

# Executive Summary

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

## Chapter 1: The Economic Context to the October 2013 Rates

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

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

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

## Chapter 2: The Impact of the National Minimum Wage

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

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

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

## Chapter 3: Young People and Apprentices

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

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

## Chapter 4: Compliance and Operation of the National Minimum Wage

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

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

## Chapter 5: The Rates

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

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



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

## **Chapter 6: The Future Path of the National Minimum Wage**

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

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

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



# Recommendations

## **National Minimum Wage Rates**

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

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

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

## **Accommodation Offset**

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

## **Migrant Domestic Workers**

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