National Minimum Wage

Low Pay Commission analysis

December 2017

This report contains a summary of the rationale for our recommendations for the rates to apply from April 2018.

All of our recommendations were accepted by the Government.

Our analysis is presented in detail in our 2017 Report.

[Read our full report here](#)

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LPC remit and recommended rates

The LPC and the NLW

The National Living Wage (NLW), the new statutory minimum wage for workers aged 25 and over, was introduced at £7.20 per hour in April 2016. The LPC's remit is to advise on the path of the NLW, with the ambition that it will reach a target of 60% of median earnings by 2020.

For the NLW, increases are 'subject to sustained economic growth', but there is a tolerance for some job loss. The Office for Budget Responsibility (OBR) estimated that the NLW's introduction would mean between 20,000 and 110,000 fewer jobs by 2020 than in its absence, though this was set against predicted employment gains across the economy of 1.1 million jobs between 2015 and 2021.

Other National Minimum Wage rates

The LPC's remit with regard to the rates for workers aged under 25, and apprentices, remains the same as before the NLW was introduced. In this regard, the LPC is tasked with helping as many low-paid workers as possible without damaging their employment prospects.

The Government accepted all of the LPC's recommended rates for 2018. They will come into force on 1 April 2018.

Future National Minimum Wage rates (from 1 April 2018)

Past and future minimum wage increases

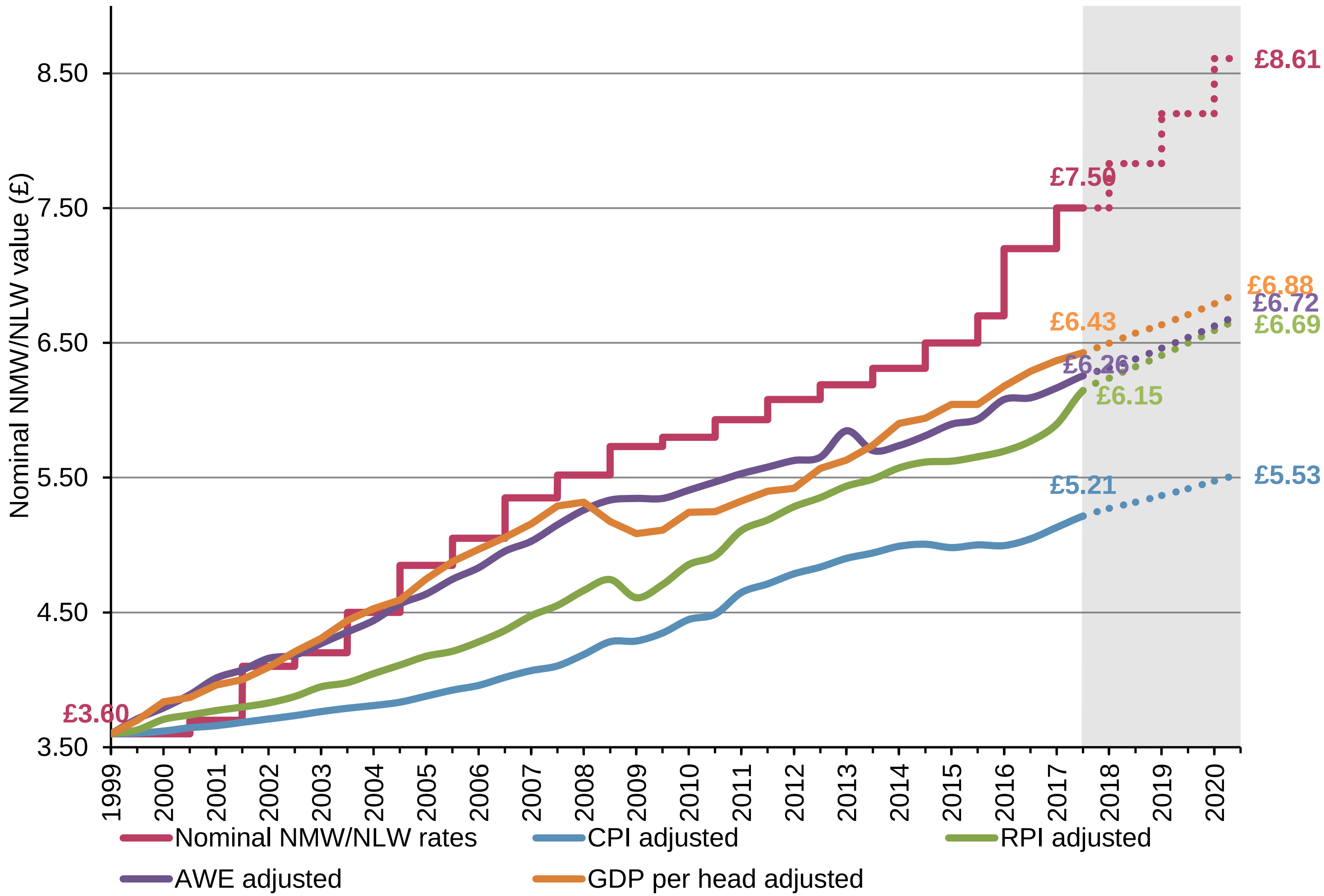
If the minimum wage had risen in line with average earnings per head since 1999, it would now be worth £6.72.

Before the introduction of the NLW, the nominal value of the adult rate of the National Minimum Wage rose faster than average earnings (AWE), RPI and CPI inflation, and GDP per head.

Since the NLW was introduced in 2016, it has risen significantly faster than all these indicators and will likely continue to do so until 2020. This is despite higher inflation over the last 12 months.

£8.61 is the projected value of the NLW in 2020, based on the median of the HM Treasury panel of independent forecasts.

Nominal value of the minimum wage compared to GDP, earnings and inflation, 1999-2020



Economic context

1.5% While GDP growth has slowed in the last 18 months, 'sustained economic growth' remains. There was, therefore, no justification for departing from the NLW's path on these grounds.

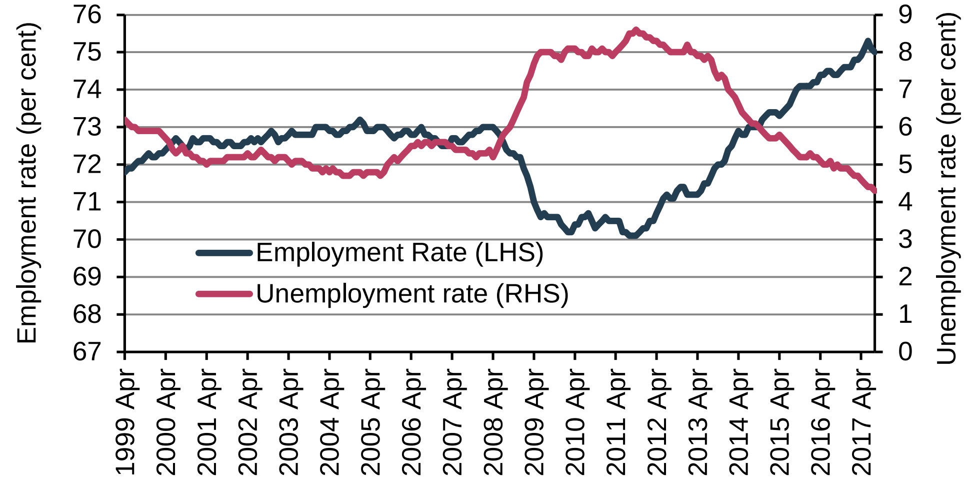
75.1% The employment rate has hit record high levels in 2017, and is higher than a year ago (74.5%). Employment in low-paying sectors has also grown in 2017.

4.3% The unemployment rate fell to in the 3 months to August 2017, from 5% in the same period last year. This is the lowest rate since 1975.

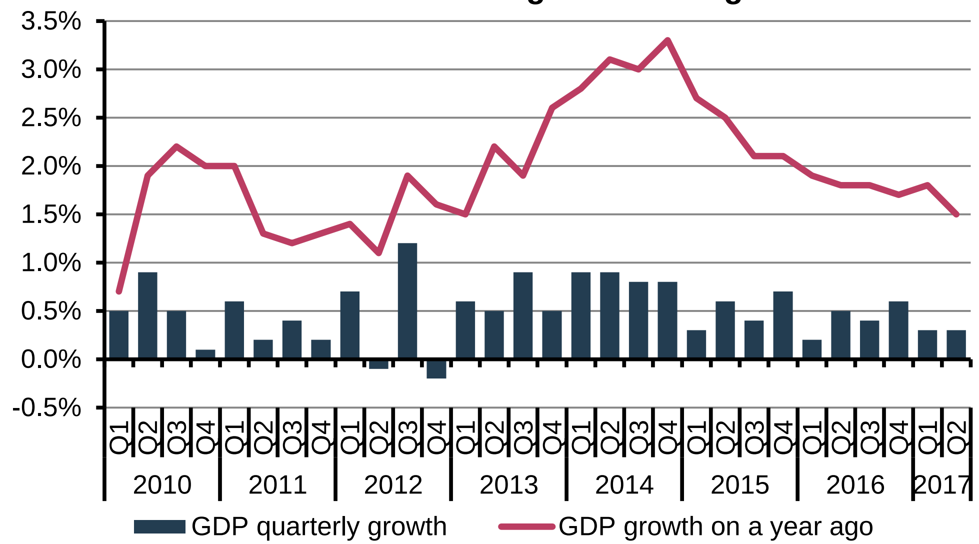
At the time that the NLW was announced (July 2015), the OBR forecast job creation of 1.1 million in the period 2015-2021. This was surpassed in 2017 – well ahead of the prediction.

However, productivity and pay growth have been slow. Output per hour was the same in the second quarter of 2017 as it was 9 years earlier in the second quarter of 2008, while output per worker and output per job was only around 1.5% higher across the whole period. Pay settlements and earnings growth remained subdued, at around 2%.

Employment at record high, unemployment record low



Slower but sustained economic growth through 2016 and 2017



Coverage of the NLW

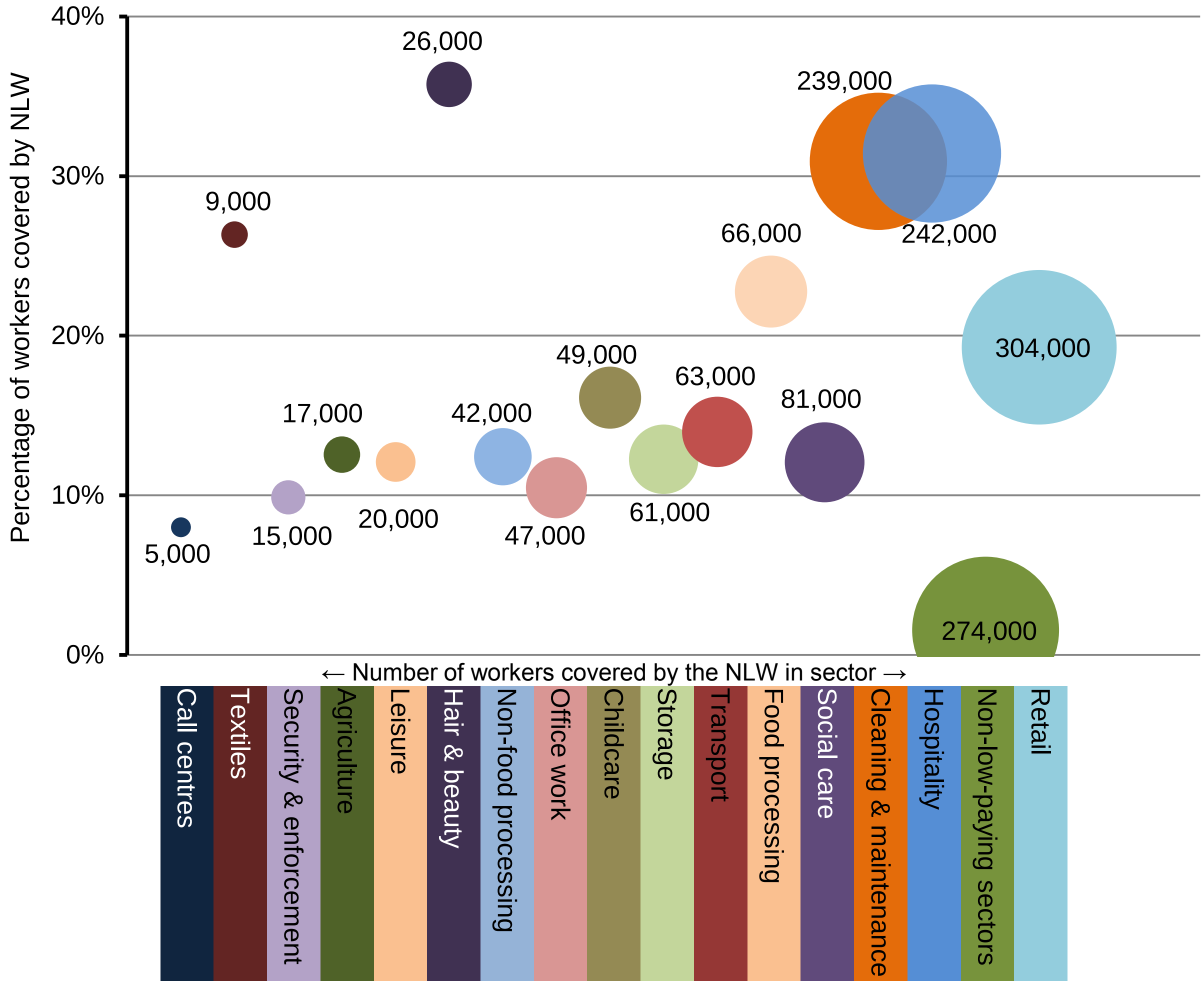
6.4% Total coverage – the percentage of workers aged 25 and over paid at or below the NLW. This is slightly lower than in 2016.

This is partly explained by the timing of the data collection (fewer workers were incorrectly identified as underpaid this year compared with last year). However, we think that the NLW being 15p lower than the OBR's initial forecast of £7.65 meant that the NLW did not 'catch' as many workers in 2017.

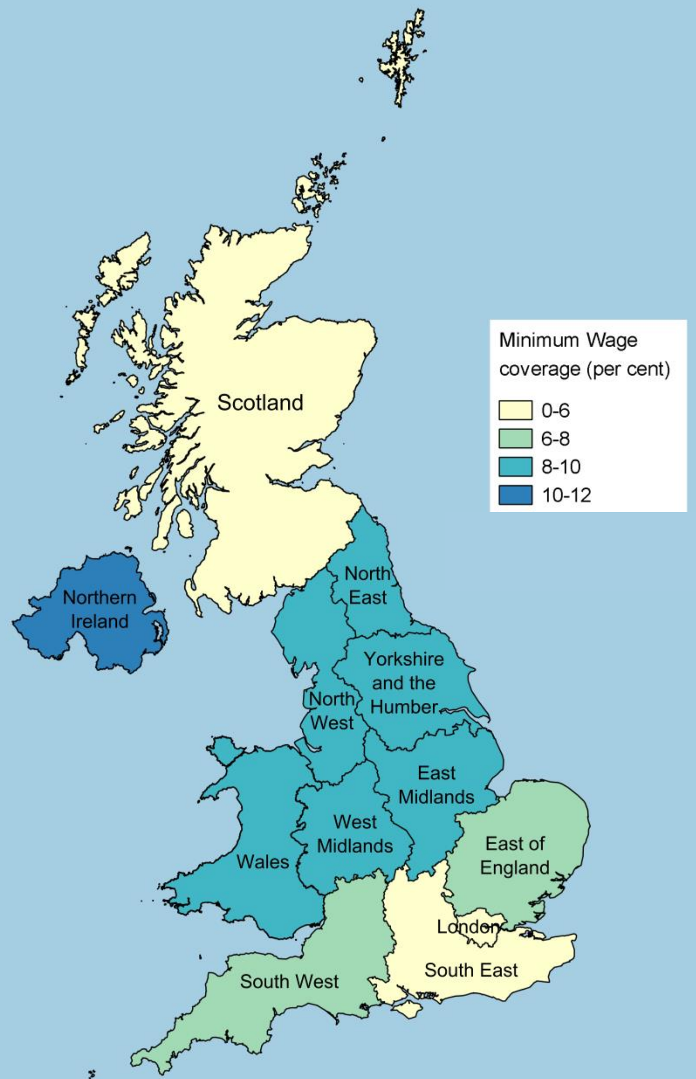
1.5 million people were covered by the NLW in April 2017. We expect this to rise to as much as **3 million** by 2020.

NLW workers are concentrated in the low-paying sectors. Retail, with, **304,000**, hospitality, with **242,000**, and cleaning and maintenance, with **239,000**, are the biggest NLW sectors. But **274,000** NLW workers are employed in sectors not generally identified as low-paying.

Percentage and number of workers aged 25 and over covered by the NLW



Coverage varies between and within countries and regions



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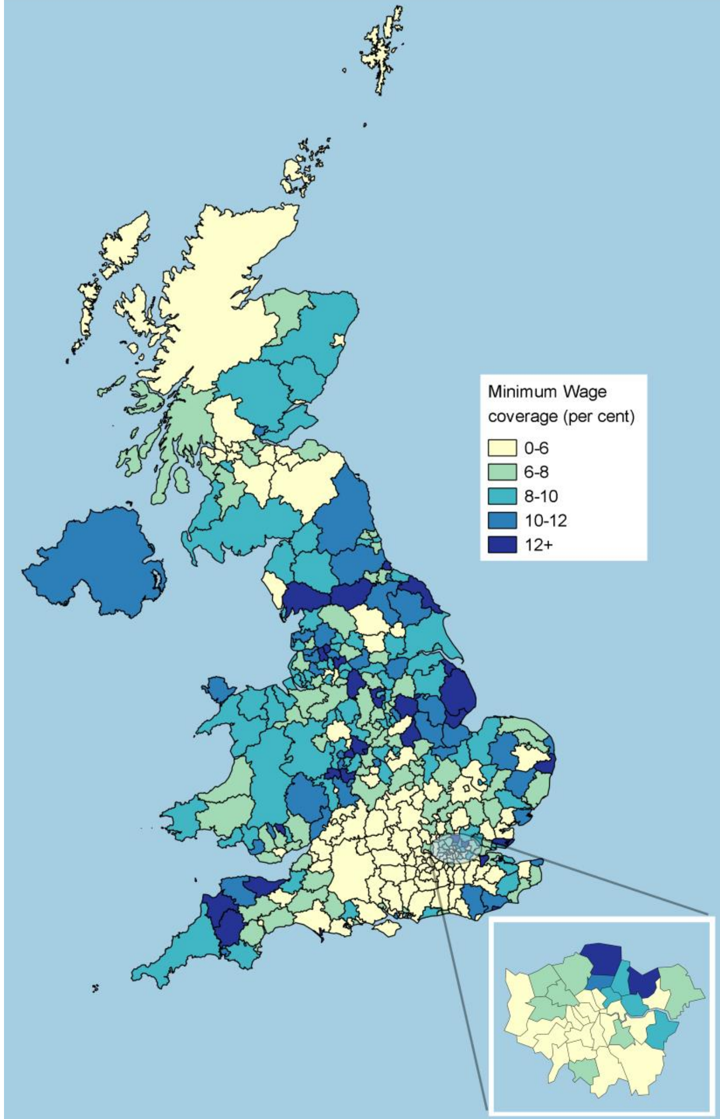
11.7% The country with the highest coverage (the percentage of all workers paid at or below their applicable minimum wage rate) is Northern Ireland. Within England, coverage ranged from 4.1% in London to 9.1% in the North East.

But coverage is higher in particular Local Authorities – around 30 have coverage of over 12%.

And the difference within regions is large. Weymouth and Portland, and West Somerset both have coverage of over 20%, whereas Poole, also in the South West, has coverage of 3%.

Within London, coverage varies greatly too. Richmond-upon-Thames, for example, has coverage of just 1.8%, compared with 15% in Redbridge.

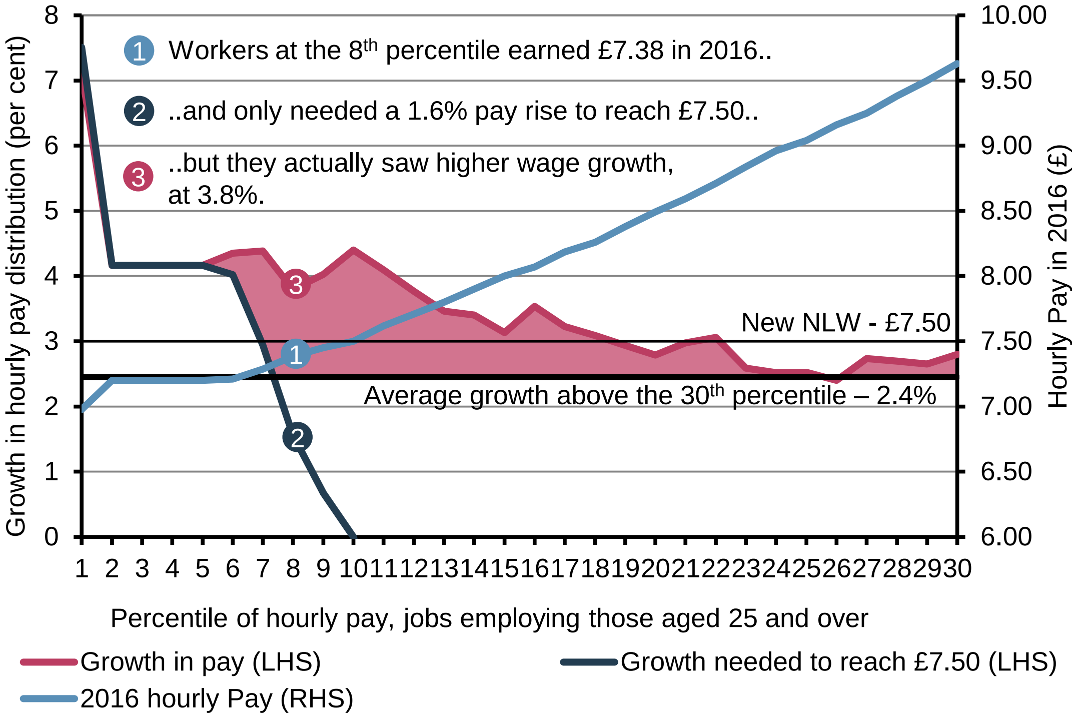
Full tables of coverage by Local Authority are available on our website.



The NLW also raised pay for those paid above it

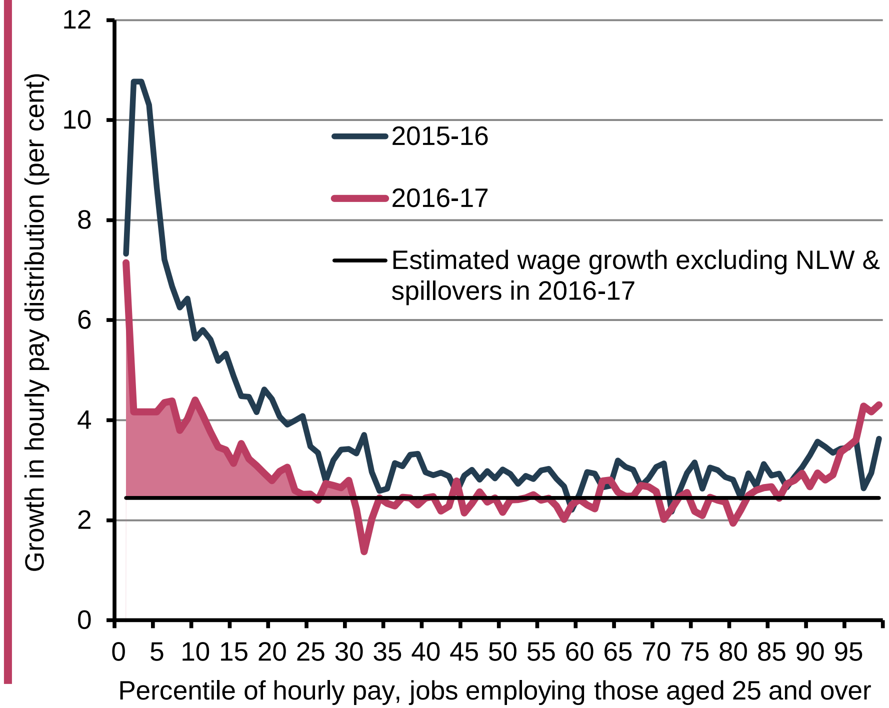
Up to **7 million** workers received a larger pay rise in April 2017 than would likely have done in the absence of the NLW increase to £7.50. We call this the 'spillover' effect of the NLW – meaning that it carries higher pay to those already paid above it too, as employers seek to maintain some differential between the NLW and higher-paid staff. Pay growth was greater in percentage terms for the bottom third of earners, meaning workers earning up to £9.50 per hour received higher pay increases.

Growth in hourly pay distribution, bottom 30 percentiles, 2016-17, workers aged 25 and over



The effect reached as far as in 2016, when the NLW was introduced and the minimum wage for workers aged 25 and over rose 10.8% on an annual basis. This means that the taper for higher pay increases was shallower this year (when the NLW increased by 4.2%), but that as many workers benefited directly and indirectly.

Growth in hourly pay distribution, 2015-16 and 2016-17, workers aged 25 and over



But differentials were reduced up the distribution

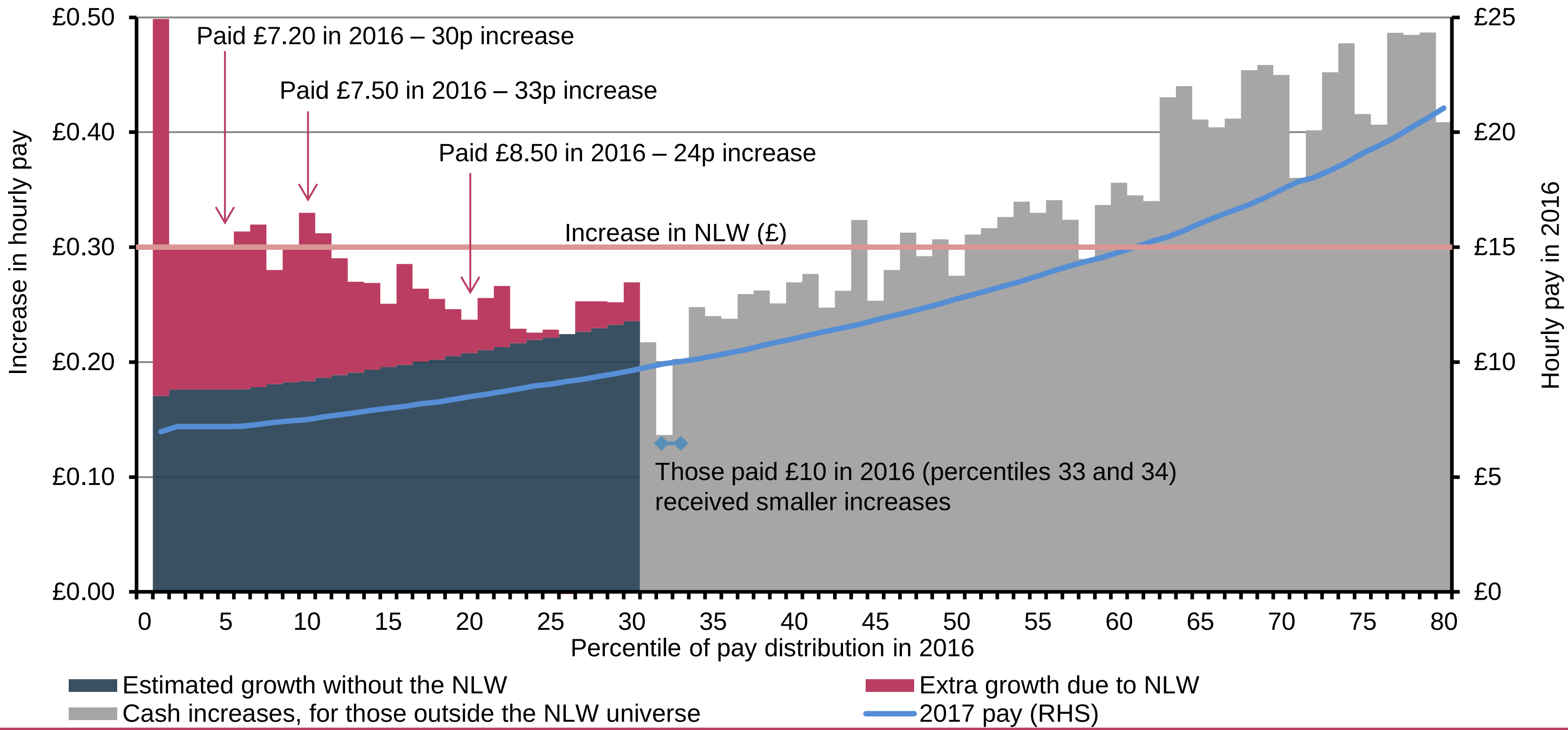
30p The increase in the NLW did not carry in full up to workers already paid above the NLW.

Those paid just above the new NLW (between £7.60 and £9.50) had a cash increase that was less than 30p per hour; however, they still received a larger percentage increase than the average across the pay distribution.

Those already paid at the current NLW rate of £7.50 saw their gap to the rate maintained.

This means that differentials between minimum wage workers and those paid above have been reduced somewhat. This matches the reports of compressed pay structures that we heard during our consultations with both employer and worker stakeholders.

Cash increase in pay, 2016-17, bottom 80 percentiles of pay distribution, workers aged 25 and over



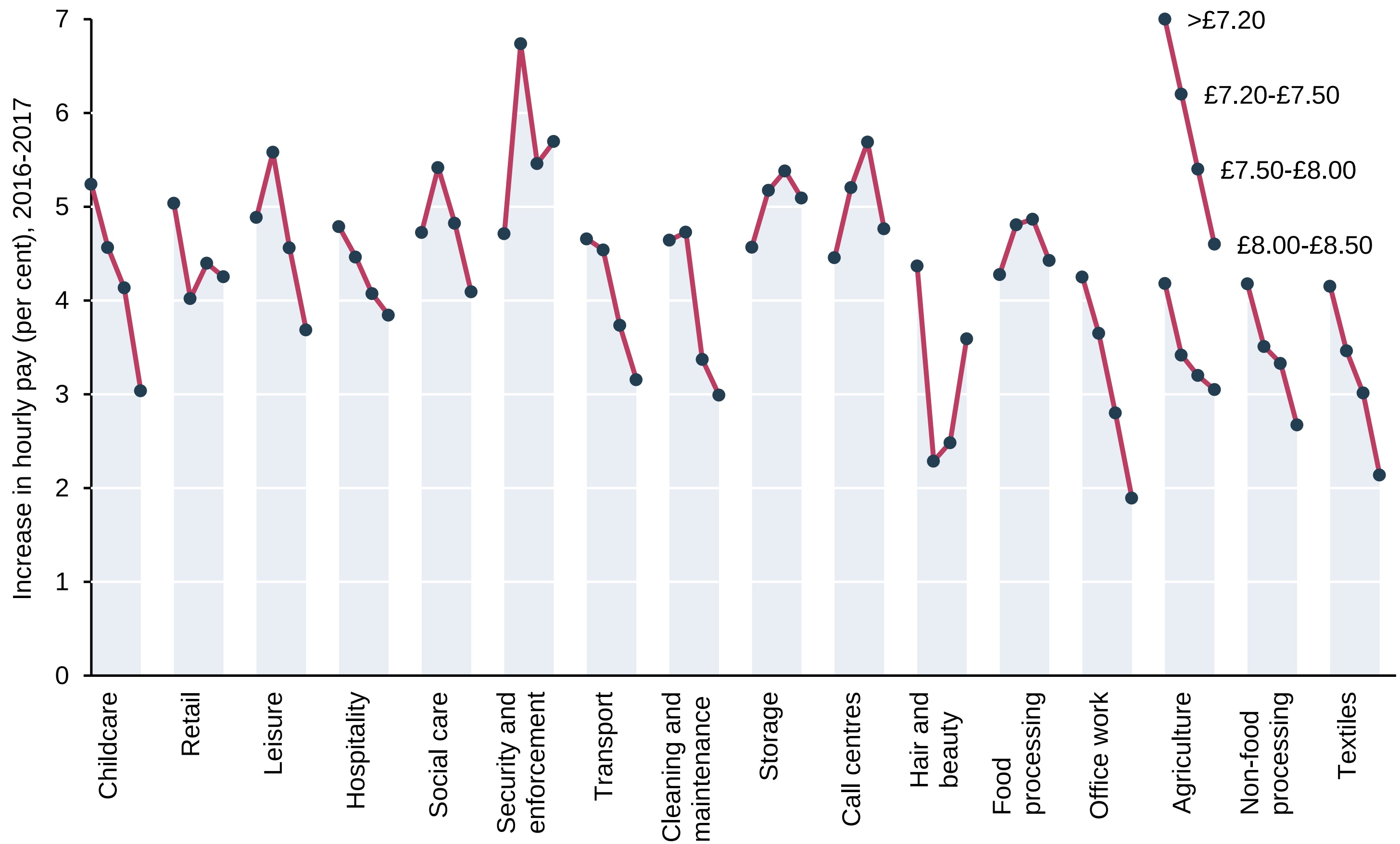
Pay differentials squeezed in most low-paying sectors

This pattern was consistent across most low-paying sectors, indicating that to accommodate the cost of the NLW increase, employers have limited the pay increases of higher-paid staff. The chart shows that across most low-paying sectors, workers paid up to £8.50 in 2016 saw higher than average wage growth in 2017, but smaller percentage increases than those paid closer to the NLW.

Stakeholders in some of the most affected low-paying sectors echoed these findings. In stakeholder surveys it was one of the most commonly cited responses to the NLW.

However, some firms told us that they had reduced differentials to a minimum when the NLW was introduced, and had no further to go.

Growth in hourly pay for those paid up to £8.50 in 2016, by sector, 2016-17, workers aged 25+

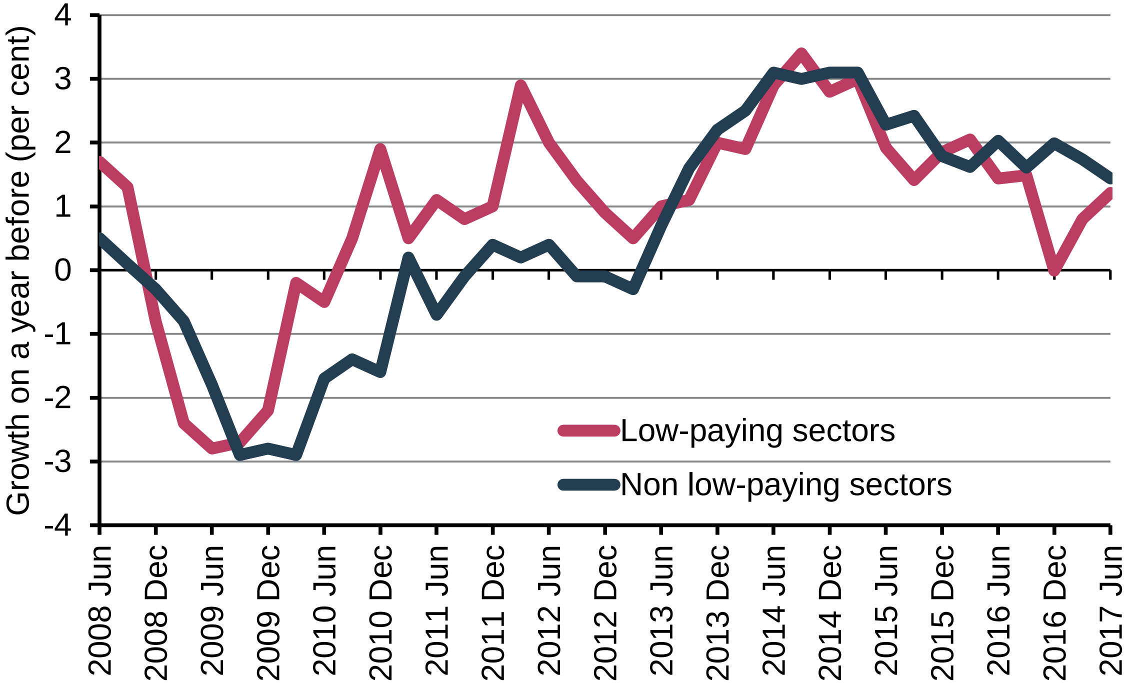


These firms, and others who have cut differentials further in 2017, told us that they are now dealing with the consequences – including problems with staff motivation and reduced progression opportunities. Workers also told us that pay differentials were causing problems.

Employment relatively strong for low-paid workers

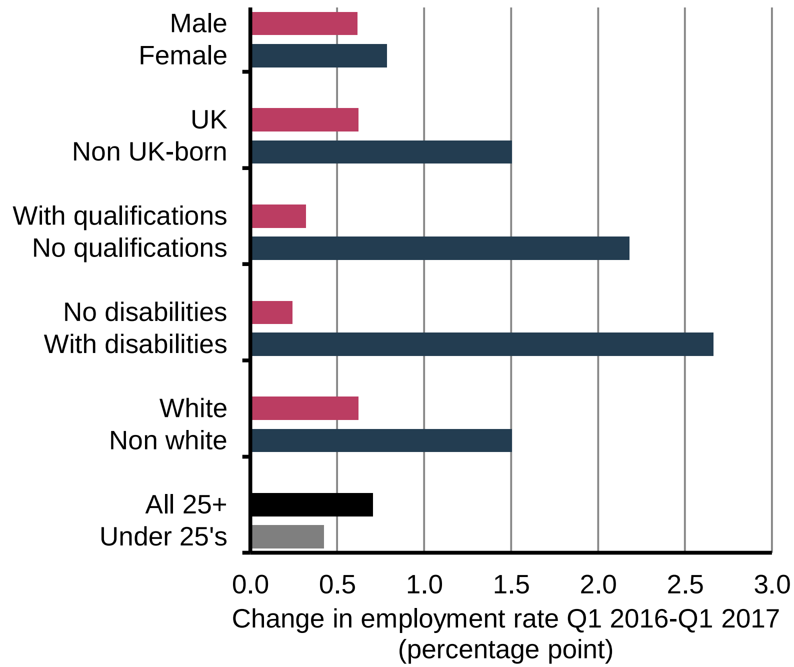
While employment growth in low-paying sectors slowed after the introduction of the NLW in April 2016, it has since picked up, and grew by more than 1 per cent in the year to June 2017. Hours growth in low-paying sectors has slowed in this period though, mirroring what we heard from stakeholders about changes to hours being more common than redundancies. However, lost hours in low-paying sectors have been more than offset by increases in non low-paying sectors.

Change in employment rate in low-paying and non low-paying sectors, 2008-2017



With employment growth already having surpassed the OBR's projections for 2015-2021, and the groups for whom the bite of the NLW is higher outperforming others (see chart below right), we judged that the employment data did not justify departing from the NLW's proposed path.

Change in employment rate, by worker characteristics, 2016-2017



The NLW again affected profits and prices

In our consultations with stakeholders, and from commissioned and independent research, we heard that businesses had, as they did with the introduction of the NLW, accommodated the latest increase by taking lower profits, and had increased prices where possible.

Profits: Accepting a reduction in profits was the most common 'response' in most stakeholder business surveys. This was of similar magnitude to last year, but stakeholders expressed concern over the continued viability of this strategy. Unions, on the other hand, cited high levels of corporate profitability as evidence that the NLW has been affordable. Indeed, corporate profitability does not seem to have declined, and insolvencies are low in low-paying sectors.

Prices: After accepting lower profits, higher prices were the next most common response businesses had taken. Firms may have been aided in raising prices by the higher level of general inflation in the second half of 2016 and into 2017. However, organisations in some sectors told us that this way of mitigating the added cost of the NLW was not viable for all businesses. Those that were price-takers or relied on Government funding were less able to use this avenue.

A range of businesses and employer representatives told us that the NLW had led to a greater focus on productivity. There were still relatively few specific examples, with more evidence of firms seeking a range of efficiency improvements than making substantial changes.

Investment was another area that businesses said had been affected by the NLW, though there appeared to be a divergence in strategies between smaller and larger businesses. SMEs were more likely to have delayed or cancelled investment plans because of the cost of the NLW, while larger businesses were more likely to be looking to invest in automation.

More generally, small businesses and their representatives were more worried about their ability to cope with the cumulative costs the NLW brings. They were also more likely to report effects on employment.

Effects on staffing were, we heard, more likely to be in the form of hours reductions or slowed hiring than redundancies. This was true for sectors reporting more difficulty affording the NLW.

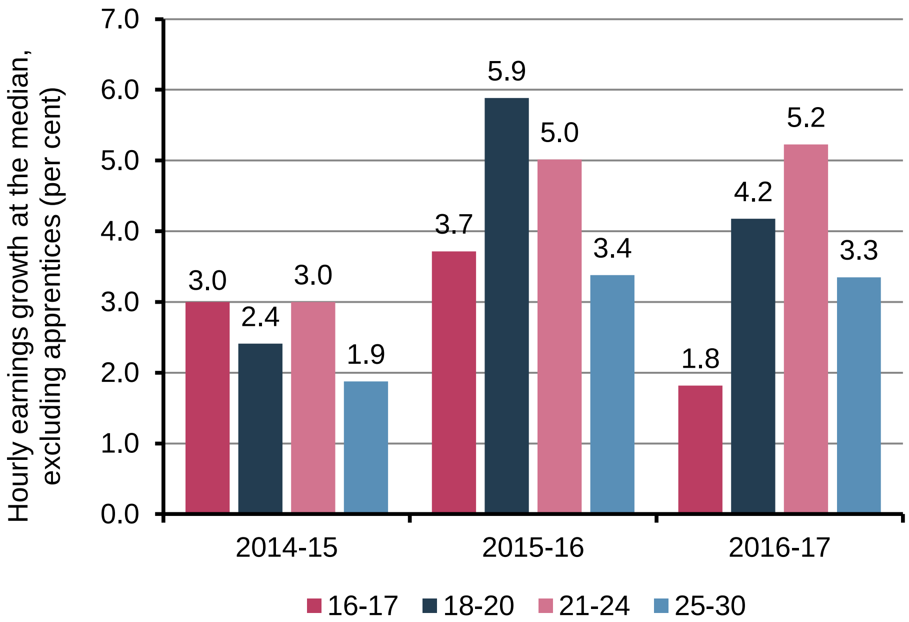
Employers had sought to minimise increases in staff costs by reducing differentials, although most businesses told us that they were not cutting back other benefits and premium pay.

Largest increases in youth rates in a decade

The LPC recommended the largest increases in the youth rates of the National Minimum Wage in a decade.

One factor was the upwards influence of the NLW on pay for workers aged 18 and over. This contributed to the strong earnings growth seen by 18-20 and 21-24 year olds over the last three years. These two groups had considerably higher earnings growth than older workers.

Hourly earnings growth for 16-30 year olds, 2014-17



The LPC, in our reports from 2011 to 2014, committed to restoring the relativities of the youth rates lost in the aftermath of the financial crisis, when we recommended smaller increases to protect the employment prospects of younger workers. Restoring the rate differentials was subject to economic conditions having improved sufficiently to do so with minimum risk. This year we judged that there was sufficiently strong evidence to justify being more ambitious regarding the rates for younger workers.

As well as strong pay growth at the median for 18-24 year olds, we took into account the following:

- Concerns about the effects of the large increases in the rates in 2016-2017 were not reflected in stakeholder evidence. Rather, analysis showed that the use of the rates for younger workers had fallen as more employers choose to pay above these minimum rates.
- Strong employment and low unemployment, both for 18-24 year olds and for older workers.
- The fall in the bite (the value of the NMW as a percentage of median earnings) of the 18-20 and 21-24 Year Old Rates was cited by some stakeholders – both employer and worker representatives – as a justification for larger increases. Several organisations also expressed concern at the prospect of the gap between the NLW and rates for younger workers widening.
- Employers and unions both raised the importance of fairness and employee relations between age groups in the workforce.

The NLW also raised pay for young people

The NLW is one of the drivers of pay growth for young people, which has been higher than for older workers.

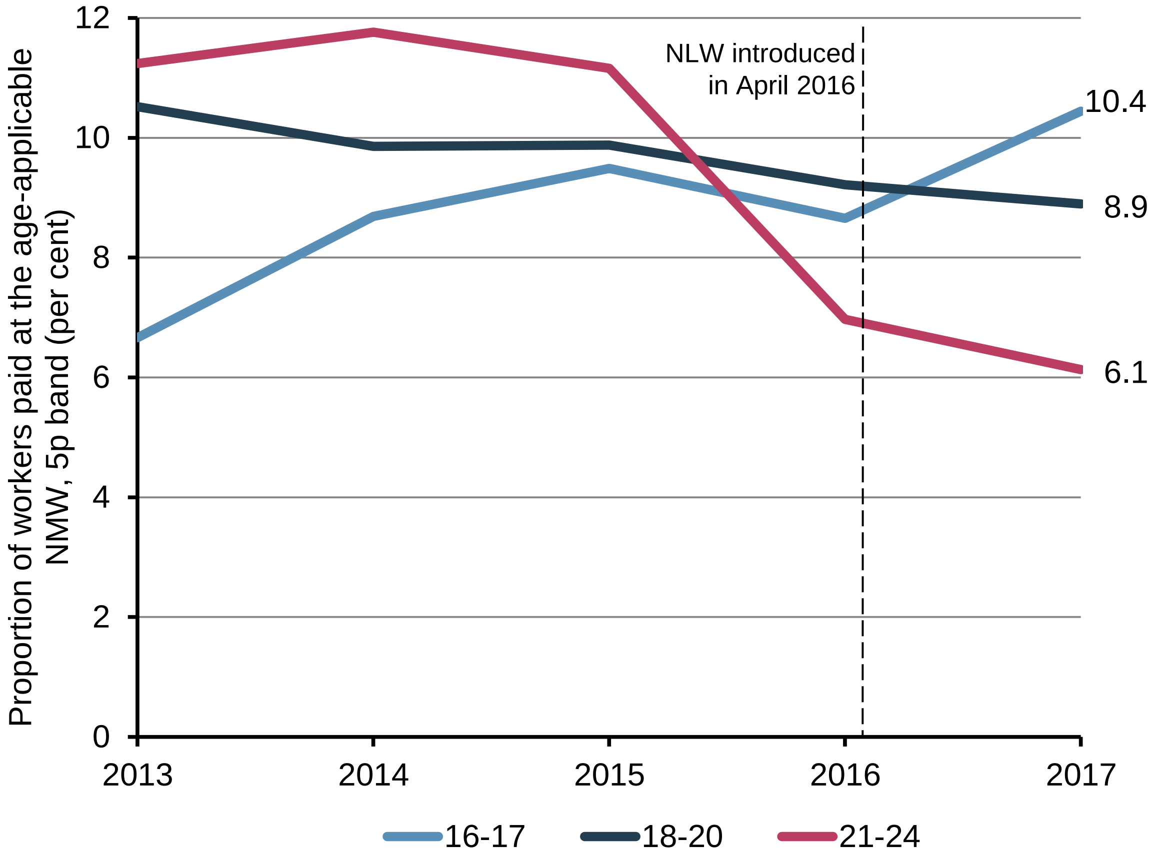
Around 1 in 20 young people (164,000) were paid at the NLW. A rising NLW pushes up the pay of those paid above the NLW, and pulls up the pay of those paid below it.

The percentage of 21-24 year olds paid at their applicable rate (now the 21-24 Year Old Rate, previously the NMW), fell in April 2016 when the NLW was introduced, with many employers choosing to pay the NLW to 21-24 year olds. The use of the 21-24 Year Old Rate fell again in 2017, and a similar – though weaker – pattern is seen for 18-20 year olds, indicating that employers are not moving to make greater use of the rate.

Similarly, evidence from employers did not generally reveal a move to using the 21-24 Year Old Rate. By contrast, use of the 16-17 Year Old Rate had increased.

While it is difficult to disentangle the factors, employers were evidently willing and able to increase pay for young workers.

Percentage paid at their age-related minimum wage rate, by age, UK, 2013-2017



Employment of young people was strong

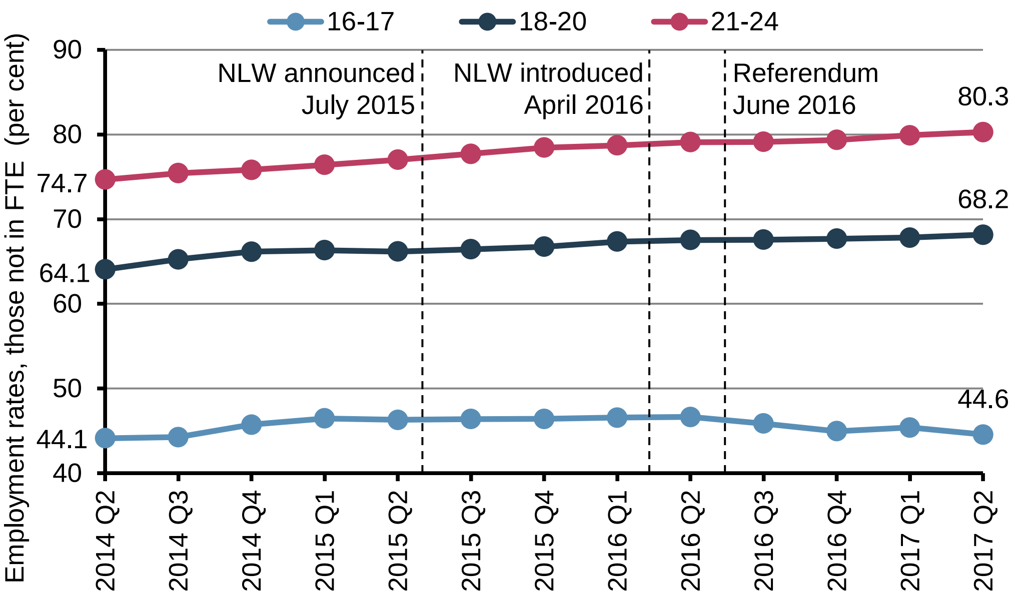
As with the UK labour market more generally, the performance of workers aged 18-24 has been very strong in the last 3 years. The groups covered by the 18-20 and 21-24 Year Old Rates (previously the youngest workers covered by the NLW) have seen their employment rates increase by around 5 percentage points between 2014 and 2017.

This continued in 2016 and 2017, indicating that the relatively large increases in their minimum wage rates in 2016 had not affected their employment prospects.

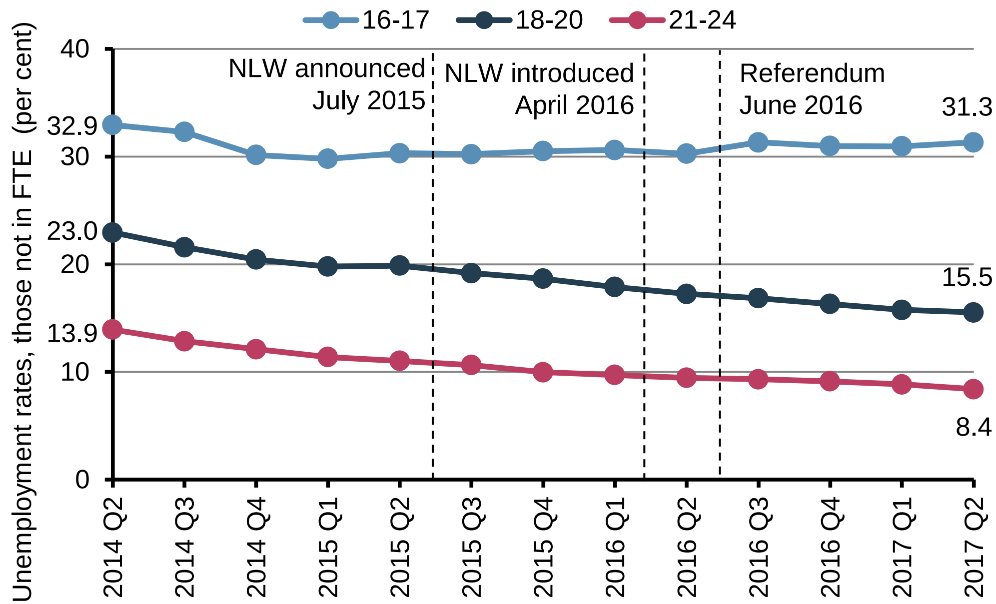
This is the key test for the youth rates of the NMW – the LPC is tasked with recommending rates that help as many low-paid workers as possible, without harming their employment prospects. Unemployment rates for 18-24 year olds showed similar improvement, so we judged their position strong enough to warrant larger minimum wage increases.

The weaker performance of 16-17 year olds on both these measures, as well as their earnings growth, led us to be more cautious with their recommended increase.

Employment rates of workers aged 16-24, 2014-2017



Unemployment rates of workers aged 16-24, 2014-2017



The path of the National Living Wage

The Government objective for the NLW is to reach 60% of median hourly earnings in 2020. The LPC role is to recommend the pace of increases 'subject to sustained economic growth'.

The median hourly wage in 2020 is uncertain so we use wage forecasts to work out the likely rate and inform decisions on the path.

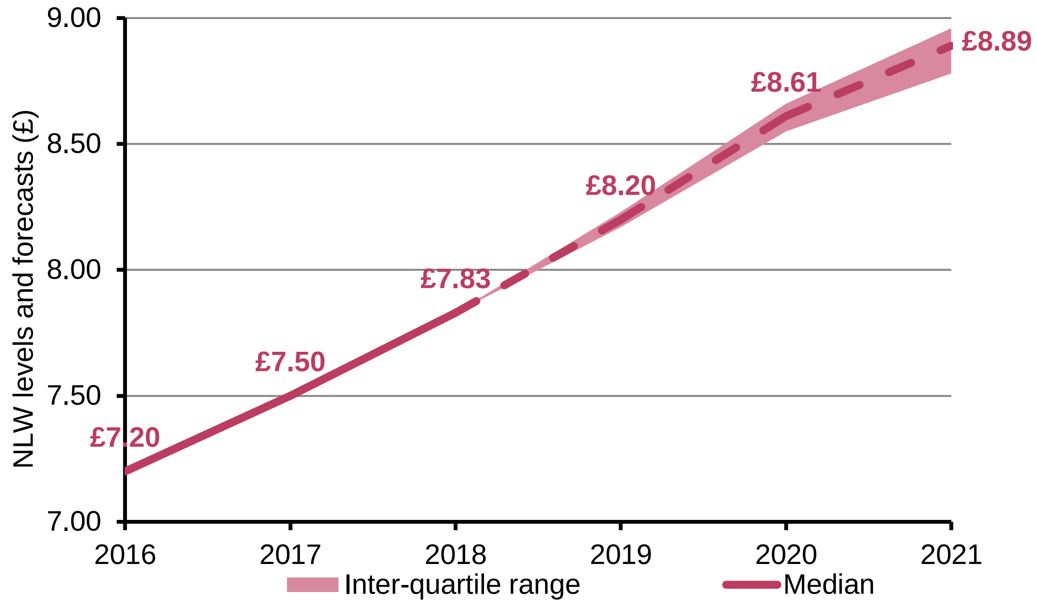
£8.61 is the projected 2020 rate for the NLW, based on the median of forecasts from the HM Treasury panel of independent forecasters. The projected rate for 2019 is **£8.20.**

Because wage growth has been lower than was forecast when the NLW was announced, the projected rates are lower than when the policy was first announced – in July 2015 the NLW was predicted to reach £9.35 by 2020.

Stakeholders were generally less concerned about the 2017 increase in the NLW than they were about its introduction in 2016. The change in the NLW's path and consequent lower-than-forecast rate (£7.50 instead of £7.65) had helped.

However, some sectors and small businesses told us that they were still worried about dealing with the current rates, while others thought future increases would be challenging. Unions, on the other hand, thought the NLW had been, and would continue to be, affordable.

Predicted path of the NLW and inter-quartile range of forecasts



Current and previous NLW path projections

Date of projection	2016	2017	2018	2019	2020
July 2015	£7.20	£7.68	£8.19	£8.74	£9.35
February 2015	£7.20	£7.64	£8.12	£8.61	£9.16
October 2016	£7.20	£7.50	£7.85	£8.23	£8.61
October 2017	£7.20	£7.50	£7.83	£8.20	£8.61

2018 National Living and Minimum Wage rates

The Government accepted all of the recommendations in the LPC's 2017 Report, including raising the National Living Wage to £7.83 per hour.

The rates for 18-24 year olds will see their biggest uprating in a decade on 1 April 2018.

The Accommodation Offset, in line with our principle of raising it towards the level of the 21-24 Year Old Rate, will also increase significantly.

In 2018 the LPC will once again consult on the effects of the NLW and other NMW rates on both employers and workers.

You can read all our reports on our website. The data used for this report is also available.

[Read our full report here](#)

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