in brief...

Britain's minimum wage: what impact on pay and jobs?

The national minimum wage is now an established part of the British labour market. In the first evaluation of all the evidence of its impact on pay and jobs, **David Metcalf** shows that there has been a big boost in the pay of those towards the bottom of the pay league table with no associated loss of jobs.

A century has passed since the first call for a British national minimum wage. In a remarkable 1906 Fabian tract, WS Sanders anticipated almost all of today's debates.

He analysed: how the wage should be set, arguing it should provide subsistence for a family with three children; its likely coverage – around 6% of workers; whether employment would fall or rise once the minimum was set; the need for a thorough inspection and enforcement regime; the interaction between the proposed minimum wage and the social security system or Poor Law arrangements; and the distinction between the minimum wage and a 'living wage'.

But the tract was also a creature of its time. It advocated a lower minimum wage for women than for men. Sanders also had salty views on Chinese workers and Jewish immigrants, writing of the 'cunning of the yellow man' and how 'the Jew overcrowds whole districts with his habit of living in misery'.

The British national minimum wage was finally introduced in 1999. It has had a profound impact on pay:

- When it was first introduced, it gave over one million workers an average pay rise of 10-15%.
- Since then it has been uprated seven times. It is now £5.35 per hour. If it had simply been indexed to prices since 1999, it would now be just £4. So the real pay of those at the bottom of the wage league table has been given a huge boost.
- This, in turn, reversed the trend in the 1980s and 1990s towards greater wage inequality.
- The minimum wage has also narrowed the pay gap between women and men. In 1998 – before the minimum wage – the gap in average hourly wages was 17.4%. It is now only 13%.
- Now, two million workers directly benefit from the minimum wage, around one worker in ten.

When the minimum wage was being discussed in the 1990s, there were dire warnings that it would lower employment. For example, Alan Walters – Mrs Thatcher's economic guru – wrote that it was 'utter nonsense' to argue that jobs might not be lost.

Perhaps this hostility was unsurprising. Orthodox economic theory predicts job losses, the scale depending on how high the minimum wage is set and the 'elasticity' (or sensitivity) of employment with respect to the wage.

But more subtle observers suggested that the labour market – especially the low wage sectors – may not mirror the economists' competitive ideal. In particular, labour market frictions – imperfect information, the costs of switching between firms and the rich variety of workers' preferences – mean that employers have considerable discretion in wage setting. Under these circumstances, a carefully set minimum wage would not necessarily cost jobs and may even boost employment as recruits are found for previously hard-to-fill vacancies.

This issue of the association between the minimum wage and employment is one of the most contentious in economics. But we now have evidence from over 25 British studies so we no longer need to rely on our prejudices. The conclusions are clear-cut – the minimum wage has not had an adverse impact on jobs:

- Aggregate employment has continued its upward trend so that there are now over 30 million jobs in the economy.
- The share of total employment accounted for by the low paying sectors – retail, hospitality, cleaning, agriculture, security, textiles, clothing, hairdressing – is 26%, identical to the share when the minimum wage was introduced.
- Tracking individual workers affected by the minimum wage, and comparing them with a control group of otherwise similar workers,

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shows no differences between the groups in their employment rates.
- The minimum wage has greater bite and coverage in a low wage county like Lincolnshire than in high wage Surrey. But there is no evidence of lower employment growth in the 'low wage, high impact' counties.
- Those workplaces with a high fraction of low wage workers in 1998 have had similar employment growth to workplaces with just a few, or no, low paid employees. Although there is a hint of some job losses in the care home sector, this may reflect previous overcapacity rather than the minimum wage.

The consensus is that the minimum wage has not cost jobs, either in the aggregate economy or in the low wage industries and occupations.

So, traditional economic theory predicts job losses but they have not happened. Why? I have examined nine possible explanations. Some can be dismissed but others are very plausible. We can probably dismiss the following:

- Was the minimum wage set too low? No: the evidence shows that it has greatly advanced the position of the low paid.
- Is there incomplete coverage with workers gravitating to low wage jobs in sectors that are not covered by the minimum wage? No: the minimum wage applies to virtually all workers.
- Have employers cut back on fringe benefits like subsidised meals or pensions to fund the minimum wage? Probably not: it is high wage workers who get these fringe benefits, not the low paid.
- Will the employment losses only show up in the future? Probably not: many of the studies look at data over a relatively long run of years. Anyway, it is almost impossible to pinpoint the labour market impact of a wage increase some years ago because so many other factors – extra holidays, hours restrictions, energy costs, etc. – come into play.
- Might the large rises in the minimum wage since 2002 have a bigger impact on jobs than before? Possibly: but a careful quantitative study of the 2003 and 2004 upratings again shows no employment effects.

It is the next four items that hold the key to the lack of any impact on jobs:

- The employer has much more discretion in setting the wage than orthodox economic theory admits. In particular, where firms were making good profits from paying low wages prior to the minimum wage, now these excess profits are moderated and channelled back to low paid workers. In such firms, profits rather than jobs took the strain.
- Although the studies I have surveyed show no employment effects, there is some suggestion of modest cuts in hours.
- There is evidence of illegal collusion between some employers and workers so that both gain at the expense of the state. The employer pays below the minimum wage but understates true hours. This permits the worker to get a larger tax credit, the top-up payment designed to 'make work pay'. There is evidence of this in some Bangladeshi restaurants and Indian clothing manufacturers.
- Incomplete compliance with the minimum wage, particularly among the immigrant communities. My own research on the Chinese labour market in London covering restaurants, health shops, food manufacture and distribution and clothing, concluded that not a single worker below the level of chef or shop manager was receiving the minimum wage.

Part of the explanation for the absence of job losses is incomplete compliance with the minimum wage

Compliance depends on the probability of being caught and the penalty for non-compliance. Frankly it is amazing that so many employers do comply with the minimum wage. A typical employer will get inspected once every 330 years. And if the employer is caught not complying he simply pays back the arrears: there is no other penalty.

Note that one unintended and favourable side effect of this non-compliance (and of illegal collusion between employers and workers) is higher employment in the non-complying sector. For example, the Chinese restaurant and health care sectors are fiercely competitive and some restaurants and shops would close if the minimum wage were fully enforced.

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This article summarises his December 2006 paper 'On the Impact of the British National Minimum Wage on Pay and Employment' (http://cep.lse.ac.uk/research/labour/minimumwage/WP1481c.pdf).