Low Pay: The nation's challenge

An independent report by Alan Buckle

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Foreword

I believe this is a time for strong political and business leadership on low pay. It is now 15 years since the introduction of the National Minimum Wage. It has been a great success, boosting pay at the bottom without loss of jobs. But the persistence of low paid work in the UK and a fall in the value of the minimum wage in recent years means that we need a new approach and renewed vigour. We have a rare opportunity to improve people's lives, enhance the quality of an economy and help the public finances.

The facts are stark:

- It is estimated that over a quarter of a million people still do not receive the legal minimum wage.
- There is a broader problem of widespread low pay that causes hardship to a large proportion of our working population. One in five workers or 5.2 million people earn less than a Living Wage, up from 4.8 million in 2012 and 3.4 million in 2009.
- Women and young people are hit hardest. A third of all women in work and nearly two-fifths of 16 to 30 year old employees are low paid.
- Things have got worse. Employees have experienced a prolonged wage squeeze in recent years and the real value of the minimum wage has fallen by five per cent since 2010
- As well as harming people directly, low pay is a drain on government finances. The cost to the exchequer of workers paid less than a Living Wage is now £3.23 billion in spending on in-work benefits and lost tax revenue.
- Many countries are changing their policy and institutional responses to tackle low pay, while our approach is unchanged after 15 years.

In September 2013, Ed Miliband MP and Rachel Reeves MP asked me to address low pay by strengthening the National Minimum Wage and encouraging more employers to pay their staff a Living Wage.

In the course of this review, I have spoken with many gifted and knowledgeable people: business leaders, unions, academics, and employer representatives. This has convinced me that the time is right to chart a course of action to the elimination of low pay. There have been many illuminating reports on low pay but few have looked at it though business eyes.

Business leaders are overwhelmingly supportive of the National Minimum Wage, and most recognise the need to boost wages and productivity because levels of low pay remain unacceptably high. As John Cridland, director-general of the CBI, put it in his New Year message earlier this year: "As the financial situation of many firms begins to turn a corner, one of the biggest challenges facing businesses is to deliver growth that will mean better pay and more opportunities for all their employees after a prolonged squeeze."

In simple terms I have three conclusions:

First, our approach must change radically to address new policy challenges. The Low Pay Commission balances the need for wage growth with concerns about the impact on employment, and enjoys widespread industry support as a result. However, its role is short term and narrow. The current regime was designed in the 1990s to stop extreme low pay and abuse. Today the challenge is different, with millions of people earning just above the minimum but still living in poverty. This requires a broader and more ambitious strategy to tackle low pay.

Second, a longer term national mission to tackle low pay should be seen as part of a strategy to move towards a more high skill, high wage economy. Businesses have choices about how to compete, and policymakers should seek to create incentives to encourage more productive, higher value business models that support higher wages. A thirty-year international business career has made me acutely aware of businesses' need for certainty and time to plan, and the lesson from the introduction of the National Minimum Wage in 1999 is that employers are able to adapt. Warnings of huge job losses proved false, and most businesses now see the minimum wage as integral to protecting them from being undercut by those competing on extreme low wages.

Third, a much stronger partnership between government, employers and employees should be strived for. Policies to tackle low pay are also good for government finances. In the past, people were poor because they were out of work, but an increasingly high proportion of working people require working tax credits in order to get by. Tax credits play an important role in supporting working families and will continue to do so, but making work pay, through an economy that supports a higher skilled, better paid and more productive workforce, is the key to cutting the social security bill and thereby improving government finances.

I have listened carefully to views of businesses and their representatives and have been impressed by the good work that many do to tackle low pay. I have taken account of the views of business in framing proposals that are practical and affordable, and give businesses time to plan and adapt. I have also taken account of the views of trade unions, the Living Wage Foundation and others who fight for fairer pay. This report sets out specific conclusions as follows:

- There is a case for a more progressive approach to the minimum wage, together with safeguards to prevent economic or social damage.
- We should seek ways to improve the 'fit' of the National Minimum Wage to ensure that where employers can afford to pay more, they do, but should be cautious so as to avoid bureaucracy and complexity.
- The remit and role of the Low Pay Commission should change so that it plays a more proactive role.
- A small number of practical steps can be taken which would improve enforcement.
- The Government should do more to encourage employers to pay a Living Wage.

I believe that my core proposal of a clear goal to increase the minimum wage over the life of a parliament is achievable as part of a national mission to tackle the problem of low pay, and that achieving this will be good for citizens, business and the government.

This is an independent report, but I hope that Labour and other political parties, in considering the recommendations, will echo the ambition and courage of 1999 when the Low Pay Commission set the first minimum wage. It's time to finish the job.

Alan Buckle

Acknowledgments

I have taken account of the work and views of many people and groups during the course of this review.

I received input from a wide range of employers and other stakeholders, who are listed in annex A.

The input of the Low Pay Commission, its current and former Chairs and members has been of great value. I also pay tribute to the Living Wage campaigns of Citizens UK which have changed the lives of thousands of people.

All the views expressed in the report are my own.

Executive Summary

The introduction of the National Minimum Wage is one of the great policy successes of our generation. This approach led to progressive improvements in pay for the lowest earners without harming employment. The decision to establish the Low Pay Commission, which recommends the National Minimum Wage rate, as a partnership between employers and employees ensured a balance between the need for wage growth and concerns about the impact on employment.

The purpose of the National Minimum Wage was to create a floor to prevent exploitation and abuse. In the 1990s, a third of low paid workers and seven per cent of the total workforce were receiving extreme low pay. Today, the challenge is the large number of people that earn above the minimum but are still low paid.

The situation has worsened in recent years.

- The wages of working people have become increasingly disconnected from levels of growth and productivity, leading to a prolonged wage squeeze, and the real value of the minimum wage has fallen by five per cent since 2010.
- The number of workers on low pay now stands at over five million one in five employees and one in three female employees, and poor enforcement in some sectors means that more than a quarter of a million people are still estimated to earn less than the legal minimum wage.
- This affects not only the poorest households but also middle income families, many
 of which rely on the income of a second earner in a lower paid job to make ends
 meet.

The UK has both higher levels of low pay and lower levels of productivity than our main international competitors. We will only succeed in the global economy if we tackle these related issues, boosting productivity and ensuring a more equitable distribution of wages. This means building an economy based on fewer low skill, low paid jobs and more high skill, high paid jobs. Higher wage floors can be a driver for change in this regard, enabling employers to raise productivity and improve product and service quality with a well-trained and committed workforce, without being undercut by those following crude cost-cutting strategies based on wage competition. In turn, wage increases are instrumental in supporting growth, ensuring that people have money to buy the goods and services that businesses are selling.

Action to make work pay is also vital if we are to address rising social security bills. The Government now spends more on benefits and tax credits for families in work than it does on unemployed families, and spending on in-work benefits like tax credits and housing benefit is set to rise in real terms over the coming years despite the recent return to economic growth. There will always be a role for tax credits to support working families, but a more ambitious wage floor will ensure that there is less reliance from the taxpayer to employers for across-the-board low pay.

This review outlines a series of policy proposals to tackle low pay, focusing in particular on policies to strengthen the minimum wage and promote the Living Wage. There are challenges but I strongly believe that none of these are insurmountable, and that the proposals put forward here are practicable and fiscally positive. I hope that Labour and the other political parties will support them.

Policy proposals:

Strengthening the minimum wage:

We need to institutionalise a progressive approach to low pay based on a more productive, more innovative economy and measures to ensure that the gains from growth are more fairly shared. We also need to ensure that the minimum wage is more responsive to the different challenges facing different parts of the economy, with action to tackle low productivity in low paid sectors and to put more pressure on employers that could afford to pay more. My recommendations seek to build on the success of the Low Pay Commission by refining and extending its powers and remit while preserving the partnership and evidence-based approach that has been the key to its success.

Towards a higher skill, higher wage economy

1. An ambitious target for a more productive economy: The Government should set a long term ambitious target for the Low Pay Commission to increase the minimum wage over the course of a Parliament, as part of a national mission to tackle low pay and build an economy with fewer low skill, low paid jobs and more high skill, high paid jobs.

The minimum wage was designed in its current form to prevent extreme exploitation, but the challenge today is the millions of people earning low wages. The minimum wage must evolve to tackle the wider problem of low pay that faces us today. Therefore I recommend a new framework for the Low Pay Commission, with a five-year target to increase the minimum wage to a more stretching proportion of median earnings. The current minimum wage of £6.31, due to increase to £6.50 in October, is 53 per cent of median hourly earnings. A stretching target would ensure that the minimum wage increases faster than median earnings for the duration of the Parliament, to reach that target over five years. This would bring the rate closer to median earnings, ensuring that there is a bond between the wealth we earn as a nation and the wages that people earn for a hard day's work.

While there is a legitimate concern that a sudden and sharp increase in the minimum wage could risk jobs, a clear five-year target will give businesses time to plan and adapt their business models to boost productivity to support higher wages. The Low Pay Commission would have to set out the steps they believe it will take to meet the target over the Parliament. Beyond the five years, the Government will clearly want to put in place measures to ensure that the strength of the minimum wage is maintained for the future.

2. Safeguarding jobs and the economy: It is important to retain flexibility in the face of shocks. Therefore, if the Low Pay Commission believes, based on the state of the economy, that the five year target cannot be met, they must write to the Secretary of State for Business, Innovation and Skills to set out their reasons why not. At the moment, the burden of proof lies with the Secretary of State if they choose not to accept the recommendations of the Low Pay Commission. Under this new system, the Commissioners would have to provide compelling evidence that these targets could not be met without significant job losses or damage to the economy. Additionally the Low Pay Commission should set out any actions that the Government should take in order to get progress towards the national target back on track.

Ensuring that when employers can afford to pay more, they do

3. Sectoral variation: The minimum wage currently puts little pressure on sectors that could afford to pay more now. Meanwhile, employers operating in sectors characterised by structural problems of low pay may struggle to meet an ambitious increase in the minimum wage unless they are supported by broader measures to boost productivity. To ensure a more tailored approach and support the five year target, the Low Pay

Commission should be empowered to identify sectors that could afford to pay more and those with systematic problems of low pay. In both cases, the Low Pay Commission would be empowered to recommend a taskforce of key stakeholders, including employer representatives and trade unions, to develop a roadmap outlining clear goals and measures to tackle low pay. In the case of low paid sectors, this would result in a plan to tackle productivity and performance issues. In sectors that could afford to pay more, the Low Pay Commission should look at the case for giving the taskforce the power to set either a higher recommended rate or a higher statutory rate for the sector.

The remit of the Low Pay Commission

4. A more empowered Low Pay Commission: Under these proposals, the role of the Low Pay Commission would change significantly. At present it oversees a process to set a short term rate and produces high quality research focused on the impact of the minimum wage. The remit of the Low Pay Commission should be re-written so that it plays a productive, long term advisory role to government, as part of a national mission to tackle low pay. It should have a new remit to investigate the causes and consequences of low pay and make recommendations to the Government.

Improving enforcement of the Minimum Wage

We need to improve enforcement of the minimum wage. More than a quarter of a million workers are estimated to be paid less than the legal minimum, and yet the number of completed inspections carried out by HMRC in relation to National Minimum Wage enforcement have more than halved in recent years. All political parties have recognised the need to strengthen penalties for non-payment of the minimum wage to provide a proper deterrent. But I believe there is more that could be done.

- 5. Improving oversight of enforcement: As part of its broader remit, the Low Pay Commission should annually examine the effectiveness of policies to enforce the National Minimum Wage and make recommendations for improvement to HMRC.
- 6. Giving local authorities a role in enforcement: Local government should be given new powers to support the work of HMRC through inspection, information and enforcement of the minimum wage. In particular, the Commissioners for Revenue and Customs Act 2005 should be amended to create more legal gateways that allow HMRC to collaborate and share information with local authorities, as well as other enforcement agencies.
- 7. Strengthening the tools of the regulators: HMRC's remit should be expanded to include non-payment of Holiday Pay, which at the moment is only recoverable if an individual takes a case to tribunal. The Low Pay Commission should also explore the case for allowing the HMRC minimum wage compliance team to impose penalties for offences related to record keeping. This would encourage stronger cooperation from employers.

Encouraging more employers to pay a Living Wage

The campaign for a "Living Wage", led by Citizens UK and a broad-based coalition of community organisations, trade unions and faith institutions, has supported thousands of low paid workers onto higher wages that help meet the basic cost of living in the UK. Many great policies start out as campaigns, and the Living Wage now has support within all political parties, alongside a strong and rising statutory minimum. I believe the Government can do more to support and promote the Living Wage campaign.

8. Using the power of procurement: Central government departments should use the power of procurement to encourage organisations bidding for large government contracts to pay their staff a Living Wage. As a first step, I recommend that all central government departments should become accredited Living Wage employers. This would ensure that all sub-contractors pay the Living Wage to any staff working on government contracts.

Analysis published by the Smith Institute estimates that this would cover nearly 200,000 people, and approximately 30,000 people would see their pay increase as a result. This could be seen as a first step towards all government contractors being required to pay Living Wage rates to staff who work on government contracts. The impact of this policy would be significantly larger if it all firms bidding for contracts of a certain size were required to become Living Wage employers themselves. The cost and potential of this should be investigated in the next Parliament.

- **9.** *Greater transparency:* Greater transparency of pay strategies would ensure that the issue is on the board room agenda and also allow investors to understand the strategy. Therefore, all public companies should disclose within their Remuneration Report:
 - Their policy on low pay, including whether they are a Living Wage employer and if not, why not; and
 - The number of staff paid below a Living Wage and the annual cost of becoming a Living Wage employer.
- 10. Creating incentives: Labour has proposed that companies that sign up to become Living Wage employers in the first year of the next Parliament will benefit from a 12-month tax rebate of up to £1,000 for every low paid worker who gets a pay rise. These 'Make Work Pay' contracts have a strong role to play in supporting firms to move towards more productive business models. I believe that they should also be used to support the new 'Living Wage Zones' being developed in some areas, where local councils, employers and other stakeholders come together to develop a plan to encourage local businesses to become Living Wage employers.

Unfinished business

Reviews focused on a single issue are inevitably restricted in scope. Throughout my review two points have continually been made that are strongly related to this review.

First, low pay is only one part of a crisis in working life. Policymakers should also take action to address the wider context of a fragmenting working world increasingly characterised by job insecurity, non-family-friendly working conditions and a lack of quality opportunities for workers who wish to progress.

Second, as a former Chairman of the Low Pay Commission put it to me: a five year journey on low pay must take place hand in hand with a 30 year journey to a higher skill, higher wage economy. The approaches set out here will ensure that businesses are able to plan, hopefully within the context of a wider strategy to ensure that businesses have the skills and finance they need to innovate and grow.

Conclusion

The proposals I have set out are ambitious, but I believe that the achievements of both the Low Pay Commission and the campaign for a Living Wage should embolden us to build on their success. The timing is good: we have a chance to improve the lives of working people, while benefiting government finances and building a more productive economy based on high skills and high wages.

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Introduction

The introduction of the National Minimum Wage was one of the great policy successes of the last Labour government. This approach led to progressive improvements in pay for the lowest earners without harming employment and without large offsetting declines in working hours or non-wage benefits.

However, the purpose of the National Minimum Wage was to create a floor to prevent exploitation and abuse. In the 1990s, a third of low paid workers and seven per cent of the total workforce were earning extreme low pay. Today, the challenge is the large number of people that earn above the minimum but are still living in poverty or reliant on in-work benefits. This demands a broader approach to tackling low pay.

This situation has worsened in recent years, following a prolonged wage squeeze and a decline in the real value of the minimum wage by five per cent since 2010. The number of workers on low pay – using the OECD definition of those earning two-thirds of median earnings – stands at over five million: one in five employees and one in three female employees. Poor enforcement in some sectors also means that more than a quarter of a million people are still estimated to earn less than the legal minimum.

Low paid workers have also been disproportionately affected by:

- An increase in insecure forms of work such as zero-hour contracts, which official statistics show have increased threefold since 2010 and could affect up to 1.4 million people¹;
- Reduced levels of public services and heavy cuts to tax credits for working families;
- Price increases in basic necessities such as energy and transport.

As well as the hardship and indignity this situation can mean for these workers, low pay and insecurity are important drivers of rising social security bills, with spending on in-work benefits like tax credits and housing benefit set to rise in real terms over the coming years despite the recent return to economic growth.² Low pay can also hold back the economy by suppressing consumption in domestically-traded sectors.

The first section of this review sets out the evidence on the rise of low pay and the current context. The second section then sets out my arguments for change. Finally, I set out a set of ambitious policy proposals to tackle low pay, focusing in particular on policies to strengthen the minimum wage and promote the Living Wage.

1. Low pay in Britain today

This section looks at the context and impact of the introduction of the minimum wage and sets out the evidence on how the problem of low pay has evolved in Britain over the last 15 years.

1.1 Background

Before 1997, some British workers were paid as little as £1 an hour. Reports at the time documented cases such as a factory worker earning £1.22 an hour, a residential home worker earning £1.66 an hour, and a chip shop worker in Birmingham who earned just 80p an hour.³ Memorably, the first report of the Low Pay Commission highlighted a post as a security officer that paid £2 per hour and required the post-holder to supply his own dog.⁴

It was to tackle such cases of extreme low pay that the Labour government introduced the National Minimum Wage on 1 April 1999. The rate of the National Minimum Wage is set by the Low Pay Commission, a tripartite body led by nine members, including a chair, and supported by a small secretariat (see box below for details).

The remit and members of the Low Pay Commission

The current remit of the Low Pay Commission is to monitor, evaluate and review the different National Minimum Wage rates and their impact, and make recommendations on the levels it believes should apply, taking into account of the state of the economy, and employment and unemployment levels. Its members are appraised under the Nolan Public Appointment rules and have a balance of:

- Members with knowledge and experience of, or interest in, trade unions or matters relating to workers generally.
- Members with knowledge or experience of, or interest in, employers' associations or matters relating to employers generally; and
- · Members with other relevant experience.

This has meant that there are effectively three members representing employers, three representing employees and three 'independents'. As well as advising on the National Minimum Wage the Low Pay Commission also advises on what should and should not be included in the minimum wage. The Commission also reports discursively on "such matters relating to [the Minimum Wage Act 1998] as the Secretary of State sees fit".

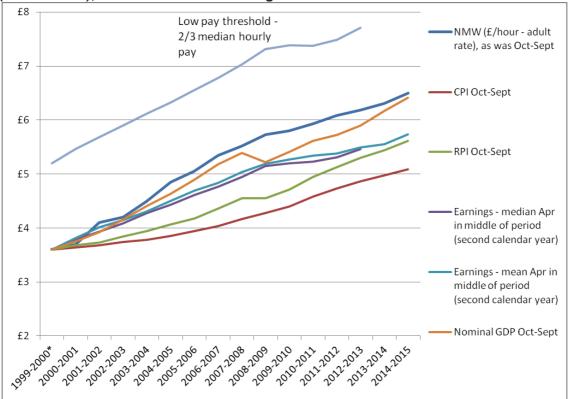
The Commission receives its remit in June and follows an annual cycle of research during the summer and evidence taking in the autumn. The new minimum wage rates are then announced in March and apply in October, 15 months after the cycle begins. Since the introduction of the national adult rate, separate minimum wage rates have been introduced for young people and apprentices, who were originally exempt from the minimum wage regulations. The current adult rate is set at £6.31, due to increase to £6.50 in October 2014.

Minimum wage rates	Now	As of October 2014
Adults	£6.31	£6.50
18-20 year olds	£5.03	£5.13
Under 18 year olds	£3.72	£3.79
Apprentices	£2.68	£2.73

1.2 The impact of the National Minimum Wage

The current low pay regime has led to progressive improvements in pay for the lowest earners. For the first 10 years after its introduction, the National Minimum Wage rose faster than inflation (both CPI and RPI) and GDP, and, after some initial "catch up", broadly in line with median earnings. The graph below shows that, if the minimum wage had increased each year by any of these measures alone, it would be lower than it is now.

Chart 1. Increases in the minimum wage since 1999 compared to increases in inflation (RPI and CPI), GDP and median earnings



Sources: the NMW rates are from the Low Pay Commission, CPI and RPI are from the ONS Consumer Prices Indices; earnings are from the ONS Annual Survey of Hours and Earnings (based on hourly earnings excluding overtime for all jobs, both full-time and part-time), and nominal GDP is from the ONS UK Output, Income and Expenditure dataset

As a result, the proportion of workers on 'extreme low pay' – defined here as below half of median pay – fell from seven per cent in 1997 to just 1.5 per cent of workers in 2011.⁵ Following years of rising inequality, the lowest paid workers also began to catch up with middle-earners again (see graph below).⁶ Estimates suggest that among low paid groups, such as young workers, as much as half the decline in wage inequality in the bottom half of the wage distribution between 1998 and 2010 can be ascribed to the National Minimum Wage.⁷

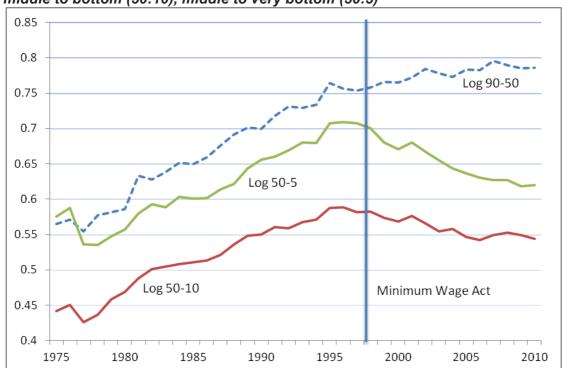


Chart 2. Ratios between key points of the earnings distribution – top to middle (90:50), middle to bottom (50:10), middle to very bottom (50:5)

Source: Butcher, Dickens and Manning (2011), cited in Whittaker and Hurrell (2013) *Low Pay Britain* 2013, Resolution Foundation

Despite the scandals of low pay, the introduction of a statutory minimum wage was controversial at the time. In 1995 the CBI argued that "even a low minimum wage would reduce job opportunities and create major problems for wages structures in a wide range of companies". Government ministers warned of 950,000 job losses right up to the 1997 general election. The Economist magazine warned that "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."

However, these predictions proved false. After more than a decade of research on the impact of the National Minimum Wage, the now widely accepted consensus is that it has helped to raise pay for the lowest earners without any measurable loss of jobs. For example, a study by the National Institute of Economic and Social Research in 2013 found no evidence to suggest that the NMW had changed average employment or investment rates for low-paying companies after its introduction or in the wake of the global financial crisis of 2008. Summarising the body of evidence, the 2013 report of the Low Pay Commission notes that the research in general finds few adverse effects on aggregate employment; the relative employment shares of the low-paying sectors; individual employment or unemployment probabilities; or regional employment or unemployment differences."

The ability of employers to adapt and absorb wage costs was underestimated when the National Minimum Wage was introduced. Studies have found that companies whose pay rates were directly impacted by the minimum wage adapted in a number of ways – including reductions in profit margins¹² and changes to working practices and management techniques.¹³ There is also evidence that the introduction of the minimum wage may have *strengthened* business performance in low-paying sectors, by encouraging companies to raise labour productivity.¹⁴ The Low Pay Commission has pointed to evidence "that the National Minimum Wage resulted in productivity improvements among low-paying firms in low-paying industries" during the initial years of minimum wage increases.¹⁵ Finally, several

submissions to this review noted the benefit the minimum wage had in creating a level playing field, protecting employers seeking to compete through quality improvements from crude cost-cutting measures by competitors.

The introduction of the National Minimum Wage has helped achieve improvements in pay. As an enforced and widely understood pay mechanism, it has helped ensure that there is a level playing field for competitive tendering with price reductions resulting from efficiency improvements rather than lower wage rates.

Submission from G4S

In the wake of this success, a new consensus has emerged that sees the National Minimum Wage as one of the great policy successes of recent decades. Politicians of all parties now support the Minimum Wage. In 2000, the Conservative Shadow Chancellor Michael Portillo noted that "the minimum wage has caused less damage to employment than we feared" and in 2005 David Cameron acknowledged that it had "turned out much better than many people expected." By 2000, polls were showing that the majority of business also supported the institution, with 53 per cent agreeing that the introduction of the minimum wage had been good for Britain and by 2006 the minimum wage enjoyed support from three quarters of employers.

1.2 The challenge today

The situation now is very different from the problems that policymakers faced in the 1990s. The Low Pay Commission and the National Minimum Wage were designed to stamp out extreme low pay and abuse, but the challenge today is the large number of people that earn above the minimum but are still living in poverty.

There are various ways of measuring low pay. The OECD and Eurostat, which produces most of the statistics for the European Commission, both use relative measures. The OECD defines low pay as less than two-thirds of median earnings and 'extreme' low pay as less than half of median earnings, while Eurostat defines low pay as 60 per cent of median hourly earnings. In addition, in the UK public attention has increasingly focused on those paid below the 'Living Wage' – an absolute measure that takes into account the cost of living as well as earnings. The graph below shows that extreme low pay (using the OECD definition of less than half of the hourly median wage) fell sharply after the introduction of the minimum age, low pay more generally (less than two-thirds of the hourly median wage) has remained steady. The number of people earning less than a Living Wage has increased in recent years to one in five workers, or 5.2 million people – up from 4.8 million in 2012 and 3.4 million in 2009.

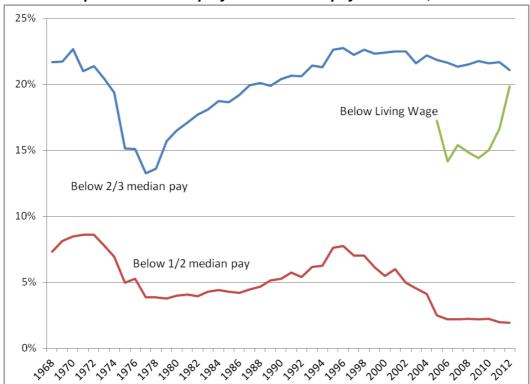


Chart 3. Proportion of all employees below low pay threshold, 1968-2012

Source: Analysis by the Resolution Foundation. Data from DWP, Family Expenditure Survey (1968-1981); ONS, New Earnings Survey Panel Data (1975-2010) and ONS, Annual Survey of Hours and Earnings (1997-2011).

The UK has one of the highest rates of low pay in the OECD and more than twice the rate of some other countries (see graph below). This situation affects female workers, younger workers and part time workers disproportionately. A third of all women in work, nearly two-fifths of 16 to 30 year old employees and 43 per cent of part time workers are low paid. Historically low paid jobs have often been portrayed as 'stepping stones' to better paid work, but a recent report found that almost three-quarters of Britain's workers who were on low pay in 2002 were still low paid 10 years later. Many of these jobs are associated with wider job quality issues such as low levels of training, job insecurity and a lack of autonomy at work.

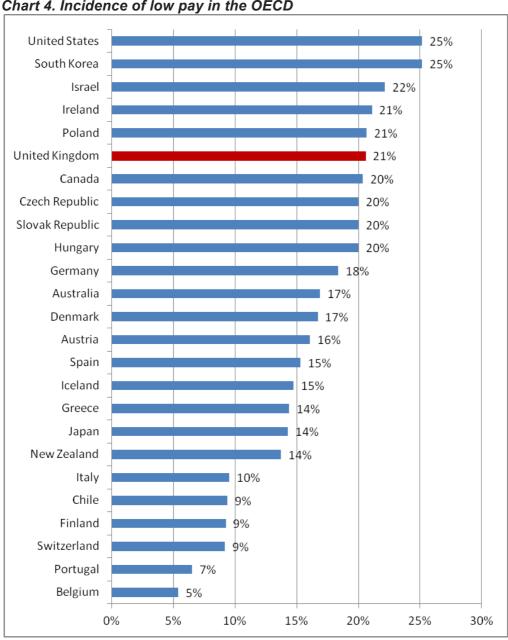


Chart 4. Incidence of low pay in the OECD

Source: OECD, data from 2010 or 2011, depending on latest available.

The vast majority (85 per cent) of low paid workers are concentrated in the private sector²⁴, mostly in domestically-traded sectors that are not vulnerable to international competition. Hospitality and retail account for 25 and 21 per cent respectively of all minimum wage jobs. The minimum wage is now the default entry-level wage in sectors such as cleaning, hospitality and hairdressing, as the graph below shows, and many more are paid just above the minimum. In cleaning, 58 per cent of the workforce is paid less than £7 an hour. Similarly, 48 per cent of workers in hospitality, 42 per cent in hairdressing and 41 per cent of those working in the childcare sector are paid less than £7 an hour. 25 Increases in the minimum wage have a particularly strong impact – or more 'bite' – for workers in these sectors. At the same time there are a significant number of people who work, either directly or as subcontractors, for employers in sectors that can clearly afford to pay more.

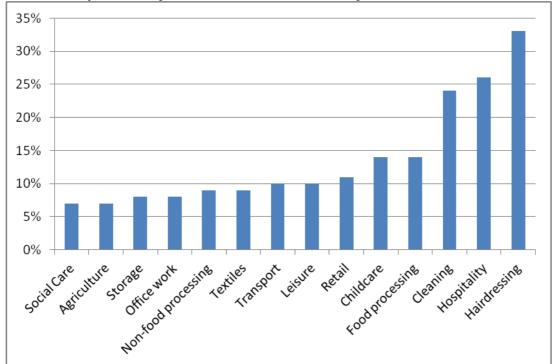


Chart 5. Proportion of jobs in sector that are NMW jobs

Source: Low Pay Commission estimates based on Annual Survey of Hours and Earnings, 2010 methodology, low-pay weights, including those not on adult rates of pay, UK, April 2012

There are also important differences in the predominance of low paid work across different regions. In less prosperous parts of the UK such as Wales, the East Midlands, the West Midlands and Yorkshire and the Humber, a quarter of all workers earn less than two-thirds of median hourly pay, compared to 11 per cent of workers in London. Rearly half (47 per cent) of all those in employment outside London are employed in low skilled occupations, which are more likely to be low paid, compared to 38 per cent of those in employment in the capital. The nature of the economy in London means that many employers can afford to pay higher wages than other parts of the country, leading some to suggest that the capital could support a higher minimum wage.

1.3 The recent context: Losing ground

The problem of low pay has worsened in recent years, as employees have experienced a prolonged wage squeeze. For low earners, this has been compounded by a fall in the real value of the National Minimum Wage of five per cent over the past four years. The Low Pay Commission has acknowledged that "in real terms using CPI, the value of the National Minimum Wage in October 2012 was similar to its value in 2004 and much less than it was worth in 2009, while using RPI the real value of the National Minimum Wage in October 2012 was less than it was in October 2004."²⁹ This has left full time workers that earn the minimum wage £13 a week worse off than they were in 2010. Even after the recent announcement that the minimum wage will increase to £6.50 in October 2014, it will still be 13p less in real terms (RPI) than it was in 2010.

We are of the view that improvements in headline growth and rising numbers in employment are masking a number of structural problems in the 'real' economy. These include falling real wages, part time working where people want to work full time, poor productivity, lack of investment in housing and infrastructure leading to higher priced basic goods, and an increasing issue with the quality and price of education.

Submission from Nigel Wilson, Group Chief Executive, Legal and General

There is also widespread evidence that the minimum wage is not being effectively enforced. As the most recent report of the Low Pay Commission puts it, "compliance remains the cornerstone of the National Minimum Wage regime" because "the minimum wage is the wage floor in practice, as well as statute, only if it is widely observed by employers". Yet the number of completed inspections carried out by Her Majesty's Revenue and Customs (HMRC) – which has responsibility for National Minimum Wage enforcement on behalf of the Department for Business, Innovation and Skills (BIS) – have more than halved in recent years. As a result, the number of companies found by HMRC not to be paying the National Minimum Wage fell from 968 in 2011 to 2012 to 736 in 2012-2013³¹, despite the fact that some data shows an increase in non-compliance over time³².

The ONS estimates that more than a quarter of a million people are still being paid less than the legal minimum³³ and Low Pay Commission research cites research showing that approximately six per cent of the bottom decile of adult earners are not being paid the legal minimum.³⁴ This is a particular problem in social care sector, where it is estimated that between 155,000 and 220,000 care workers are paid less than the legal minimum.³⁵ In addition to social care the Low Pay Commission cites hotel cleaners, home-workers, apprentices, interns, those on work experience and volunteers as particular areas of non-compliance.³⁶

1.4 The Living Wage campaign

The problem of low pay has become more prominent in the public mind and has increasingly been picked up by campaigners and activists. The most successful of these is the campaign for a "Living Wage", which began in East London in 2001. Led by Citizens UK and a broadbased coalition of community organisations, trade unions and faith institutions, the campaign has accredited more than 600 employers and supported over 40,000 low paid workers onto higher wages that help meet the basic cost of living.

To be registered as a Living Wage employer it is necessary to pay your own employees the Living Wage – currently £8.80 in London and £7.65 in the rest of the UK – and to commit to ensure all contractors pay the Living Wage to staff working on the premises at the earliest possible time. The London rate is set by the Greater London Authority in London and the UK rate is set by the Centre for Research in Social Policy at Loughborough University. The calculations are based on evidence of how much employees need to meet their basic needs, taking into account in-work benefit entitlements.

	Current Living Wage rate	Rate prior to 4 th November 2013
London	£8.80	£8.55
Rest of UK	£7.65	£7.45

The Living Wage campaign started in London and focuses mainly on contracted-out staff, such as cleaners, caterers and security staff in relatively well-paid industries. However, the campaign has had little penetration in the sectors with the largest numbers of low paid people. For example, to date just one large retailer has signed up – the cosmetics firm Lush. Many employers in these sectors are supportive of the campaign but are often unable to pay the Living Wage unless their competitors do so, due to the risk of being undercut.

Building on the ideas and energy of Living Wage campaigners, some local authorities are experimenting with how to promote and encourage more employers to adopt a Living Wage.

ⁱ It should be recognised that there is already flexibility in paying the Minimum Wage. There are categories of people who are not required to be paid the Minimum Wage include voluntary workers; students on work placements; family members in a family business and those under the compulsory school-leaving age.

Local authorities in York and Islington have organised Living Wage Zones – where stakeholders come together to plan strategies to support local private sector employers in the area to move towards a Living Wage – and others are using procurement to promote the living wage. To date, 26 Labour-led councils, one Conservative, one Liberal Democrat and one Green Party council have become Living Wage employers – paying their directly contracted and sub-contracted staff a Living Wage, and requiring their suppliers to do the same. The Greater London Authority is also a Living Wage employer, but currently no central government department has been accredited.

2. The case for change

In the course of this review I have consulted with a wide range of employers and employee representatives. I have received written submissions and held formal meetings as well as informal discussions with more than 100 organisations and individuals, including current and former members of the Low Pay Commission. Additionally, I have met with charities and campaigners concerned with the issue of low pay, including Citizens UK, which has campaigned for many years on the issue. I have also consulted labour market economists and employment lawyers, and reviewed a large body of reports and proposals by academics, think tanks and campaigners.

There are some areas where there is strong consensus:

- There is near unanimous support for the concept of a minimum wage. While a few
 people still believe that the market should set the floor to pay, the overwhelming
 consensus is that a statutory National Minimum Wage is good for the country.
- There is little appetite for an annual National Minimum Wage set by the Government, without the advice of an independent Low Pay Commission.
- There is support for a long term approach that sets a clear national goal to tackle low pay while giving employers the certainty to plan and adapt.
- There is widespread support for more effective enforcement of the minimum wage, and concern about the significant number of people still not paid the legal minimum.
- The Living Wage attracts praise as a grassroots campaign that has helped to raise
 the profile of the need to tackle low pay, but there is strong consensus that a
 statutory Living Wage would be inappropriate, as it simply duplicates the National
 Minimum Wage.

At the same time, *opinion is divided* on the following issues:

- Although there is consensus about the need for a more progressive approach to the National Minimum Wage, opinion is divided about how ambitious this should be.
- How and whether to change the role and remit of the Low Pay Commission. Some believe that the current narrow and short-term remit is essential to maintain consensus. Others believe that the Commission needs to play a more proactive role if it is to meet today's challenges.
- Whether the current single National Minimum Wage is sufficient or whether it should be made to fit different dynamics across different parts of the economy.
- How to achieve strong enforcement. There are many options to improve enforcement but little consensus on how best to do this.
- The extent to which the Government should intervene to encourage more employers to pay the Living Wage.

My work has led me to some *simple conclusions*:

- There is a case for a more progressive approach to the minimum wage, rising over time as part of a plan to raise productivity and wages across the economy.
- There should be safeguards to prevent economic or social damage.
- We should seek ways to improve the 'fit' of the National Minimum Wage to ensure that where employers can afford to pay more, they do, but should avoid bureaucracy and complexity.
- The remit and role of the Low Pay Commission should change so that it plays a more proactive role.
- A small number of practical steps can be taken which would improve enforcement.
- The Government should do more to encourage employers to pay a Living Wage.

This section explains how I have reached these conclusions, drawing directly on the submissions to the review.

2.1 A more progressive approach

The mainstream economic argument against a more ambitious approach to low pay is that it could lead to an increase in unemployment. In particular, some argue that an increase in the minimum wage while the economy is weak could risk jobs and damage the UK's international competiveness.

However, there are different ways to compete in the global economy. The UK cannot realistically compete with China or India on cost, and many of our main competitors have chosen to compete on quality instead, with high quality goods and services underpinned by a well-trained and motivated workforce. Almost all developed countries have experienced an increase in inequality and low pay in recent decades, but these countries tend to have much lower levels of low pay than the UK, having better protected the workforce from the impact of technological change and globalisation.

Many higher wage, higher skill countries are characterised by higher minimum wages, as well as greater variation in the design through sectoral and occupational approaches. New Zealand has maintained a relatively high minimum wage – currently \$14.25 New Zealand dollars an hour, just under £7.30 an hour. The Government has an explicit goal of increasing the minimum wage over time to protect the real income of low-paid workers while minimising job losses, and the rate must rise at least in line with inflation every year. Australia also has a particularly high minimum wage, at \$16.37 Australian dollars per hour (approximately £9), combined with a system of sectoral and occupational rates.

The minimum wages in New Zealand and Australia are also strong relative to other earners. The graph below shows the value of minimum wages as a proportion of median hourly earnings for full time workers. On this measure, the UK's minimum wage is 47 per cent, compared to 38 per cent of full time median hourly earnings in the USA but 53 per cent in Australia and 60 per cent in New Zealand. A number of countries are also taking steps to overhaul their approaches to low pay. Germany has a long history of sectorally-negotiated wages, and is about to set the country's first national rate at €8.50 per hour. In the US, President Obama is campaigning for Congress to approve an increase in the minimum wage from \$7.25 to \$10.10 over a two year period, and some American states have introduced minimum wages that are much higher than the Federal statutory rate.

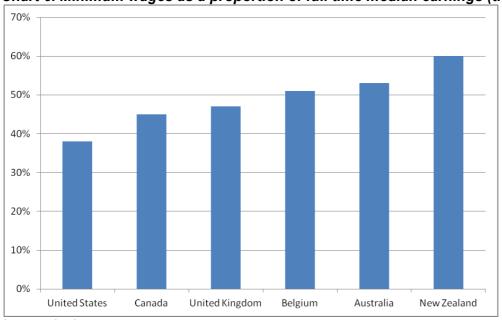


Chart 6. Minimum wages as a proportion of full time median earnings (the 'bite')

Source: OECD, 2012

This review has convinced me of the need and opportunity for a more progressive approach. In particular, the potential negative effects of minimum wages on employment levels are not borne out by the evidence. Reviewing the impact of the minimum wage in 2012, Alan Manning, Professor of Economics at the London School of Economics, summarised the position as follows: "no evidence exists of negative impacts on employment or hours strong enough to worry us about the negative effects of the minimum wage on overall employment income balancing out positive effects". The international evidence on minimum wages backs up these findings. One study shows that low cost retailers in the US have been able to boost customer experience and decrease costs by investing in staff³⁸, and even in the case of a sudden sharp increase in the minimum wage for young people in New Zealand in 2001, studies failed to find a convincing link between the minimum wage and youth employment rates or hours worked. In the UK young people are also protected by lower youth rates.

I do not believe that it is possible simply to transplant systems from elsewhere to the UK. However, the debate in other major economies should give us the confidence to change the way we do things in the UK. A sudden large increase in the minimum wage could be damaging – and therefore it is vital to raise productivity alongside increasing wages, to give businesses time to plan and adapt, and to retain flexibility in face of shocks, but the economy is currently growing, suggesting that there is capacity to raise the minimum wage.

In the long term a more ambitious approach to the minimum wage would have substantial positive effects:

- Higher wages are an incentive to stay in or return to the workforce, enabling parents in particular to better cope with the cost of childcare.
- The additional income people receive increases demand in the economy, especially when it is in the hands of the low paid who have the highest propensity to spend.
- Progression from the minimum wage to higher paid jobs has been raised as a major issue, with many people permanently trapped in low paid jobs. This is a long term issue that requires sustained attention. However, the lack of good progression opportunities only reinforces the need for a decent wage floor.
- Tackling low pay will benefit the exchequer through reduced spending on in-work benefits and higher tax receipts: the Government spends more on benefits and tax credits for families in work than it does on unemployed families, and the estimated cost to the exchequer of low paid workers is now £3.23 billion in social security spending and lower tax receipts.

Finally, there is a simple fairness argument rooted in the values shared by most people: that people should get a decent reward for a hard day's work. It is evident from UK and from the US that without strong support for low paid workers, the benefits of economic growth are not always shared with the vast majority of citizens. This needs to change.

The case for addressing low pay is overwhelming and internationally recognised. Businesses benefit from lower turnover of employees and higher staff motivation. The economy benefits from increased demand, lower levels of indebtedness and less government spending subsidising low paying employers through tax credits and in-work benefits. The societal benefits are evidenced through studies showing that living on low income has implications for levels of stress and anxiety, shame and stigma, physical health, family and personal relationships and social isolation.

Submission from UNISON

A key benefit for businesses of addressing low pay is that reputable firms would not get driven out of business by others who undercut them through the payment of low wages.

Submission from UCATT

2.2 Addressing variations in affordability and productivity

Analysis of the causes of low pay in different parts of the economy indicates that while some firms and sectors could afford to pay their lower paid workers a better wage relatively easily, for others large increases in wages for low paid workers would be a more significant challenge to their business models if not accompanied by significant improvements in productivity.

Despite this variation, the Low Pay Commission has no remit to analyse or drive changes to address the dependence of some sectors and businesses on low paid workers. At the same time the fact that the National Minimum Wage, quite rightly, has to be set with regard to employment and competitiveness across the economy means that conditions in these sectors effectively act as a brake on the rate of the minimum wage, leaving the Low Pay Commission with no levers to apply pressure on employers that could afford to pay more. As a review of the National Minimum Wage led by Sir George Bain, the first chair of the Low Pay Commission puts it, the "National Minimum Wage will always be held back from achieving its full potential in some parts of the economy because of valid concern for employment effects in more vulnerable parts of the market".

Sectors

The number and cost of low paid workers is a crucial factor in examining affordability across different sectors. Recent analysis conducted by the Resolution Foundation shows that an increase in the minimum wage would have a relatively small impact on the overall wage bill for the vast majority of employers, and particularly larger employers, but that a small handful of sectors face much larger impacts than all other sectors.⁴² This supports wider research showing that just six per cent of private sector employers overall view the minimum wage as an obstacle to growth, compared to 63 per cent reporting candidates lacking the right set of skills.⁴³ A quarter of all minimum wage workers are not employed in low-paying sectors, and the Low Pay Commission itself has stated that it believes that employers with no clear business reason for paying their staff less should be encouraged to pay more than the basic minimum.⁴⁴

Levels of productivity vary significantly across different sectors, and the ability of employers to adapt to higher minimum wages depends to some extent on this, as well as their varying profit margins, overall employment levels and the price flexibility of the products and services they sell.

The ability to pay a higher minimum wage will be largely dependent on factors such as the industry, business model, competitive landscape and the proportion of employees on hourly rates of pay, e.g. a large professional consultancy company who endorse higher National Minimum Wage rates for a relatively small number of their employee base (usually catering or cleaning services) will not feel a significant impact of this in comparison to a business in a sector which relies heavily on significantly higher numbers of hourly paid employees to deliver a service.

Submission from Louise Smalley, Group Human Resources Director, Whitbread

Research published by the Smith Institute explored the interaction of these different factors to examine the affordability of a substantial minimum wage increase in the finance, business services, construction, IT, retail and care sectors. Like the Resolution Foundation, the Smith Institute argues that, in sectors where the share of low paid workers is lower than the UK average, the magnitude of any effects are likely to be low since the increase in labour costs will be marginal. Similarly, the more an industry production process relies on capital as opposed to labour, the smaller the impact of any increase in labour costs is likely to be. The Smith Institute report also examines how these factors interact with the profitability of different sectors – arguing that in sectors with wider profit margins, employers have more

flexibility to absorb labour costs without affecting employment levels. In the absence of changes to business models and productivity, the analysis suggests that in the event of a substantial sudden increase in the minimum wage, the care and retail sectors would find it harder to absorb costs and so be more likely to exhibit material employment effects, but that the other sectors would be likely to react mildly to the policy. Of the sectors examined, the study suggests that the IT/computing and construction industries are more likely to absorb the relatively minor increase in labour costs in profits, while business services and financial services could choose to absorb the cost through profits or small price effects.

These studies show the variability in the impact of increases in the minimum wage across different sectors and suggest that, while most firms could afford an increase in the minimum wage, in some labour-intensive, low-paying sectors, a significant increase in wages at the bottom could pose affordability problems unless combined with efforts to boost productivity and business performance. Tackling systemic problems with low pay, poor progression opportunities and other job quality issues in low-paying sectors may require broader approaches to tackle the underlying causes and support employers to boost productivity or change their business models in ways that support higher wages.

There is good reason to believe that change is possible in low-paying sectors. Many firms are adept at changing their business strategies to improve productivity, reduce costs elsewhere, and better plan and organise the workforce. For example, concern about low levels of professionalism in the security sector has led to some improvements in recent years. The Low Pay Commission has recently stopped classifying the security sector as 'low-paying', after the introduction of a statutory licensing system, minimum qualification requirements for security guards, and better use of technology within the industry, improved levels of training and raised wages, including the 'going rate' for entry-level positions. 46

While some sectors are seen as inherently low-paid, international data suggests that there is wide scope for variation and, in the UK, significant room for improvement. Two in five workers employed in consumer services are low paid in the UK, compared to one in five in Denmark and just over one in 10 in Finland.⁴⁷ The share of retail jobs that are low paid varies from a high of 49 per cent in the UK to just 23 per cent in Denmark and 18 per cent in France.⁴⁸ Differences in business models and human resource strategies may partially account for these differences. Comparative studies have indicated that British employers in sectors such as food processing⁴⁹ and social care⁵⁰ invest less in the skills of their workforce than comparative firms in different countries. Eight in 10 German retail employees have completed vocational qualifications lasting two to three years and are more likely to progress to managerial careers; whereas only three in 10 of their British counterparts are trained at the equivalent level.⁵¹ A comparison of vocational training for bricklayers found this to be much broader and deeper in Germany, involving a wider range of practical and interpersonal skills as well as theoretical understanding and technical expertise.⁵²

Some people argue that sectors are hard to define, that we lack the institutions for the type of sectoral approaches seen in Germany or Australia and that such an approach could lead to excessive bureaucracy or complexity. However, the evidence above suggests the need for more a more intelligent approach that puts more pressure on sectors that could afford to pay more and also supports low-paying sectors to tackle low pay and low productivity. The comparison with other countries also suggests that, combined with wider support to boost training and productivity, ambitious wage floors can provide an effective incentive for employers to move towards higher skill, higher wage business models. The prize is a higher skill, higher wage economy. Nearly half of UK employers do not require post-secondary education, compared to 29 per cent of German firms and 24 per cent of French firms, while studies also find consistently higher levels of innovation in processes and product market strategies in France and the German-speaking and Scandinavian countries than in the UK.⁵³

London – a special case?

In general, regional approaches to minimum wages should be avoided, due to the risk that different areas will engage in a race to bottom to attract employers, and that some areas of the UK will be consigned to low wages. However, several studies recently have suggested that London could be an exception to this rule. In particular, a study by Kitty Ussher for the Centre for London points to the unique nature of the economy in London when compared to the rest of the UK, noting that all other regions and nations are relatively similar to each other in industrial structure. In particular:

- The capital has a much higher proportion of jobs in higher pay, higher productivity industries such as financial services, information and communications and real estate, and more professional, scientific and technical jobs than elsewhere.
- Higher productivity means that the capital supports higher average wages than in the rest of the country – median hourly pay is around 40 per cent higher in London than across the rest of the UK, and although the difference between London and the UK is lower in low paid sectors, low paid workers in the capital still receive a 13 per cent premium on average.⁵⁴

Ussher argues persuasively that these differences suggest that employers in London could support a higher minimum wage without having an impact on employment. London also faces particular pressures due to the higher cost of living in the capital. The high cost of housing, childcare and transport when compared to many other parts of the UK can mean that work does not always pay in the capital.

While I am sympathetic to these arguments, on balance I believe that the risk of introducing complexity and reinforcing inequality between London and the rest of the country means that now is not the time to look at this. The core focus should be on boosting pay for the country as a whole.

2.3 The role and remit of the Low Pay Commission

The Low Pay Commission is highly regarded. This is in no small part thanks to the decision to base the Low Pay Commission on a social partnership approach, which has ensured that decisions are rooted in evidence from employers and employees across different sectors and regions on the potential impact. The Low Pay Commission also has a reputation for high quality analysis, and there is a strong focus on achieving consensus between the employer and employee representatives. As a result, many of the submissions, from unions and employers alike, emphasised their support for this model.

The work of the Low Pay Commission benefits from its strong focus on examining evidence and the role of the pay academics as "swing voters", who need to be convinced of the realities of the cases made by union and business representatives for either more boldness or greater caution.

Submission from the TUC

In setting the right minimum, a broad range of factors must be reviewed, including affordability, unemployment, productivity and the wider economic climate. The final recommendation can then balance the interests of both businesses and the unemployed – maintaining growth and encouraging job creation – and workers – providing a strong minimum standard. This is the hallmark of the success of the National Minimum Wage which, because of this approach, has protected the lower paid.... Due to the robust economic approach taken towards the National Minimum Wage, CBI members support the work of the independent Low Pay Commission.

Submission from the CBI

Ensuring that the impact of any increase in the National Minimum Wage is considered from both an employee and employer perspective is vital to the National Minimum Wage's success to date.

Submission from the British Retail Consortium

While there is strong support for the Low Pay Commission in its current state, many also feel that its remit is too narrow. Sir George Bain, the first Chair of the Commission has described the Low Pay Commission as a 'child of its time', and suggested that it should evolve to meet the challenge of low pay that faces the country today. Many employers also feel that the fact that there is only six months between the announcement of the new rate and the date it comes into force can make it difficult to plan, suggesting there are cases for change on both sides of the debate.

The success of the Low Pay Commission confirms that we must not lose the strengths of the current approach: basing decisions on strong research, agreement between employers and employees and balancing the need for wage growth with concerns about the impact on employment. However, institutions also must evolve to meet the new challenges facing society. The Low Pay Commission's ability to do this is limited by the fact that it has no remit to research, analyse, or make recommendations for changes to policy or business behaviour.

2.4 Strengthening enforcement

The need for effective enforcement of the minimum wage is a view that united virtually all respondents to the review. The Government has made recent efforts to improve the situation including a campaign to 'name and shame' offending employers and increase the maximum civil penalty from £5,000 per organisation to up to £20,000 for each individual worker not paid the minimum wage. The Labour Party has pledged to increase this to £50,000. This should help to provide a strong deterrent to employers that deliberately breach National Minimum Wage regulations.

HMRC compliance officers operate an intelligence-led approach to enforcement, with investigations triggered on the basis of wider evidence, as well as reports of abuse by individuals through the Pay and Work Rights Helpline. The core focus of compliance officers is, rightly, on securing arrears for employees and ensuring that firms comply going forward. In addition, HMRC can levy civil penalties against employers and bring criminal cases against those who are found to be systematically and deliberately failing to pay the minimum wage.

This approach has significant support, but the limited resources of the compliance team and centralised approach inevitably lead to gaps. Joint-working between the HMRC and other enforcement agencies and local authorities is also weak, which limits opportunities to maximise resources across different government bodies. This is exacerbated by legal restrictions on sharing information between government agencies. Local authorities have good knowledge of local employers and already conduct significant enforcement activity through their responsibilities for licensing, planning, and health and safety and environmental health inspection. In carrying out these duties councils sometimes come across cases where they suspect violations of the NMW, yet they have no power to investigate or take action beyond referring them to HMRC.

There are also weaknesses in the regulatory scope and powers of HMRC. Certain key issues, such as holiday pay, lie outside the remit of HMRC. The only recourse for individuals to reclaim money they are owed for holidays is to take the case to an employment tribunal. Yet many employees fear for their livelihoods and have neither the financial resources nor support to take their case to court. It can also be difficult to get employers to cooperate or

provide the necessary documentation to support HMRC investigations, making cases reliant on employees, who often do not want to lose their right to anonymity. There is no penalty for failing to keep records, for example, which enables some unscrupulous employers to simply say that they do not have the information.

There is no panacea and there will, sadly, always be a minority of employers ready to prey on vulnerable people. However, I believe that with stronger oversight and some relatively small changes, a journey can begin to further minimise abuse. In addition, more regular monitoring, reporting and problem-solving with regards to the successful delivery of enforcement policy could lead to progressive improvements.

2.5 Promoting the Living Wage:

In addition to a strong National Minimum Wage based on considerations of that balance the need to tackle low pay with concerns about the impact employment, there is a case for promoting a stretching voluntary target to encourage employers to provide wages that support a decent standard of living where it is affordable. Employers' experiences of moving to a Living Wage demonstrate that tackling low pay is not only good for employees and the exchequer. It is also good for businesses, underpinning a modern workforce that is well-trained, productive and engaged.

Studies looking at the impact on firms that have adopted the Living Wage demonstrate various positive benefits for the employer. The Living Wage Foundation cites research showing that 80 per cent of Living Wage employers in London say that it has improved the quality of work of their staff, with absenteeism down by an average of 25 per cent, while two-thirds of Living Wage employers report a significant impact on recruitment and retention within their organisation. Submissions to this review backed this up. For example, the social care provider Bluebird Care Tameside said that, as well as being in line with their commitment to high quality care, becoming a Living Wage employer had reduced turnover and improved the quality of applicants. This had enabled the company to reduce spending on advertising and recruitment and instead invest more in care worker supervision and training. The result was a loyal workforce willing to go the extra mile for their clients. Other submissions from Living Wage employers cited similar benefits.

I firmly believe that paying the Living Wage makes good business sense. It improves staff recruitment, retention and productivity and consequently helps us provide the best possible service to our customers and clients. Furthermore, as a progressive response to tackling poverty in the UK, the wider benefits for society are clear. For instance, parents on a Living Wage have more time to spend with their children and more money to invest in their future, while employees earning the Living Wage are more likely to spend, save and have greater faith in the economy.

Antony Jenkins, Barclays

Politicians of all the main parties have shown enthusiasm to support the Living Wage campaign. Ed Miliband, at a speech marking the beginning of Living Wage Week in 2012, said: "Just as in the 1990s, the minimum wage was a signature achievement of the last Labour government, so in the coming years, the Living Wage will be central to our work. We need to build an economy where everyone has a stake. Not where millions of people feel they never have a chance for a decent life however hard they work." David Cameron said of the Living Wage in the run up to the General Election of 2010 that it was "an idea whose time has come" and, speaking at a Citizens UK event in 2010, that: "you've asked for a Living Wage in the public sector. As you know, I think this is a good and attractive idea. Government, after all, is the biggest employer in the country. Where it leads, others will follow, and fairness could begin to be hard-wired into pay scales up and down the country."

The question is whether the Government should go further to encourage more employers to pay the Living Wage. While there is no case for a statutory Living Wage, there is a case that the Government should do more to encourage it in other ways. The Labour Party has proposed to introduce new Make Work Pay Contracts with businesses. Under these contracts, every firm that signs up to become Living Wage employers in the first year of the next Parliament would benefit from a 12-month tax rebate for each worker that receives higher wages. The measure would be funded from the increased tax and National Insurance revenue received by the Treasury when employees receive higher wages. Figures suggest that, if the Government introduced this now, firms could receive a 12-month tax rebate of up to £1,000 – and an average of £445 – for every low paid worker who is moved onto a Living Wage.

I do not think that there is a case for permanent taxpayer subsidies for low-paying employers, but the evidence I received as part of this review suggests that temporary support such as this could help some employers to make the transition to higher pay, higher skill business models. In addition, the fact that some local authorities and central government departments are using the power of procurement to encourage their suppliers to pay the Living Wage means that others can too. In a submission to Labour's policy review, the outsourcing company G4S supported the idea of making paying the Living Wage a condition of contracts, saying that would help to prevent competition on price alone, and so enable higher quality services on government contracts. The submission suggested that an alternative route would be to allow every contract bidder to make a Living Wage-compliant bid and allow commissioners to choose whether to select this bid or the non-Living Wage-compliant bid. Finally, stronger reporting requirements could encourage major public companies to give greater consideration at board level to the issue of low pay and increase public visibility to ensure that shareholders and campaigners are able to question a company's board and management on the basis of their record on low pay.

I believe the government's principal role is to address low pay through a more progressive and dynamic approach to the National Minimum Wage and the Low Pay Commission. However, the Government should also use its position to encourage the Living Wage. In particular, the Government should ensure visibility of public company approaches to the Living Wage so that shareholders can have their say and campaigners have access to the information they need to put pressure on companies that can afford to pay more. I also believe that central government should use the power of procurement to encourage employers to pay a Living Wage where they can afford to do so.

3. Policy recommendations

I have argued that the introduction of the Low Pay Commission and the National Minimum Wage was a significant policy success, setting a minimum floor to abolish extreme low pay. Yet it was a policy for its times. Today, the challenge is the increasing numbers of low paid employees who are trapped with little prospect of being paid what they need to live. This has severe social, fiscal and economic consequences. This requires a far more ambitious approach, and another round of political bravery.

My proposals are based on the following principles:

- The Government should take a progressive step forward to address the social, fiscal and economic impact of low pay.
- We must achieve this with safeguards to avoid damaging employment or the economy.
- Employers should be helped with implementation by being given time to adjust their pay strategies and by having a regime which continues to be easy to comply with.
- We should build on the strengths of the current approach, by extending the role and remit of the Low Pay Commission.
- We need to be open to more creative approaches to different parts of the labour market, but continue to "keep it simple".
- The Living Wage should not be legally mandated but the Government must show leadership in encouraging more employers to sign up to the Living Wage and not leave the 'heavy lifting' to campaign groups.
- Temporary incentives and support have a role to play but the Government should resist long term subsidies to enable employers to pay higher wages.

3.1 Strengthening the minimum wage

My work has convinced me that it is time to build on the solid base of the Low Pay Commission. While we should preserve the partnership and evidence-based approach that has been the key to its success, the challenge of low pay facing the UK is too complex for a narrow approach to succeed. As many people I spoke to noted, the Low Pay Commission is in practice a Minimum Wage Commission. Its role is to set a single, narrow rate based on its judgement of what the economy as a whole can accommodate. Many close to the working of the Commission including former members have described an in-built cautiousness that reduces the possibility of a more progressive approach to low pay. If we want to progress, the mechanisms must change.

Towards a higher pay, higher skill economy

I firmly believe that we need a more ambitious approach to the minimum wage as part of a national mission to tackle low pay. Measures to tackle low pay must be rooted in a broader strategy to move towards a more productive, more innovative economy. But higher productivity, while essential, is not necessarily enough to tackle low pay. Recent experience in the US and the UK show that, without action from Government, there is a risk that middle and low income workers do not benefit from economic growth.

Creating a stronger upward pressure on the minimum wage will have significant positive effects, not just for low paid workers but also for the economy as a whole. Decent wage floors can provide incentives for employers to compete on the basis of an engaged and loyal workforce, and stop employers from being undercut by those competing on low skill, low wage business models. Although change will be controversial, many employers also recognise the benefits of higher wages to boosting performance and productivity.

Since its introduction under Labour, the National Minimum Wage has been very successful in boosting pay at the bottom of society without leading to a loss of jobs. But we share your concern that it has not kept pace with rising inflation and living costs in recent years. All our businesses pay over the National Minimum Wage and we therefore believe one solution would be to review the level at which it is set. This review should explore ways to strengthen the National Minimum Wage, while balancing the risks of setting it too high and taking into account the need to allow employers the autonomy they want to differentiate themselves through pay.

Submission from Ian Cheshire, Group Chief Executive, Kingfisher plc

Making work pay through a higher minimum wage would also have significant fiscal benefits, helping to get the social security bill down and increasing tax revenue to the exchequer. Every year, the savings to government in increased tax revenue and lower in-work benefit payments far outweigh the cost of minimum wage increases on the public sector wage bill. The vast majority of low paid workers are concentrated in the private sector: just five per cent of all minimum wage workers, and 15 per cent of low paid workers overall, are employed in the public sector.⁵⁹

The minimum wage was designed in its current form to prevent extreme exploitation, but the challenge today is the millions of people earning low wages. The minimum wage must evolve to tackle the wider problem of low pay that faces us today. There is a legitimate concern that a sudden and sharp increase in the minimum wage could risk jobs, and therefore my recommendations ensure that businesses have time to plan and adapt, and that there is room for flexibility in the face of unexpected economic shocks.

Recommendations:

Introduce an ambitious target for a more productive economy

The Government should set a long term ambitious target for the Low Pay Commission to increase the minimum wage over the course of a Parliament, as part of a national mission to tackle low pay and build an economy with fewer low skill, low paid jobs and more high skill, high paid jobs. I recommend a new framework for the Low Pay Commission, with a five-year target to increase the minimum wage to a more stretching proportion of median earnings. The current minimum wage of £6.31, due to increase to £6.50 in October, is 53 per cent of median hourly earnings. A stretching target will ensure that the minimum wage increases faster than median earnings for the duration of the Parliament, to reach the target over five years. This would bring the rate closer to median earnings, ensuring that there is a bond between the wealth we earn as a nation and the wages that people earn for a hard day's work.

Policymakers should set the target to be stretching rather than easy, aiming to make a significant difference to people's lives and to put pressure on businesses to adapt their business models, thus helping to chart a course to a higher wage, higher skills economy. A similar approach should apply to the youth rate, to ensure that the gap between the adult and youth rates do not get too large. While there is a legitimate concern that a sudden and sharp increase in the minimum wage could risk jobs, a clear five-year target will give businesses time to plan and adapt their business models to boost productivity to support higher wages.

Beyond the five years, the Government would clearly want to put in place measures to ensure there is no backsliding once we achieve on our national target, ensuring that the lowest paid will continue to be protected and maintaining the strength of the minimum wage for the future.

Safeguard jobs and the economy

It is important to retain flexibility in the face of shocks. Therefore, if the Commissioners believe that the five year target cannot be met, they must write to the Secretary of State for Business, Innovation and Skills to set out their reasons why not. At the moment, the burden of proof lies with the Secretary of State to choose whether to accept the recommendations of the Low Pay Commission. Under this new system, the Commissioners would have to provide clear evidence that these targets could not be met without significant job losses or damage to the economy.

Addressing variability in affordability and productivity

We also need to ensure that the minimum wage is more responsive to the different challenges facing different parts of the economy. In particular, there is evidence that the minimum wage currently puts little pressure on sectors that could afford to pay more, such as financial and business services. Meanwhile, employers operating in sectors characterised by structural problems of low pay are likely to struggle with an ambitious increase in the minimum wage unless they are supported by broader measures to boost productivity. In addition to the challenges these present in themselves, they hold back progress on the minimum wage.

As far as possible, I believe that we should avoid adding unnecessary complexity to the minimum wage, and therefore we should only adopt a sectoral approach in areas where there is a clear rationale for doing so. However, sectors that can clearly afford to pay more should do so. The adoption of the Living Wage by some but not others within the same sector should strengthen the resolve of the Low Pay Commission to address this problem. Similarly, sectors such as social care and hospitality where there are structural issues that block progress need specific reforms to enable them to pay a reasonable minimum wage and risk holding back overall progress.

All other sectors, including those that employ the vast majority of low paid workers, should be tackled through a more progressive approach to the minimum wage. I would not advocate a sectoral approach to wages in isolation but believe that this should be seen as part of an active industrial strategy that includes a strong focus on boosting skills and productivity across the economy. This chimes with submissions from both the CBI and the TUC, which called for more focus on how to raise productivity and improve progression opportunities in low paying sectors.

Recommendation:

Put pressure on employers that can afford to pay more

To ensure a more tailored approach and support the five year target, the Low Pay Commission should be empowered to identify sectors that could afford to pay more and those with systematic problems of low pay. In both cases, the Low Pay Commission would be empowered to recommend a taskforce of key stakeholders, including employer representatives and trade unions, to develop a roadmap outlining clear goals and measures to tackle low pay:

- In the case of low paid sectors, this would result in a plan to tackle productivity and performance issues.
- In sectors that could afford to pay more, the Low Pay Commission should look at the case for giving the taskforce the power to set either a higher recommended rate or a higher statutory rate for the sector. This would be set over and above the level of the National Minimum Wage.

A more empowered Low Pay Commission

The Low Pay Commission is a shining example of successful partnership between employers and employees and many stakeholders are rightly keen to build on its strengths and maintain the consensus that has served it so well. However, institutions must evolve to if they are to meet new challenges. Concerns about the National Minimum Wage when it was first introduced were overcome by the hard work on the part of many people including the first Low Pay Commission members. We need the same commitment and endeavour today.

A more proactive, long term approach will require the role of the Low Pay Commission to change significantly. At present it oversees a process to set a short term rate and produces high quality research focused on the impact of the minimum wage. If my proposals to strengthen the minimum wage are to succeed, we need the Low Pay Commission to become a body that assists the Government in creating a long-term strategy for low pay, taking account of a wide range of economic and social issues. This should include positive advice on how to remove friction points and move the agenda forward.

Recommendation:

Expand the remit of the Low Pay Commission

To support its more proactive approach, the remit of the Low Pay Commission should be rewritten so that it plays a productive, long term advisory role to government on how to tackle the problem of low pay. It should have a remit to investigate the causes and consequences of low pay and make recommendations to the Government.

3.2 Improving enforcement of the National Minimum Wage

During my investigation, I have sought to understand the main root causes of abuse. In addition to the importance of creating proper deterrents, the evidence submitted to this review suggests that there is a case for improving joint-working between the HMRC and other enforcement agencies, particularly local authorities, and for measures to improve the effectiveness of HMRC investigations and the cooperation of employers in tackling abuse.

Recommendations:

Improve oversight of enforcement

As part of its broader remit, the Low Pay Commission should regularly examine the effectiveness of policies to enforce the National Minimum Wage and make recommendations for improvement to HMRC.

Improve the reach of enforcement

Local government should be given new powers to support the work of the HMRC through inspection, information and enforcement of the minimum wage. In particular, the Commissioners for Revenue and Customs Act 2005 should be amended to create more legal gateways that allow the HMRC to collaborate and share information with local authorities, as well as other enforcement agencies such as the Maritime and Coastguard Agency. Local authorities should also be given new powers to enter premises and remove records.

Strengthen the tools of regulators

HMRC's remit should be expanded to include non-payment of Holiday Pay, which at the moment is only recoverable if an individual takes a case to tribunal. The Low Pay Commission should also explore the case for allowing the HMRC minimum wage compliance team to impose penalties for offences related to record keeping. This would encourage stronger cooperation from employers.

3.3 Encouraging more employers to pay the Living Wage

At a time when many people are struggling with the increased cost of living, the concept of a Living Wage has resonated with the public and gained widespread support from all political parties. Employers that have adopted the Living Wage are also positive about its effects, but more could be done to promote its use among those that could afford to raise the wages of low paid staff. Much of the energy behind the drive for a Living Wage lies in the fact that it has been rooted in community activism. There has also been an increase in activism among ordinary shareholders on the issue of low pay. I believe that greater transparency through stronger reporting requirements would help foster and support this community activism.

Central government should also learn from the experiments by local authorities to use the power of procurement to encourage more employers in the private sector to pay a Living Wage. Analysis published by the Smith Institute shows that, if all central government departments required contractors to pay staff working on government contracts a Living Wage, about 30,000 people would see their pay increase. The analysis shows that the impact of this policy would be significantly larger if it all firms bidding for contracts of a certain size were required to become Living Wage employers themselves – potentially affecting hundreds of thousands of employees. For example, analysis of the top 10 highest value contracts from all central government departments, accounting for about 26 per cent of all contracts, shows that this would cover 464,000 workers in total, and that over 100,000 would see their pay rise as a result.

There have been questions about the legality of proposals to use procurement to promote the Living Wage under EU procurement law. The evidence submitted to this review suggests that it is possible to use procurement to promote the Living Wage, as long as the contract is awarded on merit. Some authorities have also addressed this by asking contractors to submit two bids when applying to take on a contract: one that is Living Wage compliant and one that is not.

Finally, some businesses and campaigners have suggested that we use the tax increases and benefit savings that result from increases in wages to cushion the blow of an increase and help meet the challenge of signing up firms with large numbers of low paid people. In general, governments should be cautious about subsidising the adoption of the Living Wage as one of the benefits of higher pay is a lower benefits bill. However, I believe that such subsidies can be effective when used in a tailored way to kick start action and remove friction point. I found enthusiasm for Labour's proposal for 'Make Work Pay' contracts, particularly in the sense that it signals that the Government can work more actively and sensitively with business. This would offer firms that sign up to become Living Wage employers in the first year of the next Parliament a 12-month tax rebate of up to £1,000 for every low paid worker who get a pay rise, funded from the increased tax and National Insurance revenue received by the Treasury when employees receive higher wages. I believe that more should be done to maximise this by supporting local stakeholders to come together to promote the Living Wage among local employers in their areas.

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ⁱⁱ This includes staff directly-employed by central government departments, as well as sub-contracted staff.

Recommendations:

Introduce greater transparency on pay

Greater transparency of pay strategies would ensure that the issue is on the board room agenda and also allow investors to understand the strategy, as well as providing material for campaigners to put pressure on companies that could afford to pay the Living Wage. Therefore, within the remuneration report all public companies should disclose:

- Their policy on low pay, including whether they are a Living Wage employer, and if not, why not; and
- The cost of becoming a Living Wage employer.

Central government should use procurement to promote the Living Wage

Central government departments should use the power of procurement to encourage organisations bidding for large government contracts to pay their staff a Living Wage. As a first step, I recommend that all central government departments should become accredited Living Wage employers. This means paying their own employees the Living Wage and ensuring that sub-contractors also pay the Living Wage to any staff working on government contracts.

The impact of this policy would be significantly larger if it all firms bidding for contracts of a certain size were required to become Living Wage employers themselves – potentially affecting hundreds of thousands of employees. The cost and potential for this should be investigated in the next Parliament.

The Government should create temporary incentives to promote the Living Wage Labour's 'Make Work Pay' contracts have a strong role to play in supporting firms to move towards more productive business models. In addition, in areas such as Islington and York, new 'Living Wage Zones' are being developed, where local councils, employers and other stakeholders have come together to develop a plan to encourage local businesses to become Living Wage employers. I believe that Labour's Make Work Pay Contracts could also promote these approaches by allowing local authorities to be eligible, providing that they use some of the money to support or encourage businesses in the local area to become Living Wage employers.

4. Conclusions: unfinished business

The proposals I have set out are ambitious, but I believe that the achievements of both the Low Pay Commission and the campaign for a Living Wage, and the growing consensus for a more ambitious strategy to tackle low pay, should embolden us. At a time when we see too many in our society falling too far behind, risking deeper divisions and putting strains on family and community life, we cannot afford to be too cautious. We should seize the opportunity to strengthen our economy and our public finances, while improving the living standards and life chances of millions of working families.

These measures should not be seen in isolation but instead as part of a long term strategy to raise job quality and business performance and move towards an economy that creates more secure and better paid jobs across all sectors, occupations and locations.

I have received enthusiastic support throughout my review. Inevitably, strongly held views have been expressed about issues that are outside the remit of my review but are tangential to it. There are two particular issues which should be considered as part of a comprehensive response to the issue of low pay.

First, the issue of low pay is just one part of a fragmentation of the world of work. I have continually heard of the damage done through these changes: such as short hours working, multiple jobs, and employees continually on call without any guarantee of hours. I have also heard of the increasing inability of the many people working in this precarious environment to progress to secure, full time jobs from which they can develop a stable working life.

Secondly, the attack on low pay should be seen as a generational mission to up-skill our economy. Many have talked to me about the need for strong vocational training, a closure of the gap between the world of work and education and most fundamentally an industrial strategy to equip Britain for the 21st century.

The world has changed. The goal today should be a motivated, engaged and well-trained workforce, not a cheap one. Measures to prevent a race to the bottom in wages and skills should be central to any approach to build a new more dynamic, more innovative economy that is fairer, more equal, and less dependent on low skilled, low paid work. This will require an active industrial strategy, supporting productivity, innovation, and the growth of high skilled jobs and apprenticeships.

Taken in this context, a five year strategy to address the issue of low pay can be seen not just as an end in itself but as part of a greater endeavour.

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Confederation of British Industry

Deloitte

Employers Education Task Force

Equity

Federation of Small Businesses

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Morrisons

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National Grid

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The Low Pay Commission

The Restaurant Group

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