

2019 UK GENERAL ELECTION BRIEFING: **THE FUTURE PATH OF THE MINIMUM WAGE**

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OVERVIEW

Labour and the Conservatives both plan historically high increases to the UK minimum wage, aiming to use the minimum wage as an important tool in raising living standards. This briefing focuses on:

- The current minimum wage structure and how the rates are determined;
- The future path of the National Living Wage and the future structure of the National Minimum Wage youth rates, including an assessment of the proposals of both main parties.

KEY TAKEAWAYS

- The minimum wage rates are set by government every year in April, following advice by an independent Low Pay Commission ([LPC](#)). The rationale behind a minimum wage is fairly simple: introducing a wage floor **improves fairness and prevents exploitation of workers**. However, if you set the minimum wage too high, it **could damage job growth and increase unemployment**, as employers may cut back on hiring due to high wage costs.
- During the past 20 years, and especially since 2016, the increases to the UK minimum wage have **boosted people's earnings, with little impact on jobs**. A recent [independent review](#) for the government concluded there is **still scope to explore a more ambitious minimum wage**.
- Both Labour and the Conservatives have promised increases to the minimum wage. Labour has proposed to **introduce rapidly a £10-an-hour 'Real Living Wage' for all workers over 16**. The Conservatives have proposed to **increase the National Living Wage to two-thirds of the median wage by 2024 and lower the age eligibility to 21 instead of 25**. However, if future increases in the minimum wage are done too rapidly resulting in negative employment effects, for instance for part-time workers, younger workers or in specific industries or regions, this could **risk undermining the strong consensus around the minimum wage that has been built up during the past two decades**. It is therefore vital that the LPC has a clear mandate to determine the precise size and pace of minimum wage increases.
- The minimum wage is **not a panacea whereby low wage work can simply be legislated away by the imposition of ever higher minimum wage rates**. It needs other supporting policies including on tax and benefits, employment, education, skills, and social care and childcare.

What is the National Living Wage and the National Minimum Wage?

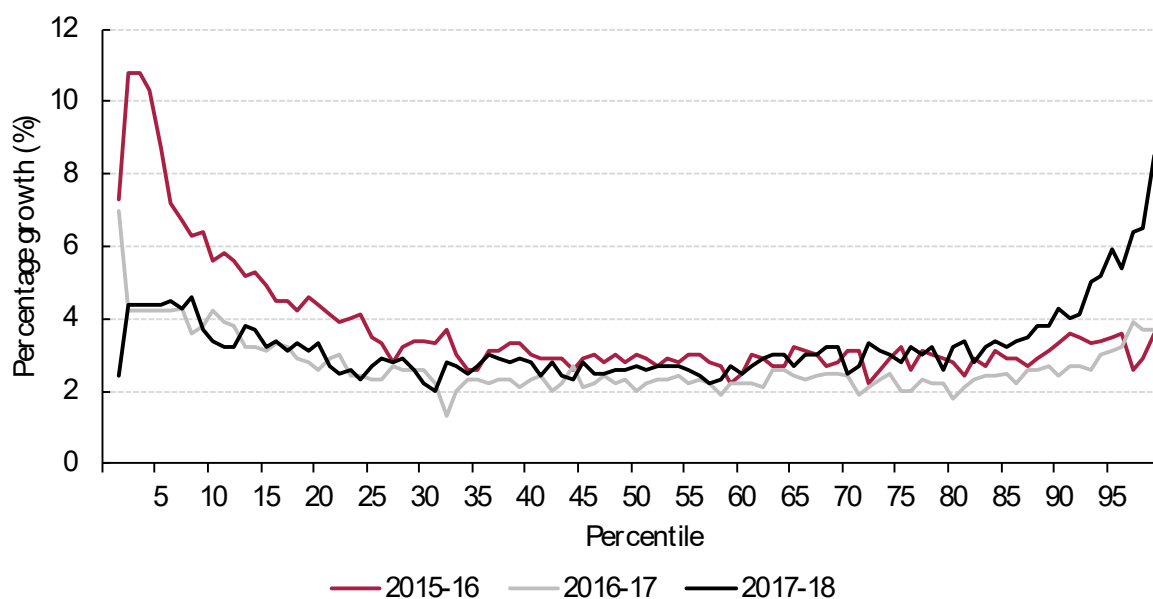
- First introduced in 1999, the National Minimum Wage sets the **minimum pay per hour** that workers in the UK are entitled to. Today, the UK has five minimum wage rates. Workers **aged 25 years and older must be paid at least the National Living Wage (£8.21)** while **lower National Minimum Wage ‘Youth Rates’** can be paid to **those aged 21-24 (£7.70), 18-20 (£6.15), 16-17 (£4.35) and apprentices (£3.90)**.

Table 1. Minimum wages by age group

Year	25 and over	21-24	18-20	16-17	Apprentice
April 2019	£8.21	£7.70	£6.15	£4.35	£3.90

- Since the introduction of the National Living Wage in 2016, recent years have seen large increases in the minimum wage. **It has risen 14% in real terms since 2015, significantly higher than real growth in average wages of about 4% over this period.**
- The **purpose of minimum wage rates is to raise the pay of low-income workers.** Figure 1 shows how the growth in hourly pay has varied over the pay distribution following the last three increases of the minimum wage in 2016, 2017 and 2018. Although many factors affect the growth in wages, Figure 1 shows that **those who are paid the least has gained the most in wages** (those towards the left of the graph). The wage growth among low earners is most pronounced following the introduction of the National Living Wage in 2016, where the minimum wage rate grew by 10.8% from April 2015 to April 2016. As a result, between 2015 and 2018, real average weekly earnings among employees in the bottom tenth of hourly wages grew by 11%, compared with 3% across all employees.

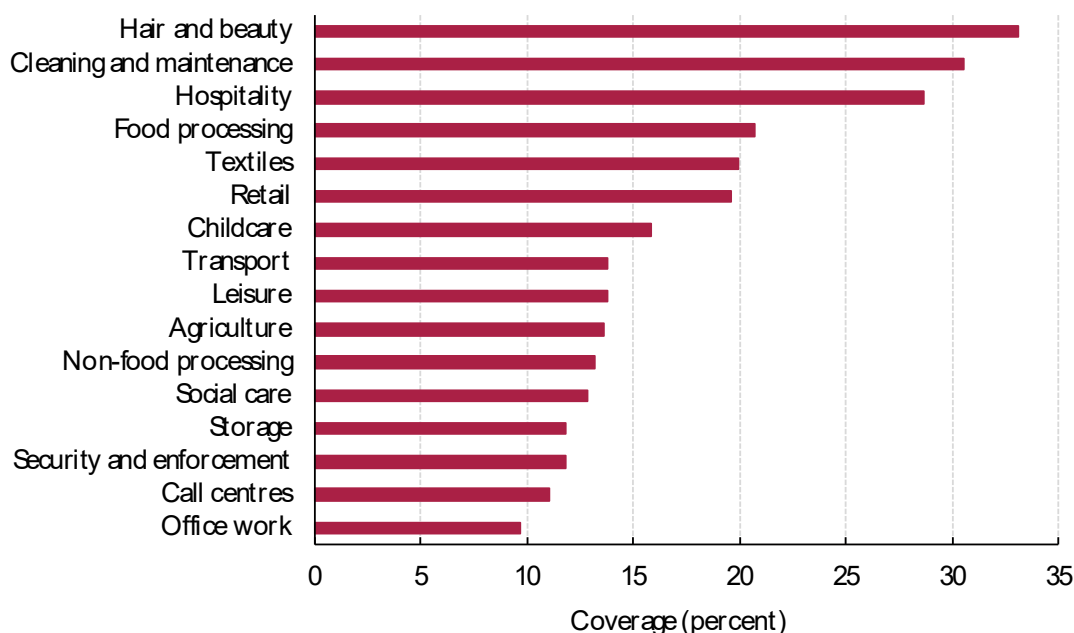
Figure 1: Percentage growth in the hourly wage distribution for workers aged 25 and over, 2015-2018



Source: Low Pay Commission Report 2018.

- In total, **about 1.6m workers** in the UK aged 25 or older are paid at or below the National Living Wage of £8.21 (around 6.5% of all jobs). About 1.9m workers aged 21 and over (8%) are paid at or below the minimum wage.
- Figure 2 shows **current coverage of the minimum wage for workers aged 25 and over in several low-paying occupations**. Over 25% of workers in hair and beauty, cleaning and maintenance, and hospitality occupations are paid the minimum wage.

Figure 2: Coverage of the minimum wage for workers aged 25 and over, by occupation, 2018



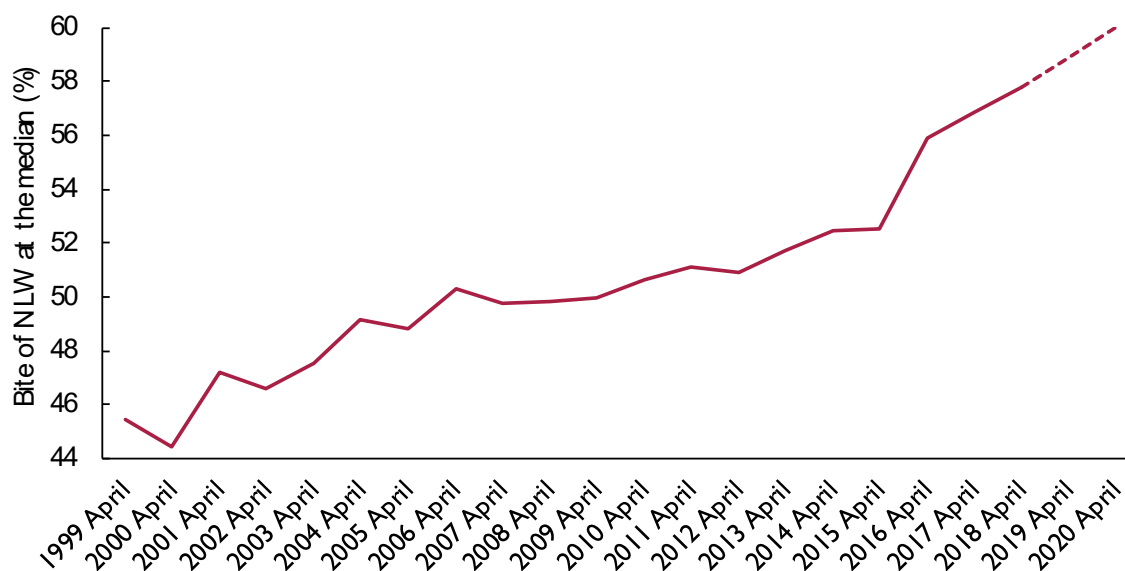
Source: Low Pay Commission Report 2018.

How is the level of the minimum wage determined?

- The rationale behind a minimum wage is fairly simple: introducing a minimum wage **improves fairness and prevents exploitation of workers**. The basic motivation behind a minimum wage reflects concerns about what is a fair remuneration for an hour or a day's work. However, a main concern is that a high minimum wage could lead employers to cut back on hiring **which would increase unemployment**. If you set the minimum wage too high, employers may not want to fill a vacancy due to high wage costs which would **destroy low-skilled jobs and lower the employment** for the very people the minimum wage was intended to help. Employers could also respond in other ways, for example by cutting back on non-wage benefits, or changing contractual arrangements, for instance by trying to shift workers to zero-hour contracts.
- Minimum wage rates are **set by government every year in April**, following review and advice by the Low Pay Commission ([LPC](#)), an independent body comprising academics as well as employer and worker representatives. The LPC do many things to inform their advice to government, including carrying out research and analysing data, as well as consulting with employers, workers and their representatives. Their focus is to evaluate **the likely impact on earnings compared to the potentially negative impact on people's employment and working hours**.

- Ultimately, the decision on the appropriate level of the minimum wage is a political one. The current remit of the LPC, set by the government, is to set minimum wage rates that **“help as many low-paid workers as possible without damaging their employment prospects.”** LPC therefore try **to set the minimum wage at a level that does not reduce jobs**, but which boosts earnings for low-paid workers as much as possible. In 2019, the government suggested that LPC’s future remit should include **“the objective of ending low pay in the UK”** which would include **more ambitious increases in the minimum wage.**
- In technical terms, the LPC’s current remit is to set the National Living Wage, so it **reaches a so-called ‘bite’ target of 60% by October 2020.** This has already led to higher increases in the minimum wage.
- The **‘bite’ is the ratio of the National Living Wage to the ‘median wage’.** The ‘median wage’ is the wage of the middle person in the UK pay distribution. One half of the UK population earns more, the other half earns less than this person. The middle person in the UK currently earns around £13.90 per hour. This means that **someone on the National Living Wage of £8.21 currently earns around 59% of the middle person**, which means the ‘bite’ is 59%.
- The Low Pay Commission says **the UK are on target to achieve the 60% ‘bite’ target** by October 2020. This is substantially higher than in the past. For instance, the first UK minimum wage in 1999 had a ‘bite’ of 45.6% (see Figure 3).
- An independent [review](#) for the government, looking at the impact of higher minimum wages on jobs, concluded in November 2019 that there is **room to explore a more ambitious remit for the UK bite**, in the range of 60% to two-thirds, or 66.7%, of median hourly earnings.

Figure 3. ‘Bite’ of the National Living Wage for workers aged 25 and over, UK, 1999-2020

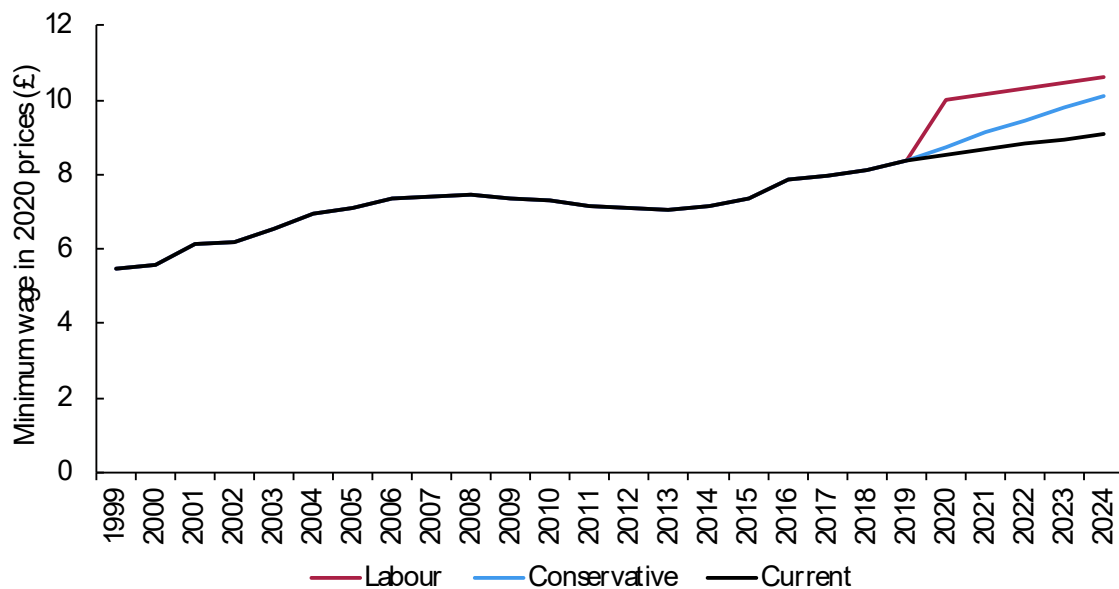


Source: Low Pay Commission Report 2018.

The National Living Wage will be changing...

- Both the Conservatives and Labour have **pledged fundamental changes to the UK minimum wages**, both in its level and age structure. The Conservatives have pledged to raise **the National Living Wage to 66.7% of the median hourly wage** (a common definition of low pay) **by 2024**, and **gradually lower the age of eligibility to 21 instead of 25**. This would represent a substantial increase relative to current policy. Two-thirds of median wages for those aged 21 and over is currently £8.85 per hour, equivalent to around 64% of median wages for those aged 25 and over.
- Labour has pledged to **introduce rapidly a £10 per hour ‘Real Living Wage’ for all workers aged 16 and over**, excluding those covered by the apprentice rate. This is equivalent to around 73% of median wages for those aged 21 and over, or 70% of median wages for those aged 25 and over.
- Figure 4 shows the **expected future path of the minimum wage until 2024**, under three scenarios: if current policy is maintained as well as the Conservatives and Labour’s proposals. Labour has not said how the path of minimum wages will evolve after increasing it to £10 in 2020, and therefore the estimates shown assume that the minimum wage will continue to be increased by the growth in average wages, but this is not Labour Party policy.

Figure 4. Estimated minimum wage, workers aged 25 and over (2020 prices)



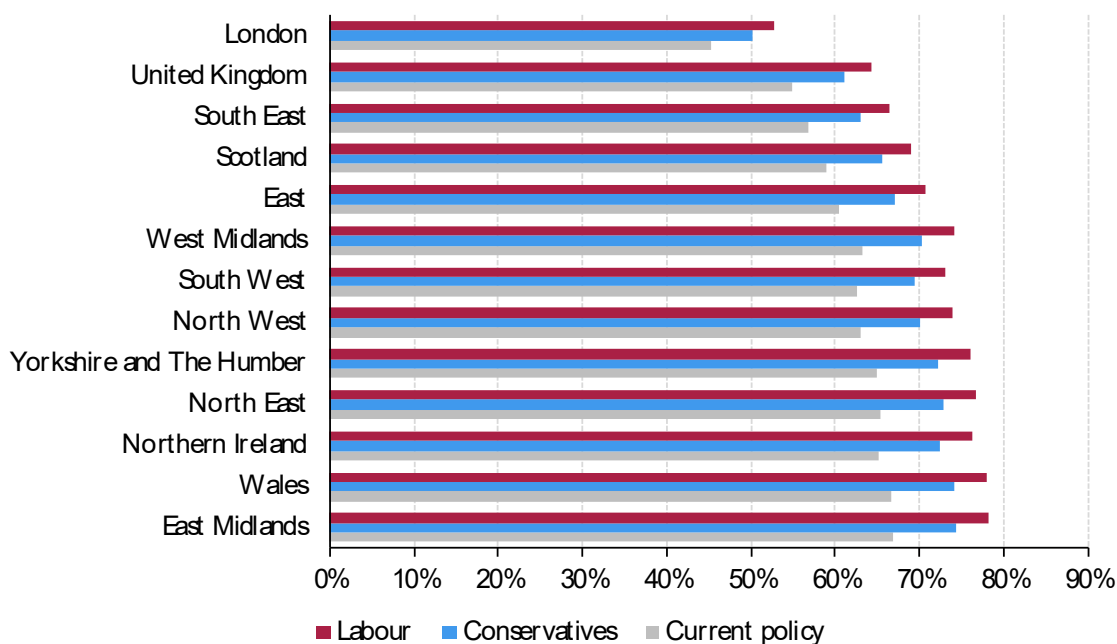
Source: Authors’ calculations using Low Pay Commission statistics, ONS (series D7BT), NIESR’s Economic Forecasts October 2019 and the Annual Survey of Hours and Earnings 2018.

Note: The figure shows 22+ rate from April 1999 to October 2009, 21+ rate from October 2010 to October 2015 and NLW (25+) from April 2016 to April 2019. Adjusted for inflation using CPI, from Q2 (April) or Q4 (October) in the year/month of introduction to 2020 Q2. Current policy (maintaining 60% median wage target) and Conservative party plans (reaching 66.7% target) for 2024 are based on the median wage increasing in line with forecast average hourly wages. Labour has not said how the path of minimum wages will evolve after increasing it to £10 in 2020, and therefore the estimates assume that the minimum wage will continue to be increased by the growth in average wages, but this is not Labour Party policy.

- These proposals would place the UK minimum wage as one of the highest among similar countries. But **how high is too high?** The world-leading expert in minimum wages Professor Arin Dube who recently undertook an independent [review](#) for the government says that eventually **there is a point at which increases in the minimum wage will start to have a negative effect** on employment, but we do not know exactly where this point is.

- The overall body of evidence from research into the effects of minimum wages suggests that **increases in the minimum wage boost pay by much more than it has negative effects on jobs**. For instance, the increase in the National Living Wage in April 2016 represented a 7.5% increase in the minimum wage, significantly larger than previous increases, but our [NIESR analysis](#) for the LPC still **found no negative impact on overall employment**. However, it found some negative effects for women working part-time, consistent with previous [NIESR research](#). All future increases in the minimum wage need to pay careful attention to demographic subgroups, such as women working part time, who are likely to be more vulnerable to losing their job or having their hours cut.
- Increases in the minimum wage, such as those suggested by Conservatives and Labour, **represent a much bigger step up in wages in some regions of the UK**, because the level of wages varies across the country. This means there is **significant variation in the ‘bite’ of the minimum wage regionally**, i.e. the proposed minimum wages would be closer to the median (middle) wage in some regions. Figure 5 illustrates that the bite of the minimum wage could be significantly higher in some parts of the country. For instance, workers in the Northeast, Northern Ireland, Wales and East Midlands would be more likely to receive pay increases, but could potentially also be at more risk of losing their job.

Figure 5: Estimated regional ‘bite’ of minimum wage for employees aged 25 and over, 2024, by region



Source: Authors' calculations using LPC statistics, NIESR's Economic Forecasts October 2019 and ASHE 2018.

Note: The figure shows estimates of the bite (minimum wage as a proportion of the median wage) for employees aged 25 and over, in cash terms for 2024. Same assumptions as Figure 2 for projected paths under the three scenarios.

- It is difficult to use past evidence to predict the likely effects of more ambitious policies such as those proposed by Labour and the Conservatives. But the body of evidence suggests that **there is scope for exploring a more ambitious minimum wage in the UK**. However, the evidence on high minimum wages is still incomplete and early. Therefore, the **precise size and pace of minimum wage increases should best be delegated to the LPC, which should have a clear mandate to pause and reconsider** the path of increases if evidence emerges of substantial job losses for those affected by the policy.

The politics of the National Living Wage

- The National Minimum Wage is considered to be one of the biggest policy successes over the past 20 years. It has **reversed historic trends where the lowest-paid people in the UK saw the weakest growth in earnings**, and it has done so **with little negative impact on jobs**.
- When Labour introduced the National Minimum Wage in 1999, it was opposed by the Conservative Party, and it even followed a long period of internal debate in the Labour Party and within the labour movement. Since then, a **strong consensus has emerged on the minimum wage**, including gaining support from all political parties and the business community. The consensus is built on academic evidence of the positive impacts on wages and limited negative impacts on employment, and arguably, it has also been built through the social partnership model which underpins the LPC, in which workers and employers come together, and make unanimous recommendations on minimum wage increases.
- Ultimately, the decision on the appropriate level of the minimum wage is a political one. While the LPC has largely been responsible for the path of the minimum wage since 1999, the minimum wage was effectively **politicised by introducing the National Living Wage in 2016**, with new ambitious targets and a new remit for LPC upratings. The politicisation continues during the 2019 General Election as both major parties engage in a **bidding war of who can offer the highest minimum wage**. The proposed changes by the Conservatives and Labour are large, with ambitious timescales, which would **take the UK into uncharted waters**.
- Both the LPC and the recent independent review for the government has **warned political parties to tread carefully**, ensuring that the employment prospects of low-paid workers are monitored carefully so any negative impacts on employment can be detected in time, and if necessary be reversed. Importantly, the increases in the National Living Wage **must be done gradually and cautiously** as it is much easier to give pay rises than pay reductions. Reductions in the minimum wage can only really be done by freezing the value of the minimum wage so its real value gradually erodes as prices in the economy increase. Therefore, if future increases in the minimum wage are done too rapidly with negative employment effects, it could be difficult to reverse, and it could **risk undermining the strong consensus that has been built up during the past two decades**.
- Minimum wage rates are a relatively easy lever for governments to pull to try and help those at the lower end of the wage distribution, but they are not a panacea; **low wage work cannot simply be legislated away by the imposition of ever higher minimum wage rates**. A wide variety of policies influence living standards, of which productivity is critical. Productivity growth in the UK has been sluggish and efforts to improve productivity are urgently needed. A wide variety of supporting policies, such as tax and welfare policy, employment, education and skills, as well as social care and childcare funding also play a key role in determining living standards.
- As an example, minimum wages can boost pay for low wage workers, however **household income after taxes and benefits is more important when considering living standards**. Minimum wage *workers* are generally not the same as minimum wage *households*. Many minimum wage workers (for example students) may live in households with people who are relatively higher earners.

Younger workers: Why are they paid less – and what will happen with Youth Rates?

- The National Minimum Wage ‘Youth Rates’ are a key policy battleground in the 2019 General Election. Labour has pledged that **all workers above 16 will be eligible for their ‘Real Living Wage’** and the Conservatives have proposed **that all workers above 21** will be eligible for the higher National Living Wage.

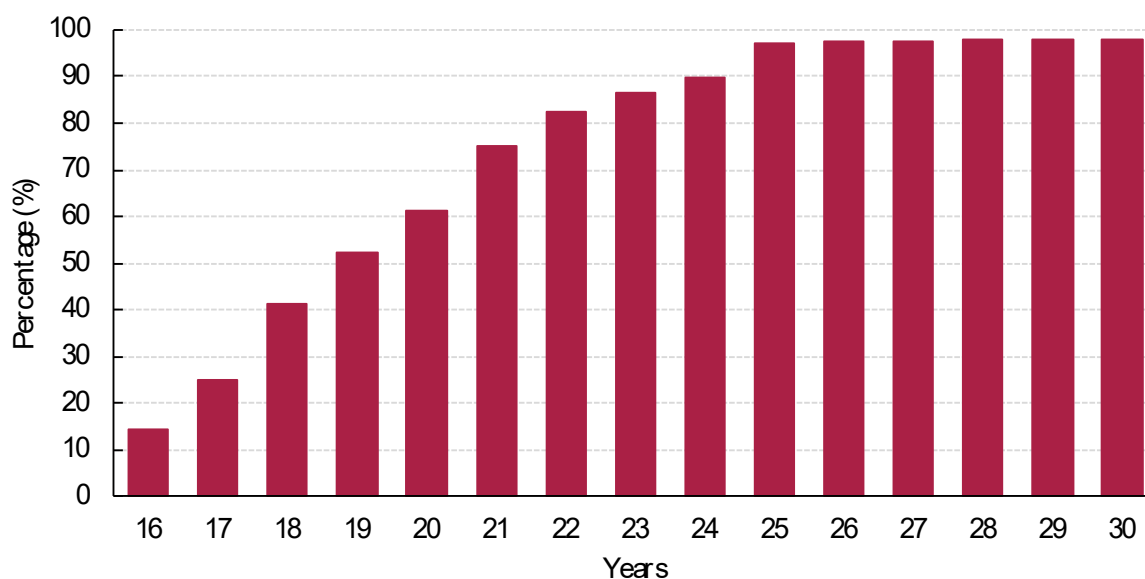
Why can younger workers be paid less than older workers?

Younger workers typically occupy a **more vulnerable position in the labour market**, and their **employment is at greater risk** than older workers to changes in the minimum wage. The lower National Minimum Wage ‘Youth Rates’ have therefore been thought of as **protecting youth jobs**, by avoiding risks such as employers recruiting older and often more experienced workers at no additional wage costs.

Lower rates of pay are meant to **promote the long-term labour market position of young workers** by ensuring they are not encouraged to leave education or training too early, and by encouraging employers to offer younger workers training on the job in lieu of pay to acquire skills and experience. Lower rates also reflect evidence that **younger workers are more likely to be unemployed**, and that spells of unemployment can be more damaging for young workers, causing **long-term ‘scarring effects’ on their future earning and employment**.

- When advising the government on Youth Rates, the LPC’s objective is to ensure that it enables young people to make a **successful transition from education to employment**, and to access job roles which provide them with work experience valued by employers. Recently, the LPC [advised](#) the Government to **gradually lower the age of eligibility of the National Living Wage from 25 to 21**. LPC argued that **21 is a more ‘natural’ cut-off point** as 21-24 year olds on most measures – such as educational participation, unemployment rates as well as where and how they work – are very similar. Another important reason was fairness, as 21-24 year olds in low-paid sectors generally do the same work, with only small, if any, differences in experiences and productivity.
- The LPC will **continue to monitor the situation for 18-20 year olds**, but note this is an important period where most young people transition from education into the labour market, and for some it is a vital launch pad for later transitions into higher-paid work. Meanwhile, **16-17 year olds occupy a distinct position**, as they are required to be in education or training, and they are often in part-time and casual jobs, primarily in hospitality and retail. Recent [NIESR research](#) for the LPC showed that employers feel more able to justify paying lower rates to 16-17 year old workers.
- The LPC advice to gradually lower the age of eligibility to 21 has been accepted by the Conservatives. It would affect around 15% of jobs held by 21-24 year olds, **amounting to almost 300,000 jobs**. In contrast, Labour has promised to scrap the Youth Rates altogether, calling it discrimination against young people. All workers above 16 would be eligible for their ‘Real Living Wage’. Figure 6 shows the proportion of jobs paid at or above the National Living Wage by different ages. It is clear that a large proportion of 16-17 year olds, in particular, would be affected.

Figure 6. Percentage of jobs paid at or above the National Living Wage, by age, UK, 2018



Source: LPC's [review](#) of Youth Rates. LPC analysis of ASHE data.

- The Labour Party proposal of lowering the age of eligibility to those aged 16 and above represents a significant policy change, and **risks damaging the employment prospects of those aged 16-24**. There are good reasons why especially 16-17 year old workers' wages tend to be lower, reflecting less experience, education and training, and more need for on-the-job training, than older workers. If employers have to pay a 16 year old the same as a 25 year old, they may be more likely to hire the 25 year old with more experience. This could lead to spells of unemployment or lack of work opportunities among young people, which may cause long-term negative impacts on their future earnings and employment.

Recent NIESR work on minimum wages

Aitken, A., Dolton, P. & Riley, R. (2018) [The Impact of the Introduction of the National Living Wage on Employment, Hours and Wages](#), Low Pay Commission, NIESR report.

Aitken, A. (2019) [Is the National Living Wage working?](#) NIESR blog.

Ebell, M., Speckesser, S., Rolfe, H.; Bursnall, M. & Naddeo, A. (2018) [National Minimum Wage and National Living Wage Impact Assessment: Counterfactual research](#), Department for Business, Energy and Industrial Strategy, NIESR report.

Hudson-Sharp, N., Manzoni, C., Rolfe, H. & Runge, J. (2019) [Understanding employers' use of the National Minimum Wage youth rates](#), Low Pay Commission, NIESR report.

Runge, J. (2019) [Younger workers: the political battle ahead on the minimum wage](#), opinion piece in Personnel Today