

BULLETIN

Low pay and government policy

Introduction

Concern about the position of low paid workers has grown over the second half of the 1980s and throughout the 1990s. While well qualified workers experienced rising real wages, earnings inequality in the labour force increased. Not only did low paid workers see their wages fall in a relative sense, but some workers at the bottom of the earnings distribution saw the real value of their earnings fall in absolute terms. Increases in earnings inequality have been accompanied by increases in the proportion of the workforce in low paid jobs and evidence of lower upward earnings mobility.

The reasons behind the observed changes are still being debated in academic and political circles. Hypotheses range from changes in institutional structures (such as decline in the power of trade unions, abolition of the Wages Councils), technological forces, shifts in the pattern of trade, to changes in the composition of the workforce (increases in both the proportion of women and of highly qualified workers). Undoubtedly some of the change in the distribution of earnings is due to structural changes in employment characterised by a 'hollowing out' of the occupational distribution of employment. Between 1981 and 1996 growth in employment was concentrated at the upper end of the occupation hierarchy (Managers and Administrators, Professional Occupations and Associate Professional Occupations) – occupations which tend to be filled by highly qualified individuals and at the lower end of the distribution (Personal and Protective Service

Occupations and Sales Occupations). These changes have been accompanied by a fall in employment in intermediate occupations (Craft and Related Occupations and Clerical and Secretarial Occupations). These trends are expected to continue over the next ten years (see *Review of the Economy and Employment*, 1997/98).

Government policy can directly and indirectly affect the situation of low paid workers. Direct policies include the introduction of a National Minimum Wage, changes in the legislative framework extending employment protection to part-time workers, introduction and extension of in-work benefits and reform of the National Insurance system. Indirect policies which affect low paid workers include changes in the unemployment benefit system, improving the provision of childcare and changes in the rules allowing Trade Union recognition.

This *Bulletin* highlights some of the recent changes in government policy which affect low paid workers, focusing on those where the Institute for Employment Research has undertaken some assessment or evaluation.

Identifying low paid workers

Low pay can be defined in a number of ways. An individual can be low paid if they receive a low hourly wage rate or if their weekly or monthly pay is below some minimum level. Some workers who are defined as low paid by one measure are not according to the other. For example, some employees working short hours can receive high hourly rates of pay and some employees on

low hourly rates of pay may work very long hours to increase their weekly pay. In a sense the most disadvantaged workers are low paid according to both definitions. Low hourly rates of pay tend to reflect a low value placed on an individual's skills and experience in the labour market which may arise through low levels of skill or a situation where supply of labour is in abundance. Individuals earning low levels of weekly or monthly pay may work only a few hours, a situation which may or may not be voluntary. For example, the only jobs available may be for a short number of hours, or the worker may have other responsibilities which limit the number of hours they can work (such as caring responsibilities or educational commitments), or they may wish to supplement other forms of income by working only a limited number of hours per week/month.

Policies aimed at helping workers on low rates of pay

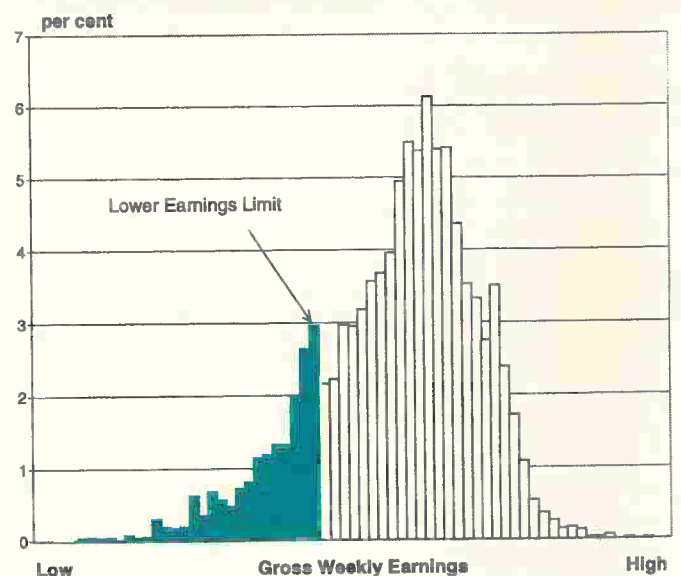
The Institute for Employment Research has recently completed or is currently undertaking a number of projects which focus on low paid workers and their experience in the labour market.

Low pay and the National Insurance system

The Equal Opportunities Commission funded a project which focused on the very lowest paid workers in the labour force: workers earning below the Lower Earnings Limit (LEL) for National Insurance (NI) contributions (McKnight *et al*, 1998). In 1997 approximately 2.6 million employees received earnings below the LEL (£62 per week). These workers (nearly 80 per cent of whom are women) not only face short-term disadvantage in terms of the low level of pay they receive, but are also exposed to long-term disadvantage as the failure to accumulate NI contributions reduces their entitlement to some state benefits. If workers remain in these very low paid jobs over long periods of time they can face a situation in retirement where the value of their basic State Pension is below subsistence needs. The operation and rules of the tax system creates an incentive for workers and their employers to keep wages below the LEL. Setting wages just below the LEL avoids the high marginal tax rates just above the LEL. Thus the employer gains by avoiding the payment of NI contributions (saving administration costs as well as the actual payments) and employees gain in the short run by increasing their take home pay. This creates 'bunching'

of employees just below the LEL. Figure 1 shows the earnings distribution of female employees. The shaded portion of the distribution represents women earning below the LEL. The crowding of employees just below the LEL is evident and provides a good example of how government policy can affect the functioning of the labour market for low paid workers.

Figure 1
Earnings distribution of female employees



Source: Family Resources Survey 1994/95

Reforms announced in the March 1998 budget should soften the impact of the threshold by reducing the high marginal tax rates just above the LEL. From April 1999 the NI threshold for employers will be raised to the higher personal taxation allowance (£81 per week, 1997/98), thereby reducing labour costs for employers of low paid workers. The Government also announced an intention to raise the NI threshold for employees whilst protecting the benefit entitlement of those earning between the LEL and the personal taxation allowance. This reform will involve a radical revision of the contributory principles underlying the NI system.

In-work Benefits

In-work benefits have been increasingly used to supplement the incomes of workers in low paid jobs. Since 1988¹ couples with children and single parents in receipt of low pay, who meet certain eligibility criteria, have been entitled to a benefit which tops up their household income (Family Credit). Since 1994 a pilot

¹ Replacing Family Income Supplement, introduced in 1971.

programme (Earnings Top-Up) extending the benefit to couples without children and single people receiving low earnings has been in operation in eight regions of the United Kingdom. The Institute for Employment Research has been commissioned by the Department of Social Security to look at the wider labour market impact of extending in-work benefits to these further groups of individuals. The benefit is aimed at increasing the incomes of low paid workers, increasing the difference between out-of-work income and in-work income and thereby increasing the incentive for the unemployed to accept low paid jobs. By guaranteeing the benefit for periods of six months it is also aimed at reducing turnover in low paid jobs. The concern is that in the process of providing a benefit to a group of low paid workers the employment opportunities of other workers is altered. This maybe by benefit recipients being substituted for non-recipients or through the displacement of workers in other sectors of the economy. Evidence from employers suggests that they are not only aware of the rules and operation of the benefit system but they use in-work benefits to keep wage costs down.

In the March 1998 Budget reforms to the delivery and increases in the generosity of Family Credit were announced, renamed as the Working Families Tax Credit. One major change is that Family Credit from April 1999 will be delivered through the 'pay packet' rather than through the benefit system, creating a stronger impression that this benefit is conditional on employment.

The introduction of Jobseeker's Allowance

Changes in the operation of the Unemployment Benefit system introduced in October 1996 resulted in the introduction of Jobseeker's Allowance (JSA). JSA replaced Unemployment Benefit and Income Support for unemployed claimants. Payment of the contributory (non-means tested) part of Jobseeker's Allowance was reduced from one year to six months followed by an entitlement based on income. These reforms were aimed at helping the unemployed search for work and, through the Jobseeker's Agreement, increasing the awareness of the individual's responsibility to search for work. The aim is to reduce unemployment by reducing the length of unemployment spells or by discouraging new claims. Many studies have shown that the longer individuals are unemployed the less likely they are to find employment (referred to in the literature as duration dependence or persistence). Although there is still disagreement on whether this is the direct result of the experience of

unemployment or if it is due to the characteristics of individuals who are more likely to remain unemployed for long periods of time, it is generally felt that helping the unemployed back into work in the early stages of a spell of unemployment is preferable (and less costly) than trying to help them after a greater time has elapsed.

An evaluation of the impact of the replacement of Unemployment Benefit with Jobseeker's Allowance, on behalf of the Department of Social Security, Department for Education and Employment, Benefits Agency and the Employment Service, is currently underway. The Institute for Employment Research is involved in a number of areas of this evaluation. In relation to low paid workers one significant piece of work will assess whether the quality of jobs (in terms of earnings) attained by claimants leaving the unemployment register at the six month threshold changed following the introduction of JSA. If entitlement to benefits ceases before an unemployed person is able to find their desired job (which matches their skills and experience) then they may be forced into accepting a job that pays less than their expected wage.

Persistence in low pay

While it is informative to examine the personal and employment characteristics of individuals currently in low paid jobs it is important to understand the long run prospects of low paid workers. Improvements in the availability and quality of datasets which contain repeat observations on individuals has led to considerable developments in our understanding of the employment and earnings dynamics of low paid workers. These studies have helped to identify factors which are associated with movement out of low paid jobs (education, training, experience) and which groups of workers are likely to remain low paid over long periods of time. Patterns of mobility reveal that low paid workers are more likely to cycle between 'low pay' and 'no pay' than higher paid workers, revealing a less stable and more tenuous relationship with the labour market. Cross-country comparisons reveal that both the increases in inequality and persistence of low pay were highest in Great Britain and the United States (compared with Germany, France, Italy and Denmark), suggesting that the increase in inequality over time has been linked with an increase in lifetime earnings inequality between groups of workers (OECD, 1997).

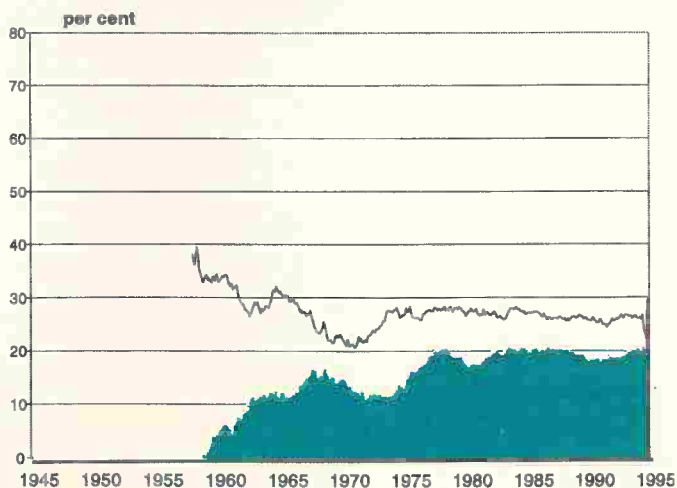
Investigation of work histories has revealed that the likelihood of leaving a spell of employment in a low wage occupation falls as the duration of the spell

increases (McKnight, 1998). This finding provides evidence of persistence in low paid jobs, suggesting that low paid workers become 'trapped' in low paid jobs.

Classification of spells of employment in low wage occupations into those which have lasted for three years or longer reveals that a large proportion of all spells of low pay are of long duration. Figure 2 shows the evolution of employment in low wage occupations over the working lives of women aged 45-54 in 1994/95. The percentage of these women's employment in low wage occupations over their working lives is indicated by the black line. A high percentage of these women started their employment in low wage occupations (around one-third). This percentage declined as they gained labour market experience and then stabilised at around 28 per cent from around 1975 when the cohort was aged 25-34. The shaded area shows the percentage of these women whose spells in low wage occupations had lasted for three years or longer. This figure shows that a large percentage of employment in low wage occupations is of long duration. Similar findings were found for women in other age cohorts.

Figure 2

The evolution of employment in low wage occupations for women aged 45-54 in 1994/95



Source Family and Working Lives Survey 1994/95

Comparing the work histories of low paid workers with better paid workers shows that low paid workers have typically spent more time out of the labour market in the past and that a greater proportion of any previous employment was in low wage occupations. For many individuals in low wage employment, low pay is not just a temporary feature of their working lives but can indicate the presence of a more permanent labour market disadvantage.

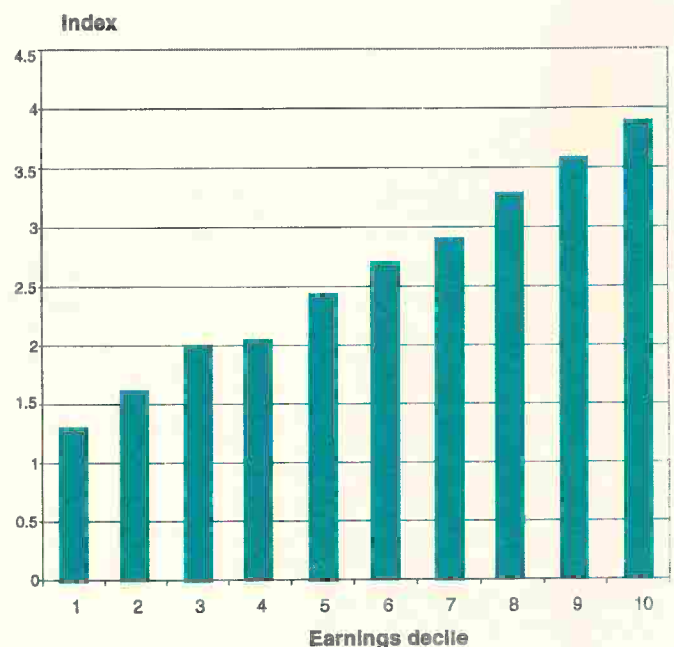
Low pay is clearly linked to concepts of poverty and other forms of social disadvantage. An important link has been established between the experience of low wage employment, unemployment and the likelihood of reliance on social housing. In a project financed by the Department of Transport, Environment and the Regions it was revealed that long periods in low wage occupations and unemployment over individual's working lives had a cumulative effect on the probability of living in social housing (McKnight and Elias, 1997).

Employment relations and conditions

A specially commissioned set of questions included in the Winter 1996/97 Labour Force Survey covered various aspects of relations and conditions of employment. These questions were used to inform the revision of the Government's social classifications (McKnight and Elias, 1997). An additive index, created from the responses to five questions on employment relations and conditions (covering structure of pay, autonomy at work and aspects of job security), can be used to compare individuals relations and conditions of employment. The index ranges in value from zero to five, where zero indicates the lowest score and five the highest. Comparisons of the average score of employees according to their position in the earnings distribution reveals that employment relations and conditions of employees increase in a fairly regular fashion with earnings (Figure 3).

Figure 3

Index of employment relations and conditions by level of earnings



Source: Labour Force Survey Winter 1996/97

Employees at the lower end of the earnings distribution not only suffer low levels of earnings but their contractual conditions of employment are considerably worse than those experienced by workers further up the earnings distribution.

National minimum wage

The introduction of a National Minimum Wage in April 1999 is the most direct way Government policy is aimed at helping low paid workers. A national minimum wage introduces a wage floor beneath which employers are not allowed to set wages. The motivation behind the introduction of a minimum wage is generally thought of as a mechanism to prevent employers from paying 'exploitative' wages. But what constitutes an exploitative wage? Depending on your perspective it can be a wage which is not considered to reflect the effort supplied by the worker or a wage which does not meet a socially acceptable level (i.e. fails to cover subsistence needs). The main concern related to the introduction of a National Minimum Wage is that while it might increase the average take home pay of low paid workers, it may also lead to a fall in employment and thereby deprive those workers it seeks to help of any earnings. International evidence suggests that a National Minimum Wage set at a reasonable level is unlikely to result in a permanent decline in the level of employment and may have positive redistribution effects.

Low wage employment plays a diversity of roles in different individuals' working lives. For some workers low paid jobs undoubtedly act as a stepping-stone to better paid jobs, or they can provide the means to support young people through further and higher education. For other workers low pay is a much more permanent feature of their working lives. Many low paid workers appear to alternate between having no earnings and low paid jobs or become 'trapped' in low wage employment. While it is important not to limit

employment opportunities it is equally important to ensure that low paid workers are not penalised through the tax and benefit system. Identification of what helps low paid workers improve their earnings could ensure that low paid jobs represent a real opportunity and not a dead end.

Current and future projects at the Institute involve:

- further in-depth analysis on the issue of wage-setting behaviour, in which employees and employers set wages in a way that leads to avoidance of National Insurance Contributions;
- examination of the role of workplace training on the probability of leaving low pay;
- an assessment of lifetime earnings inequality;
- the relationship between labour market flexibility and low wage employment;
- investigation of a link between household poverty and young peoples' labour market prospects.

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- OECD (1997). *Employment Outlook*. Paris. (IER provided the earnings information for the UK).

The full results of the Institute's latest assessment, including detailed tabulations and colour graphics, can be found in the

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Housing, Family and Working Lives

ISSN 0 9515763 6 4 £15.00

This research was commissioned by the Department of the Environment, Transport and the Regions to obtain information on housing-related issues from the *Family and Working Lives Survey (FWLS)*.

The FWLS is a detailed survey of over 9 thousand individuals aged 16-69 years conducted in 1994/95. It was designed to collect information covering the adult lives of respondents on a range of topics including education and training, work history, household formation history, receipt of benefits and housing history.

The report provides a range of information about:

- Demographic change, the evolution of household structures and housing tenure
- Housing tenure change and mobility between housing tenures
- Geographical mobility and housing tenure
- Unemployment, low wage employment and housing tenure
- Housing need
- Housing characteristics by ethnic group

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Low Pay and the National Insurance System: A Statistical Picture

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This research represents the first in-depth study of the characteristics of very low paid workers earning below the Lower Earnings Limit for National Insurance Contributions

Abigail McKnight, Peter Elias and Rob Wilson

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