More than a minimum: Low pay and the National Minimum Wage

Conor D’Arcy and James Plunkett

11 June 2014
• Assessing the minimum wage – what it has and hasn’t achieved

• Reforming the minimum wage – the recommendations
The National Minimum Wage and its architecture

• The National Minimum Wage (NMW) was introduced in 1999
  – Controversial, with predictions of up to 2m job losses and inflation

• The rate is recommended annually by the Low Pay Commission
  – An independent nine-member panel made up of employer and employee representatives, and academics
The minimum wage was eased in and then increased quickly before slowing down.
• The LPC depoliticised the process of setting the NMW
• It secured the buy-in of the businesses and unions through taking a social partnership approach
• Its process for annually uprating the NMW gave the LPC flexibility to adapt to changing economic times
• It has helped to establish a strong and objective body of research
Debates about the minimum wage’s impact on earnings and employment are now largely settled

• No general impact on employment or unemployment

• Large positive effects on the earnings of the lowest paid workers
The NMW has grown at a faster rate than average earnings and inflation.
Extreme low pay has now been all but eliminated

Hourly pay distribution: 1997 and 2012

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While some studies show unemployment effects, the balance of academic opinion is clear.

Effect of the US minimum wage on employment
1,500 estimates from 64 academic studies

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But some parts of the jobs market are vulnerable – any single national rate must therefore be cautious

• While no overall effect on employment has been found in localities, there is some weak evidence of an effect on:
  – Employment growth in very low paid regions
  – Reduced hours for young people after 2008
  – Reduced job retention among female part-time workers
  – Employment in very low paying care homes

• All weak effects, some not replicated, but gives reason for caution

• The minimum wage is an ill-fitting garment

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The impact - why didn’t the NMW cause unemployment?

• **Reducing pay gaps** between low paid and better paid workers

• **Cutting non-wage benefits and hours**, though not enough to offset the upsides

• **Pushing up prices** (slightly) in sectors like take-away food, canteens and hotels

• **Squeezing profits**, though with no identifiable effect on the rate of business failure

• **Boosting productivity** in low paying sectors, particularly in large firms
The NMW hasn’t reduced wider low pay however (and didn’t aim to do so)

• One-in-five employees in the UK are low paid including:
  – 1-in-4 **women**
  – 3-in-4 of those aged **16-20**
  – 1-in-3 of those aged **21-25** and those aged **66+**
  – 2-in-5 of those working on a **part-time** basis
  – 1-in-3 of those working on a **temporary** or casual basis
  – More than half of those in **elementary** occupations or **sales & customer services**
  – 2-in-3 of those working in the **hotels & restaurants** sector
  – 2-in-5 of those working in the **wholesale & retail** sector

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Low paid spread across different households but one in five LMIs rely solely on low paid earners
For most, low pay doesn’t provide a first step on the ladder

Proportion of all low paid employees in 2002

- Exiters (retired, etc): 9%
- Escapers: 18%
- Stuck: 27%
- Cyclers: 46%

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While some level of low pay is inevitable, the share of the workforce who are low paid varies considerably.

**Percentage of full-time workers earning below two-thirds of the median wage**

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<thead>
<tr>
<th>Country</th>
<th>Percentage</th>
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<td>United States</td>
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<td>United Kingdom</td>
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Resolution Foundation
The Resolution Foundation review of the future of the National Minimum Wage and Low Pay Commission
• **Professor Sir George Bain (CHAIR)** – founding Chair of the Low Pay Commission and former President and Vice-Chancellor of Queen’s University Belfast

• **Professor Paul Gregg** – Professor of Economic and Social Policy and Director of the Centre for Analysis and Social Policy, University of Bath

• **Professor Alan Manning** – Professor of Economics and former Head of the Economics Department, London School of Economics

• **Dr Abigail McKnight** – Senior Research Fellow at the Centre for Analysis of Social Exclusion (CASE) at the London School of Economics

• **Professor Karen Mumford** – Professor of Economics at the University of York and Chair of the Royal Economic Society Women's Committee

• **Dr John Philpott** - Director, The Jobs Economist consultancy

• **James Plunkett** – Director of Policy and Development, Resolution Foundation

• **Nicola Smith** – Head of Economic and Social Affairs Department, Trades Union Congress

• **Tony Wilson** – Director of Policy, Centre for Economic and Social Inclusion

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**Resolution Foundation**
The minimum wage has been highly successful—but it is clearly a settlement designed for the late 1990s

- **Narrow** and focused – set the UK’s first minimum wage with little evidence
- **Short-term** and cautious – taking one step at a time, not looking too far ahead
- **Passive** – taking a hands-off approach – the minimum wage plus a penny

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Narrow: Extreme low pay has collapsed while low pay more generally remains high.

Long-term trends in low pay and extreme low pay
Percentage of all employees below two thirds and half of median pay, 1968-2011

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Resolution Foundation
Short-term: The lack of direction mattered less in the early years, now there’s reason to think it matters more.

The path of the minimum wage over time
£ per hour, constant prices, adjusted for CPI
Passive: The spike at the NMW is larger than expected—and it’s growing. Many employers face little pressure to go further.

The growing spike at the minimum wage
*Percentage of employees by 5 pence pay bands*
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Our recommendations strengthen these three weaknesses—but crucially retain the core of the 1999 settlement

A single legal National Minimum Wage recommended from year to year by the independent Low Pay Commission

• **A broader approach**
  – Tackling low pay a clear ambition of economic policy
  – The LPC a powerful OBR-style low pay watchdog

• **A more far-sighted approach**
  – Giving business more clarity
  – Balancing short-term flexibility with medium-term ambition

• **A more assertive approach**
  – Noting sectors that could pay more
  – Publishing a reference rate for London

Resolution Foundation
• A broader approach
• A more far-sighted approach
• A more assertive approach
**Broader:** Tackling low pay should be a clear objective of economic policy, backed by a powerful low pay watchdog.

**Low pay across OECD countries**

*Percentage of full-time workers earning below two-thirds of the median wage*

![Bar chart showing the percentage of low-paid workers across OECD countries.](chart.png)
• A broader approach

• A more far-sighted approach

• A more assertive approach
More far-sighted: The minimum wage should strike a better balance between flexibility and medium-term ambition.

- **On the one hand, it’s vital that the minimum wage...**
  - Remain **responsive** to labour market conditions
  - Stay **evidence-based** and **depoliticised**

- **On the other hand, the policy needs a sense of direction**
  - Employers have no sense of where we are going
  - Government’s approach is **passive** – it describes the labour market as it is today, rather than trying to get somewhere different
More far-sighted: But the UK’s approach is carefully calibrated—we really don’t want to be the US...

The minimum wage in the UK and America

*Real terms, US$PPP*

Source: Resolution Foundation analysis, OECD data
More far-sighted: But the UK’s approach is carefully calibrated—we really don’t want to be the US...or France!

The path of the UK minimum wage had it been linked to inflation

Resolution Foundation
More far-sighted: We suggest a two-pronged approach—more ambition from government, more support from LPC

1. **Government sets out ambitions on the minimum wage**
   - Proportion of median earnings
   - Medium-term horizon, e.g. five years
   - 60% a reasonable lodestar for what can and cannot be achieved
   - An expression of intent...

2. **Low Pay Commission is evidence-based but more pro-active**
   - Recommends rate that’s possible from year to year
   - Notes the gap with the government’s ambition
   - Points out blockages and advises on policy to support higher rate
• A broader approach

• A more far-sighted approach

• A more assertive approach
More assertive: The NMW is a blunt tool. We need pressure points above it to avoid a strategy of ‘NMW plus a penny’

- **Inevitable constraint of a single national minimum wage**
  - Set for the most vulnerable part of the labour market
  - Many employers could afford a higher wage-floor

- **Becomes a problem if employers take it as the going rate**

- **Some argue for mandatory sector or regional rates. But...**
  - No case for regions (except possibly London)
  - Risk of complexity/enforcement problems
  - Practical difficulties

- **LPC should inform debate**
  - Reference rate for London
  - Analysis on which sectors could pay more
More assertive: The LPC should do more to inform the debate about which parts of the economy could afford to pay more

The affordability of eliminating low pay by sector

Average wage increase by industry if wage floor had been raised to low pay threshold

Easier to afford ← Sectors → Harder to afford

Resolution Foundation
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Food and drink, accommodation, residential care
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Cumulative # of low paid workers: 190k 400k 1.4m 1.5m

Food and drink, accommodation, residential care

Resolution Foundation
Summary: Retain the core of today’s settlement but strengthen it – broader, more far-sighted and more assertive

- A single legal National Minimum Wage recommended from year to year by the independent Low Pay Commission

- As part of a broader strategy to combat low pay, with the LPC as a powerful low pay watchdog

- Minimum wage set with more clarity and more balance of short-term flexibility and medium-term ambition

- A more assertive approach, pushing further in London and where sectors could afford to pay more
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