

The future path of minimum wages

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Key findings

1. Labour and the Conservatives both plan to take the minimum wage to a historical high and give the UK one of the highest minimum wages among developed countries.
2. The Conservatives have pledged to raise the National Living Wage (NLW) to two-thirds of median hourly wages by 2024 and extend it to 21- to 24-year-olds. This is around 7% higher than expected under current policy for those aged 25 and over and 16% higher for 21- to 24-year-olds.
3. Labour plans to introduce a £10 minimum wage in 2020 for all employees aged 16 and over. This represents a 17% increase on current plans for those aged 25 and over and a 26% increase for 21- to 24-year-olds. It would increase minimum wages for 18- to 20-year-olds by 58% and for 16- and 17-year-olds by 123%.
4. Around 1.9 million employees aged 21 and over (8%) are paid at or below the minimum wage in 2019, set to increase to around 2.3 million (9%) in 2020 under current policy. Under the Conservatives' plans, the number of employees directly affected would double to 4.3 million – about one-in-six employees – by 2024. Under Labour, it would treble to 6.5 million – or one-in-four employees – by 2020.
5. Women, part-time workers and those in the North of England and Wales would be most affected. Among employees aged 21 and over, a third of women, nearly half of part-time workers and around 30% of those in Wales and the North would be directly affected by Labour's £10 minimum wage. More than half of all employees aged 21 and over in the hospitality sector would have their wages effectively set by the government under the Conservatives' plans, and nearly two-thirds under Labour.
6. The Conservatives' plans would see the share of 21- to 24-year-old employees directly affected by the minimum wage rise from 9% today to 36% by 2024. Under Labour policy, 49% of 21- to 24-year-old employees, 82% of employed 18- to 20-year-old employees and 94% of 16- and 17-year-old employees would be directly affected by the minimum wage.
7. The direct benefits from minimum-wage increases would mostly go to middle- and higher-income households. Only 22% of minimum-wage workers today live in the lowest-income fifth of working households, and only 19% live in a household that is in relative poverty. Many of those who live in low-income households will see part of their gains from higher wages clawed back through reduced entitlements to means-tested benefits such as universal credit.
8. There is clearly a good case for further increases in the minimum wage if the aim is to help the low-paid. The evidence suggests that minimum-wage rises so far have substantially boosted earnings, and there is little evidence of negative effects on employment or hours of work. This includes early studies of the post-2015 National Living Wage, though the evidence on that is more tentative at this stage.
9. But caution is still required when going about further rises. Previous evidence is of very limited use when assessing the likely impacts of large additional increases. Both parties' plans would take us well into uncharted waters for the UK, while Labour's

plans would take us beyond where any similar economy has gone. Beyond some (unknown) point, a sufficiently high minimum wage must reduce employment. We need to tread carefully to boost the wages of the low-paid without damaging employment prospects too severely.

10. A concern with both parties' proposals, then, is not the scale of ambition but the implied process for trying to get there. Both parties are moving away from the previous model, based on evidence-based recommendations from an independent commission. Labour's plans in particular would leave no time to respond if it turns out that the appropriate minimum wage is somewhere between its current level and £10 per hour, since the evidence on any negative employment effects would take time to come in and yet the minimum would have been raised to £10 in one fell swoop. If parties engage in a bidding war over minimum wages, they may end up hurting the very people they hope to benefit.

Both parties plan to raise the minimum wage to unprecedented highs

Since 2016, the UK has had a separate minimum wage for employees aged 25 and over, termed the National Living Wage (NLW). In 2019–20, it is set at £8.21 an hour, which is equivalent to 59% of median hourly wages for those aged 25 and over (excluding apprentices). Under current policy, the NLW is set to reach 60% of median hourly wages in 2020–21, at £8.53.

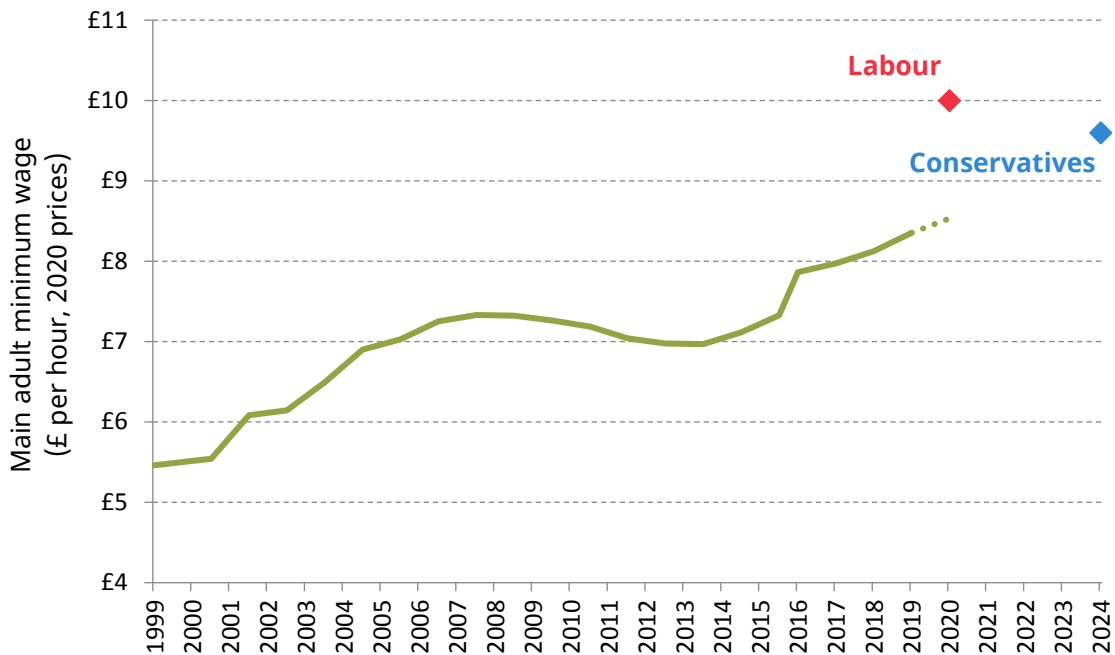
As Figure 1 shows, this comes after years of gradual increases that were accelerated after the NLW was introduced. The minimum wage has risen by 14% in real terms since 2015, far outpacing growth in real average hourly wages of just 4% over this period.

Minimum wages are lower for younger workers: £7.70 for 21- to 24-year-olds, £6.15 for 18- to 20-year-olds and £4.35 for 16- and 17-year-olds (Table 1). There is a separate apprentice rate of £3.90.

Both the Conservatives and Labour propose to increase the NLW further and to extend it to younger age groups. The Conservative party has pledged to extend the NLW to 21- to 24-year-olds, and to 'end low pay' by 2024 by raising it to two-thirds of median hourly wages (a common definition of low pay). This would be calculated against median pay for those aged 21 and over, rather than those aged 25 and over, but would still be a substantial increase on current plans. Two-thirds of median wages for those aged 21 and over is currently £8.85 per hour, which is equivalent to around 64% of median wages for those aged 25 and over.

The Labour party plans to raise the minimum wage to £10 an hour in 2020 for all employees 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. The policy would be particularly dramatic for younger employees: if current youth rates were to rise in line with forecast growth in average hourly wages, the 16–17 and 18–20 rates would be just £4.48 and £6.33 respectively in 2020. So under Labour's proposals, the minimum wage for 16- and 17-year-olds would be 123% higher, and for 18- to 20-year-olds 58% higher, than under current policy.

Figure 1. Real minimum wage for employees aged 25 and over (2020 prices)



Note: Shows 22+ rate from April 1999 to October 2009, 21+ rate from October 2010 to October 2015 and National Living Wage (25+) from April 2016 to April 2019. Adjusted for inflation using the Consumer Prices Index, from Q2 (April) or Q4 (October) in the year/month of introduction to 2020 Q2. Current policy in 2020 and Conservative party plans for 2024 based on the median wage increasing in line with forecast average hourly wages.

Source: Authors' calculations using Low Pay Commission statistics, ONS (series D7BT), OBR's Economic and Fiscal Outlook March 2019 and the Annual Survey of Hours and Earnings 2018.

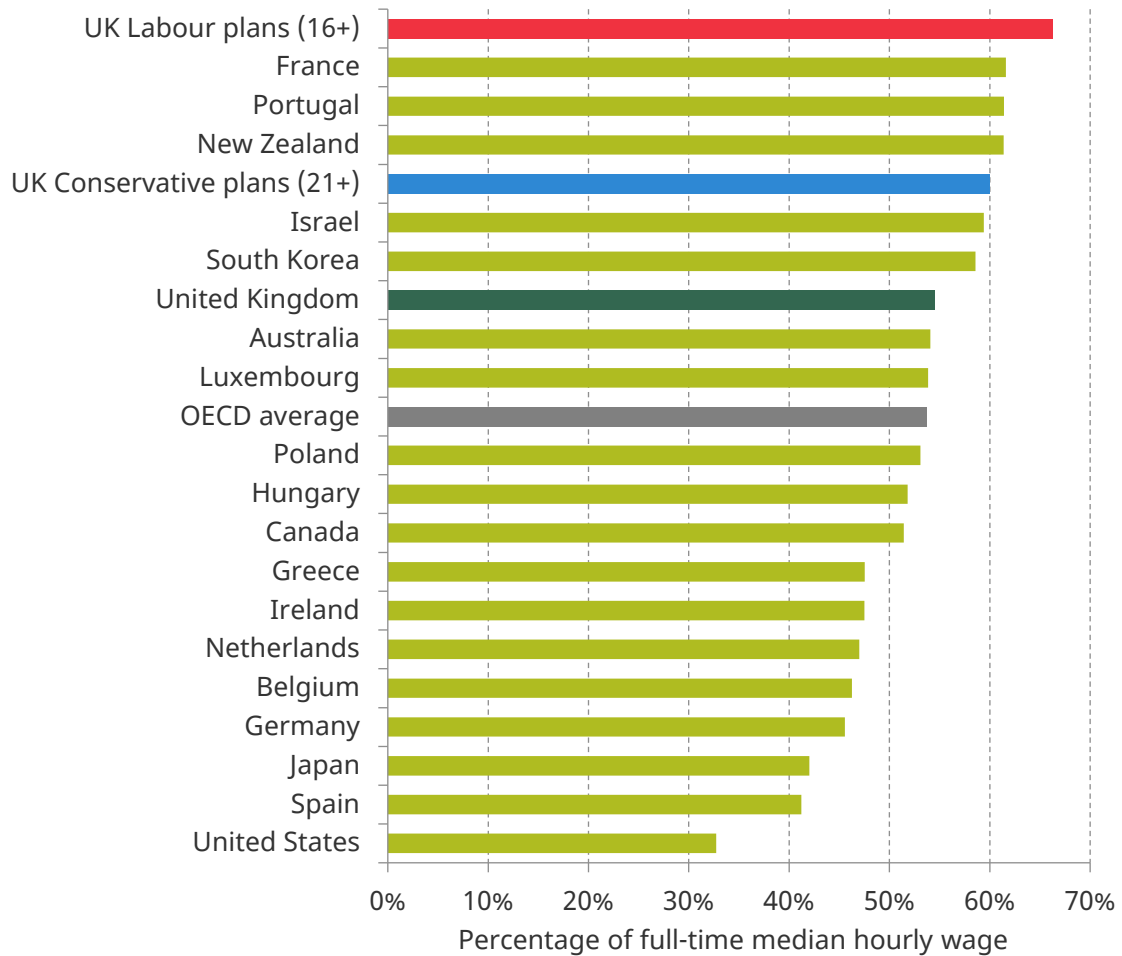
Table 1. Minimum wages by age group in 2020 and 2024 (cash terms)

Year	Policy	25+	21-24	18-20	16-17
2019	Current	£8.21	£7.70	£6.15	£4.35
2020	Current	£8.53	£7.92	£6.33	£4.48
	Conservatives	-	-	-	-
	Labour	£10.00	£10.00	£10.00	£10.00
2024	Current	£9.68	£8.99	£7.18	£5.08
	Conservatives	£10.39	£10.39	£7.18	£5.08
	Labour	£11.34	£11.34	£11.34	£11.34

Note: Assumes under current policy NLW will rise to 60% of median hourly wages in 2020 and with forecast average hourly wages thereafter. NLW under Labour assumed to rise to £10 in 2020 and with forecast average hourly wages thereafter. Youth rates assumed to rise with forecast average hourly wages unless otherwise specified. Uses forecasts for Q2 (April) in all years.

Source: Authors' calculations using Low Pay Commission statistics, OBR's Economic and Fiscal Outlook March 2019 and the Annual Survey of Hours and Earnings 2018.

Figure 2. International comparisons: minimum wage as a percentage of full-time median hourly wage



Note: Uses age group that the main rate of the minimum wage covers in each country. Median wages in 2020 (Labour) and 2024 (Conservatives) calculated by increasing current median wage in line with forecast average hourly wage growth. OECD average is the simple average, excluding countries where wage floors are set at the industry level through collective agreements. Figures for countries such as the US and Canada represent federal minimums, which are often overridden by state- or province-level minimums. For the UK, full time is defined as employees working more than 30 paid hours per week, or 25 or more for teaching professions. Uses forecasts for Q2 (April) in all years.

Source: OECD Employment and Labour Market Statistics (<https://doi.org/10.1787/data-00313-en>) and authors' calculations using the Annual Survey of Hours and Earnings 2018 and OBR's Economic and Fiscal Outlook March 2019.

Minimum wages are already high in the UK compared with similar countries. Figure 2 plots minimum-wage rates across a number of OECD countries as a percentage of median full-time hourly wages (note that this OECD measure of median wages is slightly lower than the figures above, since they exclude part-time workers who on average earn less per hour). The graph shows that the UK was in the upper-middle of comparable countries in 2018, and slightly above the OECD average.¹

¹ Small definitional differences mean that the figures we calculate using the Annual Survey of Hours and Earnings elsewhere in this briefing note differ slightly from the OECD statistics. In 2018, we calculate a bite of 53% against full-time workers, compared with the OECD figure of 54%.

The increases proposed by both parties would give the UK one of the highest minimum wages among developed countries. The only OECD countries with higher minimum wages than Labour's plans (relative to median full-time hourly wages) are Turkey, Chile, Costa Rica and Colombia, all of which are clearly very different economies from the UK in many respects, including the fact that they have a far larger informal sector where the minimum wage does not apply.

The introduction of the NLW in 2016 and subsequent rises have substantially boosted low wages and earnings. 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. So far, there is little evidence of negative effects on employment.²

However, the dramatic rises in the minimum wage proposed by the Conservatives and Labour would take us into uncharted waters. No other country has attempted such a large rise from such a high base, so past evidence is of limited use in predicting future impacts. We know that minimum wages must at some point reduce employment, but the evidence base does not tell us much about how close we are to that point.

Alongside the rise in the minimum wage, a number of other reforms in recent years have pushed up employer costs. These include the introduction of the apprenticeship levy in 2017 and a rise in employers' minimum pension contributions from 2018. The Conservative party also has plans to lower the age limit to which auto-enrolment applies (from 22 to 18) and to extend the range of earnings used to calculate minimum contributions. These reforms may make it more challenging for companies to absorb further increases in the minimum wage.

Share of employees aged 21 and over affected by the minimum wage would double under the Conservatives and triple under Labour – with women, part-time workers and the hotels and restaurants sector most affected

Figure 3 shows the share of employees aged 21 and over who would be directly affected by the proposed increases in the NLW under current policy, Labour plans for 2020 and Conservative plans for 2024. It measures the share of employees expected to earn less than the wage floor, given the current distribution of pay adjusted for forecast growth in hourly wages. Note that this does not imply that all employees who are directly affected would be paid exactly the new minimum wage, nor that other workers on slightly higher wages might not also see wage increases as employers may decide to maintain pay differentials (see below).

Around 1.9 million employees aged 21 and over (8%) are paid at or below the (relevant age-specific) minimum wage in 2019 – a figure that is set to increase to around 2.3 million (9%) in 2020 given the current target of 60% of median hourly wages for those aged 25 and over. Under Conservative policy, coverage of the minimum wage would more than

² For an overview of the UK and international evidence, see A. Dube, *Impacts of Minimum Wages: Review of the International Evidence*, 2019 (https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/844350/impacts_of_minimum_wages_review_of_the_international_evidence_Arindrajit_Dube_web.pdf).

double to 4.3 million employees by 2024 (17%). Labour's plans would see the number of employees directly affected by the minimum wage triple to 6.5 million in 2020 and coverage rise to 26%. In other words, under Labour one-in-four employees would be paid the minimum wage, while under the Conservatives this would be true of one-in-six employees.

One might wonder why the difference between the two parties is so large, when Labour's £10 minimum wage would only be 40p per hour higher than the Conservatives' in 2020 prices (see Figure 1). There are two reasons for this. First, Labour plans to bring in the new rate in 2020, whereas the Conservatives are targeting 2024, when pay will have risen across the distribution. As Table 1 shows, if Labour increased the NLW in line with average hourly wage growth after 2020, by 2024 it would be 95p (9%) higher in 2024 prices than the rate the Conservatives propose. Second, a large share of employees are paid just above the NLW, so even small changes in the threshold can lead to large increases in the number of people affected. In 2018, around 3½ million employees aged 25 and over were paid within £1 higher than the NLW.³

Low pay is more prevalent among certain types of people, places and jobs, so the share of people aged 21+ affected by minimum-wage rises will vary considerably across different groups. The Conservatives' plans would cover around a fifth of women, a third of part-time workers and a fifth of those in the North of England and Wales. Under Labour, the figures would be even higher, at a third of women, nearly half of part-time workers and around 30% of employees in the North and Wales.

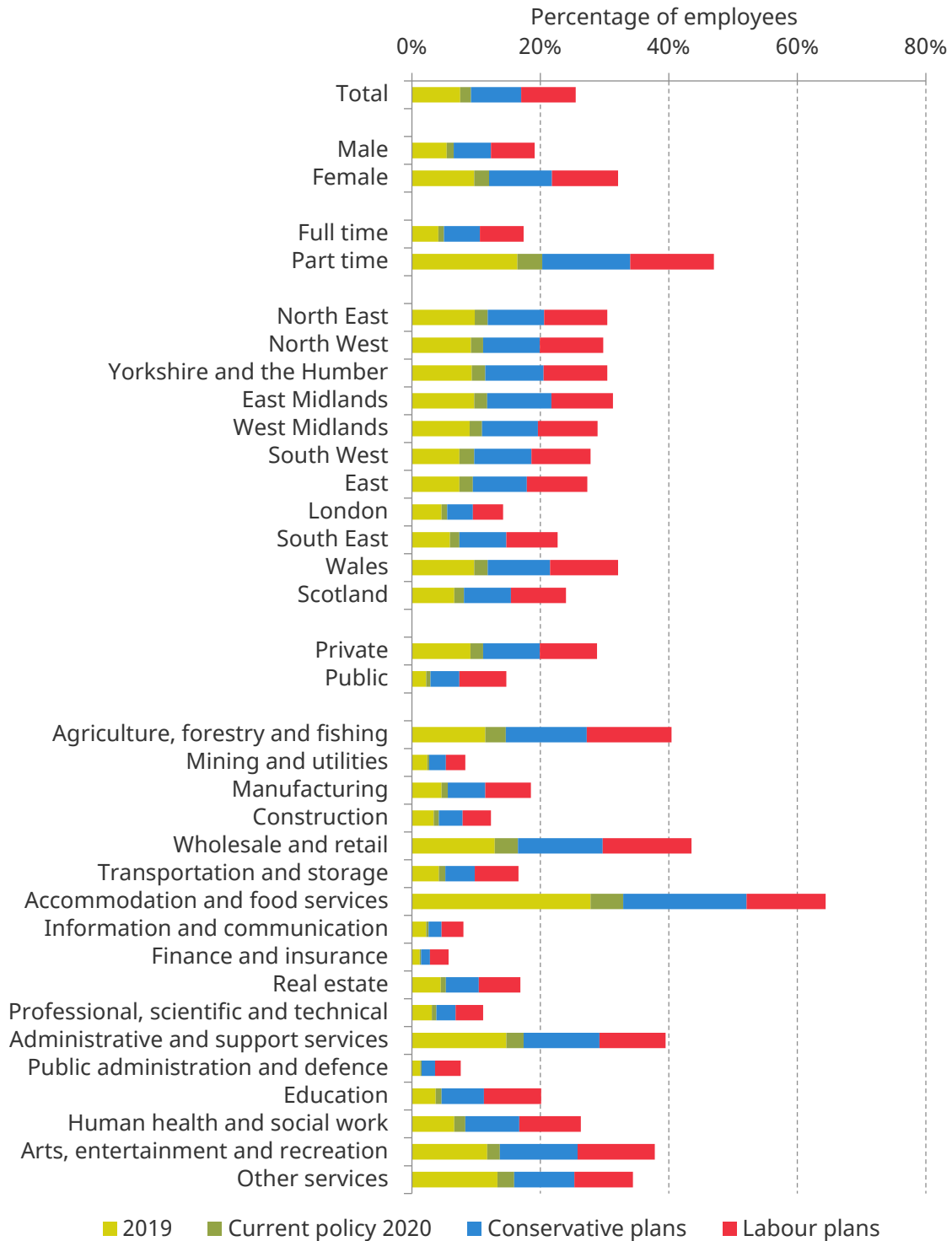
Certain low-paying sectors would be heavily affected by both parties' plans. More than half of all employees aged 21 and over in the accommodation and food sector currently earn less than 66% of median hourly wages – the minimum wage proposed by the Conservatives – and 64% would be expected to earn less than the £10 an hour proposed by Labour in 2020. This means that under the parties' proposals, the government would effectively set the pay of a majority of employees in the hotels and restaurants sector. The wholesale and retail, administrative and support services and agricultural sectors would also be greatly affected.

The substantial variation in coverage of the minimum wage across industries suggests that increasing wage floors at the sector level might be more appropriate than a nationwide hike in the NLW. Indeed, the Labour party has pledged to introduce sectoral collective bargaining to negotiate minimum terms and conditions at the sector level, which could be extended to cover minimum wages.⁴ There may also be a case for a higher minimum wage in London than in the rest of the country.

³ A. Dube, *Impacts of Minimum Wages: Review of the International Evidence*, 2019 (https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/844350/impacts_of_minimum_wages_review_of_the_international_evidence_Arindrajit_Dube_web.pdf).

⁴ <https://labour.org.uk/press/corbyn-pidcock-announce-ministry-employment-rights-workers-protection-agency/>.

Figure 3. Percentage of employees aged 21+ directly affected by the minimum wage in 2019, under current policy for 2020, under Labour plans for 2020 and under Conservative plans for 2024



Note: Includes employees with observed wages less than the minimum-wage rate. Excludes apprentices in the first year of their apprenticeship. Full time is defined as employees working more than 30 paid hours per week, or 25 or more for teaching professions. 2019 coverage estimated by downrating the 2019 NLW by average hourly earnings growth and applying this to 2018 ASHE data. Uses forecasts for Q2 (April) in all years.

Source: Authors' calculations using the Annual Survey of Hours and Earnings (ASHE) 2018. Excludes Northern Ireland as ASHE does not include Northern Ireland.

Higher minimum wages could also push up pay further up the distribution. Employers may decide to increase pay for some workers by more than required by the new NLW, and for some employees earning more than the new NLW, in order to maintain pay differentials between job grades or to help with recruitment and retention. The Low Pay Commission estimates that the introduction of the NLW in 2016 and subsequent rises have pushed up pay for employees up to about the 30th percentile of the hourly wage distribution.⁵ To the extent that there are ‘spillover’ effects, minimum-wage rises could affect even more employees, and push up employers’ costs by even more, than the direct effects described above.

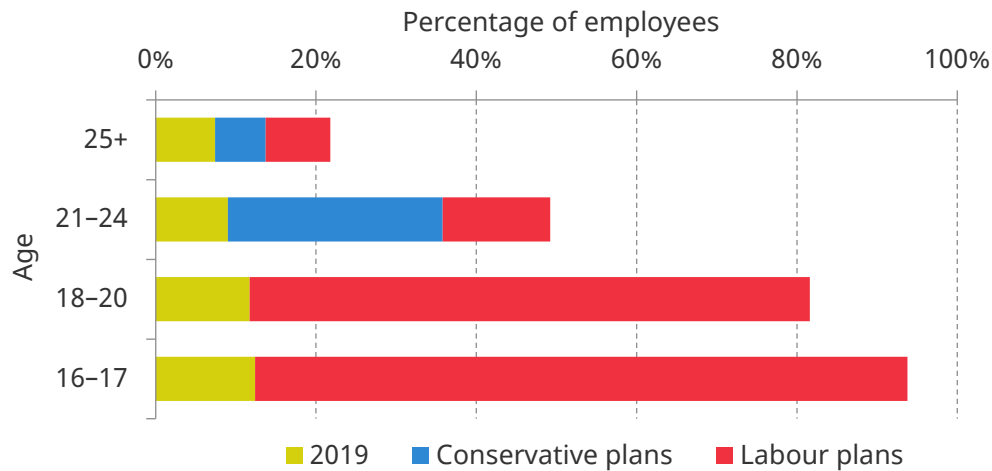
Younger workers would be hugely affected, especially under Labour’s plans

Both parties plan to extend the NLW, which currently applies to those aged 25 and over, to younger age groups. The Conservatives plan to extend the NLW to 21- to 24-year-olds, who currently face a minimum wage of £7.70 an hour, equivalent to 58% of median hourly wages for those aged 21 and over. Increasing this to two-thirds of median hourly wages would quadruple the share of 21- to 24-year-old employees covered by the minimum wage, from 9% today to 36% by 2024 (Figure 5).

Under Labour’s plans, 49% of the 2 million employees aged 21–24 would be directly affected by the minimum wage in 2020, up from 9% today. Labour further proposes to extend its £10 minimum wage to all (non-apprentice) employees aged 16 and over. Currently, 16- and 17-year-olds have a minimum wage of £4.35 an hour while 18- to 20-year-olds have a minimum wage of £6.15 an hour. This means that a Labour government would effectively set pay for almost all young employees: 82% of 18- to 20-year-olds and 94% of 16- and 17-year-olds, 0.3 million and 1.0 million people respectively.

⁵ Low Pay Commission, *The National Living Wage Beyond 2020*, 2019 (https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/844178/The_National_Living_Wage_Beyond_2020_1_.pdf).

Figure 4. Percentage of employees paid the minimum wage in 2019, under Labour (2020) and Conservative (2024) plans by age group



Note: Includes employees with observed wages less than the minimum-wage rate. Excludes apprentices in the first year of their apprenticeship. Uses forecasts for Q2 (April) in all years.

Source: Authors' calculations using the Annual Survey of Hours and Earnings. Northern Ireland not included as ASHE does not include Northern Ireland.

In practice, the difference between the impacts of Conservative and Labour policy for young employees may not be as dramatic as Figure 4 suggests, if the increase in the rate for those aged 21 and over pushes up pay for younger age groups. The Low Pay Commission (LPC) has found evidence of spillovers from the introduction of the NLW to 21- to 24-year-olds. In 2015, a large share of low-paid 21- to 24-year-olds were paid the 21+ minimum wage, but by 2018 there were three clusters at the new 21–24 minimum wage of £7.38, the 25+ NLW of £7.83 and at £8 an hour (also observed for those aged 25+).⁶ A substantial jump in wages for 21- to 24-year-olds may similarly put pressure on employers to increase pay for younger employees. This seems most likely in certain parts of the economy – in particular, those sectors or firms where younger and older workers are most commonly found together.

The LPC recently recommended extending the NLW to 21- to 24-year-olds.⁷ This recommendation was based on similarities in the characteristics of these workers to older workers, stakeholders' perceptions of fairness and previous research on employment effects by age – which was indeed why, prior to the introduction of the NLW, the main adult rate started from 21.

But Labour's plans to apply the same minimum wage to 16- to 20-year-olds in one fell swoop carry substantial risks. We have had lower minimum-wage rates for younger employees since the introduction of the minimum wage in 1999, and for good reason: younger employees are, on average, likely to be less experienced and less productive than

⁶ Low Pay Commission, *A Review of the Youth Rates of the National Minimum Wage*, 2019 (https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/845076/A_Review_of_the_Youth_Rates_of_the_National_Minimum_Wage.pdf).

⁷ Low Pay Commission, *A Review of the Youth Rates of the National Minimum Wage*, 2019 (https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/845076/A_Review_of_the_Youth_Rates_of_the_National_Minimum_Wage.pdf).

older ones, and more likely to require on-the-job training. Imposing the same minimum wage for all risks making it unprofitable for employers to hire young people, or at least putting them at a competitive disadvantage relative to older employees, or – absent substantial rises to the apprentice rate – relative to apprentices. The risks of unemployment for younger workers are arguably especially pertinent, given the formative stages of their careers and the potential for long-term damage from early career disruption. For all these reasons, the LPC did not recommend changing the minimum-wage structure of 16- to 20-year-olds in its recent review of youth rates.

Middle- and higher-income households benefit most from minimum-wage increases

The rebranding of the minimum wage as a ‘living wage’ suggests that politicians increasingly see the minimum wage as a main way to improve living standards. Over the last parliament, the Conservative government implemented successive cuts to working-age benefits whilst raising the minimum wage. The Labour party has also made its £10 ‘real living wage’ a cornerstone of its ambition to end in-work poverty by 2024.⁸

In this context, it is important to understand what kinds of distributional outcomes minimum wages do, and do not, achieve. They clearly can boost pay substantially for low earners. In broader debates about living standards, though, the more relevant issue is what happens to those with the lowest household incomes, after taxes and benefits.

Viewed this way, it is not the case that the poorest households benefit most from the minimum wage. Many low-paid workers are not in especially low-income households, partly because many live with higher-earning household members, and partly because household incomes depend on hours of work as well as hourly wages. On the first point, more than a third (36%) of minimum-wage workers today live with a higher-earning partner, and a further 14% live in a household with a higher earner. On the second point, of all households in in-work poverty, only a fifth have someone on the minimum wage – which indicates that in-work poverty is often about low working hours rather than low hourly pay. Further, minimum-wage workers who do live in low-income households often see part of their gains from higher wages clawed back through reduced entitlements to means-tested benefits such as tax credits or universal credit.

Figure 5 shows the distribution of minimum-wage workers today across household incomes. The vast majority live in middle-income households, and only 17% live in the poorest fifth of households (22% in the poorest fifth of working households). Less than a fifth of minimum-wage workers live in households in relative poverty.⁹

⁸ See, for example, John McDonnell’s speech at the Resolution Foundation, 17 July 2019 (<https://labour.org.uk/press/john-mcdonnells-speech-resolution-foundation/>).

⁹ Defined as having total net household income of less than 60% of median. Net household incomes are calculated after housing costs have been deducted (AHC).

Figure 5. Percentage of employees on the minimum wage by household income decile



Note: Shows total net household income (before housing costs) equivalised using the OECD equivalence scale. Hourly wages for low-paid workers are imputed based on employees paid by the hour in the Labour Force Survey to correct for downward bias in derived hourly wages in survey data (e.g. see M. Stewart and J. Swaffield, 'Using the BHPS Wave 9 additional questions to evaluate the impact of the National Minimum Wage', *Oxford Bulletin of Economics and Statistics*, 2002, 64, 633-52, <https://doi.org/10.1111/1468-0084.64.s.4>).

Source: Authors' calculations using the Family Resources Survey and the Labour Force Survey.

It may be possible to raise the minimum wage significantly further without endangering employment – but no one knows, so we should proceed carefully

Recent increases in the minimum wage in the UK and elsewhere have substantially boosted wages and earnings at the bottom, with little evidence of having reduced overall employment.¹⁰ The history of minimum wages across the world is one of repeated warnings or concerns about the risks, followed by reassurance that these do not seem to have materialised much in practice. Coupled with the fact that low pay is rightly one of the major concerns of domestic policy right now, the case for further minimum-wage rises looks strong.

However, to infer from the evidence so far that caution about minimum-wage rises is unnecessary is to misunderstand the issue fundamentally. It is true that the evidence seems to rule out some of the very simplest models of the labour market on which the earliest predictions were made – a market which is perfectly competitive, where workers are always paid according to their productivity, and hence where *any* mandated wage rise would price them out of a job. But even in the imperfectly competitive labour market that

¹⁰ See, for example, A. Dube, *Impacts of Minimum Wages: Review of the International Evidence*, 2019 (https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/844350/impacts_of_minimum_wages_review_of_the_international_evidence_Arindrajit_Dube_web.pdf).

we seem to have, there still comes a point beyond which a minimum-wage rise will reduce employment – when the wage floor exceeds the value of what workers can produce.

In other words, as much as past minimum-wage rises do not seem to have reduced employment, there remains no question that a sufficiently large additional rise would do so. The question is where the tipping point is, and whether the parties' plans would take us over that point.

Higher minimum wages may have other negative effects on low-paid workers, beyond reducing their employment, and again we need to look for empirical evidence about when and where those effects materialise. Firms may find ways of passing higher wage costs onto workers – for example, by lowering non-wage benefits or varying contractual arrangements to transfer business risk onto workers and/or bypass the minimum wage. Increases in the NLW may encourage companies to contract out work, or relabel employees as independent contractors, as the minimum wage does not apply to the self-employed. There is some preliminary evidence that rising minimum wages contributed to the increase in self-employment in Germany.¹¹ Research on the social care sector in the UK found that the introduction of the NLW increased the prevalence of zero-hours contracts.¹²

It is also important to note that, even if increases in the minimum wage do not lead to adverse effects on workers, employers will have to adjust to higher wage bills in some way. Whether through higher prices, lower profits or reduced quality of goods and services, any extra wage cost ultimately has to be borne by someone. A number of studies have been able to trace these kinds of effects. About three-quarters of the recent rise in minimum wages in Hungary was found to be paid for by consumers in the form of higher prices,¹³ and a study of the social care sector in the UK found that the NLW led to a deterioration in the quality of service.¹⁴

To some degree, it is possible to square the circle if the cost pressures induced by rising minimum wages spur productivity improvements. In that way, wage gains for beneficiaries need not be entirely offset by losses for others. There is some evidence of minimum wages increasing productivity by reducing turnover and shifting employment towards more productive firms.¹⁵ But again, this is only possible up to a point – the scope for productivity improvements at any point in time is finite, so a high enough minimum wage would still make it unprofitable to employ some people and would mean that the costs must be picked up by someone else.

¹¹ A. Ganserer, T. Gregory and S. Wagner, 'Minimum wages and solo self-employment - a synthetic control group approach', 2017 (https://editorialexpress.com/cgi-bin/conference/download.cgi?db_name=EEAESEM2017&paper_id=2080).

¹² N. Datta, G. Giupponi and S. Machin, 'Zero hours contracts and labour market policy', 2018 (http://www.economic-policy.org/wp-content/uploads/2018/09/996_Zero-Hours-Contracts.pdf).

¹³ P. Harasztosi and A. Lindner, 'Who pays for the minimum wage?', *American Economic Review*, 2019, 109, 2693–727 (<https://www.aeaweb.org/articles?id=10.1257/aer.20171445>).

¹⁴ G. Giupponi and S. Machin, 'Changing the structure of minimum wages: firm adjustment and wage spillovers', Centre for Economic Performance (CEP), Discussion Paper 1533, 2019 (<http://cep.lse.ac.uk/pubs/download/dp1533.pdf>).

¹⁵ See, for example, C. Dustmann, A. Lindner, U. Schönberg, M. Umkehrer and P. vom Berge, 'Reallocation effects of the minimum wage: evidence from Germany', 2019 (<http://sarkoups.free.fr/dustmann719.pdf>).

Minimum wages should be set with careful consideration of trade-offs

Setting the minimum wage should therefore be a careful balancing act between wages and employment, with consideration of other adverse effects. While it does require some political judgement – how to trade off wage gains for the low-paid against more broad-based price increases for consumers, for example – it mainly requires evidence-based, technocratic judgement.

As Professor Arin Dube writes in his review of minimum wages for HM Treasury, ‘exactly how far one can push the minimum wage before job losses start becoming pronounced is an empirical question’.¹⁶

The fact that governments want to boost wages at the bottom without harming employment prospects for the same people points towards an approach of incremental increases in the minimum wage alongside careful monitoring of labour market outcomes. Judging the speed at which the wage should rise is art (and politics) as well as science, but a government should recognise three facts:

1. the evidence on the labour market impacts of a rise in the minimum wage does not arrive instantly, and indeed can take years (though improving data availability could speed the process up and improve the quality of evidence);
2. it would be very difficult to lower the minimum wage instantaneously were we to ‘overshoot’, so the process of adjustment may be slow, probably involving freezing it in cash terms for some period and letting earnings growth reduce its bite;
3. the consequences of overshooting are not necessarily easy to reverse. Once companies invest in labour-replacing capital, for example, or young people lose out on formative work experience, it may not be possible to undo the damage.

Until 2015, minimum wages were set based on a recommendation from the independent Low Pay Commission, tasked with identifying the highest rate deemed possible without damaging employment based on careful consideration of the evidence. The fact that the introduction of the NLW did not reduce employment means that, in one key respect, the LPC did its job. One could argue that it should have been bolder, on the basis that there were other developed economies with higher minimums with little evidence of large negative effects. Even this is arguable without the benefit of hindsight, since it is rarely clear whether evidence from different countries can confidently be applied to the UK.

Either way, this does not provide a good reason to politicise what is essentially an empirical and high-stakes trade-off – not least because higher wages will garner immediate praise, while the risks may take longer to materialise, and they may materialise (or be shown to have materialised) over a time span longer than the electoral cycle.

Labour’s plans in particular would leave no time to respond if it turns out that the appropriate minimum wage is somewhere between its current level and £10 per hour,

¹⁶ A. Dube, *Impacts of Minimum Wages: Review of the International Evidence*, 2019 (https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/844350/impacts_of_minimum_wages_review_of_the_international_evidence_Arindrajit_Dube_web.pdf).

since the evidence on any negative employment effects would take time to come in and yet the minimum would have been raised to £10 in one fell swoop. This is a gamble.

The rebranding of the minimum wage as a 'living wage' is also dangerous. The concept of a living wage fundamentally divorces the setting of the minimum wage from the trade-off between pay and employment. The wage level required to guarantee workers a decent standard of living may be one that leads to huge job losses. In the long run, living standards are determined by the economy's productivity – and our lagging productivity record is not a problem that can be solved by minimum wages alone.

Minimum wages can play an important role in raising living standards, and have become an important part of a government's toolkit in addressing low pay. Recent increases in the minimum wage have substantially bolstered earnings at the bottom without reducing employment, and there may well be scope to increase the wage floor further. But what we need is a process that boosts the wages of the low-paid while limiting the risks to their employment prospects. There is substantial risk to parties engaging in a political bidding war over minimum wages, without due consideration of the trade-offs involved.