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23 February 2015

The Rt Hon Vince Cable MP
Secretary of State for Business, Innovation and Skills
1 Victoria Street
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Dear Secretary of State,

THE 2015 RATE, FUTURE PATH OF THE NATIONAL MINIMUM WAGE, AND REVIEW OF THE APPRENTICE RATE

I enclose the 2015 Report of the Low Pay Commission.

Last year we were pleased to recommend the first real terms increase in the value of the minimum wage since the recession. We argued that the minimum wage had proved its worth over the course of the slowdown, increasing relative to earnings generally and protecting the low paid during the downturn in a way not seen before, albeit, as with wages for all other workers, its real value fell. The bite (the minimum wage as a proportion of median wages) is now at its highest ever: overall, in low-paying sectors, and in firms of all sizes.

We judge that, as last year, sharp increases in the minimum wage would put jobs at risk – not least bearing in mind pressure on low-paying sectors and small firms. We do believe however that the continued recovery, and in particular the impressive growth in employment of the low paid, should this year allow a further increase in the real and relative value of the minimum wage.

We recommend that the adult rate should increase by 3 per cent to £6.70. This is likely to be a larger real terms increase than last year and, on the basis of the most recent Bank of England inflation forecast, should restore three-quarters of the fall in the real value of the NMW relative to its peak in 2007.

Our recommendation may increase the number of jobs covered by the minimum wage to over 1.4 million in October 2015 compared with 900,000 at the start of the downturn in 2008, as the minimum wage has risen in relation to median earnings.

We judge that the improved economic and labour market conditions mean once again that employers will be able to respond in a way that supports employment. However, our recommendation this year is predicated on a forecast which foresees lower input costs for business in fuel and energy, a strong economic performance, significant recovery in earnings across the economy and rising productivity. If these expectations are not borne out over the year we will take this into account when considering next year's recommendation.

In recent years we have recommended smaller increases for young people than for adults because their labour market position has been worse, and the damaging consequences of unemployment even more serious. However, over the last year, wages for 18-20 year olds have significantly outperformed those of adults and their employment position has improved. The abolition of employer National Insurance contributions for workers under 21 from April 2015 should reduce their costs to firms. We recommend an increase in the minimum wage for 18-20 year olds of 3.3 per cent to £5.30. For 16-17 year olds, whose position is also improving, though more slowly, we recommend an increase in the minimum wage of 2.2 per cent to £3.87.

Finally, we recommend that the Apprentice Rate should be increased by 2.6 per cent to £2.80. This would apply unless Government decides to proceed with reform of the rate - for example, the option set out in its evidence, merging it with the 16-17 Year Old Rate.

Structure of the Apprentice Rate

You asked us to consider this option as part of a broader review to see whether the structure of the Apprentice Rate could be simplified in order to improve compliance, and also to consider whether the Apprentice Rate should continue to be applied to higher levels of apprenticeship.

We recommend that the Apprentice Rate should not apply to Higher Apprenticeships. But in terms of other possible structural changes, we believe there would be significant risks in a merger with the 16-17 Year Old Rate. It would mean an unprecedentedly large increase in the value of the rate, of between 39 and 88 per cent. It would affect over 90,000 and possibly as many as 200,000 apprentices – up to a quarter of all apprentices – with significant impact in low-paying sectors that provide many apprenticeships and are of particular value to low-skilled 16-17 year olds. The cost to employers would be at least £160 million each year and could be much more. That would be around half the total cost of the recommended increase in the adult rate, and at a time when there are other funding pressures on employers in England from possible mandatory cash contributions to training. We discuss these and other concerns in our main report. As you requested, we have considered phased introduction, but it would not remedy these issues.

On the broader question, we agree with the Government that apprentice pay non-compliance is far too high at up to 14 per cent according to the 2014 Apprentice Pay Survey. However, the argument that structural change is the solution to this has at least two limitations.

First, the key complexity – a rate that changes with both experience and age – is inherent if policy-makers wish to keep current employer incentives to provide apprenticeships and the higher pay that rewards experienced apprentices while seeking to protect the relative attractiveness to employers of offering apprenticeships to young people. The main options we have found are a zero sum game: they either lead to lower pay for apprentices or higher costs to employers with consequent risks to training quality and the supply of apprenticeships.

Secondly, non-compliance is not simply, and possibly not primarily, a problem of the structure. Though the evidence is not conclusive, it appears substantially to reflect a mixture of a lack of understanding and awareness (as well as some deliberate evasion). This is reflected in high non-compliance where the structure is simplest, namely for 16-18 year olds. It is further supported by our preliminary analysis that up to half of non-compliance is explained by non-payment of training hours or error in reporting hours rather than problems in complying with the hourly rate.

Communication and enforcement are the weapons for lack of awareness or deliberate non-compliance. Welcome efforts to strengthen publicity and guidance are recent and small relative to need. They have also not yet addressed the weak incentives for training providers to communicate the rate. We welcome the increase in resource for HMRC enforcement.

Overall, we believe the evidence available to us does not support a case for structural change. We nevertheless present a range of possibilities for structural reform with the advantages and disadvantages of each, though we make no specific recommendation. We are conscious that reform needs to fit with broader government policies that lie outside our competence and scope, for example on training subsidies, possible higher contributions by employers, and whether the intention is that apprenticeships should be re-focused away from entry to relatively low skill occupations and more towards occupations that demand higher skills.

We recommend that if the Government decides to make a change it should do so only after further consultation. Of course any change risks an increase in non-compliance unless accompanied by the major communication effort that is anyway needed, together with firm enforcement.

I am copying this letter to the Prime Minister and Deputy Prime Minister.

Yours sincerely

David Norgrove

David Norgrove
Chairman