Recommendations on the National Minimum Wage

Low Pay Commission

November 2017

Our remit this year

To monitor, evaluate and review the levels of each of the different National Minimum Wage rates and make recommendations to apply from April 2018:

- The National Living Wage
- 21-24 Year Old Rate
- 18-20 Year Old Rate
- 16-17 Year Old Rate
- Apprentice rates
- The Accommodation offset

The remit varies across these rates

NMW

- Follows the traditional basis of the NMW since its inception: to raise pay and prevent exploitation.
- The aim is to "help as many low-paid workers as possible without damaging their employment prospects"
- Therefore the level is based on affordability not need

NLW

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

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A different remit demands a different approach

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

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;

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’.

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How we met our remit this year

- Written evidence consultation with responses from around 60 organisations
- 2.5 days of oral evidence sessions meeting with representatives of around 30 organisations
- 6 visits to Margate, Leeds, Glasgow, Belfast, Newport and Melton Mowbray encompassing around 50 meetings with employers, employees and their representatives
- Commissioning 9 independent research projects
- Comprehensive analysis of a range of economic and labour market data

Key considerations this year

NMW

- What is the state of the youth labour market in terms of employment and earnings?
- Over the recession and its aftermath the LPC recommended relatively lower increases in the youth rates to protect their employment position. At the same we committed to restore the lost differentials once economic conditions improved – has this condition been met?

NLW

- Does the most recent economic evidence meet the condition of sustained economic growth to enable the NLW to be uprated in line with the path to 60 per cent of median earnings?
- What has been the impact of the NLW so far? What is happening with pay and employment for those aged 25 and over, and those in low-paying sectors in particular

Rate recommendations

Rate	Apr-2017	Apr-2018	Annual increase (per cent)
National Living Wage	£7.50	£7.83	4.4
21-24 Year Old Rate	£7.05	£7.38	4.7
18-20 Year Old Rate	£5.60	£5.90	5.4
16-17 Year Old Rate	£4.05	£4.20	3.7
Apprentice Rate	£3.50	£3.70	5.7
Accommodation Offset	£6.40	£7.00	9.4

Rate recommendations

Rationale for the recommendations

NMW

- Record high employment and record low unemployment
- Ongoing improvements in the employment and unemployment rates of 18-24 year olds
- Wage growth for 18-24 has been higher than for those aged 25 and over for the last three years.
- 16-18 year old apprentices saw very high earnings growth and research into £3.30 suggested minimal impacts
- Both employers and unions raised the concerns about a widening gap between the youth rates and the NLW.

NLW

- The economy is growing and several indicators, notably business confidence, investment and employment intentions have improved since the immediate post-Referendum lows.
- GDP growth has surpassed forecasts for 2016 and 2017 and is predicted to grow just under 2 per cent in 2018.
- Importantly, jobs growth forecasts have been significantly revised upwards and predict an additional 125,000-175,000 jobs next year. The OBR's July 2015 forecast of 1.1 million extra jobs by 2021 has already been met

The economy and the NLW

29 November 2017

Tim Butcher

Our judgement is based on…

1. The Economy	• **State of the economy** ➢ **Economic growth** ➢ **Job growth (including the low-paying sectors)** ➢ **Productivity** ➢ **Real wage growth**
2. The NLW and impact to date	• Earnings (bite and coverage) • Employment and hours • Competitiveness
3. Prospects for the economy	• Forecasts • Implications of the forecasts for the NLW
4. Conclusion	• Next steps

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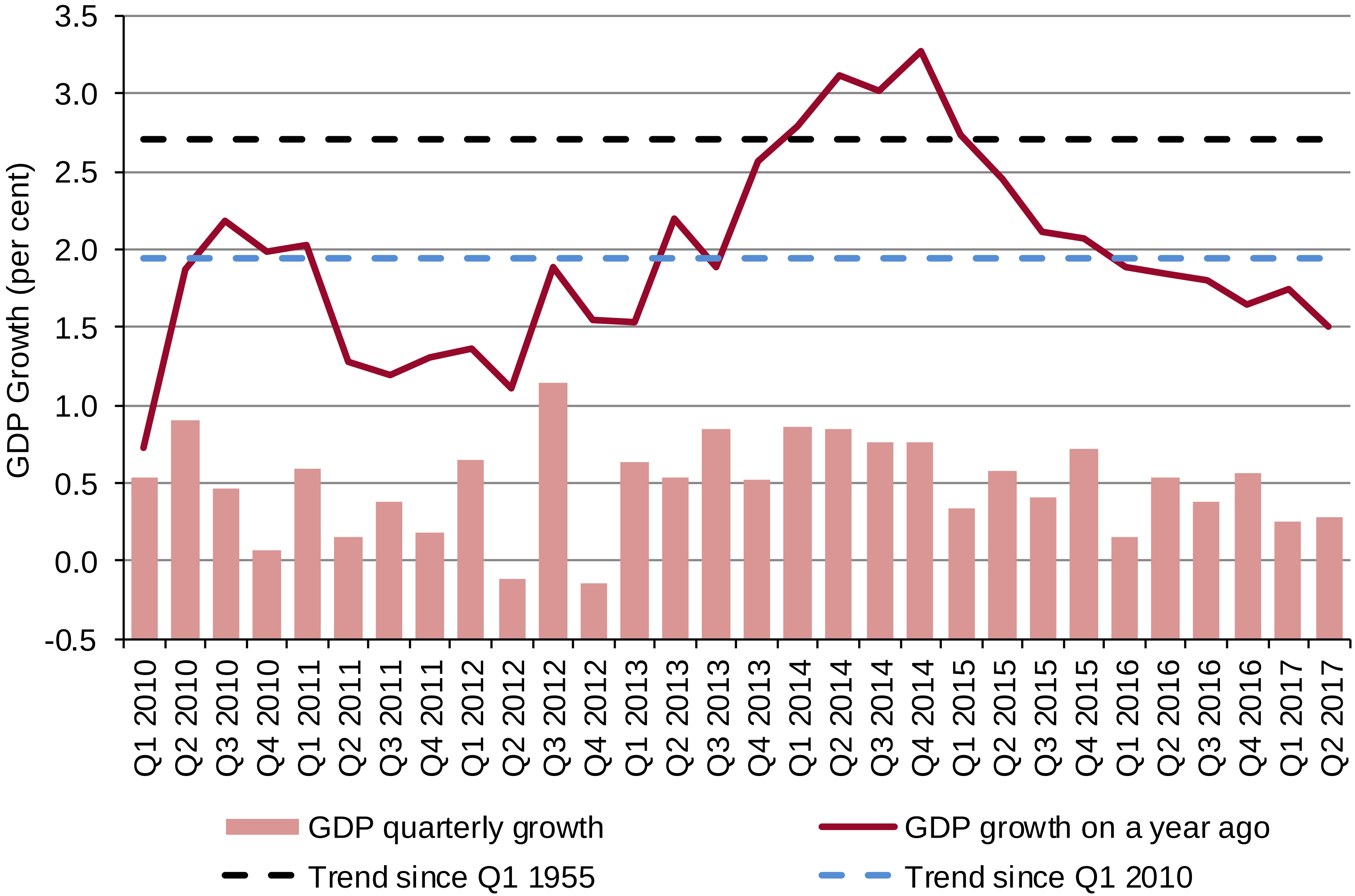
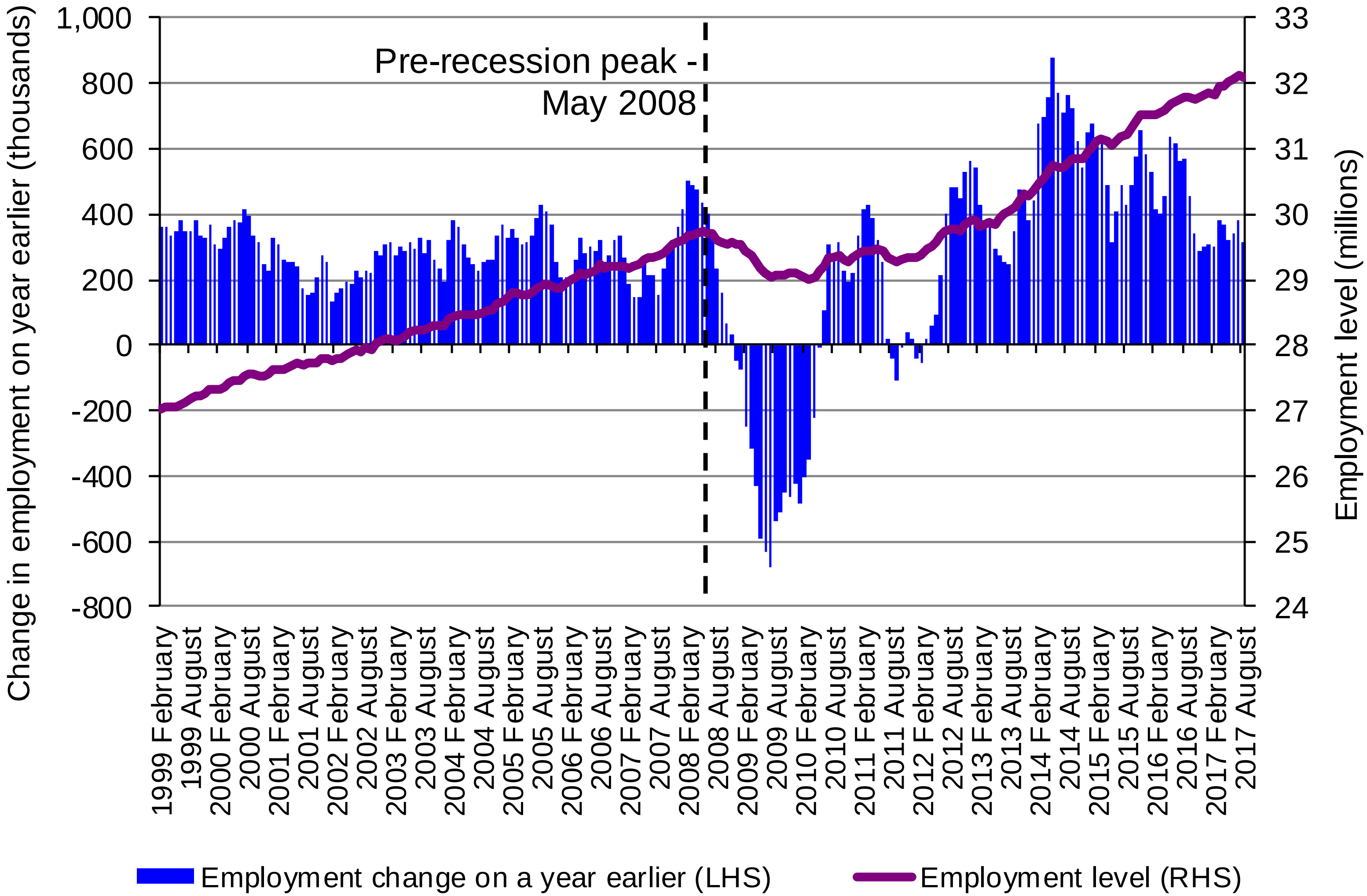
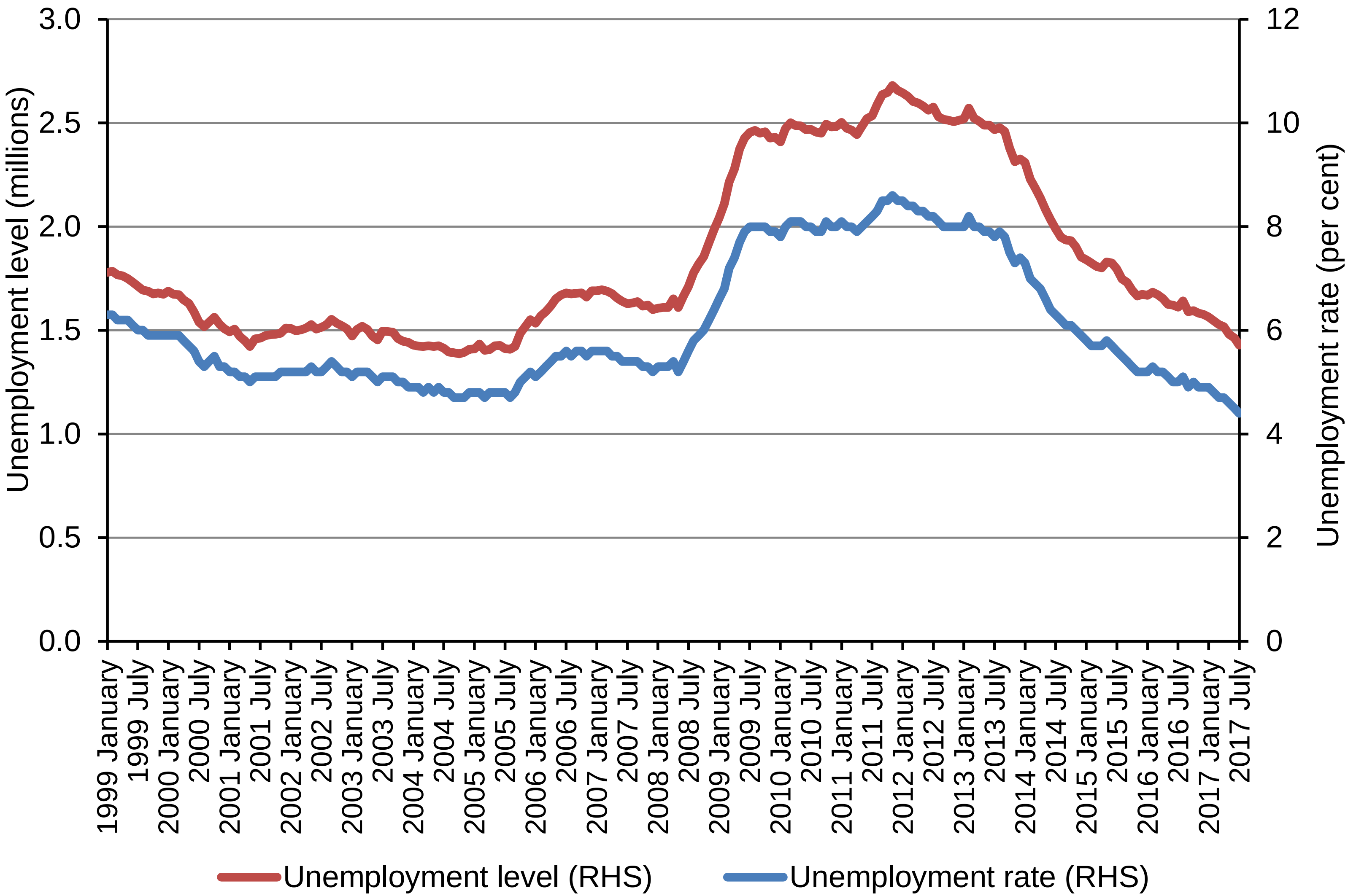
Growth slowing but still sustained



Job growth has slowed but remains strong



And unemployment continues to fall



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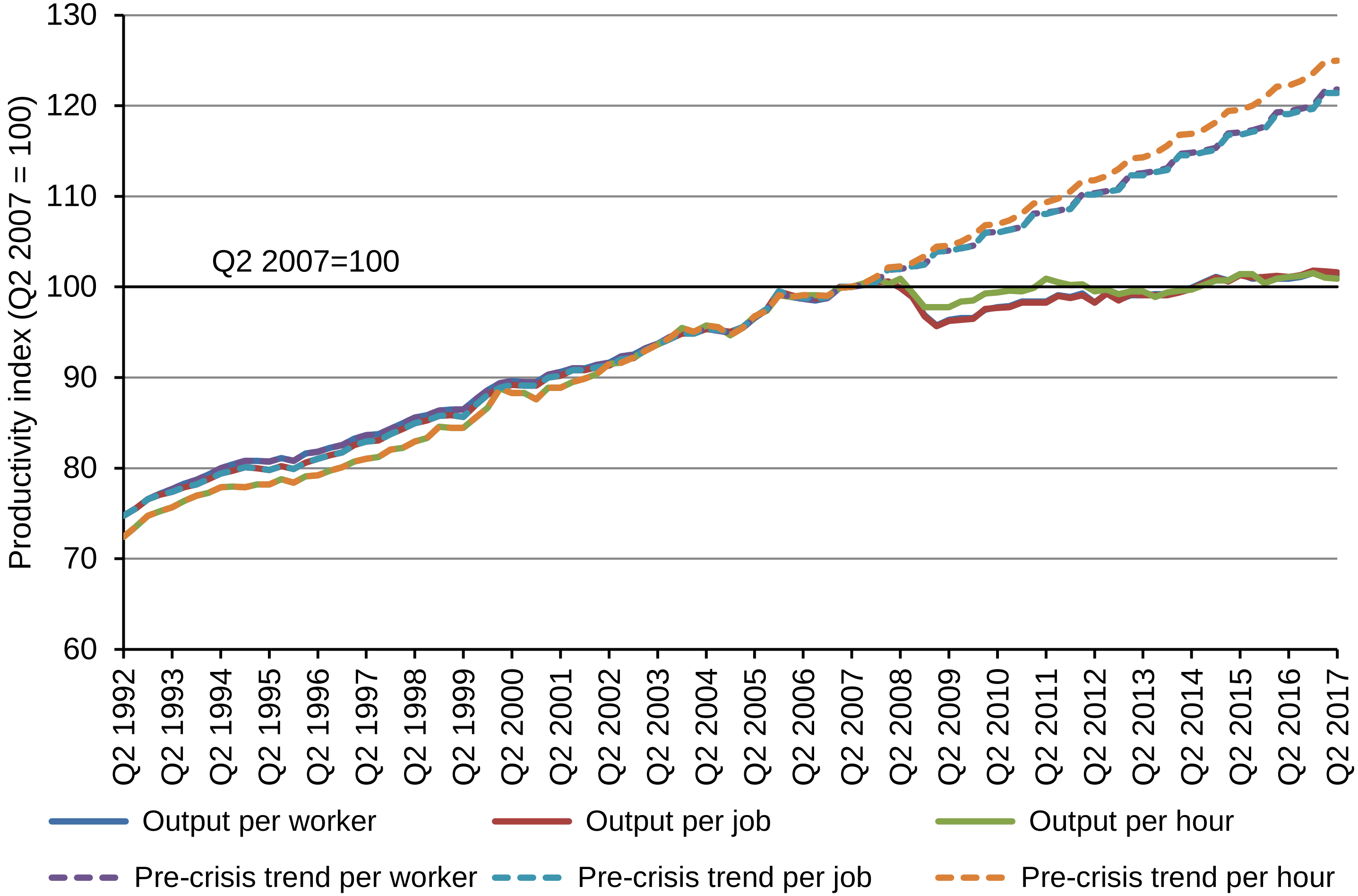
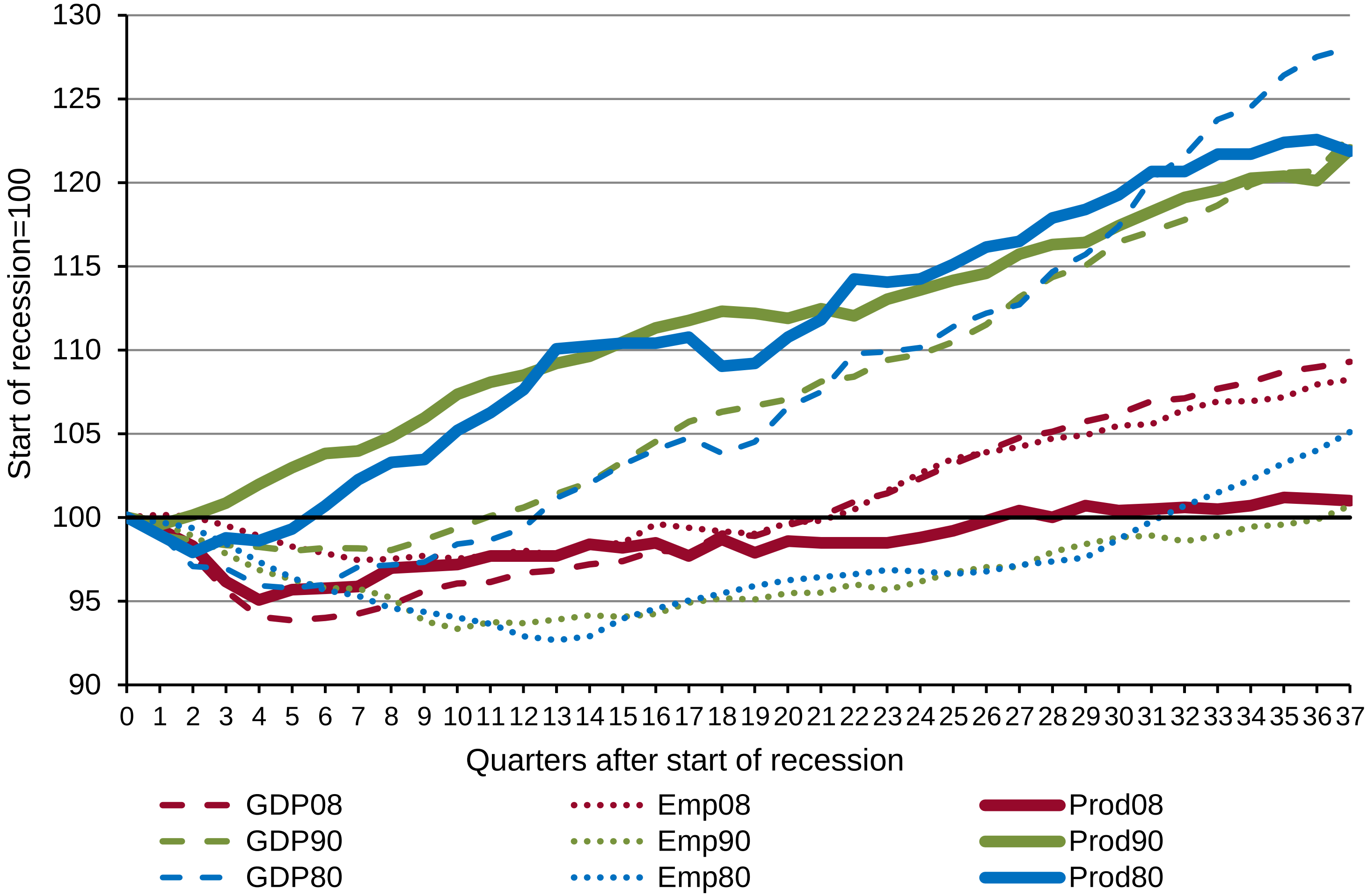
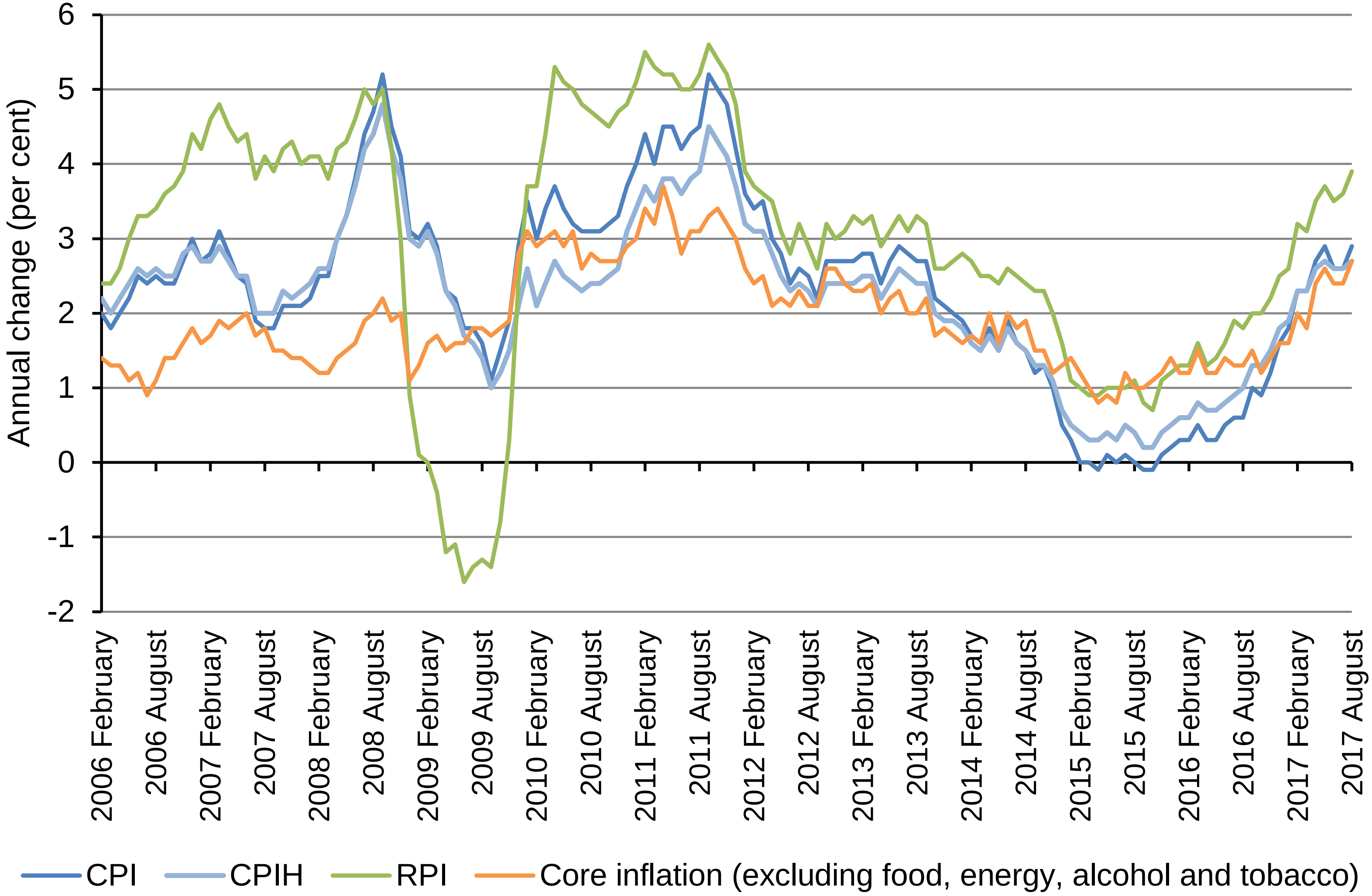
Consequently, productivity has not performed well



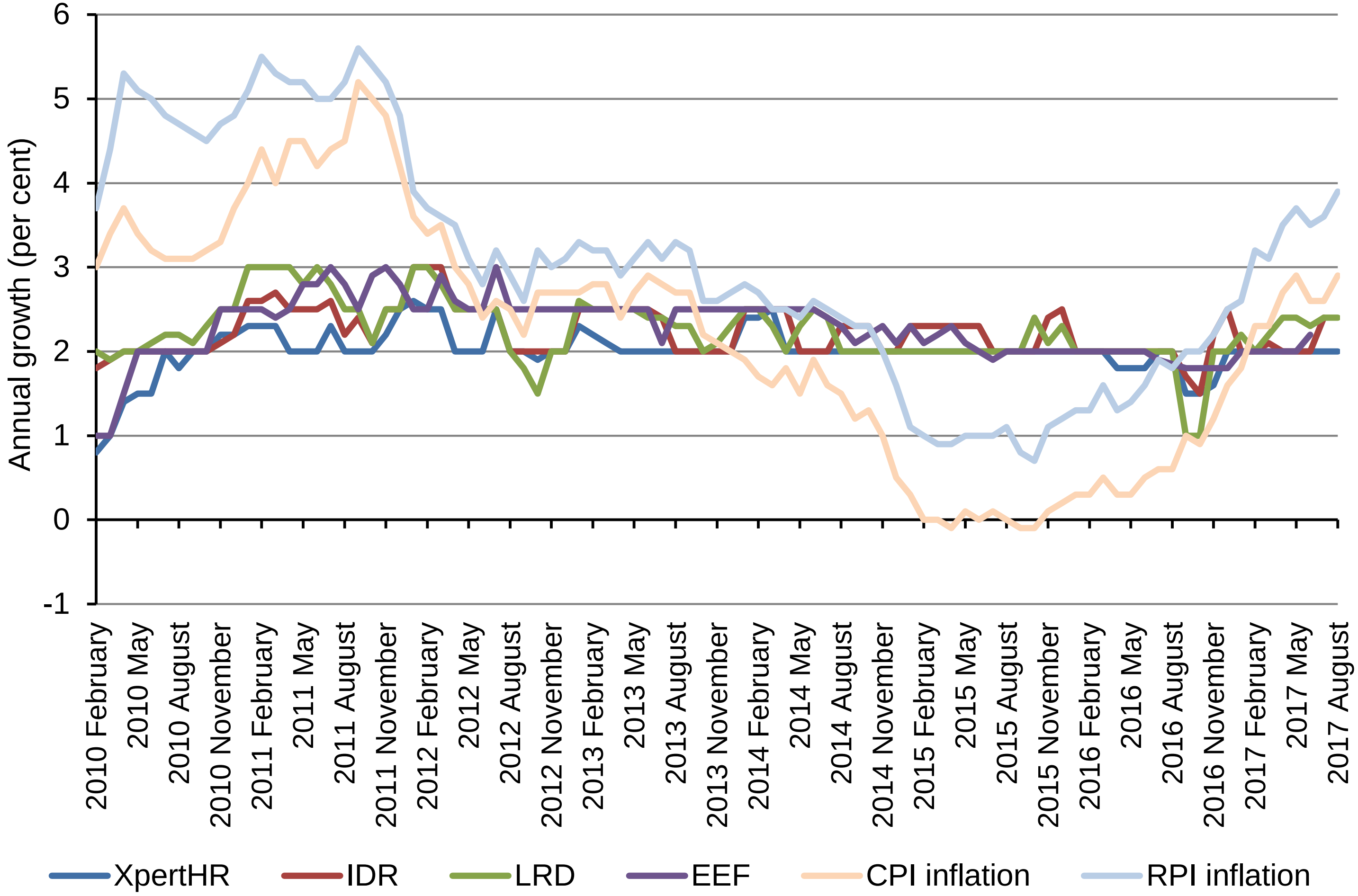
And indeed this is much worse than previous recessions



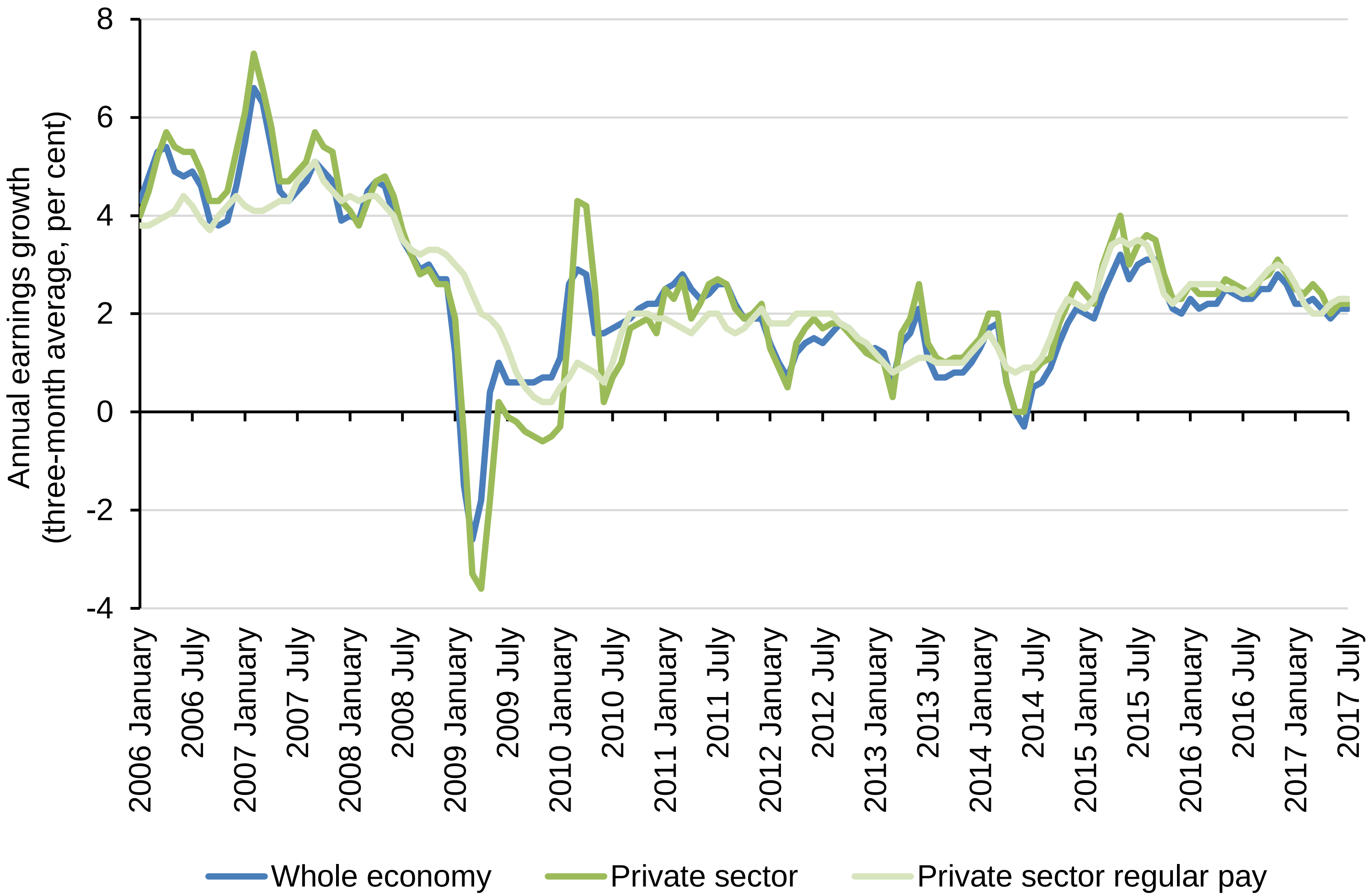
Despite inflation picking up…



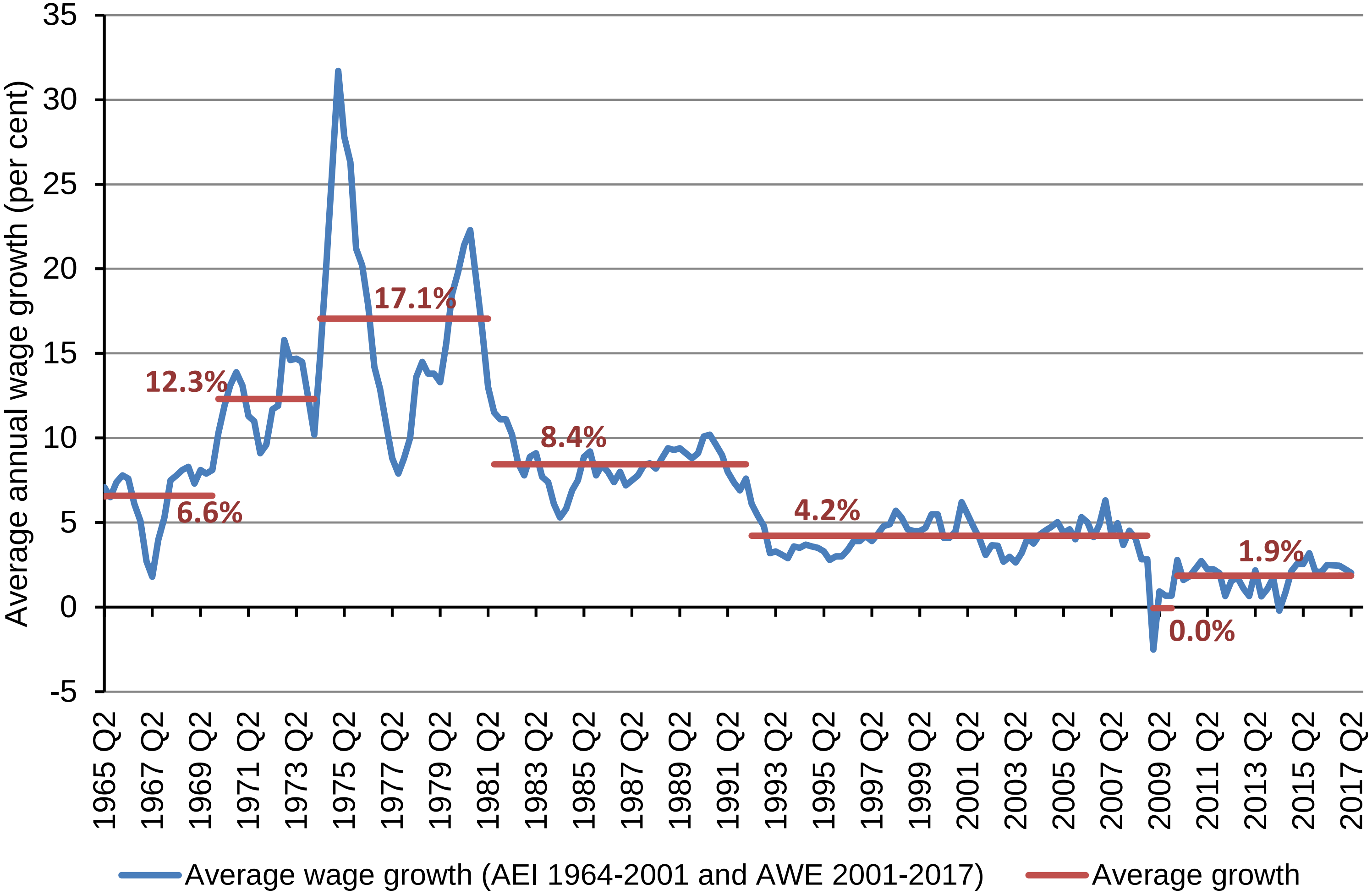
…pay settlements remain around 2%



... average earnings growth also around 2%



Indeed, 2% seems to have become the new wage norm



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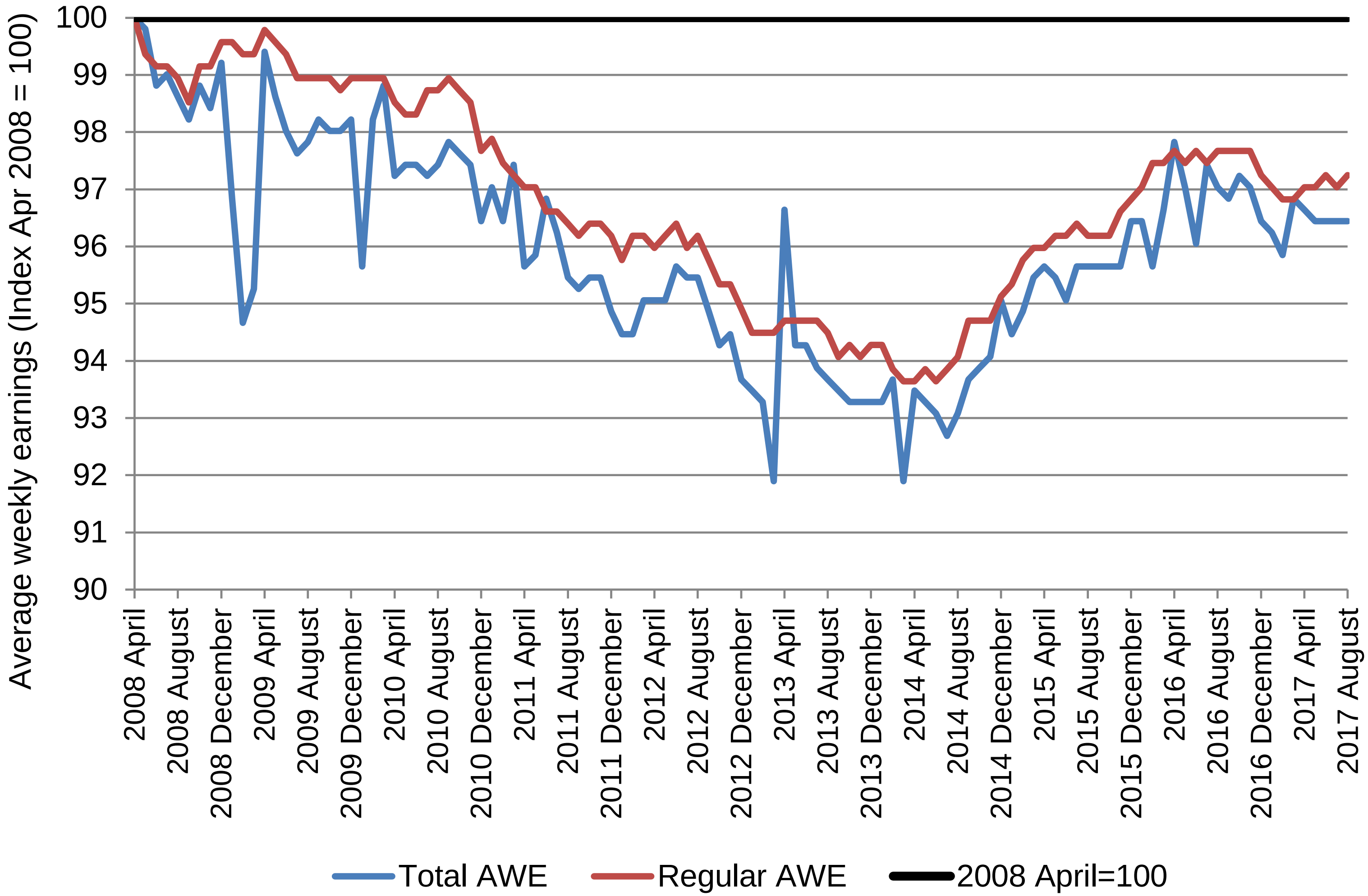
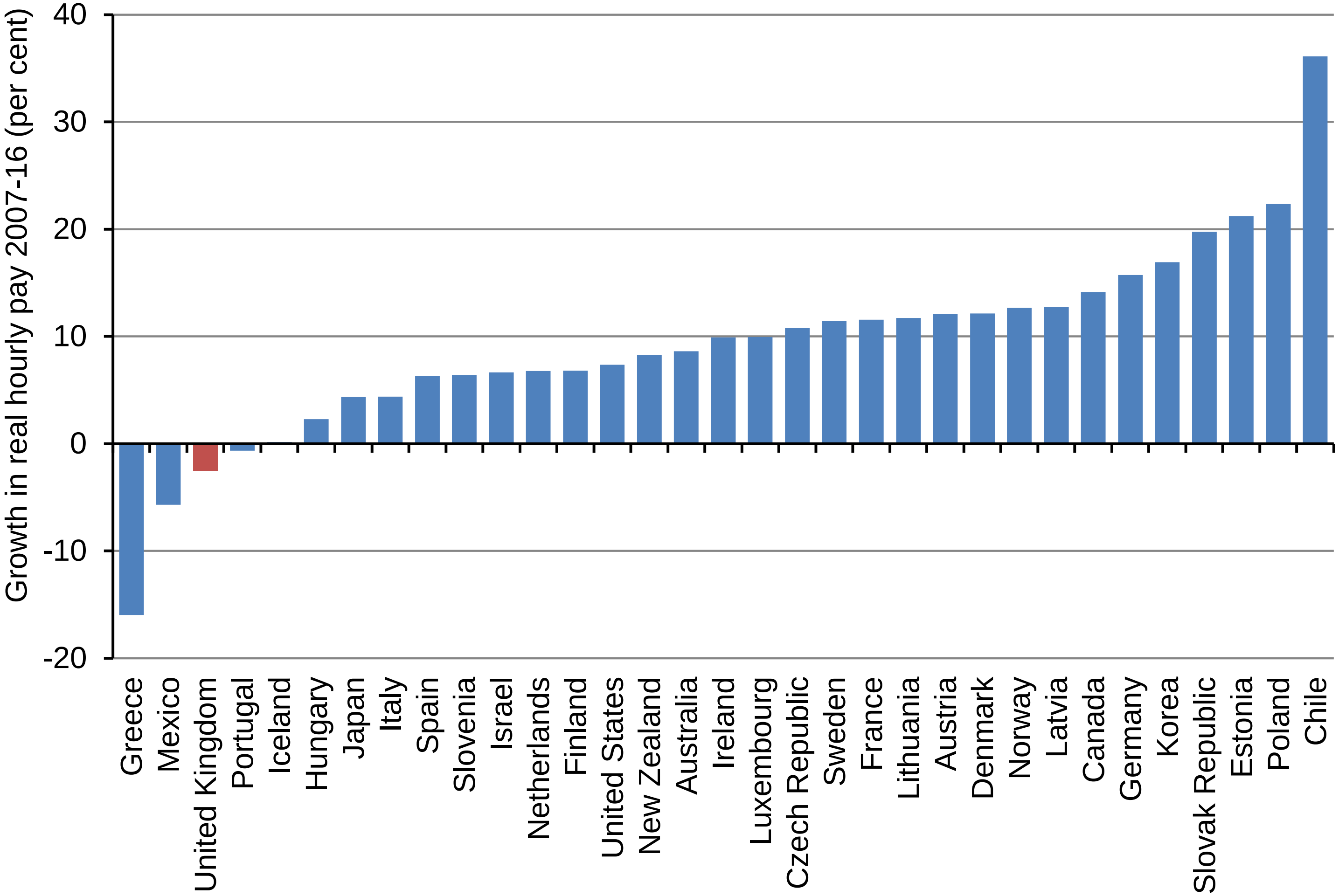
With inflation picking up that means real wages are set to fall further behind pre-crisis levels



And, since 2007, real wage growth in UK has been lower than in all but Greece and Mexico

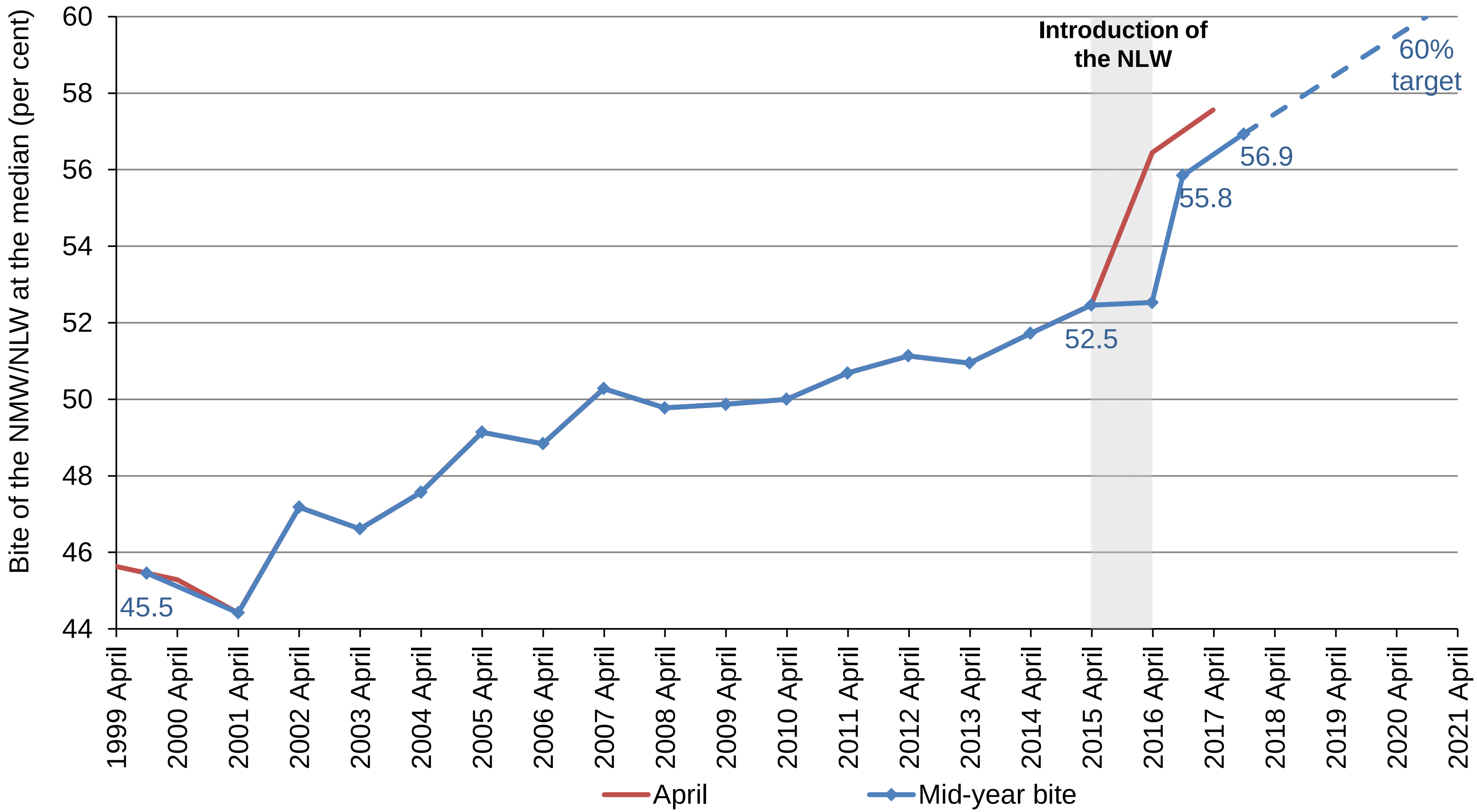


Impact of the NLW

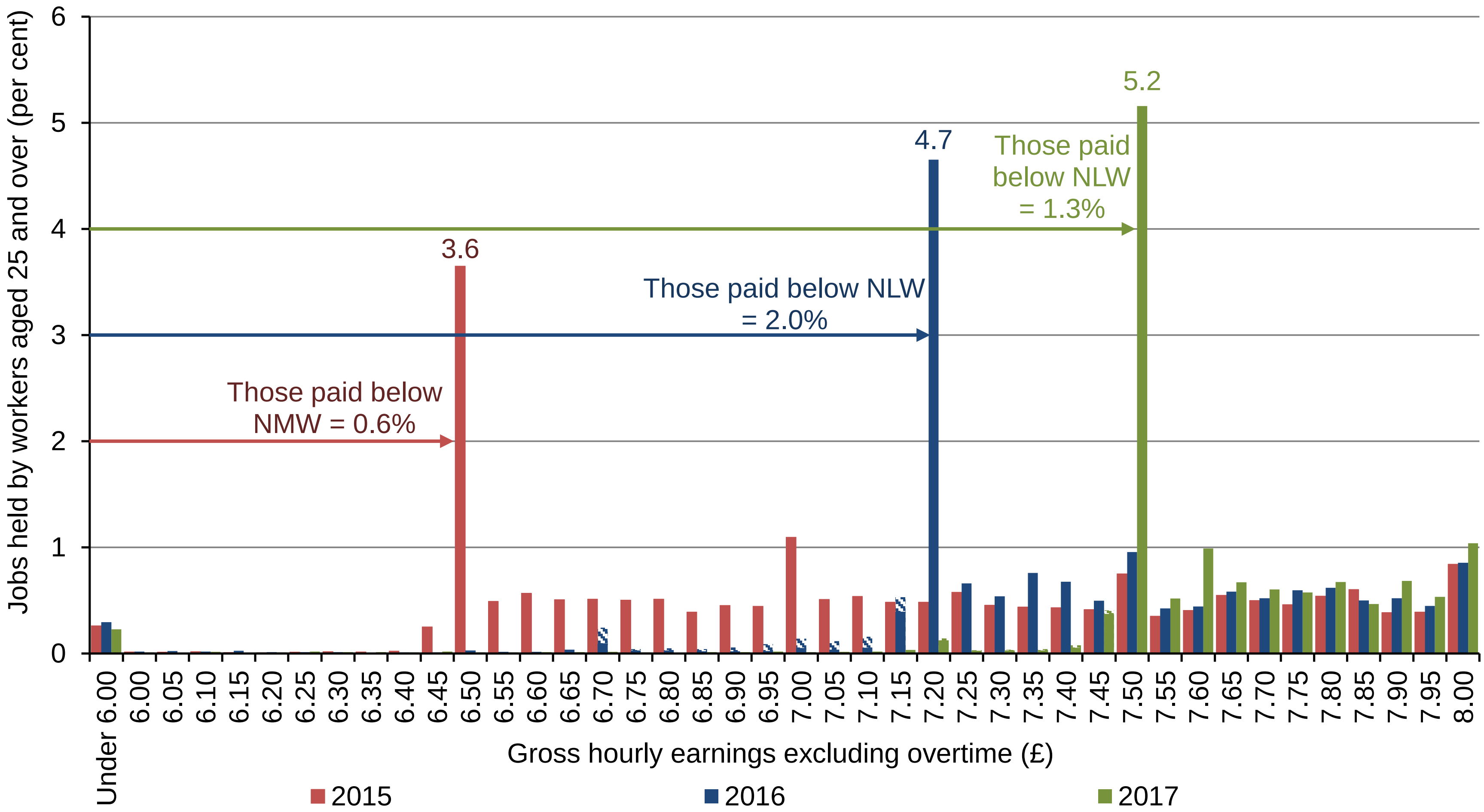
Significant recent increases in the minimum wage for those aged 25 and over

- NLW increased by 4.2% from £7.20 to £7.50 in April 2017
- That followed an increase the previous year of **10.8%** (made up of **3.1%** from £6.50 to £6.70 in October 2015 and **7.5%** from £6.70 to £7.20 in April 2016)

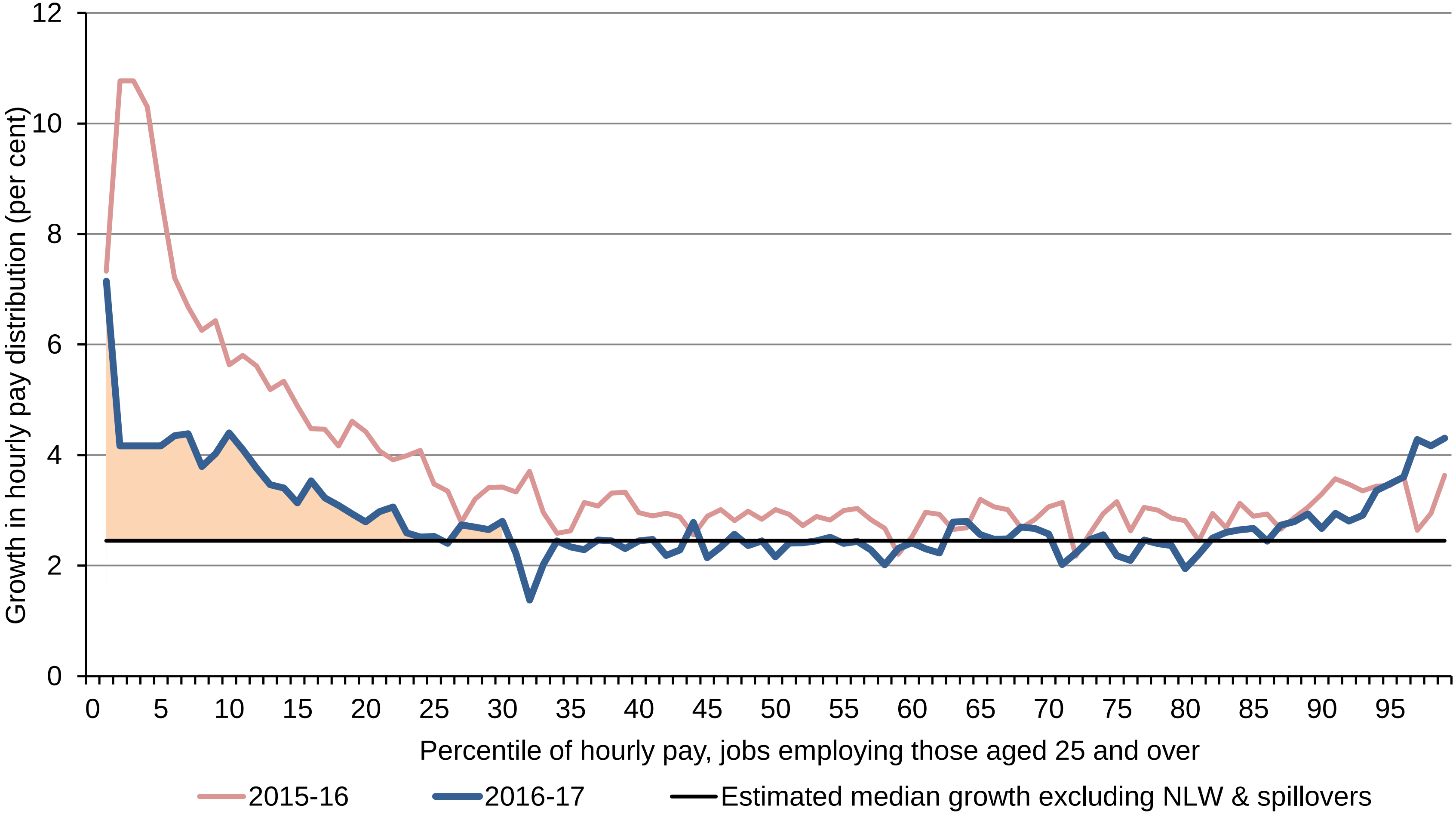
The bite of the NLW has increased along our expected path



There has been an increase in those paid at the NLW, but a fall in those paid below



Spillover effects from the NLW go up to around the 30th percentile



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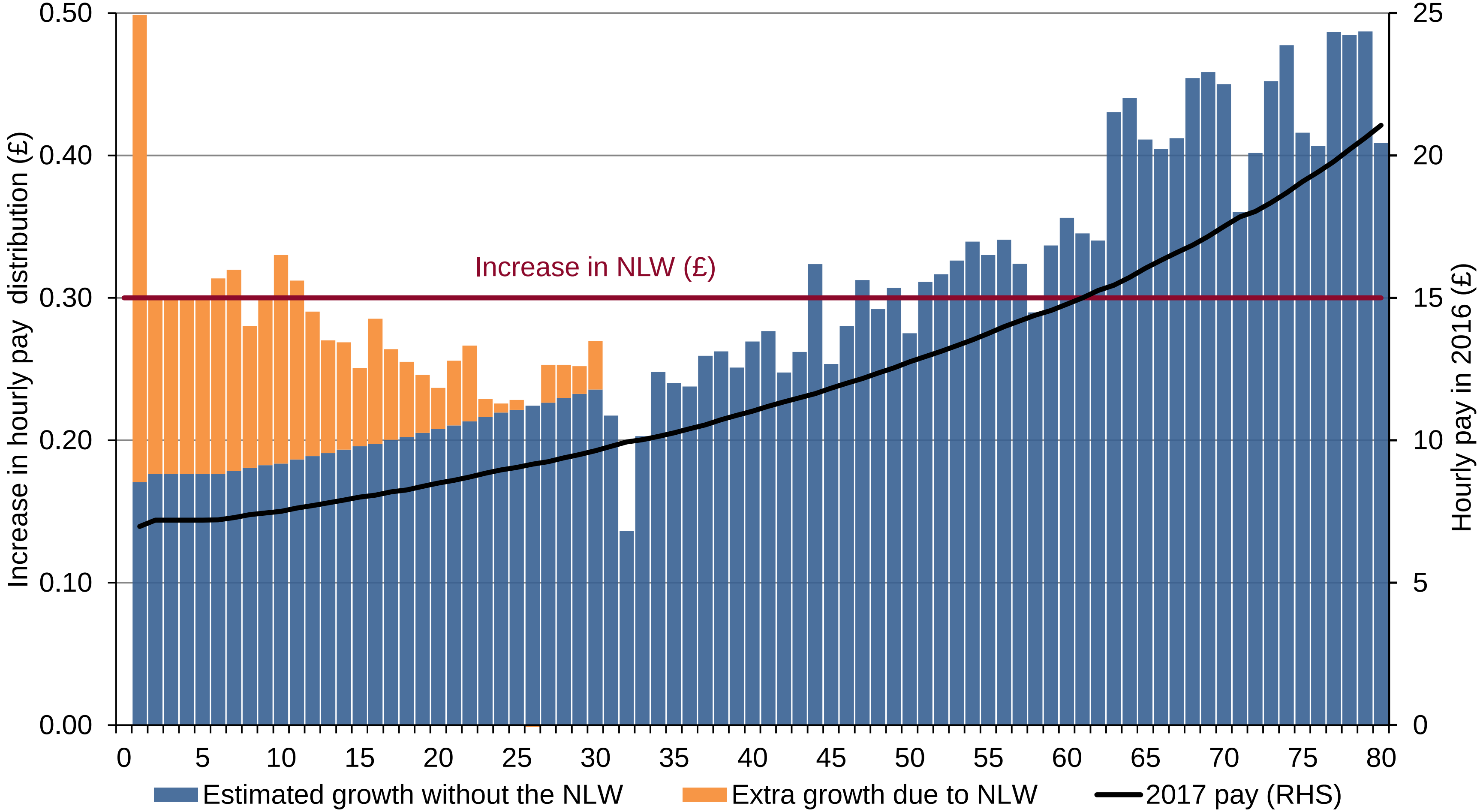
The NLW is causing a compression in penny differentials



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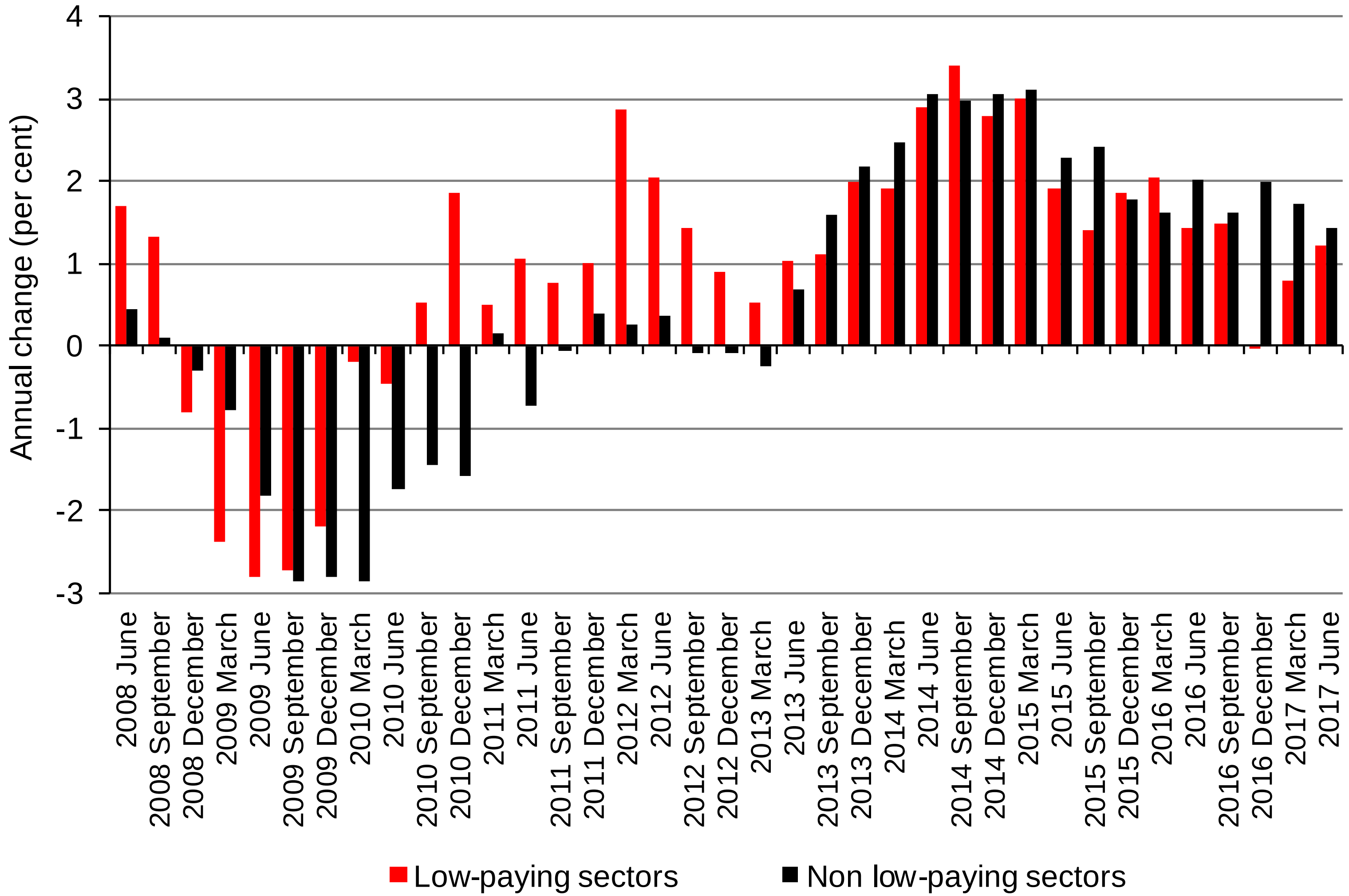
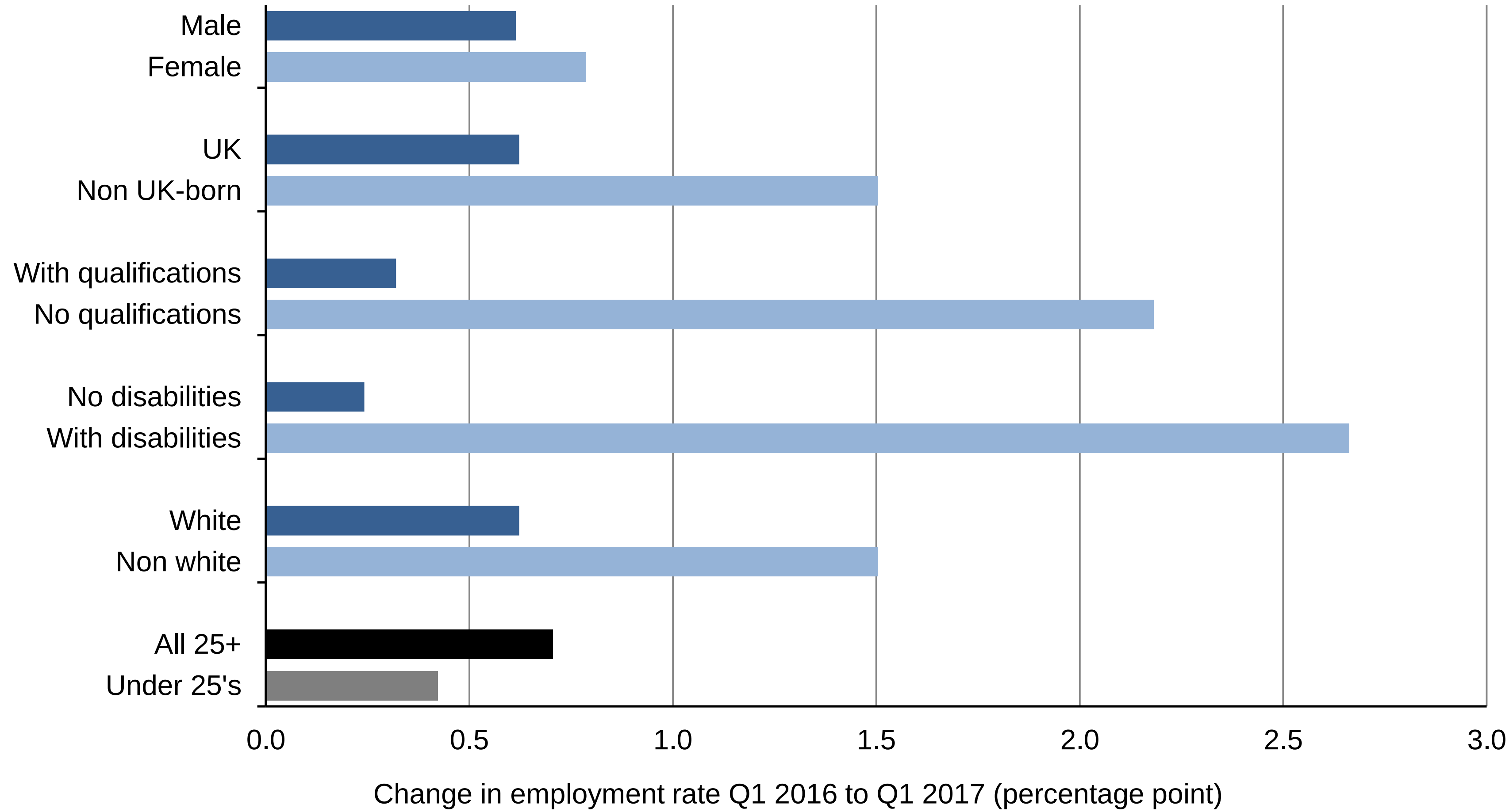
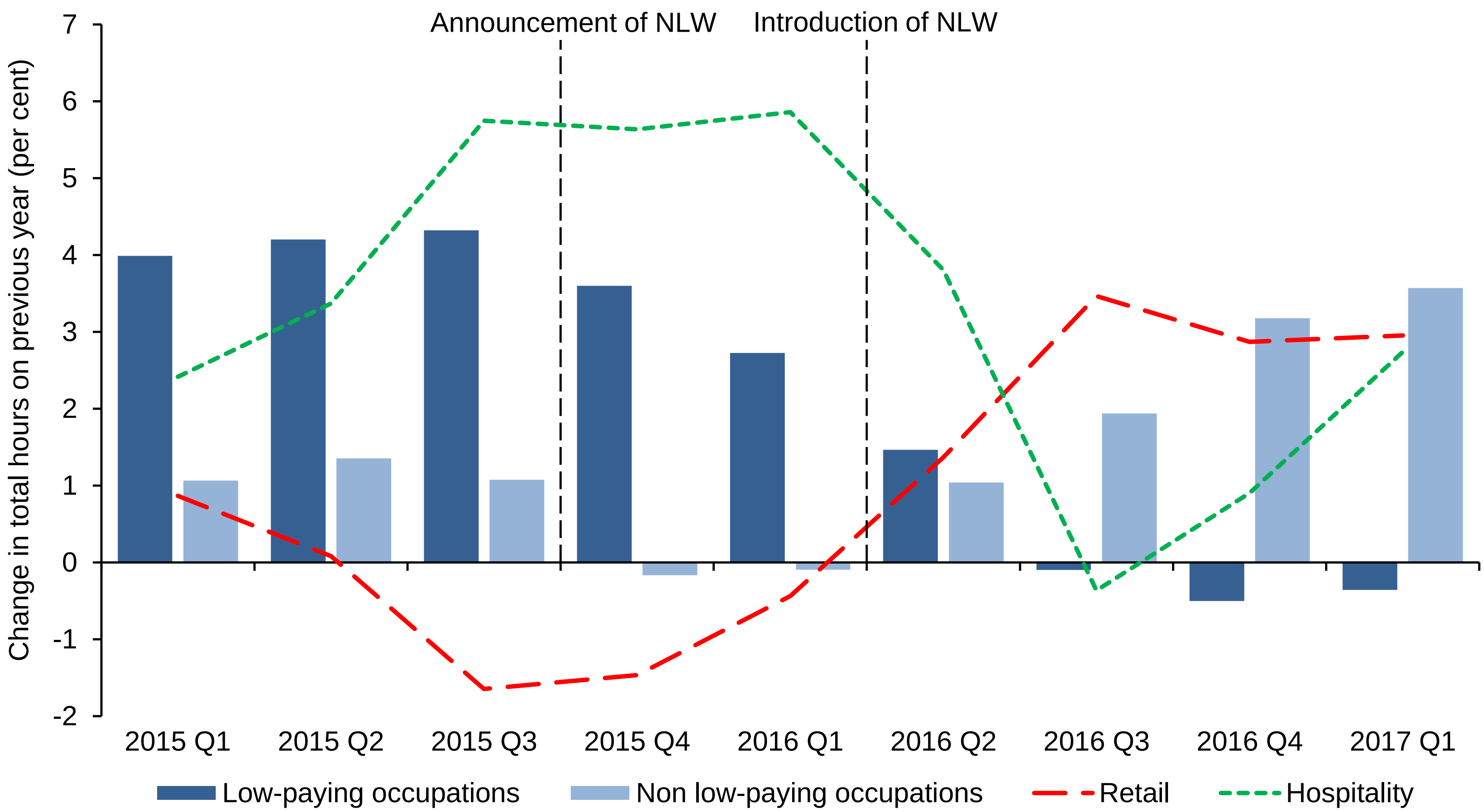
Employment has picked up in the low-paying sectors



Employment has increased faster for the groups with highest NLW coverage



However, hours have fallen in low paying occupations but not in retail or hospitality



Research evidence

- Although we again added to our evidence base, with 10 Commissioned projects, the conclusions of this research are in line with what has gone previously – little significant robust evidence of employment effects: firms have coped by increasing prices, changing pay structures, reducing non-wage costs, and squeezing profits (potentially reducing investment)
- Interesting insights on non-compliance and use of non-standard contracts

Stakeholder views on the NLW

- Less concern than about the introductory rate. But effects again widespread.
- Lower forecast path has helped.
- But some sectors and small businesses are still worried about the current rates.
- Future increases will be challenging.
- Unions thought NLW had been, and would continue to be, affordable.

Stakeholder evidence on pay and employment effects

- Evidence across many sectors of squeezed differentials and the difficulties of managing these.
- Mixed evidence on employee benefit reductions.
- Unions positive about NLW raising pay without harmful employment effects
- Some stakeholder evidence of negative employment effects in some sectors – but more likely to be from hours cuts or slower hiring.
- Warnings of ‘tipping point’ before 2020.
- Unions pointed to the strong labour market performance ad expected it to continue.

Stakeholder evidence on competitiveness effects

- Most common effects (like last year) were lower profits and higher prices.
- Price-taking sectors and sectors with funding issues under more pressure.
- Some businesses have sought to improve productivity. But still few specifics – more likely small efficiency savings.
- But also delays/cuts to investment, especially in smaller firms.

Going forwards

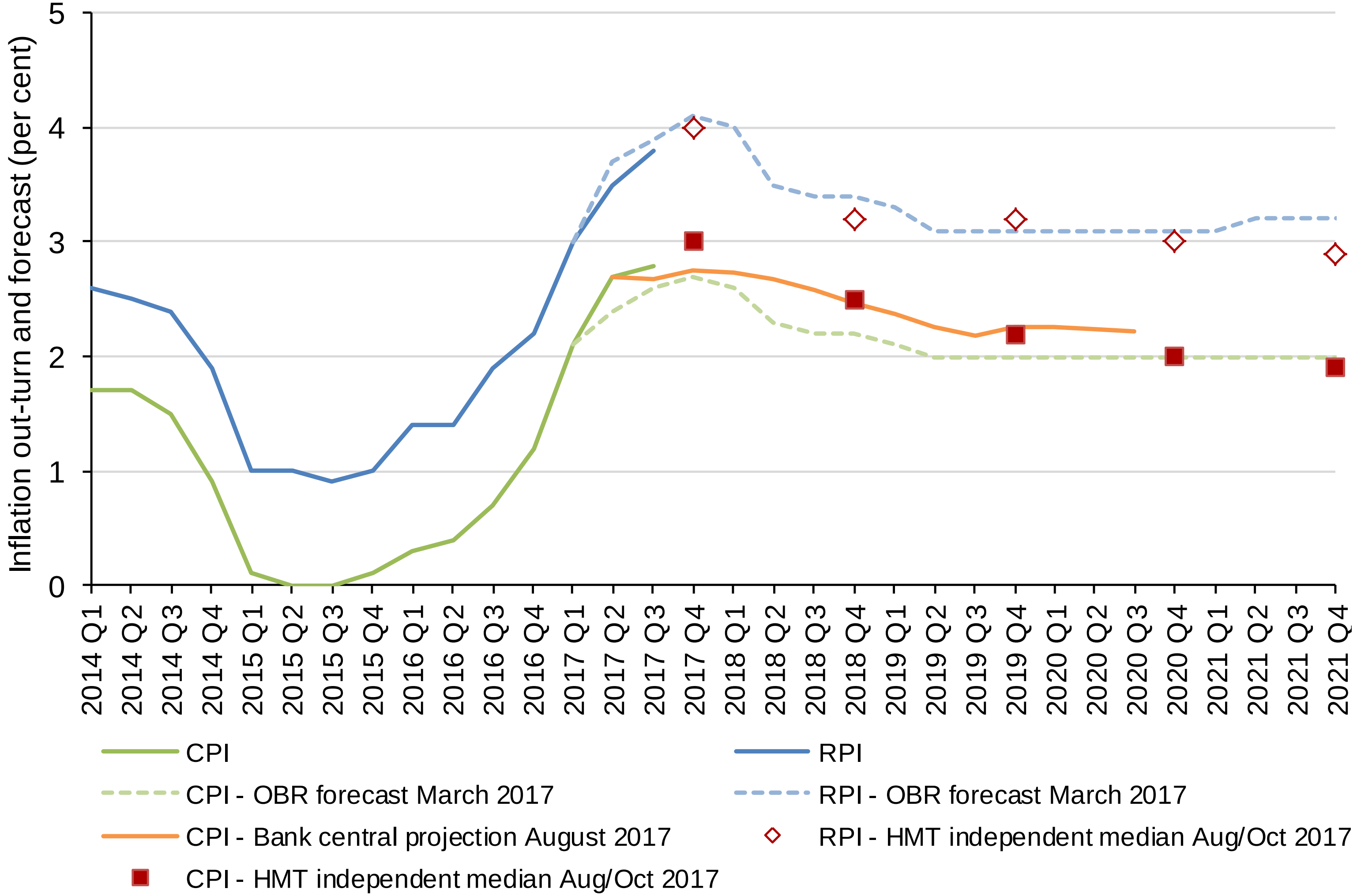
Forecasts for 2018 and 2019

- World economic forecasts had picked up with stronger growth now expected, particularly in the EU
- Concerns about Brexit (and impact of sterling depreciation on real incomes and consumption) weighed on UK forecasts for 2018 and 2019, with most analysts revising them down by around a third (compared with before the EU Referendum)
- Inflation had picked up but was expected to wane as currency and oil price effects worked their way out
- Some productivity forecasts had weakened, along with wage growth, and consequently this had lowered GDP forecasts

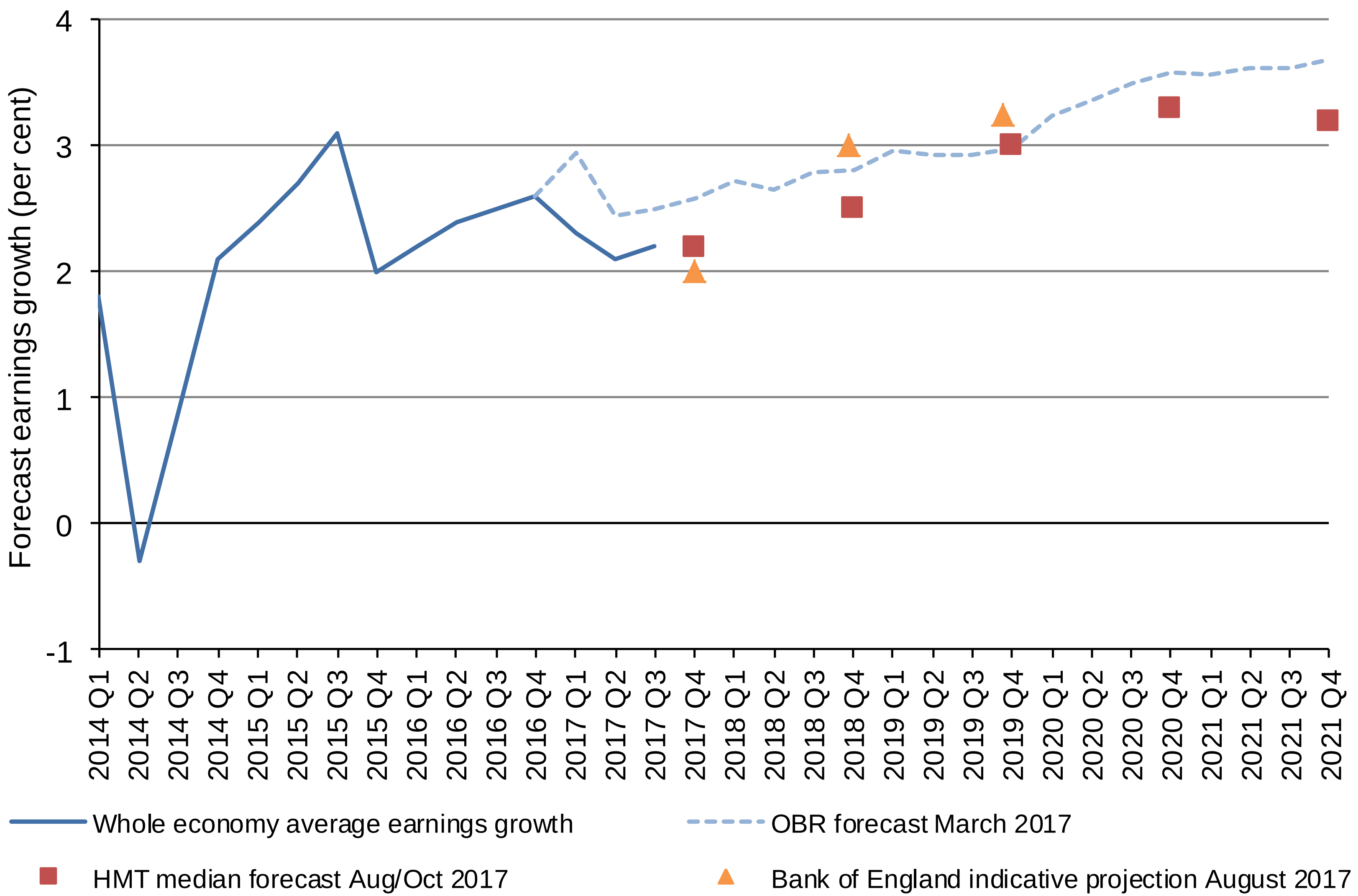
GDP growth remaining around 1.6%

	OBR forecasts (March 2017)			Bank of England forecasts (August 2017)			Median of HM Treasury Panel (August/October 2017)		
	2017	2018	2019	2017	2018	2019	2017	2018	2019
GDP Growth (whole year)	2	1.6	1.7	1.7	1.6	1.7	1.6	1.4	1.6
Average Earnings AWE (whole year)	2.6	2.7	3	2	3	3.3	2.2	2.6	3
Inflation RPI (Q4)	3.7	3.6	3.1				3.9	3.2	3.2
Inflation CPI (Q4)	2.4	2.3	2	2.8	2.5	2.2	3	2.4	2.2
Employment growth (whole year)[3]	0.6	0.4	0.4	1	0.5	0.8	1.1	0.4	
ILO unemployment rate (Q4)	4.9	5.1	5.2	4.4	4.5	4.5	4.4	4.6	4.9

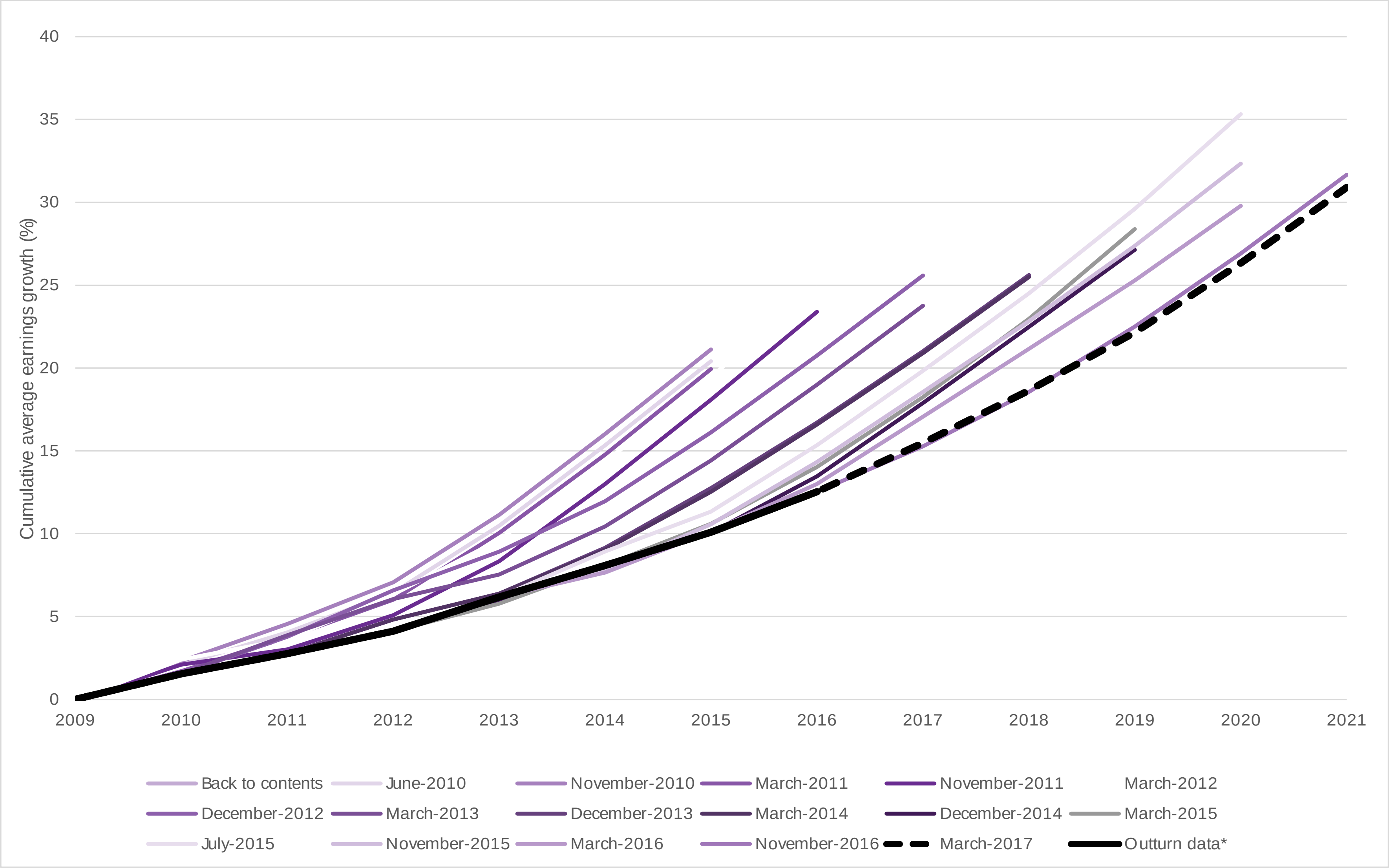
Inflation expected to peak soon but will only fall back towards 2% slowly



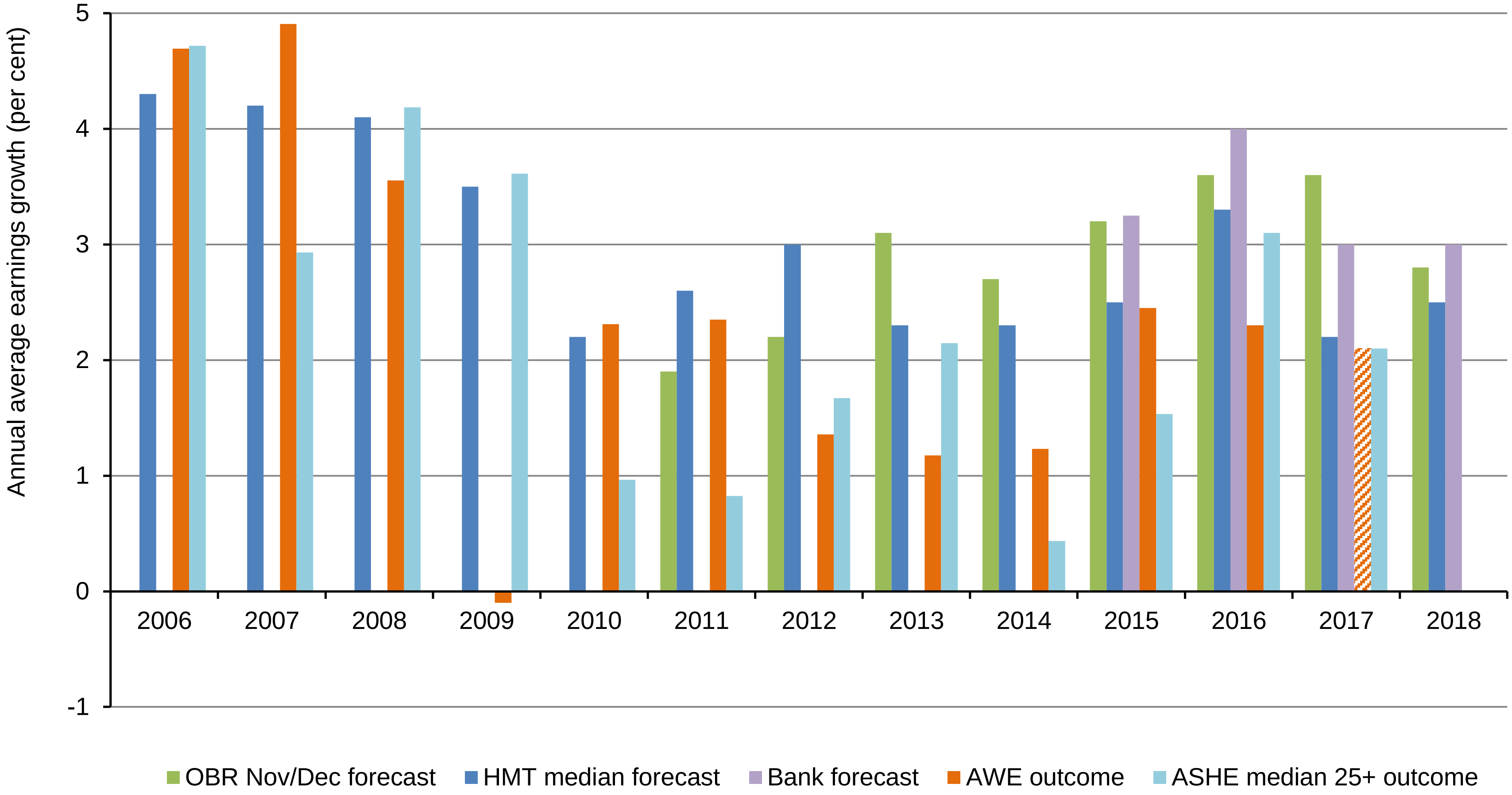
Wage growth again expected to increase towards 3-4%



But OBR has generally been too optimistic



Although HM Treasury panel forecasts have been closer to outcome than the Bank's or OBR's



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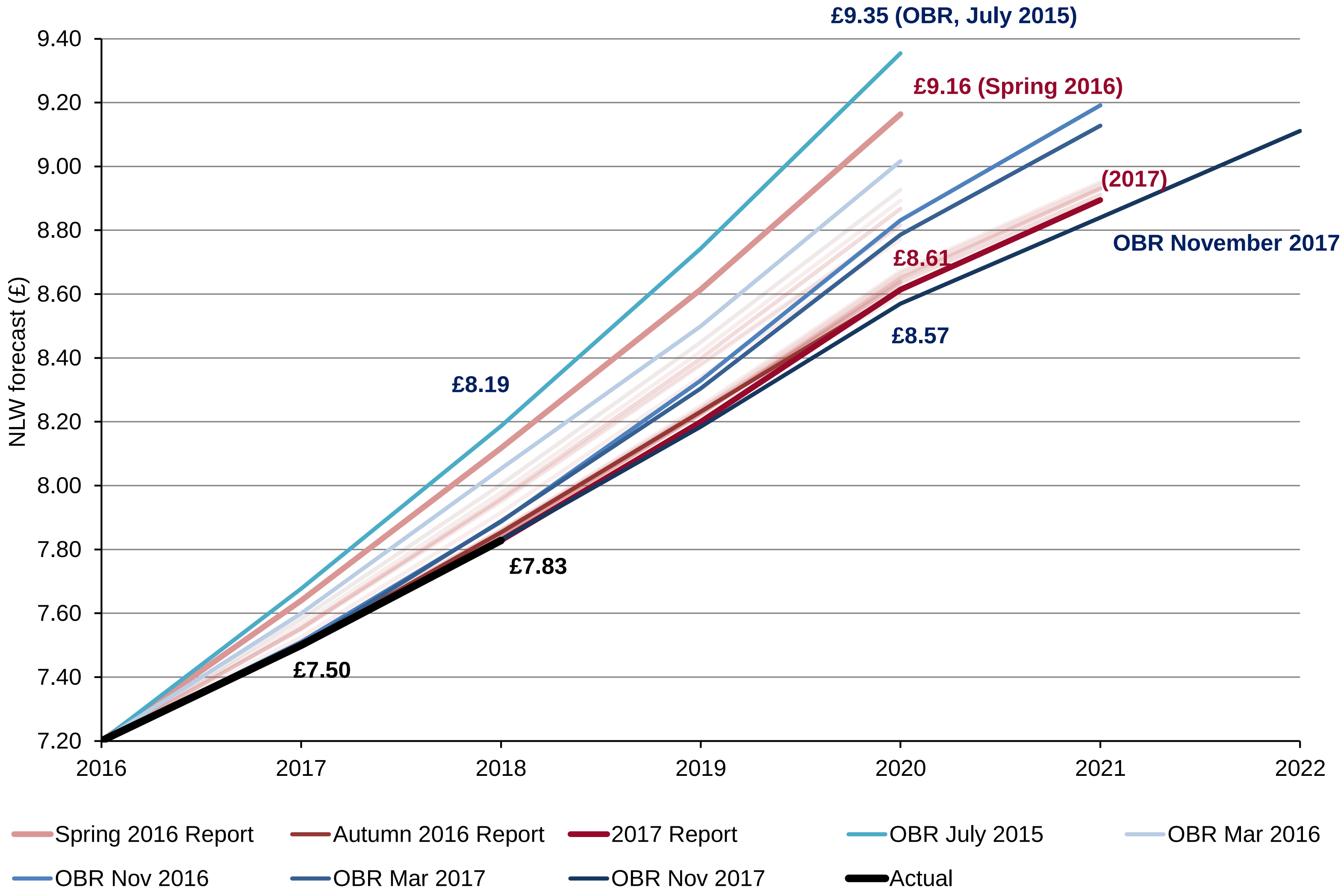
As such the NLW path has been revised down since July 2015 but was unchanged from last autumn (at £8.61 in 2020)



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The updated path for the NLW (£7.83 in 2018)

- In our Autumn 2016 Report, we projected that the NLW for 2018 would lie in the range from £7.80-£7.91 and the NLW in 2020 would be in the range £8.50-£8.73.

	2016	2017	2018	2019	2020	2021
Lower quartile			£7.81	£8.17	£8.55	£8.78
Median	**£7.20**	**£7.50**	**£7.83**	**£8.20**	**£8.61**	**£8.89**
Upper quartile			£7.84	£8.23	£8.66	£8.96

Conclusions

- GDP growth had weakened but was expected to remain above 1%
- The labour market remained resilient – strong job growth
- Inflation had picked up to 3% but was expected to fall back
- Average wage growth and pay awards remained at 2%
- Thus, real wages had fallen in recent months and remained below their 2008 peak
- Forecasts expected wage growth to pick up towards 3%
- Limited evidence of employment effects of the NLW
- No hard evidence to deviate from path

➢ **The NLW should increase by 4.4% to £7.83**

National Minimum Wage
Low Pay Commission

The youth rates

29 November 2017

Helen Connolly

The new rates

- **21-24 Year Old Rate** rises by 33 pence (4.7 per cent) to **£7.38 an hour**.
- **18-20 Year Old Rate** rises by 30 pence (5.4 per cent) to **£5.90 an hour**.
- **16-17 Year Old Rate** rises by 15 pence (3.7 per cent) to **£4.20 an hour**.

The largest increases for a decade.

- **Apprentice Rate** rises by 20 pence (5.7 per cent) to **£3.70 an hour**.

Government remit to the LPC

Help as many low-paid workers as possible, **without damaging their employment prospects**.

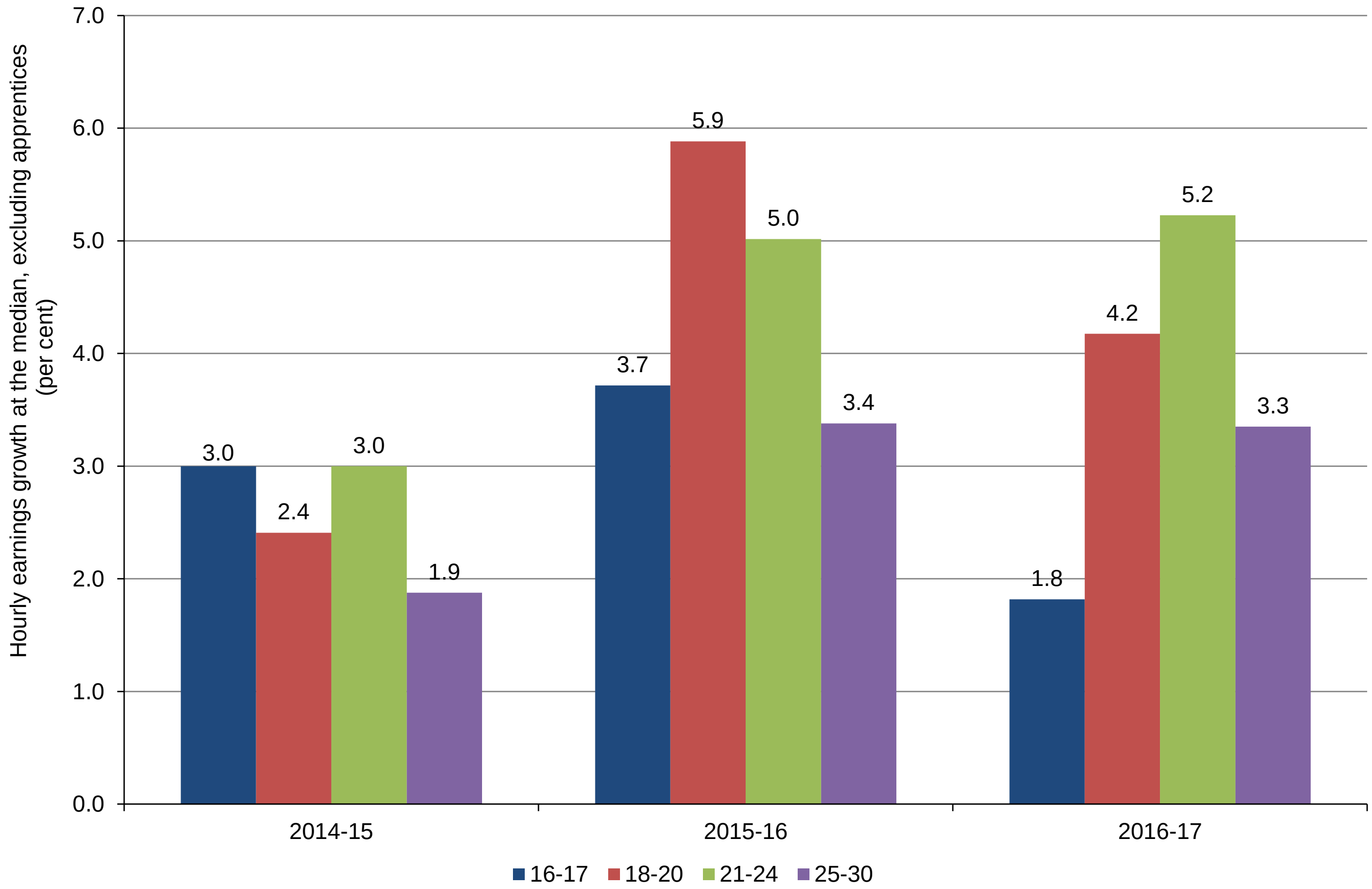
Key factors behind the youth rate recommendations

- **What is happening across the economy?**
- **What is happening to young workers' pay?** If youth pay is rising there is more scope for the youth rates to rise.
- **What is happening to the youth labour market?** A strong labour market – with rising employment and falling unemployment – is better able to sustain increases in the youth rates.
- **Are more employers using the youth rates?** Increasing use implies less willingness/capacity to pay above the rates – so increases may risk jobs.
- **Is there a problem with compliance?** Increasing underpayment implies greater stress on employers.
- **What are stakeholders telling us?**

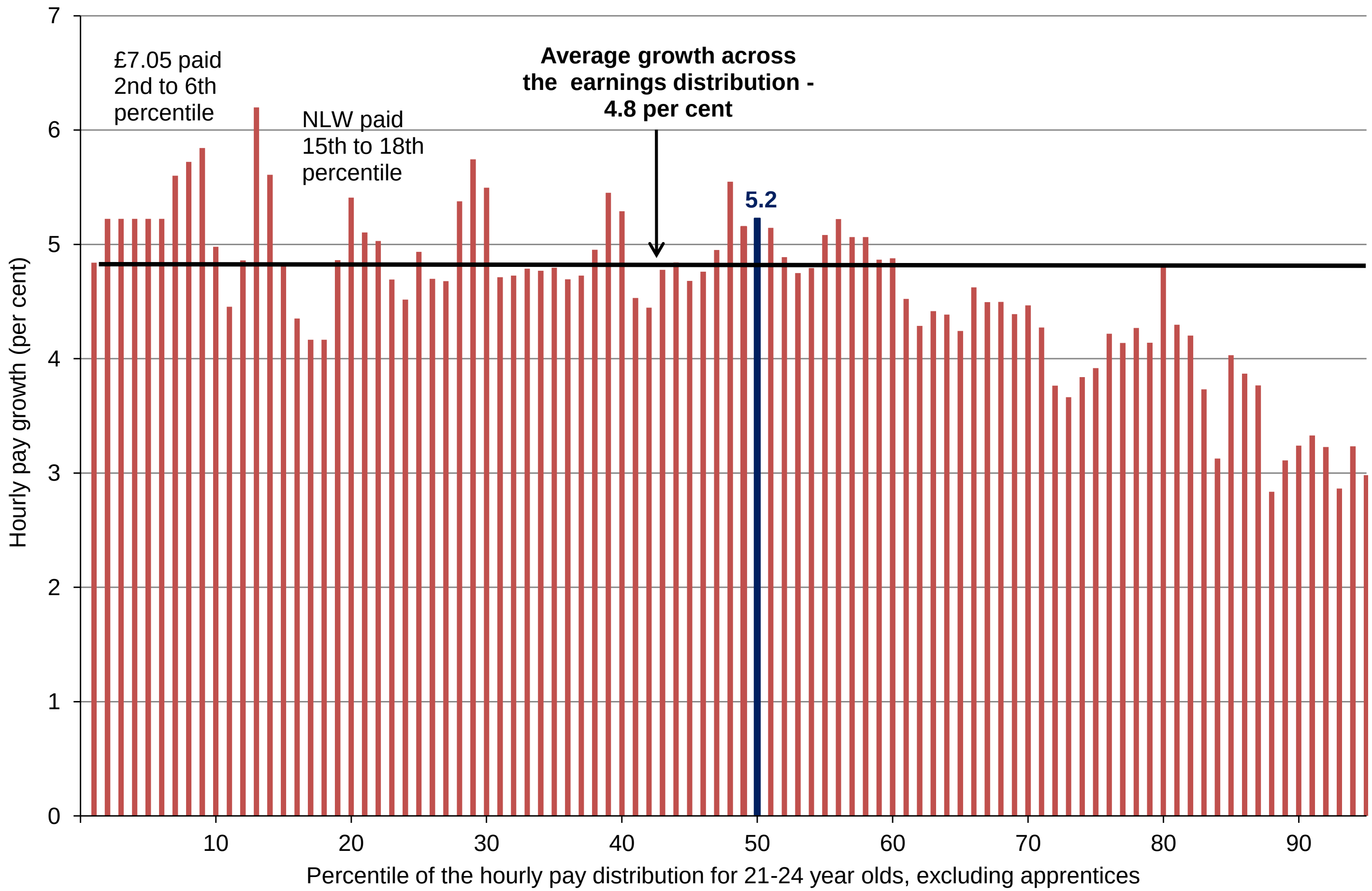
Stakeholder views on the youth rates

- No calls from employers to freeze the rates but employers, particularly small businesses, urged us to consider the employment risks of increases.
- Unions favoured extending the NLW to younger workers (as well as raising the NLW significantly).
- Unions – and some employer groups – were concerned about a widening gap between the NLW and the 21-24 Year Old Rate.
- Substitution? Only a few isolated reports of businesses introducing youth rates or switching to younger workers.

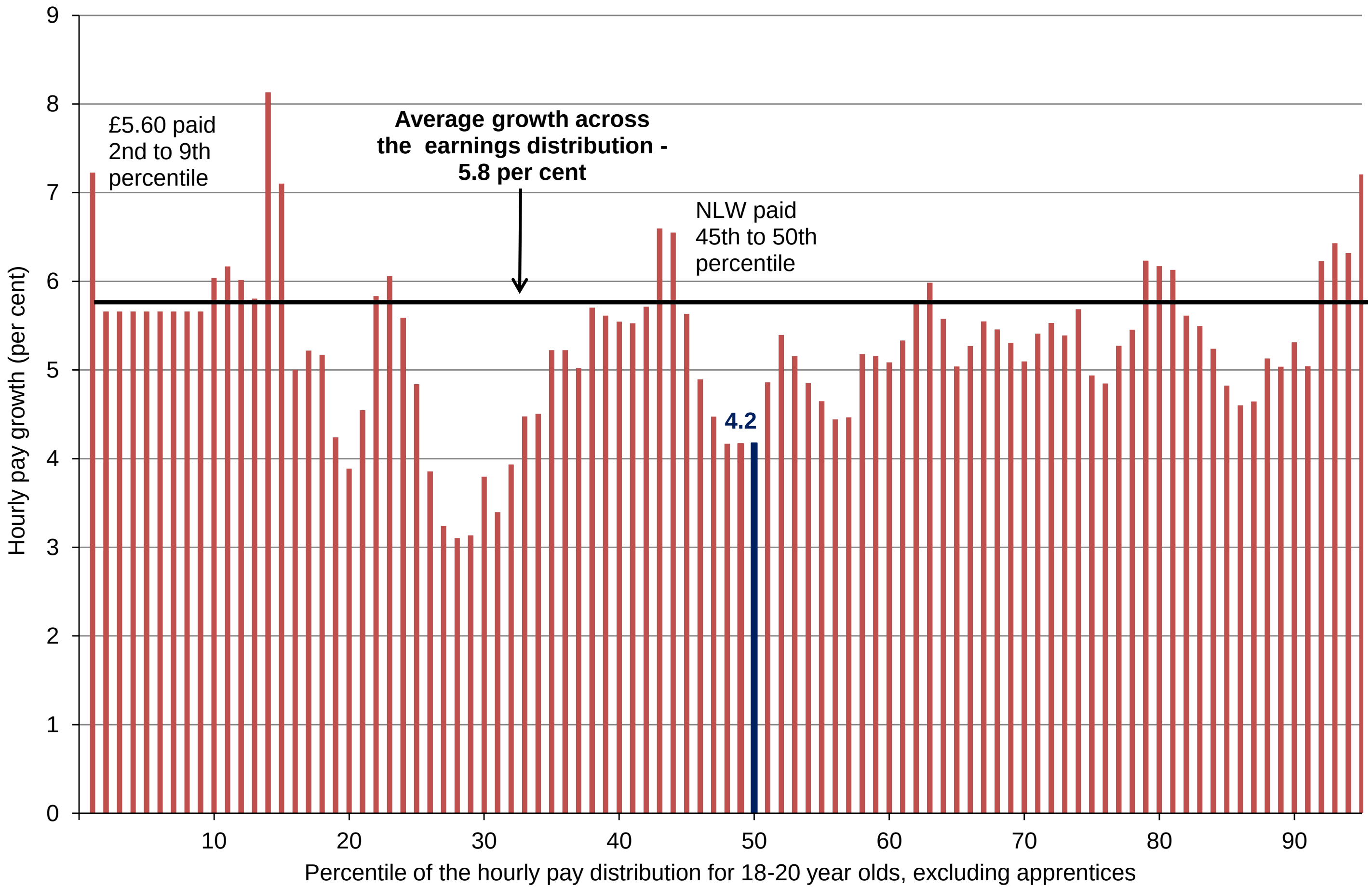
Strong pay growth at the median for 18-20 year olds and 21-24 year olds.



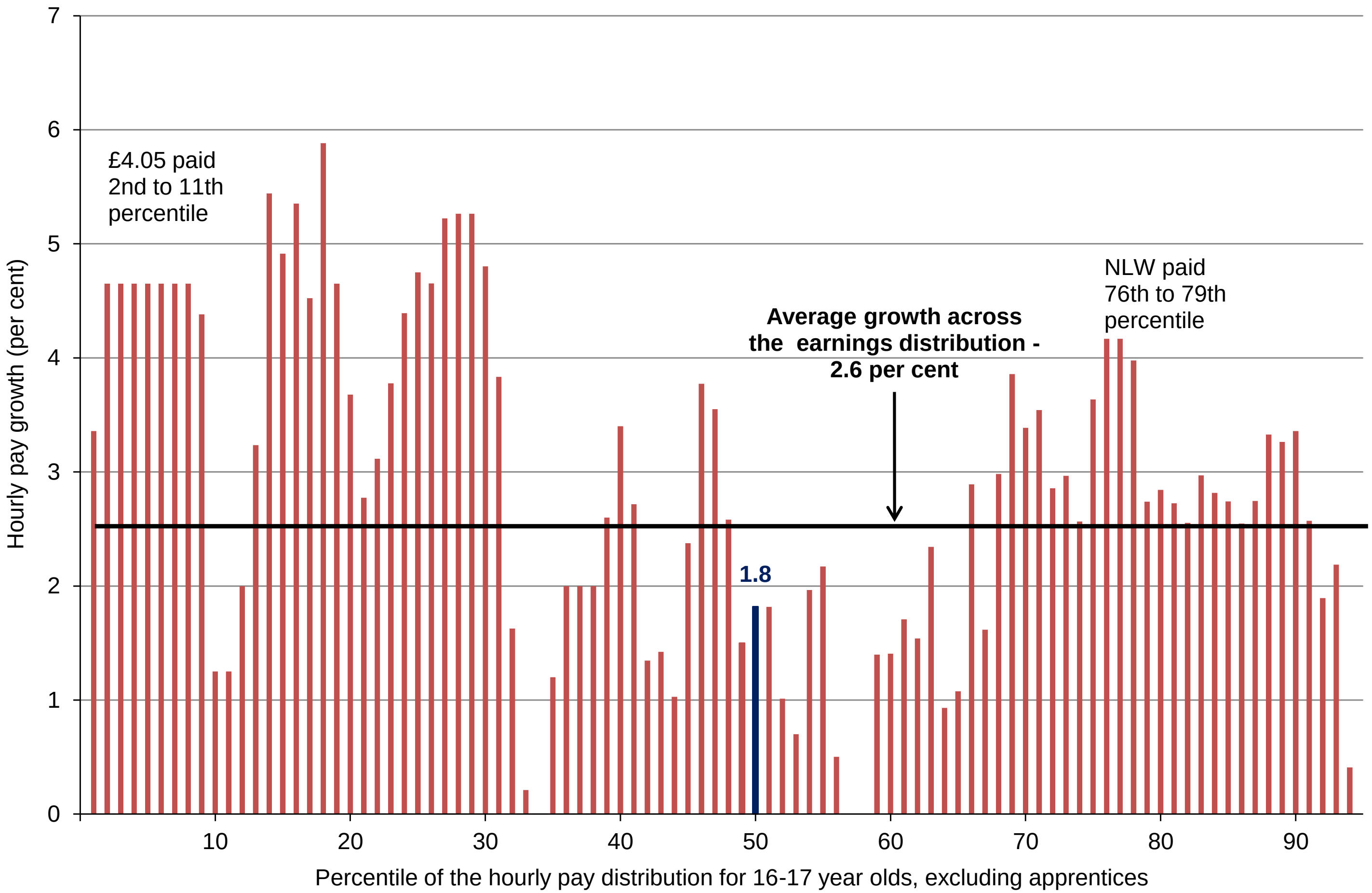
Across the distribution, pay growth for 21-24 year olds averaged 4.8 per cent.



Across the distribution, pay growth for 18-20 year olds averaged 5.8 per cent.



Pay growth for 16-17 year olds averaged 2.6 per cent across the distribution, above the median (1.8 per cent).



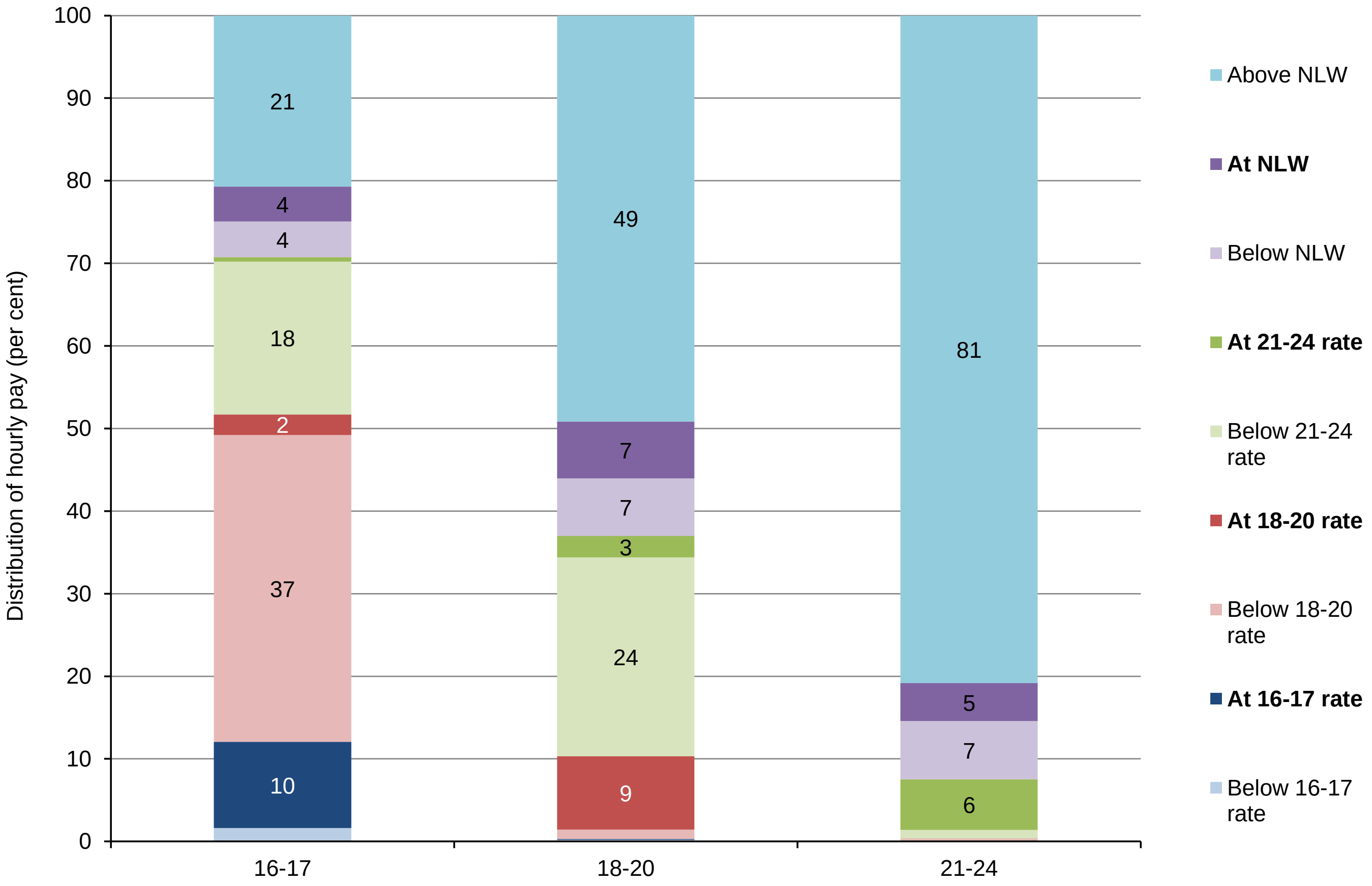
Is the high pay growth observed for young people due to the NLW?

Yes, the NLW is one of the drivers:

- Around one in twenty young people (164,000) were paid at the NLW.
- A rising NLW pushes up the pay of those paid above the NLW – and pulls up the pay of those paid below the NLW.
- But pay at the bottom is also pushed up by pay settlements which have tended to give the largest increases to those at the bottom.
- And, more generally, public debate on the scourge of low pay.
- Also, young peoples' engagement with the labour market differs. Possibly, greater turnover means higher job-to-job pay growth in a strong job market (and the reverse in a weak job market).

Difficult to disentangle factors but, irrespective of drivers, employers are evidently willing and able to increase pay for young workers.

Many young workers are paid within the NMW structure, but often between their age rate and the rate above them.



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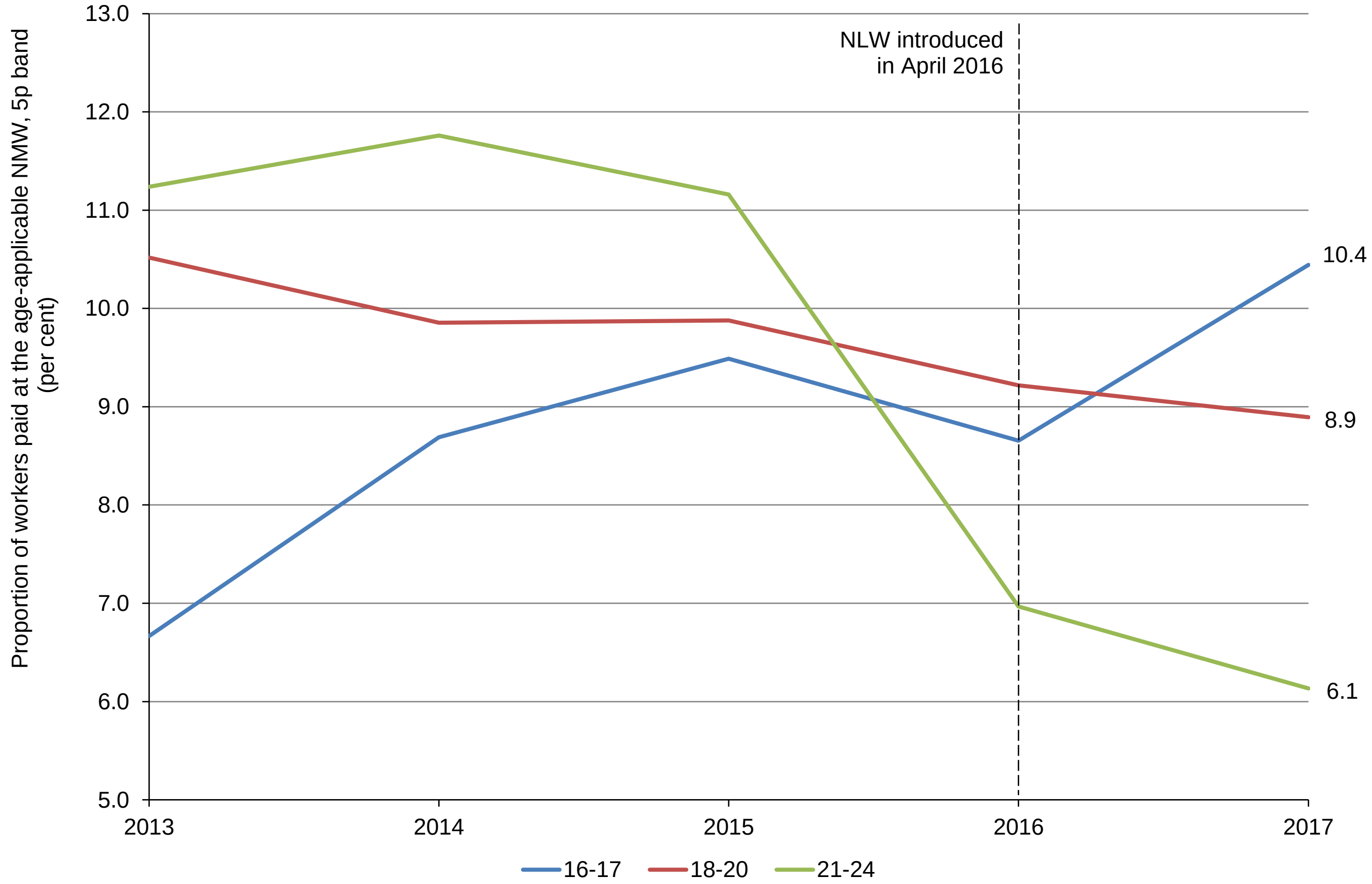
A falling proportion of 18-24 year olds were paid at their applicable minimum wage, helped by employers paying the NLW.



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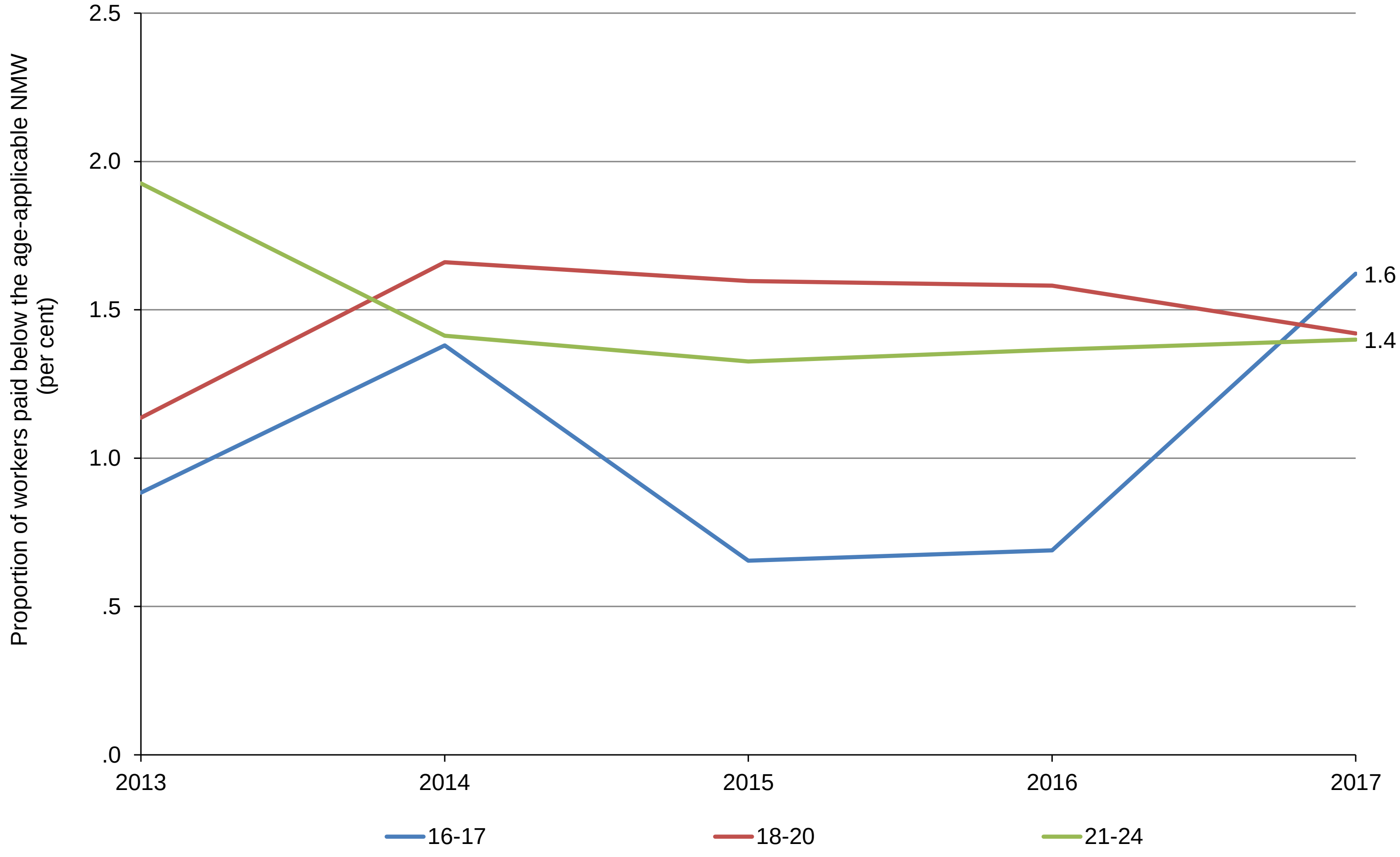
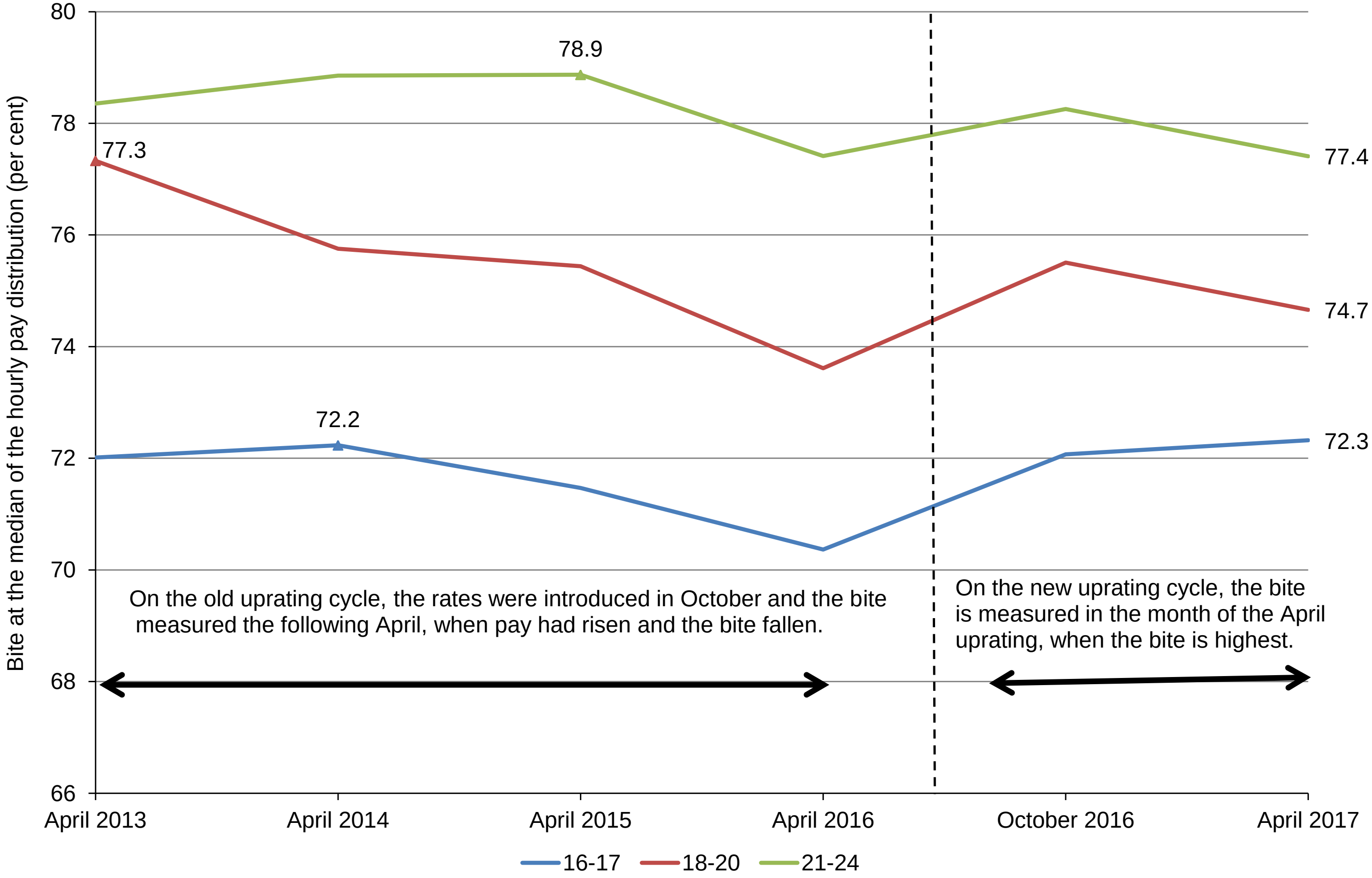
Widespread compliance. Underpayment is low and stable for 18-20 year olds and 21-24 year olds.



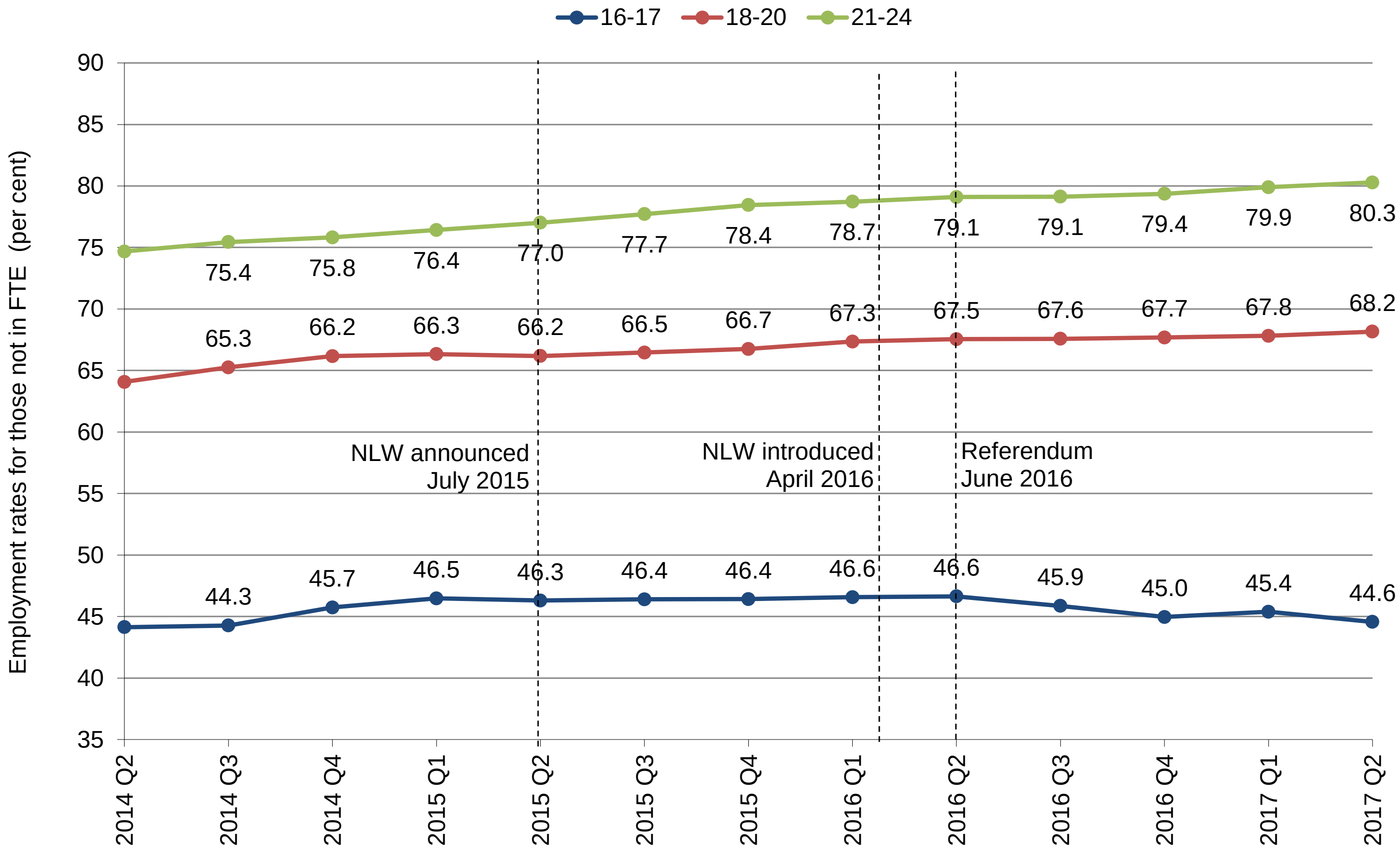
Strong pay growth means that the bite is below its peak for 18-24 year olds, and for 16-17 year olds if the new cycle is considered.



What about jobs?

- **Are young people struggling to find work?**
- **If so, increasing the minimum wage will only exacerbate their difficulties.**
- **If not, more scope to increase the pay floor.**

Rising employment rates for 18-24 year olds not in full-time education.



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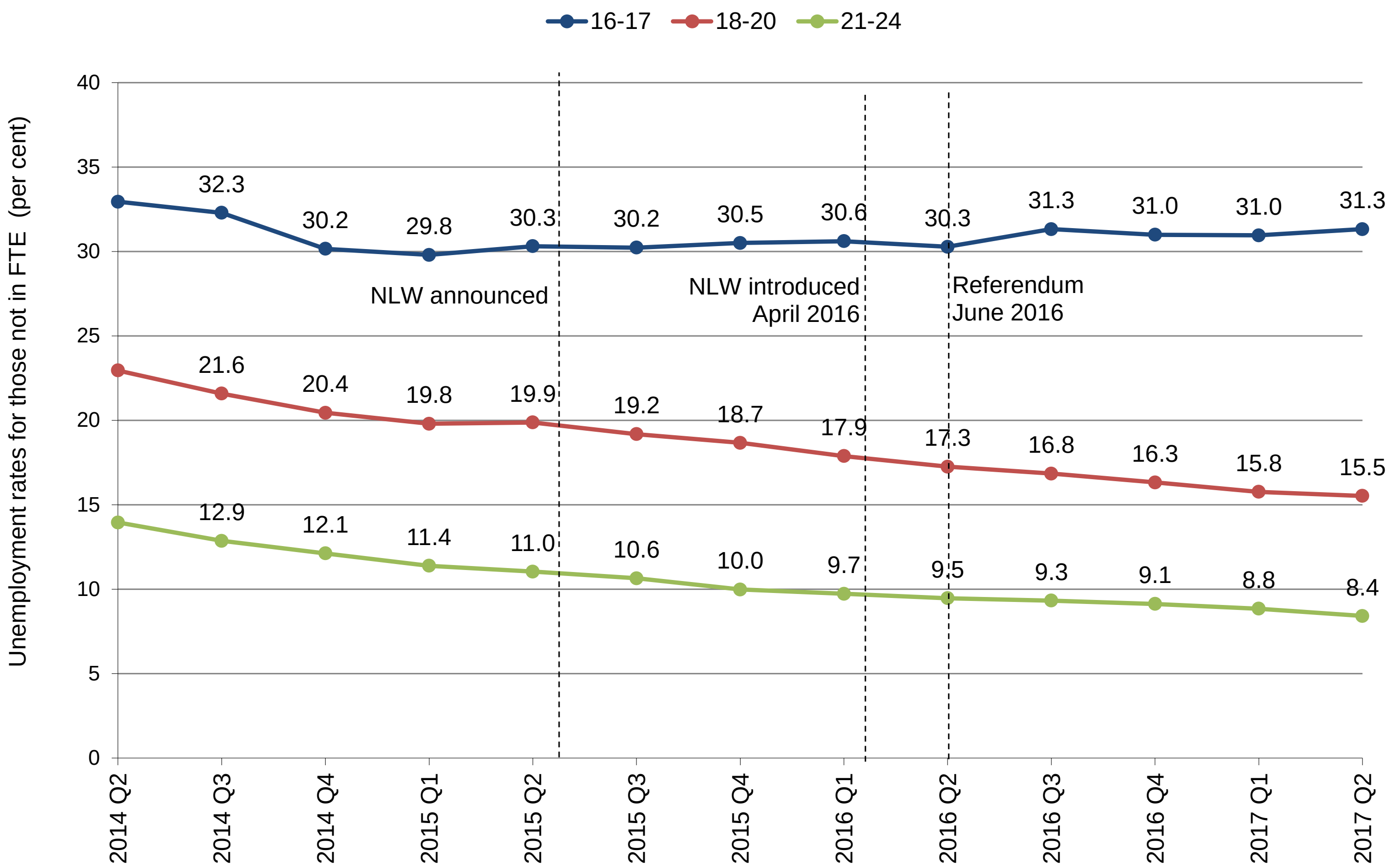
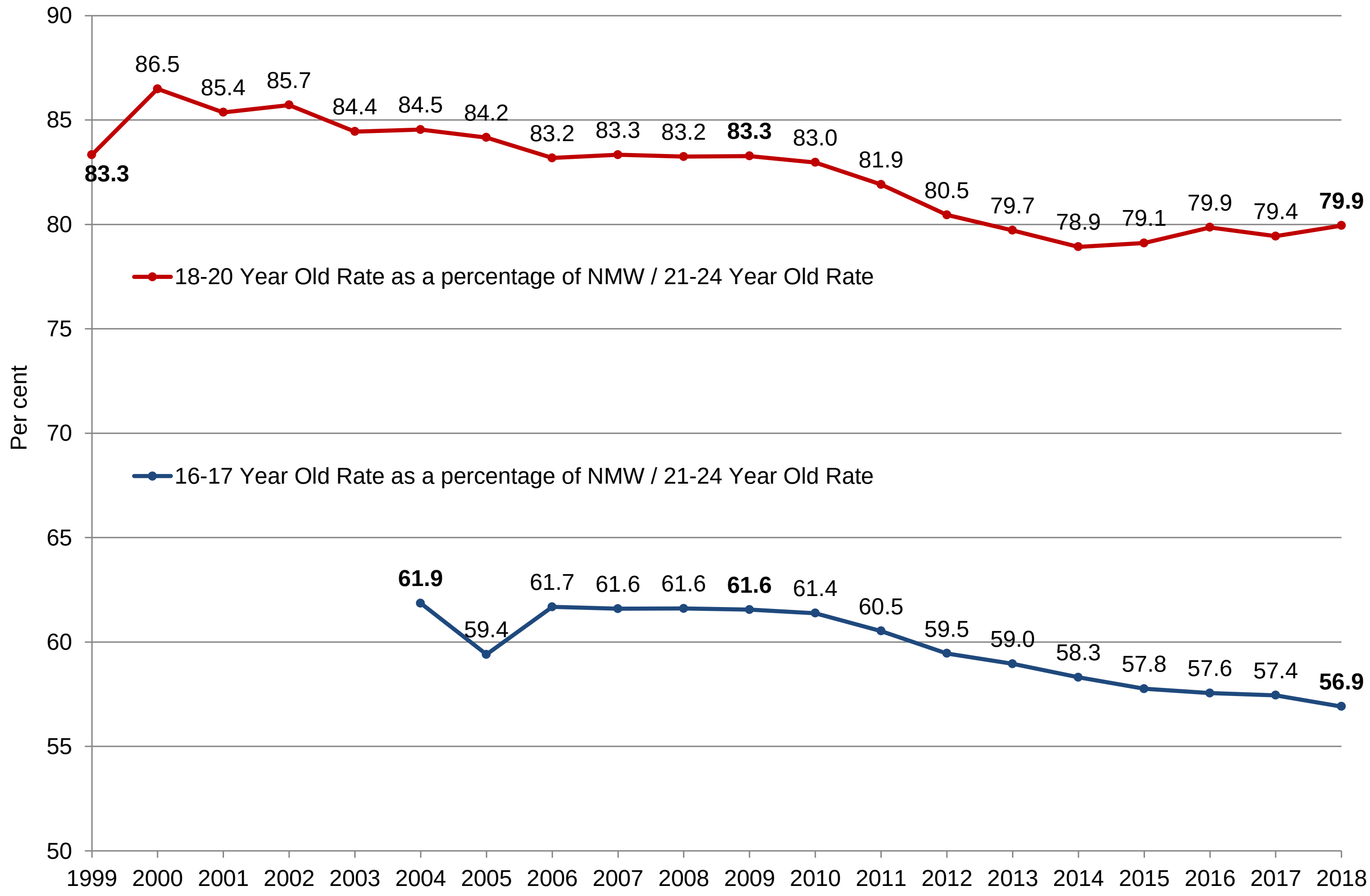
Falling unemployment rates for 18-24 year olds not in full-time education.



The relativities between the rates

- There are good reasons for having a lower wage floor for younger workers (countries with no age rates tend to have much higher youth unemployment).
- The gap between the youth rates and adult rate increased following recession, as we recommended lower increases for the youth rates to protect young people – including a freeze of the youth rates in 2012.
- Research evidence suggests that these actions helped to protect young people.
- But we said that we hoped to restore the lost value of the youth rates once economic conditions had eased.

The April 2018 upratings restore some of the relative value of the 18-20 Year Old Rate.



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Longer-term changes to the youth labour market could have implications for the rates.

- **Increasing educational participation.**
- **Falling labour market participation.**
- **Part-time jobs replacing full-time jobs.**
- **Increasing reliance on low-paying jobs, particularly in retail and hospitality.**

Are historic rates relativities appropriate for today's labour market?

Do changes to the youth labour market change the role and purpose of the youth rates?

Commissioners agreed that they wanted to take a fresh look at the minimum wage structure next year. **To ensure that the rates, and the relativities between them, are fit for purpose.**

And apprentices?

Key considerations for the Apprentice Rate: jobs, pay and stakeholder views

Jobs? Difficult to interpret the latest data on apprenticeship starts:

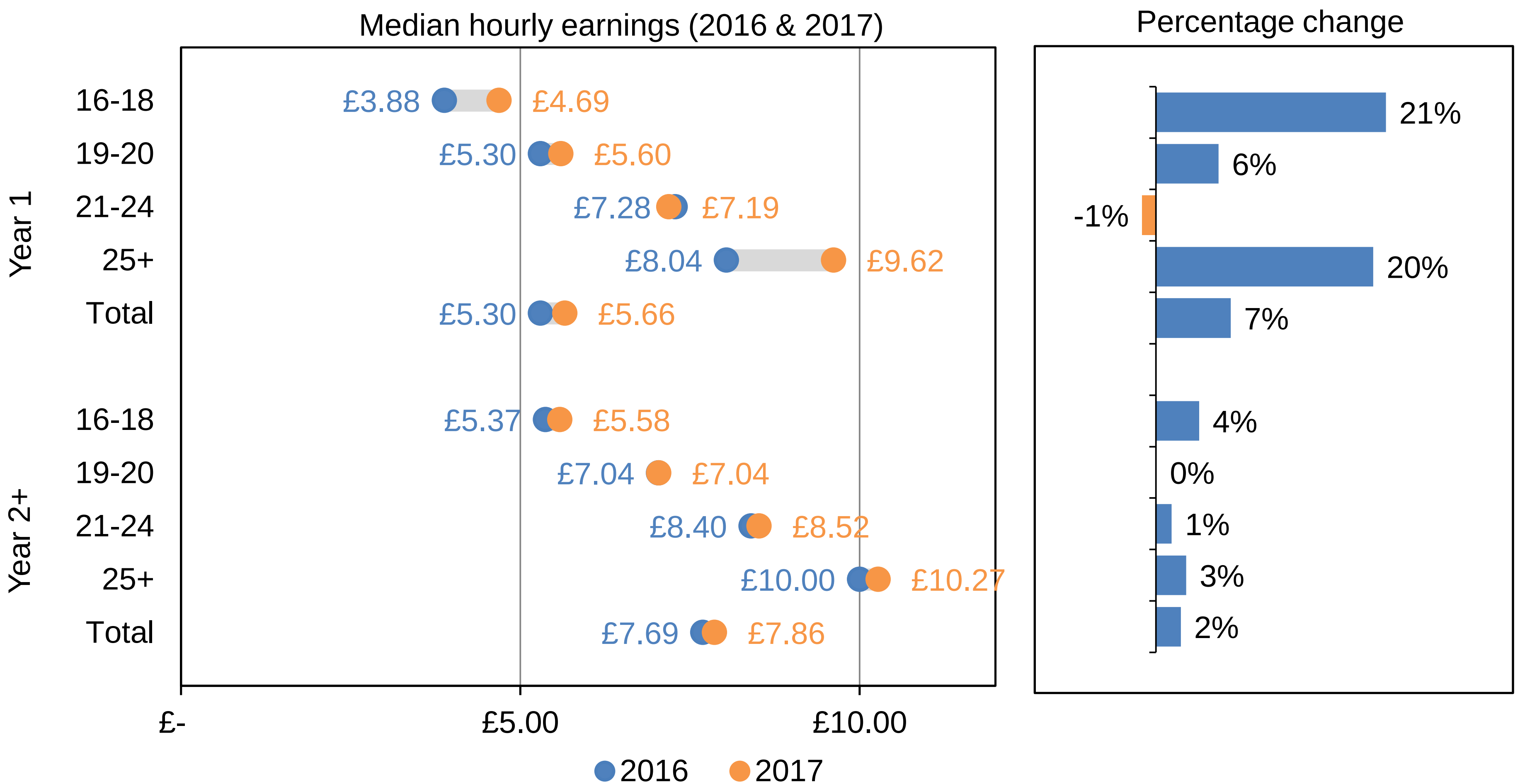
- **Approximately 1 million apprentices** studying at any one time, just over half aged 16-24 years (approximately 7 per cent of this age group).
- **Apprenticeship policy is in flux:** the introduction of the levy, co-funding, and the shift from frameworks to standards, is affecting starts in England, which were brought forward to avoid the policy changes.

Stakeholders supported an increase in the Apprentice Rate:

- Representatives of employers and employees called for an increase in the Apprenticeship Rate to increase quality and standing.

Pay data supported an increase in the Apprentice Rate.

The youngest apprentices saw a large increase in their hourly earnings.



Summary

Key evidence for the youth rates decision:

- Rising youth pay and a falling bite.
- A strong youth labour market.
- Falling use of the youth rates and no compliance problem.
- A mixed picture on the economy, some uncertainty about the future, but current growth exceeding expectations.

Recommendations on the National Minimum Wage

Low Pay Commission

November 2017