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## **Living Wage in Wales: Exploratory Study**

**A final report for the Welsh Assembly Government**



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## 1 Executive summary

1.1 WAG's policies on area regeneration, child poverty, public service provision, equality and workforce development all help Wales move closer towards the vision set out in the *One Wales* coalition agreement. If introduced, a Living Wage policy has the potential to make a further contribution towards many of these policy areas and the overall *One Wales* agenda.

1.2 While the evidence in the United States and the UK suggest potential benefits to the introduction of Living Wage laws, results are mixed on the likely impact on employment and hours worked. However, most of the studies which have looked at the effect Living Wage and Minimum Wage policies were set against a backdrop of relatively benign economic conditions.

1.3 The world has recently changed quite dramatically and we are currently within the grip of a global recession. In these changed circumstances, increasing labour costs might have more serious implications for business performance and the employment of low-skilled workers than they have in the past.

1.4 From this perspective it might be wise to exercise caution in the pursuit of Living Wage policies. Either in terms of delaying their introduction or by seeking a gradual approach in which the effects of the policy can be more carefully evaluated. Most research suggests that in benign economic conditions the negative impacts of Living Wage and Minimum Wage policies are likely to be reduced (depending on the competitiveness of labour markets).

1.5 The scale of impact from a Living Wage policy will depend heavily on its coverage and whether it extends beyond public sector employees and employees delivering public sector contracts. The most significant areas of impact are likely to be realised in improved wages among low paid workers and marginal improvements in relatively deprived communities. For many other areas it is difficult to see how impacts are likely to arise, for example inactivity rates are unlikely to be affected.

1.6 In isolation, Living Wage policies are unlikely to provide an effective means of tackling poverty. Even under more ambitious simulations (presented in this report) the proportion of workers in low income households remains high. Simulations also demonstrate the relative bluntness of Living Wage policies as a means to tackle poverty. Benefits will accrue among households with more than one person working and where at least one worker already earns above the National Minimum Wage.

1.7 Most labour market indicators indicate the recession initially hit Wales harder than Great Britain as a whole. The dramatic deterioration in Wales' recent position is a cause for concern accounting for nearly one third of the rise in unemployment across Great Britain in the three months to August 2009.

1.8 Public sector finances have been strained by falling tax revenues coupled with demand for support across a range of industries struggling in the face of the downturn. Employee costs account for a large share of operating budgets across most public sector services.

1.9 In these changed circumstances, this report sets out serious implications for businesses of increasing labour costs. There are also serious implications for the public sector in increasing labour costs in the current environment. It is likely that constraints facing public sector budgets will require careful consideration of employee costs over the short to medium term.

## 2 Introduction

### Background and Objectives

2.1 In March 2009, The Welsh Assembly Government (WAG) commissioned an exploratory study into the implications of introducing a Living Wage in Wales. This report presents the interim findings from the first phase of the analysis.

2.2 The objective of this research is to improve understanding of the implications of introducing a Living Wage policy in Wales. The aim is to develop a robust assessment of the likely benefits and costs of such a policy. In particular, the study will:

- review existing evidence;
- estimate the size of the likely gain to workers who were covered by a Living Wage policy, taking into account the interaction of such a policy with the UK tax and benefit system;
- consider the effectiveness of a Living Wage policy as a means of (i) reducing child poverty and (ii) raising the incomes of poor households;
- provide broad estimates of the financial cost to the Assembly Government and other parts of the public sector in Wales;
- provide broad estimates of the financial cost to sub-contractors in the private or voluntary sectors and other employers who may be affected by a Living Wage policy, and an assessment of their likely response;
- assess the impact of a Living Wage policy that applies to Wales but not other parts of the UK on the attractiveness of Wales as a business location; and
- review the potential wider labour market impacts, including the likely effects on labour market supply and demand.

2.3 The first stage of this study focused on evaluations of Living Wage policies implemented elsewhere and the likely effects of a Living Wage policy in Wales. More detailed modelling (including estimates of financial costs and labour market impacts) may be considered following this report.

## Structure

2.4 The report is structured as follows:

- Section two outlines the emergence of Living Wage policies, and examines the links between a Living Wage policy and the current strategic commitments of WAG;
- Section three sets a Living Wage policy in Wales in the context of the Welsh labour market and the extent and nature of poverty in Wales;
- Section four sets out the initial findings from our literature review into the impacts and implications of Living Wage policies in different locations and at different points in time;
- Section five reviews the literature; how the Living Wage has been defined, calculated and implemented elsewhere including a review of evaluation and evidence of Living Wage policies;
- Section six links the key issues facing the Welsh economy and labour market with evidence of the impact from Living Wage policies elsewhere to estimate the likely impacts of a Living Wage policy in Wales;
- Section seven outlines the context and economic climate in the UK and Wales (including public sector finances) and how the economic cycle is likely to influence the impact of a Living Wage policy; and
- Section eight outlines the conclusions of this study including the potential for a second stage of research to provide more detailed impacts.

## 3 Policy Context

### The Emergence of a Living Wage Policy

#### Living wage policies in the United States

3.1 The concept of a Living Wage gained prominence in the United States with the first Living Wage ordinance in Baltimore. The Living Wage Campaign ([www.livingwagecampaign.org](http://www.livingwagecampaign.org)) suggests around 122 ordinances are currently in place across the United States. The movement has grown over time but the number of ordinances in place is still relatively small.

3.2 In the United States Living Wage ordinances do not generally cover city authority employees, instead they tend to be applied to firms under contract with the authority and in some cases in receipt of Business Assistance. Neumark (2002) highlights the difficulty of obtaining hard data on the number of workers covered by living wage ordinances.

3.3 In particular, there is a lack of information on city contractors, their wage structures and the number of workers directly affected by the policy. On the basis of surveys of employers, information on some city contracts, and approximate calculations, researchers have nevertheless been able to make rough estimates of the coverage of living wage ordinances in the US.

3.4 Typically these estimates suggest that the share of workers in the lowest quartile of the earnings distribution covered by a living wage ordinance was likely to be small (in the 1 per cent range). However, Neumark (2002) also notes that these estimates focus only on the coverage of city contractors and not on a broader coverage that extends to firms receiving Business Assistance and to firms employing low wage workers who are affected by spillover or emulation effects. As a result the 1 per cent range should probably be seen as a lower bound to the coverage effects in the United States.

#### Policy changes in the run up to devolution

3.5 The concept of a Living Wage is relatively new in Wales and across the UK as a whole. But the concepts of 'welfare-to-work' and 'making work pay' are well established, and have formed a major part of UK employability and anti-poverty policies over the last decade.

3.6 One of the major changes that helped to drive forward this change was the appointment of the Low Pay Commission in 1997, with a remit to make recommendations for a UK Minimum Wage. The Commission reported in June 1998, recommending an initial national Minimum Wage for adults of £3.60 per hour, rising to £3.70 from April 2000. This policy was ratified by the 1998 Minimum Wage Act, and the Minimum Wage has been a statutory requirement for all UK employers since 1st April 1999. To complement this Minimum Wage policy, a new Working Families Tax Credit was introduced in March 1998 to provide a further financial incentive to work.

3.7 Working Families Tax Credit, and similar credits for people without families, may raise the incomes of workers currently paid close to or at the Minimum Wage. The introduction of a Living Wage policy will interact with the tax and benefit system with a potential reduction in tax credits paid to those on low wages. Some simple simulations are shown in this report (see Section 6) and wider tax-benefit modelling may be considered in the second stage of research.

### **Pay policy in a devolved Wales**

3.8 The 1998 Government of Wales Act, and the subsequent 2006 revisions set out the policy remit of the Welsh Assembly Government and the National Assembly for Wales. While these acts did not grant the Welsh Assembly powers to alter the statutory Minimum Wage in Wales, they did allow for the devolved administrations to determine pay levels for their own staff, and the staff of those organisations to whom it provides direct funding, including NHS Wales and Welsh local authorities.

### **Emergence of a Living Wage policy**

3.9 As part of their 2007 election manifesto, coalition partners Plaid Cymru made a commitment to “create a National Living Wage, set by an independent Welsh Pay Commission, with which all contractors for publicly-funded contracts in Wales will be asked to comply”. In October 2008, Christine Chapman, Labour AM for Cynon Valley tabled a Statement of Opinion that “This Assembly welcomes the significant contribution a Living Wage can make to the reduction of poverty across Wales and calls on the Welsh Assembly Government to promote a Living Wage in all its policies.” This was sponsored by 32 of the 60 Assembly Members.

### **Poverty, Policy and the Living Wage**

3.10 Since the elections of 2007, the strategic direction of Welsh Policy making has been guided by *One Wales*, the coalition agreement between the Labour and Plaid Cymru groups in the National Assembly for Wales, which sets out their programme for government until 2011. As a result, any policy decisions made by public sector bodies in Wales should be guided by, and give consideration to, the Government’s ambition to deliver “a Wales where

everyone achieves their full human potential and everyone can live free from poverty, discrimination, fear or abuse”.

3.11 This section will examine how WAG’s policies in the fields of area regeneration, child poverty, public service provision, equality and workforce development contribute to the delivery of this ambition, and will conclude by examining where a Living Wage policy may sit within the context of this package of provision.

### **Area Regeneration**

3.12 First published in 2004, and refreshed in 2008, *People, Places, Futures* is the Spatial Strategy for Wales. It notes that “our future depends on the vitality of our communities as attractive places to live and work”. And highlights a need to “reduce inequalities between communities whilst retaining their character and distinctiveness”. As part of this strategy to reduce inequalities, the strategy promotes the concept of greater investment in schools and the health service as a tool to address this need. A living wage policy may support the fulfilment of this objective, particularly if it is accompanied by a policy to increase the proportion of public sector jobs in less affluent communities, and provided that it includes provisions to ensure private sector participation.

### **Child Poverty**

3.13 *A Fair Future for our Children* was published in 1995 to illustrate how WAG intends to bring about improvements in the areas of participation and service quality, and to support the delivery of the UK Public Service Agreement (PSA) target for financial child poverty to “halve the number of children living in poverty by the financial year 2010-11, and to eradicate child poverty by 2020, using 1998-99 as the baseline”. The strategy argued that “better job opportunities are the main route out of the poverty”. It identified a need to “give families and young people access to adequate income and help in managing their finances”. The strategy also acknowledged the role played by the UK-wide increase in the statutory Minimum Wage in October 2004 to supporting a reduction in child poverty.

### **Public Service Provision**

3.14 *A Shared Responsibility*, WAG’s 2007 policy statement on the role of local government, highlights the need for local government in Wales to invest in the development of their staff and “place a true value on their contribution so that they can tackle the challenges that lie ahead”. It also commits WAG to providing a range of training support to improve the career prospects of Welsh local government officials.

3.15 *Making the Connections*, WAG’s 2006 strategy for transforming public services in Wales identifies the development of a “world class workforce” as one of the key components of a successful public sector, and recognises a need to harmonise employment policies across the whole of the Welsh public sector.

## Equality

3.16 *Working for Equality in Wales* was published in 2009 and details the introduction of WAG's Single Equality Scheme. The Single Equality Scheme sets out WAG's responsibilities with regards to promoting equality among an increasingly diverse population including low income families. It is seen as an integral part of helping to achieve the objectives set out in 'One Wales' and emphasises WAG's commitment towards fostering a "fairer and just society"<sup>1</sup>.

3.17 As part of WAG's Single Equality Scheme they have chosen to adopt *Inclusive Policy Making* as a method of completing Equality Impact Assessments for new and existing policies. WAG's adoption of *Inclusive Policy Making* is a concerted effort to promote equality throughout Wales and means that they are legally obliged to assess how their policies contribute to all aspects of equality such as age, religion and human rights.

## Workforce development

3.18 The *One Wales Action Plan* provides further details of WAG's proposals to support the delivery of the One Wales Agreement. The plan emphasises WAG's commitment to tackling low pay, and includes a commitment to introduce the ProAct programme, which provides wage subsidy and training to workers.

3.19 *Wales, A Vibrant Economy*, the most recent economic development strategy for Wales was published in 2005, and sets out the government's vision for developing "a vibrant Welsh economy delivering strong and sustainable economic growth by providing opportunities for all". One of the priorities identified by this strategy is a need to "raise the quality of jobs, so that (Welsh) average earnings increase and close the gap with the UK average".

3.20 A further priority identified is a need "to draw more people into work, thereby further reducing unemployment and economic inactivity", and the report acknowledges that a reduction in inactivity levels in Wales can only be delivered if new jobs are created and if these jobs "provide options that are attractive compared to an individual's current circumstances."

## Summary

3.21 WAG's policies on area regeneration, child poverty, public service provision, equality and workforce development all help Wales move closer towards the vision set out in the *One Wales* coalition agreement. The ongoing process of refreshing these policies has given WAG renewed focus and guidance. If introduced, a Living Wage policy has the potential to make a further contribution towards many of these policy areas and the overall *One Wales* agenda.

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<sup>1</sup> <http://wales.gov.uk/docs/caecd/publications/090331sesfinalen.doc>

3.22 It could also be argued that the principles of tackling poverty and inequality are already well embedded in the delivery of government services in Wales. For example, area regeneration objectives are likely to contribute to increasing income levels in less affluent areas and equality objectives ensure consistent wages for workers regardless of ethnicity, religion, language, age or gender.

## 4 Baseline Review

### Introduction

4.1 Leading up to the current recession, the Welsh economy experienced a period of strong expansion, with total gross value added rising to £44.3 billion in 2007 (an increase of 5.1% on the previous year) and GVA per head rising to £14,877 (an increase of 4.6%)<sup>2</sup>. However, in spite of this recent acceleration, Wales' economy remains less productive than the UK economy as a whole and Wales continues to have the lowest GVA per head compared to all the devolved and English regions.

4.2 This challenge is compounded by an unequal geographic distribution of wealth, which has led commentators to argue that *“Wales is a country that suffers in places from pronounced deprivation. Such areas suffer from poor standards in health, low educational attainment, substance misuse, benefit dependency and a dearth of employment prospects. Too many families experience the effects of poverty”*<sup>3</sup>.

4.3 The purpose of this section is to review the extent of, and reasons for, poverty in Wales, by reviewing in turn a number of key contributors to poverty, including employment status, life stage, type of work undertaken, qualifications, place of residence and cost of living. This section will examine each of these issues in turn, before concluding with an assessment of the overall consequences of this baseline position for a Living Wage policy.

### Employment Status

4.4 The employment status of families and individuals has implications for the level of poverty they experience. In general those in employment are less likely to experience the levels of poverty witnessed by those who are unemployed or economically inactive. However, in-work poverty is also an issue which merits increasing attention. A recent report by the DWP revealed that in the UK there are “1.4 million poor children living in working households”<sup>4</sup>. A Living Wage policy clearly has the potential to address in-work poverty in Wales.

4.5 The table below illustrates the extent to which the employment status of adults in a household influences that household's likelihood of living in poverty. Households in which all working age adults are unemployed are far more likely to be in the lowest income quintile group than those in which all working age adults are working.

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<sup>2</sup> <http://www.assemblywales.org/09-002.pdf>

<sup>3</sup> *Annual Report on Social Inclusion for Wales*, National Assembly for Wales, 2003

<sup>4</sup> “In Work Poverty: A Systematic Review”, 2009 <http://www.dwp.gov.uk/asd/asd5/rports2009-2010/rrep549.pdf>

**Table 1: Illustration of relationship between economic status and low incomes**

Economic Status of Adults in the Family	Proportion of households in the bottom income quintile
One or more full time self employed	21%
Single/couple all in full time work	3%
Couple, one full-time, one part time	4%
Couple, one full time work, one not working	17%
No full time, one or more in part time work	28%
Workless, one or more aged 60 or over	29%
Workless, one or more unemployed	70%
Workless, other inactive	51%

*Source: DWP Households Below Average Income, 1994/95-2007/08*

4.6 Wales has a population of nearly 3 million people, of which around 1.8 million (60%) are of working age. Sixty-four percent of males are of working age compared to 56% of females (Table 2), a reflection of a higher statutory retirement age for men.

**Table 2: Population composition in Wales**

	Wales total (thousands)	% of total	Working age (thousands)	% of total
Males	1,454	49%	937	64%
Females	1,526	51%	860	56%
Total	2,980	100%	1,797	60%

*Source: ONS mid-year population estimates, 2007*

4.7 Approximately 1.35 million people in Wales are classed as economically active, equivalent to 76% of the working age population. Employees account for 62% of the working age population and the self employed account for 9%. As of 2008, 6% of the working age population were classified as unemployed. Breaking down this data by gender reveals a broadly similar picture, though there is a higher economic activity rate for males than for females (79% compared to 73%), due in part to a higher proportion of working age females looking after the family home. The only notable difference is in terms of entrepreneurship, with 5% of the female working age population being self employed compared to 13% of their male counterparts (this is shown in Table 3).

**Table 3: Economic activity in Wales**

	Wales total (thousands)	% of total
<b>Economically active total</b>	1,357	76%
<i>In employment</i>		
- Employees	1,108	62%
- Self employed	159	9%
<i>Unemployed</i>	81	6%
<b>Economically active – males</b>	736	79%
<i>In employment</i>		
- Employees	567	61%
- Self employed	118	13%
<i>Unemployed</i>	46	6%
<b>Economically active – females</b>	621	73%
<i>In employment</i>		
- Employees	541	63%
- Self employed	41	5%
<i>Unemployed</i>	35	6%

Source: Annual population survey, October 2007 – September 2008

4.8 The 2008 Annual Population Survey found that 24% of the working age population in Wales were economically inactive, including 21% of men and 28% of women, and the majority (73%) of these individuals stated that they did not want a job. Of the remaining 27% who do want a job, the main reasons for being inactive are 'long term sickness' (8%), 'looking after family/home' (6%), 'other' (5%) and 'student' (4%) (this is shown in Table 4).

4.9 An understanding of these different types of economic inactivity will be important for policy development as, while a living wage policy may provide an incentive for discouraged workers to re-enter the labour market, it is likely to have less of an impact on the long term sick, and on those with studying or family care commitments. It might also make it harder for these groups to re-engage with work if a living wage policy results in fewer available opportunities due to higher wages.

4.10 As of April 2009, the total number of Job Seeker's Allowance (JSA) claimants in Wales was 79,500. Most of these jobseekers (60,000, 76%) were male; over half (40,500, 51%) were aged between 25 and 49; and a further third (27,100, 34%) were aged between 18 and 24. Just under a quarter of these claimants (18,300, 24%) have been claiming for 6 months and over (this is shown in Table 5).

**Table 4: Economic inactivity in Wales**

	Wales total	% of total
<b>Economically inactive – males</b>	<b>197,000</b>	<b>21%</b>
<i>Wanting a job</i>	55,300	28%
<i>Not wanting a job</i>	141,700	72%
<b>Economically inactive – females</b>	<b>235,800</b>	<b>28%</b>
<i>Wanting a job</i>	60,700	26%
<i>Not wanting a job</i>	175,100	74%
<b>Total inactive population</b>	<b>432,800</b>	<b>24%</b>
<i>Wanting a job (of which):</i>	116,000	27%
- Seeking work but unavailable to start work	14,400	3%
- Discouraged worker	1,600	<0.5%
- Long term sick	36,000	8%
- Looking after family/home	27,200	6%
- Student	16,800	4%
- Other	20,100	5%
<i>Not wanting a job</i>	316,800	73%

Source: Annual population survey, October 2007 – September 2008

**Table 5: JSA claimants by gender, age and duration**

	Wales total	% of total
<b>Total JSA claimants</b>	79,500	
<i>By gender</i>		
Males	60,600	76%
Females	18,800	24%
<i>By age</i>		
Aged 18-24	27,100	34%
Aged 25-49	40,500	51%
Aged 50 and over	11,200	14%
<i>By duration of claim</i>		
Up to 6 months	60,800	76%
6 to 12 months	12,600	16%
Over 12 months	5,700	7%

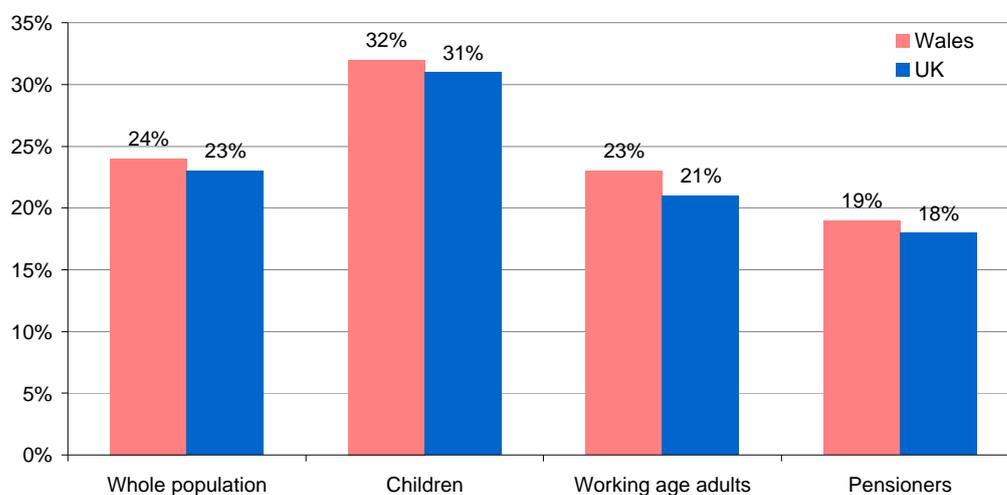
Source: ONS claimant count, 2009

## Life Stage

4.11 Research by Moore (2005) has found that “life-course events (e.g. leaving school, starting work, having children) play a significant role in shaping vulnerability to poverty<sup>5</sup>. This finding is of importance to WAG, as it illustrates the important role that decision making in all areas of policy can have on tackling poverty.

4.12 Recent research by the Department for Work and Pensions (Figure 1) has shown that the proportion of Welsh households experiencing below average incomes (UK average) is higher across all life stages. This difference is slightly higher among working age households, most likely reflecting lower wages in Wales compared to the rest of the UK.

**Figure 1: Proportion of households in low income groups by life stage**



Source: DWP - Households Below Average Income

## Type of Work Undertaken

### Employment by sector

4.13 One of the key objectives of the Welsh economic development strategy is to move the economy ‘up the value chain’, by increasing the skills of the Welsh labour force, and by increasing the number of jobs in more productive sectors and more senior occupations. The success of this strategy will be essential to the overall effectiveness of a living wage policy.

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<sup>5</sup> ‘Thinking about youth poverty through the lenses of chronic poverty, life-course poverty and intergenerational poverty’, [www.cprc.abrc.co.uk/pdfs/57Moore.pdf](http://www.cprc.abrc.co.uk/pdfs/57Moore.pdf)

4.14 Table 6 shows the current sectoral composition of the Welsh workforce. It shows that the wholesale and retail trade sector is the largest employer in Wales, with approximately 194,000 workers, equivalent to 16% of the total workforce. This is followed by Health and Social Work (15%); Manufacturing (14%) and Real Estate, Renting & Business Activities (12%).

4.15 The Living Wage policy is likely, at least initially, to be only of direct benefit to workers in public service roles, these figures provide a reasonable initial indication of the potential coverage of a Living Wage policy. The figures show that the Public Admin; Defence & Social Security; Education; and Health & Social Work sectors together account for one third of the total workforce (386,900 workers). Employment by public sector bodies across all sectors amounts to 314,000 employees (26.5% of the total workforce).

**Table 6: Total employment (employee jobs) by sector**

	Wales total	% of total
A : Agriculture, hunting and forestry	16,400	1%
B : Fishing	200	<0.5%
C : Mining and quarrying	1,900	<0.5%
D : Manufacturing	160,900	14%
E : Electricity, gas and water supply	4,800	<0.5%
F : Construction	59,600	5%
G : Wholesale and retail trade; repair of motor vehicles, motorcycles and personal and household goods	194,000	16%
H : Hotels and restaurants	82,000	7%
I : Transport, storage and communication	51,400	4%
J : Financial intermediation	31,000	3%
K : Real estate, renting and business activities	136,000	12%
L : Public administration and defence; compulsory social security	93,600	8%
M : Education	118,400	10%
N : Health and social work	174,900	15%
O : Other community, social and personal service activities	61,500	5%
Column Total	<b>1,186,600</b>	<b>100%</b>

Source: Annual Business Inquiry – Employee Analysis, 2008

4.16 The impact of a Living Wage may stretch further, depending on the level of ‘buy in’ of private sector companies who trade with the public sector and go on to adopt the Living Wage. For example, this could cover some of the 136,000 employees in sector K (above) providing IT support or security services to the public sector (as well as any direct public sector employment in sector K).

### Employment by occupation

4.17 The occupational groups that would benefit most from a Living Wage policy are likely to be elementary occupations; process, plant and machine operatives; sales and customer service occupations and personal service occupations. These groups together employ 502,600 people in Wales, and account for 38% of the total workforce, though it is likely that most of these individuals will not work in the public sector.

**Table 7: Total employment by occupation**

	Wales total	% of total
Managers and senior officials	176,600	13%
Professional occupations	157,800	12%
Associate professional & technical	181,400	14%
Administrative & secretarial	149,700	11%
Skilled trades occupations	165,700	12%
Personal service occupations	120,700	9%
Sales and customer service occupations	106,100	8%
Process plant & machine operatives	116,000	9%
Elementary occupations	159,800	12%

*Source: Annual Population Survey, October 2007 – September 2008*

### Median pay

4.18 The average median weekly pay in Wales is £347. Variation between gross median weekly pay for men and women is significant, with women receiving only £280 compared to men with £438. This can partly be attributed to differences in occupation profiles between the two gender groups, with 16 per cent of the male workforce employed as managers and senior officials, compared to only 10 per cent of all female workers.

4.19 There is no significant variation between the gross median weekly wage of male and female part time workers. Women are more likely to be employed on a part time basis and this explains some of the average gross weekly gender pay difference. In terms of full time employment the median male wage is £98 more than for females (this is shown in Table 8)<sup>6</sup>.

**Table 8: Median gross weekly pay by gender and by hours worked**

	Wales total
<b>Gross weekly pay total</b>	£347
Male full time workers	£471
Male part time workers	£150
Female full time workers	£373
Female part time workers	£147
Male workers	£438
Female workers	£280
Full time workers	£425
Part time workers	£147

*Source: Annual Survey of Hours and Earnings, 2008*

4.20 Recent research undertaken on behalf of the Joseph Rowntree Foundation (JRF) by Bradshaw et al (2008) calculated that the Living Wage ought to be set at £6.88 per hour for single, working age adults across the UK as a whole in 2008<sup>7</sup>. The Living Wage was defined as “a wage which would enable a worker to sustain a suitable standard of living” although they suggest that the appropriate wage may vary from individual to individual to account for differences in family size and the cost of living.

<sup>6</sup> The degree to which the wages in these tables constitute a living wage for a worker can depend on a number of factors, including the composition of the worker’s household. This is discussed in greater detail in Section 5 of this report.

<sup>7</sup> Hirsch et al (2009) update this minimum income standard to allow for changes in prices and for a single person of working age in 2009 the hourly rate was £7.09 for a 37.5 hour week. However, regional variation in this rate could be allowed by accounting for regional differences in housing costs and rent. Taking account of the tax credit system the hourly rates of pay needed to achieve the minimum income standards for different household types working a 37.5 hour week in 2009 were £14.13 for a single earner couple with two children and excluding childcare and £5.73 for a lone parent with one child including childcare costs.

4.21 The JRF approach used by Bradshaw et al combines two methodologies developed independently by the Centre for Research in Social Policy (CRSP) at Loughborough University and the Family Budget Unit (FBU) at the University of York to define minimum income standards needed to achieve a given living standard by different household types<sup>8</sup>. Both methods used by the FBU and CRPS seek to price items included in a representative household budget that achieve a given living standard. However, the methodologies used by FBU and CRSP to identify these budget items differ.

4.22 The FBU approach, for example, defines the items to be included on the basis of expert opinion, recognised standards, consumer surveys, and a statistical analysis of expenditure and consumption data. The CRSP approach is similar in concept but instead of using expert opinion the items are based on the opinions of ordinary people, representing different household types. The CRSP approach asks households to arrive at a consensual budget that seeks to achieve a socially acceptable minimum living standard.

4.23 Combining the FBU and CRSP approaches allows the views of experts to be reconciled with those of ordinary people, 'allowing budgets based on social consensus to be tested against expert knowledge and research' (Bradshaw et al, 2008, p3). This was achieved through a check back system whereby budgets were consensually revised by panels on the basis of any expert advice they had received<sup>9</sup>.

4.24 Figure 2 provides a comparison between the hourly wage figure of £6.88 reported in the JRF 2008 study for a single person of working age, with the Minimum Wage, and current wage levels in Wales, based on data published in the 2008 Annual Survey of Hours and Earnings. The figure shows that over 20 per cent of workers in Wales, and approximately 30 per cent of all female workers in Wales currently earn less than this 'Living Wage'. This may be partially offset by the lower cost of living in Wales, most notably property costs.

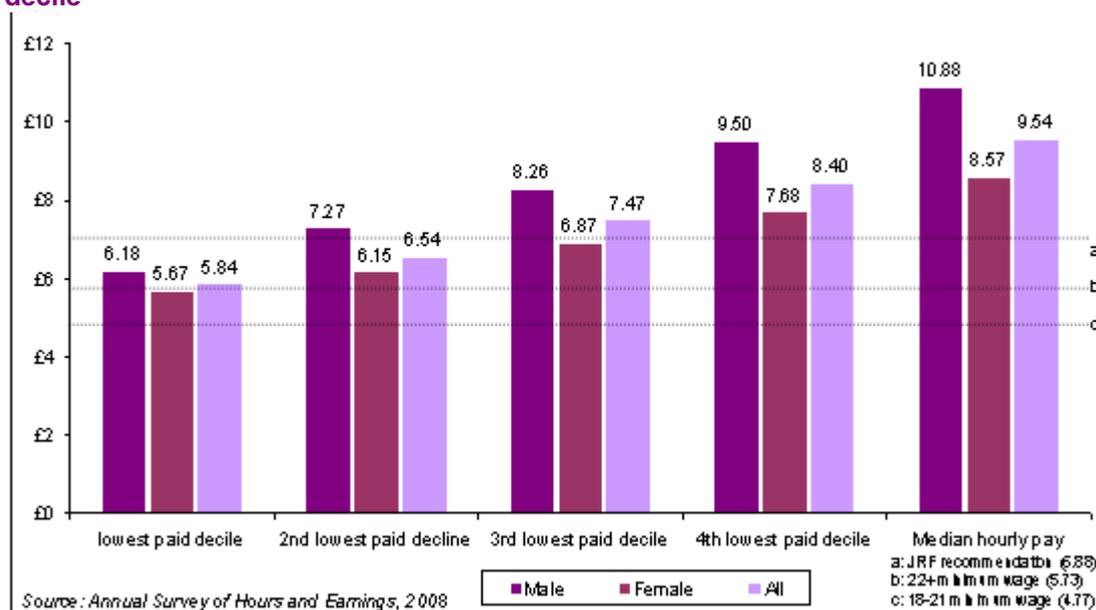
4.25 The figures also show that over 10 per cent of all female workers in Wales earn less than the current 22+ Minimum Wage of £5.73 per hour. A notable gender gap in average pay exists across the Welsh workforce as a whole, however the average difference in earnings per hour for part time women and men (32 pence per hour) is significantly lower than the gap between full time men and women (£1.67 per hour).

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<sup>8</sup> The following definition of an acceptable minimum was used: 'A minimum standard of living in Britain today includes, but is more than just, food, clothes, and shelter. It is about what you need in order to have the opportunities and choices necessary to participate in society.' (Bradshaw et al 2008, p14).

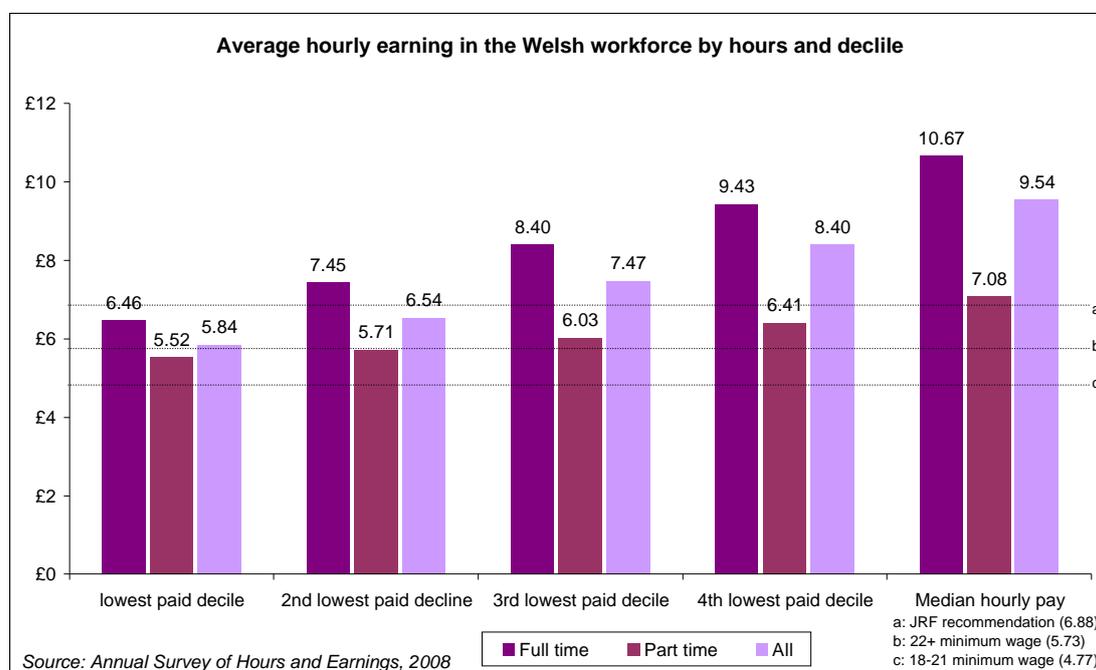
<sup>9</sup> Broadly based commodity groups included in a representative budget include food, alcohol, tobacco, clothing, water rates, council tax, household insurances, fuel, other housing costs, household services, childcare, personal goods and services, motoring, other travel costs, social and cultural participation, and rent.

**Figure 2: Average hourly earnings in the Welsh workforce by gender and decile**



4.26 Figure three provides a similar breakdown to the above for earnings by hours worked. It shows that, part time workers earn less on average per hour worked than their full time counterparts, with over 20 per cent of part time workers receiving less per hour than the 22+ minimum wage, and with over 40 per cent of part time workers earning less per hour than the JRF recommendations.

**Figure 3: Average hourly earnings in the Welsh workforce by hours worked**



4.27 Table 9 shows hourly gross wages by sector in Wales and the UK for workers in the poorest paid decile (10%) of the workforce. The table shows that, although over 90% of workers in the financial intermediation, and public administration workers earn more than the

JRF recommended Living Wage, this is not the case for any other sector (for which data is available).

4.28 The table also shows that in the wholesale and retail; hotels and restaurants; real estate; and other community services sectors, over 10 per cent of the workforce earn less than the £5.73 statutory Minimum Wage for 22 year olds and over. More detailed analysis of average incomes by decile are provided for the public sector in Appendix A.

**Table 9: Average earnings of workers in the poorest paid decline**

Sector	Hourly earnings
Average across all industries	5.83
A : Agriculture, hunting and forestry	-
B : Fishing	-
C : Mining and quarrying	-
D : Manufacturing	6.59
E : Electricity, gas and water supply	-
F : Construction	6.70
G : Wholesale and retail trade	5.55
H : Hotels and restaurants	4.68
I : Transport, storage and communication	5.99
J : Financial intermediation	7.34
K : Real estate, renting and business activities	5.61
L : Public administration and defence	7.07
M : Education	6.19
N : Health and social work	6.30
O : Other community, social and personal service activities	5.52
Average across approximate Public Sector activities	6.40
Joseph Rowntree Foundation's Proposed Living Wage	6.88

*Source: Annual Survey of Hours and Earnings, 2008, Joseph Rowntree Foundation*

4.29 Table 10 shows median earnings for workers in each of the sectors. The table shows that in most sectors, workers on average earn significantly above the £6.88 Living Wage proposed by JRF. However, median earnings in the wholesale and retail sector are equal to the proposed Living Wage, Table 6 shows 194,000 employees in the wholesale and retail sector. Median earnings in the hotels and restaurants sector are significantly below this wage, and only slightly above the £5.73 statutory Minimum Wage for the 22 + age group.

**Table 10: Gross median hourly earnings by sector**

	Hourly earnings
A : Agriculture, hunting and forestry	8.44
B : Fishing	-
C : Mining and quarrying	-
D : Manufacturing	11.44
E : Electricity, gas and water supply	-
F : Construction	10.08
G : Wholesale and retail trade	6.88
H : Hotels and restaurants	5.82
I : Transport, storage and communication	10.89
J : Financial intermediation	10.49
K : Real estate, renting and business activities	9.37
L : Public administration and defence; compulsory social security	11.83
M : Education	10.90
N : Health and social work	10.64
O : Other community, social and personal service activities	7.69
Average across approximate public sector activities	11.00
JRF recommended Living Wage	6.88
All industries	9.54

*Source: Annual Survey of Hours and Earnings 2008, Joseph Rowntree Foundation*

4.30 Figures on median earnings by occupation are provided in Table 11. These show that workers in professional occupations experience the highest average hourly earnings at £19.12 per hour, almost three times higher than the JRF proposed Living Wage. In contrast, median earnings in sales and customer service roles (£6.14) and elementary occupations (£6.44) are both below the recommended figure. This means more than half of the workers in these occupations receive less than the JRF proposed Living Wage.

4.31 The table also shows earnings for the lowest paid decile for each occupation group. This shows that over ten per cent of workers in administrative & secretarial; skilled trade; and process, plant and machine operative occupations earn less than the JRF proposed Living Wage, while over ten per cent of workers in personal service, sales and elementary occupations earn less than the 22+ statutory Minimum Wage.

**Table 11: Gross hourly earnings by occupation**

	Poorest paid decile	Median
Managers and senior officials	7.58	14.32
Professional occupations	10.20	19.12
Associate professional & technical	8.33	13.43
Administrative & secretarial	6.43	8.66
Skilled trades occupations	6.45	10.08
Personal service occupations	5.71	7.67
Sales and customer service occupations	5.52	6.14
Process plant & machine operatives	5.93	8.33
Elementary occupations	5.50	6.44

*Source: Annual Survey of Hours and Earnings, 2008*

### **Procurement links between the public and private sector**

4.32 Living wage policies implemented in cities and regions often cover employees both in the public sector and organisations delivering public sector contracts. This could cover contacts being delivered by employees in the private sector (or third sector) providing a range of goods and services from IT support to security.

4.33 Public sector contracts present difficulties in estimating a baseline position (and likely implications of a living wage) as employees are not readily classified by standard occupations or industries. Evaluations of living wage policies have highlighted the importance of accounting for employees delivering public sector contracts (see Section 5).

4.34 Some procurement data is available from the consolidated annual report and accounts for WAG. The latest report and accounts (2008-09) show expenditure on IT and telecommunications of £33 million, the largest single area of identified expenditure. These costs are relatively small but exclude procurement through NHS Trusts and local government.

### **Qualifications**

4.35 Many employers regard an individual's qualifications as a useful proxy for their skill level, and for their ability to do a job well. As a result, qualifications also provide a useful indicator of an individual's likely potential earnings, and actions taken to increase workforce qualification levels can have a positive bearing on earning levels in Wales.

4.36 Table 12A provides a qualifications profile of Wales' working age population. It shows that over three quarters of the working age population in Wales are qualified to the equivalent of NVQ Level 1 or above; two thirds are qualified to the equivalent of NVQ Level 2 or above and one quarter of the working age population have attained the equivalent of NVQ Level 4 or above. Fifteen percent of the working age population in Wales have no qualifications at all.

4.37 Table 12B shows the distribution of hourly earnings in Wales by the highest equivalent qualification held by workers. The table shows that at least one in ten graduates in Wales are paid below the Living Wage calculated by JRF (and implemented in London and Glasgow). The distribution of hourly earnings climbs more quickly for workers with higher qualifications; over half of all workers without any formal qualifications earn less than the minimum wage calculated by JRF.

**Table 12A: Qualifications profile of Wales' working age population**

	Wales total	% of total
NVQ 4+	453,000	25%
NVQ 3	782,000	44%
NVQ 2	1,137,800	64%
NVQ 1	1,383,800	78%
Other qualifications	126,900	7%
No qualifications	274,000	15%

Source: Annual Population Survey, October 2007 – September 2008

**Table 12B: Hourly earnings (£) distribution by highest equivalent qualification in Wales**

Income Decile	Degree	Below Degree	A-level	O-Level	Other	None
10 <sup>th</sup>	6.75	7.07	5.78	5.33	5.20	4.62
20 <sup>th</sup>	9.11	8.12	6.84	5.87	5.48	5.00
30 <sup>th</sup>	11.19	10.12	7.69	6.60	5.92	5.56
40 <sup>th</sup>	12.82	11.53	8.44	7.14	6.38	6.02
50 <sup>th</sup>	14.43	12.37	9.42	7.62	6.89	6.56

Source: Pooled Quarterly Labour Force Survey: 2008

(population weighted and excluding proxy earnings responses)

(estimates for other and none based on small samples)

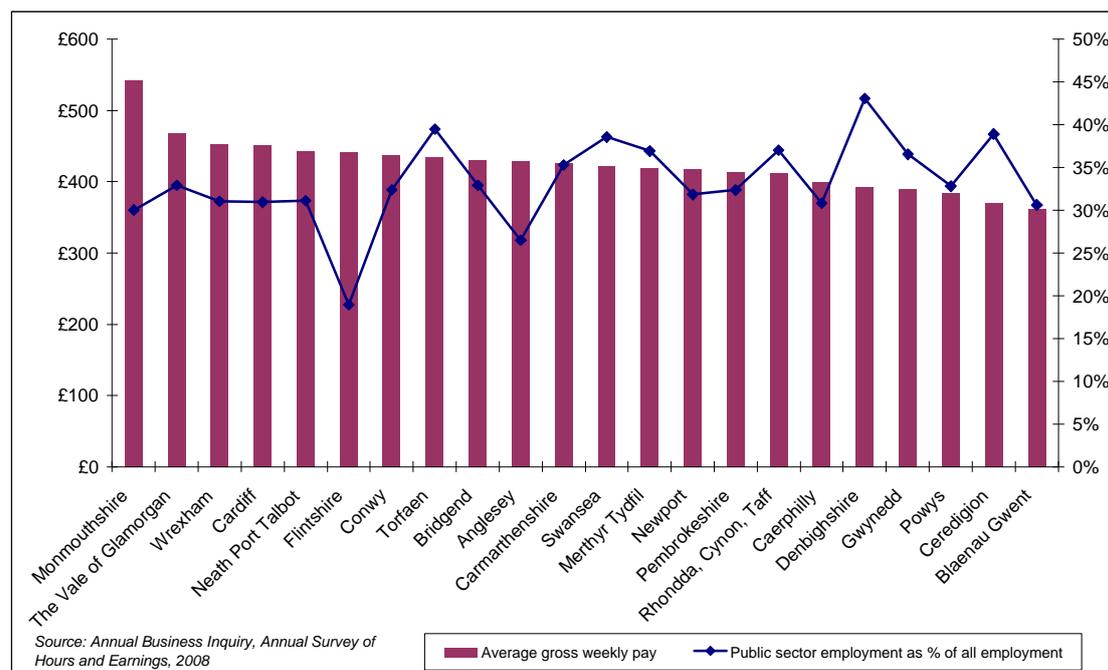
## Place of Residence

4.38 This report has already highlighted the difference in GVA that exists between Wales and the UK as a whole. While these figures are important, they mask some of the significant differences in local economic performance that exist within Wales itself, most notably the difference in the GVA per head figure in East Wales (£17,984) and the much lower figure for West Wales & The Valleys (£12,071).

4.39 These variations in local productivity contribute to variations in gross weekly earnings between each of Wales' 22 Unitary Authority (UA) areas. For example in Monmouthshire, East Wales, workers earned an average of £541.80 in 2008, whereas in Ceredigion, West Wales, gross weekly earnings stood at £370.10. These differences in earnings should not be regarded as a clear east-west divide. Blaenau Gwent has one of the lowest average weekly wage levels in Wales at £362.20 per week.

4.40 It is clear from this that place of residence will have a bearing upon an individual's susceptibility to in-work poverty and that, if appropriately targeted to areas of need, a Living Wage policy could play a role in tackling this issue. This is particularly the case in those low wage areas where the public sector (sectors L-N from Table 6) accounts for over a third of total employment, such as Gwynedd, Ceredigion and Denbighshire (this is shown in figure 4). The share of employment in the public sector as measured by the Annual Population Survey (APS) also shows a link (although weaker) between the lowest and highest paid areas and their reliance on public sector employment.

**Figure 4: Average earnings and approximate public sector employment share**



### Hours worked

4.41 One important factor which influences the risk of in-work poverty amongst part time workers is the number of hours worked. For example, a 2006 study by the Bevan Foundation found that:

- Any household containing only low paid workers working 15 hours a week or less is in poverty;
- Tax credits make a huge difference to the amount that a lone parent has to earn to avoid poverty if they work 16 hours or more;
- The minimum wage is enough to ensure that any lone parent working 30 hours a week can avoid poverty; and
- If all adults in a household are working 40 hours a week, the household will avoid poverty even at rates of pay of no more than £4 an hour.

4.42 However, it should be noted that these conclusions only apply to households with two children or less.

### Cost of Living

4.43 Although wage levels in Wales tend to be below the UK average, this may be partially offset by the area's lower cost of living, with the cost of purchasing a property in Wales, and the cost of non-housing related purchases both below the national average. For example, recent research by HBoS<sup>10</sup> found that in 2009q1, the average house price in Wales was £129,173, compared to a UK average of £160,678. Similarly, a 2005 study by the Office of National Statistics<sup>11</sup> found that non housing related costs in Wales were typically 3.5 per cent below the UK average.

4.44 The relatively low cost of living in Wales may have implications for the level at which a Living Wage would be set, which in turn would impact upon the number of people the Living Wage would actually affect. This is a point that would have to be considered carefully when setting the Living Wage to ensure that it not only reduces the aforementioned poverty gaps but alleviates the poverty felt by the citizens that require it most.

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<sup>10</sup> [http://www.hbosplc.com/common/includes/latestregionalsummary\\_lbg.asp?region=wales](http://www.hbosplc.com/common/includes/latestregionalsummary_lbg.asp?region=wales)

<sup>11</sup> [http://www.statistics.gov.uk/articles/economic\\_trends/ET615Wingfield.pdf](http://www.statistics.gov.uk/articles/economic_trends/ET615Wingfield.pdf)

## Summary

4.45 This section has provided a baseline assessment of the Welsh labour market as it stands, and has identified and assessed the size of the age, gender, geographic, sectoral and occupational groups that are most likely to benefit from a Living Wage policy. In the later stages of this research, this baseline information could be used to form a basis for the modelling analysis.

4.46 The baseline information should also be retained for future evaluation purposes in order to determine the extent to which any future Living Wage policy helps bring about a change in Wales' labour market conditions.

## 5 Literature review

### What is a Living Wage?

5.1 Living Wage policies are gaining ground in public policy debates and increasing support from a coalition of different pressure groups in the UK following their introduction in a number of urban areas in the US. As their name suggests a living wage sets a wage floor at a level which is supposed to support an average household. As such there is no need for a living wage, unlike a National Minimum Wage, to be set at a uniform rate. Instead a living wage can vary across different areas and take into account spatial variations in the costs of living.

5.2 Typically a living wage is set in one of two ways. First, in relation to the overall distribution of earnings, say 60 percent of median earnings, or second, as an average hourly wage rate that would allow an average household to achieve a predetermined standard of living based on family budget surveys. Living wage policies based on a distribution approach benefit from being simple to implement and easy to understand but they fail to address the important question of what level of income a typical household needs to sustain an 'acceptable' standard of living.

5.3 Living wage policies based on family budget surveys, which seek to identify a level of expenditure needed to achieve an acceptable standard of living for representative household types, and from which a figure for the 'average' household can then be derived, are considered superior to measures based solely on identifying a reference point in the overall earnings distribution. However, family budget surveys of this type are often criticised on the grounds of what consumption bundle is really appropriate for these households and whether the concept of the average household is an equitable concept. This is important criticism, as a uniform living wage set in relation to the average household is likely to benefit some households more than others.

5.4 From this perspective a living wage could be considered to be poorly targeted. This problem is exacerbated by the fact living wage mandates normally affect only a small number of employees. For example, private sector workers working under public sector contracts and/or public sector workers, who are in turn likely to represent only a small proportion of individuals or households in poverty.

5.5 Indeed, many would argue that poverty can only be sensibly tackled by addressing the needs of the most disadvantaged individuals who more often than not live in workless households. These households are likely to benefit most from a tax-benefit system that incentivises labour market participation across the board and not just those entering one segment of the labour market which is characterised by public sector contracts.

## Definition of the Living Wage

5.6 The aim of the Living Wage is to set a wage floor that will enable workers to meet basic needs and provide a standard of living for their families that is above the official poverty line. Typically a Living Wage may sit alongside Minimum Wage legislation and although rates may differ according to variations in the regional costs of living, Living Wage rates often exceed Minimum Wage rates.

5.7 Living Wage ordinances have become increasingly popular in the United States following their introduction in Baltimore in 1994. By the end of 2003 more than 115 local governments across the US had enacted Living Wage laws.

5.8 Neumark and Adams (2003) describe some of the more important features of living wage ordinances that have been introduced in the US. A table from their work is reproduced in Table 13, which provides details of living wage ordinances passed in 21 representative cities in the US<sup>12</sup>. Table 13 provides information on the coverage of the ordinances, the living wage provisions set (given in terms of an hourly earnings rate) and how these living wage rates compare to a reference point provided by the federal minimum wage level of \$5.15 or where appropriate to the state minimum in 2000.

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<sup>12</sup> Additional information on 113 living wage ordinances passed in the US can be found at: [www.calgary.ca/docgallery/bu/cns/living\\_wage/lwp\\_review\\_living\\_wage\\_ordinance\\_provisions.pdf](http://www.calgary.ca/docgallery/bu/cns/living_wage/lwp_review_living_wage_ordinance_provisions.pdf)

**Table 13: Information on Selected Living Wage Ordinances in the United States**

City	Coverage Specified in Ordinance	Hourly Wage Provision	State/Federal Minimum Hourly Wage in 2000	Estimates of affected workers and their share in the bottom quartile (%)
Baltimore	Construction and service contracts > \$5,000	July 1995 (\$6.10) July 1996 (\$6.60) July 1997 (\$7.10) July 1998 (\$7.70) July 1999 (\$7.90)	\$5.15	Niedt et al (1999): 1495-5976 (0.51-2.05%)
Boston	Contractors > \$100,000 Sub-contractors > \$25,000	100% of poverty level: 1998 (\$8.23) 1999 (\$8.35) 2000 (\$8.53)	\$6.00	
Buffalo	Contractors and sub-contractors > \$50,000 & >10 employees	2000 (\$6.22 with health benefits, \$7.22 without)	\$5.15	
Chicago	Contractors and sub-contractors	1998 (\$7.60)	\$5.15	
Dayton	City employees	1998 (\$7.00 with health benefits \$8.50 without)	\$5.15	Tolley et al (1999): 9807 (1.01%)
Denver	Contractors and sub-contractors >\$2000	100% of poverty level: 2000 (\$8.20)	\$5.15	

City	Coverage Specified in Ordinance	Hourly Wage Provision	State/Federal Minimum Hourly Wage in 2000	Estimates of affected workers and their share in the bottom quartile (%)
Detroit	Contractors, sub-contractors and businesses in receipt of financial assistance >\$50,000	100% of poverty level with health benefits 125% without. With health benefits: 1998 (\$8.23) 1999 (\$8.35) 2000 (\$8.53)	\$5.15	Reynolds (1999): 2300 (0.40%)
Durham	Contractors and City employees	1998 (\$7.55)	\$5.15	
Hartford	Contractors > \$50,000 & commercial development projects receiving subsidies > £100,000	110% of poverty line with health benefits: 1999 (\$9.19) 2000 (\$9.38)	\$6.15	
Jersey City	Contractors	1996 (\$7.50 with health benefits)	\$5.15	
Los Angeles	Service contractors > \$25,000; business in receipt of financial assistance > £100,000 or lump sum of \$1 million	Indexed annually for inflation: 1997 (\$7.25 with health benefits, \$8.50 without) 1998 (\$7.37 with health benefits) 1999 (\$7.49 with health benefits) 2000 (\$7.69 with health benefits)	\$5.75	Pollin and Luce (1998): 7626 (0.76%)

City	Coverage Specified in Ordinance	Hourly Wage Provision	State/Federal Minimum Hourly Wage in 2000	Estimates of affected workers and their share in the bottom quartile (%)
Milwaukee	Contractors and sub-contractors > \$5,0000	Poverty level for family of three: 1995 (\$6.05) 1996 (\$6.24) 1997 (\$6.41) 1998 (\$6.56) 1999 (\$6.67) 2000 (\$6.80)	\$5.15	
Minneapolis	In receipt of financial assistance from December 1998 > £25,000 – initial threshold set at > \$100,000	100% of poverty level with health benefits, 110% without: 1997 (\$8.03 with health benefits) 1998 (\$8.23 with health benefits) 1999 (\$8.25 with health benefits) 2000 (\$8.35 with health benefits)	\$5.15	
Oakland	Contractors > \$25,000; in receipt of financial assistance > \$100,000	Indexed annually to Bay Area CPI: 1998 (\$8.00 with health benefits, \$9.25 without) 1999 (\$8.15 with health benefits) 2000 (\$8.35 with health benefits)	\$5.75	

City	Coverage Specified in Ordinance	Hourly Wage Provision	State/Federal Minimum Hourly Wage in 2000	Estimates of affected workers and their share in the bottom quartile (%)
Omaha	City employees, contractors > \$75,000 and business in receipt of financial assistance > \$75,000	2000 (\$8.19 with health benefits, \$8.50 without)	\$5.15	
Portland	Custodial, security and parking attendant contracts	Heath benefits included: 1996 (\$7.00) 1998 (\$7.50) 1999 (\$8.00)	\$6.50	
St Louis	Contractors and businesses receiving tax breaks	130% of poverty level for a family of three with benefits, plus \$1.39 per hour for health benefits 2000 (\$8.84)	\$5.15	
San Antonio	Businesses receiving tax breaks	1998 (\$9.27)	\$5.15	
San Francisco	Service contractors > \$25,000 (\$50,000 for non tax profits); airport leaseholders; home health care workers	2000 (\$9.00)	\$5.75	Reich et al (1999): 4800 (1.99%)

City	Coverage Specified in Ordinance	Hourly Wage Provision	State/Federal Minimum Hourly Wage in 2000	Estimates of affected workers and their share in the bottom quartile (%)
San Jose	Service contractors > \$20,000; financial assistance > \$100,000 (exclude 4s trainees and workers under 18); city employees	Annually updated to poverty level for family of three and includes up-rating for San Jose cost of living 1998 (\$9.50 with health benefits) 1999 (\$9.68 with health benefits) 2000 (\$9.92 with health benefits)	\$5.75	Williams (1998): 600 (0.25%)
Tucson	Contractors	1999 (\$8.00 with health benefits, \$9.00 without)	\$5.15	

Source: Neumark and Adams (2003)<sup>13</sup>

<sup>13</sup> An unspecified poverty level refers to a family of four and typically assumes 2,000 hours worked per annum. Population sampling weights were used to estimate the percentage of workers affected in bottom quartile reported in Table 13. The fourth column in Table 13 reports the State/Federal minimum wage in force. The higher of the two rates is reported, which is the state rate where there is state provision.

5.9 Several features of the information provided in Table 13 are worth noting. Living wage ordinances cover only a sub-group of employees. Coverage differs from area to area but typically applies to city contractors or sub-contractors, employers in receipt of business assistance and less commonly to city employees. As a result the number of workers directly affected by any ordinance is estimated to be quite low when expressed as a percentage of workers in the lower quartile of the earnings distribution (Table 13). However, as the estimates reported in column 5 fail to take account of potential spillover effects (described below), and typically focus on employees of city contractors rather than on the potentially wider coverage of workers employed in firms receiving business assistance, they probably represent a lower bound to the percentage of workers affected by such ordinances.

5.10 Living wages in many cities are set in relation to the poverty line, which is defined in terms of the income needed by a particular household type (normally a family of 4 or as in the case of Milwaukee a family of 3), inclusive of health benefits to achieve an acceptable standard of living based on a standard budget survey. Poverty thresholds in the US are regularly up-dated in line with official data on price changes.

5.11 A comparison of living wage provisions set by different city ordinances with federal or state minimum wages in 2000 show that the living wages (inclusive of health benefits) exceeded federal minimum wage rates by a minimum of 20 per cent (Buffalo) and a high of 93 per cent (San Jose). In fact living wage provisions were significantly higher even in those areas that enjoyed a higher state minimum wage<sup>14</sup>. For example in San Jose living wages exceeded the state minimum wage of \$5.75 by 73 per cent.

5.12 Although the Living Wage movement started in the US it has recently spread to the UK. London has had a Living Wage campaign since 2001, and from 2005 it has been supported by the Greater London Authority (GLA) and the Mayor's Office who have set aside resources for the calculation of a Living Wage for London by GLA Economics (2009).

### Calculation of the London Living Wage

5.13 In calculating the London Living Wage GLA Economics used two basic approaches. The first approach which was developed by the Family Budget Unit calculates the (hourly) wage needed to cover Basic Living Costs for a weighted average of different family types. In 2008 the London Living Wage was based on four main family types: a two adult household with two children aged ten and four; a one adult household with two children aged ten and four; a couple without children; and a single person without children. The living costs considered fall into five main headings – housing costs, council tax, transport costs, childcare

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<sup>14</sup> In the US there is a federal minimum wage specified. However, individual states often legislate for a higher state minimum wage over and above the wage floor specified by the federal minimum.

costs and other costs including food and heating, which are up-rated regularly to reflect changes in prices. Of course some disagreement may arise about what constitutes appropriate living costs as these are usually set in relation to a representative bundle of goods informed by family budget surveys, and as the representative bundle changes so will the calculated living wage.

5.14 The second approach is simpler and based on the income distribution of different family types. Median disposable household income for different family types is used as a proxy for living standards and the Government's poverty threshold is defined as 60 per cent of median household disposable income. An estimate of the Living Wage defined by the income distribution approach is therefore calculated as a weighted average of the wage rate required to meet the poverty threshold across different family types.

5.15 In arriving at their recommended Living Wage for London, GLA Economics takes a simple average of the (hourly) wage found by the Basic Living Cost and Income Distribution approaches, to which is added a 15 per cent margin against poverty. Table 14 shows the gap between the National Minimum Wage and the London Living Wage between 2005 and 2009.

**Table 14: National Minimum Wage and the London Living Wage (£ per Hour)**

Year	National Minimum Wage	London Living Wage	Difference
2005	5.05	6.70	1.65
2006	5.35	7.05	1.70
2007	5.52	7.20	1.68
2008	5.73	7.45	1.72
2009	5.80	7.60	1.80

5.16 GLA Economics estimates that approximately 15 per cent of full time employees in London earn less than the Living Wage of £7.60. The number of workers covered by the London Living Wage are still small but include all employees working in GLA premises or for members of the GLA group which includes Transport for London, London Fire and Emergency Planning Authority, London Development Agency, Metropolitan Police Authority, Metropolitan Police Service, St Barts and London Hospital, London Borough of Ealing, London Borough Tower Hamlets, several large private sector firms, and a number of London higher education institutes and policy think tanks.

## Theory Associated with the Effects Produced by a Living Wage

5.17 Arguments about the effects of the Living Wage are similar to those used about the effects of Minimum Wage legislation. Proponents of the Living Wage claim that low wage workers are exploited and are unable to earn an adequate wage without the implementation of legislatively maintained 'wage floor'; wealth is unevenly and unfairly distributed; Living Wages support strong families; governments benefit by not needing to provide as much social support to individuals within the community; consumer spending is increased; worker morale is improved and employers gain from increased productivity (a gift exchange) and lower worker turnover. Antagonists, on the other hand, argue that where the Living Wage bites (in low skilled labour markets where the Living Wage lies above the market clearing wage) it produces a market distortion resulting in inefficiencies and the misallocation of resources.

5.18 Standard economic theory makes a number of predictions about the likely effects of a Living Wage in competitive labour markets. Increasing the relative price of low-skilled labour by introducing a Living Wage produces two effects.

5.19 Firstly, if employers are concerned about the costs of production they will substitute away from relatively more expensive low skilled labour towards alternative inputs used in the production process. For example, employers may decide to use fewer low skilled workers and hire more high skilled workers. Alternatively, employers may decide to mechanise the tasks previously performed by low skilled labour and substitute capital for labour in the production process.

5.20 Secondly, even though the employer is able to substitute away from the relatively more expensive low skilled labour, the overall effect of raising the price of low skilled labour is to increase the costs of production. Moreover, if the increased costs cannot be fully absorbed into the price paid by consumers then the level of production must be reduced, which reduces the demand for all inputs used in production, including low skilled labour. The size of the scale effect is determined by the elasticity of demand for final product. The more elastic is the demand for the final product, the less able are employers to pass on any cost increases to consumers and the larger is the resulting fall in output and demand for low skilled labour. Both substitution and scale will reduce the demand for low skilled labour either at the extensive (number of workers) or intensive (hours worked) margin.

5.21 There are a number of factors which can mitigate the employment effects of a Living Wage on low skilled workers. They can be briefly summarised as follows:

- The quantity of services or output demanded may not fall with an increase in price. The demand for some output is insensitive to price or, alternatively, if the Living Wage was only applied to workers working in the public sector or employed on public sector contracts it is feasible that the increased costs could be passed on in the form

of tax increases with no resulting reduction in service provision. However, price insensitive products are the exception rather than the rule and there is likely to be a limit to which tax increases can be used to offset cost increases associated with the implementation of a Living Wage (especially with current pressures facing public finances).

- If a Living Wage was implemented that covered some workers, say those employed in the public sector or on public sector contracts, and not others. It is possible that a private contractor operating in both the private and public sectors, and having higher skilled workers paid above the Living Wage rate and lower skilled workers paid below the Living Wage, could allocate workers on their staff between different contracts so as to be able to avoid the cost increases associated with the implementation of the Living Wage. Of course there would still be some resource misallocation associated with this type of response, which may be significant.
- If the Living Wage is not universally applied across all workers and there is a covered and uncovered sector, then Mincer (1976) has shown that the effects of a Living Wage floor on overall employment (covered and uncovered employment) may be mitigated by relative wage movements in the covered and uncovered sectors. Increasing wages in the covered sector through the implementation of a Living Wage displaces low skilled workers from this sector into the uncovered sector forcing wages of low skilled workers in that sector down and employment up. Of course it is unlikely that employment of low skilled workers in the uncovered sector would increase sufficiently to absorb the full employment decline in the covered sector. For example, the fall in wages in the uncovered sector may be limited by a wage floor imposed by a Minimum Wage; similarly the fall of wages in the uncovered sector may induce some workers to leave the labour market. Nonetheless in the presence of a covered and uncovered sector the benefits to workers of the Living Wage will be confined to those who retain jobs in the covered sector while workers in the uncovered sector may be made worse off.
- The above point ignores potential emulation effects that might arise from wage settlements agreed in the covered sector (public sector) which spillover to wage settlements agreed in the uncovered sector (private sector). The potential extension in coverage of the Living Wage which this might induce is likely to increase the likelihood of observing a negative employment effect created by the Living Wage in raising the wages of low skilled labour. Indeed if Living Wage requirements were extended to firms in receipt of subsidies designed to maintain their activities in Wales or to locate in Wales it is likely that the benefits perceived by a firm from a public subsidy would be diminished by the requirement to pay workers a Living Wage. As far as emulation effects are concerned recent evidence by Lamo et al (2008) finds

that although public and private sector wage settlements in the UK move together, there is little evidence of public sector wage leadership; instead private sector agreements seem to lead public sector agreements.

- Employment reductions associated with the implementation of a Living Wage for low-skilled workers are closely tied to the increase in unit costs induced by the higher wages paid to workers as a result of the policy. Crucially the negative employment effect of a Living Wage is based on the assumption that employers seek to minimise costs within a competitive framework. However, if workers affected by the Living Wage are employed in non-competitive sectors, in which cost minimisation is less important, employers may be able to offset the increase in low-skilled labour costs by acting on costs in other dimensions, including non-pay benefits like pensions, health insurance and employee training.
- Linked to the previous bullet point it could be that the introduction of a Living Wage has a positive effect on worker morale and motivation, which results in an increase in labour productivity that other things being equal will increase the demand for labour and offset the increase in costs associated with the Living Wage. In this context the Living Wage induces an efficiency wage effect, whereby worker's effort and pay are intrinsically linked. According to Akerlof (1982) in a gift exchange model employers provide the gift of higher pay while workers respond with the gift of higher effort. Efficiency wages also imply that because workers are paid more than the market clearing wage, unemployment acts as a disciplinary device providing workers with an incentive to increase effort and develop a long term commitment with the firm (Shapiro and Stiglitz, 1984). Reduced employee turnover is a natural consequence of this process and as employee turnover is reduced this increases the incentive for the firms and workers to invest in training. Of course, while these arguments seem valid the natural question to ask is why if paying higher wages results in higher worker productivity and reduced labour turnover, both of which are considered to be good things by the firm, then why should firms need to rely on government intervention in the form of a Living Wage to increase wages when they can themselves decide to realise the gains by voluntarily paying higher wages in the first place?

### Findings from Minimum Wage Research

5.22 Many of the negative employment effects connected to the introduction of a Living Wage are equally applicable to the introduction of a wage floor induced by legally binding Minimum Wage legislation. Although the Living Wage differs from Minimum Wage legislation in a number of important respects, for example the Living Wage often implies, but does not require, a wage floor that is above the floor stipulated by the Minimum Wage, similarly the Living Wage typically has a more narrow coverage than Minimum Wage legislation and often only applies to employment contracts involving the public sector, there is an obvious

connection between the two policies and the effects that each are likely to have on employment of workers affected by the policies. From this perspective, therefore, a review of the empirical literature on the effects associated with Minimum Wage legislation can provide useful insights on the likely effect that Living Wage legislation may have on low-skilled wages and employment.

5.23 Much of the early work on the effects of a national Minimum Wage on employment was based on time series data for the US. The general consensus was that the elasticity of employment of low skilled young workers was in the order of -0.1 to -0.3, so that a 10 per cent increase in Minimum Wages produced between a 1 and 3 per cent reduction in low skilled young worker employment (Brown, Gilroy and Kohen, 1982). The results were statistically significant and in line with the negative employment effects predicted by standard neo-classical theory. However, Minimum Wage legislation in the US appeared to have little if any significant effect on the employment of adults over the age of 20.

5.24 Second, generation studies in the US based on more recent data and using panel data challenged the classical orthodoxy of the effects of Minimum Wages on employment. These later studies used a natural experiment approach, based on a difference-in-difference estimator, to compare the effects of Minimum Wages in low and high impact states (a low impact state is one in which the Minimum Wage is low relative to average earnings (low bite) while a high impact state is one where the Minimum Wage is high relative to average earnings (high bite)) and across different types of workers (low and high skilled).

5.25 Card and Krueger (1995) have been influential and in a number of related studies they found little evidence of a negative employment effect of Minimum Wages and even in some cases found a positive effect on teen employment and general employment in low wage fast food restaurants in New Jersey who raised their Minimum Wage above the federal Minimum Wage in 1992 (Card and Krueger, 1994). A positive employment effect of the Minimum Wage is line with a monopsonistic model of a labour market whereby employers can only increase the supply of workers to the firm by raising their wage rate (see Manning 2003 for a detailed exposition). For the monopsony model there is a range for the Minimum Wage in which employment increases, which in a partial equilibrium model depends on the elasticity of labour supply faced by the firm.

5.26 Card and Krueger's finding on the effect of Minimum Wages on employment have not gone unchallenged and have been criticised on a number of different fronts including chosen methodology, quality of data, timing and the inability to control for unobserved demand shocks, which may otherwise have offset the effect of Minimum Wage increases (see Hamermesh, 1995; and Neumark and Wascher, 1995, 2000). More recently Neumark and Wascher (2006) have published a comprehensive review of the effects of Minimum Wages on employment in the US and other countries. In the vast majority of international studies considered, they found a negative effect of Minimum Wages on employment (albeit not

always significant) and fewer than 10 per cent of studies suggested a positive effect. Moreover, they noted that evidence from studies focusing on low-skilled groups found that Minimum Wages typically generated adverse employment effects.

5.27 The UK has had a National Minimum Wage since April 1999. The rate is regularly updated and based on recommendations made by the Low Pay Commission, which are invariably endorsed in full by the Government. The adult rate set for the National Minimum Wage in the UK over the period 1999 to 2009 are shown in the Table 15 together with their implementation date.

**Table 15: UK Adult National Minimum Wage Rates (£ per hour)**

Adult National Minimum Wage	Implementation Date
3.60	April 1999
3.70	October 2000
4.10	October 2001
4.20	October 2002
4.50	October 2003
4.85	October 2004
5.05	October 2005
5.35	October 2006
5.52	October 2007
5.73	October 2008
5.80	October 2009

5.28 There is now a growing body of evidence which investigates the effect of the UK Minimum Wage on labour market outcomes. The general consensus is that the effects on employment have been relatively benign and that the policy has helped low-wage earners. Some of the key findings for the UK can be briefly summarised as follows:

- While there is evidence of a negative employment effect of the national Minimum Wage in some low wage sectors, most notably for care home workers (Machin, Manning and Rahman, 2003), the effects on employment generally are not significant and broadly neutral (Stewart, 2004a, 2004b).
- There does not appear to be any systematic adverse employment effects arising from the introduction of the national Minimum Wage in geographical areas with a higher proportion of workers affected by the policy. Stewart (2002), for example, finds that employment growth in regions of the UK with a higher proportion of low-wage workers, whose wages had to be increased in order to comply with the policy,

was not significantly lower than other regions with a higher proportion of workers whose pay was not affected by the policy. On the other hand, Stewart (2002) also finds that the introduction of the Minimum Wage did have a differential effect on the wage distribution across different regions of the UK. Specifically, those regions with a higher proportion of low paid workers enjoyed higher wage growth than regions with a lower proportion of low paid workers. However, as might be expected, the effect varied across the earnings distribution with the largest impacts found at the bottom end of the distribution and much less impact at the centre of the distribution. Strong wage compression effects at the lower end of the distribution, which reduce wage inequality, were also found by Machin et al. (2003) for UK care home workers. Similarly Dickens and Manning (2004, 2006) have shown that wage inequality has fallen in the UK since the introduction of the Minimum Wage, and that much of this reduction can be attributed to the effects of the policy.

- While much of the empirical evidence in the UK has concentrated on the effect the Minimum Wage has had on employment there are a small number of studies which have looked at the effects of the policy on the number of hours worked by low wage employees. Using New Earnings data, Stewart and Swaffield (2008), find that the introduction of Minimum Wage reduced the basic hours of low paid workers by between 1 and 2 hours per week. Although estimates using the Labour Force Survey are not as robust Stewart and Swaffield conclude that “... *in broad terms the evidence presented in this paper suggests strongly that the introduction of the Minimum Wage led to a reduction in the paid working hours of both male and female low-wage workers.*” Stewart and Swaffield suggest that employers are quicker to respond to shocks by changing hours than changing levels of employment.
- Although UK research on other effects caused by the introduction of a national Minimum Wage, other than those on employment and wages, are rare; nevertheless there are some important results that deserve to be highlighted. Draca et al (2006), Forth and O’Mahony (2003), Galindo-Rueda and Pereira (2004) and Machin et al (2003) all find positive effects of Minimum Wages on labour productivity, although the precision and significance of the estimates is not always high. Similarly, Arulampalam et al. (2004) find that workers affected by the national Minimum Wage were not only more likely to receive training but also that the intensity (days) of training for these workers was also higher. The general consensus is that product prices tend to rise after the introduction of Minimum Wages and this result is confirmed in the UK by Wadsworth (2007). However, in a survey of the international evidence on price induced effects, Lemos (2008) concludes that while the introduction of Minimum Wages increases prices it does not raise them by much. In a related context, Draca et al (2006) find that the profit margins of firms affected most by the introduction of the national Minimum Wage in the UK fell by between 8

and 11 per cent. However, this reduction in profits was not accompanied by an increased chance of the firm closing down, which implies that such firms may have been making excess profits by paying low wages prior to the introduction of the national Minimum Wage and all that the policy did was moderate the extent of these excess profits by channelling them back to low-paid workers. Finally Jones et al (2004) find that Minimum Wage jobs are often a stepping stone to higher paid jobs, as under half of workers defined as low paid in one year (hourly earnings at or below the national Minimum Wage) remain in that state next year. The average duration of pay at or below the national Minimum Wage was estimated to be only 1.48 years (including workers exiting to unemployment or becoming inactive).

### Evidence on the Effects of the Living Wage

5.29 As a number of Living Wage ordinances have been passed in the US since 1994 it is not surprising that most of the empirical findings relating to the effects of the policy are based on an analysis of US data. Living Wage policies are less prominent in Europe, this is partly due to Minimum Wage levels in Europe generally being closer to the average wage.

5.30 The Minimum Wage as a percentage of average earnings in 2007 was 48.1% in France, 38.2% in the UK and 31.2% in the US (Eurostat, 2009). Among European countries, for which data is available, only the Minimum Wage in Romania and Estonia accounted for a lower proportion of the average wage compared to the US.

5.31 Living Wage studies in the US can be divided into two broad camps. First there are prospective studies that estimate the costs and benefits of Living Wage policies prior to their adoption. Second, there are evaluation studies which assess the effects of Living Wage policies after they have been implemented by comparing what happened before with what happened after (a difference-in-difference approach). In the next few pages we summarise a few of the more influential studies and also provide a table that briefly describes some of the key finding from other papers based on the US experience of living wage ordinances.

5.32 Pollin and Luce (1998) is perhaps the best known of the prospective studies, and their basic approach has been used by several others to evaluate the effects of a Living Wage policy. Pollin and Luce are strong advocates of the Living Wage and their assessment of the effects introducing a Living Wage to the Los Angeles area were based on the hourly wage needed by a family of four with a single wage earner to take them above the poverty line. The findings of the Pollin and Luce report are, as expected, very positive and given below:

- The study calculated the total cost of the proposed wage increase to affected firms and concluded that the Living Wage would increase operating costs by a small amount for most contractors, increasing overall operating costs by between 1 to 2 percent, which could be absorbed either in efficiency gains or relatively small price

increases. In fact, the costs borne by the city were estimated as amounting to less than 1 percent of municipal revenue.

- The policy would encourage ‘high road’ competition among contactors paying the Living Wage which would in turn increase productivity, reduce labour turnover and increase productive efficiency. All of which serve to mitigate, and reduce, the increase in costs faced by an employer paying the Living Wage.
- Benefits of the policy included an estimated 50 per cent reduction in the amount of government subsidies received by affected workers and their families, as well as a substantial growth in spending and home ownership as a result of the increase in income received by workers covered by the policy. According to Pollin and Luce the representative family used in their calculations were estimated to benefit to the order of a £2,500 increase in annual income as a result of the policy. Living Wages (typically public sector contracts and public sector workers), and because not all workers covered by Living Wage contracts earn less than the stipulated minimum, these benefits are typically concentrated among a small fraction of a workforce within an area operating a Living Wage (Brenner, 2004).

5.33 While these benefits seem impressive they were based on the untested assumption that the introduction of the scheme would have no impact on employment or the number of hours worked by employees affected by the policy. This is clearly a disadvantage and many later studies used pre-and post implementation data to consider the wider implications of introducing a Living Wage on labour market outcomes and producer costs. These impact studies answer a number of important questions, which we summarise in the next few pages.

5.34 Neumark and Adams (2003) use data from the US Current Population Survey (CPS) over the period 1996 to 2000 to consider the effect of Living Wage ordinances on wages, employment and urban poverty. The analysis exploited differences in whether Standard Metropolitan Statistical Areas (SMSA) in the US had a Living Wage ordinance and the timing of their implementation where they were present. Although the results of this analysis have not gone unchallenged by other commentators who feel that the estimated effects seem implausibly high given the likely coverage of the policies, the key results can be summarised as follows:

- There is a significant effect of Living Wage ordinances on the wages of low-wage workers (0-10 percentile range). Although no contemporaneous effect of the policy on wages is found. At a one year lag, strong significant effects are found with a wage elasticity of around 7 per cent. No effects are found at other points in the earnings distribution.

- Moderate negative effects of the Living Wage on employment are found for low skilled workers in the lowest 10 percent of the earnings distribution. Their estimates suggest that total metropolitan employment is about 2 to 3 per cent lower in Living Wage cities, the employment reduction effects of the Living Wage are therefore estimated to be of a similar order of magnitude as some estimates of the effect of Minimum Wages on employment, which given their lower coverage is treated with scepticism by some commentators. Positive employment effects are, however, found for workers in the higher percentiles of the wage distribution, which suggest that there is a substitution effect working against low skilled workers in favour of high skilled workers. No significant hours effects are found at any point in the earnings distribution, although the point estimates showing the effect of the Living Wage on hours worked were invariably negative.
- The effect that Living Wages have on family poverty suggests that the policy reduces the incidence of poverty in the US. Contemporaneous, 6-month and 12-month lags are all negative, implying that they reduce the incidence of poverty, but only 6-months and 12-months lags are statistically significant, suggesting that it takes time for the policy to bite and have an effect on family poverty. Using total family income to classify families as either above or below the poverty line, the estimates indicate that a 10 per cent increase in the Living Wage reduces the probability of a family living in poverty by 0.003 to 0.004, which is an implied elasticity of -0.19.

5.35 In a follow up study that tested the robustness of their previous findings Neumark and Adams (2003) confirmed that Living Wage ordinances had a positive effect of the wages of low pay workers covered by the policy but that this effect was larger in cities where the coverage of Living Wage was broader and extended coverage to employers receiving business assistance from the city.

5.36 Robustness checks on the employment affect of Living Wages, however, are not as conclusive. Specifically, while the largest estimated negative employment affect coincided with those groups with the largest positive wage effects from the Living Wage, the individual coefficient estimates lacked precision and were not statistically significant in most cases, which Neumark and Adams attribute to the small number of Living Wage increases available for analysis.

5.37 In a later study Adams and Neumark (2005) find, as in their earlier 2003 study, that whereas Living Wage laws that only apply to city contractors (i.e., limited coverage) do not have a detectable effect on the wages or employment of low-wage or low skilled individuals but that strong wage and (negative) employment effects are found where the coverage of Living Wages extends to employers receiving business assistance. They conclude that the reason for this effect is not because Living Wage laws covering employers receiving business assistance are fundamentally different from other Living Wage schemes but rather because

the extension of Living Wage laws to firms in receipt of business assistance tends to reflect the fact that these cities have had stronger Living Wage campaigns, which have resulted in stronger Living Wage laws and higher enforcement.

5.38 In the same paper Adams and Neumark also consider a number of other features of Living Wages which might explain why some ordinances appear to have more bite than others. Most notably they find that (negative) employment and (positive) wage effects are stronger in cities that are contiguous with neighbouring cities that also have Living Wage laws. Interestingly, contiguous cities with Living Wage laws were also more likely to have Living Wage laws applied to employers in receipt of business assistance. Consequently, the finding that Living Wages have a stronger effect on employers and employees in receipt of business assistance might be partly explained by the spatial concentration of Living Wage ordinances, which increases their market coverage and importance, within a region.

5.39 Other US results are of interest and include studies of the effect of Living Wage ordinances in specific areas rather than looking at city to city variations using national data sets like the CPS as undertaken by Neumark and Adams in their research. For example, Brenner (2005) uses survey data from Boston, who passed a Living Wage ordinance in 1997, to consider the effects on city contractors of the policy by comparing establishments that raised wages as a result of the Living Wage with establishments that did not. The key finding can be summarised as follows:

- The Boston Living Wage did not affect all firms equally, with only a quarter of firms covered by Living Wage contracts raising wages as a result of the law. Firms in the non-profit human services sector were more likely to be affected by the policy.
- There is no evidence that the Boston Living Wage ordinance reduced either employment or the hours worked by employees covered by the law. Instead for staff assigned to city service contracts there was evidence of positive employment effects for firms that raised wages as a result of the policy. Similarly compared to firms not affected by the policy, firms that raised wages as a result of the policy actually increased their use of full time staff.
- Qualitative and quantitative data from the survey suggested little evidence of firms affected by the policy being able to offset increased labour costs by commensurate saving on either labour turnover or absenteeism. However, there is evidence that employee effort and morale increased in those firms that raised wages as a result of the policy. Nonetheless it was considered unlikely that the increases in labour productivity were sufficient to fully offset increased labour costs. Given that contract prices did not increase in many of the affected firms the natural implication is that profits were reduced, with 38 per cent of affected firms in the sample reporting that

reduced profits was the primary means by which they adjusted to the increased labour costs associated with the Living Wage ordinance.

- There was no evidence that firms responded to the increased low skilled labour costs induced by the policy from substituting either higher skilled workers or capital for low skilled workers.

5.40 In another paper Reich et al (2005) considered the effect of a Living Wage ordinance designed to increase the wages of low-skilled workers and improve service quality at San Francisco International Airport (SFIA). Although, the results from this study are striking, they must be treated with caution as they cannot be attributed unequivocally to the effects of a Living Wage ordinance which was only one component of a multi-faceted policy initiative. With this caveat in place the main finding can be summarised as follows:

- Approximately 9,700 of 11,000 ground based staff received pay increases during the sample period, and of these it was estimated that 5,400 received wage increases as a direct result of the Living Wage policy. Pay among the low skilled significantly improved and this substantially reduced overall earnings inequality at the airport, although there was also some evidence of wage gains higher up the earnings distribution which may have been motivated by the need to restore skill differentials.
- The costs to the employer of implementing the policy were small and estimated to amount to less than 1 per cent of total revenue, which is approximately \$1.42 per airline passenger.
- For those firms that experienced a wage increase of 10 percent or more as a result of the policy, labour turnover rates fell from 50 per cent to 20 per cent per year. By contrast labour turnover in those firms that experienced a wage increase of less than 10 per cent saw labour turnover rates fall by much less (from 17 per cent to 14 per cent). Clearly raising the wages of low wage workers has a dramatic effect on their willingness to stay with a firm longer. The results also showed that worker morale and labour productivity increased as a result of the higher wages and benefits offered under the policy.
- There was no evidence of employment loss associated with the policy, or of a substitution effect towards more skilled workers. However, there was some evidence of a change in hiring patterns following the implementation of the policy, with firms hiring more male workers in some low wage occupations.

5.41 Other US findings are reported in Table 16, which provides information on the both the authors of the research and their key findings.

**Table 16: Summary of Additional US findings Relating to Living Wage Ordinances**

Author	Key Findings
F. Abdulahad and Guirguis (2003)	Tests the potential impact of living wages on part time and teen employment using a minimum wage model. Finds a negative and significant relationship between real minimum wages and the employment of both part time and teen employment
S. Adams and D. Neumark ((2005)	Based on US data covering the period 1996 to 2002 and exploits city-to-city variation in living wage ordinances. Living wage laws applied to business assistance boost the wages of the lowest paid workers at the cost of some disemployment. Overall living wage ordinances are found to reduce poverty.
J. Buss and A. Romeo (2006)	Considers trend rates of growth of employment and unemployment in a sample of US cities before and after they introduced living wage ordinances. Finds that while a few cities had a negative labour market experience after the introduction of living wage ordinances such cities represented the exception rather than the rule.
R. Bhatia and M . Katz (2002)	Estimates the magnitude of likely health improvements resulting from the proposed living wage ordinance for San Francisco. Finds that the living wage ordinance in San Francisco would be associated with substantial health improvements for both workers covered by living wages and their offspring.
M. Brenner, J. Wicks-Lim and R. Pollin (2002)	Provides a critique of Neumark’s (2002) paper based on CPS data. Suggests Neumark’s results on the wage effects of living wages are not robust to alternative classifications of workers covered by their provisions. Claims wage gains to sub-minimum wage workers found by Neumark are the result of effects produced by falling unemployment and rising minimum wage provisions for workers in Los Angeles alone.
S. Clain (2008)	Finds living wage ordinances significantly reduce urban poverty rates but there is no comparable effect from state minimum wage laws. Though the effect of living wages is significant, in line with the workers covered by their provision, the absolute magnitude of the effect was quite modest.

Author	Key Findings
D. Fairris (2005)	Starting pay of Los Angeles low wage workers rose by \$1.74 as a result of the ordinance. Establishments covered by the living wage experienced a reduction in low wage worker turn-over, a drop in absenteeism, reduced overtime, and reduced job training relative to a control; group of establishment not covered by the living wage ordinance. Living wage ordinances had no significant effect on the use of part time workers, the intensity of supervision or the tendency of living wage firms to fill vacancies from within.
D. Fairris and L. Bujanda (2005)	Based on data from 75 contractor and 210 non-contractor firms in Los Angeles. Finds that newly hired workers after the passage of the living wage ordinance were older, better educated and had already been earning higher wages elsewhere. Suggests labour-to-labour substitution is taking place which is estimated to offset as much as 40 per cent of the wage gains stemming from the ordinance.
C. Howes (2004)	Annual (employment) retention rate of new homecare providers in San Francisco rose from 39 to 74 per cent following significant wage and benefit increases associated with living wage provisions: \$1 increase in the wage rate from \$8 – the national average for homecare workers – increases retention by 17 per cent.
I. Martin (2001)	Political conditions rather than economic factors, like the extent of urban poverty, explain the emergence and success of living wage movements in the US.
Niedt et al (19990)	Aggregate costs to the city of Baltimore of 26 living wage contracts was 1.2 per cent, which was less than the rate of inflation. Non-compliance with the living wage ordinance was significant and they had an effect on only a relatively small number workers. As a result the estimated financial cost to the city were small.
D. Neumark (2004)	An analysis based on CPS data for the period 1996 to 2002. Suggests the wages of unionised municipal workers increased as a result of living wage laws covering city contractors. Provides support for the hypothesis that by increasing the wages of employees employed by city contractors living wage ordinances reduce the incentives for cities to contact out work that would otherwise be done by unionised municipal workers, which increases the bargaining strength of organised labour.

Author	Key Findings
R. Pollin, M. Brenner and S. Luce (2002)	Estimates the likely cost of the New Orleans living wage ordinance (2002) based on a survey of businesses in 1999. Found cost increases likely to be small for most firms (less than 1 per cent of operating budgets) and concluded that changes in price, productivity and distribution were the likely means by which firms would absorb any increased costs.
D. Reynolds, R. Pearson and J. Vorkampt (1999)	40 per cent of workers covered by the Detroit living wage ordinance would see wage and/or health benefits gains. Overall cost to firms of compliance relatively small. For half of contract employers the maximum cost increase was less than 1 per cent of the value of their contract.
D. Reynolds and J. Vorkampt (2005)	Based on a sample of 96 non-profit organisations covered by Detroit's living wage ordinance. Sample taken 12 to 18 months after the implementation of the living wage ordinance in 1998. Overall the living wage law had neither a negative effect on non-profit organisation nor did it result in appreciable job losses.
R. Toikka,A. Yelowitz and N. Neveu (2005)	Phase out rates of social benefit programs reduce the ability of living wage laws to reduce poverty. Found that 75 per cent of workers affected by living wages were not initially in poverty, and more than 40 per cent had total incomes of at least twice the poverty level.
G. Tolley, P. Bernstein and M Laesage (1999)	Proposed city ordinance for Chicago estimates to increase the wages of 8470 workers and causes job losses of 1,337 workers. Net impact on poverty uncertain. Finding in the study based on a proposed living wage of \$7.60, whereas the rate actually implemented in 1998 was \$7.00.

5.42 The findings reported in Table 16 vary according to the data used and the methodology used. Nonetheless as with the research summarised in more detail above there is some consensus across most of them that wages rise among the least-paid workers, while perhaps more contentiously employment levels decline (at the covered firms and maybe more generally) as a result of these ordinances. However, the numbers of workers covered by such ordinances in any single area seems to be quite modest.

5.43 There is some evidence that living wage policies reduce low wage employee turnover and promote increases in worker morale. Such effects may be due to changes in the nature of workers hired as the policy promotes labour-to-labour substitution by increasing the costs of low wage workers.

## Evidence on the Effects of the Living Wage in the UK

5.44 Evidence on the effects of Living Wages in the UK is sparse, mainly because such policies have not been implemented to any great extent here. As explained earlier, however, an exception is the London Living Wage and in a recent report, London Economics (2009) have undertaken a limited assessment of the outcomes associated with the London Living Wage. The results of this assessment are described below, however, because the findings in the report are based on small samples of employees and employers they lack statistical precision and therefore should be interpreted with caution. Nevertheless, the major findings found in this report resonate with findings from more robust US studies described earlier.

5.45 London Economics found clear evidence of gains from the London Living Wage to both employers and employees. The gains/impacts to employers implementing the London Living Wage included:

- Lower staff turnover, which reduces recruitment and induction training costs and provides for greater continuity of employment;
- Reduction in worker absenteeism rates and sick leave rates. Although worker absenteeism was low in a majority of employers sampled, one buyer indicated a reduction in absenteeism and sickness of about 5 per cent following the introduction of the London Living Wage for contracted-out services;
- Employers reported that the London Living Wage had increased worker effort and productivity. Employers also reported that worker morale and motivation had also improved as a result of the policy;
- Employers reported positive reputation benefits accruing to their business, although these could be higher if more people were aware of the policy being implemented within London; and
- Employers noted no significant impact of the policy on business performance. Nor were there any obvious disemployment effects associated with the policy, although this conclusion was based on what had actually happened to employment in firms paying the London Living Wage and not on an appropriate counter-factual assessment.

5.46 Employees were also supportive of the policy. Many reported an improvement in their standard of living and that the London Living Wage had impacted positively on their morale and produced a more positive atmosphere, which was conducive to more productive work and a higher quality of work. The policy also made employees more willing to accept organisation changes in work practices, while demanding fewer concessions from their employers wishing to implement change.

5.47 While the results from the survey of employers and employees paint a rosy picture for the success of the London Living Wage nevertheless there are a number of barriers perceived by non-London Living Wage employers of implementing the policy. As expected these revolve around the costs of implementing the London Living Wage, both in terms of labour costs and from costs of renegotiating existing contracts, and in terms of the impact the policy might have on prices and profits.

### Summary

5.48 The evidence in the US and UK suggest potential benefits to the introduction of Living Wage laws, although even here the results are mixed vis-à-vis the likely impact such a policy might have on employment and hours worked. However, most of the studies reviewed in this section, which have looked at the effect Living Wage and Minimum Wage policies have had on labour market outcomes and business performance were set against a backdrop of relatively benign economic conditions.

5.49 The world has recently changed quite dramatically and we are currently within the grip of a global recession. In these changed circumstances, increasing labour costs might have more serious implications for business performance and the employment of low-skilled workers than they have in the past and from this perspective it might be wise to exercise caution in the pursuit of these policies. Either in terms of delaying their introduction or by seeking a gradual approach in which the effects of the policy can be more carefully evaluated.

5.50 Most research suggests that in benign economic conditions the negative impacts of Living Wage and Minimum Wage policies are likely to be reduced. Benign economic conditions may include low or falling unemployment rates, rising real wages and rising real public expenditure balanced with rising public revenues.

## 6 Key impacts

### Key issues and impacts

6.1 The previous sections of this report highlighted the key issues related to employment and poverty in Wales. In addition the study team were asked to investigate the effectiveness of a Living Wage policy as a means of reducing child poverty, raising the incomes of poor households and the impact on the attractiveness of Wales as a business location.

6.2 These issues are summarised in Table 17 below with reference to literature review to provide an overview of:

- The current (baseline) position of Wales in relation to each key issue;
- The expected impact related to each key issue based on evidence say from policies implemented elsewhere; and
- The likely impact on Wales based on the expected impact and current characteristics of the Welsh economy and labour markets.

6.3 In summary the scale of impacts will depend heavily on the coverage of a Living Wage policy and whether it extends beyond public sector employees and employees delivering public sector contracts. The most significant areas of impact are likely to be realised in improved wages among low paid workers and marginal improvements in relatively deprived communities. For many other areas it is difficult to see how impacts are likely to arise, for example inactivity rates are unlikely to be affected.

### Effectiveness

6.4 There is an important qualification to Table 17 with regards to the effectiveness of Living Wage policies in tackling poverty and the cost of implementation. A range of studies identified positive outcomes in raising incomes for poor households but there is clearly a cost to the public purse. A simulation was undertaken to show how different Living Wage levels are likely to impact on poverty.

6.5 The results from the simulation are shown in Table 18 and are based on data from the Quarterly Labour Force Survey for 2008. The data is pooled over the four quarters for 2008 and the sample is then restricted to workers in employment in Wales that provided direct information on their hourly earnings. The data is grouped into six different household types: namely all households, single person household with no dependent children, single person household with dependent children, married with no dependent children, married with dependent children and other households.

**Table 17: Key issues and likely impacts**

Key issue	Current position	Expected living wage impact	Likely impact in Wales
Low productivity	Labour productivity in Wales is among the lowest of the UK regions.	Evidence on productivity is mixed. Living wage workers in London report positive benefits and there is evidence that the National Minimum Wage in the UK has increased training propensities. Evidence from the US is mixed but living wage ordinances have reduced labour turnover.	Positive impacts in reduced labour turnover and improved worker morale, but limited partly due to likely limited coverage. Extending coverage is likely to increase potential negative employment effects even if they are offset by increased productivity.
Low wages	Average wages in Wales are among the lowest of the UK regions.	The National Minimum Wage has contributed to a reduction in wage inequality in the UK. Living Wage ordinances in the US also suggest they raise the wages of affected (low wage) workers.	Positive wage growth for those affected by the policy. However coverage is likely to be limited and larger firms that service contracts in both the covered and uncovered sectors will have the ability to mitigate the effects of the policy by reallocating higher and low paid low skilled workers across public and private sector contracts.

Key issue	Current position	Expected living wage impact	Likely impact in Wales
High inactivity	<p>Unemployment had improved in recent years but inactivity rates remained high. The recent recession has hit Wales hard with higher unemployment whilst inactivity rates have remained fairly stable.</p>	<p>Evidence suggests low wages are only one of a number of potential barriers that need to be overcome to move into work (cost of childcare, transport and shortage of local opportunities). Most of the economically inactive are disengaged from the labour market and not interested in finding work in the short to medium term.</p>	<p>Limited coverage reduces the potential for impact. The effects on inactivity rates are likely to be less significant than the intended impact of ongoing reforms to the welfare payment system. In the current environment job shortages are likely to provide an even stronger disincentive to the economically inactive from entering the labour market. Many of the economically inactive are in any case inactive through choice.</p>
Deprived communities	<p>Significant difference in wages and reliance on the public sector across communities.</p>	<p>There is little evidence at this level of spatial disaggregation. However, as the share of public sector employment in total employment is high in many deprived areas of Wales, such a policy has the potential to reduce these spatial differences.</p>	<p>Positive benefits on deprived communities within Wales will depend on the numbers covered and affected by the policy. Further evidence on government and local government procurement contracts is needed to provide evidence on the likely impacts of a Living Wage policy.</p>

Key issue	Current position	Expected living wage impact	Likely impact in Wales
Household poverty	Households in Wales are at greater risk of poverty compared to the rest of the UK.	Evidence from the US suggests a reduction in household poverty with a lag of 6-12 months. Employees covered by the London Living Wage reported a significant improvement in their standard of living.	Reductions in poverty will depend on the proportion of workers in poverty affected by the policy. Simulations outlined later in this Section suggest that the impact may be limited and complicated by coverage in terms of full time and part time employees. A uniform rate is also poorly targeted and does little to address the problem of workless households in which the effects of poverty are most severely felt.
Child poverty	Children in Wales are at greater risk of poverty compared to the rest of the UK.	As outlined above, the evidence implies child poverty is reduced (depending on coverage).	A likely reduction in child poverty but limited in impact (by workless households). Child poverty is also linked with workless households (see household poverty above).
Business location choice	Over the last decade the Welsh economy expanded adding jobs but with lower economic growth compared to rest of the UK.	The impact on attractiveness as a business location is highly dependent on coverage but likely to be limited (coverage of public sector and public sector contracts).	Impact on attractiveness is likely to be limited as coverage is unlikely to extend beyond public sector and public sector contracts.

6.6 The proportion of the sample which fell into each household type used to construct the table was as follows: Single person household with no dependent children (16.37 per cent), Single person household with dependent children (6.97 per cent), Married with no dependent children (33.71 per cent), Married with dependent children (35.82 per cent), and Other household (7.34 per cent). Five different hourly earnings thresholds are defined in the table and used as column headings. Four are defined in terms of the National Minimum Wage in force at the time of the respondent's interview and the other is defined in terms of 60 per cent of median hourly earnings.

6.7 The four National Minimum Wage thresholds used in Table 18 are (i) National Minimum Wage, (ii) National Minimum Wage plus 10 per cent, (iii) National Minimum Wage plus 20 per cent, and (iv) National Minimum Wage plus 30 per cent. The first entry in each of the columns reported in Table 18 shows the proportion of respondents in households of that type in which no individual in the household earns more than the stipulated hourly earnings threshold. So for example, 22.14 per cent of all respondents live in households where no-one earns more than the National Minimum Wage plus 30 per cent.

6.8 The figures reported in brackets in each column are based on a simple simulation in which any individual earning below the stipulated threshold and who is employed in the public sector has their hourly wage made up to the threshold level. The figure in brackets is then the proportion of respondents in each household type in which no individual in the household earns more than the stipulated threshold based on the adjusted hourly earnings data.

6.9 The results reported in Table 18, therefore, are based on two assumptions. First, there are no employment effects of raising hourly earnings to the threshold level; and second, that only public sector workers below the threshold level benefit from an hourly earnings increase.

6.10 Even under more ambitious simulations for public sector wages (at least 30 per cent above National Minimum Wage) the proportion of workers in low income households remains high (17.82 per cent). The simulations emphasise the extent of low paid jobs in Wales outside of the public sector, such as hospitality (see Section 4).

6.11 The simulations also demonstrate the relative bluntness of Living Wage policies as a means to tackle poverty. Benefits will accrue among households with more than one person working and where at least one worker already earns above the National Minimum Wage. However, Living Wage policies are usually one of many policy tools used to combat poverty.

6.12 Table 18 shows a more marked reduction for single person households with dependent children, however income and poverty in these households is more heavily influenced by worklessness. Indeed, across all household types the extent of worklessness will influence the effectiveness of Living Wage policies.

6.13 After accounting for worklessness the impact of a Living Wage policy on low income households will be smaller than shown in Table 18. Workless households will also produce diminishing marginal benefits as the Living Wage increases. As the Living Wage increases wages among low income households will rise (and move from poverty) but workless households are likely to remain unaffected.

**Table 18: Proportion of Workers in Households in Wales with all earners below adult NMW or median earnings Thresholds**

Household Type	All below <i>(figures in brackets show simulated proportion if below threshold public sector workers receive the threshold wage)</i>				
	NMW	NMW+10%	NMW+20%	NMW+30%	60% of median hourly earnings
All Households	7.58 (6.12)	13.31 (10.47)	17.00 (12.60)	22.14 (17.82)	11.34 (8.47)
Single person with no dependent children	6.72 (5.75)	13.11 (11.05)	16.90 (14.43)	22.55 (19.29)	11.63 (9.13)
Single person with dependent children	11.98 (10.27)	26.64 (23.13)	35.97 (30.37)	41.82 (32.03)	23.08 (19.77)
Married with no dependent children	6.01 (5.28)	12.07 (9.97)	15.15 (12.71)	19.95 (16.62)	9.58 (7.41)
Married with dependent children	9.48 (7.21)	13.26 (10.42)	16.81 (12.47)	22.57 (17.44)	12.12 (8.00)
Other	14.75 (9.42)	22.56 (14.46)	27.93 (20.71)	35.32 (25.90)	19.47 (14.61)

*Source: Pooled Quarterly Labour Force Survey 2008  
(Population weighted and excluding proxy earnings responses)*

### Employment impacts

6.14 A further consideration of the likely impact and effectiveness of a living wage policy are the effects on overall employment levels. Evidence cited earlier in Section 5 suggests employment in the sector covered by a Living Wage policy may fall (Adams and Neumark, 2005) with an elasticity of labour demand of -0.12. This suggests that a 50% increase from the National Minimum Wage to a Living Wage may result in a 6% decline in employment within the covered sector.

6.15 An illustration of how employment could fall can be shown drawing on the baseline information and based on a reasonable assumption that a Living Wage policy may raise wages beyond the National Minimum Wage by 20% to 30%. Of the 93,600 employees in public administration in Wales (shown in Section 4) the calculations will assume, for illustration only, around 10% of employees will be paid around the National Minimum Wage.

6.16 Based on an increase in wages for 9,360 employees of 20% to 30%, the likely fall in employment will be between 2.4% and 3.6%. This means a fall in employment of 230 to 340 jobs. The evidence presented by Neumark and Adams (2005) suggests the fall in employment could be higher depending on wider coverage (such as conditions of grant funding), stricter enforcement and proximity to economies not covered by Living Wage policies (for example the Bristol city-region).

6.17 These employment effects are based on estimates of the elasticity of labour demand from the US. Although the effects provide a useful illustration of how employment could fall the calculations assume that the elasticity of labour demand in Wales, in the public sector, is the same as in the US.

### Cost of implementation

6.18 Glasgow City Council implemented a Living Wage policy at the start of the financial year 2009/10. The wage was set at £7 per hour based on the JRF approach set out in Section 4. Glasgow City Council estimated that full-time staff employed at the lowest end of the pay scale will earn a starting salary of £13,340 compared to £12,200 prior to the introduction of the Living Wage.

6.19 Glasgow City Council stated there were 681 members of staff earning less than £7 an hour and the Glasgow Living Wage will cost up to £1.2 million. The relatively small cost can be attributed to the small number of workers covered and that wages at the lowest end of the pay scale were already at £6.40 an hour.

6.20 The Glasgow Living Wage is voluntary for other employers in Glasgow but is promoted through Glasgow City Council's procurement policy. The Glasgow Living Wage is also being promoted among employers ([www.glasgowlivingwage.co.uk](http://www.glasgowlivingwage.co.uk)) with an aspiration to raise the wages of up to 80,000 low paid employees across the city.

6.21 The Glasgow Living Wage is an interesting case as the cost of implementation for the public sector is small. However, the policy is clearly aimed at encouraging the private sector and third sector to emulate the Glasgow Living Wage. This suggests negative employment effects are likely to be higher due to the indirect costs of implementation (see Section 5).

### Summary

6.22 The scale of impact from a Living Wage policy will depend heavily on the coverage and whether it extends beyond the public sector employees and employees delivering public sector contracts. The most significant areas of impact are likely to be realised in improved wages among low paid workers and marginal improvements in relatively deprived communities. For many other areas it is difficult to see how impacts are likely to arise, for example inactivity rates are unlikely to be affected.

6.23 Living Wage policies are unlikely to provide an effective means of tackling poverty. Even under more ambitious simulations for public sector wages, the proportion of workers in low income households remains high. The simulations also demonstrate the relative bluntness of Living Wage policies as a means to tackle poverty. Benefits will accrue among households with more than one person working and where at least one worker already earns above the National Minimum Wage. However, Living Wage policies are usually one of many policy tools used to combat poverty.

## 7 Context and current economic climate

### UK Context and Economic Climate

7.1 Over the last eighteen months the global economy has deteriorated sharply as many countries have moved into recession and global output has fallen. The downturn was sparked by a major financial crisis, but rising oil and commodity prices also played a part in creating an environment in which economies were particularly vulnerable to a slump in consumer and business confidence.

7.2 In Britain, as elsewhere, one of the major problems was that British banks had over invested in assets that turned out to be illiquid or 'bad'. This led to a credit crunch in which banks were reluctant to lend to one another and wholesale money markets froze up. Banking failures, and near failures, compounded the problem and led to stock market instability that seriously undermined consumer and business confidence. The onset of the recession in the UK officially began the last quarter of 2008, following two consecutive quarters of negative GDP growth, and output since then has fallen faster than at any time since the Great Depression of the 1930s.

7.3 In the second quarter of 2009 the level of GDP in the UK was 5.5% lower than in the second quarter of 2008, which is the largest annual fall on record. Most commentators now predict an imminent upturn in activity in the UK but the general consensus remains that the recovery is likely to be slow paced and that the global economy will remain susceptible to shocks for some time. Unemployment in the UK is currently at 2.47 million (7.9%) and even if output were to recover it is likely to increase to above 3 million.

### Context and Economic Climate in Wales

7.4 All regions within the UK have suffered in the current downturn but some have fared worse than others. For example, relative to the UK, Wales has suffered more, but not as badly as Northern Ireland. Most labour market indicators, particularly unemployment and employment statistics, indicate that the effects of the recession initially hit Wales harder than Great Britain as a whole. Subsequent quarterly results suggested a degree of optimism with the downturn in Wales seeming to moderate more quickly than in the UK as a whole.

7.5 However, most recently released statistics indicate that this optimism may be premature as there is a reversal of this trend across a range of key labour market indicators. Table 19 shows quarterly and annual changes in three important labour market indicators: economic activity rate, employment rate and unemployment rate (ILO), as well headline estimates of these categories of labour market activity taken from data released by the Office of National Statistics (ONS) in October 2009.

**Table 19: Labour market indicators June-August 2009, quarterly and annual changes**

Labour Market Indicator	Rates June-August 2009		Quarterly Change in Rate since March May 2009)		Annual Change in Rate June-August 2009)	
	Wales	Great Britain	Wales	Great Britain	Wales	Great Britain
Economically active	75.9	79.3	0.3	-0.1	-0.7	0.0
Employment	68.8	72.8	-1.0	-0.3	-3.1	-1.7
Unemployment (ILO)	9.1	7.9	1.6	0.3	3.2	2.1
Economically inactive	24.1	20.7	-0.3	0.1	0.7	0.0

*Source: Office of National Statistics, Statistical Bulletin October 2009*

7.6 Compared to Great Britain as a whole, Wales has a lower percentage of its working age population in employment (68.8% Wales compared to 72.8% GB), a higher unemployment rate (9.1% Wales compared to 7.9% GB), and higher levels of economic inactivity. These outcomes are not unexpected and Wales has traditionally performed less well on these indicators than GB as a whole. However, a cause for greater concern is the finding that both quarterly and annual changes in these labour market indicators show that the position in Wales is now deteriorating faster than in GB as a whole.

7.7 For example, on the basis of the position in June-August 2009 the quarterly change in the employment rate in Wales was -1.0 percentage points whereas the equivalent change in GB was only -0.3. Similarly, over the same period the quarterly change in the unemployment rate in Wales saw an increase of 1.6 percentage points compared to an increase in GB as a whole of only 0.3 percentage points.

7.8 The annual changes reported in Table 19 for these two labour market indicators are even more revealing about how the recession has impacted in Wales more than in GB as a whole. Hence the employment rate in the year to June-August fell by 3.1 percentage points in Wales compared to a fall of 1.7 percentage points in GB as a whole, while over the same period the unemployment rate increased by 3.2 percentage points compared to a 2.1 percentage point increase in GB as a whole.

7.9 These percentage point increases were the largest of any of the 11 standard regions in GB and while overall employment rates are lower in the North East of England and unemployment rates are higher in the North East and West Midlands, the dramatic deterioration in Wales' recent position is a cause for concern. In the context of the increase in overall unemployment in GB of 82 thousand in the three months to August 2009, 24 thousand (or 29 per cent) was accounted for by an increase in unemployment in Wales (although both of these figures are subject to sampling variability).

7.10 Given that the figures in Table 19 suggest only small changes in the share of the working age population that are either economically active or inactive, these movements suggest that most of the increase in unemployment is the result of job losses, which have occurred in Wales at a rapid rate despite the assistance given by the Welsh Assembly to both maintain jobs through the ProAct scheme and to provide the recently unemployed the opportunity to improve skills through the ReAct scheme. Although it is difficult to put numbers on the overall effects of these schemes clearly the position in Wales is likely to have been even worse.

### **Public Sector Finances**

7.11 Public sector finances have been strained by falling tax revenues coupled with demand for support across a range of industries struggling in the face of the downturn. Rising public sector borrowing and debt suggests the public sector is likely to face increasingly constrained budgets over the short to medium term.

7.12 Employee costs account for a large share of operating budgets across most public sector services. The latest report and accounts (2008-09) for WAG show employee costs accounted for 69% of gross administration costs. It is likely that constraints facing public sector budgets will require careful consideration of employee costs over the short to medium term.

### **Summary**

7.13 Most labour market indicators indicate the recession initially hit Wales harder than Great Britain as a whole. The dramatic deterioration in Wales' recent position is a cause for concern. Of the increase in overall unemployment in Great Britain of 82 thousand in the three months to August 2009, Wales accounted for an increase of 24 thousand (both of these figures are subject to sampling variability).

7.14 Public sector finances have been strained by falling tax revenues coupled with demand for support across a range of industries struggling in the face of the downturn. Employee costs account for a large share of operating budgets across most public sector services.

7.15 In these changed circumstances, this report earlier out serious implications for businesses of increasing labour costs. There are also serious implications for the public sector in increasing labour costs in the current environment. It is likely that constraints facing public sector budgets will require careful consideration of employee costs over the short to medium term.

## 8 Conclusions

8.1 In March 2009, The Welsh Assembly Government (WAG) commissioned the study team to undertake an exploratory study into the implications of introducing a Living Wage in Wales. This report presents the interim findings from the first stage of the analysis.

8.2 The research has found that, while the One Wales agreement does not include specific commitments to a Living Wage policy in Wales, it does make a number of commitments in the areas of area regeneration, child poverty, public service provision, equality and workforce development which would appear to be consistent with such a policy.

8.3 The research has profiled a range of different groups in the Welsh labour market who are likely to particularly benefit from a Living Wage policy, including women, the 'in-work' poor, and workers in certain geographies, sectors and occupational groups, and has estimated the size of each of these groups.

8.4 Based on an assessment of the impacts of previous Living Wage and Minimum Wage interventions, the research has identified a number of benefits associated with a Living Wage policy in terms of addressing low wages and increasing workforce efficiency. It has also found little evidence to date to suggest that such a policy can have any distortive impacts on the effective functioning of the labour market.

8.5 However, it should be noted that much of the previous research was undertaken during periods of economic expansion, and that such policies may produce different outcomes now that the macroeconomic climate has altered. Increasing labour costs might have more serious implications for business performance and the employment of low-skilled workers than they have in the past. From this perspective it might be wise to exercise caution in the pursuit of these policies, either in terms of delaying their introduction or by seeking a gradual approach in which the effects of the policy can be more carefully evaluated.

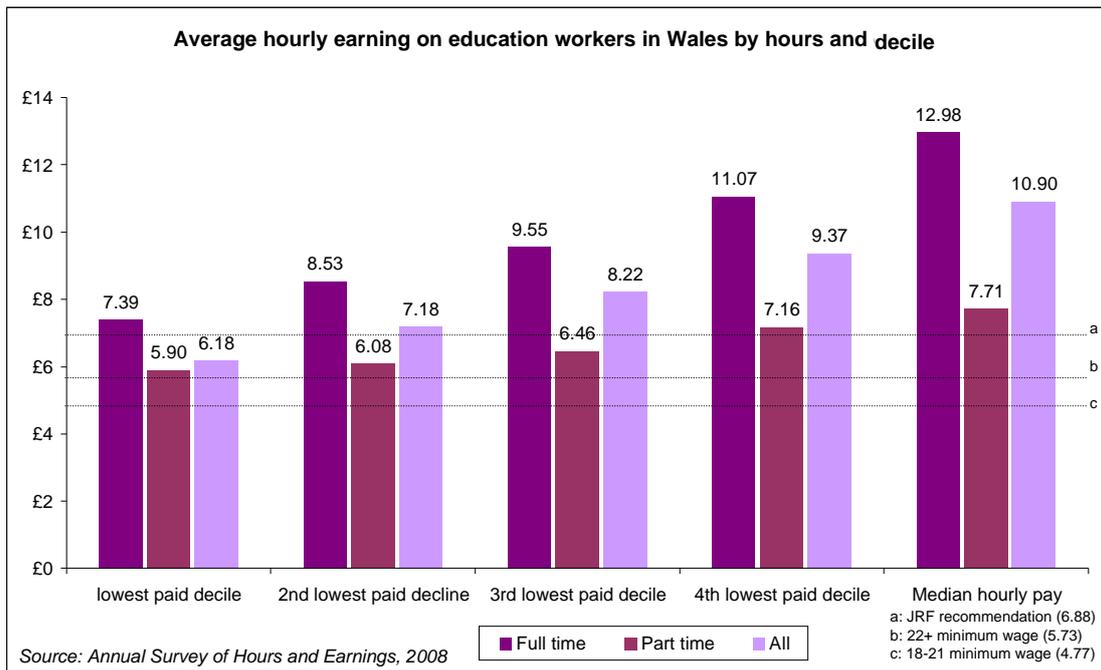
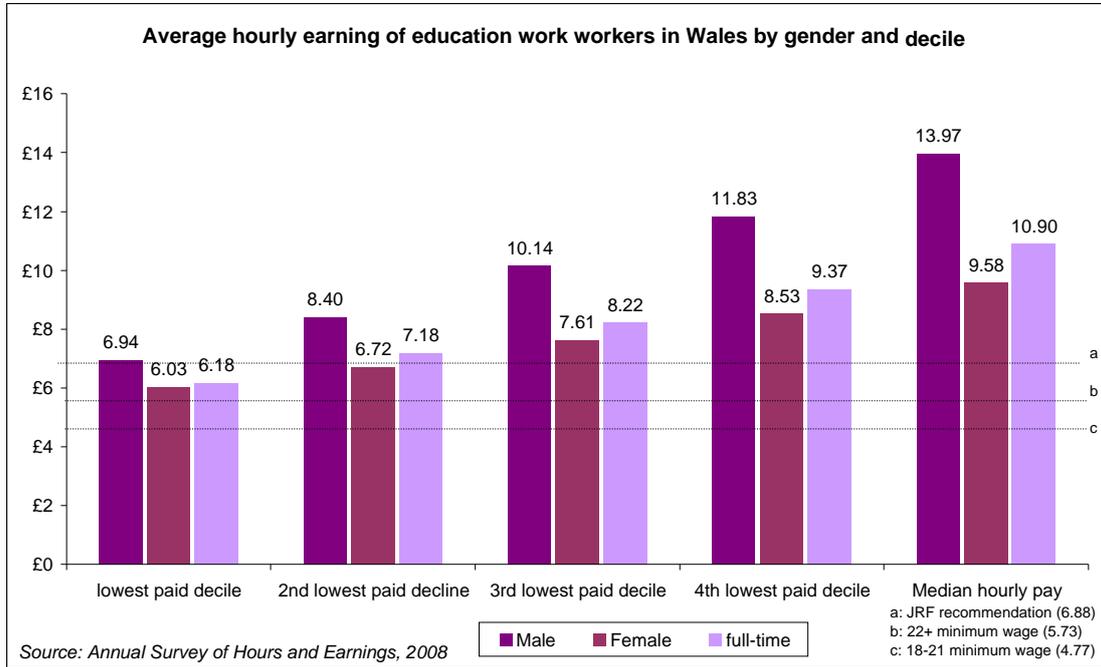
8.6 Most research suggests that in benign economic conditions the negative impacts of Living Wage and Minimum Wage policies are likely to be reduced. Benign economic conditions may include low or falling unemployment rates, rising real wages and rising real public expenditure balanced with rising public revenues.

8.7 The second stage of this research will use the evidence presented in this report to provide further detail. This will capture the scale and scope of implications of a Living Wage policy on economic performance and poverty levels across Wales.

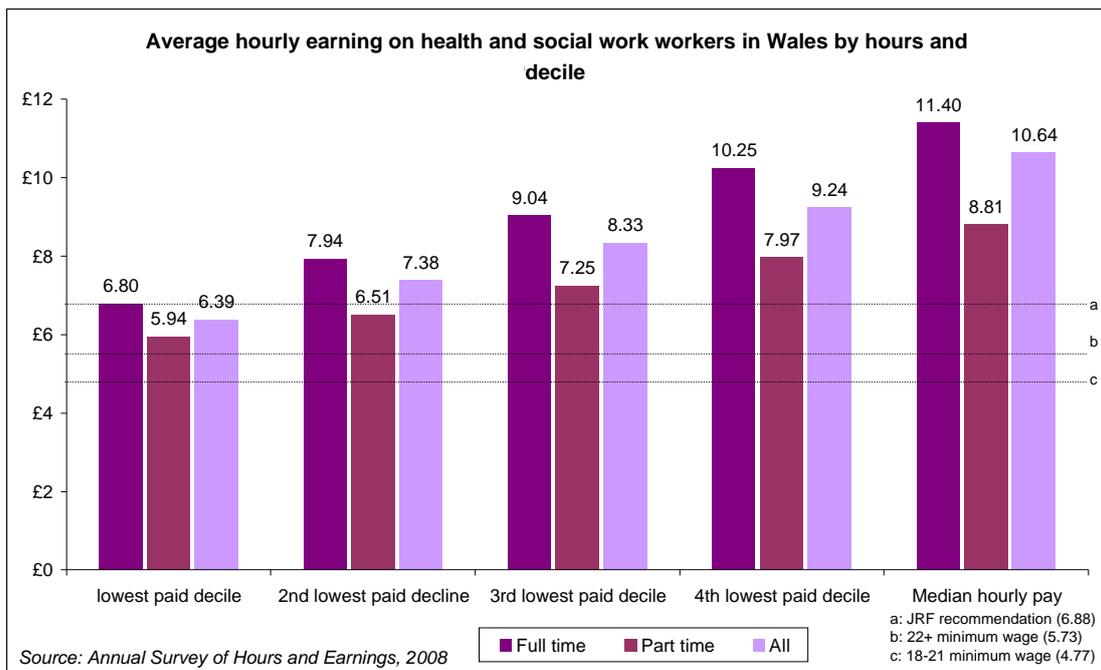
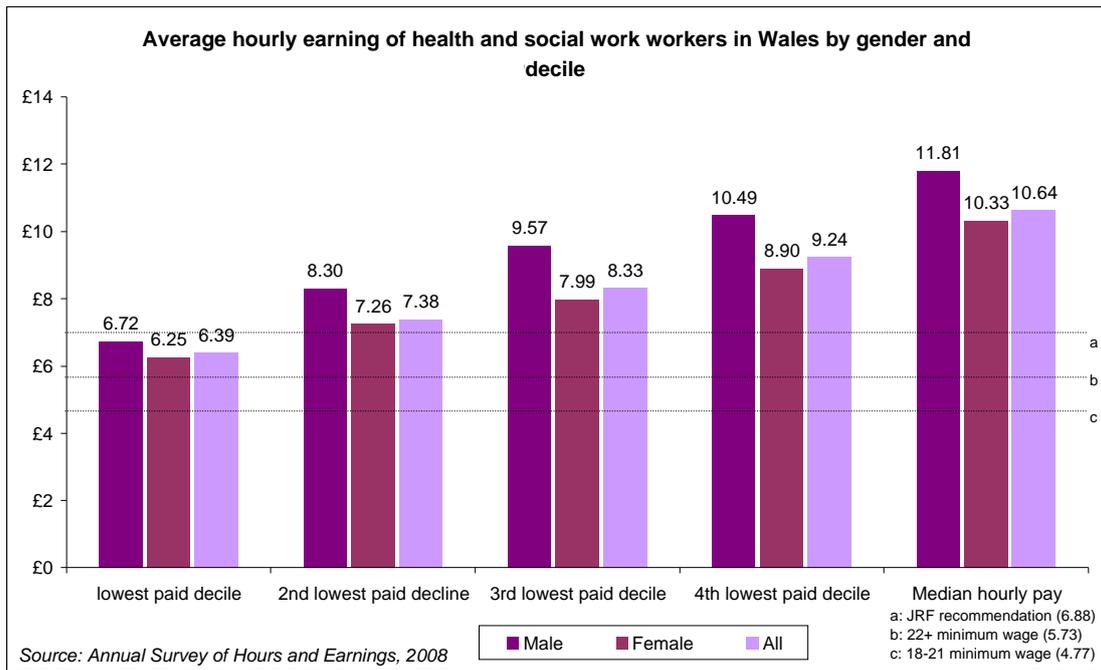
8.8 From the approaches highlighted in the literature review, a prospective approach could be applied as demonstrated by *Pollin and Luce* in a number of studies. A prospective approach would require a series of labour market assumptions to be applied to a range of likely future labour market scenarios, potential coverage and Living Wage levels.

## A. Further detail on public sector wage levels

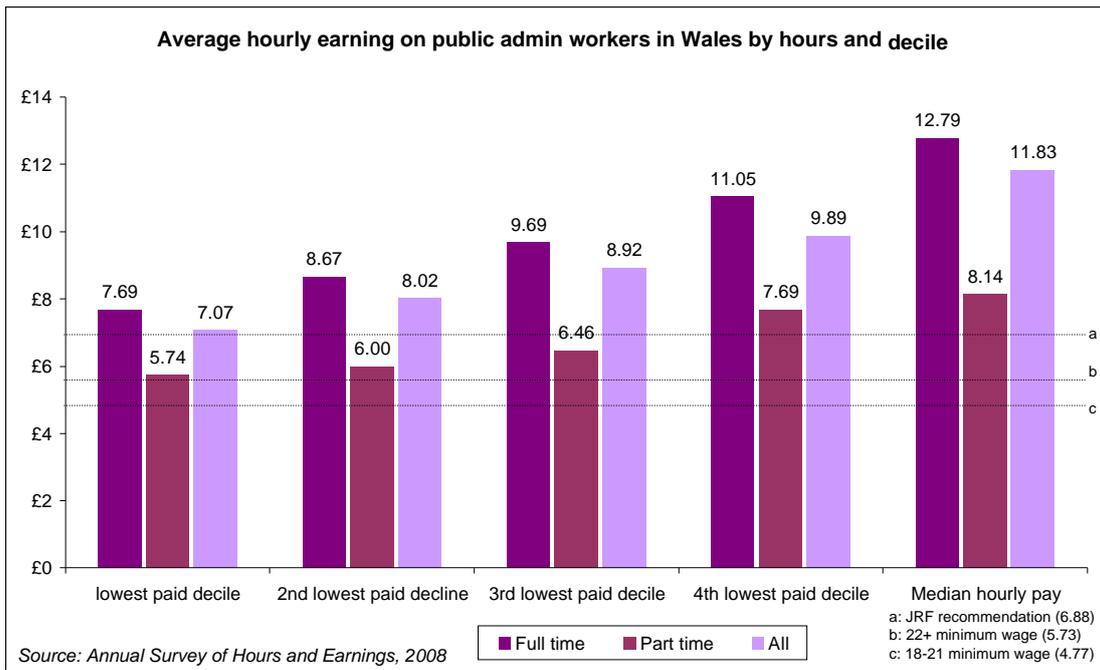
### Hourly earnings in the education sector



Hourly earnings in the health and social care sector



Hourly earnings in the public admin and defence sector



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