

Minimum wages and employment: The positive UK experience

Prior to its introduction by the Labour Party in 1999, the minimum wage raised many eyebrows in the United Kingdom. Conservatives predicted that massive unemployment would result. It did not happen. The evidence suggests that the move has benefited the country in general and the poor in particular.

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In the mid-1990s, the Labour Party in the United Kingdom made it clear that they would introduce a national minimum wage (NMW) if they won the next election. Their objective was to use an NMW to help reduce poverty and income inequality. This led to much political and economic debate about the likely impact of an NMW. Much of this focused on the employment impact. For example, in 1995 a former Conservative government minister, Iain Lang, said that a minimum wage set at £4.15 an hour would cost at least 950,000 jobs.¹

Yet by March 2001, nearly two years after the introduction of an NMW (in April 1999), the Low Pay Commission was able to conclude: “We were especially concerned about the possible negative employment effects of the minimum wage. Employment has continued to grow strongly since the introduction of the minimum wage, and there were no discernible adverse effects at the aggregate level.”² In fact, total employment increased significantly during the first two years after the introduction of the NMW.

A brief history of the minimum wage

Wage Councils were first established by Winston Churchill in 1909 to protect the pay of workers in the so-called “sweated

industries”. At their peak in the 1960s, the Wage Councils set minimum wages in some 60 sectors. After this, the number of sectors covered fell and in the early 1990s there were 26 remaining Wage Councils. But in 1993, the Trade Union Reform and Employment Rights Bill abolished all of these. Thus, from 1993 there were no minimum wages in operation in the United Kingdom, except in agriculture.

In 1997, the Low Pay Commission (LPC) was established to recommend to the Government a level for the initial rate of the NMW. The LPC did a lot of research and spent a lot of time talking to trade unions and employers before making recommendations to the Government. At the start, there were large differences of opinion about the introduction of the NMW and about what level it should be. In fact, up until the mid-1980s, the Trades Union Congress (TUC) had been against a minimum wage because they felt it might damage collective bargaining. But they changed their mind and in the mid-1990s were arguing for an NMW of over £5.

The head of the LPC, George Bain, points out that employers also changed their minds about the NMW. In 1995, the Confederation of British Industry (CBI) argued that “even a low minimum wage would reduce job opportunities and create major problems for wages structures in a

wide range of companies”³. But by 1997, Bain says, the CBI had accepted the idea of an NMW and was concerned only about the level of the wage floor. It would seem the LPC was pretty successful in bringing employers and unions closer together, demonstrating that social dialogue does work. In its initial decision, the LPC recommended a fairly modest NMW. It suggested a rate of £3.60 with a lower development rate for workers aged 18-20 and for those aged 21 and over but starting a new job or undertaking training. It also suggested that workers under 18 and apprentices should not be covered by the NMW.

In April 1999, the Labour Government led by Tony Blair implemented most of the LPC’s suggestions, but decided to introduce an even lower rate for young people. They decided on an NMW of £3.60 an hour for workers aged 22 and over, with a lower rate of £3.00 for those aged 18-21. Since that time, there have been some slight increases in the NMW and in October 2001, the main national wage for adults aged 21 and over was adjusted to £4.10 per hour.

The LPC and the Government deliberately adopted a careful approach. As Bain said: “We believe that by taking a cautious approach, the NMW can be introduced without significant extra cost to business. Nor in our judgment should its impact on the wage bill adversely affect employment or lead to any substantial increases in inflation.”⁴ The LPC estimated that the wage bill would increase by only 0.6 per cent and inflation by 0.2 per cent.

The union movement and many low-paid workers were rightly disappointed with the LPC recommendations, and somewhat disillusioned with their Labour Government. Nevertheless, after decades of Conservative attacks, this was seen as a small step towards providing much-needed protection for the low-paid.

The labour market impact

When the Low Pay Commission issued its third report in March 2001, it was pleased to note that the rate of unemployment

stood at 5.3 per cent in the final quarter of 2000. It said this was the lowest level since the UK adopted the ILO system of measuring unemployment in 1984. The LPC said: “On the basis of this measure over the period since the minimum wage was introduced unemployment had fallen by just under 235,000.”⁵

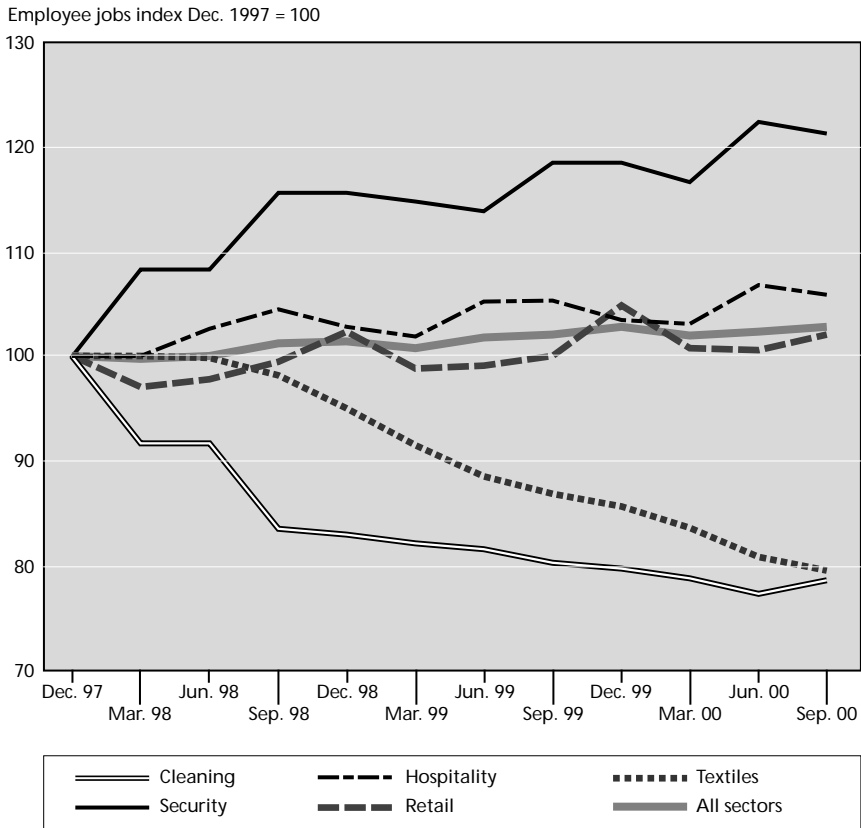
Consider the updated figures. Standardized unemployment figures from the OECD show that UK unemployment fell from 6.3 per cent in 1998 to a low of 5.0 per cent in the second quarter of 2001. Since then, there has been a very slight increase to 5.2 per cent in August 2001. This might be due to the downturn in the US and global economies which commenced in 2001. Despite this, the OECD data show that in mid-2001 UK unemployment levels compared very favourably with the OECD average of 6.8 per cent and the Euro-zone figure of 8.4 per cent.

These aggregate unemployment data strongly suggest that the UK labour market was not adversely affected by the introduction of the NMW. If anything, there may have been a positive effect. However, before drawing any sweeping conclusions, it is necessary to go further and carefully examine the implications in those segments of the labour market where the low-paid workers are concentrated. If anyone had stood to lose their jobs as a result of the NMW, it would have been workers in marginal low-productivity sectors of the economy.

Figure 1 shows changes in employment levels in some low-paying sectors of the economy, namely cleaning, security, hospitality, retail and textiles.

It may be seen that employment in the security sector has risen relatively quickly while employment in the hospitality and retail sectors has increased in line with the national average. On the other hand, employment in textiles and cleaning has declined dramatically. However, the LPC has argued that employment in the textiles and the cleaning sectors has declined in accordance with longer-term trends and structural changes in these sectors.

Figure 1. Employment change in low-paying sectors, 1997-2000



Source: Employee jobs series, CNS, 1997-2000.

The LPC commissioned a survey of firms affected by the NMW in Northern Ireland. This found that textiles and clothing firms accounted for 73 per cent of the reported direct job losses and employers in this sector were generally unable to raise prices in adjusting to the minimum wage. The results of this survey would suggest that, in particular sectors and in particular regions, there have been some negative employment effects from the minimum wage. However, the long-term employment decline in the textiles sector is probably also due to reduced international protection as well as to the movement of textile production offshore.

Other evidence suggesting that there have been some negative employment ef-

fects is an LPC survey of firms affected by the NMW. The results of this survey are summarized in figure 2. This shows that about 13 per cent of firms said they had made significant reductions in their staffing levels as a direct result of the NMW, while almost 40 per cent of firms claimed either a significant or slight decline in employment.

What is clear from figure 2 is the extent to which some industries have been affected. According to this survey, 65 per cent of hairdressers and 56 per cent of businesses in the hospitality sector have made some staff reductions as a direct result of the NMW being introduced.

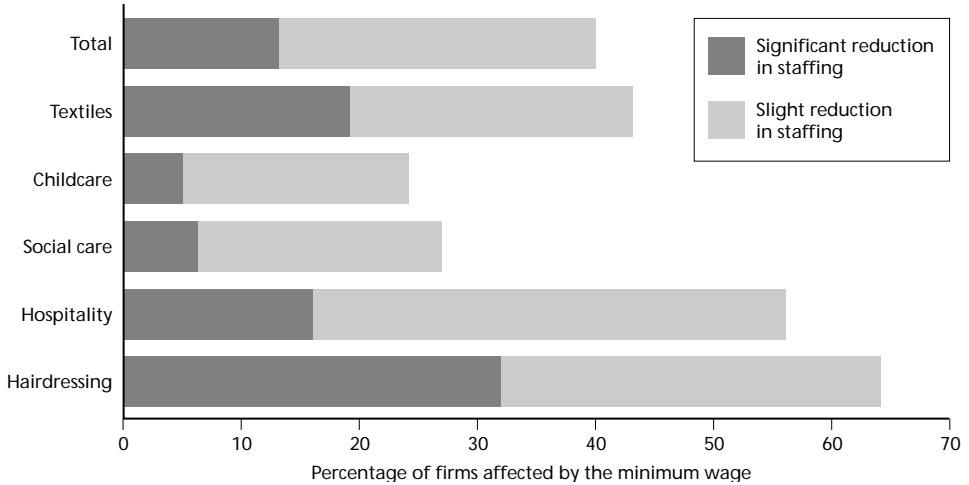
Figure 3 demonstrates exactly why hairdressers have been so dramatically af-

affected. It shows the impact on the wage bill after the introduction of the NMW.

It may be seen that the hairdressing sector experienced the greatest increase in the wage bill, about 7 per cent. This evidence suggests that in certain sectors and occupations, namely hairdressers and textiles in Northern Ireland, there has been a slight negative employment effect.

If the NMW were to have negative employment effects on the low-paid, an increase in youth unemployment might be expected. However, figure 4 shows that unemployment is now lower than in the previous trough, in 1990, across most age groups. There are two exceptions, namely 16-17 year-olds and 22-24 year-olds. For the former group, the rise in unemployment-

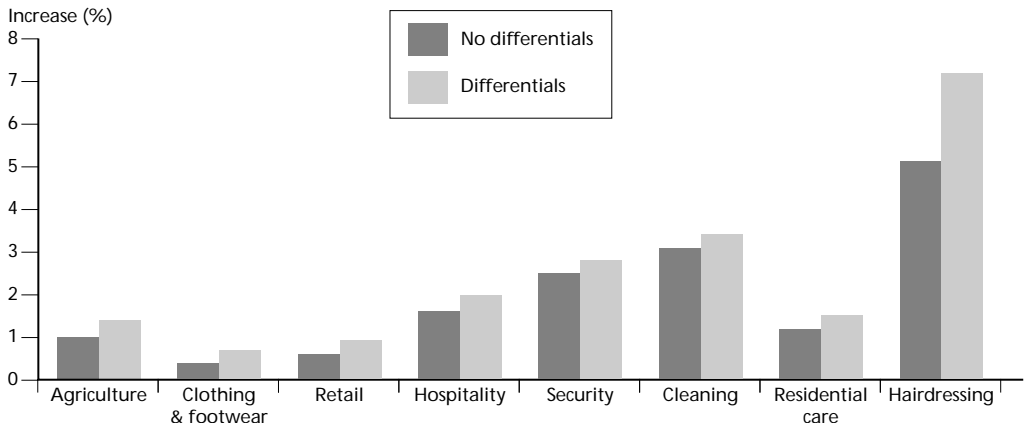
Figure 2. Reductions in staffing levels as a result of the National Minimum Wage



Note: Base, all firms affected by the National Minimum Wage in any way.

Source: Low Pay Commission Survey, September-November 2000.

Figure 3. Impact on the wage bill of the introduction of the National Minimum Wage in low-paying sectors



Source: LPC Calculations Grossed NES data, April 1998.

ment was concentrated among those in full-time education. For the latter group, the increase between spring 2000 and autumn 2000 appears to be related to those who left full-time education.

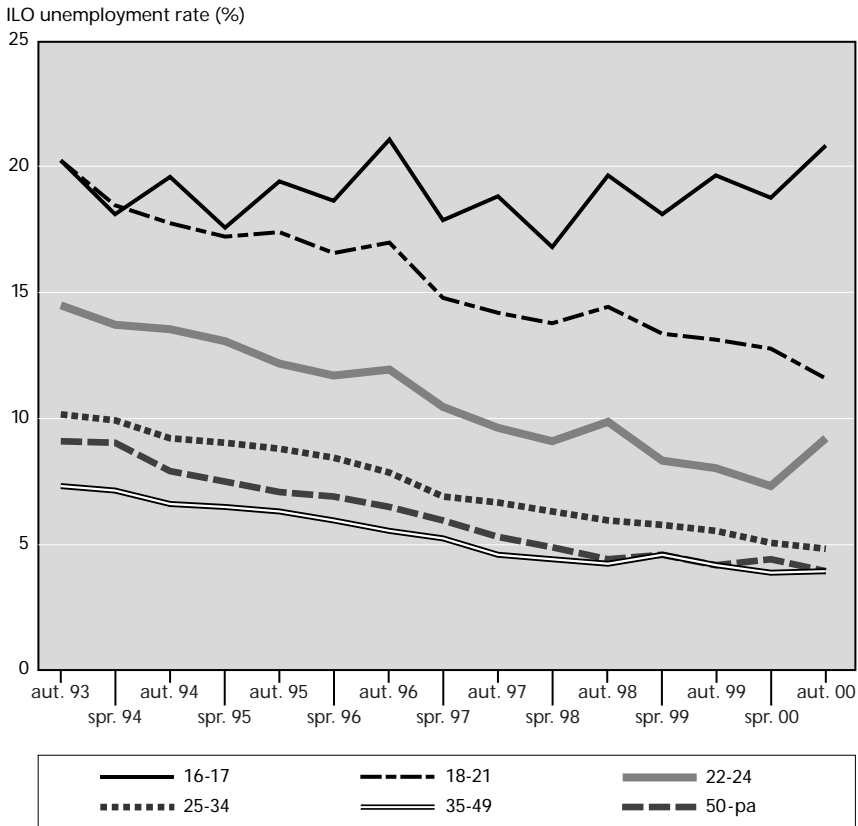
Ethnic minority groups are disproportionately represented among low-paid workers. If there were a negative employment effect for the low-paid, we might expect a rise in the number of people unemployed from these ethnic groups. But it may be seen from figure 5 that the number of unemployed people from these ethnic groups has continued to fall.

In fact, the number of unemployed from minority ethnic groups has fallen faster than for the majority population. If anything, this suggests that the introduc-

tion of the NMW may have had a small positive employment effect. From figure 5, it can be seen that between spring 1999 and autumn 2000, the unemployment rate for whites fell by 0.6 percentage points. In the same period the unemployment rate for black, Indian and Pakistani/Bangladeshi workers declined by between 1 and 1.3 percentage points.

Another group in society that is concentrated among the low-paid is disabled people. In the 18-month period after the introduction of the NMW, there was a fairly significant fall in the number of people unemployed who had a work-limiting disability. Their unemployment rate fell by some 1.6 percentage points over this period.

Figure 4. ILO unemployment rates by age, 1993-2000



Source: LFS data, spring and autumn 1993-2000.

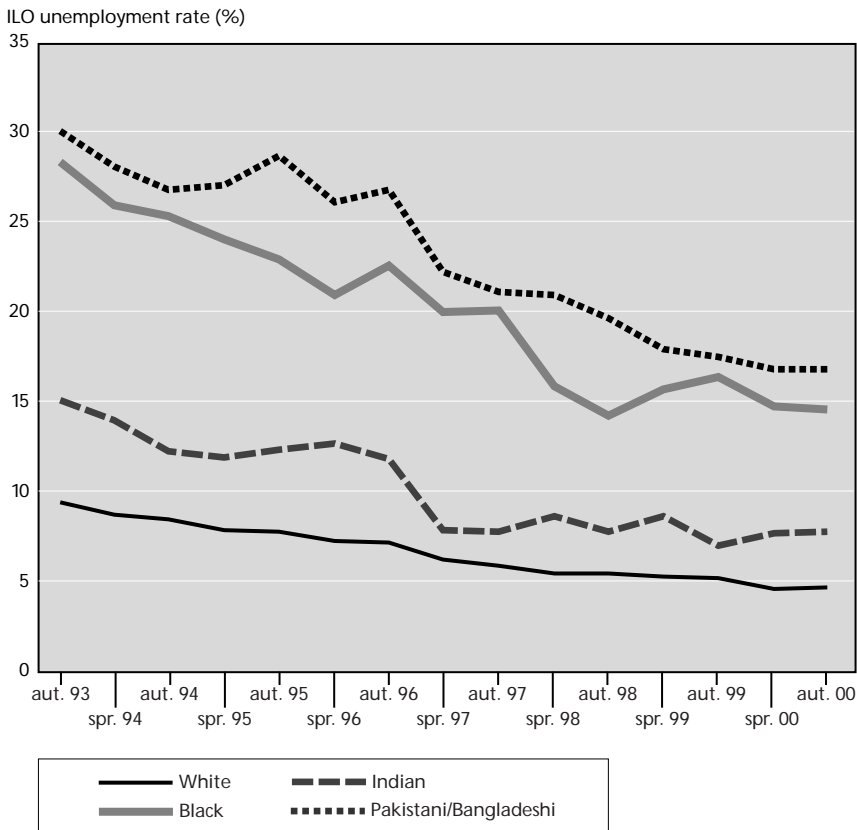
If there were to be a negative employment effect resulting from the introduction of the NMW, we would expect there to be a rise in unemployment in lower-paid regions. But again this was not the case. In fact, the lowest-paying region, the North-East, had the largest increase in employment and the largest fall in unemployment post-minimum wage.

The labour market trends for youth, ethnic groups, disabled people and workers in low-paid regions are consistent with the view that the introduction of the NMW had a small positive impact on employment for some low-wage groups. Of course, this evidence alone does not prove that the NMW definitely caused these reductions in unemployment. They could

have resulted from some other factor, such as the retraining and other help that the Government provides to disadvantaged groups in order to find employment. In fact, the Government has introduced a number of “New Deals” to help young people and the long-term unemployed get jobs over the last few years. It has also made changes to the system of social security benefits, in order to discourage unemployment. These changes probably help explain the good employment outcomes for low-paid workers in recent years.

However, the evidence collected by the LPC is also consistent with the view that the NMW helped boost incomes and consumption spending by poor workers. This might suggest that an economic multiplier

Figure 5. ILO unemployment rates by ethnic group, 1993-2000



Source: LFS data, spring and autumn 1993-2000.

effect occurred after the introduction of the NMW. But this is possible only if, after that introduction, the real income for the low-paid rose – despite fears of a poverty trap or the potential for heightened inflation. In fact, the Government took steps in the March 1998 budget to ensure that a potential poverty trap was avoided. They altered the tax and benefits that applied to low-paid workers, in order to ensure that the benefits of the NMW were not lost in higher taxes. As a result, the LPC was able to conclude that “for many employees in receipt of in-work benefits, the NMW will not only substantially increase their earnings, but also increase their total income”. This would support the idea that the NMW could have boosted consumption, aggregate demand and employment.

One of the reasons why there appear to be only very minor negative employment effects is that firms faced with the rise in their wage bill took direct action to make their businesses more productive. A survey of employers by the LPC found that about 40 per cent of firms said they had made some increase in investment and training as a response to the NMW. This information is presented in figure 6.

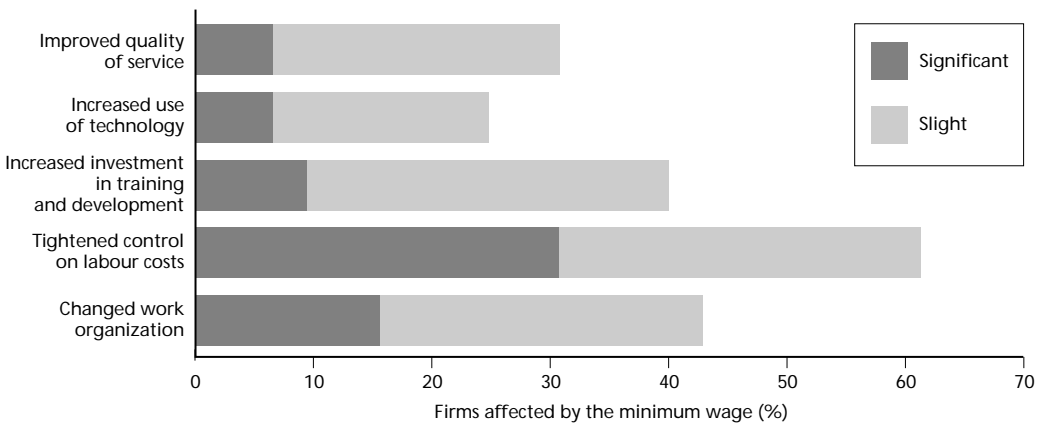
It may be seen from figure 6 that firms made many changes to improve produc-

tivity and offset the increase in their labour costs after the NMW was introduced. These include improving the quality of service, increasing the use of technology, boosting investment in training and changing their work organization. Figure 7 also shows that many employers reduced labour costs by cutting absence from work, paid breaks, staff meals and overtime rates. Thus, this evidence suggests that, rather than laying workers off, firms have tried to raise productivity.

Figure 7 is based on a survey of small and medium-sized enterprises conducted for the LPC. It attempts to show the impact of the NMW on staff motivation, staff turnover and filling of vacancies. According to this survey, over 20 per cent of firms had higher staff motivation, 10 per cent reported lower staff turnover and 8 per cent said they could fill vacancies faster.

All these factors would have either lowered labour costs or increased productivity. For example, lower staff turnover means firms do not waste the time and money they put into training workers. Based on this survey, it would seem the NMW has helped firms to retain their experienced and more highly productive workers. This evidence would strongly support the theory of efficiency wages and the notion that

Figure 6. Action taken to improve productivity as a result of the National Minimum Wage



Note: Base, all firms affected by the National Minimum Wage in any way.

Source: Low Pay Commission Survey, September-November 2000.

minimal labour standards make sound economic sense.

There is also some evidence to suggest that rather than firms laying off workers, they have increased prices to protect profit margins. This is especially true in low-paid sectors, as figure 8 demonstrates.

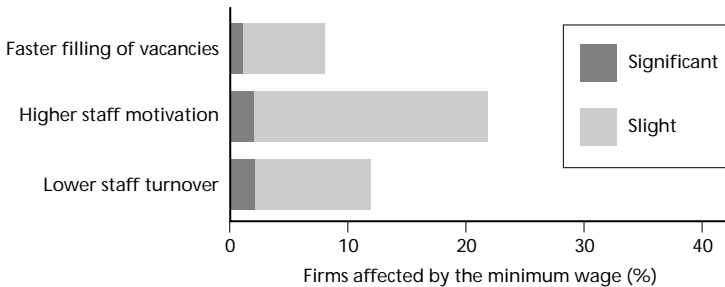
Here, it may be noted that in the hair-dressing sector – which, as we saw earlier, experienced a big increase in its wage bill – 85 per cent of firms increased their prices as a direct result of the NMW. It seems fairly clear that in several low-paying sectors, prices have risen as a re-

sult of the NMW. This suggests that economic conditions were good enough to allow firms to raise their prices in order to protect their profit margins, instead of laying off workers. Importantly, however, despite the increases in prices in some sectors, overall inflation in the UK has stayed low.

Conclusion

In any economy, employment levels are determined by many factors. Wages, because

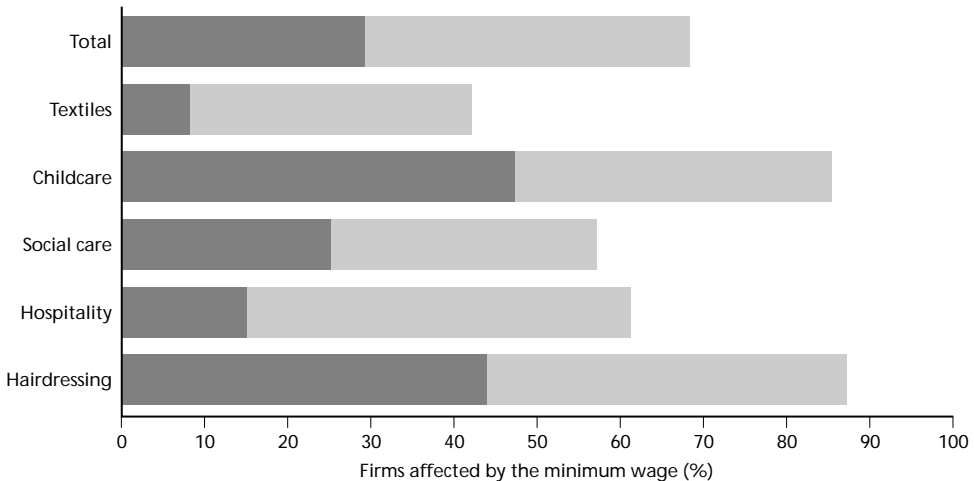
Figure 7. Benefits to business as a result of the National Minimum Wage



Note: Base, all firms affected by the National Minimum Wage in any way.

Source: Low Pay Commission Survey, September-November 2000.

Figure 8. Firms raising prices as a result of the National Minimum Wage



Note: Base, all firms affected by the National Minimum Wage in any way.

Source: Low Pay Commission Survey, September-November 2000.

they are a major component of labour costs, are clearly one important factor. But they are definitely not the only one. For example, the levels of aggregate demand, productivity and labour skills, plus changes in the costs of other factors of production, will also have an impact on employment levels. It is therefore difficult to isolate the impact of the NMW on the employment opportunities of the low-paid.

Yet, on the basis of the available evidence, it would seem fair to conclude that there have been no major negative employment effects for the low-paid as a result of the NMW in the UK. The predictions in the mid-1990s that an NMW would lead to massive job losses have proven incorrect. As the UK *Pay and Benefits Bulletin* noted: "A surprising consensus has now emerged, with government, business, unions and academics all sharing the view that there has been no significant adverse impact resulting from the statutory wage floor ... Almost eight in ten firms ... back the principle of a statutory wage floor. Just 4 per cent oppose the idea."⁶

Even the OECD, which was originally sceptical about the employment implications of the NMW, recently conceded that "while the minimum wage covers over 1.5 million workers, it is too early to assess its impact on employment although, as yet, there are no discernible adverse effects".⁷

But why have there not been increased unemployment and a fall in job opportunities for the low-paid? Neoclassical theory clearly predicts this. One particularly important reason was the strong emphasis placed on social dialogue and steps taken to promote tripartite consensus. As noted previously, the initial level of the NMW was fairly modest and most employers accepted it as being fair. As the OECD said in their Economic Survey of the UK for 2000, "the minimum wage was introduced at a prudently low level, and its planned adjustment is limited".⁸

The LPC deserves considerable credit for this outcome. They talked a lot with both unions and employers, and to a large extent the level of the NMW was a compromise between employers and un-

ions. Although many unions complained that the level was too low, it was probably viewed as fair by most employers. As one reporter recently stated, "30 months after it [the NMW] was introduced, it is generally seen as a success by both employers and workers".⁹ This was decisive, as it meant that employers did not think their businesses would be adversely affected in such a way that they needed to sack workers.

The LPC took into account the wider economic implications of an NMW, and the decision to have a lower level for young workers was probably important. The Commission believed what was needed for the United Kingdom was a "Plimsoll line for labour as well as for ships ... a line to limit ... the extent of peril and suffrage to which the worker is to be liable."¹⁰ The level to be set was to be a "Plimsoll line". It was to be a low level, to keep low-paid workers' heads just above water.

The evidence in this article gives considerable support to efficiency wage theories. The information concerning improvements in recruitment, retention and worker motivation after the NMW was introduced would suggest that paying wages at about the market clearing rate can make good economic sense, because it encourages higher productivity.

Now that an NMW has been operational for several years, and conclusive evidence has emerged that minimum wages can have positive effects on employment and productivity, it is time to push on with this experiment. It is time to raise the NMW to a level that will make a greater contribution to reducing poverty and creating decent work. The "Plimsoll line" needs to be adjusted so that more families will have their heads above water. Providing the LPC continues to promote social dialogue, and care is taken to explain the positive experience to date, it should be possible to raise the real value of the NMW in years to come without adverse labour market implications.

Notes

¹ *The Independent*, 13 September 1995.

² Low Pay Commission, *Third Report*, March 2001, Executive Summary, para. 8.

³ Bain, G. *The national minimum wage: Further reflections*, p. 16.

⁴ *ibid.*, p. 18.

⁵ Low Pay Commission, *Third Report*, Vol. 1, p. 43.

⁶ *Pay and Benefits Bulletin*, Industrial Relations Services, March 2001.

⁷ OECD, *Economic Survey, United Kingdom, 2000*. Executive Summary p. 17.

⁸ OECD, *op. cit.*

⁹ *Guardian*, "Yes, it's a wage that works", 21 October 2001.

¹⁰ Bain, *op. cit.*, p. 23.
