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*Dear David,*

Thank you for your letter of 3 July to the First Minister, Alex Salmond MSP. I have been asked to reply and I welcome the opportunity to set out the Scottish Government's views on the impact of the National Minimum Wage. Our evidence for the Low Pay Commission's report is set out within Annex A of this letter.

I look forward with interest to receiving the Commission's report and I would be happy to provide any further assistance you may require in completing this and future reports.

*Fergus Ewing*  
**FERGUS EWING**



## SCOTTISH GOVERNMENT EVIDENCE TO THE LOW PAY COMMISSION SEPTEMBER 2013

*What are your views on the outlook for the UK economy, including employment and unemployment levels, for the period October 2014 - September 2015?*

### **A. Economic Context**

At the present time, there are growing signs of a global recovery starting to take root, especially when compared to a disappointing 2012. The first half of the year has seen an improvement in key economic fundamentals across a number of advanced and emerging economies, and confidence is beginning to return following the turmoil of the financial crisis and its aftermath.

### **B. Views on the outlook for the UK economy (incl. employment and unemployment levels) for the period October 2014 - September 2015.**

#### **Output**

In its most recent forecasts, published in July 2013, the International Monetary Fund (IMF) forecast that the UK would see economic growth of 0.9% in 2013, picking up to 1.5% in 2014. More recently, the Average UK Independent Forecast figures (September 2013), which are published each month by HM Treasury, were more optimistic, forecasting output growth of 1.4% in 2013, rising to 2.1% in 2014. Although these growth rates are positive, they are still below long run trend growth rates for the UK.

Looking further ahead, the Bank of England projections indicate that it expects UK GDP growth to move closer towards long run trend rates in 2014, into 2015. Its forecast for GDP growth for the third quarter of 2015 (change on same quarter in the previous year) is 2.2%. Similarly, the Office for Budget Responsibility (OBR, March 2013) forecasted that UK annual output growth will reach 2.3% in 2015.

Turning to Scotland, the latest independent forecasts<sup>1</sup> predict output growth of around 1% during 2013, with the average forecast rate expected to pick up to 1.5% in 2014. It should be noted that these forecasts were made prior to the recent revisions to UK forecasts and we would expect the figures for Scotland to also be revised upwards. They were also published prior to the recent positive economic data for Scotland which has been released over the summer.

The Scottish Government's Chief Economist predicted in the most recent State of the Economy that the recent output growth and underlying nature of the recession in Scotland suggest the potential for Scotland's recovery to gain traction throughout 2013, and the economy as a whole to return to pre-recession levels of output in 2014. These forecasts reflect the gradual recovery, but are still below historical trend growth for Scotland.

#### **Labour Market**

UK employment levels currently (May-July 2013) stand at 29.8 million, which is above pre-recession levels. However, because of population growth over recent years, the UK employment rate of 71.6% is still below its pre-recession level. OBR (March 2013) projections expect UK employment levels to continue to grow to reach 30.1 million in 2015.

<sup>1</sup> Fraser of Allander Institute (June 2013) and Scottish ITEM Club (June 2013).



The current (May-July 2013) UK ILO unemployment rate of 7.7% is forecast by the Bank of England to fall to 7.4% by the third quarter of 2015. However, again, this is above rates seen in the UK before the recession.

Looking at UK wages (based on ONS Average Weekly Earnings data), above-target inflation has been exerting pressure on wages at a time when nominal earnings growth is weak compared to pre-recession trends. UK nominal earnings saw an annual growth rate of 0.6% in July 2013. This weak nominal earnings growth reflects both demand-side factors (e.g. continued slack in the labour market), and supply-side factors (e.g. poor UK labour productivity). The combination of subdued nominal earnings growth and above-target inflation has had the effect of holding down real wages, which has a knock-on effect on incomes. The OBR has forecast (March 2013) that wage growth will gradually pick up in the next four years. However, its forecasts also indicate that by 2017, annual wage growth will still not have recovered to rates seen before the recession.

Scottish employment levels are currently over 2.5 million, 99,000 above their recession trough. The Scottish employment rate of 72.4% is the highest across the UK nations, although still below the levels it reached before the recession. (ONS, LFS, May-July 2013)

The Scottish unemployment rate is currently 7.4% (lower than the UK rate of 7.7%) and was forecast by the Fraser of Allander Institute (June 2013) to decrease to 7.0% in 2015.

On wages, Annual Survey of Hours and Earnings data indicates that, like in the UK, real average earnings have also seen a decline in Scotland, falling by 8.1% in real terms between 2009 and 2012 (the most recent year for which data is available). The fall in real wages in Scotland since the recession has been slightly smaller than that of the UK as a whole, resulting in the gap in earnings between the two countries narrowing. Nevertheless, falling real wages have still contributed to a drop in real median household income in Scotland from a high of £461 per week in 2009/10 to £436 per week in 2011/12, a drop of 5 per cent in real terms.

### **Outlook Summary**

In line with a number of other countries, the UK recovery appears to be underway, with recent improvements seen in GDP growth and some of the headline labour market indicators. However, the UK economy is expected to take some time to fully recover and, based on current forecasts, is not expected to return to pre-recession GDP growth rates and unemployment rates by September 2015.

Scotland's recovery is also in progress, with output in Scotland currently closer to pre-recession levels than output in the UK. At Q1 2013, Scotland's output was -2.0% below its pre-recession peak, whereas the UK economy was -3.9% below (rising to -3.3% below in Q2). However, as with the UK, it will take some time for GDP growth rates in Scotland to return to their long run average. The unemployment rate in Scotland is currently lower than that of the UK as a whole and independent forecasts indicate that this trend could continue into 2015.

It is worth noting that there is uncertainty around these forecasts and they are likely to be revised as the picture becomes clearer when more up-to-date data is released.

Overall, a sustained improvement in output, employment and productivity will be required in order to allow wages and incomes to return to meaningful growth in both Scotland and the UK.



*What has been the impact of the NMW? Has this impact varied, and if so how (for example by sector, type and size of business or groups of workers (including women, ethnic minorities, migrant workers, disabled people, older workers, and those who are unqualified)?*

### **Impact on Gender**

Following the National Minimum Wage Act 1998 (and also the Equal Pay Act 1970), there has been a gradual improvement in closing the pay gap<sup>2</sup> between men and women in Scotland. In 1998, it was nearly 21% for full-time workers, based on average (mean) hourly earnings, excluding overtime. Latest (2012) figures show that the pay gap for full-time workers is approximately 13.5% (based on mean hourly earnings), or approximately 8.4% (based on median hourly earnings).<sup>3</sup>

The factors we can identify to explain this long-term improvement are complex. Since 2001, the Scottish Government has been in a partnership project, *Close the Gap*, to raise awareness about the pay gap and its various causes. The project has worked hard to encourage employers and employees to take action to reduce the pay gap and the Government has allocated funding for the project to continue its work until 2015.

Although the pay gap has improved over the last 15 years, the most recent data suggests that the gap for full time employees widened between 2011 and 2012, with the gap increasing from 11.7% to 13.5% (based on mean hourly earnings), or from 6.8 % to 8.4% (based on median hourly earnings).

There is widespread concern that welfare reforms introduced by the UK government are disproportionately impacting on women, especially those who are lone parents, thereby increasing the inequalities between the sexes.<sup>4</sup> Any increase to the National Minimum Wage would undoubtedly be welcome as it would benefit many thousands of low paid workers in Scotland - approximately two-thirds of whom are women.

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<sup>2</sup> The pay gap is defined here and by the ONS as the difference between men's and women's earnings as a percentage of men's earnings

<sup>3</sup> Annual Survey of Hours and Earnings (ASHE) 2012 (provisional), *Table 10.6a – Place of Residence by Parliamentary Constituency*

<sup>4</sup> For further analysis on the subject see Scottish Government (2013), *The Gender Impact of Welfare Reform*, <http://www.scotland.gov.uk/Resource/0043/00432337.pdf>





## Earnings by gender:

- In Scotland in 2012, the median hourly earnings for men were higher than those for women, £12.27 for men and £10.07 for women.
- However, when looking at those who work part-time hours in Scotland, median earnings for women are higher than those of men (women: £8.32; men: £7.68).

### Gender pay difference for median hourly earnings excluding overtime

(Adults whose pay was not affected by absence)

	Men's hourly earnings			Women's hourly earnings			Pay difference (Women / Men)		
	Full-time	Part-time	All	Full-time	Part-time	All	Full-time	Part-time	All
2011	12.60	7.80	12.08	11.74	8.31	10.00	6.8%	-6.5%	17.2%
2012	12.99	7.68	12.27	11.90	8.32	10.07	8.4%	-8.3%	17.9%

Source: Annual Survey of Hours and Earnings (ASHE), 2012, ONS

Notes:

1. ASHE covers those on the PAYE system only, therefore excluding for example the self-employed.
2. Estimate for 2011 are final while estimate for 2012 are provisional.

## Impact on Disabled People and Older People

We have no specific evidence on this matter which suggests that this has any additional effect on these groups.

However, the following statistics would suggest that disabled people are potentially more likely not to possess formal qualifications – which may in turn make them more likely to be in receipt of the minimum wage. Disabled people who are working, and in receipt of working tax credits may also be entitled to a disability element on their tax credits if working more than 16 hours.

- Disabled people are around twice as likely not to hold any qualifications compared to non-disabled people, and around half as likely to hold a degree-level qualification.
- 20% of working age disabled people do not hold any formal qualifications, compared to 7% of working age non-disabled people. 14.5% of working age disabled people hold degree-level qualifications compared to 26.8% of working age non-disabled people.

### Older People (aged 50+)

- Older workers are increasingly looking to extend their working lives, with over 50 per cent of workers aged 55 plus planning to work beyond the state pension age.

However, there is concern that as the pension age changes and people work longer that the impact will affect childcare, as grandparents work longer and can't provide childcare because they are still working.





## *What has been the impact of the Apprentice Rate of the NMW?*

The Scottish Government has been consistent in its commitment to tackle poverty – fair levels of pay are an important part of that commitment. With respect to the Apprentice Rate, we have received communications which indicate that this has limited the affordability of young people and first year modern apprenticeships living independently.

The SG is aware of concerns, particularly in rural areas, regarding the affordability in apprentice rates of travel to and from work, suggesting that transport costs consume a major portion of apprentices wages as illustrated in the case study below.

"I am working with a young apprentice at present who has no family around, has been made homeless, has very little income and is now living in a hostel whilst trying to maintain his apprenticeship. He made the fatal mistake of borrowing £150 from [a pay day loan company] to cover the cost of his monthly £70 bus ticket and accommodation, which has very quickly spiralled into a debt of £658 and is far beyond his means to repay. Apparently he does not qualify for emergency housing as he has a wage (£400 pcm), but [it] is hardly a living wage.

Unlike undergraduates and college students, young apprentices are not entitled to student bank accounts with interest free overdrafts, which give them a bit of financial back up when the going gets tough. Nor are they entitled to an accommodation bursary...**many young people who meet the criteria for an apprenticeship are potentially going to miss out on a successful career because of their present financial circumstances.** Not all of them are living at home with parents or guardians."

In recognition of the additional travel costs young people in rural areas may face, the Scottish Government's skills agency, Skills Development Scotland, has a specific Travel and Assistance Policy for apprentices in Argyll & Bute, Western Isles, Highland, Moray, Orkney and Shetland local authority areas. However, travel costs are limited to those incurred while travelling to the off-the-job training element of the apprenticeship.

The issue of travel costs in rural Scotland is not solely limited to apprentices. A recent report commissioned by 10 Scottish public and community service organisations revealed that some Scottish remote rural mainland and island households need between 10 and 40 per cent more income to achieve the same standard of living as people living in urban areas of England.

Produced by the Centre for Research in Social Policy (CRSP) at Loughborough University and published in July 2013, *A Minimum Income Standard for Remote Rural Scotland*<sup>5</sup> found that some remote rural households need between 10% and 40% more income to achieve the same standard of living as those in English urban areas due to a range of factors, including travel to work costs. The report states: "*Transport costs can be particularly high for working households in remote rural Scotland, who often need to travel many miles to access employment opportunities.*"

<sup>5</sup><http://www.hie.co.uk/regional-information/economic-reports-and-research/archive/a-minimum-income-standard-for-remote-rural-scotland.html>



*"A single person on minimum wage in remote rural Scotland ends up at most with about two thirds of what they need for an adequate living standard." – Donald Hirsch, Director, CRSP*

In Scotland, the take up and completion of apprenticeship opportunities remains high but the SG does receive correspondence from individuals who have become aware of the apprentice rates (e.g. Job Centre adverts for retail workers around Christmas) who are of the view that it is too low.

The SG is not aware of any evidence of systematic exploitation of apprenticeship rates. We also recognise employers' expectation that apprentices should earn a lower rate of pay whilst in training than qualified workers – it is therefore sensible to continually assess whether the Apprentice rate is at an appropriate level, and does not fall too low in real terms, particularly in comparison to the NMW for 16-17 year olds.

The Scottish Government as an employer pays the living wage.

*What is your view of the Commission's position that the current arrangements for the accommodation offset should be retained, and that it intends to recommend staged increases in the offset towards the value of the hourly adult rate of the NMW when economic circumstances mean the real value of the NMW is tending to rise?*

In 2010, the Cabinet Secretary for Education and Lifelong Learning endorsed the UK Government plans to consult on amending the rules to exempt universities and colleges from the Accommodation Offset rules, as long as the accommodation is provided to a worker who is also enrolled on a FT course of education with the institution. This is because the relationship between the university and a student is primarily educational and the rules were originally intended to stop unscrupulous employers from charging disproportionate rents to prevent having to pay some workers the minimum wage.

As such, the Scottish Government agrees with the Commission's view that the current arrangements should be maintained, including the exemption for universities and colleges.

Regarding the intention to recommend staged increases in the offset, this will effectively raise the amount of rent employers can charge to workers without going over the limit, reducing the amount of actual pay left for the worker. If the real value of the NMW is rising then this makes sense as workers should not actually be any worse off. It also means employers get better value for money for the accommodation they provide, easing the financial burden of providing employment.

We expect universities and colleges to be responsible employers, ensuring that remuneration for student workers is maintained at an acceptable level.



Are there any other views or evidence you would like to give us about the operation and impact of the National Minimum Wage?

The Scottish Government favours a policy commitment to annual increases in NMW, at least in line with inflation.

*"Around 280,000 Scots are currently classified as 'in-work poor'. Providing the living wage can help to relieve the burden for those working households living in poverty. In real terms the minimum wage has failed to increase in almost a decade and in every year since the recession of 2008 the minimum wage has failed to keep up with the cost of living. This means that the lowest paid Scots are earning the equivalent of £675 less a year... Work is the best route out of poverty. But we must ensure work pays without reducing people to penury or despair." – Alex Salmond MSP, October 2013*

Separate to NMW, addressing low pay is an explicit objective of public sector pay policy. The Scottish Government has taken direct action to raise minimum rates of pay for those parts of the public sector under its direct responsibility, going beyond any measures the UK Government has put in place for the lower paid.

The Scottish Government's public sector pay policy provides flexibility, within the real term reductions imposed on budgets, for public bodies to provide support for the lower paid working towards making sure that pay is fair and non-discriminatory.

The Scottish Government is committed to supporting the Scottish Living Wage (SLW) for the duration of this parliament giving a decisive long-term commitment to those on the lowest incomes. The Scottish Government directly supports the SLW through its public sector pay policy. The requirement, for those employers governed by the public sector pay remits, to pay a SLW was introduced in the 2011-12 public sector pay policy and assisted about 6,000 staff (including NHS staff). The last increase in the SLW rate was announced in November 2012 during Living Wage Week and is currently set at £7.45 per hour for the 2013-14 pay round.

The Scottish Government's public sector pay policy remit does not extend to local authorities. As independent corporate bodies it is the responsibility of local authorities themselves to agree the terms and conditions under which their own staff are employed. It is therefore for individual local authorities to set the rates of pay for their staff and to decide whether to implement the living wage. All 32 councils pay a Scottish Living Wage, currently at a rate of between £7.20 and £7.50. Local authorities are awaiting the outcome of the pay negotiations which will increase the living wage for all authorities to £7.50.

The Scottish Government has been exploring how we can further encourage business to pay SLW through provisions in the forthcoming Procurement Reform (Scotland) Bill. However, it is important that our procurement policy and processes comply with EU treaty obligations and legislation. That is why last year the Scottish Government sought clarification from the European Commission on this issue. Michel Barnier, European Commissioner for Internal Market and Services has confirmed that any requirement, as part of a procurement process or public contract, on contractors to pay their employees a living wage set higher than NMW is unlikely to be compatible with EU law. The issue is not the procurement directive and regulations, but EU law on the movement of workers between countries and the freedom to provide services. So amending the existing procurement regulations would not resolve the issue.





In practice, this means that public bodies cannot address payment of a living wage as part of the award criteria for a public contract nor make it a condition of contract performance. If public bodies wish to encourage contractors to pay their employees a living wage through procurement processes, this is possible. In order to understand the implications of using procurement activity as a mechanism for promoting the living wage across the private and third sectors, our consultation on the Procurement Reform Bill sought stakeholders' views on the matter. We are analysing these responses along with other evidence to develop our position on this issue. What is clear, however, is that we are unable to pursue measures in the Bill that would conflict with our EU law obligations.

The Procurement Reform (Scotland) Bill, which will shortly be introduced to Parliament and published in October, is aimed at ensuring public procurement processes are transparent, streamlined and proportionate and take into account social and environmental sustainability. It will include a provision enabling the Scottish Ministers to issue statutory guidance on how workforce related matters, such as a company's approach to recruitment and terms of engagement, should be considered when assessing the suitability of a company to bid for public contracts.

### **Living Wage Statistics**

In Scotland in 2012:

- 18.1% of employees earn less than the living wage.
- The proportion of those earning below the living wage is higher for women than it is for men (22.3% vs 13.5%). Women account for almost two thirds of employees earning less than the living wage.
- Of employees earning equal to or more than the living wage the gender split is much more even; 51% are male and 49% female.
- The proportion of employees earning below the living wage is considerably higher for those working part time hours (36.8%) compared to those working full-time (10.4%).
- Of employees who earn less than £7.20 per hour 40.7% work full-time hours and 59.3% work part-time.

Source: Annual Survey of Hours and Earnings (ASHE), 2012, ONS

Notes:

1. ASHE covers those on the PAYE system only, therefore excluding for example the self-employed.
2. Analysis based on a living wage of £7.20, the rate in April 2012 to which the ASHE data relates.
3. ASHE estimate for 2012 are provisional.

