

THE NEW 'NATIONAL LIVING WAGE' – WHAT DOES IT MEAN FOR LONDON?

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SUMMARY

Since 1998, the National Minimum Wage has been set by the Low Pay Commission based on their calculation of the highest level which would not damage employment. In July 2015 the Chancellor effectively replaced the National Minimum Wage with a new National Living Wage for those aged 25 and over. This new rate would no longer be set with regard to employment, but would instead move towards a target 60 per cent of median income by 2020.

In previous research, we argued that London could support a higher minimum wage that could progressively be increased to a long term rate as much as 20 per cent higher than the national level without leading to job losses.

This paper updates our previous estimate and concludes that from October 2015 a London-specific Minimum Wage could be set somewhere between £7.05 and £8 an hour. Given that the Chancellor's new National Living Wage will begin at the lower end of that range, starting from £7.20 an hour in 2016, it should not lead to significant job loss in London. The bulk of the 60,000 job losses that the Office of Budget Responsibility estimates will occur as a result of the new policy are therefore likely to be outside London.

The existence of very large numbers of higher paid jobs in London means that the London wage distribution displays significant differences to that of the UK as a whole

BACKGROUND AND CONTEXT

Since the National Minimum Wage was introduced in 1998, the Low Pay Commission has set it at the highest level that would not cause a loss of jobs. But the National Minimum Wage has always been set for the country as a whole, making it a better ‘fit’ for some places than others. In London, where wages at the lower end of the scale are higher, the minimum wage covers fewer people than in other cities, and is lower relative to average wages. There has always been scope for London to support a higher minimum wage.

In November 2013 Centre for London published an estimate of the level at which a London-specific minimum wage could be set so that it had the same immediate impact on low-paid London as it currently has for the country as a whole.¹ We calculated that Londoners earning the minimum wage could be given a 7 per cent pay rise. This estimate was arrived at by shadowing the methodology used by the Low Pay Commission but applying it to the London economy rather than the UK economy.

Since then there has been considerable discussion of a London Minimum Wage. In December 2013, the London Assembly passed a motion welcoming our report and called on the Mayor and the government to implement a London minimum wage.² And a number of politicians running for the 2016 London mayoral elections have endorsed our proposal.³

In the intervening two years the National Minimum Wage has been updated, to £6.50 from October 2014 and is due to rise to £6.70 in October 2015. These rises reflect changes in the economic environment. The rate of unemployment, which had been falling slowly since 2011, began to fall faster from mid-2014. And wages, which were rising more slowly than inflation when we undertook the initial analysis, started to rise in real terms around the same time.⁴

In the July 2015 Summer Budget, the Chancellor of the Exchequer effectively replaced the National Minimum Wage with a ‘National Living Wage’ for those aged 25 and over (those aged 21 to 24 will continue to receive the National Minimum

1 Ussher, K *London Rising: the case for a London minimum wage* (London: Centre for London, 2013).

2 Plenary session of the London Assembly held on 4th December 2013.

3 See for example, Lammy, D. ‘London needs its own minimum wage’, *Huffington Post*, 19 November 2013; Jowell, T. ‘London workers need a £1 boost to minimum wage’, *Evening Standard*, 16 March 2015; Diane Abbott quoted in ‘Diane Abbott: defending Hackney North with half an eye on City Hall’, *The Guardian*, 28 April 2015; Sadiq Khan statement to Unison members, available at www.unison.org.uk/documents/4632

4 ONS *UK Labour Market Statistical Bulletin*.

Wage).⁵ This new rate will no longer be set with regard to employment loss, but will instead target 60 per cent of median earnings. It will be introduced at £7.20 an hour in April 2016 and rise to an estimated £9.35 an hour by 2020, which the OBR estimates will be 13 per cent higher than the National Minimum Wage would otherwise have been for this age group.⁶ There has been some debate around what level of job losses will be caused by this new, higher rate, with the OBR suggesting that around 60,000 people will lose their jobs nationwide.⁷

In this paper we apply the methodology used in our previous research to more recent data to revisit our estimate of the minimum wage that London could support without job losses, and to compare this to the new National Living Wage proposed by the Chancellor.

METHODOLOGY

We have replicated the methodology of our original paper but used more up-to-date data in order to arrive at an estimated London Minimum Wage rate for 2015–16. The data we use is the latest available and was collected in April 2014, when the National Minimum Wage was £6.31.

The precise research question is: *“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?”*

We have considered this question in two main ways, the “coverage” and the “bite”:

THE COVERAGE

This refers to the proportion of workers that are paid the minimum wage. Using data obtained directly from the Low Pay Commission we compare the UK-wide minimum wage coverage with the coverage within London. This enables us to obtain a first estimate of the right level for a London minimum wage, based on giving it the same coverage in London as the National Minimum Wage has for the UK as a whole.

5 In this paper, we use 'National Living Wage' to refer to the Government's new policy announced in the 2015 Summer Budget. This is distinct from the living costs-based 'Living Wage Foundation National Living Wage' and 'Living Wage Foundation London Living Wage', which are described as such.

6 Office for Budget Responsibility (2015) Economic and Fiscal Outlook.

7 Ibid.

THE BITE

This refers to how the level of the National Minimum Wage compares to the median hourly rate of pay and is commonly used as a metric in academic literature to compare the impact of minimum wages introduced in different geographic areas.

However, the existence of very large numbers of higher paid jobs in London means that the London wage distribution displays significant differences to that of the UK as a whole. This pushes the London median wage up, without necessarily affecting the situation at the lower end of the wage distribution.

For this reason, rather than exploring the bite for the distribution as a whole we instead look at the bite in the 83 specific occupations that are defined by the Low Pay Commission as making up the 'low pay sectors'. For each of these, we obtain estimates of the median hourly pay for the UK, calculate the 'bite' (the National Minimum Wage expressed as a percentage of the relevant median hourly pay) and then apply this percentage to London median hourly pay rates to identify a London minimum wage.

By taking a weighted average of these 83 results we were then able to find an hourly pay rate that has the same economic impact on the low pay sectors in London as the National Minimum Wage has on these same sectors for the UK as a whole. This is our second estimate of the level of a minimum wage for London.

Being mindful of the level of accuracy of our calculations and the decision history of the Low Pay Commission, we then, as last time, take the average of these two estimates, index it up to October 2015 using the same multiple as the National Minimum Wage increases over the same period and round it to the nearest 5p.

The primary data source is the Office of National Statistics Annual Survey of Hours and Earnings (ASHE) where the most recent data are the provisional 2014 results published in November 2014. We use data on place of work, rather than place of residence, and the data relating to gross hourly earnings excluding overtime for all workers corresponding to ASHE tables 7.6a and 15.6a.⁸

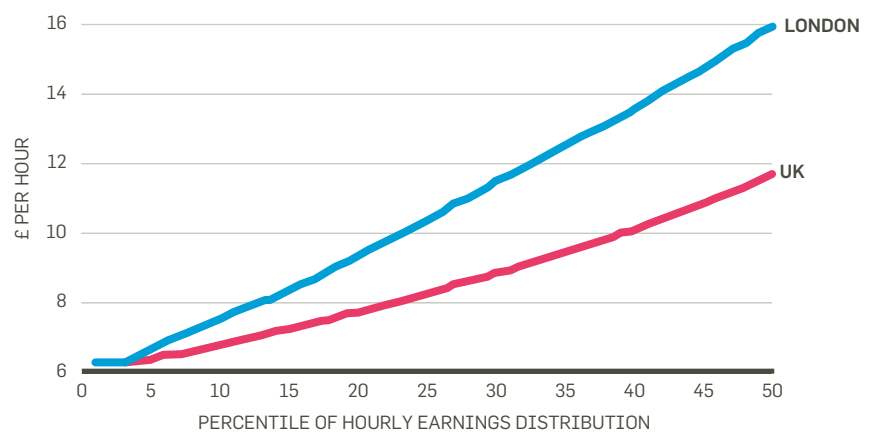
8 Our 2013 report used the tables relating to gross earnings (including overtime). The differences are very slight but we have chosen to use gross earnings excluding overtime for this update for consistency with the Low Pay Commission approach.

RESULTS

COVERAGE

The chart below shows how the lower end of the wage distribution varied between London and the UK as a whole in April 2014, when the minimum wage was £6.31, the most recent date for which data is available. As can be seen, the coverage of the minimum wage in London, at just under 3 per cent of the workforce, is less than for the UK as a whole, where wages start to rise above the minimum wage a little under the 5 per cent mark.

Figure 1: Hourly earnings excluding overtime distribution by area of work, 21+, 2014



Source: LPC estimates based on ASHE 2014, 2010 methodology, UK.

In order to achieve the same coverage of the minimum wage in London as is currently experienced by the UK as a whole, we therefore need to look at the wages paid at the 4th and 5th percentile in London. These are shown in the table below.

Table 1: Distribution of the lowest wages, London and UK

PERCENTILE	UK £	LONDON £
1	6.3100	6.3100
2	6.3100	6.3100
3	6.3100	6.3628
4	6.3158	6.5000
5	6.3787	6.6667

Source: LPC estimates based on ASHE 2014.

At the 4th percentile, the UK hourly wage is still at practically the same level as the minimum wage, but starts to rise by the 5th percentile. In order to achieve the same coverage in London in 2014, a minimum wage rate at the 4th percentile of the distribution seems to therefore be the most appropriate, namely £6.50. This is our first estimate.

BITE IN LOW PAY SECTORS

The annex to this paper (available online at www.centreforlondon.org) lists the 83 occupation types that, taken together, make up the Low Pay Commission's definition of the low paid sectors. For each, the number of jobs and the median pay in 2014 is displayed, for the UK and for London, and the bite of the minimum wage is then calculated for each.

The final column then calculates the implied minimum wage level in London that has the same bite in London as the National Minimum Wage has for the UK as a whole in that occupation classification. Table 2 shows how this is done for the largest low paid groups: "Care workers and home carers", "Sales and retail workers", "Cleaners" and "Kitchen assistants".

Table 2: Median pay and bite for selected low pay sectors, London and UK, 2014

OCCUPATION	SOC CODE	UK MEDIAN £	UK BITE AT £6.31	LONDON NUMBER OF JOBS ('000S)	LONDON MEDIAN £	LONDON BITE AT £6.31	DERIVED LONDON MIN WAGE RATE
CARE WORKERS AND HOME CARERS	6145	8.00	78.9	63	8.24	76.6	6.50
SALES AND RETAIL WORKERS	7111	6.95	90.8	144	7.67	82.3	6.96
CLEANERS AND DOMESTICS	9233	6.87	91.8	71	7.00	90.1	6.43
KITCHEN ASSISTANTS	9272	6.57	96.0	60	6.97	90.5	6.67

Source: ASHE 2014 provisional results, table 15.6a; Centre for London calculations.

Taking a weighted average of all 83 implied minimum wage rates yields a second estimate of a London minimum wage of £6.80 in April 2014.

OUR ESTIMATE

Taking an average of these two estimates gives our final estimate for a 2013–14 minimum wage for London of £6.65. This is 5.4 per cent higher than the minimum wage at the time, of £6.31. On 1st October 2015, the National Minimum Wage will be £6.70, so our equivalent London minimum wage rate using the latest data and rounding to the nearest 5p is £7.05. This is our estimate of the starting level at which a London Minimum Wage could be introduced now, and so the lower bound of a London Minimum Wage that would not lead to job losses

DISCUSSION

The immediate point to note is that the wages of the lowest paid have risen more slowly in London in the last two years than they have in the rest of the country. For example, in the year to April 2014, the pay of cleaners, and that of sales and retail workers, rose by 2.2 per cent across the UK as a whole, but in London the equivalent rises were only 0.7 per cent and 1 per cent respectively.

Tables 3 and 4 below show the wage distribution in the UK and London in 2012 and 2014, showing that the gap between London and UK wages at the 10th percentile narrowed from 13.0 per cent to 11.6 per cent in that time.

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

	NUMBER OF JOBS ('000)	PERCENTILES										
		MEDIAN	10	20	25	30	40	60	70	75	80	90
UNITED KINGDOM	24,203	11.23	6.45	7.40	7.92	8.49	9.73	13.22	15.72	17.37	19.16	24.99
LONDON	3,533	15.68	7.29	9.17	10.22	11.30	13.42	18.35	21.61	23.68	26.15	36.28
% LONDON HIGHER		39.6	13.0	23.9	29.0	33.1	37.9	38.8	37.5	36.3	36.5	45.2

Source: ASHE 2012 Revised, table 7.6a.

Table 4: Hourly pay in London and the UK, median and percentiles, 2014

	NUMBER OF JOBS ('000)	PERCENTILES										
		MEDIAN	10	20	25	30	40	60	70	75	80	90
UNITED KINGDOM	25,010	11.54	6.64	7.58	8.10	8.69	10.00	13.56	16.11	17.66	19.52	25.43
LONDON	3,789	15.80	7.41	9.12	10.08	11.23	13.42	18.42	21.60	23.63	26.35	36.03
% LONDON HIGHER		36.9	11.6	20.3	24.4	29.2	34.2	35.8	34.1	33.8	35.0	41.7

Source: ASHE 2014 provisional results, table 7.6a.

One possible reason for this convergence is that rises in the National Minimum Wage are continuing to have a greater effect outside London than in the capital itself. This is demonstrating the policy's success in tackling exploitative pay rates outside London, but also points to its relatively limited impact in London, where the wage distribution is different and higher.

Another possible reason, which may also explain why the differential narrowed across all pay levels, is that the financial crisis and subsequent recession had a more negative effect on employment outside London such that there is a greater 'bounce back' in areas outside the capital as the economy recovers.

It is important to bear in mind however that while we have estimated the rate at which a London minimum wage could be introduced today, it is likely that once introduced, the rate could be increased over time at a faster rate than for the country as a whole. The reason for this is that prior to the introduction of the National Minimum Wage the differential between low pay in the UK and in London was far wider, as table 5 below shows.

Table 5: Hourly pay in London and the UK, median and percentiles, 1997

	NUMBER OF JOBS ('000)	PERCENTILES										
		MEDIAN	10	20	25	30	40	60	70	75	80	90
UNITED KINGDOM	20,858	7.00	3.79	4.51	4.89	5.26	6.06	8.16	9.65	10.59	11.74	15.27
LONDON	2,845	9.51	4.74	5.81	6.40	7.01	8.16	10.97	12.82	13.96	15.48	20.72
% LONDON HIGHER		35.9	25.1	28.8	30.9	33.3	34.7	34.4	32.8	31.8	31.9	35.7

Source: ASHE 1997, table 7.6a.

Comparing Table 5 with Tables 3 and 4 suggests that the effect of introducing a minimum wage has indeed been to narrow the differential between low pay outside London and that within. In 1997 the differential at the 10th percentile was 25.1 per cent; in 2012 it was 13.0 per cent; the provisional data for 2014 show it has narrowed further to 11.6 per cent.

Our 2013 report suggested that if it had been asked to recommend a London rate at the outset, the Low Pay Commission might have gone for a rate of around £4.20 in 1999, which is 20 per cent higher than their recommendation of £3.50 for a starting rate for the country as a whole.

It is therefore reasonable to think that an appropriate steady state differential between the London and National Minimum Wage rate could be around 20 per cent, equivalent to a London rate of around £8 from October 2015. This would reflect the fact that the rise in low wages outside London, partly as a result of the National Minimum Wage policy, has not been paralleled by equivalent rises within the capital. We therefore consider this to be the upper bound of a London Minimum Wage that would not lead to job losses.

OTHER APPROACHES TO MINIMUM AND LIVING WAGES IN LONDON

In his 2015 Summer Budget, the Chancellor surprised many by announcing a new minimum wage policy. He introduced a new National Living Wage for workers aged 25 and above, set at £7.20 from April 2016, and asked the Low Pay Commission to set out how this could reach 60 per cent of median earnings for the relevant age group by 2020. Based on current forecasts, this means that the National Living Wage would reach £9.35 per hour by 2020. This is a shift in government policy, which previously set the National Minimum Wage at the level that would help as many workers as possible without damaging their employment prospects. By contrast, the National Living Wage will be tied to median earnings.

Can we calculate a London equivalent to the National Living Wage? This is beyond the scope of this paper, and the calculation is not straightforward. Firstly, London earnings data are not available for those aged over 25, but only for those over 21. Secondly, London has more highly paid workers, so the median London wage will be significantly higher than the national median, and not fully comparable to it. In 2014 the median hourly wage for all employees over 21 was 36 per cent higher in London than the UK – £15.94 compared to £11.71. Bearing in mind the caveats above, if the same policy were applied to London this could indicate a London equivalent to the National Living Wage in excess of £12.00 per hour by 2020 with a far steeper trajectory in the years leading up to then.

A third approach to setting a threshold for low pay in London is the London Living Wage promoted by the Living Wage Foundation. This is calculated on the basis of living costs, so represents an entirely different approach, and has been adopted voluntarily by many London businesses. The Living Wage Foundation London Living Wage currently stands at £9.15 per hour (16 per cent higher than the Living Wage Foundation National Living Wage of £7.85).

CONCLUSION

In the 2015 Summer Budget the Chancellor effectively raised the minimum wage to £7.20 for all people over 25. Using the latest data, we estimate that London could support a minimum hourly wage somewhere between £7.05 and £8.00 without job loss.

It is therefore likely that the introduction of the National Living Wage will cause negligible job losses in London, at least once the initial adjustment period is over. Because the minimum wage has always been set too low for the capital, employers in London will in effect be going through the same process of adjustment that the rest of the UK has already been through with the introduction of the original National Minimum Wage.

This report has not sought to recalculate the London Minimum Wage on the basis of the new policy. However, depending on whether policy makers would be prepared to accept job losses, a London equivalent to the National Living Wage might be set significantly higher. There continues to be a case for London to be able to set its own minimum wages, reflecting the very different economic circumstances that operate in the capital.

About the author

Kitty Ussher is an economist and Managing Director of Tooley Street Research, an organisation she set up in 2013. She was the MP for Burnley from 2005–10 and she has held Treasury and DWP ministerial posts.

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