National Minimum Wage

Low Pay Commission

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Low Pay Commission Report 2020

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Introduction

1. We, the Low Pay Commission (LPC), are the independent body charged with advising the Government on the levels of the National Minimum Wage (NMW), including the National Living Wage (NLW). We are a social partnership, and our recommendations reflect a consensus between representatives of workers, representatives of employers and labour market experts, reached through careful consideration and discussion of the available evidence. This annual report – our 22nd – provides the evidence and rationale behind our recommendations on the rates to apply from April 2021. We submitted our recommendations to the Government on 30 October 2020.

2. We write this year's report in unprecedented times. The country has experienced the largest recession in modern history and a global health crisis. The scale of the economic crisis is matched by the scale of Government intervention in the economy, particularly the labour market. Government spending on loans to businesses, wage support through the Coronavirus Job Retention Scheme (CJRS) and measures to ameliorate tax bills has been substantial. At the time of writing, the economy has begun to recover but there remains ground to make up and uncertainty over the future course of the virus, the timing and success of a vaccine and the speed and extent of the economic recovery.

3. We also have a new remit this year. The Government has tasked us with recommending the NLW increases required to reach two-thirds of median earnings by 2024. At the same time, we are asked to 'advise on any emerging risks and – if the economic evidence warrants it – recommend that the government reviews its target or timeframe'. The Government refers to this as an 'emergency brake', whose purpose is 'ensuring that the lowest-paid workers continue to see pay rises without significant risks to their employment prospects'. For the other rates of the NMW, for younger workers and apprentices, our remit remains as always: to recommend as high a rate as possible without damaging employment prospects.

4. Our job, therefore, is to recommend rates that work best for workers and employers in the context of the Covid-19 economic shock. This is no easy recommendation to make. The lag between giving advice (at the end of October) and the new rates coming into force (1 April 2021) takes on far greater significance this year. The speed of economic change is unprecedented, and a wide range of economic scenarios are possible between now and April 2021.

5. This speed of change means that even relatively short lags in the available evidence present issues. We gathered at the end of October to discuss and agree our recommendations, but much of the evidence available only covered the period up to August 2020, when parts of the economy had only just re-opened. At the same time, the policy landscape was changing rapidly.

6. Because of the lags in evidence and changing policy landscape we considered asking the Government for more time, and there is precedent for this. In the 2009 NMW cycle, during the financial crisis, we asked for two more months to gather more evidence. However, the annual cycle was quite different then: we provided advice in January, which was announced at a March Budget for an October uprating. Therefore, employers had over six months' notice, compared with just over four months in the current cycle, so there was more room to squeeze. Last year, because of the delay imposed by the General Election, the upratings were announced later than normal – between Christmas and New Year – and we heard that this caught some employers off guard. Given the unprecedented levels of uncertainty we took the view that providing certainty as soon as possible should take precedence. This is all the more important because economic volatility prevented us from producing interim estimates of the NLW path this year. Employers have had less foresight over next year's NLW rate than in any previous year.

7. Evidence gathering has been a particular challenge this year. It has been more difficult to speak directly with workers, employers and their representatives, not just because of social distancing but because these groups have been extremely busy. Employer and worker representatives alike have been arguing for support for their members, working with the Government on the design of support measures and helping their members navigate the support available. In some cases, the representative bodies themselves have been fighting for their own survival.

8. There are issues with the Annual Survey of Hours and Earnings (ASHE), which we rely on for measuring pay, understanding the impact of the NMW/NLW and plotting our position on the NLW path to the 2024 target. This survey covered a period towards the end of April this year – the lowest point of economic activity and the peak of furloughing of workers. The response rate for ASHE is considerably lower than normal and there is a substantial minority of workers whose hourly rate of pay is unknown. This latter point makes calculating a median rate of pay extremely challenging.

9. The crisis has created problems for the NLW target framework itself as well as the evidence that underpins it. As the NLW target is based on median hourly pay it adjusts, in theory, in response to changes in economic conditions. The logic is that if the economy booms so does pay which, in turn, raises the nominal NLW target; when the economy worsens, the nominal target should adjust downwards as pay growth stalls. However, because the CJRS has been covering a sizeable proportion of wage costs for a quarter of the workforce, it is arguable whether measures of average earnings reflect economic conditions in the normal way. The inclusion in a calculation of average pay of millions of workers whose pay is mainly paid by the Government renders it somewhat artificial, or at least not representative of underlying economic conditions. The natural response, then, is to exclude these workers from any calculation of average pay. But because this group is mainly low-paid, this actually raises average pay through compositional effects. This in turn raises the on-course rate of the NLW, the opposite of what the framework intends in an economic crisis.

10. By necessity then, our approach to the NLW path is different this year. While we have produced an indicative path, this is subject to more uncertainty than usual. Instead, Commissioners' approach this year has been to recommend rates that minimise any 'significant risk ' to employment prospects as per our remit, in a year when employment risks are greater than they have been in a decade.

11. Under normal circumstances we would wait until 2021 to confirm whether the NLW hit its 2020 target of 60 per cent of median earnings, as we measure this in October each year. However, the issues with the ASHE data may mean we are unable to do that next year. Nevertheless, we think it likely that the 2020 rate of £8.72 exceeded the 60 per cent target, as none of the forecasts we had in 2019 foresaw the Covid-19 shock and the associated fall in earnings.

12. Despite all of these issues, we have extended our evidence base this year. This has been aided by excellent work by the Office for National Statistics in providing more and timelier data than ever before. To compensate for our inability to visit different parts of the country and hear from workers and employers we set up remote meetings and video conferences. These are no substitute for face to face meetings but they enabled meetings with people who otherwise would not be able to travel and who would not have been heard.

13. As we do every year, we held a written consultation, launched in mid-March, shortly before the gravity of the pandemic and its consequences became clear. Because of the widespread disruption, we accepted evidence over an extended period and received 38 responses. We held oral evidence sessions in July and September with 26 bodies representing both workers and employers. And we have held meetings throughout the year with representative bodies, businesses and workers to gather the first-hand evidence, which the cancellation of this year's visits programme meant we could not hear in person. We would like to express our gratitude to all those groups and individuals who contributed to this year's evidence-gathering process. Appendix 1 lists those stakeholders who responded to our consultation and whom we met in the course of the year, and who agreed to be listed.

14. This is the first year in which the LPC has conducted in-house econometric analysis of the effects of the NMW/NLW. We had been considering doing this for some time, but this was given added impetus by Professor Arin Dube's excellent review into the minimum wage evidence base last year. He recommended that we utilise more 'off the shelf' econometric methods in our internal analysis while reserving large scale evaluations and more innovative methods for our commissioned research. This is exactly what we have done. It is also our intention for our internal work to be completely transparent and so we intend to publish the methods and code for others to replicate our work shortly. The first results are presented in Chapter 4 with a brief discussion of methods in Appendix 3.

15. This report is structured in the following way:

- Chapter 1 sets out the state of the UK economy.
- Chapter 2 considers developments in the labour market.
- Chapter 3 looks in more detail at who NLW and NMW workers are, their household status and exposure to the labour market effects of the Covid-19 pandemic and lockdown.
- Chapter 4 looks at the strength of the NLW labour market before and during the pandemic and lockdown. It examines the changes in employment over the period leading up to the imposition of the first lockdown and then how employment and hours responded to the restrictions imposed to fight Covid-19 and the characteristics of workers furloughed under the CJRS.
- Chapter 5 and Chapter 6 do the same as Chapter 4, but for younger workers affected by the age rates of the NMW and for apprentices respectively.

- Chapter 7 then looks at how employers have responded to the NMW and NLW and the other broader impacts on the economy.
- Chapter 8 considers the prospects for the economy in the coming year. This is based on forecasts and other evidence we had at the time, the current speed of change means that some of this has already changed.
- Chapter 9 sets out the rationale for our recommendations.

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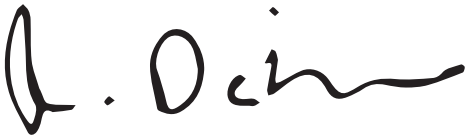

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The Government's Remit to the Low Pay Commission

National Living Wage and National Minimum Wage: Low Pay Commission Remit 2020

The government wants to make the UK the best place possible to live and work. This April, increases to the National Living Wage and National Minimum Wage are expected to boost the wages of over 2.4 million low-paid workers.

Accepting the Low Pay Commission's recommendations in full, on 1 April 2020 the National Living Wage for over 25s will increase by 6.2 per cent to £8.72. This is projected to meet the government's objective of reaching a NLW of 60 per cent of median earnings by 2020. The government is also introducing inflation-beating increases to each of the National Minimum Wage rates for younger workers and apprentices of between 4.6 per cent and 6.5 per cent.

The government asks the Low Pay Commission to monitor and evaluate the National Living Wage and recommend the rate which should apply from April 2021 in order to reach two-thirds of median earnings (of those eligible for the National Living Wage) by 2024, taking economic conditions into account. Following recommendations made by the Low Pay Commission, the National Living Wage, will apply to workers aged 23 and over in April 2021, with a target for it to apply to workers aged 21 and over by 2024.

To ensure that the lowest-paid workers continue to benefit from National Living Wage increases, the Low Pay Commission will continue to have a central role. The government asks the Low Pay Commission to monitor the labour market and the impacts of the National Living Wage closely, advise on any emerging risks and - if the economic evidence warrants it - recommend that the government reviews its target or timeframe. This emergency brake will ensure that the lowest-paid workers continue to see pay rises without significant risks to their employment prospects.

The government notes that the Low Pay Commission will continue commissioning minimum wage policy evaluations from leading researchers and is expanding its own use of standardised evaluation tools, using new methods and sources of evidence for its assessment of the impact of the National Living Wage, consistent with the recommendations of the Dube review. The government asks the LPC to set out, alongside its rate recommendation, its evidence strategy for ongoing monitoring and evaluation of the impact of National Living Wage increases towards the two-thirds median target.

The government also asks the Low Pay Commission to monitor and evaluate the levels of each of the different National Minimum Wage rates (under-18s, 18-20, 21-22 age groups and apprentice rate) and make recommendations on the increases it believes should apply from April 2021 such that the rates are set as high as possible without damaging the employment prospects of each group. In addition, we ask the Low Pay Commission to recommend the accommodation offset rate that should apply from April 2021.

In making these recommendations the LPC is asked to take into account the state of the economy, employment and unemployment levels, and relevant policy changes.

Apprentice rate review

The government notes the Low Pay Commission's intention to produce advice later this year on whether the apprentice rate remains fit for purpose. We want to ensure that the rate protects people from exploitation and does not damage apprenticeship opportunities in the labour market. In support of the government's ambition to ensure the National Minimum Wage is easy to understand for both workers and employers, and for workers to be paid the correct amount, we ask that the Low Pay Commission considers the factors behind the levels of non-compliance for apprentices when forming its advice.

Timing

The Low Pay Commission is asked to provide a final report in response to this remit to the Prime Minister and the Secretary of State for Business, Energy and Industrial Strategy by October 2020.

Executive summary

1. The job of the Low Pay Commission (LPC) is to advise the Government on the levels of the National Minimum Wage (NMW), including the National Living Wage (NLW). This report, our 22nd, contains the evidence and rationale for our recommendations to apply from April 2021. These recommendations are also the first under our new remit – for the NLW to reach two-thirds of median hourly pay by 2024.

2. In providing this advice we are asked to 'advise on any emerging risks and – if the economic evidence warrants it – recommend that the government reviews its target or timeframe'. The Government refers to this as an 'emergency brake', the purpose of which is 'ensuring that the lowest-paid workers continue to see pay rises without significant risks to their employment prospects'. For the other rates of the NMW, for younger workers and apprentices, our remit remains as always: to recommend as high a rate as possible without damaging their employment prospects.

3. The simultaneous health and economic crises the country is facing mean this advice is both extremely important and very difficult to give. Increases in the NMW take place on 1 April each year, which this year was just over a week after the country was locked down. The close proximity of the uprating with the start of lockdown and the Government's Coronavirus Job Retention Scheme (CJRS) significantly affected both pay itself and our ability to measure it. This was further complicated by the fact that what is usually our most important data source, the Annual Survey of Hours and Earnings (ASHE), covered the period only a few weeks later (22 April). All of this made it extremely challenging to understand the impact of the 2020 uprating of the NMW/NLW and pay in general. This year we have been unable to calculate where the 2020 rate of the NLW is on the path to 2024 with our usual accuracy. In these exceptional circumstances, we have opted for recommendations that minimise 'significant risks' to employment prospects as per our remit.

The Economy

4. The outbreak of the Covid-19 pandemic led to an unprecedented shutdown of the economy and the largest fall (25 per cent) in GDP in modern history as shops and other businesses were asked to close and consumers to stay in their homes. A collapse of GDP of this magnitude would normally lead to a massive rise in joblessness, potentially up to 5 million unemployed. But support schemes, particularly the CJRS, kept workers connected to their jobs and provided some protection for incomes. Compared with the 25 per cent month-on-month fall in GDP in April, the amount paid out in wages fell by just 4 per cent.

5. Businesses, hit by both falling sales and rising costs from personal protective equipment (PPE), social distancing measures and supply chain disruption, saw falls in productivity and profits. They took measures to reduce their immediate costs amid the uncertainty by cutting back on recruitment and investment substantially. Despite rising costs and reduced productivity, firms were unable or unwilling to pass these costs on to consumers through price rises, so inflation has remained low. Instead many businesses, particularly smaller businesses, have taken on significant levels of debt to survive. All of this was reflected in the evidence we heard from businesses throughout the year which emphasised the precarity and profound uncertainty facing them.

6. In contrast, the combination of restrictions on spending and income protection from the various support schemes meant consumers saved at record levels and paid down debts. The savings rate reached just under 30 per cent, twice its previous high. However, it was better off households who tended to save more, while lower income households were more likely to eat into their savings as some fell through gaps between support schemes.

7. Over the summer, as infection rates fell and the economy began to reopen, economic growth returned. GDP grew by 9 per cent in June alone, but varied significantly across sectors. For example, retail sales recovered rapidly and surpassed the previous year's levels in July. But activity in hospitality and the arts remained well below their pre-crisis levels.

8. As autumn arrived, the rapid part of the recovery appeared to be over. After the record growth of GDP in June, it slowed in the subsequent two months. Furthermore, growth in August was almost entirely driven by the recently reopened hospitality sector, itself boosted by the Eat Out to Help Out scheme and VAT cuts. Output in almost all other sectors flatlined in August.

9. This pattern, of growth tailing off after an initial rapid boost, was expected, but it has happened at a point where there is still substantial ground to make up. GDP was still 9 per cent lower in August than at the start of 2020, the same level as six years earlier, while at the time we made our recommendations, additional restrictions had been introduced (although not yet a full national lockdown).

The Labour Market

10. While employment held up well in the crisis, supported by the CJRS and other policies, there have been job losses. The Labour Force Survey (LFS) showed around 480,000 fewer people in self-employment by August, though the number of employees continued to rise. However, the Government's Real Time Information data, which captures everyone in payrolled employment, told a different story, with around 700,000 jobs lost between March and August. Alongside this, by August we saw the largest three-month increase in redundancies since records began in 1995.

11. This difference may be explained by some workers' 'loose attachment' to their jobs. In April around 700,000 workers said their job was 'on hold' because of the coronavirus, but, unlike furloughed workers, were not being paid. This group could include, for example, informal staff, who were not furloughed but still believed they would have a job to return to once the lockdown period ended. This is one example of some workers falling through the gaps in the support available.

12. These job losses show up in increased unemployment, inactivity and claims to Universal Credit. Inactivity rose first in the spring as the collapse in vacancies and social distancing made it difficult to actively search for work. Unemployment then increased over the summer, as these workers were able to begin their job search, likely joined by those leaving education for the first time.

13. Levels of vacancies continued to recover through the summer as the economy reopened. In fact, even as the recovery in GDP started to slow, vacancy levels continued to grow into October, and with them the numbers of people moving into payrolled employment. Maintaining this momentum will be critical.

14. There is one final piece to this puzzle. The LFS suggests that there has been a large decrease in the numbers of migrant workers in the UK labour market. This is reflected in a collapse in visa applications. This too may flatter the employment figures, as migrant workers who have left do not show up in unemployment figures or benefit claims. However, the LFS is not designed to measure changes such as this and further evidence is needed.

Low-paid workers

15. Before the crisis hit, the low-paying end of the labour market was in a strong position. Employment rates continued to rise for those groups most likely to be paid the minimum wage rates and in those parts of the country where coverage is high. Both our own and our commissioned econometric work continued to find no strong evidence of any employment or hours effects from increased minimum wages. However, the youth labour market had started to soften, with employment rates for the youngest age groups plateauing even before the start of the pandemic.

16. The low-paying and consumer-facing parts of the economy, from hospitality and retail to the arts and transport, have been hit hard by the crisis, which brought a great deal of attention to bear on the conditions faced by low-paid workers. Workers in these industries are less able to work from home and at greater risk from catching Covid-19 and from the economic effects of the shutdown. The evidence we heard from workers, both those furloughed and those able to continue working, reflected the difficulties and uncertainty they faced during the pandemic. This was both due to the effects of the pandemic itself and, in some examples we heard from workers, due to the inadequate response of employers.

17. A significant minority of minimum wage workers are key workers, covering critical jobs in social care and essential retail. Around 400,000 people or 21 per cent of National Living Wage fell into this category in 2019, a lower share than in the economy overall (28 per cent). Instead, minimum wage workers are more likely to work in the sectors that were forced to close by lockdown measures, with 41 per cent of minimum wage workers working in these sectors. Young people are even more likely to work in shutdown industries, and less likely to be key workers.

18. As a result, those in low-paying occupations and the young were the most likely to be furloughed. Broadly, the lower paid a worker was, the more likely they were to be furloughed and to lose pay as a result. Higher-paid furloughed workers were far more likely to have their pay topped up to 100 per cent of their normal pay. Workers told us about the profound impact of suddenly losing 20 per cent of their income; we heard about individuals taking on debt, relying on family and friends for support and cutting their spending to the bone. In addition, not all furloughed workers benefited from the April 2020 uprating of the minimum wage until they started working again.

19. As lockdown measures started to ease, low-paid workers who had been furloughed or otherwise not working began returning to their jobs. However, unemployment rates have started to creep up among the young, and there is uncertainty over what will happen in the coming months, particularly with further lockdown measures. Hours worked have increased in low-paying occupations since their low point in the spring, but have not recovered as quickly as the rest of the economy. Young people are especially hard hit by any downturn because of their relative lack of experience and reliance on vacancies to find work. There is a risk that fewer vacancies and large volumes of young people leaving education may lead to a shortage of available jobs.

20. The circumstances of the pandemic and the presence of the CJRS make it difficult to track the broader ways employers have adjusted to the rising NLW/NMW. Up to now, it has been the case that, before they make any changes to employment, employers will try to absorb the increase in their profits or pass it on where possible via price rises. Stakeholder evidence this year suggests this is still the case, but that the economic circumstances have made each of these routes more difficult. Commissioned research shed more light on how employers pass costs on through prices with the minimum wage increasing prices of the goods and services most affected by a significant amount.

21. The other key means by which employers can adjust is by investing to improve productivity. While the pandemic has forced some automation, it seems more likely that it has squeezed many companies' capacity for investment in productivity and training. Business investment, which had already stagnated since 2016, fell sharply in the first half of 2020.

22. Despite the CJRS's success in protecting employment, the impacts of the pandemic have still been spread unequally. Low-paid workers have faced considerable hardship, losing income and feeling even more keenly their lack of security. The perceived benefits of the rising minimum wage continue to be undermined by the prevalence of in-work poverty.

23. We heard that social care and childcare remain underfunded, with low-paid workers within those sectors ultimately bearing the consequences. Covid-19 has only accentuated the long-standing issues in those low-paying sectors where the Government is the main source of funding.

Apprentices

24. The labour market for apprentices has been heavily disrupted this year, mirroring activity in the wider economy. Recruitment fell precipitously in the spring, and it is unclear when or if starts will return to their former levels. A lack of pay data adds to our uncertainty about the near term. The longer-term context is that policy reforms in England have led to marked declines in starts in the areas with the highest coverage of the Apprentice Rate. Employers are offering fewer level 2 apprenticeships and hiring fewer apprentices aged under 19, driven in particular by a progressive decline in the apprenticeships offered by small firms. But the minimum wage does not play a significant role in this as the other nations have not seen the same decline, and sectors with the highest coverage do not perform worse overall.

25. Our review of the Apprentice Rate concluded there is scope to raise the rate to the same level as the 16-17 Year Old Rate, based on widespread feedback from low-paying employers. But given the volatility of the past year and uncertainty over the next, we propose to do this over two years rather than one. The majority of stakeholder evidence from both employers and workers suggests that pay is not a significant factor in employers' decision-making over whether or not to recruit apprentices. This has been a repeated message from employers in a wide variety of sectors for several years. We still believe there is a case for looking at apprentices separately from other groups of workers within the NMW structure; the ongoing changes in the composition of the apprentice cohort mean we will continue to have to consider them separately from the 16-17 year old cohort.

Recommended rates

26. Under normal circumstances our starting point for the NLW is calculating the next step on the path to the 2024 target – the 'on-course rate'. In theory, this rate adjusts in response to changes in economic conditions as it is a percentage of median pay. The logic is that if the economy booms so does pay, whereas if the economy declines, pay growth will weaken. But the sheer scale of the CJRS and its impact on pay and jobs means that changes in earnings do not reflect economic conditions in the standard way. Furthermore, our main data source for pay – the Annual Survey of Hours and Earnings – was hit by the pandemic. The sample size was much lower and there are large numbers of furloughed workers whose hourly pay is unknown.

27. All of this meant we were unable to calculate the on-course rate with our usual accuracy and so had to take a different approach this year. As per our remit, we recommended rates that minimise any 'significant risk' to employment prospects, in a year when employment risks are greater than they have been in a decade.

28. Taking all of this into account we recommend an increase in the NLW to £8.91, which is 2.2 per cent or 19 pence. This is lower than our best estimate of the on-course rate of £9.06, and therefore represents a significant adjustment in response to economic conditions. This increase is chosen to be modestly higher than that for prices in the year the rate applies, meaning low-paid workers' living standards should be protected as they will continue to receive a real-terms pay rise. Most importantly, we do not believe this increase presents a significant additional risk to employment prospects, beyond the already challenging outlook.

29. We do not recommend a change to the Government's target of reaching two-thirds of median earnings by 2024, and we remain fully committed to the goal of ending low pay. A fuller review of the path ahead – and greater clarity on a future rate path – will hopefully be possible in our 2021 Report.

30. Last year we recommended that the eligibility age for the NLW be reduced to 23 in April 2021. This remains our position as the labour market continues to treat 23 and 24 year olds similarly to those aged slightly older. For example, there are similar numbers working in the most affected sectors, similar use of the minimum wage rates, and similar rates of furlough and hours loss through the crisis. Employer representatives told us that while they were concerned about increases to the NLW, they were far less concerned with the commitment to change the age eligibility.

31. For the new 21-22 Year Old Rate we recommend a rate of £8.36, which is a 16 pence or 2 per cent increase. We have already recommended that this group become eligible for the NLW in the near future. Therefore, this increase, which is slightly lower than for the NLW, balances the need to not allow the gap to widen too greatly with their relatively greater vulnerability, while still allowing these workers to receive a pay award that will protect their living standards.

32. The evidence suggests that 18-20 and 16-17 year olds are more vulnerable still to the economic outlook, with more furloughed and more working in shutdown sectors. These age groups are also more likely to be in part-time employment and have seen these opportunities disappear, especially as many of these jobs are in non-supermarket retail, hospitality and leisure. Therefore, we recommend a lower increase to £6.56 (11 pence or 1.7 per cent) for 18-20 year olds, broadly in line with inflation expectations. We believe 16-17 year olds are the group most vulnerable to unemployment, and therefore recommend a smaller increase for this group to £4.62 (7 pence or 1.5 per cent).

33. Having completed our review of the Apprentice Rate, our view is that it should be aligned with the 16-17 Year Old Rate. By alignment we mean that there will continue to be two separate rates, but of the same value. This is in case the fortunes of 16-17 year olds and apprentices diverge in the future. However, apprentices, like teenage workers, are also vulnerable. Our evidence base for apprentices is weaker this year, as we rely on ASHE for this group too. We also know that starts have been hit by the crisis. Therefore, we propose to align these two rates over two years, with the more cautious of the rises for the Apprentice Rate in this year, given the economic picture we have outlined, and the rate aligning with the 16-17 Year Old Rate in 2022. For next April we recommend an increase of 15 pence or 3.6 per cent to £4.30.

34. Last year, we achieved a longstanding aim to raise the Accommodation Offset to the level of the National Minimum Wage (now the 21-24 Year Old Rate). This year we recommend that the Accommodation Offset again rise in line with that rate (the new 21-22 Year Old Rate). That is, an increase of 16 pence or 2 per cent to £8.36.

Recommendations

The National Living Wage and other minimum wage rates

We recommend that the following rates apply from 1 April 2021:

Minimum Wage	Rate	Increase (£)	Increase (per cent)
National Living Wage (23+)	£8.91	0.19	2.2
21-22 Year Old Rate	£8.36	0.16	2.0
18-20 Year Old Rate	£6.56	0.11	1.7
16-17 Year Old Rate	£4.62	0.07	1.5
Apprentice Rate	£4.30	0.15	3.6
Accommodation Offset	£8.36	0.16	2.0

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Chapter 1

The economic context

Key findings

The initial effects of the Covid-19 crisis were a collapse in both GDP and hours worked in March and April. Despite this, neither incomes (as measured by the total pay bill) nor employment collapsed to the same extent, as both were protected by various government support measures, especially the Government's Coronavirus Job Retention Scheme. Productivity fell dramatically on a per job basis, but far less when measured per hour worked. Restrictions prevented consumers from spending and, as incomes were largely protected, they instead saved at record levels. But that saving was concentrated in richer households.

As the economy started to recover, retail spending recovered rapidly and is now higher than last year, although this is at least in part down to substitution from consumer services. GDP growth was very strong over the summer, particularly by historical standards.

However, the rapid part of the recovery now appears to be over, with growth slowing in three consecutive months. GDP growth in August was almost entirely driven by the hospitality sector, which was boosted by the Eat Out to Help Out scheme. Growth in other sectors was flat. While this pattern of growth tailing off was to be expected, it has happened at a point where there is still substantial ground to make up. GDP in August was at the same level it was in early 2014 – over 9 per cent less than in February – with further lockdown measures lying ahead.

There is little upward pressure on prices (despite rising costs) and, while wage growth looks to have recovered somewhat, compositional effects flatter these measures.

1.1 This chapter looks at how the economy has developed since we made our recommendations on the rates for the National Minimum Wage (NMW) and the National Living Wage (NLW) in the autumn of 2019. Much has happened since we wrote our 2019 Report as the economy has been subjected to the sharpest shock since at least the Second World War, and arguably since the early 1700s. Measures to protect the health and well-being of the nation reduced economic activity in the UK by around a quarter between March and May. Despite those lockdown measures to contain Covid-19, there have been more than 65,000 excess deaths in the UK alone. This backdrop provides the context for the current state of the economy and will influence the prospects for the economy over the coming months and years. Those prospects are discussed separately in Chapter 8.

Rationale for last year's recommendations

1.2 When we met in mid-October of 2019, the consensus of forecasts expected GDP growth to slow in 2019 and 2020 but remain just above the 1 per cent threshold which, under our then NLW remit, was the key economic condition for ongoing increases in the NLW. This was a noticeable slowing from the 1.9 per cent average experienced between 2015 and 2018. As a result, employment growth was expected to be more modest than in recent years, slowing to 0.5 per cent, which would not be sufficient to prevent unemployment rising slightly, albeit remaining close to its lowest level for fifty years.

1.3 Average wage growth, however, was forecast to remain relatively robust at 3.2-3.3 per cent – down a little from the 3.9 per cent recorded in the second quarter of 2019. Pay settlements had edged up to 2.5 per cent in 2019 and were expected to remain at around this level in 2020. As inflation was expected to remain close to its 2 per cent target, real wages were expected to continue to grow in 2020 – albeit more slowly than in 2019 – with real weekly regular pay finally moving above its level in March 2008. However, it was expected that it would be 2021 before that milestone was reached for real weekly total pay. In August 2019, real weekly total pay (£502) was still 4.4 per cent below its level in February 2008 (£522).

1.4 At the time of our deliberations last year, there was great uncertainty about the political situation and around our future relationship with the European Union (EU). The Prime Minister had lost his Parliamentary majority and was running a minority Government that led to increased confusion about the UK's future relationship with the EU. The text of the Withdrawal Agreement, agreed by the Prime Minister and the EU, was published on 17 October 2019, in the middle of our meeting to agree our recommendations for April 2020. It set out proposals for a trade deal that appeared more limited than the one negotiated by the previous Prime Minister and that had been rejected by the House of Commons on three occasions. The UK in a Changing Europe (2019) estimated that these proposals would reduce income per capita in the UK by 6.4 per cent (or 7.0 per cent with a more strictive migration policy) in the long run, compared with remaining in the EU on our current terms. The impact of an exit on World Trade Organisation terms or without a deal was worse (with GDP falling by up to 8.7 per cent). Parliament had voted to remove the option of a no deal exit on 31 October 2019 but it remained a possibility for March 2020. Indeed, we noted in our letter to the Government that contained our recommendations that there 'remains a possibility of a no deal Brexit which forecasts suggest could damage the economy. In the event of a no deal Brexit, the Government has stated that "action to support the economy, businesses and households" may be required promptly. In this case, we would advise the Government appropriately on minimum wage policy'.

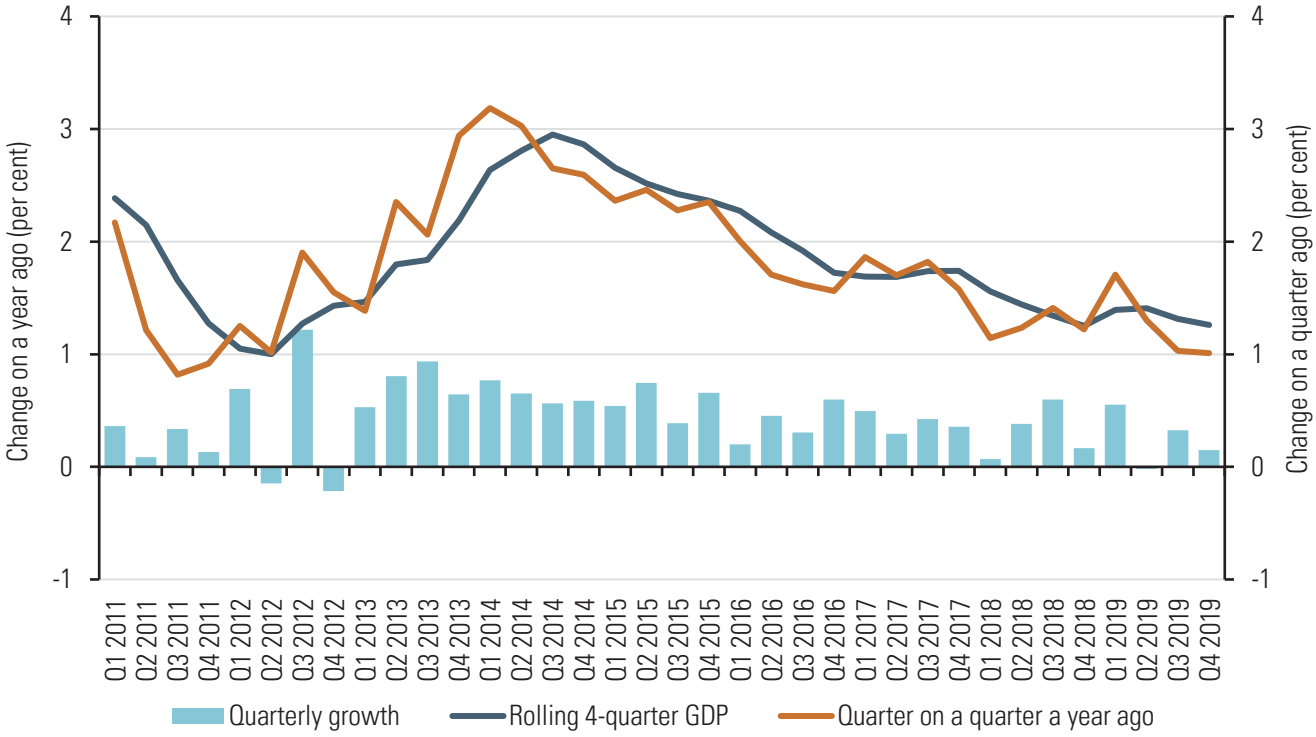
1.5 With that caveat, we concluded that the economic and employment picture, while less positive than for other recent rises in the NLW, with the bar of sustained economic growth more narrowly reached than in previous years, was strong enough to justify moving to 60 per cent of median earnings in 2020. We therefore recommended a 6.2 per cent increase in the NLW to £8.72.

The current situation

Economic growth was slowing before the pandemic

1.6 We now consider what has happened to the economy since last autumn. The economy continued to slow in the second half of 2019, growing by just 0.5 per cent, with net trade and government spending making positive contributions while consumer spending and investment acted as drags on growth. As shown in Figure 1.1, growth was slower in the fourth quarter than the third quarter. GDP was just 1 per cent higher in the fourth quarter of 2019 than it had been a year earlier. Overall, growth in 2019 was 1.3 per cent – in line with forecasts and the same as in 2018 – but lower than it had been from 2012 to 2017.

Figure 1.1: GDP growth, UK, 2011-2019



Source: LPC estimates using ONS data. GDP (ABMI), quarterly, seasonally adjusted, UK, Q2 2009-Q4 2019.

The pandemic led to an unprecedented fall in GDP

1.7 This weakening economy was then hit by the most serious, and deadly, global pandemic since the Spanish flu in 1918-20. This led to policy to restrict social contact to halt the spread of the virus. At the same time, the Government acted to protect the economy. For a detailed timeline of these events see Appendix 6. Table 1.1 sets out a high-level timeline of events. Table 1.2 provides a summary of the initial package of support measures for the economy announced by the UK Government in March and April. The measures included in the subsequent Plan for Jobs, set out by the Chancellor in early July, are summarised in Table 1.3.

Table 1.1: High-level timeline of Covid-19 measures

Month	Announcement
March	11– Budget includes £12bn package of support for the pandemic. 16 – Prime Minister advises against non-essential travel and encourages everybody in the UK to work from home. 17 – Chancellor announces £330bn package for businesses plus £3.5bn for people and businesses in Wales, Scotland and NI. 20 – Chancellor announces CJRS, additional business support and £7bn welfare support package. 23 – Prime Minister announces UK lockdown to come into force 26 March. 26 – Chancellor announces package to help self-employed including SEISS.
April	8-16 - Governments in England, Wales and NI announce extensions to lockdown. 20 – Additional support for UK start-ups announced. Online applications for CJRS open.
May	11 – Government publishes roadmap to re-opening society. Measures to lift lockdown begin to diverge across the UK from this point, with England largely in advance of other nations. 12 – Chancellor announces extension of CJRS until end of October with employers making contributions from August.
June	12-21 - Non-essential shops start to re-open in England, Wales and NI. Scotland follows suit by the end of the month. 29 – First local lockdown in Leicester announced. This is the first in an expanding series of local measures across England. Scotland and Wales will also go on to introduce local restrictions.
July	5 – Government announces £1.6bn package for the arts, culture and heritage sector. 8 – Chancellor announces his 'Plan for jobs' in summer statement. Hospitality begins to re-open across the UK throughout July.
August	Government attempts to encourage people back to workplaces.
September	9 – 'Rule of six' introduced in England, with similar measures following in Wales and Scotland from the same date. 22 – Prime Minister announces new measures following a rise in Covid-19 cases, asking people to work from home where possible and places a 10pm curfew on hospitality venues. 24 – Chancellor announces new Job Support Scheme. The scope of the scheme is expanded in further announcements in October but ultimately superseded by the extension of the CJRS at the end of that month.
October	12 – Three-tier local lockdown system announced in England. Similar plans are announced for Scotland. 23 – Wales begins a two-week 'firebreak' lockdown.

Source: Diverse media sources and Government announcements.
Note: This is not a comprehensive timeline. A more detailed narrative of events and measures is set out at Appendix 6.

Table 1.2: UK Government support for the economy announced in March and April 2020

Name	Scheme detail	Aimed at	Numbers covered	Estimated cost
Coronavirus Job Retention Scheme (CJRS)	80% of employee wages to be covered by the government, up to a cap of £2,500 per month	Individuals not working but furloughed and kept on the payroll	9m	£54bn
Self-Employment Income Support Scheme (SEISS)	80% of average monthly profits for the first phase (max £7,500 and 70% in the second phase (max £6,750) paid by government for most self-employed people	Self-employed with trading profits <£50k and >50% of total income derived from self-employment	3m	£15bn
Statutory Sick Pay support	Employers reclaiming SSP for employees unable to work due to coronavirus symptoms, shielding or self-isolating	Employers of fewer than 250 employees	1.2m	£200m
Welfare package	Employment Support Allowance paid from day one rather than day eight of illness	Low-earning employees and the self-employed	3.1m	£8bn
	Removal of minimum income floor in Universal Credit	Self-employed people whose profits are sometimes below 35 hours per week at the minimum wage		
	£20 per week increase in the generosity of Universal Credit	Low income households, including those out of work		
	More generous local housing allowance rates in housing benefit	Private tenants in receipt of housing benefit living in areas where rents have increased faster than the nationwide average since 2012		
Small business grant schemes			1m	£15bn
Business rates package				£12bn
VAT deferral	Deferral for VAT payments due in Q2 2020 until the end of 2020-21			£1.9bn
Loan schemes	See Table 1.4 on page 19			
Monetary policy measures	The Bank of England announced measures in March to reduce its base rate to 0.1% and make additional funding available to consumer banks. As of October, it held around £15 billion of corporate debt via its Covid Corporate Financing Facility and had made asset purchases of £310 billion since the start of the year (also known as quantitative easing).			

Source: HM Treasury and Bank of England website and policy announcements.

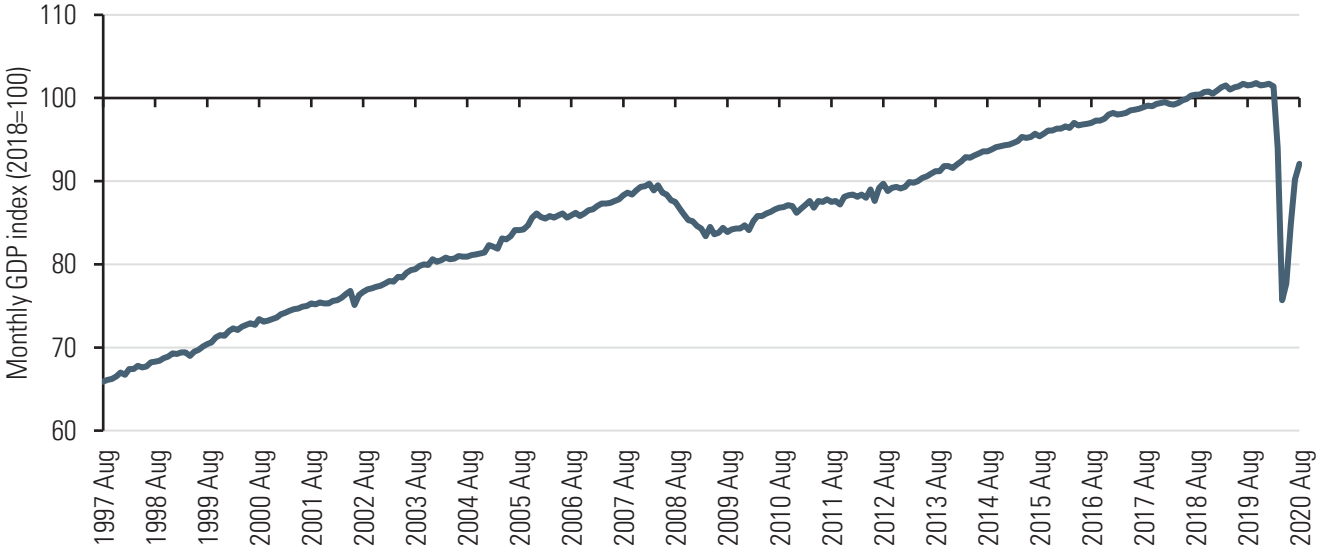
Table 1.3: UK Government Plan for Jobs, July 2020

Name	Scheme detail	Aimed at	Numbers covered	Estimated cost
Kickstart scheme	Fund to create high quality six month work placements	16-24 year olds on UC and at risk of long-term unemployment.	Hundreds of thousands	£2.1bn
Boosting work search, skills and apprenticeships	Additional funding for National Careers Service; funding to triple participation in traineeships; new payment for employers in England for each new apprentice hired; high value courses; expanded youth offer and enhanced work search support	Apprentices aged under 25; school and college leavers;		£1.6bn
Reduced VAT for affected sectors	Temporary reduced rate of VAT(5%) for food and non-alcoholic drinks; accommodation; admission fees from 15 July to 12 Jan 2021	Hospitality firms; supplies of accommodation and UK attractions		£4.1bn
Creating jobs	Includes infrastructure package, public sector and social housing decarbonisation, Green Homes Grant and Stamp Duty Land Tax temporary cut			£12.5bn

Source: HM Treasury website.
Note: Table does not include the Job Retention Bonus, which was withdrawn with the extension of the CJRS in late October.

1.8 Fear of the virus, and the public health measures aimed at restricting its spread, together led to a lockdown of the economy and the largest fall in economic activity on record. As shown in Figure 1.2, GDP fell by 25.3 per cent between February and April. The downturn lasted just two months. Other previous post-war recessions have generally lasted about five quarters or 13-15 months. During the financial crisis, GDP fell by 7.0 per cent over 13 months between February 2008 and March 2009.

Figure 1.2: Monthly GDP, UK, 1997-2020

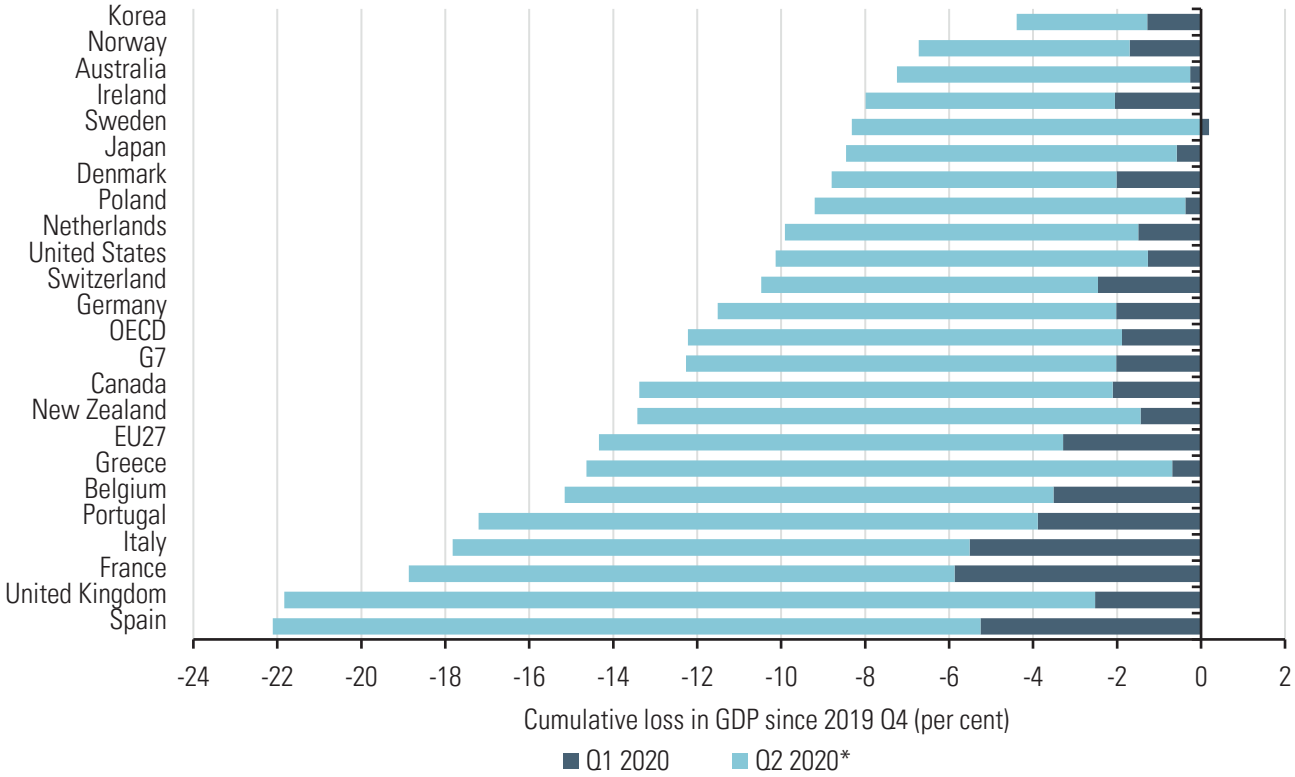


Source: LPC estimates using ONS data. Monthly GDP index (ECY2), monthly, seasonally adjusted, UK, August 1997-August 2020.

The UK was not the only country affected but it was one of the worse hit

1.9 The UK was not the only country whose economy was affected. The global nature of the pandemic is shown in Figure 1.3. Every country in the Organisation for Economic Cooperation and Development (OECD) was affected, but the UK was second only to Spain in terms of the fall in GDP in the first half of 2020. The timing of the arrival of the pandemic affected the magnitude of the impact in the first quarter. Italy, Spain and France were the first European countries to be affected with large numbers of cases and many deaths recorded. They also suffered the greatest loss in economic output in the first quarter. As we have noted, the lockdown in the UK began towards the end of March – a few weeks after those in other European countries. That resulted in the UK suffering the largest economic loss of any OECD country in the second quarter of 2020. In general, the countries that suffered the highest death rates also suffered the largest economic losses. There were notable exceptions – New Zealand had few deaths but its economy was affected more than most, while the US suffered the largest number of deaths its economy has fared better than the OECD or G7 average.

Figure 1.3: GDP growth in selected countries, 2020



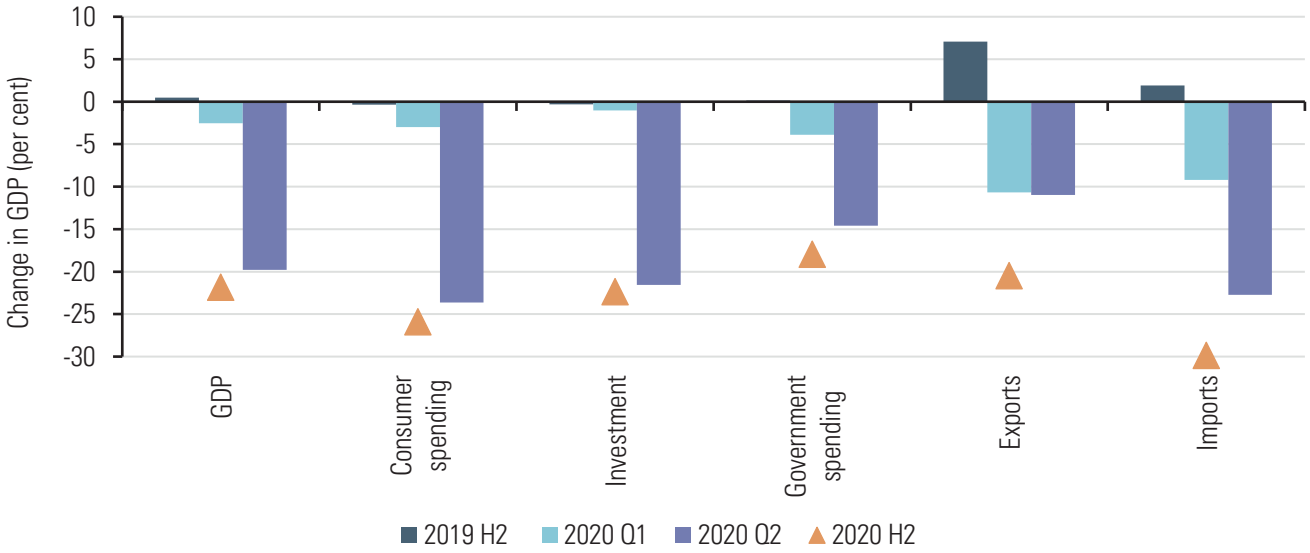
Source: LPC estimates using OECD data. Real GDP (B1_GE: Gross domestic product - expenditure approach, seasonally adjusted), Q4 2019-Q2 2020.
Note: Q1 is change on Q4 and Q2* is the cumulative change on Q4-Q1 such that Q1 plus Q2* is equal to H1.

The impacts of Covid-19 were felt across the economy

1.10 The impact on the economy was felt across all components of expenditure: consumption; investment; government spending; and trade. With the lockdown officially beginning in the last week of March, most of the shock to the economy occurred in the second quarter. However, with some indicators showing that people had already started to restrict mobility and activity in the week or so before the lockdown, the shock in the first quarter was still historically large. The falls observed in the second quarter were unprecedented.

1.11 GDP fell by 21.8 per cent in the first half of 2020 with consumer spending and investment falling by more – 25.9 per cent and 22.4 per cent respectively. With the fall in exports (11 per cent) less than the fall in imports (30 per cent), net trade was the only component that supported GDP growth. Despite the large support schemes for workers and businesses launched by the Government in the first half of 2020, the Office for National Statistics (ONS) estimated that real government spending had fallen by 17.9 per cent.

Figure 1.4: GDP expenditure components, UK, 2019-2020



Source: LPC estimates using ONS data: Gross domestic product (ABMI), consumer spending (ABJR), total investment (NPQT), government spending (NMRY), exports (IKBK) and imports (IKBL), quarterly, seasonally adjusted, UK, H1 2019-H2 2020.

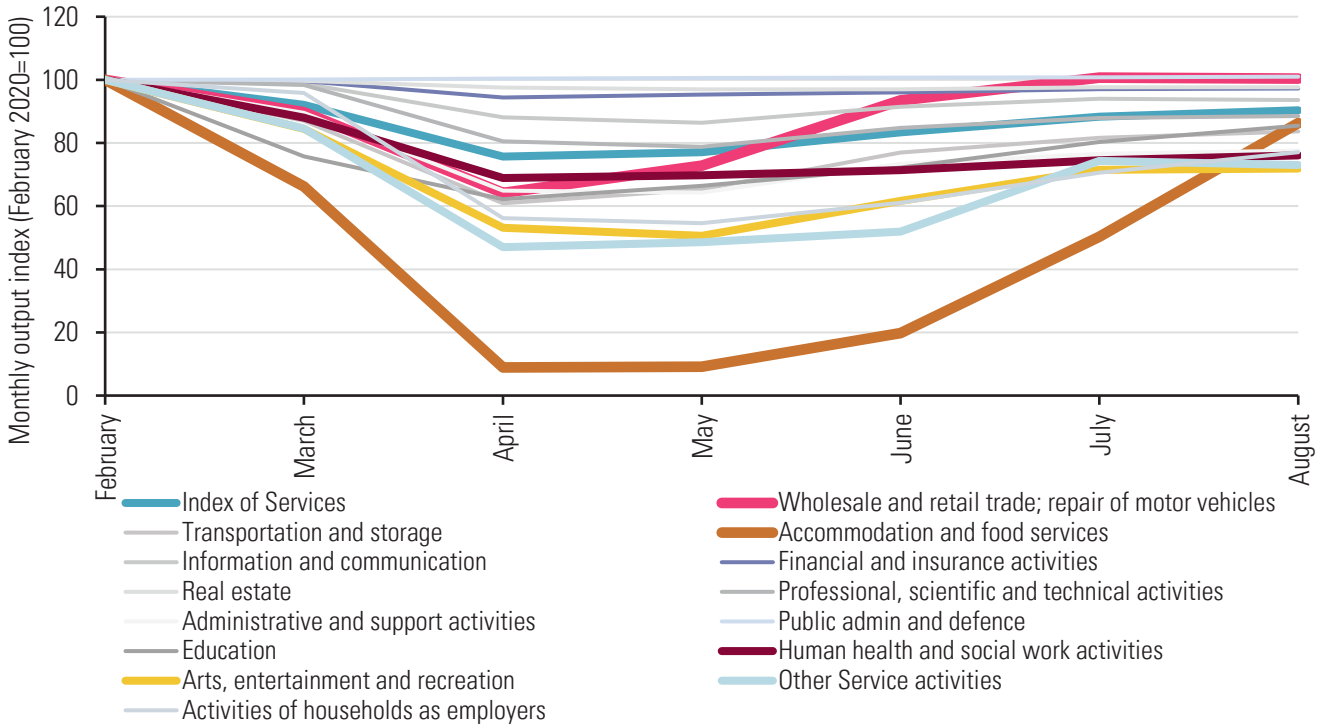
1.12 However, the calculation of GDP output in the public sector is very difficult at the best of times. This is because public services, for example state schools and NHS hospitals, do not have prices in the way that private sector goods and services do. Countries differ in the way they resolve this issue in their GDP calculations. Some countries, including France and the UK, base their measure of real government consumption on indicators of public activity, such as the number of NHS operations or the number of pupils in schools. These complexities were compounded in lockdown as public services went through significant turbulence. For example, schools were closed but children were being taught at home; it is not obvious how this should be recorded. Government consumption was recorded as reducing growth by around 3.5 percentage points in the first half of 2020. In contrast, as public spending increased sharply in the first half of 2020, the output deflator (a measure of the gap between cash spending and actual output) increased by around 55 per cent. Other countries, such as Germany and the US, divide the relevant components of public spending by input prices. As public spending rose during the crisis and input prices fell, the measurement of public sector output in countries which took this approach was generally recorded as being higher than in those countries that adopted the former approach.

1.13 In short, the falls in GDP in the first half of 2020 in countries such as the UK and France will be greater when compared with other countries, such as the US and Germany, but that should reverse in the second half of 2020 as indicators of public sector activity pick up.

The impacts of the pandemic have differed greatly by sector

1.14 Another distinctive feature of the Covid-19 crisis was the way that it affected sectors differently. Some sectors, particularly those locked down, suffered very sharp falls in output, while others remained little changed or actually grew. While services (-21.3 per cent) and manufacturing (-22.6 per cent) fell in line with the fall in total GDP in the first half of 2020, construction (-37.6 per cent) fell by more than a third while agriculture, forestry and fishing fell by only 7.4 per cent. Looking within services as a whole, as shown in Figure 1.5, we find even greater variation. Output in accommodation and food services fell by over 91 per cent between February and April, while output in public administration was little affected.

Figure 1.5: Monthly output indexed to February 2020, by sector, UK, 2020



Source: LPC estimates using ONS data. Index of services (ECYC); wholesale and retail trade; repair of motor vehicles (ECYD); transportation and storage (ECYG); accommodation and food services (ECYH); information and communication (ECYI); financial and insurance activities (ECYJ); real estate (ECYK); professional, scientific and technical activities (ECYL); administrative and support activities (ECYP); public admin and defence (ECYQ); education (ECYR); human health and social work activities (ECYS); arts, entertainment and recreation (ECYT); other service activities (ECYU); activities of HH as employers (ECYV), monthly, seasonally adjusted, UK, February 2020-August 2020.

1.15 As some of the restrictions were relaxed in June, output started to pick up. This was boosted by the general opening up from 4 July in England and the various schemes to boost hospitality in August. However, output in August was still nearly 14 per cent lower than in February. Despite some pick-up in activity since April, restrictions remained on many businesses in the arts, recreation and entertainment sector and other service activities. Output in both of those industries in August was still 27-28 per cent lower than in February. Having fallen by more than services in aggregate up to April, the wholesale and retail trade had returned to pre-pandemic levels of output by July.

1.16 As we shall discuss, there are signs that consumer spending is rebounding, with retail sales recovering back to pre-pandemic levels. However, there are few indications that businesses have returned to normal, with investment remaining weak. We will now look at the consumer and businesses in more detail.

Consumers and workers have had their jobs and incomes supported

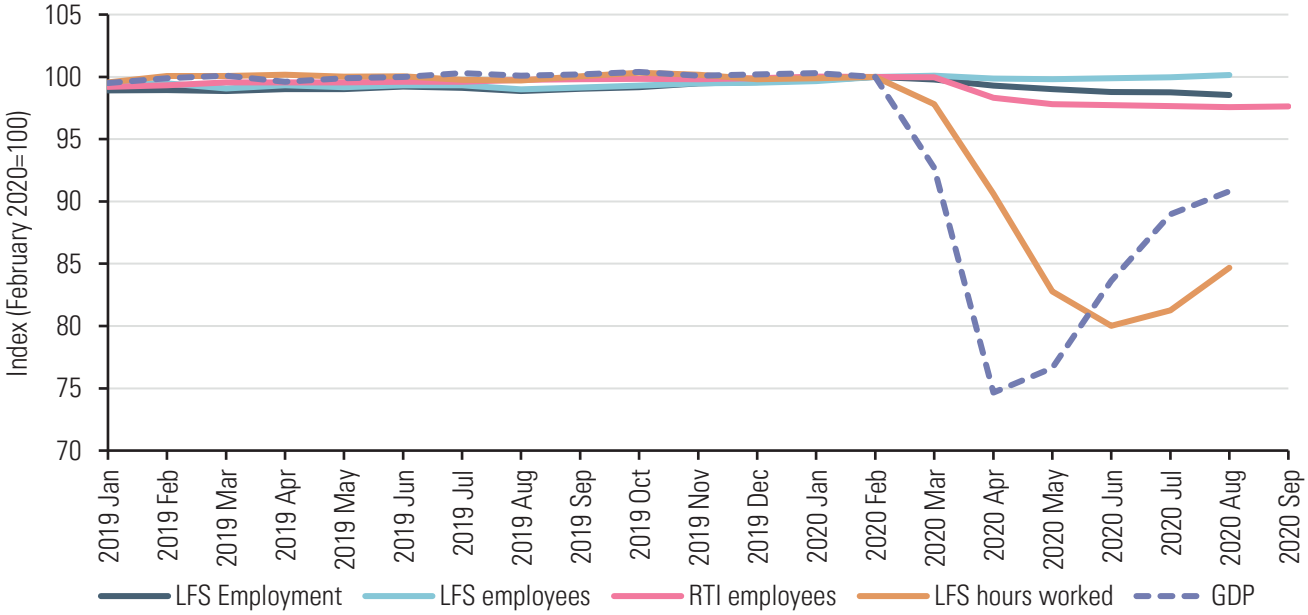
1.17 In normal circumstances we would expect an economic shock of this magnitude to have a huge impact on employment. For example, Andy Haldane, Chief Economist at the Bank of England, estimates that a 25 per cent reduction in GDP could be expected to increase unemployment to around 5 million (Haldane, 2020). This would be far worse than anything seen in previous recessions.

1.18 Given the fall in GDP, the labour market has been remarkably resilient. In previous recessions we saw significant employment effects. During the financial crisis, using monthly data, GDP fell by 7.0 per cent (between February 2008 and March 2009) with employment falling by 731,000 or around 2.5 per cent (between May 2008 and July 2009) and hours by 4.3 per cent (between May 2008 and August 2009). The fall in employment was even greater in the early 1980s and early 1990s recessions. In each, employment fell by close to 1.7 million (over 6 per cent) and hours fell by over 9 per cent but the loss in GDP was only 4.1 per cent and 2.0 per cent respectively.

1.19 However, government intervention in the labour market has supported many jobs and the job loss so far has not been anywhere near the magnitude nor the scale of previous recessions. According to the Labour Force Survey (LFS), the number of employees has remained around 27.9 million although the number in employment, driven by falls in self-employment, has fallen by 1.5 per cent or 482,000. HM Revenue and Customs' (HMRC) Real Time Information (RTI) data show the number of payrolled employees fell by 685,000 or 1.6 per cent between February and September. We discuss this in more detail in Chapter 2 (see paragraph 2.19 onwards).

1.20 Instead of jobs, the impact of the pandemic on the labour market has so far mainly fallen on hours. As Figure 1.6 shows, between March and June total hours worked fell by 20 per cent – slightly smaller than the fall in GDP. However, the rebound in hours has been slower than that in GDP. By August GDP was 9.2 per cent lower than in February but the number of hours worked was still 15 per cent lower. We discuss the labour market in more detail in the next chapter.

Figure 1.6: Employment, employees and hours, UK, 2019-2020



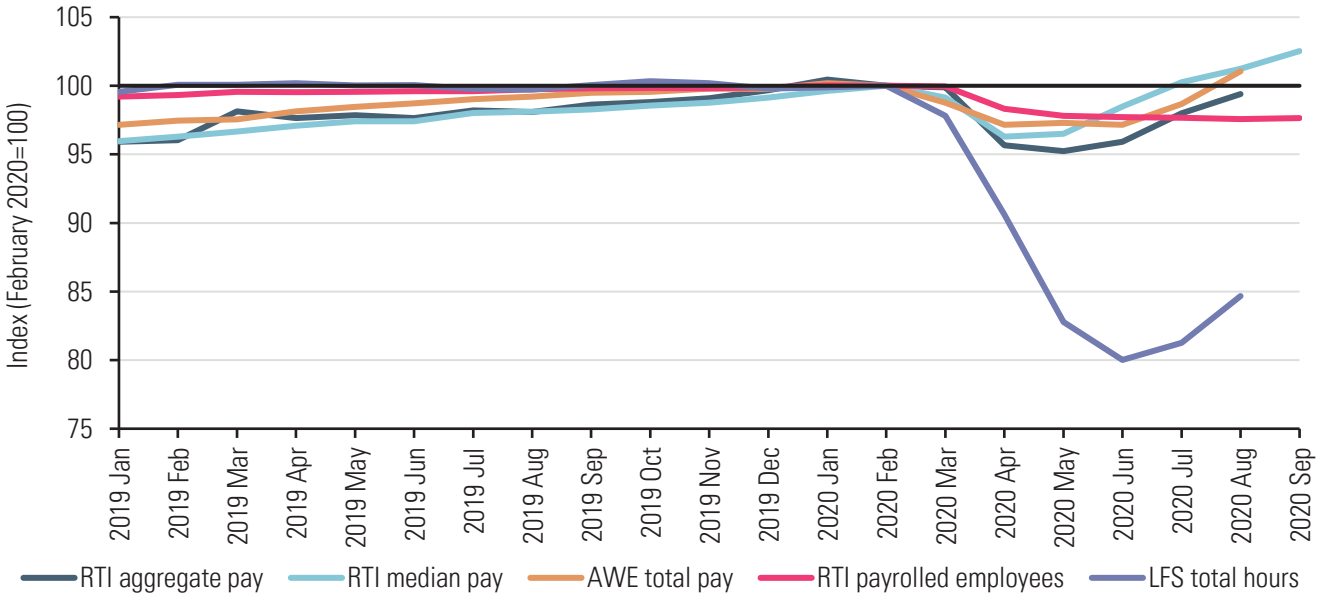
Source: LPC estimates using ONS data: total employment (MGRZ); number of employees (MGRN); total hours worked per week (YBUS); monthly GDP index (ECY2); and RTI payrolled employees, monthly, seasonally adjusted, UK, January 2019-January 2020.

Earnings fell, but have begun to recover

1.21 The CJRS has largely protected incomes. While GDP and hours worked fell by over 20 per cent in April, the total amount of wages paid fell by around 4 per cent. But because furloughed workers are entitled to a minimum of 80 per cent of their usual earnings, up to a cap, some will be getting up to 20 per cent less pay per week when furloughed. Figure 1.7 shows that wage growth fell as the number of furloughed workers increased over the spring (and the number of hours worked fell). But as lockdown measures were eased and furloughed workers returned to work over the summer, hours increased and wage growth returned across a range of measures.

1.22 Figure 1.7 also shows that while some measures of pay have recovered, or even surpassed, their pre-crisis levels over the summer, the overall pay bill and number of payrolled employees has not. This suggests that this recovery in pay is at least in part down to compositional changes. Evidence from the latest LFS, covering up to August, suggests that there were fewer young people and migrants in employment, as well as fewer workers in part-time employment (all groups whose earnings tend to be lower). In addition, low-paying and low productivity sectors have been hit hardest. Many workers in high-paying sectors were able to continue working (as they switched from offices to home working). That was not possible in many low-paying jobs. These changes may have skewed the earnings distribution with a greater proportion of higher-paid jobs and fewer low-paid jobs raising median and mean pay.

Figure 1.7: Pay, hours and payrolled employees, UK, 2019-2020



Source: LPC estimates using ONS data: AWE total pay (KAB9); total hours worked (YBUS); RTI aggregate pay; RTI median pay; RTI payrolled employees; (Earnings and employment from Pay As You Earn Real Time Information, seasonally adjusted), monthly, seasonally adjusted, UK (GB for AWE total pay), January 2019-September 2020.

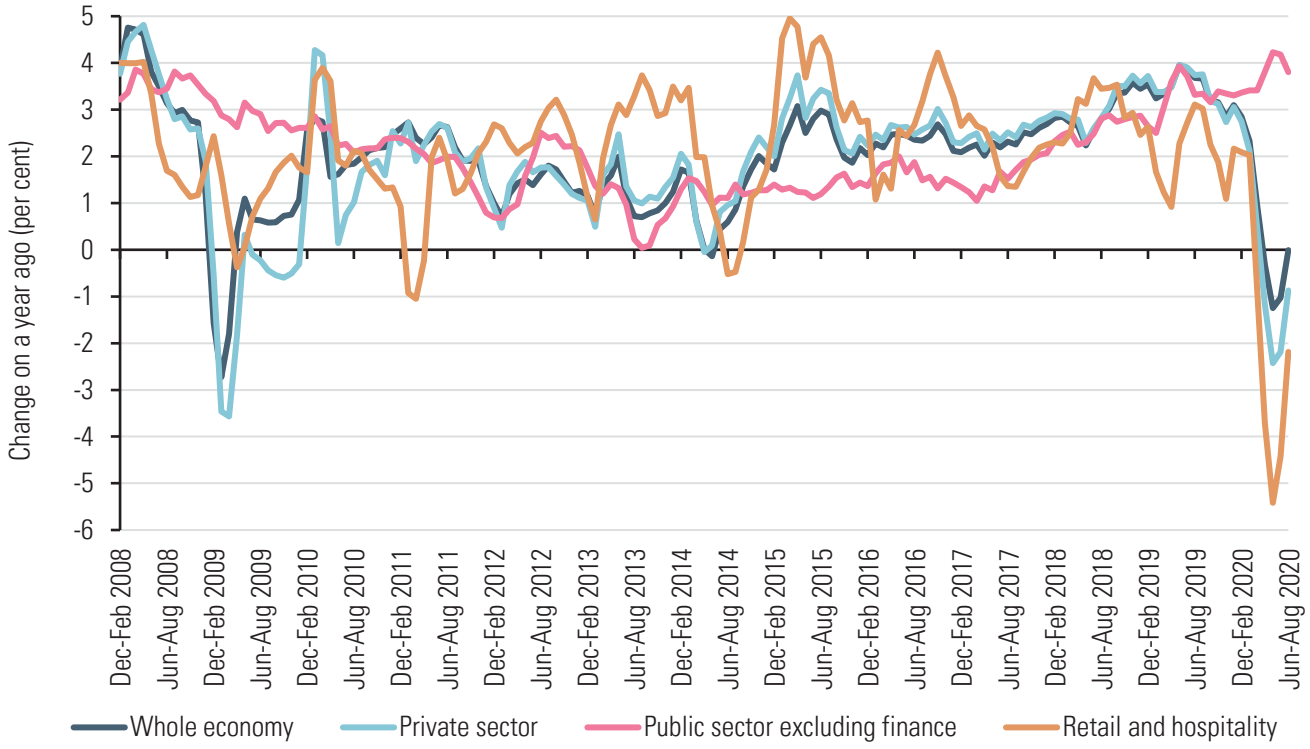
The picture on pay varies across the economy, with some groups harder hit than others

1.23 The pay picture also varies across different sectors. Over the year to June 2020, pay in retail and hospitality fell by 5.4 per cent, compared with a fall of 2.4 per cent in the private sector and 1.2 per cent in the whole economy. As the economy has rebounded, pay in retail and hospitality has picked up a little but was still 2.2 per cent lower in August 2020 than in August 2019. This contrasts, as shown in Figure 1.8, with the financial crisis where pay in this sector fell by far less. Overall, the sectors most affected by the crisis tend to be lower paid, meaning low-paid workers are more affected by furloughing and pay impacts. We discuss this throughout the report, but particularly in Chapter 3.

1.24 Figure 1.8 also shows how public sector pay has been more resilient as the public sector has continued working throughout the crisis. This reverses the trend of the previous six years where private sector pay growth outstripped public sector.

1.25 In the past, average weekly earnings growth and RTI monthly earnings growth has been a reasonable proxy for hourly wage growth as hours generally do not change much in the whole economy from month to month (once it has been seasonally adjusted). This year is different and we do not believe that hourly wages (that we are unable to measure) have fluctuated as much as weekly or monthly wages.

Figure 1.8: Average wage growth by sector, UK, 2008-2020

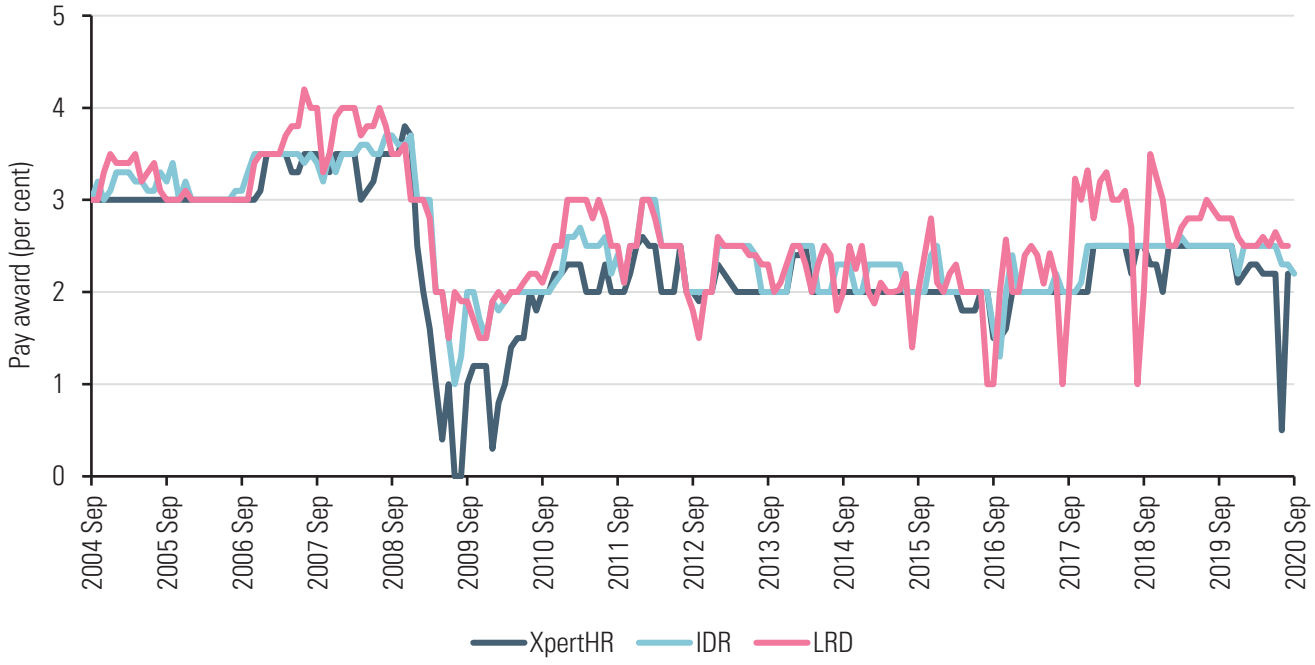


Source: LPC estimates using ONS data. AWE total pay growth (KAC3), private sector AWE total pay growth (KAC6), public sector excluding finance AWE total pay growth (KAE2), and retail and hospitality AWE total pay growth (K5CI), three months on three months a year ago, monthly, seasonally adjusted, UK, February 2008-August 2020.

1.26 As an alternative to the official measures of pay growth, for which we have just flagged concerns about interpretation this year, we can look at what has been happening to pay awards (those set by the employer or negotiated with a trade union). This might give a better guide as to what is happening to hourly pay. Although the ONS does not keep official records of pay awards, we can monitor the pay awards and pay data recorded by various private sector organisations. We monitor the data of three of these in detail – XpertHR, Incomes Data Research (IDR), and the Labour Research Department (LRD) – each covering different sectors of the economy with some degree of overlap. The pay awards recorded by these pay organisations are generally those given to the largest group of workers in a firm or the award given to the lowest-paid group of workers.

1.27 When we met last autumn, pay settlements in 2020 were expected to continue to reflect a tightening of the labour market that had seen median awards pick up in 2018 and 2019 to 2.5-3.0 per cent from 2.0-2.5 per cent, which had characterised the period from 2012 to 2017, as shown in Figure 1.9. However, the onset of the pandemic, the restrictions on business, reductions in turnover, and increased uncertainty about demand and the ability to trade in the short to medium term slowed that momentum with the median of pay awards falling back towards 2.0 per cent. Although the pandemic does not seem to have greatly affected the median, it does appear to affected the distribution of pay awards with the emergence of a bimodal distribution – an increasing number of pay freezes and a large grouping around 2 per cent with few awards elsewhere in the distribution.

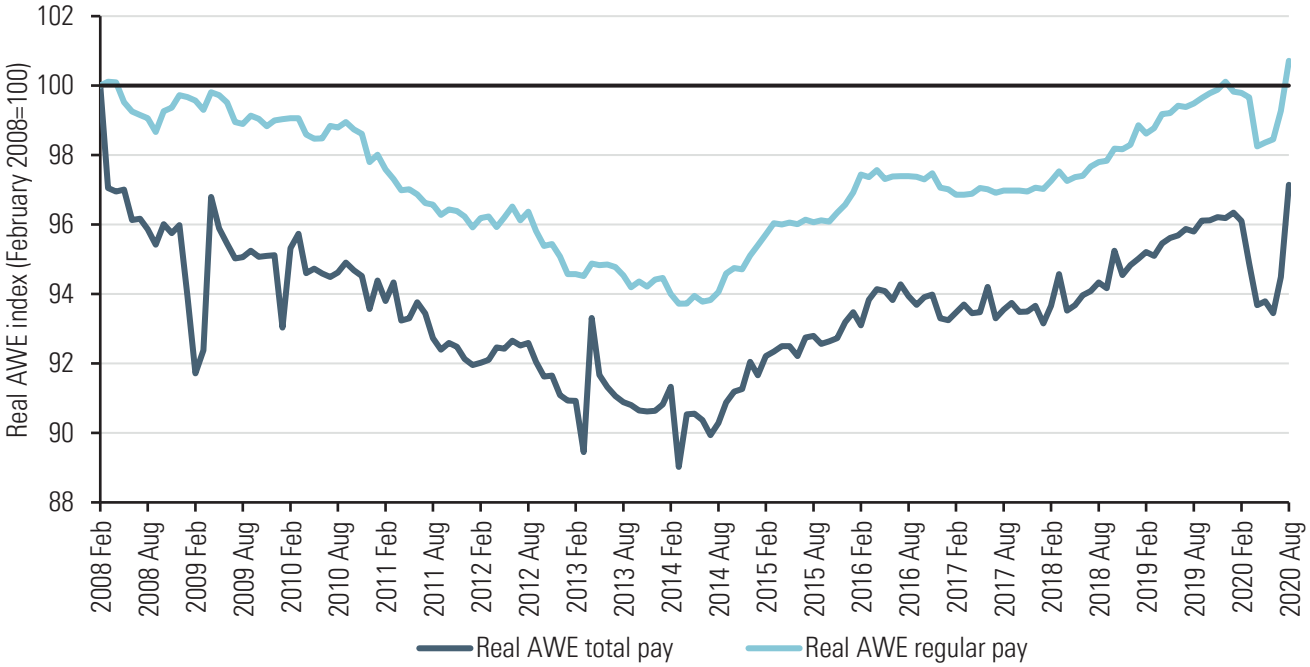
Figure 1.9: Pay settlement medians, UK, 2004-2020



Source: XpertHR, Incomes Data Research (IDR) and Labour Research Department (LRD), pay databank records, three-month medians, UK, September 2004-September 2020.

1.28 Real average weekly regular pay fell by 1.9 per cent as the pandemic hit but has rebounded strongly since June, increasing by 2.5 per cent to reach £476 in August 2020 – 0.6 per cent higher than in March 2008. The rebound was even stronger for real average weekly total pay. It fell by 2.8 per cent between January and June 2020 but has since grown by 4.0 per cent to £507, its highest since February 2008 – but despite that strong growth it still remains 2.9 per cent lower than in February 2008.

Figure 1.10: Real wages, UK, 2008-2020



Source: LPC estimates using ONS data. Real AWE weekly total pay (A3WX) and real AWE weekly regular pay (A2FC), monthly, seasonally adjusted, UK, February 2008-August 2020.

With incomes somewhat protected and spending restricted by lockdowns, households saved at record levels

1.29 Despite the large interventions to support jobs and incomes, those falls in real wages combined with the fall in employment, especially among the self-employed, led real household incomes to fall by 4.0 per cent between the end of 2019 and the second quarter of 2020. But this is far lower than the fall in output and hours worked and smaller still than that for consumer spending, 25.9 per cent. Social spending, including on restaurants, hotels, travel, holidays, entertainment, leisure and sports events, was severely affected during the lockdown. We have already noted that output in hospitality fell by around 90 per cent during the lockdown.

1.30 With spending constrained, and incomes somewhat protected consumers were able to pay down debts and save. The household savings ratio increased to 28.1 per cent in the second quarter of 2020. While saving tends to increase in recessions , as shown in Figure 1.11, this is by far the highest ratio recorded since the 1960s. Bank of England data shows that across March to May 2020 UK consumers paid off a record £15.6 billion in consumer debt (£9 billion on credit cards and £6.4 billion on other loans). The peak was in April 2020 when £7.3 billion was paid off, easily surpassing the previous record of £1.2 billion during the financial crisis in August 2009.

Figure 1.11: Household savings ratio, UK, 1964-2020

Source: ONS. Household savings ratio (NRJS), quarterly, seasonally adjusted, UK, Q2 1964-Q2 2020.

Not all have benefitted from this increased saving

1.31 Brewer and Gardiner (2020) found, in a survey of 6,000 adults in May, that falls in income had been fairly evenly shared across the income distribution, with just over a third of adults reporting that income had fallen since the onset of the pandemic in both the bottom and top 40 per cent of working age incomes (37 per cent compared with 35 per cent). However, there was a much stronger distributional effect for spending. Nearly double the proportion (57 per cent) in the top quintile of working age family incomes have experienced falls in spending compared with those in the bottom quintile (30 per cent).

1.32 Usually such falls would be associated with a reduction in incomes but that does not appear to have been the case for this occurrence. Instead, it appears that this reduction was forced with many items and services unavailable to purchase. For these generally better off families the reduction in spending has led to an increase in savings. That pattern is confirmed when looking at incomes and spending together. In the top income decile, over a third (38 per cent) of those who had falls in spending had suffered no loss of income. That compared with just 12 per cent in the bottom quintile.

1.33 The Bank of England (2020a) also observed these patterns in various household surveys. A similar proportion across the distribution reported falls in income but a smaller proportion of low-income households had reported reductions in spending. On average, lower and lower middle income households reported running down savings while those in higher middle and high income households had built up their savings.

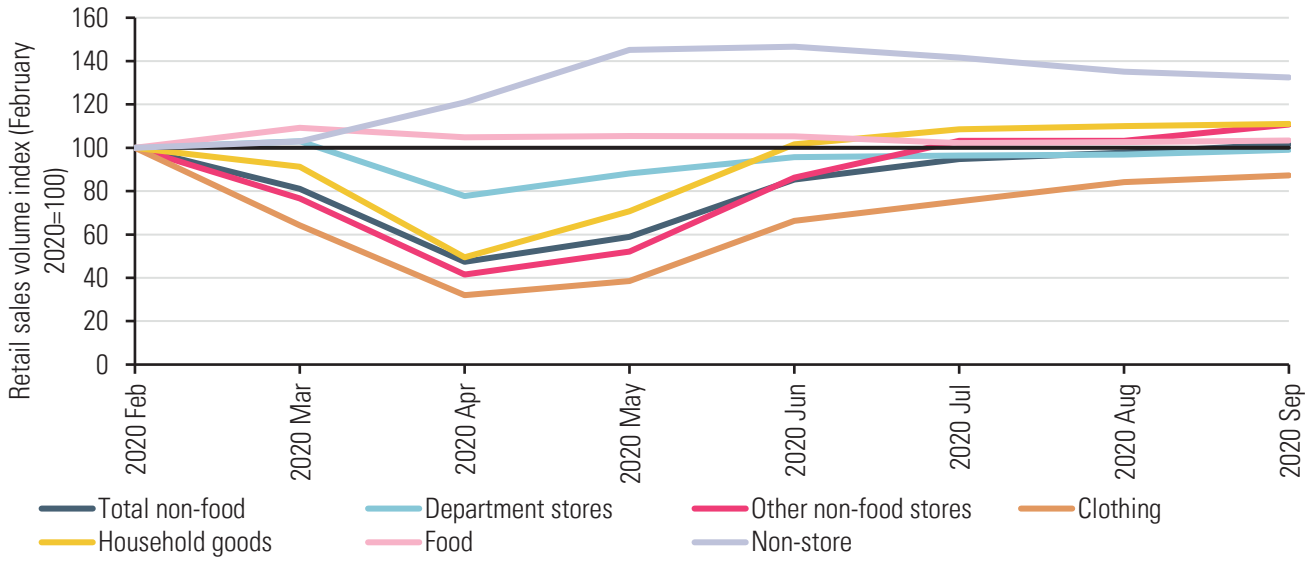
Consumer spending recovered through the summer, but patterns of spending have changed substantially

1.34 While retail spending recovered quickly, some of this may have just been a catch-up of pent-up demand and/or substitution from social spending, which was still restricted. Overall, total retail sales fell by just over 20 per cent between February and April but rebounded strongly, reaching and surpassing pre-pandemic sales volumes by July. In September, total retail sales were 5.5 per cent higher than in February.

1.35 The dispersion of economic activity is also evident within retail, as shown in Figure 1.12, where food sales have followed a different trajectory to non-food sales. With restaurants and bars closed, but supermarkets and food outlets open, people switched to consuming more food and drink at home. With some initial stockpiling, food sales increased by 9.2 per cent in March but then fell back through the summer as restaurants and bars began to open. However, in September, food sales were still 3.3 per cent higher than in February. In contrast, non-food sales fell by more than half between February and April.

1.36 Not surprisingly, non-store sales rose sharply as shoppers switched to the internet and mail order. Non-store sales were 46.6 per cent higher in May than in February. But those sales have fallen back as stores have re-opened. However, non-store sales volumes were still 32.5 per cent higher in September than in February. Most categories of spending have returned to pre-pandemic levels, but clothing sales are still 12.7 per cent lower than in February.

Figure 1.12: Retail sales, by retail sector, UK, 2020



Source: LPC estimates using ONS monthly retail sales volume index data. Total non-food (EAPV), department stores (EAPU), other non-food stores (EAPW), clothing and footwear (EAPX), household goods (EAPY), food stores (EAPT) and non-store retail (J5DZ), monthly, seasonally adjusted, UK, February 2020-September 2020.

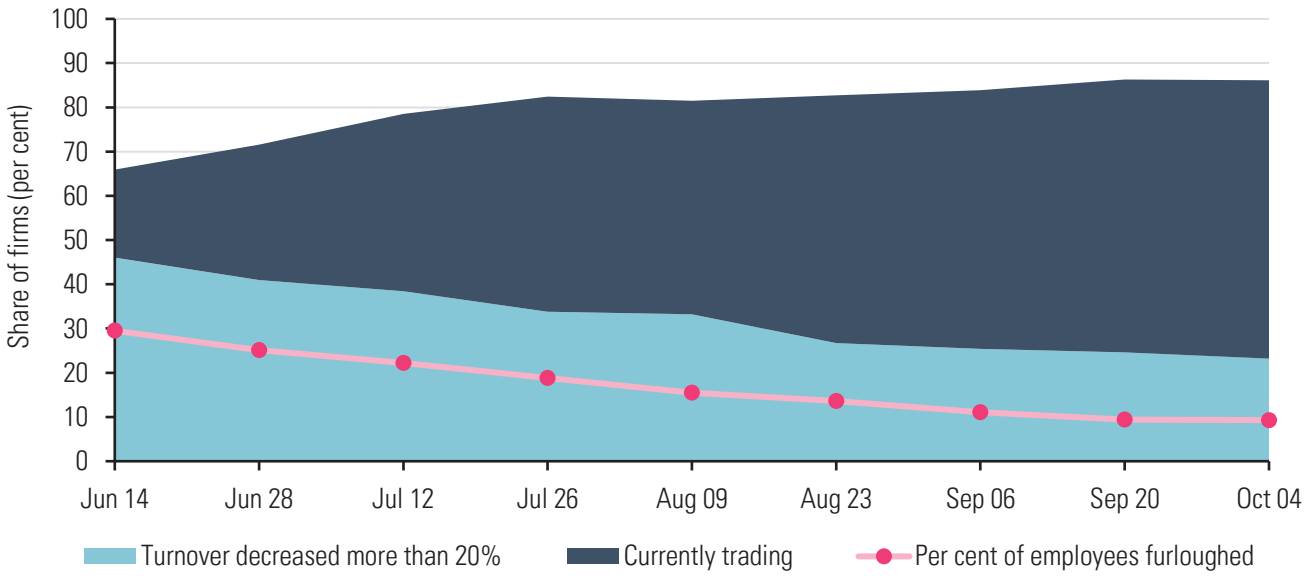
1.37 As we saw in Figure 1.4, consumer spending and investment have followed similar trajectories over the last year. Both fell marginally in the second half of 2019 and then collapsed in the second quarter of 2020 as lockdown measures reduced activity. Overall, consumers have seen their incomes and jobs largely protected, and in fact, they have seen their overall debts reduced. This enabled a rapid recovery in some parts of the economy. We showed that consumer spending had started to recover with retail sales volumes returning to pre-pandemic levels but noted that some products and services were not available. Businesses, by contrast, have fared very differently. We now look at what has happened to businesses.

Businesses and consumers have fared very differently

1.38 Many businesses, particularly those in people-facing industries including many low-paying sectors, were forced to close and saw their sales collapse. At the same time social distancing, personal protective equipment (PPE), supply chain disruption and other safety measures (for staff and customers) have increased their costs.

1.39 The proportion of firms currently trading increased over the summer, as shown in Figure 1.13, but still only 85 per cent were doing so in early October. The remaining 15 per cent had mostly paused trading rather than closed permanently. Of the two-thirds of firms trading in June, around 70 per cent of them were experiencing falls in turnover of at least 20 per cent. Trading conditions improved as the lockdown measures were eased. By October, that proportion had fallen to just over a third of the 85 per cent trading.

Figure 1.13: Firms currently trading and turnover, UK, 2020



Source: LPC estimates using ONS data. Business Impact of COVID-19 Survey (BICS) Wave 7-Wave 15, fortnightly, UK, June-October 2020.

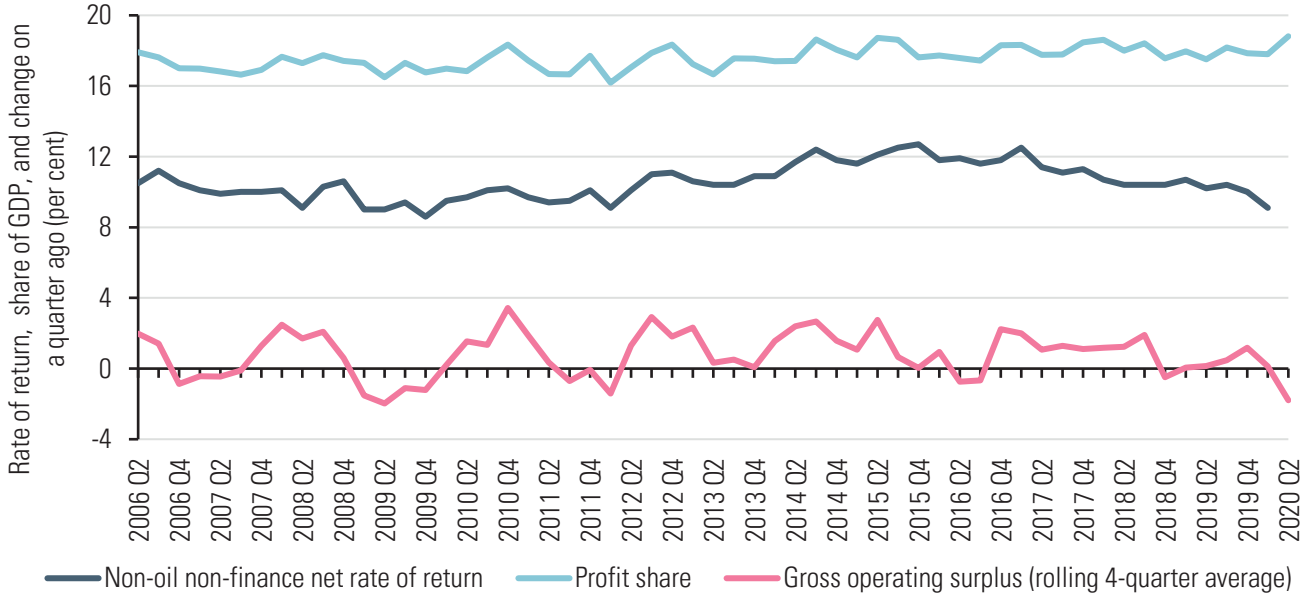
1.40 The proportion of employees furloughed, unsurprisingly, also fell as more businesses opened up. By October, around 9 per cent of employees were furloughed – down from around 30 per cent in April-June.

Measures of profits were already weakening before the pandemic

1.41 In terms of corporate profitability, rates of return on capital employed in the whole economy had fallen back towards rates last seen during the financial crisis. As shown in Figure 1.14, the rate of return for non-oil non-financial private corporations had picked up from 8.6 per cent in the fourth quarter of 2009 to reach 12.7 per cent at the end of 2015. Over the last five years it has fallen back and was just 9.1 per cent in the first quarter of 2020 (the latest available data) before the main impact of the measures to control the pandemic. The fall in the rate of return was more evident in manufacturing than in services.

1.42 That fall in profitability can also be seen in the gross operating surplus of corporations. Using a four-quarter rolling average, in order to remove some of the volatility in the data, Figure 1.14 shows that profitability has weakened since 2017. On this measure the fall in gross operating surplus in the second quarter of 2020 was the largest since the financial crisis. In contrast, the profit share of GDP in the second quarter of 2020 (18.8 per cent) was at its highest since the first quarter of 2000, as the fall in GDP was greater than the fall in gross operating surplus. It should also be noted that the fall in GDP in the second quarter of 2020 also resulted in the wage share of GDP (46.9 per cent) being its highest since the second quarter of 1977.

Figure 1.14: Profitability, UK, 2006-2020



Source: LPC estimates using ONS data. Non-UK continental shelf private non-financial corporations net rate of return (LRXO), private non-financial corporations gross operating surplus (CAER), profit share of GDP (CAER/YBHA), quarterly, seasonally adjusted, UK, Q1 2006-Q2 2020.

Firms have taken on debt to survive

1.43 We can get some idea of the financial stress that firms may be under by looking at the take-up of the various Government loan schemes as well as loans to small and medium-sized enterprises from banks and other financial institutions. These are summarised in Table 1.4.

1.44 The Coronavirus Business Interruption Loan Scheme (CBILS) enabled banks to offer loans of up to £5 million repayable over up to ten years to support SMEs with the Government guaranteeing 80 per cent of the costs of the loan and covering the costs of lender fees and interest on these loans for the first twelve months. The scheme was extended to larger businesses, via the Coronavirus Large Business Interruption Loan Scheme (CLBILS) from 20 April. CLBILS was similar to CBILS but provided loans of up to £50 million (for those with a turnover of more than £250 million) and up to £25 million (for those with a turnover of £45-£250 million). A simplified scheme for all businesses, Bounce Back Loans, was launched on 4 May. This provided loans for up to ten years of up to a maximum of £50,000 (or 25 per cent of the business's turnover) to businesses across the UK that were losing revenue and seeing their cashflow disrupted as a result of the pandemic. The scheme offered a 100 per cent government-backed guarantee and an annual interest rate of 2.5 per cent for all loans. As with CBILS, the borrower remains 100 per cent liable for the debt; is entitled to a Government Business Interruption payment covering the first twelve months' interest on the loan; and no repayment is required for the first twelve months. In addition, the Coronavirus Future Fund was launched on 20 April. This scheme issues convertible loans between £125,000 to £5 million to innovative companies, which are facing financing difficulties due to the coronavirus outbreak, but these funds are subject to at least equal match funding from private investors.

1.45 Table 1.4 shows that, up to 18 October 2020, the largest scheme in terms of value and number of facilities approved was the Bounce Back Loan scheme. Just over 80 per cent of applications have been approved with 1.34 million businesses benefitting from loan facilities of £40 billion. The average value of loan under the scheme has been around £30,000. The main scheme available prior to Bounce Back Loans was CBILS. It provided £17 billion for 73,000 businesses (an average facility of about £235,000). CLBILS and the Future Fund are much smaller schemes in terms of total funding, but these have provided larger facilities on average.

Table 1.4: Business support loan schemes, 2020

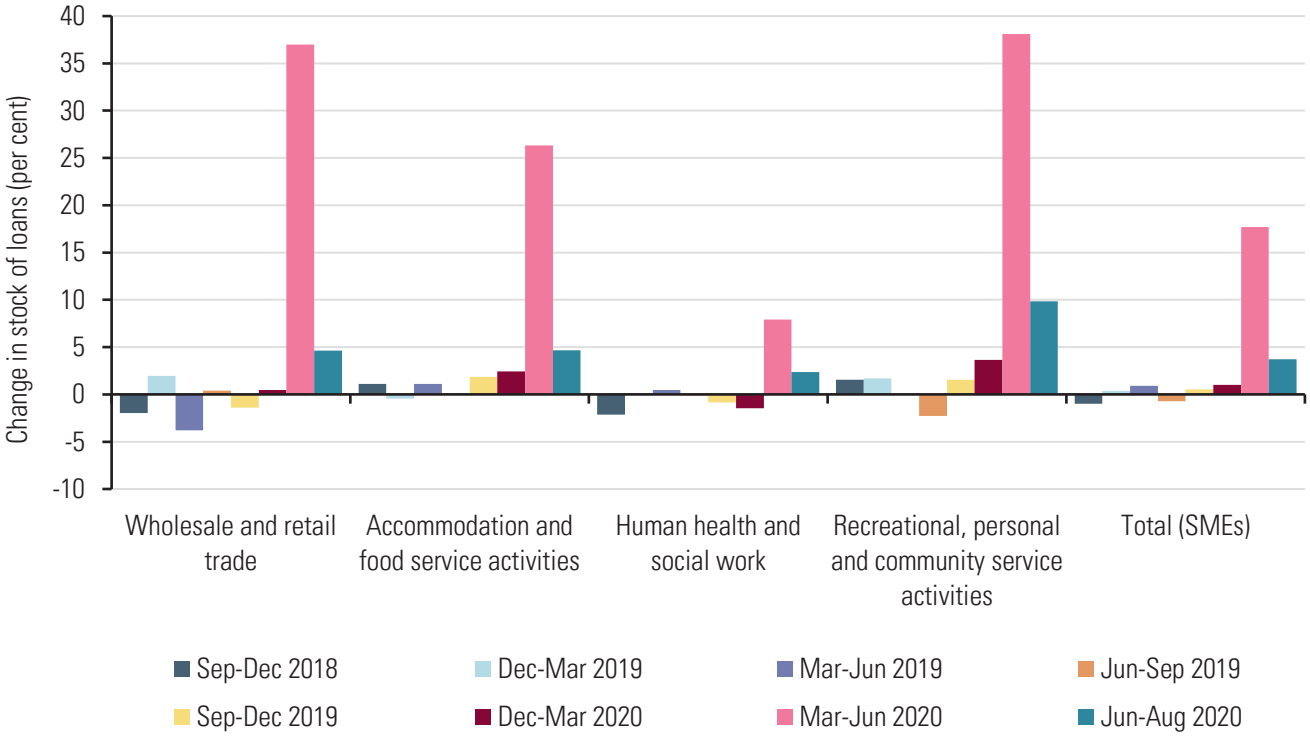
Up to 18 October	Value of facilities/loans approved	Average value of facility/loan	Number of facilities/loans approved	Proportion of applications approved
Coronavirus Business Interruption Loan Scheme (CBILS)	£17.16bn	£234,766	73,094	45.9
Coronavirus Large Business Interruption Loan Scheme (CLBILS)	£4.57bn	£7.335m	623	60.3
Bounce Back Loan Scheme (BBLS)	£40.20bn	£30,083	1,336,320	80.5
Future Fund	£770.8m	£1.035m	745	59.9

Source: HM Treasury, 22 October 2020.

1.46 The magnitude of the change in the stock of loans to SMEs brought about by the pandemic can clearly be seen in Figure 1.15. Before March 2020, the stock of loans changed by no more than 1 per cent each quarter but since March there has been a sharp increase. The stock of loans to SMEs was £167 billion in January 2020, but by August this had increased by £39 billion (25 per cent).

1.47 Not surprisingly, there have been noticeable differences across sectors. The increases have been greatest in those sectors most affected by lockdown, which are also low-paying. The largest increase has been in recreational, personal and community service activities, where the stock of loans has increased by over 57 per cent since December 2019. In wholesale and retail that increase was 44 per cent and in accommodation and food services, it was just over 35 per cent. These loans will need to be repaid in the coming years.

Figure 1.15: Loans to SMEs, UK, 2018-2020



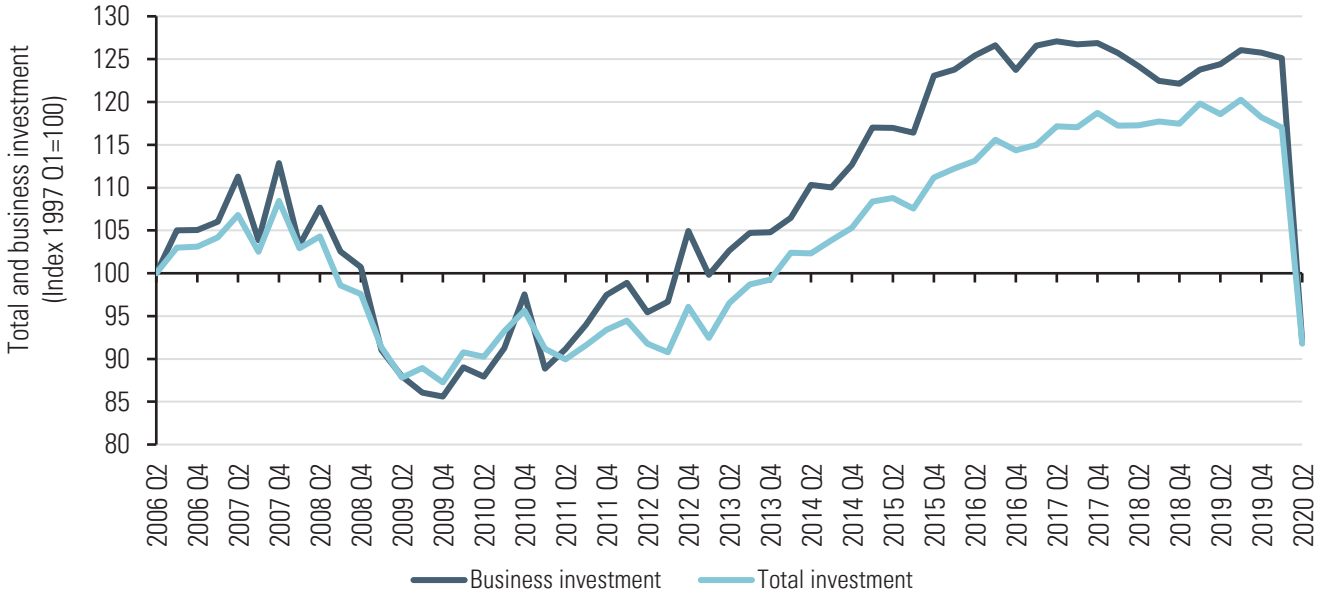
Source: LPC estimates using Bank of England data. Monetary financial institutions' loans to UK small and medium-sized enterprises: Table A8.1.1. Total small and medium-sized enterprises – SMEs (Z8YH), wholesale and retail trade (ZKT9), accommodation and food services activities (ZKU4), human health and welfare (ZKW9), recreational, personal and community services (ZKX4), monthly, UK, September 2018-December 2020.

Business investment collapsed in the crisis

1.48 Even before the onset of the pandemic, investment had been weak. Business investment recovered strongly after the financial crisis but has stagnated since the middle of 2016. Indeed, as Figure 1.16 shows, the level of business investment was no higher at the end of 2019 than it had been more than three years earlier. Total investment (which also includes government investment and dwellings) followed a similar pattern after the financial crisis but continued to grow until the third quarter of 2019, albeit at a slower pace after mid-2016.

1.49 Given the uncertain economic outlook and pressure on costs, total investment fell sharply in the first half of 2020, dropping by 22.4 per cent. The collapse in business investment was even stronger – falling by 26.9 per cent. The fall in total investment had been ameliorated to some extent by an increase in government investment of 19.3 per cent in the second quarter of 2020. Those falls in investment were larger than in the financial crisis – total investment fell by 16.3 per cent and business investment by 20.5 per cent between the second quarter of 2008 and the fourth quarter of 2009.

Figure 1.16: Investment, UK, 2006-2020



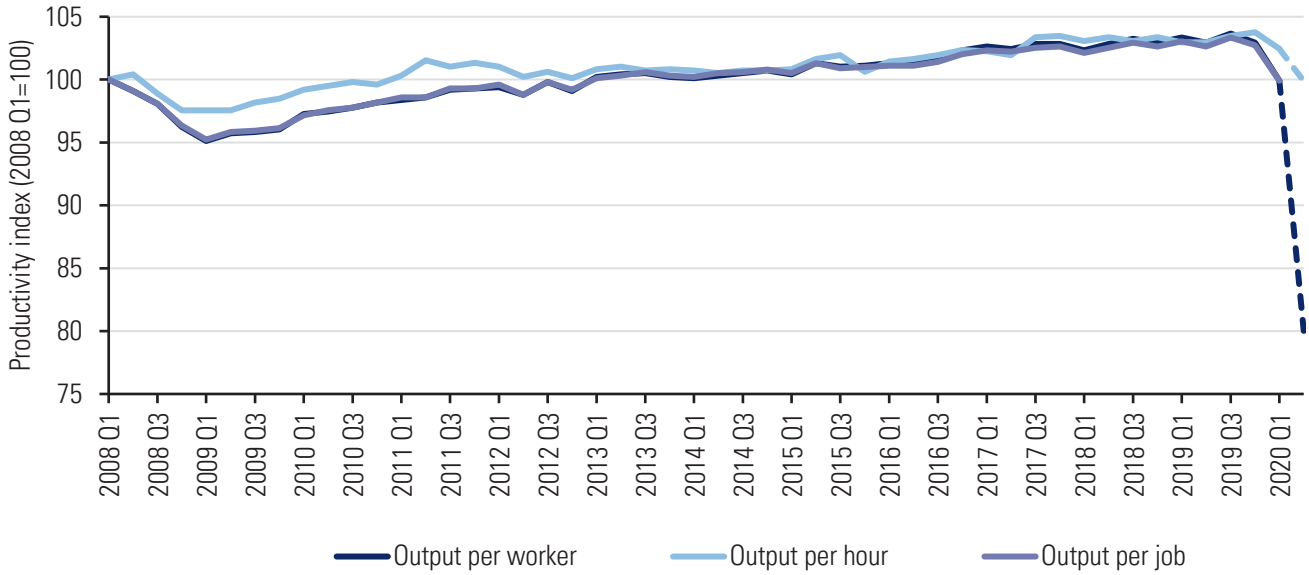
Source: LPC estimates using ONS data. Total investment – total gross fixed capital formation (NPQT), and business investment (NPEL), quarterly, seasonally adjusted, UK, Q2 2006-Q2 2020.

Productivity also weakened further

1.50 The combination of weaker sales and higher costs means productivity has weakened. Figure 1.17 shows that, even before the onset of the pandemic, the productivity performance of the UK had been modest, whether measured using output per worker, output per job, or output per hour. This, as we noted in our 2019 Report (Low Pay Commission, 2020a), reflected the weak recovery in output after the financial crisis that had been accompanied by strong employment, jobs and hours growth. At the beginning of 2015, productivity on all three measures was barely higher than it had been prior to the financial crisis but since then it has picked up modestly and was just over 3 per cent higher on all three measures in the third quarter of 2019 than in the first quarter of 2008.

1.51 With the onset of the pandemic, productivity has collapsed – output per worker falling by 22.3 per cent, though this is almost entirely driven by the fall in hours worked by furloughed workers. Output per hour fell by 3.7 per cent between the fourth quarter of 2019 and the second quarter of 2020. In general, pay does not increase in the long run without productivity increases. With weakened productivity and profits squeezed, businesses had taken measures to reduce costs, such as cutting back on investment. This has also affected their ability to give pay rises.

Figure 1.17: Productivity, UK, 2008-2020

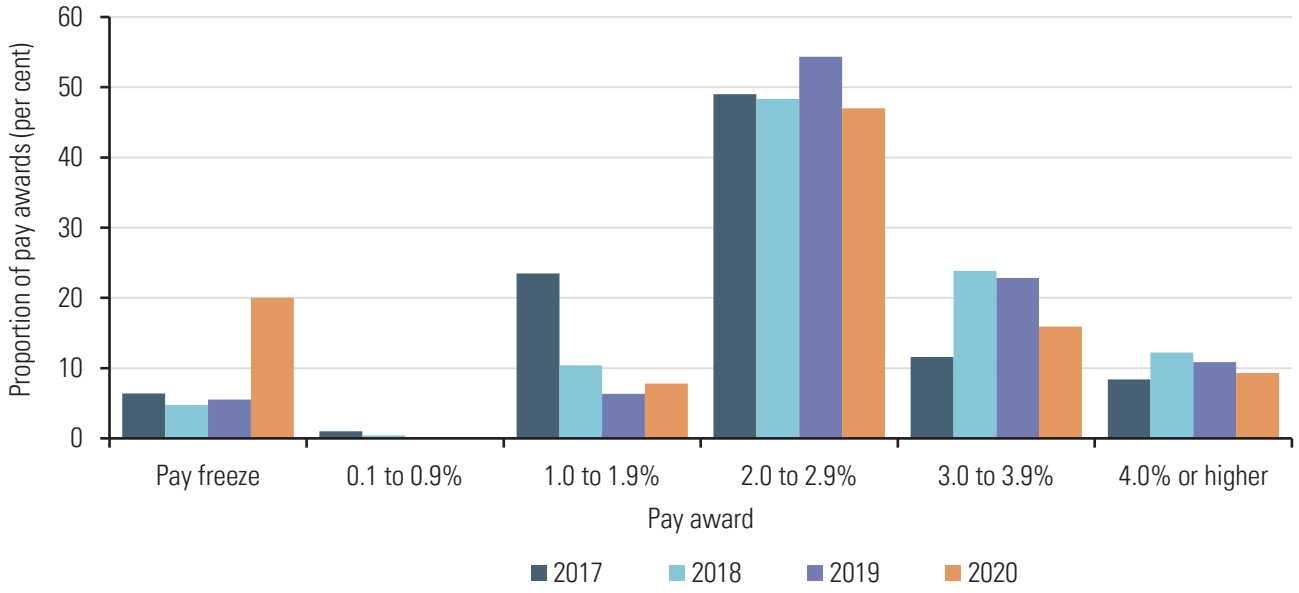


Source: LPC estimates using ONS data. Output per worker (A4YM), output per job (LNNN), and output per hour (LZVB), quarterly, seasonally adjusted, UK, Q1 2008-Q2 2020.

Increasing number of pay freezes as firms struggle with the pandemic

1.52 Although the pandemic does not seem to have greatly affected the median pay award, as we saw in Figure 1.9, it does appear to have affected the distribution of pay awards. While the bulk of pay awards are still in the 2.0 to 2.9 per cent range, there has been an increase in pay freezes. The proportion of pay freezes increased from 5 per cent to 20 per cent, while the proportion of pay awards at 3 per cent or more has fallen from over a third in 2018 and 2019 to around a quarter in 2020.

Figure 1.18: Distribution of pay settlements, UK, 2017-2020



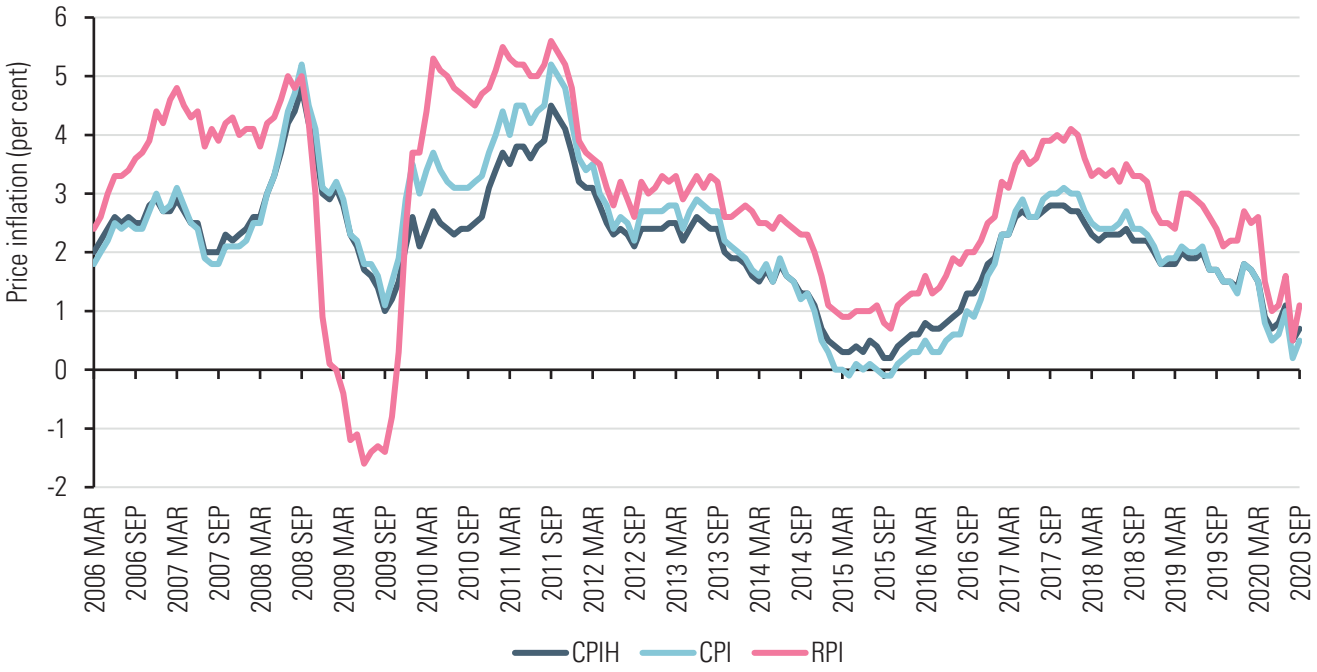
Source: XpertHR. Pay awards, UK, 2017-2020.

Despite rising costs, firms have been reluctant or unable to raise prices

1.53 Despite rising costs and reduced productivity, firms have been unable or unwilling to pass these costs on to consumers through price rises. Since peaking at the end of 2017, as seen in Figure 1.19, inflation has gradually fallen. Consumer price index (CPI) inflation had peaked in November 2017 at 3.1 per cent and had declined to 1.8 per cent by January 2020. With the onset of the pandemic, it declined sharply and fell to just 0.2 per cent in August 2020. Generally, in evidence from stakeholders and from the Bank of England's regional agents, businesses reported a reluctance to increase prices due to the uncertainty around demand (see paragraphs 7.5 to 7.6). However, many businesses had reported increases in Covid-related costs, such as personal protective equipment, other safety measures and operating at reduced capacity. These were putting upwards pressure on prices. However, in the overall price indices, these were more than offset by lower utility bills and fuel prices. CPI picked up slightly to 0.5 per cent in September 2020 but remained well below the Bank of England target rate of 2 per cent.

1.54 Other common inflation measures also followed similar trends, with measured inflation low. The new headline measure of inflation, Consumer price index including housing costs (CPIH), was 0.7 per cent, and the traditional inflation measure, the retail price index (RPI) was 1.1 per cent in September 2020.

Figure 1.19: Inflation, UK, 2006-2020

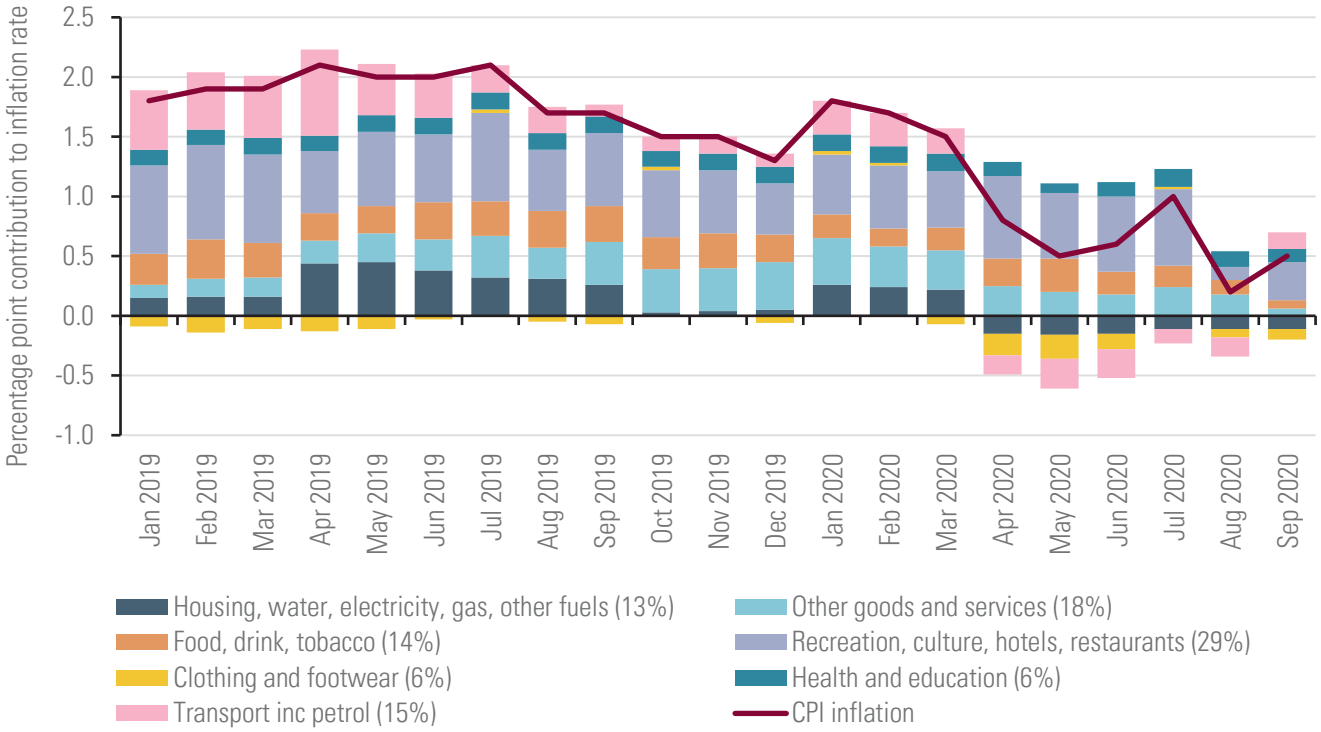


Source: ONS. Consumer price index (CPI) annual rate (D7G7), consumer price index excluding owner occupiers' housing costs (CPIH) annual rate (L550), and RPI annual rate (CZBH), monthly, seasonally adjusted, UK, March 2006-September 2020.

1.55 Over the last year, as Figure 1.20 shows, the largest downward pressures on CPI inflation have come from clothing and footwear, energy and utility bills, furniture and household goods, hotels, motor fuels and air fares. In the initial lockdown period, the price of food and alcohol increased with concerns about scarcity and evidence of panic buying. However, those price pressures have subsequently eased. During the lockdown, many goods and services were unavailable. The ONS methodology for dealing with these goods (assuming prices would have grown in line with other prices) may have put some downward pressure on the CPI index (as lower energy prices dominated).

1.56 In August, there was downward pressure in restaurants from the Government's Eat Out to Help Out scheme, which affected the prices of food and non-alcoholic drinks in participating restaurants, pubs and cafés on Mondays to Wednesdays during August. In addition, the cut in VAT for hospitality, holiday accommodation and attractions also exerted temporary downward pressures on inflation. However, some hospitality firms had reported a more limited pass-through of the VAT cut due to the increased costs of making establishments Covid-safe. On the other hand, many restaurants and cafes had continued with unofficial discount schemes in September.

Figure 1.20: Contributions to CPI inflation, UK, 2019-2020



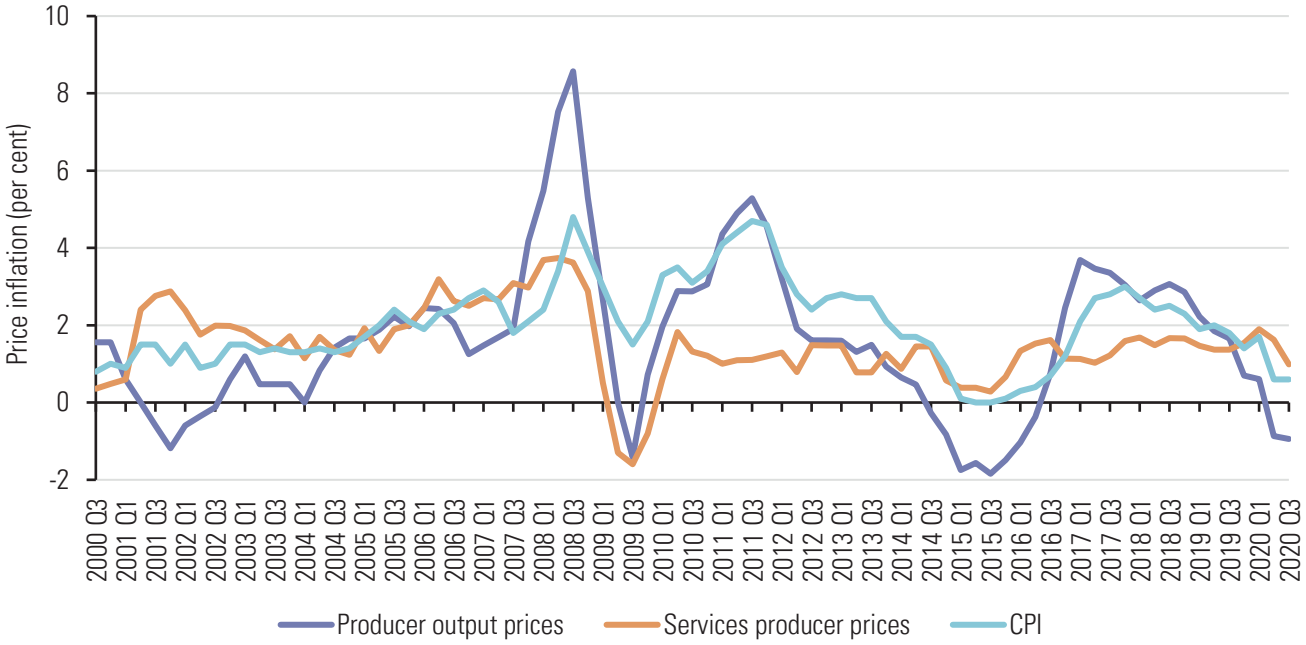
Source: LPC estimates based on ONS data. Consumer price inflation tables, table 26, monthly, UK, January 2019-September 2020.
Note: Figures in brackets are weights in the overall index in January 2020.

Firms have also been unwilling or reluctant to pass price rises on to other businesses

1.57 As well as pressures on consumer prices, we can also look at producer prices to see if there are any inflationary pressures in the production of goods and services. After peaking at the start of 2017, Figure 1.21 shows that producer price or factory gate inflation gradually fell back through 2018 and 2019. The prices of goods leaving the factory gate have been falling in both the second and third quarters of 2020. Between September 2019 and September 2020, they fell by 0.9 per cent. The main driver of that fall has been petroleum – falling by nearly 20 per cent. Food prices rose by 1.3 per cent over the year. The prices of materials and fuels purchased by manufacturers (input prices) fell by 3.7 per cent in the year to September 2020.

1.58 Services producer prices are the prices charged for services provided to UK-based businesses. Figure 1.21 also shows that the services producer price inflation has remained below 2 per cent since the fourth quarter of 2008 and it has fluctuated within a narrow 1-2 per cent band since the first quarter of 2016. After reaching 1.7 per cent in the first quarter of 2020, it has slowed to 1.0 per cent in the third quarter. The largest downward pressure came from accommodation and food services, for which prices fell by 4.1 per cent for the year to the third quarter of 2020.

Figure 1.21: Producer, services producer and consumer inflation, UK, 2000-2020



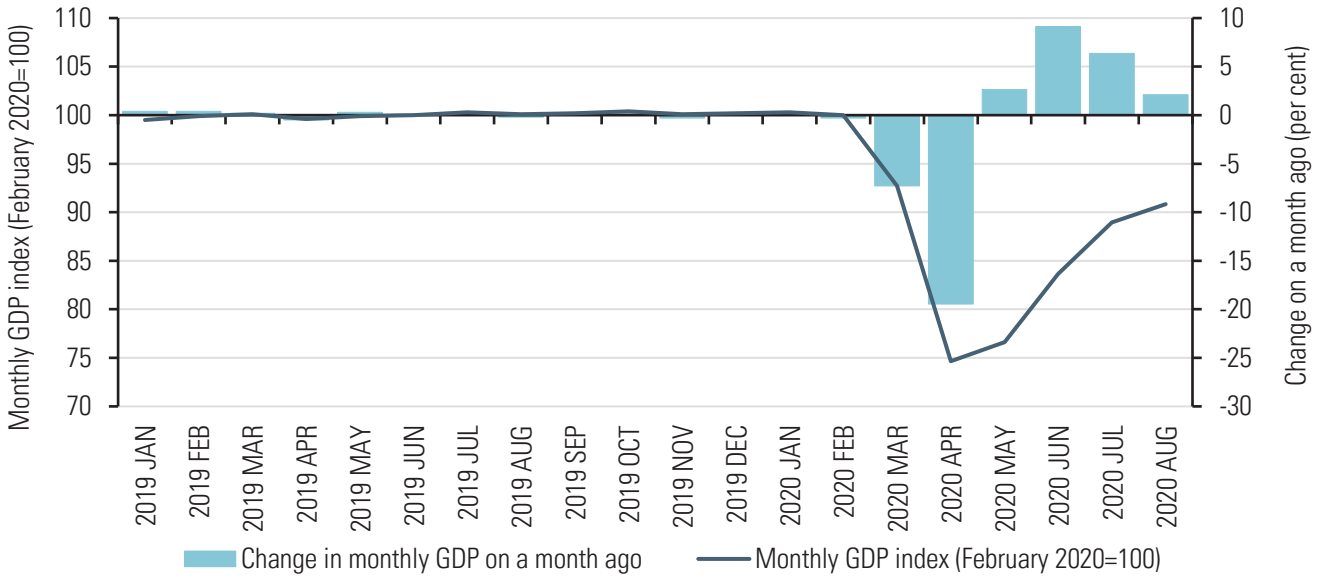
Source: LPC estimates using ONS data. Producer output price index (JVZ7), services producer price index (K8ZU), and CPI annual rate (D7G7), quarterly, seasonally adjusted, UK, Q3 2000-Q3 2020.

The economy rebounded in the summer but that rebound has weakened

1.59 As the lockdown measures in the UK eased from the middle of May, Figure 1.22 shows that the economy started growing, increasing by 2.6 per cent in May as construction and manufacturing started to return, 9.1 per cent in June as non-essential retail was allowed to re-open and by 6.4 per cent in July as hospitality opened its doors. In August, growth in the whole economy was driven mainly by hospitality, which had been boosted by the Eat Out to Help Out scheme and a reduction in VAT that enabled restaurants to keep their prices lower than otherwise. But overall growth in GDP in August was just 2.1 per cent, suggesting that the recovery was weakening.

1.60 Having fallen by 25.3 per cent between February and April, the economy then rebounded with historically strong growth of 21.7 per cent between April and August. However, that still left GDP 9.2 per cent lower in August than it had been in February before the UK had been affected by the pandemic. That compares with falls of 7.0 per cent in the financial crisis, when it took the economy five years for GDP to recover to its pre-crisis level.

Figure 1.22: Monthly GDP growth, UK, 2019-2020



Source: LPC estimates using ONS data. Monthly GDP index (ECY2), monthly, seasonally adjusted, UK, December 2018-August 2020.

Conclusion

1.61 In the wake of a global epidemic, the UK along with many other countries experienced the sharpest, steepest recession on record in the first half of 2020. GDP in the UK fell by a quarter, with consumer spending and investment collapsing. The unprecedented level of government intervention in peace time has helped support the jobs and incomes of workers, the incomes of those without work and provided financial assistance and credit to businesses. However, recovery in economic growth had begun to slow by August, a point at which GDP was still over 9 per cent lower than in February and at the same level as the beginning of 2014. While this chapter has shown that the headline impacts on the labour market have been relatively benign, there is more going on below the surface, which we discuss next in Chapter 2.

Chapter 2

The labour market

Key findings

The pre-Covid labour market was performing well; jobs growth had continued and strengthened among full-time, permanent employee jobs. The pandemic precipitated an unprecedented shock to the economy, one which would be expected to deliver a huge increase in joblessness under normal circumstances. Instead, the Government's Coronavirus Job Retention Scheme (CJRS) has largely protected jobs and incomes.

However, there have been some important changes to employment. Firstly, self-employment has fallen substantially. While some of this is due to some workers moving into employee jobs, the net effect is of a fall in employment, particularly among men.

Secondly, the CJRS has not protected every job. The number of payrolled employees fell substantially in April, even while the Labour Force Survey (LFS) finds no fall in numbers of employees. There are likely several things happening here. Some workers are 'loosely attached'; they appear as furloughed workers in the LFS – employed but say their job is 'on hold' – but they are not being paid. They may be ineligible or have been told by their employer they would be hired back in the future. However, a spike in redundancies over the summer confirms that some employees have lost their jobs.

These job losses show up in increased unemployment, inactivity and claims to Universal Credit. Inactivity rose first, as the collapse in vacancies and social distancing made it difficult to actively search for work. Unemployment then increased over the summer, as these workers were able to begin their search, likely joined by those leaving education for the first time. Young people were particularly affected. Those in work were more likely to be in shutdown sectors and those who have lost their job, or are searching for their first upon leaving education, are dependent on vacancies, which had collapsed at the crisis' outset.

Those searching for a job, whether for the first time or having recently lost one, are not directly helped by the CJRS, which only supports those already in work. Demand for workers across the economy, and measures to support it, will be key to the recovery. Vacancy levels recovered through the summer as the economy reopened and output recovered. In fact, even as the recovery in GDP started to slow, vacancy levels continued to grow into October, and with them the numbers of people moving into payrolled employment. Maintaining this momentum will be critical.

There is one final piece to this puzzle. The LFS suggests there has been a large fall in numbers of longer-term migrant workers in the UK labour market. This is reflected in a collapse in visa applications. This too may flatter employment figures, as migrant workers who have left do not show up in unemployment figures or benefit claims. However, the LFS is not designed to measure changes such as this and further evidence is needed.

2.1 As outlined in Chapter 1 and set out in detail in Appendix 6, the Covid-19 outbreak resulted in the largest and swiftest contraction in economic activity in history. The UK Government announced measures to limit social contact in order to control the spread of the virus. These made it difficult for some sectors of the economy to continue to operate. To protect both the jobs of millions of workers and the survival of many firms, the Government introduced unprecedented levels of economic support (see Table 1.2).

2.2 In this chapter we explore the macro labour market position. We briefly look at the period up to the end of the first quarter of 2020, the point at which the UK had just entered lockdown, prior to the National Living Wage (NLW) and National Minimum Wage (NMW) upratings on 1 April. We then contrast this with what happened in the labour market more recently. This period includes the national lockdown where government introduced measures to contain the spread of Covid-19 as well as the gradual re-opening of large parts of the economy into the summer months. We discuss what this meant for a range of labour market indicators including employment, hours worked and unemployment.

2.3 The post-lockdown period placed greater demand on official data sources, as policymakers attempted to understand the pandemic's impacts on the labour market. In response, the Office for National Statistics (ONS) began to release a range of new information: weekly data was included within the monthly labour market release; rolling quarterly Labour Force Survey (LFS) micro-data was made available and included a range of new Covid-related questions; a new fortnightly Business Impact of Covid-19 Survey (BICS) provided a range of information from firms on how they were responding to the pandemic; and the Opinions and Lifestyle survey asked questions to individuals about their experiences of Covid-19.

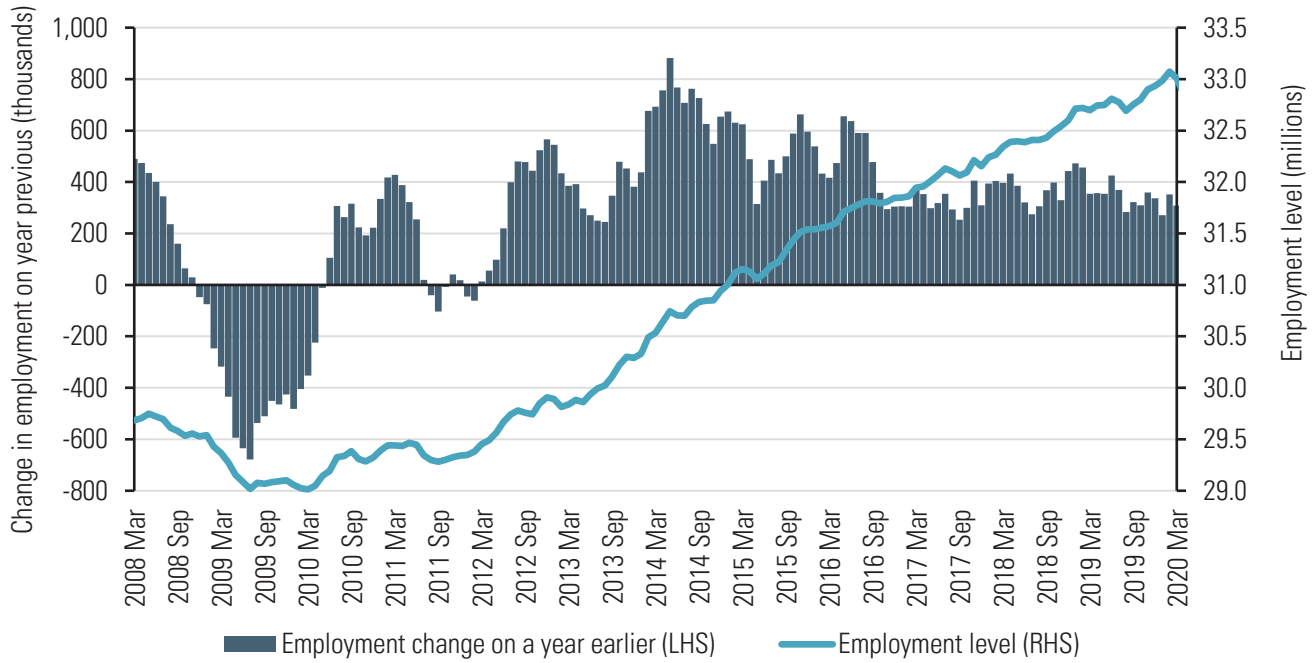
2.4 We are grateful to ONS for all the work that they have undertaken this year to ensure this range of relevant and timely data was made available, enabling users to better understand the impacts of the pandemic on the labour market.

The labour market to Q1 2020

Employment and employee jobs

2.5 In the twelve months to March 2020, the strong employment growth of recent years continued, with a record 33.1 million people in work, over 4 million more than the depth of the financial crisis. While some commentators thought the UK may have reached peak employment when levels dipped slightly in summer 2019, employment continued to grow through the remainder of 2019 and into 2020. Figure 2.1 shows how in March 2020 employment was 308,000 higher than twelve months previously, with employment rates reaching record highs of 76.6 per cent.

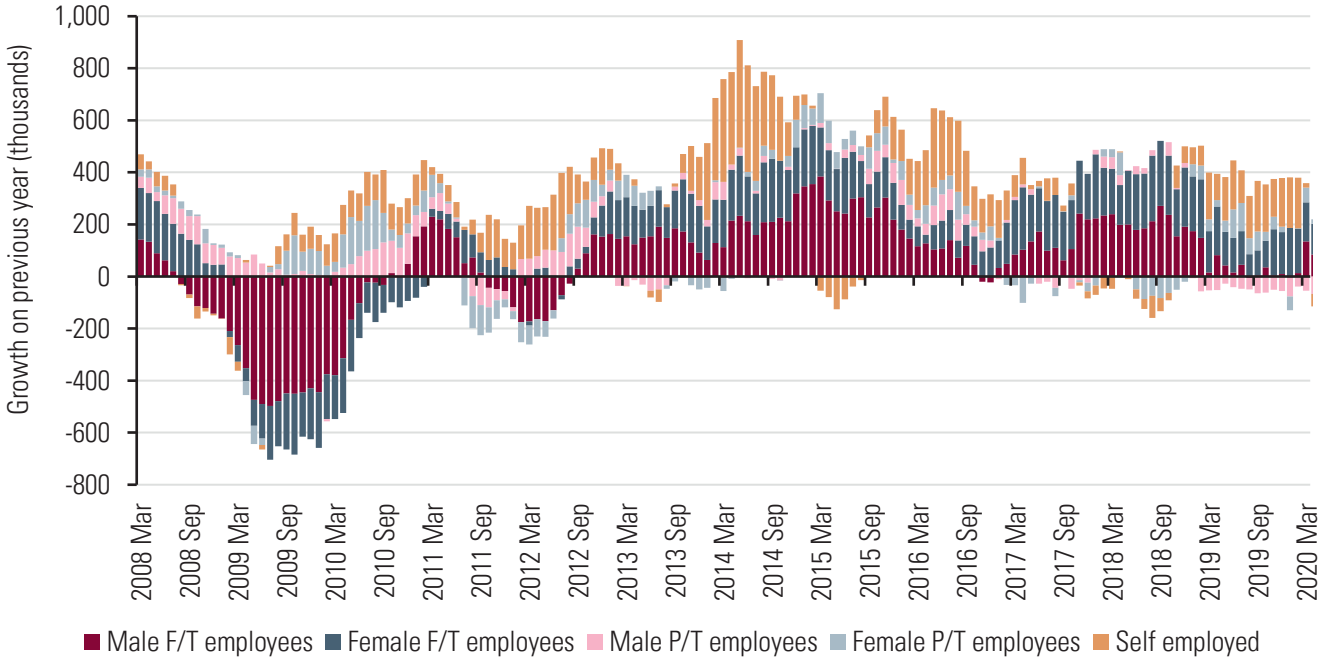
Figure 2.1: Employment, UK, 2008-2020



Source: LPC estimates using ONS data: total employment (MGRZ), monthly, seasonally adjusted, UK, March 2008-March 2020.

2.6 Figure 2.2 shows the composition of this growth, from the period just prior to the financial crisis up to March 2020. In the recent past, employment growth had largely been driven by a combination of increased female participation and rising self-employment. In March 2020, we witnessed the largest annual rise in full-time male employees since February 2019. There were also signs of the recent growth in self-employment slowing. We discuss changes in labour market composition in more detail later in the chapter.

Figure 2.2: Employment growth, UK, 2008-2020



Source: LPC estimates using ONS data: full-time female employees (YCBM); full-time male employees (YCBL); part-time female employees (YCBP); part-time male employees (YCBO) and total self-employed (MGRQ), monthly, seasonally adjusted, UK, 2008-2020.

2.7 Table 2.1 provides additional information on the groups that contributed to the strong employment growth in the year to March 2020, breaking down total employment further to additionally include age, status and contract type. It shows that while employment grew overall by over 300,000 in the twelve months to March (286,000 employees and 18,000 self-employed), growth in the final three months started to show some signs of change. The total number in work increased by 71,000 as employees grew by 153,000, the majority part-time workers, with self-employment falling by 79,000. Permanent contracts made up all the employee growth in the year to March 2020 although in the final quarter over half of the growth was in temporary contracts.

2.8 Employment growth in this period had continued to be largely from those aged 25-34, rising by 84,000, and those aged 50 and over which increased by 258,000. 35-49 year olds, who had seen little annual growth, saw employment fall by 47,000 in the three months to March. Younger workers saw small falls in their annual employment levels, although 18-24 year olds experienced slight growth of 13,000 in the 3 months to March.

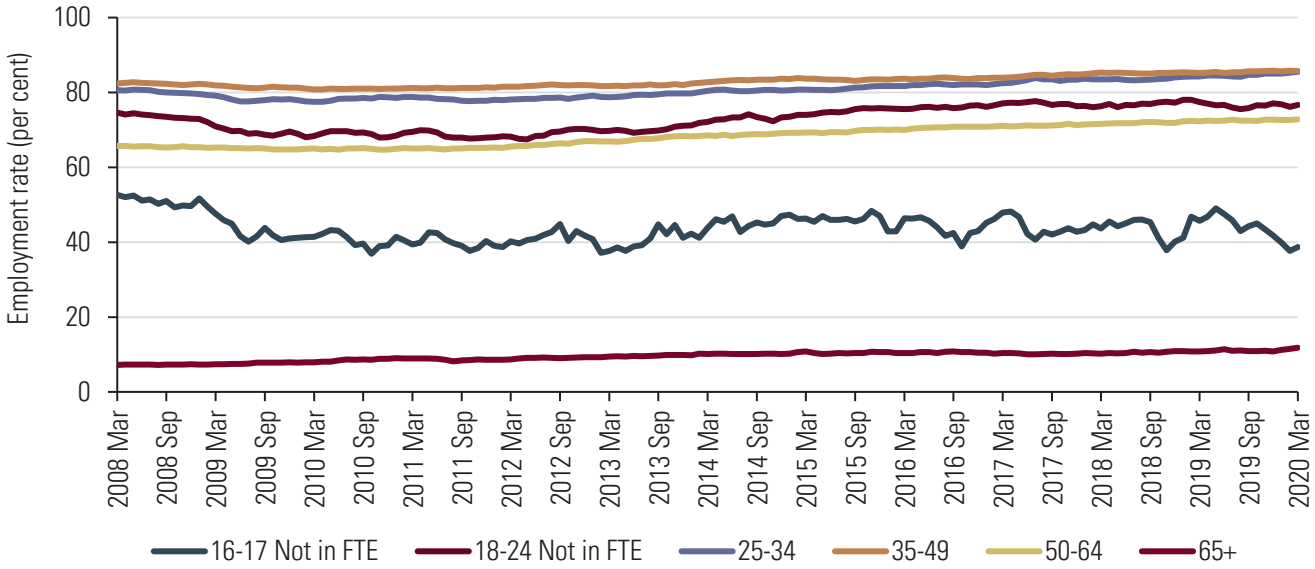
Table 2.1: Employment by status, age, hours and permanency, UK, 2016-2020

Thousands		Change on		
		Previous quarter	Previous year	
	2020 March	2019 Dec	2019 March	2016 April
Employment				
Total	33,005	71	308	1,402
Employees	27,879	153	286	1,186
Self-employed	4,948	-79	18	242
Other	179	-2	6	-25
Employment by Age				
16-17	326	-10	-16	-29
18-24	3,467	13	-30	-103
25-34	7,631	17	84	408
35-49	10,874	-47	15	108
50-64	9,304	-8	136	797
65+	1,404	107	122	223
Work Status				
Full-time Employees	20,851	59	285	1,182
Part-time Employees	7,028	94	1	4
Contract Type				
Permanent Employees	26,371	67	306	1,311
Temporary Employees	1,508	86	-20	-125

Source: LPC estimates using ONS data: employment (MGRZ); employees (MGRN); self-employment (MGRQ); other combines unpaid workers (MGRT) and Government-supported trainees (MGRW); full-time employees (YCBK); part-time employees (YCBN); permanent employees (MGRN-YCBZ); temporary employees (YCBZ); employment by age groups: 16-17 (YBTO); 18-24 (YBTR); 25-34 (YBTU); 35-49 (YBTX); 50-64 (LF26); and 65 and over (LFK4), monthly, three month average, seasonally adjusted, UK, 2016-2020.
Note: Totals may not sum due to rounding.

2.9 As employment grew, so employment rates increased for most age groups. Figure 2.3 shows how rates have steadily risen over the period. For 16-24 year olds we look solely at those not in full-time education – the resulting smaller samples make the data more volatile, especially for 16-17 year olds. In the year to March 2020 the employment rate for the youngest workers fell from 46 per cent to 39 per cent.

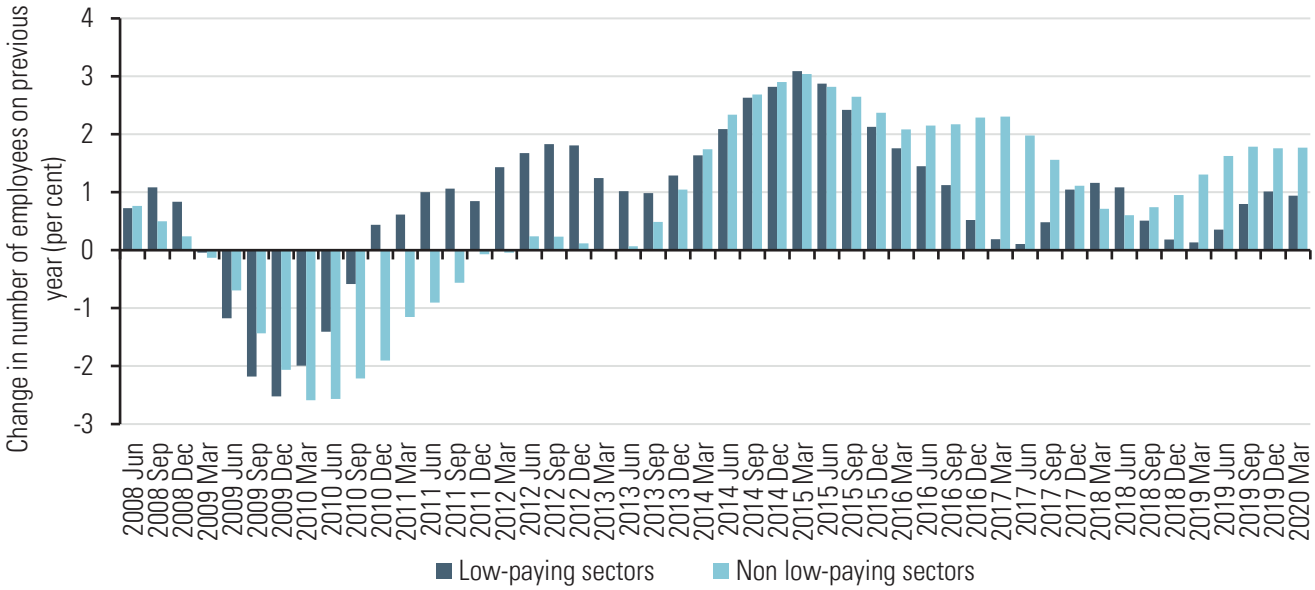
Figure 2.3: Employment rates by age, UK, 2008-2020



Source: LPC estimates using ONS data: 16-17 and 18-24 (Table 12 of A01 dataset), 25-34 (YBUG), 35-49 (YBUJ), 50-64 (LF2U), 65+ (LFK6), monthly, seasonally adjusted, UK, March 2008-March 2020.

2.10 As well as the number of individuals employed continuing to increase into 2020 we also saw the total number of jobs in the labour market grow. In March 2020, there were 30.3 million employee jobs compared with 28.0 million employees. On a rolling four-quarter average basis low-paying sector jobs increased by 0.9 per cent in the year to March 2020 whilst those in non low-paying sectors grew twice as fast at 1.8 per cent.

Figure 2.4: Annual change in employee jobs, by sector, GB, 2008-2020



Source: LPC estimates using ONS data: employee jobs series, quarterly, four quarter moving average, GB, March 2008-March 2020.

2.11 In summary in the year to March 2020 we saw continued growth in employment with record levels and rates. Yet there were also signs of the first changes in employment patterns caused by the pandemic. In the final three months, while employee growth remained strong, there was a large drop in self-employment – a sign of things to come.

National lockdown and beyond

2.12 As outlined in Chapter 1, the global pandemic led the Government to close down large swathes of the economy in spring 2020. This resulted in a significant proportion of the workforce suddenly no longer able to work and left the nation in the midst of an unprecedented economic shock.

Coronavirus Job Retention Scheme

2.13 The Coronavirus Job Retention Scheme (CJRS) is the most substantial intervention in the labour market in living memory and the driver of the majority of impacts we see in employment, hours of work and pay this year. When it was announced on 20 March, it promised to provide employers with an opportunity to retain staff and not make redundancies during a period when many firms were not able to operate due to coronavirus restrictions. Under the scheme, the Government would pay 80 per cent of an employee's wage up to a maximum of £2,500 per month. Firms could additionally top up salaries if they wished. The Government also paid employer National Insurance (NI) and minimum auto-enrolment pension contributions. The scheme went live on 20 April, with employers able to backdate claims to March, and initial payments made in time for May.

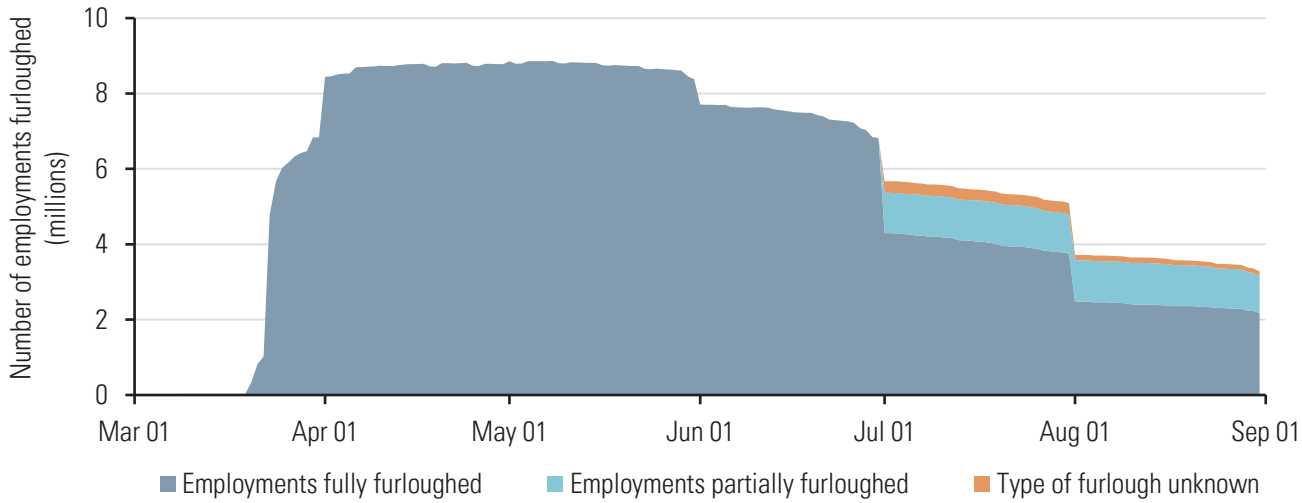
2.14 From 1 July, the Government allowed 'flexible furlough' arrangements that enabled firms to bring furloughed employees back to work on a part-time basis. Employers would pay their employees for the hours worked but could still claim under the scheme for hours not worked.

2.15 From 1 August, firms started contributing to the cost of the scheme by paying employer NI and pension contributions. From 1 September, employers were additionally required to make a 10 per cent contribution to wages (up to £312.50) which increased from 1 October, the final month of the scheme, to 20 per cent of wages (up to £625).

2.16 Up to the end of August 2020, there were 9.6 million employments furloughed with claims totalling around £39bn. Numbers peaked in early May when around 8.9 million employments were furloughed (see Figure 2.5). Numbers gradually reduced over the summer as the economy reopened and output recovered. Around 1 million employments were partially furlough from July, as the overall number furloughed fell to 4.3 million. Numbers dropped again in August as employer contributions were introduced although levels of partial furlough remained at around 1 million throughout August. By the end of August 3.3 million employments remained furloughed.

2.17 A large share of those who remained furloughed were workers from the hospitality and leisure sectors. Data from Wave 15 of BICS highlighted that 24 per cent and 28 per cent respectively of their workforces remained furloughed in early October. Workers from these sectors were the least likely to work remotely – only 6 per cent of hospitality and 15 per cent of leisure staff worked remotely compared with 28 per cent of all employees.

Figure 2.5: Number of employments furloughed, UK, March-August 2020



Source: LPC analysis of HMRC CJRS data, UK, March-August 2020.
Note: Data for July and August are provisional as claims for these periods can still be made.

2.18 It is because of the CJRS that the huge economic shock that hit the economy has not resulted in large-scale job losses. In August, HMRC's PAYE administrative data showed that of 4.3 million employments that were no longer furloughed, 90 per cent (3.9 million) remained working for the same employer. Despite this, the CJRS and other support have not been able to protect every single job and there have been significant changes within the labour market.

Employment

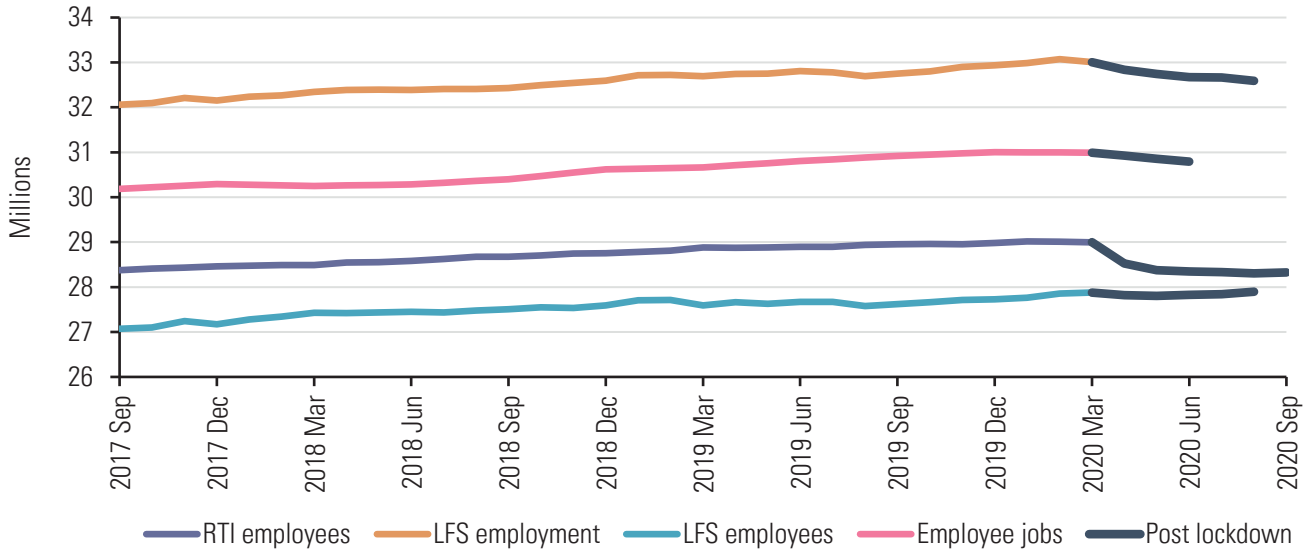
2.19 Figure 2.6 looks at how employment levels compare across the main sources of data both before and after lockdown. Each source shows a different level of employment and we will attempt to explain why that is. However, it is clear that in the years preceding the pandemic all data sources showed steady increases in employment.

2.20 The LFS measure of total employment is taken from a household survey. It counts the number of individuals who self-report as either employed or self-employed. This fell by 480,000 (or 1.25 per cent) between February and August, driven by falls in self-employment (around 470,000 in total) and partly offset by rising employee numbers. The self-employed were not protected by the CJRS but could receive financial support via the Self Employment Income Support Scheme (SEISS).

2.21 The Employee Jobs measure is also collected by ONS, but is taken from employer surveys and counts the total number of employee jobs in the economy. This is an important distinction as workers often have more than one job, and jobs can be held by more than one person. We discuss more of these differences in Appendix 3.

2.22 For the first time this year we now also have counts of payrolled employees from HM Revenue and Customs' (HMRC) Real Time Information (RTI). These data cover the number of employees that have paid employment through HMRC's Pay As You Earn (PAYE) system. This covers the whole population rather than a sample of individuals or companies, allowing for more detailed estimates. Employees with multiple payrolled jobs are only counted once. This data showed a sharp drop in April of around 475,000 payrolled workers. This was driven by a combination of a spike in workers leaving employment and a fall in those entering employment, as vacancies collapsed at this time.

Figure 2.6: Employment, UK 2017-2020



Source: LPC estimates of HMRC RTI payrolled employees, LFS total employment (MGRZ), LFS employees (MGRN) and employee jobs series, monthly and quarterly, seasonally adjusted, UK, September 2017-September 2020.

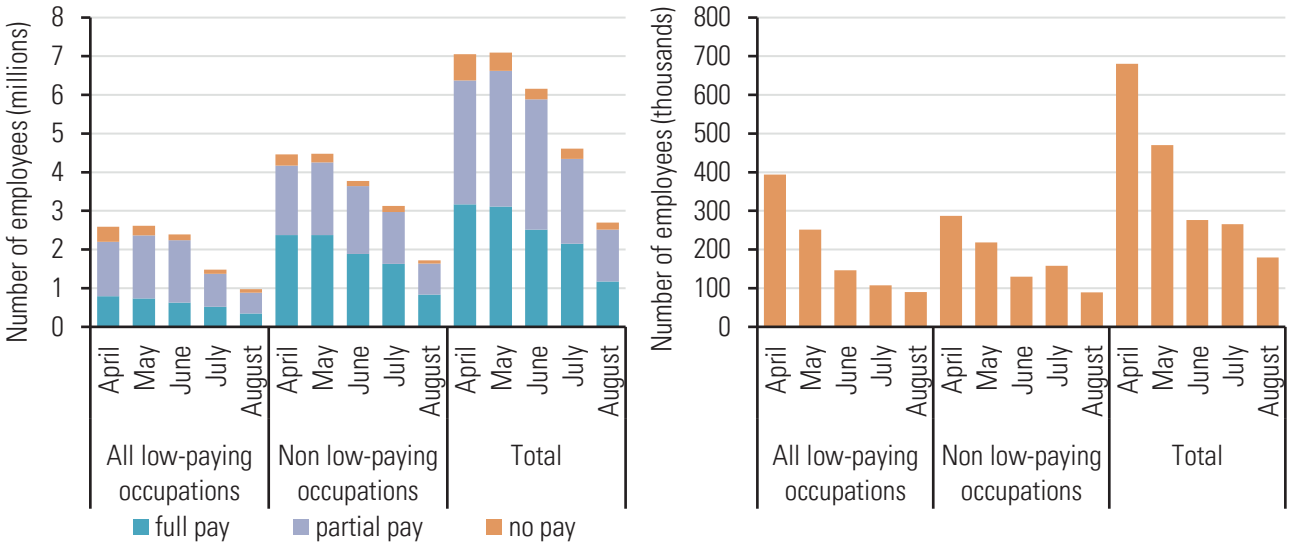
2.23 There are, then, clear differences in these measures since the onset of the crisis. LFS employee numbers have remained relatively unchanged while HMRC's RTI data show a sharp drop in April of around 475,000 payrolled workers. Below we attempt to explain this divergence.

2.24 Furloughed workers show up in the LFS as employed but with their job 'on hold'. Figure 2.7 shows in April there were around 7 million such workers, slightly lower than HMRC's data, though the pattern of decline over the summer is similar. The chart also identifies whether workers are receiving full, partial or no pay at all. Furloughed workers in low-paying occupations are less likely to be receiving full pay than their non low-paying counterparts. We explore this in more detail on Chapter 4.

2.25 However, among this group around 700,000 workers said that, unlike those furloughed on the CJRS scheme, they were not receiving any pay. This group may include those who have fallen through the cracks of the CJRS, for example because they were ineligible. However, we believe they are more likely to represent workers with a loose attachment to the labour market. They may have been told by their employer that there was no work currently, but they would be hired back later on. As with the RTI numbers, this group are likely to represent a large part of the post lockdown surge in the claimant count.

2.26 Unlike the total number of workers whose job was on hold due to Covid-19, the group receiving no pay was disproportionately from low-paying occupations. The number more than halved in the first few months after lockdown, to below 300,000 in June. This may be a result of this 'loosely attached' group either returning to paid work with their employer or becoming more informed about their employment position and therefore being recorded as unemployed, inactive or indeed in another job.

Figure 2.7: Employees whose job was on hold due to coronavirus

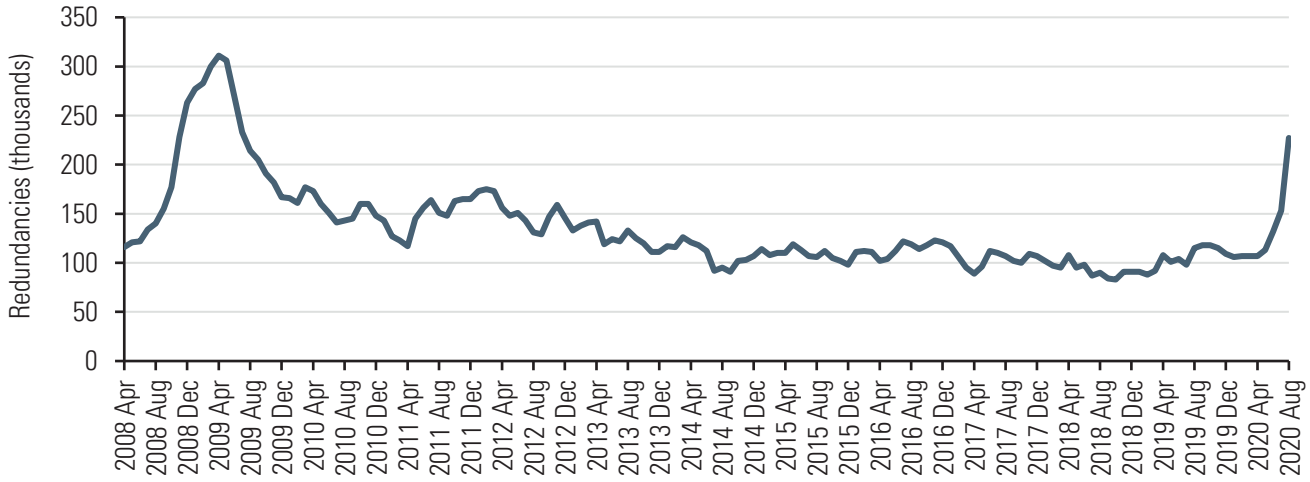


Source: LPC estimates using LFS microdata, population weights, quarterly, UK, April-August 2020.

2.27 Arguably if respondents are not receiving any pay then they should not be classed as employed. In a blog in July, Athow (2020) stated that the ONS take respondents' answers at face value and therefore included this group responding as employed but receiving no pay in their measure of employment. He also noted that the size of this group (680,000 in April) helped to explain much of the difference between the fall in RTI payrolled individuals and the number of employees shown in the LFS.

2.28 While the LFS does not show a fall in the overall number of employees, it does show an increase in people saying they have recently been made redundant. Figure 2.8 highlights the sharp increase in redundancies that fed into official data in the summer. Numbers doubled in the three months to August from 113,000 to 227,000. This was a record quarterly increase and left redundancy levels at their highest since May 2009.

Figure 2.8: Redundancies, UK, 2008-2020



Source: LPC estimates using ONS data: total redundancies (BEAO), monthly, seasonally adjusted, UK, August 2008-August 2020.

2.29 The LFS allows us to look at how the composition of employment has changed in the six-month period from February (the last full month prior to lockdown) to August (the latest available data). We can see from Figure 2.9 that total employment fell by almost half a million (482,000), but there is a distinct difference in the pattern of change between men and women. Men have seen a large fall in full-time self-employment which is down by 335,000. They have also seen small reductions in the numbers of the part-time self-employed, down 31,000, and part-time employees, down 35,000. However, the number of full-time employees increased by 116,000. Total employment for men fell by 302,000 in the 6 months to August.

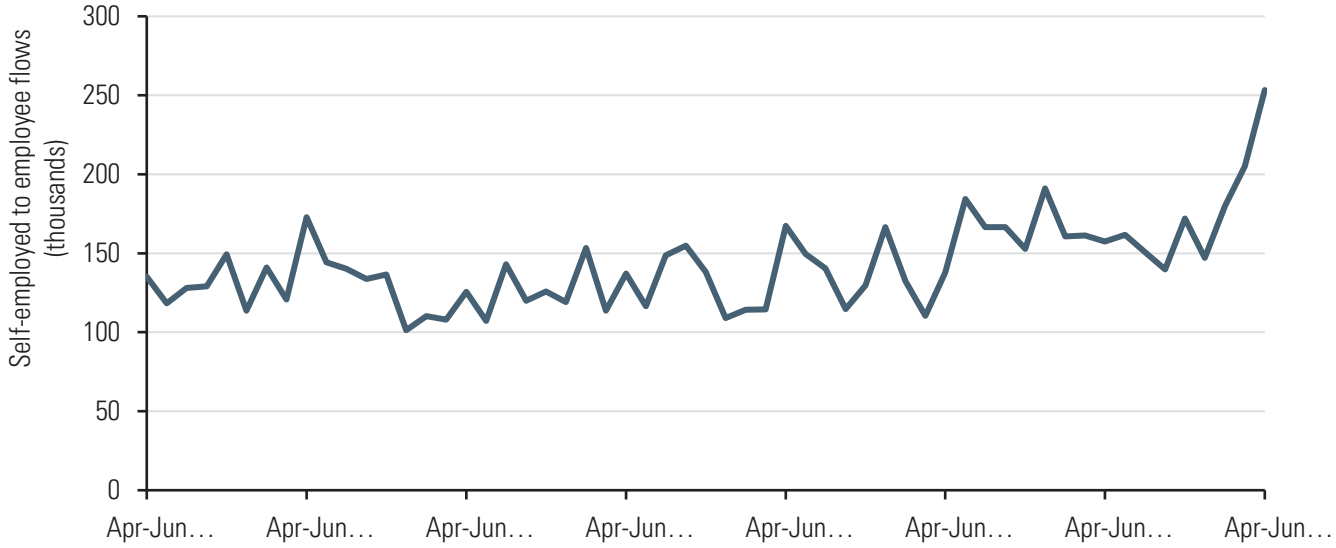
2.30 There was also a large increase among women in full-time employment, up 168,000, but this was more than offset by a large fall in part-time employment which reduced by 209,000 and a fall in part-time self-employed which was down by 99,000. Full-time self-employed workers also fell slightly. The total employment loss for women across the period was 180,000. Overall, the number of full-time employees grew by 284,000 whilst part-time employees fell by 244,000. This was a net increase of 41,000 in employees. Part-time self-employment dropped by 130,000 whilst full-time self-employment was down by 343,000, a total fall of 472,000 self-employed workers.

Figure 2.9: Change in employment, UK, Feb-Aug 2020

Source: LPC estimates using ONS data: part-time men employees (YCBO), part-time women employees (YCBP), full-time men employees (YCBL), full-time women employees (YCBM), part-time men self-employed (YCBU), part-time women self-employed (YCBV), full-time men self-employed (YCBR), full-time women self-employed (YCBS), total men (MGSA), total women (MGSB), monthly, seasonally adjusted, UK, February 2020-August 2020.
Note: Total employed also includes unpaid family workers and government supported training and employment programmes.

2.31 One explanation for this compositional shift is that there appears to have been an element of reallocation of individuals from self-employment to employee status. Figure 2.10 shows the number of people changing their employment status from self-employed to employee increased by 48,000 in the three months to June to a record high of 253,000. There may have been an element of individuals with multiple jobs changing their main job from self-employed to employee although according to ONS some of this is from individuals who have not actually changed jobs but just re-classified their type of employment. Some of the shift in status could also be driven by self-employed individuals ineligible for SEISS and unable to work due to lockdown restrictions. This may have led these workers to find alternative employee work.

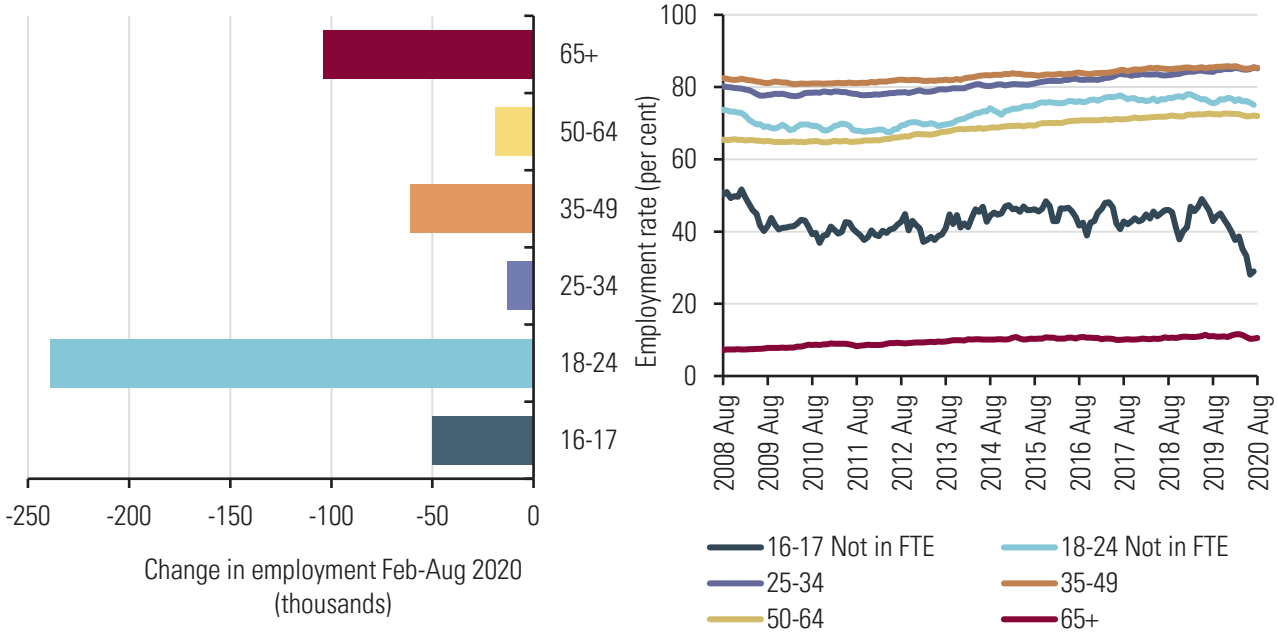
Figure 2.10: Self-employment to employee flows, UK, 2006-2020



Source: LPC estimates using ONS data: X02 Labour Force Survey flow estimates, quarterly, not seasonally adjusted, UK, Apr 2006-June 2020.

2.32 Employment fell across all age groups in the six months between February and August. But Figure 2.11 shows that the spread of this fall in employment was not evenly distributed. Almost half (239,000) of the reduction was from those aged 18-24. Older workers aged 65 and over showed the next highest fall with levels dropping by 104,000. 16-17 year olds saw a fall of 50,000 which was the largest proportionately, a 15 per cent reduction in those in employment.

Figure 2.11: Change in employment and employment rates, UK, February-August 2020 and 2008-2020



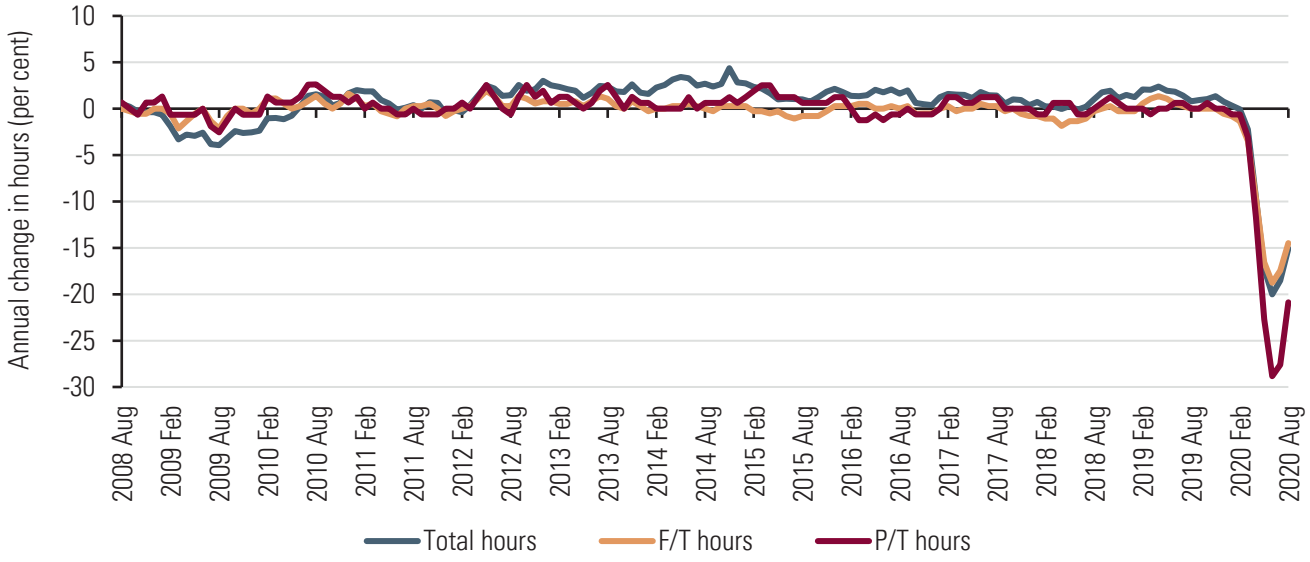
Source: LPC estimates using ONS data: Employment - 16-17 (YBTO), 18-24 (YBTR), 25-34 (YBTU), 35-49 (YBTX), 50-64 (LF25), 65+ (LFK4), Employment rate – 16-17 and 18-24 (Table 12 of A01 data set), 25-34 (YBUG), 35-49 (YBUJ), 50-64 (LF2U), 65+ (LFK6), monthly, seasonally adjusted, UK, August 2008-August 2020.
Note: Employment rates for 16-17 and 18-24 not in full-time education were not available for Aug 2020 and Mar-Jul 2020 were not updated with new LFS weighting methodology in Oct 2020 Labour Market overview release.

Hours

2.33 Levels of employment were largely protected by the CJRS, but the effect of the crisis was more apparent in hours worked, which fell substantially in the initial months of lockdown. Aggregate data for the three months to March showed an annual fall in total hours of 2.3 per cent, despite only the last two of the 13 weeks including data from the lockdown period. As more data came to light, the real extent of the impact became clear. In the three months to April 2020 (the period covering the initial six weeks of lockdown), total weekly hours fell by around 100 million hours to 953 million hours, 9.6 per cent lower than the same period 12 months previous. And when we look at the three months to June 2020, the first quarter of post-lockdown data, total hours worked in the economy were down by over 210 million hours or 20 per cent, roughly in line with the fall in GDP over the same period.

2.34 Part-time hours fell proportionately more than full-time hours. Figure 2.12 shows how in the three months to June 2020, hours for part-time workers were 29 per cent lower than the same period in 2019, down from 16.3 hours to 11.3 hours. Full-time workers saw their hours fall by 19 per cent from 37.3 hours to 30.3 hours. The latest available data showed signs of a pick-up in hours for both part-time and full-time workers, although in the three months to August average hours worked were still 21 per cent and 15 per cent lower respectively compared with the same three months in 2019.

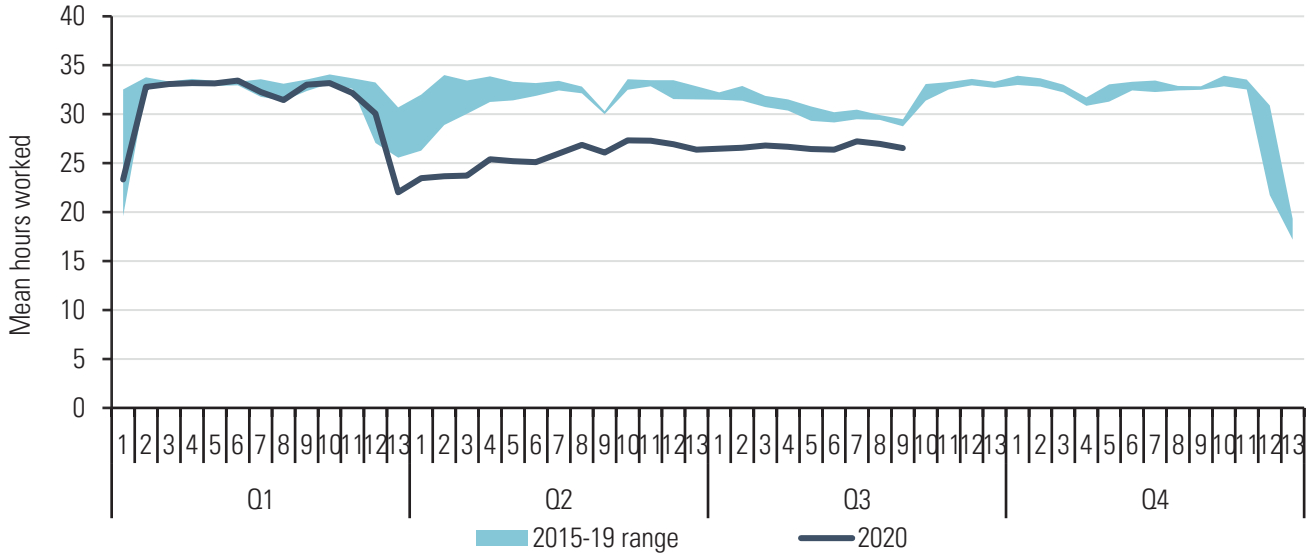
Figure 2.12: Hours worked, UK, 2008-2020



Source: LPC estimates using ONS data: total hours (YBUS), full-time hours (YBUY), part-time hours (YBVB), monthly, seasonally adjusted, UK, August 2008-August 2020.

2.35 Figure 2.13 uses weekly data from the LFS to examine the changes in hours worked in more detail. We can clearly see how, following the beginning of lockdown in March, average hours dropped sharply from around 33 down to 22. Across the second quarter there was a gradual pick up in hours worked up to around 27 hours. The gap between the average range of hours worked in the last five years (the light blue band) and hours worked in 2020 continued to narrow into the third quarter despite hours levelling off.

Figure 2.13: Average hours worked, 16+, UK, 2015-2020



Source: LPC estimates using LFS microdata, quarterly population weights, quarterly, UK, Q1 2015 – June-August 2020.

Unemployment, inactivity and claimant count

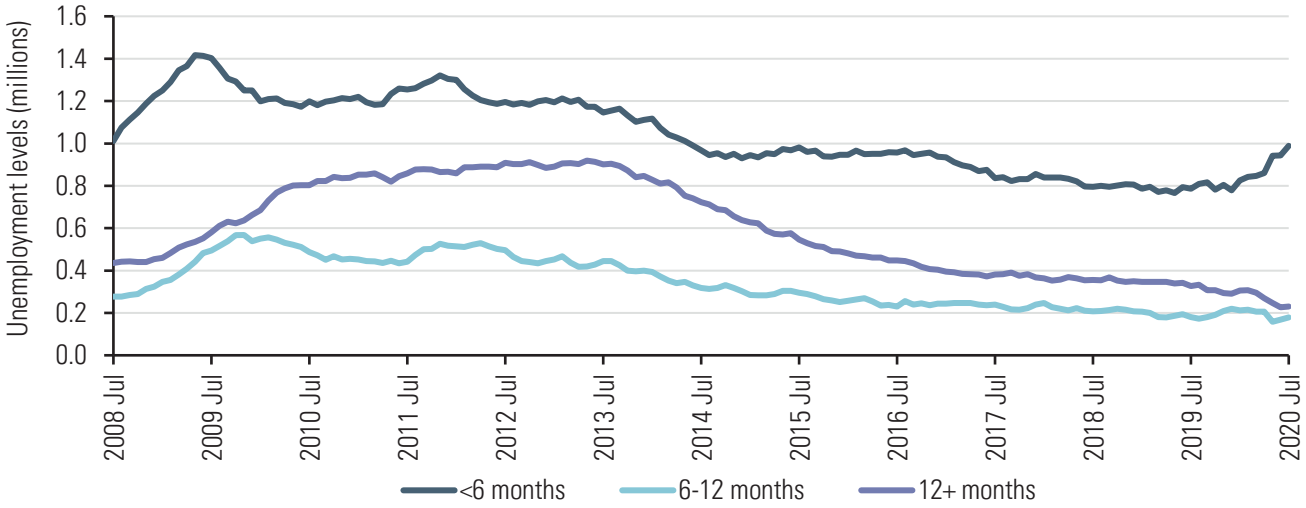
Unemployment

2.36 With job losses among both employees and the self-employed, we saw rises in unemployment, inactivity and claims for universal credit. Unemployment had been gradually falling for the last five years and 2019 saw its lowest rate since the 1970s – 3.8 per cent. Prior to March the unemployment picture was still fairly positive despite a minor increase – data for the three months to February 2020 showed there were 1.36m people aged 16 and over unemployed, a rate of 4.0 per cent.

2.37 In the initial lockdown months we first saw a jump in levels of inactivity rather than unemployment. This was likely a result of several factors, including confusion for many workers around their employment status and entitlement to CJRS or SEISS, and the sudden drop in job vacancies reducing the numbers actively looking for work. The latest unemployment data to August suggests that many in this situation who wanted a job have since moved from inactivity to unemployment as they begin their search for work.

2.38 Combined with increasing levels of redundancies we have now started to see the increase in unemployment levels that many forecast. In the three months to August unemployment increased by 138,000 to 1.5 million and the unemployment rate rose by 0.4 percentage points to 4.5 per cent for those aged 16 and over, the highest rate since March 2017. Figure 2.14 shows that most of the recent increases in unemployment have been from newer cases up to six months in duration.

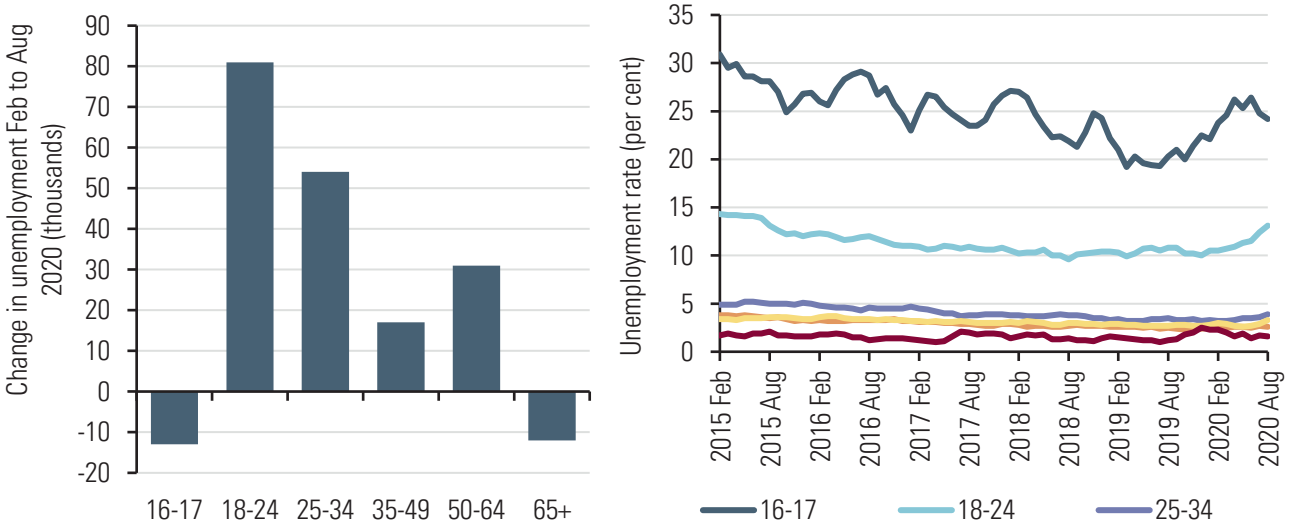
Figure 2.14: Unemployment levels, 16 and over, by duration, UK, 2008-2020



Source: LPC estimates using ONS data: 16 and over unemployment levels, up to 6 months (YBWF), 6-12 months (YBWG), over 12 months (YBWH), seasonally adjusted, UK, July 2008-July 2020.
Note: Data is not updated with new LFS weighting methodology.

2.39 Young people have taken the biggest unemployment hit to date, as seen in Figure 2.15. Those already in work were more likely to be in hospitality and leisure, the sectors most affected by the crisis. And those out of work, including many leaving education and entering the labour market for the first time, were hit by the collapse in recruitment. As a result we have seen unemployment levels for 18-24 year olds jump in recent months, up 51,000 in the three months to August and 81,000 higher than prior to lockdown measures February. Figure 2.15 also shows the unemployment rate for younger workers has increased to 13.1 per cent - the highest in five years. We know from previous recessions that younger people are often the first to lose jobs and can suffer long-term scarring effects. They are also far more likely to be out of work – usually in education – when a crisis hits, so they are more affected by the collapse in recruitment. We look at employment for young people in more detail in Chapter 5.

Figure 2.15: Change in unemployment levels and rates, 16 and over, by age, UK, February-August 2020 and 2015-2020



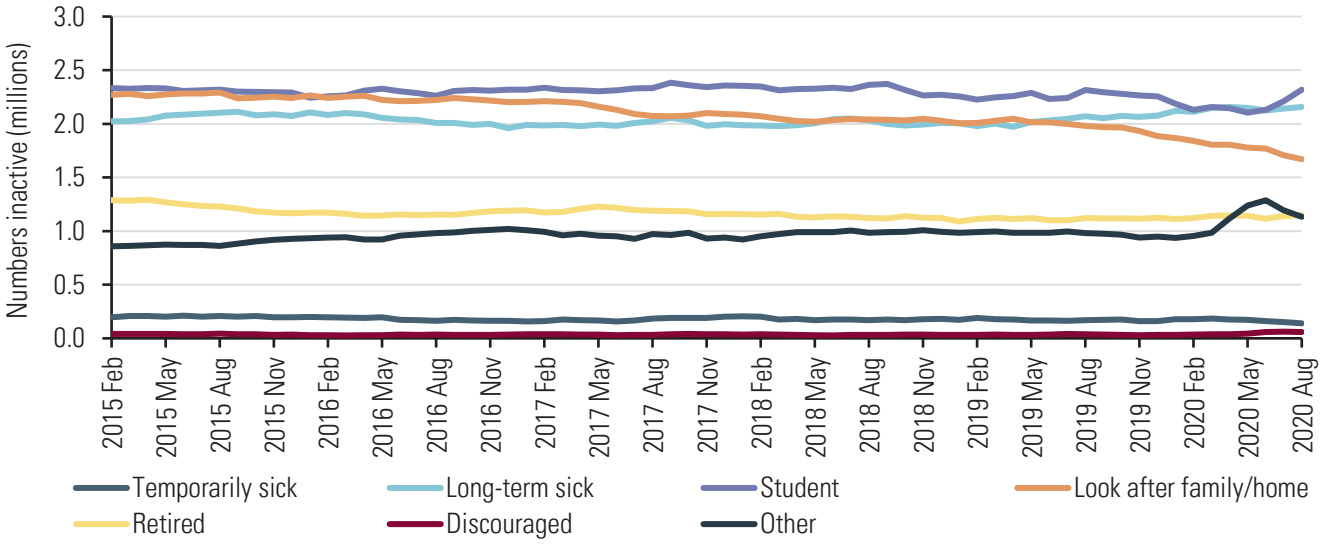
Source: LPC estimates using ONS data: Unemployment levels - 16-17 (YBVH), 18-24 (YBVN), 25-34 (YCGM), 35-49 (YCGS), 50-64 (LF28), 65+ (K5HU), monthly, seasonally adjusted, UK, February 2020-August 2020. Unemployment rates – 16-17 (YBVK), 18-24 (YBVQ), 25-34 (YCGP), 35-49 (YCGV), 50-64 (LF2E), 65+ (K5HW), monthly, seasonally adjusted, UK, February 2015-August 2020.

Inactivity

2.40 Individuals that are neither working nor available or searching for work are economically inactive. This includes students; those looking after family/home; those who are long-term sick; and retirees. Inactivity can also be split between those wanting and not wanting a job. Figure 2.16 shows how these groups of inactivity have changed over recent years. Those looking after family/home has continued its downward trend, even through the pandemic when schools were closed. We do however see interesting movements in recent data for the 'other' and 'student' categories.

2.41 In the three months to May, inactivity levels increased by over a quarter of a million. As set out in paragraph 2.37, many out-of-work individuals initially moved into inactivity rather than unemployment. Confusion around the government message of 'work from home' and the large fall in vacancies may have led to some individuals who lost their jobs deciding to not immediately look for another job, thereby showing in the data as inactive rather than unemployed.

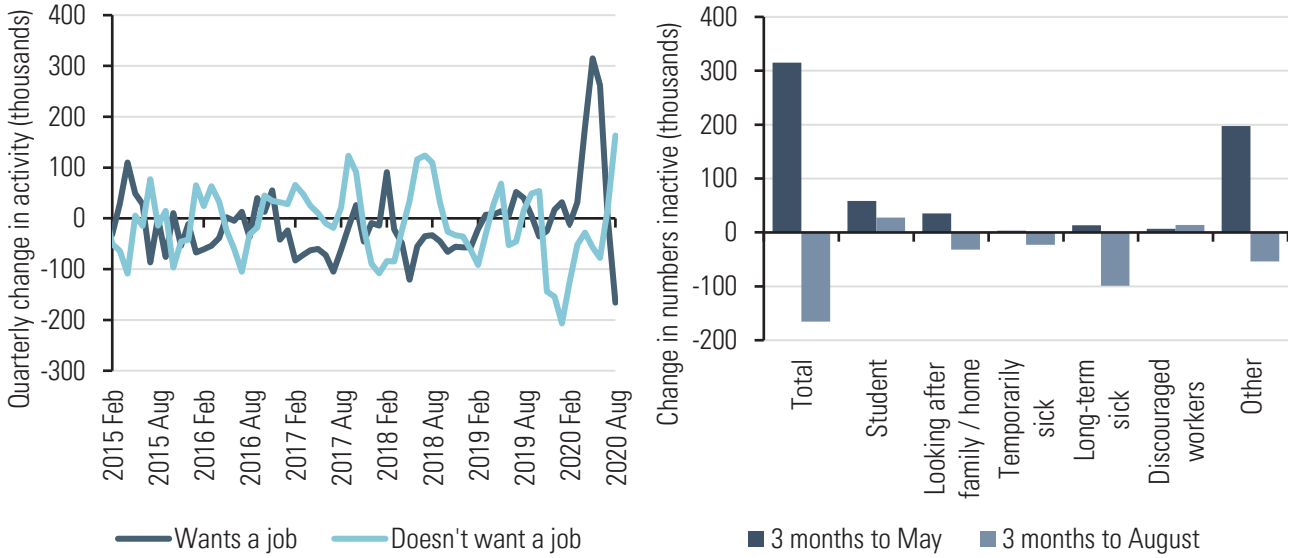
Figure 2.16: Inactivity by reason, UK, 2015-2020



Source: LPC estimates using ONS data. Temporarily sick (LF67), long-term sick (LF69), student (LF63), look after family/home (LF65), retired (LF6B), discouraged (LFL8), other (LF6D), monthly, seasonally adjusted, UK, February 2015-August 2020.

2.42 Figure 2.17 shows the sharp increase in the number of inactive saying they wanted a job. This rose by 315,000 in the three months to May, with around two-thirds of the increase (197,000) drawn from the 'other' category. This includes those who had not yet started looking for work and reflects the uncertainty surrounding the job market at the time. These numbers dropped in the subsequent three months to August, possibly reflecting the improving jobs outlook. Whilst the numbers inactive wanting a job fell sharply in the 3 months to August, overall levels of inactivity remained flat. However, we saw a dramatic increase in the period for those inactive individuals stating they were students, which recorded a record quarterly increase of 214,000. This could be a response to the large numbers of young people that have either lost their job or have been unable to work during lockdown.

Figure 2.17: Inactivity by wanting a job and reason, UK, 2015-2020 and March to August 2020



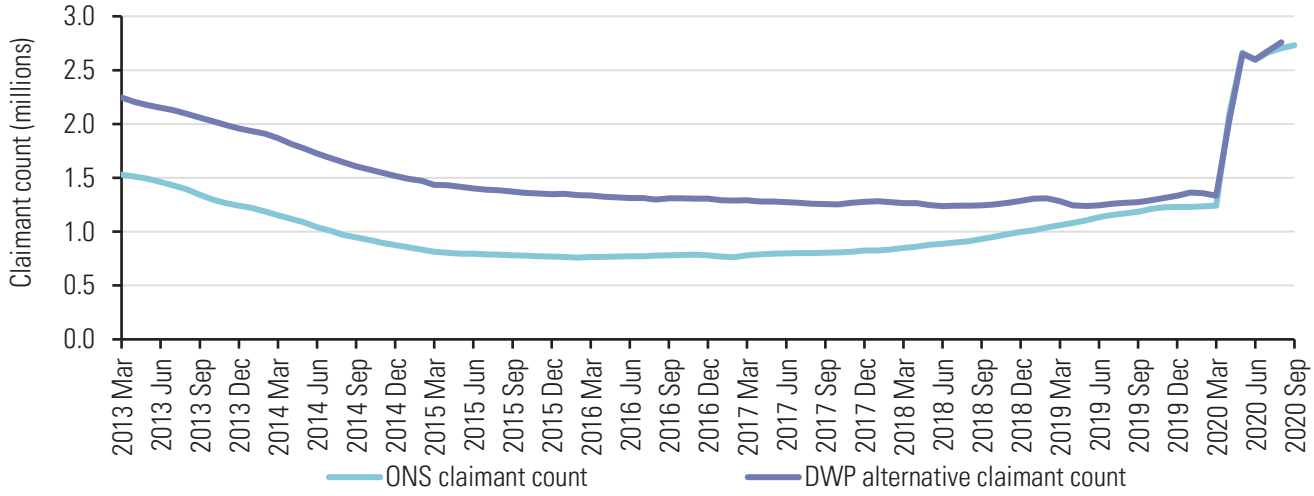
Source: LPC estimates using ONS data: wants a job (LFM2), doesn't want a job (LFL9), temporarily sick (LF67), long-term sick (LF69), student (LF63), look after family/home (LF65), retired (LF6B), discouraged (LFL8), other (LF6D), monthly, seasonally adjusted, UK, February 2015-August 2020.

Claimant count

2.43 The claimant count includes those both working with low income or hours who qualify for Universal Credit, as well as those who are not working and entitled to unemployment benefit (either Job Seekers Allowance or Universal Credit). As a response to the pandemic the government made some changes to Universal Credit (see Table 1.2) which are likely to have had an impact on the levels of claimants and make it more difficult to interpret the recent record increases in the claimant count data shown in Figure 2.18.

2.44 Firstly, from April the Universal Credit standard allowance increased by £20 per week. This will have made more low earners eligible for Universal Credit and subject to work-search conditionality and thereby included in the claimant count. Secondly, and likely to have had more impact, work search conditions and contact with work coaches were suspended. This could have resulted in large numbers of people told not to work by their employers deciding to claim Universal Credit, even though they may have been furloughed. Additionally, self-employed individuals not working were entitled to claim Universal Credit as SEISS payments did not begin until May. These groups were all partly responsible for the claimant count doubling from 1.3 million in March to 2.6 million in May. Added to this, the continued natural migration of legacy benefits to Universal Credit is likely to have accelerated during the pandemic as individuals' circumstances changes. Overall, the claimant count is now less useful as a measure of unemployment than previously.

Figure 2.18: Claimant count, UK, 2013-2020

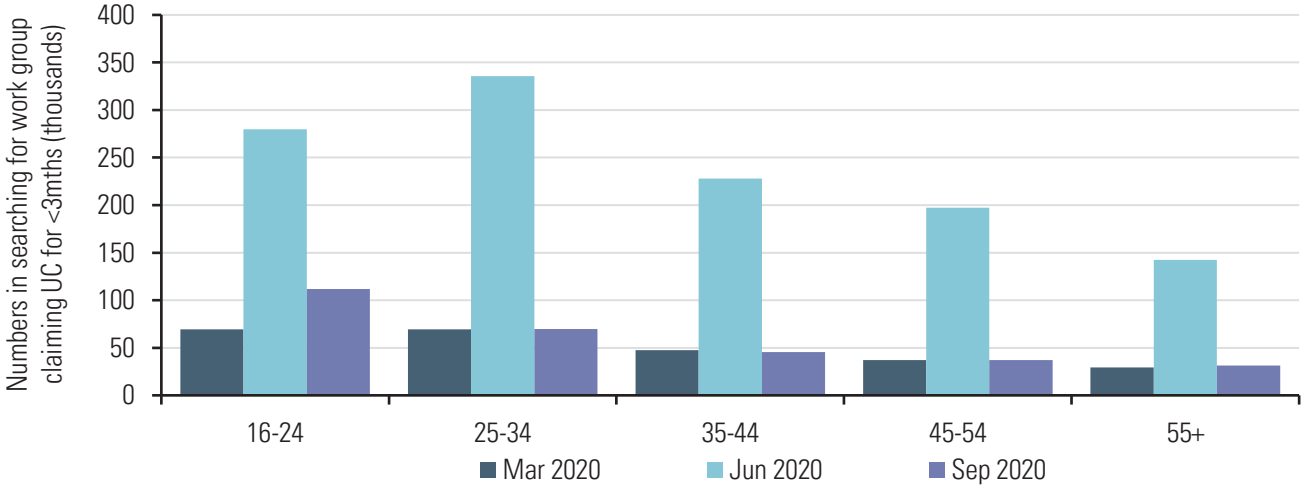


Source: LPC estimates using ONS data. Claimant count data (BCJD) and DWP alternative claimant count data, monthly, seasonally adjusted, UK, March 2013-September 2020.

2.45 Figure 2.19 looks at the numbers of new Universal Credit claimants in the searching for work category across the first three quarters of 2020. We have already seen that April saw a large outflow from employment, despite the job protections put in place. It is therefore not a surprise that we observed a large increase in new Universal Credit claimants in the second quarter. Numbers of new claimants were highest amongst younger people aged 16-34 although all age groups saw claimants increase at least fourfold.

2.46 In the three months to September, numbers of new claimants dropped back to almost the same levels seen in the first quarter prior to the start of the pandemic, with the exception of 16-24 year olds. Levels of new claimants in the youngest age group were still over 50 per cent higher than they were at the start of the year. This indicates that the recent rise in youth unemployment is likely to continue in the short-term as young people suffer disproportionately in terms of job losses. We look at this further in Chapter 5.

Figure 2.19: Numbers in searching for work group claiming universal credit for less than three months, 2020



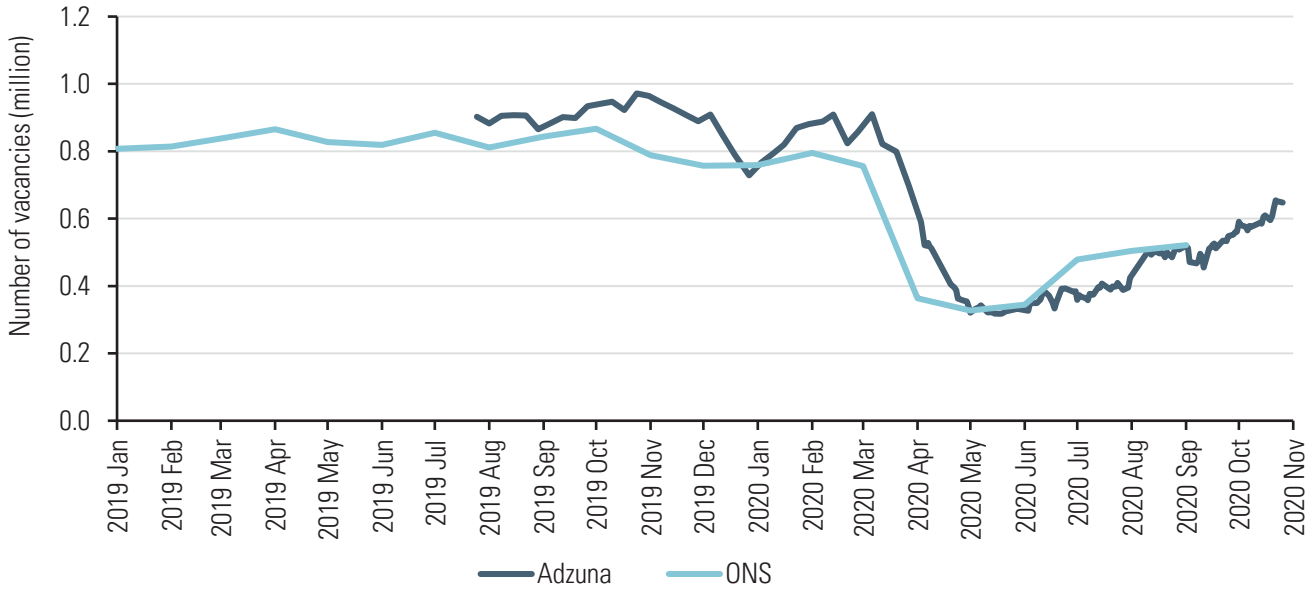
Source: LPC estimates using DWP Stat-Xplore data: universal credit claims (IIIz) by duration, conditionality regime and age, January 2020-September 2020.

Vacancies and flows into work

2.47 Demand for workers will be critical in reducing unemployment and inactivity. Vacancies in the UK had been increasing steadily since 2013 when they were around 500,000. Throughout 2019 and into the start of 2020 levels of vacancies were between 800-850,000. The pandemic and measures introduced to combat it resulted in a sudden and dramatic reduction in the demand for labour as large swathes of the economy closed or restricted their levels of operation. In the three months to June 2020 (the first three full months of lockdown) vacancies dropped by a record 453,000 to a low of 343,000, a far greater fall than during the financial crisis.

2.48 Figure 2.20 shows official data from ONS and vacancy data from online job site Adzuna. Both sources show a pick-up in vacancies from June to September, with ONS figures increasing by 144,000 on the previous quarter. Adzuna data show the trend continued into October, despite economic recovery more generally starting to slow down over this period (see paragraphs 1.59 to 1.60).

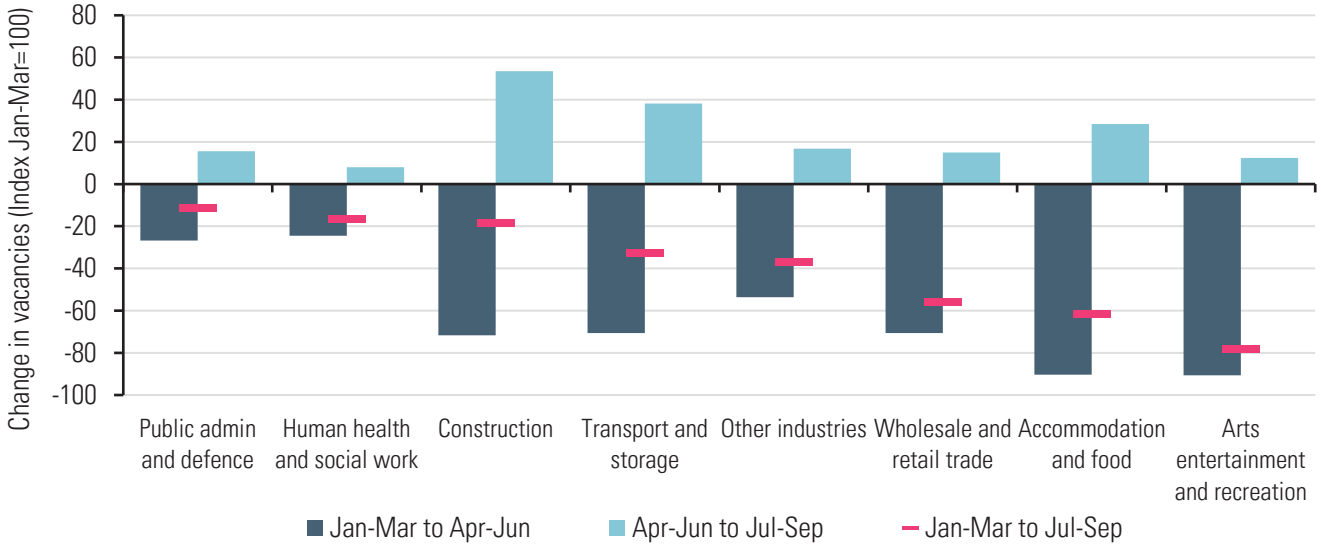
Figure 2.20: Vacancies, UK, 2019-2020



Source: LPC estimates using ONS and Adzuna data. ONS vacancies (AP2Y), monthly, seasonally adjusted, and Adzuna online job search data (Adzuna, 2020), weekly, UK, January 2019-October 2020.

2.49 Figure 2.21 shows that vacancy levels dropped sharply across all sectors between the first and second quarters of 2020, with the largest falls in the hospitality and leisure sectors where the number of vacancies was down by 90 per cent. Vacancies in construction rebounded the most between Q2 and Q3, to more than 50 per cent of the levels seen in the first quarter. There were some gains in hospitality as the sector started to re-open. Looking at the overall change from Q1 to Q3, vacancies fell the most in wholesale and retail, hospitality and the leisure sectors, all low-paying sectors affected by the lockdown measures.

Figure 2.21: Vacancies by sector, seasonally adjusted, UK, 2020

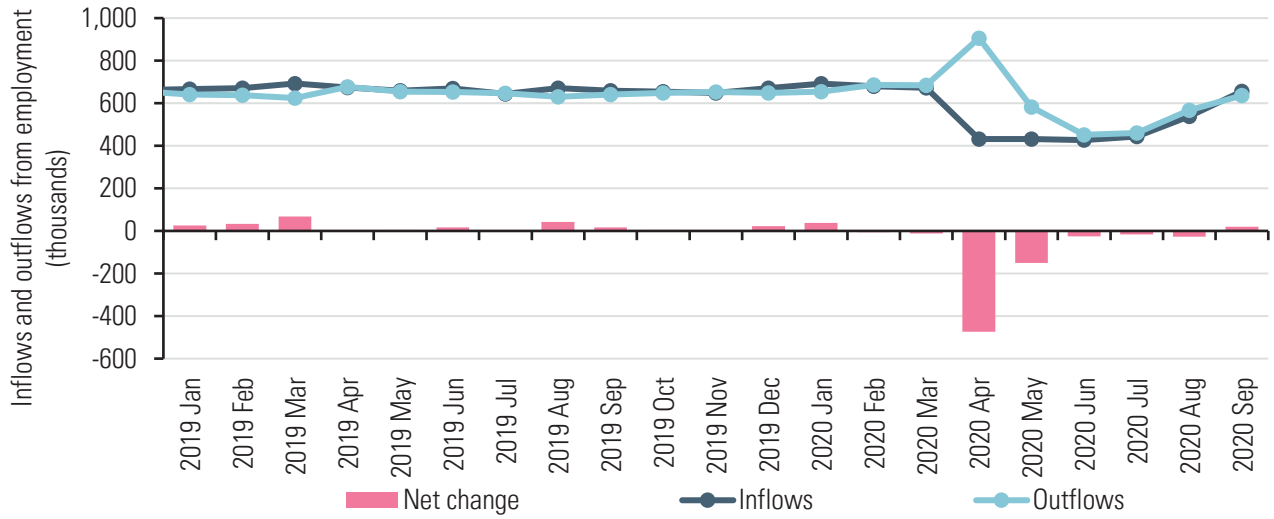


Source: LPC estimates using ONS data. Vacancies by sector, quarterly, seasonally adjusted, UK, January 2020-September 2020.

2.50 KPMG/REC (2020a) reported that in September 2020 permanent placement growth was the strongest for nearly two years while temporary billings expanded at the quickest rate since the end of 2018. These upturns were linked to the reopening of the UK economy and the recommencement of projects following the easing of lockdown measures. However, the positive news on vacancies was somewhat tempered as recent redundancies led to a substantial increase in the supply of staff.

2.51 Figure 2.22 shows how the recovery in vacancies over the summer and early autumn was reflected in the rising number of people entering payrolled employment. Despite signs of a return to pre-pandemic levels of both inflow and outflows, it is too early to say that flows are back to normal. The data could be a one-off response caused by the inability of many firms to continue with their usual recruitment processes in the immediate aftermath of lockdown, thus creating a sudden spike in recruitment. It will be important to continue to monitor the flows into employment. Figure 2.22 also helps to shed more light on the net fall in payrolled employment discussed earlier, which we can see was driven by both a fall in those moving into work and a (slightly larger) increase in those moving out.

Figure 2.22: RTI job flows, UK, January 2019 to September 2020

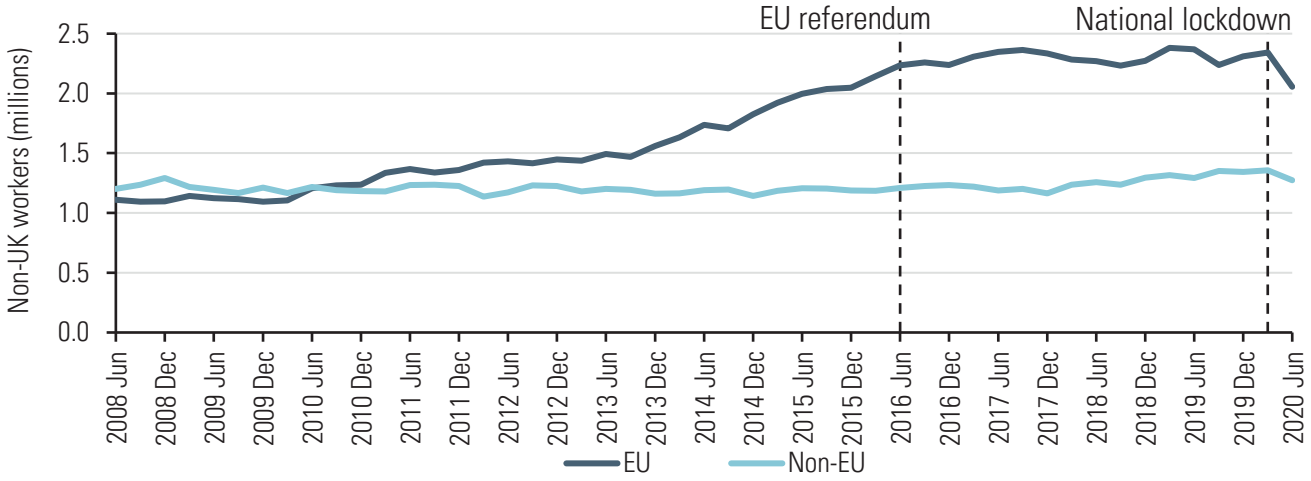


Source: LPC estimates using HMRC RTI data. Inflow and outflow, seasonally adjusted, UK, January 2019-September 2020.

Migrant workers

2.52 Another piece of the post-lockdown employment puzzle is around non-UK workers. Figure 2.23 shows we have seen a fall in non-UK workers since March, especially among workers from the EU which fell by over 280,000 in the three months to June. This may partly be a product of workers, including many with low-paying roles in hospitality unable to work, making a choice to leave the UK and return to their families.

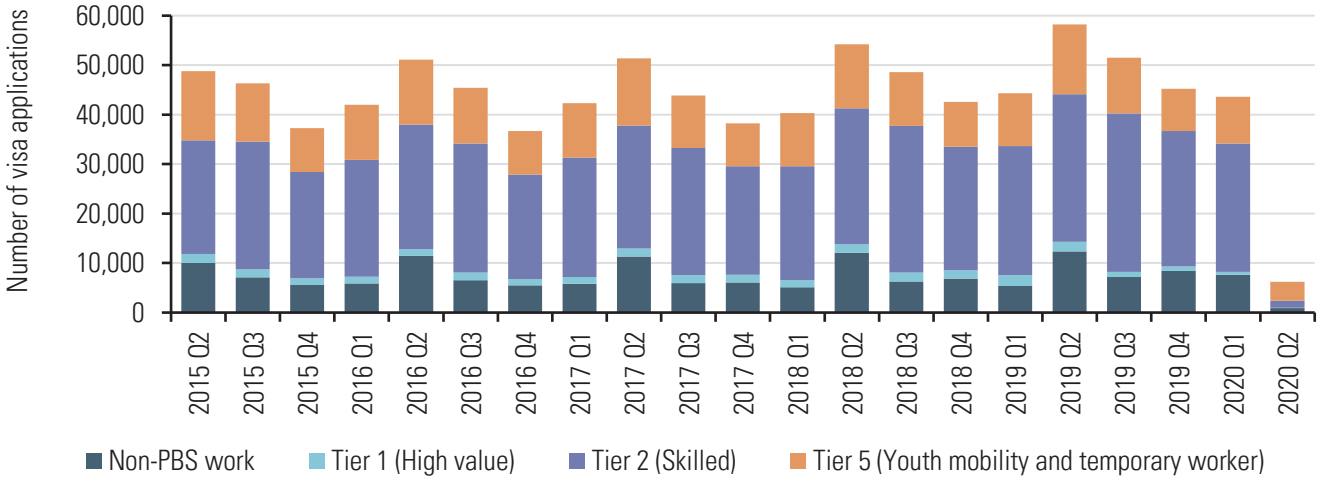
Figure 2.23: EU and Non-EU workers, 2008-2020



Source: LPC estimates using ONS data. EU27 (EQ4U), non-EU (EQ4W), quarterly, not seasonally adjusted, UK, June 2008-June 2020.

2.53 However, the LFS has weaknesses when it comes to the study of migrant workers. Migrants, especially those here for a short time, are likely to be under-represented in the sampling. This is in part due to communal establishments not being included. Another measure of the strength of the labour market for non-UK workers is the number of visa applications received. There is a degree of seasonality in the numbers - Q2 tends to be the high point each year, reaching a low in Q4-Q1. However, we can clearly see from Figure 2.24 how applications fell off a cliff in 2020 Q2 - the total of 6,200 was almost 90 per cent lower than figures a year previous. The drop was greatest in the skilled Tier 2 scheme where applications fell by 95 per cent on 2019 Q2 figures.

Figure 2.24: Non-EU visa applications, 2015-2020



Source: LPC estimates using Home Office immigration statistics. 'Entry clearance visas – applications and outcomes', quarterly, not seasonally adjusted, non-EU, Q2 2015-Q2 2020.

Conclusion

2.54 The labour market was strong going into March, with record employment and continuing job growth, particularly in full-time employment. The Covid-19 pandemic and the lockdown hit the labour market hard. While the CJRS for the most part protected employment, we did see some decreases in the numbers of workers in paid employment, and evidence of an increase in unemployment. Hours fell dramatically, before recovering close to, but still below their typical level of the past five years. A similar pattern was seen in vacancies, which fell by around half between early March and May, before increasing over the summer, but they remain down on pre-crisis levels. In the following three chapters we focus on the labour market for low paid workers in more detail.

Chapter 3

Who are minimum wage workers?

Key findings

Challenges with this year's pay data resulting from the Coronavirus Job Retention Scheme (CJRS) make it difficult to understand exactly what has happened to the pay of minimum wage workers. In particular, we cannot accurately determine bite, coverage or a true measure of underpayment.

However, this year we have been able to look into the household circumstances of minimum wage workers. This evidence suggests that minimum wage workers are more likely to be the secondary earners in a household, or to be young workers living with their parents. On average, the income from a minimum wage job makes up around a quarter of total household income, but this varies significantly.

We have also been able to look into the type of work that minimum wage workers do and how they are likely to have been affected by social distancing measures. The important role that key workers play has received considerable attention through the crisis, with focus on low-paid key workers in particular. A significant minority of minimum wage workers, 400,000 or 21 per cent, are also key workers, a lower share than in the economy overall (28 per cent). Instead, minimum wage workers are more likely to work in the sectors that were forced to close by lockdown measures, with 41 per cent of minimum wage workers working in these sectors.

The extent to which workers have been furloughed and experienced a loss of pay due to furlough is greater in low-paying sectors and for workers who normally receive lower hourly rates. This indicates that minimum wage workers are more likely to be at risk of changes to their employment and pay as these schemes are eased.

3.1 Knowing who minimum wage workers are, their work and personal situation and their characteristics is important in helping us understand how our recommendations affect individuals, households and employers. In our 2019 Report we used this chapter to explore in detail the composition of minimum wage workers and how they compared with other workers higher up the pay distribution. We looked at the type of work they undertook, the firms that employed them and where they worked. We also examined the personal characteristics of minimum wage workers compared with the rest of the workforce.

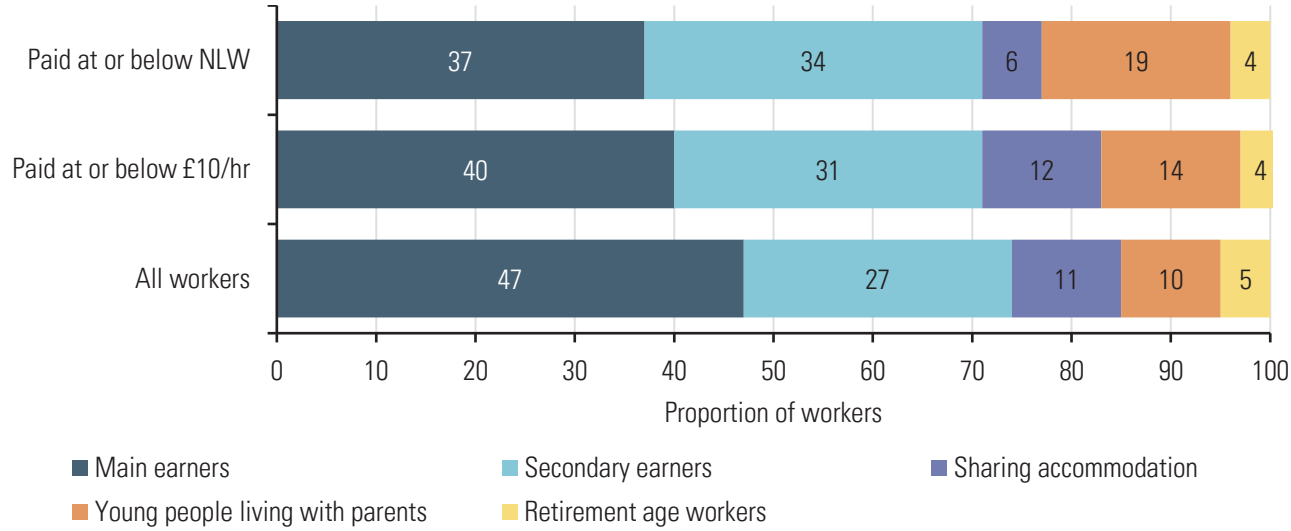
3.2 This year we focus instead on the types of households that minimum wage workers live in and the exposure of minimum wage workers and low-paying sectors to the Covid-19 crisis. Knowing more about the households that minimum wage workers live in helps us understand more about their personal circumstances and overall household income which is what matters for living standards. Knowing how many minimum wage workers worked as key workers and how many were working in shutdown sectors enables us to understand how minimum wage workers and employers are affected by the Covid-19 crisis and the lockdown and place the evidence we hear from stakeholders in context.

Households

3.3 In Professor Arindrajit Dube's review of the international evidence on the impact of minimum wages (Dube, 2019), he stated: 'There is limited evidence from the UK on how the minimum or living wage affects the family income distribution… this is important, because the link between low-wage workers and low-income families is imperfect as there may be multiple earners in a family'. We discussed the complex relationship between minimum wages and household income in our advice to Government on our post 2020 remit (Low Pay Commission, 2019b).

3.4 As part of our efforts to address this evidence gap, we have looked at the Family Resources Survey (FRS), an annual survey of around 20,000 households that aims to understand household income and circumstances.

Figure 3.1: Household characteristics of workers by hourly pay, UK, 2018/19



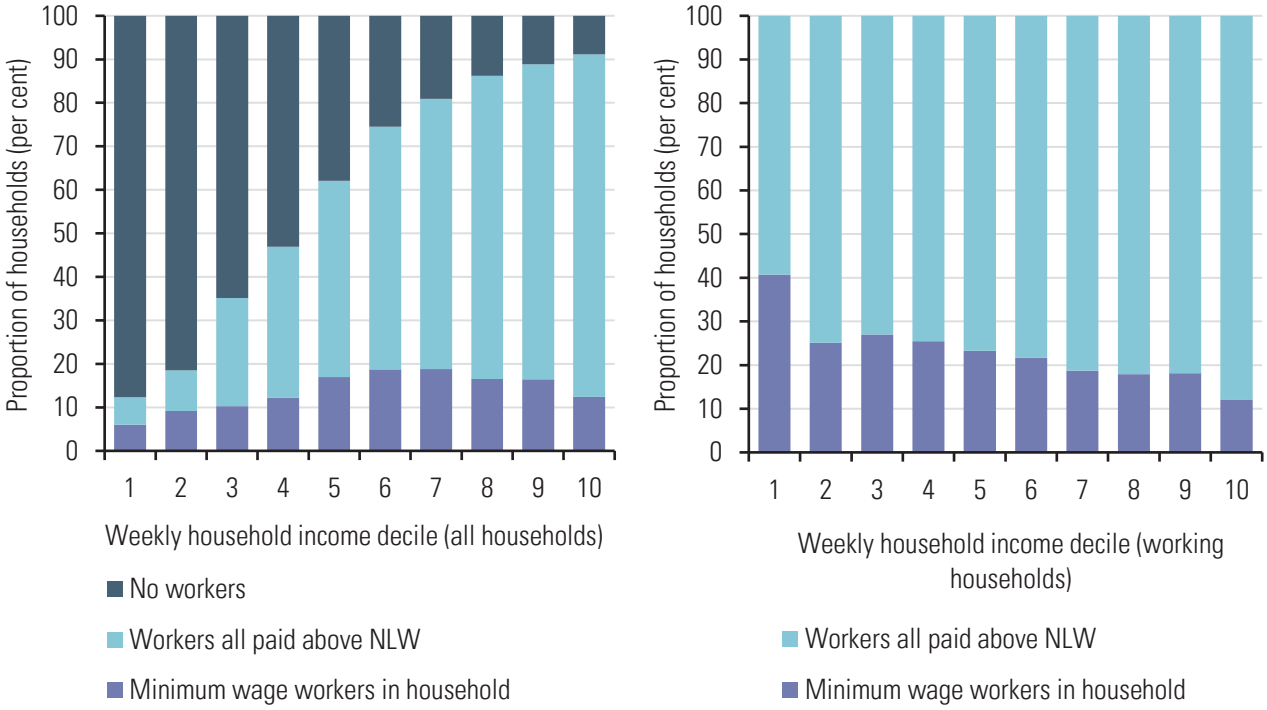
Source: LPC estimates using FRS, standard weights, UK, 2018/19.

3.5 The survey includes information on the composition of the household, as well as the jobs that members of the household do and their income from earnings and other sources, including benefit income. Using this, we have tried to understand who minimum wage workers are and what their households look like. We have grouped workers into five 'personas' – those who are the main earners in their household (including single parents and those who live alone), those who are secondary earners, those who live with other independent adults, young workers who are living with their parents, and retirement-age workers.

3.6 Figure 3.1 shows how workers on different levels of pay are distributed between these groups. Minimum wage workers, who we have here defined as anyone who is paid at or below the National Living Wage (NLW), are less likely than other workers to be the main earners in their households, and more likely to be secondary earners or young people living with their parents. Workers who are paid at or below £10 per hour, which includes all minimum wage workers as well as those who are paid within the spillovers of the NLW, are also more likely to be young people or secondary earners.

3.7 Households that include at least one worker who is paid at or below the NLW are found across the weekly household income distribution. The left panel of Figure 3.2 shows the income distribution of all households, grouped by weekly income decile. Households with at least one low paid worker are found in every decile, with the highest proportion found in deciles 6 and 7, in the top half of the household income distribution.

Figure 3.2: Weekly income decile distribution of households, UK, 2018/19

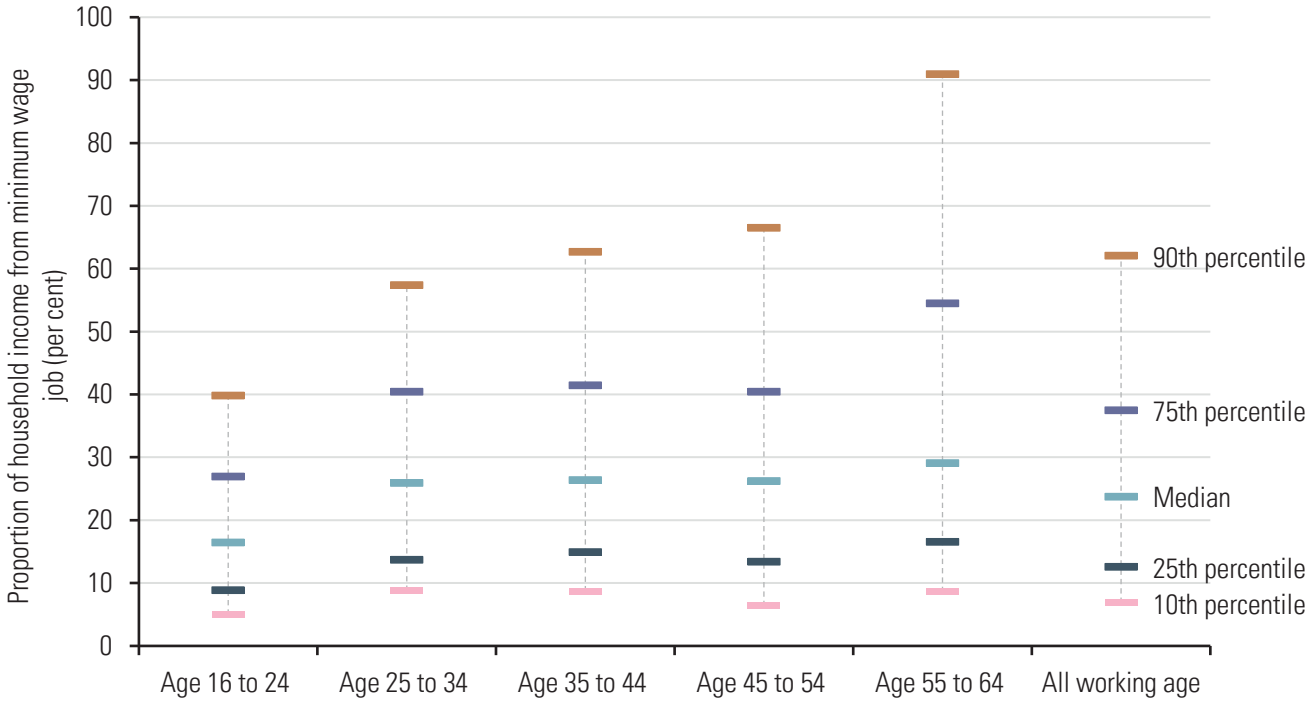


Source: LPC estimates using FRS, standard weights, UK, 2018/19.

3.8 However, this includes workless households, including retired households and those who are unemployed or inactive. Looking only at working households in the right panel of Figure 3.2, households with at least one low paid worker are still found across the distribution but with a higher concentration in the lowest income deciles.

3.9 Figure 3.3 shows the proportion of the total household income that comes from the minimum wage job and how this varies. On average (at the median), a typical minimum wage job tends to contribute around a quarter of the overall household income. But this can vary significantly from providing 7 per cent of household income (at the 10th percentile) to over 60 per cent (at the 90th percentile). The youngest workers tend to contribute a smaller share of the overall income. This demonstrates the importance of other sources of income, including benefits and earnings of other household members, in the total household income of minimum wage workers.

Figure 3.3: Proportion of household income that is from the minimum wage job, by age, UK, 2018/19



Source: LPC estimates using FRS, standard weights, UK, 2018/19.

Minimum wage workers and the response to Covid-19

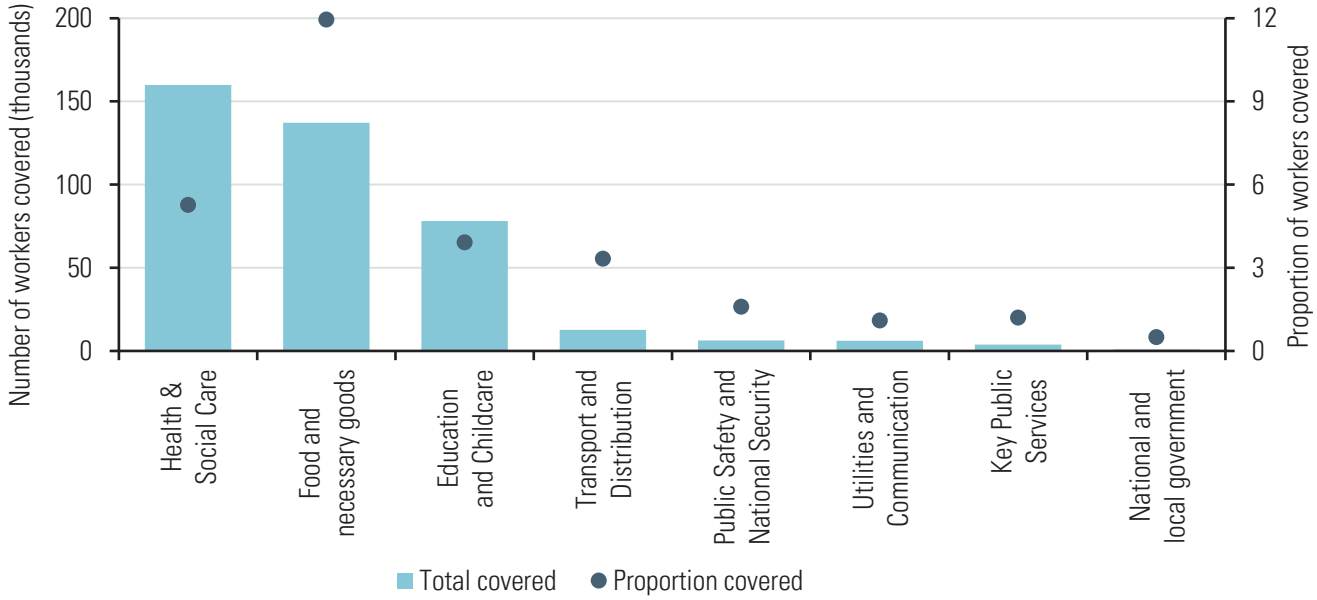
3.10 As the Covid-19 crisis hit the labour market, it became vital for us to understand how minimum wage workers and employers would be affected by it. This includes how many employees on the minimum wage worked as key workers or in sectors closed by the Government-imposed lockdown.

Key workers and shutdown sectors

3.11 Different jobs have been affected by the pandemic and the lockdown measures in different ways and minimum wage jobs are not evenly distributed across these various types. This crisis has so far been highly sectoral: while some sectors are almost completely unable to function due to social distancing measures, workers in other areas have continued to work throughout as key workers providing essential goods and services. Further, all people-facing roles and those that cannot be done from home have been shown to be at higher risk (Office for National Statistics, 2020a).

3.12 There are strong arguments that those who have worked throughout the pandemic – including key workers in care, essential retail, and other sectors – deserve recognition for working at a time of intense pressure and high risk. Figure 3.4 shows that more than 400,000 minimum wage workers were in key worker roles in 2019, with the largest groups in the health and social care sector, in food and necessary goods, and in education & childcare. However, minimum wage workers are less likely to be key workers than the rest of the workforce; 21 per cent of minimum wage workers were in these roles last year, compared with 28 per cent of the workforce as a whole. On average 5 per cent of key worker jobs are covered by the NMW or NLW, compared with 8 per cent of all other jobs. The food and necessary goods sector is a notable exception, in which 12 per cent of jobs are paid at or below the relevant minimum wage rate.

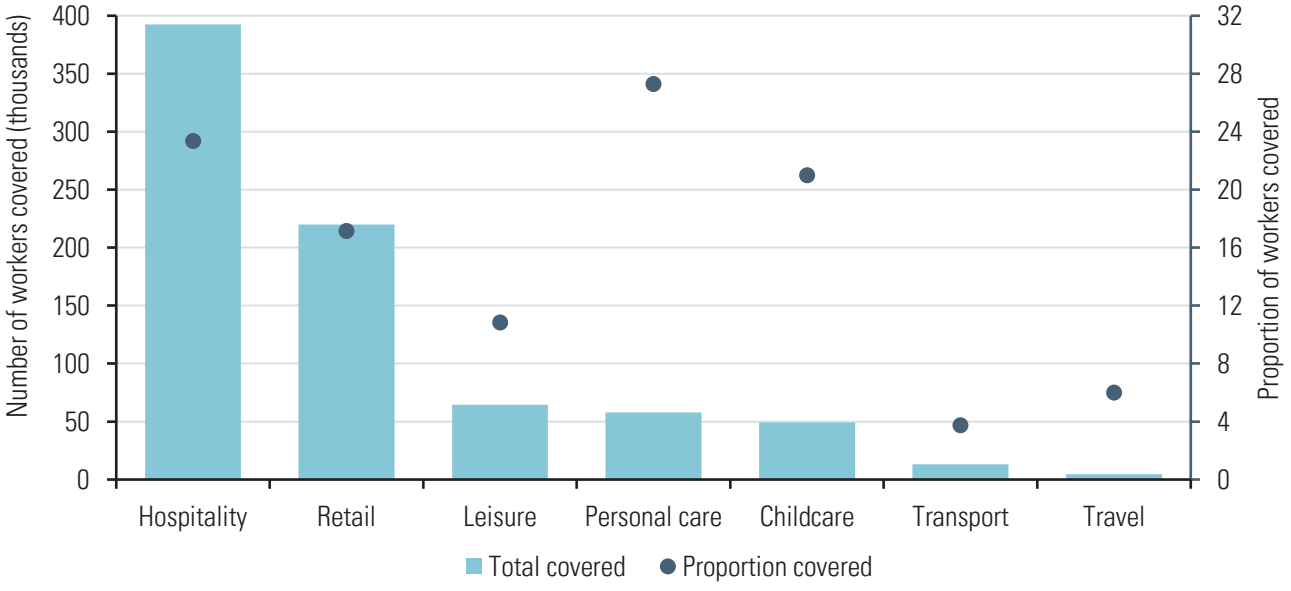
Figure 3.4: Number and proportion of workers covered by the minimum wage rates in key worker roles, UK, 2019



Source: LPC estimates using ASHE 2010 methodology, population weights, UK, 2019.

3.13 Minimum wage workers are more likely to work in the sectors most affected by lockdown measures, particularly hospitality and non-essential retail. In 2019, more than 800,000 workers paid at or below the minimum wage, or 41 per cent of coverage, worked in the sectors that would go on to be most affected by the pandemic, with the largest group in hospitality (Figure 3.5). The share of the workforce who are minimum wage workers in these sectors is substantial, with 18 per cent of the workforce covered by the rates compared with 5 per cent of all other jobs. Minimum wage workers were therefore at greater risk of changes to their pay and employment as the country went into lockdown in March.

Figure 3.5: Number and proportion of workers covered by the minimum wage rates in shutdown sectors, UK, 2019



Source: LPC analysis using ASHE 2010 methodology, population weights, UK, 2019.

Use of the Coronavirus Job Retention Scheme

3.14 As set out in the previous chapter, the Coronavirus Job Retention Scheme (CJRS) made it possible for employees to be furloughed to protect them from unemployment (see paragraphs 2.13 to 2.16). Take-up of the scheme has been broad: HM Revenue and Customs (HMRC) data shows that 1.2m employers furloughed a total of 9.6m jobs with claims valued at around £39 billion by 20 September. At its peak, 8.8m jobs were being protected through the CJRS.

3.15 The Annual Survey of Hours and Earnings (ASHE) collects information from employers about pay and hours, as well as asking if workers experienced a loss of pay during the reference period. This year, the Office for National Statistics (ONS) was able to tell whether the employee job was furloughed, using data from the CJRS. We are therefore able to distinguish between furloughed workers with no loss of pay – whose employers topped up their wages to normal levels – and those who were furloughed with a loss of pay.

3.16 Because of challenges in matching some furloughed jobs, ASHE undercounts the number of workers furloughed by around 20 per cent. Our analysis therefore focuses more on profiling the differences between these workers and others. Where levels are shown the scale of the difference between groups is of more importance than the absolute levels.

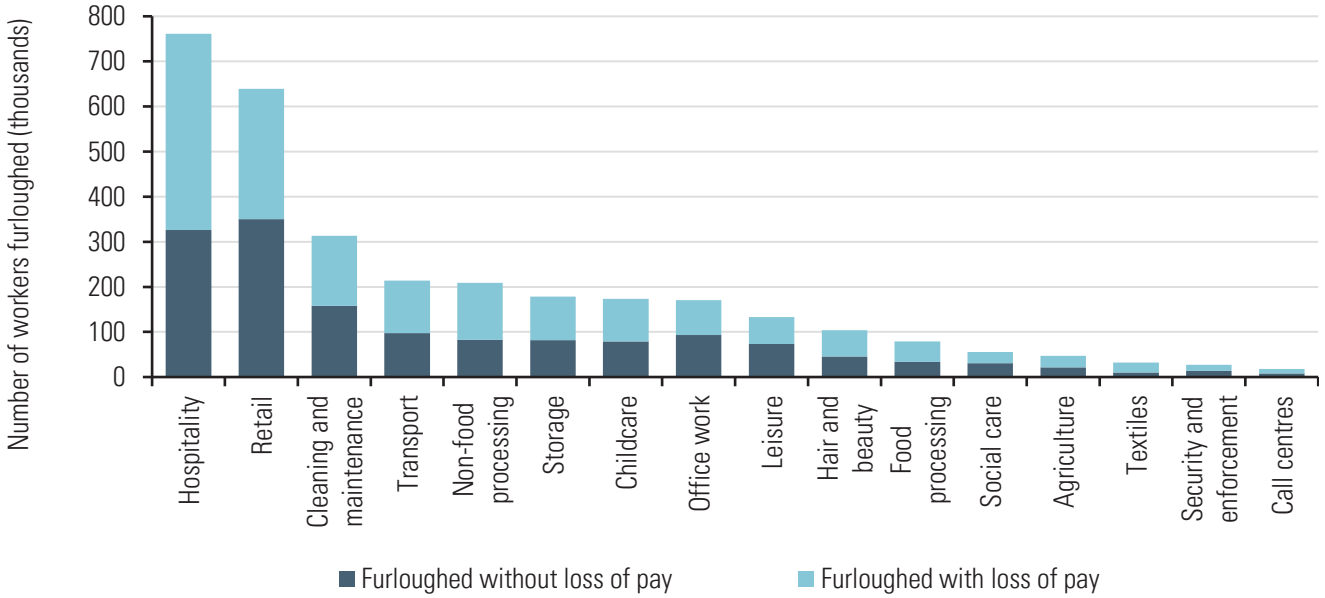
3.17 Unfortunately, we are unable to estimate use of furloughing by minimum wage status directly from ASHE. This year, the reference date for ASHE was 22 April, at the height of national lockdown measures, when many businesses were closed and approximately 8.8 million workers were furloughed. The fact that many businesses had paused trading or had limited capacity means that the response rate to the survey was reduced by around a quarter. Response rates were weakest for younger workers and in sectors including hospitality and leisure which were more exposed to the lockdown.

3.18 This means we are unable to analyse pay for many workers. The CJRS paid workers 80 per cent of their normal earnings, which employers could choose to top up further. Some employers may have chosen to partially top up wages in excess of the 80 per cent grant but less than normal pay; we are unable to identify these workers separately as they would have been recorded as having a loss of pay. Workers who were furloughed in April did not work any hours, and so it is not possible to calculate their pay as an hourly rate. Their derived pay, calculated from their total pay received and the number of hours that they would normally work, is artificially low as they will have only earned a proportion of their normal earnings. If this amount is divided by their normal hours the calculation would give an hourly rate that is only a fraction of their actual pay.

3.19 Because of these factors, it is not possible to identify a group with hourly pay data that is representative of minimum wage workers. We are therefore unable to calculate reliable estimates of bite, coverage and underpayment that are consistent with previous years. Instead we can look at the use of furloughing by characteristics we know are associated with higher minimum wage use, such as working in low-paying occupations and industries and some job characteristics.

3.20 Figure 3.6 shows the number of furloughed workers across low-paying occupations. We can see that more than twice as many workers in both retail and hospitality were furloughed than the next highest occupation, cleaning and maintenance. Some occupations, such as call centres and security and enforcement, recorded much lower totals, partly reflecting the lower number of workers in these roles.

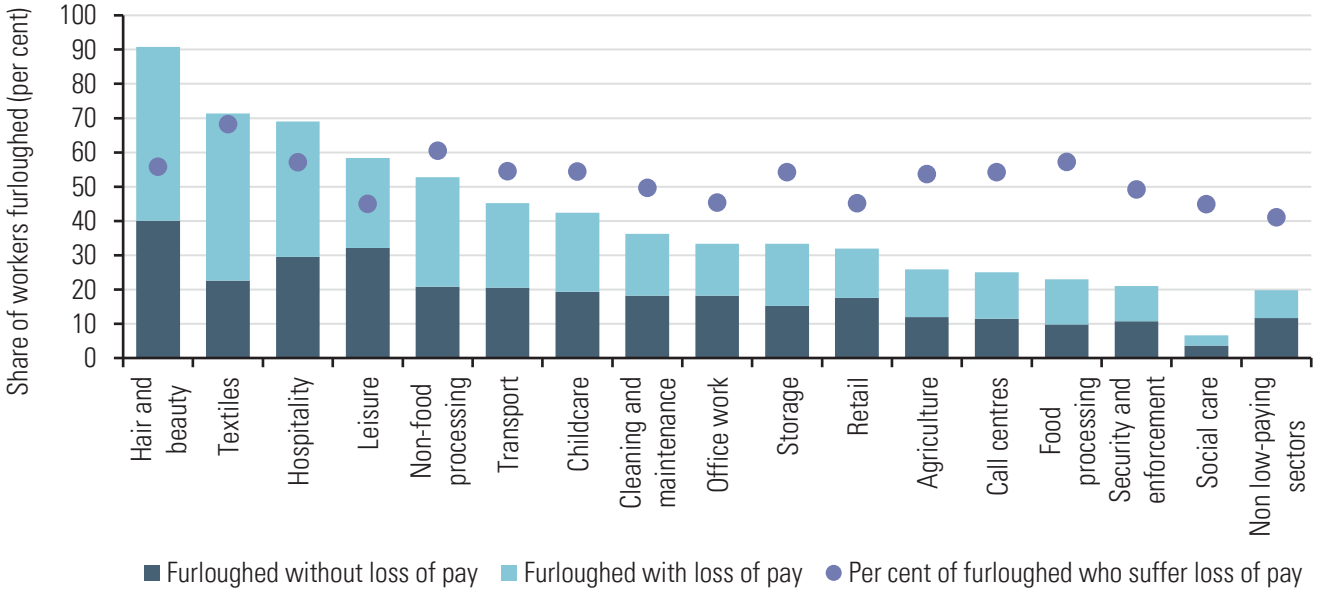
Figure 3.6: Furloughed workers by low-paying occupation, UK, 2020



Source: LPC analysis using ASHE 2010 methodology, low-pay furloughed weights, UK, 2020.

3.21 Figure 3.7 looks at the proportion of workers that are furloughed within each low-paying occupation. Nine out of ten hairdressers were furloughed, the highest share of any low-paying occupation. Textiles and hospitality workers were the next most likely to be furloughed at around 70 per cent of workers. Meanwhile, only seven per cent of social care workers were furloughed, reflecting the importance of the role throughout the pandemic. With the exception of social care, workers in all low-paying occupations were more likely to be furloughed than workers in other sectors. Around half of furloughed workers experienced a loss of pay, suggesting that the remaining half had their pay topped up to normal levels by their employer. But workers were more likely to experience loss of pay in some occupations, including textiles and non-food processing.

Figure 3.7: Proportion of workers furloughed by low-paying occupation, UK, 2020



Source: LPC analysis using ASHE 2010 methodology, low-pay furloughed weights, UK, 2020.

3.22 Table 3.1 shows the numbers and share of workers furloughed by various characteristics. Workers in the private sector are much more likely to have been furloughed, which is unsurprising as the scheme was not intended to be used by the public sector. Men are more likely to have been furloughed than women, and are marginally more likely to have experienced a loss of pay if they were furloughed. Several characteristics that tend to be associated with high coverage of minimum wage rates also show a relationship with the likelihood of being furloughed: part-time workers, workers who are paid on an hourly basis rather than salaried, workers in small business, and people who had started their job in the last year are all more likely to have been furloughed.

Table 3.1: Use of furlough scheme by job characteristic, UK, 2020

Characteristic	Number of workers furloughed thousands	Share of workers furloughed per cent of workers	Share of those furloughed with loss of pay per cent of furloughed
Public	140	2.0	4.9
Private	6,460	34.1	48.5
Voluntary	550	22.0	27.3
Female	3,290	22.8	45.2
Male	3,850	27.6	46.7
Full-time	4,500	22.4	46.5
Part-time	2,640	31.8	45.2
Permanent job	6,670	25.6	46.5
Temporary job	400	19.0	39.7
Salaried	4,090	22.6	42.4
Hourly paid	2,920	29.8	50.0
Micro business	1,460	53.7	37.8
Small business	1,940	44.3	50.9
Medium business	1,340	30.8	54.5
Large business	2,400	14.2	42.3
In job less than a year	1,530	29.5	49.0
In job more than a year	5,610	24.2	45.2
Total	**7,140**	**25.1**	**46.0**

Source: LPC analysis using ASHE 2010 methodology, low-pay furloughed weights, UK, 2020.

Coverage and underpayment in 2020

3.23 Furloughed workers did not work any hours in April, and so it is not appropriate to see their pay as an hourly rate. They were paid 80 per cent of their normal earnings, which employers could choose to top up further. For furloughed workers whose pay was not topped up, their derived hourly rate (calculated using the furlough pay and the hours they would normally work) is artificially low. These workers' derived pay is up to 20 per cent lower than the hourly rate they were paid in February. For example, a worker who received an hourly rate of £10.90 in February but who received 80 per cent of their normal pay when furloughed would appear to be covered by the NLW based on their derived hourly rate in ASHE, even though they are not a minimum wage worker. 6.6 million workers had an hourly rate between the NLW and £10.90 in 2019.

3.24 In a normal year, we would exclude workers that have experienced a loss of pay from our analysis; many of them may be on sick pay or parental leave and including their pay would skew the distributions. However, this year they make up a large proportion of the data set. The ONS therefore developed a new weighting system that would allow us to include any workers who had a loss of pay due to furlough in our analysis.

Table 3.2: Coverage of minimum wage workers, UK, 2015-2020

	2015	2016	2017	2018	2019	2020	
						Excluding furlough with loss of pay	Including furlough with loss of pay
					thousands		
Adult rate/NLW	1,029	1,591	1,612	1,604	1,621	1,520	2,427
Adult rate/21-24 Year Old Rate	257	170	166	167	154	145	298
18-20 Year Old Rate	122	114	116	120	114	107	186
16-17 Year Old Rate	30	27	33	40	36	31	47
Apprentice Rate	31	36	32	32	31	29	39
Total	**1,469**	**1,938**	**1,958**	**1,962**	**1,956**	**1,832**	**2,998**

Source: LPC estimates using ASHE 2010 methodology, standard weights, UK, 2015-2020.

3.25 Table 3.2 shows the headline total number of workers covered at each of the minimum wage rates since 2015, the year prior to the introduction of the NLW. Over the 2016-2019 period, coverage was notably flat for older minimum wage workers, remaining at around 1.6 million. Coverage of the 21-24 Year Old Rate declined over this period as firms increasingly chose to pay all workers the NLW. A relatively steady volume of nearly 2 million workers were collectively covered by all the minimum wage rates.

3.26 In 2020, we do not know how coverage has changed. We have provided two estimates for this year: one including furloughed workers with loss of pay, and another excluding them. These are both biased estimates, with a broad range. Including workers that have experienced a loss of pay due to furlough increases estimates of coverage, because furloughed employees with loss of pay are overrepresented in the lowest-paid group. Conversely, excluding this group reduces estimates of coverage because lower-paid workers were more likely to be furloughed and so excluding furloughed workers takes out a large part of the lower-paid end of the distribution.

Table 3.3: Underpayment of minimum wage workers by rate population, UK, 2019-2020

	Workers underpaid			Underpayment		
	2019	2020 exc. furlough	2020 inc. furlough	2019	2020 exc. furlough	2020 inc. furlough
	thousands			per cent of population		
Adult rate/NLW	345	297	1,619	1.4	1.3	6.4
Adult rate/21-24 Year Old Rate	32	25	229	1.6	1.8	12.2
18-20 Year Old Rate	19	18	136	1.9	1.4	14.4
16-17 Year Old Rate	3	3	31	1.2	1.2	12.6
Apprentice Rate	9	5	26	4.6	2.4	13.8
Total	**408**	**347**	**2,041**	**1.4**	**1.2**	**7.2**

Source: LPC estimates using ASHE 2010 methodology, standard weights, UK, 2019-2020.

3.27 The issues with the data that arise from the furlough scheme also have implications for estimates of underpayment. Furloughed workers with loss of pay may have an artificially low derived hourly rate that is below the minimum wage. This is not a true hourly rate; these workers did not work any hours in the reference period. Furthermore, the terms of the CJRS meant that furloughed workers received pay based on their February payslip, prior to the increases in the minimum wage rates. Furloughed workers whose pay was topped up to the previous minimum wage would also appear to be underpaid relative to the 2020/21 minimum wage.

3.28 Table 3.3 provides two estimates of underpayment, one that includes furloughed workers, and one that excludes them. The former measure overestimates underpayment, as many of the furloughed workers would not ordinarily be paid below the minimum, while the latter is an underestimate as it excludes some workers who would otherwise be underpaid. It is not possible to perfectly identify furloughed workers who would normally be paid less than the minimum.

3.29 Furthermore, underpayment is not an accurate measure of non-compliance with the minimum wage. Underpayment measures the number of jobs that are paid below the minimum wage, but it cannot be used as a measure of non-compliance with the legislation. This is always the case because it is not always possible to identify whether an individual is eligible for the minimum wage; for example, their employer may be deducting the Accommodation Offset from their wages.

Conclusion

3.30 CJRS related challenges with this year's data make it difficult to understand exactly what has happened to the pay of minimum wage workers. However, for the first time we have looked into the households of minimum wage workers, finding that they are less likely to be the main earners in a household. We have also been able to look in more detail at the kind of work that they do and how it might have been affected by the pandemic. Minimum wage workers are highly likely to work in the sectors that were forced to close by the lockdown, and as a result were more likely to be furloughed. They may be at greater risk of changes to their employment and pay as support is eased. In the next three chapters, we look in more detail at how three groups of minimum wage workers have been affected by lockdown measures, and assess the impact of previous increases in the NLW and NMW rates.

Chapter 4

The National Living Wage

Key findings

Before the pandemic the low-paid labour market was in a strong place. Labour market outcomes for the groups most associated with high minimum wage use continued to improve. Areas of the country with higher coverage of the minimum wage saw similar employment growth to other areas. While low-paying occupations and industries saw decreases in employment, there were good reasons to believe that this was linked to a tight labour market inducing moves away from these sectors.

Further commissioned research and internal analysis on wage progression for low-paid workers confirmed that these workers are more likely to move jobs and see pay increases, though these moves tend to be relatively 'short range'. While qualitative research and stakeholder views brought up familiar concerns about the risk from the NLW to progression chances, we have not found econometric evidence of this.

Since the end of March, the Covid-19 outbreak and the national lockdowns have changed the labour market situation. Employment held up initially, supported by the Coronavirus Job Retention Scheme, with some evidence of a decline in low-paying occupations and industries in June, but this was followed by a rebound in July and August. Widespread furloughing led to dramatic falls in hours worked, but more so in low-paying occupations. Hours had not recovered by the end of August. Lower-paid workers were more likely to be furloughed, and if furloughed to suffer pay loss as a result.

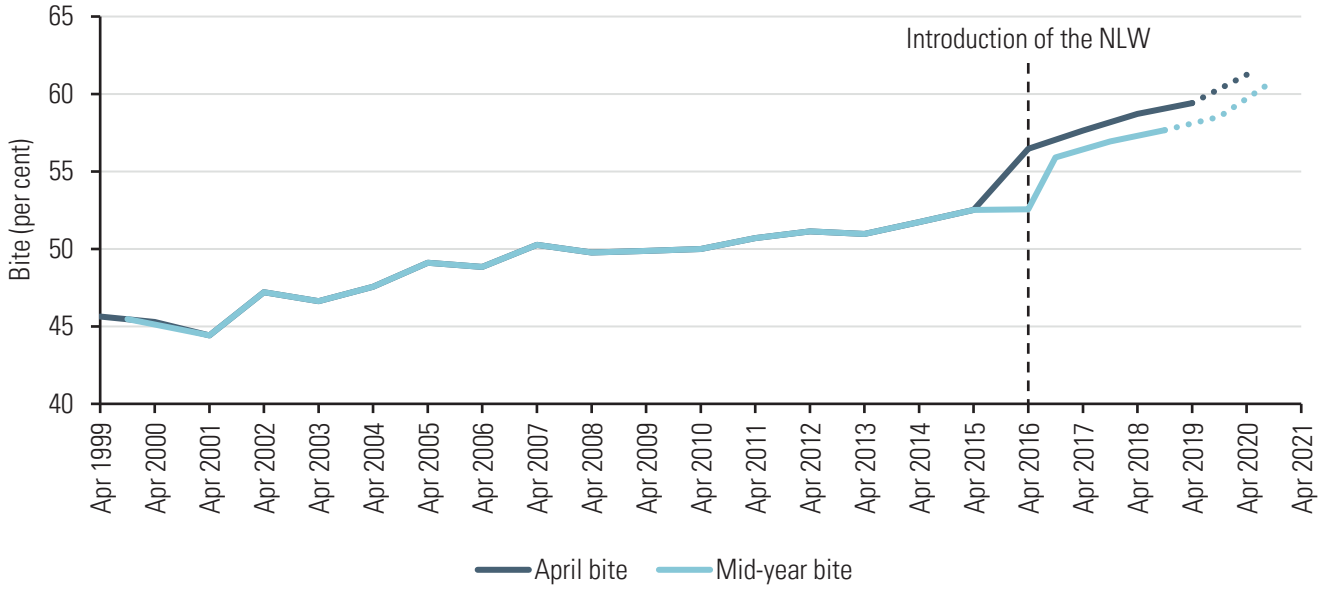
4.1 This year we have a new remit for the National Living Wage (NLW). Last year we recommended that the NLW be increased to £8.72 from April 2020. We anticipated that this would meet the Government target for the NLW to reach 60 per cent of median hourly pay for those aged 25 and over in October 2020. Our best estimate now is that the bite is 60.8 per cent as of October 2020, but this estimate is more uncertain than in a typical year. The data issues described in paragraphs 3.15 to 3.19 mean that we are less sure about what median wages were in April 2020, which means we have to forecast median wages in October 2020 from figures that are 18 months out of date, instead of the usual 6.

4.2 Our new remit, which applies from this year, sets a target for the NLW to reach two-thirds of the median hourly pay for employees aged 21 and over, in October 2024. Our new remit grants us the flexibility, if the economic evidence warrants it, to recommend changes to the target, the timeframe for meeting it or the path taken to do so. For comparison, before the introduction of the NLW in April 2016 the adult rate of the National Minimum Wage (NMW) stood at 54.6 per cent of median hourly pay for employees aged 21 and over, and 52.5 per cent of median hourly pay for employees aged 25 and over (excluding first year apprentices).

4.3 This chapter examines the NLW's impact on pay and employment for those workers aged 25 and over. We also examine the state of the low-paid labour market during the lockdown imposed due to Covid-19 and how that has changed since the restrictions were loosened. Our evidence has been obtained from a range of sources including: in-house analysis of official data, written and oral consultations and commissioned and independent econometric research. The coronavirus pandemic and the response to it has limited our ability to gather evidence from stakeholders this year and has also affected the official data collected during this period.

4.4 The first stage of the NLW, beginning in 2016, marked a significant change to our previous approach to recommending minimum wage rates. This resulted in increases relative to median wages that were typically much higher than previously. Figure 4.1 shows that between April 1999 and April 2015 the 'bite' (the ratio between the wage floor and the median wage) of the main NMW rate increased from 45.3 per cent to 52.6 per cent, an increase of 7.3 percentage points (the figures here include all apprentices aged 25 and over). Since then the NLW has increased to reach around 60 per cent[1], an increase of around 7.5 percentage points in just five years.

Figure 4.1: Bite of the NMW/NLW for workers aged 25 and over, UK, 1999-2020



Source: LPC estimates using adjusted earnings data based on ONS data: ASHE without supplementary information, April 1999-2004; ASHE with supplementary information, April 2004-06; ASHE 2007 methodology, April 2006-11; and ASHE 2010 methodology, April 2011-19, standard weights, UK. Forecasts are based on AWE total pay from Office for National Statistics (2020c), and HM Treasury (2020b) and Bank of England (2020a) average weekly earnings predictions.

Notes:

a. Bites from mid-year 2019 are based on earnings forecasts and may change when out-turn data is available.
b. Data include all apprentices (as it is not possible to identify apprentices prior to 2013). Our 2020 target bite does not include first year apprentices.

[1] Based on our forecasts and target, this is an inexact estimate, but the problems with ASHE as highlighted in paragraphs 3.15 to 3.19 limit our ability to be confident in using the median pay figures calculated from ASHE.

4.5 As the labour market underwent a rapid transformation this year as the Government imposed a lockdown to help contain the Covid-19 outbreak. Therefore we have decided to split the employment and hours section of the chapter into a first part that looks at the labour market up to the end of the first quarter of 2020 (just as the country started to enter lockdown), and a second part that focuses on the experience of the low-paid labour market during the lockdown and how it has reacted to the loosening of the restrictions imposed in March. We will then go on to look at pay and the use of the Coronavirus Job Retention Scheme (CJRS) during the lockdown.

4.6 As set out in Chapter 3 (paragraph 3.16 to 3.19), the interaction of the CJRS and the data collection for the Annual Survey of Hours and Earnings (ASHE) that we use for our pay analysis means much of our usual pay analysis cannot be performed this year. Instead we have examined the exposure of different groups of workers to the CJRS. For analysis of the historic effect from the NLW on pay until 2019, please see our previous report (Low Pay Commission, 2020a).

The NLW and the labour market for low-paid jobs

4.7 This section covers our measures of the impact that the NLW has on employment and hours. The data included in this section cover the period to the first quarter of 2020 and therefore excludes the period after the uprating of the NLW to £8.72 in April 2020 and the vast majority of the lockdown period. We examine labour demand both in terms of employment and in total hours worked, for the most part these track each other fairly closely. However, the large fall in hours worked in the last two weeks of March 2020 following the announcement of social distancing requirements and the lockdown mean that trends in employment and hours diverge at that point. Therefore, we have decided to focus on employment in this section, and, unless otherwise stated, trends in hours and employment are similar up to the first quarter of 2020.

4.8 We gauge the effects of the NLW on employment through three main routes. Firstly, we commission econometric analysis and evaluate external research on the effects of the NLW – this year we have also undertaken econometric analyses in-house. Secondly, we talk to employer and employee representatives, employers, workers and other organisations to hear about their experiences of the labour market, the NLW, and how they have responded to changes in it. Finally, we examine official data on labour market status and jobs, particularly focusing on the groups most likely to be affected by the minimum wage.

4.9 When the NLW was first announced in the 2015 Summer Budget, the Office for Budget Responsibility (OBR) forecast that there would be between 20,000 and 110,000 fewer jobs in the economy by 2020 than there would have been in the absence of the NLW (Office for Budget Responsibility, 2015). We treated this as an acknowledgement from the Government that they would be prepared to accept job losses in this range as an acceptable trade-off for higher wages.

Research evidence on the effect of the NLW on employment

4.10 The econometric research we undertake and commission provides the strongest evidence on the effect of the minimum wage on the various measures examined. This is because econometric analysis estimates a 'counterfactual' of what would have happened if the minimum wage was not introduced or increased. The outcome observed in the actual data is then compared with this hypothetical scenario. This approach enables us to make an inference of the causal impact of the minimum wage on outcomes such as earnings, employment and hours. However, this means that the findings from econometric analyses are dependent on the ability to define and estimate an adequate counterfactual, and the assumptions made in this.

External evidence and commissioned research

4.11 In the period since the introduction of the NLW we have commissioned a series of research projects examining the impact of the NLW on employment and hours. Detailed summaries of the completed research projects can be found in previous LPC reports.

4.12 Giupponi, Joyce, Lindner, Waters, and Xu (2020) shared early findings of their research with us. This is a longer-term project that will examine the impact of the NLW on employment, hours, earnings and household incomes. The project uses a similar 'bunching' approach to Cengiz, Dube, Lindner and Zipperer (2019), to examine the impact of the introduction and upratings of the NLW. Instead of using geographical variation in the level of minimum wages as Cengiz, Dube, Lindner and Zipperer (2019) used in analysing the impact of minimum wages in the US, the research exploits variation in wage levels across different geographical areas for similar workers in similar jobs. Using Travel to Work Areas (TTWAs) which approximate local labour markets and 25 pence pay bands they calculate how the number of jobs has changed in areas where the NLW has a larger effect on pay. Their initial work has given no clear reason to doubt previous findings on the impacts of the NLW on the labour market.

4.13 Baily, Popov and Wilson (2020) estimated the effect of the introduction of the NLW on businesses. Paragraphs 7.8 to 7.10 contain more detail on the research, but one of the aspects that they looked at was the change in relative employment in firms that were more exposed to the NLW. The authors linked the ASHE data set to the Business Structure Database (BSD) and used this to compare outcomes between firms that were observed to pay below the incoming NLW and those who paid a reasonable amount above it. They tested their identification methodology using the Workplace Employment Relations Survey (which captures the wider pay distribution within the firm) and found that the ASHE measure has similar strength as average labour cost threshold approaches used elsewhere.

4.14 In their main methodology they find that employment growth from 2015 to 2018 is 2 to 3 per cent lower in workplaces more affected by the NLW. This effect is largely driven by retail and food service chains, and the adjustment is through moderate reductions in headcount or the curtailment of moderate growth. In a separate exercise they repeated their approach for other years (2004 to 2017) and in many cases found similar effects – that the more NLW-exposed firms performed less well than otherwise similar firms. The authors test their results using three other measures of employment. For two of these measures the authors find similar results to their main specification. For the third measure, which excludes enterprises with multiple-units and only covers around a fifth of the sample, the employment effects are not statistically significant.

4.15 The authors interpret their employment findings by saying that firms with more NLW exposure had made general downward adjustment in labour use over the period (which was consistent with higher use of labour replacing technology such as self-service checkouts, ordering automation, etc) rather than made a distinct causal change due to the impact of the 2016 NLW.

Internal analysis

4.16 As part of his review into the impacts of minimum wages, Professor Arindrajit Dube recommended that we use a set of 'off the shelf' methods to evaluate the policy in-house (Dube, 2019). We have therefore undertaken econometric analyses using methods developed by external experts. The internal research makes full use of the expertise of the two academic Commissioners to provide advice and conduct collaborative work. We have also set up a process to help peer review our work before it is published. We have invited discussants at the research workshop in April and the research symposium in September to comment and give feedback on the methodology, data sources and interpretation of the findings. We have also established a panel of experts to give challenge and ongoing feedback on our analysis and to judge when the research is of sufficient quality to publish. 0 contains a brief summary of our methods, though we intend to publish more detailed methodology and findings, and the code used shortly.

4.17 The first project followed on from the work of Aitken, Dolton and Riley (2018), using a slightly edited version of their methodology and code. Consistent with their findings, and that of Capuano, Cockett, Gray and Papoutsaki (2019), we find that the introduction of the NLW lead to an increase in wages, by 4 percentage points for full-time workers (both male and female) and 5 percentage points for part-time workers (both male and female). In 2017 the uprating in the NLW increased pay for all the treated groups. Real pay growth was around 1 percentage point higher for workers directly affected by the NLW in each of the sub-groups examined in 2017. When we extended the analysis to 2018 we found no evidence of a wage effect from the NLW - wages for workers directly affected by the NLW grew by as much as those who earnt slightly more than the incoming NLW. In 2019 we estimated a negative wage effect from the NLW, suggesting that wages grew faster for those earning above the NLW than for workers on the NLW. The estimated effects were of the order of 0.5-1 percentage point. This is consistent with our analysis in last year's report (Low Pay Commission, 2020a) which found that wages had grown fastest in the part of the wage distribution just above the NLW.

4.18 Like Aitken, Dolton and Riley (2018) and Capuano, Cockett, Gray and Papoutsaki (2019), we find that the introduction of the NLW led to a decrease in employment retention[2] of part-time female workers. Employment retention was around 2 percentage points lower for part-time women who were affected by the NLW. We found weak evidence of a decline in employment retention of around 4 percentage points for part-time men. We found no evidence of employment retention effects in 2017. There was evidence of positive employment retention effects for part-time workers in 2018. However, this should be taken in the context that pay was not found to have increased for NLW employees relative to the control group. If the NLW did not increase pay for minimum wage workers relative to the control group, then it would not be expected to affect the relative balance in demand between the two groups. We would therefore not expect to find an employment effect. Positive employment effects in 2018 are also consistent with the findings of Capuano, Cockett, Gray and Papoutsaki (2019).These findings are based on an assumption that any differences in panel retention are consistent across years.

4.19 In 2019 there was weak evidence of negative employment retention effects for full-time women, of around 2-4 percentage points. However, we are not confident that this finding suggests a negative effect from the minimum wage on employment. Pay growth was actually higher for the control workers (who earnt above the incoming NLW) in this period – meaning that NLW workers were becoming relatively cheaper at this time.

4.20 We found no evidence that the introduction of the NLW had an effect on hours worked. Similarly, in 2017 we find no evidence of an effect on hours worked. There is weak evidence of negative hours effects for full-time women in 2018, but this should be viewed in the context of no difference in pay growth between the treated and control group. In 2019 again we see no evidence of an effect from the minimum wage on hours. Overall, the analyses seem to find little evidence of a relative fall in hours worked by those whose wages are directly affected by the incoming minimum wage.

4.21 The second project compares outcomes across segments of the UK labour market that are more and less affected by changes in minimum wages. The analysis is based on the idea that we should expect a greater impact from the NLW in areas such as the North East or Wales where the minimum wage 'bites' more than in London or the South East, similarly we would expect a larger minimum wage effect among younger workers than those who are older, and women affected more than men. We define segments of the labour market according to different geographies, age groups and gender. This enables us to capture all employment change and not just job retention as in our first project. We can therefore examine the impact of the NLW on a wide range of outcomes including employment, unemployment, hours of work, self-employment, inactivity, and use of zero hours contracts.

[2] Employment retention is where an individual is in employment in the period before an intervention and remains in employment after it, though not necessarily in the same job.

4.22 We construct a panel data set of these 'segments' for each year from 2013 to 2019 using wage data from ASHE and employment outcomes and characteristics from the LFS. We define the minimum wage year as the year from April to March (although prior to 2016, the minimum wage year was October to September). We segment the labour market into 20 regions, eight age groups and by gender which results in 320 separate region/age/sex segments. We also experiment with alternative definitions of groups (including alternative geographies). We use a difference-in-difference estimation approach, using both the bite of the NLW and the coverage rate (the proportion of jobs paid the NLW in an area) in 2015 (the baseline year) as two alternative measures of the impact across the different area, age and gender groups. We estimate effects using standard year-on-year panel regressions and also the total differences between 2015 and 2019.

4.23 We find that those segments that had higher bite or coverage experienced faster average wage increases and we see larger impacts on wages at the lower percentiles of the pay distribution. We find no evidence of significant negative impacts on employment or hours across the whole period. We do find that the NLW may have boosted participation as inactivity was significantly reduced without a corresponding increase in unemployment. We find no evidence of effects on self-employment or use of zero-hours contracts. These results are consistent with previous analysis that suggests that there had been no adverse employment effects of the NLW up to the first quarter of 2020.

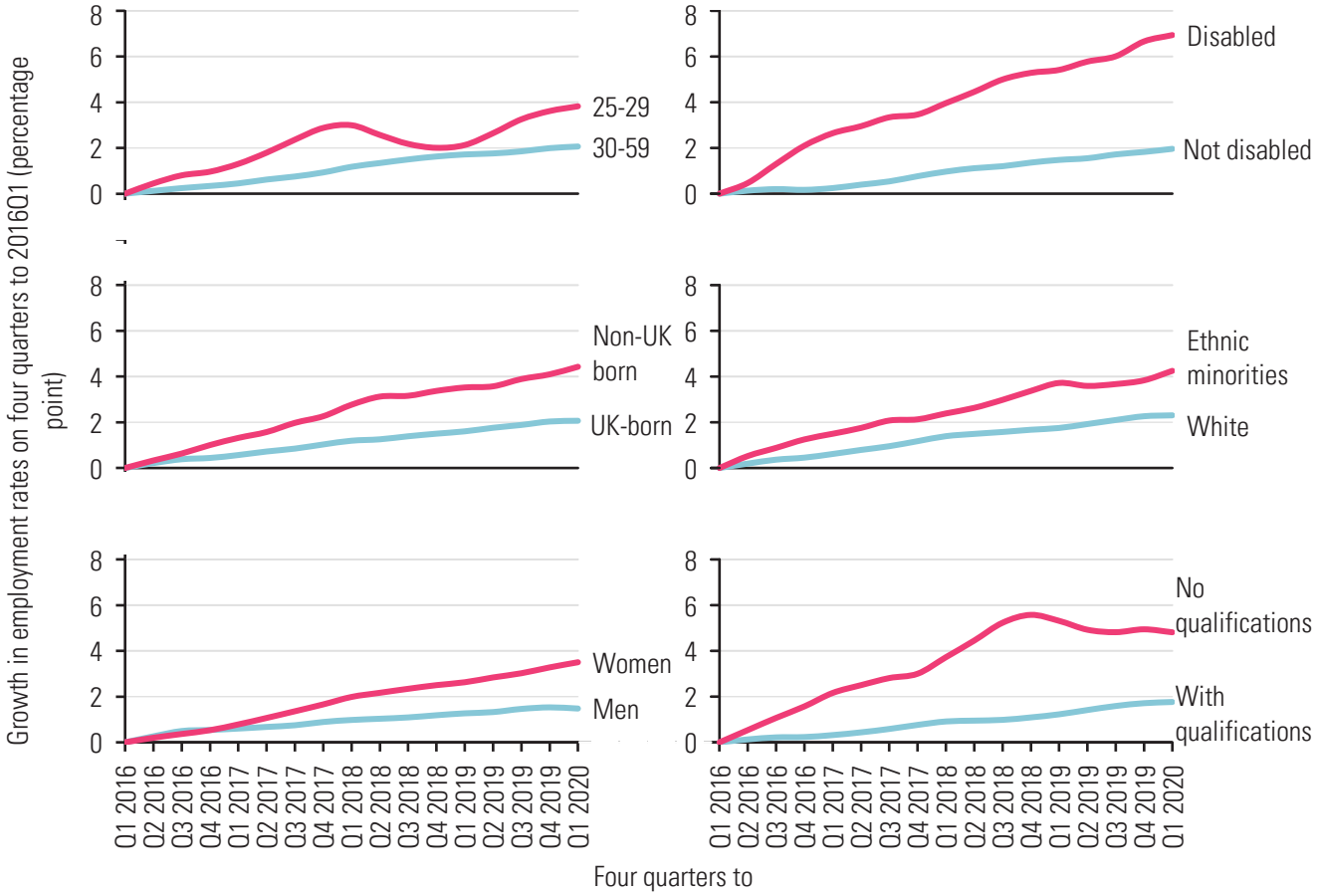
Personal Characteristics

4.24 This section compares the employment outcomes for individuals with personal characteristics associated with higher minimum wage use to workers without those characteristics. This gives us one measure of how the NLW is affecting the employment, unemployment and inactivity rates of workers. There are some drawbacks to this approach, for one it does not enable us to model what would happen in the absence of the NLW. It may be that in the absence of the NLW employment for these groups would be growing faster than it currently is, but we would be unable to see that with this approach. While the characteristics we examine contain a disproportionately large share of NLW workers, in all of them NLW workers make up less than half of workers, which means that much of the differences in outcomes may be driven by non-NLW workers.

4.25 Low Pay Commission (2020a) showed how certain personal characteristics are more associated with workers being employed on the minimum wage. Workers with no qualifications, those from minority ethnic groups, women, those aged 25-29, who were not born in the UK and who have disabilities are more likely to be paid the minimum wage, and therefore more likely to see employment decrease if the NLW were to reduce the demand for workers. Therefore, we compare labour market outcomes of these groups with the rest of the workforce to see if low-paid workers are experiencing any obvious difficulties in gaining employment.

4.26 Figure 4.2 shows that since the introduction of the NLW in 2016, employment has grown fastest for the groups with characteristics associated with higher NLW coverage. Over the year to Q1 2020, employment grew for all high coverage groups, with the exception of those with no qualifications. However there was a decline in the numbers of workers with no qualifications in the survey, which may have caused some noise in the data and resulted in the slight fall we notice. Moreover, we have seen much faster growth in employment in this group over the period as a whole than in the economy more widely.

Figure 4.2: Change in employment rates for those aged 25 and over, by personal characteristics, UK, 2016-2020



Source: LPC estimates using LFS microdata, population weights, quarterly, four quarter moving average, UK, Q2 2015-Q1 2020.

4.27 Table 4.1 shows the average employment, unemployment and inactivity rates across each NLW year, and how they changed between the introduction of the NLW and the most recent uprating. Both unemployment and inactivity have fallen by more in the groups more exposed to the NLW than the comparison group.

Table 4.1: Employment, unemployment and inactivity, by personal characteristics, UK, 2016-2019

	Q1 2016	Q1 2017	Q1 2018	Q1 2019	Q1 2020	Change Q1 2016 to Q1 2020
					per cent	percentage point
Employment						
Men	84.1	84.7	85.1	85.4	85.6	1.5
Women	72.1	72.9	74.1	74.7	75.6	3.5
White	79.2	79.8	80.5	80.9	81.5	2.3
Ethnic minorities	70.6	72.1	73.0	74.3	74.9	4.2
With qualifications	81.0	81.4	81.9	82.3	82.8	1.8
No qualifications	46.8	48.9	50.5	52.1	51.6	4.8
Not disabled	85.0	85.2	86.0	86.5	87.0	2.0
Disabled	42.2	44.8	46.1	47.6	49.1	6.9
UK-born	78.7	79.3	79.9	80.3	80.8	2.1
Non-UK born	75.2	76.5	78.0	78.7	79.6	4.4
Total	78.0	78.7	79.5	80.0	80.5	2.5
Unemployment						
Men	3.9	3.5	3.1	2.9	2.8	-1.1
Women	3.9	3.7	3.3	3.1	2.8	-1.1
White	3.4	3.2	2.8	2.7	2.5	-0.9
Ethnic minorities	7.5	6.2	5.7	5.1	4.7	-2.7
With qualifications	3.6	3.4	3.0	2.8	2.6	-1.0
No qualifications	9.3	7.4	7.2	6.4	7.0	-2.3
Not disabled	3.2	2.9	2.6	2.4	2.3	-0.9
Disabled	10.9	9.8	8.8	8.3	6.8	-4.1
UK-born	3.6	3.3	3.0	2.8	2.6	-1.0
Non-UK born	5.3	4.7	4.1	3.8	3.6	-1.7
Total	3.9	3.6	3.2	3.0	2.8	-1.1
Inactivity						
Men	12.5	12.2	12.2	12.0	11.9	-0.6
Women	25.0	24.4	23.4	22.9	22.3	-2.7
White	18.1	17.6	17.1	16.9	16.5	-1.6
Ethnic minorities	23.7	23.1	22.6	21.7	21.4	-2.3
With qualifications	15.9	15.8	15.5	15.3	15.0	-0.9
No qualifications	48.4	47.2	45.6	44.4	44.5	-3.9
Not disabled	12.2	12.2	11.8	11.4	11.0	-1.2
Disabled	52.7	50.3	49.4	48.1	47.3	-5.4
UK-born	18.4	18.0	17.6	17.4	17.1	-1.3
Non-UK born	20.6	19.7	18.7	18.2	17.4	-3.2
Total	18.8	18.3	17.9	17.5	17.1	-1.7

Source: LPC estimates using LFS microdata, population weights, quarterly, four quarter moving average, UK, Q2 2015-Q1 2020.

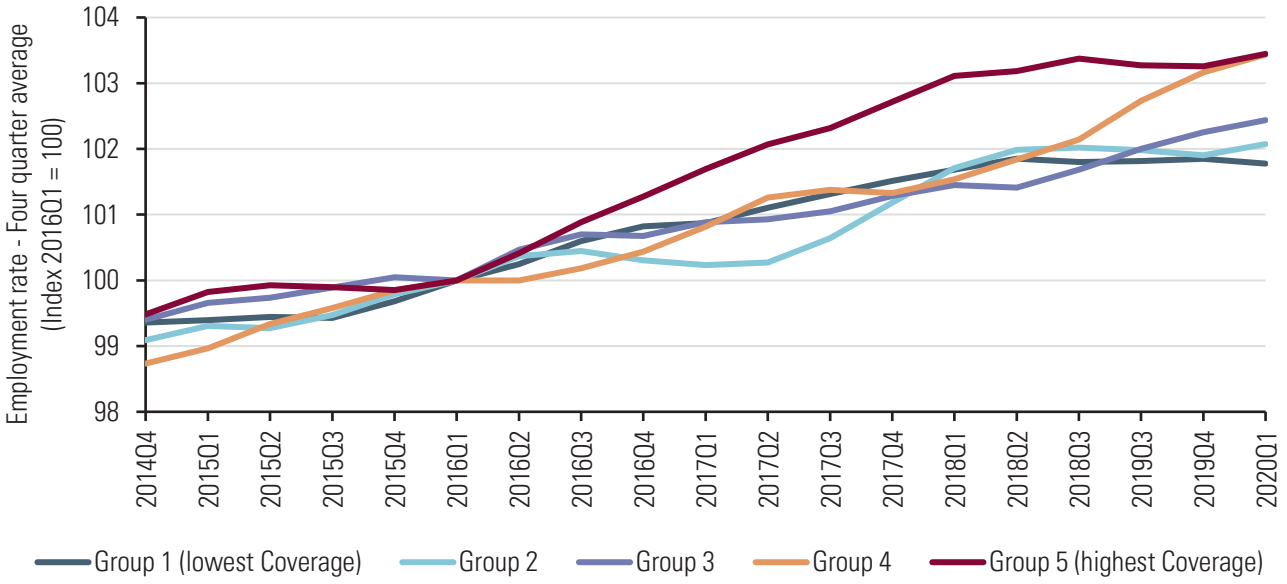
4.28 The faster increases in employment, and falls in unemployment and inactivity, in the groups more exposed to the NLW suggest that, for the period up to March 2020, the NLW was not having any large negative employment effects on these workers, or at least any effects were more than compensated for by the strengthening labour market.

Geography

4.29 Paragraphs 4.21 to 4.23 summarise our econometric analysis that uses geographic variation as part of a way to estimate the effect of the minimum wage on employment outcomes. The econometric approach used in that analysis enables us to get a better estimate of the direct effect of the NLW on employment. The approach used below acts as a higher-level check to see if the areas more affected by the NLW have seen divergence in labour market outcomes. This could be linked directly to the NLW or could reflect divergences for other reasons, and therefore functions more as an indication of the overall labour market health of these areas.

4.30 Figure 4.3 examines how employment at a Local Authority District level has changed since the introduction of the NLW by those districts' exposure to the NMW in 2015 (Northern Ireland is treated as a single local authority as the data is not available at a disaggregated level). It is important to note that in every region and local authority fewer than one in five workers aged over 25 are covered by the NLW, and that any differences we observe may be driven by labour market performance in non-NLW jobs.

Figure 4.3: Change in employment rate for those aged 25 and over, by local authority district, UK, 2016-2020



Source: LPC estimates using LFS microdata, population weights, not seasonally adjusted, four quarter rolling average, UK, Q1 2014-Q1 2020.

4.31 The employment rate for the local authorities most affected by the NLW has grown the fastest over the period. Similarly, the unemployment rate has fallen faster than average for the local authorities with the highest coverage. Inactivity has decreased by around the UK average for the local authorities that are most affected by the NLW.

Job characteristics

4.32 There are a range of job characteristics that are associated with higher use of the minimum wage. These include working in certain industries or occupations which typically employ workers on low levels of pay or jobs in smaller firms, or roles in smaller workplaces. Understanding how changes in employment in these jobs relate to the minimum wage is difficult. Declining employment for workers in these jobs could be a sign that the minimum wage is decreasing demand, or that these labour markets are not in a position to absorb further increases in the wage floor. On the other hand, it could be that the labour market is tight and that workers are choosing to work in jobs that are less associated with low pay.

4.33 This section is split between a focus on employer industry, job occupation and workplace size. Industry descriptions are given by the employer, covering the major field that the employer operates in while job occupation is given by the worker and covers the main tasks they do in their job. The differences between the two measures are partly due to the fact that the industry figures will include workers in higher paid roles within those industries, such as managers in retail, while the occupational figures will include workers doing low-paid jobs, but in employers whose predominant business is not associated with low-paying jobs, such as in-house cleaners in a financial firm.

4.34 Most jobs in low-paying occupations are also in low-paying industries and vice versa. However, the overlap between low-paying industries and occupations has declined slightly over the last few years. Using the Labour Force Survey (LFS) we can see that in 2014 around 61 per cent of jobs in low-paying industries were in low-paying occupations. However, by 2019 this had dropped to 58 per cent and early indications suggest that it decreased further in 2020. In 2014 65 per cent of low-paying occupations were in low-paying industries. By 2019 this had decreased to 63 per cent, and again the early indications are that there was a further decrease in 2020.

4.35 The industry figures in the following paragraphs are based on the employee jobs data set, which contains all jobs and is not collected in Northern Ireland, whereas the occupation figures are based on the LFS and only include main jobs. The employee jobs data set contains jobs worked by workers of all ages, whereas we restrict our analysis of the LFS to just those who are aged 25 and over, as this is the group for whom the NLW acts as a pay floor. Some of the smaller sectors can experience noise in the data due to their small sample sizes giving figures that can vary, due to randomness in the sampling of individuals.

Industry

4.36 Table 4.2 shows how employment has changed on the year, and since the introduction of the NLW, for different industries. Employment in low-paying industries was up slightly in March 2020 on March 2019, and up on the level seen before the introduction of the NLW in April 2016. However, the increases are smaller than those seen in non low-paying industries. Each of the main groups of low-paying industries, consumer services, business services, tradable sectors, and government-funded sectors saw employment growth over the year, though only in the government-funded sector was the increase faster than in the economy as a whole. The figures also show that there had been a fairly wide range of experiences in employment in different low-paying industries over the period since the introduction of the NLW, with some industries seeing substantial job falls, and others large increases.

Table 4.2: Change in employee jobs, by low-paying industry, GB, 2016-2020

	2020 March	Change on 2019 March		Change on 2016 March	
	thousands	thousands	per cent	thousands	per cent
Consumer services	6,311	40	0.6	192	3.1
Retail (including motor)	3,326	-17	-0.5	-56	-1.6
Retail (excluding motor)	2,790	-16	-0.6	-76	-2.6
Hospitality	2,298	59	2.6	226	10.9
Leisure, Travel and Sport	539	-2	-0.4	20	3.9
Hairdressing	148	1	0.5	1	0.5
Business services	1,505	6	0.4	19	1.3
Cleaning	769	26	3.5	48	6.7
Employment agencies	736	-20	-2.6	-29	-3.8
Trade	635	6	1.0	-6	-0.9
Food processing	359	-4	-1.0	0	-0.1
Agriculture	202	8	4.1	-1	-0.2
Textiles and clothing	74	2	2.8	-5	-6.0
Government	1,662	42	2.6	36	2.2
Residential care	767	37	5.0	69	9.9
Domiciliary care/childcare	895	5	0.6	-33	-3.6
Low-paying industries	10,113	95	0.9	242	2.4
Non low-paying industries	20,053	349	1.8	1175	6.2
Total	30,166	443	1.5	1,417	4.9

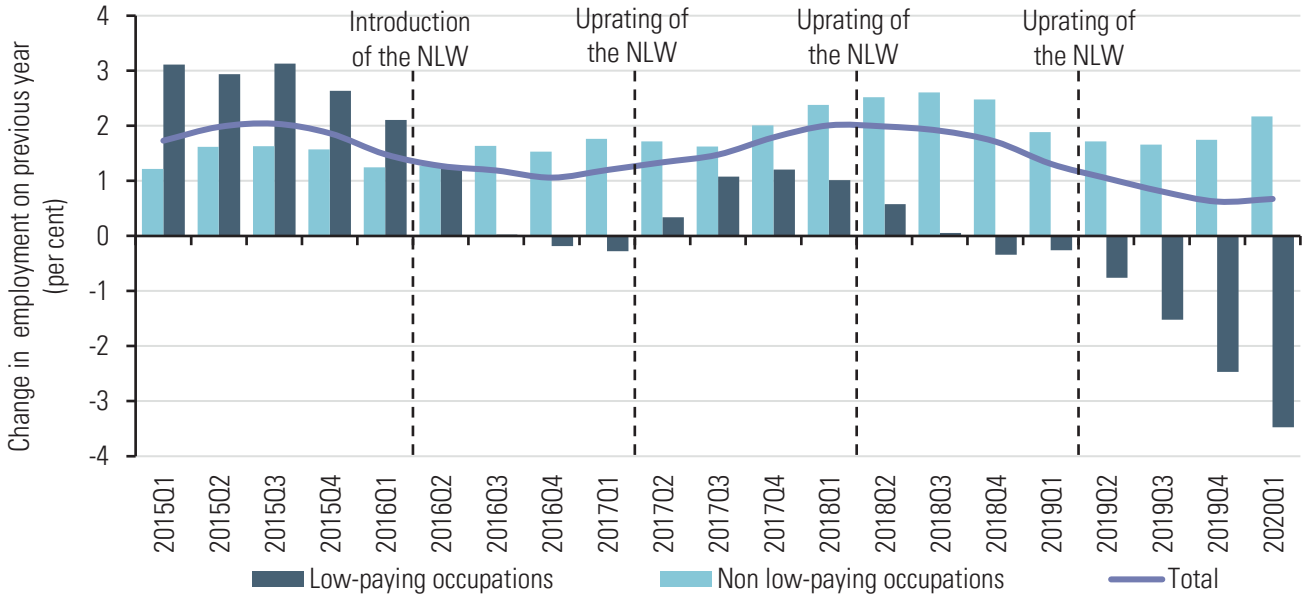
Source: LPC estimates using ONS employee jobs series, twelve-month average, not seasonally adjusted, 2015-20.
Note: Totals may not sum due to rounding.

4.37 Last year the sector representatives we talked to did not report employers reducing employment on a large scale in response to the NLW. We did hear that that some employers had made changes in the hair and beauty, convenience retail and wholesale sectors in which the NLW was a factor. Some of the decrease in employment we heard about in hairdressing roles was due to a shift towards self-employment (see paragraph 4.52). Other sector representatives talked about staff shortages.

Occupations

4.38 Figure 4.4 shows the annual change in employment by low-paying/non low-paying occupation since 2015. In the period leading up to the introduction of the NLW, employment growth was fastest among low-paying occupations, but since then growth has been considerably faster for non-low paying occupations. Employment in low-paying sectors has actually been falling at an increasing rate since the fourth quarter of 2018, down almost 4 per cent in the year to Q1 2020. However, this has been more than compensated by the faster growth in employment in non low-paying occupations. In fact, over the period between the introduction of the NLW and the start of the recent crisis, the number of jobs in low-paying occupations has fallen by 3.0 per cent, while jobs in non-low paying sectors have grown by 8.5 per cent.

Figure 4.4: Change in employment for those aged 25 and over, by occupation, UK, 2015-2020

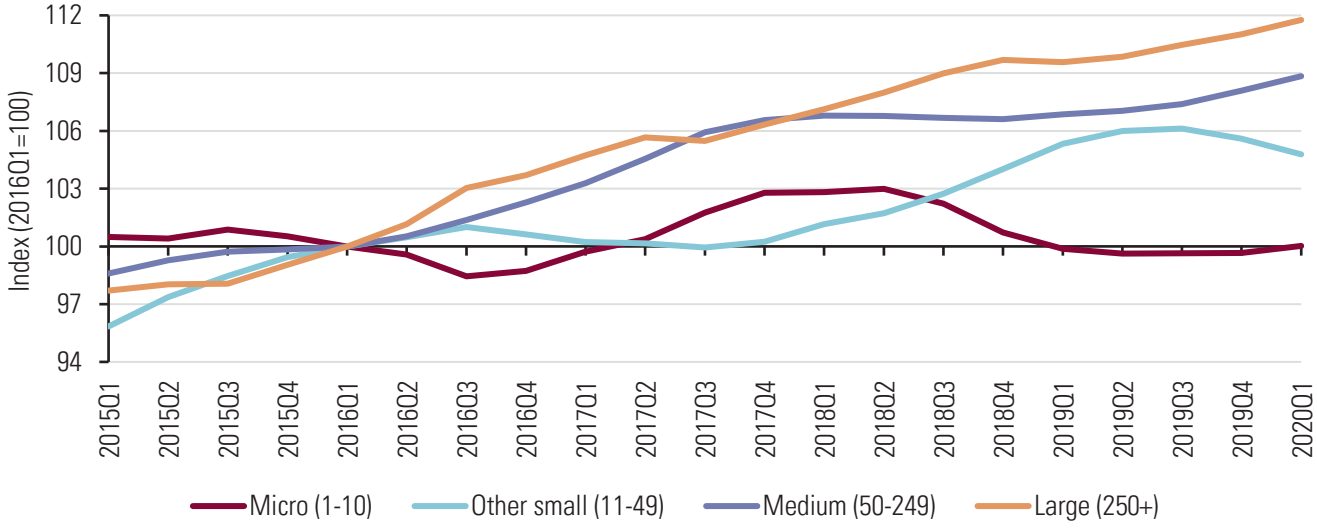


Source: LPC estimates using LFS microdata, population weights, not seasonally adjusted, four quarter rolling average, UK, Q2 2014-Q1 2020.

Workplace size

4.39 In previous reports we have shown how workplace size is correlated with minimum wage use. Workplaces with 10 or fewer staff have the highest proportion of staff paid the NLW, and NLW use decreases as workplaces get larger. Figure 4.5 shows that the number of workers who are employed in larger private sector workplaces (with more than 50 staff) has increased, while the number in small workplaces has decreased in the last year. This has been driven by low-paying occupations.

Figure 4.5: Employment for private sector employees aged 25 and over, by workplace size, UK, 2015-2020



Source: LPC estimates using LFS microdata, population weights, not seasonally adjusted, four quarter rolling average, UK, Q2 2014-Q1 2020.

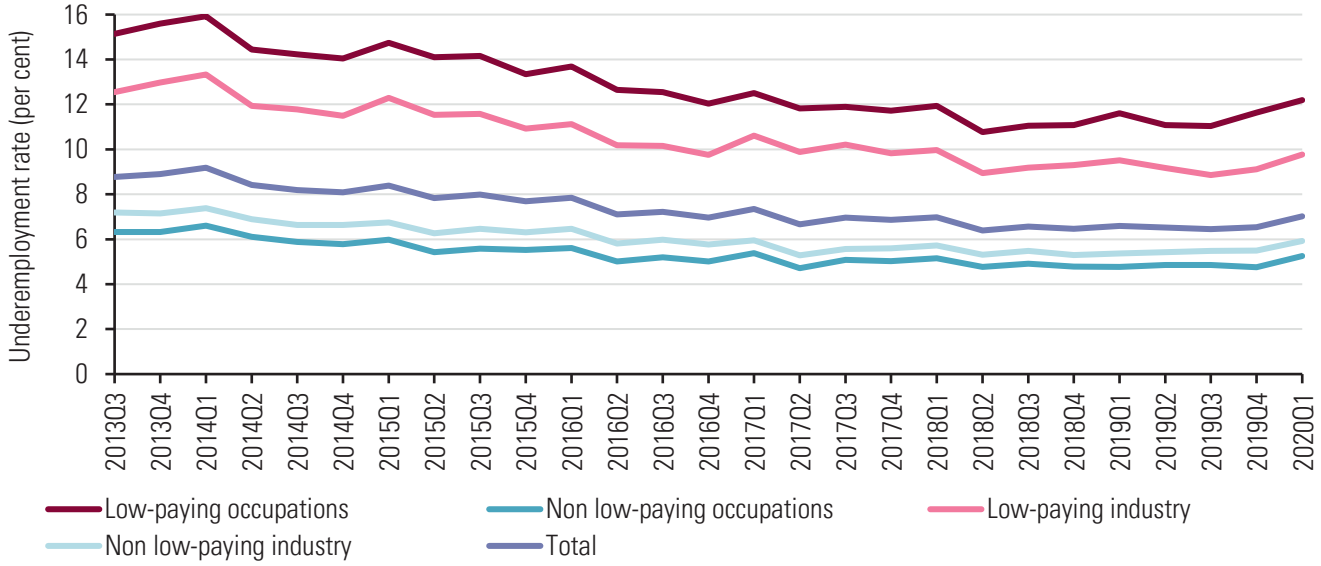
4.40 Across each of our three main measures of job characteristic (industry, occupation, and workplace size) we see that employment changes had been worse for the groups most likely to pay the NLW than for the wider labour market. This suggests that employers that were more affected by the NLW were finding it more difficult to employ workers, either by choice due to the higher cost of their workforce, or because they were unable to attract workers when in competition with jobs with characteristics less associated with low pay. This fits with what we heard from many stakeholders in low-paying sectors, before the pandemic, that recruiting was becoming more difficult, and that some employers were suffering staff shortages.

Non-traditional employment/other measures of labour market slack

4.41 So far in this section we have focused on the traditional measures of the balance between labour market demand and supply – employment and unemployment. However, these do not measure all types of slack in the labour market. Another is underemployment, when an individual is currently employed but would still prefer to work more hours than they currently do. It is measured in three ways: if an individual is looking for more hours in their current job; if they are looking for an additional job; or if they are looking for a new job with more hours.

4.42 Figure 4.6 shows how underemployment has changed since 2013, and how it varies between low-paying and non low-paying industries and occupations. Underemployment fell between 2014 and 2018, particularly in low-paying sectors. Since then underemployment was broadly flat up to the most recent quarter when it ticked up. This may be linked to the cut in hours in the most recent quarter, but it should be noted that historically we have seen a slight uptick in underemployment in the first quarter of the year, particularly in low-paying sectors. Since the move to NLW increases in April, we have typically seen a decrease in the second quarter in low-paying sectors, probably because workers benefit from NLW-driven pay increases in this period, which decreases their desire for more hours.

Figure 4.6: Underemployment rate for those aged 25 and over, by industry and occupation, UK, 2013-2020



Source: LPC estimates using LFS microdata, population weights, not seasonally adjusted, UK, Q3 2013-Q1 2020.

4.43 Employers could attempt to mitigate the effects of the NLW by passing on some of the risk in managing labour demand to employees. Employers could shift employees onto contracts with a higher proportion of non-guaranteed hours, such as zero-hours contracts. Zero-hours contracts are where no hours are guaranteed for the employee. While use of zero-hours contracts increased in the first quarter of 2020, they have grown slightly more quickly in non low-paying occupations and industries since the introduction of the NLW, suggesting that the NLW may not be the sole reason behind this shift.

4.44 Adam, Balgova and Qian (2020) use machine learning techniques to classify the work arrangements described in more than 46 million UK job vacancies. They find that low-wage vacancies and high-wage vacancies offer different types of flexibility. Job flexibility for low-wage vacancies was more likely to be of the type of work-contract that exposes workers to earnings risk. Higher wage flexible jobs are more likely to include a fixed salary. The authors conclude that employer demand for flexible work arrangements is partly driven by their desire to reduce the labour costs they face. They estimate that the NLW led to a seven percentage point increase in the proportion of flexible and non-salaried vacancies for low-wage jobs. This supports a finding by Datta, Giupponi and Machin (2018) that looked at the use of zero-hours contracts and found evidence that the wage shock from a higher minimum wage resulted in increased use of zero-hours contracts in social care specifically, and in low-wage industries more generally. Our internal analysis, as described in paragraphs 4.21 to 4.23, did not find any evidence of a link between the NLW and the use of zero-hours contracts.

4.45 Overall, in the period leading up to the start of lockdown the low-paid labour market was in a strong place. Labour market outcomes for workers with demographic characteristics associated with higher minimum wage use continued to improve and areas with a higher prevalence of NLW jobs saw similar or slightly stronger employment growth to other areas. While low-paying occupations and industries saw decreases in employment, this could be linked to a tight labour market inducing moves away from these sectors, something we heard from some stakeholders who found hiring difficult.

Stakeholder evidence

4.46 As we have seen, both our commissioned research and internal analysis have not found significant impacts on employment from the introduction of the NLW in 2016 and subsequent upratings. Stakeholder evidence, too, has tended to suggest it is rare for employers to respond to increases by reducing employment. While employers have told us about the gradual reorganisation of working hours in their businesses, and the slowing of recruitment, we have heard very few examples of jobs being cut in response to upratings. Where employment in a sector has fallen over time – as in retail, for example – stakeholders have acknowledged that, while the NLW adds to the pressure employers face, the main driver is structural change in the sector not linked to the minimum wage.

4.47 The pandemic has clearly made employment much more precarious in many low-paying sectors. We discuss what we heard about the effects of the lockdown later on in this chapter, under our discussion of the labour market in lockdown (paragraphs 4.61 to 4.69). In general, the impact of Covid-19 makes it more difficult this year to identify the specific effects the NLW has had on employers' positions. One of our main resources each year are surveys carried out by employer representative groups of their membership. Although several of those surveys were disrupted this year, those available to us, on the whole, show continuity with previous years, and as such we read them as giving a sense of the NLW's impacts, isolated from the broader pandemic. The most common ways stakeholders report dealing with NLW increases remain to absorb the increase via a reduction in profits or, where possible, to raise prices. We discuss what stakeholders told us about these responses in Chapter 7, along with another important avenue for response, productivity. Here we focus on what we have heard about employment effects.

Employment and hours

4.48 Survey data from the Chartered Institute of Personnel and Development (CIPD) found NLW increases had only a modest impact on employment levels: 16 per cent of respondents said they had reduced the number of employees through redundancies and/or recruiting fewer workers in response. Large employers were more likely to have reduced employment levels, as were those in construction (23 per cent) and retail (22 per cent). Both the British Chambers of Commerce (BCC) and Federation of Small Businesses (FSB) asked members about planned responses to future NLW increases. Nine per cent of FSB members expected to make redundancies in response to a rising NLW of £9.21, against 18 per cent who expected to recruit fewer workers and 19 per cent who thought they would reduce hours worked by staff. Similarly, 9 per cent of BCC members thought their business might respond to further NLW increases by making more redundancies (up from 6 per cent in 2019), compared with 17 per cent who would scale back recruitment plans and 12 per cent who would reduce working hours. In both surveys, these employment responses trailed the most common ways of managing the costs of increases, by raising prices, taking lower profits and slowing wider pay growth.

4.49 Retail groups including the British Retail Consortium (BRC), Association of Convenience Stores (ACS) and Federation of Independent Retailers (NFRN), told us how staff levels and hours worked had reduced in high percentages of members surveyed in previous years, compared to this year. BRC told us how it is 'difficult to attribute retail losses to any one cause' but future rises in the NLW would increase the risks of further job losses. They also noted that 38 per cent of members had reduced employees' hours of work (up by 16 percentage points since 2019). They told us the pattern of future responses is likely to mirror this with a reduction in hours being the most favoured response by retailers. ACS's survey reported that staff hours and levels had reduced this year, although this was a less common response to the survey than in previous years (48 per cent versus over 70 per cent in the past). FIR mentioned to us how the number of jobs, particularly part time positions have been reduced.

4.50 The Institute of Workplace and Facilities Management (IWFM) told us that prior to the impact of Covid-19, clients would need to investigate reducing the levels of cleaning services they use to meet any rising costs in the NLW. This in turn would have a knock-on effect on cleaning businesses, leading to them having to reduce their staff levels. The National Farmers Union (NFU) found that NLW increases led to 31 per cent of respondents reporting changes to hours worked or offered and 30 per cent of respondents reported an impact on number of workers employed.

4.51 Workers' representatives emphasised that the NLW had been benign for employment so far. The Trades Union Congress (TUC) highlighted in their consultation response that since the NLW was introduced in 2016 they have seen steadily resilient levels of employment, and the NLW has led to significant increases in the wages of the lowest paid without reducing employment levels. Usdaw also told us that they had not had to deal with any closures or job losses directly related to the NLW since its introduction. Although this year, during the pandemic hours worked in the economy fell with larger decreases in some low-paying sectors, Usdaw said there were no signs the 2020 NLW increase had itself affected hours. The point was reinforced by Unite who told us in oral evidence sessions, that despite the economic downturn, a change in the NLW would not make any differences to jobs. The Scottish Women's Convention (SWC) raised concerns to us about businesses having to reduce their employees' hours of work, particularly for workers who are already placed on low-hours contracts.

4.52 The National Hairdressers and Beauty Federation (NHBF) also provided evidence to us on self-employment and reflected on how it was a growing trend before the onset of the pandemic with 54 per cent of people working in hairdressing and barbering and 57 per cent in beauty now registering as self-employed. Around a third of their members had stressed concerns about the rising NLW and how it is driving a shift to self-employment which is expected to increase as a means of reducing employment costs, which in turn in is having an impact on businesses profitability.

Pay and differentials

4.53 Pay compression continued to be a major theme in the evidence we received this year. Employers told us about difficult decisions over whether to maintain differentials and accept the increase in costs or narrow them with consequences for staff morale and progression. Narrowing differentials was a leading response to NLW increases in survey data from the Chartered Institute of Payroll Professionals (CIPP) and BRC, with the share of BRC members reducing differentials increasing from 48 to 55 per cent in a year. The BRC told us that a growing proportion of staff were less inclined to apply for promotions. Alongside this, 38 per cent of members had 'de-layered management roles'. Forty-one per cent of CIPP survey respondents stated the NLW had impacted pay structures; members told us of pressure resulting as the rising NLW converged with the lowest points on pay spines. The NFU also told us about the pressure on agriculture businesses to maintain wage differentials for experienced staff, contributing to the overall cost pressure the sector faces.

4.54 Amongst publicly funded sectors, Community Leisure UK (CLUK) and the National Care Association (NCA) reported similar issues. CLUK told us narrow differentials were damaging staff satisfaction and negatively affecting recruitment and retention. In social care, the NCA reported concern among providers about the overall increases to the wage bill resulting from maintaining differentials when the NLW rises i.e. increases on all rates of pay for staff throughout the organisation.

4.55 Unions, too, expressed concerns. GMB told us that, in the absence of collective bargaining, lower differentials could lead to workers becoming 'stuck' and unable to progress beyond the minimum rates. Unite told us they had continued to see a narrowing (or elimination) of pay differentials for skilled workers. In some instances, chefs had seen pay rates frozen, with companies diverting tips and service charges to kitchen staff, in turn lowering pay for waiting staff. Similarly, in the food production sector we heard from poultry factory workers who had seen their skilled rates disappear, replaced by a flat rate just above the NLW. The workers we spoke to felt the rate they earned was not reflective of the amount of work required and offered no room for progression or development. Unite argued the benefits brought by the NLW risked being undermined by opportunistic employers using the NLW to remove skill differentials, and their focus in negotiations had been to at least maintain skill recognition through cash differentials between grades.

The low-paid labour market in lockdown

4.56 On 16 March, the Prime Minister announced that employees should work from home if they could, avoid non-essential contact and unnecessary travel. The Prime Minister also advised that people should avoid pubs, clubs, theatres and other social venues. This advice was strengthened on 23 March when the Prime Minister announced that people should stay at home, with limited exceptions: shopping for basic necessities, one form of exercise a day, a medical need, and traveling to and from work – but only when absolutely necessary. The Government closed all shops selling non-essential goods and stopped public gatherings and social events in England with the devolved administrations taking similar steps.

4.57 From Maythe UK Government and the devolved administrations started to take steps to open up the economy. Businesses in different sectors were allowed to re-open at different times, with the speed of opening generally related to the amount of personal contact involved. Appendix 6 contains a more detailed timeline but generally non-essential retail businesses opened in June, and hospitality businesses in July. However, there were regional variations and some local lockdowns in the period up to the end of August (the period covered here).

4.58 These restrictions had serious and immediate effects on the economy and the labour market. Moreover, low-paid workers were disproportionately affected. Around 37 per cent of NLW workers aged over 25 worked in shut-down sectors in 2019[3], around three-times the rate for non-NLW workers. Around 22 per cent of NLW workers were judged to be in critical occupations[4], slightly lower than the rate for higher paid workers.

[3] Using Joyce and Xu (2020) definition of locked-down sectors.
[4] Using Office for National Statistics definitions of key workers.

4.59 To support the economy through the lockdown the Government enacted a range of economic interventions including some focused on directly supporting workers' pay and employment (see summary at Table 1.2). As set out in paragraphs 2.13 to 2.17, the CJRS was announced on 20 March, with the Government paying 80 per cent of wages of employees who were unable to work. Between the introduction of the CJRS and 30 June workers were required to work no hours to be eligible for the CJRS, but from 1 July, workers could be brought back part-time with the Government covering 80 per cent of pay for the usual hours that were not worked. From 1 August employers were required to cover their employees' National Insurance and pension contributions.

4.60 In this section we use weekly data from the Labour Force Survey (LFS). In the analyses here data is assigned to the week that an interview took place. We do not have access to the weights that the Office for National Statistics (ONS) use to produce their 'Single-month and weekly Labour Force Survey estimates' releases. Instead, we use the quarterly weights, which may not match published ONS figures, but provide a reasonable picture of the changes in the economy over the period. The data only covers the period up to the end of August.

Stakeholder evidence during lockdown

4.61 The majority of our evidence-gathering was held between April and July this year, during the initial lockdown and gradual reopening. Much of the evidence we heard therefore reflected businesses' uncertainty over the immediate future before the emergence of the evidence we go on to discuss in the rest of this chapter.

4.62 Reactions to the CJRS were positive and it was clear that use of the scheme was widespread in low-paying sectors. In the summer of 2020, the Confederation of British Industry (CBI) and FSB both told us the scheme was a success; with two-thirds of FSB businesses having made use of the scheme. The British Beers and Pubs Association (BBPA) also informed us that 90 per cent of staff in their industry had been placed on furlough. Other stakeholder groups such as the Communication Workers Union (CWU), CLUK and the Recruitment and Employment Confederation (REC) similarly informed us that the scheme was a lifeline, saving jobs and preventing large rises in unemployment. This was similarly mentioned by the Local Government Association (LGA) who told us that the CJRS had played an important role in preventing large immediate rises in unemployment.

4.63 However, most stakeholders still expected to see a major impact on employment in the near future. The BRC and CBI both highlighted redundancies in the retail, clothing and manufacturing sectors following business closures. Other stakeholders had not yet started to shed their employees but expected possible redundancies in the near future as they better understood the fall-out of the economic shocks caused by the pandemic. UK Hospitality (UKH), the BBPA and Make UK all expected redundancies in their sectors. UKH told us based on assessments made at the end of lockdown and anticipation of reopening, they expected hospitality employment to fall significantly and the BBPA had estimated around 20 per cent of workers in their sector were vulnerable to losing their jobs. Make UK also told us redundancies were accelerating amongst manufacturers, with over 40 per cent of members planning redundancies in the next six months, with the first employees likely to be made redundant being temporary and agency workers. Unite warned of a potential 'job tsunami' in the hospitality and tourism sectors.

4.64 Businesses we spoke to were concerned about adapting to lower demand and changing consumer behaviour. BBPA members told us in May they anticipated reducing capacity by 40 per cent to comply with social distancing measures. For some members, this would mean a possible fall in trading revenues of 50-70 per cent. They felt there was 'no good answer' in this situation and recruitment freezes alone would not be sufficient, with some members mentioning the possibility to reduce staff hours and issue redundancies. We spoke to a childcare business expecting to make up to half their staff redundant as they did not see businesses in the sector returning to normal as fast as they had hoped. A café owner had placed 14 of their 17 staff on furlough and told us less than 50 per cent of staff would be able to return once the café re-opens on reduced hours. One exception to this trend was in food retail, which saw demand increase. ACS members told us food sales had risen by up to 75 per cent at their peak, with businesses recruiting additional staff to meet demand and cover those who were shielding.

4.65 Over the summer we heard particular concerns from local areas dependent on tourist seasons. Employers in these areas told us they make most of their annual revenues in the summer months; losing this trade meant it would be difficult to recoup costs in the rest of the year. We spoke to employers in Scotland, fearful of the loss of trade if tourists were slow to return. One retail business, employing around 40 staff told us he faced a complete 'wipe-out'. ACS highlighted a similar situation, with convenience retailers in rural areas seeing significant declines in footfall, leading to some temporary business closures.

4.66 The furloughed workers we spoke to were generally struggling to adapt to sudden changes in employment and income. Workers told us about being forced to rapidly reduce their outgoings, relying on family and friends for support, having to spend long-term savings or go into debt to get by. Hospitality workers told us about the impact of the loss of tips; many said that, as a third of their usual take-home pay came from tips, the fact that furlough payments did not take these into account meant their income had effectively halved. For some the furlough payments they received fluctuated each month, as employers miscalculated their hours. Concerns of incorrect furlough payments were reported by Citizens Advice Scotland, who noted high levels of enquiries from workers complaining their furlough payments did not take account of the NLW uprating. One worker told us how their furlough payments were based on hours during a period when they had had to take sick leave, greatly reducing the payment received.

4.67 A number of hospitality workers across the country expressed concerns over the uncertainty of their situation and fears of redundancy, which added to the stress of managing on a lower income. Many told us that communication from their employers while they were furloughed had been poor to non-existent. One worker had found out about their employer shutting down via a blog post aimed at customers; another found out about their employer going into administration via newspaper coverage.

4.68 Unite told us how their members had experienced pay or hours cuts. They reported that contract changes had been forced upon their members during the pandemic, with some workers being pressurised to sign contract amendments under threat of redundancy. Workers were conscious that the job market was likely to be a lot more competitive than previously and that this reduced their ability to resist changes made by their employers. We spoke with workers in catering businesses connected to the aviation sector about their experiences of working over the lockdown period. They had seen planned pay rises cancelled and felt employers were taking advantage of the crisis to rush through permanent changes to contract terms. They complained about poor communication from their employers and inadequate provision of personal protective equipment.

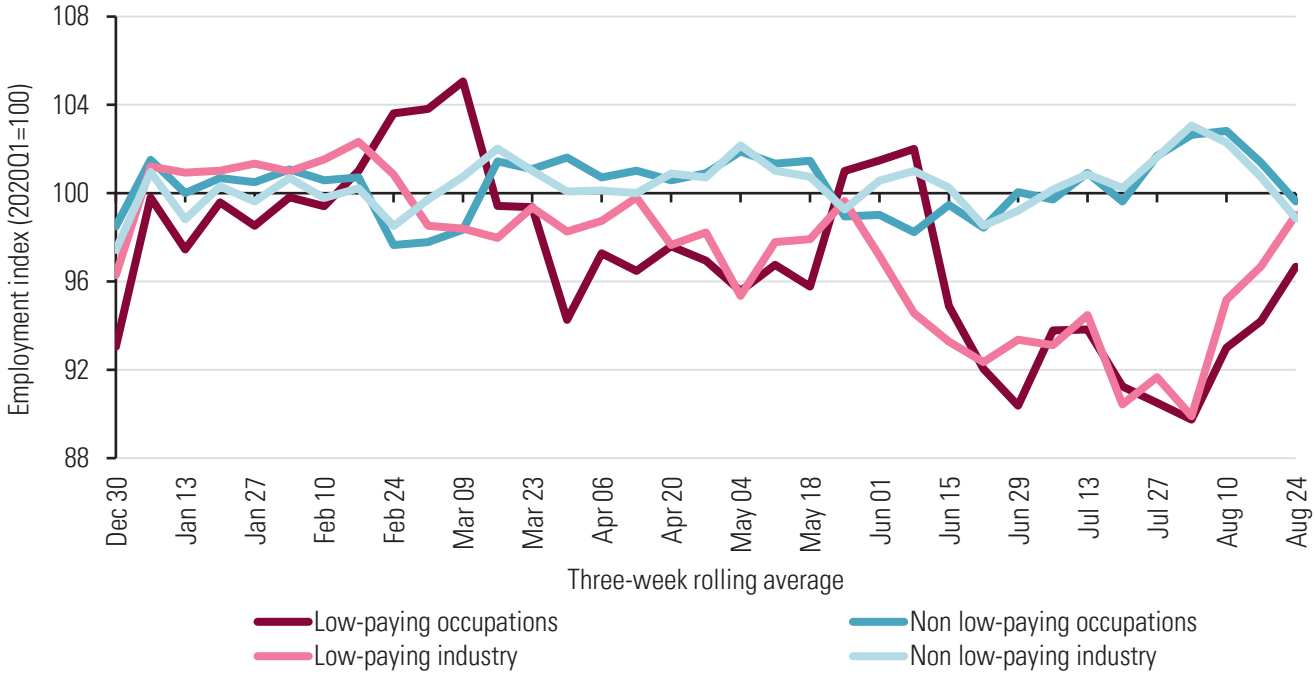
4.69 We spoke to other low-paid workers in food retail who had continued to work through the pandemic; although working in the period of panic buying had been stressful, with many workers facing customer abuse, the temporary pay uplifts offered by many supermarkets provided welcome recognition of their contributions. Usdaw told us they had negotiated a temporary ten per cent pay bonus for members who continued to serve through the pandemic, working in a range of businesses in recognition for their roles in responding to the outbreak.

Impact on employment

4.70 Despite the significant impact of the lockdown on the economy, employment did not fall dramatically because firms furloughed workers rather than made them redundant. So instead of an employment effect we saw a large reduction in hours worked. However, some other measures of employment did show decreases in the aftermath of lockdown.

4.71 Figure 4.7 shows how in the initial period after the lockdown was introduced, employment mostly held up, though there was evidence of a slight decline in employment in low-paying industries and occupations in April and early May. The announcement of the CJRS on 20 March likely supported firms in keeping their staff in employment, but on furlough (this is explored more in the Impact on hours section below). In June and July there was a noticeable decline in the number of employees in low-paying industries and occupations, while the number in non-low-paying industries and occupations held up. In July employment was around 10 per cent down on the average seen in the first quarter in low-paying occupations and industries, but employment recovered close to first quarter average by the end of August.

Figure 4.7: Number of employees in a week, for those aged 23 to 64, by occupation and industry, UK, 2020



Source: LPC estimates using LFS microdata, quarterly population weights, not seasonally adjusted, UK, Q1 2020-June-August 2020.

4.72 Around half of the low-paying sectors saw employment hold up through the first five months after the lockdown was imposed. Employment declined in low-paying food-processing, textile manufacturing, hospitality, cleaning and maintenance, childcare, non-food processing and storage occupations. However, changes in weekly employment totals in each of these occupations could just be noise in the data, given the limited time and sample size that we have to estimate any effects at an occupational level.

4.73 Employment outcomes for the groups associated with higher NLW coverage (as set out in paragraph 4.25), do not appear to be any different in the period after the introduction of a lockdown and social distancing. Unemployment increased slightly over the period, up by a half percentage point over the four months to August. This increase was no worse for the types of workers most likely to be paid the NLW.

4.74 As set out in paragraph 2.22, different measures of employment show a different picture. A measure of employees on payroll fell by 2.4 per cent to between January and September. Paragraphs 2.23 to 2.27 discuss the differences between the various measures, but it could be that any variation in employment outcomes between sectors or groups more likely to be low-paying is masked by some of the issues discussed there.

4.75 The LFS indicated that the number of workers employed on zero-hours contracts increased by two-fifths between the first and second quarters of 2020. Increases were similar in low-paying and non low-paying sectors. It is hard to know if this measures an actual increase in the use of zero-hours contacts, an increase in the awareness of workers who are on them in response to hours cuts during the pandemic, or an increase in the number of workers mis-identifying that they are employed on zero-hours contracts as they are furloughed and working no hours.

Impact on hours

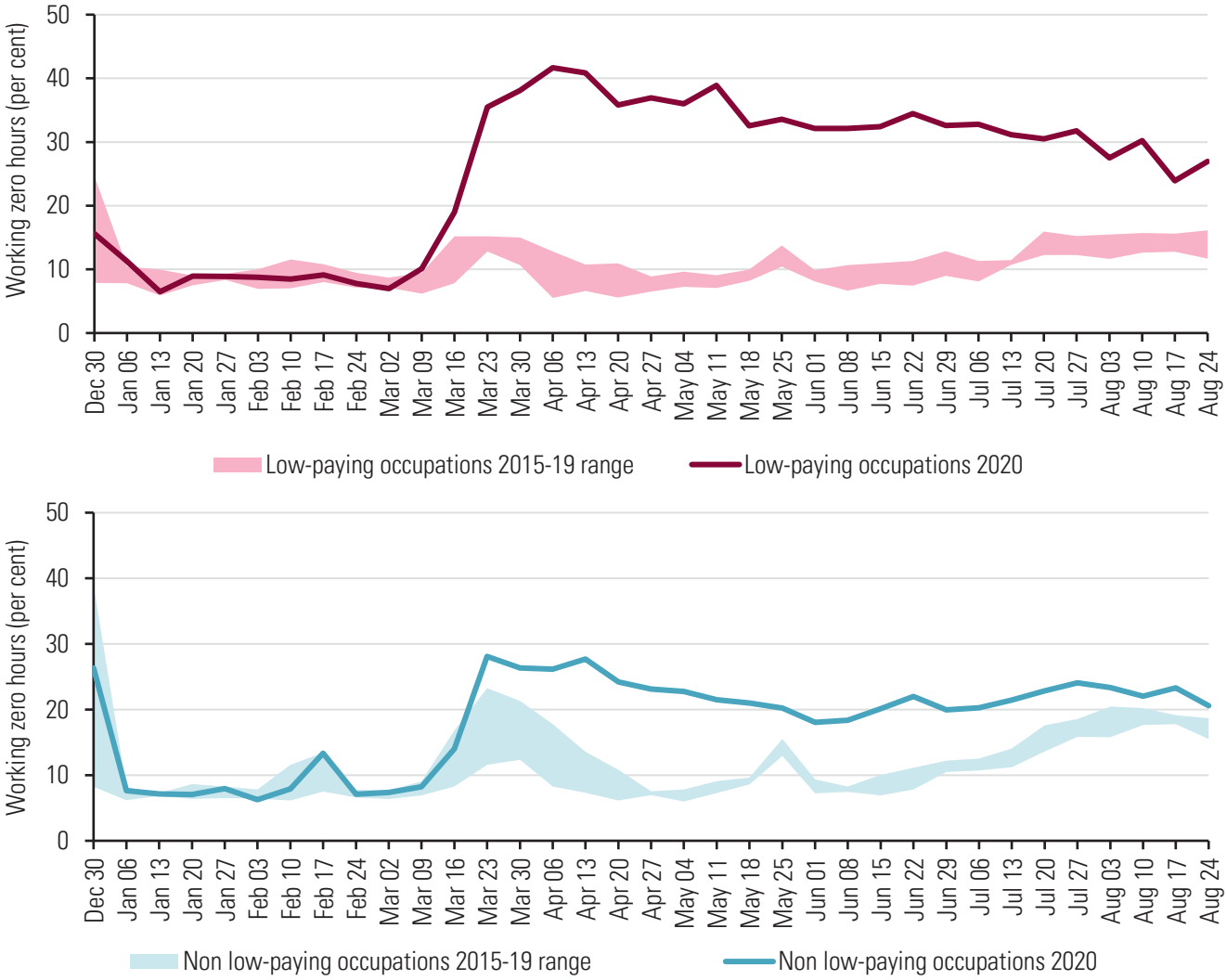
4.76 The other way that firms can manage their use of labour is by adjusting hours of work. Figure 2.13 shows how average hours worked across the economy fell in response to the lockdown as firms took advantage of the CJRS to reduce their employment costs as demand fell. The fall in hours was considerably more pronounced in low-paying occupations – which is to be expected as these jobs were more likely to be shut down, and are typically less able to be performed from home.

4.77 The majority of this hours fall was driven by a substantial increase in those working no hours. Furlough is not the only factor however, as those who continued to work saw their hours fall slightly from the range in the previous five years. Other workers working no hours may have been on flexible contracts, and not have been paid via the CJRS, or they may be on leave. Up to the start of July employers could only access the CJRS if their workers worked zero hours. Therefore the incentive for employers who wanted to reduce hours in their workforce, but not to zero, would be to furlough some workers and keep the rest working their contracted hours, rather than to reduce hours evenly across their workforce.

4.78 Figure 4.8 shows the change in the number working zero hours for low-paying and non low-paying occupations. The number working zero hours typically varies across the year, increasing around school holidays, but it jumped significantly during the period just after lockdown and remained high for the next few weeks. In low-paid occupations the proportion working zero-hours peaked at around 40 per cent during the first two weeks of the second quarter (30 March – 12 April). Much of this was driven by people who were 'temporarily away from work' – i.e. on leave or furloughed, who made up around a third of workers in low-paying occupations during this period immediately after lockdown, and around a fifth of other workers. Other workers who worked no hours could be those who were on zero-hour contracts and were 'zeroed down'.

4.79 During the second half of April, and in May and June the number working zero hours generally declined, from about 40 per cent for low-paying occupations, to about 30 per cent by late June, and from around 26 per cent for non low-paying occupations to around 20 per cent by late June, when typically the rate is around 10 per cent. The gap between the 2020 rates and those seen over the previous five years continued to close in July and August. This was partly driven by decreases in the proportion of workers in low-paid sectors working zero hours, and partly because this period covered the summer holidays and therefore overlaps with the period of the year where a higher proportion of people had worked zero hours in the previous five years.

Figure 4.8: Workers working no hours, those aged 23 to 64, UK, 2015-2020

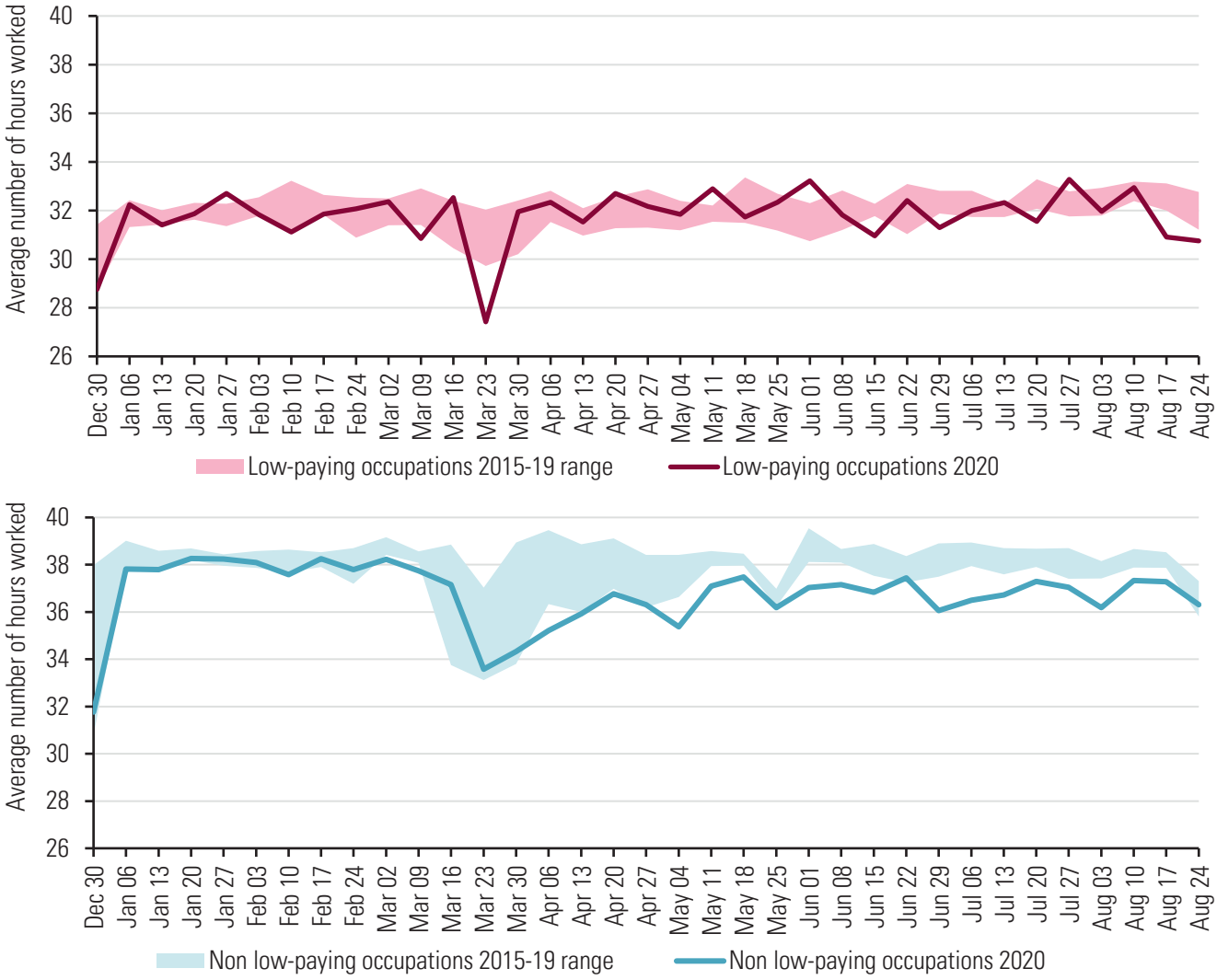


Source: LPC estimates using LFS microdata, quarterly population weights, not seasonally adjusted, UK, Q1 2020-June-August 2020.

4.80 There is again a range of outcomes across different low-paying occupations, with the increase in the proportion working zero hours varying to a significant amount in different occupations, with the smallest changes in low-paying social care occupations and particularly large sustained increases in leisure, hospitality and hair and beauty. By the end of August, the proportion of workers who were working no hours was elevated in six low-paying occupations: hospitality, leisure, retail, hair and beauty, cleaning and maintenance, and transport.

4.81 To get a picture of how hours have changed for those not on furlough we can examine how average hours have changed for those workers who worked at least one hour in the reference week. Therefore we will be excluding the effect on average hours by the increase in the numbers working zero hours. Figure 4.9 shows how this measure of average hours worked has changed over the year for low-paying occupations and for non low-paying occupations. While the average number of hours worked in low-paying occupations declined in the week after lockdown was introduced they then recovered to within the historical average by the following week. For non low-paying occupations hours similarly declined after the lockdown was introduced, but this had also happened in that week in previous years. However, hours remained slightly down on the lowest level seen over the previous five years until the end of August.

Figure 4.9: Mean hours worked for those who worked at least one hour, aged 23 to 64, by occupation, UK, 2015-2020



Source: LPC estimates using LFS microdata, quarterly population weights, not seasonally adjusted, UK, Q1 2020-June-August 2020.

4.82 The LFS asks workers who report working more or fewer hours than normal the reasons for this difference in hours. In the second and third quarter 2020, this has included asking if the reason was due to the coronavirus. In the second quarter around 7.5 million workers aged 23 to 64 attributed their fall in hours to the coronavirus. Almost three quarters of those who worked no hours in the reference week said that this was due to the coronavirus, and a third of those who did work at least an hour in that week, but did not work as much as normal said that this was due to the coronavirus. Workers mainly attributed the fall in hours due to being required to stay at home, or the effect of the virus, and the lockdown, on economic conditions. On the other hand, slightly over 900,000 workers said that they had worked more hours than usual due to the coronavirus.

4.83 As discussed in paragraph 4.41, underemployment is another measure of labour market slack. In the second quarter of 2020 the underemployment rate picked up to a level last seen in the first quarter of 2016. There were increases in both low-paying and non-low paying occupations and industries, but the increases were larger in low-paying sectors, with the changes driven by increases in those who wanted more hours in their current job.

4.84 The lockdown of the economy impacted across the labour market. However, the impact was, on average, larger for low-paid sectors of the economy. While employment mostly held up for non low-paying occupations and industries, employment in low-paying sectors appeared to experience a temporary decline. Hours fell more in low-paying occupations and industries, as a greater number of workers in low-paying sectors ended up working zero hours. While employment, hours, and the proportion of workers working zero hours had, for the most part, recovered by the end of August, employment and hours seemed further away from their historic rates for jobs in low-paying sectors than in the wider economy suggesting that these jobs remain in a relatively more precarious position than higher paid jobs.

Pay

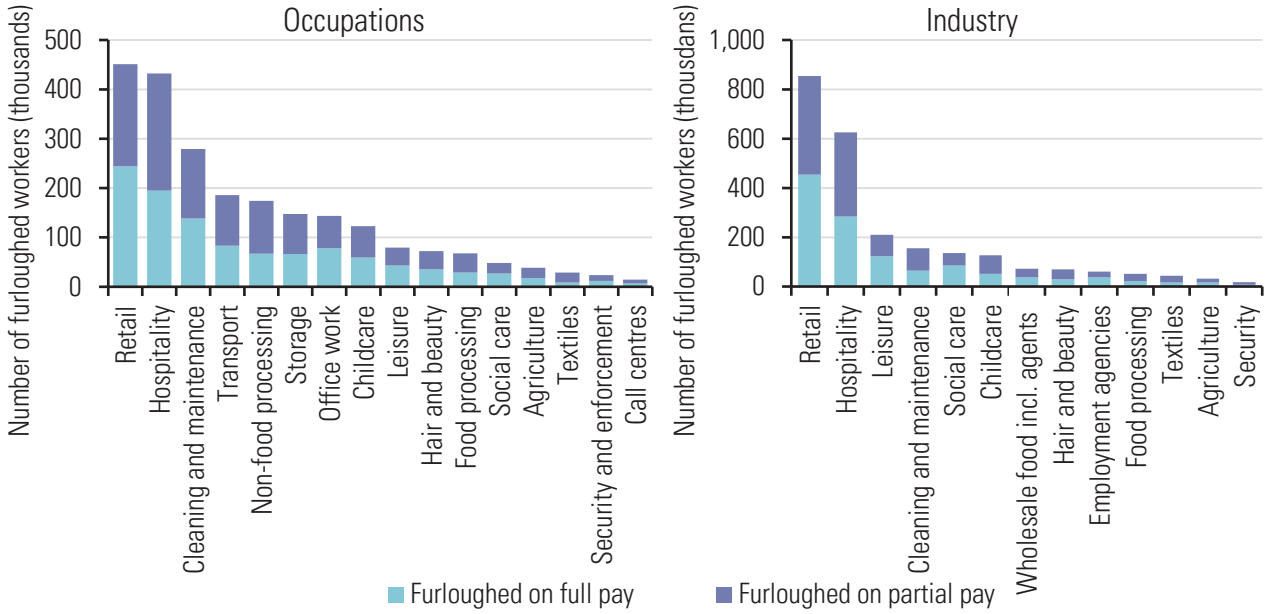
4.85 In a normal year we examine how the most recent uprating of the NLW has impacted on the pay of the workers affected. We would typically examine how hourly pay has grown across the pay distribution, including looking at spillovers from the NLW, and how pay has grown in different sectors of the economy. However, issues with ASHE data, and the effects of the CJRS, mean that many of our typical measures cannot be calculated (see paragraphs 3.15 to 3.19).

Use of the CJRS and pay for furloughed workers

4.86 As set out above, the CJRS covered up to 80 per cent of the pay in the worker received in February 2020, or the average pay between April 2019 and March 2020. However, we know that many employers chose to 'top-up' the pay of their workers to their typical level of pay. ONS have matched information on furloughed employees from the CJRS database into the ASHE data set. From that we can look at how much workers have earnt, and whether or not their employer topped up their pay to 100 per cent of its normal level. Employers who fill in the ASHE data returns are asked to indicate if the employee had received a 'loss of pay' due to absence. Guidance from the ONS asked employers to indicate this if the worker was furloughed on less than 100 per cent of pay. Therefore when we examine use of furloughing we split furloughed workers into those 'with loss of pay' (furloughed at less than 100 per cent of normal pay) and those 'without loss of pay' (furloughed at 100 per cent of normal pay). We interpret this split in the chapter as those furloughed on partial pay, and furloughed on full pay respectively.

4.87 Figure 4.10 shows that there were around 2.3 million employees aged 25 and over who were furloughed in low-paying occupations, and 2.5 million in low-paying industries, out of 5.8 million workers aged over 25 who were furloughed. Around 850,000 workers were furloughed in the retail industry and 600,000 in the hospitality industry, with about a million split across the remaining low-paying industries.

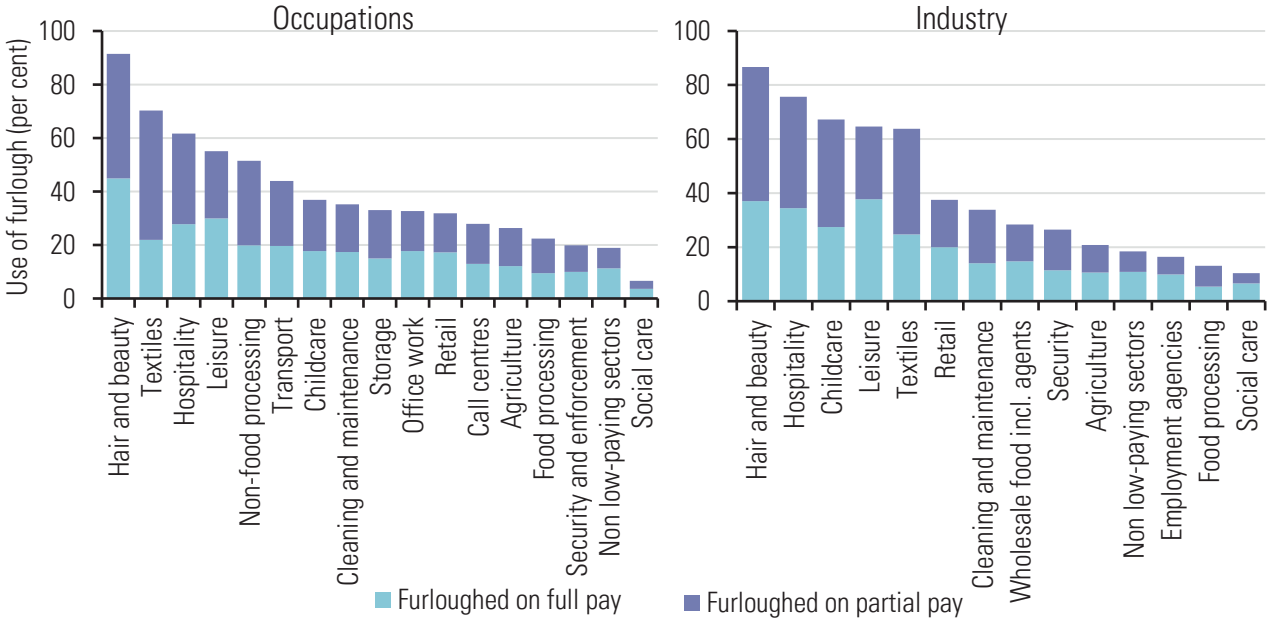
Figure 4.10: Number of furloughed employees in low-paying sectors, for workers aged 25 and over, UK, 2020



Source: LPC estimates using ASHE 2010 methodology, low-pay furloughed weights, UK, 2020.
Note: Data exclude first year apprentices.

4.88 Figure 4.11 shows the proportion of workers who are furloughed by occupation and industry. More than four in every five workers in the hair and beauty sector were furloughed in April (at a time that hairdressers and beauty parlours were closed by lockdown restrictions). Over 60 per cent of workers in the hospitality, childcare, leisure and textile industries were furloughed, while social care had very low furloughing rates, with only 10 per cent of workers in the social care industry, and 7 per cent of workers in low-paid social care occupations on furlough. Overall, 36 per cent of workers in low-paying industries were furloughed against only 18 per cent in non-low paying industries.

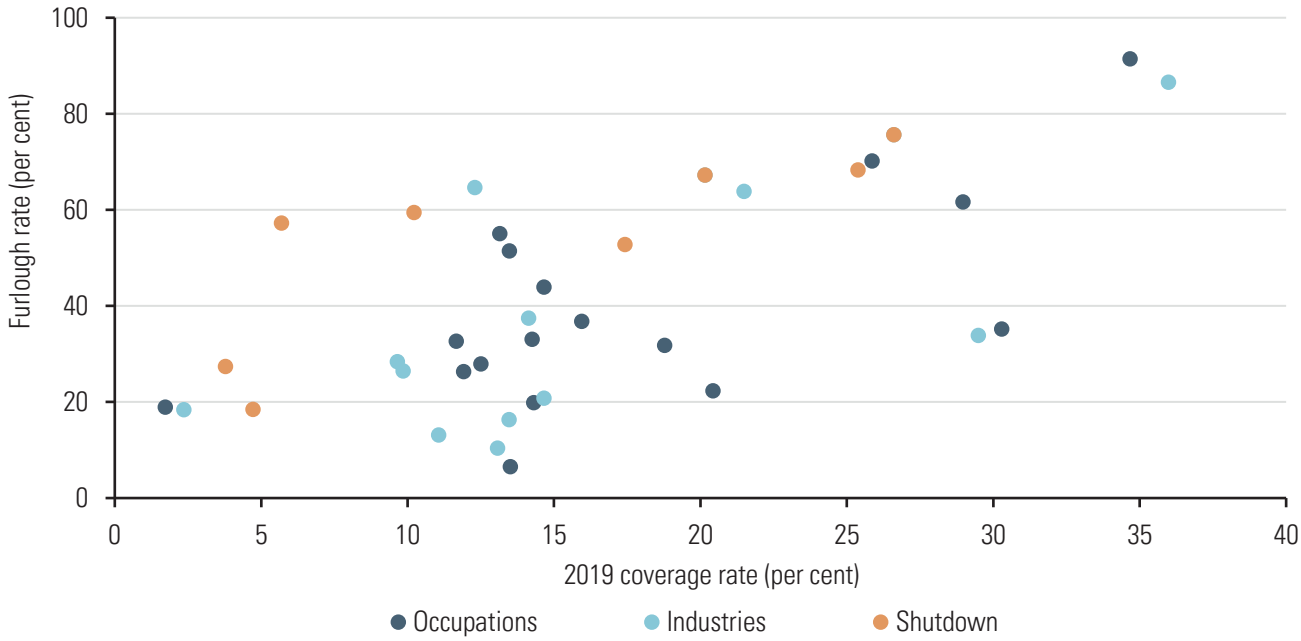
Figure 4.11: Use of furloughing for employees aged 25 and over, by sector, UK, 2020



Source: LPC estimates using ASHE 2010 methodology, low-pay furloughed weights, UK, 2020.
Note: Data exclude first year apprentices.

4.89 Figure 4.12 shows the relationship between use of the CJRS in 2020 and use of the minimum wage in 2019 by low-paying industry and occupation. Even within low-paying industries and occupations there appears to be a positive relationship between use of furloughing and use of the minimum wage, where industries and occupations that had higher coverage last year were also typically more likely to use the furlough scheme. However, the relationship is not very strong, with industries and occupations with similar coverage in 2019 having different furloughing rates in 2020.

Figure 4.12: Use of furloughing for employees aged 25 and over against coverage in 2019, by occupation and industry, and for shutdown sectors, UK, 2019-2020



Source: LPC estimates using ASHE 2010 methodology, low-pay furloughed weights, UK, 2019-2020.
Note: Data exclude first year apprentices.

4.90 Table 4.3 shows a comparison between stated and derived pay for workers furloughed on partial pay, who have a stated hourly rate. There is a range of ratios between stated and derived pay that exist in the data. However, around 30 percent of workers have a ratio of derived to stated hourly pay that is within one percentage point of 80 per cent. A further 27 per cent have a ratio of above 81 per cent but below 100 per cent.

Table 4.3: Ratio of derived pay to stated hourly pay for workers who are furloughed with loss of pay, UK, 2020

Ratio of derived pay to stated hourly pay	Proportion of workers furloughed on partial pay per cent
Less than 79%	15
79%-80%	10
80%-81%	19
81%-90%	14
90%-100%	13
100%	17
More than 100%	13

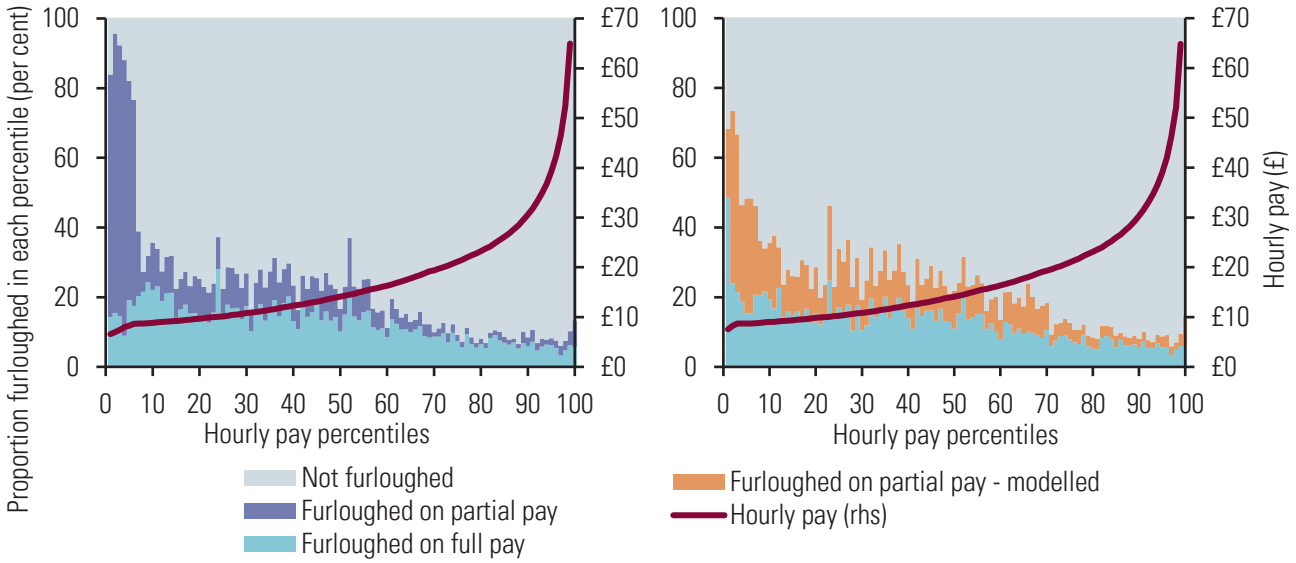
Source: LPC estimates using ASHE 2010 methodology, low-pay furloughed weights, UK, 2020.
Note: Data exclude first year apprentices. May not sum to 100 due to rounding.

4.91 Figure 4.13 shows the proportion of furloughed workers in each hourly pay percentile. The figure on the left shows pay percentiles as calculated based on the standard ASHE derived hourly pay variable. As described in paragraph 3.18 there is an issue with using the derived pay for employees who are furloughed with a loss of pay. As shown in Table 4.3 for many of these workers their calculated pay is up to 20 per cent lower in ASHE than the hourly rate they were paid in February. Therefore, workers furloughed on partial pay would be shifted down the earnings distribution versus their actual pay. We expect this approach would overrepresent the proportion of the lowest paid group who are furloughed employees on partial pay.

4.92 To overcome some of the issues with this we have created a variable that models the hourly pay employees who were furloughed with a loss of pay would have received in February. This is used to create the right-hand-side figure. To do this we take the stated hourly pay rate for the 40 per cent of furloughed workers with loss of pay who have one and use this instead of their derived pay. For the remaining 60 per cent we take their derived hourly rate and multiply it by 1.25 which would return the derived hourly wage of someone on 80 per cent of their normal pay back to 100 per cent of it[5]. Another issue is that furloughed individuals may have missed any pay increase that would have occurred in March or April (coinciding with the end of the financial year, and the NLW uplift).

4.93 Both figures show that furloughing is more common at lower pay levels. The chart on the right, which probably gives a slight underestimate of the use among the lowest paid, still shows that around 60 per cent of the lowest-paid twentieth of workers were furloughed and slightly more than half of the lowest-paid tenth of workers were furloughed. This compares with just 23 per cent of all workers in the distribution, and 9 per cent of the best paid tenth. However, it is clear that furloughing has happened across the pay distribution.

Figure 4.13: Use of furloughing for employees aged 25 and over, by hourly pay percentile, UK, 2020

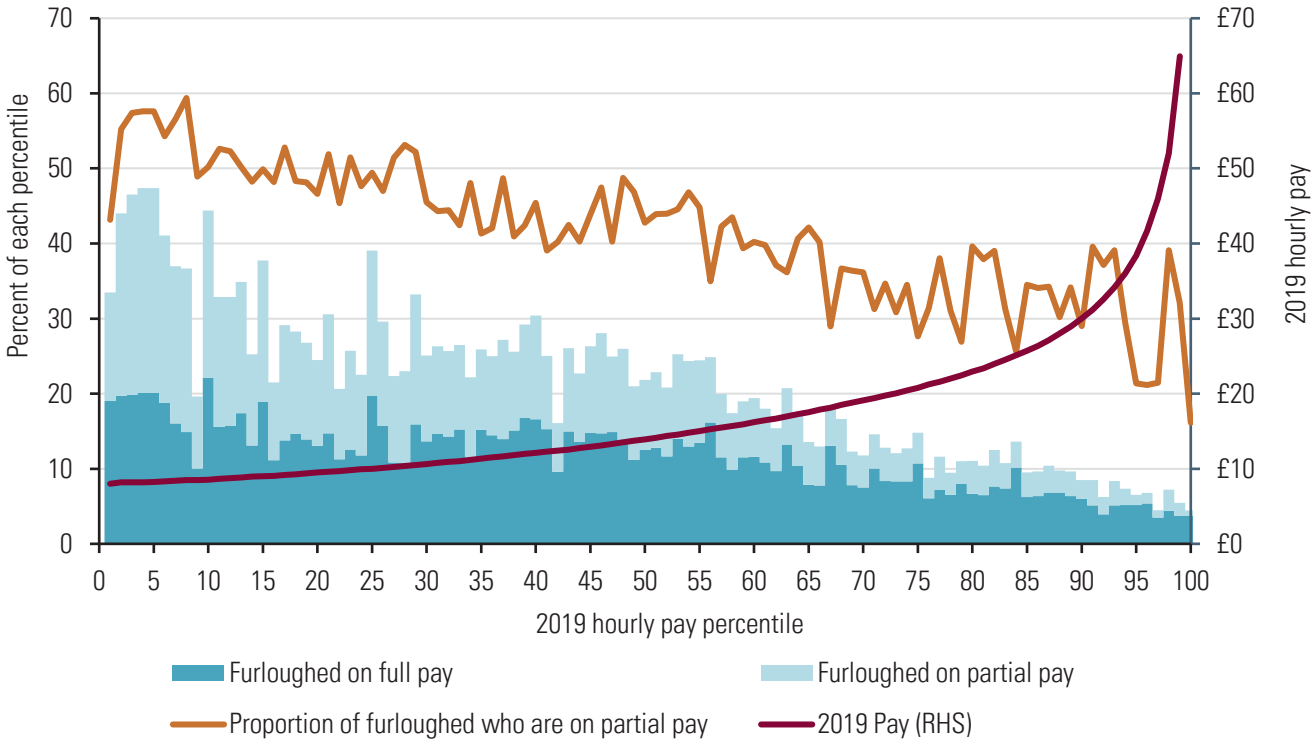


Source: LPC estimates using ASHE 2010 methodology, low-pay furloughed weights, UK, 2020.
Note: Data exclude first year apprentices.

[5] This is likely to overestimate the level of pay in February on average (at least among lower-paid individuals). Some employees may have had their pay partially topped-up to a level above 80 per cent but below 100 per cent of their normal pay and multiplying their derived pay by 1.25 would take their modelled hourly pay above 100 per cent of the February figure. On the other hand employees furloughed on the maximum CJRS claim of £2,500 a month may still have their pay underestimated.

4.94 Figure 4.13 also implies that the lower paid a worker who is furloughed is, the more likely they are to be furloughed on partial pay. However, this analysis is biased as being furloughed on partial pay will by definition affect any measure of pay. We can aim to overcome this by using a variable that is related to pay in 2020, but will not be affected by this bias. Figure 4.14 therefore uses pay data from 2019 (for those who we have been able to identify in 2020. The benefit of using pay in 2019 is that it is unaffected by the pay measurement issues and pay in one year is generally a good predictor of pay in the next. Figure 4.14 finds that, similar to Figure 4.13, furloughing is more common at the lowest pay bands. Moreover, we can see that furloughing on partial pay makes up a larger proportion of furloughing at the lower end of the pay scale. Around 40 per cent of workers in the lowest pay band in 2019 (who were in the data in 2020) were furloughed, and more than half of these furloughed workers were on partial pay. For the highest paid fifth of workers, only eight per cent were furloughed, and only about a third of these were on partial pay.

Figure 4.14: Furlough status by 2019 pay for workers aged 25 and over, UK, 2019-20

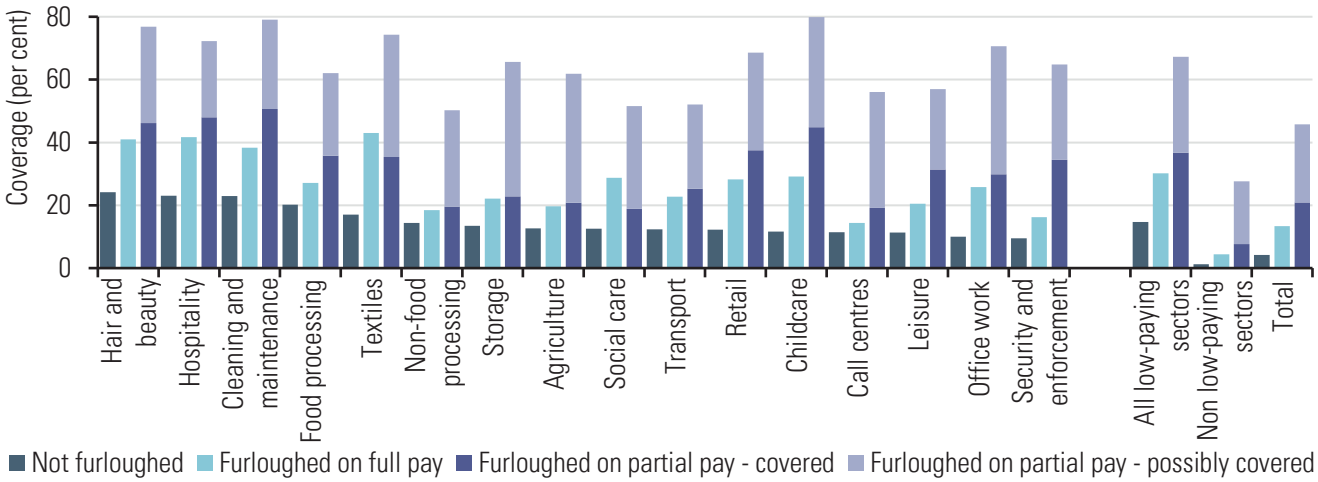


Source: LPC estimates using ASHE 2010 methodology, standard weights, UK, 2019-2020.
Note: Data exclude first year apprentices.

4.95 The issues with ASHE also make it difficult to estimate who is covered by the NLW in 2020. We have historically defined coverage as those who earn less than five pence more than the NLW. Figure 4.15 and Figure 4.16 keep coverage defined in these terms for those workers who were furloughed on partial pay and for those furloughed on full pay. For workers who were furloughed on partial pay we have estimated coverage using modelled pay and defined those as 'covered' (in dark purple), and estimated those who are additionally covered using their derived pay and called these 'possibly covered' (in lighter purple). These definitions do not take into account the number of furloughed workers who missed a planned wage uplift in March or April, so coverage for these groups would be expected to be slightly higher than for non-furloughed workers, even if the underlying pay distributions were similar for both groups.

4.96 Figure 4.15 shows these coverage estimates for low-paying occupations. It appears that even within occupational groups coverage is higher for workers who were furloughed on full pay and even higher for those who were furloughed on partial pay. This suggests that minimum wage workers were more likely to be furloughed, and to be on partial pay while being so, even when compared with slightly better-paid workers in similar roles. However, the issues outlined in paragraph 4.95 mean that caution should be exercised when reading into this.

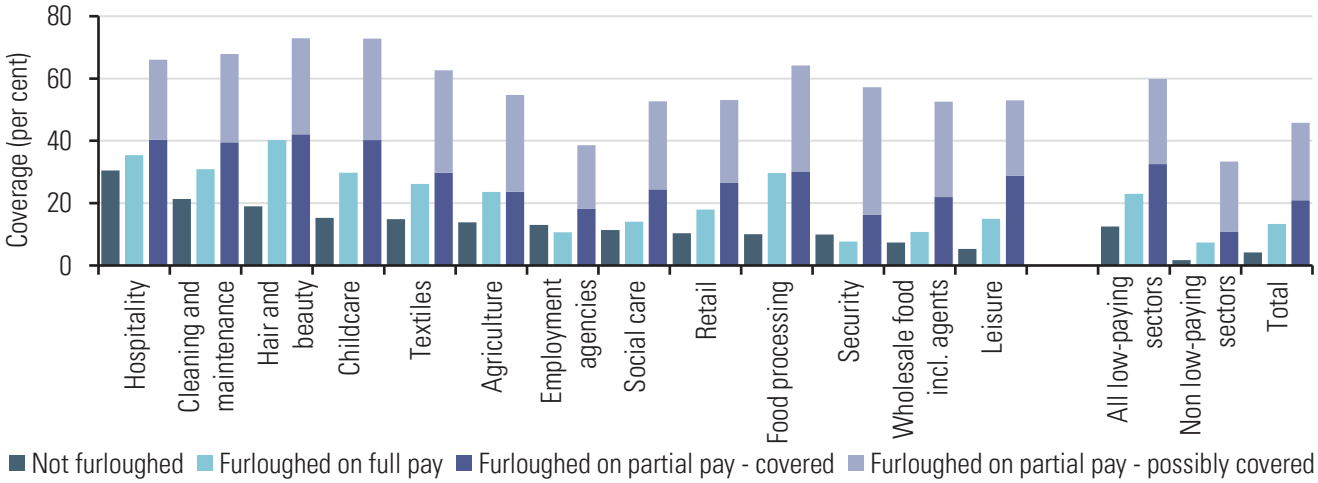
Figure 4.15: Coverage for employees aged 25 and over, by occupation and furlough status, UK, 2020



Source: LPC estimates using ASHE 2010 methodology, low-pay furloughed weights, UK, 2020.
Note: Data exclude first year apprentices.

4.97 Figure 4.16 shows coverage by furlough status for low-paying industries. It again appears that within industries coverage is higher for workers who were furloughed on full pay and even higher for those who were furloughed on partial pay. This suggests that the lowest-paid employees within an industry were more likely to be furloughed, and to suffer loss of pay while being so, even when compared with better-paid workers. Again, the issues outlined in paragraph 4.95 mean that to some extent, this could be a product of data issues and not reflect an underlying relationship.

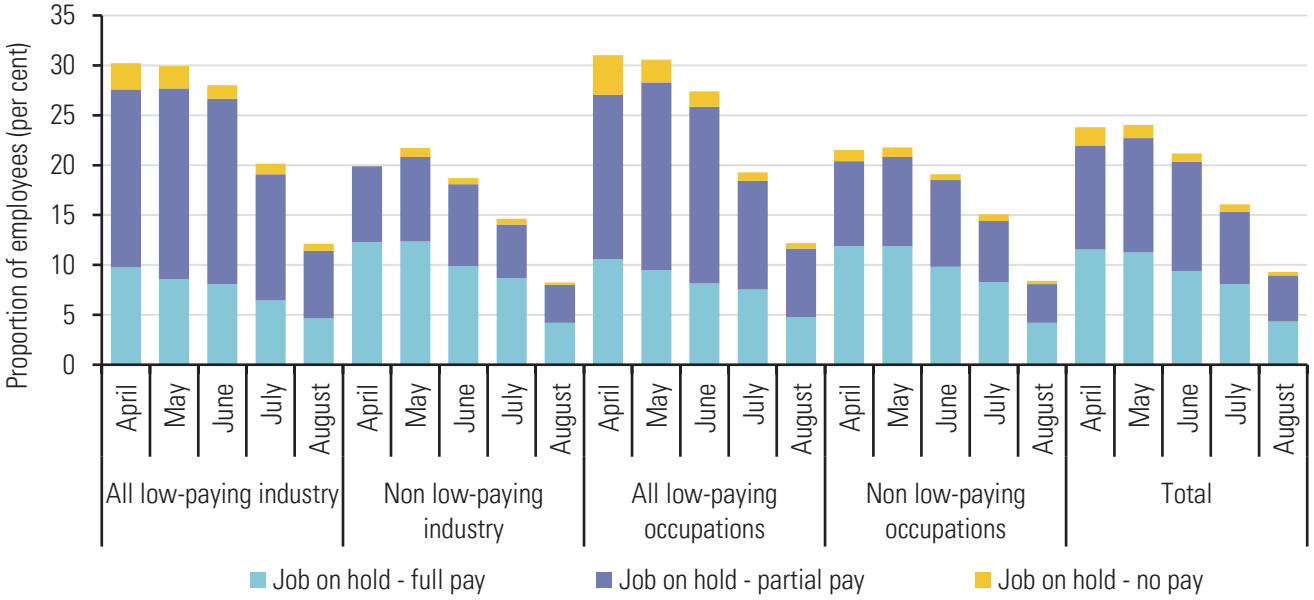
Figure 4.16: Coverage for employees aged 25 and over, by industry and furlough status, UK, 2020



Source: LPC estimates using ASHE 2010 methodology, low-pay furloughed weights, UK, 2020.
Note: Data exclude first year apprentices.

4.98 We can also look at this issue in other data. From Q2 2020 the Labour Force Survey asked those whose job was 'on hold' due to the coronavirus if they received full pay, partial pay, or were unpaid. Figure 4.17 shows that the number of employees whose jobs were on hold declined by around 60 per cent between April and August. Again we see that workers in low-paying occupations and industries are more likely to have their job be on hold, and to be on partial pay if that is the case. Despite this fall, the proportion of employees whose job is on hold and below full pay remained fairly constant at around a half and the proportion whose job is on hold who are in low-paid sectors remained reasonably steady at around a quarter.

Figure 4.17: Employees aged 23-64 whose jobs are on hold and their pay, by month, occupation and industry, UK, 2020



Source: LPC estimates using LFS microdata, population weights, quarterly, UK, Q2 2020 – June-Aug 2020.

4.99 Overall, the analysis suggests that furloughing exists across all levels of pay, but was higher for lower-paid workers and those in low-paying sectors of the economy. This partly reflects the nature of the jobs that these workers do, and the impact of the lockdown and social distancing on these roles; the lowest-paid industries and occupations have typically been those most affected by the lockdown. It may be that the lowest-paid jobs will on average be in roles where wages make up a higher proportion of total costs, and that therefore the opportunity cost of furloughing employees in these roles is lower.

4.100 Of those workers who were furloughed, the data suggest that workers with lower levels of pay were less likely to experience their employers topping-up their pay to its normal level. This could be due to low-paying employers being less able to afford such top-ups or it could be due to differing levels of market power and lower matching benefits (workers are more substitutable) in these parts of the economy.

Research on pay and progression

4.101 Avram and Harkness (2020) updates analysis published last year Avram and Harkness (2019) that used longitudinal data to examine how the introduction of the NLW and its first uprating affected minimum wage workers ability to progress into higher paying jobs. The authors use the UK Longitudinal Household Survey to examine transitions from minimum wage jobs into jobs that were either 'low-paid' (paid less than two-thirds of the average wage) or 'high-paid' (paid more than two-thirds of the average wage) or into non-employment. They also examine what other personal and job characteristics are associated with progression into higher paying employment. The authors used variation in minimum wage coverage across travel-to-work-areas to try to isolate the effect of the NLW on progression.

4.102 The authors added another wave (2018) of the UK Longitudinal Household Survey, and slightly revised their sample selection criteria to retain more cases. The results are similar to last year. Around half of minimum wage workers are able to move into better-paid employment in any given year, but most of this mobility is short range: around four-fifths of minimum wage workers who find better paid jobs continue to earn below two-thirds of median earnings.

4.103 The researchers find that the introduction of the NLW in 2016 temporarily increased the probability that a worker will remain in a minimum wage job. A worker who lived in a local area with a one percentage point higher share of minimum wage workers had an increased probability of remaining in a minimum wage job in 2016 of four percentage points or 10 per cent. The authors found that the effect is temporary and disappears in 2017 and 2018. The researchers conclude that they found no evidence that minimum wage workers' progression chances have been affected by increases in the minimum wage in the long term.

4.104 Bryson, Phan and Stokes (2020) submitted a report to us as part of a project that we are co-sponsoring to improve the ASHE data set. The researchers aimed to create a longitudinal panel data set by creating a time-consistent ASHE and New Earnings Survey (ASHE's predecessor) wage spine. They undertook substantial quality assurance tests on the data, including: cleaning existing variables, quality assuring them, and supplementing them with additional data items (such as unique longitudinal identifiers for individuals, employers and jobs). Their initial report explored estimates of the proportion of jobs on and paid around the minimum wage; low paid jobs paid above the minimum; and 'high paid' jobs. They demonstrate the percentage of jobs paying around the minimum wage has risen over the period, but so too has the number of 'high-paid' jobs.

4.105 We have also used ASHE to look at annual pay growth for workers. We linked ASHE data sets for subsequent years together to look at how pay changed for workers who were in the data sets in both years. The method we use necessitates removing individuals with multiple jobs in the data. We split the data between those who are in the same job in both years, those who have moved jobs within the same employer (those whose employer had indicated that they have been in their job for less than twelve months, but whose employer start date is consistent across years) and those who have moved jobs (those whose employer had indicated that they have been in their job for less than twelve months and whose employer start date has changed across years).

4.106 We find job changes are considerably more common for younger workers and for those in low-paying occupations. Workers paid the minimum wage were more than twice as likely to move jobs than workers paid more than £5 above the pay floor. Around two-fifths of workers who move out of low-paying occupations move into non low-paying ones[6]. We find that median pay growth is higher for those that move jobs (both within and between employers) than those who do not, but that there is a wide variation in the wage growth employees experience year-on-year. We find that the lowest-paid workers have seen the fastest median growth, and that since 2015-16 this is mostly driven by the increases in the minimum wage. We also find that moving into a non low-paying occupation is very beneficial for workers in low-paying occupations.

4.107 Incomes Data Research (2020d) constructed 22 case studies of low-paying employers through interviews with Human Resources managers. The research looks into how employers have responded to the past increases in the NLW, are planning to respond to the new target, and have been affected by the Covid-19 pandemic. The report draws out the following key findings from the case studies: the NLW has had significant implications for wage compression and differentials; many employers have limited scope to offset further increases by reducing terms and conditions; the announced changes to the NLW qualifying age are of little concern to most employers; the lockdown has had a significant impact on businesses and their pay decisions; and there is evidence of greater use of technology and multiskilling from low-paid staff.

4.108 A study by the Learning and Work Institute for the Carnegie UK Trust Gooch and Dromey (2020) found strong and broad-based support for further increases in the NLW. The study finds that many low-paid workers feel that increases will not significantly improve their financial situation with a view that any increases in pay may be offset by a reduction of in-work benefits and that employers may respond with measures which will compromise other aspects of good work.

Conclusion

4.109 The Covid-19 crisis and the lockdown has had a significant impact on the labour market for low-paid workers. Up to March 2020 the labour market for low-paid workers was strong. Employment was high and increasing for workers with demographic characteristics associated with higher minimum wage use. Employment was up in areas of the country with wider minimum wage use. While employment was down in low-paying occupations and industries, this was in the context of a tight labour market inducing workers away from these sectors, as reflected in stakeholders' views of skill shortages.

4.110 However, the Covid-19 outbreak and the lockdown of the country has reversed this. Hours fell dramatically across the economy, but by more in low-paying occupations, and had not recovered by August, driven by large increases in the proportion of workers working no hours. Employment held up, initially supported by the CJRS, but started to decline in low-paying occupations and industries in June. Workers in low-paying occupations and industries, and those on lower wages, were more likely to be furloughed, and to suffer pay loss as a result of this. Therefore low-paying employers could be in a weaker position to respond to NLW increases without impacts on employment.

[6] The definition we use splits jobs into types by occupation (the tasks that the job entails) and not by pay as in Avram and Harkness (2020).

Chapter 5

Young people

Key findings

The labour market position of young people was already starting to soften, even before the onset of Covid-19. The employment rate continued to grow for workers aged 25 and over, but fell or plateaued for younger workers.

Young people are more likely to work in the sectors that were most affected by lockdown and social distancing measures, notably hospitality and non-food retail. As a result, they have been the most likely to see changes to their jobs through being furloughed and experiencing a reduction in pay and hours. Overall, the evidence suggests that low paid workers were most exposed to these changes.

As lockdown measures started to ease, there have been signs of young people returning to work. However, unemployment rates have started to creep up and there is uncertainty over what will happen in the coming months, particularly with further lockdown measures. Low vacancies and large volumes of young people leaving education may lead to a shortage of available jobs. Young people are especially hard hit by any downturn because of their relative lack of experience and reliance on vacancies to find work.

Last year we recommended that the eligibility age for the NLW be reduced to 23 in April 2021. This remains our position as the labour market continues to treat 23 and 24 year olds similarly to those aged slightly older. For example, there are similar numbers working in the most affected sectors, similar use of the minimum wage rates, and similar rates of furlough and hours loss through the crisis. Employer representatives told us that while they were concerned about increases to the NLW, they were far less concerned with the commitment to change the age eligibility.

5.1 In addition to the National Living Wage (NLW), the Low Pay Commission advises on the level of the three youth rates which are the wage floors for workers aged 16-17, 18-20 and 21-24. Our remit for these rates is to raise pay as far as possible without damaging employment prospects.

5.2 In 2019, we reviewed the structure of the youth rates (Low Pay Commission, 2019a), concluding that there was a strong case for lowering the NLW from 25 to 21, moving first to 23 in 2021. From next year, 23-24 year olds will therefore start to be paid at least the NLW. This year marks a change in the pay floor for this age group, and in the structure of the minimum wage rates with the temporary introduction of a 21-22 Year Old Rate. The Government has committed to lowering the threshold to 21 by 2024.

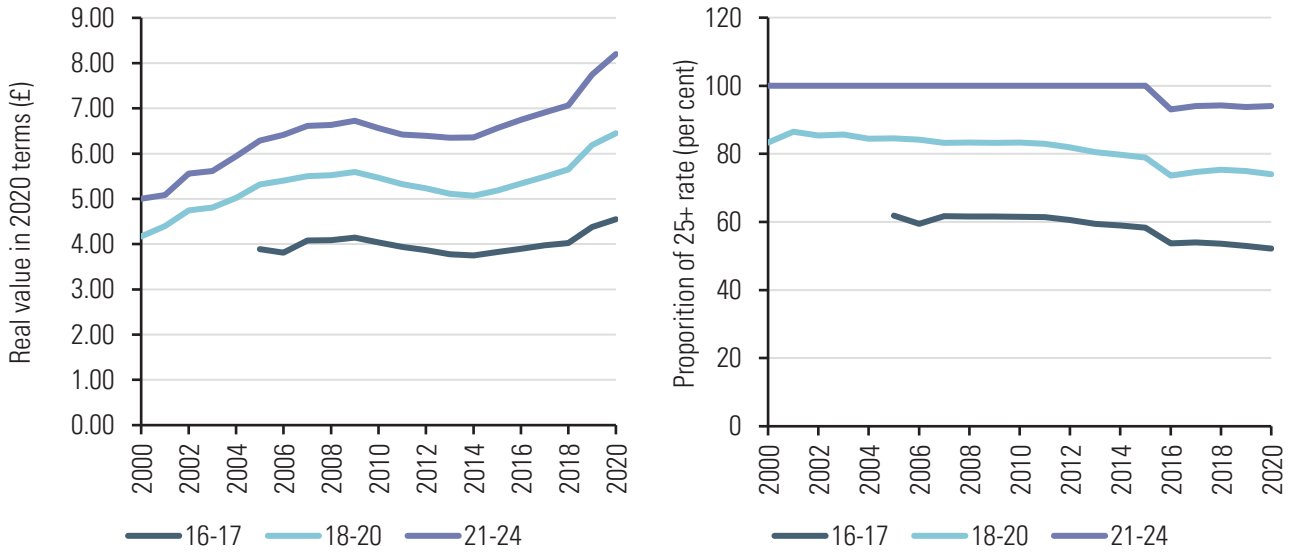
5.3 This has clearly been a challenging year for young people. Young people are more likely to work in the sectors that have been hit hardest by the social distancing measures introduced to manage the Covid-19 pandemic, including hospitality and non-essential retail. The crisis is likely to damage the employment prospects of young people in the short-term, and there is a high risk that they will suffer long-term damage as well. There is strong evidence that young people are highly susceptible to scarring, with poorer labour market outcomes lasting for several years beyond any unemployment spell (Gregg, 2004 and McQuaid, 2015). The scale and efficiency of government support for this age group will be crucial over the coming months, and it is important that the level of the youth rates is set in a way that both recognises the sacrifices that young people have had to make and takes this challenging labour market context into account.

5.4 In this chapter, we will look back at the impact of recent increases in the youth rates; at the changes in labour market activity throughout the pandemic; and then forwards to what young people may be facing in April 2021. We will also consider whether the evidence still supports lowering the age threshold for the NLW to 23 in April 2021.

The youth rates

5.5 The rationale for age-related minimum wage rates is that younger workers are at higher risk of being priced out of jobs than older workers. Average wages for younger workers tend to be lower, perhaps because they have less workplace experience and/or are in a weaker bargaining position. Furthermore, young people are more likely to experience a scarring effect if they spend time out of work, with lower wages that can last for several decades. While research into the impact of minimum wages has generally found that increases have improved earnings without significant effects on employment, there is some international evidence of negative effects for the youngest workers, with the risks greater during a recession (Wascher and Neumark, 2007 and Dolton and Rosazza-Bondibene 2011).

Figure 5.1: Real and relative value of the NMW rates, UK, 2000-2020



Source: LPC estimates using CPI (D7BT), UK, 2000-2020.

5.6 With relatively robust employment in recent years, we have been able to recommend above-inflation increases to the youth rates. Figure 5.1 shows that the value of the youth rates has increased in real terms, particularly since the introduction of the NLW in 2016 and with substantial increases in 2018-2020, when large increases in the rates coincided with weak inflation. The value of the youth rates relative to the adult rate decreased when the NLW was introduced but has since been largely maintained.

5.7 Not all younger workers are paid the youth rates. In 2019, fewer than one in ten workers aged 16-24 were paid at the relevant youth rate, and just over a third were paid less than the NLW and were therefore paid within the youth rate structure. Stakeholders report that employers may be reluctant to use the sub-NLW rates because of the appearance of fairness and because they may find it difficult to recruit and retain staff. Employers report using the same rate for all staff regardless of age or using the youth rates only partially (Hudson-Sharp, Manzoni, & H. Rolfe, 2019).

The youth labour market

5.8 In this section we assess the impact of the NMW rates on the employment and hours of young people. As with Chapter 4, we focus on the period up to the first quarter of 2020. This excludes the most recent increases to the youth rates and the spring lockdown. We will look in more detail at how their employment and hours changed in lockdown in the following section.

Economic activity

5.9 The age groups covered by the youth rates look very different in terms of their economic activity. Table 5.1 shows that among the youngest age groups, most are in full time education. For older age groups, a greater proportion are in work but there is also a significant group of young people who are unemployed or inactive and not taking part in full-time education. We are particularly interested in young people who are not in full-time education, who are more exposed in the labour market and at greater risk of scarring if they go through a spell of unemployment.

Table 5.1: Economic activity of young people aged 16-24, Q1 2020, UK

	Full time education only		Full time education and employment		Employment only		Unemployment		Inactivity	
	Q1 (per cent)	Change 2019 Q1 - 2020 Q1	Q1 (per cent)	Change 2019 Q1 - 2020 Q1	Q1 (per cent)	Change 2019 Q1 - 2020 Q1	Q1 (per cent)	Change 2019 Q1 - 2020 Q1	Q1 (per cent)	Change 2019 Q1 - 2020 Q1
16-17	66.7	-1.0	19.1	-0.4	6.2	0.4	2.4	0.7	5.6	0.3
18-20	34.0	-1.5	17.3	0.8	33.5	-0.2	5.4	0.1	9.7	0.9
21-22	19.2	0.8	10.7	-0.0	53.5	-0.8	6.7	0.6	9.8	-0.6
23-24	7.2	-0.3	4.2	-0.5	72.8	0.5	5.6	0.4	10.3	-0.1

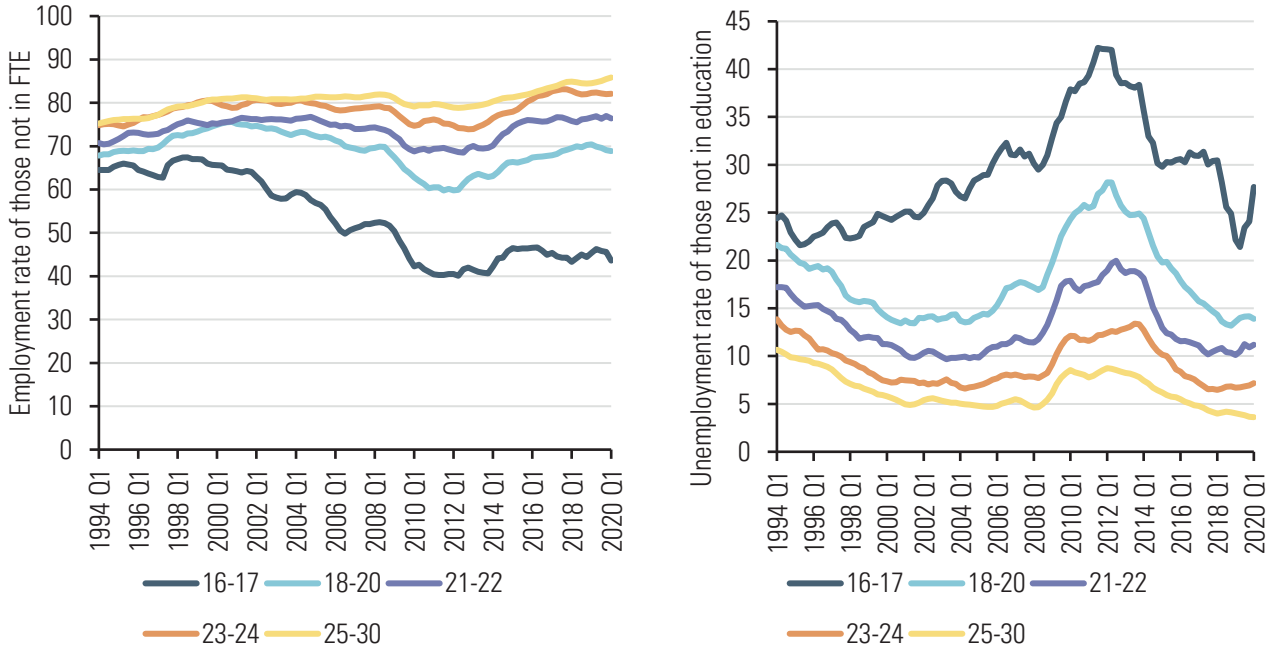
Source: LPC estimates using LFS microdata, population weights, not seasonally adjusted, four quarter rolling average, UK, 2018 Q2 – 2020 Q1

5.10 Even before Covid-19 hit, there were signs that the labour market was beginning to soften for young people as shown in Figure 5.2. For those not in full-time education, the unemployment rate rose by 5.5 percentage points for 16-17 year olds between 2019 Q1 and 2020 Q1, by 0.3 percentage points for 18-20 year olds, by 1.1 percentage points for 21-22 year olds and by 0.5 percentage points for 23-24 year olds between Q1 2019 and Q1 2020. This is compared with a marginal fall in unemployment of 0.4 percentage points on the year for 25-30 year olds.

5.11 Meanwhile the employment rate fell by 1.8 percentage points for 16-17 year olds and by 1.5 percentage points for 18-20 year olds not in education over the year. The employment rate for 21-24 year olds remained relatively steady, falling by 0.3 percentage points for 21-22 year olds and 0.2 percentage points for 23-24 year olds compared with Q1 2019. The employment rate of 25-30 year olds increased by 1.4 percentage points over the year.

5.12 It is worth noting that the employment rates for the youngest age groups can be volatile, because the number of young people in the Labour Force Survey (LFS) is small. However, it is concerning that there were falls in the employment rate across all age groups affected by the youth rates, even prior to the pandemic. Young people therefore went into the crisis already in a weaker labour market position.

Figure 5.2: Employment and unemployment of young people not in full-time education, UK,1994-2020

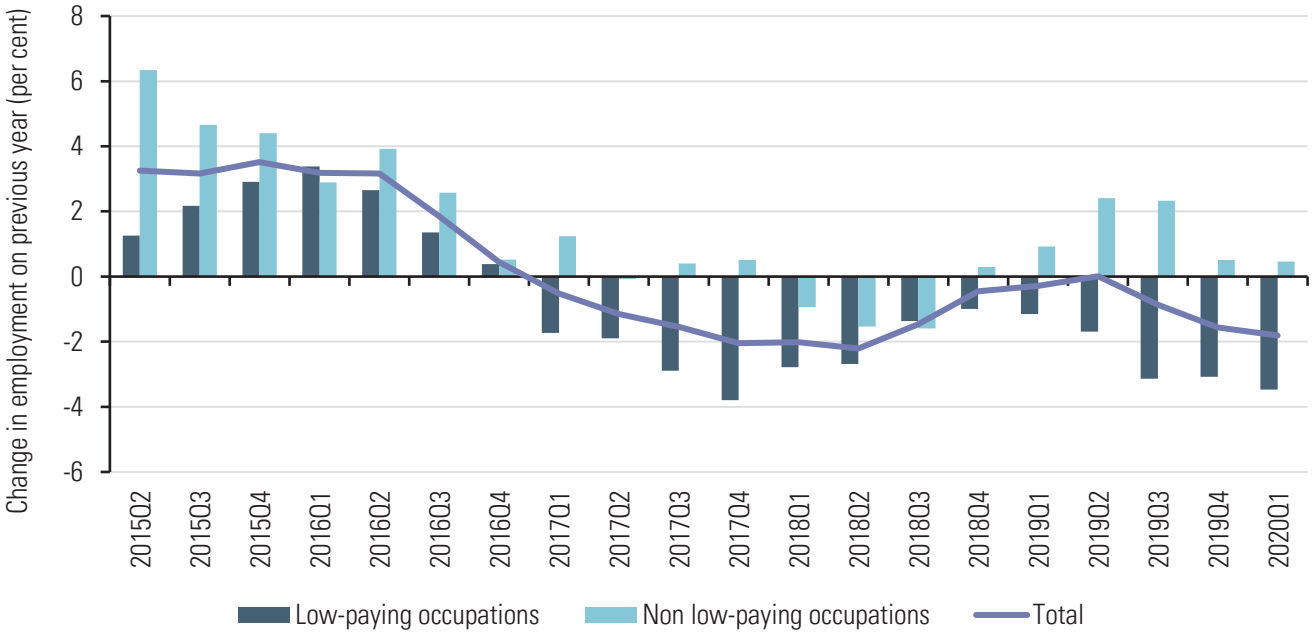


Source: LPC estimates using LFS microdata, quarterly, population weights, not seasonally adjusted, four quarter rolling average, UK, 1993 Q2- 2020 Q1.

5.13 As well as inspecting changes in employment by age group, we also look at changes in employment by sector. Some occupations are more likely to pay the minimum wage and young people in these roles are therefore more likely to be exposed to changes in the minimum wage. Figure 5.3 shows that the number of young people employed in low-paying occupations fell over the year to March 2020, while employment increased marginally in other occupations. This could be a product of a tight labour market, with young people having the flexibility to choose to work in better paid jobs. Some stakeholders, including the Early Years Alliance (EYA), the Food and Drink Federation (FDF), and the United Kingdom Homecare Association (UKHCA), reported difficulties in recruiting young people. Many cited low pay as a reason for this, with young people opting to work in other sectors where they can receive higher rates of pay.

5.14 Alternatively, it could reflect that traditionally low-paying sectors were becoming less able to afford to recruit new workers and employ young people. The Scottish Grocers' Federation told us that increases in the youth rates exacerbate cost pressures and reduce job opportunities for young people. There have also been demographic changes, with the population of 18-24 year olds steadily falling over the period. The effect of young people moving away from low-paying sectors is likely to be a combination of these factors. Overall, it suggests that the attachment between young people and these low-paying sectors was starting to weaken even before the pandemic.

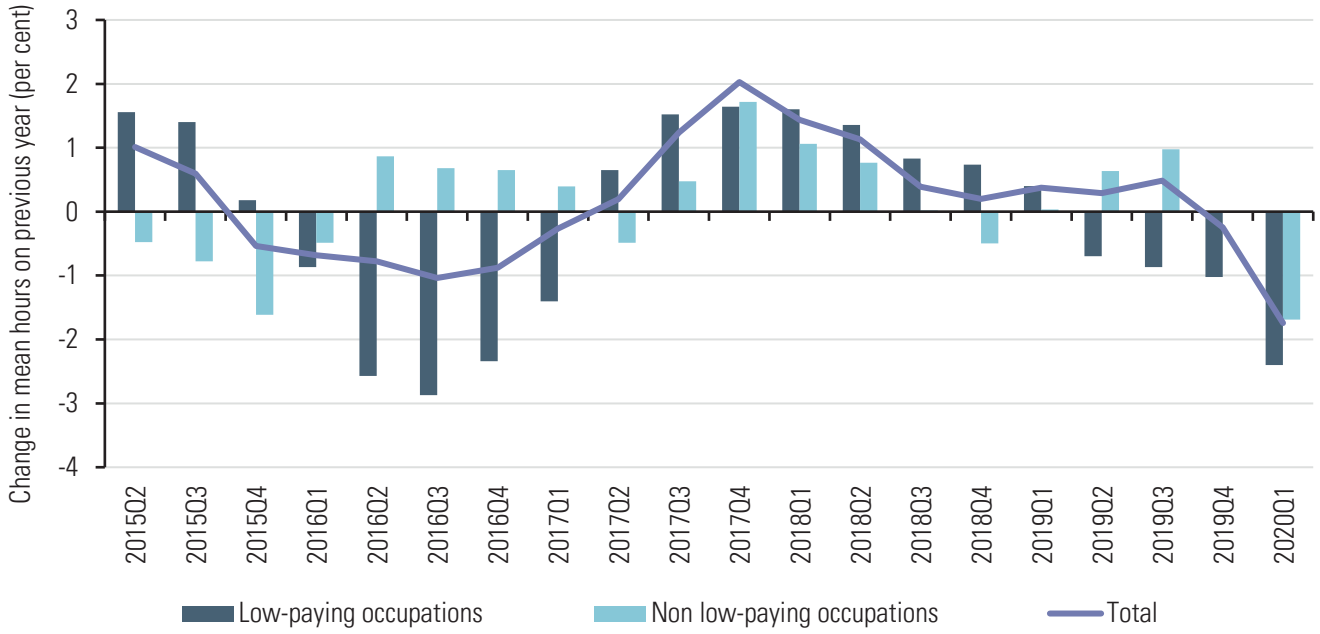
Figure 5.3: Change in employment of young people aged 16-24 by occupation, UK, 2015-2020



Source: LPC estimates using LFS microdata, population weights, four quarter rolling average, UK, 2014 Q2 – 2020 Q1.

Hours and underemployment

Figure 5.4: Change in average hours of young people aged 16-24 by occupation, UK 2015-2020



Source: LPC estimates using LFS, 2014 Q2 – 2020 Q1, population weights, four quarter rolling average.

5.15 Compared with the previous year, mean hours worked by young people fell in both low-paying and non low-paying occupations as shown in Figure 5.4. Average hours worked by young people fell by over 6 per cent in hospitality in the year to March 2020, even before the main impacts of Covid-19 were felt. However, hours can go down for a number of reasons and do not necessarily indicate affordability issues for employers. They could go down because of changes in the composition of workers or because young people are choosing to work fewer hours to fit around their other commitments. In fact, underemployment has in general been declining over recent years, although there has been a marginal increase in the last year; 20 per cent of workers aged 16-24 in low-paying occupations and 9.5 per cent of young workers in other occupations were underemployed in the first quarter of 2020 (Table 5.2). This suggests that most young people were happy with the number of hours that they worked.

Table 5.2: Underemployment of young people aged 16-24, UK, 2015-2020

	2015 Q1	2016 Q1	2017 Q1	2018 Q1	2019 Q1	2020 Q1
						per cent
Low-paying occupations	22.8	21.2	20.5	19.4	19.9	20.1
Non low-paying occupations	11.0	10.7	10.2	9.0	8.6	9.5
Total	18.0	16.9	16.2	15.0	15.0	15.5

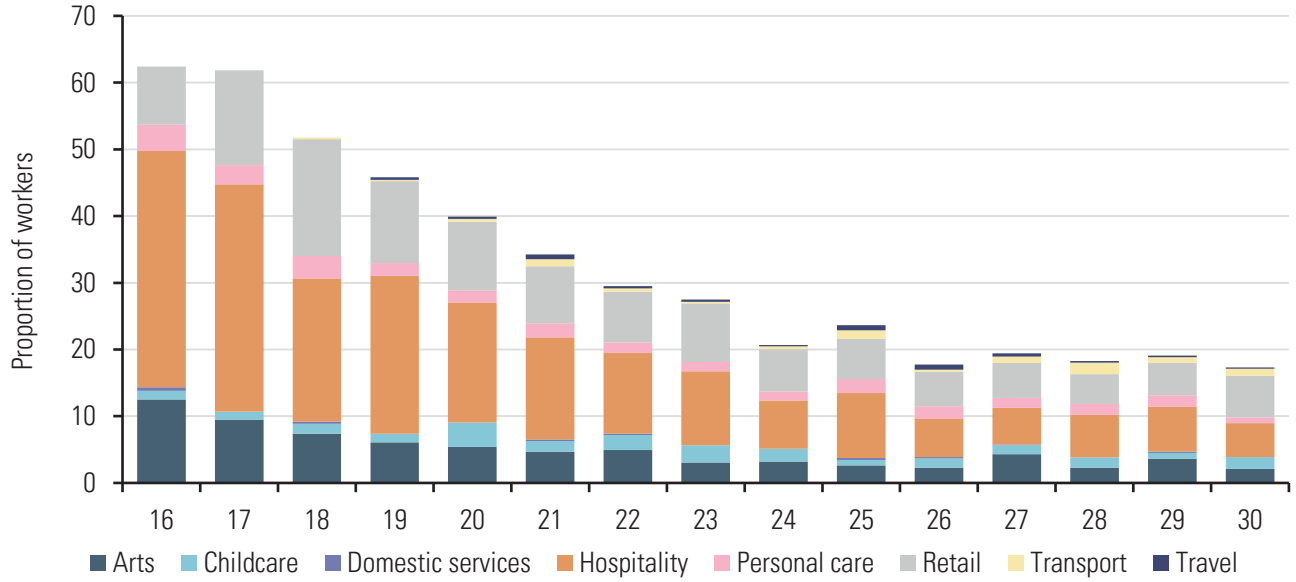
Source: LPC estimates using LFS microdata, population weights, not seasonally adjusted, four quarter rolling average, Q2 2014 – Q1 2020.

The youth labour market in lockdown

5.16 As set out in Chapter 1 (see Table 1.1) and Appendix 6, in March 2020, the Prime Minister announced that the country would go into lockdown from 23 March, with social distancing measures in place to limit the spread of Covid-19.

5.17 The sectors that were hardest hit by lockdown measures are among the most important for young people starting in the labour market, normally attracting large numbers of education leavers. Figure 5.5 shows that the youngest workers are most likely to work in these shutdown sectors, including more than half of employed 16-18 year olds. The sectors directly affected by lockdown measures are non-food and non-pharmaceutical retail; passenger transport; accommodation and food; travel; childcare; arts and leisure; personal care and domestic services (Joyce & Xu, 2020).

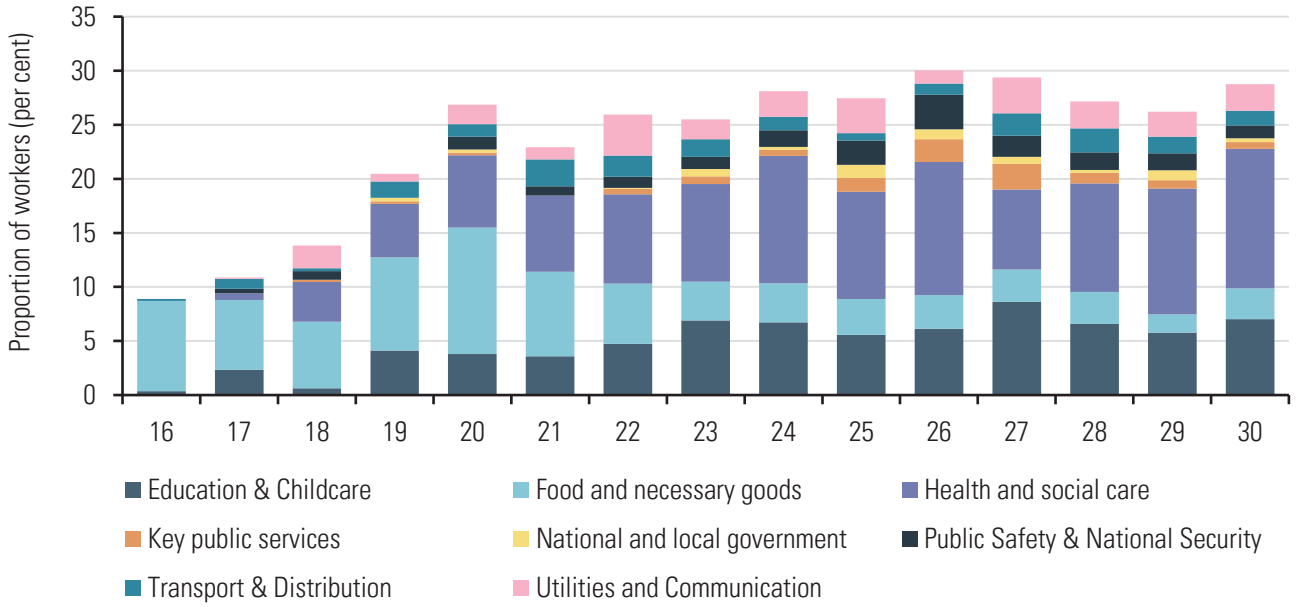
Figure 5.5: Proportion of young workers in lockdown sectors, UK, 2020



Source: LPC estimates using LFS microdata, population weights, not seasonally adjusted, four quarter average, UK, 2019 Q2 - 2020 Q1.
Note: Sectorial definitions from Joyce and Xu (2020).

5.18 While some sectors were forced to close, others worked throughout lockdown, providing essential services. The country became increasingly aware of these roles as a result of the pandemic and there are strong arguments that these key workers should be recognised and better remunerated because of their vital contribution. Figure 5.6 shows that young workers are less likely to work in these essential roles, but there are some that are more common, including working in food as well as roles in health and social care and childcare.

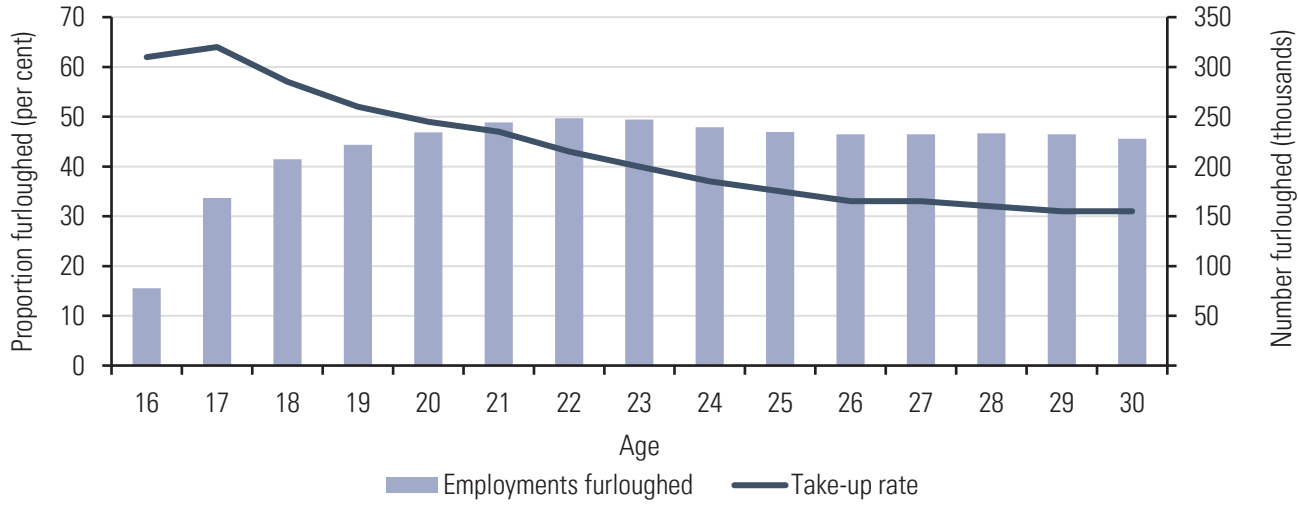
Figure 5.6: Proportion of young workers in key worker roles, UK, 2020



Source: LPC estimates using LFS microdata, population weights, not seasonally adjusted, four quarter average, UK, 2019 Q2 - 2020 Q1.
Note: Sectorial definitions from ONS SIC/SOC definitions of key workers.

5.19 On 19 March, the Government announced the Coronavirus Job Retention Scheme (CJRS, see Paragraphs 2.13 – 2.16 for more detail). The fact that young people are the most likely to work in the hardest hit sectors is borne out in the statistics on the use of the CJRS. These show that the youngest workers are more likely to have been furloughed (Figure 5.7). More than half of the roles held by 16-17 year old workers were furloughed, reducing to around one in three for workers over 25. 18 per cent of all furloughed employments were for workers under 25, despite this age group making up just 11 per cent of all jobs.

Figure 5.7: Proportion of jobs that were furloughed under the CJRS scheme, by age of worker, UK, August 2020



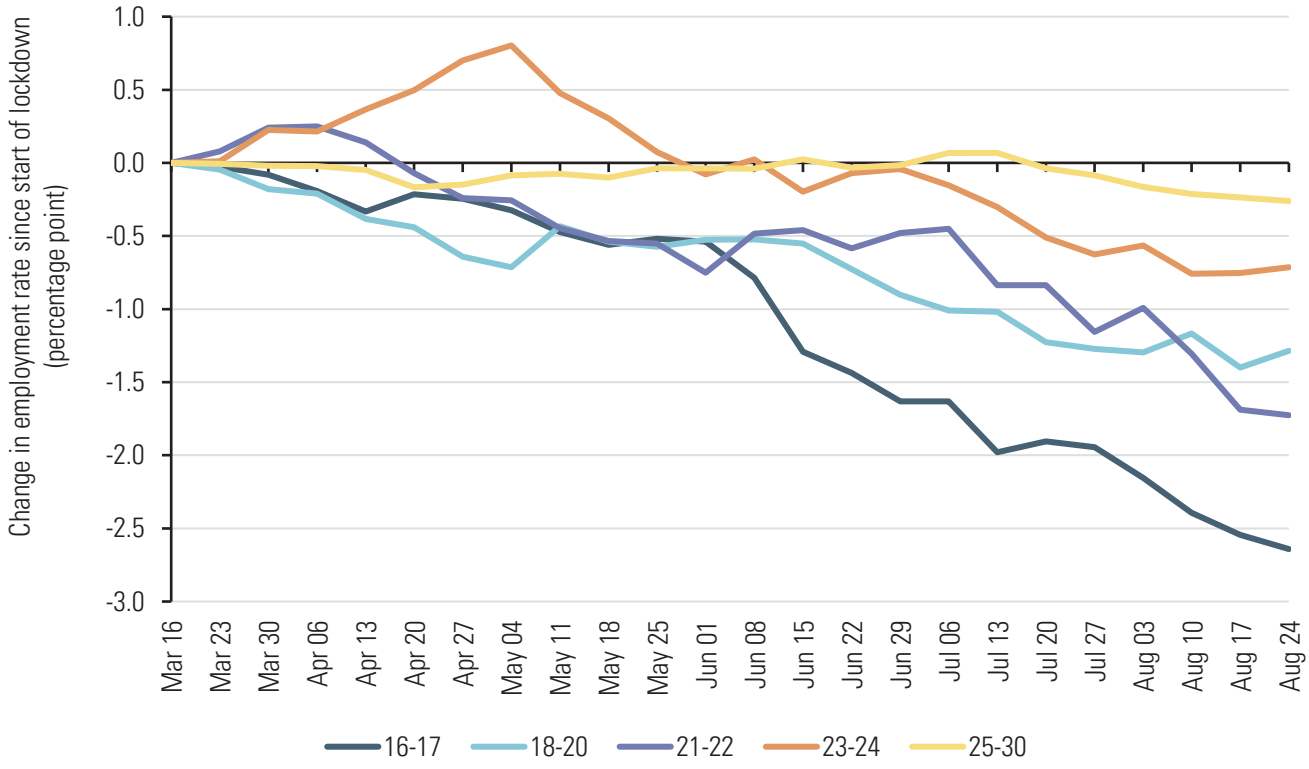
Source: HMRC CJRS statistics, UK, August 2020.

Impact on employment

5.20 Chapter 2 showed that furloughing had prevented large-scale job loss. However, even though furloughing was more prevalent for younger workers their employment rates have changed more substantially since the onset of social distancing measures. Figure 5.8 shows that the employment rate has fallen since the start of the national lockdown for all age groups affected by the youth rates. The falls have been largest for the youngest workers, with a reduction of 2.6 percentage points for 16-17 year olds, while the employment rate of 23-24 year olds has fallen by 0.7 percentage points over the period. This is likely to be just the start of more severe employment changes that will take place throughout the autumn and beyond (Henehan, 2020 and Bank of England, 2020a).

5.21 In this and the following section we consider how the labour market has evolved on a weekly basis. We use weekly data from the LFS, grouping responses by the week that the interview took place. We do not have access to the weekly weights developed by the Office for National Statistics (ONS), and so this analysis may not match their 'Single-month and weekly Labour Force Survey estimates' publication, but we use this as a reasonable way of monitoring the trends in the labour market over the period up until the end of August.

Figure 5.8: Change in employment rate since the start of lockdown by age, weekly data, UK, 2020

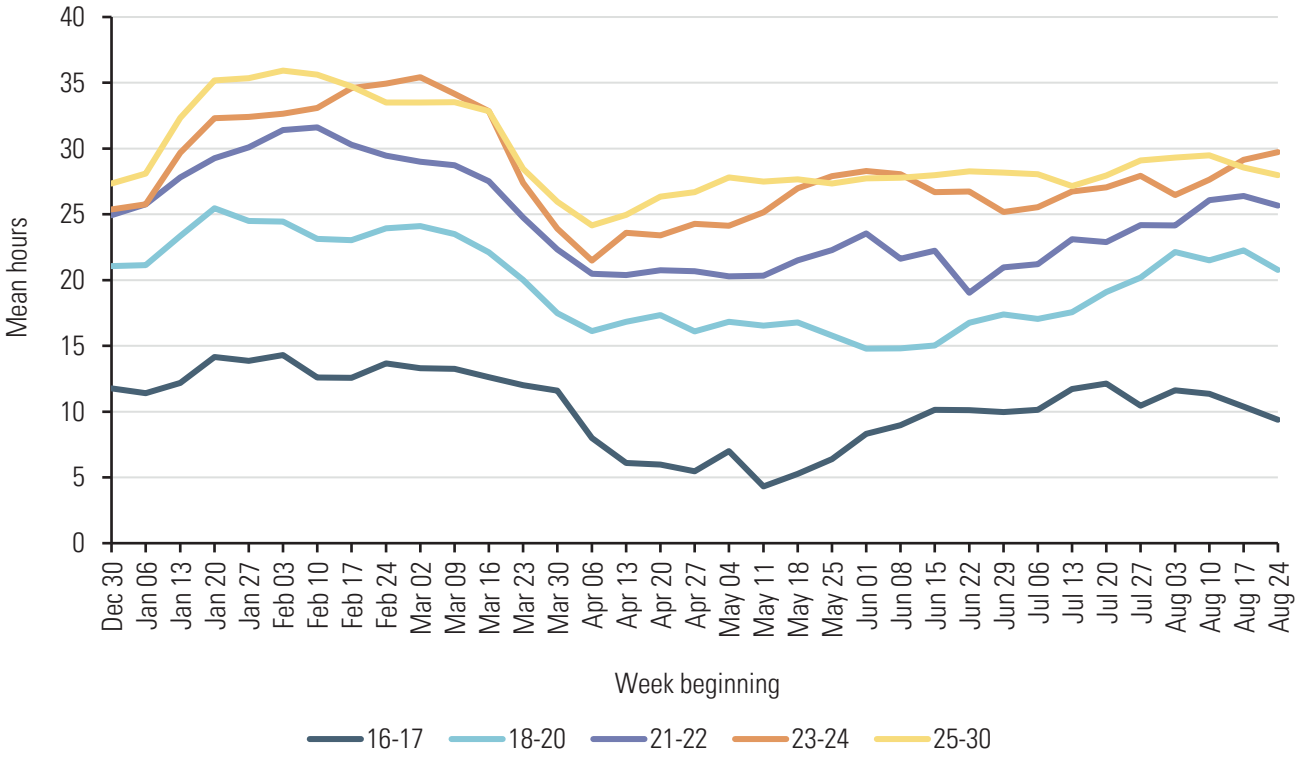


Source: LPC analysis using LFS microdata, weekly data, quarterly population weights, quarterly rolling average, not seasonally adjusted, UK, Q1 2020-June-August 2020.

Impact on hours

5.22 While the CJRS has so far limited the impact of the crisis on employment, it had a significant impact on the number of hours worked, as an initial requirement of the furlough scheme was that workers could not work any hours, apart from training. Another group of workers were not furloughed but were unable to work because of the instruction to stay at home – some of these people may not have had any shifts or clients but still considered themselves to be employed (see paragraphs 2.25 to 2.27 for more discussion of this group). Figure 5.9 shows that all age groups saw a fall in average hours as the national lockdown was introduced in March. As social distancing measures were relaxed over the summer, hours started to recover, with 23-24 year olds closely tracking the 25-30 age group. 18-20 and 21-22 year olds have shown some signs of improvement from the end of June, while the average hours worked by 16-17 year old workers has almost recovered to pre-lockdown levels, although there were some falls in average hours worked throughout August.

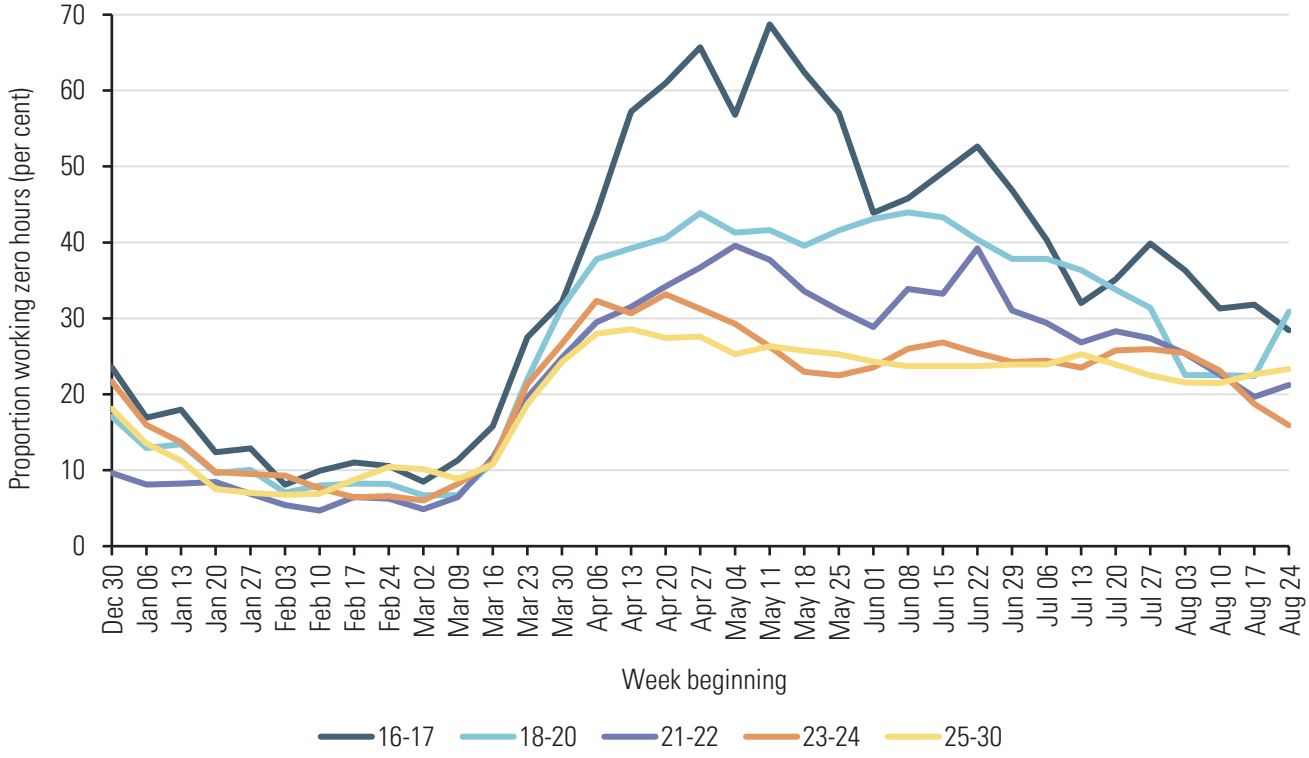
Figure 5.9: Mean hours worked by age, weekly data, UK, 2020



Source: LPC analysis using LFS microdata, quarterly population weights, three week rolling average, not seasonally adjusted, UK, Q1 2020-June-August 2020.

5.23 As with older workers, the fall in average hours was mostly driven by workers who were not working any hours, most of whom were furloughed. Figure 5.10 shows that the proportion of young people who said that they were not working any hours increased as the first national lockdown was introduced in March. This group is primarily made up of furloughed workers, as well as those people who did not have any shifts or clients as a result of the social distancing measures but still considered themselves to be employed. The proportion of young workers not working any hours started to recover as businesses were allowed to reopen but still remained above normal levels at the end of August. This is likely to reduce further as people return to work or become unemployed or inactive.

Figure 5.10: Proportion of workers working no hours by age, weekly data, UK, 2020

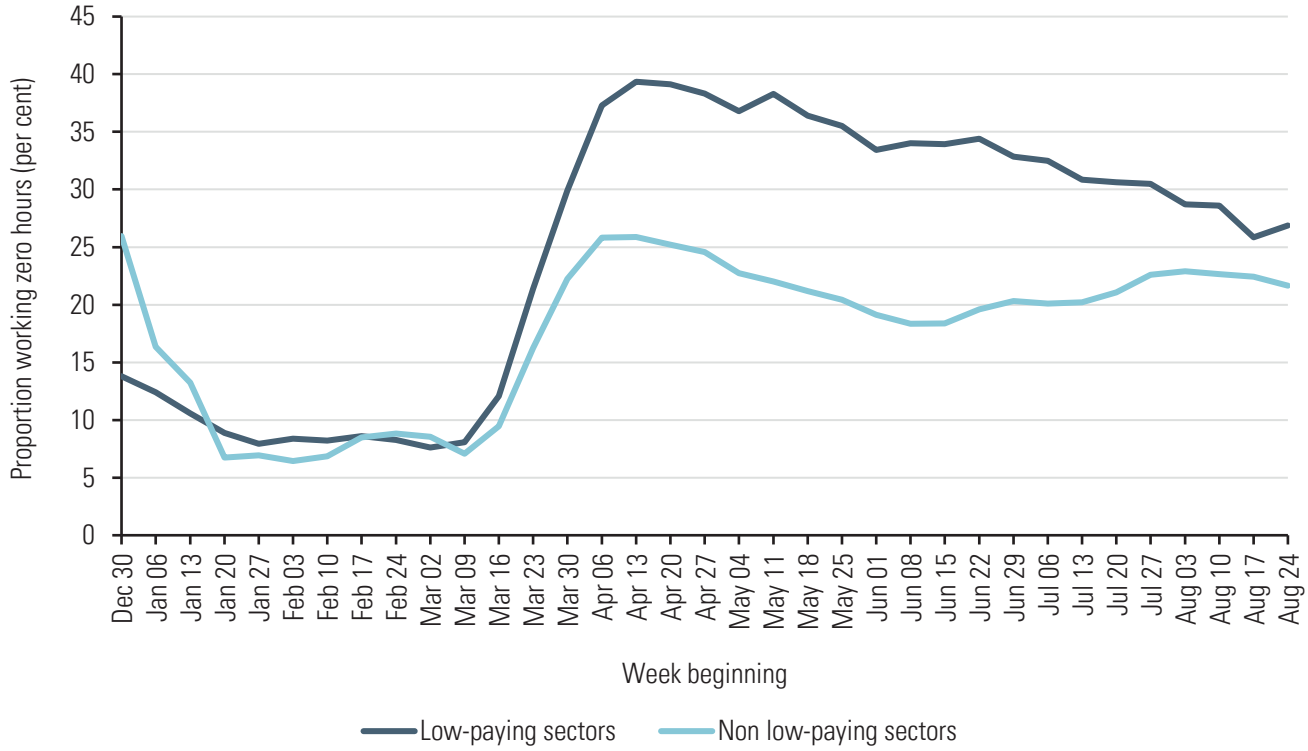


Source: LPC analysis using LFS microdata, quarterly population weights, three week rolling average, not seasonally adjusted, UK, Q1 2020-June-August 2020.

5.24 There are some differences between age groups: the youngest workers are the most likely to say that they are not working any hours, while 23-24 year olds tend to look more similar to the 25-30 population and have started to return to work. These differences are likely to be driven by the fact that more of the youngest workers are in low-paying occupations; Figure 5.11 shows that young workers in low-paying occupations were more likely not to work any hours, although this started to recover as the spring lockdown was eased.

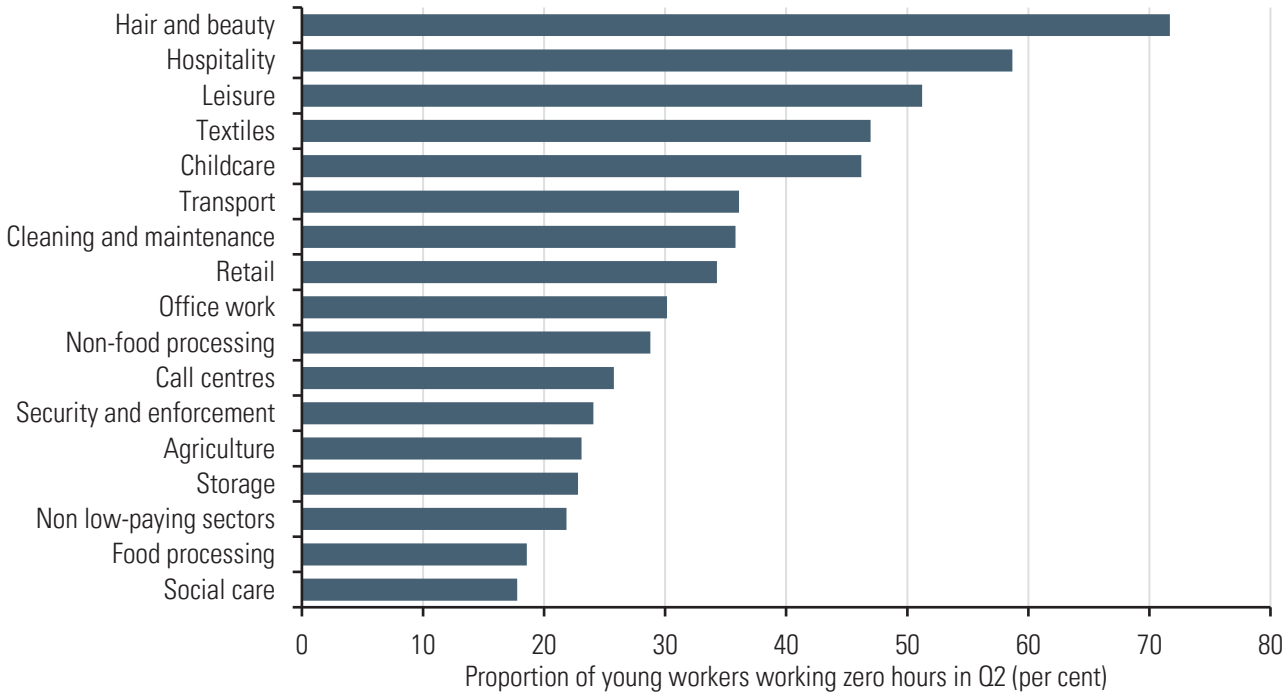
5.25 The proportion of young people who worked no hours during the spring lockdown varies by sector, as shown in Figure 5.12. Over the April – June period, more than half of young workers in low-paying sectors including hospitality, leisure, and hair and beauty did not work any hours. Meanwhile, most young people in other low-paying sectors including social care and security continued to work throughout the period, many of whom would have been classed as key workers. In non low-paying sectors, just over a quarter of workers aged 16-24 did not work any hours. A fundamental feature of this crisis is that it has been highly sectoral, with lockdown measures disproportionately affecting some of the sectors that are most likely to pay the minimum wage rates.

Figure 5.11: Proportion of workers aged 16-24 working no hours by occupation, weekly data, UK, 2020



Source: LPC analysis using LFS microdata, quarterly population weights, three week rolling average, not seasonally adjusted, UK, Q1 2020-June-August 2020.

Figure 5.12: Proportion of workers aged 16-24 working no hours, by occupation, UK, 2020 Q2

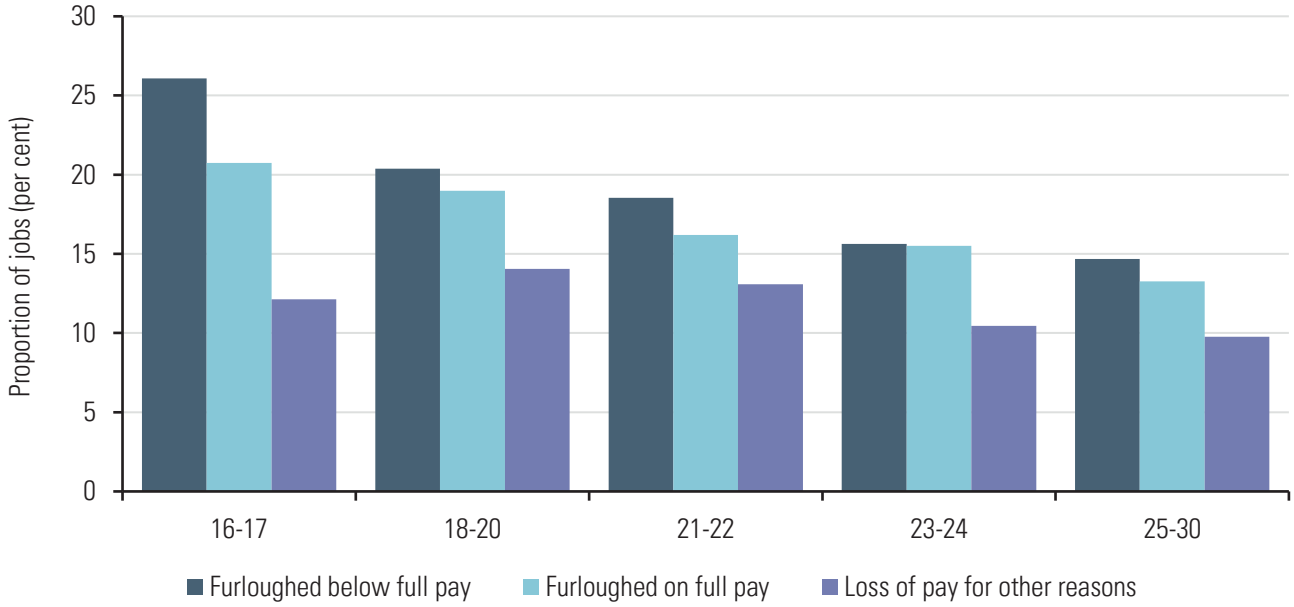


Source: LPC estimates using LFS microdata, population weights, not seasonally adjusted, UK, Q2 2020.

Impact on pay

5.26 Young workers are more likely to have seen changes to their pay over the lockdown period as a result of their high rates of furloughing. Figure 5.13 shows the proportion of jobs that were furloughed on full pay or below full pay in April 2020. The youngest workers are the most likely to have experienced reductions in their pay, with 38 per cent of all 16-17 year old workers receiving less pay than normal in that period. A further 21 per cent of this age group were furloughed on full pay. Older workers were less likely to be furloughed as a result of the lockdown, and they were also more likely to receive full pay if they were away from work. This suggests that employers may have been more likely to top up the pay of older furloughed workers.

Figure 5.13: Proportion of workers furloughed or with loss of pay, by age, UK, 2020



Source: LPC estimates using ASHE 2010 methodology, low-pay furloughed weights, UK, 2020.
Note: Data exclude first year apprentices.

5.27 The lower their pay, the more likely young people are to have been furloughed. Figure 5.14 groups young workers by earnings decile for each age group, according to their hourly stated pay. This is the hourly rate that the employer says that they pay the worker. It is a flawed measure – salaried workers do not have an hourly rate, and it is not possible to identify technical underpayment. However, given that almost 90 per cent of young workers who are paid at or below the NLW do have a stated hourly rate, it is a useful measure of what they are normally paid or would be paid in the absence of the furlough scheme. For those in the first decile, with the lowest hourly pay, nearly three quarters were furloughed, while only one in five of those with the highest hourly pay were furloughed. This is further evidence that shows that the pandemic has hit the lowest-paid workers hardest.

Figure 5.14: Proportion of young workers aged 16-24 with pay changes, by stated hourly pay decile, UK, 2020

Source: LPC estimates using ASHE 2010 methodology, low-pay furloughed weights, UK, 2020.
Note: Data exclude first year apprentices.

5.28 As a result of these changes to pay in lockdown, it is challenging to understand the impact of the most recent increases in the minimum wage rates on pay, and the scope for further increases (see paragraphs 3.15 – 3.19).

5.29 This year, the reference date for the Annual Survey of Hours and Earnings (ASHE) was 22 April, at the height of the national lockdown. The furlough scheme at this point was a major intervention in the labour market, affecting the pay of millions of workers. In April, there were effectively three groups of people – those who carried on work as normal, those who were furloughed and experienced a loss of pay, and those who were furloughed but whose pay was topped up to normal levels.

5.30 The measure of pay that we would normally use in our analysis is a derived hourly pay based on total pay for the month or week excluding overtime and bonuses, divided by total hours worked. Workers furloughed below full pay have a derived hourly rate that is artificially low, calculated as their furlough pay divided by the number of hours they would normally work. In reality, it is not accurate to see it as an hourly rate as furloughed workers did not work any hours under the CJRS at that stage.

5.31 If we include workers furloughed below full pay in our analysis, pay is biased downwards. This is because a sizeable group of people have artificially lower pay. But if they are excluded, we are ignoring a large number of workers, biased towards the lowest paid workers who were more likely to be furloughed. This approach would increase estimates of pay and mean that we exclude many of the workers who are most affected by our recommendations.

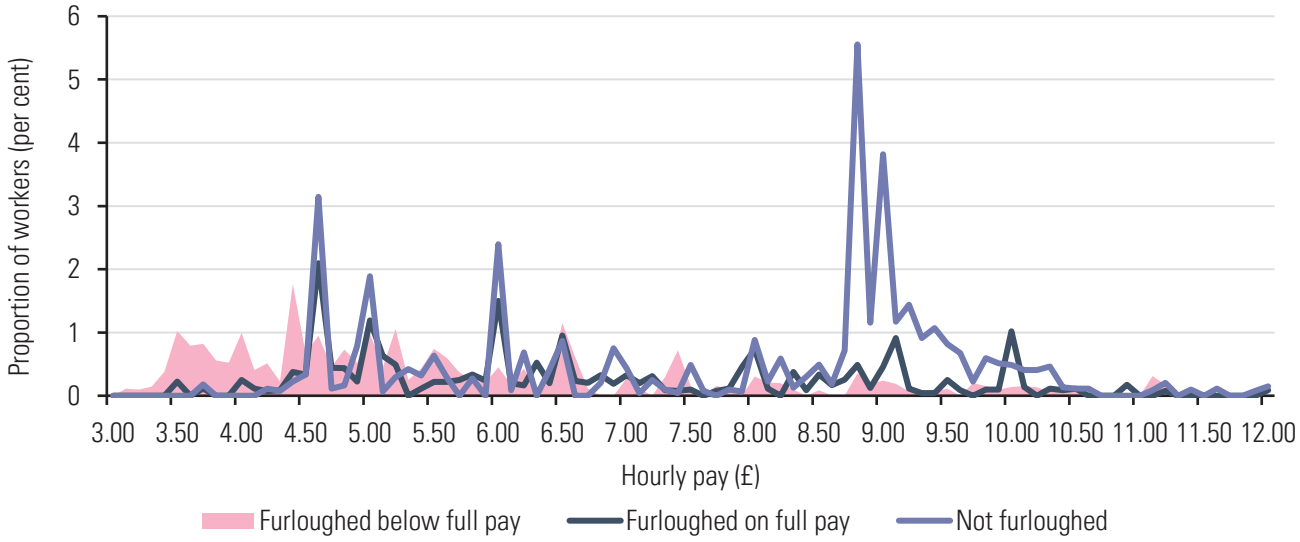
5.32 Because of these opposing biases, it is challenging to identify a group in the ASHE data that has pay that is representative of young workers. Time series analysis using metrics such as bite and coverage is unlikely to be consistent with previous years, and any estimates of pay growth would be highly flawed. Instead, we focus this year on understanding how the pay of furloughed workers and those in the most affected sectors compares with other workers.

Pay distributions

5.33 The pay distributions for 16-17, 18-20, 21-22 and 23-24 year old workers are shown in Figure 5.15 to Figure 5.18. Among those who have not been furloughed, there is a large spike in the distribution at the NLW as well as at the appropriate youth rate for each age group. This suggests that some employers are choosing to pay the NLW to all workers, regardless of age. There are similar spikes in the distribution for those furloughed at full pay, which indicates that employers who topped up pay for furloughed workers tended to pay the 2020 rates.

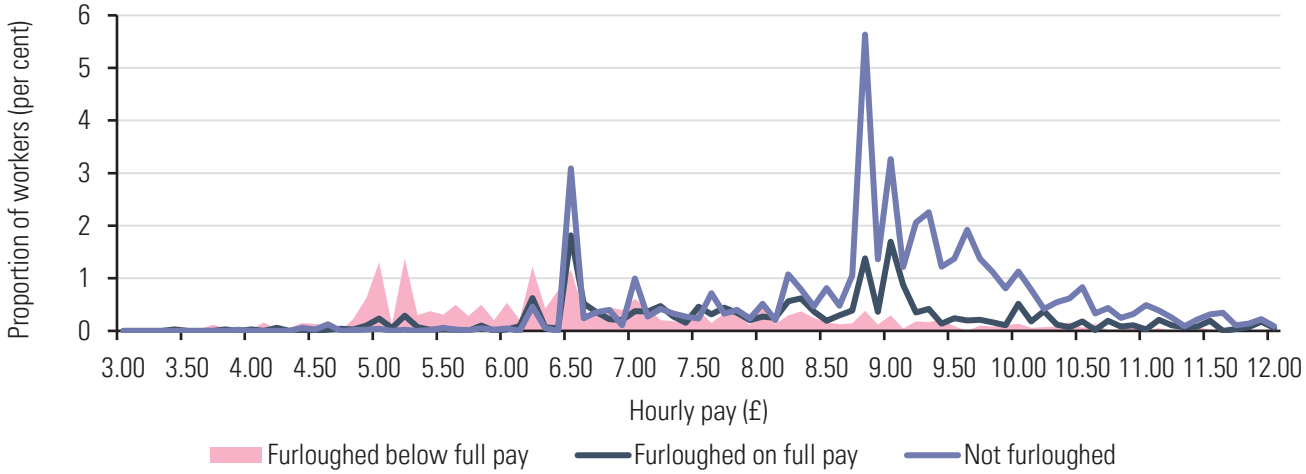
5.34 Meanwhile, the pay distribution of those who were furloughed below full pay has spikes at 80 per cent of the previous NLW, as well as 80 per cent of the previous NMW across all age groups. This has two main implications: firstly, that many of those who were furloughed would ordinarily be minimum wage workers. It is not appropriate to exclude them entirely from our analysis as they are a substantial share of the low paid labour market. Secondly, that many of the workers furloughed below full pay were paid based on the previous rates. This is because grants received under the CJRS were calculated based on February payslips, prior to the April uprating. However, it makes it difficult to calculate underpayment as there is a sizeable group of people who are legitimately paid based on the historic rate. Workers could normally be paid well above the rates and be incorrectly identified as underpaid because their pay was not increased in April, as well as because of any reduction in pay due to furlough.

Figure 5.15: Pay distribution of 16-17 year olds, by furlough status, UK, April 2020



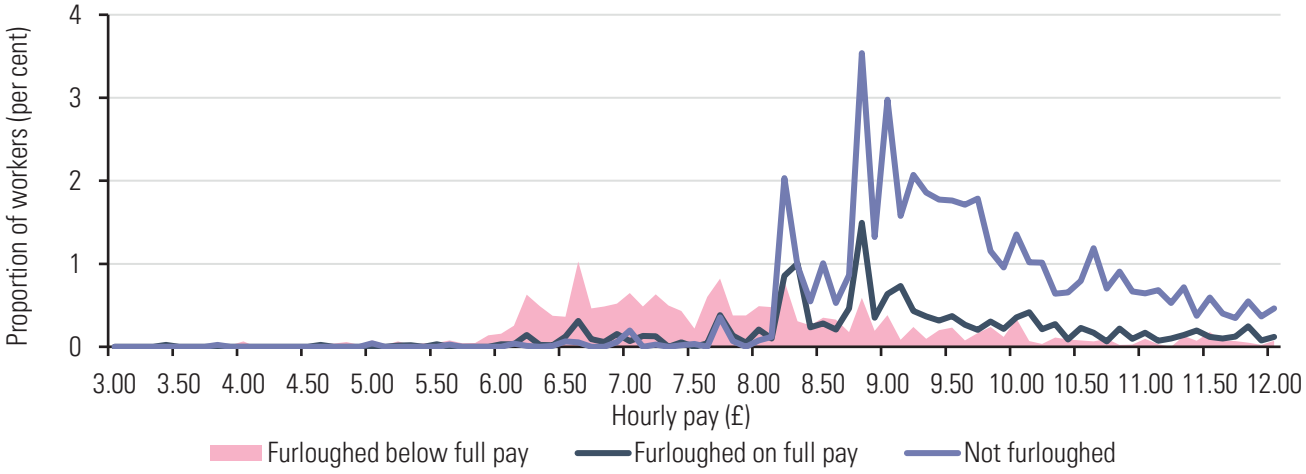
Source: LPC estimates using ASHE 2010 methodology, low-pay furloughed weights, UK, 2020.
Note: Data exclude first year apprentices.

Figure 5.16: Pay distribution of 18-20 year olds, by furlough status, UK, April 2020



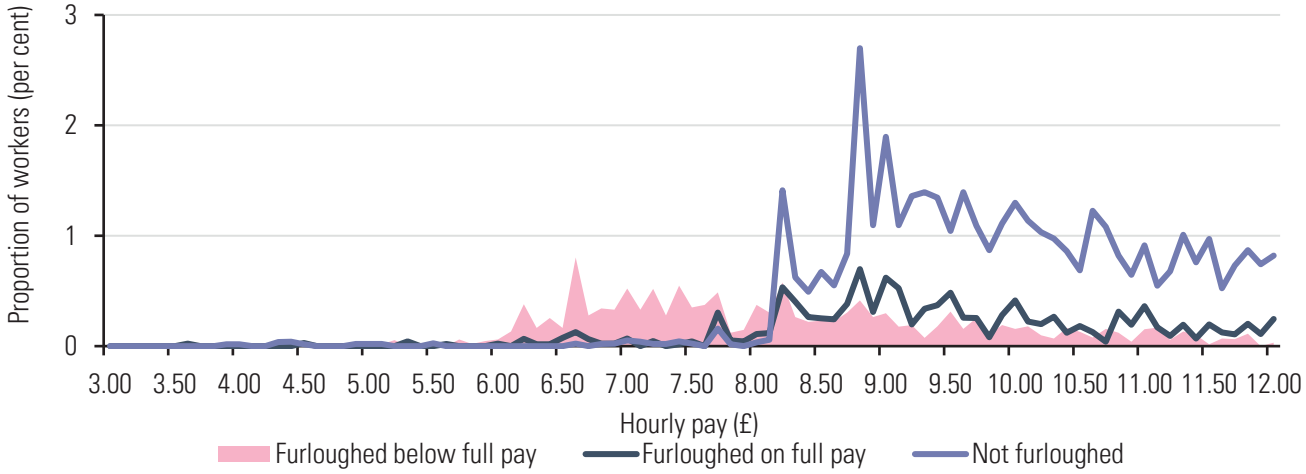
Source: LPC estimates using ASHE 2010 methodology, low-pay furloughed weights, UK, 2020.
Note: Data exclude first year apprentices.

Figure 5.17: Pay distribution of 21-22 year olds, by furlough status, UK, April 2020



Source: LPC estimates using ASHE 2010 methodology, low-pay furloughed weights, UK, 2020.
Note: Data exclude first year apprentices.

Figure 5.18: Pay distribution of 23-24 year olds, by furlough status, UK, April 2020



Source: LPC estimates using ASHE 2010 methodology, low-pay furloughed weights, UK, 2020.
Note: Data exclude first year apprentices.

Median pay

5.35 The group who experienced a loss of pay due to the furlough scheme make it challenging to calculate measures for median pay, and therefore bite, that are consistent with previous years. The resulting biases in the data lead to a range of possible values for median pay for each age group, shown in Table 5.3. The range for 16-17 year olds is particularly broad, which reflects the fact that they are the group that has been most affected by weaker response rates and high rates of furloughing.

Table 5.3: Median hourly pay, by age and including and excluding furloughed workers

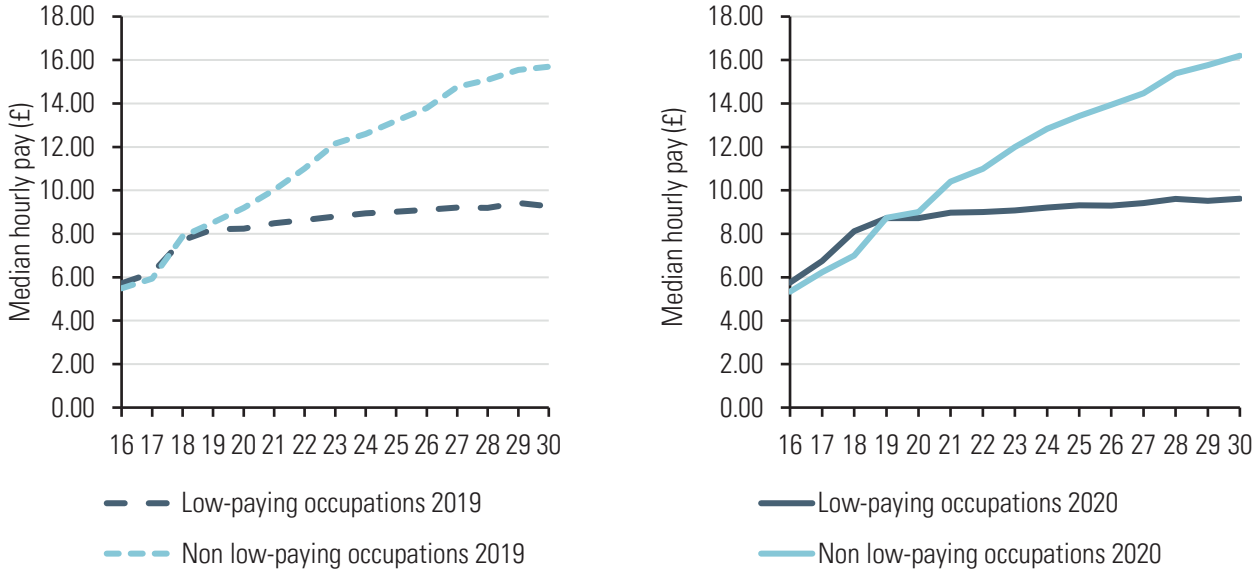
Rate population	Median – 2019	Median – 2020, including furloughed workers	Median – 2020, excluding all with loss of pay
16-17	£6.15	£6.63	£8.12
18-20	£8.27	£8.72	£8.97
21-22	£9.20	£9.50	£9.80
23-24	£10.73	£11.01	£11.58

Source: LPC estimates using ASHE 2010 methodology, low-pay furloughed weights, UK, 2020.
Note: Data exclude first year apprentices.

5.36 The biases in the data mean that it is not appropriate to compare pay between years, for example to determine pay growth, or look at changes in the bite. However, it is possible to do some internal comparisons, comparing the pay of different groups of workers in the same year. Figure 5.19 shows the median hourly pay in low-paying occupations and non low-paying occupations. Workers furloughed below full pay are included so that the population is comparable to previous years, but the pay is therefore biased downwards.

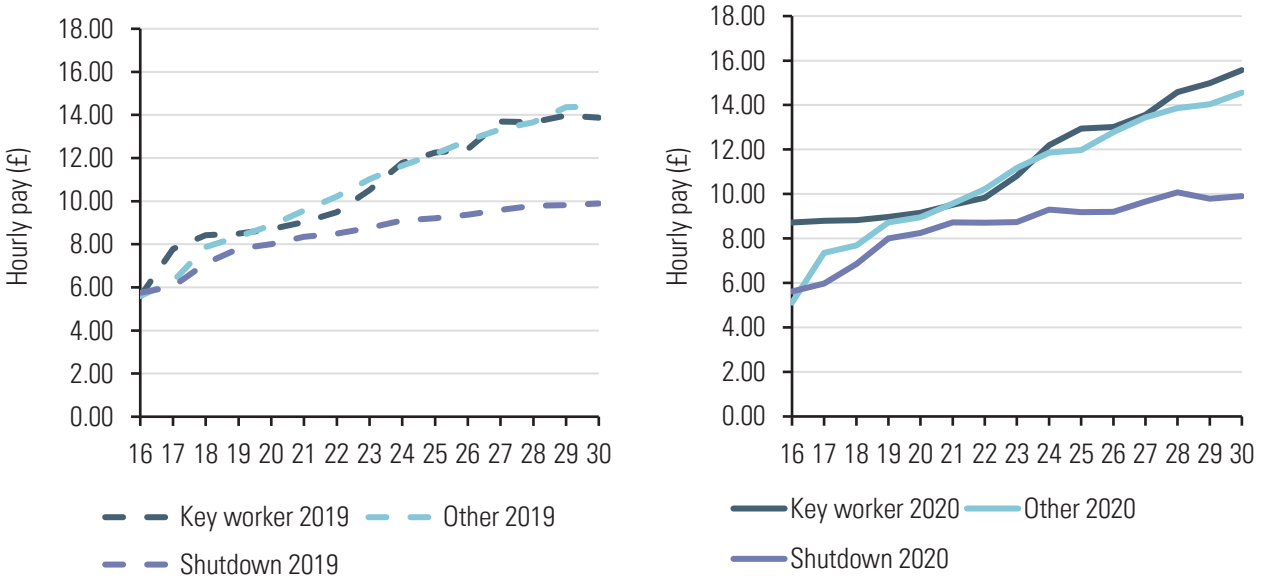
5.37 The youngest workers have the lowest pay in both groups, but the key difference is from age 20 onwards. In low-paying occupations, the relationship between age and median pay is relatively flat, with little difference between the median hourly pay of a 20 year old and a 30 year old. Workers in these occupations are likely to be paid relatively similar rates, regardless of age. Meanwhile in other occupations, pay has a strong relationship with age, and older workers are more likely to earn more per hour. This pattern holds in both 2019 and 2020, and has not been strongly impacted by use of the furlough scheme.

Figure 5.19: Median hourly pay by age and occupation, including furloughed workers, UK, 2019 – 2020



Source: LPC estimates using ASHE 2010 methodology, low-pay furloughed weights, UK, 2020.
Note: Data exclude first year apprentices.

Figure 5.20: Median hourly pay by age and type of work in lockdown, including furloughed workers, UK, 2019 – 2020



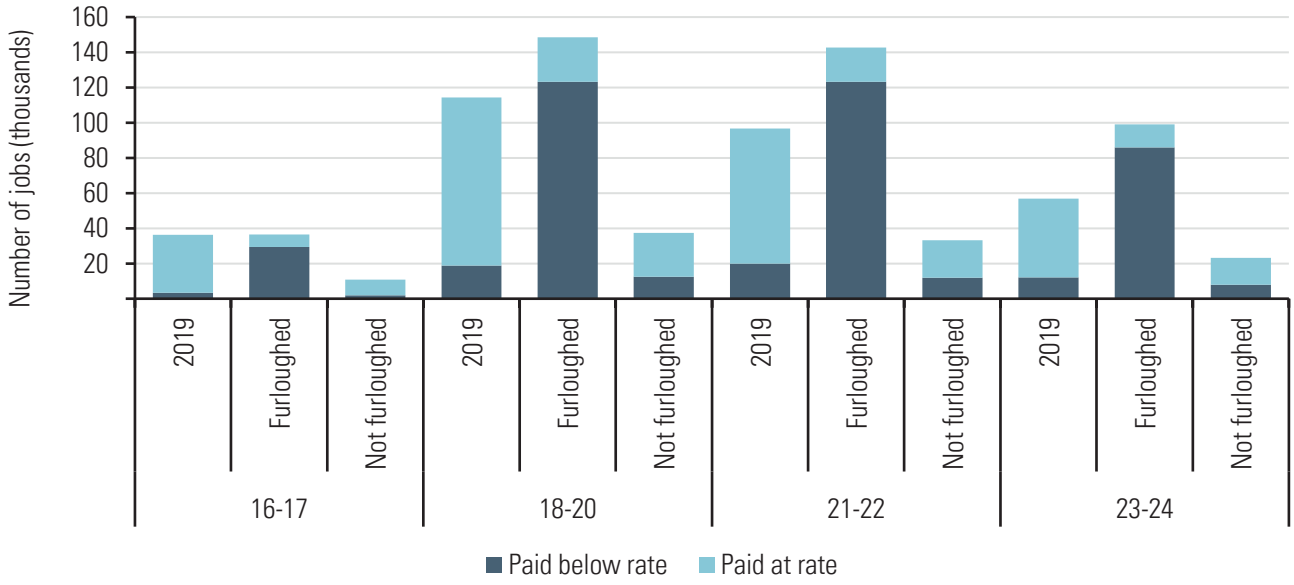
Source: LPC estimates using ASHE 2010 methodology, low-pay furloughed weights, UK, 2020.
Note: Data exclude first year apprentices.

5.38 Figure 5.20 similarly shows the relationship between median pay and age, now separated by how their job might have been affected by lockdown. Shutdown sectors are those that have been hardest hit by lockdown measures, where businesses were largely closed throughout April and May. The average worker in those sectors has lower pay than in other roles, and the relationship between age and pay follows a similar pattern to that seen in low-paying occupations. Meanwhile the median pay for key workers is in line with the median pay of other workers. Comparing the pay of key workers between years, there is evidence that the youngest workers were likely to see increases to their pay, perhaps as an incentive for working throughout the spring lockdown.

Coverage and usage of rates

5.39 As discussed in paragraph 3.23, it is challenging to identify coverage exactly in this year's ASHE data. It is not strictly accurate to talk about an hourly rate for furloughed workers who were not working any hours; some furloughed workers who were paid a quarter or more above the rates may be identified as covered by the rate, simply because their derived pay is artificially low. Figure 5.21 shows that the normal definition of coverage is primarily made up of furloughed workers who appear to be paid less than the new rates. Including these workers leads to an overestimate of coverage as many of them would not ordinarily be paid at or below the rates, while excluding them would lead to an underestimate of coverage.

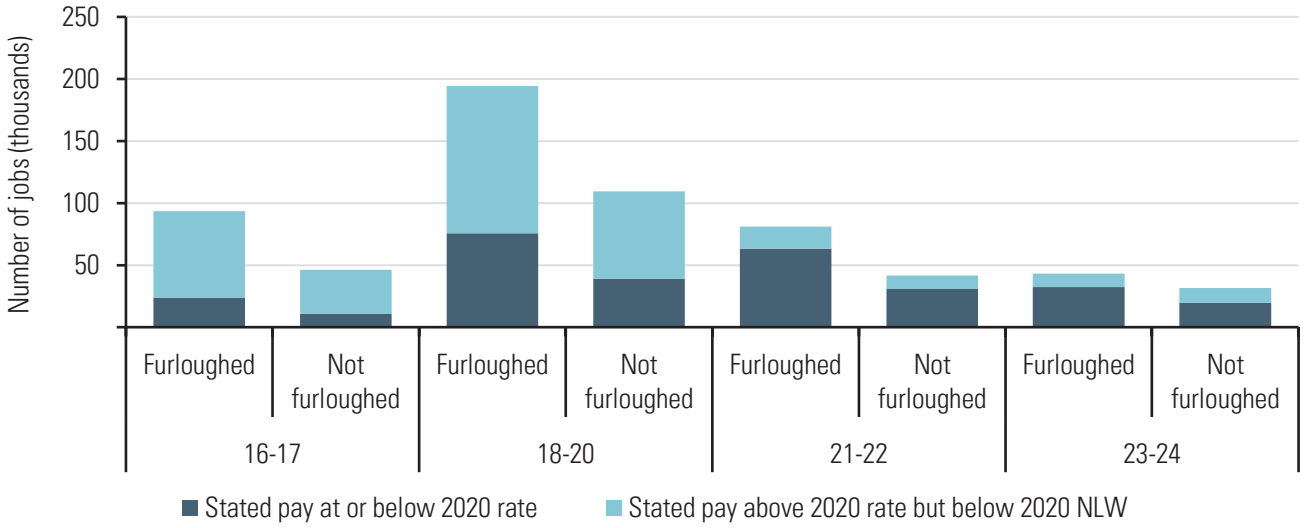
Figure 5.21: Coverage of youth rates by age, UK, 2019 – 2020



Source: LPC estimates using ASHE 2010 methodology, low-pay furloughed weights, UK, 2020.
Note: Data exclude first year apprentices.

5.40 Figure 5.22 shows the coverage and usage of the youth rates for young workers, now using the stated hourly rate as an alternative measure of pay. The oldest workers are less likely to be paid below the NLW – there are around 75,000 workers aged 23-24 who are in this group, who would see a pay rise as a result of the change in age threshold of the NLW, while more than 300,000 workers aged 18-20 are paid within the youth rate structure. Workers who have been furloughed are more likely to be covered by the rates or paid at a rate that is less than the NLW than workers who were not furloughed. This means that the people who are more likely to be affected by the increases in the youth rates are also more likely to have been furloughed and potentially at greater risk of unemployment.

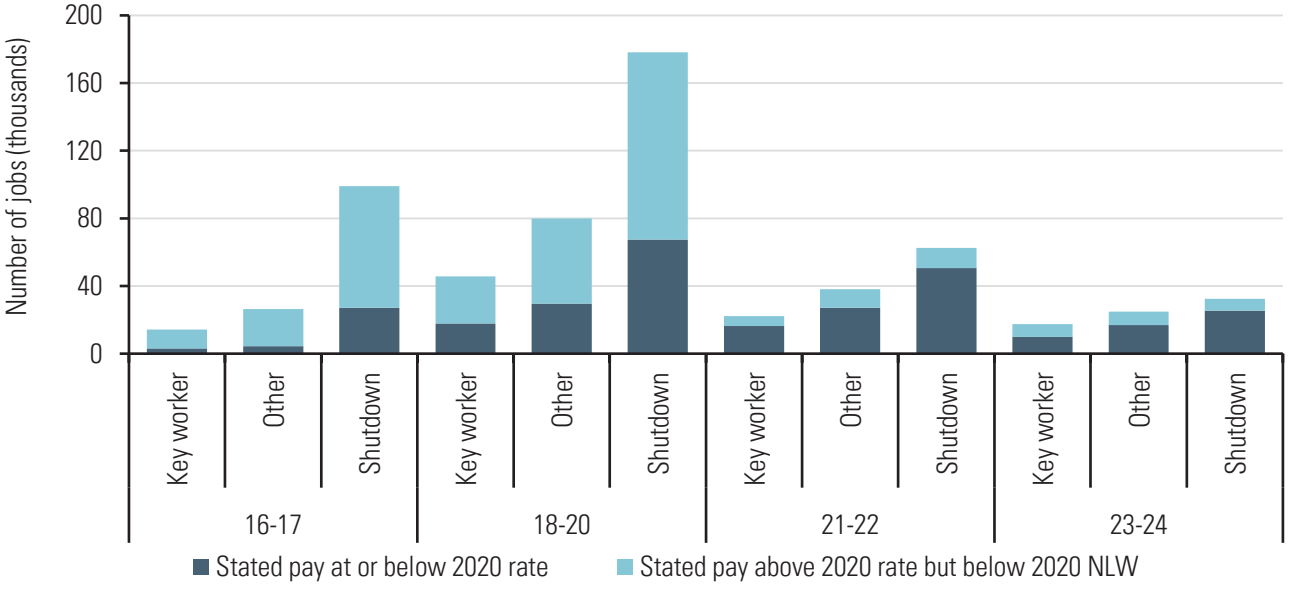
Figure 5.22: Coverage and usage of the NMW rates among hourly-paid workers by furlough status, using stated hourly pay, UK, April 2020



Source: LPC estimates using ASHE 2010 methodology, low-pay furloughed weights, UK, 2020.
Note: Data exclude first year apprentices.

5.41 Figure 5.23 similarly shows the coverage and usage of the youth rates among workers with a stated hourly rate, this time grouped by how their sector was affected by the lockdown. Workers who are covered or paid less than the NLW are more likely to work in shutdown sectors and are less likely to be key workers. This is true for 23-24 year olds as well, and it suggests that even though the number of young people who would have to see significant pay increases to meet the NLW when the threshold is changed is small, these workers are likely to be found in the sectors that have been hardest hit by the pandemic. There is a group of around 30,000 workers aged 23-24 who have an hourly rate of pay that is less than the NLW and work in these most affected sectors.

Figure 5.23: Coverage and usage of the NMW rates among hourly-paid workers by type of work in lockdown, using stated hourly pay, UK, April 2020



Source: LPC estimates using ASHE 2010 methodology, low-pay furloughed weights, UK, 2020.
Note: Data exclude first year apprentices.

Emerging from lockdown

5.42 Young people are in a vulnerable position in the labour market. Employment was already starting to soften even before Covid-19 hit. They are more likely to work in the sectors that have been hardest hit by lockdown measures, and as a result they are more likely to have seen changes to their work with more of them furloughed or working no shifts.

5.43 While the CJRS has enabled businesses to keep these workers on their payrolls, they may still be at greater risk of unemployment. It remains to be seen how businesses will be affected by further national and regional lockdown measures. Businesses that were unable to trade for an extended period of time are more likely to have limited cashflow and to be considering making changes including redundancies and restructuring. Given the high proportion of young people in these sectors, they are likely to be at greater risk of unemployment in the coming months.

5.44 In July 2020, the Chancellor announced a number of measures designed to support young people in the labour market as part of the Plan for Jobs (see Table 1.3). This includes the Kickstart scheme to create new jobs for young people at risk of long-term unemployment, funding for apprenticeships and traineeships, an expansion of sector-based work academies, as well as measures that are not directly targeted at young people but could help to support businesses and increase demand. The original CJRS has additionally been extended until March to cover the second national lockdown and beyond. These policies are largely untested, and we do not yet know whether these schemes will successfully create and protect jobs.

5.45 There was widespread recognition among the stakeholders we spoke to of the scale of the challenge that young people are likely to face in the coming year. Employer and employee representatives both acknowledged that young workers are at greater risk of redundancy and unemployment. The FDF noted the likelihood of youth unemployment as companies are considering business critical roles for the forthcoming year, though are working through the Kickstart programme to support members in addressing this. The Prince's Trust also noted how young people are twice as likely to work in shutdown sectors and the critical point would be in the autumn as the CJRS comes to an end. At the start of the pandemic, a survey conducted by The Prince's Trust found that more than one in ten young people said that they had a job or training that they were due to start cancelled, almost one in three (29 per cent) thought they would have to take a lower paid job, seven per cent had lost their job and 47 per cent thought that missing out on time in education or the workplace now would put them at a disadvantage for years to come. Youth Employment UK similarly reported that youth unemployment is expected to increase, with young people at a disadvantage because they are more likely to be employed in at risk sectors.

5.46 Several employer representatives urged caution in setting the rates as a result. Worker representatives were more likely to say that we should continue to be ambitious with the youth rates, while the government should pursue other policy options such as a jobs guarantee and programmes to build skills to support youth employment. The TUC argued that the youth rates should grow at least in line with the increases in the NLW, and at the same time the government should introduce job guarantee schemes to support youth employment. REC recommended a policy focus on building skills and improving progression opportunities for those on low wages. Similarly, the Intergenerational Foundation reported how increases in the minimum wage can be complemented using other social security policies and programs to provide safety nets and training for young people. Internationally, many countries have removed their age-related rates, and have additional mechanisms to prevent youth unemployment, including wage subsidies and training programmes.

Lowering the NLW age threshold to 23

5.47 Although the evidence on young people in general suggests caution, the LPC's position remains that the age threshold of the NLW should be reduced to 23 in April 2021 as proposed in the 2019 youth review.

5.48 The recommendation was initially based on seven main arguments: a) that use of the 21-24 Year Old Rate amongst that age group is low, b) that moving 23-24 year olds up to the NLW would result in reasonable bites, c) that 21-24 year olds are similar to 25 year olds across a range of indicators, d) that stakeholders agree that the NLW age should be lowered, e) when the NMW eligibility age was last lowered there were no significant negative impacts, f) demographic changes over the next few years reduce the risk associated with higher rates and g) record high employment and a tightening labour market are likely to offer protections to young workers

5.49 Many of these arguments continue to hold despite the economic changes caused by the pandemic. Coverage and usage of the rate is low among hourly paid 23-24 year olds, although they are more likely to have been furloughed or to work in shutdown sectors (Figure 5.22, Figure 5.23). There is uncertainty in the level of the bite for this age group, but the upper estimate is still lower than that for 21-22 year olds in 2019 (Table 5.3). However, the bite of the minimum wage for this age group tends to be highest in some of the sectors that have been hit hardest by the crisis, including hospitality and hairdressing.

5.50 There is some degree of similarity between 23-24 year olds and older workers in how they have been affected by the pandemic: they were furloughed at similar rates and appear to be returning to work at comparable rates (Figure 5.9, Figure 5.10, Figure 5.11). However, there is also some divergence in that 23-24 year olds have seen larger falls in their employment rate (Figure 5.8).

5.51 When the NMW eligibility age was reduced from 22 to 21 in 2010, following LPC advice, it led to a 20 per cent increase in the wage floor for 21-year olds. But despite the magnitude of that increase – and the implementation of the change in the immediate aftermath of the financial crisis – research has shown no significant effects on employment; indeed there was even some evidence that the higher wage floor stimulated movements into employment for some young people (Dickens, Riley and Wilkinson, 2014 and London Economics, 2015). This is particularly pertinent evidence as we will again be changing the age threshold of the main rate in a time of economic uncertainty. The penultimate argument that we made in the 2019 youth review still holds as well: demographic changes over the next few years mean that there will be fewer 21-24-year olds who are eligible for the higher rate.

5.52 However, the labour market is no longer likely to be protective. With vacancies reduced, millions of people away from work, and many businesses severely restricted in their ability to trade, it seems likely that unemployment will increase in the late autumn and winter. Government policies including the CJRS may have helped to protect jobs so far, but there is huge uncertainty over what happens next as the scheme is gradually removed, as further lockdowns are introduced, and as the UK's transition period with the European Union ends.

Stakeholder views

5.53 Views on the proposed reduction in the NLW age threshold from 25 to 23 were mixed amongst stakeholders, and largely followed their level of ambition or caution on the NLW more generally (see paragraph 8.57 onwards). Among employers, there was still widespread support in principle for the change but some calls to delay it by a year in response to the pandemic. Some groups raised concerns about the increasing costs resulting from the change. Unions welcomed the change but some thought it did not go far enough. Stakeholders representing sectors which do not tend to use youth rates (retail, most notably) were relaxed about the change. Individual employers we spoke to tended to accept the rationale for the change and to see it as positive on grounds of fairness, even where they would experience a cost impact because of it.

5.54 The Federation of Small Businesses' (FSB) written evidence stated their continued support for reducing the age threshold but asked the LPC to take 'a cautious approach' to the timing of the change'. At oral evidence, both the FSB and the British Chambers of Commerce called for the planned reduction to be delayed by a year, given the probable impact of the pandemic on younger workers. The National Hair and Beauty Federation (NHBF) thought the change would have a significant cost impact on their members and on the employment of the age groups affected. NHBF members raised concerns that they would be forced to increase their prices, take lower profits, freeze recruitment and possibly reduce the hours of their employees. The National Care Association (NCA) were supportive of the reduction but urged caution given potential impacts on profitability and investment. They advised the reduction to 21 should only take place once the economy begins to recover, with ample warning to businesses. Make UK said reducing the age threshold would place young people in low-paying roles at risk and make it difficult for members to maintain pay differentials. The National Day Nurseries Association (NDNA) noted the reduction would have a significant cost impact on their sector, as around 15 per cent of the workforce was aged between 21 and 24.

5.55 The Association of Convenience Stores (ACS) noted that 63 percent of their members agreed to the reduction in the age threshold but proposed exercising caution given the prevailing economic outlook and businesses impact of NLW increases since 2016. The National Farmers Union (NFU) also voiced concern about the ability of businesses with limited options to pass costs up their supply chain to manage the projected change to the NLW threshold, advocating that economic recovery needed to be prioritised with increases to rates and changes to age thresholds made incrementally to allow businesses to keep pace.

5.56 Unions favoured a single rate for all ages. Usdaw noted the reduction in the age threshold would not impact their members, as they had been working with employers to remove youth rates. Unite also call for the application of one rate for all age groups and support the principle of equal remuneration for work of equal value. Similarly, the TUC told us they believe the age reduction should go ahead as planned but felt in the long run there should be one rate for all age groups.

5.57 In the survey sample of Youth Employment UK, many young people stated they want the age to be lowered to 21 sooner than 2024 as it would enable them to be more independent and increase their feeling of being valued. Research by the Carnegie UK Trust and the Learning and Work Institute also found that the gap between the NLW and NMW rates for younger workers could be seen as a potential disincentive for young people to enter work. In the long term, The Prince's Trust were supportive of the lowering of the age threshold to the NLW but are slightly cautious this year due to the risk of spiralling youth unemployment.

Conclusion

5.58 The labour market position of young people was already starting to soften, even before the onset of Covid-19. Although young people have had minimal health impacts caused by the virus, they have been most affected in terms of their livelihoods. They are more likely to work in the sectors that were most affected by the lockdown and social distancing measures, and were therefore more likely to be furloughed and experience a reduction to their pay and hours. The number of young people who are furloughed is reducing but employment is also starting to fall, and we know that young people are hit particularly hard by any downturn. We therefore recommend caution in the rates for the youngest workers, while continuing to recommend that the eligibility age for the NLW is reduced to 23 in April 2021, recognising that this age group is more similar to older workers in how they have been affected by the crisis.

Chapter 6

Apprentices

Key findings

The labour market for apprentices has been heavily disrupted this year, mirroring activity in the wider economy. Recruitment fell precipitously in the spring, and it is unclear when or if starts will return to their former levels. A lack of pay data adds to our uncertainty about the near term.

The longer-term context is that policy reforms in England have led to marked declines in starts in the areas with highest coverage of the Apprentice Rate. Smaller employers are offering fewer level 2 apprenticeships and hiring fewer under-19 apprentices. But the minimum wage does not play a significant role in this, and sectors with the highest coverage do not perform worse overall.

Our review of the Apprentice Rate concluded there is scope to raise the rate to the same level as the 16-17 Year Old Rate, based on widespread feedback from low-paying employers. But given the volatility of the past year and uncertainty over the next, we propose to do this over two years rather than one. The majority of stakeholder evidence from both employers and workers suggests that pay is not a significant factor in employers' decision-making over whether or not to recruit apprentices. This has been a repeated message from employers in a wide variety of sectors for several years. We still believe there is a case for looking at apprentices separately from other groups of workers within the NMW structure; the ongoing changes in the composition of the apprentice cohort mean we will continue to have to consider them separately from the 16-17 year old cohort.

6.1 The Apprentice Rate is the final minimum wage rate we consider. This chapter has two parts. The first looks at the strength of the apprentice labour market, to assess its ability to absorb increases in the rate. The second outlines the conclusions of our review of the rate, and in particular a proposal to align it with the 16-17 Year Old Rate.

Apprentice pay

6.2 In normal years, we look at trends in apprentice earnings to assess the impact of future rate rises. There are two data sources – the Annual Survey of Hours and Earnings (ASHE) and the Apprenticeship Pay Survey (APS), which should take place every other year. The latter is our preferred data source for apprentice pay, but the last iteration of this survey was published at the start of 2020 and based on interviews which took place across 2018 and 2019.

6.3 We prefer APS to ASHE because the latter undercounts the number of apprentices in the workforce. Last year's report went into more detail on the possible causes of this problem. A key point is that ASHE may have a particular weakness in identifying apprentices on low earnings (Dickens, Riley, and Wilkinson, 2015). As set out in previous chapters, the unique circumstances of this year's ASHE make it more challenging than usual to estimate median pay, and with it the bite and coverage of minimum wage rates for all groups. In addition, the sample size is smaller than usual; last year's ASHE caught 1,860 apprentices, whereas this year's only identifies 1,650, of whom 1,150 have not suffered a loss of pay. We usually exclude workers who have suffered a loss of pay from our analysis; this issue is amplified this year because of the effects of the Coronavirus Job Retention Scheme (CJRS) and the number of furloughed workers who received less than their usual pay at the time ASHE was carried out in April. We discuss this in greater depth in Chapter 3 – see paragraphs 3.14 to 3.19.

6.4 All of this means we have not produced our usual pay analysis for apprentices this year. We cannot measure recent pay growth for apprentices, nor can we look at the impact of the most recent uprating to £4.15. Our most recent reliable pay data for apprentices remains the 2018-19 APS, carried out over 18 months ago at the time of our recommendations. This has been a significant handicap in our deliberations this year.

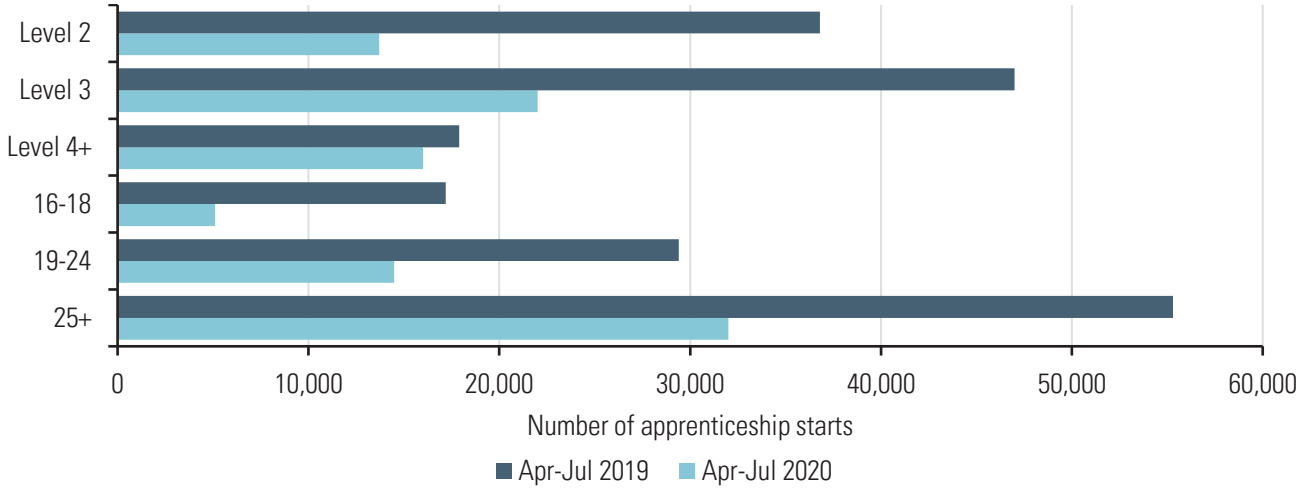
6.5 Although the pay figures in the most recent APS are almost certainly out-of-date, the overall picture it presents of where and how the Apprentice Rate is used and which groups and sectors are most exposed to it, remains relevant. We recap this in the box on page 128 (Who is covered by the Apprentice Rate?), in the discussion of the conclusions of our review of the rate.

Apprenticeship starts

Impact of Covid-19

6.6 In common with other the labour market as a whole, apprentice recruitment fell sharply during the period of the initial lockdown due to Covid-19 measures. Figure 6.1 compares starts in England from April to July 2020 with the same period a year earlier. Overall, starts fell by nearly half compared with a year earlier, with just over 51,000 starts in the three-month period, compared with over 101,000 a year earlier. There were pronounced falls in starts among all age groups and at all levels, but these were proportionally largest in apprenticeships at level 2 (a 63 per cent fall) and among 16-18 year olds (a 70 per cent fall) – the areas where low-paying apprenticeships with exposure to the Apprentice Rate are most common.

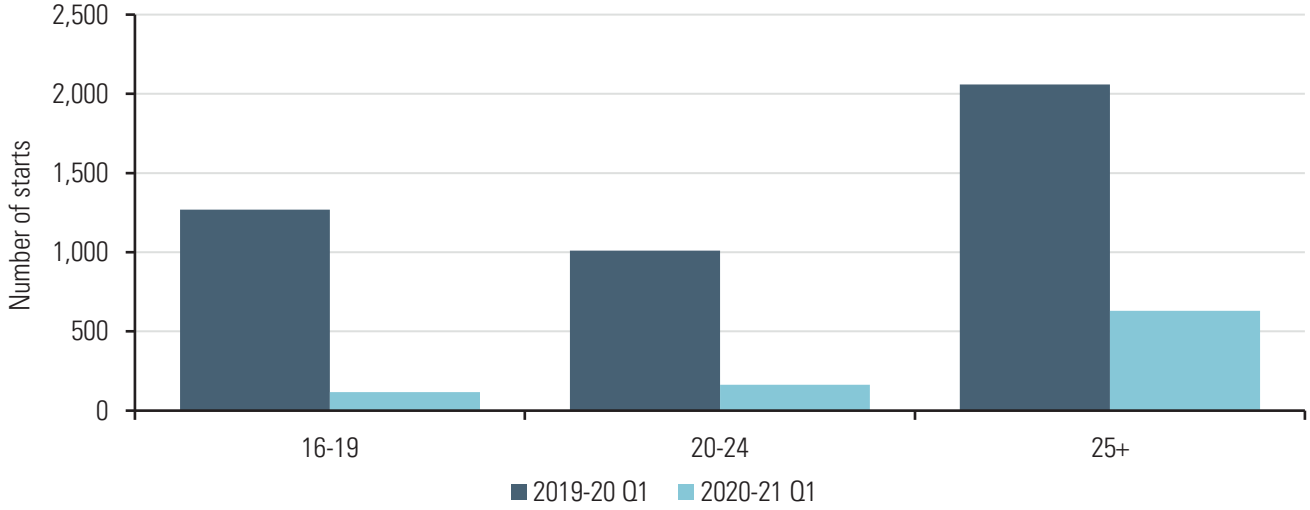
Figure 6.1: Apprenticeship starts, England, April-July 2019 and April-July 2020



Source: LPC estimates using Department for Education Apprenticeship and levy statistics (August 2020).

6.7 As Figure 6.2 shows, the picture in Scotland was even more severe, with a 79 per cent quarter-on-quarter drop in overall starts, and large proportional falls among all age groups. Apprenticeship starts for the youngest age groups were again hit the hardest, with a 91 per cent fall for 16-19 year olds. Figures for the period of lockdown were not yet available for starts in Wales and Northern Ireland.

Figure 6.2: Apprenticeship starts, Scotland, April-June 2019 and April-June 2020



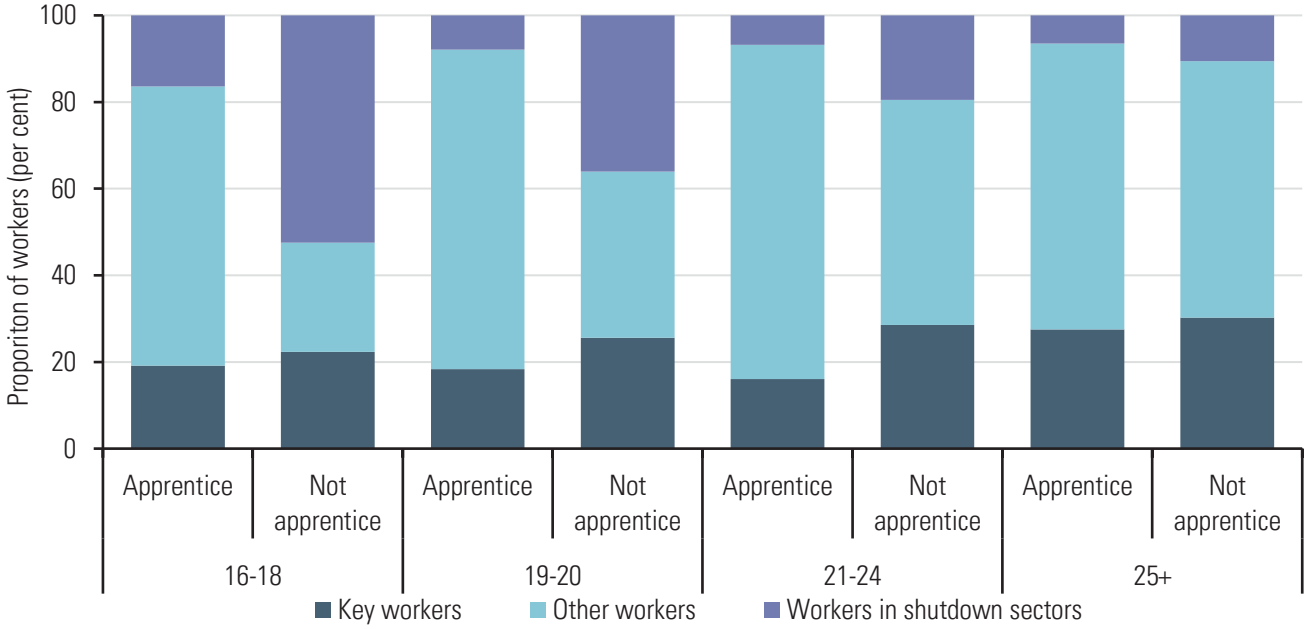
Source: LPC estimates using Skills Development Scotland Modern Apprenticeship Statistics, Quarter 1, 2021-21.

6.8 Training providers we spoke to told us that starts varied considerably between sectors: demand for apprentices was steady in those sectors which remained open, such as health and social care, but collapsed in those that did not, such as hospitality.

6.9 At the time of the initial lockdown and throughout the year, we heard from stakeholders that beyond the slowdown in starts there was disruption to existing apprenticeships, with training paused or moved online to the maximum possible extent. There was also concern that apprentices may be more vulnerable to redundancies than other groups of workers, given they tend to be less skilled than other workers and to have shorter tenure with their employer. Beyond anecdotal information, however, there is a lack of data on these effects, and we are not able precisely to identify how many existing apprentices have had their courses disrupted or have lost their jobs.

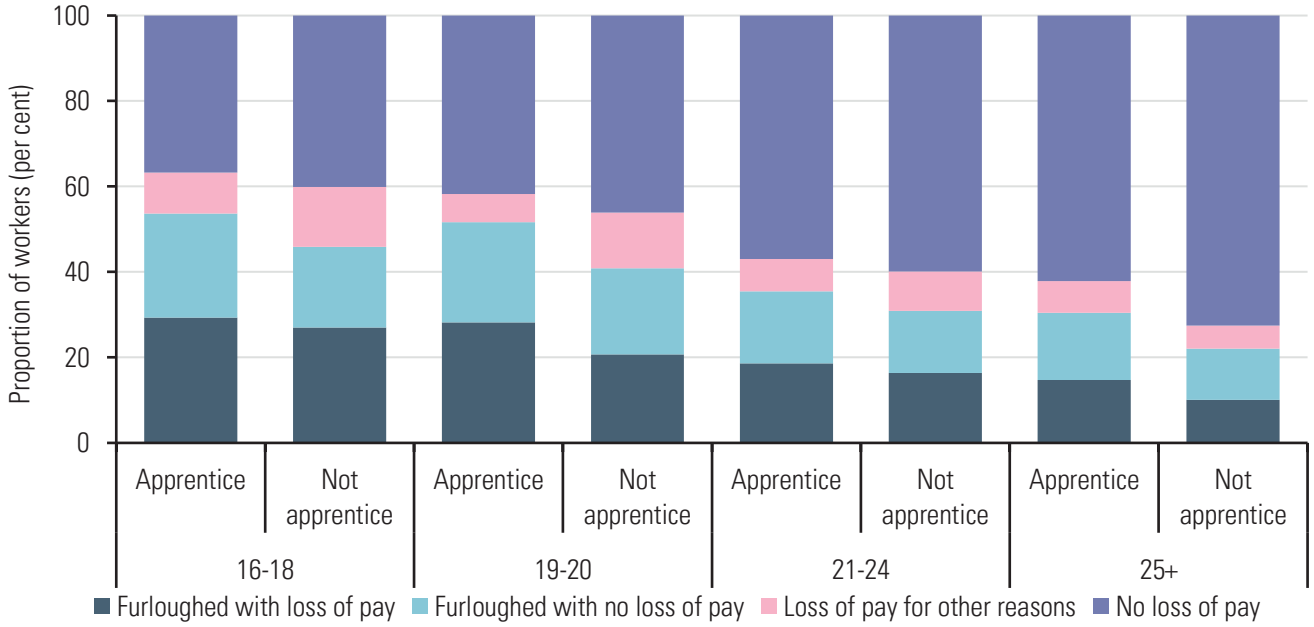
6.10 The ASHE data on apprentices, although not a reliable source of pay information, does give some sense of how many apprentices were affected by the CJRS. Figure 6.3 and Figure 6.4 show that apprentices are less likely than others to work in the sectors most affected by the crisis; but were slightly more likely to have been furloughed than their non-apprentice peers. As noted above, these figures are based on small sample sizes which likely undercount the actual number of apprentices. Nevertheless, it is clear that some apprentices were furloughed.

Figure 6.3: Proportion of apprentices and non-apprentices working in sectors most affected by the crisis, by age, ASHE, UK, April 2020



Source: LPC estimates using ASHE 2010 methodology, low-pay furloughed weights, UK, 2020.

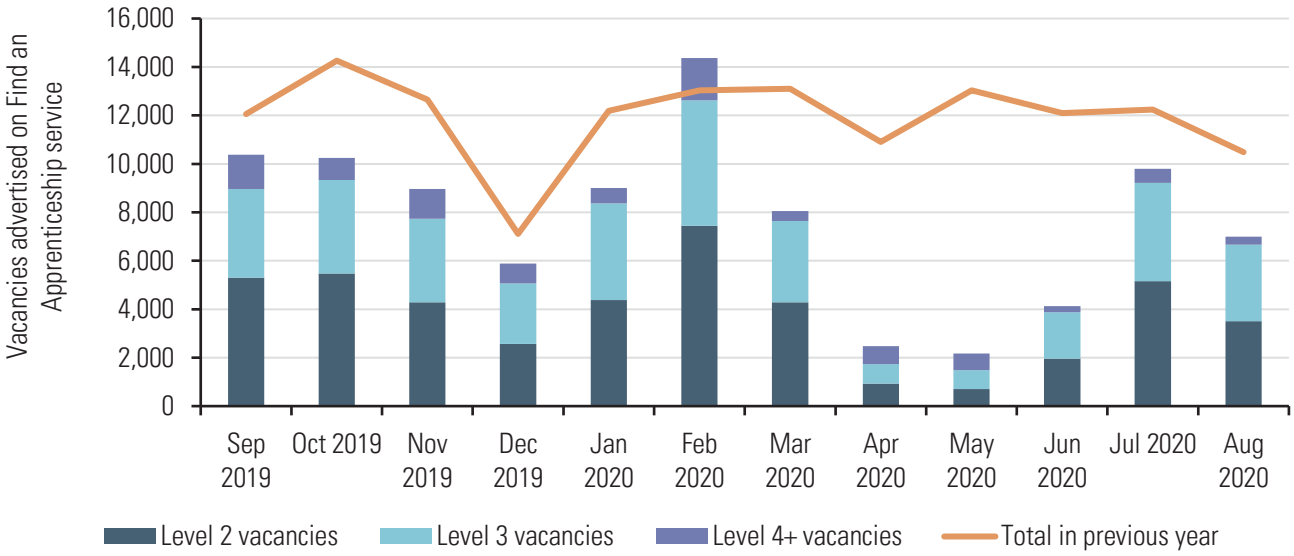
Figure 6.4: Proportion of apprentices and non-apprentices who were furloughed under CJRS, by age, ASHE, UK, April 2020



Source: LPC estimates using ASHE 2010 methodology, low-pay furloughed weights, UK, 2020.

6.11 Another available means of tracking apprentice recruitment is through job vacancies. Figures are available showing the number of vacancies advertised on the Government's online portal, Find An Apprenticeship. This does not show a comprehensive picture of the market for apprentice jobs – it is not mandatory for employers to use the portal – and the relationship between the numbers of vacancies advertised and the number of starts is not clear. But it does offer some insight as to the pace of recruitment and direction of travel – particularly for starts at level 2, which make up a greater proportion of the roles advertised than they do in the overall figures. Figure 6.5 shows that vacancies on the service collapsed in April and May to less than a fifth of their levels in the previous year. Numbers had recovered by July – still lagging the previous year's total, but on a par with figures from before the pandemic. This is broadly in line with what we have observed for the labour market as a whole – see, for example, Figure 2.20 on page 44.

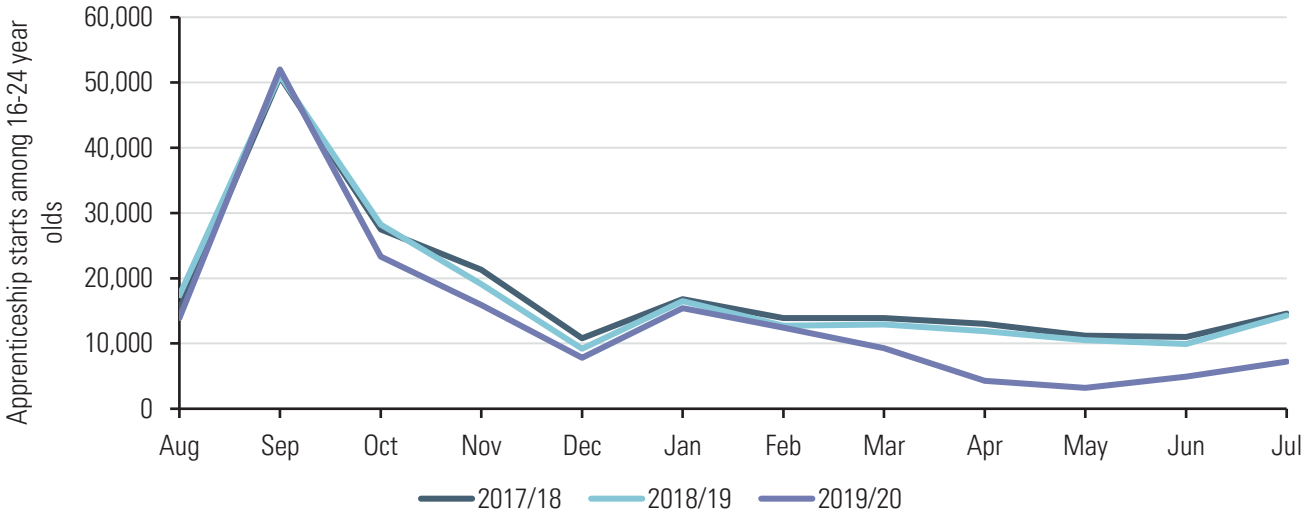
Figure 6.5: Vacancies advertised on Find An Apprenticeship service, England, September 2019-August 2020



Source: LPC estimates using Department for Education Vacancies and adverts posted on the Find An Apprenticeship website, by level (August 2020).

6.12 The trend in vacancies over the summer looks hopeful – but we do not know whether it will translate into a comparable rebound in apprenticeship starts. September is the key month in the year for starts, above all for the 16-24 age group. As Figure 6.6 shows, in previous years the total number of starts in September has been almost twice as high as any other single month. This year, Commissioners met at the end of October, before DfE and devolved administrations had published any statistics for September. The anecdotal picture from training providers seemed to be that starts remained below their level from previous years, with similar sectoral variations to those seen earlier in the year. Without this key data, however, there is considerable uncertainty over how badly apprentice recruitment has been affected to date, and even more uncertainty over how long this effect is likely to last.

Figure 6.6: Month-to-month apprenticeship starts for 16-24 year olds, England, 2017/18-2019/20



Source: LPC estimates using Department for Education Apprenticeship and levy statistics, 2017/18-2019/20.

Government support for apprenticeships

6.13 Government policy will be a key influence on trends in apprenticeship starts over the autumn and beyond. In his Summer Plan for Jobs, the Chancellor announced a temporary subsidy for employers taking on apprentices, with payments offered to employers taking on apprentices from August 2020 to January 2021 (effectively the first half of the 2020/21 academic year), as set out in Table 6.1. These payments make it relatively more attractive to take on younger apprentices – a 16-18 year old now attracting £3,000 of funding, compared with £1,500 for an apprentice aged over 25.

Table 6.1: Apprentice payments, England

	Existing funding	New additional funding
16-18 year olds	£1,000	£2,000
19-24 year olds	-	£2,000
25+ year olds	-	£1,500

Source: HM Treasury, Plan for Jobs 2020.

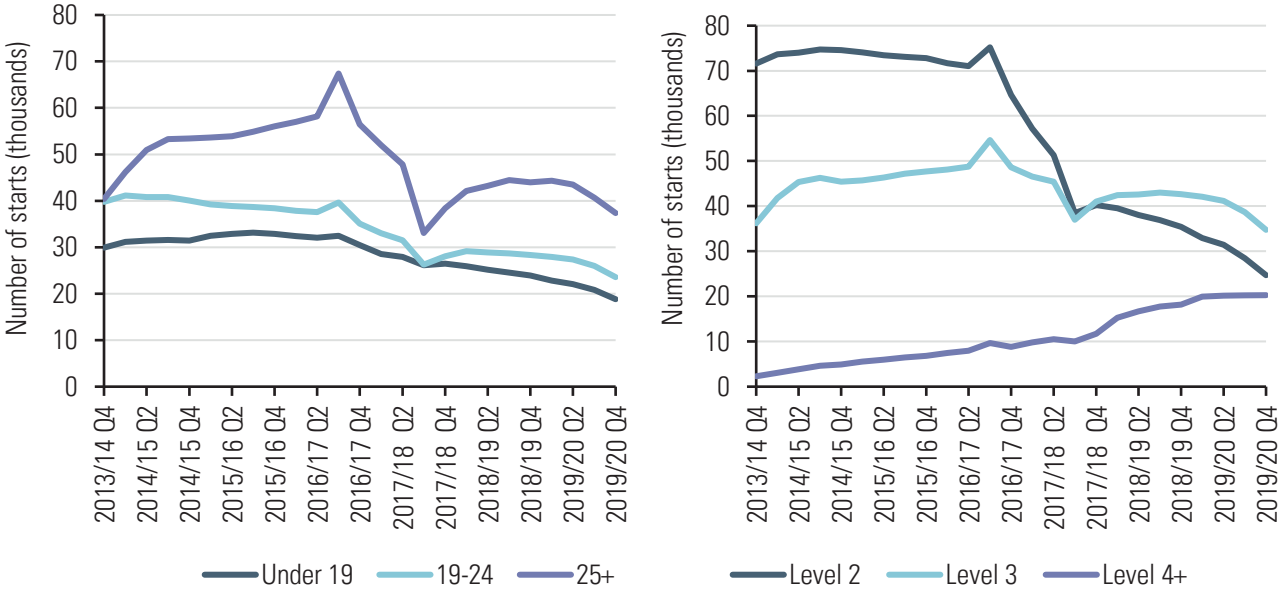
6.14 We have heard a range of views from stakeholders about the effectiveness of these payments in encouraging employers to take on apprentices – they were generally received positively, but in all cases stakeholders felt more support was needed. In evidence to us in the summer, the National Hair and Beauty Federation (NHBF) welcomed the payments, and hoped they would be extended beyond the initial six-month period. The British Chambers of Commerce (BCC) and Federation of Small Businesses (FSB) also welcomed the payments, but also noted they would continue to ask Government for other, longer-term support measures – the BCC asking for a 12 month wage subsidy for apprentices under 24 and the end of SMEs' co-payment of training costs, for example. The CBI noted an absence of support for businesses to retain existing apprentices rather than just recruit new ones. Views from training providers we spoke to in the autumn were also mixed; some reported a positive impact, but more told us that the size of the additional payments was too small to significantly influence employer behaviour.

6.15 The effect of other, more widely targeted Government interventions on the apprenticeship system is also unclear. We have already seen above that the data suggests apprentices were furloughed at a comparable rate to the rest of the workforce. There are also likely to be interactions with the Kickstart scheme and measures on traineeships which are hard to predict; employers interested in recruiting younger workers have a choice between a number of different incentives.

Longer-term trends

6.16 The short-term picture – the impact on starts of the pandemic – also needs to be considered in its longer-term context. This section looks at some of the longer-term trends in starts. There are important differences in the policy regimes across UK, driving different outcomes. Overall, England makes up a significant majority of starts. We have noted in previous reports the long-term trends in England, which have seen steady falls in the number of under-19s starting apprenticeships and the number of starts at level 2 (as set out above, the groups most exposed to the Apprentice Rate). These have been particularly in evidence since the introduction in 2016 of significant reforms to the way apprenticeships were funded. The area of growth within the English system has predominantly been higher-level apprenticeships, where the Apprentice Rate is much less likely to have an influence in setting pay. Figure 6.7 sets out these trends, which the pandemic has not shown any signs of changing.

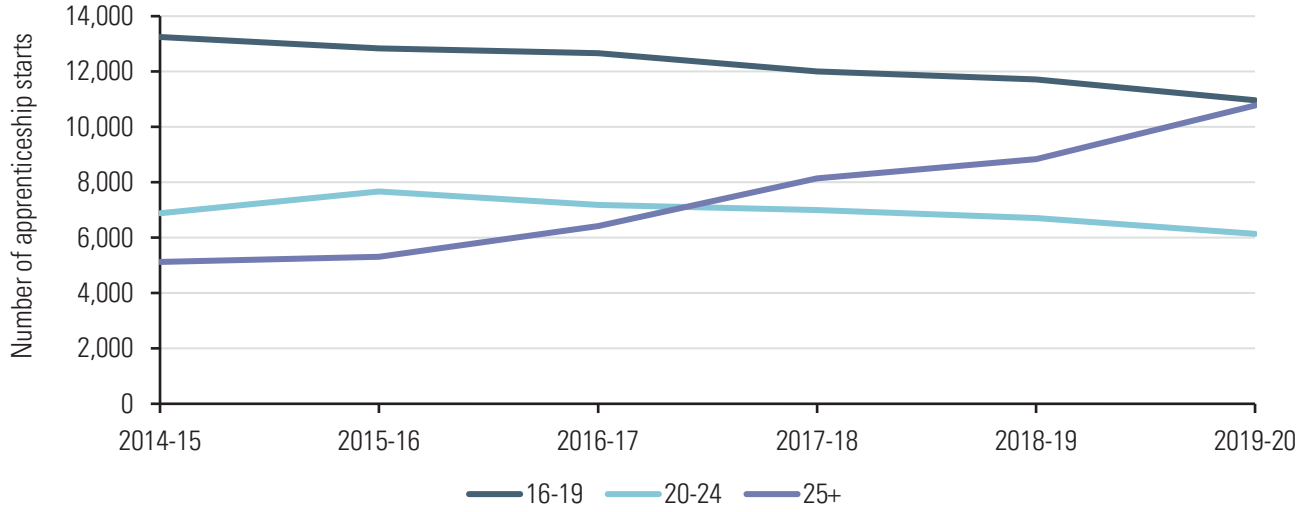
Figure 6.7: Apprenticeship starts, by age and level, England, Q4 2013/14-Q4 2019/20



Source: LPC estimates using Department for Education Apprenticeship and levy statistics, four quarter moving average, 2013/14-2019/20.
Note: Data is based on academic years (August to July).

6.17 In other nations, by contrast, apprenticeship starts have been relatively stable, with a composition by age and level distinct from England. In Scotland, as Figure 6.8 shows, the overall numbers of starts has remained fairly constant. The largest number of starts has been among the 16-19 age group, although this has declined over time, with starts among over-25s increasing significantly in recent years. A time series of starts by level was not available for the most recent years.

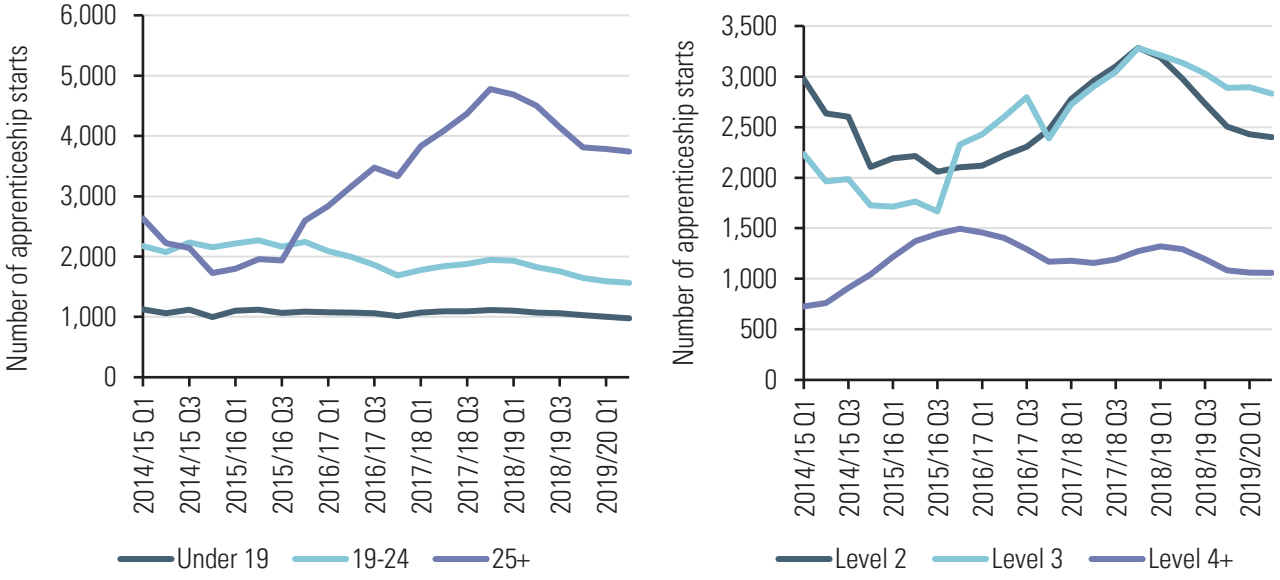
Figure 6.8: Apprenticeship starts, by age, Scotland, 2014/15-2019/20



Source: LPC estimates using Skills Development Scotland Modern Apprenticeship statistics, 2014/15-2019/20.
Note: Data is based on financial years (April-March).

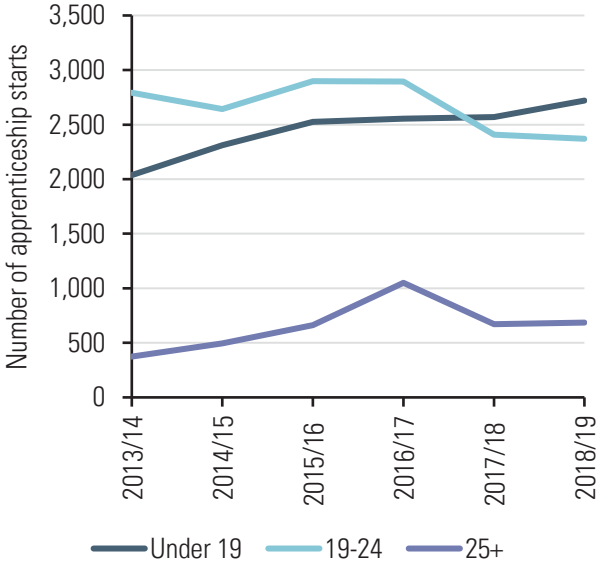
6.18 Apprenticeship starts in Wales have a similar composition to those in England, with older apprentices making up the majority of starts as shown in Figure 6.9. The total numbers, however, have remained much more stable, with the number of under-24s starting apprenticeships unchanged over time and what had been a steady rise in starts among over-25s flattening off in the last two years. The composition by level is more consistent also, without the sharp declines at level 2 which characterise the English system in recent years. In Northern Ireland, where statistics broken down by level of study are not available, the picture in Figure 6.10 is again more steady, although the composition by age is significantly different, with the youngest age groups predominating. Figures for the most recent academic year are available up to April 2020. Figure 6.11 shows around a 12 per cent decline in starts over the first three quarters.

Figure 6.9: Apprenticeship starts, Wales, 2014/15 Q1-2019/20 Q2



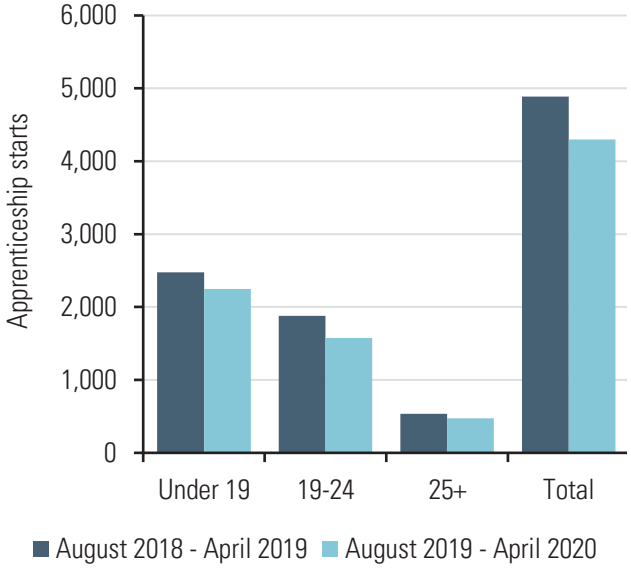
Source: LPC estimates using statistics from The Welsh Government (StatsWales), moving four-quarter average, 2013/14-2019/20.
Note: Data is based on academic years (August to July).

Figure 6.10: Apprenticeship starts, by age, Northern Ireland, 2013/14-2018/19



Source: LPC estimates using statistics from the Department for the Economy, Northern Ireland Executive, 2013/14-2018/19.
Note: Data is based on academic years (August to July).

Figure 6.11: Apprenticeship starts, by age, Northern Ireland, August 2018-April 2019 and August 2019-April 2020



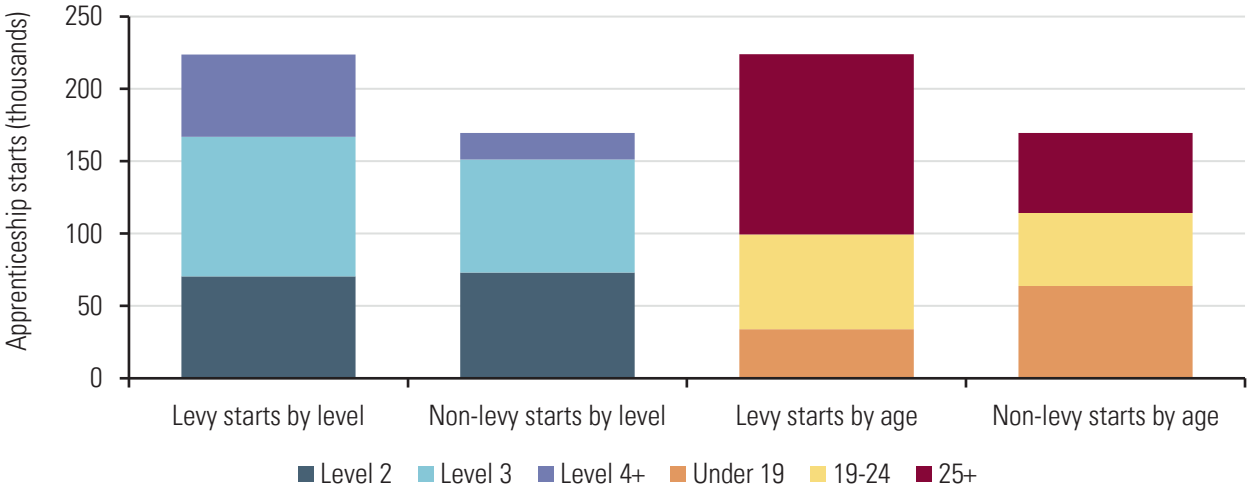
Source: LPC estimates using statistics from the Department for the Economy, Northern Ireland Executive, Q1 2018/19-Q3 2019/20.
Note: Data is based on academic years (August to July).

Drivers of long-term trends in England

6.19 The distinct patterns across different nations suggest that the Apprentice Rate is not driving the declines seen in England in the groups with highest coverage. Instead, these seem to be an effect of the reforms of recent years in England, which have introduced the Apprenticeship Levy, co-payment for SMEs, apprenticeship standards and the requirement for 20 per cent of an apprentice's time to be spent in off-the-job training (all of which have been covered in previous LPC reports – see Low Pay Commission, 2017, for example). These have effectively created two different groups of employers, the larger levy-payers and smaller non levy-payers, whose apprentice recruitment follows slightly different profiles. Over time, an increasing proportion of starts in England have been funded by the Apprenticeship Levy, as the number of starts among smaller employers has declined.

6.20 Figure 6.12 shows the composition of starts in England in the 2018/19 academic year among levy-payers and non levy-payers. Levy-payers are much more likely to fund starts at level 4 and above (i.e. degree-level apprenticeships). Non levy-payers fund slightly more starts at level 2, but this makes up a much larger slice of their overall activity. The difference in breakdown by age is more stark; non levy-payers are far more likely to start under-19s on apprenticeships, while levy-payers are more likely to do so for over-25s. This is likely to correspond to a fundamental difference in how these groups of employers use apprenticeships, with non levy-payers recruiting new starters into apprenticeships and levy-payers more likely to offer apprenticeships to existing workers. This, in turn, affects the pay of each group; existing workers will remain on their current wage level, while for new starters (especially under-19s, with low experience) the Apprentice Rate is much more likely to be a consideration in setting their pay.

Figure 6.12: Composition of apprenticeship starts, by age, level and levy status, England, 2018/19



Source: LPC estimates using Department for Education Apprenticeship and levy statistics, 2018/19

6.21 There are likely to be several reasons for level 2 starts declining among non levy-paying employers. These are explored in qualitative research recently published by the Department for Education (2020c) which interviewed employers about the causes and consequences of the decline. The factors picked out include the additional funding burden introduced by co-payment; the strengthening of expectations around off-the-job training; and requirements for apprentices to pass functional skills examinations. These have had the cumulative effect of making level 2 apprenticeships a less attractive route for bringing in inexperienced, low-skilled workers. Pay in general, and the rising Apprentice Rate in particular, is not mentioned in the report.

The level and structure of the Apprentice Rate

Introduction and background

6.22 Following the conclusion of our review of the youth rates last year, we decided it would be appropriate to take a similar look at the Apprentice Rate. It is five years since we last reviewed the structure of the Apprentice Rate, and as discussed above, there have been major reforms to the policy framework and funding system in England since then. Over the past year, we have considered the case for changes to the level and structure of the rate beyond the usual annual upratings.

6.23 The Apprentice Rate was introduced in 2010. From 1999 until 2010, many apprentices were exempt from the NMW. The LPC's first report (Low Pay Commission, 1998), noted that in the first year of an apprenticeship, wages were likely to be low, 'reflecting the extent to which the apprentice is in training rather than productive work. We must ensure that we do not cut across this important means by which young people acquire skills which will equip them for well-paid work'. The Government followed the recommendation to exempt apprentices from the National Minimum Wage (NMW), but applied this only to those aged 16-18, or to older apprentices in the first year of their apprenticeship. Despite not being part of the NMW structure, in practice weekly contractual minimum wages were in place in England as a condition of Government support, with other recommended wages and training allowances in the rest of the UK.

6.24 In 2009 the LPC looked again at the case for an apprentice minimum wage, in response to several developments: apprenticeship policy changes; the introduction of the 16-17 Year Old Rate; and stakeholder concerns that some employers were abusing the exemptions. The possibility of harmonising the de facto apprentice minimum wages across the UK was another consideration. Commissioners agreed it would be appropriate to bring apprentices into the NMW framework, but remained of the view that special treatment for them was appropriate to 'recognise the particular costs and benefits involved in the provision of apprenticeships'. The Government accepted this argument and asked the LPC to recommend an NMW Apprentice Rate, which it did for the first time in 2010, with a rate of £2.50 per hour.

6.25 For the 2015 report, the Government asked the LPC to review whether any changes could be made to the Apprentice Rate to simplify its structure and improve compliance. The problem of high non-compliance with the Apprentice Rate had been evident since the Apprentice Pay Surveys of 2011 and 2012, and the relative complexity of the rate was cited by some stakeholders as a factor. Commissioners at the time did not agree that any complexity of the rate was a cause of non-compliance, and instead highlighted low awareness of the rate and the lack of a sustained promotional campaign. After considering a number of potential changes, we did not see a case for major changes to the rate.

6.26 The problem of non-compliance with the Apprentice Rate has remained significant, with successive pay surveys recording very high levels of underpayment. Using the evidence of the 2018/19 Apprentice Pay Survey, we made recommendations to the Government addressing this problem earlier in 2020, in our report on non-compliance and enforcement (Low Pay Commission, 2020b). As in 2015, we did not think the complexity of the rate was behind widespread underpayment; the problem instead appeared to be the non-payment of apprentices' training hours, although whether the cause of this is ignorance of the rules or deliberate malfeasance is not clear. Our recommendations centred on the need to increase awareness of the rules around training hours and target this type of underpayment via enforcement. We expect a Government response to our report in the near future.

Options for change

6.27 Our current review of the rate was not in response to any request from the Government. A significant amount of time has passed since we last looked at the rate's structure in detail. In the interim, there have been significant changes to apprenticeships in England, the effects of which are not final but are reasonably apparent. All of this on its own would be enough to justify a review.

6.28 The other impetus for the review has been the strong views we have heard from stakeholders on the rate. Feedback from both workers' and employers' representatives have shown widespread dissatisfaction with the current level of the Apprentice Rate and a conviction that there is scope to push the rate higher. There are exceptions to this belief, particularly in sectors with a higher prevalence of low-paying apprenticeships. But in general, the near-unanimity of opinion on the rate has been striking and is distinct from the usual pattern of stakeholder views on minimum wage issues.

6.29 We asked several questions in this year's consultation about the Apprentice Rate. These are set out below. We addressed the problem of underpayment in our report on non-compliance and enforcement, and do not go into greater depth here. On the treatment of older apprentices we did not receive any substantial responses.

2020 consultation questions

The evidence suggests that underpayment of apprentices is high and unpaid training hours are the central cause of this. What are your views on the extent of this problem and solutions to it?

In response to feedback from a range of groups, one of the options we are considering is raising the Apprentice Rate so it aligns with the 16-17 Year Old Rate. The main groups affected by this would be younger apprentices – 16-18 year olds. What would be the effect of this change on the pay, provision and take-up of apprenticeship places, and training volume and quality for those apprentices affected?

For older apprentices, the level of the Apprentice Rate is less relevant. But there is evidence that some employers still 'use' the rate by paying their apprentices below the NMW. What effect do the Apprentice Rate and the other NMW rates have on apprenticeships for older (those aged 21 and over) apprentices? Please consider the pay, provision and take-up of apprenticeship places, and training volume and quality.

Do you have any additional evidence on the effect of the Apprentice Rate and the impact of recent upratings?

6.30 The main option on which we sought evidence was the impacts of aligning the Apprentice Rate with the 16-17 Year Old Rate. This has been a frequent stakeholder request, and one for which various rationales have been offered. These have included the potential benefits for the public perceptions of apprenticeships which a higher minimum wage would bring; the perceived simplification of the NMW structure; the harmful effects of a low Apprentice Rate on access to and completion of apprenticeships; the potential effects of a low Apprentice Rate in incentivising employers to treat apprentices as cheap labour only, and enabling their exploitation; and the inadequacy of the Apprentice Rate as a living wage. We go on to look at the merits of each of these arguments.

Who is covered by the Apprentice Rate?

Coverage of the Apprentice Rate is highest for the youngest apprentices, with 36 per cent of 16-18 year olds covered by the rate in their first year and 18 per cent in their second year. These numbers fall steeply for older apprentices, such that only 2 per cent of those aged 25 or older are covered by the rate in their first year (Department for Business, Energy and Industrial Strategy, 2020). This means that raising the Apprentice Rate mainly affects the youngest apprentices; for example, 85 per cent of the apprentices who are paid between the Apprentice Rate and the 16-17 Year Old Rate are under 19 years old.

Older apprentices in their first year may still be paid less than the NMW rate for their age group. For example, APS data show around one in four apprentices aged 25 or older are paid below the NLW. Although their pay is generally much closer to the NLW than to the Apprentice Rate, this seems to reflect employers using the opportunity to pay apprentices at a discount; it may also show the effect of unpaid training hours.

6.31 By alignment, we do not mean that the two rates would be merged. Under our remit, we are required to set NMW rates that do not harm employment. This means that for each rate we need to have regard to the labour market status and prospects of the group of workers concerned. Although there is overlap between these two groups (apprentices and 16-17 year olds), it is clear that their labour market performance is distinct; there is no reason to believe they would perform on equivalent terms in every year. As such, we draw a clear distinction between aligning the rates and merging them. In the latter case, the rates would be dissolved into a single rate and Commissioners would only make recommendations on this in the future. In the former case, which is the one we think practical, the rates are raised to an equal level in one year, but Commissioners continue to consider the two groups separately and to make distinct recommendations on each.

Stakeholder views

6.32 Most of the stakeholders who spoke to us said that they support the Apprentice Rate being aligned with the 16-17 Year Old Rate. Many said that apprenticeships can be seen as unattractive by young people seeking employment because the pay is too low, and an increase in the rate could help to resolve this. UK Fashion and Textile Association said that they expected that such an increase in the rate would help recruitment and UKHospitality thought the direction of travel should be towards more and better paid apprenticeships.

6.33 Some groups, while supporting the change in principle, argued it should be delayed because of the vulnerability of apprentices during the pandemic. The British Chambers of Commerce (BCC) recommended that the change should be postponed to 2022 with increases in line with inflation in 2021. The Federation of Small Businesses (FSB) similarly advocated caution in the near term to avoid adversely affecting starts. Both restated their support for aligning the rates in the longer term, though: the BCC said that aligning the rates would help to attract candidates and reduce complexity, while the FSB suggested that it would help to 'boost the brand' of apprenticeships.

6.34 Worker representatives including the Trades Union Congress (TUC) universally supported the alignment of the rates. They said that the low rate has been exploited by some employers who are looking for cheap labour and do not offer high quality training opportunities. Stakeholders including the Intergenerational Foundation, the Communication Workers' Union (CWU) and the GMB also reported cases of employers abusing the low rate through job substitution and not providing adequate training.

6.35 However, some stakeholders expressed concern around aligning the rates, particularly in light of the labour market context and the sustained falls in apprenticeship starts. The National Hair and Beauty Federation (NHBF) continued to strongly oppose any increases to the rates, stating that apprentices do not bring in any income and any increases would be unaffordable. The Chartered Institute for Personnel and Development (CIPD) thought that the change could discourage some employers from hiring new apprentices.

The case for aligning the Apprentice Rate and 16-17 Year Old Rate

6.36 Our remit for the Apprentice Rate, set each year by the Government, is the same as for all other NMW rates apart from the National Living Wage (NLW); that is, to raise the rates as high as possible without damaging employment. We have considered stakeholder views on increases to or alignment of rates primarily in those terms, but we have also looked specifically at the other arguments which are made around alignment, and the logic and evidence for each of those.

Access to apprenticeships

6.37 Probably the most compelling of these is that the level of the Apprentice Rate limits access to and completion of apprenticeships, by effectively limiting the candidates who apply to (and then go on to complete) apprenticeships to those who can afford to. As Youth Employment UK put it this year, 'We have been told by young people that the minimum wage for apprenticeships is too low and can be a barrier to opportunity'. In a report earlier this year, looking at the performance in the apprenticeship system of individuals from disadvantaged backgrounds, the Social Mobility Commission recommended that both DfE and the LPC 'target the financial … aspects of apprenticeship training known to depress completion rates, particularly among disadvantaged learners'.

6.38 There is a limited evidence base on the factors which bring apprentices into apprenticeships and those which determine whether they do or do not complete. One place to start could be with awareness of the minimum wage among apprentices. The Apprenticeship Pay Survey asks apprentices whether they are aware of the Apprentice Rate and whether they know what the rate is. In the most recent survey, 68 per cent of apprentices were aware of the rate, and 30 per cent knew what the rate was. These figures were much higher for younger apprentices (for under-19s, 77 and 48 per cent respectively).

6.39 In DfE's 2018/19 Apprenticeship Evaluation Survey [add reference], apprentices were asked about their satisfaction or dissatisfaction with their apprenticeship, and then about reasons for dissatisfaction. Only 7 per cent overall reported themselves as dissatisfied, and only 4 per cent of that group reported low pay as the cause, although this was higher (12 per cent) for dissatisfied under-19s, who tend to be lower-paid. On completion rates, the DfE's Learners and apprentices survey 2018 [add reference] asked a sample of 775 former apprentices who had not completed their course why this was. Only 3 per cent of those surveyed said they did not complete because their apprenticeship did not pay enough. The most common responses were that individuals had changed their mind about their future career; that their apprenticeship was cancelled before completion; or they had received the offer of a paid job elsewhere.

6.40 This evidence does not suggest that low pay is a significant factor affecting apprentices' completion rates. Instead, it is primarily anecdotal evidence which is cited to support this argument. We agree it is plausible that low apprentice pay is a factor in some cases of non-completion; but we find there is weak evidence to suggest that it is a leading factor in this, or that an increase to the Apprentice Rate would be an effective way of increasing completion rates.

6.41 There is less data by which to assess the case for the level of the Apprentice Rate dissuading apprentices from starting their course. We believe it is plausible that this takes place in some cases, and that increases in the value of the rate (and especially its value relative to the 16-17 Year Old Rate) may draw additional individuals into apprenticeships. But this is difficult to quantify, and in setting the rate, we still need to balance this with the effects on the supply of apprenticeships.

Exploitation

6.42 We have heard from various groups, in particular workers' representatives, that the Apprentice Rate is so low that it constitutes 'exploitation pay' – that employers who use it are de facto exploiting their apprentices. Part of the rationale for the Apprentice Rate, as for the NMW in general, is to prevent the exploitation of low-paid workers who have unequal bargaining power compared with their employers. Although there is no single definition of exploitation, in the context of apprenticeships, we can reasonably frame it in terms of the quality of apprenticeships and their value to apprentices. Inherent in the rate is the notion that the apprentice takes a lower wage to recognise the employer's investment in their training. If an employer using the rate does not meet its side of that bargain, it is fair to characterise the arrangement as exploitative.

6.43 When it comes to arguments about the relationships between low pay and low-quality apprenticeships, the evidence is not clear-cut. This is in large part because there is no single measure of the quality of apprenticeships, and those that exist do not allow easy comparisons between low-paying apprenticeships and relatively better-paid ones. DfE's Apprenticeship Evaluation Survey (Department for Education, 2020a) asks apprentices about their satisfaction with their apprenticeship, including satisfaction with training quality, but there appears little correlation between satisfaction across broad subject areas and average levels of pay. Apprentices at level 2 are more satisfied with the training received than those at levels 3 or 4, but this may say as much about the differing expectations of those groups than about the objective quality of the training they receive.

6.44 Ultimately, the key question is whether it is justifiable to use the Apprentice Rate as a policy tool to drive apprenticeship quality. Such an intervention is not in our remit, and in any case we do not think the evidence is there to suggest the minimum wage would be an effective way of achieving that end. Policy responsibility for quality sits with education departments in each nation, and we have heard from DfE in recent years about their measures to improve quality and increase the quantity of training throughout the apprenticeship system. We will continue to look at the evidence for links between apprentice pay and quality, but although increases in the Apprentice Rate may support this goal, it is not one of our main considerations in making recommendations.

The Apprentice Rate as a living wage

6.45 Another, related view we frequently hear is that the level of the Apprentice Rate is not a living wage. As Usdaw told us this year, 'the rate of £4.15 per hour has no place in British workplaces'. In a 2018 report [add reference], the Education Select Committee gave a view representative of those we have heard from many: 'while we understand the arguments in favour of a reduced rate, and that most apprentices are paid significantly more, we do not think the current rate strikes the right balance...£3.70 an hour is not a living wage by any definition.'

6.46 It is obviously the case that the Apprentice Rate is not a living wage in the broadly understood sense of paying enough for someone to live on independently. NMW rates are set with regard to the LPC's remit not to damage employment, rather than a calculation of the cost of living. We know from our consultations in recent years that young workers, including apprentices, can find themselves having to live and make ends meet independently. We will continue to seek evidence from apprentices on their experience of living and working on low pay. Such conversations have been more difficult to hold this year during the pandemic, but are and will continue to be an important resource for us in considering the effects of the Apprentice Rate. But our recommendations on the Apprentice Rate try to balance the benefits to workers of higher hourly pay with the risks of a rate set too high closing off opportunities. This would remain the case whether or not the rate is aligned with the 16-17 Year Old Rate, which is not set to cover the cost of living either.

6.47 What we know about the way the Apprentice Rate is used offers some reassurance on this count. Coverage of the Apprentice Rate is highest for the youngest age groups, who are least likely to live independently. For apprentices aged over 21 and over 25, the numbers paid at the rate are very small. Employers and training providers have told us that where the rate is used, it is generally as a starter rate for apprentices who are school leavers without labour market experience, and whose pay increases as they progress in their apprenticeship. This was reflected in the qualitative research carried out for us by academics at the University of Warwick (Dickinson, Hogarth, & Cardenas Rubio, 2020).

Perceptions of apprenticeships

6.48 Employer groups have told us that increasing the Apprentice Rate would improve perceptions of apprenticeships and help in attracting recruits into apprenticeships. The Federation of Small Businesses argued this year that 'gradually bringing the apprenticeship rate more closely in line with the under 18 rate would boost the apprenticeship 'brand' among young people and help small businesses attract the best young recruits'. In 2019, the British Chambers of Commerce told us that 'many employers pay above the apprentices rate and argue that the headline rate is unattractive to young people, parents and people returning to the workplace or changing careers.'

6.49 The pay rates which employers offer to apprentices are not restricted by the Apprentice Rate, which is a pay floor for apprentices. Employers are free to increase their starting rates and there are sectors where high pay is associated with prestigious apprenticeships. We accept that the level of the Apprentice Rate may affect some workers' and employers' perceptions of apprenticeships. But as we have noted, awareness of the rate amongst apprentices is fairly low – indeed this is likely a key factor in the high levels non-compliance. Increases to the rate may have the benefit of improving some perceptions, but we do not believe that the minimum wage is the right tool to manage or boost the 'brand' of apprenticeships and this will not be a consideration when we make recommendations on the rate.

Conclusion

6.50 On the basis of stakeholder submissions, our judgement is that over time there is scope to make significant increases to the Apprentice Rate within our current remit. The majority of stakeholder evidence from both employers and workers suggests that pay is not a significant factor in employers' decision-making over whether or not to recruit apprentices. This has been a repeated message from employers in a wide variety of sectors for several years. With the exception of hairdressing, we did not hear any strong objections to raising the rate. We acknowledge that a higher rate will create most pressure in hairdressing and, to a slightly lesser extent, childcare, where median apprentice pay is lowest. But we think there are other factors at work in those sectors which will continue to support apprentice recruitment – in particular, the strong tradition in the former of apprenticeships as a means of bringing new entrants into the workforce.

6.51 The coming year is likely to be a difficult one across the labour market, and for apprentices no less than any other group. The context for our decisions on the rate is an apprenticeship system greatly disrupted by short and long-term factors. Covid-19 has had an enormous short-term impact on the supply of new apprenticeships, with both starts and vacancies down considerably on previous years and, at the time of our deliberations, no data on crucial autumn months and therefore no indication of how quickly the system will return to 'normal'. But 'normality' in recent years has meant a significant decline in starts among the groups most exposed to the Apprentice Rate, with growth concentrated in higher-level apprenticeships which are outside the orbit of the minimum wage.

6.52 In addition to this, the labour market for young people (and especially 16-17 year olds) is softening. As we set out in Chapter 5, these individuals are more likely to work in sectors which have been shut down by this year's pandemic, their employment rates are falling faster than older workers and they have more to lose via the scarring effects of periods unemployed. It would never be a good outcome to limit the supply of apprenticeships for young people but in better economic circumstances we could be more confident of them getting employment elsewhere. In the current circumstances this looks less likely. For all these reasons, we are minded to be relatively more cautious this year in our recommendation on the rate, and instead aim to raise it to the level of the 16-17 Year Old Rate in 2022. In the interim we will continue to assess the strength of the recovery in apprenticeships and to consider whether the evidence justifies our intended change.

6.53 Overall, we still believe there is a case for looking at apprentices separately from other groups of workers within the NMW structure. The ongoing changes in the composition of the apprentice cohort mean we will continue to have to consider them separately from the 16-17 year old cohort. The rationale for the original exemptions of apprentices from the rate structure in 1999, and for the lower rate introduced in 2010, still holds. Like our predecessors in past Commissions, we do not want to disrupt an important route for workers – especially young workers – into training and the labour market. It is important to acknowledge the investment that employers are expected to make in training apprentices – and to be mindful that the minimum wage does not cut across this and so affect training provision. We have not seen any evidence to suggest that the current structure of the rate needs to be changed.

6.54 Since 2010 (and since our last review in 2015), there have been wholesale changes to the way apprenticeships are funded in England. Policy reforms in England have driven a shift in the way employers use apprenticeships and a shift in which employers use apprenticeships. The net effect has been to make low-paid apprenticeships less central within the 'apprenticeship system' as a whole. In part, this is a consequence of a divide between levy-paying employers (for whom there is a strong incentive to offer apprenticeships as a way of spending levy funds which would otherwise be irrecuperable) and smaller employers who do not pay the levy. For this latter group, reforms – both co-payment and the strengthening of rules around off-the-job training and functional skills – have led to a decline in the quantity of lower-level apprenticeships offered. The effect of that change is ambiguous. It could be seen both as a diminution of opportunities for young people and as a net improvement in the quality of apprenticeships. The evidence we have heard from employers tends to support the latter conclusion, although this is not universal.

6.55 We have heard and seen very little to suggest that the Apprentice Rate is a strong driver of employers' decisions or of overall numbers of starts or that changes in the rate have had an influence on numbers in recent years. One potential explanation for this is the high level of underpayment we find in the data. If unpaid training hours are as prevalent as the APS data suggest, then it may be that lots of employers are effectively providing themselves with a buffer against upratings. For many of these employers, the costs of simply complying with the rate would be greater than those of any year-to-year uprating. As set out in our report earlier in the year, solving the underpayment problem remains imperative.

6.56 Finally, the Apprentice Rate is not the right tool to solve other policy issues with apprenticeships. It is plausible that a higher rate may have some benefits for apprenticeship quality, completion rates or perceptions of the apprenticeship programme as a whole. But the evidence base does not exist to suggest these benefits would be significant, or that the NMW is a sensible tool to use to target those ends. There are separate policy apparatuses to regulate the quality and brand of apprenticeships. As long as our remit states, we will continue to make recommendations balancing the desire to increase pay with the need to protect opportunity and employment for apprentices.

Chapter 7

Other impacts on employers and workers

Key findings

The circumstances of the pandemic and the presence of the Coronavirus Job Retention Scheme (CJRS) make it difficult to track the broader ways employers have adjusted to the rising NLW this year. Despite this, it remains the case that, before they make any changes to employment, employers will try to absorb the increase in their profits or pass it on where possible via price rises. The economic circumstances have made each of these routes more difficult, however.

The other key means by which employers can adjust is by investing to improve productivity. But although the pandemic has forced some automation, it seems more likely that it has squeezed many companies' capacity for investment in productivity and training.

Despite the CJRS's success in preventing redundancies, the impacts of the pandemic have still been spread unequally. Low-paid workers have faced considerable hardship, losing income and feeling more keenly their lack of security. The perceived benefits of the rising minimum wage continue to be undermined by the prevalence of in-work poverty.

Social care and childcare remain underfunded, and low-paid workers within those sectors ultimately bear the consequences of this. Covid-19 has only accentuated the long-standing issues in those low-paying sectors where the Government is the main source of funding.

7.1 In this chapter we examine the effects that increases in the National Living Wage (NLW) and National Minimum Wage (NMW) have had for employers and workers, beyond those purely relating to employment, working hours and pay which are discussed in Chapter 4. For employers, this includes the other ways of adjusting to increases, such as price increases and productivity-enhancing measures. For workers, this includes the wider experience of living and working on low pay. This chapter also addresses the final area where we make recommendations, for the Accommodation Offset.

7.2 The timing of the pandemic, coinciding with the upratings in April, means it is difficult to disentangle the effects. Instead, this section is solely focused on the effects of the pandemic on stakeholders, with a larger focus on the worker experiences, and what we heard from them through oral evidence sessions and consultation responses.

Impact on Employers

Profits and prices

7.3 One of the most common ways of absorbing the cost of NLW increases has been via reduced profits. While that has mostly remained the case, there were signs of fewer stakeholders being able to do this. This year, survey responses showed fewer stakeholders expecting the NLW increase to affect profits. The Federation of Small Businesses (FSB) noted how the percentage of members expecting to absorb NLW costs in profits decreased from 36 percent to 30 percent, whilst British Chambers of Commerce (BCC) members survey responses in relation to lower margins or profits also decreased from 20 per cent in 2019 to 17 per cent in 2020. At oral evidence sessions both groups gave bleak outlooks on the future of the economy.

7.4 A range of factors had hit profits this year. The Food and Drink Federation (FDF) informed us how within a highly competitive and concentrated domestic grocery retail market, when discounters provide suppliers with products at a relatively low price, their margins are squeezed. In cleaning, the Institute of Workplace Facilities Management (IWFM) told us CPI-based adjustments to cleaning contracts were not enough to afford the increases in the NLW. One way small businesses attempt to alleviate this pressure on profits was for owners to work more hours themselves. The Association of Convenience Stores (ACS) and Federation of Independent Retailers (NFRN) told us how owners had worked more hours to the point it was unsustainable.

7.5 Another way to mitigate the impact of NLW increases is to pass on some or all the costs onto consumers through increased prices. As in previous years, this was a leading response in employer surveys, although there were other wider economic factors which contributed to employer decisions on prices. The number of businesses reporting price increases as a means of dealing with NLW increases were consistent with previous years in business surveys by both the Chartered Institute of Personnel Development (CIPD) and the BCC. They were less common among FSB members this year, with a decrease from 39 per cent in 2019 to 31 per cent in 2020 of employers planning to increase prices. The CIPD found a constant 8 per cent of businesses planning to increase prices. The BCC found a modest increase in the proportion of members anticipating raising prices, from 30 per cent in 2019 to 32 per cent in 2020.

7.6 Stakeholders in diverse sectors told us it was difficult to increase prices because of highly competitive markets and consumer expectations. A British Retail Consortium (BRC) survey indicated members were unlikely to raise prices in response to the increase in the NLW. The ACS told us decisions on price were driven by larger food retailers, with smaller retailers needing to remain competitive. In hospitality, UKHospitality (UKH) told us it was difficult for hospitality businesses to raise their prices due to consumers' expectations of value. Even in the context of VAT reductions, consumers would expect savings to be passed through.

7.7 This year we asked Frontier Economics to look into the extent to which increases in the minimum wage are passed on to consumers in the form of higher prices (Wilson, 2020). They exploited variation in the extent to which sectors and regions are exposed to minimum wage labour costs and used survey data on monthly inflation at the shop level to test the impact on prices. They found a small but statistically significant price effect for the most exposed products, equivalent to a price elasticity with respect to minimum wages between 0.02 and 0.11 (so a 10 per cent increase in the minimum wage would raise prices between 0.2 and 1.1 per cent). The analysis estimates that the size of the effects have increased marginally since the introduction of the NLW in 2016 at a time of larger rises in the minimum wage.

7.8 Baily, Popov and Wilson (2020) examined how business outcomes had changed after the introduction of the NLW. The authors linked the Annual Survey of Hours and Earnings (ASHE) data set to the Business Structure Database (BSD). They identified businesses that were observed to pay below the incoming NLW and compared outcomes with similar employers who were observed to pay more than 20 per cent above the incoming NLW (the authors examine how different definitions of the control and treatment group affect results as a robustness check). They tested this identification strategy against an established approach that used the Workplace Employment Relations Survey (which captures wider pay distribution within the firm) to identify low-paying employers based on their average labour cost and found that the ASHE identification measure had similar strength as an identifier. The authors use the BSD to compare employment, turnover and survival outcomes for otherwise similar firms who have different exposure to the NLW.

7.9 Paragraphs 4.13 and 4.15 discuss the employment findings in more detail, but in summary they find that employment growth from 2015 to 2018 is 2-3 per cent lower in workplaces more affected by the NLW. Looking at survival rates (the proportion of business units that continue to operate), the authors' analysis suggests that survival rates are between two percentage points higher for firms more exposed to the NLW, with the effects concentrated in the food and drink sector. The authors also aggregate their data to a sector-location level which enables them to examine the effect on business start-ups alongside exits. Their results indicate that sector-regions more exposed to the NLW have lower birth and death rates (and therefore higher survival), however these effects are largely statistically insignificant and sensitive to the approach.

7.10 The authors also examined the effect of the minimum wage on the change in turnover per employee, a proxy for productivity. The authors note issues with the turnover data, including timeliness, fluctuations in the data and the level of collection. The data suggest that turnover per employee fell in firms more exposed to the NLW, relative to firms less affected.

7.11 Gooch, Dromey and Southgate (2020) surveyed 1,002 businesses in Great Britain and interviewed industry bodies for the Carnegie UK Trust as part of an investigation into employers' views on the NLW. The fieldwork of the survey took place during the start of the initial lockdown. The study found that the majority (57 per cent) of employers supported a target NLW of £10.50 by 2024, against only 10 per cent that opposed, although amongst employers with a larger share of low-paid employees 21 percent opposed the target. Around 30 per cent of employers said that the NLW increase would have a negative impact on their organisation, but this increased to 55 per cent for organisations with a larger proportion of low-paid employees. When asked about their responses to the introduction of the NLW in 2016 and the subsequent increases, around one in six organisations said they had increased their prices to the consumer, while around one in eight said they changed their working practices to make the organisation more productive. A further one in eight reported that they hired fewer members of staff and a similar number said they had increased their use of temporary or flexible contracts. Around a fifth of employers said that they would respond to the target by passing on costs, around fifteen per cent said that they would hire fewer members of staff, around a tenth of organisations said they would increase the use of temporary or flexible contracts and a tenth of organisations said they would reduce other staff benefits.

Productivity and investment

7.12 In the long run, improving productivity is essential if businesses are to sustain increases in the minimum wage. As seen in paragraphs 1.48 and 1.49, businesses in many sectors reported cancelling or reducing investment in response to the pandemic. The FSB's survey of members' responses to the virus found 37 per cent of respondents cancelling or scaling down investment plans. In the CIPD's survey about responses to the NLW specifically, with 10 per cent of respondents saying they had cancelled investment and only minor differences between large employers and SMEs. The BCC noted a negative effect on investment in productivity and training. The NFU's survey results also noted how 52 per cent of members reported a negative impact on investment decisions.

7.13 One exception was in retail, where the BRC told us that just under two-thirds of their members had invested in automation in response to the NLW. However, in small retail, ACS reported that productivity gains had become unachievable for convenience stores at the pace needed to match rising employment costs. Investment had declined since the NLW's introduction, due to the costs for technology being too high, leading to employers attempting to squeeze hours to achieve improvements. In hospitality and pubs, UKH and the British Beer and Pubs Association (BBPA) told us that the pandemic had accelerated some automation (for example, customers using apps to order drinks), but that there was a limit to how widely this could be implemented. The IWFM also mentioned to us how many cleaning businesses were starting to use cobotics (robot-assisted cleaning, still requiring human input). The IWFM spoke to us about the reduced costs and perceived benefits and value of using cobotics.

7.14 The Association of Labour Providers (ALP) told us that their members' clients who use piece rates are requiring higher productivity to compensate for the ongoing above inflation increases in NLW. ALP members confirm that some of their clients have tightened piece rates, so that only productive workers can reach above the NLW. It has become important for labour providers to identify productive workers and their clients require that those workers that cannot rapidly meet the picking rates are replaced by workers who can. UK Fashion and Textile Association (UKFT) told us the NLW has a negative effect on the productivity of workers paid using piece rates.

7.15 Research we commissioned this year by Aitken, Forth and Riley (2020) explores the extent to which firms' responses to recent increases in the National Living Wage (NLW) vary by their opportunity to replace workers with technology and automation (their capital-labour substitution). The research uses the Financial Analysis Made Easy (FAME) data set to study responses of businesses to the NLW. FAME is a data set on the population of UK registered companies. The researchers map occupation-level measures of automatability to firms and use average labour costs as a way of identifying firms with low-paid workers. They use a difference-in-difference approach comparing the period between 2013-2015 with the period 2016-2017. The researchers find a positive wage effect from the NLW of around 2 per cent. They find no statistically significant effects on employment, labour productivity, the capital to labour ratio, or capital. They do find some evidence of a 1 percentage point fall in profit margins for more exposed firms, though this is only statistically significant at the 10 per cent level.

7.16 When exploring the extent to which the effects vary by the estimated opportunity for capital/labour substitution the researchers find no statistically significant interaction effect between industry-level automatability and NLW exposure for any of their chosen firm outcomes. They say that it is possible that there may be effects that are below the level that the analysis is able to detect, perhaps because the effects are only in a small number of industries, or perhaps those industries are already quite capital intensive. The researchers note that minimum wages are only one of numerous factors that might influence firms' decisions over the balance they choose between capital and labour.

Government support measures

7.17 In addition to the CJRS, discussed in paragraphs 2.13 to 2.16 the Government made available a set of support measures over the course of the pandemic aimed at softening the pandemic's impact. These are set out in detail in Table 1.4 on page 19. This section focuses on what stakeholders told us about these additional measures.

7.18 Sentiment varied considerably between sectors. Stakeholders in the retail sector praised the measures put in place by the Government: the BRC told us Government schemes had provided an essential lifeline for the sector. The British Independent Retailers Association (BIRA) commended business rates relief, furlough scheme and Bounce-Back Loans, which they said worked well for the sector. Union of Shop, Distributive and Allied Workers (Usdaw) noted the effectiveness of VAT reductions in supporting the hospitality and retail sectors.

7.19 In other sectors, stakeholders told us about trouble accessing support and expressed concerns about the level of debt which businesses were taking on. The NFU were concerned indebtedness would weaken the resilience of businesses in the sector. They also told us some farmers had experienced difficulties in accessing finance, "due to state aid rules restricting loan values and the short repayment period of six years with CBIL [Coronavirus Business Impact Loans] putting high serviceability requirements on many farm businesses." Similarly, in the theatre sector, Equity told us venues were in crisis due to enforced closures and many were unable to take out loans. Equity were campaigning for tailored government support for workers in their sector.

7.20 Other sectors felt they had slipped through the gaps for the support. The EYA told us the pandemic had further heightened the vulnerability of childcare providers, especially those operating in high cost, low revenue areas dependent on government support for free childcare hours. EYA explained to us that at the start of the pandemic, the Department for Education's decision to net off money claimed under the CJRS from providers' free entitlement funding had caused significant issues for the sector. In the leisure sector, Community Leisure UK (CLUK) told us that many of their members' business models meant they could not access support. Leisure providers constituted as trusts or charities struggled to access finance, either because taking on debt contravened their charters or because they leased rather than owned assets. This threatened the sector's survival.

Worker experiences in lockdown

7.21 In Chapter 4, we looked at how low-paid workers were affected by the national lockdown from late March onwards. They were more likely to work in the sectors most affected by lockdown measures, particularly hospitality and retail; they were at greater risk of changes to their pay and employment; and many, in social and health care, food retail and education, continued to work through the pandemic. Stakeholders told us about the varied experiences of low-paid workers during lockdown, adding colour to some of the statistics.

7.22 The Trades Union Congress (TUC), in their evidence to us, described how the pandemic 'has starkly exposed the huge inequalities faced by workers, especially related to pay, job security, safety and worker influence in the workplace … Unequal impacts have fallen along existing lines of inequality, including class, gender, ethnicity and other inequalities'. UNISON highlighted that 'the low-paid have taken the brunt of damage to employees' standard of living during the pandemic', noting the impact on young workers in particular. Usdaw noted that 'those most vulnerable to the effects of a turbulent economy are always those with the lowest personal income. This group is therefore the least resilient to economic change'. Citizens Advice Scotland noted that the Covid-19 outbreak 'has demonstrated again how little security low-paid work offers'; despite Government support schemes, they had seen an immediate jump in requests for advice on employment and Universal Credit.

7.23 Other groups focused on the impacts on specific groups of workers. The Scottish Women's Convention (SWC) highlighted the overrepresentation of women in some of the sectors most deeply affected, such as retail, hospitality, and cleaning. The Muslim Council of Britain informed us that 28 per cent of Muslims work in distribution, hotels and restaurants, all heavily affected sectors. They highlighted evidence from Public Health England on health disparities and the vulnerability of BAME workers to contracting Covid-19.

7.24 Many groups argued this year for recognition of the contributions of low-paid key workers during the pandemic. The GMB, TUC, Unite and Usdaw all called for key workers to be recognised for their hard work and contributions. The TUC told us how 'millions of low paid workers have kept the country running through the coronavirus pandemic...there is a strong public support recognising the contribution of key workers through the pandemic and beyond'. GMB also told us how 'low paid key workers have had 'borne the brunt of the pandemic'. Usdaw also told us about the 10 per cent bonus they had negotiated for staff working at major supermarkets and retail chains (Tesco, Ocado, Sainsburys/Argos, One Stop and B&M) in recognition for their members roles in responding to the outbreak. Our conversations with food retail workers brought home the stress of these jobs during the peak of the pandemic, with almost all facing abuse from the public at different points. On a positive note, these workers generally felt supported by their employers throughout the period, receiving a temporary uplift in their pay.

7.25 Another issue for workers during the early stages of the pandemic was confidence in being able to return to work safely. Many low-paid workers are in industries which require interaction with the public on a regular basis; workers we spoke to expressed concern over their exposure to the virus and anxiety about being asked to enforce safety rules. We spoke to cleaners in the aviation sector who had been refused personal protective equipment (PPE) by their employer even as colleagues were suffering from Covid-19. Calls for the recognition of low-paid workers' contributions went hand-in-hand with requests for adequate health and safety provision for them. The difficulty of subsisting on statutory sick pay (SSP) was another theme in the evidence we heard, with cleaners telling us about their struggle to pay rent when reduced down to SSP.

Policies and issues affecting workers

7.26 Just as the minimum wage is one contributing factor to businesses costs, wages are only part of the wider context of workers' working lives and their personal finances. We heard again from stakeholders about the problem of persistent in-work poverty, and the roles which rising living costs and the welfare system play in this.

In-work poverty

7.27 The issue of in-work poverty – and the urgency of addressing this, whether via the NMW or other policies – was a common theme in evidence to us. Unite argued that the rise in in-work poverty, from 39 per cent 20 years ago to 56 per cent in 2019, 'tarnished' the achievements of the NLW and record employment rates. UNISON made the same point, sharing evidence from the latest UK Poverty report by the Joseph Rowntree Foundation (JRF). They argued that the causes of rising in-work poverty were linked to the failure of wages to track the cost of living and 'the increased use of more exploitative forms of contract by employers. The Muslim Council of Britain also cited the JRF's finding that 56 per cent of people in poverty are in a working family. The SWC also told us how the NLW had not risen fast enough to meet changes in the cost of living, and recent economic growth had not been accompanied by any improvement in living standards of the lowest-paid, while in-work and child poverty have grown.

7.28 Unite felt this situation was particularly prevalent amongst migrant workers. We heard in a call with migrant workers in the domestic sector how many had been exposed to unsafe working conditions during the pandemic without access to PPE. They described the conditions as 'economic torture'; isolated, precarious, and very dependent on their employers, believing they were highly vulnerable to underpayment and exploitation.

Universal Credit

7.29 Universal Credit (UC) was criticised by several stakeholders, particularly as the effects of the pandemic begin to mount in the long term and more workers may become reliant on the system to supplement or replace their income. Unite told us they felt UC was largely inadequate in terms of support and the proportion of successful appeals highlighted design flaws in the system. CAS and Communication Workers Union (CWU) were also critical of elements of UC, telling us it, combined with other factors such as low wages and fluctuating hours has brought about more personal financial crises for workers. In specific, CAS told us how the five-week wait, the interaction of assessment periods with non-monthly wages (e.g. four weekly, two weekly, weekly or ad-hoc), work allowances and minimum income floors were the elements being particularly relevant to people in low-paid work.

7.30 In response to the pandemic, the government announced a temporary uplift to UC. The Institute of Fiscal Studies noted how the Basic Universal Credit entitlements increased by £1,000 per annum. Currently, around 4.2 million families are claiming UC and on average the pandemic's increase is approximately 13 per cent of their benefits. If the temporary uplift is made permanent it would lead to a benefit of approximately £6.6bn per year, benefitting 6.6m families.

Transport

7.31 For the past couple of years transport costs have been a major issue for some low-paid workers. Although we did not get as much feedback, as regional visits were cancelled due to Covid-19, there is no reason to believe this problem has diminished. Many workers still needed to pay for travel even if their hours were reduced and when receiving less of an income. For others, the cost of travel and transport time limits opportunities and prevents them from accessing larger job markets which may be relatively close by.

Publicly funded sectors

7.32 We have consistently drawn attention to the challenges faced in those low-paying sectors where the Government is the main source of funding. This year, Covid-19 brought the situation of those sectors to new prominence even as it has aggravated problems within them. The Local Government Association (LGA) told us that Covid-related costs and falling income had created a funding shortfall of around £10bn for local authorities, with knock-on effects for businesses dependent on local authority funding.

Social care

7.33 The pandemic highlighted the pre-existing issues adult social care faces, and which we have described in previous reports. Stakeholders have repeatedly told us about budgetary pressures in the sector, to which the NLW has been a contributing factor. The heightened risk of Covid-19 in older people and the prevalence of the virus in care homes in the early months of the lockdown raised the profile of care workers, but in many respects the plight of the sector remained the same.

7.34 The long-term context for the sector has been squeezed funding, increasing demand and staff shortages. The Government announced extra funding packages for the sector – two tranches of money to local authorities and one targeted infection control fund – but the Association of Directors of Adult Social Services (ADASS) told us providers were struggling to draw on this money due to very stringent criteria.

7.35 The greater-than-anticipated increase in the NLW had led to increased budget pressures in their sector. They noted the 'dissonance' between the Government asking for improved pay and conditions for staff but not providing sufficient funding to achieve it. This placed considerable pressure on local authorities commissioning care; that pressure is felt in turn by the providers who they commission from. The United Kingdom Homecare Association (UKHCA) told us that the relatively late announcement of the 2020 uprating (on 31 December 2019) had left no time to renegotiate contracts with local authorities. The National Care Association (NCA) echoed this point: they reported that 64 per cent of local authorities had not looked at any increased funding despite the 6.25 per cent increase required in light of the April NLW uplift. Most providers aimed to maintain wage-to-fee ratios of 50 per cent, but currently this was closer to 70 per cent, as businesses strove not to lose staff in an increasingly difficult period for the sector with 112000 vacancies. The funding gap meant many businesses taking on more debt just to pay staff wages; the need for infection control limited their ability to reduce costs.

7.36 The NCA told us there were 122,000 vacancies in the sector at the latest count. ADASS thought redundancies in other low-paying sectors could make the care sector a possible alternative and temporarily ease the recruitment difficulties which providers have long faced (which were likely to become worse in some areas due to new migration restrictions). However, this should not be seen as a solution to a long standing p[roblem.as people may switch back to other sector once the economy opens up again. But despite the general desire to raise the profession's esteem and improve the workforce's skills, the consensus among those we spoke to be that without significant government intervention, care would remain a low-paying sector where employers struggled to offer more than the minimum wage.

7.37 UNISON once again shared evidence of compliance issues in the care sector, with workers struggling to get a clear and accurate statement of their hours of work (a problem we highlighted in our non-compliance and enforcement report). Almost three-quarters of homecare workers responding to a July 2019 UNISON survey did not feel they had enough information in their payslips to verify that they were paid the NMW. Almost half of respondents did not believe they were paid for all their working time.

Childcare

7.38 Childcare has continued to face similar issues to the care sector, caught between a flat funding settlement (albeit with some extra funding in the most recent year) and rising employment costs (staff costs are typically 70 per cent of providers' turnover). The financial instability of many in the sector has been exacerbated by the pandemic. The lockdown from March onwards led to a collapse in demand for many childcare providers, with many settings closing temporarily, and reopening from June onwards to far lower numbers than usual. Demand did not recover during the summer holidays, the busiest part of the year for many. All of this, we heard, left many businesses with a considerable hole in their finances. In addition, for those businesses who were open, the pandemic imposed extra costs, including the provision of PPE and additional cleaning

7.39 We have already noted the problems caused by the Government's decisions around netting off money received under the CJRS from other funding (see paragraph 7.20). The EYA predicted a decline in the sector's provider base, with a survey of 3,000 providers found one in four would not be operating in 12 months and one in three areas are highly deprived of childcare provision due to the underfunding of free childcare. The National Day Nurseries Association (NDNA) shared survey data showing around 71 per cent of providers expected to make a loss over the autumn.

7.40 As in social care, the impact of these wider problems is felt by the workforce. In our recent non-compliance reports (Low Pay Commission, 2020b), we noted the very high levels of underpayment apparent in childcare. In March, Nursery World magazine shared research with us on hardship among childcare workers: more than one in ten workers had a household income of £17,000 or less, with significant numbers struggling to meet housing costs, save money or take holidays. These findings applied to childcare workers with degrees as well as to those with low qualification levels.

Leisure

7.41 For the first time this year we heard evidence from publicly funded leisure providers, another sector which has faced pressure in recent years as funding from local authorities is held flat in the face of the rising NLW. Community Leisure UK (CLUK) told us that its members faced significant issues even before the pandemic, with pay restraint eroding differentials between grades and sapping staff morale. Covid-19 and enforced closures, however, had made the situation even worse. Providers' not-for-profit models prohibit them from accessing loans through commercial banks. CLUK told us that the lack of income during the lockdown period, combined with high fixed costs, meant providers had used up their cash reserves and faced a bleak outlook without additional support.

Accommodation Offset

7.42 As in previous years, we have received limited evidence on the Accommodation Offset, concentrated on its use in the agriculture and horticulture sectors. The NFU and ALP both told us about the importance of accommodation – and with it the offset – for their members. Provision of worker accommodation is widespread in these settings, and we heard that employers have continued to invest in accommodation.

7.43 The NFU's 2019 end of year labour provider survey indicated that 36 per cent of respondents had invested in improved accommodation, at an average of £85,000 per business. At oral evidence, the ALP told us that around 70 per cent of respondents to a recent survey had invested in improving accommodation. In a webinar on the offset with around 20 ALP members, three-quarters of attendees provided accommodation to workers, and just over two-thirds deducted the offset. More than half stated that accommodation was 'the most important factor' in attracting and retaining workers'. Around 90 per cent of those in the webinar had invested in accommodation for workers in recent years, but most (65 per cent) stated that they would have done this regardless of changes to the offset. NFU Scotland members told us that accommodation, where it was provided, was highly valued by workers and employers alike, but that the planning system and rules around standards complicated its provision. One member thought there had been a rise in workers not taking on-site accommodation and instead travelling to work; another noted that a greater reliance on UK Nationals could mean less accommodation may need to be provided.

7.44 Both the NFU and ALP noted the level of the offset was too low to cover the costs of all but the most basic standard of shared accommodation. Around half of NFU survey respondents thought the offset was sufficient and 37 per cent considered it insufficient. The NFU thought the role of the offset was instead to 'contribute towards maintenance and improvement costs' and was therefore 'helpful in terms of investing in and improving accommodation'. The NFU stated they would welcome continued increases in step with NMW rates. The ALP also supported further increases to drive investment; but they repeated their request from previous years for a review of the offset and its functioning. A concern for both groups was that the offset is a 'blunt tool' which does not discriminate between situations where on-site accommodation is a necessary condition for the job, and those where workers have a choice. There was recognition, though, that this posed a challenge for enforcement.

7.45 Stakeholders reported scope for confusion in how the offset works. ALP members raised questions about what accommodation-related charges they were allowed to make to workers (utilities or TV licences, for example). The NFU and the Chartered Institute of Payroll Professionals (CIPP) both told us about their concerns around the guidance and called for the Government to take a larger role in providing more detailed information and related calculation tools.

7.46 Evidence from unions again noted the potential for unfairness in accommodation deductions, with employers already benefiting from having workers on site. The National Union of Rail, Maritime and Transport Workers (RMT) raised the issue of seafarers being subject to a charge for their accommodation, although there remains no evidence on the extent to which this takes place. The TUC raised concerns that use of the offset – and risks around residential care in particular – were insufficiently enforced, leaving open the potential for control and abuse of workers.

Conclusion

7.47 Stakeholder responses were disrupted and dominated by the effects of the pandemic. While the overall trend of responses to the rise in the NLW continued to be in line with previous years, there were signs of stakeholders being less able to absorb profits or rise prices in the long term. Aside from the CJRS, other Government support measures were praise by some as a means of safety for many sectors but for others did not go far enough. Other stakeholder feedback highlighted the inequalities faced by the lowest-paid and the manner in which the pandemic had brought to light the precarity faced by many low-paid workers. We continued to hear about the problems faced by publicly-funded sectors in meeting minimum wage upratings, with some facing an uncertain future without additional support.

Chapter 8

Forecasts for the economy

Key findings

The immediate outlook for the UK economy is particularly uncertain. There is no comparable crisis to the Covid-19 pandemic in living memory, not only for the severity of the economic impact but also for the speed of change and how Government policy has responded. This chapter presents the forecasts and future prospects we had available to us at the time of our deliberations.

While the recovery had begun over the summer, it had slowed by August, with output remaining substantially below pre-crisis levels. Most forecasts do not expect a full recovery until 2022 at the earliest. Recovery prospects depend largely on the consumer, particularly those that built up savings, which in turn depends on the labour market and confidence more generally. Businesses have seen their costs rise, sales fall and investment slashed. A recovery in investment is dependent on uncertainty surrounding both the pandemic and Brexit being resolved, but increased business indebtedness is likely to weigh on future investment. Trade will also likely be adversely hit by the change in the trading relationship with the EU. Despite upward pressure on costs, employers are unlikely to pass this on through prices, as they face weak consumer confidence and a highly competitive environment.

The outlook for the labour market is particularly hard to predict, having been protected to such a large extent by the Coronavirus Job Retention Scheme (CJRS). At the end of August there were over 3 million workers still furloughed. These workers may return to their jobs as normal or may need to find new work. Most forecasts expected unemployment to rise sharply towards 10 per cent or more but over the year the expected peak in unemployment has come down. And these forecasts were made before the CJRS was extended, which is likely to dampen any short-term rise in unemployment. However, there will be slack in the labour market and this combined with pressure on business costs is likely to push down on wage growth. We can see this in the increasing share of pay freezes agreed in pay settlements.

8.1 In contrast to the previous chapters, this chapter looks ahead and assesses the economic prospects for the UK over the next year or so and summarises stakeholder evidence on future rates. Considering the future is particularly challenging this year as the economic and health situation, and the policy response to both of these, is changing so rapidly.

8.2 In making our recommendations we used the data and information available up to 30 October 2020. This included official data for GDP growth in the second quarter of 2020 published on 30 September; monthly GDP data up to August 2020 published on 12 October; labour market data that were released on 13 October; and price inflation data released on 21 October. We are grateful to the Office for National Statistics (ONS) for granting access to a pre-release of the 2020 Annual Survey of Hours and Earnings (ASHE), which was published on 3 November.

8.3 The most recent forecasts available at the point we discussed and agreed our recommendations were from the HM Treasury panel of independent forecasters (the short-term forecasts released on 21 October and the medium-term forecasts on 19 August); the Bank of England August 2020 Inflation Report and the Office for Budget Responsibility's (OBR) Fiscal Sustainability Report from July 2020.

Economic prospects

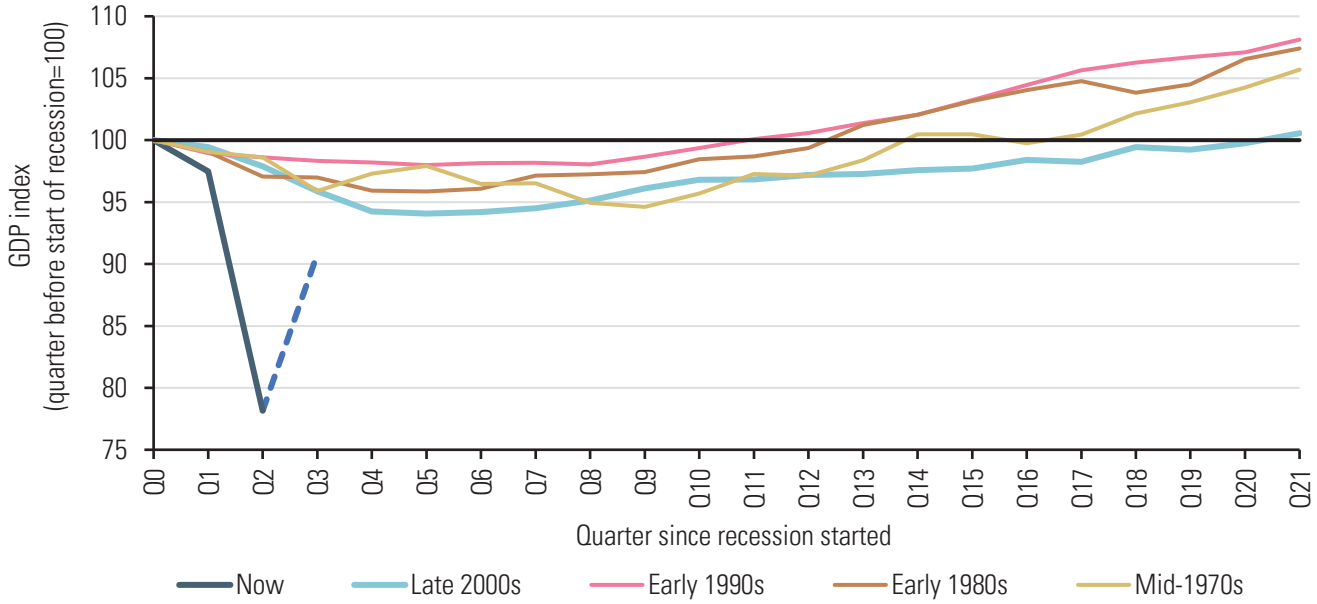
The economy is still around 9 per cent smaller than in 2019

8.4 The economic prospects for the whole economy will influence the ability of firms to cope with minimum wage increases and affect the pay and employment outcomes of the lowest-paid workers (including women, young workers, older workers, part-time workers, migrants, those with disabilities and those with limited educational qualifications). As well as depending on the aggregate level of, and growth in, GDP, the economic outlook for the low-paying sectors and low-paid workers are also likely to be affected by variations across the main components of growth: consumer spending; government spending; investment and inventories; and trade. The largest of these components is consumer spending which accounts for up to around two-thirds of GDP. Although imports and exports both account for around 30 per cent of GDP, net trade is generally responsible for only around 1 per cent of GDP. Government spending typically accounts for up to a fifth of GDP, while investment and inventories make up the rest (around 15-18 per cent).

8.5 As well as the usual uncertainty that affects our deliberations, there are two significant additional factors this year: first, the coronavirus and second, Brexit. The first has already severely affected the economy and continues to do so. The second may have also already had a detrimental impact but one that is likely to get larger as we approach the new year and enter a new trading, economic and political relationship with the EU and many other countries.

8.6 As we noted in Chapter 1, the economy has suffered a severe shock from measures to control the pandemic. GDP in the UK fell by 21.8 per cent in the first half of 2020. As shown in Figure 8.1, that was by far the largest fall of any recession since the Second World War. The previous worst was the 5.9 per cent loss during the financial crisis. The 1980s and 1990s recessions that had a large adverse impact on the labour market were much less severe in terms of their impact on output.

Figure 8.1: GDP comparisons across recessions, 1973-2020



Source: LPC estimates using ONS data. Real GDP (ABMI), quarterly, seasonally adjusted, UK, 1973-2020.
Note: Q0 is 1973 Q2 in the mid-1970s, 1979 Q4 in the early 1980s, 1990 Q2 in the early 1990s and 2019 Q4 now.

8.7 Despite rebounding from the deepest recession on record, the economy still has much ground to make up. The 9-10 per cent loss of output since the end of 2019 would still be larger than in any previous post-war recession. But the recovery appeared to be weakening by August, as further localised Covid-19 measures were implemented. That is where we start to assess the prospects for the economy going forwards.

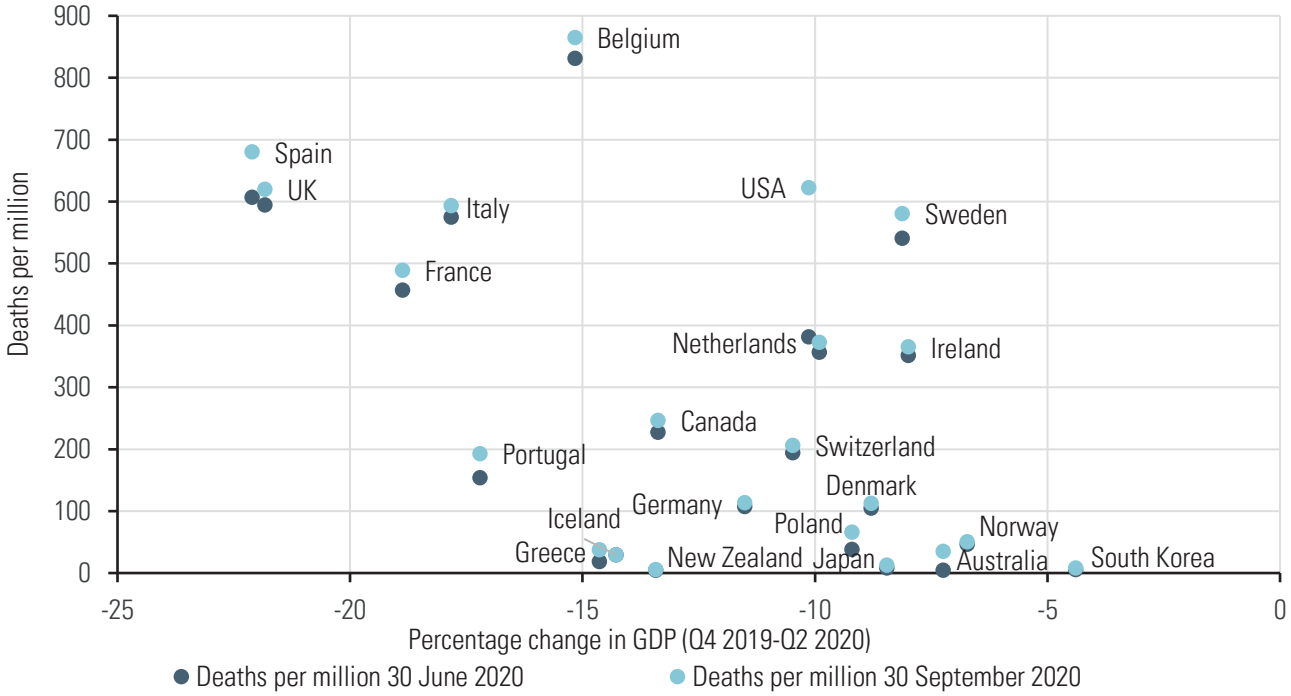
The economy will rebound in 2021 but probably will not fully recover until 2022 at the earliest

8.8 The OBR, the Bank of England and the median of the HM Treasury panel forecast that GDP will fall by around 10-11 per cent this year. That is more optimistic than some of the forecasts made at the height of the pandemic, but would still be the largest peacetime fall in any calendar year since the 1700s. There is some debate about the strength of the recovery, with the main forecasts for GDP growth in 2021 ranging from 6.4-8.7 per cent, but none of these suggest that the economy will recover the loss in output by the end of 2021.

The pandemic continues to overshadow the economy

8.9 As we have noted, the pandemic has already had a significant effect on the economy. Its future impact will depend on how successful the measures are at controlling the virus, preventing or slowing a second wave, and enabling the economy to function more normally. Vlieghe (2020) found that, so far, the differing economic performance across countries does not appear to be primarily explained by governments making different choices along a health/economy trade-off; this was a repeat of the patterns observed in the pandemic of 1918-20. Those countries that dealt with the pandemic effectively were also those whose economies were able to recover more quickly. As shown in Figure 8.2, the UK is notable in that it has not only suffered one of the largest economic hits, it also has one of the highest death rates from Covid-19.

Figure 8.2: International comparisons of Covid-19 deaths per million and change in GDP, 2020



Source: LPC estimates using OECD data. Real GDP (B1_GE: Gross domestic product - expenditure approach, seasonally adjusted) and Our World Data for total deaths per million, selected countries, 2019-2020.
Note: Our World Data uses data from the European Centre for Disease Prevention and Control (ECDC) as its source.

8.10 Measures to control the pandemic are likely to weaken demand, primarily affecting household spending. Concerns about the ending of furlough, rising unemployment and business closures are likely to exacerbate these concerns. Future lockdowns and restrictions on activity may also limit consumer spending. In such circumstances, that is likely to boost precautionary saving.

8.11 The effects are also likely to vary across sectors. While some sectors, such as hospitality and leisure, are likely to be severely affected, others may be helped. As the economy locked down, we saw consumers switching to purchase online rather than in store. We also saw an increase in food and drink bought in supermarkets as restaurants and bars were closed or operated on a more restricted basis. Many products have not been available, such as foreign travel, concerts, theatre and spectator sports, but those that have been, for example, staycations, online productions and live TV may not be regarded as perfect substitutes and in the case of staycations, for example, may also have been subject to various restrictions. If consumers think the changes are temporary, they may save now in order to spend when these products become available.

8.12 The pandemic will also continue to affect the supply of goods and services. Firms are likely to reduce capacity in order to improve social distancing for virus-conscious consumers. These supply effects are also likely to be concentrated in the same sectors as the demand effects. Those virus-related concerns may also affect how consumers behave. Until there is a general belief that the environment is safe, consumers may be reluctant to participate in the activities they did previously, to go near crowds or put themselves at risk. A successful vaccine would greatly help to address these concerns. With such a high degree of uncertainty about the duration of the pandemic and its likely path, investment and consumption decisions are likely to be delayed or cancelled. That could also have long-term effects on the economy.

From 1 January 2021 our trading relationship with the EU will not be as close

8.13 The fall in exports in the first half of 2020 was smaller than that for imports so net trade made a positive contribution to growth – the only component to do so (see Figure 1.4 on page 8). Exports picked up in the third quarter of 2020 as pandemic measures eased and economies across the globe started recovering. Imports also increased as domestic consumer spending also rebounded in the third quarter.

8.14 Effects on trade are expected prior to the transition period ending, with stockpiling boosting imports in the fourth quarter of 2020. We observed similar dynamics in March and October 2019, prior to the previous Brexit deadlines. This boosted growth in the preceding quarter, but then dragged it down in the following quarter. The magnitude of that stockpiling is expected to be much lower this time. Firms already have a high level of inventories (and Christmas competes for warehouse space). Further, firms are prioritising using resources to combat the effects of the pandemic with little spare cash or additional working capital available to build stocks even if that was desirable. In the other direction, there is some evidence that EU firms have already adapted supply chains.

8.15 The future EU trade relationship is likely to weaken trade growth. The current proposals outlined in the most recent negotiations suggest that there will be either a 'thin deal' or a 'no deal' scenario. The latter would lead to tariffs on many goods and services while both will increase non-tariff barriers of trade to the EU. In either case increased costs will likely lead to a reduction in trade. Although the UK has managed to roll over trade deals with several countries on similar terms to those when the UK was in the EU, the costs of trade with other countries may also increase. As well as rolling over trade agreements, there is the challenge of negotiating new ones.

8.16 There is also the potential for border disruption in early 2021 – not only between the UK and the EU in Calais and Dover (as well as other ports such as Harwich, Felixstowe and Hull) but also between the British mainland and Northern Ireland as the Northern Ireland protocol is implemented.

8.17 In addition, the EU may subject UK service exports to additional regulatory barriers. These are often highly specialised services, which may struggle to find alternative markets. World Trade Organization (WTO) rules mainly concern goods so would not cover many of these. With regards to trade there are also likely to be continuing impacts from Covid-19 restrictions. These are likely to affect services more. International travel has been and continues to be severely affected.

8.18 In the IFS Green Budget, Nabarro (2020) estimated that a thin trade deal would reduce GDP by 2.1 per cent in 2021, compared with staying in transition. He also estimated that a no deal exit could see output depressed by an additional 0.5–1.0 per cent. Those effects would be on top of any adverse effects on GDP from Covid-19. He also believed that the majority of the Brexit-related adjustments lay ahead; with sterling and investment weak since 2016, long-term decisions about location and future plans had been postponed. However, that may have boosted employment in recent years with hiring easier and cheaper to reverse than investment. If that were the case, any shake out of jobs may be larger.

8.19 Both Covid-19 and Brexit are likely to result in near-term disruption, medium-term reconfiguration and long-term economic costs, but it is likely that the effect of each will differ by sector. Covid-19 is likely to continue to directly affect consumer and personal services more than other industries, while Brexit will directly affect those industries that are reliant on trade. However, Brexit may also indirectly affect other sectors.

Economic prospects for 2021 depend on consumers

8.20 With the Government expected to start withdrawing support for jobs and incomes in the near future, it is likely that the Government will provide less of a stimulus next year than this year. Investment looks likely to remain on hold with high levels of uncertainty from both the pandemic and leaving the EU and firms focusing on remaining in business rather than the future. Debt levels are also increasing. The outlook for trade also looks weak as the future EU relationship still remains uncertain and the pandemic continues to weigh on international trade. With these components of GDP more likely to drag on growth rather than boost it, the economy in 2021 is likely to be even more reliant on the consumer than usual but consumer spending does typically account for around two-thirds of GDP.

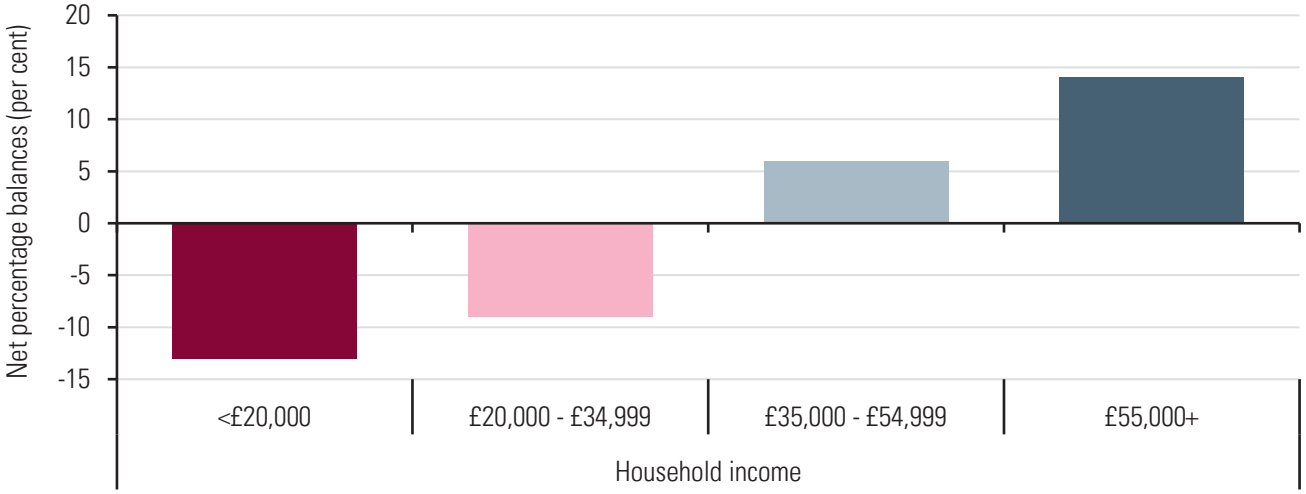
Consumer spending will depend on built-up savings and concerns about future job prospects

8.21 As we noted in Chapter 1, consumer spending collapsed in the first half of 2020 as the lockdown closed bars, restaurants, retailers and other shopping outlets. Many goods and services were unavailable to purchase. With incomes supported by various government schemes, the lack of spending opportunities led to an unprecedented increase in savings. As the lockdown restrictions eased, consumer spending picked up. We had already noted the sharp rebound in retail sales such that by August they were already 5 per cent above their level in February. That was initially largely driven by food and drink (as consumers switched from eating and drinking out to doing so at home) and more recently by durable spending, especially household goods.

8.22 There was evidence of some pent-up demand, particularly for large durable goods – especially housing and car purchases. Car showrooms started re-opening in May but did not fully open until July. Sales in July and August were higher than those at the end of the year likely reflecting both pent-up demand (those who had wanted to buy a new car in April to June but who were not able to) and those who had intended to buy a new car in July or August and did so. Car sales in September fell back a little suggesting that sales in July and August had been in part boosted by pent-up demand. House prices rose sharply, which may also reflect pent-up demand. There was evidence that some of the savings accumulated in the second quarter were spent on household and durable goods. Social consumption also grew strongly in August as millions of meals were subsidised by the Eat Out to Help Out scheme and the reduction in VAT for hospitality businesses.

8.23 Survey data – Brewer and Gardiner (2020) and Bank of England (2020a) – suggests that the likelihood that incomes have fallen varies little across the household income distribution but that a smaller proportion of lower-income households have reduced spending. Thus, as shown in Figure 8.3, high-income households have managed to build their savings substantially while lower-income households report having run down savings.

Figure 8.3: Reported savings since Covid-19, by household income, UK, 2020



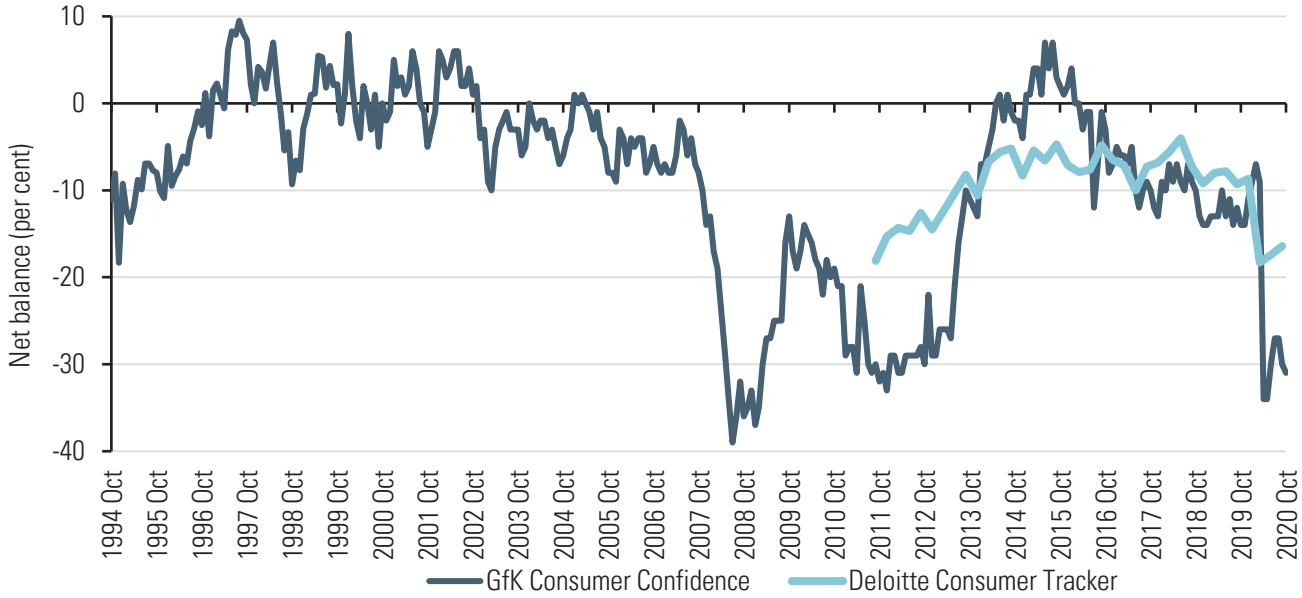
Source: Bank of England (2020a). Chart C in Section 2. Bank estimates using survey data from Ipsos MORI, UK, July 2020.

8.24 The outlook for consumer spending will in part depend on whether the savings accumulated during the crisis are spent. If concerns about job loss increase and there is a reduction in government support, then consumers may delay spending and increase precautionary savings. Fear of the virus was still pervasive even without the recent increases in cases and regional lockdowns, and during the winter there will be less scope for many businesses to use the outdoors.

8.25 There may also be a distributional dimension to this outlook. Bank of England (2020a) reported that higher income households who had built up savings may look to change spending patterns, switching away from social spending and towards spending on major purchases over time. In that case, spending might turn out higher than expected. Conversely, lower and middle-income households had lower expectations of spending on major purchases and were more likely to be pessimistic about their employment prospects (which might encourage them to save more).

8.26 Those concerns have fed into consumer confidence, as shown in Figure 8.4. The long-running GfK monthly consumer confidence measure had been declining since the end of 2015 but fell sharply in April and has remained at a similar level since then despite the revival in the economy. The net balance recorded is still above the levels recorded in the financial crisis – possibly reflecting the greater support given to households now compared with then. The more recently established quarterly Deloitte consumer tracker also fell sharply in the first half of 2020 and remains well below its level before the onset of the pandemic.

Figure 8.4: Consumer confidence, UK, 1994-2020



Source: Gfk consumer confidence index, monthly, UK, Oct 1994 – Oct 2020; and Deloitte consumer tracker, quarterly, 2011-2020.

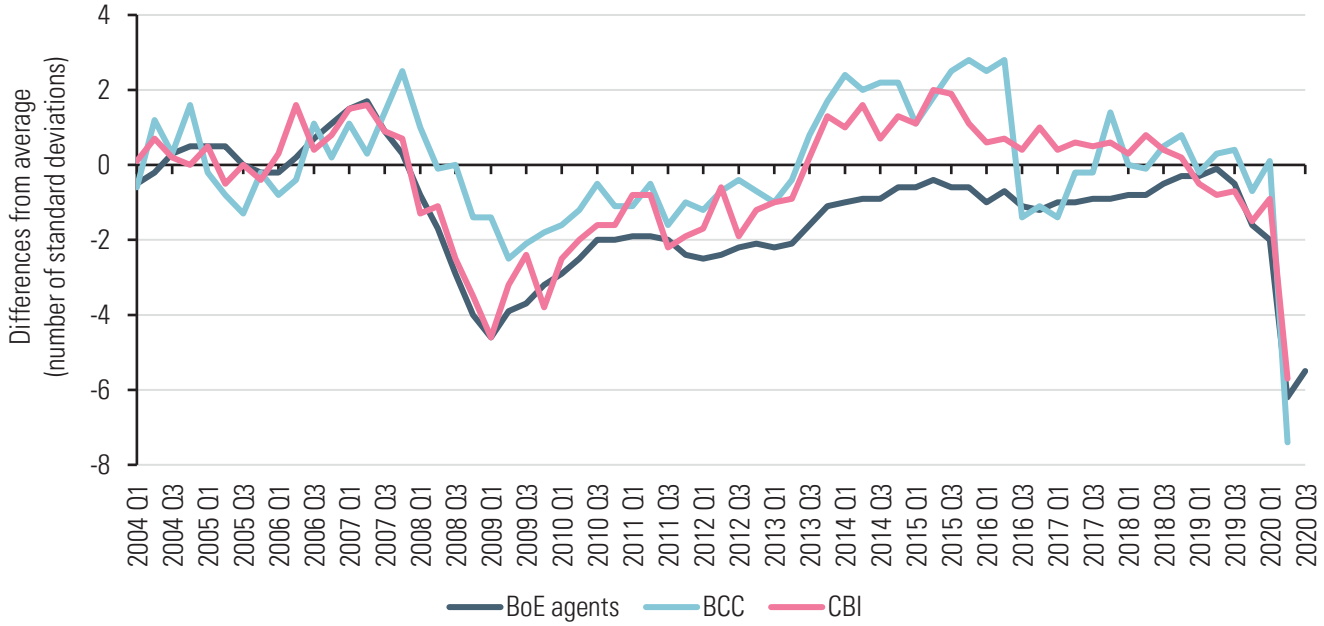
With businesses focussing on survival, investment is likely to remain weak

8.27 The unprecedented policy support for businesses has helped protect jobs and enable firms to survive in the short to medium term. However, as this support unwinds businesses will be forced to assess whether their businesses are viable in the medium to long term.

8.28 Again, as noted in Chapter 1, total investment had already weakened in recent years, mainly as a result of the uncertainty about the future trading relationship with the EU, but it collapsed in the first half of 2020, falling by 22.4 per cent. The fall in business investment, 26.9 per cent, was even sharper as firms focussed on accumulating cash and concentrating on survival. Some of the reduction in investment will just reflect timing and is likely to be reversed in the third quarter as projects and investment that were delayed go ahead but others will have been cancelled for good.

8.29 With restrictions to control the virus in place, and demand lower than usual, buildings and machinery may not be fully utilised in the coming months. Survey evidence, as shown in Figure 8.5, suggests that capacity utilisation has fallen sharply, and on all three measures, it is now below what it was during the financial crisis. Some of the responses will reflect temporary closures but even when these firms re-open, they might take time to get back towards full capacity.

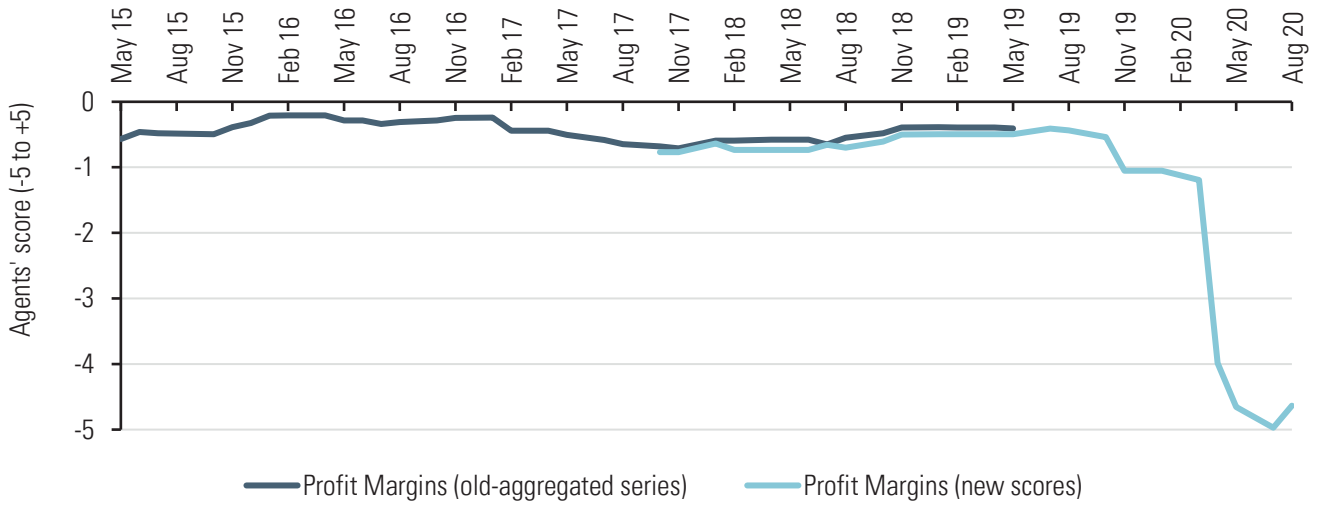
Figure 8.5: Capacity utilisation, 2004-2020



Source: Bank of England (2020d). Chart 4.4 in Section 4. Bank calculations of differences from averages since 2000. Bank of England regional agents' scores, BCC and CBI capacity utilisation, UK, 2004-2020.

8.30 The restrictions are likely to continue in some sectors for some time. Some businesses, such as shops, restaurants and bars are having to restrict the number of customers to enable social distancing. Others such as barbers, hairdressing salons and beauty parlours are doing additional cleaning between customers. All of these activities will continue to constrain supply. With reduced demand and restricted capacity, profit margins have been affected as shown in Figure 8.6.

Figure 8.6: Profit margins, 2015-2020

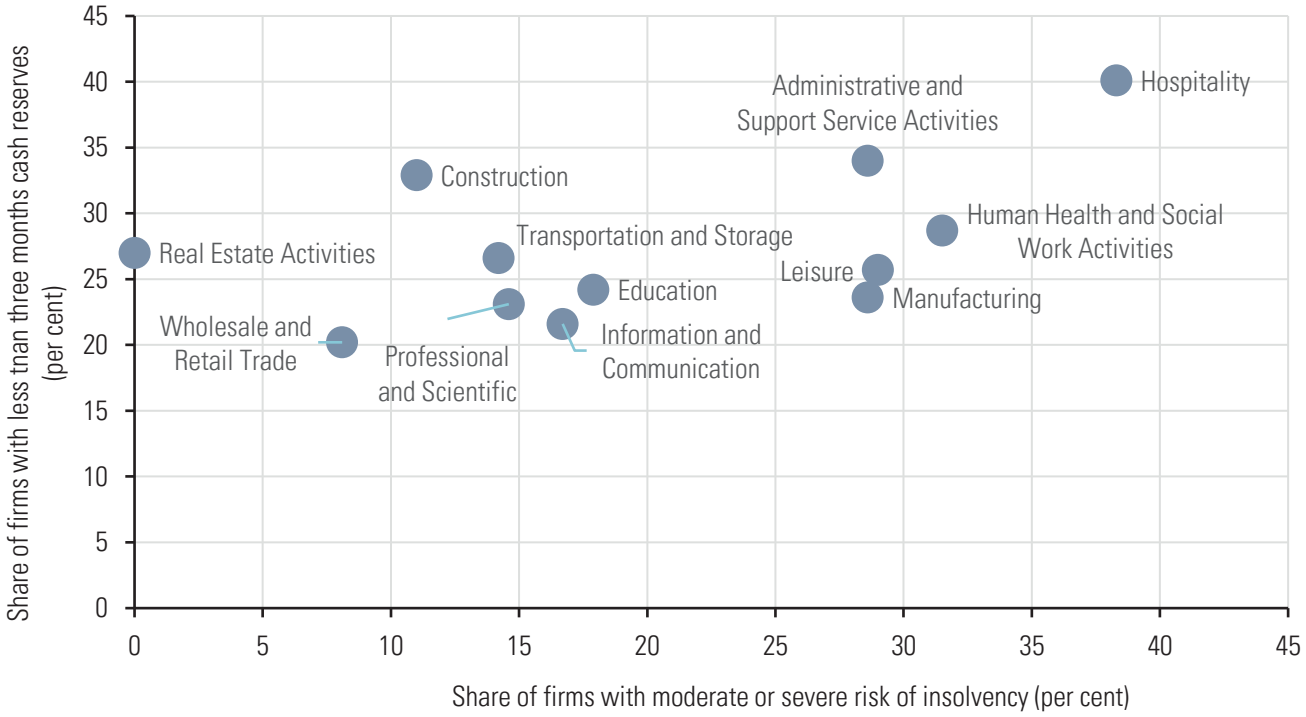


Source: Bank of England (2020b). Regional agents' scores, profit margins, UK, 2015-2020.

8.31 With revenues collapsing and costs increasing, firms have increasingly run down their cash reserves and turned to government grants and loan schemes to survive. These new loan schemes mean that credit conditions remain relatively accommodative and, as we saw in Chapter 1, there had been a large increase in loans taken out by SMEs since March. Issues remain further out when these loans need to be paid back. Despite this support, risks of insolvency have heightened.

8.32 Those risks are greater in some sectors than others. Not surprisingly, as shown in Figure 8.7, the sectors that have seen a greater share of firms drain their cash reserves are also generally the ones to have a greater share of firms at risk of insolvency. Hospitality appears to be the most vulnerable sector. Around 40 per cent of hospitality firms have less than three months of cash reserves left with a similar proportion at risk of insolvency. In contrast, wholesale and retail appears to doing better, with only one in five firms in the sector having less than three months' cash and fewer than one in ten at risk of insolvency.

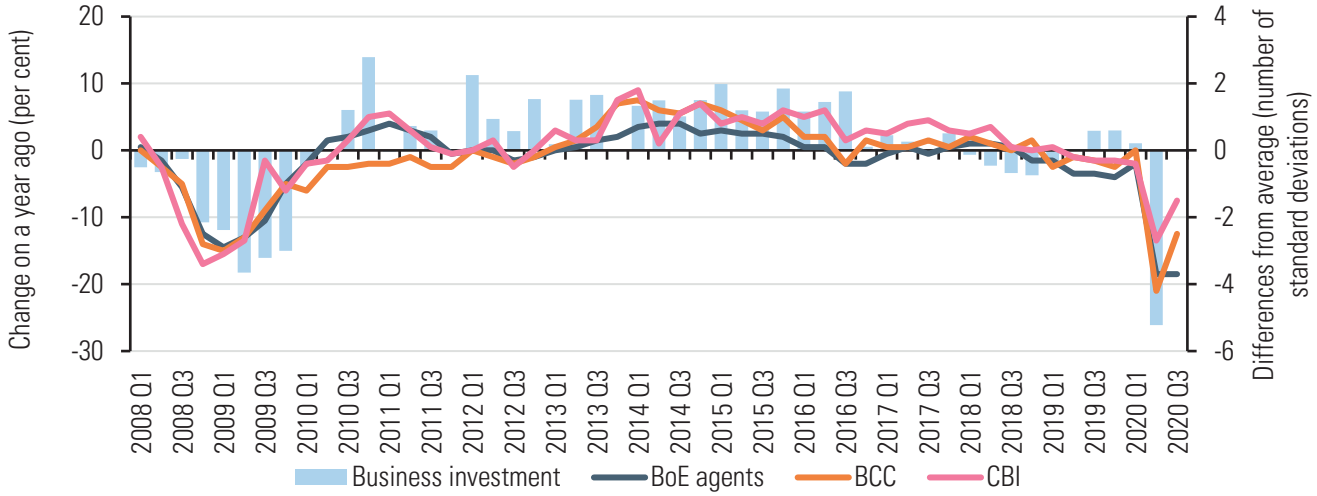
Figure 8.7: Cash reserves and risk of insolvency, 2020



Source: LPC estimates using ONS data. Business Impact of COVID-19 Survey (BICS) Wave 15, fortnightly, UK, October 2020.

8.33 With little spare cash and firms struggling to survive, there is little scope for investment, as confirmed by evidence from the regional agents of the Bank of England, and surveys from the BCC and CBI. There has been a marked fall in investment intentions, as shown in Figure 8.8. It also shows that investment intentions appear to be a reasonably good predictor of actual business investment, with sharp falls in intentions tending to foreshadow a weakening in business investment. This was very noticeable before the financial crisis and to some extent presaged the weakness in investment since 2016. The speed of the pandemic shock meant that both intentions and investment fell sharply together in the second quarter of 2020. Investment intentions did pick up in the third quarter but remain weaker than at any point since the financial crisis. Business investment is therefore expected to remain weak.

Figure 8.8: Business investment and investment intentions, 2008-2020



Source: LPC estimates using ONS data and Bank of England (2020a). Regional agents' scores, BCC and CBI investment intentions. Bank of England calculations of differences from averages since 2000. Business investment (NPEL), quarterly, seasonally adjusted, UK, 2008-2020.

8.34 Business expectations of future output remain relatively pessimistic. As well as uncertainty about the pandemic's effects on future demand and the available support, there is also the uncertainty surrounding the UK's future relationship with the EU. Until these are resolved, investment is unlikely to recover substantially. On top of this, the additional debt that businesses, particularly small ones, have taken on will hamper investment growth.

As government support schemes are withdrawn, government spending will likely fall in the second half of 2021

8.35 As we noted in Chapter 1, government support schemes have been a lifeline to the economy. The Government has intervened on an unprecedented level to support businesses by providing grants, access to loans and help with other costs, the jobs and earnings of employees, the incomes of the self-employed; and the incomes of those out of work (see Table 1.2). Nabarro (2020) estimated that the total discretionary spend on direct measures to support the economy was £188 million between March and September, with the majority of that spending (over £150 billion) incurred by July. There was also additional support of around £70 billion in Government-backed loans to businesses.

8.36 In September the Office for Budget Responsibility (2020c) reported in that public sector net borrowing was £173.7 billion in the first five months of 2020/21 – already much higher than the full financial year 2009/10 at the peak of the financial crisis. It is also much higher than last year at a similar stage (£26.8 billion) but it is a bit lower than forecast in their July report (2020b) as the fall in GDP and tax receipts has not been as great as feared. There has also been a fall in debt servicing costs. However, since then the Chancellor has announced additional support measures and the Government has enacted further measures to control the spread of the virus which will affect growth, spending and revenues.

8.37 Those recent announcements will continue to provide much-needed support, albeit not quite as generous as the schemes initiated in the early months of the pandemic. However, these generally delay the unwinding of that support from the end of October 2020 to the end of April 2021. Thus, the government spending stimulus will likely boost GDP growth in 2020 and the first quarter of 2021, but as it is withdrawn, government spending will then likely fall sharply.

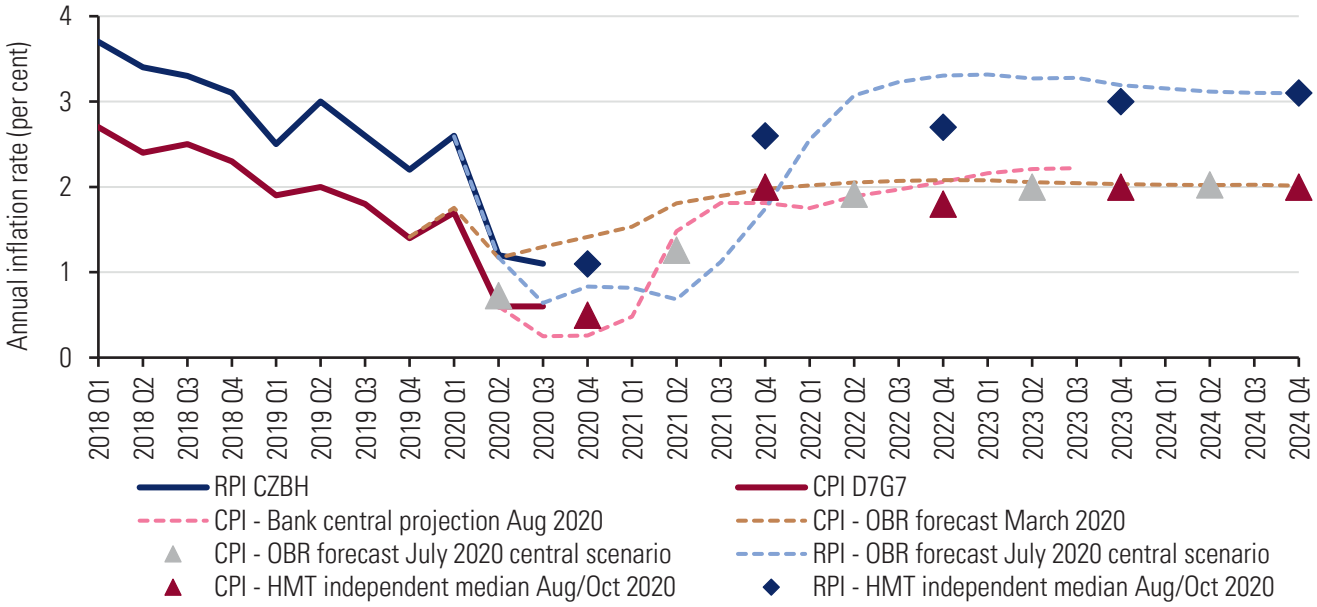
Inflation is likely to return to target in the second half of 2021

8.38 As we showed in Chapter 1, CPI inflation had slowed since the end of 2019, falling to 0.2 per cent in August and was 0.5 per cent in September, reflecting the effects of Covid-19 on the economy including the reduction in VAT in some industries, the lower energy prices and downward pressure from spare capacity.

8.39 The outlook for future prices depends on how firms respond. We heard from employers that with sales down and costs up, margins are being heavily squeezed, putting pressure on prices. The Bank of England's Decision Maker Panel (2020d) reported that they expected Covid-related costs would still be adding 4 per cent to average unit costs in the second quarter of 2021. But at the same time consumer demand is expected to remain weak, particularly in social spending. Firms told us that weak consumer confidence combined with highly competitive markets make it very difficult to increase prices. With a high degree of uncertainty about future demand, firms may delay making changes to prices in case they need to reverse that decision if the outlook picks up. Liquidity constraints may also force firms in the immediate term to focus on generating revenues rather than cutting prices.

8.40 Forecasts for inflation from the Bank of England, the OBR and the HM Treasury panel are shown in Figure 8.9. All three forecast CPI inflation to rise in the second half of 2021, as the downward pressures from lower energy prices and the temporary cut in VAT dissipate.

Figure 8.9: Inflation outturns and forecasts, 2018-2024



Source: LPC estimates using ONS data. CPI (D7BT) and RPI (CZBH), quarterly, seasonally adjusted, UK, 2018-2020. Forecasts from HM Treasury (2020a) and (2020b), Bank of England (2020a) and Office for Budget Responsibility (2020a and 2020b)
Notes:

a. CPI forecast for market mode from Bank of England parameters from MPC CPI inflation projections.
b. Notes: CPI forecast from OBR central scenario is inflation rate for whole year.

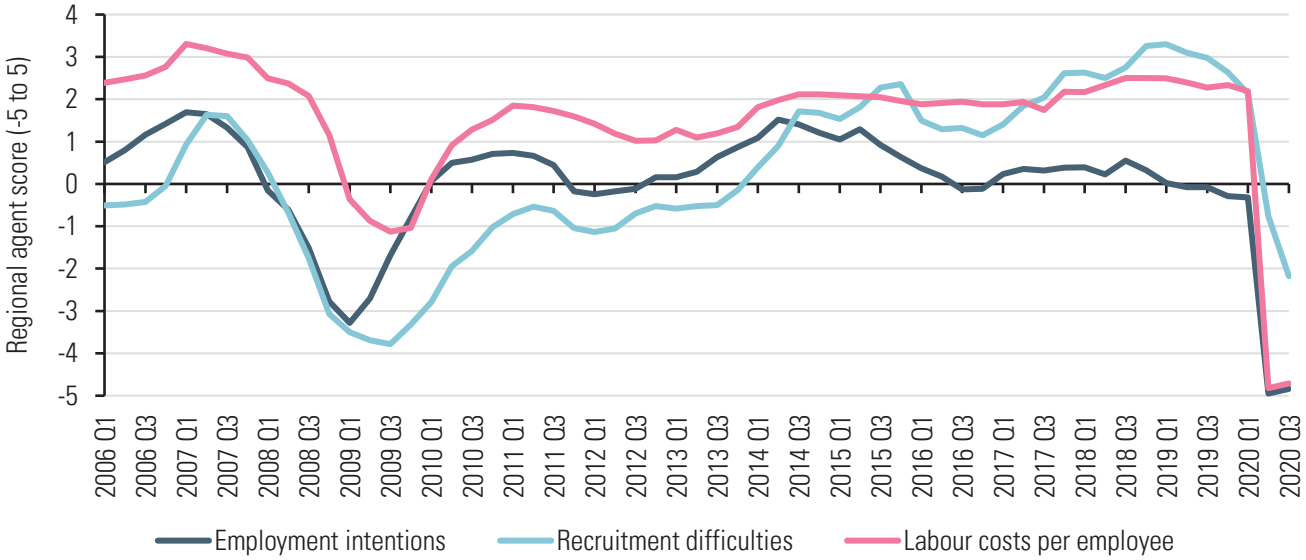
8.41 Although no longer a National Statistic, RPI inflation is still used as an indicator of the cost of living in some wage negotiations, although XpertHR (2019) and Incomes Data Research (2020b) noted that it was no longer the most commonly used measure of inflation for those purposes. More employers were now using CPI. That said, the OBR and the HM Treasury panel are forecasting that RPI inflation will remain below 3 per cent until mid-2021.

Prospects for the labour market

8.42 We noted in Chapter 2 that, according to the Labour Force Survey (LFS), the total number of employees had increased through the pandemic. There had also been a pick-up in recruitment in the late summer and early autumn, even as the recovery in output was faltering. Recruitment and Employment Confederation (2020) reported that, in September, permanent placements and temporary billings grew at the quickest rates since late 2018. However, there were other indicators of slack in the labour market. Despite the improving recruitment situation, the level of vacancies had only reached 60 per cent of pre-pandemic levels by September 2020. Compared with before the pandemic, there had been a fall in the number of payrolled employees, youth employment, part-time employment and hours worked. Redundancies had also risen sharply in recent months and the number of furloughed workers was still substantial. At the same time while unemployment had increased, these increases were relatively small, particularly in comparison to previous downturns.

8.43 That slackness is reflected in the Bank of England's Regional Agents' scores, with recruitment difficulties falling, as shown in Figure 8.10. Recruitment and Employment Confederation (2020) also noted that staff availability was growing at record rates. However, looking further forwards, employment intentions have fallen sharply on the Bank of England regional agents' measure to below the score recorded in the financial crisis (Bank of England, 2020b). Agents' contacts reported that most furloughed workers were back at work. Nonetheless, across all sectors, some companies reported concerns about what would happen when the CJRS unwinds. It was expected that job losses in some sectors, such as hospitality, retail, aviation, and automotive would be particularly severe. Others were waiting to see what happened to demand in the coming months before making employment decisions. In contrast, in sectors where demand was greater than normal such as food processing and retail, or that are more high-tech, headcounts were being increased.

Figure 8.10: Employment intentions, recruitment difficulties and labour costs, UK, 2006-2020



Source: Bank of England. LPC estimates using agents' scores. Employment intentions, recruitment difficulties and labour costs per employee, UK, 2006-2020.
Note: There is a break in the employment intentions and labour costs per employee series. Employment intentions (old-aggregated series) and labour costs per employee (old-aggregated series), 2006 Q1-2017 Q4. Employment intentions (new scores) and labour costs per employee (new scores), 2018 Q1-2020 Q3.

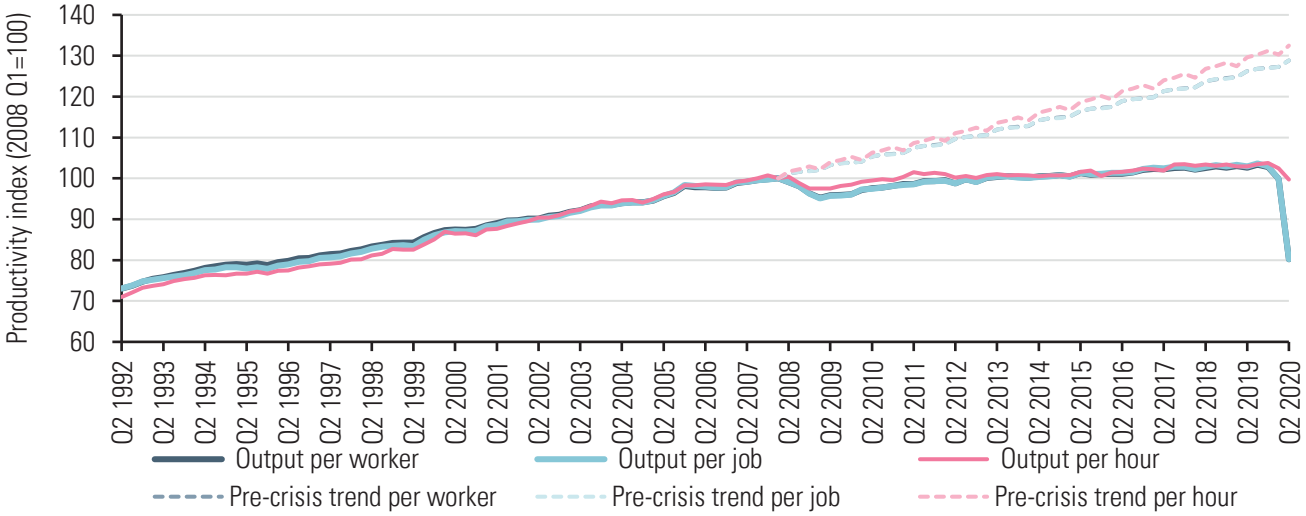
8.44 However, it is very difficult to predict what will happen to the labour market over the next year or so given the uncertainty not only over the recovery, but also the responsiveness of policy. At the end of August there were still over 3 million workers supported by the CJRS. These workers may simply return to their jobs as the majority of furloughed workers have done, or there may need to be significant reallocation in the labour market. However, the latter is unlikely to be necessary in the short term[7].

8.45 At the time of giving our advice, there was some divergence in the forecasts for employment growth and unemployment. While the Bank of England expected a large fall in employment this year and a rise in unemployment to 7.5 per cent followed by a rebound in 2021, the OBR and the median forecaster in the HM Treasury panel expected the fall in employment to be slower this year with further reductions next year. OBR was more pessimistic with unemployment rising above 10 per cent in 2021 but its latest forecasts (from July) were less timely. The median forecaster in the HM Treasury panel expected unemployment to peak this year at 7.5 per cent and gradually fall back to under 6 per cent by the end of 2022. Unemployment was likely to increase as the new furlough scheme, the Job Support Scheme, that was due to replace the CJRS, was much less generous and required a greater employer contribution, although it did extend coverage from the end of October to the end of April 2021.

Productivity growth will continue to be weak, with implications for pay growth

8.46 We noted in Chapter 1 that productivity, however measured, had been weak since the financial crisis. That was even before the sharp falls we observed in the first half of 2020. That weakness is shown in Figure 8.11, which shows that productivity on all three measures – per worker, per job and per hour – grew at a fairly consistent rate between 1992 and the onset of the recession in 2008. Data from 1955-1992 also show similar trends. That has not been the case since 2008. By the start of 2015, productivity on all three measures had barely recovered to their levels in 2008 and since then growth has been weak. Productivity on all three measures was around 30 per cent lower at the end of 2019 than had it continued to grow in line with pre-recession trends. It is considerably lower now.

Figure 8.11: Productivity per worker, job and hour, 1992-2020



Source: LPC estimates using ONS data. Output per worker (A4YM), output per job (LNNN) and output per hour (LZVB) quarterly, seasonally adjusted, UK, 1992-2020.
Note: Data for Q2 2020 estimated from ONS productivity flash estimates (ONS, August).

[7] Since we provided our advice at the end of October, the Government announced a further lockdown and the extension of the CJRS to March. This will no doubt soften the impact on unemployment in the short term.

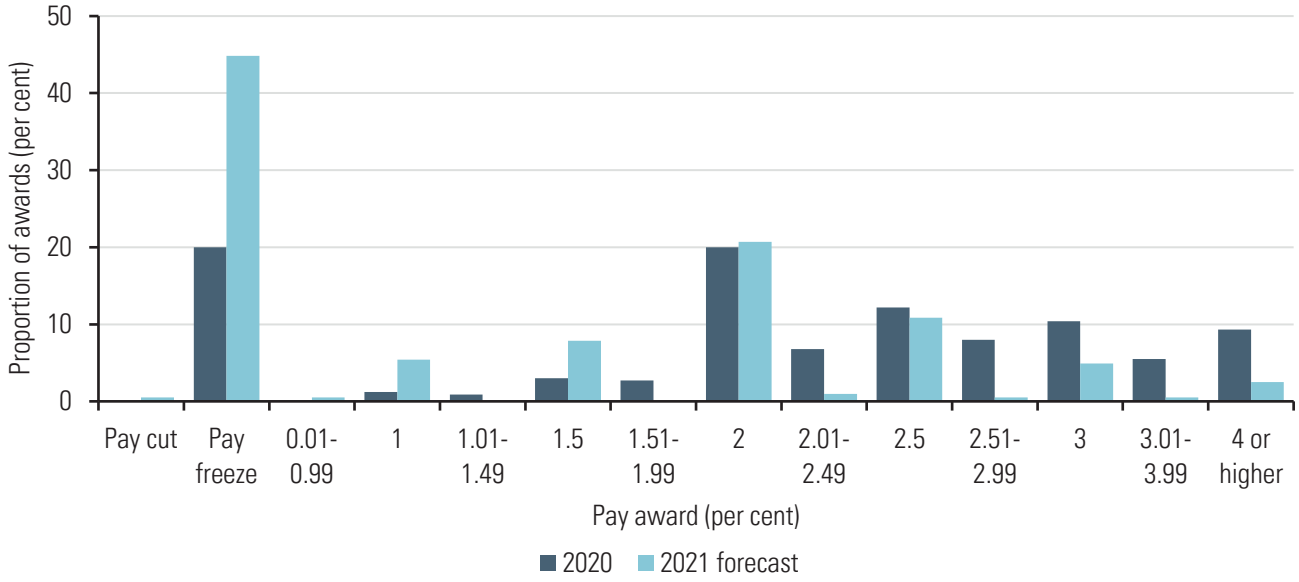
8.47 In the third quarter of 2020, the Deloitte (2020a) survey of chief financial officers found concerns about weak productivity and competitiveness ranked fourth, just behind those of Brexit but not as concerning as the effects of the pandemic and rising geo-political tensions. Productivity is unlikely to improve substantially without a significant investment recovery which, as we have already noted, will be held back by business indebtedness, exacerbated by uncertainty over the pandemic and Brexit. The weakness is reflected in the forecasts for productivity from the Bank of England (2020a). The MPC forecast that output per hour would fall by a quarter of a per cent in 2020 before growing at around three-quarters of a per cent in 2021 and 2022. Compared to a long run average of 2 per cent a year from 1955 to the financial crisis this would be historically weak and dampen future prospects for wage growth.

Pay settlements look set to weaken

8.48 With increasing unemployment and slack in the labour market, there is less pressure on firms to increase wages to attract or retain workers. We showed in Chapter 1 that pay settlements have weakened with an increasing number of pay freezes. As the most common months for making pay awards are January and April, many pay decisions this year had already been made prior to the lockdown at the end of March. As shown in Figure 8.12, more than half of all deals were set at around 2-3 per cent.

8.49 This pattern looks set to continue into 2021 with pay awards in January and April next year (2021) most likely reflecting an economy where the effects of the pandemic and measures to control it will still be strongly felt. Specifically, businesses will feel pressure to reduce costs and there will be slack in the labour market, both of which are likely to dampen pay expectations. Much will depend on the path of the virus and its effects on the economy. As we have noted, the prospects for pay more generally are intertwined with those for productivity, which in turn is dependent on investment and a host of other factors.

Figure 8.12: Pay awards for 2020 and pay forecasts for 2021



Source: LPC estimates using XpertHR data, 2020-2021.
Note: Data for 2020 are actual pay awards. Data for 2021 are forecasts from a survey of employers conducted in September 2020.

8.50 In its survey of pay awards for 2021, XpertHR (2020) reported that around 45 per cent of firms in its survey would be looking to freeze pay while around a third of awards would be around 2.0-2.5 per cent. Incomes Data Research (2020b) survey of pay planning for 2021 similarly found that nearly half of respondents expected their 2021 award to be lower than 2020. Only 14 per cent expected it would be higher.

8.51 The Bank of England agents also reported that many companies were freezing pay, with a large proportion of contacts reporting they planned to delay or cancel pay settlements this year. There were also accounts of companies in a number of sectors introducing temporary pay cuts, though these were mainly at management level. The Chartered Institute of Personnel and Development (CIPD) had also noted an increase in the number of deferred pay awards and pay freezes.

Average earnings growth rebounding slowly

8.52 With the increase in labour market slack weighing on labour demand but compositional factors also playing a part, average wage growth is expected to pick up, although there is much uncertainty about the speed and scale of that rebound. As shown in Table 8.1, the Bank of England forecasts average wage growth of 3.0 per cent in 2021 and 3.8 per cent in 2022. However, wage growth in 2020 is unlikely to fall by as much as the Bank had forecast in August, so the pick-up may be moderated. The median of the HM Treasury panel forecast suggests a more moderate pick up with average wage growth of 2.4 per cent in 2021 and 2.9 per cent in 2022. There was a high degree of uncertainty around those median forecasts with the average wage growth forecasts for 2021 ranging from a fall of 1.3 per cent to an increase of 6.2 per cent.

Table 8.1: Forecasts for average earnings, GB, 2020-2022

	2020	2021	2022	2023	2024
Median (including the Bank)	0.2	2.4	2.9	3.3	3.4
Mean (including the Bank)	0.0	2.3	2.8	3.2	3.4
Interquartile range	1.2	1.7	1.3	0.6	0.3
Lower quartile	-0.3	1.5	2.3	3.0	3.2
Upper quartile	0.9	3.1	3.6	3.6	3.6
Range	11.0	7.5	2.4	1.3	0.6
Minimum	-8.0	-1.3	1.5	2.5	3.2
Maximum	3.0	6.2	3.9	3.8	3.8
Bank of England	-1.25	3.0	3.75		
OBR (July 2020) central scenario	0.2	3.7	2.7	3.0	3.1

Source: Office for Budget Responsibility (2020b); HM Treasury (2020a and 2020b) and Bank of England (2020a).

Real wages to recover as forecast wage growth outstrips inflation

8.53 Our main forecasters – the median of the HM Treasury panel, the Bank of England and the OBR – are currently forecasting that real wages will fall in 2020 with the low level of inflation still being greater than average wage growth. However, despite productivity remaining weak, all three project average earnings growth to outpace CPI inflation in both 2021 and 2022.

Summary of prospects for the economy

8.54 Table 8.2 shows the forecasts we had available to us at the time of our deliberations. Many of these forecasts assumed that the UK and the EU would agree a deal enabling a smooth transition to the new trading arrangements and were made before the UK Government and devolved administrations introduced further restrictive measures. In October, prior to our discussions, the Central Belt of Scotland was subject to a two-week circuit break which was then extended to four weeks, Northern Ireland had implemented a month's tougher restrictions, while Wales had commenced its two-week circuit break. Rumours of a more comprehensive lockdown in England were circulating at the time of our deliberations but there had been no announcements other than that the Government was committed to its regional and local lockdown strategy.

8.55 The forecasters expected GDP to fall by around 10 per cent in 2020 and then rebound strongly in 2021 although not strongly enough to recover the lost output. That was unlikely to happen until 2022 at the earliest. CPI inflation was expected to pick up towards target by the end of 2021. Wages were also expected to increase but there was a divergence in the forecasts about the pace of that pick-up. There was also some divergence among the labour market forecasts but there was a consensus that employment would be lower and unemployment higher than prior to the onset of the crisis.

Table 8.2: Forecasts for the economy, 2020-2022

	Actual	OBR forecasts July 2020 central scenario			Bank of England forecasts August 2020			HM Treasury panel median forecast August/October 2020		
	2019	2020	2021	2022	2020	2021	2022	2020	2021	2022
GDP Growth (whole year)	1.3	-12.4	8.7	4.5	-9.5	9.0	3.5	-10.1	6.4	3.3
Average Weekly Earnings AWE (whole year)	3.5	0.2	3.7	2.7	-1.3	3.0	3.8	0.3	2.4	2.7
Inflation CPI (Q4)	1.4	0.7	1.3	1.9	0.3	1.8	2.0	0.6	2.0	1.9
Inflation RPI (Q4)	2.2	1.3	1.1	3.0				1.2	2.7	3.0
Employment growth (whole year)	1.9	-4.5	-1.2	4.0	-3.8	2.5	2.0	-1.2	-2.1	
Unemployment rate (Q4)	3.8	8.8	10.1	6.9	7.5	6.0	4.5	7.7	6.9	5.7

Source: Office for Budget Responsibility (2020b); HM Treasury (2020a and 2020b) and Bank of England (2020a); GDP growth (ABMI), total employment as measured by workforce jobs (DYDC), unemployment rate (MGSC), quarterly, and AWE total pay (KAB9), monthly, seasonally adjusted; RPI (CZBH) and CPI (D7G7), quarterly, not seasonally adjusted, UK (GB for AWE).
Note: Bank of England forecasts of unemployment rates are for the third quarters, 2019-20.

8.56 With long-term interest rates exceptionally low and credit available for businesses, monetary policy has been and remains accommodative. Despite that, investment has been weak, around 3 million workers in the private sector are still furloughed, and vacancies remain well below pre-pandemic levels. Some sectors of the economy have suffered greatly while others have seen demand for their goods and services increase. The scale of this sectoral economic dislocation is unprecedented. Much will depend on how long this persists and the extent to which reallocation is required. With the pandemic likely to continue to affect the economy well into the new year and the adverse consequences of leaving the EU becoming a more dominant factor, the outlook for the economy, especially for employment and investment, looks fragile.

Stakeholder views on future NLW rates

8.57 Stakeholder views over the April 2021 NLW increase were mixed. The majority of employers argued for a cautious increase, with a small number calling for a freeze in the rate. Unions, however, called for strong increases to protect workers' living standards, arguing that the rate of the minimum wage would not be a principal factor influencing economic outcomes. As discussed in Chapter 5, stakeholders were largely supportive of the reduction in the NLW age threshold (see paragraphs 5.53 to 5.56). This view was similarly demonstrated for the 2024 NLW target.

2021 NLW rate

8.58 Some stakeholders called for an increase in the NLW to recognise the contribution of low-paid key workers in the response to the pandemic. The collective position of trade unions (including the Trades Union Congress (TUC), Unite, and Usdaw) was to call for an increase to £10 per hour for all workers. The TUC stated that 'essential workers deserve a pay rise' as 'millions of low paid workers have kept the country running', demonstrating their importance to the economy (they estimated that 38 per cent of key workers were paid less than £10 per hour). Unite told us that increasing the NMW or NLW would 'bolster economic confidence and productivity', re-affirming '£10 per hour is affordable'.

8.59 Even if there is not a fixed rate established for all workers, several stakeholder responses noted that the on-course rate for the NLW would automatically adjust to changes in median earnings. The Trades Union Congress (TUC) referred to this as an 'automatic stabiliser', and Unite described it to us as a 'powerful insurance against changed economic circumstances', arguing the LPC should set a smooth trajectory based on forecasts for economic recovery beyond 2021.

8.60 Employers across a number of sectors recognised the contribution of key workers during the pandemic, the number of low-paid workers among them and the importance of the NLW in rewarding these groups. The British Beer and Pub Association (BBPA) acknowledged at oral evidence that, despite challenging circumstances for their members, it would be very difficult to argue against an increase in the NLW.

8.61 Against this backdrop, the majority of employer stakeholders argued for the LPC to take a cautious approach in setting the NLW, given the economic downturn and impending risks from Brexit. Caution was not always defined, but in many cases, it meant limiting increases to the level of inflation (a real-terms freeze). UKH and the BBPA said the LPC should follow the approach taken in 2008 and delay its recommendations to the Government (until end of January 2021), to allow more evidence on the pandemic's economic impacts to be gathered. The Federation of Small Businesses (FSB) also told us how it may be beneficial for a decision on the rates for April 2021 rates to be made later in the year (latest by December 2020) to allow for the collection of economic data so there is a greater understanding of the impact of wages and Covid-19 on the labour market.

8.62 The British Chambers of Commerce (BCC) believed the NLW increase should not exceed inflation, as this would create significant pressure and risk unemployment, with impacts felt most by SMEs. The CBI and BBPA also hold the view that if there is a rise, it should not be more than inflation. The BCC and CBI characterized this as using the 'emergency brake'. The Association of Convenience Stores (ACS) made a similar argument, with 84 per cent of members surveyed supporting an increase no greater than inflation. At oral evidence, they recognised that it would not be viable to freeze the rate, but stressed the uncertainty affecting their sector. The Food and Drink Federation (FDF) took a similar position, stating that although only a small number of members had called for a freeze, attempting to continue on the planned trajectory of £9.21 by April 2021 could be challenging for members who had been adversely affected by the pandemic. The National Farmers' Union (NFU) argued for the 2021 NLW to be set 'at the lower end of the range' and for economic recovery to be prioritised. The Recruitment and Employment Confederation (REC) urged 'a very cautious approach' to any increase above inflation and the CIPD recommended the rate should rise 'with inflation'. The United Kingdom Homecare Association (UKHCA) also took this position. The British Retail Consortium (BRC) recommended 'cautious and moderate' increases, stressing the uncertain outlook for their members, but they did not link this to inflation.

8.63 A small number of employers took a harder line and called for a freeze in the 2021 NLW, to protect employment and ensure business survival. At oral evidence, UK Fashion and Textiles (UKFT) called for the 2021 NLW to be frozen, although they were open to keeping the 2024 target; given the 'dire' circumstances this year, employers needed 'breathing space' and there were likely to be widespread redundancies (15-30 per cent of the workforce were already in consultation) and pay freezes in many manufacturers. The National Hair and Beauty Federation (NHBF) also called for a freeze to protect employment in their sector (and limit the consequential growth of self-employment models); 45 per cent of members surveyed had stated that future increases would be unaffordable. In the CIPD's survey, 58 per cent of businesses supported an NLW freeze (31 per cent of those strongly supported it). Just over a quarter of quarter (27 per cent) of CBI members also wanted a freeze.

8.64 A number of employer groups supported the principle of the rising NLW and continued progress to the on-course rate, albeit with concerns about affordability. This was the case in social care and childcare, for example, where both Royal Mencap and the Early Years Alliance (EYA) told us they would like to pay staff more but that funding constraints prevented them from doing so. The Association of Directors of Adult Social Services (ADASS) believed increases to the on-course rate should still go ahead and be funded but noted the major pressure they would place on commissioning budgets if they were not given full funding from Government to meet the rise. Community Leisure UK (CLUK) were also supportive but voiced strong concerns over affordability and believed redundancies would be likely. The Association of Labour Providers (ALP) supported maintaining progress to the 2024 target but noted their members could pass increasing NLW costs on to clients and that labour shortages in their sector were also driving pay as much as the NLW.

2024 NLW target

8.65 Many stakeholders linked their position on the 2021 rate with calls for the 2024 target to be extended. Groups who advocated caution on the 2021 NLW, also recommended the target of two-thirds of median earnings by 2024 should be pushed back, to take account of the impact of the pandemic on businesses. Both the BCC and FSB advocated delaying the target date by a year for this reason. The BBPA also believe the target year should be extended to 2025 at least, with the announcement on ambitious new living wage targets to be extremely difficult for members to absorb. The BRC recommended the LPC consider whether the 'flightpath' to two-thirds is sustainable, or whether a longer time-period for the target is merited. ACS also highlighted to us that in their member survey, 70 per cent of respondents thought the pathway to 2024 would be unsustainable. UKH felt that, given the 'lost year' resulting from Covid-19, it would be reasonable to push the two-thirds target back to at least 2025.

8.66 Other groups (FDF and REC) thought it was too early to consider the longer-term remit, with the main focus on managing the immediate challenges of the pandemic. CIPD also felt it was too early to decide as the target may be attainable if there was a sharp economic recovery. UKFT also thought the 2024 target could be left in place.

8.67 Unions, as well as calling for £10 per hour uniformly supported remaining on course to the target. The TUC stated it would not be appropriate to divert from the path, previously set out by the government, for the NLW to reach two thirds of median earnings by 2024. Citizens Advice Scotland (CAS) told us they supported and accepted the 2024 target, but would like to see all minimum wage levels (i.e. not just the NLW) reach at least the living wage, 'allowing workers a decent standard of living, financial resilience and job security'.

The path of the NLW to 2024

8.68 The Government have set us a target rate for the NLW of two-thirds of median hourly earnings of those eligible by 2024. Following our advice last year, the NLW should cover those aged 21 and over by 2024. Our approach to calculating the path of the NLW towards that target in future years will be similar to that used in the first four years of the NLW. If we judge that economic conditions allow, we will aim to increase the ratio of the NLW to average earnings of the group eligible for the minimum wage evenly across the period to 2024. However, there is a complication to this approach, as the age changes that are due to occur affect our calculations.

8.69 Changing the ages covered by the NLW also changes the target rate. Younger workers typically earn less than older workers; therefore, when they are added to the rate population, the median hourly wage decreases. As the target is based on the median wage, a lower median results in a lower wage floor. There are two options to take account of the changing age cohort: either to base a path on the final age range that will be covered, or to base the path on the current age group that are eligible. We have decided to take the second option and base the path on the group that will be covered in the year of the recommendation. For this reason, our calculation of the 'on-course' rate for 2021 is based on all workers aged 23 and over (whom the NLW will apply to from next year) rather than all workers aged 21 and over (whom the NLW will apply to in 2024).

8.70 As discussed in paragraphs 3.15 to 3.18 there have been data issues with ASHE, the source we normally use to estimate median pay. To recap, these issues centre around whether, in our calculation of the median, to include or exclude workers who have suffered a loss of pay. Our standard approach in previous years has been to exclude these workers. This year, the large number of furloughed workers in the data (many of whom suffered a loss of pay) means that either including or excluding these workers alters the median to such an extent it is not comparable to previous years.

8.71 To illustrate, if we were to follow our standard estimation methodology, we would calculate median pay in April 2020 for workers aged 23 and over (excluding apprentices in their first year) to be £14.65. This would represent an increase of 7.5 per cent on the £13.64 median from 2019. But we know that this 2020 figure is biased upwards as it excludes workers who were furloughed on partial pay, who were disproportionately low-paid. If we include these employees, we get an estimated median of £13.93 in 2020. However, we know that this estimate is biased downwards as it is calculated using some estimates of hourly pay that are less than the full hourly rate the individual would be paid if they were not furloughed.

8.72 To avoid this issue, we have taken a different approach this year to calculating the 'on-course' NLW rate. We have decided to follow the approach that we have historically used to grow median pay from April to October in the current year. This approach uses growth in the Average Weekly Earnings (AWE) out-turn figures published by the Government[8] to grow the ASHE observed median from 2019. We therefore estimate that, if ASHE had not been affected by the data issues caused by furloughing, the median would have been £14.05 in April 2020. We then grow this median up to October 2020 using four months of AWE out-turn and two months of forecasts. This gives us an estimated median in October 2020 of £14.14. Table 8.3 shows the effects of the different options for calculating the median hourly wage rate in more detail.

Table 8.3: Different options for calculating median pay and impact on forecasts, employees aged 23 and over, UK

Date	Standard method	Including furloughed on partial pay	Preferred methodology using AWE
April 2019	£13.64	£13.64	£13.64
April 2020	£14.65	£13.93	£14.05
October 2020	£14.74	£14.01	£14.14
October 2021	£15.01	£14.27	£14.40
October 2024	£16.45	£15.63	£15.78

Source: LPC estimates using ASHE 2010 methodology; standard weights and low-pay furlough weights, UK, 2019-2020. Forecasts are based on AWE total pay from Office for National Statistics (2020c), HM Treasury (2020a and 2020b) and Bank of England (2020a) average weekly earnings predictions.

8.73 The different approaches influence the 'on-course' rate for this year. To calculate the on-course rate we work out the 'bite' of the NLW in October 2020 (dividing the NLW in 2020 – £8.72 – by the median in October 2020). We then take this bite and calculate the rate a quarter of the way between that and two-thirds. This gives the target bite for next year, and then to get the NLW figure we multiply this target bite by our forecast of median pay in October 2021.

[8] The approach grows the median in 6-month chunks based on the 12-month moving average increase in total AWE.

8.74 Taking the standard methodology we estimate that the current (October 2020) bite is 59.2 per cent (using a 23+ median wage), and therefore the target bite in October 2021 is 61.0 per cent. Multiplying this by the forecast October 2021 median wage gives an NLW on-course rate of £9.16. Including employees furloughed with a loss of pay would give a current bite of 62.2 per cent, a target bite of 63.3 per cent and a NLW on-course rate of £9.04.

8.75 Table 8.4 shows the path using our preferred methodology. This shows that our current expectation of the on-course rate is £9.06. We calculate this by dividing the current minimum wage £8.72 by our estimated current median wage of £14.14 which gives a bite equivalent of 61.7 per cent. From this we can calculate a target bite of 62.9 per cent (a quarter of the distance between 61.7 and 66.7). Multiplying this by our forecast median pay in October 2021 of £14.40 gives the target of £9.06. We can also forecast that the NLW that is consistent with our two targets (a bite of two-thirds that applies to employees aged 21 and over) is £10.33 in 2024.

Table 8.4: Path estimates using preferred median pay calculations using AWE

Date	Age	Median pay	Estimated and target bite	NLW actual and on path
		£	per cent	£
April 2019	25+	£13.83		£8.21
April 2020	25+	£14.25		£8.72
October 2020	25+	£14.34	60.8	£8.72
October 2020	23+	£14.14	61.7	£8.72
October 2021	23+	£14.40	62.9	£9.06
October 2024	21+	£15.49	66.7	£10.33

Source: Source: LPC estimates using ASHE 2010 methodology; standard weights and low-pay furlough weights, UK, 2019. Forecasts are based on AWE total pay from Office for National Statistics (2020c), HM Treasury (2020a and 2020b) and Bank of England (2020a) average weekly earnings predictions.

Chapter 9

Recommended rates and their implications

Key findings

This year we are unable to calculate where the 2020 rate of the National Living Wage (NLW) is on the path to 2024 with our usual confidence, making it difficult to calculate the 'on-course' rate for 2021. We have instead opted for recommendations that minimise 'significant risks' to employment prospects as per our remit. Our NLW recommendation of £8.91 is lower than our best, albeit uncertain, estimate of the on-course rate and represents a significant adjustment in response to economic conditions. We anticipate that this increase will be modestly higher than that for prices, and so should protect workers' living standards.

We do not recommend a change to the Government's target of reaching two-thirds of median earnings by 2024 and remain fully committed to the goal of ending low pay. Our central estimate of the NLW in 2024 is currently £10.32, though this is also more uncertain than usual. A fuller review of the path ahead – and greater clarity on a future rate path – will hopefully be possible in our 2021 Report.

Younger workers are at greater risk because they tend to work in hard-hit sectors and are less likely to be in work in the first place. So we have recommended lower proportionate increases for these groups, though we maintain that the eligibility age of the NLW should reduce to 23 next April. The labour market continues to treat 23 and 24 year olds similarly to those aged slightly older.

Having completed our review of the Apprentice Rate we believe there is scope to make it level with the 16-17 Year Old Rate, but recommend doing this over two years given the state of the labour market currently.

9.1 The report chapters up to this point have set out the evidence upon which this year's recommendations are based. This chapter sets out the recommendations themselves and the rationale for each of them. It also looks at the implications of the recommended rates on household incomes. The section also includes estimates for the NLW on-course rates in 2022, 2023 and 2024 given our recommendation on the NLW this year.

9.2 Our remit from the Government is to recommend the rate of the National Living Wage (NLW) consistent with reaching the target of two-thirds of median earnings by October 2024. The remit asked us to 'advise on any emerging risks and – if the economic evidence warrants it – recommend that the Government reviews its target or timeframe'. The aim of this 'emergency brake' is to ensure the lowest-paid continue to see pay rises without significant risks to their employment prospects.

9.3 Following the Government's acceptance of our advice last year, the NLW will cover 23 and 24 year olds from April 2021. So this year we have also advised on a new rate for 21-22 year olds. For this and the other rates of the National Minimum Wage (NMW) our remit is to recommend as high a rate as possible without damaging employment.

9.4 Our job, therefore, is to recommend rates that work best for workers and employers in the context of the Covid-19 economic shock. This is no easy recommendation to make. The negotiations between Commissioners this year were lengthy and difficult, and for good reason. Both workers and employers have been hit by the economic crisis and there are powerful arguments both that workers need a pay rise, and that employers are facing an exceptionally tough situation that raises the threat of unemployment. Added to this, the speed of economic change and level of uncertainty over the future is unprecedented.

9.5 Our standard practice in making these recommendations is to take account of the state of the economy, employment and unemployment levels and relevant policy changes. The bulk of the evidence available only covers the period up to August 2020, when parts of the economy had only just re-opened and we did not know the outcome for workers furloughed on the Coronavirus Job Retention Scheme (CJRS), which, at the time of our advising the Government, was due to end in October. Much of the activity announced in the Chancellor's Plan for Jobs was still getting off the ground and subsequently announced policies, including the Job Support Scheme, were yet to begin.

9.6 Despite the greater difficulties in doing so this year, we spoke to a wide range of employers, workers and their representatives in virtual settings. We heard of the strain on both low-paid workers and businesses who were struggling to survive. Many low-paid workers are key workers, particularly in retail and social care, and we heard about their difficulties in continuing to work through the depths of the pandemic. For others, including furloughed workers, we heard about the income they had lost, the life changes they had been forced to make, the uncertainty over whether they would have a job to return to. We heard examples of workers feeling forced into poorer terms and conditions, with their employers blaming the crisis.

9.7 From employers we heard about the profound uncertainty which has been the norm since March, and the knife-edge of survival where many – particularly smaller businesses – find themselves. Many hospitality businesses have seen the most profitable part of the year wiped out. The structural shifts facing retailers have accelerated. And the funding crises in many publicly-funded sectors – from social care to childcare, as well as leisure and the arts – have only intensified.

9.8 The economic evidence painted a similar picture. Spring saw the largest fall in GDP in modern history, investment fell dramatically, and recruitment collapsed. Despite this, employment remained high as the CJRS successfully kept millions of workers in jobs, albeit away from work. The CJRS largely protected incomes but pay fell for those whose employers did not "top up" their pay. Others still lost their jobs or hours of work.

9.9 The NLW is based around a target set as a percentage of average earnings. Movements in pay directly affect the NLW rate; in theory, the on-course rate should adjust in response to changes in economic conditions. The logic is that if the economy booms, pay growth will accelerate and raise the nominal target, while in a weak economy pay growth will slow and the target will fall. But the sheer scale of the CJRS and its impact on pay and jobs means that measures of average earnings do not reflect economic conditions in the standard way.

9.10 There are further problems with measuring what happened to hourly pay through the crisis. We rely on the Annual Survey of Hours and Earnings (ASHE) for understanding the impact of the NMW/NLW and plotting our position on the path to 2024. This survey took place at the end of April – the lowest point of economic activity and the peak of infections and furloughing of workers. The response rate was substantially lower than normal and there is a large group of furloughed workers whose hourly rate is unknown. This means it is not possible to calculate median hourly pay in April 2020. Without this we cannot tell where £8.72 was on the bite path to 66.7 per cent of median pay with our usual precision, and this complicates the question of what the next step is on that path to 2024.

9.11 One option is to simply remove furloughed workers from our calculations on the basis that many would have lost their jobs and/or hours of work in the absence of the CJRS. But because furloughed workers tend to be low-paid, removing them actually raises average pay through compositional effects. This in turn increases the on-course rate for the NLW, the opposite of what the framework intends in an economic crisis. In short, average earnings, and therefore the on-course rate of the NLW, are not responding to economic conditions in the normal way.

9.12 By necessity then, our approach to the NLW path is different this year. While we have produced an indicative path, it goes without saying that this is subject to more uncertainty than usual. Instead, Commissioners' approach this year is to recommend rates that minimise any 'significant risk' to employment prospects, as per our remit, in a year when employment risks are greater than they have been in a decade. Our recommendations and rationale are below.

National Living Wage

9.13 The economy has seen the largest shock in modern history and, while growth was rapid over the summer, it is yet to fully recover. This means employers are in a weaker position to respond to NLW increases without impacts on employment. Employers respond by absorbing the cost and accepting lower profits, raising prices and improving productivity/efficiency, but the crisis has curtailed their ability to respond like this. Sales are down and costs are up because of social distancing, PPE and supply disruptions. Investment, a key ingredient in raising productivity, collapsed and many small firms are increasingly indebted. Vacancies fell sharply and while they too have seen rapid growth they are also yet to fully recover, particularly in hospitality.

9.14 However, it is important to recognise the contribution of low-paid workers during the crisis, including key workers – those in care work, essential retail and other sectors. All work in people-facing roles, whether key workers or not, involves higher risk. Many employers agreed that low-paid workers deserved an increase for working through the pandemic at a time of intense pressure and risk for workers.

9.15 Taking all of this into account we recommend an increase in the NLW to £8.91, which is 2.2 per cent or 19 pence. This is lower than our best estimate of the on-course rate of £9.06, and therefore represents a significant adjustment in response to economic conditions. This increase is chosen to be modestly higher than that for prices in the year the rate applies, meaning low-paid workers' living standards should be protected as they will continue to receive a real-terms pay rise. Most importantly, we do not believe this increase presents a significant additional risk to employment prospects, beyond the already challenging outlook.

9.16 We have noted the difficulties in seeing ahead to just next April; looking further still would be unwise. For this reason, we do not recommend a change to the Government's target of reaching two-thirds of median earnings by 2024, and the Commission remains fully committed to the goal of ending low pay. The increase we recommend is broadly in line with predicted wage growth, meaning progress against the Government's ambition may continue. In paragraphs 9.24 to 9.30 we set some indicative paths for the future course of the rate but, as we note in that section, these are even more uncertain than usual. As we are still at the beginning of the approach to 2024, we judge that the target is still achievable and do not propose any change. A fuller review of the path ahead – and greater clarity on a future rate path – will hopefully be possible in our 2021 Report.

National Minimum Wage

9.17 Last year we recommended that the eligibility age for the NLW be reduced to 23 in April 2021. This remains our position as the labour market continues to treat 23 and 24 year olds similarly to those aged slightly older. For example, there are similar numbers working in sectors affected by shutdowns, similar use of the minimum wage rates and similar rates of furlough and hours loss through the crisis. Employer representatives told us that while they were very concerned about increases to the NLW, they were far less concerned with the commitment to change the age eligibility.

9.18 As for the rates themselves, young people are especially hard hit by any downturn because of their relative lack of experience and reliance on vacancies to find work (most adults are already in work when a crisis strikes). During the crisis, the younger the worker, the more likely they were to work in shutdown sectors such as hospitality and leisure or be furloughed, and less likely to have their pay topped up by their employer or work in key worker jobs like social care or essential retail.

9.19 For the new 21-22 Year Old Rate we recommend a rate of £8.36, which is a 16 pence or 2 per cent increase. We have already recommended that this group become eligible for the NLW in the near future. Therefore, this increase, which is slightly lower than for the NLW, balances the need to not allow the gap to widen too greatly with their relatively greater vulnerability, while still allowing these workers to receive a pay award that will protect their living standards.

9.20 The evidence suggests that 18-20 and 16-17 year olds are more vulnerable still to the economic outlook, with more furloughed and more working in shutdown sectors. These age groups are also more likely to be in part-time employment and have seen these opportunities disappear, especially as many of these jobs are in non-supermarket retail, hospitality and leisure. Therefore, we recommend a lower increase to £6.56 (11 pence or 1.7 per cent) for 18-20 year olds, broadly in line with inflation expectations. We believe 16-17 year olds are the group most vulnerable to unemployment, and therefore recommend a smaller increase for this group to £4.62 (7 pence or 1.5 per cent).

9.21 Having completed our review of the Apprentice Rate, the view of Commissioners is that it should be aligned with the 16-17 Year Old Rate. By alignment we mean that there will continue to be two separate rates, in case the fortunes of 16-17 year olds and apprentices diverge in the future, but of the same value. However, apprentices, like teenage workers, are also vulnerable. Our evidence base for apprentices is weaker this year, as we rely on ASHE for this group too. We also know that starts have been hit by the crisis. Therefore, we propose to align these two rates over two years, with the more cautious of the rises for the Apprentice Rate in this year, given the economic picture we have outlined, and the rate aligning with the 16-17 Year Old Rate in 2022. For next April we recommend an increase of 15p or 3.6 per cent to £4.30.

9.22 Last year, we achieved a longstanding aim to raise the Accommodation Offset to the level of the National Minimum Wage (now the 21-24 Year Old Rate). This year we recommend that the Accommodation Offset again rise in line with that rate (the new 21-22 Year Old Rate). That is, an increase of 16p or 2 per cent to £8.36.

9.23 We welcome the Government's continued commitment to ending low pay. Achieving this in these difficult circumstances is likely to require the Government to think carefully about the support it provides in a range of other areas beyond the rate of the NLW. These include the stability and security of support provided to workers and businesses to help them cope with the impact of the coronavirus pandemic. We have noted before the need for additional support for the social care sector to enable it to fulfil its ambitions to pay workers a decent wage. This need has only become more urgent. We also heard this year about the acute pressures on the childcare sector, and would highlight this as a further area where government funding is vital.

The path of the National Living Wage

9.24 Our decision to recommend an NLW that did not match our estimate of the on-course rate has implications for our estimates of the on-course rates for 2022 and 2023. We estimate the rate based on the ratio of the current minimum wage to the median wage. Therefore, a minimum wage that is below the current on-course rate will also lower the on-course rate for next year.

9.25 As discussed in paragraphs 8.68 to 8.75 there are multiple ways that we could calculate median pay in 2020. Issues with the ASHE mean that we do not have a good, consistent, measure of median pay this year. Therefore, all the figures quoted in this section will, unless otherwise stated, be based on our preferred methodology. This approach grows the median hourly pay estimates from the 2019 ASHE by the same amount as Average Weekly Earnings (AWE) to get figures for April and October 2020.

9.26 We forecast that the bite of our recommended NLW of £8.91 will be 61.9 per cent (based on our favoured methodology) next year. This means that the target bite for 2022 would be 63.5 per cent (a third of the distance between 61.9 per cent and the 66.7 per cent 2024 target). If we had recommended an on-course increase, the bite next year would have been 62.9 and therefore the target for 2022 would have been 64.2 per cent.

9.27 In 2021 and 2022 the target will be based on the median wage of those aged 23 and over. Our remit states that by 2024 the NLW should apply to those aged 21 and over. We may choose to recommend lowering the eligibility age for the NLW to apply in 2023 or we may wait until 2024. If we do recommend that the NLW applies to those aged 21 and over in 2023 the on-course NLW will be lower than if we decide to wait until 2024. We therefore have multiple estimates for that year.

9.28 Table 9.1 shows the on-course rates for the NLW up until 2024. The figures for 2022 and 2023 are based on the path taking into account our recommendation of an NLW of £8.91 to apply from next year. We anticipate an on-course rate in 2022 of £9.40. If we were to recommend reducing the age threshold to 21 and over in 2023 the on-course NLW rate in 2023 would be £9.85. If we decide against recommending a change in the eligibility age, we anticipate that the on-course rate in 2023 would be £9.85. The 2024 target is anticipated to be £10.32.

Table 9.1: NLW levels and indicative forecast on-course rates, UK, 2020-2024

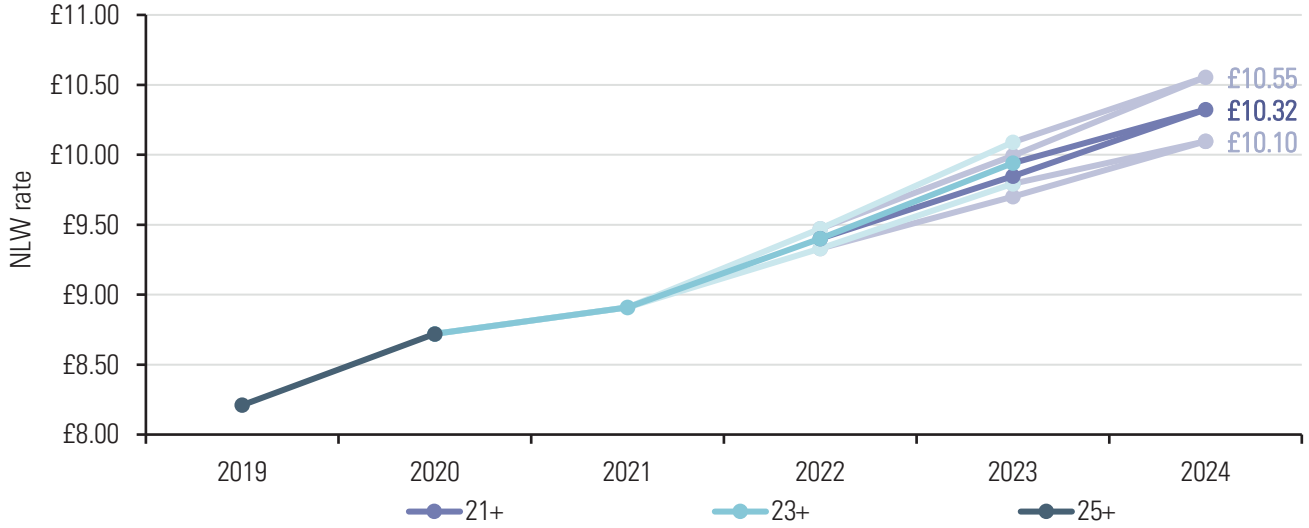
Age	2020	2021	2022	2023	2024
25+	£8.72				
23+		£8.91	£9.40	£9.94	
21+				£9.85	£10.32

Source: Source: LPC estimates using ASHE 2010 methodology; standard weights and low-pay furlough weights, UK, 2019. Forecasts are based on AWE total pay from Office for National Statistics (2020c), HM Treasury (2020a and 2020b) and Bank of England (2020a) average weekly earnings predictions.

9.29 However, there is considerable uncertainty around pay over the next few years. Even ignoring the issues with measuring the current level of median wages, we do not know how the Covid-19 pandemic will affect pay. If growth in median pay exceeds forecasts, then the on-course rates will be higher (and vice versa). Over the period of the NLW the forecasts we use have typically been within 0.5 percentage points or so of the out-turn. Figure 9.1 shows what would happen if wage growth each year was 0.5 percentage points higher or lower than forecast. The darker line in the centre gives our central estimate. The fainter lines either side of the main trajectory show how the path would be affected by a deviation in pay growth of 0.5 percentage points.

9.30 Our central estimate of the NLW in 2024 is currently £10.32, but if earnings growth were 0.5 percentage points higher or lower, this would be £10.55 or £10.10 respectively. If median hourly pay growth were 0.5 percentage points higher then our estimated on-course rate for 2022 would be £9.47. If growth were 0.5 percentage points lower then the rate would be £9.33.

Figure 9.1: Indicative on-course rates, UK, 2019-2024



Source: LPC estimates using ASHE 2010 methodology; standard weights and low-pay furlough weights, UK,2019. Forecasts are based on AWE total pay from Office for National Statistics (2020c), HM Treasury (2020a and 2020b) and Bank of England (2020a) average weekly earnings predictions.

Implications of the recommended rates

9.31 In a normal year, we would estimate how the recommended rates affect the bite of each minimum wage and the number of workers who would benefit. It is not possible to do this analysis accurately this year because of large uncertainty in the coverage and bite of the minimum wage that have arisen because of the CJRS (see paragraphs 3.15 to 3.19 for more details).

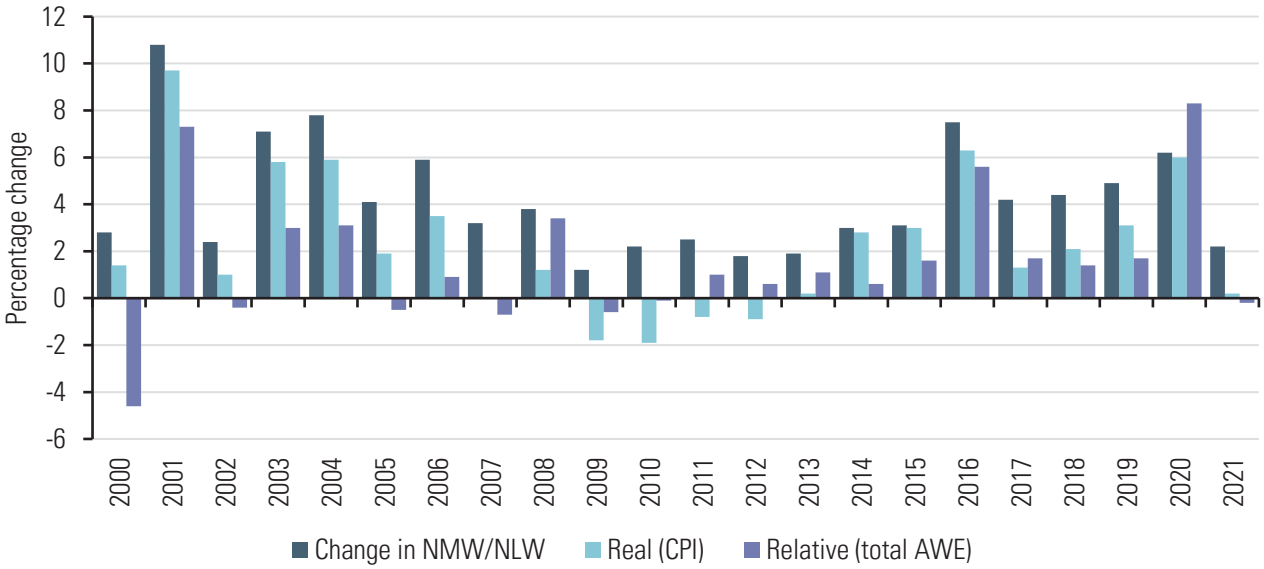
Real and relative value of the rates

9.32 Growth in the minimum wage is meaningful when it translates into greater value in real terms (i.e. greater than the increase in prices) and in relative terms (i.e. greater than the increase in average wages). When the NLW is increased to £8.91 in April 2021, this will equate to a nominal increase in the wage floor of more than 30 per cent since 2015, while prices will have risen by 10 per cent and wages by 15 per cent.

9.33 Since the introduction of a minimum wage in 1999, the NMW/NLW has grown faster than both inflation and average wage growth. However, this growth has not been uniform; in particular, throughout the last recession, increases in the NMW/NLW kept pace with wage growth but not with inflation. Figure 9.2 shows the history of increases in the rate in nominal, real and relative terms. The increase in the minimum wage is compared with inflation and average wage growth across the whole period that the minimum wage was applicable. It shows that the NMW/NLW has increased in real (CPI) terms in every year since it was introduced apart from during the time of the previous recession in 2009-12. It has increased in relative (AWE) terms in every year since 2010, and only in 2009-10 was there a fall across any 2-year period.

9.34 In the last recession, smaller increases in the NMW helped to protect employment in low-paying sectors. Although the real value of the rate was partially eroded over that period, subsequent substantial increases mean that the NLW now has the highest real and relative value in the history of the minimum wage in the UK. But once again, we are in a time of substantial economic uncertainty and so we are recommending an increase that we believe will minimise significant risk to employment prospects. Figure 9.2 shows that the magnitude of this recommended increase is in line with the increases in 2009-12. Forecasts for 2021 suggest that this is likely to be a moderate real-terms pay rise, and broadly in line with predicted wage growth. This means that minimum wage workers will be able to afford the same goods and services next year as in the current year. In the medium term we remain committed to the ambition of ending low pay.

Figure 9.2: Changes in the value of the adult minimum wage rate in nominal, real and relative terms, UK, 2000-2021



Source: LPC estimates using values of NMW/NLW, CPI, and AWE total pay, UK, 2000-2020. Forecasts for 2021 are based on HM Treasury (2020b) average weekly earnings and inflation predictions.

Impact of the rates on household incomes

9.35 What matters most for the living standards of minimum wage workers is the total income received by the household. It is therefore important to understand the impact of other factors on household income, notably the tax and benefit system. Net income varies according to household circumstances, with Universal Credit (UC) boosting the earnings of low-income households, but the amount of benefits paid decreases as earnings increase according to the 'taper rate', reducing the return to higher earnings.

9.36 Income Tax and National Insurance contributions (NICs) also reduce the take-home element of increases in earnings. The personal tax allowance is £12,500 in the 2020-21 financial year and will thereafter increase in line with the Consumer Price Index (CPI). The National Insurance Primary Threshold, at which employees start paying NICs, is £183 per week in 2020-21.

9.37 The following analysis illustrates the change in household incomes between April 2020 and April 2021 using example households. The intention is to show how household income will change next year, once the new NLW and NMW rates come into effect, after the tax and benefits applicable to that household have been taken into account. For these purposes, we assume that the household receives no housing costs support, no council tax support and no marriage allowance, and for simplicity we have excluded the temporary increase in the UC standard allowance introduced in response to Covid-19. Our aim is to understand the impact of the NLW/NMW in terms of the change in household income, rather than the absolute levels.

9.38 Table 9.2 shows that before any adjustment for tax and benefits, an NLW worker working 30 hours per week will see an increase of £5.70 in their weekly pay when the NLW is increased from £8.72 to £8.91 in April 2021. Using HM Treasury estimates, a single NLW worker over 25 will keep most of the increase in the NLW. After adjusting for tax and benefits, their weekly household income will rise by £4.27 in April 2021, while their equivalent hourly income (calculated as their net income after tax and benefits divided by the number of hours worked) will rise by 14 pence from £8.26 to £8.40. Their after-tax pay will grow by 1.7 per cent, which effectively means that they keep three-quarters of the increase in the NLW.

9.39 Meanwhile, a married-couple household, both aged over 25 with two children and only one parent working 30 hours per week, in receipt of UC, would see their weekly net income rise in cash terms by £3.34. This is equivalent to an effective increase in the hourly rate of 11 pence, from £14.56 to £14.67 per hour. Their after-tax pay will grow by 0.8 per cent, a fraction of the 2.2 per cent increase to the NLW. This is due to the combined effects of the increase in pay being above the Income Tax threshold, and the withdrawal of UC as they earn above the taper threshold.

Table 9.2: Change in household incomes resulting from changes in NLW for workers aged 25+, 2020/21-2021/22

25+ worker, 30 hour week		2020/21	2021/22	Increase £	Increase per cent
Pre-tax hourly rate	**£**	**8.72**	**8.91**	**0.19**	**2.2**
Annual pay	£	13,641	13,938	297	2.2
Tax threshold	£	12,500	12,570	70	0.6
Taxable pay (annual)	£	1,140.57	1,367.79	227	19.9
Weekly pay before tax/NICs/UC	£	261.60	267.30	5.70	2.2
Single, no children					
Weekly household income after tax/NICs/UC	£	247.79	252.06	4.27	1.7
Post-tax/benefit change	£	-13.81	-15.24		
Post-tax/benefit change	%	-5.3	-5.7		
After-tax hourly rate	£	8.26	8.40	0.14	1.7
Married couple, one working, 2 children					
Weekly household income after tax/NICs/UC	£	436.68	440.02	3.34	0.8
Post-tax/benefit change	£	175.08	172.72		
Post-tax/benefit change	%	66.9	64.6		
After-tax hourly rate	£	14.56	14.67	0.11	0.8

Source: LPC estimates using HM Treasury data, November 2020.
Notes:

a. Estimates assume that the household is in receipt of Universal Credit with no housing costs.
b. Estimates exclude Council Tax Support.
c. Estimates exclude the temporary increase in the Universal Credit standard allowance (of £20 per week).
d. Estimates assume the couples in the examples are of the same age.
e. The personal tax allowance has been increased in line with CPI.

9.40 This year marks an important change in the structure of the minimum wage rates, with the age threshold for the NLW moving from 25 to 23. As a result, 23-24 year olds who move from the 21-24 Year Old Rate to the NLW in April 2021 will see more substantial increases in their take-home pay. Table 9.3 shows that before any adjustment for tax and benefits, a minimum wage worker in this age group working 30 hours per week will see an increase of £21.30 in their weekly pay, equivalent to an 8.7 per cent increase. For a single worker after tax and benefits, this is equivalent to an increase of £14.87 in their weekly pay, or 6.3 per cent. Their effective hourly rate will be £8.40.

9.41 A married-couple household with two children and a worker who is aged 23-24 will also see an increase in their pay – their weekly income will increase by £7.14, or 1.7 per cent, giving them an effectively hourly rate of £13.85. This effective hourly rate is lower than for the equivalent household with an NLW worker aged 25 or over because the UC base rate allowance is greater for those over 25.

Table 9.3: Change in household incomes resulting from changes in NLW for workers aged 23-24, 2020/21-2021/22

23-24 year old worker, 30 hour week		2020/21	2021/22	Increase £	Increase per cent
Pre-tax hourly rate	£	8.20	8.91	0.71	8.7
Annual pay	£	12,827	13,938	1,111	8.7
Tax threshold	£	12,500	12,570	70	0.6
Taxable pay (annual)	£	327.14	1,367.79	1,041	318.1
Weekly pay before tax/NICs/UC	£	246.00	267.30	21.30	8.7
Single, no children					
Weekly household income after tax/NICs/UC	£	237.19	252.06	14.87	6.3
Post-tax/benefit change	£	-8.81	-15.24		
Post-tax/benefit change	%	-3.6	-5.7		
After-tax hourly rate	£	7.91	8.40	0.50	6.3
Married couple, one working, 2 children					
Weekly household income after tax/NICs/UC	£	408.49	415.63	7.14	1.7
Post-tax/benefit change	£	162.49	148.33		
Post-tax/benefit change	%	66.1	55.5		
After-tax hourly rate	£	13.62	13.85	0.24	1.7

Source: LPC estimates using HM Treasury data, November 2020.
Notes:

a. Estimates assume that the household is in receipt of Universal Credit with no housing costs.
b. Estimates exclude Council Tax Support.
c. Estimates exclude the temporary increase in the Universal Credit standard allowance (of £20 per week).
d. Estimates assume the couples in the examples are of the same age.
e. The personal tax allowance has been increased in line with CPI.

9.42 Table 9.4 shows the same analysis for workers aged 21-22 who become eligible for the temporary 21-22 Year Old Rate, replacing the 21-24 Year Old Rate. Before any adjustment for tax and benefits, a 21-22 year old working 30 hours a week will see an increase of £4.80 in their weekly pay when the 21-22 Year Old Rate is introduced at £8.36 in April 2021. Workers on this rate who work a 30 hour week will experience an increase in gross weekly pay of £4.80, or 2 per cent. A single employee household with no children will keep most of that increase, with their weekly pay increasing by £3.65 or 1.5 per cent. A married-couple household, with two children and only one working parent, in receipt of UC, would see their weekly income rise in cash terms by slightly less, £2.99, or 0.1 per cent, due to the taper rate benefit reductions in UC. However, their equivalent after-tax hourly rate of £13.72 is still considerably above their pre-tax hourly pay.

9.43 Table 9.4 shows the same analysis for workers aged 21-22 who become eligible for the temporary 21-22 Year Old Rate, replacing the 21-24 Year Old Rate. Before any adjustment for tax and benefits, a 21-22 year old working 30 hours a week will see an increase of £4.80 in their weekly pay, assuming when the 21-22 Year Old Rate is introduced at £8.36 in April 2021. Workers on this rate who work a 30 hour week will experience an increase in gross weekly pay of £4.80, or 2 per cent. A single employee household with no children will keep most of that increase, with their weekly pay increasing by £3.65 or 1.5 per cent. A married-couple household, with two children and only one working parent, in receipt of UC, would see their weekly income rise in cash terms by slightly less, £2.99, or 0.1 per cent, due to the taper rate benefit reductions in UC. However, their equivalent after-tax hourly rate of £13.72 is still considerably above their pre-tax hourly pay.

9.44 Overall, the evidence suggests that many households with minimum wage workers will benefit from the increases to the NLW and NMW rates. Increases to the rates over time have meant that the annual pay of a full-time minimum wage worker is now comfortably above the income tax threshold, which means that changes to earnings when the rates are increased are more likely to be subject to taxation. The taper rate of UC also reduces the share of the increase in the rate that minimum wage workers are able to keep for themselves. Changes to the tax and benefit system would be necessary for households to keep more of these gains.

Table 9.4: Change in household incomes resulting from changes in NMW for workers aged 21-22, 2020/21-2021/22

21-22 year old worker, 30 hour week		2020/21	2021/22	Increase £	Increase per cent
Pre-tax hourly rate	£	8.20	8.36	0.16	2.0
Annual pay	£	12,827	13,077	250	2.0
Tax threshold	£	12,500	12,570	70	0.6
Taxable pay (annual)	£	327.14	507.43	180	55.1
Weekly pay before tax/NICs/UC	£	246.00	250.80	4.80	2.0
Single, no children					
Weekly household income after tax/NICs/UC	£	237.19	240.84	3.65	1.5
Post-tax/benefit change	£	-8.81	-9.96		
Post-tax/benefit change	%	-3.6	-4.0		
After-tax hourly rate	£	7.91	8.03	0.12	1.5
Married couple, one working, 2 children					
Weekly household income after tax/NICs/UC	£	408.49	411.48	2.99	0.7
Post-tax/benefit change	£	162.49	160.68		
Post-tax/benefit change	%	66.1	64.1		
After-tax hourly rate	£	13.62	13.72	0.10	0.7

Source: LPC estimates using HM Treasury data, November 2020.
Notes:

a. Estimates assume that the household is in receipt of Universal Credit with no housing costs.
b. Estimates exclude Council Tax Support.
c. Estimates exclude the temporary increase in the Universal Credit standard allowance (of £20 per week).
d. Estimates assume the couples in the examples are of the same age.
e. The personal tax allowance has been increased in line with CPI.

Conclusion

9.45 This year, issues with the data arising from the furlough scheme make it difficult to assess where the 2020 NLW rate is on the path to 2024, and what the on-course rate is for 2021. In the middle of challenging economic circumstances, we have made recommendations that minimise the risk to employment. The increase in the NLW is modestly higher than the expected increase in prices, and in line with the expected increase in wages, and so should protect workers' living standards.

9.46 We have recommended more cautious increases for the youth rates, recognising that young people are more likely to work in the most exposed sectors, and are more likely to have been furloughed and experienced changes to their job in lockdown. We continue to recommend that the eligibility age of the NLW should reduce to 23, as this age group is more similar to older workers. We have also reviewed the Apprentice Rate and conclude there is scope to align it with the 16-17 Year Old Rate, but this will take place over two years given the challenging labour market context.

9.47 Every year, millions of workers directly benefit from the increases to the rates. Changes to the tax and benefit system would make it possible for workers to take home more of these increases.

Appendix 1

Consultation

A1.1 We are grateful to all those people and organisations that contributed to the preparation of this report. We would like to thank, in particular those who provided evidence, either written or oral, and those who organised or participated in Low Pay Commission meetings. All such individuals and organisations are listed below, unless they expressed a wish to remain unacknowledged.

Association of Convenience Stores
Association of Directors of Adult Social Services
Association of Labour Providers
British Beer and Pub Association
British Chambers of Commerce
British Independent Retailers Association
British Retail Consortium
Care First Management Services Limited
Carnegie UK Trust
CBI
Chartered Institute of Payroll Professionals
Chartered Institute of Personnel and Development (CIPD)
Citizens Advice Scotland
Communication Workers Union
Community Leisure UK
Early Years Alliance
Equity
Federation of Independent Retailers (NFRN)
Federation of Small Businesses
Federation of Wholesale Distributors
Food and Drink Federation
GMB
HM Government
Intergenerational Foundation
Incomes Data Research
Institute for Fiscal Studies
Institute of Workplace and Facilities Management
John Lewis Partnership
Joseph Rowntree Foundation
Labour Research Department
Learning and Work Institute
Local Government Association

Make UK
McDonald's Restaurants Ltd
Michael Nisbet
Muslim Council of Britain
National Care Association
National Day Nurseries Association
National Farmers' Union
National Farmers' Union Scotland
National Hair & Beauty Federation
National Institute of Economic and Social Research
National Union of Rail, Maritime and Transport Workers
Nicola Alison (Office for Manpower Economics)
The Prince's Trust
Recruitment & Employment Confederation
Resolution Foundation
Royal Mencap Society
Scottish Grocers' Federation
Scottish Women's Convention
Staffordshire Chambers of Commerce
Trades Union Congress
The Trees Hampshire Limited
UK Fashion and Textile Association
UKHospitality
Union of Shop, Distributive and Allied Workers
UNISON
Unite the Union
United Kingdom Homecare Association
University of Southampton
University of Warwick
Welsh Government
Weymouth & Portland Chamber of Commerce
Xpert HR
Youth Employment UK

Appendix 2

Commissioned research

A2.1 Research has been an important factor in determining our recommendations since our establishment in 1997 and continues to play an essential role in deciding what minimum wage rates we recommend. We employ the findings of both our commissioned and independent research to improve our understanding of the impact of the minimum wage rates in the UK, and the wider labour market situation that we make recommendations in.

A2.2 Alongside this report, we are publishing six commissioned research projects: four focused on the impact of the National Living Wage (NLW) on businesses; one focusing on the impact of the NLW on pay and job progression; and one examining how employers set pay for apprentices. Of these, one is an extension to a previous project, one was commissioned last year and the other four were commissioned this year. We have one additional research project that was commissioned this year, that we have very early findings for, but will not be published until it is finalised next year.

Impact of the NLW on businesses

A2.3 We start by examining the four research projects that look at the effect of the minimum wage on business outcomes and decisions. Each research project focuses on different outcomes, with one that focuses on measures of employment and productivity, another that looks at the impact on consumer prices, a third that examines how responses vary with the ability to replace workers with technology, and the fourth surveys how employers are planning to respond to the NLW with a focus on pay and conditions.

A2.4 Baily, Popov and Wilson (2020) examined how the introduction of the NLW in 2016 affected employers looking in parallel at firm-level impacts and price impacts. The firm-level analysis looks at how the level of employment, productivity and survival rates changed after the introduction of the NLW. The authors matched the Annual Survey of Hours and Earnings (ASHE) data set to the Business Structure Database (BSD) using the enterprise reference number and census output area to identify firms affected by the NLW. Workers' hourly wages were observed in the data set and then businesses were assigned into a treatment or control group based on the wage level. In their main specification businesses for whom the average hourly pay of the workers sampled in ASHE was below the incoming NLW were assigned to the treatment group, while those who paid more than 20 per cent above the incoming NLW were assigned to the control group (workers earning between 100 and 120 per cent of the incoming NLW were excluded from the analysis due to the fact that wages in this space are affected by spillovers from the minimum wage). The researchers compare their identification strategy with the more established methodology that uses labour cost per employee thresholds and find that their approach does work as a signal of low pay.

A2.5 The researchers used a difference-in-difference approach to estimate the impact of the NLW. They regressed the change in the outcome variable of interest (employment, turnover per employee and survival) against a previous change in the variable, a range of control variables, and an identifier if the firm is observed to be low-paying or not. The firm-level controls were the age in years, a dummy if the firm is foreign-owned, a dummy if the firm is in a rural location, the employment level, turnover level and whether the firm existed in 2012. The worker type controls were dummy variables for various worker age bands, a dummy for the gender of the workers and the worker's occupation code (at 2-digit Standard Occupational Classification (SOC) level). There were also industry controls (defined at the 2-digit Standard Industrial Classification (SIC) level, but with some large sectors at the 3-digit level) and regional (Nomenclature of Territorial Units for Statistics 1 (NUTS1)) controls.

A2.6 The researchers found that employment growth was around 3.0 per cent weaker in low-paying firms. When focusing the analysis on firms in low-paying sectors the authors estimate that employment growth was 2.3 per cent lower in low-paying firms with both results being statistically significant. They found no evidence of differential growth across different sectors, or for foreign-owned firms. They did find evidence that firms in rural locations and those with more workers initially grow relatively less. The researchers found that the employment effects were larger in larger chains with more sub-units and in enterprises that were part of a larger umbrella organisation. They found that the results are robust to variations in the definition of treatment and control groups. They also used a propensity score matching approach with ten 'nearest neighbours' and find a similar result to the difference-in-difference approach.

A2.7 Using a different measure for employment, that only applies to the enterprise level (and therefore the analysis excludes multi-unit enterprises) the researchers found a smaller, but statistically significant minimum wage effect for their all firms specification, and an insignificant effect in the low-paying sectors only specification. A third employment measure, that largely covers multi-unit enterprises found similar results to the main measure. Changing the functional form of the outcome measure shows that low-paying firms are 3.7 per cent more likely to see an employment fall by at least 1 per cent, 3.2 per cent more likely to see employment fall by at least 10 per cent and 3.9 per cent less likely to see employment growth of above 10 per cent.

A2.8 The researchers also examined how the NLW has affected the survival rate (the proportion of firms that continue to trade). Their findings suggest that survival rates are 2 percentage points higher for low-paying firms. In disaggregating their analysis, they noted that the survival result was largely driven by the food and drink sector, with evidence of effects also in cleaning and social care. The researchers also examined how the NLW affected turnover per employee (a proxy for productivity). They found that turnover per employee fell in in low-paying firms relative to higher-paying ones, but noted limits with the turnover data. Due to the data being captured at the enterprise level the analysis could not see what is happening within multi-unit enterprises, which account for a large proportion of the sample.

A2.9 The researchers also aggregated the data to a sector-region level. They compared differences in outcomes between all the firms in a given sector-region with a low level of average pay to the outcomes in another sector-region with higher levels of pay to estimate the effect of the NLW on firm start-ups (births) and firms closing (deaths). This specification did not find any statistically significant employment or turnover per worker effects, but did find very limited evidence of lower birth and death rates in areas with more low-paying firms.

A2.10 The researchers also estimated the effect of the minimum wage on consumer prices. They used data from ASHE and the Annual Business Survey to identify the sectors that are most likely to see price increases result from increases in the wage floor, and matched this with item indexes from Consumer Price Index data at the sector level. They used a panel regression approach to estimate the month-on-month effect of minimum wage increases in inflation for exposed items. They find evidence that inflation is higher for these items in months when the minimum wage is increased than at other times of the year, but only after the introduction of the National Living Wage in 2016. Over this period, inflation for treated items was 0.237 percentage points higher in minimum wage uplift months, compared to an average increase in minimum wages of 5.22 percentage points. This is equivalent to an elasticity of prices with respect to minimum wage of 0.045, or 0.095 if inflation in the two months following uplift are accounted for.

A2.11 Wilson (2020) estimated the effect of the minimum wage on consumer prices. He developed a theoretical model of the interaction between minimum wages and prices, which states that the elasticity of prices with respect to minimum wages should be equal to the proportion of total costs that are made up of minimum wage labour costs. He therefore used microdata from ASHE and the Annual Business Survey (ABS) to identify the sector-region splits that are most likely to see price increases result from increases in the wage floor. He estimated the share of workers earning less than or equal to the incoming minimum wage from ASHE and the share of turnover that is made up of employment costs from the ABS. He combined these two measures at the NUTS1 region and at a four-digit SIC to create a measure of how exposed each sector-region is to an increase in the minimum wage.

A2.12 The researcher then mapped monthly price quotes at the item and region level from the Consumer Price Index to the sector-region. There are approximately 700 items at this level, but around 600 are considered tradable goods – in that a substantial proportion of the input costs are set by international trade – and were excluded from the analysis. In total the researcher mapped 172 item-regions to the 50 most minimum wage exposed sector-regions, a further 200 item-regions to the next 50 most exposed sector/regions, and 957 item-regions to the sector-regions that are not in the 100 most exposed to the minimum wage. In the main analyses the treatment group was defined as the items in the 100 most exposed sector-regions, and the control group the items in the sector-regions that are not in the 300 most exposed to the minimum wage (543 item-regions).

A2.13 The researcher used a panel regression approach to estimate the effect of the minimum wage on prices. The regression estimates the month-on-month change in prices for each item-region, controlling for an item-region fixed effect, a month fixed effect and the inflation in the previous month. The approach estimates the effect on prices from a minimum wage uplift existing in the month. The regression covers the period of January 2010 to January 2020. The main specification found that inflation in 0.081 percentage points higher in months with a minimum wage uplift. The effect is statistically significant at the 1 per cent level, irrespective of the specification of standard errors or the choice of control variables. Interpreting the finding, the researcher calculated that the mean minimum wage increase was 3.55 per cent, and that therefore the elasticity of prices with respect to the minimum wage was approximately 0.023.

A2.14 When testing the sensitivity of the approach, the researcher found that focusing only on the 50 most exposed sector-regions roughly doubled the estimated effect. Using two slightly different measures of minimum wage costs as a proportion of total costs only made small or marginal differences to the findings. When restricting the analysis to the period starting with the introduction of the NLW (when minimum wage increases were larger) the researcher estimated a larger effect from a minimum wage uplift of 0.197 percentage points. This equates to a slightly higher elasticity of around 0.038. Including estimates of higher inflation in the two months after the uprating increased the overall effect to 0.59 percentage points in the 2016-2020 period, or an elasticity of 0.11.

A2.15 Adding a control group to the analysis gave results that were broadly consistent with the results under specifications without a control group. Using a continuous measure of minimum wage increases in a month, rather than a binary one, the researcher estimated an elasticity of 0.022, consistent with the standard specification. He also estimated a difference-in-difference model estimating the differential effects from the introduction and subsequent upratings of the NLW. This approach found some evidence that the NLW was associated with an increase in inflation of 0.18 per cent, but this is only statistically significant at the 10 per cent level.

A2.16 Aitken, Forth and Riley (2020) estimated how firms' responses to the NLW vary by their opportunity to substitute capital and technology for labour. They used the Financial Analysis Made Easy (FAME) data set which contains data on the population of UK-registered companies, though it suffers from a high level of missing data for small firms due to light reporting requirements for these companies. They mapped occupation level measures of job automatability to the LFS and Annual Population Survey (APS) to create an industry-level measure of automatability. Following on from Forth, Paczos, Davies and Riley (2020) the researchers used a matched sample from the Labour Market Outlook (LMO) and FAME to identify the average labour costs of firms that are associated with whether or not a firm states that they are affected to a greater extent by the NLW. They then used this to generate cut-offs in average labour costs to define treatment and control groups. The analysis then compares the change in outcomes between 2013 and 2015 (the control period) with the period 2016-2017 (treated period).

A2.17 The researchers controlled for whether the firm is foreign owned, is an exporter, is less than 6 years old, a measure of market concentration (the Herfindahl–Hirschman Index) and for exposure to uncertainty from the UK's exit from the European Union through the labour market (share of EU migrant workers) and through the export market (proportion of exports that are to the EU). They used four measures of automatability. They constructed a measure of routine task intensity by comparing the proportion of tasks in an occupation (four-digit SOC) that are routine, manual and abstract. They obtained this data from the 2012 British Skills Survey (BSS). They then aggregated the occupational measures to the industry level using the APS. They also used a measure from Office for National Statistics (2019) and a patent-based measure from Josten and Lordan (2019). In addition, they constructed a routine intensity indicator from another set of questions in the BSS. The researchers found that measures of automatability are negatively correlated with pay.

A2.18 They conducted a placebo test on their estimates of wage effects and for a non-treatment year and found evidence of positive wage effects which they linked to the increases in the NWM in these years. They therefore adjusted their regression analysis to take account of these effects. They found no evidence of effects in a placebo test on the other outcomes.

A2.19 The researchers found that the NLW has increased average labour costs for firms that were more exposed to the NLW, by 1.7-2.1 per cent. They found some weak evidence that profit margins decreased for firms more exposed to the NLW. They did not find any statistically significant differences from industry level automatability on firm outcomes between NLW-exposed firms and the control group. This finding occurred across all treatment and control group definitions and across the four automatability measure used.

A2.20 Incomes Data Research (2020d) conducted 22 telephone case studies of employers who have been affected by the minimum wage. These employers cover a range of mostly low-paying sectors and cover mostly large employers with a few medium-sized employers. The sample included firms in the private, public and not-for-profit sectors.

A2.21 The researchers found that the above-inflation increases in the NLW had sizable impacts on wage compression and differentials, with differentials with the immediate supervisors of those on the lowest levels having been reduced or eliminated in many of the organisations. In other organisations trying to retain differentials lower down the pay scale has reduced them higher up the pay scale. Some organisations are examining changes to pay structures in response to the new NLW target. Many employers have limited scope to offset any further increase in the wage floor by reducing terms and conditions as they have already made changes in these areas.

A2.22 Most employers stated that they were not concerned by the planned lowering of the NLW qualifying age to 21. Few of the employers in the sample operated youth rates, as they felt it was simpler and/or fairer to not vary pay rates by age. Employers said that the Covid-19 pandemic had a significant, and generally detrimental, impact on business activity and this affected the pay awards that they could offer. Employers are and are planning to make greater use of technology and multiskilling their workforce. Many employers said they hoped for a smaller increase in the NLW this year due to the impact Covid-19 had on their revenues. Employers asked for announcements on NLW increases to be made earlier to give greater time for them to plan for the higher wage floor.

Impact on pay and job progression

A2.23 Avram and Harkness (2020) updates Avram and Harkness (2019) adding an extra year's data and changing the sample selection criteria to retain more cases. The research examined the link between the NLW and progression out of minimum wage jobs. The researchers used the geographic variation in minimum wage coverage across travel-to-work-areas (TTWAs) – which approximate local labour markets – to estimate the effect of the NLW on progression. The authors used ASHE to calculate coverage in TTWAs and used the UK Longitudinal Household Survey (UKLHS) to examine movements out of jobs that paid the minimum wage. They stratified jobs into three groups – minimum wage jobs; 'low-paid' jobs (those that are paid between the minimum wage and two-thirds of the median hourly rate); and 'high-paid' jobs (those that are paid more than two-thirds of the median hourly rate). In their estimations, the researchers controlled for gender, age, qualifications, household composition (including number of children and having children aged less than five), self-reported health status, ethnicity, immigration status, having a previous experience of unemployment, and region. The researchers imputed measures of hourly pay in the UKLHS for the approximately two-thirds of workers not paid by the hour, by using pay from the third of workers who were paid by the hour.

A2.24 Consistent with their previous findings they found that around half of minimum wage workers transition into higher-paid employment within a year and of these, four-fifths progress to 'low-paid' employment with the remaining fifth moving into 'high-paid' employment. Transition rates over three years were somewhat higher, especially to 'high-paid' employment. Minimum wage workers were more likely to transition to high-paid employment in areas with higher median wages, although that did not account for the impact from the different worker characteristics that were observed in higher-paying areas.

A2.25 The researchers found limited evidence that the introduction of the NLW increased the probability of the worker remaining in a minimum wage job. A one percentage point increase in coverage was associated with an increase in the probability of remaining in a minimum wage job in 2016 of around 4 percentage points. This equates to a 10 per cent increase. The effect is temporary and the results vary according to the specifications used.

A2.26 The researchers found that the probability of remaining in a minimum wage job increases with the level of the (lagged) bite and is statistically significant if the bite is over 54 per cent. They also failed to find any evidence that the increase in the minimum wage harmed the hourly wage growth of minimum wage workers.

Pay setting for apprentices

A2.27 Dickinson, Hogarth and Cardenas Rubio (2020) interviewed 30 employers to explore how employers set the pay of apprentices, how the increases in the Apprentice Rate minimum wage has affected their decisions on pay, and whether training affects pay decision-making. The researchers also asked about the impact of the Covid-19 pandemic on employers' short and medium-term recruitment plans for apprentices. The researchers focused on employers who were likely to pay apprentices at or close to the Apprentice Rate and age rates of the National Minimum Wage (NMW). They analysed the Apprenticeship Pay Survey 2018/19 (APS 2018/19) to identify characteristics associated with minimum wage coverage. From this, the researchers decided to focus on employers in hairdressing; childcare and related; construction; electro-technical; and engineering, manufacturing technologies and related standards and frameworks.

A2.28 Among employers in the sample most apprentices were paid above the NMW age rate in the first year of the apprenticeship, even though employers could have paid these apprentices at the lower Apprentice Rate minimum wage. Some of the employers paid above the Apprentice Rate but at or below the age-related minimum wage. Apprentices in the second or third year of their apprenticeship were mostly paid above the NMW age-related rate. Apprentices who were existing employees would typically continue on their previous rate of pay. New recruits straight onto an apprenticeship, tended to be paid a rate which the employer decided using the NMW framework as a determinant. Most employers chose to pay the age-related minimum plus a premium. Employers said that they paid a rate above the statutory minimum due to: the apprentice's contribution to the business; the employer's views on fairness, to attract better candidates and because of externally determined national or organisational pay rates. The researchers found that across all of the frameworks there is a progression in pay from the start to the end of the apprenticeship. This approach is common across most of the apprenticeship frameworks looked at, apprentice age and levels, and organisations.

A2.29 Few of the respondents paid the NMW Apprentice Rate, with most saying that they believed it to be set at too low a level for their apprentices. When it is used it is generally for 16-17 year-old apprentices. Pay typically increases during the apprenticeship, so apprentices that start on the Apprentice Rate are likely to be paid a higher rate by the end of their apprenticeship. Some employers paid a lower pay rate for an initial period. This 'probationary' rate was used at the start of the apprenticeship to gauge commitment. Other employers paid above the Apprentice Rate but below the age rate in order to maintain differentials to qualified staff in sectors where qualified staff were paid the age-related NMW.

A2.30 The researchers found that most employers used apprenticeships to meet future workforce needs. Employers used apprenticeships to maintain a pipeline of skilled workers. Apprentices mainly received a mix of day release, externally supervised on-the-job training sessions, and distance learning. They also often received some internally supervised on-the-job training sessions and statutory training. Typically, employers reported that their apprentices spent between 25-35 hours a week working and between 6-10 hours a week in off-the-job training. There was some variation in the amount of training, with off-the-job training highest in engineering and hairdressing and lowest in health, social care and sport and retail. The majority of employers said that training costs were offset by the increase in productivity from apprentices' increased skill, which led them to not view off-the-job training as a cost pressure.

A2.31 Just under two-thirds of the employers surveyed said that their recruitment plans for this year had not been affected by Covid-19 and that they had recruited as many apprentices as they had planned to. The remainder said that their apprentice recruitment had been paused or stopped altogether because of the lockdown and/or because most staff were working from home. The researchers found that Covid-19 is more likely to affect recruitment in 2021, with around a quarter of respondents saying that their recruitment plans were uncertain for 2021. Business and administration, and hairdressing employers were most pessimistic about their recruitment plans for next year.

Table A2.1: Low Pay Commission research for the 2020 Report

Project title and researchers	Aims and methodology	Key Findings
Estimating the impact of the National Living Wage on businesses Thomas Baily, Danail Popov and Cavin Wilson (Frontier Economics)	This project assessed how the introduction of the NLW in 2016 affected on employers' level of employment, productivity and survival rates in 2017 and 2018. The research uses ASHE to identify low-paying firms and matches this to the Business Structure Database (BSD). Businesses where the worker sampled in ASHE was paid below the incoming NLW were compared with those who paid more than 20 per cent above the incoming NLW. The research examined how employment, turnover per employee (a proxy for productivity) and firm survival was affected by the introduction of the NLW. The research also used a propensity score matching approach with ten 'nearest neighbours'. The researchers used a range of different measures of employment: • The main measure which includes employment in different units within an enterprise. • A second measure that only applies to the enterprise level (and therefore the analysis excludes multi-unit enterprises The researchers also aggregated the data to a sector-region level. They compared changes in outcomes between all the firms in a given sector-region with a low level of average pay to the outcomes in another sector-region with higher levels of pay to examine survival rates (deaths) in conjunction with start-up rates (births). A separate analysis uses items from the Consumer Price Index and explores whether inflation is higher in months with minimum wage increases for high-bite items.	The main findings were: • Employment growth was around 3.0 per cent weaker in low-paying firms. • Employment growth was 2.3 per cent lower in low-paying firms when only focusing on low-paying sectors. • No evidence of differential growth across different sectors, or for foreign owned firms. • Firms in rural locations and those with more workers initially grow relatively less. • Employment effects were larger in larger chains with more sub-units and in enterprises that were part of a larger umbrella organisation. • These results are robust to variations in the definition of treatment and control groups. • Using the second employment measure: a smaller, but statistically significant, minimum wage effect for their all firms specification, and an insignificant effect in the low-pay sectors only specification. • Using the third employment measure: they find similar results to the main measure. • Low-paying firms are 3.7 per cent more likely to see an employment fall by at least 1 per cent, 3.2 per cent more likely to see employment fall by at least 10 per cent and 3.9 per cent less likely to see employment growth of above 10 per cent. • Survival rates are between 2 percentage points higher for low-paying firms. • The survival result was largely driven by the food and drink sector, with evidence of effects also in cleaning, and social care. • Turnover per employee fell in in low-pay firms relative to higher paying ones, but there are issues with the turnover data. • Very limited evidence of lower birth and death rates in areas with more low-paying firms. • The pricing analysis find that inflation for high-bite items is 0.24 percentage points higher in months in which the minimum wage increased, driven largely by the period 2014 onwards.

Project title and researchers	Aims and methodology	Key Findings
Estimating the impact of minimum wages on prices Cavin Wilson (Frontier Economics)	The report estimates the effect of the minimum wage on consumer prices. The researcher develops a theoretical model of the interaction between minimum wages and prices, which states that the elasticity of prices with respect to minimum wages should be equal to the proportion of total costs that are made up of minimum wage labour costs. The report used microdata from ASHE and the Annual Business Survey (ABS) to identify the sector-regions where minimum wages make up the most of costs. The report uses the NUTS1 region and at a four-digit SIC. The analysis covers the period of January 2010 to January 2020. The researcher then mapped monthly price quotes at the item and region level from the Consumer Price Index to the sector-region excluding tradable goods. This lead to 372 item-regions in the 100 most minimum wage exposed sector-regions (treatment group), and 543 item-regions to the sector-regions that are not in the 300 most exposed to the minimum wage (control group). The researcher regressed the month-on-month change in prices for each item-region, controlling for an item-region fixed effect, a month fixed effect and the inflation in the previous month. The approach estimates the effect on prices from a minimum wage uplift existing in the month. The researcher also estimated a difference-in-difference model estimating the differential effects from the introduction and subsequent upratings of the NLW.	The main findings were: • Inflation was 0.081 percentage points higher for exposed sector-regions in months with an minimum wage uplift, which results in an estimated elasticity of prices with respect to the minimum wage of 0.023. • Focusing only on the 50 most exposed sector-regions roughly doubled the estimated effect. • Inflation was 0.197 percentage points higher in minimum wage months when restricting the analysis to the period starting with the introduction of the NLW (when minimum wage increases were larger). This equates to a slightly higher elasticity of around 0.038. • Including estimates of higher inflation in the two months after the uprating increased the overall effect to 0.59 percentage points in the 2016-2020 period, or an elasticity of 0.11. • Using a continuous measure of minimum increases in a month, rather than a binary one, the researcher estimated an elasticity of 0.022. • Using two slightly different measures of minimum wage costs as a proportion of total costs only made small or marginal differences to the findings. • Adding a control group to the analysis gave results that were broadly consistent with the results under specifications without a control group. • Using the difference-in-difference approach finds some evidence that NLW was associated with an increase in inflation of 0.18 per cent, but this is only statistically significant at the 10 per cent level.

Project title and researchers	Aims and methodology	Key Findings
The impact of the NLW on businesses Andrew Aitken, John Forth and Rebecca Riley (National Institute of Economic and Social Research)	The report estimates how firms' responses to the NLW vary by their opportunity to substitute capital and technology for labour. The report compares the change in outcomes between 2013 and 2015 to the post NLW period (2016-2017). The report used the Financial Analysis Made Easy (FAME) data set to measure outcomes and mapped occupation level measures of job automatability to the LFS and the Annual Population Survey (APS) to create industry level measure of automatability. The researchers use a matched sample from the LMO and FAME to identify the average labour costs that are associated with a firm stating they are affected to a greater extent by the NLW following on from Forth, Paczos, Davies and Riley (2020). The researchers controlled for whether the firm is foreign owned, is an exporter, is less than six years old, the Herfindahl–Hirschman Index (a measure of market concentration) and exposure to the uncertainty from the UK's exit from the European Union through the labour market. The researchers use four measures of automatability: • Routine task intensity (the proportion of tasks in an occupation that are routine, manual and abstract from the British Skills Survey (BSS)). • The Office for National Statistics (2019) derived measure of automatability. • Patent-based measure from Josten and Lordan (2019). • Routine intensity indicator from another set of questions in the BSS. The researchers conduct a placebo test on their estimate of wage effects and for a non-treatment year and found evidence of positive wage effects which they linked to the increases in the NWM in these years. They therefore adjust down their regression analysis to take account of these effects. They find no evidence of effects in a placebo test on the other outcomes.	The main findings were: • Measures of automatability are negatively correlated with pay. • The NLW has increased average labour costs for firms that were more exposed to the NLW, by 1.7-2.1 per cent. • Some weak evidence that profit margins decreased for firms more exposed to the NLW. • No statistically significant differences from industry level automatability on firm outcomes between NLW exposed firms and the control group. This occurs across all treatment and control group definitions and across the four automatability measure used.

Project title and researchers	Aims and methodology	Key Findings
Impact of future targets for the NLW Louisa Withers (Income Data Research)	The research consists of 22 telephone case studies of employers who have been affected by the minimum wage. These cover a range of mostly low-paying sectors and cover mostly large employers with a few medium sized employers. The sample includes firms in the private, public and not-for-profit sectors. The employers studied were • Business services employer with 200 staff • Housing and social care employer with 2,700 staff • Hospitality (hotels and restaurants) employer with 35,000 staff • Housing association employer with 200 staff • Non-food retail employer with 25,000 staff • Engineering employer with 4,000 staff • Hospitality (café) employer with 17,000 staff • Hospitality (restaurants) employer with 18,000 staff • Food and non-food retailer with 82,000 staff • Local government with 1,300 staff • Social care employer with 2,500 staff • Food manufacturer with 3,700 staff • Charity with 1,700 staff • Manufacturing/engineering (automotive components) with 100 staff. • Construction firm with 11,000 staff • Food retailer with 65,000 staff • Social care provider with 400 staff • Retailer with 17,000 staff • Specialist engineering firm with 12,000 staff • Specialist engineering firm with 6,000 staff • NHS Employers (1.2 million staff on Agenda for Change terms and conditions)	The main findings were: • The NLW had sizable impacts on wage compression and differentials with differentials with the immediate supervisors of those on the lowest levels having been reduced or eliminated at many of the organisations. • Organisations that had tried to retain differentials lower down the pay scale have reduced them higher up the pay scale. • Some organisations are examining changes to pay structures in response to the new NLW target. • Many employers have limited scope to offset any further increase in the wage floor by reducing terms and conditions as they have already made changes in these areas. • Most employers were not concerned by the planned lowering of the NLW qualifying age to 21. • Few of the employers in the sample operated youth rates, as they felt it was simpler and/or fairer to not vary pay rates by age. • The Covid-19 pandemic had a significant, and generally detrimental, impact on business activity and this affected the pay awards that they could offer. • Employers are and are planning to make greater use of technology and multiskilling their workforce. • Many employers hoped for a smaller increase in the NLW this year due to the impact Covid-19 had on their revenues. • Employers asked for announcements on NLW increases to be made earlier to give greater time for them to plan for the higher wage floor.

Project title and researchers	Aims and methodology	Key Findings
The NMW/NLW and progression out of minimum wage jobs in the UK Silvia Avram and Susan Harkness (University of Essex and University of Bristol)	The research examines the link between the NLW and progression out of minimum wage jobs. The research updates Avram and Harkness (2019) adding an extra year's worth of data and changing the sample selection criteria to retain more cases. The research used geographic variation in minimum wage coverage across travel-to-work-areas (TTWAs). The researchers calculated coverage in ASHE and used the UK Longitudinal Household Survey (UKLHS) to examine movements out of jobs that paid the minimum wage. Jobs are stratified into three groups: • Minimum wage jobs, • 'low-paid' jobs (jobs paid between the minimum wage and two-thirds of the median hourly rate); • 'high-paid' jobs (jobs paid more than two-thirds of the median hourly rate). The researchers controlled for gender, age, qualifications, household composition (including number of children and having children aged less than five), self-reported health status, ethnicity, immigration status, having a previous experience of unemployment, and region in their estimations. The researchers impute measures of hourly pay in the UKLHS for the approximately two-thirds of workers not paid by the hour, by using pay from the third of workers who were paid by the hour..	The main findings were: • Around half of minimum wage workers transition into higher-paid employment within a year and of these, four-fifths progress to 'low-paid' employment with the remaining fifth moving into 'high-paid' employment. • Transition rates over three years were somewhat higher, especially to 'high paid' employment. • Minimum wage workers were more likely to transition to high-paid employment in areas with higher median wages, although that did not account for the impact from the different worker characteristics that were observed in higher-paying areas. • Limited evidence that the introduction of the NLW increased the probability of the worker remaining in a minimum wage job. A one percentage point increase in coverage was associated with an increase in the probability of remaining in a minimum wage job in 2016 of around 4 percentage points (a 10 per cent increase). The effect is temporary and the results varying according to the specifications used • The probability of remaining in a minimum wage job increases with the level of the (lagged) bite and is statistically significant if the bite is over 54 per cent. • No evidence that the increase of the minimum wage harmed the wage growth of minimum wage workers

Project title and researchers	Aims and methodology	Key Findings
How employers set pay for apprentices Peter Dickinson, Terence Hogarth and Jeisson Cardenas Rubio (Warwick Institute for Employment Research)	The research is based on in-depth interviews with 30 employers to explore how employers set the pay of apprentices, how the increases in the Apprentice Rate minimum wage has affected their decisions on pay, and whether training affects pay decision making. The research also covers the impact of the covid-19 pandemic on employers' short and medium-term recruitment plans for apprentices. The interviews focused on employers who were likely to pay apprentices at or close to the Apprentice Rate minimum wage. The researchers also analysed the Apprenticeship Pay Survey 2018/19 (APS 2018/19) to identify characteristics associated with higher minimum wage use. From this the researchers decided to focus interviews on employers in hairdressing; childcare and related; construction; electro-technical; and engineering, manufacturing technologies and related standards and frameworks.	The main findings were: • Most apprentices were paid above the NMW age rate in the first year of the apprenticeship, even though employers could have paid these apprentices at the lower Apprentice Rate minimum wage. • Some employers paid above the Apprentice Rate but at or below the age rate minimum wage. • Apprentices in the second or third year of their apprenticeship were typically paid above the NMW age rate. • Apprentices who were existing employees would typically continue on their previous rate of pay. • New recruits straight onto an apprenticeship, tended to be paid a rate the employer decided using the NMW framework as a determinant. • Most employers chose to pay the age-related minimum plus a premium. This was typically due to: the contribution of the apprentice to the business; views on fairness; to attract better candidates or; because of externally determined national or organisational pay rates. • Some employers paid the Apprentice Rate plus a premium below the age rate. This allowed for differentials to be maintained with qualified staff in childcare paid the NMW age-related rates • Across all of the frameworks there is a progression in pay from the start to the end of the apprenticeship. • Most employers said that they believed the Apprentice Rate minimum wage to be set at too low a level. • When the Apprentice Rate was used it was generally for 16-17 year-old apprentices. • Some employers paid an initial lower wage. This was 'probationary' rate was used at the start of the apprenticeship to gauge commitment. • Apprentices mainly received a mix of day release, externally supervised on-the-job training sessions, and distance learning. • Typically, employers reported that their apprentices spent between 25-35 hours a week working and between 6-10 hours a week in off-the-job training • 60 percent of the employers said their recruitment plans for this year had not been affected by Covid-19. The remainder said that their apprentice recruitment had been paused or stopped altogether because of the lockdown and because most staff were working from home. • Covid-19 is more likely to affect recruitment in 2021. Business and administration, and hairdressing employers were most pessimistic about their recruitment plans for 2021.

Appendix 3

Evidence strategy and econometric analysis

A3.1 Our 2020 remit calls for us to set out our 'evidence strategy for ongoing monitoring and evaluation of the impact of National Living Wage increases towards the two-thirds median target'. This appendix explains our approach and how we have responded to the recommendations made by Professor Arindrajit Dube in his review (Dube, 2019). With one key difference – internal econometric work – our approach will be similar to that we have previously taken.

Analysis of primary data sources

A3.2 We will continue to monitor and analyse data relating to the economy and labour market published by the Office for National Statistics (ONS) and other sources, paying particularly attention to employment, hours of work and pay and the macroeconomic factors that underpin them. We will also monitor the labour market outcomes of those groups of workers who are most likely to be paid the National Minimum Wage (NMW) and the National Living Wage (NLW). This will include their employment prospects, hours of work and pay and other shifts such as changes in the nature of their work (for example changes in self-employment, temporary or insecure work). The Annual Survey of Hours and Earnings (ASHE) will continue to be central to our understanding of pay outcomes for workers, where we will monitor changes in pay, bite, coverage and underpayment for a host of different groups and settings. We will also monitor the effects further up the pay distribution, considering the impact on pay differentials and workers' progression up through the pay distribution.

A3.3 In his review, Dube (2019) noted that it was 'important to improve the data infrastructure available to the LPC and academics to facilitate timely evaluation'. As part of improving the data infrastructure, we have worked closely with the University of the West of England; University College London (UCL); City, University of London; and the National Institute of Economic and Social Research (NIESR) on their Administrative Data Research UK funded data linkage project, Wage and Employment Dynamics (WED). This aims to provide important new insights into the dynamics of earnings and employment in Britain. It will construct a consistent ASHE/NES earnings data series; clean and quality-assure the data; and catalogue the available information. It will then match this series to the 2011 Census and other administrative datasets. This project is expected to increase understanding of how people's wages progress through their career, factoring in key characteristics such as gender and ethnicity, as well as the particular dynamics of low-pay labour markets.

A3.4 The first part of that project – using ASHE to examine low pay transitions, 2004-2019: initial exploration of the data – will contribute to our evidence-based assessment of the impact of the NMW and NLW, presenting trends in low pay incidence, transitions and duration in low pay. In initial analysis, Bryson, Phan, Stokes, Ritchie, Forth, McKenzie and Whittard (2020) report consistent time-series estimates of the percentage of jobs on and around the minimum wage; low paid jobs above the minimum; and 'high paid' jobs. The consistent ASHE/NES earnings data series and the matched ASHE/NES/Census 2011 data will be made available to the research community for future projects.

Speaking with workers, employers and their representatives

A3.5 Engaging with stakeholders will continue to be vitally important. Speaking directly with workers and employers helps us to understand the impact of the NMW/NLW on their lives and businesses. We will continue to carry out a range of local visits across the nations and regions of the UK, speaking with workers and employers in their places of work and elsewhere. As we do now, each spring we will undertake a written consultation – open to all – on all aspects of the NMW/NLW. This will be supplemented by oral evidence sessions with key stakeholders.

Econometric research

A3.6 The key change to our evidence strategy is to undertake in-house econometric analysis. The initial results of which are included in Chapter 4 of this report. The aim of this work will be to understand the impact of the NMW/NLW on pay, hours of work and employment. Where data is available and reliable, it will also consider broader questions. We had been considering doing this for some time, but this was given added impetus by Professor Dube's review. He recommended that we utilise more 'off the shelf' econometric methods in our internal analysis. It is our intention for this to be a transparent process so our approach can evolve in light of scrutiny from others. We say more about our approach to the econometric work, including how it is scrutinised, below.

Commissioned research

A3.7 Bringing some econometric analysis in-house means we can alter the focus of our commissioned research. Professor Dube noted that we should reserve large scale evaluations and more innovative methods for our commissioned research. We have taken that advice. Earlier this year, we commissioned the Institute for Fiscal Studies (IFS) to examine the longer-term impact of the NLW on employment, hours, earnings and household incomes. Professor Dube also noted some gaps in the UK evidence base on the relationship between minimum wages and household income. The IFS study will consider this as part of its work, but we will also analyse primary sources of data to understand this relationship.

Internal econometric research methods

A3.8 We have so far undertaken two econometric projects estimating the impact of the NLW. Both of these projects have been based on existing methodologies. A brief outline of the methodologies and the findings can be found in paragraphs 4.17 to 4.23, but here we will explore the methodologies in greater detail.

A3.9 The internal research also makes use of the expertise of our two academic Commissioners to provide advice and conduct collaborative work. We have also set up a process to help peer review that internal research before it is published. As part of the process of developing our in-house analysis we have worked with external researchers and specialists to test our approaches. We invited discussants at our research workshop in April 2020 and research symposium in September 2020 to comment and give feedback on the methodology, data sources and interpretation of the findings. We have also established a panel of experts to give challenge and ongoing feedback on our analysis and to judge when the research is of sufficient quality to publish. We intend to publish our findings from this year's in-house research shortly.

Using individual data to estimate wages, employee retention and hours effects

A3.10 The first project follows individuals over time to estimate how the NLW has affected their wage, employment retention and hours. Employment retention measures whether an individual in employment in the period before the minimum wage increase remains in employment after it. An employee who has been retained in this definition is not necessarily in the same job, but is still in the labour market. The methodology used in this analysis is similar to, and builds on that of Aitken, Dolton, and Riley (2018), which we initially commissioned in 2017 to examine the impact of the introduction of the NLW in April 2016 and the first uprating in April 2017 on wages, employment retention and hours. As part of the contract the researchers shared their statistical code with us, which forms the basis of the analysis in this project.

Methodology

A3.11 The methodology follows a standard approach in assessing the impact of a minimum wage, a difference-in-difference approach. This approach was first used to examine the impact of minimum wages by Linneman (1982) in the USA, and is the approach taken by many studies in the UK, for example, Stewart (2004a and 2004b); Stewart and Swaffield (2008); Dickens, Riley and Wilkinson (2015), Aitken, Dolton and Riley (2018) and Capuano, Cockett, Gray and Papoutsaki (2019).

A3.12 The difference-in-difference approach used in this analysis stratifies workers into three groups: a 'treated' group, who earn less than the incoming minimum wage, and therefore are likely to see faster increases in their wage than they would have in the absence of the increase in the minimum wage; a 'control' group who are otherwise similar to the 'treated' group, but who have not seen their wages affected by the minimum wage; and a third group who are excluded from the analysis as they are likely to operate in a very different labour market to workers affected by the NLW. For the analysis to hold, the control group are assumed to be identically affected by changes in the labour market as the treatment group, with the exception of the minimum wage.

A3.13 Individuals are observed in different time periods. The period before a minimum wage increase is the 'control' period, and the period after an increase is the 'treatment' period. The methodology compares the difference in the outcomes for treated and control individuals in the control period to the differences in outcomes in the treatment period, while controlling for other factors. This 'difference-in-difference', the change in relative outcomes, measures the effect of the treatment – the increase in the minimum wage.

A3.14 We use two definitions of the treatment group in our analysis. The first treatment group consists of the employees who earn between the current minimum and the incoming minimum wage: this group includes all workers whose pay is directly affected by the increase in the minimum wage. The second group consists only of those who earn at the current minimum, or up to 0.5 per cent above it: this group only includes the workers whose pay is most affected by the increase in the minimum wage. We also run a regression that assumes that any wage, employment retention or hours effect increases linearly with the 'wage gap' or the difference between an individual's hourly wage and the incoming minimum wage.

A3.15 Defining a control group is difficult in the UK. The absence of geographic variation in minimum wages means that we cannot identify a group who earned the same as the treated workers before the intervention, but are unaffected by the increased minimum wage. Instead we examine workers who were earning above the incoming minimum wage, and are therefore not directly affected by the increase in the wage floor. In the analyses presented here we define the control group as those earning between the incoming NLW and 10 per cent above it. However, these workers may be affected by wage spillovers from the NLW, which could bias the results. Therefore, as part of our robustness checks, we intend to consider variations in this definition in later analyses.

Data

A3.16 We use the ASHE dataset, a yearly sample of the same 1 per cent of individuals, provided that they are in employment, which is conducted each April. ASHE is (2020 apart) a reliable measure of hourly pay with a large sample size. Data is provided by the employer and the sample is based on an individual's National Insurance number. The longitudinal form of ASHE enables us to create measures of individual wage growth, employment retention and changes in hours. However, ASHE suffers from high levels of data attrition due to employers not providing data returns on their employees. If the level of data attrition is different for workers in the control and treatment groups, or is affected by the NLW, then this could bias any estimates of minimum wage effects.

A3.17 ASHE is collected for a reference week in April each year. Before the introduction of the NLW in 2016 the minimum wage was uprated in October, so data was collected six months after the minimum wage increased. However, since the NLW increases occur in April, the post-NLW measurements only occur a few weeks after the increase in the wage floor.

A3.18 ASHE contains limited demographic data. Data is collected on an individual's age, gender and home address. Data is also collected on each job's occupation, industry and location as well as the number of employees at that employer.

A3.19 We remove observations where there are inconsistencies in gender or age over time. We also exclude observations who have suffered a 'loss of pay', who have multiple jobs, or have unrealistic hours (over 112 weekly hours). We exclude individuals who are under 25 – the age cut-off for NLW eligibility in the period of the analysis – as well as those approaching retirement age.

A3.20 We use an individual leaving the data set as analogous to losing a job. However, as described in paragraph A3.16, not all employers produce ASHE returns, and so individuals may be missing from the data even if they are in employment. We are therefore likely to underestimate employment retention in our analysis. Moreover, if the likelihood of employers responding to the survey changes differently for the treated group compared with the control group over the period we examine, then this would bias any of our estimates of employment retention effects. If the relative likelihood of employers responding to the survey is consistent for the treatment and control groups over time, then any results should identify employment retention effects. If they are not, then any results would be polluted by these differing survey response rates.

Regression approach

A3.21 We consider three measures of the effects of the minimum wage on workers:

a) The change in log real wages: $\ln(\text{real wage}_{t+1}) - \ln(\text{real wage}_t)$
b) Employment retention: Probability $(\text{Employed}_{i;t+1} = 1 \mid \text{Employed}_{i;t} = 1)$
c) Change in hours conditional on remaining in employment: $\text{Hours}_{t+1} - \text{Hours}_t$

A3.22 We therefore estimate the following regression:

$$y_{it} = \gamma 0 + \gamma 1 D_{it} + \delta(T_t \cdot D_{it}) + \beta X_{it} + Y_t + \varepsilon_{it}$$

A3.23 Where:

a) y_{it} is the outcome of interest, as described above.
b) $D_{it} = 1$ if the individual is in the treatment group and 0 otherwise
c) $T_t = 1$ if the period is post-treatment and 0 otherwise
d) X_{it} are the individual, year specific controls, and Yt are a set of year dummies for common time effects.
e) δ is the estimated treatment effect of the NMW/NLW change and the coefficient of interest
f) The parameter $\gamma 1$ measures the baseline average difference in outcomes between the treatment and control groups (the normal difference).

A3.24 All of the specifications estimated include controls for age, age squared, a dummy for being in the same job, occupation fixed effects, industry fixed effects, region of work fixed effects, and year fixed effects.

A3.25 We look for common trends and run 'placebo tests' on the data. Placebo tests take the form of estimating a hypothetical NLW effect in a year where the increase in the minimum wage was substantially smaller. The year 2013 was chosen, estimating a hypothetical increase of 10.8 per cent (the increase in the first year of the NLW, between April 2015 and April 2016), when the actual increase in the minimum wage was only 1.9 per cent. We had no consistent finding of significant effects in any of the measures. This suggests that the methodology is appropriate in estimating the effects of the NLW. However, there was some evidence that hours may not be under a common trend between the treatment and control group, which would invalidate our estimates of NLW hours effects. This is something we intend to examine in more detail before publication.

Findings

A3.26 The initial findings of the analysis are described in paragraphs 4.17 to 4.20. We will provide more detail on these results when we publish a report on this project.

Using geographic, age and gender variation to estimate wage and employment effects

A3.27 In the second of our in-house econometric projects, we make use of the geographic variation of wages across the UK to compare the impact of the minimum wage in low wage areas compared with high wage areas. This builds on the pioneering work in the UK by Stewart (2002), which was further developed by Dickens, Riley and Wilkinson (2015), Dolton, Rosazza-Bondibene and Wadsworth (2009) and Dolton, Rosazza-Bondibene and Stops (2012). These studies found that wage growth at the bottom was faster in low-wage areas but did not find any evidence of substantial change in employment rates across regions with low and high initial wages. Following a similar approach, Dickens and Lind (2018) used the LFS to compare overall wage and employment rate evolutions across local labour markets, travel-to-work areas in the UK based on the share affected by the introduction of the NLW. They too found little impact of the introduction of the NLW on employment across geographic areas.

A3.28 Manning (2016) developed this methodology further by constructing 96 groups based on region, age, and gender (12 regions, 4 age groups and 2 gender categories) to look at the long-run impact of the National Minimum Wage. He also partials out age group, gender and region fixed effects, allowing for differing trends by region and demographic groups. He found that wage growth between 1997 and 2007 was much more pronounced in groups where the minimum wage share was high but the employment rate was largely constant across these groups. Dube (2019) updated that analysis using the same region/age/gender groups. He considered changes between 2014 (the year prior to the announcement of the NLW) and 2018 (the latest data available at the time). His findings on the introduction of the NLW were similar to that of the previous study on the NMW –average wage growth was much faster following the introduction of the NLW in groups with larger shares of affected workers but there was no statistically significant or sizable relationship between the affected share and employment.

A3.29 In this study, building on these recent approaches, we also compare outcomes across segments of the UK labour market that are more and less affected by changes in minimum wages. We define segments of the labour market according to different geographies, age groups and gender. For example, we should expect a greater bite from the minimum wage in the North East or Wales than in London or the South East, among younger workers rather than those in mid-career, and among women more than men. An advantage of this approach is that it is able to capture all employment change and not just job retention. We examine the impact of the NLW on a range of outcomes (including employment, unemployment, hours of work, self-employment, inactivity, part-time employment and zero hours contracts)

Data

A3.30 Using data from the Annual Survey of Hours and Earnings (ASHE) for the period 2013-2019 and from the Labour Force Survey (Q2 2013 – Q1 2020), we construct a panel data set of geographic, age and gender segments. We define a year as the minimum wage year, which runs from April to March (or from Q2 to Q1). These segments are initially based on the twelve standard regions (Government Office Regions) and eight age groups (25-29, 30-34, 35-39, 40-45, 45-49, 50-54, 55-59, 60-64) then split by males and females. This results in 192 separate region/age/sex segments. We also extend the geographic split to include separate metropolitan counties and London divided into inner and outer, which increases the number of geographic areas to 20 – giving 320 separate region/age/sex segments. In addition, we have experimented with alternative definitions of geographies, including NUTS2 and Travel to Work Areas. When considering these, sample sizes require us to reduce the number of age groups to two or three. The ASHE data is used to construct the hourly pay measures for these segment groups and the LFS to define the outcomes (including, employment, unemployment, inactivity, hours worked and self-employment) and some characteristics of the segments (for example, migrant share). We also use the ASHE data to give an alternative measure of the impact on hours.

Methodology

A3.31 We use a difference-in-difference estimation approach, exploiting the fact that different segments are subject to larger or smaller impacts from the introduction and subsequent upratings of the NLW. We measure the impact of the NLW across the different area, age and gender groups in two ways: using the 'bite' of the NLW (the ratio of the NLW to the median of the segment); and the proportion of the segment affected by the NLW in the baseline year – 2015. We report estimates from the standard year-on-year panel regressions and also report the long-term differences between 2015 and 2019.

Regression approach

A3.32 We consider several measures of the effects of the minimum wage on workers, including: hourly pay; weekly pay; the employment rate; unemployment rate; inactivity rate; basic hours; total hours; part-time employment share; self-employment share; proportion on zero hours contracts and proportion in non-standard employment.

A3.33 We estimate the following regression using our panel data of segments:

$$Y_{it} = \beta_0 + \sum_{t=2016}^{2019} \varphi_t^{DiD}(D_t . MW_{i,2015}) + \alpha_i + \gamma_t + \beta X_{it} + e_{it}$$

where $t = 2015,..2019$

- Y_{it} is the labour market outcome (for example, the employment rate) in group *i* and year *t*.
- α_i are time-invariant group fixed effects
- γ_t aggregate time dummies
- X_{it} control variables (for example, the proportion who are migrants, and the proportion aged 25 or over)
- $MW_{i,2015}$ - "Bite" or Coverage in group *i* in 2015

Findings

A3.34 The initial findings of the analysis are described in paragraph 4.23. We will provide more detail on these results when we publish a report on this project.

Appendix 4

Main data sources

A4.1 In this appendix we outline the main data sources that we have used in our analyses, including any major changes that have occurred since our 2019 report. We use three main sources of data to measure earnings in this report: the Annual Survey of Hours and Earnings (ASHE), Average Weekly Earnings (AWE), and the Labour Force Survey (LFS). We use two main sources to understand employment: the LFS and the 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 one individual can have more than one job. All of these data sources are published by the Office for National Statistics (ONS).

A4.2 In addition to employment and earnings data, we also look at a wide variety of macroeconomic data and statistics. This appendix outlines the two main macroeconomic series on inflation and gross domestic product (GDP) used in our analyses, as well as summarising any revisions that ONS have made to GDP estimates.

A4.3 This year, there are more limitations with these data sources than in previous years. The Covid-19 pandemic and resulting policy measures have made it much more difficult to understand what is happening to earnings and employment. The surveys already mentioned were not designed to monitor the unprecedented changes in the labour market that we have seen over the last few months. The ONS has reacted to these issues and modified the methodology used in many of these surveys. It has also created new surveys and statistics to fill in some of the evidence gaps that have arisen. In this appendix we describe these changes and the additional data sources that we have used in our report this year.

Annual Survey of Hours and Earnings

A4.4 The Annual Survey of Hours and Earnings (ASHE) is the main source of structural earnings data in the UK and is regarded by ONS as the best source of earnings information for cross-sectional analysis. It provides information on the level, distribution, and composition of earnings, as well as information on hours worked, gender, age, geography, occupation and industry. It is a survey of employees completed by employers and conducted in April each year. The sampling frame consists of a one per cent sample of employee jobs in Pay As You Earn income tax schemes obtained from HM Revenue & Customs (HMRC). Self-employed workers are excluded.

A4.5 ASHE data for the latest year used in our report is always provisional and therefore subject to revision. Final data is received a year later and used within subsequent reports: i.e. for this report we received 2019 final data at the same time as receiving provisional data for 2020.

Changes to the data arising from Covid-19

A4.6 This year, the reference date for ASHE was April 22, at the height of national lockdown measures, when several businesses were closed and approximately 8.8 million workers were furloughed. The fact that many businesses had paused trading or had limited capacity means that the response rate to the survey was reduced by around a quarter – with 136,000 returns in 2020 compared to 184,000 in 2019. Response rates were weakest for younger workers and in sectors including hospitality and leisure, which are more exposed to the lockdown.

A4.7 The ONS was able to tell whether the employee job was furloughed, by matching Coronavirus Job Retention Scheme (CJRS) data from April based on the National Insurance number. Because of challenges in matching some furloughed jobs, ASHE undercounts the number of workers furloughed by around 20 per cent. Our analysis therefore focuses more on profiling the differences between these workers and others.

A4.8 The ASHE survey includes the question "Did the employee earn less in the pay period due to absence from work?". Using the response to this question and the information from the CJRS, we are therefore able to distinguish between furloughed workers with no loss of pay – whose employers topped up their wages to normal levels – and those who were furloughed with a loss of pay. In a normal year, we would exclude workers that have experienced a loss of pay from our analysis; many of them may be on sick pay or parental leave and their pay would skew the distributions. However, this year they make up a large proportion of the data set and excluding them would create a sample that is compositionally very different to previous years. The ONS therefore developed a new weighting system ('lpcalwghtf') that would allow us to include any workers who had a loss of pay due to furlough in our analysis.

A4.9 However, estimates of hourly pay in 2020 are not comparable to previous years. Workers who were furloughed in April did not work any hours, and so it is not possible to calculate their pay as an hourly rate. The derived hourly pay, calculated from their total pay received and the number of hours that they would normally work, is artificially low for furloughed workers whose pay was not topped up. When this amount is divided by their normal hours the calculation would give an hourly rate that is only a fraction of their actual pay.

A4.10 Including this group biases estimates of pay downwards because many workers have a derived pay that is artificially low. Meanwhile, excluding those biases pay upwards because low paid workers were more likely to be furloughed. Because of these factors, it is not possible to identify a group with hourly pay data that is representative of minimum wage workers. We are therefore unable to calculate reliable estimates of bite, coverage and underpayment in 2020 that are consistent with previous years.

Further limitations

A4.11 Employees not on an adult rate of pay are excluded from the headline ASHE earnings estimates produced by ONS, but we include them in our own analysis of earnings from ASHE. This means that our earnings estimates may differ from those of ONS.

A4.12 From 2011, ASHE data have been reweighted to SOC 2010 codes. Thus, earnings estimates for 2011 onwards are not directly comparable with those prior to 2011. As a result of this and previous methodological changes there is no official, consistent time series of structural earnings in the UK. The best source available now consists of five overlapping New Earnings Survey (NES)/ASHE data sets: NES, 1975-2003; ASHE without supplementary information, 1997-2004; ASHE with supplementary information, 2004-2006; ASHE 2007 methodology, 2006-2011; and ASHE 2010 methodology, 2011 onwards. In order to produce a consistent time series, we have used the annual increases in the older data series to adjust the level of earnings to make the previous series compatible with the current series. This generally has the effect of reducing the estimates of the mean and median in years prior to 2011, which increases our estimates of bite (the ratio of the minimum wage relative to the median or mean) for that period.

A4.13 In 2013 two new questions on apprentices were included in ASHE as experimental statistics. These required employers to identify whether an employee was an apprentice and, if so, to record the date that their apprenticeship had commenced. The identification of apprentices also means that we can examine earnings separately for workers and apprentices. Until 2014 the grouping together of apprentices and non-apprentice workers had a downward effect on earnings for young people, as apprentices tend to have lower earnings. From 2014 onwards it is possible to distinguish between first and second year apprentices and other workers. We are therefore able to identify rate populations in the data, grouping people by the rate of the NMW that they would be eligible for.

A4.14 The introduction of the National Living Wage (NLW) in 2016 had important implications for our analysis and interpretation of ASHE data. A key change is that the NLW was introduced in April, coinciding with the ASHE data collection period. Previously, new minimum wage rates were introduced in October, with measurement of earnings, the bite and underpayment occurring six months after implementation of the new rates. Both the bite of the minimum wage, and measured underpayment, are at their highest upon introduction, and correspondingly lower when measured six months after implementation. In April 2017 all minimum wage rates were uprated to ensure alignment with the NLW. This introduced a break in the time series, with a jump in estimates of both the bite and underpayment.

A4.15 The increase in measured underpayment poses particular difficulties. In addition to a time-lag in implementing the new rates, employers are not legally required to increase pay to the new minimum wage until the first full pay period after the introduction of the minimum wage. In order to identify these workers ONS introduced a new question in 2016 ASHE to identify the start of the pay period, the results of which are shown in the variable 'ppstart'. The timing of the ASHE survey largely determines the number affected by this variable.

Average Weekly Earnings

A4.16 AWE is the lead monthly measure of the level of average weekly earnings per employee in Great Britain, based on data from the Monthly Wages and Salaries Survey. AWE provides a monthly measure of regular pay, bonus pay and total pay. It replaced the previous measure of short-term changes in earnings, the Average Earnings Index (AEI) in January 2010. 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 growth results from changes in employment across sectors. The AWE estimates do not just measure pay, but also reflect industry-based compositional changes within the workforce (but not job-type or occupation-based changes within industries).

A4.17 In 2013 ONS released three AWE historic time series, all of which are monthly in frequency and include bonus payments: the whole economy series runs from January 1963 to 2010, while public and private sector series are available from January 1990 to 2010. The method used to compile these time series takes into account the observed relationship between AEI and AWE, in particular that AWE increased faster than AEI for most of the period between January 2000 and July 2010. The difference between the AEI and AWE wage growth should not be over-interpreted, as there is considerable uncertainty introduced by the estimation process. As these historic time series are only available up to 2010, when the AEI was discontinued, there is no fully consistent complete time series for these data sets up to the present time.

A4.18 Further AWE revisions were carried out in 2017 and 2019 following regular reviews of the methodology used to calculate estimates of earnings of employees in small businesses. Businesses with fewer than 20 employees are excluded from the Monthly Wages and Salaries Survey, which is largely used for the calculation of the AWE. To compensate for this omission, pay is estimated using a factor derived from ASHE which does cover small businesses. Changes were announced that aim to better reflect earnings of employees in small businesses as well as reflecting improvements to the coverage of small businesses on the main sampling frame, the Inter-Departmental Business Register.

A4.19 The results of these reviews were released by ONS in March 2017 and January 2019 respectively. The 2017 results show that, while at the whole economy level (between July 2010 and December 2015) the trend in earnings remained similar, total pay levels had decreased by between £7 and £10 (1.6-1.9 per cent). At the sectoral level there were two distinct phases to the changes: the first covered July 2010-July 2015 (the last time the small business factors were modified), with the second covering the period post-July 2015. This step-change occurred due to inconsistencies introduced at the point at which the small business factors were last modified compared with the revised historical estimates. The 2019 results also showed similar trends in pay growth, with a maximum impact during 2015 to 2016 on the percentage change in three-month year-on-year total pay for the whole economy of 0.2-0.3 per cent.

A4.20 In 2017 ONS released an article on ASHE and AWE, presenting an overview of both measures. It highlighted which source was better for certain types of analysis and analysed movements of the whole economy series between 2005 and 2016. The article explained the differences in the headline measures and outlined the reasons for a divergence between the headline series in 2011 that has since continued.

A4.21 In April 2020, lockdown measures and furloughing led to significant changes in employee pay, making it necessary to change the way that AWE data is processed. Normally, when companies do not respond their employee and pay information is imputed based on their most recent previous response. But in a period where there have been substantial pay changes, this imputation may not always be accurate. ONS has therefore increased the level of data validation over this period.

Labour Force Survey

A4.22 The LFS is the official data source used to measure employment and unemployment. It is a quarterly survey of around 60,000 UK households conducted on a rolling monthly basis and provides information on: employment; unemployment; earnings; and personal and socio-economic characteristics, including gender, ethnicity and disability.

A4.23 Analyses of aggregate employment, unemployment and hours worked use seasonally adjusted monthly and quarterly LFS data published by ONS using the latest 2019 population weights. For detailed analyses of the labour market by age, ethnicity, disability and other personal characteristics, we conduct analyses using the non-seasonally adjusted LFS microdata. In our analyses, we generally use the four-quarter moving average of these outputs to take some account of seasonality, which is different to the seasonal adjustment method used by ONS. Consequently, our analyses based on LFS microdata may produce estimates of levels that differ from headline aggregates published by ONS.

A4.24 ASHE contains limited personal characteristic details – there is no information on disability, ethnic background, country of birth, nationality or education level. The LFS is our only timely source of data on earnings for disabled people, ethnic minorities, migrants and people with no qualifications. However, data on pay and hours in the LFS tend to be less reliable than in ASHE. Reasons for this include: a smaller sample; people answering the earnings questions without reference to pay documentation (although they are prompted to consult available documents); and some information being provided by proxy respondents. ASHE collects information from employers about employees' paid hours, whereas the LFS collects information from individuals about their actual and usual hours of work, which might include unpaid hours. This generally means that the derived hourly earnings variable in the LFS is lower than the derived hourly pay rate recorded in ASHE.

A4.25 For some workers, a stated hourly rate of pay is available in the LFS. For these workers, hourly pay is similar to that in ASHE. Where a stated hourly rate of pay is unavailable from the LFS, ONS has developed an imputation method using a nearest-neighbour regression model, which also takes account of information on second jobs in estimating the median earnings of various groups of workers. This methodology reduces the differences between hourly earnings estimates from the LFS and ASHE.

A4.26 In March 2020, in response to the Covid-19 pandemic, the LFS changed the way that it contacted people for interviews from face-to-face to telephone-based. This led to a concern of potential bias being introduced into the survey because of the change in contact method. Upon investigation, ONS found a different distribution of certain personal characteristics, particularly in the type of housing which is normally a very stable series. As a temporary mitigation, ONS therefore started to use housing tenure within the survey weighting system. They reweighted data sets from January to March 2020 onwards. This new weighting system reduced estimates of employment over the lockdown period and therefore reduced the gap that had been seen between estimates derived from the LFS and from other sources.

A4.27 Additional questions were introduced into the LFS to understand the impact of Covid-19. These questions sought to determine whether absences and changes in hours were related to Covid-19, and whether they were due to sickness, self-isolation or caring for others.

A4.28 It is possible to group LFS responses by the week that the response refers to. ONS developed a method for weighting the weekly LFS data to produce UK aggregates, which makes it possible to look at how key labour market measures change on a weekly basis. They have published these series as experimental statistics since May 2020 in order to monitor any sudden change in labour market conditions arising from the pandemic and lockdown measures.

A4.29 From April 2020, ONS started to provide us with LFS microdata on a monthly basis so that we can look at the groups of people who are most affected by our recommendations and monitor how they have been affected by the lockdown measures. Although we do not have access to the weekly weights that ONS have produced, we have used the normal population weights divided by the number of weeks as a proxy. The sample in any individual week is not representative, and the number of responses changes between weeks, and so the weekly time series that we have produced are intended only as a way of monitoring trends and not as an estimate of absolute levels. We are very grateful to the ONS for providing us with the LFS microdata on a monthly basis this year.

Employee Jobs

A4.30 The employee jobs series provides a timely breakdown of jobs in the UK. A number of Short-Term Employer Surveys, which collect data from businesses across the economy, are used to compile the employee jobs series. Figures at a more detailed industry level, however, are available only for Great Britain and are not seasonally adjusted. We therefore use a four-quarter moving average in our analyses to remove some of this seasonality, in line with LFS microdata.

A4.31 In 2014, ONS revised estimates of workforce jobs, including the employee jobs series, back to 1981. These revisions were caused by benchmarking to estimates from the annual Business Register and Employment Survey (BRES), updating the seasonal factors and taking on board late information such as later responses to the survey. A consistent back-series, based on the Standard Industry Classification (SIC) 2007, is also available back to the second quarter of 1978.

Real-time information (RTI)

A4.32 An additional data source that allows us to understand trends in the number of employees and their earnings is from Pay As You Earn Real Time Information (PAYE, RTI) administrative data. PAYE data covers the whole population of employees paid through PAYE, rather than a sample. This makes it possible to produce monthly statistics on the number of employees and their distribution of pay.

A4.33 However, administrative data sources cannot be directly compared to estimates from surveys where the administrative system is measuring a different concept to the survey, or where the population coverage is different. Statistics derived from RTI are not directly comparable to statistics from AWE, ASHE and LFS because of differences in measurement and coverage.

A4.34 The number of people receiving pay from PAYE employment is higher than in the LFS employee series, and has shown more substantial falls since the start of the lockdown measures. This is likely to be because RTI covers a different population to the LFS. RTI includes all individuals who are employed in a PAYE scheme and who were paid in the reference period, while the LFS sample has no coverage of those under 16 or temporary residents in the UK, but has a stronger coverage of people who are in work but not being paid. A further difference arises because RTI classifies any person receiving pay through a company payroll as being an employee, while the LFS only classifies a person as an employee if the interviewee describes themselves as an employee in their main job.

A4.35 Statistics on pay are also not directly comparable to AWE or ASHE. RTI estimates include earnings of employees whose pay was reduced for any reason. RTI estimates are calculated on a person basis while AWE estimates are calculated on a job basis. This difference causes RTI estimates to be higher than AWE estimates. RTI estimates also include redundancy payments paid through payroll.

Inflation

A4.36 ONS publishes monthly inflation indices which reflect changes over twelve months in the cost of a 'basket' of goods and services on which people typically spend their money. In our analyses, we have used two main inflation measures: the Consumer Prices Index (CPI), and the Retail Prices Index (RPI).

A4.37 Each measure uses the same basic price data, but the CPI (which follows international definitions) excludes Council Tax and a number of housing costs faced by homeowners that are included in the RPI. Other differences include: the methodologies used to combine individual prices at the first stage of aggregation; the sources used to derive the weighting that each component contributes; and the population that the 'basket' is designed to represent. The RPI is never revised and the CPI, although revisable in theory, has only ever been revised in exceptional circumstances.

A4.38 Our 2017 report (Low Pay Commission, 2017) detailed the chronology from 2013 onwards concerning the push for ONS to make CPIH its main measure of inflation. This included its removal and re-designation of National Statistic status. CPIH includes costs associated with owning, maintaining and living in one's own home (known as owner occupiers housing costs) along with Council Tax which are excluded from CPI.

A4.39 In 2020, the Covid-19 pandemic and subsequent lockdown measures have presented issues for the measurement of inflation. Some products that would ordinarily be included in the basket of goods, including theatre tickets and international train fares, have been unavailable to buy. This means that there is some uncertainty in measures of inflation this year, and that true inflation is likely to be lower. Furthermore, the type of goods and services that households are buying has changed substantially and the current basket is unlikely to be representative of household spending. A final issue arises due to difficulties in gathering information on prices remotely; in some cases where the sample has been too small ONS has estimated the inflation rate from a related product or from the wider class of products.

A4.40 Our analyses in this report use RPI, CPI and CPIH as measures of current price inflation.

Gross Domestic Product

A4.41 GDP provides a measure of total economic activity. It is often referred to as one of the main 'summary indicators' of economic activity and is used to measure growth in the economy.

A4.42 In 2018 ONS introduced a new publication model for GDP, reducing the number of published estimates of quarterly GDP from three to two. The new model seeks to balance timeliness with accuracy of GDP estimates, with the aim of reducing the likelihood and frequency of revisions. The model also enables the publication of monthly estimates of GDP.

A4.43 Quarterly GDP: The first quarterly estimate of GDP is published 40 days after the quarter to which it refers. This is two weeks after the previous model's preliminary estimate (but in line with other G7 release schedules) and so will contain higher quality output data. It will also contain information from the income and expenditure approaches two weeks earlier than the previous model although data for these measures will be lower than the former second estimate. A comprehensive (second) estimate of GDP will continue to be released as part of the Quarterly National Accounts, available 85 days after the end of the reference quarter as previous.

A4.44 Monthly GDP: ONS brought forward the Index of Services release by two weeks, which, alongside the Index of Production and the Index of Construction allow production of a combined monthly estimate of GDP using the output measure, the timeliest of the three GDP measures, and the only one available on a monthly basis.

A4.45 The new publication model hopes to achieve a balance between timeliness and accuracy. The previous model gave greater weight to output data in the early estimates as they are the timeliest and therefore provide the best short-term picture. The new model will still be balanced to the output estimate but will benefit from using more robust data from that source as a result of a two-week delay. This time lag also enables the measure to incorporate both income and expenditure data to quality assure the output GDP measure, ensuring a more reliable initial estimate.

Family Resources Survey

A4.46 This year, we have used the Family Resources Survey (FRS) to explore the household circumstances of minimum wage workers. The FRS is a continuous household survey which collects information on a sample of private households in the UK. It collects detailed information on respondents' incomes from all sources including benefits, tax credits and pensions, housing tenure, caring needs and responsibilities, disability, childcare, family circumstances, and child maintenance.

A4.47 The FRS is used to develop the Households Below Average Income publication, which measures household disposable incomes as a proxy for living standards. It is also used to feed into other publications, and to model the costs of benefit policies. We have used the 2018/19 survey to investigate how household composition and income varies for minimum wage workers.

Monitoring the impact of Covid-19

A4.48 Since the start of the pandemic and the resulting policy measures that the government introduced, there have been questions that the main data sets that we normally rely on are ill-equipped to answer. New data sources have been introduced to start to understand the rapidly evolving nature of the labour market this year, and we list those that we have used here.

Coronavirus Job Retention Scheme statistics

A4.49 The government announced the Coronavirus Job Retention Scheme (CJRS) on 20 March 2020 as part of its response to the Covid-19 pandemic. CJRS provides employers with financial support of 80 per cent of their employees' salaries, up to a cap of £2,500 per month per employee.

A4.50 HMRC began to publish statistics on the take-up of the scheme from April, initially posting a daily count on Twitter and then publishing weekly and later monthly data. The statistics cover the number of employments that are furloughed on a jobs basis, such that one person can be counted twice if they work for two employers and both of those jobs are furloughed.

A4.51 HMRC matched data from their RTI system on to the CJRS data to produce breakdowns of claims by the daily number of employments furloughed, employer size, sector, geography, age, gender, and use of flexible furlough.

Business Impact of Covid-19 Survey (BICS)

A4.52 Throughout this report we refer to low-paying sectors. We define these as occupations or industries which contain a high number or large proportion of low-paid workers based on the Standard Occupation Classification (SOC) and Standard Industrial Classification (SIC) codes published by ONS. We have two distinct definitions of low-paying sectors, one based on industries and one on occupations. These definitions are used when conducting detailed analysis of low-paying sectors using ASHE or the LFS. Some sectors thought of as low-paying e.g. retail and hospitality will tend to include higher paid roles such as buyers and managers when looked at on an industry basis. On the other hand, there are some low-paying occupations i.e. cleaning which are found across different industries.

A4.53 ONS began a new fortnightly business survey in March to understand how firms have been affected by the pandemic and lockdown measures. The survey increased its representative sample to 25,000 businesses in later waves with a response rate around 25 per cent. It captures responses on how their turnover, workforce prices, trade and business resilience have been affected in the two-week reference period.

Low-paying sectors

A4.54 In 2017 we reviewed the low-paying classifications to identify new low-paying sectors arising from the NLW, considering the 2020 NLW target of 60 per cent of median pay for workers aged 25 and over. As a result, we added two new groups to the industry classification: security and wholesale food (including agents), both of which included above average proportions of low-paying workers. Small changes were also made within the cleaning and maintenance and social care groups. We also added two new groups within the occupation classification: security and enforcement and call centres. As with the industry classification we also made several small changes within some of the other occupational groups.

A4.55 Our 2017 report (Low Pay Commission, 2017) provides full details on the review including new definitions of each low-paying occupation and industry based on the latest SIC 2007 and SOC 2010 codes. Table A4.1 shows our revised list of low-paying sectors defined by SIC 2007 and SOC 2010 respectively.

Table A4.1: Definitions of low-paying industries and occupations, by SIC 2007 and SOC 2010

Low-paying industry/occupation	Current industry definition (SIC 2007)	Old industry definition (SIC 2007)	Current occupation definition (SOC 2010)	Old occupation definition (SOC 2010)
Retail	45, 47, 77.22, 95.2	45, 47, 77.22, 95.2	1254, 5443, 7111,7112,7114, 7115, 7123-7125, 7130, 7219, 925	1254, 5443, 7111,7112,7114, 7115, 7123-7125, 7130, 7219, 925
Hospitality	55, 56	55, 56	5434, 5435, 9272-9274	5434, 5435, 9272-9274
Social care	86.10/2, 87, 88.1, 88.99	86.10/2, 87, 88.1	6145, 6146, 6147	6145, 6147
Employment agencies	78.10/9, 78.2	78.10/9, 78.2	-	-
Cleaning and maintenance	81, 96.01	81.2, 96.01	6231,6232, 6240, 9132, 9231, 9233-9236, 9239	6231,6240, 9132, 9231, 9233-9236, 9239
Leisure, travel and sport	59.14, 92, 93	59.14, 92, 93	3413, 3441, 3443, 6131, 6139, 6211, 6212, 6219, 9275, 9279	3413, 3441, 3443, 6131, 6139, 6211, 6212, 6219, 9275, 9279
Food processing	10	10	5431-5433, 8111, 9134	5431-5433, 8111, 9134
Wholesale food incl. agents	46.1, 46.2, 46.3	-	-	-
Childcare	85.1, 88.91	85.1, 88.91	6121-6123, 9244	6121-6123, 9244
Agriculture	01, 03	01, 03	5112-5114, 5119, 9111, 9119	1213, 5112-5114, 5119, 9111, 9119
Security	80.1	-	7122, 9241, 9242	-
Textiles and clothing	13, 14	13, 14	5411, 5414, 5419, 8113, 8137	5412-5414, 5419, 8113, 8137
Hairdressing	96.02, 96.04	96.02, 96.04	622	622
Office work	-	-	4129, 4133, 4216, 7213, 9219	4129, 4216, 7213, 9219
Non-food processing	-	-	8112, 8115-8116, 8119, 8121, 8125, 8127, 8131, 8134, 8139, 9120, 9139	5211, 5441, 8112, 8114-8116, 8125, 8131, 8134, 8139, 9120, 9139
Storage	-	-	9260	9260
Transport	-	-	5231, 8135, 8212, 8214	5231, 8135, 8212, 8214
Call centres	-	-	7113, 7211	-

Note: '-' denotes not applicable.

Appendix 5

International evidence

A5.1 We routinely track international developments in minimum wage policy, monitoring decisions in other countries and looking at how the National Living Wage (NLW) fares in comparison with other nations' rates. Despite the pandemic, we held a virtual international workshop in September. We were joined by minimum wage commissioners and officials from several other countries, as well as Eurofound and the OECD (Organisation for Economic Co-operation and Development), to share experiences of setting minimum wages during an unprecedented economic crisis. Covid-19 has had serious implications internationally for people's health and livelihoods. Many countries have introduced measures to limit the health impacts of the virus, which have included restricting the ability of businesses to trade. This has had substantial economic impacts worldwide, and other countries have also faced challenges in setting their minimum wage in this context.

International developments in 2020

A5.2 Figure A5.1 shows a selection of international minimum wage decisions that had been made between the start of the Covid-19 pandemic and October. Germany's Minimum Wage Commission made its recommendations at the end of June, for backloaded increases over a period of two years, from January 2021. These begin with a 1.6 per cent increase in January (from €9.35 to €9.50) followed by a further 1 per cent increase in July (to €9.60). These will then be followed by two larger increases in 2022, of 2.3 and 4.4 per cent. With these, the German minimum wage will reach €10.45 in July 2022, an increase of 8.9 per cent from its current level.

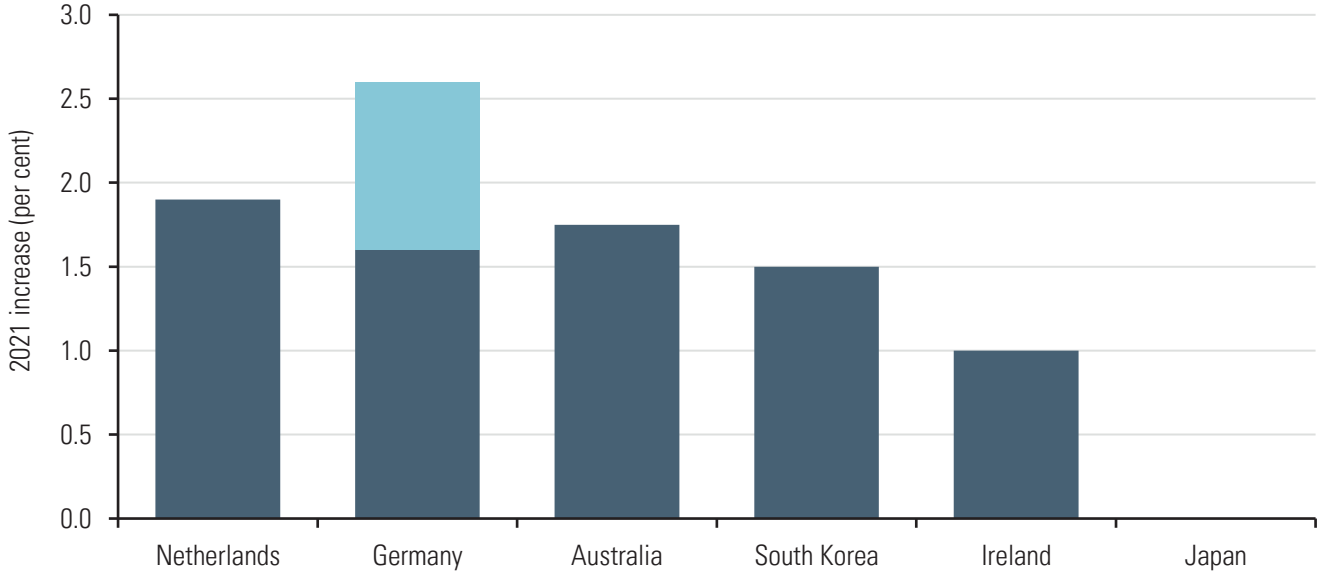
A5.3 The Netherlands increases its minimum wage every six months (in January and July), with increases based on average wage growth. The most recent increase, of 1.6 per cent came into effect in July 2020. In October, the Dutch authorities announced an increase of 0.29 per cent for January 2021, meaning a year-on-year increase of 1.9 per cent.

A5.4 Australia's Fair Work Commission published their annual decision in late June – slightly later than usual, but within the end-June deadline set for them. In it, they recommended an increase of 1.75 per cent. They also recommended varying the implementation date for the increase by sector, to take account of the differing impacts of the pandemic. The increase was implemented from 1 July for industries and sectors less affected by the pandemic, but also for frontline health care and social assistance workers, teachers and childcare workers and employees engaged in other essential services. In total, these groups represented around a quarter of total coverage. For around 40 per cent of covered workers, the increase was implemented from 1 November. For the remaining workers, implementation was delayed until 1 February 2021. This included the most adversely affected sectors, such as hospitality, arts and leisure, aviation, retail and tourism.

A5.5 In mid-July, the South Korean Minimum Wage Commission recommended an increase of 1.5 per cent, for implementation in January 2021. The recommendation meant the rate did not reach a Government target of 10,000 won by 2021. The Japanese Government announced at the end of July that there would be no minimum wage uprating this year (the uprating usually takes place on 1 August). They stated this decision reflected the impact of the pandemic on the economy and above all the effects on small and medium businesses. It followed an announcement earlier in the year that the 2020 uprating would be kept under review.

A5.6 Commissions in Australia, South Korea and Ireland all saw their usual timetables delayed by the pandemic, and all failed to reach unanimous agreement.

Figure A5.1: International decisions on minimum wage upratings, 2020



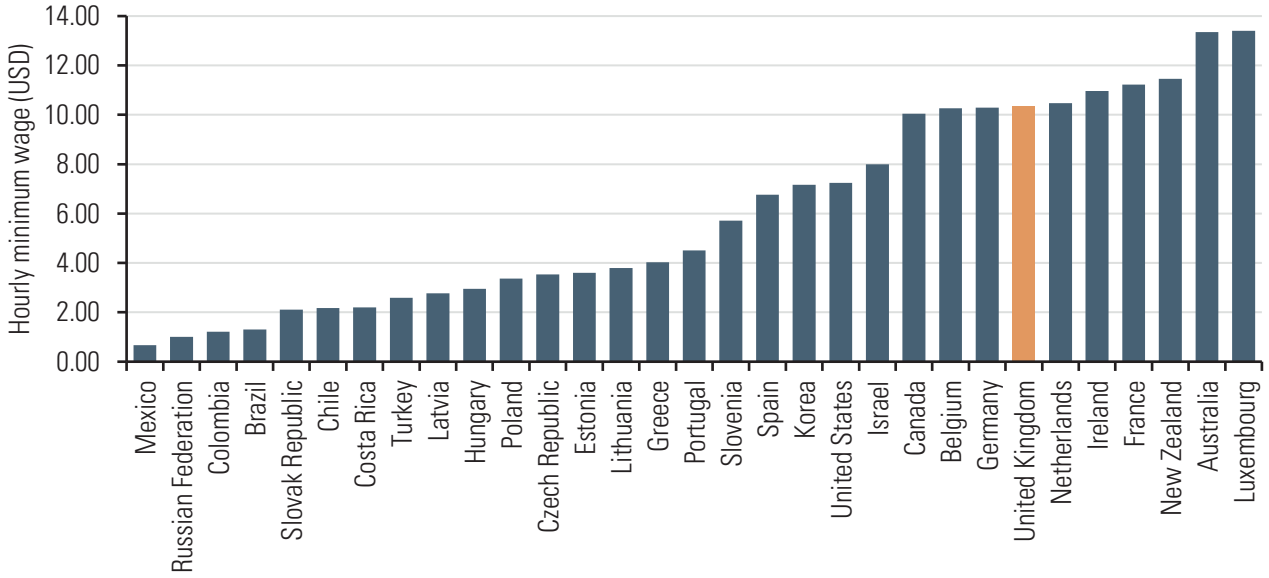
Source: German and Australian decisions announced in June; Japanese and Korean in July; Irish in September; Netherlands in October. Implementation is August in Japan; staggered between July and February in Australia; January in the Netherlands, South Korea and Ireland

International comparisons

A5.7 Comparisons of minimum wages between countries always come with heavy caveats and inevitably fail to capture differences in context and policy design between countries. These include differences in eligibility, particularly regarding age, experience and exclusions for specific types of workers; whether rates are hourly, weekly and monthly, with the problems of converting between these figures; and differences in tax and benefit regimes which affect both what workers are paid and what they cost employers. In addition, exchange rates and the cost of living influence comparisons of the value of minimum wages. Adjusting for purchasing power parity attempts to address these issues. They are more stable than market exchange rates and account for different prices of goods and services, but are also harder to measure than market exchange rates as they rely on periodic price surveys.

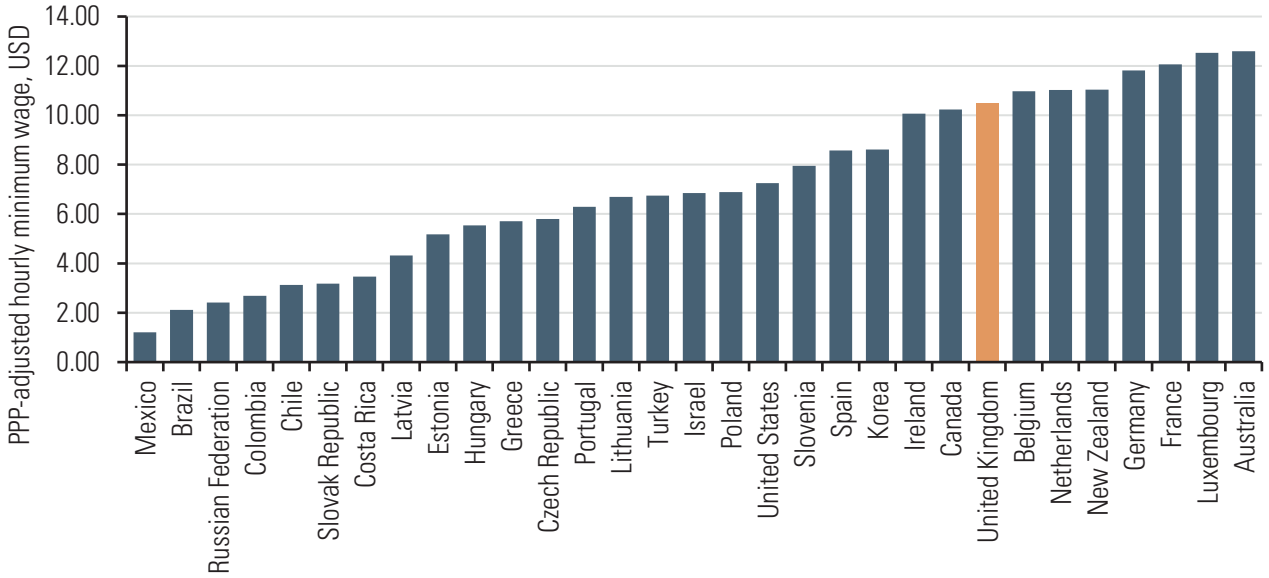
A5.8 The most authoritative source on international minimum wages is the OECD, but at the time of writing the available data only covered the period up until the start of 2019. Figure A5.2 shows a comparison of 2019 minimum wages across OECD member countries, based on US dollar exchange rates. Figure A5.3 shows the same comparison adjusted for purchasing power parity. In both cases, the UK is at the higher end of international comparisons, although the adjustment for purchasing power parity means it is leapfrogged by Belgium and Germany.

Figure A5.2: Comparison of international minimum wages, OECD, 2019



Source: OECD Real minimum wage data

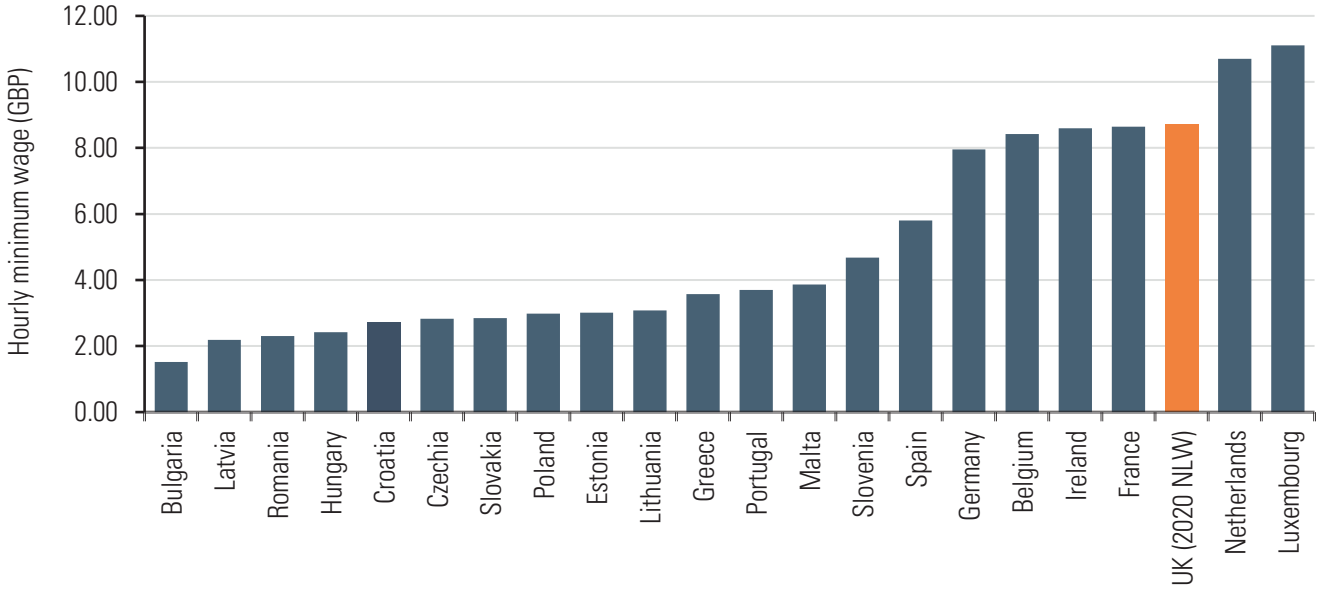
Figure A5.3: Comparison of international minimum wages adjusted for purchasing power parity, OECD, 2019



Source: OECD Real minimum wage data.

A5.9 An alternative source of more up-to-date information on minimum wages is Eurofound, whose report Minimum wages in 2020 (Eurofound, 2020) compares minimum wages across EU member states. Figure A5.4 compares the 2020 NLW rate of £8.72 with the applicable rates of EU member states in January 2020, as recorded by Eurofound. Where countries set their minimum wage as a monthly figure, we follow Eurofound in using average monthly hours of work to produce an hourly figure. On this measure, the NLW is higher than EU comparators, although this does not take into account upratings in those countries over the course of 2020.

Figure A5.4: Comparison of minimum wages across European countries, Eurofound, 2020



Source: LPC estimates using Eurofound Minimum wages in 2020: Annual review.
Note: Figures represent the minimum wage applicable in January of the given reference year, except for Ireland, where the 2020 rate was applicable as of February 2020.

Appendix 6

Timeline of the Covid-19 outbreak

A6.1 Since its beginning in early 2020, the Covid-19 pandemic has developed rapidly. Its effects on daily life and the economy have been complex, and policy responses from the UK Government and devolved administrations have proceeded in different stages. In Chapter 1, we give a high-level timeline of the outbreak and a summary of the main policy responses to it. This appendix, although by no means comprehensive, gives a more detailed overview of developments through the year.

Initial outbreak and lockdown: March to April

A6.2 Reports of an outbreak of a new coronavirus (Covid-19) began to circulate in Wuhan, China in December 2019. On 30 January 2020, the World Health Organisation (WHO) declared the outbreak a Public Health Emergency of International Concern (PHEIC) and the first cases in the UK were confirmed the next day. In response, the Government published an action plan for dealing with Covid-19 on 3 March. The first confirmed death in the UK was on 5 March. The WHO declared a pandemic on 11 March. That prompted economic action on the same day with the Bank of England reducing interest rates to 0.25 per cent and the Chancellor announcing funding of £30 billion in measures to protect the economy from Covid-19. The next day, the FTSE-100 fell by 10 per cent, its largest fall since 1987. Other markets around the world were similarly affected. The Government advised that anyone with a new continuous cough or a fever should self-isolate for seven days. On 16 March, the Prime Minister advised everyone in the UK to work from home if possible and avoid visiting social venues such as pubs, clubs or theatres. He also counselled against non-essential travel and contact with others. The Department for Culture, Media and Sport (DCMS) advised that large gatherings should not take place.

A6.3 To support businesses and the economy, the Chancellor announced on 17 March that £330bn would be made available in loan guarantees for businesses affected by the virus. Major cinema chains announced they would be closing. On 18 March, the pound fell to its lowest level against the dollar since 1985. The Government also announced that all schools in the country would shut at the end of that week, except for those looking after vulnerable children and the children of key workers. The next day, the Bank of England reduced its Bank Rate to 0.1 per cent, its lowest ever rate and the Government also announced an extra £2.9 billion to help care for the vulnerable. On March 20, as part of 'unprecedented' measures to protect jobs and support incomes, the Chancellor announced the introduction of the Coronavirus Job Retention Scheme (CJRS). Under this scheme, the Government would pay 80 per cent of wages for employees not working, up to £2,500 a month. Later that day, the Prime Minister ordered all cafes, pubs and restaurants to close from that evening, except for take-away food. All the UK's nightclubs, theatres, cinemas, gyms and leisure centres were told to close as soon as they reasonably could. Covid-19 cases and deaths continued to rise.

A6.4 After warning on 22 March that tougher measures might be introduced if people did not follow official advice on social distancing, the Prime Minister in an address to the nation on 23 March announced new strict rules, applicable to the entire UK, with the aim of slowing the spread of the disease by reducing transmission between different households. The public were instructed to stay at home, except for certain very limited purposes, such as work, exercise, providing care and essential shopping. All non-essential shops, libraries, places of worship, playgrounds and outdoor gyms were closed. These restrictions came into force on 26 March, when the Government also announced the Self-Employment Income Support Scheme (SEISS), which provided similar help to the self-employed as the CJRS did to employees – the Government would pay 80 per cent of profits, up to £2,500 a month. However, not all self-employed workers were covered – only those that had self-assessment returns in the financial year 2018/19. On 17 April, three days before the application process started, the CJRS was extended to the end of June. Covid-19 cases and deaths continued to rise.

Reopening the economy: May to July

A6.5 As the number of daily Covid-19 cases and deaths started to slow, the Prime Minister stated on 30 April that the UK had past the peak of the Covid-19 outbreak and announced that he would next week set out comprehensive plans for easing the lockdown. However, on 5 May the total number of Covid-19-related deaths reached 29,427, the highest number in Europe. On 10 May, the Government updated its coronavirus message from "stay at home" to "stay alert" and the Prime Minister outlined a phased plan to start easing the lockdown. Those who could not work from home, such as construction workers and those in manufacturing, were encouraged to return to work from the following day, but were advised to avoid public transport if possible. The second phase would involve re-opening some shops and primary schools in June and a third phase to re-open hospitality and public places would follow in July. Further details were published on 11 May. The following day, the Chancellor extended the furlough scheme until October albeit with some employer contributions from August.

A6.6 From this point onwards, official responses in devolved administrations began to diverge from those in England. The easing of lockdown measures in both Scotland and Wales was delayed until 28 May and 1 June respectively and followed a different path from the English one.

A6.7 On 13 May, the new guidelines came into effect in England, allowing the re-opening of garden centres, sports courts and recycling centres. On 24 May, the Prime Minister confirmed plans to re-open primary schools for some year groups on 1 June. On 29 May, the Chancellor announced that employers using the CJRS must pay National Insurance and pension contributions from August, then 10 per cent of pay from September, increasing to 20 per cent in October. The self-employment scheme was also extended, with a second payment in August.

A6.8 On 1 June, it was announced that car and caravan showrooms, outdoor sports amenities and outdoor non-food markets could reopen. Despite concerns about easing the lockdown, the number of coronavirus cases and deaths continue to slow. On 9 June, the Government announced that all non-essential retailers in England, along with zoos and safari parks, could reopen from Monday 15 June providing they follow safety guidelines. However, restaurants, bars, pubs, nightclubs, most cinemas, theatres, museums, hairdressers, indoor sports and leisure facilities must wait until 4 July at the earliest. On 18 June, the Bank of England announced plans to inject an extra £100bn into the UK economy to help fight the downturn precipitated by the pandemic. No Covid-19 deaths were reported in Northern Ireland or Scotland on 21 June and the number of new cases in the UK fell below 1,000 for the first time since the lockdown.

A6.9 On 25 June, the UK Government announced plans to relax rules for England and Wales allowing pubs and restaurants to utilise outdoor spaces such as terraces, pavements and car parks, while outdoor markets and fetes would no longer need planning permission. The number of weekly Covid-19 cases started to level off but a spike in cases in Leicester resulted in a local lockdown announced on 29 June. The next day, the Prime Minster set out a £5 billion post-coronavirus infrastructure recovery plan for the UK. Despite the lockdown in Leicester, hospitality and other consumer services sectors were allowed to reopen on 4 July in the rest of England. On 6 July, the UK government announced grants and loans of £1.57bn to support theatres, galleries, museums and other cultural venues affected by the Covid-19 outbreak. It also announced a £111m scheme to help firms in England provide an extra 30,000 trainee places; £21m would be provided to fund similar schemes in Scotland, Wales and Northern Ireland. Non-essential retailers were permitted to reopen in Scotland from 29 June and in Wales from 6 July. No new Covid-19 deaths were reported for Wales but the number of weekly cases in the UK appeared to have levelled off.

Summer easing: July to August

A6.10 On 8 July, the Chancellor announced a new spending package, costing £30 billion, aimed at mitigating the economic impact of the pandemic. The measures included the Eat Out to Help Out scheme, a temporary reduction in VAT for the hospitality sector to 5 per cent, a CJRS bonus scheme to pay firms £1,000 in January for each employee brought back from furlough, a scheme to get young people into employment, and a temporary rise in the stamp duty threshold. The number of weekly cases fell in England.

A6.11 Outdoor swimming pools and water parks were allowed to re-open on 11 July with nail bars and salons, tanning booths and salons, spas and beauty salons, massage parlours, tattoo parlours, and body and skin piercing services re-opening on 13 July. The temporary cut in VAT for the food and hospitality industries, worth £4bn, came into force on 15 July, lasting until 12 January 2021 – helping to boost confidence and spending in those industries. Meanwhile, a research report for the Chief Scientific Advisor flagged concerns about a second wave over the winter, and the lockdown in Leicester was extended to Oadby and Wigston. Despite that, on 17 July, the Prime Minister announced further easing of lockdown restrictions for England allowing the public to use public transport for non-essential journeys, giving employers more discretion to get workers back to the workplace. He also announced pilot schemes for indoor performances with socially distanced audiences at theatres, music and performance venues, with a view to a full return in August, and for a return to spectator sports, with a view to a full return by 1 October.

A6.12 On 21 July, the Chancellor announced that he had accepted the recommendations from the pay review bodies, giving 900,000 public sector workers an above-inflation pay rise of 3.1 per cent, in recognition of the vital role they had played during the pandemic. Although the total number of UK cases passed 300,000 on 27 July, the seven Covid-19 deaths reported was the lowest since 12 March. On 29 July, the Government announced a £500 million scheme to help film and television. Following an increased rate of transmission, restrictions were placed on Greater Manchester, parts of East Lancashire and Yorkshire prohibiting separate households from meeting indoors from midnight on 30 July. The next day, as the number of daily cases rose, the Prime Minister postponed some lockdown easing measures scheduled to begin in England on 1 August with bowling alleys and casinos remaining closed until 15 August, while wedding receptions of up to 30 people were also moved back to that date. Trials of spectator sporting events were also paused.

A6.13 Changes to the furlough scheme came into effect on 1 August. On 3 August, the Eat Out to Help Out scheme was launched, giving customers a 50 per cent discount on food (worth up to £10) at indoor venues. Restaurants, bars and hairdressers were able to re-open in England, and hospitality businesses were permitted to reopen in Wales. On 9 August, the number of daily Covid-19 cases rose above 1,000 for the first time since June. Schools returned on 11 August in Scotland and on 24 August in Northern Ireland. On 17 August, the self-employed became eligible for the second tranche of SEISS. The number of daily cases continued to increase, rising by over 1,500 on 27 August. The next day, the Government announced it was encouraging people to return to their workplaces, starting in the first week of September. The number of daily cases continued to rise with 1,715 reported on 30 August, the largest increase since mid-May, but only one additional death from Covid-19 was recorded. On 31 August, the Eat Out to Help Out scheme ended.

Return of restrictions: September to October

A6.14 On 1 September, the majority of schools re-opened in England and Wales; firms using the furlough scheme were required to contribute 10 per cent of earnings; and workers on low incomes required to self-isolate in high risk areas, and unable to work from home, became entitled to a new payment of £13 a day to top up their existing benefit claims for the duration of their isolation. The scheme was initially trialled in Blackburn, Darwen, Pendle and Oldham. On 5 September, the Government sent letters to Government departments urging them to get civil servants back to the office. The following day, almost 3,000 Covid-19 cases were reported – the highest since 22 May – with many of the new cases among young people. On 8 September, the Government announced that social gatherings of more than six people would be banned in England from Monday 14 September. Equivalent rules in Scotland and Wales also came into effect on that date. The number of daily cases continued to rise and the R number moved above 1.

A6.15 On 21 September, amid concerns that a fresh wave of Covid-19 cases would severely affect the economy, the FTSE 100 share index fell by more than 3 per cent, driven by falls in airlines, travel firms, hotel groups and pubs. On 23 September, daily cases rose to over 6,000. The Chancellor scrapped his autumn budget but announced new measures the next day. On 24 September, new regulations came into force restricting business activities between 22:00 and 05:00. A wide range of businesses were covered, including restaurants, bars, public houses, social clubs, casinos, bingo halls, bowling alleys, cinemas, theatres, concert halls, amusement arcades, funfairs (indoors or outdoors), theme parks and adventure parks. On the same day, the Chancellor announced the Job Support Scheme would replace the CJRS from 1 November. Under the new scheme, people who work reduced hours would receive Government and employer help to top up their wages to two-thirds of their full pay. The Chancellor also announced an extension (at a reduced level) of help for self-employed people, longer repayment periods for business loans, and an extension to the temporary reduction in VAT for hospitality and tourism companies. The number of daily cases continued to rise, reaching 6,634, and the R number rose to 1.2-1.5. On 29 September, 7,143 daily cases were reported and the number of Covid-19 deaths rose to 87, the highest since 1 July.

A6.16 As the R number rose to 1.3-1.6 on 2 October, about 16.8 million people were in local lockdowns. That was around a quarter of the population of the United Kingdom including 23 per cent of people in England, 76 per cent of people in Wales and 32 per cent of people in Scotland. On 7 October, Scotland announced a two-week closure of pubs and restaurants across its central belt. On 8 October, the Chancellor announced an expansion of the Job Support Scheme, with the Government paying two-thirds of the wages of employees of firms forced to close because of Covid-19 restrictions. This was more generous than the scheme open to those businesses not forced to close. Small firms would not have to make any contribution to their workers' wages if they are legally forced to shut down while large ones would only have to contribute about 5 per cent of employee costs in the form of National Insurance and pension contributions.

A6.17 On 12 October, the Prime Minister announced a new three-tier system to replace the local lockdowns in England to take effect from 14 October. Areas were classified as medium (Tier 1), high (Tier 2) or very high (Tier 3). Medium areas were subject to the rule of six and the 10pm curfew, high areas had restrictions on indoor meetings but groups of six could continue to meet in outdoor settings, and very high areas saw the closure of businesses such as pubs and casinos, but not restaurants. The Scottish Government set out a similar three-tier system on the same date. On 14 October, only Liverpool City Region was assigned to Tier 3. On 16 October, there were 27,900 new COVID-19 cases a day in England, a 60 per cent increase on the previous week. Hospitality businesses in Northern Ireland were limited to take-away only from this date. The high case numbers prompted Wales to introduce a travel ban on people from Covid-19 hotspots in other parts of the UK. On 20 October, 241 Covid-19 deaths were recorded, the highest daily number since 5 June.

A6.18 On 21 October, the Chancellor announced further changes to his Job Support Scheme with employers paying less and employees able to work fewer hours before qualifying for extra financial help. The number of daily cases continued to increase while the number of Covid-19 deaths recorded on 27 October was its highest since May. On 23 October, Wales began a two-week 'firebreak' lockdown, closing hospitality and non-essential retail, while on 31 October the Prime Minister announced a one-month lockdown and the extension of the CJRS for that period.

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