



10 South Colonnade
Canary Wharf
London
E14 4PU

lpc@lowpay.gov.uk
www.lowpay.gov.uk

22 December 2023

The Rt Hon Kemi Badenoch MP
Department for Business and Trade

Dear Secretary of State,

THE MINIMUM WAGE BEYOND 2024

The National Living Wage has been one of the most successful policies of recent years. It has increased pay for some of the lowest paid in society, including vital jobs in caring, retail and elsewhere. At the same time the effects on employment have been benign.

Leading the Commission through this ambitious period has been very challenging, particularly throughout the pandemic. But it has also been extremely rewarding. My fellow Commissioners and I are very proud of what we've achieved with the National Living Wage.

We expect our recommendations on next year's rate to achieve the Government's target of reaching two-thirds of median earnings, effectively ending low hourly pay and becoming one of the highest minimum wages in the world.

My final act as Chairman of the Low Pay Commission is to submit our advice to help you decide what Government should do next with the policy. I have appended the report's executive summary and recommendations to this letter.

Yours

A handwritten signature in black ink that reads 'Bryan K Sanderson'. The signature is written in a cursive style and is underlined with a horizontal line.

Bryan Sanderson

Chair of the Low Pay Commission

Copied to: the Prime Minister the Rt Hon Rishi Sunak MP and the Minister for Enterprise, Markets and Small Business Kevin Hollinrake MP

Annex: Executive summary and recommendations from the Low Pay Commission's advice on the minimum wage framework beyond 2024

1 In 2024 we expect the National Living Wage (NLW) to reach the Government's target of two-thirds of median hourly earnings, for workers aged 21 and over. This is a significant achievement of an ambitious target. The NLW has risen far quicker than before the target was introduced and become one of the highest minimum wages in the world.

2 The Government has asked us to help inform its next steps for National Minimum Wage (NMW) policy, which includes the NLW and the lower rates for younger workers and apprentices. We have looked at the minimum wages' impacts, alternative models for minimum wages, and the role of lower rates for young people and apprentices.

3 The NLW has delivered substantial improvements in hourly pay for low-paid workers. It has risen substantially more in real terms than median hourly pay. On average, these hourly increases have translated into weekly pay increases too. While real average hourly pay has barely changed since 2015, it has grown by 20 per cent for workers in the bottom tenth of hourly pay. The NLW is important for low-income working households, where the highest earner is often an NLW worker. Households with NLW workers have seen their income grow faster than other working households. However, the NLW's impact on total household incomes is more difficult to discern. This is because the NLW increased during a period of profound change in the benefits system.

4 NLW increases have led to higher pay for those paid above the minimum too. These 'spillover' effects happen when employers maintain a pay differential between the lowest-paid jobs and those requiring more skill or responsibility. So, while 1.3 million jobs are paid the NLW, we estimate up to 8 million more jobs have seen higher pay increases than they otherwise would have done since the NLW was introduced. Although they benefit workers, spillover effects raise the overall cost of minimum wage increases and so are a worry for employers.

5 Despite the ambitious increases, we still have not found strong evidence that the NLW has reduced employment or hours of work. Changes in the labour market since 2019, such as lower employment rates for people without degrees, are more likely driven by the Covid-19 pandemic. However, the pandemic also means there is more uncertainty over the NLW's recent employment effects than there was in its earlier stages.

6 More positively, a lower share of jobs are paid at the minimum than before the pandemic. This is against our expectations, given the rapid rise in the minimum wage. Also, more workers are escaping the wage floor for higher-paid jobs each year. The tight labour market, particularly recently, is likely a key driver here. Employers have repeatedly told us of their struggles to recruit and retain and the resulting need to pay above the minimum.

7 Instead of reducing employment in response to the NLW, employers tell us they have accepted lower profits or passed the costs on in higher prices. However, there is no evidence

that the NLW is a significant driver of inflation. Other costs – such as energy and food – have much greater impact.

8 Some employers have attempted to improve productivity. Responses here include more training, improving general business practice, or using new technology, equipment or automation. But this is difficult to do. Many productivity improvements require investment, and some employers, particularly small firms, are cutting investment to pay for the NLW. This may explain why some are simply asking staff to work harder. Low-paid workers tell us their jobs are becoming more intense. This is partly the fallout from the pandemic and shortages of staff, but also may be a result of the NLW. Some employers say that to drive productivity following the NLW they require additional tasks, higher standards, and more flexibility from their workers.

9 Predicting the impact of further increases is difficult, particularly without knowing what the future policy will be. Our best estimates of what might happen are based on the effects to date. But separating these from the effects of the pandemic is challenging. So regardless of what decision the Government takes, it will have to accept some risk. And the approach should consider other possible negative effects, not just reduced hours or jobs. However, employers of low-paid publicly-funded workers, such as childcare care and social care, are clear that further increases without commensurate increases in funding are unsustainable.

10 Responsiveness to economic conditions should remain a key principle for future policy. When the economy is booming the lowest paid should not be left behind. Likewise, when the economy is struggling we should be mindful of the risks. As we've said, the tightness of the labour market has likely contributed to the success of the NLW. If these conditions continue then the risk of further increases is lower.

11 Further rises in the NLW will likely affect a different group of jobs than those currently affected. More jobs that are publicly-funded, salaried or outside traditionally low-paying sectors could be affected by large rises in the NLW. Different jobs affected means different risks. Crucially, most jobs that would be affected by further rises are not in tradeable sectors, which international evidence suggests are the most at risk from minimum wage increases.

12 Alongside the risks, it's important to remember that there are potential benefits from further rises. More increases relative to average earnings would likely reduce hourly pay inequality further. So far, hourly NLW increases have translated into weekly pay increases and (to a lesser extent) household income increases. These benefits should be considered alongside the risks.

13 Whatever decision the Government takes with the minimum wage, it should consider what outcomes it wants to achieve and ensure related policies and the minimum wage complement one another. Over its lifetime the NMW has had a variety of aims. These have included ending exploitation, reducing inequalities of income, and boosting productivity. It also ensured 'good' businesses are not undercut by exploitative ones. It has had many successes in these regards, but it is not a panacea for all the problems faced by low-paid workers, or for the wider issues facing the UK economy. For example, many stakeholders have warned that the NLW's impact is welcome, but that low-paid workers' earnings can still vary substantially and unpredictably because of 'one-sided flexibility'. The Low Pay Commission's (LPC) view remains

that our recommendations on one-sided flexibility would provide more security here without harming the labour market. These recommendations were for all workers to have a right to switch to a contract that reflects their regular working pattern, to reasonable notice of work schedules, and to compensation if a shift is cancelled or curtailed at short notice.

14 The principle of keeping the minimum wage as simple as possible would enable workers and employers to understand their rights and responsibilities, and help the Government to enforce and communicate the policy. Similarly, the principle of maintaining the level playing field ensures employers are competing on the same basis, which is critical for employer buy in and fair competition.

15 Decisions on the rates should be based on evidence and the voice of workers and employers. Maintaining the LPC's social partnership model would play a vital role here. Its consensus building approach brings credibility to the Government's decisions and the minimum wage itself. Our recommendations on one-sided flexibility are an example of how the LPC's social partnership model lends itself well to other policy questions where a consensus between worker and employer positions is helpful.

16 Applying these principles our view is that a further target or a principle-based remit, like our pre-NLW remit, are the preferable options for recommending rates in the future. These models are suited to different policy objectives. If the Government wants further ambition and reductions in inequality then a target is likely best. If the aim is to instead protect the progress made so far and be more responsive to economic conditions then a principle-based remit may be best suited. However, both have advantages and disadvantages.

17 Targets based on future average wage levels create a roadmap against which employers can plan. Throughout the period of the NLW, employers have told us how useful this is. Targets related to median earnings also ensure the pay of the lowest earners moves at least in line with pay in the rest of the economy, preventing rising inequality. However, they are less responsive to changes in economic conditions and there are technical issues in plotting the path to a target in the future – forecasting is difficult. These issues are more acute during economic shocks, and they can mean our forward guidance on the NLW can differ to the actual rates we recommend. There is room for improvement in the methods and evidence used in plotting a forward path to a target.

18 Worker representatives point to the success of the NLW so far and advocate a further target, but there is little appetite for this among employer groups. Many employer groups view targets as "arbitrary" and recommend an approach whereby the LPC makes recommendations based on the evidence around the economy and labour market.

19 Before the NLW our remit was to "*raise the minimum wage as high as possible without damaging jobs*". Such qualitative or principle-based approaches are more flexible. They avoid the technical issues with targets and the language can be adjusted to set the policy direction without having to put this into concrete numbers. This leaves more room for Commissioners' judgement and negotiation, a key strength of the LPC. They can also respond to different policy considerations. Our pre-NLW remit focussed on employment, but a future remit could ask us to

consider a wider range of factors. However, without a target to aim for, plotting a path for employers to plan against would not be possible.

20 The NLW's ambitious increases and benign impacts have changed how negotiations might work in the future. Without a target, it is possible that Commissioners would start their negotiations on minimum wages further apart. Worker representatives might push for continued significant increases. And employers would know that there is no target to hit. The negotiations may become more difficult. That said, the LPC has a strong track record of reaching consensus, including in times of crisis like the pandemic.

21 The rationale for lower rates for young people is to protect their employment chances. But the gap between the youth rates and the NLW has widened in recent years, and we believe this should be addressed. The gap is large by historical and international standards, is regarded as excessive and unfair by many stakeholders, and median pay for young workers has grown faster than their minimum wages, reflecting healthy demand for young workers. There is scope to reduce the gap without negative employment consequences and, if the evidence continues to support it, move towards an adult rate that begins at 18.

22 We propose lowering the age of eligibility for the NLW one age group at a time and to reduce the gap between the youth rates and the adult rate where the evidence allows. However, the risks are greater than they were for lowering the age to 21. Both the level of increase required, and the share of jobs affected are higher. The current tight labour market conditions may not persist. This change should therefore be managed carefully, with time allowed for full evaluation of each step. The LPC should have the discretion to recommend the timing and extent of each change and to deviate from any planned goal if the evidence suggests it is necessary.

23 Our view is that there are also grounds to remove the Apprentice Rate. But doing this at the same time as reducing the gap between the youth and adult rates for non-apprentices brings considerable risk. We believe that reducing the gap between youth and adult rates should be prioritised over changes to the treatment of apprentices. Lower minimum wages on the basis of training are more justified than on the basis of age. To that end we recommend that we keep an apprentice rate but that, for those aged 18 and over, it changes to a simple discount of the age rate during the apprentice's first year. This, combined with the lowering of the NLW eligibility, will result in substantial increases in the wage floor for apprentices, but continue to recognise the additional costs relating to the substantial training they receive.

Recommendations

1. Government should decide what policy outcome it wants to achieve with the minimum wage and ensure that it aligns with other policies.
2. For the next steps of the minimum wage the Government should either adopt a further target or return to a principle-based or qualitative approach.

3. Government should consider the case for lowering the gap between the youth rates and adult rates and for further reducing the NLW age of eligibility, and ask us to take this forward in a future remit.
4. If Government agrees with recommendation 3 above on youth rates, it should consider the case for reforming the Apprentice Rate to a simple discount of the minimum wage that applies for that age group during their first year and ask us to take this forward in a future remit. For apprentices aged 16 and 17, the rate should remain aligned with the 16-17 Year Old Rate.
5. Government should implement our 2018 recommendations on one-sided flexibility. These are:
 - a) a right to switch to a contract that reflects a worker's regular working pattern
 - b) a right to reasonable notice of work schedules
 - c) a right to compensation if a shift is cancelled or curtailed at short notice
6. Government should provide us with better quality and more timely data, so we can better evaluate the effects of the minimum wage. We discuss a range of improvements the Government could make in Chapter 7. The three most important steps Government should take are:
 - a) The Department for Business and Trade should work with HMRC to provide us more timely access to detailed employer payroll data. This would allow us to evaluate the latest minimum wage upratings more fully.
 - b) HMRC should go ahead with their current plans to collect hours of work as part of their payroll data. This will allow us to better evaluate the minimum wage and help HMRC to enforce the minimum wage.
 - c) The ONS should publish a report on how and why different official data sources on employment and wages have diverged since 2019. They should also explain how reliable each data source is for different purposes.