Speakers

RF

Low pay and the National Minimum Wage

George Bain, first chair of the LPC

The National Living Wage and the future of low pay

Conor D'Arcy, Resolution Foundation

In-work support and low pay

Torsten Bell, Resolution Foundation

Low pay and the National Minimum Wage

CASE Welfare Policy and Analysis Seminar

George Bain

November 2015

National Minimum Wage: Achievements

- **Equal Pay: Biggest impact since Equal Pay Act of 1970**
  - Proportion of women paid below NMW before its introduction in 1999 was 11.2% compared with 3.5% of men
  - Immediately after introduction of NMW, 10% of women compared with less than 2% of men were at the minimum wage

- **Abolished Extreme Low Pay**
  - Advertisement in northern newspaper in 1997 for security guard: 100 hours a week, £2 per hour, supply own dog
  - Extreme Low Pay: defined as one-half of median wage (£5.88 ph)
  - Only 10% of low-paid workers today (compared with 32% in 1997) are on extreme low pay. To put the matter another way, in 1997 6.9% of all workers were on extreme low pay; today only 2% of all workers are on extreme low pay, a reduction of 70%

National Minimum Wage: Limitations

- **Low Pay Still Pervasive**
  - Low Pay: defined as less than two-thirds of median wage (£7.83 ph; about £15,000 p.a. working full time)
  - NMW has become the "Going Rate": about 5% of UK labour force earn within 5p of NMW
  - 21% earn less than two-thirds of the median (i.e. are low paid)
  - Hence 16% of the labour force (representing 90% of low-paid workers) is helped little by the NMW as it is presently fashioned

- **Sector-Specific Problem**
  - Low pay primarily concentrated in a few sectors: wholesale and retail, hotels and restaurants, cleaning, social care
  - Hence NMW an ill-fitting garment, pinching hard in some parts of the economy while leaving room in others where employers could pay more

National Minimum Wage: Future

- **Recommendations of RF Commission**
  - Genuine Low Pay Commission (vs Minimum Wage Commission): advising government on design of policy to eradicate low pay taking into account in-work benefits, tax, etc.
  - Medium-term Clarity over NMW: forward guidance rather than just year-by-year adjustments
  - Equipping LPC with Additional Tools: regional rates (e.g. London), "reference rates" by sector

The National Living Wage and the future of low pay

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Conor D'Arcy

November 2015

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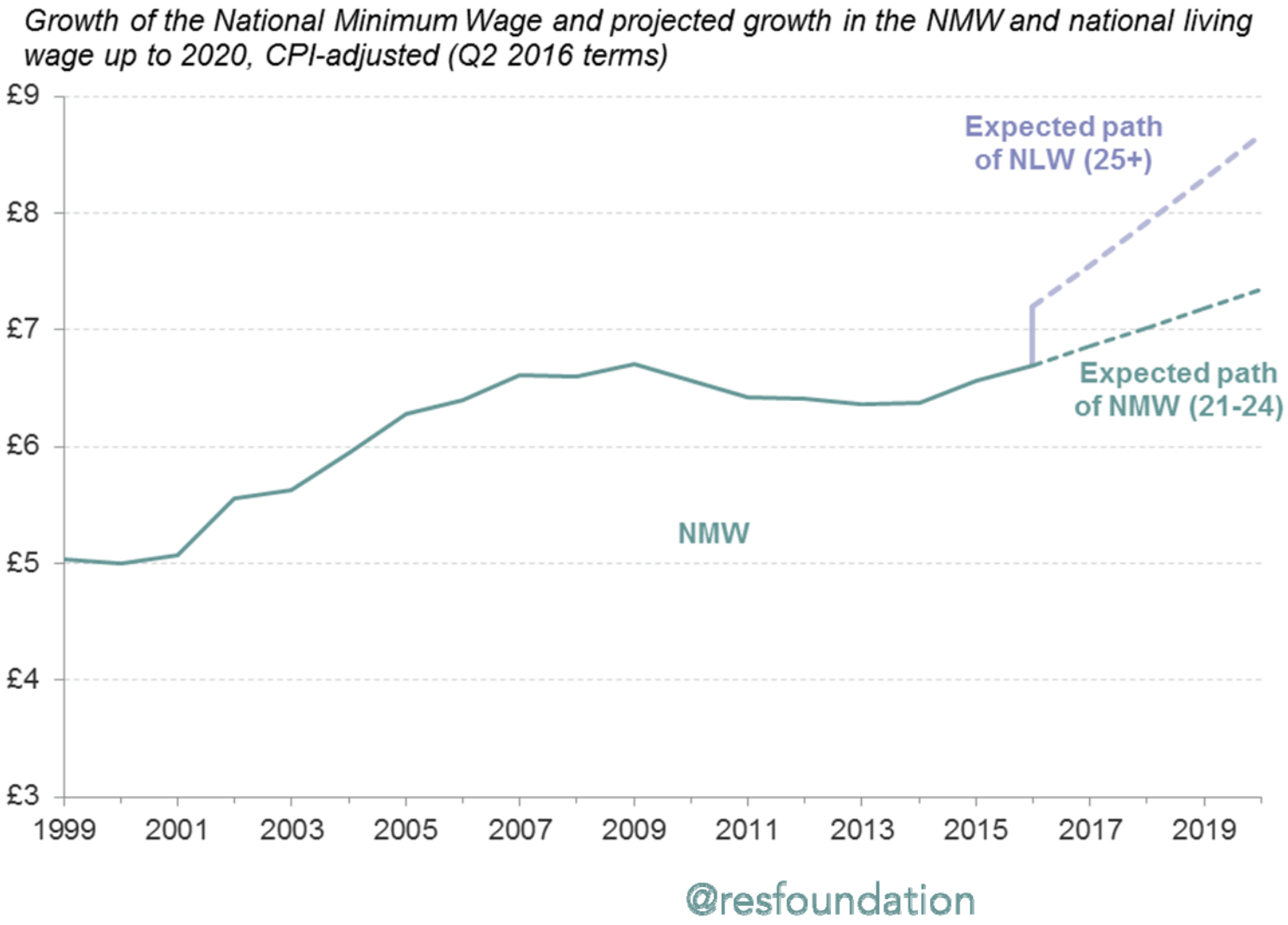
At the Summer Budget, the government announced the new 'National Living Wage' for those aged 25+



From April 2016, every worker aged 25+ must be paid at least £7.20

£7.20 is expected to reflect a bite of 55%, relative to the typical hourly wage of over-25s

The government's ambition is for the NLW to rise to a bite of 60% by 2020, different from RF review position

Around one-in-four employees expected to have their pay boosted by 2020

3.2 million 'directly affected'

- brought up to (or above) the new wage floor

2.8 million 'indirectly affected'

- already earn above NLW, but gain from 'spillover effects' as employers retain pay gaps between employees

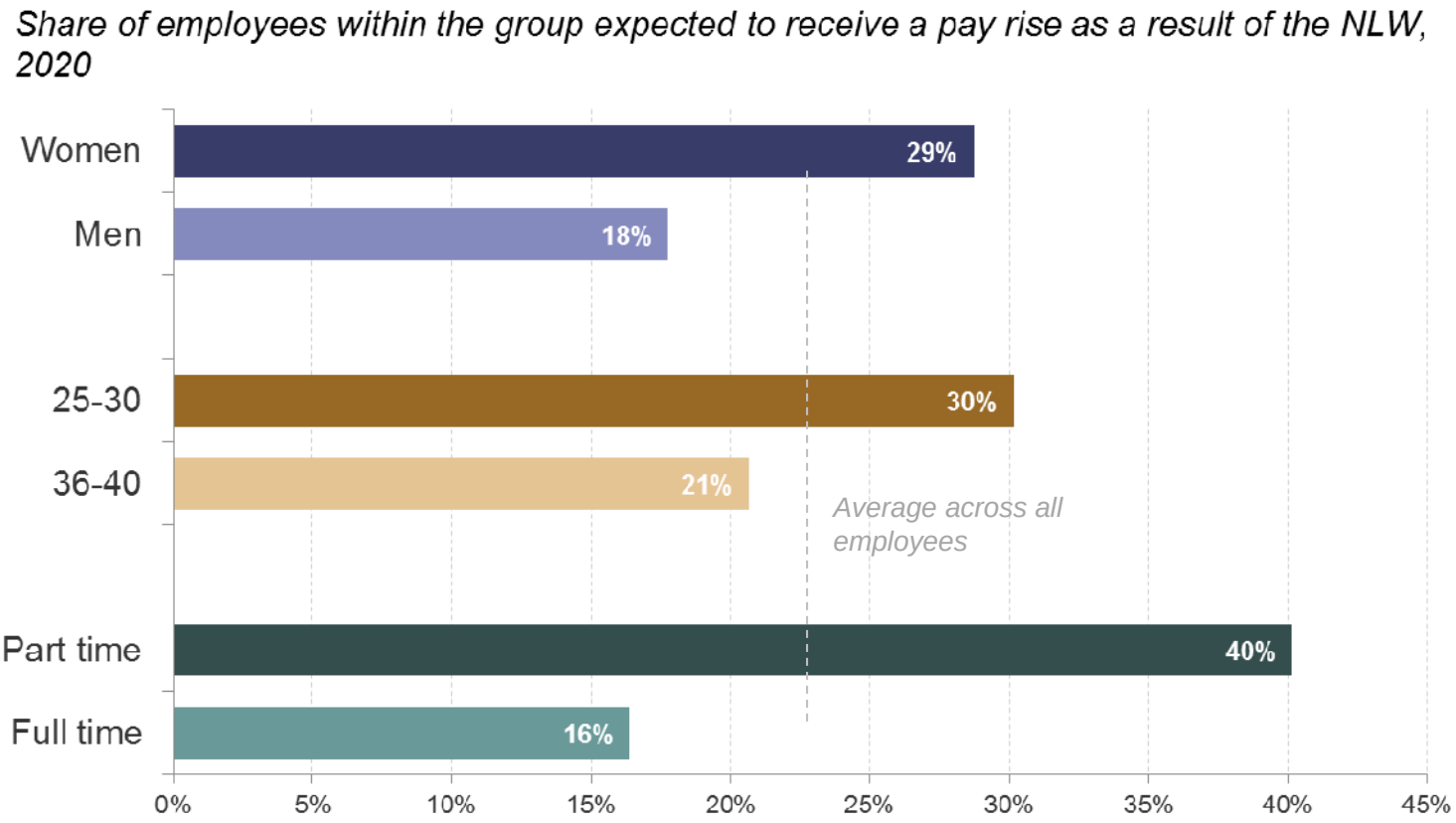
Average individual gross wage gain of £760

- higher for the directly affected

Average household net income gain of £410

- reduced by taxes and by loss of benefits for some

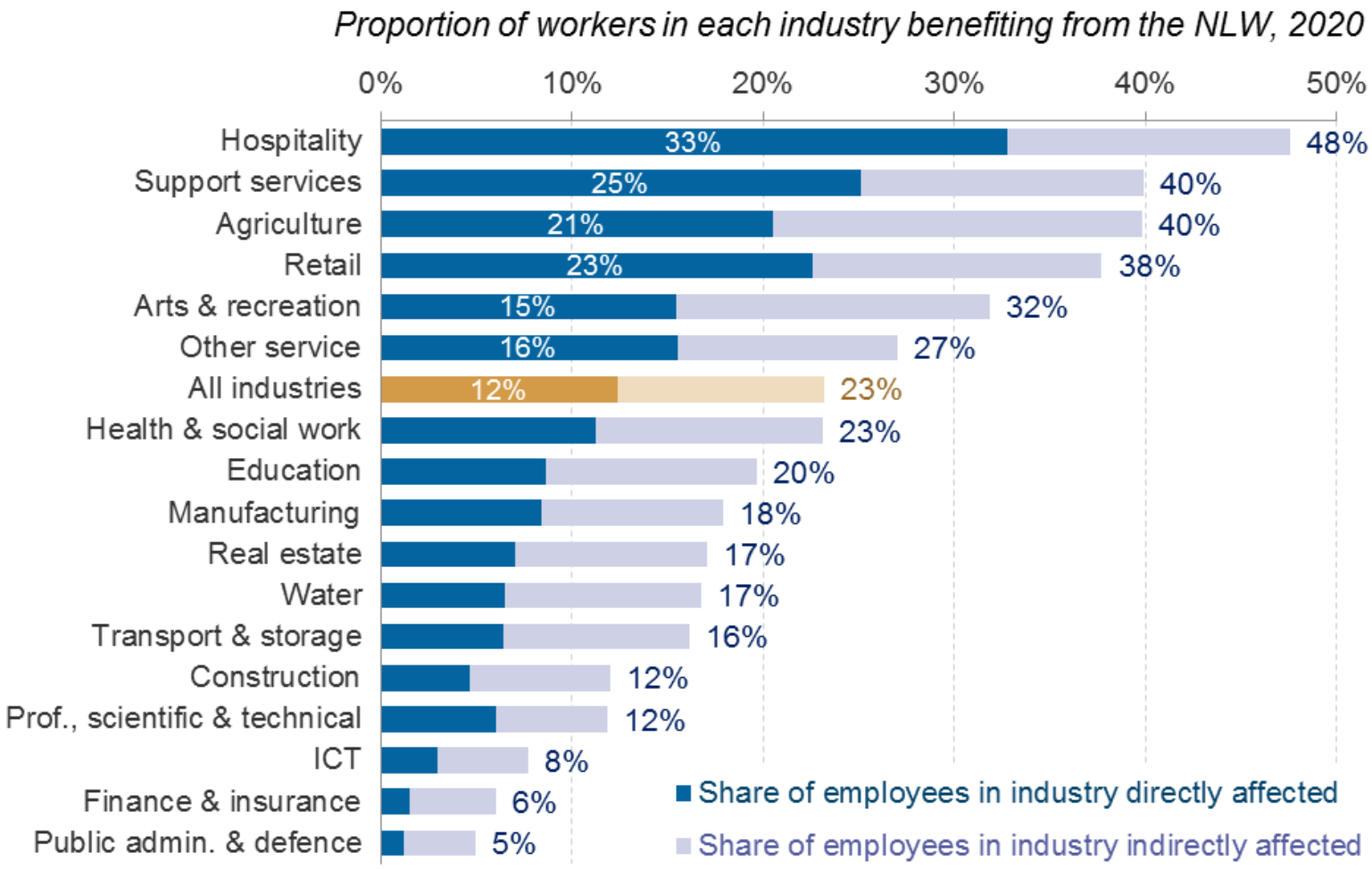
Women, 25-30 year olds and part-time workers likely to be particularly affected by the NLW



Average annual cash gain each group receives however depends pay & number of hours

While more women will get a raise, men can expect larger annual gross gains as more women work part time

The size of the impact is set to be highest in hospitality, support services and retail



RF/CIPD survey of 1,000 employers found that 54% of employers expect their wage bill to rise as a result of NLW

Raising productivity the most common response when firms asked how they will manage the NLW

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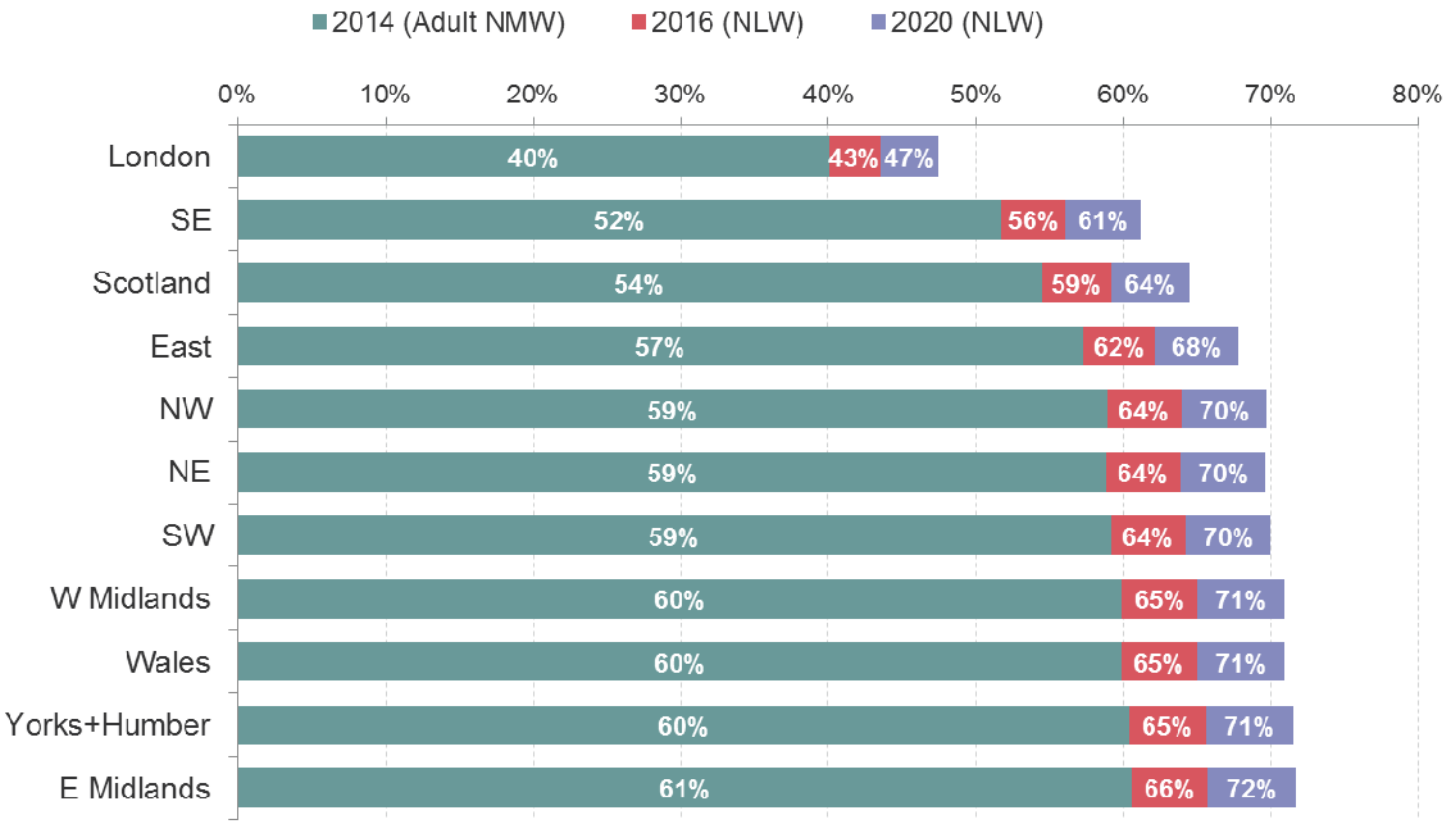
The effects are similarly varied across the regions and nations of the UK

Bite of the minimum wage by region over time, relative to all-worker median



While nearly 3 in 10 employees in the most-affected regions will receive some pay increase, in London just 14%

The NLW should mean the share of people low paid falls – but it won't disappear

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A growing share of people will be at or very close to the wage floor

Raises questions around progression

Challenges on progression and low pay more broadly mean LPC should retain core, independent role at heart of new system

Conclusions on NLW's impact on employees and employers

- What we do know:
  - The NLW is a welcome and serious intervention on low pay with millions set to gain
  - Effects will be largest in low-paying sectors like retail and hospitality
- What we don't know:
  - How employers will react: spillovers? hire more under-25s?; more self-employed?; more robots?
  - What this will mean for progression

In-work support and low pay: assessing the impact of changes announced at the Summer Budget

CASE Welfare Policy and Analysis Seminar

Torsten Bell

November 2015

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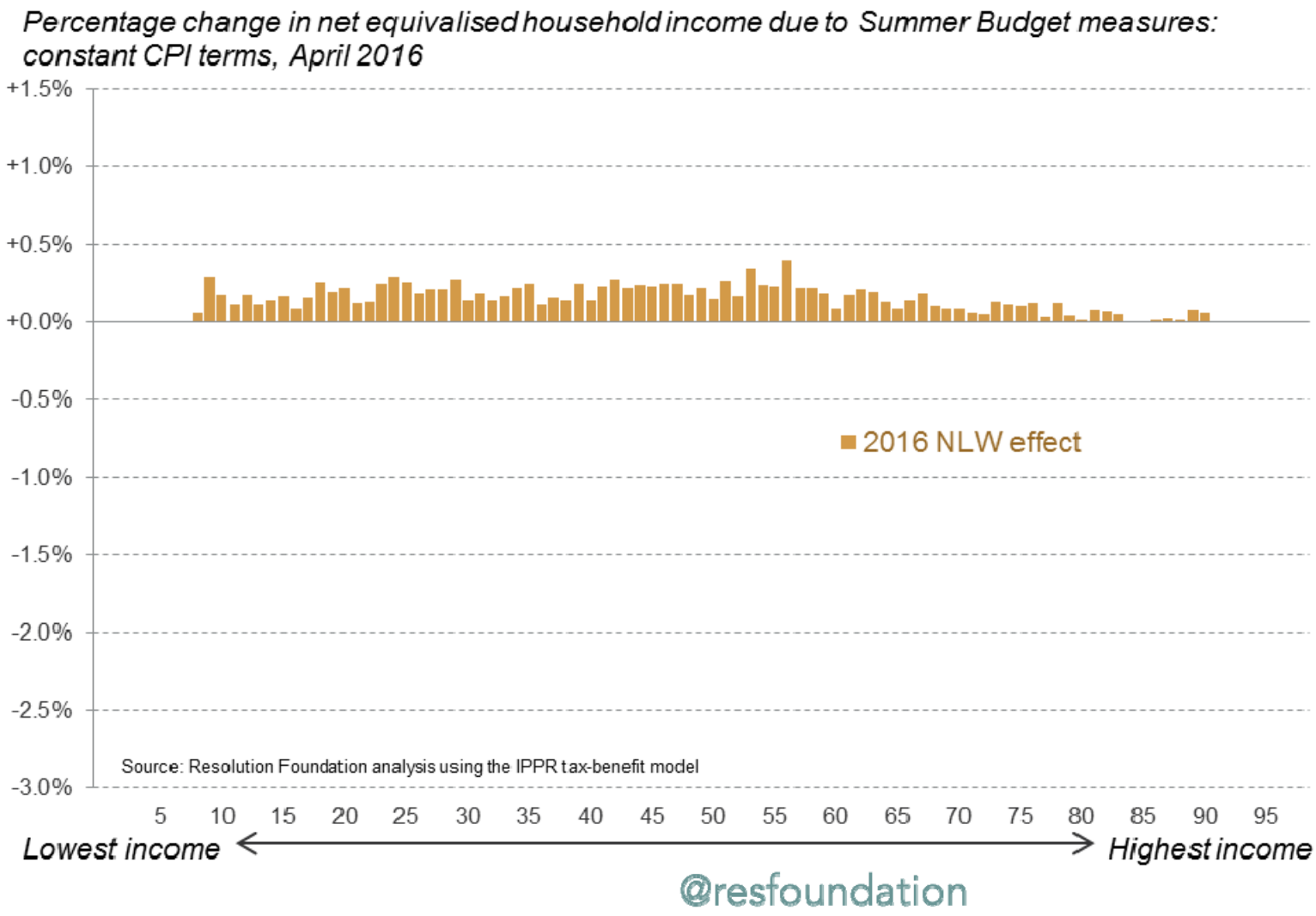
SUMMER BUDGET IMPACT I

The effect of changes in 2016

*on **incomes***

The gains from the National Living Wage are focused in the lower and middle deciles

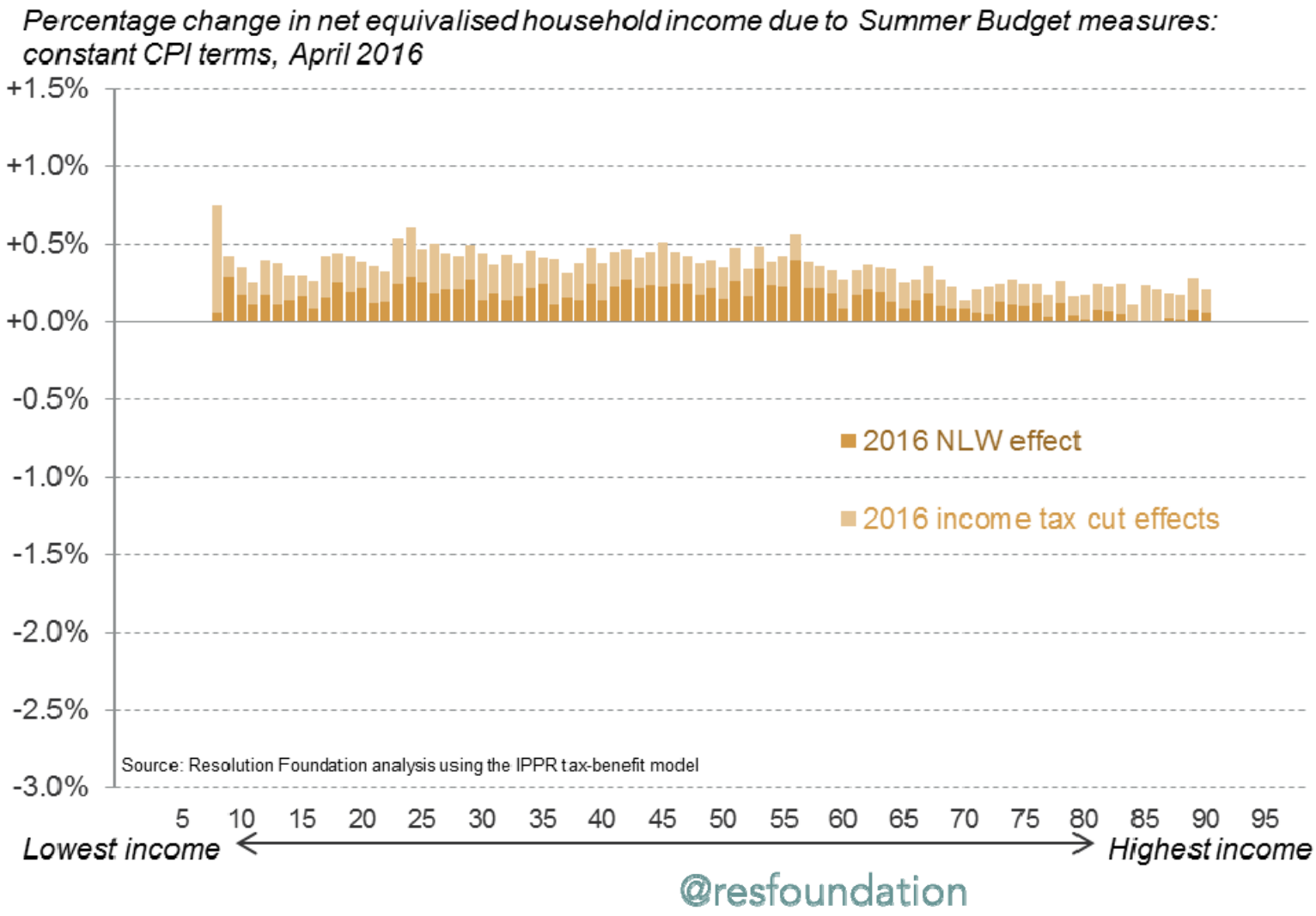


Raising the wage floor has a positive impact across the distribution

NLW gains are made in the middle of the distribution because low *earners* do not necessarily live in low *income* households

Smaller gains at the top with a 55% bite in 2016 than in 2020 (60% bite)

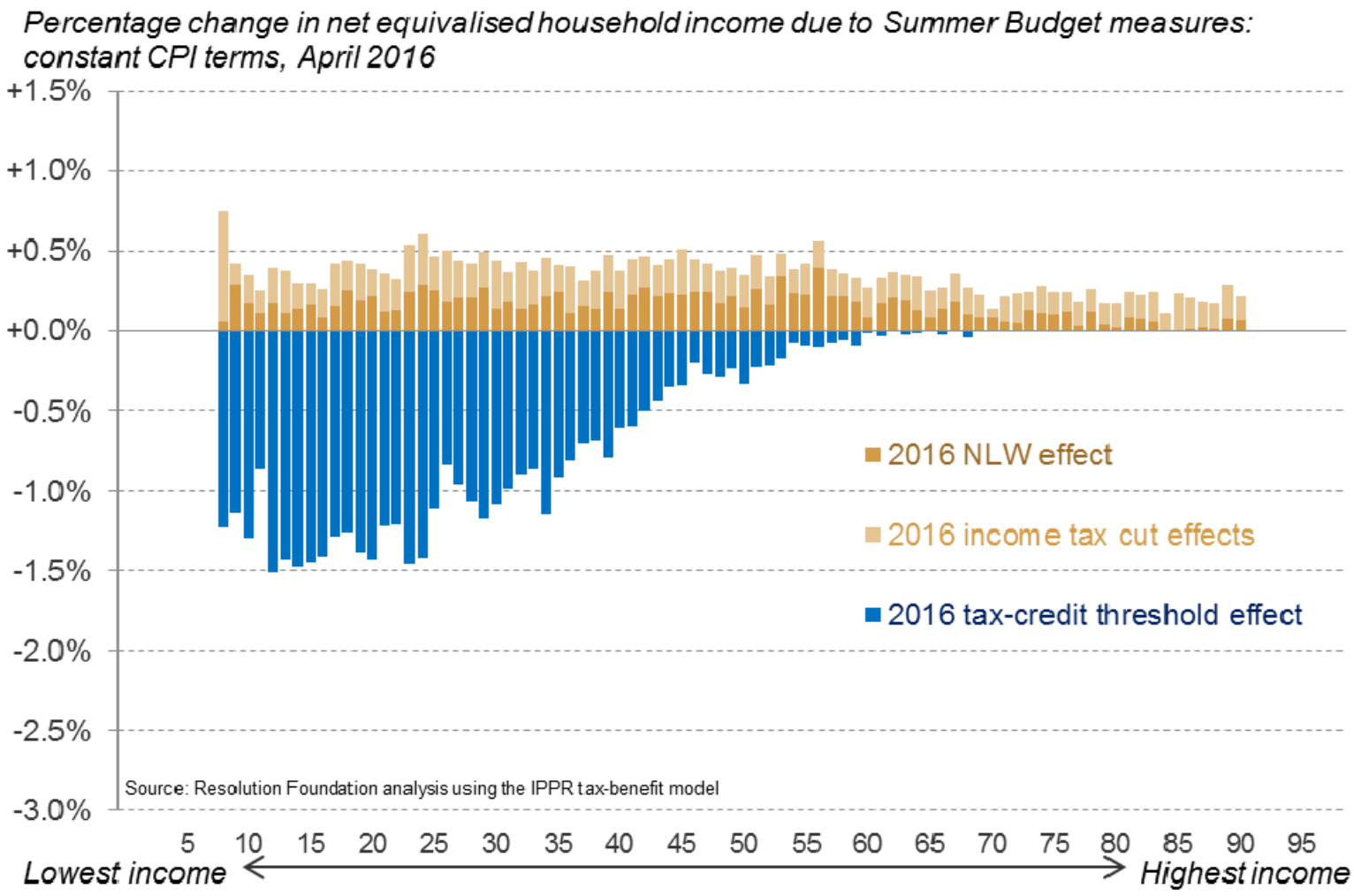
More of the gains from income tax cuts go to richer households



Increasing the personal allowance & higher rate threshold also creates gainers

Around four-fifths of the gains go to the top half of the income distribution

But losses from reducing the tax credit threshold are highly concentrated in the bottom half

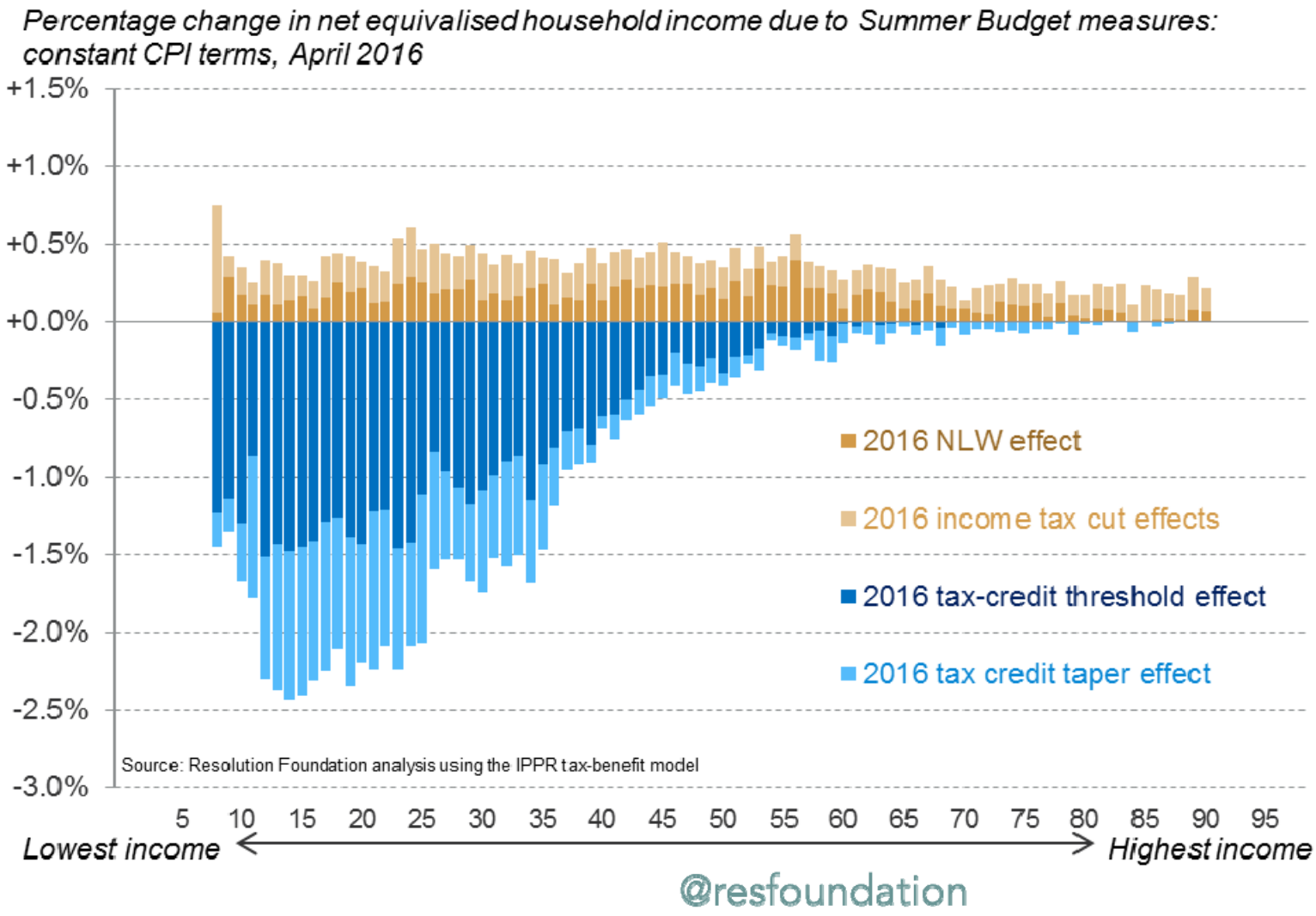


Of the cuts due in April, reducing the income threshold for tax credits has the biggest impact, with the effects felt most acutely among low and middle income households

This produces a straight income shock for all in-work tax credit recipients of up to £1,050

As are losses associated with increasing the tax credit taper

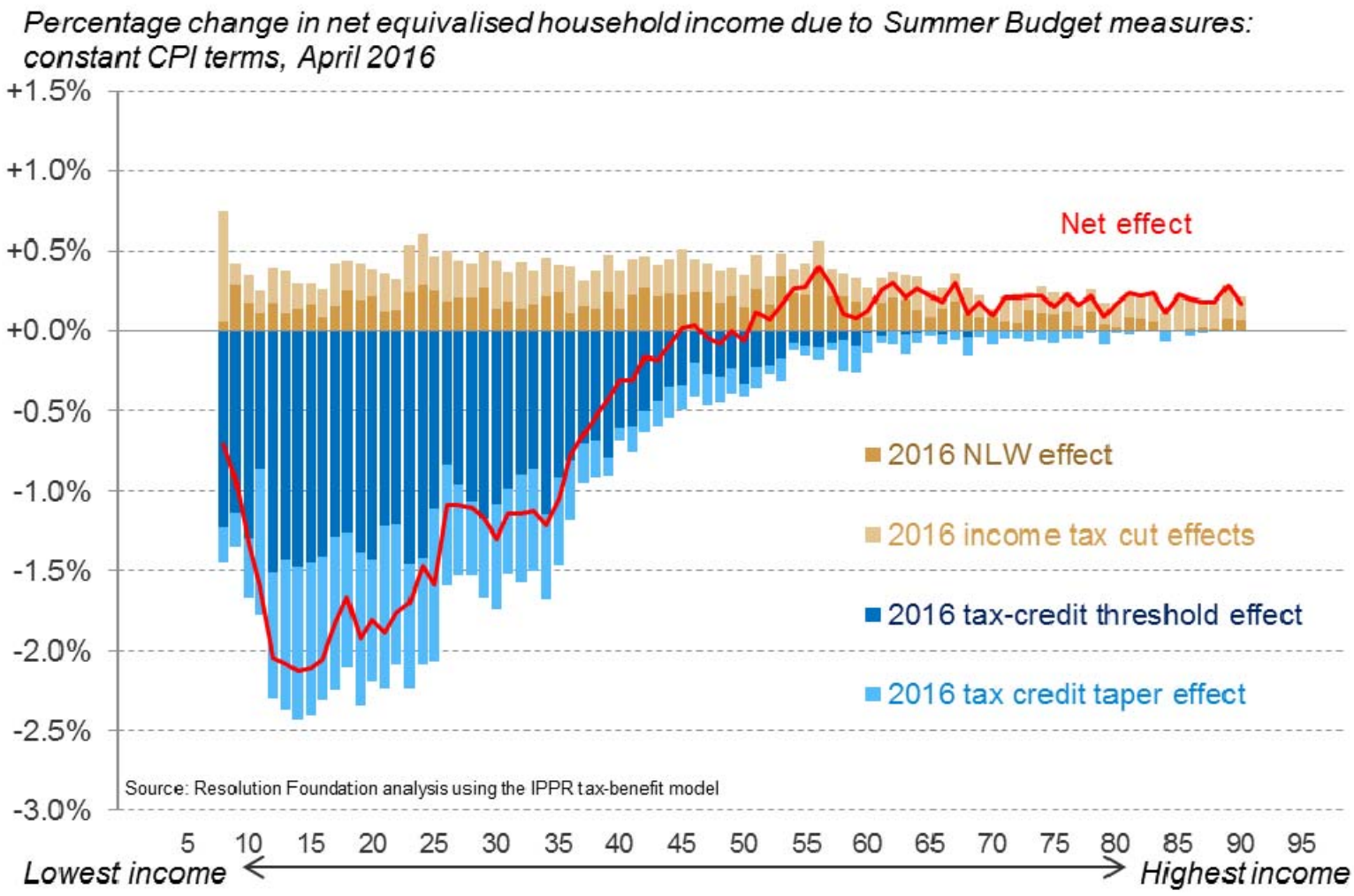
RF



Increasing the tax credit taper produces a further drag on income in the bottom half of the income distribution

The reduction in the income threshold makes the taper cut more regressive as it applies to a greater span of income

Producing a highly regressive impact on incomes overall



Overall, the even spread of gains and the concentration of cuts means that significant losses in the bottom half of the income distribution contrast with modest gains in the top half

Overall, around 3.3m working households will lose an average of £1,100 in April 2016, saving £4.4bn

- Depending on circumstances the fall in income for some families may be as high as £3,000
- A single-earner couple with two children paid at the wage floor are set to be £1,500 worse-off in 2016
- These changes will push around 100,000 working households, and 200,000 children in working households, into poverty in 2016

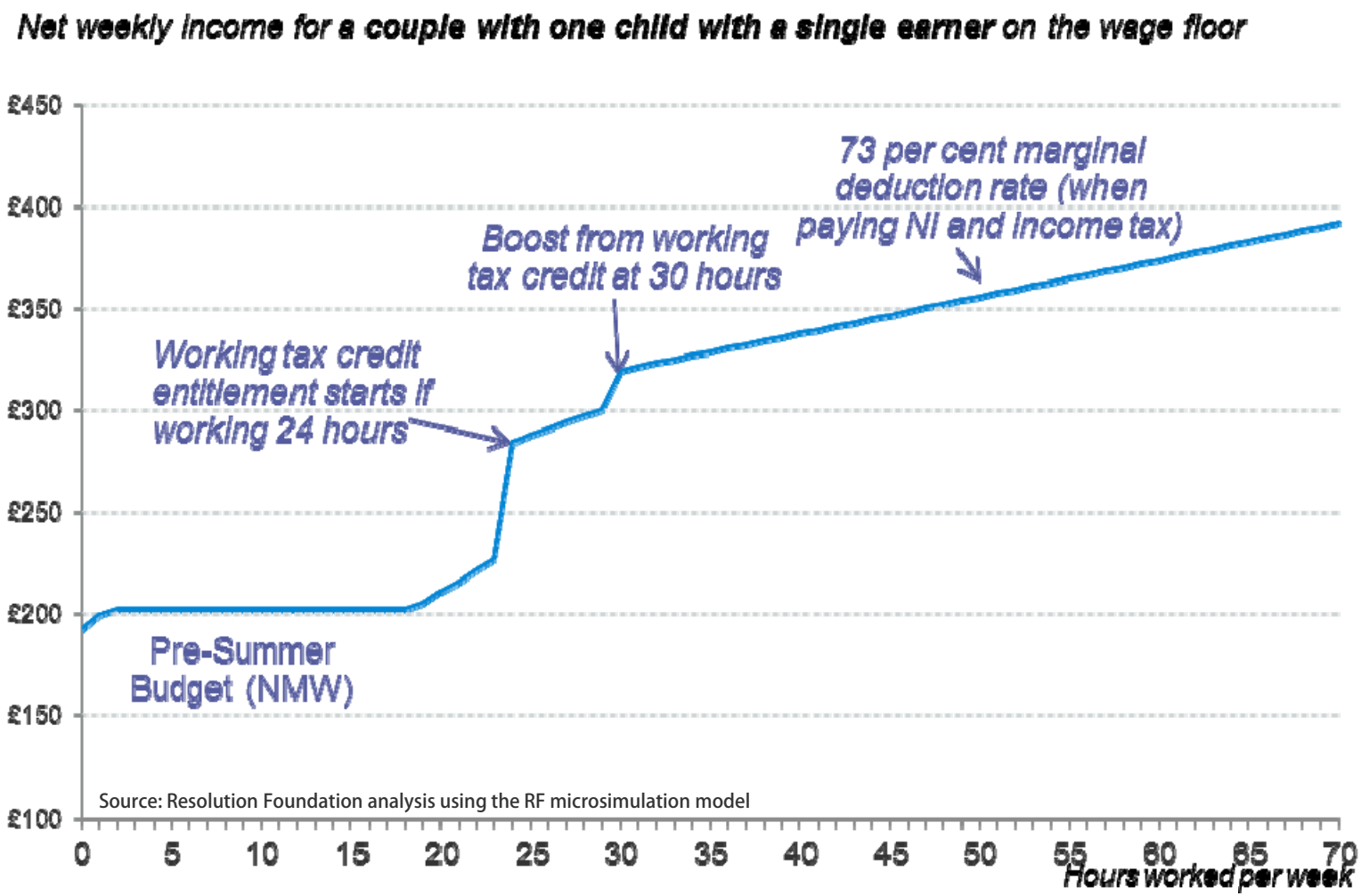
SUMMER BUDGET IMPACT II

The effect of changes in 2016

*on **incentives***

The existing tax credit system creates incentives and disincentives

RF



Provision of working tax credit when working specified number of hours (16 for a single parent; 24 for someone in a couple; boost at 30) incentivises working at certain points

But high marginal deduction rate tends to dis-incentivise working longer

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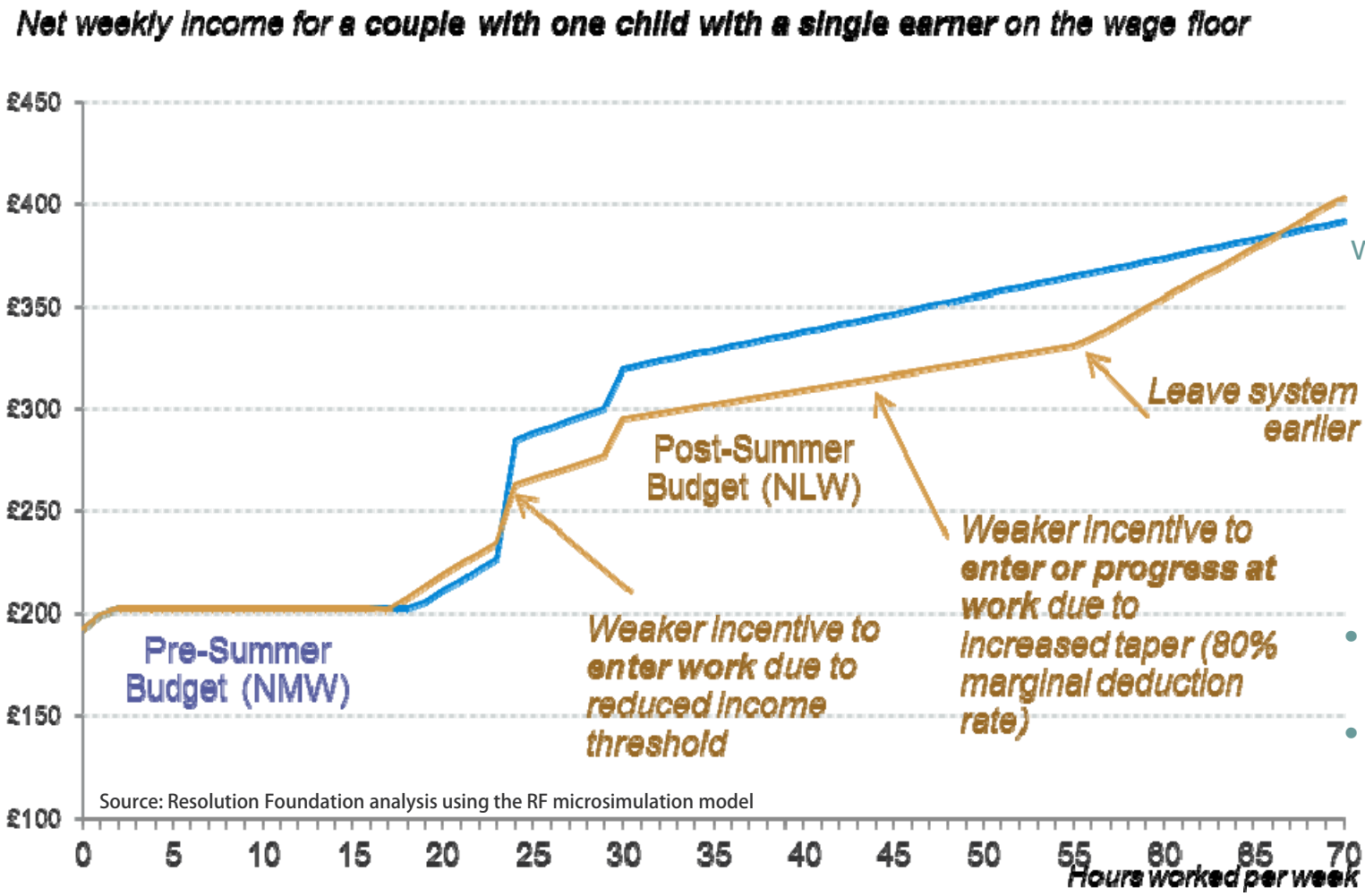
For many, Summer Budget changes will reduce the returns from entering or progressing at work

RF



The combined cuts (taper & income threshold) reduce gains from starting work by up to £1,250

Raising the taper to 48% makes progression even less attractive

Key exceptions are:

- Those losing all tax credits
- Second earners

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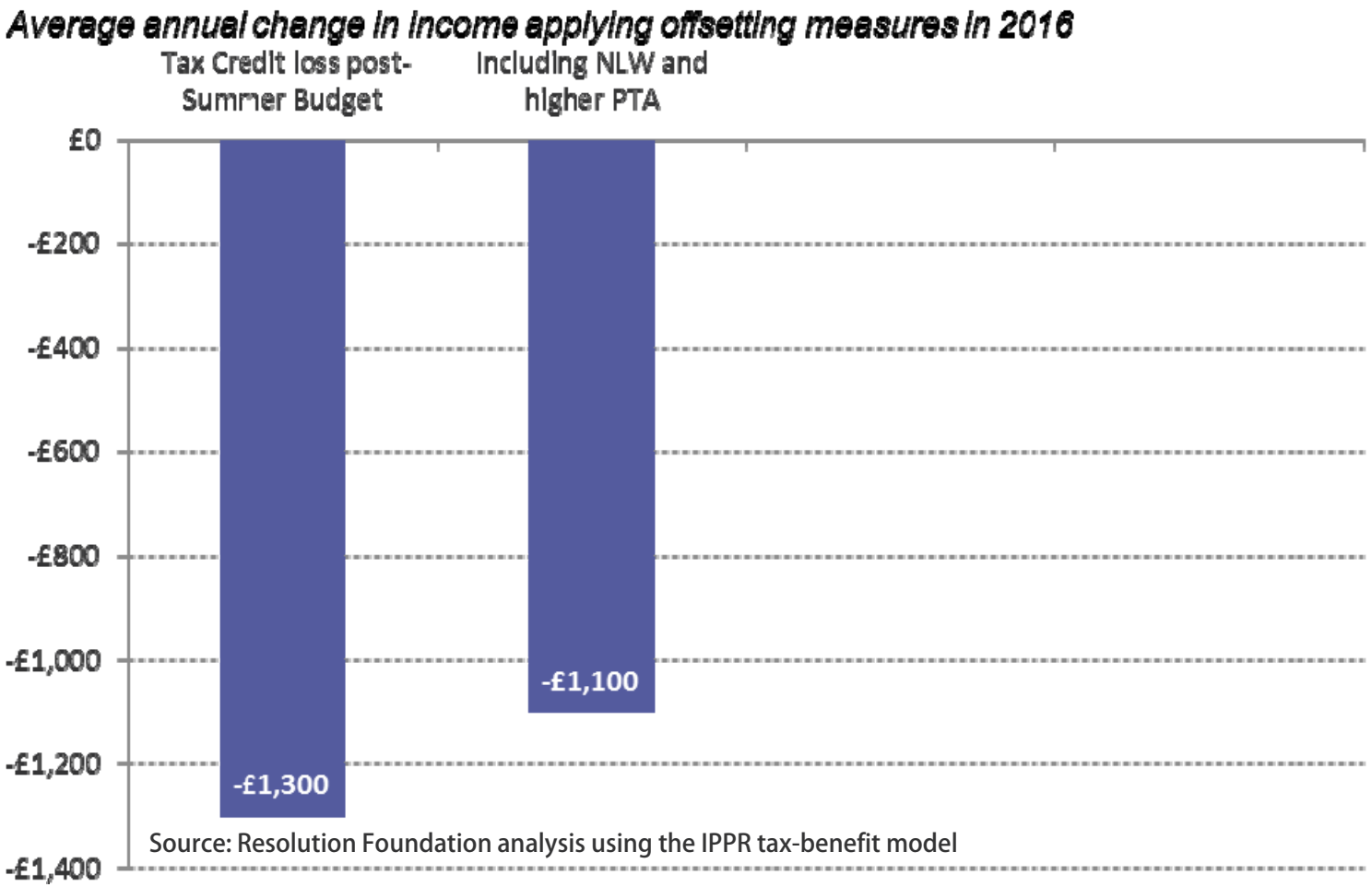
OFFSETTING THE LOSSES

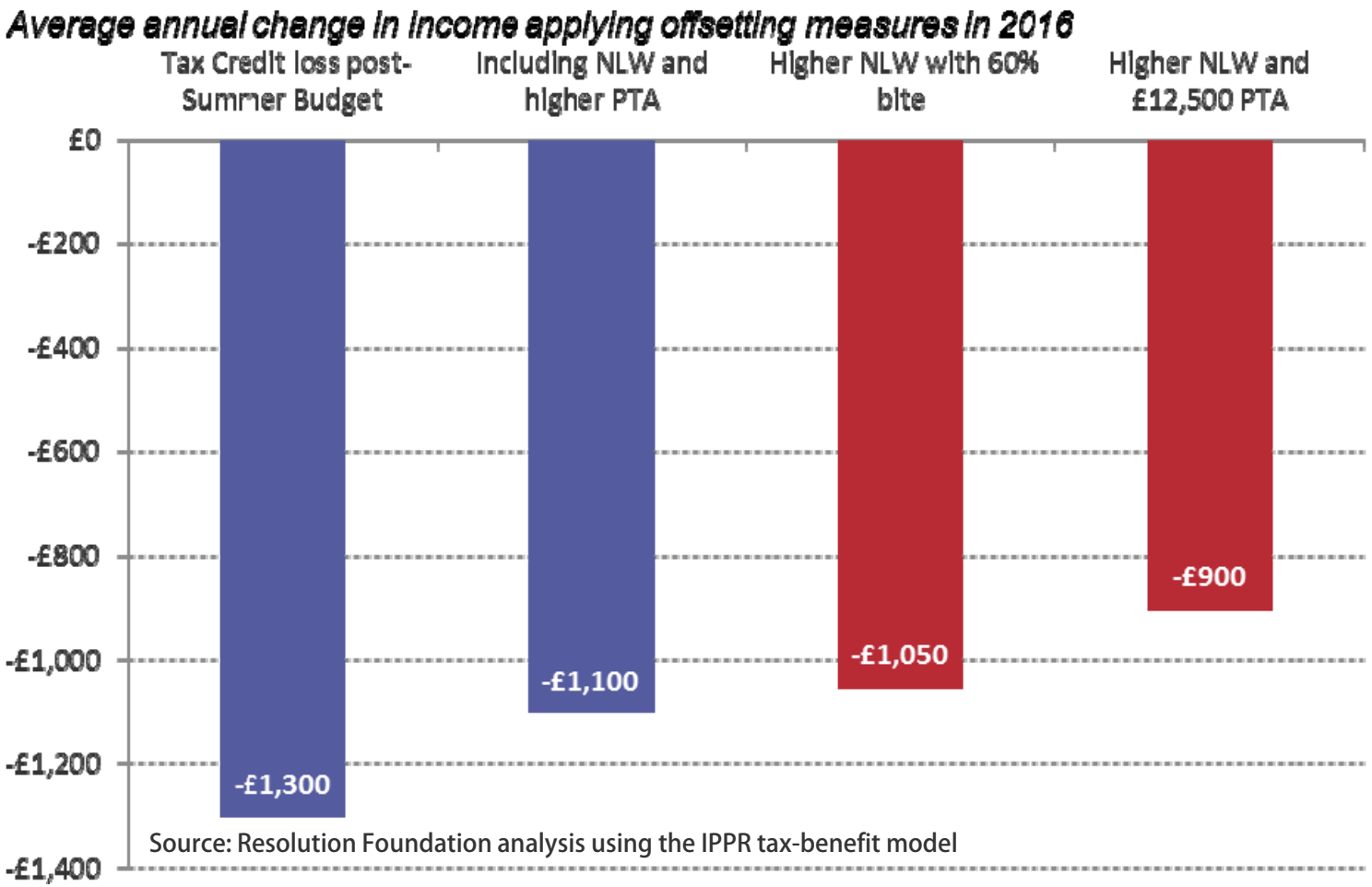
Can we compensate the tax credit losers outside of the benefit system?

Options for offsetting the losses: Bringing forward minimum wage rises and tax cuts



The increase to the personal allowance and NLW reduce gross tax credit losses on average by £200

Options for offsetting the losses: Bringing forward minimum wage rises and tax cuts



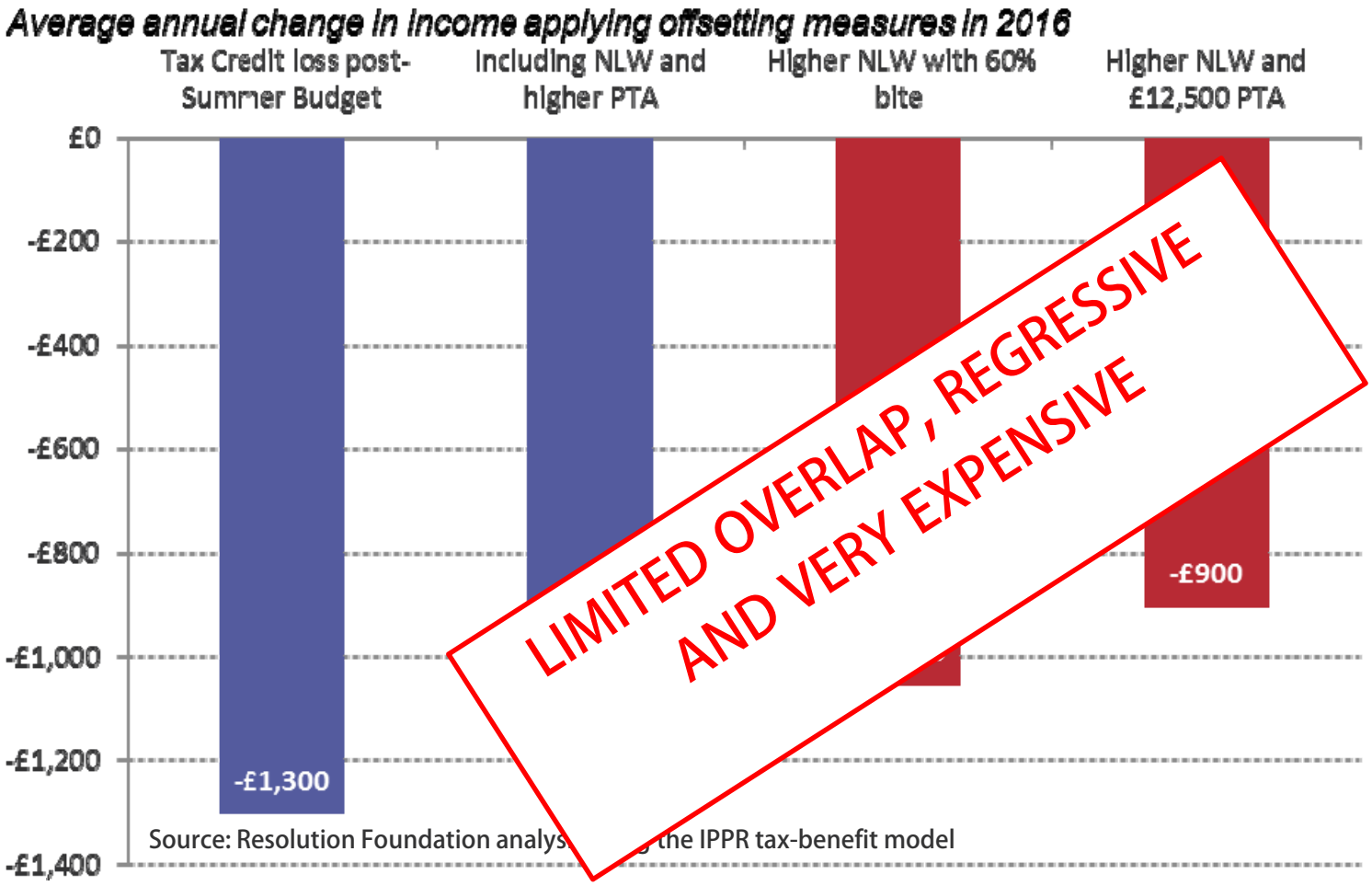
The increase to the personal allowance and NLW reduce gross tax credit losses on average by £200

A higher NLW in 2016 would do little to offset losses

Increasing the PTA to £12,500 still leaves working families on average £900 a year worse off

Options for offsetting the losses: Bringing forward minimum wage rises and tax cuts

RF

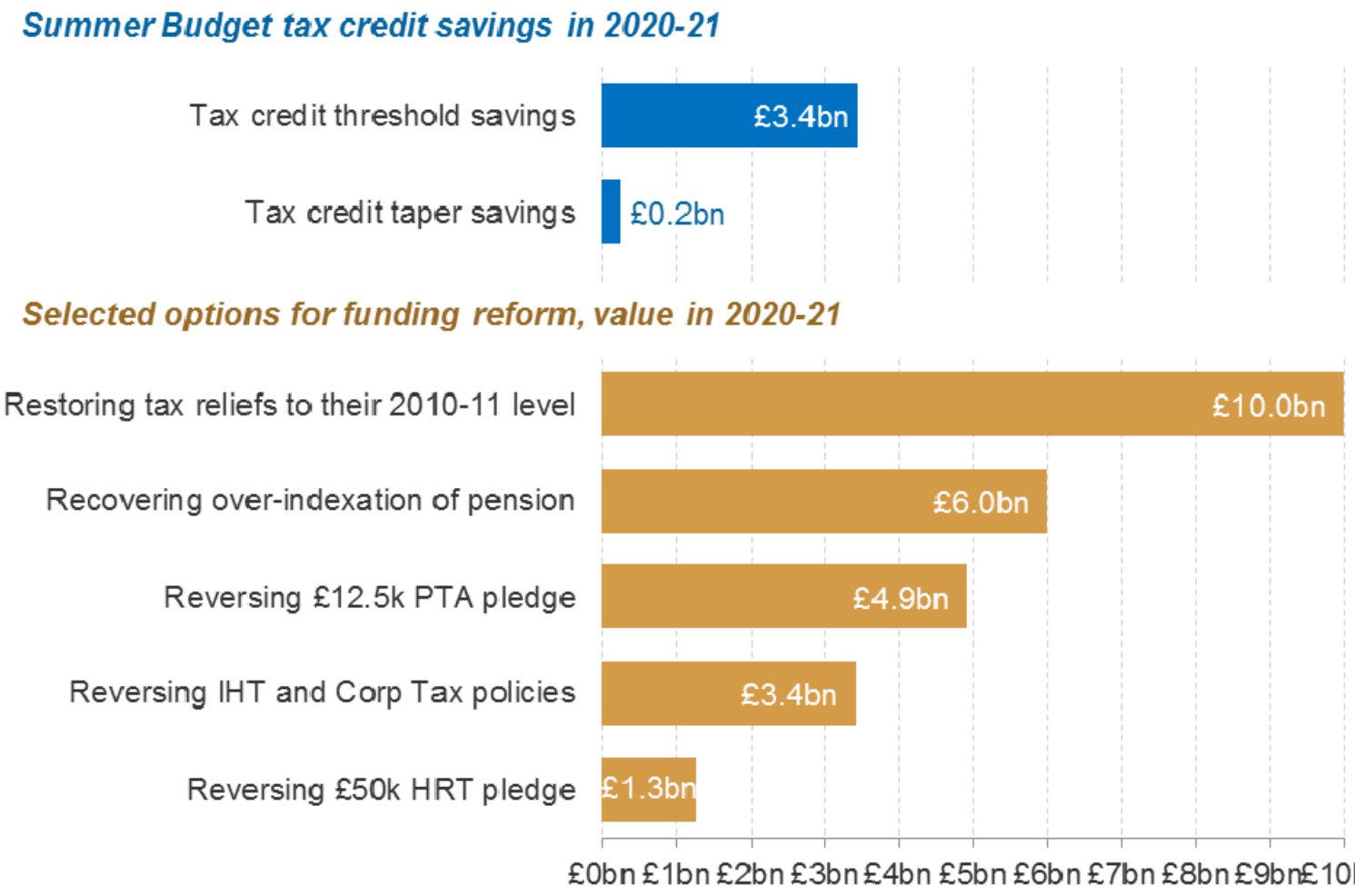


Limited overlap as many earners in low-income families already paid above the NLW

Deduction rates mean additional earnings are reduced

Tax cuts mainly benefit those in higher-income households. £12,500 PTA costs ~£9bn

Tax credit cuts need a tax credit answer – and the money is there within existing fiscal plans



Threshold and taper savings amount to around £3.6bn in April 2020

Equivalent amounts could be achieved in any number of ways.

For example, cancelling income tax pledges would raise £6.2bn

The Treasury could also choose to reduce the near-£12bn 2020 surplus

Source: Summer Budget policy costings, Resolution Foundation analysis using the IPPR tax-benefit model & author's calculations

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Conclusion – the roles of wage floors and tax credits

Working poverty as the defining challenge

Tools vary over time. New higher wage floor ambitious, but hugely welcome

Wage floors and in-work support as **complements, not substitutes**

- Competition (and robots) exist…
- …and families do too

In-work support and low pay: assessing the impact of changes announced at the Summer Budget

CASE Welfare Policy and Analysis Seminar

Torsten Bell

November 2015

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The impact of the National Living Wage on household incomes and work incentives

James Browne

CASE seminar

18th November 2015

E·S·R·C ECONOMIC & SOCIAL RESEARCH COUNCIL

Our analysis

- Calculates potential gains from NLW (higher wages), and ignores potential losses (lower hours and employment, higher prices, lower profits)
- We abstract from nature and size of losses and focus on:
  1. Distributional impact of gains
  2. Interaction with tax and benefit system: how much of the increase in gross wages do workers paid below the NLW get to keep?
  3. How do the gains from the NLW compare with the with the losses from tax and benefit reforms for different households?
  4. Impact on work incentives of those who potentially benefit
  5. Comparison with work incentive effects of tax and benefit changes

Methodology

- Use data from the Living Costs and Food Survey (LCF), the Family Resource Survey (FRS) and the Labour Force Survey (LFS)
  - FRS contains detailed household information
  - Measurement error in hourly wage measure in the FRS
  - LFS has direct measure of hourly wage for individuals paid by the hour
- Impute hourly wages of individuals in the FRS by matching them to "similar" individuals in the LFS who report their hourly pay
  - Use the level of weekly earnings, hours of work, sex, age, region and industry
  - Done only for individuals who seem potentially able to receive a pay increase as a result of the new NLW (paid less than 70 times NLW)
- Examine impact as if introduced at 60% of median wages today

Gains from the new NLW

- Our estimates suggest that
  - 21% of all employees will gain from the new NLW
  - Boost in gross wages of £5.6 billion (no knock-on effects on wages above NLW)
- OBR estimate based on ASHE data suggest that
  - 16% of all employees gain (with a total boost in gross wages of £4 billion)
- Thus, we estimate that more people will gain and that the total gain is bigger
  - We do not know which estimates that are closer to the truth

- Below we therefore present two sets of results
  1. Estimates based on the LFS and FRS (£5.6 billion increase in gross wages)
     - We describe this as a "better case"
  2. Gross wage gains are scaled to get the £4 billion suggested by the OBR (i.e. all gains are scaled by 72% (4/5.55))

Clawback and average compensation

- Not all of the increase in gross wages will feed through to an increase in net incomes
- Our estimates suggest that 63% will feed through
  - The estimated £5.6 billion increase in gross wages is expected to result in a net income rise of £3.5 billion
  - The remaining £2.0 billion would accrue to the Treasury

- Substantially smaller than the £12.5 billion of net cuts to benefits and tax credits announced in the July 2015 Budget
- Suggest, at best, an average compensation of
  - 27% in the "better case"
  - 19% using the scaled estimates (here net wages are expected to increase by £2.5 billion)

Distributional impact

Figure 1. Estimated distributional impact of personal tax and benefit measures announced for implementation in the current parliament, 2019–20

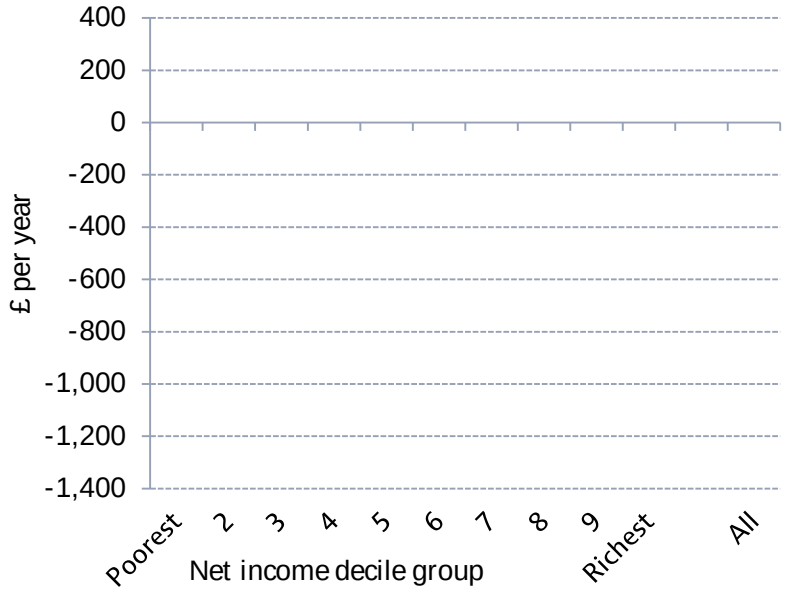
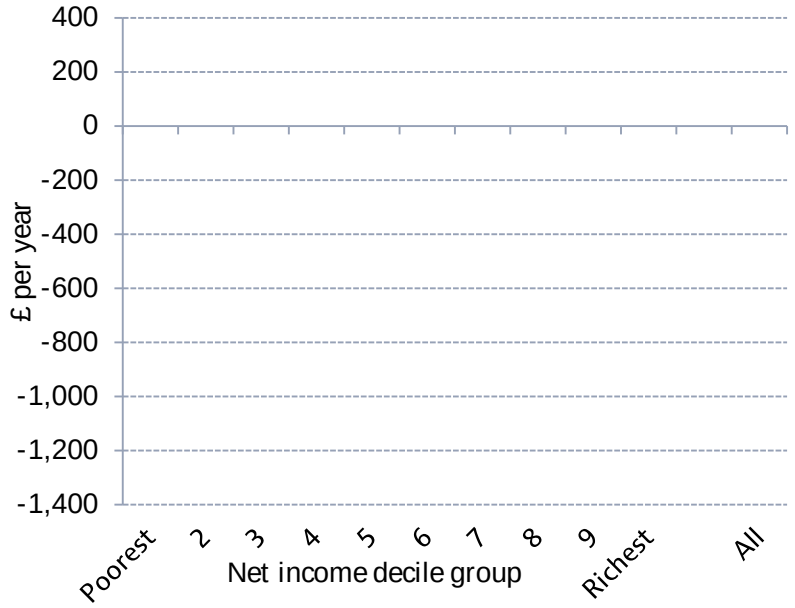


Figure 2. Estimated distributional impact of gains from the new NLW announced in the July 2015 Budget, 2019–20



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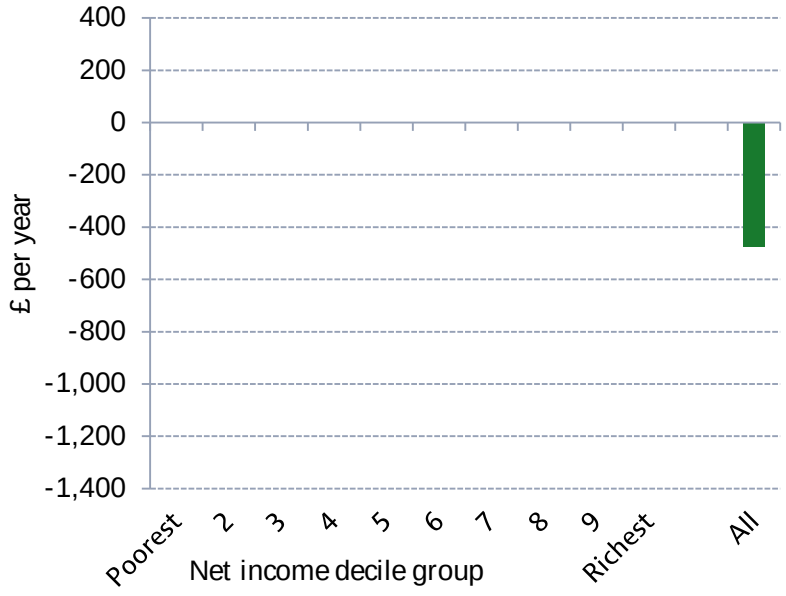

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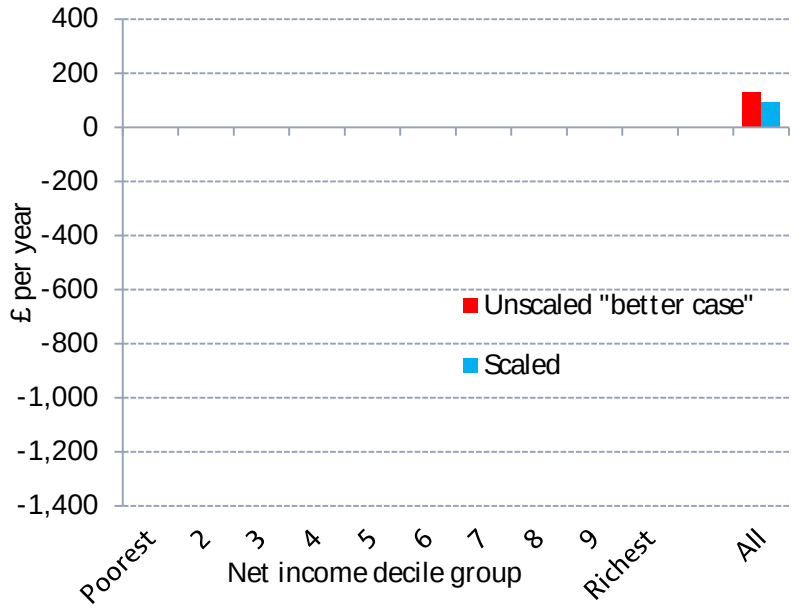

- This shows the average compensation of 27% and 19%, respectively

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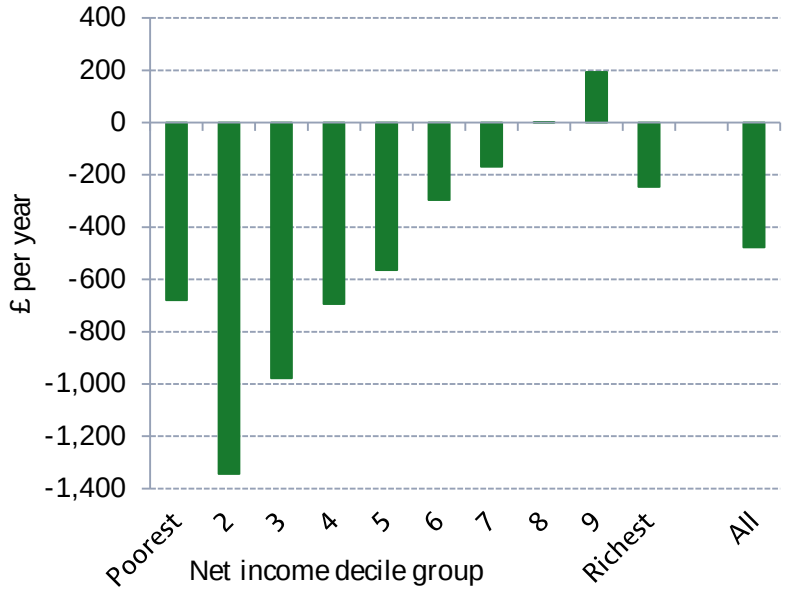

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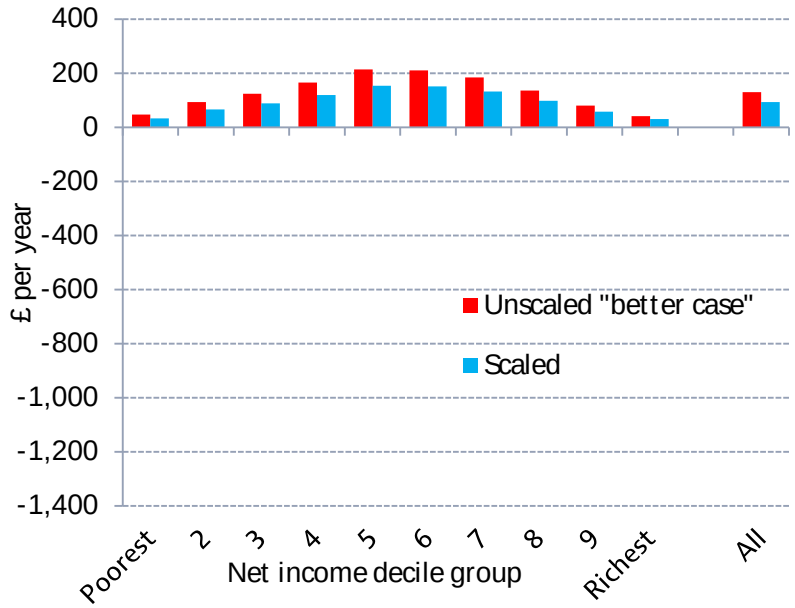

- This shows the average compensation of 27% and 19%, respectively
- Average losses from tax and benefit changes in deciles 2, 3 and 4 of the household income distribution are £1,340, £980 and £690
- Estimated gain in "better case" scenario of £90, £120 and £160
- "Better case" estimate of the compensation these groups are receiving is 7%, 13% and 24% respectively, on average.

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Impact of cuts and the new NLW for different groups

Table 2. Estimated impact of forthcoming tax and benefit changes and "better case" gains from the new NLW, by household working status and whether or not the household contains children

	Number of HHs (million)	Av. annual impact of tax & benefit changes (£ per year)	Av. "better case" annual gain from the new NLW (£ per year)	Av. "better case" net change (£ per year)
All households	27.1	–£478	£129	–£348
All working age HH eligible for benefits/tax credits				
Of which:				
with someone in paid work				
w/o someone in paid work				
All working age HH eligible for benefits/tax credits with children				
Of which:				
with someone in paid work				
w/o someone in paid work				
All working age HH eligible for benefits/tax credits w/o children				
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Of which:				
with someone in paid work	8.4	–£754	£198	–£556
w/o someone in paid work	2.9	–£2,069	£0	–£2,069
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All working age HH eligible for benefits/tax credits with children	7.0	–£1,272	£144	–£1,127
Of which:				
with someone in paid work	5.9	–£909	£172	–£737
w/o someone in paid work	1.1	–£3,159	£0	–£3,159
All working age HH eligible for benefits/tax credits w/o children	4.3	–£796	£153	–£643
Of which:				
with someone in paid work	2.6	–£400	£257	–£142
w/o someone in paid work	1.8	–£1,374	£0	–£1,374

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Impact of NLW on work incentives

Average replacement rates, workers only

	Pre-reform	Post reform:				Number in group (million)
		Without UC or NLW	With UC, without NLW	Without UC, with NLW	With UC and NLW	
Don't benefit from NLW						22.6
Benefit from NLW						4.3
All workers	52.6%	51.2%	50.6%	50.9%	50.3%	26.9

Impact of NLW on work incentives

Average replacement rates, workers only

	Pre-reform	Post reform:				Number in group (million)
		Without UC or NLW	With UC, without NLW	Without UC, with NLW	With UC and NLW	
Don't benefit from NLW	50.1%	48.7%	48.1%	48.7%	48.1%	22.6
Benefit from NLW	65.8%	64.7%	64.0%	62.9%	62.2%	4.3
All workers	52.6%	51.2%	50.6%	50.9%	50.3%	26.9

Impact of NLW on incentive to work an extra hour

Gain to workers from working an additional hour

	Pre-reform	Post reform:				Number in group (million)
		Without UC or NLW	With UC, without NLW	Without UC, with NLW	With UC and NLW	
Don't benefit from NLW						22.6
Benefit from NLW						4.3
All workers	£9.28	£9.51	£9.50	£9.59	£9.58	26.9

Impact of NLW on incentive to work an extra hour

Gain to workers from working an additional hour

	Pre-reform	Post reform:				Number in group (million)
		Without UC or NLW	With UC, without NLW	Without UC, with NLW	With UC and NLW	
Don't benefit from NLW	£10.39	£10.62	£10.60	£10.62	£10.60	22.6
Benefit from NLW	£4.22	£4.45	£4.49	£4.86	£4.89	4.3
All workers	£9.28	£9.51	£9.50	£9.59	£9.58	26.9

Gain from working an additional hour

Among those in Wales who benefit from the NLW

	Pre-reform level	Post-reform level:				Number (000s)
		Without UC or NLW	With UC, without NLW	Without UC, with NLW	With UC and NLW	
Single, no children	£4.27	£4.59	£4.61	£5.08	£5.06	994
Lone parent	£2.09	£1.63	£2.33	£1.73	£2.54	342
Partner not working, no children	£3.86	£4.20	£4.37	£4.68	£4.84	256
Partner not working, children	£2.06	£1.95	£2.02	£2.14	£2.22	314
Partner working, no children	£5.29	£5.42	£5.42	£5.84	£5.86	1,225
Partner working, children	£4.35	£4.88	£4.74	£5.33	£5.17	1,146
All	£4.22	£4.45	£4.49	£4.86	£4.89	4,277

Conclusion

- New NLW will only offer very partial compensation to the lower income groups hit hardest by cuts in benefits and tax credits
  1. Cuts are substantially larger than gains from the new NLW
  2. Part of the increase in gross wages accrue to the Treasury
  3. Many of those who will lose from the benefit and tax credit changes will not benefit from the new NLW

- Strengthens work incentives for those who potentially benefit, but effect smallest for those with weakest incentives to start with

- This does not mean that the new NLW is a bad idea
  - It will provide *some* compensation to *some* of those hit by the cuts
  - And it will strengthen work incentives, thus potentially increasing labour supply (but also likely to reduce labour demand)
  - If some individuals are paid less than their productivity warrants, then the NLW may help address this