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LONDON RISING: THE CASE FOR A LONDON MINIMUM WAGE

Kitty Ussher

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FOREWORD

The common perception is that work is a route out of poverty. And for the vast majority it is. However, in-work poverty has been increasing rapidly, particularly during the economic downturn, as wages have failed to keep pace with rising costs. In the capital over one million low-income families include at least one adult who is working, an increase of 60% over the last decade.

This is one of London's most significant challenges. We believe it can be addressed in a number of ways. Wherever they can, employers should pay a living wage and we strongly support efforts by the Mayor, London Citizens and others who promote it. However, the evidence suggests that while many London employers who don't pay the living wage could, not all employers can afford it. We therefore need to look at additional means by which we can tackle low pay. This includes ensuring that the statutory minimum wage is doing everything possible to help low-paid Londoners.

Fifteen years ago Parliament passed the National Minimum Wage Act, creating a safety net for low-paid workers. Unfortunately, in London that safety net is touching the floor and fails to offer the same protection to those in low pay as it does in the rest of the country. The evidence set out in London Rising, the first of two reports which address the issue of low pay, suggests that London employers could afford to pay a higher minimum wage than they currently do, without causing additional unemployment. In short, London needs to follow the example of those US cities, like San Francisco, that have established a city-wide statutory minimum wage.

If introduced today, a London minimum wage would mean an increase in employment income of £800 a year and could in time be up to £2,300 a year. For those at the margins this makes a significant difference. It is still less than is needed to live in this expensive city of ours, but it is an important step in the right direction. This research provides compelling evidence for the

need for change in order to ensure that the national minimum wage works as well in London as it does beyond it.

Bharat Mehta
Chief Executive
Trust for London

Ben Rogers
Director
Centre for London

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Our thanks to the project advisory group which met on 24 June and 19 September 2013.

Matthew Bolton, *Citizens UK*
Andrew Collinge, *Greater London Authority*
John Dickie, *London First*
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John Philpott, *Consultant*
James Plunkett, *Resolution Foundation*
Kieran Read, *Newham Council*
Nicola Smith, *TUC*
Jane Wills, *Queen Mary University of London*

In addition, we asked a number of organisations and individuals who routinely respond to the Low Pay Commission's request for evidence if they wished to input to our research. Some responded on a background basis; we also received submissions from the Association of Convenience Stores and the National Hairdressers Federation.

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Particular thanks to Ben Rogers and Abigail Malortie at Centre for London, Mubin Haq at Trust for London and my colleague Andy Hull for their support, constructive comments and teamwork on this project from its inception.

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Thanks also go to the project's advisory board whose guidance and insights have been very valuable in steering the overall direction. Particular thanks are due to those experts – mainly in policy and academia – who gave of their time freely and informally to ensure that this project was of a much higher quality than it otherwise would have been. All errors, misjudgements and omissions are of course the author's own.

BIOGRAPHY

Kitty Ussher is an economist and former Treasury minister. She was the MP for Burnley from 2005–10, and served as Economic Secretary to the Treasury in 2007–08 (from Northern Rock to Lehmans) and a welfare reform minister at DWP from 2008–09.

Since stepping down in 2010 she has built a portfolio of economic analysis work in the private and think tank sector which includes Chief Economic Advisor at Portland and a member of TheCityUK's Independent Economists Panel.

TOP LINE

The London economy could support an adult minimum wage today of around £6.75 per hour, seven per cent higher than the national minimum wage rate of £6.31 per hour, without threatening jobs and competitiveness.

Over time we calculate this differential could rise to around 20%, equivalent to a London minimum wage rate of £7.57 today.

These estimates are independent of the Low Pay Commission, but are based on calculations that shadow its methodology: they are the London rates that are economically equivalent to the national minimum wage rate after taking account of the different nature of London economy, in particular the low-pay economy.

Introducing a higher London minimum wage does not imply that the national minimum wage for other parts of the country would need to fall. The data shows that the national minimum wage is already being set with little reference to London. This means that where low-paid workers in the rest of the country have benefitted from its introduction, those in London have not. Quite simply there is room for London to catch up.

We therefore recommend that the 1998 Minimum Wage Act be amended to give the Low Pay Commission responsibility for additionally recommending a rate for a London minimum wage, with democratic accountability resting with the Mayor of London.

These conclusions are without prejudice to the Living Wage Campaign, which is based on the cost of living, rather than considerations of what the economy can support without job loss.

EXECUTIVE SUMMARY

There is no legislative basis for the introduction of a statutory minimum wage for London, yet the very different nature of the London economy – combined with the fact that even the low paid in London are already paid more than elsewhere – prompts the question as to whether the London economy could sustain a higher minimum wage without damaging competitiveness and jobs (chapters 1 and 2).

Based on the data available to the Low Pay Commission at the time, we estimate that had they been asked to recommend a starting rate for an adult minimum wage for London at the same time as the national minimum wage (NMW) was introduced, they would have set the London rate approximately 20% higher than the national rate.

That is, whereas the Low Pay Commission used 1997 data to estimate a reference rate for a national minimum wage in that year of £3.50, which led them to recommend a starting rate of £3.60 in April 1999, the corresponding 1997 figure for London is around £4.20 (chapter 3).

If this London minimum wage had been introduced at the same time as the national minimum wage then it is reasonable to presume that it would have been uprated by at least as much as the NMW, since the London economy has exhibited similar, or if anything more buoyant, trends to the national economy in the intervening years.

This would have meant that by 1 October 2013, the London minimum wage would have reached a level of around £7.57, maintaining the differential of a fifth higher than the current national minimum wage rate of £6.31. However, if in the intervening years evidence had shown that the London economy was responding in a different way to the average, then this figure might not be appropriate (chapter 4).

When considering the question of what rate the Low Pay Commission might recommend for a London minimum wage if it were to be introduced now, we

estimate a lower rate of around £6.75 from 1 October 2013, a mere seven per cent higher than the equivalent national rate. This rate of £6.75 has a similar bite on the low-paying sectors in London as the UK national minimum wage currently has on the low-paying sectors across the UK. It also affects a similar proportion of people in London to that which the national minimum wage does in the UK.

One explanation for the difference between the two figures is that the economy outside London has adjusted since the introduction of a minimum wage in 1999 such that it can now support a higher level, whereas London has hardly been affected because the different nature of its economy meant that wage levels were higher in the first place. Therefore it may be the case that low pay levels in London can rise further through the introduction of a higher wage floor without damaging jobs (chapter 5).

Having a different minimum wage in Greater London from the rest of the country is unlikely to cause unwelcome consequences at the boundaries. Indeed many firms already operate a London weighting, and, mirroring the experience of the US, there is no evidence of any adverse effect at the boundaries where cities have different wage rates (chapter 6).

If introduced now, a London minimum wage rate of £6.75 in 2013–14 would increase the income from employment for around 175,000 London workers by up to £800 a year. The Exchequer would benefit from increased payroll taxes and reductions in in-work benefit payments to the tune of around £61m.

Over time, and once the response function of the London economy is better understood, it would be desirable to explore whether the London economy could actually support a differential of 20% over the national minimum wage as our original estimates suggested. If this is possible, then around 315,000 London workers would see their wages rise by up to £2,300 a year in today's prices, with corresponding gains to the Exchequer through increased payroll taxes and reduced in-work benefit payments of around £280m.

As a result, we recommend that the National Minimum Wage Act 1998 be amended to require the Low Pay Commission to make recommendations for a London minimum wage. It would be appropriate if this recommendation were made to the Mayor of London for democratic approval, rather than to the national Secretary of State, although we also recommend that the Mayor of London be required to muster a two-thirds majority in the London Assembly if he wishes to reject the Low Pay Commission's recommendation (chapter 7).

Overall, the adoption of our recommendations would increase the income from employment of low paid workers in London without any adverse effects on the wider economy, including around competitiveness.

1 WHY ASK THE QUESTION?

The aim of this report is to propose a rate for an adult minimum wage for London. That is to say, we seek to find the level of a legal floor for hourly pay rates for employees aged 21 and over who work within the 32 boroughs and the City of London, that together make up Greater London.

Several things immediately need to be noted. First: since 1999, the UK has had a national minimum wage, set by government following a recommendation from the independent Low Pay Commission. The legislation that governs the remit of the Low Pay Commission does not permit it to consider what an equivalent rate might be for a smaller geographical area than the UK as a whole. We seek to fill that gap for London. Throughout, our consideration of what the Low Pay Commission might have done had it been asked to make a recommendation for the level of a London minimum wage is entirely hypothetical: there is no connection between our work and theirs. Our estimates of what they might have concluded are nothing more than the author's best guesses based on the available information.

Second, this piece of research only considers the issue of a legal minimum wage, and so is both without prejudice to – and moreover complementary to – the important analysis and campaign that exists around a London living wage. We are very supportive of the London Living Wage campaign and applaud those employers who have chosen to adopt it.

But there is an important difference between the living wage and the minimum wage as it exists in Britain. The former is calculated with reference to the costs of living, the latter is calculated with reference to the effect on the wider economy and, in practice, with particular focus on employment. Whilst the evidence of how employers respond to an increase is rich and not entirely conclusive, there would seem to be dangers in setting a compulsory wage floor that has not been designed to take account of the employer response (see for example Riley, 2013). Another important

difference is that the Living Wage Campaign is voluntary, whereas the minimum wage is statutory.

Next, our estimates of a minimum wage for London take the definition of what a minimum wage should be from the 1998 Minimum Wage Act, which established the Low Pay Commission and tasked it with recommending a minimum wage whilst having regard to its effect "on the economy of the United Kingdom as a whole and on competitiveness". The question we seek to answer is simply 'If the Low Pay Commission were asked to recommend a rate for a minimum wage for London, with regard to the effect on the London economy, what do we think it would recommend?'

In reality London is not the only part of the UK economy that exists, but the final point to be made at the outset is that it does not necessarily follow that, were London considered separately, there would necessarily be repercussions for the rest of the country. This is because the effect of the minimum wage in London has not in practice been "traded off" against the effect in other parts of the country: rather the LPC has sought to avoid any increases in unemployment as a result of the implementation of the minimum wage. It is perfectly possible in theory, therefore, that the current minimum wage could have been set at the right level for the rest of the country and just be of less relevance to London.

In fact, as is shown in chapter two, it looks likely that the London labour market is different to that of the rest of the UK, to the extent that the national minimum wage simply does not apply in London. In effect the national minimum wage already operates as a 'minimum wage for everywhere outside London'; it hardly bites in London and so would not change if the London rate were different. This immediately prompts the question as to what the equivalent rate for London should be.

Finally, we do not in this analysis consider the issues of a youth or apprentice rate, nor the value of a daily accommodation offset. Our aim is simply to explore the broader principle of whether there is a case for the London minimum wage being different from the national

rate, and to estimate what the adult rate could be. There is some discussion in chapter seven as to the issues surrounding the youth, apprentice and housing rates.

1.1 The London economy

The London economy is simply different from that of the rest of the UK.

Analysis by the Office of National Statistics (ONS, 2012) that looks at the industrial structure by region based on the standard classification of the industry where employees work, shows that London is the most dissimilar economy to that of Great Britain overall, as shown in Table 1, below.

This analysis uses a construct known as the Krugman Index which compares the industrial structure of each region/nation to the reference value of Great Britain as a whole. An index value of zero means that the place in question has an identical proportion of

Table 1: Regions/Countries with similar or dissimilar industrial structures to Great Britain, 2011. Source: ONS / Note: The higher the Krugman Index the more dissimilar is the industrial structure to that of Great Britain overall. The index has been calculated using a 3 digit SIC code industry split.

Region/Country	Krugman Index
London	0.42
North East	0.31
Wales	0.31
Scotland	0.29
East Midlands	0.26
East	0.23
Yorkshire and The Humber	0.21
West Midlands	0.21
South East	0.21
South West	0.20
North West	0.16

employees working in each industry sector to Britain as a whole. A value of two means that the industries in which employees work in the place under question are entirely different from Great Britain as a whole.

Further analysis shows that London is not only the most dissimilar part of the country when compared to the average, but it is also consistently different to every other region and nation. That is to say, for every part of the country outside London, London is the part of the country that is the most dissimilar to it. Table 2, below, again uses a Krugman index but this time compares regions and nations to each other rather than to a reference value of Britain as a whole. Again, a lower value denotes that two parts of the country are more similar to each other in terms of the industries where employees work.

The values of the Krugman Index for comparisons to London range from 0.43 with the South East (most similar to London) to 0.65 to Wales (least similar to London). By contrast, all other regions and nations

Table 2: Industrial structures of Great Britain regions/nations compared
Source: Office of National Statistics

	North East	North West	Y&H	East Mid-lands	West Mid-lands	East of England	London	South East	South West	Wales	Scot-land
North East		0.31	0.33	0.39	0.35	0.40	0.61	0.41	0.34	0.28	0.35
North West	0.31		0.24	0.28	0.26	0.29	0.50	0.31	0.25	0.30	0.31
Y&H	0.33	0.24		0.26	0.25	0.31	0.55	0.34	0.28	0.29	0.35
East Midlands	0.39	0.28	0.26		0.27	0.28	0.61	0.33	0.32	0.35	0.41
West Midlands	0.35	0.26	0.25	0.27		0.27	0.56	0.32	0.30	0.34	0.38
East of England	0.40	0.29	0.31	0.28	0.27		0.52	0.25	0.29	0.38	0.41
London	0.61	0.50	0.55	0.61	0.56	0.52		0.43	0.53	0.65	0.57
South East	0.41	0.31	0.34	0.33	0.32	0.25	0.43		0.29	0.40	0.41
South West	0.34	0.25	0.28	0.32	0.30	0.29	0.53	0.29		0.30	0.34
Wales	0.28	0.30	0.29	0.35	0.34	0.38	0.65	0.40	0.30		0.30
Scotland	0.35	0.31	0.35	0.41	0.38	0.41	0.57	0.41	0.34	0.30	

are relatively similar to each other. Indeed, the two most dissimilar regions outside of London are the North East and the South East of England with a Krugman index of 0.41. However, this still makes these two regions more similar to each other in terms of industrial structure than London is to any other region/nation of Great Britain. As the ONS puts it "London is the most dissimilar region to every other region and country in the list."

The reason for this is that London stands out over other regions and nations as having a very high proportion of jobs in the sectors of financial services, information and communication, real estate, professional, scientific and technical jobs as well as in the creative industries. London has the lowest proportion of jobs in manufacturing, agriculture and construction. Employment sectors which are reasonably evenly spread across other regions, such as retail, public services and utilities are under-represented in London as a proportion of total jobs (ONS, 2012 (2)).

Given that the productivity levels of the sectors that are over-represented in London are amongst the highest, it is perhaps unsurprising that pay in London is also higher than elsewhere in the country. In April 2012, the latest available data, the median average weekly wage in London for full-time employees was £653, nearly 30% higher than the national median, and head-and-shoulders above the next highest, the South East, at £537 (ONS, 2012 (3)). Whilst the Low Pay Commission has no statutory remit to propose a minimum wage for London, its analysis consistently shows London as an outlier in the extent that the national minimum wage impacts workers (Low Pay Commission, 1998; Dolton et al., 1999).

It is these two facts, the difference in industry structure and the (corresponding) difference in average pay rates, that give an *a priori* case for investigating whether the minimum wage rate that has been set for the country as a whole is the most appropriate for London. Could it be that industries that operate in London can afford to pay a higher minimum wage without jeopardising jobs and competitiveness?

If so, there are other public policy reasons to grasp this issue. London is an expensive place to live. This is why higher up the income scale many professions and corporate employers have long paid a London weighting to their staff working in the capital. It has low scores on wellbeing measures such as commuting times, pollution and the availability of high quality housing at an affordable price (Hawksworth et al., 2011). Child poverty amongst families where parents are in work is high: over 1.1 million people in London now live in low-income families where at least one adult is working, a two-thirds increase over the last decade (London's Poverty Profile, 2013).

These reasons alone are enough to make it worth exploring if more can be done to raise levels of income from work in London. The evidence in this chapter that the London economy is also structured differently from that of the rest of the country creates a double incentive to ask whether the national minimum wage is the right wage floor for Londoners.

1.2 **Report structure**

To answer the question, 'Could London bear a higher minimum wage?', we pursue a number of approaches simultaneously. To set the scene, the next chapter starts by asking the preliminary question of whether we would expect a minimum wage for London to come out higher or lower than a minimum wage for the UK as a whole. This introduces a more detailed description of the structure of low pay in London and how that differs from the national average, as well as a brief introduction of the extent to which the London macro economy has differed from the UK as a whole since 1997.

We then start hypothesising, 'What would the Low Pay Commission have decided to do if it were only considering London?'. We look at the factors that lay behind the LPC's consideration of what the initial rate should be (chapter three), and then explore how its views might have changed over time with reference to London, given what we know from its published reports

about its views on the economy as a whole (chapter four). This way of proceeding can at best be described as discursive and suffers from the weakness that any errors early in the process become compounded as time goes on. However, it has some merit given that our aim is to second-guess what the LPC would have done if it were only to have considered London, as we simply attempt to shadow its decisions.

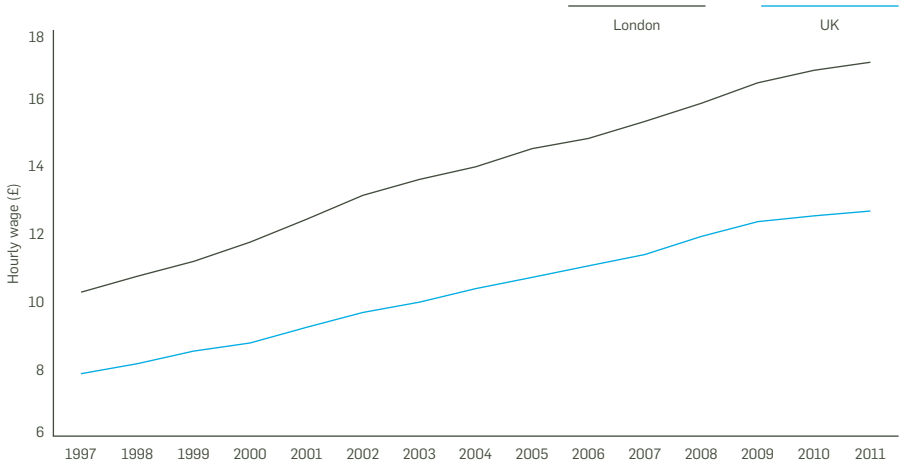
Chapter five then puts the past to one side and looks at how the Low Pay Commission might be expected to set a minimum wage for London if only the most recent data were considered, knowing what we know about the way the Low Pay Commission makes its decisions. This gives a different estimate to that arrived at in chapters three and four, and we explore the reasons for this. Before concluding, chapter six briefly considers the issue of effects at the London border from introducing a city-wide minimum wage. Finally, chapter seven draws the analysis together and makes our final recommendations on establishing a minimum wage for London.

2 HIGHER OR LOWER?

In the previous chapter we established a case for asking the question as to what the rate of a minimum wage for London might be, by showing that the London economy is not only substantially different from the rest of the UK but also that each individual nation and region of the UK is less similar to London than any other part of the country.

This chapter begins to explore what the level of a minimum wage for London might be by simply asking whether we might expect it to be higher or lower than the rate set for the country as whole. We look first at arguments for a higher rate, such as the greater level of prosperity in the capital, and then arguments for a lower rate, such as the higher levels of unemployment and pockets of persistent poverty. Our conclusion is that we would expect the rate of any minimum wage for London to be higher than the national rate but not by nearly as much as would be presumed by looking at differences in the relative overall prosperity of London compared to other parts of the UK alone.

Figure 1: Median gross hourly rates of pay, London and the UK
Source: ASHE. Minor revisions to methodology in 2004 and 2006



2.1 Arguments in favour of a higher minimum wage rate for London

As we have seen, pay in London is higher on average than across the rest of the economy. Figure 1, above, shows how the median gross hourly wage has altered since 1997 for London and the UK as a whole.

If anything, the gap has widened since the introduction of a minimum wage. Figure 2, below, shows that London median pay has grown at a faster rate than for the UK as a whole in ten of the last fourteen years.

A similar picture emerges when constant price data is used. Figure 3 shows the real percentage annual change in median hourly earnings in 2002 prices. Again the London picture is broadly stronger, both before and after the onset of the financial crisis. Since 2009 real wages have fallen across the country, but less fast in London: in the three years from 2009 to 2012, real median hourly wages for the UK as a whole have fallen by 8.49%; in London the equivalent figure is 8.03%.

The reason London can support higher average wages is that for each hour someone works, more value is created in London than elsewhere in the country. Or, in other words, as Figure 4, overleaf, shows, productivity – defined as gross value added (GVA) per hour worked – is higher in London than in any other region.

This is consistent with the findings from the comparison of the Krugman index values for each region in chapter one: London has a higher concentration of firms in high-productivity sectors. Quite simply, at a regional level people are paid more in London because the economic value of their work is higher.

A top level look at the London economy would seem, therefore, to support a thesis that a minimum wage set for London alone would be higher than for the UK as a whole; the market rate is currently higher than for the UK as a whole because it is a more prosperous place. Firms can afford to pay more in absolute terms and still remain in business because their activities are generating more value. The role of the minimum wage is to ensure that pay is as high as it can be without jeopardising jobs; this will be higher in a higher value economy than it will be in a lower value economy.

Figure 2: Percentage change in median gross hourly rates of pay, London and the UK
Source: ONS, Annual Survey of Hours and Earnings, 2012. There were changes in the underlying methodology in 2004 and 2006.

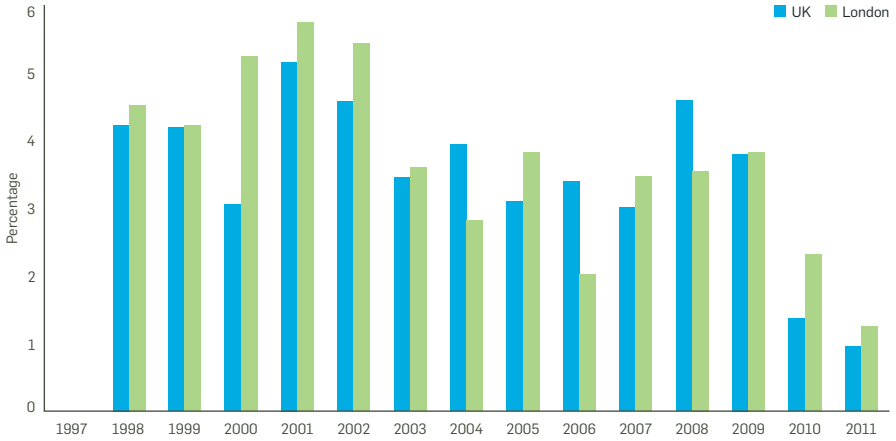


Figure 3: Real % change in median gross hourly rates of pay, London and UK
Source: ONS 2013, Changes in real earnings in the UK and London 2002 to 2012

2.2 **Arguments against a higher minimum wage in London**

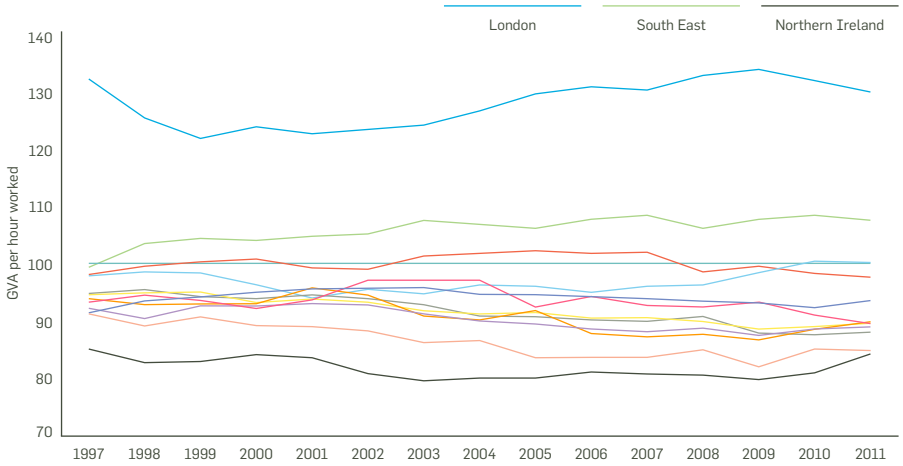
What this analysis ignores, however, is what is going on at the bottom end of the market. London may be the most prosperous part of the country when taken in the round but it also has the highest rate of unemployment of any region: Figure 5, overleaf, shows that the rate of unemployment has been consistently higher in London than for the economy as a whole, although the gap between the two rates is narrower now than it was a decade ago.

It could be argued therefore that in fact a lower wage rate is required in London in order to "clear" the labour market: if the wages were lower, then employers would take more people on. In order to establish whether this is the case, we need to take a closer look at the bottom end of the London labour market.

2.3 **Low pay London**

Given that our remit is to find the level of a minimum wage that does not raise unemployment, we need to understand how the pay of the lowest paid in London compares to the national picture.

Figure 4: GVA per hour worked by UK region/nation (UK=100)
Source: ONS



The Annual Survey of Hours and Earnings (ASHE) produced by the Office of National Statistics provides a breakdown of gross hourly pay rates on a geographic basis. A cursory look at the latest data available – for 2012 – shows that hourly pay in London is consistently higher than the national average for all deciles, but that the gap is narrower at the lower end.

So whereas for example, median hourly pay across all employee jobs was around 40% higher in London than across the UK as a whole in 2012, for the lowest paid decile of employees, the difference was substantially less, at around a 13% premium in London. Only at the 40th–80th decile does the margin of around 40% exist, before widening further for the top ten per cent of employees. This does support a conclusion that the lower end of the labour market in London is more similar to the average position across the country as a whole than the median rate. However, pay rates are still higher than the national average at the bottom end of the market, albeit by a smaller margin.

The same data source gives low pay broken down further by local authority area. The differential between London hourly pay and national hourly pay broadly persists across all local authorities. Exceptions are in Haringey, Newham and Waltham Forest, where the pay of the lowest ten per cent is a little under the national average of £6.46 at the tenth decile – at £6.35, £6.32 and £6.39 respectively – however in Haringey and Newham,

Table 3: Hourly pay in London and the UK, median and percentiles, 2012
Source: ASHE

	Number of jobs ('000s)	Median pay/hour (£)	Percentiles									
			10	20	25	30	40	60	70	75	80	90
UK	24,588	11.26	6.46	7.41	7.95	8.50	9.76	13.29	15.78	17.40	19.17	24.98
London	3,532	15.74	7.29	9.20	10.22	11.32	13.45	18.40	21.67	23.70	26.16	36.27
% London higher		*39.8*	*12.8*	*24.2*	*28.6*	*33.2*	*37.8*	*38.4*	*37.3*	*36.2*	*36.5*	*45.2*

the differential is reasserted from the 20th percentile. Only in Waltham Forest, where one per cent of London jobs are located, does lower pay than the national average persist, in this case up to the 40th percentile.

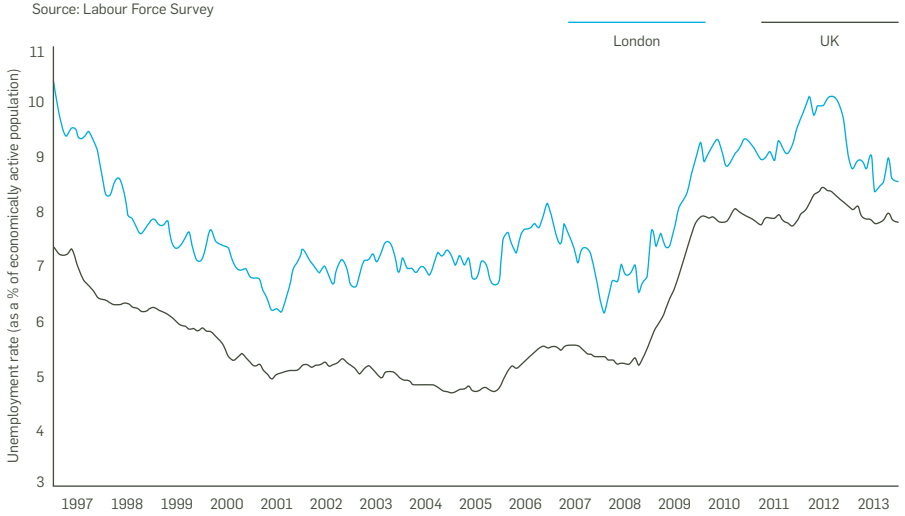
The ASHE data also permits an investigation of the lowest paid parts of London by occupation, and a comparison to the national average.

Taking the same definition of 'low-pay' as the OECD, namely pay levels below two thirds of the median, we compared the main occupations that paid less than this level for London and/or for the UK as a whole. Table 4 shows selected indicative results of the gross median hourly pay by occupation for London and the UK respectively.

Note that the italicised rows are sub-components of the corresponding 1-digit SOC (Standard Occupational Classification) code category; in both cases the tables pick out the largest of these for illustrative purposes.

What is noticeable from this comparison is that people working in the same occupations are paid more

Figure 5: Rate of unemployment, UK and London
Source: Labour Force Survey



in London across all the main categories of lowest paid work.

Even in the lowest paid category of "elementary occupations", employing three million people nationally and 300,000 in London, median pay in London, at £7.50 per hour, is nearly seven per cent higher than the national average of £7.02. Within this, the lowest paid categories nationally, waiters and waitresses and bar staff are still paid 6.6% and 4% more respectively in London than the national average. Cleaners and domestics are paid 3% more in London; care workers 4% more.[1]

What this implies is that unemployment is not in fact higher in London because the wages are too high. If that were the case then we would expect pay in London, as elsewhere, to be fixed at the national minimum wage rate, particularly for the lowest-skilled occupations such as bar staff and waiting staff. At present, there is nothing

1. A more detailed comparison of pay rates between London and the UK is included in chapter 6.

Table 4: Gross median hourly pay by indicative low-paid occupation, London and UK, 2012
Source: ASHE / Note: Two-thirds of the UK median is £7.50; Two-thirds of the London median is £10.74

Description	SOC Code	UK		London		% London higher
		000s	£ pay	000s	£ pay	
Caring, leisure and other service occupations	**6**	**2,327**	**8.30**	**234**	**9.74**	**17.3**
Teaching assistants	6125	328	8.37	37	9.44	12.8
Nursery nurses and assistants	6121	153	7.01	17	8.14	16.1
Care workers and home carers	6145	671	7.89	49	8.21	4.1
Hairdressers and related services	622	75	6.83	7	7.36	7.8
Sales and customer services occupations	**7**	**2,084**	**7.16**	**231**	**7.74**	**8.1**
Sales and retail assistants	7111	1152	6.69	141	7.47	11.7
Customer services occupations	721	437	8.54	41	9.88	15.7
Elementary occupations	**9**	**2,971**	**7.02**	**300**	**7.50**	**6.8**
Waiters and waitresses	9273	165	6.10	23	6.50	6.6
Bar staff	9274	176	6.09	17	6.31	3.6
Kitchen and catering assistants	9272	460	6.25	50	6.57	5.1
Security guards and related occupations	9241	135	8.42	43	8.67	3.0
Cleaners and domestics	9233	645	6.54	66	6.74	3.1

stopping London wages from falling further to 'clear' the market; they are not constrained by the minimum wage from doing so.

Although beyond the scope of this report, this implies the high level of unemployment is instead due to other factors separate from the existence of a national minimum wage. These might include supply-side structural factors such as a mismatch between skills and vacancies, impediments to work such as high costs of childcare, and poverty traps from the high cost of housing for those who move off benefits. That the level of economic inactivity – that is, the proportion of people of working age who are not seeking work – is also high in London indicates that there is a 'stickiness' to being out of work in the capital. This is far from being an argument that the minimum wage is too high; instead it could be argued that low-paid work in London does not pay sufficiently well to provide an incentive to seek it.

2.4 **Conclusion to this chapter**

In chapter one we established the case for looking at the London economy separately from the rest of the UK when it comes to setting a minimum wage. In this chapter we considered whether we would expect a minimum wage for London to be higher or lower than the national level of a minimum wage. Broadly speaking we would expect it to be higher, for the simple reason that the lowest paid in London are already paid more than the lowest paid in the UK. This suggests that London is currently not constrained by the minimum wage and in particular, that unemployment is not higher in London because of a minimum wage that is set too high.

The key question that we now seek to answer is what level that minimum wage for London could be set at, or more precisely how much further can the wages of the lowest paid be raised before there starts to be a negative employment effect? To what extent, if at all, are employers of the lowest paid exploiting staff in economic terms by paying them less than the true value of their work? In the terms of Table 3 above, why is the pay of

the lowest paid ten per cent of workers in London only 13% higher than the pay of the lowest paid ten per cent of workers nationally, and how much can that be raised before people start to lose their jobs?

In order to answer that question, we mimicked the methodology of the Low Pay Commission as much as possible. In chapter three we start by considering what the LPC theoretically might have set as an initial rate had it been asked to look at a rate for London. In chapter four we then look at how that might have altered over time, in order to give the corresponding weight for 2013. Chapter five then takes a snapshot view in order to consider the rate at which a London minimum wage could be set if it were introduced now.

3 FINDING THE INITIAL RATE

The Low Pay Commission was established in a highly politicised environment following the 1997 general election. The introduction of a national minimum wage had been a cornerstone policy of the Labour party, designed to:

> *remove the worst excesses of low pay (and be of particular benefit to women) while cutting some of the massive £4 billion benefits bill by which the taxpayer subsidises companies that pay very low wages.* (Labour Party, 1997)

It was equally strongly opposed by the Conservatives who argued it would destroy jobs and competitiveness. The Liberal Democrat Party, meanwhile, proposed regional minimum wage rates in their 1997 manifesto. The consensus business view in the run-up to the 1997 election was that a minimum wage would damage employment, possibly to the tune of hundreds of thousands of jobs, epitomised by *The Economist*'s article of 3 April 1997, headlined "Labour's wage policy: minimum sense", which explained how having a minimum wage would "fly in the face of economic logic".

Fifteen years later, *The Economist* changed its tune, remarking in an article on 24 November 2012 that "the consensus is that Britain's minimum wage has done little or no harm" (*The Economist*, 2012). In a Resolution Foundation seminar to mark the 15th anniversary of the minimum wage, held on 20 June 2013, the first Chair of the Low Pay Commission, Sir George Bain, remarked that their greatest achievement, apart of course from having raised the pay of some of the lowest paid people, was their success in achieving consensus.

There are two main reasons for this success. The first is the way the Low Pay Commission used its power to commission research, combined with an admirable policy on making the results of such research publicly available, to become the depository of all expertise on matters relating to a UK minimum wage. It soon became impossible to claim to know more about the UK national

minimum wage than the Low Pay Commission did. Nobody could disagree with their decisions and maintain any kind of credibility.

The second reason is its caution, particularly in the first few years. Once the Low Pay Commission had been established in late 1997, attention switched towards anticipation of what the initial level might be. Expectations were in the realm of between £3.50 and £4.00, with some in the Trade Union movement advocating higher. The decision to adopt a reference rate of £3.50 in 1997, uprated in a conservative fashion to give a below-expectations starting rate of £3.60 to be introduced in April 1999, was therefore seen as cautious and took most of the controversy out of the issue at an early stage.

There is no model or formula that is used to determine the rate of the national minimum wage, although a regular process has been established to consider the question. In the autumn of each year the Low Pay Commission invites representations on the level of the minimum wage that should be introduced from 1 October the next year. This information is combined with intelligence gathered during public hearings around the country, knowledge garnered to date on the impact and operation of the minimum wage since its inception, and any new academic research conducted since the previous year. The final decision as to the rate is made collectively by the Low Pay Commissioners in the form of a report containing a recommendation to government in February. The government then publishes this report alongside its response to the LPC's recommendations in the following weeks. Although the government is able to reject the LPC's proposals, in practice this is rare and has never happened in relation to the headline rate, although, for example, they did reject the proposed level of the apprentice rate in 2013.

In the early years, however, the timings were different. The first report was published in June 1998, shortly after the legislation establishing the Commission's mandate was passed, and made recommendations for the level of

the minimum wage that should be introduced from April 1999 and also the subsequent rate from June 2000.

This first report established what the Commissioners considered their mandate to be, namely that the minimum wage "should support a competitive economy, be set at a prudent level, be simple and straightforward, and make a difference to the low paid" and that it should offer "real benefits to the low paid, while avoiding unnecessary risks to businesses and to jobs."

For their first recommendations, the data they used predominantly related to Spring 1997. Their analysis concluded that:

> *a minimum rate of somewhat under £3.50 per hour at 1997 prices would achieve the twin objectives of being prudent while also making a difference to the lowest paid.*

This was then uprated in a consciously conservative fashion using inflation forecasts that were "based more on movements in the RPI and RPIX than in the Average Earnings Index" to arrive at a recommendation of £3.60 from April 1999 (an increase of 2.9% from £3.50) and £3.70 from June 2000 (an increase of 2.8% from £3.60). It is worth noting in this respect that the data that was used to establish the rate of the first minimum wage actually related to a period of time two years prior to the date on which the minimum wage came into force (Low Pay Commission, 1998).

In reaching a judgement about what the initial rate should be, the Commissioners took into account the impact in particular on the lowest paying sectors. They also explored in a discursive fashion, based on the evidence they had collated, ways in which businesses might be expected to respond to different introductory rates. Further, they looked at the coverage, namely the number of employees that they would expect to be affected at various different introductory rates, and the 'bite', namely the relationship between the rate of the minimum wage and the median rate of hourly pay.

In seeking to find the initial rate for London, our analysis seeks to replicate this approach. We look at the data for Spring 1997, which led the Commissioners to propose a rate of £3.50 for the UK as a whole, and calculate what the equivalent London figure might be, as well as looking at the effect on particular low paying sectors and the other issues that the LPC took into consideration. We then uprate this by the same percentage increase as the Commissioners used to arrive at the corresponding figures for April 1999 and June 2000.

However, this task is not as straightforward as it might initially appear, not only because the view of the Commissioners was in the end subjective, but also because some of the data on which they based their first decisions was known at the time to be inconclusive.

3.1 **The data issues**

At the time that the national minimum wage was introduced there were two main sources of information on the extent of low pay in Britain, both of which had significant limitations. The New Earnings Survey (NES) collected pay data via employers of individuals holding National Insurance numbers with specified digits. It therefore under-reported earnings that came in under the Pay-As-You-Earn threshold, particularly part-time work.

The Labour Force Survey (LFS) collated information on pay via interviews with individuals which also led to a number of difficulties, notably that people's perceptions of the number of hours they had worked were greater than the reality, and also that respondents answering on behalf of other family members tended to underestimate their earnings. Moreover the LFS data only related to an individual's main job, whereas the NES data looked at all jobs. These differences meant that the 1997 LFS estimate of the proportion of employees earning below £3.50 per hour was over twice the NES estimate.

In order to bridge the gap between the two, the ONS in 1997–8 developed a methodology that adjusted the estimates from both sources to take account of known biases and produced aggregate upper and lower estimates of the incidence of low pay; the LPC then used the central value between these two bounds to inform their work. However, although the headline UK-wide data from this amalgamated series was published in the 1998 report, there is no publicly available data by region so it is not possible to draw off equivalent figures for London. As a rough approximation, however, the LPC did occasionally take the average of the two published series "as a working guide" (Low Pay Commission, 1998).

However, we do have access to the Labour Force Survey data for 1997, which includes regional data, and enables inferences to be drawn of what an equivalent rate for London might have been given what we know about the national rate that was chosen.

We can also perform a similar exercise involving the separate ASHE database, which replaced the NES in 2004 with data extrapolated backwards to 1997, and is broken down by sector and region. Again, by understanding the relationship between the initial national minimum wage rate that was chosen using this data and the structure of pay rates particularly for the lowest paid across the UK at the time, we can infer what rate might have been chosen for London had the Commissioners considered the effect on that market. We can also separately look in detail at the effect of the national minimum wage level that was introduced on specific sectors and make corresponding calculations for London.

The first report of the Low Pay Commission also considered in a discursive fashion ways in which businesses might be expected to respond to the introduction of a national minimum wage. We briefly recap these and consider to what extent their views might have altered if the Commissioners were looking specifically at London.

Adopting these approaches gives four separate ways in which we can consider the initial rate that the Low Pay Commission would have set for London. We look at each of these in turn, in each case forming a view as to the range of values that it would give for a minimum

wage for London. Then in the conclusion to this chapter we bring these separate estimates together to make a judgement as to what an initial rate could have been.

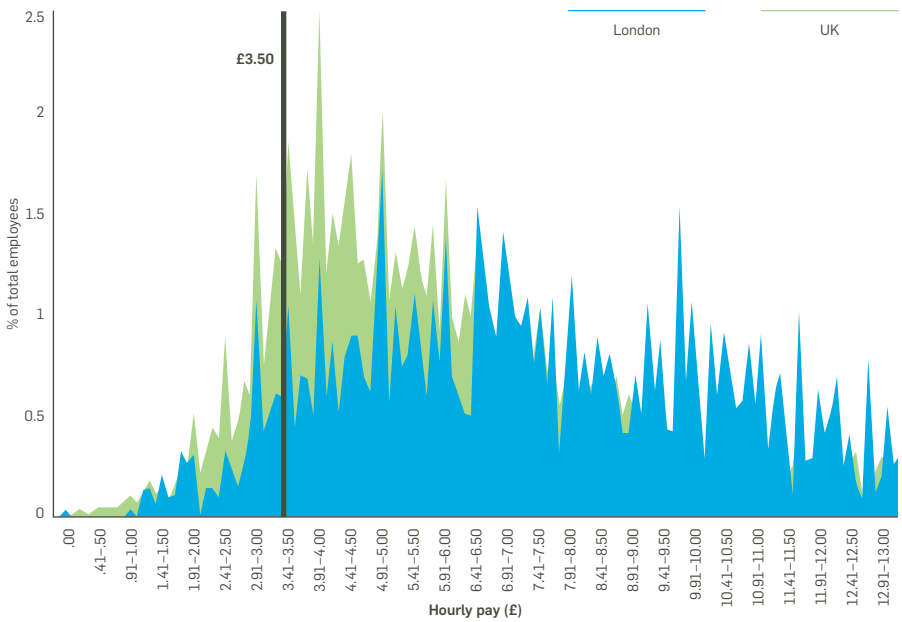
Method 1: Comparing LFS data

This first method compares the distribution of hourly pay rates across the UK with the distribution in London, using data from the Labour Force Survey for the second quarter of 1997.

Figure 6, below, shows in a stylised fashion the incidence of pay rates for London in 1997, superimposed over the incidence of pay rates for the UK, with the implied 1997 minimum wage rate of £3.50 represented by the vertical line.

It can be seen visually that if a minimum wage rate of £3.50 were in place in spring 1997 it would have

Figure 6: Frequency of hourly wage rates, UK and London, 1997
Source: Labour Force Survey



affected a lower proportion of employees in London than in the UK as a whole. In fact, as Table 5, below, shows, only 7.8% of employees in London were paid less than £3.50, compared to 14.7% nationally using the Labour Force Survey data series. If we wanted to cover the same proportion of people in London as would have been covered in the UK at a rate of £3.50, then a cautious estimate of the equivalent pay band for London would have been around £4.40: this is our first estimate of the equivalent rate for London of a £3.50 rate in 1997 for the UK as a whole. At the end of this section we compare this estimate with those obtained by other means.

Method 2: Comparing ASHE data

As mentioned above, in addition to data from the Labour Force Survey, the Low Pay Commissioners also had access to the New Earnings Survey. However, there were particular difficulties with the quality of this data which meant that the Low Pay Commission was not comfortable with relying on it. Low-paid employees who had not met the PAYE threshold may not have been captured by their employers' databases, and employees who had recently left their jobs recorded a nil return: there was no system in place to capture their earnings from their new employers until the next year. Since lower-paid casual staff were more likely to change employers this meant the data series underrepresented those at the bottom of the wage distribution.

Table 5: Incidence of pay by 10p band, UK and London, 1997
Source: LFS, Centre for London calculations

1997 pay band (£)	3.41-3.50	3.51-3.60	3.61-3.70	...	4.11-4.20	4.21-4.30	4.31-4.40	4.41-4.50
% of London covered	7.8	8.2	8.9	...	12.9	13.3	**14.1**	**15.0**
% of UK covered	**14.7**	16.2	17.2	...	25.5	26.9	28.4	30.2

Both of these weaknesses were corrected for in the new series that was introduced from 2004, the Annual Survey of Hours and Earnings (ASHE). The ONS then extrapolated their new, better, methodology backwards to create an ASHE series that ran back to 1997. However, the extrapolated series from 1997–2004 only adjusted for employees below the PAYE threshold, it did not go back and chase up those who had changed jobs in the year in question leading to nil returns. The ONS describes this methodology as "ASHE without supplementary information".

For our purposes, however, this extrapolated ASHE data for the period from 1997–2004 is nevertheless useful, because it is gathered by region and enables a direct comparison to be made between the national coverage of the minimum wage and its effect in London on introduction.

Table 6: Hourly pay and % of workers at or below the NMW by region, 1999
Source: LPC estimates based on ASHE without supplementary information, 1999, low-pay weights

	Average hourly pay	Median hourly pay	% of workers at and below NMW (all ages)	Level of NMW needed to get coverage of 3.4% per region (adult)
North East	8.01	6.55	5.8	3.60
North West	8.64	6.97	4.0	3.61
Yorks & Humber	8.36	6.74	4.0	3.60
East Midlands	8.17	6.64	4.1	3.60
West Midlands	8.6	6.99	4.0	3.60
South West	8.48	6.77	3.7	3.61
East	9.03	7.29	3.5	3.64
London	**12.64**	**9.87**	**1.4**	**4.16**
South East	9.79	7.72	2.5	3.76
Wales	8.16	6.67	4.7	3.60
Scotland	8.69	7.04	3.4	3.65
Northern Ireland	7.88	6.37	5.0	3.60
Total	**9.26**	**7.31**	**3.4**	**3.60**

During the course of our research the Low Pay Commission provided us with estimates of the coverage of the national minimum wage by region in April 1999, when the national minimum wage was first introduced, at a rate of £3.60. These estimates are shown in Table 6, above.

In the first year of its operation, according to this data source, the newly introduced national minimum wage was set at a rate that covered 3.4% of the population. The right hand column of the table shows the equivalent level of a minimum wage that would be needed if the same coverage – 3.4% – were to be obtained on a region-by-region basis. In London, the equivalent minimum wage to get 3.4% coverage in 1999 is £4.16. That is, if the Low Pay Commission had wanted to set a rate for London in 1999 that had the same coverage in London as the national minimum wage did for the country as a whole, then the relevant figure for London according to this data is £4.16.

However, this figure of £4.16 relates to April 1999, when the national minimum wage was £3.60, yet we are seeking the equivalent figure to the national reference rate for 1997 of £3.50. As was described at the beginning of this chapter, the Low Pay Commission obtained the £3.60 rate by uprating its estimate of an appropriate rate for 1997 by 2.9% which it justified by using inflation forecasts that were "based more on movements in the RPI and RPIX than in the Average Earnings Index". In order to obtain our estimate of what a London starting rate might have been using this method, we therefore deflate our 1999 figure by the same amount, which gives a rate of £4.04 for 1997. This is the second estimate of what a London starting rate might have been.

Method 3: Comparing low paid sectors using the ASHE database

The ASHE data series can also be used to hone in on the wage distribution in specific sectors. This can at best be indicative of the pressures on the Low Pay Commission as their remit does not permit them to make particular

recommendations by sector: in theory they are sector-blind, albeit having regard to the overall impact on competitiveness. In their initial report, however, the Low Pay Commission did publish information on the distribution of pay in a number of low paid sectors and considered the extent to which different sectors might be expected to respond in different ways to the introduction of a national minimum wage. They considered in particular agriculture, clothing and footwear manufacture, retail, hospitality, security, cleaning, social care, childcare and hairdressing.

In this section we use the publicly available ASHE data for 1997 that relates to each of these sectors and consider where the reference rate of £3.50 in 1997 comes in the distribution of pay for each of these sectors. We then look to see at what rate a London minimum wage would have had the same proportionate impact given what is known about how London pay was distributed at the time across different pay bands for the sectors in question.

Table 7: Distribution of low pay by selected sector, UK, 1997
Source: ASHE

Description (UK)	SOC Code	No of jobs ('000)	Percentiles				
			10	20	30	40	50
Textiles, garments and related trades	55	152	3.41	3.92	4.32	4.71	5.15
Catering occupations	62	436	3.01	3.19	3.31	3.45	3.70
Sales assistants and checkout operators	72	1,238	3.25	3.53	3.76	3.95	4.21
Security and protective service occupations (mainly security guards)	61	497	4.08	5.90	8.02	9.13	9.96
Childcare and related occupations	65	384	3.23	3.68	3.96	4.12	4.49
Other occupations in agriculture, forestry and fishing	90	96	3.50	4.08	4.46	4.69	4.97
Health and related occupations (mainly social care)	64	810	3.17	3.70	4.21	4.55	4.98
Hairdressers, beauticians and related occupations	66	50	2.76	3.08	3.35	3.63	3.95
Other occupations in sales and services (cleaning)	95	1,027	3.00	3.30	3.54	3.76	3.91

Table 7 shows the national rates of pay across the bottom 50% of the distribution for people employed in some of the lowest paid sectors in 1997. We use the two-digit SOC code for comparison purposes, as honing down in any further detail tends to encounter data issues that make comparisons hard. This means that the data, while encompassing the lowest paid, will also include some higher-paid employees such as line managers in each sector.

The percentile at which the reference minimum wage rate of £3.50 in 1997 had an impact is highlighted in each case. So, for example, a rate of £3.50 had an impact in the second decile for textile manufacturing, and at the median for catering occupations and so on.

The next table, Table 8, below, shows the corresponding wage rates for the same sectors in the London market. The agriculture subsection (SOC code 90) has not been displayed as the numbers are too small to be significant. This enables us to explore the level of a minimum wage in London that would have

Table 8: Distribution of low pay by selected sector, London, 1997
Source: ASHE

Description (London)	SOC Code	No of jobs ('000)	Percentiles				
			10	20	30	40	50
Textiles, garments and related trades	55	6	3.31	3.70	3.99	4.33	4.59
Catering occupations	62	54	3.17	3.37	3.76	4.13	4.61
Sales assistants and checkout operators	72	142	3.72	4.29	4.58	4.80	5.03
Security and protective service occupations (mainly security guards)	61	79	4.72	6.15	8.42	9.95	10.86
Childcare and related occupations	65	45	3.63	4.67	4.88	5.11	5.29
Health and related occupations (mainly care workers)	64	56	4.30	5.04	5.38	5.70	6.09
Hairdressers, beauticians and related occupations	66	8	X	3.27	3.71	4.26	4.71
Other occupations in sales and services (mainly cleaners)	95	117	3.19	3.69	4.07	4.45	4.68

had the same impact as a rate of up to £3.50 nationally in 1997.

So, for example, if a London minimum wage had been introduced at the same point in the pay distribution for people employed in catering occupations in 1997 in London as nationally, the corresponding rate to £3.50 would have been somewhere between £4.13 and £4.61. The corresponding figure for sales assistants and checkout operators would have been a little under £4.29, for security guards under £4.72, for people working in social care between £4.30 and £5.04 and so on. The full range of equivalent values is displayed in the second column of Table 9, below. In the third column we present a rough indicative estimate of an equivalent value for London based on the range of values in the previous column.

Adopting this approach leads to a range of values for an initial rate for London in 1997 of between £3.50 (textile trades) and £4.67 (health and social care). This is supportive of our general approach that the starting rate for London would have been higher than the

Table 9: Estimates of equivalent 1997 London minimum wage rates to a national rate of £3.50, by low paid sector.
Source: ASHE 1997 data, Centre for London calculations

Description	Equivalent London rate to a £3.50 national rate	Estimated single figure
Textiles, garments and related trades	£3.31–£3.70	£3.50 (centre of band)
Catering occupations	£4.13–£4.61	£4.37 (centre of band)
Sales assistants and checkout operators	A little under £4.29	£4.20
Security and protective service occupations (mainly security guards)	Under £4.72	£4.60
Childcare and related occupations	£3.63–£4.67 (nearer the latter)	£4.25
Health and related occupations (social care)	£4.30–£5.04	£4.67 (centre of band)
Hairdressers, beauticians and related occupations	£3.71–£4.26	£3.99 (centre of band)
Other occupations in sales and services (mainly cleaners)	A little under £4.07	£4.00

national rate of £3.50 but is not precise enough to be particularly useful.

Before leaving this section it is worth considering the relative sizes of the different sections in London. The largest low-paid sector in London at two-digit SOC code level is sales assistants and checkout operators, accounting for 142,000 workers, where our estimate of a London starting rate equivalent to the national rate of £3.50 is £4.20. The next largest, SOC code 95, of which the largest component is cleaners, accounting for 117,000 workers, comes in at an estimate of £4.00. Our lowest estimate of £3.50 is obtained by considering a sector that is the smallest – garment traders at 6,000 workers, and the next lowest estimate of £3.99 relates to hairdressers of which there were also only 8,000 in London in the year in question.

For illustrative purposes, and to take account of these differences in size, we computed a weighted average of all our estimates for low-pay sectors. This gave a figure of £4.28. However, this can be no more than a ball-park figure due to the various estimates and subjective assessments that were made along the way.

Method 4: looking at the effect on business and the wider economy

In its first report, the Low Pay Commission included a substantial discussion on the likely effect on business and the wider economy of the introduction of a minimum wage. This was an important part of its considerations, given that its aim was to avoid "unnecessary risks to business and jobs".

For our purposes it is not necessary to re-rehearse all these arguments, since they are implicit in the LPC's choice of an initial starting rate and so implicit in our attempts to mirror the equivalent rate for London in the analysis above.

However, insofar as we need to make a subjective assessment of what that rate might be from the various estimates we have obtained, it is worth summarising the arguments that concerned the LPC at the time to

Table 10: Summary of possible effects of national minimum wage on business in UK and London.
Source: Low Pay Commission, 1998. Centre for London conclusions.

Issue	LPC 1998 Conclusion	Different for London?
Wage inflation from need to restore pay differentials if minimum wage introduced	The effect is likely to be "limited and localised" and to "peter out in the bottom half of the earnings distribution" if the minimum wage is introduced "at a sensible level" (para 6.28).	No reason to think London would be different.
Business costs: wages	Direct impact on the total wage bill is around 0.5% if the rate is £3.50 in 1997 (paras 6.33 and 6.59), which could be absorbed in a number of ways (para 6.36). However, smaller and labour-intensive industries such as hairdressing, security, cleaning and care sectors are particularly sensitive (para 6.42).	No reason to think that the smaller and labour-intensive low-pay sectors in London would respond any differently to those in the UK as a whole. In the private service sector, there may be greater potential for cost increases to be absorbed by customers, given that average wages are higher in London.
Competitiveness, productivity and performance	There is potential for a minimum wage to spur productivity increases in all sectors, but less so where firms lack financial and managerial resources to make the necessary adjustments (para 6.47) or staff ratios are set by regulation such as in care (para 6.48). The risks will be contained by setting a prudent initial rate so that firms have time to adjust (para 6.52).	No substantive reason to think London would be different. Relative strength of hospitality and retail sectors compared to care sectors would perhaps lead to fewer concerns over ability of firms to adjust.
Inflation	There will be some initial upward pressure on price levels, which will differ between sectors, according to competitive pressure. Overall the impact of the recommended national minimum wage is "likely to be small", and over time is "unlikely to cause a lasting increase in inflationary expectations" (para 6.65).	Scope for price increases in hospitality and retail may be higher given increased affluence of retail customers, but not in a way that would give rise to macroeconomic concerns.
Employment	There is a huge and sometimes contradictory literature on the effect of minimum wages on employment (para 6.79). It is likely there is some monopsony in low-pay labour hiring, meaning that people are not being paid in accordance with the value they deliver, so a higher wage can be paid (para 6.67). It is possible to have a minimum wage without reducing employment if designed correctly (para 6.80). "A cautious approach guided by labour market studies and a wide consultation process should not lead to a significant impact on employment" (para 6.87).	Supports a cautious approach when considering a London minimum wage.

understand whether they would have led to an upward or downward pressure on the starting rate if London were the only region under consideration. Table 10, opposite, therefore, summarises the main issues that the LPC considered, and our judgement as to whether a different conclusion would be reached if it were only London under consideration (Low Pay Commission, 1998).

Overall, it is reasonable to presume that when looking at the way businesses in London might be expected to adjust to the introduction of a minimum wage, the effect is not much different to the way in which the Low Pay Commission expected businesses in the UK as a whole to adjust. If anything their considerations support an approach that is particularly sensitive to the constraints of industries that are very price-competitive, such as exporters, or that are labour-intensive with little scope to improve labour productivity, such as the care sectors. Given the low concentration of manufacturers in London, plus the relative affluence of private sector consumers of retail, hospitality and other personal services including cleaning, this points to a conclusion that if it were only considering London, the Low Pay Commission might have been particularly mindful of the effect on businesses in the care sectors.

Adopting this method of analysis, therefore, would imply that additional weight should be given to the labour market for health care and childcare workers when considering what the minimum wage for London might be. The analysis based on the ASHE data by sector (Table 9, above) shows that out of these two sectors our estimate of an equivalent sectoral rate for a London minimum wage in 1997 in the childcare sector is the lowest, at £4.25 compared to a figure of £4.67 in the healthcare sector.

The conclusion to this method of analysis is therefore that our final estimate of a London minimum wage reference rate for 1997 should not be higher than £4.25 in case it causes difficulties in the care sectors.

3.2 Conclusion to this chapter

We have looked at the question of the rate at which the Low Pay Commission would have set an initial minimum rate for London in a number of different ways.

Looking simply at the coverage of employees, the Labour Force Survey data suggests that the equivalent rate for London of the national reference rate of £3.50 based on 1997 data would have been around £4.40 in 1997. The equivalent figure using the partially-corrected, and so arguably more reliable, ASHE data (without supplementary information) is £4.04. We know that the LPC, when faced with different estimates from these two data sources, was advised by the ONS to take the average, which would imply an equivalent rate of around £4.22.

Honing in on particular low-pay sectors using the partially-corrected ASHE data suggests a very rough estimate of around £4.28 for 1997, within which the LPC might have been particularly concerned at the effect on the care sectors, of which the lowest estimate arises in the childcare sector, of around £4.25.

Taking all this into account, and being mindful of the desire of the Low Pay Commission to introduce a minimum wage at a cautious level, we postulate that had the Low Pay Commission considered a starting rate for London, it might have proposed an hourly rate of around £4.20 in 1997.

Uprating the London figure in exactly the same way as the LPC uprated the national figure gives figures for the London minimum wage of £4.32 on introduction in April 1999, rising to £4.44 in June 2000. These findings are summarised in Table 11.

It is worth noting at this stage that in the early years the Low Pay Commission put a significant emphasis on simplicity; this is why the first three rates were rounded numbers. In seeking the equivalent London rates we have not rounded the rates for 1998 and 1999, rather we have presented them for comparison purposes to aid explanation.

The overall aim of this pamphlet is to find the rate of a minimum wage for London that applies in 2013. In doing so it is useful to find the equivalent to the national reference rate of £3.50 that was arrived at by the Low Pay Commission in 1997, as we have done in this chapter, in order to give a starting point to consider how it might have changed over time. In our final conclusions to this project, our recommended rate for London in 2013 will be presented to the nearest 5p, appropriate for the level of precision in our estimates and consistent with the LPC's early approach.

Table 11: Estimates of the starting rates for a London minimum wage 1997–2000

Date	National Minimum Wage	Equivalent London minimum wage (estimate)
April 1997 (reference rate)	£3.50	£4.20
1st April 1999	£3.60 (reference rate + 2.9%)	£4.32
1st June 2000	1st June 2000 (1999 figure + 2.8%)	£4.44

4 UPRATING OVER TIME

In the previous chapter we explored what the rate of a minimum wage for London might have been had the Low Pay Commission considered the matter in the first year of its operation. Our estimate is that the level of a minimum wage for London in April 1997 that is consistent with the national reference rate of £3.50 is around £4.20.

In this chapter we consider how this figure might have altered in the years from 1997 to 2013. We start by describing the attitude of the Low Pay Commission over time, and then consider what this would have meant for a minimum wage for London given what we know about the London economy.

4.1 **History of national minimum wage upratings.** There have been three distinct phases in the way that the Low Pay Commission has uprated the adult rate of the national minimum wage over time. The first phase, which encompassed their first two reports and the minimum wage rates in 1999 and 2000, could be described with hindsight as cautious: the minimum wage was raised with reference to price inflation, at a time when price inflation was rising at a slower rate than average earnings.

From 2001 to 2006, the LPC entered a more bullish phase, raising the national minimum wage at a rate that was faster than average earnings growth. There were several reasons for this change. First, revisions to the methodology of collecting earnings data showed that the number of people covered by the initial rate was lower than the Low Pay Commission originally expected (Low Pay Commission, 2001). Second, academic evidence became available that did not show any adverse effect between the introduction of a national minimum wage and either growth, inflation or employment. Finally, the overall macroeconomic environment was benign, further reducing the risk that increases would have a negative effect on the wider economy.

By 2006 the Commissioners noted rising levels of concern about the sustainability of high levels of overall

economic growth and signalled that from 2007 they were entering a new phase and were unlikely to propose increases that were automatically above the expected average earnings growth rates. Indeed, in the next year's report, lower earnings growth in the economy as a whole plus a fall in employment in low paid sectors led the LPC to propose only a modest increase for that year. In the two years that followed, the proposed increases in the level of the minimum wage were slightly less than expected average earnings (although they turned out to be quite near to actual increases in average earnings), and since then they have "roughly kept pace" with average earnings growth, including falling in real terms as average earnings have also fallen.

Figure 7, below, which is taken from the Low Pay Commission 2013 report, shows how the actual level of the minimum wage has compared to changes in nominal

Figure 7: Increases in the Real and Relative Value of the Adult National Minimum Wage, UK, 1999–2012
Source: Low Pay Commission from various official sources / Note: The AWE series began in January 2000 and the AEI series ended in July 2010. Our earnings series is estimated using AEI (including bonuses) from April 1999–January 2000 and AWE (total pay) from January 2000–October 2012.

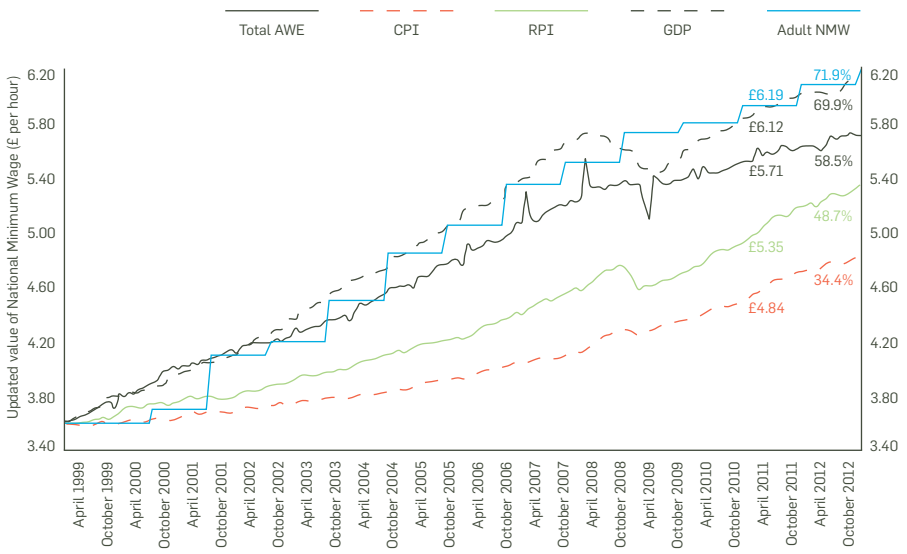


Table 12: Summary of Low Pay Commission decisions 1998–2013

Year	Summary of decision	Recommendation	% YOY Increase
1998 *First Report*	A conservative initial rate would minimize job loss while bringing the low paid away from exploitation. Projected to cover 8%, or 1.8 million workers, aged 21+.	Reference rate of £3.50 in April 1997 uprated to starting rates of: £3.60 April 1999 £3.70 June 2000	 2.9% 2.8%
2000 *Second Report*	Evidence of economic impact reviewed.	No change	
2001 *Third Report (i, ii)*	Revisions of earnings data revealed only around 5% of the adult work force has been covered (1.2 million workers). Little or no evidence of any adverse impact on growth, inflation, or employment. Inflation is stable, growth continues. Potential for substantial increase. Projected coverage of 5.5% to 6.5%.	£4.10 October 2001 £4.20 October 2002	10.8% 2.4%
2003 *Fourth Report*	There is a case for increasing the effective level, but to be achieved in stages. No evidence of negative impact on inflation, employment or particular sectors. Employment in low wage sectors continues to grow. Revisions to the data show the number of people covered is still well below the initial target of 9%. Predicted 2004 coverage of 7%.	£4.50 October 2003 £4.85 October 2004	7.1% 7.8%
2004	Reviewed estimates of the 2003 report, agreed that the increase was still appropriate.	No change	
2005	There is still scope for further increase in the effective level of the NMW. Growth has been strong, employment robust and inflation controlled. However, 2005 increase to be below expected average earnings growth (allowing businesses to adjust), followed by a larger increase in 2006.	£5.05 October 2005 £5.35 October 2006	4.1% 5.9%
2006	Noted concerns about economic prospects – consumer spending, impact on low paid sectors. Insufficient evidence to change previous recommendation. Post-2006 period, however, should not have rate increases automatically above average earnings growth.	No change	
2007	Evidence reveals wage has increasing bite, and increasing numbers of firms affected. Coverage higher than expected as earnings growth was lower. Fall in employment in low paid sectors (2005–06) suggests exercising caution. Increase in statutory leave entitlement considered. Suggested modest increase for 2007.	£5.52 October 2007	3.2%

Continues overleaf

Table 12 continued

Year	Summary of decision	Recommendation	% YOY Increase
2008	Encouraging labour market in 2007 but uncertain economic outlook due to financial sector. Also concerns from coming increases in leave entitlement. Conservative increase "close to, but less than, the predicted annual increase in average earnings."	£5.73 October 2008	3.8%
2009	Cautious approach due to reductions in consumer spending and credit scarcity. Recommended increase of less than half of predicted earnings growth, anticipating downward pressure on earnings in the future.	£5.80 October 2009	1.2%
2010	The recession brings a significant downturn in the labour market. However, employment in low-paying sectors is stronger than the economy overall and forecasts suggest the recession is nearing an end. Suggested rate increase in line with average earnings.	£5.93 October 2010	2.2%
2011	Evidence shows economic growth recovered in 2010 and projected to continue in 2011. Cuts to public sector budgets having a negative impact on average earnings. Interest rates rising to compensate for inflation. Youth unemployment is rising. Taking into account continued economic uncertainty, modest increase suggested.	£6.08 October 2011	2.5%
2012	Sluggish economic performance since late 2010. Employment and earnings growth suffered, while inflation was higher than expected. Consumer and public spending in decline. Some evidence suggests that the NMW may have led to a modest reduction in hours. Forecasts for the coming year mixed. Labour market expected to worsen in short term, but more positive long term. Conservative increase in minimum wage designed to maintain relative incomes of the lowest paid.	£6.19 October 2012	1.8%
2013	Recovery slower and inflation higher than forecast. The labour market is expected to be relatively stagnant – small rise in employment but equal rise in claimant unemployment. The youth unemployment rate is stabilising. Conservative increase proposed.	£6.31 October 2013	1.9%

GDP, average earnings and the RPI and CPI measures of inflation.

Table 12 summarises the main conclusions of each of the annual reports produced by the Low Pay Commission since 1998.

4.2 **Relevance to a rate for London**

As we saw in chapter two of this report, at a headline level the changes in the macroeconomy as a whole since the introduction of a minimum wage have been mirrored in London, except that over time the London economy taken as a whole has become stronger. Office of National Statistics data shows that in the period since 1997 the London economy grew faster than the UK as a whole: it was 19% of the economy in 1997 and 22% by 2011. Similarly, as we saw in Figure 3, the trend of average wage growth in London has mirrored that in the rest of the economy, except that in absolute terms again, London has fared better. In the last ten years, for example, real wage growth for the UK has been 2.09% but for London it has been 3.56%. Since 2009 real wages have fallen, but in London they have fallen less, by 8.03% compared to 8.49% for the UK as a whole.

Taking this headline approach might therefore suggest that if it had considered the London rate alongside the national minimum wage rate, the Low Pay Commission would have had little concern in uprating the London minimum wage in the same way as it uprated the national minimum wage. The reason for this is that the economic environment for London has been broadly similar to that for the rest of the UK, but more buoyant at the margins.

Table 13, below, considers how the London minimum wage would have altered if it had been uprated by the same percentage as the national minimum wage between 1998 and October 2012, and by various other measures of inflation and GDP. We consider the effect up to October 2012 because this is the time period that was used by the Low Pay Commission in its most recent report. If our estimated London minimum wage had been increased

by the same percentage as the national minimum wage, it would have reached a value of £7.43 by October 2012. This would also maintain the same differential between the London minimum wage rate and the national rate of 20%.

If it had been raised in line with national nominal GDP growth then it would have reached a level of £7.34 and if it had been raised in line with national average real earnings growth, it would have reached a level of £6.85. As we have seen, both of these latter figures would be higher if the equivalent figures for London GDP or London average real wages were used instead. If our estimate of the London minimum wage had simply been raised by national levels of price inflation then it would have reached a level of £6.42 (RPI) or £5.81 (CPI) by October 2012.

4.3 **Discussion**

There are important reasons why these results should be viewed with caution.

The first is, of course, that structure of the London economy is significantly different from the average: that is what justifies taking a separate look at the London economy in the first place. To raise the London minimum wage by the same proportion as the national minimum wage is to presume that the response of the London economy to the same proportionate increases would be the same as the national response. Whilst this *may* be true, it is not possible to assert that it *is* true.

Table 13: Effect of uprating the London minimum wage by various measures
Source: Centre for London calculations.

Uprating measure from 1999 to 2012. Same as...	NMW (71.9%)	Nominal GDP (69.9%)	Average real earnings growth (58.5%)	RPI (48.7%)	CPI (34.4%)
Effect on London minimum wage by October 2012 (NMW = £6.19)	£7.43	£7.34	£6.85	£6.42	£5.81

The decision to set a national minimum wage rate of £6.19 in October 2012 took account of the full body of knowledge of the effect on the national economy of all previous decisions up to that point, including the knowledge that the low-pay sectors already had twelve years' experience in responding to the setting of a national minimum wage. An economist would say that the response function of the economy was taken into account when setting the rate. So if the minimum wage had not existed prior to October 2012, it is unlikely it would have been set at £6.19 because far less information would have been available as to how the economy was likely to respond.

The national minimum wage is set in a cumulative fashion with (usually) relatively small annual increases. Whilst it might be the case that had a London minimum wage been introduced in 1998 that was based on a rate of £4.20 in 1997, it could have risen to around £7.43 by October 2012, it does not follow that a rate of £7.43 could have been introduced suddenly in October 2012 without there being an undesirable impact on the lowest paid.

4.4 **Conclusion from this chapter**

Had a London minimum wage been introduced at the same time as a national minimum wage, and had the London rate been based on a reference rate of £4.20 in 1997 (corresponding to the national rate of £3.50 in that year), then the headline performance of the London economy in the intervening years supports a judgement that this differential between the London rate and the national rate could have been maintained. By October 2012, the London rate would therefore have risen to £7.43, and by October 2013 it would have risen to £7.57.

However, that is not to say that a London minimum wage could be introduced overnight at this rate. The response function of the London economy may be different from the average; moreover having a jump in the minimum wage of nearly a fifth in one go could well lead to negative effects on the low paid sectors of the London economy.

If a London minimum wage were to be introduced we therefore recommend that a differential of around 20% with the national minimum wage should be considered a steady-state reference point when considering the level of a minimum wage for London, but that it may take many years to achieve this differential. This presumes that the direction of change in the London economy as a whole does not diverge dramatically from the average. This figure may be revised as more information becomes available as to the response of the low paid sectors of the London economy from the introduction of a London minimum wage.

5 SNAPSHOT METHOD

In the last two chapters we postulated a long-term rate of a minimum wage for London that would raise the wages of the low paid without having an adverse effect on employment. This was done by estimating a starting rate for London in 1997 that was consistent with the starting rate chosen for the country as a whole in that year, and then uprating it in the same way that the national minimum wage has been uprated since then, whilst being mindful of the ways in which the London economy differs from that of the rest of the country. This produced an estimate of a minimum wage for London in 2012 of around £7.43, consistent with the national rate in operation at that time of £6.19. The corresponding 2013 figures, uprating by the same amount, are £6.31 for the national rate and £7.57 for a London rate.

In this chapter we leave aside the historical perspective and simply consider the snapshot question: at what rate would the Low Pay Commission set a minimum wage for London if it were asked to do so now? In reality the Low Pay Commission is prevented by its legislative remit from doing this so we can only second-guess how it might approach the question. However, we have been guided by informal conversations with those close to the operation of the Low Pay Commission and also by knowledge gained in the previous section of the types of issues that the LPC concerns itself with.

This has led to the following rules of thumb:

- When faced with uncertainty, and when testing a new approach, the LPC's instinct is to be cautious.

- The LPC does not have a remit to recommend a separate London rate but it does consider specific effects in particular sectors and monitors the impact across low-pay sectors generally.

- The Commissioners come from a starting point that there is implicit or explicit economic exploitation at

the bottom end of the labour market: employees can be paid more without jobs being lost.

• The Commissioners' initial stated aim was to have around 8% of employees covered by the minimum wage, but in reality the coverage has consistently been between 4.5% and 5.5%.

• The LPC operates by consensus and makes a subjective decision based on all the evidence before it.

When considering London in particular we also make the following observations:

• The picture is complicated by the national minimum wage already operating as a floor on wage rates, albeit a very low one in the London context.

• Average wage levels are far higher in London than for the UK as a whole due to the concentration of higher productivity jobs in the capital.

• Wage differentials between London and the rest of the UK are far smaller for low wage jobs than for higher wage jobs.

• There is no automatic way of telling whether this lower wage differential is due to greater implicit or explicit economic exploitation (that is, people being paid less than the value of their work) at the bottom of the London market or whether there are other valid economic factors at play.

• In the low wage sectors, there is a higher concentration of private sector service jobs such as retail, hospitality, cleaning and security than for the UK as a whole, and a lower concentration of agriculture, manufacturing and care jobs. However, there are still a large number of care jobs in London in absolute terms.

In estimating a 2013 rate for a minimum wage for London we first of all present the evidence of how London fares when looking at the issues that we know the Low Pay Commissioners take into account, and adjusting them for what is known about the London economy. We then use this information to estimate the rate of a minimum wage for London that the LPC would make if it were asked to propose a rate for London in 2013.

There is a huge caveat to this analysis, namely that we are not comparing like with like. The UK data has been affected by the introduction of a national minimum wage to a greater degree than London; there are different forces at work. So comparing, as we do in the analysis that follows, low pay in London in 2012 to the UK as a whole is not saying as huge an amount about fundamental differences in the underlying economic structure as the analysis of 1997 data in the previous chapters.

However, it does enable us to at least explore a rate for a London minimum wage that affects the same proportion of the low paid as are currently affected by the national minimum wage across the UK as a whole. Given that if the Low Pay Commission were asked to consider the same question, they would be faced with the same situation, this seems to be as good a starting point as any. There is further discussion of this point at the end of this chapter.

5.1 **Coverage**

The latest report from the Low Pay Commission, published in spring 2013, stated that in April 2012, 5.3% of all jobs paid either below, at, or up to five pence above the minimum wage. However this includes wages paid to people who were 21 and younger for whom a different statutory rate applies. Our research is only concerned with the adult minimum wage rate.

Figure 8 below shows estimates of the wage distribution for London and the UK for workers over 21 by percentile. This data was obtained directly from the

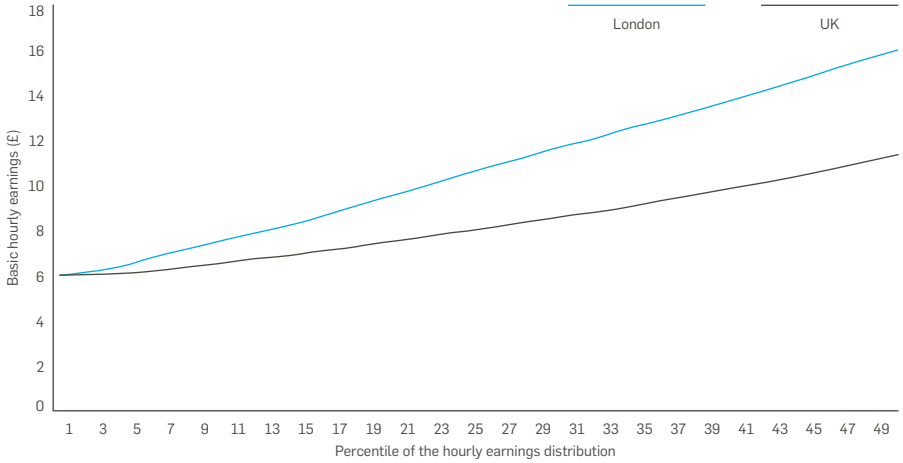
Low Pay Commission. Although based on ASHE data it is not publicly available from the routine ONS publications. Because this data refers to April 2012, the corresponding minimum wage rate is the one that was set in October 2011, namely £6.08.

According to these LPC estimates, at the fourth percentile, which is the point at which UK hourly wages rise above the national minimum wage of £6.08, the equivalent London wage is £6.35. So if we wanted to find a London minimum wage that covers the same proportion of the relevant labour market as the national minimum wage, this would suggest a London minimum wage of £6.35 set in October 2011.

5.2 **Bite**

When considering the level at which the national minimum wage should be set, commissioners are mindful of the 'bite', namely how the level of a national minimum wage compares to the median hourly rate of pay. Since the introduction of the minimum wage, the bite for the adult rate has risen from 46% of the median in April 1999 to 53% in April 2012 (Low Pay Commission, 2013).

Figure 8: Hourly earnings excluding overtime distribution by area of work, 21+, 2012
Source: LPC estimates based on ASHE 2012, 2010 methodology, UK.



In considering the corresponding rates for London the picture is complicated slightly in that the publicly available data that the Low Pay Commission uses (the ASHE series) does not provide information broken down simultaneously by age and region. For comparison purposes we have therefore considered bite for all employees rather than for those 21 and over.

Table 14, below, considers how the rate of £6.08 in April 2012, the latest date for which earnings data is available, relates to earnings across the distribution, for the UK and for London.

Row 2 of this table shows, for example, that the national minimum wage was set at 54% of the national median rate in 2012, but at 94% of the hourly rate paid at the 1st decile of the national pay distribution, 82% of the first quintile rate, 76% of the first quartile rate etc.

Row 3 then considers the bite of the same national minimum wage rate when compared to the distribution of hourly pay rates in London in April 2012. It shows that rather than being set at 54% of the median rate, the national minimum wage was set at only 39% of the London median rate. This is equivalent to 83% of the hourly rate paid at the first decile of the distribution, 66% of the first quintile. 59% of the first quartile rate etc.

The final row then gives the hourly pay rate for London that gives the same bite at each percentile as

Table 14: Comparing the bite of the minimum wage in UK and London, 2012
Source: ASHE 2012, Centre for London calculations

Row		Number of jobs ('000)	Percentiles					Median	Mean
			10	20	25	30	40		
1	United Kingdom (£)	24,588	6.46	7.41	7.95	8.50	9.76	11.26	14.82
2	*UK bite at £6.08 (%)*		*94.12*	*82.05*	*76.48*	*71.53*	*62.30*	*54.00*	*41.03*
3	London (£)	3,532	7.29	9.20	10.22	11.32	13.45	15.74	20.36
4	*London bite at £6.08 (%)*		*83.40*	*66.09*	*59.49*	*53.71*	*45.20*	*38.63*	*29.86*
5	**Rate that gives same as the national bite in London at this percentile (£)**		*6.86*	*7.55*	*7.82*	*8.10*	*8.38*	*8.50*	*8.35*

the national minimum wage rate of £6.08 gives for the national distribution of pay. So, for example, to obtain the same bite at the median as the national minimum wage, a London minimum wage would have been £8.50 in the year that includes April 2012. But to obtain the same bite at the first decile as the national minimum wage did for the UK as a whole, a London minimum wage would have been lower: £6.86 in the year that includes April 2012.

That these figures are so different arises from the wholly different nature of the pay distribution in London as compared to the UK as a whole – which we have already demonstrated in Figure 8, above. This in turn arises from the fact that the structure of the London economy is so divergent from that of the rest of the UK, as we saw in chapter one of this report, which of course is the reason why we are considering this question in the first place.

Ultimately, which figure to choose is a matter of judgement. In order to inform this judgement, the next section hones in on how the pay distribution of the lowest paid sectors in the London economy differs from that of the national distribution.

Table 15: Median pay and bite for low wage sectors, London and UK, 2012 *(continued on pages 67 & 68)*

Source: ASHE, Low Pay Commission, Centre for London calculations / [a]This column gives the rate of a minimum wage for London that would give the same bite in London for the sector in question as the national minimum wage rate gives for the sector nationally. x: insufficient data

Description of low-pay occupation	SOC code	UK number of jobs ('000s)	UK median	UK bite at £6.08	London number of jobs ('000s)	London median	London bite at £6.08	Derived London min wage rate[a]
Managers and proprietors in forestry, fishing and related services	1213	X	X	n/a	X	X	X	X
Shopkeepers and proprietors – wholesale and retail	1254	8	13.85	43.9	X	X	X	X
Actors, entertainers and presenters	3413	5	14.94	40.7	X	X	X	X
Sports players	3441	10	X	X	X	X	X	X
Fitness instructors	3443	25	9.27	65.6	X	X	X	X
Financial administrative occupations n.e.c.	4129	125	9.58	63.5	26	12.32	49.4	7.82
Receptionists	4216	237	8.00	76.0	33	9.65	63.0	7.33

Continues opposite

Table 15 continued

Description of low-pay occupation	SOC code	UK number of jobs ('000s)	UK median	UK bite at £6.08	London number of jobs ('000s)	London median	London bite at £6.08	Derived London min wage rate[a]
Horticultural trades	5112	X	7.25	83.9	X	X	X	X
Gardeners and landscape gardeners	5113	47	8.82	68.9	X	10.07	60.4	6.94
Groundsmen and greenkeepers	5114	39	8.44	72.0	X	X	X	X
Agricultural and fishing trades n.e.c.	5119	5	9.09	66.9	X	X	X	X
Smiths and forge workers	5211	X	10.17	59.8	X	X	X	X
Vehicle technicians, mechanics and electricians	5231	106	11.02	55.2	X	X	X	X
Upholsterers	5412	8	9.99	60.9	X	X	X	X
Footwear and leather working trades	5413	5	X	X	X	X	X	X
Tailors and dressmakers	5414	X	8.23	73.9	X	X	X	X
Textiles, garments and related trades n.e.c.	5419	X	X	X	X	X	X	X
Butchers	5431	28	8.00	76.0	X	8.11	75.0	6.16
Bakers and flour confectioners	5432	29	8.33	73.0	X	8.09	75.2	5.90
Fishmongers and poultry dressers	5433	X	6.93	87.7	X	X	X	X
Chefs	5434	169	7.62	79.8	32	8.25	73.7	6.58
Cooks	5435	68	7.50	81.1	7	8.92	68.2	7.23
Glass and ceramics makers, decorators and finishers	5441	6	8.57	70.9	X	X	X	X
Florists	5443	5	6.68	91.0	X	X	X	X
Nursery nurses and assistants	6121	153	7.01	86.7	17	8.14	74.7	7.06
Childminders and related occupations	6122	19	8.00	76.0	5	9.49	64.1	7.21
Playworkers	6123	40	7.20	84.4	X	9.28	65.5	7.84
Veterinary nurses	6131	11	9.13	66.6	X	10.66	57.0	7.10
Animal care services occupations n.e.c.	6139	22	7.21	84.3	X	7.04	86.4	5.94
Care workers and home carers	6145	671	7.89	77.1	49	8.21	74.1	6.33
Care escorts	6147	13	7.49	81.2	X	8.14	74.7	6.61
Sports and leisure assistants	6211	67	7.58	80.2	11	8.13	74.8	6.52
Travel agents	6212	36	8.43	72.1	6	11.11	54.7	8.01
Leisure and travel service occupations n.e.c.	6219	20	8.45	72.0	4	X	X	X
Hairdressers and related services	622	75	6.83	89.0	7	7.36	82.6	6.55
Housekeepers and related occupations	6231	44	7.47	81.4	5	8.83	68.9	7.19
Cleaning and housekeeping managers and supervisors	6240	42	7.90	77.0	5	8.58	70.9	6.60
Sales and retail assistants	7111	1,152	6.69	90.9	141	7.47	81.4	6.79
Retail cashiers and check-out operators	7112	139	7.01	86.7	16	7.58	80.2	6.57
Pharmacy and other dispensing assistants	7114	50	7.49	81.2	3	7.44	81.7	6.04

Continues overleaf

Table 15 continued

Description of low-pay occupation	SOC code	UK number of jobs ('000s)	UK median	UK bite at £6.08	London number of jobs ('000s)	London median	London bite at £6.08	Derived London min wage rate [a]
Vehicle and parts salespersons and advisers	7115	14	8.24	73.8	X	9.14	66.5	6.74
Roundspersons and van salespersons	7123	7	9.29	65.4	X	10.02	X	6.56
Market and street traders and assistants	7124	X	X	X	X	X	X	X
Merchandisers and window dressers	7125	18	8.47	71.8	4	12.15	50.0	8.72
Sales supervisors	7130	121	8.32	73.1	10	9.09	66.9	6.64
Telephonists	7213	11	8.25	73.7	X	9.96	61.0	7.34
Customer service occupations n.e.c.	7219	347	8.52	71.4	30	10.06	60.4	7.18
Food, drink and tobacco process operatives	8111	140	7.83	77.7	8	7.21	84.3	5.60
Glass and ceramics process operatives	8112	6	9.77	62.2	X	X	X	X
Textile process operatives	8113	12	8.40	72.4	X	X	X	X
Chemical and related process operatives	8114	27	10.41	58.4	X	X	X	X
Rubber process operatives	8115	4	9.19	66.2	X	X	X	X
Plastics process operatives	8116	13	9.11	66.7	X	X	X	X
Metal working machine operatives	8125	25	9.24	65.8	X	10.58	57.5	6.96
Assemblers (electrical and electronic products)	8131	16	8.23	73.9	X	X	X	X
Weighers, graders and sorters	8134	8	6.72	90.5	X	X	X	X
Tyre, exhaust and windscreen fitters	8135	15	8.22	74.0	X	8.42	72.2	6.23
Sewing machinists	8137	17	7.34	82.8	X	7.69	79.1	6.37
Assemblers and routine operatives n.e.c.	8139	105	8.85	68.7	X	9.01	67.5	6.19
Van drivers	8212	284	8.15	74.6	23	9.19	66.2	6.86
Taxi and cab drivers and chauffeurs	8214	16	7.54	80.6	X	X	X	X
Farm workers	9111	37	7.69	79.1	X	8.19	74.2	6.48
Fishing and other elementary agriculture occupations n.e.c.	9119	18	7.48	81.3	X	7.36	82.6	5.98
Elementary construction occupations	9120	68	9.00	67.6	X	10.55	57.6	7.13
Industrial cleaning process occupations	9132	15	7.81	77.8	X	7.71	78.9	6.00
Packers, bottlers, canners and fillers	9134	100	7.32	83.1	4	6.82	89.1	5.66
Elementary process plant occupations n.e.c.	9139	114	8.22	74.0	4	8.80	69.1	6.51
Elementary administration occupations n.e.c.	9219	42	6.84	88.9	6	7.16	84.9	6.36
Window cleaners	9231	X	7.75	78.5	X	X	X	X
Cleaners and domestics	9233	645	6.54	93.0	66	6.74	90.2	6.27
Launderers, dry cleaners and pressers	9234	23	6.39	95.1	X	6.24	97.4	5.94
Refuse and salvage occupations	9235	27	9.09	66.9	X	10.27	59.2	6.87
Vehicle valeters and cleaners	9236	12	6.57	92.5	X	6.89	88.2	6.38
Elementary cleaning occupations n.e.c.	9239	X	7.40	82.2	X	X	X	X

Continues opposite

Table 15 continued

Description of low-pay occupation	SOC code	UK number of jobs ('000s)	UK median	UK bite at £6.08	London number of jobs ('000s)	London median	London bite at £6.08	Derived London min wage rate [a]
Security guards and related occupations	9241	135	8.42	72.2	43	8.67	70.1	6.26
School midday and crossing patrol occupations	9244	120	7.04	86.4	9	7.84	77.6	6.77
Elementary security occupations n.e.c.	9249	16	9.78	62.2	X	9.71	62.6	6.04
Elementary sales occupations	925	81	8.20	74.1	6	9.19	66.2	6.81
Elementary storage occupations	9260	470	8.24	73.8	32	8.68	70.0	6.40
Kitchen and catering assistants	9272	460	6.25	97.3	50	6.57	92.5	6.39
Waiters and waitresses	9273	165	6.10	99.7	23	6.50	93.5	6.48
Bar staff	9274	176	6.09	99.8	17	6.31	96.4	6.30
Leisure and theme park attendants	9275	32	6.49	93.7	6	6.98	87.1	6.54
Other elementary services occupations n.e.c.	9279	15	6.77	89.8	X	6.76	89.9	6.07

5.3 **Low-pay sectors**

The Low Pay Commission defines the kinds of occupation, within the official occupation classifications, which together comprise the low-pay sector of the economy. According to their definition there are 83 different occupational classification codes (4-digit SOC 2010 codes) that together make up the low-pay section of the economy (Low Pay Commission, 2013). The number of people working in low-pay sectors make up 30% of the UK as a whole. In London, however, only 20% of workers are employed in these sectors.

In this section we compare the bite of the national minimum wage in the LPC's own definition of low paid sectors for the UK and for London. In doing so it is only possible to compare the bite at the median, the 50th percentile, because the sample size is too small for London on an occupational basis to compare other points in the distribution. For some occupations that are under-represented in London compared to the UK as a whole, it is not even possible to make a comparison at the median.

Table 15 lists the median pay in 2012 for all 83 occupations that, taken together, comprise the low-pay

sector of the economy, for the UK and for London. The bite of the national minimum wage in April 2012 in each of these sectors is calculated for the UK as a whole and for London. As seen for the economy-wide data, the bite of the national minimum wage is lower in London for practically every low pay sector when compared to the bite for the UK as a whole.

The final column of Table 15 calculates the rate at which a minimum wage for London would give the same bite in London as the national minimum wage does for that sector across the UK as a whole. This gives dozens of different values for a national minimum wage for London from £8.72 (merchandisers and window dressers) to £5.60 (food, drink and tobacco process operatives).

Of course, each of the sectors in question varies hugely in size. The largest sector, sales and retail, has 141,000 workers in London. In 2012 the national minimum wage was set at 90% of the UK median salary for sales and retail. To achieve the same bite in London would require a London minimum wage of £6.79. For care workers, however, of whom there are 49,000 in London, the national minimum wage was set at 77% of the national median salary. To achieve the same bite in London would require a London minimum wage of £6.33.

For cleaners, of whom there are 66,000 in London, the corresponding London minimum wage rate is £6.27, and for hair-dressers, of whom there are 7,000, the corresponding rate is £6.55.

Taking a weighted average using the available data on the size of each low-pay sector in London gives an equivalent value for a minimum wage for London of £6.65 for the year up to April 2012.

5.4 **Conclusion to this chapter**

This chapter has considered the question of a possible level for a minimum wage for London if the Low Pay Commission were asked to make a recommendation now. Using the latest data that is

available, for April 2012, suggests that a London minimum wage for that year might be around:

- £6.35 if the aim was to have the same coverage as the national minimum wage;

- £8.50 if the aim was to have the same relationship to London median wages as the national minimum wage has for UK median wages;

- £6.86 if the aim was to have the same relationship to London wages at the tenth percentile as the national minimum wage has to UK wages at the tenth percentile;

- £6.65 if the aim is to have the same relationship to median wages in the low paid sectors, as defined by the Low Pay Commission, as the national minimum wage has to pay in the same sectors across the country as a whole.

When considering which of these propositions is the most appropriate, the obvious outlier is the second bullet point above, the figure of £8.50 obtained by comparing the bites of the minimum wage at the median. This is because of the far wider distribution of wage rates in London when compared to the UK as a whole. Given that the purpose of a minimum wage is to raise low-pay, and that low pay sectors only comprise a fifth of the London economy as opposed to a third of the UK economy, comparing figures at the median is not comparing like for like. Similarly, although the tenth percentile figure is more relevant, it is still distorted by relying on the same distribution as the median figure.

We therefore postulate that the Low Pay Commission would be more likely to choose a rate lying between £6.35 and £6.65 for 2011–12 based on the information we have presented. Uprating both of these to 2013 figures gives a range of between £6.59 and £6.90. An average of these two figures, rounded to the nearest

5p, gives us an estimate of a London minimum wage for 2013, using this snapshot method, of £6.75, a figure around 7 per cent higher than the national minimum wage from 2013 of £6.31.

5.5 **Discussion and overall conclusions**

Drawing together the results of the previous three chapters leads to the following: Based on the data at their disposal at the time, we estimate that had the Low Pay Commission been asked to make a recommendation for a minimum wage in London that would apply in 1997 they might have proposed a rate of around £4.20, which is 20% higher than the national reference rate of £3.50.

If this London minimum wage had been introduced at the same time as the national minimum wage, then it is reasonable to presume that it would have been uprated in the same way, since the London economy has exhibited the same trends as the national economy in the intervening years, or if anything has been more buoyant. This would have caused the London minimum wage to rise to £7.57 from 1 October 2013, again 20% higher than the equivalent national minimum wage rate of £6.31. However, if in the intervening years there was evidence that the London economy responded in a different way to the national economy, then this figure could well have altered.

When considering the question as to what an equivalent London minimum wage rate might be if it were introduced now, a lower estimate of around £6.75 is obtained for 2013. This rate has a similar bite in the low-paying sectors as the minimum wage does nationally, and a similar coverage of people affected as the national minimum wage does nationally.

The difference between the two figures is accounted for by the fact that London has hardly been affected by the minimum wage to date, as it is set at a rate that is very low when compared to London wage levels. London needs to catch up. This can be illustrated by looking at the change in the differential between the pay of the lowest paid in London and the UK since the national minimum wage was introduced. Table 16 shows the difference in pay between London and the UK by decile in 1997.

We then re-present Table 3 from chapter two which shows the corresponding distributions from 2012 (see below).

As previously discussed, it can be seen that wages have risen faster in London than across the country as a whole in recent years, and above this there is a noticeable additional widening in the 90th percentile. However, the effect of the minimum wage is also clear from the 10th percentile changes. Before the introduction of a national minimum wage, the lowest paid 10% in London were still paid 25% more than the lowest paid 10% nationally. By 2012, however, this had narrowed to 13%, despite rising in absolute terms. Quite simply, the introduction

Table 16: Hourly pay in London and the UK, median and percentiles, 1997
Source: ASHE

	Number of jobs ('000s)	Median pay/hour (£)	Percentiles									
			10	20	25	30	40	60	70	75	80	90
UK	20,858	7.07	3.81	4.58	4.96	5.34	6.14	8.24	9.71	10.64	11.78	15.29
London	2,845	9.56	4.77	5.87	6.46	7.04	8.19	11.00	12.87	14.00	15.55	20.72
% London higher		*35.2*	*25.2*	*28.2*	*30.2*	*31.8*	*33.4*	*33.5*	*32.5*	*31.6*	*32.0*	*35.5*

Table 3: Hourly pay in London and the UK, median and percentiles, 2012
Source: ASHE

	Number of jobs ('000s)	Median pay/hour (£)	Percentiles									
			10	20	25	30	40	60	70	75	80	90
UK	24,588	11.26	6.46	7.41	7.95	8.50	9.76	13.29	15.78	17.40	19.17	24.98
London	3,532	15.74	7.29	9.20	10.22	11.32	13.45	18.40	21.67	23.70	26.16	36.27
% London higher		*39.8*	*12.8*	*24.2*	*28.6*	*33.2*	*37.8*	*38.4*	*37.3*	*36.2*	*36.5*	*45.2*

of the minimum wage to date has not affected London as much as the rest of the country, thereby narrowing the gap between the two. Yet there is no shortage of people in low paid occupations in London. This supports our conclusion that London has scope to catch up.

Over time, and once the response function of the London economy is better understood, it would seem sensible to explore whether the London economy can support a differential of around 20% between the national minimum wage and the London minimum wage, as this is the differential that our estimates in chapter three suggest could have been introduced from the start.

6 BOUNDARY EFFECTS

Implementing a London minimum wage means setting a border within which the wage would be enforced, in this case the Greater London boundary. Some parts of this boundary are within the green belt and so have limited development; in other areas the boundary is the same as the M25. Indeed the boundaries of Greater London have been progressively tweaked over the years precisely in order to follow natural borders. But there are some places in which the Greater London boundary runs through developed areas such as near Dartford in Kent and Waltham Cross in Hertfordshire. There are some places therefore where the introduction of a London minimum wage would mean in practice a higher minimum wage on one side of a boundary street than the other.

One could imagine that the 'two sides of the street' issue might cause undesirable outcomes, such as business relocation to outside the affected area, or other economic distortions as firms seek to take advantage of the lower minimum wage levels on one side of the street. Such developments could result in a range of problems including undermining the effectiveness of the London minimum wage in raising the living standards of the low paid, loss of amenity to those communities at the outskirts of London, reduced local tax revenues, and a consequent loss of political support for the London minimum wage in outer London boroughs.

In this chapter, we explore the existing evidence to assess what effect, if any, the introduction of a London minimum wage might be expected to have on the areas around the boundary of London, and how much of a problem this poses for the future of the London minimum wage.

6.1 The US experience #1 boundary issues

The US provides a particularly useful comparator due to the variation in minimum wage levels within the country. Whilst there is a federal minimum wage, currently $7.25 per hour, individual states are also free to set minimum wages above this level, and 20 have done so.

This existence of different minimum wages across state lines has provided an opportunity for analysis of their impact, both in general terms and specifically in relation to border effects.

In particular, there exists recent academic literature looking specifically at the effect of different minimum wages across state borders (Dube et al., 2010). This research looked at differences in the labour market on either side of, but near to, the same minimum wage boundary, in order to explore the effects of having a different minimum wage without having to correct for other differences in the labour markets between states, such as different underlying growth rates, or structural, cultural or supply-side differences. However, it is also useful for our purposes to explore the impact of having a boundary itself. In this research, data from pairs of contiguous counties on opposite sides of state lines with different minimum wages was collected. The analysis was conducted using robust payroll data over a 16 year period, and has the added advantage that the minimum wage differentials across state boundaries were in many cases large (7%–20%), so their findings can be used to draw useful conclusions about a London minimum wage rate significantly higher than the national minimum wage. As well as fast food restaurants, the research considered table-service establishments and the retail sector.

The results showed significant positive effects of a higher minimum wage on the earnings of affected workers but, crucially, that there were no significant negative effects on employment. The same authors revisited the subject in 2011, using the same methodology of comparing effects at the boundaries, with updated data sources (Dube et al., 2011). Again they found substantial positive earnings effects, and no statistically significant negative employment effects.

Other studies carried out using similar assessment of the impact at the boundaries support these conclusions (e.g. Addison et al., 2012), and these findings are now generally accepted across the political spectrum in the US.

6.2 The US experience #2: city-wide minimum wages

As well as spawning an academic literature on border effects of a minimum wage, the US experience also allows us to consider the effect of having city-wide minimum wages more generally. In recent years a number of American cities such as San Francisco and San Jose in California, and Santa Fe and Albuquerque in New Mexico have implemented minimum wages above either federal or state levels, triggering analysis of predicted and observed impacts on earnings and employment. Living wage regulations have also been passed in a number of US cities, but are restricted to certain categories of worker. New Orleans in Louisiana also had its own minimum wage for a time until it was overturned by state legislation.

In Santa Fe, New Mexico, a 2004 regulation increased the minimum wage for all firms with 25 or more employees from $5.15 to $8.50 per hour. Various studies by the state Bureau of Business and Economic Research used difference-in-differences analysis comparing Santa Fe to Albuquerque, where the minimum wage did not rise (Potter, 2006 and Potter, 2006 (2)). These used various data sources and consistently demonstrated not only increased earnings (as would be expected) but also relative employment growth in most sectors of the local economy.

The San Francisco experience demonstrates the same trends. The minimum wage was set for the city at $8.50 in 2004 (26% higher than the state-wide minimum), reached $9.14 in 2007 and is now $10.55. Case study analysis using robust data to compare with the East Bay area showed relative earnings growth, with no discernible impact on employment (Dube et al., 2007).

The experience of city-wide minimum wages in the US also provides some clues as to how the costs are absorbed. Employers affected by local minimum wage increases can broadly respond in five ways: reducing the workforce; raising prices; raising productivity; redistributing income within the business through wage compression or reduced profit margins; and relocation

(Pollin et al., 2002). The question when considering the boundary effects is whether firms will relocate to the other side of the boundary, causing a hollowing out of economic activity or a doughnut effect, with firms moving out of the higher-cost area.

However, the decision to move out of a city location in order to reduce labour costs following the introduction of a city-wide minimum wage will only take place if the savings from doing so are greater than the costs of moving, which in turn requires that the increase in the wage bill from the introduction of a minimum wage be substantial. The US evidence shows little sign of such substantial cost base increases. In New Orleans the average operating cost increase of a 19.4% rise in the minimum wage was estimated at 0.9% (Pollin et al., 2002). In San Francisco an increase in the minimum wage of 25.9% was estimated to increase costs by less than 1% for 82% of firms, with only 4.8% experiencing cost increases of 5% or more (Reich & Laitinen, 2003). Quantifying the impacts for any city, or its boundary areas, requires detailed analysis of the business base, but the similarities in the wage distribution between San Francisco and London might suggest a similar broad picture.

The US experience also demonstrates that many low wage sectors were highly location dependant, so that relocation was not viable and cost rises were absorbed in other ways (Pollin et al., 2002; Reich & Laitinen, 2003). We have already seen in the previous chapter that a large proportion of the low paid jobs in London – retail, hospitality, cleaning, care – are also location-specific, indicating that the same factor may significantly mitigate against relocation at London's boundaries. It may also be the case that in London an '020 premium' affects business relocation decisions, associated with the prestige of a London location.

When questioned about how they viewed relocation prior to a citywide minimum wage being introduced, 8% of San Francisco businesses said they would do so if their costs were substantially increased, compared with 24%

wanting to increase prices and 22% looking to increase efficiency (Reich & Laitinen, 2003). There was substantial variation in attitudes across different industries though, with 33% of surveyed manufacturers claiming they would relocate. Given that London is already unattractive as a location for manufacturing businesses, this result is less relevant for our purposes.

The US evidence also generally finds that the impact on most firms' cost structures is manageably small, and that these firms tend to respond through efficiency improvements, wage compression, and modest price increases, which is the same as the response by US employers nationwide to the introduction of a national minimum wage. The most comprehensive nationwide analysis in the US found significant evidence of efficiency improvements from the introduction of minimum wages arising from reductions in the costs of staff turnover (Dube et al., 2011). A study of firm behaviour at San Francisco airport found dramatic decreases in staff turnover among firms most affected by minimum wage increases, as well as evidence of improved staff morale and productivity (Reich et al., 2003). Evidence of the impact of the San Francisco minimum wage on restaurants showed that in addition to achieving savings through reduced staff turnover, employers also responded by compressing wage distributions within their businesses (Dube et al., 2007).

There is also evidence from the US experience that businesses have passed on cost increases to consumers in the form of price rises. In Santa Fe, most affected businesses could absorb cost increases with price rises of less than 1% (Pollin et al., 2002), but evidence from San Francisco showed increases of up to 6.2% (Dube et al., 2007). The impact of increased prices on local consumers is to some extent offset by an increase in local wealth, which has a higher multiplier effect among lower income workers since they spend a larger proportion of their income. Moreover, businesses are unlikely to increase prices if they feel it will make them uncompetitive; to the extent that they do so, therefore, it is because their

customers are sufficiently affluent to be able to cope. Retail and hospitality firms in central London might make a similar judgement to those in San Francisco.

6.3 **Business rates in the UK**

We looked next at other ways in which employer costs vary across boundaries in order to form a view as to how having a higher London minimum wage might be affected at the boundary. In particular, existing variations in local tax rates affecting employers across geographic boundaries offer an interesting comparison with the potential effects of local minimum wage variations.

There is a wealth of literature examining the impact of local growth-orientated tax policies, most of which focuses on the question of how much, if at all, such policies are successful in achieving regional growth. The majority of these studies assess the impact of variations in tax rates within jurisdictions, and are therefore of only general use in consideration of boundary effects. The literature is characterised by conflicting results and uncertain conclusions (Bartik, 1991).

However, there is some literature on the impact on business of tax rate (and therefore business cost) variation across Local Authority boundaries in the UK (Duranton et al., 2006). Business Rates in the UK are now uniform across Local Authorities, but prior to 1990 Councils had the power to set these locally, so the study draws data from 1984–1989, and examines businesses in the manufacturing sector.

The study considers two elements of business behaviour: employment, and entry into a local area. Over 4,000 pairs of businesses on opposite sides of borough boundaries where different business rates applied were identified, up to a maximum of 1km apart. This was designed to factor out underlying regional variations which might come from comparing businesses across the UK, but lends itself well to judgement of the effects of having different conditions on either side of a geographic boundary.

The conclusions on entry decisions were clear – regardless of the methodology used, local tax rates had no significant effect on firms' decisions to establish in a particular local area. On employment the picture was more complex. After working through various modelling assumptions, the paper concluded that there was a negative effect on employment: firms that face significantly higher business taxation typically take on less staff, all else being equal, consistent with a focus on increased productivity per worker to achieve the required level of price competitiveness. This is not to say, however, that existing firms faced with an increase in costs would necessarily reduce their staffing levels, as noted above.

6.4 **Differences in collective bargaining legislation**

An American study conducted in 1997 looked at the location of manufacturing firms around state borders to assess the impact of public policy on those firms' location decisions (Holmes, 1998). In a similar fashion to the minimum wage literature, subject data was restricted to contiguous counties along state borders in order to avoid distortions from underlying variations in conditions in different parts of the country.

This study focused on the impact of individual states' industrial legislation. The author classified states as either 'pro-business' or 'anti-business' based on whether they had passed legislation banning union closed shops.

The results indicated that public policy measures had a significant effect on the choice of location for manufacturing companies. On average, manufacturing employment as a proportion of a county's overall employment in a 'pro-business' state was around 33% higher than in an 'anti-business' one.

This study features in this chapter because of its specific focus on boundary regions, and because traditional theories presume that the existence of collective bargaining arrangements must increase labour costs, in the same way as minimum wage

increases do. This is, however, not widely accepted (Freeman and Medoff, 1984), and as the author of the study acknowledges, his results reflect the impact of the overall policy approach to business, since states with anti-closed shop legislation usually also featured other pro-business (or anti-worker) laws. The main conclusion that can confidently be drawn is that public policy can be a factor in the choice of business location.

6.5 **Other boundary effects**

The evidence to date indicates that having a minimum wage boundary that crosses a geographic area is unlikely to lead to a relocation of existing businesses, particularly in an area such as London that has a low density of low-wage manufacturing companies. Rather, workers likely to be affected by the minimum wage are in location-dependent occupations such as retail, care and hospitality. Moreover, the cost savings to be had from relocation are likely to be small compared to the one-off costs of moving premises.

During the course of our qualitative research a further issue arose, namely of the potential for firms that employ people off-site, such as domiciliary care workers, agency babysitters and cleaners, seeking to move their headquarters outside the boundary of a city-wide minimum wage in order to avoid having to pay the higher rates. Care would need to be taken in the design of regulations to ensure that this boundary effect did not come into play. Just as any workers in the UK are subject to the minimum wage even if their employer is not domiciled here, any workers whose physical place of work is London should be paid the London minimum wage, even if their firm is based outside the London boundary. We return to this issue in chapter seven.

For employees who work in the same physical location as their employer, even if relocation across borders does occur, its workers would still have the option of keeping their jobs, and they would not suffer wage decreases. They would simply fail to benefit from the London minimum wage and, depending on the type of firm in question, there may be a loss of community amenity. In extreme cases employers may move away from the city altogether, so that the minimum wage is not just avoided but jobs lost, although the move across the street to continue to enjoy relative proximity to capital city markets and facilities seems far more likely.

Overall, then, our trawl of the existing evidence on firms' responses is encouraging for boundary areas. Relocation is less of a threat than it may appear, since low-paying businesses often depend on location and will not experience cost increases significant enough to prompt relocation. The type of business is important since certain sectors will have higher propensities to relocate. Where any relocations did occur, they would not necessarily cause job losses but would simply mean that employees would fail to benefit from a higher wage.

Finally, we turn to the effect outside the boundary of introducing a city-wide minimum wage. Whilst generally less detailed, what evidence there is points to labour flow into the higher minimum wage area from the adjacent areas. Consequently, businesses outside but close to the boundary areas which compete for labour with those inside can be forced to pay wages above the statutory minimum in order to attract staff (Egan, 2007). In the absence of empirical analysis of the impact of this, it seems likely that those employers would be able to absorb the cost increase in the same way as businesses within the boundary, so that the earnings benefits would to some degree spill over the boundary without entailing significant negative employment effects, avoiding the development of a two-tier workforce.

6.6 **Conclusions from this chapter**

On balance we draw some comfort from the evidence of the impact of minimum wages on boundary areas. International and other comparators are reassuring, since the benefits of the policy do not seem to lessen at the boundaries, and potential specific problems appear to be less worrying in practice than they may seem on paper, due mainly to the large number of different issues

that businesses take into account when making decisions. This might explain why it is already commonplace within some professions to include a 'London weighting' in pay scales.

The principal conclusions of this chapter are:

- Low earners in the boundary areas of London would benefit from increased earnings under a London minimum wage, and there is no evidence that significant job losses would result from it. This is supported by the leading academic evidence which specifically considers boundary regions of higher minimum wage regions, as well as the experience of regions where such policies have been implemented. It is striking that none of the US literature on city-wide minimum wages refers to any particular problems in boundary areas. Evidence from other types of locally determined policy tool is not sufficient to undermine this conclusion.

- Employers are likely to broadly respond to minimum wage increases in the same way in boundary areas as elsewhere.

- It is unlikely that significant business relocation from the inside of the boundary to the outside would result from a London minimum wage, though consideration of local business characteristics will be important in determining where relocation might be expected. Care would also need to be taken in the regulations to ensure that employees whose work involves being physically located away from their employers' premises are still covered by the minimum wage if they are working in London. Where this does occur, it is not likely to lead to job losses or a worsening of conditions for low paid workers; it would just mean that workers do not get the benefits from the introduction of a higher minimum wage in London.

- Evidence from tax policy suggests that the impact on new starters in boundary areas is also unlikely to be significant.

- There may be a spill-over effect on boundary areas outside London, where wages in low paid sectors outside the boundary rise to compete for labour with firms inside the boundary.

In the next and final section we consider the wider policy implications of our analysis so far.

7 CONCLUSIONS AND RECOMMEND-ATIONS

There is currently no legal basis for the implementation of a minimum wage for London, or indeed for any other part of the United Kingdom.

The analysis in this pamphlet shows, however, that there is a rate at which a minimum wage for London could be set that is higher than, yet consistent with, the current national minimum wage.

Because the London economy is substantially different to that of the rest of the UK (chapter 1) and yet London's lowest paid are still paid more than the lowest paid elsewhere in the UK (chapter 2), the current national minimum wage has less impact in London than it does elsewhere in the country.

This means that it is likely that a higher minimum wage could be introduced in London in a way that does not lead to a rise in unemployment. We estimate that if this had been done at the start, in a way that was mindful of the same considerations as affected the initial choice of the level of a national minimum wage, London's initial minimum wage could have been around 20% higher than the national rate (chapter 3). On the presumption that the London economy would have reacted to the introduction of this minimum wage in a similar way to how we know the economy as a whole reacted, there is no reason to think this differential would not have been maintained over time, leading to a London minimum wage in October 2013 of £7.57 (chapter 4).

However, this does not mean it would be advisable immediately to introduce a London minimum wage at this rate. If the Low Pay Commission were asked to make a recommendation of a London minimum wage to be introduced now, with a similar coverage and impact on low paid sectors as the national minimum wage, it would be more likely to come up with a figure nearer £6.75 in 2013 (chapter 5). The reason for the difference is that, while the existence of a minimum wage has seen pay for the lowest-paid rise for the rest of the country since 1999, London has hardly been impacted because the wages of the lowest paid in London have always been above the national minimum wage. The existence of a national

minimum wage has over the last 14 years lifted the pay of the lowest-paid in the country nearer to that of London.

Our proposal is therefore that government should legislate to require the LPC to recommend a rate for a London minimum wage; our independent estimate is that this could start at around £6.75 in today's prices. Over time, and once the response function of low paid sectors in London is better understood, this could rise at a faster rate than either wage inflation or the national minimum wage, to a reference value of around 20% higher than the national minimum wage (or to the point at which firms cannot absorb the increases without risking job losses, whichever is sooner) because our analysis indicates that this is the London level that would be economically equivalent to the national minimum wage. Evidence from the US and also from the effect of differing business rates across UK local authority boundaries indicates that this should be achievable without particular economic distortions at the Greater London boundaries (chapter 6).

7.1 **Coverage**

It follows from the arguments above that there are currently a significant number of workers in London who are being paid less than their employers could afford; that is, they are being paid less than the monetary value of their work in the local economy.

There are around 3.5 million workers in London. If a London minimum wage were introduced at a rate equivalent to £6.75 in 2013, it would bring around another three per cent of workers into the minimum wage, as well as increasing the income from work to the two per cent who were already covered by the national minimum wage. That is to say, it would positively affect around 175,000 workers in London. The lowest paid of these would see their hourly pay from work rise by 44p per hour, equivalent to around £15 per week or around £800 per year in 2012 prices, although it is important to note that concomitant changes to means-tested benefits may not mean that their disposable income increases by this amount, depending on their overall family circumstances.

These calculations use Low Pay Commission estimates of the coverage of the national minimum wage in London by percentile in April 2012, as shown graphically in Figure 8 in chapter five. We have calculated a London minimum wage rate from October 2011 of around £6.50 that corresponds to our estimate for October 2013 of £6.75 by adjusting it downwards by the same proportion as the national minimum wage rose over this time.

If, in the long term, as we suspect, the differential between the national minimum wage and a London minimum wage could rise to nearer 20%, then using the same wage distribution, this could increase the income from work for up to 315,000 working Londoners. The lowest paid of these would see their income from work rising by up to £1.26 per hour, equivalent to £44 per week or around £2,300 per year in 2012 prices.

7.2 **Winners and losers**

On the expectation that the London economy will adjust in the same way that the national economy has adjusted to the introduction of a minimum wage, and consistent with the evidence from other countries where a minimum wage has been introduced at a prudent level, then it is likely that firms will adjust by raising productivity, achieving cost savings through reduced labour turnover, and by passing some costs to consumers. All of these effects are small since the wage bill is a small proportion of total costs for most of the businesses in question. There could be some costs to the public purse through increases in the wage bill for public sector workers, but these are also likely to be small given that public sector workers are generally paid more than the proposed minimum wage.

The Exchequer will gain through increased income tax payments and National Insurance payments, although the effect of the former will be lessened as progress is made towards a £10,000 tax-free allowance. Savings will also be made through paying out less in means tested benefits such as working tax credit, child tax credit, income support, housing benefit and council tax benefit.

The Low Pay Commission receives official estimates of the effect on the Exchequer of changes to the national minimum wage in 10p bands. In their 2013 report they used this to estimate that the Exchequer yield and savings from the uprating of the national minimum wage by 12p from October 2013, a change which they estimated would affect around two million people, would be in the order of £183m. The Exchequer effect of an increase in the London minimum wage of up to 40p, affecting a tenth of the number of people, is likely to be that the taxpayer would benefit by some tens of millions of pounds.

A number of independent models have also looked at the effect on the Exchequer of raising low pay, mainly in the context of the debate on the introduction of a living wage.

The Institute for Fiscal Studies examined the impact on receipts of income tax and National Insurance, and on spending on benefits and tax credits, if all private sector employers (and as a variant, all employers) increased wages to a 'living wage' of £7.85 in London and £7.60 in the rest of the UK, and if there were no change in employment. Their analysis concluded that there was an implied effective tax rate on the additional earnings of 46% (IFS, 2010).

The Institute for Public Policy Research, together with the Resolution Foundation, has conducted its own analysis of the Exchequer effects of introducing a living wage, including the effect in London of the introduction of a London living wage at a rate of £8.55. They concluded that if all London employees were paid at least the London living wage, it would affect 426,000 people and the Treasury would benefit to the tune of £691m, of which around two-thirds would come through increased income tax and National Insurance payments, and around a third from reduced benefit expenditure (Lawton & Pennycook, 2013).

A higher estimate – £823m – of the gain to the Exchequer from the introduction across the capital of a London living wage is obtained by case studies and analysis conducted by the Queen Mary University of London, with the difference partially attributed to a higher estimate of the number of people who would be affected (Wills & Linneker, 2012).

These figures are not directly applicable to our analysis because we are only concerned with those who would be affected by a smaller increase in the minimum wage. However, if as a rough approximation we consider that the gains would be roughly split between the individual and the Exchequer, this would imply that a 7% increase in the London minimum wage, where 3% of employees are already paid the minimum wage and a further 3% would be brought in, would lead to gains to the Exchequer of somewhere in between £36m and £73m.

In order to gain greater precision for the purposes of this project we commissioned Landman Economics to estimate specifically the Exchequer effects of an increase in the London minimum wage to firstly £6.75 and secondly £7.57. This led to estimates of £61m and £280m respectively, broken down as shown in Table 17, below.

There is no precedent from the history of the national minimum wage for the deployment of these Exchequer gains to be hypothecated for any particular purpose. However, the introduction of a London minimum wage may be more palatable to businesses if some of the gains at least were ring-fenced to be

Table 17: Exchequer effects from the introduction of a London minimum wage
Source: Landman Economics, for Centre for London / Note: Totals do not add due to rounding.

Gain to Exchequer (£m)	London minimum wage of £6.75	London minimum wage of £7.57
Income tax	15	72
Employee NICs	9	42
Employer NICs	15	68
Means tested benefit saving	8	29
Tax credit saving	15	68
Total public finance gain (£m)	**61**	**280**

associated with, for example, additional capital spending on the city's infrastructure.

7.3 **Phasing**

The potential negative impacts of the introduction of a higher minimum wage for London could be very damaging if it were introduced at too high a level or too abruptly. We therefore recommend that London businesses be given at least a year to prepare for the introduction of a London minimum wage.

If, however, the updated rate for a London minimum wage is, like our proposal, around seven per cent higher than the national minimum wage, it seems plausible that this could be introduced in one year, provided business has been given enough time to prepare and adjust. The reason is that in the early history of the national minimum wage, the rate rose by a similar amount on a number of occasions, notably in 2003 and 2004. Indeed, in 2001 the national minimum wage rose by over ten per cent in one year, although increases have been more muted since then. However, if the concurrent increase in the national minimum wage were high at the same time, then it may be more prudent to phase in the initial seven per cent differential caused by the introduction of a London minimum wage over two years.

Once evidence is collected as to the effect of a London minimum wage on the wider economy, there is scope to widen the differential with the national rate in stages. We recommend that the differential is progressively widened over a number of years, while collecting evidence as to its impact, to explore whether a differential of 20% to the national minimum wage can be achieved.

7.4 **Youth and apprentice rates**

In this report we have only considered the adult minimum wage rate for London, which applies to workers aged 21 or over. Of course, the Low Pay Commission also makes recommendations regarding:

- a youth development rate (£5.03 per hour in October 2013);
- a 16–17 year old rate (£3.72 per hour in October 2013);
- an apprentice rate (£2.65 per hour in October 2013);
- a daily accommodation offset (£4.91 per day in October 2013).

It is beyond the scope of this report to consider what the equivalent rates for London would be for these categories of worker. Given the subjective and cautious nature of the estimates we have made for the adult London rate, it is unlikely that we would be able to recommend youth rates with any precision. There is also a problem with data: the ASHE database simply does not publish information on hourly pay rates by age and region, for example, making it hard for comparisons to be made.

Moreover, there are good reasons why a simple comparison with the methodology of the Low Pay Commission in setting these additional rates might not be appropriate. For example, London attracts young people to work and study in a way that other parts of the country do not, which might mean that the youth labour market operates in a different way to elsewhere. The housing market in London is also very different from the national average, both in terms of average house prices and stratification. This may give rise to different values being attached to any accommodation offsets in London compared to elsewhere in the country.

What this report has done, however, is indicate that there is a case to be made for a higher minimum wage level for London, and give some guidance as to what an initial level might be and where it might be expected to stabilise over time. We recommend that prior to the introduction of a London minimum wage,

sufficient data be collected and analysed, in conjunction with the Office of National Statistics, for corresponding recommendations to be made regarding the other rates that could be introduced for London.

7.5 **Legislative change**

There are two ways in which a London minimum wage could be introduced. The first is through an amendment to the 1998 National Minimum Wage Act to enable the Low Pay Commission to make a recommendation to government on the level of a London minimum wage, in addition to its recommendations regarding a national minimum wage.

The second, which is more legally complex, is through amendment(s) to the Greater London Authority Act 1999 and/or the Greater London Authority Act 2007 to enable them to take on the function of setting a higher minimum wage for London, with corresponding amendments to remove this function from the national government.

It would seem advisable that the Low Pay Commission should be given the responsibility for setting a London minimum wage. It is a successful, independent and credible institution, and if it had responsibility for both rates it would be able to ensure consistency in methodology and provide greater certainty to the wider economy.

The question then would be whether the Low Pay Commission's recommendation of a rate for a minimum wage for London should be made to national government for decision, or to the Mayor of London. In practice, recommendations by the LPC are rarely overturned (although their recommendation on an apprentice rate was overturned in 2013), but the fact that the final decision rests with government is nevertheless an important democratic check on the deliberations of the Low Pay Commission.

Given the existence of democratic institutions at a Greater London level, namely the Mayor and the London Assembly, we recommend that the final

decision of a rate for a minimum wage for London should be made by the Mayor of London. However, in order to raise the threshold for the rate to become politicised, we also recommend that the Mayor should only be able to overturn a recommendation from the Low Pay Commission if he can obtain the support of a two-thirds majority of the Assembly.

There are other compliance and regulatory issues that arise from having two separate rates within one country. Although the analysis of the previous chapter suggests that economic distortions from having a minimum wage boundary are unlikely to be troublesome, there may be advantages to specifying clearly the definition of 'workplace' in the legislation in order to prevent, for example, firms from establishing a legal entity outside London in order to avoid paying the London minimum wage to employees who nevertheless work in offices or other residential or commercial premises within London. Just as an overseas-registered company must pay the UK minimum wage for employees in the UK, we recommend that people working in any of the London boroughs should be paid the London minimum wage even if their firm is headquartered outside.

7.6 **In short**

We therefore recommend that the National Minimum Wage Act be amended in order to require the Low Pay Commission to make recommendations to the Mayor of London on the level of a minimum wage for London, and that national government should continue to receive the recommendation for the level of a minimum wage for the rest of the country.

It seems likely, if this is done, that the minimum wage could be raised in London to benefit initially around 175,000 workers, and over time potentially up to 315,000. This would be a substantial inroad into low pay in the capital and could be achieved at a net benefit to the taxpayer and without damaging London's competitiveness or its wider economy.

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When the national minimum wage was first introduced, in 1997, many people worried that it would cause unemployment. Yet there is now widespread consensus that there has been little effect on employment levels, whilst the policy has ensured that people who work are fairly rewarded, with correspondingly reduced reliance on benefits. All the main political parties now support the minimum wage – indeed they are examining ways of strengthening it.

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