National Minimum Wage

Low Pay Commission Report 2007

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Chairman's Foreword

When the National Minimum Wage was introduced in April 1999 the adult rate was set at the deliberately cautious level of £3.60 an hour. About a million low-paid workers benefited. Since then the Low Pay Commission has overseen a gradual increase in the minimum wage relative to the growth in average earnings with no significant adverse effects on employment or inflation.

While the increases in the minimum wage have not outstripped or even kept pace with the increases of the highest paid, it is worth pointing out that, historically, the wages of the lowest paid have rarely kept pace with average wages. In the years immediately before the minimum wage, for example, the relative position of the lowest paid suffered by comparison with those of everyone else.

The improvement in the position of the lowest paid since the minimum wage was introduced is in part due to the work of the Low Pay Commission under the chairmanship of my predecessors, Lord Turner and Sir George Bain. Under their leadership the Commission made great progress in establishing the minimum wage as an accepted part of the UK labour market. As importantly in my view, they also established a way of working within the Commission based on partnership, openness and a respect for evidence. This approach, together with mutual respect for the positions of different Commissioners and a willingness to work towards consensus, has underpinned the successful working of the Commission to date. In my first year as chairman I have been impressed by the way in which Commissioners have worked together, with the importance attached to backing up opinion or hypothesis with evidence and with the collective appreciation of the importance of consensus. I am pleased, if a little daunted, to be following two chairmen with such excellent records. I will try to do as well.

This year sees the retirement from the Low Pay Commission of six Commissioners, four of whom have been members of the Commission since it was first established in July 1997. These four – Willy Brown, John Cridland, Paul

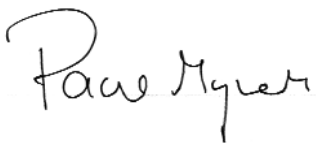
Gates and David Metcalf – have made an immense contribution to the Commission and therefore to improving the pay of the lowest paid. They depart from the Commission with our gratitude and respect. Also leaving are Angie Risley and Ian Brinkley, both of whom have made a real and lasting contribution.

This year we have been deliberately cautious. We do not make recommendations two years in advance: we confine ourselves to recommendations for uprating the minimum wage in October 2007, offering only a general indication of what is likely to be recommended in 2008. Moreover, we recommend an increase for October 2007 that is slightly below the expected increase in average earnings – the first such recommendation since 2002. In the light of the available evidence this prudent approach seems to me entirely appropriate and in the best long term interests of the National Minimum Wage and those affected by it.

Our cautious approach this year should not be taken as a signal that the minimum wage is too high. After four years of substantial increase, this year the evidence pointed to the need for moderation. Next year that might change, or the need for caution might be even stronger. Either way, I am determined that, under my chairmanship, the Commission will continue to be evidence-driven.

Although our recommendation is cautious, taking into account this year's recommended increase the minimum wage will have risen by more than 53 per cent since its introduction in April 1999. During the same period, average wages are expected to have gone up by 41 per cent.

The minimum wage has improved the pay of low earners and helped narrow the gender pay gap without significant adverse effects on business or jobs. That success reflects the commitment of Commission members and the input of our stakeholders. I am grateful to have been able to work with and learn from the six Commissioners who are leaving this year. I am also grateful to the Commission secretariat for their dedicated and professional approach. I am looking forward to working with them and with the substantially changed Commission in the coming year.



February 2007

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Executive Summary

Chapter 1: Introduction

In our remit for this report the Government asked us to monitor and evaluate the impact of the minimum wage and to consider its effect on different groups of workers. In this introductory chapter we explain how we set about fulfilling that remit and we describe the different parts of our work programme that have contributed to our conclusions and recommendations.

For this report we commissioned 11 research projects and carried out a survey of firms in low-paying sectors. We analysed data produced by the Office for National Statistics to establish better estimates of the incidence of low pay and to give us a greater appreciation of the sectors and the groups of people involved. We also used Office for National Statistics data to analyse the impact of the minimum wage on earnings, employment and other economic variables, and to estimate the likely impact of the Government's decision to increase statutory annual leave entitlement.

Consultation with employers, workers and their representatives continued to be an essential part of our work. We took written and oral evidence from a wide range of organisations and made visits throughout the UK to listen to the views of those affected by the minimum wage.

Chapter 2: The Impact of the National Minimum Wage

One of the key ways to measure the impact of the minimum wage is by means of its 'bite' – defined as the ratio of the adult minimum wage to the median hourly wage. The bite has grown from 47.6 per cent of median earnings when it was introduced in April 1999, to around 53 per cent in October 2006. Prior to the 2005 Report, the adult minimum wage increased by 35 per cent, while average earnings grew by 26 per cent. When we were

preparing our 2005 Report, independent forecasts indicated that the minimum wage increases we were proposing for October 2005 and October 2006 would be slighly higher than average earnings growth. In the event, average earnings grew by less than predicted – 8 per cent compared with the forecast 9.2 per cent – and, as a result, the bite of the minimum wage increased faster than anticipated. There is little evidence that this had any significant negative impact on employment, profits or prices over the period in question, although it is too early to assess fully the impact of the October 2006 upratings. As with average earnings, the forecast growth in the UK economy for 2005 and 2006 was not fully realised. Although predicted to grow at around 2.5 per cent in both 2005 and 2006, the economy slowed sharply in 2005 before it recovered in 2006. At the same time, price inflation grew faster than had been forecast, with the effect that the minimum wage grew less in real terms than had been expected.

In terms of coverage, using the average earnings assumption, we now estimate that the 2005 minimum wage upratings covered about 0.8 million employee jobs and that the larger increase in October 2006 covered around 1.25 million employee jobs. Estimates using the prices assumption are similar. One disadvantage of the way we traditionally calculate coverage is that it cannot allow for employers putting up wages in anticipation of statutory upratings. In a review of our coverage methodology this year, we developed an alternative approach. By downrating the minimum wage back to 1998 using the growth in average wages we can estimate what coverage would have been in 1998 before the earnings distribution had been affected by the minimum wage. Using this method, we calculated that the 2006 adult minimum wage was equivalent to nearly £4.00 in 1999, higher than the actual introductory rate of £3.60. We estimated that such an introductory rate would have covered nearly 8 per cent of adult employee jobs – almost double the estimated actual initial coverage of about 4 per cent.

Despite the slowdown in the economy towards the end of 2004 and throughout 2005, the UK labour market continued to create jobs. Total employment rose to a new record high of 29.03 million in the three months to November 2006. In our 2006 Report we noted that, since 2004, the private sector had experienced slower growth in wages and jobs than the public sector. This situation has been reversed in 2006 with both employment and average earnings growing faster in the private sector.

However, not all employment data are positive. Worryingly, employment in the low-paying sectors as a whole fell for the first time since the introduction of the minimum wage. Employment in these sectors has continued to be below its 2005 level throughout the first three quarters of 2006, but the fall has been weaker with each quarter suggesting that there has been some recovery. This recovery is expected to continue as the evidence suggests that consumer expenditure has picked up after the sharp decline in 2005.

The working age employment rate remained high in 2006, but it fell from the peak reached in the first quarter of 2005. This has been attributed to a number of factors, amongst which was the slowdown in the UK economy in 2005 and the increasing participation of older workers. Unemployment increased throughout 2005 and into much of 2006. The increase in the number of migrant workers and the growing number of older workers and women entering the labour marker were also widely seen as contributory factors. Since October 2006 the unemployment count has slowly flattened and started to fall.

Turning to other economic indicators, we see a mixed picture for 2005 and 2006. The evidence on profits is not consistent. The rate of return on capital employed is currently at or close to its record highs. However, these large and increasing returns are confined to the services and oil sectors. Share prices, as measured on the FTSE, have been strong and have grown substantially in the last 18 months. Profits measured by profit share of national income have also increased and looked healthy in 2006. However, excluding the volatile oil and financial sectors, the profits picture does not look so rosy. One other indicator of profit is the margin between input and output prices. In 2005 there were sharp increases in input prices, mainly as a result of increases in fuel, energy and commodity costs, but the corresponding increases in output prices were much lower. In 2006, input prices have fallen sharply, but remain higher than output prices even though output prices have increased.

Price inflation was subdued until the latter half of 2006. Despite the large increases in the price of oil, consumer inflation in the UK remained stable in 2005 and the first half of 2006. However, price inflation in December 2006 was at its highest for over a decade driven by increases in fuel and food. Labour productivity increased in 2005 and 2006, with a marked increase in the two main low-paying sectors, retail and hospitality.

Over the past two years there has been an improvement in the quality and reliability of the earnings and employment data provided to us by the Office for National Statistics, a development that we warmly welcome. The main changes are set out in Appendix 6. Unavoidably, these improvements have caused another problem – discontinuity. The data sets that we most use in our analyses – the Labour Force Survey and the Annual Survey of Hours and Earnings – are subject to significant discontinuities. This makes comparisons over time difficult and we urge the Office for National Statistics to do everything possible in order to produce consistent time series prior to our next report. We look forward to working with the Office for National Statistics in their continuing efforts to improve the quality of the information provided. We would also welcome additional information on the labour market performance of migrant and agency workers.

Chapter 3: The Effects of the National Minimum Wage on Specific Sectors and on Small Firms

We have identified ten industrial sectors of the economy in which low pay is common. Together they provide over eight million jobs, nearly a third of all jobs in the economy. The two largest sectors – retail and hospitality – account for nearly two-thirds of jobs in the low-paying sectors. Of course many of the jobs in these sectors are paid at a level well above the minimum wage.

While the total number of jobs in these low-paying sectors remains substantially higher than when the minimum wage was introduced, in late 2005 and during 2006 the number of jobs in these sectors declined – the first such fall in employment since the minimum wage was introduced. This occurred at a time when the level of employment in the economy as a whole has been growing. It is true that some of the low-paying sectors, such as textiles and agriculture, have been contracting in size for some time, but in 2006 employment fell in sectors which had seen some of the most rapid growth in recent years, namely retail and hospitality. It is difficult to determine what role, if any, recent minimum wage upratings have played in this decline and jobs did not reduce in all low-paying sectors.

We have also identified two low-paying occupational sectors (childcare and office work). During the year to the third quarter of 2006, there was a small

increase in the number of employees in low-paid jobs in childcare, while in the same period employment in low-paid office work decreased slightly.

Responses to our consultation provided growing evidence that the minimum wage is having an impact on pay and differentials in the low-paying sectors. Although not new, it was one of the strongest messages coming from the organisations we met during our regional visits in 2006. Other sources of information, such as our oral hearings and commissioned research, also provided evidence of an increasing influence of the minimum wage on pay structures. We found this was particularly marked in hospitality, retail, cleaning and childcare, where a growing proportion of jobs were paid at the minimum wage.

Only a small proportion of workers in agriculture are paid at the National Minimum Wage. It does, however, have a knock-on effect on differentials for the agricultural minimum rates set by the Agricultural Wages Boards. In the textiles and clothing sector, employers with incentive based pay systems reported that the minimum wage was having an increasing effect on their arrangements. The impact of the minimum wage on pay in office work occupations and in the security and food processing sectors looks to be more limited, although in the case of the latter sector there is some evidence that it is growing. The overall impact on small firms appears to have been fairly stable between 2004 and 2006.

In the year to September 2006, the social care sector experienced the largest increase in employment of all the low-paying sectors. While overall the sector has a comparatively small proportion of jobs paid at the level of the minimum wage, this proportion is far greater in the independent than the public care sector.

In their evidence some independent sector care providers again stressed the difficulties they faced as a result of local authority funding failing to reflect adequately the increases in the costs of care. Such costs included the cost of minimum wage upratings. We noted this problem in our 2005 Report and recommended that the Government should make clear to local authorities that policies on commissioning care should adequately reflect the costs of provision. We recommended that the Government should monitor the approach of local authorities in this regard and examine the reasons for any uneven provision. We also said that, if appropriate, it should provide further guidance.

We recognise the progress that has been made on the funding of social care, but the evidence suggests that the problem we identified in our 2005 Report persists in some areas of the UK. Moreover, we have seen no evidence of effective monitoring of local authority practice in this regard, as we recommended. We therefore reiterate our 2005 Report recommendation but with greater emphasis on the need for the Government to monitor actively how far the practice matches the policy. It would be helpful for such monitoring information to be made available to us when we next review the sector.

Chapter 4: Groups of Workers and Specific Enforcement Issues

Our remit asked us to assess the impact of the minimum wage on different groups of workers, including ethnic minorities, women and people with disabilities. These groups of workers are disproportionately represented in low-paying sectors and therefore stand to benefit more than most from upratings of the minimum wage.

In the 2005 Report, we found clear evidence that the minimum wage had had a major impact in narrowing the gap between the pay of women and that of men at the lower end of the earnings distribution. Since then, the median pay gap for full-time female employees has reduced further and the pay gap at the lower end of the distribution has continued to narrow.

In common with the rest of the population, the employment prospects of workers with a work-limiting disability have improved in recent years, but they have recently experienced a slight increase in unemployment.

Minority ethnic groups (as defined by the 2001 census) have also fared better in the labour market in recent years. Although the employment rates of ethnic minorities are still lower than those of white workers, they have increased at a faster rate since the introduction of the minimum wage. There has also been a sharp decline in the unemployment rates of ethnic minority groups between 1999 and 2004. Since 2004, however, the unemployment rates of ethnic minorities have been rising at a slightly faster rate than the rest of the working age population.

The minimum wage has clearly helped to improve the earnings position of workers with disabilities and those from ethnic minorities at the lower end of the earnings distribution.

The arrival of some half a million migrant workers from central and eastern Europe since the enlargement of the European Union in 2004 has been a significant recent development in the UK labour market. Many have found employment in low-paid occupations particularly in the agriculture, food processing and packing, and hospitality sectors. Much of the evidence suggests that these workers have had a positive effect on the overall economy and have filled existing vacancies and plugged skills gaps rather than displacing UK workers. Some migrant workers are vulnerable to exploitation by unscrupulous employers prepared to take advantage of their imperfect knowledge of employment rights. A number of consultation responses suggested that excessive deductions from pay were a particular problem. We discuss the need for effective awareness campaigns and enforcement in relation to migrant workers in Chapter 6.

Following the detailed review of the accommodation offset and resulting recommendations to the Government in our 2006 Report, the Department of Trade and Industry consulted on draft guidance that aimed to clarify the rules and address evasion. The final version is due to be published soon after this report. However, the evidence relating to migrant workers has demonstrated that some enforcement problems remain. We did not focus on the operation of the accommodation offset this year but we did review its level: we recommend that the accommodation offset should increase in line with the adult rate of the minimum wage to £4.30 per day in October 2007.

Homeworkers performing unskilled manual work, often on a piece rate basis, continue to face problems ensuring their employment rights are respected. We received evidence that some employers argue that these workers are self-employed in order to deny their entitlement to the minimum wage. We had hoped that new rules on fair piece rates introduced in October 2004 would simplify the calculation of minimum wage pay but the evidence we received, albeit limited, indicated that there were some practical difficulties associated with applying these rules to output work. In view of the difficulties faced by homeworkers, we continue to believe that this group warrants particular attention in terms of the enforcement of their minimum wage rights.

Despite the publication of guidance on therapeutic activity in 2003, there continue to be reports of suspected non-compliance with the minimum wage. There is no doubt that the minimum wage should apply to all workers regardless of any learning disability or mental health problem, but there are also concerns that inappropriate enforcement action, or the fear of such action, could result in the closure of therapeutic services with no alternative provision available. We welcome the fact that the Department of Trade and Industry has revised and reissued its guidance in January 2007 and we encourage the Government to continue to take steps to improve awareness of the minimum wage among those providing services to people with disabilities or other impairments.

Volunteers are another group whose status can be unclear with respect to the minimum wage. In our 2005 Report we made a recommendation, accepted by the Government, that existing guidance for the voluntary sector be consolidated and made more widely available. Since then, the Department of Trade and Industry and HM Revenue and Customs have worked with a number of sector bodies to clarify the minimum wage position for their respective constituents. In January 2007, the Government announced plans to review the minimum wage in relation to voluntary workers, work which would encompass our earlier recommendation for revised guidance. We stand ready to contribute to such a review and hope the improved guidance that we called for two years ago will be made available in the near future.

We do not want minimum wage rules to cause problems for individuals who are happy to give their time freely to benefit their community. But we received evidence this year indicating that it has become the norm in some parts of the media to expect prospective newcomers to offer their time for little or no financial reward as the price of entry to that industry. The Department of Trade and Industry and HM Revenue and Customs have worked with sector bodies in the television industry on best practice guidance and we hope this will make employers more aware of their minimum wage obligations and reduce non-compliance, whether intentional or not. We will consider how the guidance has affected employer practice in a future report.

Chapter 5: Young People and Trainees

In our 2006 Report we noted that the labour market for young people had been weakening over a number of years, most noticeably for those not in full-

time education. The evidence shows that the sharp increase in the number of inactive 16–17 year olds since 1999 can be largely explained by the increased participation of this age group in full-time education, reinforced by the introduction of the Education Maintenance Allowance in 2004. However, 16–17 year olds not in full-time education have continued to experience a worsening of their labour market prospects since 2005 and at a somewhat faster rate than in the past. We remain particularly concerned about the number of 16–17 year olds (over 120,000 in England alone) who are not in education, employment or training.

Young people aged 18–21 have also continued to fare badly in the labour market when compared with older workers. We are concerned that, since 2001, 18–21 year olds not in full-time education have been experiencing a decline in employment and a rise in inactivity. Since 2004, their unemployment rate has also been increasing. Around 540,000 18–21 year olds not in full-time education were either unemployed or inactive in 2006. Eighteen year olds not in full-time education seem to have been the worst affected. By contrast, 21 year olds have seen their employment rate increase and unemployment rate decrease since 2005.

Conclusive evidence to explain the causes of this decline remains elusive. Evidence from research on the impact of the minimum wage on employers' demand for young people provides a mixed picture, with some firms strongly inclined to employ young employees while others state a preference for older, more experienced staff. While many employers choose to pay young people above the minimum wage applicable for their age, there is evidence of a small increase, since 2004, in the use of age-related pay below the adult rate of the minimum wage.

In the light of the evidence on the labour market prospects of young people, we remain convinced that there continues to be a need for lower National Minimum Wage rates for younger workers as a protective measure. However, we also continue to believe that the 21st birthday remains the most appropriate cut-off point between the Youth Development Rate and the adult rate. The evidence shows that 21 year olds have fared better in the labour market than 18 and 19 year olds and that the overwhelming majority of them (nine in every ten) are paid at least the adult rate of the minimum wage. We recommend that the Government amend the regulations so that 21 year olds are entitled to the adult rate of the minimum wage.

As recommended in our 2006 Report, the Government abolished the little-used Older Workers' Development Rate with effect from 1 October 2006. At the same time, it removed the upper age limit on the twelve month exemption from the minimum wage for apprentices. A number of consultation respondents commented positively on the recommendation in our 2006 Report that we be invited to review the minimum wage treatment of apprentices and report in 2008. The Government has promised to consider this recommendation, but we still await a definitive response. We remain of the view that it would be appropriate for us to conduct such a review and have reiterated our earlier recommendation.

Chapter 6: Compliance and Enforcement

The majority of employers support the minimum wage and comply fully with the legislation, but non-compliance remains a problem. The continued success of the minimum wage is therefore in large part dependent upon its effective enforcement. It is important for the majority of law-abiding employers, as well as for those workers who are denied their legal entitlement, that compliance is policed effectively and non-compliance is dealt with rigorously.

Some incidences of minimum wage non-compliance arise through genuine error or misunderstanding. Improving awareness is central to addressing such cases. We recognise that the Government has taken steps to promote greater awareness, but we believe more needs to be done. The situation is perhaps most acute in relation to migrant workers. Despite sharing a common goal, a number of different bodies are currently working independently to raise awareness of employment rights among migrant workers. We believe that a more cohesive approach would help to maximise the impact of the Government's limited minimum wage publicity budget. We therefore recommend that the Government work more collaboratively with other organisations to raise awareness of the minimum wage.

While some employers inadvertently fail to comply, there are others who deliberately set out to evade the minimum wage rules. In all likelihood, such rogue employers will also have scant regard for other employment and tax requirements. Many of these employers will be operating in the informal economy and the workers they employ will be those who are particularly vulnerable to exploitation.

We are encouraged by recent indications of the Government's desire to strengthen the enforcement regime, but we consider that there is still no effective deterrent to non-compliance and no real disincentive for firms contemplating evading the minimum wage requirements. Non-compliance brings the minimum wage into disrepute and on any substantial scale will erode support for it. As we said in our 2005 Report, we do not find it acceptable that employers who underpay the minimum wage are not penalised as long as they pay up when challenged. Conversely, workers who are underpaid receive no more than their arrears of pay and as a result are worse off in real terms. The Government advised us in January 2007 that it was rejecting the recommendation we made in our 2005 Report to redress this imbalance. Although we understand the reasons given for not taking forward the recommendation, we strongly believe that a workable alternative solution needs to be found. We therefore recommend that, as a deterrent to non-compliance, the Government introduce a penalty to apply to any employer found to have underpaid the minimum wage. We also urge the Government to give further consideration to finding a means to compensate workers who have been underpaid. In addition, we believe that employers who flout their minimum wage obligations should be 'named and shamed'.

We support the Government's targeted enforcement programme but continue to believe that HM Revenue and Customs now needs to tackle a more substantial low-paying sector. In our 2006 Report we recommended that a low-paying sector that employed substantial numbers of migrant workers should be targeted, such as agriculture or food processing. In its response, the Government said that it would have been inappropriate to target such a sector, for a number of reasons, one of which was a desire to avoid cutting across the work of the Gangmasters Licensing Authority as it was beginning operations. We understand the Government's position but, in the light of growing evidence that migrant workers are at greater risk of exploitation, we again recommend that the Government choose, as part of its enforcement programme, a low-paying sector with a high concentration of migrant workers to target in 2007/08. To avoid cutting across the work of the Gangmasters Licensing Authority, we suggest a focus on either the hospitality or cleaning sector.

Effective enforcement is important for both workers and good employers. We therefore warmly welcome the Government's commitment to increase the funding for minimum wage enforcement by 50 per cent, as announced in the

Chancellor's pre-Budget Report in December 2006 (HM Treasury, 2006c). We believe this provides the scope to make a significant impact on the enforcement of the minimum wage if appropriately directed. The Government has asked us to contribute to its deliberations on how to get best value from these increased resources and we welcome this opportunity.

Chapter 7: Setting the Rates

The minimum wage is a successful policy that commands widespread support. Evidence at the macro-economic level continues to suggest that it has benefited many low-paid workers without any significant negative impact on the economy. However, the overall evidence drawn from the past two years paints a more complicated picture. Although the UK economy did less well than we anticipated when we made recommendations in February 2005, it is expected to grow at or above trend during 2007. Company profitability looks healthy but price inflation has grown more strongly than anticipated. Average wage growth has been subdued throughout 2006, but there are signs that wage pressures may be growing.

Labour market data also provide mixed messages. Over the past year there have been increases in the number of people in employment but, simultaneously, the number of people out of work has also increased. For the first time since the introduction of the minimum wage, there has been a fall in the number of jobs in the low-paying sectors.

The Government asked us to take into account, as part of this review of the minimum wage, the planned rise in the statutory annual leave entitlement and we have done so as part of our consideration of relevant economic factors. Our analysis suggests that the majority of employers will be unaffected and that the overall impact on the economy as a whole will be small. However, for some employers the impact of the forthcoming increase in holiday entitlement could be significant and a disproportionate number of those affected are likely to be in low-paying sectors.

Throughout our consultation for this report most employers and their representative organisations voiced support for the minimum wage in principle, but many said they had growing reservations about the scale of recent increases. Conversely, trade unions and some others considered that the minimum wage could and should be increased significantly above the

projected increase in average earnings. They believed that this could be done without putting jobs at risk or harming the economy as a whole.

Nearly all of those consulted accepted that the minimum wage should be uprated this year, but there was no agreement as to the appropriate amount. The CBI said that, while the minimum wage should not be allowed to wither on the vine, it was time to call a halt to increases above the growth in average earnings and suggested that an increase in line with prices would be appropriate. The TUC, on the other hand, did not think the minimum wage had reached its optimum level and called for an increase above the projected rise in average earnings.

Weighing the evidence, we came to the conclusion that the present situation requires a more cautious approach than in recent years. The bite of the minimum wage has increased. Using an alternative methodology developed over the past year our calculations suggest that coverage may be significantly higher than previously estimated. There is growing evidence of an impact on pay differentials, particularly in the retail and hospitality sectors. The impact of the substantial 2006 uprating has yet to be fully appraised. The forthcoming increase in annual leave entitlement will add to the costs of some employers in low-paying sectors. There are concerns about price inflation feeding into wage inflation. And, for the first time since the introduction of the minimum wage, there has been a fall in employment in the low-paying sectors. Taken together, we believe that these factors make the case for caution this year.

We therefore recommend that the adult rate of the minimum wage should be increased to £5.52 in October 2007. This is less than the predicted increase in average earnings, but more than the predicted increase in prices and is broadly in line with current pay settlements. We recommend that the Youth Development Rate should increase from £4.45 to £4.60 and that the 16–17 year old rate should increase from £3.30 to £3.40 in October 2007.

We believe that, as the bite of the minimum wage increases, it becomes more important to take decisions based on the most up to date data available. That is why in this report we are making recommendations for minimum wage rates for October 2007 alone. We recommend that the Government invite us to make recommendations for October 2008 in early 2008. Our present view, drawing on the analysis we have made for this report, is that the increases we are likely to recommend for 2008 will be around the predicted rise in average earnings, but much will depend on what happens between then and now in

the economy and the labour market. Two of the most important factors will be the movement in average earnings and the level of employment – especially employment in the most affected sectors. We will also want to take account of price inflation and whether it falls back in 2007 as predicted.

After four years of substantial increases, this year we have proposed a relatively modest increase, although one in line with the majority of recent pay settlements. However, this year's recommendation needs to be seen in the context of the sequence of recommendations we have made over the last eight years.

Recommendations

National Minimum Wage Rates

We recommend that the adult rate of the minimum wage should be increased from £5.35 to £5.52 in October 2007. (Paragraph 7.44)

We recommend that the Youth Development Rate should increase from £4.45 to £4.60 and the 16–17 year old rate should increase from £3.30 to £3.40. (Paragraph 7.46)

Young People

We recommend again that 21 year olds should be entitled to the adult rate of the National Minimum Wage. (Paragraph 5.54)

Training

We reiterate our earlier recommendation that the Government invite us to carry out a full review of the apprentice and pre-apprentice exemptions and report in 2008. (Paragraph 5.67)

Awareness

We recommend that the Government work more collaboratively with other organisations to raise awareness of the minimum wage. (Paragraph 6.11)

Enforcement

We recommend that the Government, as part of its enforcement programme, choose a low-paying sector to target in 2007/08 that has a high concentration of migrant workers. (Paragraph 6.44)

We recommend that, as a deterrent to non-compliance, the Government introduce a penalty to apply to any employer found to have underpaid the minimum wage. (Paragraph 6.59)

Social Care

We recommend again that the Government continue to make clear that the commissioning policies of local authorities should reflect the costs of care provision. We emphasise, in particular, the need for the Government to monitor actively how far practice matches policy, to examine the reasons for any uneven provision, and, if appropriate, to provide further guidance. (Paragraph 3.73)

Accommodation Offset

We recommend that the accommodation offset should increase to £4.30 per day in October 2007. (Paragraph 4.72)

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Chapter 1

Introduction

In our remit for this report the Government asked us to monitor and evaluate the impact of the minimum wage and to consider its effect on different groups of workers. In this introductory chapter we explain how we set about fulfilling that remit and we describe the different parts of our work programme that have contributed to our conclusions and recommendations.

For this report we commissioned 11 research projects and carried out a survey of firms in low-paying sectors. We analysed data produced by the Office for National Statistics to establish better estimates of the incidence of low pay and to give us a greater appreciation of the sectors and the groups of people involved. We also used Office for National Statistics data to analyse the impact of the minimum wage on earnings, employment and other economic variables, and to estimate the likely impact of the Government's decision to increase statutory annual leave entitlement.

Consultation with employers, workers and their representatives continued to be an essential part of our work. We took written and oral evidence from a wide range of organisations and made visits throughout the UK to listen to the views of those affected by the minimum wage.

Background

1.1 This report builds on previous reports and reflects on the impact of the minimum wage since its introduction in April 1999. In our 2006 Report, having considered relevant data and research findings and consulted widely, we acknowledged that the phase in which we were committed, as a matter of principle, to increases in the minimum wage above the average increase in earnings was over. We indicated that, when making recommendations on uprating the minimum wage for October 2007,

we would start with no presumption that further increases above the growth in average earnings were required.

Terms of Reference

1.2 Our terms of reference from the Government in June 2006 asked us to:

> 'continue to monitor, evaluate and review the National Minimum Wage and its impact, with particular reference to the effect on pay, employment and competitiveness in the low-paying sectors and small firms; the effect on different groups of workers, including different age groups, ethnic minorities, women and people with disabilities; the effect on pay structures; and taking into account the forthcoming changes to the statutory annual leave entitlement.'

1.3 We were asked to report to the Prime Minister and Secretary of State for Trade and Industry by the end of February 2007.

Research

1.4 For this report we commissioned 11 research projects through an open tendering exercise to focus on key parts of our remit and to help us arrive at our recommendations. Our research programme adds significant value to our understanding of the minimum wage and its workings. This year we sought to gain a better understanding of a number of issues, such as the movement of workers in and out of minimum wage employment, differential consumption patterns among minimum wage households relative to others, the impact of migrants on the British labour market and the enforcement of the minimum wage.

1.5 We organised a research workshop in September 2006, which enabled many of the researchers to share their emerging findings with us and each other. A full list of the research projects and a summary of the findings is set out in Appendix 2. We will publish the research reports on our website (www.lowpay.gov.uk) and make them available for study in certain libraries[1].

[1] The British Library, London School of Economics, Cambridge University, University of Oxford, Bodleian Library, London Metropolitan University, University of Warwick, National Library of Scotland, National Library of Wales, Queen's University Belfast and Trinity College Dublin.

Analysis

1.6 We have continued to work closely with the Office for National Statistics (ONS) in order to improve the provision and reliability of data on earnings and employment. We are pleased to note that the ONS has produced a consistent earnings series, the Annual Survey of Hours and Earnings (ASHE) including supplementary information, for 2004–2006. It has also extended the ASHE series excluding supplementary data to cover 1997–2004. We are also grateful to the ONS for its work in improving the earnings data available from the Labour Force Survey (LFS), work which has informed our analyses of those with disabilities and ethnic minority groups.

1.7 In the last year, the LFS has moved from seasonal to calendar quarters. We have worked closely with the ONS to try to mitigate the impact of this discontinuity on our analyses. We are pleased to note that the ONS intends, from next Summer, to complete a back series of LFS calendar quarters. Although the change is too late for this report, it should enhance future reports. Changes to both the ASHE and LFS data series are set out in greater detail in Appendix 6.

1.8 We examined available ONS data relevant to the Government's decision to increase statutory entitlement to annual leave and we were given access to the outcome of separate surveys conducted by the Department of Trade and Industry to supplement this information. We also considered, with help from HM Treasury, the interaction of the minimum wage with the tax and benefits system. We continued to take a close interest in the implementation of legislation outlawing discrimination at work on grounds of age. We have also carried out a careful analysis of the coverage of the National Minimum Wage.

Employers' Survey

1.9 As in the past, we conducted a postal survey of employers in low-paying sectors to assess the impact of the previous year's upratings of the minimum wage. We had some reservations about conducting the survey given that previous surveys had not provided a representative sample. However, we decided to go ahead as we felt that the survey could provide an insight into the effect of the October 2005 upratings on those businesses for which the minimum wage has had particular

impact. It would also enable us to compare the views expressed with those of previous surveys and provide a useful medium to elicit views from employers on the likely impact of the increased entitlement to annual leave.

1.10 Following a competitive tendering exercise, GfK NOP was appointed to administer the survey. During the Summer of 2006 questionnaires were sent to over 33,000 businesses in 11 low-paying sectors throughout the UK. The survey achieved a 13 per cent response rate. We are grateful to those businesses that took the time to complete the questionnaires. Further information about the survey and details of the results are set out in Appendix 3.

Consultation

1.11 In preparing this report and the recommendations it contains, we have consulted widely. These consultations have involved individuals, businesses and representatives from each of the low-paying sectors and they have continued to enhance our understanding of the concerns raised.

1.12 The written consultation exercise began in June. We encouraged individuals, firms and organisations to submit their evidence to us. We received over 90 written responses from employer organisations, trade associations, unions, voluntary organisations, pressure groups, academics and the Government.

1.13 We also held oral evidence sessions over two days, which gave a number of organisations the opportunity to expand on points they had made in their written evidence. They included the CBI, the TUC, the YWCA and delegations representing employers and workers in the low-paying sectors, including the hospitality, retail and cleaning sectors. We found these sessions informative and productive.

Visits

1.14 As part of our monitoring of the impact of the minimum wage and as part of our programme of consultation, we are always keen to hear first hand the views of groups with an interest in the minimum wage. We want to know how it is affecting them. Our programme of visits

focused on the low-paying sectors and we met representatives from small, medium-sized and large firms, as well as trade bodies and representatives from a variety of voluntary organisations, local authorities and unions representing workers in these sectors. We also met a number of workers. We had the opportunity to visit a range of urban and rural areas of England including Birmingham, Cornwall, Hull, Leicester, London, and Norfolk. We also had meetings in Belfast in Northern Ireland; Glasgow, Greenock, Fort William and Perth in Scotland; and Swansea in Wales. We are grateful to all of those who assisted us with these visits.

Conclusion

1.15 Finally, we would like to emphasise again our gratitude to the many organisations and individuals who have shared their views with us over the course of the past two years. Their contributions have proved extremely valuable.

Chapter 2

The Impact of the National Minimum Wage

One of the key ways to measure the impact of the minimum wage is by means of its 'bite' – defined as the ratio of the adult minimum wage to the median hourly wage. The bite has grown from 47.6 per cent of median earnings when it was introduced in April 1999, to around 53 per cent in October 2006. Prior to the 2005 Report, the adult minimum wage increased by 35 per cent, while average earnings grew by 26 per cent. When we were preparing our 2005 Report, independent forecasts indicated that the minimum wage increases we were proposing for October 2005 and October 2006 would be slighly higher than average earnings growth. In the event, average earnings grew by less than predicted – 8 per cent compared with the forecast 9.2 per cent – and, as a result, the bite of the minimum wage increased faster than anticipated. There is little evidence that this had any significant negative impact on employment, profits or prices over the period in question, although it is too early to assess fully the impact of the October 2006 upratings. As with average earnings, the forecast growth in the UK economy for 2005 and 2006 was not fully realised. Although predicted to grow at around 2.5 per cent in both 2005 and 2006, the economy slowed sharply in 2005 before it recovered in 2006. At the same time, price inflation grew faster than had been forecast, with the effect that the minimum wage grew less in real terms than had been expected.

In terms of coverage, using the average earnings assumption, we now estimate that the 2005 minimum wage upratings covered about 0.8 million employee jobs and that the larger increase in October 2006 covered around 1.25 million employee jobs. Estimates using the prices assumption are similar. One disadvantage of the way we traditionally calculate coverage is that it cannot allow for employers putting up wages in anticipation of statutory upratings. In a review of our coverage methodology this year, we developed an alternative approach. By downrating the minimum wage back to 1998 using the growth in

average wages we can estimate what coverage would have been in 1998 before the earnings distribution had been affected by the minimum wage. Using this method, we calculated that the 2006 adult minimum wage was equivalent to nearly £4.00 in 1999, higher than the actual introductory rate of £3.60. We estimated that such an introductory rate would have covered nearly 8 per cent of adult employee jobs – almost double the estimated actual initial coverage of about 4 per cent.

Despite the slowdown in the economy towards the end of 2004 and throughout 2005, the UK labour market continued to create jobs. Total employment rose to a new record high of 29.03 million in the three months to November 2006. In our 2006 Report we noted that, since 2004, the private sector had experienced slower growth in wages and jobs than the public sector. This situation has been reversed in 2006 with both employment and average earnings growing faster in the private sector.

However, not all employment data are positive. Worryingly, employment in the low-paying sectors as a whole fell for the first time since the introduction of the minimum wage. Employment in these sectors has continued to be below its 2005 level throughout the first three quarters of 2006, but the fall has been weaker with each quarter suggesting that there has been some recovery. This recovery is expected to continue as the evidence suggests that consumer expenditure has picked up after the sharp decline in 2005.

The working age employment rate remained high in 2006, but it fell from the peak reached in the first quarter of 2005. This has been attributed to a number of factors, amongst which was the slowdown in the UK economy in 2005 and the increasing participation of older workers. Unemployment increased throughout 2005 and into much of 2006. The increase in the number of migrant workers and the growing number of older workers and women entering the labour marker were also widely seen as contributory factors. Since October 2006 the unemployment count has slowly flattened and started to fall.

Turning to other economic indicators, we see a mixed picture for 2005 and 2006. The evidence on profits is not consistent. The rate of return on capital employed is currently at or close to its record highs. However, these large and increasing returns are confined to the services and oil sectors. Share prices, as measured on the FTSE, have been strong and

have grown substantially in the last 18 months. Profits measured by profit share of national income have also increased and looked healthy in 2006. However, excluding the volatile oil and financial sectors, the profits picture does not look so rosy. One other indicator of profit is the margin between input and output prices. In 2005 there were sharp increases in input prices, mainly as a result of increases in fuel, energy and commodity costs, but the corresponding increases in output prices were much lower. In 2006, input prices have fallen sharply, but remain higher than output prices even though output prices have increased.

Price inflation was subdued until the latter half of 2006. Despite the large increases in the price of oil, consumer inflation in the UK remained stable in 2005 and the first half of 2006. However, price inflation in December 2006 was at its highest for over a decade driven by increases in fuel and food. Labour productivity increased in 2005 and 2006, with a marked increase in the two main low-paying sectors, retail and hospitality.

Over the past two years there has been an improvement in the quality and reliability of the earnings and employment data provided to us by the Office for National Statistics, a development that we warmly welcome. The main changes are set out in Appendix 6. Unavoidably, these improvements have caused another problem – discontinuity. The data sets that we most use in our analyses – the Labour Force Survey and the Annual Survey of Hours and Earnings – are subject to significant discontinuities. This makes comparisons over time difficult and we urge the Office for National Statistics to do everything possible in order to produce consistent time series prior to our next report. We look forward to working with the Office for National Statistics in their continuing efforts to improve the quality of the information provided. We would also welcome additional information on the labour market performance of migrant and agency workers.

Introduction

2.1 In this chapter we assess the impact of the minimum wage since its introduction, but focus in particular on the two most recent upratings in October 2005 and October 2006. The chapter is in six main parts:

- First, we set the scene with a short history of the National Minimum Wage followed by a brief consideration of the macroeconomic context.
- Then we look at the impact of the 2005 and 2006 upratings on earnings, coverage and differentials.
- We move next to look at the workers affected. We consider the characteristics of workers in minimum wage jobs. We look at how long people stay in minimum wage jobs. And we discuss the impact of the minimum wage on household income.
- Having established the impact on earnings, we look at the effect on the labour market, including the impact on employment, unemployment, inactivity, hours, vacancies and redundancies.
- We then look at the impact on firms, including prices, profits, productivity, training, and business start-ups and failures.
- We conclude with an overall assessment.

A Short History

2.2 The Low Pay Commission was set up in 1997 and was asked by the Government to recommend a rate for the UK's first ever National Minimum Wage. Mindful of the international experience and the latest research at that time, we recommended that the National Minimum Wage be set initially at a cautious level. The Government accepted our recommendation and, in April 1999, introduced the new National Minimum Wage at £3.60 an hour for workers aged 22 and over. A lower rate of £3.00 was introduced for young people aged 18–21 and for adults on accredited training schemes. Table 2.1 sets out the evolution of the National Minimum Wage.

Table 2.1
The Evolution of the National Minimum Wage, 1999–2007

	Age 16–17		Age 18–21		Age 22 and over	
	NMW	Change (%)	NMW	Change (%)	NMW	Change (%)
Apr 1999–May 2000			£3.00		£3.60	
Jun 2000–Sep 2000			£3.20	6.7	£3.60	0.0
Oct 2000–Sep 2001			£3.20	0.0	£3.70	2.8
Oct 2001–Sep 2002			£3.50	9.4	£4.10	10.8
Oct 2002–Sep 2003			£3.60	2.9	£4.20	2.4
Oct 2003–Sep 2004			£3.80	5.6	£4.50	7.1
Oct 2004–Sep 2005	£3.00		£4.10	7.9	£4.85	7.8
Oct 2005–Sep 2006	**£3.00**	**0.0**	**£4.25**	**3.7**	**£5.05**	**4.1**
Oct 2006–Sep 2007	**£3.30**	**10.0**	**£4.45**	**4.7**	**£5.35**	**5.9**

Source: Low Pay Commission.

The Adult Rate

2.3 In the early years, we continued to take a cautious approach as we collected data and commissioned research into the impact of the introduction of the minimum wage on earnings, employment, hours, prices, profits, productivity and training. From these analyses, we satisfied ourselves that there was little or no evidence of any significant adverse impact on the economy as a whole, or on low-paid workers or on low-paying sectors as a result of the introduction of the National Minimum Wage.

2.4 Consequently, in our Third Report (2001a, 2001b), we recommended that the increases in 2001 and 2002 should raise the adult minimum wage to the level that it would have reached had it been increased in line with average earnings growth since its introduction. As the adult minimum wage had, until that point, only increased by ten pence since its introduction, and employers who provided evidence had requested a period of respite to restore differentials, it was decided to front load the increase. Accordingly, the adult minimum wage rose by nearly 11 per cent in October 2001, but by only 2.4 per cent in October 2002.

2.5 With the labour market remaining robust and the minimum wage continuing to have little discernible adverse impact on the economy, we recommended in our Fourth Report (2003) that the increases in the minimum wage for October 2003 and October 2004 should again be above predicted growth in average earnings. This time, most employers with whom we had consulted had requested that the

increases be more evenly spread. Consequently, the minimum wage rose by 7.1 per cent in October 2003 and by 7.8 per cent in October 2004. This led to another step change, whereby the adult minimum wage was now growing at a faster rate than average earnings growth.

2.6 Given that the minimum wage had been raised significantly above average earnings growth between October 2001 and September 2005, we recommended in our 2005 Report that it should be increased only marginally above predicted growth in average earnings in 2005 and 2006. In evidence gathered for the 2005 Report, employers in general had requested that the increase should be back-loaded, enabling employers to adjust differentials after the large minimum wage increases in 2003 and 2004. We took account of these representations and recommended a 4.1 per cent increase in October 2005 followed by a 5.9 per cent increase in October 2006.

2.7 When we came to review our recommendation for October 2006 in the 2006 Report, we found that actual average earnings growth had been lower than had been originally forecast in the 2005 Report[1]. At that time we had anticipated that average wages would increase by 4.5 per cent in 2005 whereas in fact they had only increased by 3.7 per cent[2]. This meant that the recommended minimum wage increase relative to average earnings was greater than anticipated.

2.8 Further, actual economic growth in 2005 had been less robust than anticipated in the 2005 Report, and forecast growth for 2006 had been shaded down. However, although unemployment had been rising, the labour market continued to be robust with employment increasing to record levels. The latest official data available (up to September 2005) indicated that employment growth in retail and hospitality was declining, as a result of the contraction in consumer spending in 2005, but it was still positive. In the light of this evidence, the Commission agreed, on balance, that *'the divergence of economic outcomes from those anticipated was not a sufficient basis on which to agree a*

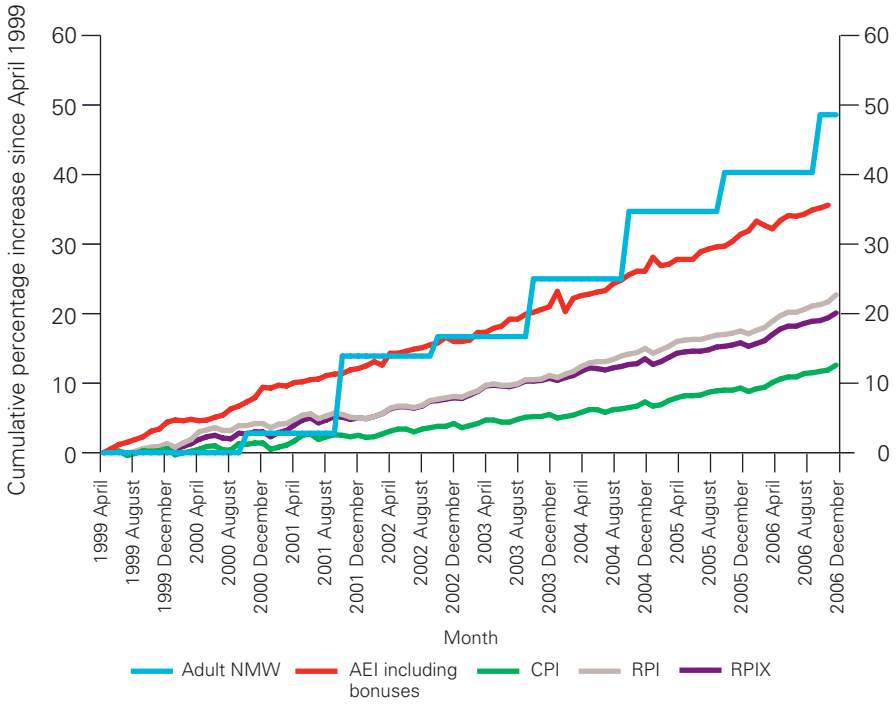
[1] Using the median of forecasts from the HM Treasury Panel of Independent Forecasts for February 2005.

[2] Including bonuses or excluding bonuses makes little difference. For consistency with other analyses in this chapter, we use the Average Earnings Index (AEI) including bonuses.

reduction in the 2006 increase'. Therefore, we confirmed our original recommendations for October 2006, while noting that the economy was not as strong as it had been.

2.9 The history is graphically illustrated by Figure 2.1. Before the introduction of the minimum wage, the wages of the lowest paid often lagged behind increases in inflation, let alone the average increases in wages. Figure 2.1 shows that, after a cautious start, the minimum wage quickly began to increase in real terms, rising faster than the increases in retail price inflation. And since 2004 it has been increasing faster than average earnings. By December 2006 the value of the adult hourly rate of the minimum wage had increased by 49 per cent since its introduction. Over the same period, the Retail Price Index (RPI) increased by 23 per cent and average earnings by 36 per cent.

Figure 2.1
Increases in the Adult National Minimum Wage Compared With Changes in Prices (UK) and Average Wages (GB), 1999–2006



Source: LPC estimates based on ONS data, AEI including bonuses (ONS code LNMQ), RPIX (ONS code CHMK), RPI (ONS code CHAW) and CPI (ONS code D7BT), monthly, seasonally adjusted (not seasonally adjusted for RPIX, RPI and CPI), GB (UK for RPIX, RPI and CPI), 1999–2006.

The Youth Rates

2.10 Since the introduction of the National Minimum Wage, the Youth Development Rate (covering those aged 18–21) has followed a similar upward trend to the adult rate, but at about 85 per cent of its value. Alerted to evidence that some employers were offering young people jobs for very low wages with no training or development prospects, we recommended in a special report (2004) that the National Minimum Wage be extended to cover all those over the school leaving age. Previously those under the age of 18 had been exempt. The rate for 16–17 year olds was deliberately set cautiously to avoid any adverse impact on participation in training or education while at the same time providing a wage floor to minimise exploitation.

The Economic Background

2.11 In this section, we first look at the record of the forecasts we used to help us come to our recommendations for October 2005 and October 2006. We then give a brief overview of how the UK economy has performed in 2005 and 2006.

Forecasts for 2005 and 2006

2.12 In February 2005, when we made our initial recommendations on the minimum wage rates for October 2005 and October 2006, the economy was forecast[3] to grow at around 2.6 per cent in 2005 and 2.5 per cent in 2006. It actually grew by 1.9 per cent in 2005 and looks set to grow at around 2.9 per cent in 2006. Growth in 2005, as a result of a slowdown in consumer expenditure, was well below that forecast. However, growth in 2006 has exceeded expectations. Taking 2005 and 2006 together, the economy was forecast to grow by 5.2 per cent but is now expected to have grown by about 4.9 per cent.

2.13 Actual inflation has turned out higher than forecast inflation in both 2005 and 2006. At the time of our 2005 Report, consumer price inflation was expected to increase by 1.8 per cent in 2005 and 1.9 per cent in 2006 (if measured by the Consumer Price Index (CPI)) and by

[3] Using the median of forecasts from the HM Treasury Panel of Independent Forecasts for February 2005.

2.4 per cent in 2005 and 2.5 per cent in 2006 (if measured by RPI). According to the CPI, actual consumer prices rose by 2.3 per cent in 2005 and 2.4 per cent in 2006. Using the RPI, they rose by 2.5 per cent and 3.7 per cent, respectively[4].

2.14 Average wage growth has been lower than forecast in both 2005 and 2006. Given that price inflation has been higher than anticipated, it is perhaps surprising that average wage growth has been so subdued. Taking 2005 and 2006 together, average earnings were expected to grow by 9.2 per cent over this period but they have actually grown by only 7.8 per cent.

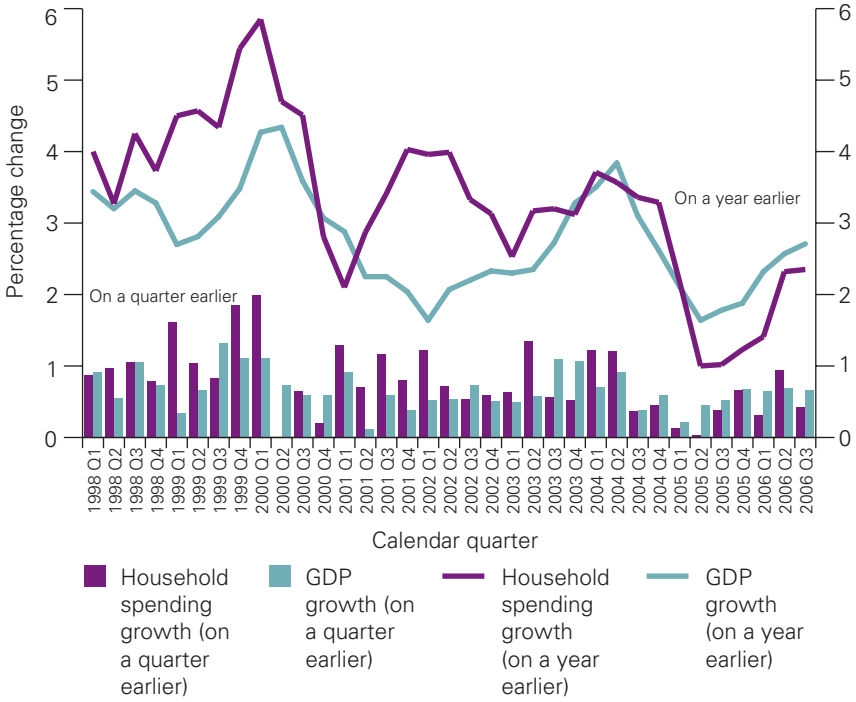
2.15 During this period, the adult minimum wage rose by 10.3 per cent – about two and a half percentage points more than average earnings. However, it rose slightly less than expected when set against inflation. The adult minimum wage was expected to increase by 5.3 percentage points more than RPI price inflation but it has in fact grown by 4.0 percentage points more than this measure.

The UK Economy

2.16 After experiencing falling growth from the middle of 2004 and into early 2005, Figure 2.2 shows that the UK economy picked up towards the end of 2005 and has now grown at or around trend for four consecutive quarters (up to the third quarter of 2006).

[4] For the year to October 2005 and the year to October 2006.

Figure 2.2
Growth in Gross Domestic Product and Household Spending, UK, 1998–2006



Source: LPC estimates based on ONS data, household final consumption expenditure (ONS code ABJR) and gross domestic product (GDP) (ONS code ABMI), calendar quarters, seasonally adjusted, UK, 1998–2006.

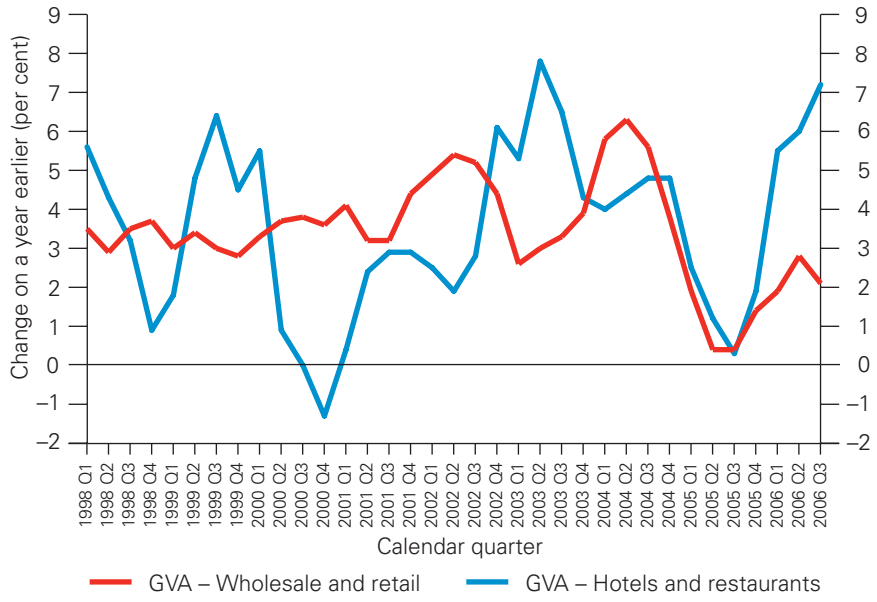
2.17 Household spending has been volatile over the last year or so but, when smoothed, appears to show reasonable growth, albeit not quite at the rate of expansion seen in 2003 and 2004. Government spending has also begun to slow. However, business investment has recovered and has continued to grow strongly into 2006. The composition of global growth has benefited UK trade as the European economy, the UK's major export market, has strengthened. Thus, the UK economy is now growing at or around trend and is no longer so dependent on consumer and government spending. However, the rise in short-term interest rates and the appreciation of sterling may make things more difficult for UK exporters.

2.18 Employment has continued to grow, reaching record levels in the third quarter of 2006. However, increased participation by workers over the age of retirement and those previously on incapacity benefits, along with the increasing number of migrant workers, particularly from central and eastern Europe, has contributed to a rise in unemployment since the beginning of 2005.

2.19 In the third quarter of 2006, oil and gas prices have fallen back from the large increases seen in the first half of 2006. Basic pay growth remains subdued, but inflation has risen above the Bank of England target and house prices have grown strongly.

2.20 Looking at low-paying sectors, Figure 2.3 clearly shows that the two largest low-paying sectors in terms of employment, retail and hospitality, were adversely affected by the downturn in consumer spending from the middle of 2004 to the middle of 2005. The retail sector experienced growth rates in excess of 3 per cent from the first quarter of 1998 to the end of 2004. The hospitality sector also grew strongly throughout this period with the exception of the downturn, partly as a result of the widespread foot and mouth outbreak, between the second quarters of 2000 and 2001.

Figure 2.3
Output Growth (Measured as Gross Value Added (GVA)) in the Wholesale & Retail and Hospitality Sectors, UK, 1998–2006



Source: LPC estimates based on ONS data, GVA in wholesale and retail (ONS code GDQC) and hotels and restaurants (ONS code GDQD), calendar quarters, seasonally adjusted, UK, 1998–2006.

2.21 The reduction in the growth of consumer spending from the middle of 2004 to the middle of 2005 had an adverse impact on both retail and hospitality, with annual growth rates of 6 per cent in retail and of 5 per cent in hospitality plummeting to just above zero by the middle of 2005. Consumer spending started to recover in the middle of 2005 and

has strengthened into 2006, helping both retail and hospitality. In the third quarter of 2006, growth in hospitality was running at an annualised rate of 7.2 per cent. During the same period, the recovery in retail was less strong (2.1 per cent). Data from the Office for National Statistics (ONS), the CBI and the British Retail Consortium (BRC) all seem to show that, after increasing rapidly in the Spring, retail sales growth stuttered in the rest of 2006. However, recent evidence from the same sources suggests that sales for Christmas 2006 were strong. We examine the low-paying sectors in more detail in Chapter 3.

2.22 In conclusion, after growing below trend in 2005, the UK economy has recovered in 2006. Manufacturing output has picked up in recent quarters but it is the service sector that continues to lead growth buoyed by a strong performance from business services and finance. There continues to be weakness in the distributive sector, which includes retail and hospitality, although the preliminary estimates for the fourth quarter show a substantial acceleration in annual output growth in the sector.

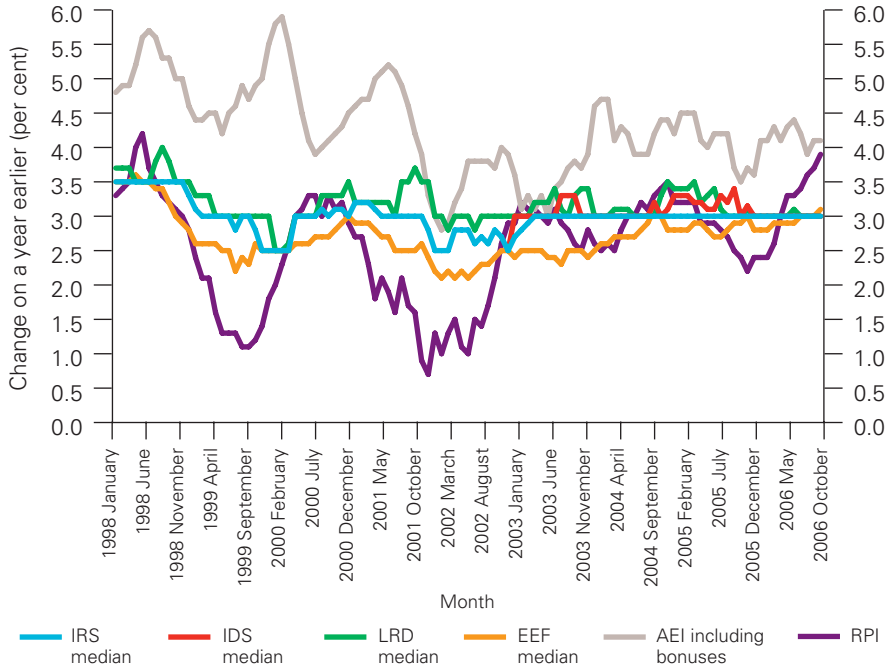
Average Earnings and Pay Settlements

2.23 We next look at average earnings growth and pay settlements in the economy. Despite the recent rise in price inflation, wage inflation continues to be moderate whether using the official ONS measures (the Average Earnings Index (AEI) including or excluding bonuses) or pay settlement data from independent private sector sources. The ONS does not collect data on pay settlements. The main providers of such data are Incomes Data Services (IDS), Industrial Relations Services (IRS), the Labour Research Department (LRD) and EEF, The Manufacturers' Organisation.

2.24 Trends in median pay settlement growth as measured by these independent organisations and official average earnings growth are shown in Figure 2.4. Price inflation (as measured by RPI) is also shown. AEI growth is typically about one percentage point higher than the median level of pay settlements, which in recent years have tended to be similar to RPI. Average earnings including bonuses have grown at around 4 per cent since the beginning of 2004, compared with around 3 per cent for pay settlements. The AEI captures the totality of changes in all elements of pay such as bonuses, pay progression, interim

adjustments and pay restructuring outside the annual pay review, as well as changes in workforce composition. Pay settlements, on the other hand, only capture consolidated increases in basic pay and performance-related pay rises.

Figure 2.4
Comparison of Growth in Average Earnings (GB) with Median Pay Settlements and Price Inflation (UK), 1998–2006



Source: ONS, AEI including bonuses (ONS code LNNC), RPI (ONS code CZBH), IRS, IDS, LRD and EEF pay databank records, monthly, seasonally adjusted, UK (GB for AEI), 1998–2006.
Notes:
1. The AEI growth rates shown are 3-month average percentage changes; the 3-month average change is the change in the average seasonally adjusted index value for the last 3 months compared with the same period a year earlier.
2. The RPI growth rates are percentage changes over a year earlier. These figures are not seasonally adjusted.
3. The IDS monthly series began in December 2002.
4. Pay settlements are medians over 3 months.

2.25 Average wages including bonuses grew by 4.1 per cent in the year to November 2006. If we exclude the impact of bonuses, earnings growth has been declining slowly since the end of 2004. In the three months to November 2006, earnings excluding bonuses grew by 3.7 per cent. These increases are lower than the 4.5 per cent increase that had been forecast when we recommended our minimum wage upratings for 2005 and 2006 in February 2005. Since the beginning of 2003, median pay settlements have remained broadly static at around 3 per cent on

all measures. Over the same period RPI has fluctuated just below this level.

2.26 There are various explanations for the subdued rate of growth in average earnings and pay settlements. One plausible explanation is that the recent increases in non-labour (energy) costs have forced businesses to keep a lid on wage increases in order to compensate for the higher input costs. It has also been argued that sluggish domestic demand may be the reason behind companies' reluctance to raise wages. Weakening demand, as well as the threat that domestic jobs could move offshore, may have also forced workers to avoid or delay demands for higher wages in an environment of uncertain job prospects. Another argument that has been voiced recently is that the increased flow of migrant workers into the UK has exerted downward pressure on wages. Recent research on migration by Gilpin, Henty, Lemos, Portes and Bullen (2006) and Blanchflower, Saleheen and Shadforth (2007) finds no evidence of such a relationship. However, Dustmann, Frattini and Preston (2007) do find evidence of such an impact but only at the bottom end of the earnings distribution.

2.27 Price inflation has edged up further recently, driven mainly by increases in utility and petrol prices. The latest inflation data for December 2006 show RPI (4.4 per cent) twice as high as in the same period a year earlier and higher than average earnings growth including or excluding bonuses. Indeed, RPI increased faster than the consensus forecast average earnings growth for 2007 (4.3 per cent). Excluding mortgage interest payments, inflation as measured by RPIX was 3.8 per cent, and the CPI was 3.0 per cent, well above the Government's inflation target (2.0 per cent). Higher inflation may be starting to have an impact on pay negotiations. IDS (2007) noted that there had been a small upward shift in the lower and upper quartile of its pay settlements.

Impact of the National Minimum Wage on Earnings

2.28 In this section we look at the impact of the minimum wage on earnings, concentrating particularly on the October 2005 and October 2006 upratings. First, we look at the 'bite' of the minimum wage, how it has changed relative to various points on the hourly earnings

distribution. We then look at whether the minimum wage has affected the distribution of hourly earnings among the low-paid. We next look at coverage in order to estimate the number of jobs covered by the October 2005 and October 2006 upratings. Differentials are then analysed. Finally, we investigate the characteristics of those covered by the 2006 October upratings.

The 'Bite' of the Minimum Wage

2.29 We start by looking at how the minimum wage has changed since its introduction relative to various points on the hourly earnings distribution. In terms of the median, the adult minimum wage went above half median hourly earnings for the first time in 2005 but it is still below 40 per cent of the mean. Table 2.2 shows that the 'bite' of the minimum wage measured against the mean or the median had fluctuated, noticeably increasing after the large increase in October 2001 (ASHE 2002 data in the table), but was no higher in 2003 than it had been at the introduction of the minimum wage. Between 2001 and 2005, however, the 'bite' measured against the median increased by nearly six percentage points although it remained flat in 2006.

Table 2.2
The National Minimum Wage as a Percentage of Various Points on the Earnings Distribution, UK, 1999–2006

		Adult NMW (£)	Adult minimum wage as % of Lowest decile	Lowest quartile	Median	Mean	Upper quartile	Upper decile
ASHE without supplementary information	**1999**	3.60	87.0	68.3	**47.6**	36.7	31.3	21.6
	2000	3.60	83.3	65.7	**46.2**	35.3	30.2	20.9
	2001	3.70	82.2	64.8	**45.2**	34.2	29.5	20.3
	2002	4.10	86.7	69.0	**48.1**	36.0	31.3	21.4
	2003	4.20	84.0	67.5	**47.5**	35.7	30.9	21.1
	2004	4.50	87.2	69.4	**48.5**	36.7	31.6	21.7
ASHE with supplementary information	**2004**	4.50	87.5	70.0	**49.0**	37.4	32.0	22.0
	2005	4.85	91.0	72.9	**51.1**	38.6	33.2	22.7
	2006	5.05	91.2	72.8	**51.1**	38.6	33.0	22.6

Source: LPC estimates based on the Annual Survey of Hours and Earnings (ASHE) without supplementary information, low-pay weights, UK, April 1999–2004 and ASHE with supplementary information, low-pay weights, UK, April 2004–2006.
Note: Direct comparisons before and after 2004 should be made with care due to changes in the data series.

Impact on the Distribution of Earnings

2.30 We now consider the hourly earnings distribution for adult workers (aged 22 and over). The hourly earnings distributions for younger workers are considered in Chapter 5.

2.31 The impact of the adult minimum wage can clearly be seen in Figure 2.5. There is a concentration of the adult workforce at the National Minimum Wage in all three years considered. This concentration is greatest in April 2006, when nearly two per cent of all jobs were paid at £5.05 an hour. There is also a much larger spike for jobs paid immediately below the minimum wage than in previous years; this may be a result of rounding to £5[5].

Figure 2.5
Hourly Earnings Distribution for Employees Aged 22 and Over, UK, 2004–2006

Source: LPC estimates based on ASHE with supplementary information, low-pay weights, UK, 2004–2006.

2.32 In April 2006, there were peaks in the adult earnings distribution at around £5.05 (the then National Minimum Wage) and £5.50, and also at £6.00 and £6.50 (not shown). Similar peaks at rounded values are observed for 2004 and 2005. These peaks lend support to the idea that

[5] We note in the data that some employers have rounded weekly pay or annual pay. For example, some employers have rounded weekly pay down to £200 (from £202) but have also stated that they pay £5.05 an hour and the employee works 40 hours a week.

firms, particularly those in the low-paying sectors, have a 'mezzanine' level: that is, firms do not want to be seen as 'minimum wage employers' and thus set their pay rates slightly higher.

Coverage

2.33 We now consider how many workers are directly affected by the National Minimum Wage. We start this section by noting the number of jobs that were paid below the existing and forthcoming minimum wage rates. We show how this has varied since the introduction of the minimum wage. We next estimate the number of jobs that were covered by the 2005 and 2006 upratings. We also produce coverage estimates using an alternative methodology.

Jobs Paid Below the Minimum Wage in April 2006

2.34 ONS data consistently show that some workers are being paid below the minimum wage. Annual Survey of Hours and Earnings (ASHE) estimates for April 2006 show that 336,000 jobs were held by people aged 16 or over with hourly pay below the appropriate National Minimum Wage rate. This represents 1.3 per cent of all UK jobs. Most of these jobs were part-time and held by women.

2.35 These figures should not be interpreted as the number of workers being denied their legal right to the minimum wage. Some workers may legitimately be paid below the minimum wage. For example, it is not possible to identify those who are exempt from the minimum wage because they are apprentices. If employers provide accommodation, they are entitled to offset minimum wage pay by up to £4.15 per day. We go on to discuss issues of compliance and enforcement in Chapter 6.

Table 2.3

Number of Jobs Paying Below the National Minimum Wage, All Employees, UK, 1998–2006

	Jobs held by employees aged 16–17		Jobs held by employees aged 18–21		Jobs held by employees aged 22 and over		All jobs	
	000s	Per cent	000s	Per cent	000s	Per cent	000s	Per cent
Spring 1998[1]			110	7.2	1,170	5.4	1,280	5.6
Spring 1999[2]			40	2.4	460	2.1	490	2.1
Spring 2000[2]			30	2.2	190	0.9	230	1.0
Spring 2001[3]			40	2.1	210	0.9	240	1.0
Spring 2002[4]			50	2.7	290	1.3	340	1.4
Spring 2003[5]			40	2.3	210	0.9	250	1.0
Spring 2004[6]			38	2.3	232	1.0	270	1.1
Spring 2004[7]			44	2.3	233	1.0	276	1.1
Spring 2005[8]	20	4.0	55	3.0	233	1.0	308	1.2
Spring 2006[9]	15	4.3	48	2.5	274	1.2	336	1.3

Source: ONS low pay methodology estimates for 1998–2003 are based on a central estimate of the Labour Force Survey (LFS) and ASHE, without supplementary information. ONS low pay methodology estimates for 2004–2006 use only ASHE with supplementary information.

Notes:

1. Figures for Spring 1998, before the National Minimum Wage was introduced, are for the number of jobs paid at less than £3.00 per hour (aged 18–21) or £3.60 per hour (aged 22 and over).
2. Rate is £3.00 per hour (aged 18–21) or £3.60 per hour (aged 22 and over).
3. Rate is £3.20 per hour (aged 18–21) or £3.70 per hour (aged 22 and over).
4. Rate is £3.50 per hour (aged 18–21) or £4.10 per hour (aged 22 and over).
5. Rate is £3.60 per hour (aged 18–21) or £4.20 per hour (aged 22 and over).
6. Rate is £3.80 per hour (aged 18–21) or £4.50 per hour (aged 22 and over).
7. Rate is £3.80 per hour (aged 18–21) or £4.50 per hour (aged 22 and over).
8. Rate is £3.00 per hour (aged 16–17) or £4.10 per hour (aged 18–21) or £4.85 per hour (aged 22 and over).
9. Rate is £3.00 per hour (aged 16–17) or £4.25 per hour (aged 18–21) or £5.05 per hour (aged 22 and over).
10. Numbers for 1998–2003 are rounded to the nearest 10,000.

2.36 Table 2.3 shows that there was an increase in the numbers of jobs paying below the minimum wage in 2006 compared with 2005 but these are fewer than after the large minimum wage upratings of October 2001 (as shown by the April 2002 data). Rounding of weekly pay or annual pay and slow adjustment by employers are more likely causes than an increase in non-compliance.

Jobs in April Paid Below the Forthcoming October Minimum Wage

2.37 Table 2.4 shows that the percentage of jobs held by adults aged 22 and over paid below the minimum wage in April each year, which was 1.2 per cent in 2006, has tended to fluctuate just below that level. But on average, in April each year, a further 4 to 5 per cent are paid below the hourly rate at which the minimum wage is due to be fixed in six months' time. As we would expect, this percentage is higher when a

large increase in the minimum wage is planned. The percentage covered in 2006 is similar in magnitude to that of 2001, when the minimum wage increased by over 10 per cent. A similar analysis is conducted for young workers in Chapter 5.

Table 2.4
Jobs Held By Adults (Aged 22 and Over) Paying Below the Existing National Minimum Wage and the Forthcoming National Minimum Wage, UK, 1999–2006

Data year (April)	Adult minimum wage rate (in April) (£)	Proposed October adult minimum wage rate (£)	Number of jobs held by adults paying less than the adult rate in April (000s)	Number of jobs held by adults in April paying less than the proposed October rate (000s)	Percentage of all employee jobs paying less than the adult rate in April	Percentage of all employee jobs in April paying less than the proposed October rate
1999	3.60	3.60	458	458	2.1	2.1
2000	3.60	3.70	195	746	0.9	3.3
2001	3.70	4.10	207	1,326	0.9	5.9
2002	4.10	4.20	290	920	1.3	4.1
2003	4.20	4.50	211	1,022	0.9	4.5
2004	4.50	4.85	232	1,399	1.0	6.2
2004	4.50	4.85	233	1,209	1.0	5.3
2005	4.85	5.05	233	1,147	1.0	5.0
2006	5.05	5.35	274	1,319	1.2	5.7

Source: ONS central estimates using ASHE without supplementary information and LFS for 1999–2004. LPC estimates using ASHE with supplementary information, low-pay weights, UK, 2004–2006.

Jobs Covered By the 2005 and 2006 Upratings

2.38 In order to estimate how many workers are covered by a minimum wage uprating we first calculate how many workers are expected to have received a wage increase between April and October to bring them from below to at least the October minimum wage level. These workers are not included in our estimates. Calculating this estimate, however, requires an assumption about what wage increases would have been in the absence of the National Minimum Wage. We make an estimate using two alternative assumptions: that the earnings of the low-paid would have risen in line with average earnings during this period; or that they would have increased in line with prices.

2.39 To estimate the numbers covered using either of these assumptions, we calculate a 'downrated' equivalent value in April of the October minimum wage rate (rounded up to the nearest 5 pence). As Table 2.5 indicates, in our 2005 Report using data from April 2004, we estimated

that around 1.3 million jobs would be covered by the October 2005 upratings using the earnings assumption. In the subsequent 2006 Report, using data from April 2005, we revised our estimates downwards to 0.87 million. Using revised data for 2005, released in October 2006, we now estimate that about 0.83 million jobs will have been covered by the 2005 upratings.

Table 2.5
Estimated Coverage of the 2005 Upratings Using the Earnings and Prices Assumptions, UK

October 2005		Earnings assumption		Prices assumption	
		Numbers	(%)	Numbers	(%)
2005 Report (February 2005 using provisional April 2004 data)	Adults £5.05	1.09 million	4.7	1.47 million	6.3
	18–21 £4.25	120,000	6.3	150,000	7.9
	16–17 £3.00	40,000	7.5	40,000	7.5
	All	**1.30 million**	**5.2**	**1.66 million**	**6.7**
2006 Report (February 2006 using provisional April 2005 data)	Adults £5.05	0.74 million	3.2	0.85 million	3.7
	18–21 £4.25	110,000	6.2	110,000	6.2
	16–17 £3.00	20,000	4.0	20,000	4.0
	All	**0.87 million**	**3.6**	**0.98 million**	**4.0**
2007 Report (February 2007 using finalised April 2005 data)	Adults £5.05	0.71 million	3.1	0.78 million	3.4
	18–21 £4.25	106,000	5.8	109,000	6.0
	16–17 £3.00	18,000	3.7	18,000	3.7
	All	**0.83 million**	**3.3**	**0.91 million**	**3.6**

Sources: LPC 2005 Report (2005), LPC 2006 Report (2006), LPC estimates based on ASHE with supplementary information, low-pay weights, UK, 2004–2005.
Note: Youths are aged 18–21 and adults 22 and over in these estimates.

2.40 Table 2.6 shows that in our 2005 Report, using data from April 2004, we estimated that around 1.29 million jobs would be covered by the October 2006 upratings using the earnings assumption. In the subsequent 2006 Report, using data from April 2005, we revised our estimates marginally to 1.28 million. The latest estimate using April 2006 data is that 1.25 million jobs were covered by the 2006 upratings. But, crucially, many more may have received the benefit of an anticipatory wage increase before April. While these workers clearly benefited from the minimum wage uprating, they will not be captured within our coverage estimates.

Table 2.6
Estimated Coverage of the 2006 Upratings Using the Earnings and Prices Assumptions, UK

October 2006		Earnings assumption		Prices assumption	
		Numbers	(%)	Numbers	(%)
2005 Report (February 2005 using provisional April 2004 data)	Adults £5.35	1.13 million	5.0	1.82 million	8.0
	18–21 £4.45	120,000	6.3	180,000	9.7
	16–17 £3.00[1]	40,000	7.5	40,000	7.5
	All	**1.29 million**	**5.2**	**2.04 million**	**8.2**
2006 Report (February 2006 using provisional April 2005 data)	Adults £5.35	1.17 million	5.1	1.49 million	6.5
	18–21 £4.45	110,000	6.2	140,000	7.9
	16–17 £3.30	30,000	6.3	32,000	6.5
	All	**1.28 million**	**5.2**	**1.63 million**	**6.6**
2007 Report (February 2007 using provisional April 2006 data)	Adults £5.35	1.10 million	4.8	1.16 million	5.0
	18–21 £4.45	121,000	6.2	123,000	6.4
	16–17 £3.30	25,000	7.2	25,000	7.2
	All	**1.25 million**	**4.9**	**1.31 million**	**5.2**

Sources: LPC 2005 Report (2005), LPC 2006 Report (2006), LPC estimates based on ASHE with supplementary information, low-pay weights, UK, 2004–2006.
Notes:
1. The youth rate was not recommended to be increased in October 2006 until the 2006 report.
2. Youths are aged 18–21 and adults 22 and over in these estimates.

2.41 The above estimates generally follow the now familiar pattern in that, at each iteration, the estimate of the total number of beneficiaries has been revised downwards. It is likely that this is mostly explained by wage anticipation, i.e. employers choosing to award the October increase before the April survey date. It should also be noted that, as price inflation has risen and wage inflation has been more subdued, our latest estimates suggest coverage of around 5 per cent for the 2006 upratings whether we use the earnings or the prices assumption.

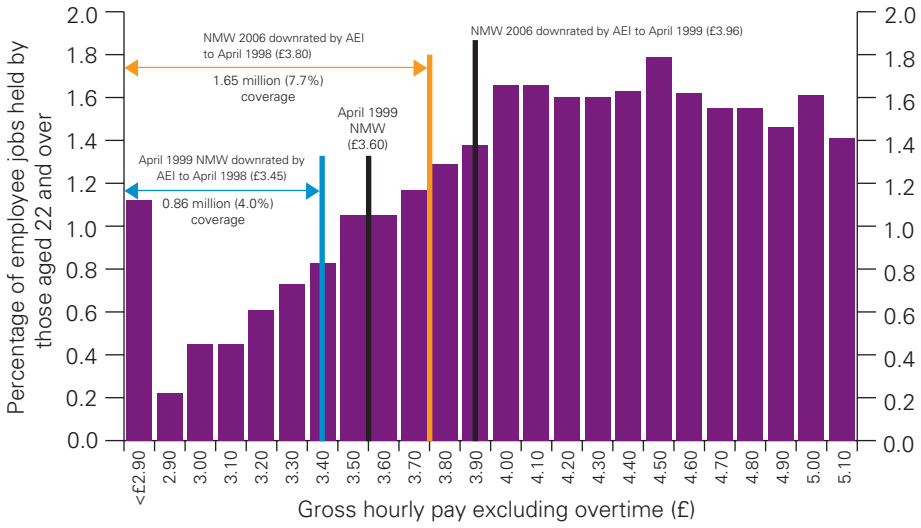
Alternative Method of Looking at Coverage

2.42 Over the past year, we have looked for an alternative way of calculating coverage in order to address the issue of employer anticipation. We devised a method whereby we attempt to 'downrate' the minimum wage not to the latest data, but to data that would have been unaffected by the introduction of the National Minimum Wage – that of Spring 1998. Assuming that wages for all would have grown in line with average earnings, the minimum wage for October 2006 is imposed on the 1998 earnings distribution by downrating it in line with the change in average earnings between April 1998 and October 2006, as shown in Figure 2.6.

2.43 Using this technique, the 2006 October adult minimum wage (£5.35) would have been equivalent to £3.96 in 1999, when the minimum wage introduced at that time was £3.60. The value of the 2006 October minimum wage would have been £3.80 in 1998, when the introductory level of the minimum wage (£3.60 in 1999) would have been equivalent to £3.45. The 2006 minimum wage (£5.35) downrated in 1998 terms would have covered more than 1.65 million jobs held by adults aged 22 and over (around 7.7 per cent of all such jobs) in 1998. This level of coverage is considerably more than that estimated for the introduction of the minimum wage (about 4 per cent) or the October 2006 upratings using 2006 data (around 5 per cent).

2.44 Although this method manages to overcome the problem of employer anticipation, it is not without drawbacks. For example, there is still an issue about which downrating series is most appropriate. Further, any inferences made are subject to the assumption that the hourly earnings distribution has not changed significantly since 1998. In fact, there have been significant changes to the UK labour market (apart from the National Minimum Wage) since 1998, although recent research by Dickens and Manning (2006) suggests that it is only the impact of the minimum wage that has changed the shape of the earnings distribution.

Figure 2.6
October 2006 National Minimum Wage Downrated to the 1998 Hourly Earnings Distribution, UK



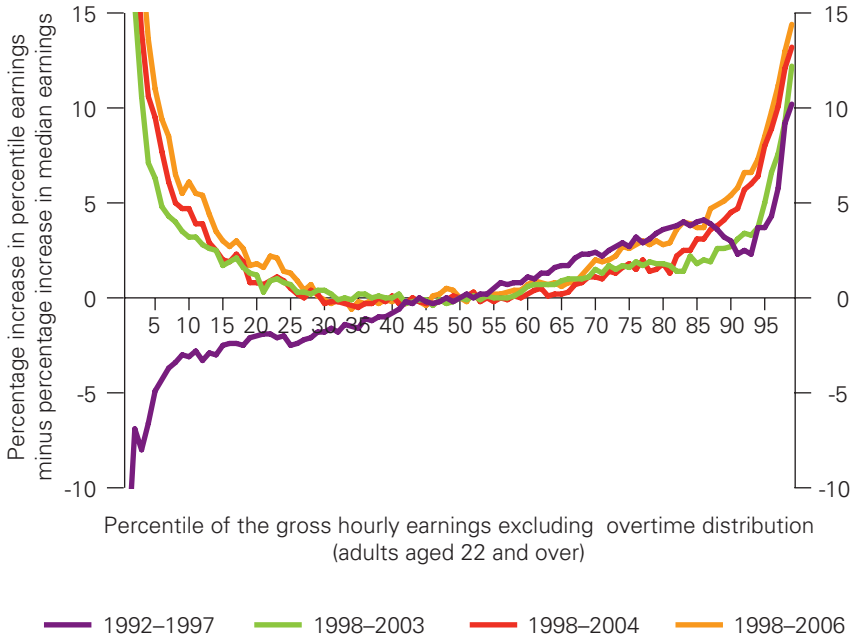
Source: LPC estimates based on ONS central estimates (ASHE without supplementary information 1998 and LFS Spring 1998) and AEI including bonuses (ONS Code LNMQ), monthly, seasonally adjusted, UK, April 1998–October 2006.

Impact on Differentials

2.45 An important factor when assessing the impact of the National Minimum Wage is the extent to which differentials for workers earning just above this level are restored following an uprating. This not only affects the number of workers who might indirectly gain from above-average increases in the minimum wage, it also affects firms' total wage bills. The further up the earnings distribution that these differential impacts occur, the greater the number of people who gain from higher wages, but the higher the cost to firms and the greater the potential impact on inflation.

2.46 This section looks at how those at the bottom end of the earnings distribution have fared compared with those at the median and those higher up the earnings distribution over the period 1992 to 2006. Supplementing analysis in Butcher (2005), Figure 2.7 shows how hourly earnings have increased, compared with the median, in different time periods. The hourly wages for those at the bottom decile of the earnings distribution rose by about 14.0 per cent, around 3.0 percentage points less than at the median, between 1992 and 1997. In this period prior to the introduction of the minimum wage, it can be generally concluded that for those below the median, hourly earnings grew less than at the median. In contrast, hourly wages grew faster for those at percentiles above the median.

Figure 2.7
Increase in Hourly Earnings Minus the Increase in Median Earnings by Percentile for Employees Aged 22 and Over, UK, 1992–2006



Source: LPC estimates based on unweighted New Earnings Survey (NES), April 1992–1997 and 1998–2003, ASHE without supplementary information, low-pay weights, UK, April 1998–2004 and ASHE with supplementary information, low-pay weights, UK, April 2004–2006.
Note: Comparisons have been made here for illustrative purposes only as no consistent earnings time series is available from 1992 to 2006. This analysis uses NES, ASHE without supplementary information and ASHE with supplementary information.

2.47 The hourly wages of those at the bottom of the earnings distribution increased substantially between 1998 and 2006. The largest increases occurred between 1998 and 2000 following the introduction of the minimum wage. Significant gains, largely attributable to the minimum wage upratings, have also been made for those at the bottom of the distribution between 2000 and 2006. It should be noted, however, that there are limitations in the data series and care should be exercised in making such comparisons. A more detailed description of the data is given in Appendix 6. Using consistent data, earnings at the bottom decile increased by about 30 per cent between 1998 and 2004 compared with around 25 per cent for those at the median.

2.48 Analysing the extent of the differential impact, Figure 2.7 shows that in the period since the introduction of the minimum wage, earnings increases up to about the 30th percentile were higher, on average, than the increase at the median but generally lower than the direct minimum wage impact. This suggests that those earning just above the minimum wage have seen their differentials squeezed compared with those on minimum wages.

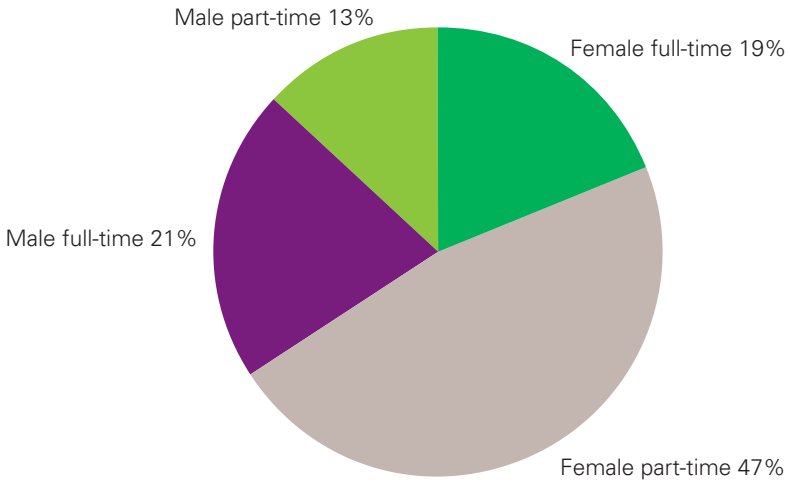
2.49 Denvir and Loukas (2006) and IDS (2006b) found that the recent minimum wage upratings had affected company pay structures, removing pay grades and squeezing differentials. However, in a more econometric study, Lam, Ormerod, Ritchie and Vaze (2006) looked at the impact of the minimum wage on company pay policies. They found that when the minimum wage was introduced and had been uprated, companies generally responded by maintaining the cash differentials between different pay grades. This implies that wage inequalities would be reduced as the percentage earnings increase would be higher for those at the minimum wage. They noted that the minimum wage *'does appear to be reducing inequality at the bottom of the wage distribution'*.

Who is Paid the National Minimum Wage?

2.50 We next investigate the characteristics of those covered by the 2006 October upratings in terms of gender, hours worked, age, occupation, sector, region, size of firm and whether firms are in the public or private sector.

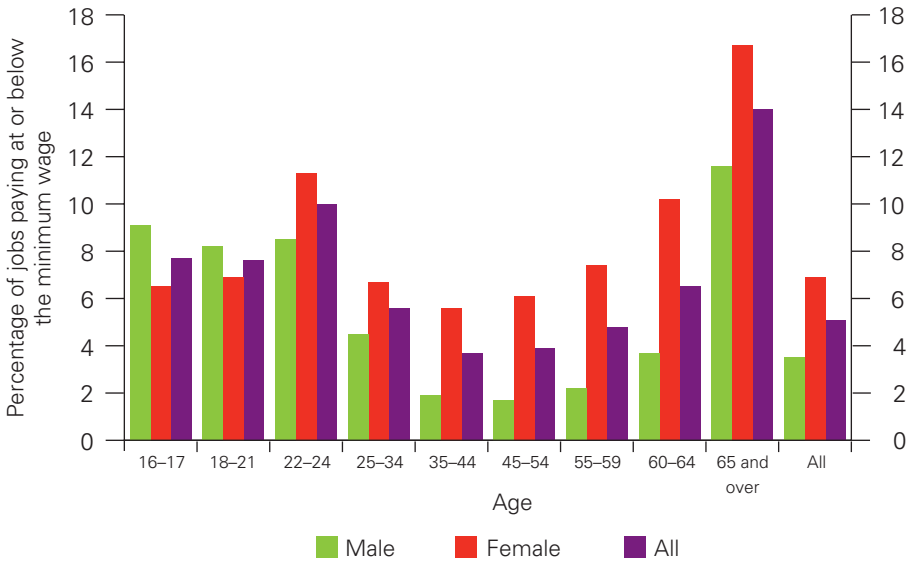
2.51 For the purposes of analysing the composition of minimum wage jobs, in this chapter we define a minimum wage job to be one that, in April 2006, paid the equivalent of the forthcoming October 2006 minimum wage downrated by the growth in average earnings back to April 2006. That is, a job held by an adult aged 22 and over paying £5.25 or less; by a young person aged 18–21 paying £4.40 or less; or by a 16–17 year old paying £3.25 or less. In April 2006, there were about 1.3 million jobs thus defined – about 5.1 per cent of all jobs in the UK labour market. Figure 2.8 shows that the majority of minimum wage jobs are part-time (60 per cent) and that two-thirds are held by women.

Figure 2.8
Minimum Wage Jobs by Hours and Gender, UK, 2006



Source: LPC estimates based on ASHE with supplementary information, low-pay weights, UK, April 2006.
Note: Minimum wage jobs defined as those held by adults (aged 22 and over) paying £5.25 or less, by youths (aged 18–21) paying £4.40 or less and by 16–17 year olds paying £3.25 or less in April 2006.

Figure 2.9
Minimum Wage Jobs by Age and Gender, UK, 2006

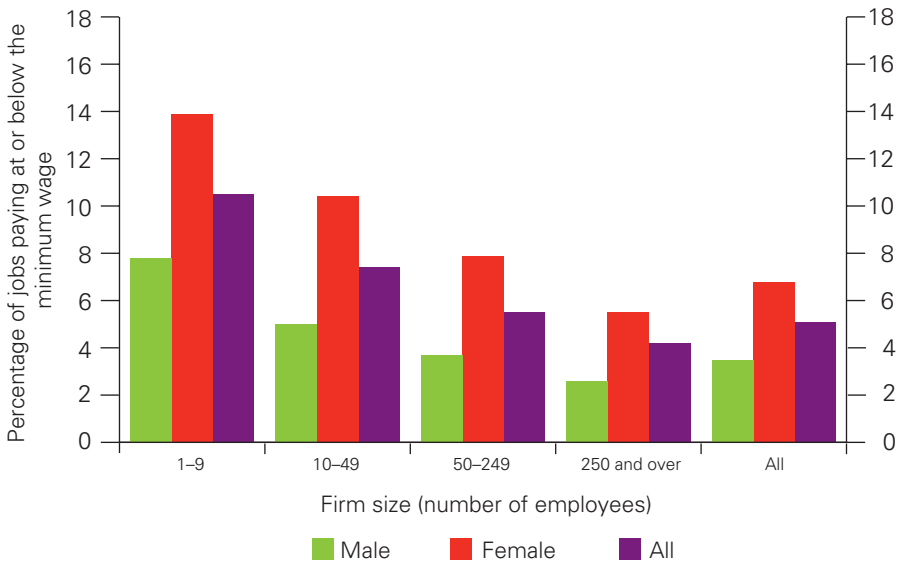


Source: LPC estimates based on ASHE with supplementary information, low-pay weights, UK, April 2006.
Note: Minimum wage jobs defined as those held by adults (aged 22 and over) paying £5.25 or less, by youths (aged 18–21) paying £4.40 or less and by 16–17 year olds paying £3.25 or less in April 2006.

2.52 We can see from Figure 2.9 that the distribution of coverage by age is generally U-shaped. About 7 to 8 per cent of jobs held by workers aged 16 to 21 years old are minimum wage jobs compared with around 10 per cent of those held by 22–24 year olds. This percentage then falls with age to around 4 per cent of jobs held by those aged 35 to 54, before increasing to about 6 per cent for those nearing pension age and about 14 per cent for those aged 65 and over. Coverage among ethnic minorities and those with disabilities is included in Chapter 4.

2.53 Figure 2.10 shows coverage of minimum wage jobs by size of firm. In general, the proportion of minimum wage jobs declines with size of firm. Just over 10 per cent of jobs in micro firms (with 1 to 9 employees) and seven per cent in other small firms (with 10 to 49 employees) were estimated to be paying around the minimum wage. Only 4 per cent of jobs in large firms were minimum wage jobs. The gender pattern is similar across all firm sizes, with women more likely to be in minimum wage jobs than men.

Figure 2.10
Minimum Wage Jobs by Size of Firm and Gender, UK, 2006

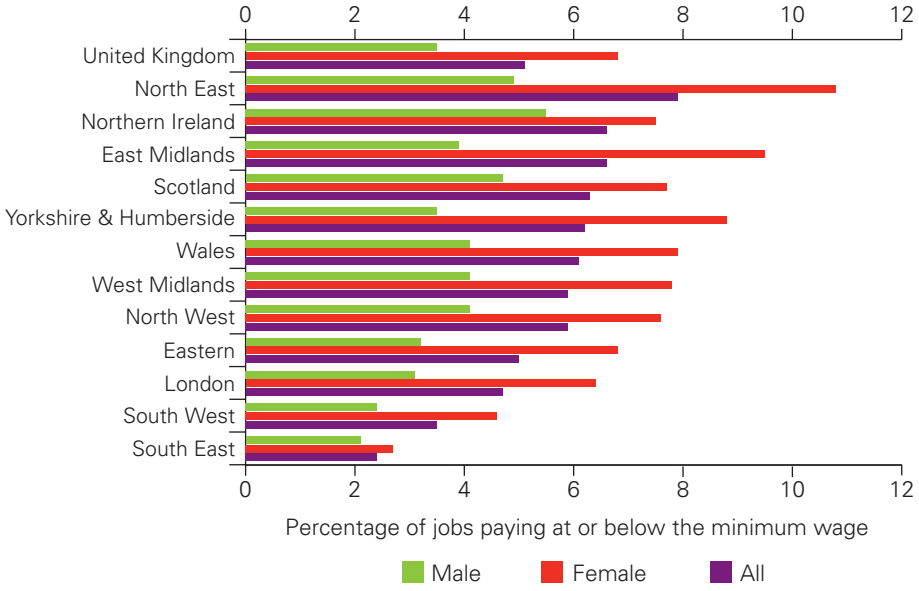


Source: LPC estimates based on ASHE with supplementary information, low-pay weights, UK, April 2006.
Note: Minimum wage defined as those held by adults (aged 22 and over) paying £5.25 or less, by youths (aged 18–21) paying £4.40 or less and by 16–17 year olds paying £3.25 or less in April 2006.

2.54 Figure 2.11 shows the percentage of jobs that were paid around the minimum wage in April 2006 by region, country and gender. The preponderance of women is again apparent. Unsurprisingly, the

proportion of minimum wage jobs in the South East of England and London is lower than the national average. However, there are also fewer minimum wage jobs in the South West even though it contains many low-paying areas (as measured by the mean or median). The highest percentages are in the North East of England, the East Midlands and Northern Ireland. Similar patterns are found using residence-based regions.

Figure 2.11
Minimum Wage Jobs by Region (Work-based Government Office Region) and Gender, UK, 2006

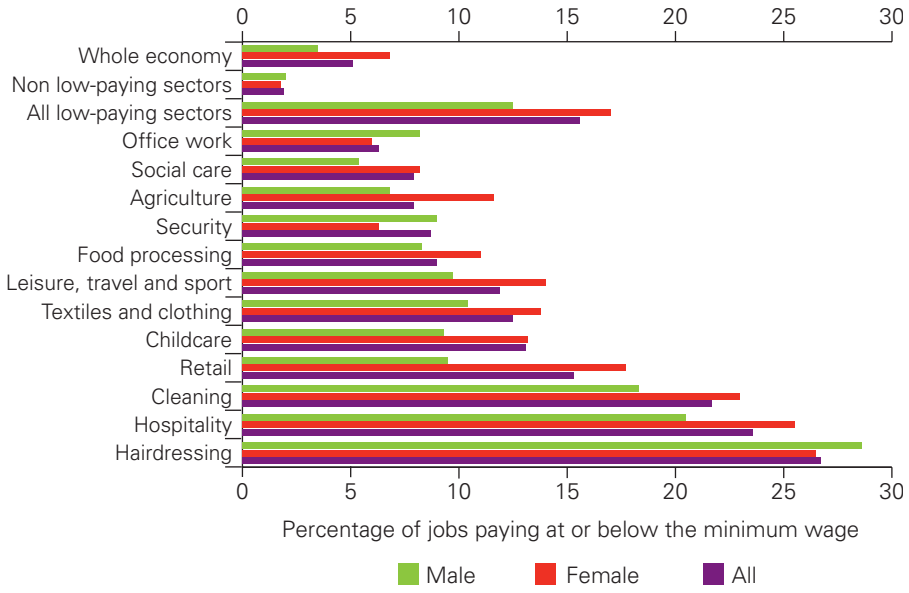


Source: LPC estimates based on ASHE with supplementary information, low-pay weights, UK, April 2006.
Note: Minimum wage jobs defined as those held by adults (aged 22 and over) paying £5.25 or less, by youths (aged 18–21) paying £4.40 or less and by 16–17 year olds paying £3.25 or less in April 2006.

2.55 There are slight gender variations. The highest proportion of men working in minimum wage jobs is found in Northern Ireland. But Northern Irish women are less likely to be employed in minimum wage jobs than women in most other regions.

2.56 We look next at minimum wage jobs by occupation and then by industry. We examine this in more detail in Chapter 3 and in Appendix 5 we present a detailed guide to low-paying sectors and occupations. Figure 2.12 shows that minimum wage jobs account for over 20 per cent of all the low-paying jobs in hairdressing, hospitality and cleaning.

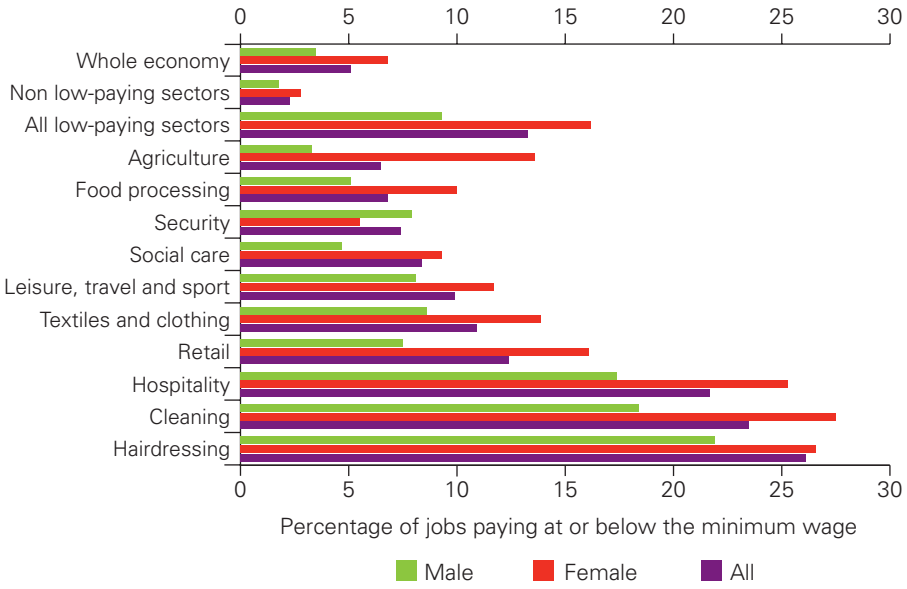
Figure 2.12
Minimum Wage Jobs by Low-paying Occupation and Gender, UK, 2006



Source: LPC estimates based on ASHE with supplementary information, low-pay weights, UK, April 2006.
Note: Minimum wage jobs defined as those held by adults (aged 22 and over) paying £5.25 or less, by youths (aged 18–21) paying £4.40 or less and by 16–17 year olds paying £3.25 or less in April 2006.

2.57 Figure 2.13 demonstrates that the picture is very similar if we examine minimum wage jobs using our industry-based groupings. More minimum wage jobs are to be found in the retail sector than any other sector. Just over 365,000 retail jobs, representing about 12 per cent of jobs in the sector, were estimated to be paid at or below the minimum wage.

Figure 2.13
Minimum Wage Jobs by Low-paying Industry and Gender, UK, 2006

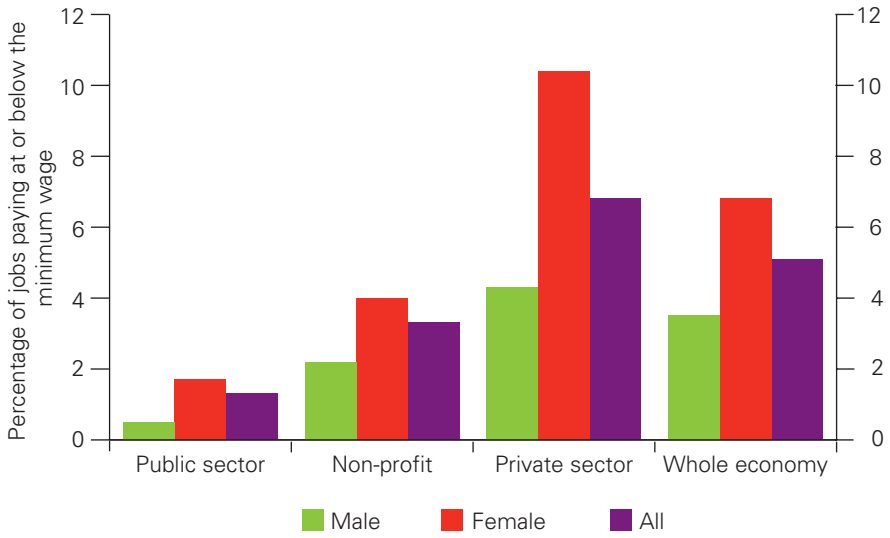


Source: LPC estimates based on ASHE with supplementary information, low-pay weights, UK, April 2006.
Note: Minimum wage jobs defined as those held by adults (aged 22 and over) paying £5.25 or less, by youths (aged 18–21) paying £4.40 or less and by 16–17 year olds paying £3.25 or less in April 2006.

2.58 While the retail sector had the highest number of minimum wage jobs, Figure 2.13 shows that the sectors with the largest proportion of jobs affected were cleaning, hospitality and hairdressing. In all three sectors, over 20 per cent of employees were in minimum wage jobs in April 2006. Compared with retail, the absolute numbers in hairdressing were very small. Hospitality, on the other hand, had over 200,000 workers who were in minimum wage jobs.

2.59 There are few minimum wage jobs in the public sector. Figure 2.14 shows that most minimum wage jobs are in the private sector and are held by women.

Figure 2.14
Minimum Wage Jobs by Public, Non-profit or Private Sector and Gender, UK, 2006



Source: LPC estimates based on ASHE with supplementary information, low-pay weights, UK, April 2006.
Note: Minimum wage jobs defined as those held by adults (aged 22 and over) paying £5.25 or less, by youths (aged 18–21) paying £4.40 or less and by 16–17 year olds paying £3.25 or less in April 2006.

Persistence of Low-paid Employment

2.60 Whether minimum wage jobs are stepping-stones to better-paid employment or whether they are part of a cycle between no work and low-paid work is an important question that we have attempted to answer by commissioning two research projects on this topic for this report. If minimum wage jobs generally were transitory and provided a platform for climbing the career ladder it would be less of a concern than if we found that minimum wage workers generally moved from unemployment to a variety of short-term minimum wage jobs. Sloane, Murphy, Latreille, Jones and Jones (2007) built on the previous results of Sloane, Murphy, Latreille, Jones and Jones (2004) using the panel dataset from the New Earnings Survey to look at the duration of minimum wage jobs. Bryan and Taylor (2006) also investigated the persistence of low pay but used the British Household Panel Survey (BHPS) for their analyses. Both studies also confirmed our findings above that minimum wage employment is associated with being part-time, female, young, working in small private sector firms and in

particular industries (for example, retail and hospitality) and with less skilled occupations.

2.61 Sloane *et al* (2007) found results consistent with their previous findings that used the LFS and concluded that *'the time spent in minimum wage employment was quite short'*. Indeed, their results suggest that fewer than five per cent of minimum wage workers remain in such jobs for more than two years. Bryan and Taylor (2006) also found that minimum wage jobs were transitory for most workers but, less reassuringly, they found that up to 40 per cent of those who had been in minimum wage jobs moved between such jobs and out of the labour market over the period of their analysis.

Household Earnings and the Minimum Wage

2.62 The analyses above have looked at the impact of the minimum wage on individual earnings. In this next section we give a brief account of how the minimum wage interacts with household income.

2.63 So far, we have looked at individual gross hourly earnings before tax. An individual's take-home pay, however, is subject to tax and National Insurance Contributions (NICs). Further, individuals may be eligible for in-work benefits, such as Working Tax Credit and Child Tax Credit, and a range of other state benefits, such as Housing Benefit, Council Tax Benefit and Child Benefits. Most of these benefits are means-tested based on household income, so an individual's eligibility will depend not only on their own earnings, but also on the earnings of other members of the household and on household circumstances such as the level of rent, the number of children, childcare costs and whether any household member is disabled. It is important therefore to take into account marginal deduction rates (MDRs) – how much of each additional pound earned is lost through tax and benefit changes – when looking at the impact of the minimum wage on household income.

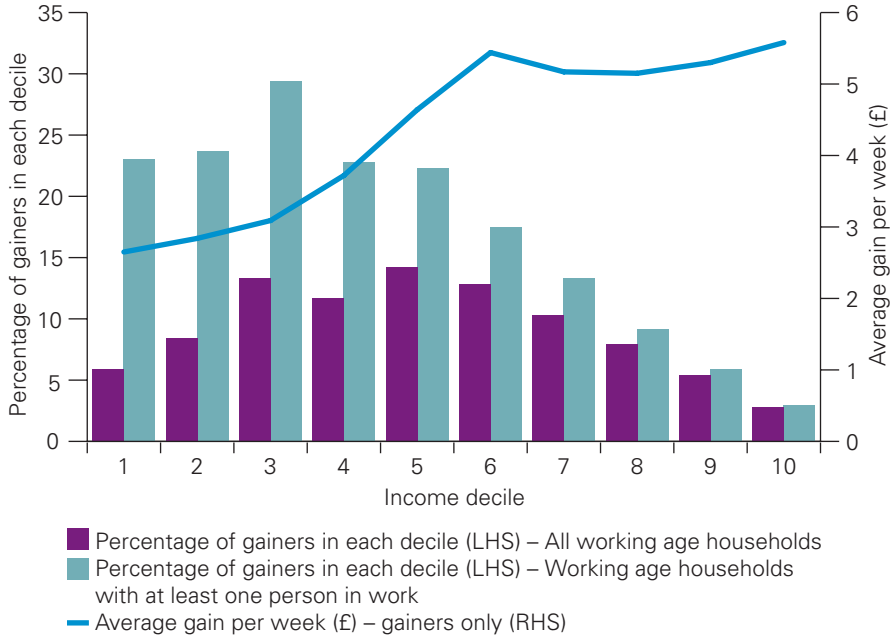
2.64 It is not easy to generalise about the impact of the minimum wage on household earnings as it will depend on the circumstances of each household. When the adult minimum wage was £5.05, gross weekly income would have been £176.75 for a 35 hour working week. Using HM Treasury estimates, this gross income was equivalent to a net income of £172.26 for a single person working full-time with no

children, once the tax and benefits system had been taken into account. However, the equivalent sum for a couple with one child (one partner working full-time and the other not working) was £265.59. Again, assuming a 35 hour working week, gross weekly income would have increased to £187.25 when the minimum wage increased to £5.35. However, the high MDRs faced by both household types meant that they would only have a net gain of £3.15 a week, compared with the gross increase of £10.50.

2.65 Analysis by HM Treasury, shown in Figure 2.15, suggests that minimum wage earners appear to be concentrated in the third to sixth decile of household incomes for all working age households. As a result of a hypothetical 25 pence increase in the minimum wage (results would be similar for the actual 30 pence increase in October 2006), about 2.3 million households (9.3 per cent) would gain on average about £4.30 a week. Those in the bottom half of the income distribution gain less on average in monetary terms, and those in the bottom 20 per cent also gain proportionately less than those in the third to seventh deciles. There are two main reasons for this. First, lower income individuals face higher MDRs, particularly on housing and council tax benefits. Second, many minimum wage workers are in dual-earner households in which at least one earner is full-time. These dual-earner households are not generally at the lower end of the income distribution.

2.66 The minimum wage cannot possibly help those households that contain no wage earners and are entirely dependent on benefits. Restricting analysis to those households with at least one person in work, Figure 2.15 shows that the minimum wage is indeed targeted most at those at the bottom of the earnings distribution. This is in line with the findings of Bryan and Taylor (2004) and the Institute for Fiscal Studies (2003).

Figure 2.15
Distributional Impact of a Hypothetical 25 Pence Increase in the Minimum Wage, UK, 2006–2007



Source: HM Treasury estimates based on Family Resources Survey (FRS) data for 2004/05, uprated to 2006/07.
Note: These figures take account of changes in tax credits, benefits, taxes and National Insurance but do not take any account of likely behavioural change caused by a rise in hourly pay, such as changed levels of employment or hours worked. They also do not include the effect of the £25,000 disregard in tax credits, which allows income to rise between one year and the next by up to £25,000 before tax credits begin to be withdrawn. This means that the reductions in tax credits would in practice be significantly smaller, at least in the initial tax year.

Consumption

2.67 In research commissioned for this report, Wadsworth (2007) investigated how those employed in minimum wage jobs were affected by changes in the prices of those goods and services that they produced. He found that average disposable income in households with an adult minimum wage earner was around half that of households with earners earning more than the minimum wage. Despite this, he found little difference in their spending patterns. He did find evidence that it was not only minimum wage households that purchased minimum wage goods and services, although they did spend relatively more on them than other households.

2.68 In conclusion, the National Minimum Wage has increased substantially faster than average wage growth since its introduction, raising the absolute and relative pay of those at the bottom of the earnings

distribution. Given this, we now turn to look at the impact of the minimum wage on the economy – the labour market (but focusing on employment and hours), prices, profits, productivity, training and entrepreneurship.

Impact of the National Minimum Wage on the Labour Market

2.69 Traditional economic theory suggests that employment will tend to fall if the minimum wage is set above the competitive wage. Firms can attain this reduction by either reducing the number of workers employed, the extensive margin, or they can cut the number of hours worked, the intensive margin. Other economic theories, such as efficiency wages (where higher wages induce greater productivity), offer the possibility that employment might actually rise in response to a wage floor. In this section, we first look at aggregate employment (and unemployment) before looking in more detail at those workers and sectors who are most affected by the minimum wage. We then summarise the research evidence before investigating the impact of the minimum wage on hours.

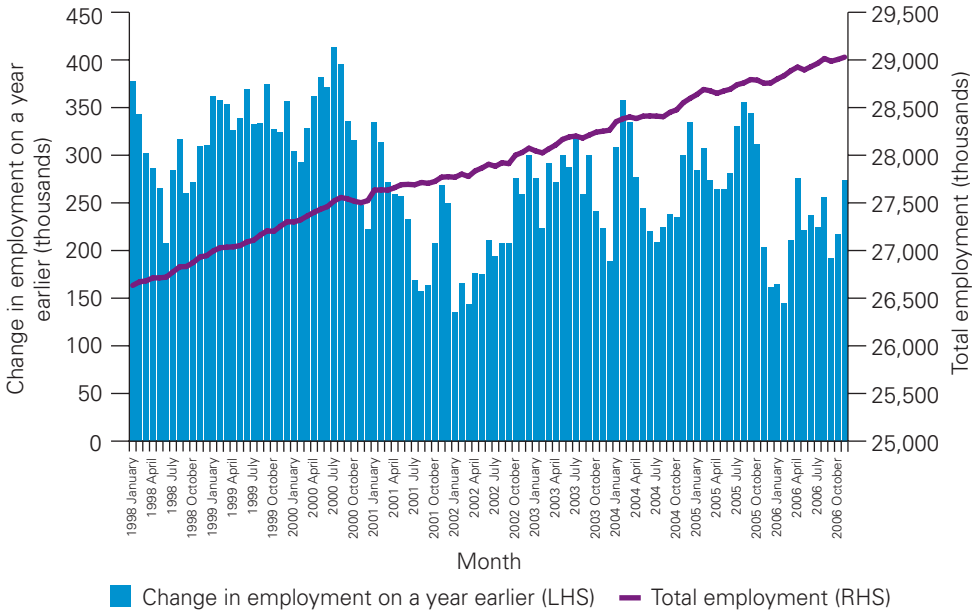
2.70 Since the introduction of the minimum wage, the UK labour market has performed well, with employment levels increasing by almost two million. In 2005 and 2006, however, labour market performance has been mixed. The economy has continued to create jobs, with employment levels reaching an all-time high in November 2006, but at the same time unemployment has increased using both official measures (headline unemployment and the claimant count) and the employment rate has fallen.

2.71 The simultaneous increase in employment and unemployment levels – a trend that started towards the end of 2005 – can be explained by the recent strong growth in the UK workforce driven by rising labour market participation (reductions in inactivity levels, particularly among older workers); and international immigration, particularly from the central and eastern European economies that joined the European Union (EU) in May 2004. These issues are explored further below.

Employment, Unemployment and Inactivity

2.72 Employment levels have continued their upward path in 2006. Driven by the inflow of migrant workers and by people moving out of inactivity, Figure 2.16 shows that employment levels rose to 29.0 million in November 2006 – up 274,000 on the same month a year ago. There are now around 1.2 million workers who are over the state retirement age. According to the LFS, the number of employees also rose by 156,000 over the year to 25.0 million in November 2006. Working age employment levels also increased, up 188,000 to 27.8 million in the year to November 2006. Although the working age employment rate remained relatively flat at around 74.5 per cent during the same period and it has fallen since 2005, it remains high by historical standards. Figure 2.16 also shows that employment growth since the fourth quarter of 2005 has not been as strong as that experienced in the first three quarters of 2005.

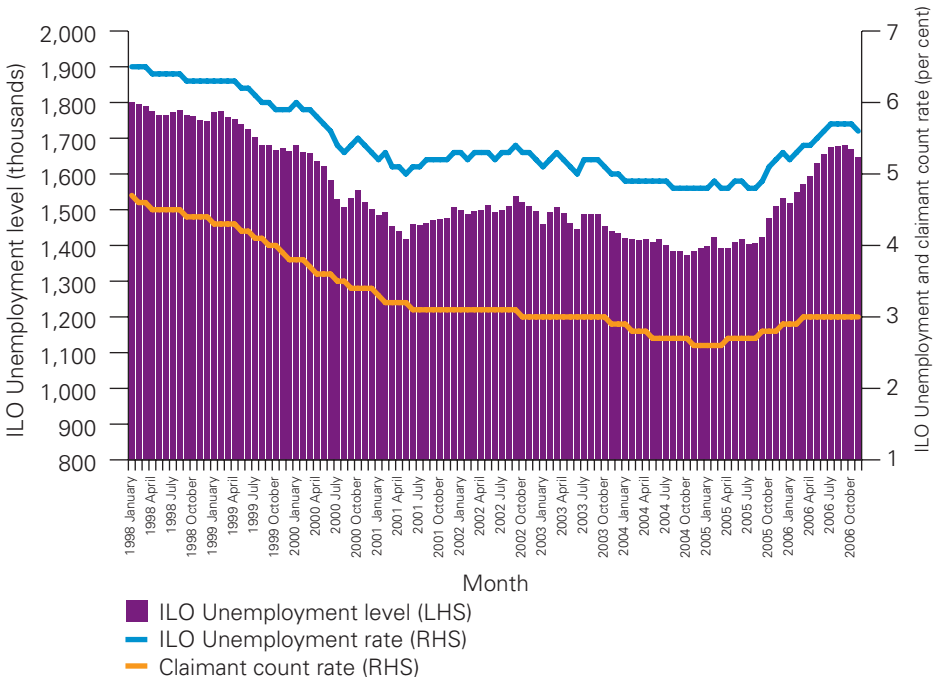
Figure 2.16
Level and Change in Total Employment of those Aged 16 and Over, UK, 1998–2006



Source: LPC estimates based on LFS data, total employment level of those aged 16 and over (ONS code MGRZ), monthly, seasonally adjusted, UK, 1998–2006.
Note: Three months to the end of the month shown.

2.73 Unemployment had been on an upward trend since the beginning of 2005 but, as shown in Figure 2.17, a peak appears to have been reached in the middle of 2006. According to the official International Labour Organisation (ILO) measure of unemployment[6], there were around 1.6 million people of working age classified as unemployed in November 2006, about 138,000 more than a year earlier. The unemployment rate increased by 0.4 percentage points, to 5.6 per cent, during the same period but it remains well below the rates experienced in the 1980s and 1990s. An alternative measure of unemployment, the claimant count, shows a similar pattern, with the number of people claiming Jobseeker's Allowance increasing by some 47,000 in the year to November 2006.

Figure 2.17
ILO Unemployment Level, ILO Unemployment Rate and Claimant Count Rate, UK, 1998–2006



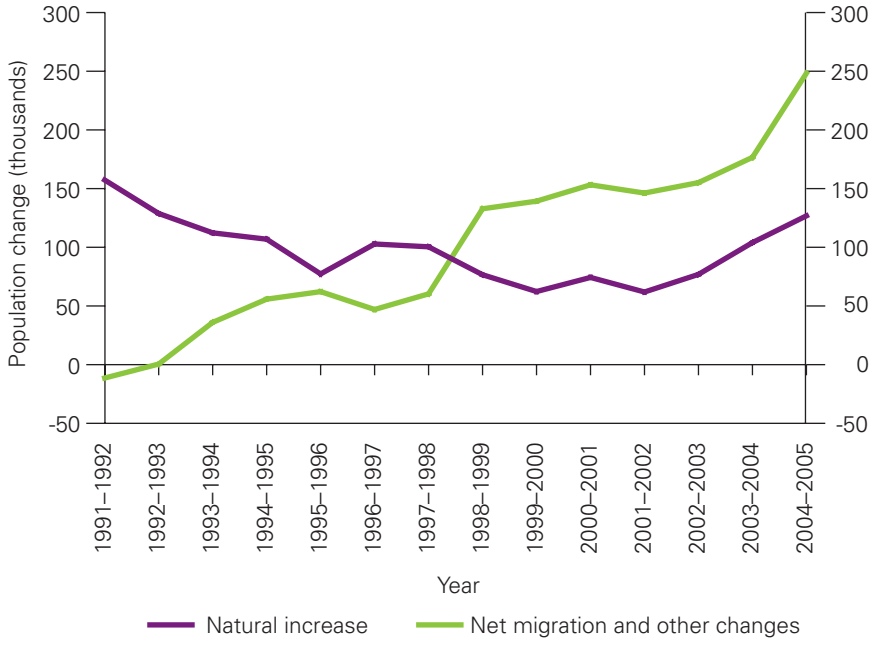
Source: ONS, LFS, working age unemployment level (ONS code YBSH), ILO unemployment rate (ONS code YBTI) and claimant count rate (ONS code BCJE), monthly, seasonally adjusted, UK, 1998–2006.
Note: ILO unemployment level and rate is for the three months to the end of the month shown. Claimant count rate is for the month shown.

[6] Those actively seeking work in the last four weeks and who are available to start work within the next two weeks.

2.74 Two main explanations are offered to account for the recent increases in unemployment. The first gives inward migration a prominent role. The second attributes the increase in unemployment to a recent reduction in economic inactivity and consequent rise in labour market participation. Both explanations seem to suggest that developments in the supply-side of the economy, rather than weak demand, are the primary factor driving up unemployment.

2.75 The UK working age population has grown sharply in recent years. A large part of this increase can be attributed to the arrival of migrant workers from the Accession countries (A8) following the EU enlargement in 2004. According to ONS figures, the UK population increased by some 375,000 between 2004 and 2005 (the last year for which data are available). More than two-thirds of this increase was due to inward migration. Migrant workers from the Accession countries accounted for around 36 per cent of the total migration inflows and 40 per cent of National Insurance numbers issued to migrants.

Figure 2.18
Change in Population and Migration Levels, UK, 1991–2005



Source: ONS population statistics, UK, 1991–2005

2.76 The official figures suffer from a number of problems and are likely to underestimate the true extent of the migration flows into and out of the UK and the resulting change in labour supply. The available data,

however, do seem to suggest that the steady increase in migrant workers from the A8 countries in the last two years has boosted the size of the UK workforce. New jobs have been created, but the number of people finding employment has failed to keep pace with the expansion of the workforce, pushing up the unemployment figures. However, Gilpin *et al* (2006) found no evidence that the rise in claimant unemployment at the Local Authority District level was associated with an increase in A8 migrants in those areas.

2.77 Another factor that explains the simultaneous increase in employment and unemployment levels is the recent decline in economic inactivity. Inactivity rates for all age groups fell in the year to November 2006, except for 16–17 year olds whose inactivity rates have continued to increase. People over the pension age experienced the largest decline in inactivity rates in the last year, driven mainly by women returning to work and continuing the trend seen in recent years.

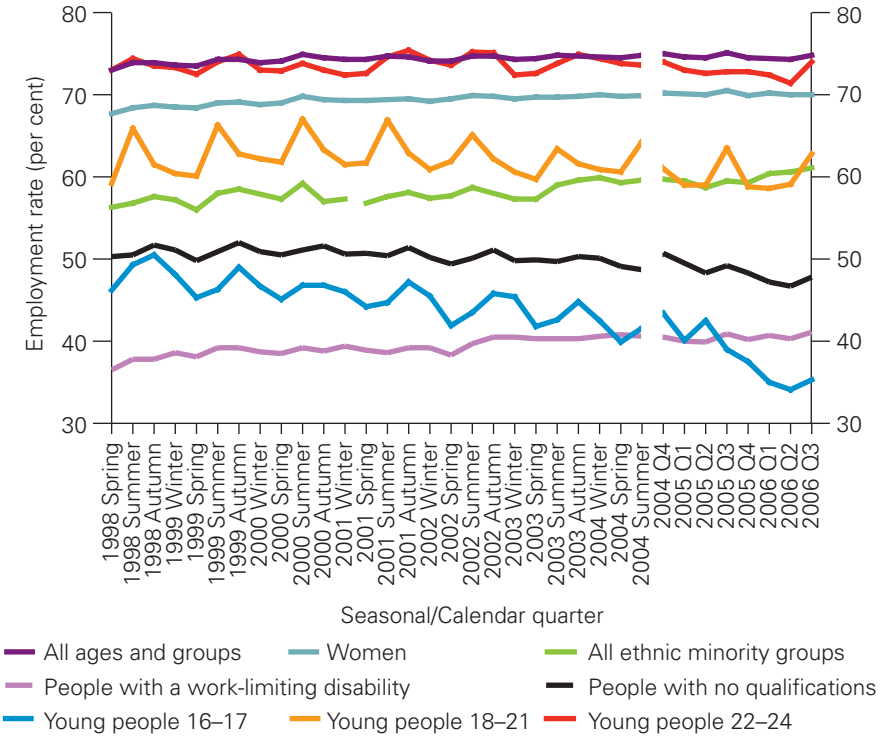
2.78 There has also been a drop in the number of economically inactive people who are long-term sick and on incapacity benefit. People who come off incapacity benefits are defined as being available for, and seeking, work which means that they would appear in official statistics as unemployed until they found employment. This, it has been argued, partly explains the recent increases in the unemployment figures at a time when employment levels also appear to be increasing.

2.79 So far we have looked at the labour market in aggregate and have observed no discernible impact of the minimum wage on employment. However, we are most likely to see a minimum wage impact by looking at those groups of workers or sectors most affected by the minimum wage. We start by looking at employment rates of certain groups of workers, before going on to discuss the impact on low-paying sectors.

Groups of Workers

2.80 Since the end of 2004, there have been notable divergences in the employment experiences of the different groups of workers considered here. Working age employment rates for ethnic minority groups and those with disabilities have increased. In contrast, employment rates for those without any educational or training qualifications and for young people under 25 have declined sharply. More detailed analysis of these groups is given in Chapters 4 and 5.

Figure 2.19
Employment Rates for Different Groups of Workers, UK, 1998–2006

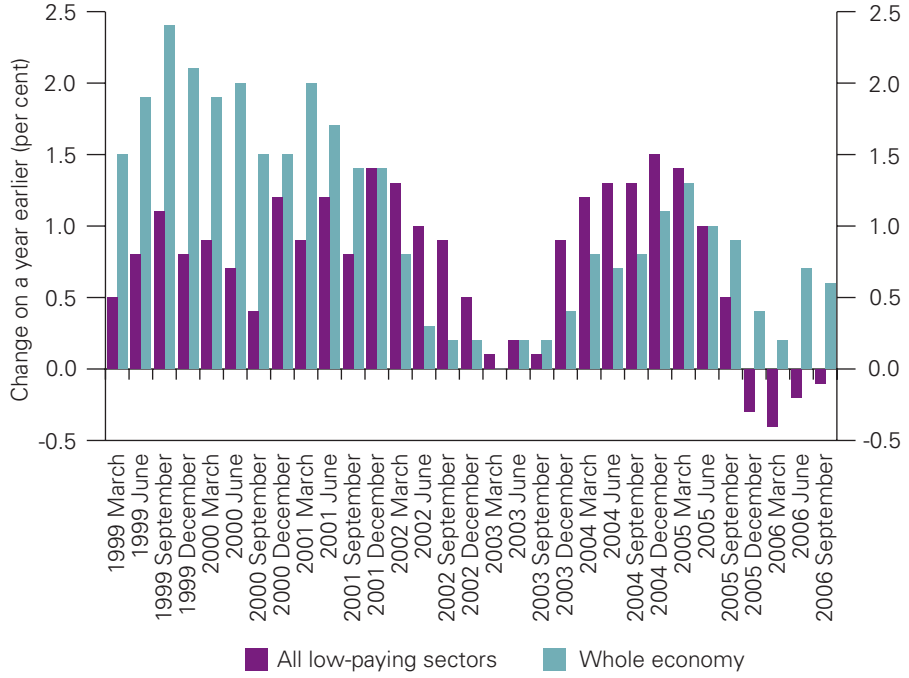


Source: LPC estimates based on LFS Microdata, seasonal/calendar quarters, not seasonally adjusted, UK, 1998–2006
Notes:
1. The break between Summer 2004 and Q4 2004 is a result of a discontinuity in the series as the LFS moved from seasonal to calendar quarters; thus comparisons should be made with care.
2. The definition of ethnic groups in the LFS changed in Spring 2001 to be consistent with the 2001 Census classifications: thus comparisons between the periods before and after should be made with care.

Low-paying Sectors

2.81 So far we have used data from the LFS, a household survey that considers the number of people in jobs. This section concentrates on trends in jobs in the low-paying sectors of the economy using information from the ONS employee jobs series, an employer-based survey.

Figure 2.20
Percentage Change in Employee Jobs in the Whole Economy and Low-paying Sectors, GB, 1999–2006



Source: ONS employee jobs series, not seasonally adjusted, GB, 1999–2006.

2.82 In September 2006, there were around 26.1 million employee jobs in Great Britain – about 32 per cent (8.3 million) of these were in the low-paying sectors. Since the introduction of the minimum wage in 1999, the number of jobs in the low-paying sectors has increased by more than 0.4 million (5.2 per cent), while jobs in the economy as a whole have increased by some 2.0 million (8.1 per cent)[7]. Figure 2.20 shows that there was a fall in employee jobs in the low-paying sectors as a whole for four consecutive quarters to September 2006. This contrasts with the growth observed in the economy as a whole.

[7] Due to the highly seasonal nature of the employee jobs series in the low-paying sectors, comparisons of like-for-like months are made, e.g. September 2006 with September 1998.

Table 2.7
Change in Employee Jobs in the Low-paying Sectors, Thousands, GB, 1998–2006

	September 2006 (000s)	Change on September 2005 (000s)	Change on September 1998 (000s)	Employee jobs share, September 2006 (%)	Employee jobs share, September 1998 (%)
All sectors	26,113	162	1,967	100.0	100.0
All low-paying sectors	8,324	-5	411	31.9	32.8
Of which:					
Retail including motor trades (new definition)[1]	3,363	-5	244	12.9	12.9
Retail excluding motor trades (old definition)[1]	2,824	-6	270	10.8	10.6
Hospitality	1,756	-25	191	6.7	6.5
Social care	1,098	16	134	4.2	4.0
Cleaning	475	0	-35	1.8	2.1
Agriculture	229	10	-86	0.9	1.3
Security	161	-1	33	0.6	0.5
Textiles and clothing	119	-5	-190	0.5	1.3
Food processing	365	-6	-65	1.4	1.8
Leisure, travel and sport	641	9	163	2.5	2.0
Hairdressing	115	3	23	0.4	0.4

Source: ONS Employee jobs series, not seasonally adjusted, GB, 1998–2006.
Note:
1. See Appendix 5 for a detailed explanation.

2.83 Since the introduction of the minimum wage, the sectors that have experienced the largest increases in jobs to September 2006 have been retail (with more than 240,000 new jobs created since September 1998) and hospitality (more than 190,000 new jobs have been created). This equates to jobs growth of 8 and 12 per cent respectively. The low-paying sectors that have grown the fastest since the introduction of the minimum wage have been leisure, travel and sport (34 per cent), security services (25 per cent) and hairdressing (25 per cent). The low-paying sectors as a whole grew by some 5 per cent over the same period. We examine employment in the low-paying sectors in greater detail in Chapter 3.

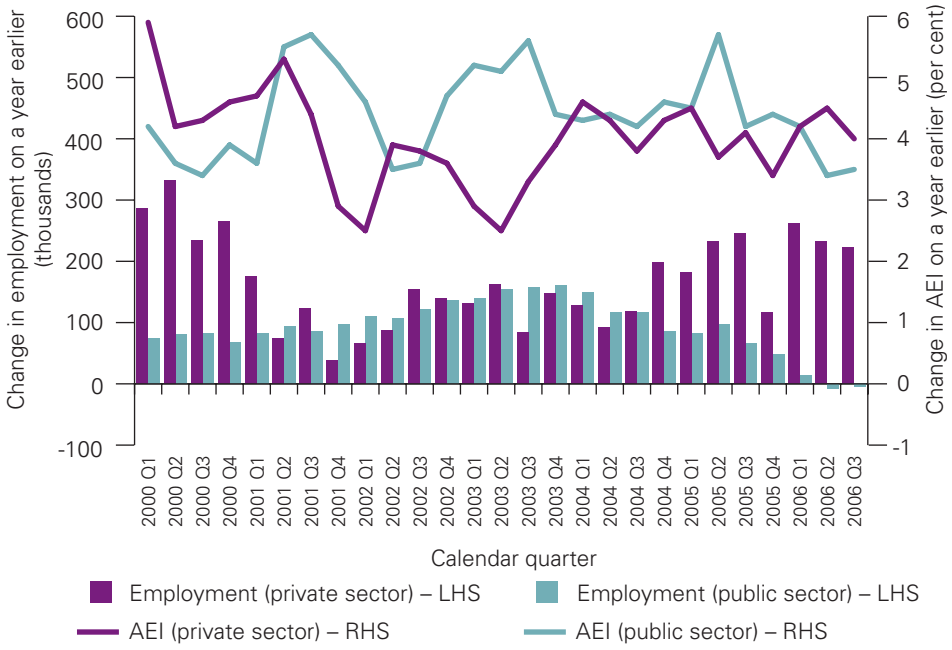
Public and Private Sector

2.84 We now turn to look at the public and private sectors. Our earlier discussion has shown that hourly wages in the private sector are more affected by the minimum wage. Figure 2.21 summarises annual changes in average earnings and employment in the public and private sectors since 2000. Throughout 2005 public sector earnings had grown faster than in the private sector. However, this has been reversed in

2006 as stronger earnings growth in private sector services (particularly financial services) and manufacturing has been accompanied by a considerable weakening in earnings growth in the public sector.

2.85 Employment in the public sector grew at a consistently faster rate than in the private sector between 2000 and 2004, driven mainly by the recruitment of frontline staff in the health and education sector. This trend has however been reversed in 2006 – public sector employment has fallen in the second and third quarters of 2006, reflecting the Government's recent attempts to tighten public sector spending and meet its fiscal targets.

Figure 2.21
Annual Growth in Employment (UK) and Average Earnings Including Bonuses (GB) in the Public and Private Sectors, 2000–2006



Source: ONS, AEI including bonuses for the private sector (ONS code LNND) and public sector (ONS code LNNE) and LPC employment estimates based on LFS data, public sector employment (ONS code G7AU) and private sector employment (G7K5), calendar quarters, seasonally adjusted, UK (GB for AEI), 2000–2006.

Job Vacancies

2.86 The number of vacancies in the economy is another key indicator of the health of the labour market. Vacancies began falling towards the end of 2004 as a result of the slowdown in consumer spending in 2004 and businesses responded by lowering their demand for labour. Since then,

there has been a steady improvement. The latest estimates from the ONS Vacancy Survey suggest that, in the three-month period October to December 2006, the number of vacancies in the whole economy was around 0.6 million, similar to the same period a year earlier.

2.87 Analysis by industry shows that one of the sectors that recorded the largest year-on-year decreases in job vacancies was Distribution, Hotels and Restaurants, a sector which is characterised by many low-paid workers. There were 6,700 fewer vacancies in October to December 2006 than in the same period a year earlier. However, the number of job vacancies in the sector has stabilised in recent months and even increased, after falling for 15 consecutive months in the period to March 2006.

Redundancies

2.88 Redundancies are another important indicator of the demand for labour. UK redundancy levels and rates began declining from the beginning of 2002 up to mid-2005. In subsequent months they increased, reaching a two-year high in September 2005 and since then we have seen a generally declining trend. The latest figures for the three months to November 2006 show the number of redundancies is marginally lower than a year earlier.

2.89 The latest ONS figures for vacancies and redundancies suggest that the labour market is growing in a relatively stable manner, with little change in the number of vacancies or the number of redundancies in 2006.

Research on Employment

2.90 Research on the impact of the minimum wage on employment can be broadly broken down into two groups – those that look at the individual probability of being employed and those that look at the impact on sectors or geographies.

2.91 Stewart (2002, 2004a, 2004b) used a variety of data sources to look at the impact of the minimum wage on individual employment probabilities. In all three studies, he found no significant effects of the introduction of the minimum wage or its initial upratings on employment for men, women, adults or young workers. Dickens and Draca (2005) also found no employment effects when they investigated the 2003 minimum wage upratings.

2.92 Galindo-Rueda and Pereira (2004) and Experian (2007) found evidence to suggest that the introduction of the minimum wage and its subsequent upratings had slowed employment growth in those counties or regions where wages needed to adjust the most in order to comply with the minimum wage. However, these effects were generally small and the most comprehensive of the studies, Stewart (2002), found no evidence of any adverse employment effects at the area level. Indeed, he found statistically insignificant positive effects even when focusing on those groups most affected.

Summary of Employment Impact

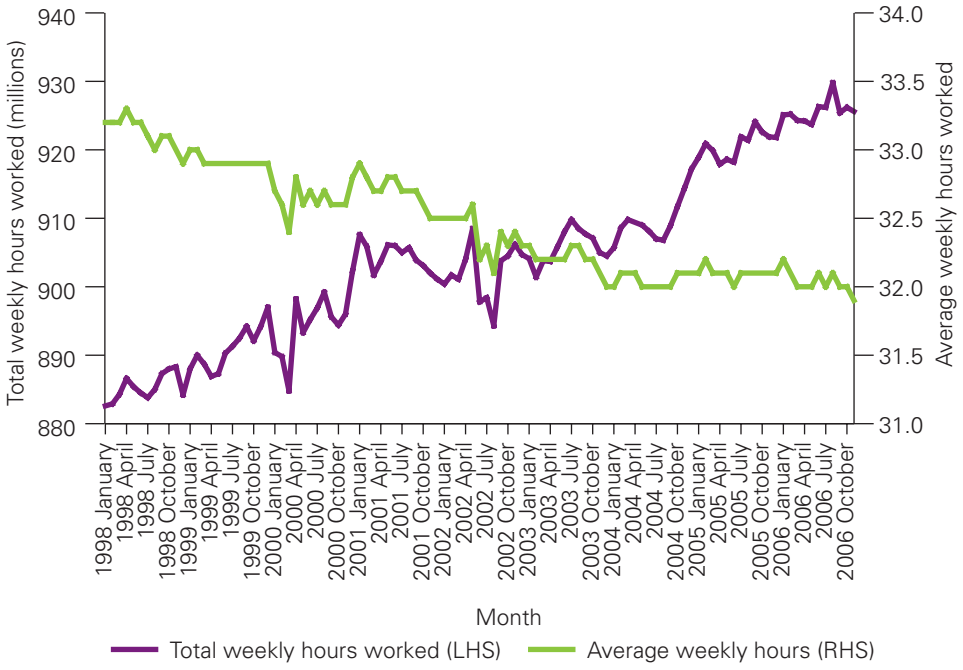
2.93 We have seen that the level of aggregate employment has continued to grow reaching record levels. An expansion in the UK labour supply, fuelled by higher participation of older workers and those previously on incapacity benefits alongside increased migration, led to a consequent reduction in the employment rate and a rise in unemployment during 2006. In other words, the growth in the number of jobs failed to keep pace with the increased supply of labour. There is some evidence that the low-paying sectors have experienced a reduction in employment. Young workers and those with no qualifications also appear to have fared worse than other groups of workers in the labour market, in terms of employment and unemployment.

Hours Worked

2.94 We now turn to look at the impact of the minimum wage on the number of hours worked. The number of hours worked gives an alternative indication of the strength of the labour market. Figure 2.22 shows that the trend in total weekly hours worked in the UK has been upward in recent years, a trend that implies that the introduction of the minimum wage and the subsequent upratings have not had any adverse impact on total hours worked in the economy.

2.95 Figure 2.22 shows that total hours worked per week in the UK were 925.6 million during the three months to November 2006, up 3.7 million from the same period a year ago. This rise in hours was mainly driven by increases in the hours worked by female workers.

Figure 2.22
Average and Total Actual Weekly Hours Worked, UK, 1998–2006



Source: ONS, LFS, total and average hours worked series (ONS codes YBUS, YBUV), monthly, seasonally adjusted, UK, 1998–2006.
Note: Three months to the end of the month shown.

2.96 Looking at trends in average weekly hours worked, the latest figures suggest that people on average are working around 1.5 hours less than they did 10 years ago. The downward trend also implies that the growth in total hours worked depicted in Figure 2.22 has been driven by gains in employment.

Research on Hours

2.97 The minimum wage does not appear to have had much impact on the aggregate number of hours worked in the economy. Connolly and Gregory (2002) investigated how the hours of low-paid women had been affected by the introduction of the minimum wage. They found a three year effect greater than the one year effect, albeit both were insignificant. This longer run effect was also picked up by Stewart and Swaffield (2004). They found no statistically significant evidence of an immediate impact of the minimum wage but, allowing for longer run adjustments, they did find evidence to suggest that the introduction of the minimum wage had led to reductions in the working week of about 1 to 2 hours for both male and female workers affected by the minimum wage.

2.98 In an analysis of second job holding, Robinson and Wadsworth (2004) concluded that the minimum wage had neither caused individuals to give up, or reduce hours in, their second jobs (due to increased earnings in their first jobs) nor had it encouraged more people to take additional jobs (if hours in their main job had been reduced).

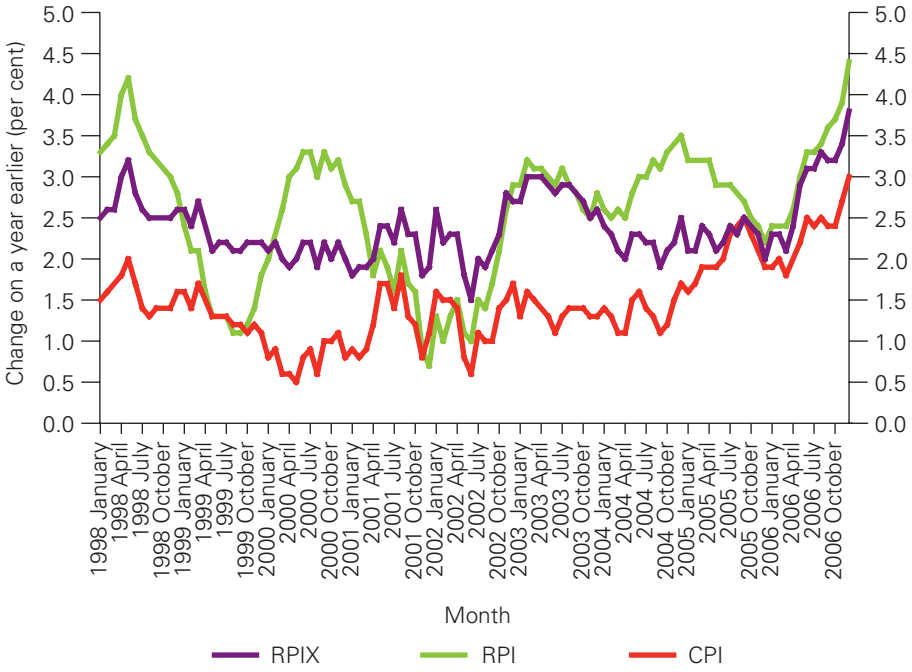
Impact of the National Minimum Wage on the Firm

Prices

2.99 In this section we examine the impact on firms, starting with prices. One way firms might respond to the minimum wage is by increasing prices. We begin by looking at how aggregate consumer prices have changed before discussing the ability of businesses to pass on any increase in their costs. Concluding this section, we summarise the available research.

2.100 The ONS produces a variety of measures of consumer price inflation. The RPI is the most familiar general-purpose measure in the UK. It measures the average change from month to month in the prices of goods and services purchased by most households in the UK. Its derivative, the RPIX, excludes mortgage payments. The measure adopted by the Government for its UK inflation target (2.0 per cent) is the CPI. Figure 2.23 shows how these indices have changed since 1998. There does not appear to be any correlation between the minimum wage and aggregate price changes whatever measure is chosen. Consumer price inflation on all three measures has picked up since the beginning of 2006 and, in December 2006, was at its highest for over a decade.

Figure 2.23
Consumer Price Inflation – A Comparison of Measures, UK, 1998–2006



Source: ONS, CPI (ONS code D7G7), RPI (ONS code CZBH) and RPIX (ONS code CDKQ), monthly, not seasonally adjusted, UK, 1998–2006.

2.101 Turning to whether businesses are able to pass on their costs to other businesses, the experimental ONS Services Producer Price Index (SPPI) provides a measure of how business prices change. It shows that, between 2002 and the middle of 2006, annual business price inflation grew from about 2 per cent to around 3.5 per cent. However, it fell in the third quarter of 2006 to about 3 per cent, reflecting a slowing down in fuel price increases affecting a number of corporate service industries.

2.102 Draca, Machin and Van Reenen (2005) investigated the impact of the minimum wage on prices but found no statistically significant impact on a range of goods and services that might be associated with the minimum wage. In a similar analysis, Wadsworth (2007) also found no evidence of any significant price increases for goods and services produced by minimum wage workers in the periods that corresponded immediately to the introduction and uprating of the minimum wage.

2.103 However, Wadsworth noted that this did not mean that prices had not been affected and extended his analysis to check whether firms took longer to adjust prices. He found that, in the period since the

introduction of the minimum wage, the price of a basket of minimum wage goods and services had risen faster (by 0.8 percentage points) than the all-items RPI. He did qualify this finding by noting that a general basket of UK produced goods and services had also experienced higher price inflation.

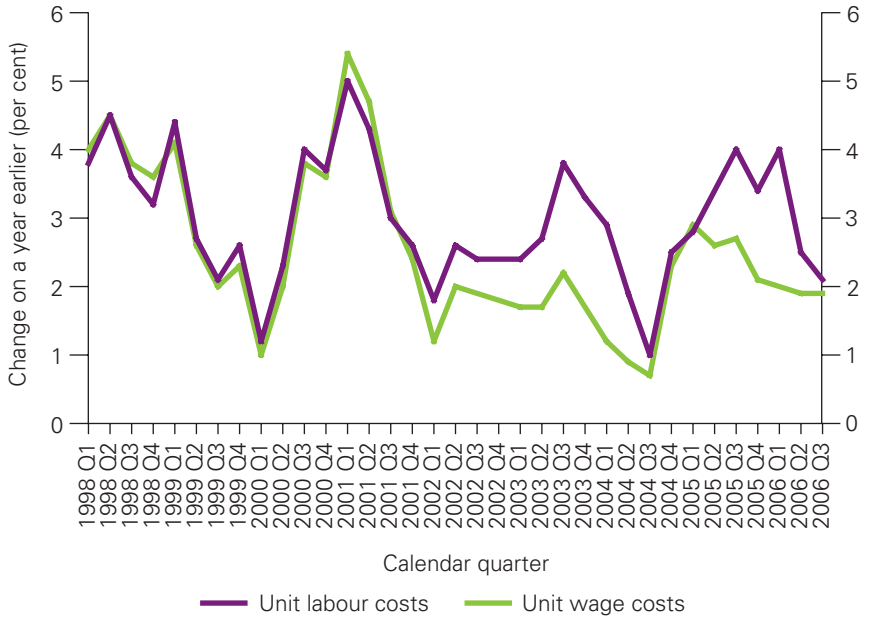
2.104 In his report, Wadsworth also found that for some minimum wage goods and services, such as dry cleaners, canteen meals and pub drinks, demand was very sensitive to price changes (price elastic). For these goods and services, it would be more difficult for businesses to pass on increased costs in price increases. For other minimum wage goods and services, such as take-away food, domestic services and hotel services, demand was less sensitive to price changes (price inelastic).

2.105 He concluded that *'the relative rate of inflation of minimum wage goods and services did increase in the period after the minimum wage was introduced and that prices rose faster for those goods and services whose demand is relatively more price inelastic'*.

Labour Costs

2.106 The cost of labour to employers is not confined to wages. Figure 2.34 shows that changes in unit wage costs, which measure the cost of wages and salaries per unit of output, and changes in unit labour costs, which include non-wage costs as well, differ over time. From the first quarter of 2005 to the beginning of 2006, unit wage costs fell (as pay settlements and average wage increases were subdued) while unit labour costs rose (due to increased NICs and greatly increased pension contributions by employers). This divergence between the two measures appears to have abated in 2006 as the growth in unit labour costs has fallen.

Figure 2.24
Unit Wage and Labour Costs, UK, 1998–2006



Source: ONS, unit wage costs (ONS code LOJE) and unit labour costs (ONS code DMWN), calendar quarters, seasonally adjusted, UK, 1998–2006.

Profits

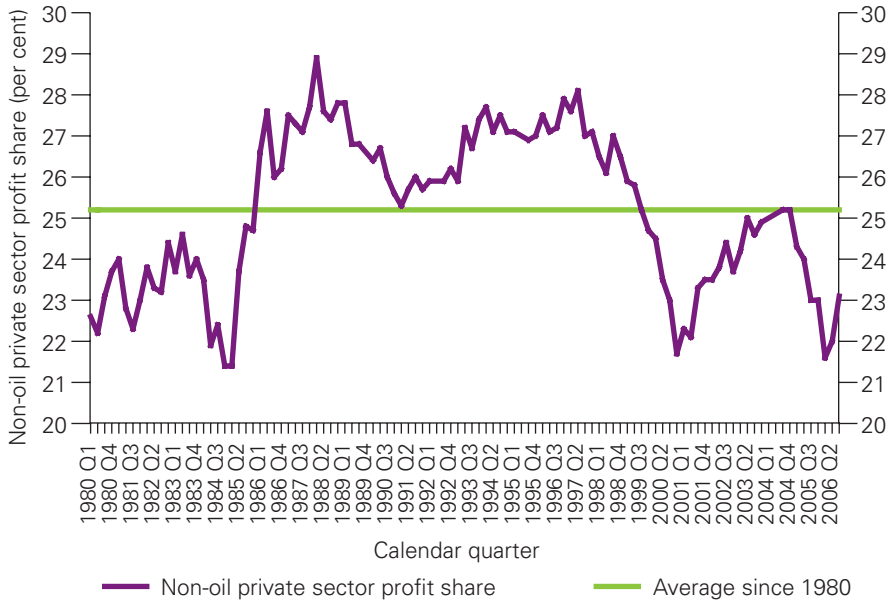
2.107 Instead of passing on the costs of the minimum wage in higher prices, firms might try to absorb these costs by reducing their profit margins. In this section, we look at aggregate measures of profitability before summarising the available research on the impact of the minimum wage on profits.

2.108 Although there is no single measure of profitability available to properly capture the financial health of UK businesses, a number of indicators point to strong corporate financial performance in 2006. Profitability in the UK economy as measured by net rates of return on capital stood at record levels in the third quarter of 2006. The very high profitability figures in the service sector are not matched, however, by the manufacturing sector. Despite the recent improvement in manufacturing output, this measure of profitability is at its lowest since 1992.

2.109 The increase in the FTSE-100 index to a level consistently above 6,000 also points to improved profitability. There has been an improvement in company financial balances – retained profits after allowing for taxes, investment and other costs – since the beginning of 2002. National

accounts data also show that companies are currently significant net lenders to the rest of the economy – Government and households.

Figure 2.25
Non-oil Private Sector Profit Share, UK, 1980–2006



Source: Bank of England estimates of the non-oil profit share based on ONS data and Bank of England calculations, UK, 1980–2006.
Note: Non-oil profit share defined as non-oil private sector profits as a share of non-oil private sector output.

2.110 However, the profit share in the non-oil private sector stood at 23.1 per cent in the third quarter of 2006, below the long-term (1980 to 2006) average of 25.2 per cent. This is highlighted in Figure 2.25 which shows that, excluding the oil sector, UK profits as a share of GDP fell throughout the latter part of the 1990s before rebounding from the end of 2001 through to the end of 2004. It then declined before picking up in 2006. However, since the introduction of the minimum wage in 1999 UK non-oil private sector profits as a share of GDP have been below the long-term average since 1980.

2.111 Further, price margins appear to have been squeezed in 2005 and for most of 2006. Producer input prices have consistently been above producer output prices during this period.

2.112 Draca *et al* (2005) analysed two data sets to assess the impact of the minimum wage on profits. Using a sample of UK firms drawn from the Financial Analysis Made Easy database, they found evidence that profit

margins had fallen by about 8–11 per cent on average in those firms most affected by the introduction of the minimum wage. Analysing a sample of care homes, they found that those homes which had had to raise their wages the most experienced the largest fall in profits. On average, they found that the introduction of the minimum wage had reduced profits by around 23 per cent for the average care home. However, they found no evidence from either sample that this reduction in profits had led to an increased likelihood of the business closing down. Experian (2007) looked at the impact of the minimum wage on sectoral profits but found no statistically significant effect. We next look at whether firms adjust to the minimum wage by increasing productivity.

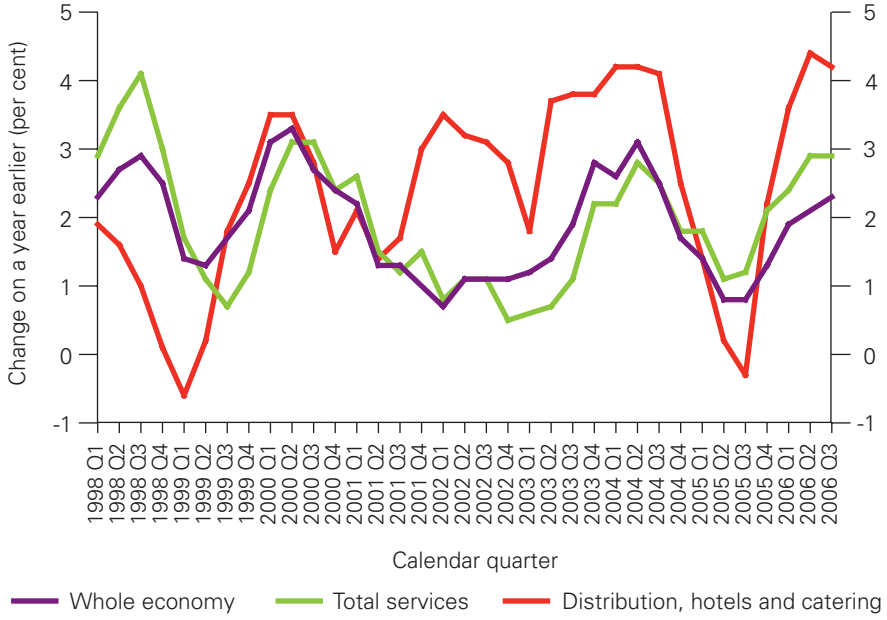
Productivity and Training

Productivity

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

2.114 Data for the third quarter of 2006 show that labour productivity (defined as output per worker) is continuing to improve. Productivity growth has now increased for the fourth consecutive quarter, after reaching a four-year low in the second quarter of 2005. In the third quarter of 2006, it stands at 2.3 per cent – 1.6 percentage points higher than a year ago. This increase is due to output growth accelerating faster than employment growth during this period. Figure 2.26 shows that this has been driven by strong performance in the services sector, especially in distribution, hotels and catering.

Figure 2.26
Growth in Productivity for the Whole Economy, Total Services and Distribution (including Retail and Hospitality), UK, 1998–2006



Source: ONS, output per job for the whole economy (ONS code LNNP) and experimental series for total services and distribution, seasonally adjusted, UK, 1998–2006.

2.115 There is little evidence of an impact of the minimum wage on productivity. Forth and O'Mahoney (2003), Draca, Machin and Van Reenen (2005) and Machin, Manning and Rahman (2003) using various data sets found positive but not significant impacts on labour productivity. However, Galindo-Rueda and Pereira (2004) did find evidence that labour productivity (but not total factor productivity) increased significantly faster in those firms most affected by the minimum wage. This finding was statistically significant for firms in the services sector but not in manufacturing.

Training

2.116 Theoretically, the impact of the minimum wage on training is ambiguous. Firms could use training in order to increase the productivity of the workforce thereby enabling them to cope better with minimum wage increases. On the other hand, some firms may reduce training as they regard it as an unnecessary cost. Analysis by Aralampulam, Booth and Bryan (2004) using the BHPS found some evidence to suggest that the introduction of the minimum wage had led to a statistically significant, albeit small, increase in training. Dickerson (2007) was commissioned to conduct a similar analysis using

a larger dataset, the LFS. He found that there was no evidence to suggest that employers had reacted to the introduction of the minimum wage or its subsequent upratings by increasing, or indeed decreasing, the amount of employer-provided training. This result held for men, women, adult workers and young workers, and was robust to different measures of wages and alternative comparison groups.

Entrepreneurship – Births and Deaths of Firms

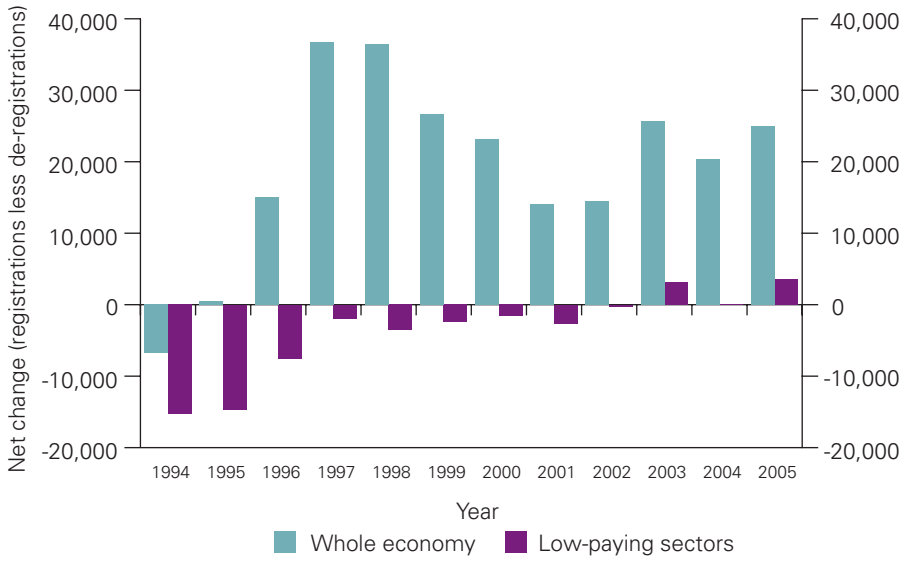
2.117 Another way of looking at the impact of the minimum wage on firms might be to look at the levels and changes in both business start-ups and business failures. An increase in the minimum wage might make it less attractive to start a business as the wage costs could increase as a result. Further,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

Business Start-ups and Failures

2.118 Figure 2.27 shows the net change in business start-ups and closures, proxied by the number of businesses registering and de-registering for Value Added Tax (VAT). Looking at the economy as a whole, the stock of VAT-registered enterprises has increased in every year since 1995. In 2005, there were some 178,000 registrations and 153,000 de-registrations, resulting in a net increase of around 25,000 in the stock of VAT-registered enterprises.

2.119 In the low-paying sectors, the period since 2003 has seen the number of business start-ups outstripping that of business closures, suggesting that the large minimum wage upratings that have taken place since 2003 have not had any adverse impact on entrepreneurial activity. In 2005, the low-paying sectors that saw the largest net increase in the stock of VAT-registered business were retail (4,000) and hospitality (4,400). The largest net fall was in the agriculture sector (2,800).

Figure 2.27
Net Change in the Stock of VAT Registered Enterprises in the UK, 1994–2005



Source: Small Business Service, business start-ups and closures: VAT registrations and deregistrations, annual, UK, 1994–2005.

Insolvencies

2.120 Another indicator linked to entrepreneurial activity and behaviour is the number of insolvencies in the economy. Insolvencies have hit record levels during the course of 2006. However, recent sharp increases in the number of insolvencies have been driven almost entirely by increases in individual insolvencies. Company liquidations on the other hand have remained relatively stable. In the year to the fourth quarter of 2006, they decreased marginally.

2.121 In research that looked at business creation, Galindo-Rueda and Pereira (2004) found, using the Annual Respondents Database, that around the time of the introduction of the minimum wage, business creation was slower in those areas of the country where wages needed to adjust most to comply with the minimum wage. However, they were unable to replicate this finding using data from VAT registrations. They found that a slowing of business start-ups preceded the introduction of the minimum wage but noted that this may have been caused by anticipatory effects. However, also using VAT registrations, Experian (2007) found evidence that the rate of company formation was lower in those regions which were most affected by the minimum wage.

Recession

2.122 The National Minimum Wage has been in existence throughout a period of unprecedented continuous growth. Aware of this and interested in what might happen in a less positive climate, we commissioned research to investigate the impact of the 1990s recession on the low-paying sectors. IDS (2006a) found that the 1990s recession had mainly affected the manufacturing, construction and financial services sectors and that the low-paying sectors had been little affected in terms of employment or earnings. It found that employment had fallen but was reasonably stable unlike the most affected sectors which experienced sharp falls in employment. Earnings in the low-paying sectors had kept pace with consumer price inflation, helped by the Wages Councils which set minimum wages and working conditions in many of the low-paying sectors. The report pointed out, however, that the lessons of the last recession may not apply to a recession that had other causes.

Conclusion

2.123 We have shown that the minimum wage has clearly affected the distribution of hourly earnings and that the recent minimum wage upratings increased its 'bite' to more than half median earnings for the first time in 2005. Research we have commissioned has also concluded that the minimum wage is more pervasive than before and is affecting the pay structures of more companies than previously.

2.124 We have shown that the minimum wage has so far not affected aggregate employment. However, there is evidence to suggest that, during 2006, employment has fallen in the low-paying sectors as a whole and in retail and hospitality in particular. There is also evidence to suggest that the employment levels of young workers and those without education or training qualifications continue to fall. Unemployment has risen for those groups most affected by the minimum wage. This may reflect the large increase in labour supply driven by strong inward migration and increased participation by older workers, those previously on incapacity benefits and women.

2.125 Our commissioned research has also found tentative evidence that employment growth had been slower in those regions most affected by the minimum wage. However, in general, research has found the impact on employment to be insignificant.

2.126 The total number of hours worked in the whole economy also continues to grow, but there is some evidence that hours have been reduced in the low-paying sectors. Previous research suggested that the minimum wage may have led to reductions in the working week of an hour to two hours for both low-paid men and women.

2.127 Consumer price inflation is now higher than it has been for over a decade on a variety of measures. Mainly driven by increases in oil, energy costs and food, prices have risen sharply in the second half of 2006. Research we commissioned has found the first evidence that businesses may have increased prices for some goods and services produced by minimum wage workers.

2.128 Consistent with subdued growth in average wages, profits in the UK in 2006 look buoyant, with the rate of return at record levels for services. The FTSE index has continued to climb. However, profit margins in manufacturing have been squeezed as input prices have increased faster than output prices. Excluding the volatile oil sector, gross operating surplus as a percentage of private sector gross domestic product has increased since the beginning of 2006 but is well below its average level since 1980. Previous research has found that profits fell in some low-paying sectors as a result of the introduction and subsequent upratings of the minimum wage.

2.129 Labour productivity in the UK has increased sharply since the beginning of 2005 with noticeable increases in both hospitality and distribution (which includes retail). Research has found that the minimum wage has contributed to some increases in labour productivity but has had little or no effect on total factor productivity.

2.130 Company start-ups outnumbered company failures in the low-paying sectors between 2003 and 2005. Research found that the introduction of the minimum wage may have reduced the number of businesses entering the low-paying sectors, but none has found that it increased the number of company failures.

2.131 In summary, the UK economy and labour market appear to be in reasonably good health. However, there are tentative signs that the minimum wage is having a greater impact, particularly on the low-paying sectors. We now go on to investigate this further in Chapter 3.

Chapter 3

The Effects of the National Minimum Wage on Specific Sectors and on Small Firms

We have identified ten industrial sectors of the economy in which low pay is common. Together they provide over eight million jobs, nearly a third of all jobs in the economy. The two largest sectors – retail and hospitality – account for nearly two-thirds of jobs in the low-paying sectors. Of course many of the jobs in these sectors are paid at a level well above the minimum wage.

While the total number of jobs in these low-paying sectors remains substantially higher than when the minimum wage was introduced, in late 2005 and during 2006 the number of jobs in these sectors declined – the first such fall in employment since the minimum wage was introduced. This occurred at a time when the level of employment in the economy as a whole has been growing. It is true that some of the low-paying sectors, such as textiles and agriculture, have been contracting in size for some time, but in 2006 employment fell in sectors which had seen some of the most rapid growth in recent years, namely retail and hospitality. It is difficult to determine what role, if any, recent minimum wage upratings have played in this decline and jobs did not reduce in all low-paying sectors.

We have also identified two low-paying occupational sectors (childcare and office work). During the year to the third quarter of 2006, there was a small increase in the number of employees in low-paid jobs in childcare, while in the same period employment in low-paid office work decreased slightly.

Responses to our consultation provided growing evidence that the minimum wage is having an impact on pay and differentials in the low-paying sectors. Although not new, it was one of the strongest messages coming from the organisations we met during our regional visits in 2006. Other sources of information, such as our oral hearings and

commissioned research, also provided evidence of an increasing influence of the minimum wage on pay structures. We found this was particularly marked in hospitality, retail, cleaning and childcare, where a growing proportion of jobs were paid at the minimum wage.

Only a small proportion of workers in agriculture are paid at the National Minimum Wage. It does, however, have a knock-on effect on differentials for the agricultural minimum rates set by the Agricultural Wages Boards. In the textiles and clothing sector, employers with incentive based pay systems reported that the minimum wage was having an increasing effect on their arrangements. The impact of the minimum wage on pay in the office work occupations and in the security and food processing sectors looks to be more limited, although in the case of the latter sector there is some evidence that it is growing. The overall impact on small firms appears to have been fairly stable between 2004 and 2006.

In the year to September 2006, the social care sector experienced the largest increase in employment of all the low-paying sectors. While overall the sector has a comparatively small proportion of jobs paid at the level of the minimum wage, this proportion is far greater in the independent than the public care sector.

In their evidence some independent sector care providers again stressed the difficulties they faced as a result of local authority funding failing to reflect adequately the increases in the costs of care. Such costs included the cost of minimum wage upratings. We noted this problem in our 2005 Report and recommended that the Government should make clear to local authorities that policies on commissioning care should adequately reflect the costs of provision. We recommended that the Government should monitor the approach of local authorities in this regard and examine the reasons for any uneven provision. We also said that, if appropriate, it should provide further guidance.

We recognise the progress that has been made on the funding of social care, but the evidence suggests that the problem we identified in our 2005 Report persists in some areas of the UK. Moreover, we have seen no evidence of effective monitoring of local authority practice in this regard, as we recommended. We therefore reiterate our 2005 Report recommendation but with greater emphasis on the need for the Government to monitor actively how far the practice matches the policy.

It would be helpful for such monitoring information to be made available to us when we next review the sector.

Introduction

3.1 This chapter looks at the impact of the National Minimum Wage on small firms and on those sectors of the economy that we have identified as having a large number or a large proportion of low-paying jobs and occupations. It is in such sectors that one might expect to find the first indications of any negative impact on business arising from the operation of the minimum wage. Since our last report (2006) we have reviewed which industrial sectors (defined with reference to industrial classification) and occupational sectors (defined with reference to occupational classification) fall into this category. This has led us to include two new industrial sectors and an additional occupational sector in the scope of our work, as well as revised definitions of some of those previously featured.

3.2 As in previous reports we feature retail, hospitality, cleaning, security, childcare, social care, textiles and clothing, agriculture and hairdressing. However, in addition we now examine the leisure, travel and sport and food processing industrial sectors and the office work occupational sector. We have revised our definition of the retail sector to include the sale, maintenance and repair of motor vehicles and motorcycles, and the retail sale of automotive fuel. We have also revised our definition of the cleaning sector to include the washing and dry cleaning of textile and fur products. We have removed footwear manufacture from the sector which includes textiles and clothing. Social care, in line with changes to the Office for National Statistics (ONS) definitions, now includes non-residential as well as residential care. More detail on the revisions is set out in Appendix 5.

3.3 As well as reassessing which sectors we should look at when considering the impact of the minimum wage, we have also identified the occupations, usually associated with each of these sectors, in which low pay is common. We have supplemented our sector analysis with additional information on trends in employment and earnings in these low-paying occupations where we found this added to our understanding of the sector and the impact of the minimum wage.

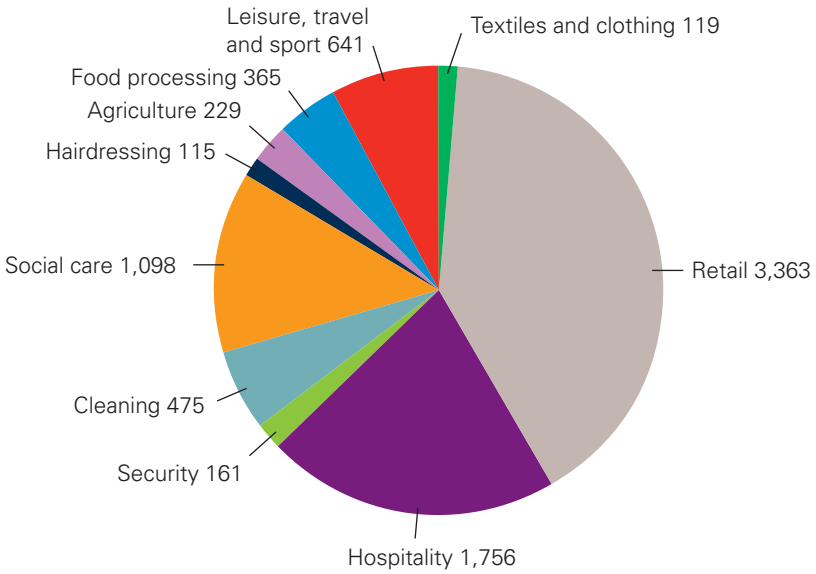
3.4 In assessing the impact of the minimum wage we have drawn on a range of evidence, including ONS data on earnings, jobs and self-employment; research we commissioned by Incomes Data Services (IDS, 2006b) and the Institute for Employment Studies (Denvir and Loukas, 2006); other independent research and our biennial Employers' Survey. The full results of the survey are given in Appendix 3. We have also drawn on evidence gathered as part of our public consultation on the impact of the minimum wage. This has been supplemented by information provided during our visits throughout the UK to speak directly to employers and workers and hear first hand their views on the minimum wage.

3.5 In this chapter we begin with an overview of employment, self-employment and pay in the low-paying sectors. We then consider the impact of the minimum wage on small firms, before examining in turn each of the ten low-paying industrial sectors, and the two low-paying occupational sectors.

Overview of the Low-paying Sectors

3.6 Figure 3.1 below shows the relative proportion of jobs in each of the low-paying industrial sectors. These sectors account for over eight million employee jobs, around one third of all jobs in the UK. Retail (now including the motor trade) continues to be the largest sector, accounting for two-fifths of all jobs in the low-paying sectors, followed by hospitality which has around a fifth.

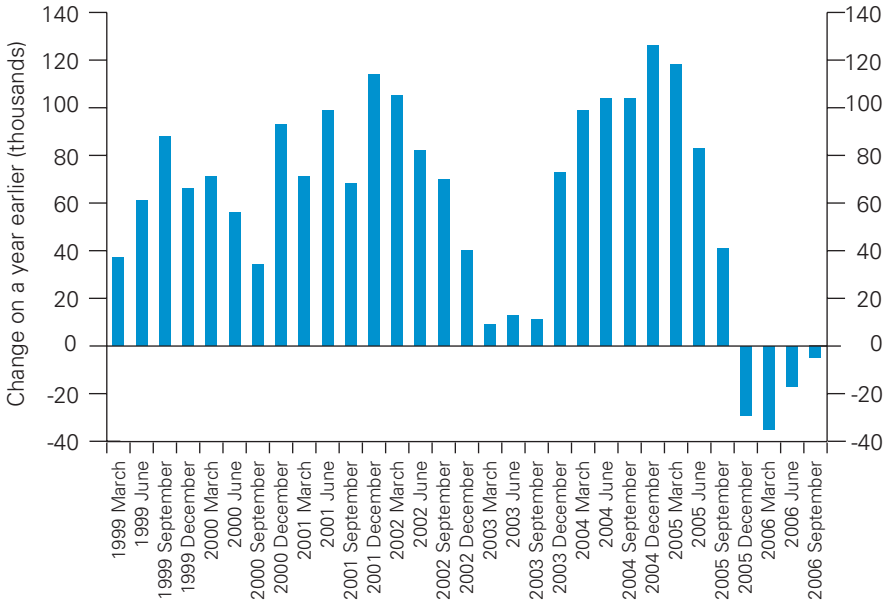
Figure 3.1
Employee Jobs in the Low-paying Sectors, Thousands, GB, 2006



Source: ONS employee jobs series, not seasonally adjusted, GB, September 2006.
Note: Retail includes the sale, maintenance and repair of motor vehicles and motorcycles, and the retail sale of automotive fuel.

3.7 As stated in Chapter 2, since the introduction of the National Minimum Wage in April 1999, the number of employee jobs in the low-paying industrial sectors has increased by around 5 per cent or 0.4 million. However, the period from December 2005 has seen the first year-on-year falls in employment in the low-paying sectors as a whole since the minimum wage came into force (Figure 3.2). In the year to September 2006 there was a slight fall in jobs in these sectors, largely accounted for by job losses in the hospitality sector (25,000), and to a lesser extent in the retail, food processing, and textiles and clothing sectors. This is in contrast to an increase of 162,000 jobs across the whole economy in the same period. While jobs in sectors such as textiles and clothing have been in long term decline, the job losses in hospitality and retail could be seen as a sign that the minimum wage is beginning to have an impact on employment in the low-paying sectors. However, it is not possible to determine whether the minimum wage is a factor, and it is too early to know whether the recent fall in jobs in these sectors signals the beginning of a more long-term decline in employment. Downward movements have occurred in hospitality and retail in earlier periods since the introduction of the minimum wage and have proven to be temporary. We look more closely at the evidence later in the chapter.

Figure 3.2
Change in Employee Jobs in the Low-paying Sectors, Thousands, GB, 1999–2006

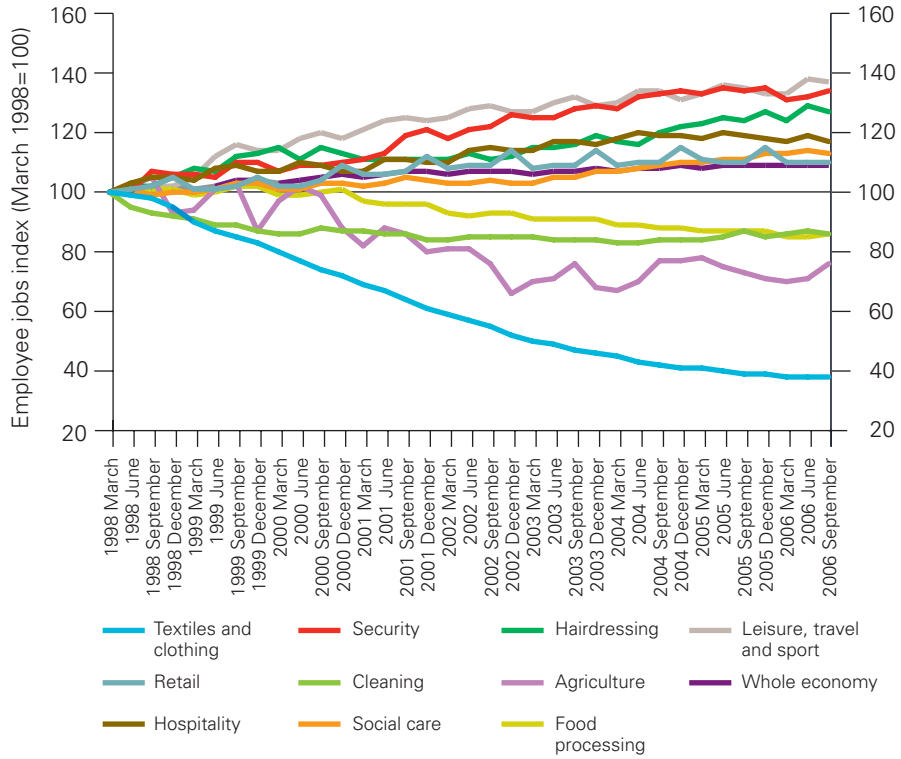


Source: ONS employee jobs series, not seasonally adjusted, GB, 1999–2006.

3.8 Figure 3.3 shows the trend in employee jobs by low-paying sector since 1998, the year before the minimum wage was introduced. Most of these sectors have experienced a growth in jobs – in particular the leisure, travel and sport; security and hairdressing sectors. But jobs in four sectors – textiles and clothing, agriculture, food processing and cleaning – show a downward trend. We explore these trends in more detail when we look at each sector later in this chapter.

Figure 3.3

Change in Employee Jobs by Low-paying Sector, GB, 1998–2006



Source: ONS employee jobs series, not seasonally adjusted, GB, 1998–2006.

3.9 When the minimum wage was introduced, some commentators were concerned that it might lead to a rise in self-employment as a means of avoidance. Table 3.1 shows changes in self-employment in the low-paying industrial sectors. The security, food processing and textiles and clothing sectors have relatively few self-employed and, as explained in the table, the figures are too small to be reliable. Looking at the other low-paying sectors, between 1998, shortly before the introduction of the minimum wage, and 2006, there have been marked increases in self-employment in two sectors which have also experienced strong growth in employee jobs (hairdressing and leisure, travel and sport). Growth in self-employment also occurred in cleaning, a sector which saw a reduction in employee jobs over the same period. The sector that experienced the greatest proportional reduction in the level of self-employment during this period was hospitality (which at the same time experienced strong growth in employee jobs). A substantial fall in self-employment also occurred in agriculture (where a loss of employee jobs has also taken place). The evidence suggests that employee jobs have not been replaced by self-employment other than perhaps in cleaning, and such a link is only evident between 1998 and 2004.

Table 3.1
Change in Self-employment in the Low-paying Sectors, UK, 1998–2006

Thousands	2006 Q3	Change on 2005 Q3	Change on 1998 Winter	Self-employed share, 2006 Q3 (%)	Self-employed share, 1998 Winter (%)
Whole economy	3,362	45	256	100.0	100.0
All low-paying sectors	1,052	-11	-51	31.3	35.5
Of which:					
Retail	324	-21	-69	9.6	12.6
Hospitality	103	-6	-24	3.1	4.1
Social care	94	-3	-9	2.8	3.3
Cleaning	62	3	8	1.8	1.7
Agriculture	166	-1	-25	5.0	6.2
Security	*	*	*	0.3	0.2
Textiles and clothing	*	*	*	0.6	0.8
Food processing	*	*	*	0.3	0.4
Leisure, travel and sport	152	19	42	4.5	3.5
Hairdressing	109	-1	24	3.2	2.7

Source: LPC estimates based on Labour Force Survey (LFS) Microdata, seasonal/calendar quarters, four quarter moving average, UK, 1998–2006.
Note:
1. * indicates that figures are too small to be reliable.
2. Q3 = Quarter 3 (July to September). Winter is December to February.

3.10 Of course not all jobs in the low-paying sectors pay at the minimum wage; around three-quarters of jobs in these sectors paid £5.50 per hour or above in April 2006. Table 3.2 below shows the proportion of jobs paying either at or below the prevailing adult minimum wage rate in each year between 2004 and 2006. Hairdressing, hospitality and cleaning have the highest proportion of jobs held by employees aged 18 and over paid at the minimum wage. For all but three of these sectors and occupations (security, hairdressing and office work) the proportions have increased over the period, illustrating the growing impact of the minimum wage. The high proportion of jobs paid below the adult rate in the hairdressing and hospitality sectors, and in the nursery nurse occupation, is likely to be due to the number of young workers who may be on the Youth Development Rate or whose pay may be affected by the apprenticeship exemptions.

Table 3.2

Percentage of Employee Jobs Held by those Aged 18 and Over Paid at the Adult Minimum Wage or Below by Sector/Occupation, UK, 2004–2006

	April 2004		April 2005		April 2006	
Sector/Occupation	**% Paid at £4.50**	**% Paid Below £4.50**	**% Paid at £4.85**	**% Paid Below £4.85**	**% Paid at £5.05**	**% Paid Below £5.05**
Retail	3.5	5.0	3.6	5.2	4.3	5.5
Hospitality	13.6	8.0	14.2	10.5	15.0	14.7
Leisure, travel and sport	4.9	5.1	5.1	5.5	5.0	6.3
Cleaning	13.7	4.4	15.0	2.2	17.4	2.5
Security	4.4	1.4	5.4	0.9	4.1	0.9
Social care	2.6	3.3	3.8	2.6	3.5	2.5
Agriculture	2.1	2.7	1.5	2.7	2.6	3.1
Textiles and clothing	4.4	2.9	4.9	2.1	5.8	2.1
Hairdressing	7.9	11.7	6.1	12.9	7.8	15.2
Food processing	2.0	1.1	2.8	1.1	3.6	1.4
Office work	2.3	3.1	2.3	3.0	2.2	3.0
Nursery nurses	3.0	8.6	4.5	8.6	5.7	10.3
All low-paying sectors	**5.3**	**4.9**	**5.8**	**5.2**	**6.5**	**6.1**
Whole economy	**1.8**	**2.0**	**1.9**	**2.1**	**2.2**	**2.5**

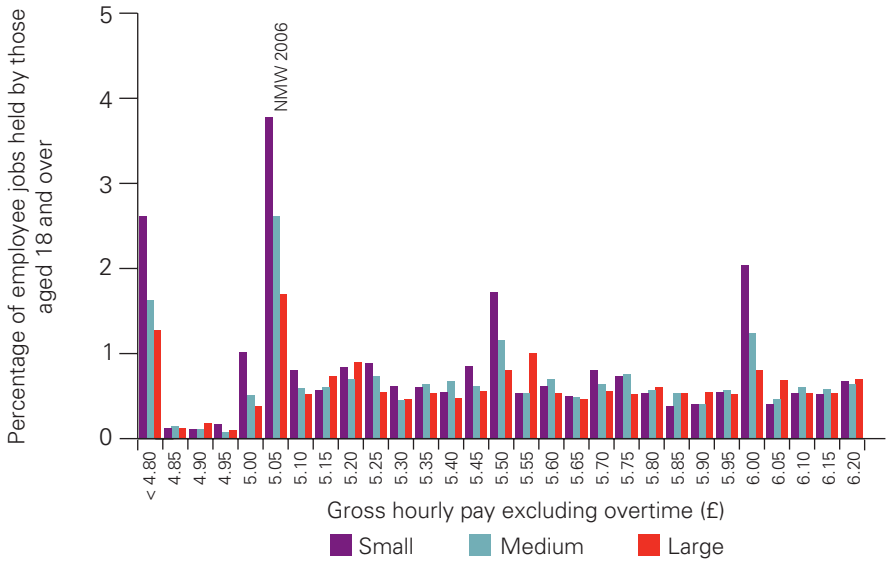
Source: LPC estimates based on the Annual Survey of Hours and Earnings (ASHE) with supplementary information, low-pay weights, UK, April 2004–2006.

Note: In contrast to Table 2.3 in Chapter 2, this table also includes those aged 18 to 21.

Small Firms

3.11 Small and medium-sized enterprises (SMEs) are important contributors to the economy. The 1.25 million businesses with at least one but fewer than 250 employees account for just over a third of UK employment and around two-fifths of UK turnover (Small Business Service, 2006b). In previous reports, we have noted that small firms tend to be more affected by the National Minimum Wage, as demonstrated by Figure 3.4. Around 4 per cent of jobs in small firms (1–49 employees) were paid at the adult minimum wage in April 2006, compared with around 2.5 per cent in medium-sized firms (50–249 employees) and around 1.5 per cent in large firms (250+ employees).

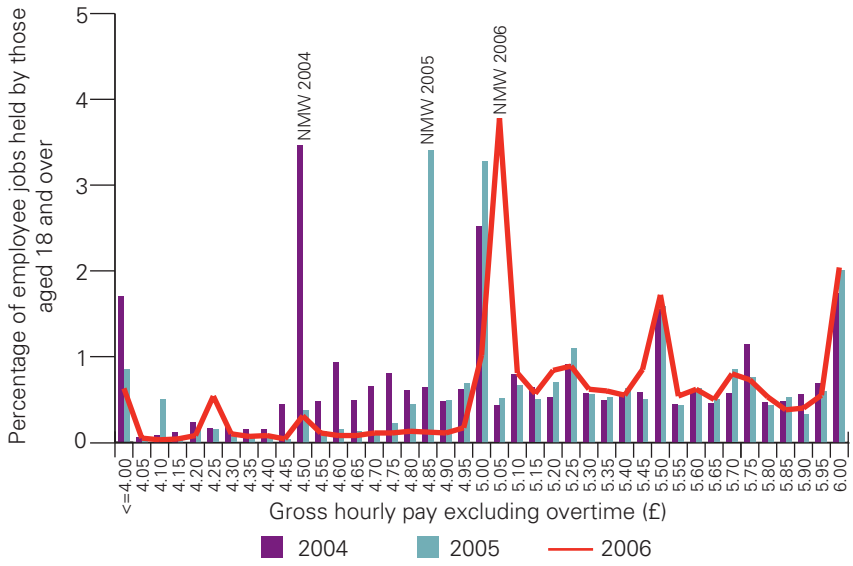
Figure 3.4
Hourly Earnings Distribution for Employees Aged 18 and Over by Firm Size, UK, 2006



Source: LPC estimates based on ASHE with supplementary information, low-pay weights, UK, April 2006.
Notes:
1. Firms are defined as small (1–49 employees), medium (50–249 employees) and large (250 or more employees).
2. NMW label shows the adult minimum wage rate in April 2006.

3.12 Figure 3.5 below indicates that the proportion of jobs paying at the minimum wage in small firms has remained fairly steady, despite the 12 per cent increase in the adult minimum wage rate between April 2004 and April 2006. The slightly higher spikes at the minimum wage in the 2006 distribution may reflect the fact that the minimum wage uprating in October 2005 overtook the £5.00 hourly pay threshold.

Figure 3.5
Hourly Earnings Distribution for Employees Aged 18 and Over in Small Firms, UK, 2004–2006



Source: LPC estimates based on ASHE with supplementary information, low-pay weights, UK, April 2004–2006.
Notes:
1. Small firms (1–49 employees).
2. NMW label shows the adult minimum wage rate in April of the given year.

3.13 In commenting on the impact of the minimum wage in their most recent evidence to us, the Federation of Small Businesses (FSB), the Small Business Council and the Forum of Private Business each emphasised that its effects should not be viewed in isolation; small businesses faced significant cost pressures arising from other employment regulation and from other factors such as the rising cost of energy.

3.14 We received similar messages directly from five small businesses invited by the Commission and the Small Business Service (SBS) to form a focus group in September 2006 to discuss their experiences of the minimum wage. They told us that small firms were finding it increasingly difficult to absorb costs arising from a number of existing statutory measures and were deeply concerned about the likely impact of planned measures including increased statutory annual leave entitlement and compulsory pension contributions. At the same time, these businesses reported intense competition from larger firms, which meant that price increases were not a viable option. We were told that this forced owners and managers in the retail and hospitality sectors to work longer hours and trim the hours worked by their staff. A further

'... although smaller businesses are managing to cope with the rises in the NMW level, there is a cumulative negative effect .... Smaller businesses are already having difficulty competing with supermarkets and out-of-town shopping centres, and if they have to increase prices, these difficulties will be compounded.'

Forum of Private Business evidence

'The NMW has caused a number of problems for us as we cannot afford to maintain the level of staffing we did previously and we have reduced the number of hours that are worked in order to keep our wage bill at a reasonable level .... Payroll costs in 2000 were 72% of total expenses and now are 86% of total expenses.'

Owner of a village store in Oxfordshire, quoted in FSB evidence

concern was the effect of reduced pay differentials on staff motivation. One hospitality sector employer reported that the wages of staff with no experience had now caught up with those of trained staff, making these employees less likely to want to remain in the industry to train and develop a long-term career.

3.15 The issue of rising costs was echoed by the Association of Convenience Stores (ACS), which wrote that small convenience stores were finding it difficult to afford cost increases and owner-managers typically increased their own hours while cutting back on staff hours. The ACS was also concerned about the long-term viability of stores that could not afford to invest in the business. The FSB reported that the minimum wage was causing firms to reduce the number of employees. A number of small bakeries recorded fears about the continuing viability of their businesses in an increasingly competitive food industry.

3.16 Surveys of small businesses indicate that the minimum wage has continued to have a notable impact. The biennial Federation of Small Businesses Survey (FSB, 2006) found that 21 per cent of small firms with employees were affected by the 4.1 per cent increase in the adult minimum wage to £5.05 in October 2005, the same proportion affected by the larger uprating in October 2003. The impact was most severe in the hospitality sector and in North East England and Northern Ireland. The SBS Annual Survey of Small Businesses 2004/05 (SBS, 2006a) found that 17 per cent of SMEs in the UK with employees had some staff on the minimum wage.

'The National Minimum Wage is having a serious impact on businesses in certain regions and industry sectors.'

FSB evidence

3.17 Our own survey of employers in low-paying sectors found that 40 per cent of respondents from small firms with 53 per cent from medium-sized firms reported an impact (compared with 59 per cent of large firms). This is slightly lower than the proportion that reported an impact in our 2004 survey. Although our survey cannot be considered representative of firms in low-paying sectors, it does support other survey evidence indicating that the proportion of small firms affected by the minimum wage upratings in 2004 and 2005 has remained stable rather than increased. It remains to be seen whether future surveys will find a greater impact arising from the larger 5.9 per cent uprating to

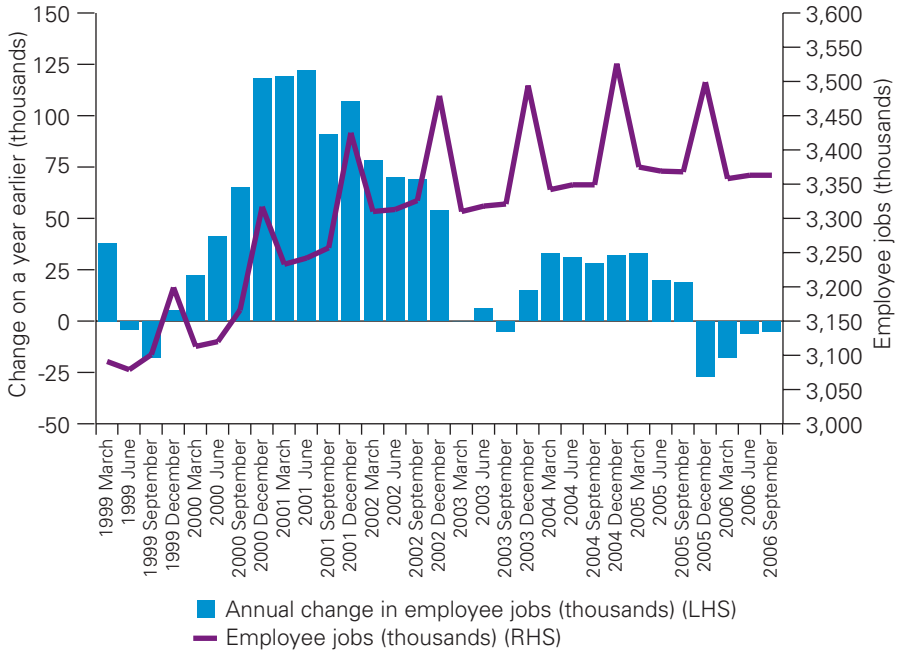
£5.35 in October 2006. We now turn to examine each of the low–paying sectors and occupations.

Retail

3.18 The retail sector experienced fairly strong output growth from the introduction of the minimum wage to the end of 2004. However, the rate of growth dropped sharply in 2005, rising by just under one per cent for the year as a whole, reflecting the general slowdown in consumer spending during the year. There has been a slight recovery since the fourth quarter of 2005. In the third quarter of 2006, year on year output growth stood at 2.1 per cent compared with 0.4 per cent in the same period in 2005, but substantially lower than in the same period in 2004. The British Retail Consortium-KPMG Retail Sales Monitor (BRC-KPMG, 2007) indicated that in December 2006 total sales were up 4.4 per cent compared with December 2005. However, the three-month trend rate of growth to December 2006 for total sales slowed to 4 per cent from 4.3 per cent. The British Shops and Stores Association (BSSA) suggested that the downturn in the economy and uncertainty on interest rates had affected customer confidence and resulted in a disproportionate effect on the high street.

3.19 As noted earlier in this chapter and detailed at Appendix 5, we have revised our definition of the retail sector to include the sale, maintenance and repair of motor vehicles and motorcycles, and the retail sale of automotive fuel. Under this new definition, there were over 3.3 million employee jobs in the retail sector in September 2006 (2.8 million in the retail trade and 0.5 million relating to motor vehicles and the sale of automotive fuel), accounting for around 40 per cent of all jobs in the low-paying sectors. The number of employee jobs in the sector has increased steadily since the introduction of the minimum wage, although since 2002 at a slower rate than in the years immediately after its introduction in April 1999 (see Figure 3.6). However, the year to September 2006 saw a slight fall in the number of jobs, compared with an increase of 19,000 jobs in the year to September 2005. There has also been a slight shift towards part-time employment in the year to September 2006.

Figure 3.6
Employee Jobs in the Retail Sector and Annual Change, Thousands, GB, 1999–2006



Source: ONS employee job series, not seasonally adjusted, GB, 1999–2006.

'For the first time in 25 years, this firm has been forced to make 10% of the workforce redundant in the last 12 months. The managing director attributes this directly to rises in the NMW above £4.85 – and a forthcoming 60% increase in electricity costs for the next year. It is clear that further NMW rises will reduce employment still further.'

Department store, quoted in CBI evidence

3.20 We can add to our understanding of the impact of the minimum wage in the retail sector by looking at employment in low-paying retail occupations (see Appendix 5 for details of these jobs). In the fourth quarter of 2003 the number of employees in these occupations reached a record high at around 2.2 million, before starting to decline. In the year to the third quarter of 2006, employment in low-paying retail occupations declined by 57,000 (nearly 3 per cent), with the number of employees in these occupations having fallen to just under 2.1 million.

3.21 Until a few years ago there was a significant disparity in the impact of the minimum wage depending on firm size, with small retail firms generally more affected than large firms. However, in our 2005 Report, we noted the increasing impact that the minimum wage was having on large retail firms. Since then a number of large retailers have reported that they had reduced staffing levels or cut staff hours in order to manage the minimum wage upratings, while generally small firms reported that they had not taken such measures, often because they had little flexibility to do so. This is borne out when we consider the number of employee jobs in the retail sector by firm size. Employment in small firms has been relatively stable since the first quarter of 2005,

whereas employment in large firms fell in each quarter between the fourth quarter of 2004 and the second quarter of 2006, although in the third quarter of 2006 there was a very marginal increase. The Union of Shop, Distributive and Allied Workers (Usdaw) was of the view that, although there had been a small decline in employment between 2004 and 2005, the figures had held up quite well at a time of a relative slowdown in consumer expenditure. It also suggested that the fall in jobs might, in part, be as a result of outsourcing of non-core jobs in the retail sector such as cleaners, security guards and call centre staff.

'Some employers are offsetting minimum wage costs by making frequent changes to the working hours of staff to maximise productivity. As a result, many of the lowest paid employees are left uncertain about their earnings from week to week.'

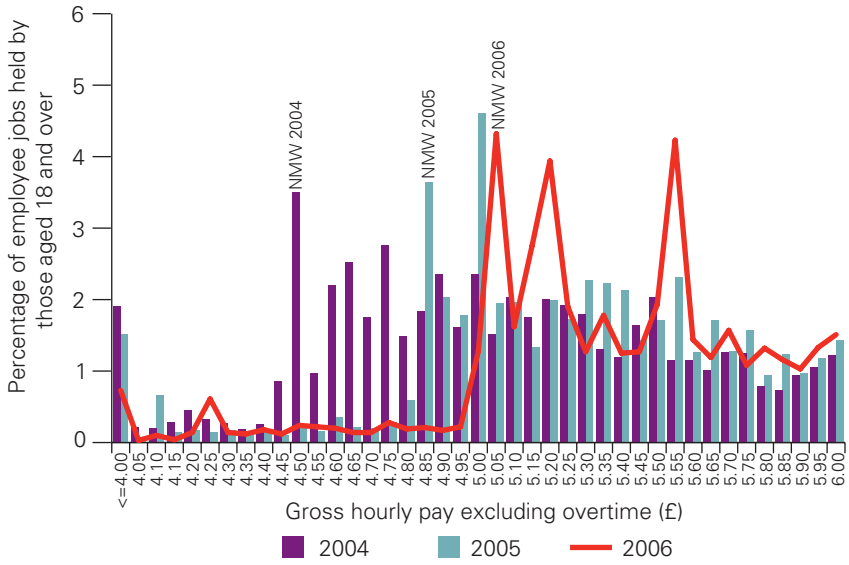
Usdaw evidence

3.22 Figure 3.7 shows the earnings distribution for employee jobs in the retail sector. There was an upward shift at the bottom end of the earnings distribution to reflect changes in the minimum wage, with over 4 per cent of retail jobs paid at the adult minimum wage in April 2006. However, as shown in Figure 3.8, the percentage of firms directly affected by upratings in the minimum wage continued to be higher in small firms. Around 7 per cent of jobs in small retail firms paid the adult minimum wage in April 2006, compared with around 5 per cent in medium-sized firms and less than 4 per cent in large firms. The earnings distribution for large firms shows that many continue to maintain a differential above the adult minimum wage. In April 2006 the highest peak in the earnings distribution for large firms was at £5.55 (50 pence above the adult minimum wage), while for both small and medium-sized firms it was at the adult minimum wage rate.

3.23 The earnings data suggest that the Youth Development Rate and 16–17 year old rate continue to be little used, despite the sector having a relatively young workforce. The research we commissioned by IDS (2006b) found that, in contrast to a trend noted in its previous research, more large companies had lowered the age at which the adult rate was paid, in most cases to 18 years. Many had, however, retained a single lower rate for 16–17 year olds.

Figure 3.7

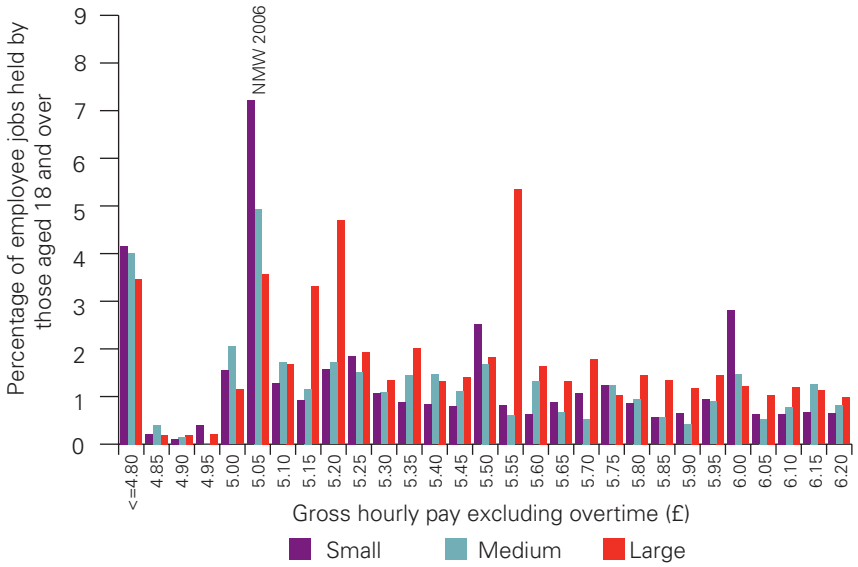
Hourly Earnings Distribution for Employees Aged 18 and Over in the Retail Sector, UK, 2004–2006



Source: LPC estimates based on ASHE with supplementary information, low-pay weights, UK, April 2004–2006.
Note: NMW label shows the adult minimum wage rate in April of the given year.

Figure 3.8

Hourly Earnings Distribution for Employees Aged 18 and Over by Firm Size in the Retail Sector, UK, 2006

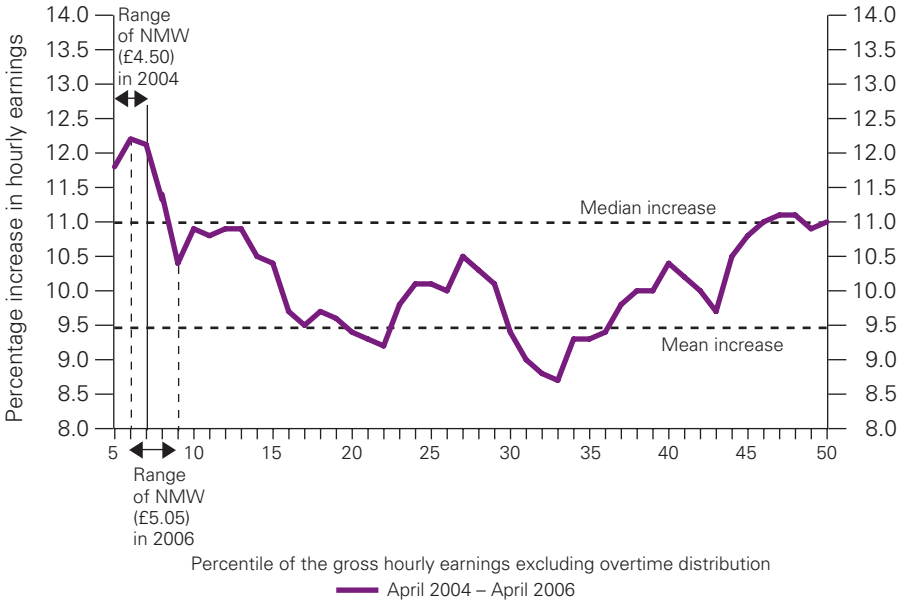


Source: LPC estimates based on ASHE with supplementary information, low-pay weights, UK, April 2006.
Notes:
1. Firms are defined as small (1–49 employees), medium (50–249 employees) and large (250 or more employees).
2. NMW label shows the adult minimum wage rate in April 2006.

3.24 In their evidence this year, the British Retail Consortium (BRC) and some large retailers again expressed concern about the influence of the minimum wage on pay structures. The IDS research (IDS, 2006b) also found that the minimum wage was having an increasing impact on pay setting and structures. Many retailers had adopted one of two approaches to setting pay – either setting their lowest rate at the adult minimum wage or maintaining a clear differential between their lowest pay rate and the minimum wage. The ACS advised that the pay rates of small retailers used to be at the top of the bottom earnings quartile, but that more had become minimum wage employers as they could not afford to increase pay in line with the minimum wage.

3.25 A key concern for many retailers was their ability to maintain pay differentials. The impact of successive increases in the minimum wage above growth in average earnings had, they said, lessened retailers' flexibility to set pay structures to maintain differentials that rewarded and motivated staff. One large retailer advised that as a result of minimum wage upratings, the pay gap between skilled and unskilled jobs had been reduced from 32 per cent in 1999 to 12 per cent in 2006. The impact of minimum wage increases on pay differentials in the retail sector is illustrated in Figure 3.9. During the 2004 to 2006 period, most jobs in retail paying around the level of the minimum wage received higher increases in earnings than those further up the earnings distribution.

Figure 3.9
Increase in Hourly Earnings by Percentile for Employees Aged 18 and Over in the Retail Sector, UK, 2004–2006



Source: LPC estimates based on ASHE with supplementary information, low-pay weights, UK, April 2004–2006.

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A medium-size retail employer said that they *'always try to pay around five per cent over the NMW as their basic rate, as the term 'minimum wage' sounds derogatory … every time the NMW increases by 30p per hour, we look at a six per cent increase for all the lowest paid staff'.* They reported that they could not also afford to maintain differentials, so these have been squeezed since October 2005.

Denvir and Loukas, 2006.

3.26 In its evidence, the BRC stated that the minimum wage had reached its 'tipping point' and called for a fundamental review to be carried out. It stressed that retailers had faced two years of strong deflationary price pressure, particularly in the non-food sector, which, combined with severe inflation in their cost base, had had a significant effect on their ability to manage further large increases in the minimum wage. The price constraints that retailers were operating under were also highlighted by other representative bodies in the sector, who emphasised that consumers were very price conscious and pointed to intense competition, resulting in ongoing price deflation. The research we commissioned by IES (Denvir and Loukas, 2006) on the impact of the National Minimum Wage (2005 upratings) found that fewer than a third of the 90 retailers that took part in its telephone survey and who had reported an impact of the minimum wage, had reported increasing prices as a result.

3.27 For a number of years prior to 2003, and well before the introduction of the minimum wage, the net change in retail business start-ups and closures had been negative. However, since 2003 the number of retail businesses registering for Value Added Tax has outstripped those de-

registering, and this positive net change has grown since. The BRC, however, noted concern about the increase in insolvencies in the sector. It advised that in the year to the third quarter of 2006, retail insolvencies increased by 20 per cent on the previous year and suggested that this reflected the severe cost and price squeeze on retailers, of which the minimum wage was a significant factor. On the other hand, Usdaw pointed out that the minimum wage did not feature in the top 65 reasons for business failures published by the UK Insolvency Helpline. It suggested that the survival of small retailers was far more threatened by competition from the large retailers than by the minimum wage. The ACS advised that small retailers were under constant pressure to re-invest in their businesses to keep up with consumer expectations and to compete, but it believed that those whose ability to do so was restricted as a result of the impact of the minimum wage might not be able to survive in the long-term.

Low Pay Commission Research

'We raise prices but customers aren't that loyal … they are very price conscious.'

Small retailer, quoted in Denvir and Loukas, 2006

3.28 The retail sector is more buoyant than it was in 2005. However, retailers are clearly finding the recent increases in the minimum wage challenging and some have reduced staffing levels or hours as a result. Overall there is no sign of any significant impact on employment levels and we cannot yet know if recent modest falls in employment in the sector indicate a significant new trend.

3.29 We now turn to look at the hospitality sector, the second largest of the low-paying sectors after retail.

Hospitality

3.30 The hospitality sector has generally enjoyed good rates of growth since the introduction of the minimum wage. In 2005, however, as with retail, growth in the sector slowed considerably. There was little growth in the third quarter, probably reflecting the London bombings on 7 July 2005 and the general slowdown in the growth of UK consumer expenditure during the year. But the annual rate of growth picked up in the first quarter of 2006, exceeding 5 per cent. It then continued to rise, reaching 6 per cent in the second quarter and over 7 per cent by the third quarter.

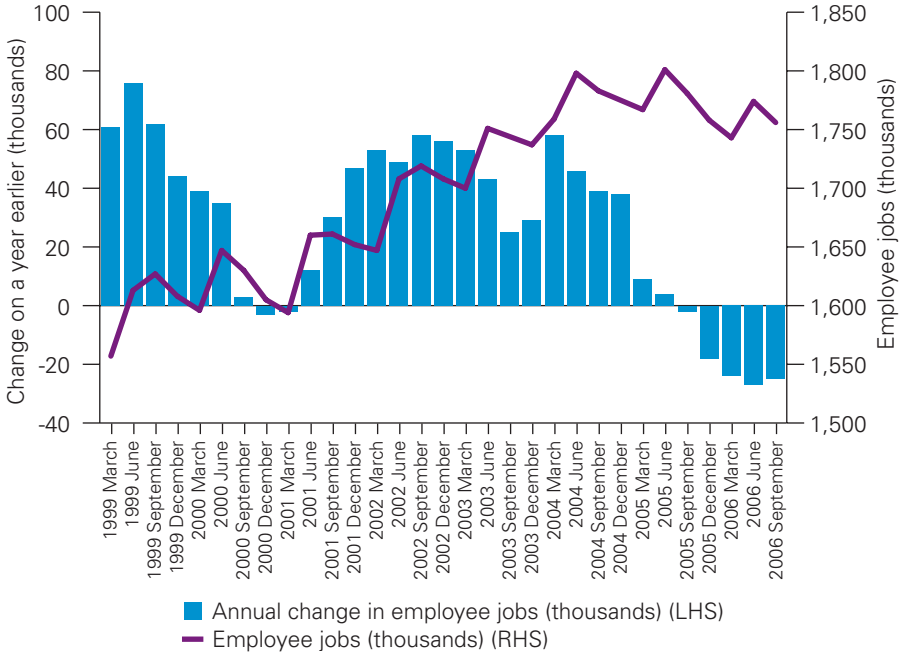
'Although the NMW provides a more level playing field, major multiple retailers are, through their competitive position and buyer power, able to operate on far higher gross profits than smaller businesses and better able to absorb cost increases.'

ACS evidence

3.31 While the number of employee jobs in the hospitality sector stood some 191,000 higher in September 2006 compared with September

1998, there was a fall of 25,000 jobs in the year to September 2006. Around half of these job losses occurred in bars. This was the fifth successive quarter in which there has been a year-on-year fall in employee jobs in hospitality (Figure 3.10). If we look at employment in low-paying hospitality occupations, we find the number of employees increased by over 90,000 (or 9.4 per cent) to 1.06 million between the third quarter of 2005 and the third quarter of 2006. This suggests that the recent falls in employee jobs in hospitality may have been in managerial and supervisory occupations, rather than affecting low-paid workers. UNISON suggested that the decline in employee jobs might be due to increased use of agency workers within the sector, which would not show up in the job figures for hospitality. However, when we raised this with employer representatives they maintained that the use of agency workers had been taking place for many years and would not explain the recent fall in employment.

Figure 3.10
Employee Jobs in the Hospitality Sector and Annual Change, Thousands, GB, 1999–2006

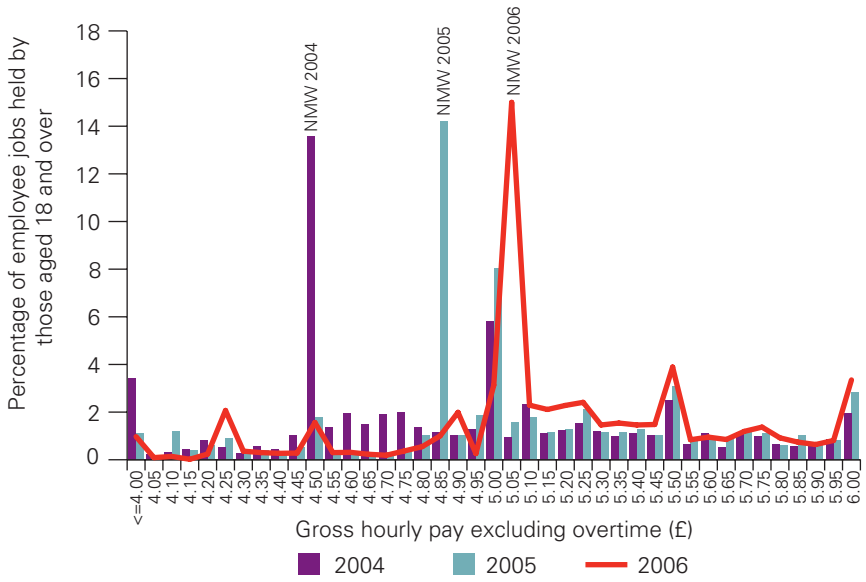


Source: ONS employee job series, not seasonally adjusted, GB, 1999–2006.

3.32 Figure 3.11 below shows clear, and growing, spikes in the earnings distribution for the hospitality sector at or around the prevailing adult rates of the National Minimum Wage. Fifteen per cent of jobs were paid

at this rate in April 2006, which is higher than in any other low-paying sector except cleaning. With increases in lowest quartile earnings failing to match increases in the minimum wage between 2004 and 2006, the minimum wage is now the prevailing rate at this point in the earnings distribution. The gap between lowest quartile and median earnings narrowed from 74 pence to 57 pence between 2004 and 2006, providing some evidence of a squeeze on differentials. The shape of the earnings distribution in hospitality is broadly similar across different sizes of firms, but the proportion of jobs in April 2006 paying at the minimum wage in medium-sized firms was slightly lower than that for the whole sector, at around 12 per cent. This compares with over 15 per cent at the minimum wage in both small and large hospitality firms.

Figure 3.11
Hourly Earnings Distribution for Employees Aged 18 and Over in the Hospitality Sector, UK, 2004–2006

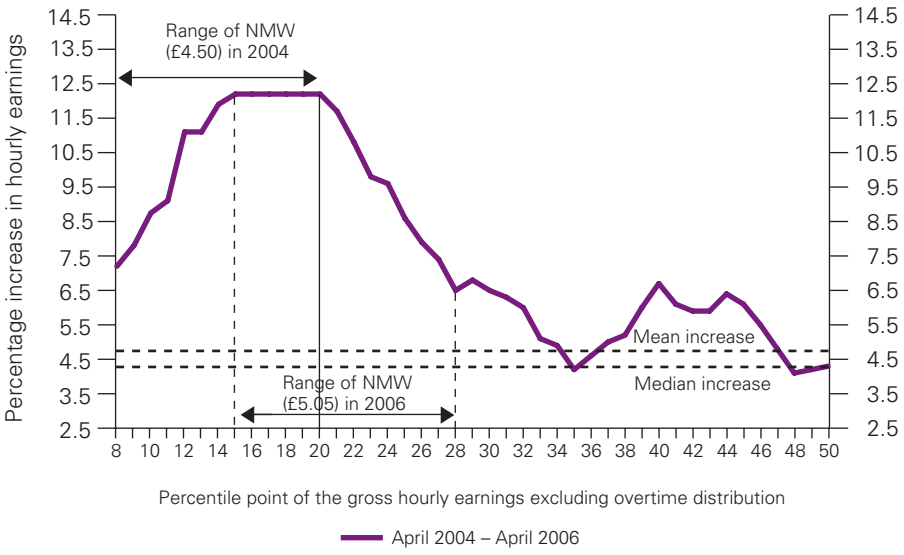


Source: LPC estimates based on ASHE with supplementary information, low-pay weights, UK, April 2004–2006.
Note: NMW label shows the adult minimum wage rate in April of the given year.

3.33 The impact of minimum wage increases on pay differentials in the hospitality sector is illustrated in Figure 3.12. As in retail (Figure 3.9), jobs paying around the level of the minimum wage in the April 2004 to April 2006 period received higher percentage increases in earnings than those further up the earnings distribution. However, whereas in retail the increases between the level of the minimum wage and the median were overwhelmingly less than the median rise, in hospitality increases

remained overwhelmingly greater than the median increase in this range of the earnings distribution.

Figure 3.12
Increase in Hourly Earnings by Percentile for Employees Aged 18 and Over in the Hospitality Sector, UK, 2004–2006



Source: LPC estimates based on ASHE with supplementary information, low-pay weights, UK, April 2004–2006.

3.34 Research we commissioned for this report found evidence that the minimum wage was having a substantial and growing impact in the hospitality sector. IDS (2006b) research in the hotel sector found that over two-thirds of the 20 hotels and hotel groups which responded to its survey had to increase pay rates in order to comply with the October 2005 upratings, in comparison with half of the respondents in its equivalent 2004 survey. A third of the hotels which responded to the survey increased pay rates for more experienced or supervisory staff to maintain pay differentials – similar to the findings of the previous IDS survey in 2004.

3.35 The research we commissioned by IES (Denvir and Loukas, 2006) found that around 70 per cent of the 174 hospitality firms taking part in its telephone survey claimed to have been affected in some way by the minimum wage since its introduction. Of the 140 firms which responded to a later question, 90 confirmed a need to increase pay rates as a direct result of the 2005 increase in the minimum wage.

3.36 Our Employers' Survey found that 54 per cent of respondents in hospitality were affected by the October 2005 rise in the minimum wage (nearly identical to the proportion in our 2004 survey), with 57 per cent of those affected stating that their total wage bill increased by more than 5 per cent. Around half of the hospitality firms which said they had been affected reported that they had decreased overall staffing levels in response. Three-quarters of those affected reported having to raise pay rates to comply with the new minimum wage rates (higher than the 63 per cent in the 2004 survey), but lower proportions than in the 2004 survey reported having to raise pay rates above this level in order to maintain differentials – perhaps reflecting the lower percentage increase in the minimum wage in October 2005 compared with October 2003.

3.37 Representative bodies also advised that the impact of the minimum wage was growing. In oral evidence the British Hospitality Association (BHA), the British Beer and Pub Association (BBPA) and Business in Sport and Leisure (BISL) said that there now appeared to be an employment effect from the minimum wage. They noted the size of recent minimum wage increases and that a rise had occurred in payroll costs in the sector, particularly as a proportion of turnover. They said that this proportion had grown in hotels from typically 25 per cent or under ten years ago, to 30 per cent in hotel chains and perhaps 35 to 38 per cent in independent operations. Rising employment costs as a proportion of turnover were also highlighted by the Association of Licensed Multiple Retailers (ALMR). It reported that when the minimum wage had been introduced it had little impact on wage rates, but a large proportion of bar staff were now earning at or just above the adult minimum wage. The BBPA also voiced concerns about the impact of the minimum wage on differentials resulting in companies finding it difficult to retain experienced staff. Businesses and employer representatives in the sector told us during our visits that firms faced difficulties in maintaining differentials, particularly for middle ranking staff, and in preserving effective pay incentives for supervisers and managers.

3.38 Consultation respondents also highlighted concerns about the cumulative impact of new employment legislation and other regulatory changes which had recently been, or were due to be, implemented

Low Pay Commission Research

One large hospitality establishment that maintained differentials this year reported that they have always done so before. One interviewee said, *'This is because more highly qualified and trained staff such as receptionists, chefs and managers are unhappy if their pay is too close to that of unskilled workers … the same situation has occurred with previous NMW increases, but is more marked this time due to the comparatively large uprating'*

Denvir and Loukas, 2006

(such as the ban on smoking in public places, changes to the licensing and gambling laws and the increase in statutory annual leave entitlement). Employer organisations in the sector once again sought increases in the accommodation offset, and we cover this topic in Chapter 4.

'We've estimated we will need to cut paid hours by 10 to 15 per cent to compensate for the increase in NMW. This takes into account the additional PAYE, NI and impact on differentials. Of course the increase comes on top of the huge cost increases of gas and electricity and business rates ....'

Hospitality employer, quoted in BHA evidence

3.39 There is growing evidence that the minimum wage is having an impact on pay rates and on differentials in the sector. For virtually the first time since the introduction of the minimum wage, the hospitality sector is experiencing job losses, whereas it had been enjoying strong employment growth since 1999. It is too early, however, to know how far this is a sign of a long-term trend, or whether these losses can be linked directly to the impact of the minimum wage. The fall in employment appears to be connected to the downturn in consumer spending in 2005. Output in this sector picked up in 2006 and we will see in due course whether this is enough for employment to rise once again in 2007.

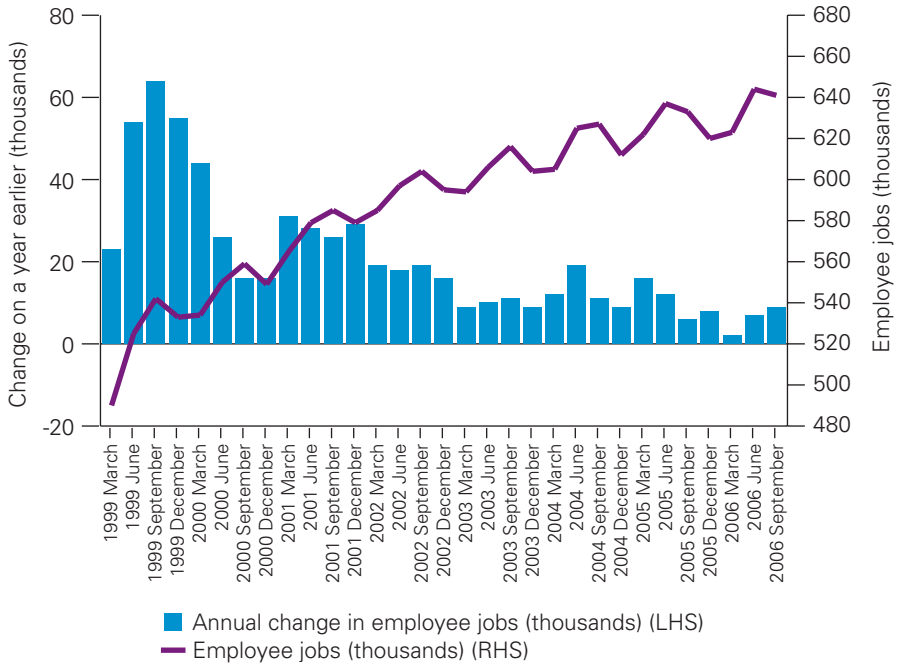
Leisure, Travel and Sport

3.40 This is the first time that we have included a separate analysis of this sector in our assessment of the minimum wage.

3.41 Figure 3.13 shows that the leisure, travel and sport sector has continued to experience an increase in the number of employee jobs, athough at a generally declining rate, a trend that began prior to the introduction of the minimum wage. The number of employee jobs in the sector stood at just over 641,000 in September 2006, one third higher than in September 1998. A small increase in jobs between September 2005 and September 2006 maintained this trend.

3.42 Employment in low-paying occupations in leisure, travel and sport increased by over 25,000 between the third quarter of 2005 and the third quarter of 2006.

Figure 3.13
Employee Jobs in the Leisure, Travel and Sport Sector and Annual Change, Thousands, GB, 1999–2006



Source: ONS employee job series, not seasonally adjusted, GB, 1999–2006.

3.43 Figure 3.14 shows that the proportion of jobs in the leisure, travel and sport sector paid at the adult minimum wage has remained at around 5 per cent over the period 2004–2006, although there are some signs that the minimum wage is catching up with wages in the sector. In 2004 and 2005 lowest decile earnings were just above the minimum wage, but by April 2006 this gap had been closed. The differential between the minimum wage rate and lowest quartile earnings fell by around a quarter over the 2004 to 2006 period.

Figure 3.14
Hourly Earnings Distribution for Employees Aged 18 and Over in the Leisure, Travel and Sport Sector, UK, 2004–2006

Source: LPC estimates based on ASHE with supplementary information, low-pay weights, UK, April 2004–2006.
Note: NMW label shows the adult minimum wage rate in April of the given year.

'The NMW is significantly eroding our position. Our competitive edge in recruitment is weakening, and diminishing differentials are eating into retention rates .... So far we have coped with increases in the NMW, but are seriously concerned about upratings in the near future.'

Holiday centre, quoted in CBI evidence

3.44 The IDS research (IDS, 2006b) reported that just under half of the 13 respondents to its survey, representing medium-sized and large organisations in the sector, set their lowest wage rate at the adult rate of the minimum wage and therefore had to raise pay rates in order to comply with the October 2005 upratings. Five respondents had taken action to restore pay differentials. The research also found evidence of an increasing impact of the minimum wage in the sector, with ten organisations saying they would be directly affected by the 2006 minimum wage upratings.

3.45 Our Employers' Survey found that one-third of respondents in the leisure, travel and sport sector were affected by the October 2005 upratings. Three-quarters of these had to raise pay rates to comply with the minimum wage rates, with 39 per cent raising pay to maintain their lowest pay rate above the minimum wage level. Nearly 40 per cent of those affected reported reducing overall staffing levels, while one third reported cutting basic hours or overtime.

3.46 BISL reported that the increase in the minimum wage to £5.35 in October 2006 would be felt in all sizes of business, and would in some

cases result in job losses or a reduction in hours in order to maintain business viability. BISL and ALMR voiced concerns about the growing impact of minimum wage increases on differentials in the sector, with BISL expressing the view that the October 2006 rise could erode remaining differentials with implications for supervision, training and staff retention. These bodies also highlighted similar concerns to those expressed by hospitality sector employer representatives about rising costs and the cumulative impact of regulatory changes, including the proposal to increase statutory holiday entitlement (covered in Chapter 7). They also called for a rise in the accommodation offset – which is covered in Chapter 4.

3.47 Our consultation suggests that the minimum wage is having a growing impact on pay in the leisure, travel and sport sector, although the earnings data indicate that this is more limited than in some other sectors. There is no evidence that this has had an effect on the overall number of jobs, which have continued to increase.

3.48 We now turn to the handling of tips, an issue which has a bearing on the earnings of staff in both the hospitality and leisure, travel and sport sectors.

Tips

3.49 In previous years we have received representations from organisations expressing a spectrum of views on how tips should be handled for National Minimum Wage purposes. Some would like all tips to count towards the minimum wage, including those distributed by a member of staff acting as a troncmaster[1], while others have argued that tips should not count towards minimum wage pay in any circumstances. In the 2005 Report we reiterated our belief that the current arrangements were working reasonably well and should remain unchanged. That is to say, only tips, gratuities or service charges paid by the employer to workers through the payroll should count towards the minimum wage.

3.50 Since our 2005 Report there has been further public debate and lobbying of the Government concerning the way tips are handled, including discussion about whether they should count towards the minimum wage. However, we have not received written

[1] A member of staff with responsibility for managing and allocating tips on behalf of other staff members.

representations on tips this year and the topic was seldom raised during our numerous visits and meetings.

3.51 There has been one recent development regarding the treatment of National Insurance Contributions (NICs) on tips used to make up minimum wage pay. HM Revenue and Customs' latest guidance (HMRC, 2006a) states that tips allocated by an independent troncmaster and passed to the employer to process through the payroll, and which subsequently appear on payslips, are not liable for NICs, even if they are used to make up the minimum wage. While this represents no change to the minimum wage position, there is a potential new incentive for employers to use tronc tips to make up minimum wage pay as no NICs may be due. But it is unclear how far in practice this will act as an incentive for employers to change their approach to tips. For many businesses, particularly small ones, the administrative burdens involved in taking advantage of the change may seem disproportionate to the perceived benefits. We will monitor whether the new guidance leads to any change of practice on the part of businesses. However, at present we do not see any need for a change to the minimum wage treatment of tips.

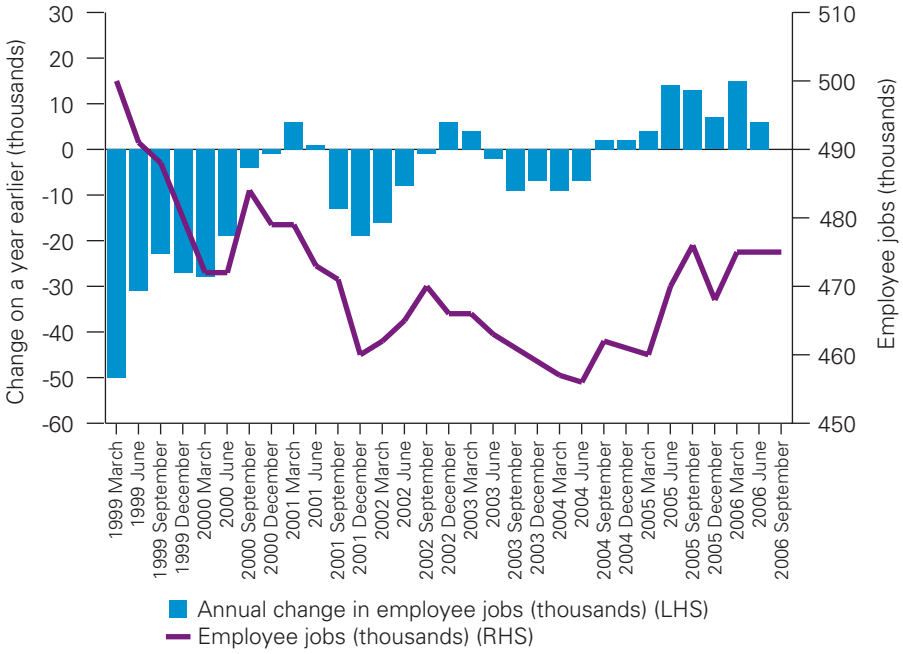
Cleaning

3.52 There are a number of sources of information on cleaning jobs and it is difficult to obtain a clear picture of the number of workers involved or of employment trends. Some workers will not be captured within the employment figures for the cleaning industrial sector because they perform a support function in firms categorised within another industry; others may be self-employed or not recorded at all because they are working informally in a domestic setting.

3.53 According to the employee job series, jobs in the cleaning sector were falling until the middle of 2004, but have subsequently been on an upward trend. However, this may be flattening out and in the year to September 2006, the number of jobs remained static at 475,000 (Figure 3.15). Similar trends are observable using a different ONS data source. LFS data on low-paying cleaning occupations also show an increase in employment in cleaning in recent years. While this data does show a small fall overall (to 682,000 employees) in the year to the third quarter of 2006, the number of full-time employees increased by

18,000. Indeed, both data sources provide evidence of a shift towards full-time employment. According to the employee jobs series, full-time jobs increased by 42,000 in the four years to September 2006, while part-time jobs fell by 37,000. Self-employment has been more volatile, although the trend has generally been upwards, with 87,000 self-employed cleaners recorded by occupation in the third quarter of 2006.

Figure 3.15
Employee Jobs in the Cleaning Sector and Annual Change, Thousands, GB, 1999–2006

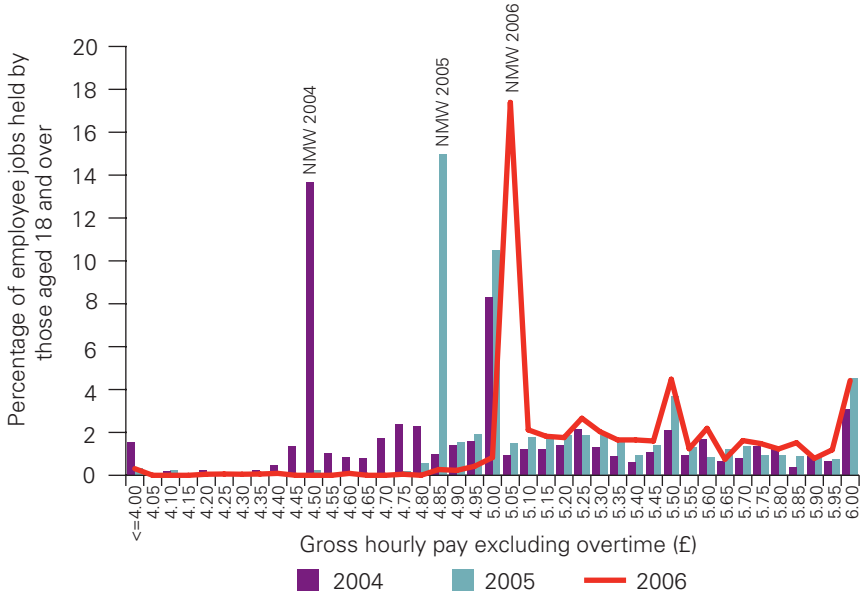


Source: ONS employee job series, not seasonally adjusted, GB, 1999–2006.

3.54 In its evidence, the Cleaning and Support Services Association (CSSA) estimated there were close to 900,000 workers in the cleaning sector, of which around 400,000 worked for firms that provided outsourced services with the balance working in-house or in the public sector. During a meeting in 2006 the CSSA suggested that apparent declines in employment might be a result of a trend towards business services firms offering a comprehensive facilities management service (and thus their cleaning employees would be classified outside the cleaning industry). It was possible that technological improvements had led to a real reduction in the workforce. However, both the CSSA and the Business Services Association (BSA) had also observed a trend towards increased hours and more full-time working, to some extent associated with more daytime cleaning, which is also borne out by the employment data.

3.55 The minimum wage continues to exert a significant influence on earnings in the cleaning sector. Seventeen per cent of employee jobs were paid at the adult minimum wage in April 2006, which is slightly higher than in both 2004 (14 per cent) and 2005 (15 per cent) despite the smaller (4.1 per cent) uprating to £5.05 in October 2005 (Figure 3.16). The increase in the proportion of jobs paying the minimum wage in April 2006 may be explained partly by the fact that the rise to £5.05 would have raised pay rates in the 10 per cent of jobs that had paid £5.00 an hour in April 2005. While 'living wage' campaigns targeting high profile firms, particularly in the financial sector and in the City of London and Canary Wharf, have received some publicity, there is little evidence of a wider impact on the pay rates of cleaners. Around two-fifths of jobs in the sector paid £5.50 or less in April 2006 and lowest decile earnings rose exactly in line with the adult minimum wage between 2004 and 2006. While lowest quartile earnings remained 15 pence above this level in 2005 and 2006, they increased by a smaller proportion (8 per cent) than the minimum wage (12 per cent) over the two years to 2006, suggesting there may have been some squeezing of differentials at the bottom of the distribution.

Figure 3.16
Hourly Earnings Distribution for Employees Aged 18 and Over in the Cleaning Sector, UK, 2004–2006



Source: LPC estimates based on ASHE with supplementary information, low-pay weights, UK, April 2004–2006.
Note: NMW label shows the adult minimum wage rate in April of the given year.

3.56 Evidence from firms in the business services sector and their representatives emphasised ongoing difficulties in absorbing minimum wage increases due to tight margins, typically below 4 per cent on a cleaning contract. Many clients were reportedly unwilling to accept cost increases in excess of price inflation, preferring to negotiate a lower level of service in response to upratings of the minimum wage. The CBI noted in its evidence that companies in the business services sector inevitably had to reduce the number of employees working on a particular contract in order to function at the same cost. The experimental ONS Services Producer Price Index (SPPI) shows that in both the industrial cleaning sector and the commercial washing and dry cleaning sector, prices charged to other businesses have increased at a level close to or below increases in retail prices since the introduction of the minimum wage, which would suggest that rising wage costs have not been passed on to clients, at least not in full. In the year to the third quarter of 2006, prices in the industrial cleaning sector and the commercial washing and dry cleaning sector increased by 2.1 per cent and 1.6 per cent respectively.

'... the NMW rate is beginning to have a significant effect on wage differentials and also on service levels in the cleaning industry.'

CSSA evidence

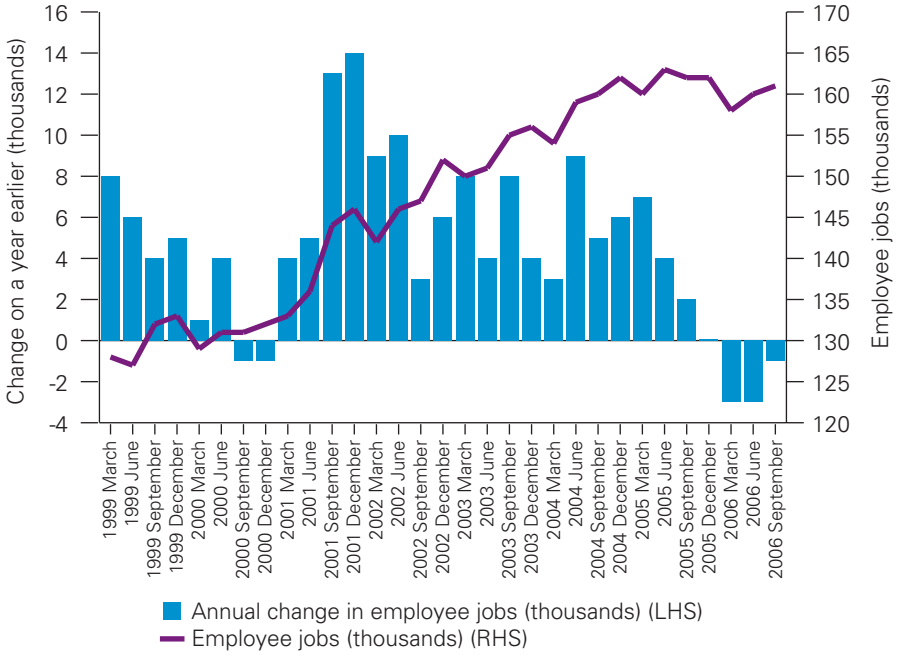
3.57 While the earnings data confirm that the minimum wage has had a strong influence on wages in the sector, the CSSA and BSA indicated that the hourly pay rates of their members – most of which are large firms – were typically in the region of 30–60 pence above the minimum wage in London and in other major cities and in regions where it was more difficult to attract cleaning staff. Both organisations had observed a narrowing of differential pay rates for supervisers, which contributed to difficulties in attracting and retaining trained staff in the industry. Despite the evident impact of the minimum wage on wage levels in the sector, the various data sources indicate a fairly positive employment picture, implying that recent upratings have not led to overall job losses in cleaning.

Security

3.58 Employment in the security sector grew strongly in the years immediately after the introduction of the minimum wage. However, since 2004 the trend has been much flatter, with employment remaining almost static at around 161,000 in the year to September 2006 (Figure 3.17). According to the LFS, employment in low-paying

security occupations has been falling since around mid-2004 and in the year to the third quarter of 2006, fell by 13,000 to 183,000. There is very little self-employment recorded in the sector.

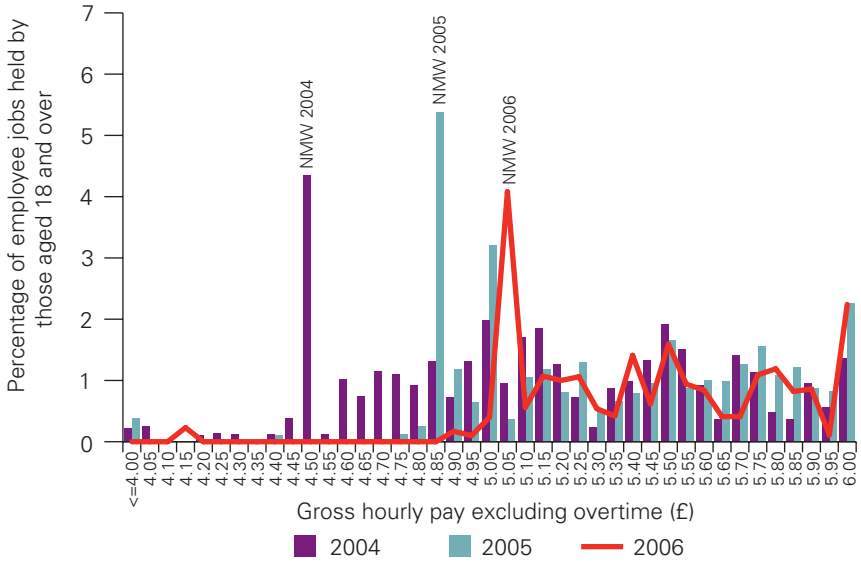
Figure 3.17
Employee Jobs in the Security Sector and Annual Change, Thousands, GB, 1999–2006



Source: ONS employee job series, not seasonally adjusted, GB, 1999–2006.

3.59 Earnings in the security sector are more widely distributed than in other low-paying sectors, particularly cleaning, hospitality and retail. Four-fifths of security sector jobs paid at least £6.00 an hour in April 2006 and median hourly earnings were £7.25. Figure 3.18 below illustrates that the proportion of jobs paid at the minimum wage level increased slightly in 2005 before falling back to 4 per cent in April 2006. In contrast to some other low-paying sectors, median and lowest quartile earnings rose by the same proportion (12 per cent) as the minimum wage between 2004 and 2006 and the margin between lowest decile earnings and the minimum wage increased by 20 pence to 35 pence between April 2005 and April 2006. The BSA told us that earnings had risen quite strongly in the security sector, largely driven by the introduction of a statutory licensing system which had led to increased training and professionalism and, consequently, that the industry rate was now about £6.40 per hour.

Figure 3.18
Hourly Earnings Distribution for Employees Aged 18 and Over in the Security Sector, UK, 2004–2006



Source: LPC estimates based on ASHE with supplementary information, low-pay weights, UK, April 2004–2006.
Note: NMW label shows the adult minimum wage rate in April of the given year.

3.60 Experimental ONS SPPI data indicate that prices charged for the provision of security services have risen strongly since the introduction of the minimum wage, which may also be a reflection of these broader changes in the industry. Prices rose by 6.6 per cent in the year to the third quarter of 2006, suggesting that some private security firms were able to pass a proportion of the costs of licensing and the minimum wage onto their customers.

3.61 In its evidence the CBI reported that wage cost pressures had led to increased use of mechanisation in the security sector – security guards were being replaced by electronic surveillance. It was also concerned that decreases in jobs in the business services sector were in some cases accompanied by an increase in activity in the informal economy. We received little additional evidence from stakeholders in the sector in response to our most recent consultation. This may be a further indication that the minimum wage is not having a significant impact on large parts of the security sector.

'The way we have coped with increased wage costs from the NMW and other regulation ... is by reducing the number of workers. It is very difficult to pass on costs to our customers, who continue to expect the same level of service, and rightly so. The result is a growth in the informal economy, particularly in rural areas, undermining fair competitiveness and contributing further to putting us in a tight spot.'

Business services company employing over 30,000 people, quoted in CBI evidence

Social Care

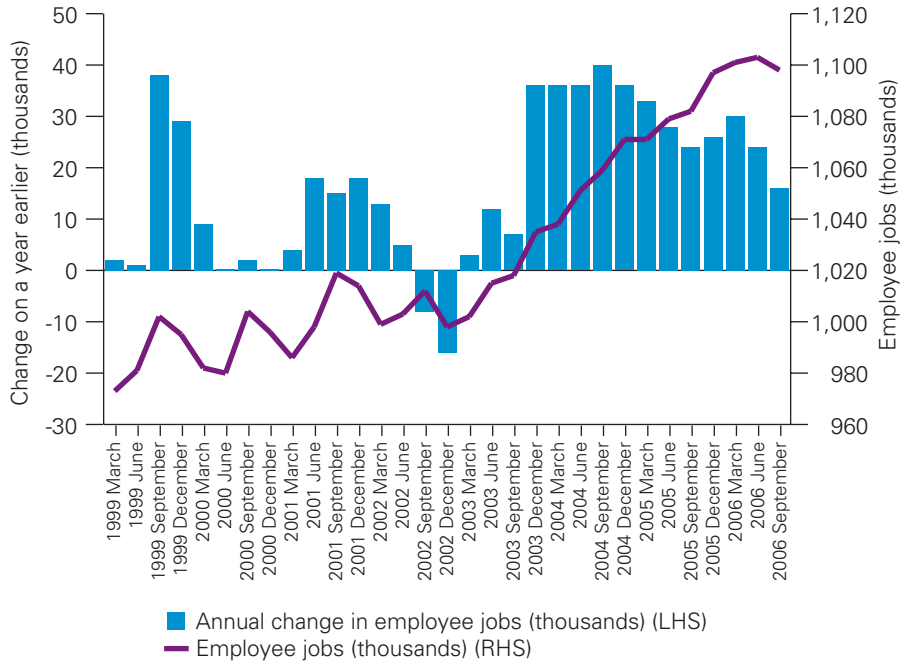
3.62 According to Laing & Buisson (2006), the value of the UK residential care sector market has continued to grow, with increased occupancy rates and, in the 2002 to 2006 period, above inflation increases in average fee levels. However, the actual number of places in the UK in residential settings for long stay care of older and physically disabled people across the private, public and voluntary sectors has continued to decline, from a peak in the mid-1990s, to stand at an estimated 468,000 places in 2006 – 2,000 lower than in 2005. Figures available from the Department of Health show a rise in the number of home care contact hours funded by English local authorities, with a further increase of 5.7 per cent in the year to September 2005 (Laing & Buisson, 2006). But the number of households receiving home care has been declining due to more intense service being delivered to the most highly dependent. While most services in the sector continue to be commissioned by public authorities, they have increasingly been delivered by the independent (private and voluntary) sector. The proportion of home care hours outsourced by English local authorities rose from 5 per cent in 1993 to 73 per cent in 2005, while by April 2006 around 60 per cent of the independent sector places in UK residential care homes were paid for by local authorities (Laing & Buisson, 2006). According to the LFS, in the third quarter of 2006, there were nearly 892,000 social care employees in the independent sector (private and voluntary), with just under 440,000 in the public sector.

3.63 The long-term upward trend in jobs in the social care sector has continued, in contrast to some other low-paying sectors. Figure 3.19 shows that the number of employee jobs rose by nearly 16,000 between September 2005 and September 2006, to stand at just under 1.1 million. Looking at data on low-paying social care occupations, we also find an increase in employment, with a rise of nearly 41,000 to 649,000 between the third quarter of 2005 and the corresponding period in 2006.

3.64 LFS data show that, while the period from the third quarter of 1999 to the same period in 2006 has seen a decline in employment in residential social care, over the same period, employment in non-

residential care has risen substantially. These different trends in employment reflect reforms, originating in the 1990s, in public policy and funding regarding the delivery of community care.

Figure 3.19
Employee Jobs in the Social Care Sector and Annual Change, Thousands, GB, 1999–2006



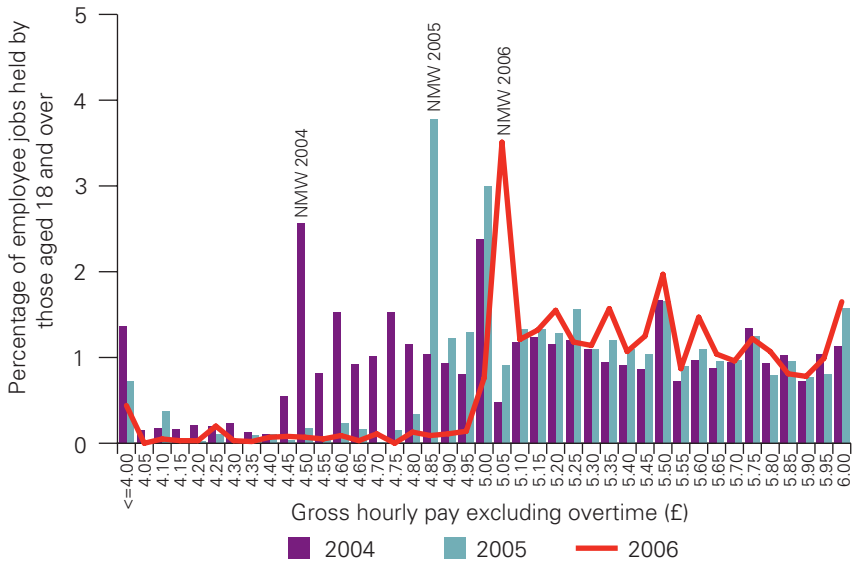
Source: ONS employee job series, not seasonally adjusted, GB, 1999–2006.

3.65 Figure 3.20 below shows the distribution of earnings for the sector between 2004 and 2006. Although there are spikes at or around the adult minimum wage rate in each year, the proportion of jobs paid at this rate fell very marginally between 2005 and 2006 to just over 3.5 per cent. However, in the private sector the minimum wage has a more substantial impact, with just under 6 per cent of jobs paying the minimum wage in April 2006, compared with nearly 4.5 per cent in April 2004. Evidence from our visits to care homes indicated that there were upward pressures on wages in the sector other than the minimum wage. We were told that the sector had to compete for employees with other sectors, such as retail, which could offer rates of pay above the minimum wage. The statutory obligation for a proportion of staff to hold NVQ level 2 or above, and the need to maintain pay differentials above the minimum wage for these staff, may also have affected wages.

A care home provider told us that the rate of pay was dictated as much by other employers, like the supermarkets, as by upratings of the National Minimum Wage.

Low Pay Commission visit to Cornwall

Figure 3.20
Hourly Earnings Distribution for Employees Aged 18 and Over in the Social Care Sector, UK, 2004–2006



Source: LPC estimates based on ASHE with supplementary information, low-pay weights, UK, April 2004–2006.
Note: NMW label shows the adult minimum wage rate in April of the given year.

3.66 However, maintaining pay differentials may be becoming more difficult. Lowest decile earnings for the sector in April 2006 remained above the adult minimum wage, although the gap narrowed slightly from 25 pence in 2004 to 18 pence in 2006. IDS (2006b) found a growing impact of the minimum wage on the sector. A third of the 123 respondents (mainly not-for-profit and private sector businesses) to a survey of organisations operating in the sector said they had been affected by the October 2005 upratings and had had to raise pay rates in order to comply, compared with a quarter of respondents in a survey examining the impact of the October 2004 upratings, although typically the proportion of staff directly affected and the size of pay increase was small. One in ten of the organisations responding to the 2006 survey had taken action to restore differentials between the lowest and more senior grades following the October 2005 upratings. During our visits, care providers told us of a growing difficulty they encountered in maintaining differentials between rates for unskilled and skilled staff – with their ability to tackle this limited by financial constraints, often associated with the level of fee income they received from local authorities.

'... low pay rates in the social care sector have a direct impact on staff shortages and the quality of care .... Rapid turnover, linked to poor pay and conditions, means that many care staff do not remain in post long enough to complete their NVQ qualification.'

UNISON evidence

3.67 BUPA Care Homes reported a growing number of staff receiving the minimum wage, and the erosion of differentials for higher paid staff, which had affected the motivation for staff to take up NVQ training. Leonard Cheshire, which operates in the voluntary sector, also highlighted the increased impact of the minimum wage, noting that only as a result of the 2004 and 2005 upratings did it find itself paying the minimum wage to some staff.

3.68 UNISON suggested that increases in pay in the private and not-for-profit sectors in recent years had been boosted by both the impact of the minimum wage and the Care Standards Act 2000 (which set a target of 50 per cent qualified staff by the end of 2005). Despite these increases, UNISON claimed that pay levels remained low and were having a direct impact on the sector's ability to recruit and retain staff. It argued that there was a need to raise further the level of pay and conditions in order to address this and in turn improve the quality of care. UNISON highlighted the fact that, on average, pay rates in the private and not-for-profit sectors were lower than in the public sector. The union saw the outsourcing of public services as a downward pressure on pay levels.

3.69 As in previous years, in their written submissions employers raised with us their concern that public purchasing of care did not reflect the actual costs involved, including the cost of the minimum wage. As noted above, this issue was also highlighted by many of the care homes we met during our visits throughout the UK in 2006. Our Employers' Survey found that, of those businesses in the social care sector that reported being affected by the October 2005 upratings, nearly four-fifths had public sector contracts. While nearly two-thirds of these businesses had tried to renegotiate their contracts to take account of increased minimum wage costs, 38 per cent of them stated they were not successful and 31 per cent only managed to renegotiate their contracts in part. Social care providers also pointed to an increasing regulatory burden, such as increases in Criminal Records Bureau fees, a new vetting and barring system, and the additional statutory annual leave entitlement.

A care home provider said that councils were not giving realistic increases to meet the needs of care and inflation and that, in some cases, private fee payers seemed to be subsidising fees in the absence of realistic fee increases from councils.

Low Pay Commission visit to Norfolk

3.70 In our 2005 Report we recommended that the Government should make clear to local authorities that policies on commissioning care should reflect the costs of provision, and that it should monitor the

approach of local authorities, examine the reasons for uneven provision and, if necessary, provide further guidance. In response the Government stated it would make clear to local authorities that it expected contracts to reflect current minimum wage rates. In its evidence to us this year, the Government stated that it had continued to stress the need for local authorities to reflect legitimate costs when agreeing fees. It also pointed to significant additional resources provided for funding social services between between 1996/97 and 2003/04 – an increase of around 22 per cent in real terms – and which had continued to rise by an average of around 6 per cent per annum in real terms until 2005/06. Although the rate of increase was lower in the 2006/08 period, the Government viewed it as sufficient to fund any cost pressures councils faced in delivering their adults' social care commitments.

'With the cost of living increase in wages and the above inflation increases in the NMW, total pay costs in Leonard Cheshire will increase by nearly 4 per cent. Average increases in fees from local authorities have only been around 2 per cent with some local authorities making no increases at all.'

Leonard Cheshire evidence

3.71 The Laing & Buisson / Joseph Rowntree fair price model (Laing & Buisson, 2006) divides fees into four bands, with increases in the 3.5–3.8 per cent band typically representing a standstill in margins (i.e. fees and costs keeping pace with each other). Laing & Buisson (2006) report that in recent years there have been above inflation increases in fees paid by many local authorities to care homes, although this was, they pointed out, from a point reached in the 1990s when the fees paid for some services had become unsustainably low. However, from 2005/06 this trend started to change. Laing & Buisson (2006) reported that the Community Care Market News (CCMN) annual survey of baseline fee rates for care of older people found that those councils responding to the survey and *'offering below inflation increases in 2006/07 significantly outnumbered those offering above inflation revisions'*. While in Scotland, Wales and Northern Ireland the number of councils offering increases in fees at or above the 3.5 per cent level exceeded the number offering less than this level, CCMN found that in England the majority – 61 per cent for residential care and 59 per cent for nursing care – increased fees below 35 per cent. The Commission for Social Care Inspection (CSCI) in its 2005–06 report on social care in England (CSCI, 2006) noted the significant differences between the highest and lowest increases paid by councils to care providers, which the CSCI said were difficult to explain – but it thought the variations suggested that the price increases were a reactive response to either capacity problems in the market or to budget pressures.

3.72 Care providers face particular constraints as to how they respond to the challenge of any increase in costs, including increased wage costs arising from minimum wage upratings. On the one hand there is a requirement for minimum (and qualified) staffing, and on the other the need for fee income from local authorities to reflect the full, and rising, costs of care. While in recent years the Government has been directing significant extra resources towards social services, the evidence from our consultation, survey, regional visits and available market data indicates that there is a geographical variation in increases for care providers – with some facing a zero increase or one below the 3.5 to 3.8 per cent level identified as necessary to maintain margins in 2006/07. While we recognise the progress that has been made on funding of social care, the problem persists in some areas of the UK and care providers continue to face significant challenges in meeting their obligation to increase wages in line with the minimum wage. Although the Government has said in its evidence that local councils should reflect the legitimate costs of providers when agreeing fee rates, we have no evidence to suggest that there has been a monitoring of the practice followed by each local authority, or of any appropriate follow-up action by the Government – both of which we called for in our previous recommendations. We believe that only an approach which actively monitors and reviews the practice followed by local authorities is likely to have an impact on the current geographical variation in the pattern of fee increases.

3.73 **We recommend again that the Government continue to make clear that the commissioning policies of local authorities should reflect the costs of care provision. We emphasise, in particular, the need for the Government to monitor actively how far practice matches policy, to examine the reasons for any uneven provision, and, if appropriate, to provide further guidance.** We suggest that it would be helpful for such monitoring information to be made available to us before we next review the sector.

3.74 In previous reports we considered the application of the minimum wage in circumstances where employees were required to sleep on the employer's premises, but might be asked to work for some or all of that period. In addition we looked at payments to staff under 'on-call' arrangements. We also commented on the issue of direct payments for

social care – where individuals are given public monies to purchase care services directly, and thus would become responsible for ensuring the minimum wage was paid to carers. These issues featured very little in evidence to our consultation, and although we do not focus on them in this report, we will continue to monitor developments.

Childcare

3.75 According to the Department for Education and Skills 2005 Childcare and Early Years Providers Survey (DfES, 2006c), there were about 320,000 paid workers in the childcare workforce in 2005, of whom over 260,000 worked within group settings (i.e. excluding child minders). This was an increase of 32,000[2] (14 per cent) for group settings on the 228,000 workers employed in 2003, reflecting the Government's strategy to develop the childcare workforce to improve the quality and availability of care for children in their early years. The survey found that growth since 2003 was mainly driven by an increase in employment in the provision of out of school care and full-day care; there was a fall in employment in sessional day care over the period. Ownership in the sector differs according to the type of provision. The majority of full day care providers are private sector, although the proportion privately owned fell in the 2003–2005 period from 78 to 60 per cent. The private sector also provided 30 per cent of sessional and 36 per cent of out of school provision. During the 2003–2005 period the proportion of organisations in the voluntary sector providing full day care (which accounted for 60 per cent of sessional and 39 per cent of out of school provision) increased to 20 per cent. In 2005 local authorities ran 9 per cent of full day care, 7 per cent of sessional care, and 13 per cent of out of school provision. Schools, colleges and others ran the balance of provision in the sector (DfES, 2006c).

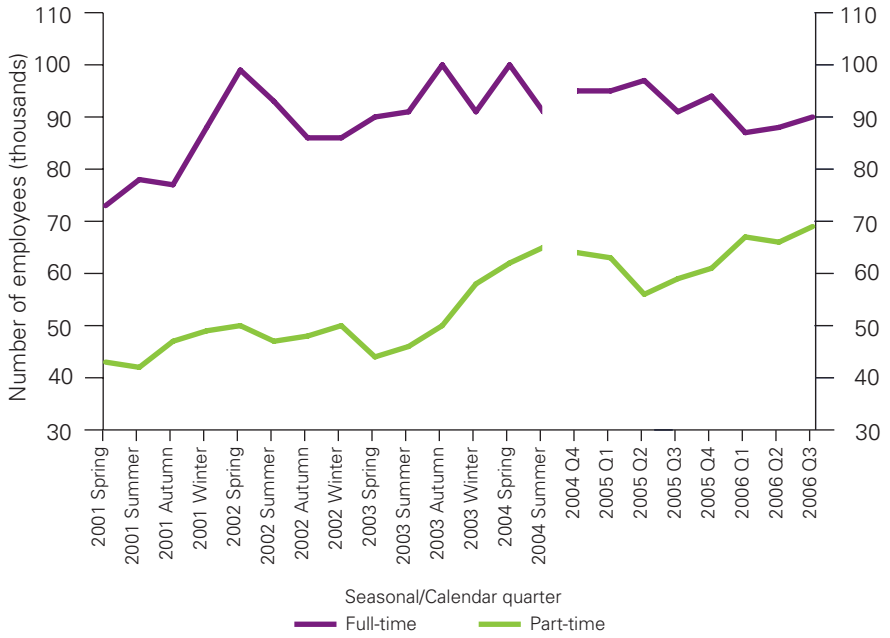
3.76 As jobs in childcare are spread across several industrial sectors, such as health and education, the ONS employee job series cannot be used to identify childcare workers. However, according to the LFS, there were over 346,000 employees in low-paying childcare occupations in the third quarter of 2006. After a fall in the level of employment in these occupations in 2005, the third quarter 2006 figure marked the

[2] Although the workforce expanded, some caution should be exercised when making direct comparisons between the 2003 and 2005 surveys as the basis for collecting information on the number of those working in 'out of school provision' changed.

second successive quarter in which there had been a small year-on-year increase.

3.77 If we look at nursery nurses (Figure 3.21), the childcare occupation we believe is most likely to be affected by the minimum wage, we see that employment has risen substantially since 2001, to stand at just over 158,000 in the third quarter of 2006. The majority of nursery nurses are employed in the independent sector, predominantly in private nurseries.

Figure 3.21
Nursery Nurse Employees, Thousands, UK, 2001–2006



Source: LPC estimates based on LFS Microdata, seasonal/calendar quarters, not seasonally adjusted, UK, 2001–2006.
Notes:
1. The break between Summer 2004 and Q4 2004 is a result of a discontinuity in the series as the LFS moved from seasonal quarters to calendar quarters; thus comparisons should be made with care.
2. Due to changes in Standard Occupational Classification codes, comparisons cannot be made with periods prior to 2001.

3.78 Looking at earnings in the low-paying occupations associated with childcare we find that 4.5 per cent of jobs in April 2006 paid at the minimum wage (up from 2.5 per cent in 2004), with nearly 8 per cent paying below this level. However, as we commented in our 2005 Report, it is in independent nurseries, notably in the private sector, that the impact of the minimum wage is most likely to be felt. Our consultation and research for this report has confirmed this to be the

case. This point is illustrated if we examine the earning distribution for nursery nurses only (Figure 3.22 below). Nearly 6 per cent of nursery nurse jobs were paid at the adult minimum rate in 2006, compared with 3 per cent in April 2004. There is also a growing proportion of jobs paid below the adult rate of the minimum wage (rising from around 8.5 per cent in 2004 to just over 10 per cent in 2006) which reflects the common use of the Youth Development Rate and the apprenticeship exemptions in the sector. Focusing on the earnings distribution for nursery nurses in private sector nurseries only, the impact of the minimum wage becomes even clearer. In April 2006 over 10 per cent of jobs were paid at the level of the adult minimum wage, and nearly 20 per cent were paid below this level.

Figure 3.22
Hourly Earnings Distribution for Nursery Nurses Aged 18 and Over, UK, 2004–2006

Source: LPC estimates based on ASHE with supplementary information, low-pay weights, UK, April 2004–2006.
Note: NMW label shows the adult minimum wage rate in April of the given year.

3.79 IDS (2006b) found an increasing impact of the minimum wage on childcare providers. Its survey of 94 childcare organisations in the independent sector (private and voluntary), employing over 8,000 staff, found that two-thirds of nurseries had to raise pay rates to comply with the minimum wage increases in October 2005 – the same proportion as in the 2004 survey. However, a higher proportion (over three-quarters) of respondents said that they would be affected by the October 2006

upratings than had been affected by the 2005 upratings. Despite two-thirds of the nurseries having taken action to restore differentials, the difference between median pay for nursery nurses and nursery assistants narrowed from 42 pence per hour in a 2004 survey to 17 pence per hour in the 2006 survey. The 2006 survey confirmed that age-related pay is widespread in the sector, with just over a third of respondents confirming they had different rates based on age. The survey also found that 14 per cent of respondent organisations had decreased staffing levels as a result of the October 2005 upratings.

3.80 The DfES survey (2006c) showed that staff turnover rates in 2005 were 12 per cent for sessional care, 17 per cent for full day care and 21 per cent for out of school provision. The National Day Nurseries Association (NDNA) stated that resolving the sector's chronic low pay was absolutely fundamental to developing the childcare workforce. Although UNISON reported a sharp rise in private sector average pay in the 2004 to 2005 period, reflecting competition for staff from public sector children's centres, the union told us that average increases were lower for those at the bottom of the scale. UNISON reported that pay for childcare occupations, whether public or independent sector, remained low when compared with earnings for similar jobs in health, social work and education. UNISON argued there was a relationship between raising pay, increasing staff retention and improving the quality of service provision – citing the findings of a study it commissioned from the Centre for Economic and Social Inclusion. The Children's Workforce Development Council (CWDC) has also looked at pay and staff turnover in the sector. In its response to the public consultation on the Children's Workforce Strategy (DfES, 2006a) the Government asked the CWDC to look at the impact of reward, not just pay, on recruitment and retention in the childcare sector. The CWDC (2006) concluded that the evidence did not indicate a direct link between levels of pay and reward, and recruitment and retention across the children's workforce, as a general rule, and that there were other influencing factors including non-financial rewards such as job satisfaction. However, in some childcare occupations it did find lower pay to be a significant factor in the high turnover of staff.

3.81 The NDNA reported that minimum wage increases since 2000 had led to a significant increase in the staff costs of nurseries, with salaries

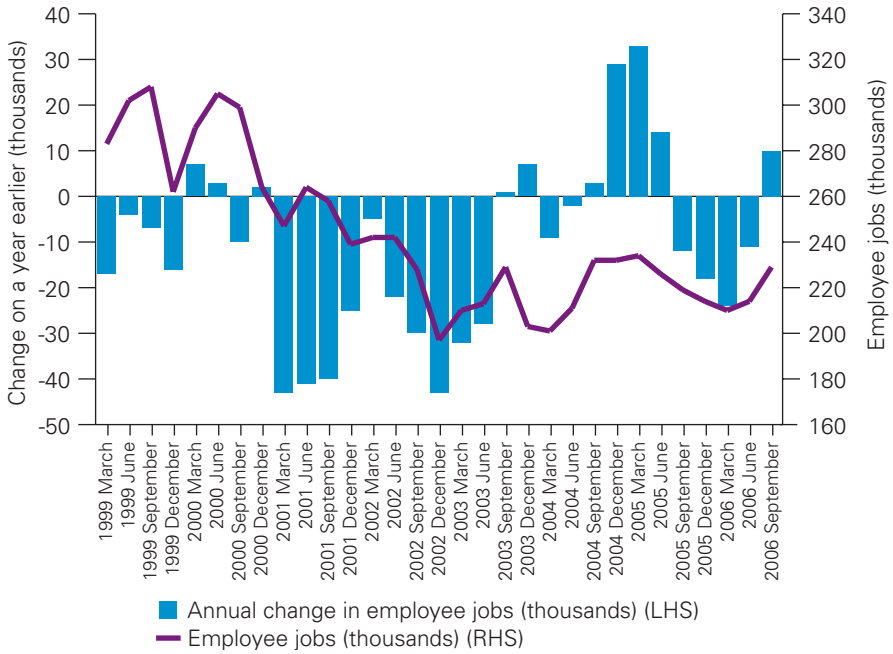
now accounting for up to 80 per cent of turnover. It claimed that minimum wage upratings now directly resulted in fee increases, and these were above the rate of inflation. This is reflected in the findings from our own Employers' Survey which found that, of the 56 per cent of respondent organisations in the childcare sector that reported being affected by the 2005 uprating, 83 per cent stated it had led to price increases – in line with in our 2004 survey findings. This was a common theme in the evidence we received from nurseries, with many noting the impact of price increases on affordability for parents and posing a question mark over the long-term sustainability of their business. DfES (2006c) found that between 2003 and 2005 there had been an increase in the proportion of loss-making providers for all types of provision, but with the decline in profitability highest for full day care providers, the provider most dependent on fee income rather than local authority or central Government funding.

3.82 The childcare sector has continued to expand and create new jobs, but there is growing evidence that the minimum wage is having an impact on pay and differentials for nursery staff. With staffing forming a significant proportion of overall costs, childcare businesses are particularly sensitive to increases in the minimum wage.

Agriculture

3.83 Since the introduction of the National Minimum Wage, employment in agriculture has continued broadly on its long-term path of decline, reflecting structural changes in the economy. However, Figure 3.23 shows that the downward trend has flattened out more recently. Indeed, jobs increased by 10,000 to 229,000 in the year to September 2006. According to the Department for Environment, Food and Rural Affairs (Defra, 2007), the total labour force in agriculture in the UK was 534,000 in June 2006, or 169,000 excluding farm owners, spouses and salaried managers. Of these workers, 64,000 were seasonal, casual or gang labour, although this snapshot estimate is likely to be significantly lower than the total number of seasonal workers employed over the course of a year.

Figure 3.23
Employee Jobs in the Agriculture Sector and Annual Change, Thousands, GB, 1999–2006



Source: ONS employee job series, not seasonally adjusted, GB, 1999–2006.

3.84 Figure 3.24 illustrates the influence on the earnings distribution for agriculture of the minimum wage rates set by the Agricultural Wages Boards (AWBs) for England and Wales, Scotland and Northern Ireland respectively. In England and Wales, the Board sets a range of minimum rates to reflect skills, experience and supervisory responsibilities, with the lowest minimum rate (Grade 1) set no lower than the National Minimum Wage. For example, the spike in the April 2004 distribution at £6.00 reflects the applicable Craft and Appointment Grade minimum rate in England and Wales while the spike at £5.40 in the April 2005 distribution reflects the minimum rate for a Standard Worker (now Grade 2). Consequently, the earnings distribution lacks the pronounced peaks around the National Minimum Wage level observed in some other low-paying sectors. Lowest decile hourly earnings remained around 40 pence above the minimum wage between 2004 and 2006, rising to £5.45 in April 2006, while median hourly earnings increased to £7.00.

3.85 These higher minimum rates also help to explain why our definition of low-paying agricultural occupations captures far fewer workers than the

industry based definition. There were 68,000 employees in low-paying agricultural occupations in the third quarter of 2006.

Figure 3.24
Hourly Earnings Distribution for Employees Aged 18 and Over in the Agriculture Sector, UK, 2004–2006

Source: LPC estimates based on ASHE with supplementary information, low-pay weights, UK, April 2004–2006.
Note: NMW label shows the adult minimum wage rate in April of the given year.

3.86 The National Farmers' Union (NFU) emphasised in its evidence that not only did the National Minimum Wage have a direct impact on agricultural wages, since in recent years it has effectively set the lowest pay rate (now called Grade 1) within the Agricultural Wages Order for England and Wales, but it has also influenced minimum pay rates for the higher grades due to the preservation – at least in part – of pay differentials. The NFU noted that the National Minimum Wage had little effect on pay rates in those parts of the sector that faced a shortage of skilled labour, such as cereals. However, it did have a significant impact on the labour-intensive, low-skilled and low-paid parts of the industry – primarily horticulture. This sector is heavily reliant on seasonal labour to supplement the permanent UK workforce, including migrant workers from the A8 accession countries and workers from outside the European Union on the Seasonal Agricultural Workers Scheme.

3.87 The NFU also told us that wage increases were difficult to manage as, despite rising input costs, farmers faced continuing downward pressure on prices. On a Commission visit to Birmingham, a horticultural firm supplying plants to major retailers from its base in North West England told us that price freezes or even reductions were required of suppliers, who also faced increasing competition from countries such as the Netherlands. A second plant supplier from the same area said that increases in agricultural minimum rates in England and Wales, driven from the bottom by minimum wage upratings, had caused labour costs to increase from 25 per cent of turnover five or six years previously to 32 per cent in 2006. It was also noted that, while the AWB had awarded smaller percentage increases for some agricultural grades, skilled and experienced staff expected their pay differentials to be maintained.

3.88 Although the minimum wage has a direct impact on the horticulture sector in particular, wages in agriculture are determined to a significant extent by AWB minimum rates as well as by market factors. Falls in employment are primarily a consequence of long-term restructuring, and while it would be very difficult to estimate the degree of any specific additional impact arising from the minimum wage, the earnings data and the recent upturn in employment suggest that this is likely to be limited.

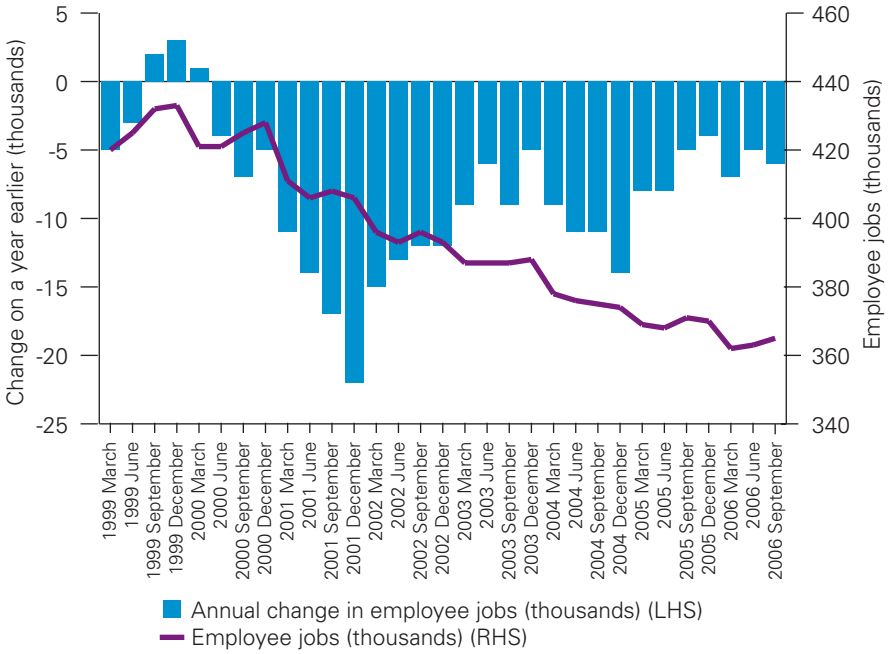
Food Processing

3.89 Following the review of our definitions of the low-paying sectors outlined in the introduction to this chapter, we include an analysis of the food processing sector for the first time. We hope to build on our knowledge of the sector in subsequent reports.

3.90 Figure 3.25 below shows a declining trend in employment in the food processing sector since 1999. Between September 2004 and September 2006, the number of jobs fell by 11,000 to 365,000. There has also been a fall in employment in low-paying food processing occupations in the last few years, although there was a small increase to 204,000 in the year to the third quarter of 2006. There may be a variety of factors behind this decline, including international competition. We also have anecdotal evidence that agency workers are

an important source of flexible labour in the sector; these jobs would not be recorded within the food processing industrial sector.

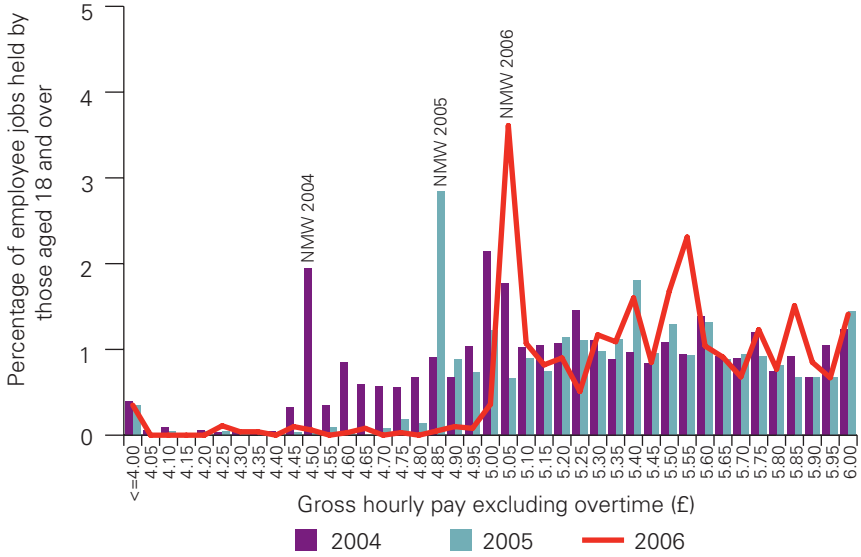
Figure 3.25
Employee Jobs in the Food Processing Sector and Annual Change, Thousands, GB, 1999–2006



Source: ONS employee job series, not seasonally adjusted, GB, 1999–2006.

3.91 The earnings distribution illustrates that the minimum wage has had a smaller impact on food processing than on other low-paying sectors, although there are signs that the impact may be increasing. Figure 3.26 shows that 2 per cent of jobs in the sector paid the adult minimum wage in April 2004, rising to nearly 4 per cent in April 2006 as the minimum wage passed the £5.00 hourly threshold. Similarly when looking at low-paying food processing occupations (not shown), the proportion of jobs paying the minimum wage increased from 4 per cent to 5 per cent between April 2005 and April 2006. Almost three-quarters of jobs in the sector paid at least £1.00 per hour above the minimum wage in April 2006, while median hourly earnings were significantly above this level (£7.55). However, the margin between lowest decile hourly earnings and the minimum wage reduced from 50 pence to 30 pence over the two years to April 2006 suggesting that the minimum wage is catching up with wages in parts of the sector. Lowest quartile earnings rose by 6 per cent over the two years to 2006, while the minimum wage rose by almost 12 per cent.

Figure 3.26
Hourly Earnings Distribution for Employees Aged 18 and Over in the Food Processing Sector, UK, 2004–2006



Source: LPC estimates based on ASHE with supplementary information, low-pay weights, UK, April 2004–2006.
Note: NMW label shows the adult minimum wage rate in April of the given year.

'This food manufacturer employs around 1,000 employees ... with the vast majority ... on the National Minimum Wage ... given the intense competition they face ... prices [are] currently 20 per cent lower in real terms than in 1997. Offshoring production is becoming an increasingly viable option as labour costs rise, with inevitable job losses ....'

Large food manufacturer, quoted in CBI evidence

3.92 Consultation responses from employer organisations indicated that the minimum wage was beginning to affect parts of the sector. The Food and Drink Federation wrote that initially the minimum wage was of little relevance, but it was now starting to have both a direct impact on the lowest pay rates in the sector and an indirect impact on differentials. It noted that profitability had been significantly squeezed in recent years and expressed concern about the future competitiveness of the sector. The CBI reported that food manufacturing faced significant cost pressures arising from intense competition in the retail food sector. It added that many businesses were operating at very low, and even negative, profit margins and those businesses that were able to survive would seek to recover costs by increasing automation and reducing the size of the workforce.

3.93 Similar comments were made to us during a visit to Scotland in 2006. A dessert manufacturer attributed a fall in profitability and a cut in the workforce to the minimum wage and reported that differentials between skilled bakery staff and unskilled operatives had fallen from 17 per cent in 1999 to 3 per cent in 2006. This manufacturer, and a separate bakery business, also located in Scotland, told us that they

had mechanised processes as much as possible, but there was a tension between the savings that this could achieve and the need to produce higher value, hand-finished goods to retain a place in niche markets. During a visit to Wales in 2006, a food manufacturer reported that 45 per cent of its workforce were now on the minimum wage and squeezed differentials had adversely affected staff morale, with some experienced staff leaving the company.

3.94 Overall, the evidence indicates a fairly small but increasing impact arising from the minimum wage.

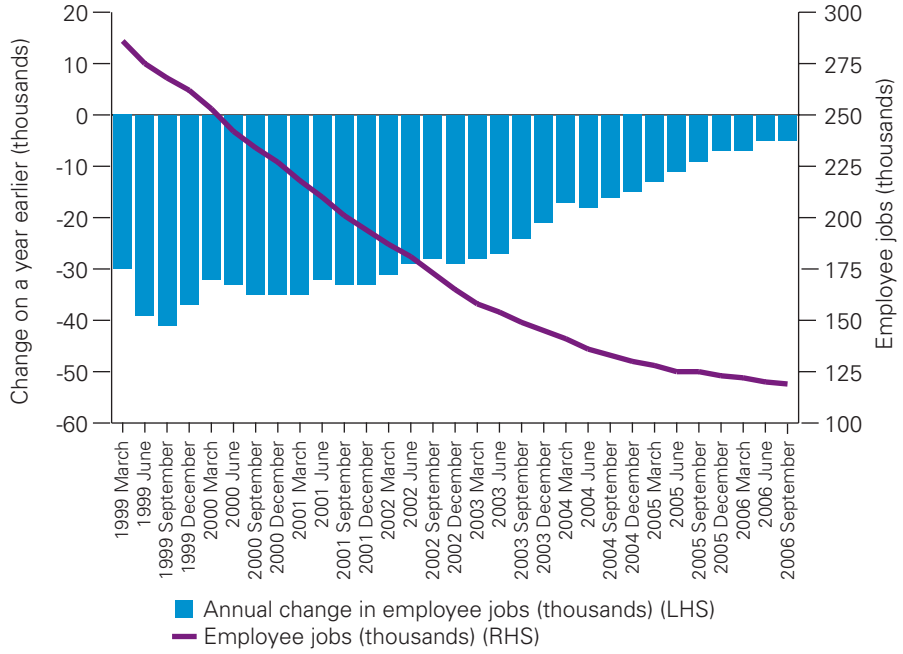
Textiles and Clothing

3.95 In previous reports we have looked at the textiles, clothing and footwear sectors. However, our analysis of earnings in the footwear sector has shown that low pay is less common than previously and, given the relatively few low-paid workers now employed in this shrinking sector, we concluded that it should no longer be included in our sectoral analysis.

3.96 The long-term decline in employment in textiles and clothing has continued. A further small fall in jobs between September 2005 and September 2006 meant there were 119,000 jobs remaining in the sector, just under 39 per cent of the number of jobs in September 1998. Low-paying occupations in textiles and clothing also showed a small drop in employment between the third quarter of 2005 and the same period in 2006.

3.97 However, the decline has been less steep in recent years, as illustrated in Figure 3.27, and this may indicate that it is beginning to bottom out as firms competing with low-wage economies have moved production offshore or closed, leaving the UK sector to those firms that have found niche markets or who are using new technologies in order to improve competitiveness. It is too early, however, to draw any firm conclusions from the data.

Figure 3.27
Employee Jobs in the Textiles and Clothing Sector and Annual Change, Thousands, GB, 1999–2006



Source: ONS employee jobs series, not seasonally adjusted, GB, 1999–2006.

3.98 We have said in previous reports that it is difficult to know to what extent, if any, the decline in jobs in the sector can be attributed to the National Minimum Wage. While employer organisations accepted that the decline of the sector was largely due to competition from low wage economies, they pointed to the impact of the minimum wage as being a contributory cause. The TUC and trade unions such as Community have viewed globalisation as the key factor at work in explaining the long-term decline in employment.

3.99 Figure 3.28 below shows that nearly 6 per cent of jobs paid the adult minimum wage in April 2006, compared with just over 4 per cent in April 2004. However, there was some evidence of a widening of the differentials in the earnings distribution, with, for example, the gap between the minimum wage and lowest quartile earnings widening slightly between 2004 and 2006, from 87 to 95 pence.

Figure 3.28
Hourly Earnings Distribution for Employees Aged 18 and Over in the Textiles and Clothing Sector, UK, 2004–2006

Source: LPC estimates based on ASHE with supplementary information, low-pay weights, UK, April 2004–2006.
Note: NMW label shows the adult minimum wage rate in April of the given year.

'The industry is already on a knife-edge. The additional pressure placed on employers by the NMW worsens an already precarious position. Inappropriate increases could mean the last straw which will break the back of the textile industry.'

Confederation of British Wool and Textiles, quoted in CBI evidence

3.100 In its evidence, the CBI reported that the sector had been hugely affected by the minimum wage, with companies looking at ways to reduce wage bills including ending apprenticeship schemes. The British Apparel & Textiles Confederation (BATC) again highlighted to us its concern about the impact of increases in the minimum wage on incentive pay schemes and on differentials. Similar concerns were raised by the Scottish Textiles Manufacturers Association. The BATC reported that the proportion of production workers on incentive based payment schemes whose pay had to be 'made-up' to the level of the minimum wage had increased since our 2005 Report from an average of 22 per cent to 27.5 per cent. In its view this was an unsustainable position for such schemes. It set this in the context of an extremely competitive sourcing situation in the high street as a result of low cost imports, and higher costs being faced by UK manufacturers due to energy price rises and new legislative measures.

3.101 In our Employers' Survey 59 per cent of the textiles and clothing firms which said they had an incentive pay system reported they had been affected by the October 2005 increases in the minimum wage, compared with 35 per cent of textiles firms without such a scheme –

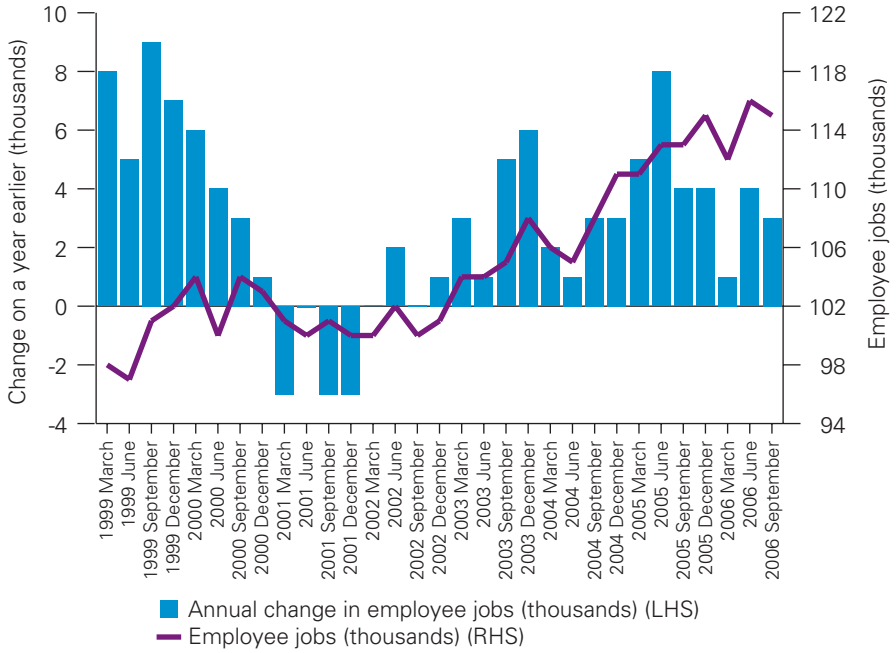
this is higher than the respective findings of 52 per cent and 26 per cent in the 2004 survey. These firms also reported a greater impact from the minimum wage than was reported in the 2004 survey in respect of a range of measures, including increased costs and reduced differentials. For textiles and clothing firms overall, 37 per cent of respondents affected by the October 2005 upratings said they had decreased overall staffing levels (49 per cent in the 2004 survey) and 30 per cent had cut overtime hours (33 per cent in the 2004 survey).

3.102 Although the minimum wage continues to have an impact on wage rates in the sector, our overall assessment remains that it is international competition from low-wage economies rather than the minimum wage that has been the main factor in the decline in employment in the textiles and clothing sector.

Hairdressing

3.103 There has been a steady increase in employment in hairdressing since the introduction of the minimum wage, except for a short period around 2001 (Figure 3.29). There were 115,000 employee jobs in September 2006, a small increase over the year. The number of people employed in low-paying hairdressing occupations has also seen an increase in recent years (up 12,000 to 126,000 in the year to the third quarter of 2006). Self-employment is significant in the sector and, while the trend has been upwards over the last few years, the number of self-employed hairdressers remained static at around 111,000 between the third quarter of 2005 and the same period in 2006.

Figure 3.29
Employee Jobs in the Hairdressing Sector and Annual Change, Thousands, GB, 1999–2006



Source: ONS employee job series, not seasonally adjusted, GB, 1999–2006.

3.104 Figure 3.30 shows that the minimum wage continues to have a considerable impact on earnings in the sector. Six per cent of jobs paid at the adult minimum wage in 2005 and 8 per cent in 2006. As with other low-paying sectors, it is clear from the spike at £5.00 in the April 2005 distribution that a significant earnings threshold was crossed when the minimum wage rose above this level, which may partly account for the increased height of the spike at the minimum wage level in the April 2006 distribution. The earnings distribution also supports our understanding that the Youth Development Rate and the apprenticeship exemptions are used more widely in hairdressing than in other sectors. In April 2006 15 per cent of jobs paid below the adult minimum wage rate and just over one-third paid £5.50 or less per hour. Not surprisingly, lowest decile earnings were below the adult minimum wage rate in the period 2004–2006. Lowest quartile earnings remained slightly above the minimum wage although the gap narrowed from 30 pence in 2004 to 9 pence in 2006, suggesting some squeezing of differentials may have occurred at the bottom of the distribution.

Figure 3.30
Hourly Earnings Distribution for Employees Aged 18 and Over in the Hairdressing Sector, UK, 2004–2006

Source: LPC estimates based on ASHE with supplementary information, low-pay weights, UK, April 2004–2006.
Note: NMW label shows the adult minimum wage rate in April of the given year.

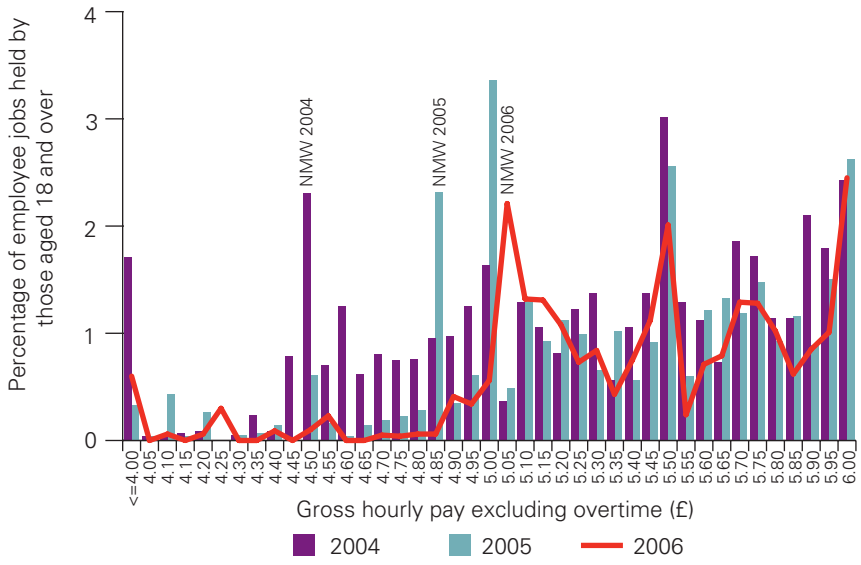
3.105 In its evidence, the National Hairdressers' Federation (NHF) reported that the sector continued to experience skills shortages, but small salons were reluctant to take on trainees over the age of 17 or 18 because of the cost. It repeated its call for an exemption from the minimum wage for the full duration of an apprenticeship to encourage salons to continue to offer training opportunities. At present, apprentices aged 19 and over are exempt for the first twelve months of their apprenticeship. As well as the impact on training, the NHF was concerned that the minimum wage had undermined incentives. It reported that most hairdressers were now on the minimum wage; in the past they would have received a low basic wage with commission payments to reflect their personal contribution to the salon's income. These two issues were highlighted in the CBI's evidence, which also suggested that increasing employment costs arising from the minimum wage and other employment regulation were leading to an increase in self-employment, some of it in the informal economy.

3.106 The minimum wage continues to have a significant impact on wages in the hairdressing sector although the employment picture remains positive. The main issue raised by employer representatives related to the exemptions for apprentices, which we examine in Chapter 5.

Office Work

3.107 Following a review of the sectors and occupations in which low-paid workers are concentrated, we examine office work occupations for the first time. This group includes telephonists, receptionists and elementary office occupations. According to the LFS, in the third quarter of 2006 there were 324,000 employees in low-paid office occupations, slightly fewer than in the same period in 2005, and in line with the general downward trend in recent years. Figure 3.31 below shows that, unlike many of the low-paying sectors, there is no pronounced spike in the earnings distribution at the adult minimum wage. Just over two per cent of office work jobs were paid at this level in April 2006. For this occupational group, the rate of pay is likely to vary considerably depending upon the industrial sector in which the job is based.

Figure 3.31
Hourly Earnings Distribution for Employees Aged 18 and Over in Office Work Occupations, UK, 2004–2006



Source: LPC estimates based on ASHE with supplementary information, low-pay weights, UK, April 2004–2006.
Note: NMW label shows the adult NMW rate in April of the given year.

3.108 Office work occupations are dispersed widely across the economy, which perhaps explains why respondents to our consultation did not raise any issues relating to this occupational group in their evidence. As these occupations are not closely associated with a particular industrial

sector, we do not have the same breadth of information to draw on to assess the impact of the minimum wage. However, the dispersed nature of these occupations implies that the impact of the minimum wage on individual firms is likely to be limited, unless they have significant numbers of other low-paid workers or are operating in a low-paying industrial sector.

Conclusion

3.109 While the total number of jobs in the low-paying industrial sectors remains substantially higher than when the minimum wage was introduced, there was a slight fall in the number of jobs in the year to September 2006. This was the fourth successive quarter in which a year-on-year fall occurred in the overall employment level in these sectors. This is at a time when employment levels have grown in the economy as a whole. Although some of the low-paying sectors, such as textiles and clothing, and agriculture, have been in long-term decline, employment fell in hospitality and retail, which have seen some of the most rapid growth in recent years. It has been suggested by some employers and their representative bodies that increases in the minimum wage were a key contributory factor to the fall in jobs, but it is not possible to determine whether this was a primary or even a contributory factor. It is, for example, possible that the fall in jobs in retail and hospitality reflects the slowdown in consumer spending in 2005 and early 2006. Some other low-paying sectors, however, continued to experience a growth in employment, in particular the social care, and leisure, travel and sport sectors. The childcare occupational sector also saw a small rise in employment.

3.110 We have seen that the minimum wage is having an increasing impact on pay in the low-paying sectors, particularly hospitality, retail, cleaning and childcare, with a growing proportion of jobs paid at the minimum wage and a growing number of firms having to make adjustments for those immediately above this wage level. For many sectors and businesses such action has not stopped differentials narrowing, as absorbing minimum wage increases has become more difficult. This was a particularly strong message from employers this year, and a point often made to us during our regional visits. Other sources of information, such as earnings data, our written consultation and oral

hearings, plus commissioned research, also provided evidence of the increasing influence of the minimum wage on pay structures. There was also some evidence of a greater impact of the minimum wage on pay in leisure, travel and sport, while in hairdressing we found an increased proportion of jobs paid below the adult rate – reflecting the common usage of the Youth Development Rate and apprentice exemptions in that sector. Textiles and clothing employers with an incentive based pay system also reported that the minimum wage was increasingly affecting these arrangements.

3.111 We found that for some sectors the impact of the minimum wage on pay remains more limited. This was the case for office work occupations and in the security and food processing sectors, although, in the case of the latter sector, the impact seems to be increasing. The impact on small firms appears to have been fairly stable over the last two years. While in the social care sector overall we found a more modest impact relative to other low-paying sectors, with a comparatively small proportion of jobs paid at the minimum wage, this proportion was far larger in the independent care sector. There was evidence, particularly from our consultation and regional visits, to suggest that recent minimum wage upratings were having an effect on pay and differentials for a number of social care providers.

3.112 However, much of the evidence from the social care sector has suggested that some local authorities continue to fail to reflect fully increases in the minimum wage in their setting of fees for independent sector care providers. While we have recognised the progress that has been made on funding of social care, the problem persists in some areas of the UK. We have therefore recommended again that the Government should continue to make clear that the commissioning policies of local authorities should reflect the real costs of provision, and have particularly emphasised the need for the Government to monitor how far the practice of each council matches this policy. Where variation occurs it should examine the reason for this.

3.113 Having looked in detail at the sectors of the economy and occupations that are most affected by the minimum wage, we focus in the next chapter on those groups of workers that are particularly affected.

Chapter 4

Groups of Workers and Specific Enforcement Issues

Our remit asked us to assess the impact of the minimum wage on different groups of workers, including ethnic minorities, women and people with disabilities. These groups of workers are disproportionately represented in low-paying sectors and therefore stand to benefit more than most from upratings of the minimum wage.

In the 2005 Report, we found clear evidence that the minimum wage had had a major impact in narrowing the gap between the pay of women and that of men at the lower end of the earnings distribution. Since then, the median pay gap for full-time female employees has reduced further and the pay gap at the lower end of the distribution has continued to narrow.

In common with the rest of the population, the employment prospects of workers with a work-limiting disability have improved in recent years, but they have recently experienced a slight increase in unemployment.

Minority ethnic groups (as defined by the 2001 census) have also fared better in the labour market in recent years. Although the employment rates of ethnic minorities are still lower than those of white workers, they have increased at a faster rate since the introduction of the minimum wage. There has also been a sharp decline in the unemployment rates of ethnic minority groups between 1999 and 2004. Since 2004, however, the unemployment rates of ethnic minorities have been rising at a slightly faster rate than the rest of the working age population.

The minimum wage has clearly helped to improve the earnings position of workers with disabilities and those from ethnic minorities at the lower end of the earnings distribution.

The arrival of some half a million migrant workers from central and eastern Europe since the enlargement of the European Union in 2004 has

been a significant recent development in the UK labour market. Many have found employment in low-paid occupations particularly in the agriculture, food processing and packing, and hospitality sectors. Much of the evidence suggests that these workers have had a positive effect on the overall economy and have filled existing vacancies and plugged skills gaps rather than displacing UK workers. Some migrant workers are vulnerable to exploitation by unscrupulous employers prepared to take advantage of their imperfect knowledge of employment rights. A number of consultation responses suggested that excessive deductions from pay were a particular problem. We discuss the need for effective awareness campaigns and enforcement in relation to migrant workers in Chapter 6.

Following the detailed review of the accommodation offset and resulting recommendations to the Government in our 2006 Report, the Department of Trade and Industry consulted on draft guidance that aimed to clarify the rules and address evasion. The final version is due to be published soon after this report. However, the evidence relating to migrant workers has demonstrated that some enforcement problems remain. We did not focus on the operation of the accommodation offset this year but we did review its level: we recommend that the accommodation offset should increase in line with the adult rate of the minimum wage to £4.30 per day in October 2007.

Homeworkers performing unskilled manual work, often on a piece rate basis, continue to face problems ensuring their employment rights are respected. We received evidence that some employers argue that these workers are self-employed in order to deny their entitlement to the minimum wage. We had hoped that new rules on fair piece rates introduced in October 2004 would simplify the calculation of minimum wage pay but the evidence we received, albeit limited, indicated that there were some practical difficulties associated with applying these rules to output work. In view of the difficulties faced by homeworkers, we continue to believe that this group warrants particular attention in terms of the enforcement of their minimum wage rights.

Despite the publication of guidance on therapeutic activity in 2003, there continue to be reports of suspected non-compliance with the minimum wage. There is no doubt that the minimum wage should apply to all workers regardless of any learning disability or mental health problem,

but there are also concerns that inappropriate enforcement action, or the fear of such action, could result in the closure of therapeutic services with no alternative provision available. We welcome the fact that the Department of Trade and Industry has revised and reissued its guidance in January 2007 and we encourage the Government to continue to take steps to improve awareness of the minimum wage among those providing services to people with disabilities or other impairments.

Volunteers are another group whose status can be unclear with respect to the minimum wage. In our 2005 Report we made a recommendation, accepted by the Government, that existing guidance for the voluntary sector be consolidated and made more widely available. Since then, the Department of Trade and Industry and HM Revenue and Customs have worked with a number of sector bodies to clarify the minimum wage position for their respective constituents. In January 2007, the Government announced plans to review the minimum wage in relation to voluntary workers, work which would encompass our earlier recommendation for revised guidance. We stand ready to contribute to such a review and hope the improved guidance that we called for two years ago will be made available in the near future.

We do not want minimum wage rules to cause problems for individuals who are happy to give their time freely to benefit their community. But we received evidence this year indicating that it has become the norm in some parts of the media to expect prospective newcomers to offer their time for little or no financial reward as the price of entry to that industry. The Department of Trade and Industry and HM Revenue and Customs have worked with sector bodies in the television industry on best practice guidance and we hope this will make employers more aware of their minimum wage obligations and reduce non-compliance, whether intentional or not. We will consider how the guidance has affected employer practice in a future report.

Introduction

4.1 Our terms of reference asked us to examine the impact of the minimum wage on different groups of workers including different age groups, ethnic minorities, women and people with disabilities. It might be expected that, if the minimum wage were to affect employment

adversely, those groups that were already faring less well in the labour market would be among the first to show signs of adverse consequences. However, analysis in our previous reports has shown that the employment prospects of many disadvantaged groups have been improving in recent years, with the exception of young people, who are considered separately in Chapter 5. We begin this chapter by examining the labour market outcomes of women, people with a work-limiting disability and ethnic minorities.

4.2 We have continued to pay close attention to developments at the low-paid end of the labour market. There has been much debate about the impact of recent arrivals from eight central and eastern European countries that joined the European Union (EU) in 2004 (known as the A8). Many have found employment in low-paying sectors such as agriculture, food processing and hospitality and here we examine the impact on the labour market. Several consultation responses noted that migrant workers were often employed through agencies, some of which were prepared to exploit their lack of knowledge of their employment rights, or their reluctance to assert them. We also received evidence relating to agency practices in the entertainment industry. This chapter therefore takes a closer look at agency workers. Our 2006 Report examined the particular difficulties that migrant workers may face in relation to accommodation. This topic was raised again this year, focused on those working through an agency or labour provider, some of whom faced excessive deductions from pay for accommodation and other services. We note developments since our last report and review the level of the accommodation offset.

4.3 In the latter half of the chapter, we look at some further groups of people who are affected by the minimum wage in very different ways. A common factor is that their entitlement to the minimum wage can be unclear, or they may face particular difficulties in enforcing their right to the minimum wage. In this context, we cover homeworkers, people undertaking therapeutic activity and volunteers.

Women, Ethnic Minority Workers and those with Work-limiting Disabilities

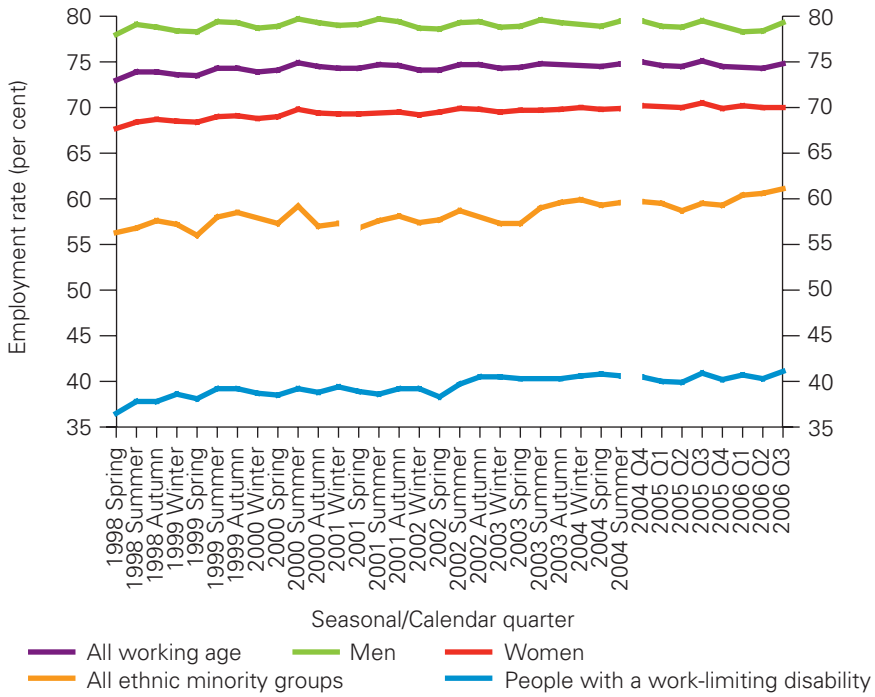
Introduction

4.4 Women, workers with disabilities and minority ethnic groups are more likely than other workers to benefit from minimum wage upratings. In the earnings analysis that follows, we observe effects that arise as a consequence of the concentration of these groups of workers in low-paying sectors and occupations. It should, however, be noted that we are tasked with recommending minimum wage rates for all workers over school leaving age. It is not part of our remit to seek to bring about social change for groups disadvantaged in the labour market. Instruments other than the minimum wage are required to address deep-rooted inequalities with complex causes.

4.5 The quality of data available to study the gender pay gap is superior to that available for studying the impact of the minimum wage on the pay of those with work-limiting disabilities and ethnic minority groups. Nevertheless, we are able to make some general comments about the earnings position of these two groups.

4.6 We look first at the broad trends in the employment, unemployment and inactivity of these three groups of workers compared with the working age population as a whole. When the minimum wage was first introduced, there were concerns that it would lead to a decline in employment, especially among those groups more likely to be low-paid. Figure 4.1 shows that this has not been the case. The general working age employment rate has increased since the introduction of the minimum wage in Spring 1999, as has the employment rate for women, those with work-limiting disabilities and ethnic minority groups.

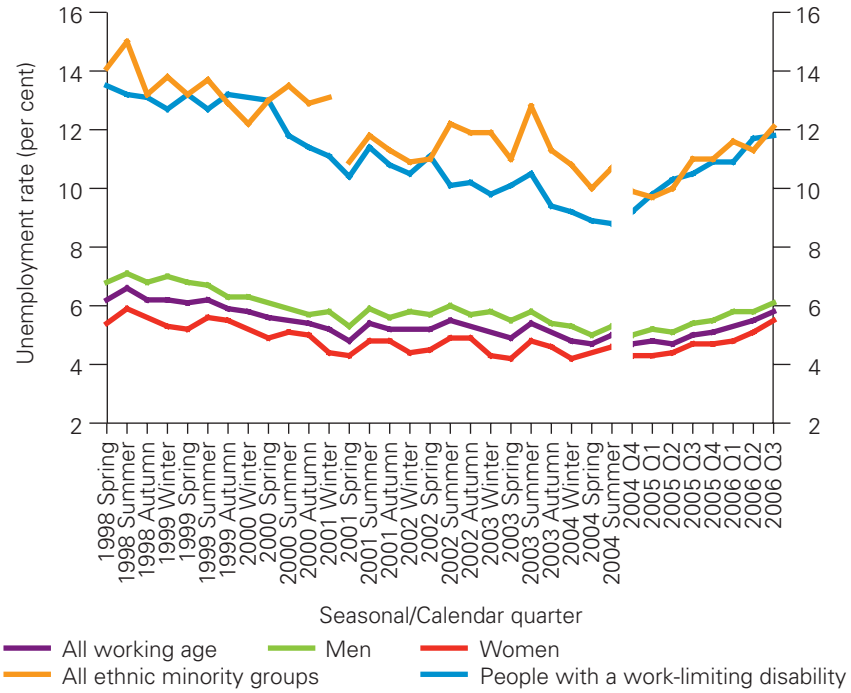
Figure 4.1
Working Age Employment Rates of Various Groups, UK, 1998–2006



Source: LPC estimates based on Labour Force Survey (LFS) Microdata, seasonal/calendar quarters, not seasonally adjusted, UK, 1998–2006.
Notes:
1. The definition of ethnic groups in the LFS changed in Spring 2001 to be consistent with the 2001 Census classifications; thus comparisons between the periods before and after should be made with care.
2. The break between Summer 2004 and Q4 2004 is a result of a discontinuity in the series as the LFS moved from seasonal to calendar quarters; thus comparisons should be made with care.

4.7 Figure 4.2 suggests that, just as there was no diminution of employment, there was also no negative impact on unemployment for those groups most affected by the minimum wage following its introduction. The unemployment rate of women, ethnic minorities and people with work-limiting disabilities steadily decreased in the late 1990s and the early part of the 2000s. However, more recently, both the rate and level of unemployment have been rising for these groups and the rest of the working age population. As we noted in Chapter 2, the simultaneous increase in employment and unemployment levels may reflect the recent strong growth in the UK labour supply. This has been driven by reductions in inactivity levels, particularly among older workers, and by the recent increase in net migration.

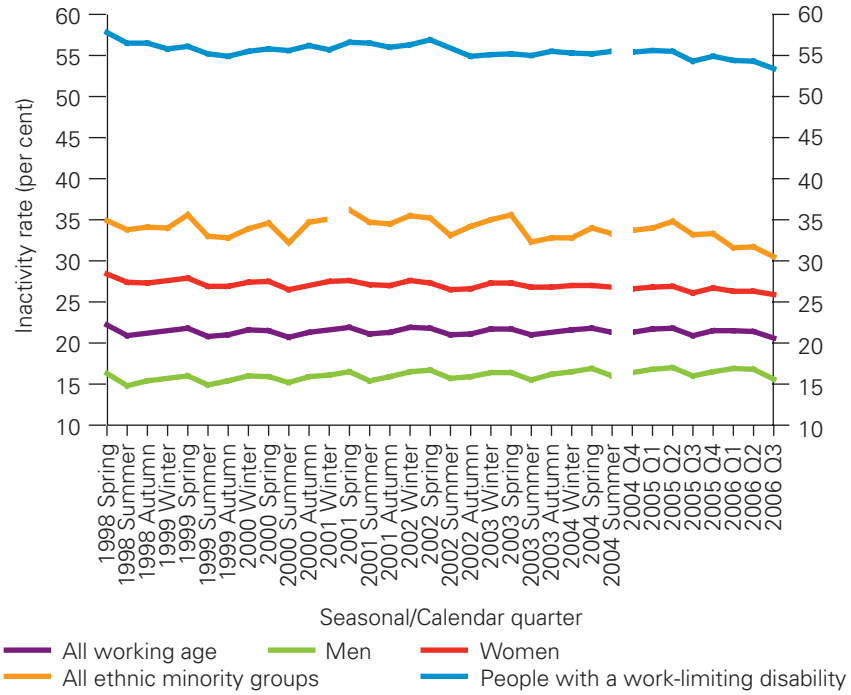
Figure 4.2
Working Age Unemployment Rates of Various Groups, UK, 1998–2006



Source: LPC estimates based on LFS Microdata, seasonal/calendar quarters, not seasonally adjusted, UK, 1998–2006.
Notes:
1. The definition of ethnic groups in the LFS changed in Spring 2001 to be consistent with the 2001 Census classifications; thus comparisons between the periods before and after should be made with care.
2. The break between Summer 2004 and Q4 2004 is a result of a discontinuity in the series as the LFS moved from seasonal to calendar quarters; thus comparisons should be made with care.

4.8 Figure 4.3 shows the trends in inactivity rates and confirms the increasing labour market participation of women, the disabled, and ethnic minority groups since the introduction of the minimum wage. Ethnic minorities in particular have seen a sharp reduction in their inactivity rate in the year to the third quarter of 2006.

Figure 4.3
Working Age Inactivity Rates of Various Groups, UK, 1998–2006



Source: LPC estimates based on LFS Microdata, seasonal/calendar quarters, not seasonally adjusted, UK, 1998–2006.
Notes:
1. The definition of ethnic groups in the LFS changed in Spring 2001 to be consistent with the 2001 Census classifications; thus comparisons between the periods before and after should be made with care.
2. The break between Summer 2004 and Q4 2004 is a result of a discontinuity in the series as the LFS moved from seasonal to calendar quarters; thus comparisons should be made with care.

Labour Market Outcomes by Gender

Employment

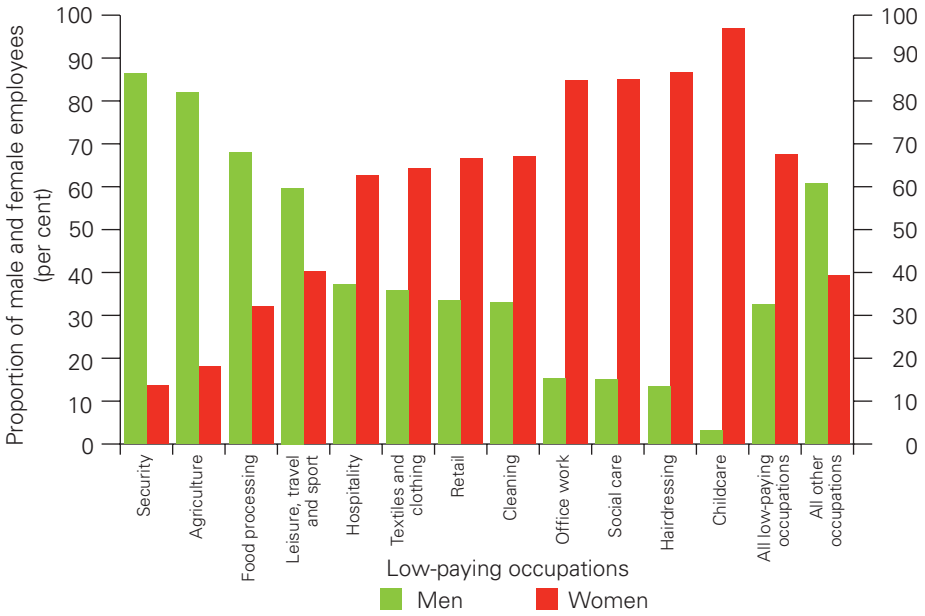
4.9 Although women's participation in the labour market has been increasing, as shown in Figure 4.1, their employment rate remains lower than that of men. In the year to the third quarter of 2006, the employment rate of women remained around 70 per cent compared with around 79 per cent for men.

4.10 Women have invariably had lower unemployment rates than men, as was indicated in Figure 4.2. Both men and women have experienced a decline in their unemployment rates in recent years, although the unemployment rate for both has been rising slowly since 2004. The unemployment rate of women stood at 5.5 per cent in the third quarter of 2006, compared with 6.1 per cent for men.

4.11 Another distinctive feature of women's employment is their much higher propensity to work part-time. According to the Labour Force Survey (LFS), in the third quarter of 2006, over 40 per cent of female employees were working part-time, compared with 9 per cent of male employees; thus nearly 4 in 5 part-time employees were women. The consequences of these different working patterns for the earnings of women are explored below.

4.12 As we have noted, women are disproportionately represented in low-paying sectors and occupations and are therefore more likely to be affected by the minimum wage. As shown in Chapter 2, according to estimates using the Annual Survey of Hours and Earnings (ASHE) 2006, about two-thirds of those covered by the 2006 October upratings were women. In the third quarter of 2006, 55 per cent of employees in the low-paying sectors were women, compared with 41 per cent in other sectors. Some low-paying sectors are particularly dominated by women, such as social care and hairdressing, where they make up over four-fifths of the workforce. The prevalence of women in low-paid jobs is even more pronounced when looking at low-paying occupations. As shown in Figure 4.4, in the third quarter of 2006 around 68 per cent of employees in low-paying occupations were women, compared with 39 per cent in other occupations. Workers in childcare, social care, office work and hairdressing occupations are overwhelmingly female. The fact that the concentration of women in low-paying occupations is even higher than in the low-paying industrial sectors reflects the vertical occupational segregation of women, as they are less likely to occupy managerial and supervisory posts.

Figure 4.4
Proportion of Male and Female Employees in Low-paying Occupations, UK, 2006



Source: LPC estimates based on LFS Microdata, not seasonally adjusted, UK, Quarter (Q)3 2006.

Gender Pay Gap

4.13 Although women's involvement in the labour market has been increasing and the gender pay gap[1] has been gradually narrowing for some time, women continue to earn less than men on almost all relevant measures.

4.14 The size of the gender pay gap and the conclusions drawn about it depend greatly on how it is measured. The pay gap can be presented using various measures of the earnings distribution. The most commonly used measures are the mean and the median. The median is often preferred because it is not unduly affected by extreme values and is therefore viewed as a more representative and less volatile measure. Because men are much more prevalent among very high earners than women, using the mean tends to suggest a larger gender pay gap. Nevertheless, the mean measure can provide an interesting insight into gender pay differences precisely because it takes into account the top end of the earnings distribution, heavily skewed towards men. In the analysis that follows, we highlight both measures

[1] The gender pay gap refers to the difference between the earnings of men and women. It is determined by calculating the gender pay ratio, that is, women's overall average pay as a percentage of men's. The pay gap is the difference between this and 100 per cent.

where possible and also look at the pay gap at different points of the earnings distribution.

4.15 The pay gap derived from a measure of annual earnings is larger than that for weekly earnings, which in turn is larger than that for hourly pay. For instance, the gender pay gap in median annual earnings in 2006 (for all employees aged 18 and over) was twice as high as the pay gap in median gross hourly earnings excluding overtime. This is because men tend to work more hours per year. Another reason for the differences in these pay gaps is that the measures of annual and weekly earnings also include additional payments, such as overtime, which are predominantly paid to men. According to ASHE 2006, basic pay made up around 94 per cent of women's mean gross weekly pay compared with about 89 per cent for men.

4.16 In our analysis, we focus on gross hourly earnings excluding overtime, which is the closest definition of pay in ASHE to that of the minimum wage. The different working patterns of male and female employees, and the fact that relatively few men work part-time, also complicate the picture and we therefore consider full-timers and part-timers separately. We focus on employees aged 18 and over as the majority of 18–21 year olds are paid at least the adult minimum wage rate. We will also consider the relationship between the gender pay gap and age.

4.17 Table 4.1 illustrates the differences in the median and mean hourly pay of male and female full-time employees aged 18 and over. Both mean and median gender pay gaps increased between 1997 and 1998, the year before the minimum wage was introduced. However, since the introduction of the minimum wage, they have gradually been narrowing, and, according to ASHE 2006, the ratio of women's pay to men's pay stood at 89.2 per cent (a 10.8 per cent pay gap) as measured by the median and 83.2 per cent (a 16.8 per cent pay gap) as measured by the mean.

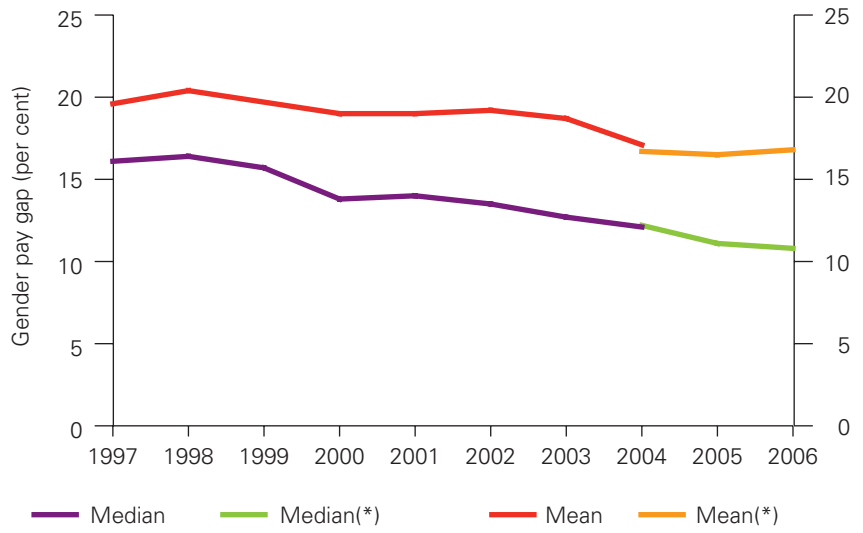
Table 4.1
Median and Mean Gross Hourly Earnings by Gender, Full-time Employees Aged 18 and Over, UK, 1997–2006

Year	£ per hour				Per cent			
	Men		Women		Pay gap		Pay ratio	
	Median	Mean	Median	Mean	Median	Mean	Median	Mean
1997	8.19	10.05	6.87	8.08	16.1	19.6	83.9	80.4
1998	8.54	10.60	7.14	8.44	16.4	20.4	83.6	79.6
1999	8.85	11.03	7.46	8.86	15.7	19.7	84.3	80.3
2000	8.87	11.29	7.65	9.14	13.8	19.0	86.2	81.0
2001	9.32	12.00	8.02	9.72	14.0	19.0	86.0	81.0
2002	9.72	12.64	8.41	10.21	13.5	19.2	86.5	80.8
2003	10.03	13.04	8.75	10.60	12.7	18.7	87.3	81.3
2004	10.48	13.45	9.21	11.15	12.1	17.1	87.9	82.9
2004	10.36	13.22	9.10	11.01	12.2	16.7	87.8	83.3
2005	10.80	13.91	9.60	11.61	11.1	16.5	88.9	83.5
2006	11.21	14.50	10.00	12.07	10.8	16.8	89.2	83.2

Source: LPC estimates based on ASHE without supplementary information, low-pay weights, UK, April 1997–2004 and ASHE with supplementary information, low-pay weights, UK, April 2004–2006.
Notes:
1. Results for 2004 and earlier are without supplementary information; thus comparisons between the two ASHE series should be made with care.
2. Gross hourly earnings excluding overtime.

4.18 Figure 4.5 highlights that the mean pay gap is greater, and has been narrowing more slowly, than the median pay gap. Indeed, it increased slightly between 2005 and 2006 (from 16.5 per cent to 16.8 per cent). The difference in percentage terms between the mean and median gender pay gap has been increasing since 1997. This reflects the growing disparity between the earnings of men and women at the very top of the distribution.

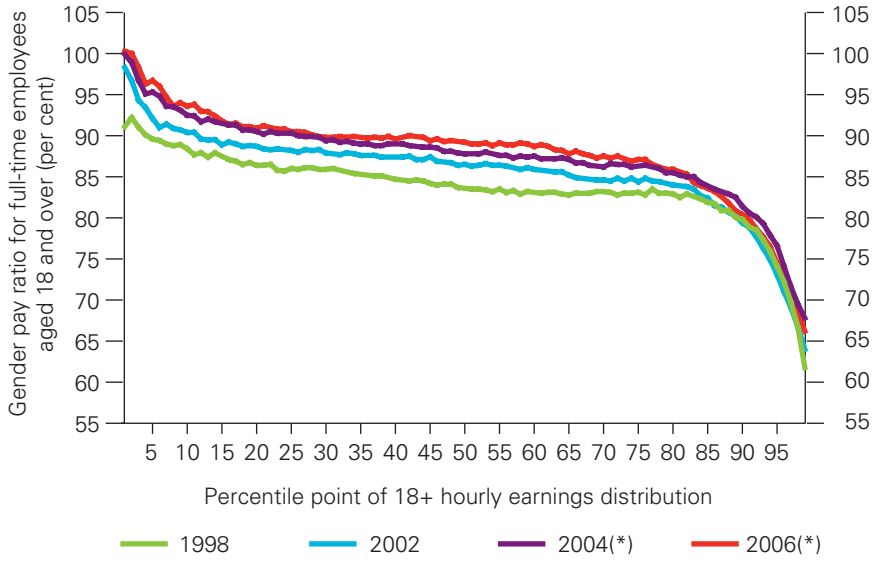
Figure 4.5
Median and Mean Gender Pay Gap, Full-time Employees Aged 18 and Over, UK, 1997–2006



Source: LPC estimates based on ASHE without supplementary information, low-pay weights, UK, April 1997–2004 and ASHE with supplementary information, low-pay weights, UK, April 2004–2006 (*).
Notes:
1. Direct comparisons between the two ASHE series should be made with care.
2. Gross hourly earnings excluding overtime.

4.19 The changes in the ratio of women's earnings to those of men across the entire earnings distribution before the introduction of the minimum wage and after successive upratings are shown in Figure 4.6. It suggests that the minimum wage has had a major impact, substantially reducing the pay gap at the very bottom of the earnings distribution and helping to close the gap further up the distribution through the impact on differentials. The gap has also continued to close in the middle of the distribution, but little progress has been made at the top end, where the gender pay gap is also at its highest, and where the minimum wage has no influence. In 2006, the gender pay gap in the bottom decile was 6.4 per cent compared with 6.7 per cent in 2005 and 7.5 per cent in 2004. By contrast, the gender pay gap in the top decile has been rising in the three years to 2006.

Figure 4.6
Women's Hourly Earnings as a Percentage of Men's Hourly Earnings by Percentile, Full-time Employees Aged 18 and Over, UK, 1998–2006



Source: LPC estimates based on ASHE without supplementary information, low-pay weights, UK, April 1998–2004 and ASHE with supplementary information (*), low-pay weights, UK, April 2004–2006.
Notes:
1. Comparisons between the two ASHE series should be made with care.
2. Gross hourly earnings excluding overtime.

4.20 In contrast to the full-time gender pay gap, Table 4.2 shows that the median pay gap between female and male part-timers is negative. On average female part-timers earn slightly more than their male counterparts except at the top of the earnings distribution. However, the hourly earnings of all part-time workers, whether male or female, are less on average than those of full-time workers. The position of female part-timers compared with that of female full-timers had been worsening slightly after 1997, before improving again since 2002. Female part-time workers also made little progress in closing the gap with male full-time workers between 1998 and 2002. Since then, the pay gap between full-time male workers and part-time female workers has closed slightly but remains substantial at 38.7 per cent in April 2006.

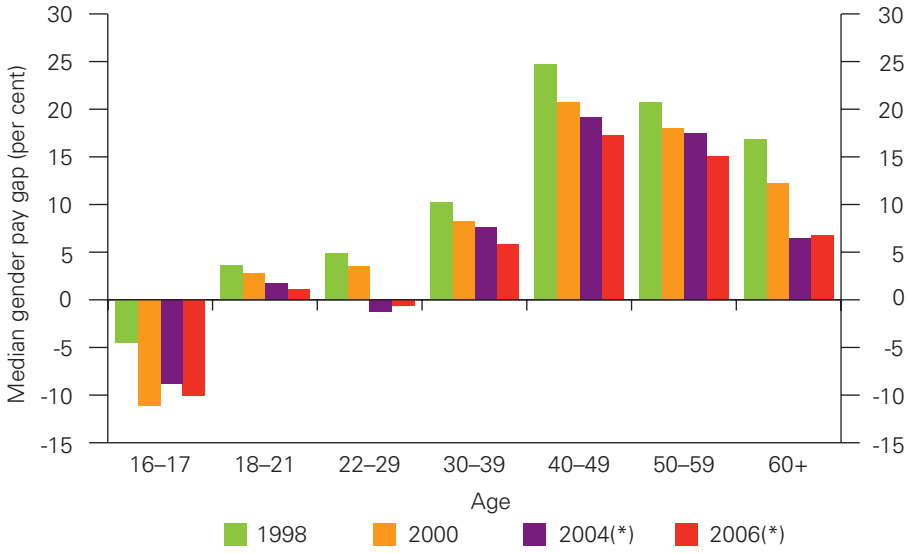
Table 4.2
Median Gross Hourly Earnings by Gender and Hours Worked, Employees Aged 18 and Over, UK, 1997–2006

Year	£ per hour				Per cent		
	Men's median earnings		Women's median earnings		Pay ratio female part-time to male full-time	Pay ratio female part-time to male part-time	Pay ratio female part-time to female full-time
	Full-time	Part-time	Full-time	Part-time			
1997	8.19	4.81	6.87	4.73	57.7	98.3	68.8
1998	8.54	4.75	7.14	4.87	57.0	102.5	68.2
1999	8.85	5.00	7.46	5.07	57.2	101.4	67.9
2000	8.87	5.00	7.65	5.12	57.7	102.4	67.0
2001	9.32	5.19	8.02	5.36	57.5	103.2	66.8
2002	9.72	5.50	8.41	5.53	56.9	100.5	65.7
2003	10.03	5.84	8.75	5.93	59.2	101.6	67.8
2004	10.48	6.00	9.21	6.18	58.9	103.0	67.0
2004	10.36	6.00	9.10	6.16	59.4	102.6	67.7
2005	10.80	6.50	9.60	6.63	61.4	101.9	69.0
2006	11.21	6.74	10.00	6.88	61.3	102.0	68.7

Source: LPC estimates based on ASHE without supplementary information, low-pay weights, UK, April 1997–2004 and ASHE with supplementary information, low-pay weights, UK, April 2004–2006.
Note: Comparisons between the two ASHE series should be made with care.

4.21 There is a clear relationship between age and the size of the gender pay gap as indicated in Figure 4.7. The median hourly earnings of 16–17 year old female full-time employees are much higher than those of male employees and the gap seems to have widened since 1998. The high negative pay gap for 16–17 year olds is due to the fact that men in this age group are disproportionately paid below the adult minimum wage rate. If we focus exclusively on those 16–17 year olds paid at or above the adult minimum wage, the gender pay gap is non-existent. For employees aged 18–29, the pay gap is very small and in the three years to April 2006, had become practically negligible. The gender pay gap then increases for employees aged 30–39 and peaks for those aged 40–49 before decreasing again. For all age groups the earnings position of women relative to men has improved since 1998.

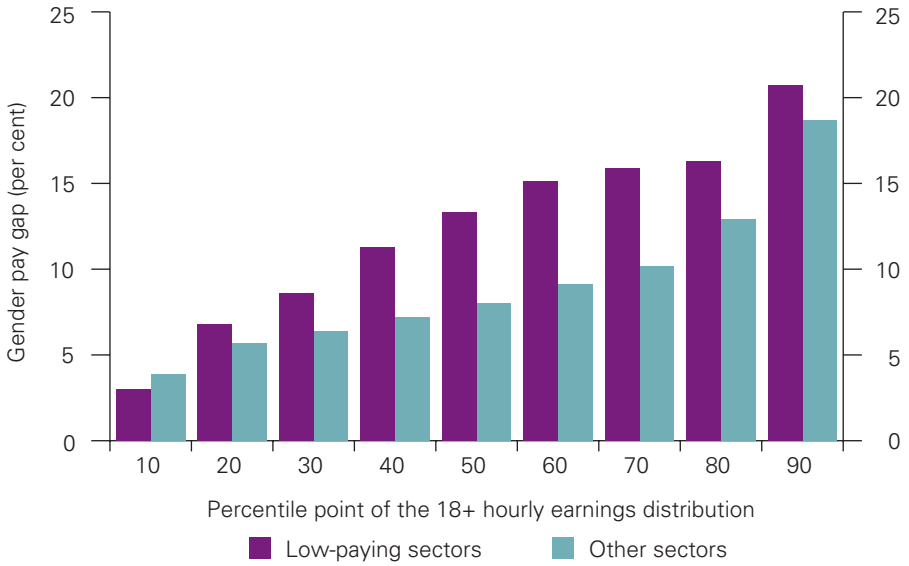
Figure 4.7
Median Gender Pay Gap by Age Group, Full-time Employees, UK, 1998–2006



Source: LPC estimates based on ASHE without supplementary information, low-pay weights, UK, April 1997–2004 and ASHE with supplementary information (*), low-pay weights, UK, April 2004–2006.
Notes:
1. Comparisons between the two ASHE series should be made with care.
2. Gross hourly earnings excluding overtime.

4.22 We now explore gender pay differences in the low-paying sectors. Although hourly earnings of both men and women tend to be lower in these sectors, the gender pay gap is proportionately greater than in other sectors, apart from in the first decile of the earnings distribution (Figure 4.8). This is indicative of greater vertical occupational segregation in low-paying sectors whereby men tend to be concentrated in higher-grade occupations within a particular sector.

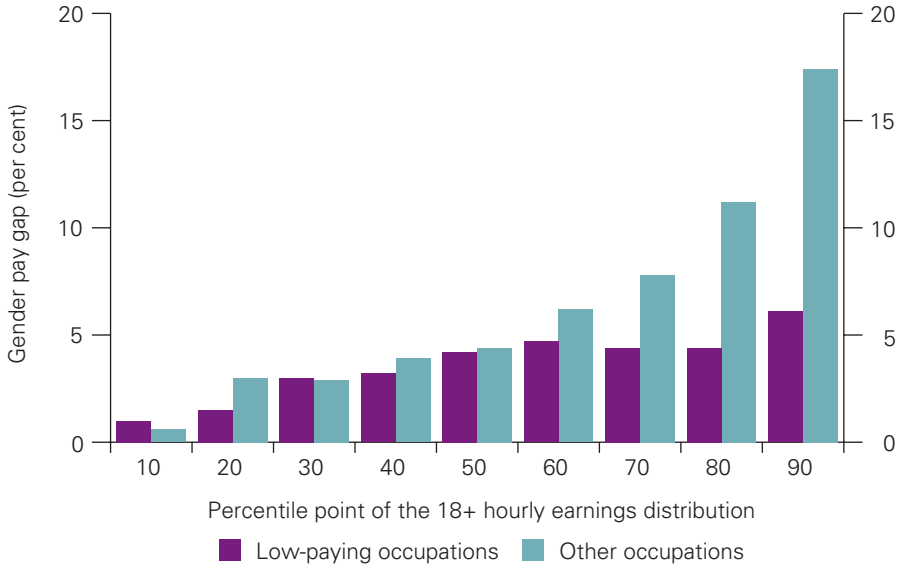
Figure 4.8
Gender Pay Gap by Decile, Low-paying and Other Sectors, Full-time Employees Aged 18 and Over, UK, 2006



Source: LPC estimates based on ASHE with supplementary information, low-pay weights, UK , April 2006.
Note: Gross hourly earnings excluding overtime.

4.23 By contrast, low-paying occupations, which hardly include any managerial or professional occupations and have a very high concentration of women, have a proportionally smaller gender pay gap than other occupations, especially as we move up the distribution (Figure 4.9).

Figure 4.9
Gender Pay Gap by Decile, Low-paying and Other Occupations, Full-time Employees Aged 18 and Over, UK, 2006



Source: LPC estimates based on ASHE with supplementary information, low-pay weights, UK, April 2006.
Note: Gross hourly earnings excluding overtime.

4.24 To summarise, the position of women in the labour market has been steadily improving in the last ten years and there is no evidence of an adverse impact on employment caused by the minimum wage. Although there has been an upward trend in unemployment for women since the end of 2004, this has also been the case for men. The median gender pay gap has been narrowing for some time and it is likely that the minimum wage continues to help close the pay gap at the bottom of the distribution, given women's prevalence in low-paying sectors and occupations.

Disabled Workers

Employment

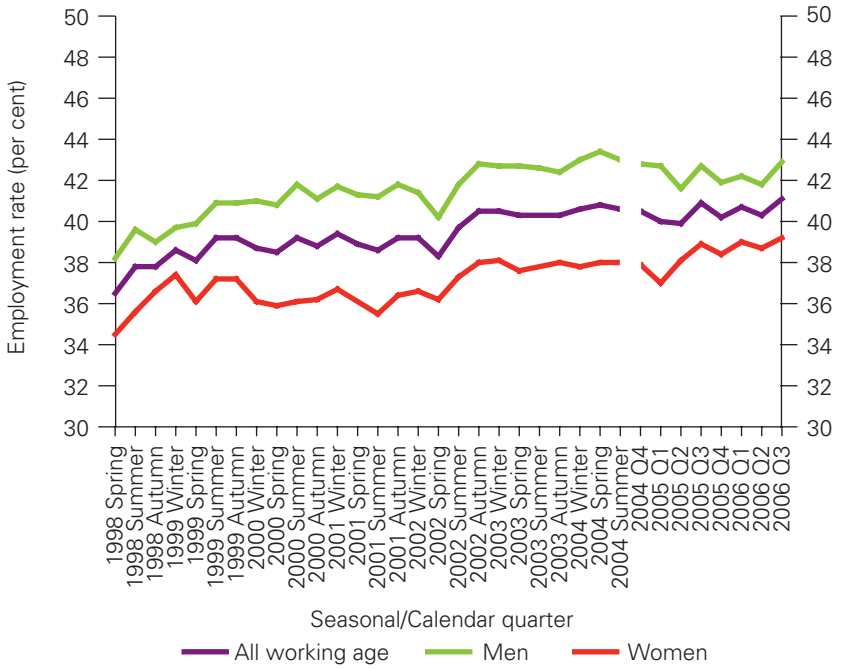
4.25 According to the LFS, there were 5.4 million working age people with a work-limiting disability[2] in the third quarter of 2006. This represents about 15 per cent of the working age population. The rate of participation in the labour market is much lower for this group but it has been increasing over the last ten years. In the third quarter of 2006, the inactivity rate of people with a work-limiting disability was 53.4 per cent compared with 14.8 per cent for those without such a disability.

4.26 The proportion of workers with work-limiting disabilities in low-paying sectors is similar to that of those without such a disability at around 8–9 per cent. However, some low-paying sectors, such as cleaning, social care and security, have a higher concentration of workers with work-limiting disabilities.

4.27 The employment rate of those with a work-limiting disability is much lower than that of those without (41.1 per cent compared with 80.7 per cent in the third quarter of 2006), although the labour market position of these workers has been improving. Figure 4.10 shows that, since the introduction of the minimum wage, the employment rate of those with work-limiting disabilities has risen from around 38 per cent in Summer 1998 to 41 per cent in the third quarter of 2006, following the general upward trend in employment of the working age population. Although there has been a slight decline in the working age employment rate for all groups over the year to the third quarter of 2006, the employment rate of disabled workers has remained fairly stable. There is no evidence that the employment prospects of this group have been further disadvantaged by the introduction of the minimum wage or as a result of subsequent upratings.

[2] Those with a work-limiting disability (as self-reported in the LFS) have a long-term health problem or disability that affects the amount or type of work they can do.

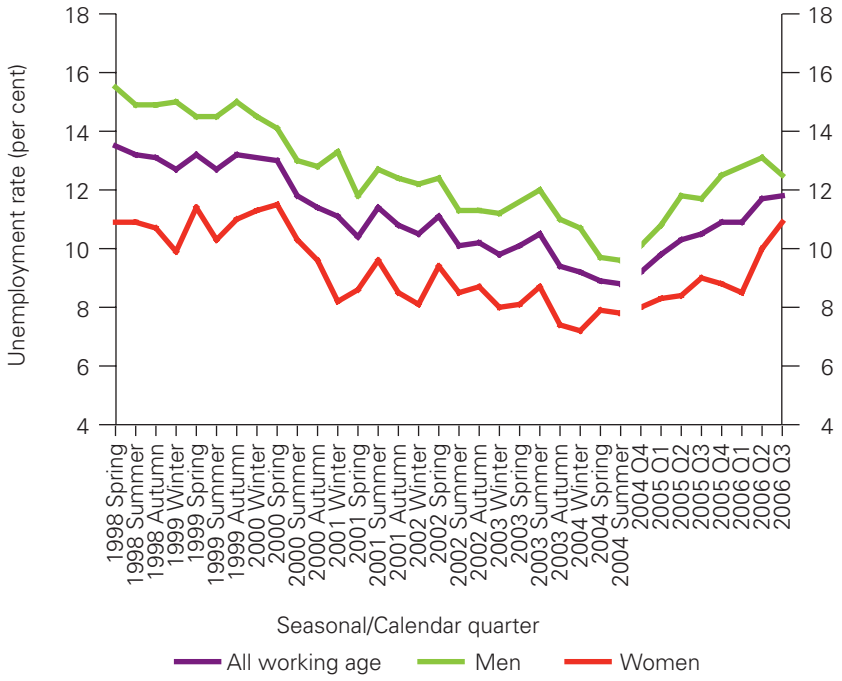
Figure 4.10
Working Age Employment Rate of those with Work-limiting Disabilities by Gender, UK, 1998–2006



Source: LPC estimates based on LFS Microdata, seasonal/calendar quarters, not seasonally adjusted, UK, 1998–2006.
Note: The break between Summer 2004 and Q4 2004 is a result of a discontinuity in the series as the LFS moved from seasonal to calendar quarters; thus comparisons should be made with care.

4.28 Figure 4.11 shows trends in unemployment rates for those with work-limiting disabilities. Despite the fact that, from the late 1990s to the middle of 2004, unemployment rates declined sharply among those with work-limiting disabilities, their unemployment rate (11.8 per cent in the third quarter of 2006) remains twice as high as that of workers without disabilities. Since 2004, disabled workers, in common with the overall working age population, have experienced a sharp rise in their unemployment rate. However, as noted above, this increase has occurred at the same time as a rise in employment rates.

Figure 4.11
Working Age Unemployment Rate of those with Work-limiting Disabilities by Gender, UK, 1998–2006



Source: LPC estimates based on LFS Microdata, seasonal/calendar quarters, not seasonally adjusted, UK, 1998–2006.
Note: The break between Summer 2004 and Q4 2004 is a result of a discontinuity in the series as the LFS moved from seasonal to calendar quarters; thus comparisons should be made with care.

4.29 As discussed in Chapter 2, the rise in the unemployment rate of the disabled may be explained partly by the number of people coming off incapacity benefits and becoming available for work. According to data from the Department for Work and Pensions (DWP) Longitudinal Study, the number of people claiming incapacity benefits in Great Britain has fallen from 2.77 million in May 2004 to 2.69 million in May 2006. This probably reflects the impact of the Government's welfare reforms designed to increase the number of incapacity benefit claimants moving back into work through schemes such as *Pathways to Work*.

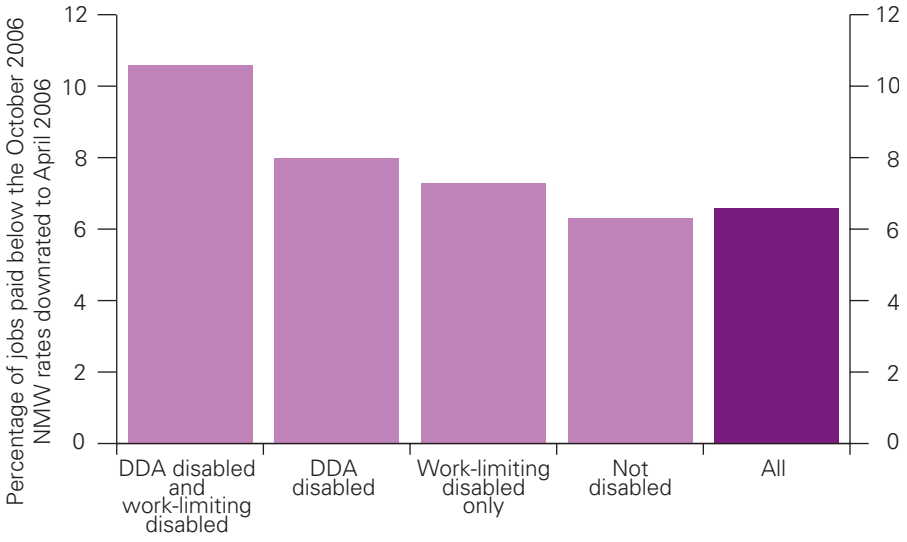
Pay

4.30 ASHE is the best data source to analyse pay but unfortunately it does not provide information on disability or ethnic background. Thus we use the LFS as our source of information to analyse the pay of workers with work-limiting disabilities and from ethnic minority groups. However, the data on earnings and hours in the LFS are considered by the Office for National Statistics (ONS) to be less reliable than ASHE.

Responses to income questions may have been given by proxy and individuals tend to record more hours worked than in corresponding employers' surveys, possibly leading the derived hourly earnings variable to underestimate hourly pay. It is nevertheless plausible to assume that the LFS data do at least reflect the relative earnings position of those with work-limiting disabilities and those without.

4.31 As shown in Figure 4.12, we estimate that 7.3 per cent of employees with a work-limiting disability were covered by the October 2006 upratings of the National Minimum Wage. The coverage increases to 10.6 per cent for those workers who have a disability as defined under the Disability Discrimination Act (DDA) and who also have work-limiting disabilities. These estimates of coverage are based on a new, improved ONS methodology to derive hourly pay estimates from the LFS (Ormerod, 2006c).

Figure 4.12
Estimated Coverage of the 2006 Upratings of the National Minimum Wage by Disability for Employees Aged 16 and Over, UK, 2006

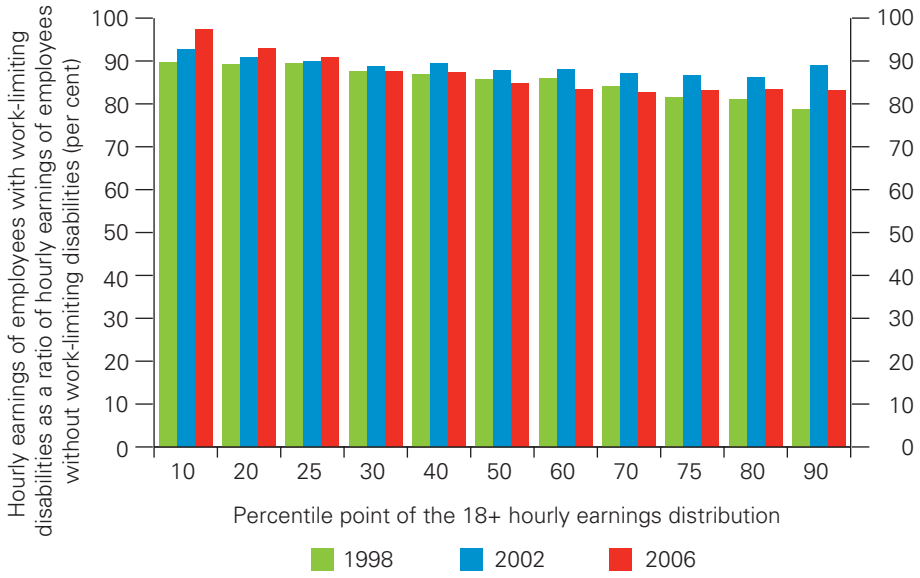


Source: ONS estimates based on LFS Microdata, not seasonally adjusted, UK, Spring 2006.
Note: Covered employees defined as adults (aged 22 and over) earning less than £5.25, youths (aged 18–21) earning less than £4.40 and 16–17 year olds earning less than £3.25 in April 2006.

4.32 Figure 4.13 shows the hourly earnings of employees with work-limiting disabilities as a ratio of the hourly earnings of employees without disabilities. The gap between the hourly pay of disabled workers and that of non-disabled workers tends to increase further up the earnings

distribution. There is a large gap between the median hourly earnings of employees with a work-limiting disability and those of other workers. However, since 1998 there seems to have been a narrowing of the pay gap in the first decile of the earnings distribution, and to a lesser extent in the second decile, suggesting a positive effect of the minimum wage on the earnings of disabled workers at the bottom end of the distribution.

Figure 4.13
Disability Pay Ratio, Employees Aged 18 and Over, UK, 1998–2006



Source: LPC estimates based on LFS Microdata, not seasonally adjusted, UK, Spring 1998–Spring 2006.

4.33 In summary, there is no evidence that the minimum wage has had an adverse impact on the employment prospects of those with work-limiting disabilities. The sharp increase in the unemployment rate experienced by this group of workers since 2004 is of concern, although the Government's welfare reforms may account for much of this increase and employment has continued to increase at the same time. Workers with work-limiting disabilities have continued to benefit from upratings of the minimum wage to a greater extent than workers without such disabilities, and the difference between the earnings of workers with and without work-limiting disabilities at the lower end of the distribution, although still evident, seems to have narrowed since the introduction of the minimum wage.

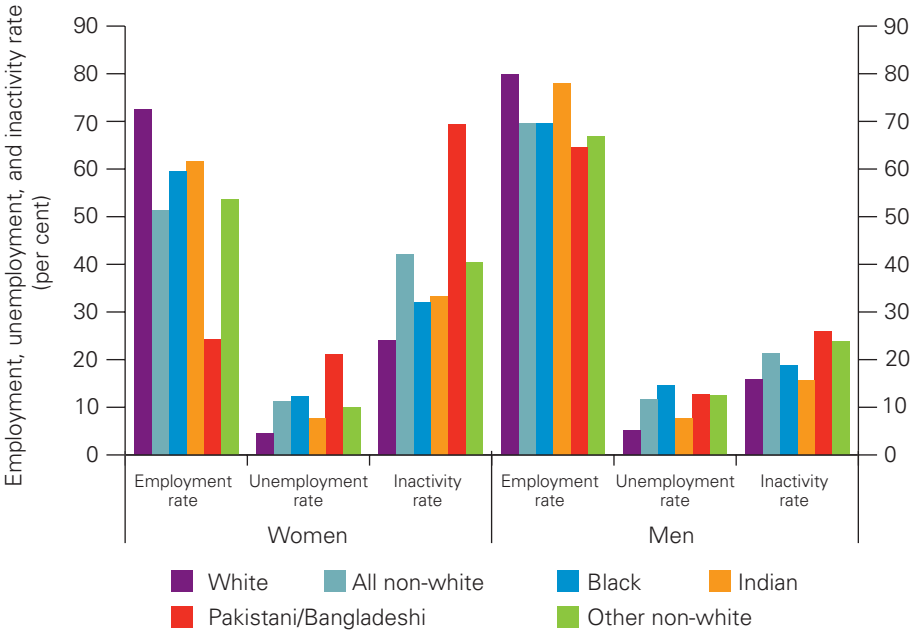
Ethnic Minorities

Employment

4.34 In the analysis that follows, we have used the LFS self-reported classification of ethnicity as adopted by the 2001 Census, nevertheless recognising the difficulties inherent in any attempt to categorise people in terms of ethnicity, and the fact that no such system of classification can be entirely free of arbitrary delineations. Nor does this analysis take into consideration the additional dimension resulting from the arrival of migrant workers from central and eastern Europe since 2004. The issue of recent migration and its impact on the labour market is discussed later in this chapter.

4.35 Figure 4.14 shows that people from ethnic minorities, whether men or women, generally have lower employment rates and higher unemployment and inactivity rates than whites. However, there are significant differences in the labour market position of different ethnic minority groups. Indian men have a similar employment rate to their white counterparts. The differences between ethnic groups are more marked among women, with women of Pakistani/Bangladeshi origin experiencing by far the lowest employment rate and the highest inactivity rate.

Figure 4.14
Working Age Employment, Unemployment and Inactivity Rates by Gender and Ethnic Group, UK, 2006



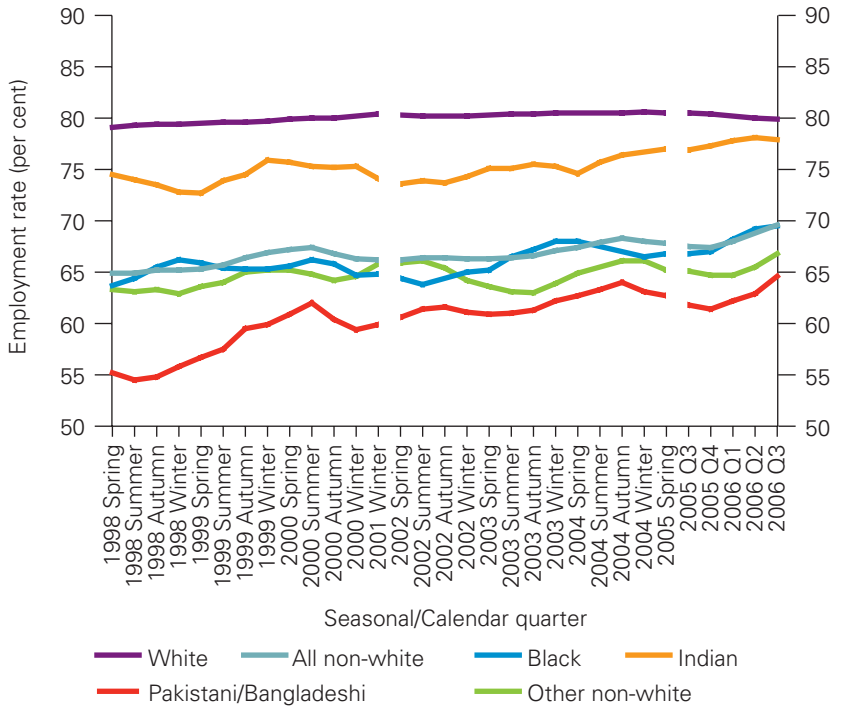
Source: LPC estimates based on LFS Microdata, four quarter moving average, UK, 2006.

4.36 As with women and people with work-limiting disabilities, workers from ethnic minorities are also more likely to be working in the low-paying sectors or occupations. Around 36 per cent of ethnic minority employees work in low-paying sectors compared with 29 per cent of white employees. There are also marked differences between ethnic minority groups, with 44 per cent of Pakistani and Bangladeshi employees working in the low-paying sectors, of whom half work in the retail sector. The sectors with the highest concentration of ethnic minority employees are food processing, hospitality, textiles and security.

4.37 We have seen that, in general, employees from ethnic minorities have lower overall employment rates than white employees. However, the labour market prospects of ethnic minority groups have been improving during the last decade. Even in the context of the overall strength of the labour market, there has been a marked increase in the employment rate of ethnic minority groups, from around 57 per cent in the year to Summer 1998 to 60 per cent in the year to the third quarter of 2006. Despite a slight slow down in the overall labour market, the employment rate of ethnic minority groups increased in the year to the third quarter of 2006.

4.38 Figure 4.15 shows that the employment rate of men has been increasing for all ethnic minority groups and the largest increase has been among those with the lowest employment rate, namely Pakistanis and Bangladeshis. In line with white workers, black and Indian workers seem to have experienced a slight dip in their employment rates in the year to the third quarter of 2006.

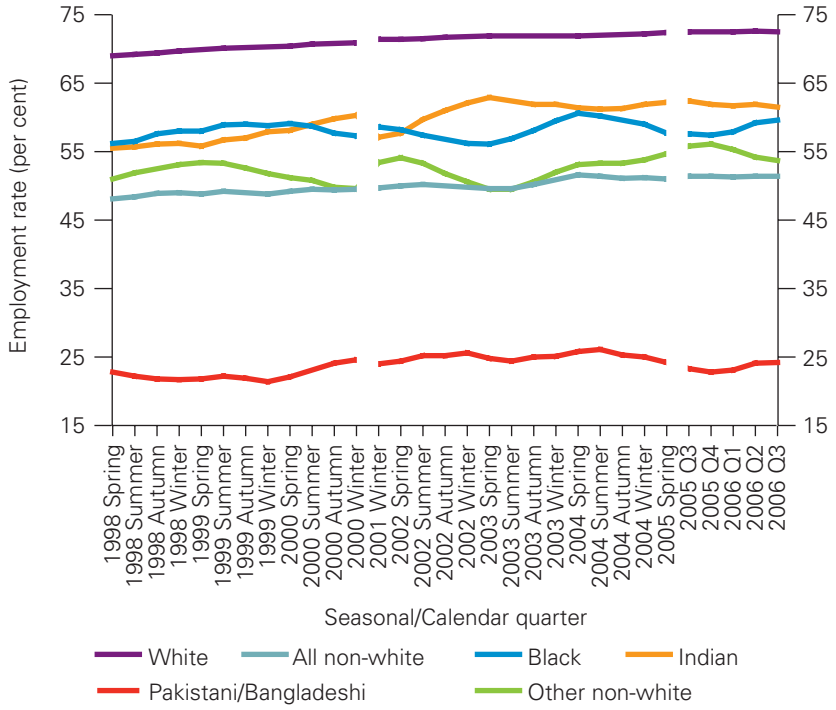
Figure 4.15
Working Age Male Employment Rate By Ethnic Group, UK, 1998–2006



Source: LPC estimates based on LFS Microdata, seasonal/calendar quarters, four quarter moving average, UK, 1998–2006.
Notes:
1. The definition of ethnic groups in the LFS changed in Spring 2001 to be consistent with the 2001 Census classifications; thus comparisons between the periods before and after should be made with care.
2. The break between Spring 2005 and Q3 2005 is a result of a discontinuity in the series as the LFS moved from seasonal to calendar quarters; thus comparisons should be made with care.

4.39 As seen in Figure 4.16, the overall employment rate of women from ethnic minorities has also been steadily increasing since 1998, although it levelled off in 2006, as did the employment rate of white employees.

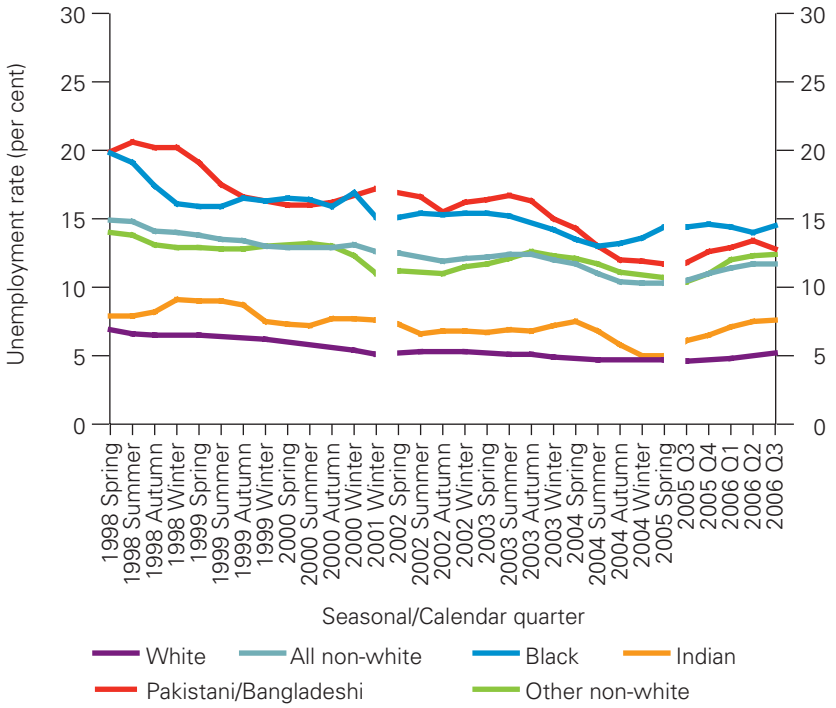
Figure 4.16
Working Age Female Employment Rate by Ethnic Group, UK, 1998–2006



Source: LPC estimates based on LFS Microdata, seasonal/calendar quarters, four quarter moving average, UK, 1998–2006.
Notes:
1. The definition of ethnic groups in the LFS changed in Spring 2001 to be consistent with the 2001 Census classifications; thus comparisons between the periods before and after should be made with care.
2. The break between Spring 2005 and Q3 2005 is a result of a discontinuity in the series as the LFS moved from seasonal to calendar quarters; thus comparisons should be made with care.

4.40 Figure 4.17 shows that the unemployment rate of men in all ethnic minority groups declined throughout the 1990s and the first part of the 2000s but started to increase in 2005 and 2006, at a faster rate than that of the overall working age population.

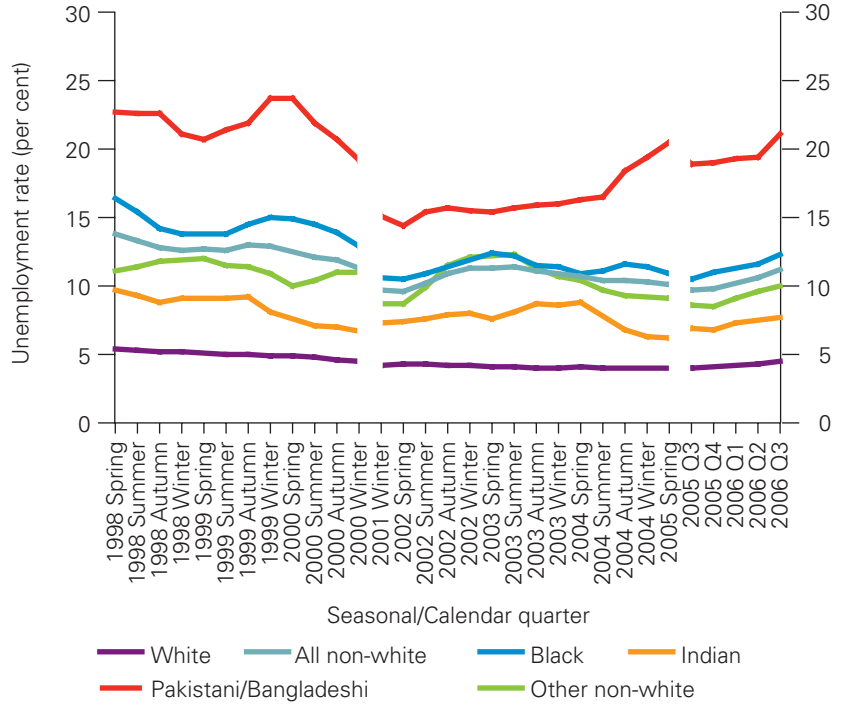
Figure 4.17
Working Age Male Unemployment Rate by Ethnic Group, UK, 1998–2006



Source: LPC estimates based on LFS Microdata, seasonal/calendar quarters, four quarter moving average, UK, 1998–2006.
Notes:
1. The definition of ethnic groups in the LFS changed in Spring 2001 to be consistent with the 2001 Census classifications; thus comparisons between the periods before and after should be made with care.
2. The break between Spring 2005 and Q3 2005 is a result of a discontinuity in the series as the LFS moved from seasonal to calendar quarters; thus comparisons should be made with care.

4.41 Similarly, as indicated by Figure 4.18, the unemployment rates of women from ethnic minority groups declined for most of the period following the introduction of the minimum wage, but they have started to increase since 2004. Of note is the much sharper increase in the unemployment rate of Pakistani and Bangladeshi women which began earlier than for other groups. However, this might be an indication of a growing attachment on the part of this group to the labour market as their employment rates have also risen and their inactivity rates have declined sharply.

Figure 4.18
Working Age Female Unemployment Rate by Ethnic Group, UK, 1998–2006

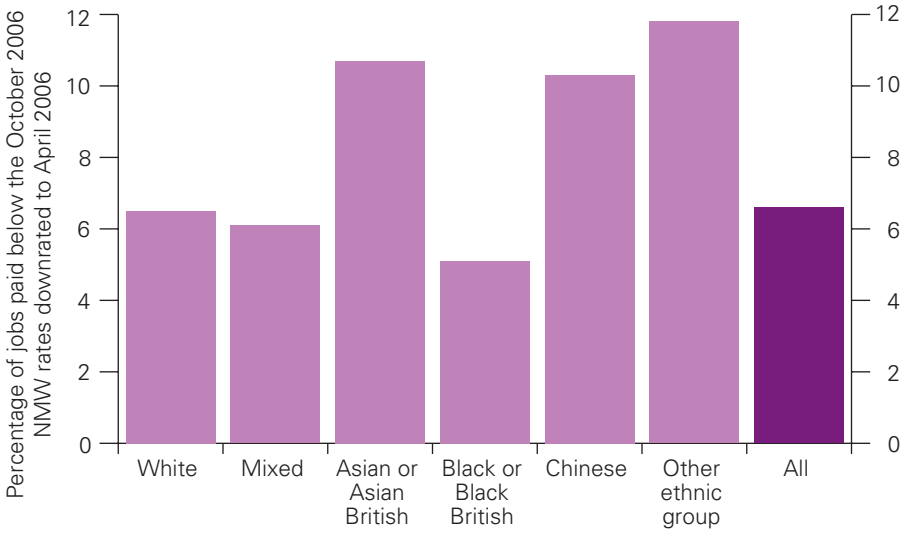


Source: LPC estimates based on LFS Microdata, seasonal/calendar quarters, four quarter moving average, UK, 1998–2006.
Notes:
1. The definition of ethnic groups in the LFS changed in Spring 2001 to be consistent with the 2001 Census classifications; thus comparisons between the periods before and after should be made with care.
2. The break between Spring 2005 and Q3 2005 is a result of a discontinuity in the series as the LFS moved from seasonal to calendar quarters; thus comparisons should be made with care.

Pay

4.42 According to ONS estimates based on the LFS, around 8.6 per cent of employees from ethnic minority groups will have been covered by the October 2006 upratings of the National Minimum Wage, compared with 6.5 per cent of white employees. As Figure 4.19 shows, the coverage among different ethnic minority groups varies, with those of Chinese and Asian origin more likely to be covered by minimum wage upratings, but Black employees less likely to be affected.

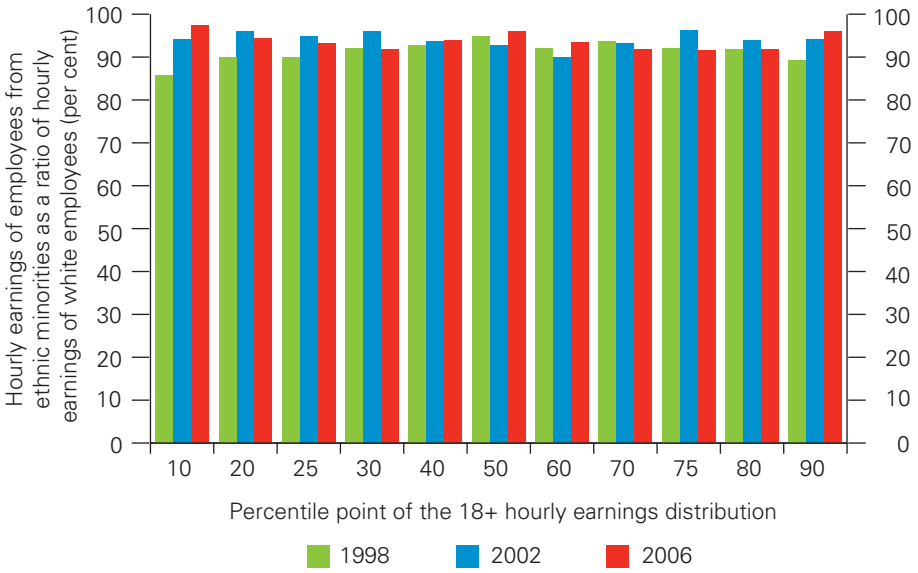
Figure 4.19
Estimated Coverage of the 2006 Upratings of the National Minimum Wage by Ethnic Group for Employees Aged 16 and Over, UK, 2006



Source: ONS estimates based on LFS Microdata, not seasonally adjusted, UK, Spring 2006.
Note: Covered employees defined as adults (aged 22 and over) earning less than £5.25, youths (aged 18–21) earning less than £4.40 and 16–17 year olds earning less than £3.25 in April 2006.

4.43 Figure 4.20 shows the pay ratio between minority ethnic groups and white employees at each decile of the hourly earnings distribution. We have had to treat all non-whites as a single group due to small sample sizes, but this will have concealed some significant differences between groups. Overall, the median ethnic minority pay gap appears smaller than pay gaps for other disadvantaged groups such as women or people with work-limiting disabilities, but it does not seem to have narrowed significantly since the introduction of the minimum wage. There has been an improvement in the pay of ethnic minorities relative to their white counterparts at the bottom of the distribution, most notably in the first two deciles, suggesting the introduction of the minimum wage and successive upratings have had a positive effect on low-paid ethnic minority workers.

Figure 4.20
Ethnicity Pay Ratio, Employees Aged 18 and Over, UK, 1998–2006



Source: LPC estimates based on LFS Microdata, seasonal quarters, not seasonally adjusted, UK, Spring 1998–Spring 2006.

4.44 The labour market prospects of minority ethnic groups have been improving since the introduction of the minimum wage, as have those of other disadvantaged groups in the labour market. However, since 2004 the unemployment rate of ethnic minorities has been increasing at a slightly faster rate than that of white employees. The minimum wage has improved the earnings position of ethnic minorities at the lower end of the pay distribution and the difference in their earnings relative to those of white workers is smaller than the pay gaps experienced by the other groups considered in this chapter.

4.45 In the next section, we focus on another group of workers that is disproportionately likely to be low-paid.

Migrant Workers from the Central and Eastern European Accession Countries

4.46 There has been a substantial increase in the number of migrant workers in the UK over a number of years, in particular following the enlargement of the EU on 1 May 2004. Nationals from eight of the ten countries joining the EU (the A8)[3] were granted access to the UK labour

[3] The Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia.

market, but were required to register under the Home Office Workers Registration Scheme (WRS) if employed for a month or more[4]. Most other established EU member states have exercised their right to regulate access to their labour markets by nationals from the A8 countries. Nationals of the two remaining accession states – Malta and Cyprus – have free movement and the right to work throughout the EU. In this section we look at the inflow of workers from the A8 countries as their arrival in the UK is arguably the most significant change to the labour market since the introduction of the minimum wage.

4.47 On 1 January 2007 Bulgaria and Romania also joined the EU. However, nationals from these countries do not have the same rights to work in the UK as those from the A8. Under transitional arrangements, the Government put in place new regulations which restrict the access of Romanians and Bulgarians to the UK labour market. The impact of this further expansion is therefore not expected to be as significant but it is too early to comment on how these arrangements are working in practice.

Workers Registration Scheme

4.48 Around 487,000 applicants from the A8 countries were approved under the WRS between 1 May 2004 and 30 September 2006 (Home Office *et al*, 2006). In the first three months of the scheme, the number of applicants peaked at over 22,000 per month, which is thought to be due partly to a number of A8 workers already living in the UK registering when the WRS came into force. Applicant numbers have fluctuated since then. In the third quarter of 2006, around 60,000 A8 migrants registered to work in the UK, a similar number to the corresponding period in 2005. By far the highest proportion of those registered were from Poland (63 per cent), followed by Lithuania (11 per cent) and Slovakia (10 per cent) and these proportions have remained broadly constant since May 2004. Four-fifths (nearly 400,000) of registered workers were aged 18–34 and 58 per cent of applicants were male.

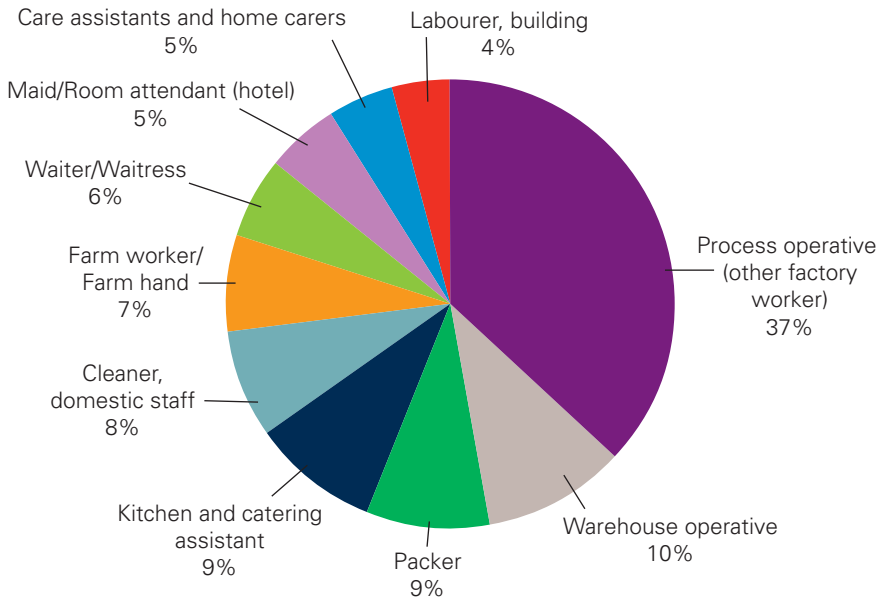
4.49 It is important to note, however, that the number of WRS registrations does not represent a measure of net migration from the A8 countries to the UK; it is a gross (cumulative) figure for the number of workers

[4] Those registered on the WRS working legally in the UK for 12 months without a break are eligible to apply for a residence permit.

applying to the WRS. It does not take into account those who have registered but who have subsequently left the UK. Given this, the WRS data may overstate the number of A8 workers in the UK at any given period. Conversely, it is believed that some workers will not have registered and therefore the WRS data are likely to underestimate the total inflow of migrant workers from the A8 countries. We cannot be sure which effect dominates, but most commonly there are thought to be a greater number than suggested by the WRS data.

4.50 Figure 4.21 below shows the top ten occupations in which A8 workers were registered, which account for 62 per cent of all workers registered under the scheme. There has been a high concentration of A8 workers in low-paying occupations since 2004. The occupation employing by far the largest number was process operative (other factory worker), with over 110,000 stating this as their occupation, followed by warehouse operative (over 30,000). The next most common occupations, each with around 27,000 A8 workers, were packers, and kitchen and catering assistants. Just over 23,000 were employed as cleaners or domestic staff.

Figure 4.21
Top Ten Occupations for Workers Registration Scheme Applicants, UK, 2004–2006



Source: Home Office, Department for Work and Pensions, HM Revenue & Customs and Department for Communities and Local Government, 2006. *Accession Monitoring Report May 2004–September 2006.*

4.51 If we look at the geographical distribution of A8 migrant workers up to the end of September 2006, Anglia was the most popular destination, accounting for 15 per cent of A8 workers; followed by London and the Midlands, with 14 per cent and 12 per cent respectively. Northern Ireland and Wales continued to attract the fewest A8 workers (4 per cent and 3 per cent respectively). While the data may not be entirely robust as they rely on information provided on application forms, the WRS indicates that nearly all A8 applicants were working full-time (i.e. more than 16 hours a week). Just under half were in temporary employment.

On a visit to a farm, which also operated a tourism business, we were told by the owners that they were dependent on migrant labour due to difficulties in recruiting suitable local workers. They required staff who were willing to be flexible and undertake a range of duties, often working unsociable hours on the tourism side, and many local people were unwilling to do this. The owners advised us that there were not enough native residents with the skills required by local businesses and migrant workers were necessary to fill these skills gaps.

Low Pay Commission visit to Norfolk

Impact on the Labour Market

4.52 There has been much conjecture about the effect of inward migration in terms of employment and unemployment levels for UK nationals and on wage rates, but the widely held view is that A8 workers are contributing to the success of the UK economy by filling gaps in the labour market. This view is consistent with the evidence we gathered when talking to employers throughout 2005 and 2006. We believe it is reasonable to assume that a substantial number of those who registered at the beginning of the WRS would have already been working in the UK prior to 1 May 2004, albeit illegally in many cases, and that this would have moderated the impact on the labour market and wages.

4.53 The impact of the increase in the number of migrant workers in the UK labour market was a key feature in the evidence received for this report. Most of those who commented on the issue believed that there had been a positive effect and that A8 workers had not affected adversely the employment of UK nationals. However, the CBI sounded a note of caution in its evidence. While it recognised the positive benefits for UK industry, it stated that there was a need to develop a better understanding of the impact of the rapid increase in migrant workers at the lower end of the labour market. During regional visits, a number of employers in the low-paying sectors noted that they had recruited migrant workers due to a shortage of local labour or because UK workers were unwilling to take the jobs on offer. The employer view of A8 migrant workers was generally very positive; in particular they were thought to be reliable, hard-working and willing to be

flexible. Of the firms that employed migrant workers responding to our Employers' Survey, 64 per cent (748 firms) said they did so because of shortages in the local labour market.

4.54 The effect of the recent inflow of A8 workers on the UK labour market has also been considered in a number of recent research reports. Research we commissioned by French and Möhrke (2006) examined the utilisation of migrant labour in North Staffordshire. The researchers found that migrant workers had largely been employed to address specific skills shortages across many economic sectors and to address labour shortages, primarily in the low-wage sectors. A study by Blanchflower *et al* (2007) found that the inflow of workers from the A8 appeared to have had little or no discernible effect on the UK unemployment rate. The researchers found that the regions that had experienced the biggest increases in immigration tended to see the smallest rises in unemployment rates. They noted, however, that this was consistent with the possibility that foreign workers were attracted to those regions where the unemployment rate was lowest and opportunities were greatest. Research carried out by the DWP (Gilpin *et al,* 2006) found that the impact of free movement of workers from the A8 countries on the UK labour market had been modest and broadly positive, and that there was no discernible statistical evidence which supported the view that A8 migrants were contributing to a rise in claimant unemployment in the UK. We will continue to monitor carefully the impact of migrant workers on the labour market.

4.55 There is a lack of reliable official data on pay rates for A8 workers. The WRS data depend on unverified responses to questions on the WRS application form. However, they show that the majority (78 per cent) of those registered were earning between £4.50 and £5.99 per hour between 2004 and 2006. This is consistent with anecdotal evidence we have gathered on A8 migrant workers' pay during our work this year. It is too early to assess the impact of A8 migration on wage inflation. However, if we look at the wage effect of migrant workers generally, research by Dustmann *et al* (2007), which examined the impact on wages of migrant workers using data that largely pre-dated the arrival of A8 workers in 2004, found some evidence that they have a small negative effect on wages at the bottom end of the earnings distribution, while native workers in the middle of the earnings

'Despite reports in the media to the contrary, BSA member company experience shows that migrants do not affect the job prospects of UK nationals in a negative manner. The reality is in fact to the contrary, with migrant workers helping to 'plug' gaps in the business service sector's workforces and helping to address the high 'attrition' rate in the recruitment and retention of staff.'

Business Services Association evidence

distribution had gained from the increasing number of migrant workers. The Association of Licensed Multiple Retailers noted in its evidence that a survey of its members found that nearly half of the 21 respondents (who collectively operated just under 1,000 outlets with 15,500 staff) employed migrant workers because they were prepared to work for lower levels of pay in non-basic jobs. Six per cent of respondents to our Employers' Survey said that they employed migrant workers to control wage costs.

Enforcement

4.56 A significant concern is that some migrant workers are particularly vulnerable to exploitation by unscrupulous employers. This was raised in evidence from worker and employer representative organisations, employers and not-for-profit groups alike and also during our visits throughout the UK. French and Möhrke (2006) found examples of exploitation of migrant workers, as well as potential discrimination within the workplace. The research, albeit based on a small number of case studies, found that those employed through international employment agencies were more likely to be paid less than the minimum wage or to have significant deductions made for accommodation and other services. A number of respondents to our consultation also linked examples of exploitation of migrant workers to the practices of some employment agencies and to abuse of the accommodation offset. We touch on these areas below within the sections on agency workers and the accommodation offset. We look in detail at compliance and enforcement in Chapter 6.

Agency Workers

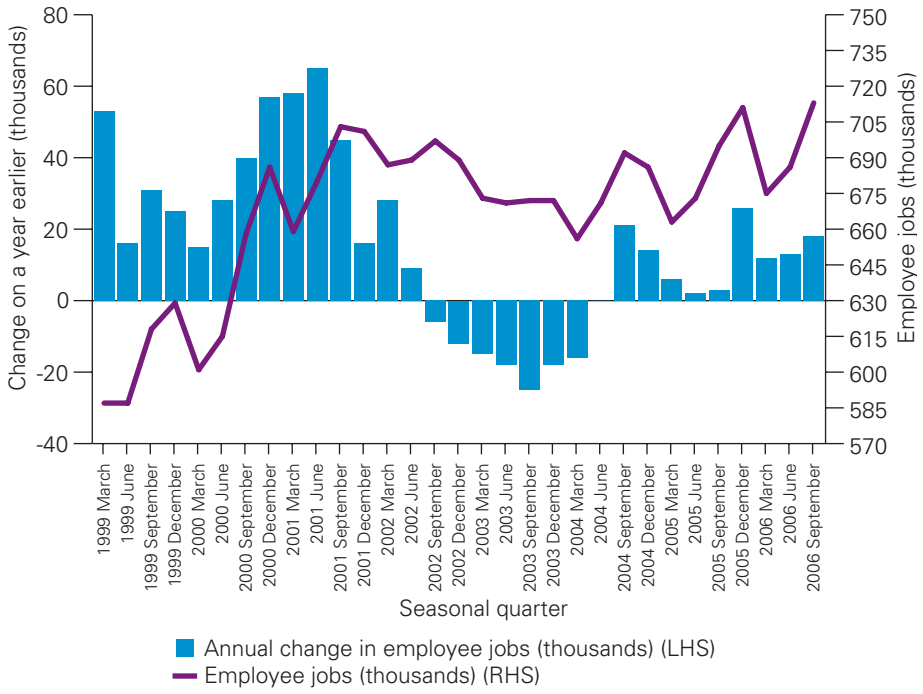
4.57 Flexible working has increasingly become a feature of working life in the UK. Agency workers are an important source of temporary, flexible labour to cover short-term absences or fill skills gaps at short notice. They can help employers to improve efficiency, manage fluctuations in demand and remain competitive. Non-standard working arrangements can also offer employment opportunities by enabling workers to gain new skills and experience, or allow them to fit work around other responsibilities or interests. Several consultation respondents commented on agency workers this year. In particular trade unions and

other bodies representing workers suggested that some agency workers were less well-protected in terms of their employment rights due to the temporary and uncertain nature of much agency work. A number of trade unions also suggested that the use of agency workers was increasing. We examine the evidence in more detail below.

Numbers and Pay of Agency Workers

4.58 The number of agency workers is difficult to establish due to conflicting data. As shown in Figure 4.22, the ONS employee jobs series records that there were 713,000 jobs in labour recruitment in September 2006, an increase of 127,000 (largely part-time jobs) since March 1999.

Figure 4.22
Employee Jobs in Labour Recruitment and Annual Change, Thousands, GB, 1999–2006



Source: ONS employee jobs series, not seasonally adjusted, GB, 1999–2006.

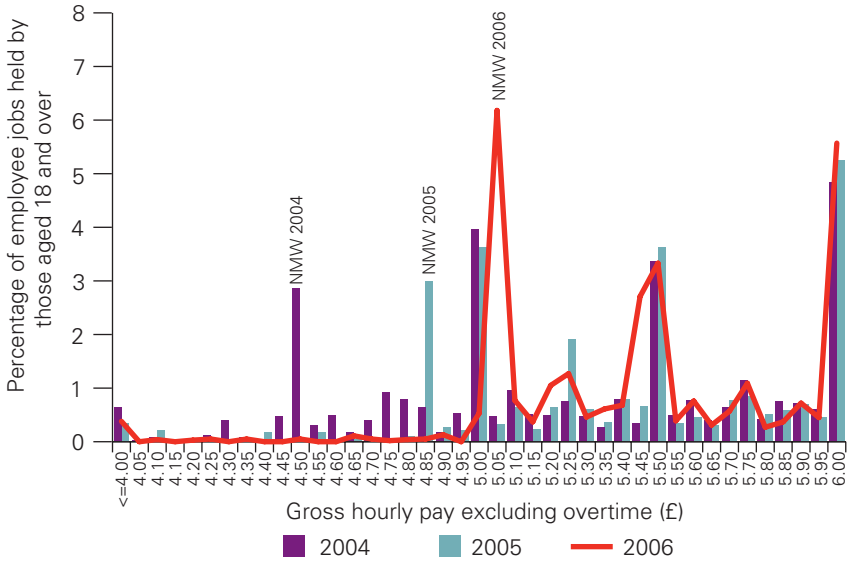
4.59 The LFS records that in the third quarter of 2006 there were around 257,000 jobs classified as 'agency temping', compared with 246,000 in Spring 1999. Examining all types of temporary and casual jobs, many of which will not involve the use of an agency, we find that there were nearly 1.4 million such jobs in the third quarter of 2006, down from just over 1.5 million in Spring 1999. Around a third of these jobs were in the

low-paying sectors, concentrated in retail (132,000), hospitality (130,000) and social care (96,000). According to the Recruitment & Employment Confederation (REC, 2006), there were 1.3 million temporary and contract placements in the year to March 2006, a 3.8 per cent increase on the previous year but fewer than the 1.5 million recorded in 2003/04. The actual number of workers involved is likely to be lower due to multiple placements.

4.60 Some trade unions noted an increase in contracting out of jobs from the public sector and suggested that increased use of agency workers might be a factor behind the recent falls in employment in retail and hospitality noted in Chapter 3. It is difficult to draw firm conclusions, but the various data sources considered here suggest that, following several years of significant growth, the number of agency workers has been more stable since around 2002 or 2003. Figure 4.22 does, however, show an increase of 18,000 employee jobs (2.6 per cent) in the sector in the year to September 2006.

4.61 The impact of the minimum wage on hourly earnings for agency jobs is shown in Figure 4.23. Three per cent of jobs paid at the minimum wage in April 2004 and April 2005, doubling to six per cent in April 2006. While this suggests the impact is increasing, it may partly be a consequence of the minimum wage uprating to £5.05, which crossed the £5.00 hourly threshold, given the clear spikes at other round figures such as £5.50 and £6.00.

Figure 4.23
Hourly Earnings Distribution for Agency Workers Aged 18 and Over, UK, 2004–2006



Source: LPC estimates based on ASHE with supplementary information, low-pay weights, UK, 2004–2006.
Notes:
1. NMW label shows the adult minimum wage rate in April of the given year.
2. Gross hourly earnings excluding overtime.

4.62 As we noted in the discussion on migrant workers, a number of trade unions and bodies and individuals representing workers highlighted the greater vulnerability of some agency workers to exploitative practices, particularly involving deductions from pay for services including accommodation. We consider the provision of accommodation by employers and agencies below. We also received evidence concerning agencies in the entertainment sector. We were informed that some extras (background or walk-on parts on TV, films and commercials) offered a day's work via an agency have found that, after deductions for commission fees and charges for including their details in a promotional publication, their earnings fell well below the minimum wage. A separate submission from Equity noted that the application of an agent's fee could result in the payment received by the performer falling below the minimum wage and suggested we examine such practices in relation to minimum wage entitlement.

4.63 While the majority of employment agencies treat their workers fairly, the DTI (2007g) has published a consultation document on a package of measures to tackle particular abuses associated with a minority of agencies. In particular, it proposes strengthening existing measures

that prevent offers of work being conditional on acceptance of other services and tightening the rules on fees charged in the entertainment and modelling sectors. This initiative should help to address some of the issues raised in evidence to us. We discuss other steps needed to tackle the problems faced by vulnerable agency workers and other workers at particular risk of minimum wage underpayment in Chapter 6.

The Accommodation Offset

2006 Review of the Accommodation Offset

4.64 We undertook a review of the accommodation offset in our 2006 Report, focusing on its application outside the traditional tied accommodation arrangements that have been a long-standing practice in sectors such as hospitality and agriculture. We had become aware that employers – in particular labour providers or agencies operating in the food processing and agriculture sectors – were increasingly arranging accommodation for migrant workers because of the difficulties these workers faced in securing accommodation on the private rental market. Many of these workers were new arrivals from the A8 countries. We considered whether there was a case for relaxing the offset rules to reflect these recent changes in the labour market. The argument put to us by employer bodies in these sectors was that, where an employer provided accommodation as an option rather than as a requirement of the job, there should be no restriction on the amount that could be charged to low-paid workers. The accommodation offset rules currently limit the maximum deduction from National Minimum Wage pay where accommodation is provided to £4.15 per day, or £29.05 per week.

4.65 However, while accepting a distinction in principle, we concluded that it would not be straightforward in practice to ensure that some of the most vulnerable workers did have a genuine choice to take up an offer of accommodation. We were concerned that some workers could be left with very little cash wages after deductions for accommodation. Therefore we recommended that the offset provisions should continue to apply to all workers housed by their employer regardless of any element of free choice. But we stated that we would continue to

monitor developments relating to migrant labour and to the provision of accommodation. We also made a number of recommendations that sought to clear up confusion about the offset rules, raise awareness and tighten up on potential loopholes.

Recent Developments

4.66 In July 2006, the DTI began a consultation on new draft guidance on the accommodation offset in response to our recommendations (DTI, 2006h). Our reply to the consultation document welcomed the initiative but said that the guidance needed to be clearer and more comprehensive. We emphasised the importance of publicity and awareness. The guidance also set out the DTI's belief that it was not necessary to introduce new measures to clamp down on employers using the device of a separate accommodation company to evade the offset rules – a recommendation that we had made in our 2006 Report. In its view, the intention of the existing rules was clear and thus the offset could be enforced where separate but related companies were involved. We understand that the finalised guidance will be issued soon after publication of our 2007 Report, in order to take account of a case concerning the accommodation offset heard at the Court of Appeal in January 2007.

4.67 In its response to our consultation this year, the Association of Labour Providers (ALP) recorded its disappointment with our conclusions on the issue of free choice and pointed out that there were already a number of areas of law where workers could agree in writing to opt in or out of arrangements, such as the 48 hour working week or deductions from pay that were not required by law. The ALP reported that, as a consequence of the Commission's position, labour providers were ceasing to provide accommodation because they could not deduct enough from minimum wage pay to cover their costs, while others were choosing to become accommodation providers only. According to the ALP, workers now faced paying higher rents charged by private landlords on the open market.

'The feedback from a number of REC members indicates that acting as a landlord is often the best and only way that the agency can ensure that there is affordable accommodation available for workers.'

REC evidence

4.68 In its evidence, the REC acknowledged that the automatic deduction of accommodation costs from workers' wages could lend itself to abuse, but argued that in many cases *'agencies are simply offering an essential service rather than seeking to derive any financial gain or*

'One of the key problems for migrant workers in particular is the practice of employers taking illegal deductions from their wages, particularly by abusing or avoiding the accommodation offset.'

TUC evidence

exploit the worker in question'. It noted the difficulties faced by migrant workers who found it hard to supply the credit references and deposits required by most landlords. Anecdotal evidence from our visits and research case studies (French and Möhrke, 2006) suggested that, while employers continue to provide accommodation for migrant workers, this might lessen as A8 workers become more established and as community networks develop.

4.69 As noted earlier, the TUC and the Transport and General Workers' Union expressed concerns that some employers continued to exploit migrant workers by overcharging for accommodation, often associated with deductions for other items such as transport, meals and utilities. While welcoming the tougher stance in the Government's draft guidance on the accommodation offset, the TUC called for us to examine its impact during 2007.

4.70 From the evidence we received on the topic of accommodation for this report, it is evident that some enforcement problems remain. But having examined the principles of the accommodation offset in detail in the 2006 Report, including the effects on particular sectors and groups of workers, we did not consider that it would be fruitful to undertake a similar detailed review this year. We made a number of recommendations in the 2006 Report, including calling for specific guidance on the offset, and further time is needed to consider the impact. In addition, the licensing system for gangmasters operating in the food processing, shellfish gathering and agriculture sectors which came into effect in October 2006 requires labour providers to show that accommodation charges are in accordance with the minimum wage and the accommodation is not of a poor standard or overcrowded. We will wish to consider the effects of the licensing requirements on use of and compliance with the accommodation offset provisions in these sectors in a future report.

The Offset Level

4.71 Consultation responses from other employer representatives focused on the level of the accommodation offset. The National Farmers' Union argued that the current rate offered no incentive to improve standards of accommodation; rather than building good quality but more costly permanent structures, some farmers and growers would be more

inclined to house workers in second-hand caravans and mobile homes. The British Hospitality Association (BHA), Association of Licensed Multiple Retailers and British Beer and Pub Association (BBPA) called for a significant increase to a level that more closely reflected employers' costs and rents on the open market, while the CBI called for the offset to be raised in line with any increase in the minimum wage. The BBPA suggested two offset rates – one for self-contained accommodation (for example a pub manager living above the pub) and one for accommodation with shared facilities.

'The October 2006 increase in the accommodation offset to £4.15 per day (6.4 per cent) is welcome, but a weekly offset of under £30 is still an inadequate reflection of the cost of supplying accommodation. In the open market, rents of double that level might be considered normal ....'

BHA evidence

4.72 In recent reports, we have recommended that the offset increase by the same proportion as the proposed increase in the adult rate of the minimum wage. Our 2005 Report set out the reasons for this approach and we believe that the balance it represents between the interests of employers and workers remains appropriate. **Therefore we recommend that the accommodation offset should increase to £4.30 per day in October 2007**. However, in view of the developments described above, we see a need to continue to keep the accommodation offset under review.

4.73 In the next section, we consider a largely hidden section of the workforce, but one which is at greater risk of minimum wage underpayment.

Homeworkers

4.74 A wide spectrum of individuals work from home, including the self-employed and professional and managerial employees. However, our focus has been on those who perform unskilled manual work often on a piece rate basis – typically packing, sewing, electronics assembly or telephone work – as these homeworkers are most likely to be low-paid and face particular difficulties in enforcing their employment rights. They often work in isolation and many of them fear that they would no longer receive work if they were to make a complaint.

4.75 Homeworkers are spread across different sectors and occupations and official data gives only a partial and incomplete picture. The LFS indicates that in the year to the third quarter of 2006 (four quarter moving average), 785,000 workers, or 2.8 per cent of the workforce, worked from within their own home in their main job. If we focus on

workers holding second jobs, we find that the proportion working in their own home rises to over 13 per cent (138,000). However, it is important to note that these figures include the self-employed and higher-paid employees. Around 225,000 people working from their own home in their main job work in the low-paying sectors, with some of these sectors, particularly textiles (8 per cent), leisure (6 per cent), social care (5 per cent), hairdressing (4 per cent) and agriculture (4 per cent), having a higher proportion of homeworkers than average. If we consider those working from home by their main occupation, we see that childcare (16 per cent), textiles (9 per cent), hairdressing (3 per cent) and office work (2 per cent) low-paying occupations have a higher than average proportion of homeworkers. Interestingly, 79 per cent of homeworkers in the low-paying sectors are self-employed, compared with an average of 55 per cent of homeworkers in all other sectors.

Consultation Evidence

4.76 Although homeworkers are specifically included within the definition of a worker under the National Minimum Wage Act 1998, in its evidence the National Group on Homeworking (NGH) raised concerns about two issues which it believed were adversely affecting their attempts to access the minimum wage. First, that ambiguity remained with respect to their employment status. In its view, many employers wrongly classified homeworkers as self-employed and thus outside the scope of the minimum wage, and Employment Tribunal decisions on employment status could be unpredictable. The NGH argued that these factors created uncertainty and discouraged homeworkers from seeking to assert their right to the minimum wage. The NGH proposed that homeworkers should only be judged as self-employed if it could be demonstrated that they were genuinely running their own business.

'Homeworkers who complain they are not being paid the NMW will frequently find their employment status is challenged by their employer. Not knowing what an Employment Tribunal will conclude about their status is a real discouragement to making a complaint.'

NGH evidence

4.77 Second, the NGH wrote that HM Revenue and Customs (HMRC) had used evidence of minimum wage compliance in earlier investigations as a basis for not pursuing later complaints made against the same organisation. It concluded that HMRC was failing to investigate such complaints adequately and this, together with the lack of clarity about the employment status of homeworkers, was forming obstacles to enforcement. It asked us to examine what happened when HMRC received a repeat complaint about a company it had already

investigated, and for more training of Compliance Officers on the specific legislation relating to homeworkers and on the piece rate rules.

Fair Piece Rates

4.78 Homeworkers are often remunerated on a piece rate basis, but there was widespread dissatisfaction with the original approach under the minimum wage – using fair estimate agreements. This led us to make recommendations for change and in October 2004, the Government introduced a new system called 'fair piece rates' based on the time a person working at average speed would take to produce a piece. From April 2005, employers have been required to multiply the rate by a factor of 1.2, so that most workers (not just those working at average or faster speeds) receive at least the minimum wage. We have received little evidence about how the new arrangements are working in practice. We attempted to gather information via supplementary questions to the textiles and clothing sector in our Employers' Survey (see Appendix 3). Unfortunately, very few of the returns were from employers who operated a piece rate system as defined under the National Minimum Wage (i.e. the employer did not control the number of hours a worker worked), and with such small numbers no real conclusions could be drawn. However, we did receive evidence from the delivery and distribution sector on experience in applying the fair piece rates system; this was also a sector in which the NGH understood that bogus claims of self-employment occurred.

4.79 We were informed that specialist distribution companies engaged thousands of temporary workers to make door-to-door deliveries of telephone directories. However, due to the range of factors that influenced delivery speed (such as weather and profile of the route), difficulties could arise in calculating a piece rate per directory in line with the minimum wage requirements. We understand this led one company to agree with HMRC to re-define the work as 'unmeasured work', with estimated daily hours and a post-delivery assessment including regular audits. It was also suggested that other piece workers in the sector were unlikely to complain about their pay, were it to fall below the minimum wage, due to the short-term nature of the work. The National Centre for Social Research also reported difficulties applying piece rates to its panel of 1,300 freelance interviewers. It was

operating with estimates made in advance of expected hours to be worked on an assignment, which were then adjusted to ensure interviewers were paid at least the National Minimum Wage. While solutions were found in both of these examples, they do highlight practical difficulties in applying fair piece rates.

Enforcement

4.80 While we look more closely at enforcement in Chapter 6, the Government's evidence pointed to work undertaken by HMRC's specialist homeworking team. Forty-nine homeworking investigations were opened between October 2004 and July 2006, with arrears of £21,000 identified in 17 closed cases during the period. The team had worked with employers on issues such as completion of fair piece rate timesheets and where employers claimed self-employed status for homeworkers. The Government's evidence also stated that, since 2004, it had become apparent that some businesses had ceased to use homeworkers, with the reasons cited by Compliance Officers including difficulties with paying the minimum wage or a desire to move work abroad.

4.81 In the 2005 Report, we called for homeworkers to be included early on in HMRC's rolling programme of targeted enforcement. Two years on, the fair piece rate system is still a relatively recent development, with limited evidence as to how it is operating. The information we have received during this year's consultation reminds us of the difficulties which can arise in applying these arrangements, and for both employers and workers in ensuring the correct wage is paid. Mindful of this, and the greater vulnerability of some homeworkers, we continue to see low-paid homeworkers as a group warranting particular attention in terms of the enforcement of their minimum wage rights.

Therapeutic Activity

4.82 In previous reports, we have commented on the application of the minimum wage in the context of services provided for people with a disability or mental health problem. We noted that it was not always straightforward to determine whether an activity was focused on providing therapeutic benefits for the individual, or whether it should be

regarded as work and attract the minimum wage. These activities, sometimes described as 'therapeutic work', 'work placements' or 'volunteering', take place in a variety of settings such as local authority (LA) day centres, sheltered workshops in the voluntary sector or within profit making companies, and can range from making greetings cards to gardening to stacking shelves in a shop. In some cases the tasks undertaken would fall into the category of work for minimum wage purposes.

4.83 Our 2005 Report focused on two issues. First, a concern that some service providers were unclear whether the minimum wage applied, which in some cases had led them to withdraw services, or to remove small levels of remuneration that had traditionally been offered as an incentive for attendance. We said that guidance on therapeutic activity (DTI, 2003) appeared to have helped to clarify the position but that, in our view, it had not been disseminated widely enough. Second, we noted some stakeholders' concerns that a number of vulnerable people who were probably doing work that should be properly remunerated were being exploited and not receiving the minimum wage. However, we have had no hard evidence about the extent of such practices.

4.84 This topic was raised again by a small number of respondents to our consultation for this report. Concern was expressed about exploitation and also a lack of willingness on the part of some local authorities to reform services to ensure compliance with the minimum wage. However, there was also a fear that disproportionate enforcement action might have a negative impact on users of local authority and other services if these services closed because they could not afford to pay minimum wage arrears following a compliance investigation, or because they feared there might be grounds for a case to be brought against them in the future.

4.85 We received evidence from a supported employment co-ordinator who arranged work placements for adults with learning disabilities. He reported that, before the introduction of the minimum wage, 'therapeutic wages' of up to £20 per week could be paid that reflected the mutual balance of benefit to both parties. In his view, such arrangements were not intrinsically exploitative. He was concerned that, if the employers involved were asked to pay the minimum wage, the placements would end immediately. In his experience, most

'If I demand that their employers pay them the NMW then tomorrow there will be 20 plus sets of parents, carers and supported living managers looking for day centre places. The capacity to meet and support this sudden increased level of demand is not there.'

Evidence from a supported employment co-ordinator who arranges work placements for adults with learning disabilities

employers were unwilling to take on people with learning difficulties, even after several years on a work placement, because of the gap they could see existed between *'a wage that has to be paid and the productivity that the employee can return'*. As well as the negative consequences for the individuals who had derived some benefit from the placement, he feared that there would be a knock-on effect on already stretched day services provision. A charitable trust wrote that it had had to change its service for the disabled from 'employment opportunities' to 'day services' and had withdrawn a small cash remuneration due to concerns about potential liability to pay the minimum wage. This echoed comments made by other organisations in previous years.

4.86 In its evidence, the TUC wrote that *'the provisions on therapeutic work are still being widely abused'*. Similarly Leicester City Council (LCC) wrote that arrangements made by local authorities and the voluntary sector could be 'lax' and even if the activities undertaken were beneficial, they might still be exploitative. LCC was also concerned that if no payments were made, HMRC was less likely to conclude that a worker/employer relationship existed, thus in LCC's view, a more exploitative employer was less likely to be found in breach of the minimum wage, compared with one that at least offered some level of payment.

'... the Working Group is concerned about the worrying number of learning disability employment providers (specifically LA and voluntary sector social enterprises) that appear to be in breach of the NMW.'

Working Group on Learning Disabilities and Employment, 2006

4.87 Similar issues were raised in a recent report, *Improving Work Opportunities for People with a Learning Disability* (Working Group on Learning Disabilities and Employment, 2006). The report suggested there was a lack of awareness of the DTI guidance and an urgent need for various Government bodies to work together to improve awareness and understanding to ensure that organisations employing people with learning disabilities recognised their obligations under the minimum wage.

4.88 Our meetings with stakeholders and the evidence submitted to our consultation illustrate that this is a complex area. We are aware that there are differing views about the most appropriate means to support people with learning disabilities or mental health problems, including helping them to participate in the labour market. We continue to believe that the minimum wage should apply to all workers regardless of any disability or other condition that might affect their productivity

and we are concerned that there continue to be reports of suspected non-compliance with the minimum wage.

4.89 As we have noted, the DTI has produced specific guidance on therapeutic work advising on the circumstances in which the minimum wage should be paid. In addition, the publication *Paying a Real Wage to People in Work Projects* (MCCH Society Ltd, 2005) provides practical advice based on one organisation's real experience of reforming services in response to the minimum wage. Therefore in our view the emphasis must be on effective dissemination of the guidance and on raising awareness. We are pleased that the DTI published an updated version of its guidance note on therapeutic activity on its website in January 2007. The guidance was also sent to over one hundred organisations, a significantly larger distribution than had been achieved for the 2003 version, and comments were invited on the contents. We will take a close interest in the response to this exercise. We strongly encourage the DTI to continue to work with other parts of Government to ensure that organisations operating in this area understand and act upon their obligations with respect to the minimum wage. It is also important that any misplaced fears or misunderstandings concerning the minimum wage based on a lack of knowledge do not inhibit the provision of services that are of real benefit to people with a disability or mental health problem.

4.90 As we discuss in the next section, there are some other groups whose status with respect to minimum wage entitlement can sometimes also be unclear.

Volunteers

4.91 Volunteers provide an important resource for numerous organisations. The 2005 Citizenship Survey (Home Office, 2005) estimated that over two-fifths of the population in England had volunteered formally at least once in the last twelve months (defined as 'giving unpaid help through groups, clubs and organisations to benefit other people or the environment'). It has also been estimated that 1.1 million full-time UK workers would be needed to replace formal volunteers, well over twice the number of full-time equivalent paid employees in the voluntary sector (National Council for Voluntary Organisations, 2006).

4.92 Genuine volunteers who give their time and effort freely are outside the scope of the National Minimum Wage Act 1998 since they are not workers. Others who may regard themselves as volunteers could in fact be workers because they receive a payment or some form of benefit for the work they undertake. However, Section 44 of the 1998 Act provides that voluntary workers engaged by charities, voluntary organisations or similar bodies are not entitled to the minimum wage as long as they receive only reasonable subsistence, accommodation or expenses. In addition, a genuine honorarium, or one-off gift with no expectation or obligation, and of a reasonable amount, would not normally signify an entitlement to the minimum wage.

4.93 At the time of our 2005 Report, we received representations from only one organisation concerning volunteers and the minimum wage, suggesting that difficulties raised in our earlier reports may have been largely resolved, but some problems remained. The Central Council of Physical Recreation (CCPR) raised several concerns, including that an entitlement to the minimum wage could be inferred where a small non-cash benefit was offered or where an honorarium had become customary for holders of a particular office. We noted that there were ongoing discussions between the CCPR, HMRC and the DTI, and expressed a hope that these would resolve the concerns.

'... it would appear that sports, and clubs, are now more aware of the NMW rules than this time last year and are successfully operating within the legislation.'

CCPR evidence

4.94 In response to our latest consultation the CCPR reported that it had agreed a policy statement with the DTI and HMRC that would apply to its members. The agreement sets out what are reasonable expenses and benefits-in-kind that will not trigger eligibility for the minimum wage. Under the agreement, HMRC will not undertake proactive investigations of CCPR members and affiliated volunteer or sports clubs for minimum wage compliance, but will investigate any complaints made to it. The CCPR told us that the policy statement had provided valuable clarity and attracted positive feedback from its members.

4.95 We welcome this positive outcome. However, it has been several years since advice for the voluntary sector as a whole was first produced. In our 2005 Report, we recommended a comprehensive updating of the guidance, taking into account developments such as the CCPR policy statement and other sector-specific materials. While the Government accepted our recommendation, the necessary action

has not yet taken place. We understand that the Government is seeking to resolve minimum wage issues with some other organisations, in particular with Project Scotland and 'V' (formerly the Russell Commission). The Russell Commission, set up by the Government in 2004 to examine youth action and engagement, recommended that young people undertaking voluntary work receive regular payments and Project Scotland offers a subsistence allowance. We have been informed that the DTI is working with both bodies to produce a policy statement which will address minimum wage enforcement in relation to a range of voluntary bodies. In its evidence, the Government stated that any policy statement which results from this would be published on its website when complete, and that the DTI would continue to keep this and other policy statements agreed with voluntary sector organisations under review.

4.96 Although we received few representations on the topic of volunteers in response to our most recent consultation, the DTI's ongoing work illustrates that there are still issues concerning the relationship between volunteers and the minimum wage for a number of organisations. While we appreciate efforts by Government policy and enforcement authorities to agree ways of operating with stakeholders, it reinforces our view that guidance for the sector should be consolidated and made widely available, as recommended in our 2005 Report. We were therefore pleased that, on 17 January 2007, the Government announced that it was to undertake a review of the National Minimum Wage in relation to voluntary workers and that this would include addressing our 2005 recommendation. We stand ready to contribute to the review process and await the outcome with interest. We trust that this will lead in the near future to the improvement in available guidance to the sector that we recommended two years ago.

Unpaid Work Experience

4.97 Given the importance of volunteers to the health of many organisations, and the particular recognition given to voluntary workers in the minimum wage legislation, we would not want the minimum wage to act as a barrier to people giving their time freely to support activities that are of benefit to their community. However, we received

submissions claiming that it is becoming commonplace in certain sectors for businesses to demand a period of unpaid work as the price of entry to a competitive industry. This may be described as 'volunteering', acting as an 'intern', or perhaps most commonly as 'work experience'. Whatever label is used it raises the same issue: whether the person is a genuine volunteer and thus outside the scope of the minimum wage, or whether the activities performed are in fact work for which the National Minimum Wage must be paid.

4.98 The TUC, the National Union of Journalists and the Broadcasting, Entertainment, Cinematograph and Theatre Union have pointed to evidence of a growth in unpaid work in the media sector. While the TUC stressed it did not want to curtail genuine work experience opportunities, it felt that the position in this sector had become one of exploitation. It called on us to re-examine the rules on unpaid work in order to check they were sufficiently rigorous. In terms of the activities being undertaken in this unpaid work, a submission from Mark Watson highlighted numerous advertisements offering work experience in the television industry as a runner, researcher or administrator, which typically involved set hours and specific duties, and called for candidates to possess particular skills or experience. In addition, Equity told us that a survey of members found that in any given week, 7 per cent in the performance industry were doing unpaid work, rising to 22 per cent in film and 21 per cent in small scale theatre.

4.99 Good practice standards and guidance have been developed for employers offering work experience placements in the television industry through consultation between the DTI, HMRC, employer and trade union representatives, the National Council for Work Experience, Skillset (the Sector Skills Council) and others. The guidelines (DTI, 2007h) make clear that there are only a few limited circumstances in which an employer may offer unpaid work experience. These include students required to do a work placement as part of a higher education course; activities that consist entirely of work shadowing with no performance of tasks; or volunteering, where those who take part are free to come and go as they choose.

4.100 As we have noted in relation to other groups, the line between work for minimum wage purposes and non-work can be a difficult one to draw. Nevertheless, we are concerned that some unpaid work

experience opportunities share many of the characteristics of work for which the minimum wage should be paid. The forthcoming guidance for the television industry should help to raise awareness on the part of applicants and employers alike and improve employers' understanding of their obligations with respect to the minimum wage. The guidance is also likely to have wider application for other sectors where similar practices are common and we would encourage the DTI to publicise it widely. We will monitor how the development and dissemination of this guidance affects employer practice. The Government's recently announced review of the minimum wage and volunteers may also have a bearing on this issue.

Conclusion

4.101 The information presented in this chapter has illustrated that there is a positive story to tell in relation to a number of groups who are disadvantaged in the labour market. As we have shown, women, ethnic minorities and people with a work-limiting disability are disproportionately represented in the low-paying sectors and therefore are more likely to benefit from minimum wage upratings. While the minimum wage has raised the earnings of low-paid workers from these groups, there is no evidence that it has had a detrimental effect on their employment prospects. We will examine another group of workers who have been faring rather less well in the labour market, namely young people, in the next chapter.

4.102 There continue to be groups of workers who are more likely to face a struggle to receive their entitlements, including the minimum wage. In this chapter we have illustrated that initiatives to improve awareness and understanding of employment rights play an important role in mitigating the problems faced by some groups. For example, national and local Government, trade unions, employer bodies and others have made significant efforts to inform migrant workers of their rights, both in the UK and before arrival. We have been encouraged by the emphasis the DTI has placed on vulnerable workers and by proposals for additional measures to protect agency workers. But the evidence from stakeholders of exploitative practices, including excessive deductions from pay and bogus claims of self-employment, has shown

that awareness alone is insufficient unless it is backed up by effective enforcement, which we consider in Chapter 6.

4.103 This chapter has also highlighted the importance of tailoring guidance for specific groups or sectors where a lack of knowledge or understanding of the minimum wage persists. We have welcomed the work that the DTI and HMRC are taking forward with the voluntary sector and with the television industry to develop a sensible and balanced approach to enforcement of the minimum wage while continuing to ensure that workers are protected. Where such guidance is available in relation to a particular sector or group and has been publicised effectively, there should be no further excuse for non-compliance.

Chapter 5

Young People and Trainees

In our 2006 Report we noted that the labour market for young people had been weakening over a number of years, most noticeably for those not in full-time education. The evidence shows that the sharp increase in the number of inactive 16–17 year olds since 1999 can be largely explained by the increased participation of this age group in full-time education, reinforced by the introduction of the Education Maintenance Allowance in 2004. However, 16–17 year olds not in full-time education have continued to experience a worsening of their labour market prospects since 2005 and at a somewhat faster rate than in the past. We remain particularly concerned about the number of 16–17 year olds (over 120,000 in England alone) who are not in education, employment or training.

Young people aged 18–21 have also continued to fare badly in the labour market when compared with older workers. We are concerned that, since 2001, 18–21 year olds not in full-time education have been experiencing a decline in employment and a rise in inactivity. Since 2004, their unemployment rate has also been increasing. Around 540,000 18–21 year olds not in full-time education were either unemployed or inactive in 2006. Eighteen year olds not in full-time education seem to have been the worst affected. By contrast, 21 year olds have seen their employment rate increase and unemployment rate decrease since 2005.

Conclusive evidence to explain the causes of this decline remains elusive. Evidence from research on the impact of the minimum wage on employers' demand for young people provides a mixed picture, with some firms strongly inclined to employ young employees while others state a preference for older, more experienced staff. While many employers choose to pay young people above the minimum wage applicable for their age, there is evidence of a small increase, since 2004, in the use of age-related pay below the adult rate of the minimum wage.

In the light of the evidence on the labour market prospects of young people, we remain convinced that there continues to be a need for lower National Minimum Wage rates for younger workers as a protective measure. However, we also continue to believe that the 21st birthday remains the most appropriate cut-off point between the Youth Development Rate and the adult rate. The evidence shows that 21 year olds have fared better in the labour market than 18 and 19 year olds and that the overwhelming majority of them (nine in every ten) are paid at least the adult rate of the minimum wage. We recommend that the Government amend the regulations so that 21 year olds are entitled to the adult rate of the minimum wage.

As recommended in our 2006 Report, the Government abolished the little-used Older Workers' Development Rate with effect from 1 October 2006. At the same time, it removed the upper age limit on the twelve month exemption from the minimum wage for apprentices. A number of consultation respondents commented positively on the recommendation in our 2006 Report that we be invited to review the minimum wage treatment of apprentices and report in 2008. The Government has promised to consider this recommendation, but we still await a definitive response. We remain of the view that it would be appropriate for us to conduct such a review and have reiterated our earlier recommendation.

Introduction

5.1 When recommending minimum wage rates for young people, we have tried to reconcile a number of different factors. We have aimed to ensure that they are not priced out of the labour market or encouraged out of education. We have also tried to protect their training opportunities. At the same time, we have always believed that young people should receive a fair rate of pay, otherwise they may feel undervalued as members of the workforce and become disillusioned with the world of work.

5.2 The evidence presented in our 2005 Report indicated that the minimum wage had not harmed the employment prospects of young people and that employment rates for 18–21 year olds had remained largely unchanged following the October 2003 upratings. However, in our 2006 Report we found that the position of 18–21 year olds in the labour

market had deteriorated slightly. We also carried out a full assessment of the impact of the 16–17 year old rate, which was introduced in October 2004 to prevent the exploitation of young people in very low-paying jobs providing minimal training and few developments prospects. We concluded there was no evidence that it had encouraged these young people out of full-time education (FTE) or training, or damaged their prospects in the labour market and therefore we decided it was appropriate to increase the rate from its introductory level. However, we expressed concern about the weakening of the labour market position for 16–17 year olds not in FTE in recent years and the rise in the number of young people who are not in education, employment or training (NEET).

5.3 In this chapter we consider first the impact of the October 2005 upratings of the minimum wage on young people's labour market performance and participation in training and education. We then estimate the coverage of the October 2006 upratings and consider the impact on earnings. We go on to assess recent trends in the use of age-related pay and consider the role of the Youth Development Rate, including its age coverage. Finally, we consider training and the minimum wage exemption for apprentices.

Employment, Unemployment and Participation of Young People

5.4 The UK labour market has remained remarkably robust since the introduction of the minimum wage although, as we noted in Chapter 2, recent performance has been more mixed. In some of our previous reports, we expressed concern about the relatively greater difficulties experienced by young people in the labour market compared with older workers. In this section, we consider whether these trends have continued, looking separately at the labour market position and participation in education and training of 16–17 year olds and 18–21 year olds.

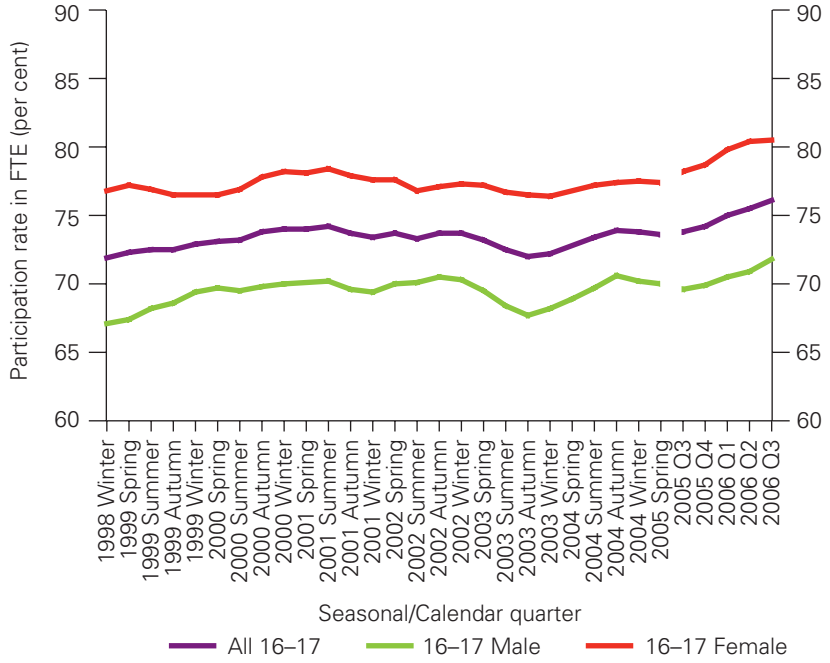
Labour Market Position of 16–17 Year Olds

5.5 The number of 16–17 year olds has gradually increased since the 1990s, as has their share of the working age population. According to the Office for National Statistics (ONS) Labour Force Survey (LFS), in the

third quarter of 2006, there were 1.58 million 16–17 year olds (0.81 million men and 0.77 million women) in the UK, making up 4.2 per cent of the working age population.

5.6 Most 16–17 year olds are in FTE and their number has been gradually increasing since the early 1990s, over and above population growth for the age group as a whole. As shown in Figure 5.1, the participation rate in FTE has therefore increased in real terms. In the year to the third quarter of 2005, 73.8 per cent of 16–17 year olds were in FTE compared with 71.9 per cent in Winter 1998. The increase in participation in FTE has been particularly marked in the last two years, increasing to 76.1 per cent in the year to the third quarter of 2006.

Figure 5.1
Proportion of 16–17 Year Olds in Full-time Education by Gender, UK, 1998–2006



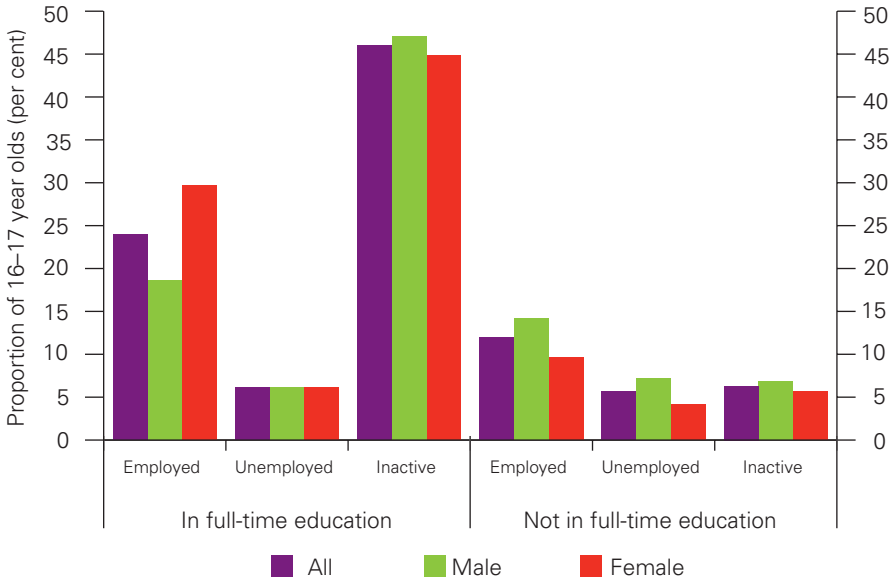
Source: LPC estimates based on LFS Microdata, seasonal/calendar quarters, four quarter moving average, UK, 1998–2006.
Note: The break between Spring 2005 and Q3 2005 is a result of a discontinuity in the series as the LFS moved from seasonal to calendar quarters; thus comparisons should be made with care.

5.7 The data suggest no adverse impact on participation in full-time education as a result of the introduction of the 16–17 year old minimum wage rate in October 2004. However, as we noted in our 2006 Report, the introduction of the minimum wage for this age group coincided with the national roll-out of the Education Maintenance Allowance

(EMA) in September 2004 and it is therefore difficult to disentangle any specific effects of the minimum wage. Evidence from evaluation of the EMA pilots (Battistin *et al*, 2005) has shown that, among eligible young people, the EMA increased the proportion who were in full-time education at both age 16 and 17 by 6.1 percentage points. The effect was particularly strong for young men, and those who had been low or moderate achievers at the end of Year 11. Research by the London School of Economics (Dearden, Emmerson, Frayne and Meghir, 2006) also found that the EMA had improved retention in education.

5.8 We now examine in detail the labour market position of 16–17 year olds. It is important to note that small sample sizes and a high degree of proxy responses for this age group mean that the data presented below need to be treated with caution. Figure 5.2 illustrates the distribution of 16–17 year olds by education status and economic activity. In the third quarter of 2006, over three-quarters of 16–17 year olds (1.17 million) were in FTE, of whom over 369,000 were employed and 706,000 were economically inactive (i.e. neither in employment nor unemployed). Young women were more likely to be in FTE and employed than young men. Around 12 per cent of 16–17 year olds were not in FTE but employed, while 5.7 per cent were not in FTE and unemployed and 6.3 per cent were not in FTE and inactive. This shows that it is important to consider the labour market position of young people in the light of their participation in FTE as it will have a significant impact on their patterns of economic activity.

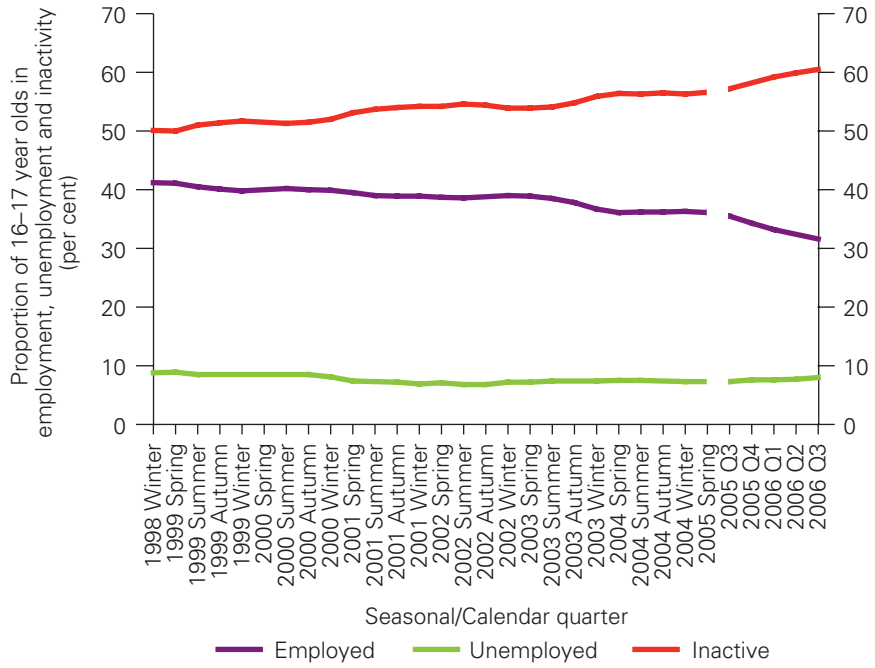
Figure 5.2
Labour Market Status of 16–17 Year Olds by Education Status, UK, 2006



Source: LPC estimates based on LFS Microdata, four quarter moving average, UK, Q4 2005 – Q3 2006.

5.9 Figure 5.3 shows the trend in employment, unemployment and inactivity among 16–17 year olds in FTE since the introduction of the minimum wage. After remaining fairly stable between the end of the 1990s and the first few years of the 2000s, the employment rate of this age group started declining in mid-2003, predating the introduction of the 16–17 year old minimum wage rate in October 2004. This decline in employment has been associated with a rise in inactivity among those in FTE which accounts largely for the rise in inactivity among all 16–17 year olds. The fall in employment and rise in inactivity seem to have accelerated since the end of 2004, coinciding with the national roll-out of the EMA.

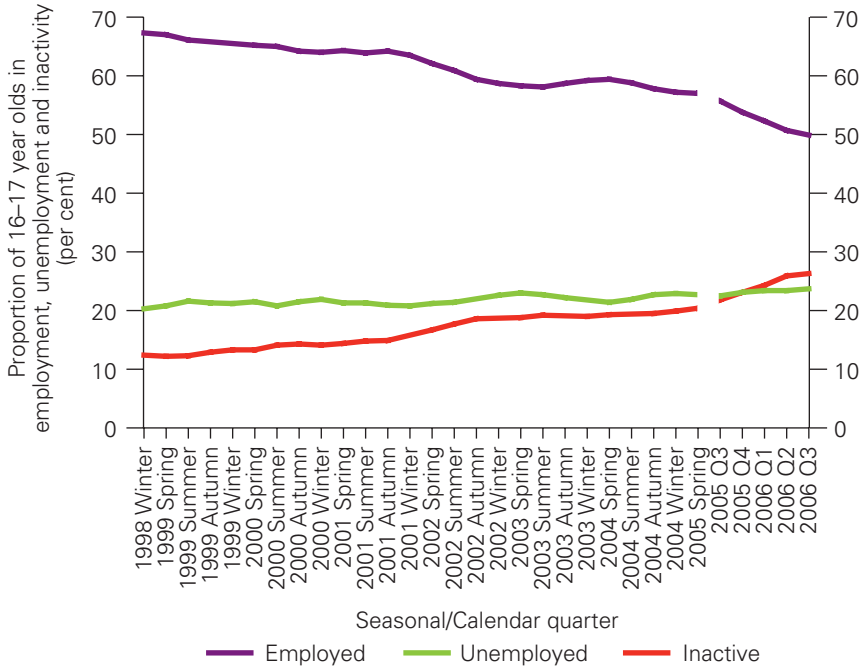
Figure 5.3
Proportion of 16–17 Year Olds in Full-time Education in Employment, Unemployment and Inactivity, UK, 1998–2006



Source: LPC estimates based on LFS Microdata, seasonal/calendar quarters, four quarter moving average, UK, 1998–2006.
Note: The break between Spring 2005 and Q3 2005 is a result of a discontinuity in the series as the LFS moved from seasonal to calendar quarters; thus comparisons should be made with care.

5.10 Focusing on 16–17 year olds not in FTE, Figure 5.4 shows that their employment rate has been declining since mid-1999. This decline in employment has been associated mainly with a rise in the proportion of those who are inactive and more recently, but to a lesser extent, with an increase in unemployment. Between the third quarter of 2005 and the third quarter of 2006, the employment rate fell from 55.7 per cent to 49.9 per cent while inactivity rose from 21.8 per cent to 26.3 per cent, overtaking the proportion of unemployed 16–17 year olds not in FTE, which increased from 22.5 per cent to 23.7 per cent. This represents an unemployment rate of 32.2 per cent, compared with a working age national average of 5.4 per cent over the same period.

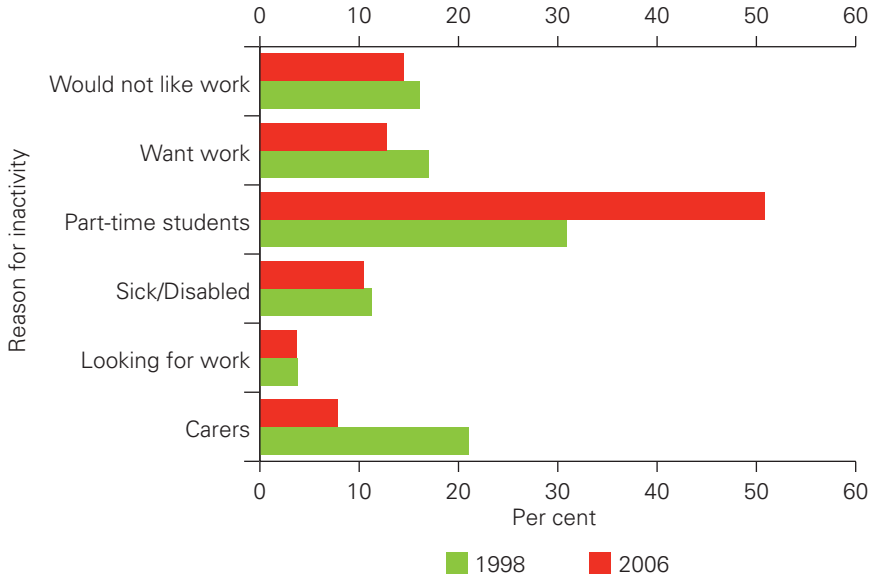
Figure 5.4
Proportion of 16–17 Year Olds Not in Full-time Education in Employment, Unemployment and Inactivity, UK, 1998–2006



Source: LPC estimates based on LFS Microdata, seasonal/calendar quarters, four quarter moving average, UK, 1998–2006.
Note: The break between Spring 2005 and Q3 2005 is a result of a discontinuity in the series as the LFS moved from seasonal to calendar quarters; thus comparisons should be made with care.

5.11 Figure 5.5 provides a breakdown of 16–17 year olds not in FTE and economically inactive by the reason they have given for inactivity. These figures should be treated with care due to the high level of proxy responses. In the year to the third quarter of 2006, over half of inactive 16–17 year olds said they were students doing part-time studies, with the proportion increasing significantly since 1998. The remainder of inactive 16–17 year olds were made up of those who had caring responsibilities (in sharp decline compared to 1998), those who were looking for or wanted to work but were not classified as unemployed (slightly down), and those who said they would not like to work.

Figure 5.5
Reasons for Inactivity Among 16–17 Year Olds Not in Full-time Education, UK, 1998–2006



Source: LPC estimates based on LFS Microdata, seasonal/calendar quarters, four quarter moving average, UK, 1998–2006.
Note: There is discontinuity in the series as the LFS moved from seasonal to calendar quarters in 2006; thus comparisons should be made with care.

5.12 The increase in the proportion of economically inactive 16–17 year olds not in FTE who said they were engaged in some form of education or training may partly explain the rise in inactivity among this age group. However, of particular concern to us are those who are NEET. According to the Department for Education and Skills (DfES, 2006d), the size of the 16–17 year old NEET group in England remained fairly stable from 1999 at around 7 to 8 per cent, but it increased to about 9 per cent in 2004 (114,000) and 2005 (124,000). In 2005, 10 per cent of 16 year old men were NEET compared with 6 per cent of women, and 13 per cent of 17 year old men were NEET compared with 9 per cent of women. For both 16 and 17 year olds, male NEET rates have increased faster than female NEET rates. The Scottish Executive (2006b) estimates that 14 per cent (36,000) of 16–19 year olds in Scotland were NEET in 2005.

5.13 There is currently a lack of evidence offering a convincing explanation for the growth of the NEET group. The Youth Cohort Study (YCS) (DfES, 2005a) shows that in 2004, 16 year olds whose parents were in higher professional occupations were much less likely to be NEET than those whose parents were in routine occupations. The YCS also found

that the likelihood of not being NEET fell significantly as attainment at year 11 increased. Almost two out of five young people who said they were persistent truants in year 11 were NEET, a rise of 10 percentage points since 2000.

5.14 To sum up, since 1999 there has been a sharp decline in the employment rate of 16–17 year olds accompanied by a corresponding rise in inactivity. These trends can be explained to a great extent by the increased participation of 16–17 year olds in FTE as most of these young people are classified here as economically inactive. The labour market prospects of the decreasing number of 16–17 year olds not in FTE have been worsening since 1998 and at a somewhat faster rate since 2005, with a decline in employment and a rise in inactivity. However, there has been a substantial increase in the number of 16–17 year olds not in FTE who are defined as economically inactive but are engaged in part-time education. The proportion of 16–17 year olds who are NEET has remained fairly constant since 1992, although there is evidence of a small increase since 2004.

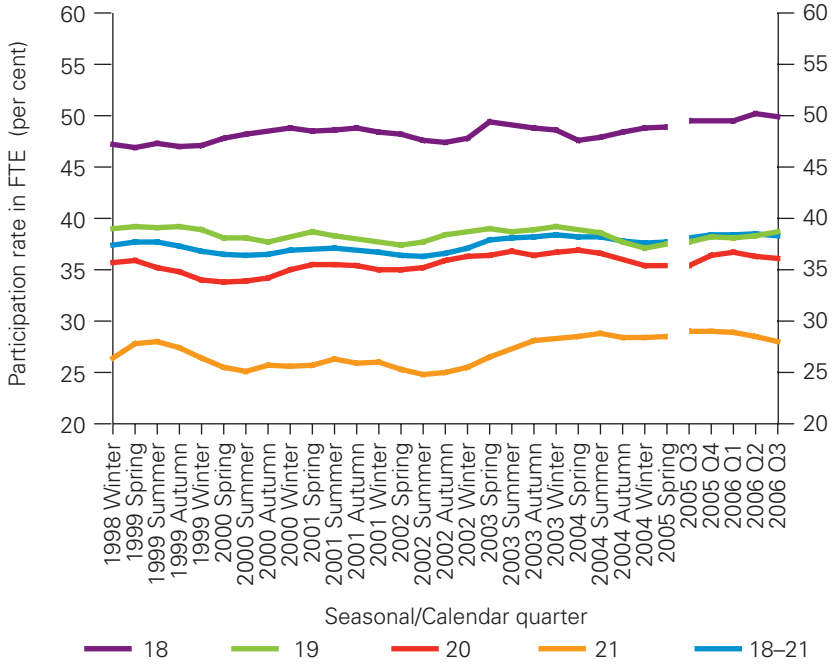
Labour Market Position of 18–21 Year Olds

5.15 The population of 18–21 year olds has increased steadily since 1999. According to the ONS 2005 mid-year population estimates, there were 3.2 million 18–21 year olds, accounting for about 8.5 per cent of the working age population.

5.16 The employment rate of 18–21 year olds rose steadily between 1997 and the end of 2000, apparently unaffected by the introduction of the minimum wage. However, since then it has been slowly but steadily declining. This fall in employment has been accompanied by an increase in the rate of inactivity and, more worryingly, since 2004 by a sharp increase in the unemployment rate, which rose from 12.4 per cent in Autumn 2004 to 14.9 per cent in the third quarter of 2006. To understand fully the dynamics of the labour market for 18–21 year olds, it is important to consider separately those who are in FTE and those who are not. Figure 5.6 shows participation rates in FTE for this age group. Not surprisingly, 18 year olds have the highest participation rate in FTE, at around 50 per cent, compared with just over a quarter of 21 year olds. The proportion of 18–21 year olds in FTE has been slowly increasing since the end of the 1990s. This in itself would tend to

depress the trend in the employment rate for this age group, since full-time students are less likely to be employed. However, the effect is likely to be small.

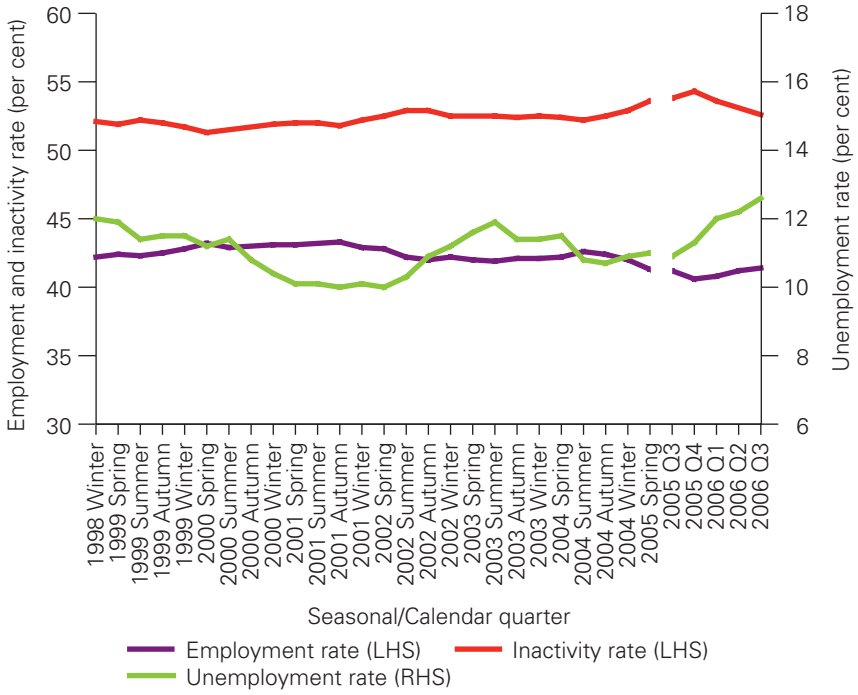
Figure 5.6
Participation of 18–21 Year Olds in Full-time Education, UK, 1998–2006



Source: LPC estimates based on LFS Microdata, seasonal/calendar quarters, four quarter moving average, UK, 1998–2006.
Note: The break between Spring 2005 and Q3 2005 is a result of a discontinuity in the series as the LFS moved from seasonal to calendar quarters; thus comparisons should be made with care.

5.17 In the third quarter of 2006, 1.17 million 18–21 year olds (38 per cent) were in FTE. Figure 5.7 shows that the employment rate of those in FTE remained fairly stable after the introduction of the minimum wage in 1999 until the beginning of 2004 when it started to decline. The 18 months to the third quarter of 2006 have seen a slight increase in the employment rate again.

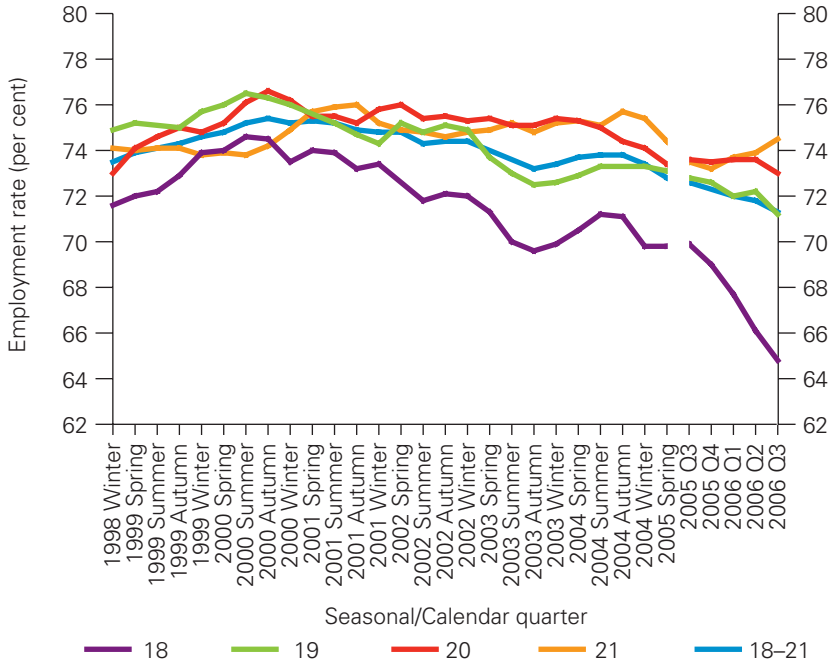
Figure 5.7
Employment, Unemployment and Inactivity Rates of 18–21 Year Olds in Full-time Education, UK, 1998–2006



Source: LPC estimates based on LFS Microdata, seasonal/calendar quarters, four quarter moving average, UK, 1998–2006.
Note: The break between Spring 2005 and Q3 2005 is a result of a discontinuity in the series as the LFS moved from seasonal to calendar quarters; thus comparisons should be made with care.

5.18 As shown in Figure 5.8, the decline in the employment rate of 18–21 year olds not in FTE has been more marked since 2004. The decline in employment was sharpest among 18 year olds, widening the gap between that age group and 19–21 year olds. Between the third quarter of 2005 and the third quarter of 2006 alone, the employment rate of 18 year olds fell from 69.9 per cent to 64.8 per cent. By contrast, during the same period, the employment rate of 21 year olds increased from 73.5 per cent to 74.5 per cent.

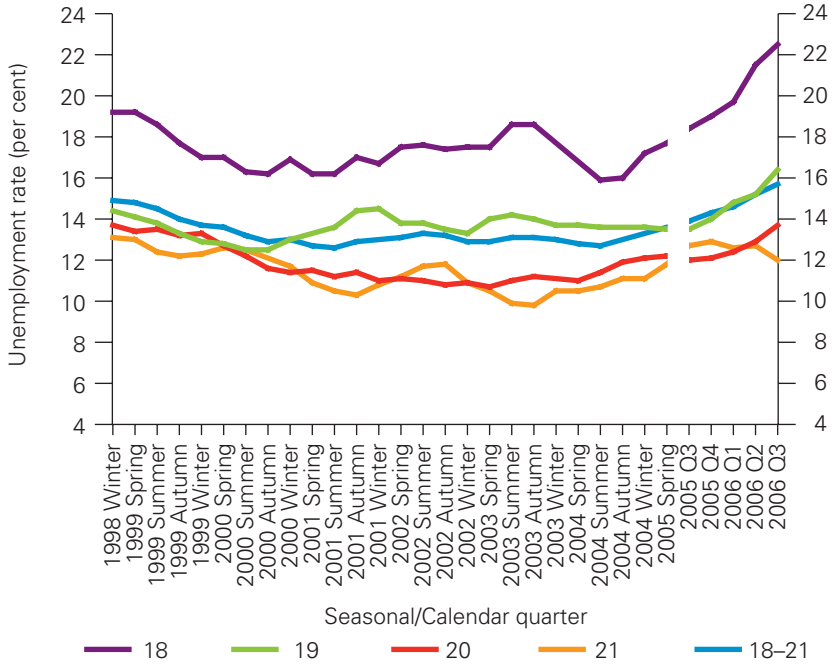
Figure 5.8
Employment Rates of 18–21 Year Olds Not in Full-time Education, UK, 1998–2006



Source: LPC estimates based on LFS Microdata, seasonal/calendar quarters, four quarter moving average, UK, 1998–2006.
Note: The break between Spring 2005 and Q3 2005 is a result of a discontinuity in the series as the LFS moved from seasonal to calendar quarters; thus comparisons should be made with care.

5.19 The trends in the unemployment rates of 18–21 year olds not in FTE, shown in Figure 5.9, have mirrored the trends in employment. After a decline in unemployment throughout the late 1990s, the unemployment rate levelled off before rising again in Spring 2004. In the third quarter of 2006, it stood at 15.7 per cent. Again, 18 year olds, who have consistently experienced a higher unemployment rate than 19–21 year olds, seem to have been hit the hardest, with their unemployment rate rising from 18.4 per cent in the third quarter of 2005 to 22.5 per cent in the third quarter of 2006. Twenty-one year olds, on the other hand, have seen their unemployment rate decline by 0.7 percentage points to 12.7 per cent during the same period.

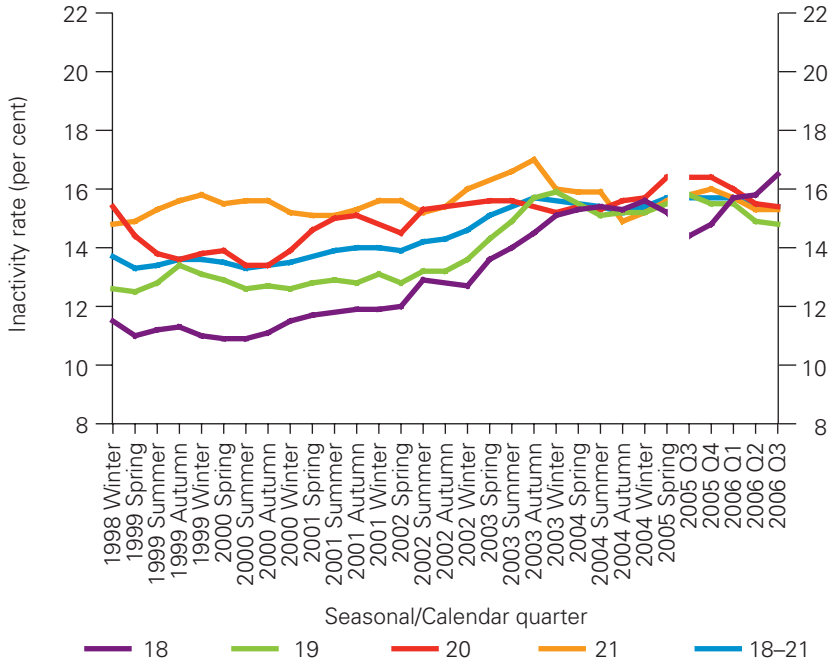
Figure 5.9
Unemployment Rates of 18–21 Year Olds Not in Full-time Education, UK, 1998–2006



Source: LPC estimates based on LFS Microdata, seasonal/calendar quarters, four quarter moving average, UK, 1998–2006.
Note: The break between Spring 2005 and Q3 2005 is a result of a discontinuity in the series as the LFS moved from seasonal to calendar quarters; thus comparisons should be made with care.

5.20 Figure 5.10 shows that the inactivity rates of 18–21 year olds not in FTE have remained fairly stable since 2003. In the third quarter of 2006, 15.5 per cent of 18–21 year olds not in FTE were economically inactive. The increase in inactivity was sharpest among 18 and 19 year olds who now have similar inactivity rates to 20 and 21 year olds. In the third quarter of 2006, nearly one in five 18–21 year olds not in FTE said they were inactive because they had caring responsibilities, compared with over half in 1998. Nearly a quarter said they were students, while just over 10 per cent said they would not like to work.

Figure 5.10
Inactivity Rates of 18–21 Year Olds Not in Full-time Education, UK, 1998–2006



Source: LPC estimates based on LFS Microdata, seasonal/calendar quarters, four quarter moving average, UK, 1998–2006.
Note: The break between Spring 2005 and Q3 2005 is a result of a discontinuity in the series as the LFS moved from seasonal to calendar quarters; thus comparisons should be made with care.

5.21 To summarise, 18–21 year olds have experienced a worsening of their labour market position. Of concern is the decline in employment and rise in inactivity they have been experiencing since 2001. Since 2004, their unemployment rate has been increasing. Amongst this age group, eighteen year olds have been the most adversely affected. By contrast, the labour market prospects of 21 year olds have improved since 2005, with employment rising and unemployment declining.

Demand for Young People

5.22 There is no hard evidence to explain this worsening in the labour market position of young people. As we noted in Chapter 2, the total UK labour supply has increased in recent years, driven by the rise in labour market participation among older workers and the recent arrival of young migrant workers from the European Union Accession countries. One explanation might be that some young people are being substituted by older workers or migrants but little evidence is available at present to substantiate this hypothesis. For instance, Blanchflower,

Saleheen and Shadforth (2007) found no statistically significant relationships between the rise in youth unemployment rates across regions and changes in regional shares of new migrants, older worker activity rates or shares of workers affected by the minimum wage.

5.23 Young people are disproportionately represented in the low-paying sectors and are therefore more likely to be paid the minimum wage. According to the LFS, three-quarters of 16–17 year olds and over half of 18–21 year olds were working in low-paying sectors in the year to the third quarter of 2006. Those in FTE were particularly likely to work in low-paying sectors. A high proportion of 16–21 year olds are employed in retail and hospitality, but other sectors such as social care; leisure, travel and sport and hairdressing also have a higher than average proportion of young employees.

5.24 The LFS also shows that between 1998 and 2006, the proportion of 18–21 year olds working in low-paying sectors increased (from 52 to 63 per cent), as did the employment share of workers of retirement age. By contrast, the proportion of 16–17 year olds in low-paying sectors declined over this time period (from 69 to 60 per cent).

5.25 Evidence from other sources indicates that the minimum wage has had little impact on employers' demand for young people. Results from our latest survey of low-paying sectors (detailed results can be found at Appendix 3) showed that the October 2005 upratings had little impact on the decisions of employers with age-related pay structures to employ young workers. Research we commissioned from the Institute for Employment Studies (Denvir and Loukas, 2006) on the impact of the minimum wage on three low-paying sectors suggested that successive upratings in the minimum wage have led to some firms being more likely to employ younger, less experienced workers because they could be paid at a lower rate. Conversely, other firms stated a preference for older, experienced staff in order to justify the rates that had to be paid, or because they tended to stay longer. One interviewee noted that the workforce was being *'split between these very young trainees and staff who are a lot older with a great deal of experience in the business'*, with the result that *'the middle market is missing out'*.

Low Pay Commission Research

Some employers were looking for a more permanent stable core of experienced staff … and felt that older workers were more likely to fit this profile. Others were looking for younger employees, as older workers were considered to have more experience than the employer was prepared to pay for ….

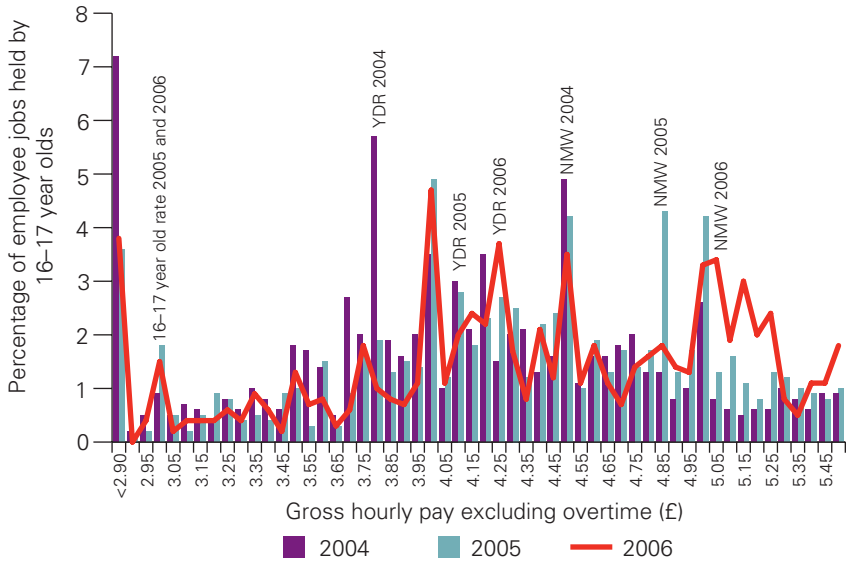
Denvir and Loukas, 2006

Earnings

16–17 Year Olds

5.26 Figure 5.11 illustrates the hourly earnings distribution of 16–17 year olds since the introduction of the £3.00 minimum wage rate for this age group in October 2004. The upward shift in the distribution indicates that some 16–17 year olds have benefited from the introduction of the 16–17 year old rate, but more notably from upratings of the Youth Development Rate and the adult rate. The main peaks in the hourly earnings distribution at April 2006 are at the Youth Development Rate (£4.25) and adult rate (£5.05), but there were also two noticeable mezzanine levels at £4.00 and £4.20 – one in ten jobs held by 16–17 year olds paid between these two rates in April 2006. The peak at £3.00 is much smaller, highlighting the relatively small proportion of 16–17 year olds paid at the 16–17 year old rate.

Figure 5.11
Hourly Earnings Distribution for Employees Aged 16–17, UK, 2004–2006



Source: LPC estimates based on Annual Survey of Hours and Earnings (ASHE) with supplementary information, low-pay weights, UK, April 2004–2006.
Note: Labels show the adult minimum wage (NMW), Youth Development Rate (YDR) and 16–17 year old rate in April of the given year.

5.27 Table 5.1 shows the proportion of jobs held by 16–17 year olds which paid below the 16–17 year old rate, the Youth Development Rate and the adult rate applicable in April of the relevant year. In April 2006, 4.3 per cent of jobs held by 16–17 year olds were paying below the 16–17 year old rate. The proportion of jobs held by employees in that age

group paid below the Youth Development Rate increased from over a quarter in 2004 to nearly a third in 2006. By contrast, the proportion of jobs held by 16–17 year olds paid at the adult rate and above remained more stable at around 40 per cent over this period.

Table 5.1
Jobs Held by 16–17 Year Olds Paying Below the 16–17 Year Old Rate, Youth Development Rate and Adult Rate, UK, 2004–2006

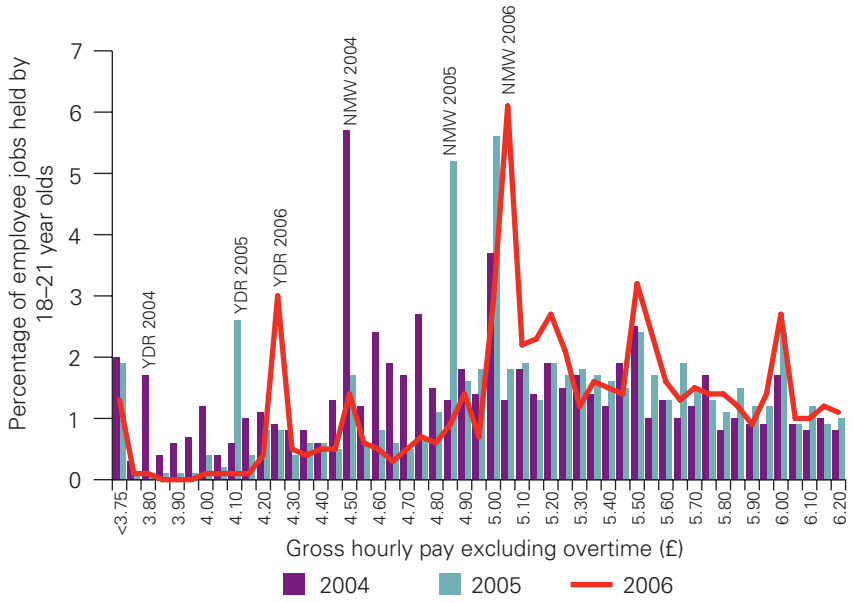
	16–17 year old rate (in April)	Youth Develop-ment Rate (in April)	Adult rate (in April)	Percentage of jobs paying below 16–17 year old rate (000s in brackets)	Percentage of jobs paying below YDR (000s in brackets)	Percentage of jobs paying below adult rate (000s in brackets)	Percentage of jobs paying at or above adult rate
2004	–	£3.80	£4.50	–	24.9 (117)	57.8 (271)	42.2
2005	£3.00	£4.10	£4.85	4.0 (20)	28.5 (141)	59.7 (295)	40.3
2006	£3.00	£4.25	£5.05	4.3 (15)	31.3 (108)	59.7 (206)	40.3

Source: LPC estimates based on ASHE with supplementary information, low-pay weights, UK, April 2004–2006.

18–21 Year Olds

5.28 Figure 5.12 shows that 18–21 year olds have also continued to benefit from upratings of the minimum wage. The main peaks in the hourly earnings distribution coincide with the adult rates and, to a lesser extent, the Youth Development Rate. Threshold levels are also noticeable at £5.00 per hour in 2003 and 2004, before the October 2005 uprating displaced the spike to £5.05, and at £5.50 and £6.00 per hour in all three years.

Figure 5.12
Hourly Earnings Distribution for Employees Aged 18–21, UK, 2004–2006



Source: LPC estimates based on ASHE with supplementary information, low-pay weights, UK, April 2004–2006.
Note: Labels show the adult minimum wage (NMW) and Youth Development Rate (YDR) in April of the given year.

5.29 In previous reports, we have commented on the fact that a higher proportion of employers tend to make use of the flexibility offered by the Youth Development Rate immediately following a large uprating of the adult rate. Table 5.2 shows that the relationship between use of the Youth Development Rate and the size of upratings has not been as evident in recent years. In April 2002 and 2004, two years in which there were relatively large upratings of the adult rate of the minimum wage (the October 2001 and 2003 upratings respectively), the proportion of jobs held by 18–21 year olds paying below the adult rate was higher than in 2000, 2001 and 2003. However, use of the flexibility afforded by the Youth Development Rate has been increasing every year since 2004, despite the fact that the October 2005 uprating of the adult rate was relatively smaller. Nevertheless, in April 2006, over four-fifths of jobs held by 18–21 year olds paid at or above the adult rate. Just under 2.5 per cent of jobs were paid below the Youth Development Rate, which is likely to reflect use of the apprenticeship exemptions.

Table 5.2

Jobs Held by 18–21 Year Olds Paying Below the Youth Development Rate and Adult Rate, UK, 1999–2006

	Youth Development Rate (in April)	Adult rate (in April)	Number of jobs paying below YDR (000s)	Number of jobs paying below adult rate (000s)	Percentage of jobs paying below YDR	Percentage of jobs paying below adult rate	Percentage of jobs paying at or above adult rate
1999	£3.00	£3.60	37	270	2.4	17.2	82.8
2000	£3.00	£3.60	34	173	2.1	10.7	89.3
2001	£3.20	£3.70	37	164	2.1	9.6	90.4
2002	£3.50	£4.10	46	245	2.7	14.1	85.9
2003	£3.60	£4.20	38	186	2.3	11.0	89.0
2004	£3.80	£4.50	38	262	2.3	16.0	84.0
2004	£3.80	£4.50	44	268	2.3	14.3	85.7
2005	£4.10	£4.85	55	287	3.0	15.8	84.2
2006	£4.25	£5.05	48	346	2.5	17.8	82.2

Source: ONS central estimate methodology LFS and ASHE without supplementary information, Spring 1999–2004. LPC estimates based on ASHE with supplementary information, low-pay weights, UK, April 2004–2006.

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

5.30 In Table 5.3, we look at those young workers paid in April of each year below the minimum wage rates due to be implemented later that year, and thus who stand to benefit from the upratings. The proportion of jobs held by 18–21 year olds that paid below the forthcoming adult rate was at its highest in 2001 and 2004, which saw relatively large upratings in the adult rate, but also in 2006, a year with a relatively modest increase in the rate. This is consistent with the observation above that use of the flexibility offered by the Youth Development Rate has increased in the last two years.

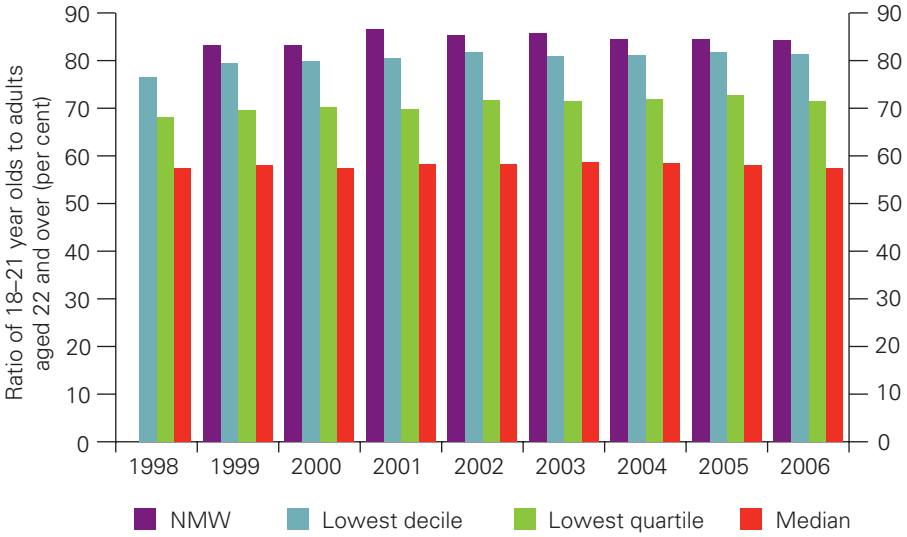
Table 5.3
Jobs Held by 18–21 Year Olds Paying Below the Forthcoming Youth Development Rate and Adult Rate, UK, 1999–2006

	Youth Development Rate (forthcoming)	Adult rate (forthcoming)	Number of jobs paying below forthcoming YDR (000s)	Number of jobs paying below forthcoming adult rate (000s)	Percentage of jobs paying below forthcoming YDR	Percentage of jobs paying below forthcoming adult rate	Percentage of jobs paying at or above forthcoming adult rate
1999	£3.00	£3.60	37	270	2.4	17.2	82.8
2000	£3.20	£3.70	84	315	5.2	19.6	80.4
2001	£3.50	£4.10	97	513	5.6	30.0	70.0
2002	£3.60	£4.20	93	400	2.7	23.0	77.0
2003	£3.80	£4.50	84	431	5.0	25.1	74.9
2004	£4.10	£4.85	68	572	6.2	34.9	65.1
2004	£4.10	£4.85	137	584	7.3	31.3	68.7
2005	£4.25	£5.05	125	545	6.9	30.0	70.0
2006	£4.45	£5.35	135	668	6.9	34.4	65.6

Source: ONS central estimate methodology LFS and ASHE without supplementary information, Spring 1999–2004. LPC estimates based on ASHE with supplementary information, low-pay weights, UK, April 2004–2006.
Note: Direct comparisons before and after 2004 should be made with care due to changes in data series.

5.31 Figure 5.13 illustrates how the hourly earnings distribution of 18–21 year olds relates to that of employees aged 22 and over for the bottom half of the distribution, as well as the relationship between the Youth Development Rate and the adult rate applicable in the years shown. Our approach so far has been to keep the ratio of the Youth Development Rate to the adult rate fairly constant. When it was introduced in April 1999, the Youth Development Rate was worth about 83 per cent of the adult rate before increasing to 87 per cent of the adult rate in April 2000. Since then, in response to the weakening of the youth labour market, the ratio of the Youth Development Rate to the adult rate has steadily decreased to reach 83 per cent again in October 2006. The introduction of the minimum wage has helped to raise the lowest decile of the earnings distribution for 18–21 year olds relative to that of adults: young people's lowest decile earnings were 77 per cent of adults' lowest decile earnings in 1998 before the minimum wage was introduced and have remained at around 81–82 per cent since its introduction. The relative value of young people's earnings to those of adults aged 22 and above at the lowest quartile and median has remained fairly constant since the introduction of the minimum wage and through subsequent upratings.

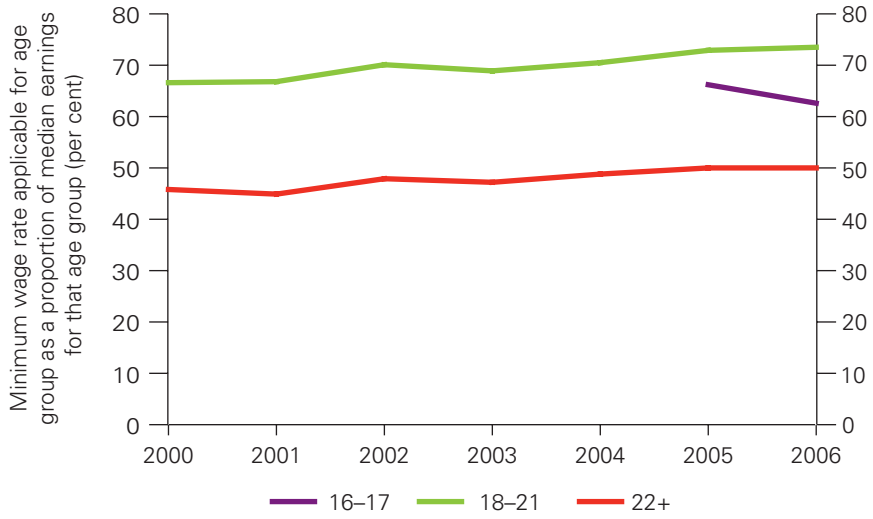
Figure 5.13
Gross Hourly Earnings of 18–21 Year Olds Relative to Employees Aged 22 and Over, UK, 1998–2006



Source: LPC estimates based on ASHE without supplementary information, low-pay weights, UK, April 1998–2003 and ASHE with supplementary information, low-pay weights, UK, April 2004–2006.
Note: There is a break in the ASHE series between 2003 and 2004. Thus direct comparisons should be made with care.

5.32 Figure 5.14 shows how the 'bite' of the various minimum wage rates, defined as the ratio of the minimum wage applicable to a particular age group to the median earnings of that age group, has changed over time. The bite of the minimum wage applicable for the age group in relation to median earnings is higher for 16–17 and 18–21 year olds than for adults aged 22 and over as young people are generally lower paid, but the bite in relation to the bottom decile is much closer between young and adult workers. For 18–21 year olds, the ratio of the Youth Development Rate to median earnings has been increasing at a faster rate than the ratio of the adult rate to the median earnings of adults, especially in the last two years. It was 73.5 per cent in April 2006, compared with 70.5 per cent in 2004. The ratio of the 16–17 year old rate to median earnings decreased between 2005 and 2006 because it was not uprated in 2005.

Figure 5.14
Ratio of the Minimum Wage to Median Earnings by Age Group, UK, 2000–2006



Source: LPC estimates based on ASHE without supplementary information, low-pay weights, UK, April 2000–2003 and ASHE with supplementary information, low-pay weights, UK, April 2004–2006.
Note: There is a break in the ASHE series between 2003 and 2004. Thus direct comparisons should be made with care.

Coverage

5.33 Our 2006 Report estimated that around 110,000 jobs held by 18–21 year olds were covered by the October 2005 uprating of the Youth Development Rate. Between 110,000 and 140,000 jobs were forecast to be covered by the 2006 uprating. Using April 2006 ASHE data, we now estimate that 106,000 to 109,000 jobs held by those aged 18–21 (around 5.8–6.0 per cent of all jobs for this age group) were covered by the October 2005 uprating of the Youth Development Rate, and that 121,000–123,000 jobs (around 6.2–7.9 per cent of all jobs for this age group) would have been covered by the October 2006 uprating.

5.34 Our 2006 Report estimated that up to 32,000 jobs would benefit from the October 2006 uprating. We now calculate that around 25,000 jobs (7.2 per cent) were covered by the 2006 uprating. This is likely to be an upper estimate as the exemptions for apprentices and those on pre-apprenticeship programmes will reduce the number of young workers who were actually covered by the upratings.

5.35 In summary, we have seen that young workers have continued to benefit from increases in the youth rates. In addition, a substantial

number of young people are paid well above the youth rates and have therefore benefited from the upratings of the adult rate. However, the proportion of 18–21 year olds who are paid below the adult rate has been increasing following the October 2004 and 2005 upratings. The use of age-related pay is considered in more detail in the next section.

Use of Age-related Pay

5.36 There is a clear relationship between age and earnings, as illustrated by Table 5.4 below. Lowest decile hourly earnings rise with age, reflecting increasing skills and experience and the fact that a high proportion of young people are employed in low-paying sectors. In all three years, the lowest decile hourly pay of 18 year olds has been equal or very close to the Youth Development Rate applicable in April and the lowest decile hourly pay of 19 year olds is much lower than that of 20 year olds. By contrast, over the last three years the lowest decile earnings of 21 year olds have equalled the adult rate applicable in April (£4.50 in 2004, £4.85 in 2005, and £5.05 in 2006).

Table 5.4
Gross Hourly Earnings for Young People by Age, UK, 2004–2006

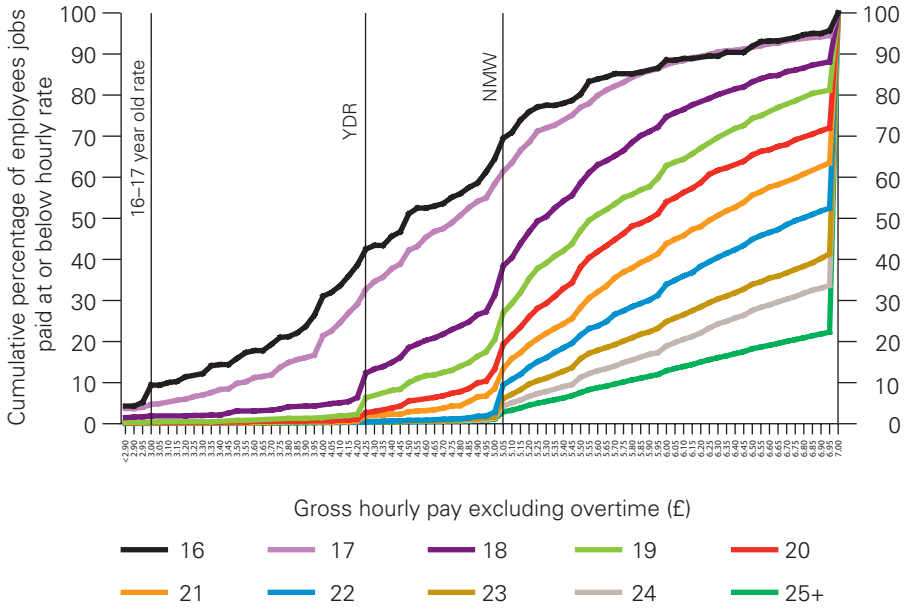
Age	Lowest decile			Lowest quartile			Median		
	2004	2005	2006	2004	2005	2006	2004	2005	2006
16	£3.00	£3.22	£3.17	£3.60	£3.91	£3.96	£4.03	£4.38	£4.50
17	£3.28	£3.55	£3.57	£3.81	£4.07	£4.16	£4.38	£4.70	£4.82
18	£3.90	£4.10	£4.25	£4.46	£4.70	£4.90	£4.89	£5.15	£5.34
19	£4.20	£4.46	£4.54	£4.63	£4.95	£5.05	£5.22	£5.50	£5.61
20	£4.49	£4.71	£4.96	£4.79	£5.00	£5.22	£5.52	£5.75	£5.96
21	£4.50	£4.85	£5.05	£5.04	£5.23	£5.48	£5.90	£6.13	£6.32
22	£4.77	£5.00	£5.11	£5.40	£5.50	£5.70	£6.49	£6.67	£6.84

Source: LPC estimates based on ASHE with supplementary information, low-pay weights, UK, April 2004–2006.

5.37 Figure 5.15, which shows the proportion of employee jobs paid at or below a certain hourly rate in April 2006, illustrates how earnings increase with every single year of age at every point of the distribution. Jumps in the distribution are noticeable at the various minimum wage rates but also at threshold hourly rates such as £4.00. There is a very clear demarcation between the cumulative earnings distributions of 16–17 year olds and 18–21 year olds, with the majority of jobs held by 16–17 year olds paying below the adult rate. The use of the adult rate

increases with age: in April 2006, 69 per cent of jobs held by 18 year olds paid at or above the adult rate, rising to 80 per cent for 19 year olds, 87 per cent for 20 year olds and 91 per cent for 21 year olds. This also reflects the fact that the proportion of young employees in low-paying sectors decreases with age.

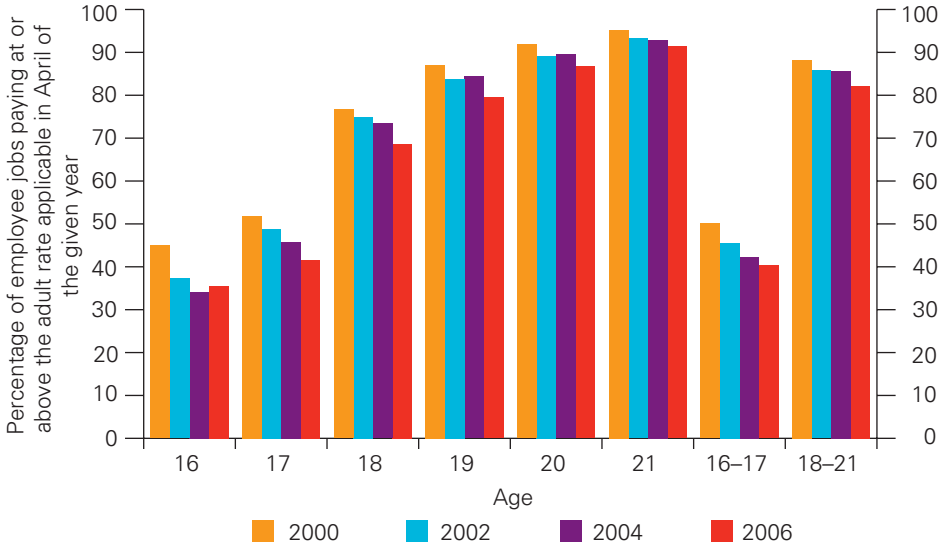
Figure 5.15
Cumulative Hourly Earnings Distribution by Age, UK, 2006



Source: LPC estimates based on ASHE with supplementary information, low-pay weights, UK, April 2006.
Note: Labels indicate the 16–17 year old rate, Youth Development Rate (YDR) and adult rate (NMW) applicable in April 2006.

5.38 As we saw earlier in this chapter, the earnings data show that in the last three years, the proportion of jobs held by 18–21 year olds paying at the adult rate and above, although very high, has been decreasing, irrespective of the size of the upratings. Figure 5.16 shows use of the adult rate over time by single year of age. Among workers aged 18–21, there has been a slight decline in the proportion of jobs paying at or above the adult rate, but the decline seems more pronounced for 18 and 19 year olds than for 20 and 21 year olds. In 2006, 91 per cent of jobs held by 21 year olds paid at or above the adult rate. This means that fewer than 50,000 jobs held by 21 year olds paid below the adult rate in April 2006.

Figure 5.16
Proportion of Employee Jobs Paying At or Above the Adult Rate of the National Minimum Wage by Age, UK, 2000–2006



Source: LPC estimates based on ASHE without supplementary information, low-pay weights, April 2000–2003 and ASHE with supplementary information, low-pay weights, April 2004–2006.
Note: There is a break in the ASHE series from 2004; thus comparisons between the two series should be made with care.

5.39 Evidence from research we commissioned, our Employers' Survey and our consultation provided a mixed picture of the use of age-related pay, with different trends across the low-paying sectors. Incomes Data Services (IDS, 2006b) found some evidence that a trend it had observed in recent years in the retail sector towards raising the age threshold for payment of adult rates, attributable to the impact of the minimum wage, had reversed. It reported that a number of large retail firms had lowered the threshold to 18 years old, although many large retailers continued to pay a single lower rate for workers under the age of 18. This finding was supported by written evidence from the British Retail Consortium based on a survey of multiple retailers. This survey found that around nine in ten employees aged 21 and below received at least the adult rate of the minimum wage, which was higher than the equivalent figure (69 per cent) in its 2005 survey. Similarly, the vast majority of multiple retailers paid 16–17 year olds above the minimum wage for this age group, with around four-fifths paying £4.25 or more in April 2006. However, use of the youth rates was much more common among small and medium-sized retailers with fewer than 250 employees.

5.40 However, ASHE data show that in 2006, the low-paying sectors had a smaller proportion of jobs held by employees aged 18–21 paid at or above the adult rate than other sectors and that the proportion had declined faster in the last three years. This was particularly the case in the hospitality sector, where 63 per cent of jobs held by employees aged 18–21 were paid the adult rate in 2006 compared with 81 per cent in 2004. This decline was most pronounced among 18 and 19 year olds. In the retail sector, the data seem to corroborate IDS findings of a reversal of the decline in the use of the adult rate, with 84 per cent of jobs held by 18–21 year olds paying above the adult rate in 2006 compared with 83 per cent in 2004 and 88 per cent in 2000.

5.41 Within the childcare sector, an IDS survey (IDS, 2006b) found that nurseries employed a substantial number of staff under the age of 22. Just over a third of the 94 respondents reported use of age-related pay, with 22 years of age the most common threshold for payment of the full adult rates. However, in the hotel sector, IDS found that the payment of adult rates from the age of 18 was fairly common. Only three of the 20 hotels and hotel groups in its survey paid their full adult rate from the age of 22.

5.42 This was also a theme during our visits across the UK to meet employers and workers affected by the minimum wage. Many employers paid above the 16–17 year old rate and the Youth Development Rate in order to attract staff or because they felt it was unfair to pay a lower rate for the same work. During a Commission visit to Birmingham, a group of pub companies and licensees from the British Beer and Pub Association told us it was common practice to pay adult rates from the age of 18 because employers did not feel they could justify paying a lower rate of pay to a younger member of staff doing identical work alongside an older worker. However, the Birmingham Chamber of Commerce did sound a note of caution with regards to young people from deprived areas of the city who had experienced long spells of unemployment. It feared some had been priced out of employment as a result of the youth rates.

5.43 Our survey of low-paying sectors showed that, compared with the 2004 survey, fewer employers reported making use of age-related pay structures, but a greater proportion of these employers said they paid younger workers below the adult rate. Around 14 per cent of

respondents reported using age-related pay structures in the 2006 survey, compared with 20 per cent in the 2004 survey. The survey also showed that a high proportion of respondent firms paid their young employees more than the minimum wage applicable for their age. Around a fifth of businesses with age-related pay structures reported paying their 18 year old employees above the Youth Development Rate and this proportion went up to 57 per cent for 21 year olds. It should be noted that the survey is biased towards those businesses most likely to be affected by the minimum wage.

5.44 We also asked those same respondents at which age they started paying the adult rate. Around 44 per cent of firms reported starting to pay the adult rate at 22 compared with 22 per cent in the 2004 survey, suggesting a growing use of youth rates among those with age-related pay.

5.45 Our analysis has shown that, while many employers choose to pay young people above the minimum wage applicable for their age, earnings at the lower end of the distribution continue to be significantly lower than those of older workers. There is also evidence of an increased use of age-related pay. In the next section, we consider how the use of age-related pay fits with new legislation outlawing discrimination at work on the grounds of age.

The Minimum Wage and Age Discrimination

5.46 An exemption within the Employment Equality (Age) Regulations 2006 permits employers to continue to base their pay structures on the three minimum wage rates in place for 16–17 year olds, 18–21 year olds and workers aged 22 and above. Employers may pay 16–17 year old workers less than those aged over 17, and may pay 18–21 year olds less than those aged over 21. However, the specific minimum wage exemption only applies if young workers under the age of 22 are paid less than the adult rate. The Government believes that the exemption can be objectively justified, as is countenanced by the European Employment Directive that the Regulations are designed to implement, on the grounds that it supports a legitimate employment policy aim of avoiding damage to youth employment.

5.47 A number of consultation responses commented on the continued use of youth rates within the minimum wage structure in the context of the new legislation, as we discuss below.

Stakeholders' Views

5.48 Trade union respondents to our consultation consistently argued that the age threshold for entitlement to the adult minimum wage rate should be lowered from 22 years of age. The TUC suggested this could be achieved by phasing down the age threshold over a number of years, beginning with 21 year olds. While several unions believed that the adult rate should, as a matter of principle, apply from the age of 16, there was a general consensus that, as a first step, it should apply from the age of 18 and that the 16–17 year old rate ought to be increased substantially. The YWCA England and Wales expressed concern that the low level of the 16–17 year old rate was causing poverty and hardship for some young women.

5.49 In the unions' view, a lowering of the age for entitlement to the adult minimum wage would not have an adverse impact on the employment prospects of young people. The Union of Shop, Distributive and Allied Workers (Usdaw) reported that many retailers already paid adult rates from the age of 18 for a variety of reasons including competitive pressures, to maintain morale among staff and in recognition of the fact that 18 is the usual age of maturity. The Transport and General Workers' Union (T&G) noted that where it had negotiated the removal of lower youth rates *'there is no evidence that this has led to a decrease in young people employed'*.

5.50 Responses from employer organisations were more cautious and stressed that the lower youth rates were necessary to ensure that young people's employment prospects were not damaged. The CBI noted that the incidence of low pay was considerably higher among younger workers and argued that the lower rates helped to maintain their employment levels and *'make up for lower productivity among younger and inexperienced workers'*. The British Chambers of Commerce indicated that the Youth Development Rate was already too high and should be scaled back to £4.35. There were few comments on the 16–17 year old rate, although the British Hospitality Association

> *'The rate for young workers aged 16 and 17 has been introduced at a modest level and should be substantially increased in future years. The TUC is keen to see the rate for this age group set at a level that will be high enough not only to prevent exploitation but also to send the message to young workers in their formative years that employment brings worthwhile rewards.'*
>
> **TUC evidence**

'The CBI has consistently argued that young workers are one of the most vulnerable groups in the labour market and inflexible minimum wages could threaten high unemployment among young people.'

CBI evidence

'Young people are one of the lowest paid and [most] vulnerable groups of workers, which is why they are the most in need of a decent level of wage protection. The current minimum wage of just £3 per hour [in September 2006] for 16 and 17 year olds does not provide adequate protection and leaves them open to exploitation by unscrupulous employers.'

BYC evidence

stated that its members had welcomed its introduction and it had not been a source of difficulty. The Business Services Association suggested that there was room to increase both the 16–17 year old rate and the Youth Development Rate at least in proportion to the next increase in the adult rate to ensure that the minimum wage provided sufficient work incentives for the young. It added that most of its members paid the full minimum wage regardless of age. However, the Newspaper Society was concerned that a higher rate for 16–17 year olds might reduce the number of entry level first jobs that provided a way into the newspaper industry.

5.51 Some respondents questioned the continued legitimacy of the youth rates following the introduction of new laws banning age discrimination at work. The British Youth Council (BYC) argued that lower statutory minimum wages for younger people contravened the spirit, if not the letter, of the legislation. It suggested that we had paid insufficient attention to the fact that a sizeable minority of young people had no choice but to leave school at 16 to seek employment. It added, *'Low pay can lead to problems around health, educational failure and social exclusion. The impact of this can be even more damaging for younger workers whose future may be at least partially determined by their first experiences of work.'* Usdaw suggested that the treatment of the youth rates under the age discrimination legislation might lead to a levelling down of pay rates for young people such that the adult rate became *'not a minimum but a maximum wage for young people'*, which would, in its view, undermine both the aim of the new provisions to reduce age discrimination and the aim of the minimum wage to increase pay.

The Role of the Youth Rates

5.52 In implementing the age discrimination legislation, the Government shared our concern that, without the flexibility afforded by the lower minimum wage youth rates, the employment prospects of young people could suffer. Our 2005 Report recorded our concerns that, if employers were required to pay the adult minimum wage rate to young workers, the already poor position of young people in the labour market might be exacerbated. The evidence we have examined in this chapter has shown that young people have continued to fare badly in the labour

market, with higher unemployment and inactivity rates and lower employment rates than older workers and there is some evidence that the position has worsened recently. We believe, therefore, that the principle of lower National Minimum Wage rates for younger workers continues to be justified as a protective measure. We note that the minimum wage exemption from the age discrimination provisions and pay practices in individual firms may be tested via legal challenges. We will continue to pay close attention to the position of young workers in the labour market and to the appropriateness of the lower rates for workers under the age of 22.

Twenty-one Year Olds

5.53 Since our First Report (1998) on the minimum wage, we have consistently recommended that 21 year olds should be entitled to the adult rate of the minimum wage. In our 2005 Report, we stated that it was important that the Youth Development Rate should remain in place but it should only apply to those age groups who were at risk of adverse employment effects arising from the minimum wage. We judged that the most appropriate cut-off point between the Youth Development Rate and the adult rate was the 21st birthday. However, we were disappointed to record in our 2006 Report that the Government had decided once again to reject this recommendation, citing concerns in its response to our 2005 Report that the economic evidence was mixed and that the employment prospects of 21 year olds remained behind those of 22 year olds and not much better than those of 20 year olds.

5.54 The latest data on 21 year olds indicate that, unlike 18–20 year olds, the labour market position of 21 year olds has improved since 2005. The earnings data also show that the overwhelming majority of 21 year olds are paid at least the adult rate of the minimum wage. Thus a move to lower the age threshold for entitlement to the adult rate from the 22nd to the 21st birthday is likely to have minimal impact on employers. **Therefore, we recommend again that 21 year olds should be entitled to the adult rate of the National Minimum Wage**.

"... caution is required to ensure that any increases in the NMW that might have negative employment consequences for younger workers are avoided. Younger workers are also typically less skilled and productive than older workers. For these reasons a lower National Minimum Wage development rate is in place that seeks to protect young workers while not jeopardizing their employment prospects."

Government evidence

Trainees

Introduction

5.55 We have always taken the view that the minimum wage should be sufficiently flexible to encourage employers to offer good quality training opportunities. Previous reports have examined the extent to which the National Minimum Wage is a factor in determining employers' training strategies and this section begins by considering recent findings from our research programme. We have been particularly concerned that the minimum wage should not disadvantage young people entering the labour market who may need to develop skills and experience in order to become fully productive members of the workforce. In our 2005 and 2006 Reports we looked in detail at two provisions designed to offer some recognition of the training costs incurred by employers and ensure that the minimum wage does not act as a barrier to training in the workplace: below we outline recent developments in relation to the Older Workers' Development Rate and the treatment of apprentices. A number of stakeholders commented this year on the recommendation in our 2006 Report that we review the exemptions for apprentices and report in 2008. We summarise the views expressed and review our earlier recommendation.

The Minimum Wage and Employers' Training Strategies

5.56 In previous reports we have examined the impact of the minimum wage on the provision of training by employers. For some, the minimum wage could act as a spur to increase training in order to improve productivity – for example by ensuring staff are multi-skilled to cover various roles. In contrast, other businesses may seek savings by cutting back on training of existing staff, or be more reluctant to take on new staff who require training. We have commissioned a number of research projects on this topic over the past few years, which found little evidence that the minimum wage has had any significant impact on the provision of training, although employers in the hairdressing sector have indicated a reluctance to hire older trainees on cost grounds. In general, the research has found that changes to training

provision are a response to changing business circumstances rather than being due to the minimum wage.

5.57 Following the more substantial upratings of the adult rate in recent years, we commissioned further research to examine whether there were any signs that the National Minimum Wage was now influencing firms' decisions about workforce training. Using the LFS, Dickerson (2007) found that the minimum wage appears to have had no statistically significant impact on the provision of job-related education or training. The result held true for different groups including men, women, adults and young workers. Similarly, in examining the impact of the minimum wage on 510 firms in three low-paying sectors, Denvir and Loukas (2006) found that only 6 per cent of firms made changes to training and skill levels that were attributed to the introduction or subsequent upratings of the minimum wage. Most commonly this was to justify changes in pay or increase staff flexibility. These findings may also help to explain why few employers have made use of the Older Workers' Development Rate.

The Older Workers' Development Rate

5.58 The Older Workers' Development Rate applied to workers aged 22 and over starting a new job with a new employer and doing accredited training on at least 26 days during the first six months of the employment. The rate had generally been set at the same level as the Youth Development Rate since the minimum wage was introduced in April 1999. As we discussed in our 2005 Report, it was intended as an incentive for employers to train new staff, but uptake had been consistently very low. The evidence suggested that this was due to a lack of awareness and to the complexity and costs associated with accredited training schemes. Our 2005 Report provisionally concluded that the Older Workers' Development Rate was unnecessary and this conclusion was confirmed in our 2006 Report. The Government accepted our recommendation and abolished the rate with effect from 1 October 2006. There was no comment on this step in our latest consultation evidence suggesting that, as we would have expected, there has been little impact.

The Apprenticeship Exemptions

5.59 We reviewed the twelve months' exemption from the minimum wage for apprentices under the age of 26 and the exemption for all apprentices under the age of 19 in our 2005 Report and concluded that they were working well. For the purposes of the minimum wage, apprentices are workers who either have contracts of apprenticeship or are taking part in specified Government training programmes. We were concerned, however, that the upper age limit of 26 for the twelve months' exemption might not be compatible with the Equal Treatment Directive (2000/78/EC). In our 2006 Report, we confirmed our provisional recommendation that this upper age limit should be removed. The Government accepted our recommendation and with effect from 1 October 2006, the one year exemption applies to all apprentices aged 19 and over with no upper age limit. This change, and the abolition of the Older Workers' Development Rate, were covered in the Employment Equality (Age) Regulations 2006 (DTI, 2006a). There has been no change to the treatment of apprentices under the age of 19.

5.60 In our 2004 Report we stated that we would wish to look at the position of apprentices and pre-apprentices in a few years' time and to consider whether the exemption for apprentices under the age of 19 should be retained following the introduction of the 16–17 year old rate in October 2004. We noted that pay rates for 16 and 17 year old apprentices were often low, to some extent reflecting the fact that the majority were working towards a level 2 qualification rather than more advanced qualifications. We expressed concern that the application of the minimum wage to these apprentices after one year of employment could deter employers from providing training.

5.61 However, in our 2006 Report we recorded the concerns of trade unions that the apprentice exemptions were being abused by some employers who offered little or low quality training and that low pay was contributing to high non-completion rates. We stated that it would be too soon to report on any impact of the abolition of the Older Workers' Development Rate or the removal of the upper age limit on the apprenticeship exemption in our 2007 report. The report also noted other developments in England such as the requirement introduced by the Learning and Skills Council (LSC) in August 2005 that waged

apprentices receive a minimum of £80 per week from their employer, and the extension of EMA entitlement to unwaged apprentices in April 2006. For these reasons we recommended in our 2006 Report that we review the apprenticeship exemptions and report in 2008.

Stakeholders' Views

5.62 Several trade unions referred to the recommendation in our 2006 Report and called for a review of the treatment of apprentices; in general they believed that such a review ought to lead to the removal of the minimum wage exemptions. The T&G and UNISON did, however, accept that there might be a need to apply a lower rate of pay to workers undergoing training. The TUC was concerned about the 'exploitative rates' paid to some apprentices and both UNISON and the BYC suggested this could lead to disillusionment on the part of young people, who might abandon their training in favour of, in the BYC's words, 'better paid, dead end jobs'. The Scottish TUC (STUC) focused on apprentices in its submission. It suggested that the exemptions were open to abuse and added that drop out rates in certain sectors such as hairdressing and hospitality were unacceptably high.

5.63 A number of respondents, including the TUC, STUC, BYC and the Equal Opportunities Commission (EOC), drew attention to the pay gap between male and female apprentices, largely a consequence of occupational segregation. A 2005 survey for the Department for Education and Skills (DfES, 2005b) had reported wide variations in apprentice pay in England. The research found that, since women made up the overwhelming majority of trainees in the lower-paying sectors such as childcare and hairdressing, the average pay of female apprentices was 74 per cent of that of male apprentices. A significant proportion of trainees in these two sectors received wages of less than £80 per week.

> *'The EOC considers it unacceptable that the skills to be acquired in the course of apprenticeships in sectors dominated by males should be paid more than those in sectors dominated by females, even before those skills have been fully acquired.'*
>
> **EOC evidence**

5.64 Since this survey was conducted, training providers have been required to ensure that employed apprentices in England receive a wage of at least £80 per week. In its evidence, the Government explained that it was felt necessary to provide a 'bottom line' for apprentice pay, so that it was at least on a par with the package of financial support available via other learning routes. This was also the rationale behind the Government's decision to remove the Minimum Training Allowance and

One in ten of the 4,174 respondents employed apprentices, with the highest proportions found in hairdressing, childcare and retail. The median hourly wage for first year apprentices was £3.60, while the median for second and third year apprentices was £4.25 and £5.00 respectively.

Low Pay Commission Employers' Survey 2006

extend entitlement to the EMA to unwaged apprentices in England (who make up around 15 per cent of all apprentices). The total financial support package for low-income families in England is now similar regardless of whether a young person remains in full-time education at school or college or enters work-based learning. Although the devolved administrations have been examining the merits of the English model, training allowances in the region of £40–£55 per week continue to apply to non-waged apprentices in Scotland, Wales and Northern Ireland.

5.65 In its evidence, the Scottish Executive wrote that it would like to see the exemptions for apprentices removed because of evidence of a link between low pay and low completion rates. It did not believe this would adversely affect take-up of apprenticeship programmes in Scotland. The Scottish Executive believed it would be simpler, as well as easier to enforce, if a minimum rate for apprentices was established within the minimum wage structure, rather than being set by the LSC in England.

5.66 There were few consultation responses from employer bodies on the topic of apprentices and they related to just one sector. The CBI reported that the minimum wage had had a negative impact on the capacity of the hairdressing sector to take on apprentices, stating that *'salons struggle in years two and three to pay trainees at a level above their economic worth'*. Similarly, the National Hairdressers' Federation (NHF) reported that salons were reluctant to recruit trainees over the age of 17 or 18 because of cost, but they were worried that new rules on age discrimination would mean they could no longer select only younger trainees. The NHF was also concerned that the £80 per week minimum pay requirement might exacerbate the problem and concluded that the minimum wage exemption for apprentices should apply for the whole period of training, which in hairdressing might be up to three years.

'We would recommend that the exemption for apprentices be increased to cover the duration of and participation in an externally accredited training programme or apprenticeship scheme.'

NHF evidence

Reviewing the Apprenticeship Exemptions

5.67 In its response to our 2006 Report, the Government said that it would consider carefully our recommendation that we should be invited to review the apprenticeship exemptions. We are disappointed that we are unable to record a definitive outcome in this report, but we look forward to receiving the Government's considered response to our

recommendation in the near future. The recent developments we have highlighted and the evidence received for this report have reinforced our belief that we should examine the minimum wage treatment of apprentices. **Therefore we reiterate our earlier recommendation that the Government invite us to carry out a full review of the apprentice and pre-apprentice exemptions and report in 2008.**

Conclusion

5.68 The labour market position of young people has been progressively worsening for some years but this seems to have further exacerbated since 2005. There has been a sharp decline in the employment rate of 16–17 year olds, accompanied by a corresponding rise in inactivity, which can partly be explained by their increased participation in FTE. However, we remain concerned about the number of 16–17 year olds who are NEET. Young people aged 18 to 21 have also experienced an increase in unemployment since 2004, especially among 18 year olds.

5.69 The causes of this decline remain difficult to explain but the evidence is strong enough to lead us to reiterate the importance of lower National Minimum Wage rates for younger workers in order to protect their employment prospects. Twenty-one year olds have seen their labour market position improve since 2005, unlike their younger peers. The earnings data also show that the overwhelming majority of 21 year olds are paid at or above the adult rate of the minimum wage. We have therefore repeated our recommendation that 21 year olds should be entitled to the adult rate of the National Minimum Wage.

5.70 We have not examined the minimum wage exemptions for apprentices in any detail in this report, but have reiterated our view that it would be appropriate for us to review their treatment under the minimum wage in our next report, which we anticipate will be in 2008.

Chapter 6

Compliance and Enforcement

The majority of employers support the minimum wage and comply fully with the legislation, but non-compliance remains a problem. The continued success of the minimum wage is therefore in large part dependent upon its effective enforcement. It is important for the majority of law-abiding employers, as well as for those workers who are denied their legal entitlement, that compliance is policed effectively and non-compliance is dealt with rigorously.

Some incidences of minimum wage non-compliance arise through genuine error or misunderstanding. Improving awareness is central to addressing such cases. We recognise that the Government has taken steps to promote greater awareness, but we believe more needs to be done. The situation is perhaps most acute in relation to migrant workers. Despite sharing a common goal, a number of different bodies are currently working independently to raise awareness of employment rights among migrant workers. We believe that a more cohesive approach would help to maximise the impact of the Government's limited minimum wage publicity budget. We therefore recommend that the Government work more collaboratively with other organisations to raise awareness of the minimum wage.

While some employers inadvertently fail to comply, there are others who deliberately set out to evade the minimum wage rules. In all likelihood, such rogue employers will also have scant regard for other employment and tax requirements. Many of these employers will be operating in the informal economy and the workers they employ will be those who are particularly vulnerable to exploitation.

We are encouraged by recent indications of the Government's desire to strengthen the enforcement regime, but we consider that there is still no effective deterrent to non-compliance and no real disincentive for firms

contemplating evading the minimum wage requirements. Non-compliance brings the minimum wage into disrepute and on any substantial scale will erode support for it. As we said in our 2005 Report, we do not find it acceptable that employers who underpay the minimum wage are not penalised as long as they pay up when challenged. Conversely, workers who are underpaid receive no more than their arrears of pay and as a result are worse off in real terms. The Government advised us in January 2007 that it was rejecting the recommendation we made in our 2005 Report to redress this imbalance. Although we understand the reasons given for not taking forward the recommendation, we strongly believe that a workable alternative solution needs to be found. We therefore recommend that, as a deterrent to non-compliance, the Government introduce a penalty to apply to any employer found to have underpaid the minimum wage. We also urge the Government to give further consideration to finding a means to compensate workers who have been underpaid. In addition, we believe that employers who flout their minimum wage obligations should be 'named and shamed'.

We support the Government's targeted enforcement programme but continue to believe that HM Revenue and Customs now needs to tackle a more substantial low-paying sector. In our 2006 Report we recommended that a low-paying sector that employed substantial numbers of migrant workers should be targeted, such as agriculture or food processing. In its response, the Government said that it would have been inappropriate to target such a sector for a number of reasons, one of which was a desire to avoid cutting across the work of the Gangmasters Licensing Authority as it was beginning operations. We understand the Government's position but, in the light of growing evidence that migrant workers are at greater risk of exploitation, we again recommend that the Government choose, as part of its enforcement programme, a low-paying sector with a high concentration of migrant workers to target in 2007/08. To avoid cutting across the work of the Gangmasters Licensing Authority, we suggest a focus on either the hospitality or cleaning sector.

Effective enforcement is important for both workers and good employers. We therefore warmly welcome the Government's commitment to increase the funding for minimum wage enforcement by 50 per cent, as announced in the Chancellor's pre-Budget Report in

December 2006 (HM Treasury, 2006c). We believe this provides the scope to make a significant impact on the enforcement of the minimum wage if appropriately directed. The Government has asked us to contribute to its deliberations on how to get best value from these increased resources and we welcome this opportunity.

Introduction

6.1 In our previous reports we have concluded that the vast majority of employers were complying with the minimum wage, but we have highlighted the informal sector as a key area of concern. In this report, we examine again how well the minimum wage is being complied with and how effectively it is being enforced, drawing on the evidence submitted to us, what we have been told during our programme of visits throughout the UK, and our research programme. This year we pay particular attention to the implications for compliance and enforcement of the arrival of a substantial number of migrant workers from central and eastern Europe (the A8 countries) following the enlargement of the European Union (EU) in 2004.

6.2 In this chapter we consider awareness of the minimum wage, the extent of non-compliance and its association with the informal economy, and migrant workers. We go on to examine recent developments in enforcement and consider evidence relating to the Employment Tribunal process. We then address the key area where we believe further action is required – the deterrent to non-compliance – before concluding by looking at the resourcing of enforcement activities.

Awareness

6.3 Awareness is central to the effective enforcement of the minimum wage. The minimum wage is largely self-enforcing and reliant on non-compliance being reported to HM Revenue and Customs (HMRC). Clearly, this can only happen if workers understand their entitlement and how to enforce it.

6.4 The Government accepted the recommendation in our 2005 Report that it review its minimum wage publicity strategy to consider how best to target low-paid workers more proactively, with a particular

emphasis on vulnerable groups of workers. In response, it carried out research to gain a better understanding of how best to inform ethnic minority workers about the minimum wage. It used the outcomes to inform the October 2006 upratings publicity campaign, which gave particular emphasis to raising awareness among ethnic minorities, women and young workers, as well as in the childcare sector which is the sector being targeted by HMRC's minimum wage enforcement teams during 2006/07.

6.5 In its evidence this year, the Government referred to the findings of the Department of Trade and Industry (DTI) Employment Rights at Work Survey of Employees 2005 (DTI, 2006f) in support of the effectiveness of its publicity on the minimum wage. The survey found that the vast majority of respondents (95 per cent) knew that workers aged 22–65 had a right to the minimum wage and nearly as many (93 per cent) knew that workers aged 18–21 were covered. There was, however, less awareness of how the minimum wage applied to those below the age of 18 and above the age of 65. The majority of respondents thought that the minimum wage rates were higher than the actual rates at the time of the survey.

'He's over 65, so the national minimum wage doesn't apply.'

Excuses, excuses…, HMRC press release, 2006.

6.6 We do not want to see overall awareness of the minimum wage diminish. The DTI's minimum wage publicity budget was substantially reduced in 2006/07. The DTI told us that this did not signify a lowering of the priority given to raising awareness, rather it reflected a more strategic approach to publicity developed in the light of its experience of the most effective ways to bring the minimum wage to the attention of vulnerable groups of workers. We have previously noted that, although awareness of the minimum wage is generally high, awareness of the specific rates is lower. Ensuring all affected workers know when the minimum wage rates are increased and to what level is essential if the minimum wage is to continue to be largely self-enforcing. While we do not believe that an effective publicity programme is necessarily dependent on the amount of money spent, we are concerned that the cut in publicity funding could be detrimental to the effectiveness of enforcement. We consider the resourcing of the Government's minimum wage enforcement effort later in this chapter.

6.7 The importance of awareness has been heightened by the arrival of a substantial number of migrant workers from the A8 countries since

2004. These workers are concentrated at the low-paid end of the labour market and many are more vulnerable to exploitation in the workplace than other workers, as they are less likely to be aware of their employment rights, including their entitlement to the National Minimum Wage. Raising awareness of the minimum wage among this group of workers has presented new challenges for the Government.

6.8 The Government has advised us of the work it has undertaken to inform migrant workers from the A8, as well as other migrant workers, of their rights to the minimum wage. It has produced information leaflets entitled 'Know Before You Go' in Polish, Lithuanian and Portuguese that have been disseminated in the respective countries and is seeking to work with other EU member states in a similar way. We fully support this approach, particularly as there is evidence that many workers sign up to employment contracts for work in the UK prior to arrival and that some of these contracts are clearly exploitative.

6.9 The DTI has also distributed information on the minimum wage and other employment rights in the UK through a variety of migrant organisations, including local community and church groups. Anecdotal evidence from our recent visits suggests that awareness among some migrant groups, and in particular Polish migrants, has increased as they have become more established in the UK and as local networks have developed.

6.10 HMRC's minimum wage helpline has for a number of years operated a 'language line' that caters for those who need help with communicating their requests for information or to make a complaint. This service is available to help migrant workers, as well as others who are unable to communicate in English. The Government has also advised us of the launch of the website Direct.gov.uk/employees to provide a central, accessible resource for individuals seeking information about their employment rights and responsibilities. The site had been developed to be user-friendly to individuals for whom English is their second language. A basic overview of how employment rights work in the UK has been included to assist migrant workers.

6.11 While we recognise the considerable efforts made by the Government to promote greater awareness, from the evidence we have considered in the course of the past year it is apparent to us that still more needs

to be done. A number of groups highlighted to us the significant incidence of ignorance of the minimum wage rules among migrant workers. We heard from some organisations, such as the TUC and the Recruitment & Employment Confederation (REC), of the work that they have been doing to raise awareness of employment rights, in some cases with support from the Government. Indeed, there appear to be a number of organisations that share the common goal of ensuring migrant workers are made aware of their employment rights, but there appears to be little co-ordination in the work they are doing. This is likely to lead to duplication of effort. A more cohesive approach by the Government would help to make the most of its limited minimum wage publicity budget. Such an approach would also help to avoid any confusion arising from the availability of a range of different materials. **We therefore recommend that the Government work more collaboratively with other organisations to raise awareness of the minimum wage.**

Non-compliance

6.12 Although it is accepted that the majority of employers comply with the minimum wage, we do not know the extent of undetected non-compliance. The Office for National Statistics (ONS) estimates that in April 2006, 336,000 jobs paid below the minimum wage (around 1.3 per cent of all jobs). However, for a number of reasons this figure cannot be used to determine the number of workers who are unlawfully paid below the minimum wage; for example, it will include apprentices covered by the minimum wage exemptions, those legitimately subject to the accommodation offset deductor, and also piece workers, whose productivity is below the piece rate threshold. Conversely, there will be workers who are not receiving the minimum wage but who do not show up in the official statistics, such as 'cash in hand' workers. We have therefore drawn on other information sources in our assessment of non-compliance, such as the work of HMRC's minimum wage team and evidence from our consultation and research.

6.13 First we look at HMRC's enforcement activities. Table 6.1 shows that over 61,000 enquiries were received by the HMRC Helpline during 2005/06, an increase of 7 per cent over 2004/05 and 15 per cent when compared with the number of calls received in 2003/04. Over 2,100 complaints about non-

payment of the minimum wage were received in 2005/06, an increase of 7 per cent over 2003/04 and 10 per cent over 2004/05. HMRC completed around 4,900 investigations into minimum wage underpayment in 2005/06, which arose either from complaints made by a worker or a third party, or were identified through its risk assessments of employers that were considered most likely to be non-compliant. The Government advised that the number of completed investigations in each of the last three years has decreased, largely due to the increased complexity and technical nature of many of the investigations being undertaken.

Table 6.1
National Minimum Wage: Enquiries and Complaints to the Inland Revenue/HMRC, and Enforcement Action Taken, 2003–2006

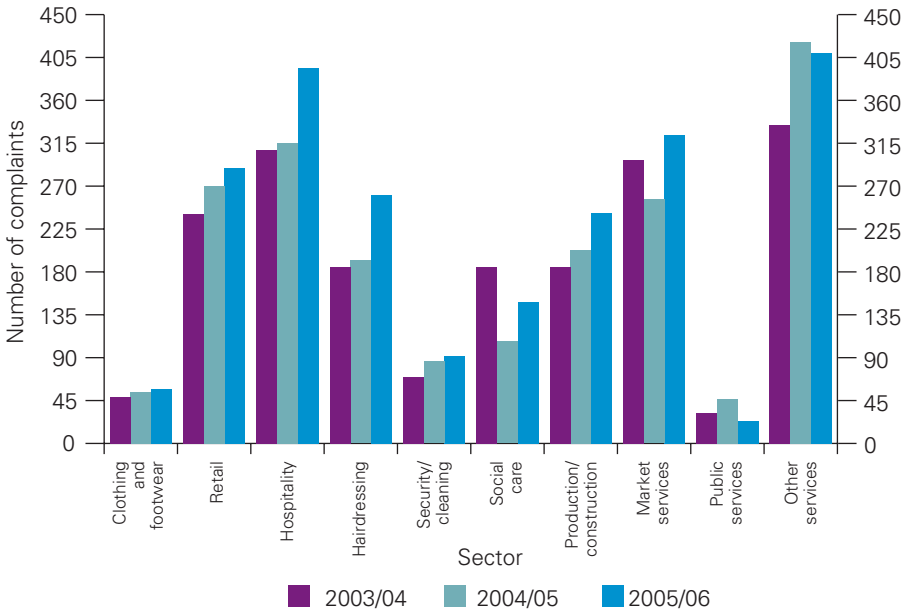
	2003/04	2004/05	2005/06	April to September 2006
Enquiries received by the Helpline	53,226	57,733	61,355	25,044
Complaints of underpayment	1,969	1,910	2,100	968
Visits to employers[1]	5,541	5,155	4,904	1,712
Enforcement notices issued	45	32	81	35
Penalty notices issued	3	0	1	0
Value of underpayments identified	£2.5 million	£3.8 million	£3.3 million	£1.4 million

Source: DTI, HMRC, UK, 2003–2006.
Note:
1. These figures are for the number of cases closed with an inspection having been made.

6.14 The incidence of non-compliance found during HMRC investigations has fallen over the last few years from 39 per cent in 2003/04 to 32 per cent in 2005/06. The total arrears identified have fluctuated quite significantly between years: arrears totalling just over £2.5 million were identified in 2003/04, rising to nearly £3.8 million in 2004/05, but subsequently dropping in 2005/06 to just below £3.3 million. The average arrears per worker in 2005/06 was £130, considerably lower than in the previous two years, mostly due to an increase in the number of workers involved in the cases where non-compliance was found. There were 2,211 cases of employer non-compliance found in 2003/04 which involved a total of 9,428 workers, whereas there were only 1,582 cases in 2005/06, but they involved 25,314 workers. A relatively few large cases, in terms of arrears or workers, can have a major impact on the results.

6.15 Figure 6.1 shows the breakdown of complaints by sector over the last three years. The hairdressing and hospitality sectors both saw a substantial increase in complaints over this period (41 per cent and 28 per cent respectively). The increase in complaints from the hairdressing sector between 2004/05 and 2005/06 was particularly marked at 36 per cent, but reflects HMRC's targeted enforcement campaign in the hairdressing sector (which we look at in more detail below). The reason for the increase in complaints in the hospitality sector is unclear.

Figure 6.1
Complaints to the HMRC Minimum Wage Helpline by Sector, UK, 2003–2006



Source: HMRC, UK, 2003–2006.

'... enforcement will become a major issue this year. We believe this for two reasons. First the increase in the minimum wage may well be enough by itself for more employers to try to evade paying the new rate. Second ... the increasing use of migrant labour in the UK economy.'

Usdaw evidence

6.16 There is a danger that the credibility of the minimum wage could be harmed if non-compliant employers are able to evade paying minimum wage arrears, or if they continue to be non-compliant following enforcement action by HMRC. Previous work by HMRC resulted in new checks to ensure arrears were paid following an investigation and the adoption of a risk-based approach that seeks to identify employers most at risk of returning to non-compliance. Where non-compliance persists, HMRC will now consider the option to prosecute repeat offenders, as we outline below.

6.17 We welcome this determination to tackle recalcitrant employers, especially as evidence presented to us during our consultations over

the last few years has highlighted the ongoing problem of non-compliance. Although by its very nature the scale of non-compliance is difficult to determine, there is a perception that the problem might be growing, particularly in respect of certain groups of workers.

6.18 Leicester City Council (LCC) advised us that its experience of encouraging take-up of the minimum wage suggested that underpayment was endemic in some communities, particularly those with high densities of ethnic minority populations. However, it has found it increasingly difficult to persuade underpaid workers to make a formal claim for the minimum wage, and suggested that one reason for this was an increased perception that minimum wage enforcement was weak. The National Group on Homeworking (NGH) raised concerns about the effectiveness of enforcement in tackling non-compliance in relation to homeworkers, as detailed in Chapter 4.

The Informal Economy

6.19 The extent to which current enforcement activities can effectively tackle minimum wage underpayment in the informal economy is of concern. This has been an issue over a number of years, but was further highlighted this year in relation to the exploitation of migrant workers. It has been suggested that enforcement is too often concentrated on the easy to reach employers rather than those who run more covert employment operations.

6.20 Reaching those in the informal sector is clearly difficult and it is a problem faced by other Government enforcement teams, such as the Health and Safety Executive (HSE) and HMRC's tax officers. Enforcement is particularly difficult in cases where there is collusion between employers and workers. Research commissioned for our 2005 Report (Ram, Edwards and Jones, 2004) suggested such collusion could be relatively common in some sectors and that there were a variety of reasons why a worker might be willing to accept pay below the minimum wage rate, for example to remain eligible for working tax credits while receiving some wages on a 'cash in hand' basis.

6.21 We received anecdotal evidence suggesting that an increase in the number of migrant workers, both those legally entitled to work in the UK and those here illegally, was exacerbating the difficulties of

'Enforcement/ Compliance has not been strengthened despite numerous assurances and commitments by the Government. Whilst acknowledging the success of the NMW the legislation continues to let down workers in low paid industries, particularly in the informal sector.'

Community evidence

enforcement in the informal economy. These workers tended to be less aware of their employment rights, and were less likely to complain about infringements of these rights.

6.22 To help tackle the problem of illegal migrant workers the Government introduced the Home Office-led Joint Workplace Enforcement Pilot (JWEP). It was launched in the West Midlands on 5 September 2005 as a three-year pilot to explore the scope for closer coordinated working between Government workplace enforcement and compliance departments for the purpose of tackling both the use and exploitation of illegal migrant workers. Those involved include the UK Immigration Service, HMRC, the DTI, the Department for Work and Pensions, the HSE and the Gangmasters Licensing Authority (GLA).

6.23 The pilot is considered by the Government to be progressing well, with the foundations in place for full joint enforcement and compliance activity. Data sharing gateways have been opened between all departments involved in the JWEP. However, the project is still in its infancy and it is too early to assess whether the JWEP model will provide better and more cost-effective results compared with departments working independently. While we are frustrated that the rate of progress is not swifter, we do believe that such a collaborative approach to enforcement is a very positive step forward. We will continue to monitor developments with interest and hope to able to report concrete outcomes in our next report.

‘From organisations working directly with migrant workers, we regularly hear reports that they are specifically warned by their employers (or agencies) not to approach a Citizens Advice Bureau for advice. Such is the fear of victimisation and dismissal amongst such workers that they are fearful of making even an anonymous or third party complaint to the NMW Helpline.’

Oxfam evidence

Migrant Workers

6.24 In Chapter 4 we looked at the changes in the labour market as a result of the arrival of migrant workers from the eight central and eastern European accession countries. We received a substantial body of evidence in response to our consultation, and during our visits throughout the UK to meet employers, workers and their representatives, about the problems being faced by migrant workers. We received specific and anecdotal evidence of minimum wage underpayment. Although in some cases the hourly rates of pay were evidently below the minimum wage, in others the position was less clear. For example, the weekly rate of pay was set at or above the level of the minimum wage, but the worker was required to work in excess

of his or her contracted hours which brought the hourly rate below the minimum wage. However, the key problem highlighted was of excessive deductions from pay for accommodation and other services. This issue arose particularly in relation to migrant workers employed through agencies and we explore it further below.

6.25 The research we commissioned by French and Möhrke (2006) found that firms employing migrant workers directly were largely compliant with the minimum wage. However, it also reported, albeit based on a small sample, that where the worker was employed through an agency, there was evidence of abuse, in particular under or non-payment of wages and excessive deductions.

6.26 Since November 2004, HMRC's minimum wage team has carried out checks on a sample of employers who use migrant workers. Each month 15 employers are selected from around the UK on the basis of a risk assessment and using information taken from the Workers Registration Scheme. Between November 2004 and December 2006, 20 per cent of the employers investigated were found to be non-compliant, with arrears of £144,000 identified for 1,171 workers.

Agency Workers

6.27 The evidence we received in respect of workers employed through agencies or gangmasters highlighted a number of problems, as noted in Chapter 4, nearly all in respect of migrant agency workers and it is this group that we concentrate on here. We were informed that these workers were often particularly vulnerable to exploitation as they were less aware of their employment rights or less likely to enforce them for fear of losing their job. While most agencies comply fully with the minimum wage, the level of deductions made by some was the key concern and anecdotal evidence suggested that in the worst cases these could reduce take-home pay to very low levels.

6.28 The TUC suggested that many of the problems faced by migrant workers were associated with employment agencies and was concerned that, as well as abuse of the accommodation offset, *'... many employers and employment agencies make illegal deductions for transport, meals, utilities and even so-called "administrative fees" in the case of some employment agencies'*. It called for such practices

A Citizens Advice Bureau said that a key problem facing migrant workers in the hospitality sector was that they were often paid a fixed weekly amount irrespective of the number of hours worked. Although the workers had been content with the level of pay when signing their contract, most ended up being required to work significantly more hours than they expected, often around 70 hours a week.

Low Pay Commission visit to Fort William

'The workers can't speak English' and 'they can't cope on their own and it's more than they would get in their own country.'

Excuses, excuses ..., HMRC press release, 2006.

to be stamped out. The Transport and General Workers' Union (T&G) raised similar concerns. The French and Möhrke research found that some agencies used the provision of services as a means to deduct substantial sums from migrant workers' pay at source, often in exchange for poor quality accommodation or even for services that were not in fact provided.

6.29 LCC also noted that agency workers, particularly migrants, were less aware of their rights and reluctant to complain in case they received no more work. It was concerned about reports of workers being offered services as an option, when in effect they had little real choice but to accept them.

6.30 Problems experienced by migrant agency workers were also raised when we met the London Citizens Workers' Association (LCWA). It advised that exploitation of agency workers in London, in particular cleaning, catering and security staff, most of whom were migrants, was widespread in the hotel sector and in museums and universities. There was a range of problems arising, including piece-rate work for cleaning where making the minimum wage in the allocated time would be impossible and reports of 2–3 days of unpaid training, illegal deductions from pay and inaccurate payslips. The LCWA advised that there was a growing use of contractors and agencies by mainstream employers (in the public and private sectors) and that this was creating a distance between the ultimate customer and responsibility for workers' welfare.

'... [there are reports of] agencies supposedly giving workers a choice but then changing shift patterns or not offering them work if they choose to make that choice.'

LCC evidence

6.31 We are concerned by the evidence that has been presented. However, we do not believe that the introduction of new rules within the minimum wage legislation would be an effective means to tackle the problem of excessive deductions from pay. In the case of accommodation, specific protection already exists in the form of the offset, although we know that there is some non-compliance. The National Minimum Wage Regulations make clear that deductions for uniforms and other equipment or tools required for the job, or any deduction which is for the employer's own use or benefit, must not bring pay below the minimum wage. For other goods and services, the regulations require that workers must have freely chosen to purchase goods (such as meals) or services (such as transport) from the employer.

6.32 To regulate further against excessive deductions would require the development of a general test of whether a worker had a genuine free choice. Herein lies the difficulty. The lack of a simple and robust test of choice, as we noted last year in respect of the accommodation offset, would apply equally to other services and goods. Also, any changes would be likely to affect adversely those workers who genuinely wished to purchase goods and services from their employer (for example discounted goods). Instead, we propose that in tackling excessive deductions, the emphasis should be on effective enforcement. Where deductions bring the level of pay below the minimum wage, HMRC or an Employment Tribunal has a role in determining whether the worker has been underpaid or if there was a genuine choice to purchase the goods and services in question from the employer.

6.33 Two Government bodies have specific responsibilities for enforcement in relation to the agency sector, in addition to HMRC's role in enforcing the minimum wage. We look at each in turn.

Employment Agency Standards Inspectorate

6.34 The activities of employment agencies and employment businesses are regulated by the Employment Agencies Act 1973 (as amended) and by the Conduct of Employment Agencies and Employment Business Regulations 2003. The Act is enforced by the DTI's Employment Agency Standards (EAS) Inspectorate. It operates a helpline and has twelve regionally based inspectors who have the power to inspect premises and check relevant records or documents. The EAS Inspectors follow up complaints made and carry out random checks. Ultimately agencies can be fined £5,000 per offence and a company or an individual can be prohibited from carrying on an agency business for up to ten years. The EAS inspectorate has an important role in taking action against agencies that impose charges for services as a condition of employment.

6.35 As part of the follow up to the DTI's *Success at Work* policy statement (DTI, 2006e), an amendment to the Conduct Regulations covering agencies is proposed. At present the Regulations clearly prohibit the take-up of services as a requirement of being offered work, but the right to withdraw from such services at a later date is less clear.

Consideration is being given to an amendment that will seek to tighten the Regulations to make explicit the worker's right of withdrawal from a service (DTI, 2007g). Although this on its own will not address the problem of excessive deductions, it will provide helpful clarification and assist the relevant Government bodies to take appropriate enforcement action.

Gangmasters Licensing Authority

6.36 The GLA was set up in April 2005 and aims to curb the exploitation of labour within the agriculture, horticulture, fish processing and shellfish gathering industries, or in the packaging or processing of these products. The GLA has been processing applications for licences from labour providers since April 2006, but it did not become an offence to operate without a licence until October 2006. From December 2006 it was also an offence to use an unlicensed gangmaster. There are stiff penalties for operating without a licence – up to a maximum ten years imprisonment and/or a fine on conviction. A labour user engaging an unlicensed labour provider faces up to 51 weeks imprisonment and/or a fine on conviction.

6.37 The GLA's compliance team is responsible for carrying out compliance inspections on GLA licence holders, using risk-based assessments coupled with a random element to identify those to be inspected. The GLA's Licensing Standards (GLA, 2006), against which licence applications and subsequent compliance inspections are assessed, include key areas of interest to us, such as the payment of wages and improper deductions, and workers' accommodation. The Licensing Standards specifically state that the worker must be *'paid at least the national or agricultural minimum wage, taking into account the rules on the accommodation offset'* and this standard has been given a 'critical' category (the most serious category of non-compliance). In addition to its own compliance team, the GLA works closely with other Government departments and agencies to share intelligence to ensure legal requirements are met and enforced.

Developments in Enforcement

6.38 In this section we consider the work that is being taken forward to improve enforcement of the minimum wage.

Targeted Enforcement

6.39 In 2005 the Government announced a strategy of targeted enforcement in the low-paying sectors (DTI, 2005a). The aim of this strategy is to improve compliance by raising the profile of the minimum wage in each sector in turn and by addressing sector-specific minimum wage concerns, followed by an enforcement drive, encouraging workers paid below the minimum wage to come forward. Hairdressing was selected as the first sector to be targeted.

6.40 In its evidence, the Government advised that during the hairdressing sector campaign there were 629 compliance cases registered – 368 selected as part of the project and the remaining 261 arising from complaints from workers or based on third party information. Five hundred and four cases had been investigated and closed. Of these, around half of the employers were found to be non-compliant, with arrears of £380,000 identified for 491 workers, the vast majority of whom were women. In a significant number of the cases where underpayment was found, it related to apprenticeships or training, for example failure to increase the rate of pay at the end of the apprenticeship period.

6.41 Working with the DTI and HMRC, we commissioned research by Croucher and White (2007) to examine the effectiveness of the targeted enforcement campaign in raising awareness and understanding of the minimum wage in the hairdressing sector. The findings suggest that the campaign has been a modest success, but that overall awareness of the minimum wage among both employers and staff in this sector remains patchy. Trainees in particular had low levels of awareness and understanding of the minimum wage. This was the first targeted enforcement campaign and, as would be expected, it has flagged up some areas for improvement. We have shared the findings of this research with the DTI and HMRC and hope that they will find them helpful in informing future campaigns. The Government's initial assessment of the first campaign is that it has

been successful, but it has recognised the need to evaluate the outcome further, drawing on the findings of the Croucher and White research.

6.42 In July 2006 the DTI announced that the childcare sector had been chosen as the second sector for targeted enforcement during 2006/07 (DTI, 2006g). It noted that targeting this sector fitted well with the wider Government initiative to improve childcare services and a recommendation by the Women and Work Commission in 2006 that *'targeted enforcement of the National Minimum Wage should be directed at sectors employing large numbers of women'* (Women and Work Commission, 2006).

6.43 While we fully support the targeted enforcement programme, we have previously expressed the view that HMRC needs to tackle a substantial low-paying sector at the earliest opportunity. In our 2006 Report we recommended that a low-paying sector that employed a substantial number of migrant workers, such as agriculture or food processing and packing, should be targeted as a priority within the programme. In its evidence, the Government confirmed its support for this recommendation for the longer term, but concluded that it would be inappropriate to target such a sector in 2006/07 for a number of reasons. In particular, a delay would enable revised guidance on the accommodation offset to be issued; would avoid tackling a sector likely to have high levels of illegal working until the Government could take advantage of the lessons and outcomes from the JWEP; and lastly would avoid targeting a sector which would cut across the work of the GLA. The Government advised that these issues would be reviewed during 2007 when it considered the next sector for targeted enforcement.

6.44 While we can understand the Government's position, we believe that the evidence of exploitation of migrant workers is compelling and has heightened our belief that it needs to be addressed as a priority. **Therefore we recommend that the Government, as part of its enforcement programme, choose a low-paying sector to target in 2007/08 that has a high concentration of migrant workers.** To avoid cutting across the work of the GLA at this early stage in its operation, we suggest that either the hospitality or cleaning sector, where there is evidence of abuse of migrant workers, would be an appropriate alternative to the sectors recommended last year.

Enforcement and Penalty Notices

6.45 In our 2005 Report we reported on a package of technical measures that the Government was introducing in the Employment Relations Act 2005 to help enforcement of the minimum wage. Two of the measures related to the treatment of Enforcement Notices. Under the 1998 National Minimum Wage Act, compliance officers were unable to withdraw enforcement notices, which set out arrears due to workers, even if new evidence came to light or an error had been made. The position was the same for Penalty Notices issued to employers who refused to comply with Enforcement Notices and the only way for notices to be rectified was through an Employment Tribunal. This created a number of enforcement problems which were subsequently addressed by the 2005 Act.

6.46 The Government has since reviewed the use of Enforcement and Penalty Notices and in January 2007 it announced a new policy to fine, on a consistent basis, employers who ignore an official demand to pay the National Minimum Wage, through the issue of Penalty Notices as provided for in the minimum wage legislation. We welcome this development.

Criminal Prosecutions

6.47 The National Minimum Wage Act 1998 provides for criminal prosecutions for six offences relating to the minimum wage. These include refusing or wilfully neglecting to pay the minimum wage and furnishing false records or information. The penalty is a fine of up to £5,000 for each offence. To date the Government has not taken forward any criminal prosecutions under the minimum wage. However, it confirmed in its evidence that, in December 2005, the DTI had agreed a criminal prosecutions strategy with HMRC and the Revenue and Customs Prosecutions Office (RCPO) and that a dedicated team had been recruited within HMRC to investigate cases for criminal prosecutions. HMRC compliance officers have put a number of cases to the prosecutions team for consideration and a few have been submitted to the RCPO to examine with a view to taking them through to criminal prosecution.

6.48 We welcome the Government's commitment to prosecute those employers who persistently flout the minimum wage rules. We are also pleased that the Government proposes to publicise these cases widely as a deterrent to others. However, the proposal to take forward only a handful of prosecutions each year is disappointing and we are not convinced that it will be sufficient to serve as a deterrent to seriously non-compliant employers. Employers contemplating non-compliance need to know that there is a real risk that they will be prosecuted if they commit one or more offences under the National Minimum Wage Act. Only by adopting a tough and systematic approach to prosecutions is this likely to be achieved. We consider other elements of the deterrent to non-compliance later in this chapter.

Employment Tribunals

6.49 The employment tribunal system provides an important means for workers to pursue claims for underpayment of the minimum wage. In 2005/06, there were 440 minimum wage applications registered by tribunals. This is fewer than the number registered in previous years, but direct comparison cannot be made as the way in which data are collated by tribunals has changed.

'... the Employment Tribunal system is fundamentally weak – if an employer wants to avoid meeting his/her statutory obligations there is practically an open door for them to do so.'

LCC evidence

6.50 The effectiveness of the tribunal system was raised by some organisations during our consultation. There was general support for it, but there was a growing concern about the number of employers failing to pay tribunal awards. A tribunal does not have the power to enforce the award and the worker must seek payment through the civil court system. Although tribunal awards were seen by consultation respondents as a good enforcement tool, with publicised successes sending an important message to employers, there were fears that this could be undermined if no action was taken against employers who failed to pay tribunal awards.

6.51 LCC advised that the Leicester Minimum Wage Project had obtained 12 successful tribunal decisions on behalf of workers, but that none of the awards had been paid. It highlighted that for a worker to take action through the civil courts to enforce an award was costly, complex and offered no guarantee of return.

6.52 No data are available to show the extent of non-payment of tribunal awards in respect of the minimum wage, but we share the concerns raised in our consultation about the need to tackle robustly those employers who show no regard to the awards made. We understand that this issue is not specific to the minimum wage, but could also apply to awards made under other jurisdictions. The Tribunals, Courts and Enforcement Bill (Department for Constitutional Affairs, 2006) currently going through Parliament includes proposals that might help to address some of the problems highlighted. We will monitor developments closely.

6.53 The TUC also noted that tribunals could only hear cases brought by individual workers and argued that this was a strong barrier to effective enforcement. It suggested that many workers with minimum wage problems were too scared to enforce their rights for fear that they would suffer some form of retribution from their employer. It called for trade unions to be able to bring cases to employment tribunals on behalf of groups of workers as a means of strengthening workers' ability to assert their rights to the minimum wage.

'... most workers fear to be the first to submit an ET [Employment Tribunal] application. This is one reason why silence may reign even in workplaces where dozens of workers are being underpaid.'

TUC evidence

Deterrent to Non-compliance

6.54 There are a range of measures that already exist under the minimum wage legislation to penalise employers who do not adhere to the requirements of the minimum wage. To date, however, they have been little used. We therefore welcome the Government's recent commitment to address this. We have noted how criminal prosecutions are being taken forward and the Government's new policy to fine on a consistent basis employers who ignore an official demand to pay the National Minimum Wage through the issue of Penalty Notices. Both developments are a positive step forward, but we do not believe they go far enough.

6.55 Employers who make good minimum wage arrears identified by HMRC within a prescribed timescale do not suffer any financial penalty. Conversely, the workers who receive arrears of pay do not receive any recompense for the fact they have been underpaid. In our 2005 Report, we sought to address this disparity by recommending that interest charges be payable on arrears arising from minimum wage

underpayment. However, the Government advised early in 2007 that, after careful consideration, it had decided to reject this recommendation. It explained that, in addition to practical difficulties in taking it forward, the amounts of interest that could reasonably be levied would be insufficient to act as a real deterrent to employers.

6.56 We are disappointed that our recommendation was not accepted. Although we understand some of the practical difficulties it presented, we are not persuaded that the small sums of money that on average would arise through interest being payable on minimum wage arrears is justification not to take action. We continue to believe that a worker who has been underpaid the minimum wage has a right to be compensated. The requirement for the employer simply to repay the money that the worker should have received at the outset is insufficient. We have been told that some employers deliberately delay payment knowing that as long as they pay in the end there will be no adverse consequences for them. In the meantime, they may have accrued interest on the underpaid wages, which might be considered as equivalent to the worker providing the employer with an interest free loan. A means therefore needs to be found to address this imbalance and we urge the Government to give further consideration to how this could best be tackled.

6.57 The lack of an effective deterrent was raised several times during our consultation. Community called for much stronger penalties, to include a large fine and interest on the amount owed to the employee. It also wanted defaulting employers to be named and shamed. The T&G believed that companies should be fined sufficiently to penalise non-compliance and to provide a real disincentive. It called for such fines to be used to fund further enforcement activity. It also supported the introduction of a 'name and shame' policy.

'There is an incentive not to pay NMW for unscrupulous employers because if found out (and it still is a big 'if'), there is only a slap over the wrist if they are prepared to fund the arrears.'

Community evidence

6.58 The TUC noted that taking forward prosecutions was a good step, and hoped it would send a strong message to employers. However, it argued that the maximum penalty allowed by the law was not commensurate with the worst offences uncovered by HMRC. It called for a substantial increase to the current penalties under the minimum wage legislation.

6.59 We believe it is essential that employers who underpay the minimum wage are penalised to an appropriate degree. At present, however, the minimum wage legislation has no provision to enable this so long as the employer makes good minimum wage arrears within a prescribed timescale; only those who refuse to pay arrears might have a penalty applied. This in effect means that there is no deterrent to non-compliance and is unacceptable. **We recommend that, as a deterrent to non-compliance, the Government introduce a penalty to apply to any employer found to have underpaid the minimum wage.** We also believe that a consistent 'name and shame' policy should be put in place to expose those employers who show wilful disregard for the minimum wage.

6.60 An independent review of penalties for failure to comply with regulatory obligations, led by Richard Macrory, Professor of Environmental Law at University College London, was published in November 2006 (Macrory, 2006). The review found that the current system is heavily reliant on criminal prosecution and that the use of administrative fines and other non-criminal penalties could resolve some cases more quickly and effectively. It recommended the use of financial penalties that deter non-compliance and change behaviour as part of a flexible enforcement regime. Although the National Minimum Wage is outside the scope of the review, the DTI has advised that its enforcement regime is being developed in line with the Macrory principles. We hope that the review will add impetus to our call for an effective deterrent to minimum wage non-compliance.

Resourcing Enforcement Activities

6.61 We recognise the valuable work carried out by HMRC and its efforts to develop the effectiveness of its enforcement activities. To be able to continue to tackle non-compliance successfully, it needs to be resourced appropriately. We therefore welcomed the Chancellor of the Exchequer's pre-Budget announcement in December 2006 (HM Treasury, 2006c) that funding for enforcement of the minimum wage is to be increased by 50 per cent.

6.62 We have noted above a concern that, as the minimum wage increases, more employers will be tempted to underpay, particularly if there is no

'The maximum penalty of £5,000 is very low indeed when compared with, say, the law that protects trademarks, where the maximum penalty is an unlimited fine and up to 10 years in prison. The maximum penalties for denying low paid workers the minimum wage should value their rights in a similar way to the value put on the right of companies to protect their trademarks, which means a substantial increase to the current penalties in the NMW Act.'

TUC evidence

'Public and Commercial Services Union members in Her Majesty's Revenue and Customs enforce the NMW. To do so they need to be given full and adequate training and resources to carry out this important role.'

Public and Commercial Services Union evidence

real penalty attached to non-compliance. Some unscrupulous employers will have become more adept at avoiding payment of the minimum wage and the time needed by HMRC to tackle these employers will inevitably increase, as noted by the Government in its evidence. The development of targeted enforcement, although positive, has so far not been assigned any additional resources and therefore has reduced the resources available for other enforcement activities. We have also looked in this report at the changes in the labour market due to the increase in the number of migrant workers and the particular difficulties that have arisen as a result.

6.63 A number of organisations called for an increase in resources to enforce the minimum wage in their evidence to us. Usdaw believed that enforcement should be given greater priority as it was likely that more employers would evade paying the minimum wage as the rates increased, and as the number of migrant workers grew. Community pointed out that the budget for enforcement had been frozen for a number of years and suggested that this had assisted unscrupulous employers. Oxfam expressed the view that HMRC's minimum wage enforcement team was under-resourced to deal with the scale and complexity of non-compliance by employers of both migrants and homeworkers working in the informal economy, as well as in sectors of the formal economy where margins were particularly tight and therefore there was a greater incentive to underpay the minimum wage.

'STUC believes that now is an appropriate time to commit further resources to enforcement, particularly in light of the growing evidence of abuse in relation to migrant workers.'

Scottish TUC evidence

6.64 The Government's additional funding for minimum wage enforcement is encouraging and should provide the opportunity to increase considerably the impact of enforcement activities. It is crucial, however, that it is directed appropriately. We are pleased that the Government has sought our input to its deliberations about how to get best value from these increased resources.

Conclusion

6.65 In this chapter we have highlighted a number of positive developments in relation to awareness and enforcement of the minimum wage. We have described the significant efforts to improve awareness of the minimum wage, as well as understanding of other employment rights,

among migrant and other vulnerable groups of workers. But we have also concluded that more needs to be done in order to maintain support for the minimum wage from the vast majority of law-abiding employers and from workers. We believe that the steps we have recommended in this chapter will strengthen both the effectiveness of enforcement and the deterrent to non-compliance, helping to ensure that more workers benefit from the minimum wage upratings that we recommend in the next chapter.

Chapter 7

Setting the Rates

The minimum wage is a successful policy that commands widespread support. Evidence at the macro-economic level continues to suggest that it has benefited many low-paid workers without any significant negative impact on the economy. However, the overall evidence drawn from the past two years paints a more complicated picture. Although the UK economy did less well than we anticipated when we made recommendations in February 2005, it is expected to grow at or above trend during 2007. Company profitability looks healthy but price inflation has grown more strongly than anticipated. Average wage growth has been subdued throughout 2006, but there are signs that wage pressures may be growing.

Labour market data also provide mixed messages. Over the past year there have been increases in the number of people in employment but, simultaneously, the number of people out of work has also increased. For the first time since the introduction of the minimum wage, there has been a fall in the number of jobs in the low-paying sectors.

The Government asked us to take into account, as part of this review of the minimum wage, the planned rise in the statutory annual leave entitlement and we have done so as part of our consideration of relevant economic factors. Our analysis suggests that the majority of employers will be unaffected and that the overall impact on the economy as a whole will be small. However, for some employers the impact of the forthcoming increase in holiday entitlement could be significant and a disproportionate number of those affected are likely to be in low-paying sectors.

Throughout our consultation for this report most employers and their representative organisations voiced support for the minimum wage in principle, but many said they had growing reservations about the scale

of recent increases. Conversely, trade unions and some others considered that the minimum wage could and should be increased significantly above the projected increase in average earnings. They believed that this could be done without putting jobs at risk or harming the economy as a whole.

Nearly all of those consulted accepted that the minimum wage should be uprated this year, but there was no agreement as to the appropriate amount. The CBI said that, while the minimum wage should not be allowed to wither on the vine, it was time to call a halt to increases above the growth in average earnings and suggested that an increase in line with prices would be appropriate. The TUC, on the other hand, did not think the minimum wage had reached its optimum level and called for an increase above the projected rise in average earnings.

Weighing the evidence, we came to the conclusion that the present situation requires a more cautious approach than in recent years. The bite of the minimum wage has increased. Using an alternative methodology developed over the past year our calculations suggest that coverage may be significantly higher than previously estimated. There is growing evidence of an impact on pay differentials, particularly in the retail and hospitality sectors. The impact of the substantial 2006 uprating has yet to be fully appraised. The forthcoming increase in annual leave entitlement will add to the costs of some employers in low-paying sectors. There are concerns about price inflation feeding into wage inflation. And, for the first time since the introduction of the minimum wage, there has been a fall in employment in the low-paying sectors. Taken together, we believe that these factors make the case for caution this year.

We therefore recommend that the adult rate of the minimum wage should be increased to £5.52 in October 2007. This is less than the predicted increase in average earnings, but more than the predicted increase in prices and is broadly in line with current pay settlements. We recommend that the Youth Development Rate should increase from £4.45 to £4.60 and that the 16–17 year old rate should increase from £3.30 to £3.40 in October 2007.

We believe that, as the bite of the minimum wage increases, it becomes more important to take decisions based on the most up to date data

available. That is why in this report we are making recommendations for minimum wage rates for October 2007 alone. We recommend that the Government invite us to make recommendations for October 2008 in early 2008. Our present view, drawing on the analysis we have made for this report, is that the increases we are likely to recommend for 2008 will be around the predicted rise in average earnings, but much will depend on what happens between then and now in the economy and the labour market. Two of the most important factors will be the movement in average earnings and the level of employment – especially employment in the most affected sectors. We will also want to take account of price inflation and whether it falls back in 2007 as predicted.

After four years of substantial increases, this year we have proposed a relatively modest increase, although one in line with the majority of recent pay settlements. However, this year's recommendation needs to be seen in the context of the sequence of recommendations we have made over the last eight years.

Introduction

7.1 The main factors we considered when we met in January 2007 to agree our recommendations were: the impact of the minimum wage so far (set out in detail in Chapters 2 to 5); the prospects for the UK labour market and the economy in 2007 and beyond; the impact of other Government legislation; and the evidence and views of interested parties gathered over the past two years. This chapter gives an overview of these factors before setting out our recommendations for minimum wage rates for adults, young people and 16–17 year olds for October 2007. For reasons we explain, we do not make explicit recommendations for 2008, but offer instead a broad indication of the likely level of upratings in October 2008. We conclude the chapter by giving our assessment of the likely impact of the recommended rates.

The Impact of the Minimum Wage So Far

7.2 In terms of the overall position regarding employment, the economic landscape is not as robust as in previous years since the introduction of the minimum wage. Although overall employment levels continued to rise during 2006, the increase in participation among older workers

along with the arrival of large numbers of migrant workers from Eastern Europe have reduced the working age employment rate. Unemployment levels and rates have increased. Further, although the number of employee jobs in the economy as a whole has increased, for the first time since the introduction of the minimum wage data from the Office for National Statistics (ONS) show a small decline in the overall number of employee jobs in the low-paying sectors. This has been particularly noticeable in the hospitality sector, one of the largest low-paying sectors.

7.3 Research commissioned for this report (Experian, 2007) found a small but statistically significant negative impact on growth in employment shares for hospitality at a regional level from the large upratings of the minimum wage in 2001, 2003 and, albeit based on provisional data, 2004. The research, in line with earlier research by Stewart (2003, 2004b), found no significant impact from the introduction of the minimum wage. However, small adverse regional effects on employment have been found by Riley and Young (2001) and Galindo-Rueda and Pereira (2004). In general, our research programme has to date found no significant impact at the individual worker or whole economy level. The data are not yet available to investigate fully the impact of the most recent rises in the minimum wage but, so far, we are aware of no evidence demonstrating that the minimum wage has had a significant adverse effect on employment since its introduction.

7.4 Before this report we had no evidence of adverse effects on inflation but research commissioned for this report from Wadsworth (2007) suggests that the costs of the minimum wage increases may have been passed on in higher prices for some products and services that are associated with minimum wage employment. However, he found that, at the aggregate level, the minimum wage does not appear to have significantly impacted on economy-wide prices.

7.5 The overall level of profitability in the economy does not appear to have been affected significantly by the minimum wage, but it is not possible from the data available to rule out any effect. Experian (2007), while noting data limitations, found no significant impact of the minimum wage on profits in retail or hospitality. However, previously commissioned research (Draca, Machin and Van Reenen, 2005) found an impact on the level of profitability of firms that predominantly

employed workers paid at or around the minimum wage, but the evidence suggested that the impact had been modest.

7.6 In reviewing our estimates of the number of workers covered by the minimum wage, we developed an alternative way of calculating the overall number affected. By 'downrating' the current minimum wage back to 1998, we can compare its value and coverage with the introductory level of the minimum wage using the 1998 earnings distribution. The advantage of this method is that the 1998 earnings distribution predates the introduction of the National Minimum Wage in April 1999 and so should be essentially unaffected by the legislation. The October 2006 adult minimum wage was worth about £3.95 in 1999 terms (35 pence more than the introductory level of £3.60). Using this method, coverage increases from about 0.86 million (4 per cent of all adult jobs) when the minimum wage was introduced to about 1.65 million (7.7 per cent of all adult jobs) in October 2006.

7.7 This suggests that we were right to be more cautious in our 2005 Report than we had been in our Third Report (2001a) and Fourth Report (2003). In the 2005 Report we recommended that the level of the minimum wage should increase slightly above average earnings growth over the coming two years (2005 and 2006). However, the growth in average earnings turned out to be lower than had been predicted by the Treasury's Panel of Independent Forecasts. As a result, more workers were covered than we had originally envisaged. To date it appears that this wider coverage has been achieved with little adverse economic consequence. However, the full impact of the 5.9 per cent increase in October 2006 cannot yet be determined. We will continue to monitor economic outcomes to identify any minimum wage effects.

7.8 As discussed in greater detail in Chapter 5, young people have fared less well in the labour market than other age groups. While employment for other groups remained robust, participation in the labour market by all workers under the age of 25 has fallen, most noticeably among the youngest – those aged 16 to 18. There is little evidence to suggest that the minimum wage is responsible for the relative weakness in the labour market of this group of workers. Few jobs held by 16–17 year olds pay below the Youth Development Rate and even fewer jobs held by 18–21 year olds are paid below the adult minimum wage. However, in the light of their relatively weak position

in the labour market there remain grounds for continued caution on minimum wage rates for young workers.

7.9 Overall therefore, a review of the evidence available in January 2007 offers firm support for the view that the adult rate has had no significant undesirable macroeconomic consequences. On the other hand, there is some evidence to suggest that the large number of migrant workers, combined with increased participation among older workers and those previously claiming sickness benefits, has put downward pressure on wages, especially at the lower end of the skills range. As a consequence, wage growth has been lower than might have been expected given the strength of the labour market. There are concerns that recent rises in price inflation may feed into pay settlements, which in turn would lead to an increase in prices. Moreover, after rising in line with the growth of whole economy employment, employment in the low-paying sectors has at best been static since the fourth quarter of 2005 and throughout 2006. These factors suggest that a period of caution is advisable. At the same time, our recommendations also need to reflect the prospects for the economy in 2007 and 2008. In the next section we consider recent economic forecasts and trends in prices, earnings, and pay settlements.

The Economy

7.10 In recommending the minimum wage rate, we need to review the economic outlook in order to gauge the ability of firms to absorb increased wages without detrimental effects on employment prospects or inflation. We also use forecasts of price inflation and earnings growth to estimate the likely coverage of future minimum wage rates. The next section therefore examines aggregate forecasts before turning to consider how prices, earnings, and pay settlement trends should influence our decisions.

Forecasts

7.11 The UK economy has generally not performed as well as had been anticipated in the 2005 Report when we made our recommendations for the October 2005 and October 2006 upratings. Output growth in

2005 was weaker than expected although it has picked up in 2006, growing slightly faster than expected. Price inflation has grown more strongly in 2005 and 2006 than had been anticipated. Indeed, the latest measures of inflation (for December 2006) are the highest for more than a decade. However, average wage growth has been comparatively subdued although there are signs in early 2007, as we write this report, that wage pressures may be growing.

Table 7.1
Actual Out-turn and Independent Forecasts of Inflation, Unemployment, Employment and Gross Domestic Product Growth (UK) and Average Earnings Growth (GB), 2006–2008

Average percentage change over a year earlier (unless stated otherwise)	2006 Q4 (Actual) %	2007 (Forecast) %	2008 (Forecast) %
Average earnings [LNNC]	4.0	4.3	4.3
CPI inflation [D7G7]	2.7	2.0	2.0
RPIX inflation [CDKQ]	3.5	2.5	2.5
RPI inflation [CZBH]	4.0	2.9	2.6
GDP growth [ABMI]	2.9	2.5	2.5
Employment growth [DYDC]	0.9	0.8	0.7
Claimant unemployment total (millions) [BCJD]	0.95	1.00	1.01

Source: ONS and HM Treasury (January 2007 (forecast for 2007) and February 2007 (forecast for 2008)).
Notes:
1. ONS codes in square parentheses.
2. For employment growth and GDP growth the figures relate to 2006 Q3.

7.12 Looking forward, the consensus of forecasts (January 2007) for the UK economy suggests that Gross Domestic Product (GDP) growth will continue to grow at around trend, albeit slightly weaker than in 2006 (see Table 7.1). At the same time, inflation as measured by the Consumer Price Index (CPI) is predicted to fall from 2.7 per cent in the fourth quarter of 2006 to the Bank of England's target of 2.0 per cent by the end of 2007. The Retail Price Index (RPI) is also forecast to fall from its 14 year high in the fourth quarter of 2006 of 4.0 per cent to below 3.0 per cent before the end of 2007. Average earnings growth is forecast to be about 4.3 per cent in 2007, a slight pick-up on the 4.0 per cent recorded in the fourth quarter of 2006.

7.13 Clearly there are many factors that could lead actual outcomes to differ from these forecasts. These include the level of migration; the incentives for older workers and those previously on disability benefits to participate in the labour market; the level of inflation and interest

rates and the strength of the housing market and the consequent impact on consumer spending; and the appreciation of sterling and the strength of the world economy, particularly the softening in the United States, the continued strength in Asia and the strength of the recovery in the Eurozone.

Changes in Pay and Prices

7.14 As shown in Chapter 2, since its introduction in April 1999 the minimum wage has more than kept up with the increase in average earnings and has thus risen faster than prices. If the adult minimum wage had been increased in line with the RPI price index since its introduction, its value would have been £4.36 in October 2006, significantly below the actual adult minimum wage level of £5.35. Alternatively, if the adult minimum wage had increased in line with average earnings, its value in October 2006 would have been £4.87. This outcome reflects the fact that since October 2001 the growth in the minimum wage has outpaced increases in average earnings.

7.15 Uprating the initial level of the Youth Development Rate (£3.00) by average earnings would have led to a rate of £4.06 by October 2006, showing that at its current level of £4.45 the Youth Development Rate has also increased faster than average earnings growth.

7.16 Pay settlements data also provide important information on earnings. Incomes Data Services (IDS, 2007), Industrial Relations Services (IRS, 2007), Labour Research Department (LRD, 2007) and the EEF (2007) have all found median pay awards throughout 2006 to have been consistently around 3.0 per cent. Although pay settlements are currently stable, IDS has reported that there have been recent upward pressures on the upper and lower quartiles of pay settlements, but this has yet to feed into the median. Further, LRD (2007) finds that recent increases in prices have fed into settlements, increasing the median to 3.2 per cent. However, IRS reports that employers believe that settlements will remain around 3 per cent in 2007. All these measures remain consistently below the growth in average earnings. This is because negotiated settlements generally exclude merit awards, promotion, and other pay drift effects.

7.17 The continued subdued nature of growth in average earnings and pay settlement data suggest that the labour market is not overheating and that skills shortages are being met, as increased participation by older workers and continued high levels of net migration exert downward pressures on wage demands.

7.18 If the minimum wage were to be increased between October 2006 and October 2007 at the same pace as pay settlements agreed in 2006, the adult minimum wage would rise to £5.51 per hour in October 2007. Projecting the current Youth Development Rate and the 16–17 year old rate forward on the same basis would give rise to rates of £4.58 and £3.40 respectively in October 2007.

Annual Leave Entitlement Changes

7.19 In our remit, the Government asked us to take account of forthcoming changes to legislation affecting the statutory annual leave entitlement. At present, the regulations do not require bank holidays to be regarded as additional to the statutory entitlement to four weeks paid annual leave and some employers have counted them as forming part of the entitlement (or its pro rata part-time equivalent).

7.20 The Government intends to increase the statutory annual leave entitlement in Great Britain from 4 weeks to 4.8 weeks in October 2007 and 5.6 weeks in October 2008 (similar legislation is to be introduced simultaneously in Northern Ireland). The new entitlement will cover all workers and be applied pro rata for part-time workers. Workers will be able to carry forward some of their additional entitlement (with their employer's agreement). The Government has ruled out allowing employers to 'buy' – or workers to 'sell' – the additional days of annual leave.

7.21 If no worker were currently entitled to more than 20 days paid leave, the new proposals would mean that all employers would have to allow for an additional four days annual leave from October 2007 (pro rata for part-timers) for which all workers would need to be paid. Assuming that employees work a five-day week, this would be equivalent to roughly a 1.7 per cent increase in their annual earnings[1]. Thus the

[1] Four out of 236 worked days (52 weeks x 5 days = 260: subtracting 24 annual leave days gives 236 working days). The Department of Trade and Industry (DTI) uses 260 days as the base for its calculations, and hence calculates the direct impact on wage bills to be 1.5 per cent.

maximum increase to the total direct wage bill would be around 1.7 per cent. However, the real impact of these proposals will be much lower as most employees already enjoy paid leave on bank holidays in addition to their basic entitlement of 20 days.

7.22 In its Regulatory Impact Assessment (DTI, 2007d), the Government estimated that up to 19 per cent of workers would be affected by the increase in annual leave entitlement to 5.6 weeks. It further noted that hospitality would be the most affected industry with up to a half of all workers affected. For all sectors, it found that the numbers affected by the increase from 4.8 weeks to 5.6 weeks was slightly more than the numbers affected by the initial increase from 4 to 4.8 weeks.

7.23 The Government estimated the direct cost to employers of the proposed October 2007 changes (from 20 to 24 days annual leave) to be around 0.2–0.3 per cent of the total wage bill for the whole economy. The most affected sector, hospitality, would face an increase in the total wage bill of around 0.5–0.8 per cent. The cost of the increase in October 2008 (the full 28 days annual leave entitlement) would be of a similar magnitude albeit slightly higher.

7.24 Using the Labour Force Survey (LFS), and the DTI Paid Annual Leave Survey, our best estimate is that around a third of all workers in the low-paying sectors will be affected by the proposed changes in October 2007. Further, we estimate that in the whole economy, at most 40 per cent of low-paid employees will be affected. In terms of direct costs, this is about 0.5 per cent of the wage bill for the low-paying sectors and 0.7 per cent for all low-paid employees. We found that hospitality was likely to be the most affected sector, with direct wage bill costs of around 0.7 per cent for the initial increase to 4.8 weeks. Our estimates are slightly higher than the industry estimates of 0.9 per cent for the entire 5.6 weeks submitted to us by the British Hospitality Association (BHA) in its written evidence. However, our estimates do not take account of indirect costs or any benefits such as reduced staff turnover or improved staff morale. They also assume full compliance, while the relevant LFS data suggest that the level of compliance with the existing legislation is far from complete.

7.25 To sum up, many workers already enjoy the proposed levels of annual leave and therefore the majority of employers will not be affected by

the legislation. However, for some employers the impact will be the full 1.7 per cent in October 2007. We conclude that the impact of the first phase of the increase in annual leave entitlement (an extra 0.8 weeks in October 2007) will be small overall, but could be significant for some employers. The impact of the full additional 1.6 weeks, due to be implemented in October 2008, is estimated at around double the estimates of the first phase.

The Views of Interested Parties

7.26 The macroeconomic data referred to above suggest that, while there are reasons to be optimistic about the performance of the UK economy in the coming year, there are also reasons to be cautious. Macroeconomic data are an important factor in our deliberations, but we also pay great attention to the evidence we gather from our consultation exercises. As in previous years, our consultation took several forms. We conducted a formal written consultation exercise over the Summer of 2006. We visited many different parts of the United Kingdom to talk to individuals and firms directly affected by the minimum wage. For two days in October 2006 we heard oral evidence from key interest groups. We also held numerous informal meetings with interested parties at their request and we arranged a series of meetings and visits by members of the Low Pay Commission secretariat. A list of organisations that were involved in our consultation and gave consent for us to publish their names can be found at Appendix 1.

7.27 As in previous years, the majority of employer organisations continued to voice support for the minimum wage in principle, but expressed reservations about the way it was developing in practice. This time round the level of concern was arguably more substantial, particularly with regard to the pressure on differentials. Nearly all employers welcomed the statement in the 2006 Report that the Commission would no longer start with a presumption that future increases would be above the predicted rise in average earnings. Many employers argued that the minimum wage should be uprated more cautiously, preferably with reference to price inflation or wage settlements rather than the growth in average earnings.

'The TUC calls on the LPC to recommend the highest increases that can be sustained without causing detrimental economic or social effects … We recommend that the minimum wage should continue to rise at a rate that exceeds the predicted growth in average earnings.'

TUC evidence

7.28 Trade unions and some other organisations, on the other hand, argued that further substantial increases in the minimum wage were needed and could be achieved without harm to jobs in the low-paying sectors or the economy as a whole. They called on us to continue to recommend increases to the minimum wage that exceeded the predicted increase in average earnings.

7.29 The CBI acknowledged that, so far, the National Minimum Wage had given rise to no negative macroeconomic consequences, but reported that many employers believed that further large increases would have a significant detrimental impact. The CBI was concerned that economic growth would be slower in 2007. With business facing rising costs elsewhere and increasing employment regulation, further large rises in the minimum wage would, the CBI argued, impact heavily on firms' employment and pay policies. For 2007, the CBI saw no case for further increasing the scope or coverage of the minimum wage. It argued that there was a strong case for a 'pause year', with only a modest rise in the minimum wage and with prices, not earnings, being the preferred yardstick.

7.30 The TUC, on the other hand, maintained that the economy was predicted to perform well in 2007. The TUC argued that, were we to propose a minimum wage uprating below average earnings growth, it *'would be to begin to undo the good work that the LPC has done so far.'* It called for an adult rate of more than £6.00 an hour by October 2008. In the written consultation exercise that closed in September 2006 the unions generally argued that the economy was strong and likely to remain so. The Transport and General Workers' Union (T&G) argued that inflation was stable and employment was at record levels with inactivity falling. The minimum wage, the T&G maintained, had so far had little impact on employment, either at aggregate level or among low-paying sectors. Like the TUC, the Union of Shop, Distributive and Allied Workers (Usdaw) and the T&G supported a wage of £6.00 by October 2008. Others proposed more substantial increases. UNISON, for example, argued that, given the benign economic conditions, the minimum wage should be set at £6.75 by October 2008.

'The CBI believes that the NMW has now reached an appropriate level of coverage … and any further increases above average earnings growth would have a significant detrimental impact on both employers and employees.'

CBI evidence

7.31 Employers tended to disagree strongly with such figures. The British Retail Consortium (BRC) reported that the total number of workers employed by large retailers had fallen by three per cent between 2005

and 2006 – amounting to a reduction of 61,000 jobs. BRC surveys suggested that both large and small retailers envisaged shedding jobs depending on the level of the minimum wage. The BRC argued that there should be no increase in real terms in the minimum wage for the next two years.

7.32 The British Chambers of Commerce (BCC) pointed out that the Low Pay Commission's research findings that found little or no effect of the minimum wage on jobs were concentrated on earlier upratings and took no account of the large increases of 2004 and 2006. The BCC believed that more recent upratings had had an observable adverse impact on employment, particularly for young people and unskilled workers.

7.33 Employers told us on visits and in written submissions that the minimum wage was causing difficulties with differentials. As the wages of the lowest paid increased and approached the level of those above, they said it was becoming more difficult to persuade people that the rewards of promotion were worth the extra responsibilities. On visits, this view received support from some workers who said that some fellow workers regarded the increase in pay that came with promotion as insufficient incentive. The evidence in national data is less clear, but there are indications that differentials may have been squeezed in the retail and hospitality sectors (see Chapter 3). On the other hand, other commentators have pointed out that there is nothing sacrosanct about existing differentials which may reflect outdated notions about the relative worth of particular jobs.

7.34 The Government's plans to introduce an entitlement to a minimum of 5.6 weeks paid annual leave (28 days) was the subject of particular comment. The TUC argued that minimum wage upratings should not be reduced on account of the parallel introduction of better minimum leave entitlements. It said that the proposed increases to annual leave were modest, applied mainly to part-timers and were spread widely amongst the industrial sectors. It said that the far more significant increases in holiday entitlement brought about by the Working Time Directive had been introduced without any noticeable negative impact.

7.35 Employer representatives claimed that the forthcoming increase to annual leave entitlement would impose significant extra costs on many

'The BRC welcomes the announcement in last year's Low Pay Commission (LPC) report that, in the future, there will be no assumption that the NMW should increase above average earnings. The BRC strongly believes that there should be no increase in real terms for the next two years, to give retailers a chance to absorb the six per cent increase effective from 1 October this year....'

BRC evidence

minimum wage affected businesses. The BHA and other hospitality bodies expected the impact to be significant in their sector and they thought that the burden would fall particularly on small employers. The BHA estimated that costs would stem from meeting the leave entitlement of irregular hours workers; employing additional agency staff; and the cost of employer 'buy-out' of entitlement. The Association of Labour Providers thought that the increases in holiday entitlement would add to the risk that labour providers would be driven into the informal economy. Leonard Cheshire Homes anticipated considerable impact arising from the new entitlement – 2,000 domiciliary staff would gain another four days holiday in 2007. The Association of Licensed Multiple Retailers believed that there would be a significant increase in wage bills arising from the new entitlement. It estimated that combining the changes would double the increase in wage costs attributable to the minimum wage alone.

7.36 We also received comments on the youth rates, which are discussed in more detail in Chapter 5. Several unions argued for the adoption of the adult rate for all workers. The TUC argued that the rate for 16–17 year olds should be raised by a series of increases above average earnings until it was close to the adult rate. Usdaw argued that the 16–17 year old rate should be equivalent to around 80 per cent of the adult rate. Most union responses argued that there should be no separate rates for younger workers, just a single rate for the job. The British Youth Council claimed that the youth rates endorsed a system that contravened the spirit if not the letter of the new age discrimination legislation. By contrast, the CBI supported the retention of the Youth Development Rate, as did most other employer organisations that commented upon the matter.

The Recommended Rates

7.37 We have said in previous reports that our overall aim is a minimum wage that helps as many low-paid workers as possible without doing damage to jobs or fuelling inflation. That remains our aim.

7.38 Reviewing all the information placed before us, we concluded in the end that the evidence called for an approach that was careful and prudent. Initially there were mixed views as to the need for caution and

the arguments for a less cautious line were set out in detail by some Commissioners. They argued, for example, that the economic indicators for 2007 and beyond were largely positive, with the UK economy expected to grow at or above trend and UK firms experiencing a general growth in profitability. They pointed out that there was no evidence that the minimum wage had harmed jobs and that employment overall was at record levels while other labour market measures (business start-up and job vacancy rates, for example,) pointed to an improving situation. However, while recognising that these arguments had merit, the Commission concluded that the countervailing arguments in favour of caution were more compelling.

7.39 We found, for example, substantial evidence to support the view that the bite of the minimum wage had grown and was having more impact on an increasing number of firms. Our latest alternative calculations of the coverage of the minimum wage – based on looking at the value of the minimum wage in terms of the 1998 hourly earnings distribution (outlined in detail in Chapter 2) – suggest that coverage may be significantly higher than we have previously estimated. Many firms in the low-paying sectors told us the minimum wage was beginning to cause them difficulties leading them to review staffing ratios, bonus packages and arrangements for premium rates. An increasing number of large firms were finding their lower rates driven by the minimum wage. There was also growing evidence of an impact on pay differentials in some low-paying sectors, in particular retail and hospitality. These considerations suggested the need for a careful approach.

7.40 Furthermore, as outlined in paragraph 7.7 above, because average earnings growth turned out lower than had been anticipated over the past two years, the coverage of the minimum wage proved higher than we had originally intended. Taking the 2005 and 2006 upratings of the adult minimum wage together, the minimum wage increased by about two and a half percentage points above average earnings – higher than the increase we intended when we made our recommendation in February 2005. Although the limited evidence available to date suggests that this increase has been absorbed without negative consequences, the available data do not yet allow a full appraisal of the

impact of the increase of October 2006, which at 5.9 per cent was substantial in real terms. We saw this as another reason to be cautious.

7.41 Increases in price inflation in late 2006 may lead to an upsurge of wage inflation. We do not believe that recent increases in the minimum wage have been a driver of inflation and we are conscious that it is the lowest paid workers who often suffer most in periods of high inflation.

7.42 As we noted in our 2006 Report, the forthcoming increase in annual leave entitlement will add to the costs of some employers in low-paying sectors. In our remit the Government asked us to take account of the proposed changes. We have done so in the same way we would take into account any other relevant economic factor that adds to employment costs for some employers. It is clear that the impact of changes to annual leave entitlement will not be evenly spread. We estimate that over two-thirds of employees in the low-paying sectors will not get an increase in their leave entitlement and therefore there will be no impact on their employers (see paragraph 7.25). Those firms that are affected will be a minority, but the impact on them is likely to be fairly significant – equivalent to about 1.7 per cent of the wage bill for those employees affected. We did not attempt to use a calculation of the costs of the increase in holiday entitlement to offset them by means of a lower recommended rate. Nor did we consider it appropriate to do so, given that the majority of firms in all sectors would be wholly unaffected. Instead we saw the increase in holiday entitlement as another factor suggesting that it might be appropriate to take a prudent approach this year.

7.43 The data on employment in low-paying sectors also gave us reason to exercise caution. Since the introduction of the National Minimum Wage we have been able, in report after report, to point to job growth in the low-paying sectors. However, this year we have seen the first fall in overall employment in the low-paying sectors since the minimum wage was introduced. And also the first falls in employment in hospitality and retail – both of which previously had experienced strong growth. While we are not convinced that these losses are attributable to the increases in minimum wage rates, we believe that it is only sensible to exercise caution in the light of such evidence.

7.44 **We therefore recommend that the adult rate of the minimum wage should be increased to £5.52 in October 2007.** This is less than the predicted annual increase in average earnings, but more than the predicted increase in prices and is in line with current pay settlements. We see this recommendation as a cautious one that affords employers the pause they have been seeking. However, if the Government implements our recommendation, the adult minimum wage will have increased by 13.8 per cent from October 2005 to October 2007. Over the same period, average wages are expected to increase by 12.2 per cent and prices (RPI) by 9.3 per cent. Over the lifetime of the minimum wage, the adult minimum wage will have increased by 53.3 per cent against an expected 41 per cent increase in average earnings.

7.45 As part of our deliberately cautious approach we have decided that it would be sensible to make explicit recommendations concerning the rates for October 2007 alone. **We therefore recommend that the Government ask us to report in early 2008 on recommended rates for October 2008.** Our view, drawing on the analysis we have made for this report, is that the increases we are likely to recommend for 2008 will be around the predicted rise in average earnings, but much will depend on what happens between then and now in the economy and the labour market. Two of the most important factors will be average earnings growth and employment – especially employment in the most affected sectors. We will also want to take account of price inflation and whether it falls back in 2007 as predicted.

7.46 **In line with our cautious approach to the adult rate, we recommend that in October 2007 the Youth Development Rate should increase from £4.45 to £4.60 and the 16–17 rate should increase from £3.30 to £3.40.** As detailed in Chapter 5, we are concerned that the employment prospects of younger workers have worsened over the past two years and we did contemplate recommending a lower figure. On balance, however, we felt that a lower increase might prove as much a disincentive to young workers to seek work as an incentive to employers to take on younger workers.

7.47 As discussed in Chapter 5, we continue to be firmly of the view that 21 year olds should be entitled to the adult rate of the minimum wage. The employment patterns of 21 year olds are markedly different from those

of 18–20 year olds. The employment rate of 21 year olds is rising and their unemployment rate has levelled off. We think it makes sense to treat 21 year olds as adults and it is clear that most employers agree with us since over 90 per cent of 21 year olds are already paid the adult minimum wage rate or more.

The Impact of Our Recommendations

Coverage

7.48 The recommended minimum wage rates for October 2007 are below the forecast increase in average earnings. As a result, these upratings are likely to cover fewer workers in October 2007 than in October 2006, when the adult minimum wage rose by 5.9 per cent – about 1.8 percentage points more than the increase in average earnings.

7.49 In April 2006, according to ASHE, there were just over 2 million jobs that paid less than the minimum wage rates we are recommending for October 2007. These were made up of around 1.95 million jobs held by those aged 21 and over (8.2 per cent), about 165,000 jobs held by 18–20 year olds (11.9 per cent) and 31,000 jobs held by 16–17 year olds (9.0 per cent).

7.50 However, in order to estimate coverage, we need to make assumptions about how the wages of the low-paid would have increased in the absence of the minimum wage upratings. We assume that wages would have risen either in line with average earnings or in line with prices.

Table 7.2
Estimated Number and Percentage of Jobs Covered by the Recommended October 2007 National Minimum Wage Upratings, UK

Estimated number and percentage of jobs covered		Earnings basis	Prices basis		
October 2007 hourly minimum wage rates		AEI including bonuses	RPI	RPIX	CPI
Adult rate (21 and over)	£5.52	1.02 million 4.3%	1.28 million 5.4%	1.34 million 5.7%	1.41 million 6.0%
Development Rate (18–20 year olds)	£4.60	101,000 7.3%	112,000 8.1%	116,000 8.4%	122,000 8.8%
16–17 year old rate	£3.40	23,000 6.7%	25,000 7.2%	27,000 7.8%	27,000 7.8%
Total		1.14 million	1.42 million	1.48 million	1.56 million
		4.5%	5.6%	5.8%	6.2%

Source: LPC estimates based on ONS ASHE with supplementary information, UK, April 2006.

7.51 In past reports, we have highlighted those estimates calculated using the average earnings assumption. However, as demonstrated by Butcher (2005), it seems unlikely that the wages of the lowest paid would have kept pace with average earnings increases. Table 7.2 therefore gives estimates based on both the earnings and the prices assumptions. Assuming that, from October 2007, 21 year olds would be entitled to the adult minimum wage and if the wages of the lowest paid were to increase in line with forecast average earnings, we estimate that at the new rate of £5.52 in 2007, the number of jobs held by those aged 21 and above that would be covered would be about 1.02 million or 4.3 per cent of the labour force. If we assume instead that the wages of the lowest paid would merely have matched forecast price inflation, a greater number of jobs would turn out to be covered – between 1.28 million and 1.41 million (5.4 to 6.0 per cent) of the adult workforce depending on the price index used. On this basis we estimate that the new rate for the minimum wage will achieve slightly lower coverage levels than that achieved by the £5.35 uprating in October 2006.

7.52 Given the less certain position of young workers in the labour market, we have also exercised prudence in recommending an increase in the Youth Development Rate in line with the adult minimum wage, of 3.3 per cent in October 2007. If we make the assumption that young people's wages would otherwise rise with average earnings, we estimate that about 101,000 jobs held by young workers (aged 18–20) would be covered by the new Youth Development rate in October 2007

– roughly equal to about 7.3 per cent of jobs held by young workers. Using the prices assumption, we estimate that coverage would be between 112,000 and 122,000 jobs (about 8.1 to 8.8 per cent of jobs held by this age group) depending on the price index used.

7.53 Turning to 16–17 year olds, we have again exercised caution. The recommended increase is less than the cautious increases in the other two rates. We estimate using the earnings assumption that 23,000 jobs (or 6.7 per cent of all jobs held by 16–17 year olds) will be covered by the October 2007 uprating. If we assume that the wages of the low-paid would otherwise rise in line with prices, we estimate that up to 27,000 jobs would be covered (around 7.8 per cent of jobs held by 16–17 year olds).

7.54 Overall therefore, we estimate that the total coverage of the recommended October 2007 upratings would be 1.14 million jobs if the wages of the low paid were to increase by the forecast growth in average earnings in 2007, or between 1.4 million and 1.6 million jobs if, instead of increasing in line with average earnings, their pay would otherwise have increased in line with prices.

Coverage by Gender

7.55 We expect that around two-thirds of those covered by the adult minimum wage upratings will be women. In Chapter 2, we estimated that around two-thirds of all minimum wage jobs were held by women. Using the earnings assumption, we estimate that the October 2007 adult minimum wage will cover 665,000 jobs held by women and 354,000 jobs held by men. On our alternative prices assumption, we find that up to 946,000 jobs held by women and 461,000 jobs held by men would be covered by the uprating to £5.52.

Coverage in 1998 Terms

7.56 In Chapter 2, we outlined an alternative method of looking at coverage by looking at the value of the minimum wage in terms of the 1998 hourly earnings distribution. Using this technique, the 2007 October adult minimum wage (£5.52) would have been equivalent to about £3.90 in 1999, when the minimum wage introduced at that time was £3.60. The value of the 2007 October minimum wage would have been about £3.77 in 1998, when the introductory level of the minimum wage

(£3.60 in 1999) would have been equivalent to £3.45. The 2007 minimum wage downrated in 1998 terms would have covered about 1.58 million jobs (around 7.4 per cent of all jobs) in 1998. This level of coverage is slightly less than that estimated for the October 2006 upratings but greater than the coverage estimated using more recent data.

Position Relative to Average Earnings

7.57 Another measure used to assess the value of the minimum wage is its relationship to average earnings, otherwise known as its 'bite'. We can measure the 'bite' by comparing the minimum wage with median earnings, our preferred measure, or mean earnings.

7.58 In April 2006, according to ASHE, the median gross hourly earnings (excluding overtime) of all employees (full and part-time) were £9.88 an hour. Uprating that figure by the growth in average earnings (including bonuses), both actual and predicted[2], yields a basis for comparison with the minimum wage. The figure arrived at in this fashion is £10.51 for October 2007. The new recommended adult rate of the minimum wage will thus be about 52.5 per cent of forecast median earnings, or more than half median earnings. This compares with a 'bite' of about 53.1 per cent in October 2006 and 47.6 per cent when the minimum wage was introduced in April 1999. Using the mean, we estimate that the 'bite' in October 2007 will be about 41.4 per cent for all employees.

7.59 If instead of looking at the median earnings of all workers, we looked just at those of full-time workers and compared the minimum wage with median full-time hourly earnings excluding overtime, the corresponding 'bite' would be nearly 47 per cent in October 2007. Comparing this UK ratio for full-time employees with that of other countries, the UK is roughly on a par with the Netherlands – in the middle of the twelve countries used as a basis of comparison in Appendix 4.

[2] Actual ONS data used for April 2006 to October 2006. 2007 forecasts used for October 2006 to October 2007.

Wage Bills

7.60 As the recommended increase in the minimum wage is below the predicted rise in average earnings and only just above the forecast rise in prices, the impact of our recommendations on the overall wage bill is likely to be small. The impact of the recommended upratings in 2007 would not be even across the economy. As discussed briefly in Chapter 2 and in more detail in Chapter 3, the impact is expected to fall more heavily on small firms and those firms in the low-paying sectors. This will again be the case for the 2007 upratings. Further, the impact of changes to annual leave entitlement is also likely to be greatest for small firms in certain low-paying sectors.

Public Sector

7.61 The minimum wage can affect the public sector in two ways: first, by its direct impact on the public sector wage bill; second, by the impact on the Exchequer of any savings resulting from reduced benefits as the minimum wage increases.

7.62 The estimated effect of the recommended rates on the public sector wage bill is small. There are two reasons for this. First, as we noted in Chapter 2, few public sector workers are affected by the minimum wage. Second, as we noted above, the estimated impact on the private sector (which has a far greater number of affected workers) is expected to be small as the recommended increase this time is in line with current pay settlements and only slightly above price inflation.

7.63 We asked the Government to provide a breakdown of the impact of increasing the minimum wage on various taxes and benefits. Table 7.3 below summarises the impact of hypothetical 10 pence and 30 pence increases in the minimum wage. As can be seen, the main impact is the increase in income tax and National Insurance for minimum wage earners that results from the increase in earnings. The Government also stands to make substantial savings from reductions in Working Tax Credit. For larger increases, reductions in Child Tax Credit are also important.

Table 7.3
Government Savings from Hypothetical Increases in the National Minimum Wage, £ Million, UK, 2007–2008

£ million	Government savings from a 10 pence increase in the minimum wage to £5.45 in October 2007	Government savings from a 30 pence increase in the minimum wage to £5.65 in October 2007
Income tax	50	165
National Insurance Contributions	24	79
Working Tax Credit	20	66
Child Tax Credit	6	22
Income Support	2	8
Housing Benefit	5	9
Council Tax Benefit	3	9
Total	**110**	**357**

Source: HM Treasury estimates based on Family Resources Survey data for 2004/05, uprated to 2007/08, UK.
Note: These figures take account of changes in tax credits, benefits, taxes and National Insurance Contributions but do not take any account of likely behavioural change caused by a rise in hourly pay, such as changed levels of employment or hours worked. They also do not include the effect of the £25,000 disregard in tax credits, which allows income to rise between one year and the next by up to £25,000 before tax credits begin to be withdrawn. This means that the reductions in tax credits would in practice be significantly smaller, at least in the initial tax year.

The Impact on Low Incomes

7.64 As part of a wider Government strategy to make work pay, the National Minimum Wage interacts with the tax and benefits system to provide financial incentives to increase participation in the labour force.

7.65 The Pre-Budget Report (HM Treasury, 2006c) provided details of minimum income guarantees for April 2007 as a result of the interaction between the benefits system and the £5.35 per hour adult rate of the minimum wage (a hypothetical increase of the minimum wage to £5.60 is given in parentheses)[3]. These were:

- £275 (£277) a week for a family with one child and one earner working for 35 hours on the adult rate of the minimum wage. This would be equivalent of £7.86 (£7.91) per hour take home pay once tax credits and benefits are taken into account;
- £178 (£181) a week for a single earner couple without children or a disability, aged 25 or over and working for 35 hours on the adult rate of the minimum wage. This equates to an hourly rate of £5.09 (£5.17).

[3] HM Treasury estimates based on Family Resources Survey data for 2004/05, uprated to 2007/08. Also see note to Table 7.3.

The Cycle of Recommendations

7.66 In previous reports we have noted various concerns, expressed mainly by employers, about the process and the timetable the Commission has followed in producing its recommendations. Some have said they would favour a form of indexation to make future upratings more predictable. Others have called for more notice of upratings. A third view was that the Commission's habit of recommending a rate two years in advance entailed basing a judgement on analysis of data and other information that was up to two years old by the time the rate came to be implemented.

7.67 We have looked at our processes and concluded that there is no single pattern of review cycle that could meet the wishes and needs of all stakeholders. If we opt to give maximum notice, we make recommendations based on older, less current information and data that does not take account of the impact of previous increases in the minimum wage. If we want to use the latest and best data, we have to make recommendations as late as we can, thereby giving little advance notice.

7.68 Reflecting on these matters, we concluded that as the bite of the minimum wage increases it becomes more important to take decisions on the best available data. Therefore, we have decided this year to limit our recommendations concerning minimum wage rates to October 2007, but to give a broad indication of our thinking about the proper level of the minimum wage in October 2008. This way we are able to use the latest and best data to inform our thinking about the rates we recommend for 2007. We also give some indication of the likely range of the recommendation for 2008, aware that next year we will be able to fine-tune our indicative thinking about 2008 with the aid of the most accurate and up to date figures.

Conclusion

7.69 In our report two years ago we noted the concern of employers and employer organisations about the pace of minimum wage increases. At that time they told us that increases of 15.5 per cent over two years had caused problems with reward structures in large companies as well as small. Since then the minimum wage has risen by a further

10.3 per cent and employer concerns have grown. In any effective social partnership there must be give and take and a willingness to recognise the legitimate concerns of both sides. After four years of substantial increases, this year we have proposed a relatively modest increase of 3.2 per cent – albeit one well in line with the majority of recent pay settlements. In large part this is in response to employers' concerns.

7.70 Our consultation this year revealed that, eight years after it was introduced, the National Minimum Wage still commands the support of the vast majority of employers, workers and their representatives. There are many different views about the way in which it should be maintained and developed, but most of the people we spoke to agreed with the CBI's view that the minimum wage should not be allowed to *'wither on the vine'*. This year's moderate recommendations need to be seen in the context of the sequence of recommendations we have made over the last eight years.

Consultation

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

Oral Evidence to the Commission

Association of Convenience Stores

Association of Licensed Multiple Retailers

British Beer & Pub Association

British Hospitality Association

British Retail Consortium

Business in Sport and Leisure

Business Services Association

CBI

Cleaning and Support Services Association

Leicester City Council

Trades Union Congress

Transport and General Workers' Union

Union of Shop, Distributive and Allied Workers

UNISON

YWCA England & Wales

Written Evidence to the Commission

Arts & Graphics + Dateline

Association of Convenience Stores

Association of Labour Providers

Association of Licensed Multiple Retailers

Birmingham Chamber of Commerce and Industry

British Apparel & Textile Confederation

British Beer & Pub Association

British Chambers of Commerce

British Hospitality Association

British Retail Consortium

British Shops and Stores Association

British Youth Council

BUPA Care Services

Business in Sport and Leisure

Business Services Association

CBI

Central Council of Physical Recreation

Citizens Advice Northern Ireland

Cleaning and Support Services Association

Community

Dyfed Cleaning Services Limited

EEF The Manufacturers' Organisation

Employment Information Services

Equal Opportunities Commission

Equality Commission for Northern Ireland

Equity

Federation of Licensed Victuallers Associations

Federation of Small Businesses

Food and Drink Federation

Forum of Private Business

Fullers Quality Bakers

Golding's Bakery Ltd

Graham R Todd

Greater Manchester Pay and Employment Rights Advice Service

H R Bradford (Bakers) Ltd

Her Majesty's Government

J W Buckley Ltd

Jessops the Bakers

Kondit Bakery and Café

Leicester City Council

Leonard Cheshire

Mardon House Residential Home

Mark Watson

MHA Care Group

Naseem Ullah

National Centre for Social Research

National Council for One Parent Families

National Day Nurseries Association

National Farmers' Union (England and Wales)

National Federation of Fish Friers

National Group on Homeworking

National Hairdressers' Federation

National Trainers Federation

National Union of Rail, Maritime and Transport Workers

NEA Northern Ireland

North Somerset Industrial Therapy Trust

Northern Ireland Public Service Alliance

Oliver Adams Ltd

Oxfam

Pamela James

Paul Rogers

PCS HMRC Cambridge Revenue Branch

Public and Commercial Services Union

Pyefleet Day Nursery Limited

Recruitment & Employment Confederation

Robert Scott & Sons Ltd

Robin Manners

Sanctuary Housing Association

Scottish Association of Master Bakers

Scottish Executive

Scottish Licensed Trade Association

Scottish Socialist Party

Scottish Textiles Manufacturers Association

Scottish Trades Union Congress

Small Business Council

The Children's House & the Montessori School

The Cottage Bakery

The Hospital of William Browne Wool Merchant Stamford

The Newspaper Society

Trades Union Congress

Transport and General Workers' Union

Union of Shop, Distributive and Allied Workers

UNISON

Unquoted Companies Group

Welsh Assembly Government

White Horse Child Care Ltd

Woodhead (Scarborough) Ltd

W T Warren & Son

YWCA England & Wales

Visits and Meetings

Advisory, Conciliation and Arbitration Service

Agricultural Wages Board for England & Wales

Anson Care Services

Arts & Graphics + Draftline

Ashers Bakery

Association of Convenience Stores

Association of Licensed Multiple Retailers

Aulds (Food) Ltd

Aylsham Care Home

Berry Head Hotel

Birmingham Chamber of Commerce and Industry

British Apparel & Textile Confederation

British Beer & Pub Association

British Beer & Pub Association, Midlands and Northern Regions

British Chambers of Commerce

British Hospitality Association

British Retail Consortium

British Shops and Stores Association

Business in Sport and Leisure

Business Services Association

Capper & Co Ltd

CBI

CBI Scotland

CBI Wales

Central Council of Physical Recreation

City & County of Swansea – Employment Training

Cleaning and Support Services Association

Clive Hurst

Cornwall Care

Cornwall Strategic Partnership

Covent Garden Restaurants

Daycare Trust

Deepdale Farm

EEF The Manufacturers' Organisation

English Community Care Association

Equal Opportunities Commission

Ethical Trading Initiative

Federation of Poles in Great Britain

Federation of Small Businesses

Federation of Small Businesses Scotland

Finsbury Foods

Fuller, Smith and Turner PLC

Gangmasters Licensing Authority

GMB

Halfords PLC

Hull City Council

Humberside Police Headquarters

Independent Health & Care Providers

Independent Retailers Confederation

Jobcentre Plus (Hull)

John Collins and Partners

Judy Scott Consultancy

Knitting Industries Federation Ltd

Knowle Hill Nurseries Ltd

Learning and Skills Council

Leicester City Council

Lochaber Citizens Advice Bureau

London Citizens Workers Association

Melton Mowbray Polish Community

Monthind Limited

National Care Association

National Care Forum

National Farmers' Union (England and Wales)

National Group on Homeworking

National Hairdressers' Federation

Northern Ireland Hotels Federation

Porters Horticultural Limited

Recruitment & Employment Confederation

Riviera Produce Ltd

Rural Shops Alliance

Scottish Executive

Scottish Trades Union Congress

Servite Houses

Shep Plastics Ltd

Small Business Council

Tesco Stores Ltd

The 50 Club

Trades Union Congress

Transport and General Workers' Union

Union of Construction, Allied Trades and Technicians

Union of Shop, Distributive and Allied Workers

UNISON

UNISON Northern Ireland

Welsh Assembly Government

Wilkinson Hardware Stores Limited

Winchester Growers Limited

Yorkshire and Humberside Churches

Low Pay Commission Research Reports

Overview

1 For the 2007 Report, we commissioned eleven research projects that have looked at various aspects of the impact of the National Minimum Wage. This appendix provides an overview of the main findings. For each of the studies, Table A2.1 details the focus of the study, the methodology used and summarises the key results. The full research reports are available on the Low Pay Commission website at www.lowpay.gov.uk.

2 As the minimum wage has risen faster than the increase in average earnings in recent years, it is perhaps not surprising that research using the most recent data has found the minimum wage exerting a more pervasive influence on the labour market. For this report, the commissioned research has looked at the impact on pay structures, employment, hours, profits, business start-ups, employer-provided training, prices and consumption patterns. We have also looked at the length of time that workers stay in low-paid (minimum wage) employment. After hearing much anecdotal evidence about the impact of migrant workers, particularly from central and eastern Europe, on local labour markets, we commissioned two reports: one was an econometric study looking at the impact of migrant workers on wages in the economy as a whole; the other was a qualitative study of migrant workers in a local economy. Research on enforcement has also been carried out.

3 Incomes Data Services (IDS, 2006b) looked at the impact of the 2005 upratings of the minimum wage on the low-paying sectors. It concluded that the steady rise in the minimum wage was affecting more employers than previously, both directly, as more employees were being paid at the minimum wage, and indirectly, as it exerted a

growing influence on pay setting and pay structures. However, the nursery sector was the only low-paying sector that reported reductions in staffing as a consequence of the 2005 increase in the minimum wage. In the retail sector, IDS found that over half of the retail firms it surveyed now paid a minimum rate at the level of the adult minimum wage, although most large multiple retail chains continue to maintain their lowest rate of pay above the minimum wage. It also noted that a growing number of pubs and restaurants were using the lower rates for under 22 year olds. In retail and hospitality, the report stated that recent increases in the minimum wage had contributed to decisions to reduce differentials between location-based pay bands and, in some cases, to reduce the number of pay bands.

4 Denvir and Loukas (2006) also looked at the impact of the minimum wage on pay differentials and changes in the workplace in three low-paying sectors. Using a telephone survey, the researchers found that the main impacts were on labour costs and profits, with smaller effects on prices, employment and non-labour costs. Over 40 per cent of the surveyed firms had increased pay rates as a result of the minimum wage increase in 2005, with more firms operating with squeezed differentials than maintaining them. Nearly all of the firms that increased pay rates identified the minimum wage as the main driver that had led to changes to the pay structure. Just over a fifth of the surveyed firms reported making changes to staffing levels and hours, particularly in the following respects: changes in recruitment and retention practice; changes to the composition of the workforce (e.g. part-time/full-time mix) and recruitment of employees with different skills, of a different age or more migrant workers.

5 In more in-depth interviews, the researchers found that most firms affected by the minimum wage had focused on the internal re-organisation of rewards and working practices, as they had felt unable to adjust prices or business practices. They concluded that some firms had changed their pay structures in response to changes in the minimum wage by removing some layers; making changes to pay rates (such as reducing special or discretionary payments); negotiating no-premium contracts with new workers; and/or reducing staffing levels (through non-replacement of staff or reductions in both operating and working hours). The study found no evidence of a direct relationship

between decisions to maintain or compress differentials, and changes to pay, staffing, training or work organisation.

6 Using a more econometric approach, Experian (2007) investigated the impact of sectoral and regional effects of the minimum wage on employment, profits and business start-ups. It confirmed that the minimum wage had impacted on regional and sectoral pay between 1999 and 2005. Experian looked at the relative performance of the low-paying sectors within regions and countries of the UK but, due to data limitations, it confined most of its analyses to hospitality and retail. Looking at the period from 1995 to 2004 as a whole, it found some evidence that the minimum wage had had a statistically significant but small negative regional employment impact in the hospitality sector. However, for retail the results were only statistically significant if London and the West Midlands were excluded. In other words, Experian found that increases in the minimum wage reduced employment growth in relatively low-paying regions while increasing employment growth in relatively high-paying regions, particularly in hospitality. Looking at individual years in isolation, the study found no significant effects on employment in retail or hospitality from the introduction of the minimum wage. However, it did find a statistically significant negative impact on regional employment for the hospitality industry as a result of the large minimum wage upratings in 2001 and 2003. No such effects were found for retail.

7 Experian found no significant impact on profits in retail or hospitality. It also investigated the impact of the minimum wage on company formation and found evidence of a statistically significant negative impact on business start-ups for the distribution industry, which consists of the wholesale, retail and motor vehicle sectors. It also found weak evidence of such an impact for the hospitality sector. Experian concluded that its results, particularly on employment, contrasted with previous findings in the literature but that might be because it was the first study to focus on effects on industries within regions and to look at the introduction and subsequent upratings of the minimum wage in an integrated framework. Further, the negative employment effects in hospitality were small in magnitude.

8 As noted above, a common theme that developed on our regional visits for the 2005 Report was the impact on the labour market of the recent

increase in migrant workers. Dustmann, Frattini and Preston (2007) studied the impact of migrants on wages in the British labour market. They found that new migrant workers in the UK tended on average to be better educated and younger than the overall British workforce. The study noted that some native workers would be adversely affected by migration while others would benefit. It found that the gains made by those that benefited were greater than the losses made by those that did not. In other words, immigration to the UK had increased average wages at the aggregate level. The authors found some evidence that wages at the bottom end of the earnings distribution had been negatively affected by the increasing number of migrant workers. European Union expansion in 2004 and the arrival of workers from the eight Accession Countries (A8) had increased the number of workers competing for jobs at the lower end of the wage distribution, thus adding to the downward pressure on wages in low-paid jobs. The researchers believed that these effects might reduce over time as better educated migrants stopped competing for low wage jobs and moved into occupations more closely matching their skills and education. The study concluded that *'the minimum wage performs an important role to secure wages of workers who would otherwise lose out from immigration'*. In other words, without the minimum wage, the downward pressure on wages at the bottom end of the earnings distribution would have been even greater.

9 The research we commissioned by French and Möhrke (2006) also focused on migrant labour. This qualitative research looked at the impact of new migrants on the North Staffordshire labour market. The findings highlighted the fact that, although migrant workers worked across a wide range of sectors, the vast majority were employed in low-skilled, comparatively low-paid employment, with most earning at or slightly above the minimum wage. The food processing, manufacturing and distribution sectors made greatest use of migrant labour. Employers' experiences of using migrant workers had been positive in terms of productivity, flexibility and retention, and these factors had resulted in substantial savings in unit labour costs, without the need to cut pay rates.

10 French and Möhrke found evidence of exploitation of migrant workers, in particular those recruited through international employment

agencies. Albeit based on a small number of case studies, the researchers found that non-payment and under-payment of workers by agencies was a recurring theme, along with evidence of a range of problems relating to the provision of accommodation and other services. However, they found that A8 workers were increasingly inclined to move away from contracts with international agencies, towards direct recruitment or local agencies. The study highlighted that many migrant workers had little, if any, knowledge of UK employment rights or how to access them. The outcomes strengthened our view, as noted in Chapter 6, that enforcement should be targeted on sectors where there is a concentration of migrant workers.

11 Following on this theme of compliance and enforcement, Croucher and White (2007) were commissioned to conduct an evaluation of the Department of Trade and Industry/HM Revenue and Customs (DTI/HMRC) targeted enforcement pilot in the hairdressing sector. The researchers found mixed results as to the effectiveness of the campaign. Although they found relatively high awareness of the fact that there was a minimum wage among employers and workers, understanding of the actual rate and in particular of the youth rates, was considerably lower, as was the understanding of how the minimum wage applied to apprentices. Interestingly, but worryingly, this research also highlighted limitations in the understanding of the employment rights of migrant workers, with some employers apparently believing that workers from outside the EU were not entitled to the minimum wage.

12 Two projects investigated movement in and out of minimum wage employment. Sloane, Murphy, Latreille, Jones and Jones (2007) found that minimum wage jobs were of relatively short duration for the majority of those affected. Using a different data set, Bryan and Taylor (2006), also found a high degree of mobility out of minimum wage employment, but they found that much of this mobility was to jobs with relatively low pay, often with subsequent return to minimum wage jobs.

13 Building on their work for the 2005 Report (Sloane *et al*, 2004), Sloane, Murphy, Latreille, Jones and Jones (2007) used the New Earnings Survey Panel Data (NESPD) to look at the persistence of minimum wage employment. They found evidence that employment in minimum

wage jobs for the majority of affected workers was of short duration. This finding, which agrees with results found in the United States, runs counter to results from previous UK studies that have looked at low pay dynamics from slightly higher up the earnings distribution. However, the authors also found tentative evidence to suggest that a small number of workers experienced much longer spells of work at or below the minimum wage.

14 While they found that young workers were more likely to be in minimum wage jobs than older workers, they also found that older workers were less likely to leave a minimum wage job and thus were more likely to experience much longer spells in minimum wage employment. Using inflow and outflow data from the Labour Force Survey (LFS), they also found that more recent minimum wage entrants had a reduced probability of moving on, so that the average duration of spells on the minimum wage was increasing over time. They concluded that the minimum wage *'has not had a particularly detrimental effect on labour market outcomes',* instead it *'has served to underpin the wages of many low-paid workers'*.

15 Bryan and Taylor (2006) used data from the British Household Panel Survey (BHPS) to look at the persistence of minimum wage employment between 1999 and 2004. They found that about 83 per cent of employees were continuously paid above the minimum wage; 12 per cent of employees were 'occasionally' (in one or two of the years) on the minimum wage; and just 5 per cent were 'persistently' (for three or more of the years) on the minimum wage. Those regarded as 'persistent' minimum wage recipients were more likely to be older, female, married, have no qualifications, be in part-time work, not in a union and working in the private sector. Those regarded as 'occasional' minimum wage recipients were more likely to be younger (and as such less likely to be married), in temporary employment and have lower job tenure. However, they were more likely to be older, female, have fewer qualifications and be in part-time work than those who had never received the minimum wage.

16 The study found that 'occasional' recipients of the minimum wage were more likely to leave for higher paid employment than 'persistent' recipients, who were more likely to move to earnings just above this level. It also found that employer changes and promotions were

associated with movements out of minimum wage jobs. 'Persistent' minimum wage recipients were more likely to work in small firms, often in the hospitality and retail sectors, and tended to have low skills. 'Occasional' recipients were also concentrated in these areas but to a lesser degree.

17 They noted that more workers experienced the minimum wage at some point in their careers than implied by the cross sectional estimates. The researchers concluded that around 40 per cent of the minimum wage recipients in their survey combined minimum wage jobs with spells out of work over the six year period covering 1999 to 2004.

18 Wadsworth (2007) investigated the consumption patterns of minimum wage households and the impact of the minimum wage on the prices of goods and services that are associated with minimum wage employment. Using the Family Expenditure Survey and its successor the Expenditure and Food Survey, he found that there was little evidence of differential consumption patterns among households with an adult minimum wage earner relative to others, although such households appeared to spend a slightly larger portion of their income on food compared to other households with non-minimum wage workers. He also found evidence that the demand for many minimum wage goods and services (such as pub drinks, dry cleaning services and canteen meals) tended to be elastic. That is, demand was sensitive to price changes, which suggests that there might be little room to pass on price rises to consumers of minimum wage goods and services. However, using difference-in-difference[1] estimation, he found some evidence to suggest that the relative rate of price inflation of some minimum wage goods and services (such as restaurant meals, canteen meals, take-away food, public houses, hotels, hairdressing, domestic help, dry cleaning/laundry and mini-cab services) did increase in the period after the minimum wage was introduced and that prices rose faster for those goods and services for which demand was relatively more price inelastic. This is the first study that we have commissioned to find econometric evidence that employers in some sectors have been able to pass on some of the costs of the minimum wage on to consumers.

[1] A treatment group of goods and services (those affected by the minimum wage) are compared with a control group (those unaffected by the minimum wage). Prices of the two groups are then compared for periods before and after the introduction (uprating) of the minimum wage. The difference between these differences provides the difference-in-difference estimate. Statistical techniques are then used to test the statistical significance of these differences.

19 Dickerson (2007) examined employer-provided training following the introduction and subsequent upratings of the National Minimum Wage using the Labour Force Survey (LFS). Previous research by Arulampalam, Booth and Bryan (2004), using the BHPS, found that the training of minimum wage workers appeared to have marginally increased following the introduction of the minimum wage. Using standard difference-in-difference techniques, Dickerson's findings revealed that the introduction of the minimum wage appeared to have had no statistically significant impact on the provision of job-related training. This result held for men and women, adults and young workers. In summary he found that the minimum wage had had no effect (positive or negative) on the incidence of employer-provided training in the UK but concluded that this was consistent with the evidence on the other aspects of the National Minimum Wage, which revealed that, to date, any impact on the labour market had been negligible.

20 In 2005, when commissioning these research projects, we had in mind the slowdown in the economy at that time. We therefore commissioned Incomes Data Services (IDS) to look at the impact of economic recession on pay increases and the low-paid. IDS (2006a) looked at the changes in employment, wages and prices in the last recession in the early 1990s. Throughout the 1990–1993 recession, UK output declined and claimant unemployment increased to nearly 3 million. Despite this, employment in the two biggest low-paying sectors – retail and hospitality – remained stable throughout, as did employment in other lower-paying sectors such as fast food, restaurants and pubs, hairdressing, cleaning and catering. Over the course of the three years, pay settlements were closely related to the level of inflation, which fluctuated a great deal. Pay increases did not vary much by sector and increases in low-paying sectors kept pace with settlements generally, as did Wages Council increases.

21 IDS concluded that during the 1990–1993 recession, jobs in the low-paying sectors were not adversely affected, at least not on anything like the scale seen in manufacturing or construction, even though pay increases in the low-paying sectors matched or slightly exceeded inflation. However, these conclusions might not carry over to a recession that had different causes, such as a collapse in consumer spending.

Table A2.1

Low Pay Commission Research Projects

Researcher	Project Title	Aims and Methodology	Key results
Christian Dustmann, Tommaso Frattini and Ian Preston (University College, London)	A Study of Migrant Workers and the National Minimum Wage and Enforcement Issues.	The analysis built on an earlier study commissioned by the Home Office that used the Labour Force Survey. Extending this analysis and using the Census of Population, they attempted to identify the impact of immigration on wages in Great Britain and examined wage effects along the entire distribution. Confining their analyses to the working age population, they compared the British-born population with those foreign-born but divided the latter group into established immigrants and new immigrants (those who had been in Britain for less than two years). Using difference-in-difference techniques, they estimated the impact of migration along the entire wage distribution. They used the spatial correlation approach and the skill cell approach. Instrumental variables were used to attempt to exclude the effects of migrants being drawn to economically prosperous regions.	Migrants were, on average, younger and better educated than the locally available pool of labour. Established migrants and British-born people had similar occupation and industry distributions. Recent immigrants tended to be working in lower status occupations than suggested by their qualifications. Not only were they more likely to be in lower-paying sectors, they were generally paid less than natives and established migrants. Recent Eastern European immigrants were even more likely to be low-paid in the low-paying sectors. Immigration decreased wages at the bottom end of the distribution but increased wages further up. Immigration led to a widening of the wage distribution but the minimum wage has prevented wages at the bottom falling further.
Stephen French and Jutta Möhrke (Centre for Industrial Relations, Institute of Public Policy and Management, Keele University)	The Impact of 'New Arrivals' Upon the North Staffordshire Labour Market.	A detailed study of the impact of migrant workers on the North Staffordshire labour market. The project included two small surveys, one of members of the Chartered Institute of Personnel and Development and one of migrant workers. It involved interviews with employer representatives in the retail and pottery sectors, with nursing agencies, and general and international employment agencies; and Citizens Advice Bureaux. Face-to-face discussions were also held with workers from the EU Accession States (A8), overseas students, and refugees and asylum seekers.	Many firms from a wide range of sectors utilised migrant labour, primarily to address labour shortages and, to a lesser extent, skills shortages. However, migrant workers made up less than 5 per cent of the workforce in over three-quarters of workforces covered by the study. The vast majority of migrant labour was employed in low-skilled, comparatively low-paid employment in the food processing, manufacturing and distribution sectors. The researchers found that employers, including agencies, had strong perceptions of what was, and what was not, migrant work and that this limited the opportunities for skilled migrant workers to move into high-skilled work. There was some evidence of employers substituting refugees in favour of A8 workers. Migrant workers were generally recruited as part of general recruitment, with limited use of international agencies or direct international recruitment. Most migrant workers who took part in the study were paid at or slightly above the minimum wage. Employers' experiences of using migrant workers had been positive in terms of productivity, flexibility and retention, and these factors had resulted in substantial savings in unit labour costs, without the need to cut pay rates. The researchers found evidence of exploitation of migrant workers, in particularly when recruitment was through an employment agency, including, but not limited to, the underpayment of workers and abuses of the accommodation offset. Other issues highlighted, albeit based on a small sample, related to poor housing conditions, long working hours, detrimental contractual changes on arrival in UK, forced relocation and little, if any, knowledge of UK employment rights or how to access them.

Researcher	Project Title	Aims and Methodology	Key results
Experian Business Strategies Limited (in collaboration with the Institute for Employment Studies)	Investigating the Sectoral and Regional Effects of the 2003 and 2004 National Minimum Wage Upratings.	The researchers looked for the sectoral and regional impact of the introduction and subsequent upratings on the minimum wage and tried to isolate it from other changes in the sectors and the economy. They investigated this issue using industry shares of regional totals and comparing them with the UK. They also compiled a measure of the potential impact of the minimum wage on average earnings, estimated from Annual Survey of Hours and Earnings (ASHE) data, to look at the minimum wage bite. Due to data limitations they confined much of their analyses to retail and hospitality.	Using the raw data, they found a clear, but small, negative correlation between the minimum wage and relative employment share growth in hospitality but no such discernible effect in retail. Using a pooled regression for 1995 to 2004, they estimated that the minimum wage had a small but statistically significant negative impact on employment in hospitality. There was no such effect in retail unless London and the West Midlands were omitted. They noted that they could find no impact from the introduction of the minimum wage on employment in retail or hospitality, using individual years. They did, however, find a negative effect in hospitality as a result of the large minimum wage upratings in 2001 and 2003. Using similar methodology, they found no effect of the minimum wage on profits at a regional or sectoral level. However, they did find some evidence of a statistically significant reduction in company formation in distribution (wholesale, retail and motor vehicles). Weaker evidence was found for hospitality.
Ann Denvir and George Loukas (Institute for Employment Studies)	The Impact of the National Minimum Wage: Pay Differentials and Workplace Change.	A telephone survey of 510 establishments in the retail, hospitality and personal services sectors to establish the extent of change to pay and pay structures, staffing, training, skills and work organisation attributed to the impact of the minimum wage. Follow-up interviews with 25 firms that had made significant or innovative changes attributed to the impact of the minimum wage to explore the nature of the changes made in greater depth. Sample split between (i) firms that had made changes to address the impact on differentials and (ii) firms that did not address pay differentials in 2005 (and therefore they were assumed to have been compressed).	The initial telephone survey found that fifty-nine per cent of firms reported that the minimum wage had had an impact on their business, with the hospitality sector the most affected. The main impacts were on labour costs (55 per cent of the whole sample), profits (38 per cent), prices (24 per cent), employment (23 per cent) and non-labour costs (22 per cent). Some 226 firms, or 57 per cent of those providing pay data, reported that they had increased pay rates as a result of the minimum wage increase in 2005. Of these 226 firms, 49 maintained pay differentials after the October 2005 increase (10 per cent of the whole sample) while 102 firms (20 per cent of the whole sample) did not. Around 31 per cent of the 510 firms made changes to the pay structure attributed to the minimum wage while 22 per cent reported making changes to staffing levels and hours. The most common responses were: changes in recruitment and retention practice, changes to the composition of the workforce (e.g. part-time/full-time mix) and recruitment of employees with different skills, of a different age or more migrant workers. The interviews with 25 case study firms found that most had focused on internal reorganisation of rewards and working practices and had felt unable to adjust prices or business practices. There was no evidence of a relationship between decisions about whether to maintain differentials and changes to pay, staffing, training or work organisation. Common responses to pressures attributed to the minimum wage included changes to pay rates (such as reducing special or discretionary payments), and a reduction in staffing levels (through non-replacement of staff or reductions in both operating and working hours).

Researcher	Project Title	Aims and Methodology	Key results
Alastair Hatchett, Catherine Chubb, Catherine Kirk and Nicola Allison (Incomes Data Services)	The Effect of the Minimum Wage on Employment and Profits in an Economic Recession.	IDS examined the experience of pay and employment during the economic recession of 1990 to 1993, using internal IDS data. IDS looked at the relationship between the general level of settlements and price inflation (RPI) during the period, identifying those industrial sectors prone to pay freezes. Internal data on Wages Council increases also enabled an assessment of statutory minimums over the period. Following the study of the effect of recession on the low paid, the implications for the minimum wage were assessed.	Organisations started to lift their lowest rates of pay in 1991 in anticipation of the introduction of a national minimum wage in 1992. Despite the large increase in aggregate UK unemployment, they found that employment in the low-paying sectors remained stable throughout the recession, even though pay increases in the low-paying sectors matched or slightly exceeded inflation. They concluded that a recession that had different causes, such as a collapse in consumer spending, might not have such little impact on the low-paying sectors as the recession of the early 1990s.
Peter Sloane, Phil Murphy, Paul Latreille, Richard Jones and Melanie Jones (University of Wales, Swansea)	Further Analysis of Flows Into and Out of the National Minimum Wage.	The researchers used the New Earnings Survey Panel Data (NESPD) to estimate the probability of being in each of four states (employed at minimum wage, employed above minimum wage, unemployed or economically inactive). They estimated exit rates from these states and investigate duration dependence. They used a random effects probit model to assess an individual's propensity to be on the minimum wage depending on certain characteristics (such as age and gender and whether they were on the minimum wage). They then used the Labour Force Survey (LFS) to examine inflows to and outflows from low pay at a regional level.	The researchers found that minimum wage employment was more prevalent among women, the young, part-timers in the private sector, multiple jobholders, those in small firms and those outside the south east of England (not in London or the South East). Although less likely than younger workers to be in low-paid employment, they found that older workers were less likely to exit such jobs and thus experienced longer spells in minimum wage employment. For the majority of workers affected, minimum wage jobs were of short duration. However, the researchers found some scarring effects for a small group of workers who experienced longer spells of minimum wage employment. The study found that more recent minimum wage entrants had a reduced probability of moving out of minimum wage jobs, so that the average duration of spells in these jobs was increasing. It concluded that the minimum wage had maintained the wages of the low-paid without any deleterious effect on labour market.

Researcher	Project Title	Aims and Methodology	Key results
Mark Bryan and Mark Taylor (Institute for Social and Economic Research, University of Essex)	Identifying the Patterns of National Minimum Wage Receipt in Britain 1999–2004.	The researchers used data for 1999–2004 from the British Household Panel Survey (BHPS) to look at how individuals moved into and out of minimum wage employment and to assess how these movements were related to the characteristics of individuals (single/multi-earner, marital status, number and age of children, housing tenure, and head of household's personal characteristics). They defined minimum wage recipients as 'occasional' if they were in minimum wage employment in one or two years but 'persistent' if they experienced minimum wage employment in three or more years. The aim of the study was to investigate whether minimum wage jobs were stepping-stones into higher paid employment or whether they were part of a low pay–no pay cycle.	They found that some 20 per cent of all workers had been in minimum wage employment at some point between 1999 and 2004. Most of these were occasional recipients, but nearly a third were persistent. Persistent minimum wage workers tended to be women (especially married women), those with no qualifications and older workers. In contrast single men were most likely to leave such employment. Around 40 per cent remained in minimum wage employment the following year. Most of those leaving went into higher paying employment rather than non-employment. However, minimum wage workers spent more time out of work than other workers. They also found that flows into minimum wage employment were highest from other low-paid jobs and unemployment. The researchers noted that there was a core of persistent minimum wage employees who remained in low-paid jobs and were more likely to return to such jobs if they managed to leave. They concluded that for many workers, minimum wage employment was a stepping stone to higher paid employment but there was also a large group that were part of a low pay–no pay cycle.
Andy Dickerson (formerly Institute for Employment Research, University of Warwick, now University of Sheffield)	Longer Term Implications of the Minimum Wage: A Re-examination of Employer Provided Training.	Recent evidence using the BHPS revealed some evidence that training of affected workers increased following the introduction of the minimum wage. This project sought to establish whether this result was robust, and to extend it using a larger dataset, the Labour Force Survey. The research used standard difference-in-difference analysis to compare the outcome of those affected by the minimum wage with a control group that, although similar in certain characteristics, were not affected. It explored the impact over subsequent upratings of the minimum wage, different forms of training (on and off the job training), and whether there were differences in any impact of the minimum wage on training provision. The research looked separately at men and women, adults and young people.	The research found that the introduction of the minimum wage had not significantly changed the provision of job-related training. It also found no effect from the subsequent upratings of the minimum wage. There was no effect for men, women, adults or younger workers. The researcher checked the robustness of these results by looking at alternative specifications of the control group and using different measures of wages. The research concluded that employers did not react to the minimum wage by either increasing employer-provided training in order to increase productivity and thus afford the higher wages, nor did they reduce employer-provided training as a means of reducing costs.

Researcher	Project Title	Aims and Methodology	Key results
Jonathan Wadsworth (Royal Holloway College, University of London)	Do Increases in the Minimum Wage Change Consumption Patterns?	This study looked at the consumption patterns of minimum wage households and also the prices of those goods and services most affected by the minimum wage. It used the Family Expenditure Survey and the Expenditure and Food Survey to document the consumption patterns of minimum wage households and investigated how they compared with other households over the period since the introduction of the minimum wage in 1999. Using Engel curves (which relate budget shares to total household expenditure), he examined how expenditure patterns had varied. He then used difference-in-difference analysis to investigate whether there were statistical differences in how expenditure shares changed between groups over time. Using detailed breakdowns in the Retail Price Index, Wadsworth also investigated the impact of the minimum wage on the prices of certain good and services. He defined minimum wage goods and services as those produced by sectors with a high share of minimum wage workers in the stock of that sector's total employees. He looked at price increases at the time of the introduction of the minimum wage as well as subsequent upratings.	The research found that average disposable income was around 50 per cent lower in households with an adult minimum wage earner than in other households with occupants in work. It found that there were no significant differences in expenditure patterns across household types and that there were few significant differences in the shapes of the Engel curves between minimum wage households and other working households. The study found little evidence of any significant change in the spending patterns of households in receipt of a minimum wage income relative to other working households. It found that minimum wage households did not exclusively consume minimum wage goods and services but they did spend disproportionately more on take-away food and less on cleaners and hotels. This means that any price effects of minimum wages will be spread across the population. The study estimated that the inflation rate of nine minimum wage goods and services (restaurant meals, canteen meals, take-away food, public houses, hotels, hairdressing, domestic help, dry cleaning/laundry and mini-cab services) rose, on average, by an additional 0.8 percentage points above the rate of aggregate retail price inflation after the introduction of the minimum wage. The research found that the relative price changes of minimum wage goods were more muted when compared with a set of domestically produced goods and services produced by sectors that employed a lower share of minimum wage workers in their workforces. The researcher concluded that there may have been a small effect of the minimum wage on the prices of some goods and services produced by minimum wage workers (particularly those whose demand was relatively more price inelastic).

Researcher	Project Title	Aims and Methodology	Key results
Alastair Hatchett, Sarah Miller, Catherine Kirk and Nicola Allison (Incomes Data Services)	Monitoring the Impact of the National Minimum Wage in Low-paying Sectors.	IDS looked at the impact of the 2005 increase in the minimum wage, and employers' ongoing responses to the minimum wage, following on from previous work for the Commission. (The methodology was essentially the same as in previous years, although the scope was more limited.) The researchers used a mixture of telephone and postal surveys (of around 1000 organisations) and followed up with more in-depth telephone-based interviews. They focused their attention on hospitality (including fast food, pubs, hotels and restaurants); care homes; nurseries; leisure; retail; business services; manufacturing (modern apprentices); and the public sector.	The study found that the minimum wage was having an increasing impact on pay setting and pay structures. It not only impacted on those workers directly affected but also on those higher paid in the firm and on higher paying firms competing in the same sector. Many firms had moved their pay review dates to 1 October. The researchers found that differentials had been affected and that grade structures had been changed as a result of the minimum wage. Many companies offering geographic pay systems to reflect varying labour market conditions had reduced the pay gap between geographic zones or reduced the number of zones. Some sectors in hospitality had made greater use of wage rates below the adult rate for those aged under 22. However, in other sectors, the common practice was to pay adult rates at age 18. The research found that the minimum wage had little impact on pay in the public sector as the lowest wage rates in the NHS, local government and the civil service were set at much higher levels. Although effects on pay structures were found in all the low-paying sectors considered, only in the childcare sector did they find any evidence that these changes had led to falls in employment.
Richard Croucher and Geoff White (University of Middlesex Business School and University of Greenwich Work and Employment Research Unit)	Awareness of the Minimum Wage in the Hairdressing Industry: An Evaluation of the DTI/HMRC Targeted Campaign.	The researchers adopted two main methods in taking forward the project. They conducted a postal survey of employers, workers and trainees, a postal survey of National Hairdressers' Federation members and a telephone survey of salons. They also held focus groups with trainees, training organisations and employees and meetings with employers.	Overall, awareness of the minimum wage among both employers and workers was patchy. Although awareness was higher among owners and managers than among employees and trainees, only a minority of respondents could correctly identify the rates and how they operated. Some significant patterns of knowledge, or lack of it, were apparent, with understanding of rates other than the main adult rate especially weak. The researchers highlighted, as an example of the lack of understanding, the fact that some respondents thought that employees from countries outside the European Union did not have to be paid the minimum wage. There was some indication from the research that membership of the employers' body, the National Hairdressers' Federation, had had a positive effect on awareness, but this was inconclusive. Trainees showed low levels of awareness and understanding of the minimum wage. The DTI/HMRC campaign had reached a modest proportion of the respondents to the surveys conducted, and in a small but significant number of cases this had led to positive changes in practice. The campaign had also improved awareness of the National Minimum Wage Helpline, allowing specific individual enquiries to be made, although enquirers had no more general understanding of the minimum wage and how it worked than non-enquirers. It was felt that improvements in the publicity given to the minimum wage could be made to further raise awareness levels.

Low Pay Commission Survey of Employers

The Survey

1 For previous reports, we have conducted surveys of employers in low-paying sectors to provide information on how businesses have responded to and coped with the National Minimum Wage. For this report, we conducted a further survey of employers to examine the impact of the October 2005 upratings of the minimum wage and to complement the information we obtained from our research programme, written and oral evidence and official statistics. We consider here the key findings of the survey, including the impact of the upratings on wage bills and differentials, staffing, productivity, prices and profits. We also look at other issues such as the pay of young people and apprentices. In addition this year we have included new questions on the employment of migrant workers, annual leave entitlement and compliance and enforcement. In line with previous surveys, we have also asked additional questions of the social care and textiles and clothing sectors. The survey questionnaire can be found at the end of the Appendix.

2 As with earlier surveys, we have targeted the main low-paying sectors as identified by our analysis of the Annual Survey of Hours and Earnings (ASHE), since they are likely to be the most affected by the minimum wage. In addition to hospitality, retail, social care, textiles and clothing, hairdressing, cleaning, security and leisure, travel and sport[1], we have included the agriculture (defined as Standard Industrial Classification (SIC) codes 01–05) and food processing (SIC 15.1–15.8) sectors for the first time in this year's survey.

3 We commissioned GfK NOP to undertake the administration of the survey on our behalf. A random sample of firms in the low-paying

1 Hereafter referred to as leisure.

sectors was selected from the Dunn and Bradsheet business database and stratified by firm size, sector and region. Smaller strata (large firms, Scotland, Wales and Northern Ireland, and smaller sectors) were oversampled to allow separate analysis. Over 33,000 postal questionnaires were distributed to employers in June and July 2006. We received 4,174 replies, which gives a response rate of 13 per cent. This is 3 percentage points higher than the response rate achieved in our 2004 survey and similar to that achieved in earlier surveys. We are very grateful to those businesses which took the time to complete and return the questionnaire.

4 Table A3.1 gives the response rates by sector and shows that the highest rate of response was in the childcare and social care sectors, as in previous years, followed by food processing. The response rate in Northern Ireland was lower than in other regions and a higher proportion of medium-sized firms responded to the survey compared with small and large firms[2].

Table A3.1
Responses to the 2006 Employers' Survey by Sector

	Agriculture (SIC 01–05)	Childcare (SIC 85.32)	Cleaning (SIC 74.7, 93.01)	Food processing (SIC 15.1–15.8)	Hairdressing (SIC 93.02, 93.04)	Hospitality (SIC 55)	Leisure (SIC 92.13, 92.3, 92.6, 92.7)	Retail (SIC 50, 52)	Security (SIC 74.6)	Social care (SIC 85.31, 85.113)	Textiles and clothing (SIC 17, 18)	All sectors
Number of responses	337	552	310	335	266	384	401	498	151	721	219	**4,174**
Response rate (per cent)	11	21	10	16	9	10	10	10	13	19	12	**13**

5 Because respondents to the survey are more likely to be affected by the minimum wage than non-respondents, the survey results are not representative of the low-paying sectors as a whole (nor because of the targeted sectors approach, are they representative of the economy as a whole). Quantifying this bias is far from straightforward and we have therefore not corrected for it – as in previous years, results are unweighted. Moreover, the number of responses can be very small for specific questions, especially when analysed by individual sectors. For all these reasons, the results of the survey should be interpreted with care.

[2] A small firm has fewer than 50 employees, a medium-sized firm employs 50 to 249 people and a large firm employs over 250 people.

6 Table A3.2 shows that the respondent firms employed over 280,000 people. This is around 45,000 more than the number of employees covered in the 2004 survey and reflects the higher response rate. The median number of employees in firms across all sectors is 17, reflecting the high proportion of small businesses in the sample.

Table A3.2
Number of Employees by Sector in the Sample

	Total number of employees	Median number of employees per firm
Agriculture	15,204	8
Childcare	11,539	12
Cleaning	33,691	30
Food processing	38,401	35
Hairdressing	2,324	4
Hospitality	28,974	24
Leisure	42,949	20
Retail	46,748	11
Security	9,826	24
Social care	41,579	25
Textiles and clothing	10,338	23
All sectors	**281,573**	**17**

Base: All firms that provided employee numbers (91 per cent).

7 Table A3.3 illustrates the distribution of respondent firms by size. Around three-quarters of respondents were small firms and one-fifth were medium-sized firms. There is a higher incidence (over 90 per cent) of small firms in the hairdressing and childcare sectors while 10 per cent of the respondent firms in the cleaning and food processing sectors employed over 250 people.

Table A3.3
Size Distribution of Firms by Sector

Per cent	1–49 employees	50–249 employees	250+ employees
Agriculture	78	17	5
Childcare	94	6	0
Cleaning	61	29	10
Food processing	58	33	10
Hairdressing	98	1	0
Hospitality	66	30	3
Leisure	70	23	7
Retail	72	22	6
Security	72	24	4
Social care	72	24	4
Textiles and clothing	68	29	3
All sectors	**74**	**21**	**5**

Base: All firms that provided employee numbers (91 per cent).

Impact

8 Table A3.4 shows that around 42 per cent of respondents said that their business had been affected by the October 2005 increase in the minimum wage in any way. In earlier surveys, the proportion of respondents affected by the 2001 and 2003 upratings was 50 and 46 per cent respectively. However, it is worth noting that the October 2005 uprating, by 4.1 per cent from £4.85 to £5.05, was more modest than the 2001 and 2003 increases in the minimum wage (which were 10.8 and 7.1 per cent respectively). As in the 2004 survey, a higher proportion of respondents were affected in the childcare, hospitality and cleaning sectors.

Table A3.4
Percentage of Firms Affected by the October 2005 Increases in the National Minimum Wage in Any Way

	Agriculture	Childcare	Cleaning	Food processing	Hair-dressing	Hos-pitality	Leisure	Retail	Security	Social care	Textiles and clothing	All sectors
Per cent	23	58	47	40	39	57	34	41	31	41	40	**42**

Base: All firms that responded to the question (97 per cent).

9 The impact of the 2005 upratings was found to be greater on large firms, with 59 per cent being affected compared with 40 and 53 per cent for small and medium-sized firms respectively.

10 It is important to note that the responses to our survey are likely to overstate the impact of the National Minimum Wage on businesses for two main reasons. First, the survey specifically targeted low-paying sectors, which are likely to be most affected by the minimum wage. Secondly, even within these sectors, those who responded are more likely to have been significantly affected than non-respondents. We tested this hypothesis of an upward bias in our Fourth Report (2003) by conducting a telephone follow-up survey of a random sample of 900 non-respondents to the postal survey. This confirmed that the proportion of those affected in the follow-up survey (27 per cent) was considerably lower than in the main postal survey (50 per cent). They also reported a smaller impact on their wage bill. This implies that the results of the survey are biased towards those who have experienced the greatest impact of the National Minimum Wage and should therefore not be taken to be indicative of the overall impact on businesses, even in low-paying sectors. The survey does, however, provide valuable information on how those affected by increases in the minimum wage have coped and enables comparisons between sectors and size of business.

Total Wage Bill

11 Table A3.5 shows that the majority (56 per cent) of respondents who said they were affected by the October 2005 upratings reported that their total pay bill had increased by more than 5 per cent, with around 41 per cent reporting a wage bill increase of less than 5 per cent and only 4 per cent of respondents reporting no change. This compares with three-quarters of affected respondents reporting pay bill increases over 5 per cent in the 2002 and 2004 surveys. The incidence of those reporting larger increases in their pay bill varied by sector, with the social care, childcare and hairdressing sectors the most affected. Medium-sized and large firms were also more likely to report pay bill increases over 5 per cent than small firms.

Table A3.5
Impact on Total Pay Bill for Firms Affected by the October 2005 Increases in the National Minimum Wage

Per cent	No change	Increased by less than 5%	Increased by more than 5%
Agriculture	6	54	41
Childcare	1	31	68
Cleaning	5	41	54
Food processing	5	41	54
Hairdressing	1	32	67
Hospitality	4	39	57
Leisure	3	54	42
Retail	5	49	46
Security	7	35	59
Social care	3	34	63
Textiles and clothing	4	61	35
All sectors	**4**	**41**	**56**

Base: All firms affected by the October 2005 increases in the National Minimum Wage in any way and that responded to the question (40 per cent).

Differentials

12 Table A3.6 indicates that over two-thirds of those respondents who had to increase their pay rates as a result of the 2005 upratings did so to comply with the new National Minimium Wage rates. A similar result was found in the 2004 survey. The cleaning, hospitality, leisure and retail sectors were particularly affected as three-quarters of firms in these sectors reported that this was the reason for increasing pay rates. This compares with only 53 per cent of respondent businesses in the social care sector.

13 Overall, around 42 per cent of respondents affected by the 2005 upratings reported that they had increased pay rates to maintain pay differentials above the lowest pay rate. This compares with 47 per cent in the 2004 survey. This was particularly the case for the childcare, food processing and textile sectors, but not so much in the hairdressing sector as only 18 per cent of firms invoked this reason to explain pay increases. Similarly, 40 and 30 per cent of affected respondents (down from 51 and 37 per cent in 2004) said that they increased pay rates to maintain pay differentials for more experienced staff and for higher grade staff respectively. In both cases, the childcare sector seemed the most affected.

14 Looking at the type of firms most affected, large firms were more likely to have increased rates to comply with the new National Minimum Wage rates and to maintain pay differentials for the lowest pay rates, while smaller firms were more likely to have increased rates to maintain pay differentials for more experienced staff.

Table A3.6
Impact on Pay Rates for Firms Affected by the October 2005 Increases in the National Minimum Wage

Per cent	To comply with the new NMW rates	To maintain pay differentials above the NMW of lowest pay rate	To maintain pay differentials for more experienced staff	To maintain pay differentials for higher-grade staff (e.g. supervisers)	Other reason
Agriculture	61	31	31	20	14
Childcare	68	54	65	51	1
Cleaning	76	43	28	28	1
Food processing	72	50	41	27	0
Hairdressing	73	18	32	8	3
Hospitality	75	37	35	27	3
Leisure	75	39	31	26	1
Retail	76	32	30	26	2
Security	69	42	29	24	0
Social care	53	45	44	31	4
Textiles and clothing	68	50	34	23	2
All sectors	**69**	**42**	**40**	**30**	**2**

Base: All firms affected by the October 2005 increases in the National Minimum Wage in any way and who responded to the question (40 per cent).
Note: Respondents gave multiple answers and row totals therefore do not add up to 100 per cent.

15 Table A3.7 illustrates the distribution of the highest hourly pay rate increased by businesses to maintain pay differentials as a result of the October 2005 upratings. The median highest hourly pay rate which firms reported increasing was £6.00, while about a third of respondent firms reported that the highest pay rate they increased was below £5.50. By contrast, nearly two-fifths of respondents said that the highest rates increased were above £6.50, compared with 22 per cent in 2004. The data suggest that the effect on the highest rates of pay was most significant in the cleaning, agriculture, social care and childcare sectors. About 47 per cent of large firms responding to the question reported that the highest pay rate increased was above £6.50, compared with 30 per cent of small firms and 43 per cent of medium-sized firms.

16 Across all sectors, the median increase to the highest rates was 40 pence per hour. The lowest median increase was in the security sector (25 pence) and the highest in the agriculture, hairdressing and hospitality sectors (50 pence).

Table A3.7
Distribution of Highest Hourly Pay Rate Increased to Maintain Pay Differentials

Per cent	£4.50 to £5.04	£5.05 to £5.49	£5.50 to £5.99	£6.00 to £6.49	£6.50 to £6.99	£7.00 and over	Median highest rate (£)	Median increase (£)
Agriculture	14	10	21	10	3	41	6.00	0.50
Childcare	12	14	17	19	11	28	6.00	0.40
Cleaning	14	16	20	4	14	31	5.88	0.35
Food processing	11	20	14	20	6	30	6.00	0.35
Hairdressing	19	22	25	17	6	11	5.50	0.50
Hospitality	23	24	19	9	4	23	5.50	0.50
Leisure	10	26	16	13	10	25	5.78	0.43
Retail	22	16	20	10	7	25	5.66	0.40
Security	4	28	20	28	16	4	5.80	0.25
Social care	8	22	17	14	8	31	6.00	0.40
Textiles and clothing	12	26	12	16	7	28	6.00	0.35
All sectors	**14**	**19**	**18**	**14**	**9**	**27**	**5.85**	**0.40**

Base: All firms that increased pay rates to maintain differentials and responded to the question (22 per cent).

Benefits

17 We asked firms affected by the October 2005 upratings in the minimum wage whether it led to any benefits for their business. Table A3.8 shows that overall, the majority (over 8 in 10) of respondents who had reported an impact said that the latest upratings did not bring any benefits. Around 14 per cent of businesses claimed to have noted an improvement in their staff motivation, although only one per cent said the change was significant. The childcare and hairdressing sectors were more likely to report increased staff motivation than other sectors. About 13 per cent of businesses affected by the 2005 minimum wage upratings reported that they experienced lower staff turnover, while 8 per cent of respondents were able to fill vacancies more quickly. This is in line with the 2004 survey results.

Table A3.8
Benefits to Businesses from the October 2005 Increases in the National Minimum Wage

	Lower staff turnover		Higher staff motivation		Faster filling of vacancies	
Per cent	**Significant**	**Slight**	**Significant**	**Slight**	**Significant**	**Slight**
Agriculture	0	7	0	16	0	7
Childcare	2	10	1	17	1	6
Cleaning	3	15	3	12	2	10
Food processing	2	6	1	10	2	4
Hairdressing	6	7	3	15	0	7
Hospitality	1	11	2	12	3	7
Leisure	2	9	0	12	1	5
Retail	1	12	1	12	1	6
Security	7	11	5	9	0	9
Social care	1	14	1	12	0	10
Textiles and clothing	0	5	0	8	0	1
All sectors	**2**	**11**	**1**	**13**	**1**	**7**

Base: All firms that increased pay rates to maintain differentials and responded to the question (39 per cent).

Staffing

18 We asked businesses that had reported being affected by the 2005 minimum wage upratings whether they made any adjustments to staffing and hours as a response. Table A3.9 shows that the most widespread adjustment reported by businesses in response to the National Minimum Wage increase was to reduce overall staffing levels, reported by 34 per cent of affected businesses. This compares with 37 per cent in the 2004 survey. The hospitality and agriculture sectors were the most affected, with 49 and 44 per cent of respondents respectively reporting changes to staffing levels. About a quarter of affected firms also said that they decreased basic hours and overtime hours – this is slightly down compared with the previous survey. Around 14 per cent of firms said they reduced overtime rates and incentive payments in response to the upratings.

19 Firms which had reported large (over 5 per cent) increases to their wage bills as a result of the October 2005 upratings were also found to be more likely to make adjustments to staffing and hours than respondents who had experienced small or no wage bill increases.

Table A3.9
Changes Made by Firms as a Result of the October 2005 Increases in the National Minimum Wage

	Overall staffing levels		Basic hours		Overtime hours		Overtime rates/ incentive payments/ bonuses/commission/ tips etc		Non-wage benefits e.g. meal vouchers, paid breaks etc	
Per cent	**Increase**	**Decrease**	**Increase**	**Decrease**	**Increase**	**Decrease**	**Increase**	**Decrease**	**Increase**	**Decrease**
Agriculture	6	44	7	15	4	30	12	17	3	3
Childcare	2	30	3	22	2	30	2	17	2	8
Cleaning	4	23	4	19	1	20	7	14	1	2
Food processing	4	36	1	23	3	37	6	22	0	4
Hairdressing	4	39	4	32	4	14	6	16	2	3
Hospitality	3	49	4	42	3	33	2	13	3	10
Leisure	3	39	2	33	1	31	7	15	0	9
Retail	2	43	1	33	2	30	5	13	1	4
Security	9	40	7	23	5	12	9	7	0	5
Social care	4	16	3	12	2	18	6	11	0	5
Textiles and clothing	0	37	0	16	1	30	8	13	0	5
All sectors	**3**	**34**	**3**	**25**	**2**	**27**	**5**	**14**	**1**	**6**

Base: All affected firms responding to the question (37 per cent).

Productivity, Prices and Profits

20 Table A3.10 shows the range of adjustments that affected firms reported they had made following the October 2005 upratings. The greatest impact by far was on profits as 78 per cent of affected respondent firms reported a reduction in their profits, compared with 80 per cent in the 2004 survey. No particular sector stood out compared with others. Around 58 per cent of affected businesses also said that they increased prices in response to the minimum wage upratings. The childcare, cleaning and hairdressing sectors were most likely to increase prices.

21 To a lesser extent, affected businesses also reported having to take measures to control labour costs (29 per cent) and non-labour costs (35 per cent). In particular, 46 per cent of firms in the hospitality sector said they had to adjust non-labour costs. Only a small proportion of businesses said that they responded to the October 2005 upratings by adjusting the quality of goods and services they provided, introducing new products or services or resorting to unskilled/unqualified labour. However, this varied across sectors: for example, one quarter of firms in the agriculture sector said they increased their use of unskilled/unqualified labour.

22 There was also some variation in the incidence of adjustments made to the business across firms of different sizes. For instance, large firms were less likely than small and medium-sized firms to have experienced a fall in profits. The impact on prices was also greater the smaller the size of the firm. The most significant differences in the response of different firm types related to labour costs: around 46 per cent of large firms took measures to control labour costs compared with 36 and 26 per cent of medium-sized and small firms respectively. Finally, small firms were less likely than others to adjust non-labour costs or introduce new technologies or processes.

Table A3.10

Has the October 2005 Increase in the National Minimum Wage Led to any Changes in any of the Following in your Business?

Per cent	Agriculture	Child-care	Clean-ing	Food pro-cessing	Hair dressing	Hos-pitality	Leisure	Retail	Security	Social care	Textiles and clothing	All sectors
Profits												
Increase	3	2	3	2	4	3	0	2	4	2	1	**2**
Decrease	79	87	77	79	73	79	72	75	78	76	81	**78**
Prices												
Increase	30	83	71	55	68	63	53	41	66	46	38	**58**
Decrease	11	2	6	3	3	3	2	3	7	3	4	**3**
Measures taken to control labour costs												
Increase	32	30	26	35	28	35	33	26	30	23	29	**29**
Decrease	6	8	5	5	7	4	5	6	9	4	5	**6**
Measures taken to control non-labour costs												
Increase	35	40	33	40	39	46	32	27	21	30	31	**35**
Decrease	4	14	11	4	9	5	4	6	9	6	4	**7**
Use of new technology/processes												
Increase	27	13	13	27	9	16	17	17	24	14	14	**16**
Decrease	1	10	2	3	4	1	2	2	2	3	2	**4**
Quality of goods and service you provide												
Increase	9	9	7	6	15	11	4	4	12	7	5	**8**
Decrease	6	7	5	6	7	8	6	5	5	5	4	**6**
Introduction of new products or services												
Increase	6	10	8	11	21	16	11	10	7	5	10	**10**
Decrease	9	11	3	6	7	4	4	5	7	5	4	**6**
Use of unskilled/ unqualified labour												
Increase	25	17	5	15	8	17	10	6	2	6	6	**11**
Decrease	7	5	2	2	11	3	6	6	2	4	5	**5**

Base: All affected firms responding to the question (38 per cent).

23 As in previous surveys, we asked additional questions of firms in the textiles and clothing sector relating to the impact of the increases in the minimum wage on their incentive pay schemes and productivity. Just over a quarter of textiles and clothing firms reported that they had an incentive pay system (e.g. piece rates or payment by results). This is in line with the results of the 2004 survey. Incentive pay systems were more prevalent in some types of businesses than others. For instance, over half of knitwear and hosiery manufacturers said they had an incentive pay system compared with about 10 per cent of print finishers and soft furnishing manufacturers. Medium-sized and large firms were also more likely to have incentive pay systems than small firms.

24 Around 59 per cent of textiles firms with an incentive pay system said that they had been affected by the October 2005 increases in the minimum wage compared with 35 per cent of textiles firms without such a scheme. We asked those firms with an incentive pay system whether they had experienced any of the effects outlined in Table A3.11. Around 62 per cent reported an increase in costs and half reported a significant increase. This compares with 31 per cent in the 2004 survey and in general, fewer firms reported no change in the 2006 survey than they did in the 2004 survey. For instance, 18 per cent of firms in the 2004 survey said the October 2003 upratings had resulted in reduced differentials compared with 44 per cent of respondents reporting an impact on differentials arising from the October 2005 upratings.

Table A3.11
Impact of the National Minimum Wage on Incentive Pay Systems in the Textiles and Clothing Sector

Per cent	Significant	Slight	None
Reduce differentials	21	23	56
Reduced competitiveness	23	17	60
Reduced ability to motivate employees	23	13	63
Reduced productivity	10	18	72
Increased costs	31	31	38

Base: All firms in the textiles and clothing sector with an incentive pay system (26 per cent).

25 As in previous surveys, we sought information from the social care sector on the extent to which businesses in this sector have been able

to renegotiate the conditions of public sector contracts following minimum wage upratings. Nearly four in five firms in the social care sector which reported being affected by the October 2005 upratings had public sector contracts and nearly two-thirds of these tried to renegotiate their contracts to take account of increased minimum wage costs. However, 38 per cent of these were not successful while 31 per cent only managed to renegotiate their contracts in part.

Employment and Pay of Young People

26 Table A3.12 shows that 14 per cent of firms responding to the survey said they used age-related pay structures. By comparison, 20 per cent of respondents said they had age-related structures in the 2004 survey. These pay structures were more common in the hospitality and childcare sectors, at 30 and 20 per cent respectively, while the security, social care and cleaning sectors were least likely to make use of age-related pay. The prevalence of age-related pay was also less (at 12 per cent) in small firms compared with medium-sized and large firms.

Table A3.12
Firms with Age-related Pay Structures

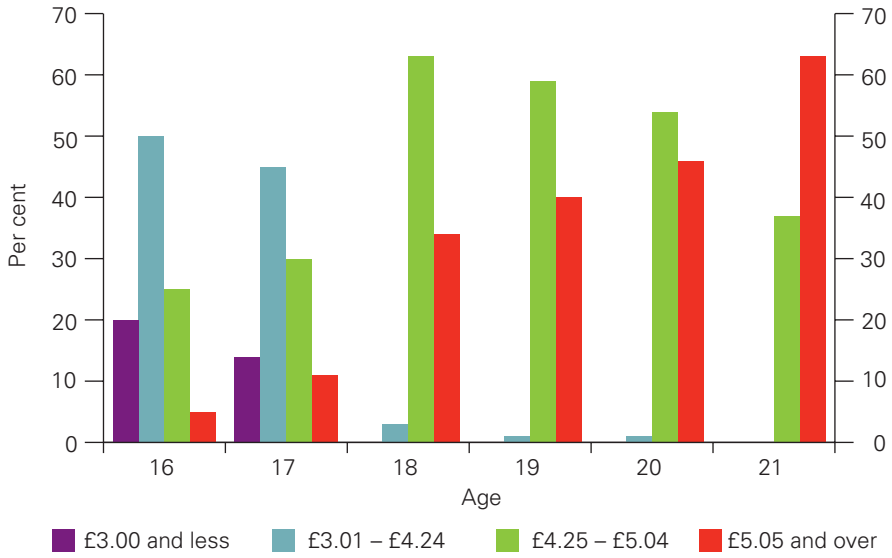
	Agriculture	Childcare	Cleaning	Food processing	Hair-dressing	Hos-pitality	Leisure	Retail	Security	Social care	Textiles and clothing	All sectors
Percentage of firms with age-related pay	12	20	6	17	17	30	14	18	2	6	10	**14**

Base: All firms that responded to the question (97 per cent).

27 Figure A3.1 gives the distribution of minimum pay rates by age for those firms in the sample which made use of age-related pay. It shows that a sizeable proportion of firms pay employees aged below 22 more than the minimum wage rate applicable for their age and that use of the adult rate clearly increases with employees' age. Over 80 per cent of firms with age-related pay structures paid their 16 and 17 year old employees above the 16–17 year old rate of £3.00 per hour, with 30 per cent and 41 per cent of respondent firms respectively paying their 16 and 17 year old employees a minimum hourly rate equal or superior to the then Youth Development Rate of £4.25.

28 Around 26 per cent of businesses with age-related pay systems reported paying their 18 year old employees above the Youth Development Rate and this proportion went up to 57 per cent for 21 year olds.

Figure A3.1
Distribution of Minimum Hourly Pay Rates by Age



Base: All firms with age-related pay structures that responded to the question (8–10 per cent).

29 We also asked those same respondents (14 per cent of all firms) to state the age from which they paid their adult rate of pay. Table A3.13 shows that 21 per cent of these firms started paying the full adult rate at 18. This is in contrast to the results of the 2004 survey, which showed that 46 per cent of firms paid the full adult rate at 18. Conversely, around 44 per cent of firms reported starting paying the adult rate to employees aged 22 and above, compared with 22 per cent in the 2004 survey. The age at which the adult rate applied varied considerably by sector. The social care and textiles and clothing sectors were the most likely (at over 36 per cent) to start paying the adult rate at 18 compared with 11 per cent of firms in the hairdressing sector.

Table A3.13

Age at which a Worker is Entitled to the Full Adult Rate in Firms with Age-related Pay Structures

	Age					
Per cent	**16–17**	**18**	**19**	**20**	**21**	**22+**
Agriculture	6	12	42	6	9	24
Childcare	1	16	1	3	25	54
Cleaning	0	19	0	13	38	31
Food processing	2	31	5	5	16	40
Hairdressing	3	11	0	8	32	46
Hospitality	4	19	3	5	24	46
Leisure	2	16	0	10	33	39
Retail	0	21	9	2	23	44
Security	0	33	0	0	0	67
Social care	0	37	2	2	20	39
Textiles and clothing	0	36	5	0	9	50
All sectors	**2**	**21**	**6**	**5**	**23**	**44**

Base: All firms with age-related pay structures that responded to the question (13 per cent).

30 Finally, we asked firms with age-related pay structures whether they would be more or less likely to employ young people as a consequence of the October 2005 minimum wage upratings. Overall, the increases had little impact on these employers' decisions regarding the employment of young workers. Table A3.14 shows that around four-fifths of businesses said it had made no difference to their employment of 16 to 21 year olds, with 8 and 13 per cent noting that they were more likely to employ 16–17 and 18–21 year olds respectively.

Table A3.14

Has the Introduction of a National Minimum Wage for 16 and 17 Year Olds in October 2004 (£3.00), or the 2005 Increase in the Youth Rate for 18–21 Year Olds (£4.25) and the Adult Rate (£5.05) Made you More or Less Likely to Employ Workers in Different Age Groups?

Per cent	**Total**
Workers aged 16–17	
More likely	8
Less likely	11
No change	81
Workers aged 18–21	
More likely	13
Less likely	9
No change	78
Workers aged 22 or over	
More likely	3
Less likely	14
No change	83

Base: All firms with age-related pay structures that responded to the question (13 per cent).

Apprentices

31 Table A3.15 shows that one in ten of the surveyed firms employed apprentices. This is similar to the 2004 survey. However, this varied significantly across sectors, with one third of respondents in the hairdressing sector and over one fifth of respondents in childcare employing apprentices. The social care, textiles and agriculture sectors were least likely to do so.

Table A3.15
Firms Employing Apprentices

	Agriculture	Childcare	Cleaning	Food processing	Hair-dressing	Hos-pitality	Leisure	Retail	Security	Social care	Textiles and clothing	All sectors
Per cent	4	22	5	8	34	5	7	15	7	3	4	**10**

Base: All firms (100 per cent).

32 Table A3.16 shows the distribution of apprentices by age group across all sectors and in those sectors employing a high proportion of apprentices. Overall, a third of apprentices were aged 16 to 17 and just under half were aged 18 to 19. Only 8 per cent of apprentices were aged 22 and above. The age distribution varied across sectors; over half of apprentices in hairdressing businesses were aged 16–17, compared with 22 per cent in the retail sector. Large firms were also found to be less likely than small and medium-sized firms to employ 16–17 year old apprentices.

Table A3.16
Distribution of Apprentices by Age Group

	Age					
Per cent	**16–17**	**18**	**19**	**20**	**21**	**22+**
Childcare	35	30	12	10	6	8
Hairdressing	54	28	9	2	1	6
Retail	22	13	22	22	5	10
Other sectors	33	17	19	12	7	12
All sectors	**34**	**27**	**18**	**10**	**5**	**8**

Base: All firms that responded to the question (10 per cent).

33 Table A3.17 shows the average (median) hourly rate of pay for apprentices across all sectors and in the three sectors that employed a high proportion of apprentices. The average hourly wage for a first-year apprentice was £3.60, rising to £4.25 and £5.00 in the second and third years respectively. The hairdressing sector, at £3.00, had lower than average apprentice pay in year 1 and 2, possibly reflecting the very high proportion of 16–17 year old apprentices in that sector.

Table A3.17
Average Hourly Rate of Pay for Apprentices

£ per hour	1st year	2nd year	3rd year
Childcare	4.03	4.25	4.25
Hairdressing	3.00	3.00	4.25
Retail	3.00	4.25	4.98
All sectors	**3.60**	**4.25**	**5.00**

Base: All firms that responded to the question (10 per cent).

Migrant Workers

34 We asked businesses whether they employed migrant workers and whether this was becoming a more frequent occurrence. As shown in Table A3.18, over a quarter of respondent firms reported employing migrants. This was much more prevalent in the food processing and hospitality sectors where about half of respondents said they employed migrant workers. The childcare, hairdressing and retail sectors were least likely to do so. One-fifth of respondents employing migrant workers said that they had started to employ migrants in the last year, predominantly in the hairdressing and retail sectors, while 42 per cent reported that the number of their migrant employees was increasing, notably in the food processing, agriculture and cleaning sectors. Finally, a third of businesses said the number of migrant employees had not changed.

35 The data suggest that only 18 per cent of small firms employed migrant workers compared with 57 per cent of medium-sized firms and 73 per cent of large firms. Among these, 30 per cent of small firms reported having started to employ migrants in the last 12 months. The employment of migrant workers was slightly more prevalent in Northern Ireland and England than in Wales and Scotland.

Table A3.18
Firms Employing Migrant Workers

Per cent	Employ migrant workers	Of which: Started employing migrants in last 12 months	Number has increased	Number had decreased	Number has not changed
Agriculture	28	22	50	7	21
Childcare	11	33	20	2	44
Cleaning	42	14	56	3	27
Food processing	52	26	51	5	17
Hairdressing	3	43	29	0	29
Hospitality	49	21	51	0	28
Leisure	20	24	32	8	36
Retail	17	34	32	1	32
Security	29	20	34	2	44
Social care	35	20	44	3	33
Textiles and clothing	26	23	35	4	38
All sectors	**28**	**23**	**44**	**3**	**29**

Base: All firms that responded to the question (91 per cent).

36 We asked businesses what were the main reasons for employing migrant workers and, as shown in Table A3.19, the great majority (64 per cent) did so because of shortages in the labour market. The security, social care, agriculture and cleaning sectors were most affected. Around 23 per cent of employers employed migrant workers because of their efficiency, especially in the childcare and textiles and clothing sectors. Only 6 per cent of respondents said they employed migrant workers because they were more qualified/skilled or to control wage costs. Of those who gave other reasons, around half said it was because they were equal opportunity employers and had recruited the best candidate for the job.

Table A3.19

Main Reasons for Employing Migrant Workers

Per cent	Because of shortages in the local labour market	Because of their efficiency	Because they are more qualified/skilled	To control wage costs	Other reasons
Agriculture	70	29	8	7	6
Childcare	30	31	19	2	26
Cleaning	73	20	4	5	12
Food processing	69	27	4	7	7
Hairdressing	43	14	14	0	43
Hospitality	68	27	6	6	8
Leisure	42	26	11	4	22
Retail	51	26	4	4	15
Security	80	5	2	2	5
Social care	71	12	6	6	15
Textiles and clothing	44	31	0	10	17
All sectors	**64**	**23**	**6**	**6**	**12**

Base: All respondent firms employing migrant workers (26 per cent).

Note: Respondents gave multiple answers and row totals therefore do not add up to 100 per cent.

Bank Holidays

37 To assess the likely impact of the forthcoming legislation on annual leave entitlement, we asked businesses whether their full-time employees were entitled to paid leave on Public or Bank Holidays (or alternative days in lieu) on top of their statutory leave entitlement – currently 20 days. As indicated in Table A3.20, nearly three-quarters of respondents said that their staff were entitled to paid leave on Bank or Public Holidays. However, fewer businesses did so in the hospitality and security sectors (55 per cent) and in the social care sector (63 per cent). Those firms which reported a larger impact of the October 2005 upratings on their pay bill were less likely to provide paid leave on these days. Employees in large firms were more likely to be entitled to paid leave on Bank Holidays than those employed by medium-sized and small firms. Only 67 per cent of Welsh businesses said that their employees were entitled to paid leave on Bank Holidays compared with 80 per cent of firms in Northern Ireland.

Table A3.20

Firms in Which Employees are Entitled to Paid Leave on Public or Bank Holidays (or Days in Lieu)

	Agriculture	Childcare	Cleaning	Food processing	Hair-dressing	Hos-pitality	Leisure	Retail	Security	Social care	Textiles and clothing	Total
Per cent	79	78	67	86	73	55	77	82	55	63	89	**73**

Base: All firms that responded to the question (95 per cent).

38 Table A3.21 shows that in the great majority (79 per cent) of businesses offering paid leave on some Bank Holidays, employees were entitled to 7 or more Bank Holidays as paid leave and in 13 per cent of respondent firms, employees were entitled to 5–6 days paid leave. In only 7 per cent of firms were employees entitled to fewer than 4 days paid leave on Bank Holidays. However, the position varied across sectors. For instance, employees were entitled to 4 days paid leave or fewer in up to 20 per cent of respondent firms in the hospitality sector, one of the sectors with already the lowest proportion of firms granting paid leave on Bank Holidays. In the textiles and security sectors on the other hand, employees were entitled to 7 or more Bank Holidays as paid leave in 88 and 93 per cent of firms respectively. Large firms were also more likely to pay for 7 days or more (93 per cent compared with 63 per cent of small firms).

Table A3.21

How Many Public or Bank Holidays (or Other Days in Lieu) are your Full-time Employees Entitled to as Paid Leave?

Per cent	4 or less	5–6	7 or more
Agriculture	7	13	80
Childcare	9	15	76
Cleaning	6	11	83
Food processing	4	12	84
Hairdressing	12	22	66
Hospitality	20	19	61
Leisure	5	12	83
Retail	6	14	80
Security	5	2	93
Social care	6	11	82
Textiles and clothing	3	9	88
All sectors	**7**	**13**	**79**

Base: All respondent firms with employees entitled to paid leave on Public/Bank holidays (68 per cent).

Compliance and Enforcement

39 We asked businesses whether they were aware of any other businesses in their local area not complying with National Minimum Wage requirements. As shown in Table A3.22, only 5 per cent of respondent firms reported that they were aware of non-compliance in their area. The most affected sectors were hospitality and security with about one in ten firms being aware of potential non-compliance.

Table A3.22
Percentage of Firms Aware of Non-compliance with National Minimum Wage Requirements in their Local Area

	Agriculture	Childcare	Cleaning	Food processing	Hair-dressing	Hos-pitality	Leisure	Retail	Security	Social care	Textiles and clothing	All sectors
Per cent	2	6	5	3	7	9	4	3	10	4	2	**5**

Base: All firms that responded to the question (97 per cent).

40 Among those aware of non-compliance, very few firms were also aware of any actions by HM Revenue and Customs (HMRC) to enforce the National Minimum Wage, including those sectors with a high proportion of firms which said that some of their competitors were not complying. However, awareness of enforcement activities was highest (42 per cent) in hairdressing, a sector which HMRC minimum wage enforcement teams targeted in 2005 in a year-long campaign of education and enforcement. Firms in the food processing and leisure sectors were also more likely to be aware of enforcement actions.

Table A3.23
Percentage of Firms Aware of Enforcement Actions by HMRC

	Agriculture	Childcare	Cleaning	Food processing	Hair-dressing	Hos-pitality	Leisure	Retail	Security	Social care	Textiles and clothing	All sectors
Per cent	13	15	0	27	42	6	24	7	13	18	0	**16**

Base: All respondent firms aware of non-compliance (5 per cent).

Conclusion

41 As in previous years, our survey has provided valuable information about the impact of the 2005 upratings on those sectors most affected by the minimum wage.

42 Just over 40 per cent of respondents to the survey said that their business had been affected by the October 2005 upratings and over half of these firms reported that their wage bill had increased by 5 per cent or more. The proportion affected is smaller than in the previous surveys. However, the 2005 minimum wage upratings were more modest than the 2001 and 2003 increases.

43 There is some evidence of the minimum wage upratings having an impact on pay differentials, with about a third of affected firms reporting having to increase pay rates to maintain differentials. Few firms affected by the 2005 minimum wage upratings reported that these had led to benefits for their business such as lower staff turnover. However, nearly four out of five affected firms said that they had experienced a decline in profits as a result of the upratings. Over half also reported an increase in prices. A quarter to a third of affected firms also responded to the October 2005 upratings by reducing their overall levels of staff and basic and overtime hours.

44 As in previous years, the survey highlighted that limited use is made of age-related pay structures, with only 16 per cent of respondents having age-related pay systems. However, 44 per cent of these firms reported starting paying the adult rate at 22, a substantial increase compared with the 2004 survey.

45 For the first time this year, we asked businesses about their employment of migrant workers. Just over a quarter of respondents reported employing migrant workers, and the great majority of these said they had started doing so, or had increased the number of such employees, in the last year. Nearly four in five businesses that employed migrant workers said they did so because of shortages in the local labour market.

46 The survey highlighted that employees were entitled to paid leave on Public or Bank Holidays in three-quarters of the businesses surveyed and the majority of these granted 7 or more such days to their employees. However, a substantial proportion of businesses in the security, hairdressing and hospitality sectors were less likely to do so.

47 Only 5 per cent of businesses reported being aware of non-compliance in their sector and among these, few, with the exception of the hairdressing sector, said they were aware of HMRC enforcement activity.

NATIONAL MINIMUM WAGE SURVEY

Using BLACK ink, please indicate your answers with a cross ☒ or write in the figures requested. All your answers will be handled in the strictest confidence.

1. How many workers in total does your business currently employ? How many are men? And how many women? (Please include all workers – full-time, part-time, and casual staff) *(Please write in number)*

Total ☐ Men ☐ Women ☐

2. How many workers in your business are aged...? *(Please write in number)*

16 to 17 ☐ 18 to 21 ☐ 22 or over ☐

3. Has the October 2005 increase in the National Minimum Wage (NMW) affected your business in any way?

Yes ☐ *(Go to Q4)* No ☐ *(Go to Q10)*

4. What has happened to your TOTAL pay bill as a result of the October 2005 increase in the National Minimum Wage? *(Please cross one box)*

No change ☐ Increased by less than 5% ☐
Increased by more than 5% ☐

5. If you have increased the pay rates of staff as a result of the October 2005 increase in the National Minimum Wage, was the increase due to any of the following reasons? *(Please cross boxes which are applicable).*

To comply with the new NMW rates (i.e. £5.05 for 22+ yrs, £4.25 for 18-21 yrs and £3.00 for 16-17 yrs) ☐ *(Go to Q7)*
To maintain pay differentials above the NMW of lowest pay rate ☐ *(Go to Q6)*
To maintain pay differentials for more experienced staff ☐ *(Go to Q6)*
To maintain pay differentials for higher-grade staff (e.g. supervisors) ☐ *(Go to Q6)*
Other reasons *(Please specify)* ☐ *(Go to Q7)*

.....

6. Please specify the highest hourly pay rate you increased to maintain pay differentials, as a result of the October 2005 increase in the National Minimum Wage. *(Please write in pounds and pence)*

From £ ☐ To £ ☐

7. Has the October 2005 increase in the National Minimum Wage led to any of the following benefits for your business? *(Please state whether significant, slight or none)*

	Significant	*Slight*	*None*
Lower staff turnover	☐	☐	☐
Higher staff motivation	☐	☐	☐
Faster filling of vacancies	☐	☐	☐

8. As a result of the October 2005 increase in the National Minimum Wage, have you changed any of the following in your business? *(Please cross one box for each potential change)*

	Significant Increase	*Slight Increase*	*Slight Decrease*	*Significant Decrease*	*No Change*
Overall staffing levels	☐	☐	☐	☐	☐
Basic hours	☐	☐	☐	☐	☐
Overtime hours	☐	☐	☐	☐	☐
Overtime rates/incentive payments/bonuses/commission/tips etc	☐	☐	☐	☐	☐
Non-wage benefits (e.g. meal vouchers, paid breaks etc)	☐	☐	☐	☐	☐

9. Has the October 2005 increase in the National Minimum Wage led to changes in any of the following in your business? *(Please cross one box for each potential change)*

	Significant Increase	*Slight Increase*	*Slight Decrease*	*Significant Decrease*	*No Change*
Profits	☐	☐	☐	☐	☐
Prices	☐	☐	☐	☐	☐
Measures taken to control labour costs (e.g. treatment of absence, paid breaks, staff meals, overtime rates)	☐	☐	☐	☐	☐
Measures taken to control non-labour costs (e.g. costs of supplies, distribution and marketing costs, improved stock control)	☐	☐	☐	☐	☐
Use of new technology/processes	☐	☐	☐	☐	☐
Quality of goods and services you provide	☐	☐	☐	☐	☐
Introduction of new products or services	☐	☐	☐	☐	☐
Use of unskilled/unqualified labour	☐	☐	☐	☐	☐
Other *(Please specify)*	☐	☐	☐	☐	☐

.....

10. Do you have age-related pay structures? Yes ☐ *(Go to Q11)* No ☐ *(Go to Q14)*

11. Please enter the current minimum hourly rates for workers in each of the following age groups in your business. If you have no workers in any age band please leave blank. *(Please write in pounds and pence)*

16 £ ☐ 17 £ ☐ 18 £ ☐ 19 £ ☐

20 £ ☐ 21 £ ☐ 22+ £ ☐

12. Has the introduction of a National Minimum Wage for 16 and 17 year olds in October 2004 (£3.00), or the 2005 increase in the adult rate (£4.25 for 18-21 yrs and £5.05 for 22+ yrs) made you more or less likely to employ workers in different age groups? *(Please cross one box for each age group)*

	More likely	*Less likely*	*No change*
Workers aged 16–17	☐	☐	☐
Workers aged 18–21	☐	☐	☐
Workers aged 22 or over	☐	☐	☐

13. At what age is a worker entitled to your full adult rate? *(Please write in number)*

☐

14. If you employ apprentices, how many of your apprentices are aged...? *(Please insert number in each age group)*

Don't employ apprentices ☐ *(Go to Q16)*

16 to 17 ☐ *(Go to Q15)*

18 ☐ *(Go to Q15)*

19 ☐ *(Go to Q15)*

20 ☐ *(Go to Q15)*

21 ☐ *(Go to Q15)*

22+ ☐ *(Go to Q15)*

15. What is your lowest hourly pay rate for employed apprentices? *(Please write in pounds and pence)*

1st year apprentices £ ☐

2nd year apprentices £ ☐

3rd year apprentices £ ☐

16. If you employ migrant workers (non-UK nationals), has their number increased over the last 12 months? *(Please cross one box).*

We don't employ migrant workers ☐ *(Go to Q18)*

Started employing migrants in last 12 months ☐ *(Go to Q17)*

Number has increased ☐ *(Go to Q17)*

Number has decreased ☐ *(Go to Q17)*

Number has not changed ☐ *(Go to Q17)*

17. For what main reason do you employ migrant workers? *(Please cross one box)*

Because of shortages in the local labour market ☐

Because of their efficiency ☐

Because they are more qualified/skilled ☐

To control wage costs ☐

Other reasons *(Please specify)* ☐

.....

18. At present, are your full-time employees entitled to paid leave on Public or Bank Holidays (or alternative days in lieu) on top of their statutory annual leave entitlement? *Full-time employees are legally entitled to 20 days (4 weeks) paid annual leave (pro-rata if paid part-time). At present, Bank and Public Holidays can count towards the 20 days.*

Yes ☐ *(Go to Q19)* No ☐ *(Go to Q20)*

19. How many Public or bank holidays are your full-time employees entitled to as paid leave? *(Please cross one box)*

4 or less ☐ 5-6 ☐ 7 or more ☐

20. In your local area, are you aware of any businesses not complying with National Minimum Wage requirements?

Yes ☐ *(Go to Q21)* No ☐ *(Go to Q22)*

21. Are you aware of any action by HM Revenue and Customs (formerly Inland Revenue) to enforce the National Minimum Wage in your local area?

Yes ☐ No ☐

22. We would find helpful any other comments that you might have about your experience of the National Minimum Wage. Please continue on a separate sheet if necessary. All your comments will be read.

Additional Questions for the Social Care Sector

23. Does your business provide services to the public sector?

Yes ☐ *(Go to Q23)* No ☐ *(Go to Q26)*

24. Did you seek to renegotiate the conditions of your public sector contract as a result of the October 2005 increase in the National Minimum Wage?

Yes ☐ No ☐

25. Were you successful in renegotiating the contract?

Yes ☐ No ☐ In part ☐

26. What percentage of the increase in your pay bill due to the October 2005 increase in the National Minimum Wage were you able to recoup through negotiation?

None ☐ 1 to 24% ☐ 25 to 49% ☐
50 to 74% ☐ 75 to 99% ☐ 100% ☐

Additional Questions for the Textiles and Clothing Sector

23. Do you have an incentive pay system (e.g. piece rate or payment by results)?

Yes ☐ *(Go to Q23)* No ☐ *(Go to Q26)*

24. What impact has the October 2005 increase in the National Minimum Wage had on your incentive system? *(Please state whether significant, slight or none)*

	Significant	*Slight*	*None*
Reduce differentials	☐	☐	☐
Reduced competitiveness	☐	☐	☐
Reduced ability to motivate employees	☐	☐	☐
Reduced productivety	☐	☐	☐
Increased costs	☐	☐	☐

25. Do you determine the hours worked by your piece rate workers?

Yes ☐ *(Go to Q26)* No ☐ *(Go to Q25)*

26. Has the change from 'fair estimate agreements' to 'fair piece rates' in October 2004/April 2005 had either of the following impacts on your incentive system? *(Please state whether significant, slight or none)*

	Significant	*Slight*	*None*
Reduced administration	☐	☐	☐
Reduced complexity	☐	☐	☐
Other *(Please specify)*	☐	☐	☐

Minimum Wage Systems in Other Countries

An Overview

1 This appendix updates the information on overseas minimum wage systems contained in the Commission's 2005 Report. It also provides brief, country-specific information where there is the possibility of a minimum wage being introduced, or where there has been interesting debate or developments in a country's minimum wage arrangements. Since our 2005 Report we have been consulted about the operation of our minimum wage arrangements by representatives from a number of countries, including Germany, Australia, New Zealand, Malaysia and Hong Kong.

2 Among the states with an established minimum wage, we describe changes to minimum wage arrangements in Australia and Portugal. We also provide information on developments in the last couple of years in France, the Netherlands, New Zealand and the United States. In Ireland the social partners were unable to agree a new rate for 2007 and the matter was consequently referred to the Labour Court to make a recommendation.

3 Among those states contemplating the introduction of a minimum wage, there has been continued public debate in Germany and the States of Guernsey (the Guernsey Government) has been conducting a public consultation.

4 As in previous reports, the information provided here has been derived from contributions provided by British Embassies and High Commissions and the Organisation for Economic Co-operation and Development (OECD). We are grateful for the assistance they have given us.

5 Eurostat (2006) looked at the minimum wage rates of EU member states and certain candidate countries on 1 January 2006. It found that these countries could be divided into three groups in respect of the level of the minimum wage. The first group had a monthly minimum wage ranging from 82 to 331 Euros – mainly Eastern European countries. The second group – Southern European – had a monthly minimum wage ranging from 437 to 668 Euros, and included Portugal, Slovenia, Malta, Spain and Greece. Group three – with a monthly minimum wage of over 1,200 Euros – was made up of the Northern European states of France, Belgium, the UK, the Netherlands, Ireland and Luxemburg. When differences in purchasing power were taken into account, the disparity between member states (in Euros) reduced, but the ranking remained virtually unchanged. Therefore, as in previous reports, we have compared the UK's minimum wage arrangements with those systems in the longer established EU states, as opposed to those which joined since 2004, and which in the main have substantially lower rates. We also include other selected OECD countries so that the information presented is consistent with that presented in previous reports.

6 We provide a comparison of minimum hourly wage rates across the selected OECD countries, as at the end of 2006 (Table A4.1). As always, caution should be taken in drawing comparisons between countries as definitions of what counts towards the minimum wage differ. Not only this, there are also differences with regard to the age at which the minimum wage rate(s) apply, whether there are any exemptions, and in the overall coverage of the respective mechanisms. In addition, anniversary dates vary, with some countries expected to increase their wage rates again in early 2007 – detailed under Specific Country Updates.

7 When measuring minimum wage rates against the general level of earnings in the UK economy, we have regarded median, rather than average (mean), earnings as the more appropriate comparator. This is because of the disproportionate influence on the UK's earnings distribution of a relatively few high earners – which drives up the mean earnings figure. The OECD has again supplied data on minimum wage rates as a proportion of median earnings, with Table A4.2 giving this information for mid-2005 (the latest available period). This ranks the UK

minimum wage in mid-table among the group of countries shown. For comparisons with mean earnings, the Government provided evidence to the Commission which can be seen at www.dti.gov.uk.

8 As in previous reports, we also describe the approaches adopted across countries for uprating their minimum wages, enforcing the provisions and any age variations. In most cases these remain the same as reported in 2005 (Tables A4.3 to A4.6).

Specific Country Updates

Australia

9 The wage-setting and adjusting functions of the Australian Industrial Relations Commission have been replaced by the Australian Fair Pay Commission. The Fair Pay Commission was established on 14 December 2005 under the Workplace Relations Amendment (WorkChoices) Act 2005 as a statutory body independent of the Australian Government. It is responsible for setting and adjusting the Federal Minimum Wage and other minimum rates of pay[1]. It also sets minimum wage rates for juniors, apprentices, trainees and employees with a disability. Its wage setting powers commenced on 27 March 2006. The Fair Pay Commission carried out a public consultation throughout the middle of 2006 and announced its first wage-setting decision on 26 October 2006. This raised the Federal Minimum Wage to Aus $13.47 per hour (an increase of 5.6 per cent), effective from 1 December 2006. The Fair Pay Commission has announced a minimum wage review in 2007, with a decision expected mid-year. It will also conduct reviews of junior and trainee wage rates.

France

10 After several years in which a range of minimum wages applied, the national minimum wage rise in July 2005, combined with lower rises in various special guaranteed monthly wage rates for workers who had moved to the 35 hour week, meant these different rates converged so there was once again a single rate. The minimum wage

[1] Contained in Australian Pay and Classification Scales (derived from pre-reform awards).

rose by 3.05 per cent to €8.27 per hour in July 2006, with the Government deciding to go beyond the minimum price-based increase required by law – which would have seen a 2.75 per cent rise.

Germany

11 In our 2005 Report we noted that a public debate was taking place in Germany over the possibility of introducing a national minimum wage, and this continued during 2006. As well as the principle of introducing a minimum wage, debate has taken place on such matters as the level at which it might be introduced; whether it should be a 'living wage' or a wages 'floor'; and the role of collectively agreed sector minimum rates in any statutory minimum wage system. Discussion has also centred on the impact of a minimum wage on work incentives for those receiving social payments.

12 At present an approximation to a minimum wage in Germany is achieved by way of the posted workers' law, which requires all employers in a particular sector to pay the collectively negotiated rate for the job. Previously the law was used only in the building industry. In 2006 the Government announced its intention to extend the use of this law, effectively to introduce a minimum wage for office cleaners. Other sectors are being considered, including agency work, agriculture, hotels and catering, security and meat processing. The Government is expected to produce proposals in March 2007 on a wider reform package, but at present it is still unclear whether a minimum wage will be included and, if so, what form it will take. Chancellor Merkel has ruled out a universal UK-style national minimum wage.

Guernsey

13 Consultation is currently taking place about the possible introduction of a statutory minimum wage in Guernsey. Jersey has had a minimum wage since April 2005; its introduction featured in our 2005 Report. At the end of 2006, the States of Guernsey Government's Commerce and Employment Department conducted a public consultation on the implications of minimum wage legislation should it be introduced. Following consideration of the comments received, the Department will

report back to the States on whether a minimum wage is required, and if so, make recommendations as to its scope, application and enforcement.

Ireland

14 Employer and trade union representatives failed to agree the minimum wage revision due to commence at the beginning of 2007. The matter was referred to the Labour Court and in early December 2006 the court recommended an increase from the existing rate of €7.65 to €8.30 on 1 January 2007 and to €8.65 on 1 July 2007. The final decision rested with the Minister for Labour Affairs, who later in December confirmed these new minimum wage rates.

Netherlands

15 Following an agreement between the Government and the social partners for a wage freeze in 2004 and 2005 in line with the Government's policy of restoring Dutch competitiveness, the minimum wage was uprated in January and July 2006, with a further rise in January 2007 to take the rate to €300.20 per week or €7.51 per hour.

New Zealand

16 Recent developments in New Zealand have concentrated on the youth rate. In 2000 the youth rate was increased from 60 per cent to 80 per cent of New Zealand's adult minimum wage and adult rates were applied to 18 and 19 year olds. Following the general election in September 2005, the Labour Government announced that it would increase the adult minimum wage to NZ $12.00 per hour in 2008 'if economic conditions allow' (the rate currently in force is NZ $10.25 per hour, up from NZ $9.50 in March 2006, and due to rise to NZ $11.25 in April 2007). Under this agreement youth rates would remain at 80 per cent of the adult wage rate. However a private member's bill was introduced to Parliament in February 2006 seeking to abolish youth rates. If the proposed legislation is passed, the adult minimum wage will be extended to cover 16 and 17 year olds. The bill has so far progressed through its legislative stages, with support from Labour, and the Select Committee will report back in May 2007.

17 Outside of the legislative process there has been a union-led campaign aimed at increasing the minimum wage to NZ $12.00 per hour and abolishing youth wages, so that young people receive the adult wage rate. This has subsequently led to some companies abolishing a separate youth wage or, as in one case in the restaurant sector, agreeing to raise youth staff pay to 90 per cent of the adult minimum wage.

Portugal

18 In December 2006 new rules were agreed between the Government and the social partners for Portugal's national minimum wage. The agreement provided that the minimum wage for 2007 would be set at €403 per month (up from €385.90 in 2006), and that it should reach €450 by 2009 and €500 by 2011. Under this new multi-annual approach, aimed at providing both workers and employers with increased stability, a new tripartite committee will be set up, bringing together representatives from the Government, unions and employers. This committee will monitor Portugal's economic conditions – looking in particular at the sectors and/or regions with the highest shares of low-paid workers and/or more exposed to international competition – as well as the economic and social impact of the minimum wage. It will issue, at the end of each year, a recommended upgrade for the national minimum wage. The Government will then consider this recommendation and, following a final consultation with the social partners, set the wage for the subsequent year.

United States

19 At the end of 2006 the federal minimum wage, last increased in 1997, remained at US $5.15 an hour, or US $2.13 an hour for employees who earn tips. This looks set to change. Increasing the minimum wage is a top priority for the Democratic-led 110th Congress that convened on 4 January 2007. Many states have not waited for federal action. More than half of the US population lives in the 22 states, and the District of Columbia, which have passed legislation requiring employers to pay more than the federal minimum. Current state levels range from US $6.15 in Delaware, Maryland and Minnesota to US $7.93 in Washington State.

Comparison of Minimum Wage Systems

Table A4.1

Comparison of Level of Minimum Wages[a] Across Countries, End 2006

	In national currency expressed as hourly rate[b]	In UK £, using: Exchange rates[c]	PPPs[d]	Date of last uprating	Age full minimum wage usually applies[e]
Australia[f]	Aus $13.47	5.41	5.88	December 2006	21
Belgium	€7.12 (€1234.20/month)	4.79	5.09	August 2005	21
Canada[g]	Can $7.57	3.58	3.85	[h]	16
France	€8.27	5.56	5.73	July 2006	18
Greece[i]	€3.50 (€27.96/day)	2.35	2.94	September 2006	15
Ireland	€7.65[j]	5.14	4.32	May 2005	20
Japan[k]	Yen 673	3.02	2.94	October 2006	16
Netherlands	€7.41[l] (€296.45/week)	4.98	5.19	July 2006	23
New Zealand	NZ $10.25	3.61	4.15	March 2006	18
Portugal[m]	€2.23 (€385.90/month)	1.50	2.05	January 2006	16
Spain[m]	€3.12 (€540.90/month)	2.10	2.56	January 2006	16
United Kingdom	£5.35	5.35	5.35	October 2006	22
United States	US $5.15[n]	2.75	3.23	1997	20

Sources: British Embassies and High Commissions. OECD Minimum Wage Database. LPC calculation of exchange rates and PPPs. PPPs derived from CPLs, OECD Main Economic Indicators, October 2006. For exchange rates, Bank of England monthly average spot exchange rate, October 2006.

Notes:

(a) In all cases, the minimum wage refers to the basic rate for adults.
(b) For countries where the minimum wage is not expressed as an hourly rate, the rate has been converted to an hourly basis assuming a working time of 8 hours per day, 40 hours per week and 173.3 hours per month.
(c) October 2006.
(d) Purchasing Power Parities (PPPs) derived by applying OECD Comparative Price Levels (CPLs) – ratio of PPPs for private consumption to exchange rates – for October 2006.
(e) Exemptions and special rules apply in many cases. For example, in France and the United States the full adult rate applies to young workers with a tenure of more than 6 and more than 3 months respectively. See Table A4.5 for further details.
(f) Federal minimum wage – expressed as hourly rate under Fair Pay Commission arrangements.
(g) Weighted average of provincial/territorial rates.
(h) Date of last uprating varies between provinces.
(i) For blue collar workers.
(j) To increase on 1 January 2007 to €8.30 (in UK £=5.58 using exchange rates, and £=4.69 using PPPs), and on 1 July 2007 to €8.65 (in UK £=5.82 using exchange rates, and £=4.89 using PPPs).
(k) Weighted average of prefectural rates.
(l) Excludes 8 per cent supplement for holiday pay.
(m) Not including annual supplementary pay of two additional months of salary for full-time workers.
(n) Federal minimum wage. Tipped employees receive a lower minimum wage of $2.13 per hour in direct wages.

Table A4.2

Adult Minimum Wages Relative to Full-time Median Earnings, Mid-2005[a]

Country	Percentage
France	58.0
Australia[b]	
– LFS	57.1
– ES	53.6
New Zealand	56.1
Ireland	54.5
Greece	48.8
Belgium	48.0
Netherlands[c]	46.0 (49.7)
United Kingdom[d]	44.9
Canada	39.9
Portugal[e]	37.6 (43.9)
Japan	33.2
Spain[e]	32.8 (38.3)
United States	32.0

Sources: Minimum wages and median earnings for full-time workers: OECD estimates and OECD Earnings Structure Database.

Notes:

(a) In all cases, the minimum wage refers to the basic rate for adults. Except for the UK and US the median earnings data for full-time workers for mid-2005 are estimates based on extrapolating data for earlier years, in line with other indicators of average earnings growth. All earnings data are gross of employee social security contributions.

(b) Two estimates of median earnings are available based on the Labour Force Survey (LFS) and an Enterprise Survey (ES). In each case, the data refer to weekly earnings. The minimum wage refers to the Federal Minimum Wage.

(c) The ratio including 8 per cent supplement for holiday pay is given in parentheses.

(d) Differs from the LPC estimate in Chapter 2 (Table 2.2), as the OECD estimate is for full-time, rather than all, employees.

(e) The ratio including annual supplementary pay of two additional months of salary is given in parentheses.

Table A4.3

Uprating of Minimum Wages

Country	Method of Uprating
Australia	An independent body (the Australian Fair Pay Commission) is responsible for setting a Federal Minimum Wage. From 2006 it replaced the Australian Industrial Relations Commission (AIRC) for this function. It handed down its first ruling in October 2006, increasing the Federal Minimum Wage with effect from 1 December 2006.
Belgium	The minimum monthly average guaranteed income is set for the private sector by a collective employment agreement reached at the National Labour Council (social partners).
Canada	In most provinces, minimum wages are fixed (and increased) by regulation. A provincial Governor-in-Council has the authority to change regulations which are frequently based on recommendations of a Minimum Wage Board, Review Committee, Labour Standards Board or the Minister of Labour. In Quebec, minimum wage increases are based on eleven indicators, including the ratio between the minimum wage and the average hourly wage. However, increases are still made by regulation. In the Yukon, the Employment Standards Board now provides regular annual minimum wage rate increases for the following year based on the consumer price index for the territory's capital.

Country	Method of Uprating
	In the Northwest Territories and Nunavut, minimum wage rates are set by statute, therefore any rate increases require a legislative amendment to be passed by the legislature. The rate for the federal jurisdiction is the general adult minimum wage rate of the province or territory where the work is performed.
France	The minimum wage is reassessed each year on 1 July. The uprating must be at least half that of the increase in purchasing power of the average hourly wage. During the course of the year if the price index increases by over two per cent, the minimum wage is increased automatically by the same amount. The Government can also increase the minimum wage at any time.
Greece	The statutory minimum wage is laid down in the National General Collective Labour Agreement (NGCLA) and applies to all workers in the private sector (civil servant pay levels are set separately by the Government). The NGCLA is the result of negotiations between the social partners. Since the mid-1990s it has covered a two-year period and upratings take account of past and anticipated levels of inflation and other factors, including the national level of productivity. Increases in the minimum wage take place once or twice yearly.
Ireland	The national minimum wage can only be increased following a recommendation in a national agreement. Where there is no national agreement, any organisation which the Labour Court is satisfied is substantially representative of employees or employers can ask the Labour Court to examine the national minimum hourly rate of pay, not earlier than 12 months after the Minister last declared a national minimum hourly rate of pay. The Labour Court can then make a recommendation to the Minister.
Japan	The system operates regionally. The minimum wage is reviewed and amended each Autumn. Regional Minimum Wage Councils, comprising representatives of labour unions, employees and public agencies, make a proposal based on their consideration of the cost of living, salary of workers in similar industries, and the financial capability of employers. The final decision is made by the Director of the Regional Labour Standard Agency. In addition, if specific industries believe it is necessary to set a higher rate than the regional minimum wage, they can set their own rate by industry within the prefecture. The labour and management representatives of the industry must submit the rate to the Regional Minimum Wage Council.
Netherlands	The Ministry of Social Affairs normally uprates twice yearly (on 1 January and 1 July). Wage inflation is used to determine by how much the minimum wage is increased. An average figure is derived from all the sectoral Collective Agreements. There are circumstances, however, when the Government can decide not to increase the minimum wage. The Government, in consultation with the social partners, may decide not to link the minimum wage to average contractual wage rises if it considers that the ratio between the number of people claiming social benefits and the number of people working is rising too fast. This happened between 1993 and 1996 and in 2004/5. A major evaluation of the minimum wage system is carried out every four years, mainly to consider whether the level is too high or too low compared with average wages and the overall condition of the labour market.
New Zealand	The Minister of Labour conducts annual reviews in accordance with the Minimum Wage Act by 31 December each year. The review considers the effectiveness of the minimum wage in meeting its objectives and there are set criteria for reviewing changes to the minimum wage. The Minister invites submissions from the New Zealand Council of Trade Unions and Business New Zealand, as well as other organisations. The Minister makes recommendations to the Governor General on the basis of these submissions and analysis undertaken by a number of Government departments. Amendments to the minimum wage usually come into force in March of the following year.
Portugal	Up until 2006 an Inter-Ministerial annual review considered the social and economic effects of the minimum wage. This included the expected inflation rate and productivity levels. Following consultation with the social partners, the wage was usually uprated annually and implemented from January of each year. However, from 2007 a tripartite committee (with representatives from Government, unions and employers) will monitor economic conditions (including inflation, GDP and productivity), consider the social and economic impacts of the minimum wage and issue a recommended annual upgrade. Following consultation with the social partners, and taking the medium-term objectives (minimum wage to rise to €450 by 2009, and to €500 by 2011) into consideration, the Government will set the annual increase, to be implemented from January of the following year. The minimum wage will rise to €403 per month in January 2007.

Country	Method of Uprating
Spain	The Government uprates annually following consultation with the social partners. The Government is obliged to take account of inflation, average national productivity, participation levels and general economic conditions.
UK	The Government considers recommendations from an independent Commission, which reports following wide-ranging consultation and consideration of the effects on the economy, as well as on specific sectors and groups of workers. Since the minimum wage was introduced in 1999 there have been annual upratings.
US	Changes to the Federal minimum wage are voted on by Congress intermittently. Most States have their own minimum wage rates. Where Federal and State laws stipulate different rates, the higher rate applies.

Source: British Embassies and High Commissions. LPC.

Table A4.4

Enforcement of Minimum Wages

Country	Method of Enforcement
Australia	In the Federal jurisdiction complaints are lodged with the Office of Workplace Services and are investigated by inspectors. Employees can also refer claims to a Small Claims Court. Similar processes apply in State jurisdictions.
Belgium	Labour inspectorate.
Canada	In each jurisdiction, the employment or labour standards legislation contains provisions for the enforcement of minimum wage requirements and the payment of wages. While the system of enforcement varies across the country, generally complaints regarding unpaid wages or a violation of minimum wage requirements may be made to the labour standards branch. Labour standards inspectors also have the legal authority to perform random inspections to ensure compliance.
France	Labour inspectorate (which is also responsible for general conditions of work and health and safety). Inspectors carry out random checks and investigate complaints from trade unions and individual employees.
Greece	Labour inspectorate. Employers can be sued by employees, who have to pay their own costs, or by inspectors.
Ireland	The national minimum wage is enforced by Labour Inspectors in the Department of Enterprise, Trade and Employment, who conduct both routine inspections and investigate complaints. Disputes can be referred to the Rights Commissioner Service of the Labour Relations Commission.
Japan	Labour inspectorate.
Netherlands	Labour inspectorate periodically reports on the application of the minimum wage in practice. Employers are informed of pay salaries below the minimum wage but the Labour inspectorate is not able to take employers to court; the employee must do this.
New Zealand	Labour inspectorate may take action in the Employment Relations Authority or the Employment Court to recover wages owing, plus penalties. Alternatively Labour Inspectors may issue a demand notice requiring that the employer pay monies to an employee, as assessed by the Labour Inspector. Complaints received from a person other than the employee are proactively investigated.
Portugal	The labour inspectorate is responsible for enforcing labour legislation and regulations governing general working conditions, including the minimum wage. Inspectors carry out random checks and investigate complaints from trade unions and individual employees.
Spain	Labour inspectorate (which also has the power to enforce a wide range of labour issues, including collectively-bargained rates). It can fine employers, or the employee can take the case to tribunal to obtain back pay. The system is both reactive and proactive. There are around 600 inspectors and 800 assistants, stationed on a provincial basis.
UK	HM Revenue and Customs is the enforcement agency. It conducts both proactive, targeted enforcement and investigation of complaints. Employees also have the right to take their case to an Employment Tribunal. There is a free telephone help-line, with all calls followed up, including anonymous complaints.
US	Wage and Hour Division in the Department of Labor is responsible for enforcing the Federal minimum wage. It both pursues complaints and is proactive, targeting specific low wage industries. There is a team of approximately 750 inspectors nationwide.

Source: British Embassies and High Commissions. LPC.

Table A4.5

Age Variations Under Minimum Wage Systems

Country	Treatment by Age
Australia	Junior rates contained in Australian Pay and Classification Scales (Pay Scales) vary across industries and occupations. Typically a sliding scale applies from age 16 (40–50 per cent of the adult minimum wage) through age 18 (65–80 per cent) to age 20 (85–100 per cent). Adult wages apply at age 21.
Belgium	Full minimum wage applies at age 21. An additional premium is payable to workers aged 21½ who have been employed for at least 6 months and to workers aged 22 who have been employed for at least 12 months. There is a 6 per cent deduction from the minimum wage for each year below age 21, with those aged 16 or under receiving 70 per cent of the full rate.
Canada	Full minimum wage at all ages except in Ontario, which has retained youth rates. Both British Columbia and Nova Scotia have introduced a first job/entry-level wage rate for workers new to the paid labour market.
France	Full minimum wage at age 18. Certain categories of young people receive a reduced rate, provided they have worked for fewer than six months in a sector (80 per cent for those aged 16 and 90 per cent for those aged 17).
Greece	Full minimum wage at age 15 (but variation depending on length of employment and marital status).
Ireland	Full minimum wage applies to an experienced adult employee, which is an employee who has had any employment whatsoever in any two years over the age of 18, unless undergoing structured training or study. Employees in the first year after the date of first employment over age 18 receive 80 per cent of the full minimum rate and they receive 90 per cent in the second year. All employees under age 18 are entitled to 70 per cent of the full adult rate.
Japan	There is no variation according to age for regional or sectoral minimum wages.
Netherlands	Full minimum wage at age 23. Youth rates are 30 per cent at age 15, 34.5 per cent at age 16, 39.5 per cent at age 17, 45.5 per cent at age 18, 52.5 per cent at age 19, 61.5 per cent at age 20, 72.5 per cent at age 21 and 85 per cent at age 22.
New Zealand	Full minimum wage at age 18. 16–17 year olds receive 80 per cent of the main rate. Although trainees aged 18 and over may be paid a training rate below the main minimum wage rate; the training rate is equivalent to the youth minimum wage rate and applies to people doing recognised industry training.
Portugal	Full minimum wage at all ages. Exceptions are apprentices and trainees in qualified or highly qualified jobs, who can receive 80 per cent for up to a year, or 6 months if the course is technical/professional.
Spain	Full minimum wage at age 16. Young people who were unemployed but join various training schemes to help them to enter the labour market receive 75 per cent of the minimum wage.
UK	Full minimum wage at age 22. Separate rates exist for 16–17 and 18–21 year olds (currently 62 and 83 per cent respectively of the adult rate).
US	Full minimum wage at all ages, except below age 20 where lower rate of $4.25 can apply (approximately 82.5 per cent of full minimum wage) for the first 90 days in any job. Also full-time students can be paid 85 per cent of the minimum wage. Additionally, student-learners (those aged 16 and over who are enrolled in vocational education) can be paid 75 per cent of the minimum wage while on the vocational education programme.

Source: British Embassies and High Commissions. LPC.

Table A4.6

Youth Minimum Wage Rates as a Percentage of Adult Minimum Wage Rates, End 2006

Country	Percentage at age 16	Percentage at age 17	Average percentage at ages 18/19
Australia[a]	50	60	75
Belgium	70	76	85
Canada	100[b]	100[b]	100
France[c]	80	90	100
Greece	100	100	100
Ireland	70	70	85
Japan	100	100	100
Netherlands	34.5	39.5	49
New Zealand	80	80	100
Portugal	100	100	100
Spain	100	100	100
UK	62	62	83
US[c]	82.5	82.5	82.5

Sources: OECD Minimum Wage Database. British Embassies and High Commissions. LPC.

Notes:

(a) As prescribed in the Pay Scales derived from New South Wales Shop Employees Award. These rates are broadly representative of the rates for younger workers prescribed in other Pay Scales.

(b) All provinces except Ontario.

(c) For France and the United States, the reduced rates apply to young workers with a tenure of fewer than 6 months and 3 months, respectively.

Review of the Low-paying Sectors

1 Since the 2005 Report, we have conducted an internal review of the composition of the low-paying sectors. In order to identify low-paid workers more accurately, we concluded that we should revise the industry-based definitions used in previous reports and introduce a new definition of low-paying sectors based on low-paying occupations. The new definitions of low-paying sectors, as set out in this appendix, are used in this report.

2 As the Annual Survey of Hours and Earnings (ASHE) data are regarded by the Office for National Statistics (ONS) as the best data source available for information on earnings by industry and occupation, the review used ASHE to identify industries and occupations that had an above average number of employees paid below certain pay thresholds. The Standard Industrial Classification (SIC 2003) and the Standard Occupational Classification (SOC 2000) were used as the building blocks to aggregate these low-paying industries and occupations into recognisable sector groups.

3 The Labour Force Survey (LFS) and the ONS employee jobs series were then used to check whether the employment data for the low-paying occupations and industries identified were of sufficient quality to enable reliable analysis.

Defining the Low-paying Sectors

4 Our analysis of the low-paying sectors and occupations in Chapter 3 is based on ten industrial sectors and two occupations – childcare and office work. Our review showed that the definitions of low-paying sectors we had been using prior to this report remained largely appropriate but it also identified a few areas where we could improve our coverage of low-paid workers. We outline below the composition of

each of these sectors and occupations and the changes we have instigated.

New Industry-based Low-paying Sectors

5 We have retained, in large part, the definitions of low-paying sectors used in previous reports with a few amendments. We have made small changes to the definition of the textiles and clothing sector and expanded the definition of the retail, social care and cleaning sectors. We have added two new sectors – food processing (which includes the manufacture of food products; food processing and food preparation) and leisure, travel and sport. Details of the revised definitions are as follows:

- **Retail:** We have added 'Sale, maintenance and repair of motor vehicles and motorcycles' (SIC2003 = 50), which includes the 'Retail sale of automotive fuel', to the previously defined retail sector (SIC2003 = 52). Our definition of the retail sector now covers all retail and repair industries but excludes wholesale activities. The 'Renting of video tapes and DVDs' industry (SIC2003 = 71.405) has also been added where the data can separately identify this category. Retail therefore now consists of the SIC2003 codes 50, 52 and 71.405.

- **Hospitality:** The sector that covers hotels, bars and restaurants has remained unchanged. Hospitality consists of the SIC2003 code 55.

- **Social care:** We have added 'Social work activities without accommodation' (SIC2003 = 85.32) to the social care sector, which previously consisted solely of 'Social work activities with accommodation' (SIC2003 = 85.31). This change has partly been driven by changes to the ONS employee jobs series, which merged these two categories in June 2005. We have also added the 'Medical, nursing home activities' sector (SIC2003 = 85.113) to our categorisation of social care. Social care now consists of SIC2003 codes 85.3 and 85.113.

- **Textiles and clothing:** We have removed 'Manufacture of footwear' (SIC2003 = 19.3) from our original definition of the textiles, clothing and footwear sector. The footwear sector employs very few workers and is no longer regarded as low-paying: only 7 per cent of

employees earned less than £5.35 an hour in April 2005. This sector has been renamed as the 'Manufacture of textiles and clothing' and consists of SIC2003 codes 17 and 18.

- **Cleaning:** We have added 'Washing and dry cleaning of textile and fur products' (SIC2003 = 93.01) to 'Industrial cleaning' (SIC2003 = 74.7) in this sector. As a result, the cleaning sector now includes SIC2003 codes 74.7 and 93.01.
- **Hairdressing:** This sector, which includes hairdressing, beauty treatments and physical well-being activities, has not been revised and will continue to be defined by SIC2003 codes 93.02 and 93.04.
- **Security:** This sector has not been revised and will continue to be defined by SIC2003 code 74.6.
- **Agriculture:** This sector, which includes agriculture, hunting, fishing and forestry, has not been revised and will continue to be defined by SIC2003 codes 01–05.
- **Leisure, travel and sport:** This is a new low-paying sector, which includes sporting activities, cinemas and other entertainment and recreational activities. The leisure, travel and sport sector consists of SIC2003 codes 92.13, 92.3, 92.6 and 92.7.
- **Food processing:** We have also introduced food processing as a new sector. It includes the production, processing and preserving of meat, fish, fruit and vegetables, oils and fats, dairy products, grain, animal feeds and other food products (SIC2003 = 15.1 to 15.8). There is some ambiguity in the demarcation of food activities considered as retail (e.g. some bakers, fishmongers, pastry shops and butchers) and those regarded as manufacturing and processing. Where the processing is minimal and does not lead to a real transformation, the unit is classified to the wholesale or retail trade. Food processing thus consists of the SIC2003 codes 15.1 to 15.8.

6 Unlike the sectors listed above, childcare cannot be assigned to a corresponding industry-based sector. It cuts across the health, social work and education industries. Nurseries are assigned to the 'Primary education' sector. Child day-care activities are assigned to 'Social work activities without accommodation'. Orphanages, children's hostels and residential nurseries are assigned to 'Social work activities with

accommodation'. Because childcare cannot be disaggregated from these broader sectors, we use an occupation-based definition as described below.

7 Similarly, office work cuts across several industries, including banking, finance, business services and public administration, and cannot be assigned to an industry-based sector, therefore we use an occupation-based definition as described below.

8 The coverage of low-paid employees using these new industry definitions is nearly 70 per cent (compared with around 55 per cent using the old definition). Table A5.1 presents the new classifications in tabular form.

New Occupation-based Low-paying Sectors

9 Previously we defined the low-paying sectors using industrial classifications, with the exception of the childcare sector, which was based on an occupational definition because an appropriate industrial classification was not available. In order to enhance our understanding of the situation of low-paid workers, we investigated the data on low-paying occupations. As a result of our investigations we have decided to supplement our definition of low-paying sectors by the use of definitions based on low-paying occupations. The sector headings relate closely to the industry-based sectors and relate mainly to the elementary occupations. Details of the categorisations are as follows:

- **Retail:** 'Retail assistants and cashiers' (SOC2000 = 711), 'Customer services' (SOC2000 = 721) and 'Elementary sales occupations' (SOC2000 = 925).
- **Hospitality:** 'Chefs, cooks' (SOC2000 = 5434), 'Hotels, porters' (SOC2000 = 9222), 'Kitchen and catering assistants' (SOC2000 = 9223), 'Waiters, waitresses' (SOC2000 = 9224) and 'Bar staff' (SOC2000 = 9225).
- **Social care:** 'Care assistants and home carers' (SOC2000 = 6115).
- **Textiles and clothing:** 'Tailors and dressmakers' (SOC2000 = 5414), 'Textiles, garments and related occupations' (SOC2000 = 5419), 'Textiles, process operatives' (SOC2000 = 8113), 'Clothing cutters' (SOC2000 = 8136) and 'Sewing machinists' (SOC2000 = 8137).

- **Cleaning:** 'Housekeeping' (SOC2000 = 6231), 'Industrial cleaning process occupations' (SOC2000 = 9132) and 'Elementary cleaning' (SOC2000 = 923).
- **Hairdressing:** 'Hairdressers and related' (SOC2000 = 622).
- **Security:** 'Security guards and related' (SOC2000 = 9241), 'Car park attendants' (SOC2000 = 9245) and 'Elementary security occupations' (SOC2000 = 9249).
- **Agriculture:** 'Elementary agricultural occupations' (SOC2000 = 911).
- **Leisure, travel and sport:** 'Sport and leisure assistants' (SOC2000 = 6211), 'Travel and tour guides' (SOC2000 = 6213), 'Leisure and theme park attendants' (SOC2000 = 9226) and 'Elementary personal services not elsewhere classified' (SOC2000 = 9229).
- **Food processing:** 'Butchers, meat cutters' (SOC2000 = 5431), 'Bakers, flour confectioners' (SOC2000 = 5432), 'Fishmongers, poultry dressers' (SOC2000 = 5433) and 'Food, drink and tobacco process operatives' (SOC2000 = 8111).
- **Childcare:** 'Nursery nurses' (SOC2000 = 6121), 'Childminders and related' (SOC2000 = 6122), 'Playgroup leaders and assistants' (SOC2000 = 6123), 'School crossing patrols' (SOC2000 = 9243) and 'School mid-day assistants' (SOC2000 = 9244).
- **Office work:** 'Telephonists' (SOC2000 = 4141), 'Receptionists' (SOC2000 = 4216) and 'Elementary office occupations not included elsewhere' (SOC2000 = 9219).

10 Table A5.1 summarises the above information. The coverage of the low-paid using these definitions of low-paying occupations is about 70 per cent.

Conclusion

11 In most low-paying sectors there is a good correlation between the industry-based and occupation-based definitions in terms of coverage, except for those sectors which have no corresponding industry or occupation classifications (office work and childcare) and for the cleaning sector (which is three times smaller in the industry

classifications). Cleaning occupations are carried out across many industries. If these are performed in-house, the cleaning jobs will be assigned to the industry in which the cleaning has taken place. In contrast, hairdressing jobs are almost entirely carried out in the hairdressing industry.

12 Future employment and wage analyses will be presented using both definitions (industry and occupation). The ONS regards the LFS as the best available measure of employment by occupation and therefore this will be our source for the low-paying occupation-based sectors. We will, however, continue to use the ONS employee jobs series for our industry-based low-paying sectors as the ONS considers that this series provides the most accurate measure of employment by industrial sector.

Table A5.1
SIC and SOC Coding of the Low-paying Sectors Defined by Industry and Occupation

Low-paying sector/occupation	Old definition (SIC 2003)	New industry-based definition (SIC 2003)	Occupation-based definition (SOC 2000)
Retail	52	50, 52, 71.405	711, 721, 925
Hospitality	55	55	5434, 9222, 9223, 9224, 9225
Residential social care	85.31	n.a.	n.a.
Social care (residential and non-residential)	n.a.	85.3, 85.113	6115
Cleaning	74.7	74.7, 93.01	6231, 9132, 923
Security	74.6	74.6	9241, 9245, 9249
Hairdressing	93.02, 93.04	93.02, 93.04	622
Textiles, clothing and footwear	17, 18, 19.3	n.a.	n.a.
Textiles and clothing	n.a.	17, 18	5414, 5419, 8113, 8136, 8137
Agriculture	01–05	01–05	911
Childcare	612 (SOC 2000)	n.a.	6121, 6122, 6123, 9243, 9244
Food processing	n.a.	15.1–15.8	5431, 5432, 5433, 8111
Leisure, travel and sport	n.a.	92.13, 92.3, 92.6, 92.7	6211, 6213, 9226, 9229
Office work	n.a.	n.a.	4141, 4216, 9219

Note: n.a. = not applicable.

Summary of Changes to Main Data Sources

1 While research and consultation are invaluable, official data also have an essential role to play in assessing the impact of the National Minimum Wage. In this appendix, we review the most important changes made since the 2005 Report to the data sources used in our analyses of employment and earnings. These are: the Labour Force Survey (LFS), the Office for National Statistics (ONS) employee jobs series and the Annual Survey of Hours and Earnings (ASHE).

Employment

2 There are two main sources of employment information, the LFS and the ONS employee jobs series. The two sources measure different things and give different results: the LFS captures the number of people in employment, while the employee jobs series measures the number of jobs in the economy.

Labour Force Survey

3 The LFS is a quarterly survey of about 60,000 UK households and is the official data source used to measure the number of people in employment and unemployed. The data set is a rich source of information on personal and socio-economic characteristics including information on an individual's current and previous jobs, income, gender, region, industry, occupation, ethnicity and disability.

4 There are two main sources of LFS data:

- those published on the ONS website, which are weighted to the latest population estimates. These are generally seasonally adjusted and published monthly in the ONS Labour Market Statistics Integrated First Release; and

- the LFS Microdata, which are weighted to population estimates in Spring 2003. These data produce estimates of the UK population that are lower than the First Release and are not seasonally adjusted.

5 Up until January 2006 the LFS Microdata were published in seasonal quarters – Spring (March–May), Summer (June–August), Autumn (September–November) and Winter (December–February). Since then, they have been released on a calendar quarter basis – Q1 (January–March), Q2 (April–June), Q3 (July–September) and Q4 (October–December) – in response to Eurostat requirements for consistent series across the European Union. Unfortunately, the ONS has only produced a limited back series on a calendar quarter basis.

6 In this report, analyses of aggregate employment, unemployment, hours worked, redundancies and productivity are based on the monthly and quarterly (calendar) data published on the ONS website. For detailed analyses of the labour market by age, ethnic status and disability, we have used the LFS Microdata based on seasonal quarters from Spring 1998 to Summer 2004 and calendar quarters from Q4 2004 to Q3 2006, with a break between the two series.

Employee Jobs

7 Figures for employee jobs are derived from the Short Term Employer Surveys, which collect information on the number of employees from a sample of 9,000 businesses in production industries each month and 30,000 businesses in the service and distribution industries each quarter. The strength of the ONS employee jobs series lies in the rich and timely industrial breakdown that it provides. However, figures are only available for Great Britain and are not seasonally adjusted.

8 The employee jobs series is published quarterly in March, June, September and December and is benchmarked annually to the latest results from the previous Annual Business Enquiry (ABI). However, in 2006 the usual December ABI revisions to the data were not published. As a result, the employee jobs data used in this report, which cover the period up to September 2006, are still benchmarked to the 2004 ABI.

9 Since September 2005, social work activities with accommodation (Standard Industrial Classification (SIC) 8531) and social work activities without accommodation (SIC 8532) have been merged and it is no

longer possible to separately identify these two sectors. Our employee jobs analyses in this report are therefore based on the amalgamated sector, social work activities (SIC 853).

Earnings

10 There are two main sources of earnings data that we use in this report – ASHE and LFS. ASHE is regarded by the ONS as the best source of information on earnings but for analyses of disability and ethnicity we have used the LFS.

Annual Survey of Hours and Earnings

11 The main source of structural earnings data in the UK is ASHE, a survey of employees completed by employers and conducted in April each year. It is based on a 1 per cent sample of employees in pay-as-you-earn income tax schemes. The self-employed are excluded.

12 ASHE contains information on the levels, distribution and make-up of earnings as well as on hours, gender, age, geography, occupation and industry. However, there is no information on employees' ethnic backgrounds nor does it collect information about disability.

13 In 2004, ASHE replaced the New Earnings Survey (NES) as the principle source of structural information on earnings. Compared with its predecessor NES, ASHE has improved coverage (especially of the low-paid); is weighted to UK population totals; and includes imputation for some missing data (item non-response). In addition, a new questionnaire was introduced in 2005 which included improvements to the collection of data relating to allowances, pensions and incentive pay.

14 Further changes were made to ASHE in 2006. First, the geographic basis of the survey moved to output areas instead of enumeration districts[1]. The change has a negligible impact at the level of government office region but is more significant for lower level geographies. Second, ASHE weights were revised to take account of

[1] Output Areas are the smallest geography at which demographic data are released from the 2001 Census. They replace the previously used postcode-based enumeration districts as the smallest building block for larger geographies.

the move from a seasonal to a calendar quarter basis in the LFS. Third, the VAT-only supplementary survey was dropped as it had not significantly improved the coverage of the low-paid.

15 The discontinuities produced by these changes to the ONS earnings series result in three earnings data sets:

- The original New Earnings Survey (NES) covers the period from 1970 to 2003;
- ASHE without supplementary information covers the period 1997–2004. This series is basically NES data with imputation and LFS weighting; and
- ASHE with supplementary information covers the period 2004–2006. The ONS regards this series as giving the best estimates of low pay. Thus, we use this series where possible. It also replaces the previously used low pay central estimate – a combination of LFS and NES/ASHE without supplementary information.

16 It should also be noted that our analyses of ASHE use low-pay weights, which take into account absence from work and those not on adult rates. With the exception of the low-pay estimates, our analyses differ from those available on the ONS website because the ONS uses weights based on those adults whose pay has not been affected by absence.

Labour Force Survey

17 Given that ASHE does not provide information on disability or ethnic background, the LFS is our main source of information on the earnings of workers with disabilities and minority ethnic groups. But data on pay and hours in the LFS are less reliable than in ASHE, especially when provided by proxy respondents. Individuals tend to record more hours worked, possibly leading the derived hourly earnings variable to underestimate hourly pay. However, the ONS has done some work recently to improve the methodology to derive low-pay estimates from the LFS and this new methodology yields similar earnings results to ASHE. See Hayes, Ormerod and Ritchie (2007), Ormerod and Ritchie (2007a, 2007b) and Griffiths, Ormerod and Ritchie (2007) for further details.

Abbreviations

A8	The eight central and eastern European Accession countries that joined the EU in May 2004
ABI	Annual Business Inquiry
ACS	Association of Convenience Stores
AEI	Average Earnings Index
AIRC	Australian Industrial Relations Commission
ALMR	Association of Licensed Multiple Retailers
ALP	Association of Labour Providers
ASHE	Annual Survey of Hours and Earnings
AWB	Agricultural Wages Board
BATC	British Apparel & Textile Confederation
BBPA	British Beer and Pub Association
BCC	British Chambers of Commerce
BHA	British Hospitality Association
BHPS	British Household Panel Survey
BISL	Business in Sport and Leisure
BRC	British Retail Consortium
BSA	Business Services Association
BSSA	British Shops and Stores Association
BYC	British Youth Council
CAB(x)	Citizens Advice Bureau(x)
CBI	Confederation of British Industry
CCMN	Community Care Market News
CCPR	Central Council of Physical Recreation

CPI	Consumer Price Index
CPLs	Comparative Price Levels
CSCI	Commission for Social Care Inspection
CSSA	Cleaning and Support Services Association
CWDC	Children's Workforce Development Council
DDA	Disability Discrimination Act
Defra	Department for Environment, Food and Rural Affairs
DfES	Department for Education and Skills
DTI	Department of Trade and Industry
DWP	Department for Work and Pensions
EAS	Employment Agency Standards
EMA	Education Maintenance Allowance
EOC	Equal Opportunities Commission
ET	Employment Tribunal
EU	European Union
FRS	Family Resources Survey
FSB	Federation of Small Businesses
FTE	Full-time Education
FTSE	Financial Times Stock Exchange
GB	Great Britain
GCSE	General Certificate of Secondary Education
GDP	Gross Domestic Product
GLA	Gangmasters Licensing Authority
GOR	Government Office Region
GVA	Gross Value Added
HMRC	Her Majesty's Revenue & Customs
HMT	Her Majesty's Treasury
HSE	Health and Safety Executive
IDS	Incomes Data Services Ltd

IES	Institute for Employment Studies
IFS	Institute for Fiscal Studies
ILO	International Labour Organisation
IRS	Industrial Relations Services
JWEP	Joint Workplace Enforcement Pilot
LA	Local Authority
LCC	Leicester City Council
LCWA	London Citizens Workers' Association
LFS	Labour Force Survey
LHS	Left Hand Side
LPC	Low Pay Commission
LRD	Labour Research Department
LSC	Learning and Skills Council
MDR	Marginal Deduction Rate
MTA	Minimum Training Allowance
NDNA	National Day Nurseries Association
NEET	Not in Education, Employment or Training
NES	New Earnings Survey
NESPD	New Earnings Survey Panel Data
NFU	National Farmers' Union (England and Wales)
NGCLA	National General Collective Labour Agreement
NGH	National Group on Homeworking
NHF	National Hairdressers' Federation
NHS	National Health Service
NICs	National Insurance Contributions
NIESR	National Institute of Economic and Social Research
NIPSA	Northern Ireland Public Service Alliance
NMW	National Minimum Wage
NVQ	National Vocational Qualification

OECD	Organisation for Economic Co-operation and Development
ONS	Office for National Statistics
PAYE	Pay As You Earn
PPPs	Purchasing Power Parities
Q	Quarter
RCPO	Revenue and Customs Prosecutions Office
R&D	Research and Development
REC	Recruitment & Employment Confederation
RHS	Right Hand Side
RPI	Retail Price Index
RPIX	Retail Price Index excluding mortgage interest payments
SAWS	Seasonal Agricultural Workers Scheme
SBC	Small Business Council
SBS	Small Business Service
SIC	Standard Industrial Classification
SMEs	Small and Medium-sized Enterprises
SOC	Standard Occupational Classification
SPPI	Services Producer Price Index
STUC	Scottish TUC
SVQ	Scottish Vocational Qualification
T&G	Transport and General Workers' Union
TUC	Trades Union Congress
UK	United Kingdom
Usdaw	Union of Shop, Distributive and Allied Workers
VAT	Value Added Tax
WRS	Workers Registration Scheme
WTC	Working Tax Credit
YCS	Youth Cohort Study
YDR	Youth Development Rate

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