

## *National Minimum Wage - ALP response to Low Pay Commission Consultation*

28 August 2006

### **Introduction**

On 26 June 2006 the Low Pay Commission began a consultation on the terms of reference for the report it is required to prepare by the end of February 2007. The Commission has been given a very wide brief by the Prime Minister and the Secretary of State for Trade and Industry. The one specific subject covered is the proposed increase to the statutory annual holiday entitlement. Comments are sought by 20 September 2006.

This paper sets out the views of the Association of Labour Providers (ALP). The Association was formed early in 2004 by 18 labour providers. It now has 120 members and is recognised as the representative voice for those labour providers that serve the agriculture and food industry. (Full information about the Association and its work is available on its website: [www.labourproviders.org.uk](http://www.labourproviders.org.uk).) Labour providers are particularly affected by the national minimum wage. For the most part, they bring workers to the UK who undertake low paid work. Because the workers are newly arrived in Britain they also need accommodation, and their income restricts the rent that they are able to pay on the open market. Labour providers therefore have a particular interest in the accommodation offset arrangements.

### **Executive summary**

The Commission should investigate the accommodation costs that low-paid workers, including migrant workers, have to meet and how this impacts on their standard of living. This would then enable a more informed debate to take place on whether uniquely restrictive arrangements should apply to accommodation provided by employers.

There seems to be an assumption that the minimum wage law is observed. It is not; it is widely ignored. However, this is generally done in a way that does not disadvantage workers as it is through the informal economy where it is the taxpayer and businesses operated lawfully who are disadvantaged. The Commission should study in detail the enforcement activity of HMRC, the operation of the informal economy and its interaction with the minimum wage.

### **Accommodation**

In its 2006 annual report the Commission reported on the operation of the accommodation offset arrangements. The Commission accepted that there was a case in principle for distinguishing between accommodation occupied as a condition of employment and accommodation provided as an option to a worker. However, it could not see a means of devising a satisfactory distinction that would operate in practice. The Commission therefore recommended a tightening of the arrangements, which the DTI is currently attempting to introduce.

The ALP cannot accept the reasoning of the Commission. The Commission did not ask the Association or others for its views on whether there could be any reasonable test which would allow such a distinction to be made. There are a number of areas where workers agree to opt out of or opt into arrangements without which such a practice would be unlawful. For example, a worker has to agree to opt out in writing of the 48-hour working week, and a worker has to agree in writing to any deductions from pay other than those required by law. The effect of the Commission's report is that labour providers are ceasing to provide accommodation, or in some cases they are becoming accommodation providers and ceasing to provide employment. There is

no evidence that suggests that as a result of the policy decision that has been taken low paid workers are now paying less for accommodation. Most of those that had the option of taking accommodation from their employer no longer have this option and have to obtain their accommodation in the open market.

Accommodation costs are a major part of living costs of low-paid workers. The Commission should conduct a study on the accommodation costs paid by low-paid workers, including particular schemes designed to help them, such as those for "key workers" and those operated by employers. This would enable a more informed debate to take place on the merits of applying restrictions on the rents that may be charged to low-paid workers by employers but not by anyone else. Such a study would also provide a good example of a joined up approach to policy-making, rather than a very narrow approach covering accommodation provided by employers and assuming that all other low paid workers do not have a problem in meeting accommodation costs.

### **Enforcement and the informal economy**

It is typical of enforcement bodies that they concentrate on easy targets, typically those operating above board in the formal economy and with ample records to inspect. In respect of income tax matters generally, HMRC staff are at their best in going through detailed records, often finding minor errors or issues on which the tax can be argued. A modest sum is suggested to cover tax that should have been paid, the HMRC targets are hit and the taxpayer feels aggrieved but simply does not have the energy to fight the issue.

Unless a business or an individual presents evidence to HMRC that it exists then the chances are that it will be left alone. As a general rule, HMRC does not have the tools to go after people in the informal economy. The Association made this point in its evidence to the Commission on the accommodation offset in 2005. The Commission chose to quote in large print an extract from the evidence –

"The real abuse is not by people with detailed records that can be examined but rather by people with no records, no tax returns, no accounts, no fixed premises but rather a phone, a white van and a great deal of cash."

The Commission should examine the enforcement activity of HMRC, including analysing the statistics on the origin of cases it chooses to investigate and the nature of the transgression.

More importantly, the Commission should examine the interaction of the minimum wage and the informal economy. Estimates of the number of illegal workers in the country range from 400,000 to one million. While technically the minimum wage law might apply to them, a worker in the country illegally is hardly going to make a complaint to an official body. It is generally considered that such workers are vulnerable to being exploited. However, to a large extent they are not being exploited; rather they are part of those who are exploiting. A dishonest employer can employ workers in the cash economy paying them below the minimum wage but which in after-tax terms leaves them as well off if not more so than workers in the formal economy on the minimum wage.

In the case of some services, such as domestic help and the hand car washing industry, arguably the informal economy does little harm in that reputable businesses are not undercut. (There is no better example than the failure of enforcement activity in Britain than that a thriving industry can develop on high streets staffed to a significant extent by illegal workers and operating largely on a cash basis.) However, in the industry in which labour providers operate, the informal economy can make it very difficult for businesses operating lawfully to do so profitably. Labour providers properly have been put under pressure to become compliant with all laws, but increasingly they do not see why they should do so when the government so blatantly ignores tax evasion. Some labour providers feel they have little choice but to join those evading tax or go out of business. The government has failed to maintain the rule of law in this important area and must accept responsibility for the consequences.

The impact of the informal economy is illustrated in the following table. The first column is a generally accepted analysis of the rate a labour provider must charge to a labour user just to cover the legal costs of providing a worker on the minimum wage. The figures take no account of management time or profit. Where transport is not provided the minimum wage of £5.05 translates into a rate that must be charged of £6.53. VAT has to be added to this. In the informal economy, a cash wage of £4.00 an hour is reasonably equivalent to £5.20 before tax and national insurance. (The exact equation depends on circumstances, in particular the period worked in respect of income tax. The longer the period worked and the higher the pay the greater the benefit of avoiding tax.) The table shows the benefit of the informal economy arrangement even if an allowance is made for holiday pay and sick pay – neither of which normally feature in the informal economy. The cash wage £4.00 translates into a cost of £5.20, a 26% reduction on what the legal operator would have to charge. If VAT evasion is added to the equation the informal operator has a 37% cost advantage.

	<b>Rate from 1/10/06</b>	<b>Informal economy rate</b>
Minimum wage	£5.35	£4.00
Employer's NICs @ 6.65%	£0.36	£0.00
Holiday pay @ 8.33%	£0.45	£0.45
Sick pay (allow 7 days) @ 1%	£0.05	£0.05
Overheads @ 6%	£0.32	£0.25
<b>Cost without transport (22%)</b>	<b>£6.53</b>	<b>£4.75</b>
Transport @ 8.4%	£0.45	£0.45
<b>Total costs with transport (30%)</b>	<b>£6.98</b>	<b>£5.20</b>

The Commission should study the interaction of the informal economy and the minimum wage, including whether successive increases in the minimum wage above increases in average pay have contributed to a growth in informal economy activity. The study should examine in particular the extent to which businesses seeking to comply with minimum wage and other laws are increasingly finding it difficult to do so because of competition from the informal economy.

#### **Increasing the holiday entitlement**

The Commission has been asked to look specifically at the impact of forthcoming changes to the statutory leave entitlement. A copy of the Association's response to the DT consultation is appended to this submission. The key point is that the proposed increase in the holiday entitlement will increase the margin that labour providers need to charge labour users by about 10p per hour for each additional four days holiday. The Association's evidence points out that there is a risk that additional add-ons to the minimum wage would drive more business into the informal economy. This is therefore connected to the previous point.

The Commission might also usefully examine in this context the use of rolled-up holiday pay. Many workers doing low paid manual work, work for only short periods of time. Having the option of having all their holiday pay rolled up into their weekly pay is an arrangement that many like. This now seems to have been outlawed. Workers should be allowed a choice.

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## **Appendix**

26 July 2006

### ***Consultation on increasing the holiday entitlement***

#### ***Comments by the Association of Labour Providers on DTI Consultation***

##### **Introduction**

In June 2006, DTI published *increasing the Holiday Entitlement – an initial consultation*, accessible at - <http://www.dti.gov.uk/consultations/page30026.html>.

Comments are sought by 22 September 2006.

This response sets out the views of the Association of Labour Providers (ALP). The ALP was founded by 18 labour providers in January 2004. It now has 118 members and is generally recognised as the trade association for those labour providers that serve the agriculture and food industry. Labour providers generally supply workers for whom they are paid an hourly rate. The increased holiday entitlement will increase the rate that needs to be paid. The consultation is very relevant to them.

##### **Executive summary**

The proposed increase in the holiday entitlement will increase the margin that labour providers need to charge labour users, by about 10p per hour for each additional four days holiday. Labour providers will struggle to secure this extra amount from labour users.

There is a risk that additional add-ons to the minimum wage will drive some business into the informal economy. The government needs to take action to prevent this.

There should be maximum flexibility in respect of how workers take their holiday entitlement – including allowing them to roll up the benefit into pay.

##### **The proposal**

It is proposed that annual holiday entitlement should rise from 20 days to 24 days from 1 October 2007. A further increase to 28 days is proposed, the timing being decided following the consultation.

## How labour providers are affected

Labour providers supply workers to packhouses and factories. They normally receive a rate of so much per worker per hour. That rate has to cover the minimum wage, all legal add-ons and the business's costs and profits. There is a well established formula which translates a given minimum wage into a minimum rate that needs to be charged.

At present 20 days holiday is equivalent to 8.33% of wage costs; the increase to 24 days would increase this to 10.17%, and to 28 days to 12.06%. How this would translate into the minimum charge a labour provider would have to make is illustrated in the table below –

		<b>Rate from</b>	<b>Effect of</b>	<b>Effect of</b>
		<b>1/10/06</b>	<b>24 days</b>	<b>28 days</b>
	Minimum wage	£5.35	£5.35	£5.35
	Employer's NICs @ 6.65%	£0.36	£0.36	£0.36
	Holiday pay @ 8.33%, 10.17% & 12.06%	£0.45	£0.54	£0.65
	Sick pay (allow 7 days) @ 1%	£0.05	£0.05	£0.05
	Overheads @ 6%	£0.32	£0.32	£0.32
	<b>Cost without transport (22%, 24% &amp; 26%)</b>	<b>£6.53</b>	<b>£6.62</b>	<b>£6.73</b>
	Transport @ 8.4%	£0.45	£0.45	£0.45
	<b>Total costs with transport (30%)</b>	<b>£6.98</b>	<b>£7.07</b>	<b>£7.18</b>

At first sight the position is straightforward. Labour providers increase their charges, workers get more holiday (or holiday pay as many do not want to take their holiday entitlement) and there is a tiny effect on inflation. But life is not so simple. Every year labour providers struggle to persuade their customers to increase rates to reflect the increase in the minimum wage. It is all too easy for labour users to use labour providers who cut corners as the risk of detection is tiny. The more the add-ons to the minimum wage the more there is a risk of business being driven into the informal economy.

To help minimise this the government must take steps to ensure that employers and labour users understand that the cost of the additional holiday entitlement has to be passed on, and should strengthen the current feeble attempts to bring the informal economy under control.

### ALP view

The government has made its mind up so there is little to consult on. The ALP has no objection to the proposal, but wishes to ensure that the government understands the consequences of what it is doing.

Many workers, particularly those working for only a short period (such as the summer or Christmas holiday period), have no interest in taking a period of holiday during their period of employment. They want holiday pay to be rolled into their regular pay. The Government has now prohibited this, causing inconvenience for some workers and their employees. This should be reversed. Accordingly, the answer to question 5 is yes, but this should apply to all holiday entitlement not to a fraction of it. The whole document is written as if the labour force comprises permanent employees in long term jobs. DTI needs to recognise that much of the economy is run on the basis of a very flexible labour market; rigid rules on how holidays entitlement must be taken are out of place in an environment where many periods of employment are counted in weeks rather than years.