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**Minimum Wage, Minimum Fuss
The Building of the British National
Minimum Wage**

Peer Review on Minimum Wage

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1. Summary

The introduction of the National Minimum Wage (NMW) in Britain in 1999 was a massive and, at the time, controversial labour market intervention. Many predicted dire economic consequences. But none have occurred. Instead the NMW won popular and political acceptance within a couple of years, amounting now to virtually approval. An early newspaper headline on its introduction was 'Minimum Wage, minimum fuss' - fifteen years later, this still holds true.

The UK had no previous experience of a comprehensive minimum wage. Pressure to introduce one arose because, from the 1980s onwards, the relative position of the low paid deteriorated rapidly as collective bargaining collapsed and competitive pressures tightened. Strong legislation was introduced in 1998, establishing a Low Pay Commission (LPC) which had started work the previous year. This Commission was an independent 'social partnership' body, with a civil service support team, whose role was to advise the Prime Minister on the NMW. It placed high priority on widespread consultation with those who would be affected by the NMW, and also on building research-based evidence of the highest quality.

The NMW was introduced at a relatively cautious level. For two years the initial impact was assessed and data, especially on pay, improved. The NMW was then gradually increased relative to average earnings until the 2008 financial crisis, since when its relative position has been maintained, although its real value has declined. The NMW applies to all employees in the UK, irrespective of region or sector, and it now has subsidiary rates for young workers and apprentices. It is important that it has been enforced by the taxation authority, Her Majesty's Revenue and Customs (HMRC). It now enjoys all-Party support.

The NMW has provided a solid floor to pay in the UK's labour market. Annual increases directly affect about 5 per cent of workers. Its value relative to median pay has risen from 46 per cent on introduction in 1999 to 53 per cent in 2013. This places it about the middle of the range of minimum wages in OECD countries. Extensive research has failed to identify any significant adverse consequences of the NMW for employment, inflation or competitiveness.

2. Background

The period leading up to the establishment, in 1997, of the Low Pay Commission (LPC) had been one of rapidly increasing income inequality in the UK. This resulted from a combination of circumstances.

Most conspicuous had been the rapid decline in trade union influence. Trade union membership density for all employees fell from 50 per cent in 1980 to 38 per cent in 1990 and to 30 per cent in 2000 (falling further to 26 per cent in 2011). This collapse was especially marked in the private sector, where extreme low pay was concentrated – falling from 36 per cent in 1990 to 25 per cent in 1998 (and to 14 per cent in 2010). The accompanying decline in collective bargaining coverage of employees in the private sector was from 30 per cent in 1990 to 16 per cent in 1998 (and to 14 per cent in 2010)¹.

A contributory factor had been the abolition, in 1993, of the 'Wages Councils'² for all but agricultural workers. For most of the twentieth century these had provided statutory minimum wages for selected sectors. The government of the time viewed them as constraints on economic efficiency. The coverage of wages councils had become patchy, protecting under ten per cent of the workforce, and left untouched more recent low paid sectors such as industrial services and care homes. In terms of both the level and the enforcement of their wage rates, they had become increasingly ineffective. Despite this, they had, for the sectors they covered, provided a floor and a structure to wages³.

The deterioration of relative wages of less skilled workers in the UK was also a consequence of international changes affecting all countries. Underlying these were the expansion and integration of the global trading economy, and the effects of technological change on relative demand for skills.

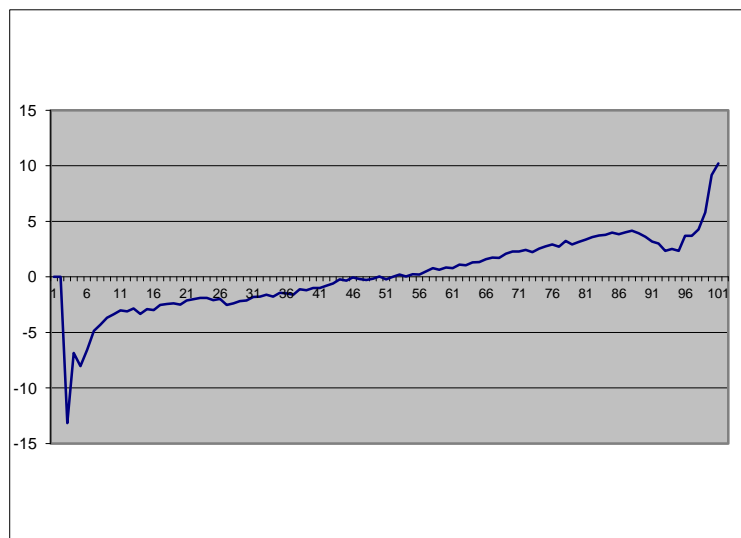
¹ Brown, W., Bryson, A., Forth, J. and Whitfield, K. (2009), *The Evolution of the Modern Workplace*, Cambridge: CUP

² The 1909 Trades Boards Act allowed statutory minimum wages and hours of work to be established on a national but sectoral basis. Renamed 'wages councils' in 1945, these comprised equal numbers of employer and worker representatives with a small number of 'independents' to break deadlocks and represent wider interests. They had a small inspectorate with authority to enforce their wages orders, the breaching of which was a criminal offence. At their peak in 1953 there were 66 wages councils providing a safety net for about 17 per cent of the employed workforce. By 1993, when all but the Agricultural Wages Board were abolished, their coverage had fallen below 10 per cent.

³ Craig, C., Rubery, J., Tarling, R. and Wilkinson, F. (1982), *Labour Market Structure, Industrial Organisation and Low Pay*, Cambridge: CUP

Chart 1 - Relative changes in pay by percentile, 1992 - 1997

Percentage change against the median of gross hourly earnings excluding overtime by percentile, employees 22 and over unaffected by absence.



Source: LPC / ONS estimates from NES

The net result was a marked increase in income inequality during the 1990s, with the lower paid receiving smaller percentage pay increases. This is demonstrated in Chart 1, showing relative changes in pay against the median, by percentile of the hourly earnings distribution in the years leading up to the NMW, from 1992 to 1997. It shows widening inequality across the whole distribution, especially marked for the top and bottom deciles.

Historically the British trade union movement had been hostile to statutory minimum wages on the grounds that they undermined collective bargaining. The changing circumstances of the 1990s removed this hostility. Private sector unions were finding it increasingly difficult to retain recognition with employers who were in competition with non-unionised firms. The public sector unions were concerned that unregulated wages in the private sector increased the likelihood of work being out-sourced from hospitals, schools, government and so on to non-unionised and low paying private sub-contractors. They led the campaign which committed the Labour Party to introduce a statutory minimum wage when it returned to power in 1997.

There were urgent policy issues arising from increasing income inequality. One concerned the rising number of children who were growing up in poverty. The proportion of children living in households with incomes below 50 per cent of the mean, which had been fairly steady at around 10 per cent through the 1960s and 1970s, rose sharply to above 25 per cent by the late 1990s⁴. A closely linked issue concerned the cost to the government of the financial benefits that it paid to working parents to mitigate the effects of family poverty. Given these benefits, it was necessary to provide an incentive to parents to remain in work. Between 1988 and 1997 the number of families on in-work benefits rose from 50,000 to 700,000, and the annual cost to the government rose from £200 million to £2,100 million. This mounting financial burden was a growing source of concern to the Conservative

⁴ Glennerster, H., Hills, J., Piachaud, D. and Webb, J. (2004), *One Hundred Years of Poverty and Policy*, York: Joseph Rowntree Foundation.

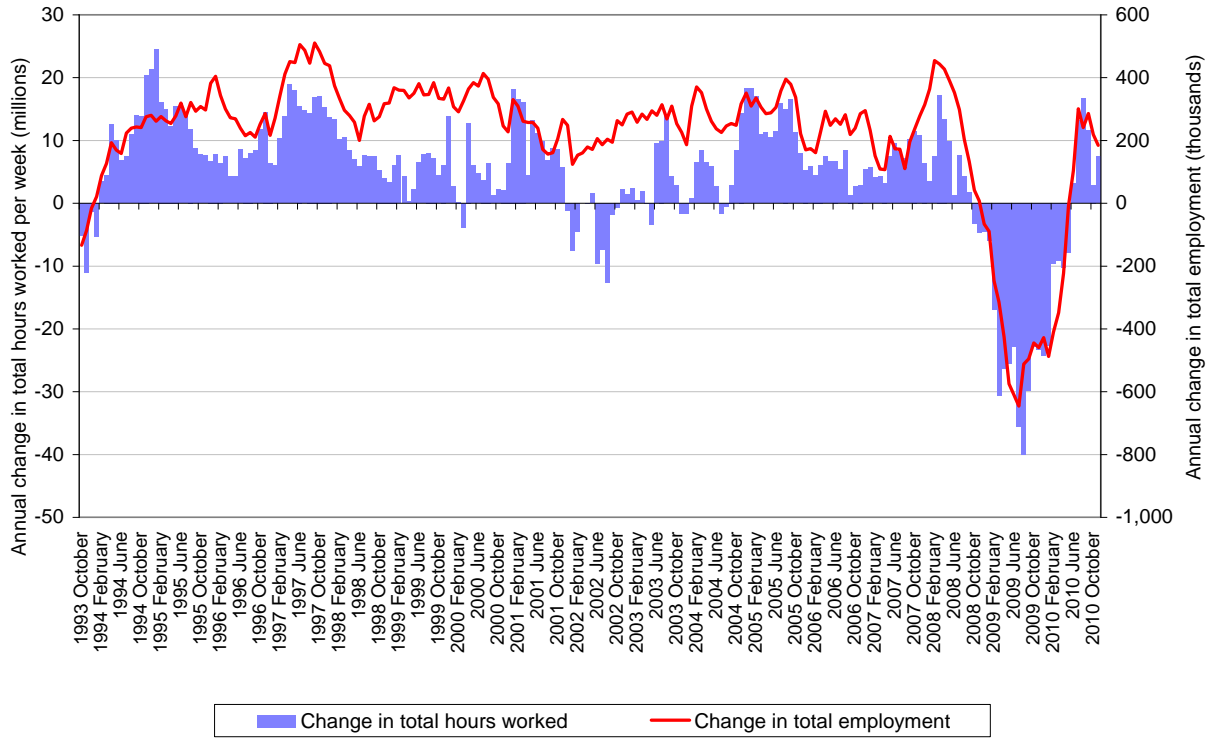
governments of the 1990s. With no statutory minimum wage, there was an unintended incentive for employers to minimise their wage costs by encouraging employees to maximise their in-work benefits. It amounted to a tacit state subsidy for low pay and poor employment practices⁵.

A deep-rooted feature of the wage fixing system in the UK that marked it out from other countries by the 1990s was its diversity and complexity. The practice of sectoral collective bargaining (resulting in what were known as 'industrial agreements') in the private sector had been in rapid decline from the 1960s. It had never had the legislative support that was common elsewhere in the European Union. Increasingly it had degenerated into *de facto* enterprise and workplace bargaining or no bargaining at all. Even where sectoral agreements set out standard terms and conditions of employment on, for example, hours of work and holiday entitlements, they could not be legally enforced. The result was extreme variation in pay systems and in rates and of pay composition, even within single firms, which was often confused further by idiosyncratic job descriptions.

The economic circumstances in which the NMW was introduced (in April 1999) were of great importance to its success. In the mid-1990s the British economy entered into a period of low inflation, low unemployment, and sustained economic growth which was to continue until the financial crisis. Chart 2 shows the steady growth in jobs, and almost continuous growth in hours worked, from 1994 to 2008. The larger of those sectors most affected by the NMW – retail, hospitality, business services, and residential care homes – were all benefiting from this sustained growth. It would be hard to imagine more benign circumstances for this massive labour market intervention. What might have been the consequences of less favourable initial economic conditions? Given the evidence-based method adopted by the LPC, they would probably simply have been more cautious in the initial pace at which they raised the NMW relative to average earnings, which was their response to the recession from 2008.

⁵ Low Pay Commission (1998), *The National Minimum Wage: the First Report of the Low Pay Commission*, CM 3976, London: TSO

Chart 2 – Changes in total employment and in total hours worked 1993-2010



3. Policy measures

3.1 Objectives

When the Low Pay Commission was established in 1997 its terms of reference were vague and its future was uncertain. It was required to recommend to the Prime Minister the coverage and initial level of the NMW, and it was unclear whether it would be required to produce more than one report. In this first report it declared that its criteria were that the NMW should 'support a competitive economy, be set at a prudent level, be simple and straightforward, and make a difference to the low paid'⁶. In due course the Commission's continuing future was assured. Although governments have never specified its terms of reference, in 2003 it declared its aim to be 'to have a minimum wage that helps as many low-paid people as possible without any significant adverse impact on the economy'⁷. This has been accepted by successive governments. The present Coalition Government programme states that 'the Government supports the NMW because of the protection it gives low income workers and the incentives to work that it provides'; frequently referred to as 'making work pay'.

3.2 Target groups

The basic principle of the NMW is one of universal coverage of all workers. Initially it was for those aged 18 and over but from 2004 those aged 16 or over were added. No exemption is made for the type of employment contract (for example, seasonal, part-time, agency, casual, home-working, short-term, payment-by-results, commission etc.). The Armed Forces, prisoners, share fishermen, volunteers and self-employed are excluded. The legal definition prevents workers in regular employment with an employer from being bogusly defined as self-employed. Around a half of the jobs in the UK that benefitted directly from the NMW increase in 2013 were in hospitality, retail, cleaning, and care homes. The sectors with the highest proportion of jobs on the NMW in 2013 were hairdressing (33 per cent), hospitality (26 per cent) and cleaning (24 per cent)⁸.

The age-related minimum rate for younger workers aged 18 to 21 years old was introduced alongside the full NMW in 1999 at £3.00, equivalent then to 83 per cent of the full rate. A minimum rate was introduced for 16 to 17 year olds in 2004 at £3.00, equivalent then to 62 per cent of the full rate. A minimum apprenticeship rate was introduced in 2010 at £2.50, equivalent then to 42 per cent of the full rate.

3.3 Timeframe

The NMW was introduced on 1 April 1999, increased on 1 October 2000, and has subsequently been increased annually on 1 October each year. The LPC was set up in July 1997 and delivered its first report in June 1998. Since then it has published one report a year and some other publications on specific aspects of its work. The annual routine is that a remit is set for the LPC between April and June, setting out what the government wishes it to consider when making recommendations for the following year. The remit is set in consultation with the LPC and has typically been uncontroversial and brief, referring, for example, to giving special attention to 'the competitiveness of small firms' or 'the position of apprenticeships'. The LPC consider what research it might want to commission and puts out projects for tender. In total the LPC has commissioned over 130 research projects from independent investigators. June to October is a consultation period with visits across the country and a call for

⁶ LPC (1998) *op cit*

⁷ Low Pay Commission (2003), *The National Minimum Wage – The Fourth Report*, London: TSO

⁸ Low Pay Commission (2013), *The National Minimum Wage – Low Pay Commission Report 2013*, London: TSO

written evidence. Considerable importance is given to these visits by Commissioners, and each year around nine visits have been arranged, always including to each of the four countries of the UK - Scotland, Wales, Northern Ireland and England. The establishments chosen for visits typically include sectors/groups of workers most affected by the NMW or which are the particular focus of that year's remit. Briefing papers are prepared on the state of the economy and any special issues. Formal oral hearings are held in November. The LPC has a retreat in December to discuss issues and data that will need to be taken into account. At a further retreat in late January the recommendations for the NMW and other issues are discussed and decided. These decisions of Commissioners have all been unanimous, arrived at through careful consideration of the evidence and sometimes lengthy negotiation. A report is agreed and made to government in late February. During March and April government considers this and whether to accept the recommendations. With minor exceptions recommendations on the rates have all been accepted. The report is published when that decision is announced.

3.4 Geographic and sectoral scope

The decision was made by the newly elected Labour government before the LPC was established that there should be a single NMW applicable to the whole UK and to all sectors. Although the issue of regional and sectoral differentiation is an occasional topic among politicians and in the press, the LPC has never been persuaded that it would be worth pursuing. There are several reasons for this. Geographically, the variance of pay is greater within regions than between regions. Although average pay differs substantially between regions, there are pockets of extreme low pay in all regions. It is true that living costs vary regionally – with relatively expensive housing in the London area and relatively expensive food in Scotland, for example – but the LPC has deliberately eschewed discussion of worker needs (such as what might constitute a 'living wage') in order to focus on what employers can afford without adverse employment effects.

Low pay is primarily an issue for small and medium sized firms in specific sectors, and these sectors are generally of service industries that are, of necessity, widely dispersed across the country. But although low pay is concentrated in specific sectors, it is also widely dispersed beyond them. Differentiating between sectors for NMW purposes would give rise to intractable definitional problems. These would undermine enforcement, because enterprises may straddle several sectors and out-source parts of their work. It would also be challenging in terms of assessing appropriate NMW levels because of the paucity of adequate sectoral data, for example, on profitability and on the elasticity of demand for labour. A founding principle, to which the LPC has adhered, has been to keep the NMW simple and straightforward.

3.5 Procedures and staff resources

The LPC is a non-Departmental public body with a quasi-independent nature. The staff are employees of the Department for Business, Innovation and Skills (BIS). Although the LPC is independent, BIS has over-all responsibility for policy and has a service agreement with Her Majesty's Revenue and Customs (HMRC) for enforcement. The LPC has 7.6 full-time equivalent staff; BIS has approximately three full-time-equivalent staff largely committed to NMW work; and HMRC has about 120 staff committed to enforcement. The nine Commissioners are paid a *per diem* rate for time spent on meetings and visits.

3.6 Financial framework

The LPC is funded by BIS. Its additional budget for commissioned research is negotiated on an annual basis. The HMRC enforcement contract is also funded by BIS.

3.7 Legal framework

The legal basis of the NMW and LPC is the 1998 National Minimum Wage Act⁹. This was comparatively strong, certainly by comparison with previous wages council legislation. It has already been mentioned that the 1998 Act adopted a broad definition of eligible workers with regard, for example, to spurious self-employment. It placed the burden of proof of compliance with the NMW on employers, requiring them to retain documentary evidence of payment and of hours or working. It also threatened those in breach with prosecution as well as the reimbursement of unpaid wage entitlements. In addition to the basic legislation there have been many Supplementary Regulations announced by successive Secretaries of State over the years to cover loopholes, inadequate definitions, ambiguities, and new circumstances, as well as to tighten enforcement and indicate changes in the actual NMW. Examples of the great variety of these are: legitimate expenses for volunteers; when workers 'on call' are eligible for NMW; when interns are eligible; the definition of a non-eligible 'au pair'; treatment of tips; what happens to agricultural workers' pay when bad weather prevents work; how free accommodation should be taken into account; and the circumstances under which people with disabilities might be paid to engage in therapeutic work. These NMW rules are available through the GOV.UK¹⁰, and both the Confederation of British Industry (CBI), for employers, and the Trades Union Congress (TUC), for trade unions, have indicated that they consider the whole package of legislation to be relatively straight-forward and well understood.

The HMRC has a substantial operation enforcing the NMW. In responsive mode, it follows up all complaints of non-compliance made by individuals. In proactive mode it carries out risk-based enforcement in sectors or areas where there is judged to be a high probability of non-compliance. In recent years there have typically been about 50,000 enquiries per year on the telephone 'helpline'. Around 4,500 investigations have been initiated, with about 30 per cent upheld and about £4 million of arrears paid. In 2009 the government increased the retrospective compensation for underpaid workers by introducing Fair Arrears, linking it to the current and not the historic NMW. Financial penalties linked to the size of underpayment were introduced, at 50 per cent of the worker underpayment up to maximum of £5,000 per case. There have, however, been relatively few prosecutions and, despite increasing LPC pressure on this point, and by 2013 only one case of a business being publicly 'named and shamed'ⁱⁱ – despite a policy to name transgressing employers being introduced in 2011. The criteria for naming were revised in late 2013, so that all transgressing employers could be subject to naming. In addition, in early 2014 the government increased the penalty from 50 per cent to 100 per cent of the underpayment, and raised the maximum penalty payment from £5k to £20k per case. It also announced its intention to make fines applicable for each underpaid worker and not just each case of a breach.

It should be noted that the UK is internationally distinctive in having no official labour inspectorate to enforce individual employment rights. With the partial exception of health and safety issues, enforcement depends rather feebly on the willingness of aggrieved individuals (or their trade unions) to bring cases to Employment Tribunals. In 2004 the Gangmasters' Licensing Authority was established with powers to investigate labour standards of labour-only agencies but, even for those, only in the relatively small sectors of agriculture and shell-fish gathering. This context makes the strong enforcement of the NMW by the HMRC all the more remarkable.

⁹ Deakin, S. and Morris, G. S. (2012), *Labour Law – Sixth Edition*, 4.46 et seq, Oxford: Hart

¹⁰ <http://www.gov.uk/search?q=National+Minimum+Wage+Regulations>

3.8 Institutional framework

The LPC is, as has been mentioned, a quasi-independent, non-governmental body whose staff are BIS employees¹¹. The CBI and TUC are both involved in the appointment of Commissioners, whose terms of office are now three year contracts, renewable for a further three years. There has always been a senior official of both the CBI and the TUC among the Commissioners, three of whom are from employer and three from trade union backgrounds. Two of the independent Commissioners are academics with backgrounds in labour economics and industrial relations. An effort is made to ensure diversity across the Commissioners in terms of regional background, gender, public or private sector, and large or small enterprises. The first Chair had an academic background and his three successors had backgrounds immediately in finance but previously in an employer organisation, business and the civil service. The officials of the Commission have generally been recruited from and, in due course moved back into BIS and other Civil Service departments.

3.8.1 Lessons learned from previous policies and evaluations incorporated into the design of this measure

The only previous statutory wage measure in the UK had been the 1909 Trade Boards Act which provided the basis for statutory minimum wages, set by what were later called Wages Councils, for a restricted number of sectors. As has been noted, these were abolished in 1993, with the exception of the Agricultural Wages Board which was finally wound up in 2013, in part because its minimum rates were seen by the Government as eclipsed by the NMW. Lessons that might have been drawn from this experience were:

- Having fifty or more sector specific minimum wages did not in practice lead to their having substantially different levels and raised problems of sector definition
- Some of the more obvious areas of low pay were emerging outside the remit of the Wages Councils in 'new' sectors such as industrial security, fast food outlets and child care
- The credibility of minimum wages depended heavily upon effective enforcement. The Wages Council inspectorate was small and under-resourced. Compliance with rates was poor and penalties for breaching them were trivial
- Employers in sectors which had Wages Council experience often reported regretting their loss after abolition because they had provided generally accepted norms and external legitimacy for the (low) rates at which they paid their workers
- Wages Councils provided not only minimum rates for their sectors but additional protections such as basic wage structures with higher minima for skilled workers and overtime payment conditions
- Statistical data available on low pay in the late 1990s were poor

In the run-up to the 1997 General Election there had been a number of attempts to model the possible economic impact of minimum wages¹². Their predictions varied widely, depending upon the assumptions made about, for example, the level of the

¹¹ Metcalf, D. (1999a), 'The British National Minimum Wage', *British Journal of Industrial Relations*, 37:2; Metcalf, D. (1999b), 'The Low Pay Commission and the National Minimum Wage', *Economic Journal*, 109

¹² Fernie, S. and Metcalf, D. (1996), *Low Pay and Minimum Wages: the British Evidence*, LSE: Centre for Economic Performance

wage, the extent of knock-on effects of its introduction and increase, and the price elasticity of demand for the affected labour. Most predicted adverse employment effects.

Evidence from the UK's regular Workplace Employment Relations Survey (started in 1980 and repeated every seven years) provided valuable institutional background data for the LPC. It suggested, for example, that the low unionisation among the very low paid would mean that knock-on effects of a minimum wage to higher wage levels could be expected to be slight.

3.8.2 Intended future adaptations

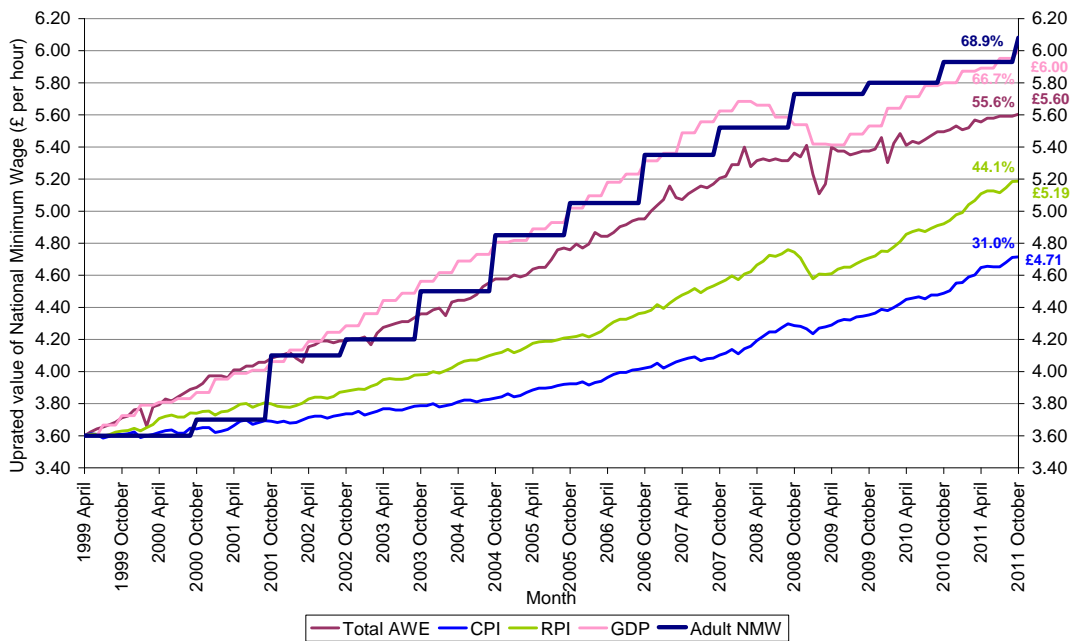
The LPC's role has required it to comment annually on ways in which the effectiveness of the NMW might be improved and there has been a steady stream of innovations to this end through fuller guidance. These have included, for example, the introduction of NMWs for 16-17 year olds and for apprenticeships; special arrangements for paid therapeutic work and for voluntary workers; and tighter definitions to protect home-workers and interns. Future adaptations can be expected as the nature of work and economy continues to change.

4. Results

4.1 Impact

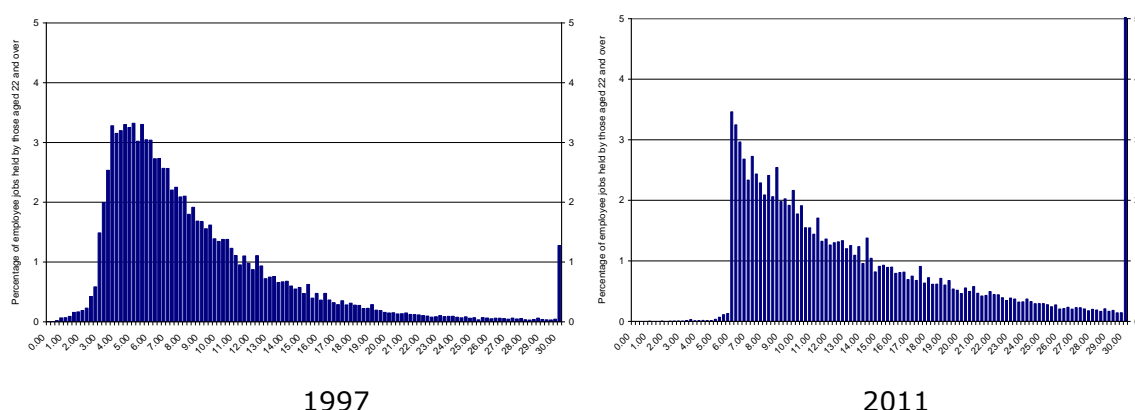
The progress of the NMW against average UK weekly earnings and two price indices is given in Chart 3. It was introduced in 1999 at a cautious level because the accuracy of pay data was uncertain and responses were unknown. For the first two years it barely kept up with prices and fell behind earnings. From 2001 until 2007 it increased faster than earnings. With the recession it slowed, increasing at times slower than prices but broadly in line with average earnings. Some numerical details are provided in the Appendix.

Chart 3 Increases in the NMW and in average earnings and prices, 1999-2011



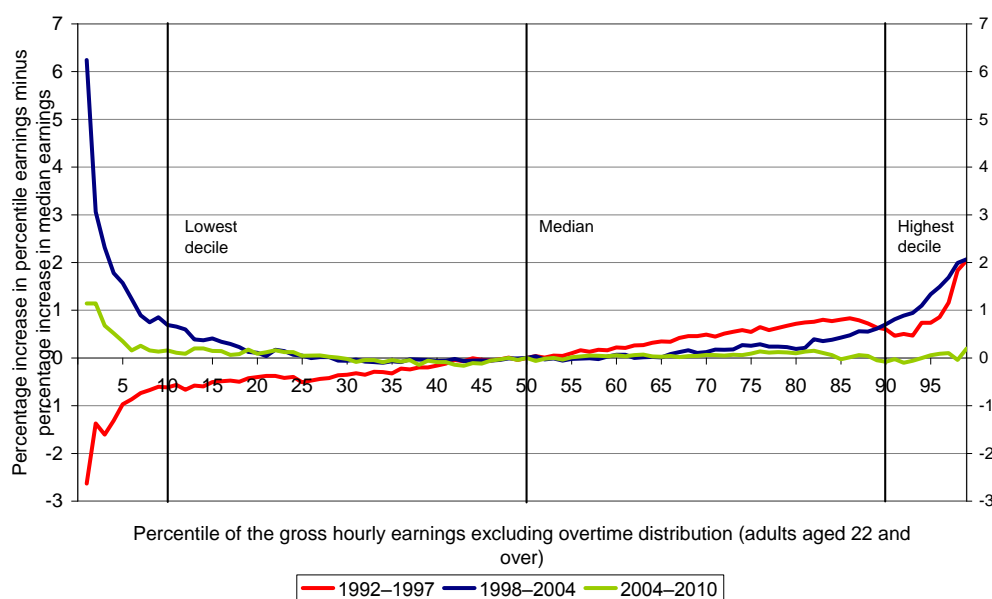
The impact on the national income distribution was substantial. Chart 4 indicates how the left hand side of the distribution was compressed between 1997, before the NMW was announced at £3.60 per hour, and 2011 when it had risen to £5.93 per hour.

Chart 4 Distribution of gross hourly earnings excluding overtime in 1997 and in 2011



Another way of indicating the impact of the NMW is in Chart 5, which indicates the extent to which the pay of different percentiles differed from the median for three periods: the five year lead-up to the NMW in red (as already shown in Chart 1); the five year period following its introduction in blue; and the subsequent five years in green.

Chart 5 Increases in gross hourly earnings by percentile of the national income distribution, 1992-1997, 1998-2004, and 2004-2010



As has been noted, the NMW was introduced at a time when the whole income distribution was widening. Its introduction can be seen to be associated with a dramatic change for the bottom 5 per cent. But the knock-on effects did not extend beyond the bottom 20 per cent. In the longer run, from 2004 to 2010, pay increases were close to the median all the way up the distribution, except that the bottom 5 per cent appeared still to be doing relatively better, presumably because of the NMW.

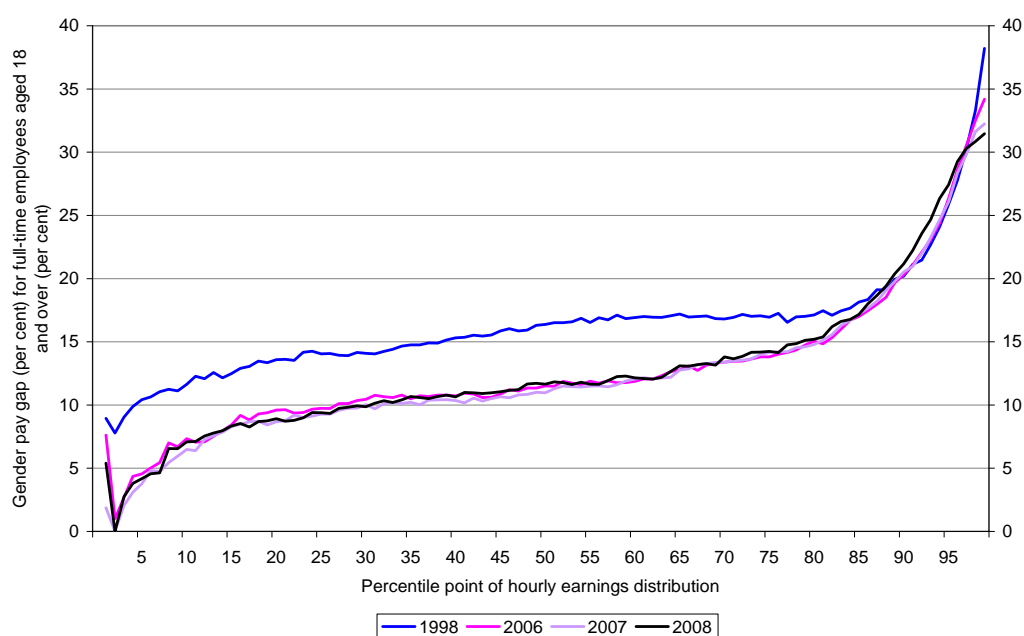
The introduction of the NMW has also had a substantial indirect effect, with a number of collective bargaining and other institutions following it in terms of both the size of pay rises and their timing. Although around 5 per cent of employees have typically benefited directly from increases in the NMW since it became established, perhaps 10 per cent of employees have benefited from it less directly. This was suggested by the

fact that, in the one year (2002) when the increase was less than that of average earnings, a substantial number of workers paid just above NMW also experienced below average increases. The 'bite' of the NMW, expressed as a percentage of the median, has increased from 46 per cent in 1999 to 53 per cent in 2012.

Estimation of the longer term impact of the NMW is unavoidably speculative because of uncertainties about what would have happened in its absence. It is not clear how far the relative decline in low pay that was under way before its introduction would have continued. We can only speculate on the effect of the wave of immigration of the early 2000s and after the extension of the EU after 2004. It was the largest ever experienced in the UK and led to downward pressure on low pay, but the NMW undoubtedly acted as a floor¹³.

The NMW was initially substantially more beneficial to women than men; initially two-thirds of those affected were women, and two-thirds of those women were part-time workers. As a result it had substantially contributed to diminishing the pay gap between men and women that occurred between 1998 and 2006. Chart 6 illustrates this.

Chart 6 Gender pay gap – difference between male and female earning by percentiles - 1998-2008



There has been extensive research on the impact of the increases in earnings arising from the NMW on different economic variables, much of it commissioned by the LPC. The LPC considered that the highest quality of evidence available was essential for its work and for the credibility of its recommendations. This has been summarised in successive reports and elsewhere¹⁴.

Two further aspects of the pay-related research deserve note. First, there is the question of how far the NMW constrained the managerial use of pay structures. There

¹³ Dustman, C., Fabbri, F. and Preston, I. (2005), 'The impact of immigration on the British labour market', *Economic Journal*, 115

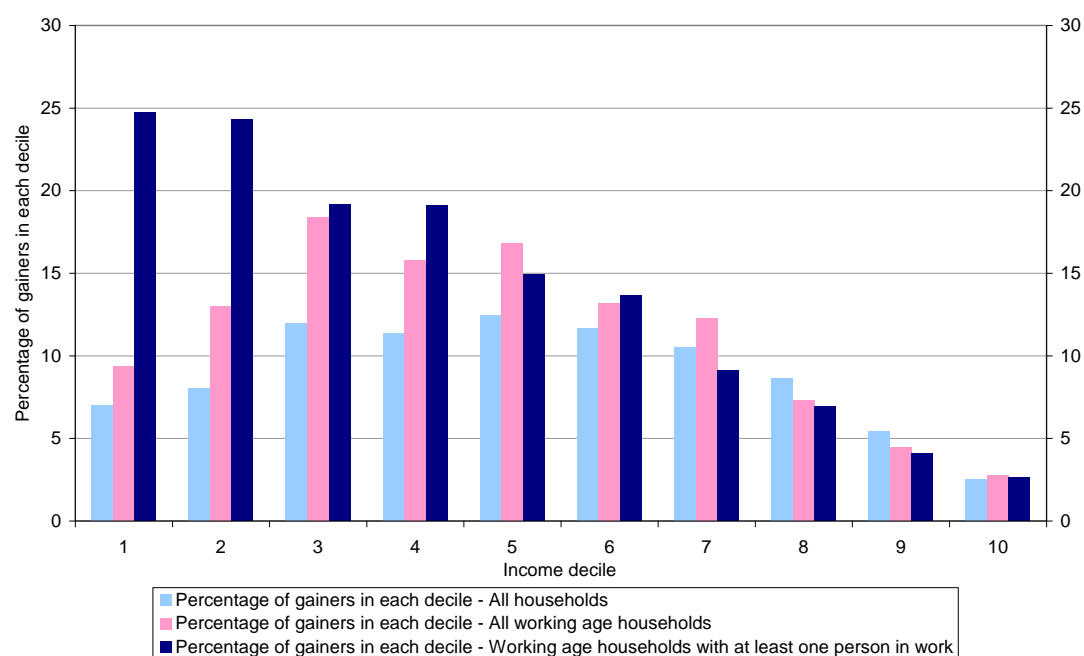
¹⁴ Metcalf, D. (2008), 'Why has the British National Minimum Wage had little or no impact on employment?', *Journal of Industrial Relations*
Butcher, T. and Metcalf, D. (forthcoming), 'The process and impact of the British National Minimum Wage', *Industrial Relations Journal*. Low Pay Commission, Reports (various)

is evidence that pay differentials have been compressed at lower levels by, for example, removing some lower pay grades. For example, there has sometimes been a reduction in the gradations of chefs and assistants in the kitchens of larger restaurants. But enterprises appear to have adjusted to this.

Second, there is the impact of the NMW on poverty. The LPC commissioned some modelling of this but summary conclusions are made difficult by the complexity of interactions with the tax and benefit system. An example may help. In 2012, an adult working a 35 hour week on the minimum wage would have had a gross weekly income of nearly £217 which, if it were a single person, would amount to a net income of £210 after tax. But if that person had a partner who was not working and two young children, their net income with benefits would be £395. The 12p per hour increase in the NMW that the worker would have received in 2013 would have raised the single person's net pay by £6 for the week, but that of the worker with a family by £8. Viewed from another perspective, the savings to the state have been substantial. The LPC estimates that, from that 12p increase in the NMW in 2013, the exchequer would gain around £183 million a year. Three fifths of this saving would be from increased tax receipts and two fifths from reduced in-work and other benefits¹⁵. The NMW has become a prerequisite for the effective functioning of the in-work benefits system.

If we look beyond individual earnings, it is possible to see how the NMW has affected earnings in households. Evidence from Treasury data shown in Chart 7 gives the percentage of households benefiting from the NMW, across the household income distribution, by household characteristic. It suggests that, among working-age households with at least one person at work, it has been the poorer households which have benefitted more.

Chart 7 Households benefiting from the NMW (HMT estimates)



Butcher, T., 2012. Still Evidence-based? The Role of Policy Evaluation in Recession and Beyond: The Case of the National Minimum Wage. National Institute Economic Review. 219, pp. R26-R40. January.

¹⁵ Low Pay Commission (2013), *op cit*, 169

A very substantial body of research has found minimal adverse employment consequences of the NMW¹⁶. The share of total employment in low paying sectors was no different in 2011 (at 32 per cent) than it was in 1999. A number of studies have failed to detect any adverse impact upon employment – using time series analyses of individual industries, case studies, and whole economy data. There is no evidence that employment probabilities have been diminished for those affected by the NMW as opposed to those being paid just above it. There is some evidence that hours of work have been reduced. There is also some evidence that, when the NMW was introduced, job growth may have been slightly slower in sectors with more workers affected, but the effects were small¹⁷. Vulnerable groups such as ethnic minorities and those with disabilities have generally done better than average in employment terms since the NMW was introduced and through the recession, with the exception of teenagers and those with no qualifications.

There is some evidence of the NMW having had a positive effect on labour productivity, but it is weak. Some increased labour costs may have been absorbed through a small reduction in hours worked. There is no clear evidence that the NMW has encouraged training. There may have been a small squeeze in profits in some sectors but this has not been associated with an increase in business failure. In some sectors not exposed to overseas competition there is some evidence of small initial consumer price increases, but there has been no general inflationary effect.

4.2 Goal achievement

In 2011, the National Minimum Wage was judged to be 'the most successful policy of the past 30 years' in a poll of members of the Political Studies Association conducted with the Institute for Government¹⁸. There is widespread awareness of the existence of the NMW. There is no significant pressure for its removal or for a change in the way it is fixed. It has so far achieved the goals of having a substantial effect in setting a floor for low pay while having no significant adverse consequences in terms of employment, inflation, or competitiveness.

How comprehensive the effective coverage of the NMW is cannot be calculated. Although enforcement by HMRC appears to be vigorous and ingenious, there are likely to be exceptions among undocumented immigrants and in the 'black economy' of cash-in-hand payment and barter beyond the reach of HMRC. There are no data on whether the NMW has affected the size of the 'black economy' but anecdotal evidence suggests that it would not have been a substantial factor.

4.3 Reflections and improvements

The design and implementation of the NMW has been subject to constant review and improvement by the LPC. The government has accepted all the LPC's substantial adult rate. The thinking of the LPC continues to be shaped by the experience of managing and researching the NMW and interacting regularly with those for whom it is an everyday reality. An example is what might be termed the dynamic interaction between minimum wages and the management of labour. Early field trips made it clear that bad employers often used low pay rather than good management as a means of remaining competitive. The productivity of labour is highly dependent on how well it is managed, motivated, trained and equipped. The minimum wage is likely to be having a gradual effect of promoting improved labour management and productivity and in shifting market share to better managed firms. But such

¹⁶ <http://www.revenuebenefits.org.uk/national-minimum-wage/policy/research-and-studies/>

¹⁷ <http://164.36.50.178/lowpay/research/pdf/t0Z2NTSH.pdf>

¹⁸ <http://www.instituteforgovernment.org.uk/our-work/better-policy-making/policy-successes>

adjustment can only be gradual, which was one reason for the LPC's cautious approach to increasing the 'bite' of the NMW over the years from 2002 to 2008.

There is a debate in some circles as to whether there should be regional differentiation in the NMW. There is a quite different debate elsewhere as to whether there should be sectoral differentiation. To some extent these debates have been encouraged with the growth in attention given to what is called the 'Living Wage' (and its London counterpart). These are voluntary rates set by a charity, the Living Wage Foundation, part of Citizens UK. They currently stand at, respectively, £7.65 and £8.80 (compared to the statutory NMW of £6.31). They are fixed according to a committee's estimate of employee 'need' – quite distinct from the LPC's estimate of what can be afforded by employers without job loss. For the reasons given, the LPC has not engaged publicly in these debates.

5. Difficulties and constraints

- **Pay data** – At the time when the NMW was being designed there were two sources of national pay survey data. One was a multi-purpose rolling ‘doorstep’ survey of individual citizens, the Labour Force Survey (LFS). This proved to be unreliable as a source of information both on what people earned and on the number of hours they worked. It tended to underestimate hourly wages. The other, the annual New Earnings Survey (NES), used employer data, but was defective in omitting workers who were not earning enough to trigger income tax payments. These were typically the very low wage, part-time workers for whom the NMW was being designed. It tended to overestimate hourly wages. These biases mattered; at the relevant part of the income distribution, 10 pence difference encompassed around a quarter of a million employees. The scale of the problem emerged after the LPC’s initial recommendation and was part of what lay behind its early caution. The Office of National Statistics responded robustly by replacing the NES in 2004 with the Annual Survey of Hours and Earnings (ASHE). This increased the coverage of the survey and dealt with missing data by imputation and weighting. It is considered to be reasonably reliable.
- **The young workers’ NMW** – The most difficult internal disagreement that the Commission had to deal with was whether there should be a separate minimum wage for young workers. The Commissioners from trade union backgrounds felt strongly that there should be a single rate and no discrimination on grounds of age. Although Commissioners were not mandated, some trade union conferences had passed strong resolutions to this effect. The problem was dealt with initially by the recommendation that such a rate should be a ‘Development Rate’ with the implication that young people receiving it should be receiving training from their employers. Reconciliation to a lower NMW for young people was later made easier by the accumulation of research demonstrating (i) that young people’s pay is on average substantially lower than that for workers aged 21 and older, (ii) that a major reason for this is that young people’s careers typically progress through lower paying sectors into higher paying sectors, and (iii) that young people are not only exceptionally vulnerable to job loss in a down-turn, but also (iv) that such job loss has a disproportionate ‘scarring’ effect on their later earnings. Having been introduced at the equivalent of 83 per cent and 62 per cent of the NMW, in the face of deep recession in 2012 the youth rates were frozen and in 2013 had fallen to 80 per cent and 59 per cent of the adult rate of the NMW.
- **Unreachable fringe employment** – homeworkers, immigrants and interns – A substantial part of the workforce, of which these are three examples, remains remote from the NMW. At least a million employees in the UK work from home. While some of these are relatively well-paid professionals, the great majority are not. They typically do piecework at very low rates of pay, often confined to home by caring needs, religious constraints, or ill health. The LPC engaged with them early on through the pressure group National Group on Homeworking. Attempts to ensure that piecework prices could be linked to the NMW through legitimate work study techniques proved impossible, partly because of the shortage of trained work study engineers. Another difficult group is undocumented (‘illegal’) immigrant labour – of whom it is estimated there are around half a million. They are highly vulnerable to intimidation and usually reluctant to seek help. Although the Gangmasters’ Licensing Authority has made some progress this is only within the agriculture/food production and

shellfish gathering industries. The number of people engaged in unpaid internships is smaller, but open to abuse, especially in recession, and hard to monitor.

- **The recession** – The LPC was aware that the NMW had the good fortune to be born in a period of sustained economic growth. Commissioners were anxious lest the NMW would be undermined by a downturn. Well before the 2008 recession started, research was commissioned on the employment and other experience of the low paid in previous recessions. As Chart 3 and the table in the Appendix show, the onset of the recession was met by more cautious recommended increases, broadly matching average earnings but falling short of price increases. As a result, although the NMW has fallen in real terms, its ‘bite’ has been increased relative to average earnings. So far there is no evidence of adverse employment consequences triggered by the recession.
- **Change of government** – The NMW had been perhaps the most controversial proposal in the Labour Party manifesto in the 1997 General Election. Given the strong opposition of the Conservative Party at that time, there was an early concern that a change of government might result in its abolition. In practice the NMW was quickly accepted as a benign policy measure without apparent adverse consequences, and accepted as such by politicians across the spectrum. When Labour lost office in 2010, the Conservative/Liberal Democrat Coalition did not question either the NMW or the role and membership of the LPC. They saw it as part of a strategy of ‘making work pay’ aimed at reducing the number of people relying on both in-work and out-of-work benefits. By 2014, leading members of the Government were publicly talking of the need for the NMW to be raised in real terms.

6. Success factors and transferability

A number of factors contributed to what has generally been judged to be the success of the NMW:

- **Legal framework** - The 1998 Act was strong in terms of the definitions it used of eligible workers and the sanctions it provided against non-payment of the NMW. It has been constantly refreshed with Supplementary Regulations in the light of the LPC's research and advice.
- **Enforcement** - The HMRC has proved to be an experienced and energetic enforcer. It has long experience of identifying errant enterprises and is widely respected. Penalties and a system of Fair Arrears have been introduced, alongside a scheme for 'naming' errant employers. Both have been strengthened recently.
- **Caution** - The LPC's early caution in setting the level of the NMW, partly a consequence of the initial inadequacy of the pay data, proved important in winning trust as the NMW was defined and launched.
- **Consultative process** - Considerable resources were devoted to formal and informal consultation with those affected by the NMW. They were encouraged, where appropriate, to submit written evidence. Formal hearings provided an opportunity for interest group leaders to demonstrate to members their involvement in the process. Small businesses were surveyed at frequent intervals – although the response rate was low, it was appreciated by their organisations and produced some interesting individual responses.
- **Extensive visits and fieldwork** - Visits to affected organisations throughout the country were appreciated especially by small businesses. They were able to be more candid on their home ground. Visits were invaluable to Commissioners as a way of discovering underlying issues behind particular NMW problems and in adding to the authority of the LPC's work. They also played an important part in building the identity of the Commission and its support staff and a further forum for the development of their thinking.
- **Replacing NES with ASHE** - A reliable basis of pay statistics was essential for the work of the LPC. Once the deficiencies of the LFS and NES had been established, it was important that the ONS was able to produce the new ASHE relatively quickly.
- **Use of high quality research** - The credibility of the NMW depended to a large extent on its evidence base being placed beyond criticism by any who had relevant expertise. This included Treasury and other government officials, employer and trade union researchers, pressure group activists, and the academic community. The LPC was able to get a wide range of authorities to undertake specialist research commissions, and did so generally with an open tendering process. They included the leading remuneration consultancies, charities with unique data access such as Low Pay Units and Citizens' Advice Bureaux, and a broad range of economists and social scientists, many with international reputations. Much of this work was later to pass through rigorous refereeing processes and was independently published in top international journals.
- **Independent and 'social partnership' model of LPC** - It was essential that all LPC decisions were unanimous. Achieving that sometimes took time, further research and patience. The Commissioners were appointed in their personal capacity and were not mandated. They showed themselves willing to be persuaded by evidence and argument. Discussions of the recommendations were in strict confidence and without minutes of those decision meetings.

Commissioners protected the independence of the LPC and reacted strongly against any inappropriate attempts to influence their decisions. This general way of working was maintained despite the fact that there was a regular turnover of individual Commissioners; it became a feature of the institution and not just of the individuals on it at any particular time. The 'social partnership' aspect of the LPC was essential to maintaining the support of outside employer organisations and trade unions.

Annexes

Increases in the UK National Minimum Wage, Average Earnings and Prices

Date of NMW increase	NMW adult rate per hour (workers aged 22+)	Increase in NMW since previous setting	Increase in average earnings index since previous setting	Increase in retail price index since previous setting
	£	%	%	%
1 Apr 1999	3.60	-	-	-
1 Oct 2000	3.70	2.8	3.1	2.7
1 Oct 2001	4.10	10.8	4.3	2.3
1 Oct 2002	4.20	2.4	3.7	2.3
1 Oct 2003	4.50	7.1	3.6	2.7
1 Oct 2004	4.85	7.8	4.2	2.1
1 Oct 2005	5.05	4.1	3.7	2.3
1 Oct 2006	5.35	5.9	4.0	3.7
1 Oct 2007	5.52	3.2	4.0	4.2
1 Oct 2008	5.73	3.8	3.2	2.7
1 Oct 2009	5.80	1.2	1.7	1.9
1 Oct 2010	5.93	2.2	2.2	4.6
1 Oct 2011	6.08	2.5	2.6	5.4
1 Oct 2012	6.19	1.8	1.4	3.1
1 Oct 2013	6.31	1.9	0.8	2.7

ⁱ Brown, W. (2009), 'The process of fixing the British National Minimum Wage, 1997-2007', *British Journal of Industrial Relations*, June, 47:2.

ⁱⁱ Low Pay Commission (2013) *op cit*