



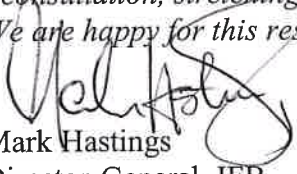
Evidence by the IFB-UCG Policy Committee for the Low Pay Commission's 2014 Recommendations on the National Minimum Wage

Note: The Institute for Family Business (IFB) merged with the Unquoted Companies Group (UCG) in 2013 to jointly support and represent the UK's thriving family business sector. Our member companies have on aggregate a turnover of more than £50 billion, and employ over 500,000 people. Our membership is spread right around the country (not only in the prosperous South-East), and we stress continuity and long horizons. Such continuity is critical for the UK's economic and social life.

Our evidence builds on an unbroken series of responses to the Low Pay Commission's calls for consultation, stretching back to 1999.

We are happy for this response to be made publicly available to any enquirer.

Signed:


Mark Hastings
Director-General, IFB
17 September 2013

EXECUTIVE SUMMARY

- Overall: While the outlook for 2014-5 for the economy as a whole has improved, unskilled and youth labour markets are still under pressure. It is necessary for the both adult and youth NMWs to increase more slowly than average wages, to allow unskilled workers to price themselves back into jobs, and to undertake apprenticeships which are necessarily low paid.
- The level and impact of the minimum wage: The latest academic studies show that a rise in minimum wages which is faster than the rise in average wages has an adverse impact on employment. Such a rise has occurred in the UK (Figures 1 and 2) which suggests that the level of the NMW is now too high.
- The outlook for 2014-15: The economic outlook is at last turning positive (Table 1), but we still see difficulties for unskilled workers. First, the high NMW puts pressure on unskilled labour which is less competitive, and second there is a continuing influx of young, job-hungry migrants, many of whom compete for low-end jobs – perhaps taking 35,000 jobs a year from unskilled UK residents.
- Effects on young people and apprentices: The youth labour market is the prototypical unskilled labour market, suffering from difficulties with failed apprenticeship and vocational training policies, and also from migrant competition. The fact that the Apprentice Rate is widely ignored is indicative of a system under strain. We have advised against the Apprentice Rate from the beginning, and now call for it to be made more realistic.
- IFB-UCG experience: Two large IFB member retailers and a further large company providing business services have lost many youth jobs during the recession, and their owners argue that the NMW has not helped. This said, we believe that the Commission's prudent policy of tailoring NMW increases to business conditions (Figure 3) has helped business, and wish this approach to continue.
- In sum: The IFB's main call is for continued restraint, with zero or token increases in the various NMWs, ensuring they increase by less than average earnings.



Introduction

1. Our evidence is in response to your consultation regarding plans for up-rating the minimum wage in October 2014. Our response to your inquiry will fall into four areas: first, the level and impact of the minimum wage; second, implications for the NMW of the outlook for the UK economy; third, effects on young people and apprentices; and fourth, experiences of IFB member companies affected by the NMW. For brevity we do not comment on the impacts of auto-enrolment pensions policy, and welfare (Universal credit) whose effects will be better discernible next year.

The level and impact of the minimum wage

2. After five years of recession, it seems that the UK economy is at last recovering, but we still call for caution. In our last evidence (UCG, 2012), we recommended a freeze in the interests of unskilled worker employment given the recession. We are therefore pleased that the Commission has recommended only small increases in the NMW rates for the coming year, and in fact a freeze for apprentices (though here over-ruled by the government for a 1% increase). The NMW has consequently decreased in real terms, which marks a step in promoting employment.
3. However, it must be remembered that the NMW has drawn ahead of average wages significantly over the years of recession, so we recommend continued restraint so as to permit unskilled workers to “price themselves” back into jobs. The position is shown in Figure 1. We see that even though the real value of the adult NMW has fallen since 2007, average earnings have fallen more. In fact, while it is true that the value of the adult minimum in real terms has now returned to its level in 2005, the value of average earnings in real terms has fallen even further - to about its 2003 level. The increase in the NMW relative to average earnings is captured by their ratio, the “Kaitz index” which has risen even during the recession – as can be seen (line with triangles), from 100 in 2005 to nearly 105 now. Yet the average worker is more skilled and more competitive than the minimum wage worker. Hence, if the average worker’s position has been weak over the past few years, the unskilled worker’s position must have been even weaker, pointing to the need for further restraint in raising the minimum.

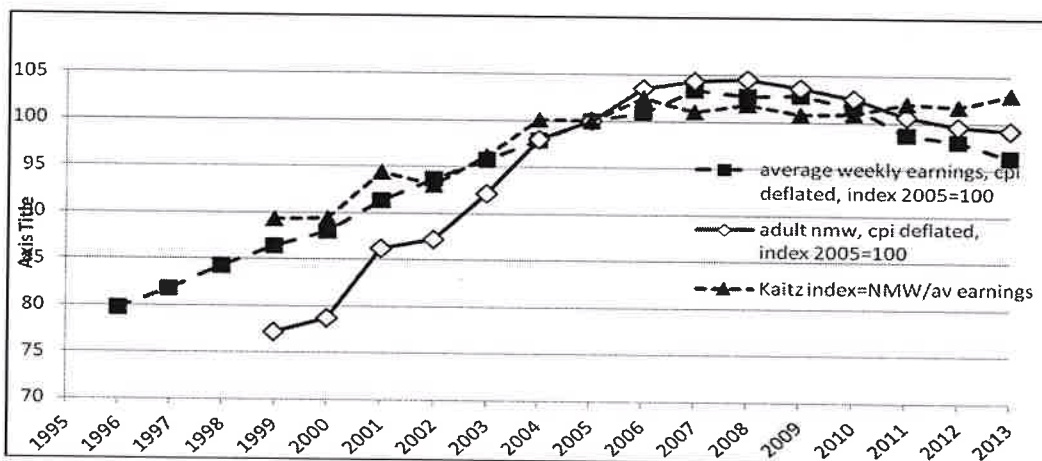


Figure 1: Adult earnings and the adult NMW



4. International research evidence shows that minimum wage setting causes higher unemployment of unskilled workers. For example, Neumark and Wascher's (2004) analysis of 17 OECD countries over 1975-2000 finds a 10% increase in the minimum wage leads to a 2% reduction in younger workers employment (aged 15-24). Moreover long-run effects should be taken into account, as shown by Baker et al's (1999) study of 9 Canadian provinces over 1975-93. This study finds that a 10% increase in the minimum reduces teenage employment by 2.5%, and that it takes 6 years for the full result to be revealed. More recently there has been the comprehensive study by Dolton and Bondiabene (2012) of 33 OECD countries which finds that a 10% increase in the minimum reduces employment by 3-4%. The Commission (2013 para 2.110) admits this international evidence, but believes that the UK must be an exception because UK evidence shows little adverse impact..
5. But why should the UK be an exception to the laws of supply and demand? While we acknowledge that studying the UK is difficult, we believe that use of appropriate techniques reveals negative effects. The basic problem is that the NMW applies over the whole country, so there are no regions without a minimum that can be used as controls to show what "would have" happened. One way to overcome this problem is to use regional variation, since the NMW has more "bite" in poor than rich regions. The latest research by Dolton et al (2013 p26) uses this approach, splitting the UK into several hundred regions, and concludes the regions with more NMW bite indeed have lower employment other things equal:

"The results imply a small significant negative long-term employment effect. The elasticity is around 0.1 implying that a 10 percent increase in the bite of the minimum wage (in terms of the Kaitz index) would lead to a fall of 1 per cent of the employment rate".

Thus, we see a significant negative effect. At the same time, we must remember that this study does not consider unskilled workers specifically, where negative effects will be stronger.
6. An alternative approach also gives negative effects. In the latest work by Dickens et al (2012), workers who have their wages raised by the NMW are compared with those paid just above that level (say, up to 10% above). These workers should have similar skills, and similar welfare benefits options. This research relates specifically to part-time women who are an important unskilled group with a high minimum wage coverage (Commission 2013, Figure 2.1). Dickens et al's (2012) essential finding is that the introduction of the NMW caused part-time women's year-on-year probability of retaining a job to fall from around 0.70 to 0.65. Another way of putting this finding is that before the NMW, median job duration was about 1.9 years for part-time women, falling to 1.7 years afterwards, that is, a fall of around 10%.
7. In sum, we feel that the research clearly shows that the setting of minimum wages will reduce employment. Looking at Figure 1, the Kaitz index has risen by nearly 15 percentage points since 1999 (90 to about 105), implying a fall in employment of around 1.5% using the Dolton et al (2013) elasticity of 0.1. This effect might appear small, but it could be twice as large for unskilled workers (the Neumark and Wascher (2004) unskilled elasticity is -0.2), and of course in recession. Indeed, the Commission's acceptance of the



adverse impact of recession has fortunately allowed smaller NMW increases over the past difficult years. Yet, as noted already, these increases have outpaced average earnings, so that the Kaitz index for adult workers (Figure 1) has moved upwards even in recession. Therefore, in setting the NMW for 2014-15 we believe there is need for a period when the NMW moves upwards more slowly than average earnings, so as to reduce the Kaitz index. To assess how much more slowly, we now turn to prospects in the unskilled labour market, and the economic outlook in general.

The outlook for 2014-5

8. The UK's economic outlook has improved considerably since we reported last year (UCG 2012), but we still see difficulties ahead. The position is shown in Table 1, looking forward to 2014 and 2015, which is the relevant period for the October 2014 up rating. The first row shows that growth in 2013 is likely to reach 1.5% according to the OECD's (2013b) latest forecast. Also, the OBR forecasts an improvement to 2.3% for 2015, which is in line with independent estimates. The second row's forecasts of an upturn in fixed capital formation in 2014 and 2015 back up this picture. Public sector net borrowing also appears to be gradually being brought under control, and no major tax increases are forecast (Memo 2). Thus, the macro-economic environment in 2014-15 appears more propitious for minimum wage setting, but we still see warning signs as we now discuss.

Table 1: The Economic Outlook – Forecasts 2013-15

Annual % change over a year earlier	Forecasts for 2013		Forecasts for 2014		Forecasts for 2015	
	OBR (made Mar '13)	Commission (made Jan '13)	OBR	Most recent independent*	OBR	Most recent independent*
Real GDP growth	0.6 [1.5] †	1.0	1.8	1.9	2.3	2.1
Private nonresidential. fixed capital formation, growth	1.9	--	6.1	5.3	8.6	5.6††
Public net borrowing, £bn	108	--	97	100	87	86
Average earnings growth	1.4	2.2	2.7	2.5	3.6	3.8††
RPI inflation	2.8	2.7	2.4	3.1	2.1	3.2
Claimant unemployment (m)	1.58	1.62	1.63	1.40	1.59	1.45
Total net migration (ONS) ^a (th.)	224	--	200	--	200	--

Memo 1: increase in adult minimum in Oct 2013 is 1.9 % (i.e. from £6.19 to £6.31). The 2 youth rates and apprentice rate rise by 1%.

Memo 2: Major taxes as a percent of GDP were 34.9% in 2009-10. They rose to 36.0% in 2011-12, and are forecast to remain around 36% in 2015-6 (OBR, 2013, Table 4.6).

* Figures are average of most recent (June-August 2013) independent forecasts as summarised in Treasury (2013).; † latest September OECD (2013b) estimate, – raised from 0.8 in OECD, Econ Outlook, June 2013; †† IFS (2013); ^a ONS (2012)

Sources: Commission (2013, Table 5.2), Office for Budget Responsibility (2013, Tables 3.5, 4.30, 4.34), OECD (2013), Institute for Fiscal Studies (2013, Tables 2.7 and 6.3, and Fig 5.16); ONS (2012).



9. The warning signs in Table 1 are the high net migration of 200,000 a year, and the continued slow growth in average earnings of 2 or 3% (below inflation) which indicates a slack labour market. The advent of so many young, work-hungry migrants has changed the market. It is true that the Migration Advisory Committee (MAC 2012 para 4.42) believes that migration has little effect on wages at the average. However, the Committee notes that at the bottom end of the wage distribution things are different, with job competition by migrants lowering unskilled wages. In other words, migrants compete with the very workers covered by the NMW.
10. The Migration Advisory Committee estimates (MAC 2012 para 6.7) that migrants strongly displace UK resident workers. This displacement is strongest in the case of non-EU migrants, who currently form around two-thirds of the total (see Table 1's notes). The displacement effect is large: for every 100 non-EU migrants gaining work, 23 residents are displaced. Thus, for the approximately 150,000 non-EU migrants entering annually, about 35,000 mainly unskilled UK residents are displaced. Admittedly, the continuing fall in claimant unemployment forecast to continue through to 2015 is a ray of sunshine. However, this fall is probably more a result of the changes in the benefit system - tougher conditionality, reduced opportunity for disability benefits - than tighter labour market conditions for the unskilled. The outcome is unemployment for particular groups such as young workers (see below) who cannot compete with the newcomers.
11. In sum, we believe that while the outlook for the UK economy is improving, that for unskilled workers is not, so a freeze in the adult minimum wage would be prudent. The influx of so many young, job-hungry migrants needs to be recognised. A freeze would permit the difference between average wages and unskilled wages to widen (so the Kaitz index falls), thereby reflecting the increased competition for unskilled work. We were not alone last year in recommending a freeze, as the Commission notes (Commission 2013 para 5.50). Difficulties in the unskilled labour market are likely to remain in the coming years, therefore we maintain our cautious position.

Effects on young people and apprentices

12. We will consider first the youth (16-24) labour market, and then apprentices. The NMW distinguishes both young (currently 18-20), and very young (16-17) groups, and for both the ratio of the minimum to the market wage for the group (Kaitz index) has risen even during the recession. The rise is particularly apparent for the 16-17 group shown in Figure 2. Here we see that the index has moved upwards approximately 15 points since 2006 (95 to nearly 110). Much of this movement has come in the recession since 2009, which is the worst time.
- 13.

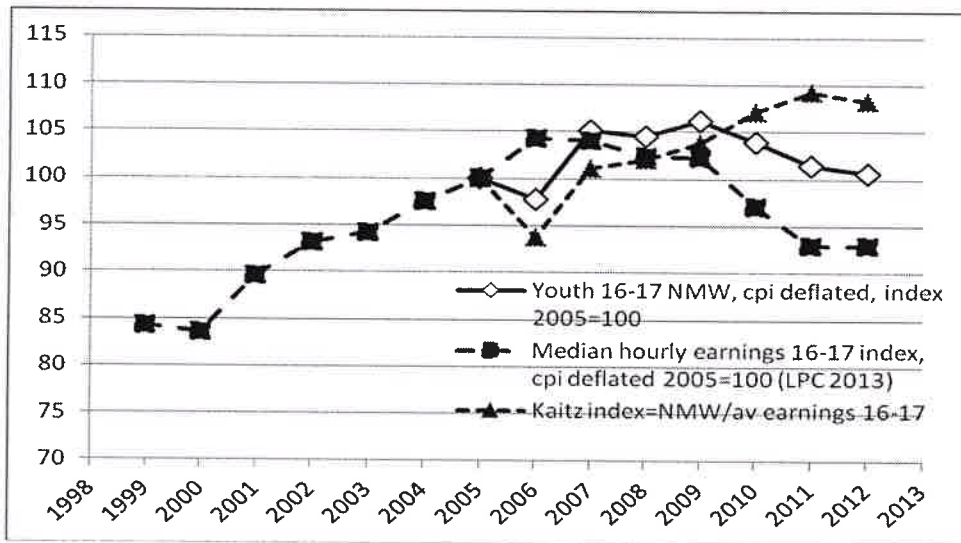


Figure 2: Youth 16-17 earnings and the youth 16-17 NMW

Source: adapted from Commission (2013, Figure 3.2).

14. The youth labour market is continuing to perform poorly, as shown in Table 2, which gives statistics for the standard youth category, 16-24 years. We see that the youth unemployment rate has risen by 50% over the period since 1999. The UK's position remains similar to that in France, long a black spot for youth, shown in the last column. In addition, as the lower panel shows, unemployment duration for the youth group has worsened, to the point where 27.4% of unemployed youth have been unemployed for over one year. This figure compares with only 15.3% in 1999. While the Commission (2013 para 5.2) believes that this period of deterioration has "stalled", we can see little basis for optimism given the continued pressure of the NMW coupled with competition of migrants noted above.

Table 2: Continuing Adverse Changes in Employment for Unskilled Workers

	All working age	No qualifications	16-24	France 15-24
Unemployment rate (%) 1999	6.3%	12.1%	13.8%	24.2%
Unemployment rate (%) 2012	8.3	18.8	21.0	23.6
Change 1999-2012	2.0	6.7	7.2	-0.6
Unemployment duration (% of 1999 unemployed > 12 mons) 2011	28.7	NA	15.3	39.6
Change 1999-2012	6.1	NA	12.1	0.7

Sources: Commission (2013, Table 2.10), and OECD (2000, 2013)

15. We have therefore been relieved by the Commission's decisions to freeze the two youth NMWs last year, and add only 1% this year. These decisions help reduce the Kaitz index, and the pressure of the minimum. We are in complete agreement with the Commission's view (2013, para 3.6) that young people are "more vulnerable in the labour market", and face a greater threat of unemployment. This view also accords with the research findings

we have detailed above. It follows that we believe that a freeze, or at most a token increase, should be recommended for 2014-5.

16. We also agree with the Commission's statement (2013 para 5.100) that it is necessary to take a cautious approach to NMW rates in economic downturn. Figure 3 provides our standard analysis of whether this approach has worked in practice. We expect NMW rates to increase more when GDP is increasing, and conversely in downturn, when GDP is decreasing. As can be seen, there is a good relationship. Moreover, the points for 2012 and 2013's NMW increases are below the fitted line, which show the freezes and low increases of these years have indeed been cautious.

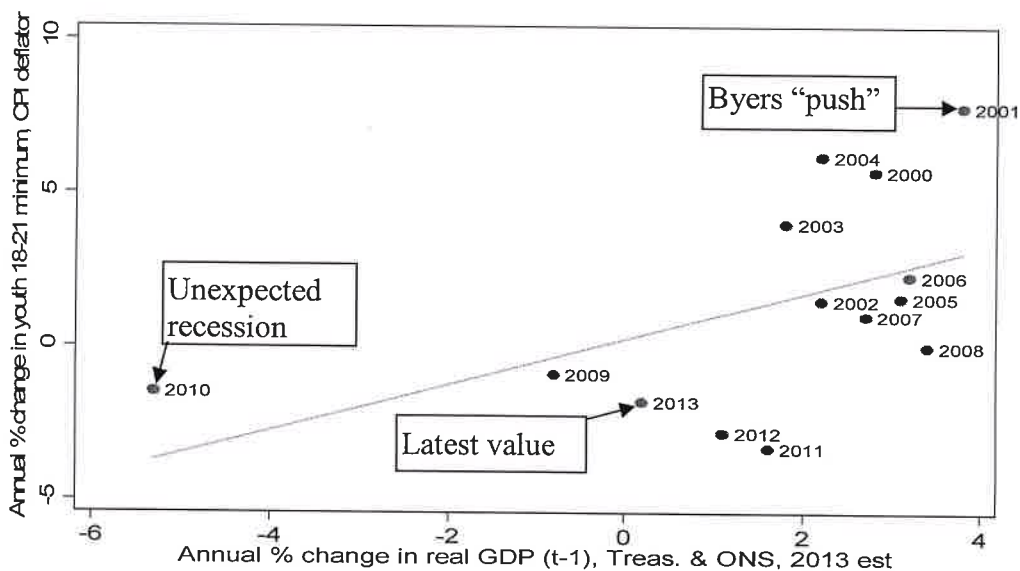


Figure 3: Changes in the Youth (18-21) Minimum Wage and in GDP

Note: date labels give the date of the NMW change, so then the GDP change date is the year before – for example, point 2013 relates the NMW percentage real increase 2012-13 to the GDP percentage real change 2011-12. **Source:** Commission, Treasury and ONS data. .

17. Lastly, under this subsection, we turn to the role of the Apprentice NMW, which the Commission reports (2013 para 4.92) is unfortunately now being widely avoided in important sectors such as hairdressing. Vocational training has long been problematic in the UK, and setting an apprentice wage minimum does not help, as we have been arguing (UCG 2008) ever since the Apprentice NMW was proposed. We see apprentices as investing in themselves, so they own their training, and the company is primarily the vehicle for achieving it. Hence, where there is low productivity the parties need to be allowed to negotiate low pay in order for the company-training slot to be kept open. The great demand for apprenticeships shows that the applicants perceive little danger of exploitation.
18. Figure 4 shows apprentice starts over the past 10 years, and there is little sign of improvement for the younger age groups, particularly the under 19s. It is true that we see a large increase in the over 25s, to around 300,000. But apprentice qualifications for this group might simply be formalising training that was previously being achieved informally. Clearly something must be done to increase the number of under 19s being



apprenticed, and while we do not believe that high apprentice pay is always a deterrent, it can be in the case of low productivity apprentices such as hairdressing, as we now discuss.

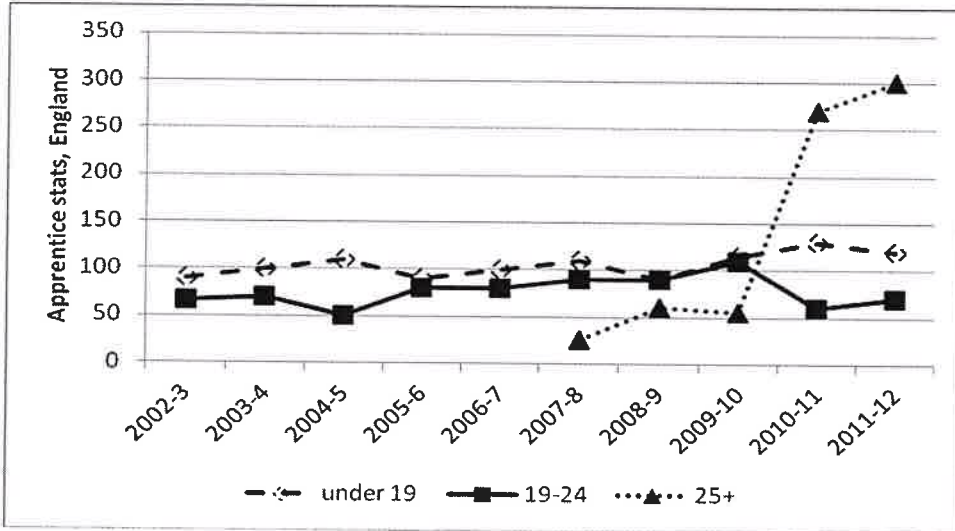


Figure 4: Apprentice Starts by Age Group

Source: adapted from Commission (2013) Figure 3.15.

19. In fact, last year we drew attention ((UCG 2012) to the plight of hairdressing. The National Hairdressers’ Federation then said in evidence (2012 para 3.6) that “training young people is now an unaffordable luxury”. Indeed, so it has turned out. For we now read (Commission 2013 para 4.90 and 4.92) that as many as 60% of apprentice hairdressers, and 30 to 40% of young apprentices generally are paid below the Apprentice Rate. Such a high level of avoidance indicates to us that apprentices are quite willing to accept low pay in return for training, just as we have always argued. The Apprentice Rate therefore needs to be reduced, as the Commission’s recommendation of a zero increase implicitly acknowledges, and it is unfortunate that the Government for political reasons required an increase. All we can recommend is that the Commission continues to make the case for a freeze, so that inflation gradually whittles the Apprentice Rate down to an affordable level.
20. The fact that the Apprentice Rate is increasingly avoided can be related to the growth of atypical work such as zero hours contracts and internships. Zero-hour contracts are mentioned in IFB business evidence below, as a means of lowering costs, which recessionary times combined with wage inflexibility constrain both sides to accept. Internship, for its part, as we argued in last year’s evidence (UCG 2012), is a means of workers being trained at low cost to the firm. Of course, NMW avoidance must be curbed, because it puts law-abiding businesses at a disadvantage, and brings the law into disrepute. Still, as we have noted in previous evidence, regulation tends to breed regulation, and the best way to stop avoidance is to make the NMW less intrusive in the first place.

IFB member company experience

21. Evidence from two large IFB member retailers employing hundreds of young workers at or near the minimum shows a downward trend in employment in both. Company I, in

Figure 5, gives us a long time series, and we see how productivity in this company jumped in 1999, coinciding with the introduction of the minimum, and this higher productivity remains currently, with no particular trend. Thus, it appears that the introduction of the NMW had a “shock” effect in causing reorganisation to soften the actual (and feared) wage cost increase, but the upratings since then have not. In other words, it could be that, after the initial shock, the Commission’s careful policy of tailoring the minimum to economic conditions (Figure 3) has assisted business to cope. Admittedly, the business in question is very large and established, so its experience might not generalise well. Nevertheless, we have another indication here that the Commission’s careful policy is helpful. We therefore urge that it be continued and in particular that the danger signs we have noted above – of strong immigration and a slack labour market – be taken into account.

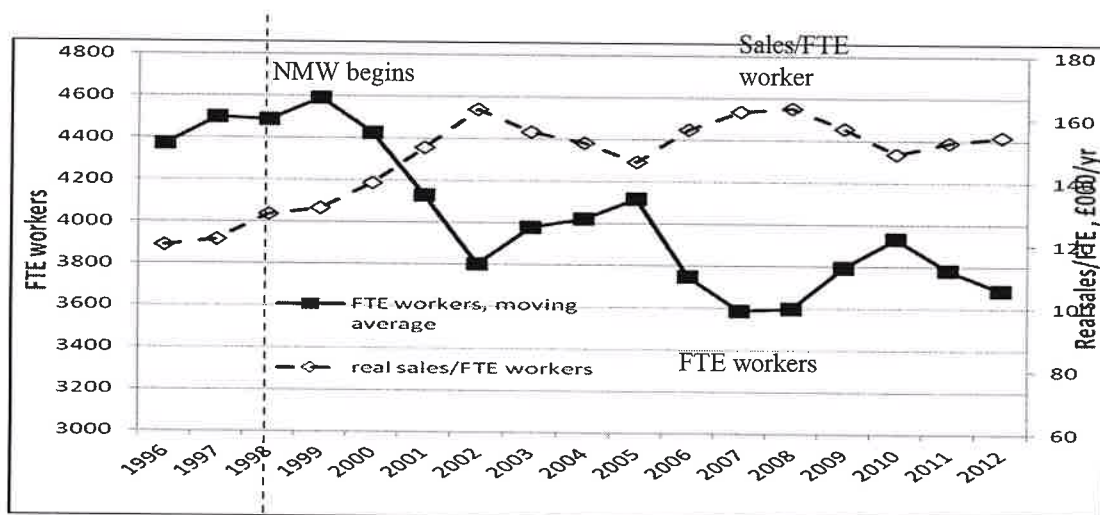


Figure 5: Employment and Productivity, National Retailer I

Source: IFB member company data. **Memo:** headcount employment in April 2012 is 10,274, and 6,443 of these are under age 22.

22. Company II, in Figure 6, provides data for 2007-12, in other words starting with the last year of the boom, and continuing into the recessionary period. This company has more of its activities in the north of the UK than Company I, and so might have felt the recession more severely. As can be seen, its FTE employment has fallen considerably, by 15%, and approximately 200 young workers have lost jobs (see Figure 6 note). Such a loss of jobs for the young is what the IFB is particularly concerned about. While the loss must be mostly attributable to the recession, the NMW does not help. The following statement gives an idea of the pressures that businesses are currently facing and how they are coping via part-time and zero-hours contracts:

“We believe the NMW has been harmful in the face of a slow-down in the UK economy. Employers are having to find new ways to combat rising employment costs such as part-time contracts, zero hours based contracts and other more flexible options. It is instructive that employees typically support these working arrangements as it suits their work/life balance better.” (Managing Director, large retailer).

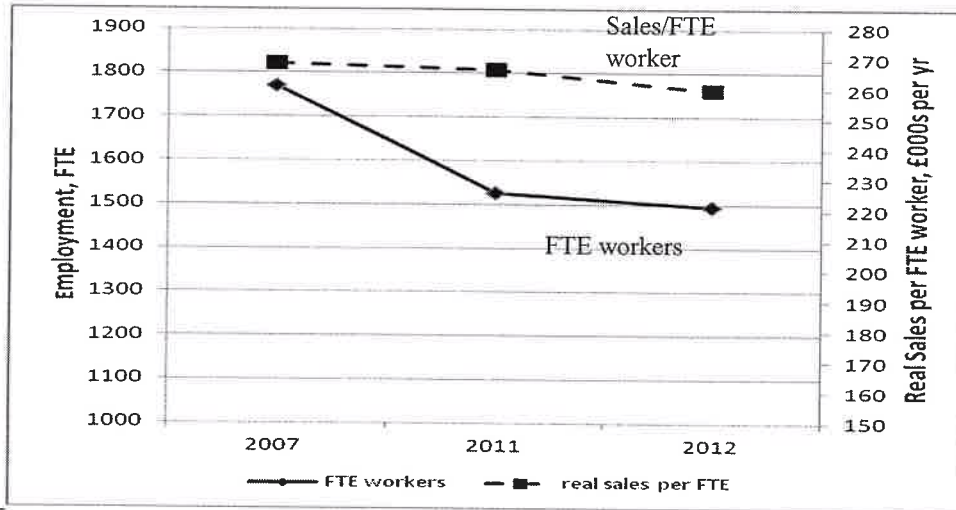


Figure 3: Employment and Productivity, National Retailer II

Source: IFB member company data. Memo: headcount employment in March 2013 (2007) is 2,402 (3019), and 418 (604) of these are under age 22.

23. A third IFB member company in the area of facilities management also employs thousands of workers on the NMW as cleaners. Management at this company likewise believes the NMW has adverse effects on youth employment:

"Employment statistics seem to indicate that it is the younger end of the employment market that is suffering most. Given our business demographic, we need to employ younger employees and provide younger people with the opportunity to get into work and on the career ladder. Freezing the NMW and keeping labour costs down will assist in achieving this objective."(Head of Reward, facilities management company).

The effect of the NMW is felt mainly in the north as usual. The company employs approximately 3,000 cleaners in this region, and over the past 5 years there has been a definite fall in under-22s employed, from around 10% to only 5% (i.e. about 150 youth jobs). Hence, it might well be the case, as we have stressed above, that younger workers cannot compete in difficult times, given the constraint of the NMW.

Conclusions

24. The economic outlook is at last turning positive (Table 1), but we still see difficulties for unskilled workers. First, there is convincing new research evidence that pushing minimum wages up faster than average wages has adverse employment effects. Such a push has occurred in the UK (Figures 1 and 2), and will especially affect less competitive workers, particularly the young and unskilled. Secondly, there is a continuing influx of young, job-hungry migrants, many of who compete for the low-end jobs. We estimate from Migrant Advisory Committee research (paragraph 10) that unskilled UK residents could lose 35,000 jobs a year from this source
25. The worsening position of young workers is shown in Table 2 for the economy, and for two large IFB member retailers in Figures 4 and 5. Both these retailers and a further IFB company providing business services have lost many youth jobs during the recession, and



their owners believe that the NMW has not helped. This said, we believe that the Commission's policy of tailoring NMW increases to business conditions (Figure 3) has reduced adverse employment effects, and certainly we would wish this policy to continue.

26. As regards apprentices, we are alarmed at the apparent widespread flouting of the minimum wage, with 30 to 40% of apprentices not being paid the minimum. We are on record as opposing the concept of the Apprentice Rate from the beginning, on the grounds that apprentices are prepared to receive low wages (in other words, "pay") in return for good training. The Apprentice Rate disrupts this exchange, and we are not surprised to see strains in the system. Since the matter has now become political (as we also warned), it becomes difficult for the Commission to prevent the Apprentice Rate rising further, but we believe it must try.
27. Given the factors weakening the unskilled and youth labour markets, the IFB's main call is for continued restraint, with zero or token increases in the various NMWs, ensuring they increase by less than average earnings. The minimum wage is a popular policy, but popular opinion is unaware of conditions in low-end labour markets, and of the way in which workers pay for training by receiving low wages. The Commission now has the difficult task of managing public opinion so as to make possible the unpopular low wage choices which we recommend.

Mark Hastings

Director-General, IFB
17 September 2013

References

- Baker, Michael, Dwayne Benjamin and Shuchita Stanger, 1999. "The Highs and Lows of the Minimum Wage Effect: A Time-Series Cross-Section Study of the Canadian Law", *Journal of Labor Economics*, 17: 318-50.
- Commission, 2013. *National Minimum Wage - Report 2013*, Cm 8565, London: Low Pay Commission.
- Dickens, Richard, Rebecca Riley and David Wilkinson, 2012, "Re-examining the Impact of the National Minimum Wage on Earnings, Employment and Hours: the Importance of Recession and Firm Size", University of Sussex and National Institute of Economic and Social Research.
- Dolton, Peter, Chiara Bondibene and Michael Stops, 2013. "Identifying the Employment Effect of Invoking and Changing the Minimum Wage: A Spatial Analysis of the UK", unpublished working paper, University of Sussex.
- Dolton, Peter and Chiara Bondibene 2012. "The International Experience of Minimum Wages in an Economic Downturn", *Economic Policy*, 27: 99-142.
- IFS, 2013. *The IFS Green Budget*, February 2013, London: Institute of Fiscal Studies.
- MAC, 2012. *An analysis of the Impacts of Migration*, London: Migration Advisory Committee



- Neumark, David, and William Wascher, 2004. "Minimum Wages, Labor Market Institutions and Youth Unemployment: A Cross-National Analysis", *Industrial and Labor Relations Review*, 57: 223-48.
- OBR, 2013. *Economic and Fiscal Outlook*, March 2013, Cm 8573, London: Office for Budget Responsibility.
- OECD, 2000, 2013. *Employment Outlooks for 2000 and 2013*, Paris: Organisation for Economic Cooperation and Development.
- OECD, 2013b. *Interim Economic Assessment – a moderate recovery in the advanced economies*, 3 September, Paris: Organisation for Economic Cooperation and Development.
- ONS, 2012. *Migration, 2010-based NPP Reference Volume*, London: Office for National Statistics.
- Treasury, 2012. *Forecasts for the UK Economy No. 316*, August, London: HM Treasury.
- UCG, 2008. *Evidence by the Industrial Relations Committee of the Unquoted Companies Group for the Low Pay Commission's 2008 Consultation on Apprentices*, 6 August.
- UCG, 2012. *Evidence by the Industrial Relations Committee of the Unquoted Companies Group for the Low Pay Commission's 2013 Recommendations on the National Minimum Wage*, 14 September.