

"...our general experience of the UK National Minimum Wage has so far been that employers have been able to absorb increases without generating any significant side effects… this finding has held true throughout the recent recession."

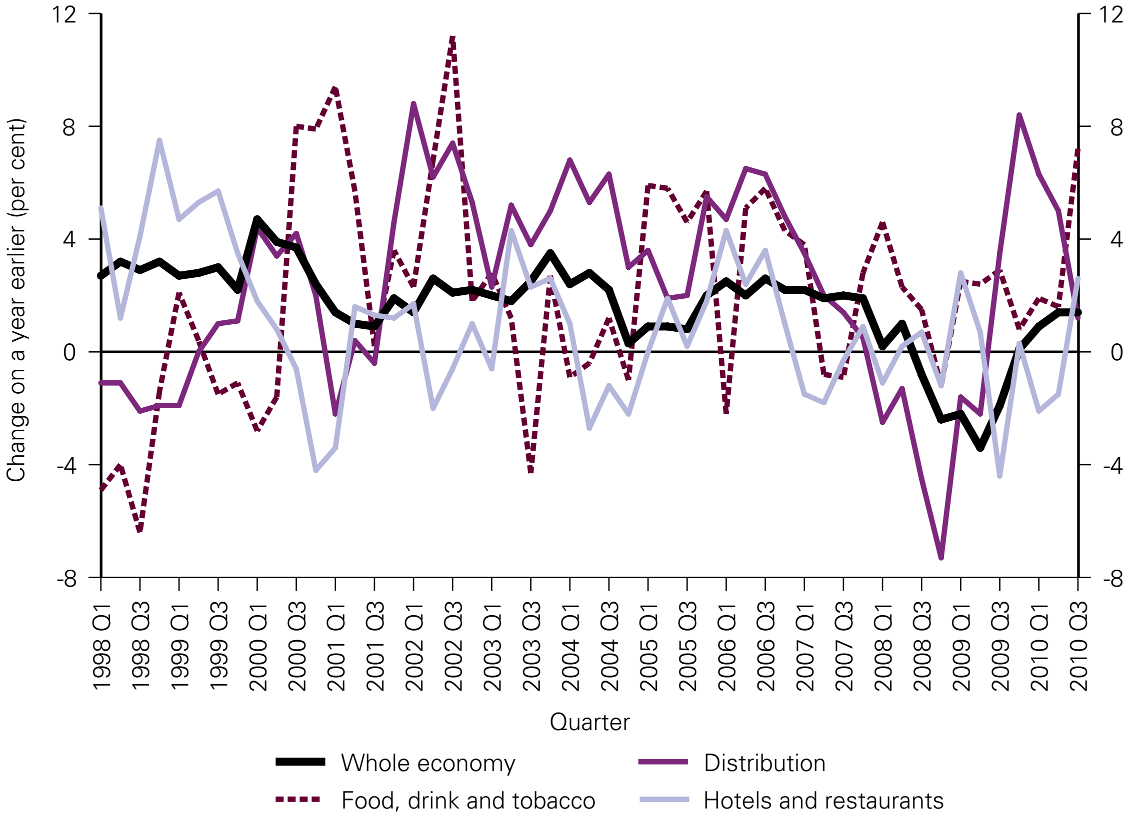
TUC evidence

Productivity

2.84 An alternative way of coping with minimum wage increases is for firms to seek to raise the productivity of their workforce. There are a number of ways that firms can increase labour productivity. First, capital could replace some labour. Second, the quality of capital might be increased by introducing new technology. Third, workers could be monitored or motivated to put in extra effort. Fourth, employers could adjust the work organisation to improve the capital:labour mix. Finally, employers could invest in improving the quality of labour through education and training. Each of these would lead to an increase in labour productivity. This section looks at aggregate and sectoral measures of labour productivity before discussing recent research findings that have looked at the impact of the minimum wage on productivity.

2.85 As noted in Chapter 1, official data showed productivity falling throughout the recession as losses in output were greater than the reductions in hours or employment. Figure 2.15 shows that this fall in productivity was observed across much of the economy.

Figure 2.15: Productivity per Hour, by Selected Low-paying Industry, UK, 1998–2010



Source: ONS, output per hour for the whole economy (LZVD); distribution (JN5H); hotels and restaurants (JN5I); food, drink and tobacco (LZWS); quarterly, seasonally adjusted, UK, Q1 1998–Q3 2010.

2.86 There were however differences between sectors concerning the extent and timing of the fall in productivity. The fall was sharpest and occurred earliest in the distribution sector, but the rebound in productivity growth after the recession has been strong. The manufacture of food experienced some fall in productivity in the fourth quarter of 2008 but has shown reasonable growth since. Productivity growth in hospitality has been more mixed, with little productivity growth between 2006 and 2008, but significant falls not occurring until the middle of 2009. It too has shown signs of revival in 2010.

2.87 The TUC said productivity was badly hit by the recession, but across the whole economy output per hour worked increased by 1.3 per cent over the last 12 months, which closely matched the increase in average weekly earnings for the same period.

2.88 Estimates derived from the Annual Business Survey carried out by the Office for National Statistics (ONS) indicate that large and medium-sized firms had higher productivity, as measured by value added per employee, than micro and other small firms in every year from 1998–2008. The finding that productivity is higher for large and medium-sized firms is common across most sectors. It is, however, small but not micro firms that have consistently produced the lowest productivity increases. In 2008, the latest year available, the value added by small firms was £7,400 lower per employee than large firms.

2.89 In general, previous research has found little evidence of an impact, adverse or otherwise, of the minimum wage on either labour productivity or total factor productivity (TFP) in the economy as a whole or in the low-paying sectors in particular. For this report, we commissioned research that investigated the longitudinal impact of the minimum wage on productivity by size of firm. Croucher and Rizov (2011) use detailed financial information from a large sample of firms, Financial Analysis Made Easy (FAME), to analyse differences across industries and firm size in TFP, that is productivity after accounting for the use of labour and capital. They found that, in general, the National Minimum Wage had a significant positive impact on aggregate productivity in the low-paying sectors. Looking at firm size, they found that the strongest positive effects were in large firms: the smallest firms showed the weakest effects. They argued that this could be explained by the greater ability of large firms to make use of monopoly power to pass on costs to their customers and reorganise their productive processes.

2.90 Although this research in general finds strong beneficial effects of the minimum wage on productivity, there are some concerns that it has just picked up differences in productivity across sectors and size of firm rather than picking up specific effects resulting from the introduction and subsequent upratings of the minimum wage. However, using the same data source, Draca, Machin and Van Reenen (2005) also found a positive association between productivity growth and the introduction of the minimum wage but it was not statistically significant.

2.91 A positive but insignificant relationship between the minimum wage and productivity was also found by Machin, Manning and Rahman (2003) in their earlier study of care homes. In a follow-up study of these care homes, Georgiadis (2006) again found no significant relationship.

2.92 In other research that has looked at the impact of the National Minimum Wage on productivity, Forth, Harris, Rincon-Aznar and Robinson (2009) investigated both industry and plant level productivity. The analysis at industry level built on earlier work by Forth and O'Mahony (2003) that found no systematic evidence of any productivity effects but only looked at the evidence up to 2002. Using data from the Annual Business Inquiry, Forth, Harris, Rincon-Aznar and Robinson (2009) found a negative association between average labour productivity and the minimum wage for all sectors, but the finding was neither robust nor statistically significant. They also found some weak evidence of a negative total factor productivity effect but concluded that there was little or no association between the minimum wage and productivity.

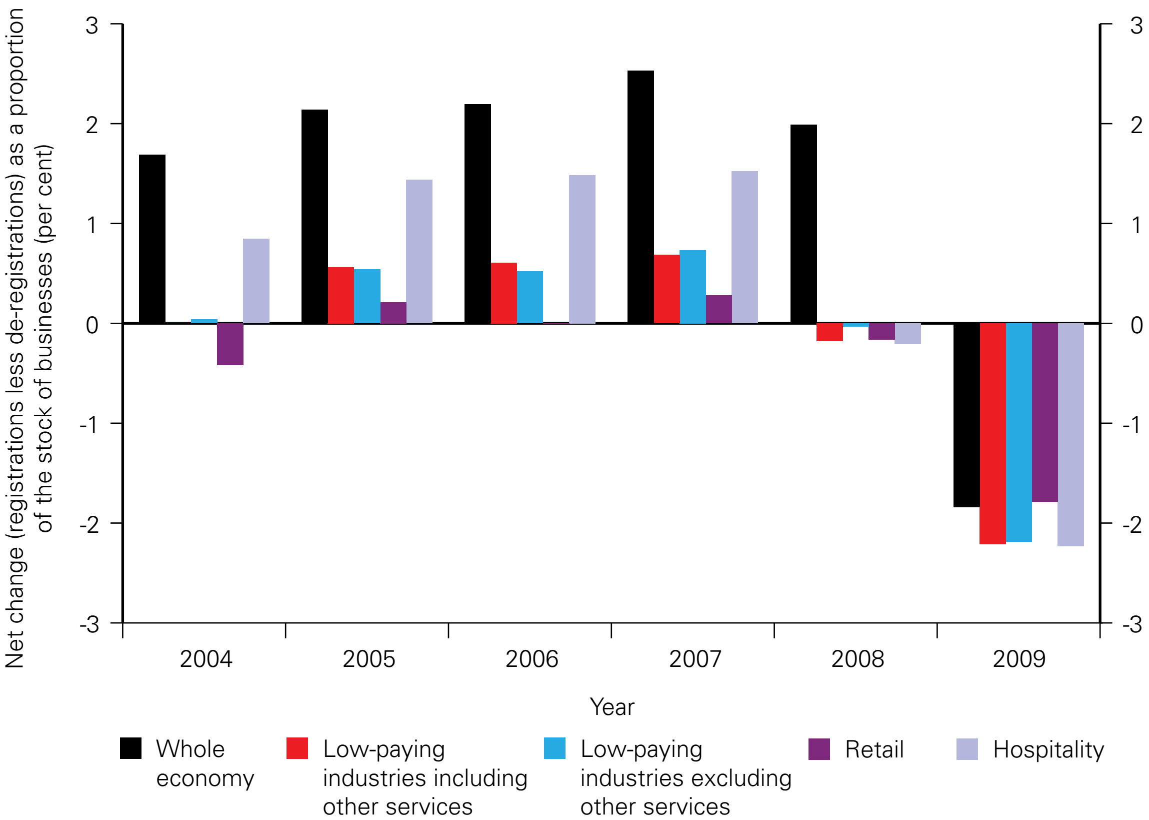
2.93 The plant-level investigation followed in a similar vein to work conducted by Galindo-Rueda and Pereira (2004), that had found some evidence of a positive impact of the minimum wage on labour productivity, particularly in the service industries, but their results were sensitive to the econometric specification employed. The results found by Forth, Harris, Rincon-Aznar and Robinson (2009) using plant-level data from the Annual Respondents Database (ARD) were inconclusive.

Business Start-ups and Failures

2.94 Another way of looking at the impact of the minimum wage on firms might be to look at the levels and changes in both business start-ups and business failures. An increase in the minimum wage might make it less attractive to start a business as the wage costs could increase as a result. Further, increases in the minimum wage might squeeze profits leading to an increased number of business failures. In this section, we look at the aggregate and, where possible, sectoral picture of business start-ups and failures, and company insolvencies. We then summarise the available research of the impact of the minimum wage on company formation and closure.

2.95 The stock of VAT-registered enterprises increased in every year from 1995 to 2008 but the recession led to the stock falling in 2009. The number of firm deaths, businesses de-registering from VAT, rose sharply from 221,000 in 2008 to 279,000 in 2009. At the same time, the number of births, firms registering for VAT, fell from 267,000 to 236,000, resulting in the first net fall in the stock of VAT-registered enterprises since 1994, when the economy was beginning to recover from the 1990s recession.

Figure 2.16: Net Change in Stock of Firms, by Selected Low-paying Industry, UK, 2004–2009



Source: LPC estimates based on ONS data; business demography, enterprise births, deaths and survivals 2009, annual, not seasonally adjusted, UK, 2004–2009.
Note: From 2008 onwards these data are based on the SIC 2007, before 2008 they are based on SIC 2003. Care should be taken in comparisons between 2007 and 2008.

2.96 In the low-paying industries, the stock of VAT-registered enterprises fell in every year between 1994 and 2001 but increased continuously between 2002 and 2007 despite the large upratings in the minimum wage. Although the stock of firms in the whole economy increased by 2 per cent in 2008, Figure 2.16 shows that it fell in the low-paying industries. In 2009, as the economy suffered its worse 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). There was a large reduction in the number of employment agencies (down 8.4 per cent), manufacturers of textiles and clothing (down 5.6 per cent) and hospitality firms (down 2.2 per cent). In contrast, the number of retailers fell in line with that of the whole economy (1.8 per cent).

2.97 Although VAT registration data are only available up to 2009, we can also look at more timely insolvency data. These suggest that the number of insolvencies for the whole economy peaked in the first quarter of 2009 and has since declined every quarter. Grouping the main low-paying industries for which data are available (retail, hospitality, manufacturing of food and manufacturing of textiles and clothing) suggests that the number of insolvencies in these industries peaked in the fourth quarter of 2008 but remained high (accounting for around 15 per cent of all insolvencies) until the fourth quarter of 2009. In 2010 insolvencies in these industries fell faster than in the whole economy and accounted for only 12.7 per cent of insolvencies in the second quarter of 2010.

2.98 There is some research evidence that the minimum wage may have affected business start-ups and failures. Draca, Machin and Van Reenen (2011), using FAME, found some weak evidence of longer-run adjustment through falls in net entry rates. Similarly, Experian (2007), using VAT registrations, found that business creation was lower in those regions most affected by the minimum wage (where pay was lowest). Galindo-Rueda and Pereira (2004) also found evidence to suggest that the introduction of the minimum wage led to business creation being slower in the lowest-paying geographical areas when using the ARD. In their industry-level analysis, Forth, Harris, Rincon-Aznar and Robinson (2009) found some weak evidence that the minimum wage had increased the exit rates of firms.

2.99 Evidence about business start-ups and failures was also provided by stakeholders in their evidence. These tended to show that the economy was beginning to recover. Research carried out by Cushman & Wakefield (2010) showed that the average availability of retail units across Great Britain's high streets was 8.8 per cent in November 2010, down from 9.8 per cent in August. This figure was the lowest level of retail availability recorded in the last 18 months.

2.100 The Local Data Company (2010) also reported a slow down in the increase in town centre store vacancy rates in Great Britain in the first half of 2010. Rates had risen from just over 12 per cent at the end of 2009 to 13 per cent at the end of June 2010. It reported that the big centres in London and the South East were holding up well, while further north vacancy rates were much higher. The British Retail Consortium (BRC) reported that it believed that the October 2009 increase in the minimum wage of 1.2 per cent was instrumental in creating an environment conducive to growth.

2.101 The ACS told us that there had been a continual decline in the number of local stores since 2000. The Rural Shops Alliance reported that significant numbers of rural shops continued to close. It estimated that between 400–500 would close in 2010 which was similar to previous years, and was to the detriment of the socially and economically excluded in rural villages. The BRC-Bond Pearce Retail Employment Monitor showed that, in the third quarter of 2010, there was a 4.2 per cent net increase in the number of stores compared with the same period a year earlier. The BRC said that there was, however, a clear distinction in the growth in store numbers between food and non-food outlets with the former outperforming the latter.

2.102 Many stakeholders acknowledged that it was very difficult to disentangle the impact of the National Minimum Wage from the impact of other factors. The NHF, however, said it believed that the minimum wage had contributed to some business failures because it had increased fixed costs and reduced opportunities to pay employees according to performance. BBPA, while acknowledging that the pub sector faced pressures from many other directions, told us for some struggling pubs an increase in the minimum wage could be the 'last straw' – an opinion that was shared by those of its members we met on a visit to Wrexham. But BBPA also said that the rate of pub closure had slowed from 52 a week in 2009, to 39 a week in 2010.

2.103 The National Farmers Union reported that the total number of farm insolvencies in 2009 increased by 22 per cent on 2008, when insolvencies were decreasing in the rest of the economy. It said there had been an increase in the number of liquidations and bankruptcies and a fall in the number of administrations and that farms that were going insolvent were not continuing to trade, they were being liquidated.

Impact on Employment and Unemployment

2.104 Neo-classical economic theory tells us that employment should fall if the minimum wage is set above the competitive, market-clearing wage. Firms can reduce employment through either the extensive margin, reducing the number of workers employed, or through the intensive margin, reducing the number of hours worked. Other economic theories, such as efficiency wages (where higher wages induce greater productivity), allow the possibility that an increase in the wage floor might actually lead to a rise in employment. In this section, we look at aggregate employment (and hours) as well as those workers and sectors that are most likely to be affected by the minimum wage. We then investige the impact of the minimum wage on vacancies, redundancies, unemployment and inactivity, before summarising the research evidence and considering the views of stakeholders.

Employment, Employee Jobs and Hours

2.105 Since the introduction of the minimum wage in April 1999, aggregate employment has grown. Despite the recession, aggregate employment (whether measured using jobs or numbers in work) was still much higher in September 2010 than it was in March 1999, prior to the introduction of the minimum wage. Table 2.8 shows that the number of employee jobs has increased by 1.1 million (4.4 per cent) and the number of employees has risen by

1.4 million (6.2 per cent). Over the same period, the number of hours worked has increased by 3.1 per cent.

Table 2.8: Change in Employment and Unemployment, UK, 1999–2010

	September 2009–September 2010		September 2008–September 2009		March 1999–September 2010	
	000s	%	000s	%	000s	%
Workforce jobs	-170	-0.6	-856	-2.7	1,659	5.7
Employee jobs	-277	-1.0	-964	-3.5	1,094	4.4
Employment	286	1.0	-496	-1.7	2,083	7.7
Employees	80	0.3	-553	-2.2	1,435	6.2
Hours worked	12,000	1.3	-30,000	-3.2	27,800	3.1

Source: ONS, workforce jobs (DYDC) and employee jobs (BCAJ), quarterly; total employment (MGRZ), employees (MGRN) and total weekly hours (YBUS), monthly, seasonally adjusted, UK, 1999–2010.

2.106 Looking at the low-paying sectors in more detail, we should first note that, since we wrote our last report, ONS has revised the workforce jobs and employee jobs series data. These revisions have changed what we believed about the recession. In our 2010 Report, we noted that the economy as a whole had suffered from greater job loss than the low-paying industries. In particular, although jobs had been lost in retail and hospitality through the recession, we pointed out that that job loss had been lower than in the whole economy. But revisions to the data now suggest that the jobs performance was similar in the low-paying sectors and the whole economy but that retail and hospitality had fared worse.

2.107 However, Table 2.9 shows that since September 2008, the loss of employee jobs in Great Britain has been greater in the whole economy (4.5 per cent) than in the low-paying sectors (3.7 per cent) but that retail, employment agencies, hairdressing and textiles and clothing fared much worse. Between September 2008 and September 2009, a period that covers the latter but most substantial part of the recession, both the whole economy and the low-paying sectors lost around 3.5 per cent of their employee jobs.

Table 2.9: Change in Employee Jobs, by Low-paying Industry, GB, 1998–2010

	2010 September	Change on 2009 September		Change on 2008 September		Change on 1998 September	
	000s	000s	%	000s	%	000s	%
All industries	**25,425**	**-264**	**-1.0**	**-1,200**	**-4.5**	**1,211**	**5.0**
All low-paying industries	**8,024**	**12**	**0.2**	**-309**	**-3.7**	**269**	**3.5**
Retail	**3,092**	-50	-1.6	-187	-5.7	4	0.1
Retail (excluding motor)	2,643	-55	-2.0	-158	-5.7	55	2.1
Hospitality	**1,716**	-31	-1.8	-85	-4.7	153	9.8
Social care	**675**	38	6.0	80	13.4	173	34.5
Employment agencies	**600**	36	6.3	-45	-6.9	127	26.8
Cleaning	**587**	-5	-0.9	-24	-4.0	-0	-0.1
Leisure, travel and sport	**466**	2	0.4	-9	-1.9	124	36.3
Food processing	**325**	-2	-0.6	-14	-4.0	-105	-24.4
Agriculture	**215**	32	17.5	-1	-0.3	-52	-19.6
Security	**171**	4	2.4	0	0.1	43	33.6
Hairdressing	**105**	-12	-10.0	-10	-8.8	31	41.5
Textiles and clothing	**72**	-0	-0.4	-14	-16.3	-229	-76.1

Source: LPC estimates based on ONS employee jobs series, three-monthly, not seasonally adjusted, GB, 1998–2010.

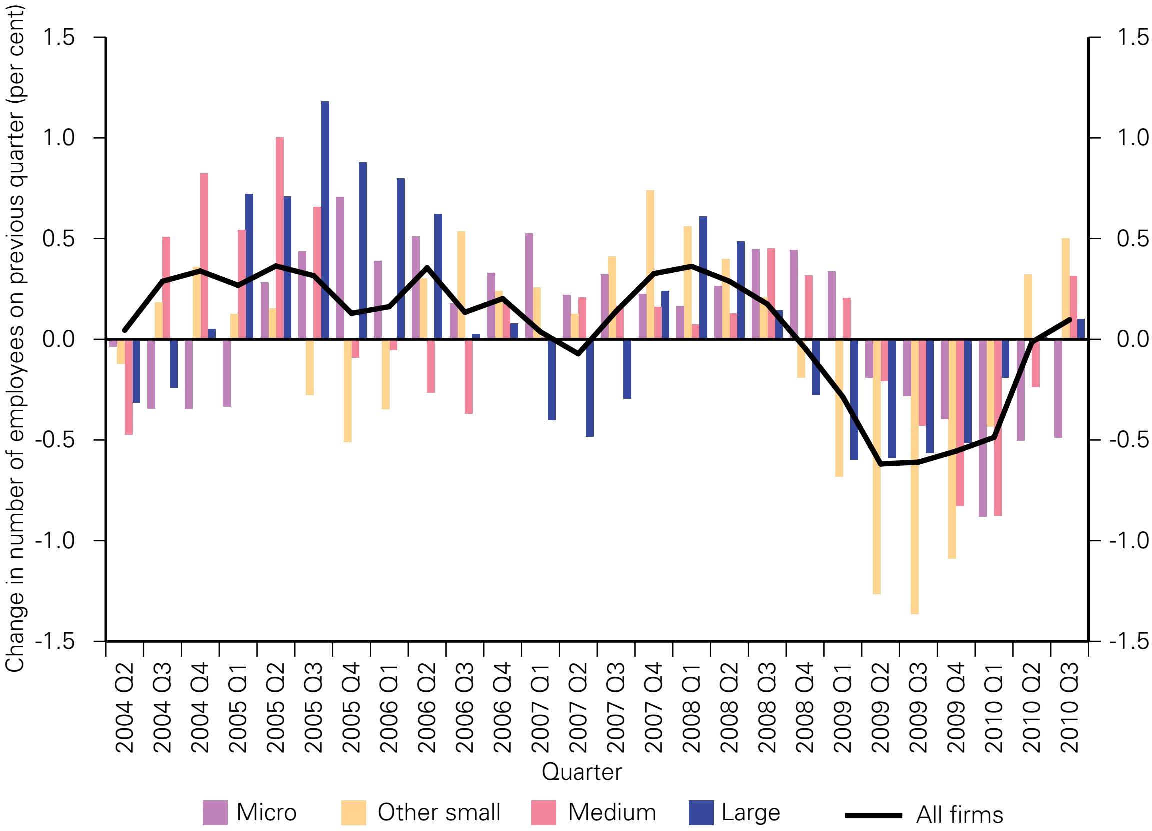
2.108 The low-paying sectors appear to be recovering faster than the economy as a whole. In the year to September 2010, jobs in the low-paying sectors grew by 0.2 per cent but the number of jobs in the economy at large continued to fall, down 1.0 per cent. Within the low-paying industries, social care, employment agencies and agriculture experienced the largest growth in jobs.

2.109 Between September 1998 and September 2010, Table 2.9 shows that the number of employee jobs in Great Britain increased by 5.0 per cent. Over the same period, the number of employee jobs in the low-paying sectors increased at a slower pace (3.5 per cent). This suggests that the minimum wage may have been an impediment to employment growth, but much of the research conducted so far has found little evidence to support such a proposition. We go on to discuss that research shortly.

2.110 According to the LFS for the third quarter of 2010, just under 50 per cent of all employees work in small firms (with fewer than 50 workers). Around 19 per cent work for micro firms (defined here as 10 or fewer workers) with about 27 per cent working in other small firms (employing 11–49 workers). The remaining 52 per cent are roughly split between medium-sized (employing 50–249) and large firms (employing more than 250).

2.111 Figure 2.17 shows that employment growth has varied by size of firm over time. The recession initially affected large firms and 'other small' firms. Micro firms (and medium-sized firms) continued to expand employment up to the first quarter of 2009. Other small firms were severely affected by the recession, losing most jobs, but have recovered as the economy has picked up, generating more jobs in 2010 than any other size of firm. Micro firms went into the recession later than large firms and have continued to experience job losses even as the economy has picked up. In contrast, employment grew for all other sizes of firm in the third quarter of 2010.

Figure 2.17: Employment Growth, by Size of Firm, UK, 2004–2010



Source: LPC estimates based on LFS Microdata, quarterly, four-quarter moving average, UK, Q2 2003–Q3 2010.

2.112 Many of the groups of workers that were expected to be most affected by the minimum wage have experienced increases in their employment rates since the introduction of the minimum wage. Table 2.10 shows that women, older workers, ethnic minorities, disabled people and migrants all have employment rates that are lower than the average. But all of these groups saw their employment rates increase between the first quarter of 1999 and the third quarter of 2010. However, over this period, the employment rates of young workers and those with no qualifications have fallen dramatically.

Table 2.10: Employment Rates, by Group of Worker, UK, 1999–2010

(Rates: per cent; changes: percentage points)	2010 Q3	Change on:		
		2009 Q3	2008 Q2	1999 Q1
Working age	**70.5**	-0.8	-2.3	-1.1
Men	**75.4**	-1.2	-3.5	-3.1
Women	**65.7**	-0.4	-1.2	0.8
16–17 year olds	**25.4**	-3.6	-8.7	-22.6
18–21 year olds	**48.6**	-3.1	-8.1	-12.6
Older workers (65+)	**8.2**	0.7	1.1	3.2
White	**72.1**	-1.0	-2.4	-0.6
All ethnic minorities	**59.9**	0.0	-0.6	3.9
Black	**61.2**	1.7	-2.6	0.1
Indian	**70.4**	1.3	1.7	7.3
Pakistani/Bangladeshi	**46.9**	-0.8	1.1	8.4
Other non-white	**59.6**	-1.6	-2.2	2.6
With qualifications	**74.4**	-1.2	-3.8	-4.0
No qualifications	**40.1**	-2.4	-6.5	-11.8
Not disabled	**75.9**	-0.4	-2.1	-1.3
Disabled people	**39.2**	-1.0	-1.2	1.5
UK born	**71.2**	-0.9	-2.4	-1.3
Non-UK born	**66.5**	-0.4	-1.5	4.2

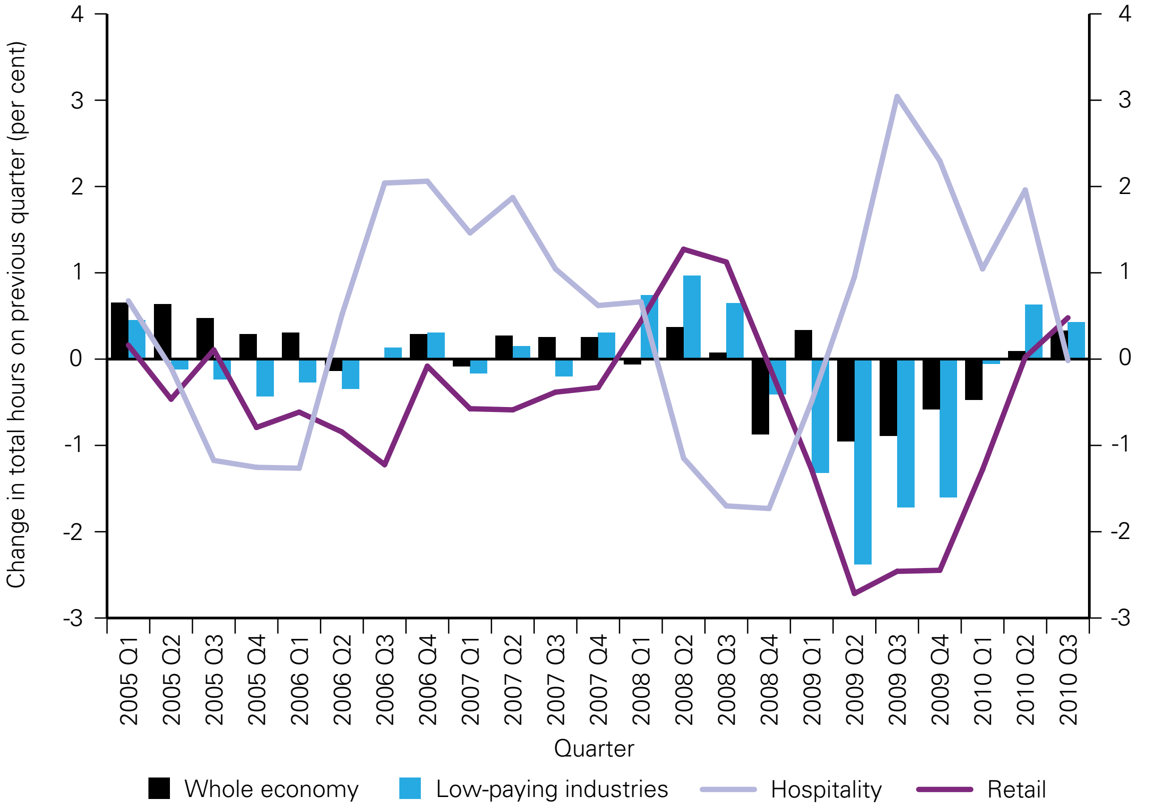
Source: LPC estimates based on LFS Microdata, quarterly, four-quarter moving average, UK, Q2 1998–Q3 2010.
Note: Working age, unless otherwise stated.

2.113 The same groups of workers have also generally fared better than average since the beginning of the recession. It is young people and those with no qualifications that have been most adversely affected. It is a similar story in the recovery although disabled people have also fared worse than average.

Hours

2.114 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 949.2 million in March 2008). It then fell in the recession by over 4 per cent, reaching a nadir of 908.4 million in January 2010, before recovering by around 1 per cent by the autumn of 2010. Figure 2.18 shows that the fall in hours was greater during the recession in the low-paying sectors than for the economy as a whole. But it also shows that as the economy has begun to recover, hours worked have picked up faster in the low-paying sectors than in the economy as a whole. There is a noticeable difference between the hospitality and retail sectors, with the growth in hours tending to be mirror images.

Figure 2.18: Change in Hours Worked, by Selected Low-paying Industry, UK, 2005–2010

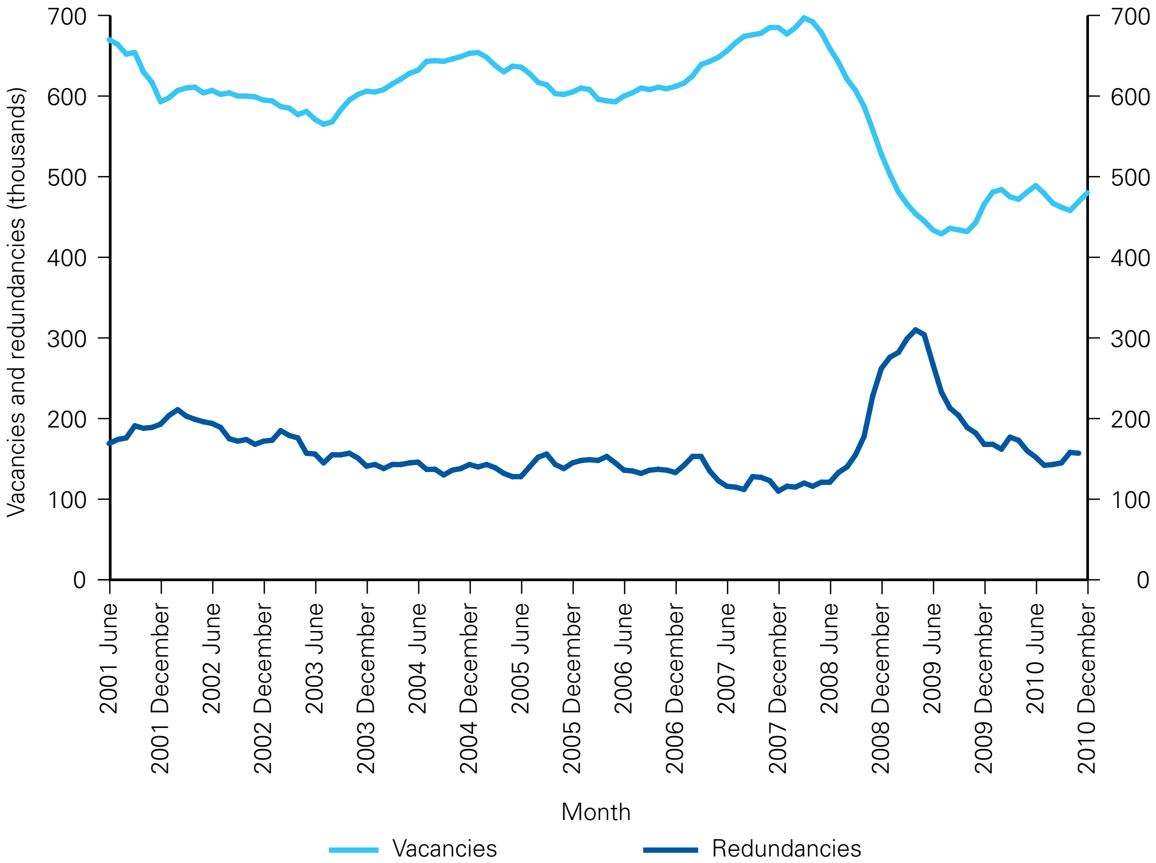


Source: LPC estimates based on LFS Microdata, quarterly, four-quarter moving average, UK, Q1 2004–Q3 2010.

Vacancies and Redundancies

2.115 Vacancies and redundancies can also be used to gauge the health of the labour market. Figure 2.19 clearly shows how vacancies and redundancies were affected by the recession. Vacancies fell from about 700,000 in March 2008 to a low of around 430,000 in July 2009 before rebounding to between 450,000 and 500,000 a month for most of 2010. The trends in redundancies were a mirror image. Redundancies began rising in December 2007, slightly earlier than the decline in vacancies, and continued to rise until April 2009, reaching 310,000 before falling back to around 150,000 in July 2010, where they have remained.

Figure 2.19: Vacancies and Redundancies, UK, 2001–2010

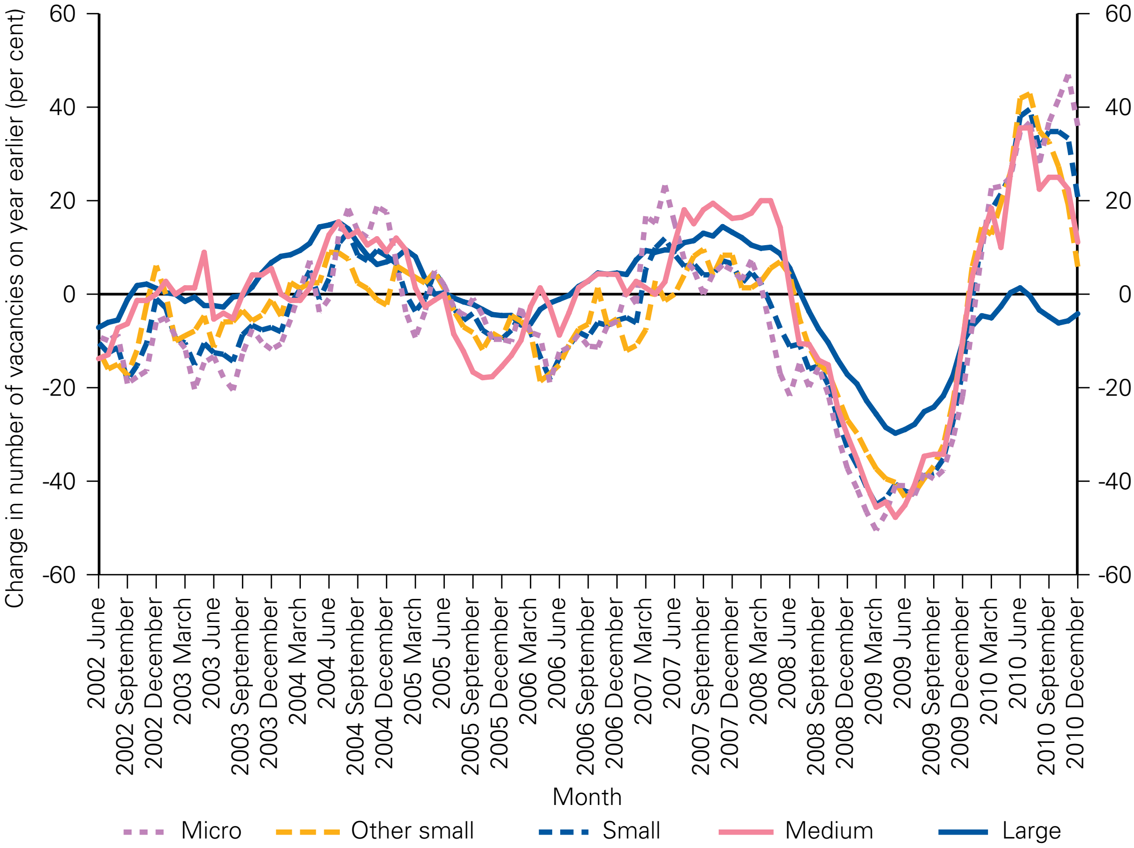


Source: ONS, vacancies (AP2Y) and redundancies (BEAO), monthly, seasonally adjusted, UK, 2001–2010.

2.116 A similar picture to the whole economy is found for distribution (which comprises wholesale and retail) and hospitality. Vacancies in both low-paying sectors peaked in March 2008 (at 133,000 in retail and 67,000 in hospitality) before falling throughout the recession (with retail reaching a low of 75,000 in May 2009 and hospitality reaching a low of 39,000 in September 2009). Vacancies in both sectors have since grown moderately, reaching 92,000 and 42,000 respectively in September 2010. Redundancies in distribution and hospitality taken together were 19,000 in February 2008 and rose to 70,000 a month in February–April 2009 before falling back to 27,000 by December 2009. However, they have risen again in 2010.

2.117 According to official estimates, the picture with regard to the number of vacancies differs depending on the size of firm, as shown in Figure 2.20. It can clearly be seen that vacancies in large firms follow a different trend to those in 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 firms with large firms being least affected. However, the growth in vacancies among small and medium-sized firms has been rapid and strong in the recovery. In contrast, large firms have yet to experience any pick-up in vacancies.

Figure 2.20: Change in Vacancies, by Size of Firm, UK, 2002–2010



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, 2001–2010.

Unemployment and Inactivity

2.118 We saw earlier that many of the groups that were expected to be most affected by the minimum wage had seen increases in their employment rates since its introduction. Table 2.11 shows that women, older workers, ethnic minorities, disabled people and migrants have also experienced reductions in their unemployment and inactivity rates since the introduction of the minimum wage. With the exception of disabled people and some ethnic minorities, these groups also coped well during the recession and in the initial stages of the recovery. Again, it is a different story for young workers and those with no qualifications who have seen their unemployment and inactivity rates rising.

Table 2.11: Unemployment and Inactivity Rates, by Group of Worker, UK, 1999–2010

(Rates: per cent; changes: percentage points)	Unemployment				Inactivity			
	2010 Q3	Change on:			2010 Q3	Change on:		
		2009 Q3	2008 Q2	1999 Q1		2009 Q3	2008 Q2	1999 Q1
Working age	**8.0**	0.6	2.6	1.7	**23.4**	0.4	0.3	-0.2
Men	**8.9**	0.6	3.2	1.9	**17.2**	0.8	0.9	1.5
Women	**6.9**	0.6	2.0	1.5	**29.5**	0.0	-0.2	-1.9
16–17 year olds	**33.7**	3.2	7.7	13.6	**61.7**	3.5	7.8	21.7
18–21 year olds	**23.3**	2.4	7.3	8.6	**36.6**	2.0	4.1	8.3
Older workers (65+)	**2.6**	-0.1	0.9	-0.2	**91.5**	-0.7	-1.2	-3.3
White	**7.4**	0.6	2.6	1.6	**22.1**	0.5	0.4	-0.7
All ethnic minorities	**13.0**	0.5	2.4	-0.4	**31.2**	-0.4	-1.2	-4.2
Black	**16.5**	0.1	3.8	1.7	**26.7**	-2.1	-0.2	-1.5
Indian	**8.0**	-1.1	1.0	-1.2	**23.5**	-0.6	-2.6	-7.0
Pakistani/Bangladeshi	**18.1**	3.1	3.7	-2.1	**42.7**	-1.1	-3.8	-9.0
Other non-white	**11.6**	0.6	1.9	-0.7	**32.6**	1.3	1.0	-2.4
With qualifications	**7.3**	0.6	2.6	1.8	**19.7**	0.7	1.8	2.6
No qualifications	**16.6**	1.5	5.3	4.5	**52.0**	2.0	4.5	11.0
Not disabled	**7.4**	0.5	2.6	1.6	**18.0**	0.0	0.0	0.0
Disabled people	**14.3**	0.9	2.8	1.3	**54.3**	0.7	0.0	-2.4
UK born	**7.8**	0.6	2.7	1.7	**22.8**	0.5	0.3	0.0
Non-UK born	**9.1**	0.6	2.2	0.4	**26.8**	0.0	0.0	-4.9

Source: LPC estimates based on LFS Microdata, quarterly, four-quarter moving average, UK, Q2 1998–Q3 2010.
Note: Working age, unless otherwise stated.

Research on Employment, Hours and Unemployment

2.119 Much of the research that has previously been conducted on the impact of the National Minimum Wage has focused on employment. Researchers have typically used difference-in-difference methodology. That is, they compare a 'treatment' group (those affected by the minimum wage) with a 'control' group (those unaffected by the minimum wage but with similar observed characteristics). Researchers broadly take one of two approaches to identifying an impact on employment. First, and most commonly, they have used individual level data over time to estimate the impact on individual employment experience. Second, and often accompanying the first, researchers have used spatial data to take advantage of the fact that the minimum wage is national and that its coverage and bite differs across areas.

2.120 We commissioned two research projects for this report that specifically investigated the impact of the adult rate of the minimum wage on employment. Dickens and Dolton (2011) adopted the methodologies explained above and used individual data to look at minimum wages in previous UK recessions. An alternative approach is to use time series data to look at whether minimum wages have affected employment.

2.121 This latter approach was used in research we commissioned by Dolton and Rosazza Bondibene (2011). Building on work by the Organisation for Economic Co-operation and Development (OECD, 1998) and Neumark and Wascher (2004), they estimated the effect of minimum wages on employment by analysing cross-national variations in minimum wages across 33 OECD and European countries over the period from 1976–2008. Their findings were in line with the previous studies if the data were not weighted by the population size of each country. That was, minimum wages tended to have a negative effect on employment.

2.122 However, this effect largely disappeared or was significantly reduced when population size was taken into account. Their analysis also found little difference in the results across the economic cycle except for young people. For those aged 15–24, they found that the impact of the minimum wage was more detrimental in the presence of an economic downturn.

2.123 In contrast to the international survey of minimum wage research by Neumark and Wascher (2008), which concluded that minimum wages adversely affect employment and hours, the consensus of the research findings of the impact of the National Minimum Wage in the UK is that it has not significantly adversely affected employment. But much of that research had been conducted prior to the onset of the recent economic downturn, using data from a period of strong economic growth.

2.124 As little data are currently available to assess fully the impact of the recession on employment and wages, Dickens and Dolton (2011) made use of data from the 1980s and 1990s to attempt to identify the effect of recessions on the impact of minimum wages set by the Wages Councils. These were bodies that set minimum wages and employment conditions in a limited number of low-paying industries. Their results suggest that minimum rates of pay set by the Wages Councils had a positive impact on employment growth and that this finding remained true through both the early 1980s and early 1990s recessions. They also found no relative employment change between the covered Wages Council sectors and uncovered comparator sectors.

2.125 They found that workers in Wages Council jobs were more likely to exit the job than those in uncovered sectors but they were also more likely to move into new jobs, suggesting a much higher turnover of staff in the sectors covered. They found that this turnover moderated in the recession of the early 1980s with both inflows and outflows falling. Overall, their findings suggested only limited recessionary effects of the minimum wage but that job turnover may slow. They found no aggregate employment differences between the sectors covered by the Wages Councils and those not covered through either of the 1980s or 1990s recessions.

2.126 In previous studies that have adopted a similar approach looking at individual data, researchers have generally found little impact on employment. Stewart (2003, 2004a and 2004b) found no evidence of an adverse impact of the introduction of the minimum wage and its initial upratings on employment. Dickens and Draca (2005) came to similar conclusions when looking at the large upratings in 2003 and 2004 on individual employment transitions. Dickens, Riley and Wilkinson (2009) examined the employment effects of the 2003–2006 upratings and were unable to find any conclusive adverse effects of the minimum wage. Mulheirn (2008) also looked at the 2006 minimum wage upratings and found no adverse impact on employment.

2.127 Connolly and Gregory (2002) found no effect of the introduction of the minimum wage on hours. However, Stewart and Swaffield (2004) found significant adverse effects on hours from the introduction of the minimum wage when a longer time span was considered. They found that weekly wages still increased as the reduction in hours was less than the rise in the minimum wage. Dickens, Riley and Wilkinson (2009) also found evidence that hours had been reduced in some years and in some econometric specifications but, unlike Stewart and Swaffield, these were not robust. In a similar vein, Robinson and Wadsworth (2007) found no evidence that the minimum wage had affected the incidence of second job-holding or the hours worked in second jobs.

2.128 The research from local area analysis also fails to find strong evidence of adverse employment effects. Stewart (2002) analysed employment changes across local areas in the period that covered the introduction of the minimum wage. He found some weak evidence of a reduction in employment but it was not statistically significant. However, Galindo-Rueda and Pereira (2004) did find a significant impact of the minimum wage on employment growth. Employment growth was not as fast in areas of the country with a higher proportion of its workforce in low-paying jobs. Experian (2007) found no relationship between the bite of the minimum wage and regional employment in general although there was some evidence of a small negative impact in hospitality. Dickens, Riley and Wilkinson (2009) found no effects on employment but they did find some weak evidence that increases in the minimum wage may have led to increases in unemployment. Although Dolton, Rosazza Bondibene and Wadsworth (2009) found little impact of the minimum wage on employment over its entire period of operation, examination of yearly effects suggested a small but significant positive effect of the minimum wage since 2003. They also found that areas where the minimum wage bite was greatest experienced higher unemployment but noted that unemployment rates fell more in these areas in the latter part of the period under study.

2.129 In summary, the consensus of the research findings of the impact of the National Minimum Wage in the UK is that it has not significantly adversely affected employment but that it may have had a small negative effect on hours. But it should be noted that much of that research was conducted when the economy was performing strongly.

Views on Employment and Hours

2.130 The CBI said the labour market situation continued to be extremely fragile and firms' ability to retain labour had been reduced by a prolonged period of poor trading. Evidence from BHA, BBPA and BISL painted a mixed picture in terms of how different parts of these sectors, and different geographical areas, were emerging from the recession. While London hotels seemed to have recovered well from the depths of the recession, regional hotels had found business more difficult. BBPA members told us that pubs often had to cut jobs or hours in order to fund increases in the minimum wage. While pubs might be willing and able to pay more to attract and retain staff who directly generated revenue (e.g. bar staff) they would probably reduce the number of jobs which did not (e.g. cleaners). Unlike increases in duties, the minimum wage was one cost the employer could control, by reducing the amount of labour they use.

2.131 In a Secretariat meeting the Association of Licensed Multiple Retailers (ALMR) told us that a recent survey it had conducted showed the overwhelming majority of its members used multiple methods to cope with increases to the minimum wage. ALMR also reported a clear shift towards employing more part-time workers. The average was 15 part-time workers per pub, up from 10 in 2008. This year was the first time the results had shown more part-time than full-time workers in the sector as a whole. Many such firms aimed to keep the wage bill static even after an increase in the National Minimum Wage, so something else had to give. Almost all respondents to the survey said they had let staff go. However, there were other factors which had a significant impact on the pub sector: these included the smoking ban, increased business rates and the downturn in the economy.

2.132 The NHF told us that increases in the minimum wage, by reducing salons' ability to reward performance, had increased the incentive for staff to join the 'grey economy'. The portability of hairdressing skills and the ease of setting up on one's own may have led to an increase in self-employment in this sector. Data give some support to the argument of a shift from employee jobs to self-employment in hairdressing, although factors such as the state of the economy are likely to have been a bigger driver of this shift than increases in the minimum wage. There has been a reduction of 12,000 in employee jobs in hairdressing between September 2009 and September 2010. At the same time, LFS data suggest that self-employment in the sector has increased by roughly similar numbers (up 10,000).

2.133 In the retail sector, the BRC-Bond Pearce Retail Employment Monitor showed that in the third quarter of 2010, retail full-time equivalent employment was up by 2.1 per cent compared with the same quarter a year earlier. This was equivalent to a net increase of 12,746 retail jobs. But in response to a survey conducted by the BHF-BSSA Group, 39 per cent said they had reduced the number of people they employed as a result of the minimum wage.

2.134 Whereas some employer representatives painted a negative picture of the performance and prospects of firms in the low-paying sectors, evidence from trade unions depicted a far more positive picture. In oral evidence the TUC told us it was sceptical about claims that jobs or hours were cut as a direct result of the National Minimum Wage. The TUC said that employers had exaggerated the likely employment effect of the minimum wage since its inception and would probably continue to do so. It said the relative position of the low-paying sectors as a whole was reasonably encouraging and that employment in sectors with a high concentration of low-paid workers had fared markedly better than employment in the whole economy. Although the retail and hospitality sectors had lost a number of jobs, these had been partly offset by increases in jobs in social work, residential care and security. Unite noted that since the introduction of the minimum wage, employment in the low-paying sectors had still increased by 518,000, or 8.2 per cent. In oral evidence, Unite claimed that the minimum wage had not had any adverse effects on the labour market and had helped millions of low-paid workers. It maintained that, although jobs had fallen sharply in retail and hospitality during the recession, the minimum wage had not been a significant contributory factor to those losses.

2.135 USDAW said that although the number of jobs in retail had decreased, a large number of these had been borne by a small number of the larger employers, particularly in non-food retailing. It said that retailing remained a vibrant sector of the economy which, even when the economy was growing slowly, had successes and was a sector of job creation where opportunities for employment continued to occur.

2.136 In oral evidence the CBI argued that one of the defining elements of the recent recession had been the way in which employers (often with help from unions) had tried, often successfully, to protect jobs. It said that, while it was undeniable that the National Minimum Wage had been successful since its inception, the real test of its efficacy was always going to be a major recession. While many employers had, in many instances frozen pay, they had been unable to freeze the wages of workers on the National Minimum Wage. There was some evidence of hours of lower-paid workers being cut, as a response to managing increased wage costs.

2.137 In a survey conducted by the ACS, 50 per cent of respondents said they had reduced staffing hours over the last 12 months. Many retailers were finding it more cost effective to remove full-time employees and replace each one with two part-time staff. The Federation of Small Businesses said that many small business owners have had to cut staff hours or numbers and freeze wages to keep their businesses going, while taking on more work themselves.

Conclusion

2.138 We again find that minimum wage jobs are more likely to be: part-time; temporary; held for less than a year; in the private sector; in small and medium-sized firms, and in certain low-paying industries (such as retail and hospitality) and occupations (such as hairdressers, cleaners, bar staff and retail assistants). These jobs are also more likely to be carried out by women, young people, older workers, disabled people, ethnic minorities or those with no qualifications.

2.139 Since the minimum wage was introduced in April 1999, it has increased much faster than both average earnings and prices. Between 1999 and 2007, the bite of the minimum wage at the median for adults rose from just under 46 per cent to about 51 per cent. Since October 2006, however, the minimum wage has increased in line with average earnings and slightly below inflation. Consequently, the bite for adults has remained at around the same level as it was in 2007.

2.140 Although the bite has remained at around the same level for the whole economy since 2007, it has continued to rise for micro and other small firms. The bite has actually fallen for large firms. Despite the increased bite, employment in micro firms does not appear to have been affected more than employment in large firms. That is not the case for other small firms which performed less well than others during the recession. However there has been a pick-up in employment in 2010 among such firms. Vacancies for small firms have also increased during 2010. In contrast, vacancies in large firms have continued to fall since the start of the recession.

2.141 When we wrote our 2010 Report it appeared that the low-paying sectors were performing better than the whole economy in terms of employment loss during the recession. Revisions to the data have made that picture less clear. However, the revised data do show that the low-paying sectors have performed better than the whole economy since September 2009, as the economy has recovered from its deepest recession since the 1930s.

2.142 We have again received evidence from the social care sector regarding the level of fee increase paid by public sector bodies when purchasing services from independent sector care providers. We have repeated our recommendation that the commissioning policies of local authorities and the NHS should reflect the actual costs of care, including the minimum wage.

2.143 The consensus of the research findings on the impact of the National Minimum Wage in the UK is that it has greatly affected the distribution of earnings but that it has not had any significant adverse effect on employment. Instead of cutting employment, some research evidence indicates that firms have attempted to cope with increases in the minimum wage by changing pay structures and reducing non-wage costs; reducing hours; raising prices; or accepting lower profits. But it should be noted that much of this research was conducted when the economy was performing strongly.

2.144 The recession and the subsequent recovery have not affected all groups of workers equally. Many of the groups of workers that are most likely to hold minimum wage jobs have fared relatively well in the last two or three years. In terms of employment, women have fared better than men, ethnic minorities better than white people, older people better than the prime aged (those aged 35–54), and disabled people better than those without disabilities. Young people and those without qualifications have fared particularly badly in the recession, although they were also doing less well before the onset of recession. We go on to discuss the economic performance of young people in more detail in the next chapter.

Chapter 3
Young People, Interns and Apprentices

Introduction

3.1 This year, as part of our remit, the Government has asked us to review the labour market position of young people (including interns and apprentices), the arrangements for the apprentice minimum wage, and the levels of each of the different minimum wage rates. This chapter covers young people, interns and apprentices. Our recommendations for the youth and apprentice rates are covered in Chapter 5.

3.2 Ever since the formation of the Low Pay Commission, we have believed that the minimum wage should be set at a lower rate for young people because the evidence shows that they are more vulnerable in the labour market and the threat of unemployment (and the associated damage it causes) is greater for young workers. We also see a lower minimum rate as appropriate because we do not want to damage young people's prospects by restricting opportunities for training, such as apprenticeships or other forms of on the job training that develop basic skills. When they are employed, we believe that young people and apprentices should be protected from exploitation. In recommending minimum wage rates for young people and apprentices we have, therefore, sought to ensure that the rates neither provide an incentive for young people to leave education or training, nor harm the opportunities for those who decide to enter the labour market or start an apprenticeship.

3.3 We begin this chapter by looking at the position of young people and how they have fared post-recession. This is followed by a section on internships. An internship is a form of work experience, often unpaid, that is designed to help young people get started in the labour market. The recent growth in the number of unpaid internships has caused concern about access to some professions, and raised questions about minimum wage compliance. Finally, we look at apprenticeships including the level of the Apprentice Rate and the associated arrangements that were introduced on 1 October 2010.

Young People

3.4 Analysis for our 2010 Report showed that the employment prospects for younger workers had been deteriorating over a number of years. This decline accelerated in the recession, with greater falls in employment rates and increases in unemployment rates for young people than for older workers. There was also evidence that employers were making greater use of youth minimum wage rates for those aged under 21 and more young people than ever were falling within the coverage of the minimum wage. We judged it appropriate, therefore, to recommend that the youth rates rise by slightly less than the adult rate in October 2010.

The evidence, however, continued to support our long-standing view that 21 year olds should be entitled to the adult rate, so we also reiterated this recommendation.

3.5 This section reviews the latest evidence on young people. We first discuss the youth rates of the minimum wage before looking at the economic position of young people and investigating how they have coped since the recession ended. In doing so we consider, in particular, the role of education and employment and how this may have affected unemployment. Further, we examine the group of young people who are not in education, employment or training (NEET) and their characteristics. We then analyse the earnings of those who have managed to find or retain jobs and investigate whether the impact of the minimum wage on earnings has increased. Finally, we review the latest evidence concerning the decision to pay the adult minimum wage rate at age 21 rather than 22.

Youth Rates

3.6 There are currently two minimum wage youth rates: the Youth Development Rate and the 16–17 Year Old Rate. The former was introduced in April 1999 at £3.00 an hour and originally covered 18–21 year olds. It has risen since then roughly in line with the adult rate. On 1 October 2010, the adult rate was extended to 21 year olds and the Youth Development Rate (18–20 year olds) was raised to £4.92, approximately 83 per cent of the adult rate. The 16–17 Year Old Rate was introduced in October 2004 at £3.00 an hour. It has risen broadly in line with the other two rates. Since 1 October 2010, the 16–17 Year Old Rate has been £3.64 an hour, which is around 61 per cent of the adult rate.

3.7 When commenting on youth rates, respondents to our consultation fell into two groups: those who supported separate, lower youth rates and those who opposed them. Many of the stakeholders in favour were from sectors that believed employers needed an incentive, such as a lower minimum wage, to recruit young workers. The CBI summed the argument up succinctly: it said that young people's employment was wage sensitive and so retaining the youth rates was crucial to ensuring young people's labour market participation. Responses from the Association of Licensed Multiple Retailers (ALMR), National Hairdressers' Federation (NHF) and the British Hospitality Association (BHA), British Beer and Pub Association (BBPA) and Business In Sport and Leisure (BISL) reported that young people required expensive additional training to get them ready for work. The Chartered Institute of Personnel and Development (CIPD) thought that young people were better off in lower-paid jobs than on welfare.

3.8 As in previous years, some of those responding to the consultation argued that the youth rates were inherently discriminatory on grounds of age. The British Youth Council, Children's Rights Alliance for England, YWCA and Save the Children all argued that many young workers carried out the same work as adults, had the same responsibilities, paid the same prices for goods and housing costs, and were financially independent. It followed that they should be paid an equal wage. Most unions were also opposed to the youth rates on equality grounds.

3.9 In order to better understand the impact of minimum wages on young people, we commissioned a literature survey of the international evidence in this area. In the survey, Croucher and White (2011) concluded overall that any negative employment effect of minimum wages on young people was small. They found some evidence that increases in minimum wage rates for 16–17 year olds affected employment, but this effect tended to disappear with age. The evidence suggested that minimum wages were more likely to have a negative effect on the youth labour market where there were no separate rates for younger workers. Further, the impact could be positive if youth rates were set at an appropriate level, and any adverse effect could disappear or become less negative if there were strong labour market interventions by governments to support employment for young workers.

3.10 This evidence confirms previous international research findings that influenced the original decision to incorporate youth rates into the UK National Minimum Wage system. Youth rates are there to protect young people and we are in no doubt that the youth rates of the National Minimum Wage are legal under UK law. An exemption within the Employment Equality (Age) Regulations 2006 (Department of Trade and Industry, 2006) permits employers to base their pay structures on the three National Minimum Wage rates. The Commission and the Government believe that the exemption can be objectively justified on the grounds that it supports a legitimate employment policy aim: that of avoiding damage to youth employment.

Economic Position

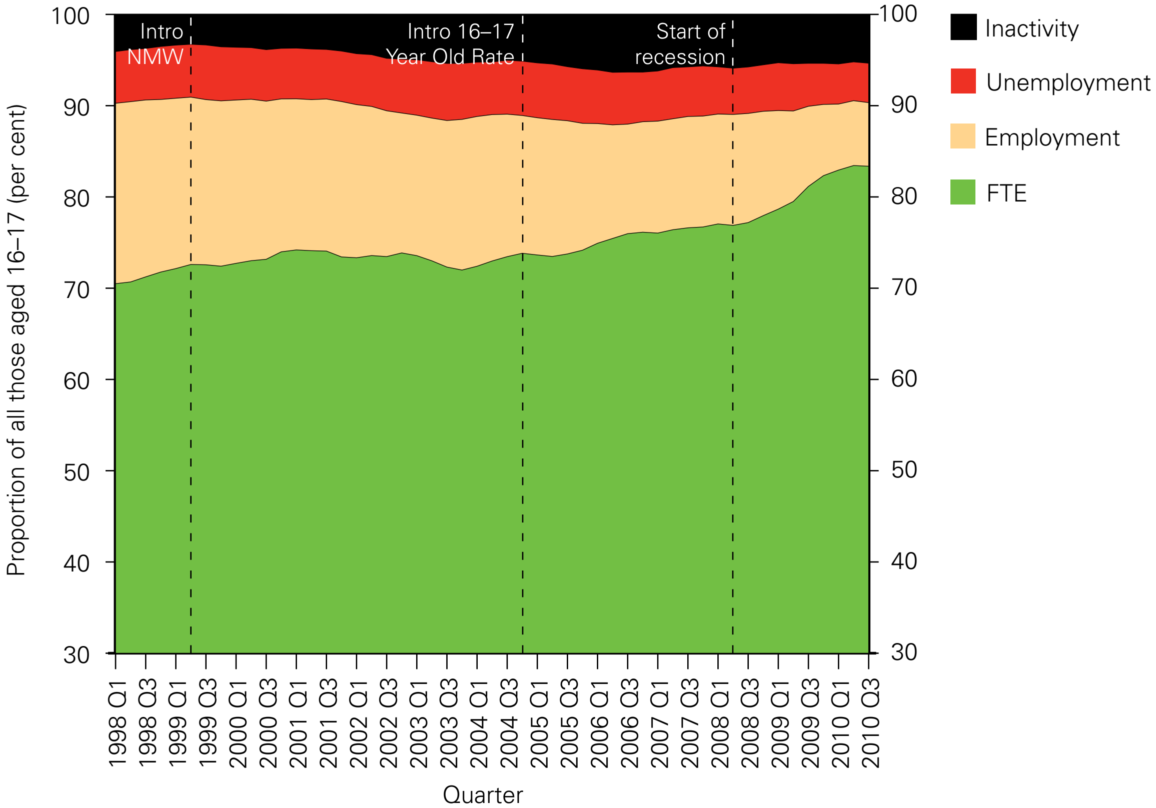
3.11 Young people are usually among the hardest hit during a recession as firms stop hiring and make their least-skilled and least-experienced staff redundant. This was particularly apparent during the 2008–2009 recession. Research we commissioned for this report using cross-national data by Dolton and Rosazza Bondibene (2011) found some evidence of a negative impact of minimum wages on employment for young people aged 15–24. It found that this detrimental impact was exacerbated in the presence of an economic downturn. Similarly, another research project we commissioned by Fidrmuc and Tena Horrillo (2011) found some evidence of a negative effect on employment for 18–40 year olds, which became stronger when labour market conditions tightened. However, these negative effects were cancelled out by an increased likelihood of moving back into work from unemployment or inactivity. Also, when the group was split further, the results were not significant for those aged 18–24.

3.12 In responses to our consultation, many stakeholders referred to the difficult labour market conditions for young people resulting from the recession. NHF reported that there had been more redundancies for junior stylists. BHA, BBPA and BISL said that there was more choice as to who to take on and that some young people were looking for more permanent roles. However, in a survey of its members, BHA found no significant evidence of young people being squeezed out of the hospitality labour market.

3.13 There has been wide publicity around the deteriorating labour market prospects of young people since the start of the recession. This needs to be put into context over the longer term, however, as trends in other activities, such as participation in full-time education (FTE), also need to be considered to provide a full and balanced overview.

3.14 With this in mind, Figure 3.1 illustrates the economic activities of 16–17 year olds since 1998. It shows that around a tenth were either economically inactive or unemployed in the first quarter of 1998. This had changed little by the third quarter of 2010. The most noticeable change has been the increase in participation in full-time education, which picked up in 2004 when the Education Maintenance Allowance was introduced and then again during the recession. As a consequence, the proportion of 16–17 year olds in employment (but not in FTE) has been squeezed. It fell from around a fifth in 1998 to less than a tenth during the recession. The ILO unemployment rate[7] for those not in FTE has, therefore, increased because of the fall in employment (and the increase in education participation), despite no increase in the size of the group that is unemployed.

Figure 3.1: Economic Activity of 16–17 Year Olds, UK, 1998–2010



Source: LPC estimates based on LFS Microdata, quarterly, four-quarter moving average, UK, Q2 1997–Q3 2010.
Note: This figure shows proportions. These are different to rates. ILO unemployment rates are defined as the unemployed as a percentage of the economically active (those employed and unemployed) and exclude the inactive.

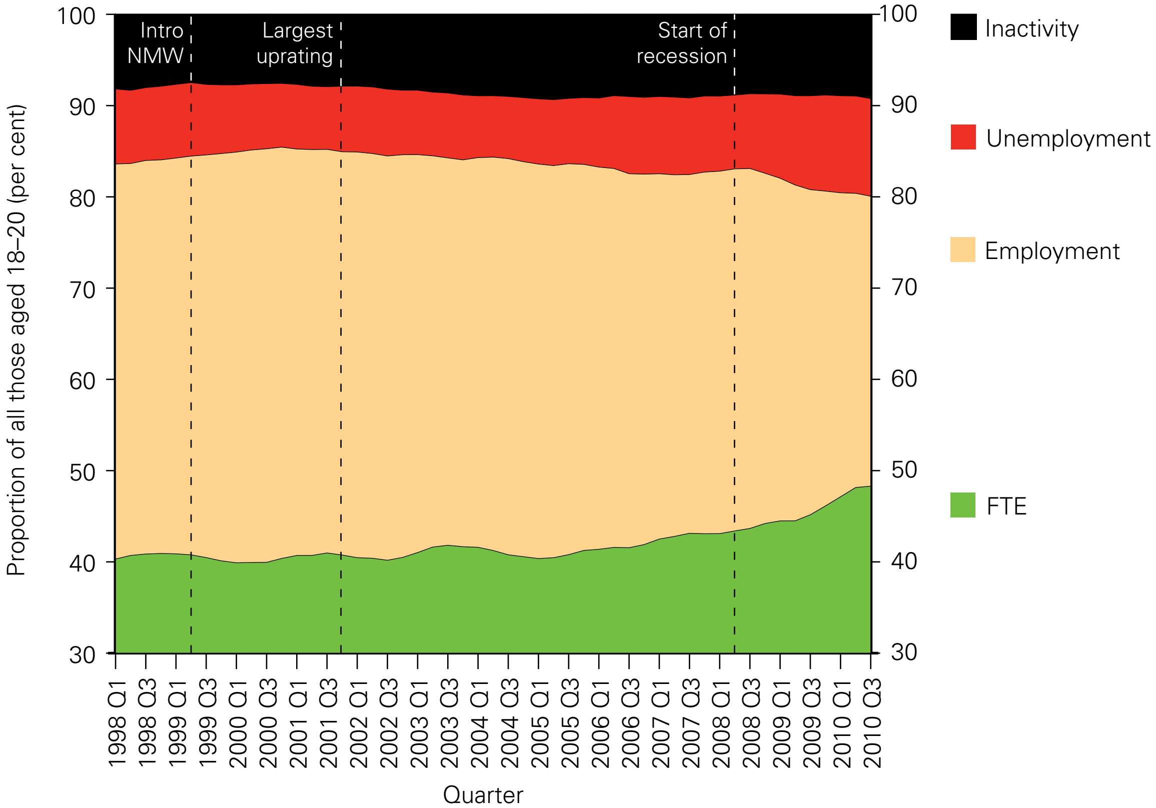
3.15 Figure 3.2 shows that the trend since 1998 in FTE participation for 18–20 year olds follows a similar trajectory to that of 16–17 year olds, but the increase is smaller. However, unlike 16–17 year olds, since the recession began there has been a clear increase in the size of the group that is unemployed. Thus two factors have contributed to an increase in the ILO unemployment rate for 18–20 year olds not in FTE. The first is the fall in employment (as they moved into education) and the second is the increase in unemployment.

"Although participation [in full-time education for 16–17 year olds] has been increasing steadily as part of a long-term trend, part of the recent increase is likely to reflect the tighter labour market. For those who wish to enter the labour market, employment is harder to come by."

Government economic evidence

7 The ILO unemployment rate is calculated as the number unemployed as a percentage of the number economically active (those employed and unemployed) only.

Figure 3.2: Economic Activity of 18–20 Year Olds, UK, 1998–2010

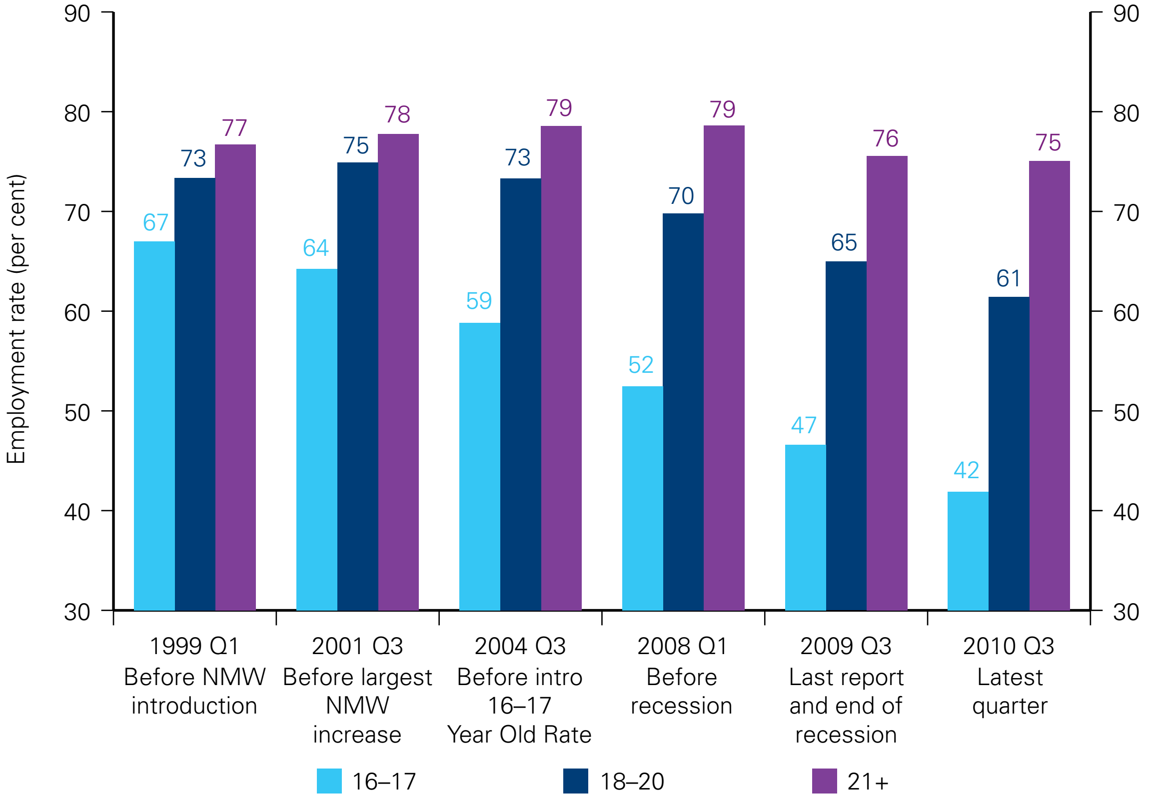


Source: LPC estimates based on LFS Microdata, quarterly, four-quarter moving average, UK, Q2 1997–Q3 2010.
Note: This figure shows proportions. These are different to rates. ILO unemployment rates are defined as the unemployed as a percentage of the economically active (those employed and unemployed) and exclude the inactive.

3.16 In research we commissioned, Lanot and Sousounis (2011) analysed the impact of the National Minimum Wage on education enrolment, educational achievement, apprenticeships and training. They found that the minimum wage did not significantly affect school enrolment or educational achievement, but it did have a small positive effect on further and higher education enrolment, a negative effect on the completion of apprenticeships relative to other qualifications (by age 23), and a negative effect on the proportion of young workers receiving training. It should be noted that the research was conducted before the introduction of the Apprentice Rate. The findings on the impact of the local unemployment rate were similar to those on the minimum wage, suggesting that a recession exacerbates those effects.

3.17 Having previously shown that the increased tendency for young people to remain in FTE has reduced employment, Figure 3.3 illustrates how employment rates for those not in FTE have changed since the first quarter of 1999 (before the introduction of the minimum wage). The employment rate for 16–17 year olds not in FTE had started to decline at the end of the 1990s, well before the introduction of the minimum wage for this group in October 2004. The Government noted in its submission that there was no evidence that the minimum wage had adversely affected employment for 16–17 year olds. The employment rate for 18–20 year olds not in FTE began to decline slightly later. More recently, the recession saw falls in employment for all three age groups, albeit larger falls for the youngest. However, while employment has been fairly stable for those aged 21 and above not in FTE since the end of the recession (third quarter of 2009), it has continued to fall for young people. The ILO unemployment rates of those not in FTE show a similar pattern, with the position of young people continuing to deteriorate after the end of the recession while that of adults stabilised. But we explained above that these rates reflect the increased propensity to stay on in education and thus do not provide a full picture of what is really happening.

Figure 3.3: Employment Rates of Those Not in Full-time Education, by Age, UK, 1999–2010



Source: LPC estimates based on LFS Microdata, quarterly, four-quarter moving average, UK, Q2 1998–Q3 2010.

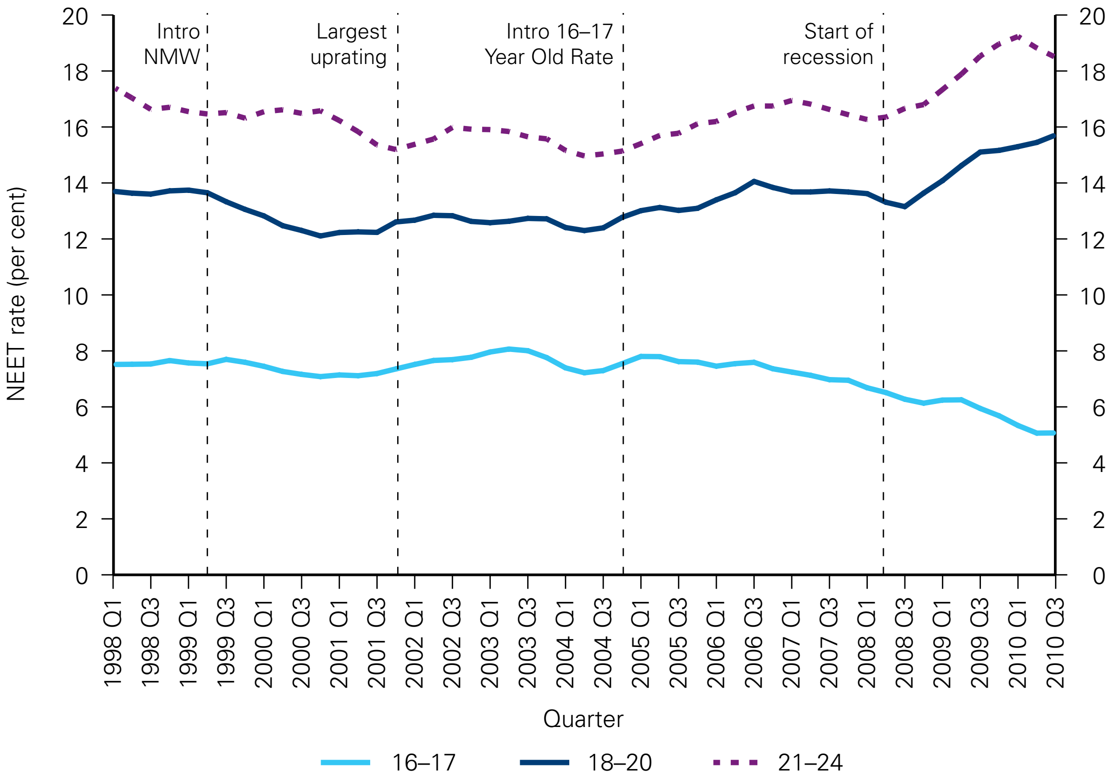
3.18 To supplement our analysis of young people's employment, we now look over time at the proportion that are not in education, employment or training (NEET). This provides another measure of young people who are faring poorly in the labour market. We use the Labour Force Survey (LFS) to define NEETs as those who are unemployed or inactive but are not: students, on a course, working towards a qualification, or apprentices.

3.19 During a recession, you might expect the proportion of young people who are NEET to increase. Figure 3.4 shows that this was the case for 18–20 year olds, as their NEET rate increased reflecting the increase in the proportion unemployed shown in Figure 3.2. However, this was not the case for 16–17 year olds. The NEET rate for 16–17 year olds has been falling since the beginning of 2005, due to the large increase in full-time education participation (as shown in Figure 3.1) and an increase in the numbers on part-time courses (not shown).

"We remain concerned about young people aged 16–18 who are not in employment, education or training.... Maintaining an effective minimum wage for young workers is a necessary condition for encouraging them to take up employment."

Trades Union Congress (TUC) evidence

Figure 3.4: NEET Rates, by Age, UK, 1998–2010



Source: LPC estimates based on LFS Microdata, quarterly, four-quarter moving average, UK, Q2 1997–Q3 2010.

3.20 The NEET group is not homogenous; it contains people with diverse characteristics. From LFS data we can identify a number of barriers, or reasons for being inactive, including looking after family and being too sick or disabled to work. In terms of the impact of the minimum wage on the NEET group, we are most concerned to understand the effect on those young people who are not in education, work or training and who have no identifiable barrier to economic activity.

3.21 Figure 3.5 breaks down 16–20 year olds NEETs into three groups. The first group are unemployed,[8] the second group contains those who are inactive but have an identifiable barrier to participation, and the third group are inactive but do not appear to have an identifiable barrier. Since the introduction of the minimum wage, around 10–12 per cent of 16–20 year olds (350,000–450,000) have been NEET and over half of these have been unemployed. The size of this unemployed group has varied over time, most noticeably increasing following the onset of recession. The unemployed NEETs are among those who we consider most likely to be affected by the minimum wage.

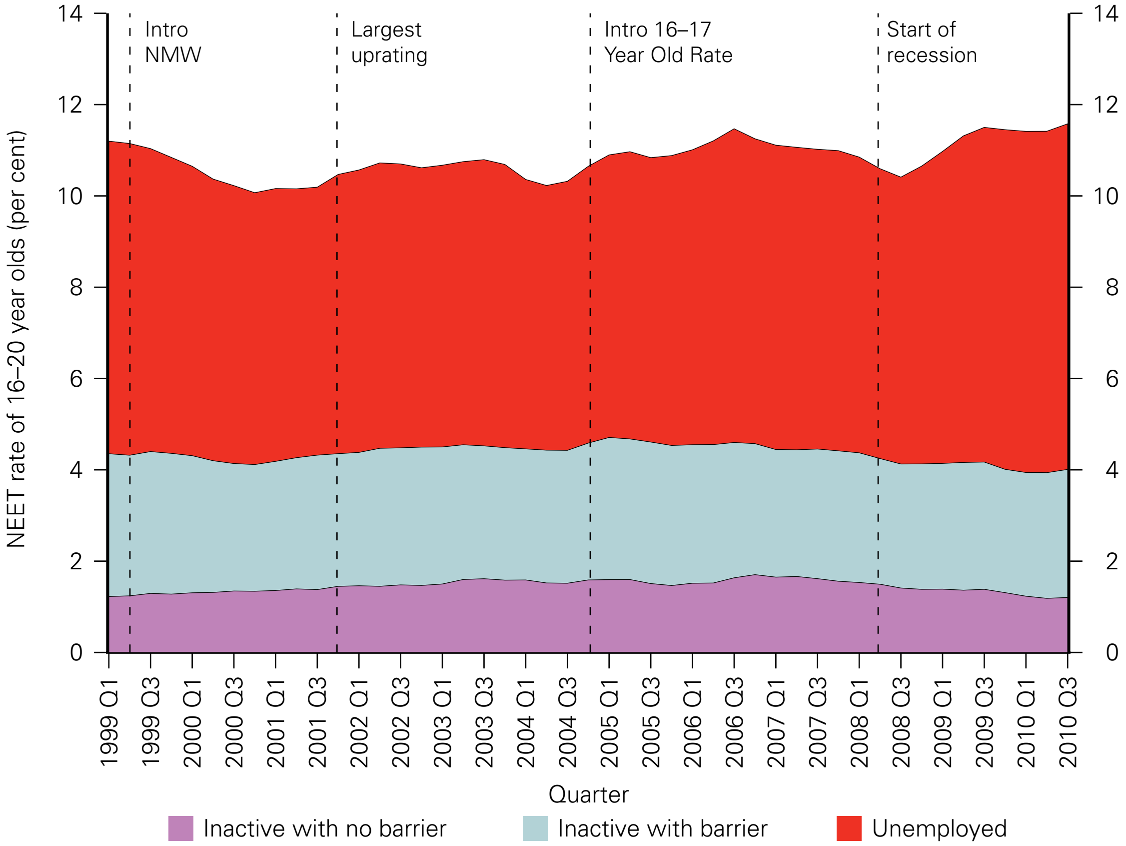
3.22 The second and third groups (inactive with and without an identifiable barrier to participation) have accounted for less than half of all 16–20 year old NEETs since the introduction of the minimum wage and there has been little variation in the size of these groups over the period. The minimum wage may play a less important role than other factors in influencing the decisions of inactive NEETs with an identifiable barrier to economic activity (110,000 or 2.8 per cent of 16–20 year olds in the third quarter of 2010). Other more influential factors are likely to include the availability and cost of support systems, such as childcare. Inactive

8 For the purpose of this analysis, we have defined unemployed NEETs as both those who are seeking work and available to start (ILO unemployed) and those who are seeking work but unavailable to start.

NEETs with no identifiable barrier to economic activity make up the smallest yet most hard-to-reach group (47,000 or 1.2 per cent of 16–20 year olds in the third quarter of 2010).

3.23 In summary, the only NEET group that has increased in size since the start of the recession are those we categorise as unemployed. Even then, the proportion is similar to what it was in the first quarter of 1999. The other NEET groups have been largely unaffected by the business cycle and over time their sizes have remained similar to the proportions observed in 1999.

Figure 3.5: NEET Rate of 16–20 Year Olds, by Group, UK, 1999–2010



Source: LPC estimates based on LFS Microdata, quarterly, four-quarter moving average, UK, Q2 1998–Q3 2010.
Note: For the purpose of this analysis, we have defined unemployed NEETs as both those who are seeking work and available to start (ILO unemployed) and those who are seeking work but unavailable to start.

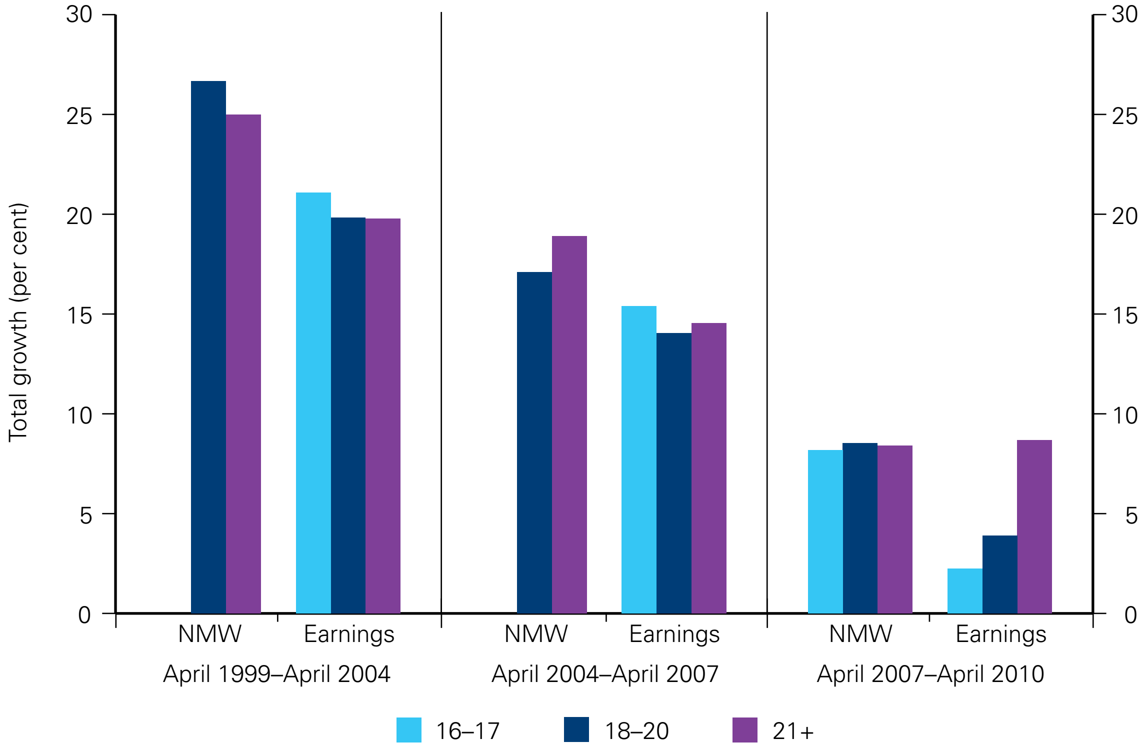
3.24 Our analysis of the economic position of young people has found that they continue to fare badly and this has been exacerbated by the recession. Some young people have managed to mitigate the recessionary impact by staying in education, but it is unclear how they will fare competing for jobs in the future against older workers. As well as having an impact on employment, the recession has also affected earnings. We go on to investigate this impact for those young people who have managed to find work and assess whether the minimum wage is still having a significant influence on their pay.

Earnings

3.25 Young people often lack experience in the workplace and are therefore likely to earn less than older workers and to work in low-paying sectors. This can be clearly observed in the latest Annual Survey of Hours and Earnings (ASHE) data that relate to April 2010. These data reflect the October 2009 minimum wage upratings which increased the 16–17 Year Old Rate and the Youth Development Rate by 1.1 and 1.3 per cent to £3.57 and £4.83 per hour respectively. These upratings were broadly in line with the increase in the adult rate, as they had been in 2007 and 2008.

3.26 Figure 3.6 shows that between the introduction of the minimum wage and April 2004, median earnings for the different age groups increased by similar amounts (around 20 per cent). There was also little difference between 2004 and 2007. As noted in Chapter 2, the adult minimum wage has increased roughly in line with average earnings since the end of 2006. Figure 3.6 illustrates that between April 2007 and April 2010 all three minimum wage rates increased by around 8.5 per cent. However, median earnings for young people increased more slowly than those for adults. Most notably, median earnings for 16–17 year olds increased by only 2.2 per cent, whereas they increased by 8.7 per cent for those aged 21 and over (and 3.9 per cent for 18–20 year olds).

Figure 3.6: Growth in the Minimum Wage and Median Earnings, by Age, UK, 1999–2010

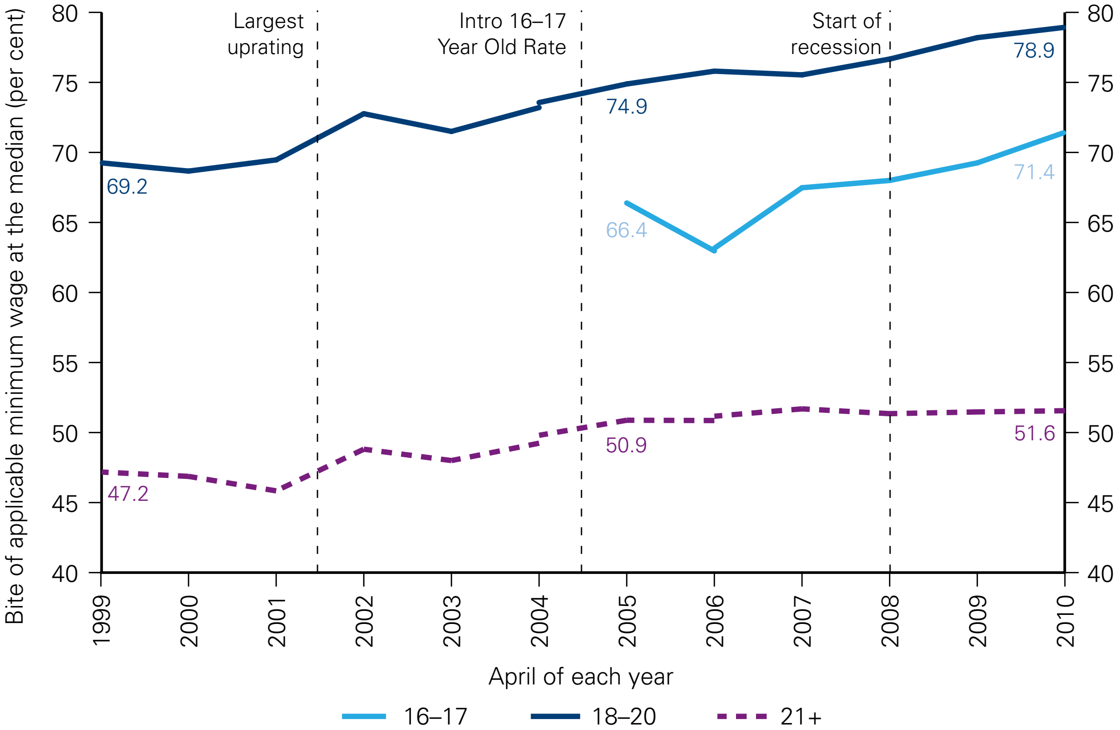


Source: LPC estimates based on ASHE without supplementary information, April 1999–2004; ASHE with supplementary information, April 2004–2006; and ASHE 2007 methodology, April 2006–2010, standard weights, including those not on adult rates of pay, UK.
Notes:

a. The 16–17 Year Old Rate was introduced on 1 October 2004 and is therefore not shown for April 2004–April 2007. Between April 2005 and April 2007 the National Minimum Wage growth for 16–17 year olds was 10.0 per cent, compared with 8.5 per cent for the Youth Development Rate and 10.3 per cent for the adult rate.
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 in the periods shown.
c. The 2004–2007 median earnings comparison is illustrative due to the change in the data series in 2006.

3.27 This downward pressure from slower growth in young people's earnings, coupled with uprating the youth rates in line with the adult rate, has meant that the bites of the youth rates (their values relative to the median) have continued to increase. Figure 3.7 illustrates this trend and shows that in April 2010, the bite of the applicable minimum wage rate was 71.4 per cent for 16–17 year olds and 78.9 per cent for 18–20 year olds. For adults aged 21 and over, the bite of the National Minimum Wage increased in the early years, but it has remained similar for the last four years at around 51.5 per cent.

Figure 3.7: Bite of the Minimum Wage at the Median, by Age, UK, 1999–2010

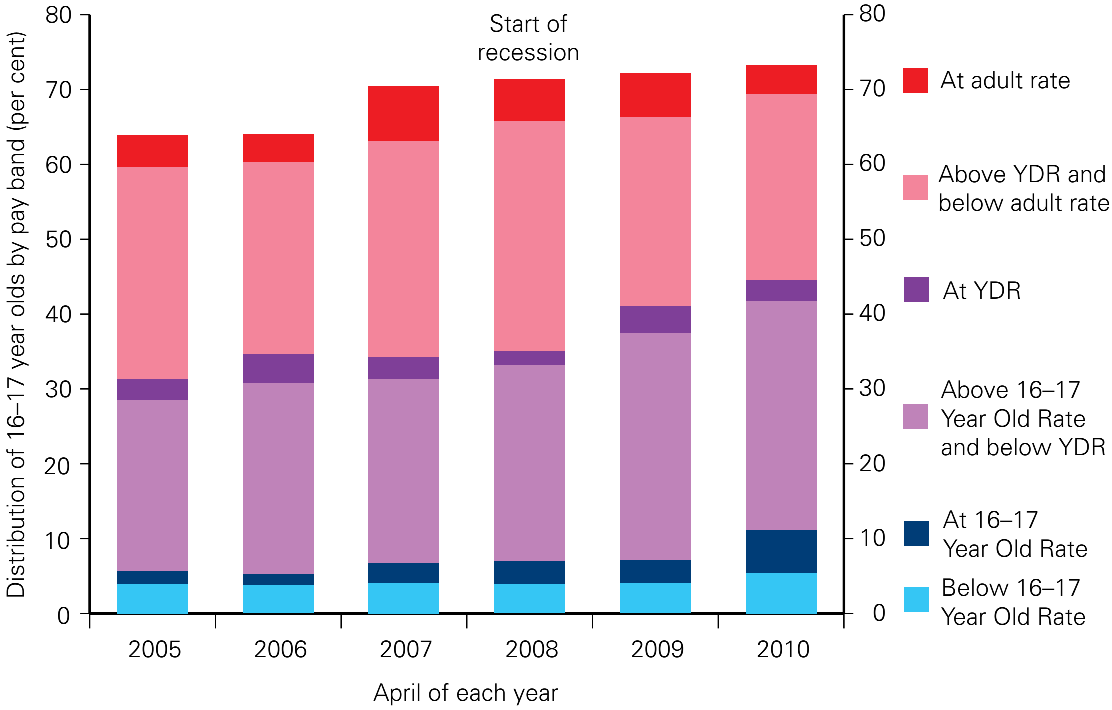


Source: LPC estimates based on ASHE without supplementary information, April 1999–2004; ASHE with supplementary information, April 2004–2006; and ASHE 2007 methodology, April 2006–2010, standard weights, including those not on adult rates of pay, UK.
Notes:
a. The median for those aged 21 and over is compared with the adult minimum wage rate, which only applied to those aged 22 and over in the period shown.
b. Direct comparisons before and after 2004, and before and after 2006, should be made with care due to changes in the data series.

3.28 When looking at the distribution of young people's earnings, ASHE data show clear spikes at the National Minimum Wage rates. Each year, these spikes move in line with the minimum wage upratings. We noted in our 2010 Report that employers had been making greater use of the youth rates. The April 2010 data show that this trend has continued, with the proportion of 16–17 year olds paid at the 16–17 Year Old Rate increasing from 3.1 to 5.7 per cent. This was the largest annual increase since the rate's introduction. In April 2010, the proportion of 18–20 year olds paid at the Youth Development Rate increased from 6.0 to 7.3 per cent.

3.29 As well as making more use of the specific minimum wage rates, employers are increasingly paying 16–17 year olds below the Youth Development Rate. Figure 3.8 shows that the proportion of jobs held by 16–17 year olds that paid below the Youth Development Rate rose to 42 per cent in April 2010. The equivalent figure was just 31 per cent before the start of the recession. Figure 3.8 also shows an increase in the proportion paid below the 16–17 Year Old Rate in April 2010 (up 1.4 percentage points on the previous year to 5.4 per cent). This is likely to be linked with the increase in the number of apprentices, which is covered later in the chapter.

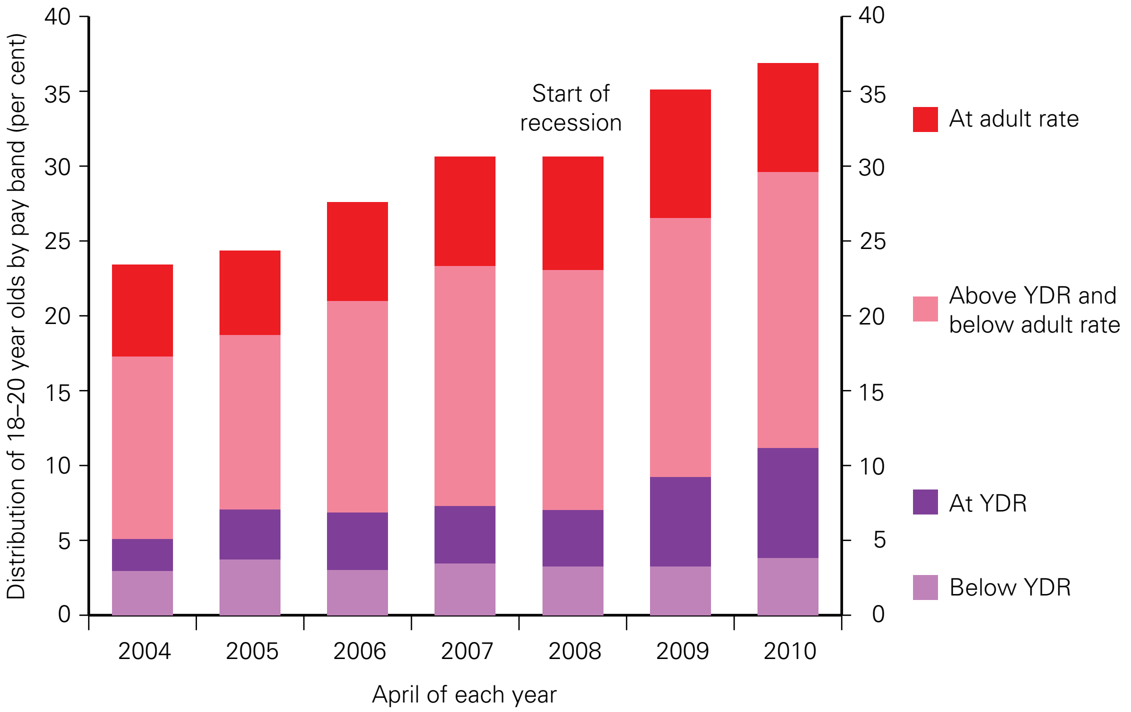
Figure 3.8: Proportion of Jobs Held by 16–17 Year Olds, by National Minimum Wage Rate, UK, 2005–2010



Source: LPC estimates based on ASHE with supplementary information, April 2005; and ASHE 2007 methodology, April 2006–2010, standard weights, including those not on adult rates of pay, UK.
Note: Direct comparisons before and after 2006 should be made with care due to changes in the data series.

3.30 As well as the increased chance of being paid the Youth Development Rate, workers aged 18–20 are more likely to have been paid below the adult rate in recent years. Figure 3.9 shows that the proportion of jobs held by 18–20 year olds paid below the adult rate rose to nearly 30 per cent in April 2010 (from around 17 per cent in April 2004). The chart also shows that the proportion paid at or below the Youth Development Rate more than doubled from 5.1 per cent in April 2004 to 11.2 per cent in April 2010.

Figure 3.9: Proportion of Jobs Held by 18–20 Year Olds, by National Minimum Wage Rate, UK, 2004–2010



Source: LPC estimates based on ASHE with supplementary information, April 2004–2005; and ASHE 2007 methodology, April 2006–2010, standard weights, including those not on adult rates of pay, UK.
Note: Direct comparisons before and after 2006 should be made with care due to changes in the data series.

3.31 In October 2010, the 16–17 Year Old Rate and Youth Development Rate increased by 2.0 and 1.9 per cent to £3.64 and £4.92 per hour respectively. As explained at the start of the chapter, these were marginally lower upratings than the 2.2 per cent increase in the adult rate. In our 2010 Report we anticipated that 6.7 per cent (23,000) of 16–17 year olds and 7.7 per cent (91,000) of 18–20 year olds would be covered by these recommended increases. However, based on April 2010 data, we now believe that more young people were covered. Our current estimates are that just over 10 per cent of 16–17 year olds (29,000) and 18–20 year olds (119,000) were covered by their respective October 2010 upratings. Our estimation method assumes that young people's earnings increased in line with whole economy average earnings between April 2010 and October 2010. If they increased more slowly, as they have done since 2007, the coverage would have been higher.

3.32 For this report, we commissioned research to investigate the relationship between productivity, earnings and age, focusing on the early years of work. Dickerson and McIntosh (2011) found that the youngest workers had lower productivity and lower earnings. They found that median earnings increased by around 40 pence per hour per year as young workers aged from 16 to 28, but that this profile was not affected by the introduction of the National Minimum Wage. A similar age profile was identified for productivity. They also found that the negative gap in productivity between young and older workers was larger than the wage gap. This suggested that young workers were overpaid relative to their productivity. But, since the introduction of the minimum wage in 1999, there was some evidence that the productivity gap had narrowed. This research covered the period up to 2007 and, as we have already shown, growth in young people's earnings only began to slow from that time onwards.

3.33 The evidence on earnings suggests that the trends presented in last year's report have continued. Lower earnings growth for young workers has led to further increases in the bites of the youth rates, even though increases in the minimum wage rates were smaller than in previous years. We have also seen an increasing proportion of young people being paid at their applicable minimum wage rates and employers have continued to make greater use of their ability to pay below the adult rate. The proportion of 16–17 year olds paid at least the adult rate has decreased from 40 per cent in 2005 to around 30 per cent in 2010. Over the same period, the proportion of 18–20 year olds paid at least the adult rate has decreased from over 80 per cent to 70 per cent. We now turn to look at the latest evidence concerning our repeated recommendation to pay the adult minimum wage rate at age 21 rather than 22.

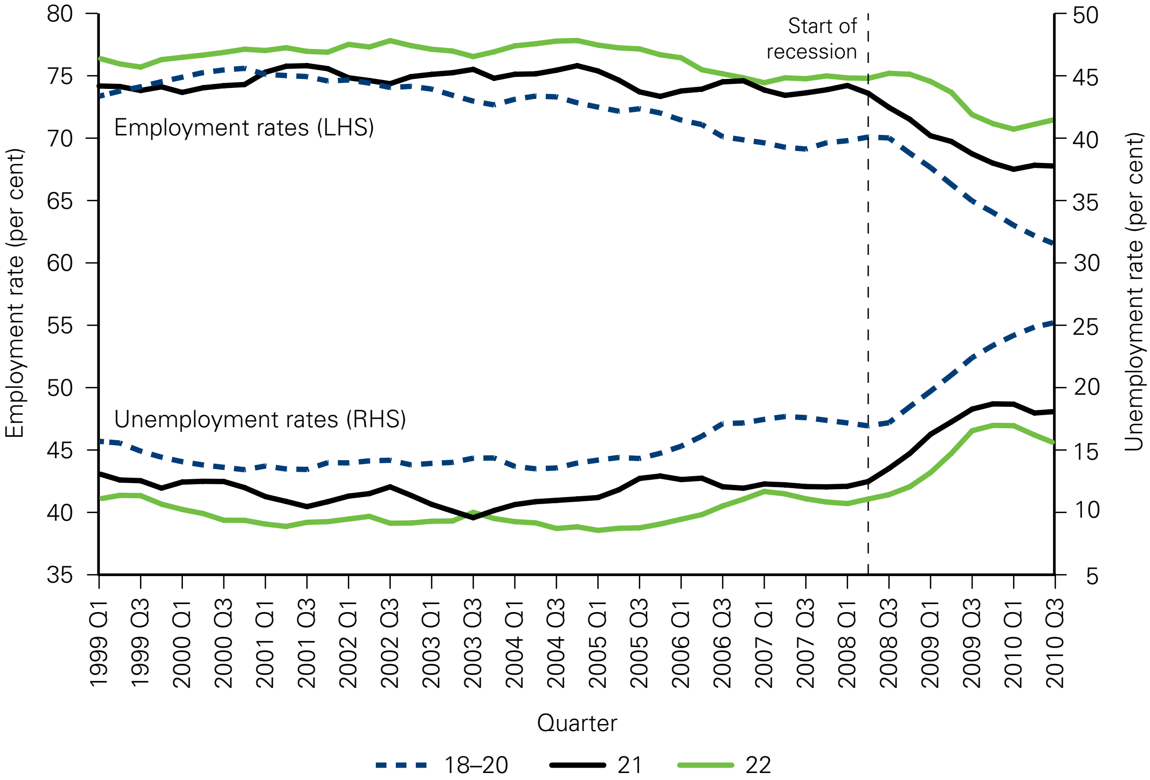
21 Year Olds

3.34 In June, the Coalition Government accepted our recommendation for 21 year olds to be entitled to the adult minimum wage rate. The change took effect on 1 October 2010, with the adult rate increasing to £5.93 per hour, an effective increase of 23 per cent in the minimum wage entitlement of 21 year olds. As it is too early to make an assessment of the effect of the change, we offer here a brief update of the evidence upon which we based our recommendation.

3.35 The latest evidence from the April 2010 earnings data continues to offer strong support for 21 year olds receiving the adult rate. First, earnings at the median and lowest decile for 21 year olds were closer to those of 22 year olds than those of 20 year olds. Second, most 21 year olds were already being paid at or above the adult rate. According to ASHE, 87 per cent of 21 year olds were in jobs that paid at or above the adult rate in April 2010, greater than the proportions for younger ages. Only 61,000 21 year olds were paid below the adult rate. Further, the majority of these workers were in large firms in the retail and hospitality sectors or in sectors that were not generally low-paying. As such, we believe that the businesses affected should be able to absorb the additional costs imposed by this change.

3.36 Turning to their labour market position, in the 2010 Report we noted that the employment and unemployment rates of 21 and 22 year olds had been closely aligned before the recession began. Although most age groups experienced deteriorating prospects throughout the recession, there have now been signs of recovery for some groups. Figure 3.10 shows that the employment and unemployment rates of 21 year olds not in FTE look to have levelled off in the latest quarters of 2010, in line with those of 22 year olds. In comparison, the employment and unemployment rates for 18–20 year olds not in FTE have continued to deteriorate. In its evidence, the Government said that the most recent data supported the view that the labour market performance of 21 year olds more closely resembled that of older workers than that of younger workers.

Figure 3.10: Employment and Unemployment Rates of 18–22 Year Olds Not in Full-time Education, UK, 1999–2010



Source: LPC estimates based on LFS Microdata, quarterly, four-quarter moving average, UK, Q2 1998–Q3 2010.

3.37 In research for our 2010 Report, Dickens, Riley and Wilkinson (2010) found that, despite a potentially large increase in hourly pay, a low-skilled individual's probability of employment increased at age 22. They found no such effects at any other age. The research suggested that lowering the starting age of the adult rate to 21 might actually increase employment of 21 year olds. In contrast, research for this year's report by Fidrmuc and Tena Horrillo (2011), using a different method, found no significant employment effect of turning 22 for either skilled or unskilled workers. Instead, they found some evidence of a decreased probability of employment at age 21 for all male workers, which they attributed to employers anticipating the additional wage cost at age 22.

3.38 There was little reference to the change for 21 year olds in responses to our consultation. BHA, BBPA and BISL said that most employers in the hospitality sector were content to pay the adult rate to 21 year olds. In written evidence, NHF and ALMR were the only stakeholders to predict an adverse impact of the change. NHF thought it was ill-timed, there would be a disproportionate cost in the hairdressing sector, and that employers may face penalties if they were unaware the age bands had changed. ALMR noted the additional cost and warned that further changes to the age bands could affect employment. During a visit to Ayr we met an hotelier who told us that because they had a high ratio of staff on the National Minimum Wage, any change affected a high proportion of their wage cost. The move from 22 to 21 was a further significant blow to their sector due to the age group they tended to employ. All other references were in support of the change.

3.39 We remain convinced that workers should be entitled to the adult rate from the age of 21. The evidence still supports that view but we will continue to analyse the data relating to the period after the change, monitor further research evidence, and present our findings in next year's report. We turn next to another recent development in the labour market for young people: the growth in the number of interns.

Interns

3.40 The previous section in this chapter has highlighted the fragile labour market position of young people. Even those with qualifications can find it hard to obtain employment if they do not have any work experience. Opportunities that provide the chance to gain such experience can be an important way of helping young people to get a firmer foot on the employment ladder. This year's remit asked us to include those on internships as part of our look at the labour market position of young people.

3.41 A growth in internships and other work experience opportunities has been promoted through government initiatives, such as the Graduate Talent Pool (GTP). In its evidence to us, the Government said it viewed the provision of internships as a legitimate and, for the most part, helpful addition to the youth labour market. It said that the best internships had a training element and could be an important way for young people to develop workplace skills. However, it recognised the concerns of the Commission and others about inappropriate use of unpaid internships in certain sectors, particularly entertainment. The Government told us it was considering what more could be done to tackle exploitation without damaging opportunity. It wanted to deliver effective enforcement and to ensure greater access for those from disadvantaged backgrounds. The Government said it would be particularly interested in evidence presented to us on the extent and nature of internships across the market place and the Commission's conclusions on developments in youth employment.

3.42 There is no official or agreed definition of what an internship is, and consequently no definitive data source on overall internship numbers. Getting the full picture on the incidence of these work experience activities is difficult, but there are sources of information which at least shed some light on the issue. A possible indication of trends in the supply of internships is provided by higher education leavers' destination data (Higher Education Statistics Agency, 2010). The most recent survey data (2008/09) showed a rise in the small proportion of all graduates undertaking voluntary or unpaid work six months after graduation, increasing to 1.6 per cent from 1.1 per cent the previous year. Between its inception in July 2009 and September 2010 more than 24,000 vacancies appeared on the GTP website, with nearly two-thirds paid and a third unpaid or receiving expenses only. The CIPD's Labour Market Outlook found that between April and September 2010, 21 per cent of employers planned to hire interns, up from 13 per cent of the employers surveyed in summer 2009. CIPD research has also found that 49 per cent of member employers paid their interns at least the adult minimum wage, while 18 per cent did not pay them any salary but covered their travel expenses (CIPD, 2010b).

3.43 An insight into the range of occupations in which internships are offered was provided to us through evidence submitted by Interns Anonymous, a web-based group set up to act as a forum for interns to share their experiences. It had conducted a small-scale survey of ex-interns, which received 235 responses. This found most interns surveyed were either in politics and public affairs (20 per cent); charities/non-governmental organisations (20 per cent), or arts and heritage (14 per cent). Around 50 per cent had an internship lasting 1–3 months. For the vast majority the internship did not lead to employment with that organisation (82 per cent) nor did their employer help them with their job search (83 per cent). Where the internship did not lead to a job in their chosen sector, over 40 per cent were now unemployed, and over 23 per cent working in another sector. Moreover, at least 37 per cent of respondents had undertaken 3 or more internships.

3.44 A substantial proportion of internships appear to be unpaid. We know, both from this year's evidence and from previous consultations, that these opportunities are particularly common in the cultural, media and political sectors. The circumstances in which such work experience opportunities can be legitimately unpaid is considered more closely in Chapter 4 as part of a wider review of evidence on unpaid work and the minimum wage law. However, notwithstanding the legal position, the evidence we have received suggests there are serious implications for the labour market position of young people if the incidence of unpaid work experience continues to expand.

"There is a rolling programme in the industry of people moving into and out of internships, leading to lower wages and only those able to work for free populating the sector."

National Union of Journalists oral evidence

3.45 Many submissions, including those from intern groups, highlighted the damaging impact of unpaid internships on social mobility by inhibiting labour market access for whole sections of young people. The TUC said unpaid internships disadvantaged those from poorer backgrounds, unable to afford to work for nothing. It hoped that a code of practice would eventually emerge from discussions in the Gateways to the Professions Collaborative Forum, including acceptance of the National Minimum Wage as the appropriate minimum standard. The Broadcasting Entertainment Cinematograph and Theatre Union said that while the minimum wage had been crucial in challenging the presumption of no pay, unpaid work was still widespread and its effect was discriminatory against young people from modest backgrounds who could not afford to work for no income for a year or two. Such young people were regularly lost to its sectors. It observed that access to paid work was crucial to young people and often determined whether they could be active, at all, in the labour market.

3.46 The YWCA also highlighted the argument that unpaid internships led to unequal access. This, it said, further exacerbated the skills gap as young women from lower socio-economic backgrounds were less able to take opportunities and progress beyond the lowest rung of the skills ladder than their more affluent peers. YWCA said the Panel on Fair Access to the Professions found that the less advantaged were most put off by the costs of undertaking an internship. The National Council for Work Experience told us of a growing practice of auctioning the more prestigious internships, which was contrary to efforts to open up professions and increase social mobility. Intern Aware (a campaign focusing on promoting fair access to the internship system) pointed out that the need to undertake unpaid work in order to get the experience necessary to gain entry into certain sectors led to some people being excluded. Interns Anonymous rejected calls for an intern wage set at the Apprentice Rate, as most interns were graduates with debts, doing jobs which should attract at least the adult rate of the minimum wage.

3.47 The experience of other stakeholders such as Actaeon Films, however, was that unpaid internships were not used as a substitute for entry-level jobs. In its view, internships provided a bridge between study and entry-level jobs. Individuals needed proper experience of working hours and tasks; work shadowing was of questionable value. The recent focus on the minimum wage had caused the company and others to cease offering such work placements. These had not been replaced by entry-level jobs, and the owner's experience did not support the view that unpaid internships were a barrier to social mobility.

"An internship can be an invaluable opportunity for a young person to gain workplace experience and employability skills which can assist the search for full-time employment."

CBI evidence

3.48 Opportunities which look to marry learning with workplace experience will undoubtedly continue to be an important element within the youth labour market. We have no wish to imperil such opportunities but we are concerned to ensure that minimum wage law is upheld. We consider in more detail the circumstances in which interns are entitled to be paid the National Minimum Wage in Chapter 4. We turn next in this chapter to look at a more formalised vocational training, apprenticeships, where the right to be paid a minimum wage has just been introduced.

Apprentices

3.49 In our last report, we recommended that a minimum wage for apprentices be established. Both the previous and current Governments accepted the Commission's recommendation and the Apprentice Rate was introduced on 1 October 2010. We have been asked by the Government this year to look again at apprenticeships, including the rate and its arrangements.

3.50 This section starts with a brief background to the introduction of the Apprentice Rate and then goes on to consider the latest available evidence on apprenticeships. First the current level of apprenticeship provision across the UK is considered, highlighting key changes in overall numbers and composition (particularly by sector and age) and describing how both policy developments and the recession have affected the provision of apprenticeships. The section then goes on to consider the available evidence on apprentice pay as well as stakeholder views on the new Apprentice Rate and the associated arrangements. It concludes with a summary of evidence, our views on the Apprentice Rate and wage arrangements, plus a look forward to future monitoring of the Apprentice Rate.

Background to the Apprentice Rate

3.51 Under the National Minimum Wage framework, the new Apprentice Rate applies to all employed apprentices previously exempt from the National Minimum Wage; is a single hourly rate of £2.50; and covers all hours of work and training – both on and off the job.

3.52 While the £2.50 an hour Apprentice Rate was broadly in line with the £95 Learning and Skills Council (LSC) weekly wage, existing apprentices working fewer than 38 hours a week faced a potential reduction in their weekly income. We therefore recommended protection for existing apprentices in England on government-supported schemes currently entitled to the LSC weekly wage, so that they continued to receive at least £95 per week for the remainder of their training or until they became entitled to the National Minimum Wage age rates.

Apprenticeship Volumes

3.53 Table 3.1 shows there was an overall increase in the number of apprenticeship starts across the UK in 2009/10 compared with 2008/09, although there was a fall or standstill in some constituent countries. The Government noted in its evidence that apprentice volumes in England had increased significantly in recent years. Following strong growth in 2007/08 and 2008/09 the programme had continued to expand in 2009/10. The Government also said that the fall in 16–18 year old apprenticeship starts in England in 2008/09, following a fall in employer recruitment affecting mostly young people entering the labour market, had been reversed in 2009/10. Table 3.1 shows English starts in 2009/10 up 14 per cent on the previous year. Starts for 16–18 year olds in England in 2009/10 were higher than in the previous year (up by 15 per cent) while those for 19–24 year olds rose by 30 per cent (they fell by 14 per cent for those aged 25 and above). The Government plans a continued expansion of apprenticeships over the next few years. The total apprenticeship budget in England will increase to over £1.4 billion in 2011/12, providing funding to train over 300,000 apprentices, at all ages.

3.54 The LSC weekly contractual wage for apprentices in England rose from £80 to £95 in August 2009 and applied during 2009/10. Given the substantial rise in starts during that year, the increased wage level does not appear to have had an adverse impact on overall provision.

3.55 The rise in starts in Scotland reflected an extra £16 million funding for 7,800 additional places in 2009/10, as well as financial incentives to retain or take on apprentices who might otherwise have been made redundant/unemployed. In Northern Ireland the level of starts has been broadly maintained. The administration introduced programme-led (non-employed) apprenticeships in September 2009 in order to ensure that an apprenticeship route remained available to those unable to immediately obtain an employed place during the economic downturn, particularly 16–17 year olds. Wales, however, experienced a fall of nearly 8 per cent in apprenticeship starts during 2009/10 compared with the previous year. Most of this reduction is probably explained by a 5 per cent reduction in the total apprenticeship budget combined with a 3 per cent increase in the rate paid to training providers, although economic conditions may also have played a role.

Table 3.1: Number of Apprenticeship Starts, by Country, 2003/04–2009/10[a]

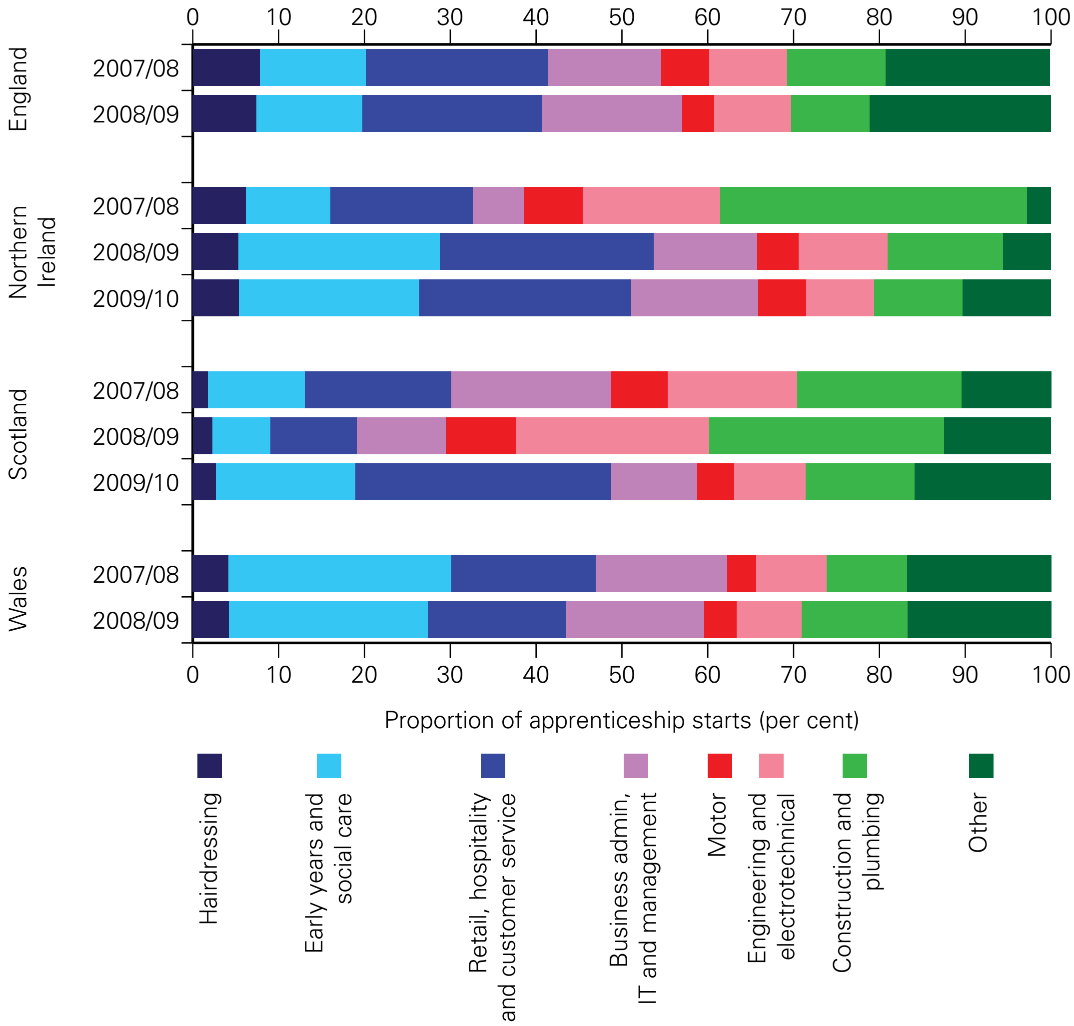
Thousands	UK	England[b]	Northern Ireland[c]	Scotland[d]	Wales
2003/04		193.6	3.5		
2004/05		189.0	3.4		24.6
2005/06		175.0	3.3		28.1
2006/07		184.4	3.3		19.6
2007/08	266.6	224.8	5.5	14.7	21.6
2008/09	275.7	239.8	7.1	10.6	18.1
2009/10	316.3	272.4	7.0	20.2	16.7

Source: UK administrations, 2003–2010.
Notes:
a. England and Wales figures are for the academic year; Northern Ireland and Scotland figures are for the financial year. No earlier years were available for Scotland and Wales.
b. Data as at 16 November 2010. Excludes the small number of Level 4 apprenticeship starts in 2008/09 and 2009/10.
c. In Northern Ireland, Apprenticeships NI replaced Modern Apprenticeships in September 2007; hence the figures from 2007/08 are the sum of these two schemes.
d. Figures for Scotland are only available for Modern Apprenticeships, which will not include all those at Level 2.

3.56 While overall apprentice numbers have continued to grow, it appears that the recession did affect the sectoral pattern of apprenticeship provision. In its evidence to us the Government drew attention to reduced provision in traditional craft occupations in England. There had been increases in apprentice opportunities in other sectors, such as in administrative, care and services frameworks. The Government, however, was concerned at the large reductions in apprenticeship places in 2009/10, particularly among young people, in areas which were important to developing the technician skills base, such as construction, engineering and electrotechnical.

3.57 Figure 3.11 provides some evidence that reveals the impact of the recession on the sectoral distribution of apprentice starts, although government apprenticeship policy and funding arrangements probably also played a role. In England, a small reduction in the proportion of apprenticeships in construction and the motor trade can be seen in 2008/09, around the time of the early stages of the recession. There was some growth for business administration. In Northern Ireland the large fall in the proportion of starts in construction and engineering after 2007/08, accompanied by a substantial rise in the proportion in early years and social care, retail and hospitality, and business administration, was probably due in large part to a combination of the recession and the introduction of Level 2 apprenticeships from 2007/08. In Scotland a combination of the recession and the introduction of Level 2 apprenticeships in 2009/10 probably accounted for the falls in the proportion of apprenticeships in the traditional, higher-paying sectors (such as construction, engineering and motor) and the rise in the proportion of starts in lower-paying sectors (particularly early years and social care, and retail and hospitality). In Wales, while 2009/10 sector data are not yet available, traditional sectors appeared to hold up well in 2008/09, with a slight fall in the proportion of starts in early years and social care. As we noted in our last report, the Welsh Assembly Government has operated the 'ReAct' and 'ProAct' programmes, giving wage and training subsidies to employers to retain apprentices and take on redundant workers.

Figure 3.11: Distribution of Apprenticeship Starts, by Country and Sector, 2007/08–2009/10



Source: UK administrations, 2007–2010.

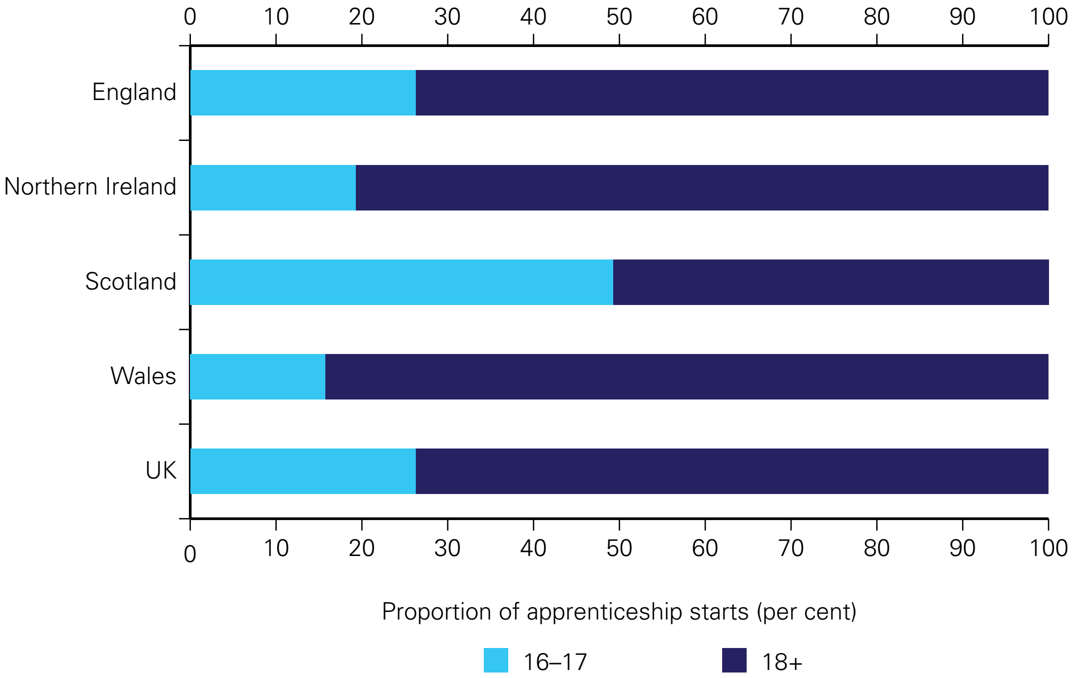
Notes:

a. England and Wales figures are for the academic year; Scotland and Northern Ireland figures are for the financial year. No later years were available in England and Wales.

b. Some definitions for sectors differ, but we have used the closest matches possible and grouped them together where necessary.

3.58 Apprenticeships remain an important route into the workplace for young people, particularly the youngest age group. Figure 3.12 shows that around a quarter of UK apprenticeship starts in 2008/09 were taken up by 16–17 year olds. The proportion of starts aged 16–17 varied across the UK nations, from under one fifth in Wales and Northern Ireland to just under a half in Scotland.

Figure 3.12: Distribution of Apprenticeship Starts, by Country and Age, 2008/09



Source: UK administrations, 2008/09.
Notes:
a. England and Wales figures are for the academic year; Northern Ireland and Scotland figures are for the financial year.
b. No other age breakdown is available for all nations.

3.59 The latest data for England, which cover around 85 per cent of all UK apprentice starts, showed that in 2009/10 three-quarters of 16–18 year olds who started an apprenticeship were on Level 2 schemes. The next section looks at apprentice pay and how this varies by age, level and year of study.

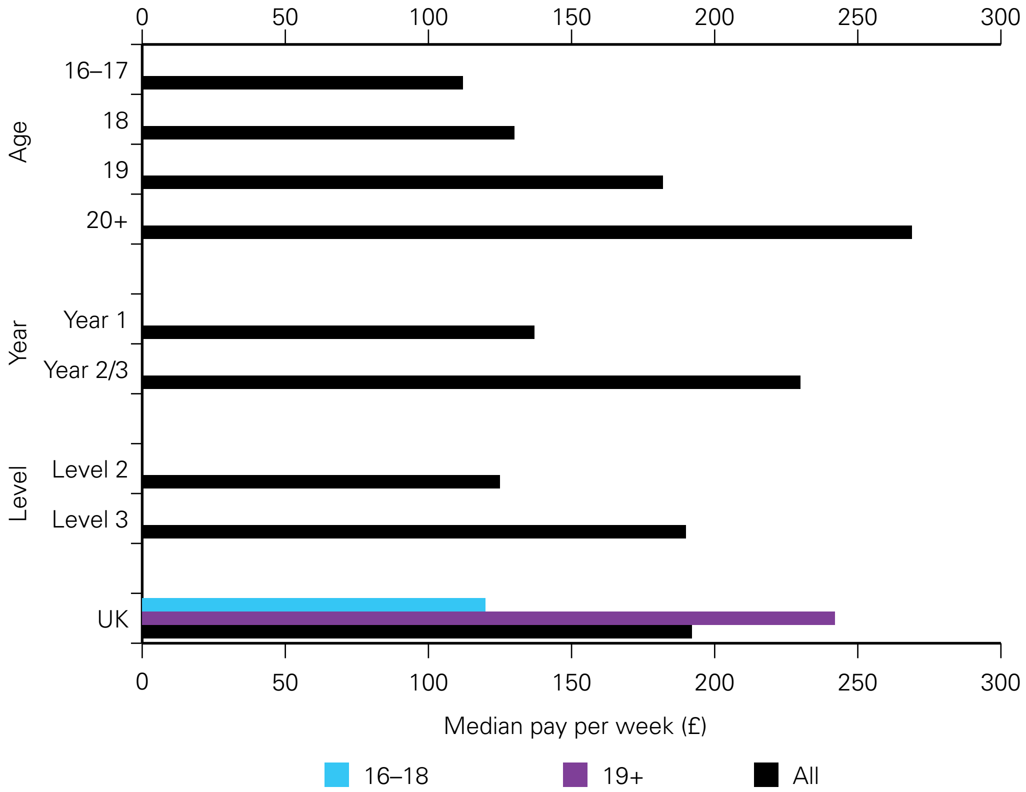
Apprentice Pay

3.60 We have noted in recent reports that the evidence base on pay, in particular wage data spanning each of the four UK countries, is inadequate. We wrote to the four UK administrations in September 2009 highlighting this problem and urging the collection of better apprentice pay data, preferably on a UK-wide basis. We are pleased to say that, in response, the Government is now commissioning a UK-wide survey for 2011. The data from that survey should be available for our 2012 Report.

3.61 For this report, however, the key data sources on apprentice pay remain the LFS and the 2007 survey of apprentice pay in England (Fong and Phelps, 2008), commissioned by the then Department for Innovation, Universities and Skills (DIUS). The latter was a particularly useful source in our 2009 and 2010 Reports, but is now dated. While the LFS is a more timely data source than the DIUS survey it has severe limitations, particularly in terms of sample sizes and proxy responses.

3.62 Figure 3.13 uses LFS data to show how median apprentice weekly pay varied in the 2009/10 minimum wage year. It was higher for older apprentices, those on Level 3 rather than Level 2 apprenticeships, and those in the second and third years of their training.

Figure 3.13: Median Weekly Pay for Apprentices, by Age, Level and Year of Study, UK, 2009/10



Source: LPC estimates based on LFS Microdata, quarterly, four-quarter average, UK, Q4 2009–Q3 2010.
Note: Sample sizes were too small to provide further breakdowns.

Views on the Impact of the Apprentice Rate and Wage Arrangements

3.63 Our recommendations for the Apprentice Rate were published in March 2010. We generally found a muted reaction from employer stakeholders to the announcement that the level of the Apprentice Rate would be £2.50 an hour. This was perhaps not surprising as a number of employer bodies had urged us to set the Apprentice Rate at or around the level of the LSC weekly wage.

3.64 There was, however, only a very limited period of time for stakeholders to gather evidence on which to base an assessment of the impact of the Apprentice Rate and the practical working of its arrangements. Several did express views about their experience so far and about their expectations of the likely impact. Some were concerned that the Apprentice Rate would adversely affect provision, while others were concerned that the rate was set too low to improve earnings substantially, affect take-up, improve completion rates, or reduce the gender pay gap.

3.65 On the question of the impact of the Apprentice Rate on provision, the Government told us it wished to ensure that requirements for employers to pay apprentices minimum levels of pay should not discourage the creation of apprenticeship places. It said that the introduction of the £2.50 hourly rate created some risk and it asked the Commission to be mindful about the possible negative impact on the supply of places, particularly for young people, as their labour market position was already vulnerable.

3.66 Among those representing employers in the lower-paying apprentice sectors, the NHF said it was concerned by the impact of the Apprentice Rate, noting that there had already been a declining number of apprenticeships offered by its members. It referred to a recent Habia survey of training providers and employers which suggested there would be an adverse impact from the new hourly rate on places, hours, quality of training and drop-out rates. Some other training organisations, such as ProCo NW, also expressed concern that an hourly-based wage could lead some employers to reduce apprentice hours and earnings.

"Having elected an hourly rate rather than a weekly minimum the hours spent on important evening training now need to be specifically paid and there is the possibility that these opportunities will be adversely affected."

NHF oral evidence

3.67 In the childcare sector, the National Day Nurseries Association (NDNA) noted that the £2.50 rate produced a weekly wage of £100 for 40 hours which was broadly in line with what nurseries were already paying as a minimum for apprentices. However, in line with evidence from other stakeholders such as the NHF and Skills for Care and Development, the NDNA drew attention to the fact that the cost of apprentices was not limited to wages alone, but also, in the early stages, included the need for hands-on support from more experienced staff.

3.68 The CBI argued that, while many employers had worked hard to retain investment in training over the last year, the situation remained fragile. It said that demand for vocational training and university places heavily outweighed supply, and pointed out that young people entering the labour market for the first time would be most affected by the ending of the apprentice exemption from the minimum wage. The CBI believed that the available evidence on the impact of the new rate pointed to the possibility of some reduction in provision, caused by the increase in cumulative costs and bureaucracy, rather than any effect on take-up and completion rates.

"A CBI snapshot survey…found…four-fifths of employers said the new rate would not affect their recruitment of apprentices aged 16–18, but a significant minority (11%) said they would have to decrease recruitment."

CBI evidence

3.69 However, some other stakeholders representing employers found little evidence of an impact of the Apprentice Rate on their members. The BHA, BBPA and BISL said their survey of members regarding employment of young people found that where respondents had apprentices they were already paying above £2.50 per hour. Evidence from trade unions also questioned the view that the new rate would discourage employers offering apprenticeships. The TUC believed there was very little evidence to show that employers found the cost of employing apprentices discouraging. It referred to the 2007 Employers Skills Survey which found only 3 per cent of employers surveyed cited financial constraints or cost as a reason for not taking on apprentices.

3.70 Some stakeholders maintained that the Apprentice Rate was too low to have any significant impact on apprentice earnings. Citizens Advice Scotland welcomed the introduction of the rate, but argued that it was set too low. The YWCA and others noted that an apprentice on the Apprentice Rate working 38 hours or fewer would earn less than the National Insurance Contribution threshold of £97 per week and thus not be eligible for contribution-based state benefits. The TUC said that, while traditional apprenticeship occupations provided for a rising pay structure over a three to five year period, in apprenticeships of shorter duration there was less time for pay progression. This would leave qualified workers on very modest rates, and suggested there ought to be less scope for any substantial discount from the main National Minimum Wage rates for such apprentices.

3.71 However, some business organisations said that UK apprentice pay compared favourably with that in other countries. The Apprenticeship Ambassadors Network submitted a research report it had commissioned on an international comparison of apprenticeships (Steedman, 2010). One of its findings was that England had the highest average apprenticeship wages and shortest duration of training compared with the other comparator countries. We note, however, that apprentice arrangements in these countries often involve a minimum apprentice allowance or wage, and this was being compared with average apprentice wages in England. The CBI thought that pay should be set at an appropriate level to reflect apprentices' lower productivity and training investment, in order to encourage more employer-based places.

> *"…if apprentices perceive their pay as being poor, this is likely to lead to poor morale and high turnover, regardless of labour market conditions."*
>
> **TUC evidence**

3.72 The TUC argued that eliminating low pay from apprenticeships would help raise completion rates. In support of this view, it noted the rise in completion rates in England around the time of the introduction of the minimum LSC contractual weekly wage, and improvements in the way apprenticeships were delivered. In contrast, the CBI's view was that strong employer involvement, rather than increased pay, was more likely to raise quality and completion rates.

3.73 A number of stakeholders referred to the equality and diversity implications of the Apprentice Rate. The Equality and Human Rights Commission welcomed the introduction of the new Apprentice Rate and the fact that apprentices would not now be expected to work unpaid overtime. It was, however, concerned that the new rate was set too low, limiting its impact on the gender pay gap and raising the possibility of young people choosing employment over apprenticeship training.

> *"There is still a danger that the current wage level will be too low for some young women to live on. This may mean that some will be forced instead to take lower-skilled but higher paid work, which will not equip them with the skills and qualifications they need to progress their careers..."*
>
> **YWCA evidence**

3.74 Employer representatives from the hairdressing sector were concerned that the age structure for the Apprentice Rate risked reducing places for older apprentices. As apprentices aged 19 and over only qualified for the Apprentice Rate in their first year of training (after which they are entitled to the appropriate age specific National Minimum Wage rate) the youngest apprentices, aged 16, would remain more cost-effective for employers to recruit. This would reduce job opportunities for older trainee hairdressers. Combers Ltd, a hairdressing business, proposed that the Apprentice Rate apply for up to three years to apprentices commencing their training at any time between the ages of 16 and 19.

3.75 During our consultations some stakeholders also raised concerns that it was not clear whether certain categories of apprentices were covered by the Apprentice Rate, despite the intention for it to cover employed apprentices previously exempt from the National Minimum Wage, on Level 2 and 3 schemes. We recognise that teething problems can arise when new regulations are introduced but we understand that the Government will take the necessary steps to ensure any ambiguity is resolved.

Summary and Forward Look on the Apprentice Rate

3.76 It is too early for us to reach final conclusions on the impact from the introduction of the Apprentice Rate, including its wage arrangements. However, its level was broadly in line with the previous LSC weekly contractual wage in England. The increase in this weekly wage from £80 to £95 per week did not appear to have had an adverse impact on apprenticeship provision during 2009/10. The approximate parity with the LSC wage rate may also explain why there was a generally muted employer reaction to the Apprentice Rate's level. A number of stakeholders, including trade unions, argued that the rate was too low to have an impact on apprentice earnings, rates of take-up and completion of training.

3.77 Concerns were, however, raised by some employer stakeholders regarding the potential impact of some of the wage arrangements, including the fact that it was an hourly rather than a weekly rate, and the way it applied to different ages. Some stakeholders favoured no age-related arrangement for the wage; others wanted to base it on the existing National Minimum Wage age rates. Our view is that, given the available evidence, there are no grounds at this stage to recommend any change to the arrangements for the Apprentice Rate.

3.78 As more evidence and experience becomes available, we will continue to monitor both the rate and the wage arrangements. Given our concern at the paucity of available information on apprentice pay, we are pleased that the Government has decided to commission a UK-wide apprentice pay survey in 2011. We intend to supplement this by commissioning our own research on apprentices to help us better understand the impact of the Apprentice Rate.

Conclusion

3.79 This chapter has reviewed the labour market position of young people, interns and apprentices and considered the arrangements for the apprentice minimum wage. We have found that the labour market prospects of young people have continued to be adversely affected by the recession. Youth employment is at record lows, although the impact on many young people has been mitigated to some extent by an increased propensity to stay in education.

3.80 Young people as a whole have been more affected by the minimum wage this year. Lower earnings growth compared with the increase in the minimum wage has led to a higher minimum wage bite. Further, employers have made increased use of their ability to pay below the adult rate of the minimum wage. While in general the research we commissioned for this report continued to show minimal effects of the minimum wage on employment, it did find some evidence to suggest that young people may have been adversely affected by the minimum wage, especially in a recession. These findings were important and influenced our thinking as we considered the options for the youth rates for October 2011.

3.81 There has been a growth in internships since the start of the recession. While we are in no doubt of the value of internships and wish to ensure that such opportunities continue to be available, there are serious issues around intern pay that need to be addressed.

3.82 Finally, apprenticeships continue to be an important source of training for young people with the expansion of such opportunities supported by the Government. Although we have not been able to come to any firm conclusions about the impact of the new Apprentice Rate, on the basis of available evidence we believe that it has been introduced at a level which is unlikely to have adversely affected provision. We propose no change to the current wage arrangements for the Apprentice Rate given the absence of evidence to suggest that they have created any significant problem.

3.83 The Commission aims to ensure that minimum wage rates do not provide an incentive for young people to leave education or training while preventing exploitation for those who are in work or completing an apprenticeship. With this in mind, we present our recommendations on the youth and apprentice rates for October 2011 in Chapter 5, alongside the stakeholder and other evidence that influenced our decisions. We next turn to the issue of compliance and how National Minimum Wage operates in practice.

Chapter 4
Compliance and Operation of the National Minimum Wage

Introduction

4.1 To be effective a national minimum wage must be widely understood and properly enforced. Accordingly, from the beginning, we have maintained a close interest in enforcement and the actions taken to raise awareness among workers and employers of their rights and obligations. Our views are well documented in previous Commission reports in which we have also made a number of recommendations designed to improve and strengthen the existing regime. In addition each year we look closely at the impact of the minimum wage on groups of workers who, by the nature of their work, face particular issues around its operation.

4.2 In this chapter we look again at compliance and operational issues. These include problems faced by some agency, migrant, and care workers; the accommodation offset; payment of tips; the use of piece rates; and some issues around internships, other forms of work experience and volunteering. We then consider the operation of the enforcement regime more generally.

Operational Issues

Migrant Workers

4.3 In Chapter 2 we looked at the labour market position of migrant workers. In earlier reports we have made recommendations intended to afford migrant workers greater protection and we have discussed government initiatives designed to address the issues they face. Despite such efforts we continue to receive evidence that indicates that this group of workers remains vulnerable to exploitation.

4.4 In evidence this year the Irish Congress of Trade Unions reported that migrant workers were particularly susceptible to exploitation and, in the majority of cases, the National Minimum Wage was their only protection. UNISON told us that, despite the strengthening of enforcement in this area, many unscrupulous employers and employment agencies were continuing to take advantage of migrant workers. Citizens Advice Scotland said that migrant workers experienced in-work problems including issues with pay and wage discrimination. These problems, it said, may be exacerbated by language barriers. At a meeting we had with the Ipswich and Suffolk Credit Union during a visit to Ipswich, we were told that migrant workers were often not informed of their employment rights. An Oxfam briefing paper (2009) estimated that there were around 300,000 migrant adult social care workers in the UK and that those employed through employment agencies and labour providers were particularly susceptible to abuse and exploitation. It said this was due to the lack of an effective enforcement regime.

4.5 The Government reported on various actions it had taken to tackle exploitation of vulnerable workers. These included: the creation of a single enforcement helpline, the Pay and Work Rights Helpline (PWRH), which has streamlined and simplified access to five enforcement bodies; increased joint working between the enforcement bodies; and the work of the Best Practice Group (sponsored by the Department for Business, Innovation and Skills (BIS)) which aims to share details of intelligence and enforcement activity. In addition to this, migrant workers were one of the specific groups targeted as part of the Government's 2009/10 awareness-raising campaign. This last initiative was pursued by various means, including a messaging campaign at bank cashpoints (ATMs) and via community radio. We report later on the Government's wider awareness-raising activities.

4.6 During a visit to London we met with a number of migrant domestic workers along with an organisation representing them. They told us about physical and mental abuse they had suffered at the hands of their employers. They identified a concern about enforcing workers' entitlement to the minimum wage, telling us that employers often cited the family worker exemption as a justification for not paying the minimum wage to migrant domestic workers. Concerns were raised by this group about the lack of enforcement action when abuses were reported to HM Revenue & Customs (HMRC).

4.7 We welcome the actions the Government is taking to protect vulnerable workers from exploitation. We were very concerned to hear about the problems faced by migrant domestic workers, many of which go far beyond the minimum wage. It is vital that these workers are given support and the full protection offered by the minimum wage legislation. We urge the Government to ensure that complaints from migrant domestic workers are given a high priority.

Piece Rates: Homeworkers and Hotel Cleaners

4.8 The National Minimum Wage Regulations provide arrangements for workers to be paid by reference to their output ('output work'). This system is called Fair Piece Rates (FPRs). Where, however, an employer controls a worker's hours of work then, for minimum wage purposes, this is regarded as 'time work' rather than 'output work', regardless of whether the employer pays by the piece, and the worker must receive at least the minimum wage for each hour of work.

4.9 Homeworkers are the group most likely to be paid by reference to FPRs. In previous reports available evidence suggested that awareness and proper use of FPRs was low. We recommended, and the Government subsequently undertook, a review of whether the FPR arrangement was meeting its objectives. The major outcome of the review was that the Government would undertake a publicity campaign aimed at homeworkers. In this year's evidence the Government told us how it had conducted such a campaign on-line, and carried out a small pilot project which placed postcards in newsagents' windows. The latter was designed to create wider awareness of FPRs as the cards would be seen by people other than homeworkers. Monitoring of the on-line campaign found there had been over 22,000 visits to the Directgov campaign's web page generated from homeworker-related searches, but there was no evidence of approaches to the helpline generated by the postcards exercise, although such calls may have been recorded under other categories.

4.10 The Northern Homeworking Project (NHP), supported by a campaign group, Homeworkers Worldwide, said it had interviewed 30 homeworkers since January 2010 and had found piece rates equating to pay below the minimum wage. It said that a primary concern of homeworkers was the lack of available homework which put homeworkers in a weak bargaining position. They did not want to complain about non-payment of the minimum wage as to do so might place at risk the little work they had. There was also a reluctance to disclose underpayment of the minimum wage arising from the fact that some homeworkers were undertaking work on an informal basis. NHP told us that some workers engaged in low-paid and irregular work were unlikely to declare such work given the present workings of the benefit system. Those who did lodge a formal complaint continued to face the hurdle of employers falsely calling them self-employed. We recognise that homeworkers remain a difficult group to reach and we fully support government efforts to find new ways to reach them.

4.11 Last year in oral and written evidence we heard of hotel cleaners engaged through agency and contract cleaning companies being paid on a 'per-room' basis. The piece rates were often set at unattainable levels, making it impossible for the workers to achieve minimum wage pay. We saw this as a significant issue and recommended that HMRC investigate whether contract and agency cleaners in hotels were receiving their minimum wage entitlement for the hours they worked. In evidence this year the Government said HMRC would respond to our recommendation by carrying out targeted enforcement in respect of hotel cleaning agencies in the London area in the final two quarters of 2010/11. HMRC has now begun this work.

4.12 Some stakeholders, such as Unite, questioned HMRC's response to the Commission's recommendation. In oral evidence, Unite told us that it had received little feedback from HMRC on complaints it had made. The Trades Union Congress (TUC) similarly reported that it was unclear how the issues around hotel cleaning had been dealt with and said that it saw this as a priority. In oral evidence, the Cleaning and Support Services Association (CSSA) supported targeted enforcement in the hotel sector. Evidence we received from another employer organisation said that larger organisations in the industry appeared to remain immune from HMRC minimum wage enforcement in spite of apparent increased activity. It regarded enforcement as vital in order to bring about change in the competitive practices of the industry.

4.13 We were pleased that the Government accepted our previous recommendation on hotel cleaning. We look forward to receiving detailed feedback from the targeted enforcement in the hotel agency and contract cleaning sector as part of the Government's evidence for our next report. We will expect this feedback to tell us more about the practices adopted by these employers, including how far they have complied with the requirements of the FPR regime.

Care Workers

4.14 Evidence this year again highlighted the difficulties faced by some care workers as they tried to ensure they were paid at least the minimum wage. In some instances, home care workers on zero hours contracts were being paid per visit rather than by the hour, unpaid for travel time, and unpaid or underpaid for travel and other work costs. The complexity of the pay systems used left them, and sometimes it seemed even their employer, unsure whether they had been paid at least the National Minimum Wage.

4.15 We also heard again about the increasing use of 'direct payments', where public authorities give individuals with care needs a budget with which to commission and pay for care themselves, perhaps by employing a personal assistant. The key issue here is ensuring that both the individual commissioner of care and the personal assistant understood their obligations and rights under the minimum wage. We therefore stress the need for the Government to ensure that official information provides clear guidance on the minimum wage rules to both employers and their staff operating with the type of complex pay arrangements common within the social care workforce.

Agency Workers

4.16 Agency work offers important flexibility for both workers and employers. It can offer a short-term solution to staffing problems for employers while offering individuals the opportunity to gain skills and experience in different areas. Agency workers are fully entitled to the minimum wage, but are not currently required to have the same pay and conditions offered to directly employed staff.

4.17 The Employment Agency Standards Inspectorate (EAS) enforces employment agency legislation and the Conduct of Employment Agencies and Employment Business Regulations 2003 (the Regulations) require agencies to ensure that agency workers are paid in full and on time. Between April 2009 and March 2010 the EAS recovered over £200,000 for agency workers, comprised mainly of unpaid wages.

4.18 We report in other parts of this chapter on specific issues which affect some agency workers, for example agency workers employed to clean hotels on a piece rate basis. We also look later at the closer co-operation and working between the enforcement agencies, in particular HMRC and the EAS. The creation of the PWRH has led to a large number of referrals resulting in joint investigations by these two enforcement bodies.

4.19 Changes to the Regulations banning the taking of upfront fees for photographic and fashion models came into force on 1 October 2010. In addition, the current cooling off period for including details in a publication or website has been extended from 7 to 30 days. In evidence, Equity welcomed the changes to the Regulations banning upfront fees.

4.20 In our 2010 Report, we recommended that the Government produced sector specific guidance on the minimum wage for the entertainment sector. The General Election earlier in the year caused a delay while the new Government considered this and our other recommendations. It did, however, subsequently accept this recommendation. Equity told us it was currently working with BIS on producing guidance for the entertainment sector.

4.21 Mr Clive Hurst again raised the issue of employers and employer agents advertising work that was paid below the National Minimum Wage. He argued that these organisations should be fined for doing so. Employers and agents knew there was a minimum wage but deliberately ignored the law because they thought they could get away with it. Mr Claude Starling complained about the lack of enforcement in the entertainment sector and also, despite the Commission's previous recommendation, the continued absence of specific advice for the entertainment sector.

4.22 The CBI, along with other business representative organisations, raised the issue of the significant additional costs businesses will face with the implementation of the Agency Workers' Directive, which is due to be implemented in October 2011. Once implemented, this will provide for equal treatment to apply after a temporary worker has been in a given job for 12 weeks. The CBI quoted the regulatory impact assessment prepared by BIS which estimated that the total cost to businesses would be £1.8 billion each year.

4.23 The Government has advised us that it is taking forward the work on sector specific guidance, which it aims to publish by spring 2011. We welcome this and also the joint working between HMRC and the EAS, which we believe can only enhance the protection offered to agency workers. We will continue to monitor developments in this area.

Unpaid Work: Internships, Work Experience and Volunteering

Minimum Wage Law

4.24 The main criterion for entitlement to the National Minimum Wage is that the person concerned is a worker; most workers in the UK are entitled to be paid at least the minimum wage. There are, however, provisions within the law for someone who would otherwise be regarded as a worker to be excluded from the minimum wage. These exemptions arise in very specific situations such as the defined category of 'voluntary workers' (employed by specific categories of organisations, such as charities); students undertaking work experience as part of Further Education (FE) or Higher Education (HE) courses; and those on Work Trials while unemployed and on Jobseekers Allowance. Volunteers are not workers, are under no contractual obligation to perform work or services, offer their time and effort for free, and are outside the scope of the National Minimum Wage Act. The objective of the 'voluntary worker' exemption was to ensure that volunteers could continue to operate in the voluntary and charitable sectors and receive reimbursement of reasonable expenses, appropriate subsistence or necessary training, without minimum wage liability. At the same time workers in these sectors retained the right to be paid at least the minimum wage. As we have explained in previous reports the terms 'intern' and 'internship' do not exist under National Minimum Wage legislation. Unpaid internships can be advertised, but if actual working arrangements are such that the person is a worker then, by law, they are entitled to be paid at least the minimum wage.

4.25 We have seen in Chapter 3 that government has in recent years encouraged expansion of work experience opportunities, including internships. It has also encouraged greater community involvement through increased volunteering, for example, the introduction of the 'v' Talent Year for young people in 2009. The Coalition Government has maintained the trend with the launch of its National Citizenship Service scheduled for 2011. Work experience and volunteering activities can be legitimately unpaid within the minimum wage regulations, but in recent years we have received evidence of situations where the term 'internship', 'volunteering' or 'work experience' has been given to activities that were clearly work and for which the minimum wage should have applied. We have encouraged better official guidance and proper enforcement of the current law as the way forward.

Stakeholder Evidence

4.26 The Government assured us it took enforcement of the minimum wage very seriously with information on interns feeding into HMRC's risk assessment process and priorities. It told us, however, that HMRC received few complaints from interns and information from advertisements was often insufficient for HMRC to act. It said that until such time as the individual accepts the job and starts work there was no contract of employment or requirement for the individual to perform services. While it indicated a desire to do more in the area of interns, future action would depend on available resources. BIS had already taken steps in recent years to revise the official guidance on the minimum wage and internships, and it told us that it was developing new guidance on interns.

4.27 Views from other stakeholders largely fell into two groups. One group called for better enforcement alongside improved guidance to ensure that the existing exemptions were not abused. The other group called for the creation of new arrangements for interns, including introducing an exemption from the minimum wage or setting a specific minimum intern rate in order to allow development opportunities to continue and minimise potential abuse.

4.28 The TUC said it regarded the increased use of internships as the fastest growing source of abuse of the minimum wage. It pointed to unpaid work advertised across a range of sectors on the Government's own Graduate Talent Pool website. A number of stakeholders gave many pages of evidence drawn from numerous websites showing examples of work being advertised for no pay and also gave links to campaigning websites and news articles. These vacancies were not confined to the 'traditional' internship occupations of media and culture, but included a spread of sectors, ranging from supermarkets to Parliament. Interns Anonymous told us in its oral evidence of the development of agencies charging businesses for supplying unpaid interns, paying a nominal wage to the intern, and levying a percentage on any intern's future salary arising from subsequent employment with that employer.

"The growing evidence of abuse of internships...whilst occurring in all sectors is predominantly visible in the media sector and with parliamentary interns.... If the government visibly tackled payment with respect to parliamentary interns it would send a strong message to other sectors on the issue."

National Council for Work Experience (NCWE) evidence

4.29 Interns Anonymous urged the Commission to recognise that in the majority of circumstances the work undertaken by interns legally required them to be paid at least the minimum wage. It maintained that internships often did not lead to jobs and that, in the majority of cases, internships were replacing entry-level jobs. Intern Aware said interns were often highly qualified and made significant contributions to the organisations they worked for.

4.30 The TUC and others said the relevant authorities appeared to have little or no appetite for enforcing the law. Relying on interns themselves to report abuse was futile as they were afraid to complain. Intern Aware proposed that the Commission recommend that HMRC take action against employers who advertise internships with terms that break minimum wage law. Intervention by HMRC at the point of job advertisement was favoured by all the organisations that attended the oral evidence session on interns (NCWE, Interns Anonymous, National Union of Journalists, and the Broadcasting Entertainment Cinematograph and Theatre Union (BECTU)). Evidence from some stakeholders concentrated on their personal experience of trying to lodge an official complaint, an experience they had found unhelpful and frustrating. Evidence from stakeholders during oral evidence also suggested a lack of satisfaction with HMRC's management of their complaints.

> *"The prevailing informality, and rhetoric of experiment and creativity, obscure the reality of employment relationships carrying obligations for workers to be paid for their work."*
>
> **BECTU evidence**

4.31 Equity asked the Commission to investigate the issue of voluntary work as it had evidence of increasing volumes of unpaid and low-paid work being advertised under the guise of voluntary working arrangements. In addition, Equity said it would like the Commission to investigate the exploitation of charitable status by institutions such as film schools. As institutions with charitable status, such schools were able to pay less than the National Minimum Wage for work on student films under the 'voluntary worker' regulations.

4.32 Among business groups, the British Hospitality Association (BHA), British Beer and Pub Association (BBPA) and Business In Sport and Leisure (BISL) expressed concern at the growth of internships, which could in practice amount to unpaid work, undermining the minimum wage and placing employers in an invidious position. The CBI, however, while condemning abuse of internships and indicating a willingness to be an active participant in any campaign to tackle such abuse, pointed to the real potential value of work experience for young people. It emphasised the importance of ensuring firms continued to offer such valuable opportunities, especially in the current context of high levels of youth and graduate unemployment.

4.33 A number of stakeholders made the point that improved official guidance should be part of the effective enforcement of minimum wage rules. The TUC believed that current guidance on interns and the National Minimum Wage was weak and argued that it gave a misleading view of an employer's legal duty. NCWE said the worker test was not understood by many employers. It thought that clarification was particularly required on what type of training was covered by the rules.

4.34 Some stakeholders took a different tack. They argued either for a separate exemption from the minimum wage for internships/work experience or for a special intern rate under the minimum wage regulations. Actaeon Films said that people in the film industry had traditionally sometimes taken on roles where they traded some or all of their up-front wages for a share of the risk and reward of that enterprise. Typically, these films were commercially risky and Actaeon Films claimed they could not be made without people working on such a basis. Increased concern that such a relationship could trigger an obligation to pay the minimum wage had, Actaeon said, led to film-makers increasingly engaging people on a volunteer-only basis, with no remuneration. It thought further tightening of the law could lead to a reduction in film production and attendant loss of training and career development opportunities. It proposed that the exemption from the minimum wage for share fishermen be extended to include films intended for theatrical release where the employee or worker has a share in any profits or gross earnings of that enterprise. It additionally proposed that an exemption from the minimum wage be made for workers to be allowed to spend up to 160 hours with any given employer to undertake an internship/work experience placement. The limit would, it argued, prevent abuse of the exemption.

4.35 The British Chambers of Commerce (BCC) proposed that a new category of intern worker be created that was not entitled to the minimum wage. This would encourage more firms to offer internship opportunities. It proposed that an intern would be an individual on a contract of no longer than 3 months' duration, provided with on the job training and given a certificate or reference letter at the end. To prevent abuse, BCC proposed that an organisation should not be able to employ an individual on another internship contract for 12 months after the original internship ended. The Chartered Institute of Personnel and Development (CIPD) proposed that interns be incorporated into the apprentice minimum wage structure and paid a training wage of £2.50 an hour. It recognised the need to address the obstacle to social mobility in the professions created by the present situation and believed that a rate of £2.50 struck the right balance between rewarding the contribution made by interns to an organisation and the costs incurred, while not deterring employers from operating the schemes.

"In the absence of full-paid employment, we believe that a Training Wage will bridge the gap for many young people between education and permanent employment."

CIPD evidence

4.36 NCWE raised the question of whether the length of the 12 month exemption from the minimum wage for those on work placements during HE and FE courses should be shortened in light of the level of student debt. It also thought that it might be helpful if the regulations defined an internship and set a specific time limit for any unpaid internship.

Recommendation

4.37 We fully recognise the value of work experience, particularly to young people entering the labour market. We are concerned, however, at the continued evidence of apparent breaches of the National Minimum Wage Regulations where opportunities, which on any reasonable test appear to be work, are unpaid. Some organisations have suggested carving out a special exemption or a special rate for interns under the regulations. They are concerned that stronger enforcement activity may lead to fewer, lower quality, work experience opportunities and have an adverse impact on production in certain industries. This would, however, require an agreed definition of internship and make the enforcement of the minimum wage more complex. In addition, much of the evidence from stakeholders suggests that interns are undertaking work for which they have an existing entitlement to the minimum wage.

4.38 We believe that stronger action needs to be taken on enforcement. It is clear this needs to be accompanied by better understanding of when a legitimate unpaid work experience opportunity becomes a work placement that should be paid at least the National Minimum Wage. **We recommend that the Government takes steps to raise awareness of the rules applying to payment of the National Minimum Wage for those undertaking internships, all other forms of work experience, and volunteering opportunities. In addition, we recommend that these rules are effectively enforced by HMRC using its investigative powers.** We intend to continue monitoring how the regulations are operating in this area when taking evidence for our next report.

Accommodation Offset

4.39 Accommodation is the only benefit-in-kind that can count towards the minimum wage. It provides a mechanism to enable employers to offset the cost of providing accommodation for workers against the minimum wage, up to a maximum daily limit that has risen over time broadly in line with the increase in the adult rate. The provision of accommodation is significant in some low-paying sectors. Offset arrangements provide protection to the worker and give some recognition of the value of the benefit, but are not intended to reflect the actual costs of provision to the employer or the commercial market value.

4.40 We undertook a detailed review of the offset for our 2006 Report, in particular focusing on its application outside traditional tied accommodation. Consideration was given as to whether there was a case for relaxing the offset rules. Our review concluded that if the rules were relaxed and accommodation could be provided as an option, it would be difficult to determine whether or not workers, particularly the most vulnerable, had a genuine choice. It was therefore recommended that the provisions should continue to apply to all workers housed by their employer.

4.41 Each year since our detailed review in 2006, we have continued to receive evidence from stakeholders on the operation of the offset. Many have argued that the level of the offset was set too low and did not reflect private rents. This, they argued, has discouraged employers from providing accommodation or investing in the quality of accommodation provided. Others have argued that a distinction should be made between accommodation provided as a condition of employment and that which is available to the worker on an optional basis. Suggestions have been made as to the way such a distinction could be managed in practice. On the other hand, trade unions have argued that the offset continues to be abused and the current arrangements should be maintained and more rigorously enforced. Evidence from stakeholders this year has repeated many of the same points.

4.42 Although we are conscious that the current arrangements are far from ideal, we have maintained them for three main reasons: to provide protection to workers; to provide some level of recognition of the value and cost of accommodation; and to keep the system simple to administer and therefore enforce. While it is possible to see merit in the suggested changes, for example using fair rents in Gangmasters Licensing Authority (GLA) regulated sectors, it would ultimately add to the complexity of the arrangements and leave some workers more open to exploitation. Over the last nine years the offset has risen in percentage terms at a higher rate than Local Authority/private rents. We do not, therefore, propose to make any change this year to the way the level of the offset is uprated. We will, however, keep the issue under review.

Tips

4.43 In October 2009 the National Minimum Wage Regulations were amended so that tips, gratuities, service charges and cover charges could no longer be used to make up National Minimum Wage pay. In addition, the Government introduced a voluntary Code of Best Practice on Service Charges, Tips, Gratuities and Cover Charges developed through stakeholder discussions (BIS, 2009). While the change in the regulations did not place employers under a legal obligation to pass on tips to their workers, the intention of the code was to make what happens to tips more transparent for consumers and workers. In evidence, the Government reported on official action during the past year to disseminate awareness of the changes. It reminded us that the previous Government had committed to carry out targeted enforcement in the hospitality sector and said that HMRC would prioritise risk-assessed cases and complaints in the sector, including reviews of the treatment of tips.

4.44 Unite told us in its oral evidence that the new regulations were generally being followed and firms had stopped using tips to make up minimum wage pay. Unite's main concern was with the voluntary Code of Practice. Unite said that the Government had shelved the planned review of the code. It told us that many businesses had not adopted the code and some were taking a large slice of tips payments for themselves. Where the code had been adopted some businesses were paying tips in full to their workers but others were imposing varying levels of administration charges for processing the monies. Unite acknowledged an administrative charge was allowed under the code but was concerned at some of the reported practice in this regard. The TUC said that the Government needed to check that the law on tipping was being obeyed. By contrast, the view of those representing hospitality businesses was that the new legal framework was being complied with and the code widely used. In oral evidence BHA, BBPA and BISL said their experience was that the industry was following the new regulations and that most major chains had adopted the code. They regarded the question of whether to make an administration charge for processing tips and the level of any such charge as a matter for individual businesses.

4.45 The evidence from stakeholders suggests that businesses are generally abiding by the new regulations on the use of tips to make up the minimum wage. HMRC's plan to target the hospitality sector will provide an opportunity to check compliance with the new regulations. The evidence from stakeholders about the extent to which the voluntary Code of Practice had been adopted was less clear. We also received differing views from stakeholders about the practice of levying administration charges for processing tips payments. The code is a matter for BIS, which brokered the voluntary arrangements, rather than the Low Pay Commission. We will, however, continue to monitor the treatment of tips under the minimum wage.

Tax-free Travel and Subsistence Schemes

4.46 In February 2010 the Government launched a consultation proposing to change the National Minimum Wage Regulations so that tax-free travel and subsistence payments would not count towards pay for minimum wage purposes. This was in response to concerns regarding the increased use of tax-free travel and subsistence payments for minimum wage workers and the implications for workers receiving these payments who might not be fully aware that they could be reducing their future entitlement to contributory-based benefits.

4.47 We received evidence from stakeholders with regard to tax-free payments in response to the consultation for our 2010 Report and during our visits around the UK. Although there was some support for the continued use of tax-free payments to count towards minimum wage pay, a number of issues were raised. Three, in particular, stood out: the expansion in the number of umbrella companies set up to run the tax-free schemes; concern that workers did not fully understand the implications of accepting tax-free payments; and a fear that businesses were at a competitive disadvantage if they did not operate such a scheme.

4.48 In responding to the consultation, the Commission highlighted its on-going concern over the issue of salary sacrifice schemes and its overriding desire to protect vulnerable workers from exploitation. While workers who receive tax-free payments generally benefited in the short term, there were a number of factors that meant they were likely to lose out in the longer term. We concluded that the Government's proposal to change the National Minimum Wage Regulations was appropriate and necessary to protect workers from exploitation. A copy of our response to the Government's consultation can be found at www.lowpay.gov.uk/lowpay/what_we_do.shtml.

Seafarers

4.49 We received a submission from the TUC concerning the position of seafarers. As a result of this, our Secretariat has been in dialogue with the TUC and the Government concerning the mechanics of enforcing the existing minimum wage rules. In addition, it has been reported that the Government has convened a working party to consider the legal position on the issue of applying the National Minimum Wage to non-UK ships travelling between UK ports. We have reported previously on the differing legal position between the Government and trade unions, so we encourage all parties to continue with their dialogue to try to resolve the issue.

Compliance Framework

4.50 In our 2010 Report we described how the Government's approach to compliance and enforcement has evolved over the last ten years in an effort to improve and enhance the enforcement regime. This culminated last year in a government review of its compliance activities which was designed to produce a new compliance strategy. In our 2010 Report, we set out what we believed the new compliance strategy should cover and what success would look like.

Compliance Strategy

4.51 The Government published its new strategy in March 2010 (BIS, 2010b). The strategy was based upon one clearly defined aim – that everyone who is entitled to the minimum wage should receive it – and the document set out how the Government intended to achieve this through the use of guidance, enforcement and the legal regime. It also undertook to publish an annual report of the Government's enforcement performance. The first such report was published in the autumn of 2010 (BIS, 2010d).

4.52 The strategy document describes a compliance approach based on prioritising according to risk and utilising a range of tools and techniques to achieve the necessary outcome. Central to this is the proposition that a 'one size fits all' approach to compliance is not the most effective way to proceed. Employers who want to comply with the minimum wage need information to enable them to do so. Effective deterrents are required to encourage compliance and there need to be sanctions for those determined to operate outside the law. The strategy document regards the use of intelligence and greater co-operation and information-sharing between enforcement agencies as crucial to the achievement of the core aim.

4.53 While the new strategy sets out the Government's vision that everyone entitled to the minimum wage should receive it, there is a clear move away from current methods, whereby all complaints are investigated in full, requiring a compliance visit to every employer who is the subject of a complaint. The Government has advised that it intends to trial new ways of working, under which it will prioritise resources according to the perceived level of risk. Using this approach, HMRC will use a range of interventions, for example contacting employers by phone and letter to resolve issues, as well as continuing with compliance visits where the risk of non-compliance indicates that this would be the most effective intervention. The Government believes that this new approach should ensure a more effective and efficient use of the resources available for enforcement while at the same time minimising the risk of burdening compliant employers with unnecessary compliance visits.

4.54 In its evidence this year the Government advised us that HMRC's risk assessment process was continually being refined using intelligence and data from a variety of sources including information-sharing gateways with other enforcement bodies such as the EAS. We know from our discussions with Compliance Officers around the country that some teams are unable to undertake risk-assessed investigations because of the high number of complaint cases they have, each one requiring a visit under the existing approach to enforcement.
In written evidence this year, the YWCA supported a rigorous compliance and enforcement strategy and the TUC supported the introduction of the new strategy but said it should be kept under review to ensure that it was effective.

4.55 We very much welcome the publication of the new compliance strategy. The publication by the Government of an annual report on its enforcement activities is also welcome. The move away from investigating every complaint is something we will monitor closely, but we are pleased that the Government is trialling some new ways of working. Clearly it will be important that it considers carefully any issues that arise from the trials. It is also important that HMRC's risk assessment process is refined and improved as greater reliance will be put on this. We are encouraged from what we have seen so far but will monitor carefully how these aspects develop and are reported on by the Government.

Naming and Shaming

4.56 In 2009 the Government accepted our recommendation that a 'name and shame' policy should be put in place to expose those employers who show a wilful disregard for the National Minimum Wage. Following a consultation in early 2010, the Government advised that a naming scheme would be implemented. This was done on 1 January 2011 (BIS, 2011b). The Government's objective for this new policy is to raise the profile of enforcement and to create an effective deterrent. It has framed the criteria to be used in such a way as to focus on employers where the breach is serious and appears to be deliberate. Any employers who meet the criteria will be named through the national and regional press. Although supporting the new naming policy, some stakeholders have raised concerns that the criteria to be used will mean that in fact very few employers will be caught and actually named. The Government has said it will keep this under review. We welcome this initiative which we have advocated for some time. It is too early to tell whether the criteria for naming have been set too tightly and we will continue to monitor this and report as appropriate.

Informal Economy

4.57 We have long been concerned about the extent to which enforcement activity has tackled those in the informal economy who pay workers less than the minimum wage. These concerns were heightened with the onset of the recession which was always likely to push more employers into the informal economy. In our 2009 Report we recommended that the Government gives urgent consideration to measures that could be taken to effectively tackle employers in the informal economy.

4.58 The Government has advised this year that HMRC's minimum wage teams have built up strong links with HMRC's Hidden Economy Group to target employers who appear to be deliberately non-compliant with tax and employment laws. This work has included an operation targeted at employers who are operating in or around the main Olympic sites in East London and has included unannounced visits to employers.

4.59 In its evidence this year the National Hairdressers' Federation (NHF) said the additional costs imposed by Government (e.g. additional taxes and cost of bureaucracy) increased the temptation for smaller businesses to resort to cash-in-hand transactions. Such activity would, in their opinion, have undoubtedly increased during the recession, undermining legitimate businesses. The CSSA suggested that we research the relationship between rises in the minimum wage, increased activity in the informal economy and the use of illegal workers. As part of our research programme for our 2012 Report we have issued an invitation to tender for research on the informal economy. The CBI emphasised the need to tackle the informal economy in order to ensure that legitimate businesses were not undercut.

"If the minimum wage is implemented by all companies, then it is not a problem, as there is equal competition. It is when companies abuse this system that there are issues."

Case study, CBI evidence

4.60 We understand that tackling those in the informal economy requires extra time and resources and the results may not always appear to reflect fully the effort involved. We are encouraged by HMRC's recent work in this area and urge them to continue. Even though the UK is coming out of recession, many businesses remain under pressure and any moves toward the informal economy create unfair competition which puts additional strain on legitimate businesses struggling to survive.

Prosecutions

4.61 The Commission has long held the view that the number of criminal prosecutions should be increased and publicised as widely as possible to act as a deterrent. The Government's response to the recommendation on prosecutions in the 2009 Report was to note the importance of criminal prosecutions in enforcing the minimum wage.

4.62 In its evidence this year the Government agreed that prosecutions can have a deterrent effect as part of an integrated compliance strategy. It has started a project to help improve the capability of Compliance Officers to identify suitable cases for prosecution and to gather appropriate evidence to underpin any referrals. However, it also highlighted the high cost of bringing a prosecution and how this needed to be considered along with other actions available under the enforcement regime. The CBI said it continued to believe there remained a strong case for increasing the number of prosecutions. In research undertaken by XpertHR (2011), just under 44 per cent of businesses surveyed supported criminal proceedings against organisations flouting their statutory obligations. During a visit to Scotland we heard directly from Compliance Officers about the increased emphasis and awareness being put on considering cases for prosecutions.

4.63 The cost of proceeding with a prosecution is clearly a concern for the Government. This is unlikely to change in the near future as the pressure on budgets becomes greater. The introduction of the new penalties regime, which we look at next, linked to the new naming regime may be an alternative to prosecutions, but there will always be serious cases of abuse and the Government must be prepared to prosecute these. We will continue to monitor closely the Government's progress on prosecutions.

Fair Arrears and Penalties

4.64 A new regime of penalties and fair arrears came into force in April 2009 under the 2008 Employment Act. These provisions mean that workers not paid the minimum wage will receive arrears at the current rate and that employers who have not paid the minimum wage will pay a fine of half of the amount of arrears identified (up to a maximum of £5,000).

4.65 The new regime has now been in place for nearly two years and statistics produced by the Government show that, between April 2009 and March 2010, penalties have been imposed in 480 cases totalling just over £162,000. Of these penalties, 236 were paid within 14 days and were subject to a

"The Government should create an environment that helps employers to be compliant and should not tempt non-compliance by continually putting up costs."

NHF oral evidence

discount of 50 per cent. The figures also show that the total amount of arrears identified was uplifted by just over £94,000 as a result of these new provisions (i.e. the additional amount awarded as arrears were paid at the current minimum wage rate). The penalties that have been imposed were based on arrears for pay reference periods starting on or after 6 April 2009 (when the new provisions were introduced). It is expected, therefore, that the number of penalties will increase in subsequent years.

4.66 In our report last year we said that the regime must be rigorously implemented and further change should only be considered if there was compelling evidence that modification would bring improvement. In its evidence this year the Government said it was considering when would be appropriate to undertake a full review of the new regime. As these provisions have been in force for nearly two years we think it is right that the Government should review the provisions within the next twelve months.

Resources

4.67 In our 2010 Report, we recommended that the Government should commit, as a minimum, to maintain the current level of funding for monitoring and enforcement of the National Minimum Wage, in real terms, until at least March 2014. We are disappointed that the Government merely noted this recommendation, commenting that it would be inappropriate to accept a recommendation that would commit it to the allocation of resources for future years.

4.68 Concerns over funding for compliance and enforcement have increased since the General Election in the wake of the Government's decision to reduce significantly expenditure across most areas. Departments were advised of their allocations in the Spending Review in October 2010, but at the time of publication of this report the impact on funding for enforcement of the minimum wage was not known. Spending on compliance and enforcement was increased by 50 per cent in 2006 (an additional £2.9 million each year for the next four years). This additional funding will cease in March 2011, which coincides with the new budgets that will be allocated following the Spending Review. The Government has said it is committed to protecting the most vulnerable members of society. As we have shown, many low-paid workers are vulnerable so in order to continue to protect them it is imperative that funding for enforcement activities is not reduced.

4.69 In its evidence this year the GMB said there needed to be sufficient resources for BIS and HMRC to enforce the minimum wage, particularly in light of the new compliance strategy. The TUC said that funding for enforcing and publicising the minimum wage should be maintained in real terms. Unite wanted to see the Government commit to making real terms increases in current funding for monitoring and enforcement.

4.70 Usdaw said the Government should commit to maintaining the current level of the budget for enforcement, awareness and publicity of the minimum wage. Citizens Advice Scotland said the Government should work with relevant stakeholders and provide adequate resources to educate employers and employees about their rights and responsibilities. The Equality and Human Rights Commission wanted to see the funding for monitoring and enforcement maintained.

4.71 This year we have seen a substantial reduction in the amount allocated by Government to publicising the new minimum wage rates that came into force on 1 October 2010, including the new Apprentice Rate and the change to paying the adult rate from age 21. Although use was made of other channels to get the message across, we are very concerned that the message will not have been as widely disseminated as previously. This can hurt employers as well as workers. Employers may find that, inadvertently, they are not paying the correct rate and are therefore liable to enforcement action. The additional funding, provided by the Department for Communities and Local Government (CLG), for the Dynamic Response Team (DRT) (which we look at later) was also cut. BIS decided, however, to continue to fund the DRT from the existing enforcement budget, but this will have an effect on other enforcement activities.

4.72 It is not clear at present what the impact of the Spending Review will be upon the compliance and enforcement budget. It is, however, unlikely that the budget will escape unscathed. We are very concerned at the prospect of diminished resource in this area. Without good information many firms (especially smaller firms) could inadvertently infringe minimum wage rules and many workers, seeking employment in difficult times, will be at greater risk of exploitation. Cuts at this time would put at risk the good progress that has been made over the last few years. We therefore strongly urge the Government to maintain existing levels of funding for compliance and enforcement activities.

Enforcement Statistics

4.73 Each year the Government provides details of HMRC's enforcement activities. In 2009/10, the total number of enquiries completed decreased on the previous year as did the number of cases of non-compliance identified. There was also a reduction in the strike rate (the percentage of cases investigated where non-compliance was found) from 40 per cent in 2008/09 to 34 per cent in 2009/10. Table 4.1 provides details of the incidence of non-compliance for the last four financial years. It is likely that the reduction in the number of enquiries completed in 2009/10 was as a result of the introduction of the new penalties and fair arrears regime. As we report later, the Government intends to move away from assessing its performance in terms of outputs and look instead at outcomes – a move we welcome.

Table 4.1: National Minimum Wage Enquiries and Complaints to HMRC: Enforcement Action Taken and Incidence of Non-compliance Identified, UK, 2006/07–2009/10

	2006/07	2007/08	2008/09	2009/10
Complaints of underpayment	2,210	3,231	2,521	2,850
Enquiries completed[a]	4,500	4,525	4,317	3,643
Cases of non-compliance	1,523	1,650	1,746	1,256
Strike rate (per cent)[b]	34	36	40	34
Value of underpayments identified (£million)	3.0	3.9	4.5	4.4
Enforcement notices issued	71	59	96	n/a
Penalty notices issued	2	25	30	n/a
Penalties charged	n/a	n/a	n/a	480
Notices of underpayment issued	n/a	n/a	n/a	591

Source: HMRC, UK, 2006–2010.
Notes:
a. Enquiries completed are the number of cases closed after an inspection has been made.
b. The strike rate is the percentage of the cases investigated where non-compliance was found.

4.74 Table 4.2 provides a breakdown of the average arrears per worker for the last four years and, although the number of cases of non-compliance decreased by 28 per cent in 2009/10, the number of workers not paid the minimum wage decreased by only 17 per cent. The average arrears per worker for all cases in 2009/10 was up by 18 per cent to £228, the highest since 2006/07.

Table 4.2: Arrears Identified and Number of Workers, UK, 2006/07–2009/10

	2006/07	2007/08	2008/09	2009/10
Total arrears (£)	3,039,680	3,897,374	4,478,485	4,390,023
Total workers	14,189	19,264	23,247	19,245
Average per worker (£)	214	202	193	228

Source: HMRC, UK, 2006–2010.

4.75 It is difficult to draw any conclusions about changes in enforcement activity over the last four years from these data, especially with the major changes that came into effect in April 2009. Over the last year the number of complaints has increased, but the number of completed enquiries has decreased, mainly as a result of the new regime.

4.76 Historically, the Government's performance on enforcement has been measured in terms of outputs: the number of cases closed; the number of workers for which arrears are identified; and the total value of arrears. These measures have given a good indication of year-on-year activity carried out. But they do not tell us what outcomes have resulted from this activity: for example, whether the Government is moving towards ensuring that everyone who is entitled to receive the minimum wage does so. Linked to the new compliance strategy, the Government says that it is considering how it can refine the way it measures what it does to take account of the outcomes it is trying to achieve. We welcome this approach and look forward to seeing the Government's proposals.

Joined-up Working

4.77 The creation of the Pay and Work Rights Helpline (PWRH) has streamlined and simplified access to the five enforcement bodies (HMRC, EAS, Department for the Environment, Food and Rural Affairs, Health and Safety Executive and the GLA) responsible for employment rights and related legislation. The helpline operators have been trained in the full range of these enforcement bodies' responsibilities and they are consequently able to refer cases to the relevant enforcement bodies. Often, cases have to be referred to more than one enforcement body – for example, HMRC and EAS. This has had a beneficial knock-on effect as the various enforcement bodies have had to collaborate on multi-issue complaints and have, as a result, considered joint investigations where possible. We have visited the PWRH, seen first hand how calls are dealt with and heard encouraging accounts of the enforcement bodies' collaboration with it and with each other.

4.78 The Government has told us that the minimum wage teams in HMRC have been forging closer links with other parts of HMRC in order to access relevant data on individuals and employers. This includes HMRC's Hidden Economy Group (HEG) and its Labour Provider Unit and they are considering the feasibility of joint visits and investigations. HMRC has also forged closer relations with the UK Border Agency which enables it to identify and target non-compliant employers using nationals from the EU working under the Worker Registration Scheme.

4.79 Over the last year, a BIS-sponsored Best Practice Group (BPG) has met to develop arrangements for more collaboration at working level across the five enforcement bodies. The BPG has agreed and refined a cross-agency agreement on procedures for handling multi-issue complaints. It has also appointed and maintained a network of single points of contact (responsible for liaising on multi-issue complaints) and arranged training for inspectors on the enforcement work of the other agencies. Moving forward, the group is looking to share more details on past and future enforcement activity, risk assessment techniques and other enforcement best practice.

4.80 HMRC and the EAS ran a twelve-month pilot with Newham Borough Council to encourage local council inspectors to pass on any suspicions of non-compliance with the minimum wage and employment agency standards. Following an evaluation of the pilot, HMRC is working with the inspectors to improve their understanding of indicators of non-compliance. In early 2010, the TUC, BIS and the enforcement bodies ran five joint regional briefing sessions.

4.81 HMRC has created a Dynamic Response Team (DRT) as a proactive, geographically flexible team to target areas where employers are using migrant labour to undercut legitimate employers by paying below the minimum wage. The DRT was funded through the £70 million Migration Impacts Fund, administered by CLG. Funds were allocated to run the DRT for two years, but as part of the Government's decision to reduce expenditure, funding was withdrawn after a year. However, given the good work of the DRT, it was decided to continue to fund it through the existing enforcement budget.

4.82 The DRT has been building relations with a number of Local Authorities (LAs) and identified a number of key LA projects and stakeholder groups. These links have helped the DRT obtain more information on migrant communities and collect detailed intelligence which has been used to inform HMRC's risk assessment model. The DRT has also been working closely with the HEG to identify those working in the informal economy. The Government advised that DRT is also exploring opportunities for joined-up enforcement with LAs and is investigating a number of employment businesses jointly with the EAS. In its evidence this year, UNISON proposed that employment agencies be made a priority target for enforcement by HMRC.

4.83 The way that the DRT works is more flexible than HMRC's usual operating procedure, with the new team having greater freedom to exercise discretion. We see this as another positive step in the direction of encouraging and promoting greater collaboration and working between different enforcement bodies.

Awareness

4.84 An important part of compliance with the minimum wage is ensuring that employers know what their legal obligations are and that workers are aware of their rights. Over the last few years, the Government has placed increased emphasis on its awareness-raising activities. This continued to be the case last year and the Government reported that the overall aim for the 2009/10 publicity campaign was to increase compliance with the minimum wage and also ensure that workers and employers knew where to go for advice or to make a complaint.

4.85 The target audience for the 2009/10 campaign consisted of workers and employers in low-paying sectors, employment agencies, new and recent migrants and young people. The awareness-raising campaign was run as part of the vulnerable workers campaign and the minimum wage messages incorporated into that campaign began in September 2009 coinciding with the launch of the PWRH. An evaluation was undertaken as part of the assessment of the vulnerable worker campaign. According to the Government, the results showed that the campaign was a success with calls to the helpline increasing by 124 per cent after the advertising began.

> *"The Government has to be realistic and realise that it can't change the legislation (i.e. increase the NMW) and then not publicise this."*
>
> **BCC oral evidence**

4.86 In its evidence this year the British Youth Council said it was absolutely critical that young people knew about their minimum wage entitlements and how to complain if they were not receiving them. It said most young people lacked the knowledge and information about who to contact if they were being paid below the minimum wage.

4.87 As we have already reported, we are very concerned by the Government's decision in 2010 to cut expenditure on publicity and the impact this will have on employers and workers. Over the last few years the Government has been more innovative in its awareness-raising campaigns and specifically targeted certain groups. This has been effective and any further cuts to the awareness budget can only have a detrimental impact on this work. We will continue to monitor closely the Government's awareness-raising activities.

Conclusion

4.88 There has been good progress in a number of areas in relation to the minimum wage enforcement regime. The introduction of a new compliance strategy is welcome. In particular the move to a more flexible enforcement approach, allocating resources according to risk, making better use of intelligence and inter-agency co-operation are, we believe, positive developments that should enhance the effectiveness of the enforcement of the National Minimum Wage.

4.89 The new penalties and fair arrears regime and the introduction, in January 2011, of a new policy on naming have the potential to strengthen the enforcement regime significantly. But it will be important to review both initiatives at the right time to ensure they are having the desired effect.

4.90 We are very concerned this year about the effect of cuts already made to the Government's budget for publicising the minimum wage and the likely impact of possible further cuts as a result of the Spending Review. It is imperative for the credibility of the National Minimum Wage that it is rigorously enforced and that upratings and other changes to the rules are known and fully understood. We will monitor closely the impact of any reduction in funding for the minimum wage and will raise any concerns as appropriate.

4.91 We continue to receive evidence that certain groups of workers are more vulnerable than others to exploitation and more at risk of being denied their entitlements under National Minimum Wage legislation. Over the years we have made several recommendations with such groups in mind. Last year our recommendations concerned those working in hotels as contract and agency cleaners. This year we have recommended raising awareness of the minimum wage rules for people undertaking internships, other work experience and volunteering opportunities coupled with better enforcement. We hope the Government accepts our recommendation, and look forward to hearing about the progress made in this area when we take evidence for our next report.

4.92 In the next chapter we conclude our report by setting out the evidence we received on future rates and our recommendations to Government for the levels of the National Minimum Wage rates in October 2011.

Chapter 5
Setting the Rate

Introduction

5.1 So far in this report we have looked backwards. In this chapter we look forward, drawing on various forecasts to reach an informed view of future prospects before we arrive at our recommendations to Government for October 2011. In the first chapter, we looked at the current state of the economy and discussed the recommendations in our last report in the context of subsequent economic events. Chapter 2 assessed the impact of the adult rate to date and considered whether the impact differed across low-paying sectors, firm size, and groups of workers. Chapter 3 investigated the impact on young people and also looked at interns and apprentices. Chapter 4 considered various compliance and enforcement issues.

5.2 In this chapter we look at the economic prospects, guided by a range of forecasts both official and unofficial. We also review the international picture to place the UK's minimum wage in a broader global context and we consider the various opinions on future rates expressed by stakeholders representing both employer and employee points of view. Having marshalled all of the relevant evidence, we then set out our considered view and our recommendations. This is followed by some discussion and analysis of the likely impact of our recommendations should they be accepted by Government.

Economic Prospects

5.3 In Chapter 1 we considered the period up to October 2010 (before the adult rate of the minimum wage was raised to £5.93 an hour) in order to assess how the economy was recovering from the deepest and longest recession since the 1930s. We now consider the prospects for the economy over the next year or so. Table 5.1 sets out the latest forecasts for growth, average earnings, inflation, employment and unemployment from the Office for Budget Responsibility (OBR) and the median of the HM Treasury panel of independent forecasters. These were the latest forecasts available when we met in mid-January 2011 to agree our recommendations.

5.4 The outlook for the economy is uncertain. Three divergent views, that encapsulate the discussion surrounding this uncertainty, have recently been expressed by members of the Monetary Policy Committee (MPC) of the Bank of England. Sentance (2010) advocated raising interest rates as he set out his concerns about inflation noting the resilience of the labour market and the strength of the recovery. In contrast, Posen (2010a and 2010b) continued to be concerned about the strength of the economy and argued that short-term inflationary pressures would abate. He proposed further quantitative easing to help foster the recovery. Bean (2010), on the other hand, concluded that the MPC was right to be cautious, noting that risks to medium-term prospects for inflation were balanced. He thought the current upward pressures on inflation were temporary and predicted downward pressure from spare capacity in the medium term. Our consideration of the prospects for the UK economy takes account of these differing views.

Table 5.1: Actual Outturn and Independent Forecasts, UK, 2010–2012

Per cent	Actual data 2010	Latest forecasts 2011		Latest forecasts 2012	
	(Actual to Q4/whole year or latest)	Median of independent forecasts (January 2011)	OBR forecasts (November 2010)	Median of independent forecasts (November 2010)	OBR forecasts (November 2010)
GDP growth (whole year)	**1.7**[a]	**2.0**	**2.1**	2.1	2.6
Average earnings AWE (whole year)	**2.3**[b]	**2.6**	**2.2**		2.4
Inflation RPI (Q4)	**4.7**	**4.0**	**3.4**	2.8	3.1
Inflation RPIX (Q4)	**4.7**	**3.7**	**2.7**		
Inflation CPI (Q4)	**3.4**	**2.9**	**2.8**	1.8	1.9
Employment growth (whole year)	**-1.0**	**0.4**	**0.3**[c]		0.7[c]
Claimant unemployment (millions) (Q4)	**1.46**	**1.56**	**1.49**	1.53	1.41

Source: HM Treasury (November 2010 and January 2011), OBR (November 2010) and LPC estimates based on ONS data, GDP growth (ABMI), total employment as 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), 2009–2012.
Notes:
a. Estimate of economic growth based on current ONS data and LPC extrapolations.
b. Estimate of average earnings growth based on January–November 2010 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.

5.5 As we noted in the first chapter, the economy appears to be recovering reasonably well with growth of 1.1 per cent and 0.7 per cent in the second and third quarters of 2010 respectively. At the same time, the world economy has recovered strongly as emerging economies have returned to their pre-recession rates of growth. The International Monetary Fund (IMF) projects that global growth will have been 4.8 per cent in 2010 and will again grow by over 4 per cent in 2011. The Organisation for Economic Co-operation and Development (OECD) also expects recovery in the industrialised countries. It forecasts that the UK economy will grow at 1.7 per cent in 2011 and 2.0 per cent in 2012. The IMF concurs with this view. In contrast, the central forecast of the Bank of England is much more optimistic with growth of 2.0–3.0 per cent in both 2011 and 2012. As shown in Table 5.1, the median of independent forecasts suggests that UK growth will be at the lower end of that range, 2.0 per cent in 2011 and 2.1 per cent in 2012. The OBR estimates are slightly higher than those, at 2.1 per cent in 2011 and 2.6 per cent in 2012.

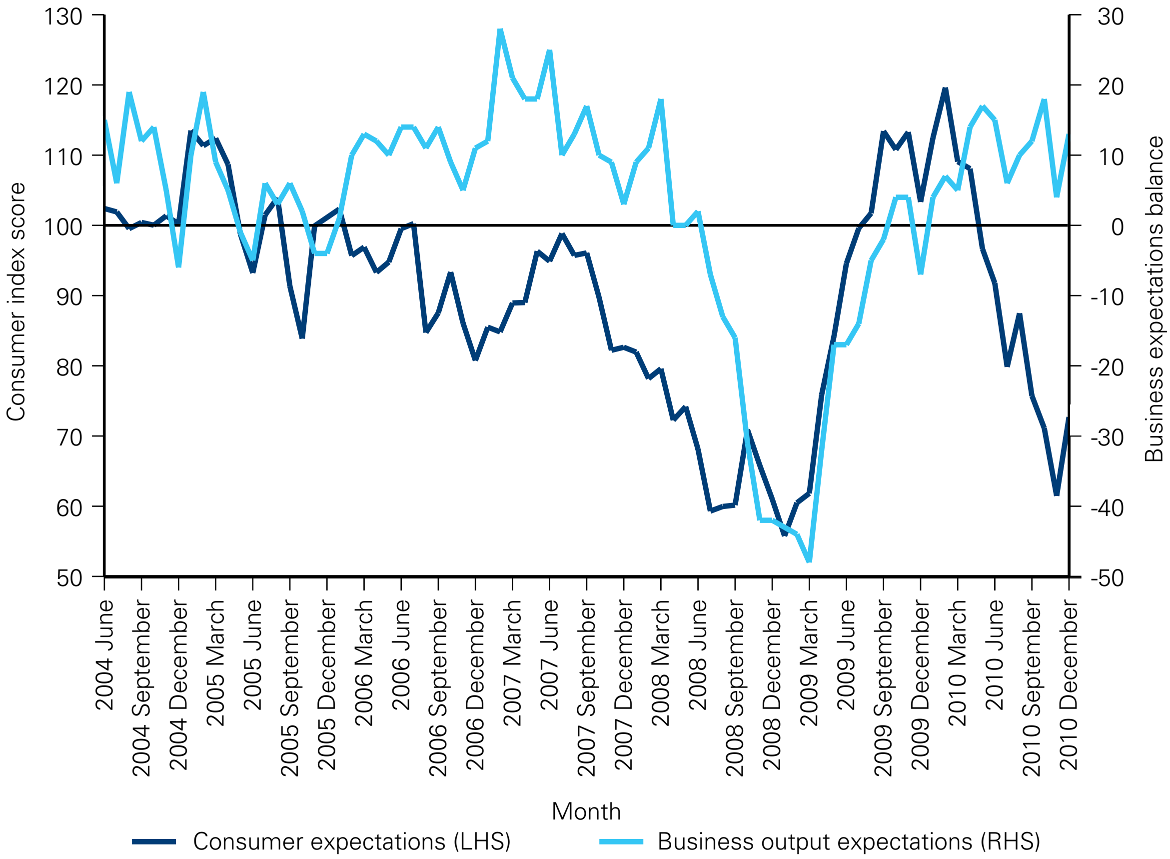
5.6 In the third quarter of 2010 output in the UK was about 2.7 per cent higher than a year earlier. An important component of that growth was ascribed to stockbuilding as the rate of inventory depletion slowed and some firms started to rebuild stocks. But this contribution to increased demand is only likely to last until inventory levels have been restored. It is doubtful whether it would continue to contribute much to growth in the medium or long term. Another key element of the recovery had been the growth in government expenditure. However, public spending is expected to fall as the austerity measures taken by the Government start to have an effect.

5.7 Prospects for the economy largely depend therefore on the outlook for consumer spending, investment and trade. During the recession, consumer spending fell by nearly 5 per cent as uncertainty about real incomes led households to reduce new borrowing and repay their debt, particularly mortgages. Meanwhile, the reduction in interest rates over this period led to higher disposable income for those with variable and tracker mortgages. As a consequence, the household savings ratio rose from -0.1 per cent in the quarter preceding the recession to nearly 8 per cent by the end of it. But, as pay increases failed to keep up with inflation, real disposable income fell in 2010 and consumers again looked to their savings to fund consumption. Despite the reduction in consumer spending, retail sales remained reasonably buoyant throughout the recession. There was some divergence in the retail sector with food retailers performing better than those selling household goods. There has been a modest pick-up in consumer spending since the end of the recession but the most recent data on retail sales suggest that spending may have weakened.

5.8 The prospects for consumer spending over the next few years depend on expectations of future incomes and wealth. Figure 5.1 shows that consumer confidence has fallen back considerably since the spring of 2010 as the fiscal measures announced by the Government have affected consumers' expectations of future post-tax income. The increase in taxation and uncertainty about employment, particularly among public sector workers, has caused consumers to feel more pessimistic about their economic situation.

5.9 However, Figure 5.1 also shows that business expectations have improved since the end of the recession. Although the outlook remains uncertain, investment has increased as future demand prospects have improved and the financial markets have steadied. The financial turmoil that led to the onset of the global recession had raised the cost and availability of finance. This, combined with the fall in demand, caused businesses to delay or cancel many investment projects. As a consequence, from its peak at the end of 2007 until the end of 2009, business investment fell by around 28 per cent and investment in dwellings by over 35 per cent. The Bank of England (2010b) continues to report that credit remains tight and costly for small and medium-sized businesses but that large firms appear to be less credit-constrained, are less dependent on the banks and have better access to capital markets. Further, as noted in our last report and in Chapter 1, the financial balances of UK businesses appear healthy, and much better than in previous recessions. Although finance is likely to continue to be a problem for small and medium-sized firms, it is less likely to constrain the investment decisions of large firms. Moreover, most capital investment is carried out by large firms. The outlook for investment will therefore depend on business expectations of the prospects for the economy. And business expectations have improved since the end of the recession.

Figure 5.1: Consumer and Business Expectations, UK, 2004–2010



Source: Nationwide, consumer expectations index, and CBI, output expectations, monthly, not seasonally adjusted, UK, 2004–2010.

5.10 The improvement in business confidence has been particularly marked among manufacturers and exporters. Despite the depreciation of sterling by around 25 per cent since the middle of 2007 and the improvement in world trade since the middle of 2009, the contribution of net exports has been disappointing. We might have expected exports to have become more profitable and UK firms to be in a better position to compete domestically against more expensive imports. Manufacturing has recovered strongly since the end of recession and the export of goods has increased sharply. The strength of total exports has been dampened by the performance of financial services, whose exports have remained weak reflecting the banking crisis and its aftermath. Sterling depreciation has led to an increase in market share for UK goods exporters. Business surveys report healthy export order books. But the growth in imports has outstripped that of exports and there is much less evidence that domestic firms are successfully competing against imports. However, it takes time for firms to adjust, especially if such adjustments require investment in distribution and marketing overseas. Reversing outsourcing and off-shoring decisions also takes time. It is likely that the effects of the depreciation of sterling will continue throughout the rest of the year.

5.11 Export performance will also depend on demand in the UK's main export markets – the European Union and the United States. In the euro area, aggregate demand has grown at a similar pace to the UK, but this masks a great divergence. While Germany has grown strongly, countries on the periphery (in particular Ireland and Greece but also Spain and Portugal) are struggling and many have not yet started to recover from the recession. Although these countries are relatively small and their impact on UK exports minimal, there are potentially more adverse effects that may accrue through the financial system, in particular the links between banks throughout Europe. Any intensification of the sovereign debt problems, and its effect on credit costs or availability, may adversely affect recovery. The United States has also recovered with growth of around 2.6–2.7 per cent in 2010 but this is expected to slow in 2011, albeit still greater than in the UK. Additional fiscal and monetary stimulus packages could further boost the US economy, although there are concerns about inflation that may lead to more restrictive policies.

5.12 In summary, the prospects for growth are dependent on private sector spending (consumption and investment) and trade. The forecasts for growth are around 2 per cent in 2011 and 2012. There are reasons to believe that there are significant risks on the downside and that the economy will grow in line with the rate experienced in 2010. However, growth will also depend on what happens with inflation as this will determine how the monetary authorities treat interest rates. Any increase in interest rates, in attempting to reduce inflation, may have adverse consequences on the three areas which are currently driving growth – consumption, investment and trade. An increase in interest rates will drive up the costs of borrowing, increase mortgage payments, make savings more attractive and result in lower consumer spending. It is likely to make finance more expensive, increase investment costs and reduce the viability of investment projects. In addition, any interest rate rise is also likely to increase the exchange rate making exports more expensive and imports cheaper, which is likely to act as a drag on growth. We turn next to the prospects for inflation.

5.13 The latest inflation data available to us related to December 2010. They showed the twelve-month growth in the Consumer Price Index (CPI) at 3.7 per cent, while the broader Retail Prices Index (RPI) had risen by 4.8 per cent. Inflation throughout 2010 consistently overshot forecasts, which the Bank of England attributed to greater than expected pressures from commodity prices, along with the effects of changes in indirect taxation and the earlier depreciation of sterling. Indeed, the Bank estimates that these three factors contributed an average of 3 percentage points to inflation in each of the last four years and that ‘domestically generated inflation’ over the period was close to zero. Forecasts for 2011 suggest further short-term upward pressures from continued commodity price rises coupled with the increase in the VAT rate from 4 January 2011.

5.14 Consequently, both leading measures of inflation could rise further during the first half of the year, falling back later on to reflect the impact of excess capacity in the economy and the steady waning of earlier upward pressures. Even so, the median consensus of independent forecasts, published by HM Treasury in January 2011, still shows CPI at 2.9 per cent in the fourth quarter of the year and RPI at 4.0 per cent. The latest assessment of the OBR, published in November 2010, is broadly in line with the median expectation with forecasts of 2.8 per cent and 3.4 per cent respectively for CPI and RPI in the fourth quarter of 2011.

5.15 Based on the year-end forecasts and the projected paths for inflation in the intervening quarters, we conclude that the UK is likely to experience relatively high inflation on both key measures until at least the end of 2011. We note, however, the Bank of England’s view that there are considerable upside and downside risks to the forecasts and that the forecasts are finely balanced. The degree of excess capacity in the economy and the implications for employers’ ability to increase prices, or employees to bid up wages, is important for future inflation levels, but is difficult to quantify. As with our last report, we remain cautious about the weight we should attach to the inflation forecasts.

5.16 It is generally accepted by commentators that inflation rates have an influence on the level of basic pay awards across the economy. This view has found support in two of our commissioned research projects this year (Dolton, Lin, Makepeace and Tremayne, 2011 and Incomes Data Services, 2011). However, the short-term relationship between inflation and settlement levels is not hard and fast, indicating at best the direction of any change, and the last two years have witnessed both high real pay growth as settlement levels exceeded the very low inflation rates in 2009, and real pay cuts as settlement levels failed to match the higher inflation rates in 2010. Other factors besides inflation clearly have an impact on pay, for example, affordability, employers' ability to put up prices, and productivity, and the balance of pressures varies between organisations, sectors and workforces.

5.17 As there are no official data on settlement levels we have drawn on figures published by Incomes Data Services, XpertHR (previously Industrial Relations Services), Labour Research Department and the manufacturers' organisation, EEF. At the time we reached our recommendations on the 2011 National Minimum Wage the most up-to-date settlement data from these sources covered the three months to November 2010. Their individual median settlement levels fell in a range of 2.0–2.6 per cent, with signs of an up-turn in the more recent months. There was a marked difference in the median settlement levels for the public and private sectors, with the former at zero or just above. Also evident was a decline in the proportion of pay freezes in the private sector, which had occasioned an unusual bi-modality in the settlement distribution in 2009 and the early months of 2010, returning the distribution to its historic 'normal' distribution. Discussions with the settlement data providers suggested that the as yet unpublished settlement levels for December 2010 would show little change in the median level of awards and a continuing decline in the proportion of freezes.

5.18 Again, there are no official settlement forecasts, but we were able to draw on researchers' surveys of employer and employee expectations, and on some early, but limited, data relating to January 2011. Surveys of employers' settlement expectations were undertaken in autumn 2010. They showed that high proportions of employers were intending to adjust pay rates this year, although some were proposing to target their awards on certain staff rather than apply a general award across all employees. In the private sector, the average expected award was around 2.0–2.3 per cent. For the public sector, the survey by the Chartered Institute of Personnel and Development (CIPD) suggested awards would average only 0.25 per cent, and 62 per cent of public sector employers planned to implement a pay freeze. The CIPD's annual employee attitude survey (CIPD, 2010a) painted a mixed picture: some employees were pessimistic about getting any increase at all, with 29 per cent of private sector employees expecting a pay freeze and 49 per cent of public sector employees expecting no award in 2011. However, those who did forecast an increase in their pay had expectations somewhat above those of employers, with median increases of 3 per cent in the private sector and 2 per cent in the public sector.

5.19 In order to get a sense of the emerging picture our Secretariat held discussions with pay researchers in mid-January 2011. They suggested an increase in the median awards in the private sector in the first month of the new year, to 2.5–3 per cent, and in the inter-quartile range of the distribution. However, this initial analysis was based on comparatively few awards and, in some cases, was heavily influenced by long-term deals with inflation-linked upratings.

5.20 Settlement data have so far been reasonably consistent with the increases in whole economy regular pay according to the Average Weekly Earnings (AWE) measure, their closest official comparator. We are unclear about the exact nature of pay settlements in 2011, although at present medians are unlikely to be much different to those in the latter months of 2010, maybe slightly higher if anything. It is apparent that assigning a value to public sector awards in 2011 will be difficult as the Government's public sector pay policy takes a wider hold. The different approaches used by the researchers might, therefore, cause some volatility in their settlement medians in the months ahead.

5.21 Finally, we considered average earnings movements using the AWE total pay measure. The provisional data for the three months to November 2010 showed average earnings across the economy 2.1 per cent higher than in the same period a year earlier. Naturally, the whole economy figure hides considerable variation between sectors. For example, earnings growth was 4.2 per cent in finance and business services but -1.3 per cent in construction. In the low-paying sectors covered by wholesale, retail, hotels and restaurants, total earnings grew by 1.2 per cent. For much of the last two years, changes in the composition of the workforce, notably a shift from high-paid to low-paid jobs, has acted to dampen measured earnings growth in the economy. But this effect has been waning over time and in the later months of 2010 was broadly neutral.

5.22 The forecast from OBR for 2011 as a whole implies little change in earnings growth compared with 2010, with an expected rate of increase of 2.2 per cent. This is somewhat below the 2.6 per cent median expectation of other independent forecasters published in January 2011. However, both forecasts amount to a very subdued picture for earnings growth in 2011 and, given inflation expectations, a further substantial fall in real pay. Such an outcome rests on restraint on earnings growth from excess capacity in the labour market, lower public sector awards (and possible reductions in higher-paid posts in the sector), and relatively weak bonus pressures in the finance sector. However, private sector pay awards might pick up, with concomitant upward pressures on earnings levels, as prospects in some parts of the economy continue to improve. Also, compositional factors and the flat cash element of the Government's public sector pay policy might lead to earnings growth in that sector higher than implied by the general pay freeze (Bird, 2010). It is possible, therefore, that current earnings forecasts for the whole economy are a little on the low side.

5.23 Having considered the prospects for growth, inflation and earnings we now turn to the outlook for employment and unemployment. As we have noted previously, the labour market was remarkably resilient during the recession and recovered quickly as output rose. Throughout much of 2010, as the economy continued to recover, employment, hours worked and vacancies rose while unemployment and redundancies fell. However, the increase in employment was mainly in part-time and temporary positions. Full-time and permanent jobs continued to be lost. Towards the end of 2010, the recovery in the labour market had begun to stall with employment and hours stable and unemployment no longer falling.

5.24 The 1 percentage point increase in employers' National Insurance Contributions (NICs) in April 2011 and the implementation of the Agency Workers Directive in October 2011 will impose some additional costs on employers. However, the Recruitment and Employment Confederation survey (REC and KPMG LLP, 2011) showed that employers were expecting to recruit more permanent and agency staff. The regional agents of the Bank of England also reported that manufacturing and service employers were expecting to recruit over the next six months. The prospects for the public sector were not as bright. The OBR had forecast that the fiscal consolidation would result in the loss of 330,000 public sector jobs. Many commentators also expected a similar number of private sector jobs to be lost as a result of government cutbacks. However, the OBR expects the rest of the private sector to generate more than enough jobs to offset these losses.

International Comparisons

5.25 Our deliberations also took account of the value of the UK minimum wage relative to those of other OECD countries with minimum wages. This relative value depends on the extent to which countries raised their minimum wages and how exchange rates and inflation rates have changed. We start by considering the change in the minimum wage in terms of national currencies. In 2010, the UK minimum wage rose by 2.2 per cent, similar to the increases in Belgium, New Zealand and Japan (2.0–2.4 per cent), but higher than in many other OECD nations. It grew by 0.5–0.9 per cent in France and Canada and was frozen in the United States, Greece and Ireland. In Ireland it will be cut by €1 from February 2011. The largest increases occurred in Australia (4.8 per cent) and Portugal (5.8 per cent).

5.26 Since 2007, sterling has depreciated by over 20 per cent against a general basket of currencies (the Bank of England Exchange Rate Index). Over the year to September 2010, sterling depreciated against the dollar (United States, Australia, Canada and New Zealand) and the Yen. As a consequence, the value of the UK minimum wage in common currency has fallen relative to those countries since we last looked at this comparison in our 2010 Report. For example, although the United States had frozen their minimum wage in 2010, its value in pounds sterling using the exchange rate rose by 4.7 per cent from £4.44 to £4.65. Accounting for these exchange rate movements, the increases in these countries ranged from 10.7 per cent in Canada to 19.7 per cent in Australia. In contrast, sterling appreciated against the euro, effectively reducing the minimum wages in each country of the euro area by 5.7 percentage points, for example the 1.0 per cent nominal increase in the Netherlands was effectively a cut of 4.7 per cent in terms of its value in sterling.

5.27 Exchange rate comparisons do not fully reflect inflation in the various countries but purchasing power parities (PPP) do take inflation into account. In terms of PPP, the United States minimum wage increased its value in pounds sterling by just 1.5 per cent from £4.77 to £4.84. In PPP terms, the UK had one of the lowest increases (2.2 per cent) with only Greece (-0.3 per cent), the United States (1.5 per cent) and Canada (1.8 per cent) having smaller increases. The highest increases were in Portugal (8.4 per cent), Japan (5.8 per cent) and, despite its minimum wage freeze, Ireland (5.3 per cent).

5.28 In summary, the increase in the minimum wage in the UK relative to that of other countries tended to be in the middle when we looked at national currencies or adjusted for exchange rates but the increase was towards the lower end after also adjusting for inflation. The level of the UK minimum wage, however, remained in the middle in all these comparisons.

5.29 Another way of looking at international comparisons is the degree to which the minimum wage bites (its value relative to the mean or median) in different countries. On this measure, the UK minimum wage has changed little in recent years and remains roughly in the middle of the 13 OECD countries that we study. Further details of minimum wages in other countries can be found in Appendix 3.

Stakeholder Views

5.30 We now turn to the views of those with an interest in the National Minimum Wage. We conducted a formal consultation during the summer of 2010 inviting stakeholder views on the appropriate rates for 2011 and other matters related to our remit. We received 80 responses. Around 30 per cent of these were from organisations that we had not heard from before or who have not provided evidence to us within the last 4 years. In addition to the consultation we undertook a visits programme to individuals and organisations at 9 locations around the UK. We heard oral evidence from 24 organisations over two days in November 2010 and our Secretariat held informal meetings with 45 interested parties throughout the year.

Adult Rate

5.31 Views on the appropriate level of the adult rate of the minimum wage for October 2011 fell roughly into two camps. Those representing employer organisations cited the uncertain economic situation going forward and urged caution in setting the rate. Others, mainly trade unions, argued that increases to the minimum wage had to ensure that low-paid workers did not lose out at a time of rising inflation.

5.32 A large number of employer organisations again called for the adult rate to be frozen this year. The Federation of Small Businesses (FSB) called for a freeze for the foreseeable future, saying this would match current public and private sector wage restrictions, at a time when businesses were struggling to stay open. The Association of Convenience Stores urged restraint and believed the steep increases in the minimum wage over the last 11 years must now level off. It said that without a freeze the cutbacks undertaken by retailers would be further magnified and that, for the majority of retailers, the National Minimum Wage was now the rate paid to their staff. Continual increases, it argued, would have a great bearing on future unemployment at a time when it was essential to encourage employment.

5.33 The UK Fashion and Textiles Association, along with others, highlighted the extremely difficult trading circumstances. It said that with wages in the public sector being frozen, the Commission should follow this lead in its recommendation for 2011. The Association of Licensed Multiple Retailers said increases in wage costs were beginning to have a very real impact on employment within the sector. It believed that in the current economic climate a freeze would be appropriate and said it may now be time for a pause and review of whether further increases were necessary rather than assuming an automatic uprating.

5.34 Some stakeholders in the leisure and travel sector referred to the difficulties of maintaining current employment levels and commented that further increases in the minimum wage could adversely affect levels of permanent employment. Stakeholders in the social care sector claimed previous increases in the minimum wage had not been matched by an increase in fees from Local Authorities, so they wanted to see an obligation on Local Authority commissioners to reflect minimum wage increases in their fees.

5.35 Some significant employer organisations did see room for an increase in 2011. The CBI urged caution given the fragility of the economic situation. It said that too big an increase would damage private sector employment growth at a time when it was expected to lead the recovery. The National Farmers' Union (NFU) urged caution given the fragile state of the economy and believed any increase over 2 per cent was likely to damage the farming industry and the wider economy. The British Retail Consortium also commented on the need for caution given the fragility of the economy and the necessity for job creation in the private sector to lead the recovery. It thought that increases in the minimum wage should not exceed long-term average earnings growth and said, over the last 12 months, that suggested an increase of 1.7 per cent. The British Chambers of Commerce (BCC) said the recovery was so precarious that we should not risk a number of additional labour costs too quickly. It therefore proposed a 1 per cent increase in the adult rate.

5.36 On the other hand, worker representatives all supported an increase in the adult rate, with varying views on the level of such an increase. Some saw an increase in line with inflation as the way forward, whereas others saw the living wage as the benchmark and ultimate goal.

5.37 The Trades Union Congress (TUC) said that, despite the recession, the UK remained a rich country and its workers had the right to expect a minimum wage that grew year-on-year. It said that employment across the low-paying sectors had stood up to the recession better than other sectors, growth had returned and there was a consensus forecast for increased growth in 2011. The TUC said any increase in average earnings had to be reflected in the minimum wage, or the lowest paid would fall behind, but it wanted the Commission to go beyond just keeping pace with the growth in earnings for the coming year. It believed that an increase of 3.5 per cent could be absorbed by employers without generating any detrimental side effects.

5.38 Unite highlighted a recent report on poverty from the Joseph Rowntree Foundation which found that a couple with two children needed to earn £7.60 an hour each to afford a basic but acceptable standard of living. It also noted that economic growth had returned and said it would be wrong to be overly cautious and risk hitting the lowest paid hardest. It therefore recommended a rise above projected RPI inflation of 3.4 per cent in 2011, that would bring the adult rate to £6.14 and as near as possible to £6.90 (half median earnings), its ultimate goal. Usdaw pointed out that the real rate of inflation facing low-paid workers was higher than RPI. It proposed that the minimum increase must be at least in line with average earnings increases, but it did recognise that the UK was just coming out of recession and the recovery was fragile. Therefore, for this year only, it recommended an increase in line with predicted RPI, implying an hourly rate of £6.16 from October 2011.

5.39 The GMB noted there had recently been positive news on the recovery for 2011. It said that the Commission's recommendation should be bold and keep pace with average earnings. Although it recommended an increase in line with average earnings, 2.7 per cent, it reminded us that its longstanding policy was for the National Minimum Wage to be increased to £7 per hour to become a living wage.

5.40 Other organisations also saw a living wage as the ultimate goal. Unison thought a decent level of the minimum wage was needed in good economic times and bad. Low-paid workers should not be the unnecessary victims of the current recession and budget cuts. It therefore recommended a level of £7.60 per hour from October 2011, to ensure an adequate standard of living for all workers. The Communication Workers Union said there was no single standard for a living wage. It also quoted the Joseph Rowntree Foundation research and although its aspiration was for a living wage in the region of £8 per hour, it recommended a minimum wage of £6.85 per hour from October 2011, making the minimum wage a more effective tool for lifting low-paid workers out of poverty.

5.41 Save the Children said that although the minimum wage had given a significant number of families an increase in their household income, it was still not having the impact on reducing poverty that it might. To combat this, it wanted to see significant year-on-year rises in the minimum wage above (CPI and RPI) inflation. The Equality and Human Rights Commission (EHRC) said the minimum wage was a key weapon in keeping the gender pay gap moving in the right direction. As it was a critical tool for fighting socio-economic inequality, it needed to keep pace with inflation so as to protect the most disadvantaged groups in society.

Youth Rates

5.42 We also received views on the level of the two youth rates. Although the BCC had recommended an increase for the adult rate, it called for a freeze for the Youth Development Rate and the 16–17 Year Old Rate as its economic forecast for young people's prospects during economic recovery was stark. The NFU said there was a shortage of young people entering the farming industry. It wanted to see the Youth Development Rate maintained and increased in line with the adult rate.

5.43 A number of trade unions would like to see youth rates replaced with the adult rate. As a first step they wanted to see the adult rate paid from age 18. Other groups held similar views. The YWCA thought that young people, particularly those who were more disadvantaged, should be supported through the current economic climate and be paid a wage that allowed them to find and keep employment. It wanted to see youth rates, which it claimed were unfair and discriminatory, removed. The British Youth Council and the Children's Rights Alliance for England said that young workers should be receiving equal pay for equal work. They proposed a single minimum wage with 16–20 year old employees being entitled to the same level as other workers. They also wanted the 16–17 Year Old Rate raised as a means of improving both current and future prospects and standards of living.

Apprentice Rate

5.44 Stakeholder views on the Apprentice Rate for October 2011 were divided. Some favoured a freeze; some a rise in line with the other minimum wage rates; others wanted a rise in line with inflation; while another group sought an increase higher than any awarded to the other minimum wage rates in order to reduce or eliminate the differential between them and the Apprentice Rate.

5.45 Several stakeholders representing businesses favoured no change to the Apprentice Rate. The Unquoted Companies Group was pleased that the Apprentice Rate had been set at a level corresponding to the Learning and Skills Council's weekly contractual wage (£95 per week) and thought this should not be increased. The BCC also said the Apprentice Rate should be frozen in 2011. The CBI said that it was too early to assess fully the impact of the new rate. It thought no decision should be taken on the rate until there had been an opportunity to properly assess the impact of the first year of the new wage arrangements. The FSB was supportive of the Apprentice Rate and would like to see it on an equal footing with 'the 16–18 Year Old Rate for people in work'. FSB also called for increased financial incentives for businesses taking on apprentices.

5.46 In the low-paying apprentice sectors, the National Hairdressers' Federation, for reasons set out in Chapter 3, had concerns over the adverse impact of the Apprentice Rate. As we noted earlier, the National Day Nurseries Association saw the £2.50 rate as broadly in line with what nurseries were already paying apprentices but thought that, in the current economic climate, any rise in the rate could have an adverse impact.

5.47 Another group of stakeholders favoured maintaining the current differential between the Apprentice Rate and the other rates. Usdaw said the Apprentice Rate needed to be more generous to attract young people to opportunities in retail. Over time it hoped the rate would be significantly increased, but believed that this year it should be increased in line with the adult rate, suggesting a rise of 3.9 per cent.

5.48 The TUC also believed that we had been too cautious in setting the initial rate at £2.50 an hour. A significant increase would be possible in future years but this year it thought that the Apprentice Rate should at least keep pace with the other minimum wage rates, implying an increase of 3.5 per cent. Freezing the Apprentice Rate would have a negative impact on completions, while sustainable rate increases would have a positive effect.

5.49 The GMB favoured at least maintaining the value of the Apprentice Rate against movements in prices. UNISON called for all apprentices to be paid the current National Minimum Wage rates and eventual alignment of all the rates. This policy was supported by the National Union of Students. Unite regarded the National Minimum Wage as the baseline for all UK workers regardless of skill level, age, or legal status.

5.50 The EHRC recommended that the Apprentice Rate should be the same as the minimum rates for young people. The YWCA thought that the wage was too low for some women to live on.

Consideration of Other Government Legislation

5.51 A number of employer stakeholders again referred in their evidence to statutory and other measures which they believed we should take into account when considering changes to the minimum wage rates. They claimed that many of these measures had, or were likely to have, an impact on their costs.

5.52 This year, the most common issue raised concerned the forthcoming changes to personal pension arrangements. One organisation estimated that these changes would equate to an increase of 1.8 per cent in the adult rate. However, the new personal pension arrangements will not come into force until October 2012 and then they will be phased over a five-year period. We commissioned research this year to look at the current take-up of pensions and the likely impact of the new arrangements. George and van de Ven (2011) found that current pension provision was greater among non low-paying sectors, in the public sector, for women and in larger firms. They also estimated that between 8 and 11 million employees would participate in these new pension arrangements and concluded that the changes might increase average aggregate labour costs by about 0.6–0.8 per cent. These estimated costs would be greater in the low-paying sectors (0.8–1.1 per cent) and small firms (1.2–1.6 per cent). We will consider and take account of these new provisions as part of our 2012 Report.

5.53 Other areas that were highlighted as likely to have a significant impact on businesses were the increase in VAT to 20 per cent in January 2011 and the increase in employer NICs in April 2011. A number of other regulatory measures were mentioned, for example the Agency Workers Directive, the Equality Act, business rates and changes to the default retirement age. Some stakeholders flagged up the costs resulting from changes to regulatory frameworks specific to their sector, such as the recent introduction of the Care Quality Commission in social care. Stakeholders also noted that changes in rules governing the inflow of migrant workers have affected, and may continue to affect, labour supply in certain industries. We took account of these changes when we considered our recommendations.

5.54 In November 2010 the Government announced its intention to abolish the Agricultural Wages Board (AWB) for England and Wales. It said this was likely to happen in October 2012. From the date of abolition, agricultural workers would only be covered by existing employment legislation, for example the National Minimum Wage Act. It is therefore unlikely to affect agricultural workers this year. We will consider the abolition of the AWB more carefully as we prepare our 2012 Report.

5.55 As part of its emergency Budget in June 2010, the Coalition Government announced that it would introduce a two-year pay freeze for public sector workers from 2011/12, except for those earning £21,000 or less, who would receive an increase of at least £250 in these years. An increase of £250 would be equivalent to 2.2 per cent for a full-time worker earning around £11,500 a year, close to the minimum wage, and 1.2 per cent for those earning £21,000 a year.

5.56 The 2011/12 tax year will see a number of changes to taxation and NICs that will affect minimum wage workers and their employers. We considered these changes in our deliberations for the 2011 recommendations. The personal allowance for those aged under

65 will be increased by £1,000 to £7,475 in April 2011, and the gains will be limited to basic rate taxpayers. Those earning between £6,475 and £7,475 will be removed from income tax altogether while basic rate tax payers are estimated to benefit by up to £170 per year. There will also be increases to the employee and employer Class 1 NICs thresholds, and a rise of 1 percentage point in the rates for those earning above the thresholds. New businesses that start up in certain areas will get a reduction in their employer NICs for a three-year period. There are also a number of changes to Child Benefit and the Child Tax Credit which will affect low-paid workers with children. As a result of these changes, a family with one child earning the minimum wage will see their net weekly income increase by around £10 to £321 in April 2011 (for a single adult with no children it will increase by £5 to £204). We also considered increases in indirect taxes, such as the VAT increase from 4 January 2011.

5.57 As noted in Chapter 3, the significant increase in full-time education participation coincided with the introduction of the Education Maintenance Allowance (EMA) in 2004, a means-tested weekly allowance of up to £30 for young people in further education courses. The Government has announced that it will replace the EMA from the 2011/12 academic year with an 'enhanced discretionary learner support fund'. This, it says, will target support for those young people facing genuine financial barriers to participation. Decisions about the needs of individual students will be made by schools, colleges, and training providers rather than the Government. We considered the impact of this change on young people in making our recommendations on the youth rates.

Recommended Rates

5.58 As we sought to agree our recommendations to Government, we discussed the evidence at length and weighed the data and advice carefully. Our discussions ranged widely and various arguments were put forward and appraised as different aspects of our brief were considered in turn.

5.59 We considered several arguments in support of recommending an increase in the adult rate that was higher than the likely average increase in earnings. Among these, it was argued that the economy was in better shape than it had been for two years and all the forecasts pointed to continued steady improvement. Unit wage costs were declining and profits were rising. Low-paying sectors had performed better than the economy as a whole and major employer representative bodies had indicated a willingness to accept a reasonable level of increase. Moreover, inflation was expected to continue to be significant and, although they were not necessarily expected to keep pace with price inflation, pay settlements and pay rises were expected to reflect it, especially in the private sector. The lowest paid in the workforce, it was argued, should not be expected to accept a decline in their pay relative to the average. All of these arguments pointed to a recommendation on the high side of the forecast average increase in earnings.

5.60 We also considered the opposite view which would support a lower rate of uplift or even a freeze in the rates. These arguments emphasised the view that the UK economy was not out of danger; it was still in recovery mode. Business confidence remained fragile and there were still many risks in the global economy and the Eurozone. The effects of the fiscal freeze were still to be fully felt. The cuts in the public sector would have an adverse effect on private sector firms and consumer confidence. The road to recovery was likely to be far from smooth. It was pointed out that the position of small and medium-sized businesses was crucial to recovery and to the creation of jobs. Small firms would struggle to cope with anything other than a very modest increase. There was a trade-off between the level of the minimum wage and the retention and creation of jobs. Above a certain point, fewer jobs could be sustained. The continued uncertainty pointed to a cautious approach and a recommendation that did not place undue pressure on jobs.

5.61 We discussed at length the strengths and weaknesses of the forecasts of future average earnings growth and debated the merits of the various arguments. We concluded that the current situation called for an approach that recognised the continued economic uncertainty while protecting the lowest-paid workers from falling further behind the average. Accordingly, **we recommend that the adult rate of the National Minimum Wage be increased by 15 pence to £6.08 an hour from 1 October 2011.**

5.62 We received no new evidence to convince us of a need to propose any adjustment to the relative position of the accommodation offset. **We therefore recommend that the accommodation offset should increase from £4.61 to £4.73 per day from 1 October 2011.**

5.63 As we set out in Chapter 3, there has been a continuing decline in the labour market position of young people. Both the evidence and its interpretation are complex, but it has become evident that, since 2007, young people's earnings have been rising more slowly than those of adult workers. While this has been happening, the youth rates of the National Minimum Wage have increased broadly in line with the adult rate. Consequently, the bite of the minimum wage for young people has continued to increase while the bite of the adult rate has remained stable. Moreover, research has found evidence that in difficult economic circumstances the level of the minimum wage may have had an impact on the employment of young people.

5.64 Against this background, we decided that it would be imprudent to recommend an uprating of the youth rates that would be likely to further increase the bite. **We therefore recommend that the Youth Development Rate be increased by 6p to £4.98 an hour and that the 16–17 Year Old Rate be increased by 4p to £3.68 an hour from 1 October 2011.**

5.65 We make this recommendation reluctantly, recognising the difficulties faced by many young people, and we shall keep their position under careful review. If new evidence shows that the minimum wage has not in fact contributed to the employment difficulties of young people we shall recommend that their relative earnings be restored.

5.66 It appears that the initial Apprentice Rate has had little or no negative effect on the supply of apprentice places. Moreover, as explained earlier, the initial rate was cautious, broadly equating to a weekly rate that had been set by the Learning and Skills Council in August 2009. **We recommend that the Apprentice Rate be increased by 10p to £2.60 an hour from 1 October 2011.**

Implications of the Recommended Rates

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

Coverage

5.68 In April 2010, according to the Annual Survey of Hours and Earnings (ASHE), there were around 1.80 million jobs that paid less than the minimum wage rates we are recommending for October 2011. These were made up of 1.62 million jobs held by those aged 21 and over (6.7 per cent), 152,000 jobs held by 18–20 year olds (13.1 per cent), and 33,000 jobs held by 16–17 year olds (11.4 per cent).

5.69 In order to estimate coverage, we need to make assumptions about how the wages of the low paid would have changed in the absence of any minimum wage upratings. In other words, we need to estimate the real value of the October 2011 minimum wage rates at April 2010 (the date of the latest earnings data) by downrating using estimated wage growth. We need to use a combination of actual (April–October 2010) and forecast (October 2010–October 2011) changes in prices or earnings in order to estimate this growth.

5.70 Assuming that the wages of the lowest paid increase in line with forecast average earnings, we estimate that about 840,000 jobs or 3.5 per cent of all jobs held by those aged 21 and over would be covered by the new rate of £6.08 in October 2011, as shown in Table 5.2. If we assume instead that the wage growth of the lowest paid match forecast price inflation, between 212,000 and 928,000 jobs (0.9–3.8 per cent) held by the adult workforce, depending on the price index used, would be covered. Using the earnings assumption, we estimate that the new adult rate for the minimum wage will achieve a lower level of coverage than the £5.93 uprating in October 2010 (when 928,000 or 3.8 per cent of jobs held by those aged 21 and over were covered). Alternatively, using prices, estimated coverage of the new adult rate would also be lower than for the previous year (889,000–964,000 jobs or 3.7–4.0 per cent using RPI or CPI respectively).

5.71 We have recommended increases for the Youth Development Rate and the 16–17 Year Old Rate from October 2011 that are smaller than our recommendation for the adult rate of the minimum wage. Assuming that young workers' wages would increase in line with average earnings, we estimate that 39,000 jobs held by those aged 18–20 would be covered by the October 2011 Youth Development Rate, representing around 3.3 per cent of jobs held by these young workers. We also estimate that 14,000 jobs (5.0 per cent) held by 16–17 year olds would be covered by the October 2011 uprating. However, if the wages of young people continue to grow at a slower rate than for adults, the actual coverage will be greater than our estimates.

5.72 Based on the price assumption, our coverage estimates for 18–20 year olds range from 34,000 to 40,000 jobs (between 2.9 and 3.4 per cent of all jobs held by that age group) and the coverage for 16–17 year olds would be between 14,000 and 15,000 jobs (between 5.0 and 5.2 per cent of jobs for that age group).

5.73 Overall, we estimate, therefore, that the total coverage of the recommended October 2011 upratings, excluding apprentices, would be 893,000 jobs (3.5 per cent of all jobs), if the wages of the low paid were to increase by average earnings between April 2010 and October 2011. If they were to increase in line with prices, we estimate coverage of between 260,000 jobs (1.0 per cent of all jobs) and 983,000 jobs (3.8 per cent of all jobs).

Table 5.2: Estimated Number and Percentage of Jobs Covered by the Recommended October 2011 National Minimum Wage Upratings, UK, 2011

October 2011 hourly minimum wage rates		Earnings method	Price method	
		AWE total pay	RPI	CPI
Adult rate (aged 21 and over)	**£6.08**	840,000	212,000	928,000
		3.5%	0.9%	3.8%
Youth Development Rate (18–20 year olds)	**£4.98**	39,000	34,000	40,000
		3.3%	2.9%	3.4%
16–17 Year Old Rate	**£3.68**	14,000	14,000	15,000
		5.0%	5.0%	5.2%
Total		893,000	260,000	983,000
		3.5%	1.0%	3.8%

Source: LPC estimates based on ASHE 2007 methodology, low-pay weights, including those not on adult rates of pay, UK, April 2010; ONS, AWE total pay (KAB9), seasonally adjusted, RPI (CZBH) and CPI (D7G7), not seasonally adjusted, monthly, UK (GB for AWE), April 2010–October 2010; and HM Treasury (January 2011), UK, 2011.

5.74 As we discussed in Chapter 2, women are more likely than men to be working in low-paid jobs. Based on our earnings assumption, we estimate that the October 2011 adult minimum wage would cover around 322,000 jobs (2.6 per cent) held by men and 519,000 jobs (4.3 per cent) held by women. Using our price assumptions, we expect that up to 349,000 jobs (2.9 per cent) held by men and 579,000 jobs (4.8 per cent) held by women would be covered by the increase to £6.08. On all measures, jobs held by women aged 21 and over would be expected to make up just under two-thirds of all jobs covered by the 2011 October increase in the adult rate.

Position Relative to Average Earnings

5.75 The 'bite' of the minimum wage, that is its relationship to average earnings (measured at the median or the mean), is another way of assessing the impact of the minimum wage on the earnings distribution. In April 2010, according to ASHE, the median gross hourly earnings (excluding overtime) of all employees aged 21 and over (full and part-time) was £11.25 an hour. In order to properly compare median earnings with the October 2011 adult rate, we need to uprate them by the growth in average earnings (total pay), both actual and predicted. On that basis, the adult rate of £6.08 is expected to be about 51.9 per cent of estimated median earnings for those aged 21 and over (£11.72) in October 2011. This is the same as the estimated bite of the October 2010 rate of £5.93 for employees aged 21 and above.

5.76 Using the mean, we estimate that the bite in October 2011 would be around 40.2 per cent for employees aged 21 and over based on the earnings assumption. Again, this is the same as the bite at the mean for the October 2010 adult rate.

Impact on Household Income

5.77 When the adult minimum wage increased to £5.93 in October 2010, gross weekly income would have been £207.55 for a 35 hour week. Using HM Treasury estimates for the 2010/11 tax year, this gross income would have been equivalent to a net income of £199.59 for a single person working full-time with no children (a net wage of £5.70 an hour for a 35 hour week). The corresponding amount for a couple with one child (one partner working and the other not) would have been around £310.75 (equivalent to a wage of £8.88 an hour for a 35 hour week).

5.78 Again assuming a 35 hour week, gross weekly income would increase by £5.25 to £212.80 following the minimum wage increase to £6.08 in October 2011. Taking into account the minimum wage uprating and the 2011/12 tax year, the net weekly income for a single person would rise by £5.98 to £205.57. For the one-child family, net income would rise by £11.79 to £322.54. The effective hourly rate for the single person would be £5.87 (17 pence higher than in October 2010) and for a one-child family would be £9.22 (34 pence higher than in October 2010). At this stage we are unable to assess the impact of the changes to the tax and benefit regime for 2012/13.

Wage Bills

5.79 We anticipate that the direct impact of our recommendations on the wage bill is likely to be limited as the recommended increase in the adult rate of the minimum wage is broadly in line with the forecast rise in average earnings and pay settlements.

5.80 The lowest rates of pay in the public sector tend to be above minimum wage levels and, as we saw in Chapter 2, very few jobs in the public sector are paid at the minimum wage. We therefore expect a very small direct impact on the public sector wage bill from the recommended October 2011 rates. Given that many public bodies employ private sector firms under contract to provide services such as cleaning, our recommended increase may lead to a small indirect effect.

Exchequer Impact

5.81 An increase in the minimum wage can also affect the public sector through savings to the Exchequer resulting from increased tax receipts and reduced benefits. Table 5.3 is based on information supplied by the Government and illustrates our best estimates of the effects of the 15 pence increase in the adult rate of the minimum wage.[9] We estimate that in total the Government would gain around £232 million from the 2011 minimum wage uprating, nearly two-thirds of which consists of additional yield from income tax (£92 million) and National Insurance Contributions (£49 million) as the earnings of minimum wage employees increase. The Government would also stand to make savings from a reduction in Working Tax Credits (£40 million) and other benefits (around £52 million in total).

9 The Government provided us with estimates of yield and savings for hypothetical increases to the minimum wage of 10 pence and 25 pence.

Table 5.3: Estimated Exchequer Yield and Savings from the Recommended October 2011 Adult National Minimum Wage Uprating, UK, 2011/12

£ million	**Exchequer yield and savings from the increase in the minimum wage to £6.08 in October 2011**
Income Tax	92
National Insurance Contributions	49
Working Tax Credit	40
Child Tax Credit	17
Income Support	10
Housing Benefit	20
Council Tax Benefit	6
Total	**232**

Source: LPC estimates interpolated from HM Treasury calculations using 10 and 25 pence increases based on Family Resources Survey 2007/08, uprated to 2011/12, UK, tax year 2011/12.
Notes:
a. The Family Resources Survey derives hourly wages from weekly income and hours worked, which overestimates the number of individuals on the minimum wage. As a result the Exchequer savings presented above are also likely to be overestimated.
b. These figures take account of changes in tax credits, benefits, taxes and National Insurance Contributions but do not take any account of likely behavioural change caused by an increase in hourly pay, such as changed levels of employment or hours worked.
c. The figures take no account of wage changes for those paid just above the National Minimum Wage or changes in Exchequer yield from business or indirect taxes.
d. The figures do not include the effect of the £10,000 disregard in tax credits, which allows income to rise between one year and the next by up to £10,000 before tax credits begin to be withdrawn. This means that the reductions in tax credits would in practice be significantly smaller, at least in the initial tax year.

Conclusion

5.82 Our recommendations this year reflect the continued volatility in the UK economy, the state of the youth labour market and the uncertain prospects for the coming year. We believe that our recommendations reflect a careful weighing of the evidence and strike a balance between caution and optimism. We will continue to monitor closely developments in the labour market, with a particular eye to developments in youth employment.

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 LPC visits and meetings. All such individuals and organisations are listed below, unless they expressed a wish to remain unacknowledged.

ABTA Ltd

Access to Employment, Ayr

Actaeon Films Ltd

Apprenticeship Ambassadors Network

Association of Convenience Stores

Association of Labour Providers

Association of Leading Visitors Attractions

Association of Learning Providers

Association of Licensed Multiple Retailers

Ayr College

Ayrshire Chamber of Commerce

Bank of England

Barnstaple Chamber of Commerce

BHF-BSSA Group

British Beer & Pub Association

British Beer & Pub Association Midland Counties

British Chambers of Commerce

British Furniture Manufacturers

British Hospitality Association

British Retail Consortium

British Security Industry Association

British Youth Council

Broadcasting Entertainment Cinematograph and Theatre Union

BUPA Care Homes

Business In Sport and Leisure

Caia Park Partnership Ltd

Careers South West Ltd

Catch 22

CBI

Chartered Institute of Personnel and Development
Children's Rights Alliance for England
Citizens Advice Scotland
Cleaning and Support Services Association
Clive Hurst
Combers Limited
Communication Workers Union
Cultural and Creative Skills
Department for Employment and Learning Northern Ireland
Department of Enterprise, Trade and Investment Northern Ireland
Devon County Council
East Sussex, Brighton & Hove Registered Care Homes Association
Ed Howker and Shiv Malik
EEF the manufacturers' organisation
Employers Forum on Age
Employers' Forum on Disability
English Community Care Association
Equality and Human Rights Commission
Equity
Federation of Master Builders
Federation of Small Businesses
Food and Drink Federation
Forum of Private Business
Frankmarsh Stores, Barnstaple
Frederic Robinson Ltd
GMB
Habia
Her Majesty's Government
HRM Homecare Services Ltd
Hydes Brewery Ltd
Icon Consultants Ltd
Incomes Data Services Ltd
Institute for Fiscal Studies
Institute of Payroll Professionals
Intern Aware
Internocracy
Interns Anonymous
Ipswich & Suffolk Credit Union

Irish Congress of Trade Unions

Jobcentre Plus, Ayr

Kalayaan

Labour Research Department

Leisureplex Ltd

Local Government Employers

Mark Watson

Menzies Irvine Hotel

National Access & Scaffolding Confederation

National Apprenticeship Service

National Care Association

National Care Forum

National Council for Work Experience

National Day Nurseries Association

National Farmers' Union

National Hairdressers' Federation

National Institute of Economic and Social Research

National Trainers Association

National Union of Journalists

National Union of Students

National Union of Teachers

North Devon Council

North Devon Homes

North Devon Plus

North Devon Voluntary Services

Northern Homeworking Project

Northern Ireland Public Service Alliance

Oxfam

Pear Shaped in Fitzrovia Comedy Club

Piccaso HR Ltd

Place UK Ltd

Premier Express, Ipswich

Prince's Trust

ProCo. NW Ltd

Public and Commercial Services Union

Real Work Skills

Registered Nursing Home Association

RT Hair & Beauty@47

Rural Shops Alliance
Save the Children
Scottish Government
Sercon Support Services Ltd
Simpsinns Limited
Skills for Care & Development
South Ayrshire Council
SPAR, Wrexham
Spotless UK
Staffline Group Plc
Suffolk Chamber of Commerce
Sugarspun Pictures
Swallowfield Plc
Tanya de Grunwald
Tesco Stores Ltd, Ingleby Barwick Store
The McCaughan Group
Torridge District Council
Trades Union Congress
UK Fashion and Textile Association
Ulster Farmers' Union
Union of Shop, Distributive and Allied Workers
UNISON
Unite
United Kingdom Home Care Association
Unquoted Companies Group
Welsh Assembly Government
White Horse Child Care Ltd
Winchester Growers Limited
Working Men's Club & Institute Union Limited
XpertHR
YWCA England & Wales

Appendix 2
Low Pay Commission Research

Overview

1 Although most UK research has failed to identify any significant adverse impact of the National Minimum Wage on employment, much of that research was of course conducted prior to the recession in a period of strong economic growth. For this Report, we commissioned ten research projects. Many of these have attempted to address this gap but there was also a focus on young people, whose labour market position had been particularly badly hit by the recession.

2 Four research projects covered aspects of the recession looking at: the impact of minimum wages on employment; the impact on pay and employment; the impact on pay settlements and pay structures; and the impact on the distribution of pay and earnings. One of those also looked at the effects on employment of young workers. A further four projects concerned young people and looked at: the relationship between age, wages and productivity; the international evidence on the impact of minimum wages; the impact on employment; and the impact on schooling, education, apprenticeships and training. The remaining two projects covered the impact of the minimum wage on productivity by size of firm and the employer provision of pensions for low-paid workers. We start by considering the research on young people.

3 Dickerson and McIntosh (2011) investigated the relationship between productivity, earnings and age, with a focus on the early years of work. They estimated empirical age-earnings profiles and wage-productivity gaps for different aged workers. Their results suggested that the introduction of the National Minimum Wage had not affected age-earnings profiles, which had remained largely unchanged with wages increasing each year by around 40 pence an hour at the median for those aged 16–28.

4 The age-productivity profile was found to be similar to the age-earnings profile, albeit a little steeper, but it appeared to flatten after the introduction of the minimum wage. They concluded that young workers were overpaid relative to their productivity compared with older workers but that this 'overpayment' had not been made worse by the minimum wage. They further concluded that the relativities of the various age-specific minimum wage rates had been set at about the right level. However, their research only covered the period up to 2007. It is therefore consistent with our analysis in Chapter 3, as the growth of young people's wages did not become slower than that of older workers until after 2007.

5 In a wide-ranging and comprehensive review of the international literature, Croucher and White (2011) assessed the impact of the minimum wage on young workers, focusing on employment, education participation and training. They found that the incidence of the minimum wage was highest among young workers, women and part-time workers in all countries. This work built on and extended the literature survey of Neumark and Wascher (2008), who had found the strongest evidence of negative effects of minimum wages among teenage and youth employment in countries without a separate youth rate. Croucher and White (2011) found that recent evidence had tended to be more mixed with smaller negative effects but they also found that the impact was more likely to be negative in countries and states that had a single unified minimum wage for all workers. For those countries with lower youth rates, such as the UK, the adverse effects of the minimum wage were mitigated to some extent.

6 Overall, they concluded that the negative effect on employment from the introduction of a minimum wage, or increases in existing minimum wages for young people, were small and tended to disappear as young workers aged. However, the general weight of evidence suggested that increases in the minimum wage did adversely affect employment for the youngest group, those aged 16–17. They also found the effects of a minimum wage on schooling were generally small and noted that the findings on employer training were mixed, partly because effects were very small.

7 Fidrmuc and Tena Horrillo (2011) investigated the impact of the minimum wage on employment from 1999–2009 for all workers aged 18–40. In contrast to previous findings, they found some evidence that those workers whose wages were set to increase as a result of minimum wage upratings were more likely to experience job losses than similar workers whose wages were not affected. However, no significant effects were found for those aged 18–24. Further, minimum wage increases also encouraged low-skilled workers who had been unemployed or inactive to enter the labour market. The two effects (the negative effect on employment and the positive effect on participation) were found to be similar in magnitude and therefore cancelled each other out. Both of these effects were found to be stronger when local labour market conditions worsened.

8 They also revisited the work carried out last year by Dickens, Riley and Wilkinson (2010), which had exploited the age-related nature of the UK minimum wage to investigate the impact on employment when the minimum wage increased on an individual's 18th and 22nd birthdays. Fidrmuc and Tena Horrillo (2011) also found a positive effect of turning 22 on employment when considering just the low skilled but that this disappeared when the changing effect of age was taken into account. They did find some negative overall effect of turning 21 for men and for both men and women turning 18. While admitting their results were not clear cut, they concluded that the age-related minimum wage rates may have had an adverse impact on the employment of young workers.

9 Lanot and Sousounis (2011) analysed the impact of the minimum wage on education and training choices. They looked at the effect on education participation, highest qualification, apprenticeships and training and investigated whether recessions had any additional effects. They found that the National Minimum Wage did not appear to have had any substantial effects on school enrolment or qualifications. Further, these did not seem to have been affected by the recession. They did however find that the minimum wage had a small, positive and significant effect on enrolment into further and higher education. Increases in the local unemployment rate reduced that effect.

10 Their research found that the bite of the minimum wage at age 18 may have adversely affected both the take-up and completion rates of apprenticeships relative to other educational and training choices. In general, they also found no effect of the minimum wage or the unemployment rate on training received in employment for all workers. However, restricting their sample to young workers aged under 26, they found that the minimum wage bite significantly reduced the proportion engaged in training.

11 Analysing cross-national variations in minimum wages across 33 Organisation for Economic Co-operation and Development (OECD) and European countries over the period from 1976–2008, Dolton and Rosazza Bondibene (2011) estimated the effect of minimum wages on employment. Their findings that the minimum wage tended to have a negative effect on employment were consistent with previous studies that have taken a similar approach, OECD (1998) and Neumark and Wascher (2004). However, these studies did not weight the data by the population size of each country. When the researchers did this, they found that their findings were not robust and largely disappeared or were significantly reduced. Further, they could not find any significant differences in the effect of the minimum wage over the economic cycle except for young people. For those aged 15–24, they found that the impact of the minimum wage was more detrimental in the presence of an economic downturn. They concluded, however, that there was presently no sound evidence that minimum wages had an adverse effect on unemployment.

12 Data to fully assess the impact of the recession on employment and wages are still not yet available. In order to surmount this problem and give an insight into the effects of recession, Dickens and Dolton (2011) made use of the Wages Councils in the 1980s and 1990s to attempt to identify the effect of recessions on the impact of minimum wages. Their results found no significant detrimental impact of Wages Council minimum wages on employment. Indeed, their industry level analysis suggested that increases in minimum wages may have had some positive employment effects. This finding is in line with previous research by Dickens, Machin and Manning (1999).

13 They do, however, find some weak evidence of a detrimental impact on hours from increases in minimum wages under the Wages Councils. This is consistent with the findings by Stewart and Swaffield (2004) that the introduction of the National Minimum Wage had led to a small reduction in hours. They did not find that the effect on hours or employment was made worse by the recessions of the 1980s and 1990s and concluded that their findings suggested only limited recessionary effects of the minimum wage but that job turnover may slow. They found no aggregate employment differences between the covered and uncovered sectors through either of the 1980s or 1990s recessions.

14 Using its pay data bank, Incomes Data Services (IDS, 2011) assessed the implementation dates and the distribution of pay settlements; the relationship between settlement levels, earnings movements and changes in the minimum wage; and the impact of the 2008–2009 recession. It reviewed the data since 1994 in respect of four time periods: immediately before the introduction of the National Minimum Wage (1994–1997); the early years of its operation (1998–2000); the period of relatively large increases (2001–2006); and the years of more modest uplifts (2007–2010).

15 The research showed that many employers made major changes to their pay systems in the period before the minimum wage was introduced. These reduced the impact of the eventual introduction of the National Minimum Wage with no discernable negative effects on either employment or pay differentials. During the period of relatively high awards some companies in low-paying sectors moved to using the minimum wage as their lowest pay rate, partly in response to the uplifts but also because of the extension of Sunday trading and longer opening hours. Some employers looked to the levels of allowances and premia to offset increases in the minimum wage, and companies in some low-paying sectors also introduced age-related scales to take advantage of the minimum wage youth rates. In this period, differentials between employees on the minimum wage and those in the immediately higher grades narrowed as the latter's pay awards failed to match the percentage increases in the National Minimum Wage. In the period of relatively modest increases in the minimum wage some employers re-established a lead between their lowest rate and the minimum wage, and restored differentials further up the pay structure. The changes in differentials over time were captured in separate analysis of pay differentials in 40 named organisations.

16 In aggregate, pay settlement medians in low-paying sectors since 2000 had broadly matched those in the whole economy, and IDS noted that awards in these sectors were, as in the rest of the economy, more likely to be influenced by inflation and other economic factors than determined solely by changes in the minimum wage. IDS noted some impact on settlement practice over time, however. The proportion of companies in low-paying sectors with an October pay settlement date for all employees had nearly doubled since the introduction of the minimum wage (to around a fifth), and there had been some move among other employers to use October as the settlement date for their low-paid staff only, using a different settlement date for other employees.

17 Noting that 2008–2009 was the first recessionary period since the introduction of the National Minimum Wage, and therefore that there was no history of setting a national minimum wage in periods of slow or negative economic growth, Dolton, Lin, Makepeace and Tremayne (2011) analysed pay data since 1977 to assess the impact of previous recessions on the distribution of pay settlements and earnings. The work involved the collection and collation of relevant pay data, and included the creation of a unique pay settlement series dating back to 1975. The authors were able to analyse a consistent yearly dataset for the period 1977–2009 for 16 and 30 industrial groups. The data were subject to rigorous econometric modelling. Perhaps surprisingly they found that the impact of economic growth on pay settlement levels appeared to be countercyclical, with pay awards higher in years of low growth. However, further analysis suggested there may be a delay before pay negotiators adjust to changing economic circumstances, with pay settlement levels lagging changes in economic growth. Consequently, for example, the lower growth was in one time period, the lower awards were in the next.

18 They also found evidence of a clear negative effect of unemployment on wage settlements, which they noted was consistent with the Phillips curve literature. They found a clear positive effect of inflation on wage settlements. That such a relationship exists has been generally accepted by pay researchers for many years, but has now been verified by econometric analysis over a long time period. Finally, they identified slightly higher increases in wage growth in the years since the National Minimum Wage was introduced.

19 Our final two research projects considered firm size and also the forthcoming changes in pension regulations. Croucher and Rizov (2011) examined the longitudinal impact of the minimum wage on firm productivity by size of firm. Using detailed financial information from a large sample of firms, they found that the National Minimum Wage had generally had a significant positive impact on aggregate low-paying sector productivity. However, in hairdressing, leisure and agriculture, the impact was not statistically significant, but still positive. Looking at firm size, they found that the strongest positive effects were in large firms. They argued that large firms were more able to make use of monopoly power to pass on costs to their customers. Internal firm reorganisation, besides long-run technology adjustments, was also likely to have played a role. But that this had not occurred in sectors such as hairdressing, where such changes had been limited. Although this research in general found strong beneficial effects of the minimum wage on productivity, it may have just picked up differences in productivity across sectors and size of firm rather than picking up specific effects resulting from the introduction and subsequent upratings of the minimum wage.

20 Following the recommendations of the Pensions Commission, the previous Government agreed to introduce new pension arrangements, aimed at low to modest income earners. Employers would be required to auto-enrol their qualifying employees into a pension scheme. The previous Government had set minimum levels of contribution of 3 per cent from employers and 4 per cent from employees, with 1 per cent tax relief. The Coalition Government has announced that it will go ahead with this scheme with some modification. George and van de Ven (2011) looked at the current provision of pensions among low-paid workers and in low-paying sectors and assessed the potential take-up and costs of the new scheme. They found that existing occupational pension provision was greatest among the non low-paying sectors, in the public sector, for women and in larger firms. It was also greatest among the highest paid. In the low-paying sectors, current pension provision was greatest among those with a significant number of employees in the public sector (social care and childcare). It was also reasonably high in office work and food processing.

21 They found that between 8 and 11 million employees would participate in these new pension arrangements. They concluded that the new arrangements may increase average aggregate labour costs by about 0.6–0.8 percentage points. The increased costs would be greater in small private sector firms, about 1.2–1.6 percentage points, and in the low-paying industries, around 0.8–1.1 percentage points on average. The highest increase in costs would be among employment agencies (1.3 percentage points) and firms in agriculture (1.2 percentage points) and hairdressing (1.1 percentage points). These costs, however, would be mitigated by the exemption of those working for their employer for less than 12 weeks announced in the Spending Review. Further, the scheme will be phased in slowly over a period of 5 years.

22 Overall our research again generally found that the minimum wage had not had any significant adverse impact on employment, however, the research this year has found more evidence of an adverse impact than in previous years. This has been particularly true of the research on the impact of the minimum wage on young people.

Table A2.1: Low Pay Commission Research Projects for the 2011 Report

Project title and researchers	Aims and methodology	Key findings and results
An Investigation into the Relationship Between Productivity, Earnings and Age in the Early Years of a Working Life **Andy Dickerson** and **Steven McIntosh** (University of Sheffield)	The researchers investigated the relationship between productivity, earnings and age. First, they looked at how earnings changed with age. Second, they examined the relationship between age, wages and productivity more explicitly. The first part of the research examined the empirical age-earnings profiles of young workers before and after the introduction of the minimum wage using the Annual Survey of Hours and Earnings (ASHE). They investigated the rate of growth of real hourly earnings by birth cohort. The study also looked at before and after regression analysis that allowed the age-earnings profiles to differ pre and post the introduction of the minimum wage. They used a variety of flexible parametric and semi-parametric functional forms in order to capture more precisely the relationship between age and earnings in the early years. Second, they used data from the Annual Business Inquiry and ASHE to construct a panel of industries over the period from 1996–2007. They then estimated productivity and wage equations at the three-digit industry level. They carried out before and after analysis to look at age-earnings profiles and age-productivity profiles. Both parts of the research were conducted separately for low-paying industries.	Their results suggested that there was little evidence of any change in the age-earnings profiles between older and younger cohorts since the introduction of the minimum wage. Wages rose quite sharply in the early years (16–28), became slightly flatter, and reached a plateau in the forties. The rate of growth of earnings by age had also been unchanged, at around 40 pence an hour for each year between 16 and 28 years of age. This conclusion appeared robust to the inclusion of controls for gender and hours worked. A similar finding resulted when focusing on low-paying sectors. They found that the average rate of wage growth by age was lower for workers in these sectors than in the whole economy (at around 20–25 pence an hour), but it had also not been affected by the introduction of the minimum wage or its subsequent upratings. The age-productivity profile was similar to the age-earnings profile, reaching a peak for workers in their forties, but was slightly steeper. It had become slightly flatter after the introduction of the minimum wage but remained steeper than the age-earnings profile. They concluded that young workers appeared to be overpaid relative to older workers but that productivity had increased faster for young workers since the introduction of the minimum wage. They also concluded that the relativities of the age-specific minimum wage rates had been set at about the right level for the period between 1999 and 2007.
The Impact of Minimum Wages on the Youth Labour Market: An International Literature Review **Richard Croucher** (Middlesex University) and **Geoff White** (University of Greenwich)	The project provided a literature review of the published evidence of the impact of the minimum wage on youth labour markets at an international level. It built on previous literature reviews by the Organisation for Economic Co-operation and Development (OECD) (1998) and Neumark and Wascher (2008). They conducted a 'systematic review', including interviews with academic experts for most of the countries surveyed. These interviews were used to inform the literature search. The researchers established a template for analysis of the material (the protocol). The systematic review method facilitated a common, clear approach for evaluating the literature. The paper provided a review of the theoretical debates concerning the relationship between minimum wages and the youth labour market. It discussed the methodology used in the various studies that it reviewed. It then provided a review of each of the 12 countries covered setting out the minimum wage system, particular arrangements for young people, and the findings from the reviewed literature. They reported a range of institutional frameworks among these countries but divided the countries into two main groups – liberal market economies (the UK, US, Canada, Australia and New Zealand) and co-ordinated market economies (France, Netherlands, Belgium, Spain, Greece, Portugal and Finland). The research focused on the impact of the minimum wage on employment, schooling and training.	They noted that their findings were subject to publication bias, in that studies that were neo-classical in method and that found positive (negative) results were more likely to be published than those whose results were neutral. They found that most international literature related to the US. Much of the early US evidence found a negative impact on employment. In their literature overview, Neumark and Wascher (2008) found the strongest evidence of negative effects of minimum wages among teenage and youth employment in countries without a separate youth rate. Recent evidence had tended to be more mixed with small negative effects. Studies from Canada and Australia also tended to find small negative effects. Weak negative employment effects had also been found in New Zealand resulting from a lowering of the age of the adult rate but youth employment rose in Portugal after such a policy change. Research in Spain had generally found significant negative effects but a more recent study found no such effect. In contrast positive effects had been found in Greece. Negative effects on schooling had been found in Canada and New Zealand although there was little evidence of such effects in the US. Overall, they concluded that employment effects were in general small in the majority of studies. The impact was more likely to be negative where there was no separate sub-minimum for younger workers. There was little evidence in the US or UK of a negative impact on education participation. The evidence on the impact of minimum wages on employer training was mixed but the estimates were generally small.

Project title and researchers	Aims and methodology	Key findings and results
The Impact of the National Minimum Wage on the Labour Market Outcomes of Young Workers **Jan Fidrmuc** (Brunel University) and **Juan de Dios Tena Horrillo** (Universidad Carlos III, Madrid)	This study looked at the impact of the National Minimum Wage on the employment of young workers. First, they used the partially longitudinal nature of the Labour Force Survey (LFS) data to analyse the labour market outcomes of young workers before and after they turn 18 and 22. They used a regression discontinuity approach to examine the impact of qualifying for a higher minimum wage. The minimum wage rose by about 20 per cent when an individual became 22 and by 35 per cent on becoming 18. They built on the previous work conducted by Dickens, Riley and Wilkinson (2010). Unlike that analysis, which focused on the discontinuity co-efficient, they also considered the effect of age on employment. Second, they complemented this analysis by using a difference-in-difference approach to assess the effect of the minimum wage and its different rates on employment for those aged 18–40. They considered all the annual increases from 1999–2009 and observed differences in the estimated employment probabilities between two groups (the treatment group being those affected by minimum wage increases, and the reference or control group being those paid just above that threshold).	As in the previous study by Dickens, Riley and Wilkinson (2010), they found a positive effect on employment from the discontinuity co-efficient for low-skilled workers but argued that this failed to take account of the changed effect of age. Once this had been done, they found no significant (positive or negative) effect of turning 22 on employment, unemployment or inactivity when considering low-skilled workers. They also found no effect for all workers (their preferred specification as they argued that minimum wage coverage for young workers was similar for those with high and low qualifications). However, they found some negative effect of turning 21 for young men. They suggested that this might be due to anticipation by the employer of a higher minimum wage rate in a year's time, although there might be another explanation. They also found a negative effect on men and women at age 18. Again, in contrast to the previous literature, they found an adverse effect of the minimum wage on the probability of remaining in employment for those aged 18–40 when the whole period from 1999–2009 was considered. But they also noted a positive effect of increases in the minimum wage on job entry from those unemployed or inactive. These two effects effectively cancelled each other out. The minimum wage had more bite in the recession with a greater negative effect on employment probability but it also had a larger positive effect on job entry. Again the two cancelled each other out. They concluded that the minimum wage may have a more pronounced effect than found in previous research, particularly among young workers.
The Minimum Wage and Human Capital Accumulation of Young Low-paid Workers in a Recession **Gauthier Lanot** (University of Keele) and **Panos Sousounis** (University of Wales, Swansea)	They investigated the effect of a downturn in economic activity on the choice of education and the incidence of training received and completed by low-paid young workers. They reviewed the literature and considered economic theories on how young people may be affected in their education choice by a reduction in demand for employment. They then conducted an econometric analysis to look at these issues. They used LFS and ASHE to construct a cohort panel that was gender, age and region specific. When considering training, they used sector rather than region. From this, they calculated the bite of the minimum wage as the ratio of the minimum wage to the cohort-specific median wage. They then estimated the impact of this bite on: ● education completion in general; ● attainment of highest qualification; ● take-up and completion of apprenticeships; and ● within-firm training. As well as assessing the bite of the minimum wage, they investigated the impact of the local unemployment rate as a measure of economic conditions. The research was conducted before the introduction of the Apprentice Rate.	They found that the National Minimum Wage had a small insignificant effect on cohort-specific school enrolment and that this effect was not changed by the inclusion of the unemployment rate. The minimum wage thus had no discernible impact on school enrolment. They did find a small and significant impact on enrolment into further and higher education but found, surprisingly, that it decreased when the local unemployment rate increased. They found that neither the minimum wage nor the local unemployment rate had any consistent significant effect on education attainment in terms of the highest qualification achieved. The research did find that the bite of the minimum wage may have adversely affected the take-up and completion rate of apprenticeships relative to other educational and training choices. Although the unemployment rate did not seem to affect the amount of training received in employment, they found some evidence that the minimum wage appeared to reduce the proportion of young workers receiving training. This finding was, however, not robust. Among older workers, they found no such association. Their findings in general suggested that the minimum wage had not had any significant and consistent impact on education enrolment and achievement. They also could not detect any consistent impact on the incidence of training. However, they did find that the minimum wage had a negative effect on the completion rate of apprenticeships.

Project title and researchers	Aims and methodology	Key findings and results
An Evaluation of the International Experience of Minimum Wages in an Economic Downturn **Peter Dolton** and **Chiara Rosazza Bondibene** (Royal Holloway, University of London)	The research aimed to cover two aspects. First, they estimated the employment effects of the minimum wage by exploiting the substantial differences in minimum wage levels across countries. Second, they estimated whether these employment effects varied over the business cycle. This report built on earlier work by the OECD (1998) and Neumark and Wascher (2004). They investigated these issues by utilising the variation in the introduction, level and timings of upratings across a panel of 33 OECD and European countries for the period from 1976–2008. They also investigated how the effect of the minimum wage on employment changed through the different stages of the economic cycle. They looked at how changes in the incidence of the minimum wage across countries were correlated with changes in country-specific employment rates, based on OECD data. The study also accounted for institutional and other policy-related differences that might have had an impact on employment other than the minimum wage. They investigated whether weighting the data by population made any difference to their findings. Youth rates and young workers were considered separately.	They found that, using unweighted data, there seemed to be evidence of a negative employment effect of minimum wages, which was robust and consistent with the Neumark and Wascher (2004) findings. This negative effect on employment was stronger for young people (those aged 15–24). However, when the data were weighted by population size in each country, the size of the negative effects were reduced. In some of the regressions, country and year effects removed the significance of the co-efficients suggesting little difference in employment between those with a minimum wage that bites most and those where it had least impact. In general, there did not seem to be much difference in the impact of minimum wages on employment over the economic cycle. However, when the focus was on young workers (those aged 15–24), they found that the impact of the minimum wage was more detrimental to their employment prospects in the presence of an economic downturn. They concluded that there was no sound evidence of any negative impact of the minimum wage on employment.
Using Wage Council Data to Identify the Effect of Recessions on the Impact of the Minimum Wage **Richard Dickens** (University of Sussex) and **Peter Dolton** (Royal Holloway, University of London)	This project examined the impact of UK minimum wages in force during the 1980s and 1990s recessions when a system of Wages Councils was in operation. It also investigated how recessions affected the low paid. First, they used the New Earnings Survey (NES) and the Workforce in Employment Survey to construct an industry level panel on employment and wages for 1975–1993 in order to examine aggregate changes in employment. Wages Councils set separate minimum rates of pay in a specific range of low-paying industries only. There were a large number of sectors that were not covered. They used difference-in-difference analysis to compare the impact of the two previous recessions (in the 1980s and 1990s) on employment and wages in the covered Wages Councils sectors with uncovered comparison industries that also contained many low-wage workers. Second, they examined employment retention and job entry using individual level microdata from the NES panel. They estimated parametric models and outflows and inflows from employment. They attempted to control for some characteristics such as age, gender and region.	Their results showed that overall the Wages Councils had not had an adverse impact on employment. Indeed, they found evidence at the industry level that increases in minimum wages under the Wages Councils had had a positive impact on employment growth. They found no differential impact through either of the recessions of the early 1980s or 1990s. Increases in the minimum wage rates in the covered industries had no impact on the relative employment between the Wages Councils and the uncovered industries. Furthermore, they found no relative employment change through either of the recessions. They did, however, find a negative impact on hours from increases in minimum wages under the Wages Councils in some specifications. In looking at individual data they found that those in Wages Council jobs were more likely to exit employment than those in the uncovered sectors. However, they were also more likely to flow into new jobs, suggesting that job turnover was higher in the covered sectors. There was also some evidence that these employment transitions were more stable in the Wages Council sectors during recessions, with both outflows and inflows falling in the early 1980s. Overall, they concluded that there were only limited recessionary effects of minimum wages but that job turnover may slow. They found no aggregate employment differences between the covered and uncovered sectors through either of the earlier recessions.

Project title and researchers	Aims and methodology	Key findings and results
The Impact of the National Minimum Wage on Pay Setting Since 1994 **Alastair Hatchett, Laura James, Anna Mayhew, Ken Mulkearn, Jack Robertson, Anna Warberg, Lois Wiggins,** and **Louisa Withers** (Incomes Data Services, IDS)	The research covered three areas. First, it looked at how pay settlements in the whole economy and in the low-paying sectors had changed over time and assessed whether the minimum wage or the recent recession had much effect. Second, it provided a narrative on the impact of the National Minimum Wage on companies' pay structures. Finally, it drew on a panel of 40 organisations to look at how the differential between the minimum wage and 'established employee' pay rates had changed over time. IDS used its pay data bank to assess the implementation dates and distribution of settlements; relationships between settlement levels; earnings movements and minimum wage uplifts; and the impact of the recession. The research covered the whole economy and the main low-paying sectors in four periods: 1994–1997 (before the National Minimum Wage was introduced); 1998–2000 (when the minimum wage was introduced); 2001–2006 (a period of relatively large increases in the minimum wage), and 2007–2010 (a period of more modest increases).	IDS found that in general pay settlements in the low-paying sectors had been broadly in line with those of the rest of the economy since 1994. Median settlements in the low-paying sectors were much more likely to be influenced by the general state of the economy and sector, wage rises for similar workers elsewhere and inflation than by minimum wage upratings. There was some evidence that employers squeezed differentials between established workers and those on the minimum wage in periods of high minimum wage rises, but with at least some restoration during periods of relatively modest rises. A similar relationship applied to supervisory and established worker rates, although the squeeze on differentials was generally not as great. There had been some moves to an October settlement date for some or all staff in companies in low-paying sectors. Many companies had changed pay structures in advance of the minimum wage being introduced in 1999, and this had made its adoption easier for them. Since 1999, pay structures had continued to change (fewer hierarchies, fewer geographic zones, reduced overtime, shift, Sunday and bank holiday premia, age-related scales) but the nature of change varied by sector and the minimum wage was just one explanatory factor among many. During the recession, there was a large rise in the number of pay freezes recorded but the incidence of freezes was generally lower in the low-paying sectors.
An In-depth Assessment of the Impact of the Recession on the Distribution of Pay Settlements and Earnings **Peter Dolton** (Royal Holloway, University of London), **Li Lin** (London School of Economics), **Gerry Makepeace** (Cardiff University) and **Andy Tremayne** (University of New South Wales, Australia)	This project looked at how recent recessions have affected the distribution of pay settlements and earnings. Special attention was paid to the low-paying sectors. Raw data on settlements from the CBI, IDS and XpertHR were merged with data from the LFS and relevant Office for National Statistics aggregates to create a data set covering the period 1975–2009. This was then disaggregated by industry (splitting the data into 16 and 30 Standard Industry Classification industry groupings). The forces that drive pay settlements were examined: productivity changes, the state of the labour market, inflation and the extent and effectiveness of trade union activity and bargaining with management. The main econometric estimation provided a basic summary of the correlations between the key variables of interest. The findings were subjected to a number of robustness checks including different estimation methods; levels of industrial disaggregation; and definitions of recession. They also looked at the dynamic structure of key variables and restricted their analysis to using just one settlement series.	The researchers found that there was a clear negative effect of unemployment on wage settlements. This was consistent with the literature on the Phillips curve. Surprisingly, and in contrast to that result, they also found a countercyclical impact of economic growth and/or recessions on the level of wage settlements. That is, the lower economic growth was, the higher wage settlements were. However, there was a partial offsetting positive effect from lagging economic growth by one time period. In those circumstances, for example, the lower economic growth in one time period, the lower pay settlement levels in the next. This may reflect a lag before pay determination reacted to changing economic circumstances. There was a clear positive effect of price inflation on wage settlements. This result was unsurprising given the importance of inflation in current and previous time periods in respect of wage negotiations. The years when the minimum wage had been in force had been characterised by slightly higher wage settlements. Their estimation was subject to extensive robustness checks but the results generally remained unchanged. Although weighting the data by number of employees did make some differences to their conclusions.

Project title and researchers	Aims and methodology	Key findings and results
The Impact of the UK National Minimum Wage on Productivity by Low-paying Sectors and Firm-size Groups **Richard Croucher** and **Marian Rizov** (Middlesex University)	The research investigated the longitudinal impact of the minimum wage on productivity of the firm. It focused on firm size and whether a firm was in a low-paying sector. The researchers used Financial Analysis Made Easy (FAME) data to estimate firm-specific productivity measures. FAME contains annual unconsolidated accounts for more than 360,000 UK companies over the period 1994–2009. It is reasonably representative in terms of coverage by sales and employment. Building on the econometric work by Olley and Pakes (1996) and further developed by Ackerberg, Benkard, Berry and Pakes (2007) and Rizov and Walsh (2009), this study employed a modified semi-parametric estimation algorithm to estimate production functions at the four-digit level. The estimation algorithm controlled for supply and demand factors affecting firms and explicitly accounted for the 'bite' of the National Minimum Wage on the average wage distribution. They then computed aggregate productivity for the low-paying sectors (and by firm size) and compared this with a counterfactual of higher-paying industries (comprised both of manufacturing and service industries). They then followed the unconditional difference-in-difference approach used by Draca, Machin and Van Reenen (2011). They investigated the impact of the minimum wage on both labour productivity and total factor productivity.	In general, the study found that the National Minimum Wage had a significantly positive effect on overall firm performance and aggregate low-paying sector productivity but the effects varied by sector. In most low-paying sectors, there was a significantly positive effect. In hairdressing, leisure and agriculture, the impact was positive but not statistically significant. When looking at productivity by firm size, the study found substantial heterogeneity in the responses of aggregate productivity to the minimum wage over time. The improvement in productivity was most marked in large firms. The researchers argued that this finding was likely to result from some degree of monopoly power that enabled large firms to pass on any cost increases to their customers. Internal firm reorganisation and long-run technology adjustments through labour-for-capital substitutions were also more likely to have occurred in large firms. Their results were similar for both total factor productivity and labour productivity. That is, the minimum wage had in general had a positive effect on productivity. They concluded that less competitive and domestically-traded sectors, such as social care, had greater relative productivity increases. But they noted that this was not the case for hairdressing where costs had not been passed on and innovation had been limited. There were, however, some concerns that their results were just picking up differences in productivity across sectors rather than due to any impact from the minimum wage.
Financial Implications of the National Employment Savings Trust **Anitha George** and **Justin van de Ven** (National Institute of Economic and Social Research)	This research investigated existing pension provision for the low paid; explored sectoral differences in pension provision for the low paid, and examined whether any differences could be accounted for. They also estimated the costs and likely take-up of the new pension arrangements, including auto-enrolment and the establishment of the National Employment Savings Trust (NEST) pension scheme, focusing on the low paid and the low-paying sectors. Their analysis used two main data sources (ASHE and the Family Resources Survey). Their initial analysis of the impact was based on two key assumptions: ● the distribution of wages and employer pension provision was the same as that estimated using ASHE; and ● all contributions to the NEST were paid at the lower limits mandated by the scheme. They then looked at likely take-up scenarios to calculate more accurate estimates of the costs.	They found that employer-provided pension provision had fallen from 65 per cent in 1995 to just 50 per cent in 2009. Within this, there had also been a substantial decline in Defined Benefit pension schemes, from in excess of 80 per cent of all employer schemes in 1997 to just over 60 per cent in 2009. They estimated that up to 46 per cent of employees (around 11 million) would be eligible for increased employer pension contributions under the new arrangements. But they estimated that only 33 per cent of employees (around 8.25 million) would actually participate. These estimates are consistent but towards the higher end of those made by the Government in its impact assessment. There was likely to be greater take-up among men, after controlling for employee wages and industry, as they currently have lower employer-provided pension provision than women. They estimated that total employer and employee contributions to the scheme would be around £10 billion, slightly higher than the official estimate (£9 billion). They estimated that the increase in average aggregate labour costs would be about 0.6–0.8 per cent. The impact was likely to be greatest among the lowest paid (0.8–1.1 per cent); those working in employment agencies (1.3 per cent), agriculture (1.2 per cent) and hairdressing (1.1 per cent); and those working in small firms, particularly those with fewer than 25 employees (1.2–1.6 per cent). They concluded that the increase in labour costs might result in a squeeze in the pay of the lowest paid as employers looked to recover any increase in costs but that the minimum wage was likely to shield the very lowest paid from bearing these costs.

Research Programme for the 2012 Report

23 We have commissioned the following projects to inform the recommendations in our next report:

- **An Analysis of the Impact of the National Minimum Wage on Earnings, Employment and Hours Through the Recession** Peter Dolton (Central London Evaluation, Analysis and Research), Gerald Makepeace (Cardiff University) and Andrew Tremayne (University of New South Wales, Australia)
- **An Analysis of the Impact of the National Minimum Wage on Earnings, Employment and Hours Through the Recession** Mark Bryan, Andrea Salvatori and Mark Taylor (University of Essex)
- **The Impact of the National Minimum Wage on Earnings, Employment and Hours: The Importance of Firm Size and Recession** Richard Dickens (University of Sussex), Rebecca Riley and David Wilkinson (National Institute of Economic and Social Research)
- **The Impact of the Minimum Wage Regime on the Labour Market Outcomes of Young People** Claire Crawford and Gill Wyness (Institute for Fiscal Studies), Joanna Swaffield (University of York) and Anna Vignoles (Institute of Education, University of London)
- **A Further Investigation into the Relationship Between Productivity, Earnings and Age in the Early Years of a Working Life** Andy Dickerson and Steven McIntosh (University of Sheffield)
- **An Assessment of the Introduction of the Apprentice Rate** John Higton, Rebecca Klahr, Ruth Lightfoot and Trinh Tu (Ipsos MORI) and Andy Hirst, Morgane Lefaucheux and Sini Rinne (Cambridge Policy Consultants)

Appendix 3

Minimum Wage Systems in Other Countries

Introduction

1 This appendix provides information that allows comparison between the UK's minimum wage and minimum wages in the same countries featured in previous reports. We are grateful to British Embassies, High Commissions and the Organisation for Economic Co-operation and Development (OECD) for supplying much of this data. Great caution should be taken when drawing comparisons between countries. 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 In comparing rates 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). We have also compared the increase in respective minimum wage rates between 2009 and 2010.

3 Table A3.1 shows that three countries experienced no increase in their minimum wage rates between 2009 and 2010: the United States, Greece and Ireland. The first of these implemented the final part of a three-year staged increase in 2009. The other two countries have reviewed their minimum wage arrangements in the context of extremely difficult economic circumstances. In Greece, the wage has been frozen in 2010 and the age for entitlement to the full adult minimum wage has been raised from 15 to 25. In Ireland there has been no rise in the wage since 2007 and the Irish Government has announced that the hourly rate is to be reduced by €1 from February 2011, a reduction of about 11.5 per cent.

4 Tables A3.2 to A3.6 give a comparison of minimum wages relative to median earnings as well as details of arrangements for upratings, variations for age, and apprenticeships. Some further commentary on these international comparisons is given in Chapter 5.

Comparison of Minimum Wage Systems

Table A3.1: Comparison of Adult Minimum Wages, by Country, 2010

	In national currency expressed as hourly rate[a]	In UK £, using:		Date of last uprating	% Increase in national currency from 2009–2010	Age full minimum wage usually applies[d]
		Exchange rates[b]	PPPs[c]			
Australia[e]	AU$15.00	9.04	6.60	Jul-10	4.8	21
Belgium	€8.17	6.86	6.07	Sep-10	2.0	21
Canada[f]	C$9.16	5.69	4.99	– [g]	0.9	16
France	€8.86	7.44	6.64	Jan-10	0.5	18
Greece[h]	€4.13	3.47	3.47	May-09	0.0	25
Ireland	€8.65	7.27	5.72	Jul-07	0.0	20
Japan[i]	JPY730	5.55	3.83	Oct-10	2.4	15/18[j]
Netherlands	€8.17[k]	6.86	6.35	Jul-10	1.2	23
New Zealand	NZ$12.75	5.97	5.19	Apr-10	2.0	16
Portugal[l]	€2.74	2.30	2.58	Jan-10	5.8	16
Spain[l]	€3.65	3.07	3.13	Jan-10	1.4	16
United Kingdom	£5.93	5.93	5.93	Oct-10	2.2	21
United States	US$7.25[m]	4.65	4.84	Jul-09	0.0	20

Source: British Embassies, High Commissions and OECD Minimum Wage Database. 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 2010. Exchange rates, Bank of England monthly average spot exchange rate, September 2010.

Notes:

a. 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.
b. September 2010.
c. PPPs derived by applying OECD CPLs – ratio of PPPs for private consumption to exchange rates – for September 2010.
d. Exemptions and special rules apply in many cases. For example, in France and the United States the full adult rate applies to young workers with a tenure of more than six and more than three months respectively.
e. Federal Minimum Wage Order, effective from 1 July 2010.
f. Weighted average of provincial/territorial rates.
g. Date of last uprating varies between provinces.
h. For blue collar workers.
i. Weighted average of prefectural rates.
j. Age 15 to receive the regional minimum wage. Age 18 to receive the sectoral minimum wage.
k. Excludes 8 per cent supplement for holiday pay.
l. Not including annual supplementary pay of two additional months of salary for full-time workers.
m. Federal minimum wage. Tipped employees receive a lower minimum wage of $2.13 per hour in direct wages.

Table A3.2: Adult Minimum Wages Relative to Full-time Median Earnings, by Country, Mid-2009[a]

Country	Per cent
Australia[b]	
– LFS	54.4
– ES	51.0
Belgium	50.8
Canada	43.8
France	59.8
Greece	41.9
Ireland	51.1
Japan	36.2
Netherlands[c]	43.5 (46.9)
New Zealand	60.0
Portugal[d]	46.0 (53.7)
Spain[d]	37.8 (44.1)
United Kingdom[e]	
– LFS	52.2
– ASHE	46.1
United States	35.5

Source: OECD estimates based on OECD minimum wage database and median earnings for full-time workers, mid-2009.
Notes:

a. In some cases, the median earnings data for full-time workers for mid-2009 are estimates based on extrapolating data for earlier years in line with other indicators of average earnings growth. All earnings data are gross of employee social security contributions.
b. Two estimates of median earnings are available based on its Labour Force Survey (LFS) and an Enterprise Survey (ES). In each case, the data refer to weekly earnings. The minimum wage refers to the Federal Minimum Wage.
c. The ratio including 8 per cent supplement for holiday pay is given in parentheses.
d. The ratio including annual supplementary pay of two additional months of salary is given in parentheses.
e. Two estimates of median earnings are available based on the Labour Force Survey (LFS) and the Annual Survey of Hours and Earnings (ASHE). In each case, the data refer to hourly earnings.

Table A3.3: Uprating of Minimum Wages, by Country, 2010

Country	Method of uprating
Australia	In April 2008 the Australian Government announced that the Australian Fair Pay and Conditions Standard, which set out base minimum conditions of employment such as the minimum wage, would be replaced by the National Employment Standards (NES). The NES came into effect in January 2010. The NES include minimum entitlements to pay, leave, public holidays, notice of termination and redundancy pay, operating alongside minimum wage orders.
Belgium	The minimum monthly average guaranteed income is set for the private sector by collective labour agreements reached at the National Labour Council (social partners). All workers benefit from salary indexation which is currently set at 5.1 per cent until 2010 (this varies according to inflation).
Canada	In most provinces, minimum wages are fixed (and increased) by regulation. A provincial Governor-in-Council has the authority to change regulations which are frequently based on recommendations of a Minimum Wage Board, Review Committee, Labour Standards Board or the Minister of Labour. The rate for the federal jurisdiction is the general adult minimum rate of the province or territory where the work is performed.
France	The minimum wage is reassessed each year on 1 January. The uprating must be in line with inflation and at least half that of the increase in purchasing power of the average hourly wage. The wage is automatically raised by the price index increase if it increases by over 2 per cent during the year. The Government can also increase the minimum wage at any time.
Greece	The National Minimum Wage is set by the National General Collective Labour Agreement (NGCLA) which is agreed by the social partners and then voted into law. The latest NGCLA was signed in July 2010 and covers a three-year period. The new agreement foresees a freeze in the minimum wage for 2010, and increases in line with Eurozone inflation for each of the following two years. There has also been a lowering of youth minimum wages.
Ireland	The National Minimum Wage can only be increased following a recommendation in a national agreement. Where there is no national agreement the Labour Court can be asked to examine the minimum hourly rate. The Labour Court can then make a recommendation to the Minister. As part of wider government economic plans, a €1 an hour reduction in the minimum wage is due to be introduced in February 2011.
Japan	The system operates regionally. The minimum wage is reviewed and amended each autumn. The Central Minimum Wage Council makes recommendations to the 47 Regional Minimum Wage Councils, comprising representatives of labour unions, employees and public agencies. The final decision is made by the Regional Director of the Labour Standards Agency. Industry level minimum wages can also be set within a prefecture.
Netherlands	The Ministry of Social Affairs normally uprates twice yearly (on 1 January and 1 July). Wage inflation is used to determine the size of the minimum wage increase.
New Zealand	The Minister of Labour conducts annual reviews in line with the Minimum Wage Act 1983 by 31 December of each year, with changes effective from the following 1 April.
Portugal	Since 2007 a tripartite committee (representatives from Government, unions and employers) has monitored economic conditions to consider the social and economic impacts of the minimum wage and recommend an annual upgrade.
Spain	The Government uprates annually following consultation with the social partners. It is obliged to take a number of economic indicators into account. Spain's Prime Minister has pledged to increase the minimum monthly wage to €800 by 2012.
UK	The Government considers recommendations from an independent commission, which reports following wide-ranging consultation. Since the minimum wage was introduced in 1999 there have been annual upratings.
US	Changes to the federal minimum wage are voted on by Congress intermittently. Most states have their own minimum wage rates. Where federal and state laws stipulate different rates, the higher rate applies.

Source: British Embassies, High Commissions and Low Pay Commission.

Table A3.4: Age Variations Under Minimum Wage Systems, by Country, 2010

Country	Treatment by age
Australia	Junior rates contained in Australian Pay and Classification Scales (Pay Scales) vary across industries and occupations. Typically a sliding scale applies from age 16 (40–50 per cent of the adult minimum wage) through age 18 (65–80 per cent) to age 20 (85–100 per cent). Adult wages apply at age 21.
Belgium	Full minimum wage applies at age 21. An additional premium is payable to workers aged 21½ who have been employed for at least 6 months and to workers aged 22 who have been employed for at least 12 months. There is a 6 per cent deduction from the minimum wage for each year below age 21, with those aged 16 or under receiving 70 per cent of the full rate.
Canada	Full minimum wage at all ages except in Ontario, which has a youth rate for students aged under 18 and working for no more than 28 hours per week. Both British Columbia and Nova Scotia have introduced a first job/entry-level wage rate for workers new to the paid labour market.
France	Full minimum wage at age 18. Certain categories of young people receive a reduced rate, provided they have worked less than 6 months in a sector (80 per cent for those aged 16 and 90 per cent for those aged 17).
Greece	Full minimum wage at age 25. For those in the 15–24 age group, the minimum wage is 84 per cent of the adult rate.
Ireland	Full minimum wage applies to an experienced adult employee (which is an employee who is not (i) under age 18 or (ii) in the first two years after the date of first employment over age 18 or (iii) undergoing structured training or study). Employees in the first year after the date of first employment over age 18 are entitled to 80 per cent of the full minimum rate and 90 per cent in the second year. Employees under age 18 are entitled to 70 per cent of the full adult rate.
Japan	The regional minimum wage applies to employees over 15 years old. The sectoral minimum wage applies to employees aged between 18 and 64.
Netherlands	Full minimum wage at age 23. Youth rates are 30.0 per cent at age 15, 34.5 per cent at age 16, 39.5 per cent at age 17, 45.5 per cent at age 18, 52.5 per cent at age 19, 61.5 per cent at age 20, 72.5 per cent at age 21 and 85.0 per cent at age 22.
New Zealand	From 1 April 2008 all employees aged 16 and over are entitled to the adult minimum wage, except for new entrants and employees to whom the training minimum wage applies. The new entrants' minimum wage and the training wage are equivalent to 80 per cent of the minimum wage.
Portugal	Full minimum wage at all ages. Exceptions are apprentices and trainees in qualified or highly qualified jobs, who can receive 80 per cent for up to a year, or 6 months if the course is technical/professional.
Spain	Full minimum wage at age 16. Young people who were unemployed but join various training schemes to help them to enter the labour market receive 75 per cent of the minimum wage.
UK	Full minimum wage at age 21 (from 1 October 2010). Separate rates exist for 16–17 and 18–20 year olds (currently 61 and 83 per cent respectively of the adult rate).
US	Full minimum wage at all ages, except below age 20 where a lower rate of $4.25 can apply (approximately 59 per cent of the current full minimum wage) for the first 90 days in any job. Also full-time students can be paid 85 per cent of the minimum wage. Additionally, student-learners (those aged 16 and over who are enrolled in vocational education) can be paid 75 per cent of the minimum wage while on the vocational education programme.

Source: British Embassies, High Commissions, and Low Pay Commission.

Table A3.5: Youth Minimum Wage Rates as a Percentage of Adult Minimum Wage Rates, by Country, 2010

Country	Percentage at age 16	Percentage at age 17	Average percentage at ages 18/19
Australia[a]	50	60	75
Belgium	70	76	85
Canada	100[b]	100[b]	100
France[c]	80	90	100
Greece	84	84	84
Ireland	70	70	85
Japan	(regional) 100 (sectoral) 0	(regional) 100 (sectoral) 0	(regional) 100 (sectoral) 100
Netherlands	34.5	39.5	49
New Zealand[d]	100	100	100
Portugal	100	100	100
Spain	100	100	100
UK	61	61	83
US[c]	59	59	59

Source: OECD Minimum Wage Database, British Embassies, High Commissions, and Low Pay Commission.
Notes:
a. As prescribed in the Pay Scales derived from New South Wales Shop Employees Award. These rates are broadly representative of the rates for younger workers prescribed in other Pay Scales.
b. All provinces except Ontario. Ontario's youth minimum wage of C$9.60 is 94 per cent of the adult minimum wage of C$10.25.
c. For France and the United States, the reduced rates apply to young workers with a tenure of fewer than six months and three months, respectively.
d. The youth minimum wage was replaced by a new entrants' minimum wage in 2008. This only applies to 16 and 17 year olds who are yet to complete three months or 200 hours of employment, whichever is shorter.

Table A3.6: Minimum Wage and Apprenticeships, by Country, 2010

Country	Apprenticeship exemptions
Belgium	Apprentices and trainees are exempt from the minimum wage and paid at a percentage of the minimum salary depending on age and year of study: 16–17 year olds are paid 25 per cent of minimum salary in the first year, 37 per cent in the second year and 53 per cent in the third year; 18–20 year olds are paid 41 per cent of minimum salary in the first year, 49 per cent in the second year and 65 per cent in the third year; those aged 21 and over are paid 53 per cent of minimum salary in the first year, 61 per cent in the second year and 78 per cent in the third year.
Canada	Apprenticeship training and pay is set at provincial level and is dependent on the regions and zones in each of the 13 territories where the apprentice is in training. The hourly salary wages for apprentices range between 50 per cent and 90 per cent of a journeyperson's wage. The exact percentage depends on the year of the apprenticeship, the occupation and the jurisdiction.
Greece	Apprenticeship training contracts can only be signed with persons in the 15–18 age group, and their duration cannot exceed 12 months. Trainees are paid 70 per cent of the National Minimum Wage. Those below age 16 are not allowed to train for more than 6 hours per day and 30 hours per week; those aged 16 and over are not allowed to train for more than 8 hours per day and 40 hours per week.
Ireland	National Minimum Wage legislation does not apply to apprentices in designated sectors prescribed by the National Training and Employment Authority. However, registered employment agreements set out the minimum rates for apprentices working in the Construction and the Electrical Contractor sectors. Minimum wage rates apply for employees aged over 18, on a course of training or study undertaken in normal working hours. Employee trainee rates apply: 75 per cent of the minimum wage rate in the first third period; 80 per cent in the second third period, and 90 per cent in the third period. The training or study must satisfy prescribed criteria including a minimum three-month duration.
Japan	Employees are exempt from the minimum wage only if the employer gets approval from the Head of the Regional Labour Standards Agency. Employees under certified vocational training, which is training approved by the Governor, are exempt from the minimum wage. Each exemption is discussed individually.
Netherlands	Students studying under the Educational Learning Path Arrangement, or enrolled in higher education, and doing an internship with an employer do not have to be paid the minimum wage and do not fall under the sectoral collective labour agreement. Students studying under the Learning by Doing Learning Path Arrangement are with an employer for four days a week and spend one day a week at school. These apprentices are required to have signed a labour contract and have to be paid at least the minimum wage. They are also subject to the sectoral labour agreement.
New Zealand	The training wage applies to apprentices who are enrolled in recognised training. It applies to those employees aged 16 years and over who are undertaking at least 60 credits a year in an industry training programme for the purpose of becoming qualified for the occupation they are employed in.
Spain	Apprentices combine work with training. The training cannot be less than 15 per cent of an apprentice's day and their wage cannot be less than the minimum wage, proportionate to their working hours. Individuals on training programmes (for people who have a degree but no professional experience) are a special case. Their remuneration is fixed by a collective agreement but cannot be less than 60 per cent in the first year and 75 per cent in the second year of the agreed salary of an experienced worker doing the same or an equivalent job.
UK	Employed apprentices below the age of 19 and older workers in the first year of an apprenticeship on Level 2 or Level 3 schemes are entitled to the Apprentice Rate of the minimum wage, set at £2.50 per hour from 1 October 2010.
US	The United States has a formal apprenticeship program that the Government runs. Anyone aged 16 or older can apply to enter an apprenticeship programme. Apprentices must be paid the minimum wage at the start of the apprenticeship with salary increasing during the programme, to be consistent with the skills acquired.

Source: British Embassies, High Commissions, and Low Pay Commission.

Appendix 4
Changes to Main Data Sources

Introduction

1 In this appendix we outline the main data sources used in our analyses and look at the principal changes that have been made since our 2010 Report. The three main sources of data that we use in this report to measure earnings are the Annual Survey of Hours and Earnings (ASHE), the Labour Force Survey (LFS) and Average Weekly Earnings (AWE). These are all published by the Office for National Statistics (ONS). The two main sources of employment information used are 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 All our main data sources are now published using the new 2007 Standard Industrial Classification (SIC) to define economic activity. In Appendix 4 of our 2010 Report we assessed how these changes affected our definitions of low-paying industries, and documented the resulting changes. We have used these new definitions for the first time in this report.

Annual Survey of Hours and Earnings

3 ASHE is the main source of structural earnings data in the UK and is regarded by ONS as the best source of earnings information. 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 employees in Pay-As-You-Earn (PAYE) income tax schemes obtained from HM Revenue & Customs (HMRC). The self-employed are excluded. We carry out our own analysis of earnings from ASHE whereby those employees not on an adult rate of pay are included in the dataset (they are excluded from ONS ASHE earnings estimates). This means that our earnings estimates will be different to ONS ASHE earnings estimates.

4 Changes to the HMRC PAYE computer system in 2009 resulted in the potential 2010 ASHE sample being much larger than expected, including a substantial number of duplicate and questionable records. ONS and HMRC worked closely to get the best quality sample possible, and the final version contained around 7 per cent more records than the 2009 sample. The response rate was in line with previous years, although there was an increased number of exemptions (mainly where the employee did not work for the employer during the survey reference period), and the final dataset was 2 per cent larger than the 2009 dataset. ONS analyses showed that the 2009 and 2010 datasets were similarly distributed across age, sex, industry and size of employer.[10]

5 In response to our request, one of the questions was changed to include apprenticeships in April 2010. It now reads, 'Was the employee paid at a reduced rate in the pay period for reasons of apprenticeship, training or age?' We are grateful that ONS made this change, and hope to work with them to explore the possibility of including questions in future questionnaires which would fully identify apprentices.

Average Weekly Earnings

6 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 Salary Survey. It 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 is a result of changes in employment across the sectors.

7 In January 2010, AWE replaced the Average Earnings Index (AEI) as the headline ONS measure of short-term earnings movements. The AEI series ended in July 2010.

Labour Force Survey

8 The LFS is the official data source used to measure employment and unemployment. It is a quarterly survey of around 52,000 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.

9 In our report, analyses of aggregate employment, unemployment and hours worked use monthly and quarterly LFS data published on the ONS website. These are seasonally adjusted estimates and are weighted to the latest population estimates. For detailed analyses of the labour market by age, ethnicity and disability, we have used the LFS Microdata. These data are not seasonally adjusted, so we take the four-quarter moving average of the outputs, and the population data used to weight them often lag behind the latest population estimates used on the ONS website. As a consequence of these differences, our analyses based on LFS Microdata produce estimates of levels that differ from the aggregates published by ONS. Estimates of proportions tend to differ less, as both the numerator and the denominator are affected.

10 Further information on the impact of the new HMRC PAYE system on ASHE in 2010 can be found at http://www.statistics.gov.uk/downloads/theme_labour/ashe/hmrc-impact-ashe2010.pdf

10 ASHE contains no information on disability, ethnic background, country of birth, nationality or education level. The LFS is, therefore, our only source of data on earnings for disabled people, ethnic minorities, migrants and people with no qualifications. Data on pay and hours in the LFS tend to be less reliable than in ASHE. Reasons for this include: the sample is smaller; people often answer the earnings questions without reference to pay documentation (although they are prompted to consult available documents); and some information is 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 LFS is below 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. This methodology reduces the differences between hourly earnings estimates from the LFS and ASHE. We use this methodology to estimate earnings for our LFS analyses.

11 In August 2010, ONS changed the definition of headline 'working age' labour market indicators used in its monthly labour market publications, as a result of the phased increases to the State Pension Age for women, from 60 to 65. Previously, ONS used a working age definition based on women aged 16–59 and men aged 16–64. The new ONS definition is 16–64 for both men and women, and we have followed this convention in our analyses. Given no other changes, however, employment rates will rise over time, and inactivity rates fall, as the age at which women reach State Pension Age increases from 60 to 65. It should be noted that ONS will also publish data on the old definition of the working age population (women aged 16–59, men aged 16–64) on a monthly basis, and on the actual working age population (16 to State Pension Age) on a quarterly basis.

Employee Jobs

12 The employee jobs series provides a timely industrial breakdown of jobs in the UK. A number of Short Term Employer Surveys (STES), which collect data from businesses across the economy, are used to compile the employee jobs series. Figures at a more detailed level, however, are available only for Great Britain (not Northern Ireland) and are not seasonally adjusted. This makes quarter-to-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 particular problem.

13 In July 2010, ONS made a number of fundamental changes to the sources, classifications, methods and systems used to produce the employee jobs series. These included: compiling and publishing the data using the new 2007 SIC; benchmarking the series to the 2007 and 2008 Annual Business Inquiry results; removing the discontinuity between December 2005 and September 2006 that had been caused by previous benchmarking exercises; and changes to the STES methodology.[11]

14 Following the removal of the discontinuity, a consistent time series is now available back to 1996, which helps us to track the impact of the National Minimum Wage on jobs in the low-paying sectors over time. The revisions led to higher estimates of employee jobs before the recession, but similar estimates for recent quarters. This has meant that the fall in jobs during the recession was steeper than previously thought. Further, these revisions varied across sectors. The revised data for retail and hospitality in particular, show much greater job losses during the recession.

11 More information on these changes can be found at http://www.statistics.gov.uk/elmr/09_10/downloads/ELMR_Sep10_Barford.pdf

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