Labour market change

Assessment of public initiatives to combat labour market segmentation in the EU Member States

Case study: The National Living Wage (UK)

Labour market segmentation: Piloting a new quantitative and policy analysis
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**Introduction**

This report presents the in-depth analysis of the UK policy measure named ‘National Living Wage’ (NLW). The NLW was introduced in 2016, in addition to the rates established as statutory minimum wages since the first launch of the ‘National Minimum Wage’ (NMW) in 1999 in the UK. The NLW implies that low paid workers aged 25 and over receive a premium on top of the legal wage floor, raising their hourly earnings from the 2015’s GBP 6.70 (£7.41) to GBP 7.20 (£7.96) in 2016. Thereafter, the NLW is expected to rise steadily until 2020, reaching its target of 60% of median hourly earnings at an indicative on-course rate of GBP 8.62 (£10.06).

With its introduction, the NLW ensures that low earners aged 25 and over are able to live off relying more on their wages and less on the in-work benefits system. It is an attempt to boost the wages of millions of low paid workers, as the NMW had had relatively little impact on the broader problem of low pay in the UK. The key reason for keeping lower minimum wages for younger workers was to protect employment (LPC, 2016a). The UK Low Pay Commission (LPC)’s remit for younger workers is defined as ‘necessarily stricter’ for the NMW than for the NLW, given that young workers are more likely to fall into unemployment and suffer longer term damage after any spell of unemployment (LPC, 2018a).

The NLW is not to be confused with the Living Wage, sometimes referred to as the ‘Real’ Living Wage. The NLW is statutory and is calculated by the government based on a proportion of the median level of earnings. The Living Wage is an hourly rate based on the basic cost of living in the UK (including costs such as rent, food and utility bills) and has no binding nature. The rate of this voluntary payment by employers is higher than the NLW and applies to all working adults above the age of 18.

The NLW does not focus explicitly on labour market segmentation (LMS), but from a theoretical perspective could contribute to reduce it by ensuring better working conditions to low-paid workers (associated with a higher salary) and by avoiding disincentivising the employment of younger workers. Empirical evidence on the effects of the NLW on LMS is, nonetheless, very limited.

**Applied methodological approach**

This case study uses secondary and primary information.

Key secondary information on the NMW and the NLW is the evidence collected by the LPC, which is summarised in their annual reports and used to make recommendations for their new rates. Sources used for the LPC’s reports and recommendations include formal written and oral consultation with employers, workers and unions; in-house economic analyses; in-house economic and statistical analyses of the impact of the minimum wage; academic research; and, front-line visits to organisations and workers around the UK to capture the impact of the policy. This evidence-based approach, although not necessarily of an evaluation type, is considered relevant for the provision of information on the context, mechanisms and outcomes of the measure in question. In parallel to the above, other secondary sources such as academic studies and impact analyses looking at the effects of the measure have also been analysed.

In addition to desk research, five semi-structured interviews with key stakeholders (including trade unions’ representatives, members of the LPC and other labour market experts) were conducted between December 2018 and January 2019 to provide information on relevant features of the measure, especially as regards contextual factors, its rationale and its potential relevance with respect to LMS.
Description of the initiative in focus

Type of initiative

The NLW is a regulatory measure related to pay and income security, with a focus on legal provisions regarding minimum wage. Specifically, the term ‘minimum wage’ refers to various legal restrictions of the lowest rate payable by employers to workers1 (Parsons, 2008), regulated by formal laws or statutes.

Statutory minimum wages have become a popular policy tool to boost wages among the lowest-paid in contexts of growing income inequality, having the objective to ‘enhance equity and establish a balance in the bargaining position between employers and workers’ (European Commission, 2017). They are generally applicable in a whole country and not limited to specific sectors, occupations or groups of employees. They are an intensely discussed topic at both national and EU level. In 2018, 22 out of the 28 EU Member States applied a statutory minimum wage (Eurofound, 2018a).

The empirical literature on the employment effects of minimum wages strongly focuses on minimum wage levels (generally in the range of 35% to 60% of the national median pay) and revisions (closely tied to the cost of living or wage inflation) (Eurofound, 2018b).

Rationale and objectives

During the 2015 Financial Statement, George Osborne (the then Chancellor of the Exchequer) announced the introduction of the NLW in addition to the already existing statutory minimum wage regime that was in place in the UK since 1999. The NLW implied a significant increase in the statutory minimum wage for workers aged 25 and over. This legally-enforced higher minimum wage was set at GBP 7.20 (€7.96) per hour for 2016 – GBP 0.50 per hour more than the 2015’s minimum wage for workers of that age.

The NLW aims to increase the wages of those on low pay and to combat growing wage inequality. As stated by the UK government (2016), the NLW is expected to contribute to moving the UK from a ‘low wage, high tax, high welfare society to a higher wage, lower tax, lower welfare society’. Interviewees explained that, although not formally stated in the official announcement of the policy measure, the launch of the NLW aimed at getting employers to contribute more and taxpayers to pay less, ensuring a pay rise, and reducing inequality by narrowing the gap between people at the bottom and people at the middle of the pay distribution. In order to achieve these objectives, the gains from an increased NLW need to exceed losses in terms of increased taxes and in-work benefits at the average individual worker level (Eurofound, 2018b; ECE, 2017).

Although this was not explicitly mentioned as a reason for the launch of the NLW, its application only to those aged 25 and over can relate to the consideration that increasing the minimum wage for young people could have led to detrimental employment effects for them. Young workers, a group with typically high unemployment rates, occupy a more vulnerable position in the labour market and have a greater need to acquire experience. Also, their average wages are lower than those of older workers, possibly a consequence of lower average experience, higher training costs or a weaker bargaining position (LPC, 2016a). If younger workers were eligible for the NLW, they could be more at risk of being priced out of the labour market, due to competition with well-qualified, more experienced older workers, and would suffer worse consequences than the latter if they ended up unemployed. Research has shown that youth unemployment leads to a higher likelihood of long-term ‘scarring’ in later life in terms of subsequent lower pay, higher unemployment, reduced life chances and greater likelihood of

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1 ‘A person is generally classed as a ‘worker’ if: they have a contract or other arrangement to do work or services personally for a reward; their reward is for money or a benefit in kind; they only have a limited right to send someone else to do the work; they have to turn up for work even if they don’t want to; their employer has to have work for them to do as long as the contract or arrangement lasts; they aren’t doing the work as part of their own limited company in an arrangement where the ‘employer’ is actually a customer or client’ (UK government website).
developing mental health problems in adulthood (Gregg and Tominey, 2004). Another reason was to prevent young people who would otherwise stay at school or college from entering the labour market full-time, since education enables higher earnings and provides job security (LPC, 2015). Due to the above reasons, for those younger than 25 the existing less generous NMW rates were maintained, with the perspective of being uprated as before according to the recommendations provided annually by the independent LPC (Eurofound, 2018b; ECE, 2017).

According to some interviewees, the definition of the 25 and over age bracket was mainly a political decision to publicly stress the UK government’s commitment to higher pay, but no research evidence seems to demonstrate that workers, from that exact age of 25, start having substantial differences from younger ones (apart from the fact that 25 is the age when most in-work benefits kick in). On the contrary, the already existing age thresholds for the NMW groups (see section on ‘target groups’ below) were defined based on the observation of differences in the characteristics of the workers in those age groups.

The NLW was also set as a multi-year commitment to raise the relative value of the legal minimum hourly wage to 60% of the national median hourly pay by 2020 (from an estimated 55% in 2015). This was expressed as a target minimum hourly rate of GBP 9.35 (€10.50) by that year, positioning it at the upper end of the international scale in terms of relative generosity of minimum wage floors. This commitment was nonetheless ‘subject to sustained economic growth’ between 2015 and 2020 (Eurofound, 2018b). The value of GBP 9.35 (€10.50) was an estimate by the Office for Budget Responsibility (OBR), based on the assumption that the growth of the median wage among those aged 25 and over would have the same pace as average earnings across the entire economy over the following five years – but much uncertainty is involved in this calculation (D’Arcy and Corlett, 2015). The latest estimation from the LPC, using HM Treasury panel and the Bank of England forecasts, is that the NLW will reach its target at an indicative on-course rate of GBP 8.62 (€10.06) in 2020. Interviewees stressed that the NLW has a substantial difference compared to the NMW: for the NLW there is acceptance of some limited, potential negative effects on employment in return for a higher minimum wage, while the remit for the other rates (16-17, 18-20 and 21-24 year-olds) maintains the NMW’s original objective of ‘helping as many low-paid workers as possible, without damaging their employment prospects’ (LPC, 2018a). Estimates by the OBR (2015) indicated that the introduction of the NLW would have implied between 20,000 and 110,000 fewer jobs by 2020 than in its absence (LPC, 2018a).

The NLW did not aim explicitly to tackle LMS in the UK, nor had implicit objectives in this respect.

**Time frame**

The measure was introduced in April 2016, modifying certain conditions of the minimum wage regime that was in place in the UK since 1999. It set an objective to reach by 2020. What will happen after then has not been defined yet.

**Target group(s)**

With the introduction of the NLW, there are five age groups of workers to which the statutory minimum wage applies, with different hourly rates (the minima are updated yearly; see section on ‘delivery methods’ below for detailed information on the rates):

- Application of the NLW: 25 and over;
- Application of the NMW: 16-17, 18-20, 21-24 and apprentices.

Before the introduction of the NLW, there were three age bands (under 18, 18 to 20 and 21 and over). Both the 21-24 and the 25 and over age bands were introduced in 2016. Workers are entitled to the correct minimum wage also if they are part-time, casual labourers, agency workers, workers and homeworkers paid by the number of items they make, apprentices, trainees, on probation, disabled workers, agricultural workers, foreign workers, seafarers or offshore workers.
The key types of workers who are not entitled to the NMW or NLW are self-employed people running their own business, company directors, volunteers, workers on a government employment programme, workers younger than school leaving age, and higher and further education students on a work placement up to one year, among others (for a full list, please see here). As stressed by the interviewees, in a nutshell the key category of worker who is exempt are self-employed people. Therefore, as everyone with an employment contract of any form has to be paid the minimum wage, it is straightforward for the employers to have a clear view of the minima they are requested to pay.

**Delivery methods**

Employers are required by law to pay the correct rates of minimum pay (NMW/NLW) to their staff, depending on a worker’s age and whether they are an apprentice. Contracts for payments below the minimum wage are not legally binding and the worker is still entitled to the NMW or NLW. It is a criminal offence for employers to not pay someone the NMW or NLW, or to fake payment records. If a worker receives above NMW there is no legal obligation on an employer to increase their pay when the NMW rate increases (unless the new legal rate is above the actual pay).

In addition to the NMW/NLW, employers must pay their workers in accordance with their contractual terms and conditions. The contracts agreed with the workers are legally binding and employers must adhere to the agreed pay arrangements.

Table 1 displays the statutory hourly rates by age group since 1999.

**Table 1: Historic NMW and NLW rates**

<table>
<thead>
<tr>
<th>Year</th>
<th>25 and over (NMW)</th>
<th>21-24 (NMW)</th>
<th>18-20 (NMW)</th>
<th>16-17 (NMW)</th>
<th>Apprentice (NMW)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2019</td>
<td>GBP 8.21 (£9.08)</td>
<td>GBP 7.70 (£8.52)</td>
<td>GBP 6.15 (£6.80)</td>
<td>GBP 4.35 (£4.81)</td>
<td>GBP 3.90 (£4.31)</td>
</tr>
<tr>
<td>2018</td>
<td>GBP 7.83 (£8.63)</td>
<td>GBP 7.38 (£8.16)</td>
<td>GBP 5.90 (£6.53)</td>
<td>GBP 4.20 (£4.64)</td>
<td>GBP 3.70 (£4.09)</td>
</tr>
<tr>
<td>2017</td>
<td>GBP 7.50 (£8.30)</td>
<td>GBP 7.05 (£7.80)</td>
<td>GBP 5.60 (£6.19)</td>
<td>GBP 4.05 (£4.48)</td>
<td>GBP 3.50 (£3.87)</td>
</tr>
<tr>
<td>2016</td>
<td>GBP 7.20 (£7.96)</td>
<td>GBP 6.70 (£7.41)</td>
<td>GBP 5.30 (£5.86)</td>
<td>GBP 3.87 (£4.28)</td>
<td>GBP 3.30 (£3.65)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Year</th>
<th>21+ (NMW)</th>
<th>18-20 (NMW)</th>
<th>16-17 (NMW)</th>
<th>Apprentice (NMW)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>GBP 6.70 (£7.41)</td>
<td>GBP 5.30 (£5.86)</td>
<td>GBP 3.87 (£4.28)</td>
<td>GBP 3.30 (£3.65)</td>
</tr>
<tr>
<td>2014</td>
<td>GBP 6.50 (£7.19)</td>
<td>GBP 5.13 (£5.67)</td>
<td>GBP 3.79 (£4.19)</td>
<td>GBP 2.73 (£3.02)</td>
</tr>
<tr>
<td>2013</td>
<td>GBP 6.31 (£6.98)</td>
<td>GBP 5.03 (£5.56)</td>
<td>GBP 3.72 (£4.11)</td>
<td>GBP 2.68 (£2.96)</td>
</tr>
<tr>
<td>2012</td>
<td>GBP 6.19 (£6.84)</td>
<td>GBP 4.98 (£5.51)</td>
<td>GBP 3.68 (£4.07)</td>
<td>GBP 2.65 (£2.93)</td>
</tr>
<tr>
<td>2011</td>
<td>GBP 6.08 (£6.72)</td>
<td>GBP 4.98 (£5.51)</td>
<td>GBP 3.68 (£4.07)</td>
<td>GBP 2.60 (£2.87)</td>
</tr>
<tr>
<td>2010</td>
<td>GBP 5.93 (£6.56)</td>
<td>GBP 4.92 (£5.44)</td>
<td>GBP 3.64 (£4.02)</td>
<td>GBP 2.50 (£2.76)</td>
</tr>
</tbody>
</table>

**Disclaimer:** This working paper has not been subject to the full Eurofound evaluation, editorial and publication process.
Key actors involved in implementation

The LPC is an independent tripartite body that advises the government about the NLW and NMW. Formed on the basis of a social partnership model, the commission is made up of nine members: three from a trade union background, three from an employer perspective and three independent members, including two academics usually with expertise in industrial relations or labour market economics, and the chair; they all act in an individual capacity. As per its remit set by the UK government, the LPC formulates evidence-based recommendations to the government on the annual revision of the statutory minimum wage rates. Once the LPC has made its recommendations for the NMW and NLW reviews, the Department for Business, Energy and Industrial Strategy (BEIS) carries out an impact assessment (NIESR, 2018). The government can then either accept or reject the recommendations received. If accepted, the recommended uprating becomes effective (Giupponi and Machin, 2018a). So far, the recommendations have always been unanimously accepted by the government. The government is committed to increasing compliance with the statutory minimum wage through the provision of guidance, support to employers and workers to understand the law and their rights, and targeted communications campaigns (BEIS, 2018).

The NMW/NLW are enforced (Pyper, 2018):

- By workers: the right to be paid the NMW/NLW takes effect as part of a worker’s contract;
- By the state, through Her Majesty’s Revenue and Customs (HMRC) on behalf of the BEIS, usually through notices of underpayment. In more serious cases where the employer may have committed a criminal offence, HMRC may refer the matter to the Crown Prosecution Service. There is also a related system of publicly naming employers that breach NMW/NLW law, designed to deter employers from underpaying workers.

There is no register or dataset allowing to comprehensively estimate the number of employers or accurately identify businesses which do not comply with minimum wage legislation. Therefore, the BEIS relies on different sources of information to assess the scale and nature of minimum wage non-compliance. Key information on jobs paid below the minimum wage at a particular point in time can be gleaned from the Annual Survey of Hours and Earnings (ASHE), a survey of employees completed by employers, but its data do not offer a direct measure of minimum wage non-compliance in the population (BEIS, 2018).

HMRC compliance officers may carry out inspections of employers at any time. There is no requirement to provide reasons for a minimum wage investigation. Officers act in response to complaints (raised by workers or others) that an employer is not paying the minimum wage.

Administrative level of implementation

This is a national measure which applies equally across the UK.

Sectoral focus

Being a single national rate, the NLW does not apply a sectoral focus. Nevertheless, sectoral differences can be observed when it comes to implementing the NLW, because different sectors have different margins and some can afford to pay better than others. The most recent evidence (LPC, 2018a) shows that the majority of NLW jobs are in low-paying sectors (namely, with a high proportion or number of jobs paid at the minimum wage). Almost half of all NLW jobs are...
found in the three largest low-paying occupations: cleaning and maintenance, retail, and hospitality, even if these sectors only account for 13% of all jobs undertaken by workers aged 25 and over. Occupations that the LPC defines as non-low-paying gather around three-quarters of all jobs, but only 19% of NLW jobs. Nine out of 10 NLW jobs are in the private sector. According to the LPC (2018a), ‘social care organisations continued to warn of a ‘crisis’ in the sector, as local authority funding often did not cover the rising cost of care. While the NLW was not the cause of the problems, it exacerbated the pressure on firms’. As confirmed by an interviewee, the cautious setting of the NMW and NLW values has allowed certain low-paying sectors, such as social care, to comply with the statutory values of wages without negative employment effects.

**Funding arrangements**

The financial burden of the NLW falls onto the employers, who need to bear the costs of an increased statutory minimum wage, which directly affects their employment bill.

**Linkages with/embeddedness into other measures (national and EU)**

The NLW is strongly linked with the NMW, as in reality it forms another minimum wage age bracket, with higher rates for people aged 25 and above and was introduced based on the success of the latter. The NLW was introduced in a time where another initiative known as the ‘Living Wage’ (or ‘real living wage’) was being promoted in policy. The Living Wage has been understood as ‘a measure of income that allows an employee a basic but socially acceptable standard of living’ (Eurofound, 2018b). The two initiatives are partly motivated by similar considerations and the NLW is, to some extent, considered as an acknowledgement and appropriation of the Living Wage concept. Both the NLW and the Living Wage aim to raise the wages of those on low pay, to improve living standards of low-paid households and to combat growing wage inequality. There are, however, significant differences between the NLW and the Living Wage.

The NLW creates a statutory minimum income floor for workers aged 25 and over and it is calculated based on a proportion of the median level of earnings. On the other hand, the living wage is entirely voluntary, with employers encouraged to pay a rate that allows their employees to have a decent standard of living. It applies to all workers aged 18 and over, with no age bands. In 2018/2019, the real Living Wage rates, as calculated by the [Resolution Foundation](http://www.resolutionfoundation.org) on behalf of the [Living Wage Foundation](http://www.livingwage.org.uk), are GBP 10.55 (€11.74) for London, 28% higher than the NLW, and GBP 9.00 (€10.02) for outside of London, 9% higher than the NLW. Since it is not legally binding, its calculations do not take account of the impact that its adoption would have on employment. They are made according to the cost of living, based on a basket of household goods and services and taking into account the higher costs of living in London. The idea that a worker’s pay should guarantee them a decent standard of living has deep historical roots, but the current campaign began in East London in the early-2000s by activists protesting the low wages of cleaners working in the premises of major international banks.

Initial fears that the NLW would distract from the Living Wage campaign have proven to be unfounded. On the contrary, it appears to have strengthened it; the number of real Living Wage-accredited firms has more than doubled in the UK since the government announced the introduction of NLW in July 2015, from 1,700 to more than 4,700 in November 2018 (Eurofound, 2018b).

**In-depth analysis of the initiative in focus**

This section presents an in-depth analysis of the context of the initiative, its details in terms of measures and target groups, mechanisms, and outcomes. These separate elements are represented in Figure 1.
Figure 1: Visual presentation of the initiative

Overview of the context

Established by the NMW Act of 1998, the statutory NMW came into force in April 1999, introducing for the first time in the UK a single legal wage floor below which no adult aged 22 and over could be paid. It is considered to be the Labour (which won the 1997 election and remained in power until 2007 under Prime Minister Tony Blair) government’s most significant intervention in the labour market (CEP, 2008).

The aim of the policy has been to deliver a fairer wage to low paid workers without limiting their employment opportunities or harming the efficiency of businesses. Therefore, its level is based on affordability and not purely on need (LPC, 2018c). The minimum wage was expected to protect workers suffering exploitation, in-work poverty and falling below basic living standards by creating a labour market able to push people out of poverty and provide them with a firmer foundation for progression in work.

Poverty was a major problem at the time when the NMW was introduced. Relative poverty in the UK had risen strongly since 1979 due to increased worklessness and earnings dispersion and benefits indexed to prices and not wages (Nickell, 2004). The economic factor behind this was the significant shift in demand towards the skilled, which weakened the low-skilled labour market and particularly the position of low-skilled men. The proportion of people living in working age households who were poor rose from 13 to 24.4% between 1979 and 1999. During the same period, unemployment among low-skilled men rose from 7 to 12%; inactivity among working age men also rose substantially from...
4.7 to 15.9%. Moreover, the UK also monitored a large number of working-age ‘workless households’; in 1996 the probability of an unemployed person to live in a household where no one else worked exceeded 50% (OECD, 1998). Public policy approaches discussed as potential solutions included improving education, introducing minimum wage laws or fair wage legislation to prevent low pay and raising tax credits and benefits for the workless.

The NMW’s introduction was surrounded with controversy, as politicians and economists were divided regarding its potential impact. The Conservative party and some economists expressed concerns that the NMW would result in higher unemployment, which would mostly limit the employment opportunities of the low earners, whom the policy was aiming to help, but also that inflation and interest rates would increase as better-paid workers would seek pay increases similar to their lower-paid colleagues (CEP, 2008). The qualitative expectation of job losses is in line with orthodox models of the labour market which predict that paying more than the market rate for staff would lead employers to cut jobs (Machin and Manning, 1996).

The LPC was established to minimise the risk that a minimum wage would increase unemployment levels. With a tripartite basis, the Commission was tasked with collecting and assessing evidence on the state of the labour market in order to recommend the level at which the NMW should be set, though the decision on the rate would ultimately rest with the government.

At first (1999), the NMW was purposely set at a low level in recognition of the uncertainty regarding its impact, at GBP 3.60 (£4.01) per hour for adult workers over the age of 22 and GBP 3.00 (£3.35) for those aged 18-22. The first increase was also cautious, with the rate raised by 10 pence (£0.11) in October 2000. While the largest nominal increase occurred in 2001, with a jump to GBP 4.10 (£4.56), it was in the mid-2000s when the NMW experienced its fastest and most sustained growth, rising by at least 30 pence (£0.35) each year between 2003 and 2006, equivalent to average annual increases of more than 6%. In October 2004, following the recommendations of the LPC, the 16-17-year-old rate was introduced at GBP 3.00 (£3.34) per hour, covering an additional age band.

The rapid growth of the NMW in the early and mid-2000s reflects the state of the UK labour market and specifically the absence of any significant negative employment effect. Employment in the UK rose from 27.04 million in April 1999 (71%) to 29.50 million (73%) in April 2008, with an annual rate of growth of approximately 1%. However, youth unemployment (18-24-year-olds) slightly increased from 10.6% in 2000 to 13.3% in 2008. Over the same period, the gap between the pay floor and the middle of the wage distribution narrowed, because the increases in the NMW were faster than wage growth for typical workers (D’Arcy et al, 2015). The bite of the NMW - a measure of the rate of the minimum wage relative to median earnings² - rose from its initial level of 48% in April 1999 to 53% in April 2007. At the same time, the share of the UK workforce who were low paid (earning below two thirds of median hourly earnings) and extremely low paid (earning below half of median hourly earnings) both decreased overall from 1999 to 2007.

The development and success of the NMW made its critics gradually change their opinion regarding the measure and by the mid-2000s it enjoyed extremely broad political support, being accepted across all parties (CEP, 2008), also thanks to its evidence-based nature promoted by the LPC.

The late-2000s recession led to a new era for the NMW, with its real-term value falling for five years in a row between 2009 and 2013. On 1 October 2010, a new rate, namely the apprentice rate, was introduced at GBP 2.50 (£2.78).

Above inflation increases returned in 2014 and NMW rates have risen ever since in real terms to above their pre-recession levels. Meanwhile, the value of UK economic output as measured by the Gross Domestic Product (GDP) has shown steady growth averaging 2.1% from 2009 to 2016 after an annual decrease in 2009 due to the 2008 global financial crisis. Throughout this period,

² ‘A higher bite for a particular sector or age group means a more compressed earnings distribution, implying the minimum wage is becoming the ‘going rate’ in that part of the economy, with consequent challenges for pay and career progression (though it should also be noted that employment has continued to grow in many sectors with high bites)’ (Low Pay Commission, 2016a).
unemployment remained stable, peaking at 8.1% in 2011. The rate steadily decreased from 2012 and returned to pre-recession levels in 2016, at 4.9%. Likewise, the youth unemployment rate (18-24 year-olds) peaked in 2012 at 19.3%, but returned to 11.7% in 2016.

A review by a panel of labour market experts (D’Arcy et al, 2014) concluded that the NMW had achieved its goals of boosting the wages of UK’s lowest earners without damaging their employment prospects. However, even though the pay levels of low paid workers increased in absolute terms, the NMW had relatively little impact on the broader problem of low pay in the UK. The proportion of those earning below the low pay threshold (two-thirds of the median hourly wage) remained stuck at one in five since its introduction. In order to close the pay differentials, the review recommended a gradual move towards a higher bite with evidence suggesting that a level of 60% would be a reasonable ambition.

In the Summer Budget of July 2015, the then Chancellor George Osborne stated his intention to ‘tackle low pay and ensure that lower wage workers can take a greater share of the gains from growth’. At the time the government, recently elected with majority, was motivating employers to increase wages but, despite the pressure, such an increase was not documented. Economic security was set as one of the top priorities, including measures to put public finances in order and move towards a more productive and balanced economy. In addition, the budget reduced taxes so that people could keep more of what they earned and reformed the welfare system to make it more affordable and fairer to the taxpayers (Her Majesty’s Treasury, 2015). In this context, and thanks to the overall improvement of the labour market and the strong recovery of the UK from the 2008 recession, the government proceeded with the introduction of the NLW. Interviewees stressed that there were ‘political appetite’ and social consensus for the measure, and that its launch also related to a political objective to appear worker friendly and concerned about low pay.

As commented by different interviewees, the ‘Living Wage’ campaign happening in the same period had an influence in the name and branding of this new policy, which was introduced as a political rather than an evidence-based initiative. The decision of the name of the NLW was criticised by some for mixing the NMW concept with the voluntary Living Wage, ‘undermining the effectiveness of the Living Wage campaign and presenting a misleading description of the NMW’ (Pyper, 2018).

Interviewees also stressed that the NLW announcement in 2015 was a shock to many stakeholders, and mainly among employers. But since it happened in a period where the Living Wage campaign was gathering a lot of public interest, many employers reacted more positively, also because they tended to be more aware regarding higher and appropriate pay. The support of the stakeholders that the NLW received, in combination with the favourable political climate, its popularity among the citizens and the involvement of the LPC, led to the success of the initiative. The latest evidence confirms the NLW’s continued success, as the hourly pay growth of low earners has far outstripped that of workers further up the pay scale, while employment continues to reach record highs.

The introduction of the NLW also reflects the reality that average wages of younger workers are sharply lower than those of older workers, as a consequence of lower average experience, higher training costs or a weaker bargaining position (LPC, 2015). In 2015, the median pay for 21-24-year-olds was much lower at GBP 8.26 (£9.20) compared to GBP 11.01 (£12.26) for 25-30-year olds. Lower median pay for this age group means that the bite of the NMW is much higher (79% in 2015). At the same time, the unemployment rates for 21-24-year olds not in full-time education was twice as high as for 25-30 year olds. Taking all these into consideration, the LPC concluded that setting the pay floor for this age group to the same level as the NLW would have been too risky regarding employment.
Overview of the mechanisms

Business behaviour

Employers’ reactions following a hike in wage floors will depend on the magnitude of the cost increases they face and the available options to adapt their operations to these higher costs – which are typically not equally distributed across sectors and are proportionately higher in low-wage industries. The LPC (2018a) stresses that most employers successfully managed to cope with the NLW increases since its introduction in 2016. Nonetheless, some businesses mentioned adjustment mechanisms adopted in reaction to an increased wage floor, as shown in Table 2.

Table 2. Key types of adjustment mechanisms and related evidence regarding the NLW

<table>
<thead>
<tr>
<th>Adjustment mechanism</th>
<th>Evidence regarding the NLW</th>
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</table>
| Reduction of working hours, resulting in a reduction of the total labour demand (negative employment effect) | • Businesses in sectors such as convenience retail, social care and hair and beauty reported that they are at/approaching a tipping point where the cost increases may cause employment effects (LPC, 2018b). The net effect in these sectors is unclear, and any changes were more likely to be through slower hiring or adjustments to hours than redundancies (LPC, 2018a and 2018b).  
  • Employers from non low-paying sectors surveyed by IDR (2017) indicated a reduction of hours to individual staff as the most common response to the NLW. |
| Reduction of non-wage benefits, such as private health coverage, pension contributions and other subsidies | • The LPC (2018a) mentions the existence of cases where benefits were reduced. Nonetheless, the causality between the NLW and these reductions is not always clear.  
  • Confirmed also by interviewees.  
  • IDR (2017) found little evidence of large reductions in benefits in low-paying sectors, but also because workers in these sectors had already experienced an erosion of reward packages before then. As a result, there is often little additional scope to offset the cost of the NLW by further changing benefits and premiums. Still, the most common reactions in this sense consist of reductions in premiums for overtime or unsocial hours (weekends, bank holidays or nights). |
| Reduction of training provision for lower-wage employees in order to offset costs | • Linked to productivity, the LPC (2018a) reports that investment in training and automation was more common in larger firms, a fact that is expected to increase as the NLW continues to rise. Smaller businesses found some of these investment opportunities too expensive or not worthwhile, and some of them considered reducing them as a way to offset the increased costs deriving from the NLW rates. |
| Wage setting practices and changes in wage structures, such as reduction of wages at the top and/or narrowing of the pay bands | • The increase of NLW had an impact on firms’ pay structures which has exceeded the original expectations. This includes the squeezing of pay不同-looking for supervisory staff, the merging of lower pay grades and the introduction of age-related pay systems in order to make use of the lower NMW rates for younger workers, with the sector most affected being retail (Eurofound, 2018a; LPC, 2018a; IDR, 2017).  
  • Similarly, many retailers abolished starter rates for staff during induction/probation periods, which were usually set at or very close to the level of the NMW, with staff moving to a higher rate after this initial period (IDR, 2017).  
  • NIESR (2018) confirms that the NLW made changes to employers’ treatment of the pay package and to the way they set wages. |
At the same time, some companies adjusted younger workers’ wages to the NLW levels (IDR, 2017).

### Price increases
- Contrarily to their stated plans before the adoption of the UK NLW, 36% of the employers surveyed three months after its introduction reported a rise in price levels, making it the main adjustment channel used by employers to adjust to the higher wage bill (D’Arcy and Whittaker, 2016). This may be explained by the fact that price increases are relatively easier to implement than productivity/efficiency improvements, especially in the short term.
- Evidence gathered by the LPC (2018a) shows that, although price increases were a prevalent response in employer surveys, there does not seem to have been a large effect on inflation in low-paying sectors. Some sectors, such as very competitive ones or those that rely on government funding, were unable to raise prices.
- Confirmed also by some interviewees.

### Reduction of profits instead of raising prices, where employers absorb the extra costs resulting from higher wage floors
- In the UK, around 30% of the employers surveyed three months after the introduction of the NLW reported that they adjusted via accepting lower profits, making it the second most important adjustment channel used by employers, after raising prices (D’Arcy and Whittaker, 2016).
- According to the LPC (2018a), employers report accepting a reduction in profits as part of their response to the NLW but are unsure regarding their sustainability as the NLW continues to rise. As evidence that the NLW has been affordable, unions mentioned high levels of corporate profitability.
- Confirmed also by some interviewees.

### Restructuring of the workforce
- As stressed by some interviewees, and related to the changes in wage structures, some employers also reacted by reducing middle management and supervisory roles.

### Boost of companies’ productivity, trying to improve efficiency and increase output with the same use of resources
- As stressed by an interviewee, many employers planned to raise productivity as a reaction to the minimum wage increase, but there is no clear evidence on whether this has happened.
- Some companies sought productivity enhancements due to reorganising roles and responsibilities and providing extra training or upskilling employees (Eurofound, 2018a). As specified by the LPC (2018a), the sluggish productivity growth in the UK indicates that these attempts of productivity increase have not been successful. Efforts to raise productivity mainly focused on more intense worker effort.

Source: Authors’ elaboration based on Eurofound (2018b), secondary sources and interviews

In addition to the above-mentioned mechanisms, evidence from some interviews and analysed documents also hint towards other behavioural/cultural changes in employers:
- Some employers stressed that the fact of having a target set by 2020 reduced uncertainty. As rates are known in advance, this allows for a better planning for pay increases (NIERS, 2018).
- Also, despite the quite substantial increase in minimum wages, employers reacted quite positively, probably as a consequence of an increased awareness on the need for adequate pay, boosted through the campaign on the Living Wage that was running at the time of the introduction of the NLW.
- On the other hand, some employers are not applying the NLW as requested by law. Enforcement issues are an important barrier for the functioning of the measure and are being addressed with stronger compliance checks and enforcement procedures (LPC, 2016b).
Workers’ behaviour

Behavioural changes induced by the NLW can also be observed on the workers’ side, mainly in cases where the employers react by squeezing pay differentials, merging lower pay grades. There, employees have stressed a decreased willingness to take up higher responsibilities within the company in exchange for a limited wage differential. No further evidence, for instance regarding labour market attachment, is available.

Overview of results and impacts

The key critical aspect of wage floors discussed in the literature relate to their potentially negative impact on employment levels. According to neoclassic economic theory, while there are more people willing to work at a higher wage level, labour demand decreases because some workers become too expensive to hire and still make a profit. This can damage the employment prospects of the lower-paid and less productive employees (typically young and low-skilled) it aims to help. From this viewpoint, even if the aggregate impact of wage floors on employment is negligible, specific groups of workers could be affected due to substitution effects. Nonetheless, in most of the cases minimum wages are part of institutional structures which often have a tripartite commission with a mandate to manage them in a conservative way, so to avoid negative labour market outcomes as far as possible. Evidence of wage floors from a number of countries confirms that, when cautiously set, modest minimum wages have no adverse employment effects (D’Arcy and Corlett, 2015). Classical economics also foresee scenarios where minimum wages may lead to employment creation. For instance, employment could be expanded as a result of higher wages, increasing workforce productivity and skills improvements. Also, it may attract individuals to the job market who would otherwise remain inactive (European Commission, 2017). Nonetheless, evidence of the effect of minimum wages on employment outcomes has evolved over time and does not offer a conclusive view (Eurofound, 2018b).

As key aspects mentioned by the LPC (2018a), the introduction of the NLW and its subsequent uprating in April 2017 and April 2018 had strong positive effects on pay for those on the NLW. Since its introduction, the groups most likely to earn the NLW are the ones which experienced the fastest employment growth. Also, both employment and hours in low-paying sectors increased over 2018, but at a slower rate than in non-low-paying ones. Pay has grown fastest among the bottom decile, who benefit most from increases in the NLW, and among the top 20% (LPC, 2018a). The NLW also affected the wage distribution for low-paid individuals aged 25 and over, with falling differentials within the workforce. No major negative employment effects were observed, although some sectors (convenience, wholesale, hair and beauty, and social care) face more challenges than others to cope with the NLW. Due to the NLW, some firms report lower profits and higher prices. Similarly, the NLW after adjusting for tax and benefits has never implied a worsening of the financial position of the worker receiving the NLW.

More detailed information of the key results identified for the NLW is listed below.

Evolution, coverage and spillover effects

The LPC (2018a) informs that the bite of the NLW has increased in 2018, being at its highest point and on track to meet the target of 60% by 2020.

Over time, the NLW has had a faster growth compared with Consumer Price Inflation, Retail Price Inflation, average weekly earnings and GDP per capita. This ensured real-terms pay rises for the lowest-paid workers, including in 2017-2018, when inflation raised (LPC, 2018a).
The introduction of the NLW induced an important increase in the number of workers paid the NLW. Analyses conducted in 2018, taking into account these numbers since 2016, show that the number of jobs that are paid the NLW (and below) has remained stable at around 1.6 million, despite of the annual increases in the rate. In 2018 still, for workers aged 25 and over, there were 1.6 million jobs paying the NLW, representing around 6.5% of all jobs held by those aged 25 and over. As Table 3 displays, more than three-fifths of all NLW jobs were held by women, compared with around half of all jobs. Also, there were almost one million part-time jobs paid at the NLW, which represents 15% of all part-time workers. Proportionally, those aged between 25 and 29 and those aged over 60 were the most likely of any age group to be working in an NLW job (LPC, 2018a). From an LMS perspective, an interviewee mentioned that the composition of this 1.6 million population – most of whom, for instance, are women – could hint to segmentation. Women face significant barriers in the labour market in terms of career trajectory as the undervaluation of women’s work, occupational segregation, part-time employment and the constraints of childcare and domesticity take their toll. No further reflections or evidence are available on this.
Table 3: National Living Wage jobs, by characteristics, UK, 2017-2018

<table>
<thead>
<tr>
<th>Characteristic</th>
<th>2017</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>NLW</td>
<td>Total</td>
</tr>
<tr>
<td></td>
<td>(thousands)</td>
<td>economy</td>
</tr>
<tr>
<td>Sector Public</td>
<td>53</td>
<td>6,197</td>
</tr>
<tr>
<td>Private</td>
<td>1,415</td>
<td>15,920</td>
</tr>
<tr>
<td>Voluntary</td>
<td>91</td>
<td>2,190</td>
</tr>
<tr>
<td>Time Full-time</td>
<td>585</td>
<td>17,863</td>
</tr>
<tr>
<td>Part-time</td>
<td>974</td>
<td>6,444</td>
</tr>
<tr>
<td>Permanence</td>
<td>1,359</td>
<td>22,584</td>
</tr>
<tr>
<td>Temporary</td>
<td>186</td>
<td>1,587</td>
</tr>
<tr>
<td>Sex Male</td>
<td>575</td>
<td>12,202</td>
</tr>
<tr>
<td>Female</td>
<td>984</td>
<td>12,104</td>
</tr>
<tr>
<td>Age 25-29</td>
<td>265</td>
<td>3,274</td>
</tr>
<tr>
<td>30-59</td>
<td>1,110</td>
<td>18,888</td>
</tr>
<tr>
<td>60+</td>
<td>185</td>
<td>2,145</td>
</tr>
<tr>
<td>Firm size Micro (1-9 employees)</td>
<td>320</td>
<td>1,870</td>
</tr>
<tr>
<td>Other small (10-49 employees)</td>
<td>320</td>
<td>3,300</td>
</tr>
<tr>
<td>Medium (50-249 employees)</td>
<td>230</td>
<td>3,500</td>
</tr>
<tr>
<td>Large (250-4,999 employees)</td>
<td>340</td>
<td>7,250</td>
</tr>
<tr>
<td>Very large (5,000+ employees)</td>
<td>350</td>
<td>8,360</td>
</tr>
<tr>
<td>Occupation Cleaning/maintenance</td>
<td>239</td>
<td>773</td>
</tr>
<tr>
<td>Retail</td>
<td>304</td>
<td>1,577</td>
</tr>
<tr>
<td>Hospitality</td>
<td>242</td>
<td>770</td>
</tr>
<tr>
<td>Other low-paying sectors</td>
<td>500</td>
<td>3,622</td>
</tr>
<tr>
<td>Non low-paying sectors</td>
<td>274</td>
<td>17,565</td>
</tr>
<tr>
<td>Total</td>
<td>1,559</td>
<td>24,207</td>
</tr>
</tbody>
</table>

Source: Authors, based on LPC (2017, 2018a)

Figure 3 shows the changes of hours worked in low-paying occupations and the wider economy since 2015. Total hours worked have grown more slowly in low-paying sectors since the introduction of the NLW. Since the uprating in 2017, a narrowing in the growth in hours between low-paying and non-low-paying occupations can be observed.

Figure 3: Change in hours for those aged 25 and over, by sector, UK, 2015-2018

Source: LPC estimates using LFS Microdata, population weights, not seasonally adjusted, four quarter rolling average, UK, Q2 2014-Q1 2018 (LPC, 2018a)

Coverage fell in 2018 for those who worked in the private sector, worked in more than one job, had been in their job for less than a year, were female, worked in temporary jobs and worked in part-time jobs. Coverage fell particularly fast for those in temporary jobs, those who had been in their job for less than 12 months and for younger workers. This can reflect a tightening labour market for the lowest paid; these workers would be most likely to have taken advantage of higher-paying jobs created in an environment with higher wage competition (LPC, 2018a). Further analyses by worker...
characteristics shows that ‘non-UK born workers, those with disabilities, those with no qualifications and ethnic minorities have higher coverage than their direct comparators’ (LPC, 2018a).

On the other hand, the number of jobs paid just above the NLW has grown significantly. Although in some sectors and geographic areas it was estimated that local competition for labour would have this effect in any case (NIESR, 2018), in general this has been interpreted as a consequence of the NLW, which has pushed companies to keep their pay above the minimum levels to either attract workers through a premium over the wage floor, or to keep differentials within their workforce structure. Nonetheless, while the pay rises for those just above the NLW were equivalent to the increase in the NLW, jobs slightly further up the pay distribution had smaller pay rises (NIERS, 2018). With the exception of those just above the NLW, cash increases are lower than the NLW increase, implying a squeeze on pay differentials. Taking into account spillovers, the LPC (2018a) estimated that five million workers benefited from the 2018 NLW uprating once. What the research mentions as unclear is how much longer employers will be able to continue to pay those jobs at a rate above the NLW, considering the foreseen increases in the minimum wage to reach 60% of median earnings in 2020 (Lord, 2018). No further information is available on progressions or transitions.

Evidence of wage spillovers also exists for younger workers, whose wages rose in parallel with the higher adult minimum wage, and without negative employment impacts. The factors behind this decision include employers’ preferences for fairness and equality, whereby they feel that age rates can be discriminatory, especially for workers of different ages who are performing the same tasks. Also, in tight labour markets, employers’ perception is that it would be difficult to recruit young staff if they paid age rates. A further reason for not paying age rates and adjusting to the NLW is administrative simplification (Giupponi and Machin, 2018a; NIERS, 2018; interviewees).

**Employment effects**

Overall, the analytical evidence suggests that negative employment effects from the NLW have so far been minimal (LPC, 2018a, also based on Aitken et al, 2018 and Capuano et al, 2018; Giupponi and Machin, 2018a). This has been stressed by the interviewees as a key success point of this measure. Looking at the groups associated with higher NLW coverage, both unemployment and inactivity have fallen, while employment has risen faster than in other groups. Also, those individuals whose characteristics are most associated with the NLW have overall experienced relatively better changes in labour market outcomes compared to the average worker (LPC, 2018a).

Moreover, the NLW seems to have a positive effect against underemployment: since its introduction, and as minimum wages increased, underemployment has decreased as the income the workers earn gets closer to the desired income level with the number of hours worked (LPC, 2018a). These aspects seem to hint to a potential contribution of the NLW to reducing LMS, in terms of work higher employment (also through transitions from inactivity or unemployment) and better working conditions. Nonetheless, further analyses (D’Arcy, 2018) show that the relationship between the change in employment and coverage of the NLW since the introduction of the NLW seems to be little and that changes in employment in low-paying areas have not differed significantly from higher-paying places. Also, the LPC (2018a) reports that different studies did not find conclusive evidence of the impact of the NLW on employment retention.

In parallel, focusing on those aged under 25, labour market data show that the 2016 and 2017 increases in the NMW youth rates succeeded in raising young people’s pay without harming their employment prospects (LPC, 2018a). Focusing on the NMW, RAND (2017) also found no statistically significant aggregate adverse employment effect of the NMW. However, estimates for different sub-groups suggest some relatively larger adverse employment effects for some labour market groups, such as part-time employees.

Specific effects can also be identified according to the sector (see Box 1) and geographic area.
Box 1: Employment effects in the care homes

A study on how care homes (a sector that is highly vulnerable to changes in minimum wages since it employs a large number of low-paid workers) in England adjusted to the NLW (Giupponi and Machin, 2018b) found that the NLW strongly affected the wages of care workers. Despite this significant wage increase, the research finds little evidence of negative employment effects (both in terms of the number of workers and hours worked). The limited ability to change residents’ fees deriving from local authority regulations also made it unlikely for care homes to respond with price increases. While it is plausible that homes suffered a profit hit, no evidence was found of increased probability of firm closure. Rather, the key effect was a deterioration in the quality of care.

As stressed by an interviewee, in general, no group of particular concern in terms of suffering segmentation has been negatively affected by the NLW. Nonetheless, it becomes harder to make a case regarding LMS: there is evidence about a wage boost, but not sufficient evidence on transitions, also considering that the measure was introduced still quite recently. Also, most of the analyses were realised on those who were already in work, rather than in unemployment, which might also offer a partial picture.

Another issue is related to non-standard forms of employment and contractual practices such as the abuse of zero hours contracts and bogus self-employment, which may wrongly lead to non-payment of the NMW (interviewees; Moore et al, 2017; TUC, 2017). Nonetheless, for the moment “evidence of such a tactic becoming more common appears limited” (D’Arcy, 2018).

Substitution effects

According to different interviewees, reflections on potential substitution effects between 25 and over and younger workers were not an explicit rationale behind the launch of the measure. Nonetheless, Pyper (2018) stresses that ‘the introduction of the NLW in parallel to a new 21-24 year old age band led to renewed interest in the rationale behind NMW age-banding, fears that workers over 25 would be discriminated against in favour of younger, cheaper, workers and concern that workers aged 21-24 were now ineligible for the full minimum wage’.

All interviewees confirmed that no clear evidence of substitution effects exists, also due to the tight labour market in the UK. Hints of substitution effects were found in Moore et al (2017), who report some evidence that ‘employers have made adjustments to terms and conditions to accommodate the NLW, primarily through cuts to hours and premia, but also increased use of younger workers’.

Transitions and LMS

As reported by the LPC (2018a), while on the one hand literature shows that the minimum wage boosts wage growth, on the other very little evidence exists regarding its impacts on wage progression. D’arcy (2018) stresses that pay progression is often not a reality for low-paid workers (‘only one in six workers who were low paid in 2006 had moved onto consistently higher wages by 2016’). Recent research by Cai et al (2018) found that the introduction of the NMW did not affect stepping stone effects of low pay, having no impacts on low wage dynamics. This confirmed previous literature on UK data. In contrast, research by Rinz and Voorheis (2018) on US data (administrative earnings data from the Social Security Administration linked to the Current Population Survey) found that minimum wages contributed to increased earnings mobility at the bottom of the wage distribution.

A study (ongoing) was commissioned to Avram and Harkness (2018) by the LPC to analyse the effect of minimum wages on job progression out of minimum wage jobs in a sample from the British Household Panel Survey data (period 2009-2016) covering workers aged 25 and over. Key preliminary findings reported by the LPC (2018a) include the following:

- Substantial mobility out of minimum wage jobs is observed, whereby half of workers at the wage floor leave their job for a higher-paying one each year. Nonetheless, most of these movements are to jobs that are still low paying but slightly above the minimum wage. No
Evidence is found of any minimum wage effects (either positive or negative) on wage progression.

- Individual and job characteristics are important determinants regarding transitions out of minimum wage jobs. Those working in the public sector, in a large firm, and those with higher educational qualification levels are more likely to transition into a non-low-paying job. Other groups are less likely to transition to a non-low-paying job, including part-time workers, workers with a history of unemployment spells, female workers, those that have been working in a minimum wage job for a longer period, and workers in sectors such as hospitality, food and beverage manufacturing and textile manufacturing (LPC, 2018a).

No research was found on the impact of the NLW on LMS. When inquired on this relationship, the interviewees reported these key reflections, stressing on the need for more evidence to support them:

- It is unclear whether a relationship exists between the NLW and LMS. There is no available evidence on this relationship, which would be worth analysing more in detail.
- Although the number of jobs that are paid the NLW has increased, this does not necessarily equate to more secure employment.
- The improvement of salaries can be expected to be associated with better working conditions, but no evidence is available in case of the NLW.
- For people who start with the minimum wage and who transition in and out of work, it could be more likely to get back to the minimum wage rather than to higher wages.
- Sectors would probably have a strong influence on transitions. In typically low-paying sectors, workers will tend to stay on the minimum wage with no progression or pay rise. In some other industries, the minimum wage is used as a starting point.
- The restructuring of the workforce as a reaction to the NLW could potentially be seen as a factor increasing LMS, with the labour force being divided into two main groups: a larger group on or close to the minimum wage, and a much smaller group of workers with managerial positions (also, smaller than before the introduction of the NMW/NLW).
- As regards the aim to enhance productivity as a reaction to higher wage floors, trying to raise productivity by making people work harder (getting them to do more for their hourly wage), typically does not help those individuals in terms of progression and skills development, and even more so if training costs are reduced as a coping strategy. But also, as the NLW increases costs, employers may attach a higher value to labour once it becomes more expensive (it would be in the employer’s interest to keep that labour because of this higher investment). This could motivate them to think about how to develop the employees to get more out of them rather than just pushing them harder – for instance, providing more training to improve their productivity, sales ability and/or output quality.

**Minimum standards in terms of pay**

As stressed by some interviewees, an important result deriving from the NLW was the introduction of minimum standards in terms of pay. NIESR (2018) also observed that the NLW was superseding the NMW in terms of importance in guiding wage policy and practice.

The above is still hindered by some non-compliance by some employers (Mor and Brown, 2018).

**Impact on skills and productivity**

NIESR (2018) reports that employers generally agree with the aim of the NLW of raising skills, productivity and labour quality, including aspects such as enhancing motivation and job satisfaction. Also, to some extent the NLW was perceived as a support to the recognition of the existing skills and responsibility of some of the low paid workers, rather than boosting productivity and skill levels. Productivity improvements, mentioned as one of the key options to face the increased wage costs, are not documented yet with sufficient evidence allowing to prove the causality of the NLW on productivity changes (LPC, 2018a).
According to the LPC (2018a), increasing levels of automation should be a common expected response to increases in the NLW, though the consequences for jobs and the role of the NLW in this trend are unclear. Cribb et al (2018) examined the impact of the NLW on automation. As the coverage of the NLW is expected to rise to 12% by 2020, it will likely cover very different jobs from the ones covered in 2015. According to the report, the jobs set to be covered by the NLW by 2020 are more than twice likely to be in the top decile of the most ‘routine occupations’ that appear easier to automate, such as retail cashiers and receptionists, than those directly affected by the NMW in 2015, such as workers in hospitality. As a result, in many cases it would be easier than before for firms to respond to a rising cost of labour by switching to machines. The report stresses that the net employment that could derive from this is unclear. As technology replaces some jobs, new jobs can be created that are complementary to that new technology. Minimum wage workers may undergo training (for instance, cross-training to prepare to multi-tasking) as a result of a higher minimum wage. Also, they may end up doing different jobs rather than losing employment altogether.

Financial impact for companies
Research by NIESR (2018) one year after the introduction of the NLW shows that most employers had to pay some increase or to change their pay package. The additional cost was higher in those companies with larger proportions of staff on the minimum wage. As described in the ‘mechanisms’ section, some employers responded to these costs by accepting lower profits, increasing prices and reducing non-pay benefits, among others.

Effects on businesses’ investments or expenditure in areas other than staffing depend on individual and sectoral specificities. Smaller firms seem to have reacted by reducing or postponing investments.

Strengths and weaknesses
As also stressed by all interviewees, key strengths of the NLW consist of the following:

- Low paid people receiving higher wages with no adverse effects on employment means that the policy has been extremely successful. The number of people who benefit from the NLW, either directly or indirectly (such as those right above the minimum wage, whose wages have been increased to keep the differentials, has been increasing. Support factors include the overall improvement of the labour market in the UK, with record employment levels, therefore with little risk of long-lasting negative employment effects.
- No major substitution effects are observed between younger and older workers.
- Positive spillover effects were observed among those in jobs above the NLW and younger workers.
- Employers, including in low-paying sectors, have overall coped with the increases so far, in some occasions through the implementation of adjustment mechanisms.
- The history of the minimum wage being successful and well respected in the UK supported a positive attitude of employers regarding the introduction of the NLW. This was also strengthened by the good reputation of the LPC, namely related to its independence, evidence-based research and social partnership model.
- As opposed to other countries where statutory minimum wages do not exist because of the strength of collective bargaining, the NLW is universal and reduces issues of coverage related to sectors.

On the other hand, the main weaknesses and challenges relate to:

- Issues related to employers’ compliance with the NLW, including the use of zero-hours contracts and bogus self-employment. This is especially relevant, considering that, after the crisis of 2008, one of the key issues related to segmentation was the proliferation of zero-hours contracts and increased casualised employment (Newsome et al, 2018).
- The political nature of the NLW initiative, which was introduced without prior consultation of social partners and without strong grounds of evidence.
- Lack of clarity regarding the relevance of the age bands as they are currently defined.
• The application of the same rates to the whole country, without adjustments to the different costs of living in different geographic areas.

**Sustainability and issues of future concern**

So far, the policy has been successful in increasing wages without having large adverse employment effects (also thanks to the positive situation in the UK labour market overall). It has been defined as a ‘very positive story’ by most interviewees. While it has so far been able to follow the path towards the 2020 target, its remit after 2020 is still to be defined.

Issues linked to sustainability and the future of the NLW relate to the following (LPC, 2018a and interviewees):

- Different contextual factors of change – such as Brexit, the changing shape of the economy and the evolution of the labour market (with increasing automation, digitalisation and self-employment, also in typically low-paying sectors such as retail) make it hard to predict whether the NLW will be sustainable in the longer term. While this could be considered a difficult time by some employers, interviewees stressed that the current context also sets the grounds for a change in firms’ behaviours, reducing the overreliance on the very low paid and focusing more on productivity improvements and progression. Both employer representatives and unions stressed the need to increase productivity, so that businesses become better prepared to manage the increased cost of the NLW.

- It is unclear what would happen in the case of a reduced labour supply deriving from Brexit.

- As the reaction of some employers is to reduce pay differentials, there is increasing concern regarding how this compression in pay structures would affect employee relations, motivation to take over new responsibilities for a limited additional pay and staff retention.

- Similarly, there is a risk of businesses investing less in training and development to keep costs low, causing negative impacts on skills.

- There is a lack of clarity regarding what would happen to the NLW if there was an economic downturn.

- It is unknown what proportion of the population would be on a minimum wage in the longer term and when/whether they would access higher paid jobs. Two main scenarios could be identified: the creation of a segmented labour market, divided between minimum wage jobs and higher paid ones, with fewer steps along the ladder, or the push of a productivity boosting approach, with higher investments in people’s skills and technology.

- Although the NLW has not caused employment losses so far, some employers are more worried about its future increases until 2020. Smaller businesses and certain sectors (retail, hospitality, agriculture, care, etc.) might face challenges to afford covering the next rates of NLW. In some cases, this might lead to negative employment effects or negative impacts on employment conditions.

**Transferability**

Relevant factors and contextual conditions needed for transferability, as stressed by the interviewees, relate to:

- Having a generally strong labour market. As the NLW implies a quick rise of the minimum wage in a short period, countries that are still on high unemployment may be unable to successfully implement this measure.

- Having an enforcement system in place and a culture of broad compliance, with the related labour market institutions and labour market inspectorates in place, to make sure that the statutory minimum wages are paid correctly.

- Having a good level of awareness among employers regarding the need for fair pays and equality.
• Having a social partnership model in place, such as the LPC, which ensures that decisions related to statutory minimum wages (including rates and age bands) are evidence-based and not purely political.

Conclusions and policy pointers

Conclusions:

• In general terms, against the specific objectives of the measure:
  o The measure is successful in terms of coverage, as it has induced an important increase in the number of workers paid the NLW. It is financially sustainable when the economy is healthy. Nonetheless, it may imply some issues of sustainability in specific sectors (such as retail, social care, etc.) and types of firms (smaller companies).
  o Its positive effects do not only affect the lowest paid, but also those slightly above the minimum wage. Nonetheless, at the same time the measure squeezes salary differentials.
  o The measure was launched in parallel to other policy initiatives, but not as part of a policy package foreseeing a clear interaction between them. At the same time, it benefitted from the campaign on the Living Wage, especially in terms of the employers’ awareness on fairness and pay rises, supporting a better acceptance of the initiative.
  o The minimum wage approach by age bands could be useful to protect youth employment, but implies issues of fairness and operational complexity. Issues of discrimination could also derive from its equal application throughout the whole UK territory without adjusting to regional differences in the cost of living, provided that the location of businesses had a strong impact on pay (NIESR, 2018). Issues could also derive from its equal application to the whole population aged 25 and over, without considering further age differences within this heterogeneous population.

• More specifically related to LMS:
  o Despite the improvements deriving from the measure, no evidence is available as regards wage progressions, transitions, job stability and improvement of working conditions. The limited available information tends to show that those receiving the NLW more easily transition to other low-paid jobs rather to better-pay jobs (horizontal rather than vertical mobility) – which suggests that the contribution of the measure to reducing LMS is limited.
  o There are issues of compliance, also related to the use of non-standard forms of employment, that could be seen as a way for employers to avoid paying the minimum wage. Moreover, from an LMS perspective, the use of these forms of employment could increase segmentation, if they result in a general acceptance of fragmented jobs that are inherently linked to low income and limited social protection (Eurofound, 2015).
  o The available evidence on the NLW does not allow to draw solid conclusions regarding the direct or the indirect contribution of the measure to tackle LMS. Some hints of potential contributions to reduce LMS, that would need nonetheless to be further explored, include a higher labour market inclusion of low skilled in low pay sectors and a lack of negative employment effects, hence avoiding downward mobility. At the same time, LMS could be increased because of a reduced offer of training, which might result in less upwards mobility.

Policy pointers:

• In general terms, against the specific objectives of the measure:
Streamlining age bands could make the application of the NMW/NLW more operational and fairer.

Taking into account the mechanisms adopted by companies in reaction to the introduction of the NLW, a stronger focus should be put on helping companies to prosper and to cope with it. Further evidence would also be needed in order to understand the changes in productivity and their relationship with the NMW/NLW.

More specifically related to LMS:

Higher awareness should be ensured as regards the need to pay the NMW/NLW (in terms of fairness, social responsibility, company practices), so to reduce bad practices by companies – including the use of bogus self-employment and zero-hours contracts as a way to avoid paying the statutory minimum wages.

Moreover, in order to ensure a clearer contribution to reducing LMS, the focus of NMW/NLW could be extended from addressing low income and income inequalities to also cover mobility aspects – shifting from a purely financial to a more integrated approach. Therefore, in order to support upwards mobility, the NLW would need to be combined with other policy measures, such as training, awareness raising and the recognition of skills, among others, alongside assistance to businesses with their reallocation of costs.

LMS largely affects women and part-time workers, who also tend to be overrepresented in minimum wage jobs. Foreseeing more targeted interventions taking into account workers’ characteristics could help addressing these issues.
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All Eurofound publications are available at www.eurofound.europa.eu


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Low Pay Commission (2015), ‘The minimum wage for younger workers - Why is the level different?’, Low Pay Commission blog.


Low Pay Commission (2016b), ‘Has underpayment increased since the introduction of the National Living Wage?’, Low Pay Commission blog.


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## List of abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>CRSP</td>
<td>Centre for Research in Social Policy</td>
</tr>
<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
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<tr>
<td>LPC</td>
<td>Low Pay Commission</td>
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<tr>
<td>NLW</td>
<td>National Living Wage</td>
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<tr>
<td>NMW</td>
<td>National Minimum Wage</td>
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<tr>
<td>UK</td>
<td>United Kingdom</td>
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</table>
Table 4: CMO configurations of the ‘National Living Wage’

<table>
<thead>
<tr>
<th>Initiative</th>
<th>The NLW is a regulatory measure related to income security, with a focus on legal provisions regarding minimum wage. The NLW was introduced in 2016 in addition to the already existing statutory minimum wage regime that was in place since 1999. The NLW implied a significant increase in the statutory minimum wage for workers aged 25 and over. The NLW aims to increase the wages of those on low pay and to combat growing wage inequality. It was set as a multi-year commitment to raise the relative value of the legal minimum hourly wage to 60% of the median hourly pay by 2020.</th>
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<tbody>
<tr>
<td><strong>Target group characteristics</strong></td>
<td>Workers (excluding self-employed) aged 25 and over.</td>
</tr>
<tr>
<td><strong>Contextual features</strong></td>
<td>• The statutory NMW came into force in April 1999. • The statutory NMW introduced for the first time in the UK a single legal wage floor below which no adult aged 22 and over could be paid. • Despite initial controversy, the development and success of the NMW made it enjoy broad political support. • The NMW had little impact on the broader problem of low pay in the UK. • In the Summer Budget of July 2015, the then Chancellor George Osborne stated his intention to ‘tackle low pay and ensure that lower wage workers can take a greater share of the gains from growth’. • In 2015, the UK had strongly recovered from the 2008 recession, according to the government. • There was ‘political appetite’ for the new NLW and a particular political objective to appear worker friendly and concerned about low pay. • The NLW is, to some extent, considered as an acknowledgement and appropriation of the Living Wage concept.</td>
</tr>
<tr>
<td><strong>Mechanisms</strong></td>
<td>Employers’ reactions following a hike in wage floors depend on the magnitude of the cost increases they face and the available options to adapt their operations to these higher costs – which are not equally distributed across sectors and are proportionately higher in low-wage industries. Key types of adjustment mechanisms adopted by employers in reaction to the introduction of the NLW typically include: • Price increases • Reduction of profits instead of raising prices, where employers absorb the extra costs resulting from higher wage floors • Reduction of non-wage benefits, such as private health coverage, pension contributions, the use of company cars and other subsidies • Wage setting practices and changes in wage structures, such as reduction of wages at the top and/or narrowing of the pay bands • Restructuring of the workforce. Less frequently adopted adjustment mechanisms include: • Reduction of working hours, resulting in a reduction of the total labour demand (negative employment effect) • Reduction of training provision for the lower-wage employees in order to offset costs • Boost of employers’ productivity • Boost of employee productivity.</td>
</tr>
</tbody>
</table>
Outcomes

- Coverage: The introduction of the NLW induced an important increase in the number of workers paid the NLW
- Spillover effects: The number of jobs paid just above the NLW has grown significantly. Evidence of wage spillovers also exists for younger workers
- Negative employment effects: so far, minimal, confirming the success of the measure
- Adoption of minimum standards in terms of pay
- In some cases, negative financial impact for companies, but so far sustainable
- No clear evidence available on LMS and transitions.
Table 5: Assessments of the ‘National Living Wage’

<table>
<thead>
<tr>
<th>Evaluation study</th>
<th>Period</th>
<th>Data source</th>
<th>Method</th>
<th>Outcomes</th>
<th>Authors’ assessment of the quality of the evidence</th>
</tr>
</thead>
<tbody>
<tr>
<td>LPC 2018 report</td>
<td>1999-2018</td>
<td>Annual Survey of Hours and Earnings (ASHE), Labour Force Survey (LFS), Average Weekly Earnings (AWE), Office for National Statistics (ONS) labour market data, economy and pay forecasts from the Bank of England’s August 2018 Inflation Report, HM Treasury’s panel of independent forecasts, Office for Budget Responsibility (OBR)</td>
<td>Consultation with employers, workers and unions; economic analysis on economic and labour market performance; economic and statistical analysis of the impact of the minimum wage; front-line visits to organisations and workers around the country</td>
<td>The NLW had led to a large increase in wages for the lowest paid, but had not led to any significant negative effects on employment or hours. However, there were some findings of negative employment effects for some groups, sectors and regions under certain specifications. But these negative findings were not robust and should be seen against a backdrop of record employment levels and rates. Instead of reducing jobs or changing hours, firms appear to have coped with the introduction of the NLW and its initial upratings by: a limited squeezing of differentials; a reduction in non-wage benefits; increasing prices; and accepting a squeeze in profits.</td>
<td>The report is very detailed and uses a robust methodology. It provides useful data on the impact of the NLW and is strengthened by the fact that it draws on multiple data sources and a combination of interviews, economic analysis and visits to various organisations. Evidence is drawn from a variety of high-quality research inputs – which converts this report in the most relevant and comprehensive source of information on the NMW/NLW. From a LMS perspective, it includes a few references to transitions.</td>
</tr>
<tr>
<td>Avram, S. and Harkness, S. (2018), The</td>
<td>2009-2016</td>
<td>Understanding Society- the UK Longitudinal</td>
<td>Difference-in-difference</td>
<td>The share of workers covered by the minimum wage increased from around 4% in 2009 to around 7% in 2016. Consequently, the share of workers earning below the low</td>
<td>The study has not yet been published, but some relevant preliminary information is available.</td>
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</table>

Disclaimer: This working paper has not been subject to the full Eurofound evaluation, editorial and publication process.
### NMW/NLW and progression out of minimum wage jobs in the UK

<table>
<thead>
<tr>
<th>Study</th>
<th>Methodology</th>
<th>Results</th>
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<tbody>
<tr>
<td>Aitken, A., Dolton, P. and Riley, R. (2018), ‘The Impact of the Introduction of the National Living Wage on Employment, Hours and Wages’, NIESR Report to Low Pay Commission</td>
<td>Difference-in-difference</td>
<td>There was clear evidence of faster real wage growth for NLW workers compared with the control groups. The NLW raised real pay by an additional 4.0-7.0 percentage points in 2016 and by an additional 0.8-1.3 percentage points in 2017. There was no conclusive evidence of an impact of the introduction of the NLW and its subsequent uprating in 2017 on overall employment retention or hours. When considering hours using ASHE, there was no evidence of reductions in hours for treated workers following the introduction of the NLW or the uprating in 2017.</td>
</tr>
<tr>
<td>Capuano S., Cockett J. and Gray H. (2018), The impact of the minimum wage on employment</td>
<td>Difference-in-difference, Triple difference-in-difference</td>
<td>The only two years when the NMW/NLW upratings had any discernible effect on employment retention were 2014 and 2016. The introduction of the NLW in 2016 was associated with a reduction in employment retention. However, that finding was not robust. The results suggest that the upratings of the NMW and the introduction of the NLW had no discernible effect on employment retention.</td>
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### Disclaimer

This working paper has not been subject to the full Eurofound evaluation, editorial and publication process.
## Assessment of public initiatives to combat labour market segmentation in the EU Member States

### Case study: The National Living Wage (UK)

**Disclaimer:** This working paper has not been subject to the full Eurofound evaluation, editorial and publication process.

<table>
<thead>
<tr>
<th>Source</th>
<th>Methodology</th>
<th>Findings</th>
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<tr>
<td><strong>RAND (2017), The impact of the National Minimum Wage on employment - A meta-analysis by Hafner, M., Taylor, J., Pankowska, P., Stepanek, M., Nataraj, S. and van Stolk, C.</strong></td>
<td>Meta-regression analysis (MRA)</td>
<td>Increases in the UK national minimum wage since 1999 had no negative employment effects on the overall UK labour market. Many of the effects following these increases were largely positive in terms of reducing pay inequality and improving the standards of living for low-paid workers. There were some adverse negative employment effects on certain sub-groups as a result of increases in the national minimum wage. This included part-time employees who have endured some adverse negative employment effects compared to other labour market groups. Only during the recession in 2008 were young employees adversely affected, with a decrease in employment retention probabilities.</td>
</tr>
<tr>
<td><strong>European Centre of Expertise in the field of labour law, employment and labour market policy - ECE (2017), Labour market policy thematic review 2017: An in-depth</strong></td>
<td>Desk research, policy review</td>
<td>In the UK the effects of introducing the NLW on employment are difficult to isolate and any effect on employment is likely to have been small, given that the wage is being introduced incrementally and also comes at a buoyant time for the UK labour market. Reduced employment does not appear to be the primary response employers make to a rising wage floor. Instead, employers were more likely to pass on their increased costs in higher prices for their goods and services.</td>
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The analysis synthesises findings from large empirical research bringing together relevant evidence on the subject. Like every meta-study, it depends on the data that feed into the analysis.

Reduced employment does not appear to be the primary response employers make to a rising wage floor. Instead, employers were more likely to pass on their increased costs in higher prices for their goods and services. The analysis is based on information collected through national research/inputs. The evidence produced is reliable; the experts selected a limited number of reforms to report on, ensuring a high focus of the content. Specific information on inequalities and LMS, though, is limited.
### Analysis of the Impact of Reforms on Inequality - Synthesis Report

<table>
<thead>
<tr>
<th>Study Title</th>
<th>Year</th>
<th>Data Source</th>
<th>Methodology</th>
<th>Findings</th>
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<tr>
<td>D’Arcy, C. and Corlett, A. (2015), ‘Taking up the floor: Exploring the impact of the National Living Wage on employers’</td>
<td>2014</td>
<td>Annual Survey of Hours and Earnings (ASHE)</td>
<td>Economic estimates of the impact of the NLW</td>
<td>The analysis has shown that 6 million workers – or 23 per cent of all employees – stand to benefit in 2020 as a result of the NLW. Of those gaining, 3.2 million earn less than the NLW and are brought up to at least that level; while another 2.8 million workers who already earn above the NLW are expected to gain as employers preserve pay gaps between different roles. On average across the 6 million affected, the NLW is expected to add GBP 760 (€856) annually to pre-tax wages. In total, GBP 4.5 billion (€5.08 billion) will be added to the wage bill of British firms in 2020. Ensuring successful implementation of the NLW will require the independent LPC to play a key monitoring and advisory role.</td>
</tr>
<tr>
<td>Giupponi, G. and Machin, S. (2018), ‘Changing the structure of minimum wages: Firm adjustment and wage spillovers’, IZA DP No. 11474</td>
<td>2016-2017</td>
<td>National Minimum Dataset for Social Care (NMDS-SC), Care Quality Commission (CQC) registry</td>
<td>Econometric analysis of the effects of minimum wages on employment, the wage distribution and firm adjustment levers</td>
<td>The NLW substantially raised wages at the bottom of the hourly wage distribution. Care homes mostly seemed to manage to cope with the additional wage costs that resulted from the NLW as there is at best modest evidence of employment changes in response to the sizable wage cost shock that ensued, and no evidence of home exit resulting from this. The quality of care services appears to have significantly suffered as a consequence of the wage shock. This reduction in care quality seems to be the main margin of adjustment identified amongst a range of possible firm responses. The structure of wages by age also substantially changed, as there are significant wage spillovers for younger workers from the NLW introduction. Thus the</td>
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Disclaimer: This working paper has not been subject to the full Eurofound evaluation, editorial and publication process.
Main wage impact of the changed minimum wage structure was on both the wages of directly affected older workers and indirectly affected younger workers, but with less evidence of employment adjustment in response to these. Employers’ preferences for fairness emerges as the most plausible explanation for the observed wage spillovers.

| National Institute of Economic and Social Research – NIESR (2018), National minimum wage and national living wage impact assessment - Counterfactual research | 2001-2016 | Annual Survey of Hours and Earnings (ASHE), Labour Force Survey (LFS), Annual Business Survey (ABS) | Counterfactual analysis | Employers were acutely aware of competition from employers in their localities for labour and adjusted rates accordingly, as well as according to inflation and their own profitability. The minimum wage does not only affect workers directly covered by an uprating. It also influences the timing of pay increases and places pressure on wages of workers higher up in the wage distribution, creating a spillover or ripple effect. Low-wage work is concentrated in a relatively small number of industries and occupations. The evidence on counterfactual growth of wages in the absence of a minimum wage regime suggests that wages of low-paid workers experience higher growth rates than the median in the presence of the minimum wage, but lower growth rates than the median in the absence of a minimum wage. At the same time, the evidence also indicates that some (non-zero) real wage growth occurred in the absence of the NMW/NLW. Even in the post-crisis period, when real wage growth was negative, nominal wage growth was positive. | Existing data sources were sufficiently informative to devise an empirical growth rate of wages in low pay employment, but not to obtain a credible estimate of all aspects of the counterfactual wage distribution. The model-based approach adds some value to the above by identifying the average wage growth in low payment in the absence of NMW and NLW uprating. |
The European Foundation for the Improvement of Living and Working Conditions (Eurofound) is a tripartite European Union Agency established in 1975. Its role is to provide knowledge in the area of social, employment and work-related policies according to Regulation (EU) 2019/127.