The Case for a £15 an hour Minimum Wage

James Meadway &
Howard Reed

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1. Executive Summary

The cost-of-living crisis is creating an unprecedented squeeze on people's living standards. The decline in real household incomes, taking account of wages, salaries, benefits, pensions and allowing for prices is the worse since official records began in the 1950s. Unofficially, the squeeze is likely to prove the worst since the bleak years of the early Industrial Revolution.

The cost-of-living crisis is the result of two factors coming together:

- first, the prices of essential goods has risen sharply in the last 12 months from a combination of factors including the damage done to supply chains by covid, extreme weather hitting production, and, most recently, Russia's invasion in Ukraine, which has seen sanctions and war damage disrupt essential commodity exports from both countries;

- second, the crisis is also the result of low wages. Whilst figures released today show prices rising by 9%, the fastest rate in forty years, wages are rising only 7%. In "real terms" (meaning after adjusting for inflation), wages and salaries are falling 2%.

It is important to understand that neither of these factors are the result only of natural disasters or big external influences. On the first, whilst "supply-side" disruptions have increased costs for many producers, those who are supplying at least some of these commodities are doing exceptionally well. UK-headquartered fossil fuel producers BP and Shell jointly made £19bn profit in the last year, simply as a result of the rise in the international price of oil and gas.

But the problem of excessive profits is bigger than just these two notorious cases. Profits for large companies have recovered very substantially since the last lockdown, reaching record levels at the end of last year. The Competition and

Markets Authority has found that the most profitable companies in the country are now selling with an average 85% “mark-up” on their costs – up from 53% a decade ago. Rising prices benefit at least some suppliers.

Wages, meanwhile, have lagged well behind weak economic growth in recent years. Britain has become a low-paying economy over the last decade, with average real-terms pay still below its 2008 levels, even before recent price rises. It is true that part of this due to low investment by firms and by government in things like new machinery and equipment. This investment helps the economy grow, in particular by making it more productive over time – and when the economy is more productive, firms find it easier to pay higher wages. For comparison, business investment in Britain was less than 10% of GDP at the end of 2019 compared to about 14% on average in the G7.

But this is not the only factor at work. As well as low investment producing lower productivity growth, new figures in this report show that the share of what society produces going to those who work has fallen. In other words, the slice of the economic “pie” for workers has shrunk since 2008 and, as a result, wages have stayed low. In 2020, because wages and salaries were somewhat protected by government, especially through furlough, even as the economy shrank, this share rose suddenly. Official forecasts, however, show the share is going to decline rapidly in the next few years.

High inflation is worsening this. Prices are currently rising much faster than wages and salaries, resulting in a rapid decline in the real purchasing power of incomes from work. This is occurring even as profits in much of the economy remain high, recovering to record levels after 2020.

Fundamentally, inflation is a question of the distribution of society’s income. The last time Britain persistently high inflation, over the 1970s and 1980s, there were institutions that could defend the workers’ share: strong trade unions, and widespread collective bargaining. In the 1970s, for example, inflation averaged 12% a year. But pay rises averaged 15%, so average real wages and salaries rose. Profits, meanwhile, fell to low levels in the same period.

However, unions and collective bargaining have both much constrained since the 1980s, with union membership falling from over half of workers in 1979 to a low of 23% in 2017, and collective bargaining coverage falling from 71% of employees in

the same year to just 21% in 2020. These institutions will not be rebuilt quickly, even with a government committed to supporting them.

The impact of relatively quicker rises in the minimum wage (after 2016, the "National Living Wage", NLW) have seen rapid improvements in the pay of at least some lower-paid workers. Pay rises for the lowest paid have occurred as a result of government action, and have not (despite predictions otherwise) resulted in higher unemployment. The minimum wage, first introduced in 1999, is near-universally viewed as a successful policy.

Currently set at £9.50, the NLW was increased by only 6.6% at its last revision, in April. With inflation presently at 7%, this represents a real-terms cut for some of the lowest-paid workers. As inflation is forecast to increase as much as 10% over this year, the real terms loss will get worse and worse. The case for NLW rises to at least meet the rate of inflation is robust.

This paper takes the established principle of rapid increases in the minimum wage, and extends it for conditions of very high inflation. With most workers not now represented by a union, or even covered by collective bargaining, there is a pressing need for government to act to protect living standards from price rises. At present the NLW is forecast to reach £10.50 per hour in 2024, or two-thirds of median earnings. This increase closely matches the central, official forecasts for inflation over the same time period.

But as the Tony Blair Institute, amongst others like campaigner Jack Monroe, have argued, pay rises at the bottom end of the income distribution need to be far higher than inflation to compensate for the higher relative price rises they face (as a result of spending proportionately more of their income on essentials like gas now rising rapidly in price). Most recently, the Institute of Fiscal Studies has suggested that the poorest decile face a true inflation rate of 14%. Clearly, pay rises for the lowest paid should not just compensate for inflation, but reach above that level.

We propose a £15/hour minimum wage to compensate employees for a "lost decade" of wages. Had wages and salaries continued to grow at the same rate in the decade after the financial crisis as they did in the decade before, the National Living Wage would be £13.60 in 2025, assuming the government achieve its NLW target level of two-thirds national income. We forecast that close to 14m people would see at least some increase in their pay.

If we further assume that inflation follows the path forecast by the Office for Budget Responsibility, and that we wish to maintain the real-terms value of the minimum wage, the implied value by the end of 2025 is £15.70 per hour. **Allowing for rapid inflation over the next few years, a £15/hour minimum wage in 2024-25 corrects for low-paid employees' losses in the last ten years and maintains the real value of their incomes.**

This is a significant increase, but should be seen in the context of:

- Flat or falling real wages since 2008 across the working population;
- Expected rapid increases in prices that will hit the poorest the hardest;
- At the macro level, the steady shrinking of the workers' share of national income, forecast to worsen over the next five years.

Many of Britain's trade unions, meanwhile, reflecting the realities of low pay over the last decade and anticipated real-terms losses to come, have passed policy supporting a £15/hour pay rise.

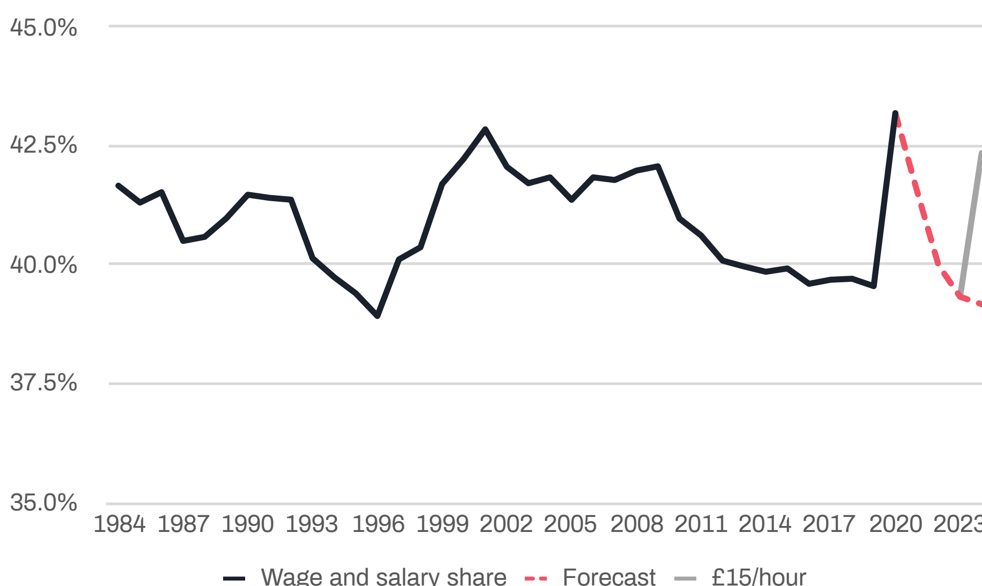
We model for an increase in the level of the National Living Wage to £15 per hour in 2024, instead of the proposed £10.50. Our modelling shows this has an overwhelmingly positive distributional impact:

- The poorest 70% of households see a 6.9% increase in their forecast incomes, compared to a 1.7% increase in the household incomes of the richest 30% (the result of some minimum wage workers living in wealthier households). The measure is very strongly redistributive, in the right direction.

- As a "Levelling Up" measure, a £15/hour minimum wage scores very highly. 33% of employees in London would benefit from the new minimum, but for (for example) the North of England 51% of employees are forecast to see at least some benefit from the new, higher minimum. This is as result of generally lower wages being paid in regions outside of London.

The total impact of the change is to shift the share of national income going to employees back to the levels of the early 2000s. The increase in the minimum wage is more rapid than has happened in the past, but should be seen as a

restoration of the labour market conditions that prevailed before the financial crisis of 2008 when Tony Blair was Prime Minister. The graph below shows the share of national income going to labour, plus the impact of the forecast.



Source: ONS National Accounts; Family Resources Survey; authors' own calculations. The wage and salary share of national income with a £15/hour minimum wage for the 2024-25 tax year is indicated.

The measure is affordable. The total forecast increase in the 2024-2025 wage bill is £74.6bn. But this increase in pay, in turn, generates higher taxes from income and National Insurance Contributions, coming to £32.7bn. In addition, there are savings to be made on income-contingent benefits payments (primarily Universal Credit) of £4.2bn. The overall result is a £25.1bn improvement in the public finances, after taking off the increase in the public sector pay bill that arises from the change.

Recognising that whilst many large companies are making super-profits, smaller companies are suffering from higher costs, we propose that this £25.1bn improvement in the government finances is used to **compensate smaller businesses. We suggest changes to the existing taxes on employment will be the most effective way to reduce employers' costs, reducing the small business employee National Insurance Contribution by 3p to wholly compensate smaller**

employers (those employing less than 50 staff, covering 97% of all employers) for their increased costs.

We argue that reductions in taxes for smaller businesses it should also be seen as an effective form of redistribution, from larger companies profits towards the smaller.

It is sometimes claimed that high wage rises would lead automatically to higher inflation. In a labour market like the UK's, where real wages have been falling for a decade, and where inflation today is being driven by international factors, this has not a plausible claim. We believe the £15/hour raise should be seen as redistributive, shifting some of the balance of incomes in the economy back towards those who work after a number of years of decline. Alongside effective monetary policy, overseen by a Bank of England seeking to maintain its inflation target, and judicious use of energy price cap-style controls where essential, inflation can be properly managed.

The primary challenge of inflation today - unlike the 1970s or 1980s - is to prevent rapid price rises eating away at household incomes. To achieve this requires a restructuring of the labour market, away from low paid and insecure work. The £15/hour minimum wage is presented here as an important step towards achieving that goal, with rapid impacts for the lowest-paid. Phasing in the move over the next few years would give more time for businesses to adjust, although a more rapid timeframe for its introduction could be applied.

2. Introduction

The shock to the economy of the first years of the covid-19 pandemic has been immense: plunges in GDP bigger than any others in peacetime history; millions furloughed; supply chains thrown into chaos. But it is becoming clear that this initial disruption has caused huge after-effects, seen in the ongoing impacts of the supply-chain disruption and, looking ahead, in the significant changes in the ways and places in which work is conducted.

Inflation figures, released at the time of writing, show prices rising at their most rapid rate for forty years, reaching 9% on the standard Consumer Price Index (CPI) measure. Official forecasts anticipate further increases this year – into double-digits, as the lockdown effect plays out and, we argue below, increased environmental instability pushes costs up across the globe.

Meanwhile, the shift to working from home and "hybrid" (part-home, part-office) work, seemingly now a permanent fixture for working life for many,[1] is amongst the most immediately visible effects of the pandemic on the labour market. But less immediately apparent are the major changes millions have made to their own working conditions. Last summer, more people changed their job in Britain than at any point since records began, with 979,000 people switching jobs.[2]

In the US, where similar trends have been apparent, this has become known as the "Great Resignation", but the cliché of the restless millennial flitting between different service-sector jobs is only part of the picture. Older workers have

[1] ONS report that 85% of those surveyed would prefer a combination of home an in-office work in the future. ONS (14 June 2021), "Business and individual attitudes towards the future of work". At: https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/articles/businessandindividualattitudestowardsthefutureofhomeworkinguk/apriltomay2021

[2] ONS (16 November 2021), "Employment in the UK: November 2021". At: https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/bulletins/employmentintheuk/november2021

reduced their hours and, in 2.4m cases, opted for early retirement.[3] A major part of the reason for the lorry driver shortage (worsened in Britain by the impact of leaving the Single Market, with its free movement provisions) has been early retirement, during the pandemic, with 75,000 lorry drivers leaving the profession since 2020 – 40,000 of them over-45s, leaving in the first quarter of 2021 alone.[4] Not all of this will be driven by free choice: it is becoming clear that the after-effects of covid infection can be, in many cases, serious and ongoing, with the ONS estimating that 643,000 people in the UK could be suffering with "activity-limiting long COVID".[5]

Taken together, all these different and ongoing impacts mean the UK labour market on this side of the covid-19 pandemic will look substantially different to the labour market pre-pandemic. This should be an opportunity to rethink how that market operates, squeezing out its more undesirable features – low pay, widespread insecurity, and high inequality chief amongst them – in favour of a labour market that works better for its participants.

The proposal for a £15/hour minimum wage presented here is offered in that spirit. We argue that, although significant, the increase should be seen as major step towards shifting the balance of income and power in the labour market back towards those who work. We demonstrate that a £15/hour minimum wage is affordable, but should be treated as an element in a broader plan to redistribute income.

This will reach further than just the labour market: we have proposed a restructuring of the existing employment tax system that is expressly designed to favour smaller businesses, charities and other employers. The costs of the £15/hour wage would be significantly covered but, perhaps more crucially for the longer-term health of the economy, the skew of the taxation system towards larger employers and rent-seeking behaviour would be ended. The intention is to create a private sector that is significantly more egalitarian and, crucially, dynamic than now, in which a large number of high-wage jobs are supported by

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[3] O'Connor, S. (9 November 2021), "Covid retirees show work-from-home revolution has not benefitted everyone", *Financial Times*. At: https://www.ft.com/content/cefbe0b0-8102-4331-b409-1a6d336cb346

[4] Whitehead, S., Huzaifa, M, Darnley, L. (9 December 2021), "HGV driver shortage – the causes the facts and the potential solutions", Brabners blogpost. At: https://www.brabners.com/blogs/hgv-driver-shortage-causes-facts-and-potential-solutions

[5] Ayoubkhani, D. (16 September 2021), "How common is long COVID? That depends how you measure it", *National Statistical*. At: https://blog.ons.gov.uk/2021/09/16/how-common-is-long-covid-that-depends-on-how-you-measure-it/

an expanded number of smaller businesses, owned by a significantly expanded class of business owners. For decades, and despite official rhetoric, economic policy in Britain has leaned hard towards bigger businesses. We are seeking here to redress the balance, to the benefit not only of workers, but of smaller business owners.

Wage rises are barrier against inflation

The shock of the pandemic, the ongoing disruptions to supply chains this brought about, the steadily worsening environment for the production of essential commodities, from food to semiconductors, and, finally, the invasion of Ukraine by Russia have all contributed to both rising instability and costs of production across the economy. But inflation is a mechanism for redistribution as much as it is a symptom of economic disorder: in this case, the redistribution of resources from households to those who can claim monopoly prices and economic rents for the supply of essential goods, from housing to gas and oil, is striking.[6] The option to, as Financial Times columnist Martin Sandbu put it, "moderate profits"[7] to restrain rising prices is too often overlooked in favour of calls for wage restraint or interest rate rises. Profits in the US have hit record levels.[8]

But the last time prices rose this rapidly, union membership was close to (or even above) 50% of the employed workforce. Today it stands at 23%, mainly in the public sector. Collective bargaining agreements covered almost three-quarters of employees the last time inflation was this high. Today, it is 20%. Fears of a "wage-price spiral", as arguably set in during the inflationary 1970s, when rapid price rises were matched (and surpassed) by rapid wage rises do not fit today's reality: the labour market institutions that might, plausibly, create the spiral, primarily the trade unions, are massively weakened. Profits, unlike the 1970s, are absolutely not being squeezed, as we show below. Real wages entering the pandemic in 2020 were only marginally above their 2008 level, and that largely as a result of

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[6] Berry, C. (18 March 2022), "Who's profiting from the cost of living crisis? Right now, it is big business owners", *Guardian*. At: https://www.theguardian.com/commentisfree/2022/mar/18/cost-of-living-crisis-big-business-economy-prices-wages

[7] Sandbu, M. (10 February 2022), "The class warriors at the Bank of England", *Financial Times*. At: https://www.ft.com/content/f5fa4747-f9c1-4e95-878f-6e9b5db5579c

[8] Daniels, W. (31 March 2022), "U.S. companies post their biggest profit growth in decades by jacking up prices during the pandemic", *Fortune*. At: https://fortune.com/2022/03/31/us-companies-record-profits-2021-price-hikes-inflation/

improvements only in the year preceding. They are currently falling at around 2% a year, given CPI inflation of 9% and wage growth reported in the Average Weekly Earnings (AWE) figure of 7%. This situation is even worse for the lowest paid, with the Institute of Fiscal Studies suggesting (allowing for differences in the goods consumed by those on different incomes) inflation for the poorest decile could hit 14% in October.[9]

Union membership reached a nadir in 2017, barely rising since; strikes recorded reached their lowest number since records began, in 1853, in the same year. Recent talk of a shift towards greater labour militancy, with rising union membership and some evidence of more assertive union bargaining are scarcely enough to break a pattern of trade union weakness.

Facing rapid increases in prices, stronger trade unions and a greater willingness to at least moderate profits would be desirable. Over the longer term, this would imply both a rebuilding of union strength and the wider spread of collective bargaining. But this will take time: it has taken decades to so undermine unions and collective bargaining that workers in Britain today face truly disastrous declines in their standard of living over the next 12 months. A rapid increase in the minimum wage is faster, delivering (as our modelling will show) the help where it is needed, and overall shifting the balance of power in labour markets back towards those who work.

[9] Karlajainen, H. and Levell, P. (25 May 2022), "Inflation for poorest households likely to increase even faster than for the richest, and could hit 14% in October", Institute of Fiscal Studies. At: https://ifs.org.uk/publications/16065

3. Welfare Impacts of Rapid Minimum Wage Rises

Minimum wages have had limited impact on employment

Previous increases in the minimum wage have had no discernible impact on either employment rates or investment. NIESR reported to the Low Pay Commission, in 2013, that "companies may have adjusted to the increases in labour costs as a result of the NMW by raising labour productivity and by reducing profitability."[10] As we will see below, in the context of rapid improvements in productivity, the option to reduce margins to sustain higher wages is particularly appealing from the viewpoint of the social good.

Summarising two decades' of experience and research on the effects of minimum wages in Britain, the Low Pay Commission noted that "Over the past 20 years, the LPC has commissioned more than 30 projects looking at the NMW's impacts on hours and employment. In this time, we have not found any strong evidence of negative effects."[11] This is consistent with empirical studies elsewhere in the world[12] and the theoretical modelling which notes the impact of employer

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[10] Riley, R., Bondibene, B.R. (2013), "The impact of the national minimum wage on firm behaviour during recession", National Institute for Economic and Social Research report to the Low Pay Commission. At: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/227398/NIESR_RileyRosazza_finalreport_22March2013_LPC12.pdf

[11] Low Pay Commission (2020), *The National Living Wage Review (2015-2020)*, London. At: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1076517/NLW_review.pdf

[12] The classic paper is Katz, L.F., Kreuger, A.B., (1992), "The effect of the minimum wage on the fast-food industry", *Industrial and Labor Relations Review* 46:1; see also Card, D. and Krueger, A.B. (1997), *Myth and Measurement: The new economics of the minimum wage*, Princeton University Press: Princeton, N.J

monopsony in labour markets,[13] and the possibility of firms choosing (as they seemingly have done) to adjust non-employment factors (like mark-ups) when facing mandatory wage cost increases in preference to cutting jobs.

The post-pandemic labour market of 2022 presents a number of peculiarities, as noted earlier. In particular, the aggregate indicators point towards a buoyant market in which unemployment is consistently falling – now at its lowest level since 1974,[14] and defying predictions of mass unemployment as covid support was withdrawn. Yet this rosy headline figure obscures the true picture.

Equality and pay rises

The National Minimum Wage (NMW) was introduced from 1 April 1999, at £3.60 an hour for those aged over 22, or £3.00 an hour for workers aged 16-22. Equivalent to £6.38 in 2021, around 830,000 workers were paid at the NMW rate at the time. Successive upratings in the two decades since, at above both the rate of inflation and average pay increases have seen the numbers paid the current National Living Wage (NLW) rise to 2m, or 7% of the workforce compared to 3.8% of the workforce since its introduction.

As we would expect, more rapid increases in the minimum wage (via the new National Living Wage, NLW) since 2016 have had a positive impact on low pay. "In 2015, 21 per cent of employees in Britain were in low pay, and the proportion of employees had been roughly this level for the previous 20 years. A fast-rising minimum wage since then pushed down the number of workers in low pay to 15 per cent in 2019. This number fell again to 14 per cent in 2020."[15]

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[13] "Monopsony" refers to a situation where a single *buyer* faces many sellers – the inverse of the more familiar monopoly, where a single *seller* faces many buyers. The impact is held to be inverted, too: instead of seeking the highest possible price like a monopolist, the a monopsonist will look to exploit their market power by driving their buying price downwards. In a labour market, a single large employer may (in theory) exploit their power by pushing wages below the level a competitive market would find. For an overview, see Congressional Budget Office (December 2019), "The Minimum Wage in Competitive Markets and Markets With Monopsony Power—Supplemental Material for *The Effects on Employment and Family Income of Increasing the Federal Minimum Wage*", Congressional Budget Office: Washington, D.C. At: https://www.cbo.gov/system/files/2019-12/CBO-55410-MinimumWage-Monopsony.pdf.

[14] ONS (17 May 2022), "Labour market overview, UK: May 2022". At: https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/bulletins/uklabourmarket/may2022

[15] Cominetti, N., McCurdy, C., Slaughter, H. (2021), *Low Pay 2021*, Resolution Foundation: London, p.5. At: https://www.resolutionfoundation.org/app/uploads/2021/06/Low-Pay-Britain-2021.pdf

The proportion of low paid jobs (as measured by those paying below two-thirds of the median income) fell to a “record low” in 2020, just ahead of the pandemic, with 15.1% of jobs reportedly paying under this measure,[16] and then (allowing for the difficulties presented for measurement in the first year of covid) to 14.2% in 2021. The primary driver for this decline in relative low pay over the last few years has been the minimum wage. Since the introduction of the National Living Wage in 2016, the legally-enforced minimum for most workers has consistently risen ahead of wages in general. The result has been to lift a significant number of the lowest paid towards the national median, given the weakness of wage growth in general.

This has helped produce a significant compression of the wage distribution at the lower end: there are many more people now paid the legal minimum, or just above, than there were before.[17] The Low Pay Commission has noted that “In 1998, 150,000 workers of all ages earned less than £2 an hour (£2.96 in 2018 prices) and 3.4% of jobs were paid less than 45% of the median hourly pay. When the NMW was introduced, this proportion more than halved. In April 2018 only 1.2% of jobs paid less than 58% of median pay, down from 13.3% in 1998.”[18] At the same time, some wage compression has taken place at the top end, with the most recent figures showing “the proportion of high-paid employee jobs falling 0.7 percentage points on-the-year to 24.5% in 2021.”[19]

The Low Pay Commission has also claimed a broader inequality impact, noting in its 20-year anniversary assessment of the minimum wage, published in April 2019, that whilst “Between 1979 and 1998, average annual wage growth for workers aged 22 and over was consistently highest for top earners… in all the periods after the introduction of the NMW in 1999 growth at the 5th [bottom] percentile has been consistently faster than at the median and the 90th

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[16] ONS (3 November 2020), “Low and high pay in the UK, 2020”. At: https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours/bulletins/lowandhighpayuk/2021

[17] McKnight, A, and Cooper, K. (March 2020), “The National Living Wage and falling earnings equality”, CASEbrief 38, LSE Centre for Analysis of Social Exclusion. At: https://sticerd.lse.ac.uk/dps/case/cb/casebrief38.pdf

[18] Low Pay Commission (April 2019), *20 years of the National Minimum Wage: a history of the UK minimum wage and its effects*, London: Low Pay Commission, p.16. At: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/790910/20_years_of_the_National_Minimum_Wage_-_a_history_of_the_UK_minimum_wage_and_its_effects.pdf

[19] ONS (3 November 2020), “Low and high pay in the UK, 2020”. At: https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours/bulletins/lowandhighpayuk/2021

percentile."[20] Set against the well-known and dramatic increases in wealth inequality over the whole period, this relative improvement in the incomes of the lowest paid is striking, and at least some of it can be attributed directly to the national minimum wage.

The impact of the (higher) National Living Wage (NLW) in 2016, and its consistent above-inflation pay rises has had a noticeable impact, particularly relative to the much more modest NMW from 1999-2015.[21] Elsewhere, the Low Pay Commission, summarising its own research, noted that "the NLW has 'compressed' the pay distribution and reduced wage inequality; workers earning above the minimum receive faster increases than they would have done." Importantly, since it impacts on social mobility and suggests that there need be no necessary trade-off between equality and efficiency or growth, they go on to add that "this compression has not led to more minimum wage workers becoming 'stuck' in relatively lower-paying jobs: the rising minimum wage has not affected the likelihood of minimum wage workers moving into higher-paid jobs."[22]

The implication from the empirical evidence is that an ambitious minimum wage goal, like the 60% median income target established by Resolution Foundation's 2014 Review of the Future of the National Minimum Wage and then adopted as part of the Conservative government's NLW policy,[23] can have significant, positive impacts on wages and inequality without damaging employment or other outcomes. We recognise that there must be some upper limit to this, or potentially diminishing returns, in competitive markets for company outputs and where companies themselves may already face net cashflow constraints. But as we argue below, the tax system can be usefully adjusted to accommodate.

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[20] Low Pay Commission (April 2019), *20 years of the National Minimum Wage: a history of the UK minimum wage and its effects*, London: Low Pay Commission, p.14. At: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/790910/20_years_of_the_National_Minimum_Wage_-_a_history_of_the_UK_minimum_wage_and_its_effects.pdf

[21] McKnight, A, and Cooper, K. (March 2020), "The National Living Wage and falling earnings equality", CASEbrief 38, LSE Centre for Analysis of Social Exclusion. At: https://sticerd.lse.ac.uk/dps/case/cb/casebrief38.pdf

[22] Lord, A. (20 January 2020), "The National Living Wage, inequality and job progression: two research projects", Low Pay Commission blog. At: https://minimumwage.blog.gov.uk/2020/01/20/the-national-living-wage-inequality-and-job-progression-two-research-projects/

[23] Low Pay Commission (31 December 2019), "National Living Wage to hit 60 per cent target in April". At: https://www.gov.uk/government/news/national-living-wage-to-hit-60-per-cent-target-in-april

Poverty and the minimum wage

Compression and a reduction in wage inequality – at least where it is the product of rapid increases in pay for the poorest – can be broadly welcomed, but the interaction between the legal wage floor and the labour market in general today challenges the original thinking behind the minimum wage itself. From being the barest minimum – an absolute rock-bottom standard below which no worker should be expected to fall – the National Living Wage has become a “floor” on which many workers find themselves resting. Seven percent of all employees (around 2m workers) were estimated to be paid at or below the legal minimum in 2019, up from 1.5m employees (or 4.8% of the workforce) in 2015, ahead of the introduction of the National Living Wage.[24]

Consistent rises in the minimum wage, faster than average wages, have not, however, prevented the notable increase in in-work poverty over the last decade. Cuts to in-work benefits, taking £14bn out of the system since 2010-11, and associated particularly with the roll-out of the Universal Credit system from 2013, have resulted in falling relative and real-terms incomes for the lowest paid. The New Economics Foundation found that the poorest 20% of households would be £750 a year (6%) worse off than if the legacy benefits system, and its level of funding support, had been maintained.[25]

The majority of those in poverty in Britain today are also in households which have some form of paid work:[26] whilst unemployment and inactivity are still strongly associated with poverty, as we would expect, for most people suffering deprivation the double-bind is to have to work and yet still end up in a household with an income below a socially acceptable minimum. This growth of in-work poverty has occurred at the same time as employment has risen, and inactivity fallen, over the last few decades, challenging the idea that work alone would be sufficient to end poverty.

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[24] House of Commons Library (22 November 2021), “National Minimum Wage Statistics”. At: https://commonslibrary.parliament.uk/research-briefings/cbp-7735/

[25] Arnold, S., Caddick, D., Krebel, L. (20 February 2021), “How our benefits system was hollowed out over 10 years”, London: New Economics Foundation. At: https://neweconomics.org/2021/02/social-security-2010-comparison

[26] McNeil, C., Parkes, H., Garthwahite, K., Patrick, R. (26 May 2021), No longer 'managing': The rise of working poverty and fixing Britain's broken social settlement, London: Institute of Public Policy Research, p.12

But this rise in in-work poverty has occurred at the same time as the minimum wage, and then the National Living Wage, have increased ahead of inflation and raised the legal "floor" to paid employment substantially. This has had a clear impact on the distribution of wages and salaries from work. The distribution of household income remains problematic, however, if the wage floor has been lifted but in-work poverty remains high – or even rising.

A major part of the issue is the rise of part-time and more insecure forms of employment. With increasing numbers working different hours to the standard full-time week, or moving into (for instance) self-employment (whether genuine or otherwise), a revision to the legal minimum rate of pay for employment alone is not going to be enough to overcome the spread of in-work poverty. Incrementally increasing the minimum wage alone is unlikely to be enough to shift this imbalance in working life and, beyond that, the inadequacies of existing welfare provision. A major step-change in its level, on the other hand, as our modelling shows below, could have a very significant impact on in-work poverty and the distribution of household income. Further changes to both welfare provision – increasing its generosity, particularly in light of the dire predictions being made as to the impact of inflation – and to the workplace bargaining institutions, shifting the balance of power back towards those who work should help complete the final pieces of the jigsaw and our conclusions indicates some directions for future policy here.

Nonetheless, we are reaching a crossroads for the future progress of the national minimum wage. It has achieved (and surpassed) its original goal in setting a "floor" for paid employment in the UK – a moral standard below which we do not want to see any work undertaken. But changes in the labour market, with the spread of part-time and insecure employment, and cuts to in-work benefits have meant that the statutory minimum wage is failing to decisively lift people out of poverty. At the same time, the increasing level of the minimum wage itself has drawn more and more workers into its orbit, and even larger numbers of employees paid barely above the legal minimum.

This poses some questions for the future direction of the policy. Particularly as the minimum, under the NLW, now approaches the median wage (with a target of 66% of the median wage by 2024), its purpose needs to be re-examined. Is the minimum wage to act as a "moral" absolute standard? Is it to act as a barrier against poverty? Or could it build on its real successes, which are in promoting

equality of outcomes and become the lever by which the labour market is shifted to the benefit of labour, post-pandemic?

Our broad argument is that a repurposing of the National Living Wage – significantly lifting its level, and aiming it more obviously as a tool to redress imbalances in the distribution of power in workplaces - should be seen as a part of a refitting of the economy more generally in the wake of covid-19. We make recommendations below not only for a significant increase in the current National Living Wage, but also for a shift in the balance of taxation to accommodate its costs, and to rebuild a small business economy in the UK.

Employed income losses since 2008

The period since the Global Financial Crisis (GFC, 2008-9) has been one of exceptionally poor wage growth by the standards of modern history. In the decade before the crash, median hourly pay rose, on average, 3.9% a year. In the decade following (2009 to 2019), median hourly wages grew by 2.1%. This is marginally below the average rate of annual inflation for the period, 2.2%. In real terms (after accounting for price rises) this was a "lost decade" for pay, something unprecedented since at least the Industrial Revolution.

If median hourly pay had continued to grow at the same pace in the decade after the GFC as it had in the decade before, median hourly pay today would be £18.10, rather than the £14.10 as recorded by the ONS – a full £4 an hour more.

If median hourly pay grows as forecast by the OBR, whose March 2022 forecast revision expects comparatively robust nominal pay over the next few years to 2025, median hourly pay will be £15.86. If, instead, we pretend pay had grown as fast in the decade after the crash as in the decade before it, and then assume it grows as forecast by the OBR, median hourly pay will be £20.39 in 2025.

The metric of median hourly pay matters, in particular, as the government has set a goal of achieving two-thirds of median hourly pay for the National Living Wage by 2024.[27] If pay now grows as fast as the OBR expects until 2025, two-thirds of median hourly pay will be £10.58 in 2025. But if pay had grown as fast in

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[27] Office for Budget Responsibility (March 2020), *Economic and Fiscal Outlook March 2020*, London: OBR, p.47. At: https://obr.uk/box/the-national-living-wage/

the decade since the crash as in the decade before, and then grows as the OBR forecasts, this two-thirds of the median figure would be £13.60.

If we further assume that inflation follows the path forecast by the Office for Budget Responsibility to 2025, and that we wish to maintain the real-terms value of the minimum wage, the implied value by 2025 is slightly over £15 per hour, at £15.70 per hour. It should be noted that the OBR forecasts may prove to be optimistic, forecasting a rapid return to the 2% target after a spike over 2022 and 2023.

In other words, a £15/hour minimum wage by 2025 can be thought of as compensation for the miserable performance of wages in the UK in the decade following the Great Financial Crisis, and an allowance for currently very high rates of inflation. A government committed to restoring this “lost decade”, pulling the pay of the lowest paid back to the levels they could have expected but for the losses of the last ten years.

4. Productivity Growth and the Minimum Wage

Improving productivity (alone) is not the answer to low pay

The argument that wage increases are only obtainable, and sustainable, on a long-term basis if they are covered by productivity improvements is a common one, and typically offered as a rejoinder to demands for higher pay. Once, when the British economy was delivering consistent productivity increases of at or above 2% a year, this may have been an acceptable argument: at a reasonably high and consistent rate of productivity growth, asking low paid workers to match wage rises to productivity growth is (theoretically) asking relatively little of them. It does nothing for *inequality* unless wage growth is held down for those on higher incomes, but at least in theory you are not actually requiring anyone to be made worse off.

This might even be an acceptable argument if wage growth actually lagged somewhat behind productivity growth. This would mean that the share of earnings for labour in national income steadily fell over time, as has happened in a number of developed countries, including the United States, since the 1980s.[28] But it wouldn't rule out wage and salary growth – just that wages would be growing more slowly than productivity. In the UK, over the whole period between 1980 and 2019, *mean* wage growth closely tracked productivity growth. But *median* wage growth was slower, indicating that it was better-paid workers

[28] OECD (November 2018), "Decoupling of wages from productivity: what implications for public policy?", *OECD Economic Outlook*, Paris: Organisation for Economic Cooperation and Development. At: https://www.oecd.org/economy/outlook/Decoupling-of-wages-from-productivity-november-2018-OECD-economic-outlook-chapter.pdf

taking a rising share of productivity gains.29 The disruption of covid has made assessment since 2019 difficult, but should that long-run trend continue, rising productivity will produce rising inequality in the UK. This is assuming productivity recovers to its previous, pre-crash trend; post-2008, of course, this has not happened.[30]

Sometimes, the argument is made the other way round: that higher minimum wages will *induce* the higher productivity seemingly needed to cover them. Then-Chancellor George Osborne made this case when introducing the much faster increases in the legal minimum wage through the new National Living Wage (NLW).[31] The Department for Business, Innovation and Skills (BIS) argued that the NLW would "encourage a model of higher pay and higher productivity".[32] This may come through the improved investment in staff training, or more capital investment (for example in automation); or, alternatively, through an "efficiency wage" effect[33] or some other behavioural impacts.

However, recent research, published by the Low Pay Commission itself, calls this assumption into question. Although previous studies have suggested some, relatively small impacts over the longer term from the initial introduction of the National Minimum Wage (NMW),[34] the Commission's research found "no evidence" of a positive productivity impact from the more rapid annual increases

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[29] Teichgraeber, A. and van Reenan, J. (November 2021), "Have productivity and pay decoupled in the UK?", Discussion paper no. 1812, Centre for Economic Performance, LSE. At: https://cep.lse.ac.uk/pubs/download/dp1812.pdf. The mean measures the "cricket average" (add the wages together and divide by the number of people being paid), and so is pulled upwards by a relatively few higher paid workers. The median takes the middle wage paid in a ranking of all the wages, and so is not affected by the ends of the distribution in the same way. As a result, if the two growth rates of mean and median diverge from productivity growth in the way the authors indicate, it implies widening inequality – faster growth at the top pulling the mean wage up, but leaving the median growing much slower.

[30] Between 1960 and 2007, British output per worker averaged 2.15% growth a year. From 2008 to 2019, output per worker averaged 0.42% growth a year. ONS (11 January 2022), "Labour productivity time series", Series: A4YN. At: https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/labourproductivity/datasets/labourproductivity

[31] O'Connor, S. (12 July 2015), "Osborne experiments with wage rise to boost productivity", *Financial Times*. At: https://www.ft.com/content/3beae17c-28ad-11e5-8613-e7aedbb7bdb7

[32] BIS (July 2015), *Low Pay Commission Remit 2016*, Department for Business, Innovation and Skills.

[33] This is argued to occur where the opportunity cost of unemployment, resulting from being caught shirking, is raised by higher wages. Stiglitz, J.E. (1976), "The efficiency wage hypothesis, surplus labor, and the distribution of income in LDCs", *Oxford Economic Papers* 28:2

[34] For example, Rizov, M., Croucher, R. and Lange, T. (2016), "The UK National Minimum Wage's Impact on Productivity". British Journal of Management 27

in the minimum wage that the NLW introduced at the level of industry or region.[35]

It is, therefore, no longer an adequate response to either low pay, or inequality, to insist on the need for productivity improvements before tackling either. Productivity improvements have not been particularly forthcoming over the last decade, and when productivity growth was more consistent pre-crash, it was not always shared fairly – improving productivity instead contributing to the startling rise in inequality of the last few decades. Nor is it convincing to find a get-out clause, claiming productivity improvements will come about from a higher minimum wage itself. The latest evidence does not sustain the (politically convenient) claim. A new approach is needed.

"High pressure" economics and regional growth

The first part of this new approach is to shift the focus away from the supply-side considerations that have dominated discussion of the minimum wages' economic impacts in Britain. Instead, we should start to think more closely about the *distributional* and therefore the *demand* consequences of rapidly increasing the minimum wage. Janet Yellen, whilst on the Board of the Federal Reserve, resurrected the idea of a "high pressure economy". As formulated by Arthur Okun, this refers to the situation where the fiscal and monetary authorities "overdrive" the economy, pushing it beyond the assumed stable point of "non-accelerating inflation" to move it into a permanently higher wage, higher employment setting. The idea depends on the assumption of multiple equilibria: that an economy, left to its own devices, may well stabilise around a "low pressure" point where low wages reinforce low demand which in turn drives low investment, leading back into low wages. A sufficiently large push from government, pumping demand into the economy, could signal to both sides – firms and workers – that they need to raise their expectations about future incomes, invest more, and demand higher wages. The economy would then (in the theory) transition to its new, better equilibrium at a point where wages and investment are both higher, now and into the future.

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[35] Latimer, E. (March 2022), "The impact of the National Living Wage on productivity", Low Pay Commission: London. At: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1076518/Productivity_report.pdf. The author highlights the possibility of firm-level impacts that are not captured in the available data.

US macroeconomic policy debates have begun to focus on this idea, given its promotion by Yellen, now US Treasury Secretary. In particular, the empirical validity of this presumed better equilibrium point is, by its nature, hard to demonstrate for the whole economy. A belief in multiple equilibria, and that the economy can end up at one which is decisively worse[36] to another requires also a rejection of the idea that a free market will select the optimum possible outcome.

But for under-performing regions within the same economy, otherwise sharing the same basic framework of laws and major institutions, there is a more solid case to be made. There are few inherent reasons for (for example) the North East of England to have persistently lower wages, higher economic inactivity, and lower productivity than the rest of England: it shares a common legal framework, common institutions for governance, common trade relations with the rest of the world, even such basics as the same currency and language as the rest of the country. Geography and proximity to markets, in particular, might account for some of the difference. But largely it looks like a clear case of joint market and institutional failure: a setting, by now hard-wired into both private markets (notably for investment capital) and public institutions (notably in the Treasury) that hold the North East in a permanently lower-potential setting.

That, at least, is the broad conclusion of recent studies looking at both the North East and wider England outside the Greater South East. The *Northern Powerhouse Independent Economic Review* identified an "investment gap" which had "widened markedly" across the whole of the North of England. Making good this gap, either through public or private investment or, most likely, some combination of both, could unlock the enormous potential here - valued as an additional £97bn in output that could be achieved in their "transformational" scenario by 2050.[37]

Put together, the existence of such significant geographical disparities is a solid argument for the kind of "high pressure" approach being advocated here. Placing greater sums in the hands of employees will undoubtedly boost demand locally,

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[36] "Pareto inferior": that is, that at least one person in the economy could be made better off than their current position without making any other person worse off.

[37] SQW/Cambridge Econometrics (24 June 2016), *The Northern Powerhouse Independent Economic Review: final report,* p.16

given the higher propensity of the lower-paid to spend from their earnings.[38] Given the presence of well-identified underused resources at a regional level, encourage greater investment and, ideally, help establish the kind of virtuous circle of sustainably higher wages and investment that the "high pressure" approach identifies. It is posited on the claim that higher local demand will lead to a positive "crowding in" of investment as the permanently higher level of demand is registered by firms and holders of capital, and translated into higher levels of investment.[39] This should, of course, be ideally matched with significant government investment and a regional industrial policy to promote growth of critical sectors.[40] But a higher minimum wage helps create the markets that would sustain such locally- and regionally-focused growth.

A significant boost in the £15/hour minimum wage could, therefore, act as a significant lever for levelling up: dramatically raising local incomes, promoting local expenditure, and so promoting local investment down the line and therefore promoting measured productivity improvements. Later, we will consider the redistributive potential of the proposed package: the £15/hour minimum wage could act as an effective means to transfer idle funds out of the hands of wealthy individuals and large corporations, and towards the worse-off workers.

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[38] eg ONS (31 March 2021), "Quarterly economic commentary: October to December 2020", p.10. At: https://www.ons.gov.uk/economy/nationalaccounts/uksectoraccounts/articles/quarterlyeconomiccommentary/octobertodecember2020/pdf

[39] Black, P.A. (1996), "A Theory of the Regional Accelerator", *Studies in Economics and Econometrics* 20:2 CHECK THIS

[40] UCL Commission for Mission-Oriented Innovation and Industrial Strategy (May 2019), A Mission-Oriented UK Industrial Strategy. UCL Institute for Innovation and Public Purpose: London. At: https://www.ucl.ac.uk/bartlett/public-purpose/sites/public-purpose/files/190515_iipp_report_moiis_final_artwork_digital_export.pdf

5. Inflation and the Minimum Wage

The rapid increase in inflation, in the UK and across the world, to levels last seen in the early 1980s has also seen the resurrection of some explanations for it also last in fashion some four decades ago. The "wage-price" spiral has become a talking point, with the Governor of the Bank of England amongst those urging pay "restraint" on employees to avoid it settling in. Whilst the Low Pay Commission found, at best, "negligible" evidence of the impact of past minimum wage increases on inflation,[41] the prospect of significant pay rises might alarm some.

But to view the world through the wage-price spiral this is to severely misinterpret the type of inflation we are now experiencing. At present, major supply-side shocks, largely arising in the rest of the world (or at least from global factors, like covid) are joined, in the case of the UK, by the complications arising from Brexit. The graph below, reproduced from a recent speech by a Bank of England Monetary Policy Committee member, shows the contribution of different factors to overall inflation since the end of 2019. The sharp increase since the start of 2021 is clearly visible: but so, too, is its dependency on energy input prices and more general supply shortages. Neither has a plausible relationship to UK wages and still less to the level of the minimum wage.

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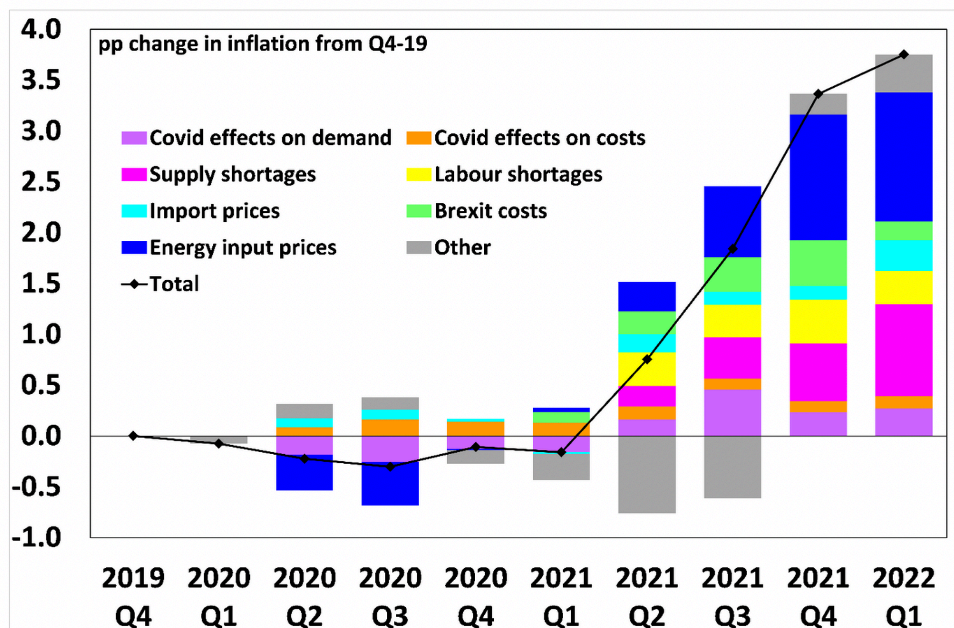
[41] The LPC find that "The 'elasticity' of the minimum wage with respect to prices is between 0.023 and 0.11, meaning that a 10 per cent increase in the minimum wage could increase prices of affected goods and services by up to 1.1 per cent. Because this only applies to a small subset of items and regions, minimum wages have a negligible impact on overall measures of inflation." Hill, E. (21 January 2021), "What does the NLW have to do with the price of fish?", Low Pay Commission blog. At: https://minimumwage.blog.gov.uk/2021/01/22/what-does-the-nlw-have-to-do-with-the-price-of-fish/ . See also Frontier Economics (September 2020), *Estimating the impact of minimum wages on prices: a report for the Low Pay Commission*, London:Low Pay Commission. At: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/942445/Frontier_Economics_-_Estimating_the_impact_of_minimum_wages_on_prices_-_FINAL.PDF



Source: Saunders, M. (9 May 2022), "The route back to 2% inflation". Speech by Michael Saunders at the Resolution Foundation. At: https://www.bankofengland.co.uk/speech/2022/may/michael-saunders-speech-at-the-resolution-foundation-event

For a wage-price spiral to develop from this situation requires us to believe that, first, workers setting their bargaining positions believe these factors to be more than temporary – plausible, at least for some portion relating to future supply-side shocks, notably from extreme weather and environmental instability. But it requires, second, that we also believe that workers are typically in a position to have a meaningful collective bargaining position of any sort. This simply does not apply to most work in the UK.

The wage-price spiral argument essentially misunderstands the type of labour market we are now in. As indicated, the bargaining institutions that might once have plausibly acted as transmission mechanisms from elevated prices (or *expectations* of elevated prices) into higher wage demands and so into higher costs are simply not there. Trade unions and collective bargaining agreements cover a small fraction of the workforce compared to the last period of sustained, high inflation in the 1970s and 1980s. And far from seeing a sustained squeeze on profits, as in the 1970s and early 1980s,[42] profits are high and have recovered

42 Lansley, S. (March 2010), *The Wage Squeeze and the Crash*, Compass: London. At: https://www.bl.uk/britishlibrary/~/media/bl/global/social-welfare/pdfs/non-secure/w/a/g/wage-squeeze-and-the-crash.pdf

rapidly. This reflects the balance of power in different markets: labour, across different sectors, is generally in a weak bargaining position but capital (in the form of the largest and most profitable firms, at least) often is not. Where there may have been a shift in favour of labour, as we have seen in some sectors around the so-called "Great Resignation", this has emerged as workers exercising their power through "exit" to alternative employment (or non-employment), rather than "voice" to demand higher pay or better conditions where they work.[43]

Corporate profits as central to inflation today

Major corporate profits have seen a very sharp recovery since the first pandemic shutdowns in 2020, far outpacing wages and salaries and whole-economy economic growth in the US, Western European economies, and the UK. Corporate profits reached their highest level since 1950 in the US last year.[44] First quarter reports for corporations in the EU show that profits are up 40% on the preceding year.[45] Certain sectors in the UK have been notoriously profitable, notably oil and gas producers, but Tax Justice UK note that major companies outside have seen extraordinary recoveries in their pre-tax profits since the end of the first lockdown.[46]

Looking a little further back, the Competition and Markets Authority (CMA) have shown that the 10% of most profitable firms in the UK have increased their mark-ups from 58% to 82% between 2008 and 2020.[47] This is consistent with similar reports of increased mark-ups, notably during the pandemic, from the US and other developed economies.[48] The apparent tendency towards growing market power and the concentration of capital has provoked a political and judicial

[43] The terms – exit, voice, loyalty – are from Alfred O. Hischmann. See Meadway, J. (12 December 2021), "When will the 'Great Resignation' turn into the Great Strike?", *Novara Media*. At: https://novaramedia.com/2021/12/12/when-will-the-great-resignation-turn-into-the-great-strike/

[44] Boesler, M. (30 March 2022), "Profits soar as US corporations have their best year since 1950", *Bloomberg*. At: https://www.bloomberg.com/news/articles/2022-03-30/2021-was-best-year-for-u-s-corporation-profits-since-1950?sref=d6fKRvkp

[45] Johnston, I. (14 May 2022), "Strone European earnings season fails to ease investor nerves", *Financial Times*. At: https://www.ft.com/content/bc2e058e-e8ef-4387-979c-cfc4e233c059

[46] Tax Justice UK (September 2021), *Pandemic Profits*, London: Tax Justice UK. At: https://www.taxjustice.uk/uploads/1/0/0/3/100363766/pandemic_profits_-_final.pdf

[47] Competition and Markets Authority (29 April 2022), *The State of UK Competition Report: April 2022*.

[48] Layne, R. (5 May 2022), "Why do businesses raise their prices? Because they can", *Harvard Business Review*. At: https://hbswk.hbs.edu/item/why-companies-raise-their-prices-because-they-can

reaction in the US, where the tradition of support for smaller businesses and free markets as a bulwark of a democratic society is strong, and where the "neo-Brandeisians" have come to dominate discussions of competition in relation to digital giants, in particular.[49]

For the current discussion, it is necessary to note only that the rise in prices has been accompanied by a rise in (money) profits for larger companies, as we might expect: if prices are rising, but wages and salaries are not, national accounting would suggest an increase in the profit share of national income.[50] Yet this feature of the current inflationary surge is woefully under-considered in most debates. Financial Times columnist Martin Sandbu put the case very clearly:

> you could prevent a terms-of-trade shock from creating domestic inflation by forcing business owners to take the hit from higher imported input prices (and wage rises enough to cover the related consumer inflation) in a compressed profit margin.[51]

Elsewhere, Bank of England chief economist Huw Pill has cautioned against firms attempting to maintain "real profit margins" in the face of supply-side shocks.[52] Certainly, if (as anticipated), the current price surge in essentials eats into household expenditure, dragging the economy back into recession, this "protection" of profit margins by large companies will look particularly indefensible.

Fresh evidence from the Federal Reserve Bank of Boston shows that the "pass-through" to final output prices from cost shocks is greater (as we would expect) when market concentration is higher: in other words, larger, more powerful corporations exercise their power to pass on rising costs to consumers and other businesses. Since corporate concentration has risen markedly in recent decades, with the US economy being 50% more concentrated on a standard measure by

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[49] Khan, L. (March 2018), "The New Brandeis Movement: America's Antimonopoly Debate", Journal of European Competition Law & Practice 9:13

[50] This has been demonstrated more formally by Michal Kalecki, amongst others. Kalecki, M. (1938), "The determinants of the distribution of the national income", *Econometrica* 6:2.

[51] Sandbu, M. (10 February 2022), "The class warriors at the Bank of England", *Financial Times*. At: https://www.ft.com/content/f5fa4747-f9c1-4e95-878f-6e9b5db5579c

[52] Strauss, D. (10 February 2022), "Bank of England chief economist cautions against 'aggressive' approach to rate rises", *Financial Times*. At: https://www.ft.com/content/21fb0b4f-500c-4375-9904-07e48399aae1

2020 than 2005, this corporate power effect is now substantial.[53] It is these impacts, rather than chasing the ghosts of 1970s unions, that we should look for the culprits in the current inflationary surge.

The clear evidence of the severe imbalance in market power between employers and employees, and the emerging evidence that powerful, "monopsonistic" producers exploit that power in output markets, suggests exactly the opposite response would make more sense: action to restrict corporate power in output markets, limiting the capacity for the "pass-through" of cost shocks through rising mark-ups would help restrain prices, whilst more robust labour market bargaining institutions would help employees win higher pay.

Strengthening trade unions and other collective bargaining institutions

It can be argued that more robust labour market institutions, like stronger trade unions and greater coverage of collective bargaining, would both be effective (perhaps even more effective) in ending poverty pay and reducing income inequality. The argument has often been made that the weakening of trade unions and other collective bargaining institutions from the late 1970s onwards led directly to rising income inequality, both in Britain and across the developed world.[54] Evidence from across the OECD suggests that a decline in labour's bargaining power in member countries was responsible for about half the observed decline in labour's share of national income between 1975 and 2017.[55]

The evidence here is persuasive, and we would anticipate that more effective collective voice in workplaces would significantly improve pay and conditions, and reduce labour market inequality. As an example, Australia's system of a national minimum wage, backed up with Fair Wage Councils that can set additional minima for specific sectors (as well as wider sectoral employment regulation) has much to recommend it, with the 2014 Resolution Foundation

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[53] Bräuning, F., Fillat, J.L., and Joaquim, G. (23 May 2022), "Cost-Price Relationships in a Concentrated Economy", Current Policy Perspectives, Research Department, Federal Reserve Bank of Boston. At: https://www.bostonfed.org/-/media/Documents/Workingpapers/PDF/2022/cpp20220523.pdf

[54] Kennedy, L. (September 2018), *Tackling Inequality: the role of trade unions*, London: Centre for Labour and Social Studies. At: http://classonline.org.uk/docs/TU_and_Inequality_for_print_18th_September.pdf

[55] Guschanski, A. and Onaran, O. (2017), "The polticial economy of income distribution: industry level evidence from 14 OECD countries", Greenwich Papers in Political Economy GPERC51. At: https://gala.gre.ac.uk/id/eprint/17518/1/ws%20oecd%20panel%20working%20paper%20gppe%2003.pdf

reporting that the combination of national minimum wage and sectoral Fair Wage Councils protected 16 percent of the workforce, or about double the numbers covered by UK minimum wage laws.[56]

But to create, or re-create, institutions like Wage Councils in the UK,[57] or to build up trade union membership and restore collective bargaining, would take a significant amount of time: it took over 80 years, and many changes in the law, for the percentage of the workforce in a trade union in Britain to rise from 9.9 percent in 1892, when comparable records began, to its all-time peak of 52.4 percent in 1979, after which point it has declined almost continuously.[58] An expansion of union membership today, if a favourable legal and political environment was nurtured, could be much quicker. But it would still be significantly slower than a legally-mandated increase in the minimum wage.

We could view labour market legislation, imposed by government "from above", as an effective substitute for collective bargaining institutions grown "from below". Abel et al. find that monopsony and concentration in UK labour markets is having a larger impact over time as a result of the decline in collective bargaining agreements. This is in line with our general contention that declining union power, and declining use of collective bargaining (covering union and non-union workers) necessitates a response from government, or else risks leaving workers increasingly exposed to an uncertain economic environment where the balance of effective market power is skewed against them.[59]

But we also argue here that a rapid rise in the minimum wage may itself help rebuild workplace collective bargaining institutions. Evidence from US states shows a statistically significant relationship between increases in the minimum wage at a state level, and subsequent increases in union membership. A one dollar increase in the state-level minimum wage is directly related to a subsequent 5 percentage point increase in state-level union membership, as a share of the total workforce. There are multiple reasons proposed for this relationship. One is that minimum wage increases act as a visible advert for the

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[56] Resolution Foundation (2014), *More than a Minimum: the Resolution Foundation review of the future of the National Minimum Wage: final report*, London: Resolution Foundation, pp.24-25. At: https://www.resolutionfoundation.org/app/uploads/2014/03/More_than_a_minimum1.pdf

[57] Their original incarnation was abolished in 1993.

[58] Bank of England (2020), "A Millennia of Macroeconomic Data". Union membership reached a low of 23.3% in 2017, after which it has risen slightly.

[59] Abel, W., Tenreyro, S. and Thwaites, G. (2018), "Monopsony in the UK", CEPR Discussion Paper 13265.

importance of trade unions through "effective advocacy". Another is that minimum wage rises alert other workers, unaffected directly by the wage rise, to the importance of collective labour market institutions.[60] Whatever the precise mechanism, **we should view minimum wage increases as part of a package of labour market reforms aimed at improving worker bargaining power** – not merely as something almost like a charitable handout.

[60] Clemens, J., Strain, M.R., (2020), "Public policy and participation in political interest groups: an analysis of minimum wages, labour unions, and effective advocacy", National Bureau of Economic Research working paper 27902. At: https://www.nber.org/system/files/working_papers/w27902/w27902.pdf

6. Modelling the Impact of a £15/Hour Minimum Wage

We have assumed throughout that this £15/hour standard would apply for all employees over the age of 18, rather than the current NLW threshold age of 22, which we view as hard to justify in relation to the costs faced by younger workers. We have not modelled for preceding years' impacts, but take it as read that an ideal path to £15/hour would include significant increases in the value of the minimum wage in the years before, forming a smooth, if rapid, "path" up to £15/hour.

Impact of the £15/hour minimum wage on the share of wages and salaries in national income

Using Family Resources Survey data for current incomes, and OBR forecasts for national income and national income growth, it is possible to forecast the share of wages and salaries in national income, as shown below for the forty year period from 1984-2024.[61] The last three years, 2021 to 2024, are all based on the OBR's forecasts, but then we have included an estimate for the total wage and salary cost based on our forecasts of the effect of the £15/hour increase.[62]

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[61] The figure we are using here differs from the usual "labour share of income" figures as it is looking only at wages and salaries for employees, excluding the earnings of the self-employed (technically known as "mixed incomes"). We are also using Gross Value Added, rather than GDP, as the measure of national output, since GVA excludes subsidies and taxes, making it more easily comparable with our wage and salary numbers. For more details on the calculation of labour share, and the impact of the self-employed on labour income, see Sidhu, S. and Dunn, M. (14 September 2018), "Estimating the impact of the self-employed in the labour share", Office for National Statistics. Available at: https://www.ons.gov.uk/economy/economicoutputandproductivity/productivitymeasures/methodologies/estimatingtheimpactoftheselfemployedinthelabourshare.

[62] Modelling here was carried out by Landman Economics, using their model of the UK household income distribution.

These four decades were, by historical standards, a period of relatively lower labour share in national income: whereas the average share over the (almost) four decades preceding, from the end of the Second World War to the early 1980s, was 51.4%, the average over this period, up to 2020, was 40.9%, more than ten percentage points lower. This decline in labour's share of national income is common to developed counties over the entire post-war period.[63]

For the UK, most of this long-term decline actually occurred in the twenty year period 1976-1996, whilst the labour share actually recovered sharply in the early 2000s before resuming its decline in after the Global Financial Crisis of 2008-9. The outbreak of covid-19, in 2020, produced a dramatic reverse of this trend, as GDP shrunk at its fastest rate in peacetime history whilst wages and salaries remained relatively stable – not least with the government paying up to 80% of the wage or salary of almost 12 million people through the Coronavirus Job Retention Scheme.

It is immediately apparent just how dramatic a shock the first year of covid was: with national output falling, but wages and salaries somewhat protected, the employee share of income automatically rose strongly. Since then, the share has declined somewhat and, with the OBR expecting the whole economy to grow faster than employee income, the share is forecast to decline over the next few years, back down to its pre-pandemic low.

2020 is the last year for which full data is currently available for household incomes. After this point, we rely on forecasts of their growth, based on the OBR headline forecasts. These suggest a rapid decline in the labour share of income over the first half of this decade, as the economy is opened up, "rebound" growth is rapid, but wage and salary growth is far lower. Should no further action be taken by government, this attempt at returning to a pre-covid "normal" implies, on the OBR forecasts, a steady decline in labour's share of national income to 39.1% by 2024 – barely above its all-time low (in the official figures) of 38.9% in 1996. Actual outcomes may well be worse than this, as inflation is presently well above forecasts and expected to continue, whilst wage growth is much more modest.

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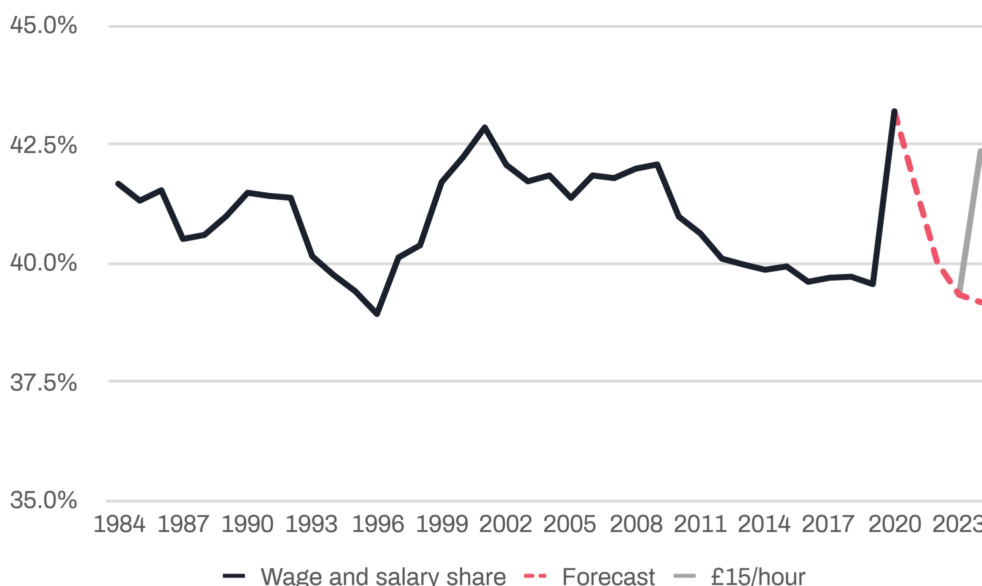
[63] See, for example, Manyika, J., et al., (22 May 2019), "A new look at the declining labor share of income in the United States", McKinsey Global Institute Discussion Paper. At: https://www.mckinsey.com/featured-insights/employment-and-growth/a-new-look-at-the-declining-labor-share-of-income-in-the-united-states

We propose, instead, that the period of reopening and adjustment to life after the initial covid outbreak is used to rebalance the economy between labour and capital. The introduction of a £15/hour minimum wage in the 2024-25 financial year would take aggregate payments to labour up to £1,045.1bn a year, up from £887.4bn in 2021-2022 and £74.5bn above the total payments to labour implied by the OBR forecasts for 2024-25.

This is a substantial increase in payments to labour, but that is the point of the exercise. The impact on labour's share of national income is also significant. In 2024, we forecast this would rise to 42.4%, a three percentage point increase on the OBR forecast, and just under three percentage points above its 2019 share. But this should not be considered unusual: even with the £15/hour minimum wage, labour's share of income remains below its early 2000s peak of 42.9% in 2000, and less than a percentage point above its 1997-2008 average of 41.4%. By the standards of recent history, the demand to raise labour's share of national income is not excessive; indeed, it could easily be seen as merely correcting the losses suffered since the financial crisis.

Wages and salaries share of UK GDP, 1984-2024 (forecast)



Source: ONS National Accounts; Family Resources Survey; authors' own calculations. The wage and salary share of national income with a £15/hour minimum wage for the 2024-25 tax year is indicated.

Instead of overseeing a continued decline in the employee share, and the restoration of the pre-covid status quo ante, a significant increase in the minimum wage could act as the foundation stone for rebuilding the economy on a more socially just basis. The demand for £15/hour, taking its effects in the aggregate would act to restore some of what has been lost to those who work during the course of the 2010s.

Including what the ONS call “mixed incomes”, here meaning the earnings of the self-employed (a “mix” of wages and profits) shifts the total paid income share upwards somewhat and, as the number of self-employed grows rapidly after 2008, the gap between the wages and salaries share, and the total paid income share, grows wider. But the growth of the total paid share (employed and self-employed earnings) is much slower than the growth of the self-employed share of the workforce, indicating the relatively poor returns (and, indirectly, high insecurity) of this form of work. Whilst recognising that genuine self-employment can bring many benefits, notably around additional flexibility of working time and type for the self-employed, and the satisfaction of “being your own boss”, this does point to the issue of “bogus” self-employment and the exposure to insecurity and low pay that forced self-employment can bring. A comprehensive proposal for labour market reform would look to significantly improve the conditions and, where possible, pay of the self-employed, both as a good in itself and to prevent its use as a cheap substitute for genuine employment.

But we would argue the growth of compensation brought about the increased minimum wage is preferable to simply allowing the economy (and wages) to follow the official forecasts, and this is because the increase in the minimum wage builds in a dramatically progressive shift in the balance of earnings. It is, as we have seen, the poorest households who stand to gain the most from a major increase in the minimum wage; the danger with simply allowing wages to rise as forecast is that it the economy will return to its pre-pandemic setting of delivering faster wage rises to those at the top end of the income distribution.

Even if the wage share grew unaided, defying official forecasts and current economic experience, we could reasonably anticipate that a return to pre-pandemic forms of economic growth would deepen inequality still further. This should be set in the context of the most recent forecasts from the OBR that

suggest they expect long-run GDP growth to now be just 1.6% a year by 2024, well below the 2.1% average growth over the twentieth century.[64]

Labour's share of national income immediately prior to the pandemic had reached its lowest level since current, official records began in 1948. Asking especially low paid workers to then wait for pay rises until – perhaps, if we are lucky – British capitalism managed to produce the productivity growth of other developed economies is in reality asking them only to make further and further sacrifices on the off-chance that the economy recovers its previous sprightliness.

The claim for £15/hour here is founded on the categoric rejection of this argument. It is unabashedly about shifting the balance of national income in favour of labour, and against capital. Should, at some point in the future, the British economy recover its previous levels of productivity growth, that is all to the good, but it cannot be guaranteed and workers who have endured a decade of flat or even falling real incomes should not have to wait any longer. To put an end to the misery, squalor and uncertainty that increasing numbers in our failing labour market actually face requires a pay rise, without preconditions. If this means profit margins are squeezed and, over time, the share of national income going to capital squeezed with them, so be it.[65]

Impact on inequality and poverty

The evidence to date has suggested that minimum wages would have only a limited impact on poverty, as a result of two factors: first, the historic concentration of poverty amongst those who do not work, and who are therefore unaffected by a minimum wage increase in the first instance; second, that

[64] Office for Budget Responsibility (March 2022), *Economic and Fiscal Outlook: March 2022*, Annex C. At: https://obr.uk/docs/dlm_uploads/CCS0222366764-001_OBR-EFO-March-2022_Web-Accessible-2.pdf

[65] There is an argument in the post-Keynesian literature to the effect that the rise in aggregate demand as a result of increasing wages itself encourages economic growth. We are not making this argument here, instead arguing only for redistribution via the labour market, but for an empirical study of this effect in the UK and EU members, please see Onaram, O. and Obst, T. (January 2016), "Wage-led growth in the EU15 member states: the effects of income distribution on growth, investment, trade balance and inflation", Post Keynesian Economics Study Group working paper 106. At: https://www.postkeynesian.net/downloads/working-papers/PKWP1602.pdf

minimum wages have generally been set at too low a level to make a truly significant difference to the incomes of the poorest.[66]

But changes in the labour market, including the more significant recent increases in the minimum wage as a result of the National Living Wage being introduced, suggest that this previous pattern may no longer hold. Poverty in the UK is increasingly in-work poverty, with more than half of those in poverty living in a working household.[67] And as the "floor" of minimum wages has been steadily raised, the compression of the wage distribution at the lower end has meant increasingly large numbers are paid at or only just above this minimum.

The result is that increases in the minimum wage are increasingly important for tackling poverty, and will have a more and more significant impact on people's earnings as they do. A significant increase in the minimum wage, meanwhile, would overcome the problem of the last few decades where piecemeal rises have resulted in limited impacts for inequality and poverty.

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[66] McKnight, A., Stewart, K., Mohun Himmelweit, S. and Palillo, M. (May 2016), "Low pay and in-work poverty:
preventative measures and preventative approaches: evidence review", LSE Centre for the Analysis of Social Exclusion/European Commission, p.70. At: https://www.lse.ac.uk/business/consulting/assets/documents/Low-Pay-and-In-Work-Poverty.pdf

[67] Joseph Rowntree Foundation (February 2020), *UK Poverty, 2019/20*. York: Joseph Rowntree Foundation. At: https://www.jrf.org.uk/report/uk-poverty-2019-20; IPPR (26 May 2021), "Working family poverty hits record high". At: https://www.ippr.org/news-and-media/press-releases/revealed-working-family-poverty-hits-record-high-fuelled-by-rising-housing-costs-and-childcare-challenges

Forecast household average incomes by decile, baseline and £15/hour, 2024-5

Income decile	Baseline forecast (£)	Increase (£)	Increase (%)
1 (poorest)	12,492	1,179	9.4%
2	21,977	1,868	8.5%
3	24,414	1,787	7.3%
4	28,566	2,024	7.1%
5	32,882	2,329	7.1%
6	37,755	2,433	6.4%
7	41,545	2,091	5.0%
8	48,807	1,799	3.7%
9	57,731	1,015	1.8%
10 (richest)	96,017	632	0.7%
average	40,219	1,715	4.3%

The poorest 70% of households see a 6.9% increase in their forecast incomes, compared to a 1.7% increase in the household incomes of the richest 30% (the result of some minimum wage workers living in wealthier households). The measure is very strongly redistributive, in the right direction.

Sectoral consequences

Using the Standard Industrial Classifications (SIC) provided by the ONS, we can forecast impacts on pay for on different sectors, given their current and forecast future structure of pay. Low-paying parts of the economy, notably agriculture and accommodation and food services, see the sharpest improvements in wages as a result of the new legal standard. A forecast 72% in agriculture, forestry and fishing and 89% of those working in accommodation and food services are forecast to see at least some improvement in their current rates of pay. Where sectors are consistently low-paid, £15/hour should, in principle, produce significant improvements in pay.

Forecast percentage of employed workforce receiving pay rise from £15/hour minimum wage in 2024-25

Sector	%
Agriculture, forestry and fishing	71.9%
Mining and quarrying	28.9%
Manufacturing	40.2%
Electricity, gas, steam and air conditioning supply	14.3%
Water supply; sewerage, waster management and remediation	41.6%
Construction	36.7%
Wholesale and retail trade; repair of motor vehicles	66.9%
Transportation and storage	42.1%
Accommodation and food service activities	89.1%
Information and communication	20.6%
Financial and insurance activities	23.5%
Real estate activities	42.7%
Professional, scientific and technical activities	27.5%
Administrative and support service activities	63.2%
Public administration and defence, compulsory social security	28.6%
Education	35.7%
Human health and social work activities	47.8%
Arts, entertainment and recreation	63.4%
Other service activities	57.4%
Activities of households as employers	88.9%

Standard Industrial Classification divisions; Landman Economics modelling

The challenges in both are the relatively tighter margins in low-paying sectors, and relatively lower productivity. Later, we examine some measures that would aid small businesses across the economy meet the demands of a much higher minimum wage. But on a by-sector basis, these two, in particular, stand out as requiring additional support from government over the longer term: both are notably affected by the fallout from the covid-19 and Brexit, and the case for

industrial strategies in both, with the explicit goal of reducing low pay, has been made elsewhere. The approach detailed in the government's *Hospitality Strategy*, which includes forbearance on debt acquired during the pandemic and support for additional investment and training, could be extended.[68]

Gender balance

Breaking down the distribution of gains from the change by household income, and by gender of employee in the household starts to illustrate some of these dynamics. The gender balance of gains from the increase are broadly equal, with women employees gaining 50.7% of the total wage bill increase compared to 49.3% for men. This is not even across households: as a result of more men being employed full-time in lower-income households, in the lowest 20% of households it is male employees who gain 57%. Moving up the household income distribution shifts the balance back towards women – the result of more women in part-time work living in households that are otherwise in higher income deciles. At the median household income, the balance is 50.9% of the gain for women compared against 49.1% for men.

"Levelling Up" impacts

England's regional inequalities have become an unavoidable political fact over the last decade. As Lord Kerslake's review of inequality noted, England has levels of geographical inequality comparable (or even worse than) some notorious divides elsewhere in Europe: worse than the North-South divide in Italy, comparable to the divide today between East and West Germany CHECK. The current Conservative administration, elected in 2019, has made "Levelling Up" one of its priorities – adopting the phrase as a catch-all for a range of policies intended to address a multidimensional problem of regional inequality. The Levelling Up White Paper, published in February 2022, defined 12 ambitious "missions" for government, including "improve the pay, employment and productivity in every area in the UK", "narrow the gap in Healthy Life Expectancy (HLE) between local areas where it is highest and lowest" and "decrease homicide, serious violence,

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[68] Department for Business, Energy and Industrial Strategy (July 2021), *Hospitality Strategy: reopening, recovery, resilience*. London. At: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1003059/1200-APS-CCS0621819592-002-BEIS-Accessible2.pdf

and neighbourhood crime, particularly in the worst-affected areas" amongst them.

Yet for all the political attention, and the noisy support of the Prime Minister himself, the government has been criticised as failing to provide the financial support needed to translate these big ambitions into reality. The Institute of Chartered Accountants' analysis of the White Paper suggests that it based on "existing initiatives" with "no new funding" announced.[69] A number of funding streams had been announced prior to the White Paper's publication, including a dedicated £4.8bn "Levelling Up Fund" and a £36bn "Towns Fund" alongside increased capital investment and public R&D spending. But analysis by IPPR North suggests that even these funds fall short of restoring previous cuts – the Levelling Up Fund is, for instance, £1.2bn a year compared to the £2bn a year Local Growth Fund it is intended to replace. Funding is, despite the rhetoric and promises of devolution, becoming more centralised, 96p in every £1 in tax now taken by Whitehall compared to 95p in every £1 four years ago.[70]

Yet the legacy of historic underinvestment across much of the country outside of London and the Greater South East is of lower pay and lower productivity. This can be seen clearly in the figures for median gross hourly pay, as derived from the ONS' Annual Survey of Hours and Earnings (ASHE), shown on the table below, along with a forecast for the same figure in 2024 using the OBR's forecasts for labour income growth.

[69] ICAEW (3 February 2022), "Levelling up: promising noises, but no new funds". At: https://www.icaew.com/insights/viewpoints-on-the-news/2022/feb-2022/levelling-up-promising-noises-but-no-new-funds

[70] IPPR North (17 January 2022), "Exposed: the gap between 'Levelling Up' rhetoric and reality". At: https://www.ippr.org/news-and-media/press-releases/exposed-the-gap-between-levelling-up-rhetoric-and-reality

Median pay by region and nation, £ per hour, 2021 and 2024 (forecast)

Devolved Administration/ English region	2021	2024
North East	12.71	13.90
North West	13.24	14.48
Yorkshire and the Humber	12.89	14.10
East Midlands	12.78	13.98
West Midlands	13.31	14.56
East of England	13.74	15.03
London	18.67	20.42
South East	14.86	16.25
South West	13.17	14.40
Wales	12.82	14.02
Scotland	14.37	15.72
Northern Ireland	12.78	13.98
United Kingdom	14.10	15.42

Source: Annual Survey of Hours and Earnings, Table 5

London's outlier status is immediately apparent. Even by 2024, a £15/hour minimum wage in London represents only just over 73% of the forecast median pay. For the UK as a whole, this is likely to be 97% of the median wage. But for much of the country outside of London, the Greater South East, and Scotland, a £15/hour minimum is ahead of the current forecast median wage.

Geographical impacts of 2024 £15/hour minimum wage, forecast

Devolved Administration/ English region	Proportion of employees impacted
North East	54.7%
North West	52.3%
Yorkshire and the Humber	53.0%
East Midlands	50.8%
West Midlands	48.9%
East of England	42.6%
London	32.9%
South East	39.6%
South West	48.9%
Wales	60.0%
Scotland	45.3%
Northern Ireland	51.1%

Source: Landman Economics modelling; Family Expenditure Survey

Can we afford this increase?

We estimate an addition to the national wage bill from the £15/hour minimum of £74.6bn in 2024-25, as a result of the significant increase on wages currently being paid. This divides between £10.4bn in the public sector, and £64.2bn in the private. To place this in context, the gross compensation for employees in 2024-25 is forecast without the change to be £970.5bn, based on the OBR forecasts for labour income growth. The minimum wage shift is therefore a 7.6% increase on the expected total compensation.

This is substantial, but in the context of the wider economy and recent history, not unbearably so. To see this, we note that increasing the minimum wage also affects the government's tax take, as it increases the amount of income tax and National Insurance Contributions (NICs) that will be paid on incomes, and then (further down the line) increases the expenditure tax take as those with higher

incomes increase their expenditure. Increased incomes for the lower-paid also reduces the government's welfare bill.

Income tax receipts, then, are forecast to increase by £13.5bn, whilst employee NICs rise by £8.8bn and employer NICs by £10.4bn. In total, we forecast that almost £33bn of the increase in wage payments is returned to government through the tax system. Meanwhile, the increase in household incomes in turn allows a reduction in Universal Credit payments of £4.2bn.

Offsetting this are a forecast reduction in Corporation Tax receipts, as companies pay more in wages and salaries, reducing their taxable profits, of £4.5bn, and (as above) a £10.4bn increase in the public sector wage bill.

In total, taking the additional expenditures away from the tax increases, **this leaves an improvement in the government's fiscal position of £25.1bn.** The amounts raised for government through income taxes, NICs contributions, and reduced benefits payments therefore easily outweigh the additional costs of the increase in public sector wages and salaries, and losses from reduced Corporation Tax receipts. This bonus to government finances is substantially the result of differences in the existing pay structures between public and private sectors in the UK: simply put, there are fewer lower-paid workers in the public sector, reflecting the kinds of work typically performed there.[71]

Impact on benefits system

We have already seen how, due to the interaction of wages and salaries with the existing welfare system, an increase in the minimum wage can be expected to reduce income-related payments now made primarily through Universal Credit. **Around £4bn is forecast to be saved in 2024-5,** as incomes of the poorest (and therefore those most likely to be in receipt of low pay) are improved the most. This is in line with the findings of Resolution Foundation's 2014 review of the

[71] A recent econometric study of pay in public and private sectors, making use of a substantial panel data set of earnings across different employers, found that after allowing for different skills and attributes of employees, and allowing for differences in employer attributes like productivity, that there was no so-called "public sector pay premium" for men, and only a 4% increase for women. The latter almost certainly reflects more egalitarian pay structures in the public sector. Singleton, C. (2019), "The public-private sector wage differential in the UK: evidence from longitudinal employer-employee data", *Economics Letters* 174, pp. 109-113. Available at http://centaur.reading.ac.uk/80309/

minimum wage system, which suggested that future increases in the rate would reduce dependency on benefits payments.[72]

It has been suggested that top-up welfare payments of this kind in reality act as a perverse incentive for employers to underpay their staff, knowing that even wage rates that (in a free market) could not be sustained will be met. “Employers may not be in a position to observe whether or not employees can top-up wages through in-work benefits, but the fact that workers are willing to supply labour for low hourly rates of pay makes it feasible for employers to adopt a business model taking advantage of this supply.”[73]

Summary of fiscal impacts from £15/hour minimum wage, 2024-25 (£bn)

Increased income tax receipts	13.5
increased NICs receipts	19.2
reduced spending on social security	4.2
increased expenditure tax receipts	3.1
reduced corporation tax receipts	-4.5
increased public sector wage bill	-10.4
Total improvement in public finances	**25.1**

Source: Landman Economics modelling

Small business and the minimum wage

Concerns about the existing National Living Wage are more likely to expressed by those running slightly larger SMEs, with only 10% of micro businesses (fewer than 10 employees) suggesting it was a concern when surveyed late last year. For all businesses, the NLW is towards the bottom of their concerns, with small

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[72] Resolution Foundation (2014), *More than a Minimum: the Resolution Foundation review of the future of the National Minium Wage*, London: Resolution Foundation. At: https://www.resolutionfoundation.org/app/uploads/2014/03/More_than_a_minimum.pdf

[73] McKnight, A., Stewart, K., Mohun Himmelweit, S. and Palillo, M. (May 2016), “Low pay and in-work poverty:
preventative measures and preventative approaches: evidence review”, LSE Centre for the Analysis of Social Exclusion/European Commission, p.46. At: https://www.lse.ac.uk/business/consulting/assets/documents/Low-Pay-and-In-Work-Poverty.pdf

businesses of all sizes ranking (for example) competition and taxes as greater worries.[74] The Federation of Small Businesses, in its submission to the government's call for evidence on National Living Wage increases, found that only 6 percent of small business owners surveyed were paying their staff below the April 2021 NLW rate, prior to its increase. 49 percent of businesses surveyed, however, reported that they faced "some" or a "large" increase in their wage bill as a result of the change, but that most (68%) of businesses had absorbed the costs.[75] Of course, this leaves a significant minority looking to scale back their expansion or, in some cases, increase prices, and suggests that a more substantial increase in the legal minimum wage will need some form of compensation paid to smaller businesses, especially.

Impact on differentials and company behaviour

Employers can react to higher wage costs – which is what they will perceive higher minimum wages as – in essentially one of three ways: through squeezing profits; through raising their sales prices; or by reducing employment costs in some other way (directly through reduced hours, or indirectly through changing terms and conditions). We have seen that at the level of the whole economy, the impact of higher minimum wages on prices has been minimal so far, and likewise there is no evidence of an impact on employment across the economy as a whole.

For individual companies, rather than the whole economy, the impacts might play out differently. Survey evidence has been provided by Incomes Data Research (IDR) for the Low Pay Commission, asking company bosses to report on existing impacts and future expectations for the impact of inflation-beating minimum wage rises. The IDR results suggest that, at least for employers in lower-paying sectors, increases in the minimum wage have produced some changes in their behaviour, including allowing a compression of pay differentials within the company itself and some alterations to non-pay terms and conditions (for

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[74] "Obstacles relating to employment are more of a concern to larger employers, so staff recruitment and skills were mentioned by 39% of small and 43% of medium-sized businesses, compared with 23% of micro businesses, and the National Living Wage was mentioned by 20% of small and 17% of medium-sized businesses, compared with ten per cent of micro businesses." Department for Business, Energy and Industrial Strategy (18 August 2021), "Longitudinal Small Busines Survey: SME Emloyers (businesses with 1-249 employees) – UK, 2020", Figure 14. At: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1045859/LSBS_2020_SME_Employers_Final_06012022_updated_January_2022.pdf

[75] FSB (June 2021), Letter to Low Pay Commission from Saira Hussain, Federation of Small Businesses. At: https://www.fsb.org.uk/static/6c26fc5e-ee4b-4b29-915c398c85f907d3/FSB-response-to-LPC-consultation-2021.pdf

instance in reduced annual leave entitlements). Larger employers have typically found it easier to absorb costs (or expect to absorb future costs) through some reduction in profits.

These results can be treated as qualitative, and will be strongly dependent on the reporting company's circumstances, rather giving a broad, systematic overview of economic impacts. Nonetheless, they are indicative where modelling results (for instance on differentials) are harder to obtain, and suggest that a sharp increase in the minimum wage, especially for smaller employers, may require some additional support.[76]

Compensation where needed

Those aggregate national figures, whilst indicating that a £15/hour minimum wage is affordable for the country as a whole, including the government, do not necessarily tell us much about what happens below that level. As we have seen above, the impact of the minimum wage varies by sector, with a significantly larger impact in generally lower-paying sectors like accommodation and retail.

Evidence from the Competition and Markets Authority, however, suggests that mark-ups for the largest and most profitable businesses have increased markedly over the last decade, rising from 52% in 2008 to 82% in 2019, ahead of the pandemic. The average mark-up for large employers (employing more than 250 people) have also risen, though less strongly, from 22% to 34% over the last two decades.[77] This strongly suggests that, at least for larger businesses, there is significant "slack" available on their balance sheets to absorb increased labour costs. Where problems arise with an increased minimum wage it will be in the smaller and more marginal employers.

The current division between small and medium enterprises (SMEs) employing fewer than 250 people, and those employing 250 or more, provides a useful

[76] IDR (November 2020), *Impact of future targets for the NLW: a report for the Low Pay Commission*, London: Income Data Research. At: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/942440/IDR_Study_of_impact_of_future_targets_for_the_NLW_FINAL_8_Dec_20.pdf

[77] Competition and Markets Authority (April 2022), *State of UK Competition Report*, London: CMA. At: https://www.gov.uk/government/publications/state-of-uk-competition-report-2022/the-state-of-uk-competition-report-april-2022

approximation to the underlying problem. Since 61% of all employees are employed by small business, we estimate that the increase in specifically small business wage and salary costs is £28.9bn. We have earlier identified a potential problem with tighter margins for small businesses and this can act as a focus for policy attention.

The side-effect of the minimum wage increase is a substantial increase in government net revenues, via a reduction in welfare payments and an increase income taxes. This creates an opportunity for government to ameliorate the costs of the pay increase for smaller businesses. Using the net improvement in the government's finances of £25.1bn, we can compensate businesses that otherwise face an increase in wage bills.

This should be viewed as a further, essential measure in the package, helping to shift the balance of income flows in the UK away from typically cash-rich and profitable larger enterprises and towards the smaller businesses that have otherwise notably during the past two years of the crisis. It should be seen as part of a general restructuring of the UK economy. A targeted intervention for smaller businesses is required.

A number of options are available. The "small profits rate" for Corporation Tax is being reintroduced from April 2023, with businesses declaring less than £50,000 of taxable profits being eligible for a lower headline rate of 19% compared to the (increased) main rate of 25%, or rates given by the system of tax reliefs obtainable between £50,000 and £250,000.[78] Further reductions in the Corporation Tax rate could be viewed as compensation for smaller businesses. However, whilst no doubt welcome for the companies affected, this does not target employment directly, and the relationship between corporation tax changes and employment is weak, at best.[79]

The relationship between payroll taxes, paid directly by the employer on their wage bill, and both employment and wages is (as might be expected) generally found to be more direct. Surveys of international evidence points towards a

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[78] HM Revenue and Customs (3 March 2021), "Policy paper: Corporation Tax charge and rates from 1 April 2022 and Small Profits Rate and Marginal Relief from 1 April 2023", London: HMRC. At: https://www.gov.uk/government/publications/corporation-tax-charge-and-rates-from-1-april-2022-and-small-profits-rate-and-marginal-relief-from-1-april-2023/corporation-tax-charge-and-rates-from-1-april-2022-and-small-profits-rate-and-marginal-relief-from-1-april-2023

[79] See summary of the UK and international evidence in Blakeley, G. (2018), *Fair Dues: Rebalancing business taxation in the UK*, London: Institute of Public Policy Research. At: https://apo.org.au/sites/default/files/resource-files/2018-03/apo-nid137856_1.pdf

generally larger impact from payroll taxes to wages and salaries than on employment. Targeting tax changes, generally to offer a cut for employing certain kinds of employees (young workers, say, or the long-term unemployed) is usually reckoned to have more impact on employment, whilst the effects may also vary by firm type: higher productivity firms may be more likely to pass on payroll tax reductions as wages rather than as increased employment.[80] It also address some of the wider issues around costs, and employers' responses to costs, that the IDR survey revealed: the core issue is to mitigate some of the costs of employment directly, rather than indirectly incentivise more employment.

For the UK specifically, the main payroll tax, directly playable by employers on employment, are National Insurance Contributions (NICs). A detailed study over changes in the rates of NICs paid by employees and employers over 35 years found that reductions in the rate faced by employers had a clear impact on the number of jobs offered by firms and the costs of employing labour.[81] The last is particularly crucial for this example, as we are looking for an appropriate mechanism to ensure that pressures on smaller businesses net cashflow from paying higher wages are reduced. That said, the scale of the changes being proposed here are substantial, relative to the more marginal alterations to the NICs system (and the minimum wage, after its initial introduction) of the last four decades. Our concern is particularly with the distribution of income flows and the provision of compensation if needed.

Freezing the National Insurance Contributions increase, currently due in April, would reduce some of the tax burden on businesses. But this is not a targeted measure: every business, large or small, and regardless of its net cashflow, would benefit. We need, ideally, to refine and target the measure on smaller businesses only.

There is some evidence to suggest that reducing National Insurance Contributions for smaller businesses has a positive impact on labour market outcomes. In 2010, a temporary NICs "holiday" was introduced for start-up businesses outside of London and the South-East. The first ten employees hired by a new business would be eligible for up to £5,000 off their National Insurance

[80] Prinz, D. (5 August 2021), "The impact of payroll tax subsidies: theory and impact", *Institute of Fiscal Studies*, presentation. At: https://ifs.org.uk/publications/15566

[81] Adam, S., Philips, D., Roantree, B. (March 2019) "35 years of reforms: A panel analysis of the incidence of, and employee and employer responses to, social security contributions in the UK", *Journal of Public Economics* 171:29-50.

Contribution in their first year. Analysis by the Federation of Small Businesses suggests that this (relatively modest) scheme created 12,075 jobs over two years, for a net cost of £30m.[82]

Equalising the current employers' contribution threshold for National Insurance with that of the employees (that is, raising it to a uniform rate of £12,500 per year) would cost around £14.1bn, or £8.6bn if applied only to small businesses.[83] This is a substantial sum but has to be placed in the context of a significant change in the level of the national minimum wage. It is, nonetheless, significantly less than the total improvement in the government's own fiscal position.

We can propose the introduction of a "small employers' rate" for National Insurance Contributions, payable by those companies employing fewer than 50 people. This would cover 97% of all businesses employing at least one person and 37% of all employment.[84] A reduction in the current employers' rate for these smaller employers only by 3 percentage points would be enough to compensate, via the tax reduction, for the whole estimated cost of the minimum wage increase to small businesses.[85] An additional element of progressivity would be introduced into the current National Insurance system, with a less dramatic step upwards to the main rate of 15.05% still applicable to employers employing more than 50 persons. The measure, costing £23.7bn, is less than the total forecast increase in government revenues of £25.1bn, allowing some scope for further compensation for larger employers.

This reduction would further reduce the incentive for employers to attempt various forms of "bogus" self-employment, although we note that proper enforcement of the legal status of employees would be needed. We make the suggestion here to illustrate the sort of compensation mechanism that can be designed to ensure businesses most exposed to cost pressures can be adequately

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[82] Federation of Small Business (2012), "Economic impacts of expanding the National Insurance Contributions holiday scheme", policy paper. Available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/225965/18_ATTACHMENT_5.pdf . The loss in NICs revenue of £230m is offset by £200m of additional income and other taxes from the new employment.

[83] Using the HMRC indicative guide to revenues from tax changes, and taking 61% of employees as employed in small businesses (those with fewer than 250 total employment).

[84] Department for Business, Energy and Industrial Strategy (7 October 2021), "Business population estimates for the UK and regions 2021: statistical release". At: https://www.gov.uk/government/statistics/business-population-estimates-2021/business-population-estimates-for-the-uk-and-regions-2021-statistical-release-html

[85] Using the HMRC's "Direct effect of illustrative tax changes bulletin" and at an estimated increase in small employers' wage and salary costs of £23.7bn (37% of the total private sector wage bill increase)

protected. Further progressivity, for instance in reductions in employment taxes for employers in the 50 to 249 employees bracket, could be introduced.

Phasing in the changes

We have shown the forecast results here only for the introduction of a £15/hour minimum wage in the 2024-25 financial year. It would be possible to introduce this earlier, and the impacts shown here would be greater: on the distribution of income, the government's fiscal position, and employers' costs. A phased introduction would allow greater time for adjustment towards the figure. This would suggest a minimum wage of £12.75/hour for the 2023-24 financial year.

Conclusion

A £15/hour minimum wage has strongly positive redistributional consequences and should be considered a fundamental labour market reform at a time of rapidly rising inflation and a falling wage share of national income. Our modelling shows it is affordable for the economy as a whole, and compensatory mechanisms can be designed for smaller businesses experiencing increased costs. Finally, in the context of very poor recent wage performance and a falling share of national income, the increase can be thought of as providing compensation for the lowest paid following a "lost decade" for wage growth.

Dr James Meadway is Director of the Progressive Economy Forum.
Howard Reed is Director of Landman Economics.

PEF Progressive Economy Forum

About PEF
The Progressive Economy Forum (PEF) was founded and launched in May 2018. It brings together a Council of distinguished economists and academics to develop a progressive and sustainable macroeconomic programme and to foster wider public engagement with economics. It opposes and seeks to replace the current dominant economic narrative based on austerity.

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Report layout and design by Daniel Norman (djnn24@gmail.com)

Contact details
Progressive Economy Forum
180 N Gower St
London
NW1 2NB

Email: info@progressiveeconomyforum.com
Phone: 020 7874 8528
Website: www.progressiveeconomyforum.com
Twitter: @pef_online

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