Non-compliance and enforcement of the National Minimum Wage

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LOW PAY COMMISSION

Contents

Executive summary

Non-compliance with the National Minimum Wage (NMW) distorts competition, and is rightly perceived by both businesses and workers as the main threat to the continued success of minimum wage policy. This is the second standalone report the Low Pay Commission has published on non-compliance and the enforcement of the NMW, with the previous report published in September 2017. We look at the most up-to-date statistical evidence on the extent of non-compliance; and use evidence from stakeholders and the Government to reflect on the policy responses to non-compliance.

In April 2018, we estimate that 439,000 individuals were underpaid in total, including 369,000 who were paid less than their entitlement under the National Living Wage (NLW); or 23 per cent of all individuals entitled to this rate. This is an increase of around 30,000 on the previous year's level of underpayment of the NLW, or a two-percentage point rise in the share of workers entitled to the rate. Although our estimate is subject to several caveats, it is consistent with a trend of increasing underpayment since the introduction of the NLW in 2016. Underpayment of other rates of the NMW is lower than for the main NLW rate, with the exception of the Apprentice Rate.

There are modest variations in the likelihood of being underpaid across different groups. A higher proportion of women are underpaid the NLW than men; and the youngest and oldest NLW workers are more likely to be underpaid than other age groups. There is a higher rate of underpayment in micro-level firms than in larger employers. The largest numbers of underpaid individuals work in hospitality, retail and cleaning and maintenance; but childcare continues to be the occupation with the highest proportion of underpaid workers. A third of all underpaid workers are based outside of the commonly accepted low-paying occupations.

Compliance with the NMW is enforced by HM Revenue and Customs (HMRC), whose capabilities have grown considerably in recent years due to budget increases since 2016 and the recruitment of more enforcement officers. The number of workers HMRC identified as underpaid; the amount of arrears paid to workers; and the fines levied on non-compliant employers all increased considerably to reach record levels in 2017/18. These increases were driven primarily by a relatively small number of large and complex cases, mainly involving employers in the retail sector. Stakeholders have suggested to us that HMRC is targeting large employers; it is true that the resource given to large and complex cases has increased in recent years. However, figures for 2017/18 suggest that such cases were driven by reactive rather than targeted enforcement. The total number of investigations closed by HMRC, the number of targeted investigations and their success rate in identifying arrears, remained consistent with previous years, reflecting (HMRC told us) the time needed to train and integrate new recruits into the workforce.

The number of complaints received by HMRC regarding NMW underpayment rose in 2017/18 but still looks small when compared to the statistical estimates of underpayment, reflecting the communications challenge with workers. Employers often complained to us about the opacity of NMW guidance and of the HMRC enforcement process. In this respect, we see the recent consultation by the Department for Business, Energy and Industrial Strategy on the NMW regulations as a positive step in meeting employers' concerns, but one that needs to be sustained by continued positive engagement with employers of all sizes.

The recommendations we make in this report focus primarily on the communications challenge, which is critical in ensuring the enforcement system protects workers. But we are sensitive to employers' concerns around how the enforcement process currently operates and will continue to monitor HMRC's activity for evidence that their resources are being used effectively and fairly.

- We urge the Government to use all available opportunities to improve the measurement of underpayment, and to investigate new methodologies for assessing the scale of non-compliance.
- We recommend that the Government continues to invest strongly in communications to workers.
- We urge the Government to consider how to build confidence in the complaints process, and to work with trade unions to understand the current barriers to reporting.
- We recommend that the Government's communications should build confidence in the third-party complaints process, including via guidance or case studies around successful complainants. We urge the Government to work closely with Acas, trade unions and other bodies to achieve this.
- We urge the Government to invest time in getting the guidance to employers right, as this will simplify the task of enforcement in the longer term.

- We recommend that the Government restart regular naming rounds to create momentum, increase coverage and allow stakeholders more time to prepare and support.

Introduction

1. We, the Low Pay Commission (LPC), make recommendations on the levels of the National Living Wage (NLW) and the National Minimum Wage (NMW) each year. We look in detail at the labour market in general and at low-paying sectors in particular, and hear evidence from workers and employers affected by the minimum wage.

2. Since our formation, we have taken an interest in the practical workings of the minimum wage, its administration and enforcement. The policy is only as effective as the mechanisms which deter and penalise non-compliance, and the level of the minimum wage would be immaterial if it were not effectively enforced. At issue here are the rights of low-paid workers as well as the need to ensure employers are not undercut by competitors' underpaying staff. This is why we report on this aspect of minimum wage policy, and have regularly made recommendations to Government to increase compliance and improve enforcement.

3. Until 2016, these reports were published as a chapter of our main report on the NMW. In October 2017, for the first time, we published a stand-alone report on non-compliance and enforcement of the NMW, with ten recommendations for the Government. This is the second such report, and it draws on our experience, analysis and the evidence we have heard since we launched our 2018 consultation on NLW and NMW rates in April of last year.

4. Since its introduction in 2016, the NLW has had a significant impact on the labour market, and not only on the individuals who are paid at the rate. The coverage of the NLW[1] increased from just over 1 million workers in 2015 to around 1.6 million in 2016. Subsequent upratings have not resulted directly in increased levels of coverage. In 2018 coverage

[1] Throughout this report, we define the coverage of a given rate as the total number of individuals paid up to and within 5 pence of the rate.

remained at 1.6 million or 6.5 per cent of the total workforce. We have though seen increasing numbers of workers being paid at a rate just above the NLW – with 630,000 individuals earning between 10 and 20 pence above the rate. There is a strong chance that future increases will increase coverage, and the number of individuals at risk of being underpaid, still further. All of this makes it ever more important that the Government has the right tools in place to promote compliance and to identify and rectify underpayment.

5. This report assesses the scale and nature of non-compliance and looks at the characteristics of the individuals who are underpaid the minimum wage. In both of these areas, we are conscious of the limitations of the available data. We have imperfect measures, in particular because they do not cover the informal economy where the most serious underpayment is likely to be located. But the data is still a valuable means of tracking whether the problem is getting better or worse overall, and whether certain groups are more likely to find themselves underpaid. We then consider evidence on the Government's enforcement activities. In both sections, we use the most recent data available – the year up to April 2018.

6. We cannot tell from the data alone the extent to which the underpayment we identify is intentional; that is, whether employers are underpaying their workers knowingly rather than accidentally. A large number of underpaid workers were paid within only a few pence of the proper NLW rate. But we estimate that 135,000 individuals (37 per cent of all underpayment) were paid under £7.20 (the introductory NLW rate in 2016) and, as already noted, it is likely that the most serious underpayment is not captured in the data. Salaried workers – for whom it may be difficult to work out a simple hourly rate – experience higher levels of underpayment, suggesting complexity of calculation is a factor. But negligent – rather than intentional – underpayment is still underpayment and denies workers their rightful income. In this report, we examine the information challenge for both employers and workers.

7. Responsibility for non-compliance and enforcement of the minimum wage is divided between the Department for Business, Energy and Industrial Strategy (BEIS) and HM Revenue and Customs (HMRC); broadly, the former sets policy and priorities and the latter carries them out. Acas also play an important role as a point of contact and advice for underpaid workers. We have heard evidence from BEIS and HMRC in producing this report. Since the appointment of Sir David Metcalf as the Director for Labour Market Enforcement

(DLME), he has taken a key role in setting the strategic objectives for NMW enforcement and reviewing the Government's enforcement approach. In our own considerations on non-compliance and enforcement, we have taken account of the DLME's recent and forthcoming reports and strategies; we believe that the DLME's view of the priorities for NMW enforcement overlap substantially with our own and will continue to engage closely with him and his office to understand and assess the Government's work in this area.

Chapter 1

Nature and extent of underpayment

How we estimate underpayment

1.1 The Annual Survey of Hours and Earnings (ASHE) is the most detailed and comprehensive source of earnings information available and is based on a one per cent sample of all UK employees drawn from HM Revenue and Customs (HMRC) Pay As You Earn (PAYE) records. ASHE enables us to provide a proxy measure of both the scale and nature of non-compliance, estimating the percentage of workers who were paid below their age-relevant rate at the time of the survey.

1.2 However, this will not give a true estimate of non-compliance for a number of reasons. Some cases of underpayment can be legitimate: for example, because of the Accommodation Offset (where employers can offset a certain amount of rent if they provide accommodation); commission and bonuses (which count towards the NMW but may not have been paid in the reference pay period); piece rates (where special arrangements exist); and apprentices (ASHE estimates of the number of apprentices are much lower than the Department for Education's records suggest). Equally, some underpayment – for example, resulting from deductions to pay through salary sacrifice – will not be shown in ASHE. In addition, employers who are knowingly non-compliant are unlikely to admit this in the survey. And importantly when discussing estimates of underpayment, ASHE is unlikely to include data on the informal economy, where we would expect to find a large share of non-compliance.

1.3 The findings of this report make clear the importance of having a confident estimate of the total amount of underpayment, particularly in the context of the Government's ambitions for the future of the NLW. We are aware that the Director for Labour Market Enforcement (DLME) has looked at the scope for new methods to establish the scale of non-compliance. **We urge the Government to use all available opportunities to improve the measurement of underpayment, and to investigate new methodologies for assessing the scale of non-compliance.**

1.4 There is also an additional ASHE-specific data issue relating to the timing of the survey to consider: the survey is conducted each April, but the date in April changes annually and can affect the number of workers recorded as paid below the minimum wage, as employers are not legally required to increase pay until the first full pay period after the uprating of the minimum wage. A survey date earlier in the month, as occurred in 2016 and 2018, will therefore result in a larger number of workers – for example, those paid monthly – identified as compliant with the previous rate but paid below the new rate. On the other hand, a later survey date, such as in 2017, will result in fewer legitimately recorded as underpaid, as most people will have experienced a pay period following the 1 April uprating. The Office for National Statistics (ONS) identify these cases via a flag on the microdata which enables us to produce a more accurate estimate. More detail is provided on this issue in an annex at the end of the report.

1.5 Table 1 sets out our estimate of levels of underpayment using the ASHE data. In April 2018, we estimate that 439,000 individuals were paid less than they were entitled. This equates to more than 22 per cent of all individuals covered by the rates. For the NLW, the relevant figures were 369,000, or 23 per cent of all those covered by the rates. The rates of measured underpayment for other NMW rates were lower, with the exception of the Apprentice Rate, where more than a quarter of individuals covered by the rate were underpaid.

Table 1: Estimated underpayment of the minimum wage by rate, UK, 2018

Rate	Coverage	Estimated underpayment (excluding ASHE survey timing cases)	
		Number	As a share of coverage (%)
NLW	1,604,000	369,000	23.0
21-24	167,000	35,000	21.1
18-20	119,000	23,000	19.3
16-17	40,000	4,000	9.0
AR	32,000	8,000	25.4
Total	**1,961,000**	**439,000**	**22.4**

Source: LPC estimates using: ASHE 2010 methodology, low pay weights, low pay flag, UK, April 2018.

1.6 In our 2017 non-compliance report we highlighted the implications of the NLW's introduction for measuring underpayment. The move to a cycle where the NLW and NMW rates are uprated in April (rather than in October, as occurred previously) means the rate increases coincide closely with the month of ASHE. The result is that we now effectively measure underpayment at the point immediately after an uprating – likely to be its highest point in the year, with much of the identified underpayment a result of employers taking time to respond to the new rates. Prior to 2016 we measured April survey data against an uprating six months earlier, in October, which resulted in substantially lower rates of underpayment at the point of measurement.

1.7 To help place this timing issue in perspective, we also look at an alternative measure of underpayment derived from the Labour Force Survey (LFS). This household survey covers a wide range of information: it is a less reliable source of information on income, as pay and hours data are self-reported (and individuals may be prone to rounding or mis-recording the numbers they report), as opposed to the employer-based ASHE. On the plus side, a household survey is more likely to pick up people working in the informal economy than a survey of businesses.

1.8 The LFS data show both higher coverage and higher underpayment figures than in ASHE, but we consider it an unreliable measure of absolute levels of minimum wage pay or non-compliance. However, the quarterly nature of the LFS allows us to monitor the pattern of underpayment across the year, whereas the ASHE takes place only in April each year. The LFS shows that, following an April peak, underpayment declines in the subsequent periods. Despite its flaws, the LFS offers a consistent time series that enables us to identify within-year patterns in underpayment and how they relate to our minimum wage upratings.

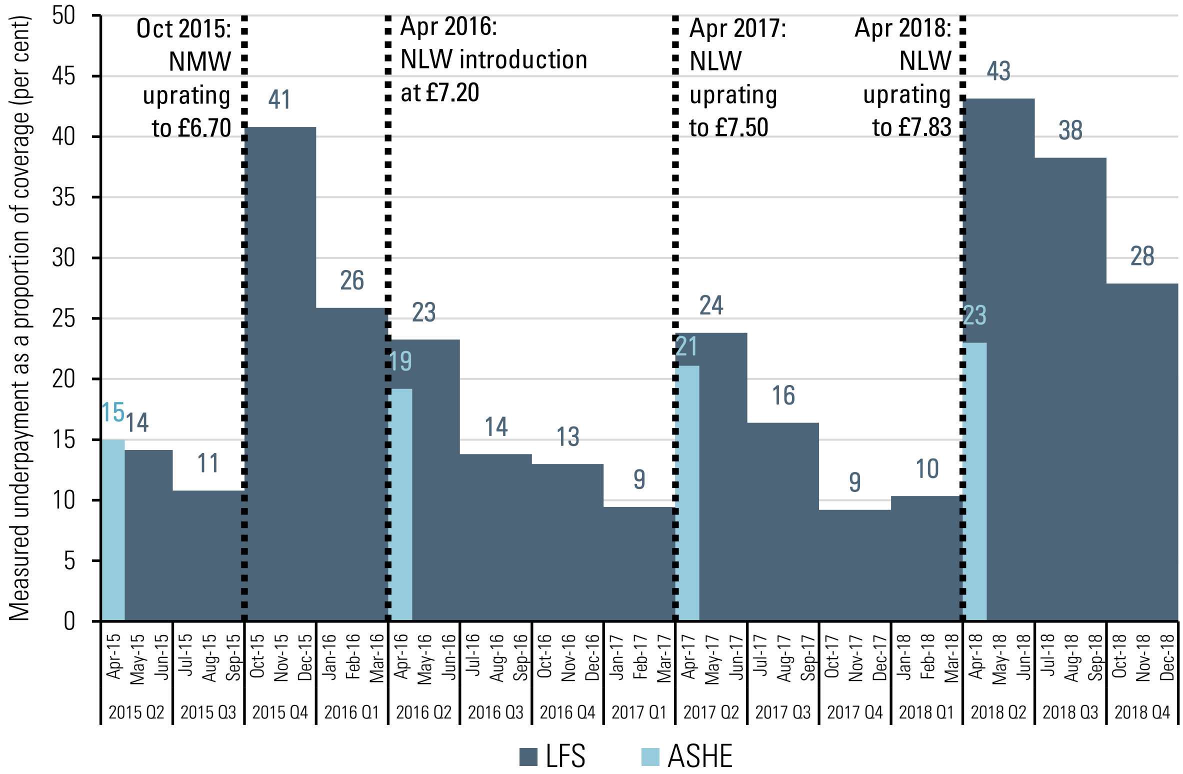
Overall levels of underpayment

1.9 As set out above, our best estimate from ASHE data (excluding survey timing cases) is that in April 2018 up to 439,000 individuals were paid less than they were legally entitled to – or 22.4 per cent of all individuals paid at the NLW or other NMW rates. In the analysis which follows, while we will note how many young workers are underpaid their respective NMW rates, we will focus primarily on workers aged 25 or over who are underpaid the NLW; this is the largest group and the one for whom we can produce the most reliable estimates.

1.10 This level of non-compliance was an increase over the previous year and the highest level recorded to date. ASHE data shows a steadily rising level of underpayment since the introduction of the NLW. For the NLW population, we estimated in April 2016 that a total of 305,000 individuals, or 19 per cent of total coverage, were underpaid. In April 2017, this had risen in absolute terms to 339,000, and as a proportion of coverage to 21 per cent. This year, the absolute level has risen again to 369,000 or 23 per cent of coverage.

1.11 Figures 1 and 2 show a comparison between the annual ASHE and quarterly LFS estimates of non-compliance. LFS data clearly illustrates the frictional nature of underpayment, at its highest in Q2 at the point of uprating before declining in subsequent quarters as employers who are slow to adjust become aware of and respond to the new minimum rates of pay. In terms of annual changes, the LFS data shows a more pronounced increase in underpayment in April 2018 compared with ASHE, to 43 per cent of coverage, or nearly a million individuals. What is more, although the level of recorded underpayment fell through Q3 and Q4, it initially fell at a slower rate and remained considerably higher than at the same points in previous years – and still higher than the figures recorded in ASHE.

Figure 1: Estimates of rates of underpayment as a proportion of NLW coverage, 2015-2018, workers aged 25 and over



Source: LPC estimates using ASHE and LFS:
Notes:
a) Annual Survey of Hours and Earnings, 2010 methodology, low pay weights, UK, 2015-18
b) Labour Force Survey, income weights, quarterly, not seasonally adjusted, UK, 2015Q2 - 2018Q4

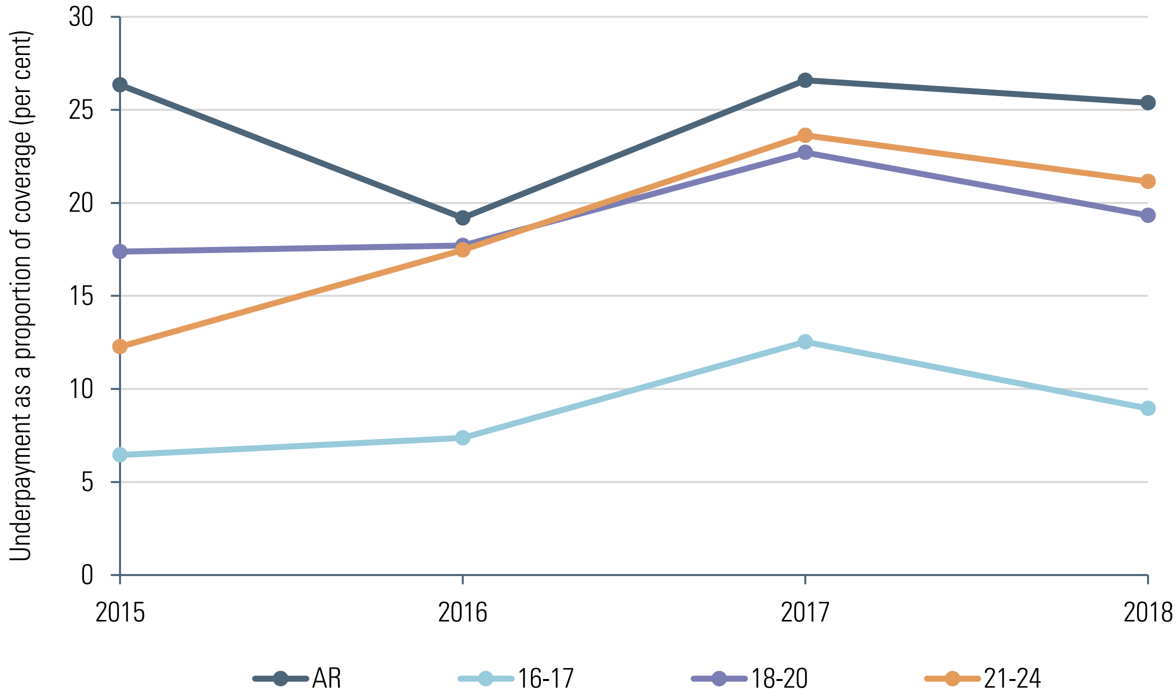
Figure 2: Estimates of number of underpaid workers, 2015-2018, workers aged 25 and over

Source: LPC estimates using ASHE and LFS:
Notes:
a) Annual Survey of Hours and Earnings, 2010 methodology, low pay weights, UK, 2015-18
b) Labour Force Survey, income weights, quarterly, not seasonally adjusted, UK, 2015Q2 - 2018Q4

1.12 We have already noted the unreliability of estimating levels of underpayment from LFS data. However, the large increase in the level of underpayment and the gap between the LFS and ASHE estimates are striking; in previous years, there was significantly less disparity, and by Q3 the LFS figure had fallen to about the level of the ASHE figure. The 2018 difference may be caused by a higher than usual degree of error in this year's LFS; or it might reflect a spike in underpayment in the informal economy, which ASHE would fail to pick up.

1.13 As shown in Figure 3, levels of underpayment of the other rates of the NMW declined slightly between April 2017 and April 2018; and (with the exception of the Apprentice Rate) are less than the NLW underpayment rate. In previous reports, we have highlighted the problem of non-compliance with the Apprentice Rate as a particular concern; this is again evident in the 2018 ASHE data and is something we will come back to in our review of the Apprentice Rate and analysis of the forthcoming Apprenticeship Pay Survey. ASHE data suggests that underpayment of the 16-17 Year Old Rate is less common than with the NLW at 10 per cent of coverage. However, results for both apprentices and 16-17 year olds are likely to be less robust as a result of small ASHE sample sizes. Around one in five 18-20 and 21-24 year olds covered by the minimum wage are paid below their respective rates; the likelihood of such underpayment grows as workers become older and the rate to which they are entitled increases.

Figure 3: Underpayment of youth rates as proportion of coverage, 2015-2018

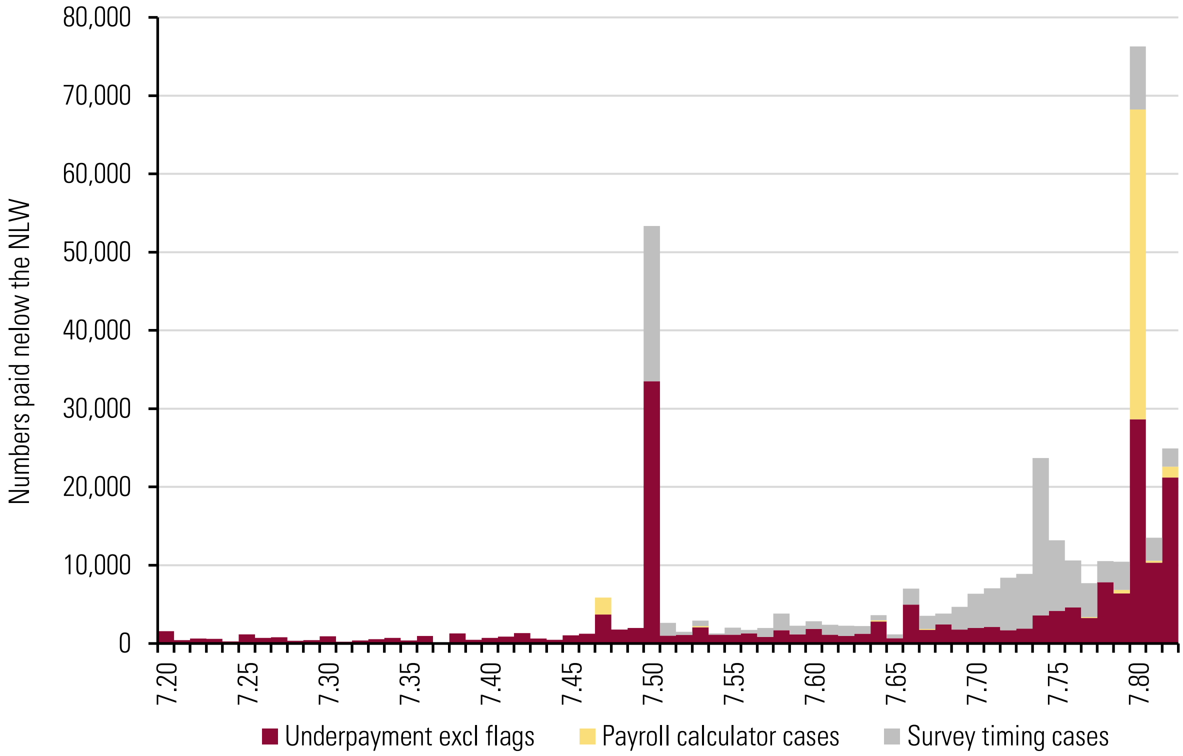


Source: LPC estimates using: ASHE 2010 methodology, low pay weights, low pay flag, UK, April 2015-18.

1.14 ASHE not only gives an indication of the number of workers underpaid, but also the extent to which they were underpaid. Figure 4 shows how underpayment for those aged 25 and over was distributed in April 2018 from the introductory NLW rate of £7.20 in April 2016.to the newly increased rate of £7.83 in April 2018. The major underpayment spikes are found at £7.50 (the rate up to April 2018) and £7.80, just below the prevailing rate of £7.83[2].

[2] The Office for National Statistics (ONS) have identified that 40,000 of these workers have a monthly pay period that should have a derived rate of exactly the NLW, but whose actual rate is slightly different due to it being calculated on exactly 52 weeks per year rather than 52.18 (365.25/7).

Figure 4: Hourly earnings distribution from £7.20 to the NLW, employees aged 25 and over, UK, 2018



Source: LPC estimates using: ASHE 2010 methodology, low pay weights, low pay flag, payroll calculator flag, UK, April 2018.

1.15 More than one third of underpaid workers (around 130,000 individuals) are paid within 10 pence of the 2018 NLW rate, of whom 116,000 (31 per cent of total underpayment) are paid within 5 pence of £7.83. A significant proportion of underpayment is therefore relatively minor. But equally, it is important to note that this chart does not cover the 135,000 individuals (37 per cent of the total) who were paid below £7.20 – these form a long, low tail of underpayment with no significant spikes. We come back to these individuals in our consideration of the characteristics of underpaid workers.

Conclusion

1.16 For many years, the overall level of underpayment of the NMW was reasonably constant. Since the introduction of the NLW in April 2016, this has changed; following that initial increase from £6.70 to £7.20, the total amount of measured underpayment nearly doubled, although this can be partly explained by the point in the cycle at which we now measure underpayment. We have, however, seen figures increase in subsequent years, suggesting this is not just a measurement issue. The number of underpaid workers has increased at a steady rate in both total terms and as a proportion of workers paid at or near the NLW. And there are more workers paid significantly below the NLW (135,000 in 2018 paid less than £7.20 with an NLW of £7.83, compared to 130,000 in April 2017 with an NLW of £7.50). In addition, LFS data indicates that the 2018 spike in underpayment immediately after the uprating has not fallen between Q2 and Q3 as much as we would expect based on previous years.

1.17 In our recent consultations, we have heard about the adjustments which businesses have had to make to adapt to the NLW. This has included squeezing the differentials between staff paid at the minimum wage and those paid just above; restructuring workforces; and raising prices. So far, we have not noted an impact on workers' jobs and hours. However, the data reveals another possible adjustment on the part of businesses, which has not emerged through our consultations; underpaying their workers. This makes it imperative that there is effective enforcement of the minimum wage, to support the policy's aims. We return to this issue in chapter three.

Chapter 2

Groups and workers affected by underpayment

2.1 In this section we look in more detail at the characteristics of underpaid workers, to better understand the types of individuals who are most likely to be affected by underpayment and to help understand where the increases might be coming from. As already noted, our analysis focuses on the 25+ NLW population as the group with the highest absolute level of underpayment. The NLW group is also sufficiently large enough to allow us to robustly disaggregate it using ASHE across a range of characteristics. This is not the case with, for example, the population underpaid the Apprentice Rate, although they have a higher relative level of underpayment[3].

2.2 Table 2 looks at the numbers of workers in April 2018 covered by the NLW and sets out the numbers of those underpaid by gender, age and whether they worked part-time or full-time. Looking firstly at the gender composition, we find that while they comprise around half of all workers, women are more likely to be in low-paid employment (62 per cent of NLW coverage) and more likely to be underpaid (64 per cent of underpayment) than their male counterparts. This means there are over 100,000 more women underpaid the NLW than there are men. In 2018 around 24 per cent of female low-paid workers were underpaid, an increase from 22 per cent in 2017 and 20 per cent in 2016. The figures for males are around 2 percentage points lower than women over the same period.

2.3 Over 60 per cent of the low-paid work part-time. The share of workers underpaid the NLW is split more evenly, with 52 per cent of total underpayment found among part-time

[3] We will look in more detail at underpayment of apprentices later this year using data from the forthcoming Apprentice Pay Survey.

workers and 48 per cent among those working full-time. As a result, when measuring underpayment as a share of coverage the rate is lower for part-time workers (20 per cent) than full-timers (29 per cent).

2.4 When it comes to age there is little variation across age groups between the proportion of low-paid workers and the share of underpaid workers. As a result, we find similar rates of underpayment as a share of coverage across all age groups (22-25 per cent). The largest increases in this measure, compared with 2017 figures, are for 25-29 year olds and 60-64 year olds who both saw increases of 4 percentage points to 24 per cent and 25 per cent in the share of coverage that were underpaid.

Table 2: Underpayment by age, gender and full-time/part-time, 25+, UK, 2018

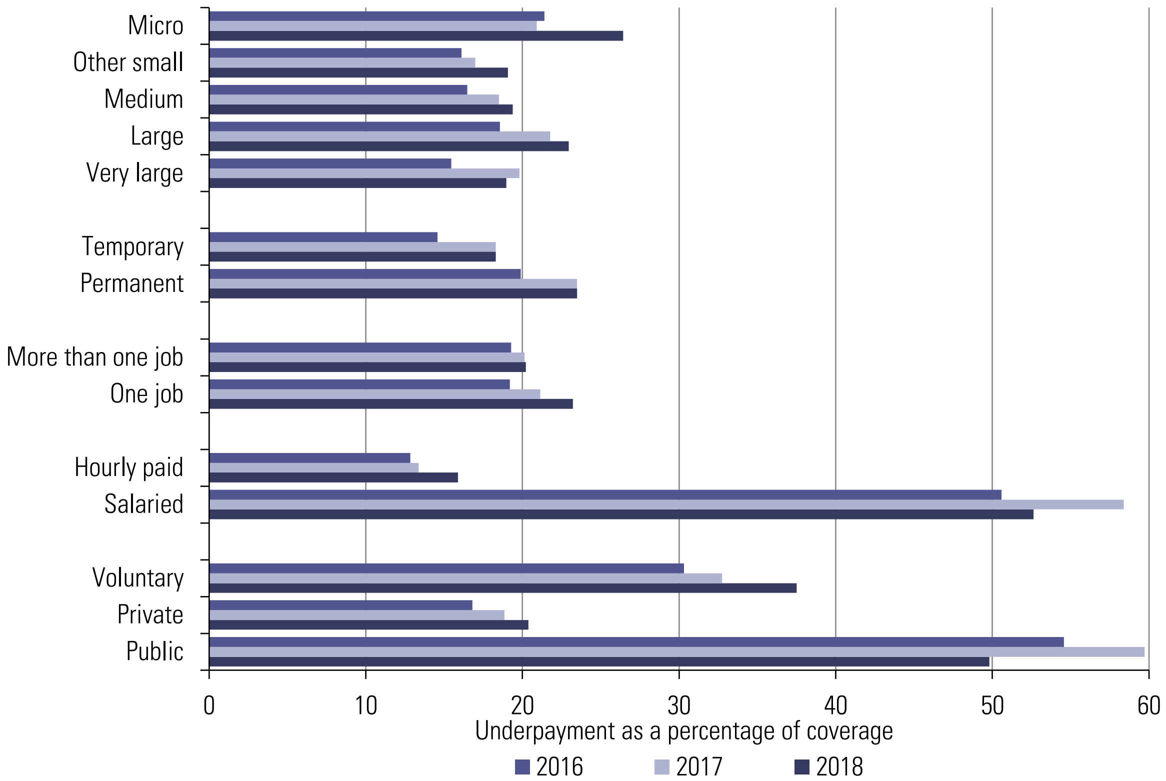
Characteristic	Low-paid workers (coverage)	Share of workers covered (%)	Underpaid workers	Share of underpaid workers (%)	Underpaid as a share of coverage (%)
Female	997,000	62.1	236,000	63.9	23.6
Male	607,000	37.9	133,000	36.1	21.9
Part-time	981,000	61.1	191,000	51.8	19.5
Full-time	624,000	38.9	178,000	48.2	28.5
25-29	253,000	15.8	61,000	16.4	24.0
30-39	398,000	24.8	87,000	23.7	22.0
40-49	381,000	23.7	84,000	22.6	21.9
50-59	367,000	22.9	88,000	23.7	23.9
60-64	124,000	7.7	31,000	8.4	24.9
65+	82,000	5.1	19,000	5.1	22.9
Total	**1,604,000**	**100.0**	**369,000**	**100.0**	**23.0**

Source: LPC estimates using: ASHE 2010 methodology, low pay weights, UK, April 2018.

2.5 Figure 5 shows the prevalence of underpayment across a variety of kinds of employer and working arrangement. The highest level of underpayment is found in micro-level employers (those with 9 or fewer workers), where 26.4 per cent of minimum wage workers, or 86,000 individuals, are underpaid. In the largest employers (those with 5,000 or more workers), the equivalent figure is 19 per cent. This is one of the few such measures to have declined, albeit slightly, from the previous year. We have heard frequently from stakeholders that the compliance challenge is more difficult for smaller employers, with less resource to give to compliance checks. It should be noted, though, that large employers (with between 250 and 4,999 workers) have the next highest level of underpayment (23 per cent), suggesting the problem is not solely one of resource.

2.6 Underpayment is also more prevalent for low-paid workers on permanent rather than temporary contracts (23.5 per cent versus 18.3 per cent of coverage). And it is substantially more likely for low-paid salaried workers[4] than for those paid hourly (52.6 per cent versus 15.9 per cent, although the former number fell significantly between 2017 and 2018). In terms of levels this equates to 163,000 of the 310,000 low-paid salaried workers being underpaid. If a worker has a simple hourly rate, it is easier for both worker and employer to know that pay is above the minimum wage. The more pay is calculated over a reference period, the more likely it is that underpayment is hidden. Increasingly, we have heard from low-paid workers who are reluctant to accept a salary rather than hourly pay rates, precisely because of the risk of underpayment when employers demand they work more hours. We will be paying particular attention to this trend in our 2019 consultation.

Figure 5: Underpayment as a proportion of coverage by characteristics, 25+, UK, 2016-18



Source: LPC estimates using: ASHE 2010 methodology, low pay weights, UK, April 2016-18.
Note: Employer size data excludes public sector employees.

[4] The definition of a salaried worker used here is a proxy measure, capturing those who are not paid an hourly rate.

Table 3: Underpayment by employment characteristics, 25+, UK, 2018

Characteristic	Low-paid workers (coverage)	Share of workers covered (%)	Underpaid workers	Share of underpaid workers (%)	Underpaid as a share of coverage (%)
Micro	325,000	20.3	86,000	23.3	26.4
Other small	307,000	19.2	59,000	15.9	19.1
Medium	231,000	14.4	45,000	12.1	19.4
Large	358,000	22.3	82.000	22.3	23.0
Very large	300,000	18.7	57,000	15.4	19.0
Temporary	165,000	10.3	30,000	8.2	18.3
Permanent	1,425,000	88.8	335,000	90.8	23.5
More than one job	126,000	7.9	25,000	6.9	20.2
One job	1,478,000	92.1	343,000	93.1	23.2
Hourly paid	1,294,000	80.7	206,000	55.7	15.9
Salaried	310,000	19.3	163,000	44.3	52.6
Voluntary	105,000	6.6	40,000	10.7	37.5
Public	81,000	5.0	40,000	10.9	49.8
Private	1,418,000	88.4	289,000	78.4	20.4
Total	**1,604,000**	**100.0**	**369,000**	**100.0**	**23.0**

Source: LPC estimates using: ASHE 2010 methodology, low pay weights, UK, April 2018.
Notes:
a. Firm size excludes public sector workers.
b. Contract type (permanent/temporary) excludes unknowns.

2.7 The number of public sector workers covered by the NLW is small: just 80,000 individuals out of total coverage of 1.6 million. (This figure does not include the large numbers of people who work for charities or private sector companies delivering outsourced but publicly-funded services.) The high rate of underpayment in the public sector should be considered in this context, but is nevertheless hard to explain. Low-paying occupations included in the public sector include childcare, cleaning and maintenance and hospitality – although around half of all low-paying public sector jobs are in non-low-paying occupations.

2.8 In our report into one-sided flexibility, published in December (Low Pay Commission, 2018b), we looked closely at the experiences of workers on zero-hours and short-hours contracts. ASHE does not specifically record this metric, covering instead a wider definition of non-guaranteed hours arrangements, but using LFS data shows that zero-hours workers are less likely to be underpaid than those not on such contracts (with 27 per cent of covered zero-hours workers underpaid versus 44 per cent otherwise). This seems consistent with the findings in ASHE that workers paid hourly or working part-time are less likely to be underpaid than their salaried, full-time counterparts.

2.9 Table 4 shows the numbers of underpaid workers in different low-paying occupations. The likelihood of underpayment varies substantially between occupations. The sectors employing the largest numbers of low-paid workers – retail, hospitality and cleaning and maintenance – have the largest absolute numbers of underpaid workers (although the proportion of underpaid workers in each is below average). But childcare has by far the highest proportion of underpaid workers, with 43 per cent of all workers at the NLW – or 21,000 individuals – not receiving their minimum wage entitlement. The sharp year-on-year increase in underpayment of childcare workers may reflect the funding freeze the sector has faced in recent years. Stakeholders told us that the rising NLW has had a marked impact in a sector where on average over 70 per cent of business costs are on staff and where the funding levels have been frozen in the great majority of local authorities.

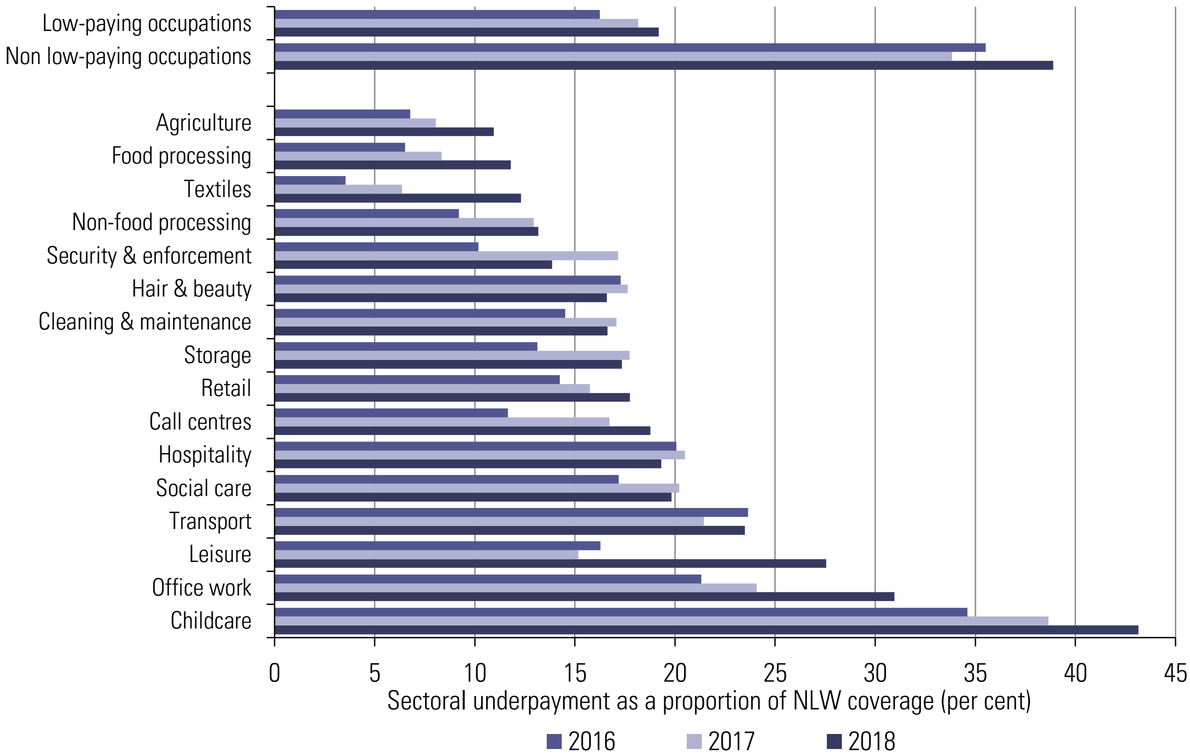
2.10 Whilst the majority of underpayment is found in occupations and sectors we define as low-paying, around 120,000 cases (approximately one third of underpayment) are in jobs in non low-paying occupations. And of the 30,000 increase observed in the level of underpayment in 2018 a disproportionate two-thirds came from non low-paying workers. Analysis of this group shows several occupations with relatively large shares of underpayment including personal assistants, other administrative occupations, teaching assistants, educational support assistants and nursing auxiliaries and assistants. Although not included within our usual definition of low-paying occupations, there are large numbers of jobs in these occupations that are low-paid, many of which are paid below the legal minimum wage. As Figure 6 shows, underpayment did not increase in all sectors: in hospitality, hair and beauty and security, for example, the proportion of recorded underpayment fell. Other sectors where there were marked increases included leisure and textiles (although only to a still relatively low level).

Table 4: Underpayment by low-paying occupation, 25+, UK, 2018

Occupation	Low-paid workers (coverage)	Share of all NLW workers (%)	Underpaid workers	Share of all underpaid workers (%)	Underpaid as a share of coverage (%)
Childcare	49,000	3.1	21,000	5.7	43.2
Office work	43,000	2.7	13,000	3.6	31.0
Leisure	23,000	1.5	6,000	1.7	27.5
Transport	66,000	4.1	15,000	4.2	23.5
Social care	94,000	5.8	19,000	5.0	19.8
Hospitality	231,000	14.4	45,000	12.1	19.3
Call centres	6,000	0.4	1,000	0.3	18.8
Retail	312,000	19.5	55,000	15.0	17.7
Storage	57,000	3.6	10,000	2.7	17.4
Cleaning & maintenance	237,000	14.8	39,000	10.7	16.6
Hair & beauty	24,000	1.5	4,000	1.1	16.6
Security & enforcement	16,000	1.0	2,000	0.6	13.9
Non-food processing	53,000	3.3	7,000	1.9	13.2
Textiles	7,000	0.5	1,000	0.2	12.3
Food processing	57,000	3.5	7,000	1.8	11.8
Agriculture	19,000	1.2	2,000	0.5	10.9
Non low-paying occupations	309,000	19.3	120,000	32.6	38.9
Total	**1,604,000**	**100.0**	**369,000**	**100.0**	**23.0**

Source: LPC estimates using: ASHE 2010 methodology, low pay weights, UK, April 2018.

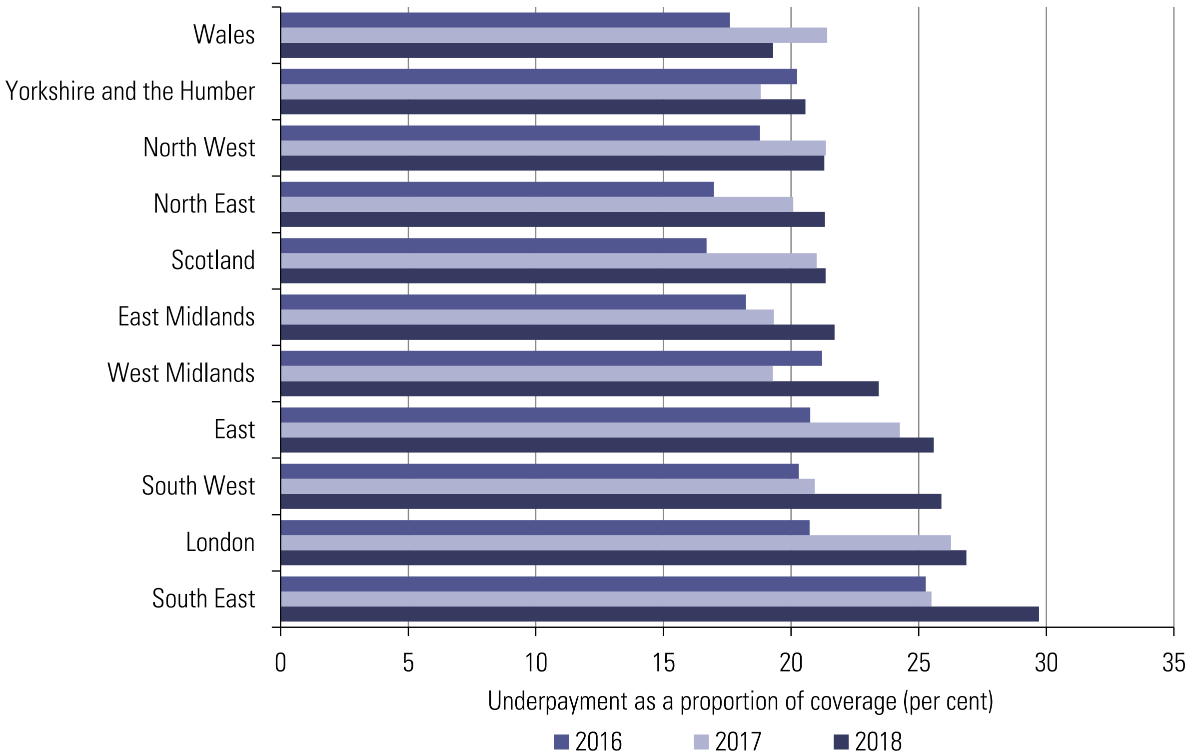
Figure 6: Underpayment as a proportion of coverage by occupation, 25+, UK, 2016-18



Source: LPC estimates using: ASHE 2010 methodology, low pay weights, UK, April 2016-18.

2.11 The regional breakdown at Figure 7 shows that underpayment is most common in London and the South East. There is a broad correlation between high shares of underpayment and low levels of coverage; in areas where more workers are paid at or around the minimum wage, they are more likely to be paid correctly. High coverage may lead to greater awareness of the rates and may mean that a greater number of workers are paid hourly, making underpayment less likely.

Figure 7: Underpayment as a proportion of coverage by nation and region, 25+, GB, 2016-18



Source: LPC estimates using: ASHE 2010 methodology, low pay weights, UK, April 2016-18.

2.12 Earlier, we noted that around 135,000 workers were paid less than £7.20, significantly below either the current or previous NLW rates and therefore much less likely to belong to the group affected by frictional underpayment – i.e. where employers are slow to respond to the change in rates. When we examine this tail of more significant underpayment, we find disproportionate numbers of workers that are full-time, salaried, from the public sector and from the East Midlands, the South West and the South East. Around half of full-time workers and salaried workers that are underpaid receive less than £7.20 per hour. And almost two-thirds of the 40,000 underpaid public sector workers received less than this figure, the NLW rate from April 2016.

CHAPTER THREE

Policy responses to non-compliance

Introduction

3.1 In this chapter, we assess what action the Government is taking to reduce non-compliance and enforce payment of the National Living Wage (NLW) and National Minimum Wage (NMW). As set out in the introduction to this report, responsibility for enforcement is held by HM Revenue and Customs (HMRC), while the Department for Business, Energy and Industrial Strategy (BEIS) set policy, priorities and funding. As the number of workers covered by the NLW has risen, the scale of enforcement activity has also increased. The budget allocated to HMRC's enforcement work has risen significantly in recent years, from £13.2m in 2015/16 to £20m the following year, £25.3m in 2017/18 and £26.3m in 2018/19. When we heard evidence from HMRC and BEIS in February 2019, they reported there were 435 enforcement officers, with 114 new staff recruited since April 2017.

3.2 Since we last reported on non-compliance, the Director of Labour Market Enforcement (DLME) published his 2018/19 strategy for labour market enforcement (Director of Labour Market Enforcement, 2018) in May 2018, setting out 37 separate recommendations for the Government, covering HMRC's NMW enforcement activities as well as the work of the Employment Agency Standards Inspectorate (EAS) and the Gangmasters and Labour Abuse Authority (GLAA). The DLME plays an important role in assessing and determining the policy response to non-compliance, setting annual strategies and reporting on Government's progress. We will continue to work closely with the DLME, sharing the evidence and recommendations on NMW underpayment which we gather in the course of our consultations and developing a common understanding of the enforcement challenge.

3.3 There are broadly two strands of policy response which we assess in this chapter. First, the Government works to make sure that employers are aware of the NMW and know what they must do to comply with it; and that workers know their rights and are empowered to assert them. Second is the work of identifying and investigating cases where workers are underpaid. This chapter first considers the Government's communications and engagement with both workers and employers; it goes on to look at the evidence on HMRC's enforcement activities in 2017/18, the most recent period for which data is available.

Promoting the minimum wage

Workers

3.4 A large proportion of HMRC's enforcement activity involves responding to complaints it receives about underpayment of the NMW. To a large extent, enforcement is dependent on the pipeline of information which the enforcement body receives from the workforce. Workers with a concern about underpayment have two routes available to contact the Government. They can either contact Acas by phone to seek advice; their enquiry may then be passed onto HMRC. Or, since January 2017, they have been able to use an online form to contact HMRC directly. HMRC aim to follow up all the enquiries they receive, via both channels. The total number of calls to Acas related to NMW underpayment, and the number of such calls passed onto HMRC, fell in 2017/18 to 4,430 and 1,980 respectively (from 4,660 and 2,310 in 2016/17). This fall was in line with a general decline in the overall number of calls to Acas on any matter. In the same period, 4,160 individuals used the online form to contact HMRC regarding the NMW. Use of the online form has driven an increase in the total number of individuals making contact with Acas and HMRC (9,150 in total, a 71 per cent increase on 2016/17).

3.5 BEIS continue to spend money on communications to workers around the minimum wage's annual uprating (£1.48m in their April 2018 campaign); and their research indicates that around nine in ten eligible workers are aware of the NLW. Nevertheless, there is an ongoing mismatch between overall levels of underpayment and the rate of reporting to HMRC. Crudely, the level of enquiries received by Acas and HMRC represents around 2 per cent of our estimate of 439,000 underpaid workers.

3.6 There are several obstacles to underpaid workers identifying and reporting their situation. They may be unaware of their right to the minimum wage, or not have access to information which would help to determine whether they are being underpaid. They may not be aware of the routes to make a complaint. Even if a worker knows she is being underpaid, she may be reluctant to press a complaint because of insecurity and the fear of losing work; and may not be aware of, or have confidence in, the confidentiality of the complaints process. Trade unions continue to report that many workers feel intimidated at the prospect of raising a complaint.

3.7 We have previously recommended that the Government carry out annual communications campaigns alongside the uprating in April, to raise awareness via all possible channels among workers of both the new rate and the routes for workers to report underpayment. Given the evidence that measured underpayment is at near-record levels, **we recommend that the Government continues to invest strongly in communications to workers**. As well as raising awareness, **we urge the Government to consider how to build confidence in the complaints process, and to work with trade unions to understand the current barriers to reporting underpayment**. At oral evidence, BEIS told us that they are working to evaluate the customer journey of individuals reporting underpayment. There is a link here to previous recommendations we have made on establishing intelligence systems which enable Government to learn as much as possible about the non-compliance which HMRC investigates. We will be interested to see the outcomes of this work.

3.8 In 2016, the LPC recommended that the Government establish a formal public protocol for the handling of third-party whistleblowing. The Government did not act on this recommendation, in part because of the legal barriers created by the necessary confidentiality of the HMRC enforcement process. We accept that there are limitations on HMRC's ability to feed information back to third-party whistle-blowers. But the underlying problem remains – that complainants are likely to be discouraged if they do not feel their reports are being responded to. **We therefore reiterate our 2017 recommendation that the Government's communications should counter this by building confidence in the third-party complaints process, including via guidance or case studies around successful complainants. We urge the Government to work closely with Acas, trade unions and other bodies to achieve this.**

Employers

3.9 Proactive communications to employers, making them aware of their responsibilities and aiming to deter underpayment, represent an increasingly important part of HMRC's activity. This has involved e-mail and text message campaigns; webinars to help move employers towards compliance; and, for limited periods, encouraging small businesses to approach HMRC directly for assistance with compliance checks. Employers taking advantage of this last offer did not receive penalties and were not publicly named if they had underpaid their workers.

3.10 HMRC are clearly reaching more employers than ever before, and their efforts to reach employers via new routes and put 'nudge' techniques into practice are commendable. But it is difficult to measure the practical effect of such interventions. HMRC have 'directly facilitated' 166,000 employers and workers accessing further information. But in a context where both coverage and non-compliance are rising, there is little way of knowing how much of the problem such figures represent. Our impression from visits and discussions with employers in 2018 was that the increase in HMRC's resources had translated into greater visibility in some sectors and regions – but this was not felt to be uniform across every sector.

3.11 Perhaps as a consequence of greater visibility, the accessibility of HMRC officials and their willingness to work with employers were a common theme in stakeholders' evidence. Alongside this, there were frequent complaints that the rules and guidance on various points were not clear; that HMRC officials were not able to apply sensible discretion, or did not do so consistently; or that in some cases the rules did not actually act in workers' favour (for example, in the rules around salary sacrifice and permitted deductions from pay). We heard repeatedly that a lack of clarity and consistency on guidance was leading to unnecessary confusion and cost. The risk of penalties and inclusion in naming rounds (discussed below) has also increased sensitivity over the clarity of guidance.

3.12 In respect of the regulations and HMRC's guidance to employers, we welcome BEIS's recent consultation on salaried workers and salary sacrifice schemes, and look forward to this being carried through in revised guidance. These were two areas where employers frequently expressed confusion, and it is clearly a positive step to clarify the guidance. But there remains work to do both in reviewing the guidance available to employers and considering how this is most effectively communicated to them – particularly to the very smallest employers among whom underpayment is most common.

3.13 Another common sentiment from employers was that the process of being investigated by HMRC could be opaque and arbitrary, and left many employers with the impression that HMRC officials were pursuing 'technical' breaches of NMW legislation – potentially at the expense of more serious non-compliance elsewhere. In their evidence to us, HMRC made the point that the aim of NMW legislation is to safeguard workers; and that there is no category of technical breach in the law, nor any distinction between accidental or deliberate underpayment. While this is, of course, correct, it is also the case that making the investigation process as transparent and clear as possible will be helpful for HMRC in the long run.

3.14 All of this underlines the importance of ensuring that the regulations work as they are intended; and that there is appropriate, accessible guidance in place to support employers in complying. On the latter point, we heard repeatedly from stakeholders that the minimum wage guidance accessible online was not sufficiently comprehensive or clear. **We urge the Government to invest time in getting the guidance to employers right, as this will simplify the task of enforcement in the longer term.** We also support the DLME's previous recommendations that HMRC review the guidance and information offered to employers. More generally, we are aware that the DLME has looked closely at how Government works with employers toward compliance: we look forward to seeing these recommendations being addressed.

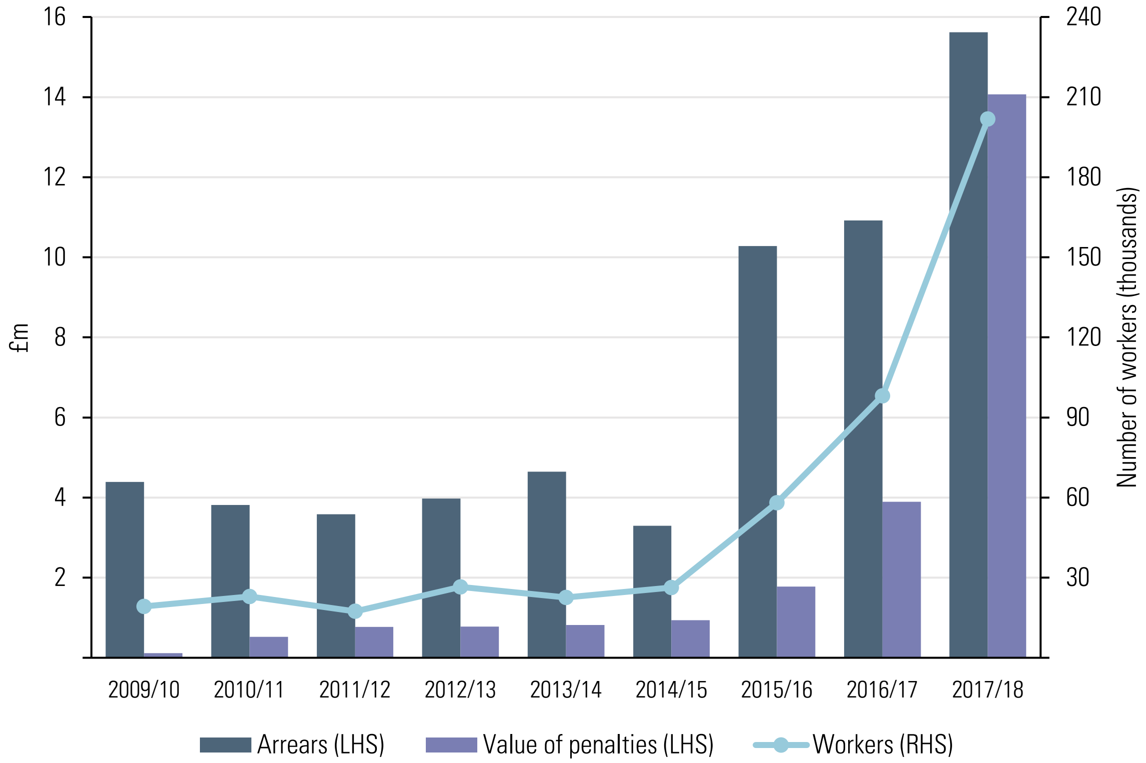
Enforcing the minimum wage

Headline figures

3.15 The main measures of HMRC's NMW enforcement are the number of cases opened and closed; the total amount of arrears identified; the total amount of penalties which HMRC levy on non-compliant employers; and the number of workers identified as having been underpaid. The data which HMRC and BEIS provide to the LPC for the latter three measures tracks these according to cases which are closed in a given financial year – and because the lifespan of cases can overlap year boundaries, the total numbers do not entirely reflect enforcement activity in the given period. They nevertheless offer a sense of the scale of HMRC's activity and the nature of the typical enforcement case.

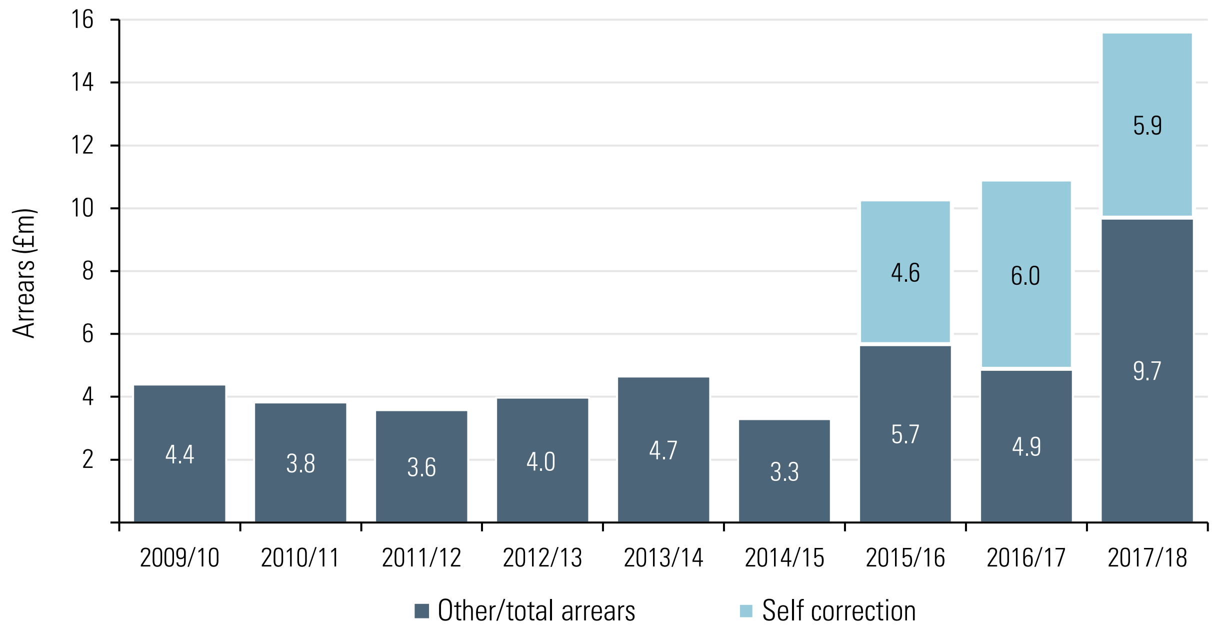
3.16 Figure 8 shows the total amount of arrears and penalties resulting from HMRC enforcement cases, alongside the number of workers identified in such cases. On all three measures, 2017/18 was HMRC's most prolific year to date, with over £15.6m of NMW arrears identified, an increase of over 40 per cent on the figure for 2016/17. More than £14m of penalties were levied on underpaying employers, reflecting the increase in the NMW ‘penalty multiplier’ (the maximum fine HMRC can levy for non-compliance) to 200 per cent, brought into effect for arrears since April 2016. Finally, the number of underpaid workers identified more than doubled to just over 200,000.

Figure 8: Amounts of underpaid workers identified by HMRC enforcement, arrears repaid through enforcement and penalties imposed on non-compliant employers, 2009/10 to 2017/18



Source: LPC analysis using data from ‘National Minimum Wage: Government evidence to the LPC’.

Figure 9: Amount of arrears identified for payment by self-correction and other means, 2009/10 to 2017/18



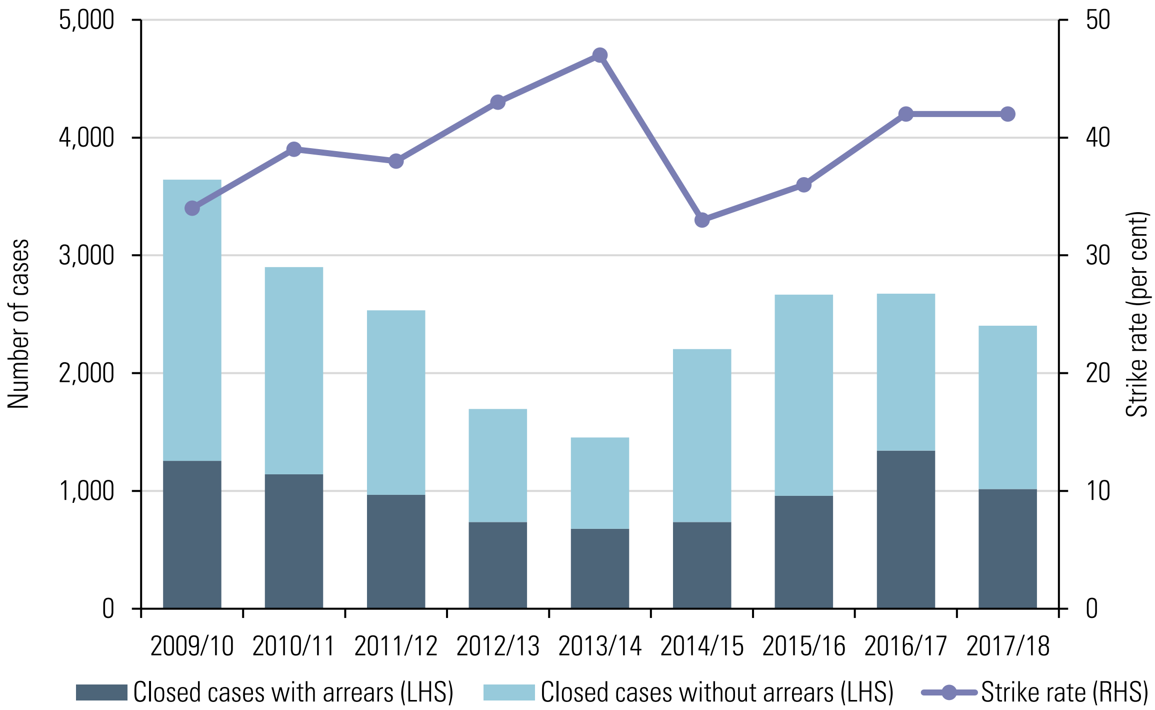
Source: LPC analysis using data from 'National Minimum Wage: Government evidence to the LPC'.

3.17 Since 2015, the balance of successfully closed cases has been made up of both those where HMRC has enforced the payment of arrears and penalties, and those where, in response to a complaint, employers have 'self-corrected' underpayment and made good on arrears to their workers. In principle, this enables HMRC to take a more light-touch approach and allocate resources to tougher cases; and allows employers to avoid penalty fines via cooperation. The amount of arrears paid via self-correction in 2017/18 remained consistent with the previous year's figure, at £5.9m or 38 per cent of total arrears. The increase in arrears across years was therefore driven by the increase in cases where HMRC have had to carry out full enforcement.

3.18 Despite this increase in headline figures, HMRC's overall caseload (the number of cases opened and closed each year) and its 'strike rate' (the proportion of cases successfully closed with arrears identified) have remained steady in recent years and not increased significantly over the long-term. The number of cases closed has been reasonably consistent since 2014/15, while the number of cases resulting in payment of arrears was level at 42 per cent in both 2016/17 and 2017/18. Alongside the sharp increase in underpaid workers and arrears identified, this shows a shift in the type of case which HMRC are taking on, towards larger cases which may involve thousands of workers and present new kinds of complexity. HMRC told us that the number of cases opened and closed is likely to increase in subsequent years, as newly recruited enforcement officers are trained and fully integrated into their workforce.

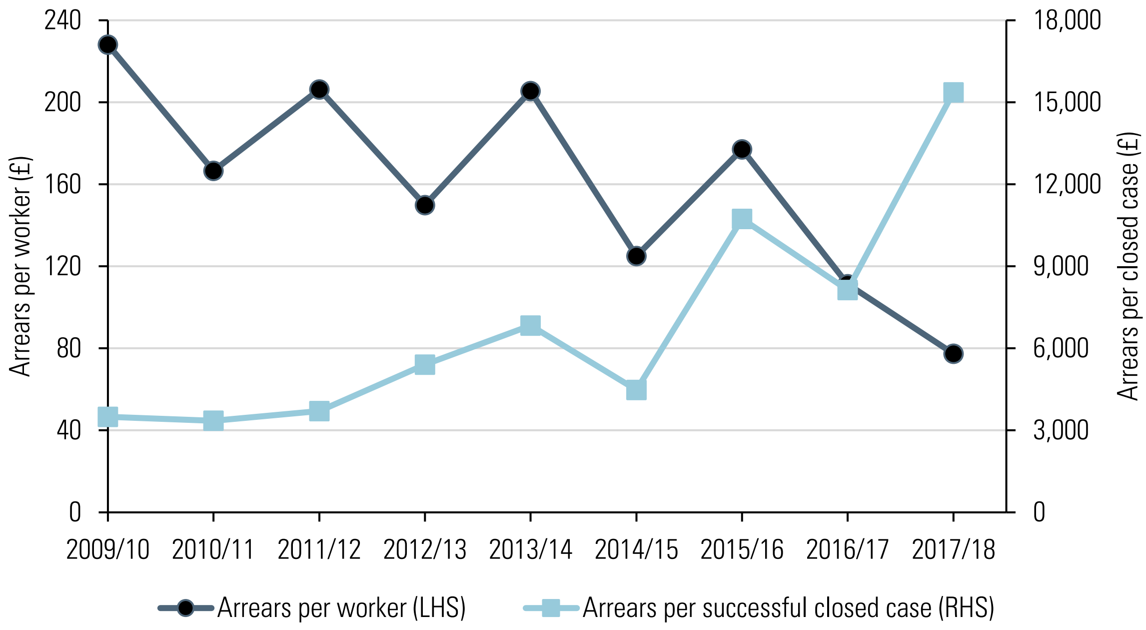
3.19 Two key measures in our analysis are how many workers, on average, are involved in each case; and the average arrears per worker. Figure 11 shows that the first of these measures has been in decline since 2016, with the average worker involved in an HMRC enforcement case receiving £77.39 in 2017/18 – this figure was almost £100 higher in 2015/16. On the other hand, the total average arrears per case jumped in 2017/18 to an unprecedented £15,370, reflecting the fact that HMRC's cases are increasingly sweeping up larger numbers of individuals than ever before.

Figure 10: Number of NMW investigation cases closed by HMRC with and without arrears and strike rate, 2009/10 to 2017/18



Source: LPC analysis using data from 'National Minimum Wage: Government evidence to the LPC'.

Figure 11: Average arrears per case and per worker



Source: LPC analysis using data from ‘National Minimum Wage: Government evidence to the LPC’.

3.20 Overall, the increase in HMRC’s resources and the growing number of enforcement officers have coincided with more arrears being collected and more underpaid workers receiving their fair wages than ever before. At the same time, there has also been a shift in the main enforcement measures, which suggests a caseload tilted towards ‘broader’ cases where a greater number of workers have been underpaid a smaller amount. This suggests that to a large extent the increase in resources up to 2017/18 was used to pursue these larger cases. This could reflect a change in the pipeline of cases which come to HMRC; or a deliberate change in organisational priorities.

3.21 In the 2016 Autumn Statement, the Chancellor announced £4.3m of additional funding per year for minimum wage enforcement (HM Treasury, 2016) which HMRC used to look specifically at ‘complex employers, some with complex supply chains, considered most at risk of non-compliance with the NMW’ (Department for Business, Energy and Industrial Strategy, 2017). At oral evidence, HMRC told us that out of the current total of 435 enforcement officers, 70 worked on large and complex cases. The numbers of officers dedicated to this kind of work had increased substantially – with large employers experiencing more enforcement attention – since 2016, in response to this additional funding.

3.22 Furthermore, the data below on targeted and reactive enforcement (Figure 13) suggests that at least some of these large cases originate in complaints, rather than the programmatic inspection of large employers. But the overall balance does reflect deliberate choices by HMRC to direct more resource at large and complex employers. Our analysis in Chapter 2 shows that underpayment in very large employers had decreased, to a lower level than for any employer size. Conversely, the greatest likelihood of underpayment is found among the smallest, micro-level employers. This does not necessarily invalidate HMRC's choices; the largest absolute numbers of underpaid employees are found in the largest employers. But it shows the complex background for HMRC's resourcing choices. We are aware that the DLME has looked closely at HMRC's prioritisation processes and we look forward to his recommendations being addressed.

3.23 Looking at the information provided by BEIS and HMRC giving banded arrears per case, the extent to which trends in the overall statistics are driven by the relatively small number of large-scale cases becomes clearer. In 2016/17, HMRC took 15 cases to completion which individually led to more than £100,000 of arrears, averaging over £450,000 to 5,000 workers in each case. In 2017/18, HMRC concluded 10 such cases, but each led to the back-payment of over £1.1 million of arrears to 17,000 workers.

Table 4: NMW closed cases, arrears and workers by banded arrears per case, 2017/18

Arrears per case	Closed cases with arrears	Arrears (£)	Workers
£1- £100	164	7,796	291
£101 - £500	251	71,661	1,229
£501 - £1000	132	94,780	1,122
£1,001 - £5000	307	713,467	3,931
£5,001 - £10,000	79	555,978	2,699
£10,001 - £20,000	51	742,650	4,298
£20,001 - £50,000	36	1,104,611	7,771
£50,001 - £100,000	16	1,157,420	6,208
£100,000+	10	11,167,246	174,236
Total	1,046	15,615,609	201,785

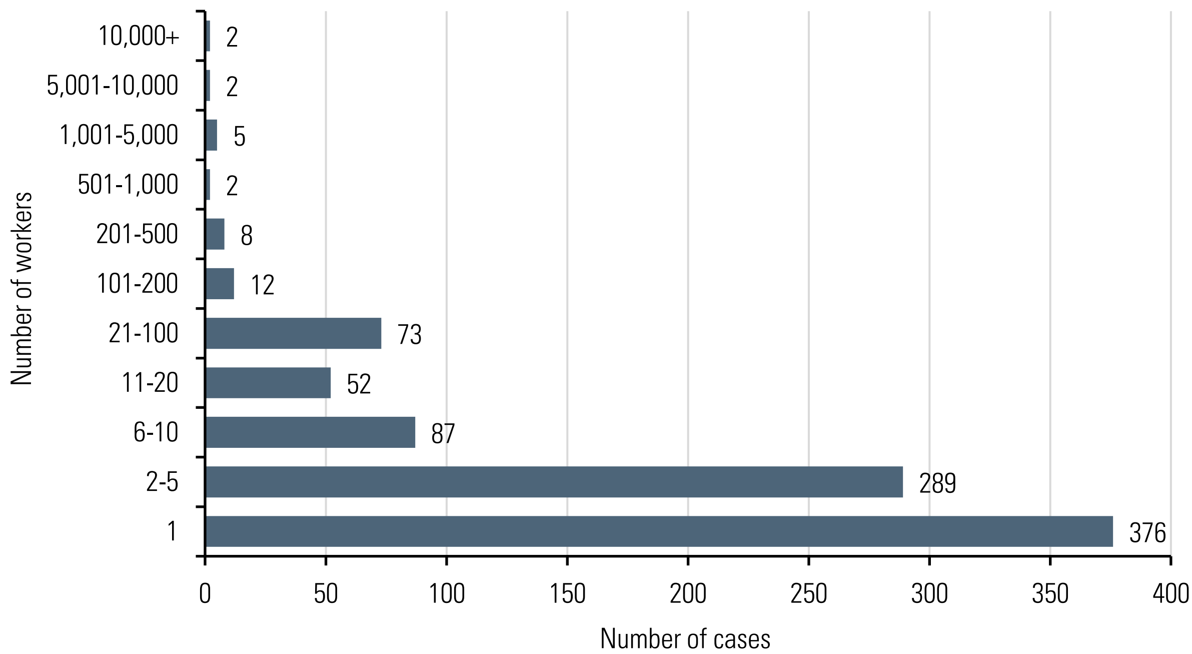
Source: 'National Minimum Wage: Government evidence to the LPC'.

Naming employers

3.24 The government has continued to operate a scheme to publicly name employers found to have underpaid the NMW. In 2017/18 there were three rounds of naming (in August and December 2017 and March 2018), as well as a further round in July 2018. In total, 911 employers were named in these rounds, representing payment of over £6.2m of arrears to more than 61,000 workers.

3.25 The profile and distribution of cases revealed in the naming rounds offers a useful validation of the general trends emerging from the enforcement data. As Figure 12 shows, the majority of cases in the four most recent rounds involved only a small number of employees. Forty-one per cent of cases involved just a single worker; 83 per cent of cases involved ten or fewer workers. In total, such cases represented £1.4m of arrears, or approximately 23 per cent of the total and led to an average of £782 of arrears per worker. In contrast, the nine largest cases, each involving over 1000 workers, led to just under £3.4m of arrears being paid to around 50,000 workers, who each received £68 on average.

Figure 12: Distribution of number of workers per case in naming rounds between April 2017 and July 2018



Source: LPC analysis of BEIS published naming cases.

3.26 Such numbers reinforce the point that HMRC's enforcement officers deal with very disparate cases. Although the number of very large cases is growing, and driving an increase in the overall enforcement measures, the bulk of the caseload is still made up of smaller-scale cases, where the individual levels of underpayment are much larger.

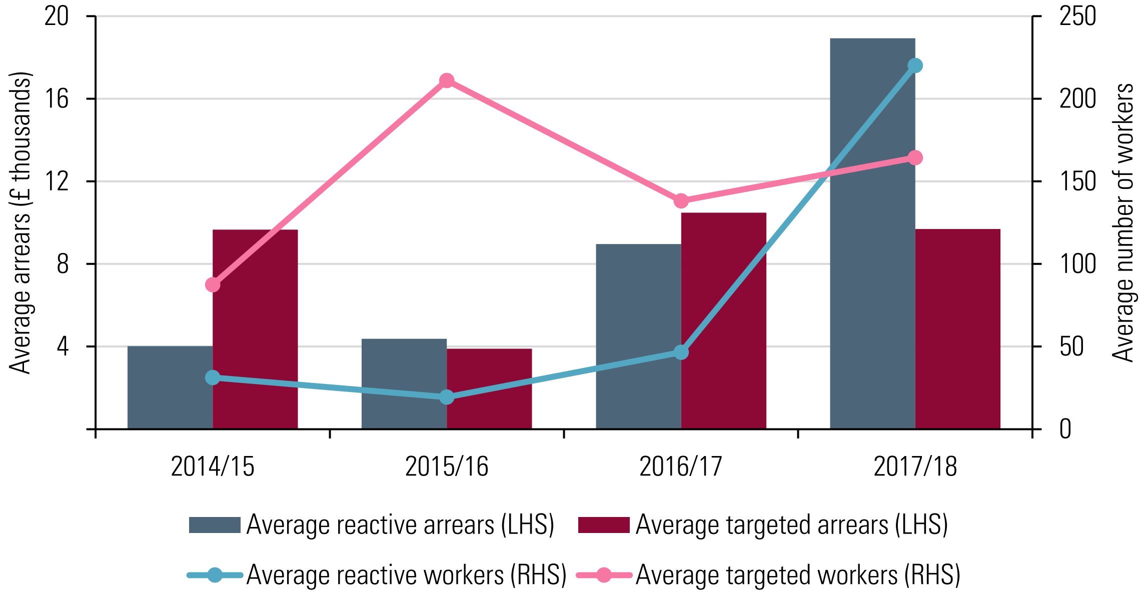
3.27 The naming round announcements attract considerable media attention, which serves to strengthen their deterrent effect. Employers we spoke to had mixed views on the effectiveness of naming rounds; a common sentiment was that in their current format they were a missed opportunity to offer case studies for understanding and avoiding compliance errors. Others told us that the length of the published lists diluted their value, or thought that the current £100 threshold for inclusion should be raised. In some areas, unions were unhappy with the ability of employers to self-correct underpayment and avoid being named.

3.28 At oral evidence, BEIS told us that they were acting on the DLME's recommendation to review the function and effectiveness of naming rounds, but could not tell us when that review would be complete or when the next round would take place. They also told us that they were learning lessons from other regulatory bodies such as the Pensions Regulator, which is a positive development and in line with previous LPC recommendations to develop a similar approach to the section 89 notices used by this body. While we support this work – and are keen for Government to maximise the impact of naming rounds – the delay since the previous round in July 2018 undoubtedly represents a missed opportunity to keep the NLW, and the issue of compliance, in the public eye. **We therefore repeat the recommendation we made in 2017: that the Government restart regular naming rounds to create momentum, increase coverage and allow stakeholders more time to prepare and support**.

Targeting enforcement

3.29 The balance of proactive and reactive cases which HMRC investigates has changed in recent years. The number of targeted cases opened and closed each year has risen considerably since 2014/15, before which point the caseload was almost exclusively reactive. In 2017/18, 40 per cent (1,603 cases) of all cases opened and 39 per cent (392 cases) of all cases closed with arrears were on the basis of targeted intelligence. The strike rate for reactive cases was slightly but not significantly higher than for proactive (44 against 39 per cent). As Figure 13 shows, in 2017/18, targeted cases on average involved fewer workers and accounted for lower arrears totals than reactive ones – and these totals have not increased significantly in recent years.

Figure 13: Comparison of average workers and arrears per reactive and targeted enforcement case, 2017/18



Source: LPC analysis using data from 'National Minimum Wage: Government evidence to the LPC'.

Table 5: Total cases closed and cases closed with arrears from complaint-led and targeted NMW enforcement, 2014/15 to 2017/18

	Closed cases			Closed cases with arrears		
Year	Total	Complaint led	Targeted enforcement	Total	Complaint led	Targeted enforcement
2014/15	2,204	2,053	151	735	675	60
2015/16	2,667	1,576	1,091	958	752	206
2016/17	2,674	1,201	1,473	1,134	640	494
2017/18	2,402	1,408	994	1,016	624	392

Source: LPC analysis using data from 'National Minimum Wage: Government evidence to the LPC'.

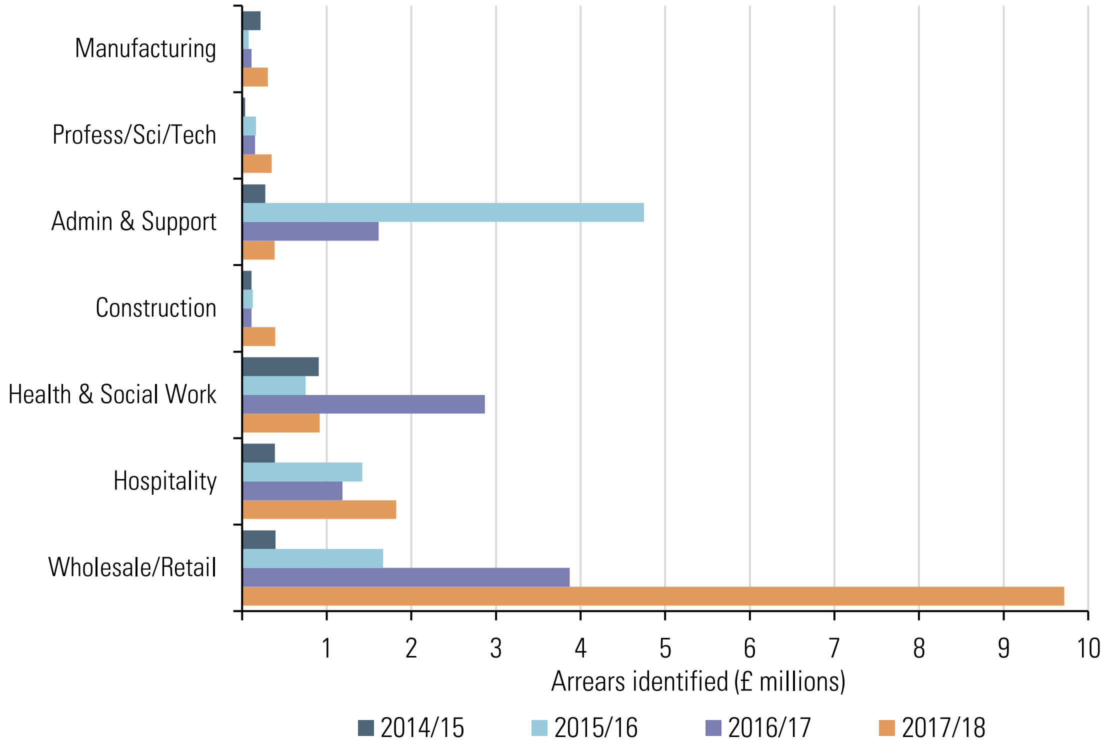
3.30 In this area, perhaps more so than elsewhere, cases successfully closed or arrears repaid are not necessarily the best measures of success. More important is HMRC's success in targeting the most serious instances of non-compliance, which may be more difficult to capture via headline metrics.

3.31 We have previously recommended that HMRC establish systems to learn about the nature and extent of non-compliance; and make greater use of intelligence shared across Government. We were therefore pleased to hear at oral evidence that HMRC have worked to develop a sophisticated risk model to direct their enforcement efforts. HMRC told us that there are three teams across the UK dedicated to serious non-compliance, with another being recruited. We also note the focus on joint working between enforcement bodies which has been a priority of DLME strategies. Such developments should increase HMRC's abilities to proactively target and pursue non-compliant organisations. It is clear that progress is being made in this area, and we hope to see the evidence of it in future evidence from the Government.

3.32 Figure 13 appears to show that the large cases which make up such a high proportion of arrears were at base reactive rather than targeted. We have heard various stakeholders suggest that HMRC is targeting large employers; these figures suggest that in 2017/18 that was not the case. But – as already discussed above – there are now more HMRC staff who specialise in large and complex cases, and the increase in resource will change the way in which reactive cases are handled. It is clear that large employers can expect to come under more scrutiny than they have previously.

3.33 Figure 14 shows a comparison of identified arrears over time in selected sectors. The cases responsible for the headline growth in statistics were clustered in the retail and wholesale sector, which saw the greatest year-on-year change and accounted for over 60 per cent of total identified arrears (although only 13 per cent of successful closed cases). In our analysis of ASHE, retail is the occupation with the highest overall level of underpayment although not to the relative extent suggested by these figures (and the proportion of underpayment relative to the NLW's coverage is below average at 15 per cent). Again, the effect of the small number of high-value cases makes it difficult to say whether this is an effect of HMRC prioritising or targeting the sector.

Figure 14: Arrears in HMRC enforcement cases in selected sectors, 2014/15 to 2017/18



Source: LPC analysis using data from 'National Minimum Wage: Government evidence to the LPC'

3.34 The priority sectors for HMRC enforcement are now identified in conjunction during the development of the DLME's annual strategy. This is a positive step and should give some confidence to employers about the direction and focus of enforcement activities. Building on this, we expect it will be a priority for HMRC, BEIS and the DLME to better evaluate and understand the effects of targeted enforcement on sectors. Targeting a sector should have a real, lasting and wide-ranging deterrent effect on employers who may be tempted to underpay their staff.

CHAPTER FOUR

Conclusion and recommendations

4.1 This report has shown that measured underpayment of the minimum wage has grown steadily since the introduction of the higher NLW in 2016. Although there are several caveats attached to the figures we identify in our analysis of ASHE data, the overall trend is clear. In addition, the data we analyse only represents declared underpayment; it is reasonable to assume that the same trends are prevailing in the unofficial economy. Estimating the real scale of underpayment is a significant challenge, and likely only to grow in importance. The introduction of the NLW represented an ambitious jump for the minimum wage; as we approach the end of its target trajectory in 2020, the Government is once more considering its ambitions for the following period. But rising non-compliance threatens to undermine any policy ambitions to end low pay, and makes it imperative that the enforcement system is adequate to the scale of the problem.

4.2 The enforcement system has seen a high degree of change in recent years. HMRC have recruited heavily, developed their systems for assessing risk and expanded the scale of their enforcement operations. And the DLME's strategies have set priorities for the system with a new rigour and driven more joint working between different agencies. In the evidence we heard from the Government, there were several positive developments to note: the development of a sophisticated risk model; the induction and integration of more front-line staff into HMRC's enforcement teams; and more proactive deterrence-focused communications with employers. But it remains challenging to make a judgement on the overall effectiveness of enforcement activity. The headline record figures of underpaid workers identified and arrears repaid are clearly positive; but they may not be a reliable guide to the overall impact of HMRC's work, affected as they are by a small number of large and complex cases. The DLME's work on evaluating the effects of enforcement activity will be a valuable future resource in this respect.

4.3 Our discussions with employers throughout the year revealed a high level of dissatisfaction with HMRC's approach to enforcement. Some of this is inevitable – indeed, desirable – as part of the deterrent effect of enforcement. But too much friction between Government and employers could ultimately be detrimental to the effective enforcement of the minimum wage. To this end, transparency and consistency are key; the underpinning regulations and guidance must be as clear and accessible as possible, and the experience of being audited by HMRC not feel arbitrary, as some employers told us it was. BEIS's recent consultation on salaried workers and salary sacrifice schemes was clearly a positive step in this respect, responding to employers' concerns, but this needs to be sustained.

4.4 There has been a marked increase in the flow of complaints to HMRC, but the overall numbers remain a small fraction of the workers we estimate are underpaid. The barriers to greater reporting are various: they start with the difficulty for many workers of accessing clear information about their hours and pay; a lack of power in the workplace leading to a reluctance to complain; and a lack of awareness of their rights under the minimum wage. The Government has already taken action on the first of these points, introducing the right to a clear statement of hours on payslips. But this right needs to be communicated and enforced; the other potential barriers must be kept under consideration as well; and HMRC should continue develop its capacity to identify risk and carry out targeted investigations, as workers most at risk from serious non-compliance are likely to face the greatest barriers to speaking out. The Government's overall communications strategy should play a key role in this challenge, not least through the use of naming rounds – while it is fair to review their operation, this should not be at the cost of not using them at all.

Summary of recommendations

4.5 We urge the Government to use all available opportunities to improve the measurement of underpayment, and to investigate new methodologies for assessing the scale of non-compliance.

4.6 We recommend that the Government continues to invest strongly in communications to workers.

4.7 We urge the Government to consider how to build confidence in the complaints process, and to work with trade unions to understand the current barriers to reporting.

4.8 We recommend that the Government's communications should build confidence in the third-party complaints process, including via guidance or case studies around successful complainants. We urge the Government to work closely with Acas, trade unions and other bodies to achieve this.

4.9 We urge the Government to invest time in getting the guidance to employers right, as this will simplify the task of enforcement in the longer term.

4.10 We recommend that the Government restart regular naming rounds to create momentum, increase coverage and allow stakeholders more time to prepare and support.

Annex: Impact of ASHE timing cases

Table A1 shows the headline estimates of underpayment from the Annual Survey of Hours and Earnings (ASHE), as well as the impact of the timing issue created by the date the survey takes place in April, as described in paragraph 1.3. In April 2018, ASHE data showed there were 582,000 individuals paid below their respective minimum wage rates. This compares to a figure of 453,000 in 2017 and on first appearance indicates a significant increase in underpayment of 28 per cent. However, if we exclude those legitimate cases of underpayment in the data, the 2018 total falls by 143,000 to 439,000 (a 25 per cent reduction). This nevertheless still represents 22 per cent of all those covered by minimum wage rates. On the same revised basis, the 2017 underpayment figure falls by a smaller 36,000 to 417,000 (21.3 per cent of coverage). Using this adjusted measure, we observe a much smaller increase in underpayment between 2017 and 2018 of 5 per cent, or 22,000 individuals. The figures we cite throughout this report reflect this adjustment.

Table A1: Estimated underpayment of the minimum wage by rate, showing impact of excluding ASHE survey timing cases, UK, 2018

Rate	Coverage	Total underpayment		Underpayment excluding ASHE survey timing cases	
		Number	As a share of coverage (%)	Number	As a share of coverage (%)
NLW	1,604,000	493,000	30.7	369,000	23.0
21-24	167,000	47,000	28.3	35,000	21.1
18-20	119,000	28,000	23.4	23,000	19.3
16-17	40,000	5,000	13.2	4,000	9.0
AR	32,000	9,000	28.5	8,000	25.4
Total	**1,961,000**	**582,000**	**29.7**	**439,000**	**22.4**

Source: LPC estimates using: ASHE 2010 methodology, low pay weights, low pay flag, UK, April 2018.

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