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BRIEFING

Turning Point?

The minimum wage in 2014 and beyond

Adam Corlett & Matthew Whittaker

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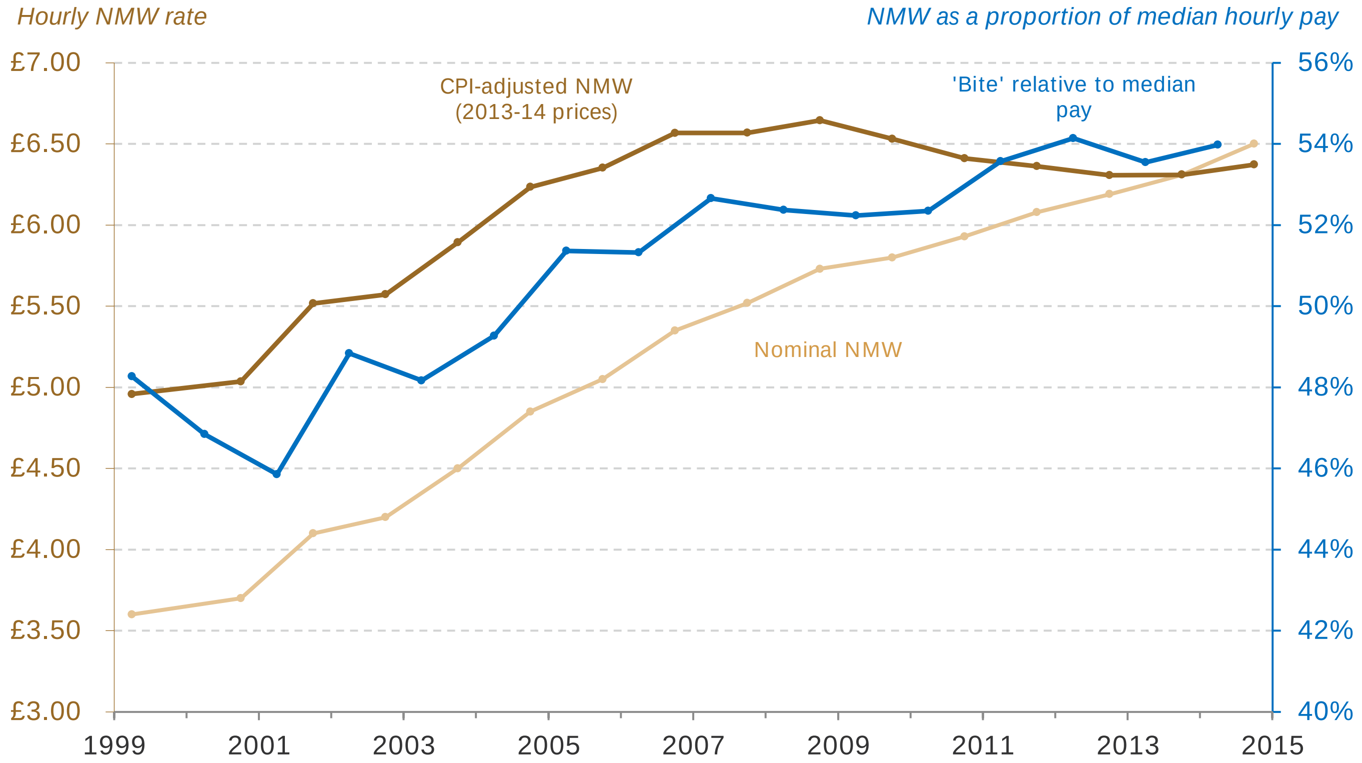
RF resolutionfoundation.org info@resolutionfoundation.org +44 (0)203 372 2960 @resfoundation

With the National Minimum Wage (NMW) rising on October 1st, this briefing note provides some background by setting out the evolution of the wage since its introduction in April 1999. It looks at the rate's real value over the intervening period, and its relationship with median pay. It also considers the number of people affected by the NMW and the number for whom minimum wages are becoming a semi-permanent feature. Finally, it compares a range of scenarios for growth in the NMW over the course of the next parliament.

The main, 'adult' National Minimum Wage (NMW) is set to rise from £6.31 to £6.50 from October 1st.[1] As Figure 1 shows, this will be the first real-terms rise (measured against CPI inflation) in six years. Yet, despite the increase, the NMW will remain some 4.1 per cent below its peak in October 2008 in real-terms and will be broadly at the same level it was in October 2005 (2p above).

Figure 1:
NMW rate and 'bite': 1999-2015



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

Notes: NMW is usually increased in October, while median pay data relates to April. The 'bite' is therefore calculated by comparing the October NMW with the following April's median. Median pay measure excludes overtime.

Prior to the financial crisis, the NMW was rising significantly faster than inflation. After an initial 'bedding in' period – during which time the newly introduced NMW first changed relatively little and then jumped by 9.5 per cent in real-terms – the average annual rate of growth subsequently stood at around 3 per cent above CPI inflation between October 2001 and October 2007.

Such growth also outpaced wages higher up the distribution, meaning that the gap between the bottom and the middle of the earnings distribution fell a bit and the NMW secured a greater 'bite'.

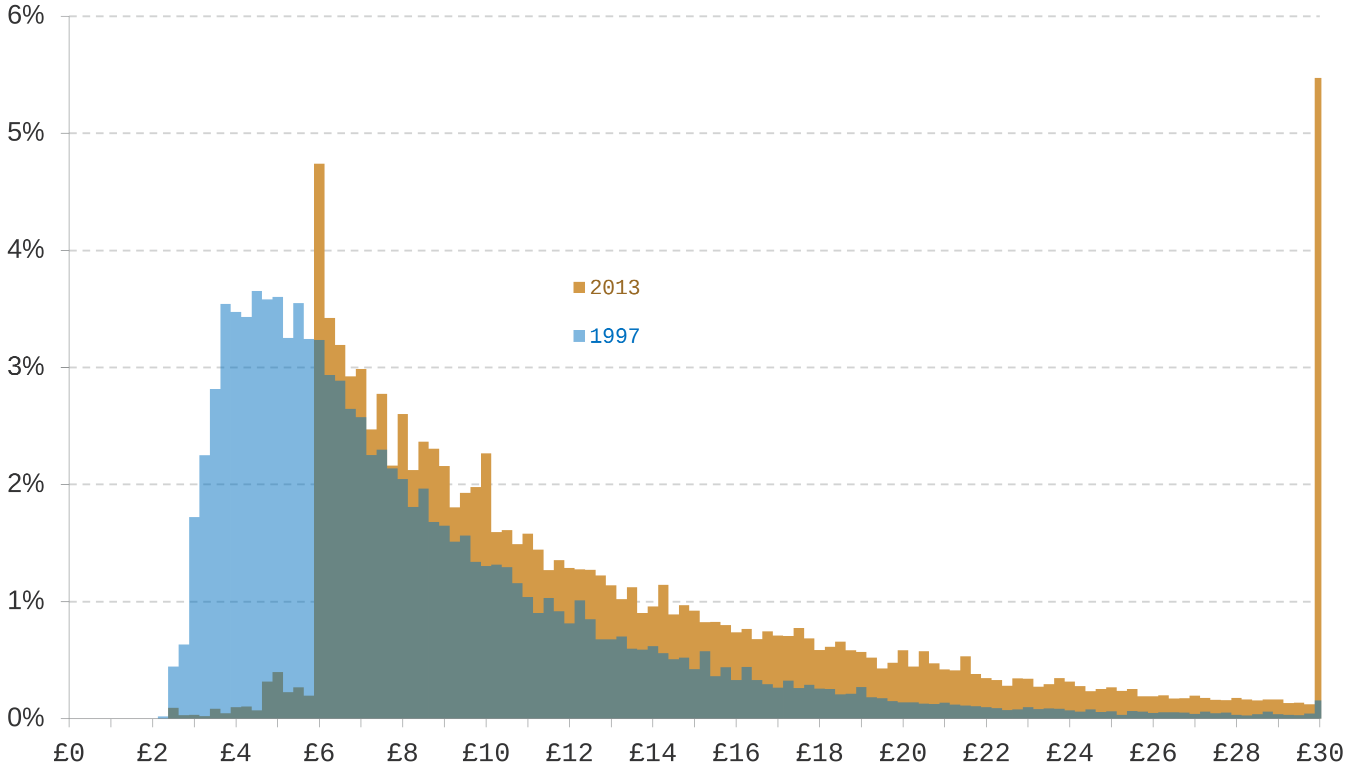
[1] The full range of rates in place since April 1999 are set out at in Annex 1

Measured against median hourly pay (excluding overtime), the bite of the NMW increased from 46 per cent in April 2001 to just under 53 per cent by April 2007. The bite subsequently remained broadly flat, reflecting the real-terms reduction in wages across the board following the onset of the economic downturn. But it rose sharply again in April 2011 and April 2012 – even as the NMW continued to fall in real-terms – because median pay fell even faster. Based on our estimate for median pay in April 2014, the bite appears to stand at around 54 per cent – more or less matching its peak in April 2012.

With the bite – and therefore the impact – of the NMW rising gently but steadily over the period, so the number of people directly affected by the rate has grown. Figure 2 compares the distribution of employees across different hourly rates of pay in 1997 – before the NMW was introduced – and in 2013 (all in nominal terms). It shows that there was a relatively long tail of low pay prior to the arrival of the NMW, stretching a significant way down the hourly wage scale. In contrast, the 2013 distribution shows a clear spike of workers paid at or around the adult NMW rate.

Figure 2:
Hourly pay distribution: GB 1997 & 2013

Proportion of all employees in each 25p pay band



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

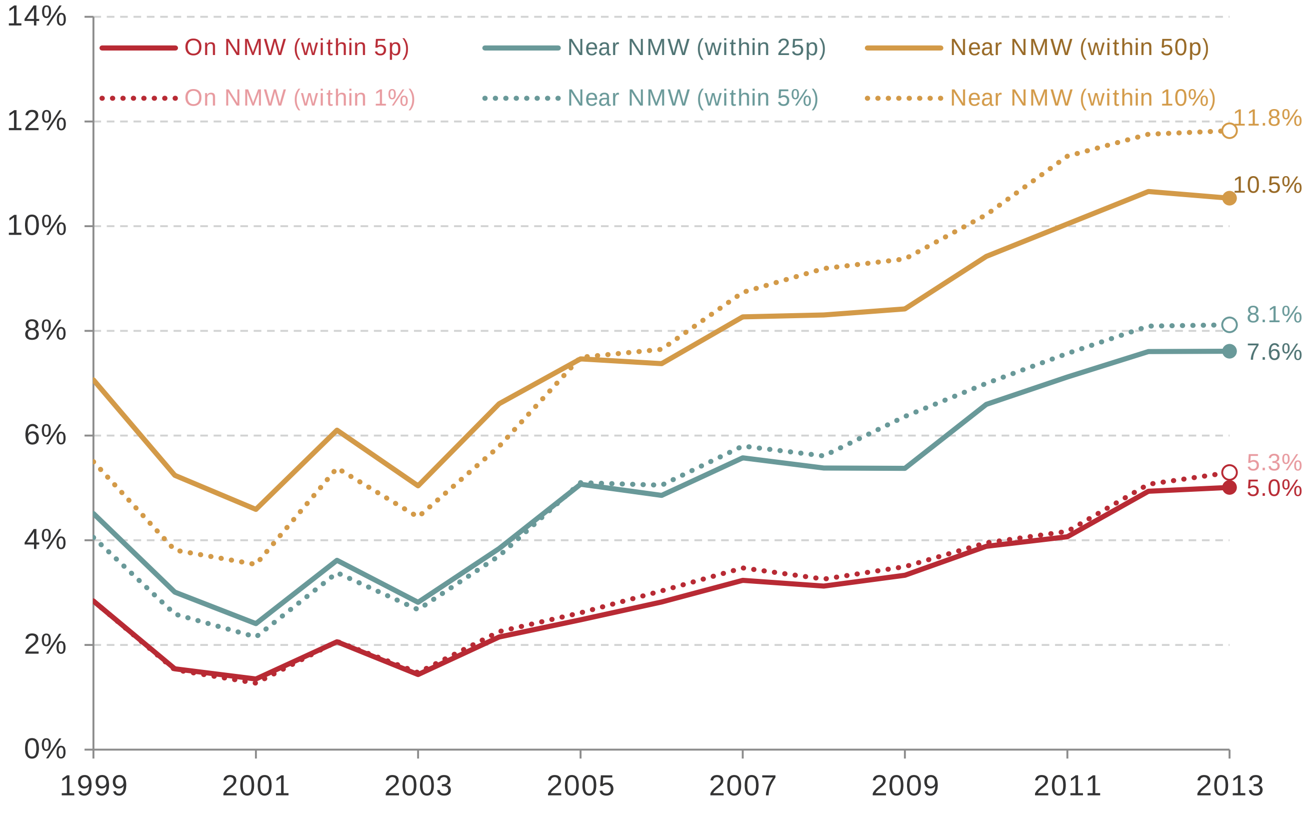
Notes: Gross hourly pay excluding overtime, set out in 25p bands. The final column shows the proportion earning in excess of £30 an hour. All figures are nominal.

The introduction of a wage floor has thus had a very clear effect on reducing the number of people in extreme low pay. The proportion of employees earning less than half of the median hourly rate has fallen from 10 per cent to just 2 per cent since the arrival of the NMW.[2] The initial strong increases in the NMW lifted the level of the floor relative to the median and so affected a growing share of employees. More recently, however, increased clustering around the NMW has been a product of the extraordinary falls in wages above the floor.

Figure 3 sets out the proportions of employees at or close to their age-specific minimum wage in each year since 1999. We present two different ways of looking at these proportions: the solid lines show those within specified cash boundaries, while the dotted lines show those paid within specified proportional boundaries. The former give an intuitive sense of proximity to the NMW, but the latter correct for inflationary changes in the value of each penny.

Figure 3:
Proportion of employees paid the age-specific minimum wage: GB 1999-2013

Proportion of employees paid close to NMW



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

Notes: We assume that anyone within 5p of the NMW is 'on the NMW' in line with the approach taken by the Low Pay Commission. Our estimate of the proportion in this position is slightly lower than the LPC's.

[2] This small group comprises a combination of legitimate exceptions to the main NMW (youth and apprentice rates) and contraventions of the legal minimum by employers breaking (knowingly or otherwise) the law.

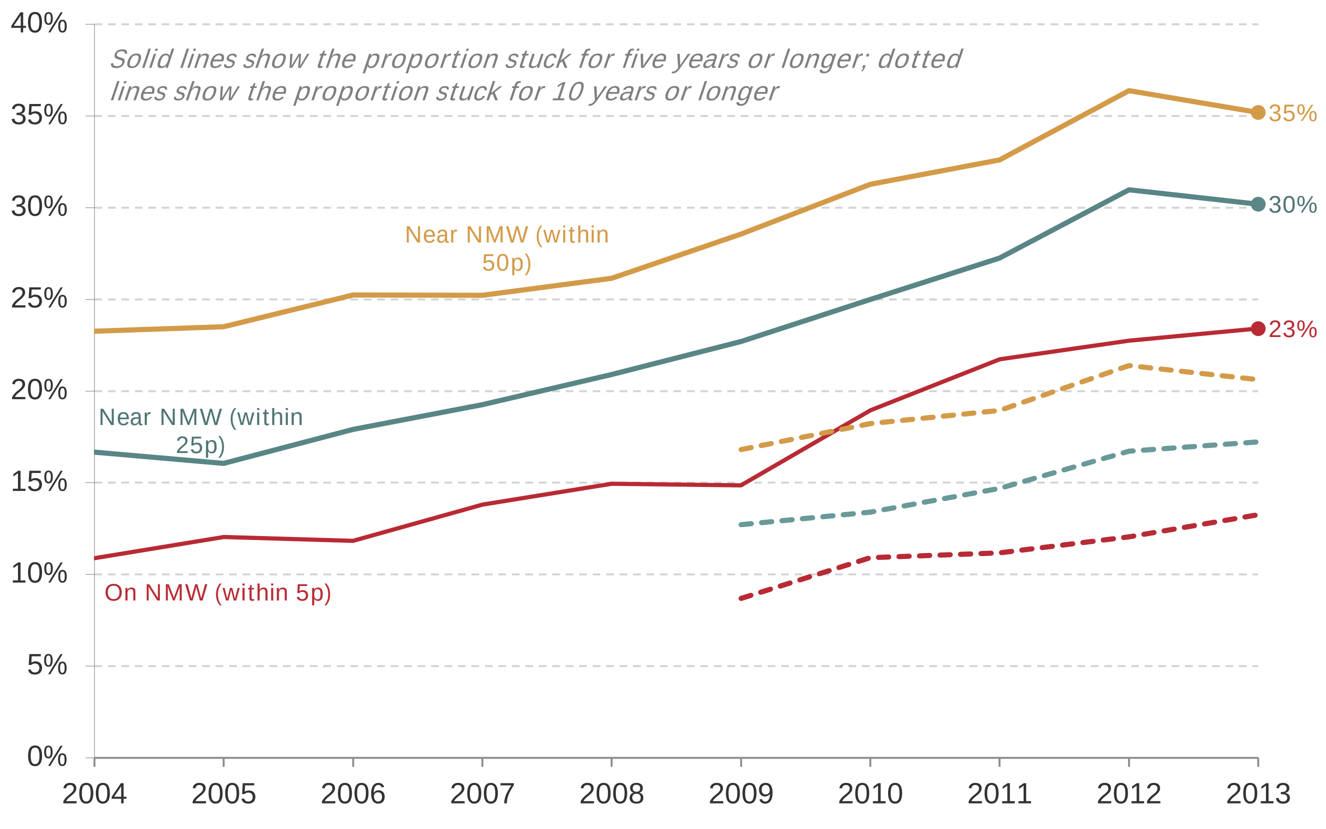
It shows that around 1-in-20 employees (or 1.2 million) were paid the minimum wage in April 2013, the highest proportion since its introduction. Looking higher up the earnings distribution, we see that 7.6 per cent of employees were paid within 25p of the minimum wage, while 10.5 per cent were within 50p. The proportion paid within 10 per cent of the NMW has increased from 3.5 per cent in April 2001 to 11.8 per cent in April 2013. The impact and what might be considered the 'shadow effect' of the NMW is therefore significant.

While for many workers the NMW can represent an entry-level rate of pay – one that they quickly surpass – for some it has the potential to persist. Figure 4 sets out the proportion of employees at or close to the NMW each year who have been 'stuck' there for at least five years in one instance (solid lines) and for at least ten years in another (dotted lines).

In defining the 'stuck', we begin by focusing on those NMW employees who have been in the workforce long enough to qualify for the five or ten years measures. That is, we exclude employees who have only been in the labour market for four (or nine) years or fewer. We consider these NMW employees to be stuck if they have never earned above the NMW (or the 25p or 50p threshold) over the previous five (or ten) years. They may have been out of the workforce (or self-employed and therefore not captured in the ASHE data) for some of that period, but when in employment they have only ever held NMW jobs.

Figure 4:
Proportion of employees stuck on or near the NMW: 2004-2013

Proportion of employees currently on NMW who have been 'stuck' for five/ten years or longer



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

Notes: An employee is considered 'stuck' if they have only ever recorded wages within the specified threshold over the past five or ten years. They may have faced some period out of the workforce (or have been self-employed and therefore not captured in the dataset). The proportions are calculated as a share of those employees who have been in the workforce long enough to qualify for the five or ten years measures.

Among those minimum wage workers in April 2013 who had been in the workforce long enough to be captured by the measure, just under one-in-four (23 per cent) had been stuck for at least five years and 13 per cent had faced 10 years or longer in this position. Widening our focus to those paid within 50p of the NMW, one-in-three (35 per cent) found themselves in this position for five years plus, while one-in-five (21 per cent) had been similarly stuck for at least 10 years.

On all measures, there has been a clear upward trend in recent years – particularly since the onset of the financial crisis. This is likely in large part to reflect the generalised slowdown in wage growth experienced across the earnings distribution in this period. We might hope, therefore, that a return to economic growth and an – eventual – associated recovery in wages will result in this trend reversing.

What is clear is that increasing numbers of individuals are affected by the NMW. And a growing number of such employees are finding that the minimum is becoming the going rate rather than a stepping stone. With that in mind, the trajectory of the NMW and the extent to which growth 'ripples' up the earnings distribution over the course of the next parliament takes on added importance.

As we discussed in a recent briefing note, there appears to be new political interest in recovering some of the ground lost by the NMW over the course of the downturn.[3] While there is a separate debate on the merit of political interventions in a process that is overseen by the independent Low Pay Commission – a debate that we make no comment on here – we can, by way of context, consider some plausible 'scenarios' for the NMW over the coming years. Figure 5, sets out five potential paths for the next parliament, including:

» **An inflation link**, where the NMW only rises in line with the OBR's projection for CPI inflation in every year from October 2015. Given recent falls and the strong employment picture, this is taken to be very much a worst-case scenario;

» **A return to the pre-crisis real-terms peak** (as measured by CPI) over the course of the parliament (which means by October 2019);

» **An earnings link**, where the April 2015 'bite' of the NMW relative to our projections for median pay (which are based in turn on the Bank of England's and the OBR's projections for average pay) is held constant over the period;

» **A return to business as usual**, with the NMW rising from October 2015 onwards in line with the annual rate of growth recorded during the pre-crisis years. Specifically, it is the real-terms rate of growth (in order to control for differences in inflation before and after the crisis) recorded between October 2001 and October 2007. The 'bedding in' period prior to October 2001 is removed, on the basis that it was atypical. Similarly, the downturn years are removed on the basis that we experience a return to a strongly performing labour market;

» An implausible, but revealing **what if? scenario** in which the real-terms growth recorded between October 2001 and October 2007 continued uninterrupted by any economic downturn.

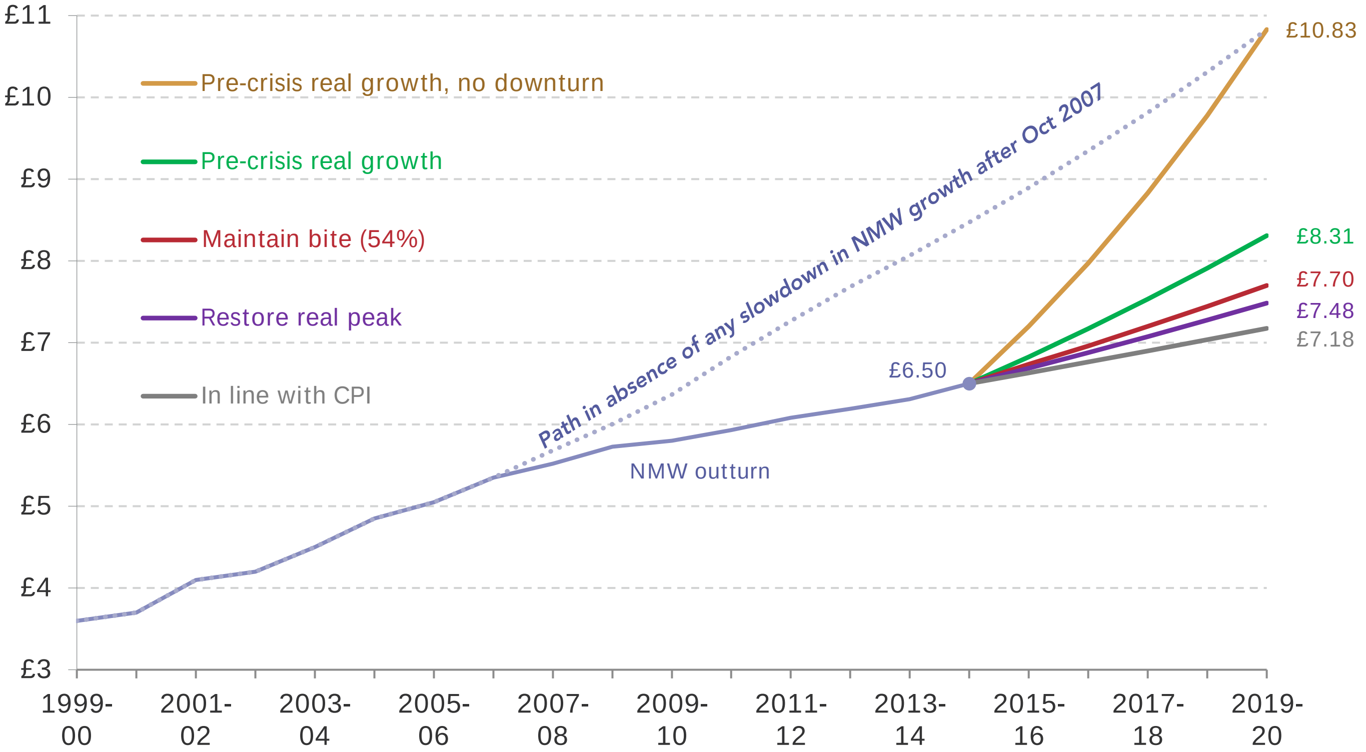
All of the scenarios are of course based on highly uncertain assumptions about the future path of inflation and median pay. But they highlight the extent to which different, plausible, scenarios return outcomes that will appear not dissimilar to some – though clearly relatively small differences will have very material effects for those being paid the NMW. The least ambitious of these scenarios – in which the NMW simply keeps pace with inflation – would reduce its bite to just 50 per cent. The most ambitious but plausible scenario – in which the pre-crisis level of growth is restored – would increase its bite to 58 per cent.

The number of people affected by such a move would of course depend on how the earnings distribution evolves over the coming years, but it has the potential to increase still further the proportion paid the NMW. By way of indication, it is worth noting that an overnight increase in the NMW bite from its current level of 54 per cent to 58 per cent would bring in the region of 1.4 million additional employees onto the NMW. The proportion paid the minimum wage would thus be roughly doubled.

[3] M Whittaker, *Raising the floor: scenarios for the minimum wage in the next parliament*, 28 September 2014

Figure 5:
Selected scenarios for the NMW by the end of the next parliament: 2000-2020

Nominal pay



Sources: RF analysis of ONS & OBR

Notes: Figures to 2015-16 are outturn/plans. In all instances we use OBR projections for CPI through to 2018-19 and assume it remains at 2 per cent thereafter. In estimating the future path of median pay, we apply an adjustment to the projections for average pay from the Bank of England and the OBR based on the historic ratio of median pay growth to mean pay growth.

The outcomes of the four 'plausible' scenarios in Figure 5 highlight also the extent to which all potential trajectories over the coming years will leave the NMW a long way short of where it might have been in the absence of the financial crisis and recession. That's an outcome that is true across the earnings distribution, but it is of course felt hardest at the bottom. So, while the NMW has done much to tackle the very lowest levels of pay, the challenge in the coming years is to restore some of the ground lost in recent times while simultaneously boosting pay *above* the minimum. It's a challenge we discussed in the Bain Review of the Future of the National Minimum Wage, and one to which we will return.[4]

[4] Resolution Foundation, *More than a minimum: The Resolution Foundation Review of the Future of the National Minimum Wage: The Final Report*, March 2014

Annex 1: Historic NMW rates

Date of change	Adult rate	18-20	16-17	Apprentice[1]
Apr 1999	£3.60	£3.00		
Oct 2000	£3.70	£3.20		
Oct 2001	£4.10	£3.50		
Oct 2002	£4.20	£3.60		
Oct 2003	£4.50	£3.80		
Oct 2004	£4.85	£4.10	£3.00	
Oct 2005	£5.05	£4.25	£3.00	
Oct 2006	£5.35	£4.45	£3.30	
Oct 2007	£5.52	£4.60	£3.40	
Oct 2008	£5.73	£4.77	£3.53	
Oct 2009[2]	£5.80	£4.83	£3.57	
Oct 2010	£5.93	£4.92	£3.64	£2.50
Oct 2011	£6.08	£4.98	£3.68	£2.60
Oct 2012	£6.19	£4.98	£3.68	£2.65
Oct 2013	£6.31	£5.03	£3.72	£2.68
Oct 2014	£6.50	£5.13	£3.79	£2.73

Notes: [1] This is the rate for apprentices aged 16 to 18 and those aged 19 or over who are in their first year. All other apprentices are entitled to the National Minimum Wage for their age.

[2] Prior to 2010, there were no apprentice rates. The adult rate covered those aged 22+, and the two additional rates were for 18-21 year olds and those under-18.

Resolution Foundation

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- *developing practical and effective policy proposals; and*
- *engaging with policy makers and stakeholders to influence decision-making and bring about change.*

For more information on this report, contact:

Matthew Whittaker
Chief Economist
matthew.whittaker@resolutionfoundation.org
020 3372 2958