The National Minimum Wage

Making a Difference

Third Report of the Low Pay Commission

Volume One

Presented to Parliament by the
Secretary of State for Trade and Industry by
Command of Her Majesty
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Chairman's Foreword

1 The National Minimum Wage has now been in place for almost two years. When we produced our second report, some nine months after the launch of the minimum wage, we concluded that it had been introduced successfully. Nothing we have seen since has caused us to change our minds. The minimum wage has brought benefits to many low-paid workers without any significant impact on employment or the economy. This major intervention in the labour market, which many considered controversial even a couple of years ago, is now widely accepted throughout the UK. A minimum wage set at a sensible level provides an effective labour market floor that protects workers from exploitative pay levels and businesses from unfair competition.

2 We are producing our third report in two volumes. The first volume includes our recommendation that the main rate of the National Minimum Wage should be increased from October 2001. The second volume, which will follow in May, will address the other issues in our terms of reference, including young people and training, the interaction of the minimum wage with the tax and benefits system, compliance and enforcement, and a process for future review.

3 We decided to approach our report in this way following representations, mainly from employers, on the length of notice they needed to be able to plan and implement changes to the National Minimum Wage. The Government had already said that it wished to implement any changes arising out of our report from October 2001. Our terms of reference asked us to report by July 2001. Employers told us that they needed about six months' notice. We were sympathetic to this, not least because we have frequently been told that one of the reasons for the successful introduction of the minimum wage was the length of notice that employers received. We therefore decided to submit our recommendation on a new rate to the Government as soon as possible after

we had taken a decision on it. And we agreed to produce the second volume on the other issues by May.

4 Our first task in our third report was to make a fuller assessment of the effect of the National Minimum Wage than was possible in our second report. Chapter 3 of our report is a comprehensive analysis of the evidence we considered. We drew on the research which we commissioned, the survey of employers which we conducted, and examined official statistics. We considered carefully the evidence, both written and oral, which we received from a wide range of organisations. And we undertook a programme of regional visits throughout the UK to learn from the experience of people affected by the minimum wage. Once more we are most grateful to all those who took the time and effort to inform our work. We hope that our assessment in Chapter 3 will provide a benchmark for future work.

5 We have worked closely with the Office for National Statistics to make progress on improving the data that inform our analysis. We hope that the Office for National Statistics will continue to work on improving the data so that we can have greater confidence in them. The number of people covered by the initial rate was lower than we originally expected, but the number of beneficiaries still remained large. About 70 per cent of beneficiaries have been women, and the latest data indicate that the minimum wage has contributed towards a further narrowing of the gap between men's and women's pay.

6 I have again been impressed with the commitment of the members of the Commission to work in partnership and to reach a decision with which we are unanimously agreed. Our analysis and consultation have led us to conclude that there is now scope for a significant increase in the National Minimum Wage, but we have continued to adopt a prudent approach in making our recommendations.

7 In the foreword to our second report I quoted a national newspaper which, in commenting on the introduction, wrote 'minimum wage, minimum fuss'. We had this

judgment very much in mind in making our recommendation on an increase to the minimum wage. We have recommended an increase which will make a real difference to low-paid workers, but will at the same time be manageable for business and the economy. And across the two volumes of our report we will present a coherent set of conclusions and recommendations, which is measured and straightforward and which we hope will contribute to the successful future of the National Minimum Wage.

March 2001

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Executive Summary

We recommend that the main National Minimum Wage for adults aged 21 and over should be increased to £4.10 per hour in October 2001 and to £4.20 per hour in October 2002.

Chapter 1: Our Task

1 In May 2000, the Government gave us new terms of reference. We were asked to recommend whether there was a case for increasing the main rate and the Development Rate and, if so, by how much. We were also asked to continue to monitor and evaluate the impact of the National Minimum Wage and to consider the case for changing the age at which workers become entitled to the adult rate. The Government asked us to report by July 2001 with a view to it implementing changes in October 2001. We were concerned that if we reported in July businesses would not have sufficient time to prepare. We therefore decided to report on the impact of the National Minimum Wage and the level of the main rate in March with further analysis and recommendations in a second volume in May.

Chapter 2: What We Did

2 As with our previous reports, we based our recommendations on extensive research and consultation. We commissioned 21 research projects and undertook surveys of firms in low-paying sectors and of employers participating in the New Deal. We analysed relevant data and worked with the Office for National Statistics (ONS) in order to establish better estimates of the incidence of low pay. We considered developments in the minimum wage systems of other countries. Consultation with employers, workers and their representatives has always been a fundamental part of our work; we therefore took written and oral evidence from a wide range of organisations and made visits throughout the UK.

Chapter 3: Assessing the Impact

3 We remain at a relatively early stage in the development of the National Minimum Wage but now have sufficient data to make an assessment of its initial impact. A large number of people have benefited. We mentioned in our first two reports that there was uncertainty with the ONS data. These have been revised again. The latest estimate based on these data suggests a lower number of beneficiaries than we originally anticipated, but the basic messages from our second report hold good.

4 Based on the revised ONS data the latest estimate suggests that 1.3 million people were entitled to higher wages as a result of the introduction of the minimum wage. Around 70 per cent of beneficiaries were women, and around two-thirds of jobs affected were part-time. In a tight labour market wages have risen ahead of the minimum wage, so the number of those set to benefit from the upratings in 2000 was significantly lower than for the introduction of the minimum wage in April 1999.

5 It appears that the substantial majority of workers have been receiving their entitlement, but we will make a fuller assessment of compliance in the second volume. As a result of the minimum wage, the overall earnings distribution and the gender pay gap have narrowed. Although some low-paying sectors have been more affected than others, the overall evidence suggested that the impact on differentials has been largely contained and there does not appear to be a major continuing effect. Our latest estimate of the initial impact of the minimum wage on the national wage bill is 0.35 per cent. This is lower than the estimate in our second report, largely because of the reduction in the estimated number of beneficiaries.

6 The large majority of firms affected by the minimum wage have managed to adapt, even if that has sometimes been a significant challenge. The buoyant labour market has undoubtedly helped, as has the prudent approach we took in recommending an initial rate. We considered whether, in coping with the minimum wage, firms had attempted to increase productivity of labour or improve their competitiveness. We found a wide range of responses by firms. Some businesses reported positive changes that increased

efficiency; others reported difficulties. Some firms responded to increased business costs arising from the minimum wage by raising prices, although the scope for doing this varied from industry to industry depending on, among other things, the degree of competition and flexibility of contracts. At the aggregate level we could not detect an impact on the Retail Prices Index (RPI) from the introduction of the minimum wage.

7 We were encouraged by many firms' use of training. Although we found some instances of reducing training to ease the cost of the minimum wage, these were rare. Some firms viewed training as part of a wider strategy to improve skills and to compete for workers in a tight labour market.

8 We were especially concerned about possible negative employment effects of the minimum wage. Employment has continued to grow strongly since the introduction of the minimum wage, and there were no discernible adverse effects at the aggregate level. In particular, employment among those groups that were particularly vulnerable – women, young people, part-time workers, most ethnic minority groups and disabled people – continued to increase. We realised that this did not, of course, tell us what employment would have been in the absence of a minimum wage; but our research showed that even after controlling for this and other factors the impact of the minimum wage was broadly neutral.

Chapter 4: Choosing a New Rate

9 In making our recommendation we have taken account of the impact of the National Minimum Wage so far, and looked to the future to assess the impact of an increased rate. We needed to choose a rate that would have a real impact on low-paid workers but at the same time would be manageable for business and the economy. A rate that was not manageable would hurt the prospects of the very people it was meant to protect, by damaging employment, profitability and competitiveness.

10 Although we did not have any target for coverage in mind, our assessment on making a real difference to the low paid was influenced by the revised data that we received from the ONS on the numbers in low pay. Our consideration about what

businesses, particularly those directly affected, and the economy could afford was based on a range of factors. We looked at the effect on wage bill costs at both the aggregate and sectoral levels, likely employment effects, and the impact on prices and on the public sector. We considered carefully the evidence from businesses, unions and other interested parties. Almost all evidence received from representatives of employers and workers accepted the principle that the minimum wage should be uprated, although some businesses expressed concern about increases that would affect their costs and competitiveness.

11 We looked at the evidence in the context of the current economic situation, but recognised that a new rate needed to be sustainable in less favourable conditions. We therefore considered prospects for the near-term future and analysed recent trends in prices, earnings and pay settlements.

12 Prospects for growth and stable inflation, revisions to the numbers in low pay and evidence from consultation suggested that there was now scope for a significant increase in the National Minimum Wage. We believed that such an increase would not adversely affect the economy or reduce aggregate employment. But we were aware that low-paying businesses, many operating on narrow margins, including smaller firms, would need to absorb and adapt to the increased costs. We considered it prudent therefore to recommend a small further increase for October 2002 before the minimum wage is reviewed in full again.

13 **We recommend that the main National Minimum Wage for adults aged 21 and over should be increased to £4.10 per hour in October 2001 and to £4.20 per hour in October 2002.**

14 This increase will ensure that the minimum wage maintains its value as a wage floor, and will provide a significant boost to earnings of workers in low-paid jobs. Between 1.3 and 1.5 million jobs, around 5.5 to 6.6 per cent of jobs for those aged 21 and over, will be covered by the increase in 2001. We believe that the impact on the total wage bill should be no more than 0.3 per cent, although this will be greater in some low-paying sectors and geographical regions. The impact on sectors affected overall and on the economy as a whole will

be significantly less than that resulting from the introduction of the National Minimum Wage. We recognise that this impact will vary across, and within, sectors but believe it can generally be managed. We hope that business organisations, trade associations, trade unions and supporting bodies such as the Small Business Service will assist businesses in adapting to the new rate through, for example, the sharing of best practice and in developing strategies to adjust. We estimate that any impact on inflation will be small, as is the likely impact on public sector finances.

Chapter 5: Conclusion

15 The implementation of the National Minimum Wage to date has been a success. Our recommendation on a new rate remains prudent enough not to have any adverse effect on employment, but bold enough to make a significant difference to low-paid workers. We have recommended a small increase in 2002 before the rate is fully reviewed again. The second volume of our third report, in May, will describe in detail the impact of the minimum wage on individual low-paying sectors, on young people and training, and on vulnerable groups, as well as its interaction with the tax and benefits system. This volume will include our conclusions and recommendations on the level and coverage of the Development Rate, the maximum accommodation offset, compliance and enforcement, and the future uprating of the minimum wage. Together the two volumes will present a comprehensive analysis of the impact of the minimum wage and its continuing development, some three years after we made our first recommendations.

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1 Our Task

In May 2000, the Government gave us new terms of reference. We were asked to recommend whether there was a case for increasing the main rate and the Development Rate and, if so, by how much. We were also asked to continue to monitor and evaluate the impact of the National Minimum Wage and to consider the case for changing the age at which workers become entitled to the adult rate. The Government asked us to report by July 2001 with a view to it implementing changes in October 2001. We were concerned that if we reported in July businesses would not have sufficient time to prepare. We therefore decided to report on the impact of the National Minimum Wage and the level of the main rate in March with further analysis and recommendations in a second volume in May.

1.1 This is the third report of the Low Pay Commission. Our first report, in May 1998, made a number of recommendations covering the rates of the National Minimum Wage, its definition, its implementation and enforcement, and its treatment of young people and training. The Government accepted all our recommendations in principle. But a few – for example on the age coverage of the Development Rate for young people – were not implemented exactly as recommended. The Government introduced the National Minimum Wage in April 1999. The Government subsequently uprated the minimum wage in 2000 broadly in line with the recommendations we made in our first report.

1.2 In our second report to the Government in December 1999, we made an initial review of the impact of the National Minimum Wage and were able to report that its introduction had been a success. Large numbers of low-paid workers had benefited from it, particularly women, and low-paying sectors had adapted well. This success was partly the result of the prudent nature of our initial recommendations and the length of time businesses had to prepare for the introduction of the minimum wage.

1.3 We argued in our first report that, in order to maintain the benefits of the National Minimum Wage for low-paid workers, it needed to be periodically reassessed. In particular, we recommended that there should be a review of the National Minimum Wage, within two years of its introduction, to examine its initial impact and to assess its future level, definition and possible exceptions.

Terms of Reference

1.4 In May 2000 the Government set our terms of reference for a third report. We were asked to continue to monitor and evaluate the impact of the National Minimum Wage, with particular reference to:

- the effect on pay, employment and competitiveness in low-paying sectors and small firms;
- the effect on particular groups of workers, such as young people, women, ethnic minorities, homeworkers, people with disabilities and voluntary-sector workers;
- the effect on pay structures, including the effect on differentials and different pay systems, and the impact of the special rules for output work, unmeasured hours work and salaried hours work;
- the interaction between the National Minimum Wage and the tax and benefits system; and
- the interaction between the National Minimum Wage and the New Deal 18–24 and New Deal 25 plus.

1.5 In making recommendations, we were asked to take into account movements in earnings and the actual and likely future impact on the economy, employment and training, paying particular attention to the youth labour market. Specifically, we were asked if there was a case for:

- increasing the main National Minimum Wage rate and the Development Rate and, if so, by how much;
- making any change to the maximum accommodation offset; and
- changing the age at which workers become entitled to the adult rate.

As with previous terms of reference, we were asked to consider the wider economic and social implications, the likely effect on employment and inflation, the impact on the costs and competitiveness of business, particularly the small firms sector, and the potential costs to industry and the Exchequer.

1.6 We were asked to report to the Prime Minister and Secretary of State for Trade and Industry by July 2001. The Government had previously announced at the publication of the second report that it would ask us to produce recommendations on a new rate that could be implemented in October 2001. We were concerned that if we reported in July businesses would not have sufficient time to prepare for an October implementation date. Many businesses told us that they would need six months' notice of the new rate. The time businesses had had to prepare for the introduction of the National Minimum Wage helped ensure its successful implementation. We decided therefore to produce a first volume of our third report, assessing the impact of the minimum wage and recommending a new National Minimum Wage rate, in March 2001. Further analysis and recommendations on youth and training, the interaction of the minimum wage with taxes and benefits, compliance and enforcement, and a future uprating process will follow in a second volume in May 2001. Our announcement of this approach, at the end of January 2001, was welcomed by those who made representations to us on the length of notice for a new rate.

Our Second Report

1.7 In our second report we noted that several years would be needed to assess the full effects of the National Minimum Wage. Our initial assessment confirmed that, as expected, the impact varied across the country and across business sectors. But employment continued to grow in low-paying sectors in the first quarter following implementation of the minimum wage, and there were no signs of a significant minimum wage effect in the unemployment figures.

1.8 Most, but not all, businesses had prepared well for the minimum wage. We observed that employers and workers in individual businesses had generally succeeded in adapting pay and working practices to ensure that workers received at least the minimum wage. The initial evidence suggested that the vast majority of employers were complying with the National Minimum Wage. The minimum wage had brought benefits to considerable numbers of workers, two-thirds of whom were women and, of these, two-thirds were part-time workers. In the year to April 1999, the gap in the average hourly pay of women relative to men narrowed by a full percentage point, the largest amount for almost a decade. These benefits were achieved without any discernible negative impact on employment.

1.9 Our second report made several recommendations and suggestions. Although the definitions of workers, pay and working time had operated well, we found that, when applied in practice, a small number of anomalies and issues requiring further guidance had emerged. We made detailed recommendations and suggestions on the treatment of National Traineeships, definitions of workers, pay, working time, and the accommodation deductor. We made recommendations and suggestions on compliance and enforcement, and to meet some specific difficulties in relation to social care and the Supported Employment Programme. And we endorsed the position taken in our first report that 21 year olds should be included in the coverage of the full National Minimum Wage.

1.10 The Government accepted most of our recommendations and suggestions. The exceptions were those which related to Government funding (the Government's response was that these were outwith our terms of reference) and, to our disappointment, our recommendation on 21 year olds. The Government published new Regulations to address our recommendations on definitional issues, and these were approved by Parliament. We will report on progress on other recommendations, for example those on compliance and enforcement, in the second volume of this report.

1.11 In our first report we had recommended that an appropriate level for the adult rate in June 2000 would be £3.70 per hour and we reaffirmed this in the second report. The Government subsequently decided to increase the Development Rate for young people from £3.00 to £3.20 per hour with effect from June 2000, and the adult rate from £3.60 to £3.70 per hour from October 2000. And the Government published revised detailed guidance in October 2000 to reflect the changes since the initial Regulations.

1.12 We are pleased that the Government has now made clear that the National Minimum Wage should be uprated and that the Low Pay Commission has a continuing role. In the words of the Secretary of State for Trade and Industry, 'the minimum wage is here to stay…we have decided to make the Low Pay Commission a permanent body' (House of Commons, 18 January 2001).

Taking Forward the National Minimum Wage

1.13 The interval between the introduction of the National Minimum Wage and this report has allowed us to make a thorough assessment of its initial impact on business and on groups of workers. We have had access to improved data on the initial coverage of the rate (and we have made an assessment of the new data in Chapter 3 and Appendix 1). We have also been able to make an initial assessment of the impact of the June and October 2000 upratings. Although the National Minimum Wage has worked well so far, we were acutely aware of the need to ensure that in recommending a new rate we maintained its benefits for low-paid workers but without damaging the economy. Based on our analysis and consultation we have been able to agree unanimously a recommendation for the National Minimum Wage in October 2001 and in October 2002.

1.14 In the course of the two volumes of our third report, we will address all the issues in our terms of reference. We will also consider the issue of compliance and enforcement. As we emphasised in our previous report, unless the minimum wage is uprated regularly it will cease to be a useful labour market tool and cease to provide any material benefit for low-paid workers. We believe that the time has come to put in place a defined system for regular uprating, and we will make recommendations on this issue in the second volume of our report.

Conclusion

1.15 Our second report was an initial assessment of how businesses had coped with the implementation of the National Minimum Wage and of the people who had benefited from it. Nearly two years after the introduction of the minimum wage, we are now in a position to consider the re-setting of the rate, and to make other recommendations.

1.16 We have remained mindful of the principles that guided us in previous reports. We have endeavoured to produce recommendations that are simple and straightforward. We have needed to be bold enough to make a difference, but prudent enough to minimise any risk to employment. Our recommendations are designed to ensure that the National Minimum Wage remains supportive of a modern, knowledge-driven economy. The minimum wage should continue to promote competitiveness through increased productivity while protecting the most vulnerable workers.

1.17 In this first volume of our third report we look in depth at the impact of the introduction of the National Minimum Wage and that of the June and October 2000 upratings. We consider how those businesses affected managed the impact. We also look to the future, considering what would be an appropriate level of the minimum wage for October 2001 and October 2002. Our recommendations in this volume focus on the main rate of the National Minimum Wage. The second volume will report in more detail on our analysis of the impact on different groups and sectors. It will also consider all the other issues we have been addressing, including the treatment of young people and training, the interaction of the minimum wage with the tax and benefits system, compliance and enforcement, and future uprating of the National Minimum Wage.

1.18 We took an open and inclusive approach to making this analysis and in developing our recommendations. The next chapter describes how we did this through research, consultation and visits.

2 What We Did

As with our previous reports, we based our recommendations on extensive research and consultation. We commissioned 21 research projects and undertook surveys of firms in low-paying sectors and of employers participating in the New Deal. We analysed relevant data and worked with the Office for National Statistics (ONS) in order to establish better estimates of the incidence of low pay. We considered developments in the minimum wage systems of other countries. Consultation with employers, workers and their representatives has always been a fundamental part of our work; we therefore took written and oral evidence from a wide range of organisations and made visits throughout the UK.

2.1 We learnt a great deal in preparing our first two reports and that experience informed our approach to our third report. As before, we based our recommendations on research and extensive consultation.

Research

2.2 We commissioned a substantial amount of original research, the results of which we have been able to draw upon throughout the two volumes of this report. We publicised our requirements in the British Universities Industrial Relations Association's (BUIRA) *Newsletter* and *Labour Market Trends*, and on our Internet web site, www.lowpay.gov.uk. We also wrote to those who had previously completed research for us and to those who had shown interest in our seminars and occasional papers. We were encouraged by the continuing interest of the research community and others in our work which led to us receiving over 30 proposals. A group of commissioners met under an independent chair from the DTI to assess them. Twenty-one projects were eventually undertaken. The research we commissioned ranged from sophisticated econometric analysis of datasets to individual surveys of those on low pay.

2.3 The projects dealt with the overall impact, employment, business, compliance and enforcement, the groups of people affected, the sectors in which they worked and the effect on poverty.

- Incomes Data Services Ltd. (IDS) once again adapted their pay monitoring exercises to give us information about the effect of the June and October upratings and whether there were effects on differentials, grading, employment, youth rates and training.
- Mark Stewart from the University of Warwick and Joanna Swaffield from the University of York used secondary analysis of the British Household Panel Survey (BHPS) to evaluate the impact of the minimum wage, including its impact on the wage distribution and the characteristics of those benefiting. Stewart also estimated the employment effects on individuals, measured by their probability of remaining in work, using the Labour Force Survey (LFS), New Earnings Survey (NES) and BHPS.
- Several researchers looked at the effect of the National Minimum Wage on employers' behaviour. Jason Heyes and Alex Gray from the Leeds University Business School surveyed firms to see whether the National Minimum Wage had resulted in employers incorporating higher skills levels into their jobs and whether there had been implications for training. Anna Bullock, Alan Hughes and Frank Wilkinson from the Economic and Social Research Council's Centre for Business Research at the University of Cambridge surveyed cleaning and security firms in the UK to see what effect the National Minimum Wage had on productivity, management practices, training and recruitment.
- Some researchers looked at the impact of the minimum wage on particular low-paying industrial sectors. Many of these included the effects on small firms. Derek Adam-Smith, Gill Norris and Steve Williams at the University of Portsmouth surveyed housekeeping and bar work in the hospitality industry in Portsmouth. Janet Winters from Canterbury Christ Church University College researched current employment practices in horseracing by surveying all racehorse trainers in the UK and visiting training establishments for people working in stables.

- Some of these projects looking at the impact on particular groups of people followed up or extended useful work that had been started previously. The National Group on Homeworking, which articulates the problems of those working at home, looked at how effectively the enforcement procedures operate in these circumstances. Maria Hudson from the University of Cambridge provided us with information about the effect of the minimum wage on disabled people, and Justine Schneider from the University of Durham considered what effect it had on the employment of disabled people. The Equality Commission for Northern Ireland assessed the effect of the minimum wage on women and men in Northern Ireland. We commissioned two projects to consider the impact on ethnic minorities: Leicester City Council surveyed workers from ethnic minorities to assess the impact of the minimum wage, and Fiona Colgon, Mary Davis and Steve Jefferys from the University of North London studied awareness and impact in an area of deprivation and high ethnicity in North London.
- Some projects focused on young people. Rosemary Lucas and colleagues at the Manchester Metropolitan University examined the treatment of young workers in the hospitality sector in urban and rural areas. They also carried out another project on the experiences of students taking work. The Greater Manchester Low Pay Unit analysed Careers Service data to inform us about the interaction of the minimum wage with the youth labour market.
- We commissioned further research on compliance from the National Association of Citizens Advice Bureaux (NACAB) and the West Midlands Low Pay Unit which monitored enquiries about the minimum wage. IDS also undertook research on the outcome of National Minimum Wage cases at Employment Tribunals.

- Finally, our terms of reference asked us to consider the interaction of the minimum wage with the tax and benefits system, which enabled us to widen the scope of our research projects. Holly Sutherland from the University of Cambridge used a tax-benefit model to analyse the impact of the minimum wage on in-work poverty. And Euan Phimister, Ioannis Theodossiou and Alana Gilbert from the University of Aberdeen looked at the potential impact of the minimum wage on earnings in rural areas through analysis of BHPS data.

2.4 The body of research findings that we have amassed from academics, voluntary groups and professional research organisations – employing a variety of research techniques – contributed to the recommendations we have made. The research findings underpin our conclusions and are reflected throughout both volumes of this report. We have much appreciated working once again with a number of researchers as well as making links with new ones. We believe that at this stage, however, we should begin to consider more long-term research, and we very much hope that in its response to this report the Government will ensure that we are in a position to encourage longer-term research projects. Although most researchers will wish to publish their own research, as last time we will ensure that copies are deposited in certain libraries, the details of which can be found on our web site and in the second volume of our report. A complete list of the projects we commissioned will be found in the second volume of this report.

2.5 To obtain an exclusive and direct indication of the impact of the National Minimum Wage on business, we once again undertook our own survey. But we broadened its coverage by targeting sectors likely to be affected by the minimum wage. Hairdressing, hospitality, retail, business services, social care, childcare and textiles were all included and we are grateful to trade associations in these sectors – and to the Black Business Association and North London Chamber of Commerce – which distributed the questionnaire to their members. Altogether we distributed over 20,000 questionnaires. We achieved response rates of between 17 and 21 per cent in the hospitality, business services, social care and childcare sectors, with the total response rate being 14 per cent. Three-quarters of the responses came from small firms. Questions focused on the overall impact of the minimum wage, the impact of the June and October upratings, pay structures, the use of the Development Rates and the likelihood of employing young people. Certain sectors received additional questions if we thought there were issues that were of particular concern to them.

2.6 As our terms of reference referred specifically to the interaction between the minimum wage and the New Deal, we also conducted a small-scale postal survey of employers who had participated in the New Deal. We are grateful to the Employment Service for helping us to identify nearly 1,500 employers (mainly small and medium-sized enterprises) to which we sent questionnaires. The response rate was 12 per cent. Questions covered the extent of New Deal participants, the impact of the minimum wage, whether employers were more or less willing to take on subsidised employees with the onset of the minimum wage, rates of pay and use of the Development Rates, and whether employers intended to continue to use the schemes. Full details of the New Deal research will be in our second volume. We used the main survey to inform our report and there are references to it in the main body of this volume. Appendix 2 gives a fuller account of the survey.

2.7 Readers of our last report will recall that there were problems with the data available on low pay. As these underpin much of this report and our recommendations, we have continued to work with the ONS to establish better estimates of the incidence of low pay. During the period that we have been working on this report, ONS has produced new estimates based on a revised methodology. We are grateful to ONS for the work it has done and hope that it will continue to work to improve the estimates of the incidence of low pay in the economy. Chapter 3 describes what the data tell us about the impact of the minimum wage, and Appendix 1 to this volume explains how the latest estimates were derived and gives our assessment of their accuracy.

2.8 We have continued to look at minimum wages in other countries and discussed their operation and the arrangements for uprating with officials in the Republic of Ireland and the

Netherlands. We have discussed questions of mutual interest with academics and government representatives from Australia, Bulgaria, Japan, New Zealand, South Africa, Sweden and Taiwan. Further information about international comparisons will be found in Appendix 3 of this volume and in our second volume.

Consultation

2.9 We now possess a database of those in a position to offer advice about the minimum wage as a result of the evidence collected for our previous reports. We sent over 400 letters to employer organisations, unions, voluntary and charitable organisations, pressure groups and academics. But we also tried to make some new contacts, especially with organisations that work with people from ethnic minorities and disabled people. Our web site also encouraged individuals, firms and organisations to submit their written evidence to us. We asked for views on any or all of the issues covered by our terms of reference but, in addition, also welcomed views on compliance with and enforcement of the minimum wage and on longer-term uprating mechanisms.

2.10 We received more than 150 pieces of written evidence from businesses, trade associations, trade unions, pressure groups, employer organisations and individuals. The vast majority of these acknowledged that the minimum wage had been of benefit to low-paid workers and that businesses had been able to accommodate it. Many of those from trade unions and pressure groups took the opportunity to argue for a substantial rise in the main rate and abolition of the Development Rate for young workers. But most employers' organisations were cautious about the next increase. Once again we were impressed by the serious and considered nature of the evidence that we received. In the case of the representative organisations this was often based upon extensive information-gathering exercises which they themselves had undertaken. Evidence, unless given to us in confidence, will be made available to the libraries listed on our web site and in the second volume of our report.

2.11 We heard oral evidence from the CBI and TUC and a number of other organisations which had expressed a wish to supplement their written evidence. A list of those we met will be in the second volume of this report. We are very grateful to all the people and organisations that gave us their views.

2.12 We have always valued the opportunity to meet those most affected by the minimum wage on their home ground. This allows us to get an impression of its impact, discuss how it is working, and what should happen next. This time we also wanted to look at some specific issues which had been raised with us when preparing previous reports.

2.13 We met providers of care homes for the elderly and their local authority partners. We met unemployed people and those from local authorities, government departments and local agencies trying to help them with obtaining benefits and getting back to work. We visited a college of commerce to meet young people, their representatives and some of their employers. They gave us their views on the Development Rate and shared details of their circumstances and the paid work that they had to undertake to pay for their education. We talked to employers about their training. We also met people recently settled in this country who were trying to find work and those whose circumstances meant that working from home was their only option. We visited an agency placing disabled workers in jobs. We were able to meet many representatives of the hospitality industry, including those providing caravan sites. We met those supplying casual workers, often from overseas, to a range of sectors. We listened to the views of small manufacturers. We saw those providing entertainment – circuses and seaside piers – and those supplying services – a village shop, dry cleaners and a company providing cleaning and hygiene services. We saw those helping people obtain the minimum wage and those to whom the Government has entrusted the task of enforcing it. We visited Northern Ireland, Scotland and Wales and – in England – the North East, North West, Yorkshire and East Anglia. We are grateful to everyone we saw and also to those who helped us arrange the visits.

Conclusion

2.14 We have once again accumulated a vast amount of information about the minimum wage and the impact it is having in the UK. Because we have solicited views from a diversity of sources, thoroughly assessed the data and sought out those with a particular view to express or experience to recount, our confidence about the unanimous recommendations we have made is strong.

2.15 In the next chapter we describe how we used this evidence to make an assessment of the impact of the introduction of the minimum wage.

3 Impact of the National Minimum Wage

The National Minimum Wage has been in force for almost two years. We are therefore still at an early stage in being able to offer a full assessment of its impact. We do know that a large number of people have benefited and that the minimum wage has been widely welcomed by low-paid workers. We mentioned in our first two reports that there was uncertainty with the ONS data. These have been revised again. The latest estimate based on the revised ONS data suggests that workers in around 1.3 million jobs were entitled to higher wages as a result of the introduction of the minimum wage and that the impact on the wage bill was 0.35 per cent. A significant impact of the minimum wage is that the overall earnings distribution and the gender pay gap have narrowed. The impact upon differentials has been contained and, although some sectors were affected more than others, there does not appear to be a continuing effect.

We received a great deal of evidence on firms' coping strategies and we found a wide range of responses by firms. Some businesses reported positive changes that increased efficiency; others reported difficulties. We could not detect an impact on the RPI from the introduction of the minimum wage, although significant numbers of firms in low-paying sectors reported increased prices. Employment continued to grow strongly, and there were no discernible adverse effects at the aggregate level. We realised that this did not tell us what employment would have been in the absence of a minimum wage; but our research showed that even controlling for this and other factors the impact of the minimum wage was broadly neutral. Employment among those groups that were vulnerable – particularly women, young people, part-time workers, ethnic minority groups and disabled people – continued to increase.

3.1 We said in our second report that several years would be needed to assess the full effects of the National Minimum Wage. We now have almost two years' data which allow us to make a more definitive assessment of the initial impact of the minimum wage. We remain of the view, however, that the National Minimum Wage is at a relatively early stage in its development and that more time is needed before a fuller assessment can be made.

3.2 Our task this time round is to continue to evaluate the range of direct and indirect effects of the introduction of the minimum wage and of the upratings. We have given special consideration to groups and sectors which have a large proportion of low-paid employees and on which the effects are likely to be greater.

3.3 It is not straightforward to isolate the effects of the minimum wage from other changes that affect pay and the labour market, such as changes in the economic cycle, other tax and benefit reforms, and working time and other regulations. A key to our evaluation strategy has been to establish what would have happened in the absence of the minimum wage. We have done this by analysing time-series data before and after the minimum wage was introduced, and by considering groups or sectors operating above minimum wage levels which we used as a control for those who are most affected.

3.4 At the whole-economy level, we considered a range of factors covering both the introduction of the minimum wage and its uprating. These include numbers and types of workers benefiting from the minimum wage; the scale of pay increases and the impact upon differentials; the effect on competitiveness, including firms' total pay bill costs and moves towards more productive working practices; employment, unemployment, and participation in the labour market; and the effect on public sector finances.

3.5 As well as covering the whole-economy effects, we monitored those sectors or groups that are most affected by the minimum wage. Among the key low-paying sectors are hospitality, hairdressing, retail, cleaning, textiles and care homes. Among the groups of workers who are likely to be disproportionately affected, and therefore required specific monitoring, are young people, women, ethnic groups, disabled people and homeworkers. The second volume of our report will contain more detailed analysis of these groups and sectors.

3.6 Our second report identified several important indirect effects of the minimum wage whereby employers and employees adopt strategies to adjust. Some of these changes occurred in the short run or were anticipated before the minimum wage was introduced; others have longer lead-in times and have only shown up in the current round of research. These dynamic effects may have positive or negative consequences on the economy as a whole, and being able to identify them and assess their importance will be key to determining the continuing success of the new legislation.

3.7 A crucial element in our evaluation strategy is the reliability of the statistical data provided by the ONS on the numbers in low pay. We are grateful to ONS for the steps it has taken to develop its methodology, but there remains scope for further improvements. We would encourage ONS to continue to develop its approach to low pay in order that the figures can be regarded as authoritative. We supplemented evidence gathered from official data sources with a research programme, a full consultation exercise and a survey of firms in low-paying sectors.

Beneficiaries

3.8 In our previous reports we highlighted the shortcomings of the official earnings data which had subsequently caused us to revise downwards our estimate of the numbers who had benefited from the minimum wage. At the time of our second report, ONS was working on refining the methodology used to provide estimates of numbers in low pay. As a result, ONS published a 'revised' central estimate of the incidence of low pay (ONS Press Release, 26 October 2000). In Appendix 1 we make an assessment of this revised methodology and its estimate of the extent of low pay in the economy.

3.9 In summary, our estimate in 1999 that around 1.9 million workers would benefit from the minimum wage was revised downwards in our second report to between 1.5 and 1.7 million workers. Using the refined ONS methodology, we have again revised the numbers downwards. Table 3.1 summarises the numbers and percentages earning below £3.60 (age 22 and over) and £3.00 (18–21 year olds) per hour in 1998, 1999 and 2000 on this revised basis.

Table 3.1

Number of Jobs Paid Below the National Minimum Wage, 1998–2000

Year	Number of jobs paid less than specified amounts (%)	Number (000s)
1998 (<£3.60/£3.00)		
18–21	7.7	120
22 and over	6.4	1,400
Total	6.4	1,520
1999 (<£3.60/£3.00)		
18–21	2.7	40
22 and over	2.4	540
Total	2.4	580
2000 (<£3.60/£3.00)		
18–21	3.1	50
22 and over	1.1	250
Total	1.2	300

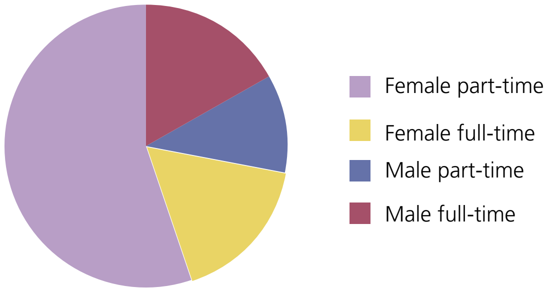
Source: ONS

3.10 The figures for 1998, in Table 3.1, are not consistent with the 1998 estimates in the second report. In order to allow for wage growth between 1998 and 1999, we based the estimates of potential beneficiaries in our second report on the numbers of jobs paying less than £3.50 per hour (£2.90 for 18–21 year olds). Using the refined ONS methodology, we now estimate that around 1.3 million jobs were paid at these levels in 1998, a significant reduction from our original estimate.

3.11 Using the refined methodology, we analysed the groups and sectors that were most affected by the introduction of the minimum wage. Although the overall numbers were smaller, Figure 3.1 shows that the composition was similar to that in our second report. Over 70 per cent of beneficiaries were women, and around two-thirds of jobs below minimum wage levels were part-time.

Figure 3.1

Proportion of Jobs Paying Less than £3.50 (22 and over), £2.90 (18–21) by Gender and Hours Worked, 1998

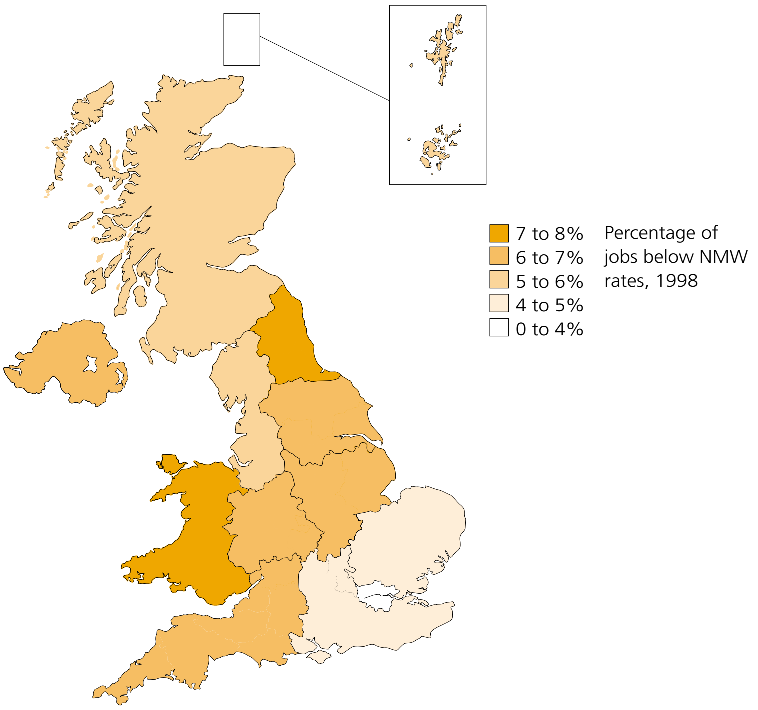


Source: LPC calculations based on grossed NES and LFS data

3.12 As can be seen from Figure 3.2, we found considerable variation between regions, with the North East, Wales, the South West and Northern Ireland having the highest proportions of jobs below minimum wage rates in 1998.

Figure 3.2

Percentage of Jobs Paying Less than £3.50 (22 and over), £2.90 (18–21) by Region, 1998

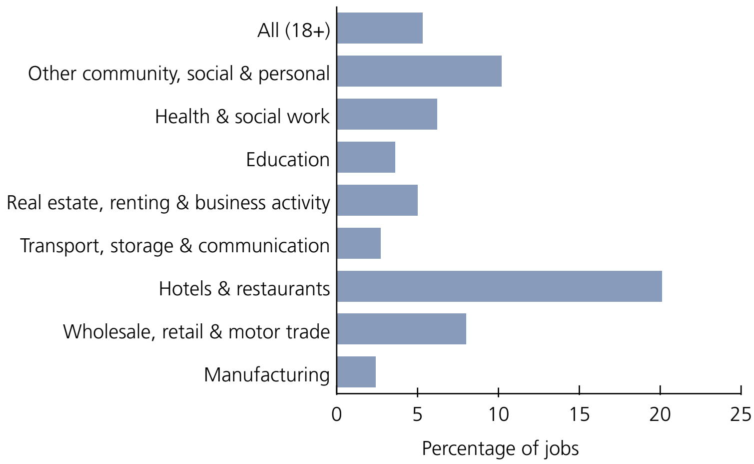


Source: LPC calculations based on grossed NES and LFS data
Note: Government Office Regions shown for England.

3.13 Figure 3.3 shows that particular sectors were also disproportionately affected, with 20 per cent of jobs in the hotel and restaurant sector estimated to be below minimum wage rates in 1998, compared with an estimated 5.3 per cent overall. Wholesale, retail and the motor trade, community social and personal services, and health and social work all had more than 6 per cent of jobs paid below minimum wage levels in 1998.

Figure 3.3

Percentage of Jobs Paying Less than £3.50 (22 and over), £2.90 (18–21) by Industry Sector, 1998



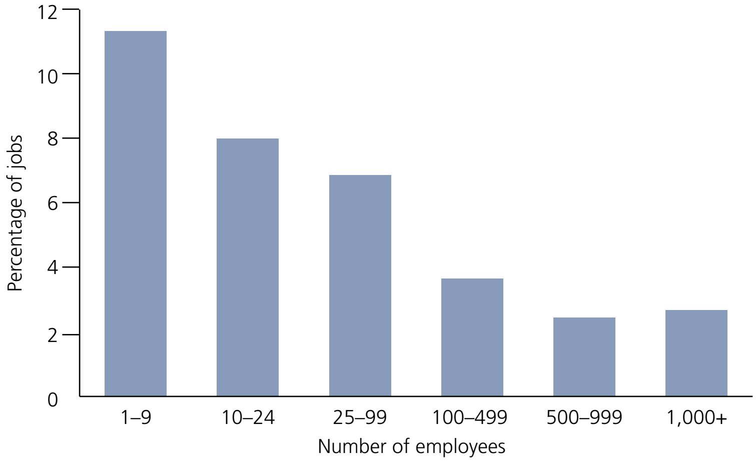
Source: LPC calculations based on grossed NES and LFS data

Note: Sample size too small for reliable estimates in other industry sectors.

3.14 Figure 3.4 shows that over 11 per cent of firms with fewer than ten employees were affected by the minimum wage. This was more than twice the national average.

Figure 3.4

Percentage of Jobs Paying Less than £3.50 (22 and over), £2.90 (18–21) by Business Size, 1998



Source: Grossed NES data, April 1998

3.15 Our analysis of the LFS suggests that ethnic minority employees were over-represented in the group paid below minimum wage rates in 1998. The sample numbers are small but Pakistani-Bangladeshi employees appear to be over-represented and so stood to benefit considerably from the introduction of the National Minimum Wage.

3.16 Low pay is common among homeworkers: those who work mainly at home. Research published last year, looking at LFS data for Spring 1997 to Autumn 1998, found that a quarter of homeworkers were paid below £3.60 per hour and, of these, nine out of ten were women (Felstead and Jewson, 2000). Manual homeworkers were particularly affected: about three-quarters of them were paid below £3.60 per hour. And pay rates among manual homeworkers were on average around half of those of manual workers who did not work at home (£2.86 compared with £5.49). Ethnic minority manual homeworkers were among the lowest paid. Many homeworkers should, therefore, have benefited as a result of the National Minimum Wage.

3.17 Disabled workers – those with a work-limiting disability – are generally more likely to be lower paid than non-disabled workers. LFS data show that in 1998 the lowest decile of hourly earnings among disabled workers was £3.62 compared with £3.78 among non-disabled workers. Few of those submitting evidence commented on the impact of the National Minimum Wage on disabled workers' pay. But we were encouraged by the views of the Advisory Committee for Disabled People in Employment and Training which told how disabled people had benefited from the minimum wage.

The introduction of the National Minimum Wage has brought to light examples of workplaces where it had not been previously known that a disabled person doing the same work as others was receiving less pay, just because they were disabled. This practice has had to stop and has been an important positive step forward.

Advisory Committee for Disabled People in Employment and Training evidence

3.18 As we mentioned in our second report, research by Incomes Data Services Ltd. (IDS) suggested that some employers had been making adjustments to their pay structures in anticipation of the minimum wage. By April 1999 the numbers earning below the minimum wage had fallen to 580,000. And at April 2000 the numbers had fallen further, with an estimated 300,000 jobs paid below National Minimum Wage levels.

3.19 We shall be covering compliance in the second volume of our report. In the meantime, we emphasise that the numbers shown below the minimum wage in the official data cannot be taken as a measure of non-compliance. Neither the LFS nor the New Earnings Survey (NES) monitors compliance with the National Minimum Wage. For example, they cannot identify those such as apprentices, those undergoing training and those eligible for the accommodation deductor, who may receive less than the National Minimum Wage. And the data show some 'bunching' just below minimum wage rates which suggests that there are minor inaccuracies in reported hours or earnings, resulting in some jobs being shown as below the minimum wage. Finally, as we said in our second report, similar surveys in countries with long-established minimum wages where compliance is regarded as universal, such as the United States and France, show large numbers of workers below the minimum rates.

3.20 In summary, our judgment is that workers in around 1.3 million jobs were entitled to higher pay as a result of the introduction of the minimum wage. Women, part-time workers and people from ethnic minority backgrounds, in particular, stood to benefit. Although the numbers who benefited were lower than we estimated in our first and second reports, the minimum wage has made a significant difference to many low-paid workers.

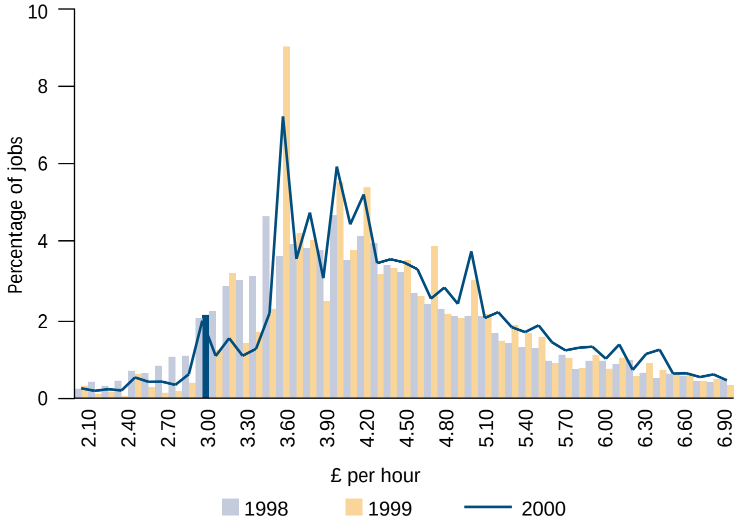
Earnings

Levels

3.21 Figures 3.5 and 3.6 show the change in the hourly earnings distribution, between April 1998 and April 2000, based on the ONS central estimate methodology. The concentration of jobs in April 1999 that paid £3.60–£3.70 per hour, (for both those aged 22 and over and those aged 18–21) had diminished by April 2000, indicating that wages had increased over and above minimum wage levels. At April 2000, around 850,000 jobs for those aged 22 and over paid below £3.70 per hour, and 100,000 jobs for those aged 18–21 paid less than £3.20 per hour, showing that fewer people stood to gain from the June and October 2000 upratings of the minimum wage than from its introduction. Increases in earnings at the bottom end of the distribution have therefore outstripped the increase in the minimum wage.

Figure 3.5

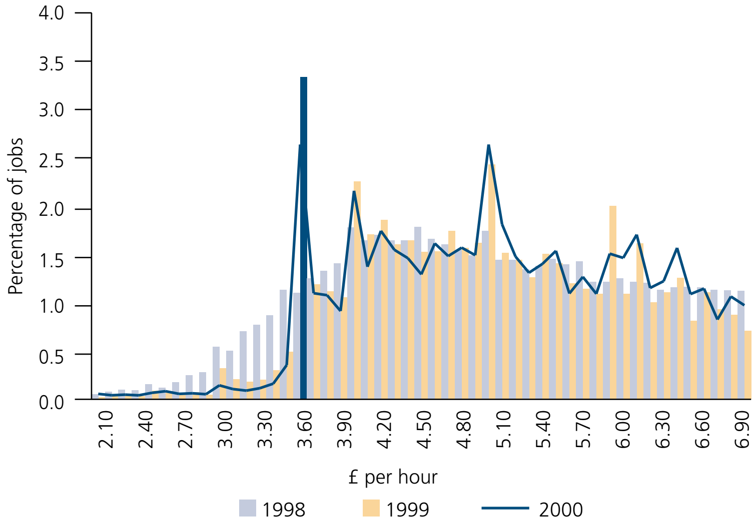
Hourly Earnings Distribution for Those Aged 18–21, April 1998–April 2000



Source: ONS Central estimate methodology

Figure 3.6

Hourly Earnings Distribution for Those Aged 22 and Over, April 1998–April 2000



Source: ONS Central estimate methodology

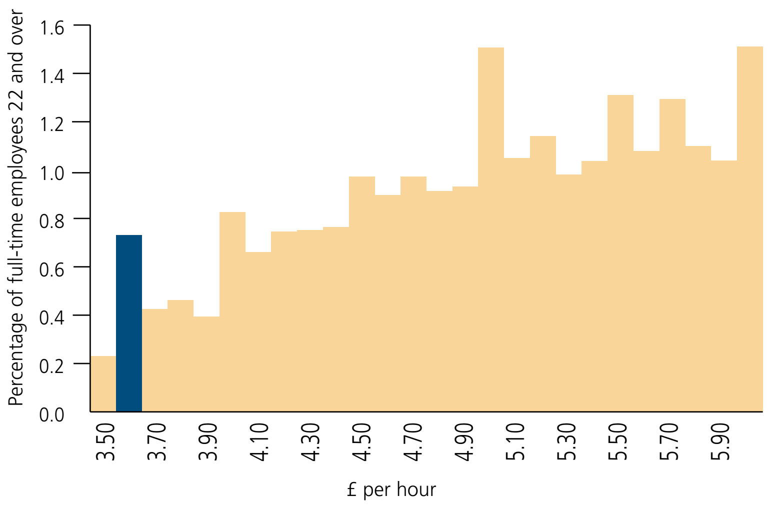
We have seen the emergence of a 'mezzanine' floor of around £4.00 an hour as leading firms take steps to keep their rates ahead of the field, driven in part by the tightening labour market.

Incomes Data Services, 2000a

3.22 As can be seen from Figure 3.7, in 2000 there were peaks in the earnings distribution for full-time employees aged 22 and over at around £4–£4.10 and £5–£5.10 per hour. The April 2000 NES data show that a greater number of full-time adult workers were paid £4.00 per hour than were paid £3.60 per hour, with a 'valley' between the spikes at £3.60 and £4.00 per hour.

Figure 3.7

Hourly Earnings Distribution for Full-time Employees Aged 22 and Over, 2000



Source: Grossed NES April 2000

3.23 Table 3.2 shows increases in the bottom decile, median, and upper decile earnings between 1998/99 and 1999/2000. Between these dates the lowest decile earnings increased faster than the median, and earnings growth in the bottom decile outstripped increases in the top decile in 1998/99 and 1999/2000.

Table 3.2

Increase in Earnings 1998–2000

	Increase in Earnings (%) 1998/99	1999/2000
Full-time age 18 and over Lowest Decile	5.4	3.3
Full-time age 18 and over Median	4.8	2.8
Full-time age 18 and over Upper Decile	5.5	2.9
Part-time age 18 and over Lowest Decile	9.1	2.8
Part-time age 18 and over Median	4.8	1.4
Part-time age 18 and over Upper Decile	5.7	2.2

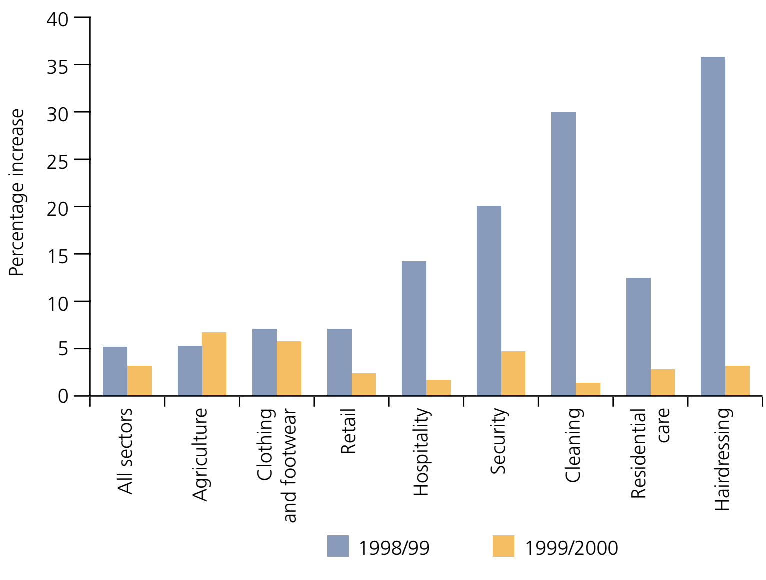
Source: Grossed NES data, April 1998, 1999, 2000

3.24 The differences in earnings between different groups, sectors and regions changed between 1999 and 2000. Women, ethnic minority and disabled workers are all disproportionately represented among the low paid. The minimum wage would therefore be expected to have a positive effect on equal pay, and on the earnings gap of other disadvantaged groups. In our second report we observed that between 1998 and 1999 the gender pay gap (the ratio of female to male hourly earnings) narrowed by a full percentage point. This gap narrowed by a further percentage point between April 1999 and April 2000: average full-time hourly earnings for women increased from 81 to 82 per cent of average male hourly earnings. A more significant increase, over the same period, was seen for part-time workers: female part-time earnings increased from 81 to 89 per cent of male earnings. Not all of this can be attributed to the impact of the minimum wage. Other factors such as changes in the composition of the workforce and changes in hours are also important. A recent study (S. Dex et al., 2000) modelled the effect of the introduction of the minimum wage on the gender pay gap. It found the minimum wage produced small increases in the overall female/male hourly pay ratio, with larger changes for manual workers, and for part-time female employees compared with all men.

3.25 As shown in Figure 3.8, there was some narrowing of the relativities in average earnings between sectors over the period 1998 to 2000. Lowest decile earnings across the low-paying sectors identified in Figure 3.8, increased about twice as fast as those across all sectors, nearly 11 per cent compared with 5.3 per cent overall in 1998/99. Since 1999, increases in lowest decile earnings have been more subdued. The largest increases were in agriculture (6.7 per cent) and clothing and footwear (5.8 per cent). Other sectors such as hospitality and cleaning saw very small changes of around 1.5 per cent.

Figure 3.8

Increase in Lowest Decile Earnings for Employees Aged 18 and Over in Low-paying Sectors, 1998–2000

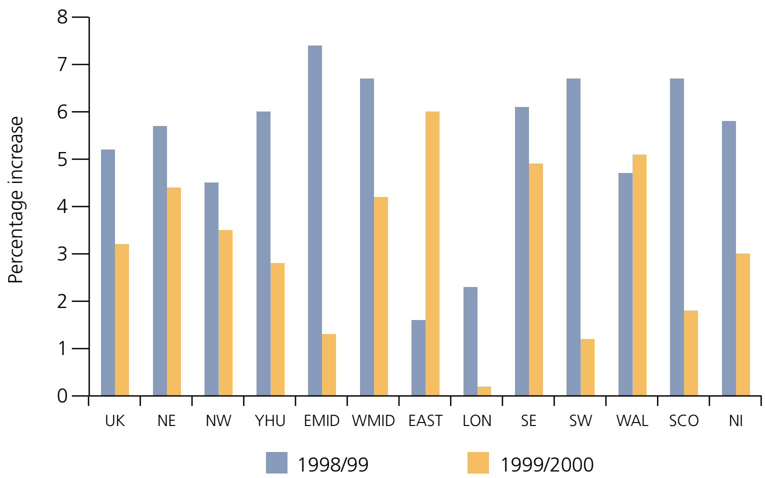


Source: Grossed NES data, April 1998, 1999, 2000

3.26 The minimum wage has also had an impact on variations in earnings between regions. Figure 3.9 shows the increase in lowest decile earnings by region between 1998 and 2000. The increase in lowest decile earnings across the UK as a whole was 3.2 per cent in the year after the minimum wage was introduced. The highest increases were in the East, Wales, the South East and the North East. Of these, the North East and Wales are low-paying regions and the higher than average increases there are likely to be a minimum wage effect. But the South East and Eastern regions are higher-paying, and large increases there are more likely to indicate a tight labour market. Other regions appear not to fit into any simple pattern. The evidence suggests that the minimum wage may have narrowed the regional pay gap, but the picture is complicated by the tight labour market and other factors.

Figure 3.9

Increase in Lowest Decile Earnings for Employees Aged 18 and Over by Region, 1998–2000



Source: Grossed NES data, April 1998, 1999, 2000
Note: Government Office Regions shown for England

3.27 In our second report, using the NES matched sample between April 1998 and April 1999, we produced estimates of the increase in wages that resulted from the introduction of the minimum wage. We estimated that those paid below minimum wage rates in 1998 and who remained in the sample in 1999, saw an increase in their wages of between 20 and 31 per cent. Not all of this increase was attributable to the minimum wage; some of the increase would have arisen through incremental pay drift or annual pay increases.

3.28 It is not possible to revisit the NES figures using the new, grossed NES data because the NES has been grossed for each year separately; the data which link individuals between years, have not been grossed. We would not recommend using the LFS data because, as is explained in Appendix 1, the LFS hourly rate variable changed between April 1998 and April 1999, and therefore comparisons between these years will not be valid.

3.29 We asked Mark Stewart of Warwick University to provide some analysis of increases in hourly earnings from the British Household Panel Survey (BHPS). The advantage of the BHPS is the panel nature of the data: the same individuals are tracked over a long time period. In addition, in contrast to the NES, coverage of the earnings distribution is complete. The main disadvantage compared with the NES and LFS is the smaller sample size.

3.30 Table 3.3 shows median hourly earnings in 1998 and 1999 for those aged 22 and over, who remained in the same job in the two years, by whether or not they earned less than £3.60 per hour in 1998. It shows that those earning less than the minimum wage in 1998 saw an increase of 15.5 per cent between 1998 and 1999, compared with a 4.6 per cent increase for those earning above minimum wage levels. While none of these estimates is entirely reliable, these data provide further indication of the boost to earnings provided to people in low pay from the minimum wage.

Table 3.3

Increase in Earnings due to Introduction of the National Minimum Wage

All aged 22 and over, who remained in the same job	Median earnings in October 1998	Median earnings in October 1999
Earning less than £3.60 in 1998	£3.16	£3.65
Earning £3.60 or more in 1999	£7.36	£7.70

Source: BHPS data, 1998,1999

Differentials

3.31 In our first report we concluded that ‘if the National Minimum Wage is introduced at a sensible level, the pressure to restore pay differentials following its introduction will be limited and localised’. This conclusion was important in making our initial recommendations because we were conscious of the need to recommend a rate that did not encourage extensive reassertion of pay differentials.

3.32 In our second report we noted that the evidence from the NES and research we had commissioned tended to bear this out. Our analysis of the NES suggested that the effect on differentials appeared to peter out at about £5.00 per hour. And IDS research and other surveys suggested that differentials were not being affected greatly or that effects were being dealt with in a straightforward way. Our conclusion was that the restoration of differentials seemed to have been limited.

3.33 We received mixed evidence on differentials in preparing this third report. Some organisations reported substantial effects and others reported minimal impact. In its evidence to us, the CBI indicated that 'of the companies reporting that the NMW had an impact on their business in the CBI *Employment Trends Survey 2000*, only 11% reported that there had been an impact on differentials'.

3.34 This view was supported by the British Retail Consortium (BRC), which argued that because the minimum wage was 'set at a workable £3.60 (now £3.70), the maintenance of differentials has not been a substantial problem'. The British Hospitality Association stated that 'we accept that the impact of the NMW on differentials has been limited, but would again stress that, if the factors behind this – a moderate introductory rate of the NMW, and labour shortages – were to disappear, there could be a more significant impact'.

3.35 But we received reports of more significant effects, especially in business services and the care home sectors. The Cleaning and Support Services Association indicated that 'some 40% of members reported an initial compression of pay differentials… resulting in higher rates of pay for supervisory and management grades, … most of which was having to be absorbed as unobtainable from clients in price increases'. The Business Services Association reported that 'inevitably, there has been some knock-on effect on differentials. These are of considerable importance in blue-collar work. The introduction of the NMW has tended to result in flattened pay structures'. The GMB said 'there have also been reports of some erosion of differentials between care assistants and domestic staff as the minimum pay has been brought up'. And the Lancashire Care

The general feeling amongst members is that their wage bills have increased by around 20% which is directly attributable to the introduction of the National Minimum Wage, and them having to maintain differential in pay levels for the various grades of staff.

United Care Homes Association evidence

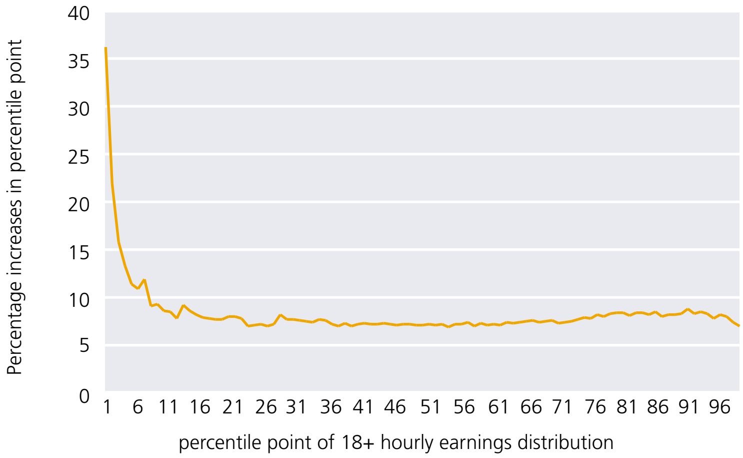
Association wrote that 'in order to maintain pay differentials it has also been necessary in many cases to increase the hourly rate for more senior staff'.

3.36 A number of organisations associated the minimum wage with changes in the levels of pay at which staff could be recruited. One employer reported that 'the National Minimum Wage is now considered to be "Poverty Level" and will continue to be considered so at whatever level it is set. To obtain competent staff employers must pay above this level – room must therefore be allowed for employers to build or enhance the National Minimum Wage in the light of their ability to do so'.

3.37 We looked at the earnings distribution across the economy to see whether we could identify the impact on differentials. Figure 3.10 shows the increases in pay, excluding overtime earnings, across the earnings distribution between 1998 and 2000 using grossed NES data. These data show that the differential effect was contained within the bottom half of the earnings distribution, with the major effect at the eighth percentile or about £3.65 per hour (at 1998 earnings) and petering out by the 32nd percentile or around £5.35 per hour.

Figure 3.10

Percentile Increases in Hourly Earnings for Employees Aged 18 and over, 1998–2000

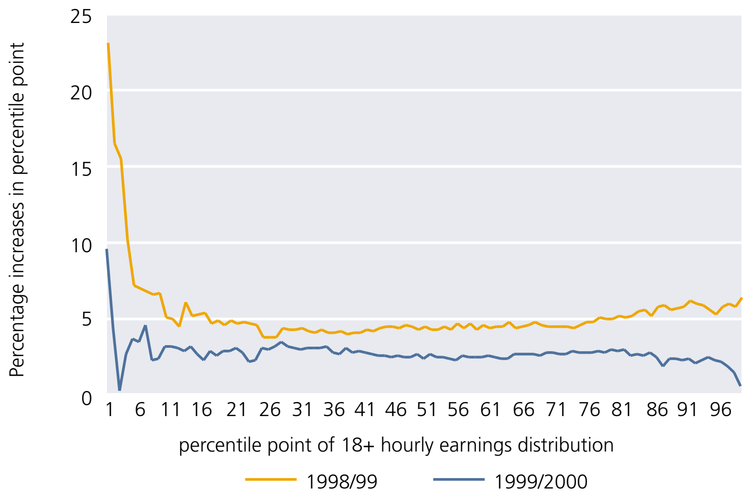


Source: Grossed NES data, April 1998 and 2000

3.38 Figure 3.11 disaggregates the data into changes between 1998/99 and 1999/2000. This suggests that the major impact between 1999 and 2000 occurred at around the eighth percentile (£3.90 per hour at 1999 levels of earnings) and peters out by around the 40th percentile (£6.20 per hour).

Figure 3.11

Percentile Increases in Hourly Earnings for Employees Aged 18 and over, 1998/99 and 1999/2000



Source: Grossed NES data, April 1998, 1999, 2000

3.39 We noted that the increases for 1999/2000 were lower than in 1998/99 and concluded that the differential effect of the National Minimum Wage appears to have become more muted since 1999 and that many organisations have returned to traditional across-the-board increases. The evidence for continuing restoration remains slight. IDS suggest that 'any substantial changes to grading at the bottom of structures would have happened in year one of the NMW and subsequent pay reviews may have only required the straightforward application of a single percentage rise' (IDS, 2000b).

3.40 IDS also analysed evidence on pay differentials in all firms which specified this as a pertinent issue (IDS, 2001a). It found these cases hard to come by, with isolated instances restricted to certain low-paying sectors such as textiles, retail, leisure, voluntary groups and hotels. Its evidence shows that most companies have not been forced to boost their lowest rates by higher percentages than those for supervisors. For example, at Roadchef Motorways, both probationers and supervisors received rises of 2 per cent from September 2000.

3.41 Our own survey of employers in low-paying sectors (that is, those firms we expected to be most affected by the introduction of the minimum wage) also provided us with information about the impact on differentials. Appendix 2 describes the survey methodology, sample and results more fully. As Table 3.4 shows, the data indicated that the median highest pay rate increased as a result of the National Minimum Wage was around £5 per hour.

Table 3.4

Median Highest Hourly Rate Increased

£ per hour	Hairdressing	Hospitality	Social care	Childcare	Total
Median	5.00	5.28	5.00	4.95	5.00

Source: Low Pay Commission Survey, September–November 2000
Note: Base, all firms affected by the National Minimum Wage in any way that increased pay rates for higher-grade staff.

3.42 Table 3.5 shows that for three-quarters of respondents the highest rate increased was less than £6 per hour, and for half of respondents it was less than £5 per hour. Our latest survey suggested that wages were increased higher up the distribution than we found in the survey we undertook for our second report. As noted in Appendix 2, the surveys are not directly comparable as they used a different sample in terms of size and composition.

Table 3.5

Distribution of Highest Hourly Rate Increased

£ per hour	Hairdressing (%)	Hospitality (%)	Social care (%)	Childcare (%)	Total (%)
£3.60 to £3.99	6	5	4	7	6
£4.00 to £4.49	15	15	21	24	20
£4.50 to £4.99	14	15	19	19	17
£5.00 to £5.49	22	16	17	20	19
£5.50 to £5.99	12	13	9	12	11
£6.00 to £6.49	10	8	4	7	7
£6.50+	21	28	25	12	21

Source: Low Pay Commission Survey, September–November 2000
Note: Base, all firms affected by the National Minimum Wage in any way that increased pay rates for higher-grade staff.

Composition of Pay

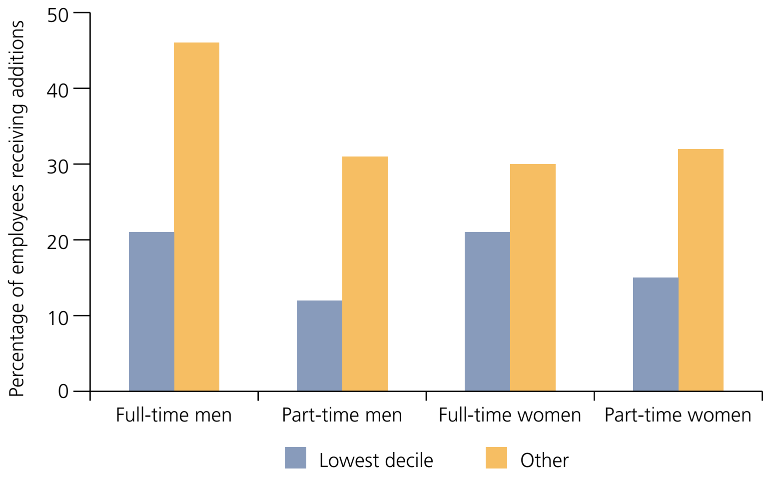
3.43 The definition of the minimum wage adopted in the National Minimum Wage Regulations allowed employers some latitude in restructuring their pay and working arrangements to take maximum advantage of the National Minimum Wage calculation. For example, employers could agree with their workers to consolidate certain pay elements that did not count towards the National Minimum Wage calculation, such as allowances and overtime premia, into basic pay so that these amounts counted towards the National Minimum Wage.

3.44 In our second report we stated that the 'evidence at a sectoral level … shows that in general the implementation of the National Minimum Wage has gone very smoothly, and the definition of the wage has been easily accommodated by business'. Most of the evidence received for this report about pay structures related to differentials or to particular aspects of the National Minimum Wage Regulations, such as the accommodation deductor or tips (with which we will deal in the second volume of our report).

3.45 The latest overall picture on the composition of earnings for the low paid from the NES statistics is shown in Figure 3.12 below. It shows that low-paid workers continue to be less likely to receive additions to basic pay than higher-paid workers. Figure 3.13 shows the figures for those in receipt of overtime and incentive pay by sector. Overtime payments remain the major additional component for low-paid workers, followed by incentive and shift pay. As expected, incentive pay remains most important in the clothing and footwear sector, followed by retail.

Figure 3.12

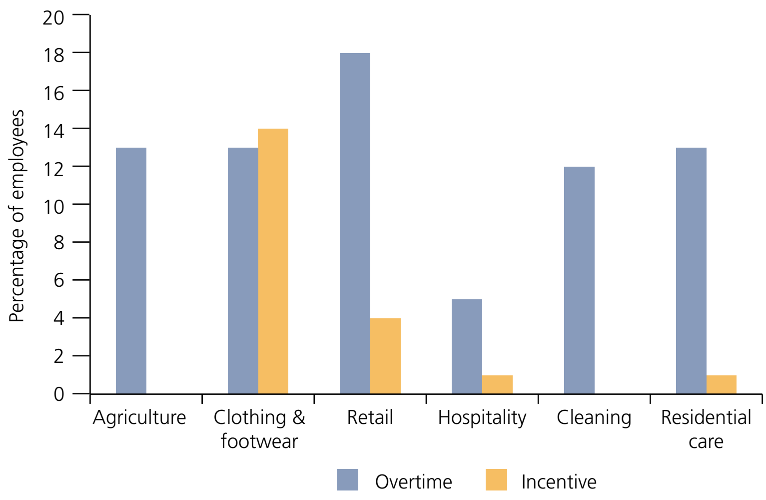
Employees in Receipt of Additions to Basic Pay, 2000



Source: Grossed NES data, April 2000

Figure 3.13

Proportion of Employees in the Lowest Decile of Earnings in Receipt of Overtime and Incentive Payments in Low-paying Sectors, 2000

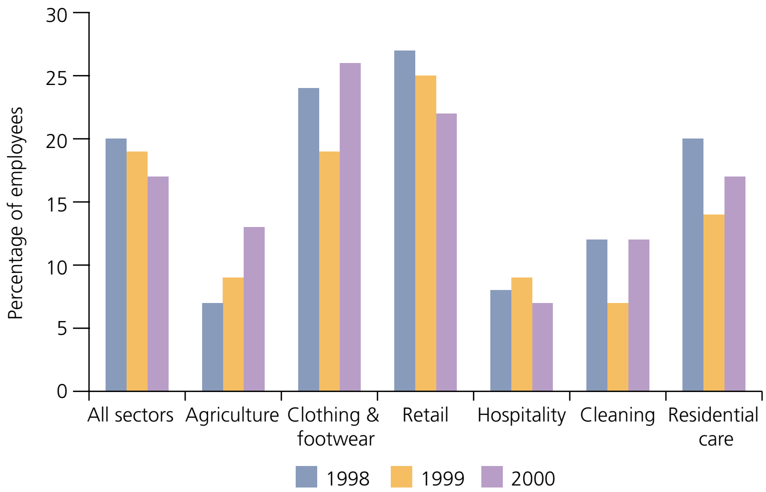


Source: Grossed NES data, April 2000

3.46 Figure 3.14 shows the proportion of employees in the lowest decile receiving additions to basic pay from 1998 to 2000 by sector. The data indicate that there was an overall decline in the percentage of employees receiving additional components for both the lowest decile and the rest since 1998. There was no clear evidence, however, of a minimum wage effect, as the picture is variable across the low-paying sectors. In some low-paying sectors there was an increase for the lowest paid, for example in clothing and footwear and in agriculture.

Figure 3.14

Proportion of Employees in the Lowest Decile of Earnings in Receipt of Additions to Basic Pay in Low-paying Sectors, 1998–2000



Source: Grossed NES data, April 1998, 1999, 2000

3.47 In summary, the earnings distribution has continued to narrow, as has the gender pay gap. The data suggest that the vast majority of workers received their entitlement to the National Minimum Wage. A recent development has been the creation of a 'mezzanine' earnings level at around £4.00 per hour, partly driven by the minimum wage and partly a result of tight labour market conditions. Our evidence suggests that the impact on differentials was limited, but some sectors were more affected than others. The major impact on differentials at the aggregate level appeared to occur with the introduction of the minimum wage; more recent changes were more muted. But the impact on firms in low-paying sectors was more marked. Evidence on pay structures shows that overtime continued to be the major additional earnings component for low-paid workers. And, in line with the trend for all workers, there has been a continuing decline in low-paid employees receiving additions to basic pay.

Employment and Non-employment

3.48 In this section we analyse the effect of the minimum wage on employment, unemployment and inactivity, focusing on the groups and sectors most affected by the minimum wage. In our second report we observed that there was no automatic link between employment and the minimum wage, and this section reviews the continuing evidence on this. We also explore the dynamic effects of the new legislation, the change in labour demand and supply on flows between employment and non-employment.

Employment

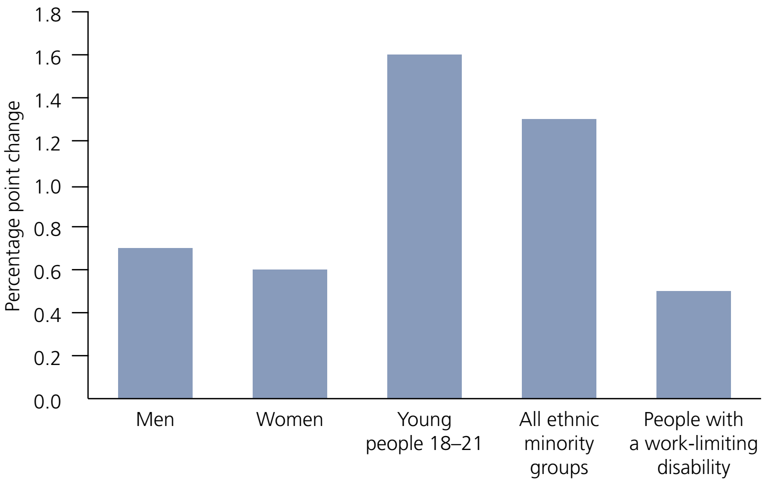
3.49 One of the conventional criticisms of minimum wages is that they cause job losses among those who stand to benefit from them. On the other hand the new economics of the minimum wage suggests that the impact on employment is broadly neutral. In this section we assess the extent to which these hypotheses are borne out by the evidence, both at the aggregate level and on groups most likely to be affected. We also present the results of econometric research we commissioned. Since this controls for factors other than the minimum wage which affect individuals' employment prospects, if any negative employment effects are to be found we would expect them to show up here.

3.50 The period since the minimum wage was introduced has been one of strong employment growth and a tightening labour market. LFS employment (the number of people in work) was nearly 28 million in October to December 2000, which is a record level. Employment grew by 765,000 since the date of our first report, and by slightly over 430,000 since the minimum wage was introduced.

3.51 We saw in our analysis of beneficiaries of the minimum wage that the groups most affected were women, part-time workers, young people, those from ethnic minorities and workers with a work-limiting disability. As Figure 3.15 shows, the labour market performance of these groups has remained strong following the introduction of the minimum wage.

Figure 3.15

Change in Working Age Employment Rate of Different Groups, Spring 1999–Spring 2000



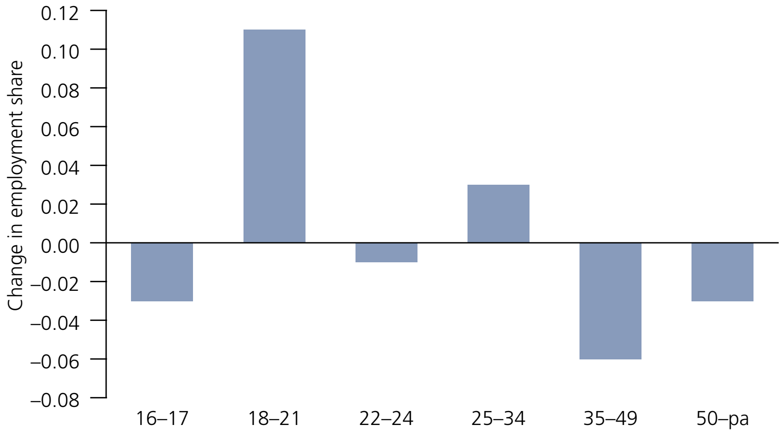
Source: LFS, Spring 1999, 2000

3.52 Between Spring 1999 and Spring 2000 the employment rate of working-age women grew fractionally less than that of men; 0.6 percentage points compared with 0.7 percentage points for men. The employment rate of young people grew at more than twice the aggregate. The increase in the employment rate among working-age ethnic minority groups was, on aggregate, much stronger than that of white workers, 1.3 percentage points compared with 0.7 for white workers. Increases were particularly marked for Black and Pakistani/Bangladeshi workers. The employment rate among working-age people with a work-limiting disability has increased by 0.5 per cent, slightly lower than the rise in the aggregate employment rate.

3.53 Over the year to Spring 2000, employment growth has been particularly marked for the 18–21 age group. As Figure 3.16 indicates, this has led them to increase their share of total employment, after controlling for relative population changes between the different age groups. This issue will be explored in more detail in volume two of our report. Part-time employment also continued to grow following the introduction of the minimum wage. By the end of 2000 there were around 7 million part-time workers, an increase of 2.3 per cent.

Figure 3.16

Change in Age-specific Employment Shares, Spring 1999–Spring 2000



Source: LFS data, Spring 1999, 2000

3.54 While it is encouraging that the aggregate data do not show an adverse employment effect, they do not tell us what employment would have been without the minimum wage. In order to investigate this we need to establish a counterfactual. We commissioned research (Stewart, 2001) to investigate the impact of the introduction of the National Minimum Wage on the probability of employment among those whose wages were below the minimum wage prior to its introduction. We considered this to be the most robust way to identify possible negative employment effects of the minimum wage.

3.55 The approach adopted by Stewart was equivalent to other studies in the United States and France (see, for example, Abowd et al., 1999). The group directly affected by the minimum wage was compared with a similar group from just above the minimum, which is used as a counterfactual. The difference between the two groups was compared across periods that cover the introduction of the National Minimum Wage and earlier periods that do not. Control variables were also included in the analysis to account for other factors that could influence the probability of employment.

3.56 Results were presented for four demographic groups – male and female adults and youths, and for three different datasets – the LFS, NES and BHPS. Overall, the results suggest that the impact of the minimum wage on the probability of remaining

Low Pay Commission Research

The Equality Commission for Northern Ireland conducted research for us on the impact of the minimum wage on the employment patterns of men and women in Northern Ireland. The research indicated that among firms in the survey direct employment losses seemed to have been relatively minor. A few firms attributed cuts in hours and job losses to the impact of the National Minimum Wage.

But job losses claimed by firms to be attributable to the National Minimum Wage accounted for only about 1 per cent of total employment in those firms reporting a fairly significant or major effect from the minimum wage. The research findings emphasised that the minimum wage may have brought forward job losses that were going to occur anyway.

Tony Dignan, 2001. *The National Minimum Wage: Its Impact in Northern Ireland on the Employment Patterns of Men and Women*

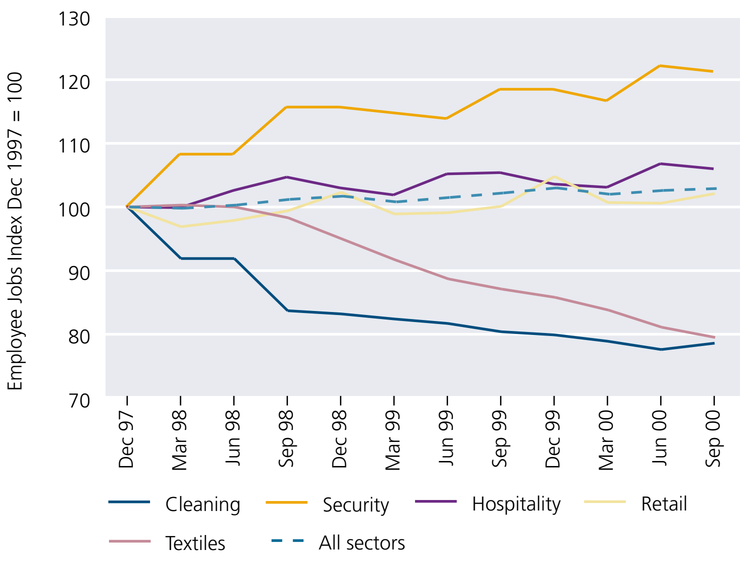
in employment is zero or, if anything, marginally positive for adult men and young people. The conclusion for adult women was less clear-cut. There was weak evidence of a reduction in employment probability post-minimum wage, but even for this group the result was not significantly different from zero.

3.57 We considered this to be a powerful addition to the growing body of evidence on the employment effects of minimum wages (see for example OECD, 1998 for a recent summary). It suggested that the orthodox view that minimum wages cut employment may not be appropriate when analysing low pay in the UK, and that other explanations, such as imperfections in the labour market, may be more relevant.

3.58 These aggregate trends mask considerable variations between sectors and between regions. Figure 3.17 shows that employment in security has increased relatively quickly, while employment in the hospitality and retail sectors has increased in line with the national average. Employment in textiles and cleaning has declined in accordance with longer-term trends and structural changes in these sectors.

Figure 3.17

Employment Change in Low-paying Sectors, 1997–2000



Source: Employee jobs series, ONS, 1997–2000

Overall we have not found negative employment effects arising as a consequence of the introduction of the NMW. Here and there we have found companies with a little local difficulty, but with a bit of ingenuity most problems have been solved. A look at the official figures on employment growth in 1999/2000 shows growth in a range of services, with the largest growth in distribution, hotels and catering.

IDS, 2000b

3.59 Sectors experiencing longer-term structural change are more at risk of external shocks such as the minimum wage. All the evidence we looked at – our own survey, external research and written submissions – showed that the minimum wage particularly affected firms in low-paying sectors and where competitive pressures were strongest. The impact on employment depended on a number of factors, principally the ability of firms to reduce profits and increase prices. A survey we commissioned, of firms affected by the minimum wage in Northern Ireland (Dignan, 2001), found that textiles and clothing firms accounted for 73 per cent of the reported direct job losses, and that employers in this sector were generally unable to raise prices in adjusting to the minimum wage.

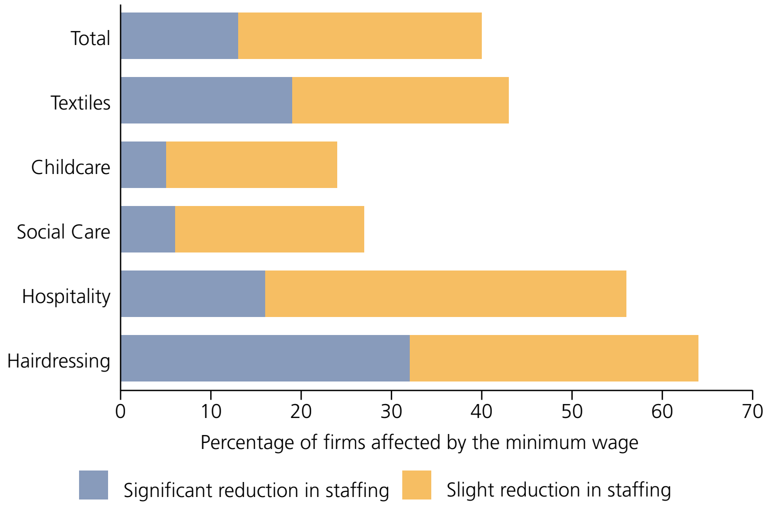
3.60 Of the firms in our survey which reported that the minimum wage had affected their businesses, around 13 per cent said that they had made significant reductions to their staffing levels as a result and 11 per cent reported that they had reduced working hours significantly. There may be a displacement effect that is reducing employment in individual sectors and firms, which is offset by rises in others. This would reconcile these findings with the aggregate level result of continued employment growth. The employment effects varied considerably by sector as illustrated in Figure 3.18. In general, the hairdressing, textile and hospitality sectors were more likely to report reductions in hours and staff, while social care and childcare were less likely. By contrast, these last two sectors were more likely to report reductions in profits and increases in prices.

The GMB reported that the clothing and textiles industry had suffered a huge number of redundancies over the last year. The main influence on these was overseas competition, and the decision of the main retailer, Marks & Spencer, to reduce the volume of clothing supplied from the United Kingdom.

GMB evidence

Figure 3.18

Reductions in Staffing Levels as a Result of the National Minimum Wage



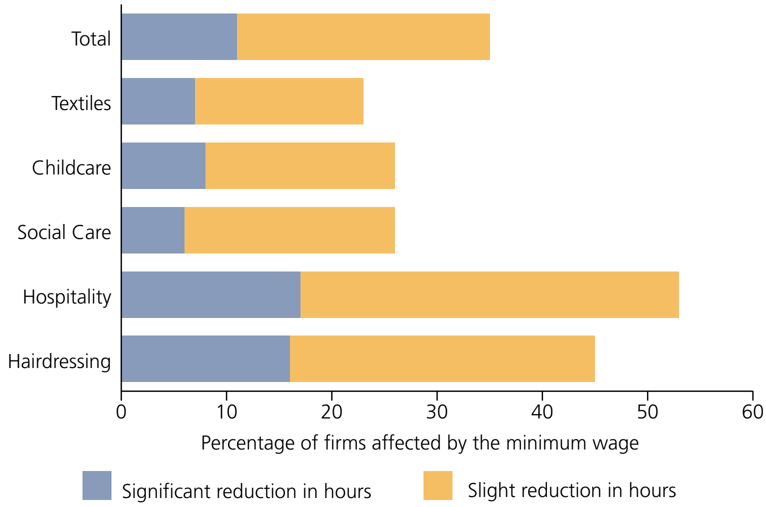
Source: Low Pay Commission Survey, September–November 2000
Note: Base, all firms affected by the National Minimum Wage in any way.

3.61 The British Retail Consortium's own survey showed that while no large businesses had reduced staff as a result of the minimum wage, 11 per cent of small retailers had done so. The Association of Convenience Stores' survey indicated that 44 per cent of respondents said that the minimum wage had led to a reduction in the number of staff employed.

3.62 Reduced working hours were reported by the Association of Convenience Stores, the Biscuit, Cake, Chocolate and Confectionery Alliance, the Brewers and Licensed Retailers Association and the Hairdressing Employers Association. The Amalgamated Engineering and Electrical Union (AEEU) evidence indicated that some employers were not recording the full hours worked in order to reduce their National Minimum Wage liability. Figure 3.19 shows the reduction in working hours by sector as reported in our own survey.

Figure 3.19

Reductions in Working Hours as a Result of the National Minimum Wage



Source: Low Pay Commission Survey, September–November 2000
Note: Base, all firms affected by the National Minimum Wage in any way.

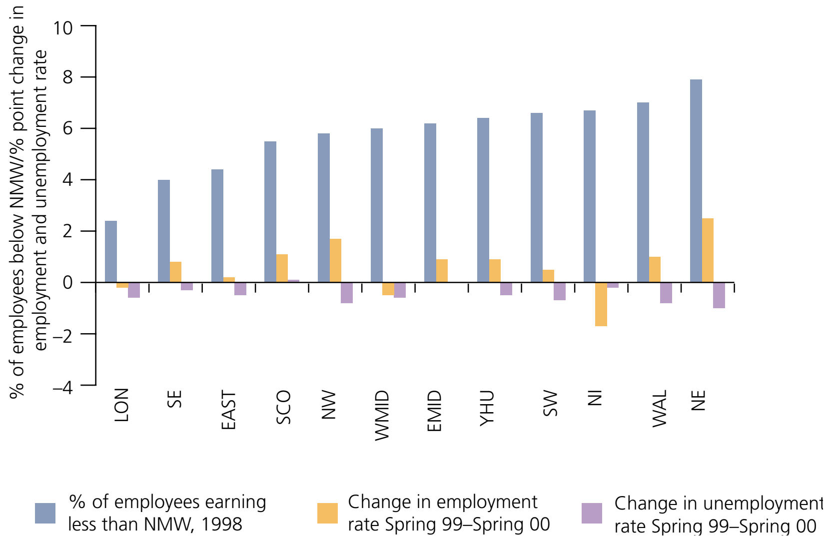
3.63 The reduction in hours identified in certain sectors is borne out to some extent by NES data on hours worked. The latest figures for paid hours of work show that while there has been little change overall, with total hours, including overtime, for the low paid averaging around 27 per week compared with 36 for the rest, the story was different for some sectors most affected by the National Minimum Wage. The sectoral data indicate that both basic and overtime hours fell for lowest-decile workers in retail, hospitality, agriculture and cleaning.

3.64 A number of organisations pointed to a regional impact. The Brewers and Licensed Retailers Association said that introducing the minimum wage at a sensible level had served to lessen the impact on some areas of the UK. Nevertheless, members reported that there had still been some regional impact, particularly in the North and the South West of England. The British Hospitality Association mentioned particularly the impact in Scotland, the South West and Wales.

3.65 If there were to be an employment effect, we would expect the aggregate data to reflect regional differences, with a minimum wage effect more evident in lower-paid regions. As Figure 3.20 below shows, this did not appear to be the case.

Figure 3.20

Distribution of Low Pay in 1998 and Change in Employment and Unemployment Rates Post-National Minimum Wage by Region



Source: LPC calculations based on grossed NES and LFS data for earnings at Spring 1998. LFS data for employment and unemployment at Spring 1999 and Spring 2000
Note: Government Office Regions shown for England. Data for Northern Ireland are not seasonally adjusted.

3.66 London was the region with the lowest proportion of employees earning below the minimum wage in 1998, but it had a small fall in employment in the post-minimum wage period. The lowest-paying region was the North East, but this had the largest increase in employment and the largest fall in unemployment post-minimum wage. This suggested that factors other than the National Minimum Wage are more important in determining regional employment and unemployment rates.

Unemployment

3.67 The trend in unemployment mirrored, to a large extent, the trend in employment post-minimum wage. International Labour Organisation (ILO) unemployment stood at 5.3 per cent in October to December 2000, the lowest level since the ILO measure of unemployment was introduced in 1984. ILO unemployment fell by just under 235,000 since the minimum wage was introduced.

Low Pay Commission Research

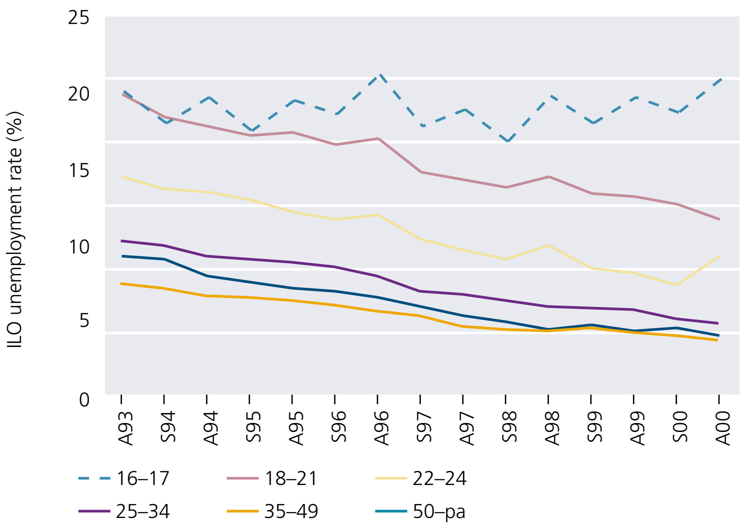
We commissioned research to examine the effect of the minimum wage on small and medium-sized enterprises in Yorkshire and Humberside. The study found that the three most important means of offsetting labour costs were increasing prices, reducing hours and improving product or service quality. When asked to list the three most important methods of offsetting labour costs, the factor most frequently mentioned by respondents was reducing working hours. Fifty-eight per cent of respondents viewed this as being one of the three most important methods.

Heyes and Gray, 2001. *The Implications of the National Minimum Wage for Training and Employment in Small Firms*

3.68 As with employment, unemployment falls have been broadly based: unemployment is now lower than the previous trough in 1990 across most age groups and among both males and females. Figure 3.21 shows that unemployment rates fell in all age groups since the minimum wage was introduced, apart from 16–17 year olds and 22–24 year olds. For the former group the rise in unemployment was concentrated among those in full-time education. As participation in education has increased substantially among this group, so has the proportion that is seeking work. For the latter group, the Spring 2000 to Autumn 2000 rise in unemployment appears to be due to seasonal factors related to leaving full-time education. The proportion of this age group in full-time education declined by 2.7 per cent over this period, with many of this group still seeking work at Autumn 2000.

Figure 3.21

ILO Unemployment Rates by Age, 1993–2000



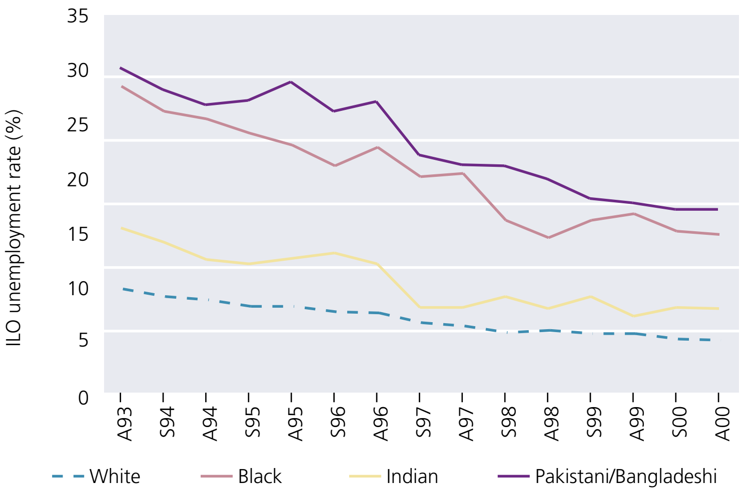
Source: LFS data, Spring and Autumn 1993–2000

3.69 In the year after the minimum wage was introduced the ILO unemployment rate fell faster for men than for women, 0.7 percentage points compared with 0.3 for women. Some of this can be explained by the larger rise in participation among women than among men. Unemployment also fell across different durations. In a period of rising employment, long-term unemployment (those unemployed for a year or more) might be expected to fall as fewer short-term unemployed reach this duration. This has been the case since the minimum wage was introduced, with long-term unemployment falling by 21 per cent compared with 10 per cent among those unemployed for up to six months.

3.70 There was also a continued improvement in the unemployment situation of ethnic groups and people with a work-limiting disability post-minimum wage. Recent unemployment trends by ethnic group are shown in Figure 3.22. Between Spring 1999 and Autumn 2000, the ILO unemployment rate for white workers fell by 0.6 per cent. The fall among the other ethnic groups shown in Figure 3.22 has been faster – between 1 and 1.3 per cent. The fall in unemployment has also been marked for people with a work-limiting disability – 1.6 per cent over this period.

Figure 3.22

ILO Unemployment Rates by Ethnic Group, 1993–2000



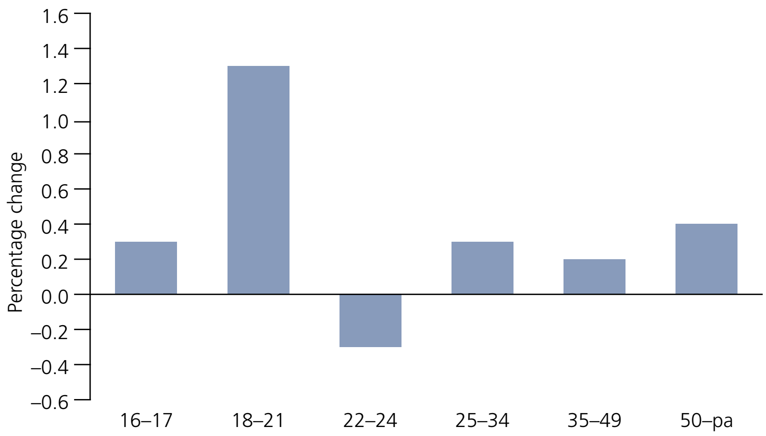
Source: LFS data, Spring and Autumn 1993–2000

Inactivity and Participation

3.71 By increasing the earnings of the low paid, and giving clarity to the level of earnings people can expect in work, the minimum wage might be expected to improve work incentives for those moving into low pay and increase participation (employment plus unemployment) in the labour market. Figure 3.23 shows changes in labour market participation in the year following the introduction of the minimum wage. Participation has risen for all ages apart from 22–24 year olds.

Figure 3.23

Change in Participation Rates by Age, Spring 1999 –Spring 2000



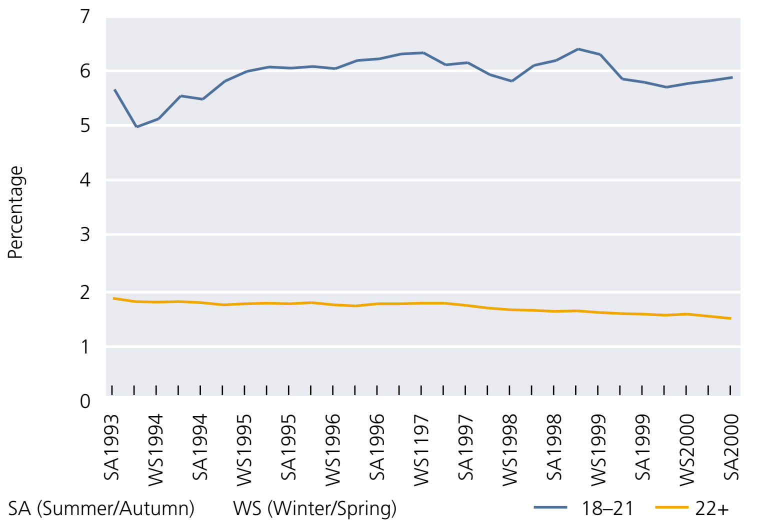
Source: LFS data, Spring 1999, 2000

3.72 Disaggregating changes in inactivity by gender produced some mixed results. Men and women aged 45–49 increased their inactivity post-minimum wage as did women aged 20–24. The reasons for inactivity are unlikely to be minimum wage-related. Among the former group, a greater proportion stated they were long-term sick. For the latter group, increased inactivity was due to a move from unemployment into inactivity as proportionately more women chose to look after the family/home, which more than offset higher employment among this group.

3.73 We also analysed movements from inactivity to other labour market states using the linked LFS data. Figure 3.24 gives the percentage of working-age inactive people leaving inactivity from one quarter to the next. It shows that in the post-minimum wage period the proportion leaving inactivity was broadly flat.

Figure 3.24

Percentage Leaving Inactivity from One Quarter to the Next by Age (4 Quarter Moving Average), 1993–2000



Source: LFS Longitudinal data, 1993–2000
Note: Due to measurement error, proportions of people changing status are likely to be biased upwards, while proportions not changing status are likely to be biased downwards.

3.74 Data on aggregate flows mask the degree of labour market attachment of the inactive group. Over the year since the minimum wage was introduced, the number of inactive people who said they would like a job remained broadly stable, although this was against a background of a fall in the working-age inactive population of around 75,000. This means that the proportion of the inactive who said they would like a job increased. Among the group showing the largest propensity to move closer to the labour market are discouraged workers (people who wanted a job but were not seeking because they believed no jobs were available); those looking after the family or home; and students.

3.75 The incentive effects of the minimum wage were analysed in more detail in research we commissioned (Stewart and Swaffield, 2001) using the BHPS data. This considered job prospects for the unemployed post-minimum wage. The analysis showed that nearly 20 per cent of unemployed respondents said that the range of jobs that they would be prepared to take has widened because of the National Minimum Wage. This effect was slightly greater for women than for men. This, together with the fact that the unemployed generally regarded their job prospects to be unchanged since

Each year the Greater Manchester Low Pay Unit conducts a detailed survey of Jobcentre vacancies in each of the ten major Jobcentres in the county. The April 2000 Jobcentre survey data show a rise of 11.7 per cent on the number of jobs recorded in April 1999. This suggests that the introduction of the minimum wage has not had a negative impact on the number of jobs available in this particular labour market.

Greater Manchester Low Pay Unit evidence

Low Pay Commission Research

A survey of students by Rosemary Lucas and Michelle Langlois, which we commissioned, suggested that the minimum wage itself had little impact on the decision by students to work. Most would seek part-time work whether or not the minimum wage applied.

Lucas and Langlois, 2000. *The National Minimum Wage: What Can Young Workers Tell Us?*

the minimum wage was introduced, provided support for the argument that the minimum wage has had a positive impact on labour supply and widened the range of jobs people moving into low pay are prepared to take.

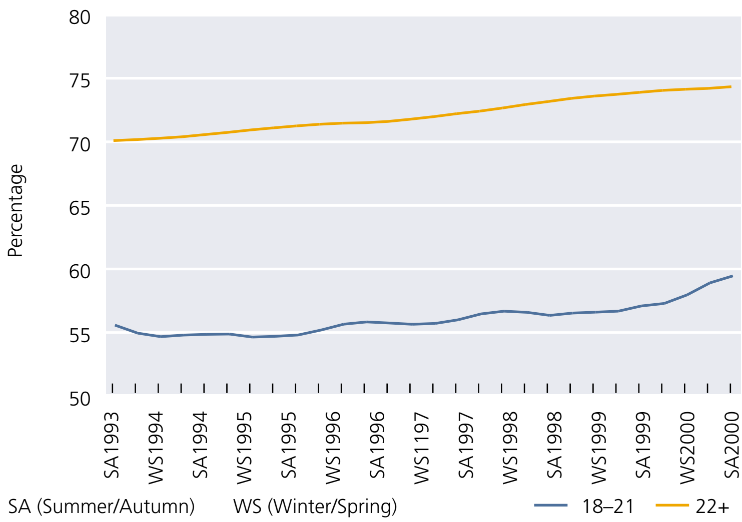
3.76 The minimum wage has to be considered together with other labour market interventions aimed at making work pay. The second volume of our report will consider the interaction of the National Minimum Wage with the tax and benefits system in more detail.

Recruitment and Retention

3.77 We would expect higher wages to improve recruitment and retention within firms. Labour turnover is strongly correlated with employment growth, with periods of high employment growth characterised by periods of high turnover. In the post-minimum wage period of high employment growth, we might therefore expect to see increased labour market turnover. Figure 3.25 shows the percentage of employees remaining in employment from one quarter to the next. Contrary to expectation it suggests that duration of employment has increased over the last few years. Between Winter/Spring 1998 and Winter/Spring 2000, the proportion of those aged 22 and over remaining in employment from one quarter to the next rose from 73 per cent to 74.2 per cent.

Figure 3.25

Percentage of Employees Remaining in Employment from One Quarter to the Next by Age (4 Quarter Moving Average), 1993–2000



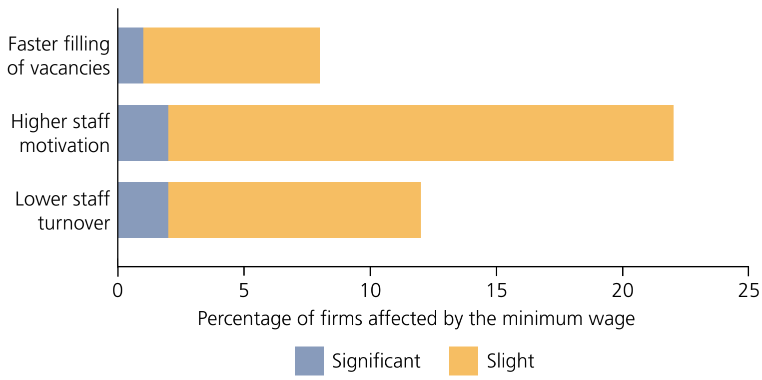
Source: LFS Longitudinal data, 1993–2000
Note: Due to measurement error, proportions of people changing status are likely to be biased upwards, while proportions not changing status are likely to be biased downwards.

3.78 Labour turnover is more prevalent in low-paying sectors and firms. Evidence from research we commissioned into small and medium-sized enterprises (Bullock et al., 2001) showed that of firms with at least half their workforce paid at the minimum, 16 per cent had turnover of less than 10 per cent compared with 44 per cent of firms paying above the minimum. Addressing labour turnover is therefore more important in the lowest-paying firms.

3.79 Our survey asked whether firms affected by the minimum wage had experienced any benefits to their business. Almost 30 per cent of firms reported that they had experienced some benefit, but few stated any significant benefit. As can be seen from Figure 3.26, the most common benefit reported was higher staff motivation, indicated by over 20 per cent. Over 10 per cent reported lower staff turnover and 8 per cent the faster filling of vacancies. Textiles firms were least likely to report any benefit to business (only 11 per cent), with none indicating any significant benefit. The results from the textiles sector were not surprising given the global competitive pressures the sector is currently facing.

Figure 3.26

Benefits to Business as a Result of the National Minimum Wage



Source: Low Pay Commission Survey, September–November 2000
Note: Base, all firms affected by the National Minimum Wage in any way.

3.80 Evidence we received suggested that the effects of the interaction of the minimum wage with the tight labour market were often difficult to disentangle. The National Pharmaceutical Association reported that 'over the sector as a whole, the introduction of the minimum wage does not appear to have impacted negatively on recruitment or retention policies of our members. However, in some areas, particularly the South East and other areas where wage levels are above average, members are experiencing difficulties in recruitment'.

3.81 Research conducted for us (Heyes and Gray, 2001) found that small employers' ability to recruit had tended to worsen (13 per cent) rather than improve (2 per cent). And retention had worsened in 9 per cent of firms, and improved in 4 per cent. In both cases increased competition in the labour market was cited as the reason.

As labour markets have tightened over the past 18 months, firms with wages in the £3.60 to £4.00 range have experienced some difficulties in staff recruitment and retention. Some firms are finding that they are having to re-position themselves in relation to others. Some lower paying firms have been rather surprised to find which other firms they are now in competition with, outside of their previous expectations.

IDS, 2000a

3.82 A common theme among some firms has been a tendency to increase wages above the minimum to aid retention and recruitment in a tight labour market. Research by the BRC showed that a quarter of retailers had increased pay rates as a result of the minimum wage, even though they were already paying more than the relevant rate. Small businesses were more likely to increase rates than larger. The BRC said that this was because larger firms could offer better terms and conditions and career progression to retain staff. Interestingly, Heyes and Gray (2001) found evidence that some small firms recognised non-wage benefits, such as training, as a means to retain staff.

3.83 IDS found this trend was mirrored in other sectors. The minimum wage led to greater competition between high-street firms which has in turn led to basic rates being increased to between £4.00 and £4.50 or higher. One textiles company told IDS that 'we set wages at this level (£4.70) to stay ahead of other firms in the area who were mostly paying the minimum wage' (IDS, 2000b).

3.84 In summary, the labour market has continued to tighten post-minimum wage. Employment continued to grow strongly, unemployment fell further and participation in the labour market increased. We were particularly concerned about employment among those groups most affected by the minimum wage: women, young people, ethnic groups, part-time workers and disabled workers. Aggregate data show that, in the main, these groups have shared in the overall growth in employment. But in a strong labour market negative employment effects could be difficult to detect, and employment may have been even higher in the absence of a minimum wage. Results from research which control for this and other factors were encouraging, and show that the effect of the minimum wage was broadly neutral or, if anything, mildly positive. Firms can make a range of adjustments to control labour costs other than shedding labour, and there was some evidence of firms reducing hours post-minimum wage; but these tended to be confined to a minority of firms in particular sectors.

3.85 Despite the minimum wage, many low-paying sectors faced retention and recruitment difficulties. The strong labour market meant that some firms faced competition from firms and sectors outside of their previous experience. The minimum wage had a mild, positive impact on work incentives. The minimum wage, together with other active labour market policies, could be helping to increase labour supply in a tight labour market.

Competitiveness

3.86 The National Minimum Wage was set at a cautious and prudent level so not to undermine competitiveness. The following section examines the impact of the minimum wage on a number of key competitiveness indicators: the wage bill, productivity, and prices and costs. In our second report we identified a highly varied response by business to the new legislation. We test whether this is a continued theme in our new evidence and report on other factors identified as challenging firms' efforts towards further efficiency improvements.

The Wage Bill

3.87 The costs to business of the minimum wage are, in the main, measured by the impact on the wage bill. And the impact is likely to be greatest in those sectors where wages form the major part of a firm's costs. In our second report we estimated that the impact of the introduction of the National Minimum Wage on the wage bill was in the region of 0.5 per cent. We have revisited this in the light of the new ONS methodology and more recent information about the impact on wage differentials.

3.88 We re-estimated the cost to the wage bill of the introduction of the minimum wage, using the grossed 1998 NES data. We assumed that everyone earning below the National Minimum Wage in 1998 saw their earnings increase to that level (as before, we used £3.50 per hour for adults and £2.90 for 18–21 year olds as the real terms estimate of the minimum wage). We estimate the increase to be around 0.25 per cent, assuming no change in differentials, or around 0.35 per cent when we include assumptions on differentials. This is lower than the estimate in our second report because the estimate of the number of beneficiaries has reduced and due to our revised assumptions on differentials.

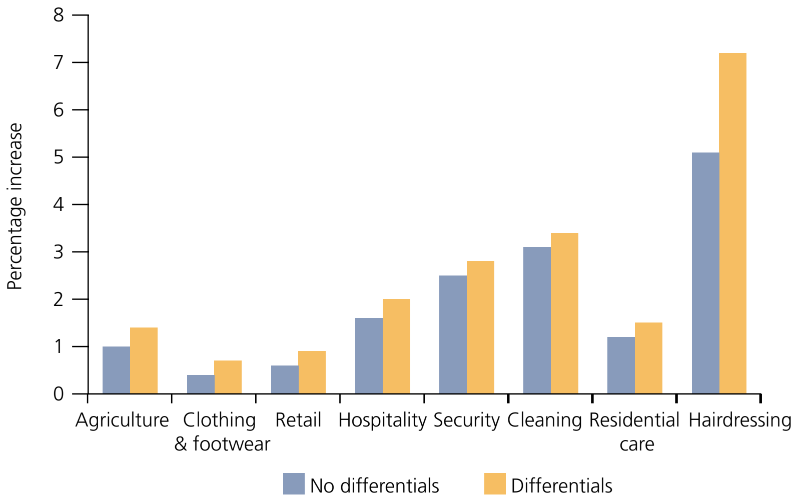
3.89 Even though this estimate is lower than that in our second report, it may have overstated the impact on the wage bill for several reasons. First, we have assumed 100 per cent compliance with the National Minimum Wage. Second, using the RPI as the deflator could bias the estimate upwards if real earnings at the bottom of the distribution outstripped inflation over the period. Finally, the extent to which firms make dynamic adjustments, such as shedding labour, cutting hours and increasing productivity, will reduce this estimate further.

3.90 Our estimate of the wage bill effect is based only on the grossed NES data. We calculated the initial wage bill impact using the LFS, but the change of methodology meant that a different imputation method was used to produce data for 1998 and the following years. We were advised by ONS that the 1998 data were likely to be of lower quality than later years, in particular when considering the whole earnings distribution. We were therefore not confident about using the LFS again for the wage bill effect.

3.91 Our estimate is an assessment of the impact on the aggregate wage bill and does not reflect differences in sectors and particular firms. Most employees and most medium-sized and larger businesses will not have been affected by the minimum wage. Figure 3.27 shows the impact on sectoral wage bills of the introduction of the minimum wage, focusing in particular on low-paying sectors. These are estimated using the methodology outlined earlier, assuming both no restoration of differentials and some restoration. The figure shows that the hairdressing sector experienced the greatest increase in the wage bill, about 7 per cent, assuming restoration of differentials. Of the low-paying sectors, clothing and textiles experienced the smallest percentage increase in the wage bill, with an estimated increase of around 0.7 per cent (including an assumption for restoration of differentials).

Figure 3.27

Impact on the Wage Bill of the Introduction of the National Minimum Wage in Low-paying Sectors



Source: LPC Calculations Grossed NES data, April 1998

3.92 Of the firms responding to our survey about half said they had been affected in some way by the minimum wage. Of those, 42 per cent reported that their wage bill had increased by 5–10 per cent and 37 per cent reported no significant change. Consistent with our estimates from the NES, the largest reported increases were in the hairdressing sector and the lowest in the textiles sector.

3.93 The impact on wage bills was most likely to be highest in regions with low average earnings. The research we commissioned into the impact of the minimum wage in small firms in the Yorkshire and Humberside region (Heyes and Gray, 2001) found that of those firms that had increased wages, the average wage bill increase was around 13 per cent. The highest increases were reported in care homes.

Productivity

Raising productivity is one of the central conditions for meeting the Government's objective of high and stable levels of growth and employment and delivering sustained increases in living standards.

Pre-Budget Report, HMT, November 2000

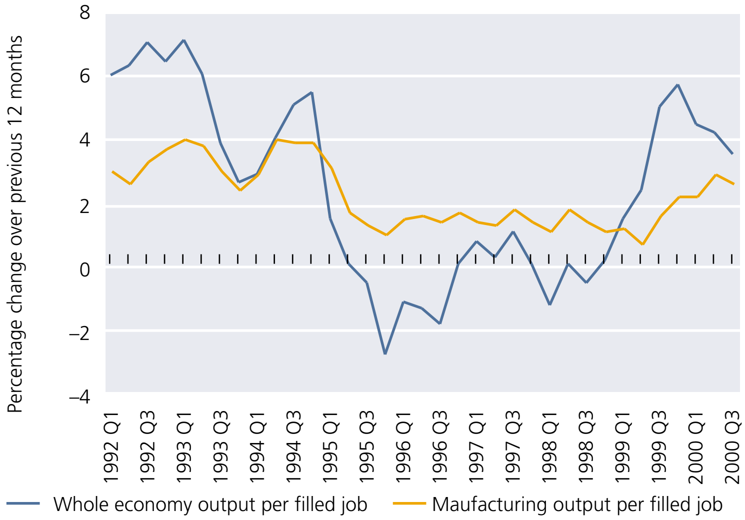
3.94 This section examines whether, in coping with the minimum wage, firms have attempted to increase productivity to improve their competitiveness. Although some firms are as competitive as their overseas counterparts, the UK has consistently lagged behind its major rivals in productivity. It is therefore important to monitor the productivity challenge the minimum wage poses to firms. There are several ways in which the minimum wage can affect firms' productivity. Some, such as changes in work practices, investment in training and skills, innovation and management attitudes, are positive and increase efficiency. Others, such as reducing hours or employment, have negative consequences for workers. In the following section we analyse aggregate data and the responses we received from our survey. We also consider the representations we received from firms and organisations in written and oral evidence and on our visits.

Productivity and Wage Costs

3.95 Figure 3.28 shows recent trends in productivity growth. After being slow throughout the latter part of the 1990s, productivity growth in the UK has shown recent signs of improvement. Although some firms have taken positive action to improve productivity in response to the minimum wage, these aggregate trends are unlikely to be related to the minimum wage. A recent study (Kneller and Young, 2000) found that the slow productivity growth in the latter part of the 1990s was due to structural changes in manufacturing and the labour market. The weakening of these factors, together with the positive effects of investment in information communications technology (ICT), strengthens the view that there is likely to be stronger growth in productivity in the next few years.

Figure 3.28

Labour Productivity Growth, 1992–2000

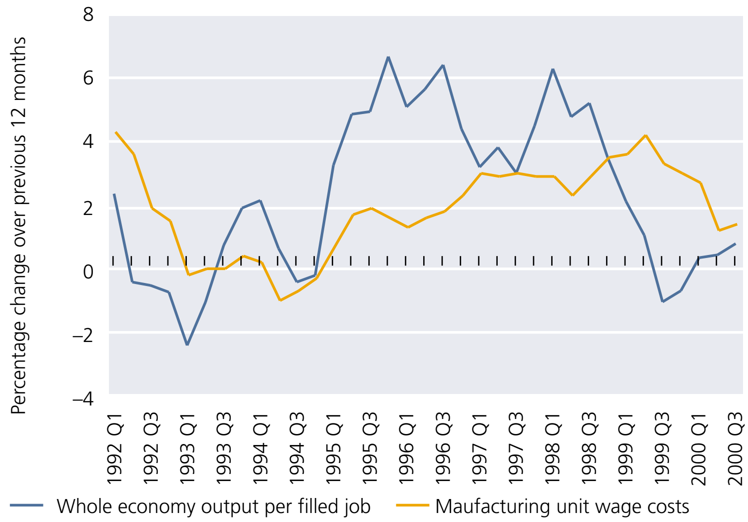


Source: ONS, 1992–2000

3.96 The minimum wage was introduced in a period of rising productivity and relatively modest earnings growth. As Figure 3.29 shows, these conditions have resulted, at aggregate level, in increases in unit wage costs (firms' labour costs per unit of output) being small, rising by just 1.4 per cent in the third quarter of 2000 compared with 3.3 per cent a year earlier. These conditions, if matched in the low-paying sectors where the minimum wage particularly bites, should make it easier for firms to sustain the effects of increased labour costs arising from the minimum wage.

Figure 3.29

Unit Wage Costs Growth, 1992–2000

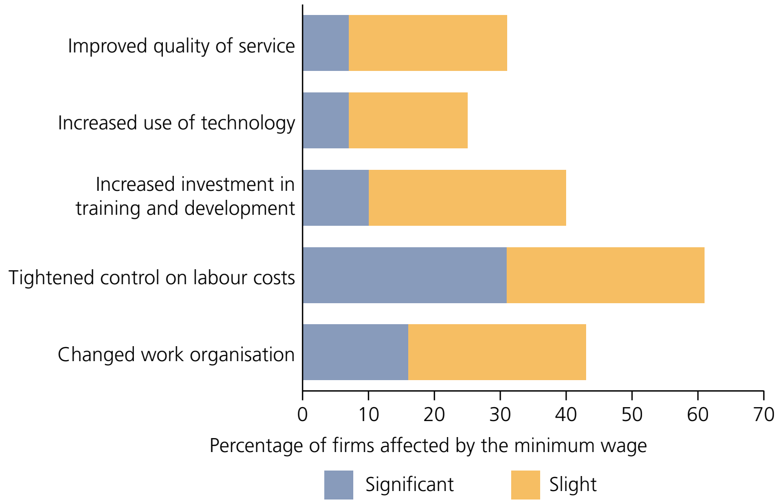


Source: ONS, 1992–2000

3.97 We found from our survey of low-paying sectors that firms made a wide range of adjustments to the National Minimum Wage. For those affected by the minimum wage, the most frequent responses reported were a reduction in profits (89 per cent), increases in prices (68 per cent) and tighter control of labour costs (61 per cent). This latter effect could include treatment of absence, paid breaks, staff meals and overtime rates.

Figure 3.30

Action taken to Improve Productivity as a Result of the National Minimum Wage



Source: Low Pay Commission Survey, September–November 2000
Note: Base, all firms affected by the National Minimum Wage in any way.

3.98 Figure 3.30 shows the range of other adjustments undertaken by firms affected by the minimum wage in our survey. Many of these were positive and likely to increase firms' efficiency. Just over two-fifths of these firms had made some changes to the way in which work was organised, and around the same proportion had increased investment in training and development. A quarter had increased the use of technology and almost a third had made some improvements in the quality of service they provided. The analysis did not vary significantly by sector, although the textiles industry was least likely to have taken such action.

3.99 We also examined the interaction of other measures firms can take to adapt to the minimum wage with the more positive changes in productivity noted above. The results showed that firms that increased prices, reduced profits or reduced staffing were also more likely to undertake the other more positive changes to productivity. This suggested that some firms were carrying out a considerable array of measures to cope with the minimum wage.

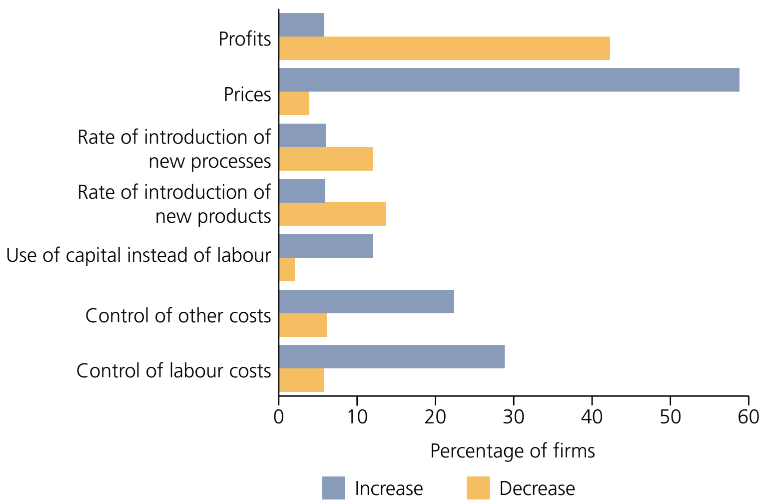
A cleaning and security services company had found that its profits had been squeezed. The company had been able to pass on some of the increased costs but also had to absorb some. Productivity had increased but cleaning was an inexact science. In some cases, productivity gains had allowed contracts to be delivered at the same quality of service while maintaining the price. Other customers were happy to accept a lower quality of service to prevent costs rising.

Low Pay Commission visit to Northern Ireland

3.100 This issue was explored in research we commissioned (Bullock et al., 2001) to examine the response of small and medium-sized enterprises to the minimum wage. Figures 3.31 and 3.32 present the range of measures undertaken by such firms, differentiated by the proportion of those they employ on the minimum wage. As might be expected in the short term, the main impact of the minimum wage was on increased prices and reduced profits. Increased prices were reported by 60 per cent of the less minimum wage intensive firms (those with less than half the workforce paid at the minimum) and three-quarters of the high-intensity firms. Reduced profits were reported by around half of the latter firms. A substantial minority of firms sought to raise efficiency by increasing control of labour and non-labour costs, and this was more prevalent among firms with more than half their workforce paid at the minimum wage. A sizeable minority, up to 14 per cent, reported substituting capital for labour. Few firms reported that they had introduced new products or processes to cope with the minimum wage; in fact, firms were more likely to reduce the introduction of these measures rather than increase them.

Figure 3.31

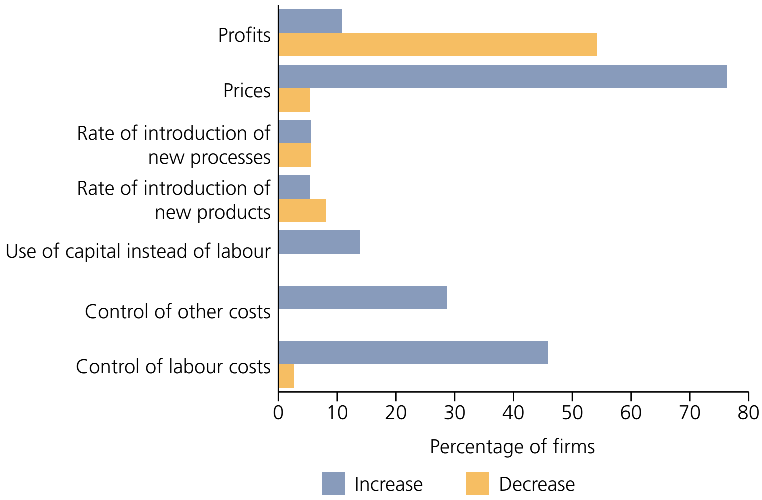
Measures Taken by Firms to Cope with the National Minimum Wage – Firms with Less than Half of the Workforce Paid at the National Minimum Wage



Source: Centre for Business Research, University of Cambridge, 2001. *The National Minimum Wage and Small Business*

Figure 3.32

Measures Taken by Firms to Cope with the National Minimum Wage – Firms with at Least Half of the Workforce Paid at the National Minimum Wage



Source: Centre for Business Research, University of Cambridge, 2001. *The National Minimum Wage and Small Business*

3.101 The research also analysed the impact of the minimum wage on a range of methods firms used to compete against their rivals. Not surprisingly, there was a notable increase in the importance of price competition. There was also greater emphasis on personal attention to clients' needs, quality, and reliance on established reputation, with between 21 and 44 per cent of firms reporting increased importance of these factors. The least important ways of competing post-minimum wage were cost advantage, marketing and promotion, and more innovative design and creativity. There was some evidence that firms were constrained in making further efficiency gains. The most important barriers to such gains were lack of skilled labour, increased cost of labour, lack of managerial skills and increased competition. A sizeable minority of firms reported other factors such as availability and cost of finance, and availability of marketing and sales skills.

3.102 Both the written submissions we received and the evidence we gathered during our visits revealed a mixed picture of the productivity response of firms. Some firms reported positive changes, for example, the CBI noted that 'the NMW may have led some companies to replace inefficient systems of work organisation and to introduce practices such as multi-skilling or team working practices, in order to enhance productivity.'

3.103 Others, particularly the small and medium-sized enterprises, reported difficulties. In its evidence, the Biscuit, Cake, Chocolate and Confectionery Alliance stated that 'the effect on larger organisations on pay rates has been negligible. However, for smaller and medium sized enterprises, the effect has been more dramatic … As a result of the increase in labour cost, the overall expenditure on capital investment was reduced … hence having a negative impact on competitiveness for these smaller organisations.'

Low Pay Commission Research

We commissioned research to examine the effects of the minimum wage on small and medium-sized businesses. Firms in cleaning and security reported a wide range of effects of the introduction of the minimum wage. But some firms reported that there may be constraints on the competence of firms to develop more competitive strategies. The research notes that 'this should not be construed as an argument against the NMW, rather that an emphasis on improving the capabilities of firms to manage and compete effectively may be an essential complement to improving the terms and conditions of the people they employ'.

Bullock et al., 2001. *The National Minimum Wage and Small Business*

Training

3.104 A key factor driving productivity growth is investment in training and skills accumulation. The Government has identified this as one of the explanations for the UK productivity gap (HMT, November 2000). In addition, there has been much debate in academic literature about the link between minimum wages, training and productivity (see, for example, Becker, 1993; Cahuc and Michel, 1996; and Neumark and Wascher, 1998). Results from these studies have been ambiguous, with some suggesting that minimum wages reduce training and others finding the opposite.

3.105 We considered it important to form our own view on whether employers' use of training had been affected by the minimum wage. Heyes and Gray (2001) also looked at this. They found that the minimum wage made little difference to the extent of participation in vocational education and employment initiatives such as the New Deal and Modern Apprenticeships. We shall examine this further in the second volume of our report. Nine per cent of employers said that the National Minimum Wage had encouraged their organisation to adopt a more strategic approach towards training and development. But most employers indicated that the minimum wage had not affected their training provision in this way.

3.106 Some low-paying jobs require minimal skills, with many employers providing informal on-the-job training. Research undertaken for us in the hospitality sector in Portsmouth (Adam-Smith et al., 2001) found that this was the case among many smaller employers. There was some limited evidence, however, that larger employers viewed training as part of a wider strategy to help recruitment and retention since the minimum wage had tended to make their rates of pay uncompetitive.

3.107 There was little in the written evidence we received to suggest that training had been cut as a result of the minimum wage. Individual cases did crop up, but these were rare. The CBI argued that 'there is little evidence so far to show that employers have increased levels of training as a direct result of the NMW', with only 3 per cent of companies in their Employment Trends Survey 2000 reporting increased training as a result of the minimum wage. Some sectors, for example hairdressing, reported that although training and investment had not been reduced, there were worries about the cumulative impact of government regulation, such as the Working Time Regulations and the National Minimum Wage, and the effect of these on competitiveness.

3.108 On the other hand, research undertaken for us (Heyes and Gray, 2001) revealed an interesting picture in that companies which undertook higher quality production strategies in response to the minimum wage were also more likely to increase training. They found that training provision had improved in 65 per cent of those establishments which had improved product/service quality compared with 13 per cent of those establishments where no improvements in quality had been made.

3.109 Our programme of visits generally revealed a positive view of training. One company in the ICT sector, which had some employees earning below the minimum rates before the National Minimum Wage was introduced, told us that they greatly encouraged their staff to obtain qualifications, ranging from those in health and safety to NVQs in manufacturing and production. This was seen as a wider strategy for motivating and retaining workers and this strategy was a common theme in other sectors. One large firm in hospitality told us that since the minimum wage had levelled off wages for lower-paid jobs, training was another factor they could use to compete for labour. This view was reiterated in research we commissioned from IDS, which reported that 10 out of 22 firms in the hospitality sector introduced new training and development

Low Pay Commission Research

Research we commissioned in the hospitality sector found that some employers view training as an attraction that offsets low pay. One establishment reported that 'I suppose that is one of the things that is important in addition to the money is the fact that they know they can get some qualifications while they are here. Although it's not the be all and end all for everybody and obviously if they are interested then we will help them through with that.'

Adam-Smith et al., 2001.
The Impact of the NMW in the Hospitality Sector

Low Pay Commission Research

We commissioned research to examine the effects of the minimum wage on small and medium-sized businesses. The study found that few firms responded to the introduction of the minimum wage by increasing training provision and even fewer reduced it. The effect was greater for firms with a higher proportion of employees on minimum wages, where 14 per cent increased it and 5 per cent reduced it.

Bullock et al., 2001. *The National Minimum Wage and Small Business*

programmes to try to improve retention or to enable them to be more flexible when recruiting.

3.110 In other sectors, the effects on training were potentially more dramatic. The Hairdressing Employers Association and National Hairdressers' Federation said that many micro-employers were now questioning the value and cost of training. The Association and the Federation suggested that in the longer term this could undermine training in the workplace, placing greater reliance on self-funded or state-funded training through colleges.

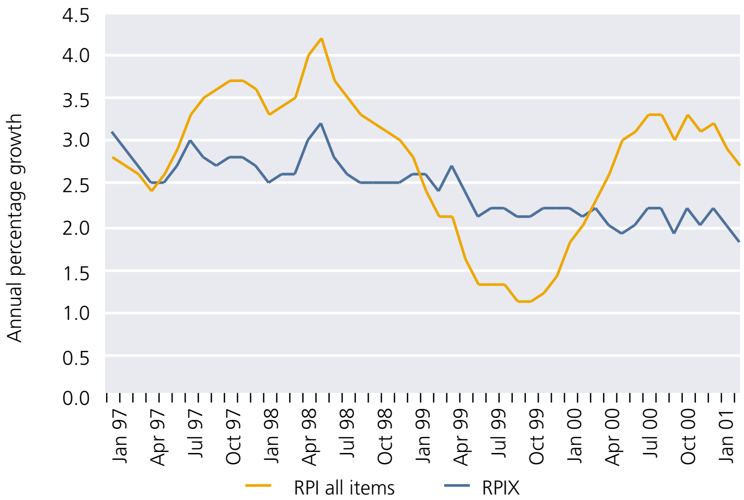
3.111 We shall discuss in detail the evidence on young people and training in the second volume of our report. In the meantime, our preliminary view from the aggregate data is that the minimum wage has not reduced participation in full-time education and apprenticeship schemes, and that, for the most part, upward trends established before the introduction of the minimum wage have continued post-implementation. The evidence we have gathered from our research and consultation suggests that although some firms had cut training, overall the minimum wage had a modest positive effect on training.

Prices and Costs

3.112 Our survey showed that some firms responded to increased business costs, resulting from the minimum wage, by raising prices. The scope for doing this varied from industry to industry, partly determined by the degree of competition and the ability of customers to pay higher prices. At the aggregate level, we could not detect an impact on the RPI from the introduction of the minimum wage. Inflation, measured by the RPI, was on a downward trend at that time and this trend continued until Autumn 1999. The decline was primarily due to falling interest rates and the falling cost of mortgage interest payments. Underlying inflation as measured by the RPI excluding mortgage interest payments (RPIX) has been low and stable by historical standards, and is below the Bank of England's target of 2.5 per cent. Figure 3.33 shows the trends in RPI and RPIX. Even allowing for compliance with the minimum wage to build up over time, and for time lags between higher wage bill costs being passed on in higher prices, there is no noticeable minimum wage effect in the aggregate inflation measures.

Figure 3.33

Retail Price Growth, 1997–2001

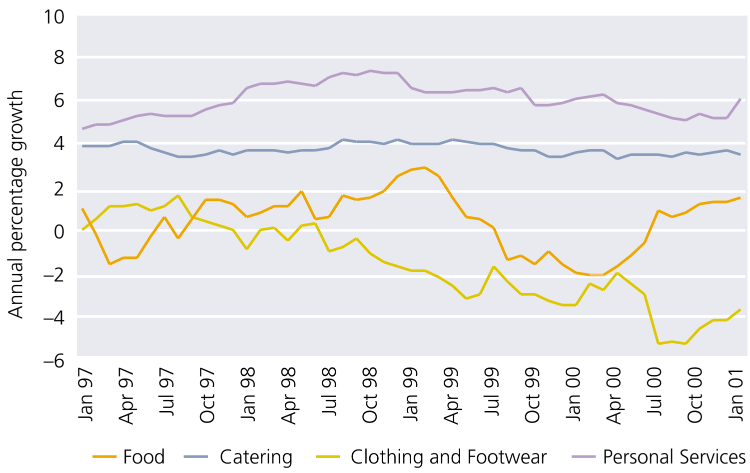


Source: Retail Prices Index, ONS, 1997–2001

3.113 We also examined retail prices for those goods and services associated with low pay, such as food, clothing and footwear, catering and personal services (including hairdressing). As can be seen from Figure 3.34, none of these indices show signs of price hikes in the period following the introduction of the minimum wage. In fact, there has been significant deflation in clothing and textiles, probably because of increased competition resulting from globalisation. Price inflation in personal services was on an upward trend until the start of 1999, but has been on a steady downward path since then. These data suggest that the effect of the minimum wage on product prices has been limited and has not resulted in sector-wide increases in prices.

Figure 3.34

Retail Price Growth, Components of RPI, 1997–2001



Source: Retail Prices Index, ONS, 1997–2001

3.114 But almost 70 per cent of the firms in our survey that were affected by the minimum wage claimed to have raised prices. Figure 3.35 shows that this was most likely in hairdressing and childcare and least likely in textiles and social care. Globalisation and the need to stay competitive in an international market will have affected the response in the textiles sector. In social care, local and central government pay for about two-thirds of residential places in independent care homes and this constrains the ability of care homes to increase prices. Although most firms in these low-paying sectors reported that the price increases had been slight, nearly 30 per cent of them said they had increased prices 'significantly'.

Figure 3.35

Firms Raising Prices as a Result of the National Minimum Wage

Source: Low Pay Commission Survey, September–November 2000
Note: Base, all firms affected by the National Minimum Wage in any way.

3.115 While the proportion of firms reporting increased prices appears high from these data, there are several reasons why this effect is not evident in the retail price component indices. First, the results reported above are of those who said they were affected by the minimum wage in some way, around 48 per cent of respondents. Second, our survey was aimed at the low-paying sectors, and so the targeted firms were those most likely to be affected by the minimum wage. Moreover, although the response rate was fairly high for this type of survey, it was still only 14 per cent, and those replying may have been those most affected by the minimum wage.

3.116 The view that the effect of the minimum wage on prices was limited to specific firms was reiterated in the written evidence we received and on our visits. The CBI evidence suggested that 'there are many factors which influence the rate of inflation and if the nmw has caused any increase in inflationary pressure, this is likely to have been offset by the effects of strong domestic competition'. It reported that 'the nmw is very sector specific in its impact and market conditions in the sectors most likely to be affected by the nmw have meant that there has been little, if any, scope to raise prices in order to reflect higher labour costs'.

The Cleaning and Support Services Association reported that, in general terms, their membership had been able to obtain upward price adjustments to reflect increases in pay rates brought about by the implementation of the NMW. But this often entailed changes in specifications and frequency of service delivery, thus reducing numbers employed in those instances, often by natural wastage. Overall, prices still remained exceptionally competitive, with lowest price still dominating the decision making process.

Cleaning and Support Services Association evidence

3.117 Increased costs, to which the minimum wage was one contributory factor, might lead to some unanticipated longer-run consequences for certain industries. Evidence from the CBI reported that one company in the business services sector said that the National Minimum Wage had led to an increase in costs of over 25 per cent. It suggested that one result of the National Minimum Wage might be that there would be consolidation in their industry, with companies needing scale economies in order to stay productive.

3.118 In summary, we found that firms continued to undertake a range of measures to ease the introduction of the minimum wage. The three most common measures were tightening control of labour costs, increasing prices and squeezing profits. A sizeable minority of firms displayed a more dynamic approach, including improving product quality, increasing use of technology and increasing investment in training. We recognise that enhancing productivity is a continuing challenge to firms. The minimum wage, among other factors, has forced companies to improve efficiency. As time goes on, short-term adjustment policies such as increasing prices or squeezing profit margins are less likely to be sustainable. We heard mixed views on this in our oral evidence with some saying that slack still remained in the system and others saying it was difficult to see where further productivity gains could be made. We hope the rationale for investment in training, research and development, and innovative work practices will change in the longer term from easing the introduction of the minimum wage to sustaining and developing more productive and efficient ways of working in the longer term.

Public Sector Finances

Public Sector Wage Bill

3.119 This chapter has so far assessed the impact of the minimum wage on individuals and on firms. We also need to have regard to the impact of the minimum wage on public sector finances.

3.120 The Government reported that no detailed estimates of the out-turn of the introduction of the National Minimum Wage were available for the public sector. Our own estimate of the increase to the public sector wage bill as a result of the introduction of the minimum wage suggests that it is small. Assuming no increase in differentials and using the methodology described earlier in the chapter, we estimate that the increase to the public sector wage bill of introducing the minimum wage was 0.08 per cent compared with an increase of around 0.33 per cent in the private sector. If we assume that there was an impact on differentials, the estimated increase would be around 0.12 per cent in the public sector and 0.45 per cent in the private sector.

3.121 Local and central government and the National Health Service (NHS) between them cover around 80 per cent of the public sector wage bill. By the time the National Minimum Wage was introduced most minimum rates in the public sector were at least £4.00 per hour. Evidence from the Local Government Association (LGA) suggested that the minimum wage had little or no effect on pay in Local Authorities. In its written evidence the LGA reported that 'the experience of the last year has reinforced our earlier impression that there have been minimal extra costs from … the NMW'.

3.122 The LGA confirmed that employers used the provisions in the National Minimum Wage Regulations which allow those paid by equal instalments throughout the year to spread their hours equally throughout the year. This was particularly useful for term-time workers such as teachers and school dinner assistants.

3.123 IDS (2000c) report that many government departments implemented pay reviews that favoured the lowest paid prior to the introduction of the National Minimum Wage. It gives the example of the 1998 pay increase in the Benefits Agency which resulted in total increases of over 10 per cent for some of the lowest-paid staff.

3.124 Government evidence reported no impact on the NHS pay bill as a result of the introduction of the National Minimum Wage because there had been no national rates for adult NHS workers at or below the minimum wage. This finding was confirmed from information received from the NHS Executive, which was based on a Department of Health survey of 400,000 staff employed by around 180 NHS Trusts in England. The data suggest that at August 1998 fewer than 1,500 staff were paid less than the minimum wage. Even this figure is

The minimum wage had minimal impact on the pay of UNISON members. Successful efforts to negotiate a £4.00 pay floor in the period leading up to the introduction of the minimum wage meant that few of our pay rates, outside of higher education and private contracting were below £3.60 in April 1999. The minimum wage had some upward effect on the pay of contract staff, for example those working in private nursing homes, and NHS Ancillary staff benefited by being given rises to bring them just above the rate for staff on private contracts.

UNISON evidence

likely to overestimate the numbers affected since some of them may have had their pay raised by the time the National Minimum Wage was introduced.

County Council officers told us that in-house pay levels were traditionally higher than outside since the Council paid above the National Minimum Wage, £4 to £5 per hour. A greater impact on the Council's in-house operations had come from the Best Value policy.

Low Pay Commission visit to the North West

Government Procurement

3.125 Previous evidence received from the Government about the effect of the National Minimum Wage on procurement from the private sector was limited. The Government's evidence for our second report stated that 'it is difficult to identify even approximately the impact of the minimum wage on procurement costs'. The Government's latest evidence made no explicit reference to procurement costs.

3.126 In August 2000, we wrote to individual government departments and agencies seeking details of the effects of the minimum wage on contracted-out goods and services. The main issues we raised were the effect of the minimum wage on the price of goods and services procured; whether contracts needed to be re-negotiated; if so, what were the main issues involved; and whether there was any evidence on the indirect effect of the minimum wage. Of the responses we received, eight reported no or minimal effect on prices of goods and services, six reported some increased costs, and three were unable to provide any information. The sectors most likely to be affected were cleaning (including window cleaning), security and catering. Price increases were predominantly in the 1–10 per cent range; two reported increases of between 20 and 50 per cent. One of these said that it was unable to distinguish between minimum wage effects and other factors, so this is likely to be an overestimate of the minimum wage effect.

3.127 Questions on contracting to the public sector were included in our survey questionnaire for the business services sector (including cleaning and security services), the social care sector and the childcare sector. The results showed that around 20 per cent of firms provided goods or services to the public sector as part of a competitive tendering process. This was much more likely in the business services sector and less likely in the childcare sector. In the social care sector, providers of domiciliary care were more likely to be involved in competitive tendering in the public sector, whether they were private or voluntary providers.

3.128 The social care sector was the only group with sample sizes big enough to analyse separately. Of respondents in the social care sector that indicated they were involved in tendering, 46 per cent said they had tried to renegotiate their contract as a result of the minimum wage. Of these, 8 per cent were successful and 14 per cent were partly successful. Over three-quarters of those who sought to renegotiate were unable to recoup anything. Most of the others recouped between 1 and 24 per cent of their increased pay bill.

3.129 The LGA evidence suggested that some local authorities reported extra costs, for example in relation to security staff or agency staff or contracted-out services such as residential care. But it concluded that 'while this assessment is almost certainly valid, it is difficult to isolate the precise effect of the NMW from a range of other cost pressures and possible savings'.

Exchequer Revenues and Expenditure

3.130 The minimum wage, by increasing earnings, will reduce expenditure on in-work benefits and tax credits. We received estimates of reduced social security expenditure and tax credit savings from the Government. These are shown in Table 3.6. These indicate the likely scale of the first-round effects on the Exchequer. The precise impact will depend on a number of factors, including the level of compliance and the impact on differentials, employment and profits.

Table 3.6

Benefit and Tax Credit Savings from the Introduction of the National Minimum Wage

Benefit/Tax Credit	Savings in 2000/01 £m
Income Support/Jobseeker's Allowance	30
Housing Benefit	55
Council Tax Benefit	20
Family Credit/Working Families' Tax Credit	75
Total	180

Source: Department of Social Security and Government evidence
Note: Estimates are based on Family Expenditure Survey and Family Resources Survey data. Employees with earnings below the level of the National Minimum Wage were brought up to initial minimum wage rates.

3.131 These estimates are lower than those reported in our second report (£280 million in 1999/2000). This was primarily due to downward revisions in the number of Working Families' Tax Credit (WFTC) claimants which reduced savings for this credit.

3.132 The National Minimum Wage will increase the receipts from income tax and National Insurance. In addition, as the low paid spend their increased earnings, there will be revenue from VAT receipts. On corporation tax, the impact is more complicated since it depends on how the minimum wage affects profits. This, in turn, depends on effects on productivity, staff turnover, labour costs and product prices. Government estimates cannot model these dynamic effects, and are therefore likely to overstate the effect on corporation tax.

3.133 The Government's evidence estimates that the net impact of the minimum wage on income tax, corporation tax and National Insurance will be a yield of £100−200 million in 2000/01. It has not been possible to disaggregate this estimate because it is subject to a wide margin of error. These estimates are much larger than the £5–10 million reported in our second report. The Government advised us that this is largely due to the revision in corporation tax estimates, which are very uncertain.

3.134 In summary our analysis showed that although there were no direct government estimates of the impact of the minimum wage on the public sector wage bill, evidence from IDS, LGA, NHS and our own estimates suggest that the effect was modest. Evidence we have on public sector procurement, our survey and the special exercise we carried out, confirmed our earlier impression that the effect on government procurement is small, with the main affected sectors being cleaning, security and catering. On Exchequer revenues and expenditure, estimated savings from the introduction of the minimum wage on benefits and tax credits were around £180 million, and extra direct tax receipts were in the range £100–200 million.

Conclusion

3.135 We have assessed the impact of the minimum wage almost two years after its introduction and after it was increased in 2000. In general, there has been widespread acceptance of the minimum wage and employers and employees have welcomed it. By far the greatest beneficiaries have been women. In narrowing the gender pay gap the minimum wage has had the greatest effect on women's pay since the Equal Pay Act 1970. The impact on differentials has been contained to the bottom of the earnings distribution. We were interested to learn of the positive benefits that the minimum wage had brought to business, such as increased staff morale, and the action firms have taken to improve productivity. But some businesses have experienced difficulties. The employment effects of the minimum wage have been broadly neutral and employment among vulnerable groups has grown. More time is needed before a full assessment can be made, but all the evidence suggests that the introduction of the minimum wage has helped low-paid workers, businesses have coped and there has been no discernible adverse effect on employment.

3.136 In the meantime, the minimum wage should be reviewed periodically to see whether it continues to benefit those it is aimed at helping. The following chapter explains how we approached the question set us by the Government on whether the main rate should be increased and, if so, by how much.

4 Choosing a New Rate

In making our recommendation we have taken account of the impact of the National Minimum Wage so far, and looked to the future to assess the impact of an increased rate. We were concerned that we should choose a rate which would make a difference to those on low pay, but at the same time would be manageable for business and the economy. Almost all evidence received from representatives of employers and workers accepted the principle that the minimum wage should be uprated, although some businesses expressed concern about increases that would affect their costs and competitiveness. Prospects for growth and stable inflation suggest that a substantial increase would not adversely affect the economy or reduce aggregate employment.

As well as recommending a rate for 2001, we believe that the minimum wage should continue to be uprated regularly, and not lose its value. Business has also said to us that it would welcome a degree of certainty to plan for the future. But we were aware that businesses in low-paying sectors, and smaller firms, would need to absorb and adapt to the increased costs. Hence we considered it prudent to recommend a small further increase for October 2002 before the minimum wage is reviewed in full again.

We recommend that the main National Minimum Wage for adults aged 21 and over should be increased to £4.10 per hour in October 2001 and to £4.20 per hour in October 2002.

This increase will ensure that the minimum wage maintains its value as a wage floor, and will provide a significant boost to earnings of workers in low-paid jobs. Between 1.3 and 1.5 million jobs will be covered by this increase. The rate we are recommending is one that we consider can be accommodated both by the aggregate economy and by the businesses most affected. The impact on the aggregate wage bill is modest, and while low-paying sectors will experience the largest increases in the wage bill, the increases are smaller than those experienced when the minimum wage was introduced. Any impact on inflation is estimated to be small, as is the anticipated impact on public sector finances.

4.1 To inform our thinking about the future rate of the National Minimum Wage, we begin by examining the views of key stakeholders, including representatives of employers and firms affected. We then go on to assess the state of the economy, looking at such factors as the prospects for the near-term future and recent trends in employment, prices, earnings and pay settlements.

4.2 Having arrived at our recommendation, we then assess the impact it is likely to have. We consider the future coverage, the effect on the wage bill, at both the aggregate and the sectoral levels, and the impact on prices and on public sector finances.

4.3 In our two previous reports we recommended that the main rate of the minimum wage should be payable to 21 year olds. We have not received any evidence that has caused us to change that judgment. Our analysis and recommendations in this volume are therefore based on the premise that the main rate should apply to 21 year olds. We shall provide a detailed analysis and recommendations on young people and the minimum wage in the second volume of this report.

Stakeholders' Views

4.4 We received a wide range of evidence from employers and unions on uprating the minimum wage. Nearly all interested parties accepted the case for uprating. Many firms and their representatives acknowledged that across the country wages have been driven up by recruitment difficulties in tight labour markets and that the additional impact of the minimum wage had been small.

4.5 But, as discussed in Chapter 3, much of the evidence emphasised that there were still some areas where significant numbers of employees were paid the National Minimum Wage. The Association of Convenience Stores told us that convenience stores 'employ staff at close to the National Minimum Wage rate – especially in rural and remote areas. Any further increase in the National Minimum Wage rate would lead to additional costs for these businesses, and also for retailers whose staff wish to maintain their differential above lower-paid staff in all sectors'. Results from a survey of their members showed that

Because of the current high employment rate and skills shortages across the sector employers are paying over the NMW rate in most areas of the country.

Business Services Association evidence

A leisure facilities company told us that they had to increase wages yearly, regardless of changes in the minimum wage, as they could not expect people to come back for the same wage each year. If the National Minimum Wage went up too much, then unless sales and visitor numbers increased accordingly, they might have to employ fewer staff on a 40-hour week or retain existing numbers of staff on reduced hours. The trigger point would be at about £4.20/£4.30 because of the differentials which would need to be maintained.

Low Pay Commission visit to the North West

A care home company told us that they would like any increases in the National Minimum Wage to be prudent, as they could not increase their prices in the way other sectors could due to local authority purchasers' dominance in the market. Any increase needed to be at a level where it was still possible to maintain differentials – a National Minimum Wage of £4 per hour would have a knock-on effect, owing to the necessity of maintaining differentials, up to about £5–£6 per hour and this was the real problem. They would like the increases to be linked to some form of index so they could plan ahead.

Low Pay Commission visit to the North West

around a quarter had altered their lowest rates of pay to be at or above the level of the minimum wage.

4.6 A significant number of businesses were comfortable with an adult rate of around £4 per hour. The British Security Industry Association wrote in its evidence that among its members 'the consensus is that the wage rate should be even higher at £4 per hour'. The British Hospitality Association was more cautious: 'it seems a reasonable assumption that an increase in the NMW to a figure above £4 would add considerably to payroll costs of hospitality employers in those regions and sub-regions where pay is lower because of market conditions'. The CBI expressed concern about a minimum wage significantly above £4 per hour. In oral evidence the CBI emphasised that the business climate was now more difficult than when the minimum wage was introduced, with more company mobility globally, slowing consumer growth and fiercer competition.

4.7 Some businesses were concerned even about a figure below £4 per hour. The Hairdressing Employers Association and the National Hairdressers' Federation suggested that 'a Basic Rate in excess of £3.85 an hour would start to place pressure on employment numbers'. The Cleaning and Support Services Association said that 'the majority of members are in favour of an increase in the NMW in 2001, but it should be restricted to 10p per hour, or not higher than the RPI'. Similarly, the British Apparel and Textile Confederation argued that any increase in the minimum wage should be kept to the minimum and no more than the level of inflation as measured by RPIX.

4.8 Some employers, for example contract cleaners, emphasised the difficulties they could have in passing on increased costs to resistant clients. Many care homes were heavily dependent on fees paid by local authorities. The Lancashire Care Association was concerned about a minimum wage of £4 per hour, which would also have a knock-on effect through other grades of staff.

4.9 The Federation of Small Businesses (FSB) asked that – at this stage – the possibility of increasing the National Minimum Wage be approached with caution. In their evidence to us, they reported that results of a survey of FSB members revealed that the average wage paid by members to their lowest-paid staff was far above current minimum wage levels. The FSB stated that it was 'not aware of any broad negative effects the introduction of the National Minimum Wage may have had on the competitiveness of small firms'. But it also believed that 'any further increases to the minimum wage in the near future could contribute to endangering the existence of some smaller businesses or at least to reducing their capacity to increase or maintain their current workforce'.

4.10 Evidence we received from employee representatives generally argued in favour of a more substantial increase. They pointed to the strong economic conditions, buoyant earnings growth and lack of adverse employment effects as evidence that a significantly higher rate could be sustained without damaging the economy.

4.11 Several bodies were concerned about the low coverage of the minimum wage and the fall in its real value since it was introduced. UNISON explained in its evidence that it favoured an immediate higher level of the adult rate set at £5 per hour. It argued that the initial rate had been set too low and that as a result too few people had benefited from the minimum wage. This, together with buoyant average earnings and economic growth, meant that its real value had declined since our initial recommendation. The Yorkshire and Humberside Low Pay Unit also presented evidence along these lines, arguing that the National Minimum Wage should, as a minimum first step, be increased sufficiently to restore the real value it had when it was first introduced. The Unit said that it could understand the reasons behind the prudent approach that we took in setting the initial rate, but argued that not increasing the minimum wage until 18 months after introduction and by less than both retail price and wage inflation had reduced its real value and its credibility as a component of the strategy to reduce poverty.

4.12 The approach adopted by some, for example UNISON and the Low Pay Unit, was in favour of the minimum wage being set at half male median earnings. They maintained that this was justified on the grounds of fairness and equity. Using such a measure would ensure that the relative position of the minimum wage in the earnings distribution remained constant over time, and that the low paid would share in the increased prosperity of the country. The Low Pay Unit argued for regular

This industry can be ferociously competitive and labour cost increases are very difficult to pass on in higher prices, simply being reflected in the reduction of margins which are already considered very tight. This factor again raises very real concerns, particularly for SMEs, about the size of any increase in the NMW.

Textile Services Association evidence

The national minimum wage has made a big difference, but the low increases this year represent ground lost. The challenge now is to regain that ground and build upon the otherwise extremely successful establishment of the national minimum wage.

Yorkshire and Humberside Low Pay Unit evidence

Advice Agencies said that some certainty about uprating the National Minimum Wage was needed so that people could plan their very tight budgets. The National Minimum Wage should at least keep pace with inflation, but more was desirable.

Low Pay Commission visit to Yorkshire

One woman who benefited from the NMW, who worked as a shop assistant, had not had a pay rise since the abolition of the Wages Council in 1993.

Low Pay Unit evidence

upratings since their research showed that many of the workers interviewed had never had a pay rise.

4.13 Many unions with large numbers of employees in the low-paying sectors supported a minimum wage of £4.50 per hour or more. For example, USDAW, referring to the former Wages Council rates, said 'a restoration at today's earnings levels would see a NMW currently somewhere well in excess of £4.00 or even £4.50 per hour, and we would firmly recommend that the Commission commence its current deliberations with that level of restoration in mind'.

4.14 Others pointed to the lack of adverse employment effects and the positive gains to business as a case for increasing the minimum wage further. In its evidence, the GMB claimed that the minimum wage was at least 20 per cent too low, and should be raised to at least £4.50 per hour in 2001. The union argued that a substantial increase in the minimum wage would help to close the gender pay gap. The union also pointed to a number of low-paying sectors, where it maintained that the minimum wage has had little effect on employment or on competitiveness, and that difficulties were caused by factors other than the minimum wage, for example overseas competition in the clothing and textiles sector.

4.15 In its oral evidence, the TUC referred to the benefits which employers had gained from the minimum wage. And in its written evidence, it argued that in the hospitality sector 'low pay is clearly a barrier to developing a skilled, high-productivity workforce'. It suggested that a large increase in the minimum wage could ease recruitment difficulties in that sector and might be expected to trigger efficiency effects.

4.16 Much of the evidence presented to us referred to the favourable economic conditions in which the minimum wage was introduced. Particular attention was paid to the strong growth in earnings since April 1999, leading to a fall in the real value of the minimum wage. The next section of this chapter reviews future economic prospects and analyses recent trends in employment, prices, earnings and pay settlements.

The Economy

Forecasts

4.17 The economic environment has a major influence on the level of the minimum wage the economy can afford. The minimum wage was introduced during a period of strong growth, both in the economy as a whole and in the labour market. Since the beginning of the upswing in mid-1992, Gross Domestic Product (GDP) has grown by an average of 2.9 per cent per year and employment has grown by over two million. Latest indications are that GDP growth has slowed to 2.4 per cent in the fourth quarter of 2000, while inflation remains subdued. In the year following the introduction of the minimum wage, employment grew by almost 350,000, faster than in the previous year. Both the strong economic background and the cautious level at which the minimum wage was initially set contributed to its successful introduction, and the lack of an adverse effect on the economy.

The long-term effects of the national minimum wage (nmw) can only be assessed over a whole economic cycle. But evidence suggests that the minimum wage has benefited a substantial number of workers without having a significantly adverse effect on the economy … The recent beneficial economic climate, as well as fierce competitive pressure in the sectors most affected by the nmw has also mitigated the effect of the nmw on wages and prices.

CBI evidence

4.18 We examined the latest predictions about prospects for growth and risks to the economy in the medium term. The Bank of England *Inflation Report* (February 2001) states that the central projection for annual GDP growth is expected to dip to around 2 per cent in the latter half of 2001, before returning to around the supply capacity of the economy in 2002. The HM Treasury *Pre-Budget Report* (November 2000) predicts growth at between 2.25 and 2.75 per cent in the short to medium term. Meanwhile, the Bank's central projection for underlying inflation is that it will stay at around 2 per cent throughout 2001 before picking up the following year, while the Treasury forecasts a slightly higher rate. Both forecasts assume constant nominal interest rates. We noted that the consensus of independent forecasters was for a modest slowdown in growth coupled with stable inflation (Bank of England *Inflation Report,* February 2001).

4.19 The main risks to prospects for continued growth come from overseas, with growth in the world economy slowing significantly in 2000. The deceleration has been particularly sharp in the United States, but growth in the euro zone has also slowed. A more acute slowdown in world trade would necessarily entail a period of weaker growth in the UK.

Offsetting this, however, is the UK's strong record on inflation, which has left it better placed to withstand external shocks.

4.20 Some forecasters have offered various reasons why the supply side of the economy may have improved recently. The first is that the functioning of the labour market has become more efficient, which has enabled unemployment to fall to lower levels without igniting inflationary pressures. This would imply a fall in the 'natural rate' of unemployment. The second stems from greater competition in product markets due, for example, to increased globalisation, changes in regulation and growth in e-commerce. The third stems from underlying improvements in labour productivity. This last point is important in considering what the economy can afford in terms of a higher minimum wage since it means that a given path of nominal earnings growth will be associated with a lower impact on unit wage costs and inflation. Different forecasters place different weights on these factors, but together they imply downward pressure on prices.

Employment

4.21 In recommending a new rate, we were conscious that we should not damage the employment prospects of those the minimum wage is intended to benefit. We commissioned a study (Stewart, 2001) of the effects of the introduction of the minimum wage on employment in the UK. The results of this were discussed in detail in Chapter 3, and they pointed to a broadly neutral effect on employment.

4.22 The UK study was based on data up to Autumn 1999. Hence it can show only the initial impact on employment. Since employment effects may take time to feed through into the labour market, we also reviewed the latest research from other countries where a minimum wage had been in operation for some time. In addition, we gathered evidence from employers about the likely employment impact of future upratings.

4.23 In our first report we reviewed the extensive literature on the effect of minimum wages on employment. The OECD *Employment Outlook* (1998) also published a summary of studies from different countries, using a variety of modelling techniques. These often produce conflicting evidence on the effect of minimum wages on job losses. Orthodox theory predicts that a minimum wage set above market rates leads to job losses, but the new economics of the minimum wage argues that this is not always the case (see, for example, Card and Kreuger, 1995). Explanations for the lack of a negative employment effect centre on the existence of imperfections in the labour market which cause employees to be paid less than the value of the work they produce. This might occur, for example, where there is imperfect information and employees are not fully aware of all jobs available to them; where there are large search costs involved in looking for another job; or where employees' bargaining position is limited.

4.24 There is evidence of imperfect information in some labour markets. When we met homeworkers, for example, we found that their bargaining position was constrained because they were fragmented geographically and they had very little awareness of other homeworkers doing similar work. This meant they faced barriers in attempting to organise themselves into effective bargaining units.

The isolation of homeworkers from both other workers and from sources of information and advice can enable employers to threaten homeworkers with loss of work by playing them off against each other and makes them unable to mount any effective form of collective organisation.

National Group on Homeworking evidence

4.25 The nature of the labour market is only one factor that will affect the precise employment response to a minimum wage. A recent study (Neumark and Wascher, 1999) found that the extent to which vulnerable groups were protected from negative employment effects was correlated to a number of factors; for example, to lower minimum rates for vulnerable groups and to the ability of firms to adjust by making organisational changes. In addition, countries that operated active labour market policies to help disadvantaged groups back into the labour market tended to show smaller disemployment effects from a minimum wage. We saw in Chapter 3 that firms responded in a variety of ways following the introduction of the minimum wage. This, together with the range of active labour market policies currently in place, may to some extent have led to the limited adverse employment effects indicated by our evidence. Notwithstanding these factors, of critical importance is the level at which the minimum is set.

4.26 Many recent studies (eg Neumark, 1999; Bazen and Marimoutou, 2000; and Turner and Demiralp, 2000) have tapped into new data sources and methodological approaches. These have produced contradictory evidence as to the direction and size of the employment effect arising from the introduction of a minimum wage. While not conclusively supporting a positive employment response, these studies suggest overall that any negative effects are small and tend to be confined to the most disadvantaged groups in the labour market such as youth, certain ethnic minority groups and the least skilled.

4.27 Evidence from the UK does not so far suggest that vulnerable groups have experienced negative employment effects. Employment across most age groups and ethnic minorities has increased since the introduction of the minimum wage. Our commissioned research (Stewart, 2001) showed that young men and women experienced zero or, if anything, mildly positive effects. We therefore conclude that in the medium term the employment effects, whether positive or negative, are likely to be small at the rate we are recommending.

Prices

4.28 As well as future growth and inflation and the effect on employment, we considered recent trends in prices and earnings as a guide to future levels of the minimum wage. Measures of inflation are concerned with the increase in the cost of living. A minimum wage that increases in line with price movements will maintain its real purchasing power. As increases in money earnings generally outstrip price movements, a minimum wage that increases only in line with prices will lose its relative value as a wage floor.

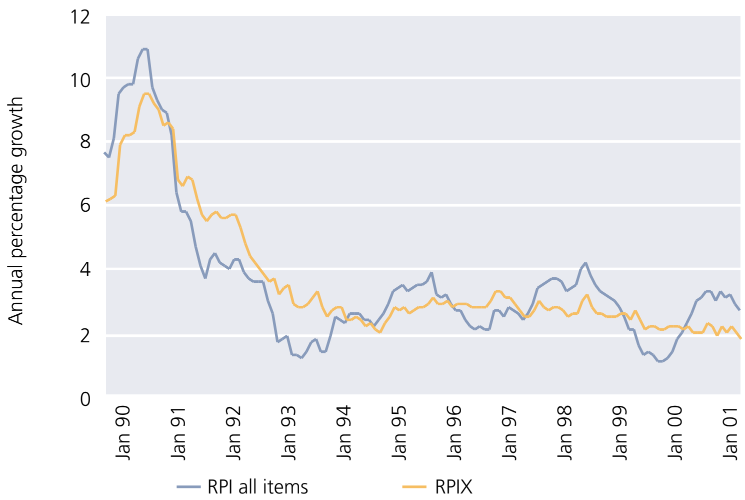
4.29 We looked at recent trends in both the all-items Retail Prices Index (RPI) and RPI excluding mortgage interest payments (RPIX). A weakness of the RPI in the context of the minimum wage is that it reflects the cost of living of the average household rather than that of low-paid households. The majority of long-term pay agreements that are inflation-linked employ the RPI. In their evidence, some employers who suggested that the minimum wage be uprated in line with the RPI also suggested that the increase be capped, for example at 5 per cent.

4.30 Compared with RPI, RPIX would perhaps better ensure that the National Minimum Wage reflected the cost of living for low-paid workers because the lowest-paid workers tend not to have mortgages. The Government uses RPIX as its measure of underlying inflation, and its target for this is 2.5 per cent.

4.31 Recent trends in prices as measured by these indices are shown in Figure 4.1 below. Following the economic downturn, inflation fell rapidly in the early 1990s and has been relatively stable over the past five or six years. Over the last two years, underlying inflation, as measured by RPIX, has been below the Government's target of 2.5 per cent. The relationship between these two measures of inflation depends on the path of interest rates. Between mid-1997 and the latter part of 1998, RPI was above RPIX. This was due largely to tight monetary policy, which was gradually relaxed towards the end of 1998. In April 1998 mortgage interest tax relief was reduced from 15 per cent to 10 per cent, causing a temporary rise in the RPI in that year.

Figure 4.1

Retail Price Growth, 1990–2001



Source: Retail Prices Index, ONS, 1990–2001

4.32 In January 2001 RPI inflation was 2.7 per cent, with underlying inflation lower at 1.8 per cent. If the level of the minimum wage at April 1999 (£3.60) had been uprated in line with prices since its introduction, and if the latest price indicators (averaging the last three months' data) continued in the future, we estimate that the value of the National Minimum Wage would be around £3.85 per hour in October 2001 if uprated by RPI, and around £3.75 per hour if uprated by RPIX.

Earnings

4.33 Increasing the minimum wage in line with earnings would ensure that it reflected growing prosperity within the economy as a whole. The earnings indices we considered included the Average Earnings Index (AEI), earnings indicators from the New Earnings Survey (NES) and the level of pay settlements. The AEI measures changes in gross earnings based on survey returns from around 8,000 employers. Each employer includes information on the total pay bill and the number of people covered by it, with no distinction for full-time or part-time staff. Because the definition of earnings includes overtime, shift payments, bonuses and profit-related pay, in addition to basic pay, it does not correspond exactly with the definition used for the minimum wage. The AEI headline rate measures the change in the seasonally-adjusted index for the last three months compared with the same period a year earlier.

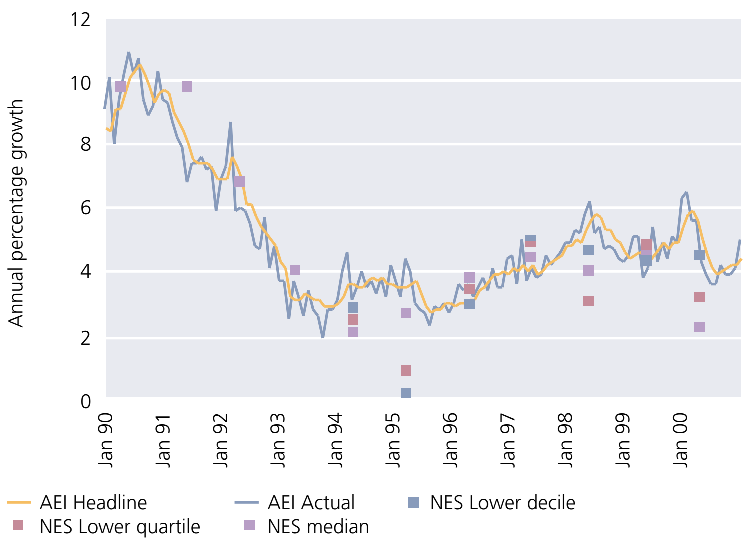
4.34 The NES, carried out in April each year, produces results from a 1 per cent sample of employees (about 150,000 people). An advantage of the NES over the AEI is that it can be used to measure increases in basic pay excluding overtime, and it therefore corresponds more closely to the minimum wage definition of earnings. Another advantage is that it can be used to estimate increases in earnings at particular points in the earnings distribution, for example, the lowest decile or the median. This means that we can identify increases for those groups that are most relevant to us, the low paid. The NES, however, has two disadvantages: it undersamples the low paid (see Appendix 1 for more details), and, because it is a 'snapshot' survey of one week in April, it is not sensitive to cycles in pay settlements.

4.35 Aggregate wage indices, such as the AEI and NES, do not just measure changes in pay. They may also reflect changes in the composition of the labour force and in the hours being worked in the economy. If, for example, participation drops, and those predominantly moving out of the labour force are the low paid, then increases in average earnings over time will be a product of the changed sample as well as increases in wages. The AEI can also be distorted by bonus payments, particularly at certain times of the year (eg the end of the financial year when many bonuses are paid).

4.36 Figure 4.2 contains indicators of earnings growth since 1990. These data show that growth in earnings has averaged just under 5 per cent per year since 1998, although growth in the latter half of 2000 has been lower, at around 4 per cent.

Figure 4.2

Earnings Growth, 1990–2000



Source: AEI, ONS and ungrossed NES data, 1990–2000

4.37 The trend in median earnings from the NES has generally matched the AEI series quite closely, except for the last few years when the AEI has been higher. Since 1997 NES lowest-decile earnings have outstripped growth in the median, except for 1999 when lowest-decile earnings were just marginally lower. Latest data for April 2000 indicate that lowest-decile earnings grew at twice the median, an effect at least partly attributable to the National Minimum Wage.

4.38 If the minimum wage had been uprated by the AEI actual index since its introduction in April 1999 (£3.60), and assuming that the most recent trends (averaging the last three months' data) continue, then its value at October 2001 would be around £3.90 per hour, slightly below the value (around £4.00 per hour) it would be if the AEI headline rate were used.

4.39 Some groups have argued that the appropriate level of the National Minimum Wage is the value equivalent to half male median earnings. Using male earnings, excluding overtime in calculating both earnings and hours – the closest definition of earnings as defined by the minimum wage legislation – we estimate half male median earnings to be £4.13 per hour in April 2000, up from £3.97 per hour in April 1999.

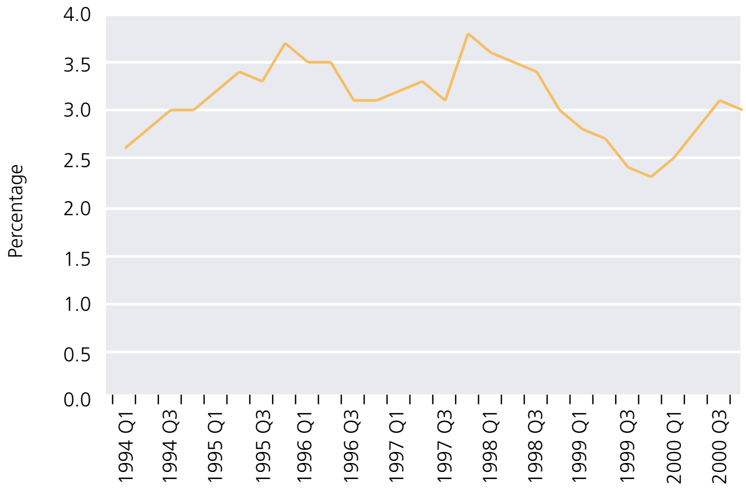
Pay Settlements

4.40 Another source of information on pay movements is the level of settlements. There are three major data banks containing information on the level of pay awards: the Confederation of British Industry (CBI), Industrial Relations Services (IRS) and Incomes Data Services Ltd. (IDS). The last two include public sector awards in their monitoring exercises, but the CBI Pay Databank relates only to the private sector. The definition of what is being measured also differs. The CBI Pay Databank measures the impact on earnings whereas IDS and IRS measure largely basic rate increases. The CBI headline figure is an average of the settlement data received while IRS quotes a median based on the number of settlements. The IDS Pay Chart does not provide a single figure but shows the range of settlement increases in a scattergram.

4.41 The CBI Pay Databank time series (see Figure 4.3) shows that the average level of manufacturing settlements has been running in a fairly narrow range between 2.3 and 4 per cent since 1994. Service sector settlements have been slightly higher than those in manufacturing (see Figure 4.4). The latest CBI Pay Databank report (19 February 2001) indicates that pay settlements in manufacturing averaged 3 per cent in the three months to December 2000, up from 2.3 per cent in the same period in 1999 (see Figure 4.3). Settlements in the private service sector averaged 4.2 per cent in the three months to December 2000 (see Figure 4.4). The CBI reported that 'the headline rate of inflation has been the main source of upward pressure on settlements'. It also indicated that recruitment and retention problems have become more important in exerting upward pressure on pay increases in the latter part of 2000.

Figure 4.3

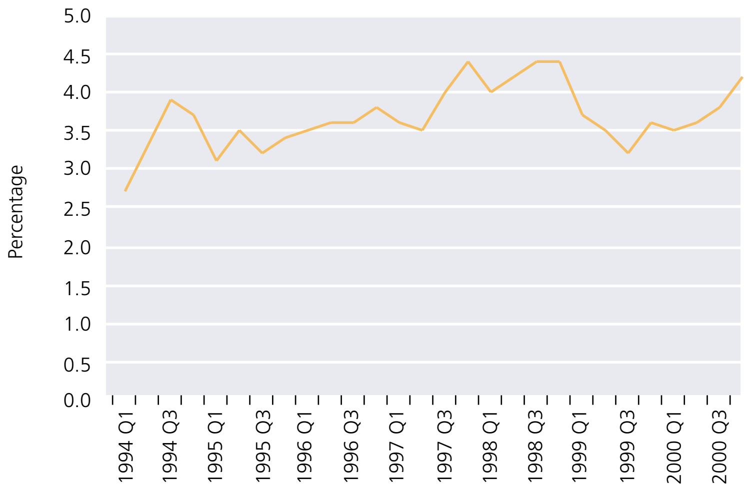
Average Settlements in Manufacturing, 1994–2000



Source: CBI Pay Databank
Note: Second, third and fourth quarter figures for 2000 are provisional.

Figure 4.4

Average Settlements in Private Services, 1994–2000

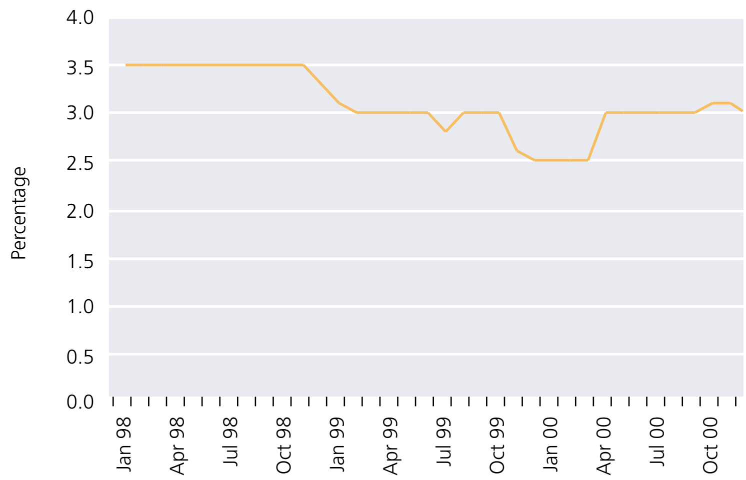


Source: CBI Pay Databank
Note: Second, third and fourth quarter figures for 2000 are provisional.

4.42 The IRS Pay Databank shows that the median level of pay awards has remained around 3 per cent since February 1999, but with a slight fall in early 2000 followed by a recovery from April (see Figure 4.5). The range remains fairly narrow, with the upper quartile at 3.6 per cent and the lower quartile at 2.8 per cent in December 2000 (IRS, 2001). The mean increase rose slightly during the year from 2.6 per cent in January to 3.4 per cent in December 2000. IRS commented that 'preliminary analysis from the IRS databank reveals that settlements are creeping up, with higher levels of headline inflation in the latter phase of 2000 filtering through to deals struck … in the early part of 2001'.

Figure 4.5

Median Level of Pay Awards, 1998–2000



Source: Industrial Relations Services (IRS) Databank

4.43 The IDS Pay Settlement Charts from January 1999 to December 2000 show the central range of pay increases at between 2 and 5 per cent in 1999, falling to between 2 and 4 per cent in early 2000, but rising slightly in the latter half of the year, reflecting the earlier rise in inflation. The latest IDS Pay Settlement Chart (IDS, 2001b), which includes 46 pay awards due for implementation from January to March 2001, suggests that the range of pay increases edged up slightly. Settlements due in January 2001 were bunching between 3 and 4.5 per cent. Of the 113 new awards added to the chart in January 2001, a third were worth 4 per cent or more and half were between 3 and 3.9 per cent.

4.44 Pay settlement data indicate no significant upward pressure on pay levels in 2000 but early indications are that there may have been some slight upward movement since the beginning of 2001. Most settlements have implementation dates in January, April, June or July, so awards in the latter part of the year are less significant.

4.45 Overall, the data on prices and pay show that earnings, both in terms of average earnings increases and in terms of the level of pay settlements, have increased faster than prices over the last two years. Up to April 2000, earnings at the lower end of the distribution have included increases resulting from the introduction of the minimum wage and have therefore outstripped the growth in median earnings. Since its introduction in April 1999 the level of the minimum wage has increased broadly in line with prices, lagging behind increases in earnings. This has resulted in a fall in the numbers covered by the minimum wage, as low earners have seen their wages increase above minimum wage levels.

The Rate

4.46 The minimum wage has not had an adverse impact on the economy in terms of growth, inflation or employment, due to a combination of the cautious introductory rate and favourable economic conditions. Economic growth seems set to continue, while inflation remains at a manageable level. At the same time, the labour market has been operating more efficiently and there have been underlying improvements in labour productivity. There has been continuing downward pressure on prices with underlying inflation being below the government target for the last two years. And pay settlement data indicate no significant upward pressure on pay levels.

4.47 Revisions to the estimates of numbers in low pay, and increases in the earnings of the low paid outstripping the rate of increase in the minimum wage, have led to a reduction in the numbers covered by the minimum wage since its introduction. In terms of the aggregate economy, therefore, there is scope for a substantial increase in the minimum wage.

4.48 As well as recommending a rate for 2001, we believe that the minimum wage should continue to be uprated regularly.

Business has also told us that it would welcome a degree of certainty to plan for the future. Setting the right rate further into the future is more difficult as economic conditions change. We therefore recommend a small further increase in 2002, before the level of the minimum wage is reviewed again fully.

4.49 **We recommend that the main National Minimum Wage for adults aged 21 and over should be increased to £4.10 per hour in October 2001 and to £4.20 per hour in October 2002.**

4.50 In unanimously choosing a rate to recommend to the Government, we wanted to satisfy ourselves of the likely impact. We wanted the rate we recommended to make a difference to those on low pay, but we also had to be sure that it could be accommodated by the economy and by business. A rate that was not manageable would hurt the prospects of the very people it was meant to protect by damaging employment, profitability and competitiveness. We are also well aware that the impact of the minimum wage will vary greatly across sectors and across different sizes of business.

4.51 Hence, in the next part of this chapter we present the results of our assessment of the impact of the rate we are recommending. We consider the coverage, the effect on the wage bill at both the aggregate and the sectoral level and the impact on prices and on public sector finances. Our conclusion is that the rate we are recommending will make a difference to those on low pay but will still be manageable for business and the economy. Although some businesses will feel the effects more sharply than others, we are confident that, given the general acceptance of the need to increase the minimum wage and the lead-in time, business will be able to devise strategies to manage such an increase.

Assessing the Impact

Coverage

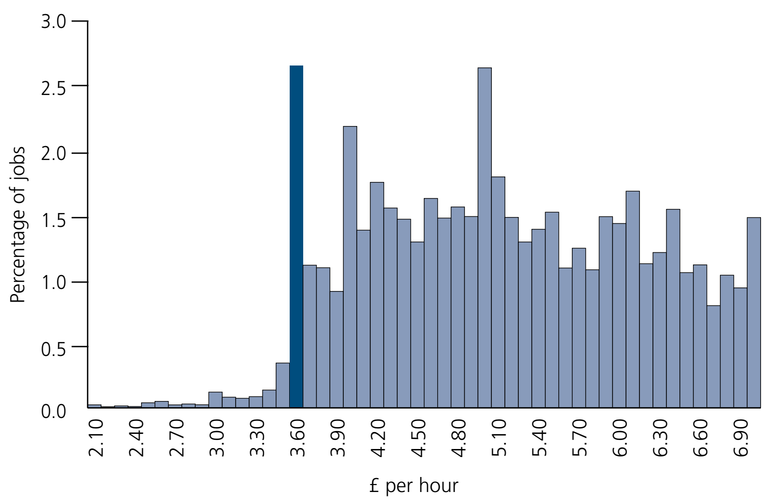
4.52 We explained in Chapter 3 that our assessment of the coverage of the minimum wage is complicated by problems with estimates made from official data sources. In our first report we estimated that 8.5 per cent of jobs for those aged 21 and over would be covered by our recommendations.

Under the refined ONS methodology this proportion fell to around 5.4 per cent. In setting a rate for 2001 we took account of the implications of these new estimates of numbers in low pay and their implications for the coverage of the minimum wage.

4.53 Figure 4.6 shows the distribution by 10p hourly rates of earnings for those aged 21 and over. At April 2000 around 2.1 million jobs of those aged 21 and over were paid at or below £4.10 per hour, in the region of 9 per cent of jobs for the age group. But the distribution of earnings in 2001 will not be the same as that in April 2000. Earnings across the distribution will have increased, and employment in low-paying sectors will also have changed independently of the impact of the minimum wage. The extent of these movements is uncertain. In order to predict the coverage of the minimum wage in 2001, we therefore assumed that earnings of the low paid would move in line with average earnings between April 2000 and October 2001 (using the last three months' earnings data to predict the future), and that the numbers employed in low-paying sectors would remain the same.

Figure 4.6

Hourly Earnings Distribution for Those Aged 21 and Over, 2000



Source: LPC Calculations, Grossed NES and LFS data

4.54 These are broad-brush assumptions. In the last few years it has been difficult to disentangle underlying increases in wages of the low paid from increases at the bottom end of the earnings distribution arising from action in anticipation of the minimum wage. In our two previous reports we therefore used forecast inflation to estimate the real value of the minimum wage. In this report, however, we have used average earnings as they are a more appropriate measure for downrating to real values and the minimum wage effect will have less impact now on the earnings series than was present at the time of the introduction of the minimum wage.

4.55 If the earnings of the low paid rise by less than our prediction of the increase in average earnings, this method will lead to an understatement of the number of jobs covered by the new level of the minimum wage. There is evidence from low-paying sectors that earnings have been rising by less than average; for example, the British Retail Consortium noted that earnings in the retail sector have fallen behind average earnings.

4.56 Assuming that earnings of the low paid increase in line with average earnings, we estimate the real value of a £4.10 per hour minimum wage in October 2001 to be around £3.85 per hour at April 2000 levels. The number of jobs of those aged 21 and over below this level is in the region of 1.3 million, around 5.5 per cent of jobs. If we assumed a smaller percentage increase in earnings of the low paid, say in line with prices, then the real value of the minimum wage would be higher, around £3.95 per hour at April 2000. This would represent around 1.5 million jobs, or around 6.6 per cent of those aged 21 and over.

Wage Bill

4.57 We were told that the minimum wage received wide acceptance from businesses because it was set at a rate that was sustainable for them. A higher rate may have had serious adverse consequences on employment and compliance. We considered these arguments alongside evidence we received from businesses on affordability and from research on employment effects. We looked at the impact of our recommendation on the aggregate economy as well as on vulnerable sectors and regions.

4.58 Predicting the cost to the wage bill in the future is not straightforward. In order to estimate the direct first-round effects we need to make some assumptions about the growth in earnings, in the absence of a minimum wage increase, for those who might be affected by the new rate. Since this is difficult to predict with precision, we adopted two assumptions which provide an upper and lower bound to wage bill costs. The first is that there is little or no earnings growth at the bottom end of the earnings distribution, and the second is that these earnings grow at roughly the same rate as the growth in average earnings. The latter was chosen to reflect the largest increase in earnings observed over the recent past using the range of indicators discussed in paragraphs 4.33 to 4.39 above.

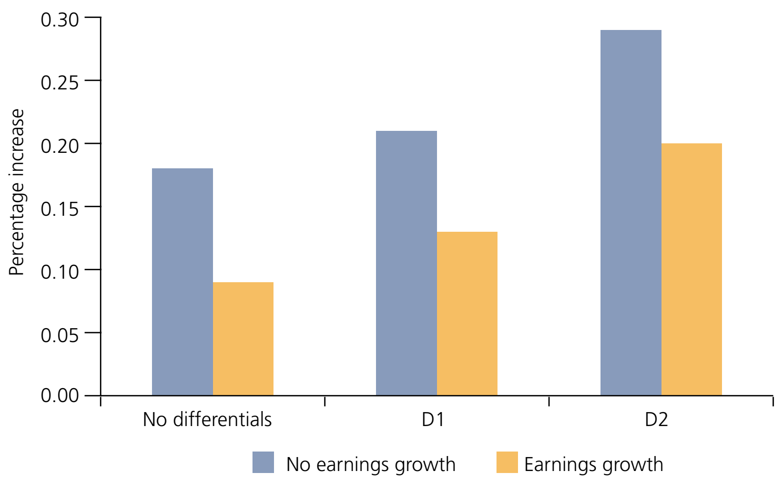
4.59 In Chapter 3 we reported that there was some evidence of higher-than-average increases in earnings for those above the minimum wage. We cannot identify precisely where the minimum wage effect on differentials stops in these data. Nor can we be certain whether our recommendation would have the same impact on differentials as the introduction of the initial rate, or whether the effect will be more modest, as was the case in comparing April 1999 with April 2000 data. In calculating the impact on the wage bill we therefore considered a range of assumptions about earnings restoration above the minimum. We have assumed that the largest impact on differentials when the minimum wage was introduced would not be repeated to such a degree with our recommendation, as the percentage increase underlying the rise in the minimum wage is not as great as that associated with its introduction. We were guided by the latest data in determining our assumptions.

4.60 In order to test the sensitivity of our assumptions on the aggregate wage bill, and because identifying precise break points in our data is subjective, we adopted two assumptions on the degree of wage restoration. The first is that wage restoration would be limited to around the eighth percentile (D1), the second is that there would be a continued, but lower, effect up to around the fortieth percentile (D2).

4.61 Figure 4.7 shows the effect on the total wage bill of an increase in the minimum wage to £4.10 per hour at October 2001 on each of the assumptions mentioned in the previous paragraph and also assuming no differential effects. The direct effect of a £4.10 per hour minimum wage is between 0.09 and 0.18 per cent of the current wage bill, depending on the assumed path of earnings growth. Assuming limited restoration of earnings differentials increases the aggregate wage bill effect to between 0.13 and 0.21 per cent of the current wage bill. Assuming preservation of differentials further up the distribution raises the upper bound to between 0.2 and 0.29 per cent. Since earnings growth pre-minimum wage for the lowest paid was close to or above average earnings growth, we might expect the wage bill effect to lie towards the bottom of this range.

Figure 4.7

Aggregate Wage Bill Impact, Minimum Wage of £4.10, October 2001



Source: LPC Calculations, Grossed NES and LFS data

4.62 There are several reasons why these estimates could be overstating the wage bill effect. We have assumed that compliance is universal, and although we have not seen evidence of large-scale non-compliance, it would be fair to assume that it was less than 100 per cent. Second, we established a baseline for October 2001 that assumed increases in wages up to the new minimum, but no restoration of differentials. Because earnings of the low paid are likely to have increased faster than the increase in the minimum wage, this will understate the baseline wage bill and hence overstate the impact of the new rates. We also found that some employers had reduced hours; this will reduce the estimates further. We have therefore placed more weight on the lower bound estimates.

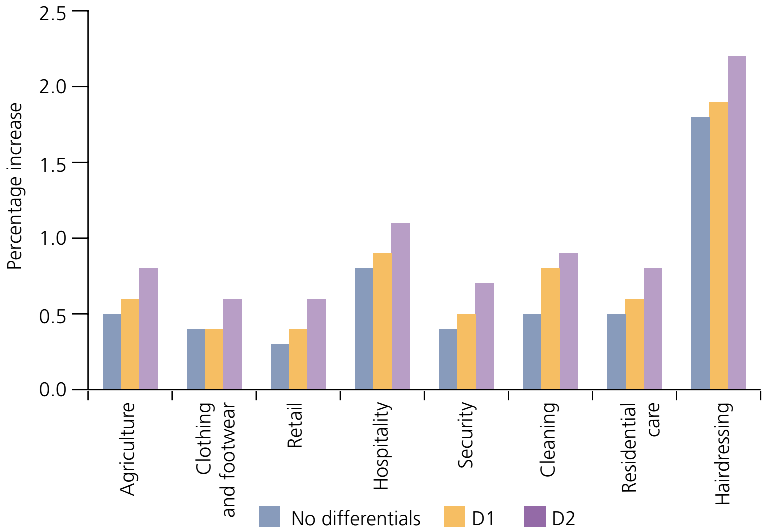
4.63 The estimated wage bill impact of this further increase to the minimum wage is therefore modest; lower than the wage bill increase resulting from the introduction of the minimum wage. In the light of our evidence in Chapter 3, and the economic context in which we are setting this new rate, we do not anticipate any adverse impact on the aggregate economy.

4.64 The estimates in Figure 4.7 are aggregate figures, an average of those most affected and those not at all affected by the minimum wage. In Chapter 3 we discussed how the minimum wage would disproportionately affect firms in low-paying sectors and small and medium-sized enterprises. In recommending a new rate, we therefore took a particular interest in the impact of various minimum wage rates on the wage bill of the key low-paying sectors and that of small firms (see Figures 4.8 and 4.9).

4.65 Figure 4.8 shows the impact on sectoral wage bills of an increase in the minimum wage to £4.10 per hour, assuming that earnings growth among the low paid rises roughly in line with average growth. The size of the wage bill impact reduces as the size of firm increases (see Figure 4.9), but in terms of the overall impact Figure 4.8 shows that the largest increases in the wage bill are in hairdressing, hospitality and cleaning. Nevertheless, the increases remain relatively small at 1.8 per cent for hairdressers, 0.8 per cent for hospitality and 0.5 per cent for cleaning; these are much smaller than the increases arising from the initial introduction of the minimum wage.

Figure 4.8

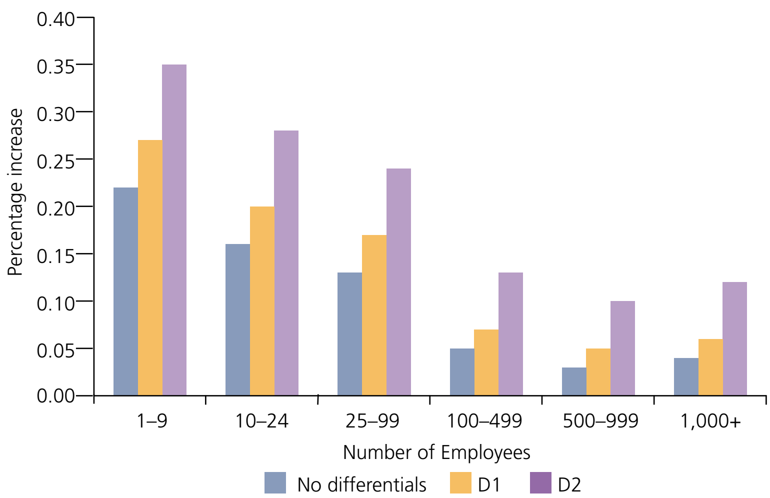
Wage Bill Impact in Low-paying Sectors, Minimum Wage of £4.10, October 2001



Source: LPC Calculations, Grossed NES and LFS data
Note: Assumes earnings of the low paid grow in line with average earnings.

Figure 4.9

Wage Bill Impact by Business Size, Minimum Wage of £4.10, October 2001



Source: LPC Calculations, Grossed NES data
Note: Assumes earnings of the low paid grow in line with average earnings.

4.66 These findings are consistent with findings from our survey of low-paying sectors of the initial impact of the introduction of the minimum wage. This shows that hairdressers were most likely to report a significant increase in the wage bill resulting from the introduction of the minimum wage. Our new estimates suggest that this would continue to be the case as the minimum wage is uprated. The impact of the uprating, however, would not be as great as that of the initial introduction.

4.67 The assumptions on differentials make less difference to the low-paid sectors than they do on aggregate. For example, in the hairdressing sector, the effect of including the larger differentials assumption in the wage bill estimate (D2) increases the impact on the wage bill from 1.8 to 2.2 per cent, an increase of 20 per cent. This compares with a more than doubling of the wage bill impact for the economy as a whole when D2 is included in the calculation. This is because the low-paying sectors have proportionately fewer workers higher up the earnings distribution where these assumptions bite.

Inflation

4.68 We saw in Chapter 3 that the minimum wage had no discernible impact on the main measures of inflation, or on components within the RPI that were particularly associated with low-paying sectors. There was some evidence, from individual firms and sectors, that the minimum wage had caused them to raise prices for certain goods and services. In practice, the extent to which this happened depended on a number of factors. These included the increase in the wage bill faced by individual firms, conditions in labour and product markets, and the way in which firms and individuals responded to the new rate, particularly in making productivity and efficiency changes.

4.69 We noted in Chapter 3 that firms exhibited a range of responses to the minimum wage. One of the important findings from our research and consultation was that firms that were restricted in raising prices (for example, because they faced strong international competition) were more likely to make other adjustments to contain costs such as reducing hours or employment. As the minimum wage is increased, such adjustments may become more widespread.

4.70 Judgments about the impact of our recommendation on inflation cannot be made in isolation from the macroeconomic response by the Bank of England. The Monetary Policy Committee has a target for underlying inflation as measured by RPIX of 2.5 per cent. In the Bank of England's *Inflation Report* (February 2001), the central projection for underlying inflation throughout 2001 is around 2 per cent, before starting to pick up to reach its target the following year. The report notes that inflationary pressures have weakened recently, reflecting the impact of lower growth and energy prices. Some forecasters put more weight on supply-side improvements and on the United States' slowdown mentioned in paragraph 4.19. These might be expected to lower the inflation profile by up to 0.5 per cent. Although there are risks with any forecast, the projections suggest continuing low and stable inflation.

4.71 Analysis of the expected inflationary impact of a minimum wage depends critically on the range of assumptions and specifications employed. We commissioned the ITEM club, an independent forecasting group, to conduct some simulations using the Treasury model of the economy. The results, shown in Table 4.1, are not definitive and are indicative only of the likely impact under the assumptions adopted. In this case it has been assumed that monetary policy brings inflation to its base forecast after two years. The analysis shows that a rise in the wage bill of 0.2 per cent (that which arises from an increase to £4.10 per hour) adds 0.07 of a percentage point to inflation in the first year, and 0.05 in the second. Even the most pessimistic estimate of the increase in the wage bill (around 0.3 per cent), increases inflation only by around 0.1 per cent in the first year, and 0.07 per cent in the second.

Table 4.1

Impact of Changes in the Wage Bill on Underlying Inflation

Percentage rise in wage bill	Percentage point change from base: First year	Second year
0.2	0.07	0.05
0.3	0.10	0.07

Source: ITEM Club

4.72 Another key assumption underlying these simulations is that there is no dynamic response on the part of individuals or firms. The models do not take account of adjustments that we have seen firms make, for example, in controlling labour costs. They are thus likely to be an upper bound. In addition, the models take no account of the potential gains to labour productivity, which will reduce unit wage costs and hence reduce pressure on inflation. If firms in the sectors most affected by the minimum wage continue to respond positively in making productivity gains, while competitive pressures limit the extent to which they increase prices, then we might expect the inflationary impact of the new rate to be subdued. Because we have not linked our recommended increase to a specific uprating index, and have taken into account views from firms on what they can afford, we would not expect any subsequent price increases to have a lasting effect on inflationary expectations.

Public Sector Finances

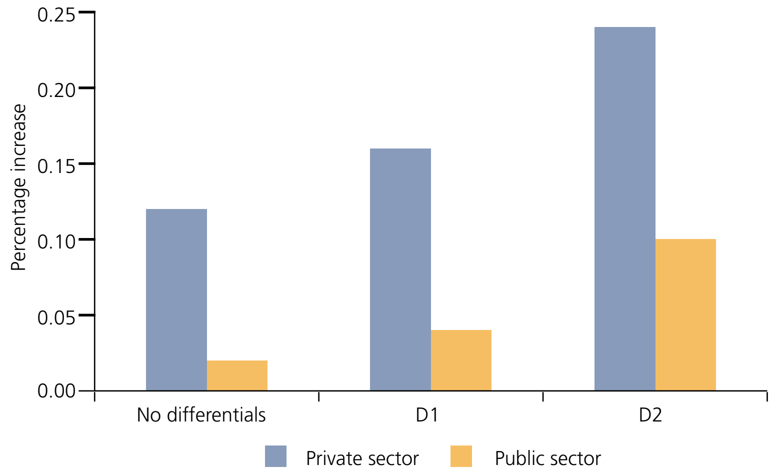
4.73 Models of the inflationary response do not take account of the impact of the change in government expenditure. In assessing the impact of the future rate on public sector finances, we looked at its impact on the size of the public sector wage bill; expenditure on tax credits and benefits; tax and National Insurance receipts; and the costs of goods and services procured from the private sector.

Public Sector Wage Bill

4.74 The evidence we examined showed that the introduction of the minimum wage had little impact on public sector pay. The lowest wage rates in national agreements for public sector wages are generally well above minimum wage levels. We have estimated the cost of our recommended rate on the public sector wage bill, using the methodology outlined in the section on wage bills in paragraphs 4.60 and 4.61 above. As Figure 4.10 shows, the estimated cost to public sector wages of our recommended increase in the minimum wage is small compared with costs to the private sector. Assuming earnings of the low paid increase in line with average earnings, and using the highest differential assumptions, we estimate that an increase in the minimum wage to £4.10 per hour will increase the public sector wage bill by around 0.1 per cent.

Figure 4.10

Wage Bill Impact in the Public and Private Sectors, Minimum Wage of £4.10, October 2001



Source: LPC Calculations, Grossed NES and LFS data
Note: Assumes earnings of the low paid grow in line with average earnings.

Tax Credits and Benefits

4.75 We asked the Department of Social Security and the Inland Revenue to provide estimates of the impact on tax credits and benefits of increasing the minimum wage to a number of different levels, the results of which are given in Table 4.2. Using Government figures we estimate that increasing the minimum wage to £4.10 per hour would reduce expenditure on tax credits and means-tested benefits by between £55 million and £100 million. Increasing the minimum wage would reduce the number of households entitled to these credits and benefits. Around 5,000 families would float off Working Families' Tax Credit (WFTC), up to 20,000 off Housing Benefit and up to 20,000 off Council Tax Benefit.

Table 4.2

Benefit and Tax Credit Impact of a Change in the National Minimum Wage

	Adult rate increased to: £4.00 per hour	Adult rate increased to: £4.20 per hour
Income Support		
Expenditure, £million	–5	–15
Losers	70,000	90,000
Floaters off	5,000	10,000
Housing Benefit		
Expenditure, £million	–15	–30
Losers	80,000	90,000
Floaters off	5,000	20,000
Council Tax Benefit		
Expenditure, £million	–5	–5
Losers	70,000	80,000
Floaters off	10,000	20,000
WFTC		
Expenditure, £million	–30	–50
Losers	165,000	195,000
Floaters off	5,000	5,000

Note: WFTC estimates are based on the 1996/97 to 1998/99 Family Expenditure Surveys, uprated to 2001/02 levels of prices, earnings and tax and benefit rates. Estimates for Income Support, Housing Benefit and Council Tax Benefit are based on the 1998/99 Family Resources Survey, uprated to 2000/01 levels. Employees with earnings below the level of the National Minimum Wage were brought up to those rates.

4.76 These estimates take no account of any secondary behavioural impact of the minimum wage, in particular of increases in spending on out-of-work benefits resulting from any adverse employment effects. We have not attempted to forecast this as, to date, we have no evidence that points to significant increases in unemployment resulting from the introduction of the minimum wage. Advice from the Government is that the calculations of the impact of the minimum wage on income tax, corporation tax and National Insurance are too approximate to enable them to break the figures down further, or to provide additional estimates to those given in the Government's evidence (December 2000).

4.77 The net overall impact on wages, taxes and benefits of our recommended increase is therefore expected to be small, with a negligible impact on the economy. More difficult to measure is the future impact on the cost of goods procured from the public sector. The evidence we have gathered to date has shown that the impact of the minimum wage on prices of goods and services has not been great. We therefore conclude that there is likely to be no significant impact on public sector finances from our recommended rate.

Conclusion

4.78 Our decision on what to recommend is based on analysing a wide range of evidence from, among others, employers, trade unions and other groups representing the low paid, low-paid workers themselves, economists, commissioned research and our interpretation of official statistics. The strength of the economy and downward revisions to the numbers in low pay suggest that a substantial increase in the minimum wage is justified.

4.79 But it is low-paying businesses in particular that will need to absorb and adapt to the increase. We hope that business organisations, trade associations, trade unions and bodies such as the Small Business Service will work with firms to help them cope with the change recommended in this volume of our report. The impact on the sectors affected and on the economy as a whole will be significantly less than the impact of the introduction of the minimum wage and can, we believe, be absorbed through continued increases in productivity. Hence we believe we have recommended an increase in the National Minimum Wage which will be manageable by low-paying sectors, but will still provide low-paid workers with a substantial rise in their hourly earnings.

5 Conclusion

The implementation of the National Minimum Wage to date has been a success. Our recommendation on a new rate remains prudent enough not to have any adverse effect on employment, but is bold enough to make a significant difference to low-paid workers. We have also recommended that it should be increased further by a small amount in 2002 before the rate is reviewed again fully. The second volume of our third report, in May, will consider the impact of the minimum wage, on individual low-paying sectors, on young people and training, and on vulnerable groups, as well as its interaction with the tax and benefits system. This volume will also include our conclusions and recommendations on the level and coverage of the Development Rate, the maximum accommodation offset, compliance and enforcement, and the future uprating of the minimum wage. Together the two volumes will present a coherent view of the impact of the minimum wage and its continuing development, some three years after we made our first recommendations.

5.1 We are pleased to be able to say that the implementation of the National Minimum Wage has been a success. Against the background of a strong economy, businesses have generally coped well with the introduction and the subsequent upratings in 2000. Workers have benefited from higher wages without any discernible negative impact on their employment prospects. Both the gender and regional pay gaps have narrowed.

5.2 The impact on wage costs has been significant in a number of low-paying sectors and some firms have faced a major challenge to adapt. But businesses told us that in most cases the impact of the minimum wage was manageable; it was often less than that of other regulatory and economic developments. The vast majority of firms affected have been able to cope through improving productivity, raising prices, accepting reductions in profits and tightening control of labour costs. The impact on differentials has generally been limited and has usually been confined to the lower end of the earnings distribution.

5.3 The amount of notice businesses had to prepare for the introduction of the National Minimum Wage helped them to manage the initial impact. Businesses told us repeatedly that six months' notice of a new rate was necessary. Because the Government intends to implement any changes arising from our recommendations in October 2001, we decided that we should report as early as we could, while completing our research and analysis in a thorough manner. Hence we have produced this volume in March, with the second volume to follow in May.

5.4 There remains scope for further improvements to the statistical data collected by the Office for National Statistics, but the recent developments in its methodology are an important step forward. The improvements in the available data have led us to revise downwards the estimate of those who could have expected to benefit from the introduction of the minimum wage to workers in 1.3 million jobs. This is still a large number of potential beneficiaries.

5.5 Statistical evidence, the work of the Inland Revenue, our research and our consultation have convinced us that the large majority of workers have received their entitlement. But we are aware that some workers are still not receiving the minimum wage to which they are entitled. We will report on compliance and enforcement in more detail in the second volume of this report.

5.6 Our consultation, research and analysis provided a very good picture of the impact of the minimum wage so far. In our deliberations on a new rate, we did not take a formulaic approach, nor did we have any particular target for coverage in mind. The labour market and the economy are dynamic and we decided that a balanced judgment was needed. We took account of the relevant economic indicators such as earnings, inflation and employment. We looked at the potential direct impact of the new rate on the wage bill, and the indirect effect from differentials. We balanced our assessment of aggregate data by analysing data on the low-paying sectors most likely to be affected. We also listened carefully to stakeholders. A wide range of research also informed our deliberations and we looked at developments in other countries. As well as considering what firms in the private sector could afford, we addressed the impact on the public sector.

5.7 As in our first report, we had to form a judgment about recommending a level of the minimum wage which would not pose a significant risk to jobs. Our initial recommendations were cautious, because they were, in a sense, a journey into the unknown. We could not know what would be the precise impact of introducing a minimum wage for the first time. Our analysis of recent evidence convinced us that there was now scope for a substantial increase in the main rate. We have also recommended that the minimum wage should be increased further by a small amount in 2002 before it is reviewed fully again. This will help retain its value as a wage floor and enable business to plan ahead. We have seen no evidence to change our view that the adult rate should apply to those aged 21 and above. We shall report on that more fully in the second volume of our report.

5.8 We believe that our recommendation is prudent enough not to have a significant negative impact on the economy and business, but is bold enough to make a real difference to low-paid workers. We estimate that the new rate in October 2001 will cover between 1.3 and 1.5 million jobs or around 5.5 to 6.6 per cent of jobs for those aged 21 and over. Of these, around 70 per cent will be women. The new rate in October 2001 and the increase in October 2002 will ensure that the National Minimum Wage continues to be an effective wage floor while increasing the benefit it provides to the lowest-paid employees. We are convinced that our recommendation is manageable for the vast majority of businesses. But we recognise that some businesses might need help to manage the change. We were impressed with the efforts that some firms had made to cope with the introduction of the minimum wage. We consider that trade associations, business support organisations, the trade unions and the Small Business Service should all have a role to play in spreading best practice.

5.9 There is, of course, more to the National Minimum Wage than the main rate. In our terms of reference the Government asked us to look at the level of the Development Rate and at the case for changing the age at which the adult rate should apply. We have also been asked to monitor and evaluate the impact of the minimum wage with particular reference to a number of issues, including the effect on particular sectors, groups of workers, the interaction with the tax and benefits system and the interaction with the New Deal. And we have been asked if there is a case for increasing the maximum accommodation offset. These are matters we will deal with in the second volume of this report.

5.10 An important benefit of the minimum wage is the protection it provides to the most vulnerable workers. In the second volume of this report we will cover in more detail the impact of the minimum wage on such groups, including people from ethnic minority backgrounds, homeworkers and disabled people. We shall also cover compliance and enforcement. And we will discuss the need to conduct research over a longer term.

5.11 All of these issues are closely inter-related. For example, certain vulnerable groups in the economy may be more likely to be victims of non-compliance. Although we have focused in our first volume on the level of the main rate, in our deliberations we have considered the implications of other components of the National Minimum Wage for the level of the main rate. We recognise that many important issues remain to be covered. We will present our conclusions and recommendations on these in the second volume.

5.12 Looking further ahead, we consider that there needs to be a defined system of regular reviews to ensure that the minimum wage continues to be an effective labour market floor, that low-paid workers continue to benefit from the prosperity of the nation, and that employers can plan ahead in a measured manner. The second volume will include our recommendations on a process for future reviews.

5.13 The National Minimum Wage was well received and is widely regarded as a success. Our task has been to set out the next steps that need to be taken to ensure the continuing effectiveness of the minimum wage. Our first volume has recommended a minimum wage that will have significant benefits for low-paid workers, but at the same time will be manageable for business. In our second volume we will cover the issues mentioned in the previous paragraphs. Together, the two volumes will present a comprehensive view of the minimum wage some three years after we made our first recommendations. The National Minimum Wage has now achieved widespread acceptance and has become firmly embedded in our society. We hope that the recommendations we will have made in the two volumes of our third report will help ensure that the minimum wage continues to develop in the way necessary to underpin a modern labour market.

Appendix 1: New Estimates of Numbers in Low Pay

1. In order to make an accurate assessment of low pay in the economy, we need accurate data on the number of low-paid workers. While surveys of firms and qualitative research give us a feel for the number and characteristics of the low paid, only the official national data sources provide the aggregate picture.

2. Our second report set out, in some detail, the uncertainties surrounding official estimates of low pay. The Labour Force Survey (LFS) and the New Earnings Survey (NES) each produce biased estimates of the numbers in low pay for different reasons. The NES under-samples individuals earning less than PAYE thresholds, and therefore understates the level of low pay. The LFS suffers from problems of bias in its estimation of hourly earnings, which lead to an understatement of hourly earnings, and produce much higher estimates of numbers on low pay than the NES.

3. We asked the Office for National Statistics (ONS) to address these problems with the data and to improve the methodology for estimating numbers in low pay. The ONS has produced improved estimates, which were first released in a press notice on 26 October 2000, and in more detail in the January 2001 issue of *Labour Market Trends*. The revised methodology produced lower estimates of numbers on low pay than we presented in our second report. Here we discuss the reasons why the estimates have fallen, and what the new figures are saying.

Overview of Previous Estimates of Low Pay

4. Appendix 2 of the second report explained in some detail how the estimates of low pay were derived. Here we give a brief overview, as this background is necessary to understand why the estimates of numbers in low pay have changed.

5. In order to obtain a central estimate of the distribution of low pay for our first and second reports a number of adjustments were made to both the LFS and the NES data:

   - the LFS was adjusted to bring numbers with low wages down; and
   - the NES was adjusted to include more people earning below PAYE levels.

6. The adjusted LFS figure produced the upper bound of the central estimate, and the adjusted NES figure gave the lower bound. In our first report, based on ONS advice, we used the mid-point between these upper and lower bounds to provide a central estimate of numbers in low pay. In our second report, again based on ONS advice, we argued that the NES estimate, the lower bound, was likely to be closer to the actual number of low paid than the central figure. This reduced the estimate of numbers in low pay to around 1.7 million.

7. The figure of 1.7 million was a combination of the NES data and the earnings data from the LFS. In Spring 1999, the NES suggested that around 10 per cent of employees earned less than the PAYE threshold, whereas the LFS estimated that around 17 per cent of cases did so. The methodology used in the second report assumed that the LFS gave the true percentage of people, and the true distribution of hourly earnings for those earning below PAYE. The number of low paid above PAYE was calculated

using only NES data. The below and above PAYE parts of the distribution were added together to produce an overall 'NES' estimate of low pay.

8. At the time of writing the second report, new work by ONS exploring the accuracy of the NES data suggested that the bias in the NES was not as great as was first thought. The second report therefore predicted that estimates of numbers in low pay might fall below the lower bound estimate of around 1.7 million, more in the region of 1.5 to 1.7 million.

Explanation of the New Methodology

9. The full methodology underlying current estimates was set out in the January 2001 issue of *Labour Market Trends.* The new methodology provides two separate estimates: one based solely on NES data, the other solely on LFS data. The central estimate is the mid-point between the two estimates.

10. The LFS estimate is now based on the results of a new question, introduced into the LFS in April 1999, that asks individuals their actual hourly rate of earnings. (The previous method for deriving hourly wage rates was to divide gross weekly earnings by usual weekly hours.) This has improved the reliability of the LFS as a means of estimating hourly pay, as estimates of hourly rates are no longer derived from inconsistent earnings and hours information.

11. Because the new hourly rate question is asked only of a subset of respondents, ONS has developed a method to impute, or model, an hourly rate variable for those who do not have, or do not know, their hourly earnings. This is done in one of two ways:

- For post-1999 data a donor method of imputation is used. This involves using information on an individual's earnings and hours worked, and such personal characteristics as age, sex and qualifications, to predict a value for their hourly rate. The donor method, which is valid only for the post-minimum wage period, then groups individuals with an actual value of the hourly rate, the 'donor', with other individuals with similar predicted hourly rates. Individuals without an actual hourly rate are then randomly assigned an actual hourly rate from a similar donor. Similar donors are found through a regression to find hourly rates. The main reason for using donors to get the final imputed values is because there is a large spike in the earnings distribution at the level of the National Minimum Wage. The donor method replicates that spike.
- The donor method is not used to estimate earnings for the period before April 1999. There is no spike in the earnings distribution pre-minimum wage, and using the donor method would have reproduced the 1999 spike in the 1998 distribution. The reason for this is that donors would have had to be drawn from the 1999 data set because the 1998 data do not include the hourly rate variable. Hourly rates for 1998 are therefore estimated using predictions from the regression itself.

12. These two methods produced slightly different estimates of low pay. The January *Labour Market Trends* article showed that when results from the two methods were compared using 1999 and 2000 data, the regression-only method produced higher estimates of the numbers in low pay than the donor method. Therefore, the 1998 estimates of low pay were based on a methodology that may produce higher estimates of the level of low pay than the methodology underlying the estimates for 1999 and 2000.

13. The NES estimate was produced by adjusting the NES so that it better reflected the characteristics of all employees and the firms in which they worked. Comparing the NES with other data sources suggested that it under-represented the number of young people and people working in small firms. This under-representation was adjusted, although not completely corrected, by grossing up the NES sample to all employee jobs in the UK. The grossing regime ensured that there was the right number of jobs in each cell of the grossing matrix, but if any given cell was not representative of the whole population, grossing could not correct for this. For example, if the NES under-represented young people in the hotel and catering industry, grossing would ensure the right number of this group, but would not compensate for the lack of low earners among them in the original sample. Hence the grossed NES data are still likely to underestimate the numbers earning below National Minimum Wage rates.

14. The population matrix used for grossing developed by the ONS had control totals for individual characteristics (age group and gender) and firm characteristics (number of employees and sector). The individual level data came from the LFS, while the firm and sector level data came from the Inter-Departmental Business Register (IDBR). The IDBR contains information on all businesses that are registered for VAT or PAYE purposes. Grossing factors were produced for each cell in the matrix.

15. The central estimate, derived from both the NES and the LFS data, is an average of the proportion below the National Minimum Wage estimated from each of the two data sources. In order to estimate the number below the minimum wage, this proportion was applied to the total number of jobs in the economy from the LFS.

New Estimates of Numbers in Low Pay

16. Table A1.1 below shows the number of jobs paid less than the National Minimum Wage based on the estimates released by ONS when it published the central estimate methodology in October 2000. These estimates show that 1.5 million jobs were paid at less than £3.60/£3.00 in April 1998, with this figure falling to 300,000 in Spring 2000.

Table A1.1

Number of Jobs Paid Below the National Minimum Wage, 1998–2000

Year	Number of jobs paid less than specified amounts (%)	number (000s)
1998 (<£3.60/£3.00)		
18–21	7.7	120
22 and over	6.4	1,400
Total	6.4	1,520
1999 (<£3.60/£3.00)		
18–21	2.7	40
22 and over	2.4	540
Total	2.4	580
2000 (<£3.60/£3.00)		
18–21	3.1	50
22 and over	1.1	250
Total	1.2	300

Source: ONS, 1998–2000

17. In the second report we explained that, in order to estimate the number of potential beneficiaries from the National Minimum Wage, we needed to downrate the level of the minimum wage to represent its real value in 1998. We therefore downrated the level of the National Minimum Wage to £3.50/£2.90 in 1998 to allow for increases in earnings over the period. The estimate of the number of jobs below £3.50/£2.90 in 1998 based on the new methodology is around 1.3 million.

18. The main reason the figures estimated under the new methodology are lower than the figures presented in the second report is that the new LFS methodology produced much lower estimates of the number of low-paid jobs. The discrepancy between the LFS and the NES estimates of numbers in low pay is now much smaller.

Are the New Figures Better?

19. In the January 2001 *Labour Market Trends* article, ONS argued that its new estimates were better than the previous ones. ONS stated that the new LFS hourly rate question is a better measure of the extent of low pay, for the following reasons:

- it does not have the very low values seen in the derived variable;
- it is more up-to-date;
- it measures only basic pay;
- it is sensitive to the introduction of the National Minimum Wage, whereas the old variable showed no discernible response to the introduction of the minimum wage; and
- it has a high level of personal response for those aged 22 and over, and evidence suggests that proxy respondents do not guess if they do not know.

20. Nonetheless, the LFS is a survey of households and it will be subject to inaccuracies and response error. The method of imputing hourly wages for people who do not answer the hourly rate question will increase the level of uncertainty about the actual hourly rate of people in the sample. The imputed answers will be estimates based on the old and imperfectly derived hourly rate variable.

21. A further reason for caution is that the stability of the LFS estimate over time has not been fully tested. Since Spring 2000 questions concerning the new variable have been asked of a greater proportion of the LFS sample, this may lead to a further refinement of the estimate of low pay. Also, as explained above, the difference between the regression-only and the donor method results suggests that the 1998 estimate of low pay using the regression-only method may have led to an overestimate on the part of the LFS.

22. Since it is derived from pay records, the NES gives more accurate estimates of hourly wages for those people in the sample. The nature of the sample, however, is to under-represent the number of people in low pay. The grossing of the NES is also an improvement on the old methodology. Comparing the grossed and ungrossed data shows that the grossed NES more fully reflects the composition of all employees. Tables A1.2 to A1.4 below give comparisons of the ungrossed NES with estimates of the number of employees by size of business and sector, and estimates of number of employees by age and sex from the data sources used in the grossing procedure.

Table A1.2

Distribution of Employees by Business Size, 1998

Number of Employees	IDBR distribution (%)	Ungrossed NES distribution (%)
1–9	12.4	8.8
10–24	8.7	7.5
25–99	11.5	10.8
100–499	14.9	13.9
500–999	6.7	6.5
1,000+	45.7	52.5

Source: IDBR and ungrossed NES data, 1998

Table A1.3

Distribution of Employees by Industry Sector, 1998

Industry Sectors	Employee jobs series distribution (%)	Ungrossed NES distribution (%)
Agriculture and fishing	1.4	1.1
Manufacturing	17.8	20.3
Mining and energy	0.9	1.1
Construction	4.6	4.5
Wholesale and retail trade	16.9	14.9
Hotels and restaurants	5.7	3.0
Transport and communication	5.8	5.1
Financial intermediation	4.3	5.5
Real estate and business activities	14.0	11.8
Public administration	5.8	9.3
Education	7.9	11.1
Health and social work	10.8	8.6
Other community, social and personal services, private households, extra-territorial organisations	4.7	3.8

Source: Employee jobs series, ONS and ungrossed NES data, 1998

Table A1.4

Distribution of Employees by Gender, Age, Part-time and Full-time Status, 1998

Age/gender	Full-time/ part-time work	LFS, percentage of 18+ working population	Ungrossed NES, percentage of 18+ working population
Male 18–21	Full-time	2.5	1.8
	Part-time	1.0	0.6
Male 22 and over	Full-time	46.9	48.0
	Part-time	2.6	2.7
Female 18–21	Full-time	1.8	1.5
	Part-time	1.3	0.8
Female 22 and over	Full-time	25.1	26.8
	Part-time	18.8	17.8
All male		53.0	53.2
All female		47.0	46.8
All full-time		76.2	78.1
All part-time		23.8	21.9
All 18–21		6.6	4.8
All 22 and over		93.4	95.2

Source: LFS and ungrossed NES, 1998

23. Grossing the NES has produced an estimate that better reflects employees and firms in the economy, but it cannot correct for a sample that misses a number of the lowest earners. For example, although the total number of young people is correct, the proportion of young people who are low-paid may not be. We concur with the ONS opinion that the NES estimate of numbers in low pay is a lower bound. The overall result of the grossing was to increase the estimate of the proportion of jobs that were below £3.60 in 1998 from 5 to 6 per cent.

24. In summary, we believe that the new methodology is better than the previous methods. But we remain concerned that there is still considerable uncertainty surrounding both estimates of low pay. This has a direct impact on our work and our ability to have confidence in the data when we consider our recommendations. We would therefore not want to rely too heavily on either one of these estimates alone, but to consider them together. The nature of the estimates and their weaknesses must be borne in mind when considering the low-pay estimates.

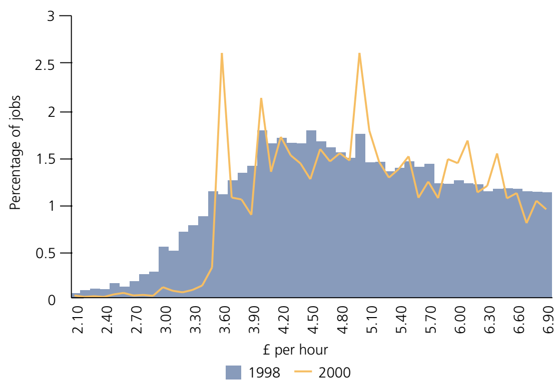
25. We were encouraged by the convergence of the estimates of low pay from the two data sources at low hourly wage rates. The difference between the NES and LFS estimates is much closer than the upper and lower bounds used for our second report. The bottom of the range is around 1.2 million (NES) and the top of the range 1.4 million (LFS). The closeness of the two figures tends to suggest that the central estimate is a better estimate of the numbers on low pay than we have had hitherto. Estimates of low-paid workers are a vital tool to inform the work of the Commission. They assist us to formulate our recommendations. We are grateful to the ONS for the work it has done in improving the data. We hope that it will continue to do further work on producing better estimates.

New Estimates of Low-paid Jobs

26. Figure A1.1 shows how the percentage of jobs paid at different hourly rates has changed since the implementation of the National Minimum Wage. The proportion of jobs below National Minimum Wage rates had declined sharply by April 2000, with an estimated 250,000 jobs for those aged 22 and over below £3.60. The figure shows a peak in the earnings distribution between £3.60 and £3.70, with another between £4.00 and £4.10. At April 2000 around 850,000 jobs for those aged 22 and over paid below £3.70 per hour, indicating that earnings of the lowest paid have increased faster than the level of the National Minimum Wage. This was also reflected in evidence from other sources: Incomes Data Services research indicated that firms have been setting a wage floor at above National Minimum Wage rates in order to be able to compete for staff.

Figure A1.1

Hourly Earnings Distribution for Those Aged 22 and Over, 1998 and 2000



Source: ONS, 1998, 2000

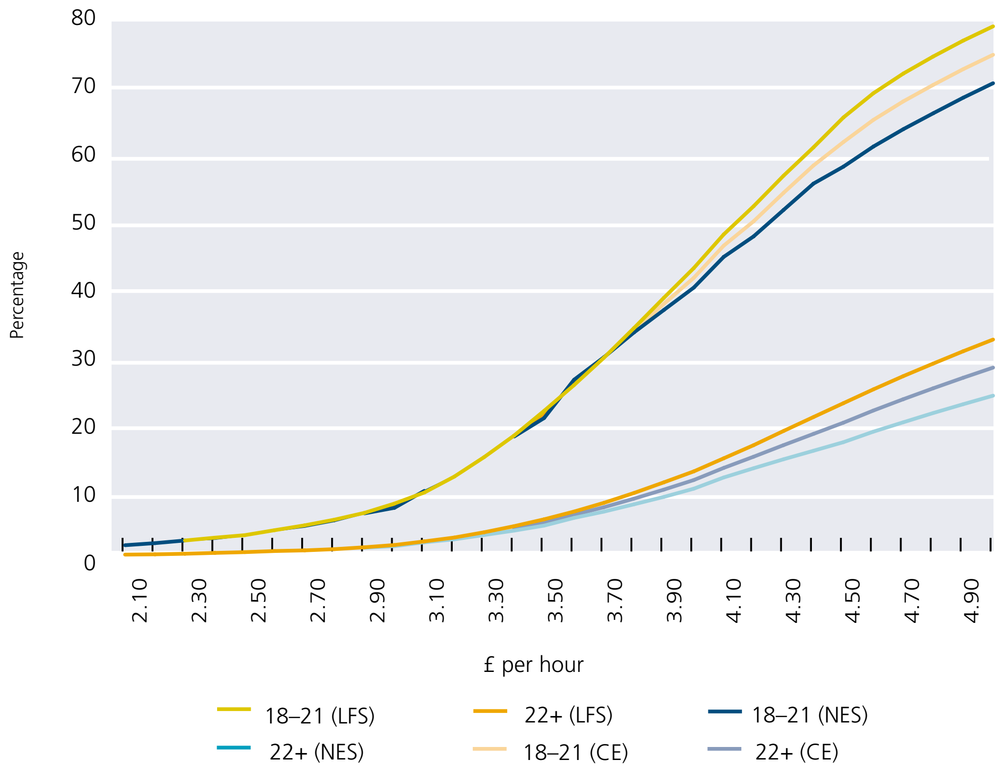
27. Tables A1.5 to A1.7 show the number of jobs in 10p bands for both the LFS and the NES estimates. Differences between the LFS and the NES estimates of the number of jobs at or around the National Minimum Wage level are relatively small but big differences remain further up the earnings distribution. While these tables show rates up to

£7.00 per hour, looking further up the distribution we can see that the disparity between the two estimates increases to around £8 per hour, when the difference begins to decline.

28. Figure A1.2 below also illustrates the discrepancy between the LFS and the NES estimates using 1998 data. The figure shows that the discrepancy between the upper and lower bounds is greater for 18–21 year olds than for people aged 22 and over. The discrepancies between the estimates stem from the differences in the coverage of the data sets and in the method of collecting data. The NES still under-samples individuals below PAYE, who are mainly young people. The LFS data are collected from individuals, and include both main and second jobs. The ONS believes that the LFS may still overstate the number of low-paid workers and is still working to improve its methodology.

Figure A1.2

Cumulative Hourly Earnings Distribution, 1998



Source: ONS, 1998

Table A1.5

Number and Percentage of Jobs Below Hourly Rates, ONS New Methodology, 1998

1998	Percentage of employee jobs, UK				Employee jobs (000s)	
Less than	18–21 (LFS)	22+ (LFS)	18–21 (NES)	22+ (NES)	18–21 (CE)	22+ (CE)
£2.10	1.9%	0.5%	2.0%	0.5%	30	116
£2.20	2.2%	0.6%	2.1%	0.6%	34	128
£2.30	2.6%	0.6%	2.6%	0.7%	41	146
£2.40	3.0%	0.8%	2.8%	0.8%	46	167
£2.50	3.4%	0.9%	3.3%	0.8%	53	188
£2.60	4.1%	1.0%	4.0%	1.0%	64	223
£2.70	4.8%	1.1%	4.6%	1.1%	74	249
£2.80	5.6%	1.3%	5.4%	1.3%	88	287
£2.90	6.6%	1.6%	6.6%	1.5%	105	343
£3.00	8.0%	1.9%	7.4%	1.8%	122	404
£3.10	9.6%	2.5%	9.9%	2.3%	155	525
£3.20	12.0%	3.0%	12.0%	2.8%	190	635
£3.30	14.8%	3.8%	14.9%	3.4%	236	790
£3.40	18.0%	4.7%	17.8%	4.0%	284	960
£3.50	21.6%	5.7%	20.6%	4.8%	334	1,151
£3.60	25.4%	6.8%	26.2%	5.9%	409	1,401
£3.70	29.4%	8.1%	29.5%	6.8%	467	1,643
£3.80	33.8%	9.6%	33.1%	7.9%	530	1,919
£3.90	38.2%	11.1%	36.4%	9.0%	591	2,211
£4.00	42.6%	12.7%	39.7%	10.2%	652	2,521
£4.10	47.5%	14.6%	44.2%	11.8%	727	2,913
£4.20	51.7%	16.6%	47.2%	13.2%	784	3,275
£4.30	56.1%	18.7%	51.1%	14.5%	850	3,649
£4.40	60.3%	20.7%	55.0%	15.8%	914	4,011
£4.50	64.7%	22.7%	57.5%	17.0%	968	4,374
£4.60	68.2%	24.8%	60.4%	18.6%	1,020	4,766
£4.70	71.1%	26.7%	63.0%	19.9%	1,063	5,132
£4.80	73.6%	28.6%	65.3%	21.3%	1,101	5,484
£4.90	76.0%	30.4%	67.6%	22.6%	1,138	5,825
£5.00	78.1%	32.1%	69.7%	23.8%	1,171	6,153
£5.10	80.2%	33.9%	71.8%	25.5%	1,205	6,536
£5.20	82.1%	35.4%	74.2%	26.9%	1,238	6,854
£5.30	83.6%	37.0%	76.0%	28.2%	1,265	7,172

Table A1.5 (continued)

Number and Percentage of Jobs Below Hourly Rates, ONS New Methodology, 1998

1998	Percentage of employee jobs, UK				Employee jobs (000s)	
Less than	18–21 (LFS)	22+ (LFS)	18–21 (NES)	22+ (NES)	18–21 (CE)	22+ (CE)
£5.40	84.9%	38.6%	77.5%	29.3%	1,287	7,468
£5.50	86.1%	40.1%	78.9%	30.6%	1,308	7,773
£5.60	87.2%	41.6%	80.4%	32.0%	1,328	8,092
£5.70	88.2%	43.0%	81.3%	33.3%	1,344	8,399
£5.80	89.2%	44.5%	82.5%	34.7%	1,361	8,713
£5.90	89.9%	45.7%	83.3%	35.9%	1,373	8,981
£6.00	90.7%	46.9%	84.5%	37.2%	1,388	9,249
£6.10	91.4%	48.0%	85.7%	38.6%	1,404	9,524
£6.20	92.2%	49.1%	86.7%	39.9%	1,418	9,792
£6.30	93.1%	50.2%	87.7%	41.2%	1,433	10,057
£6.40	93.6%	51.4%	88.6%	42.3%	1,444	10,307
£6.50	94.0%	52.5%	89.2%	43.5%	1,452	10,562
£6.60	94.5%	53.6%	89.9%	44.7%	1,462	10,819
£6.70	94.9%	54.8%	90.6%	45.8%	1,471	11,074
£6.80	95.3%	56.0%	91.1%	46.9%	1,478	11,324
£6.90	95.6%	57.2%	91.6%	47.9%	1,484	11,572
£7.00	96.1%	58.5%	92.1%	48.9%	1,492	11,819

Source: ONS, 1998

Note: CE = Central Estimate.

Table A1.6

Number and Percentage of Jobs Below Hourly Rates, ONS New Methodology, 1999

1999 Less than	Percentage of employee jobs, UK 18–21 (LFS)	22+ (LFS)	18–21 (NES)	22+ (NES)	Employee jobs (000s) 18–21 (CE)	22+ (CE)
£2.10	0.4%	0.3%	0.5%	0.2%	7	54
£2.20	0.8%	0.3%	0.7%	0.2%	12	59
£2.30	1.0%	0.3%	0.8%	0.3%	14	66
£2.40	1.2%	0.4%	0.8%	0.3%	17	75
£2.50	1.3%	0.4%	0.9%	0.3%	18	82
£2.60	2.3%	0.5%	1.2%	0.4%	28	102
£2.70	2.7%	0.6%	1.3%	0.4%	32	118
£2.80	2.7%	0.7%	1.6%	0.5%	34	129
£2.90	2.8%	0.7%	1.9%	0.6%	37	146
£3.00	2.8%	0.8%	2.6%	0.6%	44	156
£3.10	5.1%	1.3%	4.6%	0.8%	78	228
£3.20	6.3%	1.6%	5.9%	0.9%	98	275
£3.30	10.3%	1.7%	8.4%	1.1%	150	316
£3.40	11.7%	1.9%	9.8%	1.3%	173	362
£3.50	13.4%	2.3%	11.6%	1.5%	200	430
£3.60	15.0%	2.8%	14.5%	2.0%	237	541
£3.70	26.7%	7.1%	21.0%	4.3%	383	1,292
£3.80	31.6%	8.4%	24.7%	5.4%	452	1,560
£3.90	36.7%	9.7%	27.7%	6.4%	517	1,812
£4.00	39.2%	10.9%	30.2%	7.3%	557	2,049
£4.10	44.9%	13.7%	35.7%	9.0%	647	2,557
£4.20	49.1%	15.8%	39.1%	10.3%	708	2,941
£4.30	56.3%	18.2%	42.8%	11.6%	795	3,359
£4.40	59.7%	20.1%	45.8%	13.0%	847	3,720
£4.50	62.9%	22.2%	49.3%	14.2%	901	4,091
£4.60	66.0%	23.8%	53.3%	15.6%	958	4,434
£4.70	68.4%	25.5%	56.2%	16.9%	1,000	4,779
£4.80	73.1%	27.6%	59.4%	18.3%	1,063	5,171
£4.90	74.9%	29.5%	62.0%	19.6%	1,098	5,525
£5.00	76.6%	31.4%	64.3%	21.0%	1,131	5,890
£5.10	79.7%	34.6%	67.3%	22.6%	1,180	6,437
£5.20	81.5%	36.2%	69.9%	24.0%	1,215	6,778
£5.30	82.7%	37.8%	71.6%	25.3%	1,238	7,102

Table A1.6 (continued)

Number and Percentage of Jobs Below Hourly Rates, ONS New Methodology, 1999

1999	Percentage of employee jobs, UK				Employee jobs (000s)	
Less than	18–21 (LFS)	22+ (LFS)	18–21 (NES)	22+ (NES)	18–21 (CE)	22+ (CE)
£5.40	84.6%	39.1%	73.5%	26.5%	1,269	7,387
£5.50	86.5%	41.0%	75.0%	27.7%	1,296	7,726
£5.60	88.0%	42.5%	76.7%	29.0%	1,321	8,043
£5.70	88.3%	43.7%	78.1%	30.2%	1,336	8,313
£5.80	88.8%	44.6%	79.7%	31.6%	1,352	8,571
£5.90	89.3%	45.6%	80.8%	32.8%	1,364	8,817
£6.00	90.5%	48.3%	81.8%	34.0%	1,382	9,268
£6.10	90.8%	49.1%	83.0%	35.4%	1,394	9,514
£6.20	91.8%	51.2%	84.0%	36.6%	1,411	9,877
£6.30	92.0%	52.0%	85.0%	37.8%	1,420	10,103
£6.40	92.8%	53.0%	86.0%	39.0%	1,434	10,352
£6.50	93.4%	54.4%	86.8%	40.1%	1,446	10,635
£6.60	93.7%	54.8%	87.7%	41.3%	1,456	10,818
£6.70	94.2%	55.9%	88.5%	42.4%	1,466	11,067
£6.80	94.4%	56.6%	89.2%	43.6%	1,473	11,276
£6.90	94.7%	57.4%	89.8%	44.6%	1,481	11,473
£7.00	94.7%	57.6%	90.4%	45.7%	1,486	11,632

Source: ONS, 1999

Note: CE = Central Estimate.

Table A1.7

Number and Percentage of Jobs Below Hourly Rates, ONS New Methodology, 2000						
2000	Percentage of employee jobs, UK				Employee jobs (000s)	
Less than	18–21 (LFS)	22+ (LFS)	18–21 (NES)	22+ (NES)	18–21 (CE)	22+ (CE)
£2.10	0.6%	0.2%	0.6%	0.0%	10	27
£2.20	0.8%	0.2%	0.8%	0.0%	13	32
£2.30	0.8%	0.3%	1.1%	0.0%	15	34
£2.40	0.9%	0.3%	1.2%	0.1%	18	38
£2.50	0.9%	0.3%	1.4%	0.1%	20	40
£2.60	1.6%	0.3%	1.6%	0.1%	27	48
£2.70	2.1%	0.4%	1.9%	0.1%	33	59
£2.80	2.5%	0.5%	2.2%	0.1%	39	65
£2.90	2.6%	0.5%	2.6%	0.1%	43	71
£3.00	2.8%	0.5%	3.5%	0.1%	52	76
£3.10	4.4%	0.7%	5.7%	0.2%	84	102
£3.20	5.2%	0.8%	6.9%	0.2%	101	118
£3.30	6.6%	0.9%	8.4%	0.2%	126	131
£3.40	6.8%	1.0%	10.3%	0.3%	143	150
£3.50	7.9%	1.2%	11.6%	0.4%	162	179
£3.60	9.0%	1.4%	14.8%	0.9%	198	253
£3.70	17.1%	4.8%	21.1%	2.6%	318	845
£3.80	20.7%	6.0%	24.5%	3.6%	377	1,088
£3.90	26.6%	7.2%	28.0%	4.5%	456	1,326
£4.00	29.6%	8.1%	31.1%	5.3%	506	1,527
£4.10	36.2%	10.7%	36.2%	6.9%	605	2,010
£4.20	40.5%	12.2%	40.8%	8.1%	678	2,315
£4.30	47.4%	14.4%	44.3%	9.4%	765	2,705
£4.40	50.8%	16.1%	47.7%	10.6%	822	3,049
£4.50	54.6%	17.7%	50.9%	11.9%	881	3,375
£4.60	56.9%	18.8%	55.5%	13.3%	938	3,662
£4.70	60.5%	20.6%	58.4%	14.7%	992	4,022
£4.80	62.8%	22.2%	61.1%	16.0%	1,034	4,352
£4.90	66.1%	24.2%	63.3%	17.1%	1,080	4,702
£5.00	68.3%	25.9%	65.8%	18.4%	1,120	5,034
£5.10	72.7%	29.3%	68.9%	20.1%	1,182	5,627
£5.20	74.6%	31.6%	70.9%	21.4%	1,215	6,031
£5.30	76.6%	33.2%	73.2%	22.7%	1,251	6,360

Table A1.7 (continued)

Number and Percentage of Jobs Below Hourly Rates, ONS New Methodology, 2000

2000	Percentage of employee jobs, UK				Employee jobs (000s)	
Less than	18–21 (LFS)	22+ (LFS)	18–21 (NES)	22+ (NES)	18–21 (CE)	22+ (CE)
£5.40	78.6%	34.6%	74.7%	23.8%	1,280	6,651
£5.50	80.4%	36.2%	76.2%	25.0%	1,307	6,963
£5.60	82.2%	37.8%	78.0%	26.4%	1,337	7,305
£5.70	83.4%	38.8%	79.5%	27.5%	1,360	7,547
£5.80	84.3%	39.9%	80.9%	28.9%	1,379	7,828
£5.90	85.7%	40.9%	82.0%	30.0%	1,400	8,069
£6.00	87.1%	42.7%	83.0%	31.2%	1,420	8,405
£6.10	87.7%	44.0%	84.3%	32.7%	1,436	8,731
£6.20	89.1%	46.1%	85.6%	34.0%	1,458	9,111
£6.30	89.4%	47.0%	86.5%	35.3%	1,469	9,366
£6.40	90.6%	48.2%	87.5%	36.4%	1,487	9,637
£6.50	92.1%	50.1%	88.4%	37.7%	1,506	9,987
£6.60	92.4%	50.9%	89.2%	39.0%	1,515	10,227
£6.70	92.8%	52.0%	89.9%	40.1%	1,525	10,481
£6.80	93.1%	52.5%	90.5%	41.2%	1,532	10,661
£6.90	93.6%	53.4%	91.1%	42.3%	1,541	10,896
£7.00	93.8%	54.2%	91.6%	43.5%	1,548	11,110

Source: ONS, 2000

Note: CE = Central Estimate.

Conclusion

29. Since we first embarked on our task of advising the Government on the National Minimum Wage, we have had concerns about the estimates of those in low pay. We wrote about these in our first and second reports. We are grateful to the ONS for the positive way in which it has reacted to our concerns and the work that it has done to improve the statistics on low pay. This appendix gives our view on the new methodology ONS has developed and which has produced a new central estimate. Although it provides a more robust estimate of the extent of low pay in the economy, uncertainties remain. We are particularly concerned about the estimate derived from the LFS, which could in future add downward pressure to the central estimate.

30. In our first report, we estimated that the rate of the National Minimum Wage we had recommended would benefit around 1.9 million people, or about 9 per cent of those in work. Following revisions to the data last year, this number fell to 1.5 million. The latest estimates put this number at 1.3 million. We urge the ONS to continue to work on improving the estimate further so that we can be better informed in advising the Government, and so that the Government can be better informed on the extent to which the National Minimum Wage is benefiting the low paid.

Appendix 2: Low Pay Commission Survey of Employers

The Survey

1. In our second report we included evidence from two surveys of low-paying sectors which we conducted. The first survey, undertaken in December 1998, established a baseline for assessing how firms adapted to the National Minimum Wage. We followed this up in 1999 with a survey to examine action taken by firms which had indicated in the first survey that the minimum wage would affect them.

2. For this report we conducted a third survey of employers. We consider here its major findings, including the impact of the minimum wage on paybills and differentials, its benefits and its effects on businesses. We asked additional questions of the hairdressing and textiles sectors and also about contract services in the business services, and the social care and childcare sectors. We invited comments about experience of the minimum wage. The second volume of this report will include further details of this research, covering findings about young people's pay and the Development Rate and information about the New Deal. The survey questionnaire is given at the end of this appendix.

3. We decided to target the third survey at sectors that were most likely to be affected by the introduction of the minimum wage. Because the sectoral composition of the sample is very different, the overall results cannot be directly compared with the previous surveys. But the third survey gives a much broader coverage than the previous two.

Table A2.1

Sectors and Organisations Participating in the Low Pay Commission Survey

Sector	Trade Association/Organisation
Business services	Business Services Association Cleaning and Support Services Association
Childcare	National Day Nurseries Association Kids' Clubs Network Pre-School Learning Alliance
Hairdressing	National Hairdressers' Federation Hairdressing Employers Association
Hospitality	British Hospitality Association Brewers and Licensed Retailers Association The Restaurant Association
Retail	Association of Convenience Stores
Social care	National Care Homes Association Independent Healthcare Association UK Home Care Association Association for Residential Care British Federation of Care Home Proprietors
Textiles	Nottinghamshire and Derbyshire Clothing and Textiles Association British Apparel and Textile Confederation British Footwear Association Lee Valley Clothing Industry Business and Design Centre
Other	Black Business Association North London Chamber of Commerce

4. With the help of the trade associations shown in Table A2.1, we distributed postal questionnaires to over 20,400 employers, mainly small and medium-sized enterprises. We received 2,915 replies – a response rate of 14 per cent, which was reasonable for a postal survey. Table A2.2 shows the response by sectors. We are grateful once more for the assistance we received from the trade organisations which helped us distribute the questionnaires and encouraged their members to complete them. We are also grateful to those businesses which took the time to complete and return the questionnaires.

Table A2.2

Response to Survey

	Distributed	Response rate (%)
Hairdressing	2,070	12
Hospitality	4,300	21
Business Services	139	19
Social Care	3,800	20
Childcare	4,000	17
Textiles	3,600	7
Retail	2,000	2
Other	550	2
Total	20,459	14

5. The response rate in the retail sector was lower than expected. We have not presented separate results for the retail sector or the 'other' category, which also had a very low response rate. Nor have we done this for the business services sector, because the total sample size was relatively small. But the data for these sectors are included in the overall results.

6. The respondents to the survey are not a random sample of businesses in the sectors. The sample did not cover those, mainly very small, businesses which are not members of trade organisations. The respondents themselves are likely to be biased towards those most affected by the minimum wage. Thus the results are not representative of the sectors as a whole and have not been weighted.

7. Table A2.3 shows that the respondent businesses covered almost half a million employees, the vast majority of whom came from the hospitality sector. Three-quarters of responses came from small firms, those with fewer than 50 employees, as illustrated in Table A2.4.

Table A2.3

Number of Employees by Sector in the Sample

	Total number of employees	Median number of employees	Average number of employees
Hairdressing	6,375	6	26
Hospitality	303,048	40	342
Business services	54,429	633	2,268
Social care	39,900	24	53
Childcare	9,052	7	14
Textiles	39,749	69	162
Retail	3,755	12	101
Other	861	8	78
Total	457,169	20	159

Base: all firms that provided employee numbers.

Table A2.4

Size Distribution of Firms by Sector

	Hairdressing (%)	Hospitality (%)	Social care (%)	Childcare (%)	Textiles (%)	Total (%)
1–49 employees (small)	94	57	75	98	39	73
50–249 employees (medium)	6	37	21	2	50	22
250+ employees (large)	0	6	3	0	11	5

Base: all firms that provided employee numbers.

Impact

8. Table A2.5 shows that almost half of the respondents said their business had been affected. Around half of small firms and almost half of large firms said they had been affected compared with around two-fifths of medium-sized businesses. Private residential care businesses were twice as likely to have been affected as those providing private domiciliary care.

Table A2.5

Firms Affected by the National Minimum Wage in Any Way

Hairdressing (%)	Hospitality (%)	Social care (%)	Childcare (%)	Textiles (%)	Total (%)
72	37	47	55	43	48

Base: all firms.

Total Pay Bill

9. Table A2.6 shows that some 63 per cent of employers who had been affected had increased their pay bill as a result of the minimum wage, but none had done so by more than 10 per cent and almost two-fifths said there was no significant change. Two-fifths of small firms said that there had been no significant change, compared with 29 per cent of medium-sized firms and 26 per cent of large firms. In textiles, however, the results suggest that smaller firms had experienced a more significant change to their pay bill than larger firms.

Differentials

10. Table A2.7 shows that two-thirds of respondents affected by the minimum wage had increased pay rates for higher-grade staff to restore differentials. Seventy per cent of small firms said they had done this compared with 54 per cent of medium-sized firms and 45 per cent of large firms.

Table A2.6

Impact on Total Pay Bill for Those Affected by the National Minimum Wage

	Hairdressing (%)	Hospitality (%)	Social care (%)	Childcare (%)	Textiles (%)	Total (%)
No significant change	32	27	42	47	26	37
Increased by less than 5%	16	30	14	13	50	21
Increased by 5% to 10%	52	44	44	40	24	42
Increased by more than 10%	0	0	0	0	0	0

Base: all firms affected by the National Minimum Wage in any way.

Table A2.7

Firms that Increased Pay Rates for Higher-grade Staff

Hairdressing (%)	Hospitality (%)	Social care (%)	Childcare (%)	Textiles (%)	Total (%)
64	58	78	75	23	66

Base: all firms affected by the National Minimum Wage in any way.

11. The median rate increase was around the £5 mark in each sector, as shown in Table A2.8. For 43 per cent of respondents the highest rate they had to increase was below £5 but for a fifth the highest rate was £6.50 or above. These results imply that the impact of the minimum wage led to the restoration of differentials higher up the pay distribution than our 1999 survey suggested. This might be explained by the different composition of sectors in each survey.

Table A2.8

Distribution of Highest Hourly Rate Increased

	Hairdressing (%)	Hospitality (%)	Social care (%)	Childcare (%)	Total (%)
£3.60 to £3.99	6	5	4	7	6
£4.00 to £4.49	15	15	21	24	20
£4.50 to £4.99	14	15	19	19	17
£5.00 to £5.49	22	16	17	20	19
£5.50 to £5.99	12	13	9	12	11
£6.00 to £6.49	10	8	4	7	7
£6.50+	21	28	25	12	21

Base: all firms affected by the National Minimum Wage in any way that increased pay rates for higher-grade staff.

Productivity

12. Almost a third of respondents affected by the minimum wage said that they had benefited from it although few said there was a significant benefit. Higher staff motivation was the benefit most likely to be reported. The childcare and hairdressing sectors were most likely to have experienced a benefit, while the textiles sector was least likely.

Table A2.9 shows only 9 per cent of organisations affected saw increased productivity as a benefit, but Table A2.10 shows that almost four out of five firms affected had taken action to improve productivity and cope with the impact of the minimum wage.

Table A2.9

Has the National Minimum Wage led to any Benefits to Business?

	Hairdressing (%)	Hospitality (%)	Social care (%)	Childcare (%)	Textiles (%)	Total (%)
Lower staff turnover						
Significant	1	1	3	4	0	2
Slight	18	11	11	6	4	10
Higher staff motivation						
Significant	3	1	1	4	0	2
Slight	18	19	17	29	5	20
Faster filling of vacancies						
Significant	3	1	2	1	0	1
Slight	6	7	6	7	4	7
Increased productivity						
Significant	2	1	1	1	0	1
Slight	11	9	4	11	4	8
Any benefit	33	27	27	38	11	29

Base: all firms affected by the National Minimum Wage in any way.

Table A2.10

Actions Taken to Improve Productivity as a Result of the National Minimum Wage

	Hairdressing (%)	Hospitality (%)	Social care (%)	Childcare (%)	Textile (%)	Total (%)
Changed work organisation						
Significant	17	21	14	13	10	16
Slight	31	35	26	20	18	27
Tightened controls on labour costs						
Significant	43	40	28	24	25	31
Slight	32	35	31	20	32	30
Increased investment in training and development						
Significant	9	10	13	10	3	10
Slight	24	34	31	29	20	30
Increased use of technology						
Significant	3	10	8	4	6	7
Slight	19	25	18	11	17	18
Improved quality of service						
Significant	13	6	7	8	0	7
Slight	34	28	21	20	16	24
Any action taken	85	85	79	70	64	78

Base: all firms affected by the National Minimum Wage in any way.

13. Firms had made a wide range of adjustments. The most likely action across all sectors was tightening controls on labour costs; for example, the treatment of absence, paid breaks, staff meals and overtime rates. Forty-three per cent of respondents affected had changed work organisation; for example, changing work patterns, shift systems, overtime working and the mix of full- and part-time labour. Forty per cent of respondents had increased investment in training and development. Respondents in the hairdressing and hospitality sectors were more likely to have taken action than other sectors.

14. We also examined the interaction of other measures firms can take to adapt to the minimum wage with the more positive changes in productivity. The results showed that firms that increased prices, reduced profits or reduced staffing were also more likely to undertake the positive changes to productivity.

Staffing, Prices and Profits

15. Nine out of ten firms affected by the minimum wage reported a significant or slight reduction in profits as shown in Table A2.11. Increasing prices was most likely to have occurred in the hairdressing and childcare sectors and was least likely in the social care and textile sectors. Small firms were more likely to have increased prices than larger firms.

16. Almost half of respondents affected had introduced changes to pay and benefits structures, for example, changes to payment methods, overtime rates, consolidation of pay supplements, commission or tips or other worker benefits. Two-fifths of respondents reduced staffing levels, and just over a third of respondents reduced working hours. This was most likely to have happened in the hospitality and hairdressing sectors.

Table A2.11

Has the National Minimum Wage led to any of the Following in Your Business?

	Hairdressing (%)	Hospitality (%)	Social care (%)	Childcare (%)	Textiles (%)	Total (%)
Changes to workers pay and benefits						
Significant	25	18	17	19	17	19
Slight	33	33	26	24	31	28
Reduction in staffing levels						
Significant	32	16	6	5	19	13
Slight	32	40	21	19	24	27
Reduction in working hours						
Significant	16	17	6	8	7	11
Slight	29	36	20	18	16	24
Reduction in ratio of qualified staff						
Significant	19	7	4	6	5	8
Slight	27	16	13	11	15	15
Increase in prices						
Significant	44	15	25	47	8	29
Slight	43	46	32	38	34	39
Reduction in profits						
Significant	50	33	74	53	28	51
Slight	40	54	21	31	59	38

Base: all firms affected by the National Minimum Wage in any way.

17. We asked additional questions about the effect of the minimum wage on incentive schemes and productivity in the textiles sector. Sixty per cent of those with incentive schemes said they had been affected compared with 18 per cent of those without one. The results of the survey indicated, however, that the impact of the minimum wage on incentive systems might not be as great as other evidence has suggested. We asked whether firms had felt any of the effects in Table A2.12. As the table shows, a majority of respondents said that three of the five had had no impact, and only a fifth of respondents said that they had had a significant impact. The most important effects identified were increased costs and reduced differentials. Only a third said that productivity had been reduced. The impact had been greatest in the woven clothing sector, had been less significant in the knitwear and hosiery sector, and had been minimal in the textile manufacture sector.

Table A2.12

Impact of National Minimum Wage on Incentive System

	Significant (%)	Slight (%)	None (%)
Reduced differentials	21	33	46
Reduced competitiveness	22	22	56
Reduced motivation	21	21	58
Reduced productivity	15	19	66
Increased costs	22	38	40

Base: all firms in the textiles sector with an incentive scheme.

18. We also asked additional questions of the hairdressing sector. One concern following the introduction of the minimum wage was that salons would change their employees' status to self-employed to avoid having to pay the minimum wage. We did not find evidence that this had happened to any significant extent, with only 5 per cent of respondents saying they had introduced 'chair hire' arrangements as a result of the minimum wage. Over 80 per cent of respondents had no self-employed staff. Three per cent of respondents said that the percentage of self-employed workers in the salon had increased as a result of the minimum wage. We have concluded, therefore, that changing to self-employed status is occurring on a fairly small scale and may not be as a result of the minimum wage.

19. Sixty-two per cent of hairdressing respondents charged VAT in their salons and 13 per cent of respondents said the introduction of the minimum wage had been a factor in making it necessary to register for VAT. Sixty per cent of hairdressers said that increasing prices as a result of the minimum wage had led to a reduction in tips.

Contractors

20. We also sought information on the extent to which contractors were reliant on public sector contracts. The social care sector and the childcare sector had a very different mix of public and private work. Only about 30 per cent of respondents in the childcare sector did business with the public sector, whereas social care and business services were much more likely to have a mix of public and private sector work within one establishment. Small businesses were much less likely to be undertaking public sector work, and were more likely to be working only in the private sector. Private nursing homes and providers of private domiciliary care were more likely to have a majority of their work provided by the public sector. Less than one-third of day nurseries and pre-school/play groups had work in the public sector.

21. We asked those who contracted with the public sector about the distribution of their business between local authority, National Health Service (NHS), central government department and 'other'. The results confirmed that in the social care and childcare sectors, public sector work is dominated by local authority contracts. The picture for the business services sector is more mixed, with the NHS being a key customer for a number of employers.

22. We also asked whether contractors had managed to recoup the extra cost of the minimum wage from their clients. Almost half of respondents providing social care under public sector contracts sought to renegotiate the contract as a result of the minimum wage, but over three-quarters were unable to recoup anything. Most of the others were able to recoup between 1 and 24 per cent of their increased pay bill.

23. A smaller percentage of respondents provided goods or services under contract to the private sector. This was most common in the business services sector but was also found among private residential and voluntary domiciliary care organisations. Just over half of respondents providing social care under private sector contracts sought to renegotiate the contract as a result of the minimum wage. About a third said that they were successful. Almost half were unable to recoup anything. Most of the others were able to recoup between 1 and 24 per cent of their increased pay bill.

June and October 2000 Upratings

24. Two-thirds of all respondents reported that the June 2000 uprating of the Development Rate had had no effect on their business. Hairdressing, which employs a high proportion of young people, was the sector most affected by the June uprating, with 70 per cent of respondents reporting that there had been an impact on the business. The hairdressing sector also reported a higher incidence of 'reduced profits' resulting from the June uprating compared with other sectors.

25. Just over half of respondents said that the October 2000 uprating of the main rate had had no effect on their business, although two-thirds of hairdressing employers said that it had. Seventy per cent of those in the hairdressing sector had experienced a reduction in profits after the October uprating compared with half of respondents overall.

Conclusion

26. Our survey provided much valuable information about those sectors most affected by the minimum wage. It allowed us to complement the view of the minimum wage we had obtained at an aggregate level and in other evidence.

27. Firms have undertaken a range of actions to improve productivity and cope with the impact of the minimum wage. The results support evidence we have received that some firms, especially in the social care sector, have found it difficult to recoup increased costs from their clients. For most firms the June and October 2000 upratings of the National Minimum Wage have had no effect on their business.

NATIONAL MINIMUM WAGE SURVEY

1. **How many workers does your business currently employ?**
(Please include all workers – full-time, part-time and casual staff) *(Please insert numbers)*

Total (All ages) ☐ Men ☐ Women ☐

2. **How many workers in your business are:** *(Please insert numbers)*

Aged under 18 ☐ Aged 18 to 21 ☐ Aged 22 or over ☐

3. **What proportion of your employees are from an ethnic minority?** *(Please tick one box)*

Less than 10% ☐ Between 11% and 25% ☐ Between 26% and 50% ☐ 51% or More ☐

4. **Has the National Minimum Wage affected your business in any way?** Yes (go to Q5) ☐ No (go to Q10) ☐

5. **What has happened to your TOTAL pay bill as a result of the National Minimum Wage?**

a) No significant change ☐ b) Increased by less than 5% ☐

c) Increased by 5 to 10% ☐ d) Increased by more than 10% ☐

6. **Have you increased the pay rates of higher grade staff (e.g. supervisors) to maintain pay differentials as a result of the National Minimum Wage?**

a) Yes ☐ Please specify the highest hourly rate you had to increase £

b) No ☐

7. **Has the National Minimum Wage led to any of the following benefits for your business?**
(Please state whether significant, slight or none)

	Significant	Slight	None
a) Lower staff turnover	☐	☐	☐
b) Higher staff motivation	☐	☐	☐
c) Faster filling of vacancies	☐	☐	☐
d) Increased productivity	☐	☐	☐

8. As a result of the National Minimum Wage, have you taken any of the following actions?
(Please state whether significant, slight or none)

	Significant	Slight	None
a) Changed work organisation (e.g. working patterns, shift systems, overtime working, mix of full- and part-time labour)	☐	☐	☐
b) Tightened controls on labour costs (e.g. treatment of absence, paid breaks, staff meals, overtime rates)	☐	☐	☐
c) Increased investment in training and development of workers	☐	☐	☐
d) Increased the use of technology	☐	☐	☐
e) Improved the quality of service or product	☐	☐	☐

9. Has the National Minimum Wage led to any of the following in your business?
(Please state whether significant, slight or none)

	Significant	Slight	None
a) Changes to workers' pay and benefits structures: (e.g. payment methods, overtime rates, pay supplements, commission or tips, worker benefits)	☐	☐	☐
b) Overall reduction in staffing levels	☐	☐	☐
c) Reductions in working hours of workers	☐	☐	☐
d) Reduction in the ratio of qualified/skilled staff to unqualified/unskilled staff	☐	☐	☐
e) Increase in prices	☐	☐	☐
f) Reduction in profits	☐	☐	☐

10. Did the increase in the Development Rate from £3.00 to £3.20 in June 2000 affect your business in any of the following ways? (The Development Rate applies to workers aged 18–21)
(Please state whether significant, slight or none)

	Significant	Slight	None
a) Changes to workers' pay and benefits structures	☐	☐	☐
b) Overall reduction in staffing levels	☐	☐	☐
c) Reductions in working hours of workers	☐	☐	☐
d) Increase in prices	☐	☐	☐
e) Reduction in profits	☐	☐	☐

	Agree
f) No effect on business	☐

11. Has the increase in the full National Minimum Wage from £3.60 to £3.70 in October 2000 affected your business in any of the following ways? (The full rate applies to workers aged 22 and over)
(Please state whether significant, slight or none)

	Significant	Slight	None
a) Changes to workers' pay and benefits structures	☐	☐	☐
b) Overall reduction in staffing levels	☐	☐	☐
c) Reductions in working hours of workers	☐	☐	☐
d) Increase in prices	☐	☐	☐
e) Reduction in profits	☐	☐	☐

	Agree
f) No effect on business	☐

12. Do you have age-related pay structures? Yes (go to Q13) ☐ No (go to Q16) ☐

13. At what age is a worker entitled to your full adult rate? ☐

14. Enter the current minimum hourly rates for workers in each of the following age groups in your business. If you have no workers in any age band please leave blank.

16/17 £ ☐ 18 £ ☐ 19 £ ☐ 20 £ ☐

21 £ ☐ 22 £ ☐ 23 or over £ ☐

15. There could be a number of reasons why employers have age-related pay structures. Some of these are listed below. Please tick which, if any, are applicable in your case.

Productivity ☐ Reliability ☐ Experience ☐

Length of service ☐ Recruitment ☐ Legal requirement ☐

Previous Wage Council practice ☐ Other ☐ *Now go to Question 17.*

16. If there are no age-related pay structures, what other factors account for differences in your workers' hourly pay? *(Please tick any that apply)*

Experience ☐ Qualifications/skills ☐ Responsibilities ☐

Length of service ☐ Output work ☐ Performance assessment/appraisal ☐

Unsocial hours ☐ Other ☐

17. Do you make use of the Development Rate for workers aged 18–21 (i.e. pay less than £3.70 but at least £3.20)? Yes (go to Q18) ☐ No (go to Q19) ☐

18. Which of the following benefits, if any, has the Development Rate for workers aged 18–21 provided for your company? *(Please tick all that apply)*

Maintained employment ☐ Maintained training ☐ Maintained hours of work ☐

Increased employment ☐ Increased training ☐

19. Do you make use of the Development Rate for workers aged 22 and over (i.e. pay less than £3.70 but at least £3.20)? Yes (go to Q20) ☐ No (go to Q21) ☐

This Development Rate is for workers receiving accredited training in their first six months with a new employer.

20. Has the Development Rate for workers aged 22+ enabled you to improve the amount of training or quality of training you provide? Yes ☐ No ☐

21. Has the introduction of the National Minimum Wage made you more likely to employ workers exempt from the minimum wage or who can be paid a lower Development Rate?

16–17 year olds Yes ☐ No ☐

18–21 year olds Yes ☐ No ☐

22. We would find helpful any other comments that you might have about your experience of the National Minimum Wage, including details of any changes to contracts made as a result of it. Please put these on a separate sheet. All your comments will be read.

Additional Questions for Contract Service Providers

23. What percentage of your business is accounted for by:

a) Public Sector ☐ % b) Private Sector ☐ %

24. If you are doing business with the public sector, what percentage of that business is for:

a) Local Authority ☐ % b) NHS ☐ %

c) Central Government Department (e.g. DSS, MOD) ☐ % d) Other ☐ %

25. Does your firm provide goods and/or services to the *public sector* as part of a competitive tendering contract? Yes ☐ No (go to Q29) ☐

26. Did you seek to renegotiate the conditions of your contract as a result of the National Minimum Wage? Yes ☐ No (go to Q29) ☐

27. Were you successful in renegotiating conditions? Yes ☐ No ☐ In part ☐

28. What percentage of the increase in your pay bill due to the National Minimum Wage were you able to recoup through negotiation?

None ☐ 1% to 24% ☐ 25% to 49% ☐

50% to 74% ☐ 75% to 99% ☐ 100% ☐

29. Does your firm provide goods and/or services to *private sector clients* as part of a competitive tendering contract? Yes ☐ No (go to Q33) ☐

30. Did you seek to renegotiate the conditions of your contract as a result of the National Minimum Wage? Yes ☐ No (go to Q33) ☐

31. Were you successful in renegotiating conditions?

Yes	No	In part
☐	☐	☐

32. What percentage of the increase in your pay bill due to the National Minimum Wage were you able to recoup through negotiation?

None	☐	1% to 24%	☐	25% to 49%	☐
50% to 74%	☐	75% to 99%	☐	100%	☐

Additional Questions for the Textiles Sector

22. Do you have an incentive pay system (e.g. piece rate or payment by results)?

Yes (go to Q23) ☐ No (go to Q24) ☐

23. What impact has the introduction of the National Minimum Wage had on your incentive system?
(Please state whether significant, slight or none)

	Significant	Slight	None
a) Reduced differentials	☐	☐	☐
b) Reduced your competitiveness	☐	☐	☐
c) Reduced your ability to motivate employees	☐	☐	☐
d) Reduced productivity	☐	☐	☐
e) Increased costs	☐	☐	☐

Additional Questions for the Hairdressing Sector

22. Has your salon introduced 'chair hire' arrangements as a result of the National Minimum Wage?

Yes ☐ No ☐

23. What percentage of the workers in your salon are self-employed?

None	☐	1% to 24%	☐	25% to 49%	☐
50% to 74%	☐	75% to 99%	☐	100%	☐

24. Has the percentage of self-employed workers in your salon increased as a result of the National Minimum Wage?

Yes ☐ No ☐

25. **If your salon has had to increase prices as a result of the National Minimum Wage, has this led to a reduction in tips?** Yes ☐ No ☐

26. **Does your salon charge VAT?** Yes (go to Q27) ☐ No (go to Q28) ☐

27. **Were price increases resulting from the National Minimum Wage a factor in making it necessary to register for VAT?** Yes ☐ No ☐

28. **Has the National Minimum Wage reduced your employment of apprentices?** Yes ☐ No ☐

29. **Has the National Minimum Wage reduced your employment of other trainees?** Yes ☐ No ☐

Appendix 3: Minimum Wage Rates in Other Countries

1. We noted in our first report that comparing minimum wage rates across countries was not straightforward for a number of reasons. There are differences between countries in the definitions of what counts towards the minimum wage, the definitions of earnings used, the age coverage and the sectors covered. In addition, other countries may have very different economic and social environments. There are also different tax and benefits systems. Hence it is difficult to make direct comparisons.

2. Nevertheless, we have produced updates of the same commonly used measures as we did in our first report. These are shown in Tables A3.1 and A3.2. Table A3.1 compares hourly minimum wage rates for a selection of OECD countries at the end of 2000. The rates have been converted using both exchange rates and Purchasing Power Parities (PPPs). PPPs reflect differences in the cost of living between countries. Table A3.2 shows minimum rates as a proportion of median earnings.

Table A3.1

Comparison of Level of Minimum Wages[a] Across Countries

	In UK £s, using	
	Exchange rates [b]	PPPs [c]
Australia [d]	3.67	5.06
Luxembourg	4.15	4.88
Netherlands	3.86	4.87
Belgium	3.89	4.79
France	3.86	4.57
Canada	3.03	3.93
Ireland	3.23	3.75
United States	3.62	3.71
United Kingdom	**3.70**	**3.70**
New Zealand	2.14	3.45
Japan	4.13	2.73
Greece	1.55	2.36
Spain	1.48	2.09
Korea	1.09	1.90
Portugal	1.11	1.81

Sources: OECD, *Minimum Wage Database;* and OECD, *Main Economic Indicators 2000*

Notes:

a. In all cases, the minimum wage refers to the basic rate for adults.

b. As of 30 November 2000.

c. Purchasing Power Parities for private consumption as of November 2000.

d. Federal minimum wage.

e. For countries where the minimum wage is not usually expressed as an hourly rate, the rate has been converted to an hourly basis assuming a working time of 8 hours per day, 40 hours per week and 173.3 hours per month.

Table A3.2

Adult Minimum Wages as a Percentage of Full-time Median Earnings (Men and Women) [a]	
	(%)
France	69.6
Portugal	64.8
Australia[b] – LFS	60.8
Belgium	59.1
Greece[c]	56.9
Australia[b] – ES	56.6
Ireland	55.5
Netherlands	52.1
New Zealand	49.9
United Kingdom[d]	**46.0**
Canada	43.8
Japan	41.1
United States	38.0
Spain	35.8
Korea	34.4

Sources: Minimum wages and median earnings for full-time workers: OECD estimates and OECD Earnings Structure Database

Notes:

a. In all cases, the minimum wage refers to the basic rate for adults. In some cases, the average earnings data for 2000 for the different groups of full-time workers and for manual workers in manufacturing are estimates based on extrapolating data for earlier years in line with other indicators of average earnings growth. All earnings data are gross of employee social security contributions.

b. Two estimates of average earnings are available based on the Labour Force Survey (LFS) or an Enterprises Survey (ES). The minimum wage is the Federal rate.

c. Manufacturing workers only.

d. Based on ONS central estimate.

3. We need to be cautious about these figures because minimum wage rates are set at different dates from country to country. Moreover, the relationship between the minimum rate and median earnings will be influenced by the stage in the uprating cycle: the relative value will be higher at the time of uprating. For example, the rate we are recommending is estimated to be around 53 per cent of full-time median earnings (men and women aged 21 and over) in October 2001.

4. We presented information in our first report on the 1998 OECD estimates of the proportion of the workforce at or below minimum wages. Unfortunately, this has not been updated, because the data are not comparable across countries.

Abbreviations

AEI	Average Earnings Index
BHPS	British Household Panel Survey
BRC	British Retail Consortium
CBI	Confederation of British Industry
CIPD	Chartered Institute of Personnel and Development
DSS	Department of Social Security
DTI	Department of Trade and Industry
FSB	Federation of Small Businesses
GDP	Gross Domestic Product
HMT	Her Majesty's Treasury
ICT	Information Communications Technology
IDS	Incomes Data Services Ltd
ILO	International Labour Organisation
IRS	Industrial Relations Services Ltd
LA	Local Authority
LFS	Labour Force Survey
LGA	Local Government Association
LPC	Low Pay Commission
NACAB	National Association of Citizens Advice Bureaux
NES	New Earnings Survey
NHS	National Health Service
NMW	National Minimum Wage
NVQ	National Vocational Qualification
OECD	Organisation for Economic Co-operation and Development
ONS	Office for National Statistics
PPP	Purchasing Power Parity
RPI	Retail Prices Index
TUC	Trades Union Congress
UK	United Kingdom
US	United States of America
USDAW	Union of Shop, Distributive & Allied Workers
VAT	Value Added Tax
WFTC	Working Families' Tax Credit

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