

National Minimum Wage

Low Pay Commission
Report 2012

National Minimum Wage Low Pay Commission Report 2012



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National Minimum Wage

Low Pay Commission Report 2012

Presented to Parliament
by the Secretary of State for
Business, Innovation and Skills
by Command of Her Majesty
March 2012

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Commissioners' Introduction

Last year we welcomed the fact that the National Minimum Wage (NMW) is now widely accepted, but noted too that its effects need to be constantly monitored. The twelve months since then have justified our cautionary words: they have been challenging for the economy and the labour market. It has been more important than ever to ensure our recommendations are grounded in a careful assessment of the evidence, and to look carefully for any evidence that the lengthening period of low economic growth may give rise to new or different impacts of the NMW.

Although the NMW itself continues to be widely accepted, the range of beliefs about appropriate rates has if anything widened. Falling real incomes have reinforced the opinions of many who favour substantial increases. Difficult trading conditions, subdued consumer spending, and squeezed public sector budgets have strengthened the views of those calling for caution.

Remit

This is the thirteenth Low Pay Commission report. Our remit from the Government asked us to monitor, evaluate and review the NMW and to report to the Prime Minister and the Secretary of State for Business, Innovation and Skills by the end of February 2012 on the following matters, taking account of the economic and labour market context, including pension reforms:

- the level of each of the different rates of the NMW with recommendations on the appropriate levels from October 2012;
- the labour market position of young people, including those in apprenticeships and internships;
- the scope to simplify the NMW, and the effect of the proposed abolition of the Agricultural Wages Board for England and Wales;
- how to give business greater clarity on future levels of the NMW; and
- whether any of the other recommendations could be introduced more promptly.

Evidence

In addressing our remit we have gathered a great deal of information through written and oral consultations. We are again very grateful to all those who have taken the time and trouble to provide us with evidence about the impact of the NMW. This substantial and wide-ranging body of evidence has been essential to our development of recommendations. A list of those who responded to our call for evidence can be found in Appendix 1.

As in previous years, we commissioned several new pieces of research to inform our work. Details of the research projects and a summary of the findings are set out in Appendix 2. The survey of apprentice pay conducted by the Government in the summer of 2011 has been a valuable source of evidence. Our recommendations also draw on the best available economic evidence and we have worked closely with the Office for National Statistics to obtain a comprehensive and consistent database on earnings and employment.

We also visited employers, workers and others with an interest in the NMW in the four countries of the United Kingdom. This is an invaluable part of our process, and we are grateful to all those who gave us their time and shared their views. We visited Belfast, Blackpool, Glasgow, Lincoln, London (twice), Newquay and Truro, Southampton, and Swansea.

We met formally as the Low Pay Commission seven times during the year. We also participated in a research workshop at which the research commissioned for this report was presented and discussed. This year we met in January for two days to review and assess the evidence relevant to our remit and to reach a decision on all of the recommendations contained in this report.

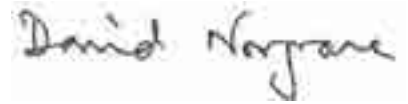
Conclusion

We have assessed all the evidence thoroughly and reviewed the issues and arguments very carefully in coming to our recommendations. We have included as much of the evidence as possible in this report so that the basis for our conclusions and recommendations is clear to the reader. These conclusions and recommendations represent the unanimous view of all Commissioners.

The Commissioners

David Norgrove (Chair)

Chair, PensionsFirst and Deputy Chairman of British Museum



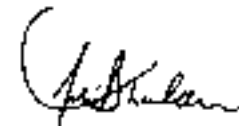
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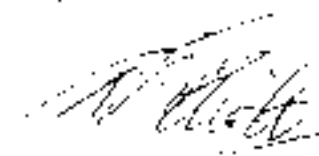
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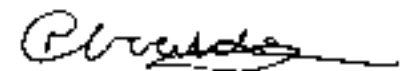
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Professor of Economics and Director of the Health Economics Research Unit, University of Aberdeen



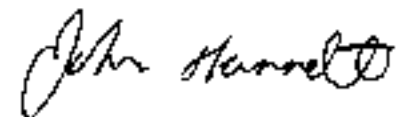
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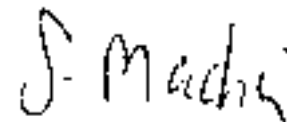
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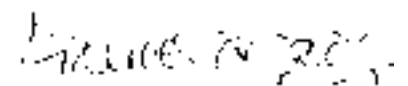
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Heather Wakefield

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Carrie Aitken

Jay Arjan

James Brennan

Tim Butcher

Gerry Franks

Jennifer Oxley

Steve Palmer

Tony Studd

Executive Summary

Chapter 1: The Economic Context to the October 2011 Upratings

- 1** Our thirteenth report, like the twelve that have preceded it, sets out the detailed evidence upon which we have based our recommendations for the different minimum wage rates and their operation. In the remit for this report, the Government asked us to monitor, evaluate and review each of the different minimum wage rates, with particular reference to previously identified groups and sectors, and make recommendations for October 2012. We have taken this as referring to small firms, our previously-defined low-paying sectors and those groups of workers who we have identified in earlier reports as most likely to be low-paid. We were also asked to review the labour market position of young people, including those in apprenticeships and internships. In addition, our remit asked us to consider whether the National Minimum Wage (NMW) Regulations could be made simpler and easier to administer, and the implications of the proposed abolition of the Agricultural Wages Board for England and Wales. We were also asked to consider the best way to give business greater clarity on future levels of the NMW and whether any of the other recommendations could be introduced more promptly. In making our recommendations, the Government asked us to take account of the economic and labour market context, including pension reforms.
- 2** In our last report we had expected the economy in 2011 to continue its recovery from the longest and deepest recession since the 1930s. Revised data have led the Office for National Statistics to estimate that the 2008-2009 recession was much deeper although not as long as first thought. The recession lasted for five quarters, the same length as the 1980s and 1990s recessions but output fell by over 7 per cent, considerably more than in those previous recessions. However, employment and hours continued to be much higher than would have been expected from the experience of the two previous recessions.
- 3** The UK economy has weakened considerably since the third quarter of 2010. By the end of the third quarter of 2011 gross domestic product was just 0.5 per cent above that of a year previously. This sluggishness in growth led to a downturn in many measures of the labour market. Employment fell and both the ILO definition and claimant count measures of unemployment rose. Vacancies were flat.

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- 4 According to pay settlements and Average Weekly Earnings (AWE), wage growth turned out close to our expectations albeit a little lower than had been anticipated in January 2011. However, data from the Annual Survey of Hours and Earnings (ASHE) suggested that wage increases had typically been less than 1 per cent, much lower than indicated by AWE. Inflation, on the other hand, had been much higher than expected. Thus, the relatively subdued average wage increases had led to large real wage cuts for many workers. But the uprating in October 2011 appears to have at least maintained the value of the adult rate relative to the average wage. This is a similar story to that recorded last year for the 2010 minimum wage upratings.

Chapter 2: The Impact of the National Minimum Wage

- 5 The adult rate of the NMW has now increased by nearly 69 per cent since its introduction. That is faster than both average earnings and prices. Since October 2006, however, the increases in the minimum wage have broadly been in line with average earnings, though below inflation. As a consequence the bite of the minimum wage at the median (the minimum wage as a proportion of median earnings) increased from 45.7 per cent in 1999 to 51.0 per cent in 2007 but then remained just under this level between 2007 and 2010. However, the growth in median hourly earnings in ASHE in April 2011 was just 0.4 per cent and this has led to an increase in the bite to nearly 52 per cent.
- 6 Although the bite stabilised in the economy as a whole between 2007 and 2010, it continued to rise in micro and other small firms, and in nearly all of the low-paying sectors. The bite rose again in these areas in 2011. However, despite the increased bite, the low-paying sectors have to date performed better in terms of employee jobs than the economy as a whole. The number of employee jobs in the low-paying sectors has increased since the end of the recession, while still falling in the economy overall.
- 7 Many of the groups of workers that are most likely to hold minimum wage jobs fared relatively well during the recession and in the subsequent recovery. In terms of the labour market, women have fared better than men, ethnic minorities better than white people, older people better than the prime aged (those aged 35-54), and disabled people better than those without disabilities. Young people and those without qualifications have fared particularly badly since the onset of the recession, though these groups were already doing less well before it.
- 8 Our research programme for the 2012 Report has added to the existing literature on the impact of the NMW on earnings, employment and hours. Taking all of this knowledge collectively, we conclude that the lowest paid had received higher than average pay rises, and the research, on balance, generally finds little or no significant adverse impact of the minimum wage on employment. Some further evidence has been gathered for this report to suggest that the minimum wage may have led to a modest reduction in hours but this finding is still not consistently robust enough across time and datasets to be definitive.

Chapter 3: Young People, Interns and Apprentices

- 9** Between 1999 and 2007 average earnings of young people increased roughly in line with those of adults, as did their minimum wages. Since 2007, earnings of young people have increased at a slower rate than those of adults, even though their minimum wages rose roughly in line with the adult rate and the general rise in wages. As a consequence, the bites relative to the median of the 16-17 Year Old Rate and the Youth Development Rate have continued to increase, to about 73 per cent and 80 per cent respectively. There is also clear evidence that greater use is being made of the youth rates of the minimum wage.
- 10** As we noted in our 2011 Report, the labour market position of young people has been deteriorating for some time. It became much worse during the recession and the subsequent recovery. An increasing proportion of 16-17 year olds have remained in full-time education (FTE) rather than entering the labour market. The proportion of all 16-17 year olds unemployed or inactive has remained fairly constant since 1998. For 18-20 year olds, there has also been an increase in the number staying in FTE, and there are now more 18-20 year olds in FTE than in employment. The proportion of all 18-20 year olds in employment has continued to fall and the proportion unemployed has continued to rise, even as the economy has come out of the recession.
- 11** Some of the research we commissioned for this report focused on young people. The research found that in the post-recession period wage differentials between age groups had narrowed slightly, but productivity differences between age groups had widened, suggesting that young workers' wages had increased by more than their productivity contribution would warrant. Other research on the impact of the NMW on the labour market outcomes of young people found that local youth wage rates did not affect the main education or labour market activities that young people undertook between the ages of 16 and 19. This suggests that marginal changes in the youth rates of the minimum wage would be unlikely to directly affect the main activities young people undertake.
- 12** Opportunities to undertake training or work experience can be an important first step for young people entering the labour market. We were once again asked to consider the position of those young people undertaking internships. While such opportunities continue to increase, the majority of evidence we received again emphasised that unpaid internships limit access for many young workers unable to afford to undertake them. The Government told us of the measures it was taking to promote fairer access and greater social mobility.
- 13** The total number of UK apprenticeship starts continued to rise in 2010/11. This rise was across all age groups, although particularly driven by an increase in England among those apprentices aged 25 and over. For this report, we were able to access improved pay data on apprentices, and also the results of our commissioned research on the introduction of the Apprentice Rate.

- 14** We have previously stated that the Apprentice Rate was introduced at a relatively cautious level, and the evidence for this report confirmed that to date the overall impact appeared minimal. However, there was evidence that the rate had more of an effect on particular employers and groups of apprentices, such as those in the low-paying apprenticeship sectors and the youngest apprentices. We also found evidence that a substantial proportion of apprentices may not have been paid their minimum wage entitlement. We see apprenticeships as an area where action is needed to improve NMW guidance and raise awareness of the rules. We have commissioned further research to gain a better understanding of the impact of the Apprentice Rate.

Chapter 4: Compliance and Operation of the National Minimum Wage

- 15** Compliance remains the cornerstone of the NMW regime. Achieving and maintaining a high level of compliance requires widespread awareness and understanding of the wage arrangements, and also effective enforcement. We have made a number of recommendations in the past on enforcement and the Government has, on the whole, responded positively to these.
- 16** We are pleased to see that good progress continues to be made with regard to improving the enforcement regime. Allocating resources to risk and making better use of intelligence are moves in the right direction, as is increased reporting in the media of HM Revenue & Customs' NMW activities. This is important in raising awareness both of enforcement activity and of the minimum wage itself. But more can be done in this area and, linked to the recent research which indicated a lack of awareness among employers, we have recommended that the Government should more actively communicate both the rates themselves, and rights and obligations under the NMW. We do not believe these communication activities should be subject to the Government's marketing freeze.
- 17** We also support the new policies that have been put in place to penalise employers who do not comply and to name those who show a wilful disregard of the rules. These are important policies, but they need to be used. We are disappointed by the failure to date to name any employers, and have recommended that the Government should make frequent use of naming.
- 18** Our remit asked us to consider whether NMW regulations could be made even simpler and easier to administer. We considered this carefully and, in the light of evidence we received, concluded that there are no regulatory simplifications whose benefits would outweigh their drawbacks. However, stakeholders gave us a clear message that improving the official guidance, to aid both employer and worker understanding of the existing regulations, would be a valuable simplification measure. We have, therefore, recommended that the Government commits itself to having effective, clear and accessible guidance in place, and first undertakes a complete review of the existing guidance. We have highlighted a number of specific areas where improved guidance is needed.

- 19** Stakeholders have again raised concerns over a number of operational issues, including the accommodation offset, piece rates and interns. The evidence received on these issues has not led us to make any further recommendations at this stage, apart from those outlined above for improved guidance and awareness raising, but we will be keeping these issues under review. We have, however, stated our intention to review the accommodation offset provisions as part of our 2013 Report.
- 20** Our remit also asked us to consider the implications of the proposed abolition of the Agricultural Wages Board for England and Wales (AWBEW). The timing of abolition is not yet settled but the research we commissioned, and evidence received from stakeholders, highlighted areas where existing AWBEW provisions differ from those provided under the NMW framework. It is clear to us that once a date for abolition is agreed, the Government will need to ensure all those affected are aware of the implications. We will continue to monitor this and will undertake further research as necessary.

Chapter 5: Setting the Rate

- 21** The UK economy weakened markedly in 2011 after a period of relatively strong growth in 2010. As a result, by the time of our meeting in January 2012 forecasters had adjusted downwards their growth expectations for 2012 to a consensus view around 0.4 per cent. Of the key drivers of growth, the outlook for trade and investment had weakened, while that for consumer and government spending, already weak, appeared to be under further downward pressure. It is not clear, therefore, what factors could drive growth this year and continued weakness in the economy must be expected.
- 22** After a prolonged period of inflation growth above the Government's target, there is now a strong expectation that Consumer Prices Index (CPI) inflation will fall in 2012 towards 2 per cent or even slightly below by the end of the year. Similar pressures suggest that Retail Prices Index (RPI) inflation will also fall, to around 3 per cent. We noted a slight pick-up in median settlement levels in late 2011 and this seemed to have been carried through into early 2012 awards. However, it is not clear that this will be maintained and settlement medians are likely to return to a 2.0-2.5 per cent range later this year. Average earnings growth continued to be subdued reflecting the weak state of the economy. The Government's public sector pay policy will continue to be a downward pressure. The consensus forecasts for 2012 as a whole show average earnings rising by 2.4 per cent, slightly ahead of the 2.3 per cent recorded in 2011.
- 23** In line with forecast weak economic growth, the UK labour market is expected to deteriorate in 2012, with forecasters factoring in some fall in employment and a rise in claimant count unemployment. Separate surveys indicate a longer-term positive outlook for private sector employment with the public sector bearing the brunt of job losses. In the short-term, however, private sector job creation is unlikely to fully compensate for losses elsewhere and unemployment levels are expected to rise for some time as a consequence.

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- 24** The evidence we gathered for this report continued to show that the NMW holds a mid-table position when compared in exchange rate or purchasing power parity (PPP) terms with the minimum wages of comparator European Union and Organisation for Economic Co-operation and Development countries, or when the bites relative to full-time median earnings are compared. In national currency terms, growth in the NMW was faster than minimum wage growth in most countries between 1999 and 2011, but lower than most from 2007. Since 2007 growth in PPP terms has been much lower than all comparators, mainly as a result of the depreciation in sterling since that time.
- 25** Stakeholder views on the appropriate level for the adult rate fell roughly into two camps. A large number of employer representatives, especially those from small businesses, called for a freeze, citing the uncertain economic outlook and the pressures businesses were currently under. They felt there should not be an increase until we were in a period of sustained growth. Some, however, saw room for a modest increase although they urged caution given the fragility of the labour market.
- 26** On the other hand, worker representatives all wanted to see an increase. They said that the economy was recovering, albeit slowly, and that a large increase was necessary to offset the fall in the real value of the minimum wage caused by inflation. Some wanted to see an increase in line with inflation (CPI or RPI) and others saw a living wage as the ultimate aim, so wanted to see a substantial increase this year, as a first step towards this.
- 27** Similar views from employers and worker representatives were expressed about youth rates. Some argued for a freeze, given the deterioration in the youth labour market, while others either wanted a single minimum wage paid from age 16, or a substantial increase in the current youth rates. Views on the Apprentice Rate were also mixed. Employers' organisations generally urged caution, often calling for a freeze, so as to avoid discouraging employers from taking on apprentices. Trade unions and those organisations representing young people called for an increase, generally either at least in line with a rise in the adult NMW or at a higher rate in order to close or narrow the differential with the other NMW rates. These organisations argued that the existing rate had not damaged the supply of places and so there was scope to increase it. This would also improve incentives to undertake and complete apprenticeships.
- 28** In assessing the arguments we faced an especially challenging task this year because of the uncertain economic environment, and the difficulty in judging the likely accuracy of the forecasts available to us. Growth is expected to be weak until 2013, and the timing and strength of the upturn are uncertain.
- 29** We reviewed the different arguments and the evidence very thoroughly, and debated them at length. After a good deal of discussion we concluded that in the current difficult economic circumstances caution is essential. Our recommendation for the adult rate is one which we expect to maintain the relative position of the lowest paid and which we believe business, including small businesses, will be able to afford. We recommend that the adult rate of the National Minimum Wage be increased by 11 pence to £6.19 an hour from 1 October 2012.

- 30** We intend to review the accommodation offset arrangements as part of our 2013 Report, and have found no reason this year to adjust the offset relative to the minimum wage. We recommend that the accommodation offset be increased by 9 pence to £4.82 a day from 1 October 2012.
- 31** The labour market position of young people has continued to worsen in 2011. Employment of young people has continued to fall, and unemployment to rise. However, there is debate about exactly how far pay is a factor. Employment of young people is more sensitive than that of adults to the economic cycle. With this in mind we reluctantly recommend freezing the rates for young people, which may increase their relative attractiveness to employers. Accordingly, we recommend a Youth Development Rate of £4.98 an hour and a 16-17 Year Old Rate of £3.68 an hour from 1 October 2012.
- 32** In 2010 we were prudent in our first recommendation for the Apprentice Rate. Last year we saw some scope to increase it, to £2.60 an hour, while preserving the differential between it and the 16-17 Year Old Rate. In 2010/11 apprenticeship starts have increased for all age groups, and we believe there is a room for a further, smaller increase. We recommend that the Apprentice Rate be increased by 5 pence to £2.65 an hour from 1 October 2012. We have no presumption in respect of our decision next year, when we expect to have a larger evidence base which we will review carefully.
- 33** We have examined a number of ways of indicating what rate recommendations might be expected in the future. A substantial majority of consultees, from across the spectrum of employers and workers, opposed these ideas. We agree with them that the disadvantage of constraining ourselves to positions which by definition cannot be based on timely evidence outweighs any benefit in increased clarity, particularly in the present uncertain business environment. On a separate point, stakeholders did indicate strong support for the publication of our report and the Government's response as soon as possible.

Recommendations

National Minimum Wage Rates

We recommend that the adult rate of the National Minimum Wage be increased by 11 pence to £6.19 an hour from 1 October 2012 (paragraph 5.83).

We recommend a Youth Development Rate of £4.98 an hour and a 16-17 Year Old Rate of £3.68 an hour from 1 October 2012 (paragraph 5.86).

We recommend that the Apprentice Rate be increased by 5 pence to £2.65 an hour from 1 October 2012 (paragraph 5.87).

Accommodation Offset

We recommend that the accommodation offset be increased by 9 pence to £4.82 a day from 1 October 2012 (paragraph 5.84).

Simplification

We recommend that in order to make operating the National Minimum Wage as simple as possible for all users, the Government puts in place, and maintains, effective, clear and accessible guidance on all aspects of the minimum wage particularly where there is significant evidence of ignorance or infringing practice. As a first step, the Government should undertake a review of all existing guidance (paragraph 4.54).

Compliance

We recommend that the Government should not only have a process for naming infringers but should also make frequent use of it. The Government should also actively seek other publicity opportunities which will help to signal that those who infringe the National Minimum Wage get caught and punished (paragraph 4.94).

We recommend that the Government should more actively communicate both the rates themselves, and rights and obligations under the National Minimum Wage. Communication activities about the minimum wage should not be subject to the Government's marketing freeze (paragraph 4.117).

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Chapter 1

The Economic Context to the October 2011 Upratings

Introduction

1.1 In this chapter we consider the economic context in which the minimum wage rate recommendations we made in our last report came into effect, on 1 October 2011. Chapter 2 assesses the impact of the minimum wage since its introduction but with particular focus on the 2010 upratings. In Chapter 3 we review the labour market position of young people, interns and apprentices before going on in Chapter 4 to discuss the operation of the minimum wage, with an emphasis on simplification, compliance and enforcement. We conclude our report in Chapter 5 by taking into account the prospects for the economy; setting out stakeholder views; assessing the implications of pension reform; and considering what we can do to give business greater clarity on the future direction of the minimum wage. We then set out and explain our main recommendations for the rates of the National Minimum Wage (NMW) from October 2012. In this report we draw on data available up to 19 January 2012, when we met to discuss and agree our recommendations.

2011 National Minimum Wage Upratings

1.2 We start by looking back at the recommendations in our 2011 Report and the reasoning behind them. We noted that the economy was in better shape than it had been for two years and all the forecasts pointed to continued steady improvement. But the UK was still recovering from recession with business confidence fragile, the effects of the fiscal freeze yet to be fully felt, and risks remaining to the global economy. We favoured an approach that recognised the continued economic uncertainty while protecting the lowest-paid workers from falling further behind the average. Accordingly, we recommended that the adult rate rise by 15 pence an hour, or 2.5 per cent, from £5.93 to £6.08.

1.3 Further, we noted that there had been a continuing decline in the labour market position of young people. It had become evident that, since 2007, young people's earnings had been rising more slowly than those of adult workers. While this had been happening, the youth rates of the NMW had increased broadly in line with the adult rate. Consequently, the bite of the minimum wage for young people had continued to increase while the bite of the adult rate had remained stable. Moreover, research had found evidence that the level of the minimum wage may have had an adverse impact on the employment of young people in economic downturns. Thus, we judged that it would be imprudent to recommend an uprating of the youth rates that would be likely to further increase the bite. We therefore recommended increases in the youth rates (1.2 per cent for the Youth Development Rate and

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1.1 per cent for the 16-17 Year Old Rate) that were less than the increase for the adult rate of the minimum wage.

- 1.4** We also argued that the initial Apprentice Rate appeared to have had little or no negative effect on the supply of apprentice places, noting that the initial rate had been set cautiously, broadly equating to the weekly rate that had been set by the Learning and Skills Council for apprentices in England in August 2009. We therefore recommended that the Apprentice Rate be increased by 10 pence, or 4 per cent, to £2.60 an hour from 1 October 2011. Table 1.1 puts all of these minimum wage recommendations into their historical context.

Table 1.1: National Minimum Wage Hourly Rates, UK, 1999-2012

	Adult rate		Youth Development Rate		16-17 Year Old Rate		Apprentice Rate	
	Rate	Change	Rate	Change	Rate	Change	Rate	Change
	£	%	£	%	£	%	£	%
Oct 2011-	6.08	2.5	4.98	1.2	3.68	1.1	2.60	4.0
Oct 2010-Sept 2011	5.93	2.2	4.92	1.9	3.64	2.0	2.50	-
Oct 2009-Sept 2010	5.80	1.2	4.83	1.3	3.57	1.1		
Oct 2008-Sept 2009	5.73	3.8	4.77	3.7	3.53	3.8		
Oct 2007-Sept 2008	5.52	3.2	4.60	3.4	3.40	3.0		
Oct 2006-Sept 2007	5.35	5.9	4.45	4.7	3.30	10.0		
Oct 2005-Sept 2006	5.05	4.1	4.25	3.7	3.00	0.0		
Oct 2004-Sept 2005	4.85	7.8	4.10	7.9	3.00	-		
Oct 2003-Sept 2004	4.50	7.1	3.80	5.6				
Oct 2002-Sept 2003	4.20	2.4	3.60	2.9				
Oct 2001-Sept 2002	4.10	10.8	3.50	9.4				
Oct 2000-Sept 2001	3.70	2.8	3.20	-				
Jun 2000-Sept 2000	3.60	-	3.20	6.7				
Apr 1999-May 2000	3.60	-	3.00	-				

Source: Low Pay Commission (LPC).

Note: From October 2010, those aged 21 are covered by the adult rate. Previously they had been covered by the Youth Development Rate.

- 1.5** The adult rate uprating in October 2011 was the largest since October 2008 but was still lower than the percentage increases that had generally occurred prior to the onset of recession. The percentage increase in the Youth Development Rate in October 2011 was the smallest ever. The percentage increase in the 16-17 Year Old Rate was also the smallest ever, apart from in October 2005 when it was frozen to allow the Commission to gather evidence about the impact of its introduction.
- 1.6** Since its introduction, the minimum wage for adults has increased by 68.9 per cent, slightly higher than the 66.0 per cent increase in the Youth Development Rate. The 16-17 Year Old Rate has increased by 22.7 per cent since it was introduced in October 2004. Over the same period, the adult rate has increased by 25.4 per cent and the Youth Development Rate has increased by 21.5 per cent.

The UK Economy in 2011

- 1.7** As noted above, we recommended that the adult rate of the minimum wage increase by 2.5 per cent in October 2011. Table 1.2 shows that, when we came to our recommendations in January 2011, this was expected to be close to average earnings growth but below inflation. The median of independent forecasts for average earnings growth was 2.6 per cent, while the Office for Budget Responsibility (OBR) forecast was a little lower at 2.2 per cent. Consumer Prices Index (CPI) inflation was forecast to be just under 3 per cent with Retail Prices Index (RPI) inflation higher (OBR was forecasting 3.4 per cent with the consensus at 4.0 per cent).

Table 1.2: Economic Forecasts Available in January 2011, UK, 2011-2012

Per cent	Forecasts for 2011		Forecasts for 2012	
	Median of independent forecasts (January 2011)	OBR forecasts (November 2010)	Median of independent forecasts (November 2010)	OBR forecasts (November 2010)
GDP growth (whole year)	2.0	2.1	2.1	2.6
Average earnings growth (whole year)	2.6	2.2	-	2.4
Inflation RPI (Q4)	4.0	3.4	2.8	3.1
Inflation CPI (Q4)	2.9	2.8	1.8	1.9
Employment growth (whole year)	0.4	0.3	-	0.7
Claimant count (millions, Q4)	1.56	1.49	1.53	1.41

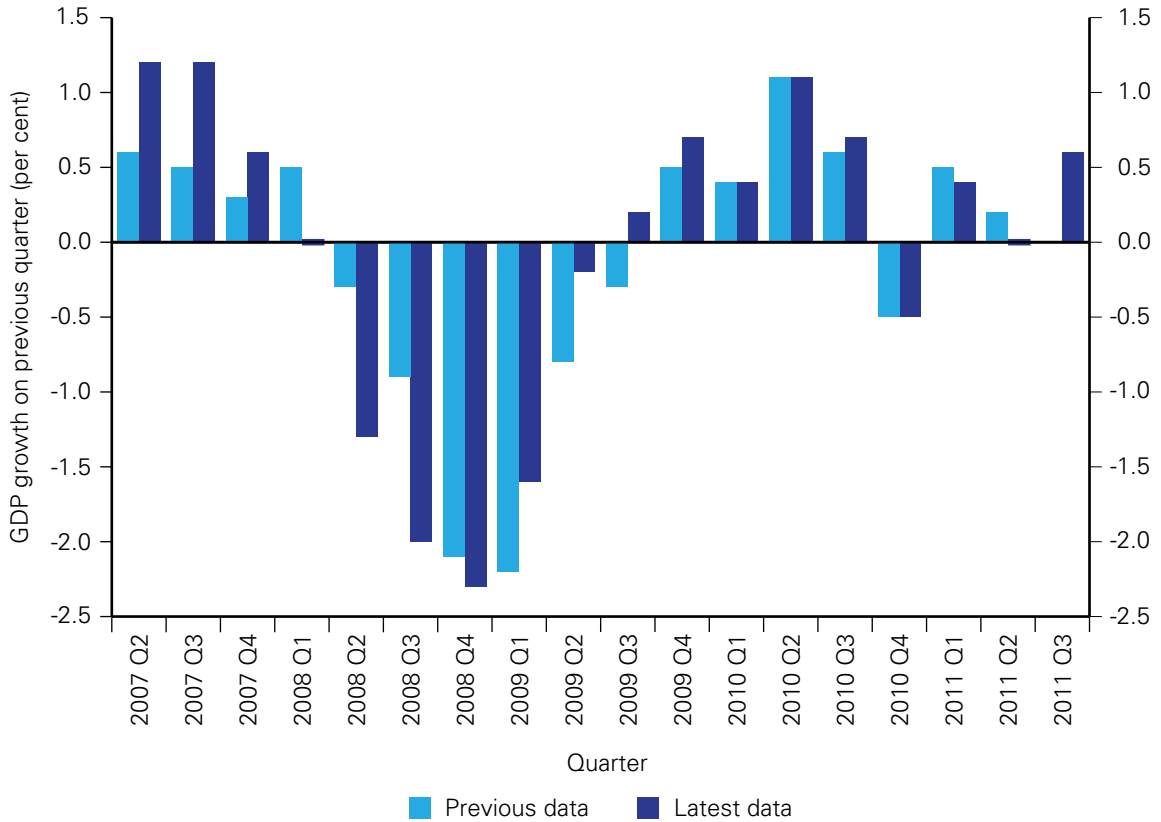
Source: HM Treasury Panel of Independent Forecasts (November 2010 and January 2011) and OBR forecasts (November 2010) based on ONS data, GDP growth (ABMI), total employment measured by workforce jobs (DYDC) and claimant unemployment (BCJD), quarterly, AWE total pay (KAB9), monthly, seasonally adjusted; RPI (CZBH) and CPI (D7G7), quarterly, not seasonally adjusted, UK (GB for AWE); 2011-2012.

- 1.8** The median of independent forecasts suggested that gross domestic product (GDP) would have grown by 1.7 per cent in 2010 and would grow more strongly in 2011 and 2012. We now consider what has actually happened to growth, inflation, average earnings, employment and unemployment.

Gross Domestic Product Growth

- 1.9** The data available at the time of writing our last report suggested that the UK had exited the longest and deepest recession since the 1930s in the fourth quarter of 2009 and had then experienced four successive quarters of growth. The level of GDP in the third quarter of 2010 was 2.7 per cent higher than it had been a year earlier, with growth particularly strong in the second and third quarters of 2010. We noted that growth for 2010 was likely to turn out at 1.7 per cent, higher than had generally been expected in January 2010. The UK therefore looked set to continue its recovery in 2011 and beyond. However, we did consider that there might be significant downside risks and that the economy might not grow as fast as forecast. We were right to be concerned. Since that time, the Office for National Statistics (ONS) has significantly revised the GDP data, mainly affecting growth since 2007, as shown in Figure 1.1.

Figure 1.1: Effect of Revisions to Gross Domestic Product, UK, 2007-2011

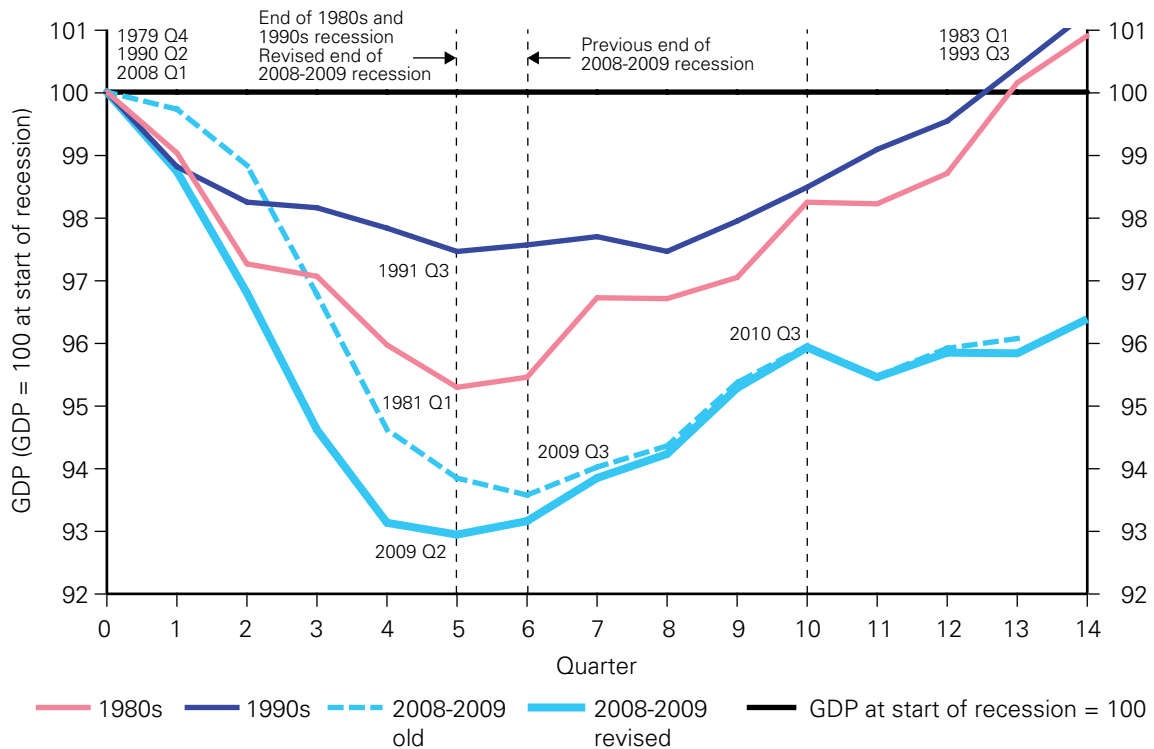


Source: ONS, quarterly change in GDP (IHYQ), quarterly, seasonally adjusted, UK, Q2 2007-Q3 2011.
 Note: The data were revised in Q2 2011 and data for Q3 2011 are not available on the old basis.

1.10 The revised data show much stronger growth in 2007, before the onset of recession, but then even lower output throughout 2008, a more robust recovery in 2009, and little change in 2010. More importantly for our recommendations, growth since the third quarter of 2010 has been much weaker than expected. In the year to the third quarter of 2011, GDP grew by 0.5 per cent and growth for the whole of 2011 was expected to be just 0.9 per cent. This is considerably below the 2 per cent growth expected when we discussed the minimum wage recommendations in January 2011.

1.11 Figure 1.2 shows that the revised data now suggest that the recession was not as long as previously thought but it was much deeper. The recession ended in the third rather than the fourth quarter of 2009. It therefore lasted for five quarters, the same length as the 1980s and 1990s recessions. GDP fell by 7.1 per cent (compared with the 6.4 per cent estimate available in January 2011). This was a considerably greater loss of output than in either of the two previous recessions – the 1980s (4.7 per cent) or the 1990s (2.5 per cent).

Figure 1.2: Gross Domestic Product in Recession and Recovery, UK, 1979-2011



Source: LPC estimates based on ONS data, GDP (ABMI), quarterly, seasonally adjusted, UK, Q4 1979-Q3 2011.
 Note: Quarter 1 is the first quarter of the recession (1980 Q1 for the 1980s, 1990 Q3 for the 1990s, and 2008 Q2 for the 2008-2009 recession).

Spending, Investment and Trade

- 1.12** The composition of growth is important as it provides the economic context in which the low-paying sectors operate. Many of the low-paying sectors are dependent on consumer spending. The sluggishness of household consumption in the recovery, particularly over the last four quarters, has direct implications for retail; hospitality; leisure, sport and travel; and hairdressing. It will also have knock-on effects on other low-paying sectors such as cleaning and security that are dependent on the strength of retail and hospitality for some of their business.
- 1.13** Government spending also plays an important role for many low-paying sectors. Although there is direct public provision of childcare and social care, the public sector also funds much of the childcare and social care supplied by the independent and private sectors. Further, government spending is also important to the hospitality, and leisure, sport and travel sectors. Government spends a significant amount on hotels, restaurants and travel,¹ while local authorities subsidise and promote leisure and sports facilities.
- 1.14** Trade will be a significant factor in low-paying sectors that depend on export markets, such as food processing; the manufacture of textiles and clothing; and agriculture. Trade also affects hospitality and retail through numbers of tourists and the amount they spend in the UK.

¹ In 2008/09, according to the Office of Government Commerce Public Sector Procurement Expenditure Survey (PSPES09), the Government (including Central Government organisations and English local authorities) spent at least £3 billion on travel, hotels, food and catering.

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Although not directly linked to any particular low-paying sector, investment in capital goods, infrastructure and housing will have implications for the long-term health of the UK economy.

- 1.15** The nature of the recession and subsequent recovery has been very different from that experienced in the 1980s and 1990s. As noted above, the 2008-2009 recession was of much greater magnitude. Table 1.3 shows that consumer spending fell sharply, investment collapsed, and inventories were run down but imports weakened more than exports and government spending barely changed. In contrast the 1980s and 1990s recessions were mainly due to falls in investment and a rundown in stocks, although reductions in consumer spending played some part in the 1990s recession. The fall in business investment and the impact on trade were similar across all three recessions.
- 1.16** In contrast to the previous recoveries, consumer spending has been much weaker this time and the latest data suggest that it is still weak. Real wage growth and real disposable income have fallen as average earnings increases and pay settlements have remained subdued. Inflation has remained high, driven by price rises in necessities such as food and energy, and taxes have increased. But exports have performed better than in the past and inventories are being built up rather than run down as in previous recessions.

Table 1.3: Components of Gross Domestic Product Growth in Recession and Recovery, UK, 1980-2011

Per cent	Average growth per quarter						Growth on previous quarter			
	Recession			Recovery			Latest			
	1980 Q1- 1981 Q1	1990 Q3- 1991 Q3	2008 Q2- 2009 Q2	1981 Q2- 1983 Q2	1991 Q4- 1993 Q4	2009 Q3- 2011 Q3	2010 Q4	2011 Q1 Q2 Q3		
Household consumption	0.0	-0.4	-1.2	0.5	0.5	0.1	-0.3	-0.4	-0.4	0.0
Government consumption	0.2	0.8	-0.1	0.4	0.0	0.4	-0.1	0.5	0.4	0.2
Investment	-3.5	-2.0	-4.2	1.1	0.3	0.3	0.0	-2.4	-0.6	1.3
Business investment	-2.4	-2.8	-2.6	0.5	-0.3	0.3	1.4	-6.3	9.5	0.3
Dwellings investment	-7.1	-2.9	-6.4	1.9	1.9	1.6	-2.9	-4.3	9.1	1.8
Change in inventories	-2.7	-2.9	-1.1	-1.2	-0.9	0.1	0.4	0.0	0.4	1.6
Domestic demand	-1.2	-0.9	-1.8	0.9	0.5	0.3	-1.4	-0.7	0.1	0.8
Exports	-1.3	0.3	-2.2	0.5	1.1	1.4	4.1	1.3	-1.5	-0.8
Imports	-3.4	-1.1	-3.1	2.3	1.3	1.2	1.2	-1.5	-0.6	0.5
Real GDP	-1.0	-0.5	-1.5	0.6	0.4	0.4	-0.5	0.4	0.0	0.6

Source: LPC estimates based on ONS data, household final consumption expenditure (ABJR), general government final consumption expenditure (NMRY), total gross fixed capital formation (NPQT), business investment (NPEL), investment in dwellings (DFEG), change in inventories (CAFU), total domestic expenditure (YBIM), total exports (IKBK), total imports (IKBL) and GDP (ABMI), chain volume measures, quarterly, seasonally adjusted, UK, Q4 1979-Q3 2011.

- 1.17** There had been hopes that the recovery this time would lead to a rebalancing of the economy with a shift towards investment and trade, and less dependence on the consumer and government. Although investment has picked up it remains fragile and has not been as strong as in the 1980s recovery. The rebuilding of inventories was a particularly strong influence on growth in the third quarter of 2011. Trade had contributed positively to growth in 2010 but exports have actually fallen since the spring of 2011 as global trade weakened amid concerns about the eurozone, inflation in China and budget deficits across the globe. As a result trade has been a drag on growth. Although the Government has announced a range of spending reductions, government spending continued to contribute to growth in 2011.
- 1.18** Table 1.4 shows that the recent recession affected a broader range of sectors than in the 1990s. Construction and manufacturing were affected in both recessions but services output held up in the 1990s with finance, along with other services, making up for the falls in hospitality ('Hotels and restaurants' in the table) and retail ('Wholesale and retail trade'). In contrast, the output of financial services and services as a whole fell in the 2008-2009 recession. The recovery this time has been more balanced between services and manufacturing. However, manufacturing output has weakened considerably since the spring of 2011 with services picking up.
- 1.19** Concentrating on the low-paying sectors, we can see a sharp contrast in the experiences of retail and hospitality. Hospitality fared worse than retail in the 1990s recession, but better in 2008-2009. Retail recovered more quickly in the aftermath of both recessions. However, hospitality has recovered strongly in 2011 as retail has weakened. That weakening has been particularly noticeable since the spring of 2011.

Table 1.4: Sectoral Growth in Gross Domestic Product in Recession and Recovery, UK, 1990-2011

Per cent	Average growth per quarter					Growth on previous quarter			
	Long-run	Recession		Recovery		Latest			
		1997 Q2-2008 Q1	1990 Q3-1991 Q3	2008 Q2-2009 Q2	1991 Q4-1993 Q4	2009 Q3-2011 Q3	2010 Q4	2011 Q1 Q2 Q3	
	Whole economy	0.8	-0.5	-1.5	0.4	0.4	-0.5	0.4	0.0
Agriculture, forestry & fishing	0.6	1.0	-2.9	-0.3	1.5	-10.0	12.1	-1.2	0.5
Construction	0.6	-2.1	-3.9	0.3	0.7	-1.3	-1.7	3.2	0.3
Manufacturing	0.1	-1.5	-2.7	0.5	0.4	0.6	0.7	0.1	0.0
Total services	1.0	0.0	-1.0	0.9	0.4	-0.3	0.8	0.1	0.7
Wholesale & retail trade; motors & repairs	0.7	-0.6	-1.7	0.0	0.3	-0.4	0.9	-0.2	-0.1
Hotels & restaurants	0.8	-2.0	-1.2	-0.2	-0.7	-3.2	0.8	1.0	1.7
Finance	1.3	0.2	-1.2	-0.5	0.3	-0.6	-0.1	-1.3	1.0

Source: LPC estimates based ONS data, GDP (ABMI), and output indices for: agriculture, forestry & fishing (GDQA and L2KL); construction (GDQB and L2N8); manufacturing (CKYY and L2KX); total services (GDQS and L2NC); wholesale & retail trade (GDQC and L2NE); hotels & restaurants (GDQD and L2NQ); and financial intermediation (GDQI and L2O6); chain volume measures, quarterly, seasonally adjusted, UK, Q2 1990-Q3 2011. Note: Due to methodological changes in the GDP data the old industry series (used for the 1990s recession and recovery) are not directly comparable with the new industry series but are shown for illustrative purposes.

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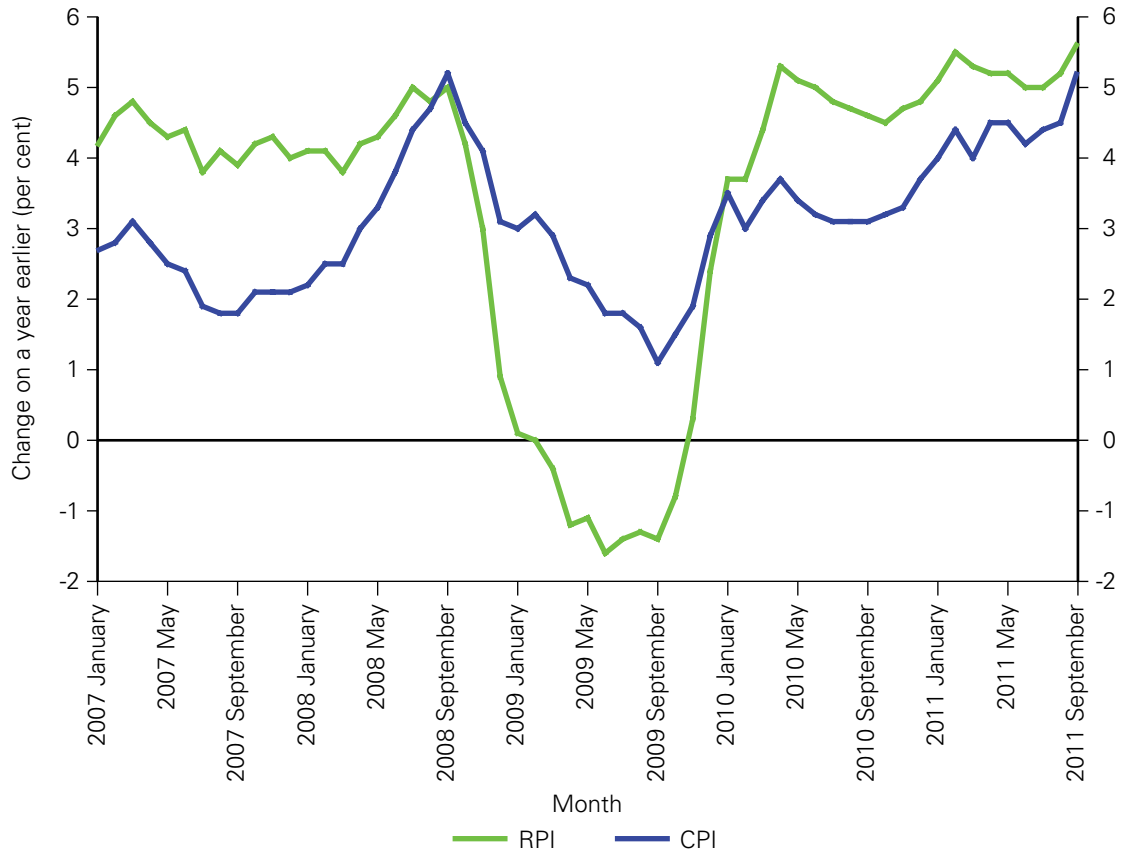
1.20 An alternative measure of output, sales, is available for the retail sector. Official retail sales figures from ONS show that the sector did relatively well during the recession with total sales values holding up (annual growth never fell below 0.6 per cent) and volumes only falling for a brief period (March-May 2009). Retail sales values have improved since March 2009 and annual growth has been above 2 per cent in every month since August 2009. But much of this growth has been due to price inflation. Retail sales volume growth has slowed since the end of 2009, and for most of 2011 annual growth has been flat. Estimates from the BRC-KPMG Retail Sales Monitor were weaker than the official estimates and showed that total retail sales growth had been averaging around 2 per cent for much of 2011. The CBI Distributive Trades Survey followed similar trends. All three surveys had also noted divergence within retail, reporting food and internet sales performing much better than other retail. We now turn to look at prices, settlements and earnings.

Prices, Settlements and Earnings

1.21 The latest inflation data available to us at the time of our 2011 Report related to December 2010. They showed annual quarterly growth in CPI and RPI at 3.4 per cent and 4.7 per cent respectively. These rates were some way ahead of 2010 forecasts and had been driven by greater than expected upward pressures from import prices and indirect taxes. Forecasts indicated these pressures would continue into early 2011, especially given the then recent energy price increases still working their way through the system, and the increase in Value Added Tax (VAT) from 4 January 2011, leading to further rises in both inflation measures in the first half of the year. Thereafter, inflation rates were expected to fall, with the median of independent forecasts showing CPI at 2.9 per cent in the fourth quarter of 2011, and RPI at 4.0 per cent.

1.22 In our 2011 Report we noted the considerable risks around these forecasts and that they were finely balanced. We were therefore cautious about the weight we should attach to them. Our caution was justified. As Figure 1.3 shows, by September 2011 there were no signs of the expected downturn in inflation on either measure, and both were substantially higher than they had been at the beginning of the year with CPI standing at 5.2 per cent and RPI at 5.6 per cent. The CPI figure was well above the Government's 2 per cent annual inflation rate target throughout the period, occasioning several explanatory letters from the Governor of the Bank of England to the Chancellor of the Exchequer. In his letters the Governor drew attention to continuing upward pressures from VAT and the steep increases in import and energy prices, and argued that without these temporary effects CPI would have been below its target.

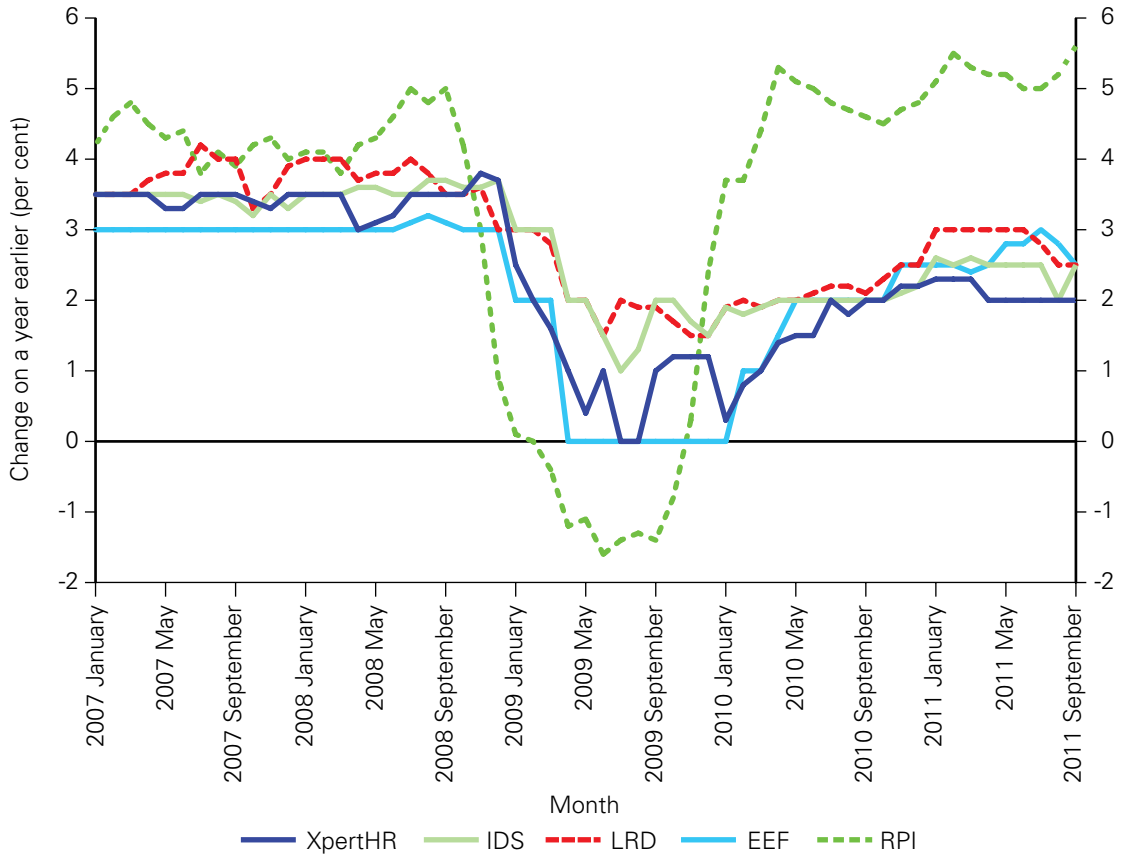
Figure 1.3: Price Inflation, UK, 2007-2011



Source: ONS, annual change in CPI (D7G7) and RPI (CZBH), monthly, not seasonally adjusted, UK, 2007-2011.

1.23 Inflation rates are traditionally a powerful influence on pay settlements, and, of course, they determine rates of real pay growth. The all items RPI is particularly influential as it is the preferred measure of inflation used by pay negotiators. For example, many long-term pay deals in the private sector link annual awards to changes in RPI. Even so, since late 2009 there has been a marked change in the relationship between pay settlements – the usually annual adjustments to basic pay rates – and RPI, as shown in Figure 1.4.

Figure 1.4: Median Pay Settlements and Price Inflation, UK, 2007-2011



Source: XpertHR (previously Industrial Relations Services), Incomes Data Services (IDS), Labour Research Department (LRD), and the manufacturers' organisation (EEF), pay databank records, three-month medians; ONS, annual change in RPI (CZBH), monthly, not seasonally adjusted, UK, 2007-2011.

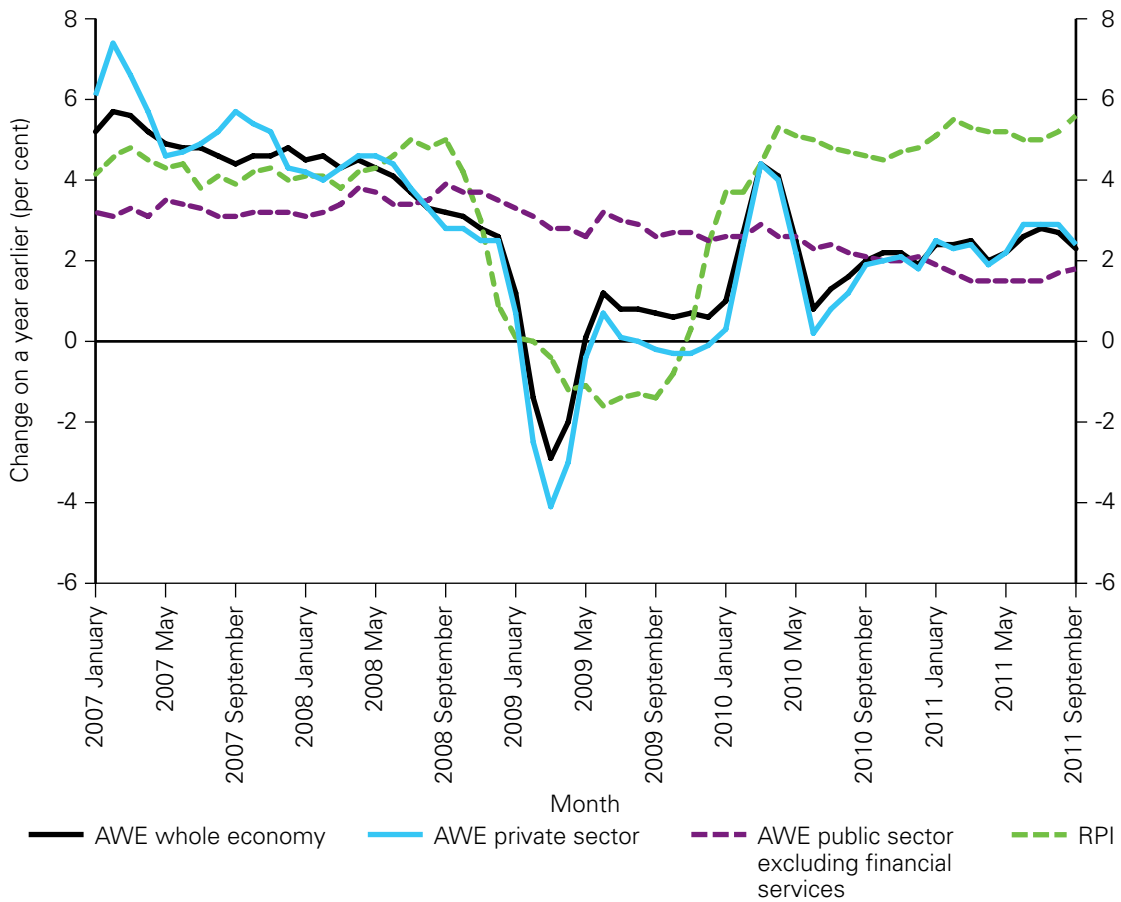
Notes:

- a. EEF covers manufacturing only.
- b. Pay settlement medians for the three months to the end of month shown.

1.24 From late 2009 pay settlement medians failed to keep up with the inflation rate, resulting in unusually large falls in real pay rates. This divergence continued through 2010. At the time of our last report, however, researchers suggested that settlements and inflation would move closer into line as settlements rose slightly and inflation fell. At that time settlement data for November 2010 showed the different medians in a narrow range of 2.0-2.6 per cent, albeit with substantial differences between the public and private sectors, and between individual industries and organisations. Researchers told us that early settlement data for December 2010 did not materially alter this picture, and surveys of employer intentions suggested more of the same in 2011. However, there was some suggestion in the few January 2011 settlements then available that the private sector median might edge up slightly to 2.5-3.0 per cent, although government pay policy pointed to a median award in the public sector of near to 0 per cent. At that stage we thought that these median levels of increase were unlikely to change much, maybe turning out slightly higher to reflect the expected upturn in the economy.

- 1.25** In fact, in the early months of the year the medians did indeed centre on 2.5 per cent, but from April 2011 they had again widened to 2.0-2.5 per cent, depending on the pay data provider. There was no prolonged upturn in three-month settlement medians in the year to September 2011 and no return to anything approaching real growth in basic pay levels.
- 1.26** Finally, we looked at average earnings trends. We used three official data sources to shed light on how wages have changed over time – the Average Weekly Earnings (AWE) total and regular pay measures; the National Accounts compensation of employees, and wages and salaries series; and the Annual Survey of Hours and Earnings (ASHE). AWE is the most timely earnings series as it is released monthly, two months after the survey date. As such, it is the preferred measure of short-term earnings movements produced by ONS. Earnings are measured as the total wage bill divided by the number of employees. The series for compensation of employees, and wages and salaries are derived from a similar data source to AWE and are available quarterly. ASHE records the pay of individuals in April each year and is considered by ONS to provide the best source of structural earnings information. ASHE provides detailed information on hours and earnings by certain characteristics such as age and gender. It also has better coverage of small firms than the other earnings series, however, it is only available annually and is usually released about six months after the survey date.
- 1.27** Our focus here is on changes to AWE total pay as the regular pay measure is similar to pay settlements. AWE total pay is shown for the whole economy and public and private sectors in Figure 1.5 along with the rate of RPI inflation. The data for the three months to November 2010 showed whole economy total pay growth of 2.1 per cent compared with the same period a year earlier, with the public and private sector rates of increase closely in line. Again we noted that these aggregate figures hid a high degree of variation in the rates of earnings growth in individual sectors and industries. OBR's 2.2 per cent earnings growth forecast for 2011 as a whole suggested little change in the prevailing whole economy rate, although at that time the median of independent forecasts was slightly higher at 2.6 per cent. It was our view that the forecast range indicated a subdued picture for earnings growth in 2011 and, at least until late in the year, further large falls in real wages. We said, however, that this outcome depended on the interplay between several factors which, on balance, we judged might lead to a slightly higher rate of earnings growth than indicated by the forecasts.

Figure 1.5: Growth in Average Weekly Earnings Total Pay, GB, and Price Inflation, UK, 2007-2011



Source: ONS, AWE total pay, annual three-month average change for: the whole economy (KAC3), the private sector (KAC6), and the public sector excluding financial services (KAE2), monthly, seasonally adjusted, GB, 2007-2011; and annual change in RPI (CZBH), monthly, not seasonally adjusted, UK, 2007-2011.

- 1.28** In the event, slower than expected economic growth in 2011 led to some labour market weakening, and the resulting spare capacity acted as a dampener on earnings growth. Consequently, although an upturn in earnings growth occurred in the summer, when the rate of increase reached 2.8 per cent, it was not maintained. Total pay growth in the three months to September 2011 of 2.3 per cent was towards the lower end of the forecast range at the time of our last report. The National Accounts measures of earnings show similar growth. In the year to the third quarter of 2011, the compensation of employees increased by 2.4 per cent while the increase in wages and salaries was 2.3 per cent. In sharp contrast, earnings growth recorded by ASHE between April 2010 and April 2011 was much lower.
- 1.29** According to ASHE, annual growth in median hourly earnings was just 0.4 per cent in April 2011 while mean hourly earnings growth was slightly higher at 0.9 per cent. This was below the growth in total earnings according to AWE for the same period, which was 2.0 per cent. There are a number of factors that may help to explain this discrepancy, for example, structural differences in the surveys such as their coverage of small employers, temporary employees, and the finance sector. These differences had not been evident in previous years. Indeed, over the longer term the two measures show similar levels of cumulative earnings increase: since 2000, the cumulative increase in AWE total pay and ASHE median pay are practically the same. However, the differences in 2011 are important as we use ASHE to look

at the distribution of earnings, the coverage of the minimum wage and the bite of the minimum wage (that is, the minimum wage as a proportion of a particular point on the earnings distribution, such as the median or lowest decile). We examine these in more detail in Chapter 2. Having considered earnings, we now look in detail at what has happened to other aspects of the labour market.

Employment and Unemployment

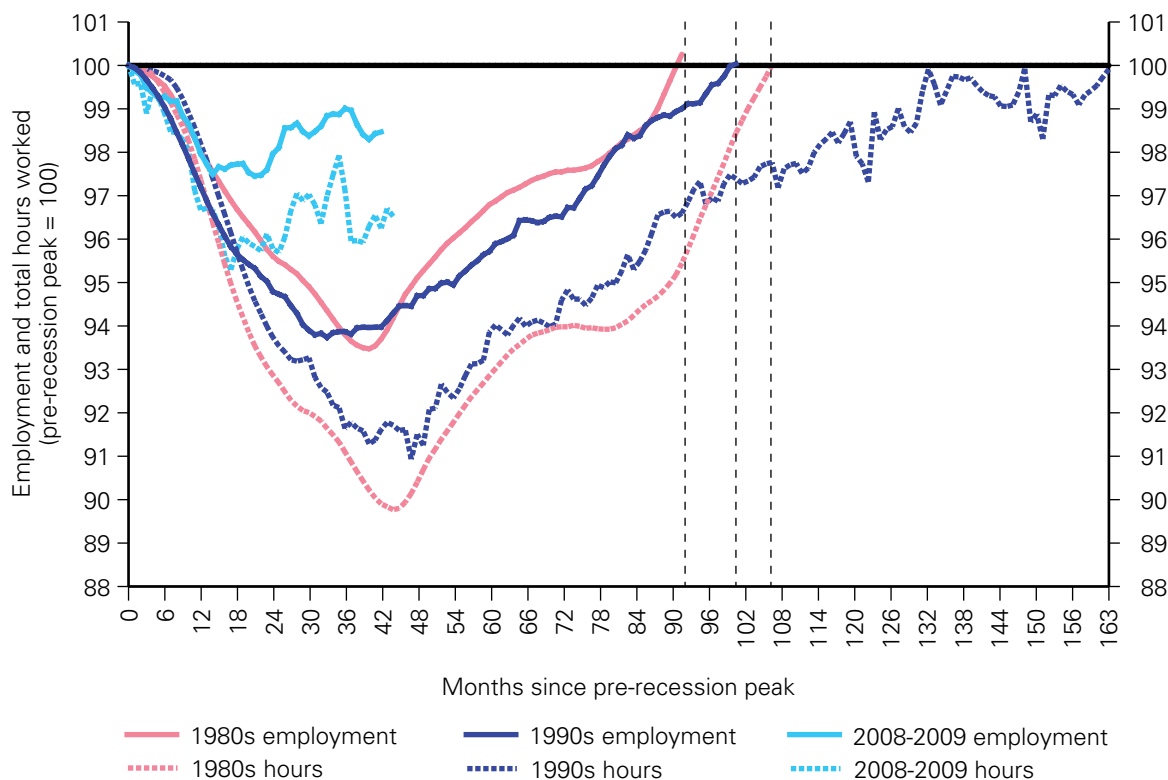
- 1.30** The OBR and independent forecasts at the time of writing our 2011 Report suggested that the improvement in the economy in 2011 would lead to employment growing by around 0.3-0.4 per cent but that this would be less than the growth in the working age population so that the unemployment claimant count would rise to 1.56 million from 1.47 million. The OBR was more optimistic than the general consensus and forecast that the claimant count would reach only 1.49 million in the fourth quarter of 2011.
- 1.31** We commented in our 2011 Report that the labour market had been remarkably resilient throughout the recession and that, over the year to September 2010, the numbers in employment and total hours worked had increased while unemployment on both claimant count and ILO measures had fallen. But we did highlight concerns about the performance of the labour market: the growth in employment had been concentrated among part-time and temporary employment; the number of employee and workforce jobs had fallen over the year; and vacancies had weakened (and redundancies had started to pick up) since the summer of 2010.
- 1.32** As noted above, economic growth has not met expectations in 2011. Perhaps surprisingly in view of this, workforce jobs increased as forecast by 0.3 per cent, since growth in self-employment has made up for the loss in employee jobs. This was the first increase in the year to September since 2007. However, Table 1.5 shows that other measures of employment suggest the labour market was not as strong.
- 1.33** Between September 2010 and September 2011, total employment fell by 109,000 (0.4 per cent) with the number of employees falling by 130,000 (0.5 per cent). The total number of hours fell by 0.8 per cent, more than the percentage fall in employment. The falls in these Labour Force Survey (LFS) measures of employment followed a year when the labour market appeared to have recovered from the recession.
- 1.34** Both ILO unemployment and the claimant count increased in the year to September 2011. After falling by 149,000 in the year after the recession ended, the claimant count rose by 125,000 in the year to September 2011 to reach 1.59 million. This was higher than both the OBR and median of independent forecasts. ILO unemployment rose by 165,000 over the year to September 2011 to 2.6 million.

Table 1.5: Change in Employment and Unemployment, UK, 2007-2011

	September 2007- September 2008		September 2008- September 2009		September 2009- September 2010		September 2010- September 2011	
	000s	%	000s	%	000s	%	000s	%
Workforce jobs	76	0.2	-674	-2.1	-159	-0.5	89	0.3
Employee jobs	136	0.5	-780	-2.8	-271	-1.0	-69	-0.3
Employment	124	0.4	-519	-1.8	311	1.1	-109	-0.4
Employees	152	0.6	-568	-2.2	95	0.4	-130	-0.5
Hours worked	1,100	0.1	-29,700	-3.2	12,000	1.3	-7,400	-0.8
ILO unemployment	179	10.9	625	34.4	-11	-0.5	165	6.8
Claimant count	124	14.7	648	66.9	-149	-9.2	125	8.5
Vacancies	-70	-10.4	-177	-29.3	30	7.0	7	1.5
Redundancies	27	21.1	50	32.3	-59	-28.8	1	0.7

Source: LPC estimates based on ONS data, workforce jobs (DYDC) and employee jobs (BCAJ), quarterly; total employment (MGRZ), employees (MGRN), total weekly hours (YBUS), ILO unemployment (LF2I), claimant count unemployment (BCJD), vacancies (AP2Y) and redundancies (BEAO), monthly, seasonally adjusted, UK, 2007-2011.

- 1.35** Vacancies and redundancies also show that the labour market has been weaker in 2011 than in 2010. In September 2009 vacancies were about 250,000 lower than in September 2007, but picked up in 2010 as the economy began recovering from the recession. The recovery in vacancies has weakened and vacancies in September 2011 were still over 200,000 below their pre-recession levels. In the depths of the recession, redundancies were 77,000 higher in the quarter to September 2009 than in the quarter to September 2007. They then fell back over the year to September 2010 by 59,000 as the economy started recovering, but this recovery stalled in 2011. The level of redundancies was more or less unchanged between September 2010 and September 2011.
- 1.36** The labour market remained relatively resilient in 2011. Although output fell by over 7 per cent during the recession, Figure 1.6 shows that employment only fell by 2.5 per cent. Many had argued that this was due to workers showing greater flexibility by reducing hours, working shorter weeks, and taking unpaid sabbaticals. Hours fell by more than employment, suggesting that this may have been a factor, but they fell by 4.5 per cent at most. In the recessions of the 1980s and 1990s, the falls in employment and hours were much greater. In both of those recessions employment fell by over 6 per cent and hours by up to 10 per cent. This suggests that the relationship between employment and hours was similar in the three recessions. However, the fall in output was much greater in 2008-2009 than in either of those previous recessions.

Figure 1.6: Hours and Employment in Recession and Recovery, UK, 1979-2011

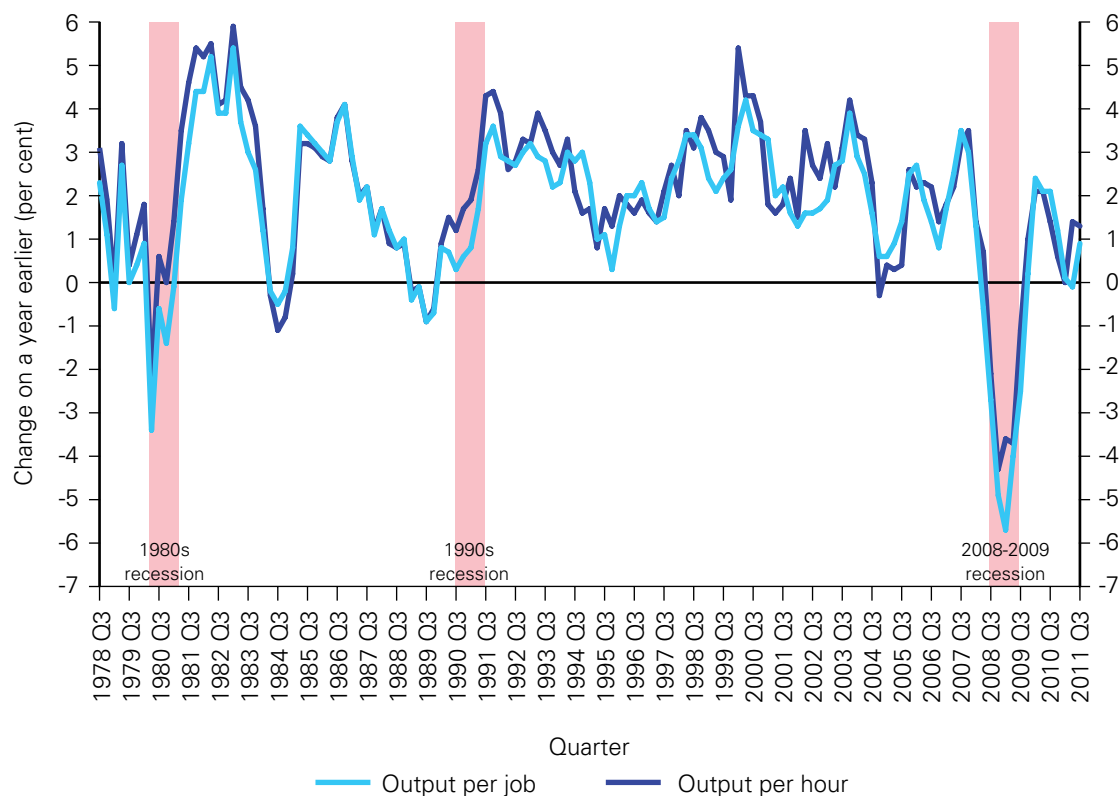
Source: LPC estimates based on ONS data, total employment (MGRZ), and total weekly hours (YBUS), monthly, seasonally adjusted, UK, 1979-2011.

Note: Month 0 is the pre-recession peak for each measure (January 1980, July 1990 and May 2008 for employment; and September 1979, December 1989, and March 2008 for hours).

Productivity

1.37 As a result of the labour market's resilience, labour productivity has been affected. In the two previous recessions, as shown in Figure 1.7, the productivity performance was better as the fall in output was less than the fall in employment. Indeed, throughout the 1990s recession, productivity increased. We noted above that the fall in hours was greater than the fall in employment in all three recessions. As a result, the fall in productivity as measured per hour has been more moderate than the fall as measured by job. The fall in productivity on both measures is much more evident in the recent recession than in the two previous recessions. But the recovery this time also seems to have been weaker and productivity growth has fallen back again as output growth has stalled.

Figure 1.7: Growth in Productivity per Job and per Hour, UK, 1978-2011



Source: ONS, annual change in output per job (LNNP) and output per hour (LZVD) for the whole economy, quarterly, seasonally adjusted, UK, Q3 1978-Q3 2011.

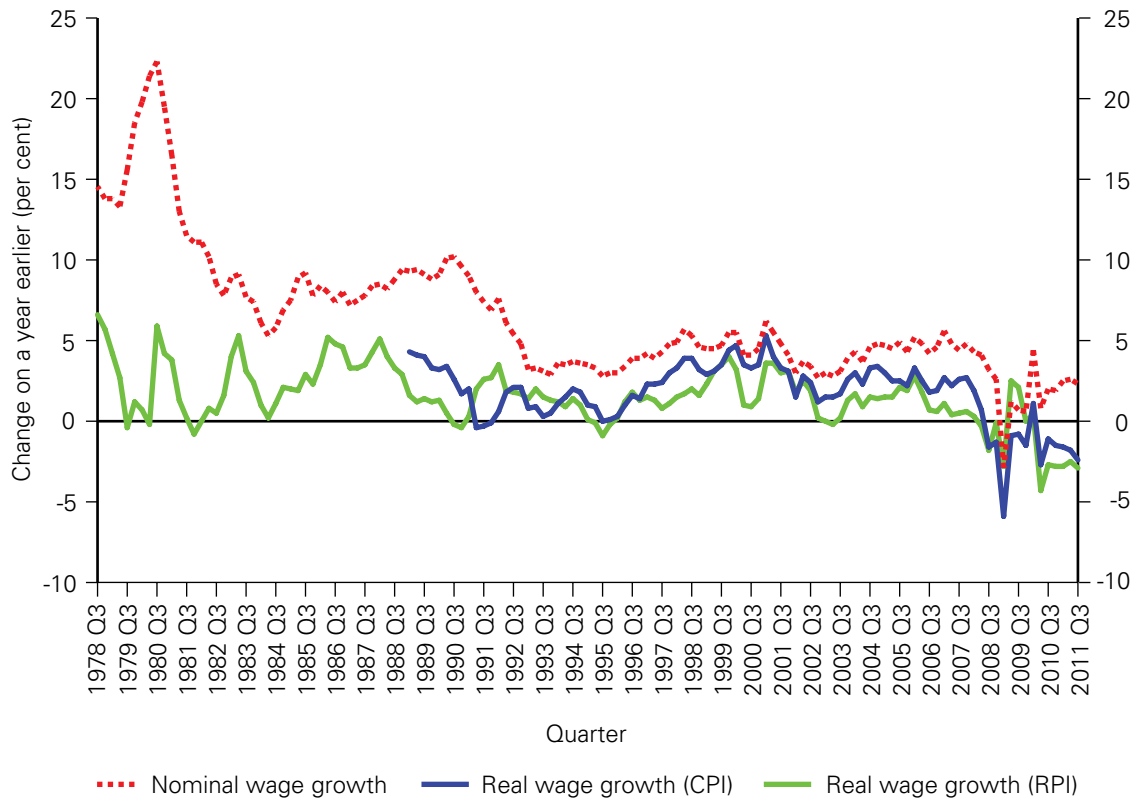
Note: Pink bars indicate recessionary periods.

1.38 In our 2010 Report, we expressed concern that in 2009 productivity had fallen and unit wage and labour costs had risen sharply. We suggested that this was unsustainable and may lead to further job losses unless output and productivity rose. This rise occurred in 2010 along with a fall in unit wage and labour costs. However, these concerns returned as the recovery in 2011 weakened.

Real Wages

1.39 The most plausible explanation of the labour market’s resilience is the fall in real wages. In the two previous recessions, inflation had been much higher than it was in the latest recession but nominal wages had generally more than kept pace. Thus, as shown in Figure 1.8, real wages had generally continued to increase throughout both recessions. In the latest recession and recovery, pay settlements and earnings have been subdued and nominal wage growth has been weaker than in previous recessions. Inflation has been much higher than forecast and higher than these nominal wage increases. This has led to a sustained fall in real wages that has now lasted for about four years, which is unprecedented in the UK in recent times.

Figure 1.8: Growth in Nominal and Real Wages, UK, 1978-2011



Source: LPC estimates based on ONS data, annual change in CPI (D7G7), Q1 1989-Q3 2011, and RPI (CBZH), Q3 1978-Q3 2011, quarterly, not seasonally adjusted, UK; annual change in AEI inc bonuses (LNNC), Q3 1978-Q4 2000, and AWE total pay (KAC3), Q1 2001-Q3 2011, monthly, seasonally adjusted, GB.

Profits

1.40 The profitability of companies is also an important factor in our deliberations. As we noted in previous reports, the reluctance of companies to invest and rebuild stocks has led to improved cash balances for many firms, particularly large ones, since 2008. The gross and net rates of return on capital employment for non-oil private non-financial corporations have also picked up in 2011 but at 11.1 per cent in the third quarter, both are below the rates observed before the onset of recession. Gross trading profits for non-oil private non-financial corporations picked up over the year from £49.2 billion in the third quarter of 2010 to £54.0 billion in the third quarter of 2011. Similarly, over the same period, total gross operating surplus in the UK increased from £63.0 billion to £66.9 billion. However, as a proportion of GDP, it has fallen from 21.9 per cent to 21.2 per cent. The wage share has also fallen as taxes (and subsidies) have taken an increasing share of GDP. Throughout the recession and since it ended, financial balances for private non-financial corporations have also been strong compared with previous recessions. However, it is likely that these strong financial balances are predominantly held by larger firms. In surveys and in evidence from our meetings with stakeholders, small firms have indicated that they have no such headroom and that profits have also been squeezed.

Revised Forecasts for 2011 and 2012

1.41 At the time of writing our 2011 Report, as we noted above and show in Table 1.6, the consensus was that GDP would grow by about 2.0 per cent in 2011 and 2.1 per cent in 2012. The OBR forecast was for slightly stronger growth. The weakness in the economy that we have discussed has led to a significant downwards revision of forecast growth in both 2011 and 2012. We, along with OBR and the median of independent forecasts, now expect the economy to have grown by just 0.9 per cent in 2011. Thus, the economic outturn has been much poorer than had been expected in January 2011. As a result the employment and unemployment performance has also been weaker.

Table 1.6: Revised Economic Forecasts, UK, 2011-2012

Per cent	Forecasts used in 2011 Report (January 2011)				Latest forecasts available (January 2012)			
	Median of independent forecasts (November 2010 and January 2011)		OBR forecasts (November 2010)		Median of independent forecasts (January 2012)		OBR forecasts (November 2011)	
	2011	2012	2011	2012	2011	2012	2011	2012
GDP growth (whole year)	2.0	2.1	2.1	2.6	0.9	0.4	0.9	0.7
Average earnings growth (whole year)	2.6	-	2.2	2.4	2.5	2.4	0.9	2.0
Inflation RPI (Q4)	4.0	2.8	3.4	3.1	5.4	2.8	5.2	2.8
Inflation CPI (Q4)	2.9	1.8	2.8	1.9	4.7	2.1	4.6	2.4
Employment growth (whole year)	0.4	-	0.3	0.7	0.4	-0.5	0.7	-0.2
Claimant count (millions, Q4)	1.56	1.53	1.49	1.41	1.63	1.79	1.62	1.79

Source: HM Treasury Panel of Independent Forecasts (November 2010, January 2011 and January 2012) and OBR forecasts (November 2010 and November 2011) based on ONS data, GDP growth (ABMI), total employment measured by workforce jobs (DYDC) and claimant unemployment (BCJD), quarterly, AWE total pay (KAB9), monthly, seasonally adjusted; RPI (CZBH) and CPI (D7G7), quarterly, not seasonally adjusted, UK (GB for AWE); 2011-2012.

1.42 On the other hand, inflation has been much greater than had been foreseen, driven by the increases in commodity prices, utility bills, petrol and VAT. The consensus was that CPI inflation would fall by the end of 2011 towards 3 per cent (with RPI at 4 per cent). OBR had forecast inflation falling back by slightly more. Table 1.6 shows that inflation was expected to be below target by the end of 2012. This is no longer expected to be the case. Inflation is now expected to be over 5 per cent for RPI in the final quarter of 2011 with CPI at around 4.6 per cent. This is considerably higher than was expected a year ago.

1.43 There has been little change in the consensus forecast for average earnings growth, with independent forecasters expecting wage growth of around 2.5 per cent in the whole of 2011. OBR, however, has been expecting much weaker wage growth of just 0.9 per cent. Both forecasts of average earnings imply considerable reductions in average real wages. The increase in the adult rate of the minimum wage in October 2011 was 2.5 per cent. This was in line with the consensus of average wage growth forecasts.

Conclusion

- 1.44** Revised data have led ONS to estimate that the 2008-2009 recession was much deeper although not as long as first thought. The recession lasted for five quarters, the same length as the 1980s and 1990s recessions but output fell by over 7 per cent, considerably more than in those previous recessions. However, employment and hours continued to be much higher than would have been expected from the experience of the two previous recessions.
- 1.45** The UK economy has weakened considerably since the fourth quarter of 2010, exacerbated by the particularly harsh wintry conditions and the additional Bank Holiday for the Royal Wedding. GDP by the end of the third quarter of 2011 was just 0.5 per cent above that of a year previously. This sluggishness in growth led to a downturn in many measures of the labour market. Employment fell and unemployment rose on both the ILO and claimant count measures. Vacancies were flat.
- 1.46** Wage growth, as measured by pay settlements and AWE, turned out close to our expectations albeit a little lower than had been foreseen in January 2011. However, data from ASHE suggested that wage increases had typically been much lower than AWE, at less than 1 per cent. Inflation, on the other hand, had been much higher than expected.
- 1.47** Thus, the relatively subdued average wage increases led to large real wage cuts for many workers. But the uprating in October 2011 appears to have at least maintained the relative value of the adult minimum wage rate to the average wage. This is a similar story to that recorded last year for the 2010 minimum wage upratings. We now go on to look at the impact of the minimum wage on earnings, pay settlements and structures, employment and competitiveness in Chapter 2.

Chapter 2

The Impact of the National Minimum Wage

Introduction

- 2.1** We have carefully monitored the impact of the National Minimum Wage (NMW) since its introduction in April 1999. We have done this by looking at whether the minimum wage has had any effects on individual earnings and on pay structures and investigating how employers have coped with these changes. In Chapter 1, we considered the macroeconomic context in which the October 2011 upratings came into effect but it is too early to assess the impact of those upratings.
- 2.2** In reviewing the impact of the NMW since its introduction, this chapter focuses mainly on the impact of recent minimum wage upratings. The increases in October 2010 were 2.2 per cent for those aged 21 and over, 1.9 per cent for 18-20 year olds, and 2.0 per cent for 16-17 year olds. Although we refer to increases in the minimum wages for young workers and comment on some aspects of the impact by age, we concentrate on the impact of the adult rate. It should be noted here that our analysis takes account of the extension of the adult rate to cover 21 year olds from October 2010. An Apprentice Rate was also introduced at that time. The impact on young workers and apprentices is covered in more detail in Chapter 3.
- 2.3** As well as investigating the impact of the minimum wage at an aggregate level, we have also sought to identify impacts where we would be most likely to find evidence of them. We know that specific groups of workers in certain jobs, industries and locations are more likely to be low paid. We start by giving a brief overview of these low-paying jobs and low-paid workers.

National Minimum Wage Jobs

- 2.4** We use the Annual Survey of Hours and Earnings (ASHE) as the main dataset for hourly earnings information. This is an annual survey of 1 per cent of the workers on HM Revenue & Customs' Pay-As-You-Earn register. The earnings and hours information in the survey are reported by employers from their records. The Office for National Statistics (ONS) regards it as the best source of information on individual earnings in the UK. The data also record each individual's gender, age, industry, occupation, home postcode, work postcode and size of firm. Further details on this dataset are outlined in Appendix 4. The latest available ASHE data are from April 2011, when the adult minimum wage was £5.93 an hour (2.2 per cent higher than in the previous year). We use hourly pay excluding overtime as the basic measure of earnings. It should also be noted that the earnings distribution in April 2011 may already, to

National Minimum Wage

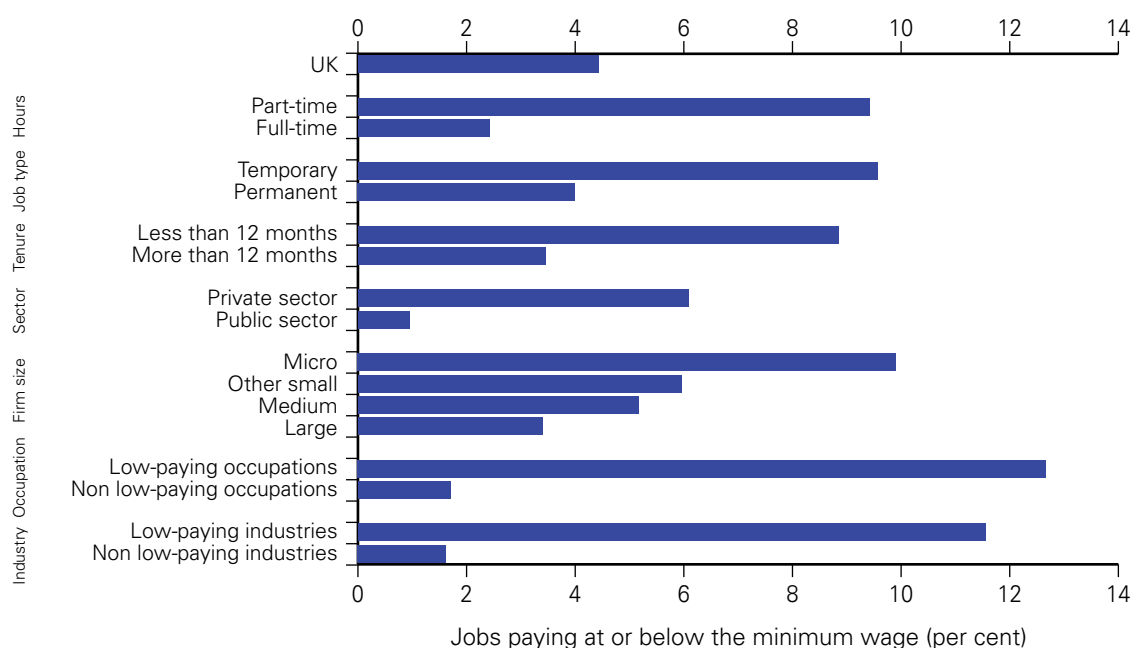
some extent, reflect the then forthcoming increases to the minimum wage in October 2011, as some employers may have pre-empted some or all of the increase.

2.5 For the purposes of analysing minimum wage jobs in this section, we define a minimum wage job to be one that, in April 2011, paid at or below the relevant NMW rate. We also include those paid up to five pence above the minimum wage. On this basis, we estimate that about 4.4 per cent of all jobs were minimum wage jobs. Figure 2.1 shows that jobs more likely to be minimum wage jobs were: part-time; temporary; held for less than a year; in the private sector; in small and medium-sized firms; and in certain low-paying industries and occupations.

2.6 Around 9 per cent of jobs that were part-time, temporary, or held for less than a year were minimum wage jobs, compared with 2-4 per cent of jobs that were full-time, permanent or held for more than a year. Over 6 per cent of jobs in the private sector but only 1 per cent in the public sector were paid at or below the minimum wage.

2.7 Figure 2.1 shows that there is a clear relationship between the proportion of minimum wage jobs and the size of firm. Workers in large firms (those with 250 or more employees) are much less likely to be paid at or below the minimum wage than those in small firms (those with fewer than 50 employees), especially micro firms (those with 1-9 employees). Nearly 10 per cent of jobs in micro firms are paid at the minimum wage compared with around 3 per cent in large firms. Nevertheless, according to ASHE, the majority of minimum wage workers work in large firms. Around 51 per cent of minimum wage workers work in large firms compared with around 17 per cent in micro firms and a further 17 per cent in other small firms (those with 10-49 employees). The remaining 15 per cent work in medium-sized firms (50-249 employees).

Figure 2.1: Characteristics of Minimum Wage Jobs, UK, 2011



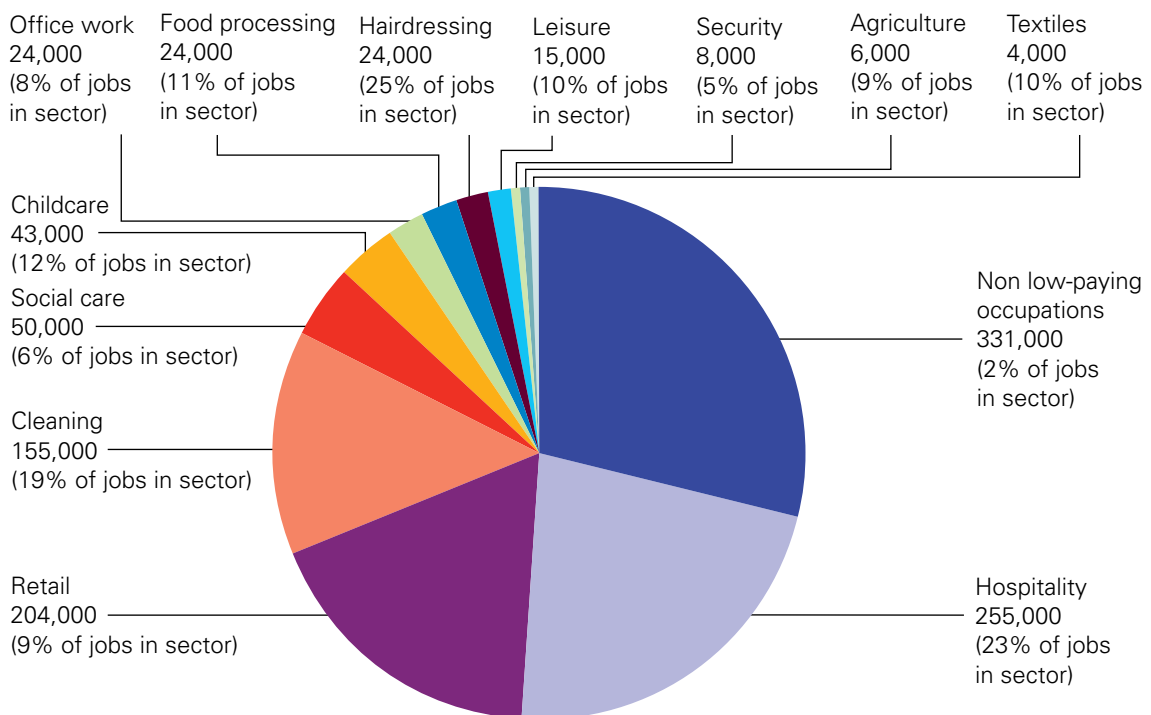
Source: Low Pay Commission (LPC) estimates based on ASHE, 2007 methodology, low-pay weights, including those not on adult rates of pay, UK, April 2011.

Note: Minimum wage jobs defined as adults (aged 21 and over) earning less than £5.98, youths (aged 18-20) earning less than £4.97, and 16-17 year olds earning less than £3.69 in April 2011.

2.8 Figure 2.1 also shows clear differences between those industries and occupations that we define as low-paying, and others. As in previous reports, we define low-paying sectors as those with a large number or high proportion of minimum wage workers. By this definition the low-paying industries are: retail; hospitality; social care; employment agencies; food processing; leisure, travel and sport; cleaning; agriculture; security; childcare; textiles and clothing; and hairdressing.² When defining our occupation-based low-paying sectors, we group low-paying occupations under the same headings (for example, retail includes trolley collectors, shelf stackers, till cashiers and sales assistants) and add office work.³ However, we are not able to provide an occupational definition for employment agencies.

2.9 Looking at the low-paying occupations in greater detail, Figure 2.2 shows that, although 812,000 minimum wage jobs are in our identified low-paying occupations, 331,000 minimum wage jobs (just under a third) are not. In April 2011, the greatest numbers of minimum wage jobs were in hospitality (255,000), retail (204,000) and cleaning (155,000), which together accounted for around 54 per cent of all minimum wage jobs. Social care (50,000) and childcare (43,000) each represented about 4 per cent of minimum wage jobs, while the remaining low-paying occupations accounted for 106,000 jobs (or around 9 per cent). Figure 2.2 also shows that hairdressing (25 per cent), hospitality (23 per cent) and cleaning (19 per cent) have the highest proportions of minimum wage jobs, whereas only 9 per cent in retail, 6 per cent in social care, and 5 per cent in security are minimum wage jobs.

Figure 2.2: Number and Proportion of Minimum Wage Jobs, by Low-paying Occupation, UK, 2011



Source: LPC estimates based on ASHE, 2007 methodology, low-pay weights, including those not on adult rates of pay, UK, April 2011.

Notes:

- a. Minimum wage jobs defined as adults (aged 21 and over) earning less than £5.98, youths (aged 18-20) earning less than £4.97, and 16-17 year olds earning less than £3.69 in April 2011.
- b. Percentages in parentheses are the proportion of jobs in each occupation that are minimum wage jobs.

² Full definitions of these low-paying industries are given in Appendix 4 of the 2010 Report.

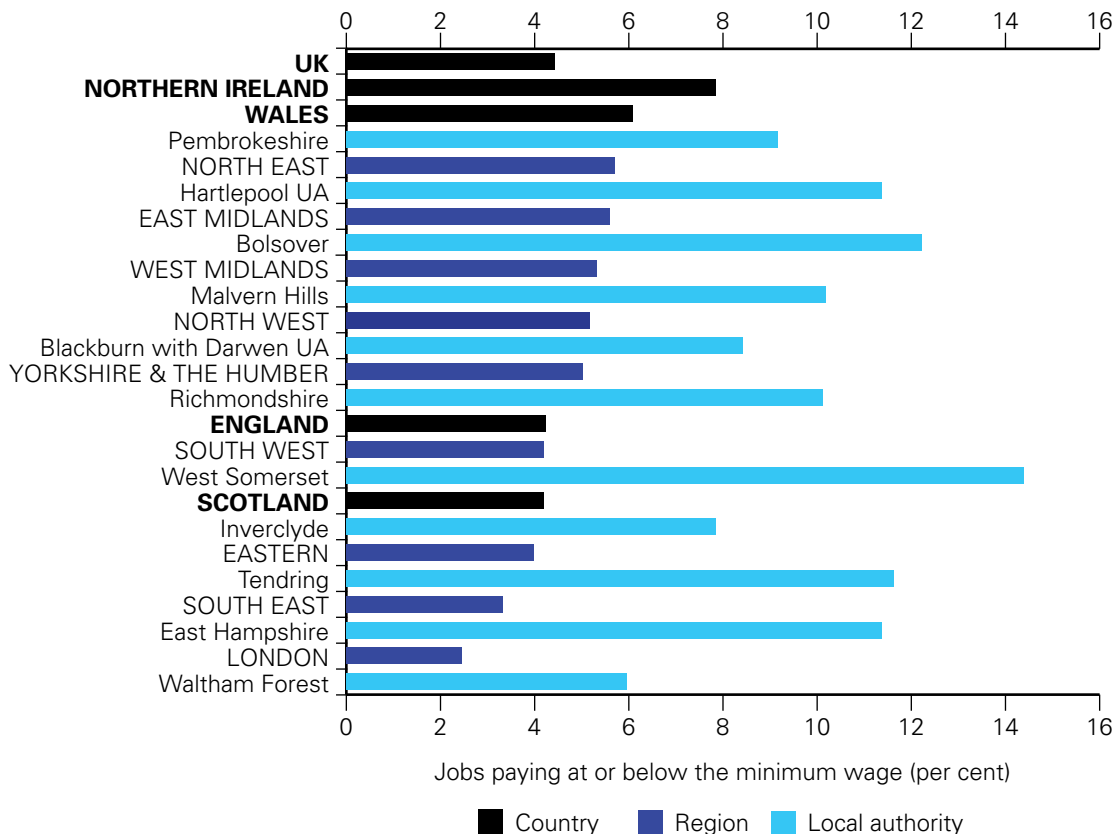
³ Full definitions of our occupation-based low-paying sectors are given in Appendix 4 of the 2010 Report.

National Minimum Wage

2.10 We find a similar pattern in the low-paying industries. Around a quarter of minimum wage jobs were not to be found in any of our defined low-paying industries. In April 2011, the largest numbers of minimum wage jobs were in hospitality (290,000) and retail (232,000), and together they accounted for around 45 per cent of minimum wage jobs. Employment agencies, social care and cleaning each accounted for around 6 per cent of minimum wage jobs (64,000-73,000 in each case). The numbers for cleaning are much smaller using the industrial definition than the numbers covered by the occupation definition in Figure 2.2, as cleaners work in most industries across the whole economy. That leaves just 10 per cent of minimum wage jobs in our other low-paying industry groups. The industry groups with the highest proportions of minimum wage jobs are hairdressing (27 per cent), hospitality (22 per cent) and cleaning (21 per cent).

2.11 Just as they are distributed unevenly across industries and occupations, so minimum wage jobs are spread unevenly throughout the UK. Figure 2.3 shows that Northern Ireland is the country with the highest proportion of minimum wage jobs (7.9 per cent), followed by Wales (6.1 per cent), while Scotland and England have the lowest (both 4.2 per cent).

Figure 2.3: Minimum Wage Jobs, by Country, Region, and Highest Local Authority Within Each Area, 2011



Source: LPC estimates based on ASHE, 2007 methodology, low-pay weights, including those not on adult rates of pay, UK, April 2011.

Notes:

a. Minimum wage jobs defined as adults (aged 21 and over) earning less than £5.98, youths (aged 18-20) earning less than £4.97, and 16-17 year olds earning less than £3.69 in April 2011.

b. The geographic areas are work-based. No regional breakdown is available for Northern Ireland.

- 2.12** Looking at regions within England, we can see that the North East has the highest proportion of minimum wage jobs (5.7 per cent) while London has the lowest (2.5 per cent). In contrast, the largest numbers of these jobs are found in the North West, the West Midlands and the South East, each accounting for more than 10 per cent of all minimum wage jobs. Although London has 14 per cent of all employees – more than anywhere else – it has only 8 per cent of all minimum wage jobs.
- 2.13** There is also significant variation among local authorities within regions. For example, within the North East just under 6 per cent of all jobs are paid at the minimum wage but this ranges from over 11 per cent in Hartlepool Unitary Authority to only 2 per cent in Teesdale. The spread is even wider in the South West, where the proportion of minimum wage jobs is 4.2 per cent, ranging from 2 per cent in West Dorset to just over 14 per cent in West Somerset.

Views on Regional Variations

- 2.14** Some stakeholders, such as the Unquoted Companies Group, were in favour of a regional approach to setting the minimum wage. The Northern Ireland Hotels Federation pointed to the cost of living and levels of disposable income being considerably lower in Northern Ireland than other parts of the UK, yet Northern Ireland was expected to operate the same minimum wage level. The British Independent Retailers Association (BIRA) said that a National Minimum Wage covering London through to Wales and the North was an impossible objective. In the social care sector, the Devon-based Stonehaven Care Group told us that care homes in Devon were in difficulty as they have had no increase in care fees for publicly funded clients for a few years, with Devon ranked 84th out of 100 local authorities for the level of care fees. It questioned whether the NMW should be set by local government in order to match it to local fiscal policies. However, other employers took a contrary view, seeing a regional wage as likely to add an unwelcome complexity for their business. The Trades Union Congress (TUC) and trade unions have also maintained support for a nationwide floor, regarding regional variation as making effective enforcement of the wage more difficult, and having damaging implications for the economies of poorer regions. There is significant wage variation within regions themselves. Further, the National Minimum Wage Act 1998 does not permit regional variation in the minimum wage.

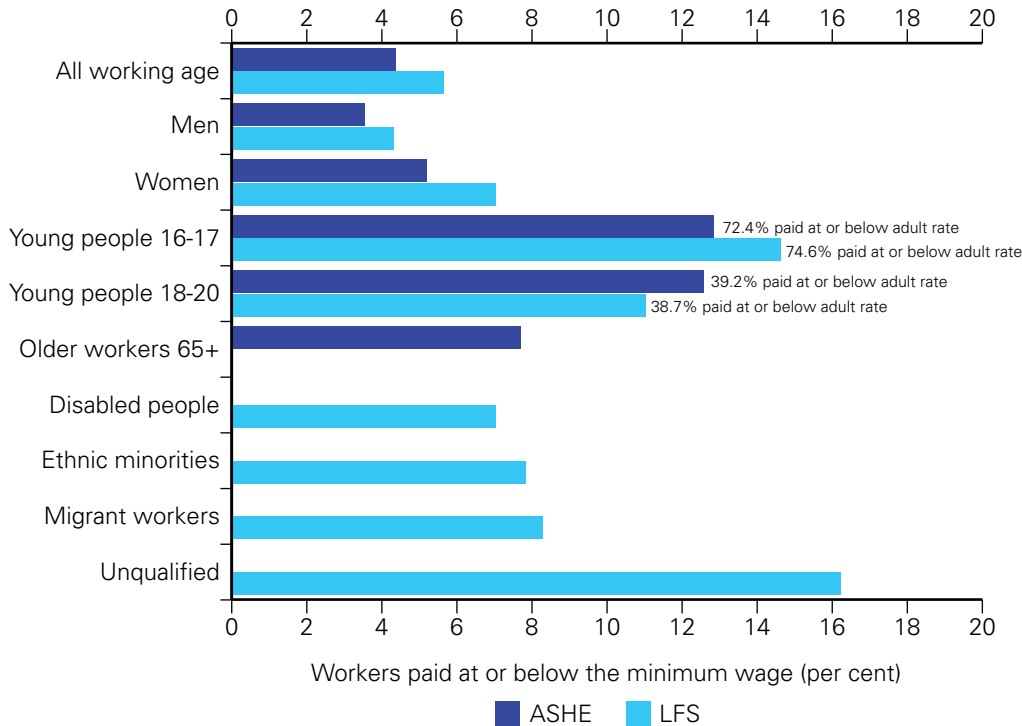
National Minimum Wage Workers

- 2.15** So far, we have looked at the characteristics of minimum wage jobs and their employers. We now turn to the people who work in these jobs. Our remit asked us to monitor the impact of the minimum wage on previously identified groups of workers. We consider these to be young workers, older workers, women, ethnic minorities, disabled people, migrant workers and those with no qualifications. Earnings data from ASHE are only available by gender and age, so we use the Labour Force Survey (LFS) for the other groups. LFS data on earnings are regarded as being less reliable than ASHE data because ASHE is based on employer records whereas LFS is self-reported and based on smaller sample sizes. Figure 2.4 shows that the LFS estimates of minimum wage jobs tend to be higher than the estimates from ASHE.

National Minimum Wage

The groups covered by our remit contain higher proportions of minimum wage workers than the overall working age population.

Figure 2.4: Minimum Wage Workers, UK, 2011



Source: LPC estimates based on ASHE, 2007 methodology, low-pay weights, including those not on adult rates of pay, UK, April 2011; and LFS Microdata, income weights, quarterly, not seasonally adjusted, UK, Q2 2011.

Note: Minimum wage jobs defined as adults (aged 21 and over) earning less than £5.98, youths (aged 18-20) earning less than £4.97, and 16-17 year olds earning less than £3.69 in April 2011.

- 2.16** The ethnic minority and migrant worker categories in Figure 2.4 are the aggregates of many different ethnicities and countries of birth and presenting them in this form hides significant variation between the constituent groups. For example, among the ethnic minorities, the proportion of black workers in minimum wage jobs is lower than that of white workers (4.9 per cent compared with 5.4 per cent), whereas the proportion is much higher among workers of Pakistani and Bangladeshi ethnicities (11.1 per cent).
- 2.17** We have established that part-time jobs, temporary jobs, jobs in small firms, and jobs in certain industries and occupations are more likely to be minimum wage jobs. Further, we have shown that these are more likely to be carried out by women, young people, those over retirement age, disabled people, ethnic minorities, migrant workers and those with no qualifications. We now go on to assess the impact of the minimum wage in aggregate and on these jobs and workers in particular.

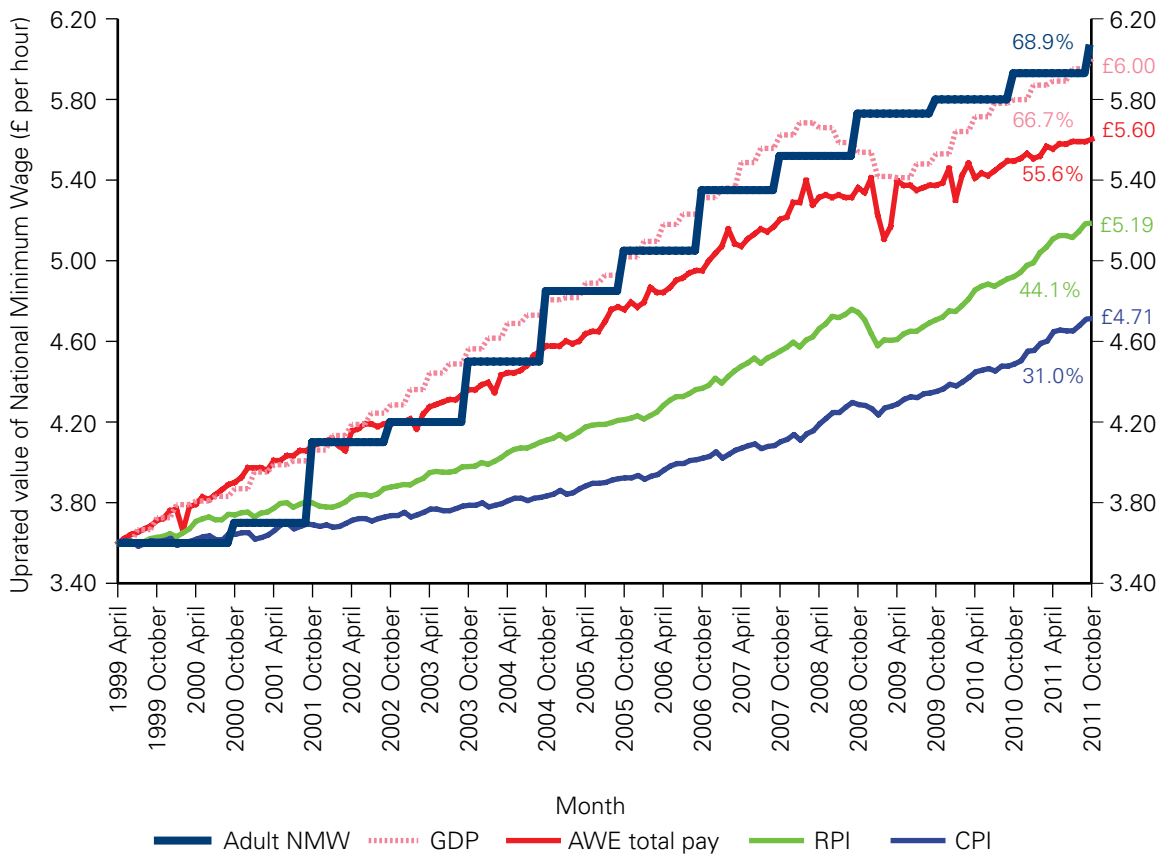
Impact on Earnings and Pay

- 2.18** We start by investigating the impact of the minimum wage on earnings. If the minimum wage had been set at a level such that it did not affect the distribution of earnings or companies' pay structures, it is unlikely to have had any effect at all. This, however, does not appear to be the case.
- 2.19** In order to assess the impact of the minimum wage on earnings, we focus our analysis on ASHE, which ONS considers the best source of earnings information. However, it is only conducted once a year, in April, and the results are not then available until about six months afterwards. Hence, we use Average Weekly Earnings (AWE) as a more timely measure of earnings in the economy and available at some degree of disaggregation, such as public and private sector, manufacturing and services, and industry (at the one digit Standard Industrial Classification).

National Minimum Wage Relative to Prices and Earnings

- 2.20** Since its introduction in April 1999, the adult rate of the NMW has increased by 69 per cent from £3.60 an hour to £6.08 an hour in October 2011. Figure 2.5 shows that this is much faster than the growth in average earnings, inflation (whether measured using the Consumer Prices Index (CPI) or the Retail Prices Index (RPI)) or the economy. Between April 1999 and October 2011, average earnings including bonuses (measured using a combination of the Average Earnings Index (AEI) and AWE) grew by around 55 per cent, RPI inflation rose by 44 per cent and CPI inflation by 31 per cent.
- 2.21** Had the initial adult rate of the minimum wage been uprated in line with average earnings growth, it would only have been £5.60 an hour by October 2011, 48 pence below its current level. If instead, it had been increased in line with price inflation, it would have been £4.71 using consumer prices and £5.19 using retail prices. These are respectively £1.37 and 89 pence less than the current adult rate of the minimum wage. It is evident, therefore, that the adult rate of the minimum wage has increased its relative value (compared with average earnings) as well as its real value (compared with price inflation) since its introduction. In contrast, nominal gross domestic product (GDP) grew by 67 per cent between the first quarter of 1999 and the third quarter of 2011, roughly in line with the increase in the minimum wage.

Figure 2.5: Increases in the Real and Relative Value of the Adult National Minimum Wage, UK, 1999-2011

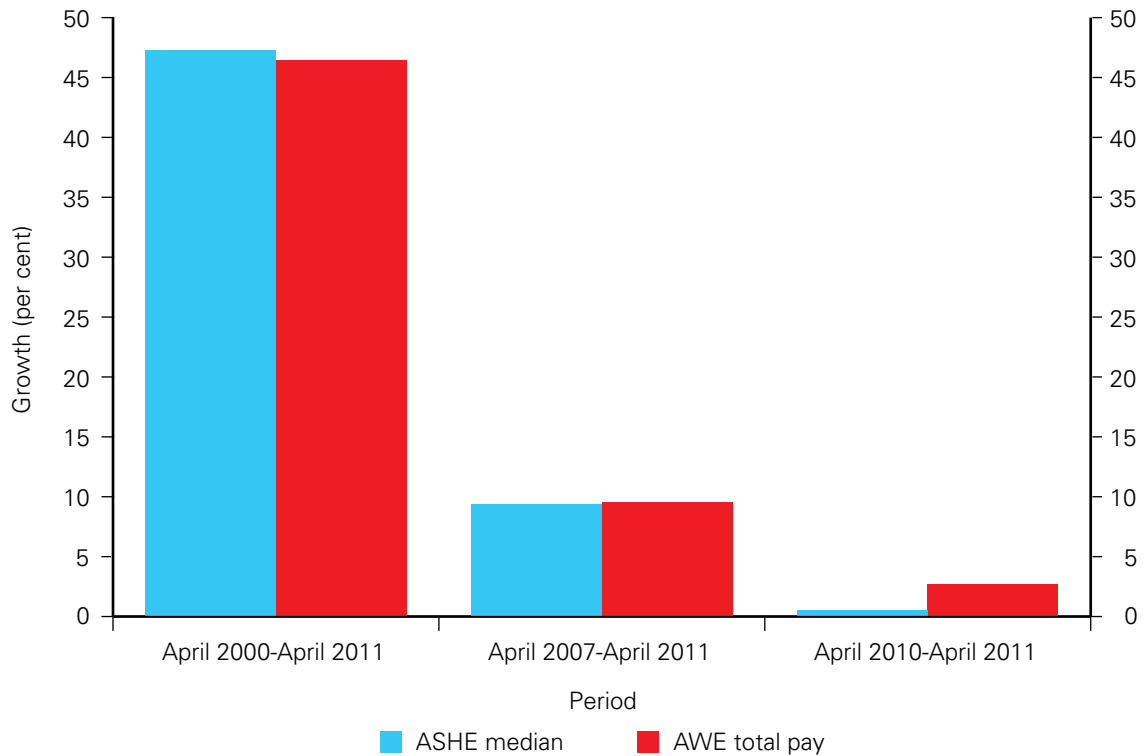


Source: LPC estimates based on ONS data, AEI including bonuses (LNMQ), 1999, AWE total pay (KAB9), 2000-2011, CPI (D7BT), 1999-2011, and RPI (CHAW), 1999-2011, monthly; and nominal GDP (YBHA), 1999-2011, quarterly, seasonally adjusted (AWE, AEI and GDP only), UK (GB for AWE and AEI).
 Note: The AWE series began in January 2000 and the AEI series ended in July 2010. Our earnings series is estimated using AEI (including bonuses) from April 1999-January 2000 and AWE (total pay) from January 2000-October 2011.

2.22 However, most of the real and relative increases in the minimum wage occurred as a result of the comparatively large upratings from October 2001-October 2006. Since that time, the adult rate of the minimum wage has risen more or less in line with average earnings but has lagged price increases. The minimum wage increased by 13.6 per cent between October 2006 and October 2011. This compares with increases of 13.2 per cent in average earnings and higher rises of 17.2 per cent in CPI and 18.8 per cent in RPI.

2.23 Between April 2000 and April 2011, as shown in Figure 2.6, average earnings grew by around 47 per cent whether measured using AWE total pay or median hourly earnings from ASHE. In more recent years (between April 2007 and April 2011), the growth in ASHE median hourly earnings (9.4 per cent) has also matched the growth in AWE (9.5 per cent). However, in April 2011, the average and median hourly earnings growth in ASHE was considerably lower (0.9 per cent and 0.4 per cent respectively) than the growth in AWE (2.0 per cent).

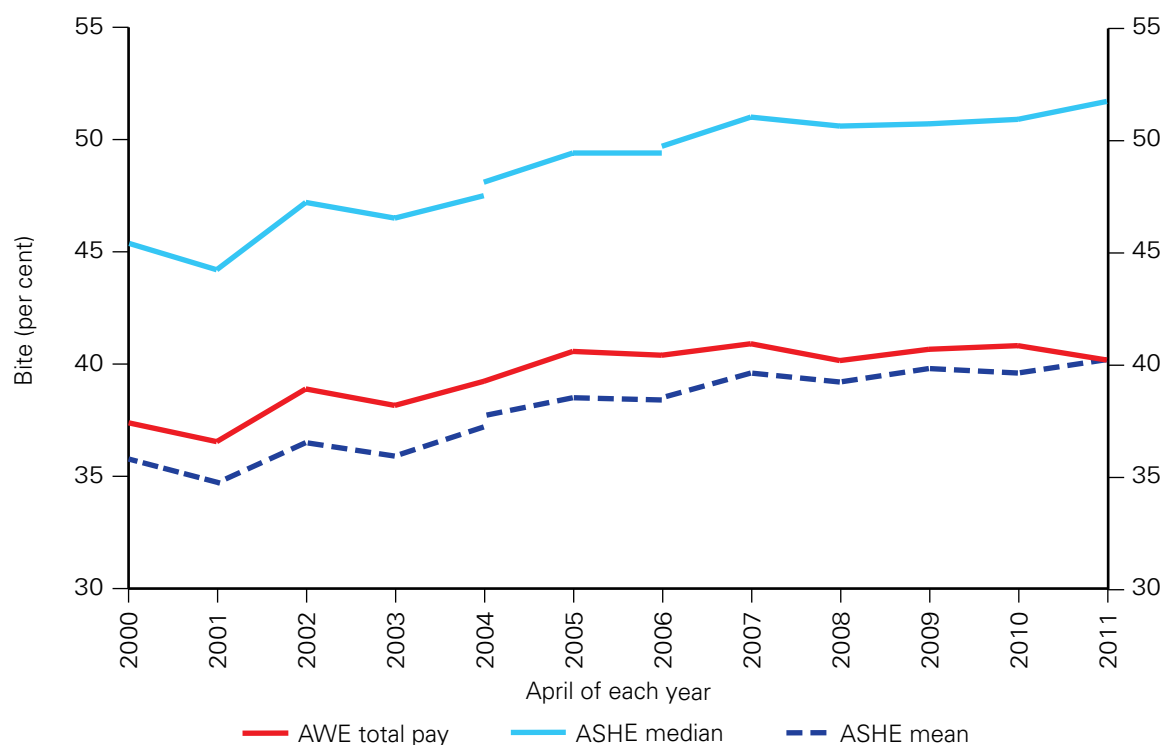
Figure 2.6: Increases in Median Pay, UK, and Average Weekly Pay, GB, 2000-2011



Source: LPC estimates based on ONS data, AWE total pay (KAB9), monthly, seasonally adjusted, GB, 2000-2011, and ASHE: without supplementary information, April 2000-2004; with supplementary information, April 2004-2006; and 2007 methodology, April 2006-2011, standard weights, including those not on adult rates of pay, UK.

2.24 Whether measuring the bite of the minimum wage (its value relative to the median or the mean) against AWE or ASHE, Figure 2.7 shows a similar pattern. The bite of the minimum wage increased between its introduction in 1999 and 2007 and remained roughly flat between 2007 and 2010. However, in 2011, the bite measured against AWE fell but it increased against both the mean and median ASHE measures. (Factors which may explain divergence between ASHE and AWE are discussed at paragraph 1.29 above.)

Figure 2.7: Bite of the Adult National Minimum Wage Using Different Earnings Measures, GB and UK, 2000-2011



Source: LPC estimates based on ONS data, AWE total pay (KAB9), GB, average actual weekly hours of work (YBUV), UK, monthly, seasonally adjusted, 2000-2011, and ASHE: without supplementary information, April 2000-2004; with supplementary information, April 2004-2006; and 2007 methodology, April 2006-2011, standard weights, including those not on adult rates of pay, UK.

- 2.25** Table 2.1 shows a similar picture with regards to the bite of the minimum wage across the whole of the ASHE hourly earnings distribution, such as the lowest decile, the lowest quartile, the median or the mean. Between the introduction of the minimum wage in 1999 and 2007, the bite at the median increased from about 46 per cent to 51 per cent. From 2007 to 2010, the bite remained just under 51 per cent, before increasing to 51.7 per cent in 2011.
- 2.26** The bite compared with other points on the distribution follow a similar pattern, increasing markedly between 1999 and 2007, then remaining stable between 2007 and 2010. According to ASHE, average hourly earnings in the UK increased by just 0.9 per cent between 2010 and 2011. This was much lower than the increase in the minimum wage (2.2 per cent). Thus, the bite at the mean has increased in 2011. The increases in the bite in 2011 have occurred across the whole of the earnings distribution but they have been greater at the bottom end of the distribution.

Table 2.1: Bite of the Adult National Minimum Wage at Various Points on the Earnings Distribution for Those Aged 22 and Over, UK, 1999-2011

	Data year (April)	Adult NMW (£)	Adult minimum wage as % of					
			Lowest decile	Lowest quartile	Median	Mean	Upper quartile	Upper decile
ASHE without supplementary information	1999	3.60	83.9	65.1	45.7	36.6	30.4	21.1
	2000	3.60	81.2	64.2	45.4	35.7	29.8	20.6
	2001	3.70	80.3	63.0	44.2	34.7	29.0	19.9
	2002	4.10	85.2	67.5	47.2	36.5	30.8	21.0
	2003	4.20	82.4	65.8	46.5	35.9	30.5	20.8
	2004	4.50	84.9	67.6	47.5	37.2	31.3	21.4
ASHE with supplementary information	2004	4.50	85.6	68.3	48.1	37.7	31.6	21.7
	2005	4.85	88.0	69.9	49.4	38.5	32.3	22.1
	2006	5.05	87.5	69.9	49.4	38.4	32.3	22.1
ASHE 2007 methodology	2006	5.05	87.5	70.0	49.7	38.5	32.5	22.3
	2007	5.35	89.2	71.7	51.0	39.6	33.6	22.9
	2008	5.52	89.7	71.6	50.6	39.2	33.2	22.8
	2009	5.73	89.6	71.7	50.7	39.8	33.3	22.9
	2010	5.80	89.7	71.9	50.9	39.6	33.2	22.9
	2011	5.93	91.2	73.4	51.7	40.2	33.9	23.2

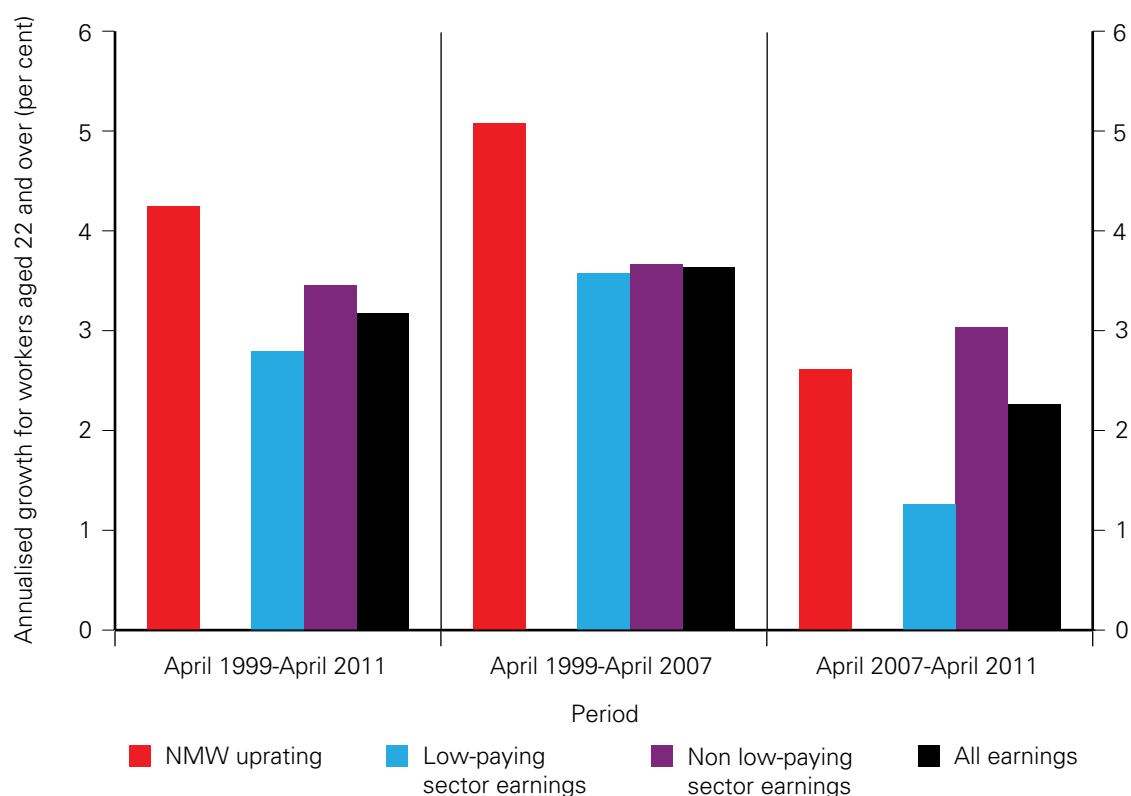
Source: LPC estimates based on ASHE: without supplementary information, April 1999-2004; with supplementary information, April 2004-2006; and 2007 methodology, April 2006-2011, standard weights, including those not on adult rates of pay, UK.

Note: Direct comparisons before and after 2004, and before and after 2006, should be made with care due to changes in the data series.

2.27 The bite in the low-paying sectors, and in small and medium-sized firms, is much greater than in the economy as a whole. In contrast to the pattern observed above, the bite in the low-paying sectors and in small, especially micro, firms continued to increase between 2007 and 2010. The bite among the low-paying sectors has increased further in 2011.

2.28 Figure 2.8 shows that between 1999 and 2011 the NMW for workers aged 22 and over increased on average by just over 4 per cent each year, compared with earnings growth of about 3 per cent in the low-paying sectors, and 3.6 per cent in the non low-paying sectors. Examining annualised earnings growth before and after the onset of the recession, we can see that between 1999 and 2007 there was very little difference between the low-paying and non low-paying sectors, although both were over 1 percentage point below the annual increase in the NMW. However, since 2007 annual earnings growth in the non low-paying sectors has been almost 2 percentage points a year higher than in the low-paying sectors.

Figure 2.8: Annualised Growth in the Adult National Minimum Wage and Median Earnings for Those Aged 22 and Over, by Sector, UK, 1999-2011

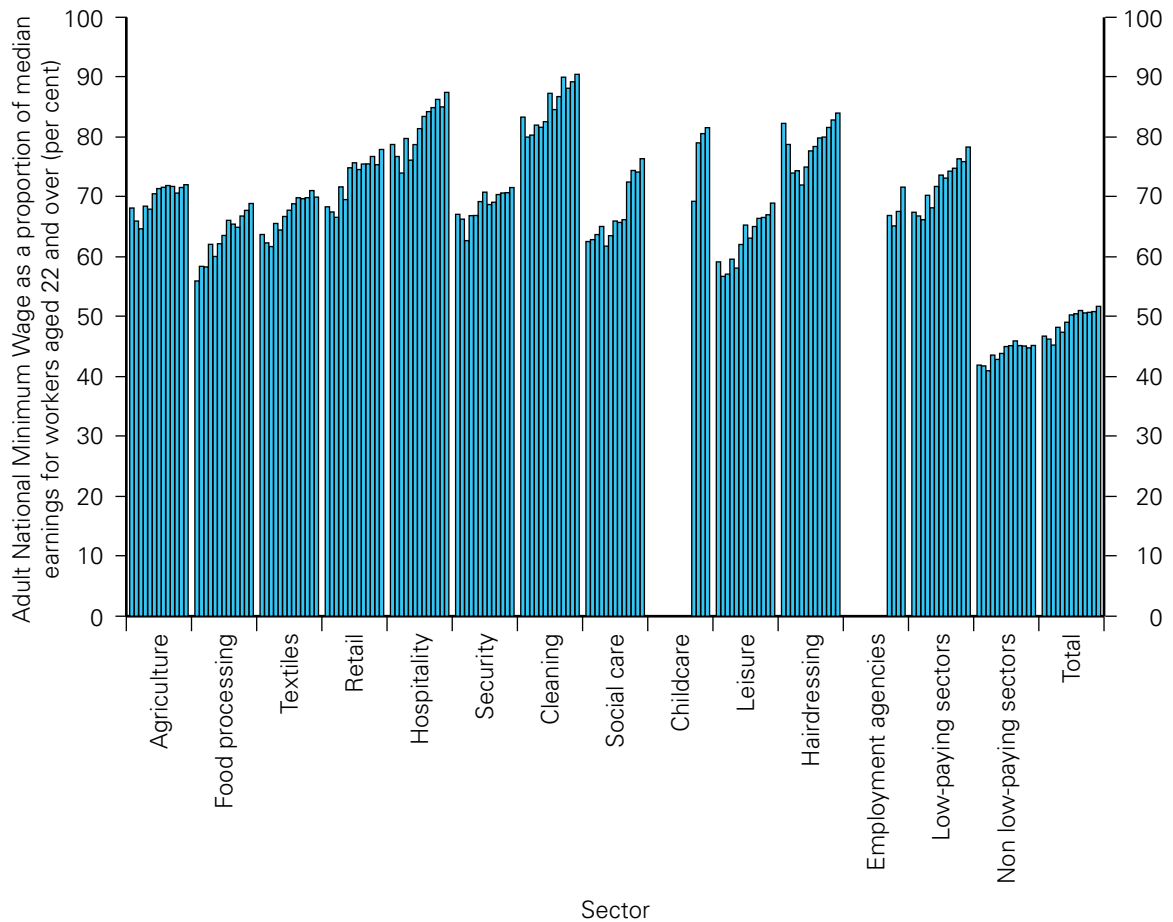


Source: LPC estimates based on ASHE: without supplementary information, April 1999-2004; with supplementary information, April 2004-2006; and 2007 methodology, April 2006-2011, standard weights, including those not on adult rates of pay, UK.

2.29 This marked difference in earnings growth has led to a divergence in the bite between the low-paying sectors and the non low-paying sectors. Since 2007, earnings growth in the low-paying sectors has been 1.3 percentage points lower than the annual increase in the NMW, so the bite has increased from 74.3 per cent in 2007 to 78.3 per cent in 2011. In contrast, annual earnings growth since 2007 in the non low-paying sectors has been 0.4 percentage points higher than the annual increase in the NMW. Consequently the bite over this period fell from 46.0 per cent in 2007 to 45.2 per cent in 2011.

2.30 Figure 2.9 shows that for workers aged 22 and over, the bite in the low-paying sectors has risen from 67.4 per cent in 1999 to 78.3 per cent in 2011. After a fall in 2010, the bite for the low-paying sectors increased by 2.4 percentage points in 2011 and re-established its upward trajectory. In contrast, the bite for the non low-paying sectors has increased more slowly over the period, rising from 41.9 per cent in 1999 to 45.2 per cent in 2011, below its level in 2007.

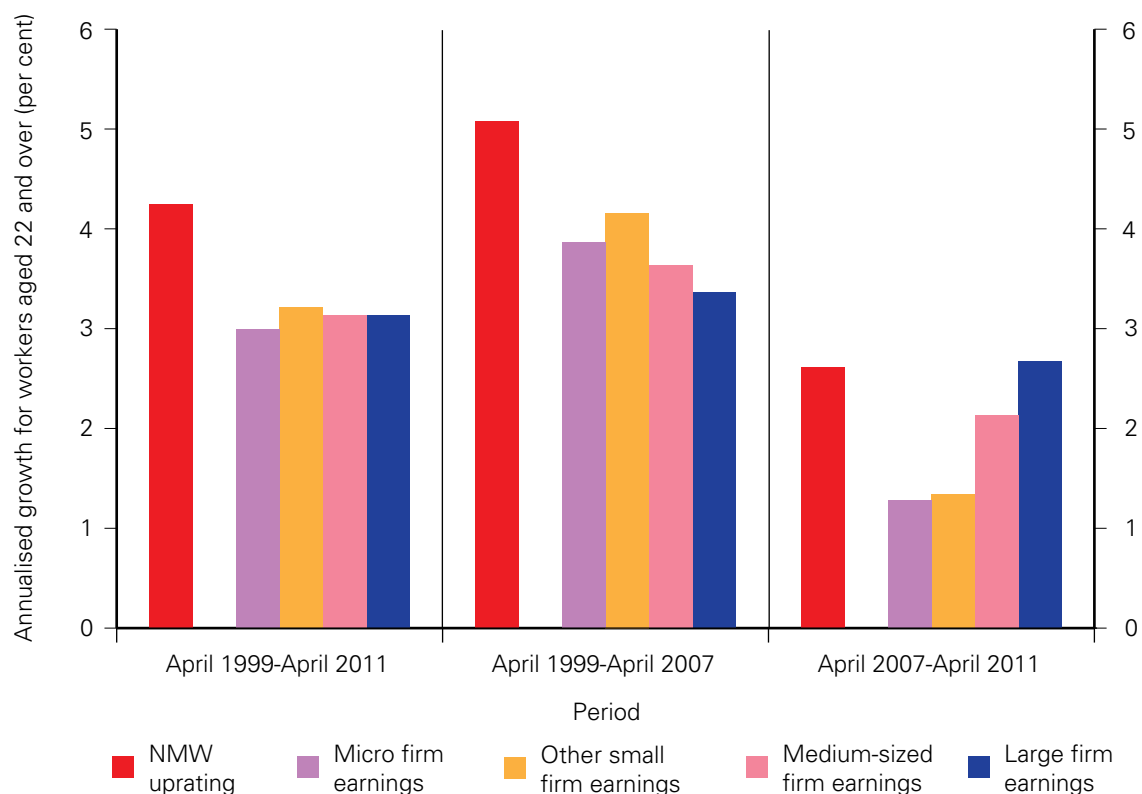
Figure 2.9: Bite of the Adult National Minimum Wage for Workers Aged 22 and Over, by Low-paying Sector, UK, 1999-2011



Source: LPC estimates based on ASHE: without supplementary information, April 1999-2003; with supplementary information, April 2004-2005; and 2007 methodology, April 2006-2011, standard weights, including those not on adult rates of pay, UK. Note: Definitions for the low-paying sectors are based on Standard Industrial Classification (SIC) codes. Data from 1999-2007 are based on SIC 2003 codes. Data from 2008-2011 are based on SIC 2007 codes. Because of this change in methodology direct comparisons before and after 2007 should be made with care.

- 2.31** Within the low-paying sectors there is some variation in the level and trend of the bite over time, but the bite has broadly increased year-on-year in every low-paying sector. In 2011, the cleaning sector had a bite of over 90 per cent, and a further three sectors, hairdressing, childcare and hospitality had bites of over 80 per cent.
- 2.32** Figure 2.10 shows a similar story by firm size. Over the whole period from 1999 to 2011, firms of all sizes have seen broadly the same annualised earnings growth of about 3 per cent. Between 1999 and 2007, micro and other small firms saw slightly higher earnings growth compared to medium and large firms. However, since 2007, micro and other small firms have seen a much lower annual growth in earnings, compared with both larger firms and the uprating in the NMW. This has increased the bite for smaller firms by more than for larger firms in recent years.

Figure 2.10: Annualised Growth in the Adult National Minimum Wage and Median Earnings for Those Aged 22 and Over, by Firm Size, UK, 1999-2011

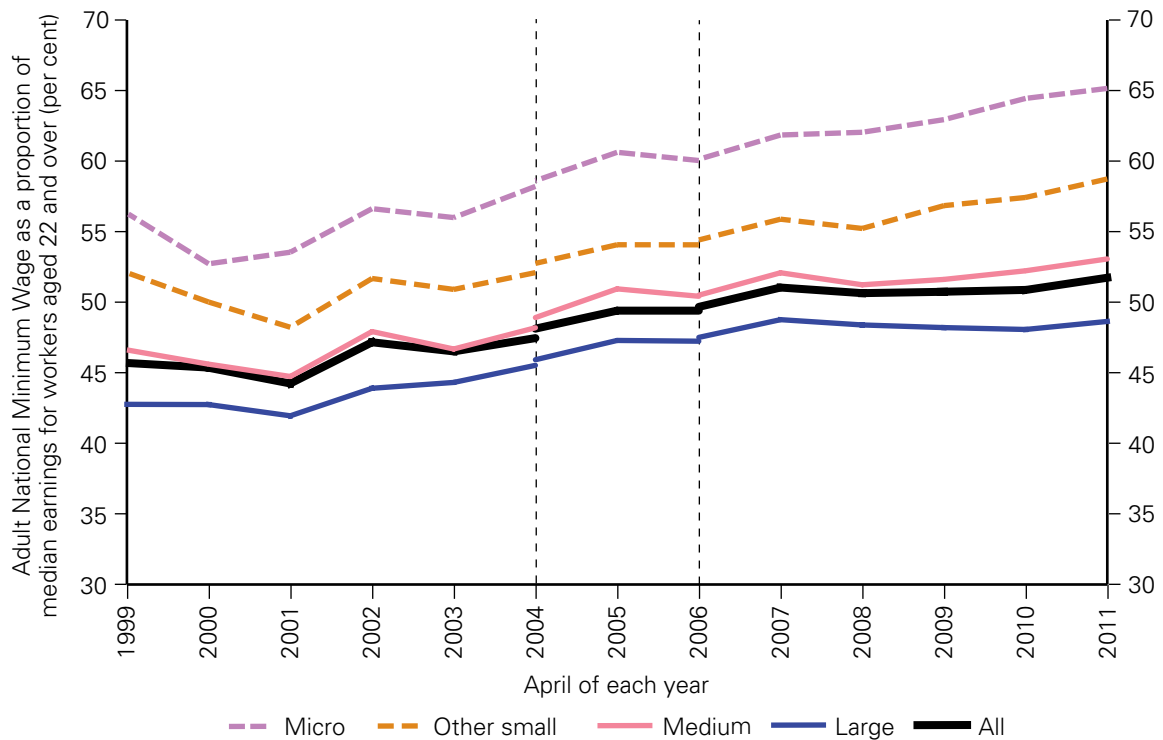


Source: LPC estimates based on ASHE: without supplementary information, April 1999-2004; with supplementary information, April 2004-2006; and 2007 methodology, April 2006-2011, standard weights, including those not on adult rates of pay, UK.

2.33 Figure 2.11 shows that the bite for workers aged 22 and over rose across firms of all sizes between 2010 and 2011. The bite for large firms rose by the smallest amount in 2011, by 0.6 percentage points to 48.6 per cent. But it remains just below the bite observed in 2007 (48.8 per cent).

2.34 Micro firms had the highest bite in 2011, 65.2 per cent, following a steady rise since 2000, but other small firms saw the largest increase: at 1.3 percentage points, taking the bite to 58.7 per cent, and continuing the general upward trend seen since 2001. Medium-sized firms saw a 0.8 percentage point increase in the bite from 2010, increasing the bite at the median to 53.1 per cent, again continuing the upward trend observed since 2001.

Figure 2.11: Bite of the Adult National Minimum Wage at the Median for Those Aged 22 and Over, by Firm Size, UK, 1999-2011



Source: LPC estimates based on ASHE: without supplementary information, April 1999-2004; with supplementary information, April 2004-2006; and 2007 methodology, April 2006-2011, standard weights, including those not on adult rates of pay, UK.

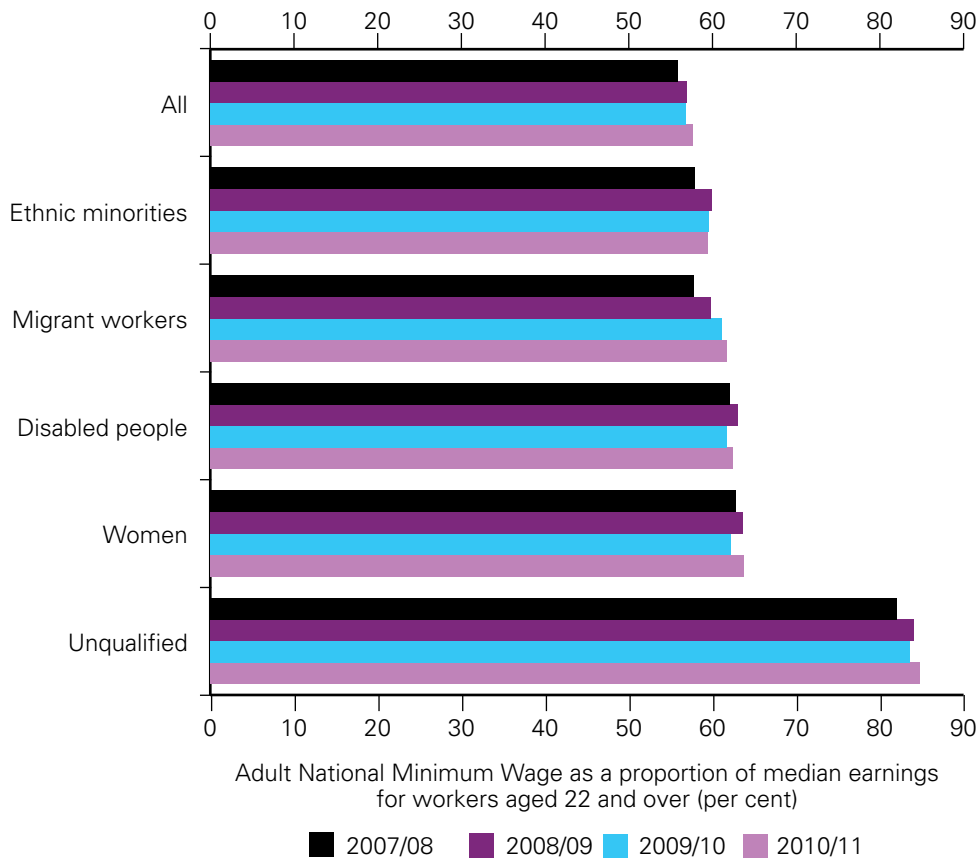
Notes:

- a. Direct comparisons before and after 2004, and before and after 2006, should be made with care due to changes in the data series.
- b. There were fewer responses to the question on size of firm in the 2002 ASHE than in other years.

2.35 Turning to low-paid workers, we observe a similar picture. In order to look at specific groups of workers, we need to use the LFS earnings data. For those of working age, the bite at the median is 58 per cent and 94 per cent at the lowest decile. These bites are higher than those estimated using ASHE (52 per cent and 91 per cent respectively). Figure 2.12 shows that the bite is highest for those with no qualifications (84 per cent). Women, disabled people, migrant workers and ethnic minorities all have a higher bite than the working age population. Most groups saw their bite rise between 2010 and 2011, having seen it fall slightly between 2009 and 2010. Ethnic minorities, however, saw their bite fall between 2010 and 2011, while the bite for migrant workers has increased every year since 2008. However, grouping all ethnic minorities together hides variation between them. The bite at the median for Indians (53 per cent) is unchanged from 2010 and lower than the bite for white people (57 per cent), whereas for Bangladeshis the bite is significantly higher (78 per cent) but has fallen since 2010.

National Minimum Wage

Figure 2.12: Bite of the Adult National Minimum Wage at the Median for Those Aged 22 and Over, by Groups of Workers, UK, 2007/08-2010/11

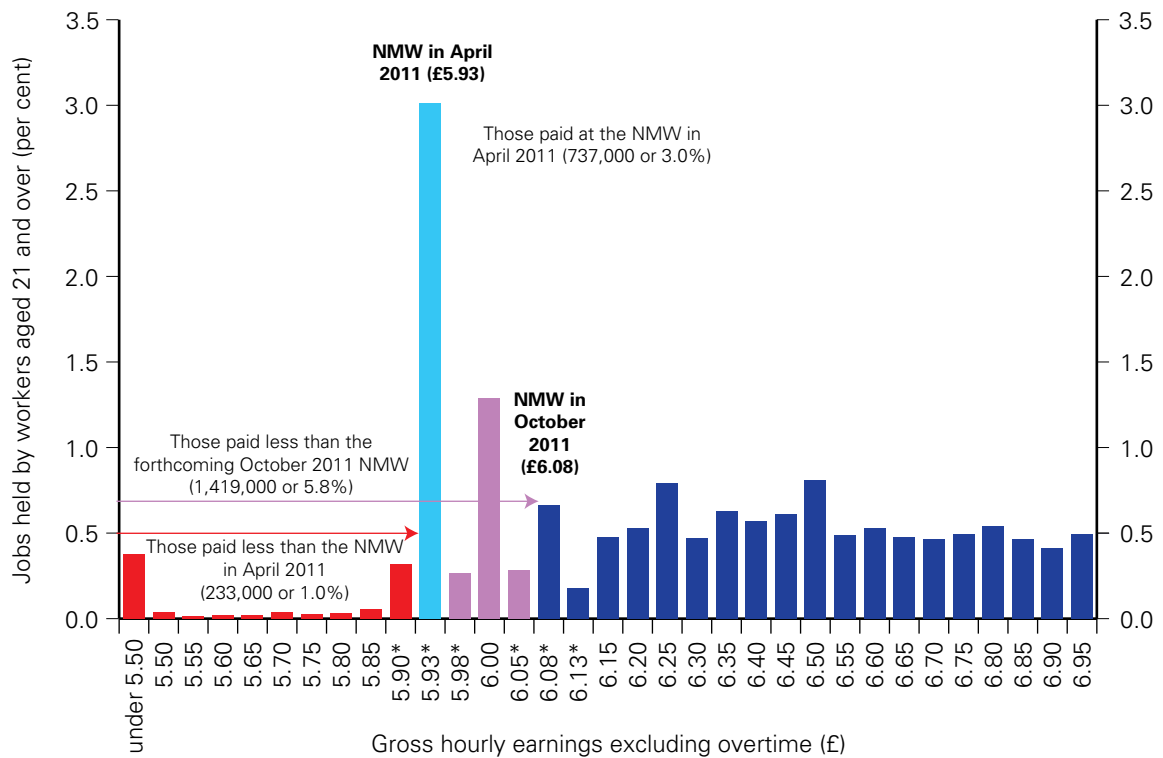


Source: LPC estimates based on LFS Microdata, income weights, quarterly, four-quarter averages, UK, Q4 2007-Q3 2011.

Earnings Distributions

2.36 The impact of the minimum wage can also clearly be seen in Figure 2.13, which shows a spike in the hourly earnings distribution at £5.93, the adult rate effective in April 2011. Around 3 per cent, or nearly 750,000 workers, were paid at that rate. A further 1 per cent (or 233,000) were paid less than the minimum wage. This is not necessarily evidence of non-compliance. Some employers can legitimately pay workers less than the minimum wage. These include those who provide accommodation, employ apprentices, or utilise the Fair Piece Rate system. In total, 1.4 million workers (or 5.8 per cent of the workforce) were paid below the then forthcoming minimum wage rate of £6.08 an hour.

Figure 2.13: Hourly Earnings Distribution for Employees Aged 21 and Over, by Five Pence Band, UK, 2011



Source: LPC estimates based on ASHE, 2007 methodology, low-pay weights, including those not on adult rates of pay, UK, April 2011. Note: * Five pence bands except where stated otherwise (bands labelled by minimum pay amount).

- 2.37** The trends over time in these numbers are shown in Table 2.2. For consistency with previous years, the figures in the table are restricted to those aged 22 and over. Further, the pay band width at the minimum wage is ten pence as there are concerns regarding the quality of precise estimates prior to 2004. Since 2003 the numbers paid below the minimum wage have consistently been around 0.9-1.0 per cent (or 200,000-240,000).
- 2.38** The numbers paid at the minimum wage tend to increase in line with the increase in the minimum wage. For example, the large jump in 2002 was a consequence of the large uprating in October 2001. However, except for that large uprating, the numbers paid at the minimum wage were fairly stable in the period from 2001 to 2006, ranging from around 2.0-2.5 per cent (400,000-550,000). There was then a step increase to around 3.0 per cent (700,000-730,000) between 2007 and 2010. There was then a further large increase in the latest data, for April 2011. The numbers now paid at the minimum wage are approaching 1 million (or 4.0 per cent of the employee workforce) using the ten pence band definition.
- 2.39** The numbers paid less than the forthcoming rate are also in part dependent on the extent of the forthcoming increase in the minimum wage. From 2004 to 2008, just over 5 per cent or around 1.2 million workers were paid less than the forthcoming rate. The smaller increases recommended during and immediately after the recession led this to fall below 1 million in 2009 and 2010. However, these numbers have risen back to almost 1.3 million as a result of the 2.5 per cent October 2011 uprating. The number is particularly high in 2011 as the uprating in the adult rate of the NMW spans the threshold of £6.00, which is a commonly paid hourly wage, received by over 211,000 adults aged 21 or over in April 2011.

National Minimum Wage

Table 2.2: Jobs Held by Those Aged 22 and Over, Paid At and Below the Existing National Minimum Wage and the Forthcoming National Minimum Wage, UK, 1999-2011

	Data year (April)	Adult minimum wage rate in April	Jobs held by adults paying less than the adult rate in April		Jobs held by adults paying the adult rate (ten pence band) in April		Forthcoming October adult minimum wage rate	Jobs held by adults in April paying less than the forthcoming October rate	
		£	000s	%	000s	%	£	000s	%
ASHE without supplementary information	1999	3.60	460	2.1	723	3.3	3.60	458	2.1
	2000	3.60	190	0.9	551	2.5	3.70	746	3.3
	2001	3.70	210	0.9	394	1.8	4.10	1,326	5.9
	2002	4.10	290	1.3	630	2.8	4.20	920	4.1
	2003	4.20	210	0.9	445	2.0	4.50	1,022	4.5
	2004	4.50	230	1.0	558	2.5	4.85	1,399	6.2
ASHE with supplementary information	2004	4.50	233	1.0	408	1.8	4.85	1,209	5.3
	2005	4.85	233	1.0	484	2.1	5.05	1,147	5.0
	2006	5.05	239	1.0	544	2.4	5.35	1,289	5.6
ASHE 2007 methodology	2006	5.05	238	1.0	544	2.4	5.35	1,289	5.6
	2007	5.35	231	1.0	696	2.9	5.52	1,215	5.1
	2008	5.52	212	0.9	731	3.1	5.73	1,245	5.2
	2009	5.73	181	0.8	726	3.1	5.80	846	3.6
	2010	5.80	203	0.9	698	2.9	5.93	981	4.1
	2011	5.93	208	0.9	971	4.0	6.08	1,297	5.4

Source: ONS central estimates using ASHE without supplementary information and LFS, UK, 1999-2004; LPC estimates based on ASHE: with supplementary information, April 2004-2006; and 2007 methodology, April 2006-2011, low-pay weights, including those not on adult rates of pay, UK.

Notes:

- Prior to 2004, all our analyses were conducted in ten pence pay bands using the ONS central estimate methodology. In contrast to elsewhere in this report, where five pence pay bands are used, we use ten pence pay bands in this table.
- Direct comparisons before and after 2004, and before and after 2006, should be made with care due to changes in the data series.

2.40 Not surprisingly, as Table 2.3 shows, there are differences by low-paying sector and size of firm. Across the economy as a whole, 3.7 per cent of jobs were paid at or below the minimum wage in April 2011 (based on a five pence band). For the low-paying sectors, more than 10 per cent of jobs were paid at or below the minimum wage, ranging from 5.2 per cent in security through 11.0 per cent in childcare, to 21.7 per cent in cleaning and 21.8 per cent in hospitality.

2.41 By size of firm the proportion paid at or below the minimum wage ranged from 2.9 per cent in large firms to 8.3 per cent in micro firms. These proportions were in general slightly higher in 2011 than in 2009. The smaller rise in the minimum wage in October 2009 had generally led them to fall a little in 2010.

Table 2.3: Proportion of Jobs Held by Those Aged 22 and Over, Paid At or Below the Adult National Minimum Wage, by Sector and Firm Size, UK, 2009-2011

Per cent Industry/Occupation/ Size of firm	April 2009			April 2010			April 2011		
	Paid at or below £5.73 ^a	Paid below £5.80	Paid below £6.50	Paid at or below £5.80 ^a	Paid below £5.93	Paid below £6.50	Paid at or below £5.93 ^a	Paid below £6.08	Paid below £6.50
Retail	7.7	8.3	33.7	6.8	9.0	29.4	7.0	11.4	27.3
Hospitality	23.3	24.0	46.8	20.3	23.6	43.2	21.8	29.8	42.1
Leisure, travel & sport	9.0	9.3	24.8	6.8	9.5	20.5	6.9	12.5	21.6
Cleaning	21.9	22.4	48.3	23.4	26.8	50.3	21.7	32.9	46.5
Security	4.4	4.5	17.1	4.8	5.2	15.7	5.2	7.4	13.0
Social care	6.2	6.4	26.0	6.4	8.9	24.1	7.9	11.9	23.6
Childcare	10.3	11.0	34.0	9.4	12.9	35.4	11.0	17.5	32.6
Agriculture	4.7	5.0	18.3	5.1	5.9	16.6	5.7	8.1	14.7
Textiles & clothing	8.3	8.3	23.1	10.4	13.0	23.5	8.7	12.6	20.2
Hairdressing	15.3	15.5	37.5	18.5	20.1	36.3	16.4	26.2	35.3
Employment agencies	10.3	10.5	22.7	11.0	12.7	22.9	14.0	18.7	25.0
Food processing	5.7	6.3	21.7	5.6	7.1	20.3	5.5	7.2	16.9
Office work ^b	4.4	4.6	17.6	3.7	4.8	15.3	5.9	9.2	16.9
All low-paying industries	10.5	11.0	32.4	9.9	12.2	29.9	10.7	15.9	28.6
Micro	7.9	8.1	20.2	8.4	9.7	20.5	8.3	13.0	19.2
Other small	4.8	5.0	13.6	4.3	5.2	12.1	4.7	7.3	12.4
Medium	4.0	4.2	11.6	4.0	4.9	11.1	4.3	6.1	10.6
Large	2.6	2.8	10.1	2.5	3.2	9.2	2.9	4.1	8.7
Whole economy	3.4	3.6	11.4	3.3	4.1	10.6	3.7	5.4	10.1

Source: LPC estimates based on ASHE, 2007 methodology, low-pay weights, including those not on adult rates of pay, UK, April 2009-2011.

Notes:

a. Based on a five pence band.

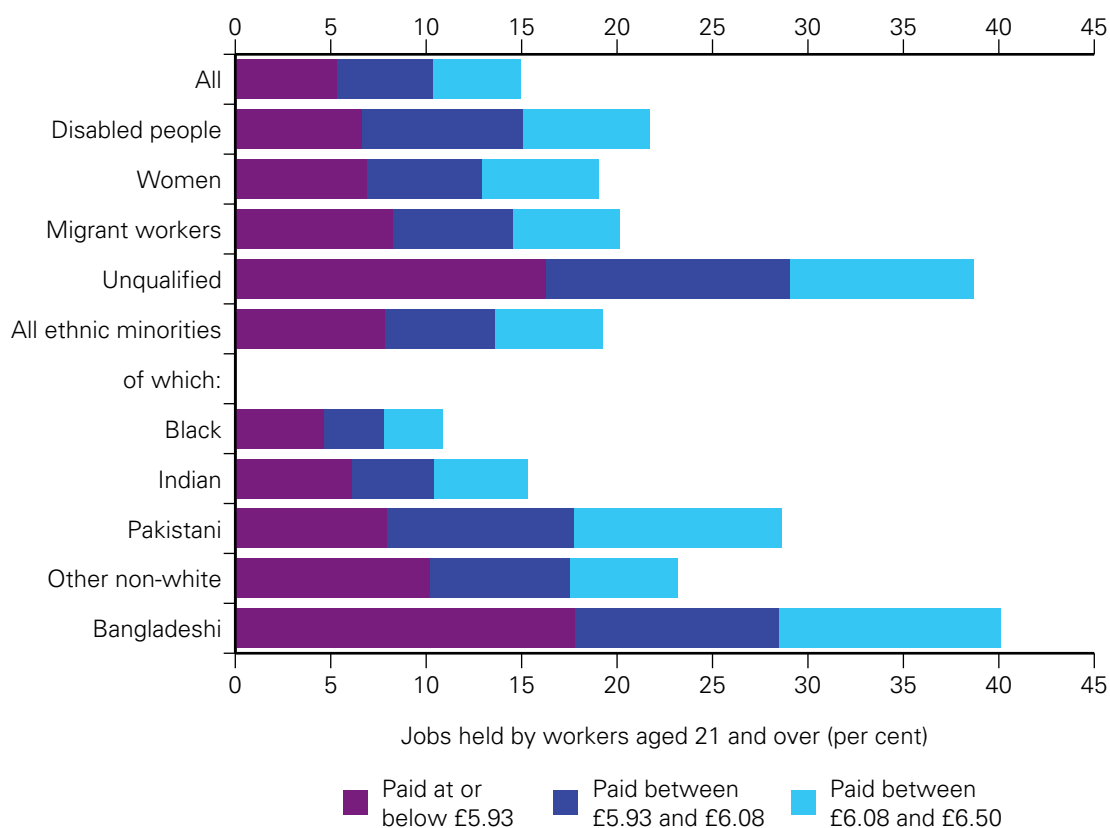
b. This sector is defined using Standard Occupational Classifications (SOC) 2000. The other sectors are based on SIC 2007.

2.42 Table 2.3 also shows the proportions paid below the then forthcoming minimum wage across low-paying sectors and by size of firm. These show a considerable increase for every sector and firm size. In April 2011, 5.4 per cent of jobs in the economy were paid less than the then forthcoming minimum wage (£6.08 an hour), compared with 4.1 per cent in 2010 and just 3.6 per cent in 2009. Across the low-paying industries as a whole, this proportion had increased from 11.0 per cent in 2009 to 15.9 per cent in 2011. All low-paying sectors experienced an increase in coverage of the forthcoming rate but it was most noticeable in cleaning (up from 22.4 per cent to 32.9 per cent), hairdressing (up from 15.5 per cent to 26.2 per cent), and employment agencies (up from 10.5 per cent to 18.7 per cent).

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- 2.43** Around 47 per cent of jobs in the cleaning industry, 42 per cent in hospitality, 35 per cent in hairdressing and 33 per cent in childcare were paid less than £6.50 an hour in April 2011, while fewer than 17 per cent were paid less than £6.50 an hour in food processing, agriculture, security and office work. Around 19 per cent of jobs in micro firms were paid less than £6.50 an hour, compared with fewer than 9 per cent in large firms. This suggests that differentials in many low-paying industries and in micro firms are already quite narrow.
- 2.44** There are also differences by worker characteristic. We can see from Figure 2.14 that certain groups of workers are more likely to be low-paid. Workers with no qualifications were nearly three times more likely to be paid below the forthcoming minimum wage than the overall working age population.
- 2.45** Again there is substantial variation among ethnic groups. Around 29 per cent of Bangladeshi workers were paid below the forthcoming minimum wage in April 2011, and 40 per cent were paid below £6.50. Only 8 per cent of black workers were paid below the forthcoming minimum wage, and they were less likely to be paid below £6.50 than the overall working population (11 per cent compared with 15 per cent).

Figure 2.14: Proportion of Jobs Held by Those Aged 21 and Over, by Pay Band and Groups of Workers, UK, 2011



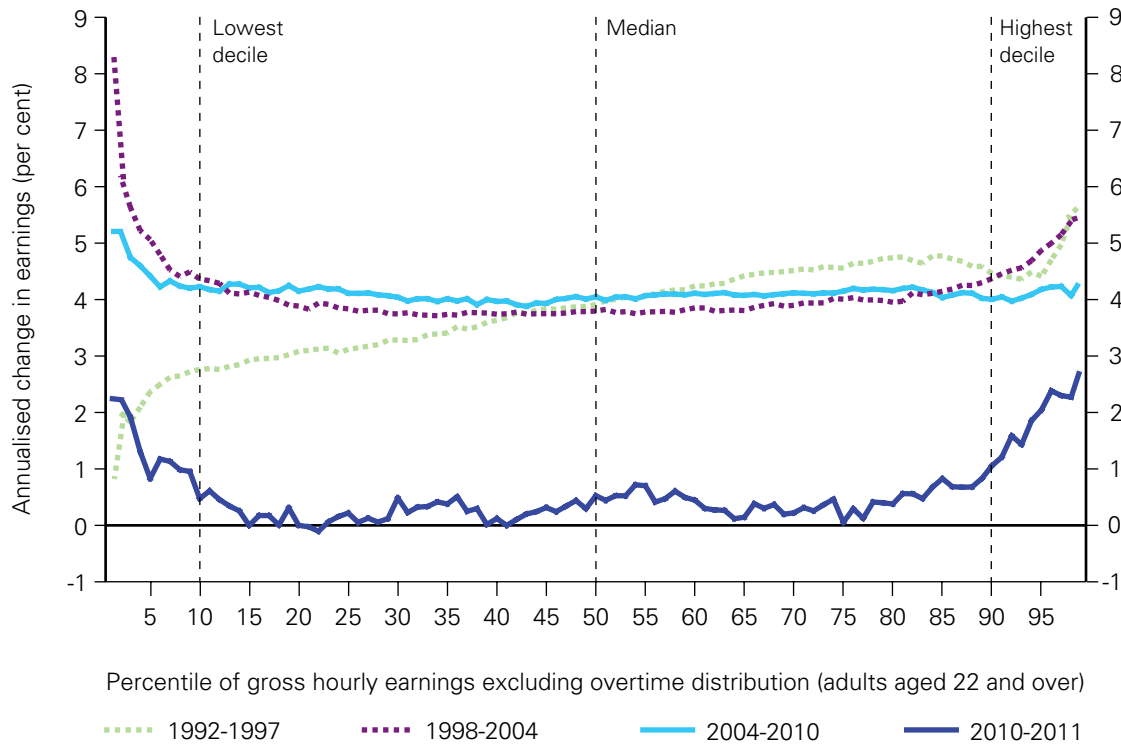
Source: LPC estimates based on LFS Microdata, income weights, quarterly, not seasonally adjusted, UK, Q2 2011.

Note: This analysis covers both main and second jobs held by employees.

- 2.46** When we rank employees by their earnings, split them into 100 equally sized groups (percentiles), and order them from the lowest paid to the highest paid, Figure 2.15 shows that before the introduction of the minimum wage those at the lowest end of the hourly earnings distribution had the lowest wage rises. Between 1992 and 1997, those in the

bottom decile had increases in line with price inflation, whereas those in the upper part of the distribution had wage rises greater than those at the median (and above average wage increases). Since 1998, those at the bottom of the earnings distribution have had much higher increases than those in the middle of the distribution. However, the increases at the bottom have moderated significantly since 2004.

Figure 2.15: Annualised Growth in Hourly Earnings for Employees Aged 22 and Over, by Percentile, UK, 1992-2011



Source: LPC estimates based on New Earnings Survey (NES), April 1992-1997, and ASHE: without supplementary information, April 1999-2004; with supplementary information, April 2004-2006; and 2007 methodology, April 2006-2011, standard weights (NES unweighted), including those not on adult rates of pay, UK.

Note: Direct comparisons before and after 1997, before and after 2004, and before and after 2006, should be made with care due to changes in the data series.

2.47 Over the year to April 2011, those employees in the bottom decile had wage rises greater than those at the median. However, those between the 15th and 40th percentiles experienced little or no growth in wages between April 2010 and April 2011. Those at the top experienced the largest increases.

Pay Gaps

2.48 We saw in Figures 2.4 and 2.14 that particular groups of workers (women, disabled people, ethnic minorities, migrants, and those with no qualifications) are more likely to be in minimum wage jobs. The extent of the difference in pay between these groups and their counterparts who are less likely to be in minimum wage jobs can be measured by looking at pay gaps (the proportional difference between the earnings of two groups). We tend to focus on the median pay gaps for full-time workers, as they allow closer comparison of like-with-like and are less affected than the mean by outliers in the earnings distribution.

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2.49 Table 2.4 shows that the median gender pay gap has gradually closed from nearly 16 per cent before the introduction of the minimum wage to just over 8 per cent in April 2011. The gender pay gap at the lowest decile is smaller and has fallen by nearly two thirds over the same period. It is now just 4.7 per cent. In contrast, the gender pay gap at the upper decile has remained close to 20 per cent for the last 15 years.

Table 2.4: Hourly Gender Pay Gap of Full-time Workers Aged 22 and Over, UK, 1997-2011

	Data year (April)	£ per hour						Per cent		
		Men			Women			Gender pay gap		
		Lowest decile	Median	Upper decile	Lowest decile	Median	Upper decile	Lowest decile	Median	Upper decile
ASHE without supplementary information	1997	4.71	8.51	17.62	4.10	7.17	14.16	13.1	15.8	19.6
	1998	4.91	8.84	18.45	4.28	7.43	14.68	12.9	15.9	20.5
	1999	5.10	9.15	19.19	4.50	7.78	15.42	11.8	15.0	19.7
	2000	5.20	9.21	19.85	4.64	7.97	15.93	10.7	13.4	19.7
	2001	5.46	9.65	21.38	4.86	8.38	16.95	11.1	13.2	20.7
	2002	5.68	10.07	22.48	5.06	8.76	17.85	11.1	13.0	20.6
	2003	5.90	10.41	23.03	5.31	9.09	18.41	10.0	12.7	20.1
	2004	6.12	10.89	23.99	5.57	9.64	19.25	8.9	11.5	19.8
ASHE with supplementary information	2004	6.03	10.75	23.52	5.53	9.51	19.09	8.3	11.5	18.8
	2005	6.31	11.22	24.77	5.82	9.98	20.16	7.8	11.1	18.6
	2006	6.55	11.65	25.94	6.07	10.42	20.70	7.3	10.6	20.2
ASHE 2007 methodology	2006	6.50	11.56	25.76	6.00	10.26	20.49	7.7	11.2	20.5
	2007	6.80	12.02	26.75	6.27	10.72	21.26	7.8	10.8	20.5
	2008	7.00	12.56	27.93	6.49	11.13	21.91	7.3	11.4	21.6
	2009	7.28	13.01	28.72	6.75	11.59	22.84	7.3	10.9	20.5
	2010	7.32	13.00	28.89	6.88	11.89	23.32	6.0	8.6	19.3
	2011	7.31	13.13	29.39	6.96	12.04	23.57	4.7	8.3	19.8

Source: LPC estimates based on ASHE: without supplementary information, April 1997-2004; with supplementary information, April 2004-2006; and 2007 methodology, April 2006-2011, standard weights, including those not on adult rates of pay, UK.

Note: Direct comparisons before and after 2004, and before and after 2006, should be made with care due to changes in the data series.

2.50 Table 2.5 shows that the median pay gaps for ethnic minorities, migrant workers and disabled people are much lower than that for women, whereas the median pay gap for people with no qualifications is almost twice as high. These LFS-based calculations include all workers so are not comparable with the gender pay gaps shown in Table 2.4 which are for full-time workers only using ASHE. While the full-time median gender pay gap from ASHE has been falling, the gender pay gap from LFS rose in 2010/11. However, median pay gaps for disabled people, migrant workers, ethnic minorities and workers with no qualifications all fell in 2010/11.

Table 2.5: Hourly Pay Gaps for Particular Groups of Workers Aged 22 and Over, UK, 2007/08-2010/11

Per cent	Lowest decile				Median			
	2007/08	2008/09	2009/10	2010/11	2007/08	2008/09	2009/10	2010/11
Unqualified	9.5	9.4	8.9	8.1	34.4	35.3	34.9	34.6
Women	9.4	8.1	6.9	6.8	19.5	19.5	17.6	19.1
Disabled people	2.9	3.5	2.3	2.5	11.1	11.7	9.9	9.5
Migrant workers	3.3	3.5	4.9	4.8	3.9	5.5	8.2	7.8
Ethnic minorities	2.5	3.2	4.5	3.2	3.9	5.3	5.0	3.4
of which								
Indian	-1.2	-3.0	1.4	1.7	-10.6	-13.2	-6.7	-8.1
Other non-white	4.0	4.5	4.5	4.0	4.4	5.3	5.5	2.9
Black	0.0	1.3	4.0	0.7	2.2	8.9	3.3	4.3
Pakistani	7.2	7.6	7.6	5.6	24.3	22.1	26.8	18.0
Bangladeshi	8.3	7.6	7.6	6.4	24.8	24.3	31.8	26.6

Source: LPC estimates based on LFS Microdata, income weights, quarterly, not seasonally adjusted, UK, Q4 2007-Q3 2011.

- 2.51** There is considerable variation in the pay gaps among different ethnic groups. For ethnic minorities as a whole, the pay gap at both the lowest decile and the median were broadly similar to those observed previously. The median pay gap for workers of Indian ethnicity was negative and suggested that median pay for these workers was around 8 per cent higher than median pay for white workers. By contrast the median pay gaps for workers of Pakistani and Bangladeshi ethnicities were both positive and high (18 per cent and 27 per cent respectively).

Views on Pay Gaps

- 2.52** Some stakeholders were concerned at the level of the pay gap between certain groups. The Public and Commercial Services Union said the pay gap between highest and lowest earners had been widening for the last thirty years and was now at a level not seen since Victorian times. However, Unite said that the minimum wage had been a positive influence in helping to close the gender pay gap and believed that a further significant rise would have a beneficial impact on that gap. Similarly it noted the impact of the minimum wage on the pay gap for ethnic minorities and for those with disabilities, and that employment for those with disabilities had increased since the minimum wage was introduced.

Pay Settlements and Pay Structures

- 2.53** As well as investigating the impact of the minimum wage on individual earnings, we can also look at its effects on pay setting and pay structures. This requires the study of employer behaviour. In order to cope with minimum wage increases, employers may adjust their pay structures or try to reduce their non-wage labour costs.
- 2.54** We start by looking at pay settlements. There are no official data sources on pay settlements, so it is necessary to use data from four pay organisations – the manufacturers' organisation

(EEF), the Labour Research Department (LRD), Incomes Data Services (IDS) and XpertHR (formerly IRS). All four generally give a similar picture on pay awards across the economy. Using IDS data, we are able to break down pay settlements by low-paying sector. In general, as shown in Table 2.6, pay settlements in the low-paying sectors have tended to broadly track pay settlements in the whole economy. There have, however, been some differences across low-paying sectors, with firms in hospitality (hotels, restaurants, pubs and leisure) awarding higher pay settlements than those in retail or care services since 2008.

Table 2.6: Annual Median Pay Settlement, by Sector, UK, 2000-2011^a

Per cent	Whole economy	Low-paying sectors	Care services & housing	Children's nurseries	Hotels, restaurants, pubs & leisure	Retail
2000	3.0	3.0				
2001	3.2	3.0				
2002	3.0	2.8				
2003	3.0	3.0				
2004	3.0	3.0				
2005	3.2	3.0				
2006	3.0	3.0				
2007	3.5	3.0				
2008	3.5	3.0	3.0	3.0	3.2	3.0
2009	2.0	2.0	2.0	3.0	2.3	1.5
2010	2.0	2.0	1.0	2.5	2.0	2.0
2011	2.5	2.2	2.0	- ^b	2.6	2.0

Source: IDS (2011c).

Notes:

a. IDS did not disaggregate pay settlements by individual sector prior to 2008.

b. Sample size too small to produce estimate.

2.55 One of the features in pay settlements since the onset of the recession in 2008 has been the increase in the number of companies implementing pay freezes. Very few companies had frozen pay in the period from 1999-2008, but the proportion rose to around 40 per cent of all awards in the depths of recession. Few of these pay freezes were in the public sector. Pay freezes still accounted for around 10 per cent of pay awards in 2011, as they became more common in the public sector. However, few pay freezes have been in the low-paying sectors.

2.56 A feature of pay reviews that does appear to have been affected by the minimum wage is their timing. In 1999, when the minimum wage was introduced, fewer than 5 per cent of all pay reviews in the low-paying sectors and in the whole economy were in October. By 2010, that percentage had risen to nearly 20 per cent of all pay reviews in the low-paying sectors, while it had only risen to about 6 per cent in the economy as a whole. Other companies have also introduced two-stage awards, where the company retains its normal pay review date for the majority of its workforce but makes a supplementary award to its low-paid staff in October if necessary.

Research on Earnings and Pay

- 2.57** We have commissioned many research studies over the years that have investigated the pay setting behaviour of employers. Much of that research has been conducted by IDS using its database on pay settlements augmented by a series of surveys of low-paying sector employers. IDS (2011a) summarised this research. It concluded that there had been three phases of changed firm behaviour as a result of the minimum wage. Prior to the introduction of the minimum wage, many employers had anticipated its introduction and had already begun making changes to their pay structures. Many employers reduced the number of pay rates across geography and occupation. This limited the adjustments that needed to be made when the NMW was introduced.
- 2.58** Employers in the low-paying sectors increasingly adopted the minimum wage as the lowest wage rate and squeezed differentials between starter rates and established rates during the period of relatively high minimum wage increases between 2001 and 2006. Throughout that period, employers also removed allowances and premia (such as unsocial hours payments, overtime, shift premia and bonuses), particularly for new workers, as a way of absorbing increased wage costs. Non-wage benefits, such as holiday entitlement, pension provision, perks and staff discounts were also made less generous. These findings generally confirmed those of earlier studies of employer behaviour, such as Grimshaw and Carroll (2002) and Cronin and Thewlis (2004). In the years covering the recession and when minimum wage increases had been more moderate, 2007-2010, IDS (2011a) found evidence of some restoration of differentials and a widening in the gap between the lowest pay rates and the minimum wage in some, mainly large retailing, employers.
- 2.59** Econometric analysis has also been conducted to assess the impact of the minimum wage on earnings. It has chiefly looked at whether the minimum wage affects the wages of those paid above the minimum wage. These effects are known in the literature as spill-over effects. In the most comprehensive econometric study of spill-over effects conducted so far, covering the period up to 2007, Stewart (2009) explored three different methods to identify whether the minimum wage affected wages higher up the earnings distribution. His analysis of individual wage changes found little evidence of any effects. However, he found some evidence of more significant spill-overs when estimating wage distribution functions or using wage quantile regression analysis. He noted, however, that his findings were sensitive to the assumptions about how wages changed in the absence of a minimum wage (or a minimum wage increase). He concluded that spill-over effects were generally small and limited, typically reaching no further up the earnings distribution than the 5th percentile.
- 2.60** Using both individual and spatial data, Dickens, Riley and Wilkinson (2012) investigated the impact of the minimum wage on the earnings distribution. In their analysis of individuals using data from 1994-2010, they found that the minimum wage had led to significantly higher wage growth for low-paid workers and that this effect was particularly large upon introduction. They also found that wage differentials between minimum wage workers and those paid just above the NMW were restored somewhat during the recent recession years (2008-2010). Their spatial analysis found a large effect of the minimum wage on pay inequality across areas, as the minimum wage compressed wages at the bottom of the distribution, particularly in the period before the recession. Those areas with the lowest

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wages prior to the introduction of the minimum wage experienced the greatest falls in inequality over the period from 1998 to 2010. They concluded that the minimum wage had led to higher wage growth for low-paid workers and that this was particularly large upon its introduction. Evidence that the minimum wage had squeezed differentials at the bottom of the earnings distribution was also found by Dolton, Rosazza Bondibene and Wadsworth (2010).

- 2.61** This supports the findings from earlier work, such as Swaffield (2009) and Dolton, Lin, Makepeace and Tremayne (2011). Both these studies also noted that lower pay rises had been awarded to low-paid workers when minimum wage increases were lower than average earnings. Dickens, Riley and Wilkinson (2012) also found evidence that supports IDS in its view that wage differentials between minimum wage workers and those paid just above the NMW had been restored somewhat during and since the recession.
- 2.62** Butcher, Dickens and Manning (2009) had found clear evidence that inequality had been falling at the bottom of the wage distribution since the introduction of the minimum wage. Building on this analysis of the impact of the minimum wage on the wage distribution, Butcher, Dickens and Manning (2012) again found modest spill-over effects for the UK as a whole over the period between 1998 and 2010. The minimum wage directly affected up to the 6th percentile, at which the spill-over effect was largest, raising wages by about 7 per cent more than in the absence of the minimum wage. This effect stretched up the pay distribution (wages were raised by about 4 per cent at the 10th percentile and still over 1 per cent at around the 20th percentile). The effect was larger for women than men. Disaggregating these affects by geography, they found that areas most affected by the minimum wage had even larger spill-over effects. In contrast to the comprehensive study by Stewart (2009) and much previous research, this suggested that spill-over effects may be larger than previously thought.
- 2.63** Dolton, Lin, Makepeace and Tremayne (2011) analysed pay data from 1977-2009. They found a clear positive effect of price inflation on wage settlements; and a negative effect of unemployment on wage settlements. In line with previous studies, they also found slightly higher increases in wage growth over the whole period since the National Minimum Wage was introduced. In contrast to those findings, and extending the pay data to 2011, Dolton, Makepeace and Tremayne (2012) could find no association between the minimum wage and earnings growth or pay settlements, which they concluded was consistent with previous research findings of limited spill-over effects of the minimum wage on earnings higher up the wage distribution.

Views on Earnings and Pay

- 2.64** CBI argued that increases in the minimum wage in recent years have acted as inflationary pressure at the bottom of pay structures. It said the minimum wage had grown faster than average private sector earnings and it was concerned at the risk of a rise in the bite of the minimum wage in some of the lower-paying sectors if earnings growth in these sectors was lower than growth across the whole economy. In terms of

“Every rise in the NMW erodes the gap between NMW employees and those on the next level up.”

Cinema Exhibitors’ Association evidence

the impact on pay structures, the British Hospitality Association (BHA), British Beer & Pub Association (BBPA), and Business In Sport and Leisure (BISL) said members had been clear that the rising minimum wage had squeezed differentials and reduced the scope for non-pay benefits. The Association of Licensed Multiple Retailers (ALMR) said its survey of members had confirmed that the minimum wage had become the average wage for the bar sector, with just over half of respondents paying between £5.93 and £6.08 an hour. It noted that the proportion was down when compared with the previous survey, but this was because there had been a marked shift towards less expensive workers and the lower age rates of the minimum wage.

- 2.65** The Federation of Wholesale Distributors said that as profit margins were at best static, and costs continued to rise, the NMW had significantly eroded the relative rate of pay its members were able to offer. In industries that operate on low profit margins, such as wholesale, the relatively high rate of the NMW made it difficult to offer and maintain a competitive difference to attract good staff.
- 2.66** On a Commission visit to Northern Ireland, Domestic Care Group told us that nearly all care provision in Northern Ireland was funded by the public sector, with a growing gap between costs and the funding available. As a consequence differentials had been squeezed and from October 2011 its residential care staff would be paid the same as catering and cleaning staff, at the forthcoming minimum wage (£6.08). In oral evidence, the National Day Nurseries Association (NDNA) told us that it had been difficult for nurseries to afford to increase pay for all staff. Feedback from members suggested around half of nurseries were either freezing pay of non-minimum wage staff or increasing their pay by about half the current inflation rate. This put a further squeeze on differentials. Also in childcare, White Horse Child Care Ltd said the NMW had reached levels whereby it had removed trainee posts due to the cost and the liability under employment legislation. It no longer employed anyone aged 21 or over who did not have a relevant qualification/high level qualification because of the removal of pay differentials through NMW increases.
- 2.67** However, in its oral evidence the TUC said that pay structure impacts had occurred when the NMW was introduced, but not recently. While unions generally favoured raising wage floors, which did squeeze differentials, they did not see evidence of adverse impacts on productivity or recruitment. The Chartered Institute of Personnel Development also said that there had been less impact from the more recent increases in the NMW. While a number of employers had reported that previous NMW increases had reduced the scope to reward top performing employees as increases must be funded out of a fixed pot, the smaller NMW rises of recent years had made this problem more manageable for some employers.
- 2.68** The British Chambers of Commerce told us that it was not uncommon that pay rises had been given in 2011 but that they would not be given in 2012. It said there were also examples of increased wage drift, as overtime payments and bonuses had been more typical than increases in regular pay.
- 2.69** Small retailers also commented on continuing erosion of differentials and how, in many parts of the sector, the NMW was the going rate for the job. BIRA said the relevance of the NMW was increasing as the gap between it and the going rates in retail was narrowing. It said the

average difference between the NMW and wages being paid had now dropped to ten pence in some sectors, and that the differential had become so small that upratings in the minimum wage had effectively become the going rate for wage increases.

Summary on Earnings and Pay

2.70 It is clear from the evidence we have presented that the minimum wage has had a significant impact on the distribution of earnings; the gender pay gap; pay structures; the timing of pay reviews; and wage and non-wage labour costs. It also appears that its effects have continued to increase, particularly among low-paying sectors and small firms. We now go on to investigate how firms have coped with the increase in labour costs.

Impact on the Labour Market

2.71 We have demonstrated that the minimum wage has affected earnings. Competitive market economic theories would suggest that a minimum wage in these circumstances would lead to a reduction in employment. This reduction in employment could be achieved through the intensive margin (reducing the number of hours worked) or through the extensive margin (reducing the number of workers). Other economic theories, such as those that consider monopsonistic (or imperfect) competition and efficiency wage theories, suggest more ambiguous effects in that an increase in the minimum wage within a certain range might lead to a rise in employment. A minimum wage set too low will have no effect and one set too high will lead to job reductions, as suggested by competitive market theories. The issue of the impact of the minimum wage on employment, therefore becomes an empirical one.

2.72 Indeed, the focus of much of the previous research and analysis carried out on the UK minimum wage has been its impact on employment. Various methods can be used to investigate this issue. We start by considering time series analysis of aggregate employment and hours, before looking in more detail at employment in the low-paying sectors and employment and unemployment among low-paid workers. We then consider more econometric analysis and summarise the research findings that have used individual data to estimate the impact of the minimum wage, before considering research that has made use of pay differences and the variation in minimum wage bite by geography.

Employment and Employee Jobs

2.73 Despite the deepest recession since the 1930s, aggregate employment (whether measured by the number of jobs or the number of workers) and total hours worked have grown since the introduction of the minimum wage in April 1999. Official data on employment are available from two main sources: the LFS, which surveys individuals; and the ONS workforce jobs series (WFJ), which surveys businesses. The LFS estimates employment by counting the number of people in employment while the WFJ series counts the number of jobs in the economy. These counts differ as a person can have more than one job. Between March 1999 (before the introduction of the minimum wage in April 1999) and September 2011, the LFS measure of aggregate employment increased by over 2 million workers from 27.04 million to 29.07 million. Over the same period, Table 2.7 shows that the number of workforce jobs

increased by 2.15 million. Ignoring the self-employed and those on training schemes, who are not covered by the minimum wage, we can see that the number of employees has increased by 1.32 million and the number of employee jobs by 1.43 million between March 1999 and September 2011. The number of hours worked in the economy as a whole increased by 2.9 per cent.

Table 2.7: Change in Employment, Jobs and Hours, UK, 1999-2011

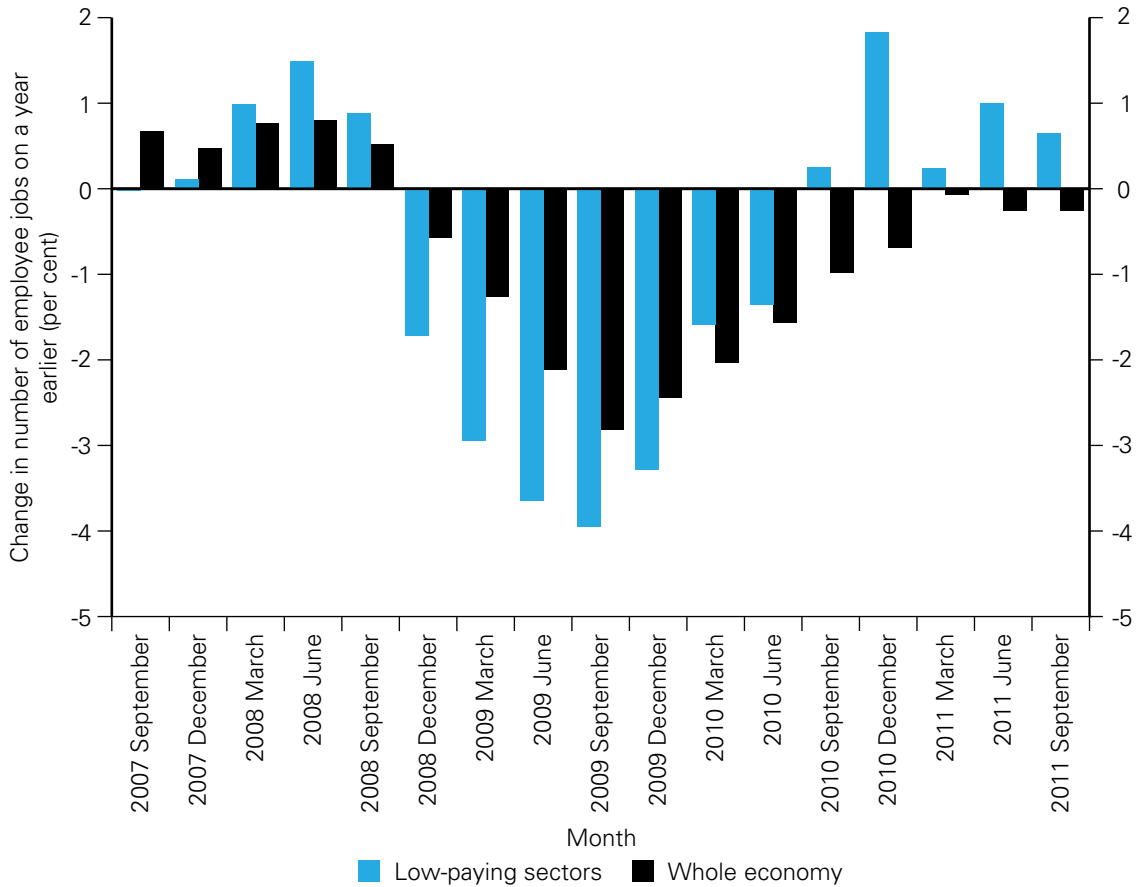
	September 2010- September 2011		September 2009- September 2010		September 2008- September 2009		March 1999- September 2011	
	000s	%	000s	%	000s	%	000s	%
Workforce jobs	89	0.3	-159	-0.5	-674	-2.1	2,145	7.4
Employee jobs	-69	-0.3	-271	-1.0	-780	-2.8	1,428	5.7
Employment	-109	-0.4	311	1.1	-519	-1.8	2,033	7.5
Employees	-130	-0.5	95	0.4	-568	-2.2	1,315	5.6
Hours worked	-7,400	-0.8	12,000	1.3	-29,700	-3.2	25,400	2.9

Source: ONS, workforce jobs (DYDC) and employee jobs (BCAJ), quarterly; total employment (MGRZ), employees (MGRN) and total weekly hours (YBUS), monthly, seasonally adjusted, UK, 1999-2011.

2.74 The recession appears to have had a different effect on employment in the low-paying sectors compared with the whole economy. Figure 2.16 shows that jobs growth between September 2007 and September 2008, going into the recession, was stronger in the low-paying sectors (0.9 per cent) than in the whole economy (0.5 per cent). However, between September 2008 and September 2009, employment in the low-paying sectors fell by 3.9 per cent, a much greater fall than the 2.8 per cent reduction seen across the whole economy. But jobs in the low-paying sectors recovered more quickly. From September 2009 to September 2011 the number of employee jobs in the low-paying sectors rose by 0.9 per cent, against a further reduction in the rest of the economy of 1.2 per cent. This suggests that employment in the low-paying sectors has fared better than the rest of the economy since the end of the recession.

2.75 In September 1998, before the introduction of the minimum wage, the low-paying sectors as a whole accounted for 32.0 per cent of all employee jobs. Between September 1998 and September 2011, Table 2.8 shows that the number of employee jobs in the low-paying sectors increased by 5.2 per cent which was lower than the increase in the number of employee jobs in the economy as a whole (6.4 per cent). As a result the employment share of the low-paying sectors had fallen to 31.6 per cent. However, since September 2001, employment in the low-paying sectors has grown faster (2.3 per cent) than in the economy as a whole (1.2 per cent). That is despite covering the period of larger upratings of the minimum wage (October 2001-October 2007). Indeed, the employment share of the low-paying sectors in September 2011 was the same as in September 1999.

Figure 2.16: Annual Change in Employee Jobs, by Sector, GB, 2007-2011



Source: LPC estimates based on ONS employee jobs series, three-monthly, not seasonally adjusted, GB, 2006-2011.

2.76 The aggregate number of jobs has increased since the introduction of the minimum wage in all the individual low-paying sectors except those in the international trading sectors (food processing, agriculture and the manufacture of textiles and clothing). Employment in these latter sectors had been in long-term decline well before 1999. The growth in jobs has been strongest in hospitality; leisure, travel and sport; and cleaning. Over the last year, Table 2.8 shows that there has been an increase in low-paying jobs (up 0.7 per cent) while jobs in the whole economy continued to fall (down 0.3 per cent). Low-paying sector growth was strongest in hospitality, without which the low-paying sectors would have seen a decline of 0.3 per cent in line with the whole economy.

2.77 Table 2.8 also shows that over the past year the growth in employee jobs in low-paying industries has been driven by those sectors that are predominantly dependent on spending from businesses and consumers. Social care, which is to a large extent reliant on government spending, has seen strong growth since September 1998 (up 17.9 per cent) but has experienced a reduction in jobs since September 2010 (down 5.4 per cent).

Table 2.8: Change in Employee Jobs, by Low-paying Industry, GB, 1998-2011

	2011	Change on 2010		Change on 2009		Change on 1998	
	September	September	%	September	%	September	%
	000s	000s	%	000s	%	000s	%
All industries	25,839	-66	-0.3	-324	-1.2	1,561	6.4
All low-paying industries	8,176	53	0.7	73	0.9	402	5.2
Consumer	5,510	82	1.5	-17	-0.3	435	8.6
Retail	3,114	-11	-0.4	-71	-2.2	25	0.8
Retail (excluding motor)	2,684	2	0.1	-64	-2.3	95	3.7
Hospitality	1,796	77	4.5	33	1.9	227	14.5
Leisure, Travel and Sport	492	4	0.8	19	4.0	150	43.9
Hairdressing	108	12	12.5	2	1.9	33	44.0
Business	1,450	25	1.8	70	5.1	253	21.1
Cleaning	638	13	2.1	13	2.1	48	8.1
Employment agencies	635	17	2.8	58	10.1	158	33.1
Security	177	-5	-2.7	-1	-0.6	47	36.2
International trade	622	-20	-3.1	13	2.1	-376	-37.7
Food processing	328	-1	-0.3	-3	-0.9	-101	-23.5
Agriculture	214	-16	-7.0	19	9.7	-53	-19.9
Textiles, clothing	80	-3	-3.6	-3	-3.6	-222	-73.5
Government	594	-34	-5.4	7	1.2	90	17.9
Social care	594	-34	-5.4	7	1.2	90	17.9

Source: LPC estimates based on ONS employee jobs series, three-monthly, not seasonally adjusted, GB, 1998-2011.

2.78 The number of part-time employee jobs in the whole economy increased over the past year (up by 0.4 per cent), but this increase was offset by a fall in full-time employee jobs (down 0.6 per cent). In the low-paying sectors there were increases in both full-time and part-time employee jobs, with a stronger increase in part-time jobs (up 1.2 per cent) than in full-time ones (up 0.4 per cent). This has particularly been the case in hospitality (where part-time jobs rose by 6.5 per cent and full-time jobs by 2.0 per cent) and employment agencies (part-time jobs rose by 5.5 per cent and full-time jobs by 1.7 per cent). In contrast retail saw a slight increase in full-time jobs (up 0.2 per cent) compared with a fall in part-time ones (down 0.6 per cent). Since September 1998, however, the number of full-time employee jobs in low-paying sectors has risen by 12.6 per cent, while part-time jobs have fallen by 2.1 per cent. This is a different picture to the whole economy which has seen an increase of 2.6 per cent in the number of full-time employee jobs since September 1998, but a much larger increase in part-time jobs (up 15.4 per cent).

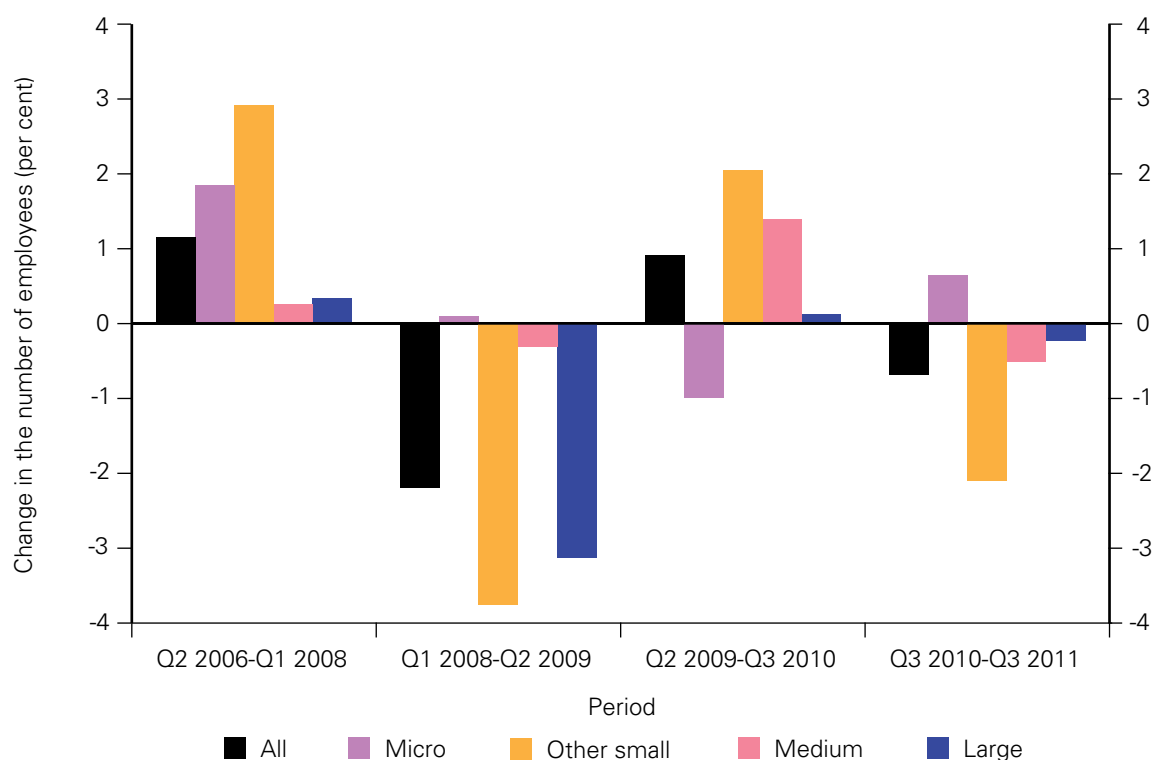
2.79 According to the LFS, in the third quarter of 2010 just under 50 per cent of all employees worked in small firms (with fewer than 50 workers). Around 19 per cent worked for micro firms (defined here as 10 or fewer workers) with about 27 per cent working in other small

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firms (employing 11-49 workers). The remaining 53 per cent were roughly split between medium-sized (employing 50-249) and large firms (employing more than 250).

2.80 Figure 2.17 shows that employment growth has varied by size of firm over time. Large and other small firms were most affected during the recession, while employment in micro firms increased slightly. Having been most severely affected by the recession, other small firms had the strongest recovery from the end of the recession to the third quarter of 2010, but have seen the largest reduction in employees since then. In contrast the number of employees in micro firms decreased between the end of the recession and the third quarter of 2010, but has increased again since.

Figure 2.17: Change in Employment, by Firm Size, UK, 2006-2011



Source: LPC estimates based on LFS Microdata, quarterly, not seasonally adjusted, UK, Q2 2006-Q3 2011.

2.81 Many of the groups of workers that were expected to be most affected by the minimum wage have experienced increases in their employment rates since its introduction in April 1999. Table 2.9 shows that women, older workers, ethnic minorities, disabled people and migrants all have employment rates that are lower than the average. But all of these groups saw their employment rates increase between the first quarter of 1999 and the third quarter of 2011. However, over this period, the employment rates of young workers and those with no qualifications fell markedly. Moreover, for young workers this fall may have been exacerbated by some young people remaining in education in order to avoid unemployment (see Chapter 3 below).

2.82 The same groups of workers also generally fared better than average since the beginning of the recession. It is young people and those with no qualifications that have been most adversely affected. It is a similar story over the past year although women and ethnic

minorities have fared slightly worse than average while the employment rate of those with no qualifications has been unchanged.

Table 2.9: Employment Rates, by Groups of Workers, UK, 1999-2011

(Rates: per cent; changes: percentage points)	2011 Q3	Change on:		
		2010 Q3	2008 Q2	1999 Q1
Working age	70.5	0.0	-2.3	-1.1
Men	75.6	0.2	-3.3	-2.9
Women	65.5	-0.2	-1.4	0.6
16-17 year olds	23.4	-2.1	-10.8	-24.7
18-20 year olds	46.3	-2.1	-10.3	-14.8
Older workers (65+)	8.7	0.5	1.6	3.7
White	72.1	-0.2	-2.2	-0.2
All ethnic minorities	59.7	-0.1	-0.7	3.7
Black	61.3	2.3	-2.2	1.3
Indian	70.4	1.8	1.3	6.6
Pakistani/Bangladeshi	49.2	2.7	3.2	10.8
Other non-white	59.2	-0.8	-1.5	2.8
With qualifications	74.3	-0.1	-3.9	-4.1
No qualifications	40.1	0.0	-6.5	-11.8
Not disabled (16-59/64)	77.9	0.0	-2.6	-2.0
Disabled people (16-59/64)	41.2	0.9	1.0	3.5
UK born	71.1	-0.1	-2.5	-1.5
Non-UK born	67.3	0.7	-0.7	5.0

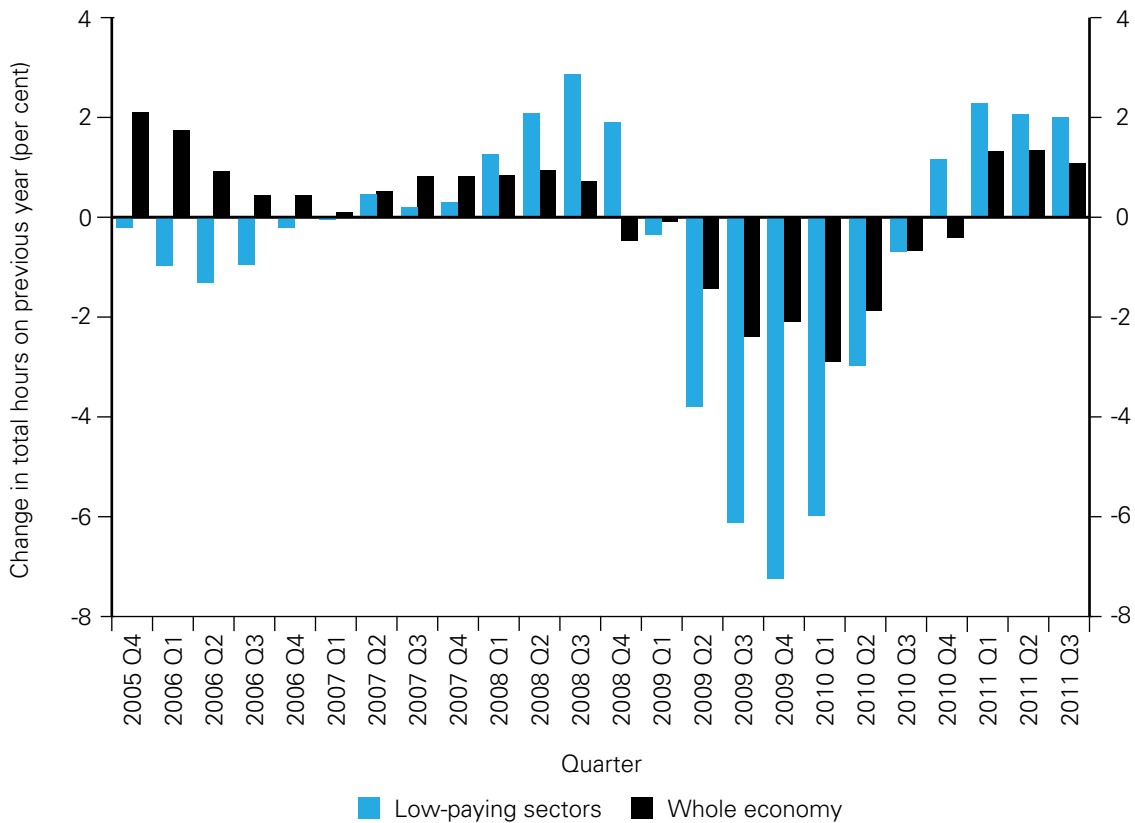
Source: LPC estimates based on LFS Microdata, quarterly, four-quarter moving average, UK, Q2 1998-Q3 2011.

Note: Working age, unless otherwise stated.

Hours

2.83 The number of hours worked in the UK economy as a whole increased by around 7 per cent between the introduction of the minimum wage and the onset of recession (from 888.3 million in March 1999 to 949.2 million in March 2008). It then fell in the recession by over 4 per cent, reaching a nadir of 908.4 million in January 2010, before slowly recovering. Figure 2.18 shows that the fall in hours was greater during the recession in the low-paying sectors than for the economy as a whole. But it also shows that from the beginning of the recovery to the third quarter of 2011, hours worked have picked up faster in the low-paying sectors than in the economy as a whole.

Figure 2.18: Annual Change in Hours Worked, by Sector, UK, 2005-2011



Source: LPC estimates based on LFS Microdata, quarterly, four-quarter moving average, UK, Q1 2004-Q3 2011.

Vacancies and Redundancies

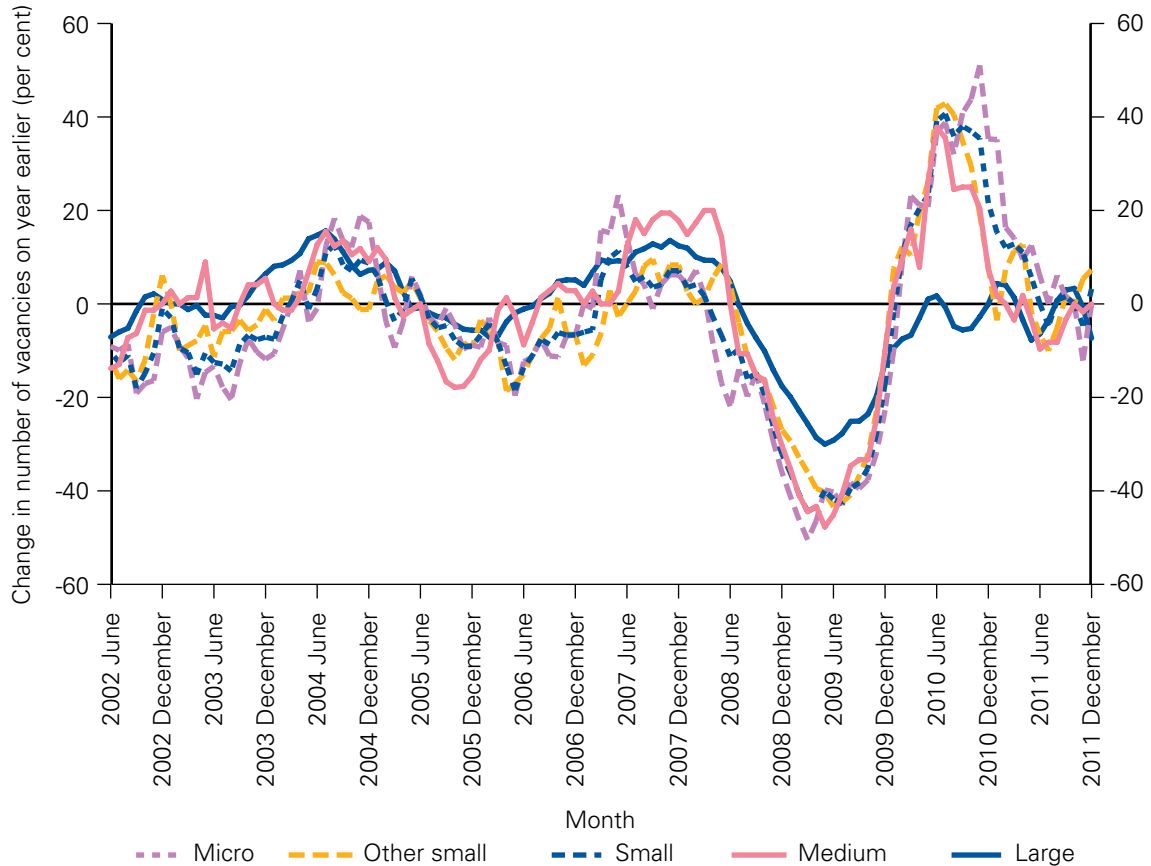
2.84 Vacancies and redundancies are indicators that can also be used to assess the strength or weakness of the labour market. Having picked up from 424,000 in July 2009 to reach 500,000 at the start of 2011, vacancies fell back in the first half of 2011 to around 460,000 and have remained there, some 230,000 below their pre-recessionary peak. In the depths of the recession redundancies peaked at over 300,000 in the three months to April 2009 and then declined steadily to just under 120,000 in the three months to April 2011. They have since risen back to around 160,000 as the public sector has begun shedding workers.

2.85 A similar picture to the whole economy is found for the distribution (which comprises wholesale and retail) and hospitality sectors. Vacancies in both low-paying sectors peaked in March 2008 (at 133,000 in distribution and 67,000 in hospitality) before falling throughout the recession (with distribution reaching a low of 75,000 in May 2009 and hospitality reaching a low of 39,000 in September 2009). Vacancies in both sectors have since grown moderately, reaching 92,000 and 43,000 respectively in September 2011. Redundancies in distribution and hospitality taken together were 19,000 in March 2008, rose to 70,000 in March 2009 before falling back to 27,000 by December 2009. However, they have risen since, reaching 45,000 in September 2011.

2.86 According to official estimates, numbers of vacancies vary by size of firm, as shown in Figure 2.19. It can be seen that the trend in vacancies in large firms differs from the trends for small and medium-sized firms. During the recession, vacancies fell first among micro firms then

other small and medium-sized firms and last among large firms. The fall in vacancies was of a similar magnitude in micro, other small and medium-sized firms with large firms being least affected. However, the growth in vacancies among small and medium-sized firms was much stronger in the recovery compared to large firms, but they have since seen a fall in vacancies from the middle of 2010. In contrast, the level of vacancies in large firms has been fairly static.

Figure 2.19: Annual Change in Vacancies, by Firm Size, UK, 2002-2011



Source: LPC estimates based on ONS data, vacancies in firms with 1-9 employees (ALY5), 10-49 employees (ALY6), 50-249 employees (ALY7), 250-2,499 employees (ALY8) and 2,500+ employees (ALY9), monthly, seasonally adjusted, UK, 2001-2011.

Unemployment and Inactivity

2.87 We saw earlier that employment rates for many of the groups expected to be most affected by the minimum wage have increased since its introduction. Table 2.10 shows that older workers, ethnic minorities, disabled people and migrants have also experienced reductions or less than average increases in their unemployment and inactivity rates since the introduction of the minimum wage. With the exception of some ethnic minorities, these groups have also coped well since the start of the recession and over the past year. In contrast to the rise in inactivity rates for men, those for women have fallen since 1999, while changes in unemployment rates were similar for both genders. Again, it is a different story for young workers and those with no qualifications who have generally seen their unemployment and inactivity rates rising.

Table 2.10: Unemployment and Inactivity Rates, by Groups of Workers, UK, 1999-2011

(Rates: per cent; changes: percentage points)	Unemployment				Inactivity			
	2011 Q3	Change on:			2011 Q3	Change on:		
		2010 Q3	2008 Q2	1999 Q1		2010 Q3	2008 Q2	1999 Q1
Working age	8.1	0.1	2.8	1.8	23.3	-0.1	0.2	-0.3
Men	8.8	-0.1	3.1	1.8	17.1	-0.1	0.8	1.5
Women	7.3	0.4	2.4	1.9	29.4	-0.1	-0.3	-2.0
16-17 year olds	37.8	4.1	11.7	17.8	62.5	0.8	8.6	22.5
18-20 year olds	24.9	1.5	8.9	10.3	38.2	1.5	5.7	9.9
Older workers (65+)	2.3	-0.3	0.5	-0.5	91.1	-0.5	-1.7	-3.8
White	7.4	0.0	2.5	1.4	22.1	0.2	0.3	-0.9
All ethnic minorities	13.4	0.3	2.8	0.1	31.0	-0.2	-1.3	-4.3
Black	17.1	-0.8	3.9	0.3	26.1	-2.1	-0.7	-1.9
Indian	8.3	-0.6	1.5	0.0	23.2	-1.4	-2.6	-7.2
Pakistani/Bangladeshi	16.3	-1.2	2.1	-4.4	41.3	-2.4	-5.2	-10.4
Other non-white	12.0	0.4	1.4	-1.1	32.8	0.7	0.6	-2.4
With qualifications	7.5	0.1	2.7	2.0	19.7	0.0	1.8	2.7
No qualifications	17.0	0.4	5.7	4.9	51.7	-0.2	4.3	10.7
Not disabled (16-59/64)	7.6	0.1	2.8	1.9	15.7	-0.1	0.3	0.5
Disabled people (16-59/64)	14.6	0.0	2.8	1.6	51.7	-1.0	-2.6	-4.9
UK born	8.0	0.1	2.9	1.9	22.8	0.0	0.3	0.0
Non-UK born	9.0	-0.1	2.0	0.3	26.1	-0.7	-0.8	-5.7

Source: LPC estimates based on LFS Microdata, quarterly, four-quarter moving average, UK, Q2 1998-Q3 2011.

Note: Working age, unless otherwise stated.

Research on Employment, Hours and Unemployment

- 2.88** The majority of the research conducted on the impact of the minimum wage in the UK has focused on its effect on employment or hours. Most of that research has analysed the impact in a period of strong economic growth. The general consensus of the research is that the NMW has not significantly affected employment. It is now nearly four years after the onset of the deepest recession since the 1930s and the most recent research has continued to find little evidence of significant adverse employment effects.
- 2.89** Researchers have generally taken four approaches in attempting to identify employment and hours effects. First, aggregate time series data have been used to compare employment effects across countries or industries over time. Second, researchers have used the national nature of the minimum wage to look at differences in coverage and bite across geographies. Third, individual data have been used to follow people over time or to compare minimum wage workers with those higher up the earnings distribution. Fourth, case studies have been used to explore the impact on individual firms.

- 2.90** We did not commission any new research that used time series data but two recent studies have taken this approach. Dolton and Rosazza Bondibene (2011) used data across 33 Organisation for Economic Co-operation and Development and European countries over the period from 1976-2008 and found that minimum wages negatively affected employment. This was in line with the findings of similar international studies. However, they found this significantly negative effect largely disappeared when weighting by the size of the labour market and using alternative specifications. There was little difference in their results across the economic cycle for adults, although they confirmed previous findings that the impact of the minimum wage was more detrimental for young people in the presence of an economic downturn. Dickens and Dolton (2011) used a time series of industries to explore the impact of the sector-specific minimum wages set by the Wages Councils in the 1980s and 1990s. In contrast to the international evidence, their results suggested that these minimum wages may even have had a positive impact on employment. They found no adverse effect during the 1980s and 1990s recessions. They suggested that job turnover may have reduced in those recessions and that this had helped maintain employment in industries generally characterised by high staff turnover. In earlier work also looking at the Wages Councils, Dickens, Machin and Manning (1999) had reached similar conclusions. However, Dickens and Dolton (2011) did find some evidence of a significant negative effect on the level of hours although this finding disappeared when considering changes in hours. They concluded that any adverse recessionary effects on employment or hours were limited.
- 2.91** We commissioned three research projects for this report to investigate the impact of the minimum wage on employment and hours. That research took two approaches, looking at either individual data or spatial analysis. In general, previous studies using these approaches have found little adverse impact on employment, although, several using the individual data approach have found some adverse impact on hours.
- 2.92** Dickens, Riley and Wilkinson (2012) investigated effects on employment and hours using both approaches. First, they used individual data and second, they took advantage of the geographical variation in wages. Using the individual data they also looked at how these minimum wage effects varied by size of firm. In contrast to previous research that the NMW had raised the earnings of low-paid workers without affecting employment opportunities, they found some evidence, using the New Earnings Survey and in some econometric specifications, that the introduction of the minimum wage may have had a small adverse impact on the employment opportunities of women working part-time. This effect was strongest when the minimum wage was introduced and during the recent recession. In comparison to other workers, low-paid workers were more likely to work in small firms. Any detrimental employment effects among low-paid female part-time employees tended to be more significant on average in large firms.
- 2.93** However, in line with previous research, they found no impact for many other low-paid workers and this finding varied little over the business cycle. They were unable to find any evidence to suggest that the minimum wage had affected average hours in general but there was some evidence to suggest that the minimum wage may have reduced hours by around 2 hours per week for female full-time workers during the recession. Size of firm did not appear to be a factor with regard to hours.

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- 2.94** In contrast to the individual results explained above, their spatial analysis found no strong evidence of adverse effects of the minimum wage on employment or unemployment. This was despite the large increases in wages at the bottom of the distribution relative to those higher up. Indeed, their findings suggested that the minimum wage may have had some positive effects on employment between 2003 and 2007 (the period of large upratings). They also found evidence that the minimum wage had reduced unemployment in these years.
- 2.95** Bryan, Salvatori and Taylor (2012) used individual data to assess the impact of the minimum wage on employment, unemployment and hours. In line with previous research findings, they found little evidence that the minimum wage had affected employment retention in the period before or during the recession. They found no consistent effect of the minimum wage on hours for adults across the years, although they did find some weakly significant evidence in some specifications of a reduction in basic hours of around 2-4 hours for both men and women following the 2010 minimum wage uprating. They did, however, find some evidence of a significant negative effect on hours among youths (aged 18-21 years old), with basic hours reduced by around 3-4 hours during the recession (2008-2010). They found similar effects for the 2003-2007 upratings, but these effects appeared stronger and more robust during the recession. However, they cautioned that these results for young workers were based on small sample sizes. The research also found that the minimum wage had no effect on the probabilities of unemployed adults entering work in any year. They concluded that there was little evidence that the recession had increased the sensitivity of employment to increases in the minimum wage. But their findings added to the existing literature that the minimum wage may have had an impact on hours, especially for young workers.
- 2.96** Previous research using individual data had generally come to similar conclusions that the introduction of the minimum wage and subsequent upratings had not adversely affected employment. Stewart (2001, 2003, 2004a and 2004b) found no evidence of an adverse impact of the introduction of the minimum wage and its initial upratings on employment. Dickens and Draca (2005) looked at the large upratings in 2003 and 2004 on individual employment transitions. Dickens, Riley and Wilkinson (2009) examined the employment effects of the 2003-2006 minimum wage upratings and Mulheirn (2008) also looked at the 2006 upratings. None of these studies found any adverse employment effects.
- 2.97** In contrast, the research investigating the impact on hours using individual data has been more mixed. Connolly and Gregory (2002) found a negative but not significant effect of the introduction of the minimum wage. Stewart and Swaffield (2004), using a longer time span of data found significant adverse effects on hours from the introduction of the minimum wage. Dickens, Riley and Wilkinson (2009) also found evidence that hours had been reduced in some years and in some econometric specifications but, unlike Stewart and Swaffield, their results were not robust. In contrast, Robinson and Wadsworth (2007) found no evidence that the minimum wage had affected the incidence of second job-holding or the hours worked in second jobs.
- 2.98** Dolton, Rosazza Bondibene and Stops (2012) conducted spatial analysis to look at the impact on employment. They found that the minimum wage had no adverse impact on local area employment and may even have had a positive effect in some years. Further, this result

seemed to be invariant to the detail of geography used or the way in which the recession was modelled. They concluded that the spatial effects of the minimum wage on employment were limited.

- 2.99** Previous research using spatial data has generally concluded that there is little strong evidence of any employment effects. Analysing employment changes across local areas in the period that covered the introduction of the minimum wage, Stewart (2002) found some weak but not statistically significant evidence of a reduction in employment. Galindo-Rueda and Pereira (2004) also found no evidence on employment levels but did find a significant impact of the minimum wage on employment growth. Looking at the 2003 and 2004 upratings, Experian (2007) found no effects of the minimum wage on regional employment. Assessing the period 2001-2006, Dickens, Riley and Wilkinson (2010) found no effects on employment but did find some weak evidence that the minimum wage may have encouraged participation and that had led to increases in unemployment. However, Dolton, Rosazza Bondibene and Wadsworth (2009) found that unemployment rates fell more in areas where the minimum wage bite was greatest in the period of large minimum wage increases (2003-2006). Over the whole period (1999-2007), they found little impact of the minimum wage on employment but they did find a small but significant positive effect of the minimum wage since 2003 when investigating individual years.
- 2.100** The impact of the minimum wage has also been investigated using numerous case studies of firms. These have generally consisted of surveys of firms across the low-paying sectors. Examples include IDS (2011a), which summarised the findings of their previous reports, Grimshaw and Carroll (2002) and Cronin and Thewlis (2004). These have generally concluded that firms have tended to make changes to their pay structures in response to minimum wage increases rather than adjust employment.

Views on Employment and Hours

- 2.101** Employers' organisations have emphasised the particular pressures currently faced by businesses, especially those which are lower-paying and consumer-facing. CBI said that these sectors, where the NMW has a major impact, face particularly challenging trading conditions. It said that consumers' budgets were stretched, and further job losses were more likely than increased levels of employment.
- 2.102** BHA, BBPA and BISL noted employment had peaked in hospitality in 2008, before falling back in the following two years. These bodies thought that some of this might be due to cumulative rises in the minimum wage, although anecdotal evidence suggested that many employers cut hours rather than headcount during the recession. The NMW may, however, have reduced job growth, although they thought this was probably not capable of proof. Unlike last year, the ALMR did not find job losses and reduced hours or benefits resulting from the rise in the minimum wage, but it remained concerned about the likely impact of any additional costs and regulatory burdens at this point in the economic cycle.

2.103 In retail, the largest of the low-paying sectors, the British Retail Consortium-Bond Pearce Retail Employment Monitor showed that in the third quarter of 2011, retail employment was down by 0.8 per cent compared with the same quarter a year earlier, the equivalent of nearly 6,000 fewer full-time jobs. However, during the same period, the number of retail outlets grew by 2.3 per cent.

2.104 Trade unions have pointed to evidence of more favourable economic conditions in the low-paying sectors and businesses in general. The TUC said there were some indications that the impact of the recession had been worse among higher-paid jobs than minimum wage jobs, referring to employment in the low-paying sectors holding up better than in the economy as a whole. The Communications Workers Union highlighted that since its introduction the minimum wage had increased ahead of average earnings without leading to reductions in employment or weekly earnings in the low-paying sectors. Unite pointed to indicators which suggested that prospects were more favourable. The latest HotStats Hotel Confidence Monitor by TRI Hospitality found UK hotel general managers remained positive. In oral evidence Unite noted that employment had been growing in hospitality and retail, that many new stores and hotels had recently opened and that this was observed throughout the UK not just in London.

“In response to NMW increases members had looked to keep payroll costs the same. They had cut jobs and reduced hours/shifts. From late 2008 to 2009/10 wages as a proportion of turnover fell as staffing was reduced as a result of the NMW. From the third quarter of 2010 jobs grew again, but away from full-time (now only 22 per cent of all jobs) towards part-time.”

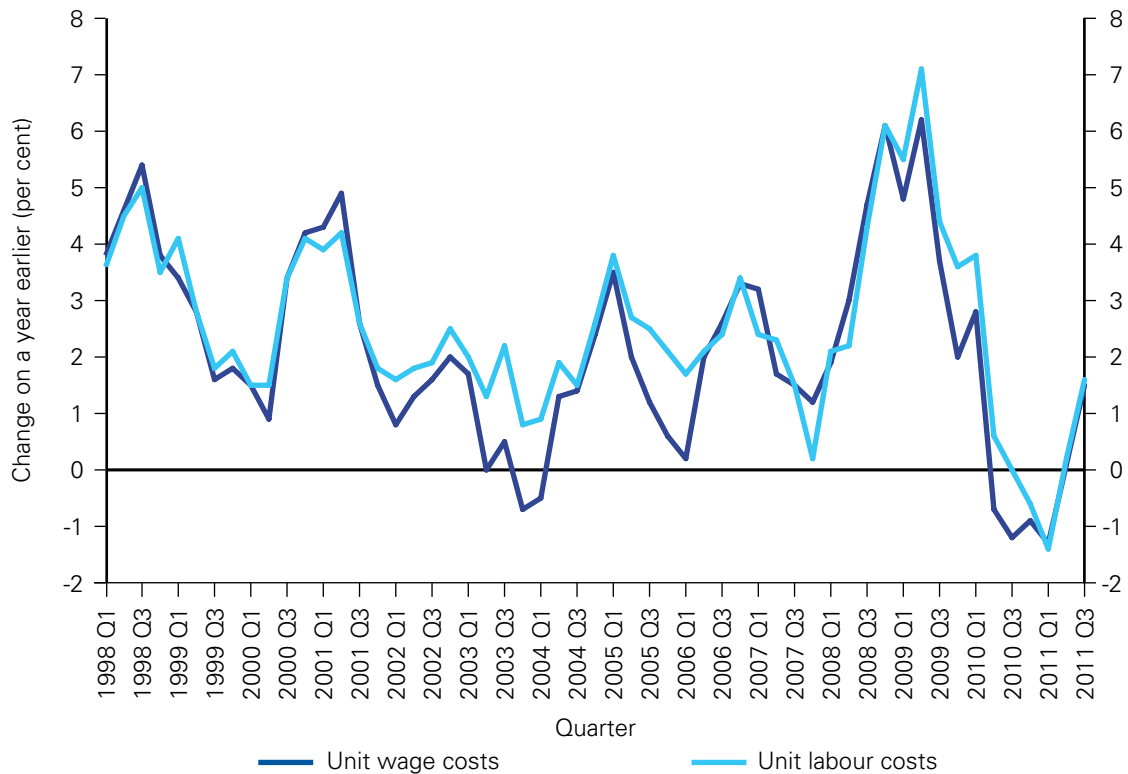
ALMR oral evidence

Impact on Competitiveness

2.105 Instead of reducing employment or cutting hours, firms may cope with minimum wage increases by seeking to raise the productivity of their workforce; pass on increases in prices to customers; or absorb it by reductions in profits. Before considering each of these, we next look at labour costs. The cost of labour is not confined to wages.

2.106 Pay settlements and average earnings growth have been relatively subdued since the onset of recession, and both have been well below inflation, although there have been signs of a slight pick up in pay settlements and nominal average earnings growth during 2011. However, wage pressures have reduced since the summer. Figure 2.20 reflects this, showing that the annual change in unit wage costs for the whole economy fell back sharply after the end of the recession (third quarter of 2009). During the recession, the annual change in unit wage and labour costs both increased from about 2 per cent (in early 2008) to around 6 per cent (in the middle of 2009), as the fall in employment was less than the loss of output. Since the end of the economic downturn, as output has recovered, growth in unit wage and labour costs has slowed, reflecting the subdued nature of earnings growth. The annual change in unit wage and labour costs picked up in the third quarter of 2011 but remains relatively subdued. Data on these costs are not available at a more disaggregated level.

Figure 2.20: Annual Change in Unit Wage and Labour Costs, UK, 1998-2011



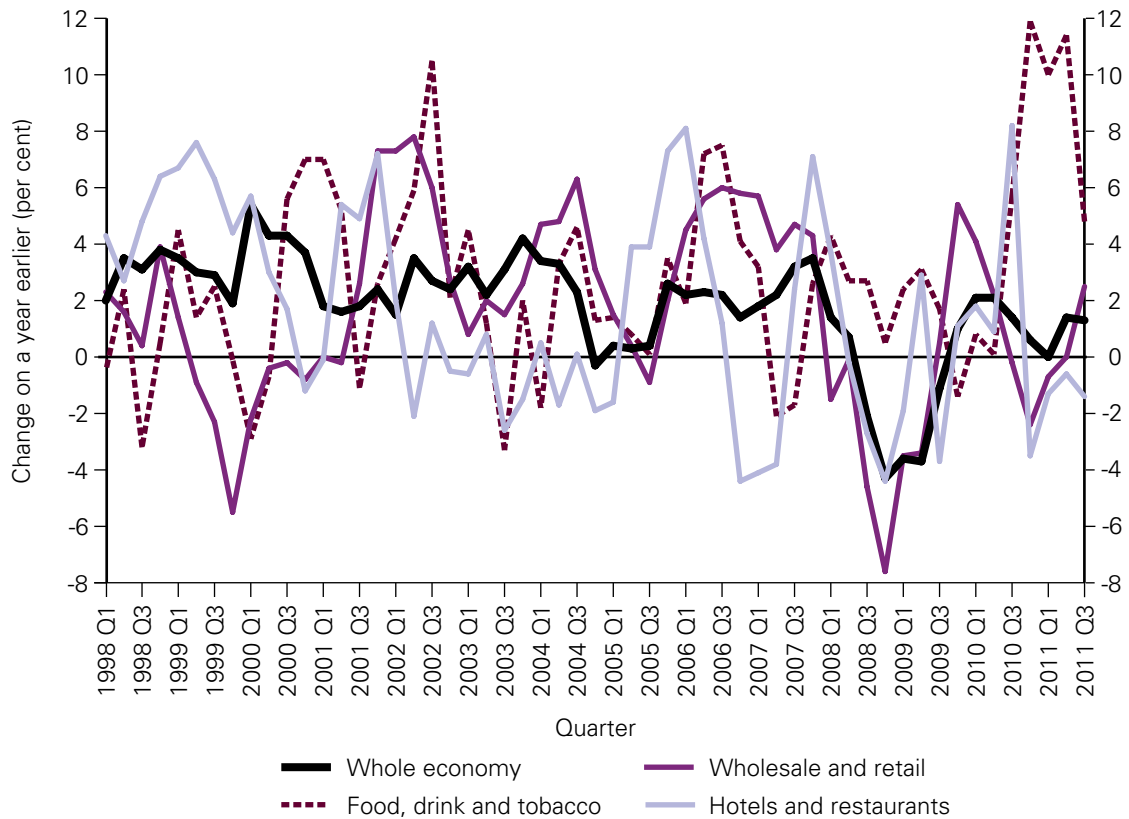
Source: ONS, unit wage costs (LOJE) and unit labour costs (DMWN), quarterly, seasonally adjusted, UK, Q1 1998-Q3 2011.

Productivity

2.107 There are a number of ways that firms can increase labour productivity. First, some labour could be replaced by capital. Second, introducing new technology might increase the quality of capital. Third, workers could be monitored or motivated to put in extra effort. Fourth, work organisation could be adjusted to improve the capital:labour mix. Finally, firms could invest in improving the quality of labour through education and training. Each of these would lead to an increase in labour productivity.

2.108 As noted in Chapter 1, official data showed productivity (whether measured per hour or per job) falling throughout the recession as losses in output were greater than the reductions in hours or employment. Since the start of 2010, the growth in productivity per hour has been slightly higher across the economy than the growth in productivity per job, with both showing weak and stuttering growth.

2.109 Figure 2.21 shows that this general weakness in productivity was observed across much of the economy, but particularly in retail and hospitality, although retail showed some signs of productivity growth in the third quarter of 2011. Manufacturing productivity markedly improved over 2010 and 2011, reflected in the strong productivity performance in the food, drink and tobacco manufacturing sector.

Figure 2.21: Productivity per Hour, by Selected Low-paying Industry, UK, 1998-2011

Source: ONS, output per hour for the whole economy (LZVD); wholesale and retail (DJQ6); hotels and restaurants (DJR4); food, drink and tobacco (DJL3); quarterly, seasonally adjusted, UK, Q1 1998-Q3 2011.

Research on Productivity

2.110 In contrast to the availability of detailed information on individual earnings and employment, there is a lack of detailed datasets on individual firms. This has proved to be a substantial barrier for researchers wishing to investigate the impact of the minimum wage on productivity, prices and profits. Thus, the body of literature on the impact of the minimum wage on competitiveness is much thinner than on employment. However, a small number of studies have been able to investigate these issues using a variety of methods and data sources. Industry and plant-level data from the Annual Business Inquiry (ABI), the Annual Respondents Database (ARD) and Financial Analysis Made Easy (FAME) have generally been used. In addition, a couple of studies have generated their own data using a survey of care homes.

2.111 For our last report we commissioned Croucher and Rizov (2011) who used FAME from 1996-2009 and found that, in general, the NMW had a significant positive impact on aggregate productivity in the low-paying sectors. They found that the strongest positive productivity effects were in large firms while the smallest firms showed the weakest effects. Using the same data source but for an earlier period, Draca, Machin and Van Reenen (2005) had also found a positive association between the introduction of the minimum wage and productivity growth but it was not statistically significant.

- 2.112** Two studies have used ARD plant-level data. Galindo-Rueda and Pereira (2004) found some evidence of a positive impact from the introduction of the minimum wage on labour productivity, particularly in the service industries, but their results were sensitive to the econometric specification employed. In contrast, Forth, Harris, Rincon-Aznar and Robinson (2009) found a negative association between the NMW and productivity when they extended the data to cover up to 2005. But their results were not robust.
- 2.113** Two studies have also used ABI data to investigate the effects on productivity of the minimum wage. Using data up to 2000, Forth and O'Mahony (2003) found some evidence that productivity may have increased in textiles, security and hairdressing but they concluded that they could find no systematic evidence that the introduction of the minimum wage had boosted labour productivity. Building on this industry-level analysis and extending the data period up to 2006, Forth, Harris, Rincon-Aznar and Robinson (2009) again found no robust association between the minimum wage and productivity.
- 2.114** Machin, Manning and Rahman (2003) in their study of care homes found a positive but statistically insignificant relationship between the minimum wage and productivity. No such relationship was found by Georgiadis (2006) in his follow-up study.
- 2.115** Another way that the minimum wage could have affected productivity is through investment in training. Two studies have looked at training. Using the British Household Panel Survey, Arulampalam, Booth and Bryan (2004) found statistically significant effects of the introduction of the minimum wage on both the incidence and intensity (number of days) of training. However, using the LFS, Dickerson (2007) found no significant effects, positive or negative, on job-related training of the introduction and first two upratings of the minimum wage. In summary, UK research has generally found some weak evidence of a small positive but not statistically significant association between the minimum wage and labour productivity.

Prices

- 2.116** Firms affected by increases in the minimum wage might try and pass their costs on to customers in the form of higher prices. There are three main sources of detailed information on consumer and business-to-business prices. The CPI and RPI collate information on prices to consumers, while the Services Producer Price Index (SPPI) collects information on business-to-business transactions. Since the introduction of the minimum wage in April 1999, CPI and SPPI have both increased by just over 31 per cent, while RPI has risen faster at 44 per cent. Table 2.11 suggests that since the introduction of the minimum wage the prices of selected goods and services (produced by firms in low-paying sectors with a high proportion of minimum wage workers) may have risen faster than prices in general.

Table 2.11: CPI, RPI and SPPI Price Inflation for Selected Goods and Services, UK, 1999-2011

		Percentage change				
		1999 Q1- 2004 Q3	2004 Q3- 2007 Q3	2007 Q3- 2010 Q3	2010 Q3- 2011 Q3	1999 Q1- 2011 Q3
CPI	All items	7.0	6.7	9.7	4.7	31.1
	Restaurants and cafes	17.2	10.0	10.6	4.9	49.5
	Canteens	28.8	11.6	7.7	3.9	60.8
	Dry cleaning	18.0	13.8	7.6	4.5	51.1
	Domestic and household services	38.5	14.4	8.4	1.7	74.7
	Hairdressing	31.1	12.2	8.2	3.3	64.4
RPI	All items	14.5	10.5	8.4	5.2	44.3
	Restaurant meals	19.1	9.0	10.4	4.4	49.5
	Canteen meals	32.0	11.9	8.7	2.8	65.0
	Take-aways and snacks	18.2	9.2	10.5	4.2	48.5
	Beer on-sales	16.4	11.4	11.4	5.7	52.8
	Wine and spirits on-sales	18.0	9.3	11.3	6.1	52.3
	Domestic services	35.0	15.5	10.4	2.8	76.9
	Personal services	32.7	14.3	12.0	4.4	77.6
SPPI	Net sector	10.6	8.7	6.0	3.0	31.7
	Hotels	9.7	13.1	-6.7	-0.6	15.1
	Canteens and catering	8.1	9.2	5.8	1.0	26.1
	Employment agencies	20.9	7.5	3.1	0.2	34.2
	Security services	23.3	10.2	1.0	0.4	37.7
	Industrial cleaning	4.2	8.0	3.2	1.6	18.1
	Commercial washing and dry cleaning	8.3	5.7	2.2	1.4	18.6

Source: LPC estimates based on ONS data, CPI all items (D7BT); restaurants and cafes (D7EW); canteens (D7EX); dry-cleaning, repair and hire of clothing (D7DM); domestic services and household services (D7E6); hairdressing and personal grooming establishments (D7EY); RPI all items (CHAW); restaurant meals (DOBE); canteen meals (DOBF); take-aways and snacks (DOBG); beer on sales (DOBI); wine and spirits on sales (DOBL); domestic services (DOCI); personal services (DOCR); SPPI aggregate net sector SIC 2003 basis (I5RX) and SIC 2007 basis (K8ZW); hotels (K8TE); canteens and catering (K8TP); employment agencies (K8XZ); security services (K8YH); industrial cleaning (K8YQ); commercial washing and dry cleaning (K8ZM), quarterly, not seasonally adjusted, UK, Q1 1999-Q3 2011. Note: SPPI net sector data are only available on the SIC 2007 basis from Q1 2003 onwards. On the SIC 2003 basis they are available from Q4 1997 to Q2 2010. Data provided here use the SIC 2003 basis and assume it would have grown at the same rate as the SIC 2007 data between Q2 2010 and Q3 2011. All other SPPI figures are on the SIC 2007 basis.

2.117 For the most part, it appears that firms may have found it easier to increase the price of minimum wage goods and services to consumers rather than to other businesses. Between 1999 and 2011, prices in restaurants and cafes, canteens, hairdressers and dry cleaners have all increased faster than CPI. Similarly, the prices of restaurant, canteen, and takeaway meals; wine and beer; and personal services have all increased faster than the general level of RPI. The cost of employment agencies and security services also increased above the general increase in SPPI but the price increases for businesses for industrial cleaning, dry cleaning and hotels have been lower than the general increase in prices.

“Members found it difficult to pass on cost increases to consumers. Consumers were often ‘trading down’, using ‘stay at home’ entertainment, or attracted only by special deals.”

BHA, BBPA, BISL, ALMR oral evidence

2.118 Firms may have been less able to pass on price rises since the start of the recession. Between 2007 and 2010, the price rises in the selected minimum wage goods and services were similar to the general increase in prices, and this has continued in 2011. Price rises for business-to-business transactions still appear more constrained than price rises to consumers.

Research on Prices

2.119 We can draw on three studies that shed light on the ability of firms to pass on minimum wage costs in the form of higher prices to their customers. Wadsworth (2007) investigated the consumption patterns of minimum wage households and the impact of the minimum wage on the prices of goods and services that were associated with minimum wage employment (‘minimum wage goods and services’). Using the Family Expenditure Survey and its successor the Expenditure and Food Survey, he found that there was little evidence of differential consumption patterns among households with an adult minimum wage earner relative to others, although such households appeared to spend a slightly larger proportion of their income on food compared with households with non-minimum wage workers. He also found evidence that the demand for many minimum wage goods and services (such as pub drinks, dry cleaning services and canteen meals) tended to be elastic. That is, demand was sensitive to price changes, which suggested that there might be little room to pass on price rises to consumers of minimum wage goods and services.

2.120 In an extension to that work, Wadsworth (2008) defined minimum wage goods and services using the LFS and ASHE to estimate the employee and wage bill shares relating to minimum wage workers in disaggregated industries. He then matched these to sectoral level data on retail and consumer prices. Although he found no evidence of an immediate impact of changes in the minimum wage on prices, he did find evidence to suggest that the relative rate of price inflation of some minimum wage goods and services did increase in the period after the minimum wage was introduced and that prices rose faster for those goods and services that were not subject to international trade. In a previous study, Draca, Machin and Van Reenen (2005) had found no significant effects of the minimum wage on prices.

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2.121 If firms are unable to improve productivity or raise prices as a result of increased labour costs they may be forced to accept a squeeze on profits. We now go on to look at the evidence of such a squeeze on profits.

Profits

2.122 In Chapter 1 we noted that profits at the aggregate level, measured in various ways, picked up in 2011. The net rate of return on capital employed fell over the recession from 12.9 per cent in the first quarter of 2008 to 9.4 per cent in the first quarter of 2010, but picked up to 11.1 per cent in the third quarter of 2011. Having fallen from 11.8 per cent to 5.5 per cent between the first quarter of 2008 and the first quarter of 2010, profits in manufacturing recovered to 11.6 per cent in the fourth quarter of 2010, but have since fallen once again and were 5.0 per cent in the third quarter of 2011. Profits in services fell by less during the recession (from 17.4 per cent in the first quarter of 2008 to 12.8 per cent in the third quarter of 2009), but have since picked up and stood at 15.9 per cent in the third quarter of 2011. However, we should note that it is difficult to get information on profits at a more disaggregated level. Our anecdotal evidence suggests that profitability has varied considerably by sector and by size of firm. Small firms and certain low-paying sectors (such as non-food retail) appear to have faced far smaller profit margins than large firms and food retailers for example.

Research on Profits

2.123 Several studies have investigated the impact of the minimum wage on profits over the years. Draca, Machin and Van Reenen (2011) built on earlier work that we had commissioned. They used FAME data and concluded that the minimum wage had significantly reduced profit margins, especially in those industries with less competition and therefore higher margins. In their previous research Draca, Machin and Van Reenen (2005) had also used FAME and had found some significant and robust evidence that increases in the minimum wage had reduced profits in low-paying sectors and in the care home sector, although Georgiadis (2006) found no such relationship in a follow-up study of care homes.

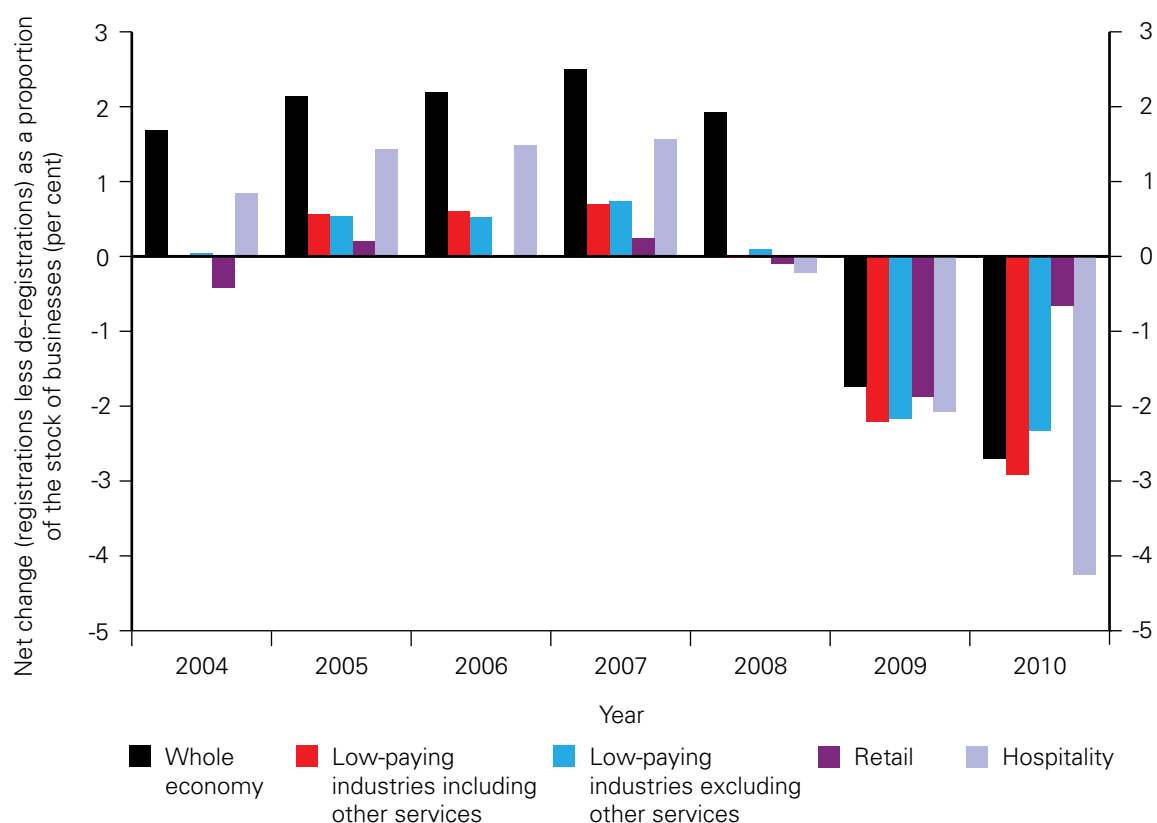
2.124 Examining the impact of the minimum wage on the rate of return to capital employed Forth, Harris, Rincon-Aznar and Robinson (2009) found a significant negative impact of the minimum wage on the rate of return on capital employed in those sectors with the highest proportions of workers affected by the minimum wage. When investigating price-cost margins, they also found a negative effect of the minimum wage, but it was neither statistically significant nor robust. They concluded that the minimum wage may have reduced profits in those sectors most exposed to the NMW and which were unable to pass on costs in other ways. Experian (2007) found no statistically significant effect on profits for any industries, when looking at the 2003 and 2004 minimum wage upratings.

2.125 In general, the research has found evidence that profits have been squeezed, especially when firms have been unable to adjust in other ways, but that this squeeze has been insufficient to lead to business failure. We turn next to investigate the impact of the minimum wage on business start-ups and failures.

Births and Deaths of Firms

- 2.126** Another way of looking at the impact of the minimum wage on firms might be to look at the levels and changes in both business start-ups and business failures. An increase in the minimum wage might make it less attractive to start a business as the wage costs could increase as a result. Further, increases in the minimum wage might squeeze profits leading to an increased number of business failures. In this section, we look at the aggregate and, where possible, sectoral picture of business start-ups and failures, and company insolvencies. We then summarise the available research of the impact of the minimum wage on company formation and closure.
- 2.127** The stock of enterprises registered for Value Added Tax (VAT) increased in every year from 1995 to 2008 but the recession led to the stock falling in 2009 and 2010. The number of firm deaths, businesses de-registering from VAT, rose sharply from 223,000 in 2008 to 277,000 in 2009 and 297,000 in 2010. At the same time, the number of births, firms registering for VAT, fell from 267,000 in 2008 to 235,000 in 2010 resulting in the first net fall in the stock of VAT-registered enterprises since 1994, when the economy was also beginning to recover from recession.
- 2.128** In the low-paying industries, the stock of VAT-registered enterprises fell in every year between 1994 and 2001 but increased continuously between 2002 and 2007 despite the large upratings in the minimum wage. Although the stock of firms in the whole economy increased by 2 per cent in 2008, Figure 2.22 shows that it fell marginally in the low-paying industries. In 2009, as the economy suffered its worst recession since the 1930s, the percentage reduction in the number of firms was greater in the low-paying industries (2.2 per cent) than in the economy as a whole (1.8 per cent). This pattern continued in 2010, but with an even greater net loss in firms in both the whole economy and the low-paying sectors. Hospitality appears to have been affected more than retail.

Figure 2.22: Net Change in Stock of Firms, by Selected Low-paying Industry, UK, 2004-2010



Source: LPC estimates based on ONS data; business demography, enterprise births, deaths and survivals 2010, annual, not seasonally adjusted, UK, 2004-2010.

Note: From 2008 onwards these data are based on SIC 2007, before 2008 they are based on SIC 2003. Care should be taken in comparisons between 2007 and 2008.

Research on Business Start-ups and Failures

2.129 The research on business failures has usually been conducted alongside the research on profits. Despite minimum wage increases appearing to squeeze profits, Draca, Machin and Van Reenen (2005 and 2011) found no evidence that this had led to an increase in the number of business failures. In contrast, Forth, Harris, Rincon-Aznar and Robinson (2009), using industry-level ABI data, found some weak evidence that the minimum wage had increased the exit rates of firms but this finding was not robust to changes in specifications.

2.130 Researchers have utilised three main data sources to investigate whether the minimum wage may have adversely affected business creation in the UK. We did not commission any research in this area for this report but one recently published study, Draca, Machin and Van Reenen (2011), used FAME and found some weak evidence of falls in net entry rates. Using VAT registrations, Experian (2007), found that business creation was lower in those regions where pay was lowest (and the bite of the minimum wage highest). Finally, using the ARD, Galindo-Rueda and Pereira (2004) found evidence to suggest that the introduction of the minimum wage led to business creation being slower in the lowest-paying geographical areas. We can therefore conclude that there is some research evidence that the minimum wage may have affected business start-ups.

Views on Competitiveness

Prices

2.131 In our last report we noted the continued difficulties faced by providers in the social care sector attempting to negotiate the price paid for their services by public sector commissioners. We thought it timely and appropriate to repeat a recommendation we had made in similar form in previous reports: that the commissioning policies of local authorities and the NHS should reflect the actual costs of care, including the NMW. The Government, as with the previous recommendations, accepted it.

2.132 In its evidence the Government reminded us that it does not directly employ care workers; the Government allocates resources to local authorities who make decisions on what proportion of their budgets to spend on adult social care. In deciding overall funding from central government the Government makes an evaluation of likely cost pressures on the adult social care system, including wages, as well as an assessment of the efficiencies that can be achieved in the sector. A similar arrangement operates for assessing overall funding from central government for care commissioned through the NHS from social care providers. The overall social care funding for local authorities is allocated to them through the Department for Communities and Local Government Formula Grant. This allocates funding on a formula basis to each local authority in England, taking into account differences in demography and other factors such as labour costs. It is then for local authorities and care providers to negotiate care fee levels to reflect local circumstances. However, we again received evidence of the continued challenges faced by care providers.

2.133 The United Kingdom Home Care Association (UKHCA) said that its own survey on commissioning found that 58 per cent of councils had cut the price they paid to the independent and voluntary sectors for homecare. The Registered Nursing Home Association (RNHA) said that by the time of any funding reforms following the Dilnot Commission in England (which it thought not likely before 2014) many local authorities will have reduced fees payable for residential and nursing care by a total of 10 per cent below the levels paid in 2010/11, which it estimated could cause a shortfall of income over expenditure of around 20 per cent. It claimed that this would cause many care homes to close. UKHCA said it still saw no evidence to suggest that the Government was moving to implement the Commission's recommendation on commissioning.

2.134 The annual Laing & Buisson UK-wide survey of local authority baseline fees for older people in nursing and residential care (Laing & Buisson, 2011) found the average fee increase was 0.3 per cent in 2011/12, down from 0.7 per cent in 2010/11 and 2.6 per cent in 2009/10, with many local authorities freezing or reducing their fees.

"This has been the worst year on record for care providers. They are being affected by the commissioning practices of local authorities. Every week there is another case of providers being expected to take a cut, and margins are already tight. Local authorities were not honouring price increases in contracts, and providers were 'taking a hit' on their bottom line."

UKHCA/RNHA oral evidence

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There was, as in previous years, a wide geographical variation in fee increases, and at the regional/country level this ranged from -1.8 per cent in East Anglia to 4.4 per cent in Wales. The averages for England, Scotland and Northern Ireland were all 0.0 per cent. Laing & Buisson estimated that in 2011/12 the increase required to keep pace with care home inflation was 2.8 per cent.

- 2.135** Since our last report the issue of social care fees has been considered by several other bodies. In July 2011, the Dilnot Commission report on possible reform of social care funding in England was published (Commission on Funding of Care and Support, 2011). There have also been a number of judicial reviews brought by care providers against local authorities in their fee setting. While these have been about the process used by local authorities, rather than determining the fee level itself, they have highlighted the types of guidance and factors authorities should have regard to when setting fees, including the costs of care. In addition, the Equality and Human Rights Commission (2011) conducted an inquiry into older people and human rights in home care in England, which strongly endorsed our recommendation on commissioning.
- 2.136** We have also received evidence of moves within government to assess and review the commissioning process. The Department of Health told us it has conducted an engagement exercise with representatives of both care providers and local government. Many of the issues raised focused on how to build a sustainable market and to improve the commissioning capabilities of local authorities and the NHS. In addition we heard of discussions between provider organisations and the Association of Directors of Adult Social Services about how councils and providers can work better together on fee negotiations, ensuring a fair reflection of costs.
- 2.137** Our view is that public commissioners of services have a responsibility to fund providers such that they are able to discharge their statutory obligations, including the NMW. We have noted the continuing developments outlined above. We welcome and encourage moves to address commissioning issues, and we ask the Government to address sustaining the supply of social care, such that providers can meet cost pressures like the NMW, in its forthcoming Care and Support White Paper.
- 2.138** In other sectors, the NDNA told us that a large proportion of fees paid by parents went directly to fund staff salaries. With average fee increases in recent years below inflation, and with a substantial proportion of nurseries struggling to break even, it claimed increases in the minimum wage would continue to have a direct impact on nursery fees and business margins. The National Hairdressers' Federation (NHF) said that the uncertain financial situation in the economy had fed through to consumer confidence and depressed spending on the high street. Clients were often cutting back on the frequency of their visits and reducing spending per visit, with consequent pressure on prices and margins.

Costs

2.139 Those representing business referred to the various cost pressures that members, particularly small businesses, were under, including the NMW. BHA, BBPA and BISL said cost pressures remained a major concern. However, as minimum wage rises had moderated since 2008, it was no longer the predominant source of concern about rising prices. Other costs affecting the sector included food and energy price rises; VAT and Excise Duty increases; and costs resulting from other regulatory changes. NHF evidence also referred to the rising costs their member businesses faced. These inflationary pressures came not just from the minimum wage, but also other regulation, fuel costs, and the rise in VAT to 20 per cent. Salons were unable to offset higher VAT through reclaimable purchases.

“Cost inflation is stifling the growth of three quarters of small firms....Small firms are disproportionately hit by increases in any business costs. As their turnover and profit margins are generally smaller than large businesses, those increases are harder to absorb.”

Forum of Private Business evidence

Margins & Profits

2.140 ALMR reported almost all members responding to its survey had experienced a reduction in business profits as a direct result of minimum wage increases, with 61 per cent of members having to increase prices. But further price increases at this point were viewed as unsustainable by many. The Cinema Exhibitors’ Association told us the profitability and performance of their sector was sensitive to changes in the level of the NMW. In a survey by BIRA, 67 per cent of respondents stated the NMW had affected their profits, up from 43 per cent on a year earlier. East Anglia and the North were among the worst affected areas.

“Employment costs (caused by the minimum wage) were minimal compared to other business costs.”

Unite oral evidence

2.141 The Association of Convenience Stores reported that the impact of minimum wage increases had become more acute in the last year. Across all areas, retailers had reduced staff hours, seen reduced competitiveness and cut back on expansion plans. In a survey, 81 per cent of its members had said that increased employment costs had affected the competitiveness of their business.

2.142 However, some trade unions pointed to different evidence on the state of business profits. Unite said that despite the recession, UK corporations made profits of £78.6 billion in the first quarter of 2011. The TUC highlighted that corporate profitability for non-financial companies in the service sector had risen and was now 1.4 percentage points higher than at the end of the recession.

Conclusion

- 2.143** The National Minimum Wage has increased by nearly 69 per cent since its introduction. That is faster than both average earnings and prices. Since October 2006, however, the minimum wage has increased broadly in line with average earnings but a little below inflation. As a consequence the bite of the minimum wage at the median increased from 45.7 per cent in 1999 to 51.0 per cent in 2007 but then remained just under this level between 2007 and 2010. However, the growth in median hourly earnings in ASHE in April 2011 was just 0.4 per cent and this has led to an increase in the bite to nearly 52 per cent.
- 2.144** Although the bite stabilised in the economy as a whole between 2007 and 2010, it continued to rise in micro and other small firms, and in nearly all of the low-paying sectors. The bite rose again in these areas in 2011. However, despite the increased bite, the low-paying sectors have to date performed better in terms of employee jobs than the economy as a whole. The number of employee jobs in the low-paying sectors has increased since the end of the recession, but is still falling in the economy overall.
- 2.145** Many of the groups of workers that are most likely to hold minimum wage jobs fared relatively well during the recession and in the subsequent recovery. In terms of the labour market, women have fared better than men, ethnic minorities better than white people, older people better than the prime aged (those aged 35-54), and disabled people better than those without disabilities. Young people and those without qualifications have fared particularly badly since the onset of the recession, though these groups were already doing less well before it.
- 2.146** Our research programme for this report has added to the existing literature on the impact of the National Minimum Wage on earnings, employment and hours. Taking all of this knowledge collectively, we conclude that the lowest paid had received higher than average pay rises but the research, on balance, generally finds little or no significant adverse impact of the minimum wage on employment. However, some further evidence has been gathered for this report to suggest that the minimum wage may have led to a modest reduction in hours but this finding is still not consistently robust enough across time and datasets to be definitive. Against the backdrop of the main body of research finding no negative effects on employment, there has been more evidence than previously that there may have been an adverse impact on employment of certain groups in particular periods. These adverse findings, however, are confined to particular workers (young workers or female part-time workers) in particular time periods using certain datasets and model specifications. We go on to discuss the labour market performance of young people in more detail in the next chapter.

Chapter 3

Young People, Interns and Apprentices

Introduction

- 3.1** As part of our remit, the Government has again asked us to review the labour market position of young people, including those undertaking an apprenticeship or internship, and the levels of each of the different minimum wage rates. This chapter focuses on young people, interns and apprentices. Our recommendations for the youth and apprentice rates are covered in Chapter 5. In recommending minimum wage rates for both young people and apprentices, we have sought to ensure that the rates neither provide an incentive for young people to leave education or training, nor restrict the opportunities available for those who want to enter the labour market or begin an apprenticeship.
- 3.2** This chapter begins by looking at the earnings and labour market position of young people, and how they have fared in the period since the recession of 2008-2009. This is followed by a brief section on interns. An internship is a form of work experience, often unpaid, that is designed to help a young person get started in the labour market. The sustained growth in the number of unpaid internships, and the volume of evidence submitted to us by stakeholders, suggests there may be an issue with minimum wage compliance for interns (this is covered in detail in Chapter 4). Finally, we look at apprenticeships, and assess the impact of the introduction of the Apprentice Rate from 1 October 2010.

Young People

- 3.3** We showed in the 2011 Report that employment prospects for young people have been deteriorating over a number of years. This decline accelerated in the recession, with greater falls in employment rates, and greater rises in unemployment rates for young people compared with older workers. Earnings data also showed that employers were making increased use of youth rates of the National Minimum Wage (NMW), and that more young people than ever were falling within the coverage of the minimum wage. We concluded that there were good reasons to take a more cautious approach when recommending the youth rates. However, we added that we would keep the position of young people under careful review.
- 3.4** This section looks at the latest research, data and stakeholder evidence on young people. We consider the youth rates of the NMW, and the earnings and labour market position of young people to assess if the minimum wage has had an effect. We also look at those young people not in education, employment or training (NEET), and see if this proportion has

National Minimum Wage

changed following the recession. Finally, we review the impact of the decision to pay the adult minimum wage rate at age 21 from 1 October 2010.

Youth Rates

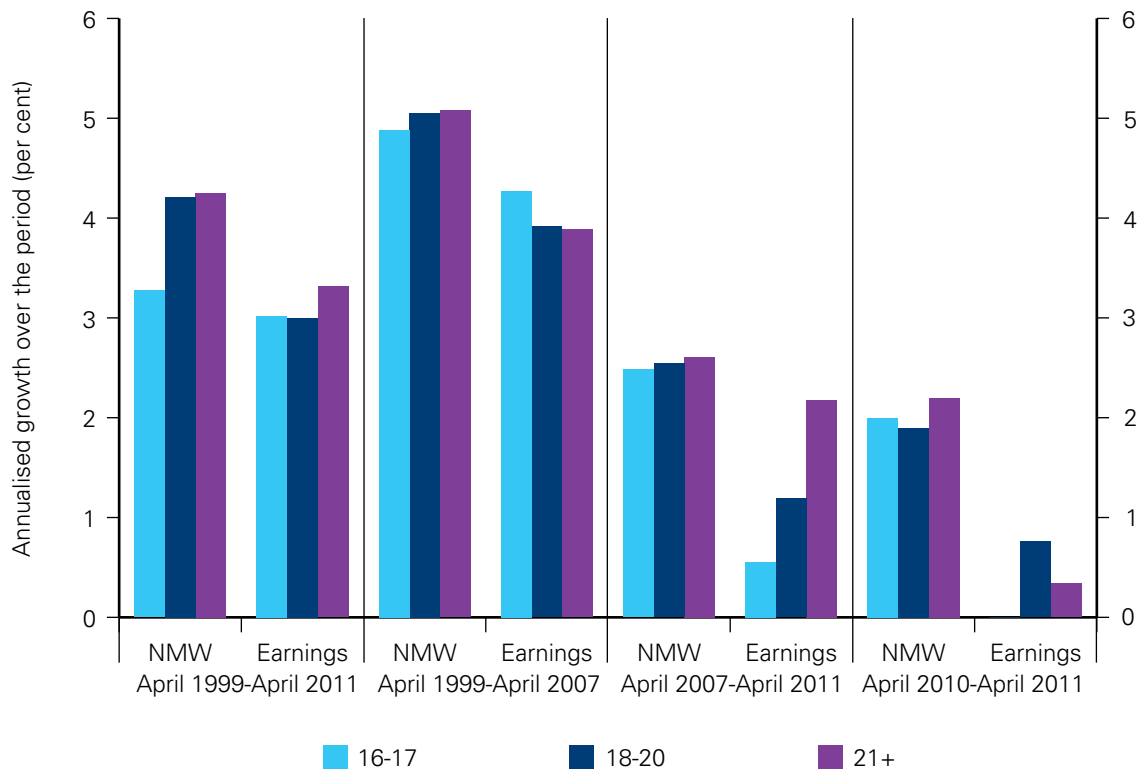
- 3.5** There are two youth rates of the minimum wage: the Youth Development Rate and the 16-17 Year Old Rate. The Youth Development Rate was introduced in April 1999 at £3.00 an hour and originally covered 18-21 year olds. Since its introduction, it has risen broadly in line with the adult rate of the NMW. From 1 October 2011 the Youth Development Rate (now applying to 18-20 year olds) was increased to £4.98, 82 per cent of the adult rate. The 16-17 Year Old Rate was introduced on 1 October 2004 at £3.00 an hour. Since 1 October 2011 the 16-17 Year Old Rate has been £3.68 an hour, 61 per cent of the adult rate.
- 3.6** We received a number of consultation responses relating to youth rates, and these broadly fell into two main categories: those who supported separate, lower youth rates, and those who opposed them. Many of the stakeholders in favour of separate youth rates argued that young people would be priced out of work by higher wages, and that young people's employment had already suffered disproportionately from the recession. White Horse Child Care Limited stated that the cost of hiring untrained young people was now too expensive, and many of the salons represented by the National Hairdressers' Federation (NHF) now viewed training young people as an 'unaffordable luxury'.
- 3.7** A number of respondents argued that having separate youth rates of the NMW was age discrimination. Save the Children, the National Union of Students (NUS) and Platform 51 all called for a single rate for all employees aged 16 or older. They argued that people doing the same work should get the same pay, regardless of age. They also argued that many young people were financially independent, and paid the same prices for housing, food, and other goods as adults, and should therefore be paid an equal wage. Most of the trade unions who responded to our consultation were also opposed to separate youth rates for younger workers, on the grounds of equality and fairness.
- 3.8** Since the formation of the Commission, we have believed that the minimum wage should be set at a lower level for young people. The evidence continues to show that they are more vulnerable in the labour market, and the threat of unemployment is greater for younger workers. When in employment, young people should of course be protected from exploitation, but we do not want the level of the minimum wage to jeopardise their employment or training opportunities.

Earnings

- 3.9** We use data from the Annual Survey of Hours and Earnings (ASHE) to look at the level and growth of earnings for employees. The latest ASHE data relate to April 2011, and cover the October 2010 minimum wage upratings. These upratings increased the 16-17 Year Old Rate by 2.0 per cent to £3.64, and the Youth Development Rate by 1.9 per cent to £4.92. They were slightly below the 2.2 per cent increase in the adult rate, marking a small departure from the previous approach when the upratings were broadly in line with the adult rate.

3.10 Figure 3.1 shows that on average the Youth Development Rate and the adult rate of the NMW have risen by just over 4 per cent a year since 1999, and the 16-17 Year Old Rate by a little over 3 per cent a year since its introduction in 2004. Over the whole period, 1999-2011, the median earnings of younger workers (aged between 16 and 20) have grown by about 3 per cent a year, and those of adult workers by 3.3 per cent a year. However, Figure 3.1 also shows that younger workers' pay increased in line with adults between 1999 and 2007, but has not kept pace since then.

Figure 3.1: Growth in the Minimum Wage and Median Earnings, by Age, UK, 1999-2011



Source: Low Pay Commission (LPC) estimates based on ASHE: without supplementary information, April 1999-2004; with supplementary information, April 2004-2006; and 2007 methodology, April 2006-2011, standard weights, including those not on adult rates of pay, UK.

Notes:

- a. The National Minimum Wage growth for 21 year olds and above is based on the adult minimum wage rate, which applied only to those aged 22 and over between 1999 and 2010.
- b. Annualised growth for the 16-17 Year Old Rate is from October 2004 when it was introduced.

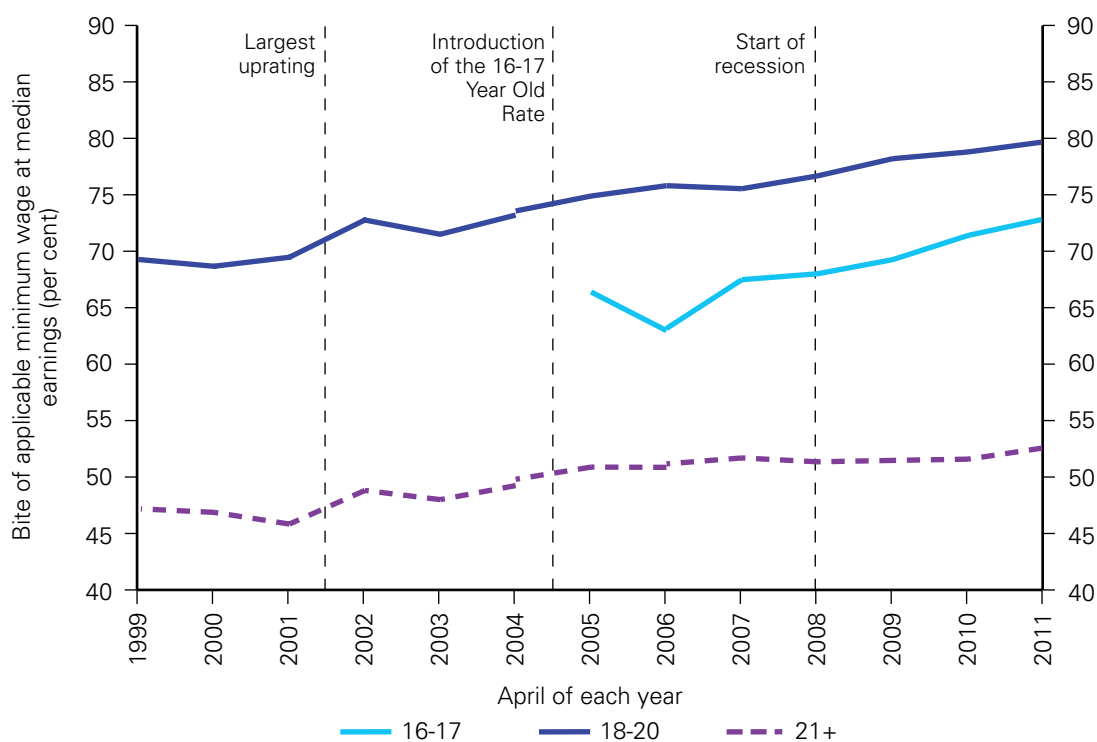
3.11 Between 1999 and 2007 there was very little difference in the annual increase in the applicable NMW rate for each age group, although 16-17 year olds did have slightly higher median earnings growth of 4.3 per cent a year. However, since 2007, when NMW upratings have been broadly consistent across age groups, median earnings growth has been significantly different. Between 2007 and 2011, adults aged 21 and over have seen annual median earnings growth of 2.2 per cent, compared with 1.2 per cent for 18-20 year olds, and 0.6 per cent for 16-17 year olds.

3.12 Between 2010 and 2011 median earnings increased by 0.3 per cent for those aged 21 and over, and by 0.8 per cent for workers aged 18-20. They remained unchanged at £5.00 an hour for 16-17 year olds – the same as in 2008.

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3.13 The low growth in earnings between 2010 and 2011, coupled with upratings of about 2 per cent in the minimum wage, has meant that the bites of the minimum wage rates (their value relative to median earnings) have continued to increase. Figure 3.2 shows that in April 2011, the bite of the applicable minimum wage rate was 72.8 per cent for 16-17 year olds, and 79.7 per cent for 18-20 year olds. For workers aged 21 and over the bite rose by 1 percentage point in 2011 to 52.6 per cent, having remained at about 51.5 per cent between 2007 and 2010.⁴

Figure 3.2: Bite of the Minimum Wage at the Median, by Age, UK, 1999-2011



Source: LPC estimates based on ASHE: without supplementary information, April 1999-2004; with supplementary information, April 2004-2006; and 2007 methodology, April 2006-2011, standard weights, including those not on adult rates of pay, UK.

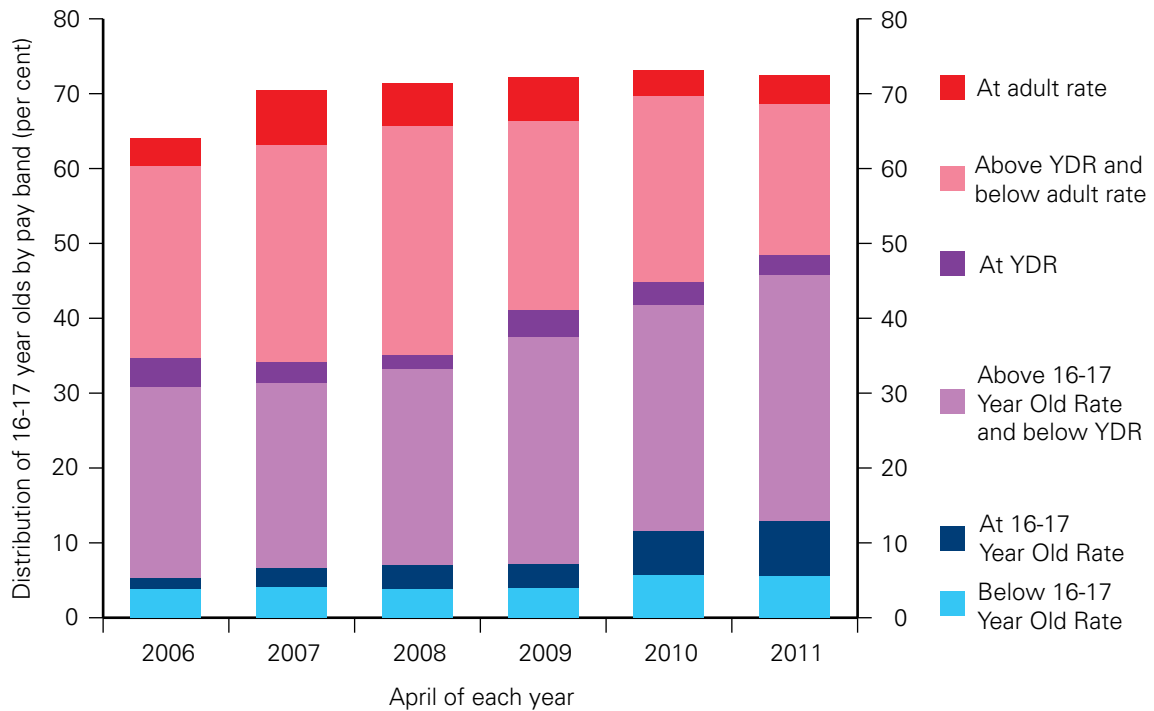
Notes:

- The median for those aged 21 and over is compared with the adult minimum wage rate, which applied only to those aged 22 and over between 1999 and 2010.
- Direct comparisons before and after 2004, and before and after 2006, should be made with care due to changes in the data series.

3.14 The ASHE data show clear spikes in the earnings distributions for young people at each of the NMW rates. We have noted in recent reports that employers appear to be making increased use of the youth rates of the NMW to pay their younger workers. Figure 3.3 shows that this trend has continued into 2011, with 7.2 per cent of 16-17 year olds paid at the 16-17 Year Old Rate of £3.64 in April 2011, the highest proportion since the rate was introduced in 2004.

⁴ Figures presented here on the bite of the NMW for adults differ from those presented elsewhere in the report, as they focus on workers aged 21 and over, rather than those aged 22 and over.

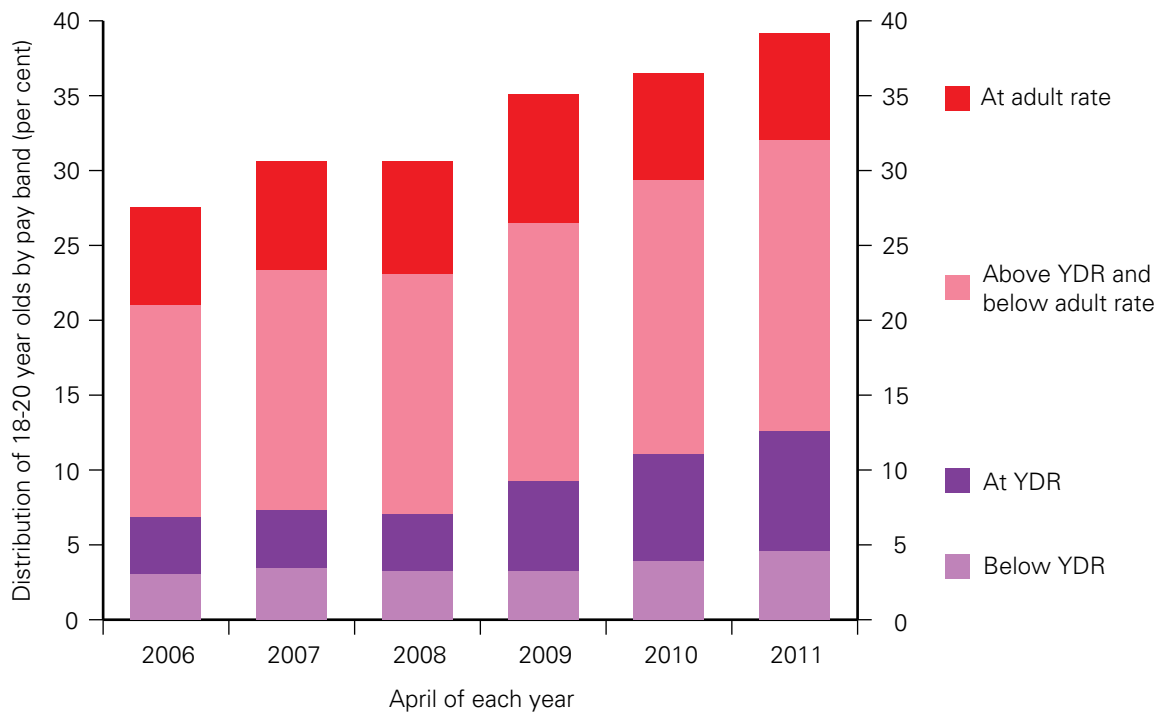
Figure 3.3: Proportion of Jobs Held by 16-17 Year Olds, by National Minimum Wage Rate, UK, 2006-2011



Source: LPC estimates based on ASHE, 2007 methodology, standard weights, including those not on adult rates of pay, UK, April 2006-2011.

- 3.15** The proportion of 16-17 year olds who are paid below the Youth Development Rate has also increased. In 2007, prior to the recession, fewer than a third of 16-17 year olds were paid less than the Youth Development Rate. By 2011 the proportion had risen to almost 46 per cent. Figure 3.3 also shows that 5.6 per cent of 16-17 year olds were paid less than the 16-17 Year Old Rate in 2011, the same proportion as in 2010. These are most likely to be apprentices, who were entitled to a lower minimum wage of £2.50 an hour in April 2011. Apprentices and the NMW are covered in more detail later in the chapter.
- 3.16** Figure 3.4 shows a similar pattern for workers aged 18-20. Almost a third of all 18-20 year old workers were paid below the adult rate in 2011, compared with less than a quarter in 2007, prior to the recession. Similarly, the proportion of 18-20 year olds paid at the Youth Development Rate increased from 3.8 per cent in 2007 to 8.0 per cent in 2011.

Figure 3.4: Proportion of Jobs Held by 18-20 Year Olds, by National Minimum Wage Rate, UK, 2006-2011



Source: LPC estimates based on ASHE, 2007 methodology, standard weights, including those not on adult rates of pay, UK, April 2006-2011.

3.17 Incomes Data Services (IDS) (2012) also found that some employers were making increased use of the youth rates. IDS analysed pay rises across a range of sectors between 2007 and 2011 and found that some employers, particularly in the fast food, pub and restaurant sector, had moved to paying their younger workers the youth rates of the NMW. They also found instances where organisations only raised pay rates for workers on the applicable minimum wage, resulting in pay freezes for those above the statutory minimum. However, the research did also find some instances, mainly in the food retail sector, where organisations had either significantly increased the starting rate for younger workers, or scrapped the use of youth rates of the NMW, and moved to paying all workers at least the adult rate of the NMW. IDS concluded that the behaviour of the employers included in its research depended largely upon how they had fared during and after the recession.

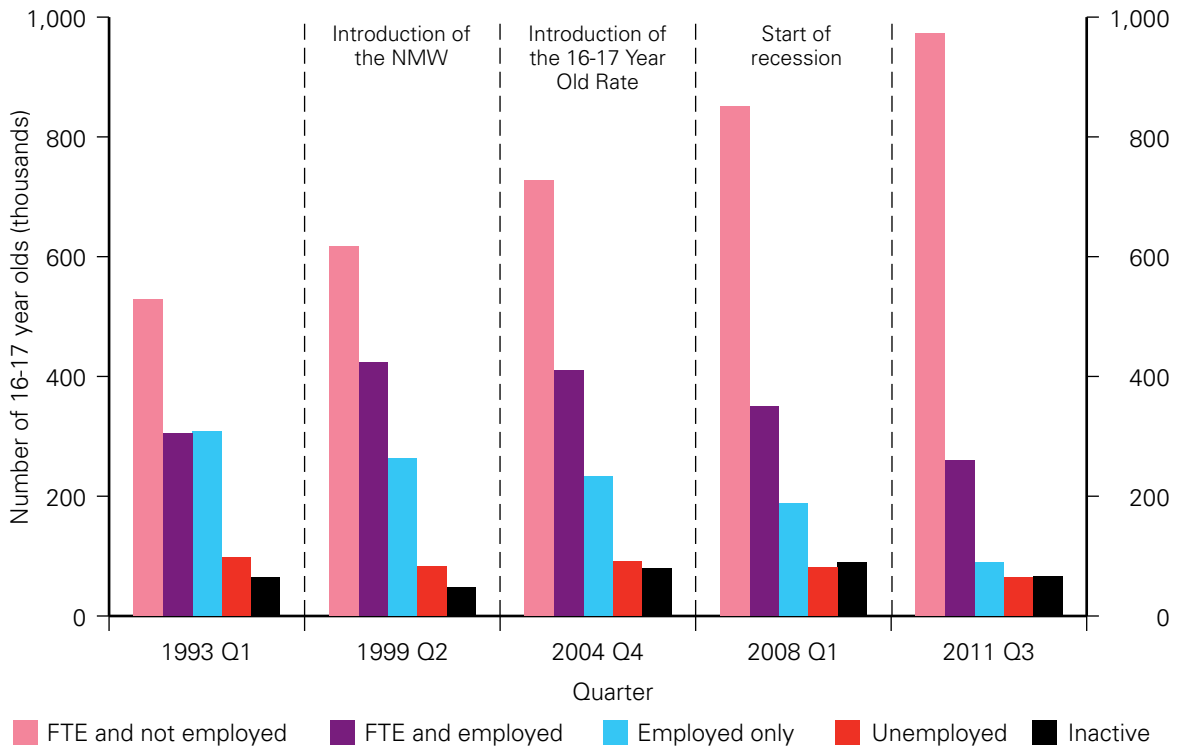
3.18 Dickerson and McIntosh (2012) built on their previous research (Dickerson and McIntosh, 2011) that investigated the relationship between productivity, earnings and age, with a focus on the early years of work. Their previous results suggested that the introduction of the National Minimum Wage had not affected age-earnings profiles and that the age-productivity profile was estimated to be similar to the age-earnings profile, albeit a little steeper. They concluded that young workers were overpaid relative to their productivity compared with workers in their 30s. The introduction of the minimum wage did not seem to have affected wage growth relative to productivity growth for young workers as relative productivity had increased for young workers between 1999 and 2007.

- 3.19** They extended their analysis up to 2010 and again estimated empirical age-earnings profiles and wage-productivity gaps across different aged workers. They found that wage differences reflected productivity differences between the age groups. They showed that wage differentials between age groups had narrowed slightly within industries in the post-recession period, relative to pre-recession, but that productivity differentials between age groups had widened, although the productivity results were not statistically significant. They concluded, however, that young workers' wages had increased more than their productivity contribution would warrant in the post-recession period, relative to prime-aged workers.
- 3.20** Having considered the earnings of those young people in work, we now move on to look at the labour market position of young people, and assess whether the minimum wage has had an impact on young people's labour market activity.

Labour Market Position

- 3.21** Young people are hit harder during a recession as firms stop hiring and tend to make their lowest-skilled and least-experienced staff redundant. This was particularly apparent during the 2008-2009 recession when youth employment fell and youth unemployment rose. However these trends need to be placed in context alongside changes to the population of young people and the increasing proportion participating in full-time education (FTE), to provide an accurate overview of how young people are engaging with the labour market. The population of young people grew much faster than the working age population between 2000 and 2011, and so there was an increased supply of young people in the labour market. However, the Office for National Statistics (ONS) forecasts that the population of young people will decline over the next decade, which may improve the job prospects of young people in the labour market, through reduced competition for vacancies.
- 3.22** In this section we use estimates of economic activity that we have derived from Labour Force Survey (LFS) data. These estimates differ from those published by the ONS due to the way we classify those individuals in FTE. The ONS classifies individuals in FTE as unemployed if they are looking for part-time employment. We classify individuals in FTE as either in FTE and employment if they also have a job, or in FTE only if they do not have a job. Therefore, in our estimates, an individual cannot appear as unemployed if they are in FTE. Because of this, our estimates of the level of unemployment for young people are lower than those of ONS.
- 3.23** Figure 3.5 shows that the number of 16-17 year olds who were in FTE without a job has increased from 529,000 (40.6 per cent of the population) in 1993 to 972,000 (67.0 per cent) by 2011. Over the same period, the number in employment (including those also in FTE) has fallen from 611,000 (46.9 per cent) to 348,000 (24.0 per cent). The number of 16-17 year olds either unemployed or inactive has remained broadly flat over the period, both between 50,000 and 100,000, and by the third quarter of 2011 there were about 65,000 16-17 year olds in each category (4.5 per cent).

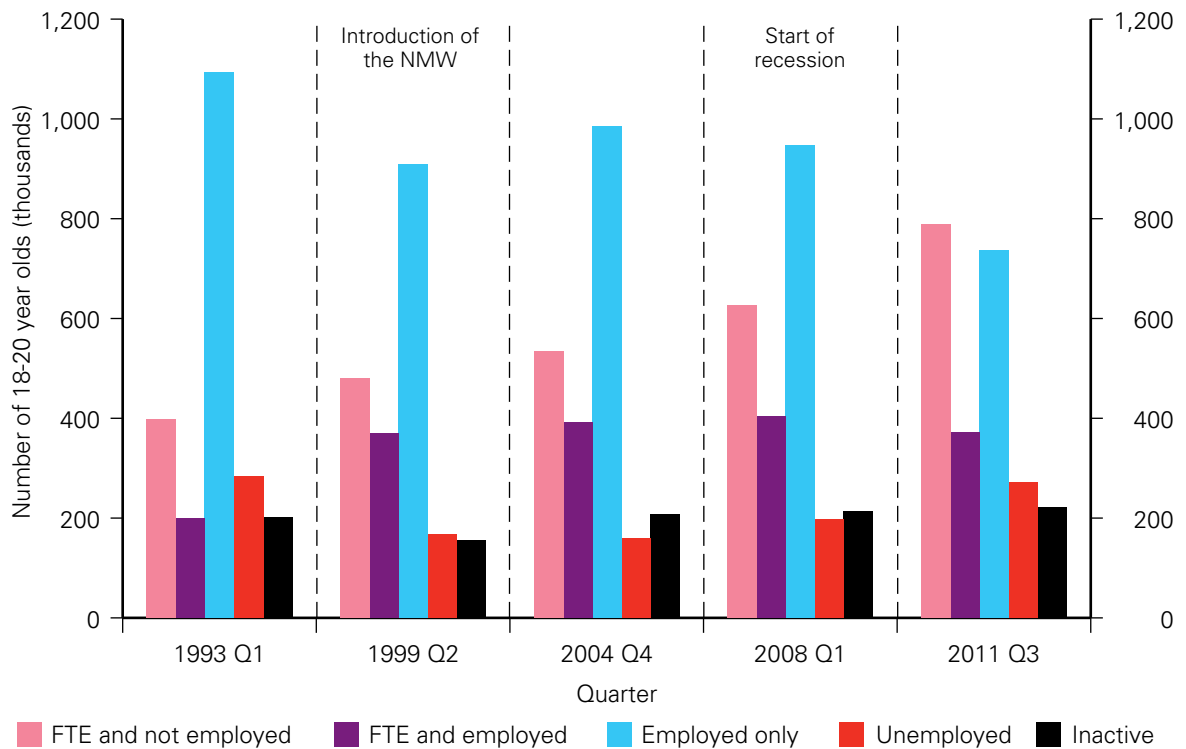
Figure 3.5: Economic Activity of 16-17 Year Olds, UK, 1993-2011



Source: LPC estimates based on LFS Microdata, quarterly, four-quarter moving average, UK, Q2 1992-Q3 2011.

3.24 Figure 3.6 shows that although the levels are different, the trends over time for 18-20 year olds are broadly similar to those for 16-17 year olds. The number of 18-20 year olds in employment fell over the period, although there was a small increase between the introduction of the NMW in 1999 and the end of 2004. This reduction has largely been caused by the fall in those 18-20 year olds who were in employment only (and not in FTE), where the number fell from almost 1 million in 2004 (43.2 per cent of the population) to 736,000 in the third quarter of 2011 (30.8 per cent).

3.25 In contrast, the number of 18-20 year olds in FTE has steadily risen over the period, reaching 1.16 million by 2011 (48.6 per cent of the entire cohort). This is the first time since records began in 1992, and probably ever, that the number of 18-20 year olds in FTE has been greater than the number in employment.

Figure 3.6: Economic Activity of 18-20 Year Olds, UK, 1993-2011

Source: LPC estimates based on LFS Microdata, quarterly, four-quarter moving average, UK, Q2 1992-Q3 2011.

- 3.26** This trend for an increasing proportion of young people to remain in FTE is likely to be further strengthened over the next few years, as a result of new government policy. In December, the Government published 'Building Engagement, Building Futures' for England (Department for Education, 2011), which set out its strategy to maximise the participation of 16-24 year olds in education, training and work. As part of this, the education participation age in England will be gradually increased so that by 2015, young people will be required to participate in learning until their 18th birthday or until they achieve a full Level 3 qualification (the equivalent of two A-levels).
- 3.27** Young people will be able to participate in learning in a number of ways, including remaining in FTE (including school, college or home education), undertaking work-based learning or an apprenticeship, or working full-time for at least 20 hours a week, while taking the equivalent of 1 day a week of accredited training. We may therefore expect to see a reduction in the number of young people in England who are unemployed or inactive after this policy is phased in from 2013, with a corresponding increase in the numbers in employment or FTE.
- 3.28** The raising of the participation age in England could affect the character of the youth labour market, as all 16-17 year olds will be required to be in some form of education or training. It will be important to develop this policy, and policy in relation to apprenticeships, in a way which sits comfortably with any future structure of the NMW.
- 3.29** At present 16-17 year old workers are entitled either to the 16-17 Year Old Rate, or if they are apprentices, to the Apprentice Rate. We have received evidence that in practice the appropriate rate is not always paid, but little evidence that there is an operational difficulty in principle over the co-existence of the Apprentice Rate and age-related rates.

National Minimum Wage

In future all 16-17 year old workers in England will be receiving training or education, but they will be entitled to quite different minimum wages according to whether their training or education takes the form of an apprenticeship or not. Care will be needed to ensure that the distinction between apprentices and others remains sufficiently clear, and to avoid unintended incentives for either employers or workers in those instances where there is similarity between apprenticeships, and the education and training received by young non-apprentices. We are pleased that officials from the Department for Business, Innovation and Skills (BIS) and the Department for Education have met our Secretariat to discuss this.

- 3.30** In research that we commissioned for this report, Crawford, Greaves, Jin, Swaffield and Vignoles (2011) analysed the impact of labour market conditions in general, and the minimum wage in particular, on the education and labour market outcomes of young people in the UK. The conclusions of this research generally confirmed the findings of previous work commissioned by us and from elsewhere, that a young person's academic ability and family background are the most important determinants of their education and labour market participation decisions, while local labour market conditions play a much smaller role.
- 3.31** Using data from the Longitudinal Study of Young People in England, the research found that during and immediately after the 2008-2009 recession local youth wage rates did not affect the main education or labour market activities young people undertook between the ages of 16 and 19, suggesting that marginal changes in the youth rates of the NMW would be unlikely to directly affect the main activities young people undertake.
- 3.32** This conclusion was supported by further analysis of the impact of the introduction of the 16-17 Year Old Rate in October 2004 using data from the LFS, which found the 16-17 Year Old Rate had little effect on the probability of staying in FTE, the probability of being NEET, or the probability of working for those 16-17 year olds not in FTE.
- 3.33** The research did, however, find evidence of a statistically significant positive effect of the 16-17 Year Old Rate on the probability of working among full-time students in low-wage areas relative to high-wage areas. This suggests that while young people's main outcomes between education and work were not affected by the introduction of the 16-17 Year Old Rate, the more marginal decision of whether to take a part-time job while studying appears to have been positively affected by the increase in the expected return to part-time work in low wage areas.
- 3.34** This research also confirmed our findings presented in Figures 3.5 and 3.6, that there has been a major shift in young people's education and labour market choices over the last ten years. Of particular note, they found that education participation increased dramatically among 16-17 year olds without a Level 2 qualification (equivalent to five GCSEs at grades A*-C) during the recession, suggesting that this group may have been choosing to stay in education longer than they otherwise would have done in order to avoid the prospect of becoming NEET.
- 3.35** Further research, from Bryan, Salvatori and Taylor (2012), used individual data to assess the impact of the minimum wage on employment, unemployment and hours. They found some evidence of a negative effect on the number of hours worked among young people (aged

18-21), with basic hours reduced by 3-4 hours during the recession. They do, however, caution that these results were based on small sample sizes.

3.36 In response to our consultation, many stakeholders touched on the difficult labour market conditions facing young people. The Chartered Institute of Payroll Professionals was pessimistic about the employment opportunities for young people given the state of the labour market; and the manufacturers' organisation, EEF, reported fewer opportunities for young people, following the abolition of the default retirement age, as an increased number of people over state-pension age would remain in work.

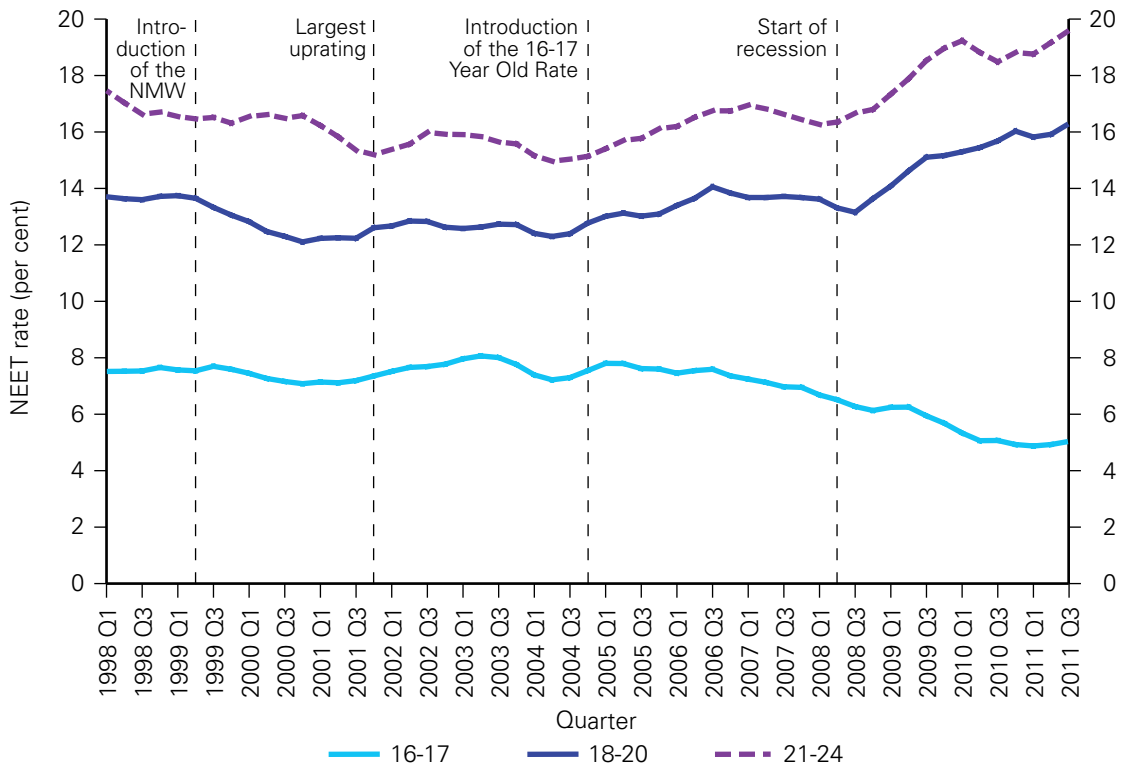
3.37 To complete the picture of how young people are engaging with the labour market, we look at those young people who become NEET, alongside those who enter employment or those who remain in FTE. We use data from the LFS to define NEETs as those who are unemployed or inactive but are not: students; on a course; working towards a qualification; or undertaking an apprenticeship.

3.38 During a recession, the proportion of young people who are NEET might be expected to rise, as employers stop hiring new staff and make redundancies. However, Figure 3.7 shows that for 16-17 year olds, the NEET rate (the proportion of the population who are NEET) has continued to fall since the recession began; dropping from 6.5 per cent in the second quarter of 2008 to 5.1 per cent by the third quarter of 2011. As mentioned above this appears to be due in part to some 16-17 year olds remaining in education during the recession to avoid becoming unemployed. In contrast, the NEET rates for both 18-20 year olds and 21-24 year olds have slowly increased since 2005, and have shown a marked rise since the start of the recession.

"The majority of young people succeed in education and make a positive transition to adult life and the world of work. But we face a very real challenge in terms of opportunities for young people, with 1.16 million young people in England aged 16-24 not in education, employment or training (NEET)."

**Government written evidence
2011**

Figure 3.7: NEET Rates, by Age, UK, 1998-2011



Source: LPC estimates based on LFS Microdata, quarterly, four-quarter moving average, UK, Q2 1997-Q3 2011.

3.39 We have seen that the number of young people aged between 16 and 20 staying in FTE has increased in recent years, and the number in employment has fallen. The next section of this chapter looks at the labour market position of 21 year olds, who became eligible for the adult rate of the minimum wage from 1 October 2010.

21 Year Olds

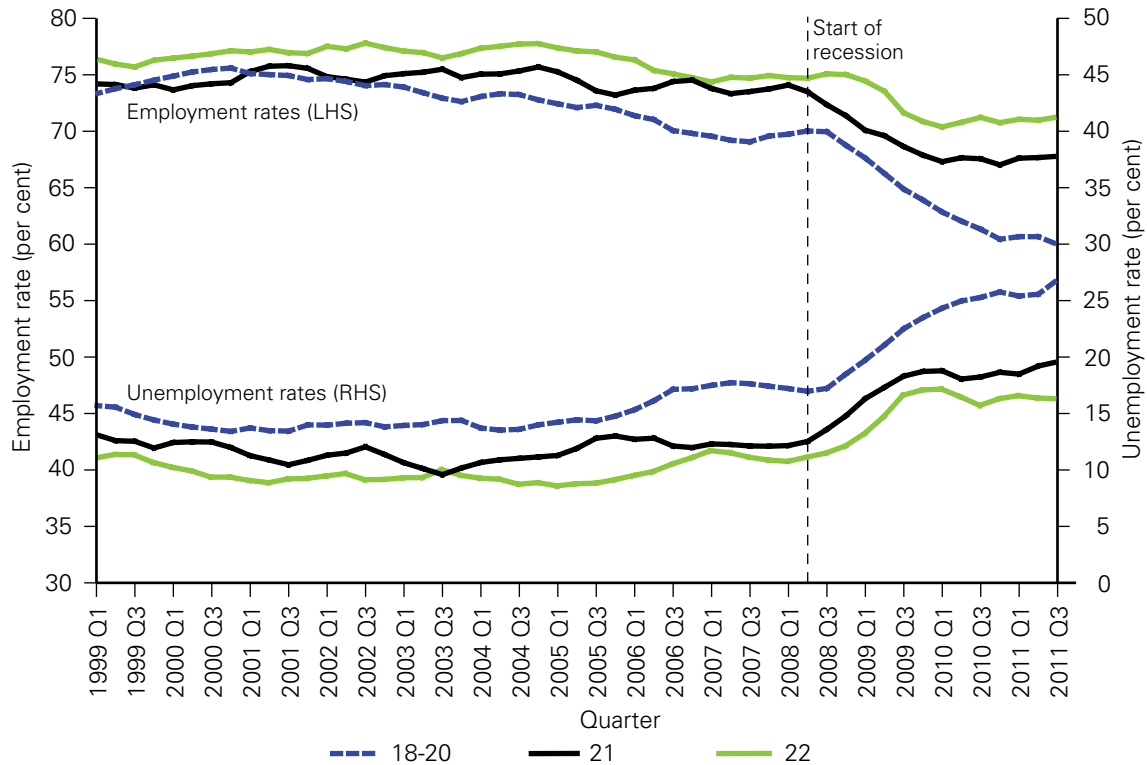
3.40 From 1 October 2010, 21 year olds have been entitled to the adult minimum wage rate. With the adult rate rising to £5.93 an hour, this was an effective increase of 23 per cent in the minimum wage entitlement of 21 year olds, from the previous Youth Development Rate of £4.83 an hour. We look next at the labour market position of 21 year olds compared with workers of a similar age, and assess if this large increase in their applicable minimum wage has had an effect on the earnings or labour market position of 21 year old workers.

3.41 The latest evidence from ASHE 2011 shows that earnings at both the lowest decile and the median for 21 year olds were closer to those of 22 year olds than 20 year olds. In addition, 81.5 per cent of workers aged 21 were being paid above the adult rate of the NMW in 2011, compared with 81.0 per cent in 2010, suggesting that employers had been able to absorb any costs associated with the change in the NMW entitlement of 21 year olds, and had not moved to paying a higher proportion of 21 year olds the adult rate of the NMW.

3.42 Turning to their labour market position, we noted in previous reports that the employment and unemployment rates of 21 year olds have very closely followed those of 22 year olds, both before and after the recession. Figure 3.8 shows that this continues to be the case, and there is a clear difference in how these rates have changed for 21 and 22 year old workers

compared with 18-20 year olds. Although employment rates fell and unemployment rates rose for all age groups following the onset of recession, both employment and unemployment rates appear to have levelled off for 21 and 22 year olds since the first quarter of 2010. However, for 18-20 year olds, employment rates have continued to fall and unemployment rates have continued to rise.

Figure 3.8: Employment and Unemployment Rates of 18-22 Year Olds Not in Full-time Education, by Age, UK, 1999-2011



Source: LPC estimates based on LFS Microdata, quarterly, four-quarter moving average, UK, Q2 1998-Q3 2011.

- 3.43** As well as analysing earnings and labour market activity, we commissioned new research for this report on 21 year olds. Crawford, Greaves, Jin, Swaffield and Vignoles (2011) found that extending the adult minimum wage to include 21 year olds had no significant effect on the likelihood of a 21 year old being in FTE, in work, or NEET. There was therefore no evidence that this change in entitlement had affected the education or labour market choices of 21 year olds compared with 20 year olds.
- 3.44** From the data presented above, there continues to be strong evidence that the earnings and labour market position of 21 year olds more closely resembles that of older workers than younger workers. Further, it does not appear to be the case that the movement of 21 year olds from the Youth Development Rate to the adult rate of the minimum wage in 2010 has had an adverse impact on their employment. We will continue to analyse new data as they become available, and monitor any further related research evidence. We now turn to another recent development in the labour market for young people: the growth in the number of interns.

Interns

- 3.45** As part of our review of the labour market position of young people, our remit asked us to consider those in internships. We look at their position in, and access to, the labour market in this chapter, and their legal entitlement to the NMW in Chapter 4. In previous reports we have noted the limited data available on the incidence of work experience or internship opportunities. There is no official or legal definition of work experience or internship, although the latter has been described as where an individual works so as to gain relevant professional experience before embarking on a career (Gateways to the Professions Collaborative Forum, 2011). With no set definition of these terms, however, the evidence is obtained from ad hoc surveys by interns groups, periodic surveys by bodies such as the Chartered Institute of Personnel and Development (CIPD), and some very limited official data on the work destinations of graduates.
- 3.46** In terms of trends in internship opportunities, we noted in our last report that CIPD's Labour Market Outlook survey had found an increase from 13 to 21 per cent between 2009 and 2010 in the proportion of employers who were likely to recruit interns in the next six months. A further CIPD survey (summer 2011) found this higher level had been sustained. Another source of evidence on the changing level of unpaid work experience opportunities is data from the Destination of Leavers from Higher Education survey (Higher Education Statistics Agency, 2011). The latest available figures from this source showed 1.7 per cent of graduates were volunteering or undertaking unpaid work six months after graduating in 2009/10. This compared with 1.6 per cent in 2008/09 and 0.7 per cent in 2002/03. Between its inception in July 2009 and July 2011 nearly 35,000 vacancies had been advertised on the Graduate Talent Pool's (GTP) website. Nearly 53,000 graduates had registered with the GTP over the same period.
- 3.47** Looking at evidence on what proportion of interns are paid, and at what rate, we again have to piece together indications from various sources. Of the vacancies posted on the GTP website between July 2009 and July 2011, nearly 21,000 (60 per cent) were paid. The remainder were unpaid, or paid only expenses. A survey of work experience and intern pay by XperthR (2011b) covering 74 organisations found 44 per cent that offered work experience for students or graduates did not normally pay them a wage, 28 per cent said they always did, while 23 per cent said they sometimes did. Around 38 per cent did not pay expenses, and 27 per cent paid neither wages nor expenses. Among those who paid a wage the level ranged from £2.50 to £10.00 an hour. The CIPD's Labour Market Outlook survey (summer 2011) found the factor which most limited employers taking on an intern was whether they needed or wanted one (32 per cent), with only 2 per cent of those surveyed saying it was the minimum wage. A survey of interns conducted by Interns Anonymous and submitted in evidence found the vast majority (87 per cent) had been expected to work a fixed number of hours or specific days or had specific duties. However, fewer than 13 per cent were paid at least the NMW in all of their internships. For around 28 per cent, none of their expenses had been covered. Over 90 per cent said they had not received advice or guidance at school or university regarding the NMW and internships.

- 3.48** The Government drew attention to its Strategy for Social Mobility launched in April 2011 (HM Government, 2011), aimed at promoting greater social mobility. It recognised the important role internships play in the youth labour market and explained that as a result, and in order to promote fair access to jobs, internships needed to be opened up to all young people. The Government has called on businesses to offer internships openly and transparently and to provide financial support to ensure fair access. It is also reforming the way internships are offered in Whitehall, with a new scheme extending the programme to attract talented people from under-represented groups. The Government has in addition supported internships in other ways, such as the continued funding of the GTP website as a free internships vacancy matching service for employers and recent graduates.
- 3.49** We again received views from stakeholders on the impact of unpaid internships on the youth labour market. Inspiring Interns, an internship recruitment agency, believed that while it was desirable for internships to be paid there would be a number of negative implications if the NMW was forcibly applied to every placement: it believed these included some companies stopping internship programmes or shortening periods of work experience. In its view this would have a negative effect on social mobility. It thought that as a minimum, expenses should be met or a training wage paid, and that the Commission should distinguish between genuine internships and circumstances where employers used the label to disguise underpaid worker positions.
- 3.50** The majority of submissions we received, however, thought that failure to pay the NMW would have a negative impact on social mobility. The National Union of Journalists said this restricted access to journalism to those who could afford to work for free, and said fewer than 10 per cent of those entering journalism came from a working class background. Often interns were, in its experience, doing a full-time job for many months, with no guarantee of a post at the end. CIPD said that in order to ensure fair access to internships employers needed to pay interns the NMW as a minimum standard. It reminded us that its past surveys found most employers already did so. It said growing numbers of employers realised that they needed to recruit from the widest possible pool if they were to compete in the tough economic environment, and unless they paid a proper wage were likely to miss out on talent.
- 3.51** Creative and Cultural Skills (CCS) and the Broadcasting Entertainment Cinematograph and Theatre Union expressed concerns over the impact of unpaid internships and other work experience on diversity. CCS noted that social mobility and diversity were being stifled in its sector by the growth in unpaid internships, lack of transparency in job advertisements, and requirements for degrees in advertisements for non-graduate roles. Women made up only 40 per cent of the sector workforce and were likely to be paid less than men. Ninety-one per cent of all workers in the creative and cultural industries were white, and in London this figure stood at 86 per cent, a figure which it said was unrepresentative of the make-up of the inner city.

National Minimum Wage

3.52 We continue to recognise and support the value of work experience opportunities to young people. However, the evidence has again highlighted the potentially damaging impact of unpaid internships on social mobility by inhibiting labour market access for particular groups who cannot afford to undertake them. We are also concerned that labelling opportunities as internships may be seen as a loophole to undermine the minimum wage. We therefore consider the legal position on payment of the NMW while undertaking a period of work experience, including internships, in Chapter 4. However, we next turn to another type of in-work training, apprenticeships, which have seen a rapid expansion of places during the past year.

Apprentices

3.53 As well as reviewing the labour market position of young people in apprenticeships our remit asked us to review and make recommendations on the Apprentice Rate as part of the consideration of each of the minimum wage rates. This section covers the former and first provides the context of the labour market for apprenticeships, setting out the latest data on numbers of apprentices and in particular their age profile. It then looks at data on apprentice pay and hours, before presenting the evidence to date on the impact of the Apprentice Rate. Our recommendation on the future level of the Apprentice Rate is presented in Chapter 5.

Apprenticeship Starts

3.54 This section looks at the latest available data on apprenticeship starts. Policy on education and training is devolved to each UK administration, whereas the NMW applies UK-wide. All the administrations support and value expansion of apprenticeships, although their specific policies sometimes differ.

3.55 Table 3.1 shows that in 2010/11 the expansion of apprenticeships across the UK continued. Scotland slightly improved upon the substantially higher number of starts seen in 2009/10, and has an even higher target of 25,000 in 2011/12. Starts in Northern Ireland increased in 2010/11 following a plateau the previous year. Wales also experienced an increase after a slight fall in 2009/10. However, by far the largest expansion was in England, where there was a rise of nearly 60 per cent on 2009/10 (based on near-final data for the 2010/11 academic year). This in large part reflected the Government's apprenticeship policy initiatives, with increased funding and highest priority given to apprenticeships as the key route for vocational training. The less traditional apprenticeship sectors experienced the highest increases in 2010/11 (e.g. starts on the customer services framework increased by about 24,000), with traditional sectors, such as engineering (an increase of about 3,000 starts) and construction (an increase of about 1,000 starts) making smaller contributions to the overall rise. In the lower-paying apprentice sectors, children's care, learning and development starts increased (by over 6,000), while total starts in hairdressing remained broadly flat compared to the previous year (down 140 starts).

Table 3.1: Number of Apprenticeship Starts, by Country, 2003/04-2010/11^a

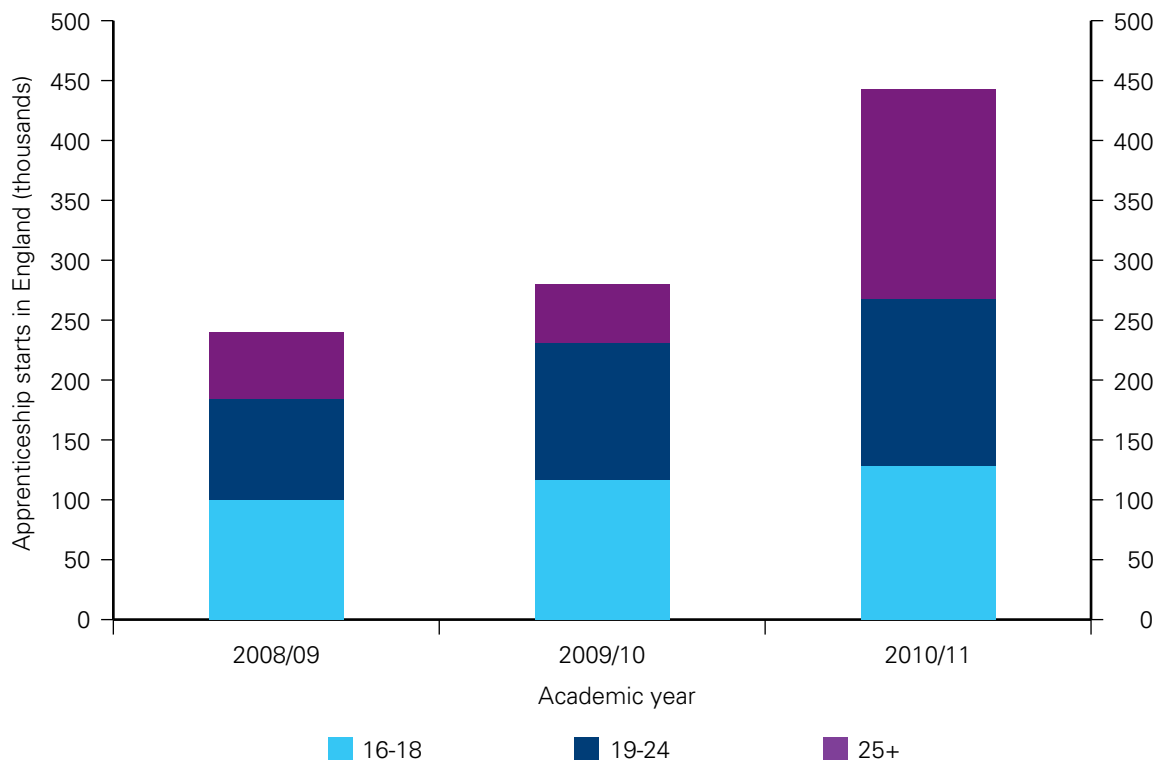
Thousands	UK	England ^b	Northern Ireland ^c	Scotland ^d	Wales
2003/04		193.6	3.5		
2004/05		189.0	3.4		24.6
2005/06		175.0	3.3		28.1
2006/07		184.3	3.3		19.6
2007/08	266.6	224.8	5.5	14.7	21.6
2008/09	275.7	239.8	7.1	10.6	18.1
2009/10	321.9	278.2	7.1	20.2	16.4
2010/11	492.2	442.7	8.9	21.2	19.4

Source: UK administrations, 2003-2011.

Notes:

- England and Wales figures are for the academic year; Northern Ireland and Scotland figures are for the financial year. No earlier years are available for Scotland and Wales.
- England data for 2010/11 are provisional, and may be subject to small revision. They exclude the small number of Level 4 apprenticeship starts from 2008/09.
- In Northern Ireland, Apprenticeships NI replaced Modern Apprenticeships in September 2007; hence the figures from 2007/08 are the sum of these two schemes.
- Figures for Scotland are only available for Modern Apprenticeships, which will not include all those at Level 2.

3.56 The increase in UK starts was across all age groups, although older apprentices now make up a larger proportion of the total. The biggest driver of the overall shift in the age composition of starts was again the changes in England. Figure 3.9 shows how those aged 25 and over accounted for the largest share of the increase in starts in England in 2010/11 (based on provisional data for the 2010/11 academic year).

Figure 3.9: Total Apprenticeship Starts, by Age, England, 2008/09-2010/11

Source: Individualised Learner Record for England, 2008-2011.

Note: Data for 2010/11 are provisional and may be subject to small revision.

National Minimum Wage

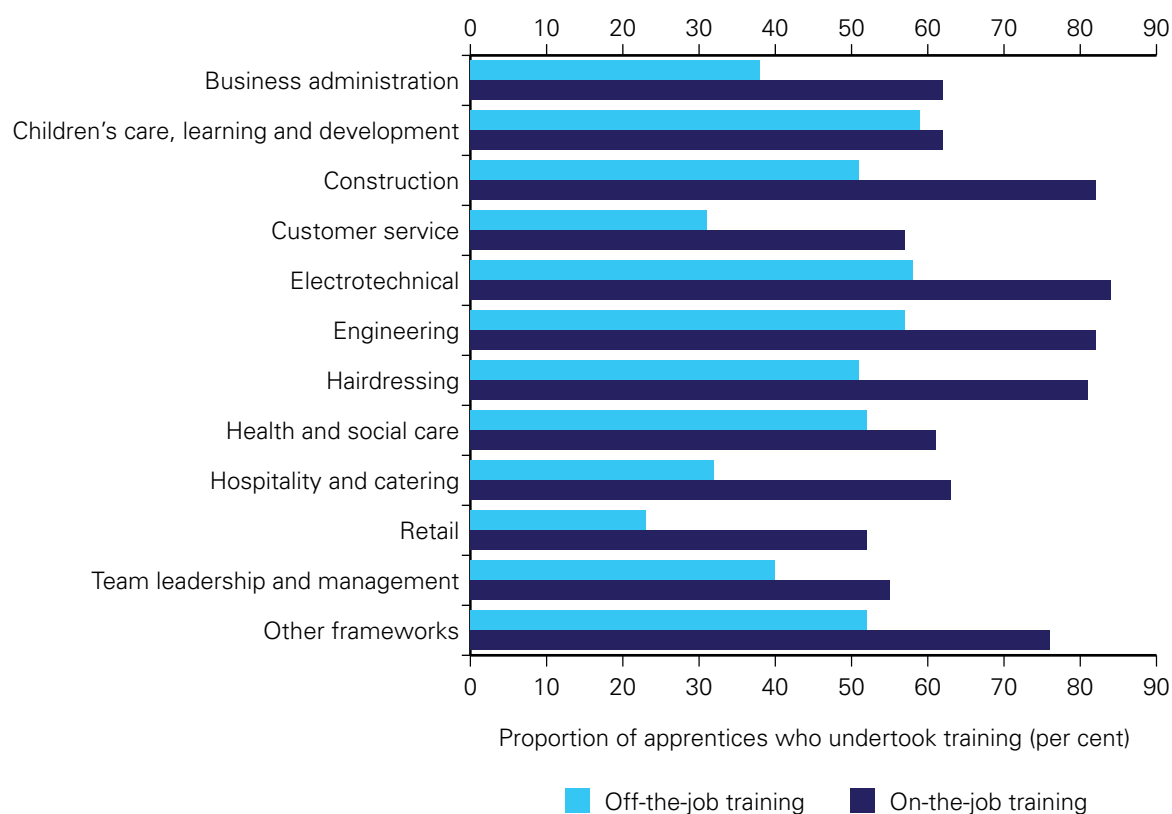
- 3.57** While the combined share of total starts by 16-18 year olds and 19-24 year olds in England fell from 82 per cent in 2009/10 to 60 per cent in 2010/11, their absolute numbers increased. Various factors may have contributed to the growing proportion of older apprentices, including the state of the labour market and the switch of existing government funding for training employees (Train to Gain) into apprenticeships. In addition the majority of apprentices were already working for their employer before starting their apprenticeship (evidence on this latter point is presented later in the chapter).

Apprentice Hours and Pay

- 3.58** We have noted in recent reports that the evidence base on apprentice pay, in particular that covering each of the four UK countries, was inadequate. In response to a request from the Commission, we are pleased that the Government commissioned a UK-wide survey of apprentice pay in the summer of 2011. Ipsos MORI (BIS, 2012b) undertook a telephone survey of a sample of individual apprentices in Great Britain, and a postal survey of all apprentices in Northern Ireland. We think it important that we build up a time series of data on apprenticeship hours and pay, and would encourage the Government to repeat this survey in 2012. This would allow us to compare the position of apprentices over time, and gain a better understanding of the impact of the Apprentice Rate.

Apprentice Hours: Work and Training

- 3.59** The BIS Apprentice Pay Survey found that the most commonly occurring weekly working hours were 35 to 39 hours (38 per cent). In addition around a quarter of apprentices had contracted hours of between 40 and 44 a week. So around two-thirds of apprentices worked between 35 to 44 hours a week. However, around 5 per cent of apprentices claimed to work fewer than 16 hours a week – the minimum number of hours required under apprentice training arrangements in England.
- 3.60** Around a third of apprentices took part in both on-the-job and off-the-job training. A similar proportion took part in on-the-job only, while 11 per cent did off-the-job training only. Figure 3.10 shows that on-the-job training is higher than off-the-job training in all sectors. Over 80 per cent of apprentices in electrotechnical, engineering, and hairdressing undertook on-the-job training compared with only 50 per cent of those in retail. Retail was also the sector with the lowest proportion of apprentices undertaking off-the-job training, whereas children's care, electrotechnical, and engineering had the highest proportions.
- 3.61** Rather worryingly, 20 per cent of apprentices said they received no training at all. The researchers found that apprentices on frameworks covering service occupations (such as retail, customer service, and business administration) were more likely to have said they received no training. However, on some frameworks there may be a grey area between on-the-job training and working.

Figure 3.10: Proportion of Apprentices Receiving On-the-job and Off-the-job Training, by Sector, GB, 2011

Source: LPC estimates based on BIS Apprentice Pay Survey, GB, 2011.

Apprentice Pay

3.62 Table 3.2 shows that the median gross hourly pay of apprentices across the UK was £5.87 in 2011, and that the mean gross hourly pay was £5.83. There was some variation on the level of apprentice pay between countries. Wales had the highest median pay of £6.30 an hour, while Scotland had the lowest, with median hourly pay of £5.62.

Table 3.2: Mean and Median Gross Hourly Pay for Apprentices, by Country, 2011

£	Mean gross hourly pay	Median gross hourly pay
England	5.80	5.83
Scotland	5.91	5.62
Wales	6.62	6.30
Northern Ireland	5.70	5.93
United Kingdom	5.83	5.87

Source: BIS Apprentice Pay Survey, UK, 2011.

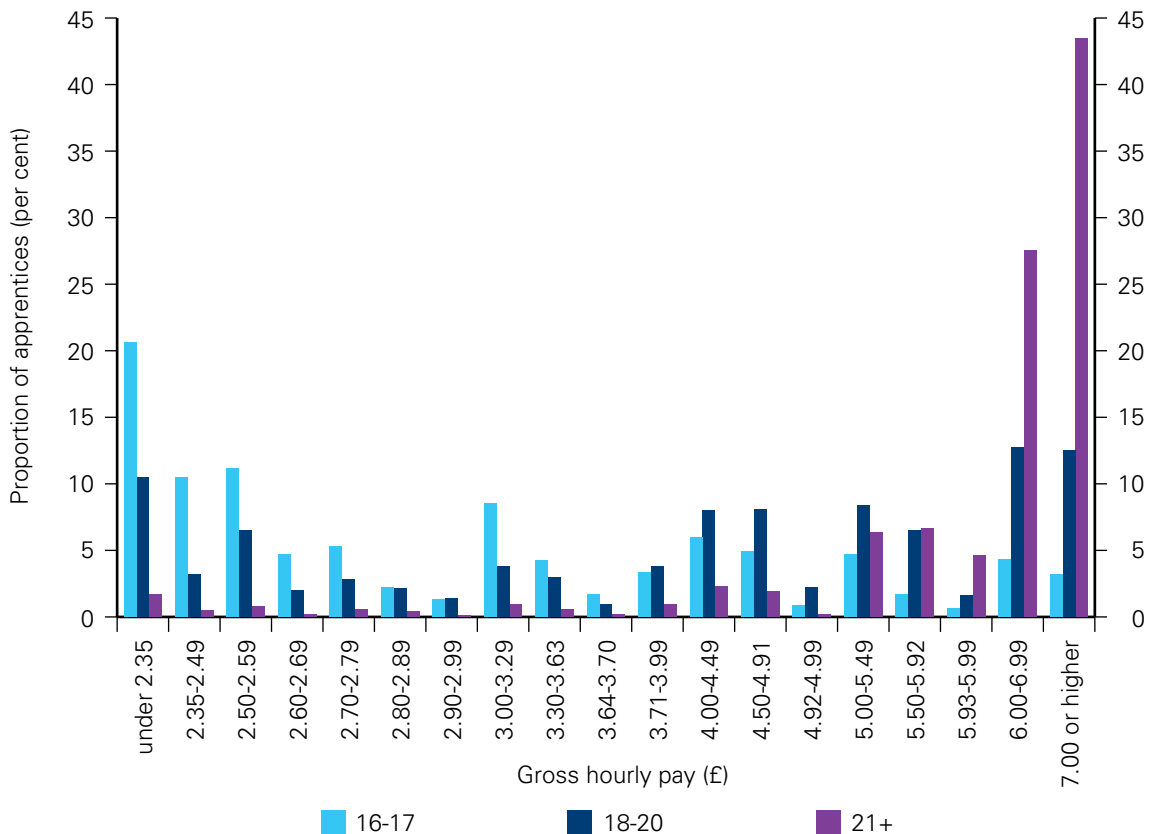
3.63 As mentioned in paragraph 3.58, a random selection of apprentices in England, Scotland and Wales (Great Britain), and all apprentices in Northern Ireland were contacted for the BIS Apprentice Pay Survey. Due to the different sampling methodologies used, the data for Great Britain are not comparable with the data for Northern Ireland. Although some very high-level estimates have been produced at the UK level (such as in Table 3.2 above), the rest of this

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chapter will look at data for Great Britain, where data for each of the individual countries are comparable on a consistent basis.

- 3.64** For 16-17 year old apprentices in Great Britain, median hourly pay was £2.71, and the bite of the Apprentice Rate at the median was 92 per cent. This is higher than the bite of the minimum wage for their non-apprenticeship equivalents (73 per cent). The median gross hourly pay for 18-20 year old apprentices was £4.62, and the bite at the median was 54 per cent. This is significantly lower than the bite of the minimum wage for their non-apprenticeship equivalents (80 per cent). The median gross hourly pay for apprentices aged 21 or higher was £6.67, and the bite at the median was 37 per cent. This is also significantly lower than the bite for their non-apprenticeship equivalents (53 per cent).
- 3.65** Around 3 per cent of all apprentices were paid £2.50 an hour, and about 10 per cent below this. A further 1 per cent of apprentices would have been covered by the rise in the Apprentice Rate to £2.60 an hour in October 2011. Among apprentices aged 16-17 Figure 3.11 shows that over 30 per cent appear to be paid less than £2.50 an hour. Around 9 per cent were paid at the £2.50 rate, with a further 3 per cent paid below £2.60. About a quarter of those 16-17 year olds paid below the Apprentice Rate are estimated to be on £2.38 an hour – equivalent to the previous £95 contractual apprentice wage in England for a 40-hour working week. About 10 per cent of all 16-17 year olds had hourly rates just above £2.60 an hour (4.7 per cent between £2.60 and £2.69, and 5.3 per cent between £2.70 and £2.79) suggesting they would potentially be affected by any future upratings.

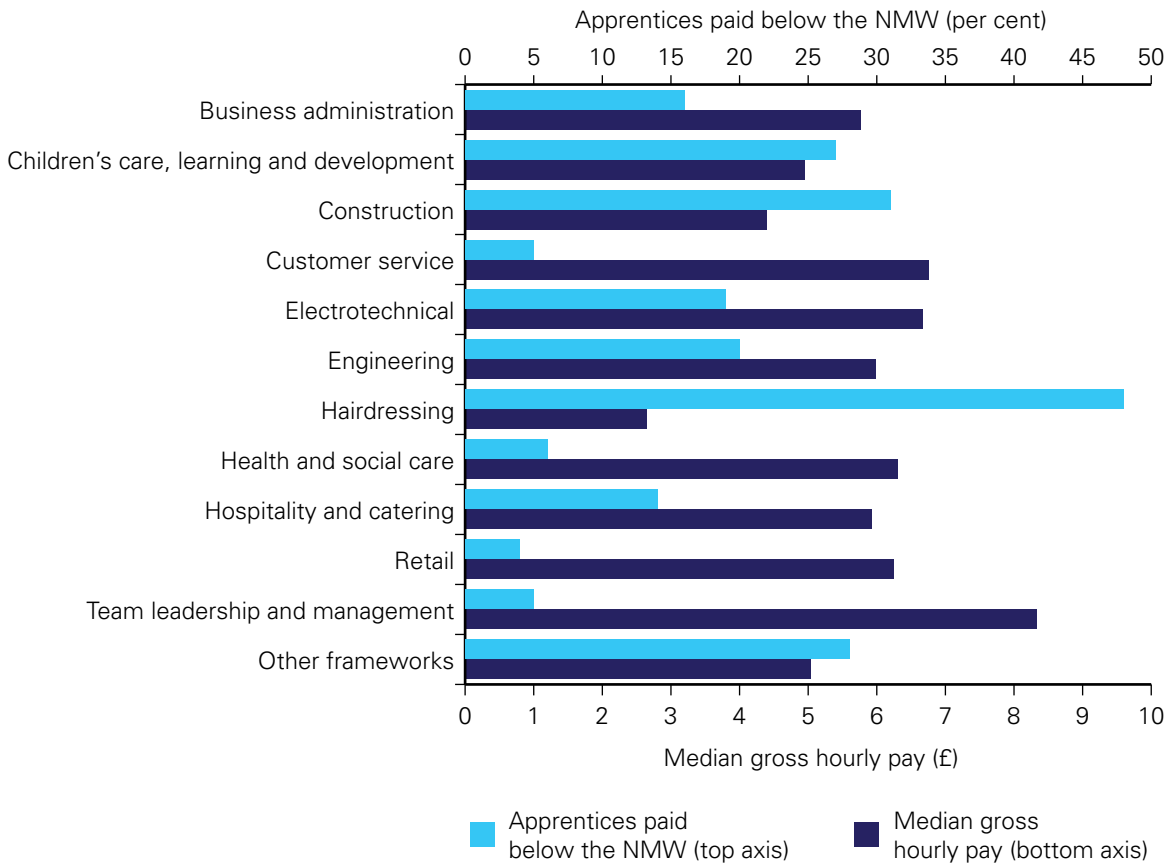
Figure 3.11: Hourly Rate of Apprentice Pay, by Age, GB, 2011



Source: LPC estimates based on BIS Apprentice Pay Survey, GB, 2011.

3.66 The BIS Apprentice Pay Survey found that around 20 per cent of apprentices may have been paid below their NMW entitlements, whether in respect of the age rates or the Apprentice Rate. Figure 3.12 shows that hairdressing was the sector with the lowest median pay rate and highest proportion of apprentices paid below their NMW entitlement.

Figure 3.12: Median Apprentice Pay and Apprentices Paid Below the Applicable Minimum Wage, by Sector, GB, 2011



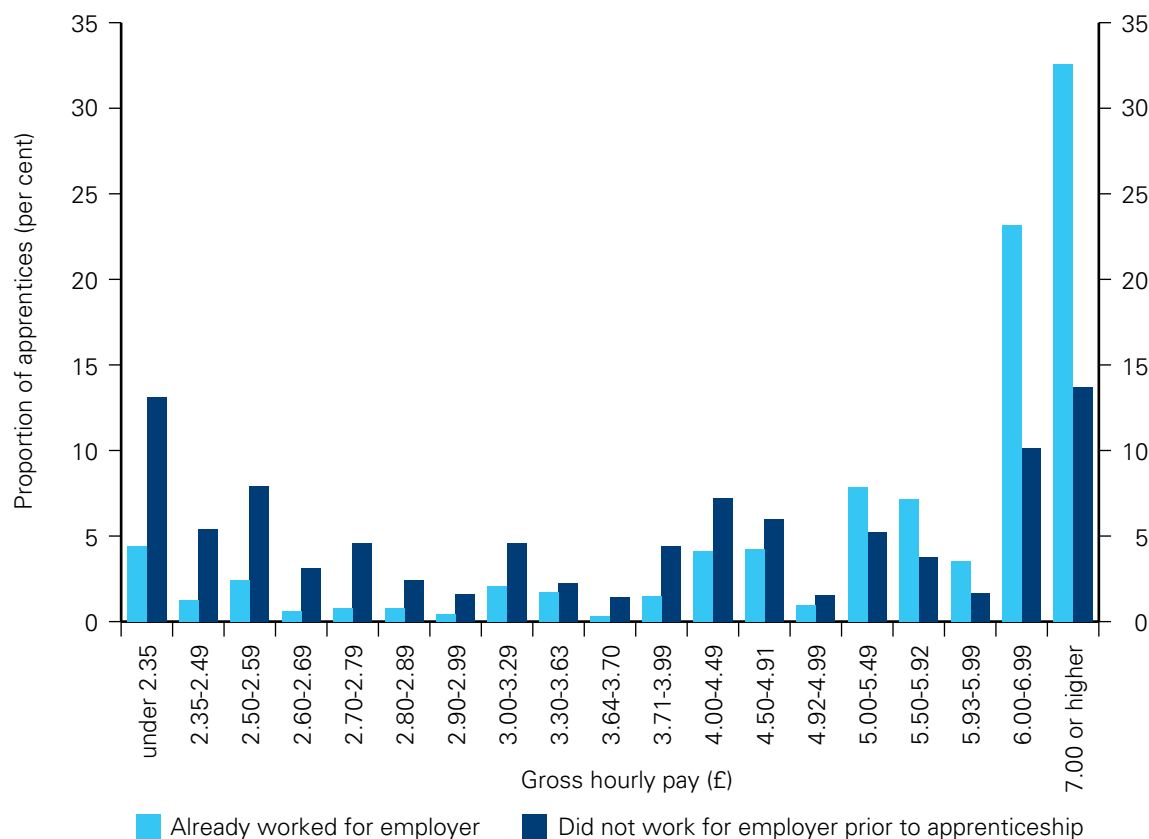
Source: LPC estimates based on BIS Apprentice Pay Survey, GB, 2011.

3.67 The survey found that seven in ten apprentices worked for their employer before starting their apprenticeship. But this proportion varied considerably between sectors. In the low-paying sectors, around 90 per cent of apprentices in retail, hospitality and social care already worked for their current employer, and around 60 per cent did so in hairdressing and childcare. Figure 3.13 shows that there is a marked difference in the pay distribution of those apprentices who already worked for their employer and those who did not. This distribution is similar if we look only at apprentices in their first year of training. Apprentices who previously worked for their employer are more likely to be paid a higher hourly wage than those who did not. Furthermore, 85 per cent of apprentices who previously worked for their employer appear to have been paid at least the relevant minimum wage, a figure which falls to 69 per cent for apprentices who were newly recruited to their employer.

3.68 Our further analysis also found that non-payment of the appropriate rate of the NMW was more likely to occur in the second and subsequent years of training than the first. About 9 per cent of apprentices in their first year of training appeared to be paid less than the NMW, rising to 39 per cent for apprentices in their second year, and falling slightly to 27 per cent for

apprentices in their third (or higher) year. This might suggest that employers are not aware of the NMW rules, whereby after twelve months in an apprenticeship those apprentices aged 19 and over must be paid the appropriate age rate of the NMW.

Figure 3.13: Apprentice Pay, by Previous Employment Status, GB, 2011



Source: LPC estimates based on BIS Apprentice Pay Survey, GB, 2011.

3.69 The survey also found a large proportion of apprentices were not being paid for overtime. Over half of apprentices surveyed worked overtime. Of these around two-thirds said they were always paid, 8 per cent said they were sometimes paid, and a quarter said they were never paid. The proportion of apprentices never paid for undertaking overtime varied greatly by sector, ranging from 7 per cent in engineering to 59 per cent in hairdressing.

Impact of the Introduction of the Apprentice Rate

3.70 The Apprentice Rate was introduced at a relatively cautious level. It broadly equated to the existing £95 contractual weekly wage payable to apprentices on government supported schemes in England, where around 90 per cent of all apprenticeships in the UK take place. In our 2011 Report we said the available evidence suggested that the Apprentice Rate had had little negative effect. This section considers the additional evidence now available on the impact of the Apprentice Rate, in particular from our commissioned research but also from stakeholder submissions.

Research

- 3.71** We commissioned Ipsos MORI and Cambridge Policy Consultants (2012) to carry out research on the impact of the introduction of the Apprentice Rate. The researchers conducted a telephone survey of 500 employers of apprentices in England, Scotland and Wales. Due to data protection issues and the absence of any centrally held employer data they were not able to access learner records to conduct a similar telephone survey in Northern Ireland. It was, however, possible to conduct an online survey of employers there, through training providers. In addition to this quantitative research, the researchers conducted qualitative research on the impact of the Apprenticeship Rate through interviews with key personnel in national delivery teams and training providers, as well as a limited number of group discussions with apprentices. Difficulties in accessing UK employers with apprentices meant that some caution should be exercised when interpreting the results. The researchers suggested that their findings should be interpreted in broad terms.
- 3.72** The survey asked UK employers offering apprenticeships after September 2010 whether the introduction of the Apprentice Rate made any change to their offer of places. It found that the Apprentice Rate appears to have had a minimal impact on these employers' decisions, with 76 per cent agreeing with the statement that the introduction of the Apprentice Rate made no change to their offering of apprenticeship places and 12 per cent disagreeing. Of the 77 employers no longer offering apprenticeships, 15 per cent agreed with the statement that the introduction of the Apprentice Rate 'was the main reason for their decision not to offer apprenticeship training', and 71 per cent disagreed with it. Only 18 per cent of employers agreed that the Apprentice Rate had led them to seek alternative methods for training young people, but 23 per cent of employers in the low-paying sectors did.
- 3.73** The researchers said their findings suggested that the Apprentice Rate was one of many elements affecting employers' overall decision making: employers that had either increased or reduced their intake of apprentices over the last year provided a wide variety of reasons for doing so, of which the Apprentice Rate typically played a minor role. In addition the qualitative research undertaken also found little effect of the Apprentice Rate. Almost all discussions with national delivery teams and training providers in each UK administration suggested that the introduction of the Apprentice Rate had no impact on apprenticeships. Discussions with apprentices themselves suggested that the impact of the introduction of the Apprentice Rate was broadly neutral.
- 3.74** The study reported around one in seven of employers surveyed said they had difficulties with one or more of the criteria which affect eligibility for the Apprentice Rate. As most of these employers identified several problems no one single problem dominated, and the researchers concluded that overall the impact was minimal. However those identifying these problems were more likely to disagree with a further statement that the introduction of the Apprentice Rate 'made no change to your offering of apprenticeship places' and agree that the Apprentice Rate would make it less likely that they would take on apprentices in the next year.
- 3.75** Among those employers who reported a problem the most frequently mentioned impact of difficulties arising through the eligibility criteria was increased financial cost to the company

(26 per cent). Other effects were also predominantly financial including reported difficulties in increasing pay to the right level for older apprentices, and also that the Apprentice Rate was too low for apprentices to cover their expenses or to reflect their input. Others questioned the financial benefit to the company of college training. Some regarded the Apprentice Rate as too high, some as too low. Of those employers experiencing at least one difficulty, most either did not know what the business had done in response to the impact (39 per cent) or said the company had absorbed it and taken no action (23 per cent). The remaining responses were spread between focusing recruitment on particular age groups or levels, adjusting the funds available, or reducing apprentice numbers or training time available – although each of these reasons was given by fewer than 10 per cent of those who faced difficulties.

3.76 The researchers found that employers thought the main impact of the Apprentice Rate was in relation to demand by young people for apprenticeships, although their views varied. Around half said the Apprentice Rate had made work-based training more attractive to young people and over a third said it had increased demand for work-based training from young people. However, around three in ten disagreed with both statements, so the impact was mixed. More clear cut was the perceived lack of impact on completion rates. Around half of employers agreed that the introduction of the Apprentice Rate made little difference to the completion of apprenticeships by young people, whereas one in five disagreed.

3.77 The survey asked employers whether they were aware of the NMW rate for apprentices. While over two-thirds said they were aware around one-third said they were not. This ignorance raises a fundamental issue for compliance. We make a recommendation aimed at raising awareness of the NMW and its rules in Chapter 4. Of those who already knew about the Apprentice Rate, most had originally found out from a learning or training provider (26 per cent). Just 5 per cent mentioned HM Revenue & Customs (HMRC), and only 5 per cent the national training body or government department responsible for apprenticeships. In its evidence to us the Government advised that apprentices formed 29 per cent of HMRC's non-compliant cases. The findings also provided evidence of possible non-compliance with regard to the training content of apprenticeships. Three in ten employers said they did not offer any off-the-job training to apprentices; this is contrary to the training specifications which were coming into effect in England around the time of the survey.

3.78 The research findings suggested that the overall impact of the introduction of the Apprentice Rate on employers was small. Most of the employers surveyed also expressed no concerns over the (then forthcoming) increase in October 2011 from £2.50 to £2.60 an hour. The researchers' overall conclusion, based on their findings, was that the current rate was about right because it allowed flexibility on the part of the employer to pay more if they wished to. They thought that this flexibility would be removed if the rate was set too high. However, this research, as with the BIS Apprentice Pay Survey, found that a proportion of apprentices were paid below the Apprentice Rate – around 5 per cent of employers in our commissioned research said they paid apprentices below the Apprentice Rate. While the BIS survey is the more robust measure of apprentice pay, the overall evidence from both surveys suggests that there is some degree of employer ignorance of, or intentional non-compliance with, the Apprentice Rate and NMW rules for apprentice pay. This may be a factor in explaining the apparent small impact to date of the introduction of the Apprentice Rate.

Views on Impact

- 3.79** In its evidence the Government acknowledged that it was too early to assess the impact of the Apprentice Rate, but it was mindful of the vulnerable position of apprentices, particularly young apprentices, in the economy given current labour market conditions. The other UK administrations were also generally cautious about the Apprentice Rate, concerned that it should not have any adverse impact on provision, although the Scottish Government expressed reservations that the level remained low. None provided any evidence of a negative impact to date and they awaited data from the BIS Apprentice Pay Survey to help inform their assessment.
- 3.80** Among employer groups there was also recognition that evidence to date is limited, but they were also concerned about the level of the bite and the impact of any future rises in the wage. The CBI said that while the limited evidence available suggested the Apprentice Rate had minimal impact, caution should still be applied to setting apprentice rates. It had calculated that the bite of the £2.60 rate from October 2011 averaged 59 per cent across all sectors against average first year apprentice pay rates, which it said was 7.5 per cent higher than the bite for the adult rate of the National Minimum Wage and 2 per cent higher than the bite for the introductory £2.50 Apprentice Rate. The Unquoted Companies Group was disappointed at the 4 per cent increase for apprentices from October 2011. It was concerned about the impact of this on employer provision of training. However, the Apprenticeship Ambassadors Network said it was content with the present arrangements and that there was little reason to interfere with an arrangement which appeared to be working satisfactorily.
- 3.81** Trade unions and groups representing young workers had a different perspective on the impact of the Apprentice Rate. The TUC provided evidence of the bite of the Apprentice Rate and NMW level of pay against starter and more senior apprentice rates in a number of craft apprenticeships. It noted, for example, that in the British Furniture Trade Joint Industrial Council Agreement, the fully qualified rate was 45 pence more than the adult rate of the NMW, yet the starting rate for 16 year olds was 85 pence higher than the Apprentice Rate. The TUC said that the increase in apprenticeship starts in 2010/11 provided some good evidence that the Apprentice Rate had not had an adverse effect. Unite did not believe it would be accurate to attribute the dramatic rise in the number of apprenticeships to the Apprentice Rate, but it could have had a positive effect. Platform 51 and the NUS had concerns that the Apprentice Rate had been set too low, preventing some groups from taking up training opportunities and having little impact on the apprentice gender pay gap.
- 3.82** The Hair and Beauty Industry Authority, the training body for the hair and beauty sector, said the interim findings from its survey across the industry indicated that the number of businesses offering apprenticeships had fallen compared with a year earlier. Just under a third employed the same number of apprentices as a year ago but nearly a half employed fewer or none at all now; on the other hand 20 per cent employed more than previously or had started to employ them in the last twelve months. NHF said that the minimum wage in some salons had led to a narrowing of differentials between juniors and stylists, so salons would look to recruit a stylist, who would bring experience, rather than someone cheaper who required more training to get up to speed. NHF highlighted what it regarded as the added complexity and burden of having four rates of the NMW now, which it thought made

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some salons more averse to recruiting, and created 'grey areas' as to which rate applied in different circumstances.

- 3.83** Stakeholder evidence also suggested that the impact of the Apprentice Rate should not be looked at in isolation from other regulations. The National Day Nurseries Association (NDNA) told us in oral evidence that the introductory rate equated with typical nursery apprentice pay. It was concerned about the impact of any further rises in the Apprentice Rate, but also raised its concerns over possible changes following the Government's review of the Early Years Foundation Stage (the statutory framework nurseries must follow). It had been proposed to change the current staffing ratio, increasing the age at which staff can be included from 17 to 18 years old. Although we understand that the Government is still examining the proposal, some nurseries had informed NDNA that without the ability to count under-18s as staff they were considering withdrawing from under-18 apprenticeships. Our commissioned research on the Apprentice Rate also highlighted that training providers felt that some aspects of wider regulation, such as restrictions on under-18s, were adding to the challenges facing young people seeking a place on an apprenticeship.
- 3.84** Another issue highlighted in our consultation was the possible negative impact on household benefits (such as child benefit) when a young person moves from college education into work, including starting an apprenticeship. We were told there could be a net fall in household income in some situations. This is a benefits issue rather than a minimum wage one but in our view the Government needs to consider this further, particularly in the context of the raising of the education participation age in England from 2013.

Conclusion

- 3.85** This chapter has looked at young people, interns and apprentices. The labour market position of young people has continued to deteriorate since the end of the recession. Youth employment is at a record low, although this is due in large part to an increasing number of young people staying in full-time education.
- 3.86** Young people have been increasingly affected by the minimum wage over the past year, with low earnings growth leading to an increased minimum wage bite. Workers aged 16-17 saw median earnings unchanged from 2010 at £5.00 an hour, the same level they were at in 2008, and workers aged 18-20 saw a rise in median earnings of 0.8 per cent to £6.18 an hour. Employers are making greater use of the minimum wage rates, with higher proportions of 16-17 year olds and 18-20 year olds being paid at their applicable rate than ever before.
- 3.87** In general the research we commissioned for this report continued to show minimal effects of the minimum wage on employment. However, Bryan, Salvatori and Taylor (2012) found that there was some evidence that minimum wage upratings had a negative impact on hours worked, particularly for younger workers. Crawford, Greaves, Jin, Swaffield and Vignoles (2011) found that a young person's academic ability and family background were the most important determinants of their education and labour market participation decisions, while the role of local labour market conditions was more limited. They found that local youth wage rates did not affect the main education or labour market decisions young people made

between the ages of 16 and 19, suggesting that marginal changes in the youth rates of the NMW were unlikely to have a direct impact on the main activities young people choose to undertake.

- 3.88** Work experience, including internships, remains an important entry route for many young people into the labour market. However, we continued to receive evidence that a substantial proportion were unpaid, with implications for social mobility and labour market access for many young people unable to afford these opportunities. We consider the legal requirements to pay the NMW in these circumstances in Chapter 4.
- 3.89** The total number of apprenticeship starts in the UK continued to rise in 2010/11. The largest increase was among older apprentices, aged 25 and over, although the number of starts increased across all age groups. The Apprentice Rate was introduced at a relatively cautious level and the findings from our commissioned research were that the overall impact to date appeared minimal. However, there was evidence that some employers, and particular groups of apprentices and sectors, may have been more affected by the Apprentice Rate.
- 3.90** The BIS Apprentice Pay Survey showed it was more likely to affect the pay of the youngest apprentices (16 and 17 year olds), apprentices in the lower-paying sectors (such as hairdressing) and those who did not work for their employer before starting. Research also suggested that a substantial minority of employers of apprentices were unaware of the introduction of the Apprentice Rate, and a substantial proportion of apprentices were paid below their NMW entitlements, in respect of the age rates as well as the Apprentice Rate. This indicated some degree of employer ignorance of, or intentional non-compliance with, the Apprentice Rate and NMW rules for apprentice pay. We believe that action is needed to improve official guidance and raise awareness of the Apprentice Rate, and we set out our recommendations in Chapter 4. As we noted above, employer ignorance of the Apprentice Rate and non-compliance may be factors in explaining the apparently small impact to date. We will commission additional research on the Apprentice Rate for our next report in order to increase our understanding of its impact.
- 3.91** We aim to ensure that the minimum wage rates do not provide an incentive for young people to leave education or training while preventing exploitation for those in work, or undertaking an apprenticeship or internship. We present our recommendations for the youth and apprentice rates for October 2012 in Chapter 5, alongside stakeholder views and other evidence that influenced our decisions. We next turn to the issue of compliance and operation of the National Minimum Wage.

Chapter 4

Compliance and Operation of the National Minimum Wage

Introduction

- 4.1** Compliance remains the cornerstone of the National Minimum Wage (NMW) regime. Achieving and maintaining a high level of compliance requires widespread awareness and understanding of the wage arrangements, and also effective enforcement. We set out in this chapter a number of developments in the areas of awareness, guidance and enforcement, as well as our recommendations for maintaining compliance.
- 4.2** We showed earlier in this report that the NMW has more of an impact on particular sectors of the economy. It also has a greater effect on particular groups of workers. This is because of such workers' type of work, the kind of payments they receive, or other aspects of their work arrangements. In this chapter we look in detail at the functioning of the NMW arrangements in respect of agency workers; the accommodation offset; migrant workers; those paid by piece rates; internships, work experience and volunteering; tips; and care workers. We also report on the latest position with regard to seafarers.
- 4.3** In addition, as part of our remit, we were asked to consider the implications of the proposed abolition of the Agricultural Wages Board for England and Wales. We consider this later in this chapter. The remit also asked us to look at whether the NMW regulations could be made even simpler and easier to administer. We gave careful consideration to this matter and consulted widely, and we look at this first.

Operation of the National Minimum Wage – Simplification

- 4.4** In this section we look at the evidence we have received in relation to how the minimum wage could be made simpler and easier to administer. Linked to this, we consider wider issues in relation to the operational aspects of the wage, for example with regard to agency workers, where these have arisen in the context of simplification.

A Simple and Straightforward National Minimum Wage

- 4.5** Having a minimum wage that is simple and straightforward has been one of the guiding principles for the Commission ever since our first report. We have always regarded this as important in making the NMW easy to understand, implement and enforce. The Government has asked us as part of the remit for this report to consider whether the wage arrangements can be made even simpler. It regards reducing and simplifying regulation as a key priority and,

through eliminating avoidable burdens of regulation, it aims to promote growth, innovation and social action. The Government sees striking the right balance – a level of regulation that promotes competition and stability without impinging on businesses’ ability to operate – as a core element of its strategy for promoting economic growth (HM Government, 2010).

- 4.6** At the same time as holding to the principle of ‘simple and straightforward’ we have also held that the wage should ‘make a difference’ for the low paid by providing an effective wage floor with protection from exploitation. The Commission has therefore had to balance a desire for simplicity with the need to protect vulnerable workers from exploitation. We have borne this in mind as we have considered evidence put to us on simplification of the minimum wage arrangements.

Evidence on Simplification

- 4.7** The rules for the NMW are contained in the National Minimum Wage Act 1998, and the related sets of regulations. However, most businesses and workers that refer to the NMW rules do so via official guidance rather than the actual statutes. Therefore, any attempt to simplify the NMW regulations needs to consider official guidance as well as the statutory rules themselves. We received a number of responses on the issue of simplification in the course of our consultation process. The majority of responses either said the regulations were simple enough already, or related to requests for better guidance and understanding.

“There is much scope to simplify employment law, but the National Minimum Wage is not an area where there is much to be gained.”

CBI oral evidence

- 4.8** Many business organisations did not detect any strong desire from members for changes to the NMW arrangements. On a Commission visit to Southampton, MITIE said it regarded the regulations as straightforward as they stood. Trade unions generally supported the current arrangements. The Union of Shop, Distributive and Allied Workers (Usdaw) believed that the current regulations were simple and easily understood, so no changes were necessary.

“The NMW is not complicated: all you need to know are the birthdays of your younger workers.”

Group HR Manager, Hastings Hotel Group, Commission visit to Belfast

- 4.9** Other employer groups, such as the Association of Convenience Stores, regarded the NMW regulations as straightforward, but echoed the view of some that clarification was needed on certain aspects: for example, should a member of staff who has to change into their uniform be paid on arrival or once they are ready to start work. There were a number of other stakeholders who also told us improvements were needed to the guidance. UNISON was concerned at the need for better guidance in the social care sector to ensure care staff were paid their full NMW entitlement. The United Kingdom Home Care Association (UKHCA) told us in oral evidence that better guidance for employers, preferably specific to the home care sector, on areas such as on-call hours and travel time would help its members.

The Newspaper Society called for better guidance where shift systems were operated. The British Hospitality Association (BHA), British Beer & Pub Association (BBPA) and Business In Sport and Leisure (BISL) thought that in general the NMW was not too complicated, but that for reasons of confidentiality HM Revenue & Customs (HMRC) gave out little information about why cases were taken up and the nature of mistakes made. They thought more information might help us to better understand whether and where the rules were overly complex. In oral evidence they and the Association of Licensed Multiple Retailers (ALMR) raised concerns about how difficult it was to find information on Business Link, and also confirmed the value of previously available sector-specific official guidance material.

- 4.10** Some stakeholders did ask for what they saw as simplification and a change in the NMW rules. GMB, like a number of other unions, supported one NMW rate for all workers, and also called for the hourly rate to be displayed on all payslips. The Association of Labour Providers (ALP) called for the removal of the accommodation offset and for the rules to allow deductions for accommodation and transport that were made voluntarily. The Newspaper Society said employers felt they should be able to offset benefits-in-kind against the minimum wage. Some organisations thought the regulations, now with four hourly rates, had become too complex. The National Hairdressers' Federation (NHF) said it would like to see simplification of the regulations to ensure greater clarity over the different rates and in what scenarios workers should be moved from one rate to another.

- 4.11** We note later in the chapter that while trade union organisations think that the NMW is simple to understand and easy to enforce, the Trades Union Congress (TUC) was concerned at employers trying to create loopholes. It referred to evidence of abuse of piece rates in the hotel cleaning industry, and asked us to consider abandoning or restricting the use of Fair Piece Rates. The National Farmers' Union (NFU) called for simple and consistent means of calculating working hours, as well as simple and consistent definitions of worker categories, and any steps to simplify the required record keeping process. It also said confirmation or modification of the regulations relating to output work should enable an employer to set hours for submission of picked items.

"The Business Link sections on the NMW are not very user friendly."

BHA, BBPA and BISL evidence

"There are currently four rates for the NMW and administering and managing this is becoming increasingly complex and burdensome, especially for small salons..."

NHF evidence

"We do not believe the regulations as they stand are overly burdensome on business....Where businesses may be unsure of their obligations...the best solution is well-publicised guidance, rather than changes to the regulations."

HomeWorkers Worldwide evidence

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- 4.12** In addition to the evidence we gathered, the Government said it would forward to us ideas to simplify the NMW which emerged from its Employment-Related Law spotlight in the Red Tape Challenge. This invited proposals during a two week period in October 2011. Officials from the Department for Business, Innovation and Skills (BIS) subsequently informed us that the process generated very little interest in the NMW, and identified no problems with the regulations. The few comments that were received were mainly on the level of the rate (including making it a living wage). We set out elsewhere in this report the importance of the NMW as a wage-floor for the low paid. Our aim in making our recommendations each year is to help as many low-paid workers as possible without any significant adverse impact on employment or the economy. We have not therefore explored suggestions likely to add significantly to the regulatory costs on business or substantially reduce the labour market protections for the lowest paid, such as abolishing the NMW entirely.
- 4.13** By far the most common response from stakeholders who called for any action on simplification were requests to improve both the format and content of the official guidance in order to raise both businesses' and workers' understanding of the application of NMW rules in particular settings. In the course of this chapter we identify a number of specific areas where better dissemination of the information would help both employers and workers. We now go on to consider those areas.

Agency Workers

- 4.14** Agency workers are fully entitled to the minimum wage but, until recently, were not entitled to the same pay and conditions as directly employed staff. The Agency Workers' Regulations (AWRs), implemented in October 2011, provide for equal treatment to apply after a worker has been in a given job for 12 weeks. This new provision might lead to some workers receiving higher wages.
- 4.15** In our 2011 Report, we referred to the banning of upfront fees for photographic and fashion models that came into effect in October 2010. We also reported on employer groups' concerns about the likely additional costs as a result of the introduction of the AWRs. We noted that the Government was taking forward its work on sector-specific guidance for the entertainment sector (following a recommendation we made in 2010), which it intended to publish by spring 2011. This recommendation had been made in recognition of the complex nature of this sector, for example the tax status of individuals, the diversity of opportunities (fringe theatre, student films, etc.) and the fact that both HMRC and the Employment Agency Standards Inspectorate had an involvement in the sector.
- 4.16** The Government has updated and clarified its online guidance on the banning of upfront fees and the use of internships and work experience (including the provision of an entertainment sector-based example). It said that views from entertainment sector-based organisations were sought and considered in producing the guidance.
- 4.17** Equity has been critical of the Government's response to our previous recommendation. It said that although the revised guidance was marginally helpful, it only provided one example of an actor who worked unpaid in a short film and that as this was very specific it was unclear how this advice could be applied to other areas. Equity wanted to see the Government revisit

the issue and provide the sector-specific guidance to which it originally agreed. This stance was supported by actors we met as part of a visit to London.

- 4.18** We have again received evidence from stakeholders about the likely impact of the AWRs. Previously, stakeholders had raised concerns about the additional costs this would put on businesses, at a time when many were already struggling. A survey published by Allen & Overy (2011) found that nearly a third of medium and large businesses were planning to avoid increased costs by terminating agency worker contracts before the 12-week qualifying period kicked in. It also found that 52 per cent of respondents would employ more fixed-term workers, as they believed this would be a better option. The survey results showed that 38 per cent of employers would only hire temporary workers subject to the so-called 'Swedish derogation', under which the worker was employed by the agency and therefore not subject to the equal treatment provision of the regulations, as far as pay was concerned.
- 4.19** The AWRs have now come into force and we have heard initial reports of how some companies are getting around the regulations. Some of the evidence we have received with regard to agency workers relates to unpaid work and hotel cleaners, and these issues are covered later in this chapter. We will monitor carefully the impact of the AWRs and report further on this next year.
- 4.20** Although the Government has updated Business Link and produced guidance on interns, we share the views expressed by some stakeholders that this does not go far enough in providing clear guidance for those operating in the entertainment sector. The Government's actions have clarified some issues but there is scope to do more. We believe, therefore, that specific guidance for the entertainment sector should be drawn up, in conjunction with interested parties, and incorporated in the Government's overall guidance on the minimum wage (which we recommend at paragraph 4.54 below).

Migrant Workers

- 4.21** There has been much conjecture about the effect that migrant workers have had on employment levels and wage rates of UK nationals. Academic research suggests that overall migrant workers have had a positive impact on the UK economy by filling gaps in the labour market. However, that research also suggested that there had been downward pressure on wages at the bottom of the distribution but that the NMW had prevented wages falling further. At the time of writing this report, the Government has received further advice from the Migration Advisory Committee on the impact of immigration.
- 4.22** In our 2011 Report we noted the enforcement action the Government had undertaken in order to address the issues faced by migrant workers. In addition, having received evidence about the problems faced by migrant domestic workers (MDWs), many of which go wider than the NMW, we urged the Government to ensure that complaints from MDWs were given a high priority. In response the Government advised that it had worked with staff on the Pay and Work Rights Helpline (PWRH) to ensure that the advice they provide to MDWs was as accurate as possible.
- 4.23** In evidence, the TUC said that there was compelling evidence that a worrying number of MDWs were abused in ways that go far beyond not paying the NMW, sometimes involving

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physical and sexual abuse. It called for the exemption for domestic workers to be abolished so that all domestic workers were covered by the NMW. Kalayaan, a charity supporting MDWs, has again submitted evidence concerning the continuing abuse and exploitation of MDWs. It said many employers argue, some successfully, in Employment Tribunals that the individual workers were exempt from the NMW under the family worker exemption. Kalayaan also raised the issue of the Government's consultation on MDWs, in which the Government proposed to either stop MDWs being allowed to come to the UK, or limit them to a twelve month stay.

4.24 UNISON again highlighted that migrant workers were particularly at risk from exploitation. Problems encountered by migrant workers included low wages, unclear payslips and unauthorised deductions from wages. This was despite the strengthening of enforcement measures. During a visit to Glasgow, Citizens Advice Scotland told us that its evidence showed migrant workers were clearly being exploited.

4.25 All workers are entitled to the NMW unless they are covered by a specific exemption and there are processes for individuals to follow if they have a grievance. MDW employers are required to sign a document covering the main conditions of employment. The Domestic Worker section of the UK Border Agency's (UKBA) website states that an employer cannot change the conditions of MDWs' employment unless they agree and that MDWs must be paid the agreed rate which must be at least the NMW.

4.26 The issue of exploitation and abuse of MDWs is one which goes beyond the NMW. In relation to the minimum wage, abolishing the family worker exemption would adversely affect its legitimate and useful applications, such as for au pairs. We believe that clear and consistent guidance on relevant government websites is required which will unambiguously show MDWs' entitlement. The advice given to helpline operators should be updated accordingly.

Piece Rates

4.27 The NMW framework includes arrangements to determine whether a worker paid according to the number of items they produce has been paid at least the hourly minimum wage. However, if the employer controls the worker's hours, then they must make sure they pay at least the minimum wage for each hour of work. The employer remains free to contract with the worker to pay on a piece rate basis, but while this may determine how far pay rises above the NMW floor it does not allow payment below it. The NMW arrangements for paying by the piece those workers whose hours are not controlled by the employer, and for determination of whether or not the NMW has been paid, are called 'Fair Piece Rates' (FPRs).

4.28 The Labour Force Survey shows that around 1 million people work at home, but this of course covers a very wide range of occupations and only a proportion of these workers would be paid by reference to FPRs. Homeworkers paid at or around the NMW are the group of workers most likely to be paid using a piece rate/FPR: they are undertaking work away from the employer's premises and in circumstances where control of their hours would not usually be possible. It is difficult to access information about homeworkers, a group with few representative bodies.

4.29 One body which does, however, represent this group is HomeWorkers Worldwide (HWW). In its evidence it said that the most common concerns raised by homeworkers were a lack of work; irregularity of work; low pay; and a lack of employment rights. There were compliance problems and HWW said its conversations with homeworkers confirmed that many on piece rates continued to be paid below the minimum wage. HWW regarded FPRs as essential for providing a framework for paying homeworkers the NMW. It said the FPR system recognised the reality of those homeworkers paid by a piece rate, both in the UK and throughout the world. It thought abuses should be tackled through proactive, well-resourced enforcement, as well as through supporting workers to come forward to complain. HWW evidence also highlighted a need for better guidance on FPRs; it had received calls from employers seeking information on their obligations to homeworkers, including calculation of FPRs, and it told us that the information which exists on Business Link was difficult to find and could be better signposted.

4.30 For our 2010 Report we received evidence concerning hotel cleaners employed through agencies and contract cleaning companies. They were being paid on a 'per-room' basis at rates which often made it impossible for them to receive payment of at least the minimum wage. We recommended that HMRC investigated whether these workers were receiving their minimum wage entitlement for the hours they worked. The Government accepted this recommendation and told us HMRC would undertake targeted enforcement in the final two quarters of 2010/11.

4.31 In its evidence for this report, the Government told us that HMRC had worked with the BHA to target hotels in London that employed agency cleaning staff. HMRC wrote to around 80 hotels that were using hotel cleaning services provided by employment agencies. A number of compliance interventions were undertaken resulting in arrears of over £33,000 being identified for around 300 workers. HMRC also carried out a number of enquiries into employers, end users of agency staff and contract cleaning workers. In one case involving an agency supplying labour to over 170 hotels, HMRC successfully challenged the piece rates being used on the basis of actual working practices and worker testimonies resulting in the payment of £19,000 of minimum wage arrears to 30 workers. We hope HMRC will use the experience and information from this campaign to inform future campaigns and to look at hotels outside London.

"CSSA members manage the issue [piece rates] by tracking hours worked as well as 'pieces' completed and thereby ensuring that the NMW is not breached."

Cleaning and Support Services Association oral evidence

4.32 Some stakeholders thought that given the evidence of abuse of hotel cleaners, there were grounds for scrapping the FPR arrangement, or at least excluding its use in the hotel sector. The TUC said that while it regarded the minimum wage as one of the simpler employment rights, it was concerned that there was a problem with certain employers actively trying to create loopholes. It thought that FPRs were an area which might constitute an unnecessary complication to the wage arrangements. The TUC said abuse of piece rates in hotel room cleaning had continued and that this type of arrangement had spread to other sectors such as parcel delivery and fast food delivery. It had not been able to find any evidence that these employers had used time trials to establish a Fair Piece Rate. The TUC concluded that these provisions were more regularly abused than properly used and questioned whether FPRs should be retained. In oral evidence it asked us to consider whether there could be a tightening of the defined circumstances where piece rates may be used. Unite called for the removal of the FPR system from the hotel sector. In oral evidence it told us of a range of dubious practices by unscrupulous agencies, which included abuse of piece rates.

“There are a number of dubious practices in hotel cleaning, including unpaid ‘training weeks’; short-term workers not getting paid if they had worked for less than two weeks; wage slips not recording hours or calculations of pay; abuse of piece rates; and bogus self-employment.”

Unite oral evidence

4.33 Some employer organisations have also called for reform of the FPR arrangements. Under the Agricultural Wages Order the employer must make pay up to at least the hourly rate of the Agricultural Minimum Wage for all workers, including those being paid piece rates. An NFU survey suggested that 8.5 per cent of workers in horticulture (where it estimated 80 per cent of seasonal workers were on piece rates) had their pay ‘topped up’. NFU said that with the removal of the Agricultural Wages Board for England and Wales it was probable that agricultural employers would seek to adopt a FPR, but it thought they should be allowed to set hours when picked items were submitted. The UK Fashion and Textile Association (UKFT) was concerned at the effect on incentives of a continued rise in the proportion of piece rate workers having their pay made up to the level of the minimum wage.

4.34 We carefully considered the calls from some stakeholders for reform of FPRs in light of evidence of abuse of piece rate arrangements in hotel cleaning. However, we doubted it would change the situation faced by these workers. Reform or removal of FPRs would probably not affect the employers in question because we have no evidence that their pay arrangements were attempting to conform to the requirements of FPRs. In sectors where workers’ hours are controlled, including hotel cleaning, even where a piece rate system is operated the worker must be paid at least the minimum wage for every hour they work. Even if FPRs were abolished employers would face the same test as now: whether they have paid the workers at least the minimum wage for all the hours worked. Scrapping FPRs would, however, remove the most appropriate means of assessing NMW compliance from those homeworkers paid by reference to the number of pieces they produce in circumstances where employers cannot control their hours. We also did not support

proposals from other stakeholders to allow employers to control hours in some way, still pay by the piece, but not be obliged to make pay up to the minimum wage. In our view this would risk undermining the basis of the minimum wage – that it is a minimum hourly rate – and provide a potential loophole for those seeking to abuse and exploit the FPR arrangements.

- 4.35** We welcome HMRC’s investigations into hotel cleaning following the Commission’s recommendation. HMRC’s enquiries have found that the main issue was that these workers were not paid the NMW for all the hours they worked. We strongly urge the Government to continue to focus enforcement resource in this sector and also ensure that guidance on payment by piece rate is revised, and disseminated, as part of our wider recommendations on reviewing the official NMW guidance and communicating the rules (see paragraph 4.54).

Unpaid Work: Internships, Work Experience and Volunteering

- 4.36** We made clear in our 2011 Report that we recognised the value of work experience, particularly for young people new to the labour market, but that we continued to receive evidence of apparent breaches of the NMW rules. We did not favour suggestions that there should be a special exemption or rate for interns. We recommended instead that the Government took steps to raise awareness of the rules for those undertaking internships, all other forms of work experience and volunteering opportunities. In addition, we recommended the rules be effectively enforced by HMRC using its investigative powers.
- 4.37** In September 2011 the Government launched its revised NMW guidance on work experience and internships. While the TUC and intern groups welcomed the new guidance, they also called for this to be backed up with tougher enforcement. The Broadcasting Entertainment Cinematograph and Theatre Union (BECTU), however, pointed out to us what it regarded as failings in the guidance in respect of the definitions used for ‘worker’ and ‘volunteer’.
- 4.38** Other guidance also became available over the course of the summer when the Gateway to the Professions Collaborative Forum (which includes representatives from professional bodies, related organisations and the TUC) launched its ‘Common Best Practice Code for High-Quality Internships’. The Code included guidance on remuneration, and the rules for payment of the NMW.
- 4.39** The Government advised us it was working to ensure effective enforcement of the minimum wage in sectors where internships and work experience positions were prevalent. In the latter half of 2011/12 HMRC commenced targeted enforcement activity. In addition the PWRH has started fast tracking and referring all calls about unpaid work to HMRC. Initially the focus of the targeted enforcement was in the fashion and TV/film sectors. BIS and HMRC would then consider whether to extend the campaign to other sectors in light of HMRC’s findings. We are pleased to see HMRC publicising the action it is taking with regard to the targeted enforcement campaign on interns. In October 2011 the Government introduced a new quality assurance system for vacancies placed with the Graduate Talent Pool. In the first month of operation, the number of unpaid/expenses only internships dropped from around 40 per cent of the total to 26 per cent. Only 18 per cent of the new, checked, vacancies were in this category.

4.40 The majority of the evidence on interns we received for this report has again been from trade unions, intern groups and interns themselves. This has highlighted that unpaid work is still a major issue, whether it be called internship, work experience or volunteering. Their experience was that such unpaid positions were still on the increase. These stakeholders repeated calls for better guidance and enforcement of the existing minimum wage rules.

4.41 The submission by the Graduate and Interns Alliance (GAIA – made up of Interns Anonymous, Intern Aware and Internocracy), along with evidence from a number of others, provided examples of hundreds of jobs being offered for no pay, very low pay or expenses only. A number of individual interns, or their families, told us of their experiences. These were typically graduates, unable to access one of the professions without undertaking unpaid work, which they could not afford. They found that entry level posts had been largely replaced by a requirement to first undertake an unpaid period of work experience.

4.42 There was generally strong support for the Commission's 2011 Report recommendation. The National Union of Students said the Commission should continue to recommend that strong action was taken to enforce the minimum wage and to avoid exploitation of young workers. Many stakeholders, however, called for stronger action by the enforcement body against unpaid work, as well as supporting good guidance. Equity suggested enforcement would be enhanced if unions and other bodies could take representative and group cases to an Employment Tribunal, as it believed many workers were too afraid to take a case themselves. Another proposal, supported by the TUC and others, was to outlaw the advertising of jobs paid below the NMW. Others suggested HMRC should follow up on employers advertising work paid below the NMW, and also take action against the hosting sites themselves. Some urged greater support for more prosecutions and a wider publication of them. GAIA suggested HMRC target those companies that 'buy' and 'sell' interns.

“Unpaid internships exploit those who do them and those who can't afford to do them. In terms of helping the position of young people in the labour market, unpaid work isn't a solution, it's part of the problem.”

**Tanya de Grunwald
(GraduateFog) oral evidence**

“There is no shortage of employers happy to flout the law because they are able to get away with it. Until this is tackled, with high profile penalties, we are not sure things will change very much.”

**National Union of Journalists
oral evidence**

4.43 We also heard from an internship recruitment agency, Inspiring Interns. It matches graduates with employers offering internship opportunities. We reported in Chapter 3 how Inspiring Interns believed that while it was desirable for internships to be paid there would be a number of negative implications if employers had to pay the NMW for every intern placement; including some companies stopping internship programmes.

4.44 We also heard again how internships and other unpaid work had spread across a range of sectors. During one of our London visits, Commissioners heard evidence from Unite's Parliamentary Branch as to how internships were widespread in Parliament. It told us work undertaken by interns often closely resembled that undertaken by those in salaried positions. In the TV/film sector, one of those being targeted by HMRC enforcement, BECTU contrasted properly managed opportunities with its experience of the part of the sector where there was a constant churn of micro film-making businesses, and unpaid work was sometimes championed, often using the rhetoric of 'volunteering' linked to vague promises of creative fulfilment or a contribution to a CV. Equity highlighted institutions, such as film schools, which relied on the exemption for 'voluntary workers' under Section 44 of the NMW Act due to the fact that they were registered charities. Equity did not believe film schools' use of professional performers to work for nothing on student films was compatible with the intention of the Act. Tanya de Grunwald (GraduateFog) said in oral evidence that abuse of the voluntary workers' exemption had undermined the third sector's image: it was using it as a licence to obtain unlimited and unpaid junior support.

4.45 We raised our concerns in this area in our last report and recommended action by the Government. It has responded and is addressing our recommendations. In evidence for this report some stakeholders have urged further action to be taken. We judge that time should be allowed for the new guidance to have an effect and for the targeted enforcement to take place. However, we also note the continued evidence of the apparent breaking of the NMW rules, including possible abuse of the voluntary workers' exemption. In addition, we have received initial feedback from some stakeholders on the revised guidance. While generally welcomed, this has highlighted concerns which should be considered as part of our general call for a revision of the overall guidance on the NMW (see paragraph 4.54).

4.46 We ask the Government to report to us on progress with its enforcement campaign in time for our next report, and we will then be in a better position to judge whether further measures are needed.

"Naturally some internships fall under NMW legislation and interns should be remunerated accordingly. However, we fear a blanket application of NMW to internships will do more harm than good to both interns and companies."

Inspiring Interns evidence

Care Workers

4.47 Evidence for the 2011 Report highlighted difficulties faced by care workers as they tried to ensure they were paid at least the NMW. Both worker and employer representative bodies again submitted evidence suggesting action was needed to help maintain compliance in the sector, particularly in relation to provision of home care.

“There are grey areas in the NMW guidance around time spent ‘on-call’ and time spent travelling.”

UNISON oral evidence

4.48 We were told, including during our visits around the UK, that local authorities often commissioned home care on the basis of payment for visit contact time only. The UKHCA told us survey data showed an increase in both 15-minute and 30-minute visits between 2009 and 2010, but a decrease in 60-minute visits. Payment for visit contact time put pressure on wage costs and providers in turn frequently paid their staff on a visit time basis. UNISON was concerned that visits often took longer than the time allocated, and staff were not paid for the additional time. It called on HMRC, BIS and the Department of Health (DH) to investigate ‘15 minute slot’ visit payment systems used by home care agencies, and provide best practice guidance to ensure staff were paid their full minimum wage entitlement.

4.49 We received evidence, including from UNISON, that a system of paying staff according to visit contact time may lead to a failure to pay them for their full travel time between home care visits. In oral submission we heard that the UKHCA was aware that UNISON believed there to be evidence of providers breaking NMW rules. UKHCA pointed to evidence that the average home care hourly wage was above the NMW, so it would be possible for employers not to pay for travel time and remain compliant. However, we are concerned that given the cost pressures in the system and complexity in pay systems, breaches of the NMW may be occurring, whether by design or default.

4.50 Both UNISON and UKHCA evidence expressed concern about the possible implications of the continued expansion of self-directed support through employment of Personal Assistants, including the risk of non-payment of the NMW. Both organisations also saw a lack of clarity and need for better guidance on the rules for staff during ‘stand-by’/‘on-call’ time. UKHCA was seeking to develop further guidance for its members but also called in its oral evidence for improvements in the official guidelines.

“BIS guidance is too generic for social care. We would like sector specific guidance.”

UKHCA and Registered Nursing Home Association oral evidence

4.51 We met a representative from the Association of Directors of Adult Social Services and discussed the scope to remind members of the rules that providers should be following in respect of travel time. We also heard from HMRC that compliance issues in social care were on its radar, and we welcome its efforts to target issues in the sector.

4.52 The sector requires greater awareness of the NMW rules, good guidance and appropriate enforcement. It also requires guidance by the lead departments in social care to dovetail with

the existing NMW guidance on Business Link and Directgov. We are aware that DH has recently been working with the care sector in producing a framework to enable support for Personal Assistants and their employers (Department of Health, 2011). We welcome this, but believe that the official NMW guidance can be better geared to the NMW issues experienced by both employers and workers in the care sector. We see this as one of the areas feeding into an overarching need to improve guidance, which we cover next.

Guidance

- 4.53** The above discussion of sectors and workers particularly affected by the minimum wage has underlined and illustrated the evidence we mentioned in paragraph 4.13 above in relation to simplification of the NMW. As we indicated earlier in this chapter, most businesses and workers that refer to the NMW rules do so via official guidance rather than the actual legislation or regulations themselves. So any effort to simplify the NMW rules needs to include the official guidance as well as the statutes. In our view the most important thing that the Government could do to simplify the minimum wage is provide better and more complete guidance for businesses and workers.
- 4.54** The Government is creating a single website to bring together all of its information and a test site is already in existence. This means that the BIS website, as well as Directgov and Business Link, will close. We see this as an opportunity to review the current guidance on the NMW and to address some of the concerns raised with us. A number of stakeholders made the point that the current guidance is too legalistic and ‘not written from the practical point of view’. In terms of simplification of the NMW, the need for better and clearer guidance was the strongest message from our consultations. Therefore, **we recommend that in order to make operating the National Minimum Wage as simple as possible for all users, the Government puts in place, and maintains, effective, clear and accessible guidance on all aspects of the minimum wage particularly where there is significant evidence of ignorance or infringing practice. As a first step, the Government should undertake a review of all existing guidance.** We would welcome our Secretariat’s participation in such a review.
- 4.55** The issues such a review should cover, include:
- Sector-specific guidance and examples to underpin understanding of the rules where there are known areas of concern, for example payment of travel time and on-call hours in social care, and issues for the entertainment sector.
 - Payment for time spent preparing for, and finishing, work, for example to put on and to take off uniforms.
 - Clearer guidance in respect of apprentices, including whether the Apprentice Rate or the other rates of the NMW apply. The research presented in Chapter 3 showed there was evidence of an apparent lack of awareness of the Apprentice Rate, and when apprentices should move from the Apprentice Rate to the higher (NMW) rates.
 - Clearer guidance on payment of the minimum wage when working irregular hours. This could involve shift systems or seasonal changes.

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- Guidance on piece rates and the NMW which reflects business circumstances and clearly sets out where Fair Piece Rates are, and are not, applicable.
- Reinstating previously available guidance on the accommodation offset. A stand-alone guide was available, and understanding of the offset would be improved if an updated version was made available.
- Specific guidance for migrant domestic workers, showing their entitlements under the NMW Act (as is shown on the UKBA website).

4.56 We have again received evidence on a number of other operational issues and in the next section, we consider the evidence on these and indicate where further action is necessary.

Operation of the National Minimum Wage – Other Issues

Tips

4.57 Since October 2009 the minimum wage regulations have not allowed tips, gratuities, service charges or cover charges to be used to make up NMW pay. At that time the Government also introduced a voluntary Code of Best Practice on Service Charges, Tips, Gratuities and Cover Charges, which had been developed through stakeholder discussions. The changes in the law did not place employers under a legal obligation to pass on tip payments to their workers, but the purpose of the Code was to make what happens to tips more transparent to worker and consumer alike. The evidence we received confirmed the position reported last year that there was a successful introduction of the new rules, with employers generally observing the new arrangements. Unite confirmed that it was not coming across major infringements of the rules on the use of tips and the NMW; although there may still be some issues in some independent establishments. In oral evidence BHA said it regarded the requirement not to use tips to make up NMW pay as a 'settled issue'.

4.58 There remained a difference of views between worker and employer representatives on use of, and compliance with, the voluntary Code. GMB said there continued to be very little evidence in any restaurant or other tipping establishment of what happened to tips, while BHA told us that the Code encouraged businesses to explain to customers what happened to their monies. Unions were also concerned at what they regarded as evidence of inappropriate employer influence over *tronc* arrangements,⁵ and employers taking a larger slice of tips monies. However, on the basis of the evidence we have received it appears to us that employers are generally following the new NMW rules.

⁵ A special pay arrangement used to distribute tips, gratuities and service charges.

Seafarers

4.59 Seafarers are covered by the minimum wage when they are employed to work on a ship while it is in the UK or its internal waters, regardless of where the ship is registered. In addition, a seafarer working on a ship registered in the UK must be paid the minimum wage wherever in the world that ship may be, unless:

- all the work takes place outside the UK (and its internal waters); or
- they are not normally resident in the UK and the ship is outside the UK (and its internal waters).

4.60 In last year's report, we advised that the Government had convened a working party to consider the legal position on the application of the NMW to non-UK registered ships travelling between UK ports. We encouraged all parties to continue with their dialogue to try to resolve the issue. Following a ruling by the Court of Appeal in 2011 it is possible that the NMW may be applied to workers on non-UK flagged ships where it can be shown they have a jurisdictional link with the UK. The Government has advised it is considering this.

Accommodation Offset

4.61 Accommodation is the only benefit-in-kind that can count towards the minimum wage. It provides a mechanism to enable employers to offset the cost of providing accommodation for workers against the minimum wage, up to a maximum daily limit that has risen over time broadly in line with increases in the adult rate. Offset arrangements provide protection to the worker and give some recognition of the value of the benefit, but are not intended to reflect the actual costs of provision to the employer or the commercial market value of the accommodation.

4.62 When it was initially recommended, an offset for accommodation was designed to be a protective measure. The Commission's intention was to discourage employers both from levying excessive accommodation charges and from withdrawing the provision of accommodation, which Commissioners recognised would affect the most vulnerable workers.

4.63 Since its introduction, we have commented on the evidence received in relation to the offset: mainly from employers' representatives that the level was too low and from workers' representatives that it should be held down in order to protect low-paid workers. We have consistently maintained our rationale for the offset and have recommended increases in line with those for the adult rate of the NMW.

4.64 For our last report employer organisations informed us that the level of the offset was too low and it was therefore uneconomical for their members to provide accommodation. Trade unions thought that the offset arrangements continued to be misused. We concluded that although the arrangements were far from ideal, they had been maintained for three main reasons: to provide protection to workers; to provide some level of recognition of the value and cost of accommodation; and to keep the system simple to administer and therefore enforce.

4.65 We have heard evidence along similar lines for this report. Northern Ireland Hotels Federation advised in written evidence, and during our visit to Belfast, that consideration should be given to other benefits provided to employees, such as meals, when recommending the NMW rates. BHA, BBPA and BISL again contended that the level of the offset was below the economic rate for what was being provided, equating now to only about a third of the market value. This message was also given by ALP during oral evidence who said that, as a result, most of its members no longer provided accommodation. The ALMR said the low level of the offset was having an adverse effect on the provision of accommodation and the current disparity between the offset and what would be available commercially acted as a disincentive to employers to provide accommodation.

4.66 An NFU survey in 2011 found that the average cost of providing accommodation in agriculture was £5.62 a day (an increase of 6.6 per cent on 2010). It also found that 43 per cent of farm workers had a tied cottage and 15 per cent had another type of accommodation. During a visit to Cornwall, Winchester Growers told us that the level of the offset was no longer in line with reality. It favoured a system where local councils would be the source of 'fair rent' information and the Gangmasters Licensing Authority (GLA) would monitor and ensure that workers were only charged an amount that was fair and could be demonstrated to be in line with the true cost.

"It is likely that a substantial increase in the offset will yield better reinvestment in accommodation. Better quality accommodation is likely to encourage more domestic workers into farming."

NFU evidence

4.67 Kalayaan, a charity supporting migrant domestic workers, supported the offset saying it provided a vital basic protection to workers, many of whom were vulnerable, and should, as a minimum, remain in place. Ideally it would like to see any deduction for accommodation confined to monies earned in excess of the NMW. Unite said abuse of the accommodation offset had led to many workers, in particular migrant workers, being paid below the NMW. It also noted that the offset had risen previously in line with increases in the adult NMW, and supported a similar approach this year.

4.68 During two of our visits, discussions with employers have shown that there is not a clear understanding of the offset rules and that advice on Business Link is not as clear as it could be. Previous guidance issued by the Department for Trade and Industry (in 2007) is no longer available and in order to remove any current confusion, we believe this (or similar) more detailed guidance should be re-issued (see paragraphs 4.54 and 4.55).

4.69 We have very little robust evidence to show how far the offset is protecting low-paid workers; how far its level may be depriving them of accommodation that would otherwise be offered; and how far it may have led to changes, if any, in the provision of accommodation. We also have little evidence about how far the arrangements are being abused (figures from HMRC show that 6 per cent of non-compliant cases (68 cases) in 2010/11 related to the offset).

4.70 The offset arrangements were last investigated in detail in 2006, when the Commission undertook a review. That review concluded that if the rules were relaxed and accommodation could be provided as an option, it would be difficult to determine whether or not workers had a genuine choice. As it is six years since we last looked at the provisions in detail, and given the shortfall in our evidence base on provision and other aspects of the offset, we intend as part of our 2013 Report to fully review the offset arrangements, including the rationale for them. As a result, this year we do not intend to change the way the level of the offset is updated.

Abolition of the Agricultural Wages Board for England and Wales

4.71 In July 2010 the Government announced its intention to abolish the Agricultural Wages Board for England and Wales (AWBEW). In our remit for this report the Government has asked us to consider the implications of the proposed abolition of the Board, pending the outcome of the legislative process. In fulfilling this aspect of the remit we have sought evidence from the relevant parties and commissioned research on the operation of the Board and the potential implications for us of its abolition. In addition, our Secretariat has spoken separately to the various bodies representing employers and employees in the agricultural sector, and to officials at the Department for Environment, Food and Rural Affairs (Defra), the sponsoring department.

4.72 The proposed abolition does not apply to the Agricultural Wages Boards in Scotland and Northern Ireland, which will continue as at present. In England and Wales, the Government is required to consult before introducing secondary legislation to abolish the Board. The consultation period will last three months and is due to commence early in 2012. At the time of writing our report, therefore, the AWBEW is still in existence and its Orders still have statutory effect. Following abolition, the statutory terms and conditions of agricultural workers in England and Wales will be solely determined by the NMW Regulations and other employment legislation. Existing employees will continue to have a contractual right to their current terms and conditions.

4.73 The AWBEW dates from the 1948 Agricultural Wages Act. It consists of equal numbers of employer and employee representatives, along with four independent members and an independent chair. Its Wages Orders have statutory force and set out minimum pay rates and a range of terms and conditions covering full-time and part-time employees in the sector. It was unaffected by the abolition of the Wages Councils in 1993, and its status was confirmed in 1995 following a separate review of the Agricultural Wages Boards.

4.74 The decision to abolish the Board is supported by the main employer bodies. NFU told us that abolition will bring arrangements in agriculture into line with other sectors, and provide employers and employees alike with the flexibility to consider the employment package as a whole. It would also remove the confusions that can arise about whether certain employees are covered by the NMW or the Agricultural Wages Order. It noted that most agricultural employees already received pay rates above the statutory minima which, it argued, suggested the market was already the main determinant of pay levels in the sector. ALP also

National Minimum Wage

supported abolition, pointing to the practical difficulties arising from definitions of 'agricultural work' used in the Order. It said this raised particular problems with packing workers who worked in facilities located away from where the produce was grown. It also argued that the terms of the Orders were difficult to understand when compared with the NMW, and that enforcement within the sector was minimal.

- 4.75** The employee bodies take a different view. The TUC said that abolition would lead to lower rates of pay and an increase in rural poverty. It asked us to support continuation of the Board, but, in the event of its abolition, to recommend that expertise and funding for enforcement be transferred from the Defra Inspectorate to HMRC. It also believed that we should research and monitor the impact of abolition on a range of issues. Unite thought that abolition was being driven by horticultural employers under pressure from supermarkets to cut prices. It was concerned that existing terms and conditions would be eroded over time. Usdaw and UNISON also opposed abolition.
- 4.76** Incomes Data Services (IDS) (2011b) highlighted the diverse nature of the agricultural sector in England and Wales, both in terms of farm type and size. Overall, there are about 144,000 holdings in the two countries, but only 44 per cent actually have employees. Farmers, their partners, directors and spouses make up over half of the agricultural labour force, and over a third of agricultural workers are casual or seasonal employees. In total, Defra figures suggest that 140,000 agricultural workers will be directly covered by the NMW Act following abolition of the Board.
- 4.77** It was also clear that there are marked differences in the respective terms of the AWBEW Wages Order and the NMW. Broadly, these can be summarised as follows:
- We recommend one minimum adult rate and other minimum rates for young people. The AWBEW sets minimum rates for a six-grade structure and the appropriate grade minimum applies to all workers irrespective of age, with one exception. All these minima have in practice been higher than the NMW rates. The Wages Order also has a separate rate for workers of compulsory school age for which there is no NMW equivalent. These workers are exempt from the NMW. Both the NMW and AWBEW have different rates for apprentices.
 - Under both the Wages Order and the NMW Regulations, where an employer controls a worker's hours then, irrespective of whether a piece rate system is in place, the worker must be paid at least the appropriate minimum rate for each hour worked. However, under the NMW Regulations, but not the Wages Order, where an employer does not control a worker's hours, and a piece rate system that conforms to Fair Piece Rates is in place, pay can be determined by output rather than hours, and may therefore be lower than the NMW.
 - Deductions for accommodation provided to agricultural workers depend on whether an entire house is available or some other type of accommodation, and can be subject to the employee having worked a minimum of 15 hours a week. The NMW does not have different rates based on accommodation type or a minimum hours requirement.

- The Wages Order contains provisions governing a range of terms and conditions outside the NMW Regulations. These include provisions covering flexible workers, holidays, overtime, on-call, sickness, bereavement leave, and working dogs.
- Enforcement of the Wages Order is the responsibility of a Defra inspectorate; the NMW is enforced by HMRC.

4.78 The employee bodies generally believe that pay and conditions will inevitably decline once the Board is abolished, while employers argue that greater flexibilities post-abolition will improve the competitiveness of the sector. Based on experiences in other sectors that have moved away from industry-wide pay determination arrangements, IDS (2011b) posited a number of possible outcomes in the agricultural sector following abolition of the Board, but it is difficult to judge at this stage what the balance of outcomes will be and, therefore, what the full implications of transition to the NMW will be. Our remit invited us to consider the implications of the abolition of AWBEW as part of the Government's simplification agenda. Because the Agricultural Wages Order provides statutory protections beyond those set out in the NMW Regulations, abolition and the removal of these protections will tend to simplify the minimum wage regime in agriculture.

4.79 In the meantime, we have asked our Secretariat to give thought to how we can assemble evidence on the impact of the changes, and we will commission research as necessary. It is, however, already clear to us that abolition of the Board would bring with it the need to ensure employers and employees in the sector are aware of the change and its impact – we note, for example, some stakeholder confusion over the requirements and limitations of Fair Piece Rates – and have already drawn our view to the attention of Government officials.

4.80 Having considered a number of operational issues under the minimum wage, we now go on to look at how the enforcement function is being carried out and the extent of compliance with the minimum wage.

Compliance and Enforcement

4.81 In our 2011 Report we set out actions the Government had taken in relation to enforcement of the minimum wage. This was in the context of the new compliance strategy it had published, setting out its aim for the enforcement regime over the next five years. We looked at where progress had been made and also where we had concerns, in particular over the reduction in spending on awareness raising activities. In this next section we look again at aspects of the enforcement regime and changes that have occurred since our last report.

Compliance Strategy

4.82 The compliance strategy published by the Government in March 2010 was based on one clear aim – that everyone who is entitled to the minimum wage should receive it – and it set out how the Government intended to achieve this through the use of guidance, enforcement and the legal regime. In the autumn of 2011, the Government published its second annual report on its enforcement performance (BIS, 2011b).

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- 4.83** In its evidence, the Government detailed how it has been implementing its new strategy, including HMRC moving towards a more risk-based approach to enforcement, and developing and adopting new ways of working. The move to allocating resources to risk enables HMRC to focus its effort on where it can have maximum impact, but it has also put other processes in place to ensure all complaints are dealt with, albeit without necessarily triggering a full investigation. The Government said a number of changes were not put into effect until the latter part of the year, so it was too early to evaluate their impact.
- 4.84** We fully support the Government's aim and actions under the compliance strategy. We are pleased to see it is developing its enforcement action, maximising the use of its resources and placing a greater emphasis on intelligence and risk. We will continue to monitor progress.

Fair Arrears and Penalties

- 4.85** A regime of fair arrears and penalties was introduced under the Employment Act 2008 and enacted in April 2009. These provisions meant that workers not paid the minimum wage would receive arrears at the current rate and that employers who have not paid the minimum wage would pay a fine of half of the amount of arrears identified (up to £5,000). The new regime has now been in place for over two years and statistics produced by the Government show that in the last financial year (2010/11) penalties were imposed in 937 cases totalling just over £560,000.
- 4.86** Research undertaken by BIS (2011d) on employers' attitudes towards compliance with the minimum wage found that those who expressed a view accepted that a mechanism was needed to ensure workers were not out of pocket. There were diverging views on whether arrears should be paid at the current rate and also on whether there should be a financial penalty. A number felt it was unfair to penalise employers that had made a genuine mistake. NHF told us there should be more of a carrot rather than a stick approach to enforcement, one based on support, advice and encouragement to businesses to get it right.
- 4.87** On the other hand, the view has been expressed to us that the £5,000 penalty limit is not high enough, especially where there are substantial amounts of arrears due. We share the concern that £5,000 is not a sufficient penalty in every instance. A higher penalty, which may require the use of the criminal law, will be necessary in some cases. It is very important that the correct balance is struck between the use of civil penalties and criminal sanctions and as we report later on, we do not believe this is yet the case. The Government has advised that existing enforcement powers and penalties are included in the ongoing review it is undertaking into enforcement of workplace rights.
- 4.88** In 2010, the Government said it was considering when would be an appropriate time to undertake a full review of the fair arrears and penalties regime. We have previously commented that changes should only be made after a full review, and in our 2011 Report we said that we thought the time was right to review the provisions within the next twelve months. Given that the provisions have now been in force for nearly three years; research on compliance has recently been undertaken covering these provisions; and the Government is currently reviewing the enforcement of workplace rights, we strongly

urge the Government to set a date by which it will have undertaken a full review of the fair arrears and penalties provisions.

Naming

- 4.89** We have long maintained that those who show a wilful disregard for the minimum wage should be named and shamed. In 2009, the Government accepted the Commission's recommendation that a name and shame policy should be put in place. The criteria for naming are based on offences in the NMW Act and, following a positive response to its consultation, the new policy was implemented on 1 January 2011.
- 4.90** The Government's stated objective for this new policy was to raise the profile of minimum wage enforcement and to act as a deterrent to other employers who may be tempted to flout the law. The criteria that would be used had been framed to focus on employers where the breach was serious and appeared to be deliberate. BIS is responsible for naming the employer under this scheme but its decision is based on information obtained by HMRC during the course of its investigations. The employer would be named through national and regional press notices.
- 4.91** In written evidence, GMB said it was concerned that despite this new policy, there had been little change and that the criteria for naming meant that not many employers were identified. NHF said naming could devastate a business, and this would be undeserved especially if it transpired it was as the result of a genuine error. During our visits around the UK we have found general support for the policy, although some employer representatives raised concerns over too heavy handed an approach and about those making genuine mistakes being named and shamed. There was, however, support for a strong enforcement regime.
- 4.92** Research undertaken by BIS (2011d) on employers' attitudes towards compliance with the minimum wage found that naming employers who flout the NMW law was seen to be a good thing. Employers said that it would show the NMW legislation was taken seriously by the Government as it could result in severe consequences.
- 4.93** When the introduction of this policy was announced in October 2010, the Employment Minister said "bad publicity can be a powerful weapon....their [employers] reputation can be badly damaged if they are seen to be flouting the law." The Government has advised that by December 2011, seven cases had been referred by HMRC to BIS for consideration of naming. But to date, no employers have been named. During a meeting with BIS and HMRC in the autumn, we raised our concerns that nearly a year on, no employer had yet been named. In our 2011 report we said it was too early to tell whether the criteria for naming have been set too tightly. It would appear that they have been. We also questioned, at our meeting with BIS and HMRC, whether BIS should be responsible for naming. Functions like this are not part of its core activities and we wonder whether the necessary priority and organisational competence are present. HMRC, which is more oriented to performance of this sort of task, may be better placed to make naming work.
- 4.94** The Commission agrees with the Government's objective and welcomed the introduction of the naming policy in January 2011. It is very disappointing that, although there are still in excess of 1,000 employers found not to be paying the minimum wage each year, no one has

yet been named. Therefore, **we recommend that the Government should not only have a process for naming infringers but should also make frequent use of it. The Government should also actively seek other publicity opportunities which will help to signal that those who infringe the National Minimum Wage get caught and punished.**

Prosecutions

- 4.95** As we have detailed in previous reports, we have long held the view that the number of criminal prosecutions should be increased and publicised as widely as possible to act as a deterrent. The Government's response to the recommendation on prosecutions in our 2009 Report was to note the importance of criminal prosecutions in enforcing the minimum wage. Last year we said that we would continue to monitor closely the Government's progress on prosecutions.
- 4.96** In its evidence, the Government has again supported the use of prosecutions, as part of an integrated compliance strategy. It said that a number of initiatives had been taken, including better guidance to enable Compliance Officers to identify suitable cases for prosecution and gather the appropriate evidence. It said that it was too early to evaluate the initiatives but that there had been an improvement in the quality of cases being identified for criminal investigation.
- 4.97** Prosecuting any employer is resource intensive. It involves gathering evidence, preparing a case, and seeing it through to final prosecution. It is right that prosecutions will not be appropriate in the majority of cases of non-compliance. And other enforcement measures have now been introduced, for example fair arrears and penalties, and naming, which might be considered more appropriate than prosecutions in some instances. However, civil sanctions are insufficient for serious infringements. They should be accompanied by prosecutions of serious offenders. We remain very concerned that the extremely low number of prosecutions to date (seven) is not sending the right message that non-compliance will not be tolerated.

Informal Economy and Non-compliance

- 4.98** It has always been difficult to get any accurate picture as to the full extent of non-compliance. Official data show that in April 2011 around 233,000 adults (aged 21 and over) were paid less than the minimum wage. However, this figure should not be interpreted as a measure of non-compliance as there are legitimate reasons why workers may be paid below the minimum wage, for example those who have accommodation provided by their employer and those who are apprentices. There is almost certainly under-reporting of unlawful failure to pay the NMW, for obvious reasons. Non-compliance has been in the media spotlight during the past year, and television programmes have highlighted infringement issues in a number of areas, such as the social care sector and among interns. We have commissioned research as part of our 2013 Report to try to gain a better understanding of the extent of non-compliance with the minimum wage.

4.99 We have previously raised concerns about the extent to which enforcement activity has tackled those in the informal economy who pay less than the minimum wage. We recognise that this requires extra effort and resource. For this report, we commissioned Ipsos MORI and Community Links (2012) to undertake research into non-compliance and the informal economy, by talking to relevant employers. They found that some informal employers thought the minimum wage was just a guideline (and it was not strictly enforced) or that employers were not paying it because they felt their businesses could not afford it.

Some employers thought there were those who should not be paid the minimum wage, for example students and those doing casual work to supplement income from a first job. Many employers included in the research told the researchers that their businesses were variable and therefore they needed flexibility in the wages they paid. Some paid a percentage of profit to employees.

4.100 The research found that there were different tactics used to evade detection, for example keeping two sets of books or using an accountant who would falsify records. In general, the employers felt that the benefits of non-compliance outweighed the risks. It was reported that they felt that the lack of evidence (such as failure to provide detailed records) meant that HMRC would not have enough evidence to convict them of any illegality.

4.101 In written evidence, the UKFT said there was still significant evidence that some employers were managing to avoid paying the minimum wage by running two sets of books, one showing the correct number of hours worked, the other showing working hours corresponding to payment of the minimum wage. It said this needed further policing.

4.102 In its evidence, the Government has provided information on what it is doing to tackle non-compliance in the hidden economy. The Dynamic Response Team has been operating closely with other parts of HMRC, along with other enforcement bodies (including the GLA, UKBA, and the police) and undertaking a number of unannounced sweeps of businesses suspected of operating in the informal economy in major cities. For example, operations have taken place in London, Leicester and Exeter and have found a number of cases of non-payment of the minimum wage.

“Have you heard of anyone being inspected? I’ve heard of two restaurants being targeted in terms of illegal working, but nothing about non-compliance with the NMW.”

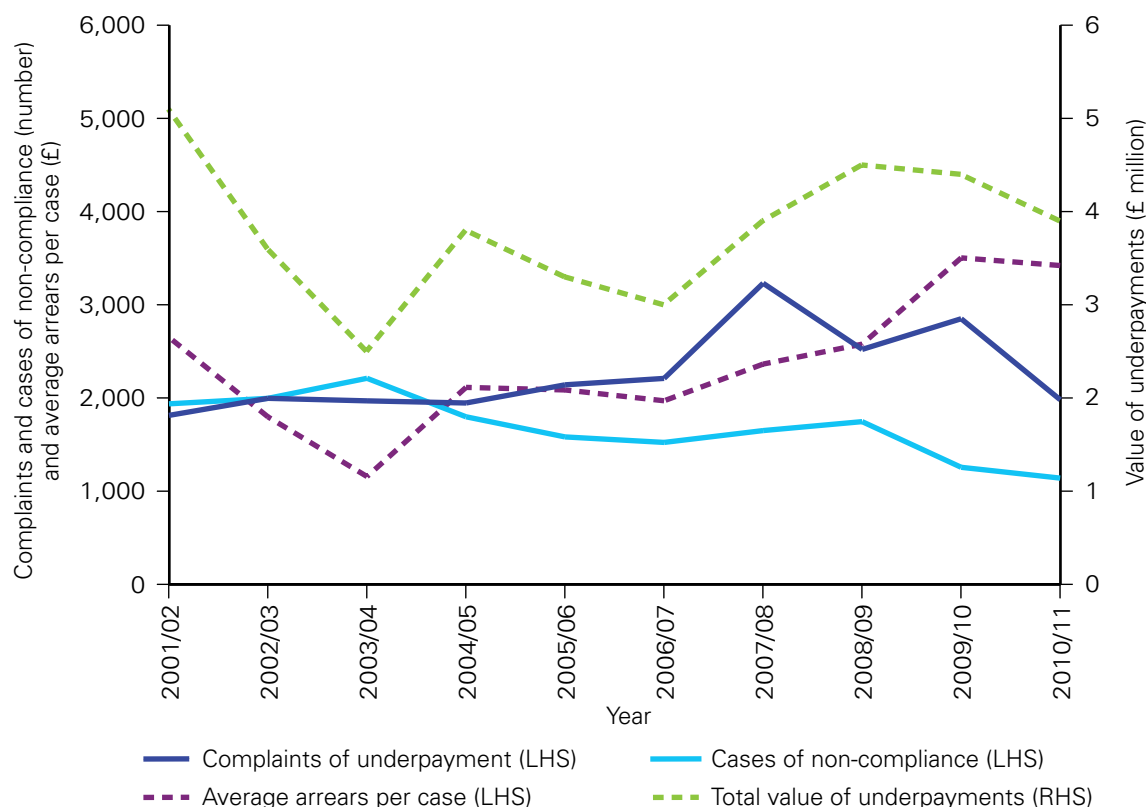
Interviewee, Ipsos MORI and Community Links research, 2012

Enforcement Statistics

4.103 The Government publishes statistics annually on the results of the enforcement activities of HMRC over the financial year. In 2010/11, the total number of enquiries completed (and the number of cases of non-compliance) decreased on the previous year. There was, however, an increase in the strike rate (the percentage of cases investigated where non-compliance was found) from 34 per cent in 2009/10 to 39 per cent in 2010/11.

4.104 Figure 4.1 shows that since 2006/07, the average arrears per case have increased, apart from in 2010/11, when there was a slight decrease on the previous year. During the same period, the number of complaints has fluctuated, as has the total number of cases of non-compliance. In 2010/11 the total number of complaints was only slightly higher than it had been in 2001/02.

Figure 4.1: Complaints and Cases of Non-compliance and Average Arrears per Worker, UK, 2001-2011



Source: HMRC, UK, 2001-2011.

4.105 The number of enquiries completed each year has been decreasing since 2007/08. In the 2011 Report we said that this was likely to be as a result of the introduction of the penalties and fair arrears regime (April 2009), as Compliance Officers had to familiarise themselves with the new process and approach to enforcement. The statistics show that over the last four years the number of complaints of non-compliance has fallen. At the same time, the average number of workers per case of non-compliance has steadily increased, but the total number of workers for which arrears have been identified has fluctuated, between 19,000 and 23,000.

4.106 It is possible to draw different interpretations from these statistics. We recognise that progress has been made in the way enforcement is carried out, for example targeted enforcement, allocating resources to risk, and the introduction of the Pay and Work Rights Helpline (PWRH). But the reduction in the recorded cases of non-compliance does not necessarily mean compliance has improved. Complaint numbers will be influenced by, among other things, levels of awareness of how to make a complaint and preparedness to do so (which may be affected by concerns about job security in a tougher labour market). As already stated, we have commissioned research as part of our next report to increase our understanding as to the actual extent of non-compliance.

4.107 Historically, the Government's performance on enforcement has been measured in terms of outputs: namely, the number of cases closed; the number of workers for which arrears are identified; and the total amount of arrears. These measures have given a good indication of year-on-year activity carried out and associated results. But they do not tell us whether or not the Government is moving towards its stated goal of ensuring that everyone who is entitled to the minimum wage receives it. The Government is, therefore, considering how it can refine the way it measures what it does to take account of the outcomes it is trying to achieve, and our Secretariat will contribute to this process.

Resources

4.108 In our 2011 Report we expressed our disappointment that the Government declined to commit to maintain funding in real terms for monitoring and enforcement, as we had recommended in our 2010 Report. We raised concerns last year that the freeze on marketing expenditure and widespread cuts across government may reduce the enforcement budget and that enforcement activities would suffer as a result. The Commission therefore strongly urged the Government to maintain the existing levels of funding for enforcement activities.

4.109 In evidence, GMB said it was important to maintain the current funding for enforcement activities. The Public and Commercial Services Union (which represents Compliance Officers) said the funding and resources for enforcement, and prosecutions, needed to be increased to send a stronger message to employers who try to evade the law. It said compliance teams were only scratching the surface of parts of the economy where workers were afraid or unable to complain. The TUC said there was a close relationship between the resources available for enforcement and the quality of enforcement. It therefore wanted to see the budget for enforcement increased. Unite also wanted to see real term increases in funding for enforcement. The Business Services Association encouraged ongoing vigilance and high-level enforcement efforts.

“Every year employers develop new ways of trying to avoid the minimum wage rules so constant vigilance is needed.”

TUC evidence

4.110 The Government has advised that HMRC's enforcement budget for 2011/12 was £8.2m, an increase of 2.4 per cent on 2010/11. Although less than inflation this increase is welcome, bearing in mind the budget cuts taking place elsewhere. We will continue to monitor the budget situation in subsequent years and report as appropriate.

Awareness

4.111 Widespread awareness of the minimum wage is a pre-requisite for maximising compliance. It is, therefore, imperative that the minimum wage rules are widely publicised and not just at the time of any change in the minimum wage rates. Prior to 2010, the then Government had put an increased emphasis on its awareness-raising activities and had undertaken a number of specific campaigns targeting particular groups, for example migrant workers. We have reported previously on the good work done in this area.

4.112 Following the General Election in 2010, the new Government put a freeze on marketing and communications activity. As a result BIS had to make use of a number of alternative channels to publicise the changes being made to the NMW in October 2010. These changes included the introduction of the Apprentice Rate and the lowering of the age at which the adult rate was paid to 21. These were perhaps the most significant changes to the Regulations for a number of years. BIS engaged with a number of stakeholders to encourage them to distribute information to their members, as well as issuing its own press release and updating Directgov and Business Link.

4.113 In evidence, HWW expressed concern over the limited publicity for the new rates. It believed it was very important that both employers and workers were made aware of the minimum wage rates and that where workers were vulnerable, unorganised and isolated (such as homeworkers), public advertising was of particular importance. The Forum of Private Business emphasised the importance of government-run awareness campaigns. It said there were significant penalties for businesses that fail to pay the minimum wage, so the Government (as well as trade bodies) had a crucial role in continuing to raise awareness.

4.114 The Federation of Small Businesses was concerned by the reductions in spending on communications. It said the rates usually changed annually and occasionally new categories were added, and the reduction in communications meant small businesses were struggling to keep on top of the yearly changes. Usdaw said it was short-sighted of the Government to abandon the regional visits BIS used to undertake in order to highlight the NMW. It said this will have worsened problems of underpayment and helped those employers who felt they could get away with breaches of employment rights. The TUC was concerned that awareness of the practical details of the minimum wage was slipping among workers and employers. It wanted BIS to be given a budget that was sufficient to advertise the minimum wage rates.

"I don't think my workers know anything about the National Minimum Wage because they don't speak English."

Interviewee, Ipsos MORI and Community Links research, 2012

4.115 BIS has said that in light of the continuing marketing freeze, it will again maximise low or no cost awareness-raising activities. As well as using press releases and stakeholder channels it is considering exploiting digital communication better, including announcements on Twitter and entries on appropriate blogs/forums.

4.116 BIS (2011d) found that awareness of the NMW enforcement regime and repercussions for those found to be non-compliant was low, until an inspection had taken place. In addition, employers were not aware of the PWRH. The research found that in relation to government guidance, the signposting of information could be improved to highlight the issues of specific interest to users. Many employers cited the usefulness of communications from trade bodies which they felt were specific to their sector and in a language relevant to them. The research we commissioned into non-compliance (Ipsos MORI and Community Links, 2012) found that in general, awareness of the NMW was high, although knowledge of the specific rates was low.

4.117 We are, like a large number of stakeholders, very concerned about the reduction in the Government's awareness-raising activities as a result of the marketing freeze. We understand that BIS is doing its best to use alternative channels and we support them in their efforts to do this. However, both BIS and our own commissioned research have shown that awareness levels need to be raised, especially as this is one of the strands of the Government's compliance strategy aimed at ensuring everyone who is entitled to the minimum wage receives it. The current budget for awareness is extremely modest (equal to around 1 per cent of HMRC's enforcement budget) but because of the freeze even this may not be used. Restricting this activity is short-sighted and is likely to increase unintentional non-compliance, which will affect both workers and employers. Therefore, **we recommend that the Government should more actively communicate both the rates themselves, and rights and obligations under the National Minimum Wage. Communication activities about the minimum wage should not be subject to the Government's marketing freeze.**

Conclusion

4.118 This chapter has looked at issues around simplification of the minimum wage, enforcement, and also specific issues with regard to its operation. It has drawn heavily on the views of stakeholders and also from our own discussions with the Government.

4.119 We have considered carefully the evidence of the Government and other consultees, and have not identified any regulatory simplifications whose benefits would outweigh their drawbacks. We agree with the majority of respondents to our consultation that the NMW is a relatively simple part of the employment law framework. Stakeholders have told us that improving the official guidance is the most important simplification measure. Some shortfalls are in specific areas and in some fields there is now less guidance than there used to be. It is imperative that relevant, accurate and easy to find guidance is available on the minimum wage. We have recommended that the Government commits itself to having effective, clear and accessible guidance in place, and first undertakes a complete review of the existing guidance. We have highlighted a number of specific areas where improved guidance is needed.

4.120 Good progress is being made with regard to improving the enforcement regime. Allocating resources to risk and making better use of intelligence are moves in the right direction. It is difficult, at present, to measure these improvements, but we have started to see increased reporting in the media, particularly on the targeted enforcement campaigns. This is important in raising awareness both of enforcement activity and of the minimum wage itself. But more can be done in this area.

4.121 In addition, new policies have been put in place to penalise employers who do not comply and also to name those who show a wilful disregard of the rules. These are important policies, but they need to be used and also reviewed at the appropriate time. We are disappointed by the failure to date to name any employers at all, and have recommended that the Government should make frequent use of naming.

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- 4.122** Stakeholders have again raised concerns over the Government's reduction in funding of activities to raise awareness of the minimum wage. These concerns have been supported by research findings for this report which indicate that there is a lack of awareness among some employers. This is not good, either for workers who won't get their entitlements or employers who may inadvertently break the law. We would like to see the Government restore its previous communication activities, and place its NMW communications outside the restrictions of its marketing freeze.
- 4.123** In the next chapter we now set out the evidence received on future levels of the different minimum wages and our recommendations to Government for these levels in October 2012.

Chapter 5

Setting the Rate

Introduction

- 5.1** We met to discuss and agree our recommendations in mid-January 2012. In this report, we have therefore only considered data that were available up to 19 January 2012. That was before the release of the first estimate of gross domestic product (GDP) growth in the fourth quarter of 2011.
- 5.2** In making our recommendations, we have taken account of our understanding of the current state of the economy (as laid out in Chapter 1); the impact of the minimum wage so far on earnings, employment and competitiveness (as discussed in Chapter 2); the impact on young people, interns and apprentices (as summarised in Chapter 3); and the operation of the National Minimum Wage (NMW), including compliance and enforcement (as covered in Chapter 4). We also consider the economic prospects over the coming year or so; stakeholder views; other government legislation (including changes to the tax system and pension arrangements); and international comparisons. As required in our remit, we consider how business clarity might be improved. This chapter discusses these issues before setting out our recommendations and their implications.

Economic Prospects

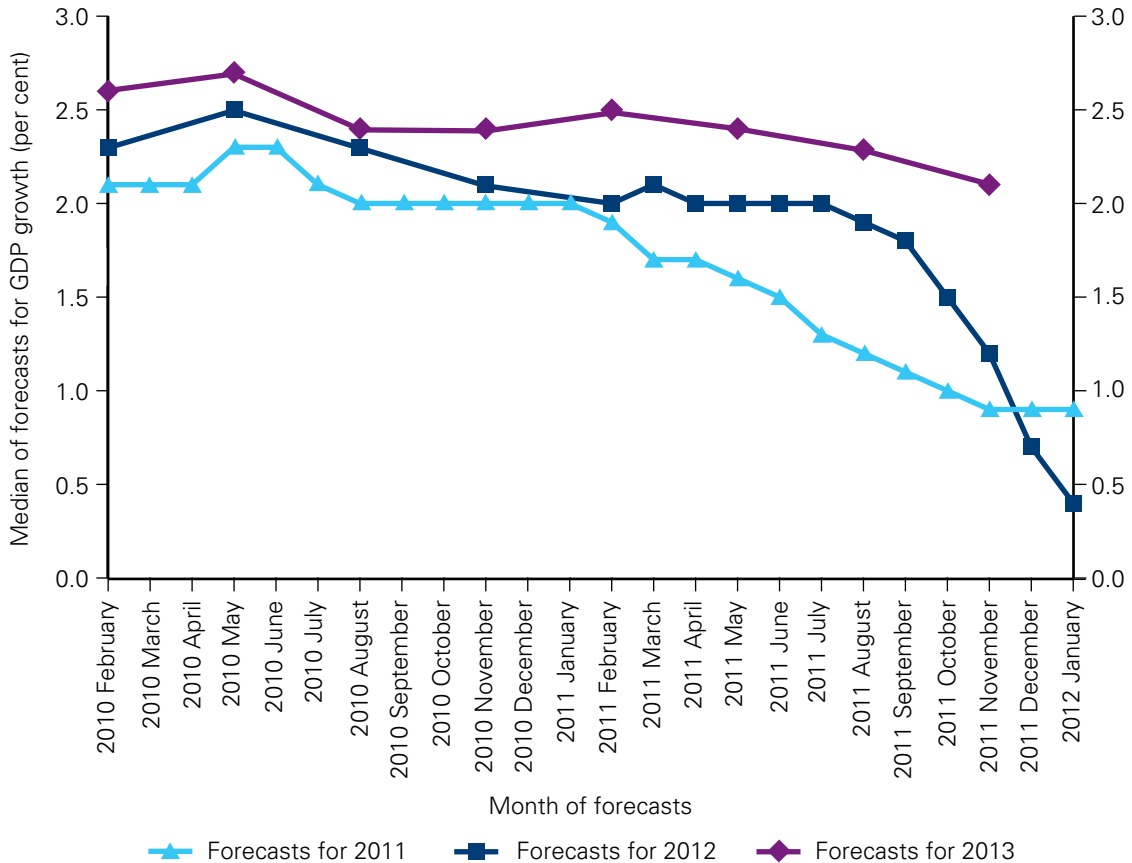
- 5.3** We first consider the prospects for the UK economy in 2012 and 2013. In arriving at our recommendations for the minimum wage, it is important to consider future affordability to the economy (and especially to the low-paying sectors and small firms) as well as the real and relative levels of the minimum wage, that is, its real level (after taking account of inflation) and its value relative to average earnings. In assessing future affordability, we look at the prospects for growth in the economy as a whole and in the low-paying sectors in particular. We then look at the prospects for inflation, pay settlements and earnings before considering how employment might be affected.

Prospects for Growth

- 5.4** Throughout 2010 and much of 2011 independent forecasters expected growth in 2012 to be around 2.0-2.5 per cent, as shown in Figure 5.1. The economy was expected to continue its recovery from the deepest recession since at least the 1930s. However, as we discussed in Chapter 1, the economy performed weakly in 2011 after relatively strong growth in the first three quarters of 2010. But it wasn't until the late summer of 2011 that sentiment changed noticeably and since then there have been large downward revisions of projected GDP

growth by most forecasters. These revisions have been substantial in the last three or four months, with the median of independent forecasts for growth in 2012 falling from 1.8 per cent as recently as September 2011 to just 0.4 per cent in January 2012, at the time we considered our recommendations. In November 2011, the Office for Budget Responsibility (OBR) and the Bank of England also revised their estimates for growth in 2012 downwards. There has also been some downward revision of forecast growth in 2013.

Figure 5.1: Gross Domestic Product Forecasts, UK, 2011-2013



Source: HM Treasury Panel of Independent Forecasts (monthly, February 2010-January 2012), based on ONS data, GDP growth (ABMI), quarterly, seasonally adjusted, UK, 2011-2013.

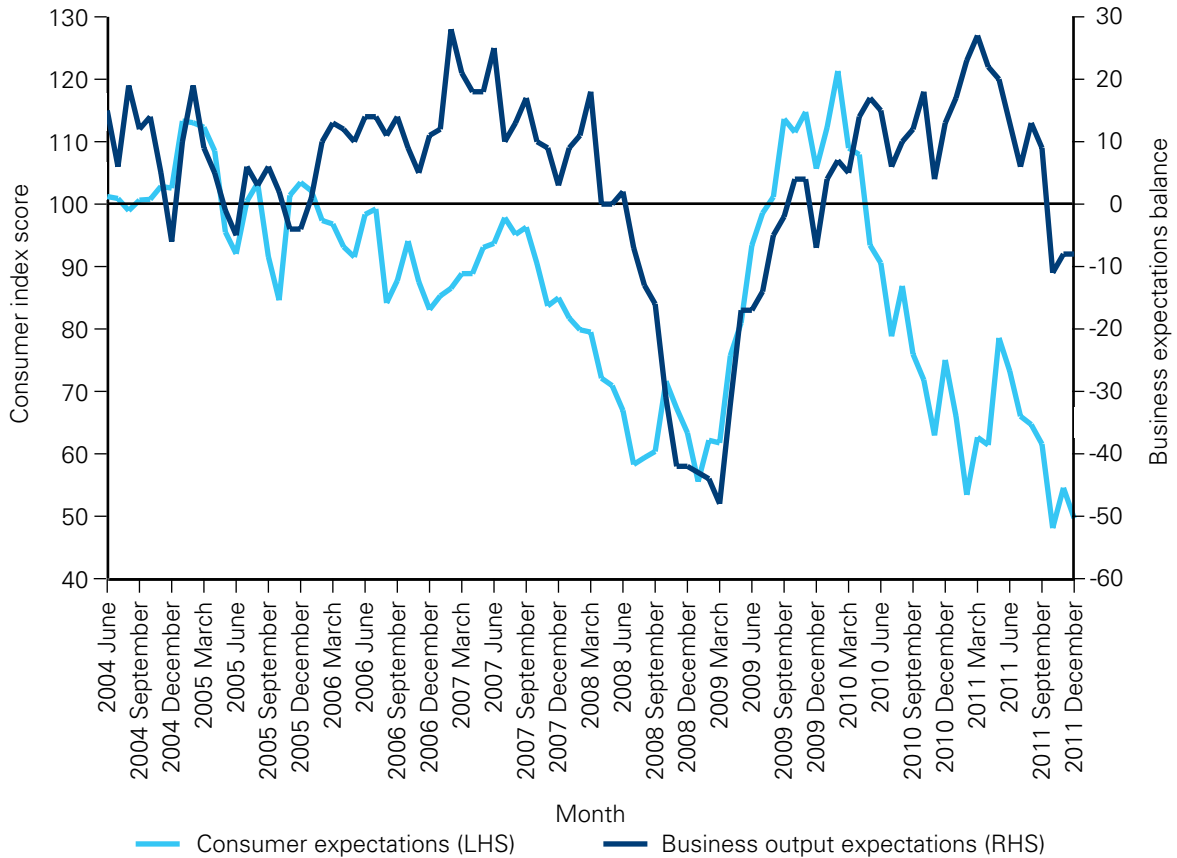
5.5 These recent revisions highlight the degree of uncertainty that is attached to these forecasts this year. The outlook for investment and trade has weakened notably in the last few months, whereas the outlook for consumer and government spending was already weak. Many forecasts take account of the difficulties in several eurozone countries but most assume that the European Union (EU) will muddle through and a major adverse economic shock will be avoided.

5.6 In Chapter 1, we noted the importance of the components of growth to the low-paying sectors. The prospects for consumer spending will affect low-paying sectors such as retail; hospitality; and leisure, travel and sport. The level of, and growth in, government spending will be an important determinant of prospects for companies in the social care and childcare sectors, which rely heavily on government funding of places. Hospitality, cleaning and security will also be affected by changes in government spending. The outlook for trade will be a significant factor for low-paying sectors, such as agriculture, food processing and the manufacture of textiles and clothing. Tourism is also important for retail, hospitality and

leisure. Indirectly, cleaning and security will be affected by consumer and government spending. Investment will help determine the long-run outlook for the UK economy and thus the health of many low-paying sectors. We now turn our attention to the prospects for consumer spending, investment, trade and government spending.

- 5.7** Consumer spending depends on current income and wealth, as well as that expected in future. Over the coming year, the forecasts suggest that nominal wage growth and pay settlements will remain subdued, increasing by around 2.0-2.5 per cent. Although inflation is expected to fall throughout 2012, Consumer Prices Index (CPI) inflation is forecast to remain above the Bank of England target (2.0 per cent) by the end of 2012 with Retail Prices Index (RPI) inflation still close to 3.0 per cent. This still implies that real earnings are likely to fall throughout 2012. We discuss the detailed prospects for pay settlements and real earnings growth later in this section. The measures already in place to tackle the public sector deficit are likely to increase taxes, reduce tax credits and reduce benefits, thereby reducing post-tax disposable incomes. Indeed, OBR forecasts suggest that real disposable household income will have fallen by 4.7 per cent between 2009 and 2012, the largest fall in any comparable period since records began in 1955. The previous largest fall was 1.9 per cent between 1974 and 1977. Further, per capita real household disposable income is expected to be no higher in 2015 than it was in 2005. The previous worst ten-year period was 1973-1983 when it grew by 14.4 per cent.
- 5.8** During the 1990s and the pre-recessionary 2000s, wealth and expectations of future wealth were important drivers of consumer spending. Increases in house prices led to substantial equity withdrawal that helped fund housing renovations and extensions, new cars and holidays. House prices fell during the recession and equity withdrawal has fallen sharply. The housing market remains subdued and is not expected to pick up to any great extent in 2012. Indeed, property transactions, mortgage approvals and new builds are all well below their pre-recessionary levels. Personal loans and credit card lending are also relatively subdued, and likely to remain so, as many consumers attempt to reduce their debts. Although equity prices picked up towards the end of 2011 and into 2012, there had been sharp falls in the summer of 2011 as concerns about the euro and the indebtedness of banks across Europe heightened. Equity prices were still much below their levels in 2007. All of these influences on consumer spending suggest that it will be unlikely to boost growth appreciably. Further, Figure 5.2 shows that consumer expectations about prospects for the coming year have fallen back since the middle of 2011. However, despite the expected fall in real disposable income, OBR and the median of independent forecasts expect a small increase in private consumption in 2012 (0.2-0.3 per cent).

Figure 5.2: Consumer and Business Expectations, UK, 2004-2011



Source: Nationwide, consumer expectations index, and CBI, output expectations, monthly, not seasonally adjusted, UK, 2004-2011.

5.9 As part of the rebalancing of the economy away from dependence on the consumer and on government spending, it was hoped that private sector investment and trade would pick up. Indeed, they are the areas that forecasters, and the Government, are expecting to drive the recovery. As we noted in Chapter 1, inventories had been rebuilt after the recession and had contributed significantly to growth in 2010 and 2011 but voluntary stock-building was not expected to play much of a part in the recovery in the longer-term. The path of future investment will depend on its cost and on the prospects for the economy. Although, at 0.5 per cent, the Bank base rate has been historically low and is expected to remain so for some time, business investment has stayed well below its pre-recessionary levels. The cost of credit to many businesses, however, was appreciably above this rate and higher than it had been before the recession. The interconnectedness of the financial system and the exposure of British and other banks to the debts of many eurozone countries and banks had increased strains in bank funding markets. These had not yet led to a further tightening in access to credit for British business. However, small firms in particular continued to find access to credit, particularly overdrafts, difficult.

5.10 Further, as shown in Figure 5.2, the weakened prospects for the economy and the uncertain outlook had led business confidence to fall since the spring of 2011. As a result, many firms had cancelled or postponed investment. In addition, despite a small boost announced in the Chancellor’s Autumn Statement, public sector investment has also been scaled back. This could affect the potential for growth when the economy finally picks up.

- 5.11** The prospects for net trade (exports minus imports) depend on the relative value of sterling and the outlook for economic growth in the main trading partners of the UK. The effective exchange rate for sterling fell sharply between 2007 and the end of 2008, and has remained more than 20 per cent below its 2007 value since the middle of 2009. As a result of that relative fall in sterling, exports had picked up and there had been some evidence of a switch from imports to domestically produced goods. Exports were also helped by the upturn in global demand from the middle of 2009 that was sustained throughout 2010 and into 2011. However, concerns about: deficit reduction programmes in developed countries; sovereign debt sustainability in the eurozone; inflationary pressures in fast-growing developing countries; natural disasters in Japan and Thailand; and political uncertainty in the US, had led to a significant weakening in world trade, especially since the middle of 2011. On the back of these concerns, the World Bank, the International Monetary Fund and the Organisation for Economic Co-operation and Development (OECD) have all significantly reduced their forecasts for world trade in 2012, with growth in the eurozone particularly weak. However, growth was expected to hold up in the US, where recent labour market figures had been stronger than expected. The outlook for trade was therefore not as strong as it had appeared last year. Despite these concerns, the OBR and the median of independent forecasts were expecting exports to perform better than imports, thus acting as a net contributor to UK growth in 2012.
- 5.12** Since the end of the recession, government spending has contributed positively to growth. Together with weaker growth since the autumn of 2010, the public sector deficit has worsened. Consequently, the Chancellor announced in the Autumn Statement (HM Treasury, 2011b) that the fiscal tightening would be extended for a further two years. The Institute for Fiscal Studies told us that this would be the largest sustained cut in real government spending on record. It estimates that public service spending will fall by 16.2 per cent in real terms over seven years from 2010/11 to 2016/17. The previous largest real cut over a similar seven year period was 9.3 per cent (1975/76-1982/83). Among other things, this is likely to adversely affect public funding for social care and childcare.
- 5.13** The recovery had been slower than forecast and growth was expected to continue to be weak in 2012 and weaker than previously thought in 2013. We now go on to look at the prospects for inflation and wage growth.

Prospects for Prices, Pay and Earnings

- 5.14** Inflation data for the twelve months to December 2011, the latest available to us, showed the CPI at 4.2 per cent, and the broader RPI at 4.8 per cent. Both measures had fallen sharply on November, in the case of CPI registering the biggest fall for three years. Even so, CPI was over 4 per cent, and occasionally over 5 per cent, throughout last year. This was more than double the Government's inflation target, and was largely attributed by the Governor of the Bank of England to a combination of the increase in Value Added Tax (VAT) in January 2011, and higher energy and commodity prices. With the exception of the December figure, RPI was above 5 per cent throughout 2011, driven mostly by the same upward pressures, but also reflecting differences in the ways the two inflation measures are calculated – the

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so-called 'formula effect' – which has resulted in RPI rates typically averaging around 0.7 percentage points above CPI since 1989.

- 5.15** The Governor contended that the upward pressures he had identified would be short-lived in their effects and CPI should slow further in 2012 to around the 2 per cent target or slightly below towards the end of the year. For example, the effects of the 2011 VAT increase will fall from the index during 2012, reducing CPI by around 1 percentage point. The slowing in the world economy will put downward pressures on commodity prices, with the World Bank expecting non-oil commodity prices, which had risen 20.7 per cent in 2011, to fall by 9.3 per cent in 2012, and oil prices, having risen 31.6 per cent in 2011, to fall by 5.6 per cent. Finally, the large increases in domestic energy prices in the autumn of 2011 were unlikely to be repeated in 2012 – in fact, most major providers had already announced falls in some prices. This prognosis is supported by other forecasters: the median of the independent forecasts published by HM Treasury in January 2012 has CPI at 2.1 per cent in the fourth quarter of 2012, while in its November 2011 Economic and Fiscal Outlook the OBR forecasts a slightly higher CPI fourth quarter figure of 2.4 per cent.
- 5.16** RPI will be subject to the same downward pressures in 2012, although the formula effect is expected to keep the rate above CPI. The median of January forecasts shows RPI at 2.8 per cent in the fourth quarter of 2012, exactly in line with the OBR forecast.
- 5.17** Given the broad consensus around the forecasts, and the disinflationary pressures highlighted by the Bank of England (and already evident), the path for inflation over the next twelve months is expected to be clearly downwards. However, in its November 2011 Inflation Report the Bank of England cautioned that both the pace at which CPI would fall, and how far it would fall, were uncertain. The pace of decline could be slowed, for example, if companies sought to restore profit margins, which were below their pre-recessionary average levels, or if they sought to pass on previous increases in import prices where full adjustment had not yet taken place. A slower than expected rate of decline could also feed into inflation expectations putting upward pressure on pay growth and adding to employers' costs. In light of these uncertainties we can do no better than note the inflation forecasts and, while expecting the rates of increase to slow, exercise caution.
- 5.18** Research has long indicated a strong medium to long-term relationship between the rate of inflation as measured by RPI and the level of basic pay increases, and, more recently, Dolton, Makepeace and Tremayne (2012) have confirmed these findings. In the short-term, however, especially in periods when the inflation rate is particularly volatile, this relationship may break down. Certainly, during the period of recession and weak recovery of the last few years, basic pay has increased much more slowly than RPI resulting in quite large and prolonged real cuts in pay rates. Factors other than inflation are therefore clearly influential. The Chartered Institute for Personnel and Development (CIPD) (2011) noted an organisation's ability to pay, productivity and performance, the going rate of awards elsewhere, and recruitment and retention issues, alongside inflation as key determinants of pay increases. It is worth noting that the balance of these factors varies across and within sectors, and base pay adjustments across the economy as a whole reflect this.

- 5.19** As there are no official measures of pay settlements we have again looked at data published by the manufacturers' organisation (EEF), and pay specialists Incomes Data Services (IDS), Labour Research Department (LRD) and XpertHR, augmented by analysis from the Bank of England and the CIPD. The latest available published data related to the three months to November 2011. They showed the whole economy median level of settlements between 2.0 per cent and 3.0 per cent, depending on the pay specialist, a range that had been reasonably consistent since the first quarter of 2011. The level of pay freezes in the private sector overall had fallen to less than 10 per cent of awards, although EEF reported a rate of 15 per cent in manufacturing. IDS showed substantial variation in median settlement levels by sector: the median level in both the public and not-for-profit sectors was 0 per cent; and while the median in the private sector was 2.5 per cent overall, it was 3.1 per cent in manufacturing, 2.5 per cent in services and 2.0 per cent in construction. In a specially commissioned report, IDS (2011c) noted that in low-paying sectors the median award was 2.2 per cent, but the median in retail was 2.0 per cent, and in hospitality 2.6 per cent.
- 5.20** Mean settlement levels were somewhat lower. The average of awards weighted by employee numbers in the three months to November was 1.5 per cent according to XpertHR and 1.6 per cent according to IDS. These figures should be treated with some caution as they can be highly volatile from month to month and are heavily influenced by the public sector where a limited number of settlements covers a very large number of employees. The private sector settlement mean calculated by the Bank of England from a variety of sources was 2.2 per cent in the twelve months to September 2011.
- 5.21** Some of the pay specialists provided our Secretariat with their then unpublished settlement figures for the three months to December 2011. These suggested a narrowing of the range of medians to 2.5-3.0 per cent. They were also able to provide some initial analysis of January 2012 awards, an important month as it covers around a third of all settlements. This showed a further narrowing of the range of medians to 2.8-3.0 per cent. However, they cautioned against putting too much weight on the medians at that stage, as comparatively few awards had yet been recorded, and those that had tended to be dominated by existing, RPI-linked, long-term pay deals. They also noted that practically all the awards related to the private sector, the majority in manufacturing where awards had recently outstripped those in the much larger service sector. They drew attention to a similar trend in the early months of 2011 and thought that the medians might fall back as the influence of long-term deals declined, and the generally lower public and service sector awards started to 'kick in' from April 2012.
- 5.22** We were also able to draw on surveys of employer intentions carried out in the latter months of 2011. Both the XpertHR and CIPD surveys suggested that around a fifth of all employers were not expecting to make an award in 2012, but for those that were the median private sector award was 2.5 per cent. There was, however, a large variation by sector around this figure and, according to XpertHR, the retail and wholesale sector had a somewhat lower forecast median of 2.0 per cent. An IDS survey suggested a slightly more bullish outcome in that 80 per cent of surveyed employers expected to make the same or a higher award this year than last. IDS thought this might increase the award median to 3.0 per cent. CIPD also regularly surveys employees. Its November 2011 survey indicated that a third of employees expected a pay freeze in 2012; some 58 per cent expected a pay rise with a median private sector expectation that this would amount to a 3.0 per cent increase.

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- 5.23** We conclude that there may be some short-term volatility in settlement medians, and a clear picture of settlement trends in 2012 is unlikely to emerge before April data become available. However, none of the analyses available to us suggested that aggregate settlement levels in 2012 would differ radically from those in 2011, albeit outcomes could be different across individual sectors and organisations. We are conscious, however, that the settlement data contain a bias towards larger and/or unionised organisations and may not capture pay settlement outcomes in small companies, which separate earnings analysis suggests might be lower than in medium-sized or large enterprises.
- 5.24** Settlement data measure changes in basic pay rates, and in this respect they are broadly equivalent to the regular pay element of the Average Weekly Earnings (AWE) series published by the Office for National Statistics (ONS). However, pay settlements do not capture changes in pay levels resulting from factors such as progression, variable payments, allowances or premia, or the effects of shifts in the composition of the labour force. For information on changes in earnings levels we therefore concentrate on the AWE total and regular pay measures and related forecasts.
- 5.25** As it happened, the latest AWE figures, covering the three months to November 2011, showed the same year-on-year increases in whole economy regular and total pay of 1.9 per cent. Similarly, the figures were the same for the private sector, both at 2.0 per cent, and the public sector, both at 1.4 per cent. Total pay growth has been relatively subdued throughout 2011 and rarely outside a range of 2.0-2.5 per cent. It has been markedly low in all the broad AWE sectors with the exception of finance and business services, where growth for much of 2011 exceeded 5.0 per cent, although that had fallen to 3.2 per cent in November. In wholesaling, retailing, and hotels and restaurants, which cover a large proportion of low-paid employees, total pay growth through 2011 had been as low as -1.3 per cent in April and as high as 2.6 per cent in July, although it was 1.7 per cent in the three months to November and broadly in line with the whole economy figure.
- 5.26** The median of January forecasts for 2012 as a whole shows AWE total pay growing by 2.4 per cent; over half of the forecasts are in the range 2.0-2.8 per cent. OBR forecasts average earnings growth of 2.0 per cent in 2012 and 3.1 per cent in 2013. These are less than the forecasts for RPI inflation in 2012 and slightly below expected settlement medians. The OBR quarterly forecasts show a dip in earnings growth in the second half of this year before picking up in 2013. The Bank of England points out that while there is continued pressure on wage growth from the substantial degree of slack in the labour market, there may be offsetting pressures from, for example, employee demands for higher awards after a period of sharp falls in real pay. On balance the Bank also thinks there may be a gradual rise in pay growth but not until 2013.
- 5.27** We noted in Chapter 1 that for the purposes of measuring the impact of the minimum wage – its bite – we compare the NMW rates against the median of the relevant earnings distribution taken from the Annual Survey of Hours and Earnings (ASHE). As we have no forecasts for ASHE, we use average earnings growth forecasts as a proxy. Many of these are based on AWE. We have also noted that ASHE and AWE differ in a number of respects and that there can be short-term variations in the levels of earnings growth emerging from the two measures. This was particularly noticeable in 2011. In the longer run, however, these

short-term variations largely cancel out so that, for example, since April 2000, the earliest date from which we can compare the two series, the ASHE median has actually grown marginally faster than AWE total pay, the difference over the eleven years to April 2011 amounting to just 0.8 percentage points.

- 5.28** For completeness, we have looked at the quarterly average earnings forecasts prepared by OBR which, as they are calculated in a way that takes account of forecast changes in employment, are thereby broadly comparable with ASHE and may give an indication of the level of bite arising from our 2011 and 2012 recommendations. The OBR forecast for the first quarter growth in average earnings in 2012 is 2.3 per cent. Of course, we recommend rates for a full twelve months, from October to October, whereas ASHE is a snapshot of earnings levels in a specified period each April. It seems appropriate, therefore, to look at earnings growth forecasts for the full period based on averaging the OBR forecasts for the four quarters from the second quarter of 2011 to the first quarter of 2012 (April 2011 to April 2012). This gives a figure of 1.7 per cent. The same analysis for 2013 shows earnings growth in the first quarter of that year at 2.4 per cent, or 2.0 per cent on average for the period from April 2012 to April 2013.

Prospects for Employment

- 5.29** As a result of the weakness in output growth, the UK labour market is likely to deteriorate in 2012. The OBR and the median of independent forecasters expect a fall in employment in 2012, albeit by only 0.2-0.5 per cent, while claimant unemployment is expected to increase from 1.60 million at the end of 2011 to 1.79 million by the end of 2012. The expected upturn in growth in 2013 should lead to increased employment and a fall in unemployment.
- 5.30** The quarterly CIPD Labour Market Outlook (autumn 2011) showed that the labour market was expected to weaken further going into 2012. Expectations among private sector employers continued to show a positive outlook for employment but it was stronger looking forward over the next twelve months than in the short-term. In contrast, employment was expected to fall across the public sector throughout the next twelve months. This suggests that the rate of job growth in the private sector will continue to slow in the short-term and may be insufficient to make up for the job losses in the public sector. This growth in private sector jobs is therefore unlikely to offset the increase in the working age population (around 60,000 a quarter) and unemployment is likely to increase for some time as a result.
- 5.31** The Recruitment & Employment Confederation's (REC) Jobs Outlook (2011) had found that about 80 per cent of employers intended to increase or maintain their temporary workforces and this was up on the same time a year ago. However, the REC and KPMG Report on Jobs (2012) showed that in December 2011 recruitment consultants had placed fewer people in permanent placements for the third month running. That rate of decline had been modest but temporary billings had also decreased for the first time since July 2009, around the time that the recession had officially ended. The availability of both permanent and temporary staff had also accelerated markedly, increasing at its fastest pace since October 2009. This suggests that the labour market had weakened in recent months as uncertainty about the eurozone had fed a lack of confidence. But the Report on Jobs showed that vacancies were still strong.

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- 5.32** The recessions of the early 1980s and early 1990s saw much greater falls in employment and hours than in output. Output fell by 4.7 per cent in the 1980s recession but employment fell by 6.5 per cent and hours by 10.2 per cent. The fall in output in the 1990s recession was much lower, 2.5 per cent, but employment (down 6.3 per cent) and hours (down 9.1 per cent) fell by nearly as much as in the 1980s recession. In contrast, during the recent recession, the loss in output (7.1 per cent) was much larger than both the fall in jobs (2.5 per cent) and the reduction in hours (4.7 per cent). After the earlier recessions, it took eight quarters for output to return to its pre-recessionary levels. Output in the third quarter of 2011, nine quarters after the end of the 2008-2009 recession, is still 3.5 per cent below its level in the first quarter of 2008.
- 5.33** Employment did not return to its 1980s pre-recessionary level until 91 months (over seven years) after the start of the recession. It took 101 months (over eight years) after the start of the 1990s recession. Hours took even longer to recover from both recessions. The resilience of the labour market during the most recent recession might lead us to hope that employment and hours may recover more quickly this time.
- 5.34** Summarising these forecasts, Table 5.1 shows that the economy is expected to grow weakly in 2012 before picking up towards trend in 2013. Inflation is expected to fall back throughout 2012 but remain higher than average wage growth, implying a continuation of real wage cuts. However, real wage growth is expected to return, albeit somewhat muted, in 2013. All the forecasts do, however, carry a higher than usual level of uncertainty because of the current volatile economic environment.

Table 5.1: Actual Outturn and Independent Forecasts, UK, 2011-2013

Per cent	Actual data 2011	Median of independent forecasts (November 2011 and January 2012)		OBR forecasts (November 2011)	
	(Actual to Q4/ whole year or latest)	2012	2013	2012	2013
GDP growth (whole year)	0.9^a	0.4	2.1	0.7	2.1
Average earnings growth (whole year)	2.3^b	2.4	-	2.0	3.1
Inflation RPI (Q4)	5.1	2.8	2.6	2.8	3.0
Inflation CPI (Q4)	4.6	2.1	2.0	2.4	2.0
Employment growth (whole year)	-0.3	-0.5	-	-0.2^c	0.3 ^c
Claimant count (millions, Q4)	1.60	1.79	1.76	1.79	1.74

Source: HM Treasury Panel of Independent Forecasts (November 2011 and January 2012), OBR Forecasts (November 2011) and Low Pay Commission (LPC) estimates based on ONS data, GDP growth (ABMI), total employment as measured by workforce jobs (DYDC) and claimant unemployment (BCJD), quarterly, and AWE total pay (KAB9), monthly, seasonally adjusted; RPI (CZBH) and CPI (D7G7), quarterly, not seasonally adjusted, UK (GB for AWE), 2010-2013.

Notes:

a. Estimate of economic growth based on current ONS data and LPC extrapolations.

b. Estimate of average earnings growth based on January-November 2011 compared with the same period a year earlier.

c. OBR forecasts employment levels rather than growth. Growth forecasts shown here reflect the percentage differences between these forecast levels.

Stakeholder Views

5.35 We again sought views on the minimum wage from stakeholders. We received 76 responses to our formal consultation from the UK administrations, employers and their representative organisations, trade unions, youth organisations and from individuals. In addition, we undertook a visits programme to eight locations around the UK and heard oral evidence from 33 organisations over two days in November 2011. The Secretariat also held numerous informal meetings with interested parties.

Adult Rate

5.36 Views on the adult rate from October 2012 again fell roughly into two camps. Those representing employer organisations stressed the difficult and uncertain economic environment and urged caution, with a large number calling for a freeze. Others, mainly trade unions, emphasised evidence that by October 2012 some economic growth could be expected and supported increasing the rate in order to reverse the fall in its real value due to high inflation.

5.37 A large number of employer organisations, particularly those representing small businesses again called for the adult rate to be frozen from October. The Federation of Small Businesses (FSB) said an increase ran contrary to business needs in the current climate and the wage should be frozen until we entered a period of substantial and sustained business growth. The Association of Convenience Stores (ACS) recommended a freeze on the basis of evidence from its members that clearly identified the impact the minimum wage was having on their ability to expand, maintain staffing hours and maintain competitiveness. While in the hospitality sector, the Association of Licensed Multiple Retailers believed that in the current economic climate a freeze in the NMW in 2012 would be appropriate. In oral evidence the Registered Nursing Home Association also called for the rate to be frozen.

5.38 As well as highlighting the state of the economy and impact this has had on individuals' discretionary spend (particularly in the retail and hospitality sectors), many business organisations raised other cost pressures. These included the increases in utilities and business rents as well as transport and other input costs. A large number also commented on the additional cost burdens arising from regulatory change, including the new pension reforms from October 2012. We look at pension reforms later in this chapter.

5.39 Some organisations, while calling for a freeze, said if there were to be an increase, it should be kept to a modest level. The National Hairdressers' Federation (NHF) said that, against the difficult economic backdrop, any increase would put enormous further and undue pressure on hairdressing salons that could lead to redundancies. It said there was a compelling case for the minimum wage to be kept at the current level but if it did have to be raised, it should only be by a modest amount. The National Day Nurseries Association (NDNA) said members sought stability in the wage, with either a freeze or an increase not exceeding wage inflation. In the hospitality sector, the British Hospitality Association, British Beer & Pub Association, and Business In Sport and Leisure, said in oral evidence that there was a case for more caution.

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- 5.40** The CBI told us that while the economy was expected to expand gradually, there were huge downside risks. Global prospects had deteriorated and business confidence had declined with them. It also said the challenges ahead were greatest for the low-paying, consumer-facing sectors where the NMW had a major impact. It said a highly cautious approach to the 2012 uprating was essential. Recommending that the bite of the NMW was not increased, the National Farmers' Union (NFU) said an increase of over 2 per cent was likely to be inflationary and damage the fragile economic recovery. The British Retail Consortium (BRC) repeated its view that the NMW should not exceed long-term earnings growth, which in the twelve months to October 2011 suggested 2.1 per cent. It added that caution was needed given the volatility of the labour market. The Association of British Bookmakers said anything more than a "nominal increase (less than 1 per cent)" was likely to lead to further significant job losses.
- 5.41** On the other hand, organisations representing workers all supported an increase in the adult rate, particularly given the impact of high inflation on the low paid. A number supported a move towards a living wage.
- 5.42** The Trades Union Congress (TUC) said that the economy was returning to growth and the labour market had been more resilient through the downturn than many expected. It argued that by October 2012 the slowly recovering economy would be able to support a considerably more substantial increase than the one in October 2011, which would improve the position of low-paid workers. It favoured increasing the adult rate by at least the greater of inflation or average earnings. This would help offset the fall in the real value of the minimum wage caused by inflation, and support growth by increasing demand in the economy.
- 5.43** The Union of Shop, Distributive and Allied Workers (Usdaw) said that the economy remained in a precarious situation and there was a real danger of slipping back into recession. However, there were many reasons for this and the level of the NMW was not one of them. It said there should be a significant increase in the NMW, which should be above any projected RPI inflation figure, to take into account current RPI and the upratings below inflation in the last two years. Unite quoted a recent Joseph Rowntree Foundation report which said that a minimum income standard for the UK should be £7.67 an hour. Unite's policy was that the NMW should be half male full-time median earnings which it calculated would be £6.84 in October 2012. It recommended a rise in the NMW of 6.1 per cent, to bring it nearer its target.
- 5.44** Several trade unions wanted to see the NMW reach the level of a living wage in time. The GMB expressed this ambition, but recognised that an increase to this level in October 2012 was unrealistic. It therefore supported an increase in line with at least forecast RPI of 3.3 per cent. The Communication Workers Union wanted a rise to £7.00 an hour (15 per cent) as a step towards a living wage. This was, it stated, the mid-point between the current rate of the NMW and £8.00 an hour, which was what it expected living wage estimates to be in 2012. UNISON supported a substantial increase in October 2012 to reflect the increased cost of living in recent years, and after 2012 it should move in stages towards a living wage of around £8.00 an hour.

- 5.45** Other unions supported the NMW increasing to the level of a living wage in October 2012. The National Union of Students (NUS) supported an increase to at least £8.20 an hour (a rise of 35 per cent) and the Public and Commercial Services Union thought that given the weighty evidence for abolishing low pay and tackling wage and wealth inequalities, the National Minimum Wage should be raised to at least £8.25 an hour (an increase of 36 per cent).
- 5.46** In its evidence the Government asked us to concentrate on the effect of a rise in the adult NMW on employment and inflation. In relation to youth rates (which we consider below) it said there were extra reasons to be cautious and moderate because of the labour market difficulties experienced by young workers.

Youth Rates

- 5.47** As with the adult rate, consultation responses on future levels of the youth rates of the NMW fell into two camps: those calling for a freeze; and those calling for large increases with a move to either the adult rate of the NMW, or to a living wage.
- 5.48** Organisations calling for a freeze included the British Chambers of Commerce (BCC), and the CBI, who argued that both youth rates of the NMW should be frozen in view of the challenging employment prospects for young people. While not calling for a freeze, the NFU argued that the Youth Development Rate should only be raised by half the increase in the adult rate.
- 5.49** Save the Children, Platform 51 and NUS were among those wishing to see the same rate for young people as adults. Trade unions were supportive of an increase in the youth rates of the minimum wage, with most calling for a single minimum wage to apply to workers of all ages from the age of 16. The TUC called for the adult rate to apply to all workers from the age of 18, and for the gap between the adult rate and the 16-17 Year Old Rate to be narrowed.

Apprentice Rate

- 5.50** The Government said that there were important supply and demand issues that needed to be considered when reviewing the Apprentice Rate. It said that in order to encourage the supply of apprenticeships, an apprentice wage needs to be set at a level which provides appropriate incentives for individuals to participate, without dissuading employers from providing schemes. The Northern Ireland administration pointed out that there were important financial implications for employers in ensuring that the level of the Apprentice Rate did not deter them from offering apprenticeships. The Welsh Government said employer costs should not be unnecessarily increased, but this needed to be balanced so that apprentices were protected from exploitation without deterring businesses from taking them on. The Scottish Government had reservations that the level remained too low.

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- 5.51** Generally organisations representing business urged the Commission to be cautious in respect of any future uprating. The CBI argued that the Apprentice Rate was in its infancy and should be frozen, in line with the youth rates, until its effects could be properly assessed. The BCC and the Unquoted Companies Group also counselled against raising the Apprentice Rate. The FSB, however, while proposing a freeze in the other minimum wage rates, suggested there should be an increase in the Apprentice Rate to £123 per week, a level which it said was roughly in line with the 16-17 Year Old Rate (£3.68 from October 2011). The FSB said that its members would take on more apprentices if they were incentivised by an upfront payment or wage subsidy.
- 5.52** In the low-paying sectors, the Hair and Beauty Industry Authority remained concerned that the current economic situation meant businesses in the hairdressing industry were operating with low margins. With labour costs the biggest single outlay, it said any increase in these costs would further restrict the number of available apprenticeship places. As set out above in the section on the adult rate, the NHF believed there was a case for freezing the minimum wage. In the childcare sector NDNA said it would be concerned about further changes to the minimum wage which put more barriers in the way of young people moving into work. The Business Services Association encouraged a continued cautious approach to increasing the Apprentice Rate.
- 5.53** Those organisations representing workers believed there was room for an increase in the Apprentice Rate. The TUC said it advocated an iterative approach, with a significant uplift as soon as there was enough evidence to warrant this. It argued that the Apprentice Rate should be increased to what it considered to be a cautious target. It estimated a rate of £2.80 would currently benefit around 15 per cent of apprentices, and allowing for likely uplift in pay, might cover around 10 per cent in October 2012.
- 5.54** Other union organisations also supported a rise. The GMB called for the Apprentice Rate to be increased at the very least in line with RPI (£2.69). Usdaw said that apprenticeships needed to have attractive rates of pay to be seriously considered by young people and called for the rate to be increased by at least the same percentage increase as the adult rate. Some trade unions continued to maintain the policy principle that apprentices, like all other workers, should be paid at the same NMW rate from age 16. Unite said it regarded the NMW as a national baseline wage for all workers in the UK regardless of level, age or legal status. It believed that the Apprentice Rate (as well as the youth rates) should increase by more than the adult rate to help reduce the differential between the rates. UNISON called for the Apprentice Rate to rise to match the existing youth rates in 2012.
- 5.55** Among organisations representing young people, NUS called for the Apprentice Rate and other NMW rates to be harmonised at the level of the adult rate. Platform 51 said the wage must increase well above the current rate as it was not enough to live on and created a disincentive for young people to train when they could work for higher rates of pay.

Implications of Other Government Legislation

Pension Reforms

- 5.56** Our remit for this report asked us, when making recommendations on the minimum wage, to take into account pension reforms. These reforms commence in October 2012 and from this date, eligible workers will be automatically enrolled by their employers into a qualifying pension scheme. Eligible workers are defined as those who earn more than £7,475 a year (in 2010/11 earnings terms) and who are aged 22 years old and above but under State Pension Age.
- 5.57** The reforms are being staged, with workers in large firms joining first from October 2012, and all other eligible workers joining later. The contribution rates of employers and employees are to be phased in, and when complete, a total minimum contribution of 8 per cent per employee will be paid. That contribution would be made up of 3 per cent from the employer, 4 per cent from the employee and 1 per cent in tax relief. In November 2011, the Government announced that small firms (those employing fewer than 50 employees) would not begin automatically enrolling their staff until June 2015, instead of April 2014 as previously planned. The new timetable issued in January 2012 confirmed that small firms would join between June 2015 and April 2017. It also stated that the full minimum contribution (8 per cent) would apply from October 2018 and not October 2017, as originally planned.
- 5.58** In response to our consultation, a number of employer organisations raised concerns over the additional costs for employers as a result of the pension reforms. The FSB told us that the additional costs, both administrative and financial, would add significantly to the burdens businesses faced. The Forum of Private Business said that some businesses would undoubtedly choose to provide pension payments rather than an increase in salary to staff. However, businesses paying the NMW did not have the luxury of this decision: they would face both an increase in the NMW and obligations under auto-enrolment.
- 5.59** The ACS, in commenting on the impact, said that this would vary greatly depending on the size of the business. It said that it was likely that the smallest retailers would avoid paying pension contributions by restructuring staffing hours to employ more part-time staff earning under the minimum earnings threshold. This is something we heard from a number of organisations. A worker paid the NMW would only reach the qualifying earnings threshold if they worked in excess of 23 hours a week. We also heard from employer representatives that some of their small business members had omitted to factor additional pension obligations into their cost assumptions in bidding for long-term contracts. Our sense from the evidence we have received is that in some quarters there is overstatement of the impact of the reforms while in others it is under-recognised. We understand that the Government's communication campaigns are currently aimed at firms who will be joining first, but we believe it is important that all firms are made aware of the changes, even if the impact on many is a few years away.

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- 5.60** Usdaw pointed out that almost 60 per cent of the retail workforce in the UK was part-time and that, according to official statistics, in 2010 the average part-time contract in retail was 16 hours. This suggested that the majority of the 1.6 million part-time workers in retail would not be eligible for auto-enrolment. It also said that those most likely to be affected, the very small employers, would not come within the scope of pension reforms this year.
- 5.61** During the period for which we are making our minimum wage recommendations (October 2012-September 2013), only employers employing over 1,250 workers will be affected by the new arrangements. Boulding, Johnson and Yeandle (2010) suggest that over 50 per cent of employees in large firms (250+ employees) eligible for auto enrolment under the new reforms already have a qualifying pension. This percentage drops considerably for employees in medium-sized and small firms. The impact assessment produced by the Department for Work and Pensions (2011) shows that of those employees eligible for auto enrolment, it is expected that between 20 and 40 per cent will opt out, although this is not broken down by size of firm.
- 5.62** The research we commissioned for our 2011 Report, undertaken by the National Institute of Economic and Social Research (George and van de Ven, 2011), found that existing employer pension provision was less prevalent among low-paid workers in small firms and that on average, to offset employer contributions required under the reforms, wages would need to fall by between 0.8 and 1.1 per cent. Our own analysis has shown that during the phasing stage when the employer contribution is 1 per cent (currently between October 2012 and September 2016), for a worker on the minimum wage working 40 hours a week, the employer contribution will be just under £70 a year (0.55 per cent of the worker's wage). For someone working 30 hours a week, the annual cost falls to £38 (0.4 per cent of the worker's wage). Given the coverage and likely take-up, we estimate that the cost to employers in the first year (2012/13) will be no more than 0.2 per cent of their total wage bill on average.
- 5.63** It is clear that the new pension arrangements will have an impact on both employers and workers. However, the evidence shows that the impact will be greatest for smaller firms, and they will not be joining until at least June 2015. The phasing of contributions will also lessen the impact in the early years. The data also show that existing qualifying pension provision is already high in large firms, and these are the only ones that will be affected from October 2012. We have, therefore, carefully considered the impact of the new pension arrangements in reaching our recommendations on the minimum wage this year. We will monitor the reforms in future years, and consider the impact as firms of different size join and as contributions increase.

Changes to Personal Tax and Benefits System

- 5.64** The 2012/13 tax year will see changes to the tax and benefits system that will affect minimum wage workers. We considered these changes in our deliberations for the 2012 recommendations. According to the 2011 Budget (HM Treasury, 2011a) the personal tax allowance for those aged under 65 will be increased by £630 to £8,105 in April 2012. Those earning between £7,475 and £8,105 (working between 23.6 and 25.6 hours a week at the minimum wage) will be removed from income tax altogether while anyone earning more

than the personal allowance will benefit by £126 per year. There will also be increases to the employee and employer Class 1 National Insurance Contribution thresholds.

- 5.65** Most benefits will be increased in line with CPI from April 2012, although the couple and lone parent elements of Working Tax Credit will not be updated. There will also be changes to the hours criteria for claiming Working Tax Credit. At present a couple with at least one child can claim Working Tax Credit if they work at least 16 hours a week, but from April 2012 this will increase to at least 24 hours a week, so those working 16-24 hours a week will lose their entitlement.
- 5.66** As a result of changes to taxes and benefits (excluding Housing and Council Tax benefits) a family with one child, where one person works and earns the minimum wage, will see their net weekly income for a 35 hour week increase by around £6 to £329 in April 2012. For a 16-24 hour week their net weekly income will fall by £61-72 as a result of the changes to Working Tax Credit. A single adult with no children working 35 hours a week will see their net weekly income increase by £3 to £209.

Abolition of the Agricultural Wages Board for England and Wales

- 5.67** Our remit asked us to consider the implications of the proposed abolition of the Agricultural Wages Board for England and Wales (AWBEW). We have set out in Chapter 4 the findings from our commissioned research and also the evidence received from stakeholders. The timing of abolition is not yet settled but the evidence we have gathered has highlighted areas where existing AWBEW provisions differ from those under the NMW framework. It is clear to us that once a date for abolition is agreed, the Government will need to ensure all those affected are aware of the implications. We will continue to monitor this and will undertake further research as necessary.

International Comparisons

- 5.68** As in previous reports we gathered evidence on minimum wage systems in other countries and in setting the rate considered how the NMW in the UK compared. For consistency, we have again compared the NMW against the same group of major EU and OECD countries we have looked at since the NMW was introduced. As we have noted in previous reports, changes to the relative value of the UK minimum wage depend on how far other countries have changed their minimum wages and movements in exchange rates and inflation rates.
- 5.69** In 2011 the comparator group divided between ten countries who made an uprating during the year and three who did not. The UK was among the former, and the rise in the UK was higher than the majority, but lower than in Australia, France and Canada. The countries making no increase in 2011 were the US, Belgium and Ireland (where the wage was reduced for a brief period and then moved back up to its previous level). However, when we looked at where these changes placed the current value of the UK minimum wage we found that it remained in the middle of comparator country wage rates. This was the case whether exchange rates and purchasing power parities (PPPs) were factored in or when considering its value relative to median earnings.

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5.70 This year we also considered how the increase in the NMW since its introduction compared with increases over the same period in other countries. Most countries have had smaller increases in the national currency value of their minimum wage than the UK over the period from 1999-2011. Since 2007, however, average growth in the NMW has been lower than average growth in the national currency values of most other countries' minimum wages. In PPP terms the average increase in the NMW since 2007 has been much lower than in all the comparator countries, mainly as a result of the depreciation of sterling between 2007 and 2009 when the pound lost around 25 per cent of its value but also because of higher inflation experienced in the UK relative to most other countries. We found that the ranking of the NMW relative to median earnings remained in a similar position from 1999-2010 (the latest available year), lower than in a majority of the other countries. Further details on minimum wages in other countries can be found in Appendix 3.

Clarity

5.71 Our remit for this report asked us to consider the best way to give business greater clarity on future levels of the minimum wage, including the option of two-year recommendations. We previously gave two-year recommendations in our Third, Fourth and 2005 Reports for the upratings of the minimum wage between 2001 and 2006. We moved to annual recommendations in our 2007 Report as we felt the increasing bite of the minimum wage and greater economic uncertainty meant it was important that our recommendations were based on the most timely data.

5.72 Some stakeholders supported two-year recommendations in their responses to our consultation. The FSB thought that two-year recommendations would aid business planning, and the ACS reported that two-year recommendations would allow retailers to budget further ahead and restructure staff with a longer-term perspective in mind. Some stakeholders in favour of two-year rates, including the ACS and the Scottish Licensed Trade Association, felt it was important that we retain an ability to review and change the second year rates to reflect the economic climate. The BRC said there is an urgent need for businesses to acquire a better understanding of future levels of the NMW.

5.73 A few stakeholders called for even longer-term recommendations. The Cinema Exhibitors' Association felt that knowing the increases three to five years ahead would help planning of financial and human resources, while members of the Cleaning and Support Services Association reported that they would be able to factor the increases into their tenders if they were known up to three years in advance.

5.74 However, most stakeholders thought that we should continue to make annual recommendations, particularly given the current economic conditions. These stakeholders included the TUC, Unite, CBI, the BCC, and other representative organisations of both employers and employees. Many of these stakeholders cited the importance of basing the recommendations on timely information, and a need for us to retain flexibility to respond to volatile economic conditions.

- 5.75** We have examined a number of ways of indicating what rate recommendations might be expected in the second year. A substantial majority of consultees, from across the spectrum of employers and workers, opposed these ideas. We agree with them that the disadvantage of constraining the Commission to positions which by definition cannot be based on timely evidence outweighs any benefit in increased clarity, particularly in the present uncertain business environment. We have also considered whether the implementation date for our recommendations could be moved in order to give increased notice of upratings, but again this would mean the data informing our recommendations would be less timely than at present.
- 5.76** On a separate point, stakeholders did indicate strong support for the publication of the Commission's report and the Government's response as soon as the Government is able to publish them. Many stakeholders suggested there should be a deadline by which the Government should publish our report and respond to our recommendations. The CBI thought the rates should be confirmed before the start of the new financial year, while others thought that the time of the Budget should be the latest the Government should respond. The timetable for publicising our report and responding to our recommendations is a matter for the Government.
- 5.77** Our remit also asked us to consider whether any recommendations could be introduced more promptly. During our consultation stakeholders stressed that there should be no reduction in the current time period between the rates being recommended and implemented. We also believe that the regulatory process needed to enact the upratings in law prevents this from being possible. Our non-rate recommendations are not generally time-bound.

Recommended Rates

- 5.78** In arriving at our recommendations to Government we examined the evidence carefully and at length. We took a number of factors into account, including those which our remit specifically directed us to consider.
- 5.79** We recognised a number of arguments for a substantial increase in the adult rate. Although the economy had performed worse than expected in 2011 some forecasters were predicting stronger growth from late 2012, the time at which an uprating would come into effect. The sustained period of high inflation, including significant price rises for necessities such as food and energy, had materially reduced the real incomes of the lowest paid. Although inflation was forecast to fall over the year, RPI was still forecast to be rising at around 3 per cent in the fourth quarter of 2012. We also noted that employment in low-paying sectors had increased in the year to September 2011 while total jobs in the economy had fallen.
- 5.80** We could on the other hand also see arguments for a freeze or small increase. The economy had not recovered, and could remain weak for some time to come. The bite of the minimum wage was higher than ever, and had continued to rise in low-paying sectors and among small firms. The relative resilience of the labour market was probably due to falling real wages. Productivity was weak and an increase in the minimum wage which pushed up real wages

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could risk jobs. Difficult trading conditions meant that many businesses, particularly small firms, were already under intense pressure. Now was not the time to burden them with additional costs.

- 5.81** In assessing the arguments we faced an especially challenging task this year because of the uncertain economic environment, and the difficulty in judging the likely accuracy of the forecasts available to us. At the time of our decision forecasts for GDP growth in 2011 and 2012 have been revised quite sharply downwards since the late summer of 2011. Growth is expected to be weak until 2013, and the timing and strength of the upturn are uncertain.
- 5.82** One source of uncertainty is the continuing crisis affecting the euro. We make our recommendations below on the assumption that the eurozone finds a way through its current difficulties, and that the major economic setback likely to be associated with a more disorderly outcome is avoided.

The Adult Rate

- 5.83** The National Minimum Wage now gives the lowest paid a level of pay which is a higher proportion of median earnings than it has ever been. The weight of the evidence is that this has happened without adverse effects on employment. This is a substantial achievement. We have judged that in the current difficult economic circumstances a further significant increase would carry too great a risk of jeopardising those important gains. We have come to this conclusion reluctantly, because we recognise that real incomes have fallen, but we believe that at this stage caution is essential. We are therefore recommending an increase which we expect to maintain the relative position of the lowest paid and which, after careful consideration, we believe business – and we have paid particular attention to the challenges facing small businesses – will be able to afford. If in a year's time it is clear from the performance of the economy that we have misjudged the degree of caution required then we shall reflect that in our recommendations for 2013. **We recommend that the adult rate of the National Minimum Wage be increased by 11 pence to £6.19 an hour from 1 October 2012.**

The Accommodation Offset

- 5.84** We intend to review the accommodation offset arrangements as part of our 2013 Report, and have found no reason this year to adjust the offset relative to the minimum wage. Therefore, **we recommend that the accommodation offset be increased by 9 pence to £4.82 a day from 1 October 2012.**

The Youth Development and 16-17 Year Old Rates

- 5.85** Increases in their minimum wages have exceeded rises in average earnings of young people over several years and so the wages of the lowest paid young people relative to their peers are now higher than they have ever been. The labour market position of young people has continued to worsen in 2011. Employment of young people has continued to fall, and unemployment to rise. However, there is debate about exactly how far pay is a factor.

- 5.86** Employment of young people is more sensitive than that of adults to the economic cycle. With this in mind we reluctantly recommend freezing the rates for young people, which may increase their relative attractiveness to employers. Accordingly, **we recommend a Youth Development Rate of £4.98 an hour and a 16-17 Year Old Rate of £3.68 an hour from 1 October 2012.** Because of the sensitivity to the economic cycle we would expect to be able to recommend increases for young people when economic conditions have eased.

The Apprentice Rate

- 5.87** In 2010 we were prudent in our first recommendation for the Apprentice Rate, intending to support the attractiveness of apprenticeships to employers by setting it at £2.50 an hour, substantially below the 16-17 Year Old Rate, while providing minimum wage protection to apprentices. Last year we saw some scope to increase it, to £2.60 an hour, while preserving this differential. Over the past year apprenticeship starts have increased for all age groups, and we believe there is a room for a further, smaller increase. **We recommend that the Apprentice Rate be increased by 5 pence to £2.65 an hour from 1 October 2012.** This represents an increase of 6 per cent since the Apprentice Rate was introduced. We have no presumption in respect of our decision next year, when we expect to have a larger evidence base which we will review carefully.

Implications of the Recommended Rates

- 5.88** In assessing the likely impact of our minimum wage recommendations, we have looked at various factors, including coverage and bite (its value relative to average earnings), as well as likely changes to household income, wage bills and the Exchequer.

Coverage

- 5.89** In April 2011, according to ASHE there were around 1.90 million jobs that paid less than the minimum wage rates we are recommending for October 2012. These were made up of 1.72 million jobs held by those aged 21 and over (7.0 per cent), 142,000 jobs held by 18-20 year olds (12.8 per cent), and 33,000 jobs held by 16-17 year olds (12.8 per cent).
- 5.90** In order to estimate coverage, assumptions are needed about how the wages of the low paid would change in the absence of any minimum wage upratings. In other words, in order to estimate the value of the recommended upratings at April 2011 (the date of the latest earnings data) the recommended rates need to be downrated using estimated wage growth. OBR quarterly forecasts for earnings growth and inflation were used to estimate average annual growth from April 2011 to April 2012, and from April 2012 to April 2013.
- 5.91** Assuming that the wages of the lowest paid increase in line with forecast average earnings, it is estimated that about 938,000 jobs or 3.8 per cent of all jobs held by those aged 21 and over in April 2013 would be covered by the new rate of £6.19, as shown in Table 5.2. This is a lower level of coverage than for the current rate of £6.08 in April 2012 (when it is estimated that 970,000 or 4.0 per cent of jobs held by those aged 21 and over would be covered). Inflation is estimated to increase faster than earnings growth between 2011 and 2013,

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using both the RPI and CPI measures. If, however, the wages of the lowest paid were assumed to increase in line with inflation, estimated coverage of the adult rate in April 2013 would be similar to the numbers paid below the adult rate of £5.93 in April 2011, fewer than 140,000 workers (or around 0.5 per cent of the workforce).

5.92 We have recommended that the Youth Development Rate and the 16-17 Year Old Rate are frozen. Assuming that young workers' wages increase in line with average earnings, it is estimated that 40,000 jobs held by those aged 18-20 would be covered by the Youth Development Rate in April 2013, representing around 3.6 per cent of jobs held by these young workers. It is also estimated that 14,000 jobs (5.2 per cent) held by 16-17 year olds would be covered by the 16-17 Year Old Rate in April 2013. However, if the wages of young people continue to grow at a slower rate than for adults, the actual coverage will be much greater than these estimates.

5.93 Overall, the total coverage in April 2013 of the minimum wage, excluding apprentices, is estimated to be 992,000 jobs (3.8 per cent of all jobs), if the wages of the low paid were to increase by average earnings between April 2011 and April 2013. This is 36,000 or 0.2 percentage points lower than the estimated coverage in April 2012.

Table 5.2: Estimated Number and Percentage of Jobs Covered by the Recommended National Minimum Wage Upratings, UK, 2012-2013

	April 2012		April 2013	
	NMW rates	Coverage	NMW rates	Coverage
Adult rate (aged 21 and over)	£6.08	970,000 4.0%	£6.19	938,000 3.8%
Youth Development Rate (18-20 year olds)	£4.98	44,000 4.0%	£4.98	40,000 3.6%
16-17 Year Old Rate	£3.68	14,000 5.6%	£3.68	14,000 5.2%
Total		1,028,000 4.0%		992,000 3.8%

Source: LPC estimates based on ASHE, 2007 methodology, low-pay weights, including those not on adult rates of pay, UK, April 2011; and OBR quarterly earnings forecasts (November 2011), UK, 2011-2013.

5.94 As we discussed in Chapter 2, women are more likely than men to be working in low-paid jobs. Based on these earnings assumptions, it is estimated that in April 2013 the adult minimum wage would cover around 366,000 jobs (3.0 per cent) held by men and 571,000 jobs (4.7 per cent) held by women. Jobs held by women aged 21 and over would be expected to make up just under two-thirds of all jobs covered by the adult rate.

5.95 Using data from the BIS Apprentice Pay Survey, 14.5 per cent of all apprentices were paid below the uprating we are recommending for the Apprentice Rate. If apprentice pay increases in line with forecast average earnings between April 2011 and April 2013, it is estimated that the Apprentice Rate would cover 12.5 per cent of all apprentices.

Position Relative to Average Earnings

- 5.96** The bite of the minimum wage is another way of assessing the impact of the minimum wage on the earnings distribution. In April 2011, according to ASHE, the median gross hourly earnings (excluding overtime) of all employees aged 21 and over (full and part-time) was £11.28 an hour. In order to properly compare this median with the recommended adult rate for October 2012, it needs to be uprated by the predicted growth in average earnings. On that basis, the adult rate of £6.19 is expected to be about 52.9 per cent of estimated median earnings for those aged 21 and over (£11.70) in April 2013. This is slightly lower than the estimated bite at the median in April 2012 of 53.0 per cent for employees aged 21 and above.
- 5.97** Using the mean, the bite in April 2013 is estimated to be around 40.8 per cent for employees aged 21 and over based on the earnings assumption. Again, this is slightly lower than the bite at the mean in April 2012.
- 5.98** In order to compare the estimated bite with the historical time series we need to exclude those aged 21 from the analyses. In April 2013 £6.19 is expected to be about 52.1 per cent of median earnings for those aged 22 and over. Compared with mean earnings, we estimate the bite to be around 40.4 per cent for those aged 22 and over. The bites at both the median and mean for those aged 22 and over are expected to be slightly lower in April 2013 than in April 2012. As we have recommended freezing the rates for young people their minimum wage bites would be expected to fall.

Impact on Household Income

- 5.99** When the adult minimum wage increased to £6.08 in October 2011, gross weekly income would have been £212.80 for a 35 hour week. Using HM Treasury estimates for the 2011/12 tax year, this gross income would have been equivalent to a net income of £205.57 for a single person working full-time with no children (a net wage of £5.87 an hour for a 35 hour week). The corresponding amount for a couple with one child (one partner working and the other not) would have been around £322.75 (equivalent to a wage of £9.22 an hour for a 35 hour week).
- 5.100** Again assuming a 35 hour week, gross weekly income would increase by £3.85 to £216.65 following the minimum wage increase to £6.19 an hour in October 2012. Taking into account the minimum wage uprating and the 2012/13 tax year, the net weekly income for a single person would rise by £4.30 to £209.87. For the one-child family, net income would rise by £6.89 to £329.64. The effective hourly rate for the single person would be £6.00 (13 pence higher than in October 2011) and for a one-child family would be £9.42 (20 pence higher than in October 2011). At this stage we are unable to assess the impact of the changes to the tax and benefit regime for 2013/14. We have commissioned research for our next report that will investigate the impact of the introduction of Universal Credit and its interaction with the minimum wage and the tax and benefit system from 2013/14 onwards.

Wage Bills

5.101 Given the size of our recommended increase we expect that the direct impact of our recommendations on the wage bill is likely to be limited. We expect a very small direct impact on the public sector wage bill as very few jobs in the public sector are paid at the minimum wage.

Exchequer Impact

5.102 An increase in the minimum wage can also affect the public sector through savings to the Exchequer resulting from increased tax receipts and reduced benefit payments. Table 5.3 is based on information supplied by HM Treasury and illustrates our best estimates of the effects of the 11 pence increase in the adult rate of the minimum wage.⁶ We estimate that in total the Government would gain around £190 million from the 2012 minimum wage uprating, nearly three-fifths of which consists of additional yield from income tax (£72 million) and National Insurance Contributions (£40 million) as the earnings of minimum wage employees increase. The Government would also stand to make savings from a reduction in Working Tax Credits (£33 million) and other benefits (around £45 million in total).

Table 5.3: Estimated Exchequer Yield and Savings from the Recommended October 2012 Uprating of the Adult Rate of the National Minimum Wage, UK, 2012/13

£ million	Exchequer yield and savings from the increase in the minimum wage to £6.19 in October 2012
Income Tax	72
National Insurance Contributions	40
Working Tax Credit	33
Child Tax Credit	16
Income Support	6
Housing Benefit	18
Council Tax Benefit	5
Total	190

Source: LPC estimates interpolated from HM Treasury calculations using 10 and 20 pence increases based on Family Resources Survey 2009/10, uprated to 2012/13, UK, tax year 2012/13.

Notes:

- a. The Family Resources Survey derives hourly wages from weekly income and hours worked, which overestimates the number of individuals on the minimum wage. As a result the Exchequer savings presented above are also likely to be overestimated.
- b. These figures take account of changes in tax credits, benefits, taxes and National Insurance Contributions but do not take any account of likely behavioural change caused by an increase in hourly pay, such as changed levels of employment or hours worked.
- c. The figures take no account of wage changes or behavioural response for those paid just above the National Minimum Wage or changes in Exchequer yield from business or indirect taxes.
- d. The figures do not include the effect of the £10,000 disregard in tax credits, which allows income to rise between one year and the next by up to £10,000 before tax credits begin to be withdrawn. This means that the reductions in tax credits would in practice be significantly smaller, at least in the initial tax year.

⁶ HM Treasury provided us with estimates of yield and savings for hypothetical increases to the minimum wage of 10 pence and 20 pence.

Conclusion

5.103 Our recommendations this year again take account of the continued fragility in the UK economy, the state of the youth labour market and the uncertain prospects going forward. We believe that our recommendations reflect a careful weighing of the evidence and strike a balance between caution and optimism. We will continue to monitor closely developments in the labour market, with a particular eye to youth employment.

Appendix 1

Consultation

We are grateful to all those people and organisations that contributed to the preparation of this report. We would like to thank in particular those who provided evidence, either written or oral, and those who organised or participated in Low Pay Commission visits and meetings. All such individuals and organisations are listed below, unless they expressed a wish to remain unacknowledged.

Agricultural Wages Board for England and Wales
Alliance of Sector Skills Councils (SSCs)
Angels Childcare
Apprenticeship Ambassadors Network
Association of British Bookmakers
Association of Convenience Stores
Association of Directors of Adult Social Services
Association of Labour Providers
Association of Learning Providers
Association of Licensed Multiple Retailers
Avante Partnership Ltd
B&CE Insurance Ltd
Bank of England
Batemans Brewery
Beardmore Hotel and Conference Centre
BECTU, Broadcasting Entertainment Cinematograph & Theatre Union
Bellshill NISA Local
Blackpool Pleasure Beach Limited
Borowski, Konrad
British Beer & Pub Association
British Beer & Pub Association Midland Counties
British Chambers of Commerce
British Furniture Manufacturers
British Hospitality Association
British Independent Retailers Association
British Retail Consortium
British Youth Council
BUPA Care Services
Business In Sport and Leisure
Business Services Association
Caring Hands Domiciliary Services Ltd
CBI
Chartered Institute of Payroll Professionals
Chartered Institute of Personnel and Development

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Cinema Exhibitors' Association Limited
Citizens Advice Bureau (CAB) Cornwall
Citizens Advice Scotland
CK's Supermarkets
Cleaning and Support Services Association
Coldwater Seafood
Communication Workers Union
Cornwall Chamber of Commerce
Creative & Cultural Skills
D McGhee & Sons Ltd
de Grunwald, Tanya (GraduateFog)
Department for Employment and Learning Northern Ireland
Department of Enterprise, Trade and Investment Northern Ireland
Domestic Care Group
EEF the manufacturers' organisation
English Lakes Hotels Resorts & Venues
Equity
Federation of Small Businesses
Federation of Wholesale Distributors
Food and Drink Federation
Forum of Private Business
Four Seasons at Skypark
G's
Gangmasters Licensing Authority
Glasgow Chamber of Commerce
Glasgow City Council
GMB
Greggs plc
Guoman Hotel Management (UK) Ltd
Hair and Beauty Industry Authority (Habia)
Hampshire Domiciliary Care Providers Limited
Hastings Hotels
HM Government
Holloway, Jeremy
HomeWorkers Worldwide
Hurst, Clive
Inclusion Cornwall
Incomes Data Services Ltd
Independent Health and Care Providers
Independent Parliamentary Standards Authority
Inspiring Interns
Institute for Fiscal Studies
Institute for Social and Economic Research
Intern Aware
Internocracy

Interns Anonymous
Jack McPhee
Jeary, Ayesha
JW Grant Co
Kalayaan
Kershaw, Betty
Klotz, Tim
Knitting Industries' Federation
Kurnia Group
Labour Research Department
Local Government (LG) Group
Maclean's Highland Bakery
Marriott Hotel, Glasgow
MITIE Cleaning and Environmental Services Ltd
Monthind Limited
National Apprenticeship Service
National Association of Master Bakers
National Association of Pension Funds
National Care Forum
National Day Nurseries Association
National Farmers' Union
National Hairdressers' Federation
National Institute of Economic and Social Research
National Union of Journalists
National Union of Students
Newspaper Society, The
North & Western Lancashire Chamber of Commerce
Northern Ireland Hotels Federation
Oddies Bakery
Office for Budget Responsibility
Optima Training
PFS (Helston) Ltd
Platform 51
Policy Exchange
Prime Care Community Services Limited
Public and Commercial Services Union (PCS)
Punch Taverns
Recruitment & Employment Confederation
Rees Partnership, The
Registered Nursing Home Association
Rural Shops Alliance
Save the Children UK
Schoolhouse Daycare Limited
Scottish Bakers
Scottish Government

National Minimum Wage

Scottish Grocers' Federation
Scottish Licensed Trade Association
Social Enterprise UK
Somerset Care
Stage Management Association
Stonehaven Care Group
Thorne, Graham
Trades Union Congress
Truecare (New Forest) Ltd
UK Fashion and Textile Association
Union of Shop, Distributive and Allied Workers
UNISON
Unite
United Kingdom Home Care Association
Unquoted Companies Group
Victoria Inn, Lincoln
Watson, Mark
Welsh Government
White Horse Child Care Ltd
Winchester Growers Limited
XpertHR

Appendix 2

Low Pay Commission Research

Overview

- 1** The National Minimum Wage (NMW) was introduced in the UK in April 1999 and since then numerous researchers, funded independently or by the Commission, have investigated its impact. The general consensus of these studies is that the minimum wage has raised the earnings of the low paid without significantly affecting employment or generating wage inflation. Instead of cutting employment, research evidence indicates that firms have attempted to cope with increases in the minimum wage by changing pay structures and reducing non-wage costs; reducing hours; raising prices; or accepting lower profits. But it should be noted that much of this research was conducted when the economy was performing strongly, although the research commissioned for our 2011 Report, taking account of some of the recent economic downturn, drew similar conclusions. However, that research also found some tentative evidence that the employment of young people may have been affected by the minimum wage during the recession.
- 2** For this report, we again commissioned research that focused on the impact of the minimum wage in recession and the impact on young people. We start this section by discussing the impact of the minimum wage on the earnings distribution and pay differentials, before considering wider issues of employment and hours. We also investigated whether these effects differed by size of firm. Our focus then turns to young people to again consider the relationship between age, wage and productivity; the impact on employment and schooling; and the reasons why wage growth among young people had been slower than for older workers during the recession. We then consider the impact of the introduction of the Apprentice Rate in October 2010. Our research programme was completed by investigating non-compliance, and the impact of the potential abolition of the Agricultural Wages Board for England and Wales (AWBEW).
- 3** Butcher, Dickens and Manning (2012) built on their previous analysis of the impact of the minimum wage on the wage distribution, which had found clear evidence that inequality had been falling at the bottom of the wage distribution since the introduction of the minimum wage. For the UK as a whole, over the period between 1998 and 2010, the researchers again found modest spill-over effects. The minimum wage directly affected up to the 6th percentile, at which the spill-over effect was largest, raising wages by about 7 per cent more than in the absence of the minimum wage. This effect stretched up the pay distribution (wages were raised by about 4 per cent at the 10th percentile and still over 1 per cent at around the 20th percentile). The effect was larger for women than men. Disaggregating these effects by geography, they found that areas most affected by the minimum wage had even larger

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spill-over effects. In contrast to earlier research, such as Stewart (2009), this suggested that spill-over effects may be larger than previously thought.

- 4 Three research projects were commissioned to investigate the impact of the minimum wage on earnings, employment and hours. Dickens, Riley and Wilkinson (2012) investigated these effects in two ways. First, they used individual data and second, they took advantage of the geographical variation in wages. Using the individual data they also looked at how these minimum wage effects varied by size of firm. In their analysis of individuals using data from 1994-2010, they found that the minimum wage had led to significantly higher wage growth for low-paid workers and that this effect was particularly large upon introduction. They also found that wage differentials between minimum wage workers and those paid just above were restored somewhat during the recent recession years (2008-2010). Their spatial analysis found a large effect of the minimum wage on pay inequality across areas, as the minimum wage compressed wages at the bottom of the distribution, particularly in the period before the recession. Those areas with the lowest wages prior to the introduction of the minimum wage experienced the greatest falls in inequality over the period from 1998 to 2010.
- 5 In contrast to previous research that the NMW had raised the earnings of low-paid workers without affecting employment opportunities, they found some evidence from individual data, using the New Earnings Survey and in some econometric specifications, that the introduction of the minimum wage may have had a small adverse impact on the employment opportunities of women working part-time. This effect was strongest when the minimum wage was introduced and during the recent recession. In comparison to other workers, low-paid workers were more likely to work in small firms. Any detrimental employment effects among low-paid female part-time employees tended to be more significant on average in large firms.
- 6 However, in line with previous research, they found no impact for many other low-paid workers and this finding varied little over the business cycle. They were unable to find any evidence to suggest that the minimum wage had affected average hours worked in general but there was some evidence to suggest that the minimum wage may have reduced hours by around two hours a week for female full-time workers during the recession. Size of firm did not appear to be a factor with regard to hours.
- 7 In contrast to the individual results explained above, their spatial analysis found no strong evidence of adverse effects of the minimum wage on employment or unemployment. This was despite the large increases in wages at the bottom of the distribution relative to those higher up. Indeed, their findings suggested that the minimum wage may have had some positive effects on employment between 2003 and 2007 (the period of large upratings). They also found evidence that the minimum wage had reduced unemployment in these years.
- 8 Bryan, Salvatori and Taylor (2012) used individual data to assess the impact of the minimum wage on employment, unemployment and hours. In line with previous research findings, they found little evidence that the minimum wage had affected employment retention in the period before or during the recession. They found no consistent effect of the minimum wage on hours for adults across the years, although they did find some weakly significant evidence

in some specifications of a reduction in basic hours of around 2-4 hours a week for both men and women following the 2010 minimum wage uprating. They found some evidence of a significant negative effect on hours among youths (aged 18-21 years old), with basic hours reduced by around 3-4 hours a week during the recession (2008-2010). They also found similar effects for the 2003-2007 upratings, but these effects appeared stronger and more robust during the recession. They did, however, caution that these results for young workers were based on small sample sizes.

- 9** The research also found that the minimum wage had no effect on the probabilities of unemployed adults entering work in any year. They concluded that there was little evidence that the recession had increased the sensitivity of employment to increases in the minimum wage. But their findings added to the existing literature that the minimum wage may have had an impact on hours, especially for young workers.
- 10** Noting that the recent recession was the first recessionary period since the introduction of the NMW, Dolton, Lin, Makepeace and Tremayne (2011) analysed pay data from 1977-2009 to assess the impact of previous recessions on the distribution of pay settlements and earnings. Building on that work and extending the data period to 2011, Dolton, Makepeace and Tremayne (2012) again found a clear positive effect of price inflation on wage settlements; a negative effect of unemployment on wage settlements, consistent with the previous literature on the Phillips Curve and the Wage Curve; but in contrast to their previous study, they found no significant effect of minimum wage upratings on wage growth or pay settlements over the whole period since the National Minimum Wage was introduced. This, they argued, was consistent with previous research findings of limited spill-over effects of the minimum wage on earnings higher up the wage distribution.
- 11** Dolton, Rosazza Bondibene and Stops (2012) conducted spatial analysis to look at the impact on employment. They found that the minimum wage had no adverse impact on local area employment and may even have had a positive effect in some years. Further, this result seemed to be invariant to the level of geography used or the way in which the recession was modelled. They concluded that the spatial effects of the minimum wage on employment were limited.
- 12** Four of the research projects related to young people, looking again at the relationship between age, wages and productivity; the impact on employment, schooling, and education; relative earnings growth; and the impact of the introduction of the Apprentice Rate.
- 13** Dickerson and McIntosh (2012) built on work commissioned last year (Dickerson and McIntosh, 2011) that had investigated the relationship between productivity, earnings and age, with a focus on the early years of work. They extended their analysis up to 2010 and estimated empirical age-earnings profiles and wage-productivity gaps across different aged workers. Their previous results suggested that the introduction of the NMW had not affected age-earnings profiles. The age-productivity profile was estimated to be similar to the age-earnings profile, albeit a little steeper. They concluded that young workers were overpaid relative to their productivity compared with workers in their 30s. The introduction of the minimum wage did not seem to have affected wage growth relative to productivity growth for young workers but relative productivity had fallen for older workers since 1999.

- 14** In contrast to their previous findings that were limited to the pre-recessionary period, their new research found a flatter age-productivity profile than age-earnings profile, estimated across the full 2003-2010 period that they considered. Their wage equation results showed that wage differentials between age groups had narrowed slightly within industries in the post-recession period, relative to pre-recession, but that the productivity of young workers relative to older workers had declined. Although they noted that the productivity results were not statistically significant, they concluded that young workers' wages had increased more than their productivity contribution would warrant in the post-recession period, relative to workers in their 30s and 40s.
- 15** In a comprehensive overview, Crawford, Greaves, Jin, Swaffield and Vignoles (2011) investigated the impact of the minimum wage on the employment and education choices of young people. Their results generally confirm the findings from previous research commissioned by the Commission and elsewhere. They found that local wage and unemployment rates appeared to play only a minor role in determining young people's labour market and education participation. The most important factors were found to be a young person's academic ability and family background.
- 16** The research found little impact of the introduction of the 16-17 Year Old Rate on the probability of staying in full-time education, the probability of being NEET (not in education, employment or training), and the probability of employment for those not in full-time education. They did, however, find some statistically significant evidence that the minimum wage had increased the probability of working among full-time students in low-wage areas relative to high-wage areas. When investigating the outcomes for 18 year olds they again found little evidence of significant effects before or during the recession on education or employment outcomes. They concluded that future changes in the minimum wage were unlikely to significantly affect young people's main choice between education and employment. Further they also found no evidence that the reduction in age of entitlement to the adult rate had affected education or labour market choices for 21 year olds compared with 20 year olds, although this was based on data from only the first few months after the change.
- 17** We also undertook some analysis to assess how pay structures for young people had changed during the recession. Our 2011 Report had noted that the wages of youths had grown more slowly than those of adults. We worked with the Chartered Institute of Personnel and Development and Incomes Data Services (IDS) to identify how large firms, predominantly in retail and hospitality, had rewarded staff by age through the recession and into recovery. Two contradictory trends were identifiable: in some cases companies had tended to move away from age-related rates towards paying the adult rate of the NMW from age 18, or from 16 or 17; other companies, however, had introduced youth rates or reduced the differentials between their existing youth rates and the statutory minima. IDS (2012) noted that in the retail sector there was a clear link between company performance and approaches to pay. Retailers that struggled in the recession tended to make greater use of youth rates; those that had coped better tended to pay adult rates from age 16 or 18.

- 18** Another recent development in the labour market for young people was the introduction of the Apprentice Rate in October 2010, initially set at £2.50 an hour. Ipsos MORI and Cambridge Policy Consultants (2012) were commissioned to undertake an assessment of its impact. Using information gathered mainly from employers, the researchers concluded that the impact had been minimal. This finding was unsurprising as the hourly rate had been set in line with the pre-existing Learning and Skills Council minimum weekly apprentice pay in England of £95 a week. It also found that the average minimum hourly pay for apprentices reported by employers in the UK was £5.41 but this varied from £3.08 in hairdressing to £7.10 in team leadership and management. Of more relevance to the Commission, around 10 per cent of employers said apprentices were paid less than £2.60 an hour, the then forthcoming October 2011 rate.
- 19** The research also found that some employers had expressed concerns regarding the move from a weekly to an hourly rate and that this might lead to changes in training hours. A minority of employers had difficulties with the rules. It also found that awareness of the Apprentice Rate was low. This is particularly disappointing to the Commission as these employers all employed at least one apprentice.
- 20** Although we have commissioned research looking at issues of non-compliance previously, the extent and character of non-compliance remains a significant gap in our knowledge. In an attempt to rectify this, Ipsos MORI and Community Links (2012) were commissioned to investigate why employers did not comply with minimum wage (or other employment) legislation. Conducting face-to-face interviews, they found that employers who were non-compliant ranged from those who said they could not afford to pay the minimum wage to those for whom it was a deliberate choice. Employers in this latter group cited as reasons to justify non-compliance the need to be competitive; the existence of a pool of workers prepared to work for less; the lack of a productivity incentive provided by a minimum wage; the exploitation of illegal workers; the provision of additional non-wage benefits; and that some workers (e.g. students, housewives, carers) or some jobs (casual, part-time unskilled) were not 'proper'.
- 21** The research identified three main pathways to non-compliance: first, a hobby that developed into a business; second, a business start-up; third, inheriting or buying an existing informal business. In all three cases, ignorance of the correct procedures became harder to undo over time. Further, there was a perception that the penalties for non-compliance of the minimum wage were low and that they were unlikely to be caught.
- 22** Looking forward, we also attempted to take account of future government measures by commissioning research on the implications of the abolition of the AWBEW. Existing agricultural workers would be entitled to their current terms and conditions after abolition. IDS (2011b) concluded that abolition would therefore probably only immediately affect existing Grade 1 agricultural workers (mainly casual, seasonal and unskilled) as the Low Pay Commission would be recommending a national minimum wage. It was likely that these workers would be paid the NMW, historically 1-2 pence an hour lower than Grade 1 under the AWBEW. For those currently working at Grade 2 and above, there would be little short-term effect other than removing them from a national pay-setting mechanism that also covers employment terms and conditions.

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- 23** The research did however highlight several issues where future workers might have reduced terms and conditions compared with existing workers. First, the agricultural minimum wage is paid from age 16 and young workers in future may be paid at rates lower than previously. Second, new apprentices may also receive lower wage rates than those of existing apprentices. Third, under the AWBEW, school-age children are entitled to a minimum wage but when the NMW framework applies to agriculture they will be exempt from the minimum wage. Fourth, the NMW does not include entitlements such as annual leave, sick pay, bad weather payments and a dog allowance, which may affect new workers. Fifth, the accommodation offset is the same under both the AWBEW and NMW (currently equivalent to £33.11 a week) except for those living in tied cottages, where the maximum offset is just £1.50 a week. In future, workers in such employer-provided accommodation may have to pay higher rents than they would currently.
- 24** Our research programme for the 2012 Report has added to the existing literature on the impacts of the NMW. Taking all of this knowledge collectively, we again conclude that, on balance, the research generally finds little or no adverse impact of the minimum wage on employment. However, some further evidence has been gathered this year to suggest that the minimum wage may have led to a modest reduction in hours but this finding is still not consistently robust across time and datasets to be definitive. Against the backdrop of the main body of research finding no negative effects on employment, there has been more evidence than previously that there may have been an adverse impact on employment of certain groups in particular periods. These adverse findings, however, are not robust, being confined to particular workers (young workers or female part-time workers) in particular time periods using certain datasets and model specifications. The research found little evidence of an adverse effect of the introduction of the Apprentice Rate on the provision of apprenticeships by employers.

Table A2.1: Low Pay Commission Research Projects for the 2012 Report

Project title and researchers	Aims and methodology	Key findings and results
<p>The Impact of the National Minimum Wage on the Wage Distribution</p> <p>Tim Butcher (Low Pay Commission), Richard Dickens (University of Sussex) and Alan Manning (London School of Economics (LSE))</p>	<p>After almost two decades of rising wage inequality, the wages for the bottom quintile of workers have been catching up with the median since the late 1990s. While it is tempting to assign this to the minimum wage, evidence suggests that only about 5 per cent of employees are directly affected by the National Minimum Wage (NMW). The researchers hypothesised that the falls in hourly wage inequality in the bottom half of the distribution were a combination of the direct impact of the NMW, plus a spill-over effect whereby wages further up the distribution were raised to restore some of the pay differential.</p> <p>Building on previous research (Butcher, Dickens and Manning, 2009) they extended this analysis further. They constructed area-level panel data using both the Annual Survey of Hours and Earnings (ASHE) and Labour Force Survey (LFS) in order to examine spill-over effects across areas that were differentially affected by the minimum wage.</p> <p>In addition, they utilised New Earnings Survey (NES) data from the 1990s, a period before the introduction of the minimum wage, in order to carry out robustness checks.</p>	<p>Key findings included the following:</p> <ul style="list-style-type: none"> ● The NMW was introduced 12 years ago and, at about the same time, wage inequality at the bottom of the earnings distribution started to fall, having risen over the preceding 20 years. The falls relative to the median went up to the 25th percentile. ● The direct effect of the minimum wage had not been enough to explain the observed fall in wage inequality. However, allowing for modest spill-over effects, their model fitted the decline in inequality at the bottom of the labour market reasonably well. ● They found that the direct effect was largest at the bottom percentile, raising wages by nearly 30 per cent. This effect rapidly declined and only reached up to the 6th percentile. The spill-over effects were largest at the 6th percentile, raising wages by about 7 per cent more than in the absence of the minimum wage, and stretched further up the pay distribution. ● For women, the spill-over effect was greater and reached further up the distribution. ● They also found that areas most affected by the minimum wage, the lowest-paying areas, had the largest spill-overs with effects evident up to the 25th percentile. <p>They concluded that spill-over effects may be larger than previously thought and were much greater than any purely direct effect.</p>
<p>Re-examining the Impact of the National Minimum Wage on Earnings, Employment and Hours: the Importance of Recession and Firm Size</p> <p>Richard Dickens (University of Sussex), Rebecca Riley and David Wilkinson (National Institute of Economic and Social Research (NIESR))</p>	<p>The aims of the report were to re-examine the earnings, employment and hours impacts of the NMW and shed light on two issues:</p> <ul style="list-style-type: none"> ● What has been the impact of the NMW on the earnings of low-paid workers and on the demand for low-paid workers during recession and was this different from its impact during periods of strong economic growth? ● Has the NMW affected differently low-paid jobs in small, medium and large size firms? <p>They used standard difference-in-difference (DID) estimators to examine the labour market impacts of the NMW.</p> <p>They used LFS and NES Microdata to analyse the impact of the NMW on employment retention, changes in hours worked, and wage growth, distinguishing NMW 'treatment' effects by firm size and by time.</p> <p>To study whether the impact of the NMW depends on the general state of the economy they examined NMW labour market impacts over time using both individual and spatial (local area) data.</p> <p>They also conducted sensitivity analysis that included varying the control groups, differencing groups and time periods, outcome measures, and data sources.</p> <p>They examined the NMW impacts for adult workers by gender and by full-time/part-time status. They were unable to examine young workers due to sample size restrictions.</p>	<p>They found a positive effect of the NMW on wage growth for all groups considered, which was particularly large upon introduction. They also found some evidence that differentials had to some extent been restored during the recession.</p> <p>Using NES they found a small negative effect of the NMW on annual employment retention for low-paid female part-time workers, associated mainly with introduction and more recent years. This effect was not evident using the LFS. They generally found little evidence to suggest that the NMW had changed employment retention for full-time workers.</p> <p>Some evidence suggested that the NMW may have been associated with a small reduction in weekly hours for female full-time workers during recession.</p> <p>The adverse effects of the NMW on employment retention for female part-time workers tended to be more significant on average among workers in large firms. However, the adverse effect on hours worked did not appear related to firm size.</p> <p>Their spatial analysis of the impact of the NMW suggested that it had raised the wages of those at the bottom of the distribution relative to those higher up. This had resulted in a fall in inequality in the bottom half of the wage distribution. In terms of employment and unemployment outcomes, they found no strong evidence that the NMW had a harmful effect on individuals' labour market positions.</p>

Project title and researchers	Aims and methodology	Key findings and results
<p>The Impact of the National Minimum Wage on Earnings, Employment and Hours Through the Recession</p> <p>Mark Bryan, Andrea Salvatori and Mark Taylor (Institute for Social and Economic Research, University of Essex)</p>	<p>The project aimed to address three main areas:</p> <ol style="list-style-type: none"> 1. the effect of the minimum wage on employment and hours; 2. the effect of the minimum wage on earnings; and 3. the effect of the minimum wage on entry to employment. <p>The analysis built on previous work by Dickens, Riley and Wilkinson (2009) and Stewart (2004a). It used DID methods similar to previous studies of the impacts of the NMW. The DID method involved comparing outcomes for a treatment group of individuals that was directly affected by the NMW with those for a control group of similar individuals earning just above the NMW. Using two variants of the DID method, they examined:</p> <ol style="list-style-type: none"> (i) changes over time in the outcomes of the treatment and control group (horizontal DID); and (ii) differences between the treatment and control groups with respect to two additional groups further up the wage distribution (vertical DID). <p>The two methods embodied different assumptions about the effects of macroeconomic trends on the treatment and control groups, and provided a sensitivity check on these assumptions.</p> <p>The research covered adults (those aged 22 and over) and youths (those aged 18-21) and used the periods 2003-2007 and 2008-2010 to discern recessionary effects.</p> <p>They used their results from this first part to address the impact on earnings.</p>	<p>The findings showed little evidence of NMW upratings adversely affecting employment retention either before or during the recession.</p> <p>There was some evidence of upratings having a negative impact on hours, particularly among young workers. They found that hours were reduced by 3-4 a week. There was some evidence of the impact on hours being greater during the recession than it was previously. It should be noted that these results for young workers were based on relatively small samples.</p> <p>The effect of upratings on the weekly earnings of minimum wage workers depended on the extent to which the magnitude of the uprating was offset by any negative effect of the NMW on hours. The impact was greatest for young workers who may have seen reductions in weekly income.</p> <p>The NMW was found to have had no impact on the job-finding probabilities of unemployed adults in any year.</p> <p>They concluded that there was little evidence that the recession had increased the sensitivity of employment or hours to the NMW but that their results added to existing evidence that the minimum wage may have adversely affected hours. They believed that hours should be the focus of future research.</p>
<p>Econometric Modelling of Pay Settlements and Earnings by Industry 1977-2011</p> <p>Peter Dolton (University of Sussex and Centre for Economic Performance, LSE), Gerry Makepeace (Cardiff University) and Andrew Tremayne (University of New South Wales)</p>	<p>This project extended their previous analysis (Dolton, Lin, Makepeace, and Tremayne 2011) that had looked at how recessions affected the distribution of pay settlements and earnings. The period under consideration was extended from 2009 to 2011 and used quarterly data as well as annual data.</p> <p>Raw data on settlements from the CBI, Incomes Data Services (IDS) and XpertHR were merged with data from the LFS and relevant Office for National Statistics aggregates to create a data set covering the period from 1977-2011. This was then disaggregated by industry (splitting the data into 14 and 28 industry groupings).</p> <p>The forces that drive pay settlements were examined: productivity changes; the state of the labour market; and the extent and effectiveness of trade union activity and bargaining with management.</p> <p>They used a modified Panel Instrumental Variable estimation method to assess the dynamic relationships between the variables.</p> <p>The findings were subjected to a number of robustness checks including different estimation methods; levels of industrial disaggregation; and definitions of recession. They also looked at the dynamic structure of key variables and restricted their analysis to using just one settlement series.</p>	<p>The main estimation results from this project were:</p> <ul style="list-style-type: none"> ● The effect of the NMW on wage settlement levels was not statistically different from zero. This contrasted with the significant positive finding in their previous research. ● The driving force of settlement levels was the past level of settlements. This finding demonstrated the importance of the dynamic modelling of the settlements process. ● The macro variables had a strong and consistent effect on settlements. ● There was a negative effect of unemployment on wage settlements. This was consistent with previous literature on the Phillips Curve and the Wage Curve. ● Counter to earlier findings (in the previous year's report by the authors) the effect of growth on pay settlements was not counterintuitive and now appeared to be positive but of variable impact when the dynamic structure was taken into account. ● There was a clear positive effect of price inflation on wage settlements. This result was unsurprising given the importance of inflation in current and previous time periods in wage negotiations. <p>Their estimation was subjected to extensive robustness checks but the results generally remained unchanged, although weighting the data by number of employees did make some differences to their conclusions.</p>

Project title and researchers	Aims and methodology	Key findings and results
<p>The Spatial Analysis of the Employment Effect of the Minimum Wage in a Recession: The Case of the UK 1999-2010</p> <p>Peter Dolton (University of Sussex and Centre for Economic Performance, LSE), Chiara Rosazza Bondibene (NIESR) and Michael Stops (Institut für Arbeitsmarkt- und Berufsforschung, Nurnberg).</p>	<p>This project assessed the impact of the NMW on employment in the UK during the period 1999-2010, with particular emphasis on the effects of the recent recession, which they defined as covering the period, 2008-2010.</p> <p>It extended the incremental difference-in-difference approach used in previous work by Dolton, Rosazza Bondibene and Wadsworth (2009) to estimate the effect of the NMW and its uprating on employment. It made use of the variation of the bite across local labour markets. The research used ASHE and LFS data to explore the employment effects.</p> <p>The authors relaxed their earlier assumption of independent local labour markets to take account of the interconnectedness of the different local labour markets and to explore location spill-over effects.</p> <p>They noted that much previous work examining the effect of the NMW on employment had ignored potential identification problems associated with netting out the effect of changes in the aggregate economy.</p> <p>They attempted to solve this problem by using geographically varying information from gross value added as an instrumental variable for aggregate demand at the regional level. Regional gross value added was used to measure the onset, severity and duration of the recession in different locations.</p> <p>Various robustness checks were also carried out, including different definitions of geography.</p>	<p>The main conclusions from the study were:</p> <ul style="list-style-type: none"> ● There were very small positive or zero incremental employment effects of NMW upratings in a year-on-year context. ● The years where there were small positive effects were 2003, 2004, 2005 and 2006 – years when the NMW increases exceeded the increase in RPI inflation and were therefore relatively generous. ● The underlying effect of the presence of the NMW is captured in the Kaitz Index coefficient. This nearly always had a negative and significant effect on employment. ● The authors suggest that the underlying negative effect on employment they found was due to the presence of the NMW rather than its uprating. ● The positive employment effects of the latter offset the underlying negative effects – especially when upratings exceeded RPI inflation. <p>Their conclusions were robust to different methodologies and different definitions of geographies.</p>
<p>Further Investigation into the Relationship Between Productivity, Earnings and Age in the Early Years of a Working Life</p> <p>Andy Dickerson and Steve McIntosh (University of Sheffield)</p>	<p>This research examined the relationship between age, wages and productivity. It was an extension to the work undertaken for our 2011 Report, which had estimated wage and productivity equations for 1996-2007.</p> <p>Our 2011 Report noted that between 1999 and 2007, wages of different age groups had generally grown in line with each other. Since 2007, the wages of young workers have grown more slowly than those of older workers. This research extended their earlier research to cover the period up to 2010.</p> <p>They estimated sectoral productivity and wage equations using Annual Business Inquiry/Survey data combined with ASHE data for 2003-2010. They created a dataset consisting of 114 industrial sectors based on the 2007 SIC.</p> <p>Productivity was measured using gross value added. The estimated equations included net capital expenditure and workforce composition variables, including age.</p> <p>Fixed effects equations were estimated to control for unobservable characteristics that might affect productivity or age.</p> <p>Their focus was on examining the wage and productivity relationships between workers of different ages before and after the recession. They compared the period 2003-2007 with 2008-2010.</p> <p>They also investigated low-paying sectors separately.</p>	<p>These results, extending the study period up to 2010, suggested that the slow growth of wages among young workers since 2007 was due to slower wage growth in youth-dominated sectors rather than within industries, where they found that wage differentials between age groups had actually narrowed in the recession period.</p> <p>Therefore, an increase in the proportion of prime-aged workers (those in their 30s and 40s) relative to young workers within a sector had a smaller positive effect on average wages in that sector, compared with the pre-recession period.</p> <p>The positive productivity growth differential in favour of young workers observed pre-recession had however reversed, so that prime-aged workers were associated with relatively higher productivity growth in the post-recession period.</p> <p>Their finding that the productivity of prime-aged workers increased relative to younger workers was stronger when the sample was restricted to the low-paying sectors.</p> <p>They also found that there was a large fall in net capital expenditure in the recession period compared with before.</p> <p>They concluded that their results suggested that the wages of younger workers may have increased relatively more than their productivity compared with prime-aged workers in the period since the onset of recession. This contrasted with the finding in their earlier study that relative productivity growth had been stronger for younger workers in the period 1999-2007.</p>

Project title and researchers	Aims and methodology	Key findings and results
<p>The Impact of the Minimum Wage Regime on the Labour Market Choices of Young People</p> <p>Claire Crawford, Ellen Greaves, Wenchao Jin (Institute for Fiscal Studies), Joanna Swaffield (University of York) and Anna Vignoles (Institute of Education)</p>	<p>The aim of this report was to provide evidence on the impact of local labour market conditions and the NMW on the education and labour market choices of young people in the UK. The researchers drew together five strands of evidence using LFS, ASHE and the Longitudinal Study of Young People in England.</p> <p>First, they provided a detailed picture of how education participation, employment, earnings and hours have changed among young people aged 16-17 and 18-21 over the last 10 years but with a particular focus on the more recent period that included the 2008-2009 recession.</p> <p>Second, building on previous work by De Coulon, Meschi, Swaffield, Vignoles and Wadsworth (2010), they investigated the role of local wage and unemployment rates in determining the labour market outcomes of 16-18 year olds, including the proportion not in education, employment or training (NEET). They looked at how the results varied by age, region, sector and other individual background characteristics.</p> <p>Third, they assessed the impact of the introduction of the 16-17 Year Old Rate on these outcomes using a DID methodology and spatial analysis, taking advantage of the geographical pay variation.</p> <p>Fourth, they studied the impact of the entitlement to the Youth Development Rate among 18 year olds using a regression discontinuity approach, similar to that used by Dickens, Riley and Wilkinson (2010). They also looked at whether the impact changed during the recession.</p> <p>Finally, they looked at the impact of changing the age of entitlement to the adult rate from 22 to 21. They used DID techniques to compare outcomes with 20 year olds over time.</p>	<p>They noted that the proportion of all young people going into full-time education had increased substantially since 2000. The proportion of 16-17 year olds in work had fallen by about the same amount but the proportions of 18-20 year olds in work had fallen more. NEET rates had therefore risen for 18-20 year olds but not for 16-17 year olds.</p> <p>The research generally confirmed the findings of previous work, that a young person's academic ability and family background were the most important determinants of their education and labour market participation decisions rather than the role of local labour market conditions.</p> <p>In terms of the impact of the minimum wage specifically, the research found little evidence that it affected the main activity choices made by young people, although it did seem to play some role in their decision of whether or not to work while in full-time education.</p> <p>They also found that extending the adult rate of the minimum wage to 21 year olds had no significant effect on the education or employment choices of 21 year olds compared with 20 year olds.</p> <p>They concluded that there was little evidence that the NMW regime had drawn young people out of education and into the labour market, or that it had adversely affected their employment chances.</p>
<p>An Examination of the Trends in Earnings Growth for Young Workers</p> <p>Laura James, Anna Mayhew and Louisa Withers (Incomes Data Services (IDS))</p>	<p>In our 2011 Report, we noted that the median earnings for young workers increased more slowly in the period 2007-2010 than those for adults, compared to the previous period from 1999-2006 when the earnings of young people and adults grew more or less in line.</p> <p>This IDS report explored the possible reasons behind these recent trends in earnings growth by providing examples of company practice from its monitoring of pay.</p> <p>IDS examined pay practice in a range of private sector organisations drawn largely from the retail and fast food, pubs and restaurant sectors.</p> <p>It examined different employer approaches to the pay of young workers and whether changes to pay differed between young and older workers.</p> <p>As possible explanations for the slower pay growth among young workers, it looked at differentiated pay rises for young workers; the introduction of youth rates; pay cuts; changes to progression arrangements; and the influence of company performance on pay strategy.</p> <p>It also investigated youth rates in retail and hospitality; the gaps between company rates and the relevant NMW minima; and the movements in these differentials over time.</p>	<p>The researchers found that the picture was complex. There were different interactions between firms' pay policy decisions and the youth labour market during recession. IDS concluded that the recession may have simultaneously had upward and downward pressures on pay for young workers. More specifically, they found:</p> <ul style="list-style-type: none"> ● Typically employers pay young people above the youth rates of the minimum wage and therefore have some 'headroom' to give small pay rises (or cut pay rates for new entrants) while still complying with NMW regulations. Some organisations had only raised rates for workers directly affected by the NMW, with no increases for young workers above the relevant statutory minimum. ● Two contrasting trends existed side by side: some companies had increased youth pay more slowly than for adults, while some had sought to narrow (or close) the gap between youth rates and the adult rate. ● Similarly, while some companies had introduced youth rates in recent years, others had abolished them altogether or reduced the number of youth rates. ● Sector was important. There appeared clear differences between retail and hospitality, as well as within sectors. IDS found a clear distinction between the pay strategies adopted by supermarkets and non-food retailers. There was a clear link between company performance during the recession and recovery and approaches to pay.

Project title and researchers	Aims and methodology	Key findings and results
<p>An Assessment of the Introduction of the Apprentice Rate</p> <p>John Higton, Rebecca Klahr, Cheryl Salmon (Ipsos MORI), Andy Hirst and Morgane Lefaucheux (Cambridge Policy Consultants (CPC))</p>	<p>This research aimed to assess the impact of the introduction of the Apprentice Rate. The analysis combined qualitative and quantitative elements. It focused on employers but was also informed by discussions with each UK administration, training providers and apprentices.</p> <p>There were five strands to their research:</p> <ul style="list-style-type: none"> ● A literature review that built on that undertaken by the Commission for its 2010 Report. ● Analysis using apprenticeship datasets from the four UK countries. ● Qualitative interviews with national programme officers in England, Wales, Scotland and Northern Ireland. These discussions explored the take-up and completion of apprenticeships. ● Qualitative research with apprentices. Six focus groups (two each in England and Scotland, and one each in Northern Ireland and Wales). ● Quantitative telephone survey of 500 employers of apprentices (300 in England, and 100 each in Scotland and Wales). This was drawn by reference to employer data from the apprentice database in each country (the Individualised Learner Record in England and equivalent in other UK administrations) and, as necessary, against other business databases to produce employer contact details. An online survey of employers in Northern Ireland, contacted via learning providers (41 completed survey forms). 	<p>Given limitations with the representativeness of the data, the researchers said the quantitative results should be read by considering broad themes and general magnitude in the results. These can be set in context against the Department for Business, Innovation and Skills Apprentice Pay Survey (2012), also conducted by the same researchers in 2011.</p> <p>According to their employer survey, employers of apprentices paid a minimum of £5.41 an hour on average and 5 per cent paid apprentices less than £2.50 an hour (the Apprentice Rate at the time of the survey).</p> <p>The main finding was that the introduction of the Apprentice Rate had a minimal impact on employers' decisions to offer apprenticeship places. However, it found that around one in seven employers had difficulty with one or more of the criteria concerning the arrangements for the Apprentice Rate. No single issue dominated, and overall the impact was minimal.</p> <p>Further, employers expressed limited concerns about increasing the Apprentice Rate to £2.60 an hour, although up to around 10 per cent of employers said their apprentices were paid less than this amount.</p> <p>An important finding of the research was that a substantial minority of employers were unaware of the Apprentice Rate (around a third) even though they employed apprentices.</p> <p>Employers thought the introduction of the Apprentice Rate had increased demand from young people but, in the focus groups, apprentices suggested that the impact was broadly neutral.</p>
<p>Non-compliance with the National Minimum Wage</p> <p>Suzanne Hall, Jane Darragh, Anne Charlton (Ipsos MORI), WeiHsi Hu, Aaron Barbour, and Marien Llanes (Community Links)</p>	<p>The research aimed to provide an understanding of why businesses pay below the NMW and whether the recession had changed employment practices. It was a two-stage qualitative project.</p> <p>First, they conducted a literature review on the impact of the minimum wage, and explored the drivers for operating in the informal sector. This ensured the research built on existing knowledge.</p> <p>Second, they conducted 18 face-to-face interviews with employers operating in the informal economy and deliberately avoiding paying the NMW. Researchers drew on their experience of recruiting similar audiences in accessing this sample.</p> <p>In conjunction with our Secretariat, they designed a discussion guide for the interviews. This covered business attitudes to the NMW; triggers to working informally; and minimum wage enforcement.</p> <p>Interviews with each employer lasted about 45-60 minutes and were conducted in June and July 2011.</p> <p>Thorough analysis was undertaken of the evidence gathered, resulting in a report that comprised case studies, customer journey maps and recommendations for change. Where possible, sectors more susceptible to the informal economy were identified.</p>	<p>The study focused on a number of sectors in London and Nottingham. It found that although the interviewees viewed the NMW positively, they generally saw the NMW as more applicable to other employers and employees. The interviewees felt that their workers benefited from the (non-payment of the NMW) arrangements in place.</p> <p>Awareness of the actual rate of the NMW was low, although some thought it was higher than it actually was. Most businesses justified the way they were operating because that was all they could afford.</p> <p>Different tactics were employed by the interviewees to avoid detection. Most thought the chance of getting caught was slim and that in any event, the benefit of non-compliance outweighed the risk. They felt that the lack of any evidence (such as a failure to have detailed records) meant that HM Revenue & Customs would not have enough evidence to convict them of any illegality.</p> <p>Employers claimed that they were either unable to afford to pay the NMW or that they were unwilling to pay it. This latter group gave six main reasons for not paying the NMW:</p> <ol style="list-style-type: none"> 1. the business needed to be competitive; 2. there were a large number of workers prepared to work for less than the NMW; 3. paying a flat rate (the NMW) provided no incentive to the workforce; 4. they only employed illegal workers or those claiming benefits so they were doing workers a favour; 5. they provided additional benefits (travel, meals etc.); and 6. these weren't 'proper' jobs (as they were irregular or part-time).

Project title and researchers	Aims and methodology	Key findings and results
<p>The Implications For The National Minimum Wage Of The Abolition Of The Agricultural Wages Board In England And Wales</p> <p>Alastair Hatchett, Anna Mayhew, Joe O'Donnell and Louisa Withers (IDS)</p>	<p>The Government intends to abolish the Agricultural Wages Board for England and Wales (AWBEW), bringing agricultural workers in the two countries solely within the provisions of the NMW and other statutory employment legislation. The Agricultural Wages Boards in Scotland and Northern Ireland will be unaffected.</p> <p>This project provided a comprehensive overview of the AWBEW, its provisions, and the implications of its abolition for the NMW. It included analysis on the composition of the sector, the coverage and operation of the Board, minimum rates in the sector and changes to their structure over time. It looked at the key provisions of the 2011 Wages Order, the contractual and statutory employment provisions that will remain in force once the Board is abolished, and the possible implications of abolition. For completeness it also listed the key terms of the separate Wages Orders in force in Scotland and Northern Ireland.</p> <p>The research was based on a review of the NMW Regulations and the Agricultural Wages Orders, and on interview and questionnaire responses from the main parties in the sector. This was augmented by analysis from the employment law and pay research teams within IDS.</p>	<p>The main findings from this research study were:</p> <ul style="list-style-type: none"> ● The agricultural sector in England and Wales is very diverse, both as to the nature of farming, and to the size of establishment. Around two-thirds of establishments do not have employees. In total, around 350,000 people work in the sector in the two countries, but only 40 per cent are employees. Of these, around a third are seasonal or casual employees. ● The Board sets minimum pay rates for six grades, along with other terms and conditions. Pay rates exceeded the NMW rates, but, in the case of the lowest (Grade 1) only by 2 pence from 1 October 2011. Other key differences compared with the NMW are that the minimum rates in agriculture are paid from age 16, and that agricultural minimum apprentice rates were higher. With the exception of the accommodation offset, many other terms and conditions were not provided for at all under the NMW Regulations. ● Following abolition, agricultural employees will continue to be covered by the minimum statutory rights contained in other employment legislation, and by the NMW. Existing employees will retain a contractual entitlement to AWBEW terms and conditions. ● IDS noted that it was too early to be certain of the effects of abolition, but based on previous experiences of the removal of industry-wide pay arrangements, it concluded that it was likely that there would be greater divergence of pay practice; lower rates of pay, and a downward drift in skills differentials and/or the dilution of the skills base. Other terms and conditions were also likely to be eroded. <p>However, IDS noted that the agricultural sector was not immune from external labour market pressures, especially for skilled workers (some of whose rates were still determined under other industry-wide agreements) and young people (who had fewer ties and more willingness to move).</p>

Research Programme for the 2013 Report

25 We have commissioned the following projects to inform the recommendations in our next report:

- **An Analysis of the Impact of the National Minimum Wage on Earnings, Employment and Hours Through the Recession** Mark Bryan, Andrea Salvatori and Mark Taylor (Institute for Social and Economic Research, University of Essex)
- **An Investigation into the Impact of the Minimum Wage Regime on Employment and Hours of Young Workers by Sector and Size of Firm** Jan Fidrmuc (Brunel University) and Juan de Dios Tena Horillo (Universidad Carlos III, Madrid)
- **An Assessment of the Impact of the Introduction of the Apprentice Rate of the National Minimum Wage** Felix Behling and Stefan Speckesser (Institute for Employment Studies)
- **The Substitution Rate Between Low-pay Workers and the National Minimum Wage** Gauthier Lanot and Panos Sousounis (Keele University)
- **The Impact of the National Minimum Wage on Firm Behaviour During the Recession** Rebecca Riley and Chiara Rosazza Bondibene (National Institute of Economic and Social Research)
- **The Impact of the National Minimum Wage Regime on Firm Investment and Labour Hoarding During the Recent Recession** Claire Crawford, Wenchao Jin (Institute for Fiscal Studies), Helen Simpson (University of Bristol) and Anna Vignoles (Institute of Education, University of London)
- **Analysing the Interaction of the National Minimum Wage with the Tax and Benefits System** Mike Brewer, Paola De Agostini, Francesco Figari and Holly Sutherland (Institute for Social and Economic Research, University of Essex)
- **An Investigation into the Extent of Non-compliance with the National Minimum Wage** Paolo Lucchino, Stephanus le Roux and David Wilkinson (National Institute of Economic and Social Research).

Appendix 3

Minimum Wage Systems in Other Countries

Introduction

- 1 As in previous reports we have gathered evidence on minimum wage systems in other countries. These are again the same group of major European Union and Organisation for Economic Co-operation and Development (OECD) countries we have looked at since the introduction of the National Minimum Wage (NMW). We are once more grateful for the contribution made to this part of our work by British Embassies and High Commissions as well as the OECD.
- 2 As well as looking at minimum wage rates in national currencies we also consider their values in exchange rate terms, which takes into account the relative value of the relevant currency, and in purchasing power parity (PPP) terms which additionally factors in the effect of price inflation. The value of each country's minimum wage relative to median earnings is also analysed.

Minimum Wages in 2010/11

- 3 In this section we compare the minimum wages in different countries using the latest available data. That is for the end of 2011 in respect of minimum wage rates, and mid-2010 in respect of comparisons of minimum wage rates against median earnings.
- 4 Table A3.1 shows that among those countries which increased their minimum wage in 2011, the NMW increase was higher than most, including Japan, New Zealand and Portugal, but below the increases in Australia, France and Canada. Some countries had no increase in 2011: in the US changes depend on votes in Congress and occur irregularly (the last of an agreed three years of increases was in 2009); in Ireland the adult wage was reduced to €7.65 on 1 February 2011, but then reverted to €8.65 on 1 July 2011; and in Belgium there was no agreement to increase the wage.
- 5 However, when both exchange rates and PPPs are taken into account, the UK wage remained, as in 2010, in the middle of the range of comparator country rates. In PPP terms the UK rate was broadly similar to New Zealand and Canada, above countries such as Spain, US and Japan, but well below others such as Australia, France and Belgium.

National Minimum Wage

Table A3.1: Comparison of Adult Minimum Wages, by Country, 2011

	In national currency expressed as hourly rate ^a	In UK £, using:		Date of last uprating	% Increase in national currency from 2010-2011	Age full minimum wage usually applies ^d
		Exchange rates ^b	PPPs ^c			
Australia^e	AU\$15.51	10.05	7.73	Jul-11	3.4	21
Belgium	€8.17	7.12	6.98	Sep-10	0.0	21
Canada^f	C\$9.80	6.20	5.90	- ^g	7.0	16
France	€9.19	8.01	7.86	Dec-11	3.7	18
Greece^h	€4.20	3.66	4.16	Jul-11	1.7	25
Ireland	€8.65	7.54	6.86	Jul-11 ⁱ	0.0	20
Japan^j	JPY737	6.08	4.83	Oct-11	1.0	15/18 ^k
Netherlands	€8.28 ^l	7.22	7.37	Jul-11	1.3	23
New Zealand	NZ\$13.00	6.69	6.31	Apr-11	2.0	16
Portugal^m	€2.80	2.44	2.87	Jan-11	2.2	16
Spain^m	€3.70	3.23	3.62	Jan-11	1.4	16
United Kingdom	£6.08	6.08	6.08	Oct-11	2.5	21
United States	US\$7.25 ⁿ	4.59	5.67	Jul-09	0.0	20

Source: British Embassies and High Commissions. Low Pay Commission (LPC) calculations of country minimum wage rates in pounds sterling using exchange rates and PPPs. PPPs derived from Comparative Price Levels (CPLs), OECD Main Economic Indicators, September 2011. Exchange rates, Bank of England monthly average spot exchange rate, September 2011.

Notes:

- For countries where the minimum wage is not 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.
- September 2011.
- PPPs derived by applying OECD CPLs – ratio of PPPs for private consumption to exchange rates – for September 2011.
- Exemptions and special rules apply in many cases. For example, in France and the United States the full adult rate applies to young workers with a tenure of more than six and more than three months respectively.
- The Australian Federal National Minimum Wage Order, effective from first pay period after 1 July 2011.
- Weighted average of provincial/territorial rates.
- Date of last uprating varies between provinces.
- For blue collar workers.
- The hourly minimum rate was reduced from €8.65 to €7.65 for adult workers on 1 February 2011. That reduction was reversed and the hourly rate went back up to €8.65 on 1 July 2011.
- Weighted average of prefectural rates.
- Age 15 to receive the regional minimum wage. Age 18 to receive the sectoral minimum wage.
- Excludes 8 per cent supplement for holiday pay.
- Not including annual supplementary pay of two additional months of salary for full-time workers.
- Federal minimum wage. Tipped employees receive a lower minimum wage of \$2.13 per hour in direct wages.

6 Table A3.2 shows that in mid-2010 the NMW was also middle-ranking when the value of each country's minimum wage is compared to full-time median earnings (the bite). It was in the 45 to 50 per cent range alongside Canada, above countries such as the United States, Spain and Japan, but well below those with the highest bite, New Zealand and France. As the bites are compared with full-time median earnings (as only full-time earnings data are available internationally) the UK number differs from the bite discussed in Chapter 2, which is compared with all earnings (i.e. including part-time earnings).

Table A3.2: Adult Minimum Wages Relative to Full-time Median Earnings, by Country, 2010^a

Country	Adult minimum wage as a percentage of full-time median earnings
Australia ^b	51.8 (47.2)
Belgium	51.7
Canada	45.0
France	60.1
Greece	41.9
Ireland	51.9
Japan	37.0
Netherlands ^c	43.6 (47.1)
New Zealand	59.1
Portugal ^d	48.0 (56.0)
Spain ^d	37.6 (43.8)
United Kingdom ^e	46.1
United States	38.8

Source: OECD estimates based on OECD minimum wage database and median earnings for full-time workers, mid-2010.

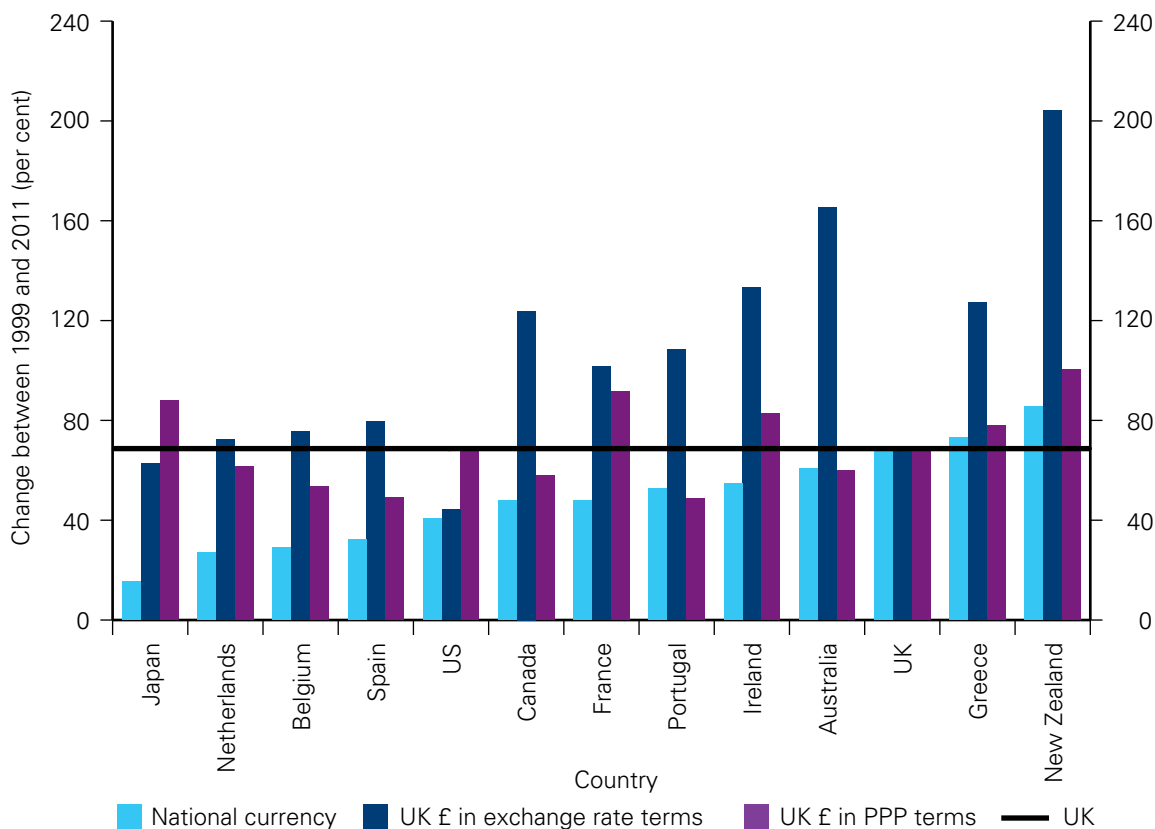
Notes:

- In all cases, the minimum wage refers to the basic rate for adults. In some cases, the median earnings data for full-time workers for mid-2010 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.
- Two estimates of median earnings are available in Australia based on its Labour Force Survey (LFS) (51.8) and an Enterprise Survey (ES) (47.2). In each case, the data refer to weekly earnings. The minimum wage refers to the Federal Minimum Wage.
- The ratio including 8 per cent supplement for holiday pay is given in parentheses.
- The ratio including annual supplementary pay of two additional months of salary is given in parentheses.
- Differs from LPC estimate in Chapter 2, as the OECD estimate is for the minimum wage relative to the median earnings of full-time, rather than all, employees.

Period Since the Introduction of the National Minimum Wage

- Rather than comparing countries' wage rates for a single year, this section looks at how these rates compare over time, since the NMW was introduced in the UK in 1999. This is considered in terms of the value of each country's wage in national currency, sterling exchange rate and PPP terms, and its worth relative to median earnings. Comparisons for Ireland begin in 2000 when its minimum wage was introduced.
- Figure A3.1 brings together the increases in the value of the adult minimum wage for each country in national currency, exchange rate, and PPP terms between 1999 and 2011. Most countries have had smaller increases in the national currency value of their minimum wage than the UK over this period. However, when exchange rates are taken into account a different picture emerges, with all countries bar two (Japan and USA) having a higher increase over the period than the UK. When PPPs are factored in, the UK's increase over the period was more of a mid-table position, with five countries having an increase higher than the NMW.

Figure A3.1: Change in Adult Minimum Wages, by Country, 1999-2011

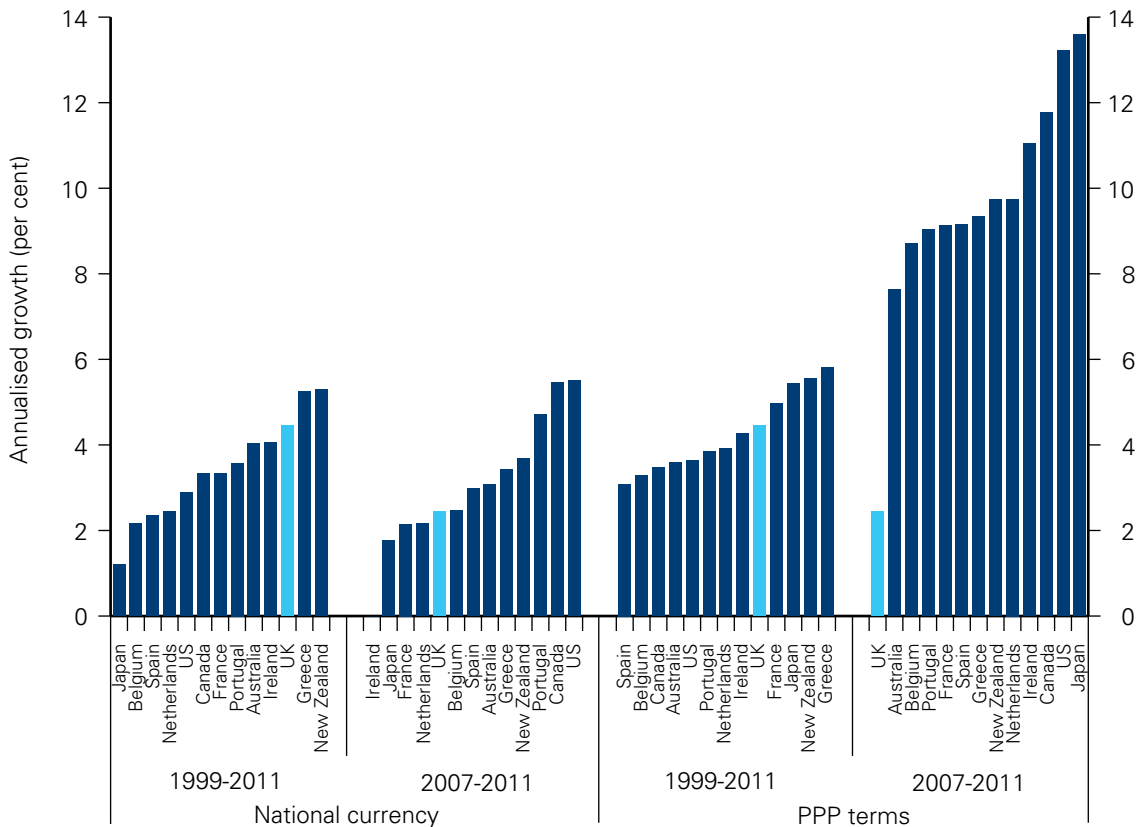


Source: British Embassies and High Commissions. LPC calculations of country minimum wage rates in pounds sterling using exchange rates and PPPs. PPPs derived from CPLs, OECD Main Economic Indicators, November 1999 and September 2011; and exchange rates, Bank of England monthly average spot exchange rate, November 1999 and September 2011.

Note: Figures for Ireland are from 2000 when its minimum wage was introduced.

- 9 There is, however, a marked difference in the changes before and after 2007. Figure A3.2 shows that between 1999 and the end of 2011 the NMW grew by an average of 4.5 per cent a year. This was higher than the average growth in the national currency values of all other countries' minimum wages apart from Greece and New Zealand. Since 2007, however, the NMW has only increased by an average of 2.4 per cent a year. This is similar to the average growth in France, the Netherlands and Belgium, but lower than in most other countries.
- 10 In PPP terms only France, Japan, New Zealand and Greece had higher average increases than the UK between 1999 and 2011. The depreciation of sterling between 2007 and 2009, when the pound lost around 25 per cent of its value, combined with relatively higher UK inflation, meant that since 2007 all our comparator countries have experienced much higher average increases to their minimum wages in PPP terms than the UK. Ireland saw no increase to its minimum wage in national currency terms from 2007 to 2011, and yet in PPP terms it increased by an average of over 11 per cent a year over the same period.

Figure A3.2: Annualised Growth in Adult Minimum Wages, by Country, 1999-2011



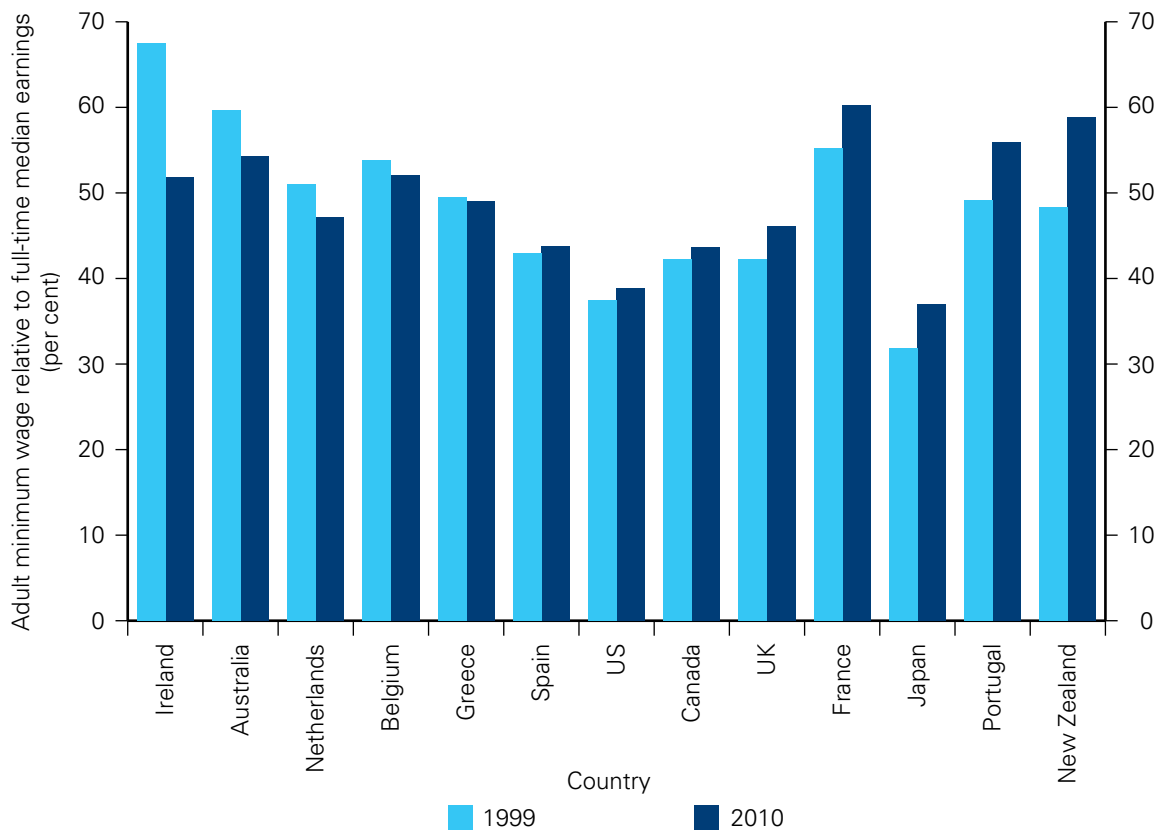
Source: British Embassies and High Commissions. LPC calculations of country minimum wage rates in pounds sterling using PPPs. PPPs derived from: CPLs, OECD Main Economic Indicators, November 1999, September 2007 and September 2011; and exchange rates, Bank of England monthly average spot exchange rate, November 1999, September 2007 and September 2011.

Note: Figures for Ireland are from 2000 when its minimum wage was introduced.

11 Turning to the value of each country’s minimum wage in 1999 and 2010 relative to full-time median earnings and averaged over the year to allow for timing and number of upratings, Figure A3.3 ranks the countries according to the change in the bite of their respective minimum wage rates. It shows that the growth in the bite of the UK’s minimum wage was higher than in most other countries, but below that in France, Japan, Portugal and New Zealand. However, in both 1999 and 2010 the level of the UK bite was lower than in the majority of the other countries. This was also the case across the years not shown.

National Minimum Wage

Figure A3.3: Adult Minimum Wages Relative to Full-time Median Earnings, by Country, 1999 and 2010



Source: OECD estimates based on OECD minimum wage database and median earnings for full-time workers, 1999 and 2010.

Notes:

- Average value of minimum wage in each year.
- Figures for Ireland are from 2000 when its minimum wage was introduced.
- Countries ranked according to the change in the bite of their minimum wage rates.

Appendix 4

Main Data Sources

Introduction

- 1** In this appendix we outline the main data sources used in our analyses and look at any significant changes that have been made since our 2011 Report. There are three main sources of data that we use in this report to measure earnings: the Annual Survey of Hours and Earnings (ASHE), Average Weekly Earnings (AWE), and the Labour Force Survey (LFS). We also consider the measures of earnings from the National Accounts. These are all published by the Office for National Statistics (ONS). There are two main sources of employment information: the LFS and the ONS employee jobs series. The LFS captures the number of people in employment, whereas the employee jobs series measures the number of jobs in the economy. This is an important distinction as a person can have more than one job.
- 2** ONS has revised the Standard Occupational Classification (SOC) that defines occupations. The new classification (SOC 2010) is replacing the previously used SOC 2000 in ONS outputs, but it is not possible to make direct comparisons between data on the old and new classifications. Our definitions of low-paying occupations are based on SOC 2000, and we have explained the implications of this change in the following sections.
- 3** In addition to labour market data, we also look at a variety of macroeconomic data. The final section of this appendix outlines the two main macroeconomic datasets that we use, measuring inflation and gross domestic product (GDP), and summarises the revisions that ONS have recently made to the GDP figures.

Annual Survey of Hours and Earnings

- 4** ASHE is the main source of structural earnings data in the UK and is regarded by ONS as the best source of earnings information. It provides information on the levels, distribution and make-up of earnings, as well as on hours, gender, age, geography, occupation and industry. It is a survey of employees completed by employers and relates to a reference period in April each year. Results are based on a 1 per cent sample of employees in Pay-As-You-Earn income tax schemes obtained from HM Revenue & Customs (HMRC). The self-employed are excluded. We carry out our own analysis of earnings from ASHE whereby those employees not on an adult rate of pay are included in the dataset (they are excluded from ONS ASHE earnings estimates). This means that our earnings estimates will be different from those published by ONS.

National Minimum Wage

- 5 The ASHE 2011 dataset published in November continued to use the old occupation codes (SOC 2000). ONS is currently recoding ASHE 2011 to SOC 2010. The reworked results will be published in March 2012. When this has occurred, we will use the re-released data to assess how the changes to occupational codes affect our definitions of low-paying occupations. This review will be similar to the re-assessment of the definitions of low-paying industries we undertook when the Standard Industrial Classification (SIC) changed. That review was reported in Appendix 4 of our 2010 Report. We will present the results of this occupational review in our 2013 Report.

Average Weekly Earnings

- 6 AWE is a short-term measure of the level of average weekly earnings per job in Great Britain which is based on data from the Monthly Wages and Salary Survey. It is available monthly, showing regular pay, bonus pay and total pay. AWE uses current industry weights that are updated each month to take account of the distribution of jobs across sectors. ONS also produces a decomposition of the growth rates to show how much growth is due to wage growth, and how much is a result of changes in employment across the sectors. Other than the standard regular revisions as new information and weighting become available, these data have not changed this year.

Earnings from National Accounts

- 7 In addition to the main earnings datasets detailed above, we also look at the compensation of employees series from the National Accounts, and in particular its wages and salaries component. Compensation of employees includes: wages and salaries; employers' pension and National Insurance contributions; bonuses; and benefits-in-kind. Annual estimates for compensation of employees are based on HMRC pay data, and AWE data are used to extrapolate quarterly figures.

Labour Force Survey

- 8 The LFS is the official data source used to measure employment and unemployment. It is a quarterly survey of around 45,000 UK households conducted on a rolling monthly basis and provides information on employment, unemployment, earnings, and personal and socio-economic characteristics including gender, ethnicity and disability.
- 9 In our report, analyses of aggregate employment, unemployment and hours worked use seasonally adjusted monthly and quarterly LFS data published by ONS. For detailed analyses of the labour market by age, ethnicity, disability and other personal characteristics, we use the non-seasonally adjusted quarterly LFS Microdata. Our initial outputs from the LFS Microdata are consistent with the non-seasonally adjusted aggregate data on the ONS website. We often use the four-quarter moving average of these outputs to take account of seasonality. Consequently our analyses based on LFS Microdata produce estimates of levels

that differ from the headline aggregates published by ONS, but the estimates of proportions are affected less.

- 10** ASHE contains no information on disability, ethnic background, country of birth, nationality or education level. The LFS is, therefore, our only source of data on earnings for disabled people, ethnic minorities, migrants and people with no qualifications. However, data on pay and hours in the LFS tend to be less reliable than in ASHE. Reasons for this include: a smaller sample; people often answering the earnings questions without reference to pay documentation (although they are prompted to consult available documents); and some information being provided by proxy respondents. ASHE collects information from employers about employees' paid hours, whereas the LFS collects information from individuals about their actual and usual hours of work, which might include unpaid hours. This generally means that derived hourly earnings from LFS are below the derived hourly pay rates recorded in ASHE. Where a stated hourly rate of pay is unavailable from the LFS, ONS has developed an imputation method using a nearest neighbour regression model, which also takes account of information on second jobs. This methodology reduces the differences between hourly earnings estimates from the LFS and ASHE, and we use it to estimate earnings in our LFS analyses.
- 11** The LFS started using SOC 2010 in the first quarter of 2011. This and subsequent datasets retain some high-level SOC 2000 variables, but they are not detailed enough to identify the low-paying occupations. As we have not yet been able to define the low-paying occupations using SOC 2010 we have not used the LFS for any analyses of low-paying occupations in this report, but we intend to do so in future reports.
- 12** In this report the data we have presented on disabled people have used the old definition of working age (men aged 16-64 and women aged 16-59), rather than all aged 16-64, in order to allow the data to be consistently compared across time. The LFS changed the way it asked questions on disability in 2010, which caused a discontinuity in the time series. Prior to 2010 most women aged 60 or over were not asked whether they had a work-limiting disability. Since the state pension age for women started to increase (in April 2010) the question has been asked of all women aged 60-64. Men were not affected by this change. Until there are sufficient data on the new basis to form a substantive time series, we will continue to use the old working age definition for analyses of disabled people.

Employee Jobs

- 13** The employee jobs series provides a timely industrial breakdown of jobs in the UK. A number of Short Term Employer Surveys, which collect data from businesses across the economy, are used to compile the employee jobs series. Data at a more detailed level, however, are available only for Great Britain and are not seasonally adjusted. This makes quarter-to-quarter comparisons problematic, particularly as much of the employment in the low-paying sectors is of a seasonal nature, for example Christmas trading in the retail sector. Comparisons between one quarter and the same quarter a year earlier, however, help to alleviate this particular problem. Other than the annual benchmarking exercise, there were no substantive revisions to the data.

Inflation and Gross Domestic Product

- 14** ONS publishes monthly inflation indices which reflect changes over twelve months in the cost of a 'basket' of goods and services on which people typically spend their money. We use two main inflation measures: the Consumer Prices Index (CPI) and the Retail Prices Index (RPI).
- 15** Each measure uses the same basic price data, but the CPI (which follows international definitions) excludes Council Tax and a number of housing costs faced by homeowners that are included in the RPI. Other differences include: the methodologies used to combine individual prices at the first stage of aggregation; the sources used to derive the weighting that each component contributes; and the population whose spending the 'basket' is designed to represent.
- 16** GDP provides a measure of total economic activity. It is often referred to as one of the main 'summary indicators' of economic activity and is used to measure growth in the economy. In 2011 ONS implemented significant methodological changes in the production of GDP figures, which brought the UK into line with international standards. These changes included: adopting the 2007 SIC; using a revised classification of products; changing the method of calculating inflation; utilising new sources of financial services data; and revising the base and reference year.
- 17** Following these changes the 2008-2009 recession has been shown to be shorter (five quarters instead of six) but deeper (7.1 per cent cumulative loss of output instead of 6.4 per cent) than previously thought. The industrial breakdowns of GDP using SIC 2007 are only currently available from 1995 onwards, meaning that consistent comparisons by sector with previous recessions are not yet able to be made.

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