

Comments in full to FT on national living wage

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My answer is A (it will do more harm than good); although I think that the harm may well be as much from muddying the water as from the actual economic damage done.

A brief summary of my reasoning

1. If George Osborne has an economic rationale for this policy (other than the political one of stealing a policy from Labour – which has been very successful) it appears to be that he believes the corporate sector (or more precisely, the low wage corporate sector) should share some of the burden of mitigating poverty.
2. This seems unlikely to work as advertised. I would assume that this part of the economy is probably closer than most to the standard competitive model with near-constant returns and free entry and exit. That being the case, the standard model would predict that this sector of the economy will contract until most or all of the impact of the wage rise is passed on to consumers in higher prices. So ultimately consumers of goods and services produced by the low wage economy will pay.
3. The most positive light you can put on this is that such consumers are probably less likely to come from the lower end of the income distribution, so that, if there were absolutely no impact on employment in the low wage sector, the policy would be mildly redistributive (in which case I *might* change my answer to B).
4. However, this effect is clearly going to be more than offset if it raises unemployment in the low wage+low productivity sector (which is where most of the unemployment is already). I know that the evidence for adverse employment effects of minimum wages is pretty muddly, but I think that the priori case is sufficiently strong as to make this the major risk. The standard model would suggest that the extent of any employment losses in the low wage sectors will depend on the elasticity of demand for their goods and services. Indirectly the evidence seems to be quite strong that in the long term these effects can be quite large (viz, for example, the steady fall in the number of pubs in the uk, as drinking in pubs becomes progressively more expensive relative to competing activities).
5. If the existing low wage sector contracts it is not clear where those working in it (who typically have low productivity and skills to match their low wages) will go to work instead. I would expect this adverse distributional effect to swamp the possibly beneficial effect of my point 3.
6. But just as important I believe, is that these policies muddy the water. Wages are a very blunt instrument to tackle poverty (though not as blunt as universal benefits for the elderly!). Eg, if you look into the detail of the GLA's calculations of their London Living Wage ("A Fairer London: The 2015 Living Wage in London") you'll see that, when they calculate living wages bottom up by looking at the consumption needs of different household types (their Table 2.4, appended to this note), they get very different answers for different households. Indeed, they end up having to suppress the result that given the current system of benefits, the living wage for a family of two working parents is actually *below* the current minimum wage). But, since they need a single number, all they can do is average across all the different types. A single Living Wage, built up from consumption needs, is not a logical construct: if it had any basis at all it should be a *set* of living wages, for different household types (but with

the bizarre implication that, in the current benefit regime, having children would result in a *reduction* in the relevant Living Wage).

7. My personal view is that poverty reduction for those in work can be, should be, and (as that 2 working parents example shows) already *is* carried out by government benefit policies. The tax credit system was one of the great unacknowledged success stories of Gordon Brown, and I'm pretty sure that it has been the primary factor behind our sustained low unemployment rate, and the resilience of employment during the recession. It seems a shame to start to throw this away just as it has really proved its value.

From: GLA Economics “A Fairer London: The 2015 Living Wage in London”

Table 2.4: Hourly wages required to meet basic living costs for different households
2.4a: Households with children

Earnings	Couple with two children				Lone parent	
	2ft	1ft 1pt	2pt	1ft	ft	pt
Number of adults	236,600	236,900	16,700	255,000	35,800	43,200
Wage level including all the relevant benefits	6.95*	6.95*	9.05	6.95*	8.00	10.80
Wage level excluding means-tested benefits	11.20	11.35	15.80**	11.60	15.80**	15.80**

2.4b: Households without children

Earnings	Couple with no children				Single no children	Weighted Average***
	2ft	1ft 1pt	2pt	1ft	ft	
Number of adults	382,900	88,700	10,300	213,800	627,000	2,146,700
Wage level including all the relevant benefits	6.95*	7.65	11.80	8.85	8.55	7.80
Wage level excluding means-tested benefits	6.95*	8.60	13.50	12.90	8.75	10.10

Notes: ft=full-time and pt=part-time

* Average of the NMW (£6.70) and the NLW (£7.20 from April 2016). This average has been used as a lower limit for the wage when calculating the weighted average wage as it is generally illegal to pay wages below either the NMW (for all workers from October 2015 to May 2016 and from April 2016 to September 2016 for those aged 21-24) and/or the NLW (for workers aged 25 and over from April 2016).

**An upper limit of £15.80 has also been applied. This is the median hourly pay (excluding overtime) for all employee jobs in London taken from the ONS 2014 Annual Survey of Hours and Earnings (provisional results).