The National Minimum Wage

Fourth Report of the Low Pay Commission

Building on Success

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The National Minimum Wage

Fourth Report of the Low Pay Commission

Building on Success

Presented to Parliament by the
Secretary of State for Trade and Industry by
Command of Her Majesty
March 2003

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Chairman's Foreword

1 The National Minimum Wage has brought benefits to over one million low-paid workers. It has done so without any significant adverse impact on business or employment. Far from having the dire consequences which some predicted, the minimum wage has been assimilated without major problems – even though it has been a challenge for some businesses. It has ceased to be a source of controversy and become an accepted part of our working life.

2 That reflects the success of the Low Pay Commission, and in particular of its first Chair, Sir George Bain. Under his leadership, the Commission made recommendations on the introduction of the minimum wage, assessed its initial impact, and made the first recommendations for increased rates. Just as importantly, George helped to establish the way in which the Commission operates: an approach based on openness, consultation and partnership, underpinned by rigorous analysis. As a newcomer to the Commission, I have been struck by the spirit of co-operation which is a mark of all the Commission's debates and discussion. The Commission has worked effectively and achieved unanimity on all its recommendations because of the commitment of all Commissioners to honest and informed debate, leading to a shared understanding of the issues.

3 We can now draw on nearly four years of data to assess the impact of the minimum wage. The assessment set out in this report is based on statistical analysis, specially commissioned research, consultation and visits, looking in detail at both the aggregate impact and the impact on those groups of workers and sectors of the economy most affected. This analysis provides the basis for our recommendations on the future course of the minimum wage.

4 We want the minimum wage to build on its initial success, producing the maximum benefit for low-paid workers which can be achieved without damaging business and employment prospects. Since the Commission made its first recommendations on minimum wage rates, the low pay statistics prepared by the Office for National Statistics which underpin much of our analysis have been revised. The revised statistics show that the numbers of workers directly affected by the minimum wage are smaller than the

Commission originally forecast. The impact on firms' wage bills has also been less than originally predicted. And both overall figures for the whole economy and detailed academic research of specific sectors suggest that there has been a negligible impact on employment. All the signs are therefore that the minimum wage can now be increased as a percentage of average earnings – benefiting more workers – without producing damaging economic effects.

5 We therefore believe that the effective level of the minimum wage should now be increased, with a series of increases above average earnings over a number of years, gradually increasing the number of people benefiting. But there is also a need for caution in economic circumstances which could prove difficult. We have therefore decided not to recommend the full adjustment to a new level within two years, but propose a partial step towards that end. The upratings which we recommend in this report would increase the number of beneficiaries from around one million to 1.7 million over a two-year period. We will consider what further steps are appropriate if asked by the Government to produce a fifth report in early 2005.

6 Both business and employee groups have told us that they would prefer future increases in the minimum wage to be phased more evenly than they have been in the past. We have responded to this concern in our recommendations. We are also conscious that businesses need sufficient advance notice of changes to minimum wage rates to enable them to adapt. But we are equally aware of the danger of setting rates too far in advance – particularly when the recommended increase is substantial and when economic prospects are uncertain. As the Commission envisaged in its third report, we have therefore made recommendations for the next two years, but have also proposed that we should revisit the recommended rates for October 2004 nearer the time. This will enable us to fine-tune the recommendations if there have been either significant improvements or a major deterioration in economic circumstances.

7 It is clear that overall the minimum wage is working well, and the vast majority of employers are complying with it. But through consultation and visits we have become aware of areas where further work is needed. So, as well as recommending new rates, we make a number of recommendations which we believe will enhance the operation and the enforcement of the minimum wage.

8 In the Commission's third report, George Bain said the Commission had laid a firm foundation on which future developments could safely be built. We believe that the recommendations contained in this our fourth report will build on that foundation and will ensure the continued success of the minimum wage.

February 2003

The Commissioners

From left to right standing:
Margaret Prosser
David Coats
Adair Turner
John Cridland
Paul Gates

From left to right seated:
Ian Hay
Angie Risley
David Metcalf
William Brown

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Vice Chairman,
Merrill Lynch Holdings Ltd.

Professor William Brown, CBE
Professor of Industrial Relations and
Master of Darwin College,
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David Coats
Head of Economic and Social Affairs Department,
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Professor of Industrial Relations,
London School of Economics

Margaret Prosser, OBE
Former Deputy General Secretary,
Transport and General Workers Union

Angie Risley
Human Resources Director,
Whitbread Group PLC

Executive Summary

Chapter 1: Introduction

1 In October 2001, the Government confirmed our permanent status and gave us a remit for a programme of longer-term research. In June 2002, it gave us terms of reference for a fourth report to be submitted by February 2003.

2 As with our previous reports, we have based our recommendations on extensive research and consultation. We commissioned 12 research projects and carried out a survey of firms in low-paying sectors. We analysed relevant data and actively encouraged the Office for National Statistics (ONS) to establish better estimates of the incidence of low pay. Consultation with employers, workers and their representatives remains a fundamental part of our work. We took written and oral evidence from a wide range of organisations and made visits throughout the UK.

Chapter 2: Impact of the National Minimum Wage

3 The October 2001 uprating of the minimum wage represented a significant increase in earnings for many low-paid workers. We estimate that workers in 1.1 to 1.5 million jobs benefited from the increase and that, as a result, the aggregate wage bill rose by up to 0.11 per cent. The smaller uprating at October 2002 benefited people in fewer jobs – around one million. Low pay is concentrated among certain sectors and groups of workers. Women, part-time workers, young people and some ethnic groups in particular benefited. The minimum wage has had a significant impact on the gender pay gap at the bottom of the earnings distribution. Once again we note the importance of accurate data on low pay to our assessment of the impact of the minimum wage. We recommend that the ONS should make continued efforts to improve these data.

4 The 2001 uprating was substantial, but was preceded by a small increase in 2000 and followed by a small increase in 2002. Evidence from our consultation suggests that some employers

found the 2001 increase harder to accommodate than initial introduction. But it is clear that over the long term the impact on the wage bill has been contained, with only limited restoration of differentials above minimum wage levels.

5 The labour market remains tight by historical standards, but employment growth has slowed. Employment growth among groups and sectors most affected by the minimum wage has, however, generally been stronger than average. The main exception to this is among young people. Formal tests of the impact of the minimum wage on employment of those directly affected suggest minimal negative effects.

6 We found no significant effect, positive or negative, of the minimum wage on productivity. But productivity gains have been made in most low-paying sectors, a trend which started before the minimum wage was introduced. We found a minority of firms are undertaking innovative measures to cope with the changes whilst others have reported difficulties. We therefore recommend that organisations such as the Small Business Service (through its Business Link network) and sectoral trade bodies should be encouraged to continue to provide advice and consider further ways to promote best practice.

7 The National Minimum Wage has had minimal impact on public sector wage bills with the vast majority of direct public sector workers earning above minimum wage levels. Government evidence suggests that the minimum wage has had a small positive impact on public sector finances.

Chapter 3: Working with the National Minimum Wage

8 Amongst the sectors which have been most affected by the minimum wage, firms' capacity to respond may be influenced by a number of external factors which are not directly related to the minimum wage. While the response therefore varies across the sectors, we find no evidence that any sector is unduly constrained in its ability to cope with the National Minimum Wage. Across many of the sectors small firms are, however, more affected than larger firms, and we make recommendations for improving the information available to them.

9 We recommend that the Government should continue to promote implementation of the 2001 agreement between central and local government, health bodies and independent care providers on commissioning social care, and should ensure that its impact is carefully monitored. We also note the relevance of the rules on 'sleepovers' to the care sector, and reaffirm our view that the original policy intent of the Regulations should be preserved.

10 We have received further evidence about problems with fair estimate agreements. We give our initial views on these issues and we will respond separately to the Government's consultation paper.

11 A number of organisations expressed concern at the lack of clarity surrounding the rules on therapeutic activity and the National Minimum Wage. We set out our views on how we believe the dividing line should be drawn between therapeutic activity and work which qualifies for the minimum wage, and we recommend that the Government should monitor the impact of its new guidance on this matter.

12 On the composition of pay which can count towards the National Minimum Wage, we recommend that the maximum weekly accommodation offset should be increased to £24.40 in October 2003 and £26.25 in October 2004, and that the rules for calculating the offset should be simplified. We conclude that the present arrangements for the treatment of tips should be retained.

Chapter 4: Young People and Workforce Skills

13 The October 2001 uprating of the youth Development Rate benefited 18–21 year olds in just over 90,000 jobs, with others gaining indirectly from the increase in the adult minimum wage. There has been a slight easing in the labour market in the past two years and, in the year following the October 2001 uprating, the employment rates among some groups of young people fell. Analysis of these recent trends and examination of commissioned research lead us to conclude that changes to the youth labour market have been primarily driven by the economic cycle, and that the minimum wage has had at most a minor impact on young people's employment.

14 We recognise the argument that an age-related Development Rate lacks equity but we continue to believe that young people are vulnerable in the labour market and merit special consideration. It is a matter of judgment where the cut-off for the adult rate should apply but on balance, looking at economic data and employers' practice, we continue to recommend that 21 year olds should receive the adult rate. While we continue to believe that the youth Development Rate should apply to 18–20 year olds we propose to keep the age coverage under review.

15 We note evidence of very low pay for 16–17 year olds and believe that, in principle, there is a case for introducing a separate minimum wage for this age group. We need to consider further the precise rate and the relationship between the minimum wage and education policy. We recommend that the Government should invite the Commission to report on its findings by February 2004, so that a rate could be introduced by October 2004.

16 The exemption from the National Minimum Wage for apprentices continues to work well and we consider no change is needed at present, but the apprentice exemption will need to be considered as part of any further report on introducing a minimum wage for 16–17 year olds. While use of the older workers' Development Rate continues to be low, we think it should remain in place for the time being, particularly in view of the flexibility it has offered to firms most affected by the minimum wage, and we will continue to monitor its use and impact.

Chapter 5: Compliance and Enforcement

17 Most employers are continuing to comply with the National Minimum Wage, but we are concerned that some workers are still being underpaid, particularly, though not exclusively, in the informal economy. While awareness of the existence of the minimum wage remains high, we recommend that the Government should continue to publicise the minimum wage to businesses and to workers on an ongoing basis. Evidence we received welcomed the Inland Revenue's work so far in enforcing the minimum wage, and we strongly support the work being done by pilot projects to promote reporting of underpayment.

18 To tackle continuing non-compliance with the minimum wage, we recommend that there should be further proactive enforcement work. This should include greater co-ordination with wider Government compliance initiatives; encouraging initiatives by employers and unions to promote compliance; and evaluating the use of existing powers to identify whether any changes in practices or powers are needed to strengthen the deterrent to non-compliance. Detriment and dismissal related to the minimum wage also continue. We welcome the scope which the Advisory, Conciliation and Arbitration Service (ACAS) and the Inland Revenue have identified for improving co-ordination between them, and we recommend that the Government should evaluate the impact of these measures on service to customers. We also recommend that the Government should further publicise ACAS's information and advice services for businesses, to help businesses manage their response to the minimum wage within the law.

Chapter 6: Choosing New Rates

19 In making our new recommendations we have taken into account evidence of the impact of the National Minimum Wage so far, looked at prospects for the economy and considered views of stakeholders. The evidence of the impact shows that the minimum wage has been a success. There have been negligible adverse effects on employment or inflation. It has benefited many low-paid workers, although fewer than we originally forecast. Although some firms have found adjustment difficult, the impact on aggregate and sectoral wage bills has been minimal and much lower than we originally anticipated. And as the minimum wage has been in place for almost four years, we can be confident of our assessment. Our aim is to have a minimum wage that helps as many low-paid people as possible without any adverse impact on the economy. We therefore believe there is a strong case for a significant step up in the level over the next few years, contingent on economic circumstances.

20 Economic forecasts suggest that such a step up could be achieved against a background of steady low-inflation growth. Most stakeholders accepted the case for uprating, with some arguing for a significant increase but with others advocating an indexation with prices. The latter approach would, however, lead to a steady withering of the minimum wage – a view the Commission cannot support.

21 We therefore believe that there is a case for increasing the effective level of the minimum wage, implying a series of increases for a number of years above average earnings, and increasing gradually the number of people benefiting. We are also, however, conscious of the need for caution in economic conditions which could prove difficult. We have therefore decided not to recommend the full adjustment to a new level in two years, but to take a partial step towards that end, increasing the number of jobs benefiting from around one million to about 1.3 million in October 2003 and 1.7 million in October 2004. We recommend that the adult rate of the minimum wage should be increased to £4.50 in October 2003. The rate should be further increased to £4.85 in October 2004, subject to confirmation by the Commission in early 2004. We will consider what further steps are appropriate if asked by the Government to produce another report in early 2005.

22 Our examination of young people implied the need for some caution on youth rates. We recommend that the Development Rate should be increased to £3.80 in October 2003 and – subject to confirmation nearer the time – to £4.10 in October 2004, i.e. by more than the forecast increase in average earnings, but by slightly less than the adult rate.

23 In making our recommendations we have taken into account stakeholders' clear preference for further increases to be more equally phased, and for sufficient advance notice to be given. We have recommended rates for a two-year period and also given an indication of what we see as the appropriate medium-term direction of the minimum wage, subject to economic conditions. We believe, however, that the economic uncertainties are such that the precise figures for October 2004 should be made contingent on the economic circumstances then in place. We are therefore making only a preliminary recommendation for 2004. We recommend that the Government should give the Low Pay Commission a remit to fine-tune the recommended October 2004 upratings of the adult rate and the Development Rate in early 2004, enabling us to consider whether our recommendations remain appropriate in the light of economic circumstances.

24 Our recommendations will considerably increase the number of low-paid workers who benefit from the minimum wage. But as the wage bill impact is likely to be moderate, and considerably lower than estimates of initial introduction, overall it should be manageable by businesses. The inflationary impact is likely to be small, as is the impact on the public sector. We expect our recommendations to have a small positive impact on work incentives and to benefit households in the bottom half of the income distribution the most.

Recommendations

National Minimum Wage Rates

The adult rate of the minimum wage should be increased to £4.50 in October 2003. The rate should be further increased to £4.85 in October 2004, subject to confirmation by the Commission in early 2004. (Paragraph 6.39)

The Development Rate should be increased to £3.80 in October 2003 and – subject to confirmation nearer the time – to £4.10 in October 2004. These rates should apply to 18–20 year olds and to workers on the older workers' Development Rate. (Paragraph 6.40)

The Government should give the Low Pay Commission a remit to fine-tune the recommended October 2004 upratings of the adult rate and the Development Rate in early 2004, enabling us to consider whether our recommendations remain appropriate in the light of economic circumstances. (Paragraph 6.41)

Young People

Twenty-one year olds should receive the adult rate of the National Minimum Wage and the age coverage of the youth Development Rate should be kept under review. (Paragraph 4.64)

The Government should ask the Commission to consider in detail the introduction of a minimum wage rate for 16–17 year olds and to report by February 2004, so that a rate could be introduced by October 2004. (Paragraph 4.81)

Accommodation Offset

The level of the accommodation offset should be increased in line with the increase in the adult rate, producing a rate of £24.40 per week in October 2003 and £26.25 per week in October 2004, and the hourly and daily rates should be abolished. Where accommodation is provided for less than the full week, the accommodation offset should be correspondingly reduced. (Paragraph 3.102)

Low Pay Statistics

The Government should ensure that the Office for National Statistics devote sufficient attention and resources to achieving the improvements to the low pay statistics identified as necessary in the *Review of Distribution of Earnings Statistics*, in accordance with the timetable set out in the implementation plan. (Paragraph 2.3)

Awareness

The Small Business Service should actively promote and disseminate factual information on the National Minimum Wage that is tailored to small firms. (Paragraph 3.18)

The Government should continue to publicise the minimum wage both to businesses and to workers on an ongoing basis. Publicity should cover the headline rate and the Helpline, with targeted publicity tailored to different groups. (Paragraph 5.7)

Enforcement

There should be further proactive enforcement, with greater co-ordination between Inland Revenue and wider Government compliance initiatives, and encouragement of employers' and unions' compliance initiatives. The Government should also evaluate the use of existing powers, and identify whether any changes in practices or powers are needed to strengthen the deterrent to non-compliance. (Paragraph 5.32)

The Government should evaluate the impact on customer service of the action taken to strengthen co-ordination between the Inland Revenue and the Advisory, Conciliation and Arbitration Service. (Paragraph 5.40)

Advice to Businesses

Organisations such as the Small Business Service (through its Business Link network) and sectoral trade bodies should be encouraged to continue to provide advice and consider further ways to promote best practice. (Paragraph 2.117)

The Government should further publicise the information and advice services provided by the Advisory, Conciliation and Arbitration Service for businesses to help them manage their response to the minimum wage within the law. (Paragraph 5.43)

Social Care Sector

The Government should continue vigorously to promote implementation of the 2001 agreement on commissioning care and should ensure that its impact is carefully monitored. (Paragraph 3.54)

Sleepovers

The Government should examine whether the present uncertainty over the treatment of 'sleepovers' can best be resolved through revised guidance, or whether a change to the Regulations is required. (Paragraph 3.59)

Therapeutic Activity

The Government should monitor the impact of its revised guidance on the minimum wage and therapeutic activity very closely, in particular whether it helps to reduce uncertainty for those involved in this field, and should ensure that people doing therapeutic activity are not adversely affected by uncertainty about the minimum wage. (Paragraph 3.94)

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1 Introduction

In October 2001, the Government confirmed our permanent status and gave us a remit for a programme of longer-term research. In June 2002, it gave us terms of reference for a fourth report to be submitted by February 2003.

As with our previous reports, we have based our recommendations on extensive research and consultation. We commissioned 12 research projects and carried out a survey of firms in low-paying sectors. We analysed relevant data and actively encouraged the Office for National Statistics (ONS) to establish better estimates of the incidence of low pay. Consultation with employers, workers and their representatives remains a fundamental part of our work. We took written and oral evidence from a wide range of organisations and made visits throughout the UK.

Background

1.1 In its response to the recommendations we made in our third report, in June 2001 the Government stated that the Low Pay Commission would have a permanent role in monitoring the National Minimum Wage. This was confirmed in October 2001 when the Government asked us to carry out a programme of research on the impact of the minimum wage.

1.2 We recommended in our third report that the minimum wage should be subject to biennial reviews reporting in February for implementation in the following October. The Government agreed that when reviews were undertaken they should be over a two-year period, in advance of the relevant budget. This is therefore the approach that we adopted once the Government gave us the terms of reference for our fourth report. In this report we examine the impact of the minimum wage to date, and look forward over the next two years.

1.3 The National Minimum Wage has been in place for almost four years. It has become an accepted part of our working life and has largely ceased to be controversial. We are now in a position not only to continue our assessment of the overall impact of the minimum wage but also to see how people have coped with the first major uprating of the minimum wage, which took place in October 2001.

1.4 In this introduction we describe how we have gone about our task. We outline how we obtained the information and data which have informed our debates and discussions, and which underpin our conclusions and recommendations. We have always striven to combine rigorous analysis of the data with a clear understanding of the practical issues raised by the minimum wage. To achieve this we have relied on research, analysis of statistical data, consultation and discussion. We are indebted to all those who have assisted us in our task by providing information, undertaking research and engaging with us in consultation and debate.

Terms of Reference

1.5 In June 2002, the Government set out the terms of reference for our fourth report. We were asked to:

- continue to monitor and evaluate the impact of the National Minimum Wage, with particular reference to the effect on pay, employment and competitiveness in low-paying sectors and small firms; the effect on different groups of workers; the effect on pay structures; and the interaction between the National Minimum Wage and the tax and benefit systems; and

- review the levels of both the main National Minimum Wage rate and the Development Rate and make recommendations, if appropriate, for change.

1.6 In making our recommendations, we were asked to have regard to the wider economic and social implications; the likely effect on employment, especially amongst disadvantaged groups in the labour market, and inflation; the impact on the costs and competitiveness of business; and the potential costs to industry and the Exchequer. We were also asked to have regard to our current research remit as published by the Government in October 2001.

Research

1.7 In our third report we underlined the importance which we attached to research and analysis to underpin our conclusions and recommendations. We commissioned a number of research projects and were also able to draw on research findings which others made available to us. We also said that we wanted to initiate more long-term research, and we expressed the hope that the Government would ensure that we were in a position to encourage longer-term research projects.

1.8 We were therefore pleased that in October 2001 the Government gave us a remit to set up a programme of longer-term, strategic and rigorous research. We were asked to:

- commission research which would investigate the impact of the minimum wage, over time, on employment and joblessness levels of various age groups;

- find out more about the effect of the minimum wage on the supply of, and demand for, work-based training, and on the link between the minimum wage, education, training and skills development more generally; and

- commission rolling research into the impact of the minimum wage, and the various increases to the rate, on business as a whole and on small businesses in particular.

1.9 In response to this research remit, we carried out a tendering exercise and commissioned 12 research projects. A list of these research projects and a summary of their findings are set out in Appendix 2. We will also publish details of the research on our website (www.lowpay.gov.uk) and make the full results of the research available in certain libraries.

1.10 The research projects covered a wide range of topics and methodological approaches. They included econometric studies of the impact of the minimum wage on employment and unemployment; qualitative studies examining how firms have reacted to the minimum wage, focusing on small firms and particular low-paying sectors; an examination of firms' pay and grading structures and of changes which firms have made as a result of the minimum wage; studies of youth pay and employment practices; qualitative studies of the relationship between the minimum wage and employers' decisions on training; and a study of the relationship between the minimum wage and productivity.

1.11 We commissioned fewer projects than we did when preparing our third report. But in doing so we have been able to focus them more directly on the areas identified in our research remit and on issues which we had identified through our previous work as requiring further study. This more focused approach has also enabled us to commission some more substantive projects than would otherwise have been possible.

Low Pay Statistics

1.12 As information on the number of low-paid workers underpins much of this report and our recommendations, it is critical that these data are accurate. Our previous reports highlighted the problems with the data on low pay and acknowledged the work that the ONS was doing to improve their accuracy.

1.13 We have continued actively to encourage the ONS to improve estimates of the number of low-paid workers. Appendix 3 sets out the changes that it has made to its methodology and those planned for the future. We are grateful to the ONS for the work it has done to improve the data on low pay and we urge it to implement its programme of planned improvements, so that we have better estimates to inform our next review of the minimum wage.

Postal Survey

1.14 As for our previous reports, we conducted our own survey on the impact of the minimum wage. Again we targeted this survey on sectors that were most likely to be affected, i.e. hospitality, social care, manufacture of textiles, clothing and footwear, hairdressing, retail, childcare, security and cleaning. And for the first time, we included businesses from the leisure sector. We expected the October 2001 increase in the National Minimum Wage to have had an effect on these sectors and we were keen to see how they had coped with it.

1.15 Rather than distributing the questionnaires through trade associations, as we have done in the past, we commissioned the Sample Surveys Research Group to administer the survey on our behalf, using the Dun and Bradstreet business database to select the sample. This allowed us to broaden the coverage of the survey, and in particular to include more small firms.

1.16 We are grateful to those businesses that took the time to complete the questionnaires. Further information about the survey and details of the results are set out in Appendix 4.

Consultation

1.17 We have always been keen to carry out our work on an open and consultative basis. We have sought views from a wide range of organisations and individuals who have been affected by the minimum wage or would be well-placed to comment. We wrote to over 450 employer organisations, unions, voluntary and charitable organisations, companies, pressure groups and academics to invite them to submit written evidence on the impact of the minimum wage. Our website also encouraged individuals, firms and organisations to submit their written evidence to us. We asked for views on any or all of the issues covered by our terms of reference and, in addition, sought views on compliance with and enforcement of the minimum wage.

1.18 We received over 100 pieces of written evidence and, as for previous reports, we were impressed by the serious and considered nature of the evidence we received. In the case of representative organisations this was often based upon surveys, consultation and research which they themselves had undertaken. A list of those who provided evidence is set out in Appendix 1 and, unless given to us in confidence, this evidence will be made available in selected university libraries.

1.19 We heard oral evidence from the CBI and TUC, and from organisations representing employers and workers in low-paying sectors. These discussions provided an opportunity to explore points which had been made in written evidence, and to test arguments and counter-arguments. A list of the organisations which gave oral evidence is provided at Appendix 1.

1.20 Our terms of reference and our research remit specifically invited us to examine the impact of the minimum wage on small firms. We are grateful to the Small Business Service for providing funding for MORI to run focus groups on our behalf. These consisted of representatives from small firms in the hospitality, retail, manufacturing and cleaning sectors paying at or around National Minimum Wage rates. Participants were asked about their knowledge of and views on the minimum wage. This is a new approach for us, and one which yielded useful information and insights which have enriched our understanding of the issues faced by small businesses.

1.21 Through our consultation we become aware of issues of concern to particular groups. In some cases the best way to reach a satisfactory outcome may be to bring a range of interested parties together to hear the various viewpoints and to try to reach agreement on a preferred way forward. As part of our work for this report we held a round table discussion with organisations working with people with learning disabilities or mental health problems and others. The meeting helped us to deepen our understanding of the practicalities involved in determining what should be treated as work for National Minimum Wage purposes, and what should be considered therapeutic activity to which the minimum wage should not apply. Taken with the other evidence we received, that discussion was instrumental in helping us to crystallise our views on the subject which are reflected in this report.

1.22 We also held meetings with over 50 organisations representing low-paying sectors and groups of workers affected by the minimum wage. We are very grateful to all of the organisations and individuals that gave us their views in writing and in face-to-face discussions.

1.23 We have always been keen to visit employers and workers affected by the National Minimum Wage to hear from them direct about its impact, to discuss their views on future rates, and to hear about any practical issues arising from implementation of the minimum wage. In preparing this report, we carried out a series of regional visits to inner city and urban areas and to rural communities. We visited Northern Ireland, central Scotland, South Wales and – in England – East Anglia, the South West, the West Midlands, London, Lancashire and the North East.

1.24 The groups we met included textiles manufacturers, small retailers, hairdressers, managers of hotels and pubs, people who run childcare nurseries, managers of care homes and a representative from social services, agricultural employers, hospital managers, firms that provide contract cleaning and security services, and cleaners and ancillary workers themselves. We also visited student representatives and a Low Pay Unit where we heard direct from a worker who was not being paid the minimum wage.

1.25 A list of the organisations we visited is provided in Appendix 1. We are grateful to everyone we saw and also to those who helped us to arrange the visits.

Conclusion

1.26 Having seen the successful introduction of the National Minimum Wage, we went through the process of reviewing its impact and making recommendations for uprating. This report provides an opportunity to evaluate that uprating process and to see what the response has been to the first major increase in minimum wage rates.

1.27 As well as making recommendations on minimum wage rates, our reports have also contained a number of recommendations aimed at improving the operation of the National Minimum Wage and clarifying areas of uncertainty. We have continued this approach in our fourth report. We are pleased that the Government has continued to give us terms of reference which are sufficiently broad to enable us to undertake a thorough assessment of the minimum wage.

1.28 We begin by assessing the impact which the minimum wage has had so far, looking in particular at the impact of the October 2001 uprating. In Chapter 2 we consider the impact at the aggregate level, and in the following chapter we look in more detail at the impact on particular sectors and groups of workers.

2 Impact of the National Minimum Wage

The October 2001 uprating of the minimum wage represented a significant increase in earnings for many low-paid workers. We estimate that workers in 1.1 to 1.5 million jobs benefited from the increase and that, as a result, the aggregate wage bill rose by up to 0.11 per cent. The smaller uprating at October 2002 benefited people in fewer jobs – around one million. Low pay is concentrated among certain sectors and groups of workers. Women, part-time workers, young people and some ethnic groups in particular benefited. The minimum wage has had a significant impact on the gender pay gap at the bottom of the earnings distribution. Once again we note the importance of accurate data on low pay to our assessment of the impact of the minimum wage. We recommend that the Office for National Statistics (ONS) should make continued efforts to improve these data.

The 2001 uprating was substantial, but was preceded by a small increase in 2000 and followed by a small increase in 2002. Evidence from our consultation suggests that some employers found the 2001 increase harder to accommodate than initial introduction. But it is clear that over the long term the impact on the wage bill has been contained, with only limited restoration of differentials above minimum wage levels.

The labour market remains tight by historical standards, but employment growth has slowed. Employment growth among groups and sectors most affected by the minimum wage has, however, generally been stronger than average. The main exception to this is among young people, who are considered in Chapter 4. Formal tests of the impact of the minimum wage on employment of those directly affected suggest minimal negative effects.

We found no significant effect, positive or negative, of the minimum wage on productivity. But productivity gains have been made in most low-paying sectors, a trend which started before the minimum wage was introduced. We found a minority of firms are undertaking innovative measures to cope with the changes whilst others have reported difficulties. We therefore recommend that organisations such as the Small Business Service (through its Business Link network) and sectoral trade bodies should be encouraged to continue to provide advice and consider further ways to promote best practice.

The National Minimum Wage has had minimal impact on public sector wage bills with the vast majority of direct public sector workers earning above minimum wage levels. Government evidence suggests that the minimum wage has had a small positive impact on public sector finances.

Introduction

2.1 The National Minimum Wage has been in place for nearly four years, giving us a reasonable time period over which to evaluate its impact. In this chapter we first assess the impact on the labour market, looking at wages, employment and participation, and then go on to consider firms' productivity and costs.

2.2 As in previous reports, we have given particular attention to those groups and sectors where the minimum wage is likely to have a significant impact. One of our most difficult tasks has been to isolate the impact of the minimum wage from other changes in the economy. These include changes in the economic cycle; external factors such as foot and mouth disease, which has badly affected agriculture, tourism and hospitality; and the impact of other employment legislation such as the Working Time Regulations and holiday and paternity leave entitlements. We have made our assessment by examining the impact of the minimum wage on groups, sectors or firms most affected and comparing them with others less affected or not affected at all. In some cases this has been achieved through formal models, where unaffected groups are used as controls for those directly affected. In others we have assessed the impact on, for example, employment among groups or prices among sectors we know are more at risk.

2.3 The reliability of the statistical data provided by the ONS on the numbers in low pay is crucial to our evaluation of the minimum wage's effect. We note the steps the ONS has taken to improve the reliability of the data and recognise that estimates are now more stable. But there is still more that can be done, and we set out our assessment of the current data and plans for improvement in Appendix 3. The need for further improvements was identified by the ONS in its *Review of Distribution of Earnings Statistics* published in October 2002. Because of the importance of the ONS data to our assessment of low pay, **we recommend that the Government should ensure that the ONS devote sufficient attention and resources to achieving the improvements to the low pay statistics identified as necessary in the *Review of Distribution of Earnings Statistics*, in accordance with the timetable set out in the implementation plan.**

2.4 Our analysis of the impact of the minimum wage has not, however, relied entirely upon official aggregate data. An important part of our research strategy has been to supplement these with both quantitative and qualitative survey data, analysis of results from our research projects, and our extensive consultation and visits programme.

2.5 Our key findings on the impact of the minimum wage are set out below in the following sections:

- beneficiaries;
- earnings;
- employment, unemployment and participation;
- competitiveness – the wage bill, productivity, prices and profits and training; and
- public sector finances.

Beneficiaries

2.6 In our third report our best estimate was that workers in around 1.3 million jobs gained from the initial introduction of the minimum wage. This was a significant reduction on our original estimate of two million jobs. Since then the ONS has undertaken further methodological work on the low pay statistics and published revised estimates on the National Statistics website (www.statistics.gov.uk) on 3 October 2002. These developments have led to a further small reduction in our estimate of the initial impact of the minimum wage. We now estimate that workers in 1.2 million jobs gained from the introduction of the minimum wage.

2.7 Our focus has now moved away from the introduction of the minimum wage and we concentrate in this report on the impact of the October 2001 uprating and, where data are available, the October 2002 uprating. The impact of these upratings provides a more recent guide to how business is coping with the minimum wage and to the impact on low-paid workers.

2.8 In our third report we estimated that between 1.4 and 1.7 million jobs among those aged 18 and over stood to benefit from the October 2001 uprating. This estimate was based on earnings distribution data at Spring 2000 and assumptions about the future path of earnings and prices. We now have earnings distribution data for Spring 2001, six months before the National Minimum Wage was uprated, and can review our assessment. But in order to estimate the number of beneficiaries, we still need to make some assumptions about how earnings of the low paid would have changed in the absence of a minimum wage. In our last report we made two alternative assumptions about the path of earnings of the low paid to produce an upper and lower estimate of likely beneficiaries. The first was that earnings of the low paid would have risen in line with average earnings between April and October 2001, and the second was that they would have increased in line with prices. The equivalent real terms value of the minimum wage at Spring 2001 downrated by these indices, and the corresponding estimates of the number and percentage of jobs that gained, are shown in Table 2.1.

Table 2.1 Estimated Beneficiaries of the October 2001 National Minimum Wage Uprating

	Beneficiaries and equivalent April 2001 rate of National Minimum Wage	
	Downrated by earnings	Downrated by prices
Adults 22+		
£4.10 at October 2001	£4.00	£4.05
Number of jobs that gain	1.0 million	1.4 million
Percentage of jobs that gain	4.4	6.1
Young People 18–21		
£3.50 at October 2001	£3.45	£3.45
Number of jobs that gain	90,000	90,000
Percentage of jobs that gain	5.3	5.3
All 18+		
Number of jobs that gain	1.1 million	1.5 million
Percentage of jobs that gain	4.5	6.0

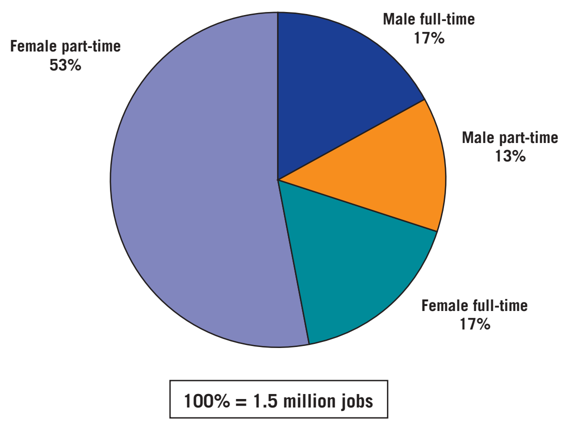
Source: LPC calculations based on grossed NES and LFS data, Spring 2001.

Note: Estimates of adult jobs that gain rounded to nearest 100,000 and youth jobs that gain to nearest 10,000. Estimates of percentage of gainers rounded to nearest 0.1 per cent. Totals may not sum owing to rounding.

2.9 The table shows that people in 1.1 to 1.5 million jobs are estimated to have benefited from the October 2001 uprating, just over 90,000 of whom are young people. This represents between 4.5 and 6 per cent of all jobs among those aged 18 and over. The large range in our estimates reflects significant bunching in the number of jobs just above the £4.00 per hour level, which are included in our estimated beneficiaries when we downrate by prices, but not when we do so by earnings.

2.10 In the analysis that follows we consider the characteristics of beneficiaries and sectors affected by the October 2001 uprating. To simplify the analysis we use just one of the above assumptions on the path of earnings of the low paid in the absence of an uprating – that they would have risen in line with prices. Figure 2.1 shows that the composition of beneficiaries is similar to that seen for the introduction of the minimum wage as described in our third report. Seventy per cent of beneficiaries were women, and around two-thirds of jobs that gained from the uprating were part-time. The breakdown of beneficiaries in the 18–21 age group is slightly different from that for adults. We consider the impact of the uprating on young people in more detail in Chapter 4.

Figure 2.1
Jobs Paying Less than £4.05 (22 and over), £3.45 (18–21): Breakdown by Gender and Hours Worked, Spring 2001



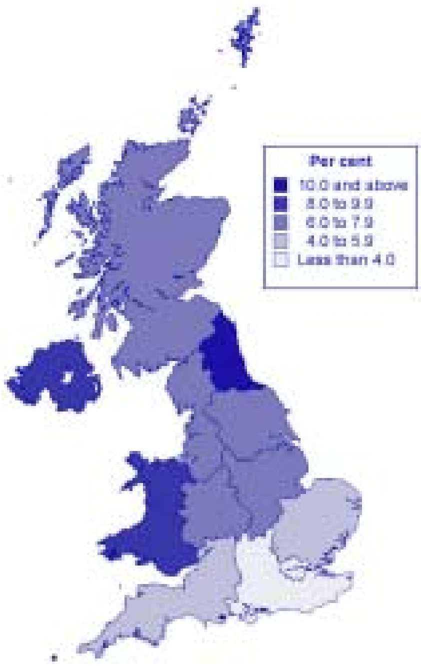
Source: LPC calculations based on grossed NES and LFS data, Spring 2001.

2.11 As can be seen from Figure 2.2, we found considerable variation between regions with the North East, Northern Ireland and Wales having the highest percentage of jobs benefiting from the October 2001 uprating. The difference between the regions with the highest and lowest percentage of beneficiaries has widened since initial introduction of the minimum wage. In our third report we

> *'Our members in high wage parts of the country report that the National Minimum Wage is not a significant factor in determining the wage rates offered to staff. In these areas, the labour market requires employers to pay in excess of the National Minimum Wage in order to attract staff.'*
>
> **Association of Convenience Stores evidence**

estimated that the difference between the most affected and least affected regions was 5.5 percentage points (North East 7.9 per cent, London 2.4 per cent). This range has now increased to 7.6 percentage points (North East 10.6 per cent, South East 2.9 per cent). Evidence we received also referred to the differential impact between regions. The Cleaning and Support Services Association noted that, owing to labour shortages in many parts of the UK, only 30–35 per cent of employees in the sector are paid the National Minimum Wage.

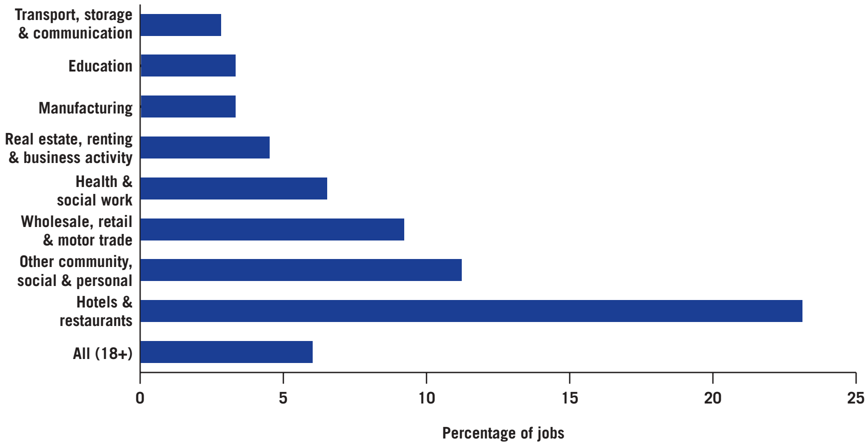
Figure 2.2
Percentage of Jobs in each Region Paying Less than £4.05 (22 and over), £3.45 (18–21), Spring 2001



Source: LPC calculations based on grossed NES and LFS data, Spring 2001.
Note: Government Office Regions shown for England.

2.12 Figure 2.3 shows that, as with the introduction of the minimum wage, particular sectors were disproportionately affected by the October 2001 uprating. Twenty-three per cent of jobs in the hotel and restaurant sector were estimated to be affected compared with an estimated 6 per cent of jobs overall. Wholesale, retail and the motor trade, community, social and personal services, and the health and social work sectors all had more than 6 per cent of jobs estimated to be affected by the October 2001 uprating.

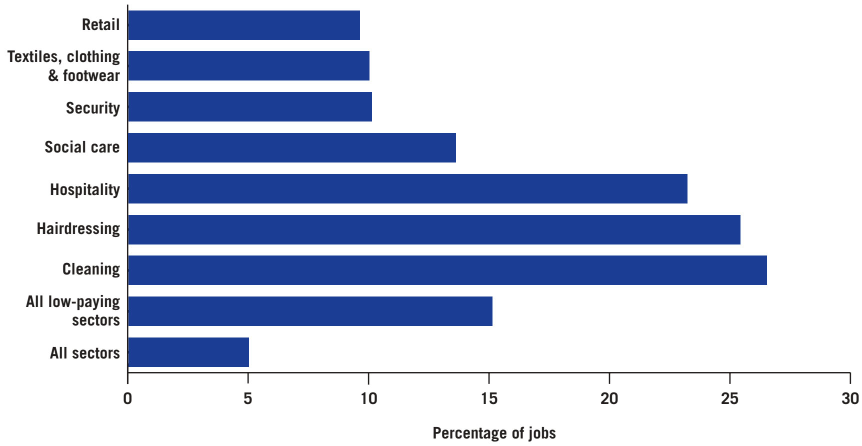
Figure 2.3
Percentage of Jobs in each Industry Sector Paying Less than £4.05 (22 and over), £3.45 (18–21), Spring 2001



Source: LPC calculations based on grossed NES and LFS data, Spring 2001.
Note: Sample size too small for reliable estimates in other industry sectors.

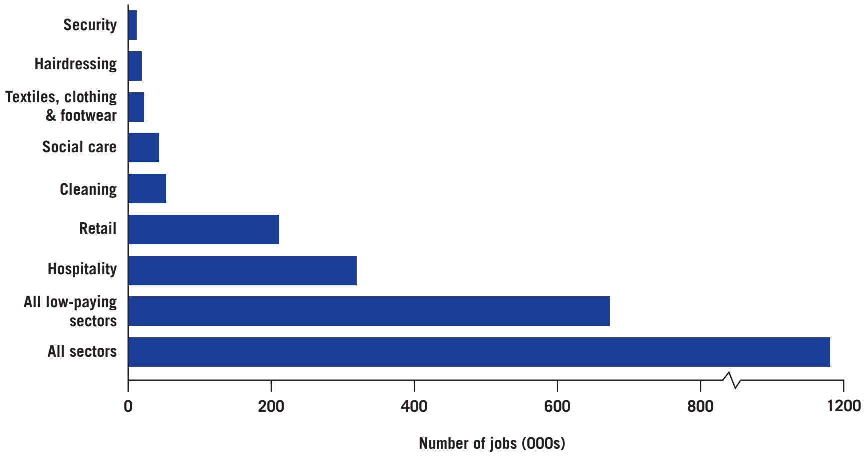
2.13 Our estimates of the overall numbers of beneficiaries are based on combined data from the New Earnings Survey (NES) and the Labour Force Survey (LFS). In order to look at the sectors most affected by the minimum wage at a more disaggregated level, we need to use data from the NES on its own, as it has a larger sample than the LFS. According to the NES, 5 per cent of jobs (almost 1.2 million) benefited from the October 2001 uprating, compared with 6 per cent (1.5 million) based on the central estimate, which is an average of the NES and LFS estimates. These are the upper bound estimates based on the prices growth assumption. Figure 2.4 and Figure 2.5 focus on beneficiaries in those low-paying sectors that we identified in our previous reports. These sectors account for 57 per cent of all beneficiaries. Indeed the hospitality and retail sectors on their own account for more than half a million beneficiaries, 45 per cent of the total. It can be seen that over 20 per cent of jobs in the hospitality, cleaning and hairdressing sectors gained from the October 2001 uprating.

Figure 2.4
Percentage of Jobs in each Low-paying Sector Paying Less than £4.05 (22 and over), £3.45 (18–21), April 2001



Source: Grossed NES, April 2001.

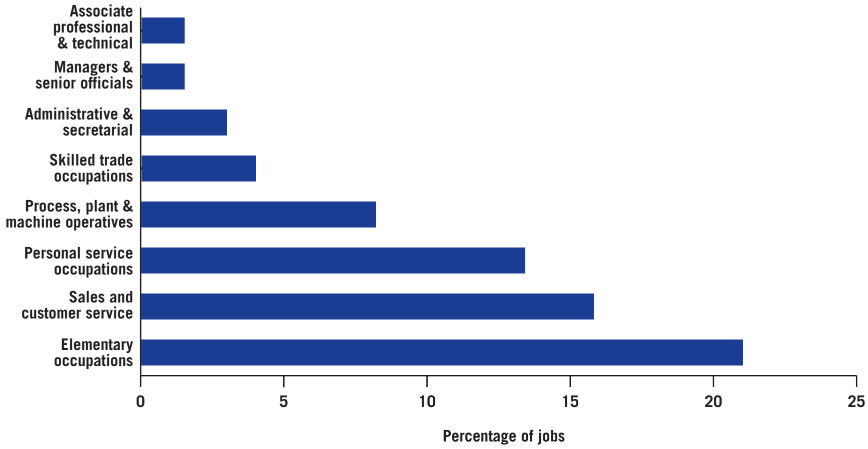
Figure 2.5
Number of Jobs in each Low-paying Sector Paying Less than £4.05 (22 and over), £3.45 (18–21), April 2001



Source: Grossed NES, April 2001.

2.14 Similarly, particular occupations were also disproportionately affected by the October 2001 uprating, as shown in Figure 2.6. Twenty-one per cent of jobs in elementary occupations, such as waiting staff, bar staff, cleaners and porters, were estimated to be affected. The two other occupational groups most affected were sales and customer service (including check-out operators and petrol pump attendants) and personal service occupations (such as care assistants, playgroup assistants and hairdressers).

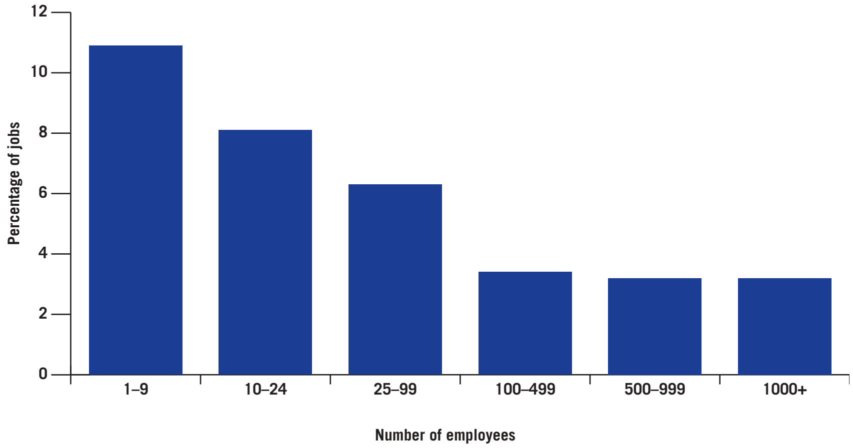
Figure 2.6
Percentage of Jobs in each Occupation Group Paying Less than £4.05 (22 and over), £3.45 (18–21), Spring 2001



Source: LFS, Spring 2001.
Note: Sample size too small for reliable estimates for professional occupations.

2.15 Figure 2.7 shows that small firms were more affected than large ones. Overall, 11 per cent of jobs in firms with fewer than 10 employees were affected by the October 2001 uprating. This was more than twice the national average, based on the NES data only.

Figure 2.7
Percentage of Jobs in each Size of Firm Paying Less than £4.05 (22 and over), £3.45 (18–21), April 2001



Source: Grossed NES, April 2001.

2.16 In our third report we noted that ethnic minority groups were over-represented among the low paid. Since then the ethnicity classification in the LFS has been revised in line with the 2001 census. This means that data from 2001 onwards are not directly comparable with earlier data for ethnic groups. Our latest analysis suggests that ethnic minority employees as a whole were not over-represented in the group benefiting from the October 2001 uprating. We estimate that ethnic minority workers in around 75,000 jobs benefited, representing around 4 per cent of all beneficiaries. As this number is based solely on LFS data it is an upper bound estimate. There are differences between ethnic minority groups. The sample numbers are small, but specific groups such as Pakistani and Bangladeshi employees appear to be over-represented among the low paid.

> *"In our opinion the NMW has been a positive development for people with disabilities."*
>
> **Association for Supported Employment evidence**

2.17 Disabled workers – those with a work-limiting disability – are generally more likely to be low-paid than non-disabled workers. This is reflected in our estimate of disabled people who gained from the October 2001 uprating. Our analysis suggests that disabled people in 235,000 jobs benefited from this uprating. As this is based on LFS data only it is an upper bound. It represents 13 per cent of all beneficiaries (estimated from the LFS), which is considerably higher than the percentage of jobs held by disabled people – 8 per cent. It should be noted that the LFS uses a very broad definition of disability – broader, for example, than that used to monitor the effects of the Disability Discrimination Act 1995. And since 1998 there has been a significant increase in the proportion of employees reporting a disability (see Smith and Twomey (2002)).

2.18 Low pay is common among homeworkers. Analysis of this group using LFS data is limited due to small sample sizes, and focuses on homeworkers who do not work with a computer or telephone essential to their job. The data suggest that manual homeworkers are over-represented among gainers from the October 2001 uprating.

2.19 Turning now to the October 2002 uprating of the minimum wage rates to £4.20/£3.60 per hour, our assessment of the number of jobs that benefited, as derived from the Spring 2002 data, is shown in Table 2.2. Changes in both average earnings and prices over the period suggest that the equivalent real value of the minimum wage in Spring 2002 was £4.15 per hour for adult workers and £3.55 per hour for young workers. Using these assumptions we estimate that workers in just under one million jobs (4 per cent of employee jobs) benefited from the latest uprating, of whom just under 90,000 were young workers. The fall in the estimated number of beneficiaries since the October 2001 uprating reflects the fact that the October 2002 uprating of the minimum wage has fallen behind the increase in earnings for the lowest paid over the period.

Table 2.2 Estimated Beneficiaries of the October 2002 National Minimum Wage Uprating

	Beneficiaries and equivalent April 2002 rate of National Minimum Wage downrated by earnings/prices
Adults 22+	
£4.20 at October 2002	£4.15
Number of jobs that gain	900,000
Percentage of jobs that gain	3.9
Young People 18–21	
£3.60 at October 2002	£3.55
Number of jobs that gain	90,000
Percentage of jobs that gain	4.9
All 18+	
Number of jobs that gain	1.0 million
Percentage of jobs that gain	4.0

Source: LPC calculations based on grossed NES and LFS data, Spring 2002.

Note: Estimates of adult jobs that gain rounded to nearest 100,000 and youth jobs that gain to nearest 10,000. Estimates of percentage of gainers rounded to nearest 0.1 per cent. Totals may not sum owing to rounding.

2.20 In summary, the minimum wage has made a significant difference to many low-paid workers, but the estimates of the number of beneficiaries from the October 2001 uprating are below the numbers we originally estimated would benefit from initial introduction. Our judgment is that workers in 1.1 to 1.5 million jobs were entitled to higher pay as a result of the October 2001 uprating. Women, part-time workers and people from some ethnic minority backgrounds, in particular, benefited. The smaller minimum wage increase in October 2002 has fallen behind increases in average earnings and prices over the period, so that it benefited fewer workers. Our best estimate is that people in just under one million jobs were entitled to higher pay as a result of this uprating.

Earnings

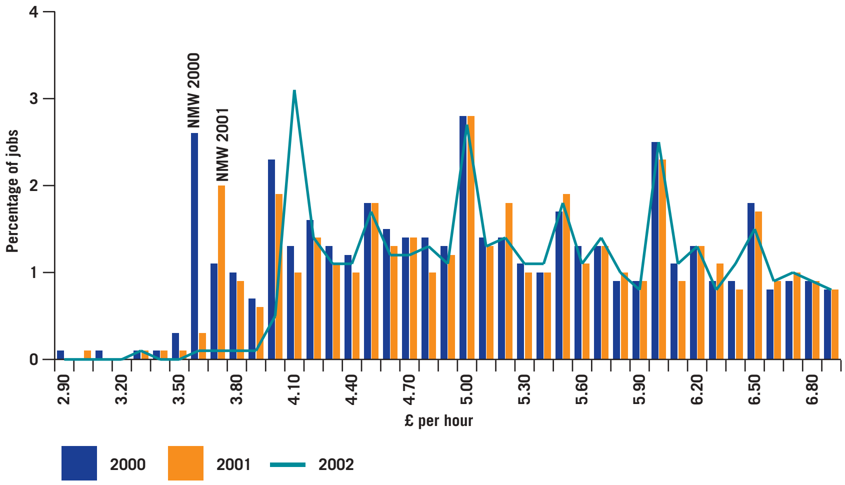
Levels

2.21 Figure 2.8 shows the change in the hourly earnings distribution for adult workers between Spring 2000 and Spring 2002, based on the ONS central estimate methodology. The hourly earnings distribution for young workers is considered in Chapter 4. The changes in the distribution are conditioned to a significant extent by the different size of the October 2000 and October 2001 upratings. The concentration of adult jobs paid at minimum wage

> *We are not a national minimum wage paying company; we wouldn't like to be seen to be led by regulation. But we are affected by large rises in the minimum wage, and are forced to raise our own pay when our competitors make adjustments to comply. Given the competition in our sector, there is no real scope to pass on these costs to customers.*
>
> **Large retailer, quoted in CBI evidence**

rates decreased between 2000 and 2001, with the small rise in the minimum wage, but increased in 2002, following the much larger minimum wage uprating in October 2001. In 2002 there were peaks in the earnings distribution for adult jobs at around £4.50, £5.00 and £5.50 per hour. These peaks were also seen in 2000 and 2001, and the level of the peak has not changed significantly since 2000. In their research for us Incomes Data Services Ltd (IDS) reported that in response to the competitive labour market in low-paying sectors there was a 'lower mezzanine' around £4.50 per hour and an 'upper mezzanine' around £5.00 per hour (IDS (2002a)). IDS (2002d) also reported that some employers were setting rates above the minimum wage to aid recruitment or to stay ahead of competitors. Some companies told IDS (2002a) that they do not want to be seen as 'minimum wage payers'.

Figure 2.8
Hourly Earnings Distribution for Employees Aged 22 and Over, Spring 2000–2002



Source: ONS central estimate methodology, Spring 2000–2002.
Note: NMW label shows the adult NMW rate in April of the given year.

> *Do we need this legislation? Yes, unequivocally, the NMW has provided a base from which we calculate our charges to clients and has enabled us to negotiate rates allowing us to pay our staff considerably higher than NMW.*
>
> **Constant Security Services evidence**

2.22 The pattern of increases in earnings at different points of the earnings distribution between 2000/01 and 2001/02 is shown in Table 2.3. Changes over the two years are different and can be explained by the pattern of minimum wage increases. The small increase in October 2000 produced a lower than median increase for lowest decile workers between 2000 and 2001. The higher increase in October 2001 resulted in an increase for the lowest decile which was higher than the median in 2001/02. This 'concertina' effect is found throughout much of the analysis in this chapter, and is considered in more detail in the section on differentials. We will see there that one effect of the large uprating is to squeeze differentials at the bottom of the earnings distribution, with employers using the year of a small increase in the minimum wage at least partially to restore differentials.

2.23 A similar pattern is seen when we compare full-time and part-time earnings. In 2000/01 full-time employees saw higher increases than part-time employees, but again this reversed in 2001/02. We saw earlier that most of the beneficiaries of the October 2001 uprating were part-time workers. Indeed in 2001/02 the lowest decile hourly earnings of part-time employees aged 18 and over rose by 6.9 per cent (from £3.84 per hour to £4.10 per hour) compared with 4.3 per cent for full-time workers.

Table 2.3 Increase in Hourly Earnings for Employees Aged 18 and Over, 2000–2002

	Increase in hourly earnings %	
	2000/01	2001/02
Full-time lowest decile	5.2	4.3
Full-time median	5.5	3.9
Full-time upper decile	7.0	4.8
Part-time lowest decile	3.8	6.9
Part-time median	5.3	4.5
Part-time upper decile	4.2	5.2
All jobs lowest decile	4.8	5.0
All jobs median	5.5	4.3
All jobs upper decile	6.1	4.9

Source: Grossed NES, April 2000–2002.

2.24 Evidence we received from our written consultation and from research we commissioned from IDS (2002a and 2002d) suggested that firms in many sectors found the increase to £4.10 more difficult to accommodate than the initial introduction of the minimum wage, or the previous year's small increase. It is unclear from the figures, however, why this should have been the case. The maximum increase resulting from the October 2001 uprating was 10.8 per cent for firms that paid at the previous minimum. In fact the NES linked data show that this was the median increase in pay of those earning between the October 2000 and 2001 minimum wage rates, reflecting the fact that many companies were paying the previous minimum. But the median increase for those earning below the minimum wage in the year leading up to its initial introduction was 19.2 per cent. The number of jobs affected in 2001 meanwhile, which we estimate at 1.1 to 1.5 million, is not substantially higher than the 1.2 million affected at introduction. We also noted in our third report that the estimated impact of the 2001 uprating on wage bills was lower than that for introduction. The aggregate data therefore do not suggest that the October 2001 uprating should have had more impact on firms than the initial introduction. The difference between the impact suggested by the aggregate data and the experience reported by employers may be an indication that employers had not expected such a large increase in 2001, following the ten pence increase (well below average earnings growth) in 2000. Evidence from Business in Sport and Leisure bears this out. They stated that 'the effect of [the October 2001] rise had a much more significant and damaging impact on the leisure and hospitality sector. For the first time, it pushed up the level of the National Minimum Wage well above that which companies were planning to award.'

2.25 Despite this, IDS (2002d) reported that most firms affected by the October 2001 uprating were able to absorb the increase to minimum rates without too much difficulty. They found that organisations employing large numbers of staff around the minimum wage typically left the uprating to October rather than uprating earlier. In some cases this meant moving previous review dates from Spring or Summer to October. Other companies introduced a two-stage increase, raising pay at their normal review date and then again in October. A common theme, particularly among retailers, is that the pressure on pay rates has not come exclusively from the increase in the National Minimum Wage. As we will see in Chapter 3, adjustments to pay rates and structures have come from competitive pressures as much as from the National Minimum Wage.

2.26 The impact of the October 2001 uprating was also seen in changes in earnings between different groups, sectors and regions. We have already seen that women, some ethnic minority groups and disabled workers are all disproportionately represented among the low paid. The minimum wage is therefore expected to have a positive effect on equal pay and on the earnings gaps of other disadvantaged groups – although now the wage floor has been established we may not see the same impact that there was on its introduction.

2.27 The NES 2002 data showed a slight widening of the gender pay gap for full-time employees. Women's average hourly pay in April 2002 was 81.1 per cent of men's, compared with the 81.5 per cent recorded in April 2001. However, the ONS reported that the

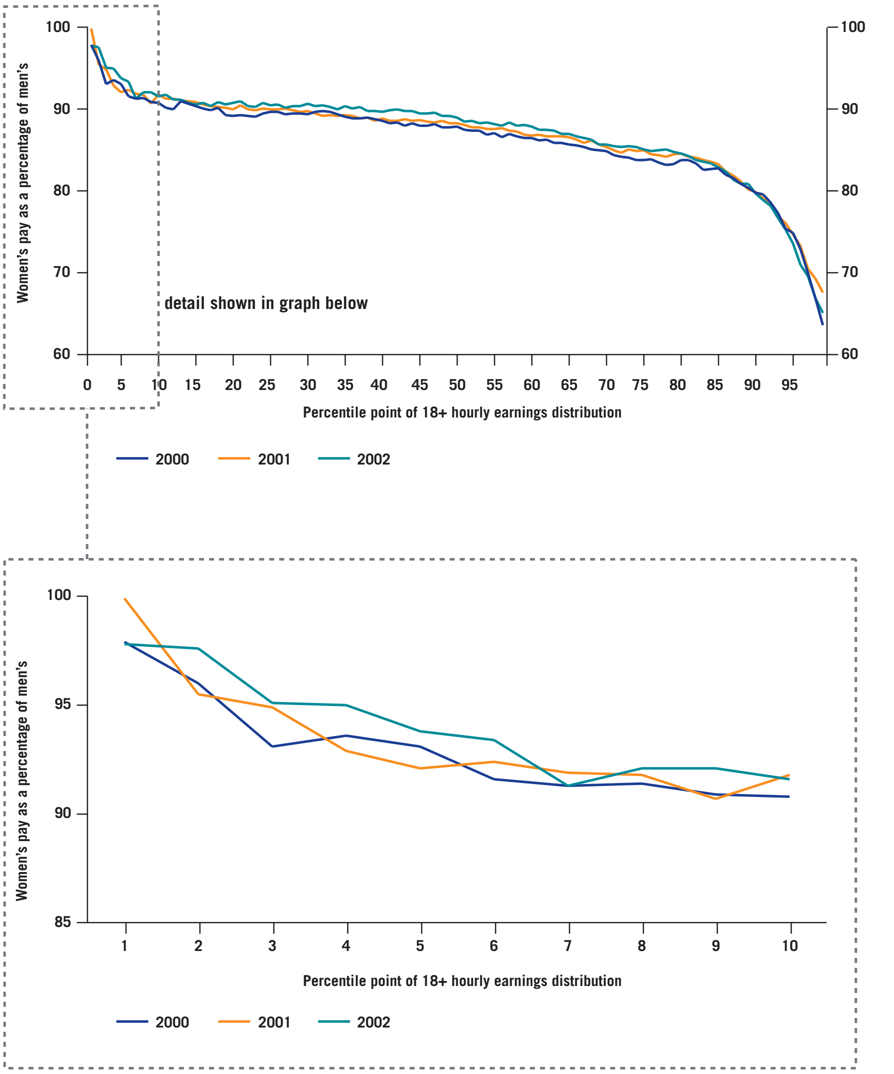
Low Pay Commission Research

IDS reported that in their previous research carried out for us (IDS (2000)), most medium and large retailers managed to accommodate increases in the NMW without much additional cost to their pay bill. However, the increase from October 2001 had more of an impact on the sector. The research shows that companies have responded to the 10.8 per cent increase in the minimum wage in a number of ways including: 'bottom-weighting' pay increases; giving a general increase from the usual Spring or Summer anniversary date, followed by 'top-up' from 1 October 2001; deferring the annual pay review until 1 October 2001; and abolishing induction rates.

IDS, 2002a. *Report to the Low Pay Commission on the Impact of the National Minimum Wage*

widening of the gap was largely the result of stronger growth in men's earnings in very high-paid occupations and, as Figure 2.9 shows, the gender pay gap narrowed at virtually all percentile points up to the 83rd. To look at the effect of the minimum wage on the gender pay gap we need to focus on differences in male and female earnings at the bottom of the pay distribution. The highlighted section of the figure shows a significant narrowing of the gender pay gap after the second percentile, showing that the minimum wage is making a difference at this level of earnings. For all women the minimum wage rate of £4.10 per hour is at the fifth percentile, and for men it is at the second percentile.

Figure 2.9
Women's Pay as a Percentage of Men's by Percentile, All Employees Aged 18 and Over, April 2000–2002



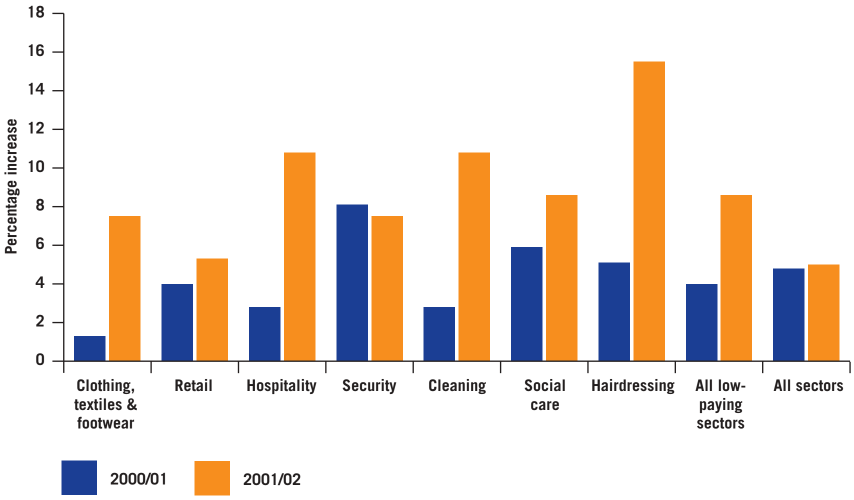
Source: Grossed NES, April 2000–2002.

2.28 To look at the pay gap for workers with a work-limiting disability and for ethnic minority workers we need to use the LFS data. We have noted previously that disabled employees are generally more likely than non-disabled employees to be low-paid. In Spring 2002 the lowest decile hourly pay rate for main jobs of disabled employees was £4.30 compared with £4.49 for non-disabled employees. Between 2001 and 2002 the pay gap for lowest decile disabled and non-disabled employees narrowed by one percentage point. Disabled workers' pay as a proportion of non-disabled workers' pay rose from 94.7 per cent to 95.7 per cent at this point in the earnings distribution.

2.29 We noted previously that although ethnic minority employees were not over-represented among the low paid in 2001, some groups – in particular Pakistani/Bangladeshi employees – were more likely to be low-paid, and this is still the case. Although sample sizes are small, the lowest quartile hourly rate of pay for Pakistani/Bangladeshi employees in main jobs increased from £4.27 in Spring 2001 to £4.77 in Spring 2002. Pakistani/Bangladeshi workers' pay as a proportion of white workers' pay rose from 84.2 per cent to 93.2 per cent at this point in the earnings distribution.

2.30 Relative movements in lowest decile earnings by sector also reflect the 'concertina' effect noted earlier. In 2000/01 increases in lowest decile earnings were 4 per cent across the low-paying sectors identified in Figure 2.10, and 4.8 per cent across all sectors. The largest increases in 2000/01 were in security (8.1 per cent) and social care (5.9 per cent). Other sectors such as hospitality, cleaning, and clothing, textiles and footwear saw changes of less than 3 per cent. In 2001/02 this was reversed with low-paying sectors seeing faster growth in lowest decile earnings than all sectors – 8.6 per cent compared with 5 per cent overall. The largest increases were in hairdressing, cleaning and hospitality.

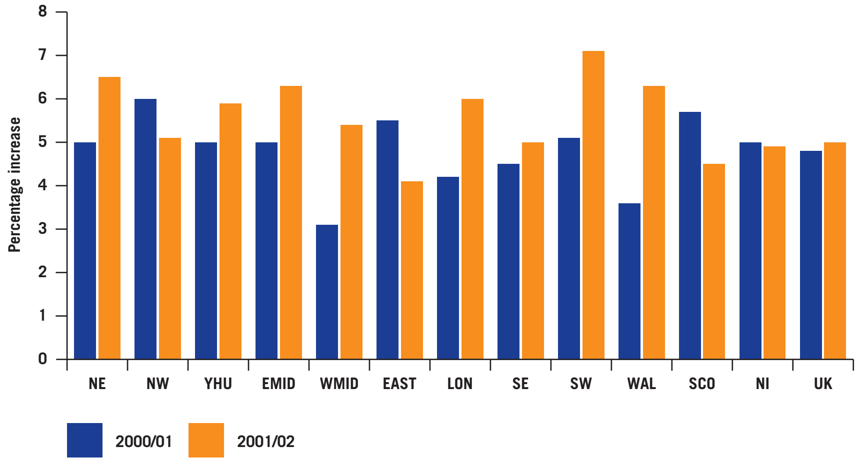
Figure 2.10
Increase in Lowest Decile Earnings for Employees Aged 18 and Over in Low-paying Sectors, 2000–2002



Source: Grossed NES, April 2000–2002.

2.31 As Figure 2.11 shows, the minimum wage has also had an impact on regional variations in earnings. The variation in lowest decile earnings by region as a proportion of lowest decile earnings in the UK as a whole has generally narrowed since the minimum wage was introduced, indicating a narrowing of the regional pay gap at this level of earnings. This narrowing continued, but at a slower pace, during 2001/02. The increase in lowest decile hourly earnings across the UK as a whole was 4.8 per cent in 2000/01 and 5 per cent in 2001/02. The highest increases between 2001/02 were in the South West, North East, East Midlands and Wales, whilst lowest decile earnings rose less quickly in the East, Scotland and Northern Ireland than in the UK as a whole. The significant increases in the traditional low-paying regions are likely to be related to the minimum wage. In other regions, lowest decile earnings are significantly above the minimum wage, and are more likely to be driven by the tight labour market and other factors.

Figure 2.11
Increase in Lowest Decile Earnings for Employees Aged 18 and Over by Region, 2000–2002

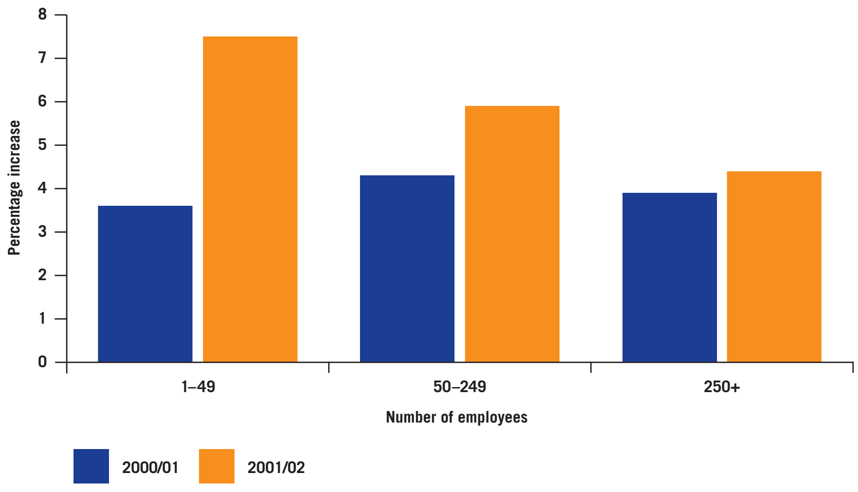


Source: Grossed NES, April 2000–2002.
Note: Government Office Regions shown for England.

2.32 Despite the aggregate data showing a slight narrowing of the regional pay gap, significant variations in earnings do exist, and this was reflected in the evidence we received. The Textile Services Association reported that the impact of the minimum wage was felt most in the non-metropolitan areas of England, Scotland and Wales. They argued that for employers in these areas the National Minimum Wage is the starting rate of pay whereas in larger conurbations firms had to pay significantly above the minimum wage to attract staff. IDS (2002a) reported that firms in the retail sector were increasingly operating zonal pay structures to accommodate the various pay pressures that exist around the country. Hull Cityventure Ltd reported that even traditional low-paying areas such as Hull have pockets of higher pay where 'labour market forces within the sub-region have determined pay rates more than the NMW has'.

2.33 The minimum wage has also had an impact on variations in earnings between small, medium and large firms, as Figure 2.12 shows. In 2000/01 employees in small firms had the smallest increase in lowest decile earnings (3.6 per cent compared with 4.3 per cent in medium and 3.9 per cent in large firms). However, the pattern changed in 2001/02 with lowest decile earnings of employees in small firms increasing by 7.5 per cent – another example of the 'concertina' effect. Earlier we saw that small firms had the highest proportion of employees that stood to benefit from the October 2001 uprating and this is reflected in these results.

Figure 2.12
Increase in Lowest Decile Earnings for Employees Aged 18 and Over by Size of Firm, 2000–2002



Source: Grossed NES, April 2000–2002.

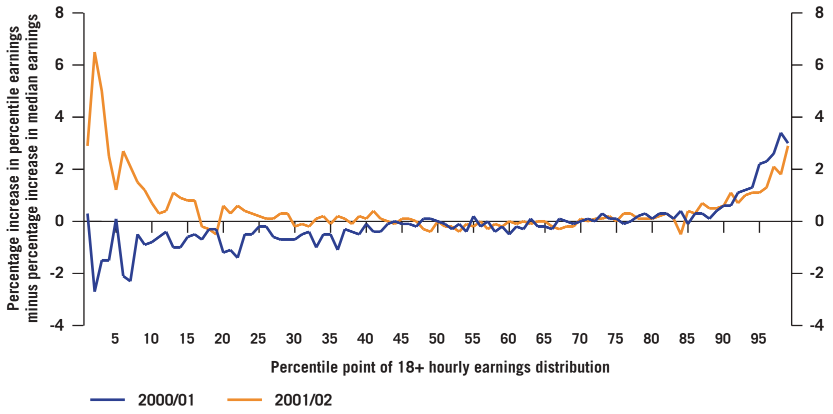
Differentials

2.34 The impact of the minimum wage on differentials is important for two reasons. First, it affects the number of people who might have above-average increases in pay and who therefore indirectly gain from the minimum wage. Second, it affects firms' total pay bills and total earnings across the economy, with potential implications for inflationary expectations. The higher up the earnings distribution the differential effect bites, the greater the number of people gaining from higher wages, but the higher the cost to firms and the greater the danger of cost-push inflation.

2.35 We noted in our third report that the impact of the introduction of the minimum wage upon differentials had been contained and, although some sectors were affected more than others, there did not appear to be a continuing effect in the years after the introduction. Average increases at the bottom of the earnings distribution for 1999/2000 were lower, in percentage terms, than in the previous year. The pattern of differentials in the two years was quite similar, with higher than average increases up to around the tenth percentile in 1998/99, and around the eighth percentile the following year. We concluded in our third report that the impact on differentials in 1999/2000 petered out at around the 40th percentile (£6.20 per hour at 1999 levels).

2.36 We now have data from two further years from which to analyse the impact of the minimum wage on the earnings distribution. Figure 2.13 shows the difference in earnings increases at each percentile point compared with the median increase in 2000/01 and 2001/02. These cover the small 2000 uprating to £3.70/£3.20 and the larger October 2001 uprating to £4.10/£3.50 respectively. The impact of the October 2001 uprating is similar to the pattern of the introduction of the National Minimum Wage that we noted in our third report. The direct impact is seen in the first two percentiles with employees here moving to the new minimum. Above this point earnings increases up to the 16th percentile (£5.00 per hour at 2002 levels) are higher than average but lower than the direct minimum wage impact, leading to a squeezing of differentials. Increases between the 16th and 41st percentiles fluctuate around the median, with average rises here only just above the median increase. But the striking feature of these data is that earnings increases in 2000/01, covering the small minimum wage increase, are generally lower at the bottom of the distribution than increases further up the distribution. This reverses the pattern seen at the initial introduction of the minimum wage and at the time of the relatively large 2001 uprating, and is a graphic demonstration of the 'concertina' effect noted earlier.

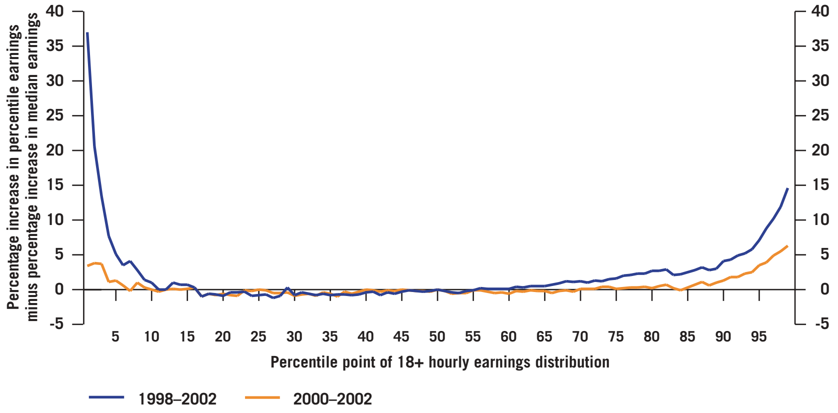
Figure 2.13
Increase in Hourly Earnings Minus the Increase in Median Earnings by Percentile for Employees Aged 18 and Over, 2000/01 and 2001/02



Source: Grossed NES, April 2000–2002.

2.37 Because of the very different pattern of differentials in these two years, we examined the response of earnings across the distribution over a longer time period to assess the overall minimum wage impact. The data are shown in Figure 2.14, covering the period from introduction of the minimum wage to the present (1998–2002), and covering the October 2000 and 2001 upratings together (2000–2002).

Figure 2.14
Increase in Hourly Earnings Minus the Increase in Median Earnings by Percentile for Employees Aged 18 and Over, 1998–2002 and 2000–2002

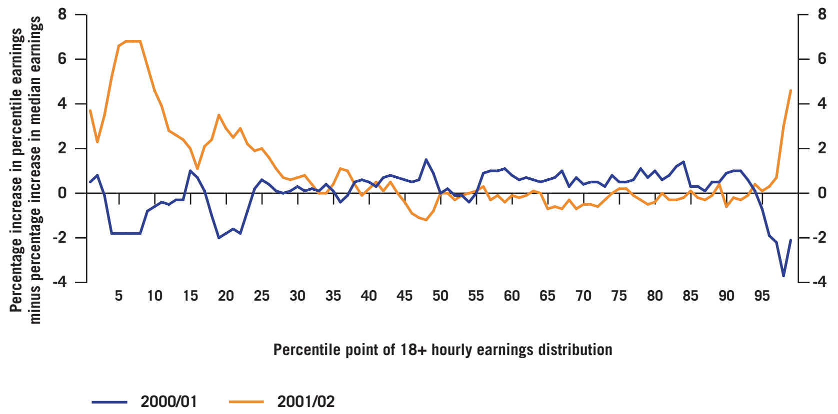


Source: Grossed NES, April 1998–2002.

2.38 When looking over these longer time periods, the impact of the minimum wage is much smoother and the underlying impact on differentials lower. Over the period 1998–2002 (spanning introduction and upratings), earnings increased by more than the median up to around the 16th percentile (£5.00 per hour at 2002 levels). The October 2000 and 2001 upratings together (shown by data over 2000–2002) have also produced an effect up to around this point, but the increases are much lower and between the 11th and 16th percentiles are only just above the median increase.

2.39 To examine the impact of the more recent upratings further, we looked at differentials in the low-paying sectors only. Increases compared with the median for 2000/01 and 2001/02 are given in Figure 2.15.

Figure 2.15
Increase in Hourly Earnings Minus the Increase in Median Earnings by Percentile for Employees Aged 18 and Over in Low-paying Sectors, 2000/01 and 2001/02



Source: Grossed NES, April 2000–2002.

> *The uprating of the NMW does have a knock-on effect on differentials because they are tight and employers must reward higher qualifications and greater responsibility. Staff in the social care sector have historically been undervalued, yet they remain highly committed to the work they do. However, when pay structures flattened in the early days of the NMW, some staff refused to take on more complex and responsible jobs, and recruitment problems increased. This prompted employers to re-introduce grade differentials.*
>
> **GMB evidence**

2.40 The figure shows the same pattern of differentials in low-paying sectors as across the economy as a whole in the two years: the effect of the small uprating in 2000 is to produce lower increases at the bottom of the distribution, and higher increases further up; whilst the impact of the 2001 uprating follows the pattern of introduction, with higher increases at the lower end of the distribution. A striking feature of this figure is the symmetry of earnings response: employees who received low percentage increases in 2000/01 received higher increases the following year and vice versa. This suggests that one effect of the pattern of a relatively large increase in the minimum wage followed by a much smaller increase is to drive up earnings at the bottom of the distribution in the year of a significant increase, which is then compensated for in the following year, when wage increases for the low paid fall behind average increases. The impact on differentials, over both a one-year and a two-year period, is contained to at most the 44th percentile of the low-paying sectors distribution in 2001/02, which corresponds to the same hourly rate, £5.00 per hour, suggested by the overall earnings distribution.

2.41 Other evidence we have received is consistent with this broad picture. IDS (2002a) report that, following the 2001 uprating, the increase for employees at the lowest pay rate was substantially higher than that for employees at higher grades, leading to considerable compressing of differentials. Where this has happened, some employers have reported the new pay structure to be causing difficulties, but most have not. Some employers have conceded that they will need to re-examine the issue of differentials at a later date. Evidence on differentials in specific sectors is considered in more detail in Chapter 3, but it is notable that many employers reported a squeezing of differentials in 2001/02 in order to contain costs. Hospitality sector employers said they were using the small minimum wage increase in 2002 to restore some of the previous year's imbalance in pay structures. This suggests a pattern of differentials in 2002 along the lines of that seen in 2000/01, where employees towards the bottom of the distribution receive smaller than average increases.

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IDS reported to us that in a large number of the 2001 settlements they monitored among firms in the low-paying sectors, the lowest rate was raised by a much larger percentage than other grades. For example, Somerfield raised the rates for the lowest three grades by 6.9 per cent. This placed all employees in these grades, from cleaner to checkout assistant, on the same rate of pay, and the company said it would re-examine the issue of differentials at a future date.

IDS, 2002a. ***Report to the Low Pay Commission on the Impact of the National Minimum Wage***

2.42 As well as the aggregate data presented above, we also have evidence from our survey of employers in low-paying sectors, covering firms most affected by the minimum wage. Appendix 4 sets out the survey methodology and sample results in more detail. As Table 2.4 shows, the survey evidence suggests that differential restoration effects extend to a higher level than that suggested by the aggregate earnings data. Across the sectors surveyed, firms reported that, on average, the highest rate increased was £5.84 per hour. There is not much difference across sectors, but business services and childcare had the highest median rates and leisure the lowest. In two-thirds of firms that increased rates for staff above the minimum, the highest rate of pay that was increased was less than £6.50 per hour. The difference between the aggregate data and our survey results may be due to other changes occurring within firms, and the difficulty some employers may have in distinguishing minimum wage from other effects.

Table 2.4 Highest Hourly Rate Increased – Median Reported Figure

Sector	Median, £ per hour 2002 levels
Hospitality	5.88
Social care	5.85
Textiles	5.89
Hairdressing	5.90
Retail	5.75
Childcare	6.00
Business services	6.00
Leisure	5.60
All sectors	5.84

Source: LPC Survey, May 2002.

Base: All firms affected by the October 2001 uprating of the National Minimum Wage in any way that increased pay rates for higher-grade staff.

2.43 In summary, our analysis suggests that the impact of the large increase in the National Minimum Wage in October 2001 was to squeeze differentials, with increases for employees at the lowest rates of pay substantially higher than for employees in higher grades. This reverses the pattern found in the previous year where the lowest paid received smaller than average increases. Over a two-year period the impact of the 2000–2002 upratings extends to at most the 16th percentile or around £5.00 per hour at 2002 levels. This is consistent with the picture across the low-paying sectors alone. There is some evidence, both from the quantitative data and from our programme of research and evidence gathering, that some employers have used the period of a small increase in the minimum wage to restore differentials. But the aggregate data suggest this is through lower than average increases for those towards the bottom of the earnings distribution rather than higher than average rises further up. Evidence of this is already emerging in some sectors for wage increases during 2002.

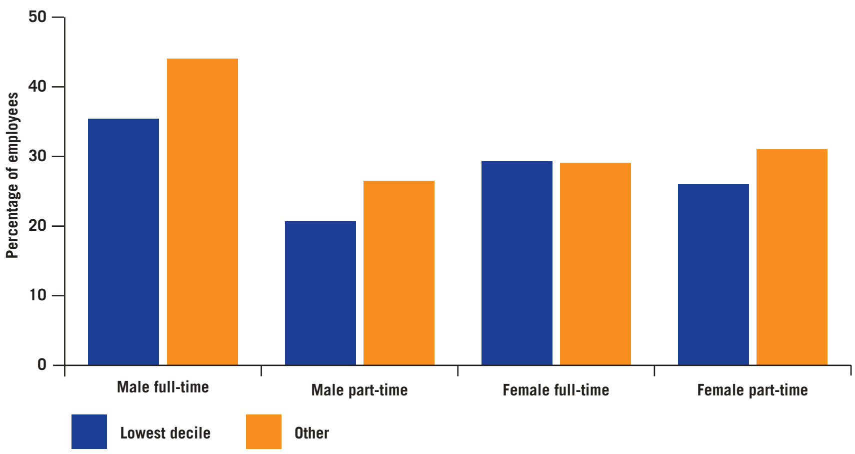
Composition of Pay

2.44 The definition of the minimum wage adopted in the National Minimum Wage Regulations allows employers some latitude in restructuring their pay and working arrangements to bring payments within the definition of pay for minimum wage purposes. Employers may agree with their employees to consolidate additional pay elements that do not count towards the National Minimum Wage into base pay so that they do count. In this context it should be noted that incentive pay can be counted towards the National Minimum Wage, whereas overtime pay cannot.

2.45 We have therefore been interested to see whether the definition of pay in the National Minimum Wage has had an impact upon the composition of earnings for low-paid workers. In our second report we said that the 'evidence at a sectoral level … shows that in general the implementation of the National Minimum Wage has gone very smoothly, and the definition of the wage has been easily accommodated by business'. Our third report confirmed this picture.

2.46 The latest overall picture on the composition of earnings for the low paid from the NES data is shown in Figure 2.16. The data continue to indicate no significant change. They show that low-paid workers are generally less likely to receive additions to basic pay than higher-paid workers. All low-paying sectors except cleaning have seen an increase in the percentage of the lowest paid receiving additions to basic pay from 2001 to 2002.

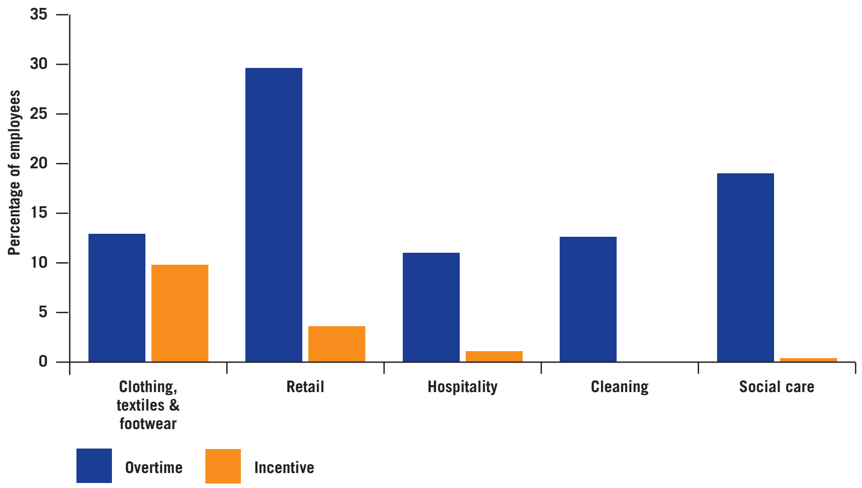
Figure 2.16
Employees in Receipt of Additions to Basic Pay, April 2002



Source: Grossed NES, April 2002.

2.47 Overtime payments remain the major additional earnings component for low-paid workers, followed by incentive pay and shift premia. The percentage of low-paid workers receiving overtime pay has increased since 2000. Between 2001 and 2002 there was a slight increase in the percentage of lowest decile workers in receipt of incentive pay. As illustrated in Figure 2.17, overtime pay is most significant in the retail and social care sectors. Incentive pay is only really important in textiles, clothing and footwear and, to a lesser extent, retail.

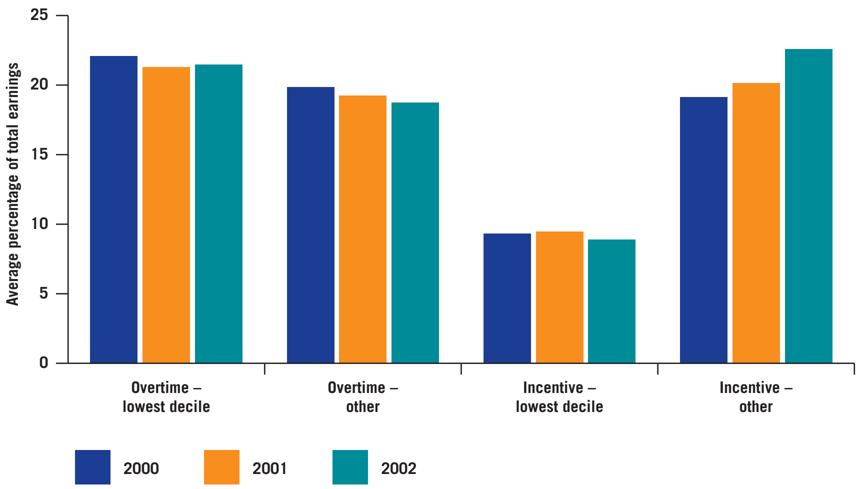
Figure 2.17
Percentage of Employees in the Lowest Decile of Hourly Earnings in Receipt of Overtime and Incentive Payments in Low-paying Sectors, April 2002



Source: Grossed NES, April 2002.

2.48 Figure 2.18 shows the contribution of overtime and incentive pay to total earnings for those who receive these payments for both the lowest decile and other workers. As a proportion of total earnings, overtime pay has fallen slightly since 2000. While incentive pay grew for higher-paid workers, it remained static for the lowest-paid workers.

Figure 2.18
Average Contribution of Overtime and Incentive Pay to Total Pay for Employees Who Receive Them, April 2000–2002



Summary on Earnings

2.49 Throughout this section we have noted examples of the 'concertina' effect of the minimum wage on earnings. The period of the small rise in the minimum wage (2000/01) was associated with increases in earnings of the lowest paid falling behind those of workers further up the distribution, whilst the opposite was true for 2001/02, spanning the period of the larger minimum wage uprating. This pattern was repeated among groups and sectors most affected by the minimum wage. It was also clear in our analysis of differentials. This showed significant increases for employees at the lowest rates of pay following the October 2001 uprating, reversing the pattern of the previous year of below-average increases for these workers. Between 2000 and 2002 the overall impact on differentials is contained at or below the 16th percentile (£5.00 per hour at 2002 levels). Evidence is emerging that firms in some sectors are restoring differentials during 2002, with below-average increases for workers towards the bottom of the distribution. Our micro-data showed that some firms found the significant increase in 2001 difficult to manage, with consultation and research evidence suggesting this had more of an impact than introduction. But this was not supported by the aggregate data, and may be due to differences in employers' expectations of minimum wage increases.

Employment, Unemployment and Participation

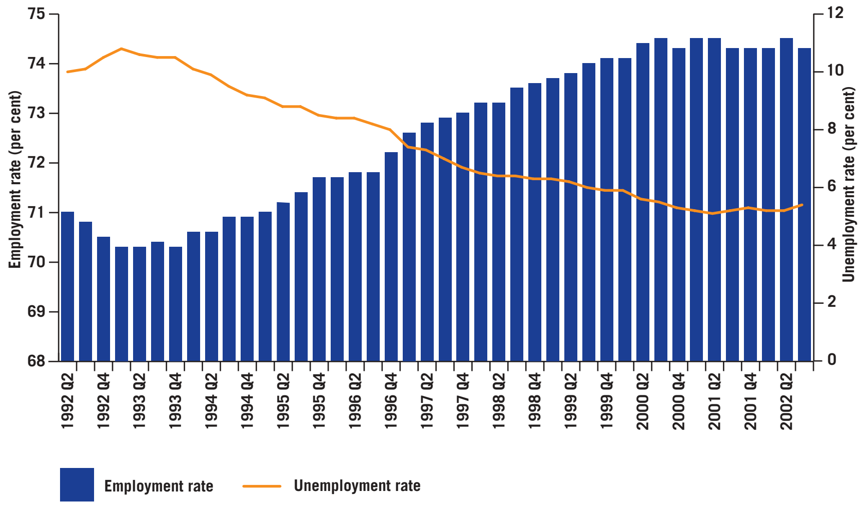
2.50 In this section we analyse the impact of the minimum wage on employment, unemployment and labour market participation. Our focus is on the October 2001 uprating, but we also review new evidence on the impact of the initial introduction of the National Minimum Wage. The extensive academic research on the effect of minimum wages on employment often produces conflicting results. Because any negative employment impact is more likely to be found among those groups and sectors most affected, our analysis has paid particular attention to these areas.

2.51 We structure this section by first analysing trends in employment and unemployment and then examining labour market participation. People outside the labour market, that is not in work and not seeking and/or available for work, are classified as 'inactive'. This group comprises a potential source of labour supply, and inflows into employment have increasingly come from this group rather than from the unemployed. In the section on labour market participation we consider the evidence on the minimum wage providing an incentive for the inactive population to move into work.

Overall Trends in Employment and Unemployment

2.52 The National Minimum Wage was introduced in a tight labour market, with employment rising and unemployment falling. Figure 2.19 shows that the labour market has eased somewhat since then. The working age employment rate has been more or less flat for the last two years, although the employment level has increased because there are more people in the labour market. Similarly, after being on a downward trend since 1992, unemployment for those of working age started to edge up in Spring 2001 but at 5.3 per cent in October 2002 remains at historically low levels.

Figure 2.19
Trend in Working Age Employment and Unemployment Rates, 1992–2002



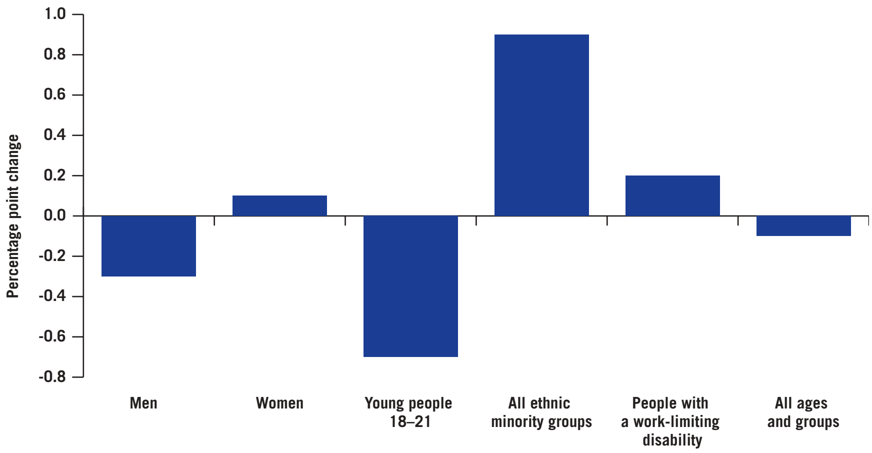
Source: LFS, 1992–2002.

2.53 In the year since the October 2001 uprating the employment rate for those of working age has risen marginally to 74.6 per cent whilst the number of people in employment rose by nearly 200,000. During this period the unemployment rate has edged up from 5.2 to 5.3 per cent, representing an extra 25,000 people in unemployment.

Analysis of Groups and Sectors

2.54 In order to examine the impact of the 2001 uprating on individuals' employment prospects it is important to focus on those groups most at risk of adverse effects – women, part-timers, young people, disabled people and some ethnic groups. At this more detailed level the LFS data are not regrossed to Census 2001 data, as are the data in Figure 2.19. Figure 2.20 shows the labour market performance of these groups in the period covering the October 2001 uprating. The figure compares data in the year to Summer 2001 (September 2000-August 2001) with the following year, averaging over four quarters' data in order to take account of possible seasonal effects.

Figure 2.20
Change in Working Age Employment Rate of Different Groups, Autumn 2000-Summer 2001 Compared with Autumn 2001-Summer 2002



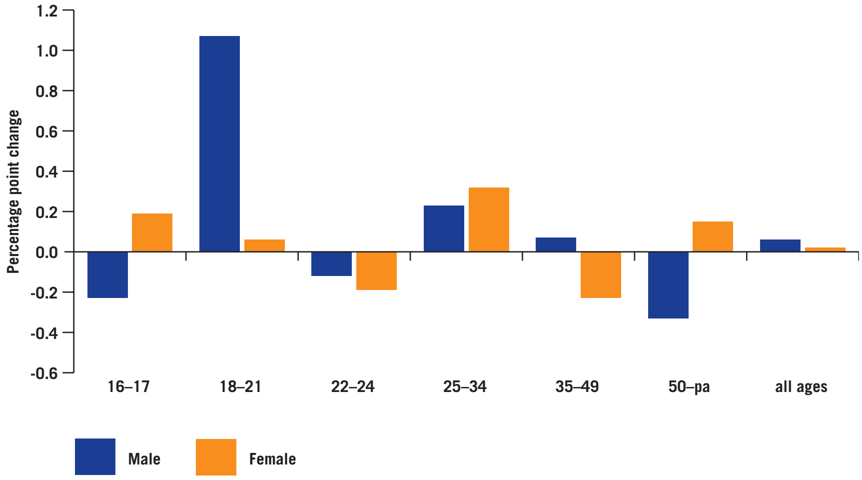
Source: LFS, Autumn 2000–Summer 2002.

2.55 These data show that in the year to Summer 2002 (i.e. mostly covering the post October 2001 uprating period), the employment rate among those of working age fell by 0.1 percentage points, but the number of working age people in work increased by nearly 160,000 as the working age population continued to grow. As Figure 2.20 shows, there was a sharper fall in the employment rate for men, which was partially offset by a rise among women. Ethnic minority groups and those with a work-limiting disability have fared better than average. The employment rate among ethnic minority groups rose by 0.9 percentage points, reflecting strong employment growth among Indian and Pakistani/ Bangladeshi groups. But another vulnerable group – young people – have fared worse than average, their employment rate falling by 0.7 percentage points over this period. Chapter 4 examines employment among young people in more detail.

2.56 Earlier in this chapter we noted that around two-thirds of beneficiaries of the 2001 uprating were individuals working in part-time jobs, the majority of them women. At Spring 2002 over eight million people worked part-time, representing around a quarter of all employment. In the year up to Spring 2002 the proportion of people working part-time rose marginally, with a fall among female part-timers more than offset by a rise among men working part-time. This rise in part-time working continues to reflect people choosing to work part-time rather than people accepting part-time jobs because they cannot find full-time posts. Among both men and women, the proportion of workers stating they did not want a full-time job rose, and the proportion stating they could not find a full-time job fell.

2.57 The trend in employment is mirrored to a large degree by the trend in unemployment. As mentioned above, after falling for much of the previous decade, unemployment started to rise marginally in the last year or so. To examine the response of unemployment to the October 2001 uprating, we have compared the average change in the unemployment rate by age in the year to Summer 2002 with the average over the previous year. This is shown in Figure 2.21.

Figure 2.21
Change in Unemployment Rates by Age, Autumn 2000-Summer 2001 Compared with Autumn 2001-Summer 2002

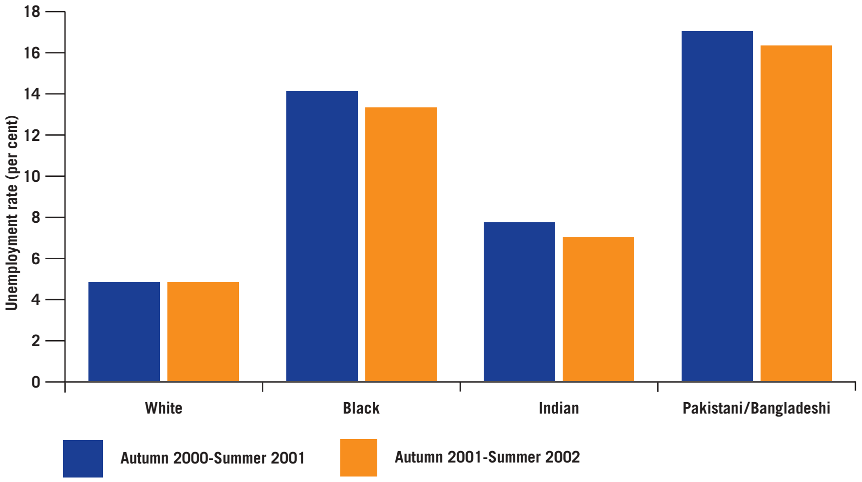


Source: LFS, Autumn 2000–Summer 2002.
Note: pa = pension age.

2.58 Men aged 18–21 experienced the biggest increase in their unemployment rate over this time. This rise has been concentrated among those not in full-time education, and has been accompanied by a fall in employment of this group. All other age groups apart from 25–34 year olds saw a fall in their unemployment rate, although there were differences in changes for men and women, with women on the whole faring better since the October 2001 uprating. Chapter 4 considers whether the minimum wage might be causing a substitution effect away from young people and in favour of older age groups.

2.59 We mentioned above that employment growth among ethnic groups has been stronger than average. Figure 2.22 shows that this is also reflected in their unemployment rates. During the period of the 2001 uprating, the unemployment rates of all the ethnic minority groups shown fell whilst that of white people increased.

Figure 2.22
Unemployment Rates of Ethnic Groups, Autumn 2000-Summer 2001 Compared with Autumn 2001-Summer 2002



Source: LFS, Autumn 2000–Summer 2002.

2.60 Overall, the above analysis shows that labour market conditions have weakened slightly since our last report. Those groups most likely to be affected by the minimum wage – women, ethnic minority groups, disabled people and those working part-time – have mostly experienced stronger than average employment growth in the year following the October 2001 uprating. The main exception to this is young people, and in particular young men, who have fared worse than average over this period.

Research Results

2.61 Analysis of the aggregate data alone, however, does not tell us how those directly affected by the minimum wage have fared compared with other groups whose wages are above the minimum wage. Since our last report, three new pieces of research have modelled the impact of the minimum wage on employment: Stewart (2003) extended the research we commissioned for our third report (Stewart (2001)) to cover the 2000 and 2001 upratings; Machin *et al*. (2002) examined the employment impact in care homes; and Stewart (2002a) used the geographical variation in wages to examine the regional employment impact. We consider the results from each of these studies in turn.

2.62 We commissioned Stewart (2003) to re-examine the evidence of the impact of the minimum wage on aggregate employment using the latest data. The original research is extended in several ways: it is now possible to examine the impact of the 2000 and 2001 upratings to the minima; the research takes account of individuals' position in the earnings distribution relative to the minimum wage (the 'wage gap') – that is, it distinguishes between those whose wage needed to be increased a lot due to the minimum wage and those who only needed a small increase, and compares them with the control group above the minima; and it takes account of factors specific to certain sectors and regions which might affect employment in different labour markets.

2.63 As last time the group directly affected by the minimum wage is compared with a similar group from above the minimum, which is used as a counterfactual. The difference in employment rates between the two groups is compared across periods that cover the introduction of the minimum wage and its upratings, and those that do not. Factors other than the minimum wage that affect the probability of employment are again controlled for. The impact of the minimum wage and the upratings is tested using both the LFS and NES datasets, and using various specifications of the model. Two basic approaches are used: comparing the employment response of individuals directly affected with those further up the earnings distribution and testing the difference in their employment probabilities over time (the 'employment probability' approach); and secondly, comparing how much individuals' wages needed to be raised due to the minimum wage with those not directly affected (the 'wage gap' approach). The results are presented for four groups: adult and young men and women, although in some cases sample sizes did not allow for the full breakdown. Detailed results of this research are given in Table 2.5.

Table 2.5 Summary of Results From Research on Employment Effects of the National Minimum Wage, Stewart (2003)

Analysis	Data	Results
Introduction of National Minimum Wage	LFS	Estimated effects insignificant for all specifications, for employment probability and wage gap. No adverse employment effect found for all groups.
	NES	Majority of estimates are negative but insignificant. Negative wage gap estimate for adult men under one specification is the only one that is marginally significant.
2000 uprating	LFS (young men and women considered as one group due to small sample numbers)	Evidence that differential impact of the overall slowdown in employment growth may bias estimates that do not allow for this. When this is controlled for, the estimates showed no significant negative employment effects. Estimates that do not allow for this are also largely insignificant. Exception is wage gap estimate for adult women, but this result is sensitive to choice of wage variable.
	NES	Estimates that control for differential impact of overall slowdown showed no significant negative employment effects. When this is not allowed for, some evidence of negative impact for men, but only with wage gap estimates. No adverse impact with employment probability approach.
2001 uprating	LFS (adult men and women only)	Estimates that control for differential impact of overall slowdown showed no significant negative employment effects. When this is not allowed for, weak evidence of adverse effect found for adult women, but for wage gap estimates only, and sensitive to wage variable used.
	NES	Not available.
Other controls		
Time and sector-specific growth rates	LFS	Adding these controls had no impact on results.
High-growth versus low-growth sectors	LFS	No support for hypothesis that the minimum wage bites more in sectors with low growth than in those with high growth.
Sector disaggregation	NES	No compelling evidence of a negative employment impact found. Some evidence of negative effect for female catering staff, but this is sensitive to the specification used. No evidence of a negative impact in retail, for cleaners, childcare or care assistants.

2.64 The results suggest that there is little evidence that the introduction of the National Minimum Wage had an adverse impact on the probability of subsequent employment of those affected. The estimates of the 2000 uprating are more mixed. There is some evidence of a negative effect, mainly for adult women, but it is sensitive to the choice of wage variable and estimation method and was only significant in one of the four specifications. Moreover, there is evidence that the differential impact of the slowdown in employment growth (which may affect low-paid workers more than those higher up the earnings distribution) biases the estimates. Once this is controlled for the results are insignificant. Analysis of the impact of the 2001 uprating is restricted by the available data, but initial results largely support the view that there was no adverse impact.

2.65 The second study, by Machin *et al*. (2002), focuses on the impact of the National Minimum Wage in residential care homes in Britain. They surveyed firms in this sector both before and after the introduction of the minimum wage, enabling them to examine changes in wages and employment over this period. The study examines employment in this sector only, so it does not capture falls in employment in this sector that are offset by rises elsewhere. This sector was chosen because the chances of finding employment effects from the minimum wage might be higher here for several reasons. First, the residential care sector is one of the lowest-paying sectors in the UK. Second, the sector consists of a large number of small firms providing a similar service, making it highly competitive. Third, a large proportion of residents have their fees capped by the Government, which makes it more difficult to pass on higher wage costs in the form of higher prices.

2.66 Machin *et al*. (2002) examine the relationship between the change in employment in each firm and the extent to which the minimum wage has an impact upon the wage structure within the firm. The greater this change, the higher the expected impact on employment. They use regression analysis to control for other characteristics in the firm. The study reports two different measures of employment – total hours and total employment; and two different measures of the impact of the minimum wage – the proportion paid below the minimum and the wage gap (the increase in wages due to the minimum wage as a percentage of the wage bill).

2.67 Their results show that those firms affected most by the introduction of the minimum wage are more likely to experience falls in employment and hours. Elasticities of employment with respect to the change in wages are in the region of –0.2 to –0.4 in this sector, depending on the precise specification used. This means that a 10 per cent increase in wages leads to a 2 to 4 per cent fall in employment. As we noted earlier, this is a very unusual sector that is most at risk of adverse employment effects. The study finds no evidence that the minimum wage has affected home closures.

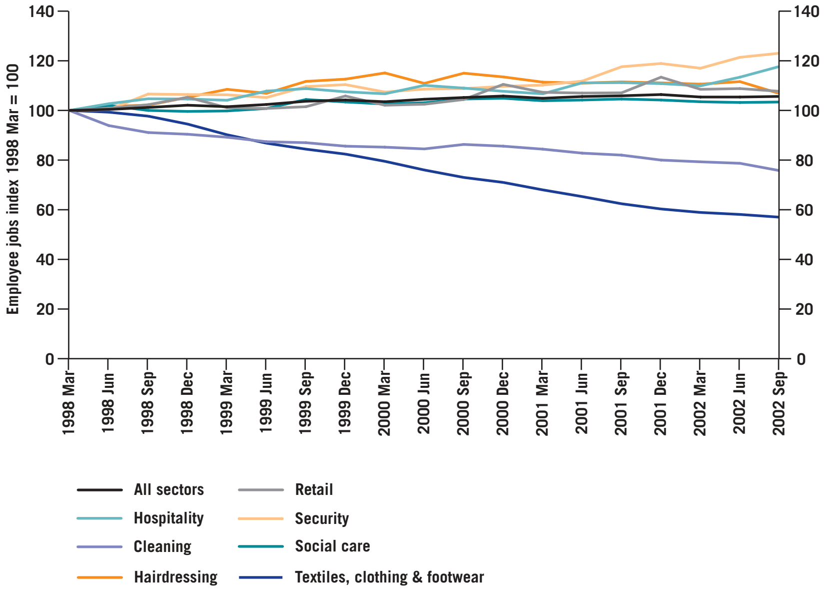
2.68 In another study, Stewart (2002a) evaluates the impact of the introduction of the National Minimum Wage by analysing the geographical variation in wages, which means that the minimum wage 'bites' at different points in the earnings distribution around the country. The results indicate that, although the minimum wage had differential wage-distribution effects across the 140 areas of the country, employment growth after its introduction was not significantly lower in areas of the country with a high proportion of low-wage workers, whose wages had to be raised to comply, compared with that in areas with a low proportion of such workers.

2.69 These are valuable pieces of research which add to our understanding of the impact of the minimum wage on employment in the UK labour market. The results from Stewart (2003) show that the minimum wage has had no strong adverse impact on employment, particularly when the impact of the growth slowdown on workers at different points of the earnings distribution is taken into account. Even where negative effects are found, they are confined to specific groups and specifications and the size of the effects is modest. The Machin *et al*. (2002) study is an important piece of research into a sector particularly vulnerable to adverse employment effects of the minimum wage. But this study relates to one sector, and does not therefore take account of offsetting rises in other sectors. Even if these employment effects were replicated in all low-paying sectors, the effect on aggregate employment would be minimal.

Sectoral Findings from Surveys and Consultation

2.70 In addition to looking at aggregate data and detailed research analysis, we have sought to understand how the 2001 uprating has affected different sectors, and how it has been perceived by firms. Recent trends in employee jobs by sector are shown in Figure 2.23, which is based on data drawn from the employer-based surveys published by the ONS. The data show that between September 2001 and September 2002 employment across the low-paying sectors as a whole rose by over 60,000. This represents an increase in employment across the low-paying sectors of over 1 per cent compared with a fall of 0.3 per cent across all sectors. But there are some differences among the low-paying sectors, with strong growth in hospitality and security but falls elsewhere, notably in textiles and clothing and cleaning. Chapter 3 explores trends in these sectors in more detail.

Figure 2.23
Employment Change in Low-paying Sectors, 1998–2002

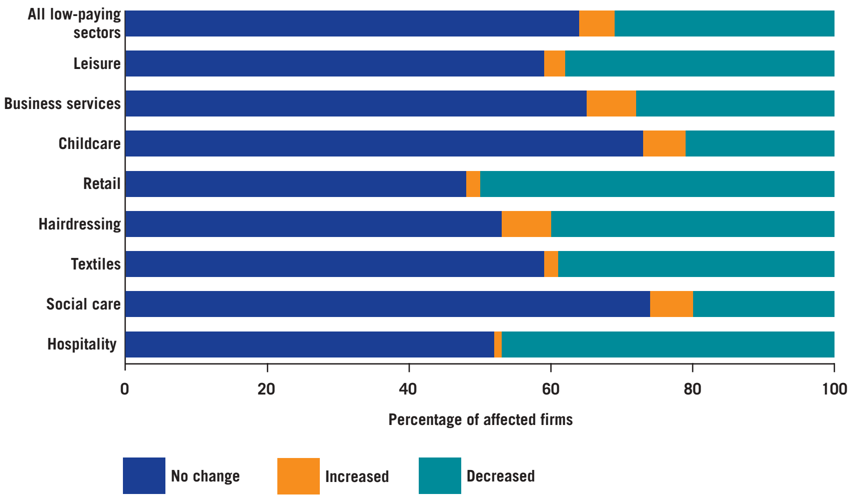


Source: ONS employee jobs series, 1998–2002, GB.
Note: Data are not seasonally adjusted.

2.71 We also asked firms in our own survey whether they adjusted employment following the October 2001 uprating. As we explain in Appendix 4, the survey was targeted at those sectors most likely to be affected by the minimum wage. We also found that those responding to the survey were more likely to be affected than those not responding. The responses reported below are therefore not representative of all firms, and are biased towards those most affected.

2.72 Figure 2.24 shows that overall the vast majority of firms, nearly 65 per cent of those affected, reported no change in staffing following the October 2001 uprating. Just over 30 per cent of those affected said they reduced staffing levels whilst 5 per cent said they increased them. But these represent only 14 per cent and just over 2 per cent respectively of all respondents to our survey. There was no large variation by sector, but the childcare and social care sectors were least likely to report reductions.

Figure 2.24
Change in Staffing Levels as a Result of the October 2001 Uprating of the National Minimum Wage



Source: LPC Survey, May 2002.
Base: All firms affected by the October 2001 uprating of the National Minimum Wage in any way.

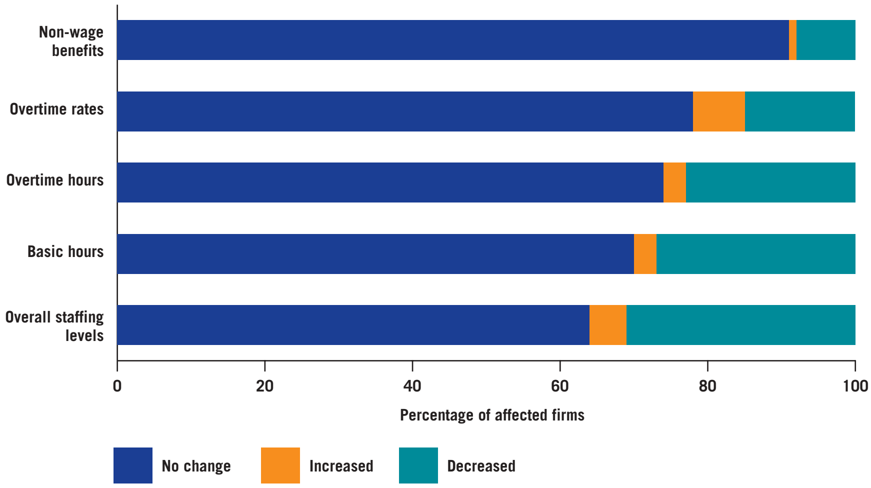
2.73 Reducing staffing levels is just one way in which firms can reduce labour costs. Other less drastic measures include reducing basic and overtime hours and rates, and cutting back on non-wage benefits. As Figure 2.25 shows, our survey found that firms were less likely to undertake these measures. Around 25 per cent of firms affected by the 2001 uprating reported reducing hours and nearly 15 per cent said they reduced overtime rates. Firms in retail and hospitality were most likely to reduce hours, and firms in retail and hairdressing to cut overtime rates. Perhaps surprisingly, large firms reported they were more likely to take such action than smaller firms.

Low Pay Commission Research

We find very little evidence of an adverse impact of the NMW on employment. Around one in three of the case-study firms experienced falling employment during the period 1988–2002, but this is mainly explained by the complex relationship between product market strategy, changing pressures of competition and profitability. Some firms cut jobs as part of a move into niche markets, some closed establishments to boost profit margins and others reduced their workforce in direct response to declining product demand. Only one firm – a knitwear factory – stated that the NMW was a direct factor leading to job cuts and, ultimately, to closure of the business.

Grimshaw and Carroll, 2002. *Qualitative Research on Firms' Adjustments to the Minimum Wage*

Figure 2.25
Change in Employment and Working Hours as a Result of the October 2001 Uprating of the National Minimum Wage



Source: LPC Survey, May 2002.
Base: All firms affected by the October 2001 uprating of the National Minimum Wage in any way.

Salons have already made such changes that are possible to working arrangements such as reduced hours, flexible working and fewer employees to accommodate the National Minimum Wage. Other measures … are not necessarily suitable or workable in a firm with less than five workers.

National Hairdressers' Federation and Hairdressing Employers Association evidence

2.74 The CBI evidence to us showed that most employers are not directly affected by the minimum wage. Only 25 per cent of companies in its annual survey, which focused on firms in low-paying sectors, reported taking action as a result of the October 2001 uprating, and less than one in five (17 per cent) reported that it had a significant effect on basic pay. But the responses suggested that the October 2001 uprating had more impact than the initial introduction of the minimum wage. Twelve per cent of firms taking any action (or 3 per cent overall) reported making job cuts as a direct result of the uprating, compared with the 8 per cent of such firms (1 per cent overall) following introduction. Firms reporting cuts were primarily those in hospitality, leisure, textiles and social care.

2.75 In its evidence to us, the British Retail Consortium focused on the difference in impact of the uprating on small and large firms. Its survey found that whilst 5 per cent of large businesses had reduced staff in response to the October 2001 uprating, 17 per cent of smaller ones had done so. A slightly larger proportion had taken other measures to reduce labour costs such as recruiting fewer staff or cutting hours, although again there was a considerable difference between the proportions of large and small firms reporting these measures. Some of the evidence we received suggested that firms had already responded in many ways to the National Minimum Wage and that there was little leeway left to make further adjustments.

2.76 Several of the responses we received from our written consultation noted the combined impact of the Working Time Regulations and the National Minimum Wage, saying that a minimum wage coupled with a reduction in hours would leave those individuals it was trying to help no better off. We examined the aggregate data on working hours from the 2002 NES. The average number of paid hours of work for the lowest paid across all sectors has continued at around 27 per week, broadly unchanged over the past two years. But there are some differences across sectors. Since Spring 2000, both normal and total hours have fallen for the lowest paid in the clothing, textiles and footwear and security sectors, and increased in the cleaning sector. This latter effect is consistent with evidence we received from the cleaning sector.

2.77 We also commissioned Stewart and Swaffield (2002) to conduct research to test whether there was evidence of a reduction in working hours among low-paid employees following the introduction and subsequent upratings of the National Minimum Wage. They constructed a model to compare the change in hours of workers paid below the original National Minimum Wage rate or below the uprated levels with that of workers above the minima; the model then tested whether there was a significant difference between these two groups. The model controlled for factors associated with individuals' choice of hours. But this would not necessarily control for the fact that changes in hours could be a result of changes in individuals' preferences rather than the demand for labour on the part of firms. In order to check this, the research also tested employees' responses to hours preferences and satisfaction based on data from the British Household Panel Survey (BHPS).

2.78 The models used NES, LFS and BHPS data and were constructed over three time periods – the year after the National Minimum Wage was introduced; the year after the 2000 uprating; and up to six months after the 2001 uprating. The NES and LFS results suggest that there was no significant reduction in hours for young people or for adult women for each of the time periods considered. For adult men the results show that there was a significant reduction in hours in the periods following the introduction of the National Minimum Wage and the October 2000 uprating, but not the October 2001 uprating. But the results showed that adult women had significantly increased their hours after the introduction of the National Minimum Wage. It was not possible to model young people separately using the BHPS data due to small sample sizes.

Low Pay Commission Research

Salon owners who wished to maintain, rather than grow the scale of their operation often made only modest efforts to monitor or control business effectiveness (other than through price rises), to market the business to new clients or to manage employment creatively. The majority of respondents had made no changes to the opening hours of the salon because of the National Minimum Wage.

Druker *et al.*, 2002. *Report to the Low Pay Commission on the Impact of the National Minimum Wage on the Hairdressing Sector*

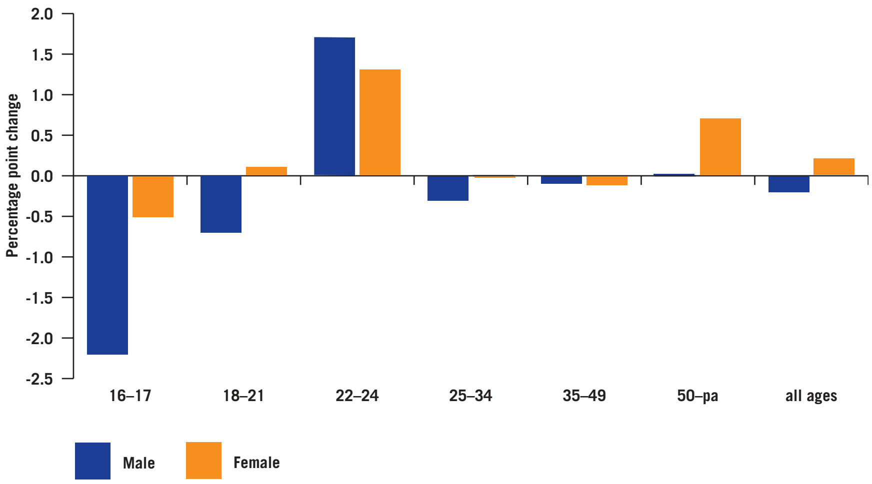
2.79 In general, our written consultation produced fewer reports of firms reducing staff numbers or hours than of other action such as changes in wage structures or working practices. Even employers in those sectors in longer-term decline such as textiles and clothing reported no significant impact on employment levels, at least in the formal sector.

Labour Market Participation

2.80 The analysis presented so far has focused on what has happened to the demand for workers since the introduction of the minimum wage and its subsequent upratings. But the supply side of the labour market, that is the decisions people make on whether to search for work or not, is also important. The National Minimum Wage and other recent policies such as the New Deals and the Working Families' Tax Credit would be expected to improve incentives for individuals to take up low-paid employment and thus to increase participation in the labour market.

2.81 Over the past decade economic activity rates for men have been on a downward trend whilst those for women have increased. In our third report we saw that participation rates had increased for most age groups in the year after the National Minimum Wage was introduced. Figure 2.26 shows more recent changes, comparing the year following the October 2001 uprating with the previous year.

Figure 2.26
Change in Participation Rates by Age, Autumn 2000-Summer 2001 Compared with Autumn 2001-Summer 2002



Source: LFS, Autumn 2000–Summer 2002.
Note: pa = pension age.

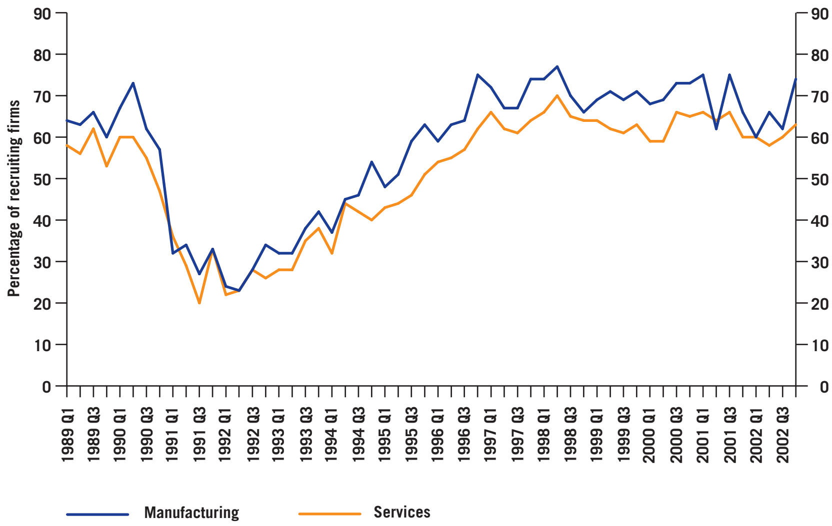
2.82 The data show that in the year to Summer 2002 overall participation rates fell among men and rose for women, continuing the trend over the past decade. But there were more marked changes among different age groups. Participation rates for 16–17 year old men fell by over 2 percentage points, largely reflecting a fall in employment rates for those not in full-time education. Activity rates for 18–21 year olds rose for women but fell for men. For men, this largely reflects a fall in employment among those not in full-time education. Activity rates among 22–24 year olds rose markedly in this period, largely due to increases in the number of men in work and in the proportion of women seeking work.

2.83 The initial analysis thus suggests that the minimum wage has not led to a significant change in participation rates, with trends established before the introduction of the minimum wage largely continuing. The exception to this is activity rates among 16–17 year olds, which have fallen in the past two years. Reasons for changes among the younger age groups are explored in more detail in Chapter 4.

Recruitment and Retention

2.84 By driving up wages at the bottom end of the labour market, the minimum wage might be expected to improve recruitment and retention within firms. But, despite the recent easing of the labour market, recruitment difficulties remain high according to some employer surveys. The British Chambers of Commerce conducts a quarterly survey of recruitment difficulties of firms in the manufacturing and services sectors. The trend in the percentage of firms recording difficulty in recruiting staff over the previous three months as a percentage of all those recruiting is shown in Figure 2.27. The data show that firms in both sectors which are seeking to increase employment are reporting high levels of recruitment difficulties, with only a slight easing in recent months. The series have remained relatively flat since the minimum wage was introduced, indicating little evidence of a positive labour supply effect at this aggregate level.

Figure 2.27
Percentage of Recruiting Firms Reporting Recruitment Difficulties, 1989–2002

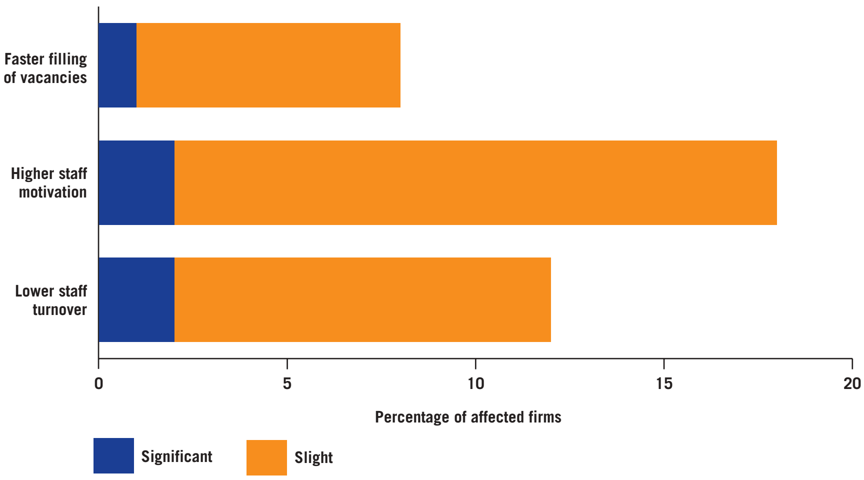


Source: British Chambers of Commerce, 1989–2002.

2.85 The Chartered Institute of Personnel and Development 2002 annual survey of labour turnover reports trends in turnover that are consistent with this broad picture. The data indicate that labour turnover slowed to 18.2 per cent in 2001 compared with 26.6 per cent a year earlier. But turnover rates in some low-paying sectors remain high. The highest turnover rates were found in wholesale and retail, at around 33 per cent in 2001, although markedly down from 48 per cent the year earlier. Against the overall trend, turnover in the hospitality and leisure sector increased to stand at a quarter in 2001, from 16 per cent a year earlier.

2.86 In our survey of low-paying sectors we asked firms affected by the October 2001 uprating whether it had brought any benefits to their business. Nearly 30 per cent of firms reported they had experienced some benefit, but most stated this had been slight. As Figure 2.28 shows, the most common benefit was higher staff motivation followed by lower staff turnover. There were some differences by sector, with hairdressing and childcare the most likely to report a benefit, and the retail sector the least likely.

Figure 2.28
Benefits to Business as a Result of the October 2001 Uprating of the National Minimum Wage



Source: LPC Survey, May 2002.
Base: All firms affected by the October 2001 uprating of the National Minimum Wage in any way.

2.87 Evidence from our research programme and our consultation exercise indicated that recruitment and retention remain a problem in many sectors and regions. In the nursery sector, IDS (2002d) found that two-thirds of firms sampled reported that they had difficulty in recruiting staff. Problems were widespread across all regions, but firms in the South East and North West reported greatest difficulty. The United Kingdom Home Care Association reported that problems in the care sector were originally most severe in the South East and South West but that this had spread to areas with above-average unemployment.

Summary of Employment, Unemployment and Participation

2.88 In summary, growth in the labour market has slowed over the recent past but conditions remain tight. Despite this easing there is little evidence that the introduction of the National Minimum Wage or subsequent upratings led to a worsening in the employment prospects of groups most affected, particularly women and ethnic groups. Young people's employment has, however, fallen relative to employment rates generally; this could be a cyclical effect and is discussed further in Chapter 4. Results from research that formally tests the employment response of groups directly affected generally indicate minimal negative effects. Where adverse effects are found they are limited to particular models and time periods. Results from our survey and

Low Pay Commission Research

IDS reported that several companies had experienced recruitment and retention difficulties. One example was Carlton Clubs, who pay bingo assistants an induction rate of £4.60 an hour. The company told IDS that recruitment had been difficult in a few locations and that it had consequently boosted local rates accordingly. Bristow's of Devon also noted the difficulty in recruiting production staff at an induction rate of £5 per hour.

IDS, 2002d. ***Report to the Low Pay Commission on the Impact of the National Minimum Wage***

consultation show that a minority of firms affected by the October 2001 uprating undertook other measures to reduce labour costs, including reducing hours. Research we commissioned to test for a minimum wage effect on hours shows a fall in hours worked among male workers, but not among groups most likely to be affected – women and young people. Data at the sectoral level indicate that, since the October 2001 uprating, employment in low-paying sectors as a whole has been stronger than in non low-paying sectors. Econometric research in the residential care sector indicated a modest negative employment effect on this sector.

2.89 Despite the easing of labour market conditions, a high proportion of firms still experienced retention and recruitment difficulties. Some firms reported an easing of pressures due to the October 2001 uprating, but these were a small minority. There is little evidence that the National Minimum Wage has led to an increase in labour supply, with trends started before the introduction of the minimum wage largely continuing afterwards.

Competitiveness

2.90 In recommending a new rate for the National Minimum Wage, the Commission wanted to make a difference to those on low pay, but also to ensure that it could be accommodated by business. We were mindful that a rate that was not manageable would hurt the prospects of the very people it was meant to protect by damaging firms' profitability and hence employment. This section examines the impact of the minimum wage on some key indicators of competitiveness: the wage bill, productivity, and prices and profits.

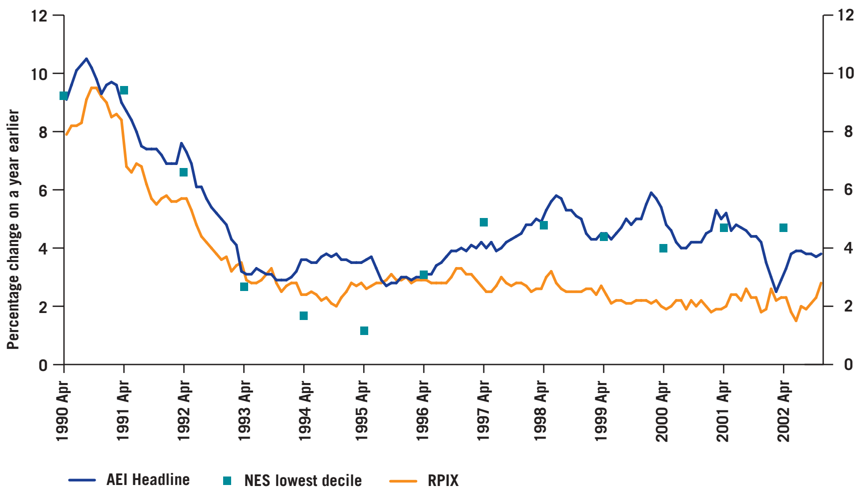
The Wage Bill

2.91 The direct effect of the minimum wage on firms is through higher labour costs which increase the wage bill. In order to estimate the effect of the October 2001 uprating, we need to establish a counterfactual and ask what would have happened to wages in the absence of the increase. Because we can never know this with certainty, we need to make some predictions based on our interpretation of the available data. We need to make two fundamental assumptions: what would have happened to earnings of those paid below the new rate had there been no minimum wage increase; and would the shape of the earnings distribution above the minimum have been any different – that is, has the uprating affected differentials in a way which changes the distribution?

2.92 In our third report, we adopted two alternative assumptions about the growth in earnings of the low paid in the absence of a new rate. Together these provided an upper and lower bound to wage bill estimates. The assumptions were, first, that there would be no earnings growth at the bottom end of the earnings distribution (which produces an upper bound for the impact of the minimum wage); and second, that these earnings would grow at roughly the same rate as the growth in average earnings (which produces a lower bound).

2.93 Figure 2.29 shows the trend in earnings and prices over the recent past. The data show that, before the minimum wage was introduced, earnings growth for lowest decile workers was, on average, between growth in earnings and prices. These data suggest that our upper bound wage bill assumption, of no earnings growth of the low paid, was too cautious. In the revised estimates presented here, we adopt a more realistic assumption for the upper bound that says that earnings of the low paid would have risen in line with prices (RPIX) in the absence of a minimum wage uprating. Adopting this assumption means the methodology of estimating wage bill effects is consistent with the methodology we use when we estimate beneficiaries.

Figure 2.29
Growth in Earnings of the Low Paid Compared with Average Earnings and Prices, 1990–2002



Source: AEI, RPIX and ungrossed NES data, 1990–2002.

2.94 The second main assumption we need to make is about the effect of differentials on the earnings distribution. In our third report we adopted two assumptions on the degree of wage restoration. The first was that the impact on differentials would be limited to around the eighth percentile and the second was that there would be a continued, but much lower, effect up to the 40th percentile. These assumptions were based on our interpretation of data from April 1999 to 2000.

2.95 As we noted earlier, we now have two further years' data from which to assess the impact of the minimum wage further up the earnings distribution. Our main conclusion from that analysis was that the impact of the October 2001 uprating was for significantly higher than average increases up to around the 16th percentile (£5.00 per hour at 2002 levels), and a more muted effect further up. But evidence is emerging that employers are using 2002 to award lower than average increases to those at the bottom of the earnings distribution, to balance out the above-average awards in the previous year. As shown in Figure 2.13, this was also the case with the ten pence uprating at October 2000. When considered over a longer time frame, the impact of the minimum wage on differentials is lower and limited to at most the 16th percentile in the earnings distribution, as Figure 2.14 shows. In estimating the wage bill impact of the October 2001 uprating, we have therefore used this point as the limit of the response of differentials. Our data show that above-average increases beyond this point were offset by below-average increases in the previous year.

2.96 Figure 2.30 compares latest estimates of the wage bill impact of the October 2001 uprating with those made at the time of our third report. Our current estimate is that the direct effect of the October 2001 uprating was to increase the aggregate wage bill by between 0.07 and 0.09 per cent, compared with 0.1 to 0.19 per cent as estimated in our last report. The difference between these estimates is due to a combination of new data on the earnings distribution and our new upper bound assumption that earnings of the low paid would have risen in line with prices rather than show no increase in the absence of a minimum wage. Taking account of the impact on differentials raises the aggregate wage bill estimate to 0.11 per cent on aggregate. Adopting a slightly revised assumption on differentials has made little additional difference to estimates, although the range of our estimates has now reduced.

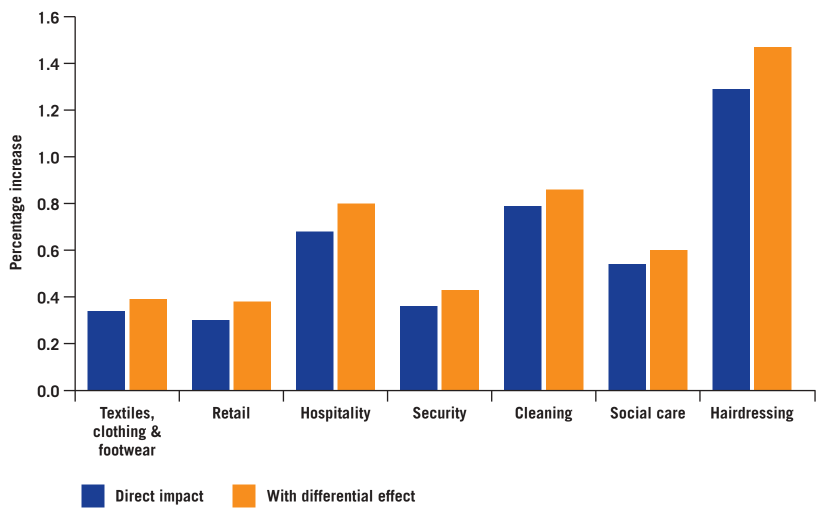
Figure 2.30
Impact of the October 2001 Uprating of the National Minimum Wage on the Aggregate Wage Bill

Source: LPC calculations based on grossed NES and LFS data, Spring 2001.

2.97 But there is still a degree of caution built into our estimates, for various reasons. First, we have assumed that compliance is universal whereas in practice this is unlikely to be the case. Second, we noted in our third report that some firms were taking measures to limit the impact on their wage bill, such as action to control labour and non-labour costs and to improve efficiency. These effects would reduce the actual impact on firms further.

2.98 The estimates given above are average figures across the whole of the economy, and therefore underestimate the impact on those firms and sectors with a higher proportion of affected workers. Figure 2.31 shows the impact on sectoral wage bills of the October 2001 uprating, focusing on those sectors most affected. These are estimated using the methodology outlined earlier, but focus on the upper bound assumption that earnings of the low paid would have risen in line with prices in the absence of an increase. The figure shows that the largest increases were in hospitality, cleaning and hairdressing, with increases ranging from 0.68 to 1.47 per cent in these sectors. These are much smaller than the increases stemming from the introduction of the minimum wage.

Figure 2.31
Wage Bill Impact in Low-paying Sectors of the October 2001 Uprating of the National Minimum Wage



Source: LPC calculations based on gross NES and LFS data, Spring 2001.
Note: Assumes earnings of the low paid grow in line with prices in the absence of an increase in the National Minimum Wage.

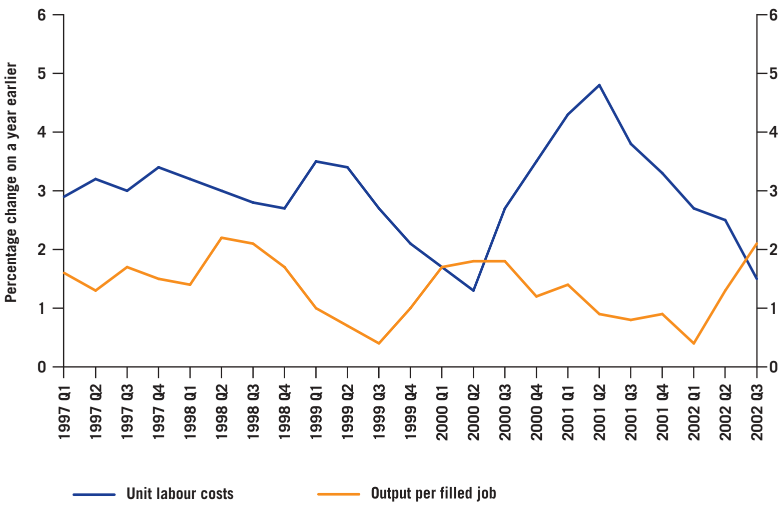
Productivity, Prices and Profits

2.99 The effect of the minimum wage on firms can be felt through three possible routes: a fall in profits, an increase in prices or an increase in productivity. As with previous topics considered in this chapter, we examined aggregate and survey data and research to try to gauge the balance of the impact between each of these outcomes. But the economy-wide data in this case are the most difficult to interpret since they are only available at a highly aggregated level, making it difficult to draw any firm conclusions.

Aggregate Data

2.100 Figure 2.32 shows productivity and unit labour cost growth in the economy as a whole. Growth in unit labour costs is determined by growth in both average earnings and productivity so, other things being equal, if the minimum wage is not accompanied by an increase in productivity we might expect to see a rise in unit labour costs. Growth in unit labour costs rose sharply between the latter half of 2000 and mid 2001, and has since dropped back to stand at 1.5 per cent in the third quarter of 2002. This largely reflects earnings growth over this period rather than productivity, and is influenced by the impact of bonuses on earnings, which fell back after the middle of 2001. Productivity as measured by output per job fell between the end of 2000 and early 2002, stemming from a steep fall in productivity growth in manufacturing. This might be expected as output has fallen significantly in this sector, and firms tend to adjust their workforce in response to this only after a time lag. In fact productivity rose to more normal levels during 2002. There is no discernible break in these aggregate trends since the minimum wage was introduced suggesting that, at this level, there is no evidence of an impact of the minimum wage on productivity.

Figure 2.32
Whole Economy Productivity and Unit Labour Cost Growth, 1997–2002



Source: ONS, 1997–2002.

2.101 More relevant though is what has been happening to productivity and unit labour costs in the sectors most affected by the minimum wage. We commissioned Forth and O'Mahony (2003) to examine trends in labour productivity and unit labour costs over the period 1995–2000. They compared trends in low-paying sectors with trends in higher-paying sectors, using both a descriptive analysis of trends and a statistical analysis of labour productivity growth to assess whether any element of this can be linked to the introduction of the National Minimum Wage.

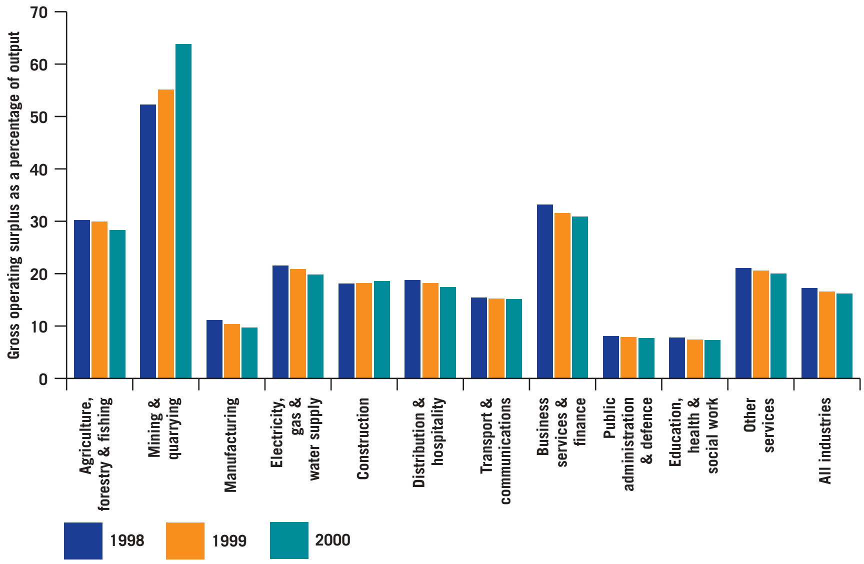
2.102 The focus of this research was on seven sectors where the wage bill impact of the minimum wage was greatest: textiles, clothing and footwear, retail, hospitality, security, cleaning and hairdressing. They found that between 1995 and 2000 labour productivity rose in all sectors except in clothing and footwear. In three sectors – textiles, security and hairdressing – the average annual growth in labour productivity was higher in the period 1998–2000 than it had been over the period 1995–1998. In textiles and security this has been achieved through the substitution of capital for labour. In hairdressing it has been achieved through other means, with an increase in the share of skilled labour in this sector appearing to play a minor role. But the statistical analysis found no robust association between the wage bill impact of the National Minimum Wage and rates of labour productivity growth across a wider range of sectors.

2.103 The direction of change of unit labour costs in the low-paying sectors is determined by whether the rise in productivity found in most low-paying sectors above was greater or less than the change in employment costs over the period. Forth and O'Mahony (2003) found that of the seven sectors examined, unit labour costs rose only in hospitality during 1998–2000. In four of the sectors – textiles, clothing and footwear, security and cleaning – they fell between 1998 and 2000 after rising in the previous three years. The authors state 'the introduction of the NMW does not therefore appear to have brought any general increase in aggregate unit labour costs across these seven sectors'.

2.104 The overall conclusion from the research was that the introduction of the minimum wage has not provided a general boost to labour productivity in the low-paying sectors, although it may have had some effect in specific sectors. But neither is there any evidence of the minimum wage leading to a general increase in unit labour costs.

2.105 The other two types of effect the minimum wage could have are through higher prices or a squeeze in profit margins. We examined data on firms' operating surplus and prices to see if this was evident at the aggregate level. Figure 2.33 shows operating surplus by sector as a percentage of Gross Domestic Product (GDP). It shows that across all sectors this measure of profitability fell by half a percentage point in the year after the minimum wage was introduced. But sectors with a large proportion of low-paying firms – distribution and hospitality and part of manufacturing – have not been disproportionately affected. And over a longer time trend the data show that firms' operating surplus is strongly associated with growth in the economy generally; this cyclical effect, rather than a minimum wage effect, is likely to have been the key cause of the slight decline in overall margins since 1998.

Figure 2.33
Operating Surplus as a Percentage of GDP, 1998–2000



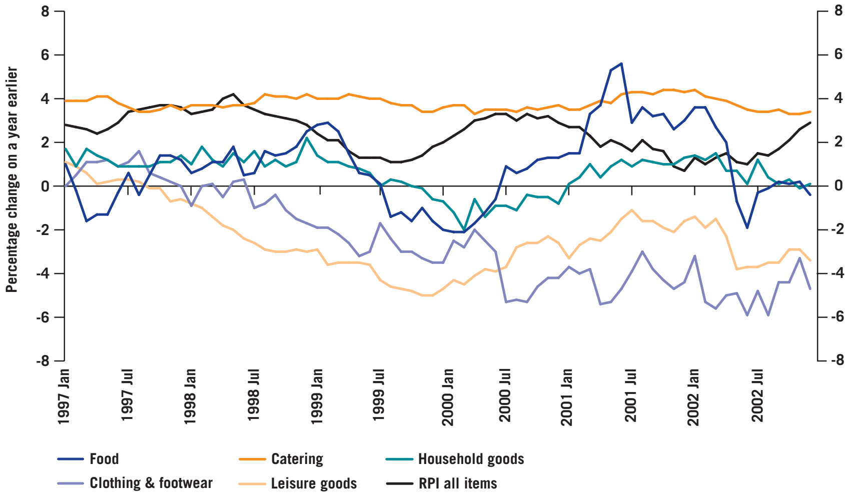
Source: ONS Blue Book, 2002.

2.106 Figure 2.34 shows the change in retail prices of some goods and services produced by low-paying sectors. Prices of food and non-alcoholic beverages rose in early 2001 as a result of the foot and mouth crisis, but have since subsided. There is deflation in the textiles sector, shown by the falling prices of clothing and footwear, and in those sectors selling leisure goods such as CDs and tapes, toys and sports goods.

2.107 But relatively subdued retail price inflation does not necessarily indicate that there has been no pass-through of higher wage costs associated with the minimum wage into higher prices. The minimum wage is just one of several factors that affect prices – others include the extent of product market competition and the cost of inputs. The retail sector has seen a decline in input prices in the recent past, so it is possible for output prices to fall without leading to lower profits. In such circumstances it is possible that retailers have raised prices in response to the minimum wage, but that such rises have been more than offset by other factors bearing down on prices.

> *‘[Following the October 2001 uprating] increasing prices of products offered was regarded as impracticable, due to competition from supermarkets and other multiples. Even village stores suffer from such competition; many residents in rural areas find it worthwhile, despite the travel cost, to make monthly food purchases from a supermarket in a town some distance away.’*
>
> **Scottish Grocers’ Federation evidence**

Figure 2.34
Trend in Components of Retail Price Index, 1997–2002



Source: ONS, 1997–2002.

2.108 In summary, it is difficult to assess from the aggregate data how the balance of the impact of the minimum wage has been shared between prices, profits and productivity. This stems from the difficulty in disentangling minimum wage effects from other factors operating at the aggregate level. Our preliminary conclusions are that it is likely that prices of some goods and services produced by low-paying sectors have been affected. But some sectors have less leeway to raise prices than others, and in such cases it is likely that profits have been affected, or that firms have taken measures to raise productivity. In residential care for example, the difficulty in raising prices or changing staff levels (and hence productivity) means that the primary effect is likely to be on profits. Our research found that the minimum wage has not provided a general boost to productivity, with trends established pre-minimum wage largely continuing afterwards. But neither is there any evidence of the minimum wage leading to a general increase in unit labour costs. We now examine the impact of the minimum wage on these factors from micro-level data.

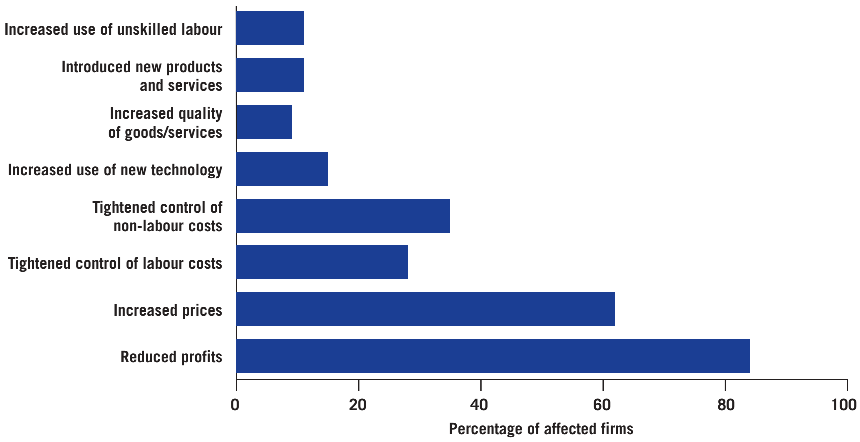
Survey and Research Results

2.109 In our own survey the most common effect reported by firms in response to the October 2001 uprating was a fall in profits followed by an increase in prices. These were reported by 84 per cent and 62 per cent of firms affected respectively, marginally lower than the corresponding figures in our third report. These results appear to contradict the evidence from aggregate data. But there are several reasons why these effects show up more strongly in our survey. First, our survey is aimed at firms in the low-paying sectors where the minimum wage bites; second, as Appendix 4 shows, responses are likely to be biased towards those most affected; and finally the percentages given above are presented as a proportion of those affected by the minimum wage which, when looking from an aggregate perspective, represent a small minority of all firms.

2.110 But the most significant change since last time is the reduction in the proportion of firms affected by the minimum wage reporting tighter control of labour costs, down from 61 per cent of firms in our third report to 28 per cent currently. As last time, we found that a significant minority of firms have undertaken more innovative measures to cope with the minimum wage: 35 per cent increased control of non-labour costs; 15 per cent introduced new technology and processes; and just over 10 per cent introduced new products and services. Figure 2.35 shows the range of adjustments reported by firms.

> *More enlightened local employers on the whole appear to have a very positive attitude to the national minimum wage and recognise the benefits to them and to the city in terms of productivity, competitiveness, staff retention and economic multiplier effects of offering wage rates above the NMW for even lower-skilled jobs.*
>
> **Hull Cityventure Ltd evidence**

Figure 2.35
Effect on Productivity, Prices and Profits as a Result of the October 2001 Uprating of the National Minimum Wage



Source: LPC Survey, May 2002.
Base: All firms affected by the October 2001 uprating of the National Minimum Wage in any way.

2.111 A more detailed industry breakdown showed that the textiles sector was least likely to increase prices, with less than a third of affected firms in this sector reporting this factor. Firms in the hospitality and retail sectors were most likely to control labour costs and the business services sector to introduce new technology or processes. Hairdressers were most likely to introduce new products and services. In general, small firms were less likely than larger businesses to report taking such measures, particularly to control labour and non-labour costs. Our survey also found that firms whose pay bills had increased by over 10 per cent as a result of the uprating were more likely than those less affected to undertake such measures.

2.112 The different ways in which firms responded to the minimum wage were explored in research we commissioned (Grimshaw and Carroll (2002)), to examine 36 small firms in low-paying sectors in the North West, predominantly around Manchester and Cheshire. The research gathered information from interviews with owners of firms in a variety of low-paying sectors, covering the cleaning, clothing, hospitality, residential care, retail and security sectors. The research showed that the National Minimum Wage has the potential to act as a benchmark among firms within these sectors, particularly those characterised by highly competitive product markets. This would mean that small firms could build the increased labour costs into their pricing structure without the fear of being undercut by competition. At one security firm, for example, the owner stated: 'we pointed out that anybody charging less than this could not legitimately be doing it … and we actually broke down the costs for them … the pay rates and employer's National Insurance and things just really to prove that we were not intending on making vast profits out of them'. Ultimately this proved successful and contracts were renegotiated, leading to more stable prices and more stable employment contracts. But this positive effect was only apparent in a minority of firms visited, and depended on the product market in which firms operated.

Low Pay Commission Visit

On a visit to the West Midlands to meet employers of clothing firms, one employer told us he had switched production from low-cost clothing to high quality, high priced executive beanbags. This involved paying higher wages due to the extra skills needed for this type of work, but was ultimately more profitable. This decision had been precipitated by the minimum wage.

Low Pay Commission visit to the West Midlands

2.113 Our research also found that the minimum wage encouraged some firms to improve the quality of their products and services. The owner of one cleaning firm in the study by Grimshaw and Carroll noted that she was able to pass on higher wage costs to clients through charging relatively high prices since she guaranteed a quality cleaning service. Examining the impact of the National Minimum Wage in the textiles sector, Ram *et al*. (2001a) pointed to the move towards 'niche markets' as being one strategy for survival in an intensely competitive and declining sector. Firms choosing this route reported a shift from high volume, low price work to high quality, higher priced output. This was usually accompanied by job losses, increased training and the use of higher skilled staff.

2.114 We found several examples of the minimum wage acting as a catalyst for change. A Commission visit to a laundry firm in the Birmingham area found that since the minimum wage was introduced the owner purchased several new pressing and folding machines that led to efficiency savings. The owner suggested that the minimum wage had been a factor in his decision making. The scope for introducing new technology varied by sector. Grimshaw and Carroll (2002) suggested that the National Minimum Wage had generally acted as an instrument enabling positive change in the way firms adapted their product market strategy and approach to managing employment. But because the minimum wage is not the only pressure on firms, the final outcome is not necessarily positive, and depends on an array of other internal and external factors.

2.115 There were a number of examples where constraints and pressures arising from external factors outweighed potential gains in productivity. In the study by Grimshaw and Carroll (2002), three examples stood out: security firms forced to compete with firms operating in the informal economy; the inability of individual private nursing homes to alter their pricing arrangements with local authorities; and increased willingness among large British retail chains to shop abroad for cheaper products, including clothing and footwear products. These had led to cuts in service quality, reductions in staff numbers and/or hours or, in some cases, businesses shutting down altogether.

2.116 We found that measures taken to cope with both the external demand conditions and the introduction of the minimum wage had not always been positive. As Ram *et al*. (2001a) pointed out, some companies had opted for a 'grey market' response that entailed a shift towards illegal working practices, such as not accounting for full hours worked and producing counterfeit clothing. Paying employees on a cash in hand basis and misreporting of hours were also reported in the Druker *et al*. (2002) study in hairdressing, although there was no evidence that this had increased since the minimum wage. Other textile firms in the Ram *et al*. (2001a) study cut back their business and concentrated on core operations. One firm chose to cut back by closing one of the two businesses at its site. This was blamed on imports, but the National Minimum Wage was said to have had a final contributory effect.

Low Pay Commission Research

At some of the security firms, the higher rates passed on to client firms following the introduction … of the NMW encouraged many clients to switch from a policy of using 'static' guards … as the main source of security to use mobile security services or installation of more high-tech surveillance technologies.… Profit margins earned from the 'mobile' contracts are higher, so while reduced hours for 'static' jobs decreased overall revenue, profits have remained steady during the period of the NMW.

Grimshaw and Carroll, 2002. *Qualitative Research on Firms' Adjustments to the Minimum Wage*

In the past when competition increased and prices reduced we could have asked workers to have less pay but we can't now, it's illegal … it's closed the business down – we couldn't sustain the level of outgoings with the level of income.

Ram *et al.*, 2001a. *Once More into the Sunset? Asian Clothing Firms After the National Minimum Wage* (quoting small textiles firm)

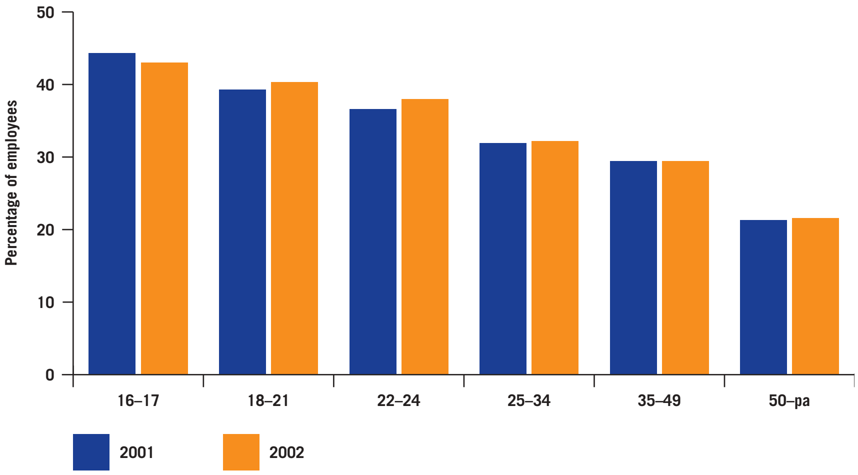
2.117 We noted earlier that a minority of firms are undertaking innovative measures to cope with the minimum wage. But such cases are the exception rather than the rule. **We therefore recommend that organisations such as the Small Business Service (through its Business Link network) and sectoral trade bodies should be encouraged to continue to provide advice and consider further ways to promote best practice.**

Training

2.118 An important factor influencing productivity is investment in training and skills development. The academic literature on the impact of minimum wages on training provision is inconclusive, with some studies suggesting that employers have an incentive to cut training in order to rein in costs, whilst others argue the case for employers offsetting the higher wage costs with higher training to increase productivity. One of the key insights from this debate is that employer strategy matters. Different firms may choose different wages and training strategies depending on the costs and returns to training and impact on productivity, making it difficult to predict how firms will respond to higher costs. It is therefore important to gather as much evidence as possible on the impact of the minimum wage on training decisions within individual firms and sectors. In this section we explore the evidence received on this so far, focusing on how decisions on training fit in with other strategies firms use to raise productivity.

2.119 Figure 2.36 shows that since the October 2001 uprating, the proportion of employees receiving job-related training has increased or remained flat for all age groups apart from 16–17 year olds. But in the main low-paying sectors, training increased for both the younger age groups (16–17 and 18–21 year olds) over this period.

Figure 2.36
Percentage of Employees Receiving Job-related Training in the Last 13 Weeks by Age, Spring 2001–2002



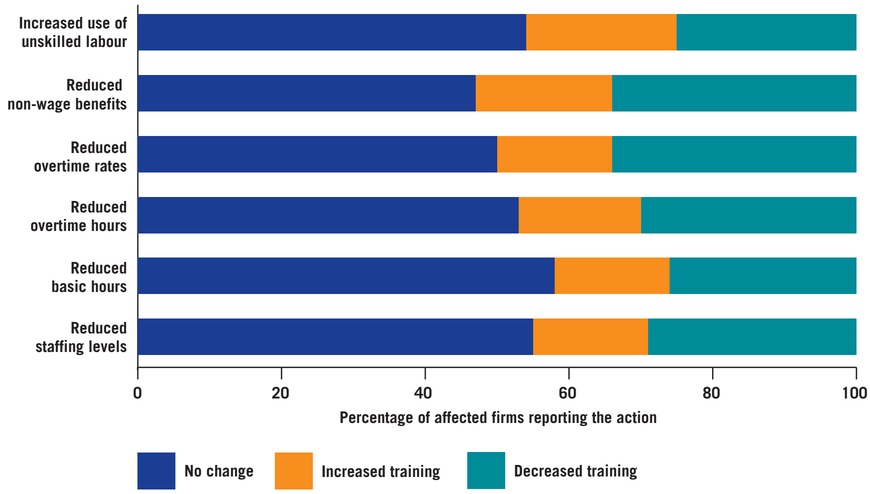
Source: LFS, Spring 2001–2002.
Note: pa = pension age.

2.120 But the aggregate data do not show how employees directly affected by the minimum wage compare with those already earning above the minima. Arulampalam *et al.* (2002) used data from the BHPS to test whether workers directly affected by the minimum wage had different training outcomes from those who were unaffected. Using difference-in-difference techniques they found no evidence that the introduction of the minimum wage reduced training of affected workers, and some evidence that it increased it. In particular, they found that the probability of training incidence or intensity increased by about 8 to 11 percentage points for workers affected by the minimum wage.

2.121 Our survey asked about firms' training provision since the October 2001 uprating of the minimum wage. Around 70 per cent of firms affected by the uprating said they had not changed their training provision, with only slight differences across different age groups. Overall, a slightly higher proportion of firms said they increased training provision than said they reduced it.

2.122 We also examined the interaction of training provision with other changes in working practices. As shown in Figure 2.37, firms that took measures to reduce labour costs or non-wage benefits such as meal breaks were more likely to reduce training in the past year than to increase it. In many cases the difference was significant. Among firms that had reduced overtime rates for example, up to twice as many firms reduced training as increased it.

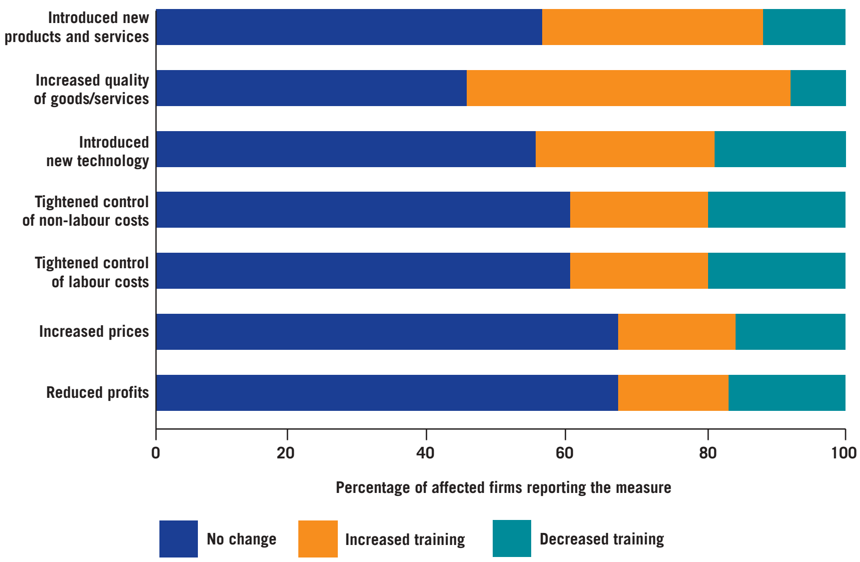
Figure 2.37
Effect on Training Provision by Changes in Working Practices as a Result of the October 2001 Uprating of the National Minimum Wage



Source: LPC Survey, May 2002.
Base: All firms affected by the October 2001 uprating of the National Minimum Wage in any way which reported the action.

2.123 The picture was different when we examined the association between training provision and other measures taken by firms to raise productivity. As shown in Figure 2.38, firms that introduced new products or new technology or improved the quality of their product were more likely to increase training provision than to reduce it. This was particularly marked among firms that said they went for higher quality products, where 8 per cent said they had reduced training and 47 per cent said they had increased it. This is because moving towards higher quality often necessitates retraining and reskilling. Among the other actions taken by firms, such as increasing prices and reducing profits, the proportions reporting increases and decreases in training were roughly the same.

Figure 2.38
Effect on Training Provision by Other Responses to the October 2001 Uprating of the National Minimum Wage



Source: LPC Survey, May 2002.
Base: All firms affected by the October 2001 uprating of the National Minimum Wage in any way which reported the measure.

2.124 Firms' training decisions were examined in several of the research reports we commissioned. Grimshaw and Carroll (2002) found little association between the form of training provision within the firm and its product market strategy or ability to pay. They found that higher pay was not necessarily associated with investment in formal programmes of skill development, or with innovative forms of work organisation and multi-skilling. Instead, the research suggested that the relationship between training and pay was more complex and depended on factors such as: employers' previous experience with formal training programmes; some employers' preference to poach skilled workers rather than to train them in-house; the existence of regulations governing the form of training required for specific jobs; and the ability of firms to exploit the new skills of their workers. There was, therefore, no clear link between the minimum wage and firms' training strategies.

2.125 Research we commissioned by Miller *et al*. (2002) in the hospitality, retail and hairdressing sectors found that the main reason why employers increased training following the minimum wage was to improve quality and flexibility. The authors noted that in hospitality firms the two most frequently cited reasons for increasing training were to improve quality of service and to help attract staff. In the retail sector, service quality as well as the need for a highly skilled and flexible workforce were cited. In its

> *The margins of micro and small employers have been squeezed by the implementation of the National Minimum Wage, and further cost increases cannot be absorbed. In some salons wage costs account for 50% of turnover. Many micro employers are now questioning the value and cost of training.... More firms now believe that it is probably more cost efficient to entice trained personnel from other employers rather than undertake the extended, structured programme of Modern Apprenticeship. The proliferation of such practice would undermine the ethos of training.*
>
> **National Hairdressers' Federation and Hairdressing Employers Association evidence**

evidence to us, the British Retail Consortium stated that the impact of the minimum wage so far had been to increase training and, perhaps surprisingly, this was more evident among small retailers than large ones.

2.126 But among other firms, disincentives to the provision of training remain. These were typically found in the low-skill, low-paid jobs common to many low-paying sectors. At one of the security firms visited in the Grimshaw and Carroll (2002) study, the owner argued that poaching remained a serious problem: 'if you invest a lot of time, money and effort in an officer, you might just end up doing it for somebody else'. In the Miller *et al.* (2002) study, firms cited different reasons for reducing training. In one of the hairdressing salons, training had been cut for financial reasons, whilst another also said there was no need to improve quality and the work did not require more than the standard skills levels.

2.127 In other sectors there was little evidence that the minimum wage had led to positive transformation in working practices. Grimshaw and Carroll (2002) found that in one footwear factory visited there was little evidence of multi-skilling, with workers doing repetitive tasks and little rotation between specialities. Since specialisation was associated with higher productivity, managers had resisted any change, and this led some managers to challenge the industry standards for National Vocational Qualifications (NVQs), which were initially designed to promote acquisition of broad skills across a range of job tasks. Druker *et al.* (2002) found that the National Minimum Wage did not lead to significant changes in employers' willingness to train apprentice and trainee hairdressers or in the type or level of training made available, although many firms in this study were not willing to provide training to those aged over 16 or 17.

Summary on Competitiveness

2.128 In summary, we estimate that the 2001 uprating has increased the aggregate wage bill by up to 0.11 per cent, considerably lower than our estimates for initial introduction. Firms in some low-paying sectors were more affected. The minimum wage can potentially affect firms through three main routes – their product prices, profits or productivity. It is difficult to judge, from the aggregate data, the balance of the impact between these factors. This will probably depend on an array of factors operating in particular markets. We found no significant impact, positive or negative, of the National Minimum Wage on productivity. Research we commissioned focusing on the low-paying sectors showed that the introduction of the minimum wage had not provided a general boost to productivity, but neither had it led to a general increase in unit labour costs. Analysis of our own survey showed that by far the most common measures reported by firms affected by the October 2001 uprating were reducing profits and increasing prices. A minority of firms undertook more innovative measures such as introducing new technology and improving the quality of goods and services they provide. Some firms, particularly those working in declining markets or constrained by strong competition or other factors, have found it more difficult to cope. We are therefore recommending closer working between business and advisory bodies. The aggregate data show that training has increased marginally over the last two years. But the qualitative research suggests that the minimum wage is just one factor among many that determine firms' training strategies.

Public Sector Finances

Public Sector Wage Bill

2.129 Our estimates of the 2001 uprating of the minimum wage on the public sector wage bill suggest that the impact is small. Assuming no impact on differentials and the upper bound assumption that earnings of the low paid would have risen in line with prices in the absence of a minimum wage, we estimate that the increase to the public sector wage bill is 0.02 per cent compared with 0.1 per cent in the private sector. If we assume that there is an impact on differentials, the estimated increase would be around 0.03 per cent in the public sector and 0.14 per cent in the private sector.

2.130 In its evidence to us, the Government stated that it does not expect the increase in the minimum wage to have a significant impact on public sector pay. However a detailed breakdown of the effects of the minimum wage on public sector pay was not available. There is a continuing concern over the funding of care homes which is detailed in Chapter 3. The impact of the uprating on particular groups of workers and wage structures in local government has also been minimal. Evidence from the Employers' Organisation for local government stated 'our national pay negotiations and spinal column point framework mean that even those on the lowest pay point are paid above the NMW'. But the minimum wage can have indirect impacts in local authority contracting. The evidence states that the lowest local government rate tends to be ahead of the minimum wage, so that the local government rate can be uncompetitive when bidding for contracts. However, local authority costs do rise if the National Minimum Wage rises, as any increase in contractors' costs is passed on. On balance, there tends to have been a narrowing of the gap between the costs of services local authorities provide directly and the costs of those services provided by third parties.

Exchequer Revenues and Expenditure

2.131 As well as the direct wage bill effect, the minimum wage affects public spending and revenues through three main routes: by increasing in-work income, the minimum wage reduces spending on in-work benefits and tax credits; at the same time it increases the amount of income tax and National Insurance Contributions (NICs) paid by those who have been affected; and to the extent that the minimum wage adversely affects firms' profits, it reduces the expected revenue from corporation tax.

2.132 In its evidence to us, the Government provided estimates of the simulated impact on the Exchequer of a ten pence increase in the minimum wage from the current rates, in April 2003. This simulation assumes that the new tax credits announced in *Budget 2002* are in place. The estimates are given in Table 2.6.

Table 2.6 Benefit and Tax Credit Savings From a Ten Pence Increase in the National Minimum Wage

Benefit/Tax Credit	Savings at April 2003, £million
Working Tax Credit	10
Child Tax Credit	4
Income Support/Job Seeker's Allowance/Pension Credit	2
Housing Benefit	5
Council Tax Benefit	2
Total excluding tax credits	9
Total including tax credits	23

Source: Government evidence.

Note: The figures on the new Tax Credits include the child premia paid as a part of the Income Support (IS) and Job Seeker's Allowance (JSA) in the transitional period. In order to avoid double counting, the premia have been excluded from the IS/JSA figure.

2.133 These estimates are indicative and assume no behavioural response from those in work or those seeking work. The precise impact will depend on a number of factors, including the level of compliance and the impact on differentials and employment. In addition, the new tax credits will have an annual disregard of increases in income of £2,500, so that an increase below this level in a given tax year will be disregarded until the end of the year. Therefore beneficiaries of the minimum wage who are also in receipt of tax credits will receive the full value of the increase in the minimum wage to the end of the tax year as long as their income rises by less than £2,500.

2.134 The Government evidence estimates that a ten pence increase in the minimum wage from current levels would yield around £35 million in income tax and a further £35 million in NICs. On corporation tax, the impact is more complicated since it depends on how the minimum wage affects profits. This in turn will depend on factors such as productivity, employment and staff turnover, labour costs and product prices. Given the uncertainty in these assumptions, the Government decided against providing an estimate on corporation tax this time round. The Government states that 'on the whole, the impact of a minimum wage increase should have a broadly neutral although tending to negative impact on corporation tax receipts'.

2.135 On aggregate therefore, the estimates are that a ten pence increase in the minimum wage would increase Exchequer revenues and cost savings by around £93 million. But these are estimates of a marginal change in minimum wage rates that assume no behavioural response on the part of workers or firms.

A larger uprating is likely to have a bigger impact on work incentives and on firms' labour costs and their decisions on how to offset these higher labour costs. Therefore these estimates are unlikely to increase proportionately for each additional ten pence minimum wage rise.

2.136 In summary, the National Minimum Wage has had little impact on public sector wage bills, with the vast majority of public sector workers earning above minimum wage levels. There has been a small positive impact on public sector finances stemming from reduced spending on in-work benefits and increased revenue from tax and NICs.

Conclusion

2.137 We have assessed the impact of the minimum wage, focusing on the October 2001 uprating. We continue to find strong support for the minimum wage, from employers as well as workers. The 2001 uprating increased the earnings of over one million employees, the majority of them women. Growth in the labour market has slowed in the past two years, but employment among groups and sectors most affected by the minimum wage has generally continued to grow. Evidence from econometric studies suggests negative effects have been minimal. Most firms have been able to accommodate the increase without too much difficulty but we noted that some firms argued for more even increases over time. A minority of firms have undertaken positive measures to improve their working practices and to bring about changes to productivity.

2.138 It is important that we continue to monitor the impact of the minimum wage, and to plug gaps in our current knowledge. Some key issues for the future are a more detailed assessment of the minimum wage on firms' profitability; and an exploration of the dynamics of the minimum wage, in terms of movements in and out of work and how this might affect our assessment of beneficiaries. We now go on to consider those sectors and groups of workers where the impact of the minimum wage has been most acute, examining in detail the issues affecting them.

3 Working with the National Minimum Wage

Amongst the sectors which have been most affected by the minimum wage, firms' capacity to respond may be influenced by a number of external factors which are not directly related to the minimum wage. While the response therefore varies across the sectors, we find no evidence that any sector is unduly constrained in its ability to cope with the National Minimum Wage. Across many of the sectors small firms are, however, more affected than larger firms, and we make recommendations for improving the information available to them.

We recommend that the Government should continue to promote implementation of the 2001 agreement between central and local government, health bodies and independent care providers on commissioning social care, and should ensure that its impact is carefully monitored. We also note the relevance of the rules on 'sleepovers' to the care sector, and reaffirm our view that the original policy intent of the Regulations should be preserved.

We have received further evidence about problems with fair estimate agreements. We give our initial views on these issues and we will respond separately to the Government's consultation paper.

A number of organisations expressed concern at the lack of clarity surrounding the rules on therapeutic activity and the National Minimum Wage. We set out our views on how we believe the dividing line should be drawn between therapeutic activity and work which qualifies for the minimum wage, and we recommend that the Government should monitor the impact of its new guidance on this matter.

On the composition of pay which can count towards the National Minimum Wage, we recommend that the maximum weekly accommodation offset should be increased to £24.40 in October 2003 and £26.25 in October 2004, and that the rules for calculating the offset should be simplified. We conclude that the present arrangements for the treatment of tips should be retained.

Introduction

3.1 In Chapter 2 of this report we set out our assessment of the impact of the National Minimum Wage on the labour market. We described the impact on the economy as a whole and identified the groups and sectors where the impact had been greatest. In this chapter we focus on those sectors and types of firms and workers most affected.

3.2 Small firms are proportionately more affected than larger firms, and we therefore begin by examining the needs of small businesses. We go on to look at the sectors where low pay is common: retail, hospitality, business services, social care, childcare, the manufacture of textiles, clothing and footwear, and hairdressing. We present information on the economic circumstances in which these sectors are operating, and outline how they have responded to the October 2001 uprating of the minimum wage.

3.3 We go on to consider the needs of two groups of people for whom the current rules on the National Minimum Wage pose particular difficulties. We look first at pieceworkers, and the use of fair estimate agreements. We then consider the position of people, typically with learning difficulties or mental health problems, who undertake various forms of therapeutic activity which do not necessarily qualify for the minimum wage.

3.4 Finally, we examine two issues relating to the composition of pay: the accommodation offset, and tips and gratuities.

Small Firms

3.5 In our previous reports we found that small firms in low-paying sectors were disproportionately affected by the minimum wage. They also typically have fewer resources to respond to government regulation. In preparing this report we were therefore keen to consider specifically the impact of the minimum wage on small firms.

3.6 The majority of firms in the UK are small – over 80 per cent of firms have fewer than 10 employees. But, as Table 3.1 shows, small firms are not found disproportionately among the low-paying sectors: the proportion of small firms in these sectors is similar to the proportion in the economy as a whole. In each of the low-paying sectors we examine, over half of firms have fewer than 10 employees, rising to almost 90 per cent in the retail sector.

Table 3.1 Distribution of Firms with Employees in Low-paying Sectors by Size of Firm, 2001

Sector	Micro (1–9)	Small (10–49)	Medium (50–249)	Large (250+)
	Per cent			
Hotels/restaurants	85.1	12.9	1.6	0.3
Textiles/clothing	67.3	24.8	6.6	1.3
Retail	89.2	9.6	0.8	0.3
Security	74.9	17.4	6.0	1.8
Industrial cleaning	76.1	15.6	6.0	2.3
Social work activities	50.1	43.4	6.0	0.6
All sectors	82.2	14.6	2.5	0.7

Source: Small Business Service, 2001.

Note: Data for the hairdressing sector are not available. Social work activities include those with and without accommodation.

3.7 Firms with fewer than 10 employees account for around 15 per cent of employed workers, as shown in Table 3.2, and some 30 per cent of employment is provided by firms employing fewer than 50 staff. The security and cleaning sectors have a higher proportion of employment in medium and large businesses.

Table 3.2 Distribution of Employment in Low-paying Sectors by Size of Firm, 2001

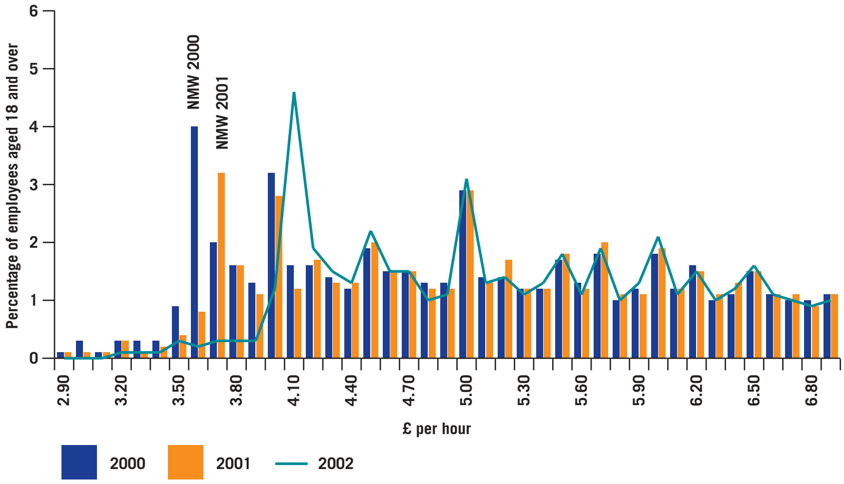
Sector	Micro (1–9)	Small (10–49)	Medium (50–249)	Large (250+)
	Per cent			
Hotels/restaurants	25.2	17.3	10.5	47.0
Retail	19.3	9.0	4.4	67.2
Security	7.0	8.2	15.0	69.9
Industrial cleaning	7.6	8.4	16.7	67.3
All sectors	15.5	14.0	12.1	58.4

Source: Small Business Service, 2001.

Note: Data for the hairdressing, textiles and clothing and social work sectors are not available.

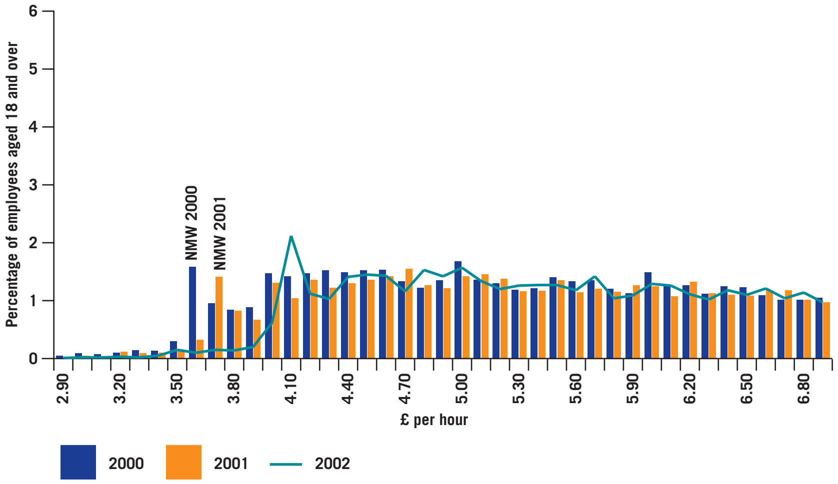
3.8 Although small firms are not disproportionately represented among the low-paying sectors, they do have a higher proportion of employees paid at or around minimum wage rates. As Figures 3.1 and 3.2 show, the impact of the minimum wage on pay rates for businesses with fewer than 50 employees has been substantially greater than on larger firms.

Figure 3.1
Hourly Earnings Distribution for Employees Aged 18 and Over in Small Firms, April 2000–2002



Source: Grossed NES, April 2000–2002.
Note: Firms with fewer than 50 employees. NMW label shows the adult NMW rate in April of the given year.

Figure 3.2
Hourly Earnings Distribution for Employees Aged 18 and Over in Medium and Large Firms, April 2000–2002



Source: Grossed NES, April 2000–2002.
Note: Firms with 50 or more employees. NMW label shows the adult NMW rate in April of the given year.

3.9 The difficulty faced by small firms in adjusting to increases in the minimum wage is a theme that emerged from our consultation. As we saw in Chapter 2, at times there is a divergence between the evidence provided by macroeconomic data on the overall impact of the minimum wage, and the information we have gathered on the impact which it has had on individual firms. But the findings from these two different sources are not contradictory. There is evidence from the aggregate statistics and surveys that the minimum wage has had no adverse impact at the aggregate or sectoral level. But clearly increases in the minimum wage do create difficulties for some firms – albeit a minority – and these are reflected in some survey findings and in comments from individual firms.

3.10 At the aggregate level recent surveys have shown that, although the National Minimum Wage is an issue for small firms, only a minority have been adversely affected. For example, in a survey of 6,000 small and medium enterprises by the Small Business Service some 11 per cent of respondents cited the National Minimum Wage as an obstacle to the success of their business. A survey of over 1,000 small firms by Blackburn and Hart (2002) found that while the National Minimum Wage was the most significant employment right having an effect on small firms, the percentage experiencing a negative impact was low overall (6.4 per cent).

3.11 In our own survey we found that the impact of the October 2001 uprating varied by firm size. Figure 3.3 shows that the smallest firms (1–9 employees) were least likely to have been affected by the uprating. This appears to contradict the evidence that small firms are disproportionately affected. However, it is not inconsistent with findings by Blackburn and Hart that larger small firms (with 20–49 employees) were more likely to perceive a negative impact.

3.12 Our own survey found that large firms were more likely to report having reduced staffing levels, overtime hours and overtime rates, while the smallest firms were more likely to report having decreased basic hours. It also found that larger firms were more likely to report having increased the use of new technology and increased controls on labour and non-labour costs.

3.13 These findings are consistent with research by Grimshaw and Carroll (2002), which looked at the response of 36 small firms in the North West. They found that most firms had adjusted pay structures in direct response to the minimum wage and a minority had taken measures to improve product market strategy. But there was very little evidence of an adverse impact on employment.

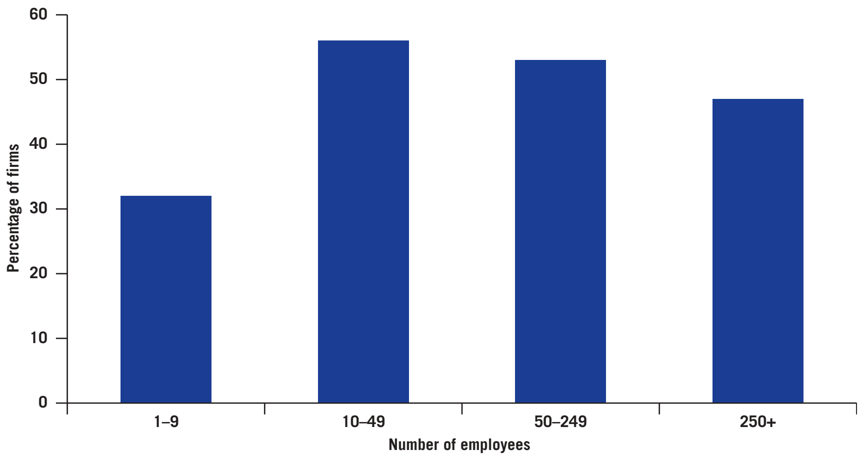
"As a result of NMW, more than two fifths of small retailers (44%) have already reduced staff hours and recruited fewer staff. Two fifths (42%) would also cut staff, staff hours or recruitment if NMW were set at £4.50 or £4.75.... Therefore, in reviewing NMW, I hope very much you can keep the effects on small British businesses at the forefront of your considerations."

British Shops and Stores Association evidence (reporting on British Retail Consortium Survey)

"The majority of respondents did not believe that the NMW had a notable effect on their clients' businesses.... [However] it was clear that the NMW has an impact on the way a number of [small] businesses functioned, with a significant proportion of respondents noting that businesses had cut staff working hours, increased workloads, reduced overtime/holiday entitlements and decided not to recruit someone they otherwise would have done."

Association of Chartered Certified Accountants evidence

Figure 3.3
Percentage of Firms Affected by the October 2001 Uprating of the National Minimum Wage



Source: LPC Survey, May 2002.
Base: All firms that provided employee numbers.

> *Big business … can afford to pay their staff more, they have the buying power … they attract all the best staff as well. You don't have the cushion of spare cash to cover it … you can't do it in a small business.*
>
> **Small firm, 1–9 employees, retail Focus group**

> *While such an impact [of new employment legislation] may turn out to be progressively positive in the longer term, smaller employers often have limited reserves and are therefore less able to wait out the initial fall in profits.*
>
> **Federation of Small Businesses evidence**

3.14 To help us to understand why small firms find it more difficult to adjust to increases in the minimum wage and what we could do to help ease the burden, the Small Business Service funded MORI to run some focus groups on our behalf. A number of small firms in the hospitality, retail, manufacturing and cleaning sectors which paid at or around National Minimum Wage rates were asked about their knowledge of and attitude to the minimum wage.

3.15 The smallest firms believed that it was harder for them to react to regulatory changes such as the National Minimum Wage for a number of reasons. For example, they considered that they have less bargaining power with suppliers, and less access to resources to meet the additional costs of the National Minimum Wage. They also commented that smaller firms employ fewer specialist staff, so when they cut back on staff they lose proportionately more skills; and that small firms are more likely to compete with firms operating in the informal economy. In the light of these concerns they argued that future increases in the minimum wage should be moderate.

3.16 In terms of regulatory burden, the consensus was that the minimum wage was easy to understand and did not create administrative burdens. There was also a high level of awareness of the existence of the minimum wage, although less awareness of the detailed provisions. These findings are borne out by Blackburn and Hart (2002), who found that there was almost universal awareness (98.8 per cent) of the minimum wage among small firms, although knowledge of its detailed provisions was not as high.

3.17 The focus groups also suggested that they would find it useful to have some factual information about the National Minimum Wage – details of rates, including planned increases; a dedicated helpline or website for specific queries; and information on other businesses' reactions to the minimum wage.

3.18 There was little awareness among the focus groups of the information that was currently available on the minimum wage, such as the Employment Guides for small firms produced jointly by the Advisory, Conciliation and Arbitration Service (ACAS) and the Business Link network run by the Small Business Service, which include fact sheets on a range of employment rights. This suggests there is scope for more publicity of the factual information which is already available for small firms. **We therefore recommend that the Small Business Service should actively promote and disseminate factual information on the National Minimum Wage that is tailored to small firms**.

> *Ignorance is no excuse for businesses not paying the NMW, but the onus is on us to find out about it … but we simply don't have the time to seek out all the relevant information.*
>
> **Small firn, 20–49 employees, manufacturing**
> **Focus group**

3.19 The focus groups suggested that more notice of increases in minimum wage rates would be helpful. However, from the discussion, it became clear that participants had first heard about the October 2002 uprating from the publicity in the month leading up to the increase. And even though the focus groups were held on 30 September and 1 October 2002, one participant was not aware of the increase taking place on 1 October 2002.

3.20 There was also very limited awareness of the existence of the National Minimum Wage Helpline. There was even less awareness of the fact that the Helpline offered advice to employers as well as to employees.

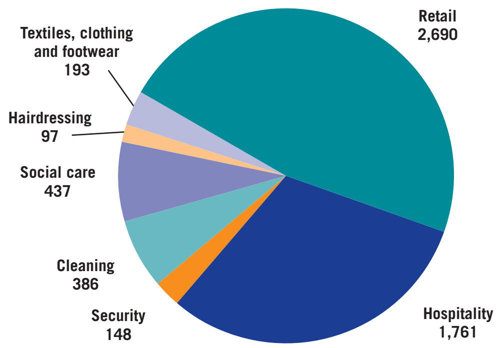
3.21 It would appear, therefore, that what is needed is more information for small firms at the earlier stages following the announcement of future increases to the minimum wage, and more publicity to business of the National Minimum Wage Helpline. We make recommendations on publicity for the minimum wage and the Helpline in Chapter 5. This publicity should be designed to meet the needs of businesses – and small businesses in particular – as well as workers.

3.22 Having considered the impact of the National Minimum Wage on small businesses, we now turn to examine the impact on those sectors which have been most affected.

Sectors

3.23 Between them, the sectors we consider here account for over 5.7 million jobs – around 23 per cent of all employee jobs. They also account for some 57 per cent of all beneficiaries of the October 2001 uprating. Figure 3.4 illustrates the relative proportion of jobs accounted for by each of the sectors most affected by the minimum wage. Across these sectors, 15 per cent of jobs were directly affected by the uprating, ranging from 26 per cent in cleaning to 10 per cent of retail jobs. More detailed information on employment trends and earnings in each sector can be found in Appendix 6.

Figure 3.4
Breakdown of Jobs in Low-paying Sectors, Thousands, September 2002



Source: ONS employee jobs series, September 2002, GB.

Retail

3.24 With almost 2.7 million employees, the retail sector accounts for nearly half of all employees in the low-paying sectors considered here. At the aggregate level there is little sign of the October 2001 uprating having an adverse effect. Output growth in the wholesale and retail sector has been strong since the minimum wage was introduced and growth in retail sales remains robust. Since the October 2001 uprating, output has grown faster in this sector than in the services sector as a whole.

3.25 Although some employer representatives reported that the minimum wage has led to reductions in employment, employment has been on an upward trend since the National Minimum Wage was introduced, and this has continued since the October 2001 uprating. But a number of companies reported having reduced employment levels or staff hours to cope with the minimum wage. Our survey found that businesses in the retail sector were more likely than those in other low-paying sectors to increase controls on labour costs, and 50 per cent of respondents in the retail sector affected by the minimum wage reported that they had reduced overall staffing levels (20 per cent of all retail respondents).

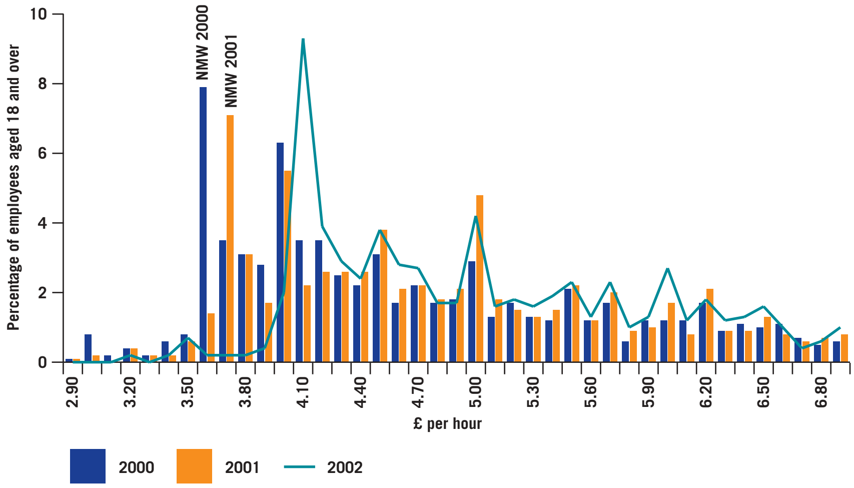
3.26 What is most striking in this sector is the difference in the impact which the minimum wage has had on small and large firms, as illustrated in Figures 3.5 and 3.6. Small firms are more likely to have needed to increase wages to comply with the National Minimum Wage. Around 9 per cent of employees in small firms were paid the adult National Minimum Wage in 2002, compared with 4 per cent of employees in large firms. For small firms there is a pronounced spike in the distribution at the adult National Minimum Wage rate which is absent from large firms. Large firms are not entirely unaffected, however, and Incomes Data Services Ltd (IDS) found that a number of large retailers had to adjust their pay to comply with the October 2001 uprating (IDS (2002d)).

3.27 The difference in impact on small and large firms was also reflected in evidence from trade associations. The British Retail Consortium (BRC) reported that 30 per cent of small businesses had increased wages as a result of the National Minimum Wage, compared with 19 per cent of large businesses.

‘We are aware that a number of our members’ stores have had to impose restrictions on employment to cater for the effect of the increase in the National Minimum Wage in October 2001 and there is now no staff flexibility remaining to mitigate the impact of such an increase.’

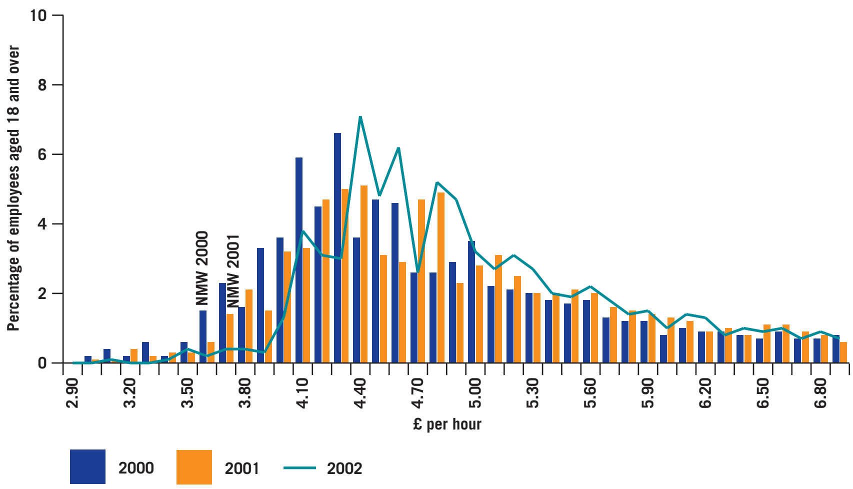
Scottish Grocers’ Federation evidence

Figure 3.5
Hourly Earnings Distribution for Employees Aged 18 and Over in Small Firms in the Retail Sector, April 2000–2002



Source: Grossed NES, April 2000–2002.
Note: Firms with fewer than 50 employees. NMW label shows the adult NMW rate in April of the given year.

Figure 3.6
Hourly Earnings Distribution for Employees Aged 18 and Over in Large Firms in the Retail Sector, April 2000–2002



Source: Grossed NES, April 2000–2002.
Note: Firms with 250 or more employees. NMW label shows the adult NMW rate in April of the given year.

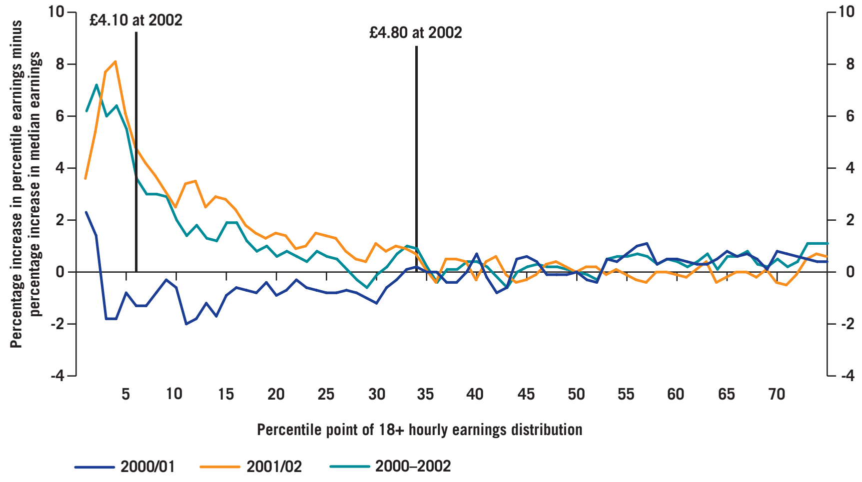
Low Pay Commission Research

IDS found that 'on the whole in the retail sector, where increases have been made to meet the NMW, moves have not been made to restore differentials further up the pay structure. However, there is a parallel trend towards fewer grades below that of supervisor.'

IDS, 2002d. ***Report to the Low Pay Commission on the Impact of the National Minimum Wage***

3.28 The tight labour market has also had an impact on pay, with retailers facing increased competition from other sectors to recruit labour. IDS (2002d) reported that 'a number of retail employers are deliberately setting rates above the NMW to aid recruitment'. As Figure 3.7 shows, there has been partial restoration of differentials following the October 2001 uprating, but the extent of this was limited to employees earning less than £4.80 an hour. Moreover, these rises followed below-average increases in the previous year.

Figure 3.7
Increase in Hourly Earnings Minus the Increase in Median Earnings by Percentile for Employees Aged 18 and Over in the Retail Sector, 2000–2002



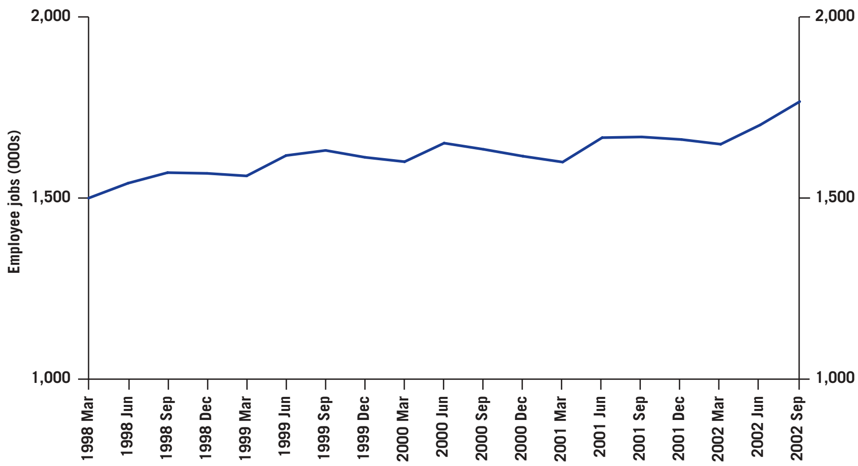
Source: Grossed NES, April 2000–2002.

3.29 Written evidence from many retailers emphasised the competitive nature of the sector and the limited scope for increasing prices. This is supported by aggregate data on output prices of some retail goods. The BRC also noted that prices of non-food retail items have been in decline over the recent past. As we noted in Chapter 2, what is not clear is what impact this decline in output prices has on profit margins, given that input prices to the retail sector are also in decline. It is possible that output prices are, as a result of the minimum wage, higher than they would otherwise have been (i.e. that retailers have been able to raise prices to accommodate increases in the minimum wage).

Hospitality

3.30 The hospitality sector was badly hit by the foot and mouth crisis and the impact of the terrorist attacks in the US and has yet to recover fully. But despite the sharp fall in output since mid 2000, employment has continued on an upward trend since the minimum wage was introduced, as illustrated in Figure 3.8. Employment is now at its highest level since 1988, and around 200,000 higher than when the minimum wage was introduced. The continued growth in employment in the face of difficult external demand conditions may be partly explained by the sector's ability to adjust hours. Over half of employees in this sector work part-time, and the turnover rate is high at 25 per cent in 2001. As might be expected, there is a strong seasonal element to employment, with peaks in the summer months.

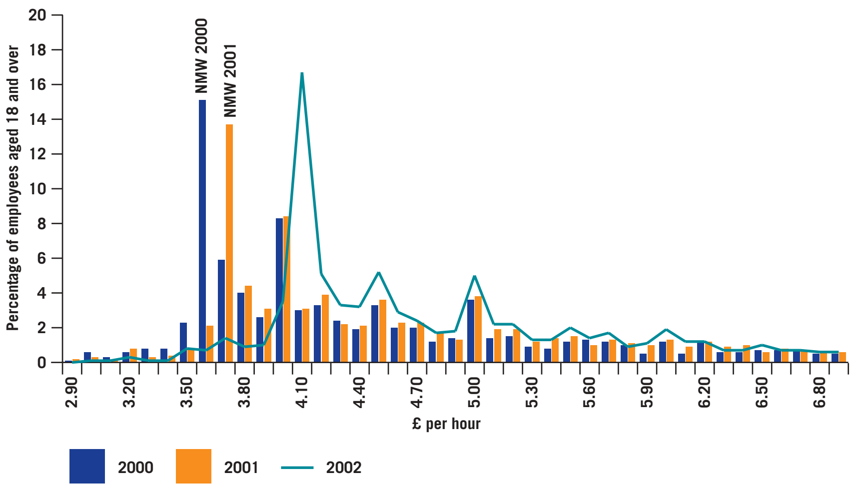
Figure 3.8
Trend in Employee Jobs in the Hospitality Sector, 1998–2002



Source: ONS employee jobs series, 1998–2002, GB.
Note: Data are not seasonally adjusted.

3.31 The impact of the minimum wage on earnings in the hospitality sector is shown in Figure 3.9. Around 17 per cent of employees were paid the adult National Minimum Wage in April 2002 and, in contrast with the retail sector, there is little difference between small and large hospitality firms. The impact of the minimum wage can clearly be seen at the lower end of the pay distribution, with lowest decile earnings moving in line with minimum wage rates.

Figure 3.9
Hourly Earnings Distribution for Employees Aged 18 and Over in the Hospitality Sector, April 2000–2002



Source: Grossed NES, April 2000–2002.
Note: NMW label shows the adult NMW rate in April of the given year.

3.32 The upward shift in earnings at the lower end of the earnings distribution has contributed to increased wage costs for the hospitality sector. An August 2002 survey by the British Hospitality Association of 360 members found that in the previous 12 months payroll costs had risen by more than 3 per cent in almost two-thirds of businesses and by over 10 per cent for 15 per cent of businesses. But it is difficult to differentiate between the impact of the minimum wage and the tight labour market in raising wage costs. A large majority of respondents (83 per cent) to an IDS survey (2002b) said they were having difficulties recruiting and retaining staff despite the downturn in tourism in 2001.

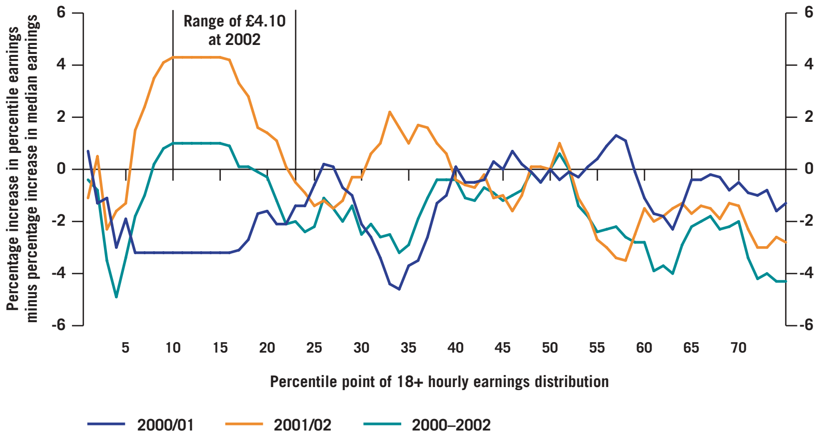
'The increase in payroll costs is blamed on competition from other industries – three-quarters of respondents said they needed to compete in this way to recruit and retain staff. But nearly half (46 per cent) cited the increase in the National Minimum Wage which reflects, almost exactly, the proportion of hotels whose lowest payment is at or about the NMW.... A clear north/south divide appears to exist, with 16 per cent in the south on NMW and 28 per cent in the north.'

British Hospitality Association news release October 2002

3.33 Our survey found that 47 per cent of respondents in the hospitality sector affected by the minimum wage reported reducing overall staffing levels and 41 per cent reported that they had reduced basic staff hours (i.e. 23 per cent and 20 per cent respectively of all respondents in the sector). Evidence from the British Beer & Pub Association reported that productivity levels and the working patterns of existing staff were being made more efficient, with adjustments made to working hours of existing employees before recruiting new staff.

3.34 Differentials were also being squeezed in 2001/02 as a result of the large October 2001 increase. But IDS (2002a) reported that, in contrast with previous increases in the minimum wage, the October 2001 uprating has not led to fundamental restructuring of pay structures or the removal of tiers. Business in Sport and Leisure reported that the effect of the uprating was 'to diminish or eliminate differentials in pay rates in the wages paid to supervisory staff. Whereas companies were previously able to offer supervisors a rate significantly above the basic rate, now the rates offered were only a few percentage points higher.' In their oral evidence to us, employers in the hospitality sector suggested that the squeezing of differentials in 2001/02 was due to the substantial increase in the minimum wage and the need to contain costs. There are signs that employers are using the following year to restore some of the previous balance in pay structures. The macroeconomic evidence discussed in Chapter 2 suggests that this is being achieved by implementing below-average increases for the lowest-paid staff rather than through knock-on increases further up the earnings distribution. This is also borne out by the sectoral data on earnings differentials presented in Figure 3.10.

Figure 3.10
Increase in Hourly Earnings Minus the Increase in Median Earnings by Percentile for Employees Aged 18 and Over in the Hospitality Sector, 2000–2002



Source: Grossed NES, April 2000–2002.

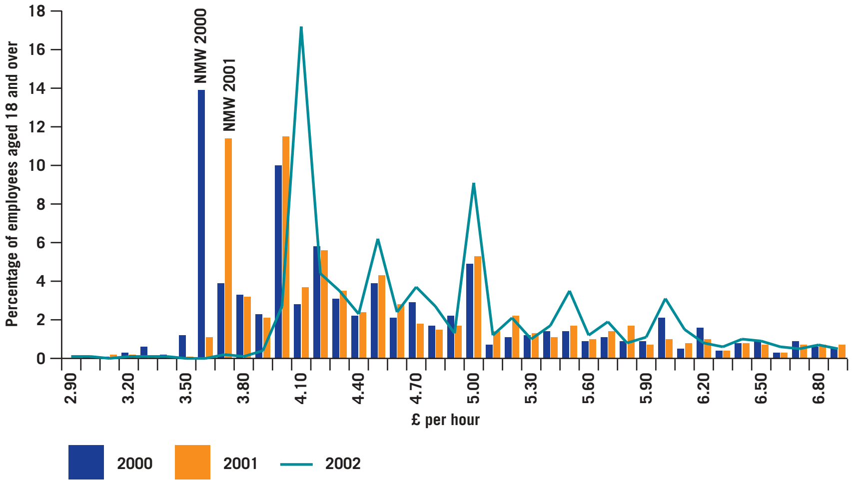
Cleaning and Security

3.35 Data from the Office for National Statistics (ONS) employee jobs series, which is based on employer surveys, show there are around 385,000 jobs in the cleaning sector. But data from the Labour Force Survey (LFS) show that many workers classifying themselves as cleaners work in other sectors, suggesting the total number of cleaning employees is around 700,000. This estimate is still lower than estimates from the Cleaning and Support Services Association (CSSA) of around 800,000. The CSSA evidence suggests that the actual number of cleaners may be even higher since this excludes those working as domestic helpers in private houses.

3.36 The official employee jobs data suggest that the trend in the number of employees in the cleaning sector has been downwards since the minimum wage was introduced. But LFS data, covering cleaners in all sectors, suggest that it has been broadly flat.

3.37 In the cleaning sector changes at the lower end of the earnings distribution closely mirror changes in the National Minimum Wage, reflecting the high proportion of workers earning the minimum wage. Lowest decile earnings in this sector correspond with the adult minimum wage rate. As demonstrated in Figure 3.11, there is a substantial spike at £4.10–£4.19 per hour, with 17 per cent of employees aged 18 and over earning in this range.

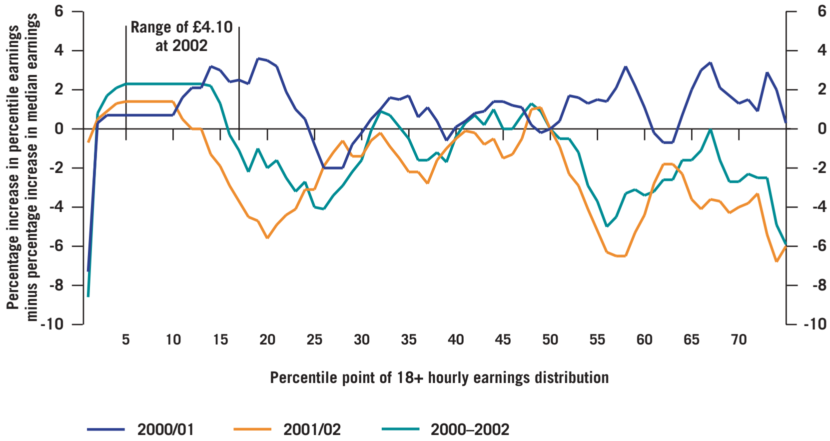
Figure 3.11
Hourly Earnings Distribution for Employees Aged 18 and Over in the Cleaning Sector, April 2000–2002



Source: Grossed NES, April 2000–2002.
Note: NMW label shows the adult NMW rate in April of the given year.

3.38 The impact of the recent upratings on the cleaning sector differs significantly from the impact on other low-paying sectors. Differentials in the cleaning sector are very compressed. As illustrated in Figure 3.12, a wide range of the earnings distribution is at the October 2001 minimum wage, which extends between the 5th and the 17th percentiles. The direct impact of the October 2001 uprating therefore extends to the 17th percentile, but workers between the 14th and 17th percentiles actually received less than the median increase and differentials were compressed further beyond this point. Over a two-year period higher than average increases were only received by workers up to the 15th percentile, and workers between that point (£4.10 at 2002 levels) and the 30th percentile (£4.50 at 2002 levels) all received less than average increases, further compressing differentials. The squeeze on differentials may be a consequence of the widespread use of fixed-term commercial contracts, which limit scope for pay increases and shift the emphasis towards redefining service levels in order to contain rising costs. We discuss the impact of fixed-term commercial contracts in more detail below.

Figure 3.12
Increase in Hourly Earnings Minus the Increase in Median Earnings by Percentile for Employees Aged 18 and Over in the Cleaning Sector, 2000–2002

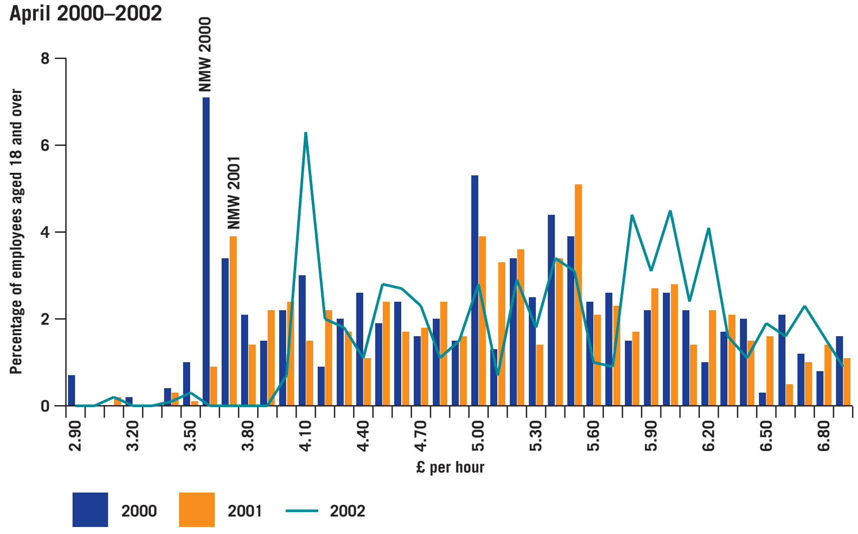


Source: Grossed NES, April 2000–2002.

3.39 Employment in the security sector has been on a slight upward trend since the minimum wage was introduced and has remained stable since the October 2001 uprating. Around 70 per cent of workers in this sector are men and the majority of employees – nearly three-quarters – work full-time.

3.40 Along with textiles, hourly earnings in the security sector are the highest of the low-paying sectors. As Figure 3.13 shows, the spike at the minimum wage is relatively small, with considerable bunching in the distribution between £5.80 and £6.30 per hour in 2002. The youth Development Rate is not generally used. Evidence from the Business Services Association (BSA) suggested that labour shortages have meant that wages exceeded minimum wage levels in many parts of the country. The minimum wage had little or no effect in areas with labour shortages, but our evidence suggests that in some areas it has prompted significant increases in wages.

Figure 3.13
Hourly Earnings Distribution for Employees Aged 18 and Over in the Security Sector, April 2000–2002



Source: Grossed NES, April 2000–2002.
Note: NMW label shows the adult NMW rate in April of the given year.

3.41 The main issue of concern to both the cleaning and security sectors is the impact of minimum wage increases on fixed-term commercial contracts. Contracts in the business services sector typically last for several years and generally either operate for a fixed price or provide for price increases based on the Retail Price Index.

3.42 Following increases in the minimum wage contractors seek to renegotiate the price and the level of purchased service with the client. The industry reports that while some clients may be willing to fund direct increased costs resulting from the minimum wage, they will provide little or no assistance towards the cost of maintaining differentials.

3.43 The BSA recommended that a standard clause should be included in all relevant contracts committing the client to review the contract with the contractor in the event of the Government increasing the National Minimum Wage. We do not believe that the problem warrants regulation, although trade associations and other business advice services may want to highlight the need for firms to build the cost of the minimum wage into contracts, or to include review clauses.

3.44 The BSA and CSSA both report that Government agencies, particularly the Ministry of Defence, are some of the more reluctant clients to renegotiate contracts. We would encourage the Government to follow what is now considered to be best practice in the private sector by providing for rates and service levels to be reviewed to take account of increases in the National Minimum Wage.

‘There is evidence of client unwillingness to honour NMW increases in contracts. A reduction in hours purchased has sometimes been the response, so as to contain contract costs. More importantly clients have been unwilling to honour the knock-on effects of NMW increases in NI contributions, holiday pay and associated labour charges.’

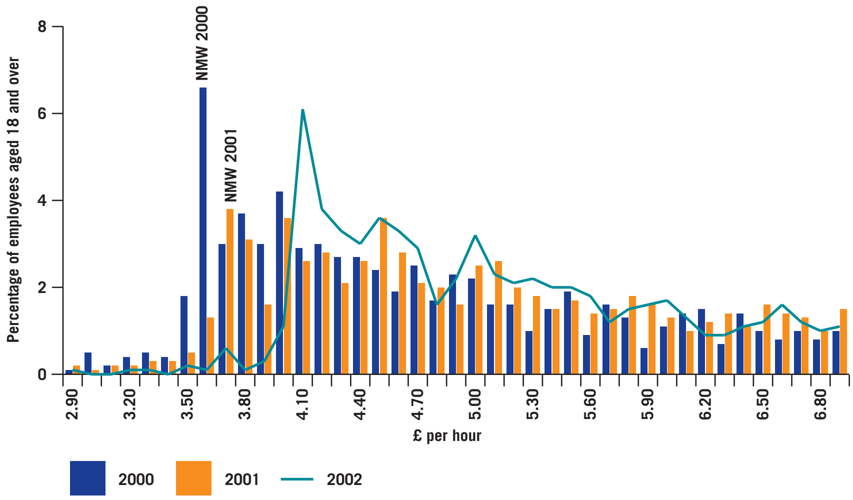
CSSA evidence

Social Care

3.45 Employment in the social care sector has been relatively stable over the past few years, and has remained so since the October 2001 uprating of the minimum wage. The vast majority of workers in the sector – around 85 per cent – are women. Around 60 per cent of these women work part-time and this has not changed since the minimum wage was introduced.

3.46 As Figure 3.14 shows, 16 per cent of employees in the social care sector aged 18 and over were paid less than £4.10 per hour in April 2001, and there is a clear spike in the distribution at the adult rate of the minimum wage: 6 per cent of employees were paid at or just above £4.10 per hour in April 2002, whilst lowest decile hourly pay has remained close to the minimum wage.

Figure 3.14
Hourly Earnings Distribution for Employees Aged 18 and Over in the Social Care Sector, April 2000–2002



Source: Grossed NES, April 2000–2002.
Note: NMW label shows the adult NMW rate in April of the given year.

3.47 While the minimum wage has had an impact on the sector, some care home managers whom we visited told us that this was now outweighed by other factors – particularly funding arrangements, the new care standards and local labour market conditions. But there appears to be significant regional variation. Laing (2002) concluded that the increase in the adult rate of the minimum wage to £4.10 in 2001 'had a major impact on care home operators in less affluent areas of the country, such as the North, the extreme South West and Wales, which tend to pay at minimum wage rates. Operators in the affluent South were not affected.'

Low Pay Commission Research

A care home said, 'we are ticking over but there is nothing we can alter unless we say [to the patients] you don't have puddings any more, you don't eat cakes, ... or staff don't wear aprons and gloves ... or if we don't have fresh flowers.'

Grimshaw and Carroll, 2002. ***Qualitative Research on Firms' Adjustments to the Minimum Wage***

3.48 However, there are other pressures on pay rates. Grimshaw and Carroll (2002) noted that for care assistants, homes compete with other sectors, particularly supermarkets, which pay higher rates for jobs that are seen as less demanding and stressful. In addition, the Registered Nursing Home Association told us that the care standards target for 50 per cent of the workforce to be trained to NVQ level 2 by 2005 was likely to magnify the impact of the minimum wage because trained staff would be in demand, further impacting on the cost of care.

3.49 The regulatory and funding environment within which they work means that social care providers are more constrained than many other sectors in the ways in which they can respond to the National Minimum Wage. In particular, regulatory requirements limit scope to reduce staffing levels or otherwise increase productivity; and funding arrangements can limit the scope to increase prices. The study by Machin *et al*. (2002) described in Chapter 2 found some evidence of employment and hours reductions after the minimum wage introduction, though the estimated effects were not that sizable given how heavily the wage structure was affected. Results from our survey suggest that profit margins may be more affected than employment. Twenty per cent of social care respondents to our survey who had been affected by the 2001 uprating reported reducing overall staffing levels in response – the lowest proportion of all low-paying sectors sampled. By contrast 90 per cent of social care respondents affected by the uprating (half of all respondents in this sector) reported a reduction in profits – a higher proportion than any other sector. The Association for Residential Care reported that some employers tried to contain costs by keeping workers' hours and wages below the tax and National Insurance thresholds, but this meant their clients were cared for by increasing numbers of workers, which was undesirable.

3.50 In our third report we commented that the social care sector is in an almost unique position because of its reliance on public funding. In our view, unless adequate funding was provided to meet the additional costs of the minimum wage in social care there could be a detrimental impact on provision. We recommended that the Government should ensure that a new agreement between central and local government, health bodies and independent care providers made clear that policies on commissioning care should reflect the costs of provision.

Low Pay Commission Research

A care home said, 'there's a new retail park going to be built in [the local area].... How the hell are we going to keep our employees when they do that? I haven't the faintest idea, because they will pay them a damn sight more.'

Grimshaw and Carroll, 2002. *Qualitative Research on Firms' Adjustments to the Minimum Wage*

Low Pay Commission Research

In the care sector in an English East Coast resort town, strategies for coping with the minimum wage included use of part-time hours, attempting to reduce hours in non-care areas, cutting down on premium payments (e.g. for bank holiday working) and deferring promotions and training.... There was evidence of owner/managers taking cuts in earning and pay themselves.... There was some evidence of the care homes trying to reduce staffing, but this was extremely difficult given the Care Standards stipulations on staffing levels. One care home owner/manager tried reducing the hours of domestic staff but found it difficult to maintain standards of cleanliness.

Rainbird *et al.*, 2002. *The National Minimum Wage and Training*

3.51 We were pleased that the Government accepted our recommendation. The publication of the agreement *Building Capacity and Partnership in Care* in October 2001 was accompanied by the announcement of £100 million additional funding for local authorities in England for the second half of 2001/02 and a further £200 million for 2002/03 (Department of Health (2001b)). In addition, in the 2002 Spending Review the Government announced that social services resources in England would increase by an annual average of 6 per cent above inflation over the next three years, with £1 billion of support for older people's social care services by 2006. The Confederation of Scottish Local Authorities also agreed higher fees for publicly funded clients in nursing and residential homes.

3.52 During the past year or so there have been some increases in fees. *Community Care Market News* reported in June 2002 that the vast majority of councils had implemented fee increases above 3 per cent; of those councils which reported their fee rates, 35 per cent had increased some or all rates by at least 10 per cent since the previous year (Laing & Buisson (2002a)). Laing & Buisson (2002b) noted that the Department of Health expected that about one-third of the £1 billion per year additional funding for older people's services projected by 2005/06 could be spent on care home fees.

"As a rough guide, we believe that for every 10p on the minimum wage adds £100 million to the national care home bill."

Laing & Buisson (Publications) Ltd evidence

3.53 At the same time, as the Government's evidence to us noted, it is for local authorities to decide how to allocate the funds they receive. In our survey, among social care respondents affected by the 2001 uprating of the minimum wage, 80 per cent had public sector contracts and, of these, almost three-quarters tried to renegotiate their prices after the 2001 minimum wage increases. However, among those who tried, six out of ten said they were unable to recoup any of the increase in their pay bill, and a quarter recouped less than 25 per cent of the increase.

3.54 It is clear that in the past year or so fees paid by some local authorities have reflected greater recognition of the costs of provision. But it is also clear that some problems remain. We continue to believe that the agreement has a key role to play. **We recommend that the Government should continue vigorously to promote implementation of the 2001 agreement on commissioning care and should ensure that its impact is carefully monitored**.

3.55 Having considered the overall economic impact of the minimum wage on the social care sector, we now turn to a more specific policy question of particular relevance to the sector, namely how the National Minimum Wage applies to 'sleepovers'. 'Sleepovers' cover situations where, for example, someone works a day shift in a care home and then sleeps in the home overnight and is available to deal with emergencies but would not necessarily expect to be woken. Similar situations may arise with workers who care for an elderly or disabled person in his or her own home and sleep on the premises, or with wardens in sheltered housing who are available to deal with emergencies during the night.

3.56 In our earlier reports we concluded that for 'sleepovers', where the assumption is that the worker will not normally be woken, the National Minimum Wage should not apply (in practice an allowance is usually paid) but workers should be entitled to the National Minimum Wage for the times when they were awake and required to be available for work. We noted the difference between these 'sleepovers' and on-call or standby arrangements where a worker is required to be at the workplace outside of normal working hours with the expectation that he or she will be required to work, for which the National Minimum Wage is payable. The Government accepted and acted upon our recommendations, and we believe that these still reflect the right approach.

3.57 Certain recent Employment Appeal Tribunal judgments have held that the National Minimum Wage was payable in circumstances where the worker was able to sleep at times during the night. Some respondents to our consultation expressed concern that these judgments might imply that the National Minimum Wage was payable in the 'sleepover' cases which we had considered earlier.

3.58 We recognise that a variety of practical arrangements exists, ranging from cases where it would be extremely rare for the worker to be woken during the night through to cases where the worker would expect to spend a significant part of each night working. We doubt that it would be feasible or desirable for the Regulations to attempt to prescribe detailed solutions for each possible set of circumstances. Some business representatives whom we have consulted have also suggested that any remaining uncertainties can be resolved through contractual agreements between employer and employee.

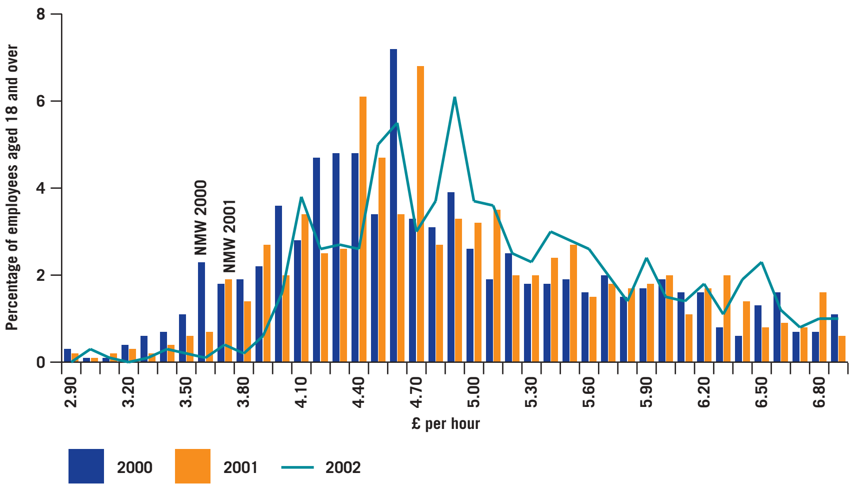
3.59 Nevertheless, it is clear that some uncertainty remains. We believe it important to ensure that the position as set out in our earlier recommendations on 'sleepovers' is maintained and clarified. **We therefore recommend that the Government should examine whether the present uncertainty over the treatment of 'sleepovers' can best be resolved through revised guidance, or whether a change to the Regulations is required.**

Childcare

3.60 Provision of childcare has expanded rapidly over the past few years. It is not possible specifically to identify those employed in the childcare sector from the published sectoral data, and so Appendix 6 does not include employment data for this sector. But the Childcare Workforce Surveys (Department for Education and Skills (2002b)) suggested that between 1998 and 2001 the numbers of providers of nurseries and out of school clubs increased by 42 and 86 per cent respectively, and during the same period the numbers of places in nurseries and out of school clubs grew by 95 and 130 per cent respectively. Over this period, the workforce in the sector (excluding childminders, who are self-employed) grew by 52 per cent to 202,000 employees. The sector is characterised by a large number of small providers. The National Day Nurseries Association told us that around 85 per cent of day nursery provision is by single-site owner-managers.

3.61 As Figure 3.15 illustrates, around one in ten employees aged 18 and over working in childcare occupations was paid below £4.10 per hour in April 2001; and in April 2002, 4 per cent were paid at or only a few pence per hour above the minimum wage adult rate. In addition, lowest decile hourly pay between 2000 and 2002 has remained close to the minimum wage.

Figure 3.15
Hourly Earnings Distribution for Employees Aged 18 and Over in Childcare Occupations, April 2000–2002



Source: Grossed NES, April 2000–2002.
Note: NMW label shows the adult NMW rate in April of the given year.

3.62 In our survey of firms in low-paying sectors over two-fifths of childcare respondents reported wage bill increases of 5 per cent or more due to the 2001 increases in the minimum wage, and nearly half said they had increased pay for higher-grade staff. IDS (2002d) reported similar findings. In a survey of 140 day nursery employers, 39 per cent indicated they were 'significantly affected' by the 2001 uprating of the minimum wage, just under half said they had had to raise pay rates to comply, and a fifth said they had raised rates for more senior staff to maintain differentials.

3.63 But it is doubtful whether wage bill pressures can be attributed purely to the minimum wage. IDS (2002d) found that almost two-thirds of respondents in their survey of day nurseries reported difficulty in recruiting staff, and that problems with recruitment were widespread across almost all regions. Respondents cited an overall national shortage of qualified childcare workers when the nursery sector was expanding; losing staff to take up jobs in schools; and the high cost of living in some areas.

3.64 Childcare is similar to the social care sector in that regulatory requirements constrain employers' ability to reduce staffing levels or increase productivity. But, compared with the social care sector, there appears to be more scope to recoup increased wage costs by raising fees. In our survey, 42 per cent of childcare respondents reported increasing prices, compared with 32 per cent of social care respondents. Seventeen per cent of childcare respondents said they had taken measures to control non-labour costs and 11 per cent reported reducing overall staffing levels.

Low Pay Commission Visit

The owners of a nursery told us that, following the minimum wage, unqualified employees' pay rose to within £30 per month of pay for qualified employees who resented this. So the nursery increased qualified employees' pay by £1,000 per year following introduction of the minimum wage and again after the October 2001 uprating. The minimum wage had not improved staff motivation. In addition, the nursery could not legally reduce staffing because of statutory staff:child ratios. It coped chiefly by increasing fees, but increases had not kept pace with the increase in the minimum wage because of competition from other nurseries and childminders. The increases had led some parents to move their children to childminders.

Following the introduction of the minimum wage, the owners of another nursery had to devise a new pay structure so that qualified under-22s supervising older, unqualified staff would be paid above the minimum wage adult rate. The minimum wage had no positive impact on morale as the higher wages were expected. The increases in nursery fees were larger than they otherwise would have been, and the extra revenue was used to fund the higher wage bill rather than maintaining and refurbishing the nursery; this was feasible for a few years but not indefinitely. They now prefer to employ students of a younger age, thus giving a greater differential between their wages and those of the qualified staff.

Low Pay Commission visit to Greater Manchester

The National Day Nurseries Association told us that the Autumn 2001 uprating caused fees to jump as firms tried to recoup increased pay bills; some parents seeking lower-cost childcare withdrew their children but generally children stayed. The Daycare Trust similarly reported that some parents had complained about increased fees but few had withdrawn their children.

Textiles, Clothing and Footwear

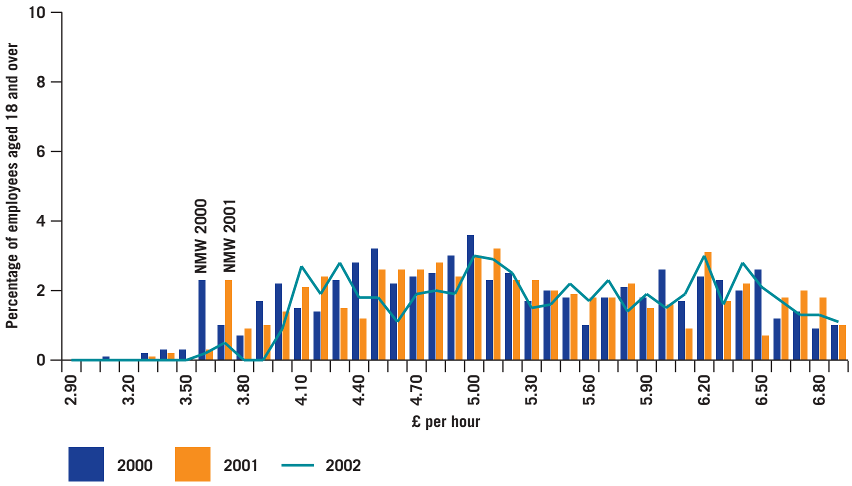
3.65 The sector has been in long-term decline and output continues to fall. The fall in output is mirrored by the decline in employment, which has been on a downward trend since before the introduction of the minimum wage, with the sector now accounting for some 190,000 jobs.

3.66 From the evidence we have received it is clear that the main pressure on this sector comes from strong competition from low-wage economies abroad, rather than from the minimum wage. Evidence from our visits and other research (for example Ram *et al*. (2001a)) suggested that the future for much of the industry in the UK lay in low volume, quick turnaround runs to fill in gaps in supply and branching out into niche markets. UK firms cannot compete with countries with much lower labour costs for longer-run production contracts. This is likely to be the case even in the absence of the National Minimum Wage. We believe that – at most – the minimum wage has done no more than accelerate an existing trend.

3.67 We also note that firms which operate at the upper end of the market tend to be far less directly affected by the minimum wage. For example, the Scottish Textile Manufacturers Association commented that 'to date, within businesses that are still operating, there has been no significant impact on employment levels reported as a result of the current [minimum wage] rates.… Pay levels have, in general, had to reflect local market rates to attract and maintain good people, and these have still tended to be above the minimum rates.'

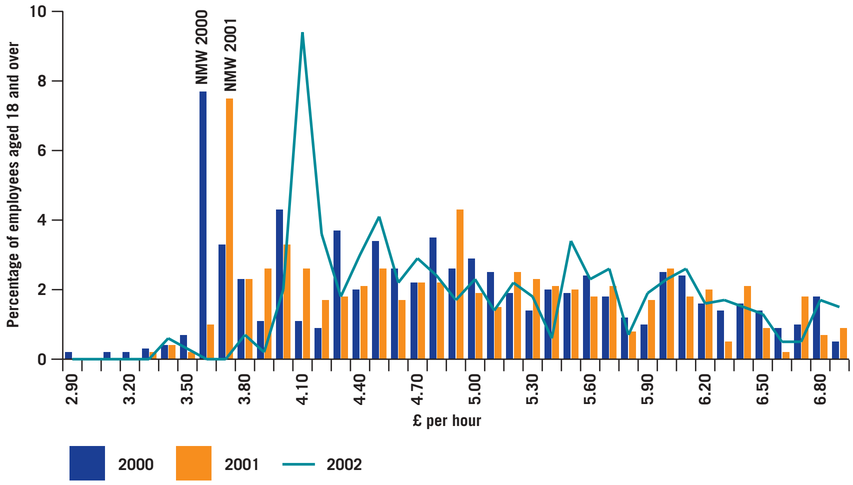
3.68 The earnings distributions for the textiles and the clothing and footwear sectors are shown in Figures 3.16 and 3.17 respectively. The two distributions are quite different, with clothing and footwear on the whole being much lower-paid. In clothing and footwear, 18 per cent of employees aged 18 and over were paid less than £4.10 per hour in April 2001 whereas in textiles the figure was 7 per cent. In addition, in clothing and footwear there is considerable bunching of earnings around the adult minimum wage rate in April 2002, but in textiles the distribution is much flatter. Lowest decile pay in clothing and footwear has remained very close to the minimum wage adult rate between 2000 and 2002.

Figure 3.16
Hourly Earnings Distribution for Employees Aged 18 and Over in the Textiles Sector, April 2000–2002



Source: Grossed NES, April 2000–2002.
Note: NMW label shows the adult NMW rate in April of the given year.

Figure 3.17
Hourly Earnings Distribution for Employees Aged 18 and Over in the Clothing and Footwear Sectors, April 2000–2002



Source: Grossed NES, April 2000–2002.
Note: NMW label show the adult NMW rate in April of the given year.

3.69 Some firms in the clothing industry make significant use of incentive pay schemes and piece rates. We have received conflicting evidence on the effect of the minimum wage on these schemes. The British Apparel & Textile Confederation told us in oral evidence that the 2001 increase had had a severe impact on incentive payment schemes, wage bill costs and differentials. In addition, five clothing manufacturers whom we met in Coventry were unanimous that the minimum wage had restricted the effectiveness of the piecework system. The minimum wage meant there was no incentive for the less productive workers to achieve a satisfactory level of output or productivity.

3.70 Our survey showed that firms with incentive pay schemes were more likely to have been affected by the October 2001 uprating than firms without (58 per cent compared with 22 per cent). But the impact of the minimum wage was different from that reported in oral evidence and on visits. Fifty per cent of the firms in our survey with incentive pay schemes reported that the minimum wage had had no impact on differentials, competitiveness, motivation or productivity.

3.71 Compared with other sectors, only a small proportion of textiles firms (11 per cent) responded to the 2001 uprating by increasing prices: as Grimshaw and Carroll (2002) noted, clothing and footwear firms ‘find it impossible to press for a rise in product prices from high street chains and wholesalers in the UK because retailers are increasingly able and willing to look abroad for cheaper products’.

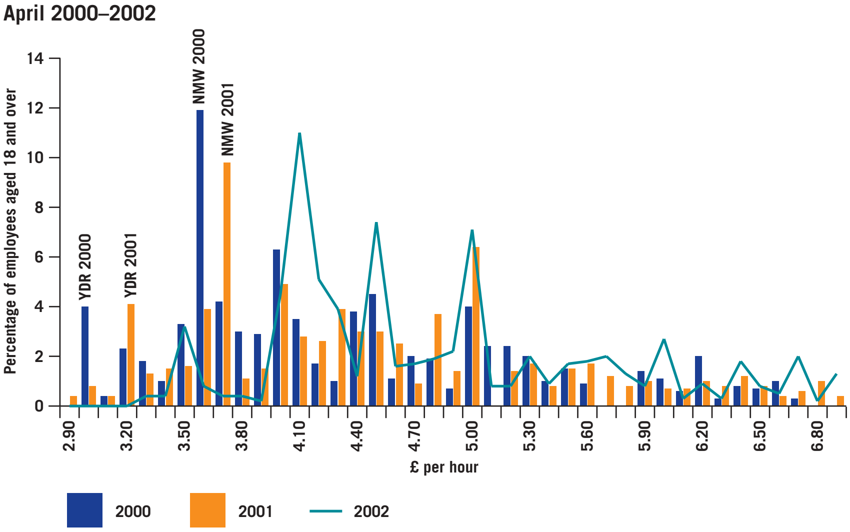
3.72 While it is inevitably difficult to quantify, there is a lot of anecdotal evidence to suggest that the informal economy is a significant factor in this sector. Some sources suggested to us that the informal sector might match the formal sector in size. Grimshaw and Carroll (2002), who carried out research in North West England, reported that ‘confidential sources with extensive knowledge of the local industry informed us that the going rate of pay for most workers is currently around £2 to £3 per hour’. This clearly raises questions of compliance and of unfair competition for those firms which do pay the National Minimum Wage from those which are prepared to flout the law. We examine non-compliance with the minimum wage in Chapter 5.

Hairdressing

3.73 The number of people employed in hairdressing has remained very stable – at around 100,000 – since the introduction of the minimum wage. The proportion of employees working part-time in this sector is on a gradual upward trend, with more than 50 per cent of hairdressers now working part-time.

3.74 The percentage of employees paid less than the adult minimum wage rate has remained relatively high compared with other sectors; this is partly because the hairdressing sector makes more use of the youth Development Rate and training exemptions than other sectors. As illustrated in Figure 3.18, 12 per cent of employees aged 18 and over were paid less than £4.10 per hour in April 2002; and around 11 per cent of employees were paid the adult National Minimum Wage.

Figure 3.18
Hourly Earnings Distribution for Employees Aged 18 and Over in the Hairdressing Sector, April 2000–2002



Source: Grossed NES, April 2000–2002.
Note: NMW label shows the adult NMW rate in April of the given year. YDR label shows the youth Development Rate in April of the given year.

3.75 Research carried out for us by Druker *et al.* (2002) indicated that the minimum wage had a significant effect when it was introduced in April 1999, although the upratings in October 2000 and 2001 had less impact. Some salons reported that they now review their pay rates at the same time as upratings in the minimum wage which they use as a benchmark for pay rates.

3.76 The majority of hairdressing businesses are micro-businesses, usually single salons. Druker *et al.* found that many of the small businesses they spoke to were concerned to maintain a 'steady state' in their business. If this is the case, proprietors may simply adjust to increases in the minimum wage by absorbing the costs rather than making more innovative changes to the way the business is run. Indeed Druker *et al.* found that the most common response was to increase prices to customers. This was also the case in our latest survey of low-paying sectors. But representatives from the hairdressing sector told us there was a limit to how much prices could be raised without affecting demand.

3.77 The biggest issue for the hairdressing sector in relation to the minimum wage is the impact on young workers, most of whom are apprentices or trainees. It was an issue discussed by many interviewees in the research by Druker *et al*.. Apprentices and younger workers bring in little if any income from clients, and in some cases jobs were lost with the introduction of the minimum wage. Since then interviewees reported that the result of the youth Development Rate has been to limit the recruitment of apprentices and trainees over the age of 18, or even 17, because of the longer-term cost implications of their employment. Our own survey found that a third of the hairdressers affected by the minimum wage reported that they were now more likely to employ 16–17 year olds, and almost half reported that they were now less likely to employ 18–21 year olds. Salon owners are concerned about the cost of paying the youth Development Rate from age 18 (or 19 if the young person continues on an apprenticeship). The long period when the trainee is unproductive has also removed opportunities for adult workers to retrain as hairdressers in salons. This was confirmed to us in evidence received from the National Hairdressers' Federation and the Hairdressing Employers Association.

3.78 Druker *et al*. found some evidence that the minimum wage is encouraging employers to pay more attention to training. Some salon owners reported that they were monitoring trainees' development more carefully to ensure that they would meet the required standards in a given time frame (in many cases by the time they became eligible for the National Minimum Wage). If standards were not met the apprentice might not be retained. Conversely, there were opportunities for good trainees to progress more rapidly.

Low Pay Commission Research

The only difference is that I have to seriously think about taking on 17 year old apprentices – 18 is a no-no. Just because of the age. People of 20 apply to us who know they need 2.5 years training and we cannot take them on.

Managing Director, Hairdressing group with 11 salons, London

18–19 year olds are the problem – if you have to pay them £3.50 per hour they have to generate three times that amount to be worth it. This is the issue with the NMW. In the past when you might have paid them, say, £88 per week it was easier. Salons operating in the black economy don't have these problems of course.

Salon owner/manager, Neath

Druker *et al.*, 2002. *Report to the Low Pay Commission on the Impact of the National Minimum Wage on the Hairdressing Sector*

Piecework and Therapeutic Activity

3.79 In each of our reports we have looked at the needs of groups of workers or others undertaking work-like activity who may be particularly affected by National Minimum Wage rules. In preparing this report we have looked particularly closely at the needs of two groups. We continue to be concerned that people who work from home, typically on piece rates, may not be receiving their minimum wage entitlement. And a number of organisations have expressed concern at the lack of clarity surrounding the application of the minimum wage in cases where people with learning difficulties or mental health problems undertake activities for therapeutic purposes.

Piecework

3.80 Many pieceworkers are homeworkers, amongst whom low pay is common, as we saw in Chapter 2. Under the minimum wage Regulations employers of people on piecework (called output work in the Regulations) have two options for calculating the pay of these workers. Either the worker should be paid the minimum wage for every hour worked; or the employer and the worker should come to a fair estimate agreement (FEA) as to the hours to be worked, under which the worker must be paid at least the minimum wage for the hours worked up to a limit set in the agreement. The estimate of the number of hours that the worker is likely to spend on doing the output work will not count as 'fair' if it is less than four-fifths of the time an average worker would take to do the same amount of work in the same conditions.

3.81 In our third report we noted that research had found that very few homeworkers who were paid according to output were covered by a fair estimate agreement. We heard that employers' estimates of how much work homeworkers could do in an hour were so unfair that workers were being paid £1 or £2 per hour. We also received evidence from the National Group on Homeworking (NGH) – and, shortly before we submitted our report, from an employers' organisation – which proposed amendments to the Regulations on fair estimate agreements. In view of the range of evidence received, we recommended that the Government should consult representatives of output workers and their employers to see whether there was a case for change in the Regulations on fair estimate agreements. The Government accepted our recommendation and said that it intended to issue a consultation paper on it shortly.

3.82 In preparing this report we have received further evidence about problems which homeworkers have encountered in the operation of fair estimate agreements. NGH wrote that in their experience most homeworkers were paid according to their output. In addition, most homeworkers were still not subject to a fair estimate agreement. Where a fair estimate agreement existed, particular problems surrounded the 'four-fifths rule' outlined above. NGH reported that, since the October 2001 uprating of the minimum wage, 'where homeworkers were already subject to a FEA and pay at £3.70 an hour, they actually saw their hourly wages decrease to 4/5ths of £4.10 = £3.28 an hour'. NGH suggested various changes to the Regulations including clarification or removal of the four-fifths rule.

'Our experience shows that there is a problem with the current wording of the NMW regulations which is allowing home workers to be paid less than the NMW. Some unscrupulous employers are using the four-fifths rule and timings adjustments so that the number of items that had to be covered in an hour of production increased by 20%. Therefore, although the NMW rose from £3.70 to £4.10, these home-workers did not see a 40 pence hourly rise.'

Transport and General Workers Union evidence

3.83 The GMB and the Transport and General Workers Union also expressed concern about the four-fifths rule. Suggesting changes to the Regulations, the GMB wrote, 'we are still receiving information that some employers are interpreting the requirement for a comparison with an "average worker … in the same working circumstances" as a comparison with factory workers doing similar work. It also appears that far from being agreements, many homeworkers are being co-erced into accepting employers' estimates, however stringent.'

3.84 The Government's evidence noted that both homeworker employers and representatives had suggested that it would be more straightforward to simplify fair estimate agreements with a system of fair piece rates that provided an hourly rate linked to the minimum wage. The Government said the fair piece rate proposal would appear to be more straightforward and easier for both employers and homeworkers to understand and implement, and that it seemed that it could therefore bring substantial advantages to both sides.

3.85 The Government published its consultation paper on fair piece rates in February 2003. We are pleased that the consultation paper has been issued but are disappointed that it was not issued sooner after the Government accepted the recommendation in our third report. The consultation paper was published too late for us to consider the proposals in time for this report, and we will send our response to the Government separately. A fair piece rate would express the pay rate as a price per item produced (which would be calculated on the basis of the number of items which the worker could reasonably be expected to produce per hour). A piece rate is something with which many homeworkers are already very familiar, in contrast with the present fair estimate agreement system, which requires the employer and worker to agree the number of hours the worker is likely to take to produce the required number of items. So we have sympathy with the Government's desire to simplify the rules on output work. And we share the concerns which have been expressed on the inequity of the four-fifths rule. We will be interested to see the outcome of the consultation, which we hope will lead to simpler rules and the abolition of the four-fifths rule.

3.86 We recognise that simplifying the provisions on fair estimate agreements will not solve all the difficulties faced by homeworkers. This is an area where it is inherently difficult to apply or to enforce provisions effectively. Nevertheless, ensuring that the rules are as clear, straightforward and fair as possible will help to provide an effective basis for the Inland Revenue to take enforcement action where necessary. We discuss enforcement of the minimum wage in Chapter 5, where we describe the initiatives already under way to help those homeworkers who are not receiving the wages to which they are entitled. We hope that changes to the Regulations on fair estimate agreements will be accompanied by effective, targeted enforcement action.

3.87 One further issue relating to piecework that was raised with us concerned agricultural workers. We were told of some farmers' concern that, although seasonal agricultural workers are commonly paid according to piece rates, Agricultural Minimum Wage legislation contains no provision for employers to reach fair estimate or fair piece rate agreements with their workers. It was suggested to us that farming employers would find it helpful if this and other aspects of the Agricultural Minimum Wage were brought more closely into line with National Minimum Wage provisions. The rules and operation of the Agricultural Minimum Wage are a matter for the Agricultural Wages Boards, the Government and the devolved administrations. But we welcome the fact that the Government has made clear that it plans to modernise the way in which the Agricultural Wages Board for England and Wales operates, and that work on this is continuing in consultation with the National Farmers Union, the Transport and General Workers Union and other stakeholders (Department for Environment, Food and Rural Affairs (2002b)).

People Undertaking Therapeutic Activity

3.88 In preparing our second report we found there was confusion over which activities should be defined as work for the purpose of the minimum wage. Some of the work designated 'therapeutic' for benefits purposes was in fact similar to that undertaken in open or supported employment, where people are entitled to the minimum wage. We said the basic principle must be that an individual should be considered a 'worker' unless the employer can demonstrate otherwise. There were cases, however, where the activity was purely therapeutic rather than productive, and of no commercial benefit to the employer. So we recommended that the relevant departments and agencies should produce clear guidance on what constitutes worker status for individuals undertaking therapeutic activity to ensure they are not adversely affected by confusion about the legal position. The Government accepted our recommendation and, after consulting various outside organisations, it published guidance in December 2000.

3.89 In our third report we noted that evidence submitted to us before the new guidance was issued showed continuing concern about which activities should be defined as work for the purpose of the minimum wage. Some evidence suggested that there should be some form of exemption. Other evidence argued that an exemption was not the solution. We said that we were not persuaded that an exemption would be in the interest of disabled people, but we were pleased that the Government had invited interested organisations to provide feedback on the guidance that had been issued, and in our future monitoring we would be interested to see how the guidance operated in practice.

3.90 In preparing this report we have received a substantial quantity of evidence from statutory and other organisations and individuals serving people with learning disabilities or with mental health problems. The greater level of response which we have received on this issue this time appears to have been prompted by increased awareness of the minimum wage and the possibility that it might apply, rather than because arrangements likely to attract the minimum wage have themselves become more common. As well as receiving written evidence, we have met organisations with a range of viewpoints to discuss the issues. We have visited some facilities providing activities for people with learning disabilities or mental health problems. We have also received views from service users and others. All this has shown that there is still considerable uncertainty and concern about which activities should be defined as work for the purpose of the minimum wage. We have been told that some schemes have closed because of the uncertainty over whether the minimum wage was payable or not.

Low Pay Commission Visit

A registered charity runs a sheltered workshop for people with mental health problems. All are referred by, for example, psychiatrists or community psychiatric nurses. The charity gives clients £4 per day if they attend. If a client does not attend this is followed up only in order to check on the client's health. Clients are not required to produce or do anything and, if they do, can take as long as they choose: there are no production targets. The charity has some external contracts but it does not accept contracts which would depend on clients producing output to deadlines. If necessary to ensure it delivers to contract, the charity falls back on its (waged) supervisors.

3.91 We want to reaffirm unequivocally that disabled people and people with mental health problems who are performing work are entitled to the National Minimum Wage just like any other workers. There is not, nor should there be, any productivity condition attached to entitlement to the minimum wage. We also believe, however, that activity whose focus is on providing therapeutic benefits for individuals, rather than meeting the requirements of the organisation providing it, should not be classified as work for National Minimum Wage purposes. In practice there is a spectrum of activities, and to draw a precise dividing line between what should and what should not be classified as work is not straightforward. Nor would it be possible to provide certainty on whether or not the minimum wage applies in every individual set of circumstances. But the level of uncertainty which now exists is unacceptable. We are particularly concerned that, if uncertainty causes organisations to cease genuinely therapeutic activities, it may have the perverse effect of reducing longer-term work prospects for disabled people and people with mental health problems, by reducing opportunities for them to gain the skills they need to prepare them for work.

3.92 We have discussed with a range of outside organisations where the boundary should lie between work, attracting the minimum wage, and non-work activity, to which the minimum wage should not apply. In the light of this and of all the evidence we have received, in our judgment an activity should not be regarded as work if all of the following four conditions apply.

- The activity is demonstrably focused on meeting the needs of the individual involved rather than the needs of the organisation. It should be permissible for the organisation to derive some benefit from the activity – such as from selling any output produced by the individual to help offset the cost of providing the activity – but the activity should be intended, and designed, to serve the needs of the individual rather than of the organisation.

- The individual is referred to the activity – and is monitored and supported in it on an ongoing basis – by a health or social care professional (such as a GP, psychiatrist or social worker) who is employed by the NHS, a local authority or a charity.

- The arrangement has been agreed with the individual and not made over her/his head.

> *"We see no case for the exemption or partial exemption from the NMW for employees on the grounds that they are disabled and would oppose any such move."*
>
> **Association for Supported Employment evidence**

> *"Both client and provider are finding that instead of being more able to help the disabled achieve employment, the Government, through the NMW, has inadvertently created the first barrier."*
>
> **Shaw Employment Services evidence**

> *"We believe that people with mental health problems who are paid on the basis of the hours or sessions they work be it in open employment or more sheltered settings should be covered by the National Minimum Wage."*
>
> **South West London and St. George's Mental Health NHS Trust evidence**

> *If people … could gradually increase their hours up to 16 per week [without affecting their benefit] … (as people on incapacity benefit alone can), then their confidence will increase and many more will progress into ordinary jobs.*
>
> **Institute for applied health & social policy, King's College London evidence**

- The tempo of the activity, and of any output or delivery target, reflects the needs of the individual rather than those of the organisation.

3.93 In our view, if all the above conditions are met it should be permissible for an individual doing such activity to receive some payment without being covered by the minimum wage. If any of the conditions is not met the activity should be regarded as work and attract the minimum wage.

3.94 In its evidence the Government wrote that it would issue revised guidance on the minimum wage and therapeutic activity. **We recommend that the Government should monitor its impact very closely, in particular whether it helps to reduce uncertainty for those involved in this field, and should ensure that people doing therapeutic activity are not adversely affected by uncertainty about the minimum wage.**

3.95 Much of the evidence which we have received about therapeutic activity has also expressed concern about the way in which the minimum wage interacts with benefits paid to people because of illness or disability. Numerous evidence submissions have said that people with learning disabilities or mental health problems who receive an income-related benefit are very anxious not to earn over £20 per week as it would require their benefits to be reassessed. This can take time and causes anxiety, so recipients are deterred from trying to increase the number of hours which they work beyond about four hours per week.

> *For most people with learning disabilities or mental health problems, the minimum wage rule only allows 4.7 hours work without detriment to benefit payments. This is unreasonable. The fact that someone has a learning disability or severe mental ill-health means that learning has to be structured, practised and ongoing. Trying to learn a new task for one half day each week means that progress will be very slow or non-existent.*
>
> **Mental Health Matters evidence**

3.96 The Government has made clear in *A National Service Framework for Mental Health* and in its strategy for learning disability *Valuing People* (Department of Health (1999) and (2001a)), that it wants to promote employment opportunities for disabled people and people with mental health problems. In *Valuing People* the Government said it recognises that the rules on earning income while in receipt of benefits can discourage disabled people from taking up employment. Various measures have been introduced to address this. Our remit is the National Minimum Wage, rather than the design of benefits. But in view of the Government's overall employment objectives for disabled people and those with mental health problems, we hope that if – even with the new measures – the interaction of the minimum wage with benefit rules were to impede these objectives, further consideration would be given to ensuring effective work incentives for these vulnerable groups.

Accommodation Offset and Tips

3.97 In preparing this report we have received written evidence, and had discussions in meetings and visits, about two aspects of the composition of pay: the accommodation offset, and tips and gratuities. We consider these issues here.

Accommodation Offset

3.98 Where an employer provides accommodation for a worker, this benefit in kind may count towards National Minimum Wage pay up to a maximum of £22.75 a week. Amongst the low-paying sectors which we examine, provision of tied accommodation is more common in the hospitality sector than in any other sector.

3.99 A number of employer organisations in the hospitality sector have called for a considerable increase in the level of the offset to around £35–£65 per week on the grounds that this represents a more realistic recognition of the cost to the employer and would encourage employers to continue to provide accommodation to workers. The British Beer & Pub Association reported that the level of the accommodation offset appears to be prompting some companies to move away from accommodation as a benefit in kind in favour of wages that count towards the National Minimum Wage. But we are also aware that the number of people in tied accommodation in the hospitality sector increased last year.

3.100 In previous reports we have concluded that the offset should not be intended to reflect either the commercial value of the property or the cost to the employer of providing accommodation. On the other hand, it is reasonable to have a mechanism which reflects, at least partially, the costs to the employer and the benefits to the worker. We continue to believe that this is the right approach. Our aim is to retain the balance between providing employers with a reasonable amount which they can deduct in respect of accommodation while not reducing the value of the minimum wage to workers.

> *‘BISL would like the accommodation offset in the context of the National Minimum Wage to be set at £50 per week nationally and £65 per week in London. Employers would obviously still have the discretion to provide free or lower cost accommodation.’*
>
> **Business in Sport and Leisure evidence**

> *‘We were disappointed that the LPC decided to increase the accommodation deductor and by such a large amount.... We believe that, certainly for the next few years, the offset should be frozen at the present level while the NMW is raised.’*
>
> **GMB evidence**

3.101 It is also important that the rules on the accommodation offset should be simple and easily understood. At present the National Minimum Wage Regulations provide for an offset of 57 pence per hour worked or a daily offset of £3.25, whichever is the lower, and subject to a total maximum offset of £22.75 per week. In our second report we noted concern among some employers about the method of calculation of the offset and recommended that the Government should investigate simplifying the Regulations. We reported in our third report that the Government had 'looked into simplifying the Regulations regarding the application of the accommodation offset but concluded that any simplification would be at the expense of fairness'.

3.102 We continue to believe that the provision for hourly and daily rates represents an unnecessary complication. Evidence from the Association of Licensed Multiple Retailers stated that 'accommodation is offered on a daily basis and we therefore believe that the Commission should propose ending the current system of considering both daily and hourly offset rates. Within the sector shift patterns are not uniformly steady week to week and it is therefore often difficult to judge at which rate the offset should be calculated.' We have also seen some evidence which suggests that both employers and employees can find the present combination of hourly, daily and weekly rates confusing, which may lead to inadvertent non-compliance. We do not believe that accommodation is generally provided to people working only a few hours each week and, even where it is, we believe that a reasonable weekly charge would be considered fair by employees. **We therefore recommend that the level of the accommodation offset should be increased in line with the increase in the adult rate, producing a rate of £24.40 per week in October 2003 and £26.25 per week in October 2004, and that the hourly and daily rates should be abolished. Where accommodation is provided for less than the full week, the accommodation offset should be correspondingly reduced**. We continue to believe that benefits other than accommodation should be excluded from the calculation of the National Minimum Wage.

3.103 Several employers raised concerns about the relationship between the National Minimum Wage and the Inland Revenue's treatment of accommodation as a benefit, on which it placed a higher value than the amount allowed by the accommodation offset. It was also queried whether the rules on deductions from gross pay eligible to count towards the National Minimum Wage altered employees' tax charges and liability for National Insurance Contributions (NICs). We have corresponded with the Inland Revenue and are satisfied that the tax and NICs provisions governing employer-provided accommodation and meals have not changed as a result of the National Minimum Wage.

Tips

3.104 At present only tips collected centrally by the employer and distributed to staff through the payroll are eligible to be included within the National Minimum Wage calculation. There was a limited call among respondents to our consultation for the rules about the treatment of tips and gratuities to be reconsidered.

3.105 In our third report we drew a distinction between 'income' and 'remuneration'. We also noted that the purpose of the minimum wage is to provide a wage floor, not a minimum 'income'. Therefore although the Inland Revenue treated all tips as 'income' for taxation purposes, we believed that the National Insurance treatment of tips was important in making a distinction between remuneration – passing through the employer's hands – and the distribution of tips by the employees themselves.

3.106 In September 2002 the European Court of Human Rights (ECHR) considered a case brought by four waiters working in London. The claim covered the six-year period prior to 6 March 1989 and centred on whether tips added to a cheque or credit card payment could count towards the 'minimum wage' if paid by the employer under the PAYE system. (It should be noted that the 'minimum wage' was set by wages councils established under the Wages Councils Act 1979 and the Wages Act 1986 and the case predated the National Minimum Wage Act 1998.) Tax and NICs were paid on the amounts received and the ECHR ruled that the employer had legitimately included the tips made by cheque or credit card payment in the minimum wage.

3.107 We consider the ECHR ruling entirely consistent with the treatment of tips under the National Minimum Wage and remain of the view that only money collected centrally and distributed through the payroll should be allowable against the National Minimum Wage.

Conclusion

3.108 As well as looking at the overall impact of the minimum wage, we have been concerned to understand what effect it has had on those sectors and groups of workers which have been most affected. We have obtained information from statistical data, from responses to our consultation exercise – in particular from the relevant trade associations and employee representatives – from research and from our programme of visits. Some firms have found coping with the minimum wage a challenge, particularly when it has been combined with a difficult external environment. But in each of the sectors we have looked at we conclude that the minimum wage and the October 2001 uprating have been absorbed without significant adverse impact on employment. There have, however, been some difficulties for the social care sector and the cleaning and security sectors, prompted largely by their reliance on local authority funding and their extensive use of fixed-term commercial contracts respectively.

3.109 We remain concerned that homeworkers continue to be among the most vulnerable groups of workers. We hope that, following its consultation, the Government will bring forward new Regulations on fair estimate agreements which will be easier to operate and will help to ensure that homeworkers receive at least the minimum wage. We are also concerned about continuing uncertainty over the position of people doing therapeutic activity, and we recommend that the Government should monitor the impact of its revised guidance very closely.

3.110 We recommend that the accommodation offset should be increased in line with the adult rate of the minimum wage. We also recommend that the rules for calculating the offset should be simplified by removing the daily and hourly rates.

3.111 In the next chapter we turn our attention to another sector of the population who are liable to be particularly affected by the minimum wage. We examine the impact which the minimum wage has had on young people's earnings and employment. And we look at the relationship between the minimum wage, training, and the acquisition of skills.

4 Young People and Workforce Skills

The October 2001 uprating of the youth Development Rate benefited 18–21 year olds in just over 90,000 jobs, with others gaining indirectly from the increase in the adult minimum wage. There has been a slight easing in the labour market in the past two years and, in the year following the 2001 uprating, the employment rates among some groups of young people fell. Analysis of these recent trends and examination of commissioned research lead us to conclude that changes to the youth labour market have been primarily driven by the economic cycle, and that the minimum wage has had at most a minor impact on young people's employment.

We recognise the argument that an age-related Development Rate lacks equity but we continue to believe that young people are vulnerable in the labour market and merit special consideration. It is a matter of judgment where the cut-off for the adult rate should apply but on balance, looking at economic data and employers' practice, we continue to recommend that 21 year olds should receive the adult rate. While we continue to believe that the youth Development Rate should apply to 18–20 year olds we propose to keep the age coverage under review.

We note evidence of very low pay for 16–17 year olds and believe that, in principle, there is a case for introducing a separate minimum wage for this age group. We need to consider further the precise rate and the relationship between the minimum wage and education policy. We recommend that the Government should invite the Commission to report on its findings by February 2004, so that a rate could be introduced by October 2004.

The exemption from the National Minimum Wage for apprentices continues to work well and we consider no change is needed at present, but the apprentice exemption will need to be considered as part of any further report on introducing a minimum wage for 16–17 year olds. While use of the older workers' Development Rate continues to be low, we think it should remain in place for the time being, particularly in view of the flexibility it has offered to firms most affected by the minimum wage, and we will continue to monitor its use and impact.

Introduction

4.1 In this chapter we look in more detail at the impact of the National Minimum Wage on young people and on workforce skills. We have noted in previous reports that young people have a vulnerable position in the labour market: their wages are lower than older workers and they have higher unemployment rates. We must therefore take care to ensure that young people are not priced out of the labour market, particularly given evidence of the scarring effect of unemployment (Stewart (2000)) and international evidence (e.g. Organisation for Economic Co-operation and Development (1998)) that potential adverse effects of minimum wages are more likely to be felt among young people than adults.

4.2 Young people need appropriate experience and training to establish their position in the labour market. And, for workers of all ages, development of work skills widens job opportunities. From the outset we have been concerned that the minimum wage should not reduce training and our previous reports have recommended measures to encourage firms to increase the provision of training.

4.3 In this chapter we review aggregate and survey data, research and consultation evidence to assess the impact of the minimum wage on the youth labour market. We then consider the role of the youth Development Rate, including its age coverage, and the case for a statutory minimum wage for 16–17 year olds. Finally we assess the impact of the National Minimum Wage on training and workforce development, including the minimum wage exemption for apprentices and the older workers' Development Rate.

Beneficiaries

4.4 We now estimate that just over 90,000 jobs for those aged 18 to 21 (around 5.3 per cent of all jobs for this age group) were affected by the October 2001 uprating of the youth Development Rate (the methodology is set out in Chapter 2). This is lower than the estimate we made in our third report, where we estimated that 115,000 to 125,000 jobs for 18–20 year olds (9 to 9.7 per cent) would gain from the 2001 uprating. There are two reasons for this reduction. Firstly, including 21 year olds in the youth Development Rate reduces the overall proportion of the age group that is directly affected by the Development Rate, since earnings increase with age. Second, revisions to the data (which we outline in Appendix 3) have produced lower estimates of beneficiaries.

4.5 Similarly we estimate that a little under 90,000 jobs (4.9 per cent of jobs of 18–21 year olds) gained from the October 2002 uprating. The slight fall in the estimated number of jobs affected by the uprating in 2002 suggests that between October 2001 and October 2002 earnings of the lowest-paid young people rose faster than the ten pence increase in the minimum wage.

4.6 As with beneficiaries from the adult rate, women were more likely to benefit than men, although the difference is less marked for young people. About 55 per cent of beneficiaries aged 18–21 were women, with female part-time workers accounting for 44 per cent of the total. Compared with adult workers, younger beneficiaries were more equally split between those in part-time jobs and those in full-time jobs. A higher proportion of young people work part-time, so we might have expected a larger proportion of younger beneficiaries to be part-time workers. But this did not occur because wages for younger people are more equal across the number of hours worked than for older workers.

Earnings

4.7 Figure 4.1 shows that over the last three years a higher proportion of 18–21 year olds have been paid the adult rate than the youth Development Rate. In Spring 2002 9.2 per cent of jobs of 18–21 year olds were paid between £4.10 and £4.19, compared with 2.7 per cent paid between £3.50 and £3.59. This high proportion of young people being paid at or around the adult minimum wage rate indicates that a substantial number of young people indirectly gained from increases in the adult rate, as well as the direct beneficiaries from the youth Development Rate.

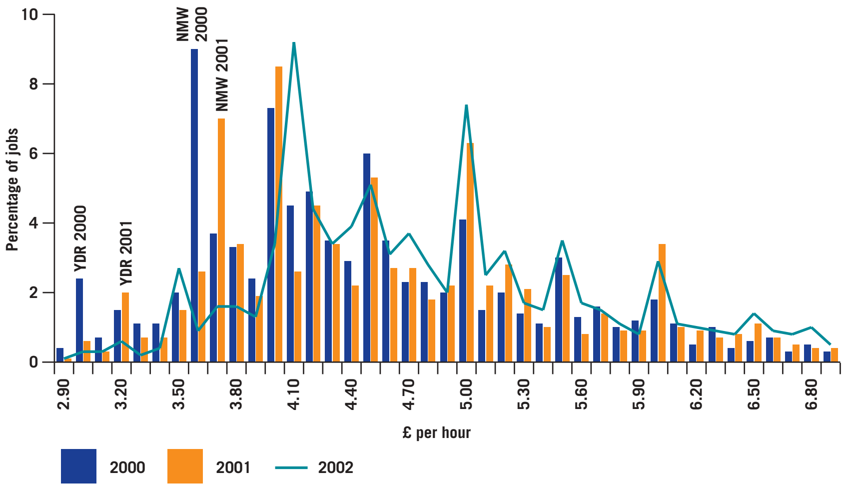
4.8 In Spring 2001 the proportion of young people's jobs paid below the adult minimum wage rate fell to 9.5 per cent, from 11 per cent in Spring 2000, demonstrating that earnings of young people

> *Employers in the convenience store sector tend to favour older staff who have the experience of a working environment which helps them to be more pro-active and to take more responsibility. The youth rate for the National Minimum Wage offers an incentive for employers to employ young people.*

Association of Convenience Stores evidence

at the bottom of the distribution outstripped the increase in the minimum wage following the relatively small October 2000 uprating. In Spring 2002 the proportion paid below the adult minimum wage increased to 14 per cent, suggesting that between 2001 and 2002 the adult minimum wage increased faster than earnings of the lowest-paid young people. This suggests that an increasing proportion of employers made use of the flexibility offered by the youth Development Rate following the minimum wage uprating in October 2001.

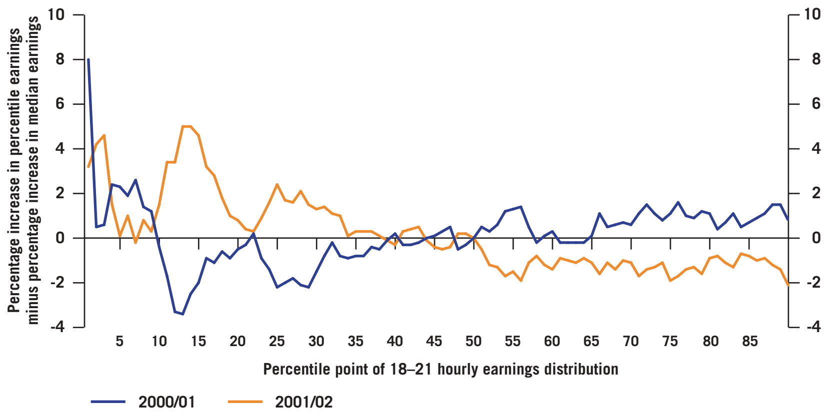
Figure 4.1
Hourly Earnings Distribution for Employees Aged 18–21, Spring 2000–2002



Source: ONS central estimate methodology, Spring 2000–2002.
Note: NMW label shows the adult NMW rate in April of the given year. YDR label shows the youth Development Rate in April of the given year.

4.9 The hourly earnings distribution of 18–21 year olds narrowed between Spring 2001 and Spring 2002. Lowest decile hourly earnings increased by 6.2 per cent according to New Earnings Survey (NES) data, whereas the upper decile increased by 2.6 per cent. Figure 4.2 demonstrates that between Spring 2001 and Spring 2002, spanning the period of the October 2001 uprating, earnings of those at or below the 34th percentile increased faster than the increase in the median, while earnings increases at the top of the earnings distribution were less than the increase in the median.

Figure 4.2
Increase in Hourly Earnings Minus the Increase in Median Earnings by Percentile for Employees Aged 18–21, 2000/01 and 2001/02



Source: Grossed NES, April 2000–2002.

4.10 There are three main peaks in the 2001/02 percentile increases. The first peak is at around the third percentile, showing increases due to the youth Development Rate uprating in October 2001. The second peak is at around the 14th percentile (£4.09 per hour at April 2002 levels), and the third peak is at the lower quartile, or £4.28 per hour at 2002 levels. Increases in earnings at or around the third peak are smaller than increases lower down the distribution, demonstrating that while there has been a partial restoration of differentials, there has nevertheless been some compression further up the distribution.

4.11 We identified two reasons for higher than average earnings increases above the adult minimum wage rate. The first is that some firms have sought to maintain differentials following the October 2001 uprating. Evidence of this was found in surveys by Incomes Data Services Ltd (IDS) of firms in the hotels and retail sectors (both of which employ a large proportion of young people). The pay and conditions survey of the hotels sector found that a quarter of respondents had increased pay for employees on the next step of the pay scale, such as junior supervisory staff, in order to maintain the differential between them and the staff they were supervising (IDS (2002d)).

4.12 A second reason for higher than average increases above the level of the adult rate could be that some firms are ‘tracking’ the minimum wage from above, by increasing wages in order to maintain the gap between their lowest pay rates and the minimum wage. This may be because they wish to avoid being seen as minimum wage employers. Commenting on its survey of the hotels

Low Pay Commission Research

Savora Hotels in London increased pay for its lowest-paid waiting staff, cleaners and porters from £4 to £4.20 an hour – maintaining a differential of 10 pence per hour, compared to the earlier differential of 30 pence per hour over the NMW.

IDS, 2002d. ***Report to the Low Pay Commission on the Impact of the National Minimum Wage***

Low Pay Commission Research

One company that has decided to restore differentials is Arcadia.... At this year's review … the bottom end of the most populated 'standard level' band … was increased by 7.3 per cent and the maximum rate was increased by 11 per cent.

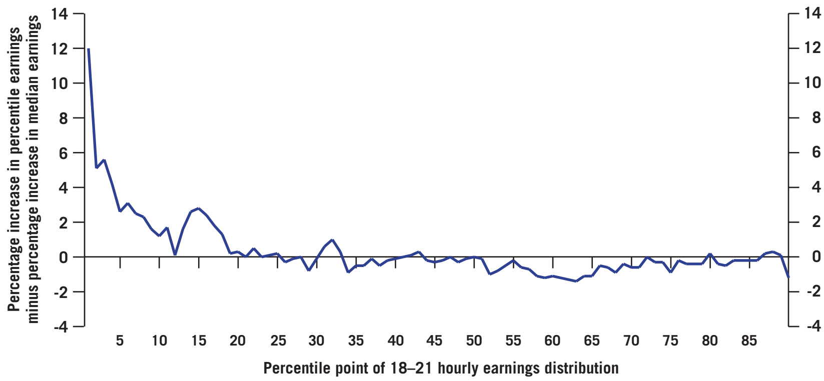
IDS, 2002d. ***Report to the Low Pay Commission on the Impact of the National Minimum Wage***

sector, IDS (2002d) stated that 'a few of the increases took the basic rate of the lowest-paid employees above £4.10 an hour. This is a consequence of employers seeking to maintain their position in the labour market by ensuring a differential between their rates of pay and the statutory floor.'

4.13 Figure 4.2 shows that in 2001/02 above-median increases in earnings peter out at around the 34th percentile, or around £4.50 per hour in 2002. The figure also shows that the pattern of earnings increases over the period of the 2000 upratings was very different from that spanning the October 2001 uprating. While earnings up to the lowest decile increased faster than the median in 2000/01, increases in earnings between the 10th and the 39th percentiles were lower than the increase in median earnings. The figure shows that earnings differentials were restored in part higher up the distribution. This is similar to the 'concertina' effect in the adult earnings distribution described in Chapter 2, where differentials are squeezed in a year with a large increase in the minimum wage, but are restored when the increase is smaller. The slight difference in the pattern for youths is that young people at the very bottom of the distribution received above-median increases in 2000/01. This is because of the proportionately greater increase in the youth Development Rate in 2000, which increased by 20 pence compared with the ten pence increase in the adult rate.

4.14 Figure 4.3 shows the joint impact of the 2000 and 2001 upratings, with above-median increases in earnings petering out at around the 19th percentile, or £4.10 at Spring 2002 levels. There is some evidence that following the 2002 uprating some firms are restoring differentials in their 2002 pay settlements, with lower increases for those at the lowest levels (IDS (2002d)).

Figure 4.3
Increase in Hourly Earnings Minus the Increase in Median Earnings by Percentile for Employees Aged 18–21, 2000–2002



Source: Grossed NES, April 2000–2002.

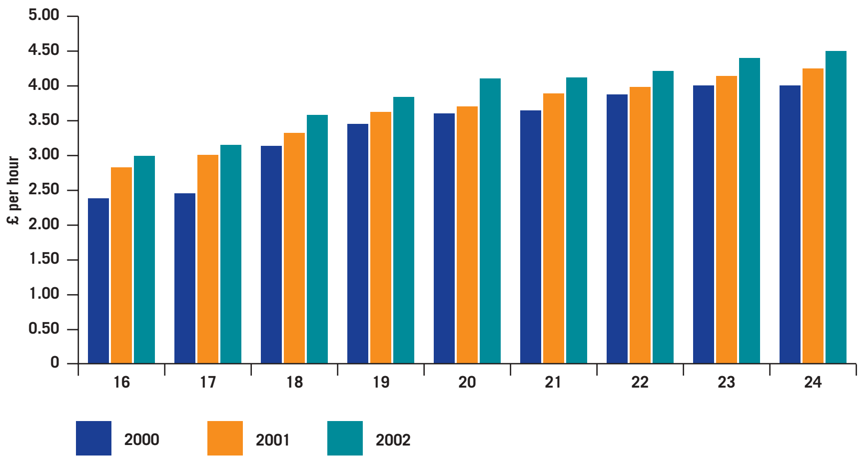
4.15 Figure 4.4 shows that lowest decile hourly earnings rise with age. In our third report we demonstrated that this is because young people are disproportionately represented in low-paying sectors, and not because firms use age-related pay structures. Commissioned research, written evidence and information gathered during visits suggest that this continues to be the case, and that many employers pay adult rates from the age of 18. The IDS (2002d) survey of low-paying sectors found that of 66 respondents, 47 said that they did not use age-related pay, and 14 paid adult rates from 18. Eighty-eight per cent of all respondents to our own survey paid their adult rate by age 18 and 95 per cent by age 21.

Low Pay Commission Research

Four-fifths (81) of the firms we contacted pay adult rates from age 18 or younger. Within the four-fifths, a minority (16) pay adult rates from age 16. Around a fifth of the companies (20) pay adult rates from older than 18. Of these, half pay them from age 19 or 20, and half from age 21 or 22. (Survey of 101 medium and large-sized companies in the retail, leisure and hospitality sectors.)

IDS, 2002c. *Youth Pay: Measuring the Value of Work*

Figure 4.4
Lowest Decile Earnings of Young People, April 2000–2002



Source: Grossed NES, April 2000–2002.

4.16 We found little evidence of firms using the youth Development Rate precisely as it is defined in law – i.e. paying the youth Development Rate for all 18–21 year olds. Figure 4.1 showed that only 2.7 per cent of 18–21 year olds were paid between £3.50 and £3.59 in Spring 2002. Our survey found that only 4 per cent of firms had age-related pay structures with adult rates starting at age 22.

4.17 There is evidence, however, that firms use the flexibility of the youth Development Rate to pay some young people less than adult workers. In Spring 2002, 14 per cent of 18–21 year olds earned less than £4.10 per hour, an increase from 9.5 per cent in Spring 2001. We found evidence that following the October 2001 uprating some firms reconsidered the age at which they paid their adult rate, and a few (some employing large numbers of young people) subsequently increased the threshold for paying the adult rate above the age of 18.

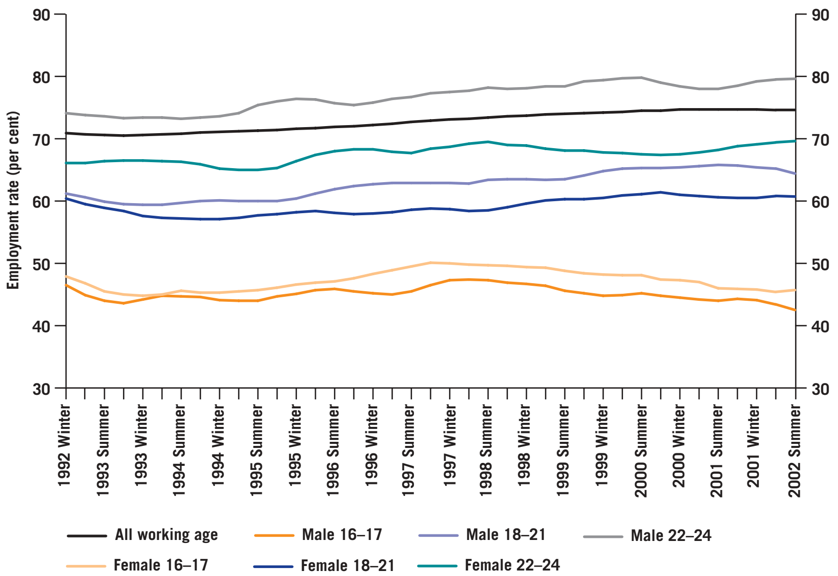
4.18 In summary, we have seen that the October 2001 uprating directly benefited just over 90,000 young people, but that this number fell slightly following the October 2002 rise. Many young people have also indirectly benefited from the increase in the adult rate. We next look at changes in employment by different age groups, to determine whether the minimum wage has affected the employment of young people.

Employment, Unemployment and Participation

4.19 The minimum wage was introduced in a period of strong growth in the labour market. But in the year following the October 2001 uprating the labour market eased, with a slowdown in employment growth and a slight increase in unemployment. Over the same period there was a decline in the employment rate of 18–21 year olds, and a slight rise in their unemployment rate. This was primarily due to changes in male employment and unemployment; employment and unemployment rates for women remained broadly flat. At the time of writing, the latest data suggest an increase in the employment rate of young men (18–24 year olds). But these data were not available at a sufficiently disaggregated level to enable us to analyse them in detail.

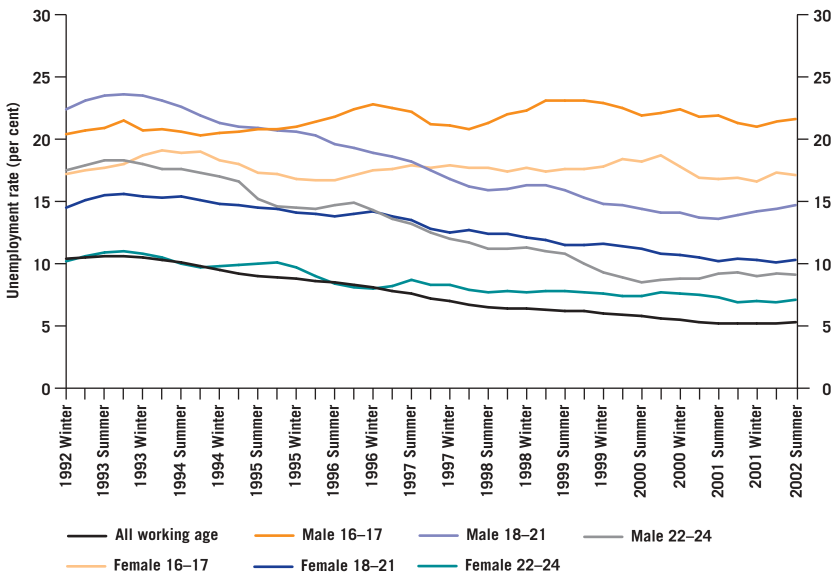
4.20 As Figure 4.5 shows, the employment rate of 18–21 year old men began to fall from a peak in Summer 2001. In Summer 2001 the employment rate of 18–21 year old men was 69.9 per cent, falling to 66.5 per cent in Summer 2002. This represents over 50,000 fewer young men in employment. The employment rate of 16–17 year olds has been on a declining trend since mid 1997, with a particularly sharp decline in the employment rate of 16–17 year old men since Autumn 2001. Figure 4.6 shows that for 18–21 year olds the unemployment rate has mirrored the employment trends, with the unemployment rate of 18–21 year old men turning upwards at around Spring 2001.

Figure 4.5
Employment Rates by Age and Sex, Four Quarter Moving Average, 1992–2002



Source: LFS, 1992–2002.

Figure 4.6
Unemployment Rates by Age and Sex, Four Quarter Moving Average, 1992–2002



Source: LFS, 1992–2002.

4.21 In this section we analyse these recent changes in the labour market status of young people to determine whether there is evidence of any impact of the minimum wage on the demand for or supply of labour. We consider labour market data and evidence from our research in order to determine whether recent changes in the youth labour market are due to:

- a cyclical effect;
- a direct adverse employment effect of the minimum wage;
- substitution away from young people in the labour market as a result of the uprating; and/or
- a labour supply effect.

4.22 Overall we conclude that there is a strong probability that the recent relatively poor performance of young men's employment is primarily related to growth in the economy. We find little evidence to support the view that the minimum wage has led to an adverse employment effect, a substitution effect or a change in young people's labour supply.

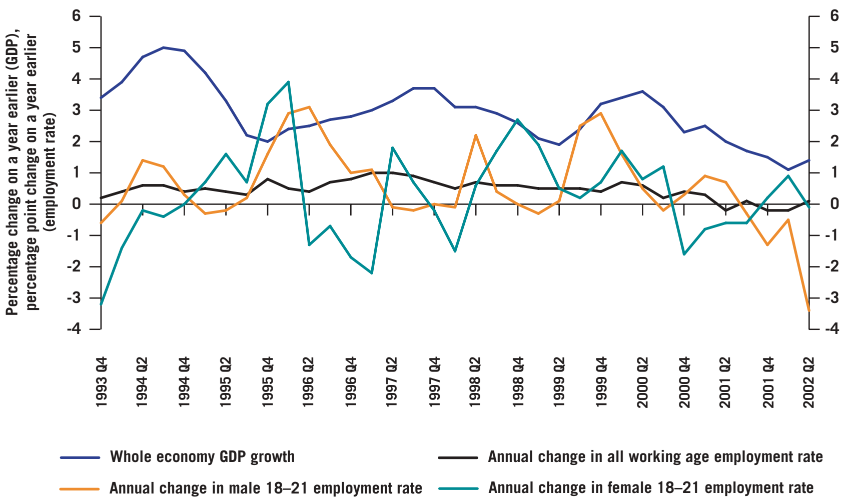
4.23 As in Chapter 2 we use standard labour market classifications of 'in employment', 'unemployed', 'active' and 'inactive'. Those who are employed or unemployed are classified as active members of the labour market. The inactive are those currently not in work and not looking for work, and/or those not available to start work within the next two weeks. These terms apply independently of whether or not a young person is in full-time education (FTE). A young person in FTE would be classified as active if they had a part-time job or were looking and available for work. They would be classified as inactive if they were neither in work nor looking for work, or not available to start work.

Demand Effects

4.24 Young people entering work for the first time are more likely to be affected by the economic cycle than other groups of workers. Firms adjust to falls in demand by reducing recruitment, which affects young people disproportionately. In addition young people lack experience and skills and are thus the most vulnerable when firms reduce the size of their workforce, as firms are more likely to keep on their more experienced workers. As Figure 4.7 demonstrates, young people's employment rates are more volatile than those of older workers.

4.25 The figure shows that Gross Domestic Product (GDP) growth began to slow in the second half of 2000, about a year before the peak in the male youth employment rate. Since Summer 2001 the employment rate of 18–21 year old men fell as aggregate employment rate growth eased, with the sharpest fall in the second quarter of 2002. The Office for National Statistics (ONS) points to slower than expected growth in that quarter due to a dip in both manufacturing and services output in June as a result of holidays taken around the time of the Golden Jubilee. It is possible that this effect fed into the employment rate of young people. Latest provisional data suggest an increase in both GDP growth and young men's employment rate in the latter half of 2002.

Figure 4.7
Change in GDP Compared with Change in Employment Rate, 1993–2002



Source: ONS, LFS, 1992–2002.

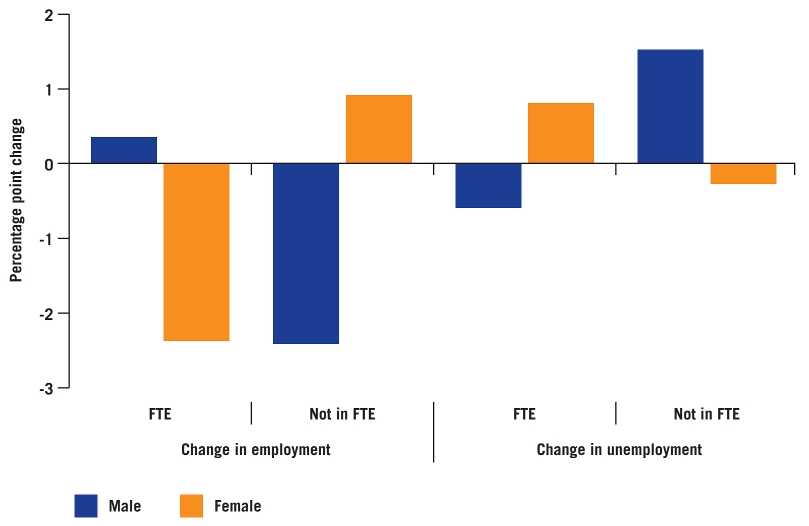
4.26 The fall in the employment rate of 18–21 year old men occurred at around the time of the October 2001 uprating, with the increase in the unemployment rate beginning slightly earlier. As we would expect a lag between increases in the minimum wage and any reduction in employment, we consider that the reduction in employment is probably too early to be a result of the uprating. Nevertheless, in order to check whether there is any link with the minimum wage we analysed changes in young people's employment and unemployment in more detail, focusing on those young people and those sectors we would expect to be most affected.

4.27 For this analysis we used the quarterly Labour Force Survey (LFS) data over the period covering the October 2001 uprating. We compared the average of four quarters from Autumn 2001 to Summer 2002 with the average of Autumn 2000 to Summer 2001, averaging the quarters to take account of seasonal effects. (As we noted in Chapter 2, the quarterly data are not regrossed to Census 2001 data.) Over this period, the employment rate of 16–17 year olds fell by around one percentage point and that of 18–21 year olds fell by 0.7 percentage points. Over the same period the employment rate of 22–24 year olds increased by 1.5 percentage points.

4.28 Although the minimum wage does not apply to 16–17 year olds, it is possible that it could still affect their employment: if firms pay 16–17 year olds the same rate as adult workers, or a fixed proportion of their adult rate, they may be less likely to employ the youngest workers as the minimum wage increases. But Figure 4.5 showed that the recent fall in the 16–17 year old employment rate is part of a longer trend and we therefore consider that it is not related to the minimum wage. The latest steep fall in the employment rate of this age group is also related to an increase in the number of 16 and 17 year olds in the population. In the year following the 2001 uprating this increased by over 35,000 while the number in work increased by only a couple of thousand.

4.29 The fall in the employment rate of 18–21 year olds in the year to Summer 2002 was due to a reduction in male employment. Overall the employment rate of 18–21 year old men fell by 1.4 percentage points, while the employment rate of 18–21 year old women remained broadly flat. Figure 4.8 shows that the fall in the male employment rate was concentrated among those not in FTE. While the overall female employment rate was broadly flat over this period, there was a fall in the employment rate of women in education, and a rise for those not in education. Changes in unemployment rates support this picture, with male unemployment rates rising for those not in FTE, and female unemployment rates rising for those in FTE.

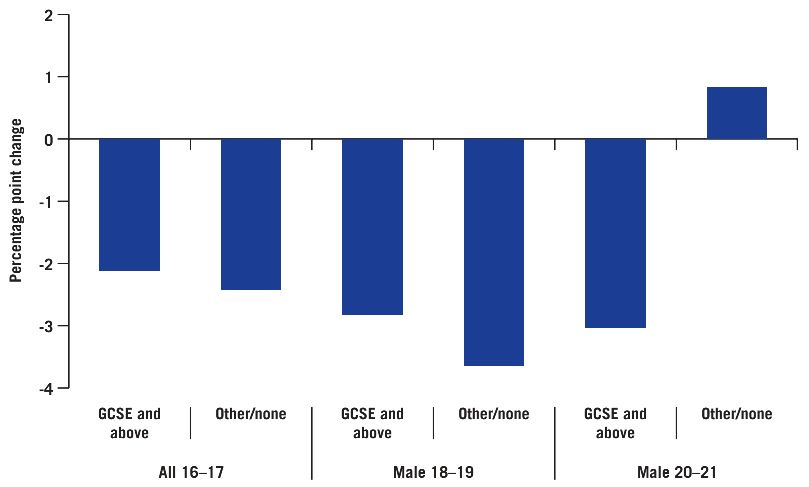
Figure 4.8
Change in Employment and Unemployment Rates of 18–21 Year Olds by Sex and Education Status, Autumn 2000-Summer 2001 Compared with Autumn 2001-Summer 2002



Source: LFS, Autumn 2000–Summer 2002.

4.30 The concentration of the fall in employment among 18–21 year old men not in FTE is consistent with either a potential minimum wage effect or a cyclical effect. If it is a minimum wage effect, we would expect the employment effect to be among those with the lowest qualifications, especially for those not in FTE. But Figure 4.9 shows that the reduction in the employment rate of young people not in FTE was not linked to skill levels, with the only increase in employment rates among 18–21 year old men not in FTE being for 20–21 year old men with no qualifications. This is a slight indication against a minimum wage effect.

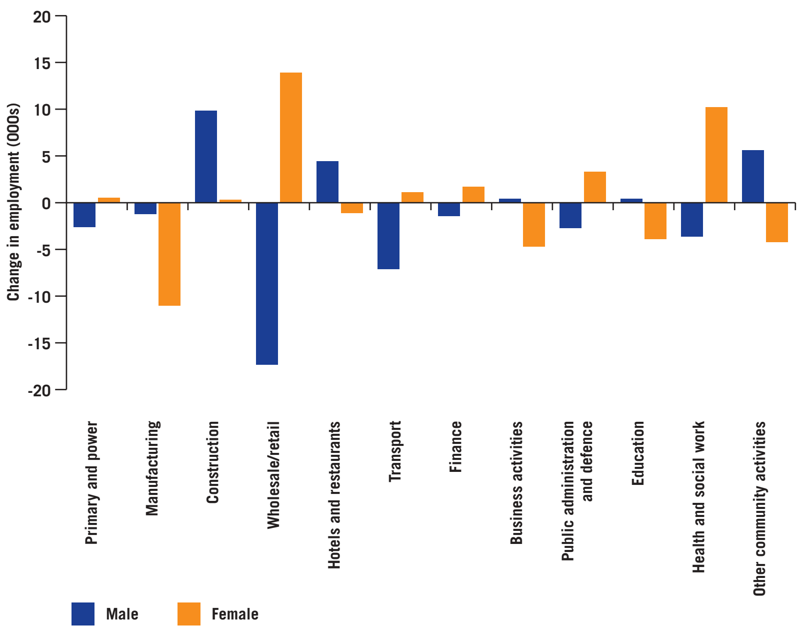
Figure 4.9
Change in Employment Rate of Young People Not in Full-time Education by Qualification Level, Autumn 2000-Summer 2001 Compared with Autumn 2001-Summer 2002



Source: LFS, Autumn 2000–Summer 2002.

4.31 Looking at the sectoral picture, Figure 4.10 shows that there has been a large reduction in the number of 18–21 year old men employed in the retail sector (a low-paying sector), but also a fall in the numbers employed in transport (a high-paying sector). Conversely, there has been an increase in the numbers employed in hotels and restaurants. There were falls in the number of women employed across a number of sectors; but the number of women employed in retail and in the health and social work sectors (both low-paying) increased. The reduction in employment is not therefore concentrated in sectors most affected by the minimum wage. Nor was there any particular sectoral pattern in the fall in employment amongst the group most at risk – young men not in FTE: while there was a fall in employment in manufacturing among this group, indicating a cyclical effect, there was also a fall in wholesale and retail, which could be linked to the minimum wage.

Figure 4.10
Change in Employment of 18–21 Year Olds by Industry Sector, Autumn 2000-Summer 2001 Compared with Autumn 2001-Summer 2002



Source: LFS, Autumn 2000–Summer 2002.

4.32 As part of our research programme we commissioned Stewart (2003) to examine changes in employment over the period of the minimum wage's introduction and upratings. The methodology and results are presented in Chapter 2. The overall conclusion of the research was that, when the model took account of changes in the economic cycle, there was no evidence of a significant negative impact on young people's employment of either the introduction of the minimum wage, or of the subsequent upratings in 2000 and 2001. Without the growth adjustment there was some evidence of a negative effect for young men, but for only one out of the four specifications.

4.33 Evidence both from the aggregate data and from our commissioned research therefore suggests that the decline in the employment rate of 18–21 year old men is primarily related to the economic cycle. We found little evidence to suggest that the minimum wage has had a negative impact on youth employment. But we also need to consider whether any of the fall is due to the minimum wage prompting employers to substitute older workers for younger workers. We suggested in our third report that there might be some evidence that the youth Development Rate was encouraging employers to employ younger workers at the expense of older workers. But, given the more recent reduction in the employment rate of 18–21 year olds, it is possible that the uprating of the minimum wage may have led firms to substitute employment away from young workers. In order to determine whether there has been any such substitution effect, we examined the change in employment share by age group, controlling for population changes. Figure 4.11 supports the employment data, showing that 16–17 and 18–21 year olds have seen a fall in employment share, with an increase in the employment share taken by 22–24 year olds. However, people aged 25–34 also saw a reduction in their share of employment.

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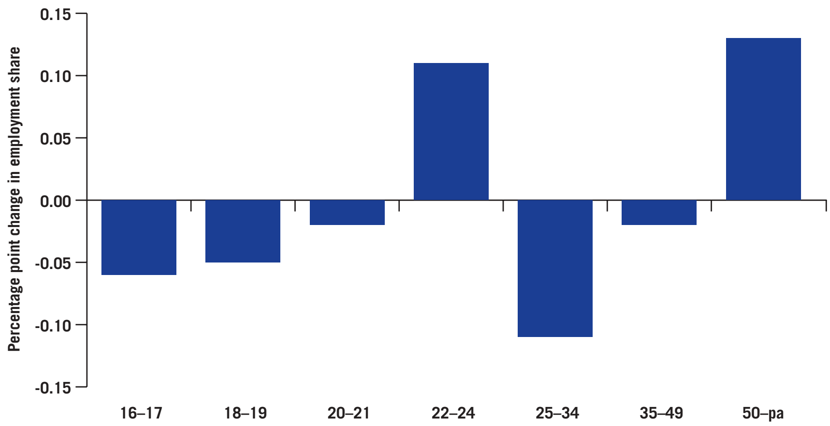
Only one of the 36 firms had substituted youth for adults in order to reduce wage costs by paying at the youth minimum rate. In part, the lack of evidence for this employment practice reflects the resistance to paying workers different rates for similar work.

Grimshaw and Carroll, 2002. *Qualitative Research on Firms' Adjustments to the Minimum Wage*

Figure 4.11
Change in Employment Share by Age, Autumn 2000-Summer 2001 Compared with Autumn 2001-Summer 2002



Source: LFS, Autumn 2000–Summer 2002.
Note: pa = pension age.

> *Another retailer reported that the NMW discriminated against older employees as it encourages employers, particularly at retail, to take on younger people at lower cost.... Another writes: "We have to recruit 16–19 year olds as £4.10 per hour is too high a cost for our business ... we now only employ older people as supervisor or assistant supervisor."*
>
> **British Sandwich Association evidence**

4.34 Results from our own research and consultation give a mixed picture, with most suggesting little substitution of workers as a result of the minimum wage. The only substantial piece of information to suggest substitution away from young people came from a CBI survey, presented in the CBI's evidence to us. It found that 76 per cent of employers affected by the minimum wage said they had not changed their recruitment strategy to hire a different proportion of young people since the introduction of the minimum wage. However, the CBI survey found that where employers had changed their strategy, they were much more likely to have reduced the numbers of young people employed (both 16–17 and 18–22 year olds) than to have increased them. While fewer than 3 per cent of firms affected by the minimum wage had increased the number of young people employed, 23 per cent said that they had reduced the number of 16–17 year olds employed, and 19 per cent reduced the number of 18–22 year olds.

4.35 The reported substitution away from employing 16–17 year olds is an odd result. We would expect that the increase in the minimum wage would make 16–17 year old workers more attractive to employers. It is possible that the reported reduction in employment of this age group is because employers are opting to pay the minimum wage from age 16, but we doubt that it is minimum wage-related.

4.36 IDS (2002d) conducted three surveys of firms in low-paying sectors to examine the impact of the minimum wage. These comprised a general survey of low-paying sectors, a survey of nurseries and a survey of the hotels sector. Firms were asked how the minimum wage had affected their organisations. There was little to indicate either any substantial employment effect or a substitution effect. The only reported example of substitution occurred in a day nursery, which stated that it had taken on younger staff.

4.37 In our own survey of employers, the vast majority of those who were affected by the October 2001 uprating reported that it had not changed the likelihood of their employing workers in different age groups. Table 4.1 shows that the differences in the proportion of employers who were more or less likely to employ workers in each age group were slight. This was particularly true for 18–21 year olds, with only one percentage point difference between those stating that they were more likely to employ 18–21 year olds and those stating that they were less likely to do so. Although responses varied considerably by sector, there was no discernible pattern.

Table 4.1 Has the October 2001 increase made you more or less likely to employ workers in different age groups?

%	Total
Workers aged 16–17	
More likely	11
Less likely	14
No change	75
Workers aged 18–21	
More likely	16
Less likely	15
No change	70
Workers aged 22 or over	
More likely	8
Less likely	15
No change	77

Source: LPC Survey, May 2002.

Base: All firms affected by the October 2001 uprating of the National Minimum Wage in any way.

4.38 A substitution effect away from younger age groups will only occur if employers view older workers as more productive than younger workers. We commissioned IDS to investigate the considerations employers have in mind in setting pay for young employees and their reasons for employing young people. IDS (2002c) examined 20 firms (mainly in the retail, leisure and hospitality sectors) employing large numbers of young people and found most of the organisations paid their adult rates from the age of 18 (or younger), with only three paying their adult rates from the age of 22.

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Some employers observed that while there were certain kinds of performance issues with younger employees, such as greater absenteeism, there were other problems with older staff, such as a greater level of genuine sickness, or parental responsibilities which sometimes required them to take more time off work – and these caused just the same problems for managers.

IDS, 2002c. *Youth Pay: Measuring the Value of Work*

4.39 IDS (2002c) concluded that 'most organisations said that young people generally performed just as well as older colleagues – and some vigorously refuted the idea that they might perform less well'. In organisations where young people were paid less than older workers, this was often driven by wage bill costs. IDS reported that 'a minority have a higher threshold for paying adult rates, of 19, 21 or 22. In most of these cases this policy was either introduced at the same time as the NMW as a direct reflection of the legislation, or was introduced last year in order to offset the cost of implementing the October 2001 rise in the NMW.'

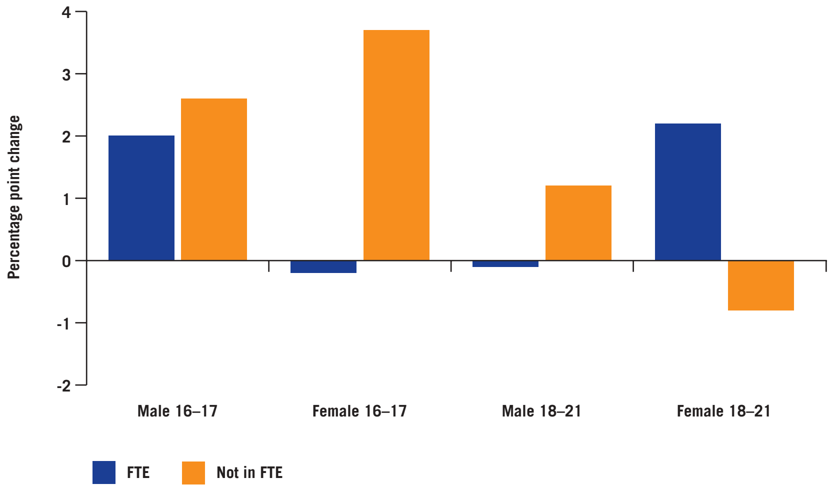
4.40 In summary, we have not observed any strong evidence of a substitution effect, and employers' views suggest that such an effect would be unlikely. We now turn to consider young people's participation in the labour market and in education.

Participation in the Labour Market

4.41 Our analysis so far has considered whether the minimum wage has had an impact on the demand for employment of young people, and in particular young men. Here we look at changes in overall labour market participation to determine whether there has been any impact on labour supply. Chapter 2 showed that in the year following the 2001 uprating there was a fall in the participation rate of 18–21 year old men, and a slight increase in the participation rate of 18–21 year old women. Overall, comparing the period Autumn 2000 to Summer 2001 with Autumn 2001 to Summer 2002, there has been a fall in the number of 18–21 year old men who are active members of the labour market, with a fall in employment of around 17,000, and an increase in unemployment of 11,000. It appears therefore that the rise in the 18–21 year old male unemployment rate in that period resulted from a combination of a reduction in labour demand (leading to a rise in the numbers unemployed) and a reduction in supply (with a fall in the numbers of active members of the labour market).

4.42 Figure 4.12 shows that, while there has been little change in labour market participation rates of 18–21 year old men in FTE, there has been an increase in the inactivity rate of men not in FTE. The total increase in this latter group is over 10,000, of whom around 7,000 say that they do not want a job. Contrary to what we would expect if this were a minimum wage effect, however, we found that the increase in inactivity of men not in FTE was not among those with the lowest skills. Inactivity rates for 18–21 year old women have fallen (increasing their participation in the labour market) for those not in FTE, but risen for those in FTE.

Figure 4.12
Change in Inactivity Rates of Young People by Sex and Education Status, Autumn 2000-Summer 2001 Compared with Autumn 2001-Summer 2002

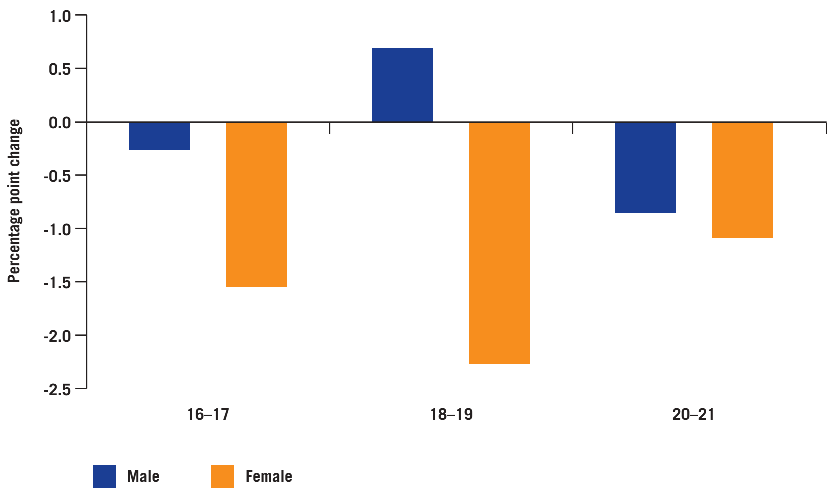


Source: LFS, Autumn 2000–Summer 2002.

4.43 We commissioned research from Mark Stewart (2002b) to look at changes in labour market transitions over the period of the minimum wage. The research compared movements between employment (at different wage rates), unemployment and inactivity before and after the introduction of the minimum wage. Overall this research found little evidence of significant changes over the period of the minimum wage. Where significant changes were found, they point to a positive labour supply influence. The research found a significant increase in the proportion of the inactive group wanting to work after the introduction of the minimum wage, although this finding was significant only for older people. Those entering employment from unemployment were found to be doing so at higher wages post minimum wage, and the probability of remaining in the bottom wage group fell significantly. Both these effects were significant for the younger age groups. These changes are not necessarily a consequence of the minimum wage and could be due to other influences in the labour market. Moreover the small number of significant changes in labour market transitions post minimum wage suggests that there is little evidence of the minimum wage having any impact on labour market transitions.

4.44 We are concerned that the minimum wage should not reduce the incentive for young people to stay in FTE. Figure 4.13 shows that the proportion of 18–21 year olds in FTE fell in the year following the October 2001 uprating, particularly for women. Over that period, employment of 18–21 year old women in FTE fell and inactivity increased. This was offset by an increase in employment of those not in FTE, which could be evidence that the minimum wage is encouraging women to move from being employed while studying, to being employed and not in education. We would, however, need to observe this over a longer period and consider the influence of other factors before we could assess whether the minimum wage was indeed having such an effect.

Figure 4.13
Change in the Percentage of Young People in Full-time Education by Age and Sex, Autumn 2000-Summer 2001 Compared with Autumn 2001-Summer 2002



Source: LFS, Autumn 2000–Summer 2002.

Conclusion

4.45 We have seen a fall in the employment rate of young people – in particular of 18–21 year old men – in the year following the October 2001 uprating. This could indicate that the minimum wage has had some negative impact on young people's employment. But as the fall in employment was not concentrated in sectors affected by the minimum wage, nor among those individuals with the lowest skills, we conclude it is likely that the primary driver of the fall was the slowdown in growth in the economy. When cyclical changes are taken into account, the econometric research found no significant impact on young people's employment as a result of the minimum wage. When looking for evidence of substitution away from younger to older workers we found that, while aggregate data give some evidence of such a shift in employment, our commissioned research and other evidence do not suggest that this is a minimum wage effect. Latest provisional figures suggest that both output growth and young people's employment rate increased in the latter half of 2002.

4.46 While there has been an increase in the inactivity rate of 18–21 year old men, there is no strong evidence that the minimum wage has affected labour supply. The increase in inactivity of men not in FTE was not among those with the lowest skills, which we would expect if it were a minimum wage effect. Research into changes in labour market transitions found little significant change overall when comparing the position pre and post minimum wage.

4.47 We therefore conclude it is unlikely that the fall in the employment rate of 18–21 year olds is in large part a consequence of the minimum wage. Having considered the impact of the minimum wage on young people's earnings and employment, we turn to consider the role of the youth Development Rate.

The Youth Development Rate

4.48 Since the introduction of the National Minimum Wage, trade unions and groups representing young people have argued strongly against a lower rate for young workers. Many of these organisations argue that the adult rate should be payable from age 18 and some, such as UNISON and the British Youth Council, advocate entitlement from the age of 16. Their principal objections to the youth Development Rate are that it is discriminatory and that it goes against the social norm that adulthood starts at 18.

4.49 Employers' associations largely favour maintaining a youth Development Rate. Many employers pay adult rates from the age of 18, particularly in areas with a tight labour market, but the existence of the youth Development Rate provides businesses with

> *A stark example of the inequity that can arise from the youth rate was reported to us by GMB Yorkshire Region involving members under the age of 22 as senior care assistants and yet paying them £3.50 an hour, while older colleagues were receiving £4.10 as care assistants with fewer responsibilities.*
>
> **GMB evidence**

> *It should also be recognised that there are a number of jobs in the UK that do not require significant training... there is a risk that if young people employed to do these jobs had to be paid the adult rate, or if the youth rate required a commitment to train where it was not needed, the jobs would simply not be created.*
>
> **CBI evidence**

> *We also need a learning and skills sector which engages much more effectively with local and regional businesses and employers to play its full part in meeting skill needs and improving productivity.*
>
> **Department for Education and Skills, 2002c. *Success for All: Reforming Further Education and Training. Our Vision for the Future***

added flexibility. Firms argue that it enables them to provide job opportunities that might not otherwise exist, by allowing them to take account of the lower productivity or responsibilities of young workers in their remuneration, and by providing some compensation for the additional time and money spent on their training.

4.50 We recognise the argument that the youth Development Rate lacks equity, and in our previous reports we have expressed a long-term aspiration that the youth Development Rate should be linked to accredited training. As we commented in our first report, the acquisition of qualifications, skills and experience at an early age improves employability, reduces the likelihood of subsequent unemployment and enhances prospects of higher wages later in life. The desire to see all young people undertaking some form of education or training – whether in school, college or at work – has been a key influence on our recommendations from the outset.

4.51 We remain concerned that not enough young people go into coherent work-based training. Recent Government initiatives to tackle the need to improve training are, therefore, welcome. However, for a youth rate linked to accredited training to operate effectively the training would need to be relevant to the needs of both workers and firms, and delivered in ways which suit them and with the minimum necessary administration and cost. The evidence we have gathered for this report suggests that at present this is frequently not the case. In addition many firms – particularly small firms – are not involved in accredited training and would need advice and support to help them start to offer this training.

4.52 Moreover, the acquisition of skills is not just about formal training. From the outset we have emphasised the need for young people to gain experience of work which will allow them to acquire basic skills and enable them to develop. The need to guard against adversely affecting employment among young people is, therefore, a continuing concern. Our monitoring of the operation of the minimum wage and the youth labour market over four years has confirmed that some sectors are a key source of work for young people, particularly entry-level jobs. Of young people aged 18–21 who are in work, 40 per cent work in retail, wholesale or hospitality. Even where little or no formal training is provided, these jobs offer young people the chance to gain experience, learn the disciplines of work and acquire worthwhile, transferable job skills. Yet, in many cases, their content does not require much, if any, accredited training and the young people doing them frequently work part-time, for relatively short periods, or intermittently. Consequently, to make accredited training a condition of paying the youth Development Rate would risk discouraging firms from offering these jobs to young people.

‘The provision of learning that is accessible in the workplace is important…. We need to build on the work that is already taking place … to bring flexible, good quality learning to the workplace.’

Scottish Executive, 2003. ***Life Through Learning; Learning Through Life. The Lifelong Learning Strategy for Scotland***

4.53 We continue to believe strongly in the importance of training. But it is clear that the conditions are not in place to enable the youth Development Rate to be made conditional on accredited training without creating a risk to youth employment. However, we remain concerned to ensure that the youth Development Rate only applies to those who need its coverage. We consider next the precise age groups to which it should apply.

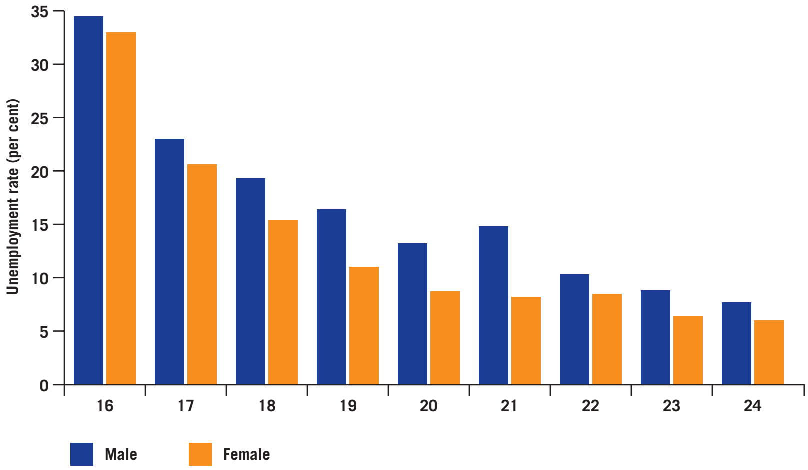
Treatment of 18–21 Year Olds

4.54 The exact cut-off point for the adult rate is a matter of judgment. In our first report, we concluded that ‘the really dramatic distinctions in the youth labour market are in the earlier years: the most rapid change takes place in the years up to the age of about 20. Thereafter the transition from young worker to adult slows down.’ Employers overwhelmingly supported including 21 year olds in the adult rate and we therefore recommended that the youth Development Rate should cover 18–20 year olds. We made similar recommendations in our subsequent reports and were disappointed the Government rejected for a third time our unanimous recommendation that 21 year olds should be entitled to the adult rate. Responding to the recommendation in our third report the Government stated that ‘while the Government understands the LPC viewpoint on this issue, it does not judge it sensible in current circumstances for the minimum wage for 21 year olds to rise by 90p (28%) in October’.

4.55 In its recent evidence to us, the Government pointed to the relatively weak labour market performance of young people in the year to Summer 2002, and of 21 year olds in particular. It noted that employment of workers (excluding students) aged 22–24 had increased between 2000/01 and 2001/02, but fallen for 18, 19 and 21 year olds. The Government also looked at unemployment rates by age (excluding students) and concluded that employment and unemployment rates of 21 year olds appeared to be more aligned with the younger age group than the 22–24 age group.

4.56 Figure 4.14 shows that in the year Autumn 2001 to Summer 2002, the unemployment rate of 21 year old men not in FTE was higher than that of their counterparts aged either 20 or 22. Unemployment rates for 21 year old women not in FTE were lower than for 20 and 22 year olds. The peak in the male unemployment rate at age 21 has become more pronounced in the later data; in the year to Autumn 2001 there was no such peak in male unemployment (not in FTE) at age 21. Similarly, between Autumn 2001 to Summer 2002 there was a dip in the employment rate of 21 year olds not in FTE, which was not present the year before. In its evidence to us the Government considered whether this dip could be due to the influx of graduates aged 21–22 who do not gain immediate employment. The Government stated ‘it is notable that the exclusion of graduates [from the employment rates] does not seem to explain the dip in employment at age 21’.

Figure 4.14
Unemployment Rates of Young People Not in Full-time Education by Age and Sex, Autumn 2001-Summer 2002



Source: LFS, Autumn 2001-Summer 2002.

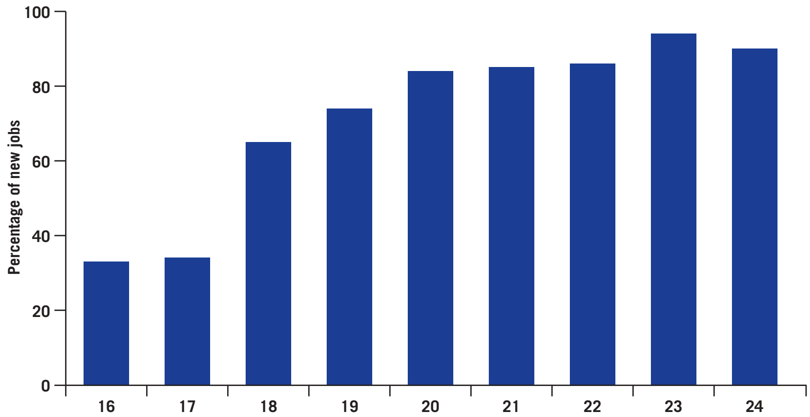
4.57 While we accept that these labour market data give reason for caution, we do not believe that the increase in the unemployment rate of 21 year old men is minimum wage-related. As we explained earlier, we consider that the slowdown in economic growth is the primary driver of recent changes in male employment and unemployment.

4.58 Firms' wage-setting behaviour is also important in determining the impact of entitling 21 year olds to the adult minimum wage rate. We have shown that there continues to be limited use of the youth Development Rate, with the majority of firms paying their adult rates from the age of 18. In Spring 2002 86 per cent of 18–21 year olds earned at least the adult rate of the minimum wage. Of all the organisations which gave evidence, only the British Activity Holiday Association argued that 21 year olds should not receive the adult rate.

4.59 Figure 4.4 showed that there is relatively little difference between the lowest decile earnings of 20–22 year olds. In 2002 lowest decile hourly earnings were £3.58 for 18 year olds and £3.84 for 19 year olds, somewhat below the current adult rate. Lowest decile hourly earnings for 20, 21 and 22 year olds were £4.10, £4.12 and £4.21 respectively, indicating that these age groups are more likely than the younger ages to be paid the adult minimum wage.

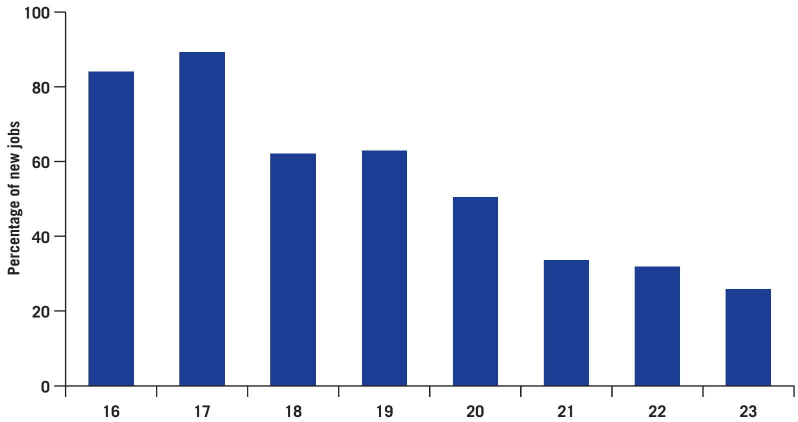
4.60 Figures 4.15 and 4.16 present LFS earnings data for young people who have been in their current job for six months or less, which we use as a proxy for starter rates for young people entering the labour market. Figure 4.15 shows that the proportion of new jobs of 20, 21 and 22 year olds which pay at least £4.20 per hour is very similar, and much higher than the proportion of new jobs of 18 year olds which pay at least that rate. Figure 4.16 shows that the proportions of 21 and 22 year olds in new jobs that pay less than £5.00 an hour are very similar, and much lower than the corresponding proportion of jobs for those aged 20 or younger.

Figure 4.15
Percentage of New Jobs Paying at Least £4.20 per hour by Age, Spring 2002



Source: LFS, Spring 2002.

Figure 4.16
Percentage of New Jobs Paying Less than £5.00 per hour by Age, Spring 2002



Source: LFS, Spring 2002.

4.61 Only a small number of 21 year olds would be affected should they become eligible for the adult rate. Latest ONS data show that in Spring 2002, fewer than 30,000 21 year olds were paid less than £4.10 per hour. Some of these 21 year olds may be exempt from the National Minimum Wage – for example they could be in the first year of an apprenticeship.

4.62 In summary, therefore, we believe that decisions on the age coverage of the youth Development Rate need to be based both on an assessment of the labour market impact and on the evidence of firms' wage-setting behaviour. We recognise the argument that an age-related Development Rate lacks equity but we continue to believe that young people are vulnerable in the labour market and merit special consideration. The labour market position of 21 year old men, and in particular those not in FTE, worsened relative to 20 and 22 year olds in the year to Summer 2002; but our analysis indicates that the economic cycle, not the minimum wage, has been the main driver to changes in young people's labour market status.

4.63 For the youth Development Rate to be credible, it should only apply to those needing protection. It is a matter of judgment where the cut-off for the adult rate should apply but on balance, looking at economic data and employers' practice, we believe that 21 year olds can be entitled to the adult rate without harming their employment prospects.

4.64 **We therefore recommend, once more, that 21 year olds should receive the adult rate of the National Minimum Wage and that the age coverage of the youth Development Rate should be kept under review**. We now turn to the case for a statutory minimum wage for 16 and 17 year olds.

Treatment of 16–17 Year Olds

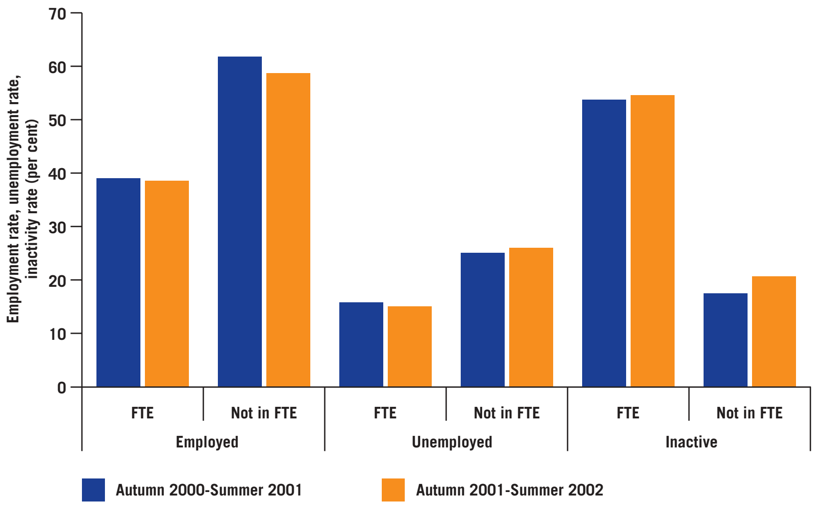
4.65 In previous reports we recommended that 16 and 17 year olds should not be entitled to a statutory minimum wage, but that their treatment should be kept under review. We took the view that this age group should not be considered full participants in the labour market – the overwhelming majority of 16 and 17 year olds were in FTE, part-time education or work-related training – and we did not want to recommend any changes that would damage their longer-term employment and training opportunities.

4.66 For this report we have received more evidence on the arguments both for and against introducing a minimum wage for this age group. An examination of the participation of 16–17 year olds in the labour market and of earnings data sets the context for this debate. We then consider the arguments – both of principle and of practice – put forward by stakeholders. And we consider the relationship between a minimum wage and incentives for this age group to remain in education or training.

4.67 The very high proportion of 16 and 17 year olds in FTE distinguishes this age group from older workers – the percentage of 16 and 17 year olds in FTE in the year Autumn 2001-Summer 2002 was 72.6 per cent. Around 650,000 people in this age group have some form of employment, of whom around 400,000 are working while in FTE.

4.68 Figure 4.17 shows that between Autumn 2000-Summer 2001 and Autumn 2001-Summer 2002 the labour market position of 16–17 year olds worsened, particularly for those not in FTE. The employment rate of 16–17 year olds fell by 0.4 percentage points for those in FTE and by 3.1 percentage points for those not in FTE. The unemployment rate of those not in FTE increased from 25.1 to 26.0 per cent. Of most concern is the increase in the number of 16–17 year olds who are detached from the labour market. The inactivity rates for 16–17 year olds who are not in FTE rose from 17.5 per cent to 20.7 per cent.

Figure 4.17
Labour Market Status of 16–17 Year Olds by Education Status, Autumn 2000-Summer 2001 Compared with Autumn 2001-Summer 2002



Source: LFS, Autumn 2000–Summer 2002.

4.69 There is unlikely to be a direct relationship between the employment patterns of 16–17 year olds and the minimum wage, as 16–17 year olds are exempt. Moreover, as explained earlier in the chapter, the fall in employment of 16–17 year olds is part of a longer trend which began before the introduction of the minimum wage. Research and written evidence present mixed evidence of any substitution effects. The strongest evidence of substitution towards 16 and 17 year olds came from the hairdressing sector, where research suggested that there has been a shift towards recruiting 16 and 17 year old trainees, away from 18–21 year olds. This trend is not replicated in other sectors.

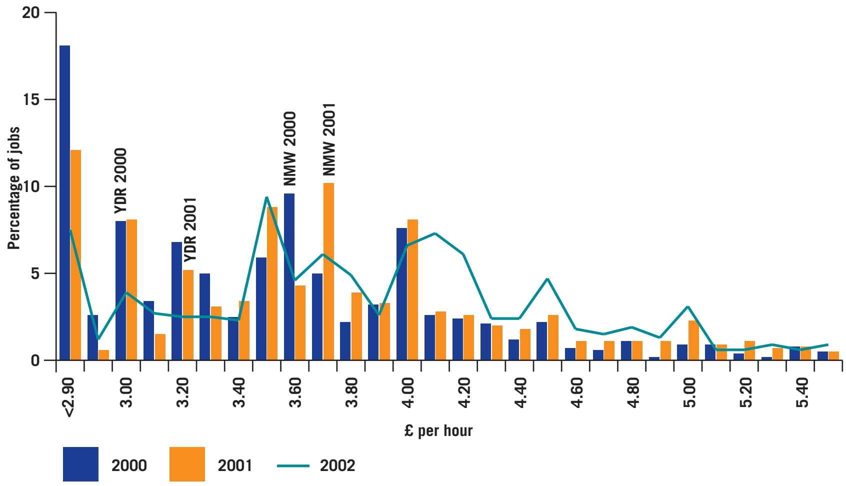
4.70 Earnings data for this age group should be treated with caution given the small sample sizes; but as an illustration, Figure 4.18 shows that there has been a significant reduction in the number of 16 and 17 year olds earning less than £2.90 per hour in the last two years, falling from 18 per cent in 2000 to 7.5 per cent in April 2002. Lowest decile hourly earnings in April 2002 were £3.05 per hour and lowest quartile hourly earnings were £3.52, roughly the level of the youth Development Rate.

4.71 Figure 4.18 also shows a peak in the earnings distribution at the level of the youth Development Rate, and there is some evidence that firms use this rate as a marker for setting wages of 16–17 year olds. For example the British Beer & Pub Association reported that 'feedback from members would indicate that these employees would generally be paid in the region of the Youth Rate'. This may help explain why the pay of 16 and 17 year olds has not fallen relative to that of 18–21 year olds since the introduction of the minimum wage. Over the last three years mean and median hourly earnings for 16 and 17 year olds have remained at broadly 80 per cent of the level for 18–21 year olds. Despite these increases we are concerned about examples of full-time jobs for 16 and 17 year olds offering low wages and no training. Evidence from the Union of Shop, Distributive and Allied Workers (Usdaw) was particularly striking and provided details of a number of full-time jobs offering no formal training and paying less than £2.00 per hour.

> *'The lowest rates we found were: A sales assistant … on £1.33 an hour. A lift engineer's mate … on £1.53 an hour. A general farm assistant … on £1.70 an hour. A general duties hotel worker … on £1.75 an hour. A warehouse operative … on £1.86 an hour. Other examples show that £2.00 an hour appears to be a common rate received by young workers.'*
>
> **Usdaw evidence**

> *'The current legislation enables unscrupulous employers to exploit young workers as a source of cheap labour. There are numerous examples of 16 and 17 year olds earning as little as £1.90 an hour.'*
>
> **Children's Rights Alliance for England evidence**

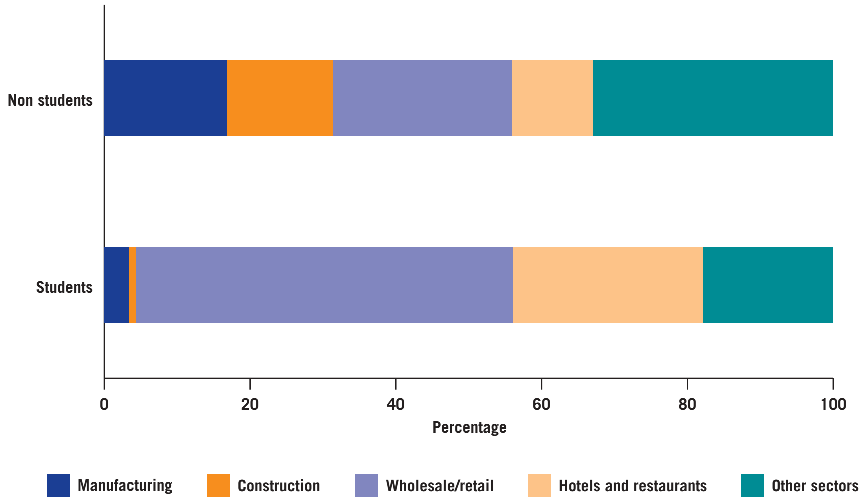
Figure 4.18
Hourly Earnings Distribution for Employees Aged 16–17, Spring 2000–2002



Source: LPC calculations using grossed NES and LFS data, Spring 2000–2002.
Note: NMW label shows the adult NMW rate in April of the given year. YDR label shows the youth Development Rate in April of the given year.

4.72 Figure 4.19 shows that employment of 16 and 17 year olds is concentrated in a narrow range of sectors. Overall, over 60 per cent of employment of this age group is in the retail and hospitality sectors. Employers in these sectors argue that they offer starter jobs and provide young people with basic work skills which subsequently benefit the wider economy. There is a considerable difference between the sectoral patterns of 16–17 year olds in FTE and those not in education, with over three-quarters of students with jobs being employed in retail and hospitality. It is likely that jobs in these sectors are more attractive to those in FTE due to their more flexible working patterns, which enable jobs to be fitted around studies. In contrast 31 per cent of employed 16–17 year olds not in education work in manufacturing and construction, compared with 4 per cent of those in FTE.

Figure 4.19
Employment by Industry Sector of 16–17 Year Olds, Autumn 2001-Summer 2002



Source: LFS, Autumn 2001-Summer 2002.

4.73 We received considerable evidence on the question of whether 16 and 17 year olds should receive a statutory minimum wage. Trade unions and groups representing young people argued strongly for this age group to be brought within the coverage of the National Minimum Wage. While some suggested entitling 16 and 17 year olds to the adult rate, the majority favoured introducing a new rate based on a proportion of the adult rate.

4.74 Those in favour of a minimum wage for 16 and 17 year olds emphasised the moral argument for protecting this age group. Trade unions and youth organisations recognised that as many 16 and 17 year olds as possible should be in FTE, but several trade unions also noted that over 600,000 of this age group were in some form of employment, even if only to help support their studies. It was suggested that those 16–17 year olds in FTE and in some form of work risked damaging their educational attainment, and that a minimum wage would enable them to reduce the number of hours spent in employment. It was also argued that 16–17 year olds were doing similar work to older colleagues and that businesses such as cinemas, record shops and clothes shops specifically recruited young workers to match the image of the products.

‘What sort of society have we got where a young person’s first experience of work can be exploitation and the reward of a wage of £1 an hour or even less? All the arguments for a legal underpinning of wages are as relevant for 16 and 17 year olds today as they were for adults when the National Minimum Wage was first established.’

Usdaw evidence

‘Low wages compel young people to work longer hours, damaging their education. Young people also have the right to leave education if they wish to and should not be exploited as a consequence.’

Children’s Rights Alliance for England evidence

4.75 Centrepoint highlighted specific problems facing homeless people aged 16 and 17. Their evidence noted that the Social Security Act 1988 withdrew automatic entitlements to benefits for 16 and 17 year olds. Centrepoint called for 'a rationalisation of the current system of financial support for this age group, replacing it with a "youth allowance" or "maintenance allowance" paid to young people whether they are studying, training or seeking employment. In the case of 16 and 17 year olds in employment, the allowance would be linked to the provision of in-work training.'

4.76 With the exception of business services employers' associations, employer organisations opposed the introduction of a minimum wage for 16 and 17 year olds. Reasons given included that it could reduce participation in FTE, there were legal restrictions on their roles and they needed greater supervision. The British Retail Consortium stated that 'retailers are a major employer of under 18s. Indeed for much of the population retail was the very first job they had, demonstrating how retail acts as a gateway to the wider world of work. Under 18s are restricted in the work they are allowed to do. They cannot for instance sell alcohol, petrol or operate certain machines. As a result under 18s cannot do the full range of tasks that employees over 18 can, restricting the value they can create.' Hairdressing employer associations were particularly concerned about any removal of the exemption from the National Minimum Wage of workers under 18. They commented that such employees were starting their training and made little or no contribution to the economy of the salon.

"Our survey found that 29% of respondents expected their demand for unqualified workers to fall in the next three years. Given the need for greater participation in post 16 education, it would seem unwise for the LPC to intervene in a way which might upset the present beneficial trend towards greater participation in post 16 education."

CBI evidence

4.77 In previous reports we highlighted the range of initiatives operated by the Department for Education and Skills (DfES) and the devolved administrations to encourage 16 and 17 year olds to pursue their education or training and we stated that this reinforced our view that they should not be considered full participants in the labour market. The Welsh Assembly Government (2002c) launched proposals in October 2002 for reforming the learning pathways of 14–19 year olds. Earlier this year DfES (2003) set out specific policies for reform of further education and training for 14–19 year olds and the Scottish Executive (2003) published its five-year strategy for lifelong learning. All envisage moving away from 16 being a traditional cut-off point in education and encouraging young people to continue to learn.

4.78 Since our third report a key development has been the announcement that the pilot Education Maintenance Allowances (EMA) Scheme will be extended across England from September 2004. A separate Scottish EMA scheme will be extended to cover all of Scotland from September 2004. The decision to extend EMA nationally was based on positive results from the evaluation of the pilot; it is estimated that EMA increased participation in education among eligible young people in England by nearly six percentage points (Centre for Research in Social Policy, Loughborough University and Institute for Fiscal Studies (2002)).

4.79 We would be reticent about recommending a statutory minimum wage for 16 and 17 year olds if it might reduce their participation in further education or training. Wilkinson (2001) investigated whether changes to the wage structure for young people had influenced participation rates in education and training. He found little evidence of the National Minimum Wage having any adverse effects on participation in FTE, particularly at age 16 and 17, but stated it was possible that participation rates in FTE could have been higher still without the National Minimum Wage. He also 'could not assess whether the NMW had an effect on participation in full-time education beyond the simple fact that jobs may have become more attractive to young people because actual pay has increased'.

4.80 We continue to believe that 16–17 year olds should be in FTE or training. We support the initiatives operated by DfES and the devolved administrations to encourage young people to pursue their learning until at least the age of 18 but recognise that for some people, particularly those with few (if any) qualifications, remaining in education is not a realistic expectation. We are also concerned by evidence of full-time jobs for 16–17 year olds offering very low pay and little or no training.

4.81 On balance the evidence we have received leads us to believe that, in principle, there is a case for introducing a minimum wage for 16–17 year olds, set at a lower rate than that for 18–20 year olds. But we do not wish to encourage 16–17 year olds to leave FTE or training positions, nor to harm their employment or training opportunities. We therefore need to examine further the relationship between the minimum wage and education policy (particularly EMA) and the level at which a rate should be set. **We therefore recommend that the Government should ask the Commission to consider in detail the introduction of a minimum**

wage rate for 16–17 year olds and to report by February 2004, so that a rate could be introduced by October 2004. We would also want to consider the interaction of a minimum wage rate for 16–17 year olds with the current exemption for apprentices aged under 19. At this stage, we think it likely that it would be appropriate to retain the current exemption for apprentices under the age of 19.

4.82 So far in this chapter we have examined the impact of the minimum wage on young people, the role and the age coverage of the youth Development Rate and the importance of encouraging training and development opportunities for young people. The wider impact of the minimum wage on workforce skills is also important, and to this we now turn.

The National Minimum Wage and Training

4.83 In our three previous reports we have taken care to ensure that the minimum wage offers some recognition of the costs incurred by employers who provide good quality training for their workers. We have also made clear our hope that the minimum wage would encourage firms to increase their support for training and workforce development. In practice, as we described in Chapter 2, aggregate data show that job-related training has increased marginally over the last two years but the qualitative research which we commissioned suggests that the minimum wage is just one factor among many that determine firms' training strategies. The wider policy environment is extremely important, and a range of Government initiatives to promote workforce development is under way. These include targets to increase the number of young people undertaking Modern Apprenticeships, and a new National Modern Apprenticeship Taskforce; Employer Training Pilots, testing new measures to improve access to training for low-skilled adult workers; a review of funding for adult learning; a new target to reduce by at least 40 per cent the number of adults in the UK workforce who lack National Vocational Qualification (NVQ) level 2 or equivalent qualifications by 2010; and the establishment of employer-led Sector Skills Councils.

4.84 We also noted that the minimum wage does not appear to have had an adverse impact on the New Deal. The Government's evidence said it is not aware of any evidence that the minimum wage is discouraging employers from employing 18–24 year olds on the New Deal. Figures published by the Department for Work and Pensions show that the percentage of those leaving the New Deal for 18–24 year olds Gateway to go into employment was steady between 1999 and 2001 and over the first nine months of 2002, at 32 to 33 per cent (Department for Work and Pensions (2002d)). In preparing this report we have heard no suggestion that the minimum wage has affected employers' willingness to take on or retain New Deal employees.

4.85 The potential impact on training and skills of Government initiatives to promote workforce development is much greater than that of the National Minimum Wage. But the minimum wage nevertheless has a role to play, and we conclude by examining the two specific features of the minimum wage which are designed to provide some recognition of the costs of training:

- the minimum wage exemption for apprentices; and
- the older workers' Development Rate.

The Exemption for Apprentices

4.86 Apprentices need not be paid the minimum wage if they are under age 19, or under age 26 and in the first twelve months of their apprenticeship. In this context, apprentices are workers who either have contracts of apprenticeship or are taking part in the specific Government training programmes known as Modern Apprenticeships, Skillseekers to level 2 or 3 in Scotland, National Traineeships in Wales and Jobskills Traineeships in Northern Ireland. Government data show that in Summer 2002 across the UK there were around 300,000 people on these Government programmes.

4.87 In our third report we found that apprentice numbers had increased and use of apprenticeships varied between low-paying sectors. Hairdressing was a particularly significant user, with about 10 per cent of employees being apprentices. But use was much lower in sectors such as retail and hospitality. We concluded that the minimum wage did not appear to have had an adverse impact on apprentices. For this report we have again reviewed the use of apprenticeships and apprentice pay rates, to assess whether the minimum wage has had any impact on employers' interest in offering apprenticeships or on young people's interest in undertaking them.

4.88 Government data show that in 2001/02 150,000 employed Modern Apprenticeships were begun in England, nearly 60 per cent more than the equivalent figure for 1998/99 (96,000 including National Traineeships). Over the same period, in six sectors where low pay is common – hospitality, retailing, hairdressing, health and social care, early years care and education, and security – the overall number of employed Modern Apprenticeships begun grew even faster, by nearly 80 per cent. In Scotland the total number of Modern Apprentice and level 2 or 3 Skillseeker starts was 29,000 in 2001/02 – the majority with employed status – compared with 23,000 in 1998/99. It is not possible to say what would have happened in the absence of the minimum wage. But these figures do not suggest that the minimum wage has reduced employers' willingness to offer Modern Apprenticeships, either generally or in low-paying sectors. Research for the Scottish Executive found that where employers had recruited young people without using Modern Apprenticeships, the main reasons were that the work was part-time or the job did not require someone to be trained to the Modern Apprenticeship level (SQW Limited (2001)).

4.89 We also found no evidence that employers overall have shifted their recruitment of Modern Apprentices towards the very young and away from older people, even though an apprentice starting at age 16 is exempt from the minimum wage until age 19. In 1998/99, 28 per cent of employed Foundation Modern Apprenticeships begun in England were among the 19+ age group, whereas in 2001/02 the proportion was 40 per cent. There was a similar pattern in low-paying sectors, although in hairdressing the proportion aged 19 and over remained below 10 per cent.

4.90 The evidence suggests that apprentice hourly pay rates are lower than the youth Development Rate in the first year or phase, but that they commonly increase to above the Development Rate before age 19. Analysis of 20 collective agreements, relating mainly to manufacturing and construction industries, shows that, while 16 of them pay apprentices below the youth Development

Rate initially, only one explicitly pays below the Development Rate until the law requires it to be paid (ONS, ongoing). Pay rates reported by Faichnie (2002) suggest that employers trying to recruit Modern Apprentices commonly sought to use the apprenticeship exemption: for every age group between 18 and 22 a substantial majority of the Modern Apprentice jobs advertised in Careers Offices offered starting pay below the minimum wage rate otherwise applicable, although it is not known how many of the jobs were filled nor what the actual ages and pay rates of successful applicants were. However, among 145,000 apprentices aged 16–25 in various stages of their training, Spring 2002 LFS data indicate that lowest quartile pay was £3.72 per hour – above the youth Development Rate – and median pay was £4.48 per hour.

4.91 We also examined whether the minimum wage has had any impact on young people's interest in undertaking apprenticeships. The overall increases in numbers of Modern Apprenticeships begun since 1998/99 do not suggest that the minimum wage exemption rule has led aggregate demand among young people to fall. But evidence confirms that pay is a factor in young people's thinking. In a survey of 500 14–17 year olds, 89 per cent saw earning while learning as one of the most attractive features of Modern Apprenticeships (DfES and Learning and Skills Council (2001)). DfES data show that 9 per cent of Advanced Modern Apprentices and 12 per cent of Foundation Modern Apprentices who left without completing their training said their reasons included not enough money. Druker *et al*. (2002) reported that – among 16 hairdressing apprentices – most felt their low wages encouraged them to think about leaving the industry. We have, though, seen little evidence that low pay resulting from use of the minimum wage apprenticeship exemption has deterred young people from starting or continuing an apprenticeship.

4.92 In written evidence, the West Midlands Employment and Low Pay Unit suggested abolition of the exemption, and the Public and Commercial Services Union suggested that an apprentice should start receiving the minimum wage once they had completed their first year even if they were not yet 19. But few other submissions mentioned the exemption, and the information available suggests that the current rules neither discourage employers nor deter young people. The current exemption is also clearly used by many firms. Given this, we consider no change is needed to the exemption for apprentices, but we will continue to monitor its use and will consider the interaction with any minimum wage for 16–17 year olds.

The Older Workers' Development Rate

4.93 The older workers' Development Rate applies to workers aged 22 and over starting a new job with a new employer and doing accredited training on at least 26 days during the first six months of the employment. In our third report we noted that take-up of the older workers' Development Rate remained low: only 5 per cent of respondents to our employer survey said they were using it. But of these, 40 per cent said it had enabled them to improve the amount or quality of training which they provided.

4.94 Spring 2002 LFS data indicate that there were fewer than 30,000 employees aged 22 and over who had been in their main job for six months or less and were being paid between the Development Rate and the adult rate (that is, between £3.50 and £4.09 per hour). This suggests that the maximum number of jobs where the older workers' Development Rate as currently defined might be in use is small. Even if it were 30,000, this would represent no more than around 1.4 per cent of all main jobs held by workers aged 22 and over who had been in post for six months or less.

4.95 Use of the older workers' Development Rate continues, therefore, to be small-scale. In our survey of firms in low-paying sectors, only 4 per cent of respondents said they used it. Hairdressing firms were the most likely to do so, but even here the proportion was no more than 11 per cent. Use hardly varied by size of firm. But it was greatest among respondents whose wage bills had risen the most due to the minimum wage uprating in 2001 – 9 per cent among firms whose wage bills had increased by more than 10 per cent.

4.96 Research which we commissioned (Miller *et al*. (2002) and Rainbird *et al*. (2002)) and written evidence which we received also showed few firms using it. Miller *et al*. (2002) reported that only four of the 26 firms surveyed had heard of it. When told about it, the hairdressing firms surveyed saw it as potentially more helpful than the hospitality and retail sectors. In general, three problems were anticipated with its use – a reduced wage rate would not be viewed favourably by recruits even if training was being provided; there would be difficulty in identifying 'one day a week training' if training was being provided on the job; and most people following N/SVQs or Modern Apprenticeships do not become fully productive for much longer than six months. Table 4.2 shows that, in our survey, the commonest reasons given by employers for not using it were that it was hard to recruit at this lower rate of pay and that recruits already had the skills needed. The third commonest reason was that employers were not aware of it.

Table 4.2 Reasons for Not Using the Older Workers' Development Rate

%	Hospitality	Social care	Textiles/ clothing	Hairdressing	Retail	Childcare	Security	Cleaning	Leisure	Total
Hard to recruit at this pay rate	38	43	28	23	22	32	42	36	26	33
Recruits already have skills needed	26	21	31	47	27	45	21	30	32	32
Not aware of Development Rate	17	24	17	22	23	24	18	20	14	21
Unfair/ divisive	24	28	11	10	14	18	26	25	16	20
Accredited training not appropriate	12	7	16	7	24	4	15	16	16	11
Does not make accredited training worthwhile	9	10	6	5	4	6	7	9	4	7
Too difficult to administer accredited training	12	6	11	6	11	4	8	7	4	7

Source: LPC Survey, May 2002.

Base: All firms not using the older workers' Development Rate.
Note: Respondents were asked to tick any reasons that were applicable in their case.

4.97 Our survey also asked respondents whether they had increased the amount or quality of training they provide as a result of using the older workers' Development Rate. Of the 150 firms who said they used it, a third said yes. For the others, it is unclear how far it has provided an incentive to recruit and train older workers and how far it has simply helped offset the costs of training which they would have provided anyway.

4.98 In our third report we concluded that there might be a case for abolition of the older workers' Development Rate if low take-up continued but we needed a longer period before we could advise on this. In consultation for this report, some organisations have said they would like it to remain as now, while others have suggested abolishing it. The Hairdressing Employers Association and the National Hairdressers' Federation proposed that firms should be able to use the older workers' Development Rate for the duration of training rather than just six months. Usdaw accepted a role for the lower rate

Low Pay Commission Research

In hospitality and retail, most of the small and medium-sized case-study companies do not have the capacity to meet the criteria for using the older workers' Development Rate. Even if they do, they prefer to train more established staff rather than new recruits, who may be recruited initially on a casual or temporary basis and may leave.

Rainbird *et al.*, 2002. *The National Minimum Wage and Training*

> *We … remain supportive of the Development Rate which continues to meet specific business needs with regard to attracting and training new recruits in the licensed retail sector.*
>
> **British Beer & Pub Association evidence**

> *We see no value in the training rate of pay at NMW. It is not possible to cost a contract to include a percentage of youth or trainee numbers in the structure.*
>
> **Cleaning and Support Services Association evidence**

but commented that it does not need six months to achieve basic job capability in retailing and suggested that the rate should apply for a much shorter period, with improved checks on the training carried out.

4.99 Abolishing the older workers' Development Rate would do limited damage to employers' incentives to provide accredited training for adult recruits, since few firms use it and, in our survey, a majority of those who did use it said it had not led them to improve their training provision. Abolition would also close off a potential loophole for exploitation and simplify the minimum wage. On the other hand, it is clear that some firms find it helpful in adjusting to the minimum wage. Our survey found that the firms which experienced the largest wage bill increases due to the 2001 uprating were the most likely to use it. Keeping it would preserve the incentives it offers for employers to provide accredited training for adult recruits and, as there is no obligation to use it, it does not affect firms which do not find it useful. On balance, we think the older workers' Development Rate should remain in place for the time being, particularly in view of the help it has provided to firms experiencing the largest increases in their wage bills; but we will continue to monitor its use and impact.

Conclusion

4.100 The October 2001 uprating of the minimum wage increased hourly earnings for young people, with just over 90,000 (5.3 per cent) of jobs of 18–21 year olds affected, narrowing the distribution of earnings of young people. While there was a fall in the employment rate of 18–21 year olds (particularly among men) from Summer 2001, the evidence suggests that the minimum wage was not the driving factor. The fall in employment was not among the sectors most affected by the minimum wage and there is very little evidence of substitution away from young people. We would expect young people's employment to be more affected than aggregate employment by the slowdown in economic growth, and we believe that the economic cycle is the primary driver of the fall in 18–21 year old male employment. The econometric research found no significant impact of the minimum wage on young people's employment when the effect of the economic cycle was taken into account.

4.101 We recognise the argument that an age-related Development Rate lacks equity but we continue to believe that young people are vulnerable members of the workforce who merit special consideration. In previous reports we have expressed a long-term aim to link the Development Rate to accredited training rather than age. While this is desirable, it is clear that the conditions are not in place to make use of the youth Development Rate conditional on the provision of accredited training.

4.102 However, we believe that the youth Development Rate should only apply to those who need its coverage and have again recommended that the adult rate should be payable at age 21. We will continue to keep the age coverage of the youth Development Rate under review.

4.103 We are concerned by the examples of very low pay received by some 16–17 year olds. We believe that, in principle, there is a case for introducing a separate minimum wage for 16–17 year olds and have recommended that the Commission should consider this further and report by February 2004.

4.104 While job-related training has increased marginally over the last two years, research suggests that the minimum wage is just one of many factors influencing firms' training strategies. The current exemption for apprentices is working well and no change is needed at present, but we will continue to monitor its use and will consider its interaction with any minimum wage for 16–17 year olds. Although use of the older workers' Development Rate continues to be small-scale, we think it should be retained for the time being.

5 Compliance and Enforcement

Most employers are continuing to comply with the National Minimum Wage, but we are concerned that some workers are still being underpaid, particularly, though not exclusively, in the informal economy. While awareness of the existence of the minimum wage remains high, we recommend that the Government should continue to publicise the minimum wage to businesses and to workers on an ongoing basis. Evidence we received welcomed the Inland Revenue's work so far in enforcing the minimum wage, and we strongly support the work being done by pilot projects to promote reporting of underpayment.

To tackle continuing non-compliance with the minimum wage, we recommend that there should be further proactive enforcement work. This should include greater co-ordination with wider Government compliance initiatives; encouraging initiatives by employers and unions to promote compliance; and evaluating the use of existing powers to identify whether any changes in practices or powers are needed to strengthen the deterrent to non-compliance. Detriment and dismissal related to the minimum wage also continue. We welcome the scope which the Advisory, Conciliation and Arbitration Service (ACAS) and the Inland Revenue have identified for improving co-ordination between them, and we recommend that the Government should evaluate the impact of these measures on service to customers. We also recommend that the Government should further publicise ACAS's information and advice services for businesses, to help businesses manage their response to the minimum wage within the law.

Introduction

5.1 In our third report we concluded, from all the evidence which we received, that the vast majority of employers were complying with the National Minimum Wage. But we made clear that we were not complacent, because some workers continued to be underpaid. For this report we have again looked closely at how well the minimum wage is being complied with and how effectively it is being enforced. We have invited organisations and individuals to address compliance and enforcement in their written evidence to us; we have asked about it in our visits; and we have met the head of the Inland Revenue minimum wage enforcement team. In this chapter we consider in turn awareness of the minimum wage, non-compliance, progress in enforcement, and detriment and dismissal related to the minimum wage.

Awareness

5.2 Awareness of the minimum wage is crucial, since – as we proposed in our first report – the minimum wage should be self-enforcing as far as possible. In our third report we found that overall awareness of the existence of the minimum wage was very high, but that awareness of the actual rate of the minimum wage and of the National Minimum Wage Helpline was considerably lower. We welcomed the action the Government had taken to publicise the minimum wage and its intention to mount a further publicity campaign in the run-up to the uprating of the minimum wage in October 2001. We recommended further publicity for the headline rate of the minimum wage as well as for the existence of the enforcement service and the National Minimum Wage Helpline number. We also suggested that publicity for the uprating be followed up with ongoing publicity to continue to promote awareness, and that publicity be targeted to reach different groups of workers – such as young people, ethnic minority workers and homeworkers – as well as employers, particularly small businesses.

> *'Clearly employers and workers need to know about the minimum wage if it is to be successful.'*
>
> **Government evidence**

5.3 We were pleased that the Government accepted our recommendation. The Government's evidence reported that since then it has run two further national publicity campaigns, related to the 2001 and 2002 upratings of the minimum wage. These aimed to inform employers and workers of the new rates and encourage both groups to contact the Helpline for more information and advice and, if necessary, to make a formal complaint about non-payment of the minimum wage. The Government's evidence also noted that survey research published by the Department of Trade and Industry (DTI) – Blackburn and Hart (2002) – showed that awareness of the minimum wage was almost universal among small firms (over 98 per cent). Almost eight out of ten respondents were aware that there was a different rate for those aged under 22. However, detailed knowledge of the actual minimum wage rates was somewhat lower. In December 2002 the Government sent us the results of independent research it had commissioned into levels of awareness following the 2002 advertising campaign. These show that 99 per cent of employers surveyed in eight low-paying sectors, and 97 per cent of low-paid workers, were aware of the minimum wage when prompted. But awareness of the new rates and of the National Minimum Wage Helpline was substantially lower. The results are shown in Table 5.1. The research also found that only 3 per cent of low-paid workers said they would contact the Helpline or the Inland Revenue for advice on the minimum wage, compared with 36 per cent and 27 per cent, respectively, who said they would contact a Citizens Advice Bureau and a Job Centre. These levels of awareness of minimum wage rates are lower than those found after the Autumn 2000 publicity campaign, which we described in our third report. The researchers noted that the 2002 campaign was smaller than previous campaigns and so awareness was expected to be lower than that found in previous research.

Table 5.1 Awareness of the National Minimum Wage Following the October 2002 Uprating

	Employers in low-paying sectors	Low-paid workers
	Percentage aware	
The existence of the National Minimum Wage	99	97
The new adult rate	32	28
The new youth rate	13	Not applicable
The National Minimum Wage Helpline	32	12

Source: Department of Trade and Industry.

Note: 600 employers were surveyed in eight low-paying sectors: retail, hospitality and catering, care work, hairdressing, cleaning, security, production and construction. Low-paid workers were aged 22 or over; 226 were in work, earning £5.00 per hour or less, and 74 were unemployed and seeking work.

5.4 The Government's evidence also said the minimum wage had been publicised to ethnic minority workers and homeworkers through enforcement pilot projects covering the textiles industry in Leicester, the homeworking industry in Bradford and ethnic minority groups in the West Midlands. Other steps to ensure that awareness remained high included the interactive website www.tiger.gov.uk; joint DTI and Inland Revenue presentations known as Customer Responsive Outreach Work (CROW); minimum wage staff attending all of the Inland Revenue's tax/national insurance awareness events in 2001/02; and inclusion of information about minimum wage rate changes and the Helpline in the Inland Revenue's employer bulletins and packs and the Small Business Service Employment Law Update, which are each sent to around 1.5 million tax-registered employers. In Autumn 2001 the DTI also produced short guidance leaflets aimed at both employers and employees in Braille, audio, large print and a variety of ethnic languages, including the main Asian ones.

> *Our survey [of 186 young people] shows that whilst 69% were aware of the NMW, only 10% could actually tell us the hourly rates.... 93% of the young people reported that they did not know whom to contact in the event of not receiving the NMW, and of those that thought they did, none of them mentioned the Inland Revenue Enforcement Agency.*
>
> **British Youth Council evidence**

> *Polling shows relatively high recognition of the minimum wage adult rate. As the target constituency has a generally low awareness of their employment rights this achievement is not to be underestimated. However, more can be done.*
>
> **TUC evidence**

5.5 We have received further evidence for this report that awareness of the existence of the minimum wage is high but that detailed knowledge is somewhat lower. Written evidence from UNISON and the Low Pay Unit reported that 'awareness of the NMW is undoubtedly widespread; but knowledge as to the statutory amount is far less well known, and the right to make an anonymous complaint even less'. The National Group on Homeworking (NGH) wrote that 'levels of awareness of the rate of the National Minimum Wage remain low among some sectors of society; in particular, homeworkers from Pakistani and Bangladeshi communities'. NGH reported that in research in Bradford, when asked what they thought was the rate of the minimum wage, although most interviewees mentioned rates between £3.50 and £4.00 the lowest rate mentioned was £1 an hour. The GMB told us that 'awareness that there is a headline NMW rate is generally high, although upratings are not always as readily picked up. Where there are language barriers and isolated workers, awareness of the headline rate drops.' The GMB reported that it had found some clothing manufacturers in East London who were not paying the minimum wage, and that none of the workers – a mixture of Bengali, Vietnamese and Kosovan workers – had been aware of the minimum wage. The Transport and General Workers Union wrote that 'there are indications that some workers are still not benefiting from the NMW because they are unaware of their rights'. A number of organisations also highlighted lack of awareness about the minimum wage among young people. The Trades Union Congress (TUC) reported that its own polling showed a degree of confusion about the minimum wage amongst young people and suggested that the next information campaign should target them specifically.

5.6 A number of organisations expressed support for continued publicity for the minimum wage. For example, the TUC commented in oral evidence that advertising was targeted around the uprating but should continue throughout the year. UNISON and the Low Pay Unit proposed action to increase awareness and information to both employees and employers in particularly low-paying areas and a rolling programme of awareness-raising and information on the minimum wage more generally. The National Group on Homeworking suggested that 'more publicity needs to be directed at homeworkers from Asian communities – in particular Pakistani and Bangladeshi communities, in their languages.... Distribution of information at the community level [is needed, together with] ... changes to the NMW Information Line to provide easier access for non-English speakers.'

5.7 In summary, we welcome the various steps which the Government has taken to publicise the minimum wage and the Inland Revenue National Minimum Wage Helpline. We are also encouraged that awareness of the existence of the minimum wage appears to continue to be at a high level. At the same time, we noted in Chapter 3 that awareness among small firms could be improved. There is also evidence that lower awareness persists among some groups of workers – including ethnic minorities, young people and homeworkers – and among some other employers. **We recommend that the Government should continue to publicise the minimum wage both to businesses and to workers on an ongoing basis. Publicity should cover the headline rate and the Helpline, with targeted publicity tailored to different groups**.

> *'We believe there is still a lot of work to be done in terms of getting the message through in micro-economies such as [clothing manufacturers in the East End of London] which are isolated and where fluency in English, familiarity with legal requirements and contact with agencies are all limited.... We welcome the publicity activities associated with both the 2001 and 2002 upratings which we believe have been successful in reaching far and wide.... Publicity should continue to highlight successful enforcement actions as well as the headline rates, and we believe there is much value in targeting particular audiences such as local, and ethnic minority radio stations, "youth" magazines and press and radio aimed at disabled workers.'*
>
> **GMB evidence**

Non-compliance

5.8 We noted in our third report that, while the Office for National Statistics produces estimates of the number of jobs paid below minimum wage rates, neither of the surveys on which its estimates are based – the Labour Force Survey (LFS) and the New Earnings Survey (NES) – is designed to monitor compliance with the minimum wage. Neither survey can identify people such as apprentices, those undergoing training and those eligible for the accommodation offset who may legally be paid less than the minimum wage. We noted that the data also showed some 'bunching' just below minimum wage rates, and this has continued. The grossed NES results for April 2002 show that, of those employees aged 22 and over with an hourly pay rate below £4.10, a quarter had an hourly rate of £4.09. It seems unlikely that employers would deliberately avoid paying the minimum wage by such a small amount, and the more likely explanation is that the methodology of the NES calculation (which takes reported earnings divided by reported hours worked) produces small errors. The grossed NES 2002 results also show that a further 30 per cent were paid between £4.00 and £4.08 per hour. So we have based our assessment of compliance and non-compliance on other information sources, including written evidence, external research and other statistics.

5.9 Information on enquiries and complaints to the Inland Revenue, and on enforcement action which it has taken, provides a starting point. Table 5.2 gives figures. These indicate that the number of enquiries received by the Helpline, and the number of complaints received, were about the same in 2001/02 as in the preceding year. Investigations between April 1999 and September 2002 found around 6,200 employers not complying with the minimum wage.

Table 5.2 National Minimum Wage: Enquiries and Complaints to Inland Revenue and Inland Revenue Enforcement Action

	April 1999-March 2000	April 2000-March 2001	April 2001-March 2002	April 2002-September 2002	Total April 1999-September 2002
Enquiries received by Helpline	120,562	77,473	77,610	28,994	304,639
Complaints of underpayment	4,591	1,823	1,813	999	9,226
Visits to employers (See note)	4,548	4,475	4,288	2,855	16,166
Enforcement notices issued	136	213	86	16	451
Penalty notices issued	1	61	65	6	133
Value of underpayments identified	£1.2 million	£3.0 million	£5.17 million	£1.63 million	£11 million

Source: Department of Trade and Industry, Inland Revenue.

Note: These figures are for number of cases closed with an inspection having been made.

5.10 These figures do not say anything about non-compliance not reported to the Inland Revenue, so information from other sources is key to our assessment of compliance and non-compliance as a whole. The information available to us does not give a quantitative indication of under-payment of the minimum wage. However, the overall message continues to be that most employers are complying with the minimum wage, but that some workers are still being underpaid. For example, the Transport and General Workers Union wrote that ‘across the economy as a whole, there is widespread compliance with the NMW’. Written evidence from Citizens Advice Scotland showed that enquiries about terms and conditions of employment – which included both minimum wage and non-minimum wage enquiries – made up 7 per cent of new enquiries to Scotland’s Citizens Advice Bureaux in 2001/02.

‘The CBI accepts reports from the CAB and others that some problems with compliance exist.’

CBI evidence

5.11 But we are concerned that non-compliance continues to affect some workers. We have also received more evidence than previously about non-compliance in the informal economy. Several employer organisations and unions from a number of sectors raised this with us. The Business Services Association and the Cleaning and Support Services Association told us in oral evidence that there was a large informal economy servicing small businesses and households. Grimshaw and Carroll (2002) reported that the six security firms surveyed said the minimum wage had not yet driven out 'cowboy' firms, which offered cut-price security by operating illegally. The GMB wrote that it 'has had reports from the security sector of large clients awarding contracts on the basis of bids which can only be fulfilled by breaching the NMW regulations. This is fairly easy to spot in bids which are about person-hours required to provide a round-the-clock security presence.'

5.12 The British Apparel & Textile Confederation (BATC) also told us in oral evidence that there was non-compliance in the informal economy part of the textiles and clothing sector, and employers got round minimum wage legislation by under-recording hours worked. KFAT, which represents workers in the knitwear, footwear and apparel trades, suggested that the informal economy part of the sector has mushroomed and non-compliance by these firms is a major problem. And the Hairdressing Employers Association and the National Hairdressers' Federation told us that the informal economy accounts for about one third of visits and around one quarter of the industry's turnover.

5.13 At the same time, evidence suggests that non-compliance is not confined to the informal economy. The TUC told us in oral evidence that various practices existed in the formal economy such as telling workers that they were not eligible for the minimum wage. UNISON and the Low Pay Unit reported underpayment affecting care home workers, contract staff and agency workers. And childcare workforce surveys found that 36 per cent of playgroups and 25 per cent of out of school clubs paid childcare workers an average rate which appeared to be lower than the minimum wage (Department for Education and Skills (2002b)); the Government's evidence said it was looking to discuss the position with organisations representing the sector.

Low Pay Commission Research

One security firm said 'How can you pay a guy £4.10 if you're only charging the customer £4.00? … I put a price in – it was £5.99, and we were paying the guy £4.50. They said "no sorry – we're only being invoiced £4.00 an hour".'

A knitwear firm said, 'What happens, is that – not us – but at the cheaper end of the market, [other employers] … take advantage of [the first generation immigrant workers]. And they don't know about the legislation, they don't know about the minimum wage … and [the firms] do that to achieve their lower prices … I'm not blaming them. Everyone else is doing it.'

Grimshaw and Carroll, 2002. *Qualitative Research on Firms' Adjustments to the Minimum Wage*

"The minimum wage hasn't affected us that much. We show that we're complying to the rules but on the books we have 5 staff working at the restaurant when really, there's 12 of us."

"It has not affected us, we discuss new laws with our accountant and decide on how best to deal with it. Some people we say are working less than they actually are. We reduce the hours worked so that it works out appropriately."

"The wages we pay are lower than the minimum wage. Our accountant works it out so that we have less hours on the books."

"It has not affected our business. We are running the way we have always done, we've just changed the paperwork to comply with the law."

Ram *et al.*, 2001c. *Employers and Illegal Migrant Workers in the Clothing and Restaurant Sectors* (quoting restaurant employers' responses to the minimum wage)

5.14 In a small survey of restaurant and clothing employers, Ram *et al.* (2001c) also found widespread evasion of the minimum wage among the restaurants, with pay rates commonly below £3 per hour.

5.15 We have found in previous reports that particular groups of workers may be especially vulnerable to being underpaid, notably pieceworkers, homeworkers and ethnic minority workers. Evidence which we have received for this report suggests that this continues to be the case. For example, Grimshaw and Carroll (2002), who interviewed clothing firms in the North West of England, reported that the practice for many of these firms was to specify a 40-hour week and a fixed weekly wage that met the minimum wage legislation but to design a system of piece rates which meant that workers had to work longer hours than in their contracts in order to earn the expected weekly wage; this led to hourly rates often below the minimum wage. The National Group on Homeworking wrote, 'among homeworkers interviewed … an overwhelming majority received rates well below the National Minimum Wage (sample size of about 50). The majority engaged in card and related goods packing work received the equivalent of about £1.50–£2.00 an hour (all paid by piece rates). The worst case of underpayment recorded by NGH in 2002 was a woman who received £1.25 for 5 hours work packing pins (equating to 25 pence an hour).' NGH also reported underpayment affecting homeworkers from Pakistani and Bangladeshi communities.

5.16 In summary, it is clear from the evidence we have received that most employers are continuing to comply with the minimum wage. But we are concerned that some employers are not. And the evidence suggests that some groups of workers continue to be particularly vulnerable to being underpaid. Non-compliance with the minimum wage is very serious for the individual workers concerned, and it underlines the critical importance of effective enforcement. So we consider next the progress which is being made in enforcing the minimum wage and securing for workers the pay they are due.

Progress in Enforcement

5.17 Effective enforcement of the minimum wage is in the interests both of workers and of other employers who are complying. In its written evidence the CBI commented that most employers want to see the minimum wage effectively enforced, since this prevents them from being undercut by unscrupulous competitors.

5.18 The Government's evidence noted that Inland Revenue minimum wage compliance officers identified more than £5 million in wage arrears in 2001/02, and that the total of arrears identified from April 1999 to September 2002 was over £11 million. It also reported that 36 per cent of employers investigated were found not to be paying the minimum wage, a 6 percentage point increase compared with 2000/01 and a 16 percentage point increase on 1999/00. The Government's evidence commented that these figures suggest that the Inland Revenue is becoming more effective at targeting non-compliant businesses and identifying arrears, but that they also reflect the 'maturity' of the minimum wage so that cases are now likely to cover longer periods.

> *'The Inland Revenue's role is to ensure workers know their rights and responsibilities and get what they are entitled to; ensure employers know and understand their obligations and pay what they should; and provide an accessible and effective information and enforcement service.'*
>
> **Government evidence**

The Effectiveness of Enforcement

5.19 A number of evidence submissions which we received, including from advice agencies and others trying to help low-paid workers, have been complimentary about the work of the Inland Revenue in enforcing the minimum wage, and this is encouraging. UNISON and the Low Pay Unit said, 'we have always applauded the Government's decision to appoint the Inland Revenue as the overseers of NMW payment compliance. And their record on payment retrieval has been good.' The West Midlands Employment and Low Pay Unit commented, 'one of the successes of the government's NMW policy has been a dedicated enforcement body, the Inland Revenue (IR), which we welcome'. The CBI wrote that the current twin-track structure of enforcement, using both the Inland Revenue and the Employment Tribunal system, has proved successful and should be maintained.

5.20 However, there is evidence that some low-paid workers are still reluctant to report non-compliance or to have the information which they provide cited to their employer as evidence. KFAT told us that workers in the informal economy part of the textiles and clothing sector, who are commonly from ethnic minority communities, are reluctant to report underpayment because they fear losing their jobs (employers operate a blacklist) and being seen as betraying their community. The GMB reported that it had informed the Inland Revenue of underpayment by some clothing manufacturers but had found great difficulty in getting workers to make individual complaints. The National Group on Homeworking wrote that the overwhelming majority of homeworkers who are not receiving the minimum wage are unwilling to make a complaint to the National

Information is given by workers, who wish to remain anonymous, that indicates that they are being paid less than the minimum wage. The reasons why workers wish to remain anonymous are very real – if identified they risk losing their job, there is an employer network that will not allow them to work, they risk being accused of selling out on their community and, in some cases, physical violence. Minimum wage enforcement officers find it difficult to obtain firm documentary evidence that the minimum wage is not being paid and, with workers being unwilling to be identified, it becomes difficult for the Enforcement Officers to use the information that has been given to them … to challenge what the employer says.

Leicester City Council evidence

Minimum Wage Enforcement Agency. NGH reported that the most important reason cited by homeworkers for not enforcing their right to the minimum wage is fear of losing work – including fear that others in the community will also lose their work and/or that the company will close.

5.21 It was the need to encourage workers to come forward and report non-compliance which led us to recommend, in our second report, that the Government should fund a small number of community-based pilot projects. The aim was to build workers' confidence in the effectiveness of enforcement procedures and thereby encourage greater levels of reporting of non-compliance. We were pleased that the Government acted on our recommendation, setting up seven pilot projects with outside partners in various locations around the UK.

5.22 The Government's evidence described the progress being made by these projects.

- A local minimum wage helpline was established in conjunction with the Northern Ireland Association of Citizens Advice Bureaux in Belfast in September 2001, partly because evidence suggested that workers in Northern Ireland were reluctant to call the national Helpline in Longbenton. This had received 2,250 calls up to October 2002, from which over 100 complaints of non-compliance were referred to the Inland Revenue regional compliance team for investigation.

- The Inland Revenue has worked with KFAT and Leicester City Council to establish links with the local clothing and textiles trades. Despite initial reluctance to come forward, leads from workers have been emerging and one early success secured arrears of over £40,000 for a group of factory workers.

- The Inland Revenue is working with the National Group on Homeworking in a project based in Bradford, focusing on promoting minimum wage awareness and compliance in relation to homeworkers. Extensive work by NGH including drop-in sessions, local publicity campaigns and minimum wage education for employers in the Bradford area has significantly raised awareness there.

- The Inland Revenue and the West Midlands Employment and Low Pay Unit are working together to highlight minimum wage issues, including issuing publicity material and meeting local community associations and work groups.

- A project in Hull running a local telephone helpline was supported by local radio advertising but only produced a fairly small number of complaints.

- In Scotland and Tyneside, projects with Citizens Advice Bureaux (CAB) offered personal interviews about the minimum wage to workers at local CAB offices, although only small numbers of workers sought interviews.

5.23 The Government's evidence reported that the Scotland project was being restructured with the introduction of a specific Scottish helpline, to be operated by the Scottish Low Pay Unit and, where the caller wished to have face-to-face advice, offering it through the nearest CAB. It is hoped that providing this service through non-government organisations will encourage people who are uneasy about approaching the authorities to complain.

5.24 Additional projects are now being developed. The Inland Revenue analysed data to identify areas in the UK where fewer complaints had been received than anticipated and three areas were identified – South Wales, Cornwall and Derby. Proactive campaigns have begun in each of these areas using local publicity, working on cases identified through risk analysis, and working with community groups; there has been an increase in the number of complaints in all three areas.

5.25 The Government's evidence also noted that all the projects are pilots and that monitoring and evaluation are continuing in order to understand why some projects appear more successful than others, and to draw out general principles for enforcement work which can be replicated around the country.

5.26 We welcome the work put into these projects, and in particular the co-operation between Government and external partners. We are pleased that the majority of the projects are continuing, since building trust among vulnerable workers takes time, and we will continue to follow the progress of existing and further projects.

Proactive Enforcement

5.27 A key feature of the pilot projects is that, rather than simply waiting for workers to come forward and report underpayment, they take the initiative. The importance of proactive enforcement is stressed in much of the evidence which we received, from both employers' and workers' organisations. Focus groups of small businesses convened by MORI for the Small Business Service suggested that there should be more enforcement, and that small businesses felt disadvantaged by having to compete with the informal economy. While describing the Inland Revenue's record on payment retrieval as good, UNISON and the Low Pay Unit said, 'we would like to see the Inland Revenue enforcement team direct their resources more towards the particularly low-paying areas, and to be more proactive in their work'. The Union of Shop, Distributive and Allied Workers (Usdaw) suggested that the Inland Revenue should target inspections on non-unionised firms in the retail and catering sectors.

5.28 We noted in our third report that some non-compliant employers will inevitably be more difficult to deal with, and we expressed the hope that the Government would make full use of initiatives such as the Joint Fashion Industry Teams (JoFITs) and Joint Shadow Economy Teams (JoSETs) to tackle non-compliance. JoFITs are drawn from several Government Departments and JoSETs are joint Customs and Excise, Inland Revenue and Department for Work and Pensions teams. In its evidence, the Government reported that the Inland Revenue is attempting to overcome the difficulties it encounters in the textiles trade by moving towards a multi-agency approach. Minimum wage teams now receive compliance reports from JoFITs advising where they have come across minimum wage issues, together with evidence on these. In 2002/03 the Inland Revenue expected to deal with around 100 JoFIT-sourced cases. The Government also said the Inland Revenue was looking at ways to extend this partnership further by obtaining the support of local authorities and trade unions. The British Apparel & Textile Confederation and KFAT both voiced support for the work which the JoFITs are doing and hoped that it would be continued and expanded.

5.29 We also received evidence on how organisations outside Government might help promote compliance. The British Apparel & Textile Confederation told us in oral evidence that enforcement among informal economy firms in textiles and clothing seemed to await complaints from employees, who tended not to come forward.

The industry was, therefore, taking measures to tackle non-compliance. The BATC and the trade unions were engaged in a feasibility study under the DTI Partnership Fund to try and improve standards within the informal economy firms. They have also offered to give details of national collective agreements and other joint initiatives such as in health and safety to large retailers to encourage them to invite their suppliers to meet these standards and some have agreed to take this forward. The BATC suggested that, rather than waiting for employees to complain to the Inland Revenue, a solution might be certification for employers who sourced their products from firms which complied with legislative requirements and nationally agreed standards. The GMB said in oral evidence that it wanted to explore the scope for a Code of Practice whereby the customer or primary contractor in a contract would take some responsibility for ensuring compliance by sub-contractors with the minimum wage; and in its written evidence it recommended that the Inland Revenue target some communications work to cover companies' contracting practices.

5.30 Other evidence suggested further ways in which enforcement could be made more effective. KFAT told us in oral evidence that Inland Revenue minimum wage compliance officers did a good job but they should be allowed to make fuller use of their powers. At present they are sometimes told to invite employers to pay arrears and avoid a penalty, rather than just issuing a penalty notice. Employers therefore have a positive incentive not to pay the minimum wage since, if found out, there is no penalty as long as they pay the arrears due, even where these are substantial (£40,000 in one case). KFAT also suggested that, although failing to keep minimum wage records is a criminal offence, where the Inland Revenue found no or inadequate records compliance officers accepted employers' claims that they did not know they had to keep them or that records had been lost or destroyed. In addition, KFAT, Leicester City Council and the West Midlands Employment and Low Pay Unit suggested that the Inland Revenue should make more use of unannounced visits rather than pre-notifying employers. We noted from the Government's evidence that in 2001/02 – while over 5,300 investigations were completed, of which 36 per cent, or 1,900, found non-compliance – only 86 enforcement notices were issued.

5.31 The Inland Revenue told us that the National Minimum Wage Act gives their compliance officers an element of discretion over the issue of a penalty notice: in no sense is it an automatic procedure.

> *'A visit by the IR officers in October 2002 did not achieve anything as the employer claimed that hand written time records were telephoned through to the accountant and the records then thrown away.... Feedback from the complainant revealed that the employer stopped using the clocking machine and started keeping time records once the IR arranged a date to visit, got rid of the clocking machine the day before the visit, and primed all the workers to say that they were being paid the NMW.'*
>
> **KFAT evidence**

The officer must consider all the facts of which he or she has knowledge, and each case needs to be judged on its individual merits. The Inland Revenue also told us that pre-notifying visits is in line with the Inland Revenue's policy in other areas, and that it believes employers would be able to hide information just as easily if officers called unannounced, by saying that records were unavailable. However, we understand that although the Inland Revenue has now acquired considerable practical experience in enforcing the minimum wage, there has not so far been a systematic evaluation of the use of the formal powers available to it and of the adequacy of these powers in the light of experience to date. In view of the points which have been put to us during consultation, we believe that an evaluation of this kind would be useful.

5.32 In sum, we have received a substantial amount of evidence about the importance of effective proactive enforcement of the minimum wage, including ways in which organisations both within and outside Government could work together. The work which the Inland Revenue has done to enforce the minimum wage so far is, rightly, welcomed. At the same time, it is vital that there should be an effective deterrent to non-payment of the minimum wage, and there is clearly more to be done to tackle the kinds of non-compliance which have been described in evidence to us, particularly in the informal economy. So **we recommend that there should be further proactive enforcement, with greater co-ordination between Inland Revenue and wider Government compliance initiatives, and encouragement of employers' and unions' compliance initiatives. The Government should also evaluate the use of existing powers, and identify whether any changes in practices or powers are needed to strengthen the deterrent to non-compliance.**

5.33 One other development since our last report was the case of Bebb Travel. In August 2002 an Employment Appeal Tribunal ruled that Section 19 of the National Minimum Wage Act 1998 meant that the Inland Revenue could only issue enforcement notices in respect of future payment of the minimum wage or in respect of both future and past failures to pay the minimum wage, and that it could not issue notices solely in respect of a past failure to pay the minimum wage. In its evidence to us, the Government said that it believed that Ministers clearly intended, when introducing the Act, that compliance officers should be able to pursue cases involving workers who are no longer employed by the employer in question. The Government said it intended to restore the position as soon as possible, so that the Inland Revenue and Agricultural Minimum Wage compliance officers could once more pursue these cases fully. The Government submitted an appeal to the Court of Appeal in September 2002 and the hearing is scheduled for March 2003.

5.34 The Government has since introduced a Bill into Parliament to restore its original policy intention. We warmly welcome this. We have no doubt that it is in the best interests of workers who have been underpaid the minimum wage, and that it will also reduce the exposure of good employers to unfair competition from under-payers.

Detriment and Dismissal

5.35 Workers have the right not to be dismissed or victimised because they try to ensure they are paid the minimum wage or because they are, or are going to become, eligible for the minimum wage. Where employers respond to the minimum wage by, for example, reducing workers' hours or consolidating allowances into the basic wage, these are legal means of coping with the minimum wage if they are taken by agreement with the workers concerned. However, where reductions in terms and conditions are introduced unilaterally by employers it is a contravention of National Minimum Wage legislation.

5.36 A worker who has been dismissed or experienced detriment for trying to ensure he or she is paid the minimum wage or because of eligibility for the minimum wage can apply to an employment tribunal. The Government's evidence showed that the number of minimum wage applications registered by the Employment Tribunal Service has fallen sharply between 1999/00 and 2001/02 – by 48 per cent for cases brought under Main Jurisdiction and by 61 per cent for cases brought under Other Jurisdictions (see Table 5.3). The Government's evidence also noted that there were 57 cases in the five months between April and August 2002 with the minimum wage as their Main Jurisdiction. Some of the minimum wage applications are likely to have been concerned with minimum wage-related detriment or dismissal, but information on the breakdown is not collected.

Table 5.3 Applications Registered by Employment Tribunals: Great Britain

	1999/00	2000/01	2001/02
Number with NMW as Main Jurisdiction	357	337	184
Number with NMW as Other Jurisdiction	949	515	372
Total NMW applications	1,306	852	556
Total applications under all Jurisdictions	103,935	130,408	112,227

Source: Government evidence.

Note: The Employment Tribunal Service identifies the 'Main' Jurisdiction as the principal type of claim made when first received. A claim may be brought under more than one Jurisdiction or be subsequently amended/clarified in the course of proceedings, but will be counted only once against the Main Jurisdiction.

5.37 Evidence which we have received for this report suggests that, unfortunately, detriment and dismissal related to the minimum wage continue to take place. For example, the Transport and General Workers Union wrote that 'there are often occasions when workers are receiving the NMW but then see their terms and conditions suffer as a consequence of changes imposed by an employer seeking to claw back the cost of the NMW. These detrimental changes include: changes in paid holiday entitlement; reductions in working hours; the ending of rest break payments; and overtime cut-backs or changes in overtime rates.' The TUC referred in oral evidence to cases of staff having their hours reduced, for example in the care sector. Written evidence from Citizens Advice Scotland included two cases where workers were dismissed when they queried their pay in relation to the minimum wage.

5.38 Various organisations representing low-paid workers suggested that the Inland Revenue should have wider enforcement powers to enable it to deal with detriment and dismissal related to the minimum wage, as well as non-payment. We commented in our third report that we had reservations about broadening the role of the Inland Revenue. But we continued to stress the importance of effective co-ordination between Inland Revenue National Minimum Wage officers, who deal with non-payment cases, and ACAS, who handle both non-payment and detriment and dismissal issues. So we recommended that the Inland Revenue and ACAS should continue to monitor service to customers at the boundary between the two organisations and examine the scope for action to strengthen it.

5.39 We were pleased that the Government accepted our recommendation. In its evidence, the Government said that discussions had taken place between ACAS and the Inland Revenue; a number of proposals had been agreed and action was being taken to implement them. We are particularly interested to see the actions relating to the organisations' contacts with customers.

- The Inland Revenue Helpline will send ACAS literature to callers.

- Publicity will be enhanced: references to the minimum wage Helpline and website in ACAS literature are being considered; Inland Revenue literature is being examined to identify scope for inclusion of ACAS references; and better links through the websites are being explored.

- Options are being investigated for ACAS and the Inland Revenue to work together to resolve difficult cases. Guidance is to be drafted for Inland Revenue officers on bringing ACAS into cases where appropriate, and the organisations are examining the practical and policy implications of closer involvement on casework.

- ACAS and the Inland Revenue will link more closely at exhibitions, presentations and events.

5.40 We are pleased that scope has been found for improving service to customers in the ways described in the Government's evidence, and we hope that the proposals set out above will be adopted. Reflecting the importance of this work, **we recommend that the Government should evaluate the impact on customer service of the action taken to strengthen co-ordination between the Inland Revenue and ACAS**. We will follow the progress of all this with interest.

5.41 One other matter related to detriment and dismissal which was raised in evidence to us is the Employment Act 2002. The Government's evidence referred to new requirements under Section 32 of the Employment Act for employees in certain circumstances to have raised grievances with their employer before they can apply to a tribunal. The Government wrote that, for minimum wage purposes, these requirements apply only to Section 24 of the National Minimum Wage Act 1998 – that is, to detriment in relation to the minimum wage. The new requirements do not affect workers who wish to make a complaint about underpayment to the Inland Revenue. Nor do they apply to the Inland Revenue or to workers who wish to bring a case to a tribunal about underpayment. The Government's evidence said that this and other changes will not come into effect until further consultation has been carried out on the detailed Regulations. This consultation was planned for the early part of 2003, with a view to the Regulations being placed before Parliament around Autumn 2003. The Government also noted that the Employment Act 2002 does allow for the possibility that, following the consultation, other tribunal jurisdictions could by affirmative order be added to or taken from the Schedule of jurisdictions to which Section 32 applies.

5.42 We are pleased that the new requirements under the Employment Act 2002 do not affect workers who have been underpaid the minimum wage. To have required them to raise the matter with their employer before they could report the underpayment to the Inland Revenue would have denied them the anonymity which is clearly important to many and which is one of the very important advantages of having a minimum wage Enforcement Agency. We note from the Government's evidence that the new requirements do not apply to dismissal related to the minimum wage either, and we also welcome this. However, workers who have experienced detriment related to the minimum wage will be required to raise the matter with their employer before applying to a tribunal. We have received very little evidence on this matter. There is an argument that having to go through an internal grievance procedure before applying to a tribunal may deter workers who have experienced minimum wage-related detriment from seeking redress. On the other hand, there is also an argument that providing a route for workers to raise grievances through an internal procedure may make it easier for them to pursue their rights. We will be interested to see the views expressed on this during the Government's consultation.

5.43 Even better than cure is prevention. We noted in Chapters 2 and 3 that some employers have responded to the October 2001 uprating of the minimum wage by actions such as cutting overtime rates or holiday entitlements. Where done by agreement with the workers concerned, these are legal means of coping with the minimum wage. However, if reductions in terms and conditions are introduced unilaterally, it is a contravention of minimum wage legislation. So it is important that firms are aware of the requirements of the law and, where they need it, are able to obtain information and advice to help them cope with the minimum wage while remaining within the legislation. ACAS provides a range of relevant information and guidance materials for employers as well as offering a very valuable telephone helpline service. **We recommend that the Government should further publicise the information and advice services provided by ACAS for businesses to help them manage their response to the minimum wage within the law.**

Conclusion

5.44 The evidence we have received indicates that most employers continue to comply with the National Minimum Wage, awareness of the existence of the minimum wage remains high, and the Inland Revenue is working hard to enforce payment. Pilot projects are continuing to test ways of encouraging workers to report non-compliance, and ACAS and the Inland Revenue have identified several ways of improving co-ordination between them. But we are concerned that some workers are still being underpaid or experiencing detriment and dismissal related to the minimum wage. We recommend that the Government should continue to publicise the minimum wage; undertake further proactive enforcement; monitor and evaluate the impact of ACAS's and Inland Revenue's procedural improvements on service to customers; and further publicise ACAS's information and advice services.

5.45 Awareness of the minimum wage is crucial and we recommend further publicity, particularly about the headline rate. This is especially important since the rates of the minimum wage are subject to change. Our terms of reference asked us to review the levels of the main rate and Development Rates, and in the next chapter we report on how we have addressed these issues.

6 Choosing New Rates

In making our new recommendations we have taken into account evidence of the impact of the National Minimum Wage so far, looked at prospects for the economy and considered views of stakeholders. The evidence of the impact shows that the minimum wage has been a success. There have been negligible adverse effects on employment or inflation. It has benefited many low-paid workers, although fewer than we originally forecast. Although some firms have found adjustment difficult, the impact on aggregate and sectoral wage bills has been minimal and much lower than we originally anticipated. And as the minimum wage has been in place for almost four years, we can be confident of our assessment. Our aim is to have a minimum wage that helps as many low-paid people as possible without any adverse impact on the economy. We therefore believe there is a strong case for a significant step up in the level over the next few years, contingent on economic circumstances.

Economic forecasts suggest that such a step up could be achieved against a background of steady low-inflation growth. Most stakeholders accepted the case for uprating, with some arguing for a significant increase but with others advocating an indexation with prices. The latter approach would, however, lead to a steady withering of the minimum wage – a view the Commission cannot support.

We therefore believe that there is a case for increasing the effective level of the minimum wage, implying a series of increases for a number of years above average earnings, and increasing gradually the number of people benefiting. We are also, however, conscious of the need for caution in economic conditions which could prove difficult. We have therefore decided not to recommend the full adjustment to a new level in two years, but to take a partial step towards that end, increasing the number of jobs benefiting from around one million to about 1.3 million in October 2003 and 1.7 million in October 2004. We recommend that the adult rate of the minimum wage should be increased to £4.50 in October 2003. The rate should be further increased to £4.85 in October 2004, subject to confirmation by the Commission in early 2004. We will consider what further steps are appropriate if asked by the Government to produce another report in early 2005.

Our examination of young people implied the need for some caution on youth rates. We recommend that the Development Rate should be increased to £3.80 in October 2003 and – subject to confirmation nearer the time – to £4.10 in October 2004, i.e. by more than the forecast increase in average earnings, but by slightly less than the adult rate.

In making our recommendations we have taken into account stakeholders' clear preference for further increases to be more equally phased, and for sufficient advance notice to be given. We have recommended rates for a two-year period and also given an indication of what we see as the appropriate medium-term direction of the minimum wage, subject to economic conditions. We believe, however, that the economic uncertainties are such that the precise figures for October 2004 should be made contingent on the economic circumstances then in place. We are therefore making only a preliminary recommendation for 2004. We recommend that the Government should give the Low Pay Commission a remit to fine-tune the recommended October 2004 upratings of the adult rate and the Development Rate in early 2004, enabling us to consider whether our recommendations remain appropriate in the light of economic circumstances.

Our recommendations will considerably increase the number of low-paid workers who benefit from the minimum wage. But as the wage bill impact is likely to be moderate, and considerably lower than estimates of initial introduction, overall it should be manageable by businesses. The inflationary impact is likely to be small, as is the impact on the public sector. We expect our recommendations to have a small positive impact on work incentives and to benefit households in the bottom half of the income distribution the most.

Introduction

6.1 In developing our recommendations we have considered three main factors: our assessment of the impact of the minimum wage so far (set out in detail in Chapters 2 to 4); an assessment of the prospects for the economy over the coming period; and the views expressed by stakeholders. This chapter covers each of these three factors in turn before setting out our recommendations for minimum wage rates for adults and young people for October 2003 and October 2004. It then sets out our assessment of the likely impact of the recommended rates on the number of beneficiaries, the wage bill, inflation, public finances and household income.

The Impact of the Minimum Wage So Far

6.2 The National Minimum Wage has inevitably created adjustment difficulties for some firms but, as Chapter 2 set out, the economic evidence suggests that overall there have been negligible adverse effects on inflation or employment. The impact on wage bills has been small. We estimate that the 2001 uprating increased the aggregate wage bill by up to 0.11 per cent – considerably lower than our estimates for initial introduction of the minimum wage. While the labour market has slowed in the past two years, employment among most of the sectors and groups of workers most affected by the minimum wage has continued to grow. And recent academic research focusing on some of the vulnerable sectors and groups suggests that the minimum wage has had little or no negative impact on employment.

6.3 This absence of adverse effects is a success. But Chapter 2 also explained that – largely because of revisions to the statistical data – the number of people who have benefited from the minimum wage is less than the Commission originally forecast. In our first report we estimated that the minimum wage would affect two million or 9 per cent of jobs for those aged 18 and over; using latest data, we now estimate that the initial introduction of the minimum wage affected 1.2 million or 4.9 per cent of such jobs, and that the October 2001 uprating affected 1.1 to 1.5 million jobs (4.5 per cent to 6.0 per cent). The October 2002 uprating benefited slightly fewer than one million jobs, or about 4 per cent. Since the number of people in employment has risen since our first report, our original coverage estimate of 9 per cent of jobs would equate to around 2.26 million jobs at Spring 2002.

6.4 We therefore believe that there is a case for increasing the adult minimum wage as a percentage of average earnings. The evidence on the impact of the minimum wage so far indicates that this can be achieved – bringing benefits to more workers – without damaging business or employment prospects.

6.5 As we saw in Chapter 4, however, labour market data suggest that some groups of young people have fared slightly less well. The employment rate of young men began to fall towards the middle of 2001. There is little evidence to suggest the minimum wage was the primary cause of this fall, or that it has prompted employers to substitute older workers for younger workers. But this volatility of youth employment underlies the need for caution on youth rates.

6.6 Overall, therefore, the evidence of the impact so far suggests a strong case for a significant increase in the adult rate, combined with some caution in respect of young people. But the pace of any adjustment needs to reflect prospects for the economy. In the next section we therefore consider recent economic forecasts and trends in prices, earnings and pay settlements.

The Economy

6.7 The economic outlook affects our assessment of the level of the minimum wage that firms can afford without detrimental impacts on employment prospects or on inflation. We also need forecasts of prices and earnings growth to estimate future wage bill costs and the likely coverage of future minimum wage rates. This section therefore examines aggregate forecasts before turning to detailed consideration of how price, earnings and pay settlement trends influence our decisions.

Forecasts

6.8 Economic performance has weakened since our third report. Preliminary estimates suggest that output expanded by 1.7 per cent in 2002, the lowest growth for a decade, and there continue to be imbalances between the services and manufacturing sectors of the economy. The manufacturing sector started to contract at around the start of 2001 and remains in difficulty. Output in the service sector meanwhile continued to grow in 2002, although at

2.3 per cent growth was nearly one percentage point lower than in the previous year. Growth in the labour market, however, has eased only slightly in this slowdown. In the year since the October 2001 uprating, the working age employment rate rose marginally and the number of people in work increased by almost 200,000. Job losses in manufacturing have been offset by rises elsewhere. Inflationary pressures remain subdued. Increases in average earnings were running at under 4 per cent per year towards the end of 2002, and recent pay settlements data suggest a dip in awards. And while inflation has edged up in recent months to stand at 2.7 per cent – slightly above the Government's target – this reflects higher oil prices and buoyant services price growth.

6.9 Latest forecasts for the UK economy predict a pick up in Gross Domestic Product (GDP) growth and continued low inflation. As Table 6.1 shows, the average of the independent forecasts is for GDP growth of just under 2.5 per cent for this year and next: this represents a reduction in expectations compared with six months ago. Most forecasters also expect inflationary and earnings pressures to remain under control, with average earnings growth of about 4.4 per cent – roughly in line with the long-term trend – but with unit labour costs subdued as real earnings increases are affected by productivity improvements.

Table 6.1 Independent Forecasts of GDP Growth, Inflation and Average Earnings

	Percentage change over a year earlier	
Average, range in brackets	2003	2004
GDP growth	2.3 (-0.4 to 3.1)	2.4 (-0.3 to 3.3)
RPIX	2.4 (1.7 to 3.6)	2.3 (1.5 to 3.2)
Average earnings	4.3 (3.5 to 4.9)	4.4 (3.0 to 5.5)

Source: HM Treasury, 2003.

6.10 All forecasts are uncertain, but the risks today are exacerbated by political instability in the Middle East, by slowing growth in the US and euro-areas and by the fall in global equity prices. And British economic prospects depend upon how the present imbalance between the household and export sectors of the economy unwinds. Downside risks to domestic demand could stem from a sharp reversal in the housing market, the fall in equity prices moderating consumer spending, and the increase in National Insurance Contributions (NICs) in April 2003 feeding through to depress incomes. Underpinning demand is strong public expenditure growth. Upside risks to inflation could arise from continued strong house price growth and from a potential surge in oil prices.

6.11 Against this background the best estimate of the employment outlook is fairly flat, continuing recent performance; but a major shortfall in growth, resulting from either domestic or global demand falls, could make that outlook less favourable.

6.12 Our recommendations have to be based on the best independent forecasts now available, and these suggest continued low-inflation growth, with neither a further downturn nor a dramatic recovery. But the uncertainties suggest the need for caution in the phasing of the changes we recommend.

Prices

6.13 Since its introduction in April 1999 the minimum wage has more than kept up with the cost of living. If the adult minimum wage had been increased in line with the RPIX price index since introduction, its value would have been £3.87 by October 2002, well below the actual £4.20 level. If the youth Development Rate had been uprated in line with prices since introduction its value would now be £3.22 rather than £3.60.

6.14 But a minimum wage that increased only in line with prices would rapidly lose its value as a wage floor, with the lowest paid not sharing in the overall rise in earnings and prosperity. Indeed if the minimum wage rates had been merely indexed to prices in the manner just illustrated, the number of jobs benefiting in October 2001 would have been just 590,000 (2.4 per cent of the total), i.e. around half the number of jobs we now estimate to have benefited from initial introduction – 1.2 million (4.9 per cent).

6.15 While therefore it is important that we understand likely future trends in prices, we believe that increasing the minimum wage in line with prices would be a recipe for making the wage increasingly irrelevant and is not a long-term option.

Earnings

6.16 Increasing the minimum wage in line with average earnings would imply an increase above the rate of inflation, and would keep the minimum wage in line with the increase in the general level of prosperity in the country. In the year to November 2002, average earnings as measured by the Average Earnings Index (AEI) increased by 4.0 per cent, compared with an average of 4.4 per cent in the previous year. The lower 2002 figure can be explained in large part by lower bonuses in the first quarter of 2002, leading to lower increases in private sector pay. Looking forward, increases of 4.3 per cent and 4.4 per cent are forecast over the next two years, as shown in Table 6.1.

6.17 Since its introduction the adult minimum wage has increased roughly in line with average earnings, growing by 16.7 per cent between April 1999 and October 2002 compared with an AEI increase of 15.9 per cent. Increasing the minimum wage in line with average earnings from April 1999 would have led to a minimum wage of £4.17 by October 2002, marginally lower than the actual adult rate. Projecting this forward using forecast earnings would lead to minimum wage rates of £4.35 in October 2003 and £4.54 in October 2004. The minimum wage was at its highest level in real terms in October 2001. Projecting this level forward using forecast average earnings would produce a minimum wage of £4.43 in October 2003 and £4.63 in October 2004.

6.18 Uprating the introductory value of the youth Development Rate (£3.00) by average earnings would have led to a rate of £3.48 by October 2002, showing that the youth Development Rate has increased faster than earnings. But if we take our initial recommended rate of £3.20 as a base, the increase to October 2002 is slower than implied by uprating in line with earnings. Taking the October 2001 value of the minimum wage forward by forecast earnings would lead to a youth Development Rate of £3.78 by October 2003 and £3.95 by October 2004.

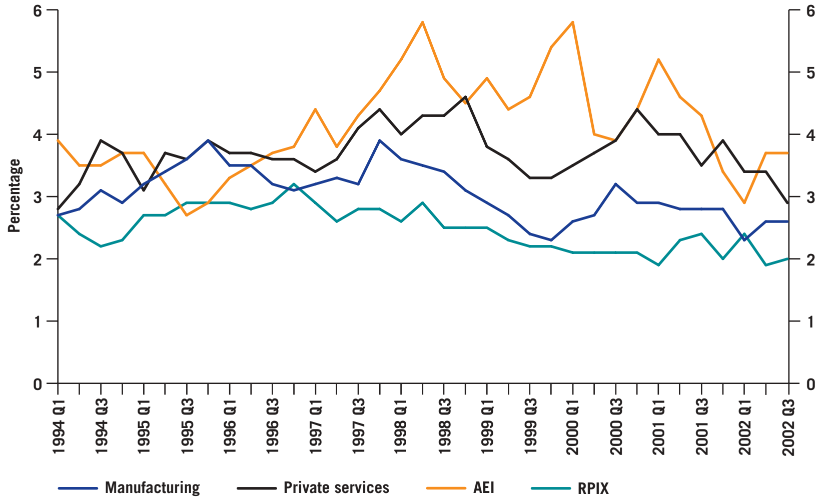
6.19 These earnings-uprated projections provide a benchmark against which we can judge how the minimum wage is progressing relative to earnings overall. But the conclusion from our analysis of the impact of the minimum wage to date was that a step increase in the effective level of the minimum wage would now be appropriate. We have therefore taken the earnings-based projections as a lower bound of appropriate rates for the next two years.

Pay Settlements

6.20 The level of pay awards provides an important indicator of general movements in pay. There are three major sources of information, each of which uses a different methodology to measure the overall level of increase in the economy. The CBI Pay Databank, established in 1980, is the longest-running time series on pay settlement levels but does not include public sector settlements. Its headline figure is an average of the settlement data received, with the definition of an increase being the increase in average earnings resulting from the award. The other two sources are Industrial Relations Services (IRS) and Incomes Data Services Ltd (IDS), both of which include public sector awards. IDS generally measures the average increase received by employees in a bargaining group while IRS measures only basic rate increases, so that 'all merit' increases – where there is no underpinning basic rate rise – are excluded. Despite the differences in methodology all three datasets indicate similar trends, and all produce figures below average earnings increases due to merit awards, promotion and other pay drift effects.

6.21 Figure 6.1 shows that since 1994 levels of pay increases as measured by the CBI have been running at between 2.3 and 4.6 per cent. Over the last two years mean pay settlements have remained fairly stable, with average settlements in private services running at 3.7 per cent and at 2.7 per cent in manufacturing. There has been a slight decline in the level of awards since 2001 but the mean has remained ahead of inflation and generally below the growth in average earnings. Both IDS (2002e) and IRS (2002) show a similar decline in the level of median pay awards.

Figure 6.1
Average Settlements in Manufacturing and Private Services, 1994–2002



Source: CBI Pay Databank, AEI, RPIX, 1994–2002.
Note: CBI pay data for the third quarter 2002 are provisional.

6.22 The CBI (2002c) note that the major downward pressures on pay awards in manufacturing in 2002 were the inability to raise prices and low profit levels, while the main upward pressures were the cost of living and recruitment and retention problems. In services the downward pressures were low profits and the low cost of living, while the major upward pressure was recruitment and retention problems. Both IDS (2002e) and IRS (2002) point to the low level of inflation and the tight labour market as the balancing factors explaining the current stability in the level of awards.

6.23 In terms of pay prospects, both IDS and IRS indicate a possible slight rise in pay awards in 2003 (although both these forecasts pre-date the Autumn revisions in the Treasury's economic forecast). Based on its annual survey of employers' pay intentions, IRS notes 'employers are less confident of their ability to keep a lid on pay rises in their forthcoming wage negotiations. Almost one in four employers expects to award a higher pay rise than last year, compared with just one in 10 a year ago.' Just over half the respondents expected their awards to be in the 3 to 4 per cent range while a fifth expected them to be above 4 per cent. Both IDS and IRS suggest a rise towards a median of 3 per cent in 2003. There is also concern that the increase in NICs, to be implemented in April 2003, will provide an additional upward pressure on pay awards.

> *"Employers' pay expectations suggest a modest upwards shift in settlements over the course of the forthcoming pay round."*
>
> **IRS, 2002. *Pay and Benefits Bulletin*. 555**

> *"With inflationary pressures still rather modest … we would anticipate that basic pay increases will remain in the 2.5 to 3.5 per cent range. If inflation moves higher by early 2003, then settlements could rise a little."*
>
> **IDS, 2002e. *IDS Report*. 866**

> *We believe the approach taken in 2001 of recommending a very big increase in 2001, followed by a smaller increase in 2002, was a mistake, leading … to significant cost rises for industry … any recommended increase should as far as possible be accomplished by means of two roughly equal rises, rather than two of unequal size.*
>
> **British Hospitality Association evidence**

> *Any consideration of rates of pay must have regard to the full consequential effects of any adjustment of the rate and the impact of government employment legislation. For example, changes to statutory paid holiday entitlement must be factored into the business impact assessment as well as increases in employers' social security contributions.*
>
> **British Holiday & Home Parks Association evidence**

6.24 Overall, therefore, the pay settlement outlook is consistent with the forecasts for average earnings which we have used in our 'benchmark' calculations – a slight rise from the subdued level of the last year, but no significant inflationary pressure.

Stakeholders' Views

6.25 Our analysis suggests that it is possible to increase the effective level of the minimum wage, but current economic circumstances sound a note of caution. These two elements of the debate – the scope for a significant increase in the value of the minimum wage and concerns about its affordability – were also reflected in the views of those who responded to our consultation and whom we met in meetings and visits.

6.26 We received evidence from employers, trade unions and others about future levels of the adult National Minimum Wage rate. The vast majority accepted the case for uprating. Employers generally argued for the minimum wage to rise by no more than price inflation. By contrast trade unions and other organisations advocated more substantial increases. There was, however, almost universal support for increases to be more evenly phased than in the past.

6.27 Evidence from employers highlighted the difficulties caused by the scale of the October 2001 uprating and the cost of other employment legislation. There was also concern about the forthcoming increase in NICs and the uncertain economic outlook. The majority of employers commenting on the future level of the National Minimum Wage believed that it should be uprated by no more than price inflation. A few employers' organisations suggested that it should be frozen at its current level.

6.28 A few employers commented that a minimum wage of £4.50 per hour would cause problems, and many more expressed particular concern at the prospect of a rise in the adult rate to £5.00 per hour. The CBI stated 'it is clear that any uprating in excess of £4.50 in 2003 … would present real problems for employers in low paying sectors and would lead to further reductions in employment and profitability'. It argued that 'a nmw of £5 … would lead to wide scale job losses and company closures in regions such as the North East, Wales and Scotland and in sectors such as social care, business services and leisure'.

6.29 Some employers noted the varying regional impact of the minimum wage and stressed the need for the rates to be set bearing in mind low-paying parts of the UK. The Association of Convenience Stores commented that 'the National Minimum Wage was introduced as a floor under which wages should not fall. It must therefore be affordable to all parts of the United Kingdom, including the poorest areas and the types of businesses who have least ability to pay.' A few organisations – the Federation of Small Businesses, the National Hairdressers' Federation and the Hairdressing Employers Association – advocated the introduction of a regional minimum wage. Our remit, however, is to set a national rate.

6.30 As we noted in Chapter 3, employers in some sectors face difficulties passing on increased costs to clients, for example in social care and the cleaning and security sectors, and this theme was strongly reflected in written and oral submissions. The Independent Healthcare Association suggested that a significant increase in the National Minimum Wage should not be recommended unless a number of conditions were in place, including that fees paid by local authorities should increase by an amount that took into account the true staffing cost of raising the minimum wage and the related effects. We address the relationship between the minimum wage and funding for social care provision in Chapter 3, and also the difficulties created by fixed-price commercial contracts in the cleaning and security sectors.

6.31 Trade unions and other organisations such as the Low Pay Unit pressed for a more substantial increase in the adult rate. They argued that the large October 2001 uprating had no adverse impact on unemployment or inflation. They also commented that the initial level of the minimum wage had been set at a cautious level and that because of problems with official statistics the minimum wage was benefiting fewer people than originally intended.

6.32 The Trades Union Congress (TUC) stated that there should be substantial rises in the National Minimum Wage to take the rate to between £4.60 and £4.75 by October 2003 and to between £5.00 and £5.30 by October 2004. The GMB argued that it should be £5.00 in October 2003 and at least £5.30 in October 2004. Other trade unions and workers' organisations focused on the rate for October 2004. Several suggested either that it should be set at

'The TUC believes that if there is a time for prudence then there is also a time for boldness. Three upratings to the NMW have been successfully implemented since introduction with no obvious negative effects. Equally, there is a view expressed by many commentators and shared by the TUC that the level of the NMW is too low.'

TUC evidence

'We believe that the minimum wage should rise significantly to a rate of £6 an hour by October 2004.... In the absence of minimum income standards we have always believed that the minimum wage should be immediately set at half male median earnings, with the long-term aim of the threshold being set at two-thirds average earnings.'

UNISON and the Low Pay Unit evidence

We are calling on the Commission to recommend that the adult rate of the NMW be uprated to secure a rate which at least matches former Wages Council rates as a proportion of male median earnings, with an appropriate further adjustment, so that the eventual rate is in the £4.84 to £5.38 range.

Union of Shop, Distributive and Allied Workers evidence

We would argue that a fundamental aim of minimum wage policy should be to raise the level of the minimum wage over time so that it is set at a sufficiently high level to enable individuals and families to earn a living wage without relying on state intervention through social security and in-work benefits.

Greater Manchester Low Pay Unit evidence

half male median earnings or that it should take into account former Wages Councils rates. It was also proposed that the impact on closing the gender pay gap should be considered when setting the level of the minimum wage.

6.33 A number of organisations, such as UNISON and the Low Pay Unit, commented on the interaction between the National Minimum Wage and the tax and benefit system. They argued that the minimum wage should be a 'living wage', with the rate set at a level such that a full-time worker was not reliant on state benefits. The East London Citizens Organisation highlighted the higher living costs in London and noted the large pool of workers on, or just above, the National Minimum Wage facing exceptionally high living costs. Health benefits of a 'living wage' were also noted.

6.34 There was limited comment on the need to uprate the youth Development Rate. We reported in Chapter 4 that employers are generally in favour of maintaining the youth Development Rate, while trade unions and other organisations (including youth organisations) believe that, as a minimum, workers should be entitled to the adult rate from the age of 18. The few employers' organisations that commented suggested that the differential between the youth Development Rate and the main rate should be retained.

The Recommended Rates

6.35 In reaching our recommendations we have sought to balance medium-term and short-term considerations, and to take into account both quantitative and qualitative inputs, and overall macro-economic and sectoral effects. Our aim is to have a minimum wage that helps as many low-paid people as possible without any adverse impact on inflation, employment and competitiveness.

6.36 Quantitative analysis of the impact of the minimum wage shows that it has not had significant inflationary or employment destructive effects, at either the overall or sectoral level. Its wage bill impact has been less than originally anticipated, and well below levels which create a danger of an inflationary spiral. And the number of beneficiaries has been significantly less than originally anticipated. All of this suggests the case for a significant step up in the level over the next few years.

6.37 Economic forecasts suggest that such a step up could be achieved against a background of steady low-inflation growth. But there are major uncertainties in the economic outlook, arising from both economic and political factors.

6.38 While some stakeholders argue for a major uprating, others argue conversely that uncertainty should mean minimal increases, in some cases arguing indeed for indexation with prices. Such an indexation would lead to a steady withering of the minimum wage towards irrelevance, and the Commission does not therefore support a price-linked approach over the medium or long term. But we do take very seriously business concerns about too rapid an adjustment, and the preference of all stakeholders for a more evenly phased approach, noting in Chapters 2 and 4 the effect which alternating large and small increases have had on earnings differentials and firms' pay structures.

6.39 Balancing these considerations, we believe that there is a case for increasing the effective level of the minimum wage, implying a series of increases for a number of years above average earnings, and increasing gradually the number of people benefiting. We are also, however, conscious of the need for caution in economic conditions which could prove difficult. We have therefore decided not to recommend the full adjustment to a new level in two years, but to take a partial step towards that end, increasing the coverage from around 1.0 million to about 1.3 million jobs in October 2003 and 1.7 million jobs in October 2004. **We recommend that the adult rate of the minimum wage should be increased to £4.50 in October 2003. The rate should be further increased to £4.85 in October 2004, subject to confirmation by the Commission in early 2004**. We will consider what further steps are appropriate if asked by the Government to produce another report in early 2005.

6.40 We believe that it is also possible to increase the value of the Development Rate in real terms. But, as we saw in Chapter 4, the labour market conditions for young people give cause for some caution. We therefore propose that the Development Rate should increase by more than the forecast increase in average earnings, but by slightly less than the adult rate. **We recommend that the Development Rate should be increased to £3.80 in October 2003 and – subject to confirmation nearer the time – to £4.10 in October 2004. These rates should apply to 18–20 year olds and to workers on the older workers' Development Rate**.

6.41 These recommendations also take account of the need to give sufficient advance notice of further increases. We have recommended rates for a two-year period and also given an indication of what we see as the appropriate medium-term direction of the minimum wage, subject to economic conditions. We believe, however, that the economic uncertainties are such that the precise figures for October 2004 should be made contingent on the economic circumstances then in place. We are therefore making only a preliminary recommendation for 2004. **We recommend that the Government should give the Low Pay Commission a remit to fine-tune the recommended October 2004 upratings of the adult rate and the Development Rate in early 2004, enabling us to consider whether our recommendations remain appropriate in the light of economic circumstances**.

6.42 Before arriving at our recommendations we considered the likely impact of the new rates on business, on low-paid workers and on the economy more generally. We wanted to be confident that our recommendations would both widen the benefits of the minimum wage and be manageable for business. In the next part of this chapter we present the results of our assessment. We consider the number of beneficiaries the new rates would produce, the relationship of the recommended rates to average earnings, and the impact on wage bills and inflation and on public finances. We conclude by considering the impact of the minimum wage on household incomes and poverty alongside the tax and benefit system.

Assessing the Impact

Coverage

6.43 Our recommendations envisage increases in the minimum wage in October 2003 and October 2004 above the forecast growth in average earnings in both years. The recommended increase in the adult rate between October 2002 and October 2004 is 15.5 per cent, the recommended increase in the Development Rate 13.9 per cent, whereas the average independent forecast is for average earnings growth of just under 4.5 per cent in each year. These increases above average earnings are likely to produce an increase in coverage.

6.44 To estimate future coverage at these recommended rates, we need to assess how wages of the lowest paid would increase in the absence of the minimum wage. As with previous estimates throughout this report, we use two assumptions: the first is that earnings of the lowest paid would rise in line with prices, and the second that they would rise in line with average earnings. Where we do not have actual data on earnings and prices growth we have used forecasts, as given in Table 6.1. Over the two-year period in particular the earnings assumption is likely to be more realistic than the prices assumption.

6.45 These two sets of assumptions produce a range of estimates for beneficiaries – set out in Table 6.2. The upper bound estimate (low wages rising in line with prices) would see total beneficiaries rising rapidly from 1.0 million in October 2002 to 2.5 million in October 2004. The more realistic earnings assumption sees total beneficiaries rising to 1.7 million in October 2004.

Table 6.2 Estimated Jobs Gaining From Recommended Increases in the National Minimum Wage at October 2003 and October 2004

		October 2002[1]	October 2003[2]	October 2004[2]
If low wages would otherwise increase with prices	Adults			
	– number	900,000	1.5 million	2.3 million
	– %	3.9	6.5	9.7
	Young people			
	– number	90,000	100,000	150,000
	– %	4.9	7.4	11.3
	Total			
	– number	1.0 million	1.6 million	2.5 million
	– %	4.0	6.5	9.8
If low wages would otherwise increase with average earnings	Adults			
	– number	900,000	1.2 million	1.6 million
	– %	3.9	5.2	6.9
	Young people			
	– number	90,000	80,000	100,000
	– %	4.9	6.3	7.6
	Total			
	– number	1.0 million	1.3 million	1.7 million
	– %	4.0	5.2	6.9

Source: LPC calculations based on grossed NES and LFS data, Spring 2002.

Notes:
1. The number and percentage of young people covered relates to jobs among those aged 18–21.
2. The number and percentage of young people covered relates to jobs among those aged 18–20.
3. Estimates of adult jobs are rounded to the nearest 100,000 and youth jobs to the nearest 10,000. Estimates of the percentage of gainers are rounded to the nearest 0.1 per cent. Totals may not sum owing to rounding.

Position Relative to Average Earnings

6.46 The position of the minimum wage in the earnings distribution is often used as an indicator of how far the minimum wage 'bites'. Some commentators have argued that the National Minimum Wage should be equivalent to half male median earnings. While this is only one of a number of possible measures, if it is to be used it needs to be calculated correctly. As we argued in Appendix 8, Volume 2 of our third report, the method used by some groups is flawed, as it does not compare like with like. A better measure to use is half male median hourly earnings where the calculation of both earnings and hours excludes overtime. The best available data we can base this on is the Office for National Statistics central estimate – an average of the New Earnings Survey (NES) and the Labour Force Survey (LFS). Table 6.3 shows our estimates of half male median hourly earnings using this methodology. For 2001–2002, these are derived from the Spring data and uprated by average earnings increases to October. We estimate that the figure for half male median earnings was £4.51 per hour in October 2001 and £4.71 in October 2002. This implies that the minimum wage, which was nearly 89 per cent of half male median hourly earnings at introduction in April 1999, rose to just over 90 per cent after the significant October 2001 increase, but fell back to around 89 per cent in October 2002.

6.47 Looking forward, and making the assumption that median earnings rise in line with forecast average earnings, the recommended increase in the adult rate will take the minimum wage to 94.5 per cent of half male median hourly earnings in October 2004.

Table 6.3 Comparison of the Adult National Minimum Wage with Half Male Median Hourly Earnings

	April 1999	October 2001	October 2002	October 2003	October 2004
Half male median earnings (central estimate per hour)[3,4]	£4.06	£4.51[1]	£4.71[1]	£4.92[2]	£5.13[2]
Adult NMW (per hour)	£3.60	£4.10	£4.20	£4.50	£4.85
NMW as percentage of half male median earnings	88.7	90.9	89.2	91.5	94.5

Source: LPC calculations based on LFS and NES data, Spring 1999–2002.

Notes:
1. Estimates based on half male median hourly earnings at April uprated by average earnings growth to October in the respective years.
2. Estimates based on half male median earnings at April 2002 uprated by forecast average earnings growth.
3. Estimates refer to male employees aged 22+ and cover full-time earnings in the main job only.
4. Elements of pay such as regional allowances and waiting time cannot be separately identified and removed from these calculations to make them consistent with the definition of earnings used in the minimum wage legislation.

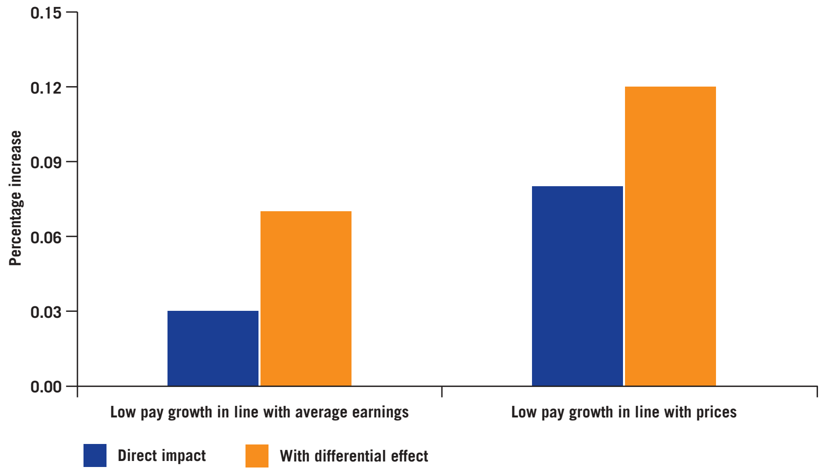
6.48 Alternatively, we can compare the position of the UK National Minimum Wage as a proportion of full-time median earnings with that of other countries. Table A5.2 in Appendix 5 shows such an international perspective at mid 2002. Of the 12 countries shown, the UK was ranked sixth highest in terms of the level of the adult minimum wage as a proportion of male and female median earnings at that time. Other things being equal, our recommended rates for October 2003 and October 2004 (converted to April 2002 levels) would not significantly alter the UK's position relative to the other countries, although the UK may rise above the Netherlands in 2004. So although we are recommending real terms increases in the rates, the new rates would keep the UK in the middle of this ranking.

Wage Bill

6.49 The impact of the new rates on the wage bill will be made up of a direct impact on the wages of those paid the minimum wage, together with a differential restoration effect. Estimating both effects requires us to make assumptions. To estimate the direct effect we need to make an assumption about how the earnings of the low paid would have changed in the absence of the minimum wage: here we use the same assumptions as used in considering coverage, i.e. that earnings of the low paid would otherwise rise either in line with prices or with average earnings. On differentials, we utilise our earlier findings that the differential restoration effect is limited to around the 16th percentile for adult earnings and the 19th percentile for young people's earnings.

6.50 Figure 6.2 shows the combined impact of the recommended adult and youth minimum wage increases for October 2003. The direct impact of a £4.50 per hour adult minimum wage is an increase of between 0.03 and 0.08 per cent in the current adult wage bill, depending on the assumed path of earnings growth. Assuming restoration of differentials increases this wage bill effect to between 0.06 and 0.11 per cent. The direct impact of a £3.80 per hour minimum wage for those aged 18–20 is between 0.03 and 0.1 per cent of the current youth wage bill, depending on the assumed path of earnings growth. Assuming restoration of differentials increases the wage bill effect to between 0.3 and 0.47 per cent of the current youth wage bill. These impacts are higher, in percentage terms, than the increase in the wage bill for those aged 21 and over. But because there are far fewer young people affected the impact on the overall wage bill in cash terms is much lower. The combined result for all workers aged 18 and above is to increase the total wage bill by between 0.03 and 0.08 per cent if no differential effect is assumed, and by between 0.07 and 0.12 per cent if differentials are restored in line with our assumptions.

Figure 6.2
Aggregate Wage Bill Impact, National Minimum Wage £4.50/£3.80, October 2003



Source: LPC calculations based on grossed NES and LFS data, Spring 2002.

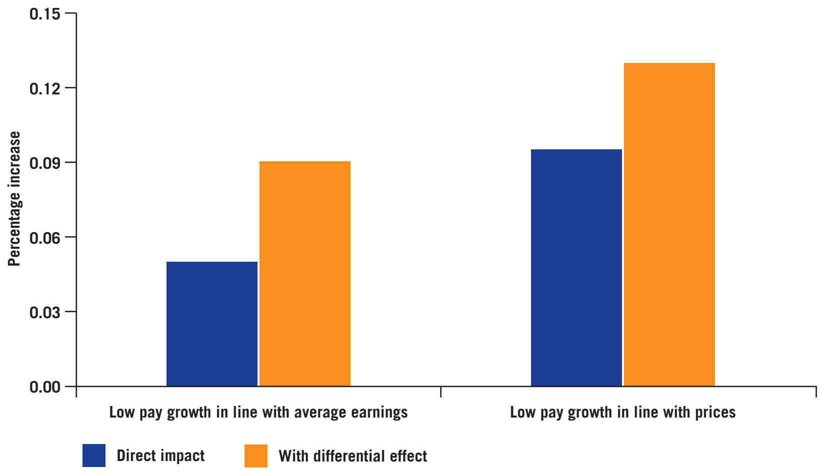
6.51 These estimated wage bill increases are lower than the wage bill increase resulting from the introduction of the minimum wage, and generally lower than the estimated impact of the October 2001 uprating that we reported in Chapter 2. (The exception is the upper bound estimate under the prices growth assumption which is just marginally higher.)

6.52 Moreover, as we noted in Chapter 2, there are various reasons why our estimates could overstate the wage bill effect. First, we have assumed that compliance is universal. Second, we have also noted that some firms were taking measures to limit the impact of upratings in the minimum wage on their wage bills. For example, some were taking action to control labour and non-labour costs and to improve efficiency. These actions would reduce the effective wage bill impact on firms.

6.53 The same assumptions on the autonomous growth of earnings of the low paid and on differentials restoration are used to estimate the impact of the recommended uprating in October 2004. Over this longer period the estimates become more uncertain, but we are confident that the top end of our range of figures illustrates the upper bound of any wage bill impact.

6.54 Figure 6.3 shows that the direct impact of the October 2004 recommendations is between 0.05 and 0.09 per cent of the current wage bill for all jobs, depending on the assumed path of earnings growth of the lowest paid. Assuming restoration of differentials increases the wage bill effect to between 0.09 and 0.13 per cent of the current wage bill. The estimated impact of the recommended October 2004 uprating is at most 0.02 percentage points higher than the October 2003 uprating.

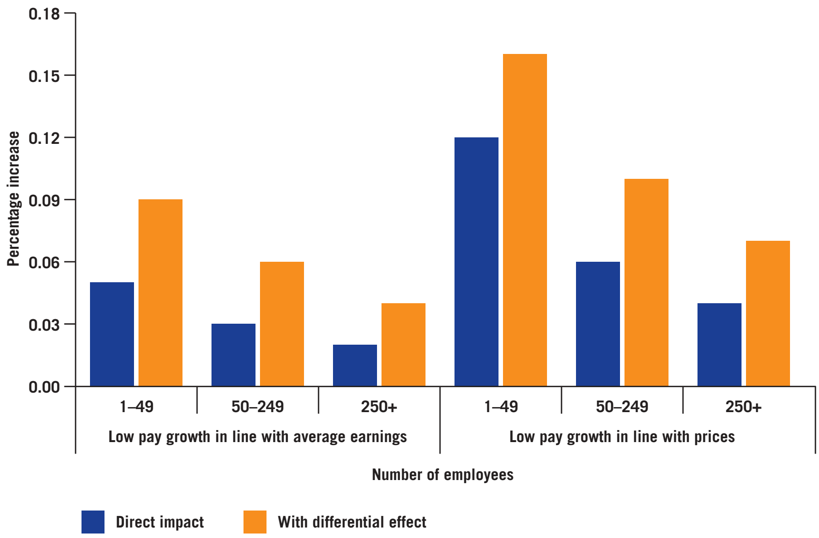
Figure 6.3
Aggregate Wage Bill Impact, National Minimum Wage £4.85/£4.10, October 2004



Source: LPC calculations based on grossed NES and LFS data, Spring 2002.

6.55 The estimates discussed so far show the impact at the aggregate level, which covers both those most affected and those not affected at all by the minimum wage. In Chapters 2 and 3 we discussed how the minimum wage principally affects firms in low-paying sectors and small and medium-sized firms. We therefore took a particular interest in the impact of the new rates on the wage bill of these sectors and firms (see Figure 6.4 and Figure 6.5). The estimates provided here are for the combined impact of the changes in the adult rate and youth Development Rate in October 2003.

Figure 6.4
Wage Bill Impact by Size of Firm, National Minimum Wage £4.50/£3.80, October 2003



Source: LPC calculations based on grossed NES data, April 2002.

Figure 6.5
Wage Bill Impact in Low-paying Sectors, National Minimum Wage £4.50/£3.80, October 2003

Source: LPC calculations based on grossed NES and LFS data, Spring 2002.

6.56 As seen before, the wage bill impact reduces as the size of the firm increases (Figure 6.4). But even for the smallest firms, and with the least favourable assumptions, the impact is limited to 0.16 per cent. In sectoral terms, Figure 6.5 shows that the largest increases in the wage bill are in hairdressing, cleaning and hospitality. Nevertheless, the increases remain relatively small at up to 0.99 per cent for hairdressing, 0.92 per cent for cleaning and 0.71 per cent for hospitality under the most pessimistic assumptions. These are much smaller than our third report estimates of the impact of the initial introduction of the minimum wage. For most sectors wage bill estimates of the October 2003 recommendations are lower than for the October 2001 uprating. This is true for all estimates using the earnings assumption. Under the upper bound estimates (using the prices growth assumption and a differential effect), estimates are slightly higher in retail and cleaning.

6.57 In Chapter 2 we assessed the evidence of the impact of the minimum wage on prices. We saw there that at the aggregate level it was difficult to judge whether the prices of goods and services produced by low-paying sectors had increased as a result of the minimum wage. But even if prices of some low-paying sectors were higher than they would have been in the absence of the minimum wage, at the aggregate level this represents a change in relative prices rather than an upward shift in inflation.

6.58 Nevertheless we are concerned that our recommendations should not lead to an increase in inflationary expectations. We therefore commissioned the ITEM Club, an independent forecasting group, to undertake some simulations of the impact of hypothetical future wage bill increases on inflation. The ITEM Club uses the latest public version of the HM Treasury model of the economy, but the results still depend crucially on the assumptions made and the precise specification of the model. The results, shown in Table 6.4, are not definitive and indicate the likely impact under the assumptions adopted. One of the underlying assumptions is that monetary policy brings inflation to its base forecast by the third year. The simulations also assume that the Government takes no measures to offset the impact of the rise in the wage bill on Government spending or the Public Sector Borrowing Requirement.

Table 6.4 Impact of Changes in the Wage Bill on Underlying Inflation (RPIX)

Percentage increase in the wage bill in each year	Percentage point change on RPIX inflation	
	Year 1	Year 2
0.1	0.04	0.06
0.2	0.07	0.12

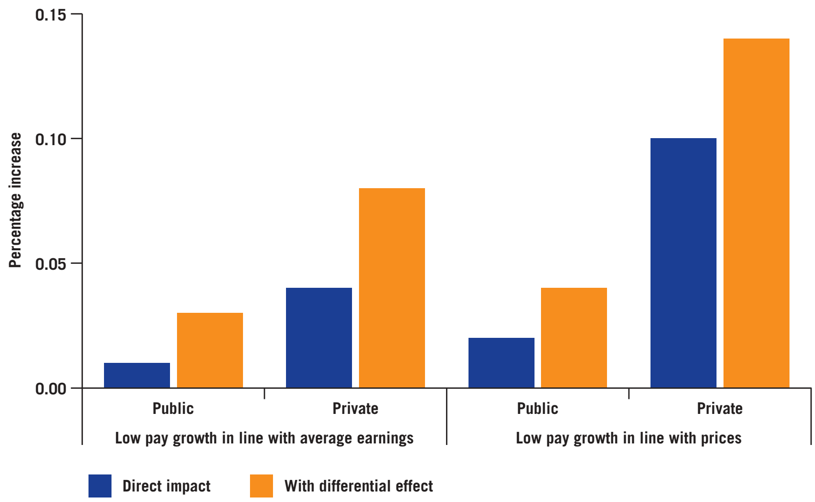
Source: ITEM Club.

6.59 These simulations assume that there are no dynamic adjustments on the part of firms in terms of the measures they take to offset higher wage costs. As we saw in Chapter 2, although at the aggregate level it is difficult to detect a significant impact of the minimum wage on prices, productivity or profits, those firms most affected have made changes, for example in controlling labour and non-labour costs, or in undertaking more innovative measures to raise productivity. These factors would dampen the (already small) impact on inflation.

Public Sector

6.60 In Chapter 2 we reported that the minimum wage had had little impact on public sector pay. The lowest wage rates in national agreements for public sector wages are generally well above minimum wage levels. As Figure 6.6 shows, the estimated cost to public sector wages of our recommended increase is small compared with costs to the private sector.

Figure 6.6
Wage Bill Impact in the Public and Private Sectors, National Minimum Wage £4.50/£3.80, October 2003



Source: LPC calculations based on grossed NES and LFS data, Spring 2002.

6.61 We asked HM Treasury to provide estimates of the public expenditure implications of hypothetical increases in the adult rate. The results of a 30 pence increase in 2003/04 on income tax, NICs, tax credits and benefits are given in Table 6.5.

Table 6.5 Savings from a 30 Pence Increase in the Adult National Minimum Wage

	£million, 2003/04
Income Tax	100
National Insurance Contributions	100
Working Tax Credit	30
Child Tax Credit	10
Income Support/Job Seeker's Allowance	5.5
Housing Benefit	10.5
Council Tax Benefit	2.5
Total of above	258.5

Source: HM Treasury estimates based on 2000/01 Family Resources Survey data uprated to 2003/04 prices.

6.62 The table shows that the full-year savings in these elements of the tax and benefit system arising from an increase in the adult minimum wage in line with our 2003 recommendation are in the order of £260 million. These estimates assume that the tax and benefit system as at 2003/04 applies. Including our recommended increase in the youth rate should not significantly affect this total. The estimates are indicative only and assume no behavioural response on the part of workers or employers. No estimates are available of the impact on corporation tax. Increasing the minimum wage will also have an impact on the cost of goods and services procured by the public sector. Public sector costs will rise if any increase in contractors' costs stemming from the increase in the minimum wage is passed on. Chapter 3 highlighted some evidence of this occurring (for example in the cleaning sector), but overall contract costs did not always rise and were sometimes offset by reductions in the amounts procured or in efficiency savings. We therefore believe the overall impact of our recommendations on public sector procurement is likely to be small.

Incomes

6.63 For the lowest-paid workers, earnings form only a part of total household income. Total income is a combination of earnings, tax credits and benefits. The impact of the minimum wage on total income therefore needs to be considered alongside changes in the tax and benefit system. In this section we consider the role of the minimum wage, in combination with the tax and benefit system, in relation to:

- incentives to work; and

- the impact it has on the income distribution and the extent to which it is targeted on those on lowest incomes.

6.64 In *Budget 2002* the Government gave details of its proposed reforms to the tax and benefit system, and in particular the new Working Tax Credit (WTC) and the Child Tax Credit, which are to be introduced in April 2003. For families with children, the WTC will broadly replicate the support for adults provided through the current Working Families Tax Credit and Disabled Persons Tax Credit. It also extends support to low-income working people without children aged 25 or over and working 30 hours or more a week. *Budget 2002* contained estimates of guaranteed incomes from WTC of:

- £237 a week for a family with one child and one earner working full-time on the National Minimum Wage; and

- £183 a week for a single earner couple without children or a disability, aged 25 or over and working full-time on the National Minimum Wage.

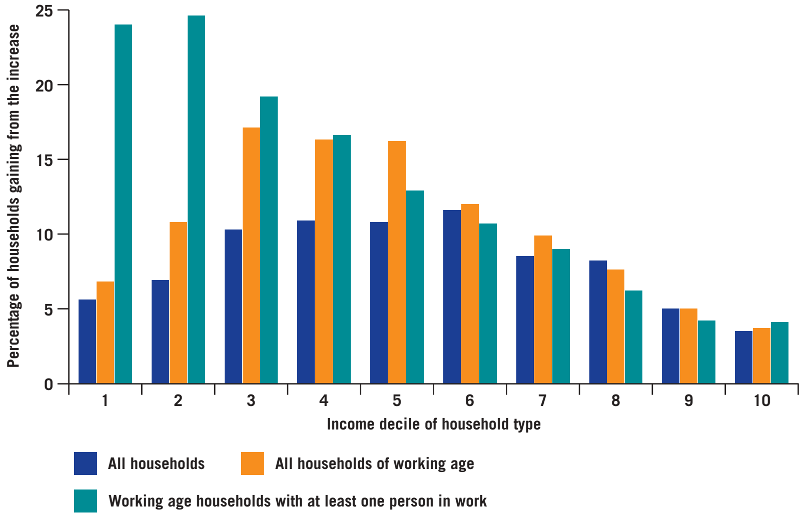
6.65 These illustrate the importance of tax credits and benefits in the disposable income of families on low earnings. In the first example shown an hourly minimum wage rate of £4.20 would be topped up to £6.30 per hour after taxes once tax credits and benefits are taken into account. Our recommendations should further improve incentives to move into work, although the precise impact will depend on any forthcoming Budget measures.

6.66 Another important aspect of the tax and benefit system is whether workers have an incentive to increase their hours and earnings when in work. Many low income households face high marginal deduction rates (MDRs). These measure how much of every £1 that a worker earns is lost as they pay more in tax and national insurance and their entitlement to benefits and tax credits reduces. Households on lower incomes receiving benefits or tax credits face higher MDRs. Our recommended increases in the minimum wage will not affect MDRs themselves. But increases in the National Minimum Wage can contribute to float people off benefits altogether, thus reducing the number of households subject to higher MDRs. As we noted in Chapter 2, an important feature of the new tax credits is that they will be based on an assessment of the previous year's family income. Since any increase of less than £2,500 in income throughout the year is disregarded, this means that workers on the minimum wage will receive the full benefit of the increase until the end of the tax year, when their tax credit will be reassessed. This should improve work incentives by providing certainty that employees will receive the full benefit of the first slice of a rise in earnings, whether moving into work or increasing earnings through increased hours or overtime.

6.67 We commissioned the Institute for Fiscal Studies (IFS) to model the impact of hypothetical increases in the minimum wage on the income distribution, taking into account offsetting reductions in taxes and benefits. Results are based on the 2001/02 Family Resources Survey uprated to April 2003 earnings levels, modelling the tax and benefit system as currently proposed for April 2003. As we commissioned this research before reaching a view on future minimum wage rates, the hypothetical figures chosen (£4.50/£3.85) do not correspond exactly with our recommendations. But the difference between these April 2003 figures and our recommendations for October 2003 will not change the overall conclusions.

6.68 The biggest impact of the minimum wage is not seen at the bottom of the incomes distribution, since the poorest households are generally not in work – they tend to be unemployed or in retirement. Figure 6.7 shows that the proportion of all households gaining from an increase in the minimum wage is spread fairly evenly across the income distribution, with the highest proportion of households gaining in the third to the sixth deciles. But if we focus on working age households with at least one person in work, the highest proportion of gainers is in the first and second deciles.

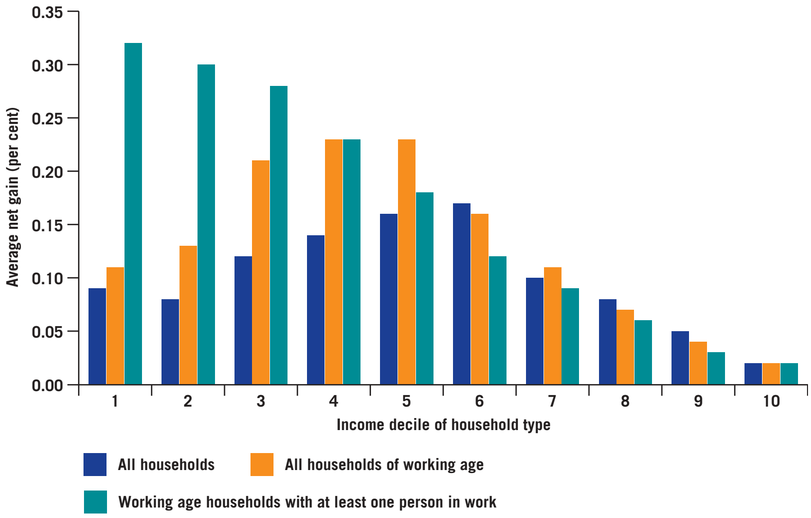
Figure 6.7
Percentage of Households in Each Income Decile Gaining from an Increase in the National Minimum Wage to £4.50 (22+), £3.85 (18–21) at April 2003 Levels



Source: IFS.

6.69 Figure 6.8 shows the average net gain, as a percentage of household disposable income, from these increases in the minimum wage, by household type and by decile. The overall pattern of gains is similar to that seen in Figure 6.7, with the gains better targeted on lower income groups when looking at the distribution of households with at least one worker.

Figure 6.8
Average Net Gain, as a Percentage of Net Household Disposable Income, from an Increase in the National Minimum Wage to £4.50 (22+), £3.85 (18–21) at April 2003 Levels, for Households in Each Income Decile



Source: IFS.

6.70 Thus, while the minimum wage is only one part of total income of low-earner families, it provides an earnings floor that underpins the tax and benefit system. In combination with the new tax and benefit system, increases to the minimum wage will slightly increase the incentive to work, by increasing in-work income. Increases to the minimum wage are not targeted on the poorest households, which do not generally contain people in work, but are well targeted on the poorest households with at least one person in work.

Conclusion

6.71 The Low Pay Commission is persuaded that in the medium term the minimum wage should be uprated faster than the increase in average earnings, provided that economic conditions are favourable. We have recommended above-average earnings increases in the minimum wage for 2003 and 2004 based on evidence that the minimum wage has not adversely affected the economy, and that independent forecasters are predicting low-inflation growth in the medium term. While we have found virtually no evidence of a negative minimum wage impact on young people, we have taken into account the vulnerability of young people's employment in recommending a slightly lower increase in the youth Development Rate than the adult rate. We recognise that forecasts for 2004 are uncertain, and therefore consider it prudent that we are given a remit to reconsider the recommended rates in early 2004 in the light of the most recent information on economic circumstances.

6.72 The rates we recommend will lead to substantial increases in the number and proportion of jobs covered by the minimum wage. We estimate that the minimum wage will rise substantially in relation to average earnings and by October 2004 will be approaching half male median hourly earnings. While these increases will be costly for some firms in low-paying sectors, we estimate that the impact will be manageable for the economy as a whole. We predict that the impact on the wage bill will be similar to that of the October 2001 uprating, and will have only a small impact on inflation and on public sector finances. Overall, the increases will have a small positive impact on income of the poorest working households.

APPENDIX 1

Consultation

We are grateful to all the people and organisations that helped us by providing oral and written evidence, and by organising or participating in visits and meetings. All organisations which participated, and gave consent for us to publish their names, are listed below according to the nature of their contribution.

Oral Evidence to the Commission

Association of Convenience Stores

British Apparel & Textile Confederation

British Beer & Pub Association

British Hospitality Association

British Retail Consortium

Business in Sport and Leisure

Business Services Association

CBI

Centrepoint

Cleaning and Support Services Association

GMB

Hairdressing Employers Association

KFAT

National Hairdressers' Federation

Trades Union Congress

Trades Union Congress Youth Forum

Transport and General Workers Union

Union of Shop, Distributive and Allied Workers

UNISON

Written Evidence to the Commission

Association for Supported Employment

Association of Charity Shops

Association of Chartered Certified Accountants

Association of Convenience Stores

Association of Licensed Multiple Retailers

Avon Tyrrell Activity and Residential Centre

Bradshaw J, and Finch N, Social Policy Research Unit, University of York

British Apparel & Textile Confederation

British Association of Leisure Parks, Piers and Attractions

British Association of Removers

British Beer & Pub Association

British Dental Association

British Holiday & Home Parks Association

Written Evidence to the Commission *(continued)*

British Hospitality Association

British International Freight Association

British Printing Industries Federation

British Retail Consortium

British Shops and Stores Association

British Youth Council

BUPA Care Services

Business in Sport and Leisure

Business Services Association

CBI

Centrepoint

Cheshire County Council

Children's Rights Alliance for England

Churches Main Committee and the Methodist Church

Citizens Advice Scotland

Citizen's Income Trust

Cleaning and Support Services Association

Communication Workers Union

Constant Security Services

Council for Voluntary Action South Lakeland

Dyfed Cleaning Services Limited

Engineering Employers' Federation

Employers' Organisation for local government

Equality Commission for Northern Ireland

Equal Opportunities Commission

Equity

Federation of Licensed Victuallers Associations

Federation of Small Businesses

Food and Drink Federation

Forum of Private Business

General Assembly of the Church of Scotland Committee on Church and Nation

General Federation of Trade Unions

GMB

Greater Manchester Low Pay Unit

Greggs plc

Hairdressing Employers Association (joint submission with National Hairdressers' Federation)

Her Majesty's Government

Hull Cityventure Ltd

Independent Healthcare Association

Institute for applied health & social policy, King's College London

Institute for Outdoor Learning

Institute of Directors

KFAT

Laing & Buisson (Publications) Limited

Leicester City Council

Local Authority Caterers Association

Low Pay Unit (joint submission with UNISON)

Making Space

Mendip Vale

Mental Health Matters

National Federation of Fishermen's Organisations

Written Evidence to the Commission *(continued)*

National Federation of SubPostmasters

National Group on Homeworking

National Hairdressers' Federation (joint submission with Hairdressing Employers Association)

National Housing Federation

National Pharmaceutical Association

National Trainers Federation

Northern Ireland Amusement Caterers' Trade Association

Northern Ireland Public Service Alliance

Office of the First Minister and Deputy First Minister, Belfast

Pembrokeshire County Council

Public and Commercial Services Union

Registered Nursing Home Association, Wales Branch

Royal College of Midwives

Save the Children UK

Scottish Executive

Scottish Grocers' Federation

Scottish Licensed Trade Association

Scottish Low Pay Unit

Scottish Textile Manufacturers Association

Shaw Employment Services

South West London and St George's Mental Health NHS Trust

Superior Cleaning Services

Textile Services Association

The Bingo Association

The British Sandwich Association

The East London Citizens Organisation (TELCO)

The Work Foundation

Trades Union Congress

Transport and General Workers Union

Traprain Consultants Ltd

UNIFI

Union of Shop, Distributive and Allied Workers

UNISON (joint submission with the Low Pay Unit)

United Kingdom Home Care Association Limited

Unquoted Companies Group

West Midlands Employment and Low Pay Unit

White Horse Child Care Limited

Wholesale Confectionery & Tobacco Alliance Ltd

Working Men's Club & Institute Union Limited

Young People's Rights Network

Zacchaeus 2000 Trust

Visits and Meetings

England

Anglia Polytechnic University

Association for Residential Care

Association of Convenience Stores

British Activity Holiday Association

British Apparel & Textile Confederation

British Beer & Pub Association

British Chambers of Commerce

British Hospitality Association

British Hospitality Association, Southwestern

British Retail Consortium

British Youth Council

BUPA

Business in Sport and Leisure

Business Services Association

Centre for Economic Performance, London School of Economics and Political Science

Centrepoint

Cleaning and Support Services Association

Cosy Toes Child Care and Nursery School

Coventry Clothing Centre

Daycare Trust

Devon Residential and Nursing Home Managers

Devon Social Services

Disability Rights Commission

Employers' Organisation for local government

Equal Opportunities Commission

Ethical Trading Initiative

Fawcett Society

Federation of Small Businesses

Forum of Private Business

Francesco Group

Fusion Personnel

GMB

Hairdressing Employers Association

Haygrove Limited

Homerton University Hospital, NHS Trust

Hospitality Training Foundation

Independent Care Organisations Network

Institute for Fiscal Studies

Judy Scott Consultancy

KFAT

Learning and Skills Council

Low Pay Unit, London

Manchester User Network

Mental Health Matters

Midland Linen Services Ltd

MITIE Group

National Association of Master Bakers

National Day Nurseries Association

National Group on Homeworking

National Hairdressers' Federation

National Union of Students

Nationwide Building Society

North Tyneside Council

Pepper Alley Public House

Visits and Meetings *(continued)*

Registered Nursing Home Association

Richmond Fellowship

Small Business Research Centre, Kingston University

Stoneleigh Trading

Strand Limited

Sussex Enterprise

The East London Citizens Organisation (TELCO)

The Village Nursery

The Work Foundation

Torbay Council

Trades Union Congress

Transport and General Workers Union

Union of Shop, Distributive and Allied Workers

UNISON

University of Essex, Jobshop Manager

West Midlands Employment and Low Pay Unit

Working Group on Employment and People with Learning Disabilities

Northern Ireland

Blu Property Management

Brian Burke Salons

Checkmate Guarding and Security

Reliance Security Services

Scotland

McPhies Craft Bakers

Scottish Executive

Scottish Textile Manufacturers Association

Wales

Spar/Lamphey Service Station

St Brides Hotel

National Assembly for Wales

APPENDIX 2

Low Pay Commission Research Projects

Table A2.1 Low Pay Commission Research Projects

Contractor	Aims and Objectives	Methodology	Results
J. Druker, C. Stanworth and G. White (University of Greenwich Business School)	To investigate the impact of the minimum wage in the hairdressing sector.	Face-to-face interviews were held with the owner/manager at 48 hairdressing salons throughout the UK. Employee interviews were also conducted in 24 of these salons. In addition training providers in three regions were interviewed. Four focus groups were held with trainees.	The industry has now largely adjusted to the National Minimum Wage and increases had less impact than the initial introduction. The most common response of salon owners was to increase prices. The strongest impact of the National Minimum Wage in terms of employment was on the costs and employment opportunities for young workers. Many employers were no longer willing to provide opportunities for those who commence their training above the age of 16 or 17.
C. Faichnie (Greater Manchester Low Pay Unit)	To study the impact of the minimum wage on young people's pay and employment.	Research was based on: analysis of Jobcentre and Career Services data on vacancies; and a short questionnaire to Career Services about their views and experience of the minimum wage.	There was little evidence that employers were limiting jobs to 16 and 17 year olds to avoid paying the minimum wage. In general, jobs that offered formal training offered lower rates of pay than jobs which offered 'in-house' or 'on-the-job' training. The use of age-related pay rates in jobs advertised in Jobcentres was small, and concentrated in retail and hospitality occupations. The experience of Careers Officers was that employers paid the adult minimum wage to younger age groups. The increase in the minimum wage to £4.10 did not lead employers to take advantage of the lower rates for younger ages.

Table A2.1 Low Pay Commission Research Projects *(continued)*

Contractor	Aims and Objectives	Methodology	Results
J. Forth and M. O'Mahony (National Institute of Economic and Social Research)	To measure productivity and labour costs in low-paying sectors.	The authors compiled sectoral measures of the levels of labour productivity and unit labour costs on an annual basis over the period 1995–2000. These were used to describe changes in the levels of labour productivity and unit labour costs in seven low-paying sectors, and to compare with the trends in higher-paying sectors unaffected by the minimum wage. A statistical analysis of labour productivity growth was also conducted to assess more robustly whether labour productivity growth could be linked to the introduction of the National Minimum Wage.	During this period labour productivity rose in six out of seven low-paying sectors – the exception being in clothing and footwear. In three sectors – textiles, security and hairdressing – the average annual growth in labour productivity was higher in the period 1998–2000 than in the previous three years. But the statistical analysis found no robust association between the wage bill impact of the minimum wage and rates of labour productivity growth across a wide range of sectors. There was no evidence of the National Minimum Wage leading to a general increase in unit labour costs over this period.
D. Grimshaw and M. Carroll (University of Manchester, Institute of Science and Technology)	To investigate the range of actions taken by small firms in response to the National Minimum Wage.	Interviews with the owner or managing director of 36 small firms drawn from the clothing and footwear, hospitality, residential care, retail, security and cleaning sectors. Firms were chosen from three geographical areas in the North West to reflect differences in labour market conditions. Follow-up interviews were held with a sample of employees at five of the case-study firms.	Half the firms in the sample raised their pay to comply with the National Minimum Wage. Of those affected, less than half restored pay differentials. The research reported little evidence of an adverse impact of the National Minimum Wage on employment, but a reduction in hours was reported by some firms, especially in the care sector. There were a number of constraints, internal and external to the firm, which impacted negatively on firms' ability to adjust prices for a given product or service in response to the National Minimum Wage. The research reported little association between the form of training provision within the firm and its ability to pay. The minimum wage had generally acted as an instrument enabling positive change in the way firms adapted their product market strategy and approach to managing employment.

Table A2.1 Low Pay Commission Research Projects *(continued)*

Contractor	Aims and Objectives	Methodology	Results
Incomes Data Services Ltd	To monitor the impact of the minimum wage in the period leading up to the October 2001 uprating and afterwards.	Research undertaken included a general cross-sector survey targeted at firms in low-paying sectors, detailed surveys of the nursery and hotels sectors and in-depth analysis of the retail sector. This was supplemented by ongoing monitoring of firms in the care and voluntary sectors.	The October 2001 uprating had more of an impact on many firms than the initial introduction or the 2000 uprating. Despite this, most firms had adjusted without much difficulty. Some employers whose rates were already over the minimum re-positioned themselves at higher rates. A minority of firms reported a squeezing of differentials further up the earnings scale. But these were not generally seen as unworkable. Restoration of differentials was more of an issue in those sectors, for example among nurseries, where pay scales were already compressed. Recruitment and retention problems were evident in many parts of the country. The vast majority of firms employing young people did not use age-related pay. The research found that most firms were able to adjust to the October 2001 minima with little change to employment, pay structures or staff training and development.
Incomes Data Services Ltd	To determine the considerations that employers have in mind in setting pay for young employees.	Twenty case studies of large-scale employers, mostly in the retail, leisure and hospitality sectors, the majority of which employed a high proportion of young people under the age of 22 in their workforce. The information was gathered through a mixture of in-depth face-to-face interviews, questionnaires and telephone interviews.	Most of the case study organisations paid adult rates from age 18 or younger. A minority had a higher threshold for paying adult rates; in most cases this was introduced as a result of the minimum wage. Most employers said that young people performed the same duties as older people, except where legal restrictions applied, and that the performance of young people was generally no different from that of older people. They also received similar training. Several employers said that they considered it wrong to pay young people less than older workers and most paid students the same rates as other employees. Several organisations that had lower rates for under 18s had made moves to boost rates for junior staff.

Table A2.1 Low Pay Commission Research Projects *(continued)*

Contractor	Aims and Objectives	Methodology	Results
A. Manning and R. Dickens (Centre for Economic Performance, London School of Economics and Political Science)	To investigate alternative approaches to estimating the impact of the minimum wage using the Labour Force Survey (LFS). Then to look at the impact of the minimum wage on the wage distribution, poverty and the gender pay gap using these alternatives.	Analysis of the LFS data to investigate the robustness of estimates of the impact of the minimum wage to different methods of solving the 'missing data' problem (i.e. the incomplete data on hourly pay rates).	The hourly rate variable is a better measure of the hourly wage than the hourly pay variable (derived by dividing gross weekly earnings by usual weekly hours). Estimates of the percentage of employees affected by the National Minimum Wage are sensitive to the precise method used to estimate hourly earnings. The results suggest that using the hourly rate measure of the hourly wage does make the minimum wage appear better targeted on poor working households.
L. Miller and J. Hurstfield (IRS Research) and N. Stratton (Learning Society)	To examine the impact of the minimum wage on firms' training decisions.	Short telephone interviews with 121 mainly small firms in hospitality, retail and hairdressing around Britain. Longer, face-to-face interviews with 26 of these firms.	Changes to training provision were generally in response to changing business circumstances rather than directly due to the minimum wage. Increases in training were usually to improve productivity or quality of performance. The older workers' Development Rate was not used, mainly because firms were unaware of it. Employers believed the Development Rate would be difficult to implement where training was largely on-the-job, and this lower rate would tend to exacerbate recruitment difficulties. There was some evidence that the minimum wage had made some hairdressing firms reluctant to employ older trainees.

Table A2.1 Low Pay Commission Research Projects *(continued)*

Contractor	Aims and Objectives	Methodology	Results
H. Rainbird, L. Holly and R. Leisten (University College Northampton)	To examine the extent to which the minimum wage – particularly the youth and older workers' Development Rates and the exemption for apprentices – has given employers incentives to invest in training.	Interviews in 19 small and medium-sized firms in three sectors in an economically depressed resort town and a relatively buoyant county town.	The minimum wage had had a more significant impact in the resort town than in the county town; all the county town firms surveyed paid above the minimum wage though some had reviewed employment practices and timing of wage increases. The main drivers for training were firms' wider business strategies in response to regulatory standards in social care, changes in the customer base in hospitality and maintaining retail markets, rather than the minimum wage. Firms' use of training to recognised standards was also influenced by the local training infrastructure. No firms used the older workers' Development Rate.
M. Stewart (University of Warwick)	To estimate the employment effects of the minimum wage.	Using data from the LFS and New Earnings Survey (NES), the research drew on previous research commissioned by the Low Pay Commission (Stewart (2001)), and extended it in several ways. First, it examined the impact of the 2000 and 2001 upratings to the minima. Second, it took account of individuals' position in the earnings distribution relative to the minimum wage (the 'wage gap') – that is, it distinguished between those whose wage needed to be increased a lot due to the minimum wage and those who only needed a small increase, and compared them with the control group above the minima. It also took account of factors specific to certain sectors and regions which might affect employment in different labour markets.	The research found little evidence that the introduction of the National Minimum Wage had an adverse impact on the probability of subsequent employment of those affected. The estimates of the 2000 uprating were more mixed. There was some evidence of a negative effect, mainly for adult women, but it was sensitive to the choice of wage variable and estimation method and was significant only in one of the four specifications. There was evidence that the differential impact of the slowdown in employment growth (which may affect low-paid workers more than those higher up the earnings distribution) biased the estimates. Once this was controlled for the results were insignificant. Analysis of the impact of the 2001 uprating was restricted by the available data, but initial results largely supported the view that there was no adverse impact.

Table A2.1 Low Pay Commission Research Projects *(continued)*

Contractor	Aims and Objectives	Methodology	Results
M. Stewart (University of Warwick)	To examine whether there has been a significant difference in the pattern of labour market transitions since the introduction of the minimum wage.	Labour market transition matrices were constructed from quarterly LFS data (March 1997 to February 2002). The paper examined differences in the transition probabilities before, spanning and after the introduction of the minimum wage, and looked at the impact of age, gender and region on these differences. Three linear probability models were constructed to examine the change in three particular transition probabilities before and after the minimum wage, controlling for personal characteristics and other factors.	Significant changes in the transition probabilities fell into three groups. • Those entering employment from unemployment were found to be doing so at higher wages post minimum wage, with the proportion moving from unemployment into the bottom wage group falling, and the proportion moving into the top wage group increasing. The fall in the proportion moving to the bottom wage group from unemployment was found to be significant when modelled controlling for other factors. The fall was found to be most significant for women, for those aged below 35, and for those in London and the South East. • The probability of remaining in the bottom wage group fell significantly post minimum wage, and transitions from the bottom real wage group to the next group increased significantly. The fall in the proportion remaining in the bottom group was found to be significant when other factors were taken into account. The changes were predominantly outside the South East, and of the three age groups examined, were more significant for the youngest and oldest age groups, and more significant for men than for women. • The proportion inactive and wanting to work rose significantly post minimum wage; the proportion moving from inactive and wanting to work, to inactive and not wanting to work, fell significantly. The increase in the proportion inactive and wanting to work was found to be significant. Controlling for other variables, this was found to be primarily for those outside London and the rest of the South East, and for those over 35.

Table A2.1 Low Pay Commission Research Projects *(continued)*

Contractor	Aims and Objectives	Methodology	Results
M. Stewart (University of Warwick) and J. Swaffield (University of York)	To identify whether the introduction of the minimum wage in April 1999 and its subsequent upratings have had a significant impact on the number of hours worked by low-paid employees.	The researchers used individual level longitudinal data from three national data sets (NES, LFS and British Household Panel Survey (BHPS)) to estimate the impact of the minimum wage on the hours of work of employees whose wages had been raised to comply with minimum wage levels. The researchers estimated a model of the individual employee's change in paid working hours as a function of the individual's initial position in the wage distribution. They used a difference-in-difference estimation method to examine whether changes in working hours of employees whose wages were directly affected by the minimum wage were significantly different from those whose wages were not affected.	NES and LFS data showed a significant negative impact on hours worked of adult males in the period following the introduction of the minimum wage (April 1999 up to September 2000), suggesting a lagged impact of the introduction of the minimum wage. No evidence was found of an impact of either the October 2000 or the October 2001 uprating on adult males. These data showed no impact of the introduction, or of subsequent upratings, of the minimum wage on hours worked of young people. Results from the NES found a slight indication of a negative initial impact on hours worked of adult females, but only when the control group used was varied. No significant impact was found using the LFS. BHPS data indicated a positive and significant impact on hours worked of adult females which was robust to changes in the control groups. However, as the BHPS samples were so much smaller than those from the NES and LFS this evidence was argued to be less persuasive.

APPENDIX

3 Developments in Low Pay Statistics

Introduction

1 In order to make an accurate assessment of low pay in the economy we need accurate data on the number of low-paid workers. While qualitative research helps to explore certain issues in detail, only the official national data sources provide the aggregate picture.

2 Our third report set out, in some detail, the changes that had been made to the low pay statistics methodology in 2000. At that time we noted that the Office for National Statistics (ONS) was still working to improve its methodology and we anticipated that further refinements would be made. We urged the ONS to continue its work to improve the estimates. Discussions between the Commission and the ONS have continued since the publication of our third report. Both organisations have appreciated these discussions, which have given the ONS a greater understanding of our needs, and provided us with an opportunity to learn more about the ONS's work in this area.

3 During 2002 the ONS has continued to develop the low pay statistics methodology, undertaking work on both the New Earnings Survey (NES) and Labour Force Survey (LFS). On 3 October 2002 it published a press notice with revised estimates. More detailed data were published on the National Statistics website (www.statistics.gov.uk). These included data on the number of jobs paid within each ten pence band for hourly earnings, together with a description of the changes made to the methodology. Short items were published in the November 2002 and February 2003 issues of *Labour Market Trends*. A further *Labour Market Trends* article on patterns of low pay is planned for publication in Spring 2003. The revised methodology produced lower estimates of the numbers on low pay in 1998 than we presented in our third report, although the reduction was not as great as that which resulted from the more radical methodological changes made in 2000, on which we commented in our third report. Here we outline briefly some of the changes made, review their impact and look at the ONS's plans for developing the low pay statistics further. We also include results from research that we commissioned to explore the LFS methodology in more detail.

Developments to the Low Pay Statistics Methodology

4 The data collection methods for the LFS and NES are very different. The LFS is the largest regular household survey in the United Kingdom. In any three month period, a nationally representative sample of approximately 120,000 people aged 16 and over in around 61,000 households are interviewed about a range of labour market issues, including their earnings. The NES is based on a 1 per cent sample of employees in Great Britain – information on whose hours and earnings is obtained in confidence from employers. A similar survey is carried out in Northern Ireland. Around 90 per cent of the sample is identified from lists supplied by the Inland Revenue containing selected National Insurance numbers. Details of the remaining 10 per cent are obtained directly from the large organisations that employ them.

5 The ONS has focused most of its attention on improving the quality of the LFS estimates of low pay. In particular, it has looked at ways to improve the accuracy of the information the survey gathers on people's hourly pay rates. In Spring 1999 the survey began to ask some individuals their actual hourly pay rate. (Previously, hourly pay rates had been derived by dividing gross weekly earnings by usual weekly hours.) But this question was originally asked only of individuals who were paid more frequently than monthly. Since Spring 2000, the question has been asked of everyone who is paid an hourly rate. This additional information on hourly pay rates has now been used to produce revised low pay estimates for 2000 and 2001, and in the estimates for 2002. As far as possible, revised estimates have also been produced on a consistent basis for 1998 and 1999.

6 Where data on hourly pay rates are not available the ONS needs to impute, or model, the information. Regression imputation is used to provide each individual, whether they have an actual rate or not, with a simulated hourly rate. Characteristics used in determining this simulated rate include earnings, hours worked, age, sex and qualifications. The ONS has reviewed this regression process and made changes to the variables included. Some variables were found to be not significant and were removed while others have been introduced. The resulting list of variables was found to be sufficiently robust to be used in the regression analysis for all LFS quarters. The simulated rates are used to estimate rates for those cases for which there is no actual hourly rate, using a 'donor'

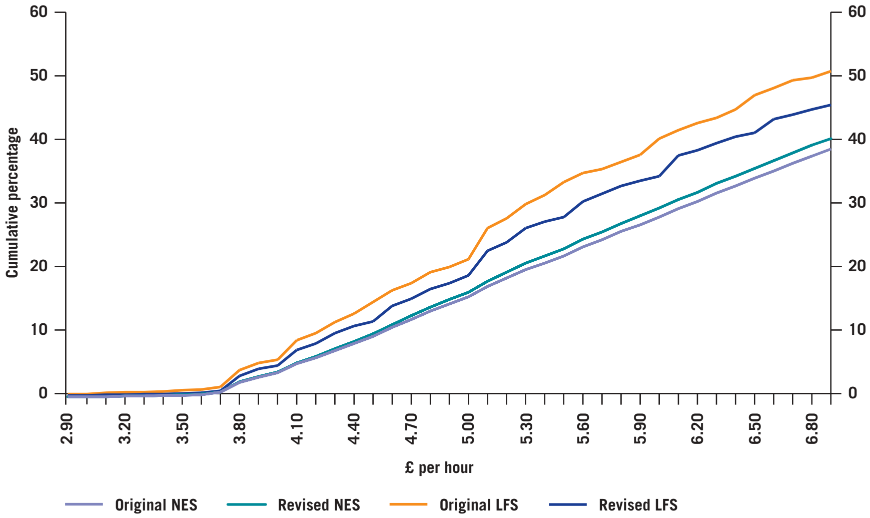
method of imputation. All the cases are ordered by their simulated hourly rates. A case missing an hourly rate then takes the actual hourly rate of its nearest five neighbours above and below. To reflect the structure of minimum wage rates, the imputation now uses donor classes based on three age groups. This means, for example, that a young person aged 18–21 can only donate a rate to another young person rather than to someone eligible for the adult minimum wage.

7 Within the NES, the method of deriving hourly pay rates has been revised to conform more closely to the definitions used in the National Minimum Wage legislation. Whereas the old derived hourly rate variable included shift premium payments, these have now been excluded. (Shift premia do not count towards National Minimum Wage pay.) The resulting estimates therefore provide a better measurement of low pay for our purposes.

8 The ONS has also introduced changes so as to measure people's ages more accurately. Although the NES is carried out in April, individuals' ages were recorded as at 1 January. From 2000 onwards, age is now measured as at 1 April. This change helps to improve our analysis of young people's pay in particular, where the very narrow age range under consideration makes accuracy in measuring individuals' ages all the more important.

9 Figure A3.1 shows the impact of these methodological changes on the distribution of hourly earnings in 2001. The figure shows that the LFS distribution has moved closer to the NES distribution, particularly at lower rates of pay. Note also the 'steps' in the LFS distribution at the £4.00, £5.00 and £6.00 per hour levels, reflecting spikes in the LFS distribution at these levels. These spikes at exact numbers of pounds per hour could be either because employers are more likely to pay such 'round' rates or because LFS respondents round the rates of pay when they report them. The second explanation is more likely as we do not see similar spikes to the same extent in the NES. Tables A3.1 and A3.2 illustrate the difference between the original and revised methodology at certain pay thresholds. The central estimate is an average of the percentages below a given pay threshold estimated from each of the two data sources. In order to estimate the number of jobs below a certain threshold, this proportion is then applied to the figure for the total number of jobs in the economy provided by the LFS.

Figure A3.1
Comparison of Original and Revised LFS and NES Cumulative Distributions for Hourly Earnings for Jobs of Those Aged 22 and Over, Spring 2001



Source: LPC calculations based on grossed NES and LFS data, Spring 2001.

Table A3.1 Comparison of Original and Revised Estimates of the Percentage of Jobs of Those Aged 22 and Over Paid Below Certain Thresholds from the NES, LFS and Central Estimate, Spring 2001

%	Original estimate			Revised estimate		
	<£4.00	<£4.50	<£5.00	<£4.00	<£4.50	<£5.00
NES	3.8	9.4	15.5	3.9	9.8	16.2
LFS	5.8	14.7	21.3	4.9	11.7	18.8
CE	4.8	12.1	18.4	4.4	10.8	17.5

Source: LPC calculations based on grossed NES and LFS data, Spring 2001.

Note: Estimates of percentage of jobs rounded to nearest 0.1 per cent.

Table A3.2 Comparison of Original and Revised Estimates of the Number of Jobs of Those Aged 22 and Over Paid Below Certain Thresholds from the NES, LFS and Central Estimate, Millions, Spring 2001

Millions	Original estimate			Revised estimate		
	<£4.00	<£4.50	<£5.00	<£4.00	<£4.50	<£5.00
NES	0.9	2.2	3.6	0.9	2.2	3.7
LFS	1.3	3.4	4.9	1.1	2.7	4.3
CE	1.1	2.8	4.2	1.0	2.5	4.1

Source: LPC calculations based on grossed NES and LFS data, Spring 2001.

Note: To be consistent with the central estimate, the NES percentages have been applied to the LFS total jobs figure. Estimates of adult jobs rounded to nearest 100,000.

10 The differences in the NES and LFS series reflect the different nature of the datasets they are based upon, and we do not expect the distributions from each source to be exactly the same. The NES data come directly from employer payroll records and the data are grossed to allow for incomplete coverage of the earnings of young people and part-time employees. The grossing adjusts for the under-representation of these people in the sample but cannot completely correct for it. The LFS is a household survey in which the data are often provided by individuals without reference to pay slips and are therefore more likely to be subject to measurement error. In summary, the NES is likely to provide a more accurate measure of the pay rates of those included in the survey, but to under-represent people in low-paid jobs. The LFS provides better coverage of low-paid and more marginal jobs, but is likely to give a less accurate measure of pay rates.

11 The NES and LFS estimates are much closer than they would have been without these latest methodological developments. The difference between the two revised series is illustrated in Tables A3.3 and A3.4. The tables show the number of jobs that stood to benefit from the uprating of the minimum wage to £4.10/£3.50 per hour in October 2001 using the downrated values of £4.00/£3.45 per hour and £4.05/£3.45 per hour as outlined in Chapter 2.

Table A3.3 Comparison of Estimates of the Percentage of Jobs Benefiting Derived from the NES, LFS and Central Estimate, Spring 2001

%	Lower estimate			Upper estimate		
	£4.00	£3.45	Total	£4.05	£3.45	Total
NES	3.9	5.2	4.0	5.0	5.2	5.0
LFS	4.9	5.5	5.0	7.1	5.5	7.0
CE	4.4	5.3	4.5	6.1	5.3	6.0

Source: LPC calculations based on grossed NES and LFS data, Spring 2001.

Note: Estimates of percentage of jobs rounded to nearest 0.1 per cent.

Table A3.4 Comparison of Estimates of the Number of Jobs Benefiting Derived from the NES, LFS and Central Estimate, Spring 2001

	Lower estimate			Upper estimate		
	£4.00	£3.45	Total	£4.05	£3.45	Total
NES	0.9 m	90,000	1.0 m	1.1 m	90,000	1.3 m
LFS	1.1 m	100,000	1.2 m	1.7 m	100,000	1.8 m
CE	1.0 m	90,000	1.1 m	1.4 m	90,000	1.5 m

Source: LPC calculations based on grossed NES and LFS data, Spring 2001.

Note: To be consistent with the central estimate, the NES percentages have been applied to the LFS total jobs figure. Estimates of adult jobs that gain rounded to nearest 100,000 and youth jobs that gain to nearest 10,000. Totals may not sum due to rounding.

12 The ONS made an initial estimate of the 95 per cent confidence interval around each estimate for adult jobs paid below £4.05 per hour in 2001. The confidence intervals given here are calculated using a method that takes into account the effective sample sizes used in arriving at the estimates. They take into account the donor imputation system used in deriving the LFS estimates. However, they are still experimental and not National Statistics approved, and may be subject to later revision. The results are illustrated in Table A3.5. So, for example, it can be said with 95 per cent certainty that the central estimate of the number of jobs held by adults paid less than £4.05 per hour lies between 1,319 thousand and 1,491 thousand. The confidence interval for the LFS estimate is higher than that for the NES: this is to be expected as the LFS sample size is much smaller than that of the NES.

Table A3.5 Confidence Intervals for the Number and Percentage of Jobs of Those Aged 22 and Over Paid Below £4.05 per hour, Spring 2001

	Estimate (thousands)	Confidence interval (thousands)	Estimate (per cent)	Confidence interval (per cent)
NES	1,160	+/- 28	5.0	+/- 0.1
LFS	1,650	+/- 170	7.1	+/- 0.7
CE	1,405	+/- 86	6.0	+/- 0.4

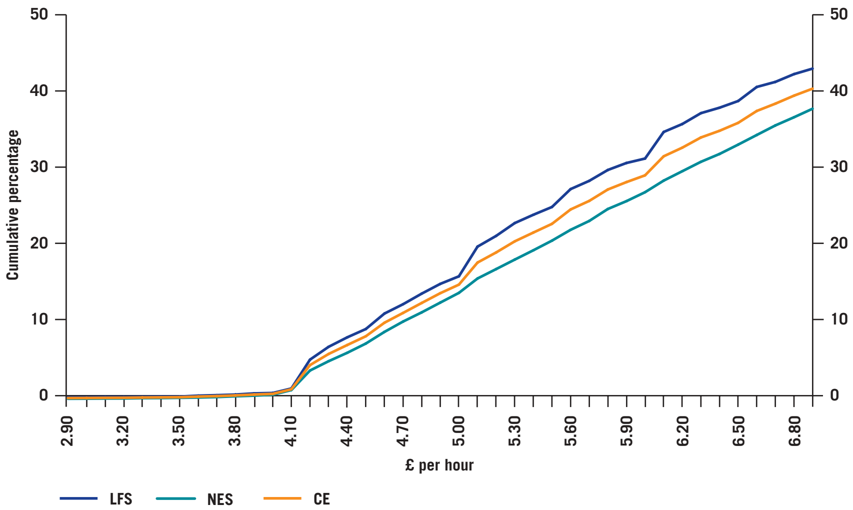
Source: ONS calculations based on grossed NES and LFS data, Spring 2001.

Note: To be consistent with the central estimate, the NES percentages have been applied to the LFS total jobs figure. Estimates of percentage of jobs rounded to nearest 0.1 per cent.

Low Pay Statistics 2002

13 In considering what new rates to recommend, we have used the low pay statistics for 2002 to help us assess the impact of a range of possible new rates. These statistics provide earnings distribution information for Spring 2002. Figure A3.2 presents the latest data for adult jobs, that is for employees aged 21 and over in accordance with our recommendation. This illustrates that the NES and LFS estimates are relatively close together until the £5.00 per hour level where again we see a step in the LFS series, with the two series diverging from that point. Table A3.6 illustrates this in more detail for a range of pay rates.

Figure A3.2
Comparison of LFS, NES and Central Estimate Cumulative Distributions for Hourly Earnings for Jobs of Those Aged 21 and Over, Spring 2002



Source: LPC calculations based on grossed NES and LFS data, Spring 2002.

Table A3.6 Comparison of Estimates of the Number and Percentage of Jobs of Those Aged 21 and Over Paid Below Certain Thresholds from the NES, LFS and Central Estimate, Spring 2002

	Number (millions)				Percentage of jobs			
	<£4.20	<£4.60	<£5.00	<£5.10	<£4.20	<£4.60	<£5.00	<£5.10
NES	0.9	2.1	3.3	3.7	3.7	8.7	13.7	15.6
LFS	1.2	2.6	3.8	4.7	5.1	11.0	15.8	19.7
CE	1.1	2.4	3.5	4.2	4.4	9.9	14.8	17.6

Source: LPC calculations based on grossed NES and LFS data, Spring 2002.

Note: To be consistent with the central estimate, the NES percentages have been applied to the LFS total jobs figure. Estimates of adult jobs rounded to nearest 100,000. Estimates of percentage of jobs rounded to nearest 0.1 per cent.

Commissioned Research

14 We commissioned Alan Manning and Richard Dickens from the London School of Economics and Political Science to investigate the robustness of estimates of the impact of the minimum wage to different methods of solving the 'missing data' problem in the LFS (i.e. the incomplete data on hourly pay rates). They considered a number of alternative approaches and found that the estimates of the percentage of beneficiaries are sensitive to the choice of methodology, and indeed the assumptions used within any one methodology. In short there is considerable variation in estimates of coverage from the different methods used.

15 We have shared the results of this project with the ONS. We will be discussing with the ONS how to take these results forward, and their potential implications for developments in the low pay statistics.

Looking Ahead

16 In October 2002 the ONS published the *Review of Distribution of Earnings Statistics*. This report recognised that the provision of annual structural earnings data was a priority issue and outlined proposals for producing better estimates of low pay. In January 2003 a workplan was published outlining how these proposals will be taken forward. To improve the data on low pay the ONS proposes to develop the NES in a number of ways. One of the most important developments from our perspective is the proposal to examine the extent to which the PAYE system, on which the current NES is based, is not representative of the population of employees and to consider how the under-representation of low-paid employees might be addressed with a supplementary survey. We hope that this will help to rectify the current undersampling of low-paid workers in the NES, thereby providing us with more accurate information. The LFS will also be reviewed with the aim of collecting better quality information on earnings, hours, industry and occupation.

17 We are pleased that the ONS has recognised the importance of data on the low paid to enable us to monitor and evaluate the National Minimum Wage effectively. Good quality estimates are vital for us. We urge the ONS to implement its programme of planned improvements in line with the timetable it has put forward.

Conclusion

18 We have noted in previous reports our concerns about the estimates of those in low pay. We are grateful to the ONS for the work that it has done to improve the statistics on low pay. The developments to the LFS series reduced the estimates of the numbers on low pay. This caused us to reduce our estimates of the number of jobs benefiting from the introduction of the minimum wage. But the revised methodology, and the work which the ONS now has in hand, should enable us to produce more accurate estimates for future reviews.

19 We were encouraged by the proposals outlined in the *Review of Distribution of Earnings Statistics* and the subsequent workplan. We urge the ONS to implement its programme of planned improvements in line with the timetable it has put forward.

APPENDIX 4

Low Pay Commission Survey of Employers

The Survey

1 In our second and third reports we included evidence from surveys of low-paying sectors that we conducted. For this report we carried out a further survey of employers to examine the impact of the October 2001 increase in the National Minimum Wage. We consider here its major findings, including the impact of the minimum wage on pay bills and differentials, its benefits, and its effects on businesses. We also outline the survey's findings on young people's pay and employers' use of the Development Rates. The survey questionnaire is given at the end of this appendix.

2 As with our previous surveys, we targeted this survey on sectors that were most likely to be affected by the minimum wage, i.e. hospitality, social care, manufacture of textiles, clothing and footwear, hairdressing, retail, childcare, security and cleaning. In general these are the same sectors that we covered in our previous reports, as our analysis of the New Earnings Survey data indicated that these continued to be the main low-paying sectors. But for the first time we also included businesses from the leisure sector (defined here as SIC 92.6 (Sporting activities) and SIC 92.7 (Other recreational activities)). We specifically targeted the survey on these low-paying sectors as we expected the increase in the National Minimum Wage to have an effect on them, and were keen to see how they had coped with it.

3 In the past trade associations helped us distribute our questionnaires. For this survey we wanted to broaden the sample coverage to include firms that were not necessarily members of trade associations, and to include more smaller firms. We were also keen to follow up a sample of non-respondents to the survey (see below for more details). Thus we chose a different research approach that would help us achieve these objectives.

4 We commissioned the Sample Surveys Research Group (SSRG) to undertake much of the administration of the survey on our behalf. They selected a sample of firms in low-paying sectors from the Dun and Bradstreet business database and distributed postal

questionnaires to 30,000 employers, mainly small and medium-sized enterprises. Questionnaires were posted in May 2002, seven months after the increase in the adult rate of the National Minimum Wage to £4.10. We received 3,783 replies – a response rate of 13 per cent, which is reasonable for a postal survey. We are very grateful to those businesses that took the time to complete and return the questionnaires.

5 Although the survey approach was very different from previous surveys the overall response rate remained similar. Table A4.1 shows the response rates by sector. The response rates were highest in the social care and childcare sectors. The sample contained a relatively small number of businesses in the security sector, and so for some of the following analysis results for security firms are combined with those for cleaning firms under the heading business services. The sectoral and size composition of the sample is very different from that of previous Low Pay Commission surveys: for example we have used a different sampling frame, and there is a higher proportion of small firms in the sample and also a higher proportion of firms from the business services and retail sectors compared with previous surveys. The overall results cannot therefore be directly compared with the previous surveys. But this survey gives a much broader coverage than the previous ones, and has a larger number of responses overall.

Table A4.1 Response to Survey

	Distributed	Response rate (%)	Number of responses
Hospitality (SIC 55)	3,776	9	356
Social care (SIC 85.31)	3,600	19	684
Textiles (SIC 17, 18, 19.3)	3,600	9	316
Hairdressing (SIC 93.02)	3,600	8	298
Retail (SIC 52)	3,750	11	426
Childcare	3,600	25	904
Security (SIC 74.6)	1,310	10	129
Cleaning (SIC 74.7)	3,164	10	303
Leisure (SIC 92.6, 92.7)	3,600	10	367
Total	30,000	13	3,783

6 The respondents to the survey are not a random sample of businesses in the sectors. Respondents are likely to be biased towards those most affected by the minimum wage. Thus the results are not representative of these sectors as a whole nor, because we have focused on low-paying sectors, are they representative of the economy as a whole. Results have therefore not been weighted. Larger businesses are over-represented in the responses to the survey even though the majority of respondents are small firms.

7 Table A4.2 shows that the respondent businesses employed more than a quarter of a million people. This is a smaller total than for the survey conducted for the third report, reflecting the fact that the present survey includes a higher proportion of responses from small firms. Eighty per cent of responses came from small firms, defined as those with fewer than 50 employees, as illustrated in Table A4.3.

Table A4.2 Number of Employees by Sector in the Sample

	Total number of employees	Median number of employees	Average number of employees
Hospitality	27,994	33	81
Social care	29,802	20	44
Textiles	18,342	15	59
Hairdressing	2,318	4	8
Retail	93,772	18	228
Childcare	16,718	11	19
Security	20,706	25	162
Cleaning	33,920	14	114
Leisure	24,254	11	68
Total	267,776	13	72

Base: All firms that provided employee numbers.

Table A4.3 Size Distribution of Firms by Sector

%	1–49 employees (small)	50–249 employees (medium)	250+ employees (large)
Hospitality	59	38	3
Social care	81	18	1
Textiles	76	20	4
Hairdressing	98	2	0
Retail	61	31	8
Childcare	96	3	1
Security	63	30	8
Cleaning	74	22	4
Leisure	83	13	4
Total	80	17	3

Base: All firms that provided employee numbers.

Impact

8 Table A4.4 shows that fewer than half of the respondents said their business had been affected by the October 2001 increase in the minimum wage. A higher proportion of respondents in the social care and childcare sectors said they had been affected. Just over half, 53 per cent, of medium-sized firms said they had been affected compared with 44 per cent of small firms and 47 per cent of large firms.

Table A4.4 Percentage of Firms Affected by the October 2001 Increase in the National Minimum Wage in Any Way

Hospitality	Social care	Textiles	Hairdressing	Retail	Childcare	Security	Cleaning	Leisure	Total
48	59	37	48	40	53	40	35	29	46

Base: All firms.

9 When we carried out our survey for our third report we felt that businesses that had been affected by the minimum wage were more likely to respond to it than those that had not been affected. This would lead to an upward bias in the proportion of businesses saying they had been affected. We wanted to test this hypothesis and so commissioned SSRG to conduct a short telephone follow-up survey among a random sample of 900 non-respondents to the postal survey. The results are shown in Table A4.5. They support our hypothesis, as the proportion of those who said they had been affected by the October 2001 increase was much lower than in the main (postal) survey – 27 per cent compared with 46 per cent. Those in the telephone survey that had been affected also experienced a smaller impact on their pay bill. These results are important in interpreting the postal survey results. They suggest that the respondents to the postal survey will tend to represent firms that have experienced the greatest impact from the minimum wage.

Table A4.5 Percentage of Firms Affected by the October 2001 Increase in the National Minimum Wage in Any Way – Telephone Follow-up Survey

Hospitality	Social care	Textiles	Hairdressing	Retail	Childcare	Security	Cleaning	Leisure	Total
28	35	32	26	23	38	24	17	18	27

Base: All firms.

10 In summary, the responses to our questionnaire overstate the overall impact that the National Minimum Wage has had on business for two main reasons. First, the survey specifically targeted those low-paying sectors that were most likely to have been affected. Second, even within these sectors, those who responded were more likely to have been significantly affected than non-respondents. For these reasons the survey responses should not be taken as indicative of the overall impact on business, or even in low-paying sectors. What it does provide is valuable information on how those affected by the increase in the minimum wage have coped with it.

Total Pay Bill

11 Table A4.6 shows that almost all of the respondents who had been affected reported increasing their pay bill as a result of the increase in the minimum wage, and three-quarters (that is around a third of all respondents) said they had done so by 5 per cent or more. Respondents in the childcare and social care sectors were more likely to say that their pay bill had increased by more than 10 per cent. We also found that firms with fewer than 50 employees experienced a more significant change to their pay bill than larger firms, although the proportion reporting a change in the pay bill was about the same.

Table A4.6 Impact on Total Pay Bill for Those Affected by the October 2001 Increase in the National Minimum Wage

%	No significant change	Increased by by less than 5%	Increased by 5% to 10%	Increased by more than 10%
Hospitality	7	24	48	21
Social care	2	15	46	37
Textiles	9	37	42	13
Hairdressing	6	26	42	26
Retail	4	29	44	22
Childcare	2	15	51	32
Business services	4	29	47	20
Leisure	11	31	50	9
Total	4	22	47	27

Base: All firms affected by the October 2001 increase in the National Minimum Wage in any way.

Differentials

12 Table A4.7 shows that three-quarters of respondents affected by the October 2001 increase in the minimum wage said they had increased pay rates for higher-grade staff to restore differentials. This is slightly higher than the two-thirds of respondents found in our third report. Again, the childcare and social care sectors were most affected.

Table A4.7 Percentage of Firms that Increased Pay Rates for Higher-grade Staff

Hospitality	Social care	Textiles	Hairdressing	Retail	Childcare	Business services	Leisure	Total
66	85	50	57	56	90	74	58	75

Base: All firms affected by the October 2001 increase in the National Minimum Wage in any way.

13 The median for the highest hourly rate which firms reported increasing was around the £5.90 per hour mark in half of the sectors in the survey, as shown in Table A4.8. For 28 per cent of respondents affected by the increase in the minimum wage the highest rate they had to increase was below £5.50 per hour, but for a quarter the highest rate was £6.50 per hour or above. The data suggest that the knock-on effect on higher rates of pay was most significant in the childcare, social care and business services sectors, and in businesses employing more than 50 employees. The results imply that the minimum wage uprating led to the restoration of differentials in some firms at higher pay rates than our previous surveys suggested. This is to be expected, to a certain extent, as the adult minimum wage rate, and earnings more generally, increase.

Table A4.8 Distribution of Highest Hourly Rate Increased

%	Hospitality	Social care	Textiles	Hairdressing	Retail	Childcare	Business services	Leisure	Total
£4.10 to £4.49	5	7	2	6	3	4	2	6	5
£4.50 to £4.99	10	13	13	7	11	11	8	10	11
£5.00 to £5.49	11	14	6	8	8	15	14	11	12
£5.50 to £5.99	11	13	4	8	8	15	14	10	12
£6.00 to £6.49	10	8	12	8	9	14	12	11	11
£6.50+	20	29	13	19	17	31	25	11	24
No increase for higher-grade staff	34	15	50	43	44	10	26	42	25
Median rate increased (£)	5.88	5.85	5.89	5.90	5.75	6.00	6.00	5.60	5.84

Base: All firms affected by the October 2001 increase in the National Minimum Wage in any way.

Benefits

14 We asked firms affected by the increase in the minimum wage whether they had experienced any benefits, such as lower staff turnover, as a result of it. Around a quarter of respondents affected by the increase in the minimum wage said that it had brought benefits, although few said there was a significant benefit. The hairdressing and childcare sectors were most likely to have experienced some benefits, while the retail sector was least likely. Table A4.9 shows that higher staff motivation was the benefit most likely to be reported.

Table A4.9 Has the October 2001 increase in the National Minimum Wage led to any of the following benefits to your business?

%	Hospitality	Social care	Textiles	Hairdressing	Retail	Childcare	Business services	Leisure	Total
Lower staff turnover									
Significant	1	3	4	6	1	1	2	4	2
Slight	11	10	7	6	5	12	15	5	10
Higher staff motivation									
Significant	1	2	3	0	0	4	1	1	2
Slight	18	17	10	11	9	20	17	8	16
Faster filling of vacancies									
Significant	0	1	2	1	1	1	1	0	1
Slight	7	9	9	6	4	7	8	8	7
Any benefit	28	28	28	30	15	31	28	25	28

Base: All firms affected by the October 2001 increase in the National Minimum Wage in any way.

Staffing

15 The 46 per cent of firms affected by the October 2001 increase in the minimum wage reported making a wide range of adjustments to staffing in response to it. The most likely action across all sectors was to reduce overall staffing levels, reported by 31 per cent of firms affected by the uprating (that is around one in eight of all respondents). The results presented in Table A4.10 suggest that overall the retail and hospitality sectors have been most affected in terms of the impact on staffing levels and hours worked. Sectors such as social care and childcare may be more restricted in their ability to change staffing levels and hours worked because of legal requirements.

Table A4.10 As a result of the October 2001 increase in the National Minimum Wage, have you changed any of the following in your business?

%	Hospitality	Social care	Textiles	Hairdressing	Retail	Childcare	Business services	Leisure	Total
Overall staffing levels									
Decreased	47	20	39	40	50	21	28	38	31
No change	52	74	59	53	48	73	65	59	64
Basic hours									
Decreased	41	18	24	38	47	18	23	36	27
No change	57	77	72	58	51	79	73	62	70
Overtime hours									
Decreased	32	18	34	28	36	17	15	31	23
No change	67	77	63	70	63	79	82	67	74
Overtime rates etc									
Decreased	18	12	19	20	22	9	13	19	14
No change	79	78	67	75	72	86	74	76	78
Non-wage benefits									
Decreased	13	8	4	6	10	6	4	10	7
No change	86	91	96	92	89	93	93	90	91

Base: All firms affected by the October 2001 increase in the National Minimum Wage in any way.

16 We also examined the interaction of increased pay bill costs with the impact on staffing. Respondents reporting increases in their pay bill of 5 per cent or more were more likely to have taken action on staffing levels and hours worked. For example 34 per cent of those with an increase in their pay bill of 5 per cent or more reported a decrease in overall staffing levels, compared with 21 per cent of those whose wage bill increased by less than 5 per cent.

Productivity, Prices and Profits

17 Table A4.11 shows the range of adjustments that affected firms made following the October 2001 uprating. Over eight out of ten firms affected by the October 2001 increase in the minimum wage (i.e. around a third of all respondents) reported a reduction in profits, which was the most common change reported. This, together with increasing prices reported by just over three-fifths of firms affected by the uprating, were by far the two most common changes reported. But a significant minority of firms undertook more innovative measures. For example, nearly a quarter of firms in the textiles sector said they increased the use of new technology or processes. Businesses in the retail and hospitality sectors were more likely to increase controls on labour costs. Firms in the business services sector were more likely to increase control of non-labour costs and introduce new technology. Respondents from

the hairdressing sector were more likely to report improvements in the quality of the service they provide and also the introduction of new services. Increasing the use of unskilled/unqualified labour was more likely in the childcare sector.

Table A4.11 Has the October 2001 increase in the National Minimum Wage led to changes in any of the following in your business?

%	Hospitality	Social care	Textiles	Hairdressing	Retail	Childcare	Business services	Leisure	Total
Profits									
Decrease	85	90	82	76	85	81	85	76	84
No change	14	8	14	20	14	17	12	24	14
Prices									
Increase	60	55	31	66	50	80	68	51	62
No change	39	42	61	29	48	19	27	48	35
Measures taken to control labour costs									
Increase	40	22	36	24	40	24	31	23	28
No change	52	72	61	69	53	69	64	73	65
Measures taken to control non-labour costs									
Increase	34	35	32	41	38	32	41	30	35
No change	59	54	63	46	52	56	53	66	55
Use of new technology/processes									
Increase	18	13	22	12	20	12	22	13	15
No change	80	80	75	77	76	82	75	86	80
Quality of goods and services you provide									
Increase	10	8	9	12	7	9	12	9	9
No change	85	82	83	77	86	85	80	81	83
Introduction of new products and services									
Increase	14	6	14	23	14	8	15	8	11
No change	80	81	76	69	77	84	81	86	80
Use of unskilled/unqualified labour									
Increase	15	6	8	13	12	17	9	4	11
No change	82	89	81	78	83	77	86	93	83

Base: All firms affected by the October 2001 increase in the National Minimum Wage in any way.

18 Small firms were generally more likely than larger firms to report 'no change' when asked about the impact of the minimum wage on a range of factors in their business. Small firms were less likely than larger businesses to report that they had increased controls on labour and non-labour costs. For example 18 per cent of respondents with 1 to 9 employees reported that they had increased controls on labour costs compared with 44 per cent of respondents employing 50 or more employees. They were also less likely to increase the use of new technology. Again, respondents reporting increases in their pay bill of 5 per cent or more were more likely to have taken action to improve productivity and control costs. For example 37 per cent of those with an increase in their pay bill

of 5 per cent or more reported an increase in measures taken to control non-labour costs, compared with 29 per cent of those whose wage bill increased by less than 5 per cent. Businesses which reported a significant, rather than a slight, reduction in profits were twice as likely to have increased their prices significantly – 24 per cent compared with 12 per cent. They were also more likely to report a significant increase in controls on both labour costs and non-labour costs.

19 Previous surveys and consultation showed that the textiles sector made particular use of incentive pay schemes. We therefore asked firms in this sector additional questions about the effect of the increase in the minimum wage on incentive schemes and productivity. Two-fifths of respondents in the textiles sector reported that they had an incentive pay system. Fifty-eight per cent of those with incentive schemes said they had been affected by the increase in the minimum wage compared with 22 per cent of those without one. We asked whether firms had felt any of the effects outlined in Table A4.12. As the table shows, for four out of the five possible effects identified, a majority of respondents reported no impact. Even for the remaining factor – increased costs – almost half of respondents said that there had been no impact.

Table A4.12 Impact of National Minimum Wage on Incentive System

%	Significant	Slight	None
Reduced differentials	19	22	59
Reduced competitiveness	19	18	64
Reduced motivation	17	20	63
Reduced productivity	13	16	71
Increased costs	22	29	49

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

20 In our second and third reports we noted the reliance of the social care sector on local authority fees. We therefore sought information on the extent to which businesses in this sector had been able to renegotiate the conditions of public sector contracts following the increase in the minimum wage. Eighty per cent of those affected by the October 2001 increase in the National Minimum Wage in this sector had public sector contracts. Almost three-quarters of these had tried to renegotiate their contracts following the October 2001 increase, but only 13 per cent of those that tried to renegotiate said they were successful. Six out of ten were unable to recoup any of the increase in their pay bill following the increase in the minimum wage, and a quarter could only recoup up to 24 per cent of the increase.

Substitution of Workers

21 We asked firms affected by the October 2001 increase in the National Minimum Wage whether it made them more or less likely to employ exempt workers, those who could be paid the youth Development Rate, or older workers. Overall for each age group around three-quarters of respondents reported that it made no difference, as shown in Table A4.13. The remaining employers were evenly split between those who were more likely and those who were less likely to employ younger workers. For workers aged 22 or over twice as many employers reported that they would be less likely to employ them (15 per cent) compared with those saying they were more likely (8 per cent).

Table A4.13 Has the October 2001 increase made you more or less likely to employ workers in different age groups?

%	Total
Workers aged 16–17	
More likely	11
Less likely	14
No change	75
Workers aged 18–21	
More likely	16
Less likely	15
No change	70
Workers aged 22 or over	
More likely	8
Less likely	15
No change	77

Base: All firms affected by the October 2001 increase in the National Minimum Wage in any way.

22 Firms in the hairdressing sector were most likely to report a change. A third reported that they were now more likely to employ 16–17 year olds, and almost half reported that they were now less likely to employ 18–21 year olds. A third were also less likely to employ older workers. These results support other evidence that hairdressers are looking to employ younger trainees where possible. But this picture appears to be confined to the hairdressing sector. A fifth of employers in the hospitality sector reported that they were more likely to employ workers aged 18–21, while businesses in the textiles and business services sectors were less likely to employ young workers. Sixteen per cent of those businesses with an increase in their pay bill of 5 per cent or more reported that they were less likely to employ staff aged 22 or over, compared with 11 per cent of those who experienced a smaller pay bill impact.

Training

23 Most of the businesses that were affected by the increase in the minimum wage reported that they had provided job-related training to their workers in the last three years (see Table A4.14). No definition of job-related training was provided, so these results are dependent on the individual employer's interpretation of their training provision. Employers in the leisure and textiles sectors were least likely to report that they had trained their staff.

24 We asked employers what the effect of the minimum wage uprating had been on their training provision. Around 70 per cent of respondents affected by the uprating and employing workers in each age group replied that there had been no change to their training provision. Overall, slightly more firms reported that they had increased training than said they had decreased it, and there was virtually no difference in firms' training response for different age groups of workers. Businesses with an increase in their pay bill of 5 per cent or more were more likely to take some action than those with a smaller pay bill impact, and were almost evenly split between those who increased and those who decreased their training provision.

Table A4.14 Provision of Training and Impact of the October 2001 Increase in the National Minimum Wage on Training Provision

%	Provided training in past 3 years	Increased	Decreased	No change
Workers aged 16–17	82	17	15	69
Workers aged 18–21	88	17	13	70
Workers aged 22 or over	84	16	13	71

Base: All firms affected by the October 2001 increase in the National Minimum Wage in any way, and employing workers in the relevant age group at the time of the survey, and providing training to their staff (final three columns only).

Pay Structures

25 All employers were asked if they used age-related pay structures. No definition of an age-related pay structure was provided, so the results are dependent on how individual employers interpret their own pay structure. Use of age-related pay structures ranged from a third of respondents in the hospitality and retail sectors to just 5 per cent in the business services sector, as shown in Table A4.15. Firms employing 16 and 17 year olds were more likely to use age-related pay.

Table A4.15 Firms with Age-related Pay Structures

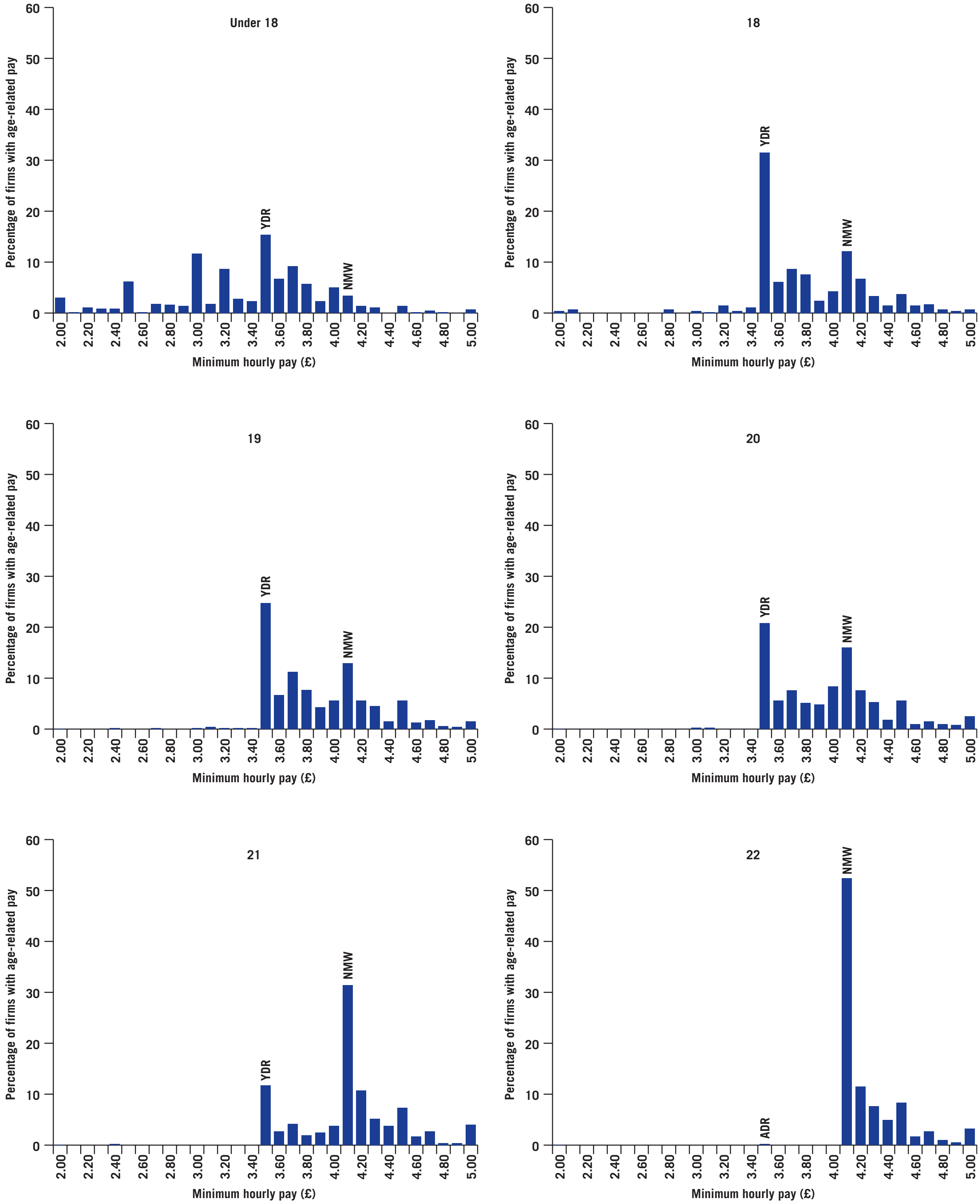
%	Hospitality	Social care	Textiles	Hairdressing	Retail	Childcare	Business services	Leisure	Total
Total with age-related pay	33	15	15	21	33	18	5	13	18
Percentage of firms with adult pay starting at age:									
17	0	0	0	0	0	0	0	0	0
18	11	5	6	6	10	3	1	5	5
19	0	0	0	1	3	0	0	0	1
20	1	0	0	1	2	0	0	0	1
21	10	6	4	6	9	6	2	5	6
22	10	3	3	5	6	6	0	2	4
23	0	0	0	0	0	0	0	0	0

Base: All firms.

26 Some 5 per cent of all firms responding to the survey had age-related pay structures with adult rates starting at 18 or younger. Eighty-eight per cent of all respondents were paying their adult rate at age 18 or younger, and 95 per cent at age 21 or younger. Despite the influence of the age threshold for the adult National Minimum Wage rate only 4 per cent of firms had age-related pay structures with adult rates starting at age 22. Firms that use the youth Development Rate are more likely to pay their adult rate at age 21 or 22 than those that do not use the youth Development Rate.

27 Firms with age-related pay structures were asked about their minimum hourly rates, but we have no information on how many of their employees were paid these rates. Figure A4.1 gives the distribution of minimum pay rates for those firms in the sample with age-related pay structures and employees in the specific age group. It shows that average minimum hourly rates increase steadily with age. The percentage of firms using age-related pay with a minimum hourly pay rate of £4.10 for 20 year olds is 16 per cent, and 21 per cent have a minimum rate of £3.50. The picture is very different for minimum hourly pay rates for those aged 21. By age 21 the percentage of firms with minimum hourly rates of £4.10 has increased markedly, with 31 per cent having a minimum rate of £4.10 and 12 per cent having a minimum rate of £3.50. Twenty-seven per cent of firms with age-related pay structures had a minimum hourly rate of less than £4.10 for 21 year olds (around 3 per cent of all respondents). Minimum pay rates for those aged under 18 were below £3.50 per hour in 46 per cent of firms with age-related pay structures.

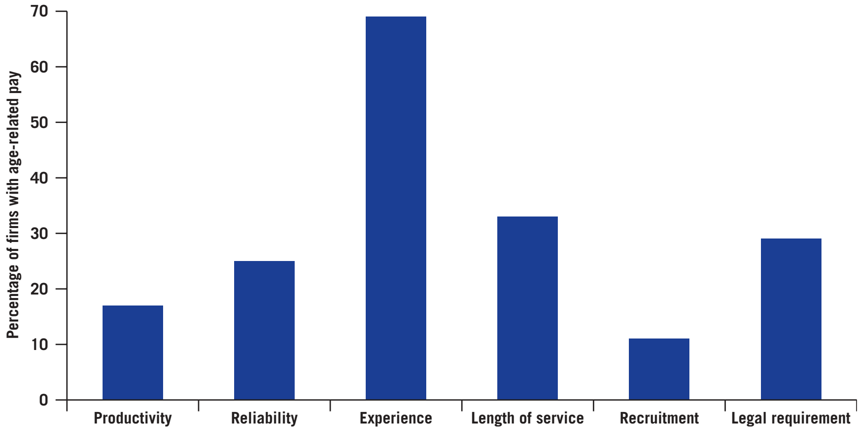
Figure A4.1
Distribution of Minimum Hourly Pay Rates by Age



Note: NMW label shows the adult NMW rate. YDR label shows the youth Development Rate. ADR label shows the older workers' Development Rate.

28 Seven out of ten firms said the reason for using age-related pay systems was to take account of employees' levels of experience (see Figure A4.2). This was by far the most common reason in each sector.

Figure A4.2
Reasons for Age-related Pay



29 Among those firms not using age-related pay the most common basis for differentiating pay was the level of employees' responsibilities (65 per cent), with experience (60 per cent) and qualifications/skills (58 per cent) also figuring strongly. In all sectors these were the three factors most likely to influence pay.

Youth Development Rate

30 Twenty-one per cent of respondents said they used the youth Development Rate (see Table A4.16), with more than a third of firms in the hairdressing sector using it. More than two-thirds of firms used neither the youth Development Rate nor age-related pay. A third of firms currently employing 18–21 year olds reported that they used the youth Development Rate. Three-quarters of firms using the youth Development Rate were affected by the increase in the minimum wage.

Table A4.16 Percentage of Firms Using the Youth Development Rate

Hospitality	Social care	Textiles	Hairdressing	Retail	Childcare	Security	Cleaning	Leisure	Total
28	17	12	37	20	31	6	6	12	21

Base: All firms.

31 Most of the employers using the youth Development Rate reported that it had made no difference to their employment or training of young people, or to the hours that they worked (see Table A4.17). Around one in seven did report that they had increased employment or training for young workers as a result of using it. Firms in the hairdressing sector were most likely to say that they had decreased employment, training and hours worked of 18–21 year olds as a result of using it.

Table A4.17 Changes Made as a Result of Using the Youth Development Rate

%	Increase	Decrease	No change
Employment of workers aged 18–21	16	6	78
Training of workers aged 18–21	15	5	80
Hours of work of workers aged 18–21	9	7	84

Base: All firms using the youth Development Rate.

Older Workers' Development Rate

32 Only 4 per cent of respondents said they used the older workers' Development Rate (see Table A4.18). Employers in the hairdressing sector were most likely to use it, but even there the figure was only 11 per cent. Thirty-six per cent of respondents using this Development Rate said it had enabled them to improve the training they provided.

Table A4.18 Percentage of Firms Using the Older Workers' Development Rate

Hospitality	Social care	Textiles	Hairdressing	Retail	Childcare	Security	Cleaning	Leisure	Total
5	4	1	11	4	7	1	0	1	4

Base: All firms.

33 Firms that had not used the older workers' Development Rate were asked the reasons why. Table A4.19 shows that the most frequently reported reasons were that employers found it difficult to recruit at this lower rate of pay, and also that recruits already had the skills required for the job, and so did not require accredited training. Almost a fifth of respondents not using the older workers' Development Rate reported that they were not aware of it. Businesses in the hospitality, social care and business services sectors were more likely to say that paying trainees less would be unfair or divisive. Firms employing 50 or more employees were more likely to report that it was too difficult to administer accredited training.

Table A4.19 Reasons for Not Using the Older Workers' Development Rate

%	Total
Hard to recruit at this rate of pay	33
Recruits already have the skills needed	32
Not aware of Development Rate	21
Paying trainees less would be unfair/divisive	20
Accredited training not appropriate for this business	11
Development Rate does not make accredited training worthwhile	7
Too difficult to administer accredited training	7

Base: All firms not using the older workers' Development Rate.

Conclusion

34 Our survey provided much valuable information about those sectors most affected by the minimum wage. It complemented the view of the minimum wage we had obtained from our other research projects, written consultation, visits and economic analysis.

35 Fewer than half of the respondents to the survey said that their business had been affected by the October 2001 increase in the minimum wage. Three-quarters of firms affected (around a third of all respondents) reported that their pay bill had increased by at least 5 per cent. The response to our telephone follow-up survey supported our hypothesis that those affected were more likely to respond to the survey and so lead to an upward bias in the results.

36 Firms have undertaken a range of actions to cope with the impact of the minimum wage. Increasing prices was one of the main responses reported, together with a reduction in staffing levels. The results also support evidence we have received from other sources that some firms, especially in the social care sector, have found it difficult to recoup increased costs from their clients.

37 The survey also provided indications of limited use of age-related pay structures – in particular the use of age-related pay scales beyond the age of 21. Eighteen per cent of firms in the sample used age-related pay structures. A third of these firms paid their adult rate from age 18 or younger. Our previous survey found that 22 per cent of firms used age-related pay structures and 10 per cent of all firms paid their adult rate from age 18 or younger. Comparison between the two surveys should be treated with caution due to the different survey populations, but there is not strong evidence from our survey of an increase in the use of age-related pay following the October 2001 increase in the minimum wage.

38 The youth Development Rate was used by a fifth of employers, many of whom saw benefits from it. The older workers' Development Rate was less widely used. The main reasons given for this were that employers found it difficult to recruit at this rate, and that recruits already had the skills required for the job.

NATIONAL MINIMUM WAGE SURVEY

1. **How many workers in total does your business currently employ? How many are men? And how many women?** (Please include all workers - full-time, part-time, and casual staff) (Please insert numbers)

Total ☐ Men ☐ Women ☐

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

Under 18 ☐ 18 to 21 ☐ 22 or over ☐

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

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

4. **Has the October 2001 increase in the National Minimum Wage affected your business in any way?**

Yes *(go to Q5)* ☐ No *(go to Q13)* ☐

5. **What has happened to your TOTAL pay bill as a result of the October 2001 increase in the National Minimum Wage?**

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

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

6. **Have you increased the pay rates of higher-grade staff (e.g. supervisors) to maintain pay differentials as a result of the October 2001 increase in the National Minimum Wage?**

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

b) No ☐ £

7. **Has the October 2001 increase in the National Minimum Wage led to any of the following benefits for your business?** (Please state whether significant, slight or none)

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

8. **As a result of the October 2001 increase in the National Minimum Wage, have you changed any of the following in your business?** (Please tick one box for each potential change)

	Significant Increase	Slight Increase	Slight Decrease	Significant Decrease	No Change
a) Overall staffing levels	☐	☐	☐	☐	☐
b) Basic hours	☐	☐	☐	☐	☐
c) Overtime hours	☐	☐	☐	☐	☐
d) Overtime rates/ incentive payments/ bonuses/commission/ tips etc	☐	☐	☐	☐	☐
e) Non-wage benefits (e.g. meal vouchers, paid breaks etc)	☐	☐	☐	☐	☐

9. **Has the October 2001 increase in the National Minimum Wage led to changes in any of the following in your business?** (Please tick one box for each potential change)

	Significant Increase	Slight Increase	Slight Decrease	Significant Decrease	No Change
a) Profits	☐	☐	☐	☐	☐
b) Prices	☐	☐	☐	☐	☐
c) Measures taken to control labour costs (e.g. treatment of absence, paid breaks, staff meals, overtime rates)	☐	☐	☐	☐	☐
d) Measures taken to control non-labour costs (e.g. costs of supplies, distribution and marketing costs, improved stock control)	☐	☐	☐	☐	☐
e) Use of new technology/processes	☐	☐	☐	☐	☐
f) Quality of goods and services you provide	☐	☐	☐	☐	☐
g) Introduction of new products or services	☐	☐	☐	☐	☐
h) Use of unskilled/ unqualified labour	☐	☐	☐	☐	☐

10. **Has the October 2001 increase in the National Minimum Wage made you more or less likely to employ workers in different age groups?** (Please tick one box for each age group)

	More likely	Less likely	No change
Workers aged 16–17	☐	☐	☐
Workers aged 18–21	☐	☐	☐
Workers aged 22 or over	☐	☐	☐

11. **Have you provided job-related training to your workers in the last three years?**

	Yes	No
Workers aged 16–17	☐	☐
Workers aged 18–21	☐	☐
Workers aged 22 or over	☐	☐

12. **As a result of the October 2001 increase in the National Minimum Wage has the amount of training you provide to your workers increased or decreased?** (Please tick one box for each age group)

	Significant Increase	Slight Increase	Slight Decrease	Significant Decrease	No Change
Workers aged 16–17	☐	☐	☐	☐	☐
Workers aged 18–21	☐	☐	☐	☐	☐
Workers aged 22 or over	☐	☐	☐	☐	☐

13. **Do you have age-related pay structures?**

Yes *(go to Q14)* ☐ No *(go to Q17)* ☐

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

15. **Enter the current minimum hourly rates for workers in each of the following age groups in your business. If you have no workers in any age band please leave blank.** (Please write in pounds and pence)

16/17 £ 18 £ 19 £ 20 £

21 £ 22 £ 23 or over £

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

Productivity ☐ Reliability ☐ Experience ☐

Length of service ☐ Recruitment ☐ Legal requirement ☐

Previous Wage Council practice ☐ Other ☐

Please specify..

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

Experience ☐ Qualifications/skills ☐ Responsibilities ☐

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

Other ☐

Please specify..

18. **Do you make use of the Development Rate for workers aged 18–21 (i.e. pay less than £4.10 but at least £3.50)?**

Yes *(go to Q19)* ☐ No *(go to Q20)* ☐

19. As a result of using the Development Rate for workers aged 18–21, have you changed any of the following in the business? (Please tick one box for each potential change)

	Significant Increase	Slight Increase	Slight Decrease	Significant Decrease	No Change
a) Employment (of workers aged 18–21)	☐	☐	☐	☐	☐
b) Training (of workers aged 18–21)	☐	☐	☐	☐	☐
c) Hours of work (of workers aged 18–21)	☐	☐	☐	☐	☐

20. Do you make use of the Development Rate for workers aged 22 or over (i.e. pay less than £4.10 but at least £3.50)?

Yes *(go to Q21)* ☐ No *(go to Q22)* ☐

21. As a result of using the Development Rate for workers aged 22 or over have you increased the amount or quality of training you provide?

Yes ☐ No ☐

22. There could be a number of reasons why employers do not use the Development Rate for workers aged 22 or over. Some are listed below. Please tick which, if any, are applicable in your case.

Recruits already have the skills needed	☐	Hard to recruit at this rate of pay	☐
Not aware of Development Rate	☐	Accredited training not appropriate for this business	☐
Too difficult to administer accredited training	☐	Paying trainees less would be unfair/divisive	☐
Development Rate does not make accredited training worthwhile	☐	Other (Please specify)	☐

23. **We would find helpful any other comments that you might have about your experience of the National Minimum Wage. Please put these on a separate sheet if necessary. All your comments will be read.**

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Additional Questions for the Social Care Sector

24. Does your business provide services to the public sector?

Yes ☐ No *(go to Q27)* ☐

25. Did you seek to renegotiate the conditions of your public sector contract as a result of the October 2001 increase in the National Minimum Wage?

Yes ☐ No *(go to Q27)* ☐

26. Were you successful in renegotiating the contract?

Yes ☐ No ☐ In part ☐

27. What percentage of the increase in your pay bill due to the October 2001 increase in the National Minimum Wage were you able to recoup through negotiation?

None ☐ 1 to 24% ☐ 25 to 49% ☐

50 to 74% ☐ 75 to 99% ☐ 100% ☐

Additional Questions for the Textiles Sector

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

Yes *(go to Q24)* ☐ No *(go to Q25)* ☐

29. What impact has the October 2001 increase in the National Minimum Wage had on your incentive system? (Please state whether significant, slight or none)

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

APPENDIX

5 Minimum Wage Systems in Other Countries

An Overview

1 This appendix presents updated information on minimum wage systems in the other countries we examined in our previous reports. We also report progress on proposals for a minimum wage in Jersey. We are grateful to the Organisation for Economic Co-operation and Development (OECD) and a number of British Embassies and High Commissions for their assistance with our research.

2 Table A5.1 compares minimum wage levels across countries. As noted in previous reports we need to be cautious about direct comparisons: there are differences between countries in the definitions of what counts towards the minimum wage, the definitions of earnings used, the age coverage and the sectors covered. In addition minimum wage rates are set at different dates from country to country, making comparisons at a single point in time difficult. Table A5.2 compares minimum wage levels across countries as a percentage of full-time median earnings. Again caution should be exercised in making direct comparisons since the figures will favour those countries which had uprated their minimum wage in the first half of 2002.

3 In previous reports we highlighted the approaches adopted across countries for uprating their minimum wages, for enforcing the provisions and for the treatment of young people. This information has been updated in Tables A5.3–A5.5 respectively. The only significant developments to the minimum wage systems have taken place in Jersey, New Zealand and the Netherlands, and these are outlined below.

Specific Country Updates

Jersey

4 An overall strategy dealing with employment legislation in the Island is intended to come into force during 2003. Part of the strategy will include the introduction of a minimum wage system, which will closely follow that of the UK.

5 The Employment Forum (an independent body broadly based on the Low Pay Commission) is considering the level at which the minimum wage should be set initially and the operation of the system. It is proposed that all those aged 16 and over who are employed for more than eight hours each week will receive the full rate. Those on accredited training programmes will be entitled to a 'trainee rate' for a maximum period of one year, but it will only apply to employees starting a job with a new employer. Accommodation is the only benefit in kind which will count towards Jersey minimum wage pay.

New Zealand

6 Under the Minimum Wage Act 1983, the Government is obliged to review the minimum wage rate annually. A youth rate was introduced in 1994 and in 2001 the age bracket was changed from 16–19 years old to 16–17 years old. At the same time the eligible age for the adult minimum wage was reduced from 20 to 18 years.

7 Currently employees undertaking a set level of training may be paid below the relevant minimum wage. Legislation currently before Parliament will allow the Government to set a training minimum wage, which is intended to be set at the level of the youth minimum wage.

8 Disabled people employed by approved sheltered workplaces are currently not entitled to the minimum wage. The Government has announced its intention to remove this exemption, but people employed in sheltered workplaces whose productivity is not sufficient to earn the minimum wage will be able to apply for an under-rate worker's permit. These permits are available under the Minimum Wage Act and set a minimum wage for the individual worker at a rate less than the standard minimum wage, based on productivity. There will be a five-year transition period.

The Netherlands

9 A proposal is being discussed in the Lower House of Parliament to abolish any offsets to the minimum wage. At present several deductions are possible, including for accommodation and meals. The earliest introduction date will be 2004.

10 The Hague court ruled in December 2002 that working youths aged 13 and 14 were entitled to a minimum wage. The judge gave the State one and a half years to develop a minimum wage for this age group. It is not known how the State will respond, but in the meantime the trade union federations propose to adopt the minimum wage for 15 year olds.

Comparisons of Minimum Wage Systems

Table A5.1 Comparison of Level of Minimum Wages[a] Across Countries, end 2002

	In national currency[b]		In UK £, using:		Date of last uprating
			Exchange rates[c]	PPPs[d]	
Australia[e]	Aus $10.79	(431.4/week)	3.79	5.12	May 2002
Belgium	€6.71	(1163/month)	4.23	4.74	1 February 2002
Canada[f]	Can $6.90		2.81	3.67	– [g]
France	€6.83		4.31	4.74	1 July 2002
Greece	€2.79	(22.35/day)	1.76	2.47	1 July 2002
Ireland	€6.35		4.00	4.12	1 October 2002
Japan[h]	Yen 664		3.53	2.66	2002
Netherlands	€7.11	(1231.8/month)	4.48	5.02	1 July 2002
New Zealand	NZ $8.00		2.42	3.65	18 March 2002
Portugal[i]	€2.01	(348.01/month)	1.27	1.90	1 January 2002
Spain[i]	€2.55	(442.2/month)	1.61	2.14	December 2001
United Kingdom	£4.20		4.20	4.20	1 October 2002
United States	$5.15		3.31	3.49	1997

Sources: OECD Minimum Wage Database; for exchange rates and PPPs, OECD, Main Economic Indicators; British Embassies and High Commissions for dates of last uprating.

Notes:
a. In all cases, the minimum wage refers to the basic rate for adults.
b. For countries where the minimum wage is not expressed as an hourly rate, OECD converts it to an hourly basis assuming a working time of 8 hours per day, 40 hours per week and 173.3 hours per month.
c. Average of daily rates for September 2002.
d. Purchasing Power Parities (PPPs) for private consumption as of September 2002.
e. Federal minimum wage.
f. Weighted average of provincial rates.
g. Date of last uprating varies between province. For example the rate was last increased on 1 November 2002 in Saskatchewan and 1 April 1995 in Ontario.
h. Weighted average of prefectural rates.
i. Not including annual supplementary pay of two additional months of salary.

Table A5.2 Adult Minimum Wages as a Percentage of Full-time Median Earnings (Men and Women), mid 2002[a]

	Percentage
France	62.1
Australia[b]	
– LFS	58.4
– ES	54.9
New Zealand	52.9
Ireland	50.6
Netherlands	47.5
United Kingdom[c]	44.7
Canada	41.9
Portugal	40.0
Greece[d]	38.5
United States	33.9
Japan	32.3
Spain	29.6

Sources: Minimum wages and mean and median earnings for full-time workers: OECD estimates and OECD earnings structure database.

Notes:
a. In all cases, the minimum wage refers to the basic rate for adults whereas the data for median earnings include supplementary pay such as for overtime and other monthly and annual bonuses. In some cases, the median earnings data for full-time workers for mid 2002 are estimates based on extrapolating data for earlier years in line with other indicators of average earnings growth. All earnings data are gross of employee social security contributions.
b. Two estimates of median earnings are available based on either the Labour Force Survey (LFS) or an enterprise survey (ES). In each case, the data refer to weekly earnings. The minimum wage refers to the Federal Minimum Wage.
c. LPC calculation.
d. Data refer to manufacturing workers only.
e. Figure unavailable for Belgium. Information from the British Embassy in Belgium indicated that on the basis of October 1999 data the minimum wage represented 56.8 per cent of gross median earnings.

Table A5.3 Uprating of Minimum Wages

Country	Method of uprating
Australia	Independent body (Australian Industrial Relations Commission) is responsible for setting minimum 'safety net' rates for awards and the Federal Minimum Wage. Reviews are triggered by the Australian Council of Trade Unions and usually, but not necessarily, take place each year. Reviews consider economic factors and the needs of the low paid.
Belgium	The minimum monthly average guaranteed income is set for the private sector by a collective employment agreement reached at the National Labour Council (social partners).
Canada	Uprating is generally based on recommendations from provincial Labour Ministries from time to time, taking into account cost of living and views of employers and employees. The recommendations are reviewed and voted on by the provincial Parliament. In Quebec the rate is reviewed annually based on 11 indicators, including the ratio between the minimum wage and the average hourly wage.
France	Uprating takes place annually, at least in line with a statutory minimum indicated by a formula. Uprating is calculated on the basis of the annual rate of price increases (excluding tobacco) in the year to May, added to half the value of the averaged increase in hourly purchasing power of manual workers in the first quarter.
Greece	Minimum wages are increased every six months or every year, depending on the two-year National General Collective Labour Agreements. They are the result of negotiations between the social partners and uprating takes account of the anticipated level of inflation and other factors (including the national level of productivity).
Ireland	There is no automatic mechanism for uprating the minimum wage, which has so far been agreed in negotiation between the social partners at national level and incorporated into the national Programme for Prosperity and Fairness.
Japan	The system operates regionally. The minimum wage is reviewed and amended each Autumn. Regional Minimum Wage Councils, comprising representatives of labour unions, employees and public agencies, make a proposal based on their consideration of cost of living, salary of workers in similar industries, and the financial capability of employers. The final decision is made by the Director of the Regional Labour Standard Agency.
Netherlands	The Ministry of Social Affairs uprates twice yearly (1 January and 1 July) taking account of the increase in average wages, unless wages and/or the social security bill have risen too fast. If the ratio between the number of people claiming social benefits (including unemployment benefit and pensions) and the number of people working exceeds the level of 82.6 per cent, the Government may decide not to link the wage to average contractual wage increase (as it did between 1993 and 1996). If the ratio is lower than 82.6 per cent (as has happened since 1996), the minimum wage must be linked to wage growth. The minimum wage system is evaluated every four years, mainly to consider whether the level is too high or too low compared with average earned wages and labour market circumstances. The next evaluation will be in 2003.
New Zealand	The Minister of Labour conducts annual reviews in accordance with the Minimum Wage Act. The review considers the effectiveness of the minimum wage in meeting its objectives and there are set criteria for reviewing changes to the minimum wage. The Minister invites submissions from New Zealand Council of Trade Unions and Business New Zealand, as well as other organisations, as part of the review.
Portugal	An Inter-Ministerial annual review considers the social and economic effects of the minimum wage. This includes the expected inflation rate and productivity levels. Following consultation with the social partners, the wage is usually uprated annually and implemented from January of each year.
Spain	The Government uprates annually following consultation with the social partners. The Government is obliged to take account of inflation, average national productivity, participation levels and general economic conditions.
UK	Uprating takes place periodically. Government considers recommendation from an independent Commission, which reports following wide-ranging consultation and consideration of the effects on the economy, sectors and groups of workers.
US	Changes are voted on by Congress intermittently.

Source: British Embassies and High Commissions.

Table A5.4 Enforcement of Minimum Wages

Country	Method of enforcement
Australia	In the Federal jurisdiction complaints are lodged with the Department of Employment and Workplace Relations and are investigated by inspectors. Employees can also refer to a Small Claims Court. Similar processes apply in State jurisdictions. An estimated 220,000 full-time adult employees, excluding working proprietors, earn below the federal minimum weekly wage.[a]
Belgium	Labour inspectorate.
Canada	Labour inspectorate. Usually the employee contacts the Labour Board and files a claim for lost wages, then the problem is investigated. The inspectorate can perform random investigations.
France	Labour inspectorate (which is also responsible for general conditions of work, health and safety). There are approximately 500 inspectors and 2,000 assistants. They carry out random checks and investigate complaints from trade unions and individual employees.
Greece	Labour inspectorate. Employers can be sued by employees, who have to pay their own costs, or by inspectors.
Ireland	Labour inspectorate carries out inspections, both routine and in response to complaints. Seven new minimum wage inspectors were recruited in late 2000 to join ten existing inspectors. An employee may instead opt to bring a complaint to a Rights Commissioner for investigation.
Japan	Labour inspectorate.
Netherlands	Labour inspectorate periodically reports on the application of the minimum wage in practice. Employers are informed of pay salaries below the minimum wage but the Labour inspectorate is not able to take employers to court; the employee must do this.
New Zealand	Labour inspectorate may take action in the Employment Relations Authority or the Employment Court to recover wages owing. Alternatively Labour Inspectors may issue a demand notice demanding that the employer pays monies to an employee as assessed by the Labour Inspector. Complaints received from a person other than the employee are proactively investigated. According to the June 2002 Income Supplement to the Household Labour Force Survey 43,100 people reported earnings less than the applicable minimum wage.[b]
Portugal	Labour inspectorate.
Spain	Labour inspectorate (which also has the power to enforce a wide range of labour issues, including collectively-bargained rates). It can fine employers; or the employee can take the case to tribunal to obtain back pay. Labour inspectorate is both reactive and proactive. There are around 600 inspectors and 800 assistants, stationed on a provincial basis.
UK	Inland Revenue is the enforcement agency. Conducts both proactive, targeted enforcement and investigation of complaints. Employees also have the right to take their case to an Employment Tribunal.
US	Wage and Hour Division in Department of Labor. Both pursues complaints and investigates likely areas of non-compliance. There is a team of approximately 950 inspectors, spread over 54 offices.

Source: British Embassies and High Commissions.

Notes:
a. According to unpublished data from the Australian Bureau of Statistics (Employee, Earnings and Hours catalogue).
b. Figure should be treated with caution. For example some people may be legitimately receiving less than the minimum wage and some will misreport their earnings.

Table A5.5 Age Variations Under Minimum Wage Systems

Country	Treatment by age
Australia	Full minimum wage at 21 in most awards. Below 21 a sliding scale applies from age 16 (40–50 per cent of the minimum wage) through age 18 (65–80 per cent) to age 20 (85–100 per cent). The remainder of awards provide the full minimum at 18, 19 or 20, or provide the full minimum to all ages.
Belgium	Full minimum wage applies at age 21. An additional premium is payable to workers aged 21½ who have been employed for at least six months and to workers aged 22 who have been employed for at least 12 months. There is a 6 per cent deduction from the minimum wage for each year below age 21, with those aged 16 or under receiving 70 per cent of the full rate.
Canada	Full minimum wage at all ages except in Ontario, the North West Territories, Nunavut and the Yukon. Both British Columbia and Nova Scotia have introduced a first job/entry-level wage rate for workers new to the paid labour market.
France	Full minimum wage at 18. Workers aged 16 receive 80 per cent; workers aged 17 receive 90 per cent (both for first six months only, then the full rate). Percentage of minimum wage paid on some Government assisted employment training contracts.
Greece	Full minimum wage at 15 (but variation depending on length of their employment).
Ireland	Full minimum wage two years after first employment acquired after the age of 18 unless undergoing structured training. All employees under age 18 are entitled to 70 per cent of the full adult rate.
Japan	Full minimum wage at 18. Under 18s and over 65s usually receive the lower regional minimum wage rather than the sectoral rate.
Netherlands	Full minimum wage at 23. Youth rates are 30 per cent at 15, 34.5 per cent at 16, 39.5 per cent at 17, 45.5 per cent at 18, 52.5 per cent at 19, 61.5 per cent at 20, 72.5 per cent at 21, and 85 per cent at 22.
New Zealand	Full minimum wage at 18. 16–17 year olds get 80 per cent of the main rate. Youth rate only introduced in 1994; young workers previously exempt.
Portugal	Full minimum wage at all ages. Exception is apprentices and trainees in qualified or highly qualified jobs, who can receive 80 per cent for up to a year, or six months if the course is technical/professional.
Spain	Full minimum wage at 16.
UK	Full minimum wage at 22. 18–21 year olds receive a lower rate. 16–17 year olds are exempt.
US	Full minimum wage at all ages, except below 20 where lower rate can apply (approximately 80 per cent of full minimum wage) for first 90 days in the job.

Source: British Embassies and High Commissions.

Table A5.6 Youth Minimum Wages as Percentage of Adult Minimum Rates, end 2002

Country	Percentage at age 16	Percentage at age 17	Average percentage at ages 18/19
Australia[a]	50	60	75
Belgium	70	76	86.4
Canada	100[b]	100[b]	100
France[c]	80	90	100
Greece	100	100	100
Ireland	70	70	85
Japan[d]			
Netherlands	34.5	39.5	49
New Zealand	80	80	100
Portugal[e]	100	100	100
Spain	100	100	100
UK	Exempt	Exempt	86
US[f]	82.3	82.3	82.3

Source: OECD and British Embassies and High Commissions.

Notes:
a. Actual rates vary according to individual awards. This example uses the rates applicable to a key award in retail, a major employer of young people, and is broadly indicative of youth minimum wages generally.
b. In most provinces.
c. The reduced rates apply only to youth with tenures of less than six months.
d. Varies by prefecture.
e. Except for apprentices and trainees, as explained in Table A5.5.
f. The reduced rates apply only to youth with tenures of less than three months.

APPENDIX 6

Sectoral Employment and Earnings Data

Trends in Employee Jobs in Low-paying Sectors

Figure A6.1
Retail (SIC 52)

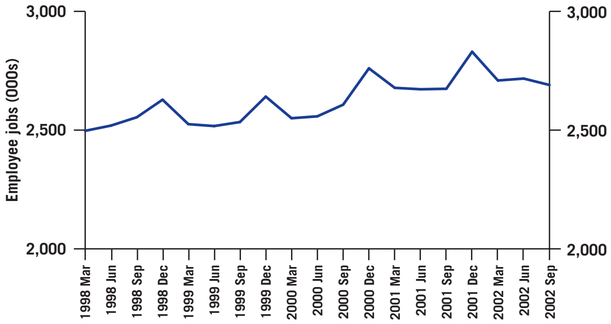


Figure A6.2
Hospitality (SIC 55)

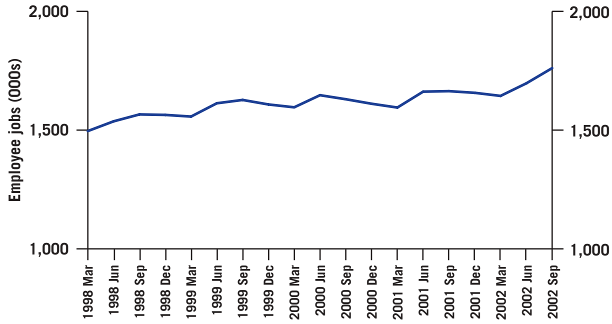


Figure A6.3
Cleaning (SIC 74.7)

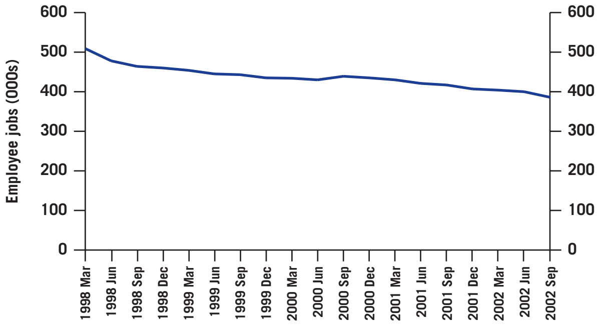


Figure A6.4
Security (SIC 74.6)

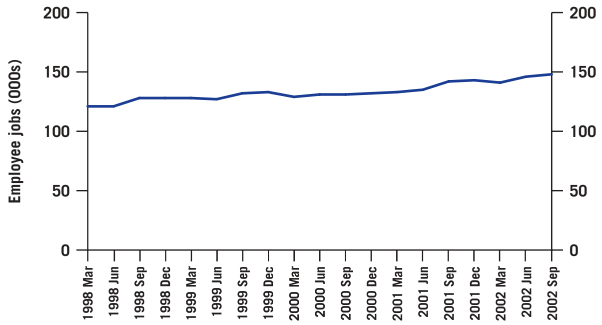


Figure A6.5
Social Care with Accommodation (SIC 85.31)

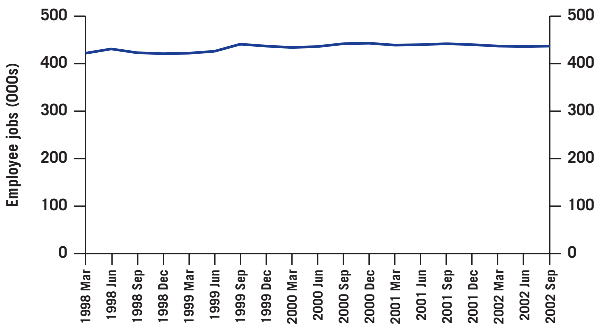


Figure A6.6
Manufacture of Textiles (SIC 17) and Manufacture of Clothing and Footwear (SIC 18 and 19.3)

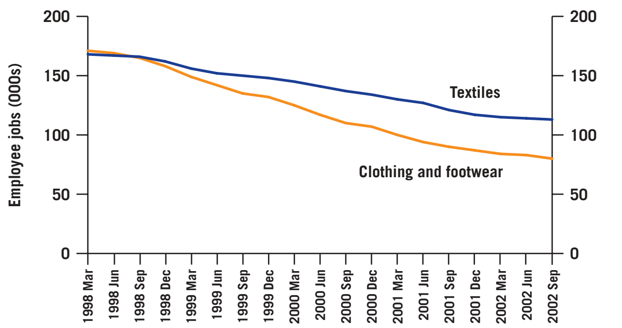
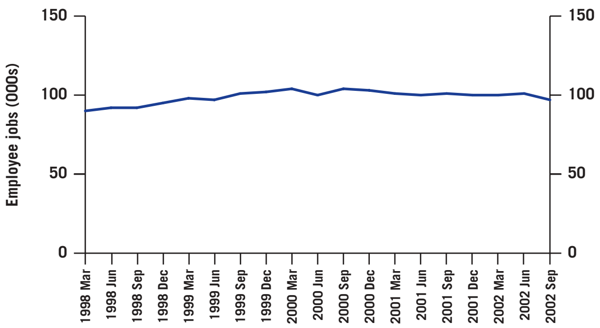


Figure A6.7
Hairdressing and Beauty (SIC 93.02/93.04)



Source: ONS employee jobs series, 1998–2002, GB.
Note: Data are not seasonally adjusted.

Trends in Hourly Earnings

Table A6.1 Hourly Earnings Distribution for Those Aged 18 and Over in Low-paying Sectors, April 2000–2002

	Rates (£ per hour)			Percentage increase	
	2000	2001	2002	2000/01	2001/02
Retail					
Lowest decile	3.85	4.00	4.21	4.0	5.3
Median	4.91	5.14	5.28	4.6	2.7
Mean	6.27	6.55	6.83	4.6	4.2
Hospitality					
Lowest decile	3.60	3.70	4.10	2.8	10.8
Median	4.34	4.60	4.90	6.0	6.5
Mean	5.53	5.82	6.01	5.1	3.3
Cleaning					
Lowest decile	3.60	3.70	4.10	2.8	10.8
Median	4.48	4.57	5.00	2.0	9.4
Mean	5.42	5.62	6.09	3.8	8.3
Security					
Lowest decile	3.70	4.00	4.30	8.1	7.5
Median	5.40	5.67	6.00	4.9	6.0
Mean	6.33	6.65	6.93	5.0	4.2
Social care					
Lowest decile	3.66	3.88	4.22	5.9	8.6
Median	5.12	5.63	5.85	10.0	3.9
Mean	6.22	6.58	7.05	5.8	7.2
Childcare occupations					
Lowest decile	3.87	4.03	4.26	4.3	5.6
Median	4.89	5.10	5.34	4.4	4.4
Mean	5.33	5.57	5.80	4.6	4.0
Manufacture of textiles					
Lowest decile	4.14	4.25	4.46	2.6	4.9
Median	5.93	6.09	6.43	2.7	5.7
Mean	7.18	7.62	8.10	6.1	6.2
Manufacture of clothing and footwear					
Lowest decile	3.71	3.81	4.11	2.9	7.7
Median	5.27	5.54	5.72	5.1	3.3
Mean	6.42	7.11	7.10	10.7	-0.1
Hairdressing					
Lowest decile	3.32	3.49	4.03	5.1	15.5
Median	4.32	4.69	5.00	8.5	6.7
Mean	4.93	5.44	5.75	10.3	5.7

Source: Grossed NES, April 2000–2002.

Note: Childcare occupations' results are based on SOC 65 (Childcare and related occupations), whereas the other data relate to specific low-paying sectors.

Abbreviations

ACAS	Advisory, Conciliation and Arbitration Service
ADR	Adult/Older Workers' Development Rate
AEI	Average Earnings Index
BATC	British Apparel & Textile Confederation
BHPS	British Household Panel Survey
BRC	British Retail Consortium
BSA	Business Services Association
CAB	Citizens Advice Bureau
CE	Central Estimate
CROW	Customer Responsive Outreach Work
CSSA	Cleaning and Support Services Association
DfES	Department for Education and Skills
DTI	Department of Trade and Industry
ECHR	European Court of Human Rights
EMA	Education Maintenance Allowances
ES	Enterprise Survey
FEA	Fair Estimate Agreement
FTE	Full-time Education
GB	Great Britain
GCSE	General Certificate of Secondary Education
GDP	Gross Domestic Product
GP	General Practitioner
IDS	Incomes Data Services Ltd
IFS	Institute for Fiscal Studies
IR	Inland Revenue
IRS	Industrial Relations Services
IS	Income Support
JoFIT	Joint Fashion Industry Team
JoSET	Joint Shadow Economy Team
JSA	Job Seeker's Allowance
KFAT	National Union of Knitwear, Footwear and Apparel Trades
LFS	Labour Force Survey
LPC	Low Pay Commission
MDR	Marginal Deduction Rate
MORI	Market and Opinion Research International
NES	New Earnings Survey
NGH	National Group on Homeworking
NHS	National Health Service
NI	National Insurance
NICs	National Insurance Contributions
NMW	National Minimum Wage
NVQ	National Vocational Qualification
OECD	Organisation for Economic Co-operation and Development
ONS	Office for National Statistics
PA	Pension Age
PAYE	Pay As You Earn
PPP	Purchasing Power Parity
RPI	Retail Prices Index
RPIX	Retail Prices Index excluding mortgage interest payments
SIC	Standard Industrial Classification
SMEs	Small and Medium-sized Enterprises
SOC	Standard Occupational Classification
SSRG	Sample Surveys Research Group
SVQ	Scottish Vocational Qualification
TIGER	Tailored Interactive Guidance on Employment Rights
TUC	Trades Union Congress
UK	United Kingdom
US	United States of America
Usdaw	Union of Shop, Distributive and Allied Workers
WTC	Working Tax Credit
YDR	Youth Development Rate

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