Institute for Fiscal Studies

Minimum wages in the next parliament

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Jonathan Cribb, Robert Joyce and
Agnes Norris Keiller

Nuffield Foundation

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Jonathan Cribb, Robert Joyce and Agnes Norris Keiller[1]

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Key findings

1. The Conservatives and the Labour Party both plan increases in the minimum wage by 2020 that would take it to a historic high. For those aged 25 and over, the Conservative plan would result in the minimum wage being £8.75 per hour in 2020. This is 5% higher than if it increased from its current level in line with average earnings. Under the Labour plan, it would be £10 per hour in 2020, which is 20% higher than under average earnings indexation.
2. A higher minimum wage may be effective at boosting the wages of low earners. However, a significantly increased wage for some workers must be paid for by other households via some combination of reduced profits, higher consumer prices, and lower earnings for higher-paid workers. Crucially, there must also be a point beyond which higher minimum wages have substantial negative impacts on employment. That point is not known, which makes any large and sudden increase inherently risky.
3. 4% of employees aged 25 and older were paid the national minimum wage in 2015. The Conservatives' 'national living wage' currently covers 8% of employees aged 25 and over. This is forecast to rise to 12% under current Conservative plans by 2020 and to 22% in 2020 under Labour plans. In other words, over just five years, we are looking at either a threefold increase or a more-than-fivefold increase in the proportion of employees aged 25 and over paid the minimum wage.

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4. The minimum wages proposed by both parties are also high relative to those in other comparable countries. Labour’s plans would result in a minimum wage level (relative to average earnings) similar to that in France, which is the highest among comparable countries.

5. Part-time, female and private sector employees and those in the North of England, the Midlands and Wales are most likely to be affected by the proposed increases. For employees aged 25+, under Labour’s plans, the government would effectively set the wage of around one-quarter of female employees, of private sector employees, and of employees in the Midlands, the North of England and Wales. It would be setting the wages of almost half of part-time employees aged 25 and over.

6. The benefit from minimum wage increases is concentrated among middle-income households, not the lowest-income households. A few factors explain this. Many individuals on low wages are in middle- or high-income households as a result of the earnings of their partner; many of the lowest-income households have no one in work at all; and low-income households that do gain are likely to see significant reductions in means-tested benefits as a result of higher wages, offsetting some of the gains.

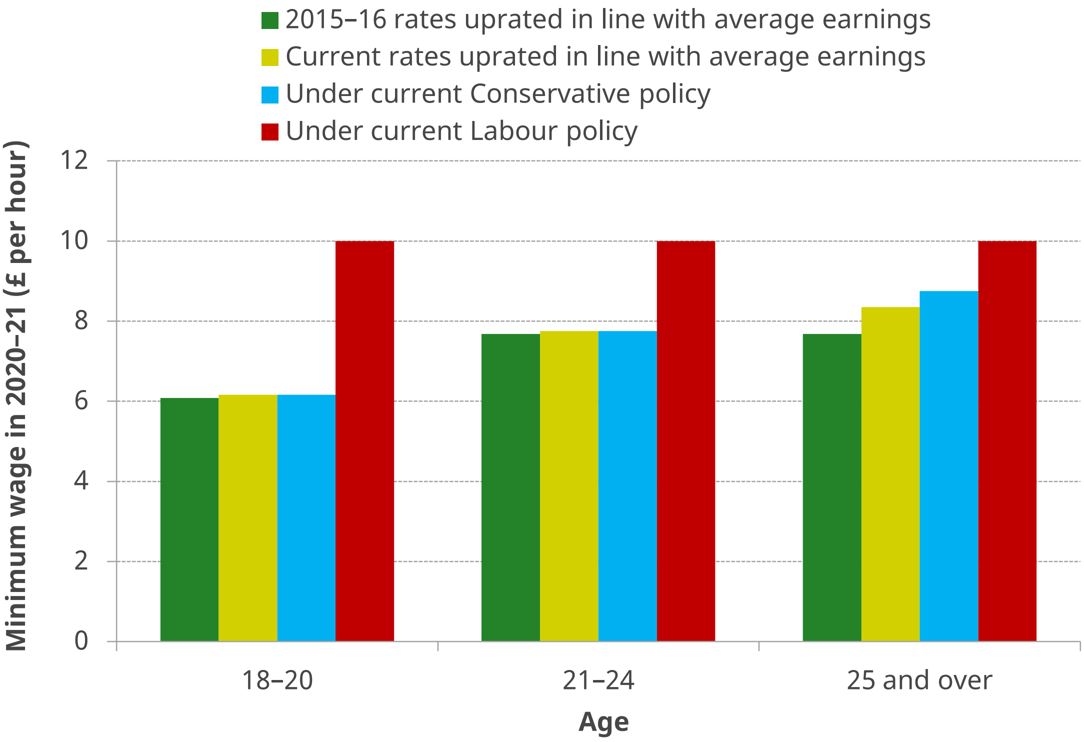
7. Labour’s plan to extend their proposed £10 minimum wage to all employees aged 18 and over amounts to a 62% increase in the minimum wage for 18- to 20-year-olds and a 29% increase for 21- to 24-year-olds, relative to earnings indexation. This would mean that 60% of 18- to 24-year-old employees would be paid the minimum, including 77% of those aged 18–20. Given that unemployment can have severe and long-lasting effects on young people, even a modest negative employment impact resulting from such large increases in their minimum wages would be a cause for considerable concern.

8. Both parties’ plans imply big increases in the costs of employing workers. The Conservative plan raises the cost of employing at least 2.8 million workers by 4% on average; the Labour plan raises the cost of employing 7.1 million workers by almost 15% on average. If employers did not cut employment (or hours of work), total employer costs from wages and employer National Insurance would – in the absence of any offsetting compensatory measure – rise by £1 billion per year under the Conservatives and by £14 billion per year under Labour. In addition, there are possible substantial knock-on effects on those with earnings just above the proposed minima, which may be considerable.

9. The Conservative and Labour parties are both moving away from the previous model of minimum wage setting in which the independent Low Pay Commission recommended minimum wage levels while carefully considering the consequences for employment. There may well be a case for higher minimum wages than we have had up to now. But we do not know at precisely what point a higher minimum wage will start having serious negative employment effects. Therefore large and sudden increases create considerable risk that those who are supposed to be the beneficiaries of the policy end up paying the cost in higher unemployment or lower hours of work.

Conservatives plan increases in the minimum wage; Labour's planned increases are much larger and also affect 18- to 24-year-olds

Figure 1. Scenarios for minimum wage rates in 2020–21, by age



Note: Conservative policy is for the national living wage (minimum wage for those aged 25 and over) to reach 60% of median earnings in 2020–21, which is currently forecast to be £8.75 in 2020–21 by the Office for Budget Responsibility (OBR). Given no statements on the rates for younger people, we assume that under Conservative policy, the rates for 18- to 20- and 21- to 24-year-olds would grow in line with average earnings, as forecast by the OBR.

Source: Authors' calculations using OBR Economic and Fiscal Outlook March 2017, Summer Budget 2015 and Labour Party statements.

In 2017–18, minimum wages are £7.50 an hour for those aged 25 and over, £7.05 for 21- to 24-year-olds, £5.60 for 18- to 20-year-olds and £4.05 for 16- to 17-year-olds. There is a separate apprentice rate of £3.50. Both the Conservative Party and the Labour Party have plans to increase minimum wages in the next parliament. Upon the announcement of the national living wage (NLW, the minimum wage for those aged 25 and over) in 2015, the Conservative government announced that the NLW would rise to reach 60% of median (middle) hourly earnings in 2020. This level is currently forecast to be £8.75 in 2020–21: 40p (5%) higher than if the NLW were instead increased in line with average earnings and £1.10 (14%) more than it would have been had the national minimum wage (NMW) increased with average earnings from 2015. The setting of the minimum wages for younger employees aged 16–17, 18–20 and 21–24 remains with the Low Pay Commission, which is meant to set these rates as high as is possible 'without damaging their employment prospects'.

In contrast, the Labour Party has announced that, in government, it would increase the minimum wage to reach £10 per hour for all employees (excluding those eligible for the apprentice rate) aged at least 18 in 2020.[2] This would imply especially large rises in the minimum wage for those aged under 25, who are currently subject to lower rates. Compared with increasing all minimum wage rates in line with average earnings, this amounts to an increase of 20% (£1.65 per hour) for those aged 25 and over, 29% (£2.25 per hour) for 21- to 24-year-olds and 62% (£3.85 per hour) for 18- to 20-year-olds.

Higher minimum wages are not costless and, beyond some (unknown) level, must substantially increase unemployment

Minimum wages do not come for free. First, even where the higher wages are simply paid by employers, those wage increases must be paid for by other people to at least some extent. This is because they will either lead to lower profits, affecting business owners and shareholders (including large numbers of people with pensions invested in listed companies), or higher prices faced by consumers, or pay cuts for other workers (or some combination).

Another potential effect of a higher minimum wage is for workers to be offered fewer hours of work or to lose their jobs – or for unemployed workers not to find one – as it is no longer profitable for employers to employ them. To date, studies of the effect of the minimum wages in the UK (and elsewhere) have not found significant negative effects on employment.[3] Contrary to popular perception, this does not contradict modern economic theory. It contradicts a simple model of a perfectly competitive labour market in which all workers are just paid according to their productivity (or more precisely their 'marginal product'). But it is perfectly possible to explain why a carefully set minimum wage may not have negative impacts on employment. For an overview of the theory and evidence see Manning (2016).[4]

However, there will be a level beyond which a higher minimum wage will start to reduce employment. This is not in doubt and is implied by any reasonable description of how a labour market might work. It should be clear from an extreme example: if wage contracts of less than £100 per hour were outlawed, it would be unprofitable to employ vast swathes of the population and fewer would be employed. What is not clear is at precisely what point substantial job losses would materialise from further increases in the minimum wage.

Minimum wage increases will always, therefore, create both winners and losers. These losers could include shareholders, consumers or higher-paid workers, but they could also be lower-paid workers if the higher minimum wage leads to reduced employment. Hence, whilst a carefully applied minimum wage may well be a useful policy lever to boost the earnings of low-wage workers, it is a policy lever that could harm those it intends to help. Even if politicians accept the risk of lower employment, they should be clear about the potential consequences of their actions: if there are winners then there will be losers too.

[2] See Jeremy Corbyn's speech on 10 April 2017: 'That's why Labour will raise the legal minimum wage for all to at least £10 an hour by 2020'.

[3] However, while the studies do not find short-run negative effects on employment, they do not consider long-run negative impacts as employers slowly switch to using technology instead of labour as a result of the higher minimum wage (see Aaronson, French, Sorkin and To, 'Industry dynamics and the minimum wage: a putty-clay approach', *International Economic Review*, 2017).

[4] A. Manning, 'The elusive employment effect of the minimum wage', CEP Discussion Paper 1428, 2016.

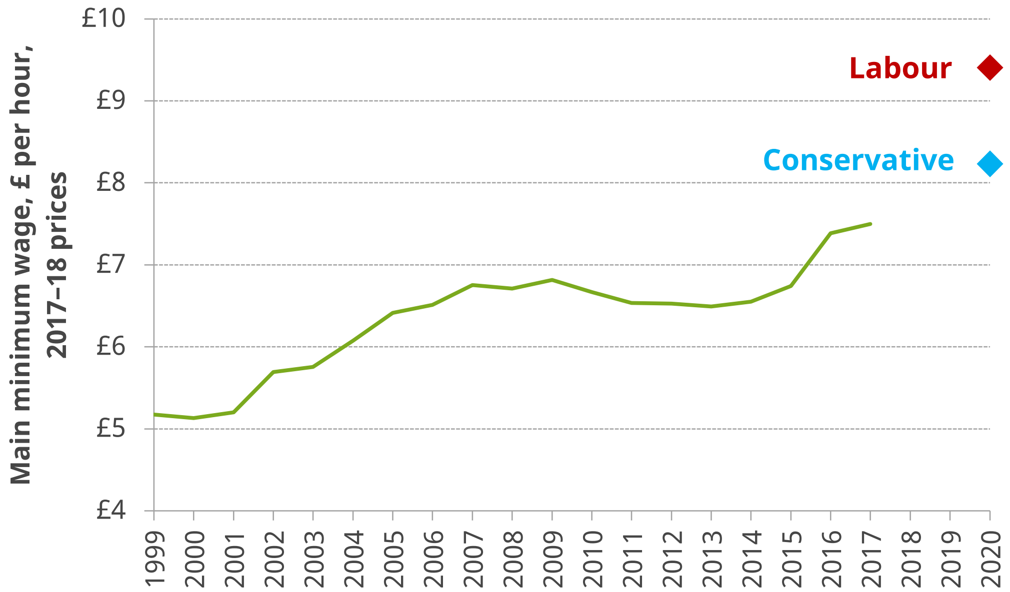
It is possible that a higher minimum wage could boost productivity, perhaps through increases in motivation or morale, or by reducing employee turnover (therefore reducing the amount spent by employers on hiring new employees), or – in the long run – because employers invest more in productivity-enhancing capital. Higher productivity could partially offset reductions to national income caused by lower employment. However, upon the introduction of the NLW, the Office for Budget Responsibility (OBR) assessed that it would decrease national income by 0.1% (about £2.3 billion per year in 2020) overall, implying that the wage gains for those benefiting were more than offset by losses for other households.

Unfortunately, the evidence on the impacts of minimum wages provides very little guidance as to the effect of considerably higher minimum wages than the UK currently has, as proposed by both Conservative and Labour parties. It is therefore very hard to predict how employers and individuals will respond to a minimum wage that is increased as sharply as the main parties are planning.

This briefing note examines how the proposed minimum wages compare with the minimum wages set since 1999 and with minimum wages in other countries. It also looks at which groups of employees will be particularly affected by the proposed policies.

Both parties' plans would see the minimum wage rising to historic highs ...

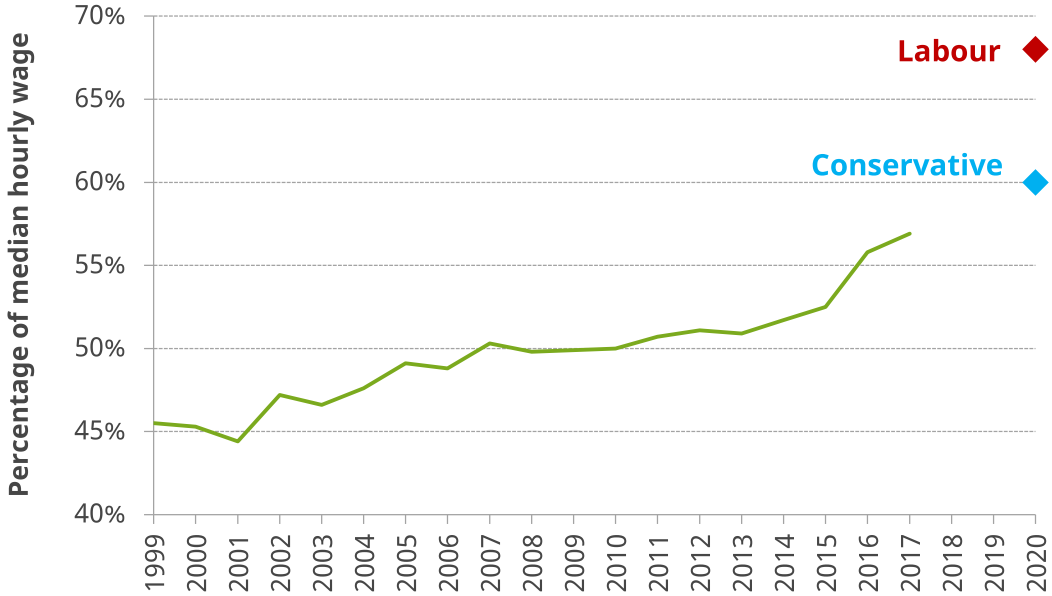
Figure 2. Real minimum wage for employees aged 25 and over, 1999–2017 and under Conservative and Labour plans for 2020



Note: Minimum wage measured in April of each year. National minimum wage for 1999 to 2015; national living wage for 2016 to 2020. Adjusted for inflation using the Consumer Prices Index (OBR forecasts from 2017–18 to 2020–21).

Source: Authors' calculations using Low Pay Commission statistics.

Figure 3. Minimum wage as a percentage of median hourly wages for employees aged 25 and over, 1999–2017 and under Conservative and Labour plans for 2020



Note: Measured in April of each year. National minimum wage for 1999 to 2015; national living wage for 2016 to 2020. Excludes apprentices in the first year of their apprenticeship.

Source: Figure 2.4 of Low Pay Commission Autumn Report 2016 and authors' calculations using the Annual Survey of Hours and Earnings.

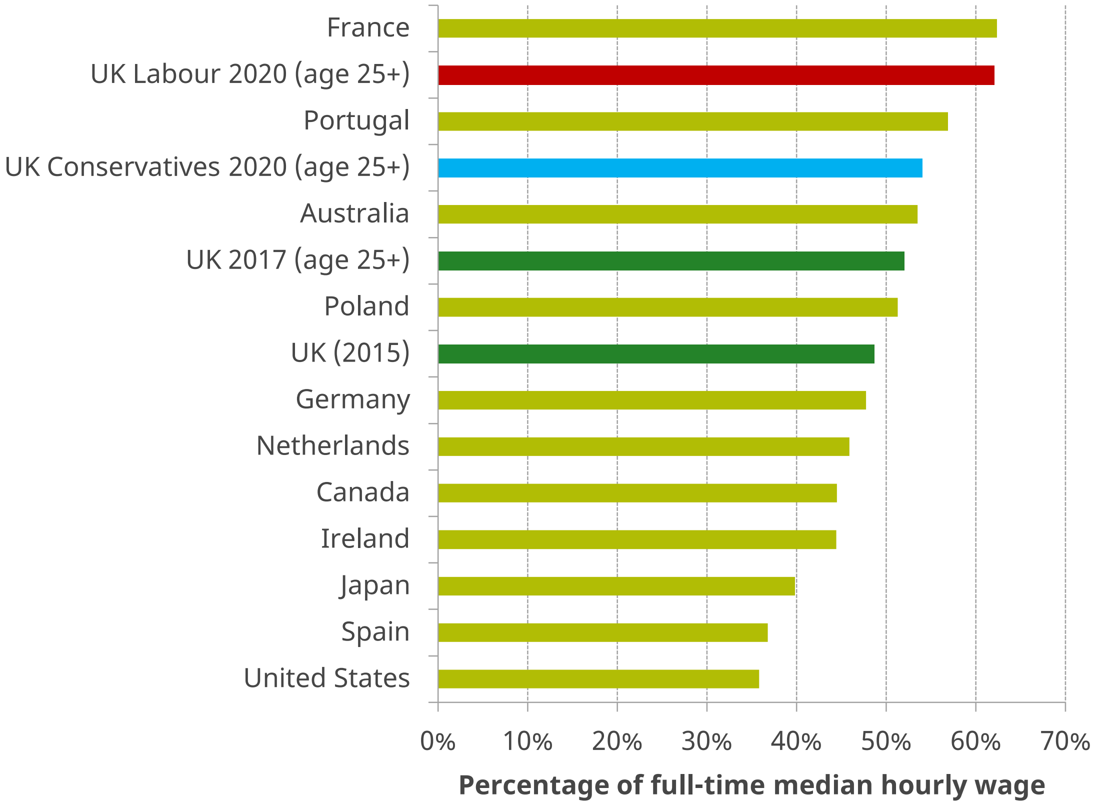
Both Labour's proposals and the Conservatives' plans for the minimum wage represent sizeable increases in the minimum wage received by employees aged 25 and older. Figure 2 shows the Conservatives' NLW is forecast to grow by 10% between 2017 and 2020 (after accounting for inflation), whereas Labour's policy would lead to a 25% increase over the same period.[5] These rises would come on top of growth of 11% just seen over two years between 2015 and 2017 due to the introduction of the NLW in April 2016.

These substantial increases would result in the level of the minimum wage relative to average earnings reaching historic highs. While Figure 3 shows the minimum wage has tended to grow faster than median earnings since its introduction – rising from 46% of median earnings in 1999 to 53% in 2015 – both parties' policies would cause a step change in this trend. The introduction of the NLW has already boosted the share to 57% in 2017. Further rises under a re-elected Conservative government would see the NLW hit 60% of median earnings by 2020 – the official objective of the policy – whereas the minimum wage under a Labour government would be equivalent to 68% of median earnings by 2020.

[5] Note that Labour's minimum wage is not equal to £10 here as we express future cash amounts in current (2017–18) prices (i.e. taking into account the effect of forecast inflation).

... and, especially under Labour, high relative to other comparable countries

Figure 4. Minimum wage as a percentage of full-time median hourly wage



Note: All non-UK figures are for 2015.

Source: OECD Employment and Labour Market Statistics (http://www.oecd-ilibrary.org/employment/data/earnings/minimum-wages-relative-to-median-wages_data-00313-en) and authors' calculations using the Annual Survey of Hours and Earnings.

To place the Conservative and Labour plans in an international context, Figure 4 ranks developed countries by their national minimum wages as a share of average full-time earnings.[6] It shows the UK was roughly in the middle of the international ranking in 2015 and had moved slightly higher by 2017 as a result of the introduction of the NLW. Further increases in the NLW proposed by the Conservatives would see the UK's minimum wage rise to a level similar to Australia's by 2020. Labour's plans, by contrast, would result in a minimum wage similar to that of France, which currently has the highest minimum wage among comparable countries. In this context, it is unfortunate that we have little robust evidence on the impact that France's minimum wage has had on employment.[7]

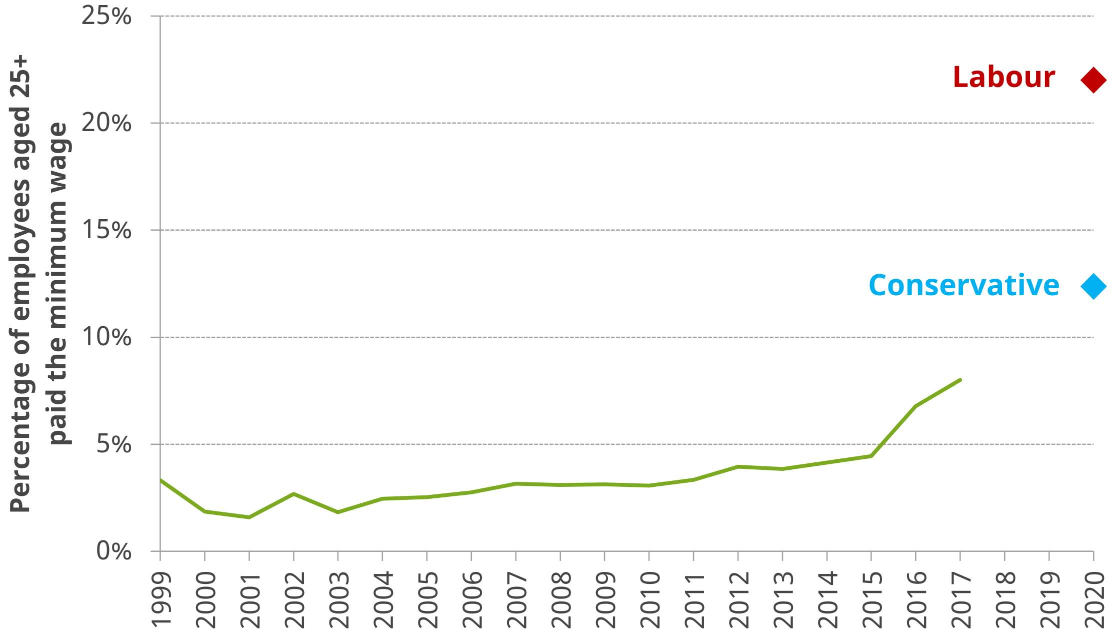
6 We do not include countries such as Italy, Norway and Sweden where pay floors are set using collective bargaining. The shares for the UK shown in Figure 4 differ slightly from those shown in Figure 3 to allow for comparison with available international statistics.

7 See A. Manning, 'The elusive employment effect of the minimum wage', CEP Discussion Paper 1428, 2016. Comparisons between countries are further complicated by substantial differences in other labour market institutions.

Under Conservative plans, and to an even greater extent under Labour, the minimum wage would rise well above levels seen before in the UK, and to amongst the highest levels in comparable countries. To implement these policies would be to take a risk. We do not know what the impact on employment and hours worked would be.

Share of employees aged 25+ paid the minimum wage would rise from 8% now to 12% under Conservative plan or 22% under Labour

Figure 5. Percentage of employees aged 25+ paid the minimum wage, 1999–2017 and under Conservative and Labour plans for 2020



Note: Measured in April of each year. National minimum wage for 1999 to 2015; national living wage for 2016 to 2020. 'Paid the minimum wage' also includes workers with observed pay less than their minimum wage rate. Excludes apprentices in the first year of their apprenticeship.

Source: Figure 2.9 of Low Pay Commission Autumn Report 2016 and authors' calculations using the Labour Force Survey and the Annual Survey of Hours and Earnings.

Figure 5 shows that the minimum wage rises planned by both the Conservatives and Labour are expected to increase substantially the proportion of employees aged 25 or above who are paid at the national wage floor. Whereas only 4% of employees aged 25 and over in 2015 were paid the NMW, and 8% are now (in 2017) paid the NLW, this is forecast to rise to 12% in 2020 under Conservative plans and 22% under Labour plans. In other words, over just five years, we are looking at either a threefold increase or a more-than-fivefold increase in the proportion of employees aged 25 and over paid the minimum wage.

One might wonder why the difference here between the two parties sounds so large, when Labour's £10 minimum wage in 2020 (in nominal terms) would be only £1.25 per hour higher than the Conservatives'. This reflects the fact that a lot of employees are paid slightly more than the current NLW. As a result, even small changes can substantially increase the number of employees paid at the minimum. For example, the relatively small increase of 5% (compared with indexation in line with average earnings) proposed by the Conservatives between 2017 and 2020 still leads to an extra 4% of employees aged 25 and over (940,000 people) being paid the minimum wage.

Higher minimum wages could also have important impact on those who earn more than the new minimum wage. Many of those people will be in jobs that are more skilled or come with more responsibility than minimum-wage jobs, and employers may feel it necessary to increase their pay too to preserve at least some of the differential between their pay and that of lower-paid (and lower-skilled) jobs. This kind of 'spillover' effect has been observed before after the introduction of the NMW in 1999 and also the NLW in 2015.[8] These wage increases increase employers' costs further, and – just as with the pay increases of those on the minimum wage – must ultimately be paid for by other households.

Part-time, female and private sector employees and those in the North, Midlands and Wales most likely to be affected by minimum wage rises

Minimum-wage and other low-paying jobs are more prevalent among certain types of employees. This means the proportion of employees paid at or below the minimum wage under Conservative and Labour plans would vary considerably between different groups. This can be seen in Figure 6, which shows that minimum-wage jobs are most prevalent among part-time (working less than 30 hours per week), female and private sector employees and in the North of England, the Midlands and Wales.

By 2020, these groups would see the greatest rises in the proportion of employees paid at the minimum wage under both Conservative and Labour plans. Hence these groups face the greatest potential gain from higher minimum wages, but also probably the greatest risk of substantial job losses.

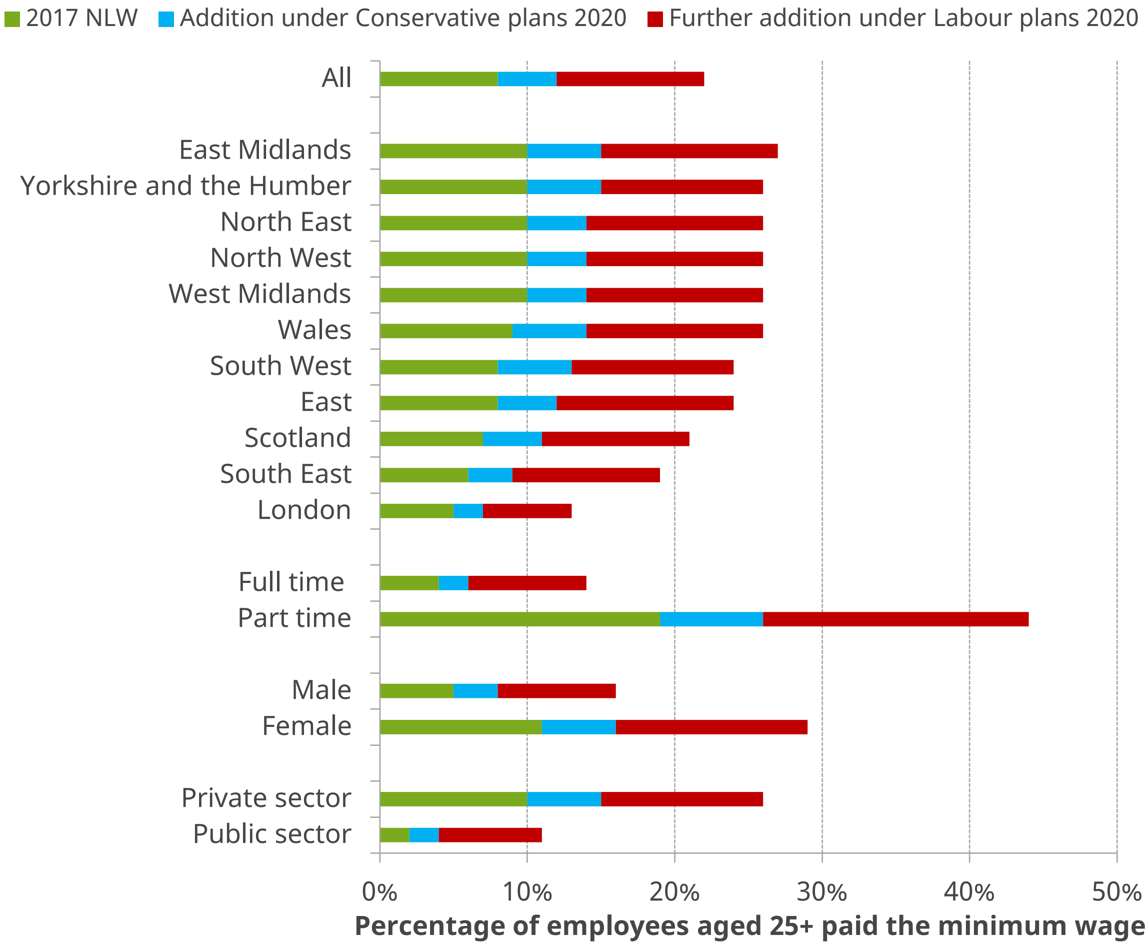
Labour's plans would see the following fractions of employees aged 25 and over paid the minimum wage in 2020 (assuming, of course, that these people all continue to be employed, which would be by no means assured):

- more than a quarter of women;
- more than a quarter of private sector employees;
- almost half of part-timers;
- more than a quarter of those in the North of England, the Midlands and Wales.

The Conservatives' NLW, by contrast, would directly affect about one in four of those working part time and almost one in six female, private sector employees and of those working in the North of England, the Midlands and Wales. While these are lower than the figures under Labour, they would represent substantial increases relative to the current situation, as Figure 6 makes clear.

8 See Low Pay Commission Report (Autumn 2016) and T. Butcher, R. Dickens and A. Manning, 'Minimum wages and wage inequality: some theory and an application to the UK', CEP Discussion Paper 1177, 2012.

Figure 6. Percentage of employees aged 25+ paid the minimum wage in 2017 and under Conservative and Labour plans for 2020

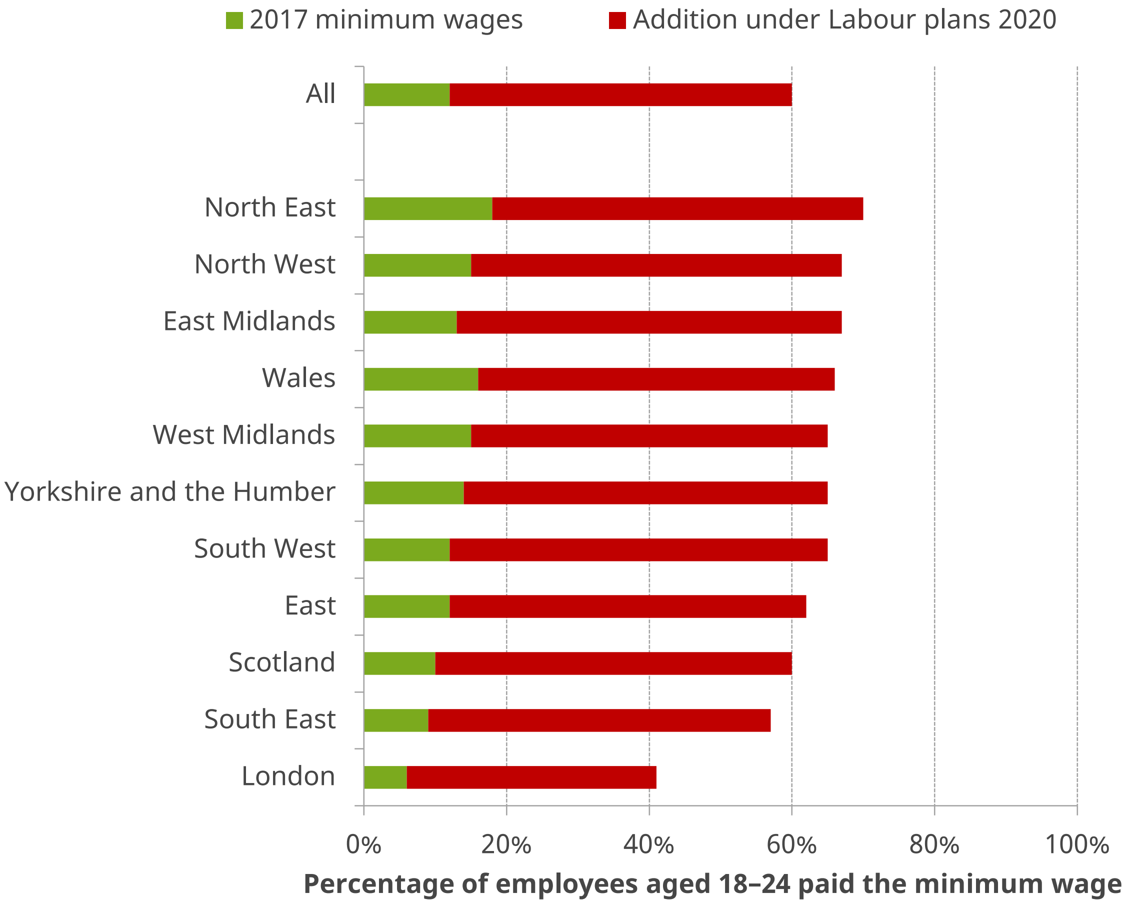


Note: 'Paid the minimum wage' also includes workers with observed pay less than their minimum wage rate. Excludes apprentices in the first year of their apprenticeship.

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

Share of employees aged 18–24 paid at the minimum would rise fivefold, from 12% to 60%, under Labour plans

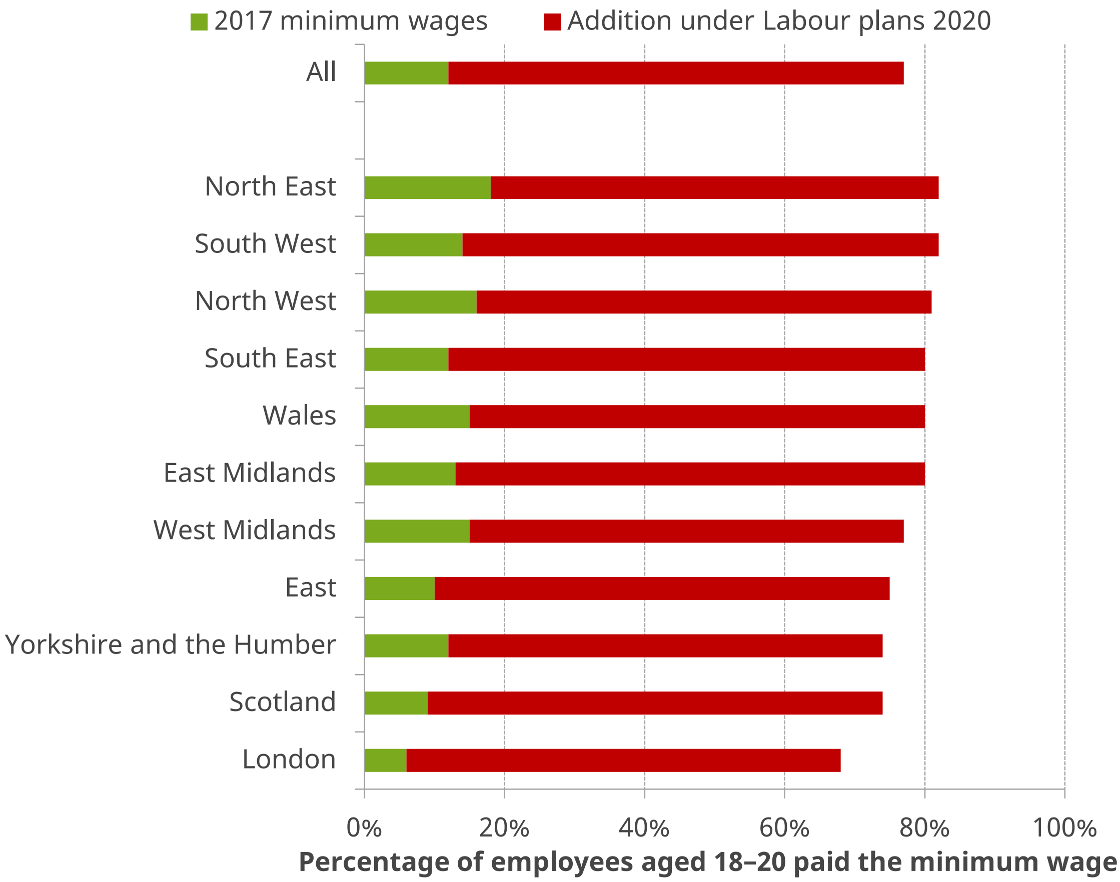
Figure 7. Percentage of employees aged 18–24 paid the minimum wage in 2017 and under Labour plans for 2020



Note and source: See Figure 6.

A major part of Labour's (but the not the Conservatives') minimum wage plans is to extend the proposed £10 minimum wage to all employees aged 18 and over. This means the minimum wage for 21- to 24-year-olds (currently £7.05) would be 29% higher in 2020 than if it increased in line with average earnings, and for 18- to 20-year-olds (currently £5.60) it would be 62% higher. Figures 7 and 8 show this would lead to a massive rise in the proportion of young employees paid at the legal minimum. A Labour government would effectively be directly setting the wages of 60% of 18- to 24-year-old employees by 2020 and 77% of those aged 18–20 (compared with 12% now in both cases).

Figure 8. Percentage of employees aged 18–20 paid the minimum wage in 2017 and under Labour plans for 2020

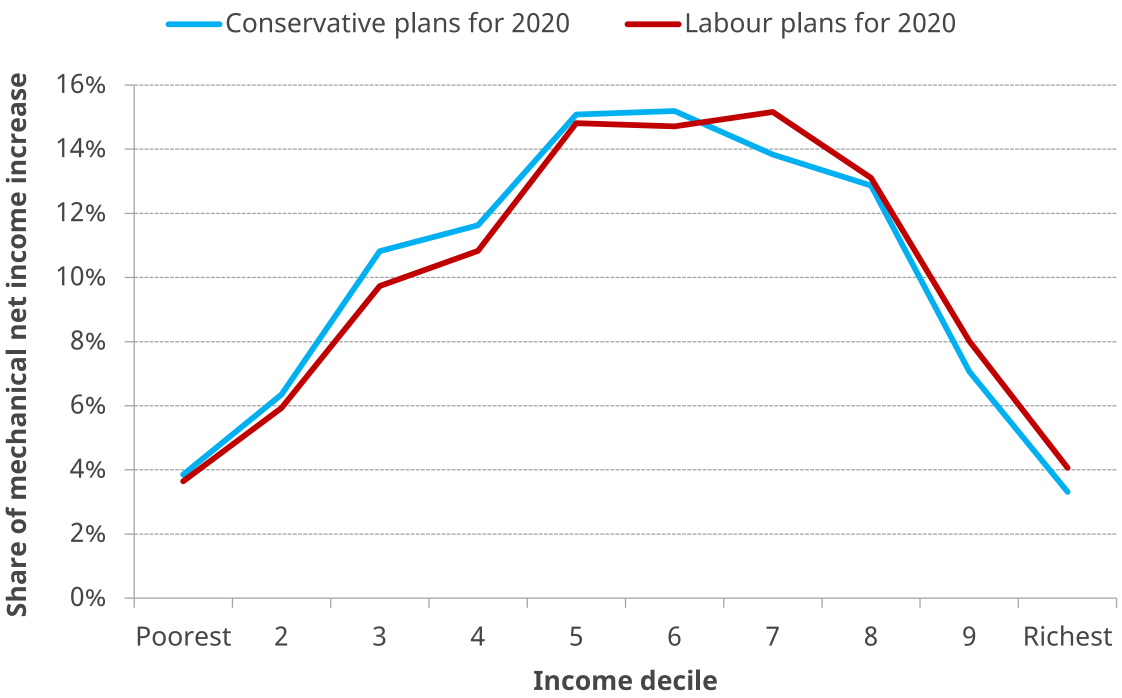


Note and source: See Figure 6.

We have had lower minimum wage rates for younger employees since the introduction of the minimum wage almost two decades ago. There are good reasons for setting lower minimum wages for younger people. Younger employees, on average, have considerably lower wages than older workers. There is no question that much of this reflects productivity differences, due to the benefits of experience, training and expertise (and many younger workers are receiving training and have low wages in light of the costs of providing that training). Setting the same minimum wage for all risks making it unprofitable for employers to hire younger workers and hence putting them at a disadvantage in terms of employment prospects. Unless there are proposals also to raise the apprentice rate of the minimum wage substantially (currently £3.50 per hour), it would give employers a large incentive to employ young people only as apprentices. Moreover, there is good evidence that unemployment at a young age can have a particularly damaging impact on people's later lives. Therefore such a rapid and large increase in the minimum wage for younger employees is particularly dangerous. It could have an immediate negative impact not only on their employment, but also on their labour market prospects for years to come.

Those who do benefit from minimum wage increases tend to be in middle-income households

Figure 9. Estimated share of mechanical increase in net household income accruing to different parts of income distribution from increases in minimum wage



Note: Income is measured as total net household income (before housing costs) equivalised using the McClements equivalence scale. Conservative and Labour policies are measured relative to a baseline scenario in which all current (2017–18) minimum wage rates and the NLW are uprated in line with average earnings.

Source: Authors' calculations using the IFS tax and benefit model, TAXBEN, run on the 2015–16 Family Resources Survey and the 2015–16 Labour Force Survey.

Politicians may claim that increasing minimum wages helps those on low incomes. However, although the direct impact of an increase in minimum wages is to boost the earnings of employees with the lowest hourly wages, this does not mean low-income households gain the most from such policies. This can be seen in Figure 9, which shows the share of the total increase in net household income under Conservative and Labour proposals received by each income decile. It is extremely important to realise that this is simply looking at the direct, mechanical gains; as we emphasised earlier, in reality, the money used to pay higher wages must be coming from somewhere (ultimately other households) and there may be knock-on effects on employment, neither of which is incorporated in the analysis in Figure 9.

The chart shows that middle-income households are the largest direct beneficiaries from a higher minimum wage. A key reason for this is that many individuals with low hourly wages are not in especially low-income households. In particular, many have a working partner and two-earner families do not tend to have the lowest household incomes; of course, many of the very lowest-income households have no one in paid work at all. In addition, employees who do have relatively low household incomes will often find that increases in wages are partially offset by resulting reductions in entitlements to means-tested benefits, an effect which is much less important for employees in middle- (or high-) income households.

In the absence of responses by employers, Conservative plans would increase employers' costs in 2020 by at least £1 billion; Labour by £14 billion

Table 1. Increases in employer costs in 2020 (from combination of wages and employer National Insurance contributions)

	Conservative plans in 2020	Labour plans in 2020
Average increase in cost to employer, per employee brought on to minimum wage	£480 per year (4.0%)	£2,000 per year (14.7%)
Percentage of all employees directly affected by higher minimum wages	10%	26%
Number of employees directly affected by higher minimum wages in 2020	2.8 million	7.1 million
Average increase in cost to employer per employee	£50 per year (0.1%)	£530 per year (1.5%)
Total direct increase in employer costs	£1.3bn per year (0.1%)	£14.1bn per year (1.5%)
Of which:		
Increased cost of employees aged 18–24	£0bn per year	£4.5bn per year
Increased cost of employees aged 25 and over	£1.3bn per year	£9.5bn per year

Note: Conservative and Labour policies are measured relative to a baseline scenario in which all current (2017–18) minimum wage rates and the NLW are uprated in line with average earnings. Employer cost includes both wages and salaries paid to employees and employer National Insurance contributions. It does not include any mandatory employer pension contribution if employees do not choose to leave a workplace pension into which they will have been automatically enrolled.

Source: Authors' calculations using the Annual Survey of Hours and Earnings.

One way to understand why there could be significant responses from employers to the proposed increases in minimum wages is to examine the direct increase in the cost of employing workers that they face as a result of higher minimum wages. Table 1 sets out the extra cost to employers under the Conservative and Labour proposals, accounting for the impacts on wages as well as employer National Insurance contributions. It only looks at the effect on employers' costs from increasing the pay of those paid under the new minimum wage, not any potential effect on the earnings of those paid above that level. This latter effect could in practice be very substantial.

The Conservative plans would result in increased employer costs for 10% of employees – totalling 2.8 million in 2020, averaging £480 per year, or 4.0%, for each employee brought on to the minimum wage, or £50 per year per employee when spread across all employees. This is equivalent to 0.1% of the total cost of employing workers or a total of £1.3 billion per year. As stated above, this extra cost would have to be borne by someone – be it shareholders, consumers or employees.

Table 1 highlights the scale of the impact of Labour's proposed £10 per hour minimum wage. The cost of employing one in four employees would rise as a direct result, averaging £2,000 per affected employee per year – a 14.7% rise in the employer cost of employing those affected employees. The fact that so many employees are affected (7.1 million in 2020) and with such a large increase in their cost means that the increase in employer cost is £530 per employee per year even when spread across all employees (not just those directly affected). This amounts to a total of £14 billion per year (1.5% of the total cost of employing workers).

Of course, the increase in employer cost will be concentrated in firms and sectors that tend to hire low-skilled employees: for example, cleaning, hospitality, hairdressing, retail, food processing, childcare and social care. Faced with an increase of such magnitude, it is easy to imagine why employers – particularly in the most affected sectors – would seek to reduce their labour costs, most obviously through reducing employment (perhaps in some cases substituting through contracting self-employed individuals, who do not qualify for the minimum wage, to carry out specific tasks), but also by reducing non-wage benefits, such as pensions, overtime, or maternity or sick pay.

It is also worth noting that these extra costs would come on top of increased costs of providing pensions to employees due to the roll-out of automatic enrolment, as the minimum employer contribution to workplace pensions increases from 1% of (qualifying) earnings now to 3% by 2019.

The next government could seek to mitigate some of the extra costs to employers: for example, through some form of tax break for employers deemed particularly financially vulnerable to large increases in the minimum wage.[9] This is an option, but it would of course come at a cost to the taxpayer – under Labour in particular, compensating employers for a significant fraction of the increase in cost would clearly be expensive.

A key challenge would be to target any such support effectively at the parts of the economy most in need of it. But there would be other tricky issues. Any taxpayer support that simply transferred certain sums of money to certain employers, without making that amount dependent on their future decisions about how many people to employ, would not actually affect the cost of employing *any individual worker.* Hence it would not incentivise firms to employ more workers (or make fewer redundant, given the increases in wages). To be most effective at mitigating employment effects, any support would need to be targeted at increasing the incentive to hire the (low-skilled) workers that a higher minimum wage makes it less desirable to hire. That is likely to be complicated. It also starts to look rather like the state trying to make transfers to low-paid workers through

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[9] For example, the Shadow Chancellor of the Exchequer, John McDonnell, said in his Labour Party Conference Speech in September 2016, 'But we know that small businesses need to be a part of the bargain. That's why we will also be publishing proposals to help businesses implement the Living Wage, particularly small and medium-sized companies. We will be examining a number of ideas, including the expansion and reform of Employment Allowance, to make sure that this historic step forward in improving the living standards of the poorest paid does not impact on hours or employment'.

rather convoluted means when more straightforward methods, such as restoring the generosity of work allowances in universal credit, are available.

There may well be a case for raising minimum wages above their current levels. But large and sudden increases in minimum wages are extremely risky: we do not know what their effects will be. If they do not result in increased unemployment, it will be more by luck than judgement.

Until the Summer Budget in 2015, the minimum wage was set by the government after careful consideration of the evidence of its likely impact, and based on a recommendation by the independent Low Pay Commission. The minimum wage was meant to be set at the highest level that was deemed to be possible without damaging employment prospects. The introduction of the NLW marked a departure from this careful process.

There are reasons for being somewhat more radical than the Low Pay Commission has been. A somewhat higher minimum wage might not damage employment prospects very much, and might boost pay and push employers towards greater investment in skills and in capital. But the worry must be that the minimum wage becomes a political bidding tool, with competing parties pledging higher minimum wages as an offer to voters, without explaining the potential risks and dangers of their proposed policies, and by picking juicy-sounding round numbers without careful analysis of the implications. Would politicians be willing and able to lower minimum wages if they are found to have deleterious effects on the labour market and people's employment prospects?

There are also specific concerns with the way that minimum wages would be set under the Conservatives' and Labour Party's proposals. For the Conservatives, by introducing the national living wage and pledging to increase it significantly each year until 2020, they have given themselves no chance to assess its impact before introducing further rises. However, the '60% of median earnings target' does at least reduce the growth of the minimum wage if earnings growth in general turns out to be weak.

On the Labour side, there are a number of other concerns. First, their promise to deliver a £10 hourly rate by 2020 is independent of the path of the economy over the next few years. Indeed, the OBR now expects average earnings will be 3% lower in 2020–21 than when Labour first stated the £10 pledge in September 2016. Such an inflexible target increases the risk that the minimum wage affects an even greater share of the workforce than is currently expected or than Labour themselves originally intended.

Second, the Labour Party has said that it would set minimum wage policy in consultation with a 'Living Wage Review Body'. As the concept of a living wage is based on the cost of achieving a certain standard of living, this would fundamentally divorce the setting of the minimum wage from any consideration of its impact on employment. Put another way, a 'living wage' is calculated as the wage that should guarantee a certain standard of living for people who work full time. It does not take account of the number of people who would actually be able to obtain employment at such a wage in the first place. Setting a key economic policy without regard to its most potentially harmful outcome is not sensible.

Finally, setting a minimum that is the same for an 18-year-old as for a 30-year-old is particularly risky. Few 18-year-olds are highly skilled and few can command high wages (as evidenced by how few earn more than the equivalent of £10 per hour). If in work, what they need more than anything is often experience and high-quality training. If any group is likely to be priced out of paid work by this policy, it looks likely to be the young. The long-term costs to them of being priced out could be very large indeed.

Ultimately, the most difficult thing about the setting of minimum wage policy is that we do not know the point at which the minimum wage significantly hits employment. But this should lead to a very simple conclusion: politicians should be particularly careful when setting its level. There is a good case for a minimum wage. But large and sudden increases create considerable risk that those who are supposed to be the beneficiaries of the policy end up paying the cost of ill-thought-out proposals in higher unemployment or lower hours of work.