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The Rt Hon Alok Sharma MP
Department for Business, Energy and Industrial Strategy

30 October 2020

Dear Secretary of State,

NATIONAL MINIMUM WAGE RATES FOR 2021 INCLUDING THE NATIONAL LIVING WAGE

I write with the Low Pay Commission's (LPC) recommendations for the rates of the National Minimum Wage (NMW) and National Living Wage (NLW) to apply from April 2021. This letter summarises the rationale for our recommendations, which are the agreed view of the whole Commission.

We recommend that the following rates apply from 1 April 2021:

	2021 rate	Annual increase (£)	Annual increase (%)
National Living Wage (23+)	£8.91	0.19	2.2
21-22 Year Old Rate	£8.36	0.16	2.0
18-20 Year Old Rate	£6.56	0.11	1.7
16-17 Year Old Rate	£4.62	0.07	1.5
Apprentice Rate	£4.30	0.15	3.6
Accommodation Offset	£8.36	0.16	2.0

Our remit from the Government is to recommend the rate of the NLW consistent with reaching the target of two-thirds of median earnings by October 2024. The remit asks us to "advise on any emerging risks and – if the economic evidence warrants it – recommend that the Government reviews its target or timeframe." The aim of this 'emergency brake' is to ensure the lowest-paid continue to see pay rises without significant risks to their employment prospects.

Following the Government's acceptance of our advice last year, the NLW will cover 23 and 24 year olds from April 2021. So this year we also advise on a new rate for 21-22 year olds. For this and the other rates of the NMW our remit is to recommend as high a rate as possible without damaging employment.

Our job, therefore, is to recommend rates that work best for workers and employers in the context of the Covid-19 economic shock. This is no easy recommendation to make. The negotiations over the rates have been some of the most lengthy and difficult I have been involved with, and for good reason. Both workers and employers have been hit by the economic crisis and there are powerful arguments both that workers need a pay rise, and that employers are facing an exceptionally tough situation that raises the threat of unemployment. Added to this, the speed of economic change and level of uncertainty over the future is unprecedented. The lag between giving advice in October and the rate applying (April 2021) takes on far greater significance this year, and a wide range of economic scenarios are possible up to April 2021.

Our standard practice in making these recommendations is to take account of the state of the economy, employment and unemployment levels and relevant policy changes. The bulk of the evidence available only goes up to August 2020, when parts of the economy had only just re-opened and we do not know the outcome for workers furloughed on the Coronavirus Job Retention Scheme (CJRS), which ends in October. Much of the activity announced in the Chancellor’s Plan for Jobs is still getting off the ground and subsequently announced policies, including the Job Support Scheme, are yet to begin.

We also speak directly with a wide range of employers, workers and their representatives across the country. This is essential for understanding how employers are responding to the NLW and the impact it has on workers’ lives. But this year it has been more difficult. This is not just because of social distancing but because these groups have been extremely busy. Employer and worker representatives alike have been arguing for support for their members, working with the Government on the design of support programmes and helping their members navigate the support available. In some cases, the representative bodies themselves have been fighting for their own survival.

Nevertheless, we spoke to a wide range of employers, workers, and their representatives in virtual settings. We heard of the strain on both low-paid workers and businesses who are struggling to survive. Many low-paid workers are key workers, particularly in retail and social care, and we heard about their difficulties in continuing to work through the depths of the pandemic. For others, including furloughed workers, we heard about the income they had lost, the life changes they had been forced to make, the uncertainty over whether they would have a job to return to. We heard examples of workers feeling forced into poorer terms and conditions, with their employers blaming the crisis.

From employers we heard about the profound uncertainty which has been the norm since March, and the knife-edge of survival where many – particularly smaller businesses – find themselves. Many hospitality businesses have seen the most profitable part of the year wiped out. The structural shifts facing retailers have accelerated. And the funding crises in many publicly-funded sectors – from social care to childcare, as well as leisure and the arts – have only intensified.

The economic evidence painted a similar picture. Spring saw the largest fall in GDP in modern history, investment fell dramatically, and recruitment collapsed. Despite this, employment remained high as the Government’s CJRS successfully kept millions of workers in jobs, albeit away from work. The CJRS largely protected incomes but pay fell for those whose employers did not “top up” their pay. Others still lost their jobs or hours of work.

Movements in pay have a direct bearing on the NLW rate as its target is a percentage of average earnings. In theory, the on-course rate adjusts in response to changes in economic conditions. The logic is that if the economy booms so does pay and vice versa. But the sheer scale of the CJRS and its impact on pay and jobs means that measures of average earnings do not reflect economic conditions in the standard way.

There are further problems with measuring what happened to hourly pay through the crisis. We rely on the Annual Survey of Hours and Earnings (ASHE) for understanding the impact of the NMW/NLW and plotting our position on the path to 2024. This survey took place at the end of April – the lowest point of economic activity and the peak of infections and furloughing of workers. The response rate was substantially lower than normal and there is a large group of furloughed workers whose hourly rate is unknown. This means it is not possible to calculate median hourly pay in April 2020. Without this we cannot tell where £8.72 was on the bite path to 66.7 per cent of median pay with our usual precision, and this complicates the question of what the next step is on that path to 2024.

One option is to simply remove furloughed workers from our calculations on the basis that many would have lost their jobs and/or hours of work in the absence of the CJRS. But because furloughed workers tend to be low-paid, removing them actually raises average pay through compositional effects. This in turn increases the on-course rate for the NLW, the opposite of what the framework intends in an economic crisis. In short, average earnings, and therefore the on-course rate of the NLW, are not responding to economic conditions in the normal way.

By necessity then, our approach to the NLW path is different this year. While we have produced an indicative path, it goes without saying that this is subject to more uncertainty than usual. Instead, Commissioners' approach this year is to recommend rates that minimise any "significant risk" to "employment prospects" as per our remit, in a year when employment risks are greater than they have been in a decade. Our recommendations and rationale are below.

National Living Wage

The economy has seen the largest shock in modern history and, while growth was rapid over the summer, it is yet to fully recover. This means employers are in a weaker position to respond to NLW increases without impacts on employment. Employers respond by absorbing the cost and accepting lower profits, raising prices and improving productivity/efficiency, but the crisis has curtailed their ability to respond like this. Sales are down and costs are up because of social distancing, PPE and supply disruptions. Investment, a key ingredient in raising productivity, collapsed and many small firms are increasingly indebted. Vacancies fell sharply and while they too have seen rapid growth they are also yet to fully recover, particularly in hospitality.

However, it is important to recognise the contribution of low-paid workers during the crisis, including key workers – those in care work, essential retail and other sectors. All work in people-facing roles, whether key workers or not, involves higher risk. Many employers agreed that low-paid workers deserved an increase for working through the pandemic at a time of intense pressure and risk for workers.

Taking all of this into account we recommend an increase in the NLW to £8.91, which is 2.2 per cent or 19 pence. This is lower than our best estimate of the on-course rate of £9.06, and therefore represents a significant adjustment in response to economic conditions. This increase is chosen to be modestly higher than that for prices in the year the rate applies, meaning low-paid workers' living standards should be protected as they will continue to receive a real-terms pay rise. Most importantly, we do not believe this increase presents a significant additional risk to employment prospects, beyond the already challenging outlook.

I have noted the difficulties in seeing ahead to just next April; looking further still would be unwise. For this reason, we do not recommend a change to the Government's target of reaching two-thirds of median earnings by 2024, and the Commission remains fully committed to the goal of ending low pay. The increase we recommend is broadly in line with predicted wage growth, meaning progress against the Government's ambition may continue. In our report we will set some indicative paths for the future course of the rate but these will be even more uncertain than usual. As we are still at the beginning of the approach to 2024, we judge that the target is still achievable and do not propose any change. A fuller review of the path ahead – and greater clarity on a future rate path – will hopefully be possible in our 2021 Report.

National Minimum Wage

Last year we recommended that the eligibility age for the NLW be reduced to 23 in April 2021. This remains our position as the labour market continues to treat 23 and 24 year olds similarly to those aged slightly older. For example, there are similar numbers working in sectors affected by shutdowns, similar use of the minimum wage rates and similar rates of furlough and hours loss through the crisis. Employer representatives told us that while they were very concerned about increases to the NLW, they were far less concerned with the commitment to change the age eligibility.

As for the rates themselves, young people are especially hard hit by any downturn because of their relative lack of experience and reliance on vacancies to find work (most adults are already in work when a crisis strikes). During the crisis, the younger the worker, the more likely they were to work in shutdown sectors such as hospitality and leisure or be furloughed, and less likely to have their pay topped up by their employer or work in key worker jobs like social care or essential retail.

For the new 21-22 Year Old Rate we recommend a rate of £8.36, which is a 16 pence or 2 per cent increase. We have already recommended that this group become eligible for the NLW in the near future. Therefore, this increase, which is slightly lower than for the NLW, balances the need to not allow the gap to widen too greatly with their relatively greater vulnerability, while still allowing these workers to receive a pay award that will protect their living standards.

The evidence suggests that 18-20 and 16-17 year olds are more vulnerable still to the economic outlook, with more furloughed and more working in shutdown sectors. These age groups are also more likely to be in part-time employment and have seen these opportunities disappear, especially as many of these jobs are in non-supermarket retail, hospitality and leisure. Therefore, we recommend a lower increase to £6.56 (11 pence or 1.7 per cent) for 18-20 year olds, broadly in line with inflation expectations. We believe 16-17 year olds are the group most vulnerable to unemployment, and therefore recommend a smaller increase for this group to £4.62 (7 pence or 1.5 per cent).

Having completed our review of the Apprentice Rate, the view of Commissioners is that it should be aligned with the 16-17 Year Old Rate. By alignment we mean that there will continue to be two separate rates, in case the fortunes of 16-17 year olds and apprentices diverge in the future, but of the same value. However, apprentices, like teenage workers, are also vulnerable. Our evidence base for apprentices is weaker this year, as we rely on ASHE for this group too. We also know that starts have been hit by the crisis. Therefore, we propose to align these two rates over two years, with the more cautious of the rises for the Apprentice Rate in this year, given the economic picture I have outlined, and the rate aligning with the 16-17 Year Old Rate in 2022. For next April we recommend an increase of 15p or 3.6 per cent to £4.30.

Last year, we achieved a longstanding aim to raise the Accommodation Offset to the level of the National Minimum Wage (now the 21-24 Year Old Rate). This year we recommend that increases in the Accommodation Offset again rise in line with that rate (the new 21-22 Year Old Rate). That is, an increase of 16p or 2 per cent to £8.36.

The Commission welcomes the Government's continued commitment to ending low pay. Achieving this in these difficult circumstances is likely to require the Government to think carefully about the support it provides in a range of other areas beyond the rate of the NLW. These include the stability and security of support provided to workers and businesses to help them cope with the impact of the coronavirus pandemic. The Commission has noted before the need for additional support for the social care sector to enable it to fulfil its ambitions to pay workers a decent wage. This need has only become more urgent. We also heard this year about the acute pressures on the childcare sector, and would highlight this as a further area where government funding is vital.

Yours sincerely,

Bryan K. Sanderson

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Chair, Low Pay Commission

Letter copied to the Rt Hon Boris Johnson MP and Paul Scully MP