



Autumn 2016 Report

Key findings

November 2016
Low Pay Commission

The UK minimum wage in October 2016

National Living Wage (25+)	£7.20
21-24 Rate	£6.95
18-20 Rate	£5.55
16-17 Rate	£4.00
Apprentice Rate*	£3.40

Five rates overall:

NLW – rate for workers aged 25 and over, creating a new age band for 21-24 year olds.

Long-standing youth rates, set at a lower level than the main rate to reflect employment risks.

Apprentice Rate set at a discount to the 16-17 Year Old Rate to reflect employer training costs.

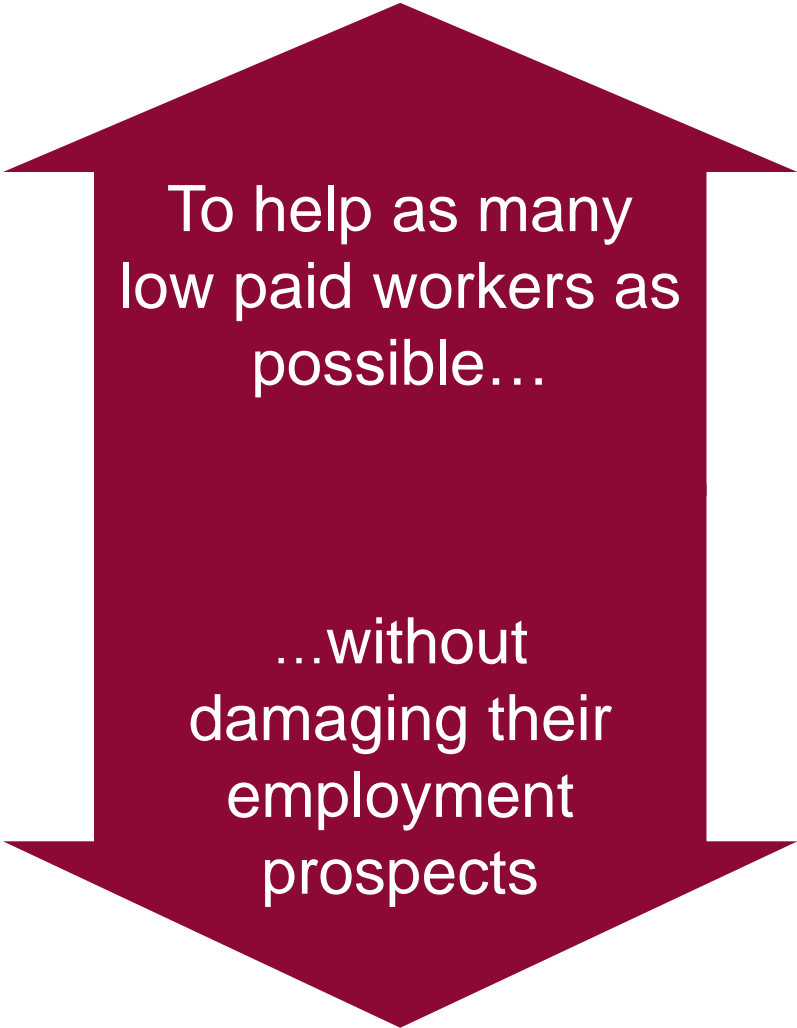
* Applicable in first year of an apprenticeship and any year for 16-18 year old apprentices.

**LPC task for this report:
recommend April 2017 rates & 2018 NLW indicative rate**

Rate	April/ Oct 2016	April 2017	April 2018
National Living Wage (25+)	£7.20	?	?
21-24 Rate	£6.95	?	
18-20 Rate	£5.55	?	
16-17 Rate	£4.00	?	
Apprentice Rate	£3.40	?	

But with different roles for the NLW and the other rates

Unchanged basis for recommendations on rates for under-25s and apprentices



To help as many
low paid workers as
possible...

...without
damaging their
employment
prospects

- Following the traditional basis of the NMW: to raise pay and prevent exploitation.
- Level based on affordability, not need.
- Goal of zero harm to employment.

Different basis for the NLW: target and more tolerance for employment loss



To recommend the pace of increase to reach 60 per cent of median earnings by 2020...

(subject to sustained economic growth)

1. **Target:** ‘ambition of 60 per cent of average earnings and an objective of £9’. LPC role is to plot the path.
2. **Some job loss tolerance:** The OBR forecast a 20,000-110,000 increase in unemployment by 2020 (vs 1.1m employment gains 2015-2021).
3. **Stricter test for increase not to happen:** ‘subject to sustained economic growth’.

LPC set out its approach to the NLW in our Spring 2016 Report

Three flexibilities in the NLW

2020 goal	A moving target, its value should adjust in line with pay.
The profile	Can front-load or back-load the path.
The brake	Increases are subject to 'sustained economic growth'.

We proposed:

- ✓ calculating the rate putting NLW 'on course' for 60 per cent using the latest forecasts and assessing affordability;
- ✓ a straight line bite path was most likely;
- ✓ the projected on-course rate was £7.64 for April 2017 and £9.16 for 2020.

And for the other rates

2015	21-24s	25-30s
Pay level	£8.26	£11.01
NMW/ NLW 'bite'	79%	59%
Coverage	11%	5%
Unemployment (not in FTE)	11%	6%

We thought:

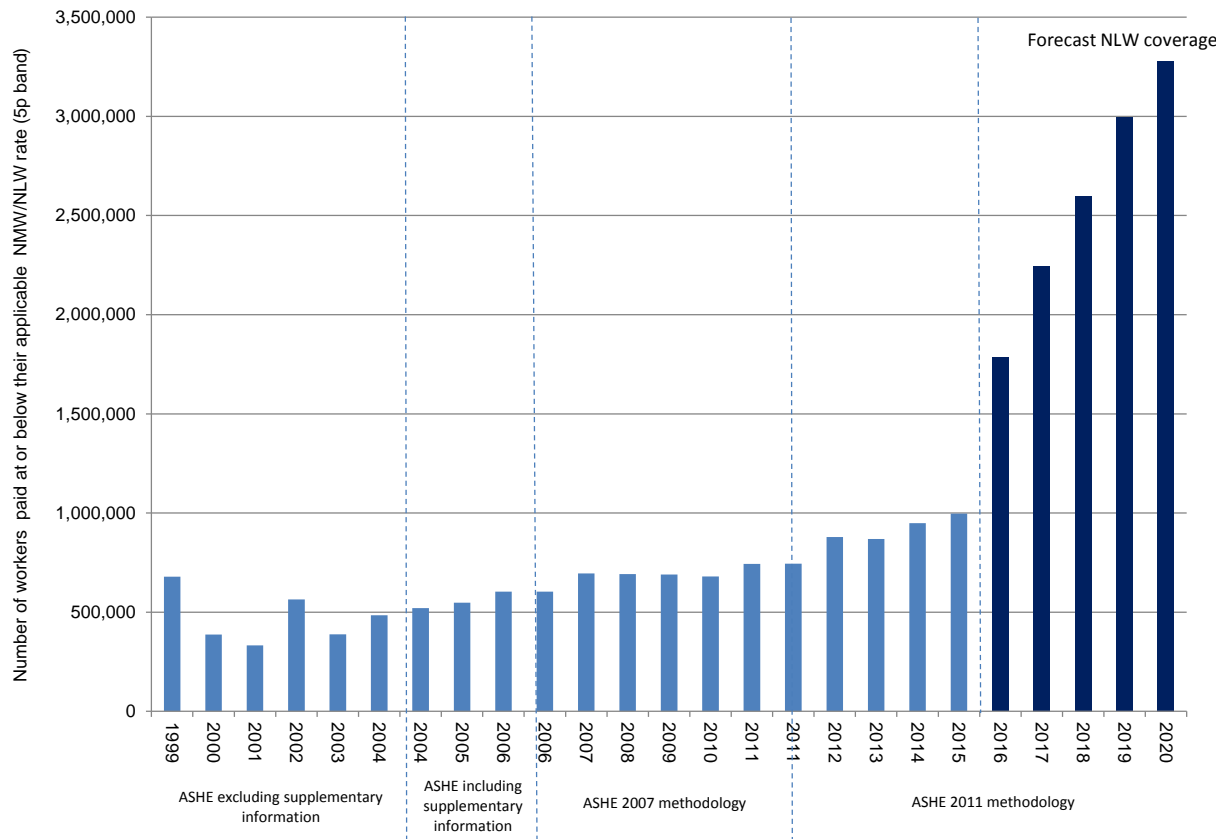
- ✓ remit requires more caution;
- ✓ genuine labour market differences that meant pay floor for younger workers should be lower, including 21-24s, and would likely increase more slowly than NLW;
- ✓ NLW an upward pressure, and we needed to pay attention to the 'gap';
- ✓ new calendar a downward pressure for 2017.

Inherent difficulty of early NLW recommendations compounded by the vote to leave the EU



- **Limited evidence post-introduction of the NLW** - one quarter of labour market data; no econometric research; little on relativities.
- **Much more uncertainty** -re growth, employment, pay and productivity following vote to leave the EU. Little hard evidence.
- **New cycle** - no recent OBR forecasts at time of decision

LPC showed in the spring: the NLW is ambitious



Gains for workers: £680 in 2017.

Pace: the relative increase for 25+s is the same 2015-2020 as 1999-2015.

Scale: tripling of coverage by 2020.

Key question: rate adjusting down; was a straight-line path still affordable, or did we need to exercise discretionary flexibilities?

EU exit influences the NLW via effects on growth, jobs and pay

Sustainable minimum wage increases depend on:

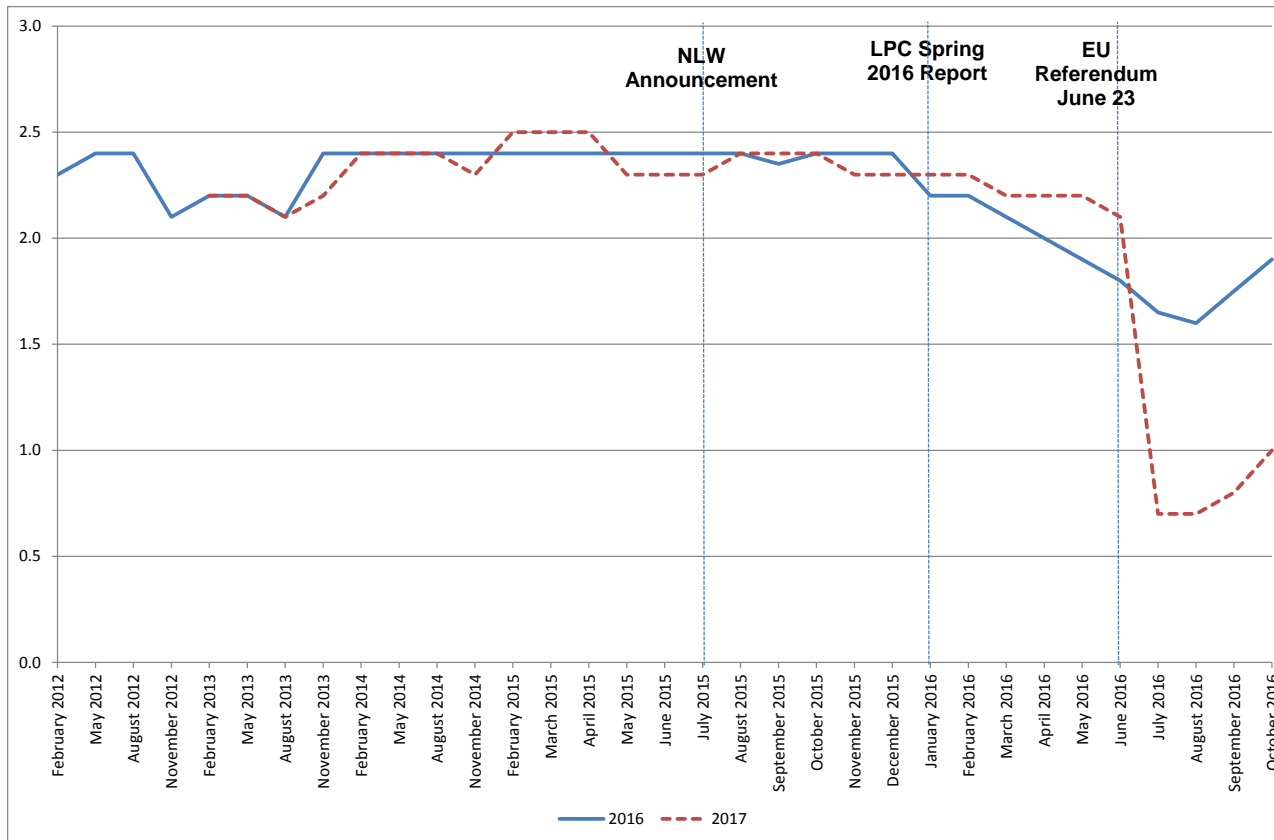
- ✓ Growth in GDP
- ✓ Employment
- ✓ Pay and productivity.

The effect of leaving the EU depends on its impact on these factors:

- No immediate recession;
- Consumer confidence, share prices and business confidence fell and then recovered;
- Hiring intentions weakened but partly recovered;
- Pound fallen sharply;
- Inflation likely to rise;
- Much greater uncertainty – overall, migration, fiscal position.

Weakening seen in growth forecasts available in October (didn't have OBR Nov)

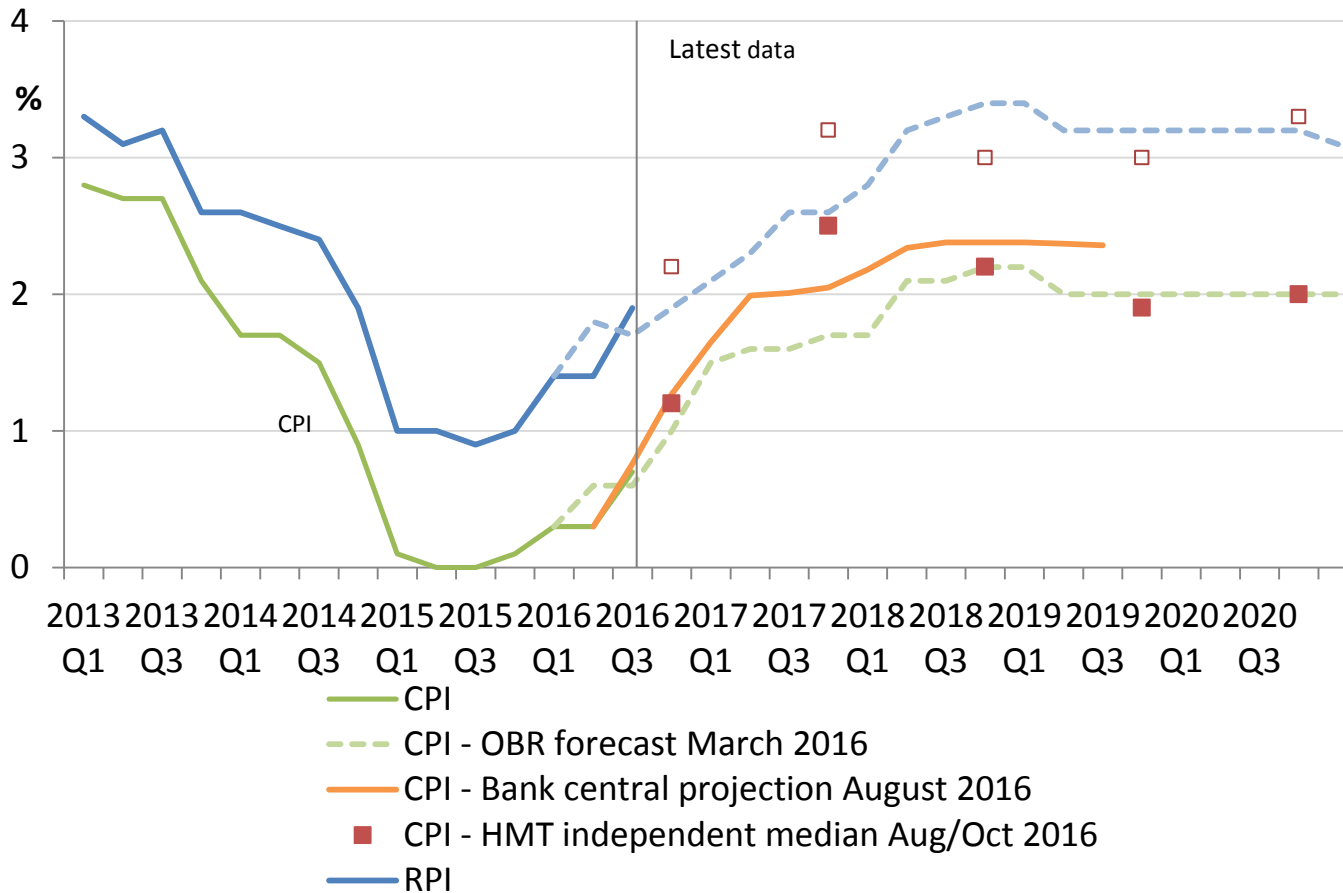
•Forecasts for 2016 and 2017 GDP growth, UK, 2012-2016



Source: LPC estimates using HM Treasury Panel of Independent Forecasts: median of recent forecasts, UK, 2012-16.

- Outlook mainly affected in 2017 onwards, not 2016.
- Growth expected to be c.1-1.5% in 2017, not over 2%.
- Better than expected GDP data in October didn't change the shape significantly.

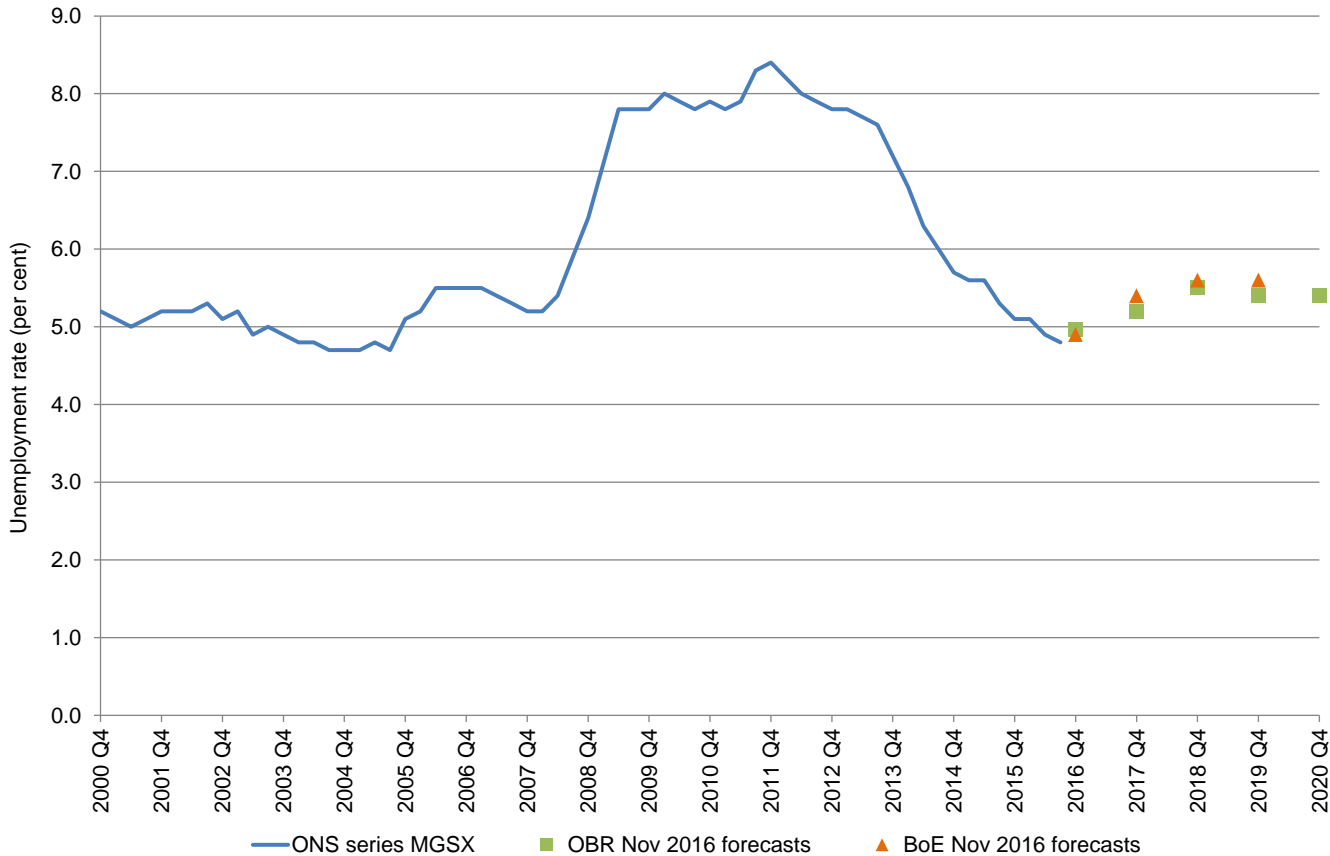
And in higher inflation



- CPI inflation forecasts to be 2.1% to 2.5% in Q4 2017 and RPI 3.2%.

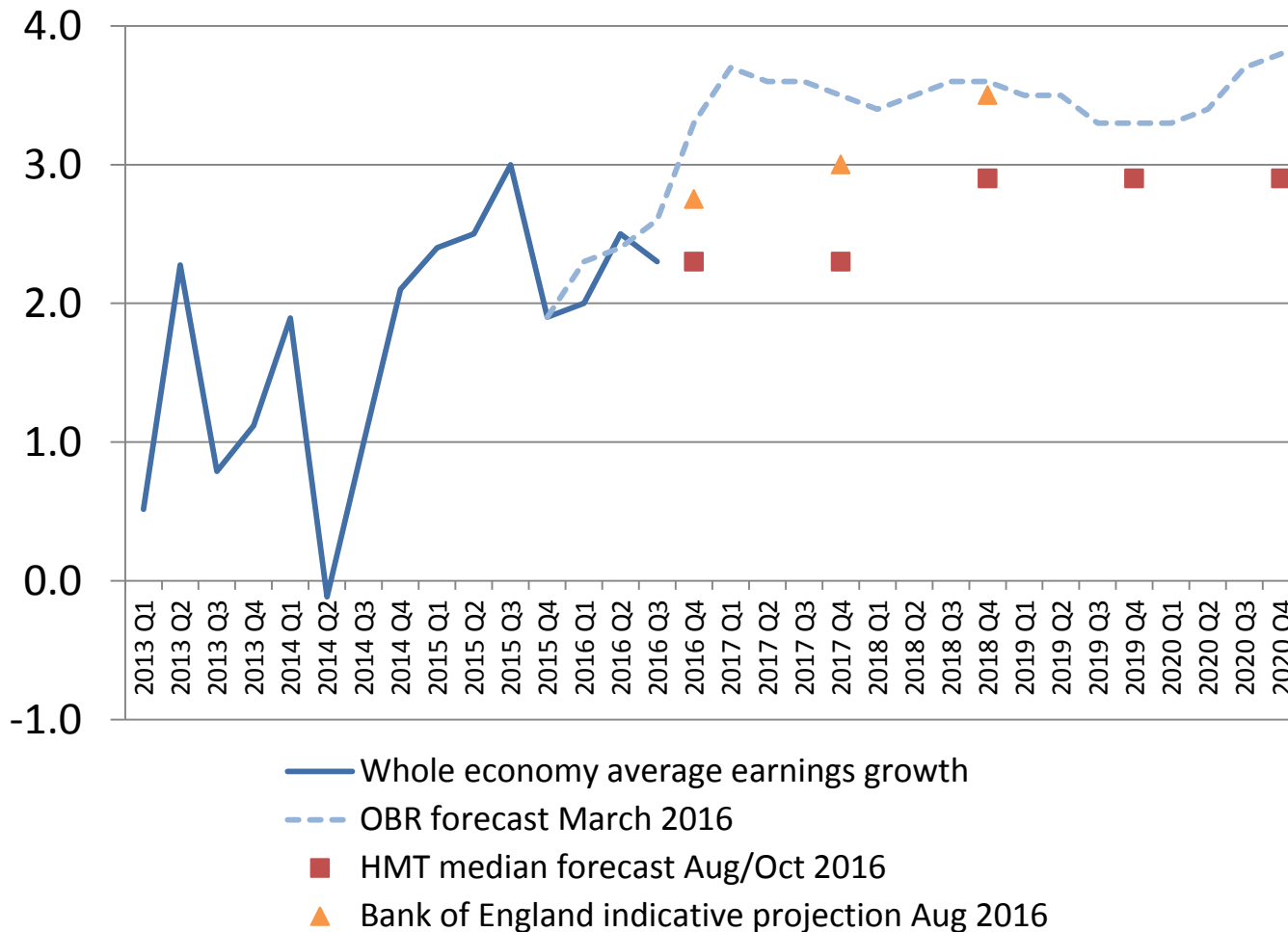
Source: LPC estimates using ONS data: CPI (D7G7), RPI (CZBH), quarterly, not seasonally adjusted, UK, Q1 2013-Q2 2015; Bank of England Inflation Report (2016); OBR (2016); and HM Treasury Panel of Independent Forecasts.

And in forecasts for unemployment



- Bank of England expected unemployment to rise by 0.5pp (200,000-250,00) in 2017, peaking at 5.5% in 2018 and 2019
- (Although well below post recession rates, and against backdrop of record employment growth)

And in forecast pay: expected to be 2.3% in 2017, down from 3-4%

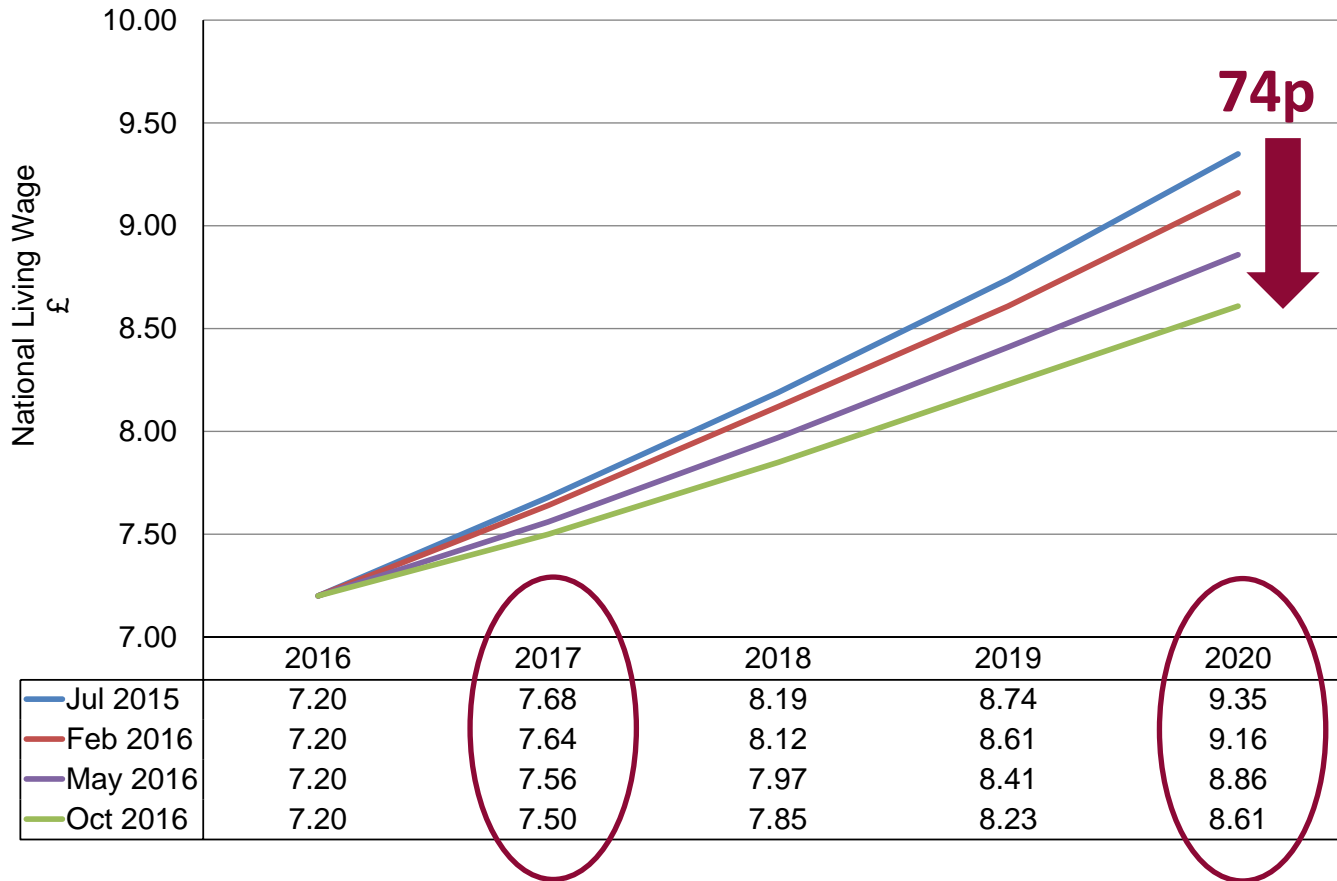


Use **median of HMT panel and BoE** to calculate the rate.

In Feb 2016, thought pay would grow 19.1 per cent April 2016-October 2020.

In Oct 2016, thought pay would grow 12.4 per cent over the same period.

Target NLW has therefore adjusted



2020 figure has adjusted from £9.35 when policy first announced... to £8.61 in our Autumn 2016 Report.

2016 figure has adjusted from £7.68... to £7.50.

Implies 4.2% increase in 2017 to £7.50.

Source: LPC estimates using ASHE April 2014-16, standard weights, UK; OBR (2015, and 2016) forecasts for hourly earnings; HMT panel of independent forecasts (2016); and Bank of England (2016)

Case for (additional) caution

Back-load or delay

- On course rate is a relatively large relative increase in pay – 4.2% vs 2-3% for other workers. Second biggest increase since 2006 – but at a time of high uncertainty and possible volatility.
- Large downward growth revision: GDP 1-1.5 per cent in 2017.
- Unemployment forecast to increase in 2017.
- £7.20 rate has been challenging for some sectors: competitiveness and employment effects in convenience, horticulture, social care, childcare?
- NLW has more progress than expected to 60 per cent goal.
- Has pay adjusted down enough? Forecasts have persistently been too optimistic and if this were the case again, the on course rate could accidentally frontload the NLW path.
- Delay would give more time to see what happens to the economy.
- And help manage pressures in April 2017 arising from pensions automatic enrolment (now covering small businesses) and the Apprenticeship Levy (affecting larger businesses).

Case for staying on course

At least the on-course rate

- The NLW remit has changed the burden of proof.
- Economic growth remains positive.
- Labour market performance is strong. Higher unemployment comes against a backdrop of record employment and low unemployment.
- No general evidence of negative employment effects from the introductory rate of the NLW: exposed groups performing strongly.
- Inflation set to rise, so protection needed against real pay cuts.
- The on course rate has adjusted down 14p since March and by the same proportion as growth – a third lower increase than expected in July 2015.
- The adjusted pay forecasts look more aligned with other pay data than in the past, so unlikely to accidentally frontload the path.
- Lower increases now would mean sharper increases towards 2020.
- In any event, the forecasts may be too pessimistic. Hard data since June has surprised on the upside.
- Can be more cautious in future decisions should problems emerge.

On balance, Commissioners recommended staying on course

- Overall: **recommend 30 pence increase to £7.50 per hour – the on-course rate.**
- **2018:** HMT Panel/ Bank of England forecasts imply a NLW within a **range of £7.80 to £7.91.**
- A material worsening in economic performance and prospects would lead us next year to consider recommending that the NLW should not increase relative to median earning, moving below a straight line path to 60 per cent, to safeguard employment.
- Highlighted pressures on sectors: social care, horticulture, childcare and small retail.
- 60 per cent of median earnings in 2020 will equate in cash terms to an NLW of **£8.61, within a range of £8.50 to £8.73.**
- Compares with 2017 pay forecasts around 2-2.5%.
- About 10 pence lower than in March.
- Increase pay for typical minimum wage workers (26 hours) by £400 to £600 (f/t).
- Raises coverage by up to 390,000, from 1.6 million jobs (6.7%) in April 2016 to up to 2.0 million (8.3%) in April 2017.

Other rates: moderate increases

LPC recommendations for the minimum wage					6m	12m	On Oct 2015
Rate	Oct 15	Apr 16	Oct 16	April 17			
NLW		£7.20		£7.50	n/a	4.2%	n/a
21-24	6.70		6.95	7.05	1.4%	3.2%	5.2%
18-20	5.30		5.55	5.60	0.9%	3.1%	5.7%
16-17	3.87		4.00	4.05	1.25%	2.8%	4.7%
App Rate	3.30		3.40	3.50	2.9%	4.5%	6.1%

Ambition:

- Looking backwards saw very strong pay growth to April 2016 and significant falls in unemployment.
- Enjoy shelter of NLW.

Caution:

- Looking forwards, are more exposed to risks from any slowdown.
- are getting a second increase in 6m.
- 16-17s weaker than 18-24s; high underpayment for apprentices.

How has Autumn Statement changed things?

Year	LPC Report (Oct 2016)	OBR (Nov 2016)
2016	£7.20	£7.20
2017	£7.50	£7.50
2018	£7.85 (7.80 to £7.91)	£7.90
2019	£8.23	£8.30
2020	£8.61 (£8.50 to £8.73)	£8.80

The rate – slightly higher

- OBR gets slightly higher NLW estimates towards 2020.
- Reflects higher forecast pay growth (our estimates don't change using Nov HMT Panel forecasts + BoE).
- Independent forecasts have been closer to out-turn in recent years.

The path – doesn't change evidence

- OBR more optimistic than HMT panel on GDP growth and wage growth.
- OBR GDP, wage and real wage expectations are weaker than when NLW established in July 2015, but labour market predicted to perform as strongly.

Conclusions

- NLW a relatively large increase for 2017, but lower than previously expected in cash terms.
- Currently still expect the NLW to reach 60 per cent by 2020, but cash figure inevitably very uncertain (£8.50-£8.80?).
- Commissioners' starting point remains following a rolling straight line bite path but the LPC will give consideration to recommending the NLW should not increase relative to median earnings next year should there be a material worsening in economic performance and prospects.
- In the absence of a change in relative performance of different age groups, the other rates are likely to increase more slowly than the NLW towards 2020.
- To inform future decision, we are particularly interested in evidence on employment effects and relativities.

Impact of the introductory rate of the National Living Wage

Early findings

Summary: the NLW raised pay but presents challenges

Area of impact	We look at	Messages
1. Overall: bite and coverage	<ul style="list-style-type: none"> • General scale of benefits/impacts 	<ul style="list-style-type: none"> • Sharp increases • Gains for workers • Challenges in managing reach of NLW into economy/ progression of workers
2. Pay effects	<ul style="list-style-type: none"> • Spillovers up distribution • Pay compression • Spillovers down age range • Pay consolidation • Underpayment/ non-compliance 	<ul style="list-style-type: none"> • Raised pay for NLW workers and more (large effects) • Women/ part-timers benefit • And under-25s • Some pay consolidation reported but can't see it in data (yet?) • High frictional non-compliance
3. Employment effects	<ul style="list-style-type: none"> • Stakeholder survey evidence on hours and jobs • Labour market data on hours and jobs 	<ul style="list-style-type: none"> • Stakeholders in some sectors concerned • Can't see clear effects in early data
4. Competitiveness effects	<ul style="list-style-type: none"> • Stakeholder evidence on prices, productivity, profits • Data on prices 	<ul style="list-style-type: none"> • Stakeholders in some sectors concerned • Prices up

More certainty/ data

less certainty/ data

Summary: the NLW raised pay but presents challenges

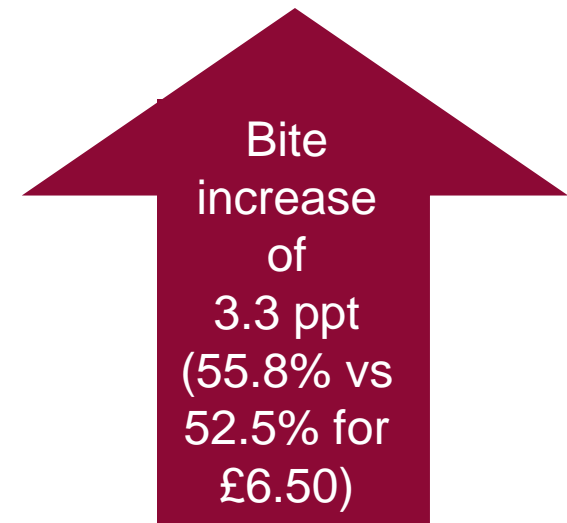
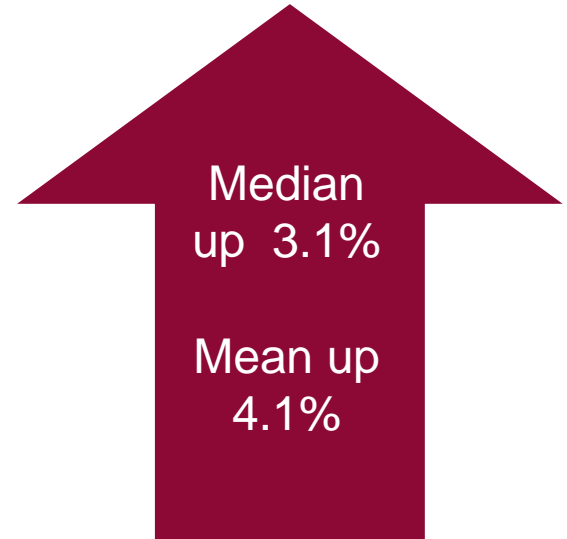
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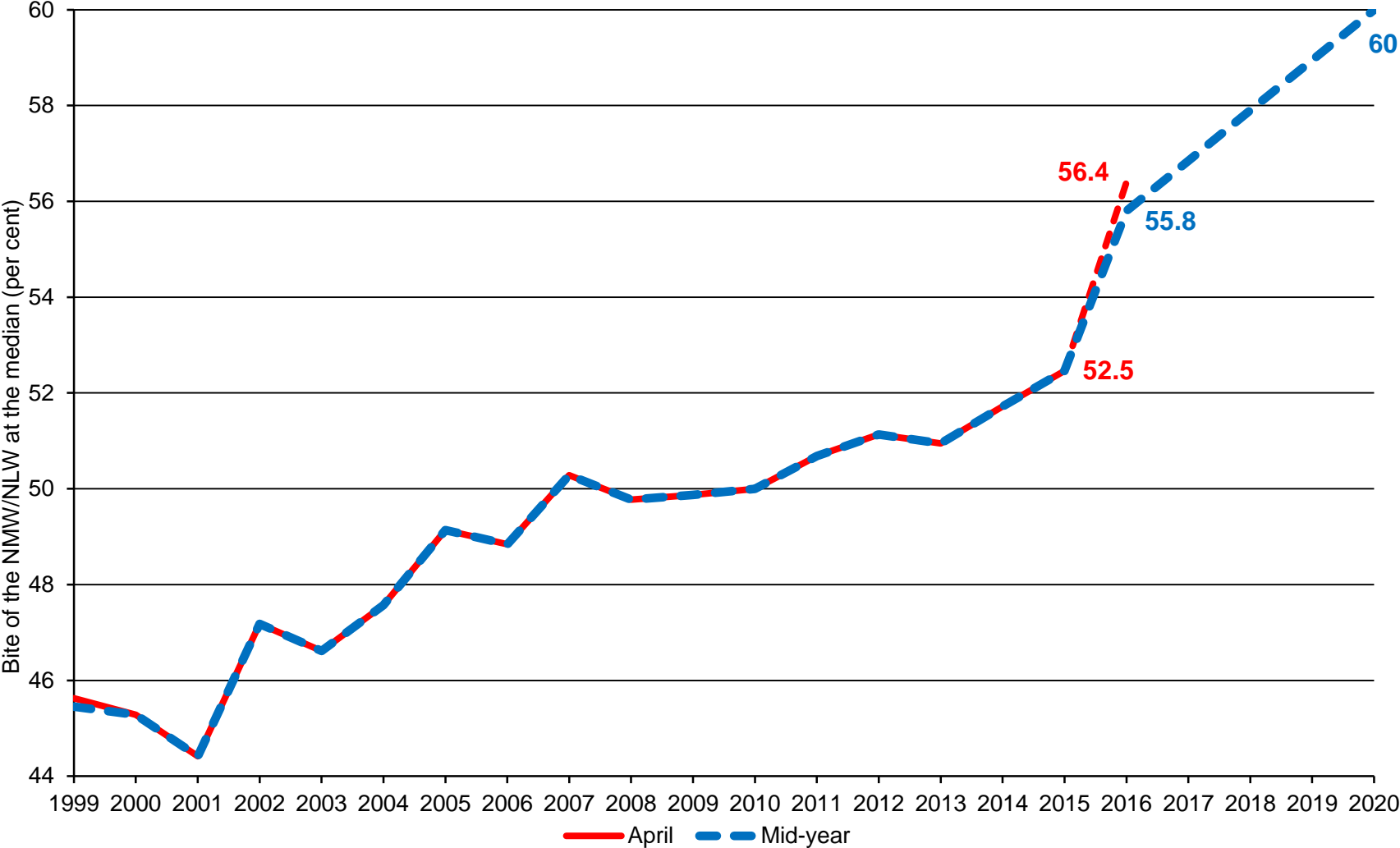
less certainty/ data

Introductory rate the largest ever cash increase in the minimum wage

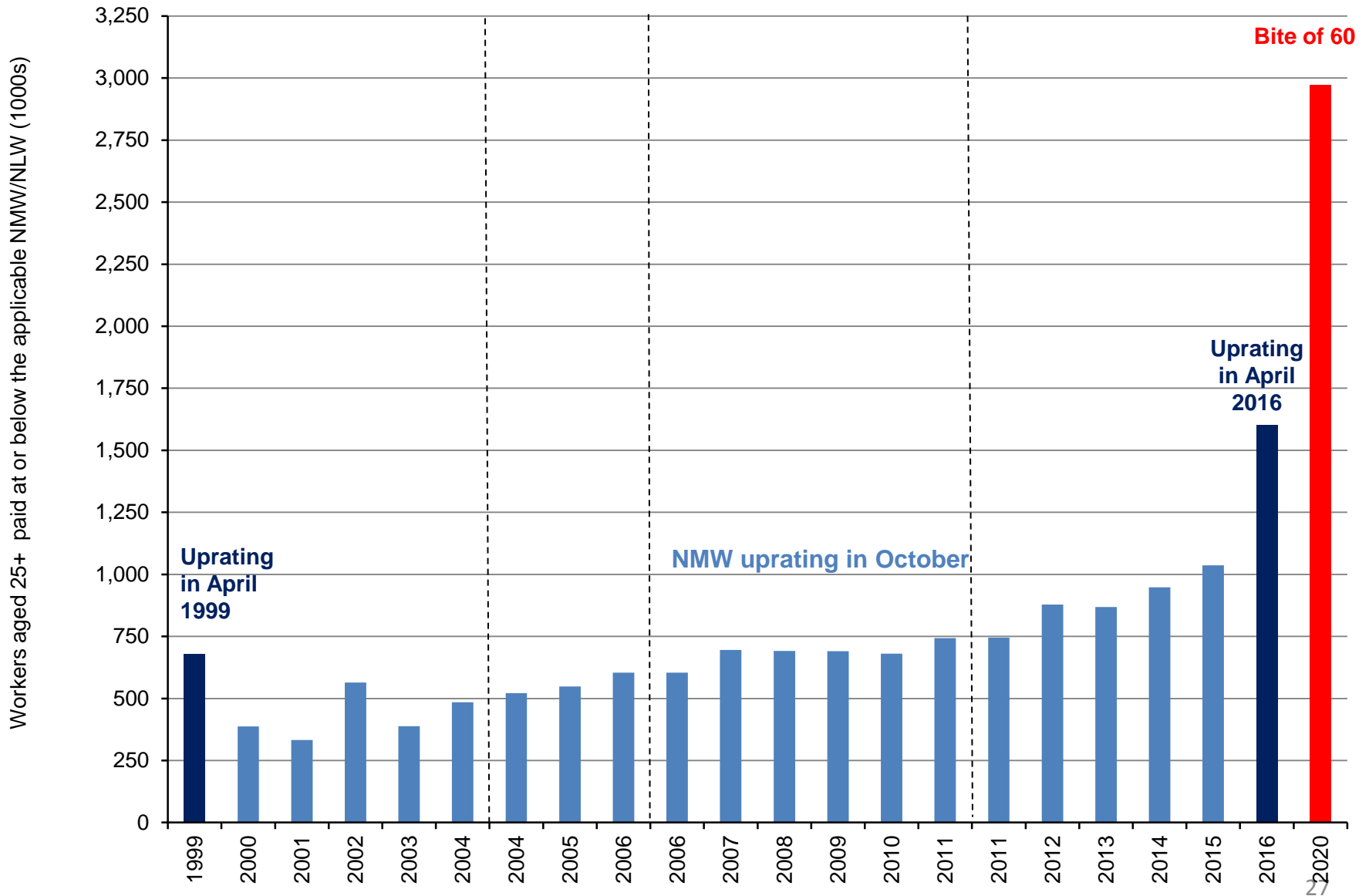
- 7.5% increase in April 2016 or 10.8% year on year.
- Up to three times median pay growth.
- Main rate at highest ever real rate (vs typical wages 5-10% below CPI and RPI peaks).
- Also at highest relative rate (bigger than expected bite increase).
- Annual gains/costs per worker (26hrs) of £680 nominal, £590 real (CPI) or £390 (vs average earnings growth).



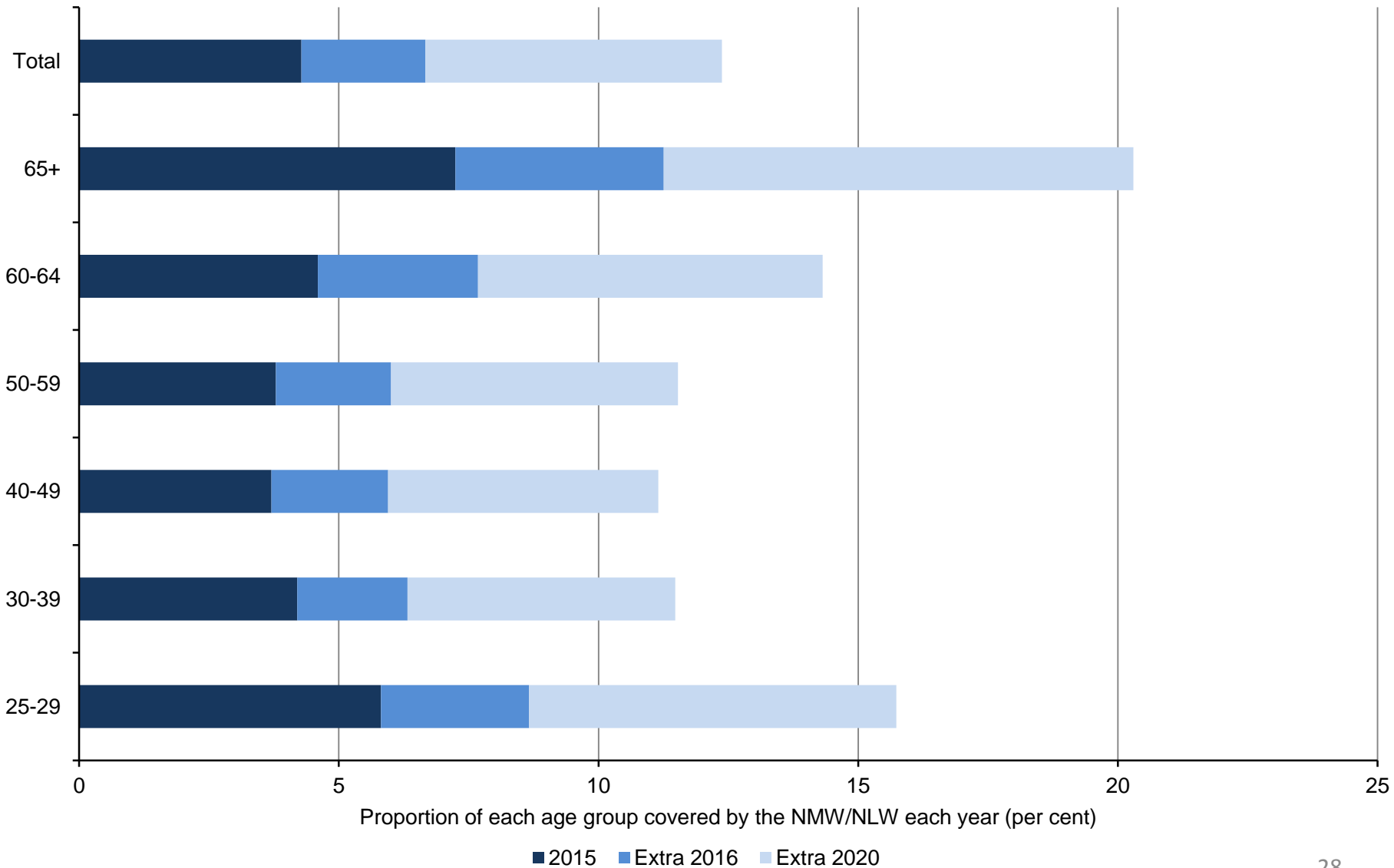
£7.20 delivered a substantial increase in the bite, a steeper jump than the remaining path to 2020



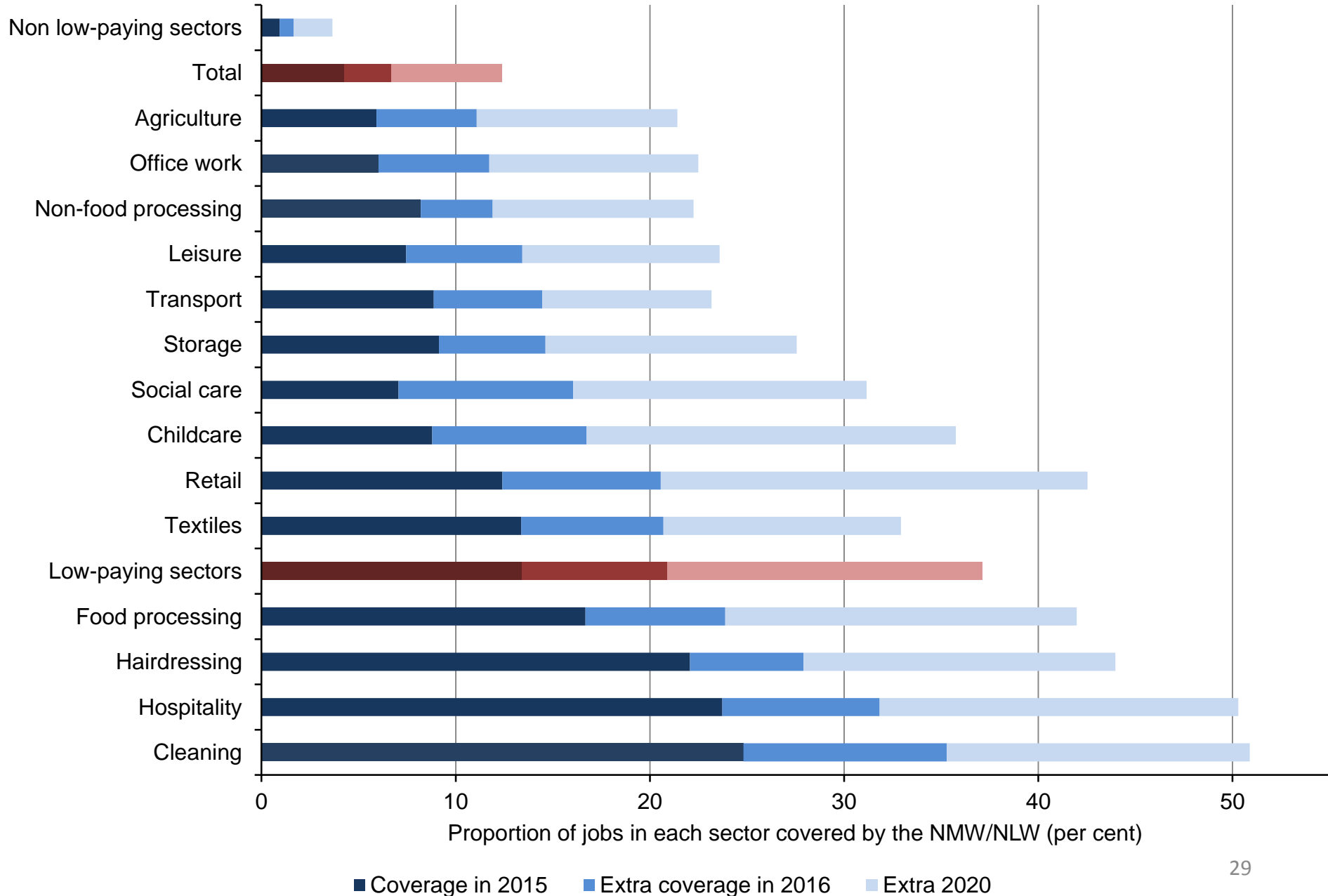
Reflected in higher coverage: 6.7% of 25+ jobs in 2016, v. 4.3% in 2015



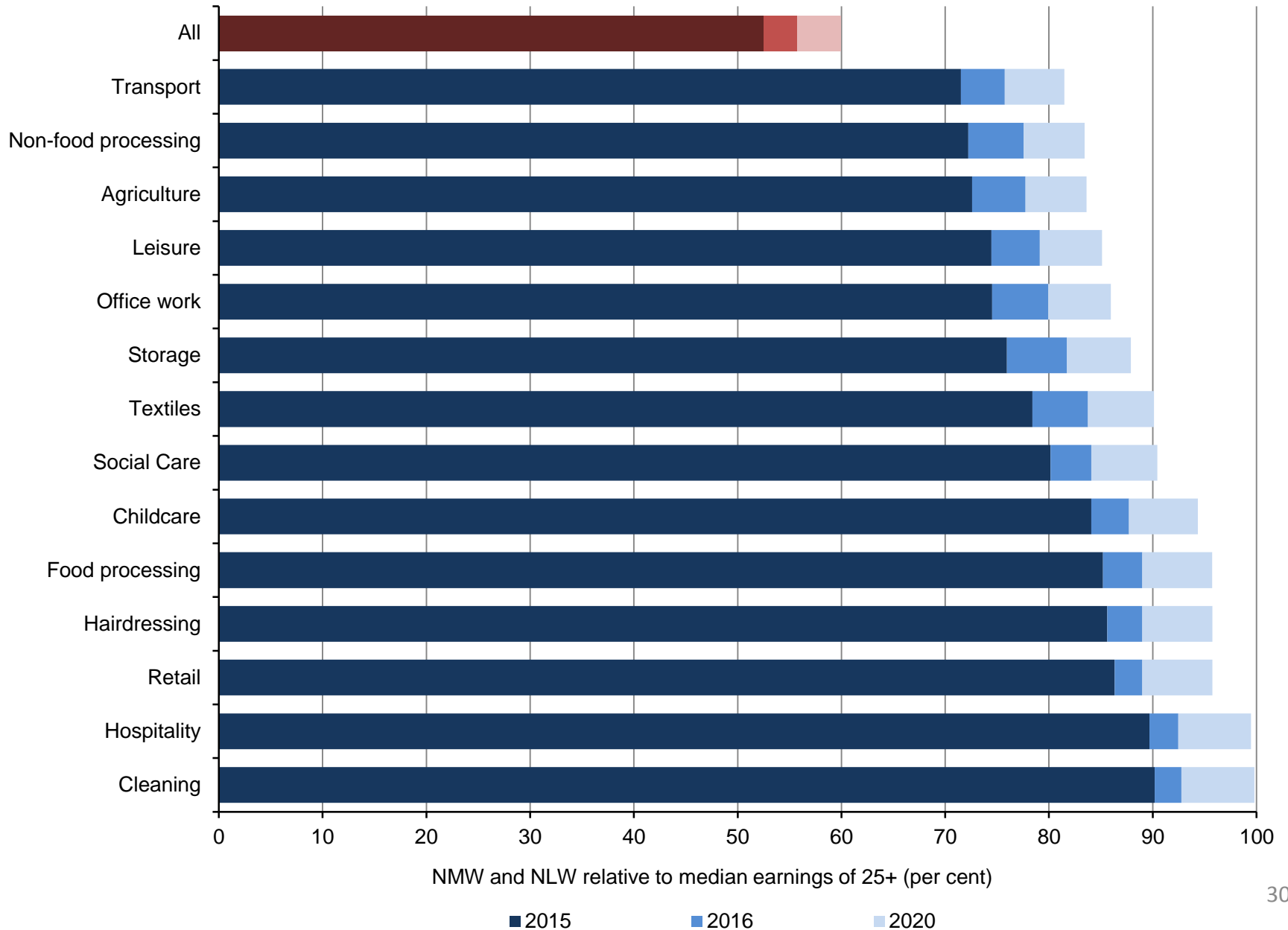
Coverage rate and rate increase highest for the youngest & oldest age group (but NLW increasingly prime-aged workers)



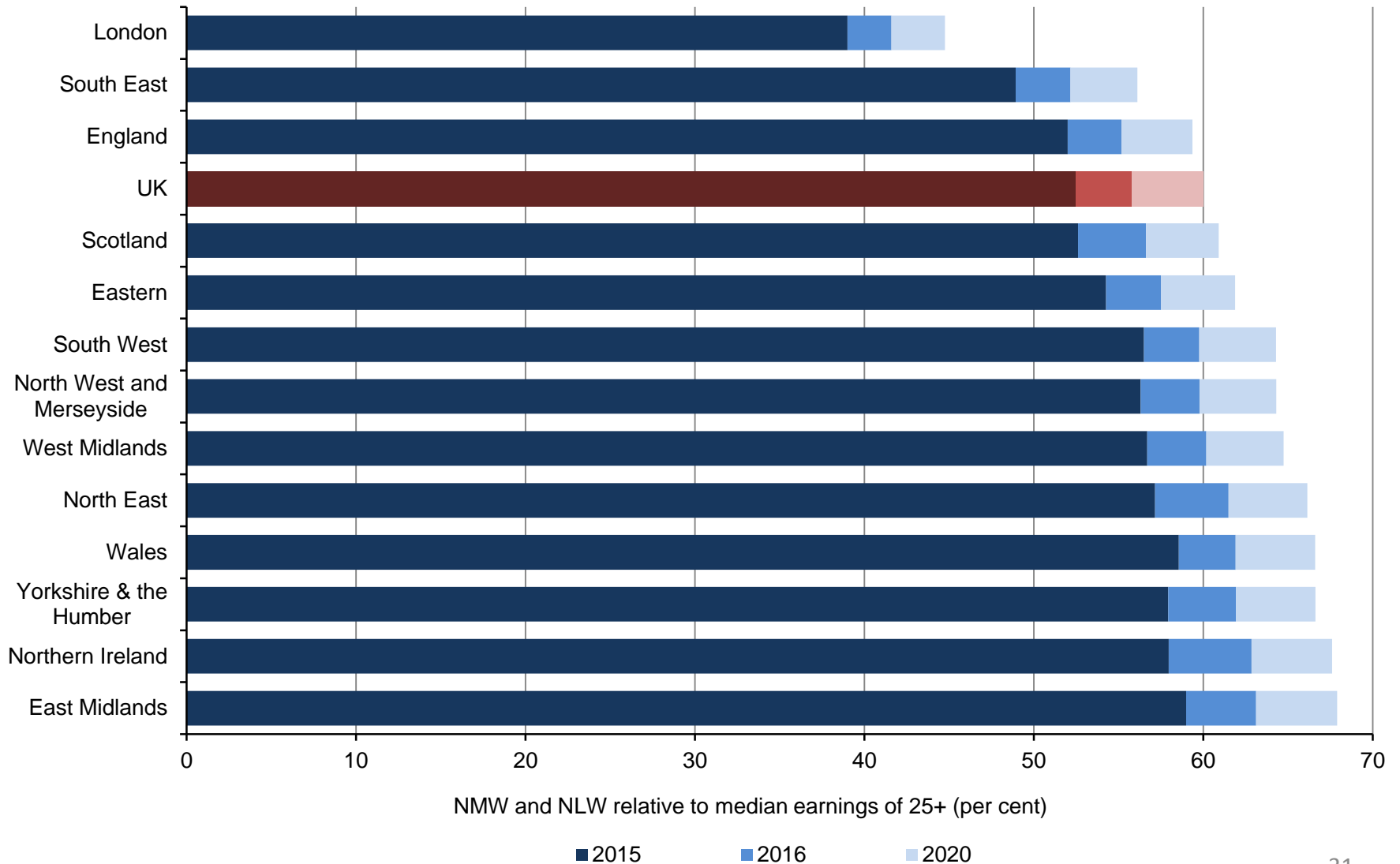
Coverage in low paying occupations: a going rate?



Similar story for the bite: pressure on progression?



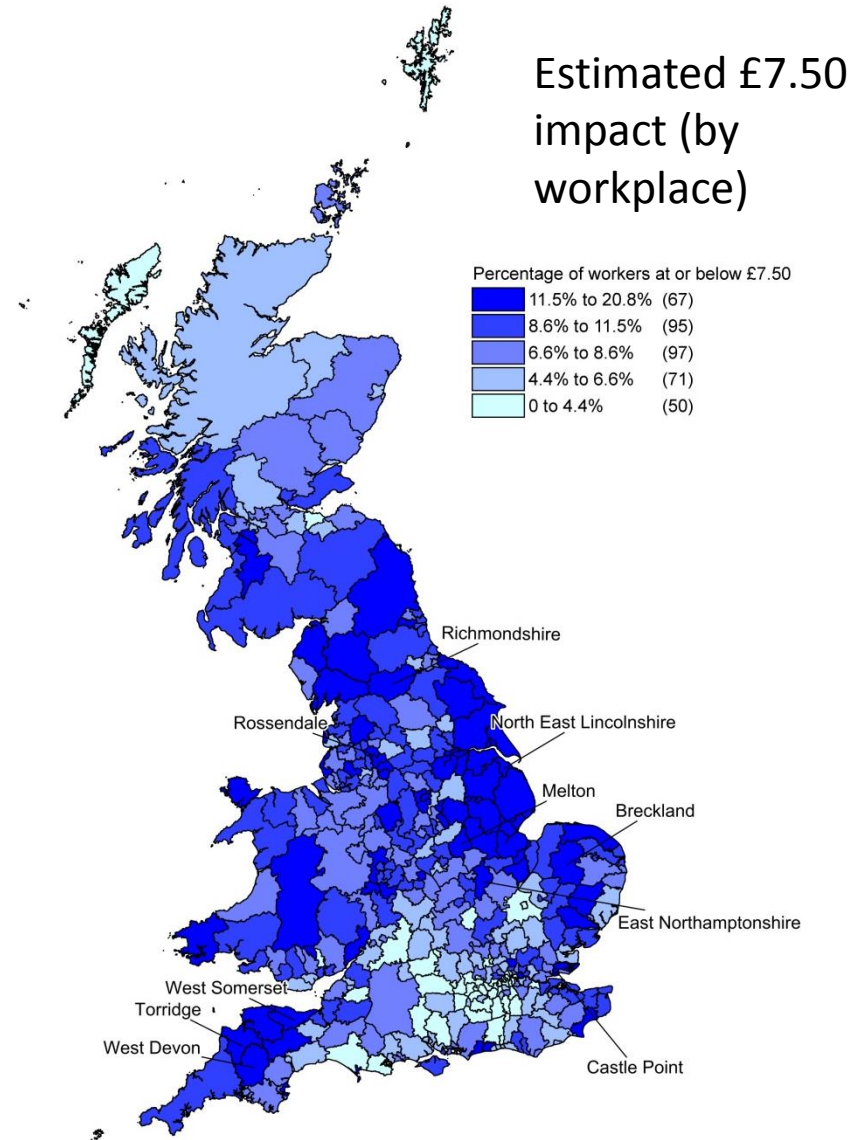
Half regions/nations set to have 'met' 2020 target of 60 per cent - in 2016



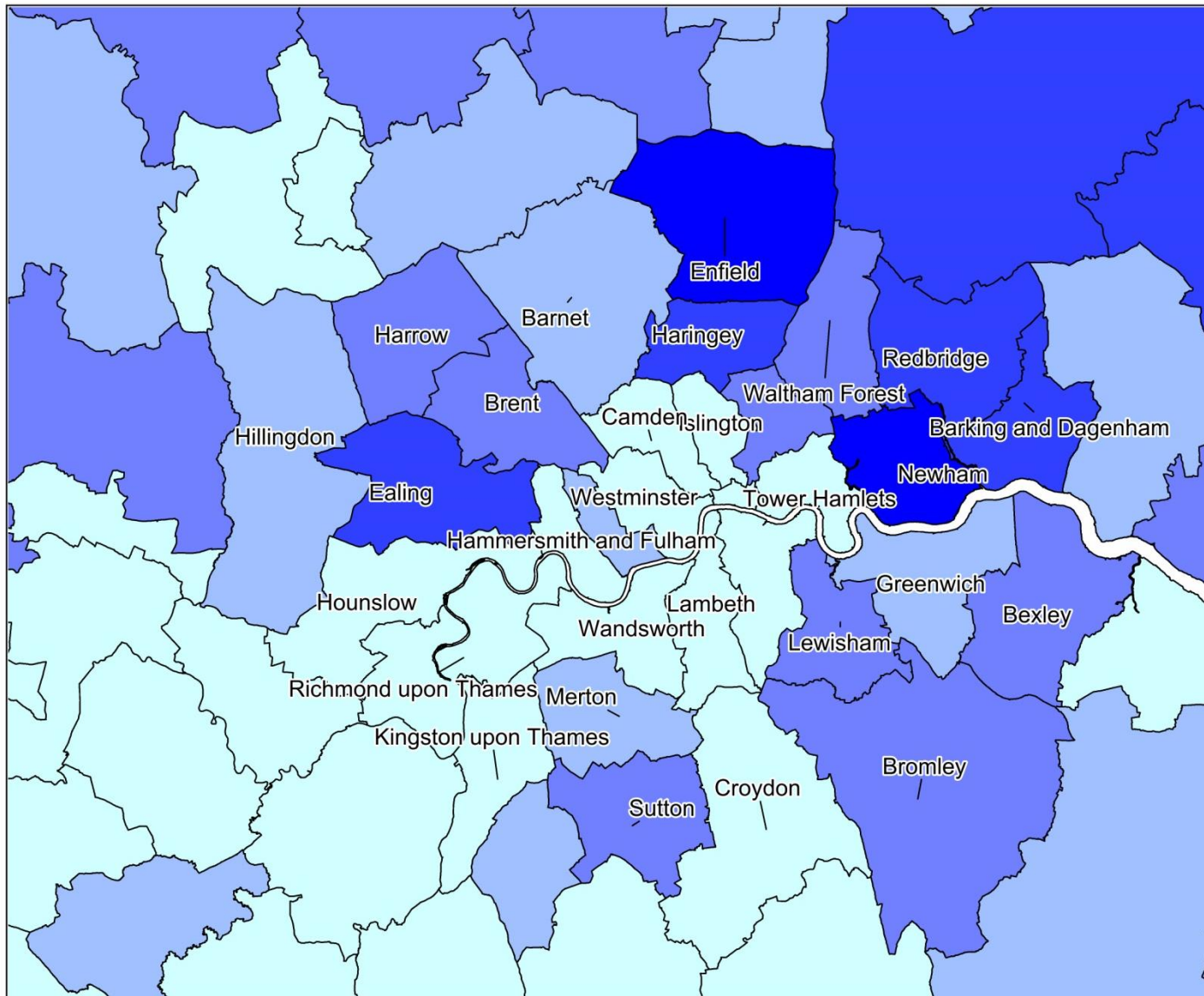
But difference within regions as big as between

Local Authority	Region	Workers at or below £7.50
West Somerset	South West	20.8%
Torrige	South West	20.0%
Rossendale	North West	19.4%
West Devon	South West	19.2%
Castle Point	East of England	17.3%
North East Lincolnshire	Yorkshire and The Humber	17.0%
Melton	East Midlands	17.0%
East Northamptonshire	East Midlands	16.8%
Richmondshire	Yorkshire and The Humber	16.3%
Breckland	East of England	16.0%

Local Authority	Region	Workers at or below £7.50
Hart	South East	2.3%
Surrey Heath	South East	2.2%
Guildford	South East	2.2%
Test Valley	South East	2.2%
Oxford	South East	2.1%
South Cambridgeshire	East of England	2.1%
Mole Valley	South East	2.1%
Spelthorne	South East	2.1%
Runnymede	South East	1.9%
City of London	London	0.8%



£7.50 coverage by workplace: some boroughs of London with high levels of low pay



Estimated
£7.50
impact (by
workplace)

Summary: the NLW raised pay but presents challenges

2. Pay effects

- Spillovers up distribution
 - Pay compression
 - Spillovers down age range
 - Pay consolidation
 - Underpayment/ non-compliance
- Raised pay for NLW workers and more (large effects)
 - Women/ part-timers benefit
 - And under-25s
 - Some pay consolidation reported but can't see it in data (yet?)
 - High frictional non-compliance

More certainty/ data

less certainty/ data

Stakeholder divided three ways

Supportive/ manageable:

- Employee representatives: supportive but NLW needs to be higher and won't compensate for benefits cuts.
- Some retail: majority of firms in BRC survey thought future path 'about right'.
- Lower labour/turnover cost employers (eg, engineering) & professional services firms).

Challenging now (and later):

- CBI: a 'a real stretch' and 'out of step with pay growth in the lower-paying industries and the economy as a whole'. Most affected sectors are: 'generally labour-intensive, low-margin and price-taking sectors where the challenge of paying higher wages is compounded by little room to pass on increases in costs to customers and limited scope to boost productivity in the near-term'.
- Social care, horticulture, small retail, textiles.

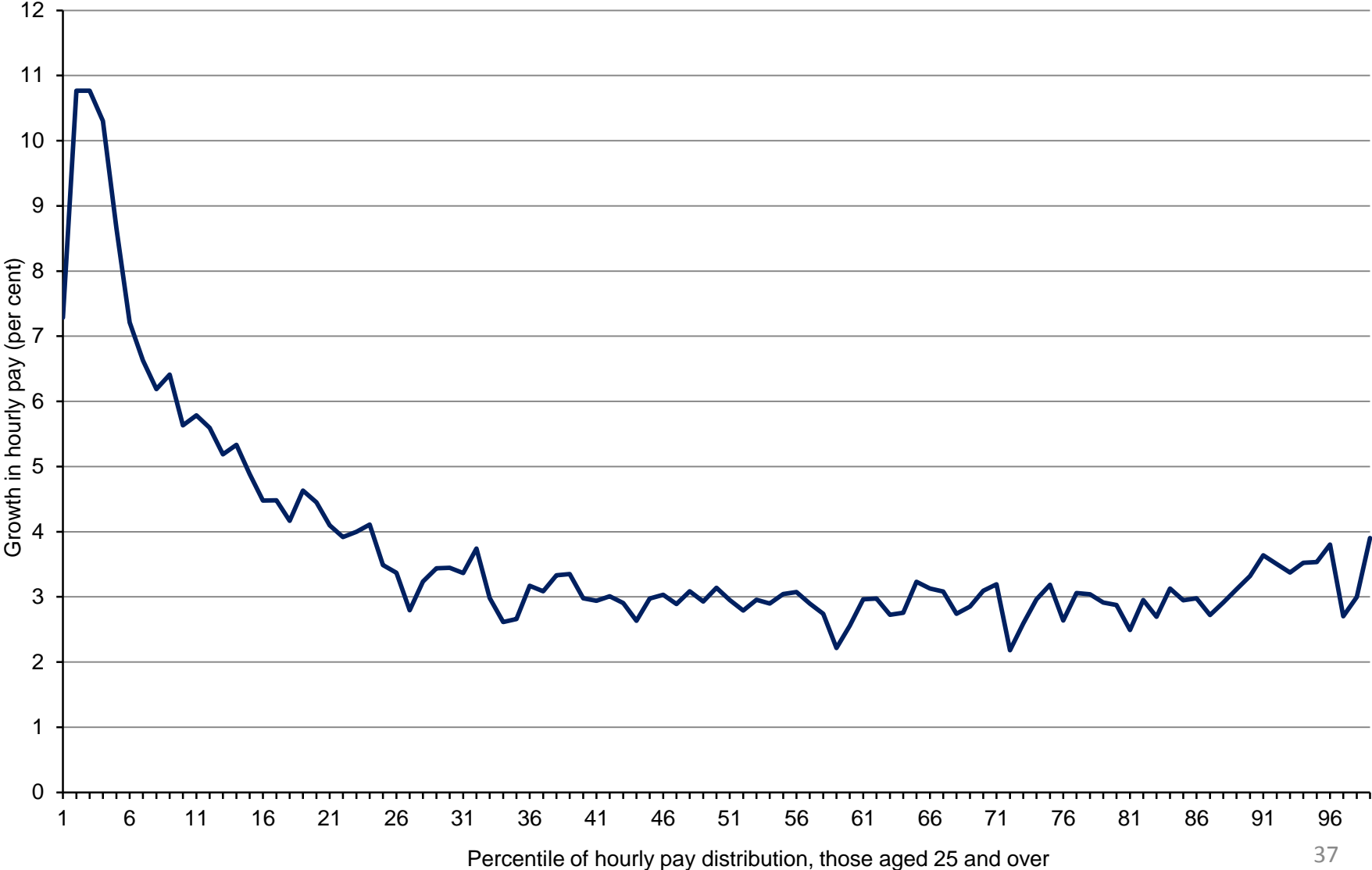
Worried about the path:

- Some (bigger) retail, hospitality, bars and restaurants, hairdressing.

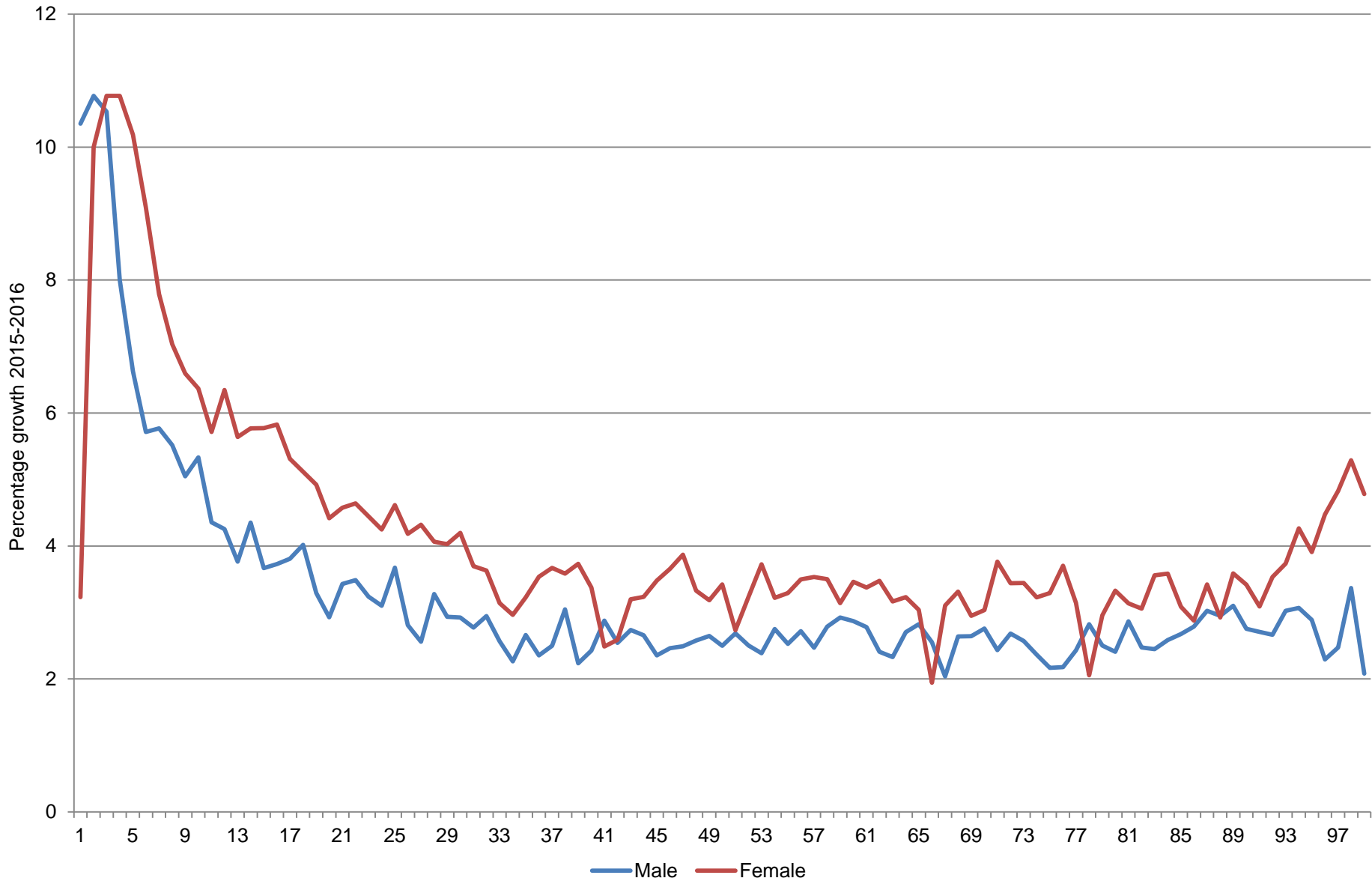
Views on pay effects of the NLW

- **Higher wage bills:** a third (BCC) to a half (CIPD/FSB) of firms.
- **Spillovers up the pay distribution** (John Lewis) and **down the age distribution** (care firms).
- Some firms **maintained differentials** (ALMR, CBI), others **flattened pay scales** (UKHCA, BRC, ACS) – some said flattening was mainly in smaller firms (FDF).
- Reports of **cuts to employee benefits:** pay premiums, overtime, bonuses (CIPD, FSB, UKHCA, BRC, FWD), but unions reported these were overstated in coverage or predated the NLW (TUC, Unite).

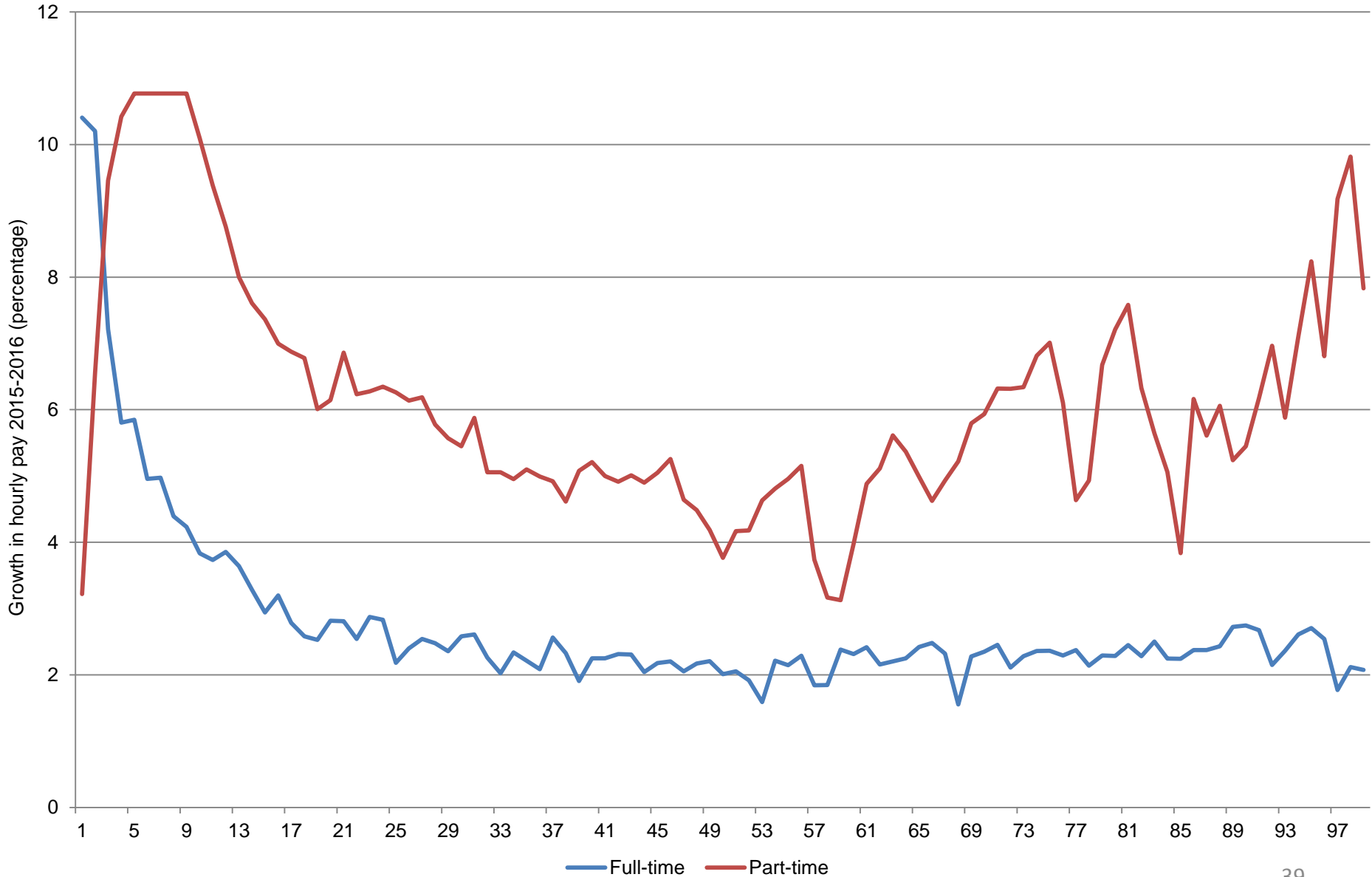
NLW has driven substantial increases in pay across the bottom of the distribution



Women particularly benefit



And part-time workers



Increases in hourly pay above what was needed to reach £7.20

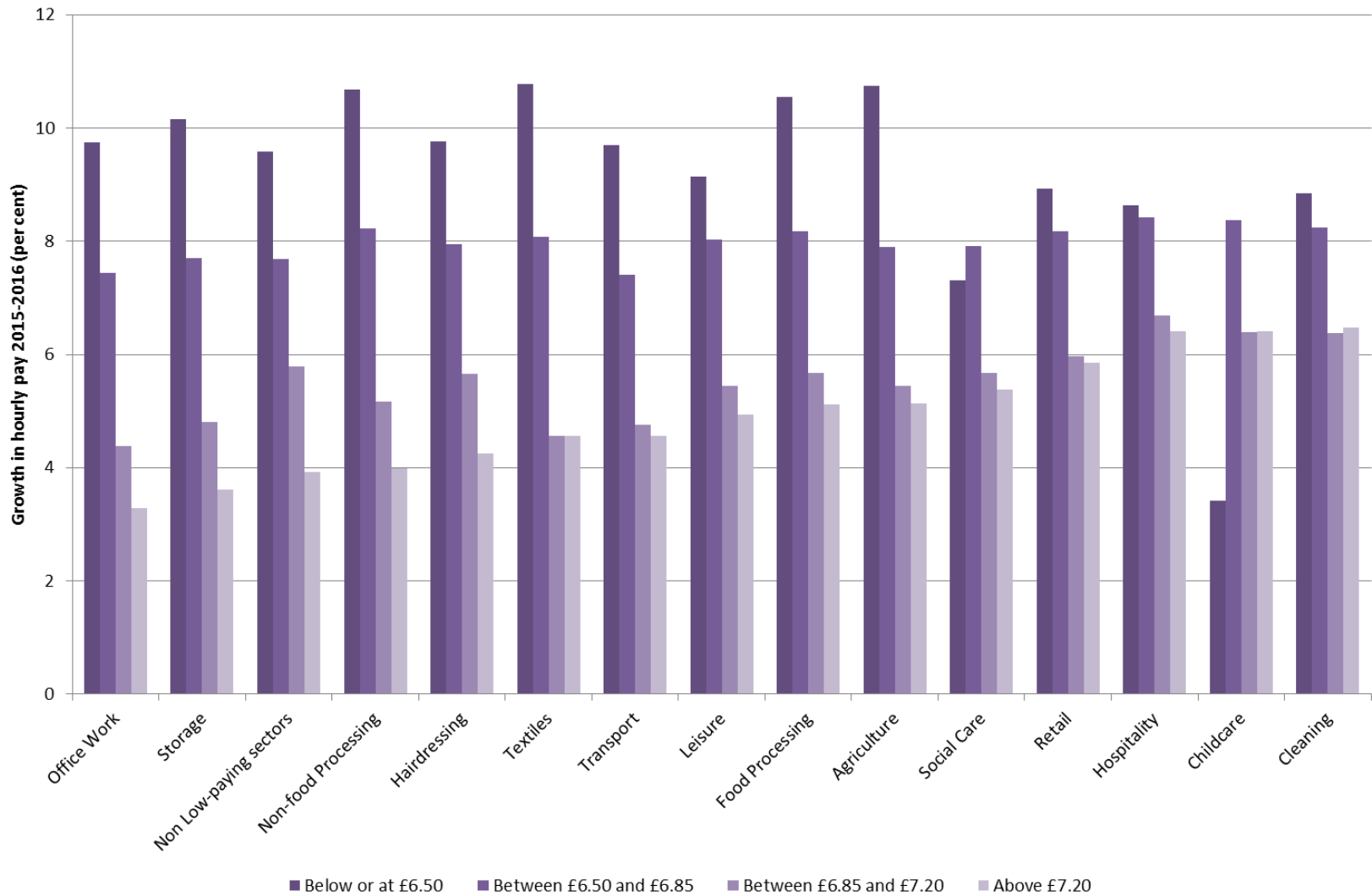


■ Growth in hourly pay 2015 to 2016 (LHS)

▲ Growth in hourly pay needed to reach £7.20 (LHS)

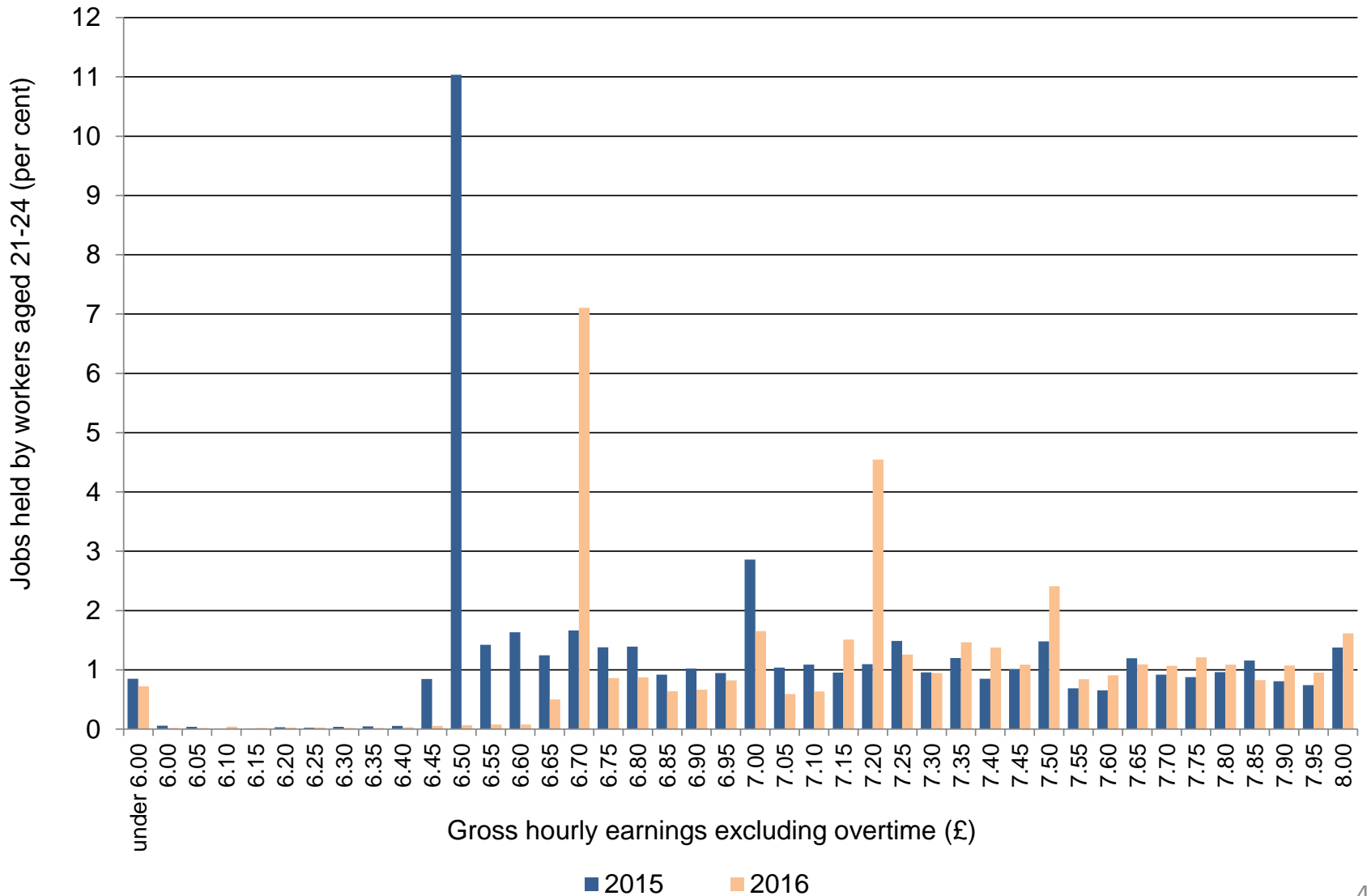
◆ 2015 hourly pay (RHS)

But also some squeezing in hourly pay – highest in office work



(Sectors on right may have already compressed pay)₁

Younger workers: spillovers down the age distribution



Found no clear evidence of pay consolidation (in early data)



- No drop in the use or level of shift premium pay or overtime in the data for the latest year – although some changes may not be present yet.
- Haven't looked at all areas of pay and benefits package – incentive pay, pension contributions, annual leave entitlement.
- Surveys and stakeholders argue this hasn't been the most popular response among employers (and predates NLW).

Higher under-payment – frictional non-compliance?

April 2016

306,000 cases paid below the NLW

1.3% of cohort

19% of NLW coverage

(Follows NLW introduction)

April 2015

160,000 cases paid below the NMW

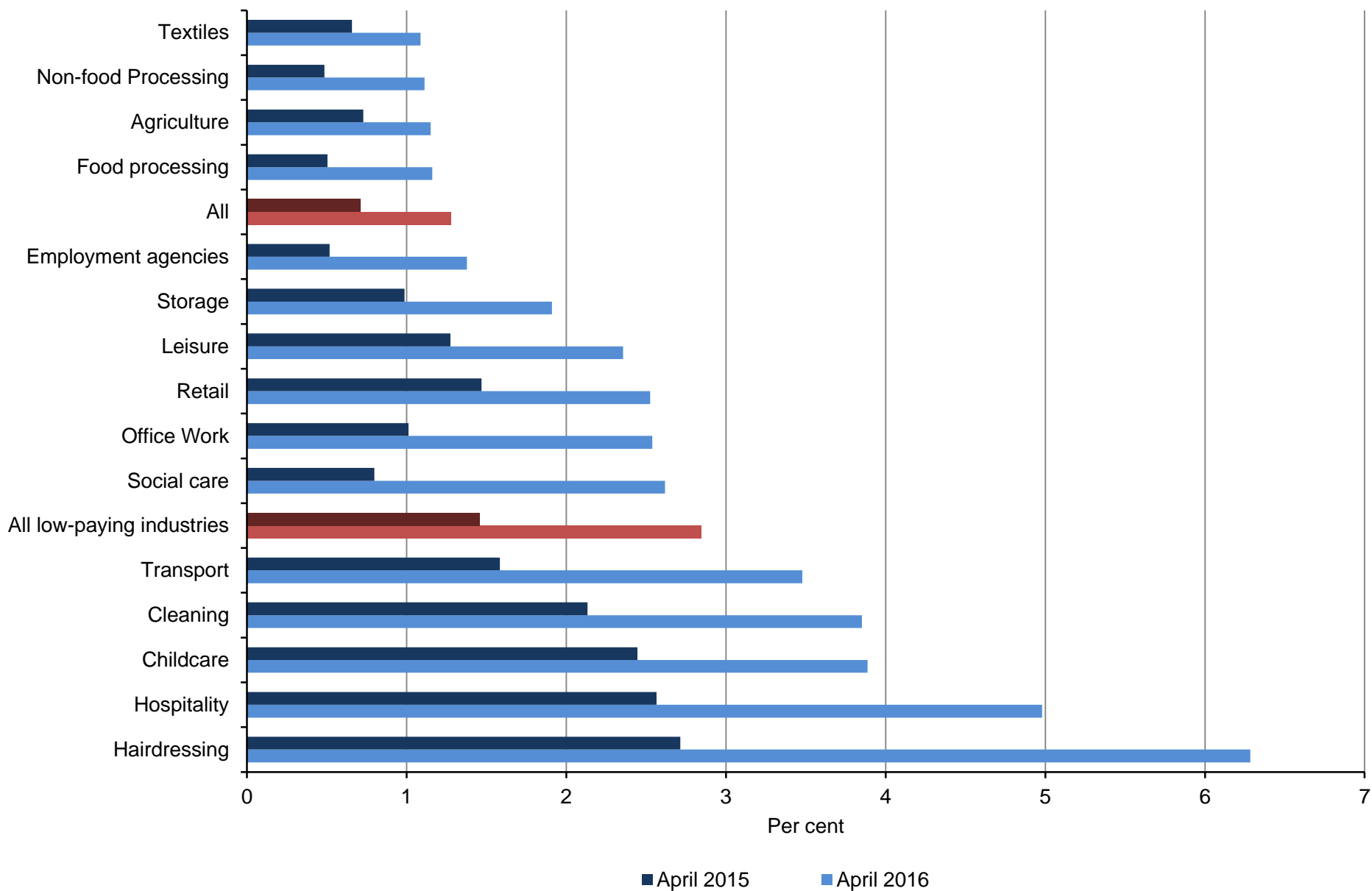
0.7% of cohort

15% of NMW coverage

(middle of NMW year)

- In April 2016, 480,000 cases paid below the NLW – 2.0%. But – NLW isn't the legally applicable wage until the pay reference period that starts after 1 April 2016.
- Adjusted data suggest 306,000 paid below £7.20.
- But comparing different points of the year... start of year underpayment? (and not all underpayment is non-compliance).
- Frictional non-compliance still a problem.

Under-payment highest in hairdressing, hospitality, childcare, cleaning,



Summary: the NLW raised pay but presents challenges

3. Employment effects

- Stakeholder survey evidence on hours and jobs
- Labour market data on hours and jobs
- Stakeholders in some sectors concerned
- Can't see clear effects in early data

More certainty/ data

less certainty/ data

Contrasting evidence on the labour market impact of the NLW

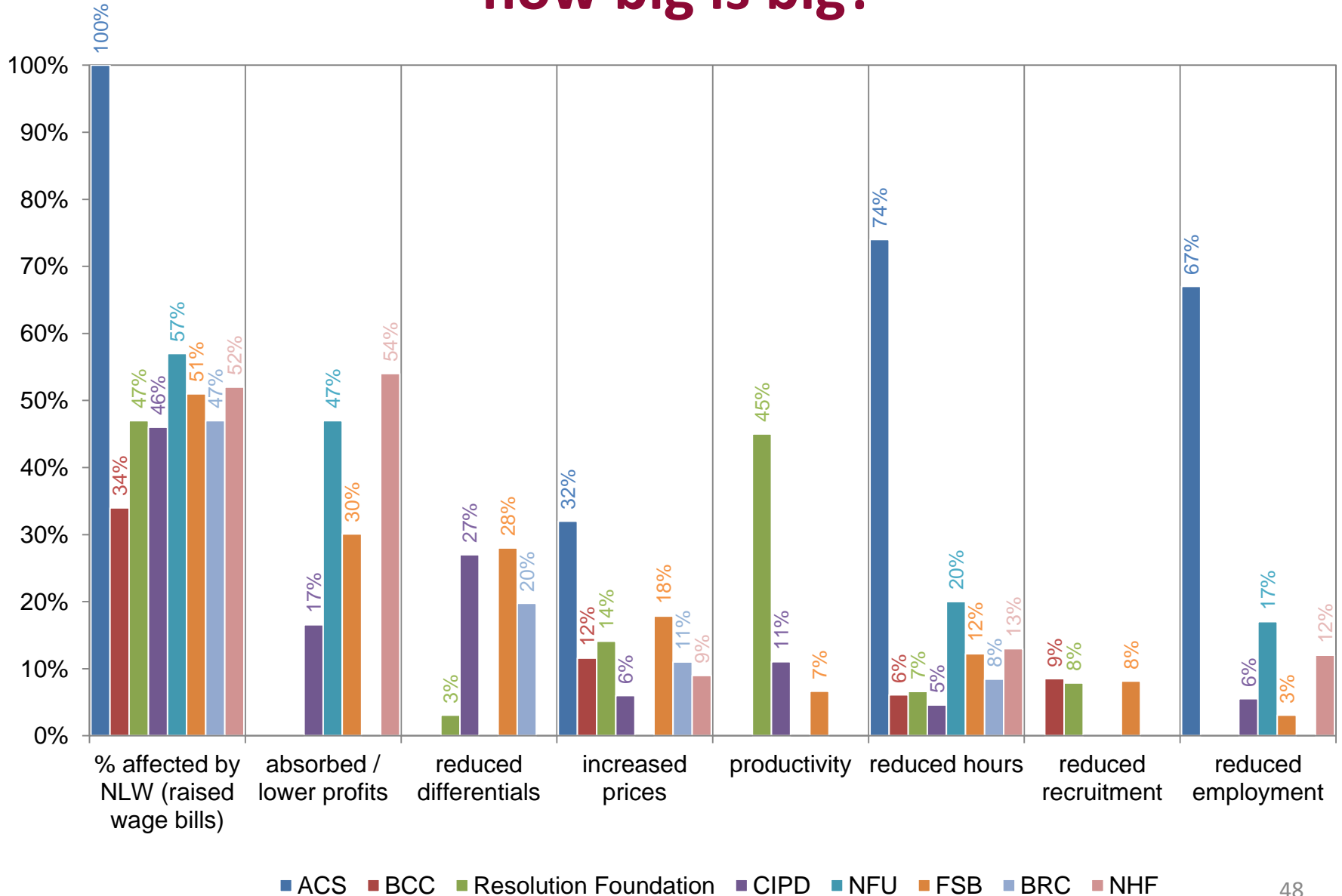
Aggregate labour market data

- No evidence of negative NLW impact by different groups of workers.
- Low-paying sector employment and jobs growing. Changes in some sectors (care, cleaning, agriculture, hairdressing), and in micro firms.
- Premature for strong conclusions – one quarter data post implementation/ 4 quarters post announcement - will continue to monitor.

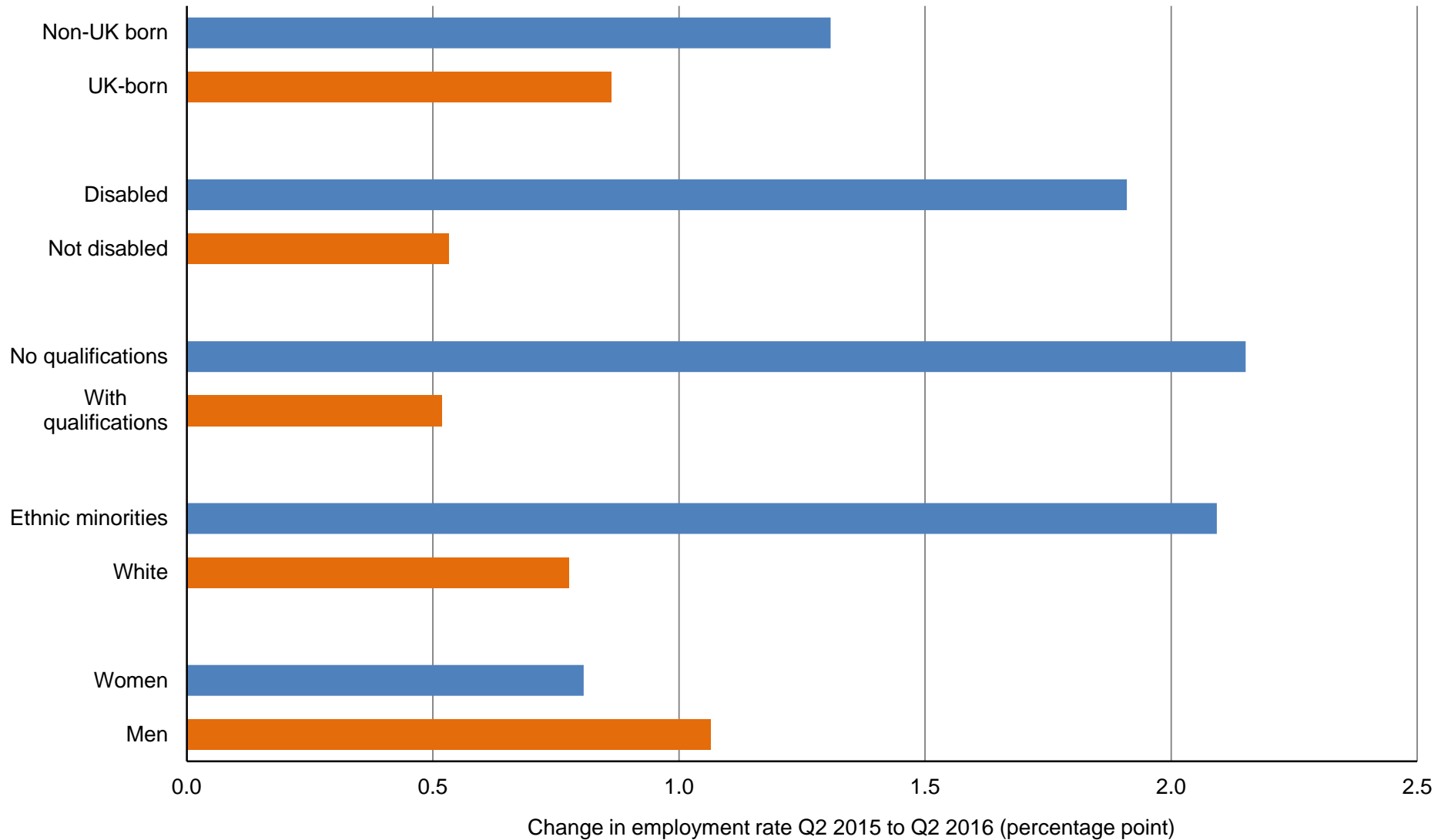
Stakeholder and survey evidence indicated:

- In some sectors:
 - Hours reductions;
 - Slower job growth;
 - Small number of redundancies.
- Horticulture, convenience stores, textiles.
- But hard to establish the absolute magnitude of these effects.

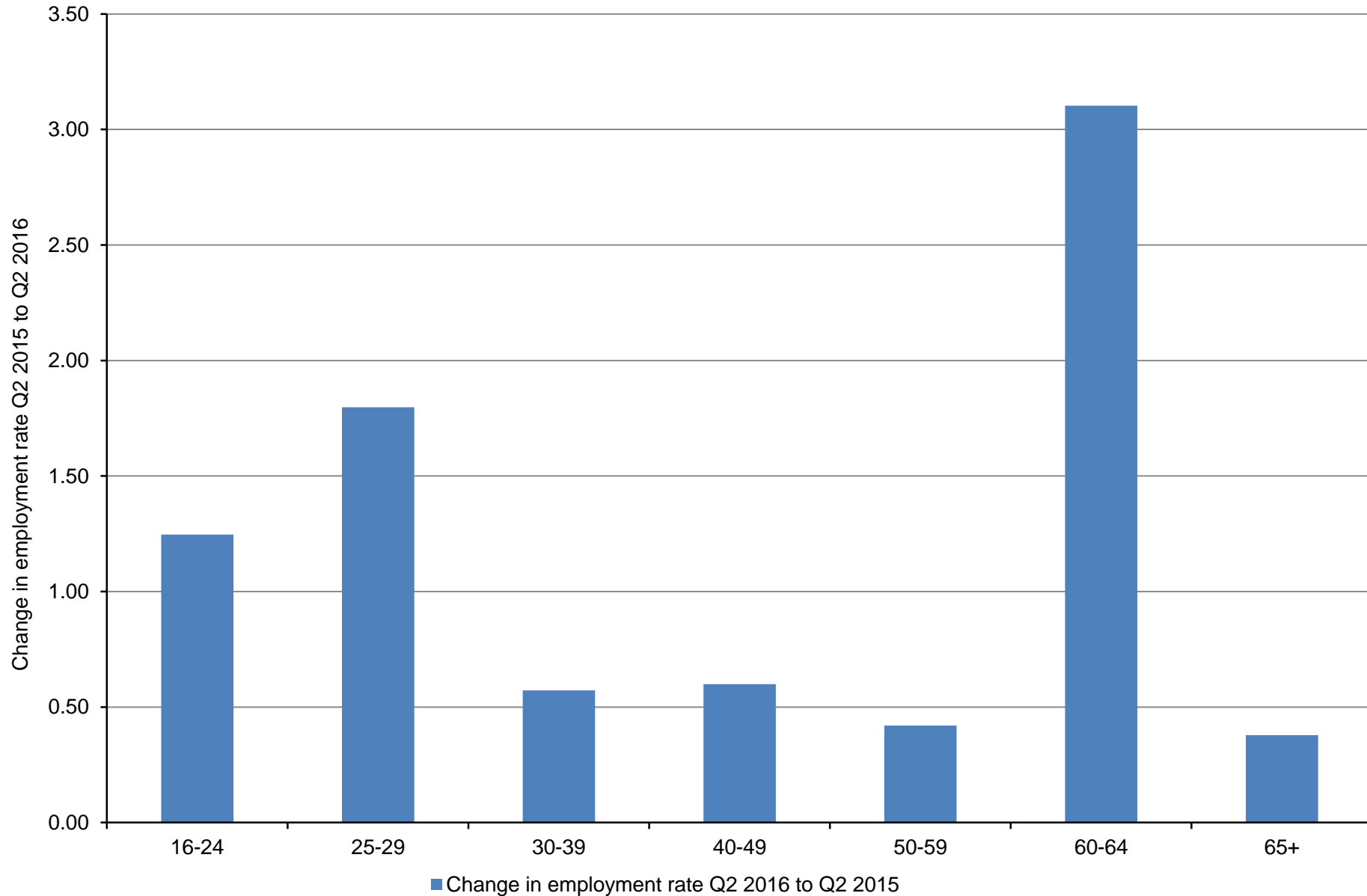
Employer surveys on effects of the NLW – how big is big?



LFS data: exposed groups outperformed comparators (apart from men and women)

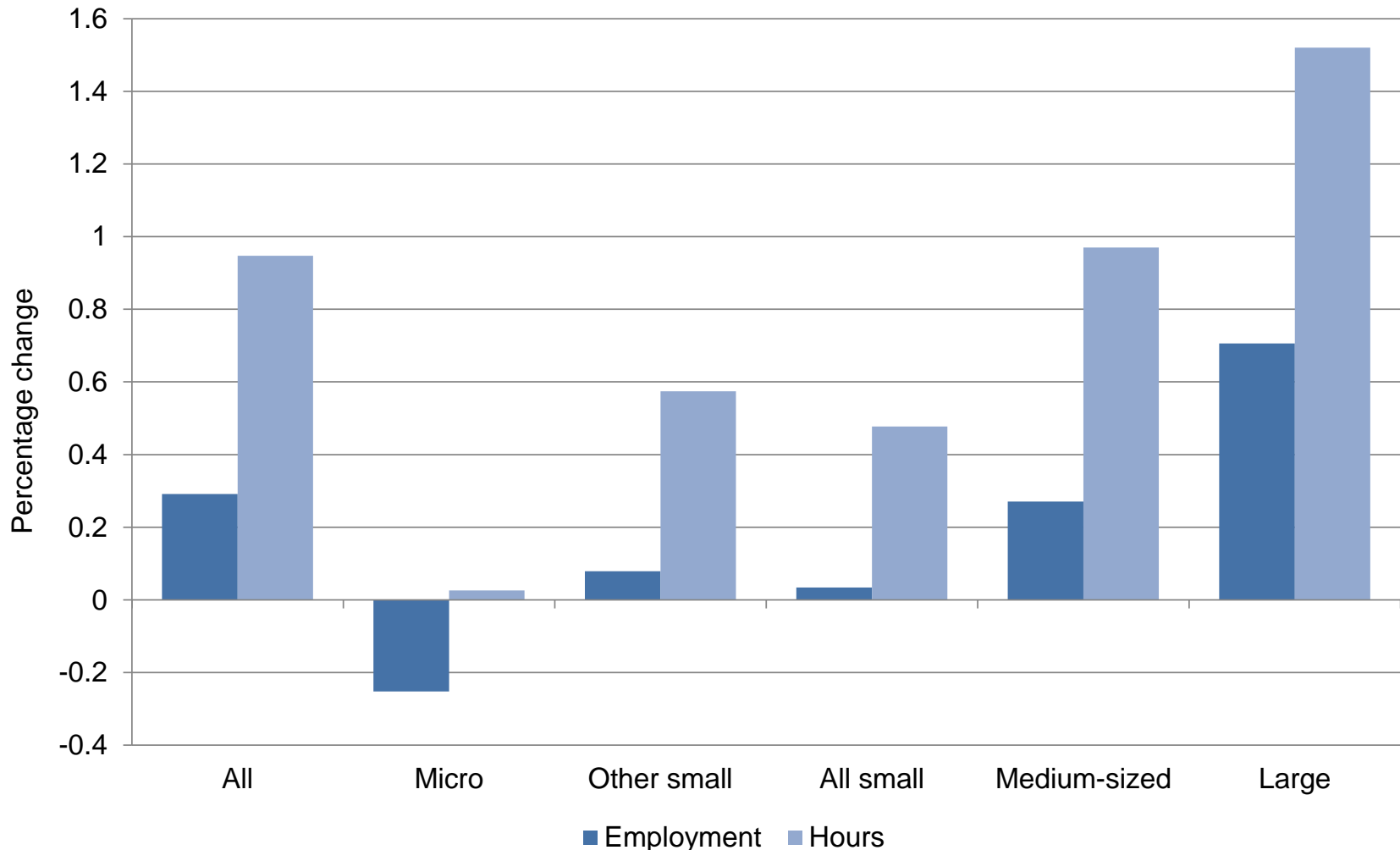


Similar story across different age groups



Source: LPC estimates based on LFS microdata, UK, Q2 2015- Q2 2016 – not seasonally adjusted.

Growth in hours and employment across all firms sizes – except micro firms



Source: LPC estimates based on LFS microdata, quarterly, four-quarter moving average, UK, Q1 2016 - Q2 2016.

Employment and hours in low-paying sectors growing robustly, but fell in cleaning, food processing, social care

Sector (percentage change on previous year)	2016 Q2	
	Employment	Hours
Agriculture, forestry & fishing	1.5	-2.3
Childcare	3.7	4.3
Cleaning	-6.0	-4.1
Employment agencies	11.9	14.1
Food processing	-2.8	0.1
Hairdressing	0.4	-3.8
Hospitality	1.3	2.3
Leisure, Travel & Sport	3.1	3.0
Retail	2.7	2.5
Social Care	-1.7	-1.7
Textiles & clothing	28.5	25.5
Other sectors	1.4	1.3
All low-paying sectors	1.4	1.5
Whole economy	1.4	1.4

General growth on employee jobs, but falls in hairdressing, agriculture and homecare/ childcare

	Change on June 2015	
	000s	%
All industries	349	1.2
Non low-paying industries	287	1.5
All low-paying industries	62	0.6
Consumer services	51	0.8
Retail	21	0.6
Retail (excluding motor)	4	0.1
Hospitality	40	1.9
Leisure, travel and sport	11	2.1
Hairdressing	-21	-13.6
Business-to-business	12	0.8
Cleaning	3	0.4
Employment agencies	9	1.2
Trade	17	2.6
Food processing	8	2.3
Agriculture	-3	-1.6
Textiles, clothing	12	12.0
Government-funded	-18	-1.1
Residential care	24	3.1
Domiciliary care/childcare	-42	-5.0

Summary sectoral labour market data

- Low-paying sectors generally had strong performance – textiles, food-processing, employment agencies. But:
 - **Social care** - hours and employment down; employee jobs down in domiciliary care/childcare (up in residential);
 - **Cleaning** – Hours and employment down, jobs increased;
 - **Agriculture** – Hours and jobs decreased, employment increased
 - **Hairdressing** – Hours and jobs decreased, employment increased.
- Very early data, so cannot draw strong conclusions

Summary: the NLW raised pay but presents challenges

More certainty/ data

less certainty/ data

4. Competitiveness effects

- Stakeholder evidence on prices, productivity, profits
- Data on prices
- Stakeholders in some sectors concerned
- Prices up

Stakeholder views on competitiveness

- **Reduced profits** accepted by many firms (a third, CIPD, to three fifths, FSB).
- Others **increased prices** (a third, RF, BRC, FSB) . But for some this is not possible (social care; retail?).
- **Reductions/delays in investment** in some sectors (a third, NFU, to two fifths ACS).
- Lots of interest in **productivity increases** (a quarter of firms, CIPD) but few concrete examples and employment effects unclear.
- **Threat to viability of firms in some sectors?** Convenience, care, horticulture.
 - But only isolated examples of business failures so far.
 - And some sectors growing (eg, convenience).

'Minimum wage goods' have generally seen greater price increases than average

		2015-2016	
		Q2	Q3
CPI	All items	0.3	0.8
	Restaurants & cafes	2.2	2.4
	Canteens	1.4	1.6
	Cleaning, repair and hire of clothing	2.2	2.4
	Domestic and household services	3.7	3.3
	Hairdressing	2.0	2.2
RPI	All items	1.4	1.9
	All items excluding mortgage interest payments	1.6	2.0
	Restaurant meals	2.2	2.4
	Canteen meals	1.5	1.7
	Take-aways and snacks	1.9	2.0
	Beer on sales	2.2	2.3
	Wine & spirits on sales	3.0	3.1
	Domestic services	3.1	3.1
	Personal services	3.1	3.3
SPPI	Net sector	1.2	
	Hotels	-0.7	
	Canteens & catering	1.0	
	Employment agencies	-1.2	
	Industrial cleaning	2.0	
	Commercial washing and dry cleaning	1.0	

Summary: the NLW raised pay but presents challenges

- **Sharp increase in coverage and bite**, with particular areas and sectors affected, and set to grow further to 2020.
- **Substantial increases in pay** for NLW workers, and those earning above the rates. Women and part-timers particularly benefited, as well as some under 25s.
- **Some squeezing of differentials.**
- **Pay consolidation?** No significant drop in use of premiums or overtime in aggregate data.
- **Higher non-compliance** (at the beginning of the NLW year?).
- **No clear impact on employment/hours yet**, with the little aggregate data we have, but **too early to be confident.**
- **Firms reported range of competitiveness effects** - aggregate data fits with increasing prices.
- **Sectoral pressures:** social care, horticulture, childcare, cleaning, hairdressing, convenience, textiles.