

ECONOMIC IMPACT OF MINIMUM & LIVING WAGE

September 2023





Minimum and Living Wages

ISLE OF MAN MINIMUM AND LIVING WAGES

The Minimum Wage is the statutory minimum hourly wage that must be paid to workers in the Isle of Man. As of 2023 there are two bands for the Minimum Wage covering workers over compulsory school age (but under 18) and workers aged 18 and over. Previous iterations of the minimum wage have had a range of age bands and separate 'Development Worker' categories.

The Isle of Man Living Wage was borne out of a Tynwald motion in 2017 around Government bringing forward proposals for a voluntary 'Living Wage' and has been produced since then. The Isle of Man Government has a stated policy commitment to increase the Minimum Wage towards parity with the Living Wage (Isle of Man Government, 2023).

The distinction between Minimum and Living Wages is not always clear: as described above a Minimum Wage is the statutory minimum set by Government, whereas a Living Wage is an estimation of "the minimum required to allow people the basic opportunities and choices necessary for them to participate in society" (Isle of Man Government, n.d.). As a result the Living Wage has many subjective aspects and will usually vary by personal circumstances. The Living Wage and Minimum Wage can sometimes be the same or can be different.

UK MINIMUM AND LIVING WAGES

The United Kingdom has a statutory Minimum Wage, but since 2016 this has been referred to as the 'National Living Wage' for workers over the age of 23. This is not calculated based on minimum income standards however, and is instead based on reaching a target proportion of median earnings (60% by 2020 and 66% by 2024). The 'Minimum Wage' is retained to refer to the statutory minimum for under 23 year olds.

Separate to this, the Living Wage Foundation (a UK-based campaigning organisation) produces what it terms the 'real Living Wage', intended to be a measure of minimum income standards to meet an acceptable standard of living. This is produced in collaboration with the Resolution Foundation (a UK-based think tank) and Loughborough University.

It is important to note that the Isle of Man Government's commitments regarding bringing Minimum and Living Wages into line relate to efforts around minimum income standards for participation in society and are not based on proportions of median earnings as per the UK's statutory 'Living Wage'.



CALCULATION OF ISLE OF MAN LIVING WAGE

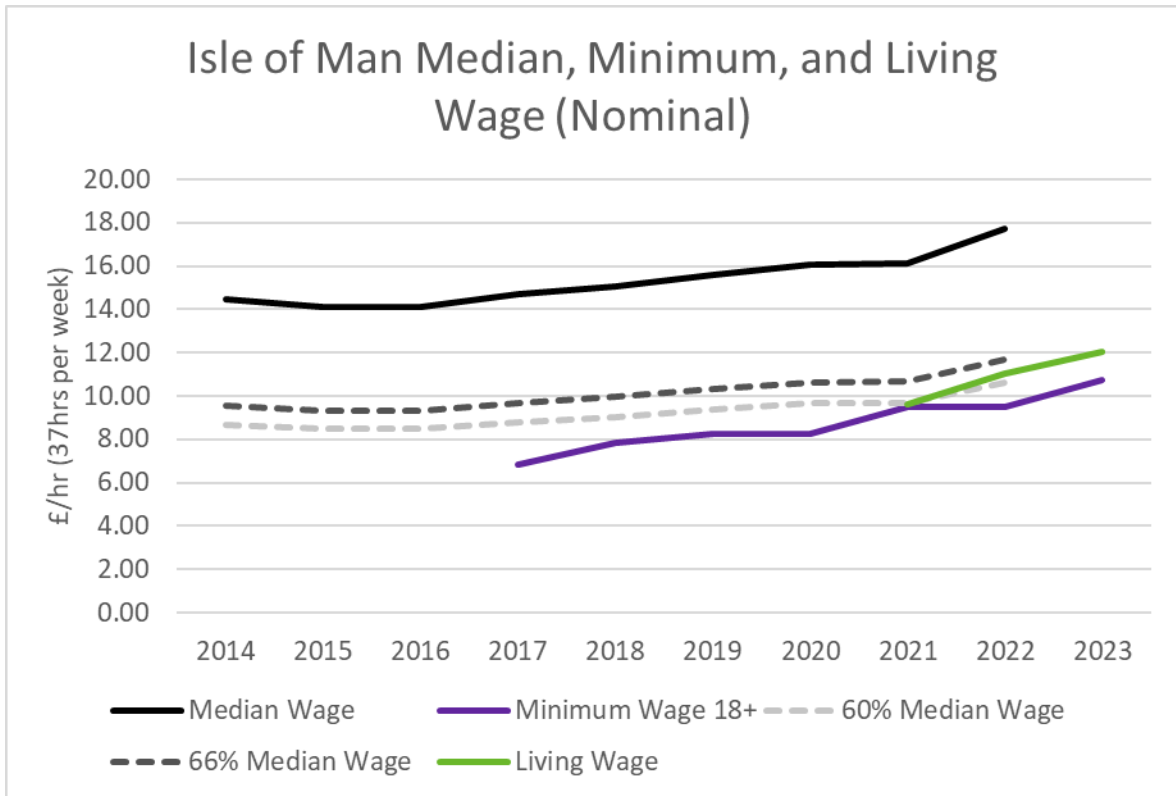
Assessing of minimum income standards in the Isle of Man has been undertaken by the Economic Affairs Division (now Statistics Isle of Man) based on modifications to the basket of goods used in the Living Wage Foundations reports (Statistics Isle of Man, 2023). These modifications have been made to ensure that the calculation reflects the different costs of goods and services in the Isle of Man. Since 2022, these calculations have been verified by Loughborough University. One significant issue with the calculation of Living Wages through Minimum Income Standards (MIS) is the subjectivity associated with agreeing such a standard.

Although the calculation of MIS is undertaken through a range of interviews and focus groups, there are likely to be large differences in perceptions of what could be considered an 'acceptable' standard of living / level of participation in society. Even when this is agreed on, producing a single living wage figure across different individuals' circumstances involves a degree of averaging out differences.

On a more fundamental level, there are likely to be varying opinions around the purpose of a minimum wage – especially whether it should be considered a backstop for wages for the most vulnerable in society, or a viable level at which people could work permanently. A relevant example is whether a student working during summer holidays should be protected by the same minimum wage as a working single parent. Some of these issues motivate the separation of statutory minimum wages by age groups, though these also potentially over-generalise circumstances and present further problems. Other justifications for differentiating minimum wage rates based on age rely on arguments around perceived experience levels / employability of younger vs older workers – again this is a generalisation that can be challenged.

TIME SERIES OF ISLE OF MAN LIVING AND MINIMUM WAGES

The below chart shows the time series of the Isle of Man Minimum Wage for over 18s, the calculated Living Wage, and the 60% and 66% levels of median earnings (for comparison against the UK Government policy). This shows that statutory minimum wage is currently below 60% of median earnings, while the calculated Living Wage for 2022 is just over this level. Median earnings for 2023 are not available at the time of writing.



Of key concern in the setting of statutory minimum wage rates is the effect such rates may have on the economy and society. Of particular interest are the impacts on employment levels and economic activity.



Minimum Wage impacts on the Economy

THEORETICAL & EMPIRICAL BASIS

The theoretical interaction between minimum wage rates and the economy vary depending on economic schools of thought. Neoclassical economic theory suggests that as minimum wages rise, firms must raise the price of their goods and services, leading to reduced consumer demand. Low-paid workers with low marginal productivity are also priced out of the market (ILO, n.d.).

Other theories suggest that employers have a degree of power over wage-setting, and are able to keep wages below the level of marginal productivity that workers bring. This implies that there is a degree of flexibility for firms to increase wages to lower-paid workers through reduced profits, reduced pay rises to higher-paid workers, or other cost-saving and productivity-enhancing measures (ILO, n.d.).

Uncertainty over the potential impacts of minimum wages on economies has motivated extensive research on the topic. The USA represents a particularly rich source of statistical data on which to test models, by virtue of it having different minimum wages between States, while being part of the same country and broad economy. As a result many studies reference US experience.

Further studies and research attempts to aggregate the findings of statistical and econometric studies to try to tease out conclusions. (Belman & Wolfson, 2014) highlight the numerous statistical challenges that face many studies and therefore the difficulty in reaching firm conclusions on this complex topic.

WAGE CONSIDERATIONS & INEQUALITY

While Minimum Wage policies are generally targeted at improving the livelihoods of workers who earn less than the proposed new minimum wage, a common concern raised relates to the impact on higher-paid workers. As well as impacting those paid below the new minimum wage rate ('bound' workers in the literature), minimum wage rises can lead to wage rises throughout pay scales as employers (and workers) seek to maintain wage differentials related to experience or skills ('spillover effects' in the literature). This can be mechanistic, in cases where pay scales are set at multiples of the minimum wage, or can be influenced through pay negotiations between workers and employers. These effects tend to diminish further up pay scales (ILO, n.d.).

Available evidence supports that a larger body of workers are affected by minimum wages than those who are paid at minimum wage levels. An example of a US study cited by the ILO puts the number of workers paid at minimum wage levels at 5% of the total, but the number who benefit from the policy to be up to 25% (ILO, n.d.).



In relation to inequality, minimum wages have a positive effect on reducing inequality through raising the wages of some of the lowest paid workers (Belman & Wolfson, 2014). This effect is stronger for women than men, particularly when it comes to spillover effects.

EMPLOYMENT CONSIDERATIONS

Given minimum wages improve wages for low-paid workers, this raises the question of how such wage rises can be accommodated. As noted above, some economic theories suggest that higher wages are accommodated by reducing employment levels.

A number of wide-ranging studies have taken place in an attempt to estimate the effect of minimum wages on employment. As per the ILO (ILO, n.d.):

"[...]the most frequent finding is that employment effects are close to zero and too small to be observable in aggregate employment or unemployment statistics"

Similarly, a study commissioned by the UK Government (Dube, 2019) concluded:

"In the US, a large body of high-quality research has investigated the impact of minimum wages on employment. Overall, this body of evidence points to a relatively modest overall impact on low wage employment to date. Recent work helped identify how this impact may vary by the level of the minimum wage. Across US states, the best evidence suggests that the employment effects are small up to around 59% of the median wage. Evidence using sub-state county-level variation found this to hold even in lower wage counties where the minimum stood at up to 81% of the median wage. Research conducted for this report also finds that in the 7 US states with the highest minimum wage, where the minimum is binding for around 17% of the workforce, employment effects have been similarly modest."

This discrepancy between theoretical expectations (that workers would be priced out of the market) and real world findings has been of interest to researchers. (Belman & Wolfson, 2014) discuss this problem, suggesting that the employment market is far from the perfect market described by economic models, and that the huge number of other factors weighing on an employers' production decisions mean that moderate changes to minimum wages rates are not major determinants of behaviour.

It is not clear what level of discrete minimum wage increase would be large enough to generate negative employment effects, partly because available evidence covers only moderate increases.



INFLATIONARY CONSIDERATIONS

There is a complex link between minimum wage policy and inflation – businesses can choose to absorb higher minimum wages in a number of ways, including:

- Reducing headcount / hours
- Accepting lower profit
- Raising prices
- Improving productivity

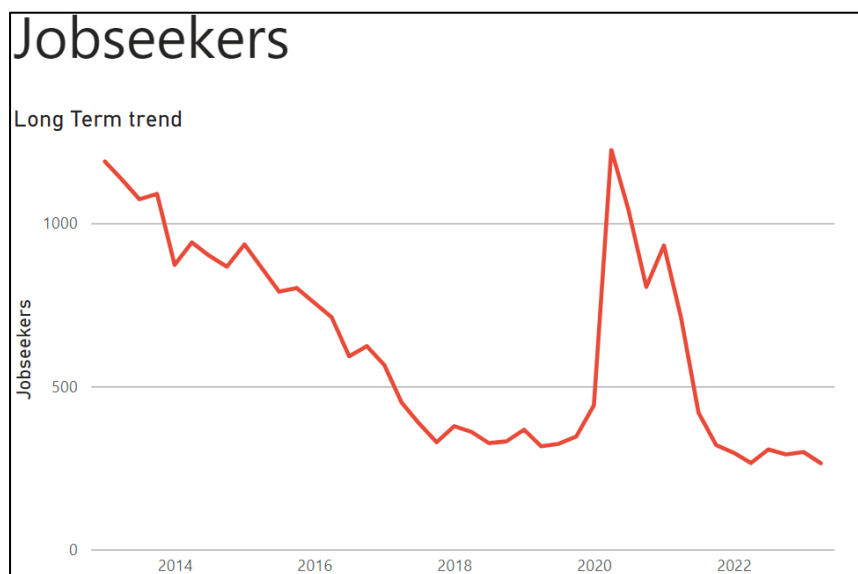
In the case of raising prices, this would feed into inflation to a degree. There is also an indirect effect on inflation from stimulated consumer demand associated with higher wages. The extent of either of these effects is not clear with the data available for the Isle of Man economy, though wider studies suggest that the impact of minimum wages on prices and inflation are relatively small (Lemos, 2004). This is partly due to the fact that minimum wage changes only affect a subset of workers (those who are paid below the proposed new minimum and those exposed to spillover effects), and wages are themselves a subset of overall costs faced by a business.

During periods of existing high inflation (such as observed in 2021 – 2023), the case for raising minimum wages is relevant in policy discussions around cost of living support. In this way, minimum wage floors can be an important policy tool in preventing real-terms erosion of wages and living standards for lower-paid workers (OECD, 2022).

Isle of Man Situation

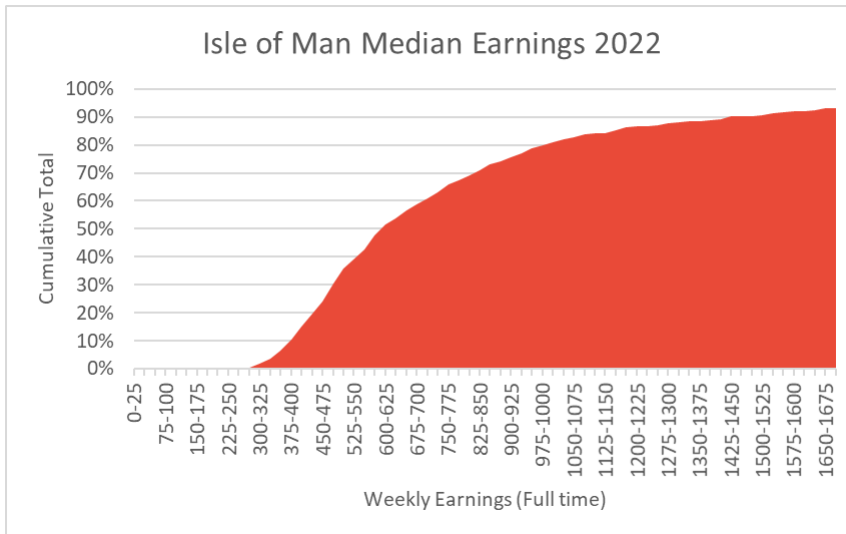
ISLE OF MAN LABOUR MARKET

As of 2023, the Isle of Man continues to experience an extremely 'tight' labour market, with very limited unemployment. Although registered jobseekers spiked during the pandemic lockdowns in 2020 and 2021, the level has since declined to record lows (since monitoring began in 2013).

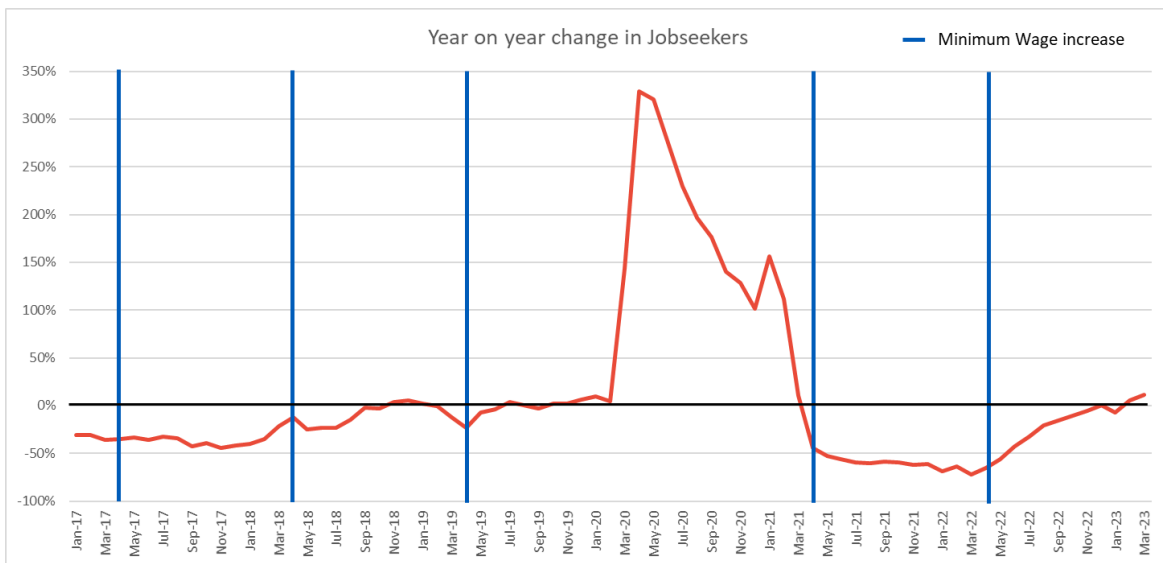


While Jobseekers are at record lows (around 250 individuals), the number of vacancies is high, generally over 1,000 but sometimes as high as 1,500 in a given month. There is a clear disconnect between businesses' hiring plans and the availability of suitable labour to fulfil these. This would suggest that workers will have a relatively high degree of bargaining power when it comes to wages. This situation is also replicated to a degree in the UK at the current time.

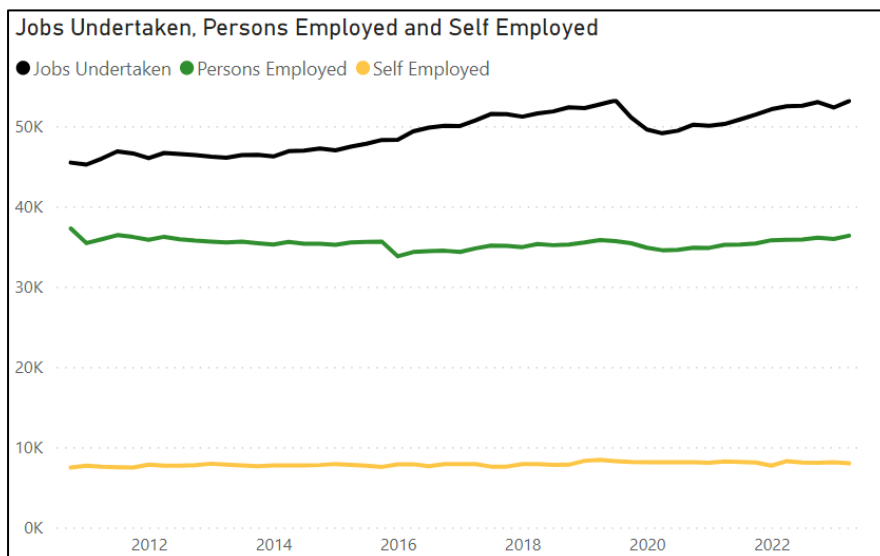
Mean earnings in the Isle of Man tend to be heavily skewed by a small number of very high earners. Considering median earnings reduces this effect. As per the 2022 Earnings Survey, the proportion of workers earning less than the Living Wage (and therefore impacted directly by moves to bring the minimum wage into line) was 16.9%. 4.5% of all workers earned the Minimum wage.



In previous instances where the minimum wage has been increased, there has been no clear impact on Jobseekers:



Likewise, the number of jobs undertaken and persons employed has increased steadily or remained stable (notwithstanding COVID impacts) regardless of minimum wage changes:



HARMONISATION POLICY

The Island Plan sets out Isle of Man Government policy in relation to harmonisation of the Minimum and Living Wages under the sub-category “An Island of health and wellbeing” (Isle of Man Government, 2023):

“Implement approved recommendations of the July 2021 Poverty Report, including increasing the Minimum Wage towards parity with the Living Wage to address income disparities”

Alignment of the minimum wage and Living Wage is timetabled in the Island Plan to take place in 2025.

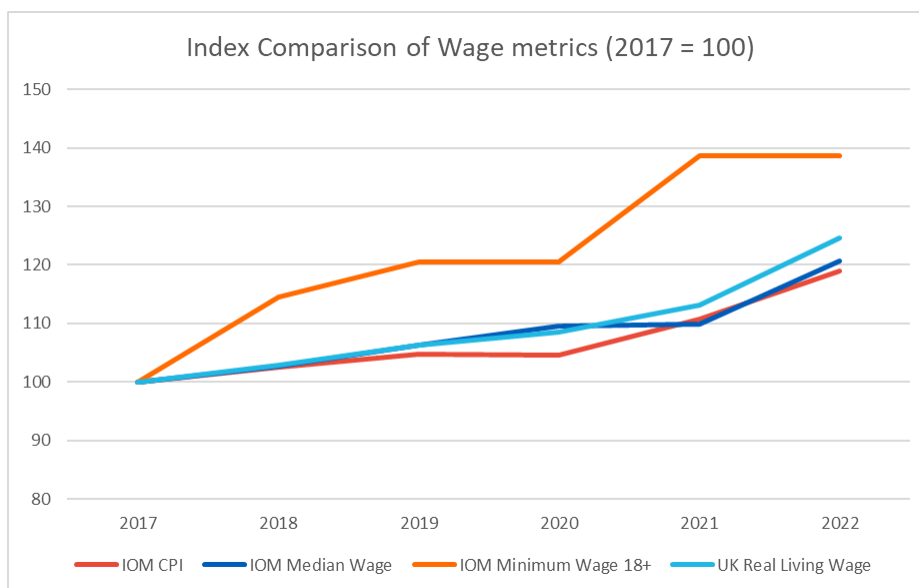
This policy position points toward a desire to grow the wages of the lowest paid at a faster rate than the higher paid, thus reducing income disparities, and would be suggestive of faster-paced upward movements in minimum wage rates, as well as minimum wages being a higher percentage of median wages.

Based on 2022 levels of the Living Wage, the Minimum wage would need to be around 62% of median earnings to be harmonised, and therefore similar to the proportion of median earnings as set in the UK. The below table shows a comparison of key rates over the past six years.

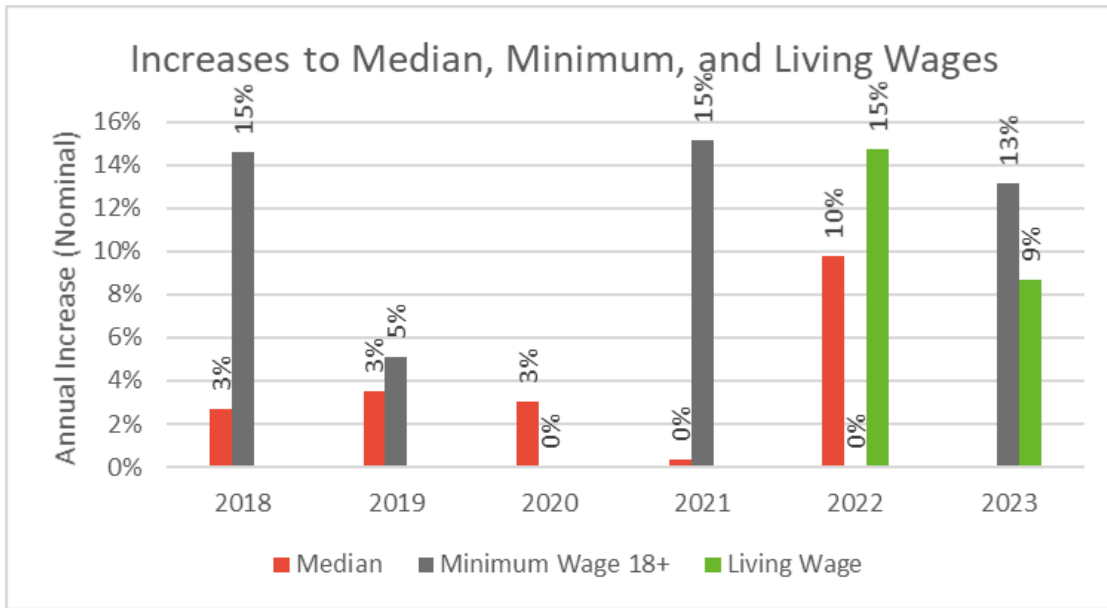


£/hr	2017	2018	2019	2020	2021	2022	2023
Median Wage	15.08	15.49	16.03	16.51	16.57	18.19	
60% Median Wage	9.29	9.29	9.62	9.91	9.94	10.91	
Minimum Wage (18+)	6.85	7.85	8.25	8.25	9.50	9.50	10.75
IOM Living Wage					9.63	11.05	12.01

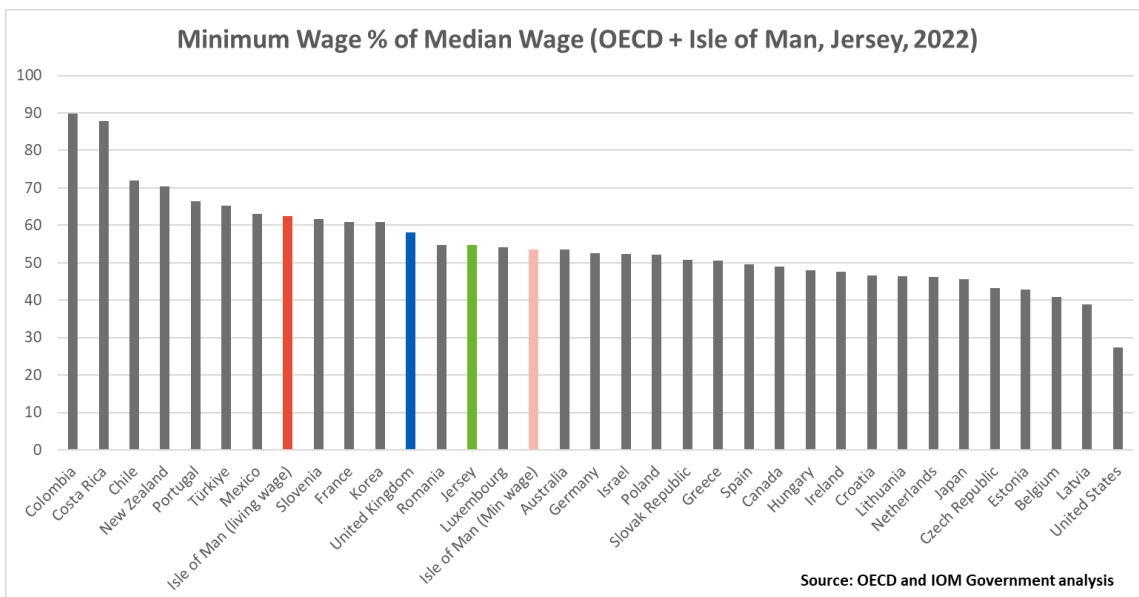
The below chart shows the indexed progression of different price/wage measures since 2017. As the IOM Living Wage is not available for this period, the UK Real Living Wage has been shown instead. This shows that IOM Median wages have broadly followed CPI, with Minimum Wages increasing at a faster rate. This is in line with the policy position to increase Minimum Wages to the higher Living Wage level.



Comparing the annual increases in Living and Minimum wages, this is a very varied picture year-to-year. Some years see the minimum wage rise substantially, while others are low or zero increases. Median earnings tend to grow slowly, though saw a larger increase in 2022 as Cost of Living/inflationary pressures took hold. Note that median earnings for 2023 are not currently available.



The Isle of Man has a minimum wage rate that is similar or somewhat higher than neighbouring jurisdictions in absolute terms (see (Minimum Wage Committee, 2022)), however when comparing across jurisdictions with different costs of living this does not give the full picture. Comparisons to median wages can be useful to show equality of wage rates.



Overall, the Isle of Man (as of 2022) was fairly typical compared to OECD countries, though below Jersey and the UK (2023 median wages are not available hence the above chart does not show the impact of the latest minimum wage increase). Had the Isle of Man harmonised the minimum and living wages in 2022, this would mean the Isle of Man would move up the comparison chart, higher than all EU OECD countries except Portugal but lower than some Latin American countries, New Zealand, and Türkiye.



MINIMUM WAGE COMMITTEE

Under the Minimum Wage Act 2001, a Minimum Wage Committee is constituted to make recommendations on the rate of minimum wage. The Committee generally makes recommendations annually in line with the annual changes made to the Minimum Wage rates. The most recent recommendation was made in December 2022 (Minimum Wage Committee, 2022).

Specifically on the topic of Minimum Wage and Living Wage harmonisation, the Committee resolved that, based on feedback from businesses, the proposed rate rise to £11¹ would have a material impact on the ability of some businesses to continue trading. At least part of this recommendation appears to have been based on impending recession in the UK which appears to have been avoided based on the latest available data, although UK economic performance remains subdued.

The Committee considered the evidence relating to disadvantaged groups and felt that these groups would be negatively impacted by a higher minimum wage due to the additional costs of employing these groups.

In relation to inflation, the Committee noted that the recommended rate was following inflation, rather than driving it.

Finally, the Committee reiterated the position from the 2021 recommendation that the situation whereby minimum wage workers on full time hours were liable for higher rate income tax should be reviewed (Minimum Wage Committee, 2021).

¹ The minimum wage rate ultimately approved by Tynwald was £10.75



IMPLICATIONS OF HARMONISATION POLICY

As of the 2022 Earnings survey, 4.5% of workers earn the Minimum Wage and 16.9% earn less than the Living Wage. Therefore an increase in the Minimum Wage to match the Living Wage in 2022 would have required increased wages for 16.9% of workers, with further spillover impacts on other wage groups. Since that time, the minimum wage has increased to £10.75 per hour. Given this is faster growth than median earnings, it is likely the number of 'bound' workers has increased.

The 2023 IOM Living Wage is 12% higher than the 18+ minimum wage. Noting the commitment to harmonise the two measures by 2025, there are two remaining uprating cycles in which to close the gap (noting that the Living Wage is something of a moving target). Three indicative scenarios have been evaluated for potential growth in the Living Wage over the next two years:

- Living Wage growth by 3% per annum
- Living Wage growth by 5% per annum
- Living Wage growth by 10% per annum

In the first scenario, a 9% rise in the minimum wage per year would reach the required level by 2025. In the second scenario, an 11% increase per year is required, while in the third scenario, a 16% increase per year is required.

With the exception of the third scenario, the other increases are not dramatically out of line with previous upratings to the minimum wage, although would be sustained over multiple years rather than being interspersed with years of low/minimum uprating. The position with the Living Wage going forward is unclear – although previous years have seen relatively large increases (of 15% and 9% respectively), the rate may decline in line with subsiding general inflation in the economy.

In the latest recommendations from the Minimum Wage Committee, the Committee suggested an erosion of 50% of the difference in April 2024, with the remainder eroded in April 2025 (Minimum Wage Committee, 2022).



Discussion

A number of concerns have been raised by the Island's business community around the impact of increases to the Minimum Wage, both in terms of timeframe for harmonisation with the Living Wage and subsequent increases in the Living Wage outstripping other price measures. The key concerns can be summarised as follows:

- Increases to minimum wages could lead to reduced employment of lower-paid workers as these roles become unaffordable for businesses, leading to increased jobseekers / welfare support required
- Increases to minimum wage rates are unaffordable for businesses, leading to risk of business failures
- Increases to minimum wages could lead to a wage-price spiral / embedded inflation
- Increases in line with Living Wage calculations are out of line with other price measures (such as median earnings / CPI)

The underlying theme behind these concerns is around inability of employers to absorb cost increases leading to undesirable economic effects.

Employment

Based on the available empirical evidence, it appears that moderate increases to minimum wage rates do not lead to statistically significant employment effects, although there is uncertainty about what level of increase would change this conclusion. Mitigating factors in the Isle of Man's experience are that proposed minimum wage rates are broadly similar to the UK's targeted level (60-66% of Median earnings). The Isle of Man's case minimum wages have been below this level for some years, which may be having implications for the lowest-paid in society and/or is reflective of higher income inequality. Exacerbating factors include the general cost pressures being faced by businesses at the moment due to inflation of other inputs which may mean some business models in lower wage sectors are not viable, and this perhaps forms the main concern being reported by the business community. This risk is elevated in cases where there is extensive employment of under-18s (who currently receive a lower level of minimum wage). The Minimum Wage Committee concluded that "the removal of the current age banding would prove problematic" (Minimum Wage Committee, 2022), although this issue was not explored in detail in their 2022 recommendation.

Ultimately, the level of this risk in terms of likely business failures is unknown, especially in the context of numerous compounding economic pressures over the past few years including the COVID pandemic and inflationary situation.

Inflation

High inflation is an issue for both businesses and workers. Lower-paid workers are especially vulnerable to the type of inflation that has been seen recently due to the larger proportion of their household budgets spent on areas that have seen some of the highest cost pressures (including food and energy), along with reduced capacity to absorb economic shocks using



savings. If Minimum Wages do not rise in line with inflation, then the lowest-paid workers may see their wages decline in real-terms. There is a risk that this could necessitate further direct support measures which are either not sustainable in the long term or would represent ongoing distortion of the Isle of Man's labour market (by effectively subsidising low-wage labour).

There are concerns that rising minimum wages will fuel inflation and wage-price spirals. Some businesses will undoubtedly raise prices to reflect the minimum wage rises – and this may have a knock on impact on general inflation. This 'cost' effect will be spread widely over the whole of society, while the 'benefit' of higher (minimum) wages will accrue more to the lowest-paid. Cost impacts would be expected to decline over time, assuming that Living Wage growth is moderated in the medium-term. Minimum wage costs do not represent the majority of wage costs in the economy even if impacts will cover a larger number of workers than they currently do (though some sectors will be more exposed than others – namely those operating in low-pay sectors). This would be expected to reduce the likelihood of wage price spirals, so long as higher-paid workers' wages do not rise by as much.

Regarding concerns around growth in the calculated Living Wage vs growth in other price measures, it is difficult to draw firm conclusions on this given the limited time series of Isle of Man data. This is especially challenging to assess given the current inflationary situation where essential goods and commodities have increased in price faster than the wider basket. A further complicating factor is the potential for subjectivity in the determination of the Living Wage.

IMPLICATIONS FOR FUTURE RESEARCH

As discussed in this paper, minimum wage research is a complex field in labour economics. The Isle of Man has very limited useable data for the purposes of assessing the economic impact of minimum wage rises on the economy, hence why this paper has focused largely on existing research and literature reviews of much larger studies. Of particular interest to policymakers would be local studies of the anticipated impacts of minimum wage policies, including the harmonisation policy, however achieving reliable results would be difficult. For example, a survey of businesses to help assess potential reactions to minimum wage rises would likely require a sample of over 1,100 businesses (around a quarter of employers) in order to generate statistically precise conclusions. Assessing impacts on specific economic subsectors would require even larger (proportional) samples. Given low response rates to voluntary surveys and the need to ensure a non-biased response, it is likely that any selected businesses would need to be legally compelled to respond through the use of the Statistics Act. Surveys would have to be very carefully constructed to generate useful data.

Another potential research avenue would be detailed examination of business accounts for sectors of particular concern. As with surveys, it is likely this information would need to be legally required in a suitable format. This could require additional work on the part of smaller businesses to generate the level of accounting detail required. External consultants could be



commissioned (as has been requested by some members of the business community) however they would face the same challenges in terms of local research so would likely have to rely upon the wider literature as well, along with general expertise from reviewing similar situations.



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