MORE THAN A MINIMUM

The Resolution Foundation Review of the Future of the National Minimum Wage: **The Final Report**

Resolution Foundation

BARROW CADBURY

Contents

Chair's Foreword 5

Executive Summary 7

Summary of Recommendations 12

SECTION 1 – LESSONS LEARNED 15

Chapter 1 – Evidence on impacts **16**
Chapter 2 – Evaluating today's approach **26**

SECTION 2 – BUILDING ON SUCCESS 34

Chapter 3 – A broader approach to low pay **35**
Chapter 4 – A more far-sighted minimum wage **40**
Chapter 5 – A more assertive approach with new tools **48**

Conclusion 54

Acknowledgements

The panel would like to thank the wide range of experts who have given advice throughout the project, including Professor Jeff Borland, Professor William Brown, David Coats, Dan Corry, Matt Cowgill, Professor Richard Dickens, Donald Hirsch and Professor David Metcalf. We are grateful for conversations with representatives from the Federation of Small Businesses, the Confederation of British Industry and the Trades Union Congress, and to those who attended a roundtable to discuss our developing ideas in December 2013.

The panel's work has been hosted by the Resolution Foundation. Alex Hurrell and Giselle Cory led the analysis of sectors and provided analytical support to the project throughout. Conor D'Arcy supported the project and provided an essential contribution to the interim and final report. James Plunkett oversaw the work.

The work received the generous support of the Barrow Cadbury Trust, an independent, charitable foundation committed to bringing about socially just change. The Trust provides grants to grassroots community groups and campaigns working in deprived communities in the UK, with a focus on Birmingham and the Black Country. The Trust also works with researchers, think tanks and government, often in partnership with other grant-makers, seeking to overcome the structural barriers to a more just and equal society.

Expert panel membership

Professor Sir George Bain (CHAIR) *founding Chair of the Low Pay Commission and former President and Vice-Chancellor of Queen's University Belfast*

Professor Paul Gregg *Professor of Economic and Social Policy and Director of the Centre for Analysis and Social Policy, University of Bath*

Professor Alan Manning *Professor of Economics and former Head of the Economics Department, London School of Economics*

Dr Abigail McKnight *Senior Research Fellow at the Centre for Analysis of Social Exclusion (CASE) at the London School of Economics*

Professor Karen Mumford *Professor of Economics at the University of York and Chair of the Royal Economic Society Women's Committee*

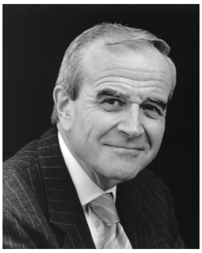
Dr John Philpott *Director, The Jobs Economist consultancy*

James Plunkett *Director of Policy and Development, Resolution Foundation*

Nicola Smith *Head of Economic and Social Affairs Department, Trades Union Congress*

Tony Wilson *Director of Policy, Centre for Economic and Social Inclusion*

Chair's Foreword



The UK's minimum wage turns fifteen this year. As the chair of the Low Pay Commission that set the first rate, I did not think it would survive this long. In 1999 when the minimum wage became law, the business community was roundly opposed, opponents predicted two million unemployed, and the House of Commons was divided. We felt engaged in an embattled experiment.

Today's context could hardly be more different. The minimum wage enjoys broad political support and the academic consensus shows clearly that it boosted earnings without causing unemployment. Low pay itself has changed too. When we started our work fifteen years ago, I remember seeing jobs advertised paying £1 an hour. Such extremes are now all but eliminated. Yet the more general problem of low pay remains. Five million workers in the UK are low paid – one in five of the total workforce, a figure that has barely dipped in the last decade and a half.

I decided to chair this review because it is time to reflect on what the minimum wage did and did not achieve, and to think about where the policy should go next. The minimum wage was one of the most radical policy interventions of modern times, yet while over one hundred empirical studies have been published to investigate its effects, its design has never been reviewed in the round. Far from protecting the policy, this lack of reflection risks allowing the minimum wage to lose relevance. Indeed, it would be surprising if the settlement built fifteen years ago was right for these different times.

For the past nine months I have worked with a panel of leading academic and policy experts, exploring whether there are practical ways in which the minimum wage could be strengthened while – crucially – not putting at risk what has already been achieved. At the outset of the work, I did not know if this could be done. I now think it can. The judicious reforms we recommend in this report would retain the core of the late 1990s settlement, but strengthen it for new times.

Not everyone will agree with our proposals. Some will say they ask too much of the minimum wage and the Low Pay Commission. Perhaps more common will be the response that they do not go far enough given the scale of low pay. My own view is that they represent a sensible middle ground, building on the foundations of the minimum wage a broader, more far-sighted and more assertive approach, better equipped to take on today's challenge of low pay.

Professor Sir George Bain
Chair of the Low Pay Commission, 1997/98 – 2001/02 and 2008/09

Executive summary

This is the final report of the Resolution Foundation's review of the future of the National Minimum Wage. The review has worked for the past nine months under the chairmanship of Professor Sir George Bain, the founding chair of the Low Pay Commission, exploring whether the minimum wage and its supporting architecture could do more to tackle Britain's pervasive problem of low pay. This report sets out the collective views of the expert panel that has led the work and arises from primary and secondary analysis and conversations with academics, employer organisations and unions.

Since we began our work, interest in the minimum wage has grown. The system that was established in 1998 is now more than ever in flux. There is a growing acceptance that the late 1990s settlement that served the policy so well in its first fifteen years falls short of what is now needed. Recent interventions by the Chancellor, the Secretary of State for Business and the Low Pay Commission (LPC) itself have suggested the need for a stronger or more ambitious framework for the National Minimum Wage (NMW). But these interventions have so far been ad hoc: they do not amount to a new policy and there has been no official review of the National Minimum Wage and the Low Pay Commission, or what should come next. The purpose of this report is to set out proposals that strengthen the minimum wage more formally, giving the policy renewed relevance in the coming years.

Now is the right time to do this work, not least because the basic arguments about the minimum wage are largely settled. As Chapter 1 shows, we now know beyond any reasonable doubt that the minimum wage boosted earnings considerably without causing unemployment. Employers did not simply fire people in response to the minimum wage; they were smarter than this. They adapted through other channels, adjusting profits and pricing strategies, changing pay differentials and, in low paying sectors, boosting productivity. The simple lesson of the last fifteen years is that a successful strategy to tackle low pay will need two pillars: new efforts to raise the productivity of low paid workers, and judicious policies to push employers to pay more where they can afford to, especially in buoyant labour markets.

As we show in Chapter 2, the success of the minimum wage owes much to the policy's careful design. The 1998 settlement was intentionally cautious. The Low Pay Commission did not bite off too much; it focused on the narrow, technical (and difficult) task of setting Britain's first minimum wage. It took things one step at a time; its overriding concern was to keep the minimum wage alive through its vulnerable infancy and not to worry overly about the long-term. And beyond the NMW it stayed hands-off: its purpose was to eliminate extreme low pay, not to worry about whether employers went beyond this legal obligation or to be concerned about the wider incidence of low pay. This reflected in part the government's wider economic strategy, in which other tools, notably tax credits, were used aggressively to address the wider issues of low earnings and incomes.

Today's world is different in fundamental ways: the minimum wage has widespread support; there is a deep evidence-base; low pay itself has changed; and this government and the next one are likely to be severely constrained by fiscal pressures. As a result, some of the minimum wage's initial strengths are now weaknesses. Three stand out when we assess the settlement afresh in 2014.

First, the LPC's work, and the government's wider work on low pay, is simply too narrow. The LPC is better described as a Minimum Wage Commission; it has never been asked to even measure low pay. This focus made sense in the late 1990s, when a third of low paid workers were in extreme low pay. But more than nine in ten low paid workers (91 per cent) now earn between the minimum wage and the £7.71 low pay threshold – two-thirds of the median hourly wage - putting them in effect out of the reach of today's settlement. This limitation is not just a feature of the LPC's remit: it reflects the lack of any wider strategy to tackle low pay under current and previous governments.

Second, the LPC's one-step-at-a-time process for setting the minimum wage now seems too short-sighted. Most immediately, this short-sightedness creates uncertainty for employers. The NMW is announced barely six months before it comes into force. More fundamentally, the minimum wage as a whole lacks direction. In its effort to keep politics out of the NMW, the government has fallen into a strange neutrality about the minimum wage: there is no official preference over whether it rises or falls. This leaves the policy rudderless. The LPC is only asked to describe the labour market as it sees it today, not to advise the government on how to make a higher minimum wage possible. Ad hoc political interventions to encourage a higher NMW are one result of this formal lack of direction.

Third, the LPC's focus on extreme low pay is too restricted, inadvertently leaving the body concerned only that employers pay the minimum wage 'plus a penny'. In the late 1990s, this was not anticipated to be a problem; it was widely thought that the effects of the minimum wage would ripple upwards naturally. On the contrary, the minimum wage has become the going rate in some sectors – eight per cent of employees now earn within 25 pence of the

NMW – with employers often feeling no pressure to pay more. This in part reflects the powers that were given to the LPC, which has only the blunt tool of a single mandatory NMW at its disposal. It has neither the power nor the responsibility to incentivise employers to go further even when they could afford to do so. And it has no role in informing an important public debate about what might be possible, even when there is evidence that large parts of the UK economy could pay more.

When we embarked on our review, we did not know if these weaknesses could be fixed without breaking the current system. After nine months of research, consultation and deliberation, we now think they can. We can say this because our recommendations retain the fundamentals of today's settlement – but they also build on it in important ways. Our recommendations cover three areas, arguing for a broader, more far-sighted and assertive approach.

First, we need a broader approach. We therefore recommend that the government make it an explicit long-term ambition of economic policy to reduce the incidence of low pay, setting out a plan to reduce the share of employees who earn below two-thirds of the hourly median wage. We suggest that the government adopt the ambitious but achievable long-term goal of reducing the UK's high incidence of low pay from 21 per cent to 17 per cent, a reasonable goal against international benchmarks. This would entail lifting around 1 million employees out of low pay. To complement this ambition, we recommend that the LPC's Terms of Reference be revised to broaden and elevate the body into the government's official watchdog on low pay, monitoring and pushing progress in the manner of the Office for Budget Responsibility on fiscal policy.

Second, we need to make the minimum wage more far-sighted. Here we recommend that the process for setting the rate be reformed in several respects. We make two recommendations to increase clarity. In the short-term, the Secretary of State for Business should ask the LPC to set out how long it will now take for the National Minimum Wage to recover the value it has lost in real terms during the exceptional down-turn we have recently experienced. This is a short-term fix to an immediate and unprecedented problem, but setting out a recovery path of this kind should also become standard practice whenever the NMW falls in real terms, as it sometimes will. And to give business more certainty, we recommend that the LPC be asked to publish alongside its recommendation for each year's minimum wage a preliminary view on its intention for the following year's minimum wage.

More fundamentally, the minimum wage should strike a better balance between short-term flexibility and medium-term ambition. To achieve this, we recommend a change in the government's relationship with the LPC. To the former, we recommend that government routinely set out its views on how the NMW can contribute to its wider goal of reducing the incidence of low pay. This should be done by publishing an ambition for the level of the minimum wage expressed as a proportion of the median wage that could be attainable over the medium term (e.g., five years). This would clarify expectations about the role of the minimum wage, as well as its clear limits. Our view, based on UK and international evidence, is that a wage-floor worth 60 per cent of the median wage is a reasonable lodestar, indicating the most that a minimum wage could contribute to the goal of reducing low pay over the medium to long term.

Turning to the LPC, we recommend that it should retain its role of recommending the NMW that can safely be put in place at any point in time. This flexibility is a cornerstone of the current model. But the LPC's Terms of Reference should be amended to support the government's objective. To this end, the LPC should be required to publish not only its recommendation for the NMW but also (a) an assessment of the extent to which this recommendation differs from the trajectory aspired to by the government; and (b) where the recommendation falls short, advice to the government on the blockages to a higher rate and policy actions that could make a higher rate possible. This should include work to identify those sectors of the economy that could in theory already pay the higher rate today and the small handful of sectors that face major barriers and that will require more fundamental support. It should be a goal of policy to make a higher NMW possible, for example by delivering more adequate and responsive funding in social care and a lower burden of employer taxes on small employers.

Third, because a single legal wage-floor – which we favour – will always be a blunt tool, a key role for the LPC should be to encourage a debate over when employers could go further than today's statutory NMW. The proper arena for this debate is civil society, not Whitehall, but the state can help shift the terms of debate, in part by publishing information. Our analysis suggests that industrial sectors are a good way to start. The Secretary of State for Business should ask the LPC to publish analysis to show which sectors of the economy could afford to pay more than its recommended NMW. Whatever its value, many employers will be able to go further than the legal NMW. The LPC's authority should be brought to bear behind this argument.

Finally, we believe that a similar case can be made for London. While we oppose the idea of regional minimum wages, in the capital we feel there is a case for moving directly to the publication of a single reference rate – a non-mandatory minimum wage giving in effect a London-weighting for the NMW. The Secretary of State for Business should ask the LPC to carry out a review of the wage-floor that could be applied in London without significant negative employment effects. This figure should be published as a non-mandatory reference rate, released annually to inform wage negotiators, campaigners and public debate.

Together these recommendations would mean a broader, more far-sighted and more assertive settlement, but they retain the fundamental principles of the agreement struck in 1998. There must still be a single mandatory NMW that is recommended from year to year by the independent and evidence-based social partnership model of the LPC. Indeed, as insecurity has grown in Britain's low paid labour market, a single, clear, mandatory NMW is more important than ever. For this reason, we have rejected ideas that would fundamentally break with this approach. We do not recommend regionalising the minimum wage or introducing mandatory sector minimum wages. Nor do we propose raising the minimum wage to the Living Wage or indexing it to the rate of inflation. We want more balance between flexibility and medium-term ambition and we do not want to over steer.

In taking this overall approach, we diverge from two schools of thought that we have encountered in the course of our work. One of these contends that any change to the status quo runs the risk of breaking the minimum wage. We disagree: the evidence-base is strong enough, and indeed the reputation of the LPC is robust enough, to sustain a stronger version of the established settlement. The model designed fifteen years ago was never going to be perfect for all times, and we do not serve that settlement well by preserving it in aspic.

The other school of thought argues for more radical changes to the minimum wage to tackle Britain's pervasive problem of low pay. We sympathise with this instinct. But we also think it would be foolhardy to jeopardise an institution like the LPC without first seeing what a stronger version of that body can do. The LPC has proven its worth and is the envy of many countries. Britain does not have many authoritative and evidence-based institutions that have forged cross-party political support. Those we have should be sustained.

Summary of our recommendations

Argument I
The government should make it an explicit long-term ambition of economic policy to reduce the incidence and persistence of low pay in the UK labour market, and it should broaden and elevate the Low Pay Commission to be its main watchdog on low pay, monitoring and advising on the issue in a similar manner to the OBR on fiscal policy.

Recommendation 1: The government should commit to reducing the share of employees who earn below two-thirds of the hourly median wage. An ambitious but achievable long-term goal, based on international benchmarks, would be to reduce the share of low pay in the UK economy from 21 per cent to 17 per cent of employees.

Recommendation 2: The government should set out a practical cross-government plan to deliver on its ambition to reduce the incidence of low pay. This should include but not be limited to its judgment of what the National Minimum Wage can and cannot contribute (see Recommendation 6).

Recommendation 3: The Low Pay Commission's permanent Terms of Reference should be revised to establish it as the government's main watchdog on low pay, broadening its responsibilities and elevating its status to monitor the extent and persistence of low pay and to advise the government on how to tackle these entrenched problems.

Argument II
The process for setting the National Minimum Wage should be reformed to strike a more even balance between short-term flexibility and medium-term ambition. The goal should be to give more clarity and drive to the NMW in the medium-term, while retaining the LPC's vital role in recommending the rate from year to year.

To bring more clarity to the minimum wage in the short-term:

Recommendation 4: The Secretary of State for Business should ask the LPC to publish its best estimate of how long it will now take for the National Minimum Wage to recover the value it has lost in real terms in recent years. It should become standard practice for the LPC to publish a recovery path of this kind whenever it is in the unusual position of recommending a real terms cut in the NMW.

Recommendation 5: The LPC currently submits its recommendation for the NMW in February and the government announces in March or April the rate that will apply from October, giving barely six months between the announcement and the rate becoming law. To increase certainty for employers, the LPC should also be asked to set out a preliminary intention for the subsequent year. This judgment would be open to revision.

To better balance the NMW's short-term flexibility with medium-term ambition:

Recommendation 6: The government should, as a matter of routine, set out its ambitions for the future value of the minimum wage. This should be no more than an expression of intent, leaving the LPC free to pass judgment on the NMW that can be put in place from year to year. This ambition would best be expressed as a proportion of the median wage to be achieved over the medium-term. It would need to be arrived at by the government through an evidence-based assessment of what is possible but our early work suggests that a NMW of 60 per cent of the median wage is a reasonable lodestar, indicating the most that a minimum wage could contribute to the reduction of low pay over the medium- to long-term.

Recommendation 7: The LPC's permanent Terms of Reference should be amended to require that the LPC publish, alongside its recommendation for the NMW (a) an assessment of the extent to which its recommendation meets or falls short of the trajectory aspired to by the government; and (b) where its recommendation falls short, a commentary on the blockages to a higher rate and advice on policy changes that could make a higher rate possible in future. This should include an assessment of how close different sectors of the UK economy are to being able to pay the government's aspirational NMW today.

Argument III
A single mandatory NMW will always be a blunt tool and there is a risk that the minimum wage becomes a going rate as employers feel little pressure to go beyond their legal obligation. The LPC should be given additional tools to complement the legal NMW, publishing analysis to indicate which parts of the UK economy could afford to pay their lowest paid workers more.

Recommendation 8: Many sectors of the UK economy could afford to pay more than the NMW. This is inevitable with any single national wage-floor, whatever its rate. A key role of the LPC should be to inform public debate over when employers could go further than the NMW. The Secretary of State should ask the LPC to publish analysis to inform this debate, showing how affordable it would be in different sectors to meet a higher wage-floor.

Recommendation 9: The Secretary of State for Business should ask the LPC to carry out a review of the wage-floor that could be applied in London without significant negative employment effects. The LPC should publish this figure as a non-mandatory reference rate to guide the behaviour of employers

Scope and Outline of the Paper

This report focuses on the design of the minimum wage and its supporting policy architecture, the Low Pay Commission. To that end, we have not looked in detail at enforcement, except where enforcement has a bearing on policy design. Enforcement is nonetheless a foundation for the NMW's success and should not be taken for granted. It is also not our intention in this report to look at low pay more generally. Low pay is a far broader problem than the NMW, being driven by a wide range of factors including the productivity and skills of low paid workers and collective bargaining arrangements. We recognise that the minimum wage is a limited-purpose vehicle and only one element of any strategy to combat low pay.

In **Section 1** of this paper we summarise the lessons learned during the NMW's first fifteen years.

Chapter 1 outlines the evidence on the impact of the NMW to date, focusing on its effects on wages and employment.

Chapter 2 evaluates the strengths and weaknesses of the current settlement, identifying the aspects of the approach that must be retained and those that are in need of reform.

In **Section 2** of the paper we make three broad arguments for a stronger and more confident settlement that more closely measures up to today's challenge of low pay.

Chapter 3 considers how the narrowness of the policy's scope holds it back from tackling the wider issue of low pay. It contrasts the current arrangement with the remit of a more genuine Low Pay Commission, making recommendations to broaden the approach.

Chapter 4 looks at the short-termism of the NMW. It makes recommendations that strike a more even balance between short-term flexibility and medium-term ambition.

Chapter 5 looks at how the LPC could be equipped with additional tools to complement the powerful but blunt tool of a single mandatory NMW.

The Conclusion touches on the risks and rewards of our recommended approach.

Section 1
LESSONS LEARNED

Chapter 1
Evidence on impacts

This chapter begins by outlining the evidence on the impact of the National Minimum Wage (NMW). It focuses on the two most important questions for any evaluation of a minimum wage: what impact did the policy have on the earnings of the lowest paid; and were there any effects on employment? As well as summarising the evidence on earnings and employment, this chapter also reflects on the important question of why the NMW did not impact on employment.

Overview of the policy

The NMW was eased in and then increased quickly before slowing down…

The introduction of the National Minimum Wage was a fiercely fought battle. But the hardest decision still lay ahead when the National Minimum Wage Act received royal assent in 1998. Setting the rate (initially covering all employees aged 22 and over, with lower rates for younger people) was a daunting proposition. As The Economist wrote in 1997, "coming up with a minimum wage that will not seriously harm the economy, and destroy jobs, will require the wisdom of Solomon – or extraordinary luck."[1] The rate also had to be set sufficiently high to have a meaningful effect on earnings.

Box 1: Does a higher minimum wage raise household incomes?

Low pay is only one aspect of the wider question of household incomes and living standards. A stronger minimum wage is not the only way to raise household incomes and indeed the relationship between the two is more complicated than is commonly realised. There are well-formed arguments for why wages can have a limited impact on the incomes of certain households.* The flip-side of this argument is the likely savings to government from a higher minimum wage in reduced benefit spending and increased tax revenues, though these too are complicated to calculate.

An increase in the minimum wage will not filter through equally for all households. The size of that gain will depend on interactions between National Insurance contributions, income tax and tax credits. The introduction of Universal Credit complicates matters further. Case studies can help us understand the proportion of a 10p increase in the NMW which is passed on to household income:

- A single person in their twenties who lives with their parents and works part-time at the NMW would keep all of any increase in the minimum wage, assuming they earned below the thresholds for National Insurance and income tax and received no state support.

- A single parent working full-time at the NMW fares less well, with a net benefit of just over a quarter of the rise (2.7 pence). This is the result of lost tax credits in addition to direct taxes.

- A second earner in a couple with children working full-time at the NMW will also receive ▶

1"The minimum wage: Devilish details" The Economist (5th June 1997)

2.7 pence as a result of a 10 pence increase in the minimum wage. However, when Universal Credit is introduced, that will fall to 2.4 pence, highlighting the lower work incentives faced by second earners.

* Bennett, F. and Lister, R. 'The "Living Wage": The right answer to low pay?'

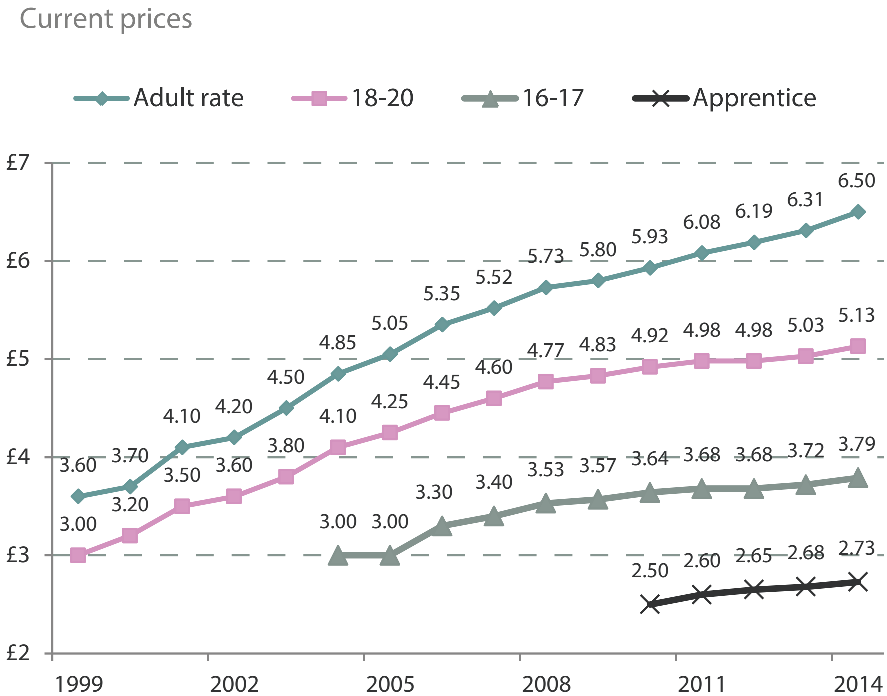
The Low Pay Commission (LPC) was created to meet this challenge. Formed on the basis of a social partnership model, the LPC is made up of nine members: three from a trade union background, three from an employer perspective and three independent members, including two academics usually with expertise in industrial relations or labour market economics, and the Chair. Its primary role was to recommend a rate for the very first NMW to the Secretary of State for Trade and Industry, today's Department of Business, Innovation and Skills. Despite the potential for disagreement among the Commissioners, the LPC has always reached a unanimous decision on their recommendation for the rate. The Secretary of State retains the power to disregard the LPC's recommendation on the NMW but none has ever done so, with ministers diverging from the LPC's broader advice only twice: on the rate paid to apprentices, and the age at which the adult rate should begin.

Figure 1 tracks the path which the NMW has taken. Partly due to the controversy surrounding the introduction of the NMW and the uncertainty over its effects, the UK's first rate was set at a low level, at £3.60 from April 1999. The LPC was asked to monitor the impact of the NMW and offer advice on whether and by how much the NMW should increase. The first increase was similarly circumspect, with the rate rising by only 10p in October 2000. While the largest nominal increase occurred in 2001, with a jump to £4.10, it was the mid-2000s which saw the NMW experience its fastest and most sustained growth, rising by at least 30p each year between 2003 and 2006, equivalent to average annual increases of more than 6 per cent.

The speed at which the NMW rose slowed considerably from 2007 onwards with small nominal increases in subsequent years reflecting the difficult prevailing conditions in the wider economy. Only in 2014, following five years of decline in real terms, is the NMW set to rise again, with the Chair of the LPC writing to the Secretary of State for Business, Innovation and Skills (BIS) to recommend a rise in October 2014 of 3 per cent to £6.50, and pointing to the likelihood of further real terms increases in subsequent years. The Prime Minister has indicated that the government will accept the recommendation for 2014.

What impact did the NMW have at these levels? The LPC's terms of reference ask it to 'recommend levels for the minimum wage rates that help as many low-paid workers as possible without any significant adverse impact on employment or the economy.' In the following section, we summarise the best evidence on whether this was achieved, outlining the research on the effects on the NMW on wages, employment and other variables.

Figure 1: Value of the UK minimum wage
£ per hour, current prices not adjusting for inflation



Notes: The adult rate of the NMW initially applied to employees aged 22 and over and this cut-off was later reduced to 21.

Source: Low Pay Commission

The NMW's effect on earnings

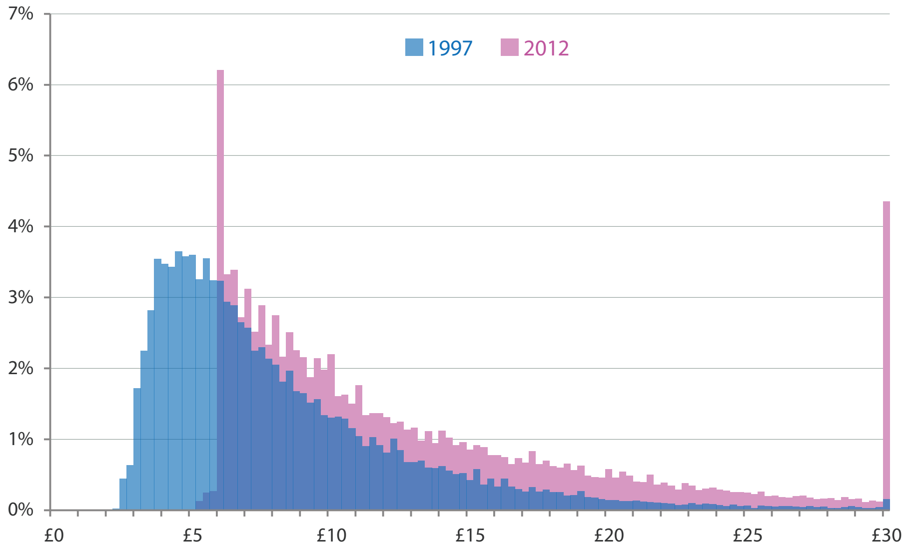
The NMW resulted in higher earnings for the lowest paid workers…

Assessments of the NMW's impact on the wages of the UK's lowest earners are unequivocal: the NMW achieved its goal of boosting the wages of the lowest paid employees. In terms of the scale of its potential effects, the LPC's second report estimated that around 1.7 million employees were entitled to higher wages as a result of the NMW. A wide range of indicators can be used to gauge the actual impact of the NMW on earnings. Figure 2 compares the distribution of hourly wages in the UK in 1997 to the distribution in 2012.

The large spike in the wage distribution at the minimum wage is clear. Although there remain concerns around the effectiveness of enforcement with particular sectors seen as 'black-spots', the overwhelming majority of employers have complied with the NMW.

Figure 2: The distribution of UK wages before and after the minimum wage

Percentage of workforce by 25 pence band



Notes: Gross hourly pay excluding overtime, set out in 25p bands. The final column shows the proportion earning in excess of £30 an hour.
Source: RF analysis of ONS, Annual Survey of Hours and Earnings

Several studies commissioned by the LPC give a more detailed account of the policy's effects on earnings. A recent paper finds that the NMW had a positive effect on the wage growth of low earning groups, particularly women in part-time employment.[1] Impacts were not limited to those who previously earned below the NMW, with analysis finding that the NMW directly affected earnings up to the 6th percentile, raising wages by around 7 per cent.[2] We discuss this in more detail below when we touch on so-called "ripple effects".

While the UK's changing pay distribution provides a striking insight into the wage effects of the NMW, it is also helpful to get a sense of how the NMW has grown relative to prices and wages in the wider economy. In nominal terms, the level of the NMW increased by 75.3 per cent from 1999 to 2013. Figure 3 shows how this compares to prices and earnings.[3] Average earnings grew by 60.2 per cent over the same period. If the NMW had been indexed to the growth of average earnings, it would be £5.77 in 2013, almost 60p lower than its actual rate. The growth of the NMW is even stronger by comparison to inflation. The minimum wage has outpaced both the RPI (52.5 per cent) and CPI (37.3 per cent) measures of inflation. The NMW roughly kept pace with the growth of GDP from 1999 to 2012.

1 Dickens, R., Riley, R. and Wilkinson, D. (2012) Re-examining the impact of the national minimum wage on earnings, employment and hours: the importance of recession and firm size

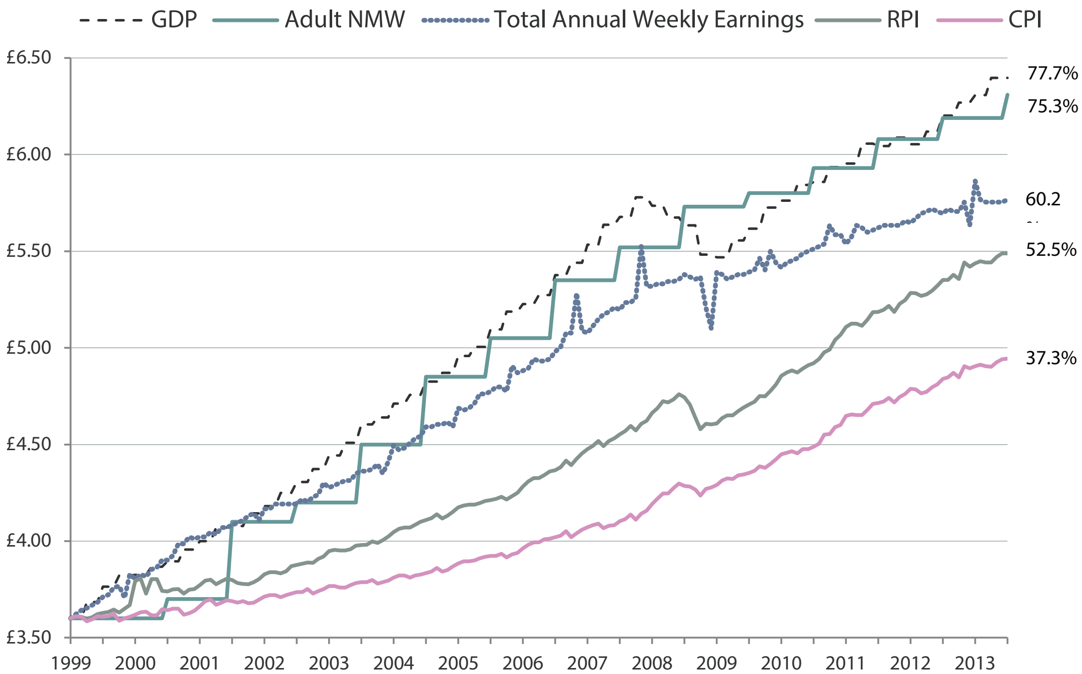
2 Butcher, T., Dickens, R. and Manning, A. (2012) Minimum Wages and Wage Inequality: Some Theory and an Application to the UK

3 Figure 3 is drawn from data kindly provided by the Low Pay Commission. See also Butcher, T. (2012) Still evidence-based? The role of policy evaluation in recession and beyond: the case of the National minimum Wage, National Institute Economic Review No 219

While these data tell us a lot about how the NMW has grown over time, because of an error in the data supplied to the LPC when calculating the first rate, the first minimum wage was set much lower than intended. It is important to remember this artificially low base when considering how the NMW has risen since its introduction.[1]

Figure 3: The value of the NMW over time

£ per hour and equivalent growth in GDP, Total Average Weekly Earnings, RPI and CPI

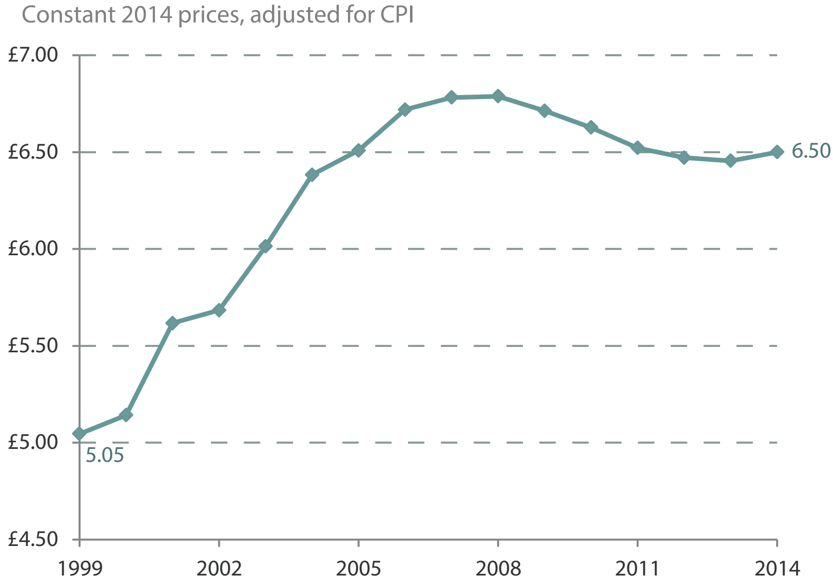


Source: Low Pay Commission, with thanks to Yi Zhang for sharing data

Figure 4 also shows how the real terms growth of the NMW has differed over time. After a tentative introduction, the NMW saw strong real terms growth for a number of years, rising relative to median earnings. But Figure 4 also shows the severity of the recent decline in the NMW relative to inflation. Had the NMW kept pace with the CPI from 2008, the rate would be £6.64 today rather than £6.31 (in 2013 prices). Figure 5 shows that even after its planned increase in October 2014, the minimum wage will still be no higher than its level in 2005 in real terms. While the rise to £6.50 represents a 3 per cent increase over its 2013 level, given that the OBR estimates that inflation (measured with the CPI) will run at 2.3 per cent for 2014, that amounts to a real terms increase of just over 4 pence.

1 Had the LPC set a rate to cover 8 per cent of the workforce in 1998, the NMW would have started at around £3.96. Raising this to its subsequent rate of £6.31 in October 2013 would have meant growth of 59.3 per cent, below GDP and earnings growth but above inflation.

Figure 4: The real terms value of the National Minimum Wage



Source: Resolution Foundation analysis of ONS, Annual Survey of Hours and Earnings; and OBR Economic and Fiscal Outlook December 2013

Another important indicator of the strength of the NMW is its 'bite' relative to the median gross hourly wage. This is in some ways a more useful measure than comparisons to average earnings, which include bonuses and are skewed upwards by a small number of very high earners. The bite gives a better sense of how the NMW compares to the earnings of a typical employee.

Despite recent falls in the real terms value of the NMW, the bite remains near to historic highs. In 2012, the UK NMW was 55.1 per cent of hourly median earnings and in 2013 it fell back to 54.6 per cent. The bite of the NMW has risen even while its real value has fallen because of historic declines in median earnings. It is also important to note that the bite varies widely, for example by age, gender and by sector. For example, industries that contain a considerable proportion of low paid employees such as accommodation, food service and retail have bites of 75 per cent and higher, while sectors with a relatively low proportion of low paid people, for example finance, have bites in the region of 40 per cent. We return to this point later in the report.

The NMW's effect on employment

The minimum wage has not caused unemployment…

What price was paid for these positive effects on earnings? On the policy's introduction, opponents of the NMW feared that employers would adjust by reducing their employment of low paid workers. The most pessimistic forecasts predicted that up to 2 million jobs would be lost as a result of the policy, with higher unemployment having a fiscal cost in terms of reduced income tax receipts and higher welfare spending.[1] There were concerns that older workers would be displaced by younger employees as employers took advantage of the lower youth rate.[2] There were even worries that the negative impact would not be limited solely to employment but would raise inflation across the economy.[3]

There is now academic consensus that the UK NMW has not had a negative generalised effect on employment. As the LPC notes in its 2013 report, 'our overall conclusions … are that as a result of the NMW the lowest paid have received higher pay rises than their peers, and that there remains little evidence of a significant adverse effect of the minimum wage on employment.'[4]

These findings remain robust for the effects on overall employment, on employment in low paying sectors, on the employment prospects of different individuals and social groups and on employment levels in different regions.[5] Evidence also shows no overall effect on hours worked and no larger effect on the hours worked by low paid workers. Latest research confirms that these findings have held throughout the recent recession, the deepest in modern times. Indeed, the labour market has been in the words of the LPC 'remarkably resilient' when compared with previous recessions and both employment and unemployment have recovered faster than expected. This has happened while the NMW, despite having fallen in real terms, has risen relative to median earnings throughout these difficult years.

While the balance of academic opinion is clear, the evidence on the minimum wage is not unanimous. Figure 5 makes this point for the US literature. It draws from a study of over 1,500 estimates of the impact of the US minimum wage on employment.[6] The horizontal axis shows the estimated employment effect of the minimum wage, from negative to positive, and the vertical axis shows the statistical accuracy of the estimate (for example, reflecting the sample size). The cluster of accurate estimates at zero is clear; this reflects the balance of opinion that there is no overall employment effect. But individual results are scattered from negative to positive. This is why supporters and opponents of the NMW have each been able to cite studies in support of their arguments. A meta-analysis for the UK finds similar results.[7]

1 For more discussion see The National Minimum Wage: The Evidence of its Impact on Jobs and Inequality, Centre For Economic Performance, LSE

2 See for example http://news.bbc.co.uk/1/hi/uk_politics/113011.stm

3 See for example http://news.bbc.co.uk/1/hi/uk_politics/115395.stm

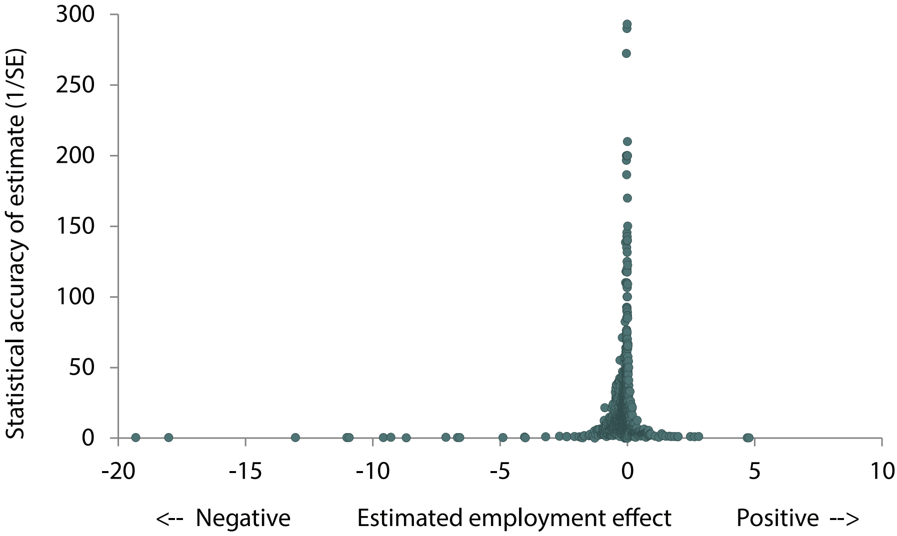
4 Low Pay Commission (2013)

5 p.182, Low Pay Commission (2013), Lanot and Sousounis (2013) Dickens, Riley and Wilkinson (2012), for example, find that the minimum wage may have had positive effects on employment from 2003 to 2007. Dolton, Rosazza Bondibene and Stops (2012) find no impact, including in the recession, and again find a positive impact on employment in some areas.

6 Doucouliagos H. and Stanley T.D. (2009) "Publication Selection Bias in Minimum-Wage Research? A Meta-Regression Analysis".

7 Linde Leonard, M. Stanley T.D. and Doucouliagos, H. (2013) "Does the UK Minimum Wage Reduce Employment? A Meta- Regression Analysis".

Figure 5: The effect of the US minimum wage on employment



Source: Doucouliagos and Stanley (2009)

Evidence also points to where employment effects would show up first…

As well as examining headline indicators, an extensive literature has examined the effects of the NMW on specific groups of workers. No overall effect has been found on the employment and participation rates of women, older workers, people with disabilities or migrants.[1] While research has not found statistically significant employment effects for any major group, results do point to parts of the labour market that are more vulnerable to the minimum wage:

- While no employment effect has been found overall, there is weak evidence that growth in employment has been slower in some very low paid regions, potentially reflecting the higher value of the NMW relative to median pay (the 'bite') in these areas.[2] Other papers have found more mixed effects or even positive effects.[3]
- Early research into the minimum wage found a small negative effect on employment in care homes containing a high share of minimum wage workers.[4] This likely reflects both the low pay of this sector and its heavy reliance on inadequate, unresponsive public funding.
- While evidence on younger employees remains mixed, one study finds reduced hours for young people in the years after the 2008 recession as a result of the NMW.[5] Although the authors have not been able to replicate these

---

1 Butcher, T. (2012) Still evidence-based? The role of policy evaluation in recession and beyond: the case of the National minimum Wage, National Institute Economic Review No 219.

2 Galindo-Rueda, F. and Pereira, S. (2004) The Impact of the National Minimum Wage on British Firms, Centre for Economic Performance, LSE, Yale University and University College London.

3 Dolton, P. Rosazza-Bondibene, C. and Wadsworth, J., (2009) The Geography of the National Minimum Wage, Royal Holloway College, University of London and Dolton, P., Rosazza Bondibene,, C. and Stops, M., (2012) The Spatial Analysis of the Employment Effect of the Minimum Wage in a Recession: The Case of the UK 1999-2010, University of Sussex, CEP, LSE, NIESR and IAB Nurnberg.

4 Machin, S., Manning, A. and Rahman, L. (2003) Where the Minimum Wage Bites Hard: Introduction of Minimum Wages to a Low Wage Sector. Journal of the European Economic Association. 1(1), pp. 154-180.

5 Bryan, M., A. Salvatori and M. Taylor, (2012) The Impact of the National Minimum Wage on Earnings, Employment and Hours Through the Recession, Institute for Social and Economic Research.

specific findings, young workers have been shown to be more sensitive to the effects of a minimum wage in a range of studies.[1]

• Recent research finds evidence of reduced job retention among female part-time workers.[2] This does not directly imply lower employment, and may simply represent increased churn into and out of work; it may nonetheless reflect the relatively large impact that the NMW has had on this group.

This evidence should guide our caution on the NMW. It reminds us that the LPC is right to be careful when recommending the rate of the NMW but it also suggests that a higher NMW would not lead to a sudden spike in overall unemployment – effects would show first in specific areas. Moreover, it seems that these effects have not happened yet, even in parts of the economy that are highly exposed to the NMW. This may also suggest, as the LPC has hinted in recent work, that in the rest of the economy there is headroom for a higher rate.

Why did the minimum wage not cause unemployment?

A key question raised by the literature is: why did the minimum wage not cause unemployment?[3] In the years since the NMW was introduced in the UK, labour market economists have sought to understand why classical labour market theory failed to model accurately the minimum wage's impact, and some have developed new models that better explain the empirical results.[4] These are complicated debates relating to questions of employer monopsony and to the extent that frictions affect low wage labour markets. But it now seems that one basic mistake of the early opponents of the minimum wage was that they over-simplified the reactions of employers. We now know that employers did not simply reduce employment in response to the NMW, but instead adapted strategically through a range of other channels:

• Some firms absorbed higher wage-bills into lower profits.[5] Importantly though, this did not cause an increased rate of business failure among low paid firms.

• Some employers compressed their wage distributions.[6] This had the positive effect of absorbing the cost of the NMW without causing unemployment and the negative effect that workers paid slightly above the NMW often saw few of the benefits; their pay went up but not as much as had been anticipated.[7]

---

1 See, for example Bryan, M., Salvatori, A. and Taylor, M., (2013) The Impact of the National Minimum Wage on Employment Retention, Hours and Job Entry, Institute for Social and Economic Research, University of Essex and Dolton, P. and Rosazza Bondibene, C. (2011) An Evaluation of the International Experience of Minimum Wages in an Economic Downturn, Royal Holloway, University of London.

2 Dickens, R., Riley, R. and Wilkinson, D. (2012) Re-examining the Impact of the National Minimum Wage on Earnings, Employment and Hours: The Importance of Recession and Firm Size. University of Sussex and National Institute of Economic and Social Research.

3 For further discussion of this question see Schmitt, J. (2013) Why Does the Minimum Wage Have No Discernible Effect on Employment? Center for Economic and Policy Research and Metcalf, D. (2007) Why has the British national minimum wage had little or no impact on employment? Centre for Economic Performance, LSE.

4 For the leading work on labour market monopsony, see the work of Alan Manning. For example, Manning, A. (2010) Imperfect Competition in the Labour Market, CEP Discussion Papers DP0981, Centre for Economic Performance, LSE.

5 Draca, M. Machin, S and Van Reenen, J. (2005) The Impact of the National Minimum Wage on Profits and Prices: Report for Low Pay Commission.

6 Butcher, T., Dickens, R. and Manning, A. (2012) The Impact of the National Minimum Wage on the Wage Distribution. Low Pay Commission, University of Sussex and London School of Economics.

7 Denvir, A. and Loukas, G. (2006) The Impact of the National Minimum Wage: Pay Differentials and Workplace Change, Institute for Employment Studies.

• Employers in the UK's low paying sectors raised productivity in response to the NMW. [1] This effect was more marked in larger firms.[2] Evidence suggests that this increased productivity was the result of capital-deepening in low wage sectors.

• There is some evidence that the NMW resulted in higher prices for specific goods that are dependent on very low paid workers.[3] Other research suggests that these specific effects did not feed through into more widespread effects on prices. [4] In general, early concerns that the NMW might cause generalised inflation have proven unfounded. This is partly because the NMW has had lower ripple effects than anticipated, not raising wages across the economy.

• Some employers experienced reduced staff turnover meaning they could absorb the costs through reduced spending on recruitment and retraining.[5] This finding reflects the importance of frictions in labour markets, a phenomenon that was underplayed in predictions of unemployment effects from the minimum wage.

These lessons do not mean the minimum wage would never cause unemployment. At some level the NMW would inevitably cost jobs. But the evidence on the NMW does show clearly that any strategy to boost the earnings of low paid workers will need two pillars: efforts to raise the productivity of low paid groups and low paying parts of the economy, for example through skills policy; and judicious tools to put pressure on employers to pay more when they can afford to. Fifteen years of research suggests that the latter can do more work than we thought but it is still a key challenge for policy to get this balance right.

1 Croucher, R. and Rizov, M. (2011) The Impact of the UK National Minimum Wage on Productivity by Low-paying Sectors and Firm-size Groups, Middlesex University and Riley, R. and Rosazza Bondibene, C. (2013) The Impact of the National Minimum Wage on Firm Behaviour During Recession, National Institute of Economic and Social Research.

2 Croucher and Rizov (2011).

3 Wadsworth, J. (2008) Did the UK Minimum Wage Affect Prices? Royal Holloway College, University of London.

4 Draca, M., Van Reenen, J. and Machin, S., (2005) The impact of the National Minimum Wage on profits and prices, LSE and UCL.

5 Schmitt (2013).

Chapter 2
Evaluating today's approach

Having assessed the empirical effects of the minimum wage, this chapter evaluates the strengths and weaknesses of the wider settlement that underpins the policy. This is important if we are to retain and reform the right aspects of the system. In addition to its success at recommending a sensible level for the minimum wage, the approach of the LPC has had several clear strengths in the policy's first fifteen years.

First, it has helped to establish a strong and objective body of research…
The evidence-base the LPC has developed in the UK is one of the largest in the world, matched only by that of the US. And the objectivity of the UK evidence-base is arguably stronger, with statistical analysis suggesting that there is less publication bias in the UK minimum wage literature than in its US equivalent.[1] The LPC has played a central role in this, commissioning the majority of UK research on the minimum wage. This has transformed our understanding of the impacts of wage-floors and the operation of low wage labour markets, producing most of the findings outlined in Chapter 1.

Second, the LPC has helped to depoliticise Britain's minimum wage…
Opinion over the NMW was divided in the late 1990s. The UK minimum wage now enjoys extremely broad political support. Secretaries of State under both Labour and today's Coalition government have always accepted the LPC's main recommendation for the adult minimum wage—in all political and economic weather. This is testament to the work of successive LPC chairs and the body's commissioners and secretariat. It is important not to forget how difficult this basic job is, particularly in recent years.

The success of the LPC in depoliticising the NMW is all the more impressive when the UK is compared with the US. America's Federal Minimum Wage (FMW) can only be raised by an Act of Congress meaning that increases are periodic and come only through hard-fought battles in which politics can take precedence over evidence. The US FMW is now worth around 30 per cent less than it was worth in 1968 after controlling for inflation.[2] As yet unable to secure the support of Congress, President Obama has been limited to raising the FMW solely for federal contractors, something that stands within his executive authority. This does not simply reflect the tone of US politics; in certain others policy areas, such as the Earned Income Tax Credit (America's equivalent of tax credits), debate has been less highly charged.

1 Linde Leonard, M. Stanley T.D. and Doucouliagos, H. (2013) "Does the UK Minimum Wage Reduce Employment? A Meta-Regression Analysis"; Doucouliagos H. and Stanley T.D. (2009) "Publication Selection Bias in Minimum-Wage Research? A Meta-Regression Analysis"

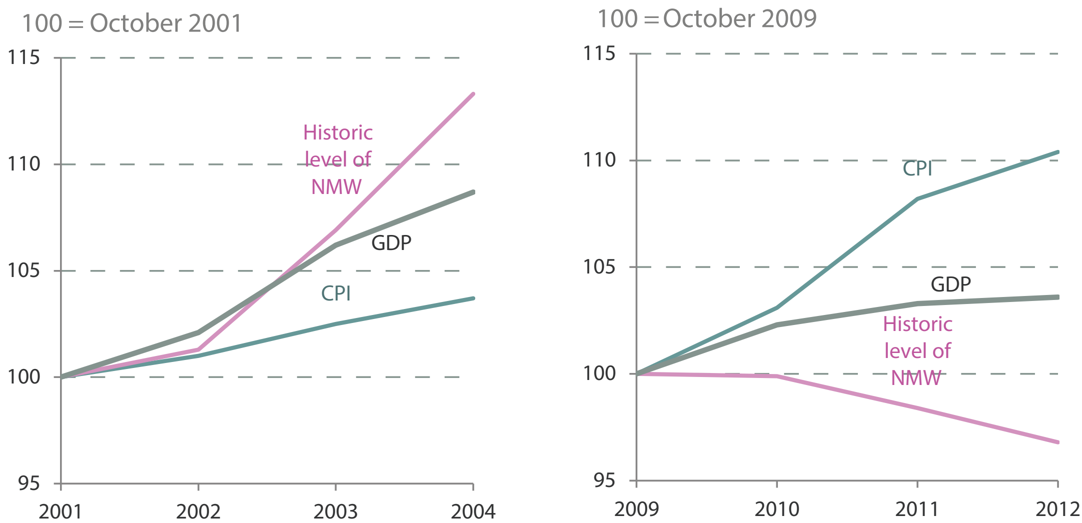
2 Cooper, D. (2013) Raising the federal minimum wage to $10.10 would lift wages for millions and provide a modest economic boost, EPI

Third, the LPC has secured the buy in of employers and unions…
The UK's decision to use a social partnership model to recommend the rate of the minimum wage has proven highly successful, securing the buy-in of business and trade unions. The LPC's union and employer representatives have agreed a unanimous recommendation every year since 1999, including in the difficult years from 2008. This is a major achievement, particularly given the wide diversity of opinion which feeds into the LPC's deliberations.

Fourth, the UK minimum wage responds to labour market conditions…
The LPC's annual process of reflecting on evidence and then recommending a rate has made the UK minimum wage highly responsive to labour market conditions. This has led to smooth annual increases, avoiding the sporadic large jumps seen in economies like America.

The UK minimum wage has also been less rigid than equivalent policies in countries like France, where the minimum wage rises in line with a measure of prices. Figure 6 shows what would have happened in the UK if the minimum wage had been linked to inflation. On the left, it focuses on the buoyant economic period of 2001 to 2004 and on the right on the difficult years of 2009 to 2012. If it had been indexed to inflation, the UK minimum wage would have grown much more slowly in years when the economy was strong and much more quickly when it was weaker. Overall, it would have ended up lower than it is today.

Figure 6: The path of the UK minimum wage had it been linked to inflation



Source: RF analysis of data from Low Pay Commission and ONS

The minimalism of the 1998 settlement now falls short in several ways…
The LPC has performed admirably against the tasks it was set. But three weaknesses now stand out when the settlement is assessed afresh in 2014.

1. The government's approach to low pay is narrow…

The minimum wage and the LPC take a narrow approach to low pay. This narrowness is a feature of the legislation and governance arrangements that underpin the LPC. The National Minimum Wage Act 1998 asked the LPC to offer recommendations on:

- The hourly rate of the NMW.
- How the hourly rate should be defined (for example, whether tips and accommodation should be included).
- Whether a different rate should be applied to young people and what that rate should be and (within very tight limits) other classes of people to whom a different NMW should be applied.[3]

The narrowness of the LPC's work also extends to its Terms of Reference. These are not legislated but are the government's way of defining the LPC's responsibilities. The exact wording of the Terms of Reference has varied from year-to-year but currently the LPC is asked "to recommend levels for the minimum wage rates that help as many low-paid workers as possible without any significant adverse impact on employment or the economy." Looked at in this way, the LPC is not a Low Pay Commission but a Minimum Wage Commission.

One practical consequence of this closely-defined brief is that the LPC, along with other parts of the UK government, has a particularly narrow conception of low pay. The LPC defines low pay as being pay at or around the minimum wage, sometimes extending this definition to those paid within 10 per cent of the NMW. The Government's submission to the LPC defines low pay as "less than the appropriate NMW rate", the same definition used by the Office for National Statistics in its annual report "Low Pay".[4] This latter definition captures around 279,000 workers. Official international definitions of low pay are far broader, capturing 5 million workers in the UK who earn below two-thirds of the median wage—around a fifth of the workforce.

Figure 7 shows how the LPC's focus made more sense in the late 1990s than it does today. In 1997, a third of low paid workers (and 7 per cent of the total workforce) suffered from extreme low pay, earning below half the median wage. This was a good place to begin the battle against low pay. Today, in no small part due to the NMW, extreme low pay is greatly reduced. Fewer than one in ten low paid workers (9 per cent) are now in extreme low pay, the vast majority apprentices or teenagers. Illegal non-payment of the NMW makes up the remainder. Enforcement should of course be a crucial concern for both the LPC and government. Indeed, any attempt to strengthen the NMW relies upon high levels of compliance among employers, making enforcement the bedrock of a stronger approach – particularly where there is evidence of systematic abuse. But extreme low pay is now a less useful focus for the policy as a whole.

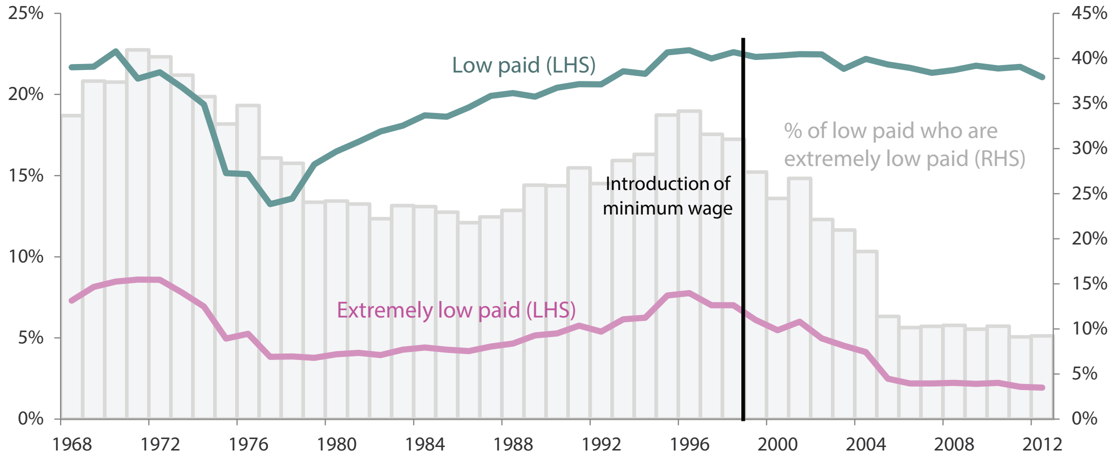
3 The LPC is only permitted to consider different minimum wages for people under the age of 26 and those in the first six months of employment.

4 Office for National Statistics, Low Pay (April 2013)

As Figure 7 also shows, a fifth of all employees remain low paid on the more general measure of two-thirds of the median. This share of low pay is far higher in the UK than in most developed economies.[1] The 9 in 10 workers who earn in the region between the NMW and the low pay threshold are the new frontline in the battle against low pay

Figure 7: The changing composition of low pay

Percentage of UK workforce who are low paid (earning below two thirds of median hourly earnings) and extremely low paid (earning below half of median hourly earnings).



Notes: Figures are drawn from three separate data sources. Where these sources overlap, differences exist in the proportions of employees reported to be below the various low pay thresholds. Figures prior to 1997 have been adjusted to account for the magnitude of difference recorded in these overlapping periods, in order to create a consistent time series. The original, unadjusted, data is presented in Whittaker, M, (2013) Low Pay Britain 2013.

Sources: RF analysis of DWP, Family Expenditure Survey (1968-1981); ONS, New Earnings Survey Panel Data (1975-2012); and ONS, Annual Survey of Hours and Earnings (1997-2012)

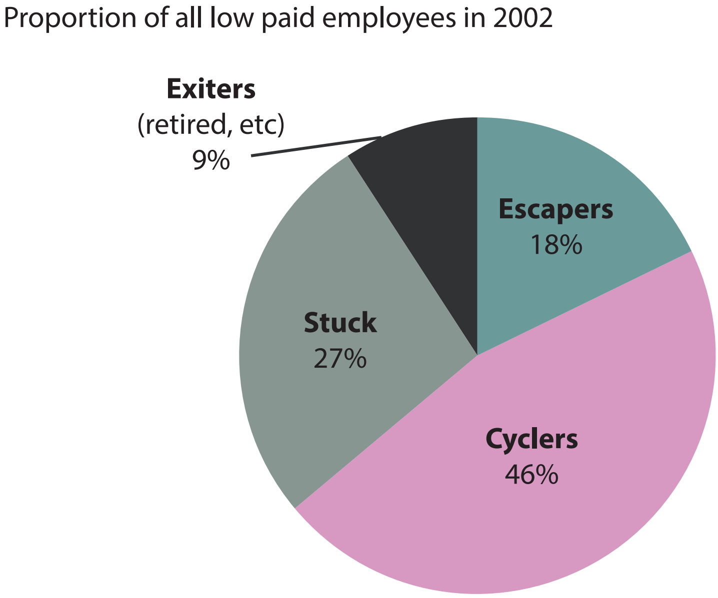
Another important weakness of today's narrow settlement is the lack of attention it gives to the persistence of low pay. The NMW was intended to act as the wage-floor from which employees should move up with experience and skills. There was even hope that the NMW might encourage employers to invest in their staff to allow for progression. Findings from the Resolution Foundation suggest that all too often, the NMW is failing to act as a springboard to higher earnings. In 2012, just under a fifth (17 per cent) of minimum wage workers, around 320,000 people, had only held minimum wage jobs in the last five years.[2] The problem is not limited to the NMW. Almost three-quarters of low paid workers in 2002 had not fully escaped low pay ten years later in 2012,[3] as Figure 8 shows.

1 See annex 2 for a more in-depth overview of the state of low pay today and how the UK's performance compares with other developed economies

2 Minimum wage workers and jobs defined as within 25 pence an hour of the NMW. D'Arcy, C. and Hurrell, A. (2013) Minimum stay: understanding how long people remain on the minimum wage.

3 Hurrell, A. (2013) Starting out or getting stuck: An analysis of who gets trapped in low paid work – and who escapes.

Figure 8: Earnings mobility of the low paid
Proportion of low paid employees in 2002 who escaped low pay, cycled in and out of low pay, remained stuck on low pay and exited the labour market over the subsequent decade



Notes: (1) Escapers are defined as those among the 2002 low paid who are in work and no longer on low pay in the most recent three years (2010, 2011 and 2012).
(2) The stuck are defined as those of the 2002 low paid who only ever held low paid jobs for all years they were employed in the subsequent decade (2003-2012).
(3) Cyclers are defined as those among the 2002 low paid that had a non-low paying job for at least one year in the subsequent decade (2003-2012).
(4) Exiters are defined as those among the 2002 low paid who became self-employed or left the workforce for the entirety of the subsequent decade. Reasons for leaving the workforce include: retirement, death, frequent or long-term unemployment, moving abroad or prolonged economic inactivity (e.g. those in full-time education, stay-at-home parents and full-time carers).
Source: Resolution Foundation analysis of NESPD 1975-2012

2. The process for setting the minimum wage is short-sighted…
The second clear shortfall of today's settlement is the short-termism of the process for setting the minimum wage. The LPC has never been required to look ahead to the medium-term when making its recommendations for the future value of the NMW, although it did choose to do so in its earlier years, before the economy weakened in 2008. This short-sightedness plays out in a number of respects.

Of late, it has raised pressure on politicians to say when the NMW will recover the value it has lost in recent years. As we saw in Figure 4, the minimum wage fell in real terms for five years in a row from 2008 to 2013, dropping back to a level last seen in 2004. The LPC has now recommended a cash increase in the minimum wage to £6.50 in October 2014, representing a small real terms rise. The government suggests it will accept this recom-mendation. Even so, the minimum wage still looks likely to be lower in real terms in October 2014 than it was in October 2008. The pressure to restore the NMW's lost value is quite specific to today's context and helps to explain the Chancellor's recent advocacy of a higher minimum wage. The LPC has now itself begun to respond to this concern, saying that 2014 will mark the start of "a new phase – of bigger increases than in recent years."[1]

A more permanent aspect of the minimum wage's short-termism is the uncertainty it creates for employers. The minimum wage is announced barely six months before it comes into force.[2] This has been a particular complaint of small firms and is increasingly out of line with best practice in economic policy, where there has been a general move to giving more clarity over policy intentions.[3] Some employers have argued that more notice would make it easier to adapt to the NMW in positive ways. While it is hard to test this argument, evidence does suggest that employers have adapted to the NMW in both short-term ways (such as raising the price of certain goods) and more positive long-term ways (raising productivity in low paying sectors through capital-deepening). It might be that more notice could encourage the latter.

The most fundamental aspect of the NMW's short-termism, though, is its lack of direction. In its effort to depoliticise the minimum wage, the government has ended up in the strange position of being formally neutral about the rate. Neither the government nor the LPC have any stated goal or aspiration on the reduction of low pay, nor any preference over whether the minimum wage rises or falls. Leaving to one side the Chancellor's recent remarks which have not as yet been formalised into a new policy, this lack of direction leaves the minimum wage rudderless. The LPC's job is simply to describe the labour market it sees today. The LPC itself acknowledges that the minimum wage the UK economy can bear is not an unalterable fact; policy changes can constrain or free up the NMW.[4] For example, the LPC suggests that inadequate social care funding holds back the minimum wage across the entire economy because of concerns about unemployment in that sector. Without any ambition to raise the minimum wage, there is no impetus in the system to identify these blockages.

As with the other shortfalls we identify, the lack of direction in the minimum wage was less problematic when the policy was introduced. The LPC's task was then to take Britain from having no NMW to having one set at a reasonable level. In the early years, research into the past effects of the NMW lit the way down this path, giving the LPC enough confidence to raise the rate from its very low starting point to a rate that puts Britain in the middle of international league tables. Today, things are different in two respects. First, the journey is harder: the job is now to take Britain from an average NMW to an ambitious one. Second, the evidence is

1 David Norgrove's letter to the Secretary of State, February 2014.

2 While the LPC typically submits its recommendation to government in February each year, the timing of the government's announcement varies; in 2013 the NMW for 1st October was not announced until 15th May.

3 See for example recent comments by the Federation of Small Businesses which called for the NMW to be set out five years in advance, with an upper and lower range for each year. http://www.fsb.org.uk/News.aspx?loc=pressroom&rec=8549.

4 This was most recently spelt out by the chair of the LPC, David Norgrove, in his letter to the Secretary of State for BIS: "government measures to reduce employer costs increase the scope for higher pay, and the opposite. But for the purpose of the minimum wage the effects of government policy are often felt more at a sectoral level. Local authority spending on social care and regulation in many industries are a case in point."

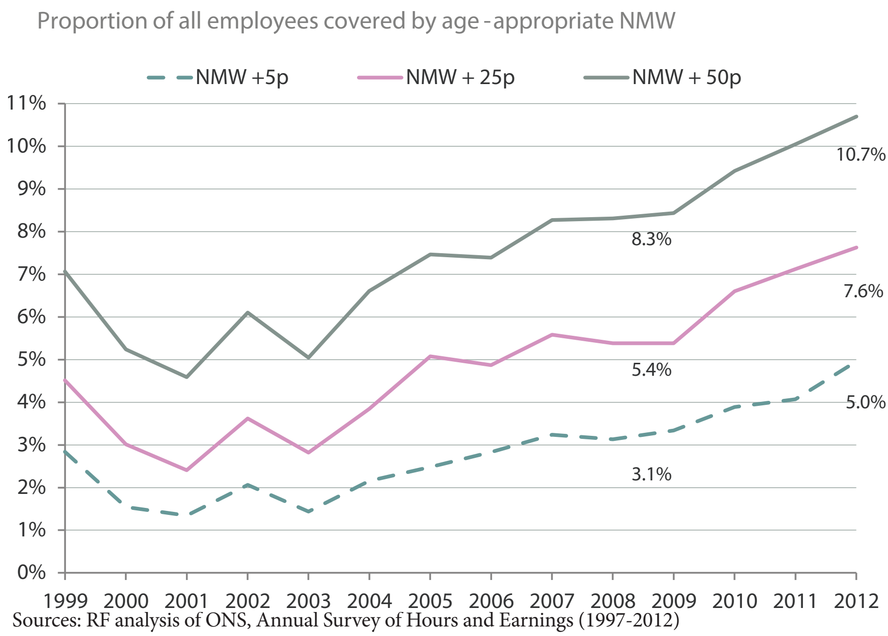
less illuminating: little is learned by refining earlier findings on the back of small incremental changes in the NMW from year to year. A more ambitious minimum wage is likely to require a more pro-active research agenda.

3. The approach is passive, putting no pressure on employers once they pay the NMW…

A concern on the introduction of the NMW was the extent to which its effects would ripple up through the labour market, pushing up wages across the economy and causing inflation.[5] The opposite problem has transpired. The spill-over effects of the NMW have been far smaller than anticipated, leaving a growing number of workers to be paid at or around the NMW. The minimum wage has become in effect the going rate in some sectors and occupations of the UK economy, something the LPC was clear it never intended.

Figure 9 shows how the share of people paid the NMW has grown. Around 5 per cent of employees, some 1.2 million people, are now paid within 5p of the minimum wage. An additional 1.4 million people earn between 5p and 50p above the NMW. These shares have increased even as the NMW has fallen in real terms since 2008, either because new entrants to the labour market earn less than previously or because the NMW has fallen by less than the earnings of employees who are paid slightly more. Figure X shows the same phenomenon from a different angle. In recent years the wage distribution has become increasingly clustered at the minimum wage as employers have faced little pressure to go beyond their legal responsibility to pay the NMW. The spike at the NMW has grown by around 58 per cent since 2008, even as the rate itself has fallen in real terms.

Figure 9: The UK's growing minimum wage workforce

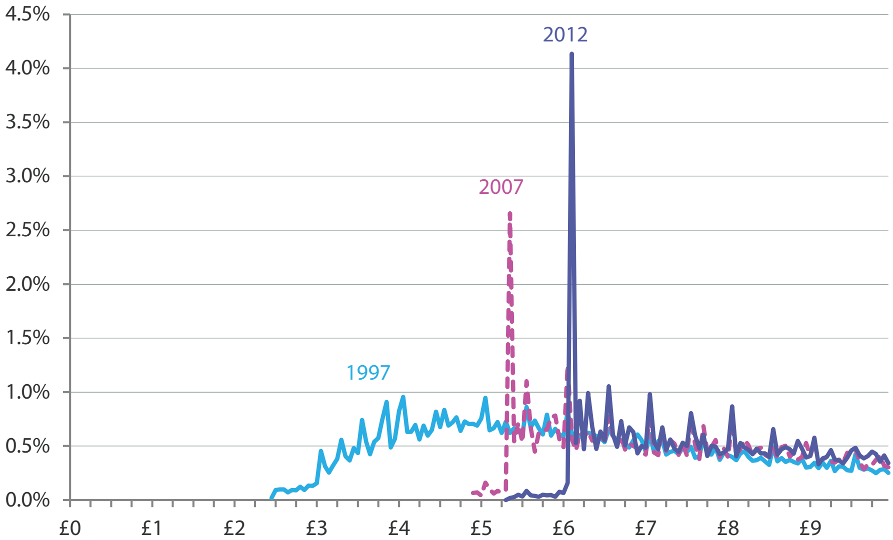


Sources: RF analysis of ONS, Annual Survey of Hours and Earnings (1997-2012)

5 See for example http://news.bbc.co.uk/1/hi/uk_politics/115395.stm.

Figure 10: The growing spike at the minimum wage

Percentage of workforce, 5p bands current prices – not controlling for inflation



Notes: Gross hourly pay excluding overtime, nominal terms, in 5p buckets.
Sources: RF analysis of Annual Survey of Hours and Earnings (1997-2012)

The lack of pressure beyond the NMW is notable given that evidence suggests that many employers would see only a small effect on their overall wage bill if they were to pay their lowest paid workers more. While this point has been acknowledged by the LPC itself, this cannot be taken into account in the current framework.[6] On the contrary, because the LPC is tasked with setting a single mandatory national rate, the LPC rightly bases its judgment on what can be borne in the most vulnerable part of the labour market. This generates little pressure or insight around whether particular sectors or regions could afford to pay more.

6 In his 2014 letter to the Secretary of State for Business, Innovation and Skills, the current Chair of the LPC David Norgrove's note that "[m]any employers may be able to raise their wages without damage to their businesses."

Section 2
BUILDING ON SUCCESS

We have seen in Section 1 of this report that much has been learned since the National Minimum Wage (NMW) came into force. The economic and political context has also changed considerably. We now face a different challenge to fifteen years ago and some of the policy's key strengths have become weaknesses. In recent months, policymakers have begun to respond to these changes by modifying this year's process for setting the NMW in an ad hoc fashion. But no new policy has yet been developed. In this section we describe how the minimum wage could be strengthened more systematically, securing a more confident approach while retaining the core principles of the 1998 Act.

The three arguments of this section respond to the three weaknesses identified above:

• In Chapter 3 we argue for a broader approach to low pay that goes beyond a narrow focus on the minimum wage. We argue that the government should make it a clear goal of economic policy to reduce the number of workers paid below two-thirds of the median wage and should broaden and elevate the LPC to become a watchdog on low pay in the manner of the Office for Budget Responsibility (OBR) with regard to fiscal policy.

• In Chapter 4 we make the case for more ambition and direction on the minimum wage itself. We set out reforms that retain the flexibility of the minimum wage from year to year, and that keep the LPC's central responsibility to make this judgment, while at the same time injecting political ambition into the value of the minimum wage over the medium-term.

• In Chapter 5 we argue that a single mandatory minimum wage will always be a blunt tool and that the LPC should have additional powers and responsibilities to push employers to pay more when they could afford to. We argue in particular that the LPC could do more to inform a public debate about parts of the UK economy that could afford to pay their low paid workers more.

In all cases we recommend retaining the fundamental core of today's approach.

Chapter 3
A broader approach to low pay

In this chapter we describe a broader approach to low pay and the minimum wage. This goes beyond the institutions of the minimum wage and the LPC, with recommendations that bear on the government's wider approach to low pay. These broader recommendations seem to us a pre-condition for a stronger and more strategic minimum wage.

Our central argument in this chapter is that the government should make it an explicit long-term ambition of economic policy to reduce the incidence of low pay in the UK labour market. The LPC should then be broadened and elevated to become the government's main watchdog on low pay, supporting its wider ambitions in a similar fashion to the Office for Budget Responsibility on fiscal policy.

In the course of our deliberations we have weighed up several ways in which the government could drive its work on low pay, most prominently the idea that it should pledge to reduce the share of people earning below the Living Wage. We have settled against this specific idea and argue instead that the government should build its low pay strategy on the official relative definition of low pay: those who earn below two-thirds of hourly median wage.

Specifically, **we recommend that the government make it an explicit goal of economic policy to reduce the share of employees earning below two-thirds of the hourly median wage.** This commitment should be in the form of an ambitious but achievable long-term goal, informed by a reasonable benchmark from international evidence. Reducing the UK's share of low pay from 21 per cent to 17 per cent seems to us to a reasonable goal given international evidence. This ambition to reduce the incidence of low pay should be complemented by new work on the persistence of low pay, including new efforts to understand the scale of the problem.

We make our recommendation on the incidence of low pay after weighing up the well-known downsides of relative measures as a guide to government policy. We recognise that such measures are necessarily arbitrary and tell us little about the actual adequacy of people's pay and how this is changing over time. And we recognise that such measures have performed counter-intuitively in recent years: since 2008, official rates of low pay and relative poverty have fallen slightly as the bar against which they are measured—the median—has itself become lower.

But relative measures do tell us something important about how low paid workers are faring relative to the wider workforce. It is a problem, both socially and for the UK economy, that a large swathe of workers in the UK labour market are paid so much less for their labour than a typical worker.

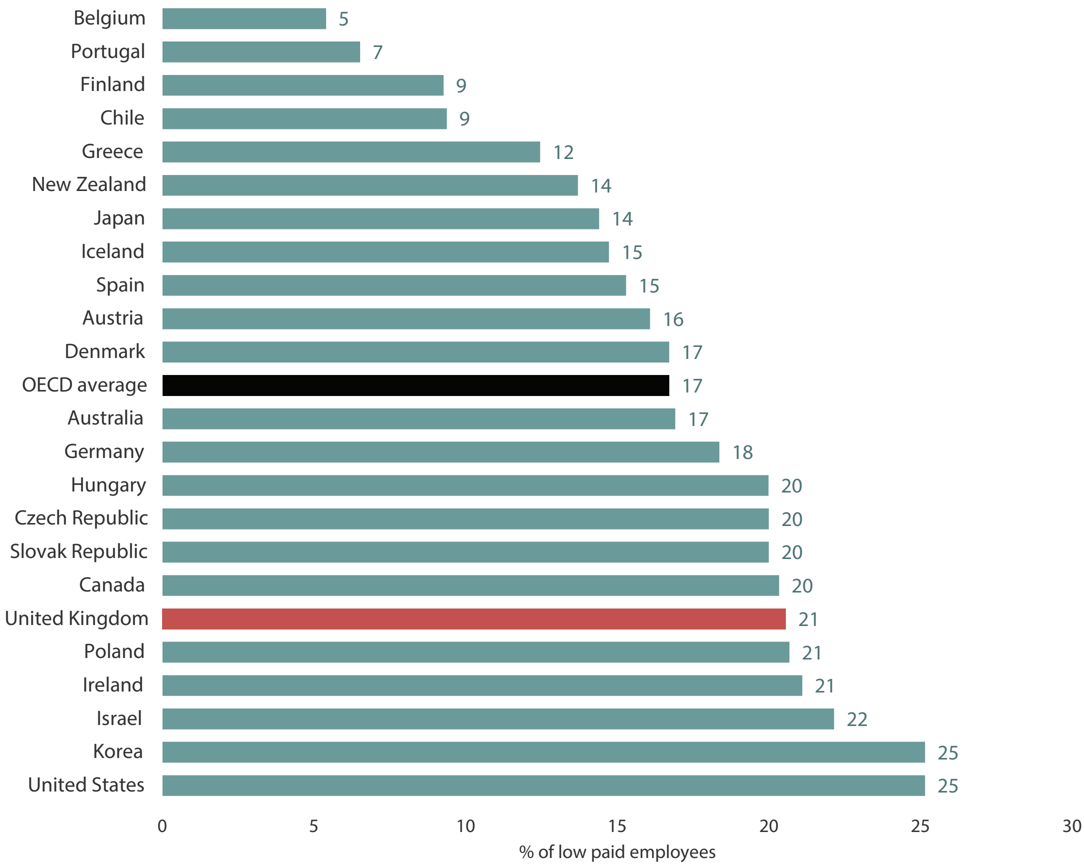
In focusing on a relative measure of low pay we have decided against basing policy on absolute measures like the Living Wage. We support the Living Wage campaign but think the LW is problematic as a formal guide to government policy. This is partly because the LW and the share of people earning below it is all but certain to rise steeply in the coming years regardless of trends in the wider economy (see Box 2, p.40 for details). This outcome is built into the formula for the LW. The LW is also a volatile measure; from 2009 to 2012, the share of workers earning below the Living Wage jumped from 14 per cent to 20 per cent. This would be a problem if we were to use the LW to frame a strategy to tackle low pay.

Finally, because the formula through which the Living Wage is set is highly sensitive to changes in the prices of certain goods and to changes in tax and benefit policy, a strategy to tackle pay below the Living Wage is far broader in scope than a focus on pay itself. It would include, for example, efforts to control the prices of key goods and would include much of welfare policy. This breadth clearly has upsides. But it also draws the focus away from the specific and important problem of why some workers secure such low returns for every hour they work, a problem we think deserves specific attention. We focus on low hourly low pay for a similar reason; isolating issues of skills and productivity rather than working hours and employment rates.

Being an average performer would be a good first step…
In terms of the level of ambition, international benchmarks are a useful indicator. There are a number of benchmarks which could guide a strategy to tackle low pay (see Annex 2). One possible goal would be to reach the OECD average incidence of low pay. The UK's current share of low pay is 21 per cent of employees compared to an average of 17 per cent across the OECD – see Figure 11. These figures focus only on full-time workers but give a reasonable sense of the level of ambition needed to make the UK an average performer.

In practice of course, it would be appropriate for the government to consult on the precise figure for this ambition, particularly to examine how the UK's scale of part-time workers affects its performance on low pay relative to other developed economies. As a sense of scale, if the UK were to reduce its share of low pay from 21 to 17 per cent, this would mean lifting about 1 million people out of low pay, a challenge that is ambitious but not unachievable. For example, as we note in Chapter 5, many low paid employees work in sectors of the UK economy that seem likely to be able to pay their lowest paid workers significantly more.

Figure 11: Low pay in the OECD
Percentage of full-time workers earnings below two-thirds of the gross hourly wage for full-time workers, 2011



Sources: RF analysis of stats.OECD

To make its ambition meaningful, **we recommend that the government set out a practical plan to deliver on its ambition to reduce the incidence and persistence of low pay.** This should include its view on the contribution that the minimum wage can and cannot make to its broader ambition on low pay (see later recommendations in Chapter 4). But this cross-government plan should extend well beyond the minimum wage and the wider work of the LPC to include, for example, targeted skills investments to raise the productivity of low paid groups of workers and specific work in regions and sectors of the UK economy that fall short on international productivity comparisons.

The government's plan to tackle low pay should also major on earnings mobility. This area of policy is less well developed and we would not want a focus on persistence to distract from work on the incidence of low pay, which we think is important in its own right. The priority accorded to both of these areas should be raised. But in the case of persistence, there is a stronger case for new work, particularly to develop fuller and more timely measures of the persistence of low pay for different groups, so that policy can better be targeted.

The LPC should be broadened and elevated to become the government's main watchdog on low pay…
Having set out an explicit objective and plan to tackle low pay, the government would benefit from a fuller policy infrastructure to support this goal. In other areas of economic policy, from fiscal policy to skills policy, well-resourced bodies (e.g. the OBR and UK Commission for Employment and Skills (UKCES)) are established with wide-ranging responsibilities to drive progress.

We believe that a similar architecture would improve the quality of policy-making and the momentum behind an ambition to tackle low pay. **We recommend that the LPC's permanent Terms of Reference be revised to give it a central role as the government's main watchdog on low pay, broadening its work to include monitoring the extent and persistence of low pay, diagnosing its causes and consequences, advising the government on how to reduce its scale and assessing the government's performance on achieving its ambition.**

A number of core responsibilities should be included in the revised Terms of Reference for a broader LPC:

• To publish a comprehensive annual audit of the scale and persistence of low pay in the UK labour market. A primary shortcoming of the current settlement is that the LPC does not monitor the extent or persistence of low pay. As the problem of low pay has grown, parts of government—the Social Mobility and Child Poverty Commission, UKCES and parts of the Department of Work and Pensions and BIS—have picked up some of these responsibilities. But no part of government is tasked with setting out a full account of the extent and persistence of low pay. Again, it would be wise for the LPC to focus on the official measure of low pay in its work on the incidence of low pay. (Annex A gives a guide to the kind of analysis that could be included in an audit of low pay.) But this work should also be extended to cover the vital issue of the persistence and to develop more accurate and timely ways of understanding this problem.

• To analyse the causes, costs and consequences of low pay. This should include research into the skills and productivity of low paid workers and the widespread costs of low pay for individuals and society but should also cover the impact of low pay on the public finances. A number of estimates have been made for the impact of low pay, and of a higher minimum wage, on the public finances. While there are large direct positive effects from a higher minimum wage as a result of reduced benefit spending and higher tax revenues, there are also indirect effects that, while much harder to measure, are likely to be negative. Given the importance of this issue, far more work is needed to understand fully the interaction of low pay and the minimum wage with the fiscal position.

• An account of the link between low pay and household incomes. Low pay is a problem in its own right, independent of its link to incomes. But a key reason to care about low pay is its association with low overall household income. This is particularly important because the minimum wage's impacts on incomes vary for different types of households (see Box 1). For example, the NMW lifts incomes more when households are not in receipt of state support. This is not uncharted territory for the LPC: its 2005 report, for instance, included work on the impact of the minimum wage on incomes following the introduction of tax credits.

Chapter 4
A more far-sighted minimum wage

In this chapter we turn to how the minimum wage itself could be made more far-sighted and ambitious, contributing more to the government's overall goal on low pay. This is not an easy reform to get right. The flexibility with which the NMW is set and its responsiveness to labour market conditions are essential to the policy's success. The minimum wage is cautiously set for good reason and in our discussions we have rejected several ideas that would have departed too far from the simplicity of the 1998 settlement. Our proposals retain the core of this approach and build on it rather than changing it fundamentally.

The minimum wage has a short time horizon for good reason…
While some of the short-termism of the minimum wage reflects the particular battles of 1997-98, other aspects are more fundamental to the policy's success. In particular, it is vital that the minimum wage stay responsive to changing labour market conditions. This is an essential feature of the UK NMW and one that should not be sacrificed. We are clear therefore that the fundamental role of the LPC, recommending the rate of the minimum wage each year on the basis of the latest evidence and the agreement of social partners, should be retained. Handing this decision to politicians, or committing the LPC in advance – for example by pledging to raise the NMW to a rate such as the Living Wage – would destroy much of what is good about today's system and would fragment its coalition of support.

For the same reason, we reject the idea of indexing the NMW to a measure of the cost of living. As we saw in Chapter 2, had the UK minimum wage been linked to inflation it would have grown more slowly in the good years and more quickly in the bad years, and would have ended up lower overall. This seems to us in all respects a worse outcome than today's approach.

Box 2: Why can't the government raise the minimum wage to the Living Wage?

The Living Wage campaign itself recognises that the Living Wage (LW) should not be mandated through government policy. It is clear that the LW is to be pursued through a voluntary civil society campaign. To understand why this approach is necessary, we need to understand how the LW is set. The national rate is calculated as follows:*

- Focus groups agree on the basket of goods that is needed to live a basic standard of living in Britain today for nine different types of households.
- The cost of these baskets is used to calculate the lowest wage a person living in each of the households would need to earn, working full-time and after taxes and benefits are taken into account, to pay for these goods. These nine results are then averaged to produce a single figure.

• This figure is in effect the real LW and is known as the 'reference rate'. In 2013-14 it is £9.08. However, to prevent the LW from rising too quickly, annual increases are capped at the growth of average earnings plus two percentage points. In recent years this cap has limited the 'applied' LW to £7.65 an hour. This is the rate of the LW used by campaigners today. When the applied rate lags the real rate, as it does today, it is allowed to catch up over time, limited only by the cap.

This formula has a number of implications. First, because the applied rate has fallen some way behind the real rate, the Living Wage is now all but certain to rise 2 per cent faster than average earnings for the foreseeable future as it catches up with the rate calculated by the formula. Second, the value of the LW is affected by changes to welfare policy; the LW rises when state support is cut and falls when state support is made more generous. Third, because it reflects the cost of a minimum standard of living, the LW is highly sensitive to the prices of certain goods.

These characteristics are inevitable in any attempt to calculate an absolute measure of living standards like the LW. They do mean, though, that the LW moves largely independently of wider earnings in the economy. They also mean that the LW will cover a rapidly growing share of the UK workforce in coming years, building on the growth seen in recent years. From 2009 to 2012 the share of UK employees earning below the LW rose from 14 to 20 per cent.

* The London Living Wage also takes into account the poverty line and adds a buffer of 15 per cent to reflect the need to save for large irregular costs.

The minimum wage can be strengthened while retaining flexibility…

So we agree that the core process for setting the minimum wage should be retained. But we see a strong case for building on this foundation, giving more clarity over the future direction of the minimum wage and striking a more judicious balance between short-term flexibility and medium-term ambition. There are two main aspects to the short-termism that we identified in Chapter 2, and these demand slightly different responses:

• First, there is a lack of clarity. This has an immediate aspect, in that there is political pressure to restore the value that the minimum wage has lost in recent years. This is essentially a one-off problem that has arisen from the highly unusual situation in which wages have fallen across the economy in recent years, with the NMW being allowed to fall alongside them. And it also has the more permanent element that employers receive little notice each time the NMW is uprated. This creates uncertainty and has long been a complaint of small employers and employers in low paying sectors whose work requires them to bid for contracts, often more than a year in advance.

• Second, there is the more fundamental and general question of how the process for setting the minimum wage balances short-term flexibility with medium-term ambition. This is a more challenging problem to fix but our work, drawing lessons from other areas of economic policy, suggests that a stronger approach is not impossible. As things stand, the process for setting the NMW stresses short-term flexibility at all costs and has no direction. We recommend a more balanced approach.

Starting with clarity, we sympathise with those who want to know when the minimum wage will recover its lost value. For this reason, we support the sentiment of the Chancellor's recent announcement. But we have concerns about ad hoc interventions late in the course of the LPC's well-formed process and would argue for a more formal, considered approach. **We recommend that the Secretary of State for Business ask the LPC to publish its best estimate of how long it will take for the National Minimum Wage to recover the value it has lost in recent years**. In our view, it should become standard practice for the LPC to publish a recovery path of this kind whenever it faces the unusual situation of having to recommend a real terms cut in the NMW, as it sometimes will.

To reduce uncertainty for employers in the longer-term, our view is that there would be more benefit than harm in the LPC being open about its future intentions for the minimum wage. The LPC currently submits its recommendation on the NMW in February and the government typically announces the new rate in April. This gives employers just six months' notice before the new NMW comes into force. Small firms have understandably complained about this process and employers in low paying sectors have noted the difficulty of bidding for contracts with little clarity over their future costs. **We recommend that the LPC be asked to publish, alongside its main recommendation for the NMW that can safely be introduced later that year, a preliminary recommendation for the subsequent year**.

The LPC's preliminary second-year recommendation would be open to revision. The LPC would be wise to set out its logic for this recommendation to reduce the political costs to either employers or unions from changing the figure in its final recommendation a year later. For example, the LPC might explain that its second-year recommendation is based on the NMW rising to a certain proportion of median earnings. If median earnings growth was then weaker than forecast, the figure could be revised. We understand the difficulty of forecasting over 18 months. But much longer-term forecasts are now commonplace in economic policy, including in areas where they guide government policy. For all their uncertainty, most would accept that these statements are better than having no forecasts and no signal of the government's intentions at all.

The main game – making the minimum wage more ambitious

The second and more fundamental respect in which the NMW is short-termist is in the balance it strikes between short-term flexibility and medium-term ambition. Currently, the NMW leans entirely towards the former and the process for setting the UK minimum wage gives no sense of direction. This reflects the extreme caution with which the settlement was designed. In its effort to depoliticise the minimum wage, the government has fallen into the unnecessary position of being entirely neutral about its value. This constrains what the minimum wage achieves by making the policy more passive than it needs to be. Without a sense of where the government would like the NMW to go, the LPC is left simply to describe the UK labour market and all its constraints as it sees them today, rather than advising the government on ways to make a higher NMW possible over time.

How could this approach be changed without losing flexibility? We recommend a two-pronged approach, incorporating a stronger role for government in setting out its political ambitions for the minimum wage and a slight reframing of the LPC's work that nonetheless retains the LPC's responsibility to pass judgment on the rate that can be safely introduced from year to year.

On the political side, **our recommendation is that the government should, as a matter of routine, set out its ambitions for the future value of the minimum wage.** This expression of intent would leave the LPC free to pass judgment on the NMW that can safely be put in place from year to year. The government should set its medium-term goal on the NMW to reflect what it thinks the NMW can and cannot contribute to its wider goal of reducing the incidence of low pay. This goal should be ambitious but achievable over the medium-term with the support of wider policy action.

There should be an ambition to raise the NMW relative to median earnings…
Setting a goal for the NMW raises two questions: what form should the government's ambition take and what level should it set? In terms of the form, we do not think the government should fix a target for the minimum wage to a particular year. This overstates the government's power to shape the labour market and also runs the risk that the target becomes increasingly unachievable as the deadline approaches, losing all force and even undermining efforts. We are more persuaded by the idea of a rolling ambition of the kind that guides fiscal policy. This has the attractive quality of retaining flexibility while also giving a trajectory and forcing the government to always have in place a credible, auditable plan.

While we understand the salience of the real terms value of the minimum wage, or a cash figure, this is not the right way of framing the government's objectives on the NMW. As the NMW has fallen in recent years, it has become commonplace for policymakers and politicians to talk of a return to real terms growth in the minimum wage. This raises real concerns of an era of diminished expectations – in any normal period, it should be a given that the minimum wage, along with wages in the wider economy, rises in real terms. Nor should a cash figure become a lodestar for the LPC to follow. The NMW has always risen in cash terms, even in recent years. The important question is its trajectory and its relationship to wages in the wider economy. We therefore favour an aspiration for the minimum wage as a proportion of the median wage.

In terms of the level of the ambition, it would fall to the government of the day to settle on a goal through an official process of research and consultation. Our own sense of the UK evidence to date and international experience is that an adult minimum wage of 60 per cent of the median wage is a reasonable lodestar, indicating the most that a NMW could contribute over the medium- to long-term. This assumes that policy works actively to ease pressure on certain parts of the economy. The highest bite the UK minimum wage has seen to date is 55 per cent of median hourly pay in 2012 and the minimum wage would have risen to 57 per cent under the Chancellor's suggestion of a £7.00 minimum wage in 2015.

International comparisons are also reassuring, although they need to be used with care. The most comprehensive comparisons of minimum wages come from the OECD. However, these figures compare minimum wages with median pay for full-time employees and therefore give much lower figures than comparisons with the overall median.[1] This needs to be taken into account when thinking about how a UK NMW of 60 per cent of the overall median would rank internationally. OECD data suggest that the UK minimum wage is 47 per cent of median full-time earnings, which is 7 percentage points lower than its bite for all workers. In a number of countries the NMW for full-time workers is several percentage points higher (for example, 60 per cent in New Zealand and 53 per cent in Australia). This implies an overall bite of 60 to 65 per cent in leading countries, suggesting that a NMW of 60 per cent of the overall median would put the UK somewhere in the top third of developed economies.

We see this goal, be it 60 per cent of the median wage or another figure, as having two purposes. It would inject ambition, shifting the LPC onto the front foot – especially when linked to our recommendation below. But just as importantly, it would also clarify what the NMW cannot do. The minimum wage cannot simply be raised to 66 per cent of the median wage in order to eradicate low pay – even in the long-term this is not kind of role a minimum wage can play. Aiming for a minimum wage of 60 per cent of median earnings therefore emphasises that, while the NMW may be able to do more work in reducing low pay, a full strategy to tackle low pay will need to draw on a far wider range of policy tools and will need to be a joint effort between the government, business and civil society.

The LPC's work should be reframed to complement this political goal…

The other half of our proposal to inject ambition into the NMW is to reframe the LPC's work. We are clear that the government's ambition on the NMW should be no more than an expression of intent: the LPC should continue to make the empirical judgment of the value at which the minimum wage can be set without employment effects from year to year.

But as the LPC acknowledged this year, the minimum wage that the labour market can bear is not an unalterable fact; government policy can make it more

1 Full-time workers earn more than part-time workers and therefore have a higher median than that of all workers.

or less risky to raise the NMW. Once the government departs from neutrality on the minimum wage, to be clearer that it would like to see a higher rate, this frees up the LPC to take on a more pro-active role, advising the government on how this can be achieved.

We recommend that the LPC's permanent Terms of Reference be amended to require that the LPC publish, alongside its recommendation for the NMW (a) an assessment of the extent to which its recommendation meets or falls short of the trajectory aspired to by the government; and (b) where its recommendations fall short, a commentary on the blockages to a higher rate and advice on policy. This should include an assessment of how close different sectors of the UK economy are to being able to pay the minimum wage to which the government aspires.

Our intention is that the LPC complement its vital ongoing role of monitoring the historic effects of the minimum wage with more forward-looking work that asks:

- What is the gap between the minimum wage that can safely be introduced today and the minimum wage to which the government aspires over the medium-term?
- What can be done to close this gap so that we can safely recommend a higher NMW in future?

Box 3: How could policy support a higher minimum wage?

As the LPC has acknowledged, the minimum wage that the labour market can bear is not an unalterable fact. The government's choices in other areas of policy can either free up or restrict the safe level of the NMW. This is a relatively unexplored area, not least because it has not been built into the LPC's work to date, but evidence already points to certain policy areas that are relevant when thinking about how to allow for a higher NMW:

- **The gap between the youth rate and the adult rate** – although evidence is mixed, some studies have suggested small effects on hours worked for young people since 2008. These findings have not been replicated but other studies have also suggested that young people may be more sensitive to the minimum wage.[1] As the adult NMW rises, the LPC would be wise to monitor the gap between the adult and younger persons rate.[2]

- **The funding of social care** - the underfunding of social care has been repeatedly cited by the LPC as potentially exacerbating the non-payment of the NMW.[3] Evidence also suggests a small negative effect of the NMW on employment in small low paying care homes.[4] The LPC itself has now suggested that a more adequately funded social care sector might enable a higher NMW over time.[5]

- **Employer taxes for small firms** – our own research suggests that small employers face propor-

1 Bryan, M., Salvatori, A. and Taylor, M. (2013) and Dolton, P. and Rosazza Bondibene, C. (2011) An Evaluation of the International Experience of Minimum Wages in an Economic Downturn, Royal Holloway, University of London

2 The LPC has recommended a minimum wage for 18-20 year olds of £5.13 an hour from October 2014 and £3.79 an hour for 16-17 year-olds.

3 Resolution Foundation research has confirmed this problem, finding that around 200,000 domiciliary care workers are likely to be paid less than the legal wage-floor. Pennycook, M. (2013) Does it pay to care? Under-payment of the National Minimum Wage in the social care sector, Resolution Foundation.

4 Machin, S., Manning, A. and Rahman, L. (2003) Where the Minimum Wage Bites Hard: Introduction of Minimum Wages to a Low Wage Sector. Journal of the European Economic Association. 1(1), pp. 154-180

5 Letter from the Chair of the Low Pay Commission to the Secretary of State for Business, Innovation and Skills, February 2014

tionately larger increases in their wage-bills when the NMW rises. (See Annex 3.) Shifting the balance of employer taxes away from small firms may be one way of easing the transition to a higher NMW.

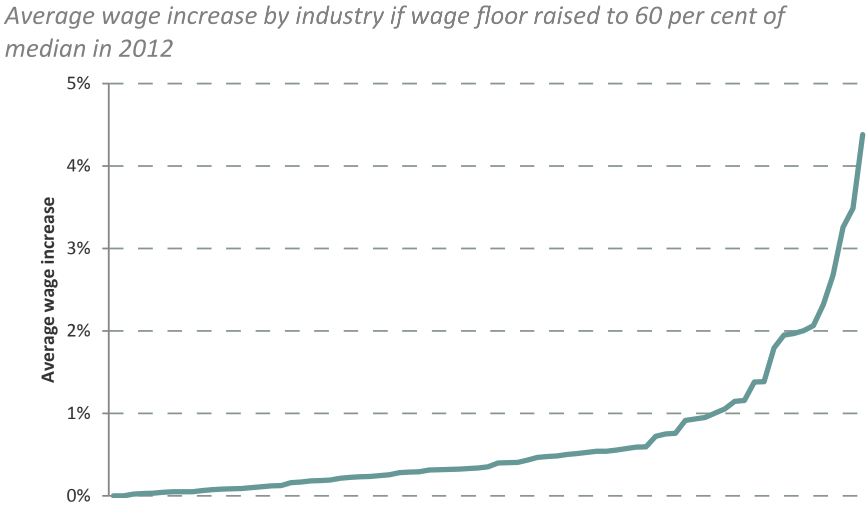
Support for low skilled employees – the productivity of low paid workers remains an important constraint on what the NMW can achieve without negative employment effects. This is likely to be a particular constraint in certain industries and among certain groups of workers. It may be that targeted skills support could reduce the vulnerability of these parts of the economy to a higher NMW. It is also worth considering the demand for skills, for example the introduction of occupational licensing into the security sector required increased investment in employee training and may have contributed to the NMW having greater ripple effects (see Annex 3) in the sector.

The LPC should monitor progress towards the government's ambition by sector…
With the LPC taking a more pro-active approach, one of the priorities for analysis would be an assessment of how close different sectors of the UK economy are to being able to afford the government's ambition for the NMW. For example, if the government is aiming for a NMW of 60 per cent of the median, how many sectors could already afford to pay that today?

This is a question worth asking because exposure to the minimum wage varies significantly by sector. Figure 12 shows the average increase in the wage-bill that would result in each of the 85 sectors of the UK economy if the minimum wage were raised to 60 per cent of the national median wage. The results are ranked from sectors on the left that could easily afford a higher minimum wage to sectors on the right that would struggle. Two implications are clear. First, many sectors of the UK economy could likely already afford a minimum wage of 60 per cent of the median, which would cause only a small increase in the wage-bill. Second, a small handful of sectors face much larger impacts than all other sectors. These sectors present a more fundamental obstacle to a higher minimum wage and would merit more attention.

Figure 12: How much would a higher minimum wage cost different sectors?

Average increase in wages by sector from a minimum wage worth 60 per cent of the median wage



Source: Resolution Foundation analysis, Annual Survey of Hours and Earnings

Judgments like these could contribute to a more strategic approach to the NMW. The LPC could indicate, for example, sectors that could already afford to pay a minimum wage of 60 per cent of the median today; sectors that could likely adapt to the higher rate over time without fundamental changes, if given enough notice; and sectors that face much more fundamental barriers and would likely require more intensive support and reform.

Chapter 5
A more assertive approach with new tools

In the final chapter of this section we turn to how other tools could complement the NMW. For all that the minimum wage could be more ambitious, a single mandatory wage-floor will always be a blunt way of pushing employers to pay more. The tools we propose in this chapter should add to, rather than replace, the mandatory NMW, which should remain the UK's only legal wage-floor. But new pressure points should be used to encourage employers to treat the NMW as an absolute floor, rather than a going rate.

There is no strong case for sectoral or regional minimum wages…
We saw in Chapter 2 evidence of the growing number of workers who earn at or around the minimum wage. Too many employers have come to treat the minimum wage as the going rate, a guide to pay rather than a red line that should never be crossed. This raises the question of how new pressure points could be created, encouraging employers to go beyond their legal duty when they could afford to do so.

One suggestion made to us in the course of our work is that this could be done by setting more than one legal minimum wage. It is worth addressing this idea head on. Some have argued for regional minimum wages while others have argued for mandatory minimum wages to be set by industrial sector. There is a logic to these arguments: a single wage-floor will always be held back by the most vulnerable region or sector in the economy. Allowing the rate to vary would allow higher rates – and, some say, lower rates – to be set in certain geographical areas or sectors.

We reject the idea that lower rates should be set in any part of the UK economy. This reflects a misunderstanding of the LPC's remit. The remit is already clear that the minimum wage should be set as the rate that the lowest paid sector or region of the UK could bear. And indeed evidence suggests this has been achieved; there is no clear evidence of an unemployment effect from the NMW even in the lowest paying region of the economy. This gives us no reason to support lower regional rates.

We are more persuaded by the argument, reinforced by the LPC in its 2014 report, that some parts of the UK economy could afford to pay more; indeed, this is an inevitable feature of any single mandatory minimum wage. This raises the prospect that the UK could emulate federal systems such as Canada, Australia and the US, where sub-national governments have the power to set a minimum wage higher than the national rate. Our considered view in this report is that other steps should be tried before the risk is taken of varying the legal minimum wage. Such variation would depart entirely from the simplicity of the 1998 settlement. There are also concerns of practicality, although it is worth noting that many others countries already allow regional variation and that some (Australia, for example) already impose mandatory sectoral minimum wages. The UK itself used to operate a system of sectoral minimum wages through the wages councils.

While we believe that fragmenting the legal minimum wage is a step too far, we do think the LPC could do more to emphasise that large parts of the UK economy could afford to pay their lowest paid workers more than the NMW. Informing this debate should be part of the LPC's role. This could use the LPC's authority to good effect, creating new pressure points above the legal minimum wage that push employers to go beyond their legal responsibilities where they could afford to. It is also a sentiment with which the LPC agreed in its 2014 report, in which it welcomed the pressure already facing some employers to pay more.

Without mandating different minimum wages, the LPC could still foster and inform the debate by publishing information. As we saw in Chapter 4, industrial sectors are a good place to start when analysing the wage-floor that different types of employers could afford to pay. **The Secretary of State should ask the LPC to publish analysis that shows which sectors of the economy might be able to pay more than the recommended NMW.** This analysis would re-emphasise that, whatever its value, many employers will be able to go further than the legal NMW.

Publishing data of this kind would be a new approach for the LPC and finding the right balance will require iteration. On the one hand, it would be helpful to campaigners, wage-negotiators and employers for analysis to be intuitive, simple and salient. On the other hand, it is important not to over-simplify the pressures that face different employers. The analysis would need to take into account, for example, factors such as the impact on employers' wage bills of raising the NMW and the importance of wage-costs to employers' overall operating costs and profits.

As we noted in Chapter 4, one question worth investigating is: how much does a higher minimum wage push up wages on average in different sectors of the economy? Figure 13 expands our earlier analysis to show how much wages would rise on average in different sectors if employers effectively eliminated low pay, raising the pay of their lowest paid staff to £7.45 an hour (two thirds of the median wage in these 2012 data). The estimates include conservative spill-over effects higher up the wage distribution. The results vary widely; while some sectors would struggle to eliminate low pay, some may be able to absorb the costs of doing so.

Figure 13 also gives a sense of how much could be achieved if employers in these sectors were to agree to pay their lowest paid workers more. It shows the cumulative number of low paid workers by sector, running from sectors that could easily afford a higher minimum wage to those that would struggle. The number of low paid workers in promising sectors depends on our definition of what is 'affordable':

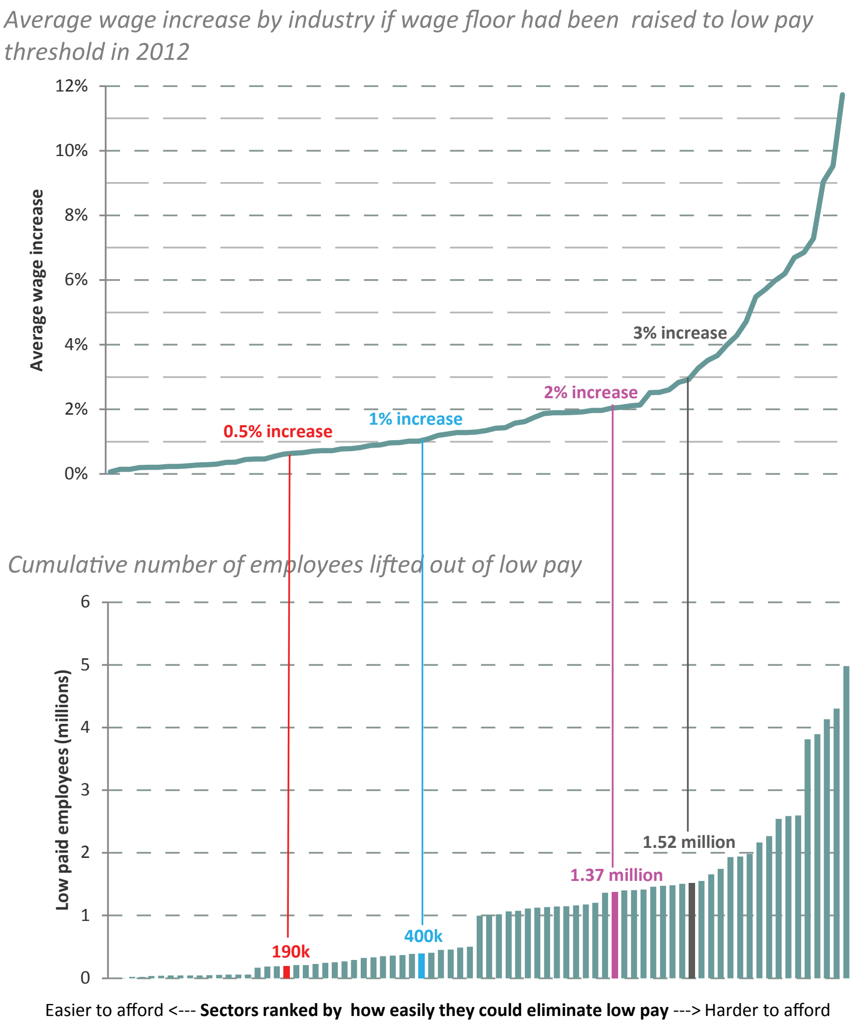
- If we assume that employers are able to absorb an average increase in wages of 0.5 per cent, 190,000 low paid workers work in sectors that could afford to eliminate low pay;

• If we assume that employers are able to absorb an average increase in wages of 1 percent, 400,000 low paid workers work in sectors that could afford to eliminate low pay.

• On a more stretching estimate, if we assumed that employers were able to absorb an average increase in wages of 2 per cent, 1.4 million low paid workers would work in sectors that could afford to eliminate low pay. Lifting this number of workers out of low pay would more than achieve the ambition of reducing the UK's share of low pay from 21 per cent to 17 per cent.

These figures should not be taken as definitive judgments on the wages that different sectors could afford to pay. And of course an affordability analysis only takes into account one relevant variable, not considering the distribution of workers' productivity. But this analysis gives a sense of how much the affordability of a higher minimum wage is likely to vary by sector.

Figure 13: The affordability of eliminating low pay by sector



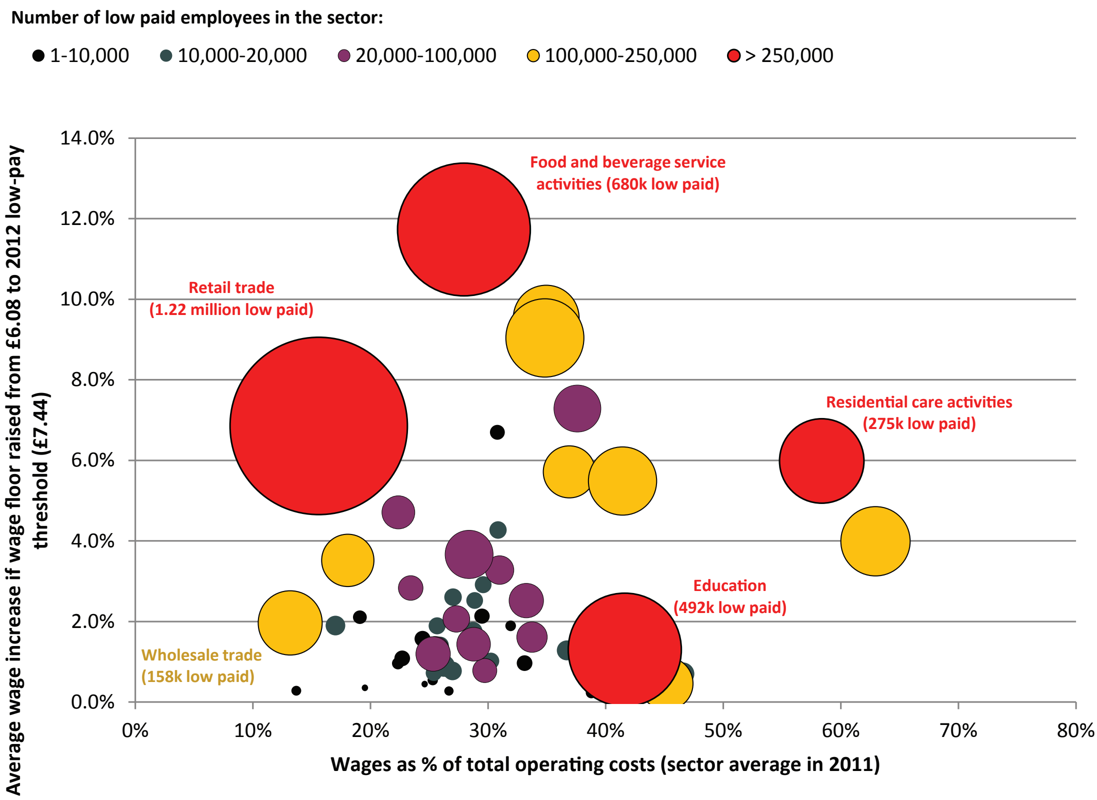
Source: Resolution Foundation analysis, Annual Survey of Hours and Earnings 2012

Another area for investigation would be: how significant are wage costs as a proportion of overall costs? This is relevant because a low-paying employer might see a large increase in their wage-bill from paying their lowest paid staff more, but might find this easy to absorb because wages are a small portion of their overall costs. Likewise, in some sectors wages are by far the largest component of employers' costs. In these sectors a large average increase in wages is harder to bear.

When we consider the significance of wages to overall costs, a slightly different picture emerges. Figure 14 presents some exploratory analysis, setting out a scatter plot in which the vertical axis shows the average increase in wages in different sectors if the lowest paid workers were paid two thirds of the median wage. The horizontal axis adds new information, showing how important wages are to overall costs (wages as a percentage of total operating costs). The bubble sizes show the number of low paid employees in each sector.

Figure 14: Understnding the affordability of a higher minimum wage by sector

Scatter plot of wage-bill effects and wages as a share of costs



Source: Resolution Foundation analysis, Annual Survey of Hours and Earnings and Annual Respondents' Database

The results suggest, for example, that it might be relatively less costly to eliminate low pay in retail than in some other low paying sectors. This is because wages account for a smaller share of retailers' overall costs than they do in other sectors, for example social care. Given the size of this sector – retail contains over one million low paid employees, more than one in five of all low paid employees in the UK – it might be a good candidate for pressure from campaigners against low pay. An important caveat to this point is that our exploratory analysis also suggests that retailers with fewer than 10 staff struggle more with a higher minimum wage, while very large retailers appear to face proportionally lower costs.

This exploratory analysis also reconfirms that social care is one of the main obstacles facing any strategy to tackle low pay. Our analysis suggests that five sectors of the UK economy face particularly prohibitive costs if they were to eliminate low pay today by paying their lowest paid workers more. These sectors are: Personal Services (e.g. hairdressing), Residential Care (e.g. nursing homes), Accommodation Activities (e.g. hotels), Food and Drink Activities (e.g. restaurants) and Social Work Activities (e.g. elderly care and childcare). These highly problematic sectors together contain 1.25 million low paid workers, a third of whom (420,000) are employed in the largely publically-funded sectors of Residential Care and Social Work Activities.

The point of this analysis is not to make definitive judgments about what different sectors could afford to pay. Instead the intention is to indicate the likely extent of variation between sectors and to demonstrate that there is a productive agenda here for the LPC, turning its evidence-based approach to this issue to inform public debates about low pay. As we argued in Chapter 4, this sort of analysis, as well as creating pressure to go beyond the NMW, could also help to contribute to the goal of raising the NMW itself. It could help the LPC and government to be more strategic about where they direct pressure and where they direct support.

The LPC should investigate and publish an affordable wage for London…
Finally, turning to regions, our reading of the evidence is that the UK labour market does not vary enough by region or country to justify different wage-floors on either a mandatory or generally non-mandatory basis. When looking at the UK's internal labour markets however, the standout exception is London. Many national employers already have a specific London-weighting which they add to the wages of those working in the capital to recognise the higher cost of living. We see merit in a similar model for the NMW.

While the bite of the NMW varies by region, in most parts of the UK the NMW is equal to between 50 and 60 per cent of the hourly median wage. In London the bite is just 39 per cent.[1] Research already suggests that the London economy could bear a higher wage-floor.[2] Given its authority, it would be sensible for the LPC to carry out similar analysis, backed up by commissioned research, not least to secure the legitimacy of the social

1 RF analysis of ASHE 2013
2 Ussher, K. (2013) London Rising: the case for a London minimum wage, Centre For London

partnership model. **The Secretary of State for Business should ask the LPC to research and publish a figure for the minimum wage That London could bear without significant adverse effects on employment.** Our instinct is that this rate should not initially have the force of law, and should be published as a non-mandatory reference rate. But if the LPC judged that London could bear a higher rate, and employers did not respond to pressure to pay this rate, there may well be a case in future for granting the relevant authority in London the power to adopt the LPC's recommendation as a mandatory rate in the capital.

Conclusion

The recommendations set out in this report retain the core of the minimum wage settlement introduced in 1998. The UK is right to have a single mandatory minimum wage, recommended from year to year by the independent and evidence-based social partnership model of the LPC. This model should it be retained. But the government should build on this foundation a settlement that is broader, more far-sighted and more assertive. Far from replacing today's policy, this would give the minimum wage renewed relevance.

Of course we do not pretend that the reforms recommended in this report would solve the problem of low pay. The minimum wage could never do that alone. A serious effort to tackle low pay will need two pillars: efforts to raise the productivity of low paid workers and low paying parts of the economy; and judicious efforts to push employers to pay their low paid workers more when they could afford to. A more ambitious minimum wage, complemented by additional tools, and overseen by a more powerful LPC, is just one part of this.

Our conclusions diverge from two schools of thought that we have encountered in the course of our work. One of these contends that any change in the minimum wage runs too high a risk of breaking the system. We reject this idea. The LPC's reputation is robust enough, and its evidence-base and political support are deep and broad enough, to sustain a stronger approach. Of course a broader body would need more resources.[1] But there is no fundamental reason why the LPC could not rise to the challenge we set out here. Indeed, the LPC has already recognised many of the arguments we make in this report.

The other school of thought argues for more radical changes to the minimum wage to tackle the UK's pervasive problem of low pay. We sympathise with this instinct. But we also think it would be foolhardy to jeopardise an institution like the LPC without first seeing what a stronger version of that body can do. The LPC has proven its worth and is the envy of many countries. Britain does not have many authoritative and evidence-based institutions with broad political support. Those we have should be retained.

1 The LPC's budget is just £870,000, less than half that of the OBR (£1.75m) and a twentieth that of the more activist UK Commission for Employment and Skills (£19.2m excluding programme funding).

ANNEX 1
MAPPING LOW PAY

This report has recommended that the LPC be broadened and elevated to become a powerful watchdog on low pay, with a responsibility to monitor the extent and persistence of low pay and to advise on how to tackle these entrenched problems. We propose that a key part of this monitoring role would be for the LPC to produce a comprehensive annual overview of low pay in the UK labour market, informing public debate and supporting a more strategic response from the government.

There are a number of aspects of low pay which could be included. This annex builds on previous Resolution Foundation analysis which has sought to throw light on low pay in Britain.[1] An important part of this work is to examine how the extent of low pay differs by:

- household type
- age
- gender
- region
- job profile[2]

In addition, the Resolution Foundation has carried out important work on the persistence of low pay.

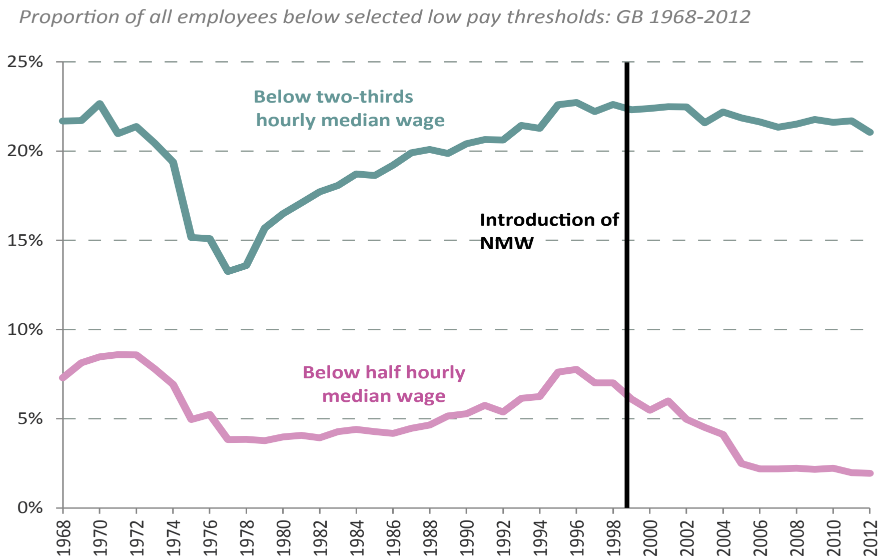
The shape and scale of low pay

The composition of low pay in the UK has changed since the introduction of the NMW in 1999. Figure 1 shows how the proportion of people who are extremely low paid – earning below half the hourly median wage – is at its lowest level for decades. It also highlights that the incidence of low pay – the proportion of people earning below two-thirds of the hourly median wage – has remained stubbornly high, hovering at around 20 per cent throughout the 1990s and 2000s.

1 See for example Whittaker, M. Low Pay Britain 2013 and Plunkett, J., Hurrell, A. and Whittaker, M. The State of Living Standards.

2 For an in-depth analysis of low pay by sector, see Annex 3.

Figure 1: The changing shape of low pay



Notes: Figures are drawn from three separate data sources. Where these sources overlap, differences exist in the proportions of employees reported to be below the various low pay thresholds. Figures prior to 1997 have been adjusted to account for the magnitude of difference recorded in these overlapping periods, in order to create a consistent time series. The original, unadjusted, data is presented in Whittaker, M, (2013) Low Pay Britain 2013.

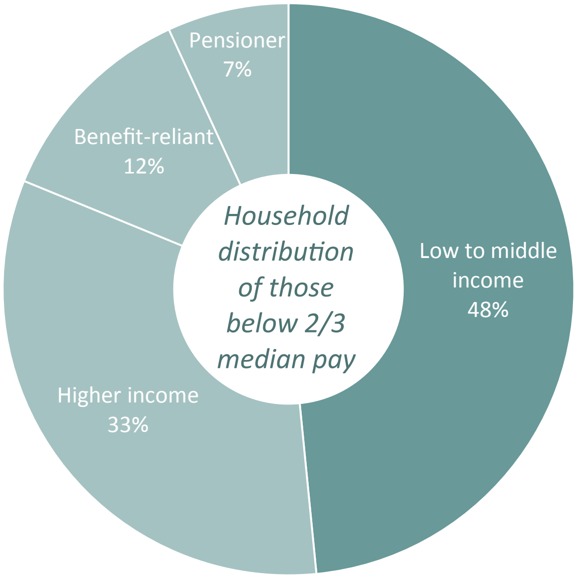
Sources: RF analysis of DWP, Family Expenditure Survey (1968-1981); ONS, New Earnings Survey Panel Data (1975-2012); and ONS, Annual Survey of Hours and Earnings (1997-2012)

Household types

It is also important to understand how the risk of low pay compares for different groups of workers and in different parts of the UK economy. Figure 2 describes the kinds of households in which low paid workers are found. We define those on low to middle incomes as households with before-tax incomes that are below median 'equivalised' (that is, adjusted for the size of the household) working age income, but above the poorest 10 per cent of working-age households. For a couple with no children, this is equivalent to an annual income of £12,000 to £30,000. We exclude those obtaining more than one-fifth of their total income from means tested benefits. Alongside this low to middle income group, we define households in the poorest tenth of the working-age distribution and those who receive more than one-fifth of their gross household income from means tested benefits as 'benefit-reliant.' We define those above the middle as 'higher income.'

Figure 2 shows that just under half of all those who are low paid live in low to middle income households. A third are found in higher income households while a smaller proportion live in benefit-reliant or pensioner households. This highlights the importance of low pay to low to middle income households but also underlines that the link between low pay and low income is complicated: some low paid people live in high income households, and some low income households do not suffer from low pay.

Figure 2: Distribution of low paid workers across household income groups: UK 2010-11



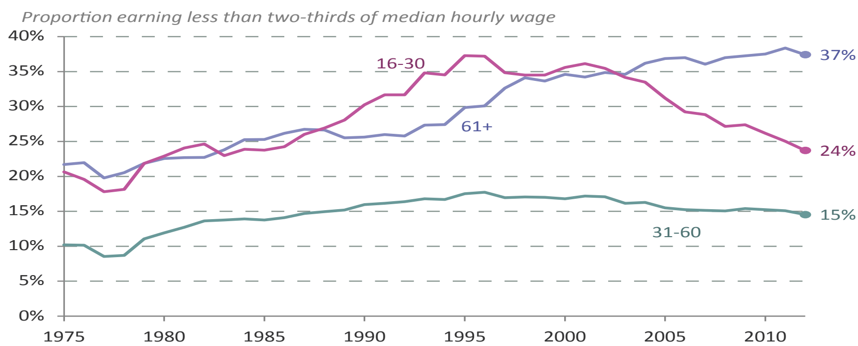
Notes: Figures based on derived hourly pay variable which should be treated with some caution due to potential inaccuracies and misalignments in self-reported hours and earnings data.

Source: RF analysis of DWP, Family Resources Survey 2010-11

Age

One of the most significant ways in which low pay varies is by age. Figure 3 shows how the risk of low pay within age groups has changed over time. Younger workers are more likely to be low paid. But the incidence of low pay by age has also changed over time. While the risk of low pay for people aged 61 and over has fallen dramatically since the early 2000s – from a peak of 37 per cent to 24 per cent in 2012, the opposite has occurred for workers aged 16-30. Since the early 1990s, there has been a steady increase in the proportion of that group which is low paid, from 25 per cent to 37 per cent.

Figure 3: Proportion of low paid employees by age group

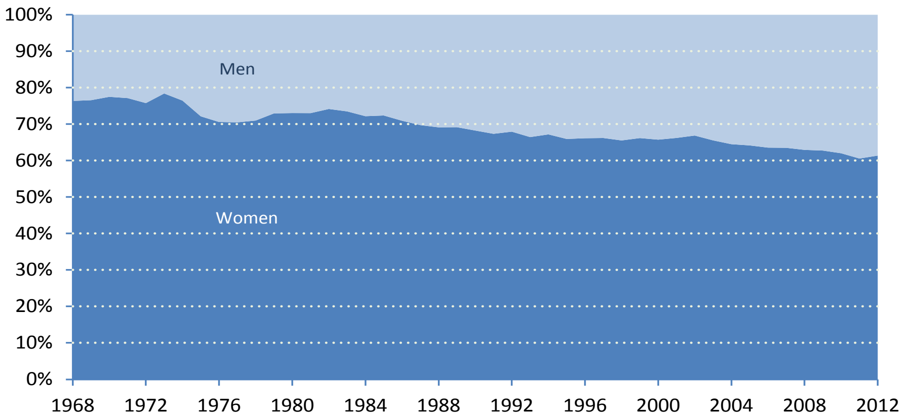


Notes: Figures are drawn from two separate data sources. Where these sources overlap, differences exist in the proportions of employees reported to be below the various low pay thresholds. Figures prior to 1997 have been adjusted to account for the magnitude of difference recorded in these overlapping periods, in order to create a consistent time series.
Sources: RF analysis of ONS, New Earnings Survey Panel Data (1975-2012) and ONS, Annual Survey of Hours and Earnings (1997-2012)

Gender

Women have historically received much lower rates of hourly pay than men. Figure 4 looks at trends in the distribution of low pay between the sexes over time. While the proportion of low paid work accounted for by men has risen over the past three decades from just under one-quarter (24 per cent) of all low paid workers to nearly two-fifths (39 per cent), women continue to comprise the bulk of all low paid workers.

Figure 4: the shifting gender make-up of low pay

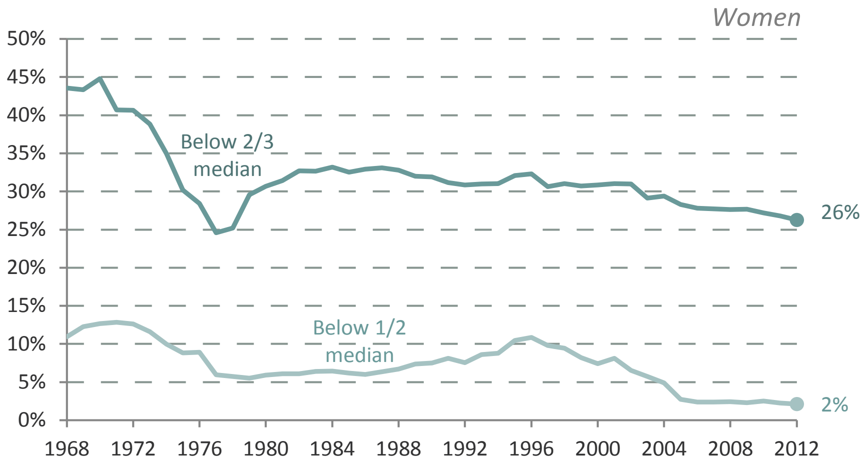


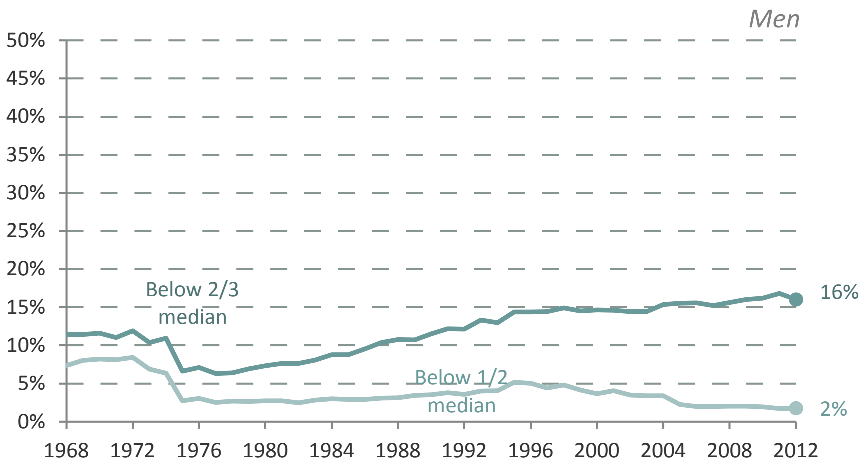
Notes: See Figure 1
Source: RF analysis of DWP, Family Expenditure Survey (1968-1981); ONS, New Earnings Survey Panel Data (1975-2012); and ONS, Annual Survey of Hours and Earnings (1997-2012)

Digging below the surface offers a slightly more encouraging picture on the increase in wages of low paid women. Figure 5 illustrates the rapid gains made on low pay for women in the early 1970s, when the incidence of low pay fell from a peak of around 45 per cent to a low of 25 per cent in just over a decade. This fall is largely the result of the 1970 Equal Pay Act.

Although the proportion of low paid female workers subsequently increased, reaching around one-third in the early-1980s, the trend over the last three decades has been one of gentle but steady improvement. In contrast, the proportion of low paid male workers climbed relatively rapidly between the mid-1970s and late-1990s, albeit from 6 per cent to 15 per cent, levels that remained well below those recorded among women. As with the overall trends, the proportions in extreme low pay declined significantly for both men and women alongside the introduction of the NMW. Evidence suggests that the NMW has had a more significant effect on the gender pay gap than any policy since the Equal Pay Act.

Figure 5: Proportion of low paid employees by gender



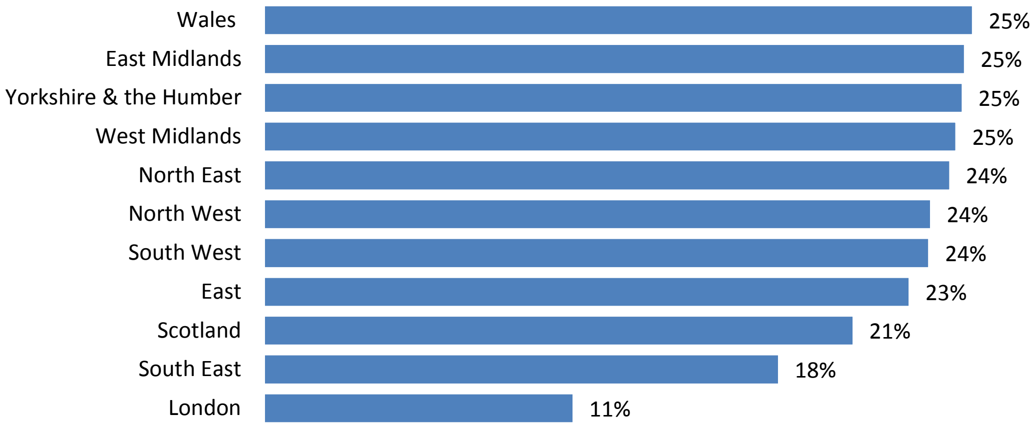


Notes: See Figure 1
Source: RF analysis of DWP, Family Expenditure Survey (1968-1981); ONS, New Earnings Survey Panel Data (1975-2012); and ONS, Annual Survey of Hours and Earnings (1997-2012)

Region

Low paid workers can be found in every region of Britain, although there is a clear distinction between London, and to a lesser degree the South East, and the rest of the country. Just one in-ten (11 per cent) employees in London earned less than two-thirds of median hourly pay in April 2012 in London, compared with one-in-four (25 per cent) in many other parts of Britain, as Figure 6 shows.

Figure 6: Proportion of low paid employees by region



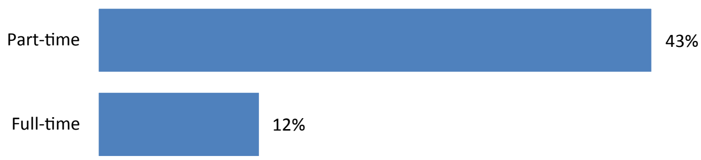
Source: RF analysis of ONS, Annual Survey of Hours and Earnings

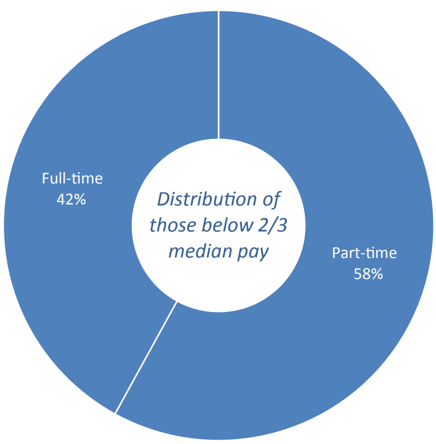
Job status

Low pay in the UK varies significantly when we compare full-time workers with part-time workers. As Figure 7 shows, the risk of low pay is much higher for part-time employees, with 43 per cent low paid, while only 12 per cent of those working full-time are low paid. Part-time employees make up the majority of the low paid, accounting for 58 per cent of all those earning less than two-thirds of the median hourly wage.

Figure 7: Proportion of low paid employees by employment status

Proportion earning less than two-thirds of median hourly wage

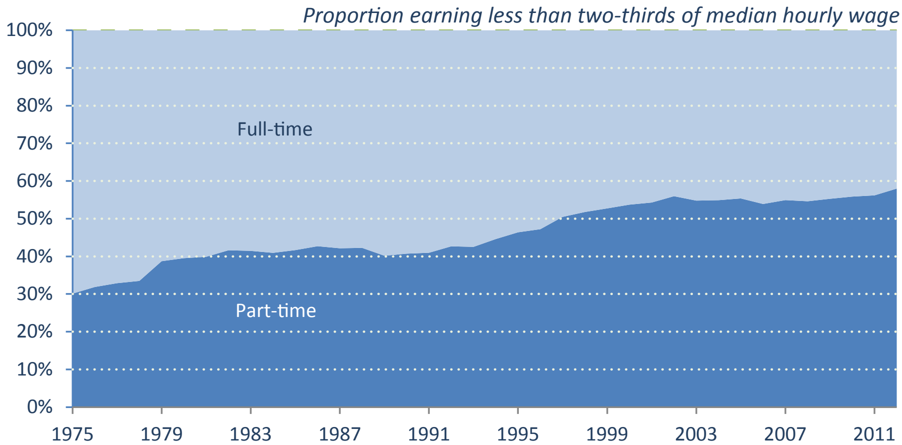




Source: RF analysis of ONS, Annual Survey of Hours and Earnings

The relationship between job status and low pay has changed over time. Until 1996, full-time employees always made up a larger share of the overall low paid workforce than part-time employees. But, as Figure 8 highlights, since then part-time employees have made up the majority of low paid workers. Previous Resolution Foundation research has stressed the importance, particularly to women, of improving the quality of part-time work.[3]

Figure 8: Proportion of all low paid employees by employment status



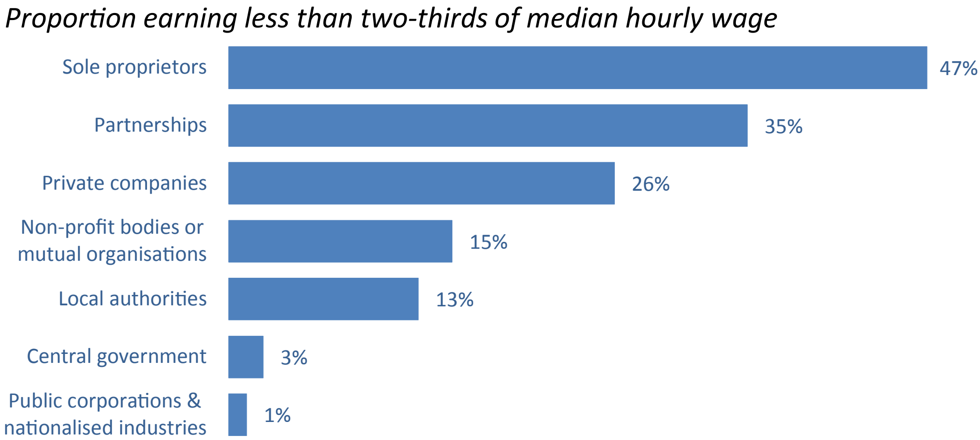
Source: RF analysis of ONS, Annual Survey of Hours and Earnings

The risk of low pay is closely associated with precarious forms of employment. A third of workers employed on a temporary or casual basis were low paid in April 2012, compared with one in five (20 per cent) permanent employees. Temporary workers (5 per cent) were also much more likely to be in extreme low pay than their permanent counterparts (2 per cent).

The kind of organisation you work for also influences the likelihood of being in low pay. As Figure 9 illustrates, employees of sole proprietors face the highest risk of being low paid while employees of central government and public corporations and nationalised industries have the smallest risk of low pay.

3 Alakeson, V. (2012) The price of motherhood: women and part-time work

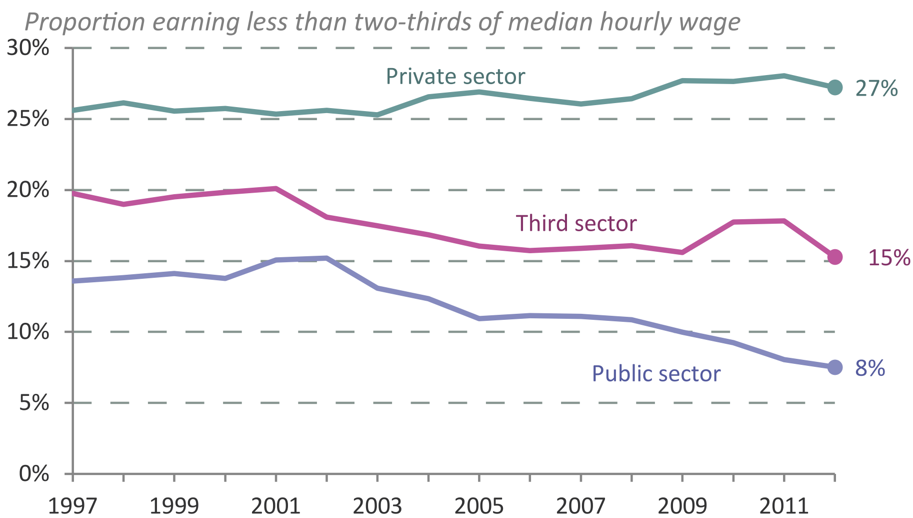
Figure 9: Proportion of low paid employees by employer type



Source: RF analysis of ONS, Annual Survey of Hours and Earnings

The proportion of low paid employees in the public and third sectors has fallen considerably since the late 1990s to 8 and 15 per cent respectively. Figure 10 reveals that the private sector has seen far less change over that period with its proportion of employees who are low paid standing at 27 per cent, slightly higher than its equivalent in 1997.

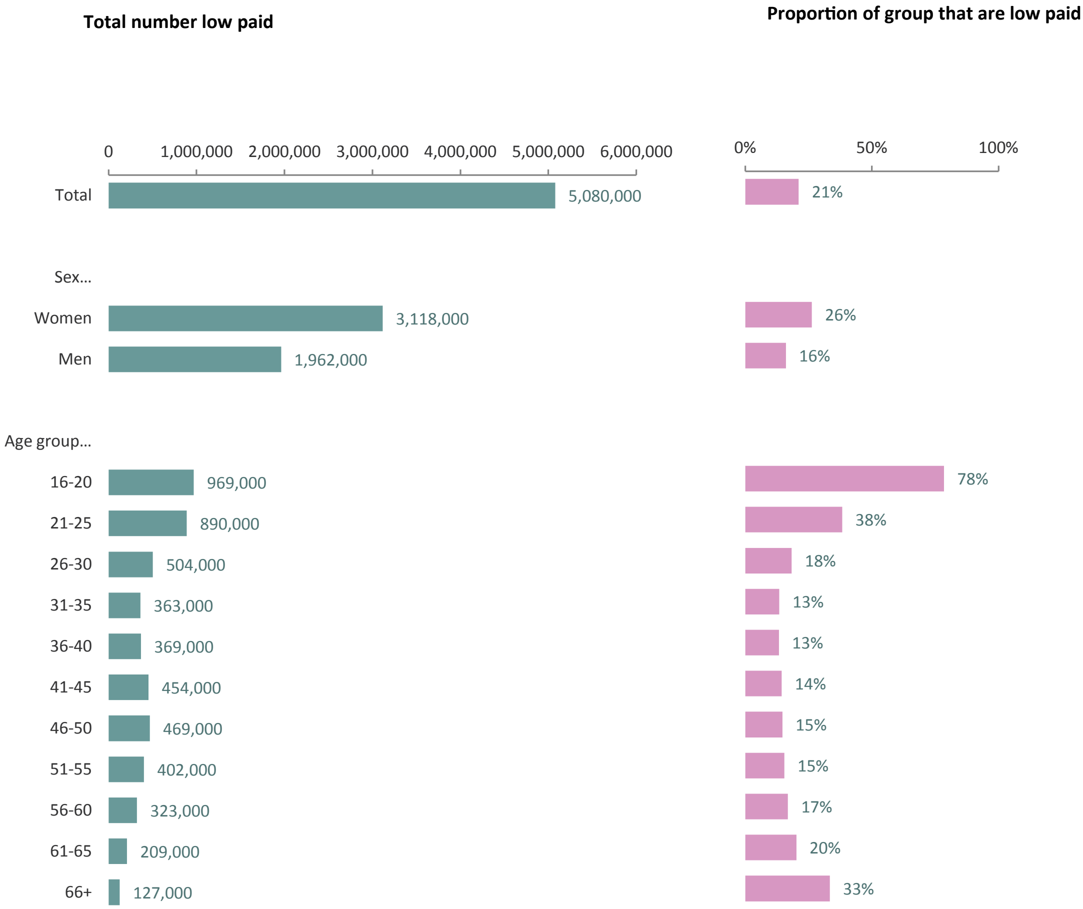
Figure 10: Low pay in the private, public and third sectors



Source: RF analysis of ONS, Annual Survey of Hours and Earnings

Figure 11 summarises these results, mapping the risk of low pay for different groups of workers.

Figure 11: A summary of those most at risk of low pay



Source: RF analysis of ONS, Annual Survey of Hours and Earnings

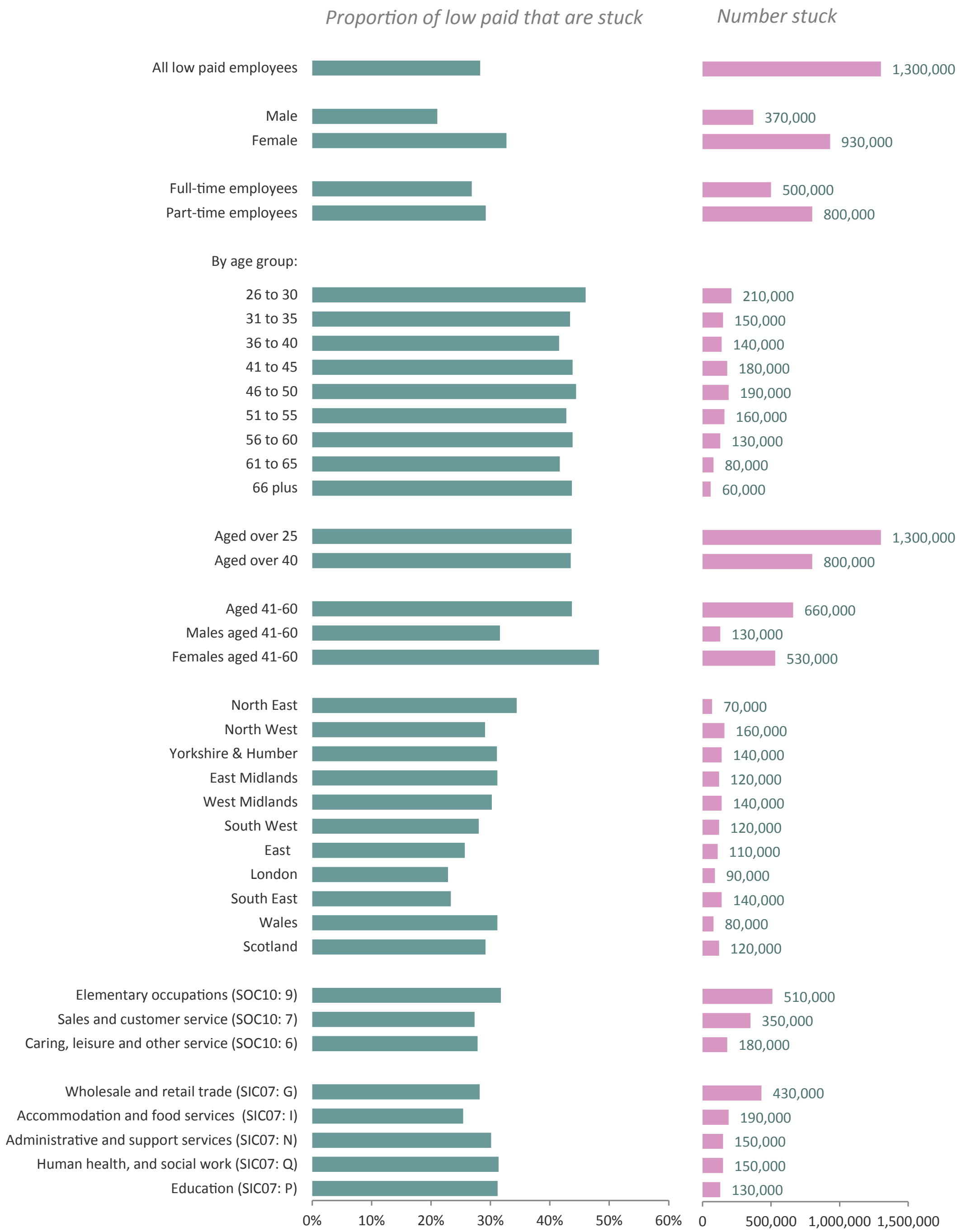
The persistence of low pay

While the incidence of low pay is important, the persistence of low pay has often been overlooked. This tells us whether individuals remain low paid over time. Recent Resolution Foundation analysis has sought to investigate the issue by calculating, for the most recent period (2012), how many of the low paid were consistently trapped on low pay over the previous decade (2002-2011).[4] Figure 12 provides an outline of the study's findings.

The study found that nearly three-quarters (73 per cent) of those who were low paid in 2002 had not managed to fully escape low pay by 2012. Nearly half (46 per cent) had escaped low pay at some point during the decade but, worryingly, subsequently found themselves back in low pay by 2012. Over a quarter (27 per cent) had stayed on low pay in every year they had been employed in the period. The likelihood of becoming stuck is not evenly shared across the distribution.

4 Hurrell, A. (2013) Starting out or getting stuck? An analysis of who gets trapped in low paid work – and who escapes

Figure 12: Proportion of low paid employees and total number of employees that are stuck on low pay by characteristics



Source: RF analysis of ONS, Annual Survey of Hours and Earnings

Table 1 below lists the characteristics which are positively linked to escaping from low pay and those which are negatively linked.

Table 1: Factors associated with progression ourt of low pay

Positive factors	Negative factors
1. Being **male**	1. **Age** (although this effect is less pronounced for women)
2. Number of years in **employment**	2. Already **stuck on low pay** (1992-2002)
3. Number of years working for **central government**	3. Number of years in **part-time** employment
4. Number of years working for a **local authority**	4. Number of years where employee has **switched jobs** within the last year (as of April that year)
	5. Number of years working for **very small employers** (<10 employees)
	6. Number of years working for **private companies**
	7. Remaining in ***manufacturing, mining & quarrying*** industry
	8. Remaining in ***wholesale & retail*** industry
	9. Remaining in ***accommodation & food services*** industry
	10. Remaining in ***caring, leisure & other service*** occupations
	11. Remaining in ***sales and customer service*** occupations
	12. Remaining in ***process, plant and machine operative*** occupations
	13. Remaining in ***elementary*** occupations

Pay progression is especially low in the retail, hospitality and manufacturing sectors and for elementary, sales and customer services and caring occupations, where large numbers of workers appears to be trapped in low pay for long periods of time. Many of these workers only find higher paying roles by changing their industry or occupation.

Women also face particular barriers to pay progression, and are more likely to remain trapped in low pay than their male counterparts. According to Resolution Foundation analysis, in 2012 one third of low paid women had spent the previous ten years on low pay, against 21 per cent of men.

ANNEX 2
INTERNATIONAL COMPARISONS

International benchmarks will be important to a more pro-active approach to low pay and the minimum wage. There are a number of measures which can be used to compare minimum wages across countries:

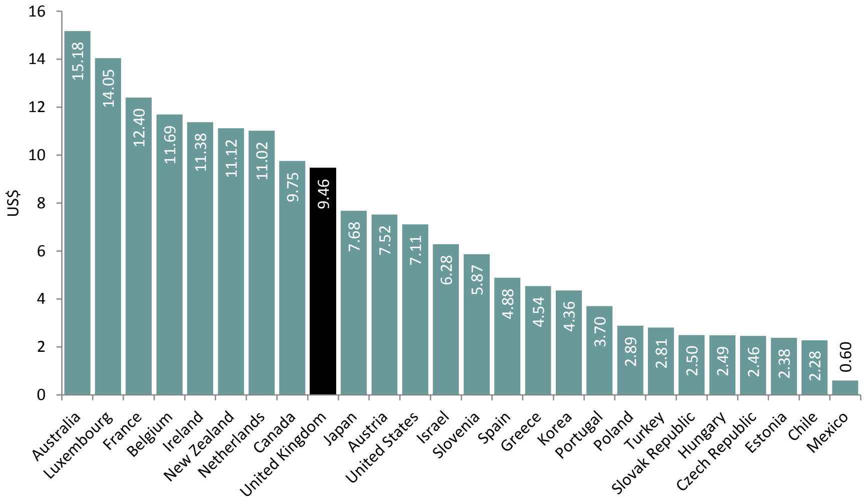
- the absolute value of the minimum wage
- its local purchasing power
- its value as a proportion of the median wage

Each of these provides an important insight into how minimum wages function and what they mean for those who earn them. There is however a need for caution when dealing with international comparisons. Not every country has a single wage-floor as in the UK; the US, for example, has a federal wage of $7.25 but a range of higher state-level minima. It is also important to note that some data are not directly comparable, and in some cases the population covered, or the measures used, varies (for example between full-time and part-time workers or weekly and hourly measures). And of course local factors, not least the productivity of low performing parts of the economy, affect how high a minimum wage can be set without the risk of job losses, meaning that simple international comparisons need to be complemented by more detailed analysis.

Comparing minimum wages

Figure 13 shows a straight comparison of minimum wages in absolute terms. The UK minimum wage ($9.46) is in the upper half of OECD countries but still falls well behind Australia ($15.18) and Luxembourg ($14.05). Since this does not adjust for purchasing power, these direct measures give little sense of the minimum wage's worth. Figure 14 takes account of purchasing power parity and ranks the UK in a similar position.

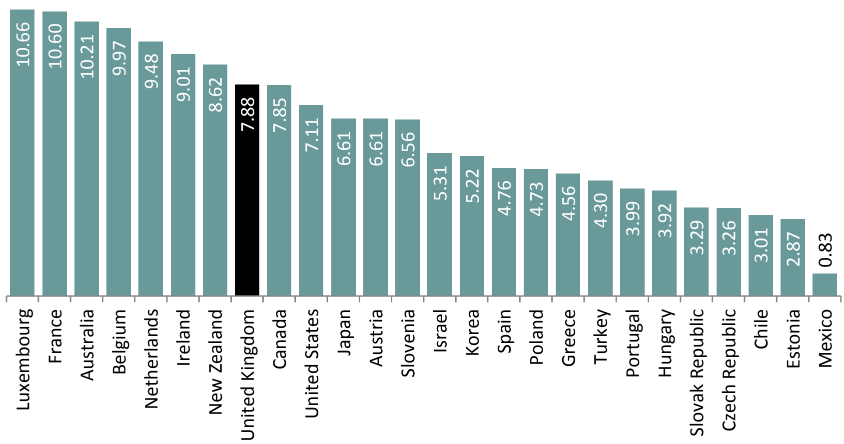
Figure 13: The absolute value of the NMW



Source: RF analysis of stats.OECD

Figure 14: The relative value of the NMW

Minimum wage in US $ adjusted by OECD for purchasing power parity

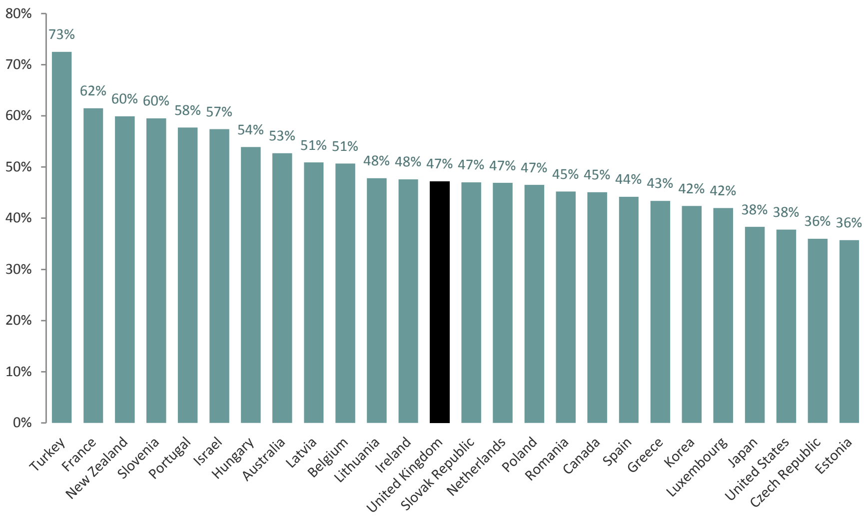


Source: RF analysis of stats.OECD

A more useful comparison of the value of minimum wages can be gained by comparing their value with the earnings of a typical employee. The value of the hourly minimum wage expressed as a proportion of the gross hourly median wage is known as the 'bite'. As Chapter 4 discussed, the UK's NMW currently has a bite of 54 per cent. That figure is calculated by taking the median hourly wage earned by all employees.

Data collected by the OECD, as shown in Figure 15, give us a similar measure of the bite but focus on the minimum wage relative to the median wage of full-time employees across the OECD. This means the bite is significantly lower. In the UK's case, the full-time bite (47 per cent) is 7 percentage points lower than the overall bite (54 per cent). If a similar relativity holds in other countries, the overall bite of the minimum wage is likely to range from around 45 per cent in countries with low minimum wages to around 55 per cent for countries with moderate minimum wages to around 65 per cent for countries with high minimum wages.

Figure 15: the "bite" of minimum wages across the OECD



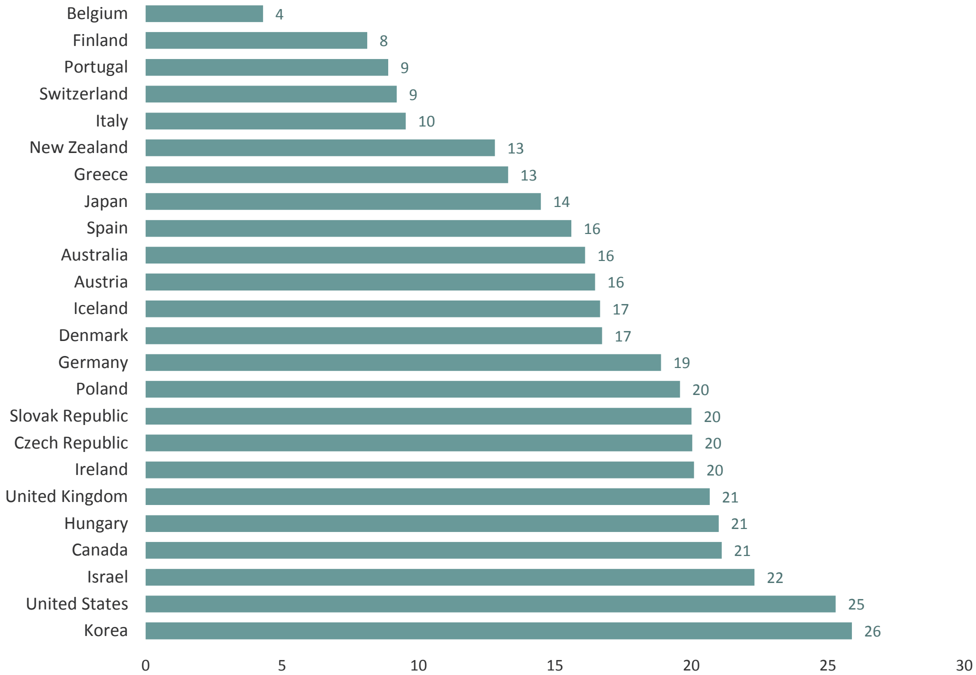
Source: RF analysis of stats.OECD

Comparing the extent of low pay

The incidence of low pay varies significantly internationally. The OECD calculates low pay as the proportion of employees earning below two-thirds of the median gross hourly wage. The OECD carries out these comparisons on the basis of full-time employees only while the European Commission takes into account only those who work in firms with 10 or more employees. Figures 16 and 17 display the incidence of low pay as reported by the OECD and European Commission respectively.

Figure 16: low pay across the OECD

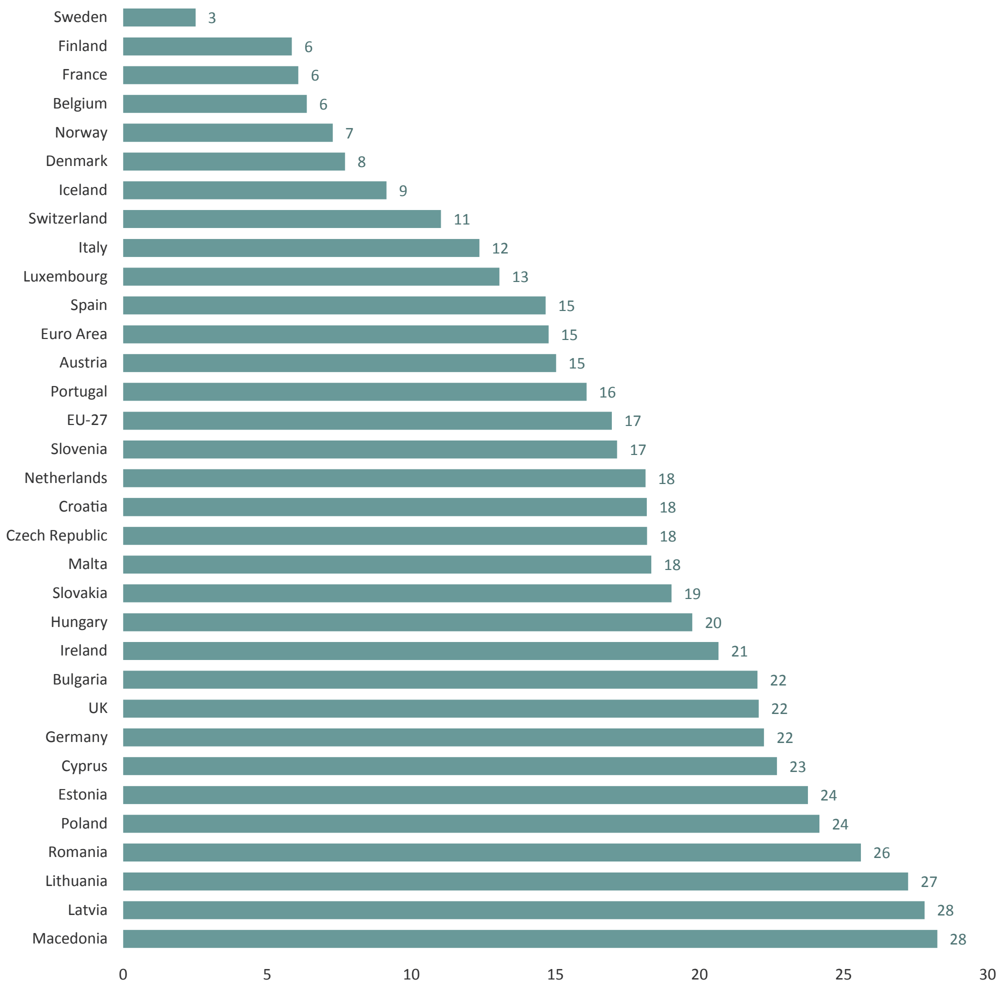
Percentage of full-time workers earnings below two thirds of the gross hourly wage for full-time workers



Notes: In calculating the median hourly wage, the analysis consider only full-time employees
Source: RF analysis of stats.OECD

Figure 17: low pay across the European Union

Proportion of employees earning less than two-thirds of the gross median hourly wage



Notes: In calculating the median hourly wage, the analysis consider only those working for organisations which employ 10 or more employees

Source: RF analysis of EUROSTAT

Under both methodologies, it is clear that the UK has one of the highest extents of low pay among all developed economies, with over a fifth of employees low paid. This concurs with our analysis above of data from the ONS's Annual Survey of Hours and Earnings.

ANNEX 3 EXPLORING THE AFFORDABILITY OF A HIGHER MINIMUM WAGE BY SECTOR

Low pay varies significantly between different sectors of the UK economy. One argument we make in this report is that most sectors of the economy could afford to pay their lowest paid workers more than the legal minimum wage. In the body of the report, we propose that the LPC publish analysis to inform this debate. In this annex we give an exploratory indication of what this analysis could look like, and also touch on two case studies that throw light on a sector-approach: the example of Australia and the example of the UK security sector.

Which UK sectors could afford to pay more?

As the LPC has acknowledged, many employers could afford to pay their lowest paid workers more than the NMW. Without mandating different minimum wages, we have suggested that the LPC encourage debate by publishing information. As we saw in Chapter 4, industrial sectors are a good place to start when analysing the wage-floor that different types of employers could afford.

Publishing data of this kind would be a new approach for the LPC and it will take iteration to find the right balance. On the one hand, it would be helpful to campaigners, wage-negotiators and employers for analysis to be intuitive, simple and salient. On the other hand, it is important not to over-simplify the different pressures that face different employers. The analysis would take into account factors such as the impact on employers' wage bills of raising the NMW and the importance of wage-costs to employers' overall costs and profits.

How should such an analysis be carried out? Table 2 explores some useful indicators that give a sense of the wage distribution by industrial sector. It sets out for each sector the number of low paid employees, the proportion of employees who are low paid and the proportion of the total low paid workforce of the UK that this represents. There are a number of important lessons to be taken from this table.

• Fourteen sectors account for more than four-fifths of all low paid employees.
• Some sectors – like education and human health activities – have a high number of low paid people but a low overall proportion of low pay.
• Other sectors – like a number of manufacturing industries – have a low number of low paid people but a high proportion within their sector.

Table 2: The sectoral distribution of low pay in the UK

Industry 'division'	Code (SIC2007 two digit)	Number of employees that are low paid	Proportion of employees that are low paid	Share of all low paid employees
All divisions	---	4,893,180	19%	100.0%
Retail trade, except of motor vehicles and motor-cycles	47	1,215,470	50%	24.0%
Food and beverage service activities	56	680,400	68%	14.0%
Education	85	492,390	12%	10.0%
Residential care activities	87	275,190	44%	6.0%
Services to buildings and landscape activities	81	236,240	54%	5.0%
Social work activities without accommodation	88	185,830	31%	4.0%
Employment activities	78	179,720	35%	4.0%
Accommodation	55	168,360	57%	3.0%
Wholesale trade, except of motor vehicles and motorcycles	46	158,380	16%	3.0%
Human health activities	86	108,610	5%	2.0%
Wholesale and retail trade and repair of motor vehicles and motorcycles	45	105,190	24%	2.0%
Sports activities and amusement and recreation activities	93	104,810	37%	2.0%
Manufacture of food products	10	89,710	28%	2.0%
Other personal service activities	96	85,160	44%	2.0%
Land transport and transport via pipelines	49	46,210	10%	1.0%
Office administrative, office support and other business support activities	82	45,870	19%	1.0%
Specialised construction activities	43	43,820	10%	1.0%
Gambling and betting activities	92	42,470	40%	1.0%
Crop and animal production, hunting and related service activities	1	42,090	36%	1.0%
Manufacture of fabricated metal products, except machinery and equipment	25	35,940	13%	1.0%
Legal and accounting activities	69	32,370	7%	1.0%
Security and investigation activities	80	31,410	27%	1.0%
Real estate activities	68	30,460	10%	1.0%
Activities of membership organisations	94	27,550	14%	1.0%
Manufacture of rubber and plastic products	22	27,530	18%	1.0%
Rental and leasing activities	77	23,640	19%	0.0%

Warehousing and support activities for transportation	52	22,960	7%	0.0%
Computer programming, consultancy and related activities	62	20,000	5%	0.0%
Architectural and engineering activities; technical testing and analysis	71	19,710	5%	0.0%
Public administration and defence; compulsory social security	84	18,760	1%	0.0%
Construction of buildings	41	18,370	7%	0.0%
Activities of head offices; management consultancy activities	70	17,780	7%	0.0%
Activities auxiliary to financial services and insurance activities	66	17,620	5%	0.0%
Postal and courier activities	53	15,680	7%	0.0%
Publishing activities	58	15,260	9%	0.0%
Travel agency, tour operator and other reservation service and related activities	79	14,850	18%	0.0%
Printing and reproduction of recorded media	18	14,160	14%	0.0%
Manufacture of electrical equipment	27	14,080	13%	0.0%
Financial service activities, except insurance and pension funding	64	13,420	2%	0.0%
Manufacture of machinery and equipment n.e.c.	28	13,360	6%	0.0%
Other professional, scientific and technical activities	74	12,710	15%	0.0%
Motion picture, video and television programme production, sound recording and music publishing activities	59	11,820	15%	0.0%
Manufacture of textiles	13	11,650	29%	0.0%
Other manufacturing	32	11,170	16%	0.0%
Civil engineering	42	11,080	7%	0.0%
Waste collection, treatment and disposal activities; materials recovery	38	10,970	12%	0.0%
Manufacture of furniture	31	10,880	20%	0.0%
Manufacture of wood and of products of wood and cork, except furniture; manufacture of articles of straw and plaiting materials	16	10,850	21%	0.0%
Manufacture of computer, electronic and optical products	26	10,830	8%	0.0%
Manufacture of motor vehicles, trailers and semi-trailers	29	10,100	6%	0.0%
Manufacture of other non-metallic mineral products	23	9,850	13%	0.0%
Advertising and market research	73	9,570	9%	0.0%
Activities of households as employers of domestic personnel	97	9,510	19%	0.0%
Manufacture of chemicals and chemical products	20	9,450	9%	0.0%

Libraries, archives, museums and other cultural activities	91	9,080	15%	0.0%
Veterinary activities	75	8,690	17%	0.0%
Manufacture of wearing apparel	14	8,620	44%	0.0%
Creative, arts and entertainment activities	90	7,280	17%	0.0%
Repair and installation of machinery and equipment	33	5,540	6%	0.0%
Insurance, reinsurance and pension funding, except compulsory social security	65	5,280	3%	0.0%
Manufacture of paper and paper products	17	5,120	9%	0.0%
Telecommunications	61	4,770	2%	0.0%
Repair of computers and personal and household goods	95	4,300	15%	0.0%
Manufacture of basic metals	24	4,090	4%	0.0%
Electricity, gas, steam and air conditioning supply	35	3,800	2%	0.0%
Manufacture of other transport equipment	30	3,360	2%	0.0%
Scientific research and development	72	1,980	2%	0.0%
Manufacture of basic pharmaceutical products and pharmaceutical preparations	21	1,680	3%	0.0%
Water collection, treatment and supply	36	1,650	4%	0.0%
Manufacture of beverages	11	1,620	4%	0.0%
Information service activities	63	1,610	3%	0.0%
Air transport	51	1,570	2%	0.0%

Notes: (1) An employee is defined as low paid if their gross hourly wage is less than two-thirds of the overall median. (2) These figures relate to all working-age adult employees (i.e. aged between 18 and State Pension Age), excluding those aged 21+ whose earnings are less than the October 2011 adult National Minimum Wage rate (£6.08). (3) The analysis excludes sectors containing very low numbers of low paid employees, as this data is potentially disclosive and therefore could not be released by the ONS. (4) The bite of the minimum wage bite is defined as the October 2011 to October 2012 NMW as a percentage of the April 2012 sector median. (5) The cost of abolishing low pay is based on the average increase in wages that would result if the wage floor had been raised from £6.08 to low-pay threshold (£7.44) in 2012.
Source: Resolution Foundation analysis of ONS's Annual Survey of Hours and Earnings (2012).

Table 3 presents a number of variables that could inform a debate about how affordable it would be for different sectors to pay their lowest paid workers more.

As was discussed in Chapter 2, approximately 5 per cent of employees are paid the NMW, putting the NMW at the 5th percentile of the overall UK wage distribution. Table 3 shows the 5th percentile in each of sector and infers from this what an 'equivalent' minimum wage would be in these sectors in 2013. For the purpose of this analysis, we cap the highest wage-floor at £7.71, the low pay threshold for April 2013. The 5th percentile varies quite significantly by sector and in many sectors is as high as the low pay threshold. Only in fifteen sectors are employees at the 5th percentile paid at the minimum wage. Unsurprisingly, these are the same sectors that Table 2 above demonstrated have high proportions of low pay.

Table 3 also presents several other useful indicators:

Column 4: The bite of the minimum wage relative to the median wage in the sector.

Column 7: The average increase in wages that would result in each sector if low pay were eliminated; that is, if the pay of the lowest paid worker were raised to two-thirds of the UK median wage. This gives a sense of the size of the impact on wages that would have to be absorbed if that sector were to abolish low pay simply by raising the wage-floor.

Column 8: The minimum wage that would cause an average increase in wages of 0.5 per cent. This gives a sense of the variation in affordability by sector. For example, in some sectors, a very small increase in the minimum wage from £6.31 to £6.37 would mean firms having to absorb an average increase in wages of this size. However, in many sectors the wage-floor could rise all the way to £7.71 (the low pay threshold) before causing an impact of this size. (The figures are again capped at £7.71.)

Table 3: Understanding the affordability of a higher wage-floor by sector

Industry 'division'	Code	Median hourly wage	Minimum wage "bite"	5th percentile hourly wage (2012)	Equivalent 2013 minimum wage (based on 5th percentile)	Average wage increase from abolishing low pay	Minimum wage that would cause a 0.5% average increase in wages
Food and beverage service activities	56	£6.45	94%	£5.05	£6.31	11.70%	£6.37
Accommodation	55	£6.90	88%	£5.40	£6.31	9.50%	£6.37
Services to buildings and landscape activities	81	£7.00	87%	£6.10	£6.31	9.00%	£6.37
Retail trade, except of motor vehicles and motorcycles	47	£7.30	83%	£6.10	£6.31	6.90%	£6.50
Gambling and betting activities	92	£7.70	79%	£6.10	£6.31	6.20%	£6.50
Residential care activities	87	£7.75	78%	£6.10	£6.31	6.00%	£6.56
Other personal service activities	96	£7.75	78%	£5.00	£6.31	7.30%	£6.44
Manufacture of wearing apparel	14	£7.80	78%	£6.10	£6.31	6.70%	£6.44
Crop and animal production, hunting and related service activities	1	£8.00	76%	£6.10	£6.31	4.70%	£6.56
Sports activities and amusement and recreation activities	93	£8.25	74%	£5.80	£6.31	5.70%	£6.50
Employment activities	78	£8.50	72%	£6.10	£6.31	5.50%	£6.50
Activities of households as employers of domestic personnel	97	£8.50	72%	£6.50	£6.75	1.90%	£7.00
Security and investigation activities	80	£8.55	71%	£6.10	£6.31	3.30%	£6.69

Social work activities without accommodation	88	£8.85	69%	£6.10	£6.31	4.00%	£6.63
Manufacture of textiles	13	£9.00	68%	£6.10	£6.31	4.30%	£6.56
Manufacture of food products	10	£9.05	67%	£6.10	£6.31	3.70%	£6.63
Manufacture of wood and of products of wood and cork, except furniture; manufacture of articles of straw and plaiting materials	16	£9.05	67%	£6.25	£6.49	2.50%	£6.75
Wholesale and retail trade and repair of motor vehicles and motorcycles	45	£9.35	65%	£6.10	£6.31	3.50%	£6.63
Manufacture of furniture	31	£9.85	62%	£6.10	£6.31	2.90%	£6.69
Rental and leasing activities	77	£9.85	62%	£6.10	£6.31	2.80%	£6.69
Manufacture of rubber and plastic products	22	£10.00	61%	£6.30	£6.54	2.10%	£6.88
Travel agency, tour operator and other reservation service and related activities	79	£10.20	60%	£6.40	£6.64	1.90%	£6.94
Postal and courier activities	53	£10.35	59%	£7.20	£7.47	0.70%	£7.45
Veterinary activities	75	£10.40	58%	£6.35	£6.59	2.00%	£6.88
Office administrative, office support and other business support activities	82	£10.50	58%	£6.15	£6.38	2.50%	£6.75
Waste collection, treatment and disposal activities; materials recovery	38	£10.75	57%	£6.55	£6.80	1.40%	£7.00
Other manufacturing	32	£10.80	56%	£6.30	£6.54	1.90%	£6.88
Wholesale trade, except of motor vehicles and motorcycles	46	£10.80	56%	£6.35	£6.59	2.00%	£6.88
Land transport and transport via pipelines	49	£10.80	56%	£6.70	£6.95	1.20%	£7.13
Manufacture of fabricated metal products, except machinery and equipment	25	£10.95	56%	£6.50	£6.75	1.60%	£6.94
Printing and reproduction of recorded media	18	£11.15	55%	£6.40	£6.64	1.80%	£6.88
Sewerage	37	£11.15	55%	£7.15	£7.42	0.60%	£7.57
Libraries, archives, museums and other cultural activities	91	£11.20	54%	£6.20	£6.43	2.10%	£6.75
Manufacture of electrical equipment	27	£11.30	54%	£6.65	£6.90	1.30%	£7.13
Manufacture of other non-metallic mineral products	23	£11.35	54%	£6.50	£6.75	1.60%	£6.94
Repair of computers and personal and household goods	95	£11.35	54%	£6.40	£6.64	1.90%	£6.88
Other mining and quarrying	8	£11.75	52%	£7.65	£7.71	0.70%	£7.45

Real estate activities	68	£11.80	52%	£6.55	£6.80	1.30%	£7.07
Activities of membership organisations	94	£11.85	51%	£6.25	£6.49	2.00%	£6.81
Specialised construction activities	43	£11.90	51%	£6.45	£6.69	1.40%	£6.94
Civil engineering	42	£12.00	51%	£7.15	£7.42	0.90%	£7.26
Manufacture of paper and paper products	17	£12.10	50%	£6.55	£6.80	1.20%	£7.00
Creative, arts and entertainment activities	90	£12.30	49%	£6.25	£6.49	2.10%	£6.81
Warehousing and support activities for transportation	52	£12.35	49%	£7.00	£7.26	0.80%	£7.38
Manufacture of machinery and equipment n.e.c.	28	£12.90	47%	£7.10	£7.37	0.80%	£7.38
Other professional, scientific and technical activities	74	£12.90	47%	£6.25	£6.49	1.90%	£6.88
Construction of buildings	41	£13.05	47%	£6.95	£7.21	0.90%	£7.26
Education	85	£13.25	46%	£6.65	£6.90	1.30%	£7.13
Water transport	50	£13.45	45%	£7.40	£7.68	0.30%	£7.71
Repair and installation of machinery and equipment	33	£13.70	44%	£6.85	£7.11	1.00%	£7.13
Advertising and market research	73	£13.70	44%	£6.75	£7.01	1.00%	£7.26
Manufacture of beverages	11	£14.10	43%	£7.60	£7.71	0.40%	£7.71
Publishing activities	58	£14.15	43%	£6.55	£6.80	1.30%	£7.00
Human health activities	86	£14.15	43%	£7.45	£7.71	0.50%	£7.71
Manufacture of motor vehicles, trailers and semi-trailers	29	£14.25	43%	£7.20	£7.47	0.70%	£7.45
Water collection, treatment and supply	36	£14.25	43%	£7.55	£7.71	0.40%	£7.71
Manufacture of chemicals and chemical products	20	£14.35	42%	£6.90	£7.16	1.10%	£7.13
Public administration and defence; compulsory social security	84	£14.40	42%	£8.35	£7.71	0.10%	£7.71
Manufacture of computer, electronic and optical products	26	£14.95	41%	£6.75	£7.01	1.00%	£7.19
Manufacture of basic metals	24	£15.00	41%	£7.55	£7.71	0.50%	£7.64
Legal and accounting activities	69	£15.20	40%	£7.05	£7.32	0.80%	£7.32
Architectural and engineering activities; technical testing and analysis	71	£15.55	39%	£7.35	£7.63	0.60%	£7.51
Insurance, reinsurance and pension funding, except compulsory social security	65	£15.60	39%	£7.70	£7.71	0.30%	£7.71

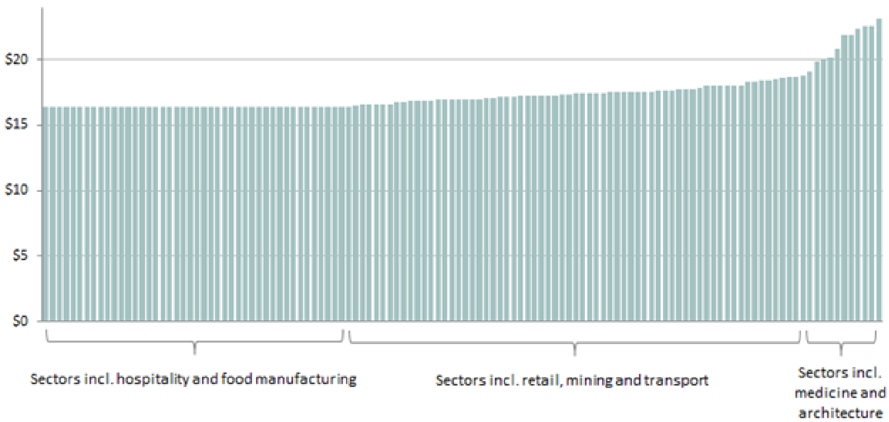
Motion picture, video and television programme production, sound recording and music publishing activities	59	£16.10	38%	£6.10	£6.31	2.60%	£6.63
Financial service activities, except insurance and pension funding	64	£16.10	38%	£8.00	£7.71	0.20%	£7.71
Programming and broadcasting activities	60	£16.20	38%	£8.25	£7.71	0.10%	£7.71
Activities of head offices; management consultancy activities	70	£16.20	38%	£6.80	£7.06	1.00%	£7.13
Electricity, gas, steam and air conditioning supply	35	£16.25	37%	£8.20	£7.71	0.30%	£7.71
Manufacture of basic pharmaceutical products and pharmaceutical preparations	21	£16.70	36%	£8.90	£7.71	0.20%	£7.71
Manufacture of other transport equipment	30	£16.80	36%	£8.80	£7.71	0.30%	£7.71
Activities auxiliary to financial services and insurance activities	66	£17.10	36%	£7.45	£7.71	0.50%	£7.71
Telecommunications	61	£17.20	35%	£8.20	£7.71	0.20%	£7.71
Air transport	51	£17.45	35%	£8.45	£7.71	0.20%	£7.71
Scientific research and development	72	£18.25	33%	£9.40	£7.71	0.10%	£7.71
Computer programming, consultancy and related activities	62	£18.40	33%	£7.60	£7.71	0.70%	£7.38
Information service activities	63	£18.70	33%	£8.15	£7.71	0.40%	£7.71
Mining support service activities	9	£19.20	32%	£9.35	£7.71	0.20%	£7.71

Notes: (1) The median and 5th percentile hourly wage rates are shown rounded to the nearest 5 pence. (2) The 5th percentile wage rates are calculated over all working-age adult employees (i.e. aged between 18 and State Pension Age), excluding those aged 21+ whose earnings are less than the October 2011 adult National Minimum Wage rate (£6.08). (3) Under the percentile approach, the indicative 2013 sector wage floors are calculated by applying the ratio between the 5th percentile and the NMW rate in 2012, to the 2013 NMW rate (£6.31), capped at the 2013 low-pay threshold (£7.71). The 5th percentile is used because this corresponds approximately to where the NMW rate fell in the wage distribution of working-age, NMW-compliant employees in 2012. (4) Under the wage impact approach, the indicative 2013 sector wages are calculated by applying the ratio between the NMW rate and the estimated wage floor rise corresponding to a maximum average individual wage increase of 0.5% in 2012, to the 2013 NMW rate (£6.31), once again capped at the 2013 low-pay threshold (£7.71). (4) The analysis excludes very small sectors containing low numbers of employees in the data.
Source: Resolution Foundation analysis of ONS's Annual Survey of Hours and Earnings (2012).

Case studies of a sectoral approach

We do not recommend mandatory sector minimum wages for reasons set out in the body of this report. But we have explored this idea in the course of our work. One case study we have examined is that of Australia, where a single National Minimum Wage is complemented by higher minimum wages in specific sectors and occupations. When the Australian NMW is raised, these sectoral and occupational wage-floors generally rise too, spreading the effects to a larger group of workers. As a result, the system directly protects the pay of around 16 per cent of the Australian workforce—around three times the proportion protected by the UK minimum wage. The Australian system is overseen by a single body, Fair Work Australia, which has the responsibility and power to ensure that workers get a fair deal, including monitoring and responding to exploitative contractual terms.

Figure 18: Example variation of sector minimum wages in Australia

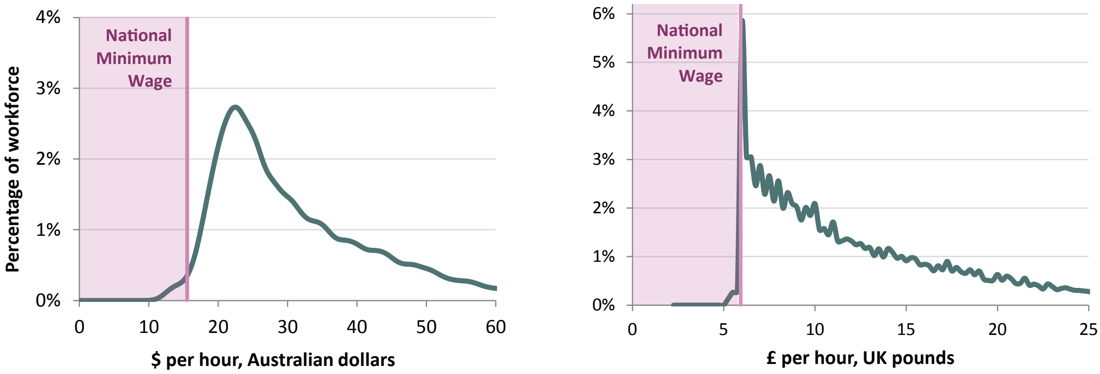


Source: Resolution Foundation analysis, Australian Fair Work Commission, figures current as of August 2013

In Chapters 1 and 2, this report discussed the "spike" which has developed in the UK's pay distribution at the level of the minimum wage. Figure 19 hints at how Australia's minimum wage system has a different impact to that of the UK's NMW. While there are limitations in this data, the figure suggests that the Australian system results in a lower spike at the NMW.

We have recommended that the UK should not take this path, and instead should maintain a single, national wage-floor. But we have explored ways in which new pressure points could be created above the NMW.

Figure 19: Comparing the distribution of pay in Australia and the UK



Notes: Australian distribution in $0.50 bands; UK distribution in £0.25 bands. Casual workers deflated to adjusted for casual loadings.
Source: Employee Earnings and Hours (EEH) survey, Australian Bureau of Statistics, with thanks to Matt Cowgill of ACTU for sharing data.

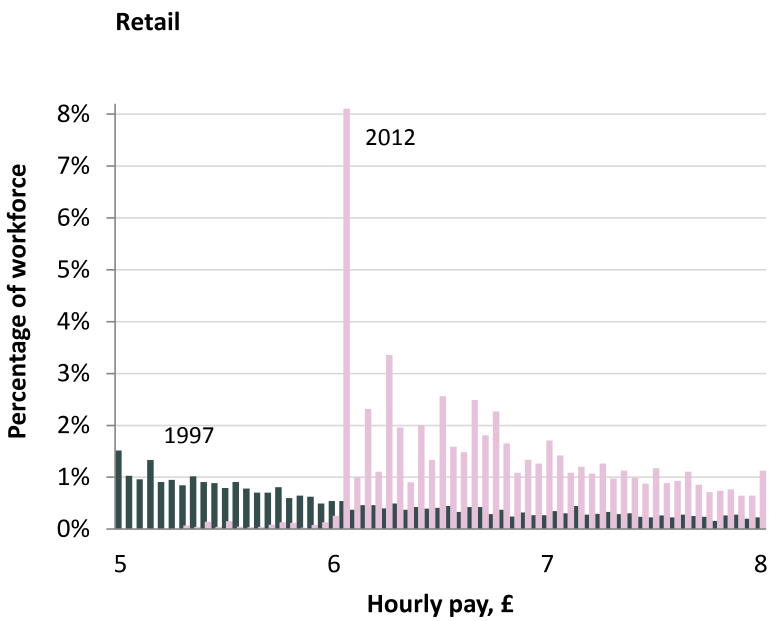
The example of security

One concern expressed in this report is that in a number of low-paying sectors, the NMW has become a "going rate" rather than an absolute minimum. One case study relevant to this question is that of the security sector. When the minimum wage was introduced, security was officially a low paying sector in the LPC's analysis. It is now the only sector to have been lifted out of the LPC's definition of low pay.

It is believed that the enactment of the Private Security Industry Act 2001, which laid the foundations for the Security Industry Authority (SIA), played a role in this change. This body is responsible for the occupational licensing of people working in security roles. This has required increased investment in employee training and has built a pay structure into the sector.

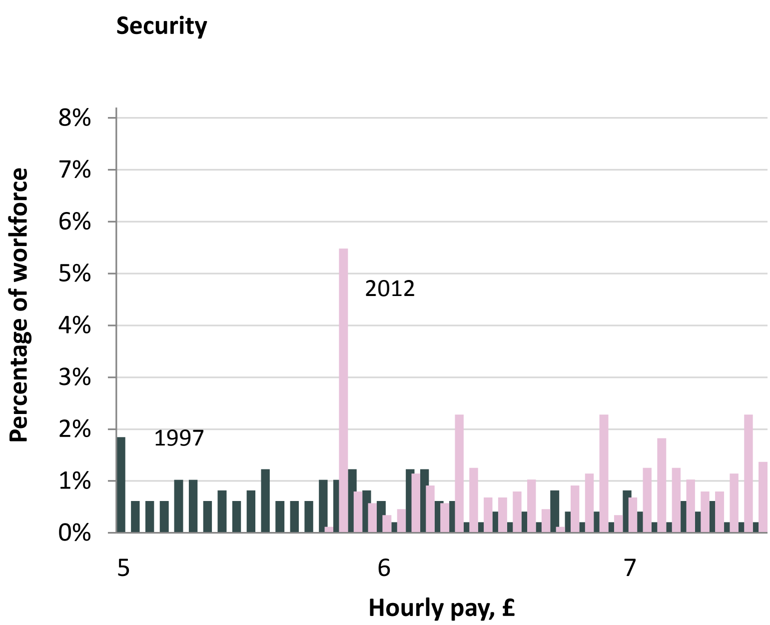
One test of the success of this approach is whether it has had any effect on the distribution of pay within the sector. Figures 20 and 21 below explore this question. The first chart displays the distribution of pay in retail before and after the NMW's introduction. A large spike has developed at the NMW, with approximately 8 per cent of employees in retail employed on that wage. The second chart shows the distribution of pay in security. Like retail, a spike has formed at the level of the minimum wage, but around two-thirds the size of the spike in retail. In security we see a number of smaller spikes higher up the distribution, representing the pay structure. This might suggest that occupational licensing is a useful way to create pressure points above the entry-level of the NMW.

Figure 20: The spike at the minimum wage in retail
Percentage of workforce by 10 pence band



Source: Resolution Foundation and Low Pay Commission analysis, Annual Survey of Hours and Earnings

Figure 21: The spike at the minimum wage in security
Percentage of workforce by 10 pence band



Source: Resolution Foundation and Low Pay Commission analysis, Annual Survey of Hours and Earnings