

# Why Worry Any More About The Low Paid?

Catherine Howarth and Peter Kenway

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New Policy Institute,  
109 Coppergate House,  
16 Brune Street  
London E1 7NJ

Tel: 020 7721 8421

Fax: 020 7721 8422

Email: [info@npi.org.uk](mailto:info@npi.org.uk)

Website: [www.npi.org.uk](http://www.npi.org.uk)

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## 1. SUMMARY

### **THE GOVERNMENT'S ACHIEVEMENTS ON EMPLOYMENT AND POVERTY**

Some of government's most conspicuous successes in recent years have been in the labour market. There are two million more jobs than in 1997. At almost 75%, the rate of employment in the UK is the highest among the G7 group of leading economies and third highest within the EU. Around a million additional jobs have been taken by young people, lone parents, the long-term unemployed, the over-50s and people with disabilities.

Partly thanks to this employment growth, and partly due to the increasingly generous system of tax credits, poverty rates have fallen since 1997. The number of children and pensioners living in poverty has fallen by 800,000 and 600,000 respectively since Labour took office. Reducing child poverty by a million by 2004 – the first milestone in the 20 year journey to end child poverty – is a real possibility.

As we survey these achievements with a recognition that a Labour government has delivered on what is unmistakably a Labour agenda, we ask ourselves – but is something missing?

In our view, the answer is an emphatic 'yes', for despite the importance attached to employment, little attention has been paid to the full extent of low pay or the multiple disadvantages at work which people in low paid jobs frequently face. An anti-poverty strategy which has employment as its cornerstone overlooks pay and conditions at the bottom end of the labour market at its peril.

First, if people are dissatisfied with the jobs they do, merely creating more jobs will do little to foster a 'feel good' effect: a good overall record on employment growth may bring a government little political credit. Second, low paid jobs with poor conditions of work are often low productivity jobs - and low productivity is a major, endemic problem for the UK which the government is keen to address. Third, and most important of all, if low pay and the manifold problems faced by low paid workers are ignored, the drive to lift children above the poverty line will stall.

There are, after all, still more than three million children in the UK living in poverty. The next milestone on the road to ending child poverty is to reduce that number by 2010 by another million (so halving it compared with the late 1990s). Steady employment growth, a major overhaul of the tax and benefit system and the introduction of the National Minimum Wage have taken us one quarter of the way along this road. With two-fifths of working-age households who are in poverty having someone in paid work - a proportion that has been rising - remedies for the problems of low pay and the poor conditions suffered by low paid workers are now essential.

### **THE LIMITATIONS OF THE CURRENT STRATEGY**

As a first step, it is necessary to recognise the limits of the policies to tackle poorly paying jobs which have been pursued since 1997. In our view, too much of the burden of addressing low pay has been left to the National Minimum Wage (NMW), while too much of the burden of easing poverty has been left to the system of tax credits. Meanwhile the poor quality of many low paid jobs has received insufficient attention from policy makers.

First, low pay cannot be solved by the NMW alone.

- It is not right to see the NMW as the threshold that defines low pay – in other words, that someone is only ‘low paid’ if they get the NMW or less. Instead, given the importance attached to the idea of work as the route out of poverty, ‘low pay’ has to be thought of as pay that is too low to allow a worker and their dependents to be free of poverty without means-tested support. At £4.85, the NMW falls short of that level even for a single adult working full-time.
- Although many factors have to be taken into account to reach a precise figure, our analysis suggests that the threshold defining low pay should currently lie somewhere in the range £6 to £7 per hour. The level of the NMW has recently been rising more sharply – by 7% in both 2003 and 2004. But even if it continues to rise at 7% , it would take five years just to reach the bottom of that £6 to £7 range.
- As a result, while the NMW has certainly been effective in tackling the most extreme low pay, it has not dealt with the bulk of low pay in the economy – and on the present course, will not do so for some time.

Second, poverty cannot be solved by tax credits alone.

- At the start of the anti-poverty drive in the late 1990s, tax credits were an excellent idea which has since played a big part in achieving the reductions in poverty seen in recent years. As employment levels have risen, the role of tax credits has become ever more central to the strategy for achieving the ambitious poverty targets the government has set itself. The concern, however, with tax credits is that they treat the symptoms of low pay, namely household poverty, without treating the problem itself.
- Furthermore by treating the symptoms of low pay, tax credits run the danger of undermining efforts to tackle the deeper causes of low pay, including low productivity and weak organisation amongst low paid workers. By subsidising the employers of low paid workers, tax credits not only make low pay work economically possible, they create disincentives for employers to do anything about it. While it may make sense to help prop up low paying firms or even industries facing temporary difficulties, it makes no sense to prop up indefinitely firms whose very existence depends on paying poor wages.

Third, the quality of low paid jobs cannot be ignored.

- The emphasis on moving people from welfare to work as the cornerstone of the anti-poverty strategy has tended to blunt critical analysis of the quality of the jobs that are accessible to people moving into employment.
- Certain workplace rights introduced since 1997, for example to paid holiday, have undoubtedly made a very positive impact on low paid workers, particularly to women part-timers. But because the people most at risk of unemployment and economic inactivity are also the ones most vulnerable to exploitative and insecure employment, low-paid workers have not enjoyed the benefits of other, voluntary government initiatives (such as the efforts to encourage employers to adopt more family friendly workplace practices) to nearly the same degree as better-paid workers.

### THE SCALE AND EXTENT OF LOW PAY

Using a low pay threshold within the £6 to £7 range identified above produces a figure of between six and a half and seven million low paid workers in the UK:. That total is made up of:

- More than four million women (one in three female workers), and two and a half million men (one in five male workers);
- three and half million full-time workers, divided almost equally between men and women;
- three million part-time workers, four fifths of whom are women.

Clearly, women are disproportionately affected by low pay, women part-timers in particular. Caring for children is one of the main reasons why people opt for part-time work. For most people in these jobs, part-time work is a positive choice rather than a necessity forced upon them by a failure to find full-time work. Nevertheless, part-time work is often poorly rewarded – and part-time work is mainly done by women.

Turning to an analysis of the sectors of the economy where low pay work is most likely to be found, we see that:

- the largest single sector, with more than 25% of the economy's low paid jobs, is retail and wholesale trade;
- another 25% of low paid jobs are in the direct employment of the public sector, in health, education and social work;
- another 15% are in miscellaneous business services, including private security and contract cleaning, while a further 10% are in hotels and catering.

Two things stand out from looking at the sectors which contain most of the low paid jobs. First, the public sector accounts for a sizeable minority of them, one quarter directly and a further proportion indirectly, for example, through contractors in cleaning, catering and care work. The pay and conditions of these jobs are at least under the indirect control of central government, and many are under the direct control of local government. The implication of this is that the public sector as employer and contractor of services has a big role to play in tackling poverty pay in the economy.

## 1. Summary

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Second, very few low paid jobs are in industries directly exposed to international competition from low cost, low wage producers. The low paid industries like textiles and food processing where this is the case are in national terms very small, accounting for only some 3% of the low paid. Even the whole of manufacturing only accounts for about 15% of low paid jobs.

While manufacturing is not the only sector where low paid jobs are exposed to international competition, these statistics clearly imply that rather few low paid jobs in the UK are low paid because they are forced to be so by international competition. The causes of low pay for the most part lie within our society, rather than outside.

These ‘internal’ causes of low pay are many and varied. They include basic economic truths like the fact that a job cannot for any length of time be paid more than the value of what it produces. They also include the fact that many low paid workers lack bargaining power. Yet neither of these factors completely determines the actual patterns of low pay and job disadvantage that we see today. Other things come into play too.

In the public sector at least, pay depends not on the value of sales but on the size of the budget, itself dependent on myriad political decisions. Custom and inertia are important: pay scales and remuneration patterns can endure for decades. Attitudes and assumptions matter too. The very phrase ‘part-time’ has a pejorative ring to it. Beneath the immediate reasons why women are paid less is the possibility that this work is valued less precisely because it is done by women.

That a wide variety of factors are involved in producing low pay provides grounds for hope. For the less that low pay and poor conditions are the ‘ineluctable workings out of the iron laws of economics’ the greater the scope for a government to do something about the situation if it so chooses.

## **A NEW DEAL FOR THE LOW PAID**

The problems outlined above, which affect millions of people, require a comprehensive response. The Labour government's first term in office was galvanised by its comprehensive approach to addressing long-term unemployment through the New Deal for the Unemployed. This was more than just a set of policies to address a complex and deep-seated problem. The New Deal first of all served to identify and draw attention to the problem, giving it a public profile and emphasising its political importance. Announcing and campaigning for it also helped to mobilise and/or cajole the many organisations and institutions who had to be involved if the goals were to be achieved.

In our view, that is exactly what is needed now to address the problem of low pay. The time has come, in other words, for a New Deal for the Low Paid, building on the very real successes of the last New Deal but developing the approach so as to address in a comprehensive manner what is becoming one of the key economic problems of our time.

It is not the purpose of this pamphlet to propose a detailed blueprint for a New Deal for the Low Paid. It is clear to us, however, what some of the key elements of it should be.

First, the public sector as both employer (of a significant minority of low paid workers) and purchaser of services (from firms who employ many more), would have a leading role to play. It would need to use its power to set the pay and conditions not just of its own direct employees but also of the firms who provide services either to it or on its behalf. An end to the two-tier workforce would be a key element of a New Deal for the Low Paid.

The weight of public sector employment, especially in more deprived areas, means that raising standards in the public sector will put pressure on private sector employers, who are competing for much the same labour, to follow suit. In this way, direct action by the public sector can have an impact more widely – although how much more so cannot be said at the moment. What can be said, is that following the years of strong employment growth, the prospects of exerting pressure on employers via the market are better now than they have been for a long time.

## 1. Summary

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Government, though, would need to act in a variety of ways to make the public sector play this role. The evidence of the last seven years shows that only a minority of public sector employers are prepared to rectify the disadvantages suffered by their low paid workers voluntarily. Public sector employers would therefore need to be placed under various duties to act.

Government would also need to make changes to the tax credit system to remove the disincentives for employers to raise the wages of low paid workers receiving tax credit. There may be an opportunity here if the savings in tax credit that the Treasury makes when low paid workers' pay rises sharply are allowed to flow back to employers - provided they are improving the conditions of low paid workers in other ways.

Existing public investment aimed at increasing training and raising skill levels amongst UK workers would need to be focused more specifically on the lowest paid, who are by no means the most likely to take advantage of funding and opportunities which are available. This could meet multiple goals, not only benefiting those workers themselves, but also contributing to improved productivity.

The New Deal for the Low Paid would also require stronger enforcement mechanisms around workplace and employment rights. At present, low paid workers are far more vulnerable than other workers to infringement of their rights but compared to better paid workers are less likely to be in a union who can act for them or to opt for a tribunal process.

The Low Pay Commission would also have a crucial part to play, dealing directly with the most extreme end of low pay. It would need to stick to the course it first took in its fourth report, in spring 2003, when it proposed 7% rises in the NMW for both 2003 and 2004. If this looks ambitious, it should be remembered that when the NMW was introduced, it was expected to benefit some 2 million people. Yet in practice, it benefited barely half that number. Even now, the Commission is still only really playing catch-up.

The Commission certainly needs to maintain an evidence-based approach. Employers should never again be allowed to overstate their case as they clearly did five years ago when the decision over what rate to start the NMW at led to it being introduced at a very cautious level.

## 1. Summary

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The trade unions, too, would have a key role. With just one in six low paid workers belonging to a trade union, the first challenge is to raise the level of union membership sharply among these workers. Neither financing that, nor servicing an often very fragmented low-paid membership, will be at all easy. The TUC would need to become involved here, finding ways to make the cause of low paid workers a concern for the trade union movement as a whole.

Trade unions would also need to pursue strategies that advance the interests of low paid workers further and faster than some better paid employees who are, nevertheless, trade union members. Unions will do this – and are doing this. But to do this consistently over a number of years is bound to be a great challenge.

Yet it is here that the wider effects of launching a New Deal for the Low Paid become so important. By drawing attention to the problems, by insisting that action be taken to deal with them and by acting decisively itself, the government would strengthen the position of those inside unions, public sector bodies and companies too who want to take action to improve the pay and conditions of low paid jobs. It is just so much easier to win the argument if the argument is running with the spirit of the times. Creating that spirit is what a New Deal for the Low Paid would help do.

## 2. WHAT HAS BEEN ACHIEVED ON EMPLOYMENT AND POVERTY

### LABOUR'S RECORD

The election of a Labour government in May 1997 raised huge expectations that new political leadership would bring a change of direction for a country tired after 18 years of Tory rule. On both employment and poverty, many of those expectations have been amply realised.

Labour early on established full-employment as an explicit goal of government policy. Under the Conservatives, full employment had come to be seen as a relic from the 1960s, an almost utopian idea which really had no place in the modern, competitive global economy. Despite this widely held view, Labour resurrected full employment as a firm policy goal, and began to implement the New Deal, a programme to address mass unemployment through a range of supply-side measures to increase the 'work-readiness' of the long-term unemployed in particular.

Labour also committed itself to trying to abolish child poverty within a generation. This pledge, made in a speech by Tony Blair almost two years after the election, came as a big surprise. Under the Conservatives, child poverty had risen dramatically, from one in seven children in 1979 to one in three by 1997: more than 4 million children.<sup>1</sup> Even bringing child poverty back to the levels of the 1970s, never mind abolishing it, would have seemed an unusually ambitious public commitment. But the pledge was not left as just a worthy long-term ambition; instead, intermediate targets were introduced, to reduce child poverty by a quarter by 2004 and by a half by 2010, rapidly becoming the benchmark against which the government's performance on poverty was judged.

These two commitments were linked through a policy approach that emphasised 'work as the route out of poverty'. This required two things to happen: first, that people must be helped into jobs and second, that those jobs must then offer people a clear financial gain compared with the income to be had from the state benefits available to people not in work.

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## 2. What Has Been Achieved On Employment And Poverty

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The plan was to achieve this through a combination of: the New Deal, which gave support to individuals in preparing for and finding jobs; an approach to the management of the economy designed to produce stable conditions in which companies could expand, generating a steadily increasing demand for labour; and a mixture of measures aimed at making sure that work did indeed ‘pay’.

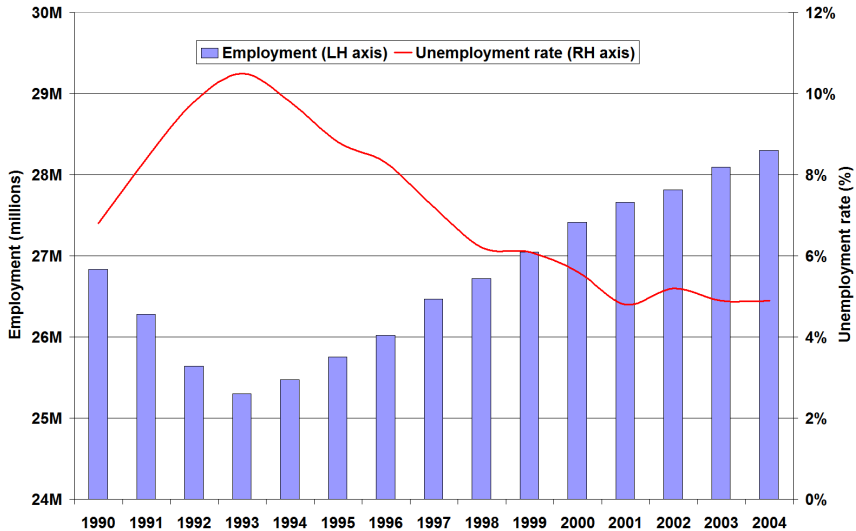
The measures to make work pay comprised the UK’s first National Minimum Wage, introduced in April 1999, along with a complete overhaul of the system of state support for low income, working households. There was already some support for such households via Family Credit, a traditional social security benefit which had been around in some form since the 1970s. Labour replaced this in October 1999 with a new system of tax-credits administered by the Inland Revenue. A second wave of changes, completing this reform, came in April 2003. Each time, the system became more generous, providing more money and offering support to more people.

Seven years on, how successful has government been in meeting the expectations that were raised on employment and poverty? As figure 1 shows, the number of people employed has grown every year, to a level that exceeds the previous peak in 1990. The rate of unemployment, which fell during the Labour government’s early years has now stabilised, but at a level that is much lower than the best that was achieved during the economic boom of the late 1980s. Meanwhile, at almost 75%, the rate of employment in the UK is the highest among the G7 group of leading economies and third highest within the EU.<sup>2</sup>

Half a million 18 to 24-year-olds have moved into jobs from the New Deal since 1997.<sup>3</sup> Independent evaluation of the programme showed that, in its first two years, 40,000 young people moved into jobs who would not have done without the support of the programme.<sup>4</sup> Other ‘hard to help’ groups have also been drawn into the labour market, often more rapidly than for the population overall. For example, the employment rate of lone parents has increased by 8%, generating a net saving to the tax-payer of £40 million a year.<sup>5</sup> Since 1997, the number of long term unemployed – people without work for over two years – has fallen by over 200,000 in part thanks to the support provided through the New Deal.<sup>6</sup>

## 2. What Has Been Achieved On Employment And Poverty

**Figure 1: Trends in Employment and Unemployment<sup>7</sup>**



After 1997, the unemployment rate continued to fall until 2001, since when it has remained stable at around 5%, nearly 2% below the lowest that was achieved during the late 1980s boom.

Employment numbers have done even better, growing every year. At more than 28 million, employment in 2004 is 1½ million higher than it was in 1990 (the previous peak) and some 2 million higher than in 1997.

On poverty, as figure 2 shows, the number of children living in poverty is down by 800,000 compared with when Labour came to office, or 600,000 compared with 1998/99 which is the base year against which progress towards the official targets is measured. With two more years of data still due, government is just about on track to meet the first target, to reduce child poverty by a quarter by 2004. Pensioner poverty is also down sharply, by some 600,000 to 2002/03 compared with 1997.

Taken together, the record on employment and poverty is one of considerable achievement: an unprecedented number of people in employment, sustained low rates of unemployment, and a fall over the first six years of its life of 1.4 million in the numbers of children and pensioners in poverty. In short, a Labour government has delivered on what is unmistakably a Labour agenda.

**Figure 2: Trends in Child and Pensioner Poverty<sup>8</sup>**



Child poverty, which peaked in 1996/97 at 4.4 million, had fallen by 800,000 to 3.6 million in 2002/03. The fall relative to the base year for the official poverty target (1998/99) is 600,000.

Pensioner poverty which began falling in 1999/00, coincident with the introduction of the Pensioners' Minimum Income Guarantee, had fallen by 600,000 to 2.3 million in 2002/03 compared with its level when Labour came to office.

### THE QUESTIONS IT RAISES

Against this background of genuine success, do we still need to worry about low pay and the low paid, about, in other words, the jobs at the bottom of the labour market?

What leads us to ask this question is a sense that many people seem to assume that a combination of the National Minimum Wage and tax credits has taken care of the UK's low pay problem. Yes, there are still concerns about the way the policies are been implemented – the level of the National Minimum Wage, its enforcement and people not getting tax credits to which they are entitled – but fundamentally, the basic approach is widely assumed to have addressed the problem.

## 2. What Has Been Achieved On Employment And Poverty

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We, though, think that this view is fundamentally mistaken and the primary purpose of this pamphlet is to try to show why. We do this by presenting and interpreting a range of evidence. First, we look at the role and development of the National Minimum Wage. Second, we examine who is low paid, where they work and how many people there are in this position. Finally, we look at a range of issues to do with the quality of jobs at the bottom of the labour market.

Having looked at the evidence, we then turn to the question of what should be done. While it is not our purpose here to examine possible policies in detail, we do identify some of the elements of what would be required. Most importantly, the strategy that is required has to be one in which responsibility for action does not just rest with central government alone. On the contrary, all employers, especially those in the public sector, have a key role to play, along with central government. This is quite different from leaving it all to the National Minimum Wage and tax credits, decisions about which are taken by the Treasury.

### 3. TAX CREDITS AND THE MINIMUM WAGE

#### A SHORT HISTORY OF THE NMW

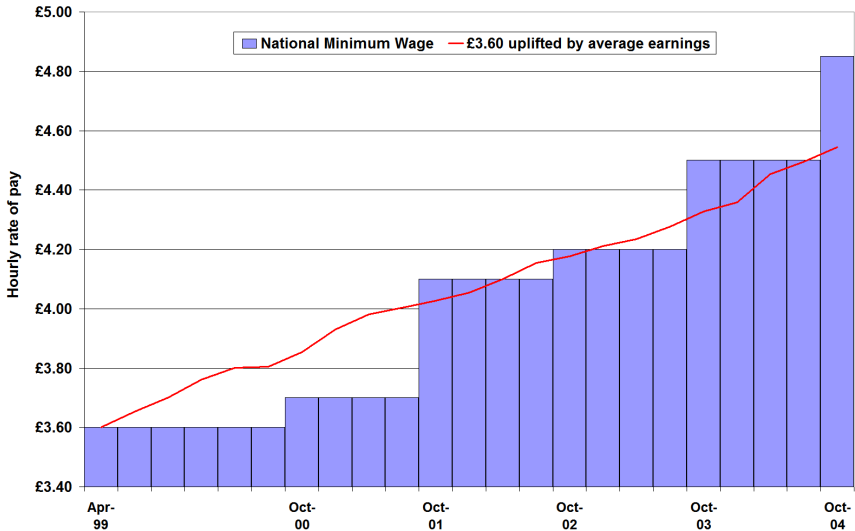
The National Minimum Wage (NMW) was introduced in April 1999 at a rate of £3.60 an hour for workers aged 22 and over and a ‘development rate’ of £3.00 an hour for workers aged 18 to 21. It was this country’s first ever national minimum wage and the recommendations on both its original rate and its subsequent up-rating are the responsibility of the Low Pay Commission, made up of representatives from business, the trade unions and academia. However, Government, with whom the final decision rests, has not always followed all of the Commission’s recommendations (for example, that 21 year olds should be covered by the adult rate of the NMW).

At first, the Commission moved cautiously, leaving the rate unchanged for eighteen months and then only increasing it by 10 pence, in October 2000. In October 2001, however, the NMW went up to £4.10, some 14% higher than the original £3.60 and an increase in line with that for average wages over the period. A smaller increase in October 2002 maintained this parity and then in October 2003, a further increase to £4.50 took the cumulative increase in the NMW above that for average wages. A further big increase in October 2004 to £4.85 leaves the NMW some 35% above its April 1999 level. Since average wages have risen 26% over that period, the NMW is now clearly, and for the first time, rising in a way that reduces the gap between pay rates at the bottom and average pay.

Clearly, not only is the NMW now well established but the Commission is becoming bolder in the increases it proposes. As far as it goes, this is good. The trouble is, though, that the number of people benefiting remains rather few. The official estimate of the number who gained from the NMW’s introduction is 1.2 million, or some 5% of the workforce.<sup>9</sup> Some academic estimates have put the figure lower, at some 800,000 people.<sup>10</sup> Similar sorts of numbers – in the one million plus range - are officially estimated to have benefited from the subsequent up-ratings, although the forecast for October 2004 is higher, at 1.7 million.<sup>11</sup>

### 3. Tax Credits And The Minimum Wage

**Figure 3: National Minimum Wage 1999 to 2004**



Introduced in April 1999 at £3.60, the NMW was first raised in October 2000, since when it has been raised every year.

The 2001 rise restored the NMW to the value that it would have had it grown in line with average earnings. Big rises in 2003 and especially 2004 mean that it has now grown more than average earnings.

If it seems churlish to label a million plus workers as ‘rather few’, it should be borne in mind that at the time of the NMW’s introduction, the Commission was expecting some 2 million workers (8.5% of the workforce) to benefit.<sup>12</sup> Moreover, as the Commission has made clear, the NMW has so far exerted very little upward pressure on rates of pay just above the minimum wage (although the Commission is watching this much more closely now, following the big rise in 2003). As a result, there are very few ‘indirect’ beneficiaries of the minimum wage to add to those benefiting directly.

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### 3. Tax Credits And The Minimum Wage

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The point we are trying to make here is perhaps a subtle one: we are not attacking the NMW - it is certainly important – but its impact on low pay has been limited, tackling the most extreme low pay rather than the bulk of low pay. Another way of seeing this is to look at its effect on the gender pay gap, that is, the extent to which women are paid less than men. The introduction of the NMW benefited many more female workers than male workers (11% of the former compared with 4% of the latter): good. Thanks to this, the gender pay gap closed, slightly: again, good. But out of an overall gap of about 23%, the NMW managed to close the gap by just half a percent: so, good but, evidently, only a small part of the answer to that particular problem.<sup>13</sup>

#### **THE INTERACTION BETWEEN TAX CREDITS AND THE NMW**

This sense that the NMW is positive but limited in its impact is also apparent when we look at the effects of increases in the NMW on net household income.

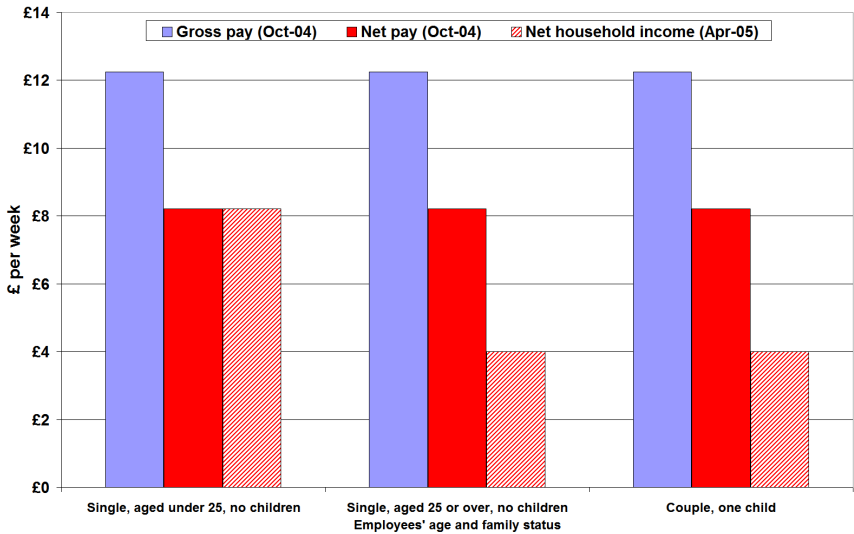
For low income workers who receive tax credits, a rise in the NMW on its own eventually yields only a small increase in net household income – unless the Chancellor of the Exchequer also raises thresholds within the tax credit system. As a result, it is as important to lobby the Treasury over the minutiae of the tax credit system as it is to lobby the Low Pay Commission over the level of the NMW. This a point that we suspect has not yet been absorbed by trade unions, but it is significant as it applies to any rise in wages at the lower end of the earnings scale, not just to rises in the NMW itself.

Figure 4 illustrates this problem with reference to three employees, all of whom work 35 hours a week at the NMW. Due to their family size and composition, one is not eligible for tax credits while two are. When the NMW went up in October 2004, their gross weekly pay went up by £12.25 while their net weekly pay went up by £8.20. For the employee who does not get any tax credits, that is the end of story.

### 3. Tax Credits And The Minimum Wage

For the other two, however, come April 2005, their tax credit and therefore their net household income are reduced, leaving them just £4 a week better off as a result of the rise in the NMW. This is because tax credits are calculated on the earnings in the previous financial year, and - thanks to the increase in the NMW - these employees earned more in 2004/05 than they did in 2003/04. As a result, six months after the NMW goes up, the two employees claiming tax credits keep just a third of the value of the gross increase in their wages. The other two thirds goes to the Treasury. This shows the high marginal tax rate – in effect a ‘super tax on the poor’ as the economist John Grieve Smith has recently described it - which is part and parcel of the tax credit system.

**Figure 4: The Effect of Tax Credits on Household Income<sup>14</sup>**



For a worker doing 35 hours a week on the NMW, the rise to £4.85 increases gross and net weekly earnings by about £12 and £8 respectively.

Age and family circumstances mean some of these workers also get tax credits. As these are calculated using last year's earnings, the amount of the credit falls in April 2005, leaving household income up by just £4 a week on what it was before the NMW rise

### 3. Tax Credits And The Minimum Wage

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This kind of outcome is a nightmare for any form of collective wage bargaining around low wages, not just the NMW. What it means is that it is now impossible to say with certainty what a pay increase will be worth to particular employees come the next financial year, since this will depend on what the Chancellor decides to do about tax credit thresholds. He or she could decide to adjust the tax credit system so as to leave people enjoying the full (post tax) fruits of a rise in the NMW – that is, retaining parity between the three employees. But there is nothing automatic about this at the moment.

There is another unhappy paradox here. The first employee who gets no tax credits and therefore enjoys the full fruits of their pay increase, could be part of a high income household (since 8% of the working age households with someone in work who would gain from a rise in the NMW are in the top fifth of the income distribution).<sup>15</sup> By contrast, the other two employees who receive tax credits are certainly in low income households, yet they could end up seeing much less of any increase in the NMW. In this situation, the Low Pay Commission is actually more use to higher income households who include a low paid worker than to most lower income households.\*

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\* The only thing that stops this paradox from being complete is the fact that employees under aged 25 without dependent children are not entitled to the working tax credit (something itself which is an outrageous case of age discrimination). Employee 1 could therefore either be part of a much higher income household or they could be living on their own in a very low income household.

## 4. LOW PAY AND LOW PAID JOBS

### PAY BELOW THE NMW

A small fraction of UK workers earn less than the National Minimum Wage (NMW). Amongst these, some do so legitimately due to a number of legal exceptions for workers in particular circumstances. Others are paid below the NMW illegally. The latest official data (for spring 2003) shows some 260,000 people or 1% of the workforce earning below the minimum wage. Since the NMW was introduced in April 1999, the official estimate is that year by year, between 240,000 and 330,000 jobs were paid at below the NMW.<sup>16</sup>

The official statisticians stress that this is not a measure of non-compliance with the NMW because the number include some employees who are not entitled to the NMW.\* While the existence of the NMW must now be very well-known, and the enforcement policies of the Inland Revenue are thought to be working well in most parts of the country, compliance is by no means perfect.<sup>17</sup> For example, there are serious problems in the informal sector of the economy where abuses, particularly of migrant workers (who are entitled to the NMW), are not uncommon.<sup>18</sup> As a result, it is not known how accurate the 260,000 figure is as a guide to the level of non-compliance.

Even if this is a fairly accurate figure, however, it does not mean that the low pay is a problem confined to between a quarter and a third of a million employees. That conclusion can only be drawn if the NMW is used to *define* low pay. Yet if we look at the international variation in the level of minimum wages, say between the United States where it is set very low and Denmark where it is set very high, we can see that the level of the NMW is essentially a political decision.

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\* Various groups are excluded from the provisions of the NMW. They include: the self-employed; most company directors, workers under 16 years old, some apprentices and some trainees on government-funded schemes; higher education students on work experience; people living and working within the family; friends and neighbours (jobs done under informal agreements); members of the armed forces; prisoners; voluntary workers; residential members of religious and other communities.

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#### 4. Low Pay And Low Paid Jobs

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Prior to taking office in 1997, the Labour party talked of a NMW which would be a ‘living wage’, enough to allow at least a single person to afford decent accommodation and food. But the Low Pay Commission set up by the new government did not attempt to discover what income workers would need to be able to live. Instead, it focused on what firms would be able to afford - and has done so ever since.

Using the NMW to define low pay is one of a number of dangers that need to be avoided with an official minimum wage. Another is that the official minimum comes to be understood as defining an ‘ok’ wage – which makes the mistake of confusing a standard (which the NMW is not) with a floor (which it is).

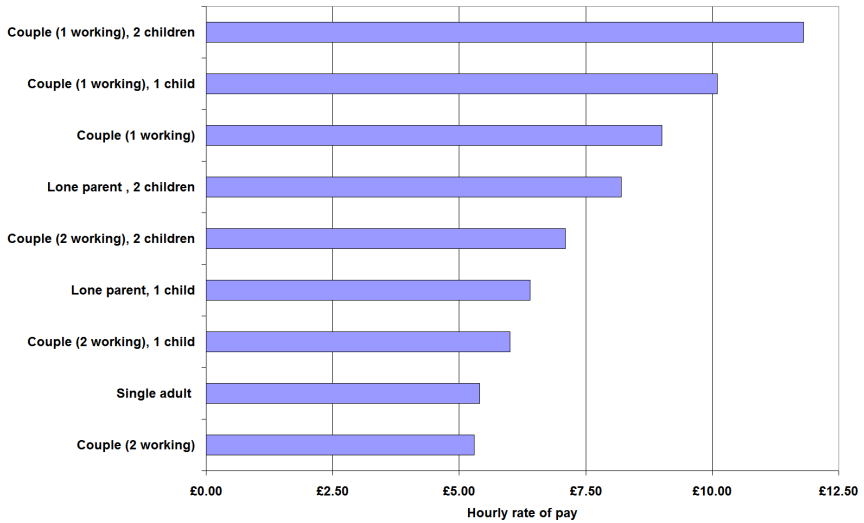
#### **LOW PAY DEFINED AS POVERTY PAY**

If it is not to be the level of the NMW, how should ‘low pay’ be defined? While there is certainly no single, accepted definition, the over-riding importance that is attached to the idea of work as the route out of poverty, leads us to conclude that an appropriate definition would be *a rate of pay that is too low to allow the worker and their family to be free of poverty without means-tested support.*

This does, of course, mean ignoring the money that households get from tax credits. In doing this, we are not saying that credits are unimportant: clearly they are great help to those who receive them and clearly, too, they are here to stay. But in the long run, big reductions in child poverty will only be sustained if we have jobs that can *pay* enough to keep most working families out of poverty. Tax credits are not relevant to that calculation.

In practice, the rate of pay needed to get a household out of poverty varies depending on the number of people in the family, the number of adults working, and the number of hours being worked. As figure 5 shows, there is a big range here. At one extreme, single adults working full time, and couples where one works full time and one part time, need to be paid about £5.30 an hour to escape poverty – still 10% above the NMW even after its increase in October 2004.<sup>19</sup> At the opposite extreme, a full time worker supporting a partner and two children – what might be thought of as the stereotypical ‘traditional’ family – needs to be paid almost £12 an hour – above the average wage - *just to escape poverty.*

**Figure 5: Required Rates of Pay to Avoid Poverty Without Tax Credits<sup>20</sup>**



These figures are estimates for mid 2004.

None of the example families presented here could escape poverty earning a wage of less than £5 an hour.

Broadly speaking, couples where one works full time and one part time need between £5.25 and £7 an hour; single adult and lone parents working full time need a little more.

Couples where only one person is working (full time), need between £9 and £11.75

This wide range of values, stretching even above the average wage, means that it is not possible to set a threshold for low pay that would take every worker out of poverty whatever the composition of their household. This after all, would mean a definition of low pay that left average wages counting as 'low'.

One possibility would be to set the threshold at the bottom of the range, at a rate that at least allows *some* workers to escape poverty on the basis of their wages alone. But choosing this threshold would mean that all we are asking of pay is that it be enough to support adults without children. As a result, the whole burden of supporting the children of millions of workers is thrown onto the state, even where the one adult in a household works full time, or the two adults work full time and part time. This would make a nonsense of the idea that it is actually work which is ending child poverty. We therefore reject this approach.

Inevitably, there is a degree of arbitrariness involved in setting a threshold somewhere within the range indicated in figure 5. The criterion we have used is to set the threshold at a level that enables at least a reasonable proportion of people just above it to be able to escape poverty by means of their wages. Looking at the range of value for different household types suggests a threshold somewhere between £6 and £7 an hour: £6 an hour is what a couple with one child needs to be paid to escape poverty; and £7 an hour or so is what a couple with two children needs. This range also brackets the £6.40 an hour that the lone parent with one child needs (though not if they have two children) and exceeds the amount that both a single person working full time and a couple without children, working full time and part time, need.

In order to put a single figure on the number of low paid workers, we use as a threshold 60% of median full-time hourly pay. This is similar to thresholds used elsewhere in Europe and has echoes of the way that poverty is measured.<sup>21</sup> On this basis, there were 6.8 million low paid workers in the UK in spring 2003, some 27% of the total.<sup>22</sup>

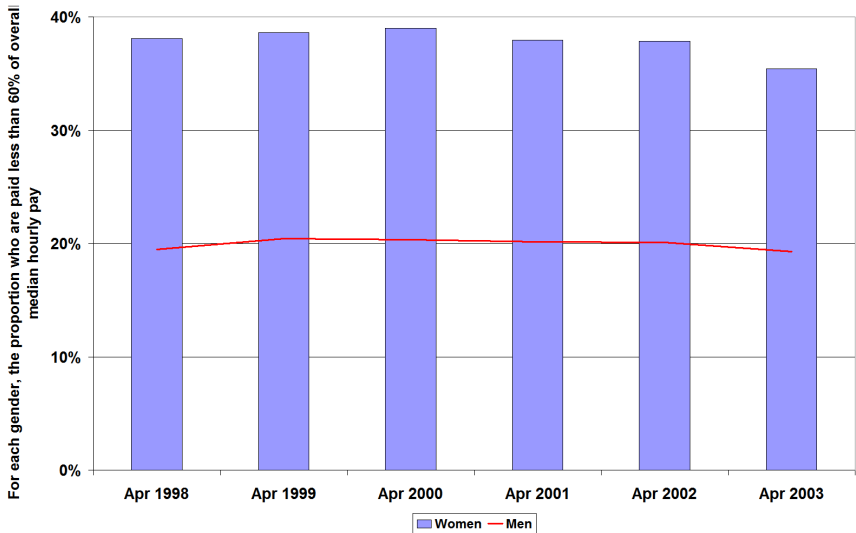
#### **LOW PAY BY GENDER AND ETHNICITY**

Figure 6 shows how the proportion of jobs in the economy earning less than 60% of the full time hourly median wage proportion has changed over the period 1998 to 2003. In fact, the proportion is down slightly, from 28% to 27%. Since the total number of jobs was rising over this period, however, the number of low paid jobs remained almost unchanged. On now very out-of-date data, the UK has the highest proportion of its workforce on low pay in the EU (prior to the recent enlargement).<sup>23</sup>

Figure 6 also shows that the proportion of female workers who are low paid - more than a third - is far greater than the proportion of male workers - one fifth. However, it is also clear that there has been a perceptible fall in the proportion of low paid women, whereas there has not been a comparable fall for men.

#### 4. Low Pay And Low Paid Jobs

**Figure 6: Trends in the Proportion of Jobs Which Are Low Paid<sup>24</sup>**

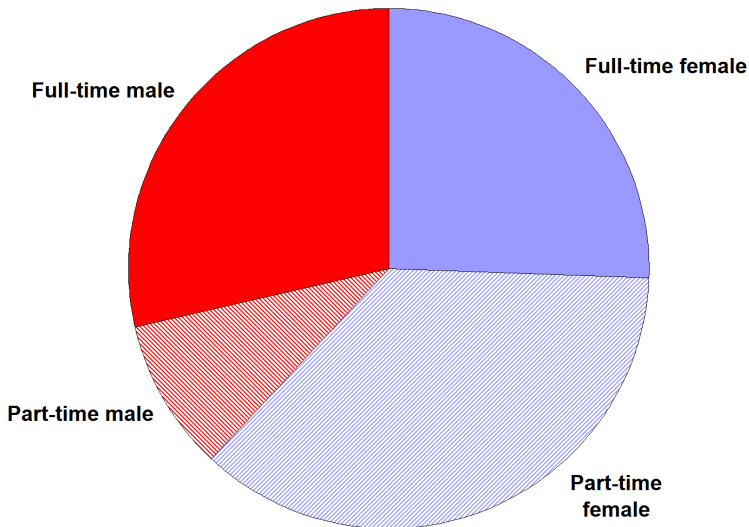


Using a low pay threshold of '60% of full-time median hourly pay', the proportion of workers on low pay was slightly lower in April 2003 than five years earlier, at least for women.

In general, pay inequality between men and women is not nowadays because two workers, one male and one female, are paid differently for doing the same job in the same circumstances. That sort of crude discrimination is now rare. Nevertheless, for reasons which include domestic responsibilities, the segregation of jobs between men and women, and discrimination, a substantial 'gender pay gap' exists which the European Commission notes is one of the largest in the EU.<sup>25</sup>

Figure 7 refines this picture by classifying low paid workers both by sex and whether they are full time or part time. It shows that the great difference between men and women here lies in the very large number of low paid, part time women who account for more than one third of all low paid workers. As a result, whereas low paid full timers are divided roughly equally between men and women, 80% of low paid part-timers are women.

**Figure 7: Low Paid Workers by Gender and Whether Full or Part Time**<sup>26</sup>



Some two thirds of low paid workers are women, while just under half are part time.

It is also clear, however, that the big difference between men and women here is to be found among part-timers: whereas the numbers of full time men and women who are low paid is roughly the same, the great bulk of low paid part-timers are women.

Caring for children is one of the main reasons why people opt for part-time work. For most people in these jobs, part-time work is a positive choice rather than a necessity forced upon them by a failure to find full-time work (unlike short term work, which is usually taken because permanent work cannot be found).<sup>27</sup> Yet part-time work is often poorly rewarded.

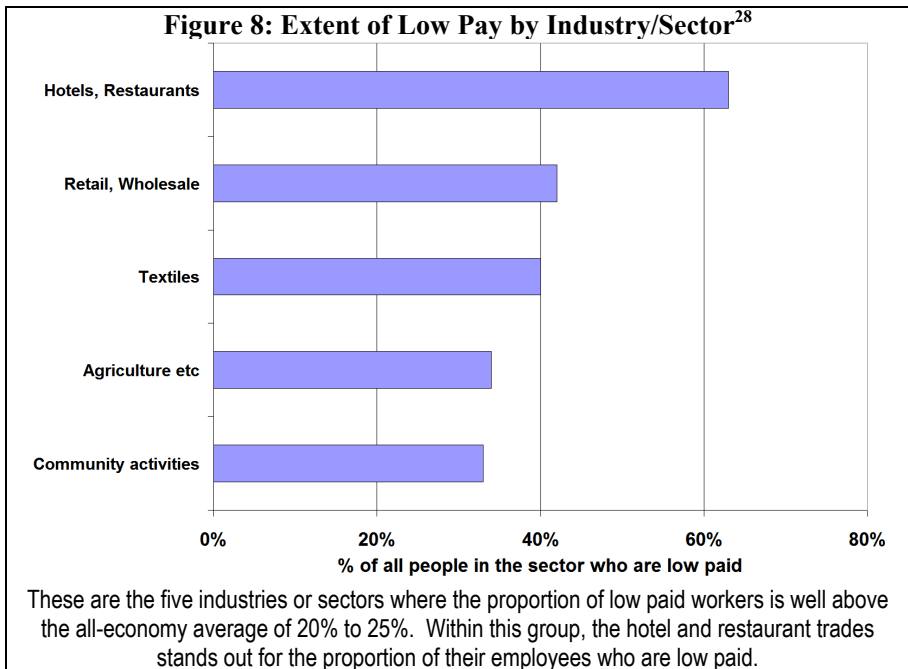
We also looked to see what the evidence shows about the extent to which low pay was especially concentrated among workers from ethnic minorities. What it shows was that although a slightly higher proportion of workers from ethnic minorities are low paid than for the workforce as a whole, the difference was slight and - given the relative shortage of data on almost any aspect of ethnic minorities' economic circumstances within the official data sets - probably not significant.

#### 4. Low Pay And Low Paid Jobs

Why should this be? We suspect that there are at least two parts to the explanation. The first is that, while casual observations suggests that large numbers of low paid workers in London are from ethnic minorities, pay in London is somewhat higher than elsewhere. Mixing London with the rest of the country therefore slightly distorts the picture. Second, the ethnic minority population as a whole is a highly diverse group. In fact, since the distribution of earnings among them right across the pay scale seems to be similar to that for the workforce as a whole, we can probably conclude that, as far as pay is concerned, they are as diverse as the white population.

#### WHERE LOW PAID WORKERS WORK

Figure 8 shows the top five industries according to the proportion of their employees who are low paid.

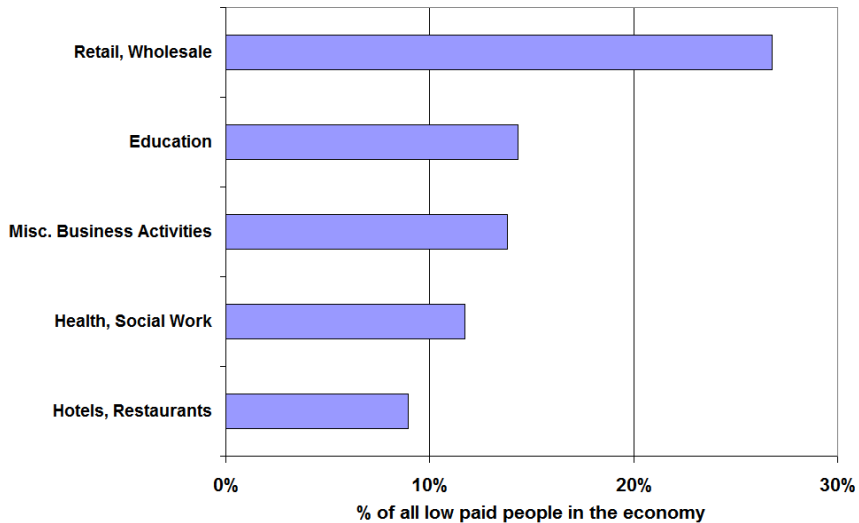


#### 4. Low Pay And Low Paid Jobs

On this basis, the hotel and restaurant sector stands out, with more than half of its employees being low paid. The other four - retailing, textiles, agriculture and various community and social activities - form a group with upwards of a third of their employees on low pay. The remaining industries and sectors divide broadly into two groups. One group, containing education, health and social work, food processing industry and miscellaneous business activities, have levels of low pay that around average, between a fifth and a quarter. The remainder have below average levels of low pay, typically around a tenth but sometimes much lower.

A high proportion of low paid workers only means a high proportion of the total number of low paid workers if the industry or sector is large. For four of the five shown above, this is not the case. Figure 9, which does take account of the size of each industry or sector and therefore shows the places where most low paid workers work, presents a very different picture.

**Figure 9: Industries and Sectors where Most Low Paid Employees Work<sup>29</sup>**



Whereas the hotel and restaurant trades stands out for the proportion of their employees who are low paid, it is the retail (and wholesale) trade which accounts for the largest share of low paid employment in the economy.

Retail is followed by education, health and social and work (public sector) and miscellaneous business services (private sector), ranging from accountancy to cleaning.

#### 4. Low Pay And Low Paid Jobs

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Now, it is retail which stands out, employing more than a quarter of all the low paid. Another quarter is employed in education, health and social work with a further large chunk in the miscellaneous business activities sector. Between them, these four sectors along with hotels and restaurants (the fifth largest), account for three quarters of all low paid jobs.

This is an important conclusion for two reasons. First, rather little of low paid employment is in industries where the jobs are directly exposed to international competition. Manufacturing, of course, is exposed, yet that only accounts for 7% of low paid employment. Clearly some of the miscellaneous business services will be exposed too, but by no means all; indeed, some of the parts known to have higher numbers of low paid employees, such as security and cleaning, are definitely not exposed.\*

Second, a sizeable minority of low paid employment – between a quarter and a third – is to be found within the public sector. In addition, there are people who work for public sector institutions but are actually employed by private sector contractors. Not only, therefore, are the forces and pressures that cause low pay overwhelmingly domestic in origin rather than international, a significant part of them are not just impersonal market forces at all but rather the policies and politics of the public sector.

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\* This is not the same thing as arguing that the forces of international competition and globalisation have no role in the causing low pay in the UK. The steep decline in manufacturing employment – more than ¼ million jobs on these figures since Labour came to office - almost certainly can be put down to competitive forces aided by an over-valued pound. This is an important part of the story because this typically represents the loss of better paid jobs with better conditions. On this view, globalisation contributes to the conditions which low paid employment in the UK can grow, but rarely causes it directly.

## 5. THE QUALITY OF LOW PAID JOBS

For people in low paid work, poor wages are typically just one of many difficulties with their employment: low paid work in the UK is of a poor quality in many other respects too, ranging from the availability of training to access to employer pension contributions.

The stress placed on work as the best route out of poverty has blunted criticism of the quality of job opportunities available to people at the bottom of the labour market. Yet, the very success in increasing levels of employment since 1997, including amongst groups with low participation rates such as lone parents, people from ethnic minority communities and the over 50s, actually increases the need to look critically at the quality of low paid jobs. The same groups who are at risk of unemployment and economic inactivity are often at risk of suffering the worst experience at work.

Some regulations introduced since 1997 - often originating from Europe - have improved job quality. For example, new legal rights to paid holiday have made a significant difference, particularly for women workers who were much less likely than men to get paid leave. However, there is often weak enforcement of legal workplace rights for the most vulnerable and poorly paid workers.<sup>30</sup>

### FACTORS DETERMINING THE QUALITY OF EMPLOYMENT

Pay itself is directly associated with the quality of a job. Levels of pay determine not only the living standard of workers, but also denote respect, status and personal worth. Some have argued that the correlation of social status with pay has grown over the last decades.<sup>31</sup> But pay is not, and has never been, the only important issue for workers in evaluating the quality of their employment. Other important factors are:

- the work environment, including health and safety at work;
- work intensity, work organisation and autonomy;
- the quality of management and supervision of work;
- occupational justice, including procedures for disciplinary action and redress for discrimination at work;
- the availability of training and opportunities for career development and promotion;
- job security;

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## 5. The Quality Of Low Paid Jobs

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- employee benefits, including pensions and entitlement to sick pay, carer's leave and other family friendly provisions;
- opportunities to voice ideas and concerns at work, either through an independent trade union or other mechanism.

Data on the quality of jobs is much less sophisticated than data on pay or on labour market participation. Where we do have hard data on measures of job quality, however, it is clear that low pay is strongly associated with worse outcomes on these measures. These include the degree of access amongst low paid workers to various employee benefits, to employment-related training, and job security. A selection of statistics from our annual report *Monitoring Poverty and Social Exclusion*, illustrates this.<sup>32</sup> For example:

- Access to training: only 10% of workers with no qualifications receive any job-related training in a typical three-month period, compared with 25% of those who have five or more good GCSEs and 40% of those who have a higher education qualification.
- Security at work: 40% of people making a new claim for Job Seekers' Allowance were last claiming the benefit less than six months previously.
- Pensions: 60% of the poorest fifth of working adults are not contributing to a non-state pension, compared with 25% in the richest fifth.

For other factors, such as the quality of management of low paid workers, opportunities to voice concerns at work, and health and safety in low paid occupations, there is less robust data. Nevertheless, qualitative evidence suggests that, in these areas too, people in low paid work get a much worse deal than workers whose employers pay them better and apparently value them more.

The 1998 Workplace Employment Relations Survey collected data from 30,000 employees in 3,000 workplaces on a wide range of subjects, including the availability of family friendly provisions and work-life balance practices. These included parental leave, paid leave at short notice, subsidised child care, flexi-time, home working and job sharing. A key finding of analysis conducted on the survey was that, "*employees with a lower hourly wage, a shorter job tenure and lower levels of education, who work less hours and who are not managers or professionals are less likely to have access to work-life balance practices*".<sup>33</sup>

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## 5. The Quality Of Low Paid Jobs

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Broadening access to family friendly workplace practices and supporting employees in achieving work-life balance has been a key theme for the Labour Government, particularly since 2000 when it launched a campaign to encourage employers to introduce more flexible working practices. In terms of new legal regulations, both the Parental Leave Directive giving the parents of young children an entitlement to up to 13 weeks unpaid leave, and a right to time off for domestic emergencies, have been introduced.

However, workplaces with certain characteristics have been found to be less likely to provide employees with access to work-life balance provisions. These include ones with either a high proportion of women, a high proportion of younger people, higher dismissal and resignation rates or without either a human resources representative or union recognition in negotiations.<sup>34</sup> These characteristics are all more typical of low paid jobs and workplaces.

### **ENFORCING LEGAL RIGHTS AT WORK**

Employee benefits include such things as sick pay, holidays, pensions, entitlement to family friendly employment provisions, maternity pay and parental leave. All workers have a right to written particulars detailing their employee benefits within two months of starting work, but failure to provide a written contract is far more common amongst low paying employers in sectors with high staff turnover, and particularly by agencies.<sup>35</sup>

The Citizens Advice Bureaux help people with 600,000 employment problems a year. Workers are typically seeking help because their legal rights to paid holiday, sick leave and maximum working hours are being flouted. Based on a wealth of practical experience and individual cases, Citizens Advice concludes that *“for the most vulnerable and low paid workers in the UK economy, the government’s vision of a labour market underpinned by an ‘infrastructure of decency and fairness’ remains exactly that – a vision”*.<sup>36</sup>

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## 5. The Quality Of Low Paid Jobs

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A particular problem is that many key employment rights, including new rights legislated since 1997, can only be enforced through an Employment Tribunal. These include rights to holiday pay, to statutory sick pay, to maternity pay and parental leave, to rest breaks, and to maximum working hours. The UK is the only EU country without an enforcement body charged with ensuring that employers comply with their legal obligations. In the UK, it is up to the individual employee to secure their rights from their employer, with support from a trade union if they belong to one. The employment tribunal system through which this can ultimately be achieved is an adversarial, lengthy and daunting one for individual employees. Not surprisingly it is the workers most at risk of malpractice by employers who are least likely to take a case to a tribunal, and least likely to fully understand what rights at work they have.

Journalist Fran Abrams spent a number of months working in a range of minimum wage jobs in different areas the country. Her book, *Below the Breadline*, captures many of the realities of low paid work which cannot be found in official statistics: *“For a variety of reasons the low-paid are left both powerless and voiceless. They feel they have little choice but to put up with being underpaid or being denied their other rights. Because they don’t have the leverage to make a difference, they find it easier to walk away from a job than to demand fair play from an employer. And so the carousel swirls on, with workers constantly getting on and off.”*<sup>37</sup>

A particularly significant feature of the jobs undertaken by Abrams was that, whilst in all cases the work was advertised at just above the minimum wage, in every single case she was actually paid less thanks to a range of illegal deductions from pay: hours worked were ‘lost’ when wages were calculated by the employer; one made employees work an unpaid ‘training day’; and all made their employees pay for the protective clothing they were legally required to provide.

What Abrams says here should not be written off as untypical. In two years of work with workers in London doing service work such as cleaning, catering, care work, and estate caretaking, this experience has been amply corroborated. Workers without good skills in literacy and numeracy, of whom there are a high proportion amongst the lowest paid, are usually unable to figure out what deductions from pay are legitimate. Pay slips are often confusing in their design and relatively few workers challenge them, although stories of unfair deductions and failure to pay for holiday are widespread.

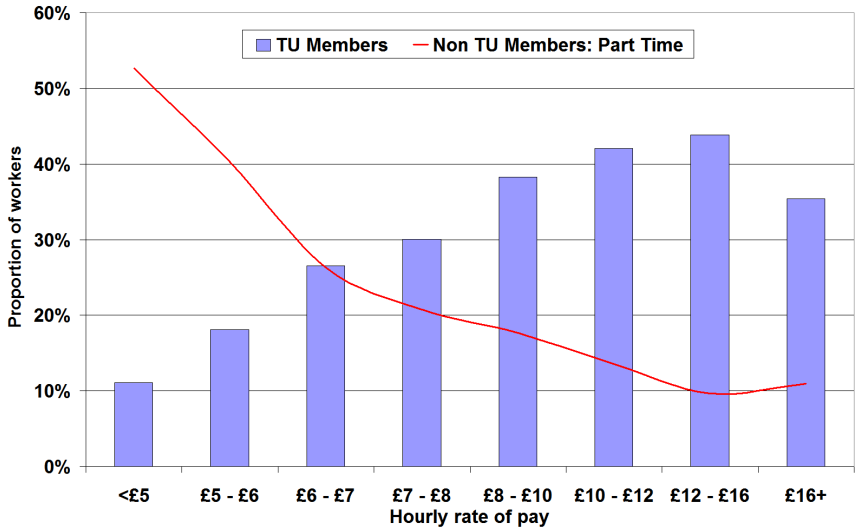
Migrant workers employed in care homes, cleaning, hotels and restaurants as well as agriculture and food processing are particularly vulnerable. Whilst problems with gang masters have received the most public attention, the majority of migrant workers are not employed through gang masters, although a higher proportion are employed with agencies some of whom share characteristics with gang-masters. Migrants are most likely to be non-unionised and most unlikely to resort to the Employment Tribunal system to enforce their workplace rights. For many, poor English greatly increases their vulnerability to exploitation. Citizens Advice notes that due to the enforcement regime established for the NMW through the Inland Revenue, observance of the minimum wage itself is superior – despite the typical problems experienced by Abrams – to other legal rights at work for which there is no pro-active system of enforcement.

### **TRADE UNIONS AND LOW PAID WORKERS**

Unions are a force for fairness in the UK workplace. Where unions are active, pay distributions are typically narrower, there are fewer accidents and more family friendly policies. However, union membership is weakest amongst the lowest paid workers who need them the most. For example, the hotel and catering industry, in which over 50% of staff are low paid, has just 5% union membership. Retail is the largest low pay sector, responsible for well over a quarter of all low paid workers in the UK, but only 11% of sales staff belong to a union, compared to 48% of professionals.<sup>38</sup>

The overall picture depicted in figure 10 is even more striking. Among workers earning the equivalent of £10 to £20 an hour (most of the upper half of the earnings distribution), more than 40% are members of a trade union. By contrast, among those earning £6 an hour or under, barely 15% are trade union members. A similarly striking difference can be seen in the extent to which non-unionised workers at different pay levels are part-timers. So among employees earning £8 an hour or more, only a small fraction – around 15% - are part timers and not in a union. By contrast, among those on less than £6 an hour, nearly half are.

Figure 10: Trade union membership: by hourly rate of pay<sup>39</sup>



Trade union membership, which is barely more than 10% among those on £5 an hour or less, rises to around 30% for those on £7 to £8 an hour and around 40% for those between £10 and £20 an hour.

Among workers who are not in a union, more than 50% of those on less than £5 an hour are part-timers, compared with around 10% for those on more than £10 an hour

The picture on unionisation in London is particularly telling. Black and Minority Ethnic (BME) workers are increasingly concentrated in London's low pay sectors such as retail, distribution, hotels and catering, where white workers' presence is actually declining. Between 1993 and 2000, the number of BME employees working as retail assistants and checkout operators more than doubled, to 72,000, whilst the number of white workers employed in these jobs in London fell by 11% to 95,000. This has been accompanied by a differential decline in union density. Over the same period, there was a 16% decline in union density amongst BME male workers and a 10% decline in density amongst BME women workers in London. This contrasts with a smaller decline in union membership amongst white workers: 12% for men and 2% for women.<sup>40</sup>

### **OTHER REASONS FOR FOCUSING ON THE QUALITY OF LOW PAID WORK**

Apart from the obvious justice arguments for ensuring that all workers stand a reasonably similar chance of having their basic legal rights at work protected, there are other reasons for raising the quality of work.

One is that the quality of employment has important implications for people's motivation to take work. In London, thanks to high living costs, the financial gain from taking work at the minimum wage is often non-existent. To be just £24.65 per week better off than on benefit, a lone parent with child-care costs to pay in London needs to earn £7.43 per hour on a full-time basis. Outside London, a single person living in private rented accommodation working a 35 hour week at the national minimum wage is £15.60 a week better off than they would be on benefits. In London this gain disappears altogether.<sup>41</sup>

When the financial benefits from working are slim, other aspects of the job become more important in assessing whether work is worth taking or not. If work is physically demanding, tedious and subject to arbitrary and poor supervision, and when employers do little to recognise people's family commitments beyond the workplace, people are less likely to take work. It is no co-incidence, perhaps, that London has high unemployment levels and economic inactivity levels. Raising the quality of work, as well as the pay, would help to draw people into the labour market in London, and in other parts of the UK where inactivity rates remain high.

A second reason is that there are a number of hidden costs to the public purse and to employers arising from poorly paid and insecure employment. A recent research study drawing on survey data that tracked people over time showed the adverse impact on a previously healthy group of working age men and women arising from a shift into insecure employment and low wages.<sup>42</sup> The study found that lower income is associated with a higher risk of limiting illness independent of education, social class, education or employment status. People with less autonomous and less secure working conditions, and those with lower earnings, are two and a half times more likely to develop an illness which limits their capacity to work than people in better paid and more secure jobs. Security of employment also significantly increases the likelihood of recovery from a limiting illness.

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## 5. The Quality Of Low Paid Jobs

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This finding has significant and rising cost implications for both employers and the NHS since the incidence of a limiting long-term illness amongst adults in Great Britain increased dramatically from 21% in 1972 to 35% in the year 2000. The researchers in this study have noted that, *“Increasing flexibility in the workforce is often presented as an economic benefit. However there may be hidden costs to labour market ‘flexibility’, not only in terms of the costs of health service provision but also in terms of economic productivity”*.<sup>43</sup>

The most substantial longitudinal study of the health of a working population in the UK is the famous Whitehall II study, which collected data over time on British civil servants aged 35 to 55 based in 20 departments within London. In the fourth phase of data collection, it became possible to compare the evolving health of workers whose jobs remained secure with those whose jobs were subject to changing degrees of security. The study found that those exposed to chronic job insecurity had the highest self-reported morbidity, and women experienced an increase in blood pressure and a decrease in weight.<sup>44</sup> Large-scale studies of Finnish workers have shown that self-reported job insecurity is associated with poorer health, regardless of employment contract.<sup>45</sup> The same studies have shown that poor interpersonal relations between workers and their managers are associated with rising sickness absence.

In conclusion, there are a number of reasons why the quality of employment amongst low paid workers should become a more focused priority for policy makers. These start with the basic justice arguments. It is difficult to see why some workers get pension contributions from their employers whilst others get nothing at all, or why some have access to paid sick leave whilst others - the lowest paid – often live in fear of getting sick as this can make the difference between managing to get by and facing severe hardship, and often getting into unaffordable debt.

## 6. BEYOND THE CURRENT STRATEGY

The seven million people who on our estimate are low paid are in jobs that are often disadvantaged in all sorts of ways besides the low rate of pay itself. The majority of them are women and many of them are in part-time work.

So what is to be done about this? In our view, a sea-change in attitudes towards low pay and low paid jobs is required. Responsibility for tackling the problem will have to be accepted way beyond central government. But central government will have to provide the lead. There is a promising precedent. But to get going, it will be necessary to go well beyond the strategy that has been pursued so far. That means recognising that:

- low pay cannot be solved by the NMW alone;
- poverty cannot be solved by tax credits alone;
- higher productivity is part of the solution to low pay;
- attitudes and assumptions matter.

### **LOW PAY CANNOT BE SOLVED BY THE NMW ALONE**

In 2003 and 2004, the level of the NMW has at last begun to move upwards faster than average earnings. That is excellent although there is much ground to make up in view of the excessive caution in setting the original level of the NMW.

The Low Pay Commission needs to keep steady to its new course of increasing the NMW faster than average. Every year that it does that, the NMW comes closer to escaping from being a poverty wage. For example, if it continued to rise at its current rate for just a couple more years, it would be near the level where it was no longer a poverty wage for some single adults and working couples without children. This would represent an important re-balancing in the effort to reduce poverty amongst people in working households, with more of the work being done by wages and less by tax credits.

With employment levels as high as they are at the moment, these next few years ahead may be the best opportunity for a while to adjust upwards the level of the NMW so that it gradually comes to benefit the number of workers originally intended that is, around 2 million in the economy.

But even if that happens, it would still leave the NMW protecting fewer than half of those who are currently low paid according to the definition which takes into account the government's poverty line. To protect everyone who is low paid, the NMW would need to rise even further and faster than it has done in the last two years. A NMW of £7 an hour by October 2007 is the kind of level that would be required – but that sort of figure in that sort of time seems unrealistic.

As it is, keeping to the path taken since October 2003 will be a challenge enough for the Low Pay Commission. The vocal opposition of some employers is bound to grow as the level of the NMW rises but it should be remembered that it was thanks to the lobbying of employers that the NMW was introduced at its cautious original level, benefiting only one instead of two million workers. The predictions of job losses made by employers have proved almost completely unfounded. It will be important for the Commission to continue to make its recommendations to the government on the strength of the evidence and not be swayed by dire predictions.

### **POVERTY CANNOT BE SOLVED BY TAX CREDITS ALONE**

At the start of the anti-poverty drive in the late 1990s, tax credits were an excellent idea which have since played a big part in achieving the reductions in poverty seen in recent years. As employment levels have risen, the role of tax credits has become ever more central to the strategy for achieving the ambitious poverty targets set by the government.

The trouble is, though, that while tax credits address poverty directly by supplementing household income, they are, at best, no more than a partial assault on the causes of poverty. It is true that by increasing the differential between what a household receives when no one is working and what it receives when someone is working, they encourage people to work. In doing this, though, they do nothing to address the question of why the pay is so low as to require supplementing in the first place. To continue to overlook this is not a viable strategy in the long term.

For a start, it is surely too expensive. Even though up-to-date figures on this most important subject are remarkable for their absence, an early Treasury estimate suggested that some £13 billion would be disbursed via child tax credits alone in 2003/04.<sup>46</sup> If that is what it has taken to get child poverty down by a quarter, it is clear that the sums involved to get it down by a half (the 2010 target), never mind eliminate it, are going to be very big indeed.

As it is, cross-country comparisons show that in terms of the amount of public money going to low-paid families through tax credits, the UK is already near the top of the league. One international study of child poverty concludes that, *“market incomes play a larger role than state transfers in accounting for the cross-national diversity of outcomes for disadvantaged children. The English speaking countries, other than the USA, actually provide quite substantial income transfers to their most needy children. The living standards of these children, however, remain relatively low because of low labour market incomes”*.<sup>47</sup> This conclusion, it should be noted, pre-dates the changes to the tax credit system in 2003 which it made it more generous still.

International comparisons also show that across both European and English-speaking countries, wage inequality and child poverty are strongly correlated - with the level of wage inequality in the UK being among the highest.<sup>48</sup> Yet not only do tax credits compensate for low pay rather than tackle it, they encourage it. In turn, this also encourages and makes possible those low productivity jobs which can only afford low pay. From an economic point of view, this may be the worst effect of tax credits.

Employers may bemoan the time and effort involved in administering tax credits but they also gain considerably from them. For although tax credits are designed to help poor workers, they are also a subsidy to employers who are able to find workers willing to work at a low hourly wage because their incomes will be topped up by the state. The replacement of workers not eligible for tax credits by ones who are does not have to be a conscious strategy on the part of employers – the ‘invisible hand’ of the market can take care of it. It won’t happen overnight. But tax credits worth billions of pounds a year are a big intervention in the labour market – and there are bound to be effects on the behaviour both of workers and employers as a result.

One defence of tax credits as job subsidies is that they help to keep struggling firms in business, saving employees from unemployment. Where a firm’s problem is a short term one, this argument makes sense. What does not make sense, though, is to use public money to prop up firms for an unlimited period, firms whose very existence depends on paying employees poor wages. The same money could almost certainly be put to more productive purposes like training for low paid workers, with longer term benefits for the public and for the low paid.

Tax-credits don't just go to workers in struggling firms but to those in large and profitable ones too. This includes the major UK supermarket chains operating in that sector of the economy – retail – in which the largest number of low paid workers are found. Many supermarket employees are eligible for tax credits. So too are a high proportion of people employed by contractors and suppliers with whom the supermarkets bargain so hard to keep prices down. Shoppers impressed by bargains in stores should bear in mind that, as tax payers, they are paying a price for this good value through the tax credits which subsidise the wage bills of both supermarkets and their suppliers.

Tax credits are now well-established and have become a vital lifeline to the people who receive them. The aim of public policy, though, should be to find ways of reducing poverty which address its underlying causes, so that tax credits can, over time, become less important not more so.

### **THE IMPORTANCE OF HIGHER PRODUCTIVITY**

If we want to eliminate low pay altogether, it will be necessary to address the causes of low pay. One of them is low productivity. Poverty, low pay and low productivity need to be linked.

Making this link is sensible for various reasons. First, it ties what will be seen by most people as the private problem of low-paid workers and their families to a public problem - low productivity – which the government is concerned to address in the economy.

Second, it focuses attention on the jobs that low-paid workers do and what is needed in order for them to do their jobs more effectively. Because so many low paid workers are front line workers, contributing directly to the quality of public services, this is another way of turning the issue into something that both the government and the public are very concerned about.\*

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\* The government is very keen that the quality of public service should be measured and included in the National Accounts and has asked Sir Tony Atkinson to look into how this can be done. The Atkinson Review Interim Report was published in July 2004, with final report due at the start of 2005.

Raising productivity has little to do with getting people to work longer, or harder for the same amount of time and money. The UK's productivity problem is not that we work too little but that we produce too little when we do: the problem, as the European Commission has recently emphasised, is low productivity per hour. And as it goes on to explain: "*this is in part due to the prevalence of low skills amongst the workforce, including insufficient basic skills.*"<sup>49</sup>

Higher productivity amongst the lowest paid is a strategy to be pursued over a number of years, not a tactic to be used to determine pay rises from one year to the next. It requires investment, in both people and equipment, and effective investment takes time.

It also calls for better management. Part of the productivity problem for low paid workers lies in poor management. The supervisors and managers of low paid staff are frequently quite poorly paid themselves yet the management tasks they face can often be complex involving supervision of large numbers of people and requiring strong managerial skills for which people have not been adequately trained.

### **ATTITUDES AND ASSUMPTIONS MATTER**

One of the telling findings from the analysis of where the low paid jobs in the UK are to be found is how few of them are low paid as a direct result of globalisation and competition from abroad. Most low paid jobs in the UK are not directly exposed to this competition. A large proportion of them are in the public sector. Globalisation cannot possibly explain why women are so much more affected than men.

The conclusion we draw is that many, if not most, of the causes of the problem lies within our society, not outside. Low productivity is one of these causes. Lack of bargaining power is another. In our view, however, it is vital to recognise that these are by no means the only factors that account for the pattern of low pay and poor conditions experienced today. In particular, attitudes and assumptions matter too.

Sometimes, even quite innocuous assumptions have serious effects. For example, the use of percentages to describe the size of pay increases is entirely unexceptionable. But percentages widen inequalities: '5% across the board' may sound very fair, but it could mean that the chief executive enjoys a £100 a week pay rise while the worker on the minimum wage gets just £6 a week more.

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## 6. Beyond The Current Strategy

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Another assumption is that, beyond complying with the law, low pay is not actually something employers are responsible for doing anything about. The existence of the NMW, whilst helpfully putting a protective floor into the labour market, has reinforced that view. In recent years, government has not sought to suggest that employers should be expected to pay a living wage.

In the public sector at least, pay depends not on the value of sales but on the size of the budget, itself dependent on myriad political decisions. Custom and inertia are important: for example, patterns of bonus payments in some parts of local government, very much to the disadvantage of part time workers (who don't get them) date back to the Clegg Commission of the late 1970s.

The very phrase 'part-time' has a pejorative ring to it. Subconscious valuations like this are bound to impact not only on the way in which jobs are paid but on whether the people in them are treated as being equally as important, deserving of security, training, pension and promotion as people in full-time jobs. And negative valuations will often be shared by those doing part-time jobs; it is not just 'others' who hold those views.

And why are women on average paid less than men? Domestic responsibilities certainly restrict opportunities in the labour market but whether such structural factors are enough to explain the systematic differences in pay levels is doubtful. When the President of the Royal College of Physicians recently warned that the trend towards the feminisation of the medical profession would lead to it losing power and influence, she seemed to be saying that women lack power because they are women. By this logic, women are paid less because the work they do is valued less, and the fact that that work is done by women is the very reason for that under-valuation.

The point about these sorts of considerations is that they provide ground for hope and scope for action. For the less that low pay and poor conditions are the 'ineluctable workings out of the iron laws of economics' the more room there is a government to do something about the problems if it so chooses.

## 7. A NEW DEAL FOR THE LOW PAID

The role of the Government in setting the level of the NMW and in paying tax credits is clearly a central one in addressing low pay. However, if the NMW cannot be set at a level which will end low pay, and if tax credits are a means of reducing poverty in households with low paid workers but not of addressing low pay itself, then other mechanisms and institutions will also be required to bring about a long-term and substantial erosion of the low pay problem in the UK.

The problems of low paid workers require a comprehensive approach from government. Labour's first term in office was galvanised by its comprehensive approach to long-term unemployment and economic inactivity through its New Deal for the Unemployed. In our view, what is needed now is a New Deal for the Low Paid.

The New Deal for the Unemployed had a number of distinctive features which were crucial to its success. First, it was dealing with a problem that was hurting people and communities yet which also represented an economic waste which the market was failing to rectify. Making it the subject of a New Deal helped identify and draw attention to it, giving it a public profile and emphasising its political importance.

Second, it was radical. It involved a major investment of public money targeted at specific goals, initially the rate of youth unemployment but shortly afterwards other groups at high risk of being excluded from the labour market. It also involved bold policy innovation and genuine reform of the institutions (e.g. the employment service and benefits service) which had failed to deliver in the past. In addition, it engaged employers around their needs and concerns.

This is the kind of comprehensive approach that it is needed to deal with low pay. Although it is not this pamphlet's purpose to argue for particular policies that would go into a New Deal for the Low Paid, some elements are clear.

### **A LEADING ROLE FOR PUBLIC SECTOR EMPLOYERS**

With more than a quarter of low paid workers employed within education, health and local and central government, increasing pay and improving conditions for the lowest paid workers employed by the public sector would have a major impact on low paid work in the UK.

It would also contribute greatly to the government's objective of narrowing the UK's gender pay gap. A large proportion of low paid public sector workers are women, many of them undertaking front-line public services within their local communities. Improving their pay could become a more focused priority within the overall changes taking place throughout these services. If it did, it would almost certainly contribute to raising the standard of public services, including services for some of the country's most vulnerable people.

If employers in the public sector took this lead, employers in the private sector would have to respond. In many areas in Britain, the NHS and the local authority together are the single biggest employers. The pay and conditions they set exert significant influence on local labour markets, setting a standard which private sector employers must respond to if they are to attract and retain staff. The tighter the local labour market, the stronger this effect will be. The recent years of steady employment growth and continued low unemployment mean that conditions are as good now as they are ever likely to be for this tactic to work.

But recent history shows that few public sector employers are going to do what is needed voluntarily. For example, in 1997, employers and unions in local government reached agreement to put manual and non-manual workers in local government on the same conditions of service – the 'Single Status' agreement. This would have gone some of the way towards improving the pay and conditions of both low paid and women workers. Yet seven years later, only one quarter of local authorities have even completed the grading exercise which is the necessary precursor to putting the agreement into effect. If 'Single Status' or something like it were to be included in the New Deal for the Low Paid, government would need to place a duty on local authorities to implement it.

Government would also have to provide the money needed to meet the cost of such an agreement. Because of the way that it hits low income, working households the hardest, council tax is a particularly unsuitable source of money for funding increases for low paid workers. This is compounded by the way in which the tax credit system then claws back (via reduced credits) a proportion of the money that local government puts into the wages of low paid workers.\*

The situation in the NHS, where ‘Agenda for Change’ provides a nationally applicable framework for pay and conditions is more promising. It is also helped by the big sums of money now going into the NHS – provided government is prepared to allow some of that money to be used to benefit the low paid.

### **MINIMUM EMPLOYMENT STANDARDS**

Besides their own employees, a further substantial proportion of the low paid in the UK are indirectly employed by the public sector through private and not-for-profit organisations.

Pay was always low in these service occupations but employee benefits were typically broadly in line with the rest of the public sector prior to privatisation. The pay and conditions of individual staff transferring from the public to private sector have long been protected. However, in high turnover sectors such as cleaning, it is usually not long before contractors have a large segment of the workforce newly employed and working for lower pay and benefits. Within the public services, the jobs affected have mainly been in cleaning, catering, care and personal services.<sup>50</sup> Moreover, both transferred and newly hired employees alike have suffered a steady intensification of their work under private employers: for example, the number of staff cleaning hospitals has fallen substantially following privatisation.<sup>51</sup>

The trade unions have long arguing for the re-introduction of fair wage agreements which prevent private contractors from undercutting public sector pay and conditions. A commitment to do this would seem to be essential element of a New Deal for the Low Paid – as, too, would a commitment to protect the interests of agency workers who are thought to be another, often hidden pool of low paid people working for the public sector.

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\* However, because of this claw-back, the net cost to the Treasury of financing pay increase for low paid workers would be considerably less than the gross cost.

Public sector organisations can already use their power as ‘buyer’ to influence the pay and benefits of its contractors. The London Mayor is doing this, with certain contracts awarded by the Greater London Authority requiring pay and conditions that are broadly in line with public sector standards.

There are also signs that some within the private sector are now willing to act in this way. Under pressure from community campaigners, HSBC recently paid for a considerable uplift in wages and employee benefits for contract cleaning staff at its headquarters in Canary Wharf. This followed a similar move by Barclays Bank earlier in 2004. Thanks to the actions of these two banks and the publicity which followed, the UK’s financial services industry as a whole may now be starting to see the pay and benefits of low paid outsourced cleaning, catering and security staff as an issue of ‘corporate social responsibility’.

A New Deal for the Low Paid would need to promote these examples of good practice vigorously, putting pressure on all large private sector organisations to follow suit. A requirement on firms to disclose the amount of tax credits paid to employees could be an element of this. Monitoring of low pay is another, as the London Mayor’s ‘Living Wage Unit’ in City Hall will do.

There would also be a need for stronger enforcement mechanisms around workplace and employment rights. At present, low paid workers are far more vulnerable than other workers to infringement of their rights yet they are also less likely to be in a union who can act for them, or to opt for a tribunal process. As the Low Pay Commission notes, the proactive approach to the enforcement of the NMW by the Inland Revenue finds support among both trade unions and employers.<sup>52</sup> A similar approach (although not carried out by the Inland Revenue) could be applied to employment rights more generally. Enforcement, which impacts on the ‘rogue’ end of any industry, is not the same as ‘more regulation’, which impacts upon all.

‘Minimum standards’ would also need to cover access to training. Left to themselves, employers put far more investment into workers whose skills levels and qualifications are already higher. This needs correcting. By using public investment to improve the skills and productivity of low paid workers, a New Deal for the Low Paid could help correct this imbalance.

**LOW PAID WORKERS AS A PRIORITY FOR THE TRADE UNION MOVEMENT**

The trade unions would have a key role to play in making a New Deal for the Low Paid work – but in many ways, the challenges facing them are the greatest of all. With only 15% of low paid workers belonging to a trade union, their capacity to do anything on low paid workers’ behalf is currently very limited. The fundamental question, not for individual unions or parts of unions who do represent low paid workers, but for the union movement as a whole, is how to ensure that it can properly be said to represent, and speak for, the low paid.

The immediate problem is to raise the level of trade union membership among the low paid. Neither financing that nor servicing a low-paid membership are easy. The membership of one local government branch in East London spans more than a hundred employers, the result of the fragmentation due to privatisation. It may make sense to look at ways of spreading the cost both of organising and representing low-paid workers across the movement as a whole. The TUC would clearly have a big role to play here.

The other part of the challenge is to create space within which to advance the interests of the low paid even when doing so requires restraint on the part of better paid employees who are, nevertheless, trade union members. The most recent pay claim in local government, submitted jointly by the three main unions, aimed to do just this. It is also argued that slightly better paid workers anyway recognise that all employees gain from seeing conditions at the bottom raised. But to continue pressing the case for the low paid - and continue it would need to - would require a more general justification, something that allows it be seen as part of a wider attempt to achieve greater ends.

This is where the secondary benefits of launching a New Deal for the Low Paid are important. By drawing attention to the problems, by insisting that action be taken to deal with them and by acting decisively itself, the government would strengthen the position of those inside unions, public sector bodies and companies too who do want to act in the same way.

At the same time, a New Deal for the Low Paid would present unions with an opportunity to pitch arguments for particular policies - like an end to the two-tier workforce in local government - in a different way. Rather than ‘winning concessions for their members’, such policies can quite properly be presented as a necessary part of a strategy to achieve goals that are approved of by government and society alike.

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- 18 Citizens Advice, 2004, *Nowhere to Turn – CAB Evidence on the Exploitation of Migrant Workers*
- 19 These estimates are for the time of writing, that is, mid 2004.
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- 22 Source: authors' calculations. Data on median hourly earnings for full time employees is taken from *New Earnings Survey 2003*, table A31. Data on the number below the 60% threshold is then calculated using *Tables showing the distribution of the low paid by 10 bands*. (Office for National Statistics). In April 2003, the 60% threshold defining low pay was £5.88.
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