Uk national minimum wage

The UK National Minimum Wage is currently set at less than 50 per cent of median earnings. Should it be set higher?

The National Minimum Wage (NMW) was introduced in the UK in 1999, with the goal of helping “ as many low-paid workers as possible without any significant adverse impacts on inflation or employment” (Low Pay Commission, 2006) This essay will explore whether the minimum wage should be higher than its current level of £5. 80 using the demand-supply framework in a competitive market as a tool. The impact of the minimum wage on the UK economy will be investigated, and compared against the original goals of the minimum wage back in 1999.

The central argument for a NMW is that it protects low paid workers from exploitation. It is “ rooted in concern about the ability of markets to provide income equity for the least able members of the work force” (Eatwell et all, 1987). Whilst there is general consensus that socially and morally the NMW is a good thing, the economic benefits versus drawbacks have been vigorously debated for years. The principle argument against is that setting a NMW above the equilibrium point of the demand and supply curves (essential for a NMW to be effective) in a competitive market will cause unemployment through an increase in the supply of labour (because workers are incentivised by higher wages) and decrease in the demand for labour (because firms cannot afford to pay for the same volume of labour as before). One crucial point is that the equilibrium point (and the corresponding supply and demand curves) relates to each worker, and their employability, and therefore there is no one equilibrium point that holds for the market.

There is no one accepted definition of what low pay is, or indeed what the level of the minimum wage should be. At the upper limit, the Council of Europe defines a so called ‘ decency threshold' that originally was 2/3 of the mean wage level (Council of Europe, 2008). This has now been revised down to 60% of net earnings. This would give a NMW in the UK of between £8. 17 and £9. 00 (40-55% higher than the current £5. 80 level). As a result of this up to 38% of full-time workers would have their wages improved (Sloman and Hinde). If the NMW was set at 2/3 of median male earnings rather than mean wages, this would lead to a NMW of £7. 50, and positively impact 20% of men and 40% of women. (Sloman and Hinde, 2007)

Regardless of which measure is chosen to compare the NMW to average (mean, median, full-time male etc), it is clear that the UK NMW is someway off the 60-67% of ‘ average' earnings suggested as appropriate. On the flipside, the Low Pay Commission has recommended (and had accepted) above average earnings rises in the minimum wage over the past 10 years (Low Pay Commission, 2009).

A minimum wage acts as a “ classical price floor on labour” (Ehrenberg and Smith, 1994). It goes on to explain that “ if set above the equilibrium price, more labor will be willing to be provided by workers than will be demanded by employers” The result is “ a surplus of the commodity” and this “ takes the form of unemployment, which tends to be higher with minimum wage laws than without them” (Sowell, 2007).

It is clear from the above diagram that in a competitive market, setting a minimum wage above the equilibrium rate, leads to deadweight welfare loss.

The consumer (employer) surplus must decrease, while producer (employee) surplus may or may not increase; however the decrease in consumer surplus must be greater than the increase in producer surplus

Back in 1946, Stigler argued (Stigler, 1946) that “ a rise in the minimum wage leads perfectly competitive employers to cut employment”. The level of the NMW is not the sole factor determining the size of this employment gap. The elasticity of price for a sectors goods has an impact as well (Sloman and Hinde). Since the NMW applies to the sector as a whole, and not an individual firm, this elasticity effect is attenuated, and the potential unemployment in any one firm minimized. Additional complications such as replacing staff with machines, or overseas threats, serve to ensure that the NMW has the potential to cause unemployment in some sectors prone to these 2 cost reduction techniques.

Under monopsonistic competition, in which the employer has “ some influence over rates of pay (Sloman and Hinde), an “ appropriately set minimum wage could increase both wages and employment, with the optimal level being equal to the marginal productivity of labor” (Manning, 2003). In this sense, the NMW is seen from the perspective of being a “ market regulation policy akin to antitrust policies, as opposed to an illusory " free lunch" for low wage workers” (Manning, 2003) . Dickens et al (Dickens, Machin and Manning, 1999) propose that a modern monopsonistic framework, less based on unrealistic company town concepts, and more on “ labor market frictions” could explain the (neoclassically) anomalous neutral/positive employment impacts caused by the introduction of a NMW. They studied the ‘ Wage Councils' in the UK, the forerunner to the UK NMW, and found that such firms potentially have a “ degree of monopsony power” (Dickens, Machin and Manning, 1999) because those that cut wages “ do not instantaneously lose all their workers, so the supply of labor to a firm is not perfectly elastic”. They found that “ irrespective of specification and data definition, the effect of minimum wages on employment is always estimated to be nonnegative and in many cases to be positive”. They do add a word of caution, however, that if the NMW was set “ high enough”, their theoretical framework could lead to negative results.

Blinder (Blinder, 1996) argues that an increased NMW encourages employees to stay, thus reducing turnover and training costs (associated with new employees). It could also “ render moot” (Blinder, 1996) the potential problem of recruiting workers at a higher wage than current workers. He further argues that minimum workers may be such a small part of a businesses cost that it doesn't matter. Whilst these are not proven points, they could explain part of the reason why the NMW has not had a negative impact on the UK economy as a whole.

Contrary to initial concern, and possibly as a result of the deliberately cautious (Low Pay Commission, 2009) initial £3. 60 rate; there has been little evidence that the NMW has had a negative economic impact. Research by the Low Pay Commission has found that employers may have “ reduced their rate of hiring, reduced staff hours, increased prices, and have found ways to cause current workers to be more productive (especially service companies)” (Low Pay Commission, 2005)

Research in the US by Card and Krueger (Card and Krueger, 1994) (Card and Krueger, 1995) showed that increases in the minimum wage actually increased employment. This result was supported by Krugman (Krugman, 2007) and Stiglitz (Stiglitz, 2002), but vehemently opposed by Murphy, Mankiv (Mankiw, 1999) and Becker (Becker, 1995).

In the UK, Machin et al (Machin, Manning and Rahman, 2003) demonstrated that the " current evidence on the employment effects of the National Minimum Wage suggests that these effects (employment and hours reduction) have been small or non-existent, whilst Stewart (Stewart, 2004) showed " there to have been no reduction in the employment probabilities of minimum wage workers as compared to workers slightly higher up the wage distribution".

The Low Pay Commission in their 2009 commission report (Low Pay Commission, 2009) assert that the NMW continues to exert " significant influence on wages at the bottom of the earnings distribution" whilst " firms appear to have adapted to these increases in wage costs by changing pay structures, removing wage premia, and reducing non-wage costs" This would suggest that the NMW is achieving its goals of benefiting low paid workers, whilst having a " benign influence on the economy" (Low Pay Commission, 2009)

The efficiency hypothesis states that " the productivity of workers rise as the wage rates rise" (Sloman and Hinde, 2007) Therefore the introduction of a NMW should improve workers, and firms, productivity. However, however empirical studies in the UK (Low Pay Commission, 2009) have found no evidence for this to be true.

Draca et al (Draca, Machin and Reenen, 2005) showed that wage increases were not passed onto consumers as price increases, and therefore profitability was " significantly" affected by the introduction of the NMW in the UK. They also observed, however, that few firms had gone out of business, and suggested that the effect of the NMW was to ' moderate these excess profits by channeling them back to the wages of low paid workers'(Draca, Machin and Reenen, 2005)

Since the introduction of the minimum wage in the UK in 1999, the level has risen against median earnings year on year. The low pay commission has sought to exhibit a " cautious approach" (Low Pay Commission, 2009) during times of uncertainty, whilst increasing it faster than the average wage during economically stable periods, and thus improving the " effective level of the minimum wage" (Low Pay Commission, 2009). Studies on the impact of the NMW, both in the UK (Machin, Manning and Rahman, 2003) (Stewart, 2004), and the US (Card and Krueger, 1994) (Card and Krueger, 1995) have shown neutral to positive employment probability impacts of the NMW, negligible consumer product prices rises with a reduction in firm profitability (Draca, Machin and Reenen, 2005). At the same time, a significant number of workers have benefitted (Low Pay Commission, 2009) (Dickens and Manning, 2004). However, this picture must be considered against the backdrop of a buoyant economy and increasing labour market flexibility between 1999 and 2007 (Sloman and Hinde). Since 2007 there has been " relative economic uncertainty" (Low Pay Commission, 2009), and the Low Pay Commission has recommended a more “ modest increase” (Low Pay Commission, 2009) this year of 7 pence taking the adult NMW to £5. 80. In light of the data showing a year on year fall in aggregate employment in 2008 (Low Pay Commission, 2009), combined with studies showing that whilst small rises in NMW appear to have a relatively benign economic impact (Stewart, 2004), increasing the NMW outside its “ range of indeterminacy (Sloman and Hinde, 2007) to the levels suggested by the Council of Europe (Council of Europe, 2008) , may well lead to the negative employment and inflation impacts predicted in the literature (Mankiw, 1999) (Becker, 1995). An increase in the NMW is, therefore, currently not recommended.

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