

LSE Works: Centre for Economic Performance public lecture

The Minimum Wage in the UK and Beyond

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The Minimum Wage in the UK and Beyond

Alan Manning

Centre for Economic Performance

And Department of Economics

Overview of the Talk

- Some history on the UK experience with minimum wages
- Our minimum wage research at CEP
- The establishment of the National Minimum Wage
- Evidence on the impact of the NMW
- Influences of the NMW beyond the UK
- The future of the NMW in the UK

A Brief History of Minimum Wages in the UK, pre-1992

- 1909: Winston Churchill establishes Wages Councils to set minimum wage rates in certain industries – the ‘sweated trades’
“It is a serious national evil that any class of His Majesty's subjects should receive less than a living wage in return for their utmost exertions”
- This was a complicated and (by 1992) archaic system
 - Covered some very small industries ‘ostrich and fancy feather and artificial flower’
 - Did not cover some large low-paid industries e.g. cleaning, social care
- So there was a need for change
- In 1992 UK general election:
 - Labour proposes to introduce a National Minimum Wage
 - Conservatives proposes abolition of the 26 remaining Wages Councils

The arguments for and against minimum wages then (and now)

- **Those in favour**

- argue minimum wages are necessary to protect against extreme exploitation in the labour market and is an important part of an anti-poverty strategy

- **Those against**

- Argue minimum wages destroy jobs so may harm those it seeks to help

Some Intellectual Background

- 25 years ago economists were generally very hostile to the minimum wage
- Supporters of the minimum wage were widely regarded as economically illiterate

The Motivation for our early Research

- In early 1990s Richard Dickens, Steve Machin and I became interested in the impact of the minimum wages set by Wages Councils
- Partly inspired by policy differences in the 1992 election
- But also inspired by a new wave of academic research in the US led by David Card and Alan Krueger that challenged the conventional wisdom – also connected with political battle in the US to raise the minimum wage

The Conventional Wisdom: The Minimum Wage Destroys Jobs

- For example, OECD Jobs Study (1994)
“Reassess the role of statutory minimum wages as an instrument to achieve redistributive goals, and switch to more direct instruments. If it is judged desirable to maintain a legal minimum wage as part of an anti-poverty strategy, consider minimising its adverse employment effects”
- The only question is how many jobs are lost

The Theory Behind the Conventional Wisdom

- Most economists thought labour market well-approximated by perfect competition
- Market wages equate supply and demand
- Any institution that raises wages causes demand for labour to fall causing job loss
- So strong is this view held by some that this is regarded as a 'natural law'
 - In congressional testimony Finis Welch said “If you drop an apple and it rises, question your experiment before concluding that the laws of gravity have been repealed”

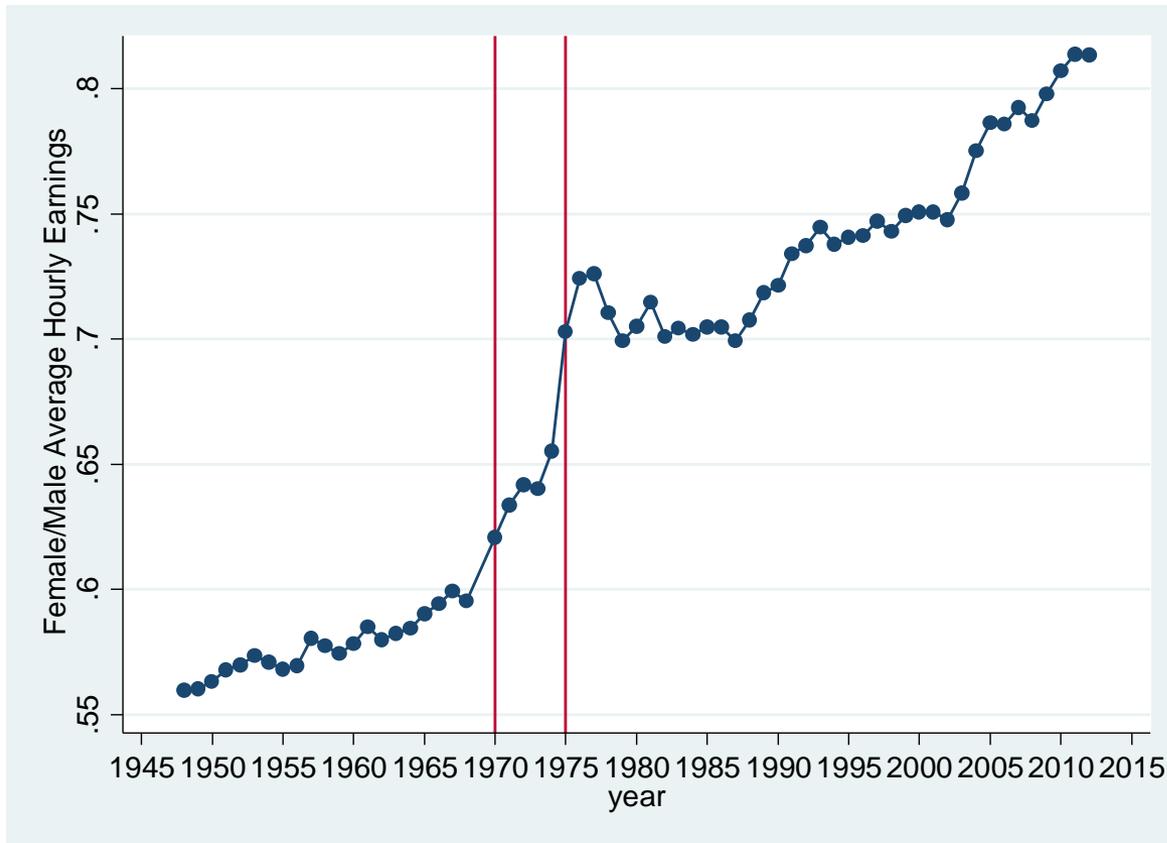
The Problem with the Conventional Wisdom

- The empirical evidence that minimum wages causes job loss is a lot weaker than for gravity
- In the US this point was made by David Card and Alan Krueger in their book 'Myth and Measurement' – published in 1994
- This was controversial – to say the least
- But there is a lot of evidence that the relationship between employment and wages is not so simple

My favourite example

- Best evidence that one can alter wage structure in big way without harming employment comes from the Equal Pay Act, 1970
- This raised pay of women relative to men by a lot

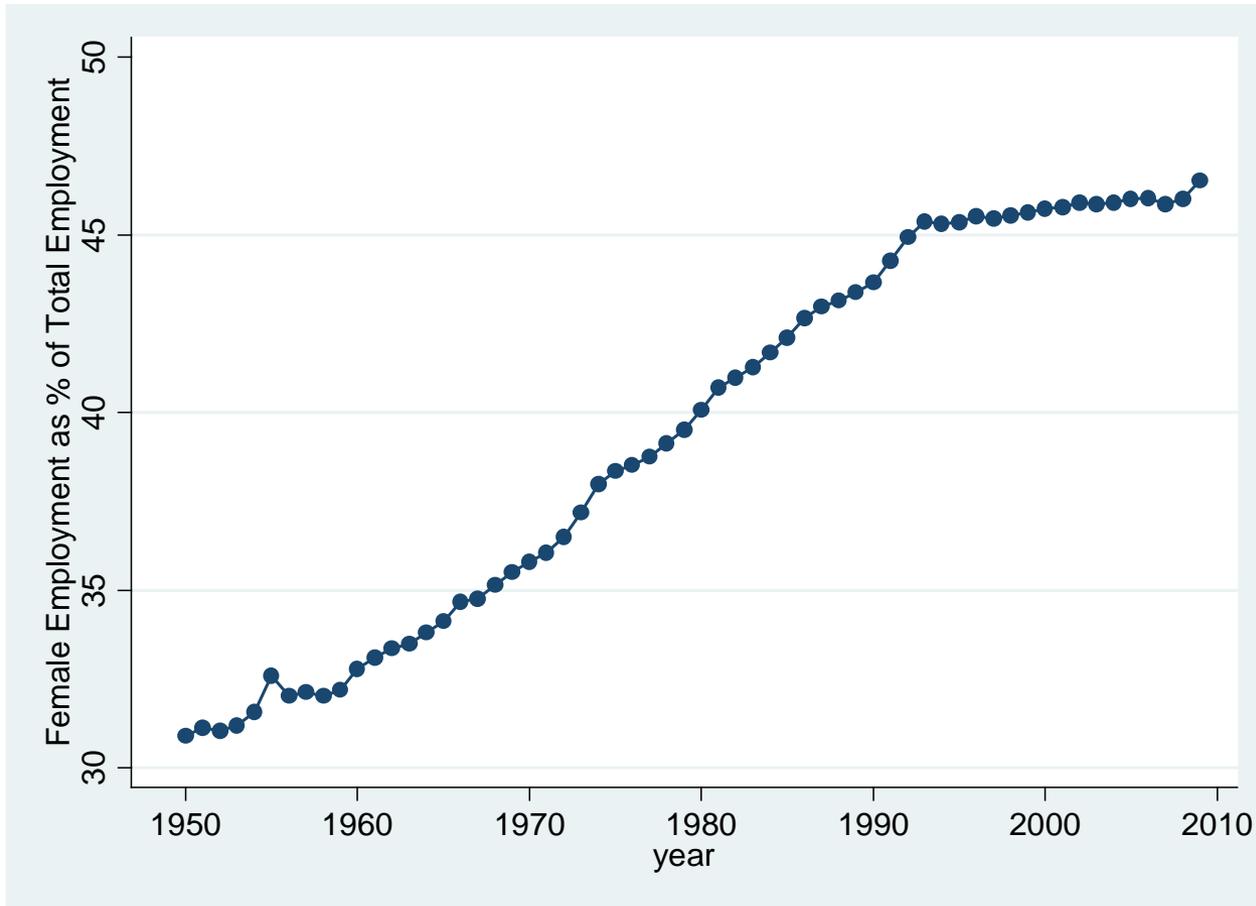
The headline gender pay gap in hourly earnings, 1948-2009



The Times – October 1st 1969

There were strong indications that in industries heavily reliant upon large numbers of women workers like textiles, electronics, footwear, and food, drink and tobacco, employers would cut back on female employment. Executives suggested that men could be trained to do jobs traditionally done by women, and employers faced with the choice of a man or a woman, at the same wages, would opt for a man.

The Share of Female Employment



How is this possible?

- A simple plausible explanation – labour markets are not perfectly competitive
- Employers have some market power over their workers
- Actual employment outcomes a balance between demand and supply factors
- If raise minimum wage reduce incentives of employers to hire workers but raise incentives to work

Implications

- Over some range minimum wage may not lose jobs, may even raise employment
- But nobody in their right mind thinks there won't be some point at which minimum wage causes job loss
- Have to have evidence to decide about the effect, theory is not enough

Our early research on Wages Councils

- We found no evidence that the minimum wages set by Wages Councils had caused job losses
- If anything higher minimum wages seemed to be associated with higher employment

Reference to this in the FT led a prominent businessman to complain to the Director of LSE about us

Doubt cast on minimum-wage link to job losses

By David Goodhart,
Labour Editor

RESEARCH on the effect of wages councils on employment in the UK has cast doubt on the assumption that the introduction of a national minimum wage, as proposed by Labour, would lead to a significant

increase in unemployment. Mr Stephen Machin and Mr Alan Manning argue in a paper for the Centre for Economic Performance at the London School of Economics that the minimum wages set by wages councils for about 2.5m workers have not reduced employment. "If anything," they say,

"there is weak evidence that they have increased it." They say that researchers who have concluded that a minimum wage would increase unemployment have not looked at the economics of particular sections of the labour market. They also point to the fact that employment of

women continued to rise after the 1970 Equal Pay Act. The paper notes that the toughness of the control imposed by wages councils declined in the 1980s as a result of government intervention, but there was no corresponding increase in employment. Indeed, when wages

councils were tougher there was a positive effect on employment. "Employment has declined as a result of the decreasing effectiveness of the wages councils, an effect that seems particularly strong in the catering sector," they conclude. "Our findings cannot

tell us anything about the employment effects of a minimum wage at £3.40 an hour. However, they do question proposals aimed at abolishing the wages council system on the grounds that it inhibits job creation."

Letters, Page 19

1992-1997

- But John Major won the 1992 election, abolished the Wages Councils in 1993, claiming this would lead to an increase in employment
- Our research suggested it did not
- From 1993-1997 there was no wage floor in the UK (except in agriculture)
- Some very low rates of pay
 - Security officer £2 per hour, must provide own dog

The 1997 election

- In 1997 election campaign, Labour again proposed a National Minimum Wage, opposed by Conservatives
- Lot of scare stories about how millions of jobs would be lost
- Labour won, set up the Low Pay Commission

The Low Pay Commission

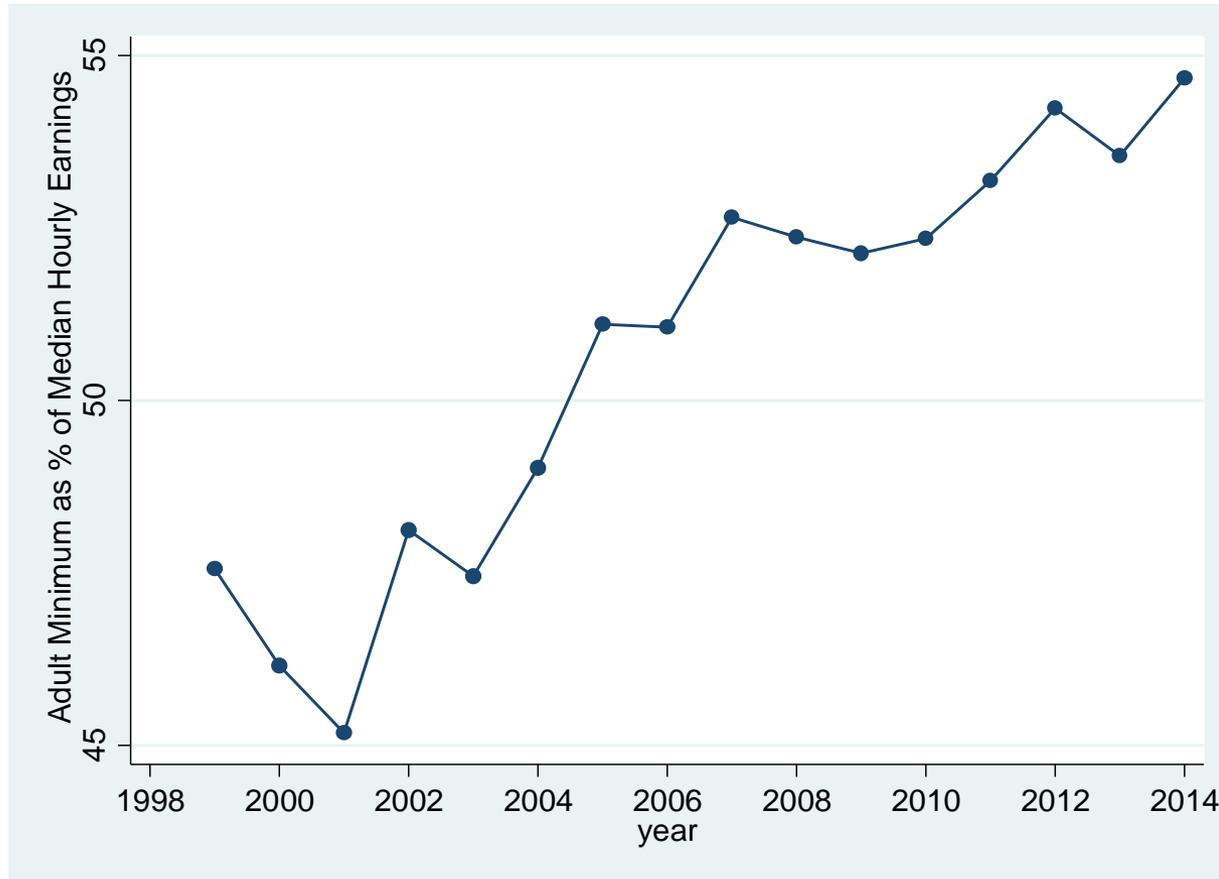
- Makes recommendations to government on level and form of NMW
- Recommendations have almost always been accepted
- Consists of employer and worker representatives plus ‘independents’
- Has always taken an ‘evidence-based’ approach
 - Commissions its own research
 - Absence of ideological/political posturing

Establishing the National Minimum Wage

- The Low Pay Commission produced its first report in 1998
- In April 1999, the National Minimum Wage came into being.
- Initially cautious – set at a relatively low level of £3.60

The Level of the NMW

Adult Minimum Wage as Percentage of Median Hourly Earnings



Current Level and Form

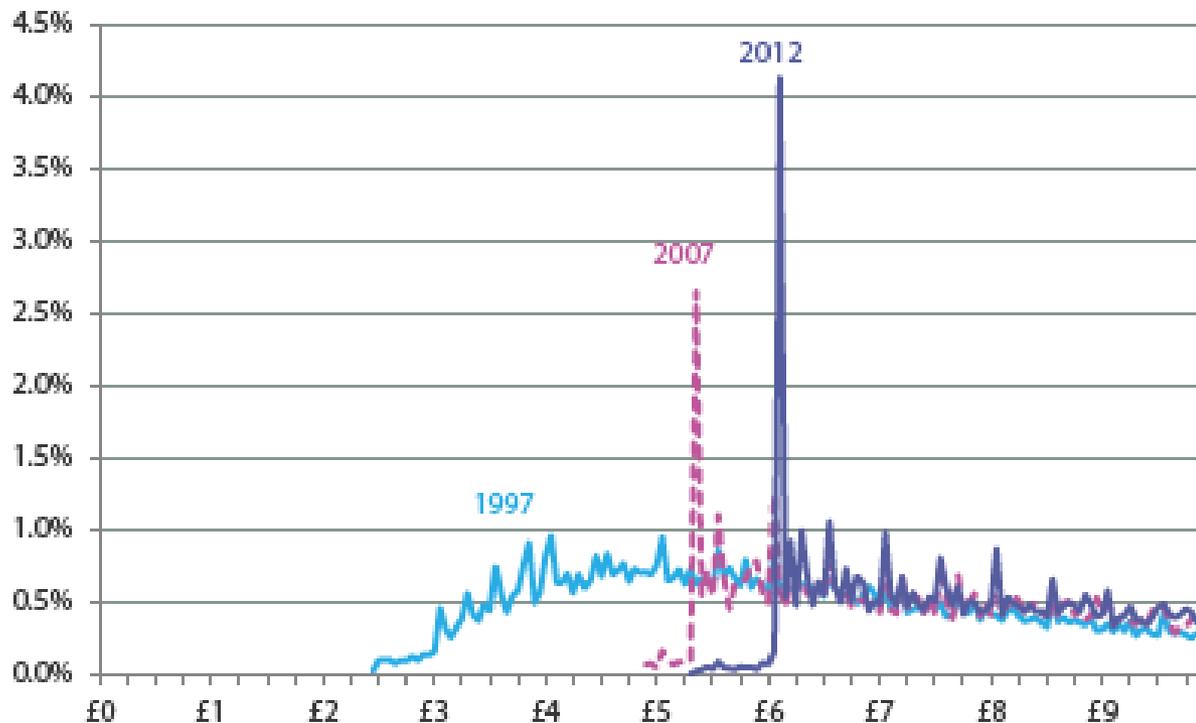
- £6.50 per hour for those aged 21+
- £5.13 per hour for those aged 18-20
- £3.79 per hour for those aged 16-17
- £2.73 per hour for apprentices
- For context
- £11.54 is median hourly earnings
- £6.64 is 10th percentile of hourly earnings

The LPC Strategy

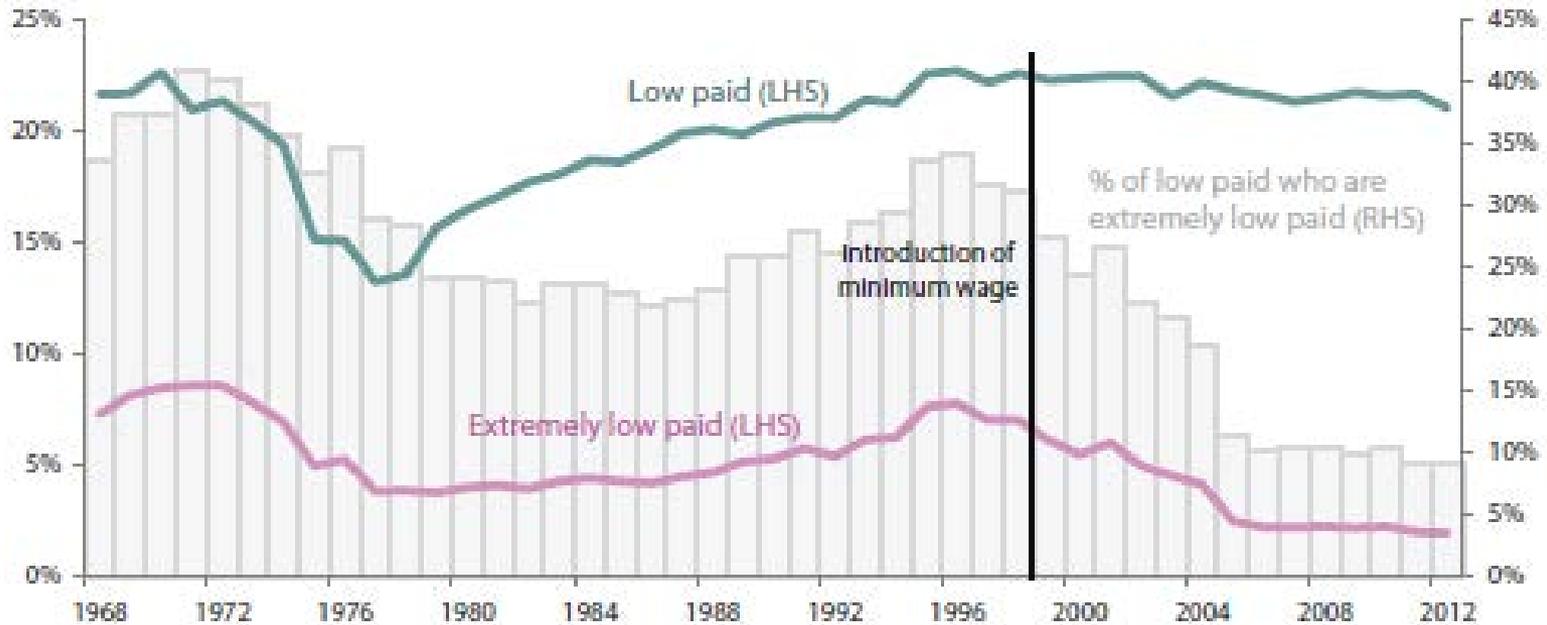
- Would like to increase NMW but limit set by fears about job losses
- Initial level of NMW was low
- Fears that dangers of being too high and having to cut it bigger than dangers of being too low.
- Then increased faster than median earnings as job losses did not materialize – research very important in reaching this conclusion.

Has the Minimum Wage had any impact – the answer is a clear YES

Figure 10: The growing spike at the minimum wage
Percentage of workforce, 5p bands current prices – not controlling for inflation



The NMW has helped to reduce wage inequality in bottom half of the wage distribution



What About Job Losses?

- Prior to NMW some estimates suggested it would destroy 1m jobs
- Turned out to be only scare stories
- Loss of credibility for those who had told them
- Virtually none of the research commissioned by the LPC has ever found evidence of significant job losses
- Some evidence of modest job losses among care workers in retirement homes (30% of workers paid the NMW)

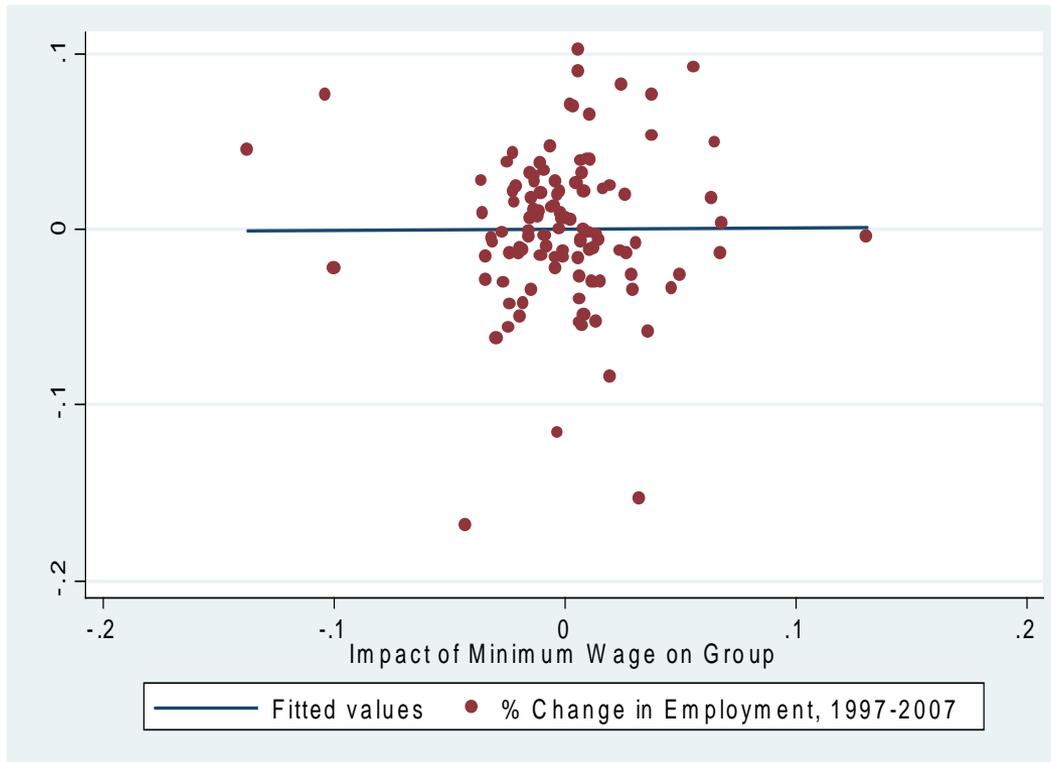
Longer-Term Impact of the NMW

- NMW has bigger effect on low-paid workers – women, the young, in low-wage regions
- Lets look at changes in wages and employment, 1997-2007 by these labour market segments

Clear Impact on Pay of Low-Paid Workers



But little evidence for impact on employment



But....

- now smaller and smaller rises in NMW so hard to get good estimate of employment effect as hard to disentangle impact of NMW from other factors
- There is no doubt there is a level of the NMW that would cause job losses
- LPC currently cautious about aggressive rise in NMW

The NMW and LPC have been fabulously successful

- Conservative party went from opposition to support
 - 2005 David Cameron 'I think the minimum wage has been a success'
 - 2008 George Osborne “Modern Conservatives acknowledge the fairness of a minimum wage”
- Institute of Government voted the minimum wage the most successful UK government policy of the past 30 years
- Currently no sizeable lobby campaigning for abolition of NMW

Beyond the UK

- The success of the NMW and LPC structure become a model in a number of countries which have increasingly been introducing minimum wages e.g.
 - Hong Kong from 2011
 - Germany (from January 2015)

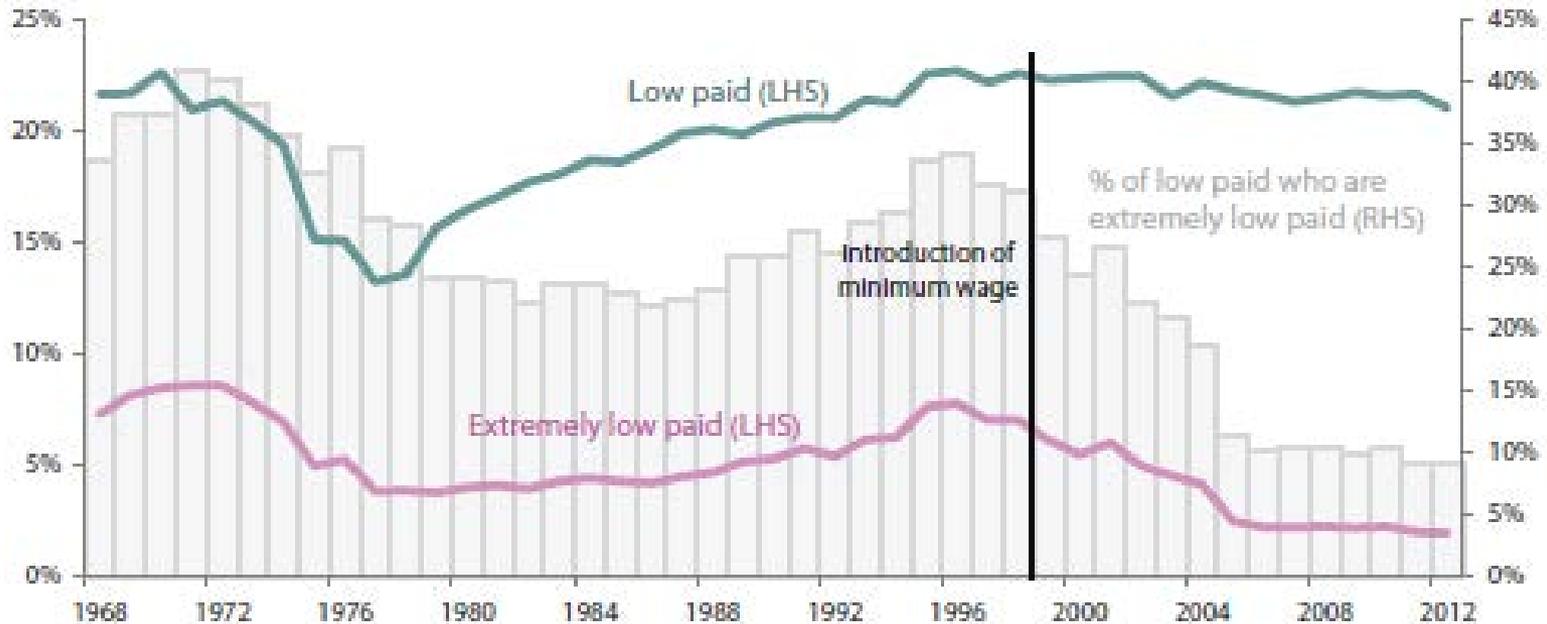
Advice of international organizations has changed

- 2012 joint report of the IMF, OECD, ILO and World Bank (not always bed-fellows when it comes to labour market policy)
 - “a statutory minimum wage set at an appropriate level may raise labour force participation at the margin, without adversely affecting demand, thus having a net positive impact especially for workers weakly attached to the labour market”

But what about the future for the NMW and LPC in the UK?

- Has been very successful so one argument is ‘if its not broken, don’t fix it’
- But some concerns it has become prematurely middle-aged
 - Is it very cautious and short-term, learning little from relatively small changes in the minimum wage
 - Still have a wider problem of persistent low pay
- All political parties are pressing for more aggressive approach
 - George Osborne dropped heavy hint he thought £7 was affordable

The NMW has done nothing to reduce the fraction of people paid less than 2/3rds of median



Ideas for rejuvenation

- A Wider remit
 - The Low Pay Commission has become a Minimum Wage Commission and needs to focus on wider problem of low pay
 - That requires more tools than the minimum wage
- More explicit long-term targets
 - E.g. Labour Party wants £8 by end of next Parliament (58% of median)

More ideas.....

- The living wage (currently £7.85, £9.15 in London)
 - Is this just a much higher minimum wage?
 - Should there be rewards/pressure on those employers who can afford it to pay the living wage
- Should there be higher minimum wages in London, in some industries?

Conclusion

- 25 years ago it looked like minimum wages were disappearing
- Now they are a very active area of policy and debate
- Research and the UK experience has played an important role in this
 - They can reduce wage inequality without harming jobs
- But, don't expect minimum wages to do everything – they are useful but limited

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