THE LOW PAY COMMISSION AND THE NATIONAL MINIMUM WAGE*

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Great Britain has had statutory regulation of minimum pay for most of this century but never previously had a national minimum wage (NMW). This paper outlines the history of minimum wage regulation culminating in 1997 with the establishment of the Low Pay Commission (LPC). The three key debates within the LPC are analysed, namely the definition of the wage, what to do about youngsters, and the level to set the NMW. The impact of the NMW on the pay distribution, employment, family incomes and exchequer finances is set out. The paper concludes that the LPC is a fine example of successful social partnership.

The tendency of our wage-system is to always drive down the price of their labour to the lowest level of life liveable. What is to be the remedy? A plimsoll line for labour as well as for ships; a line to limit the extent of peril and suffering to which a worker is to be liable.

Harold Spender, preface to Phillip Snowden, The Living Wage, 1912.

Almost a century after Spender's plea, and one year before the millennium, this labour market plimsoll line will finally be introduced. A National Minimum Wage (NMW) of £3.60 an hour for those aged 22+ is to be paid from April 1999 with a lower rate for those aged 18–21. This paper describes the work of the Low Pay Commission (LPC) which recommended the NMW and assesses the probable impact of the minimum wage.

A brief history of minimum wage regulation is presented in Section 1, followed in Section 2 by a discussion of the LPC as an institution and its process of operation. The pattern of low pay is set out in Section 3. The major debates within the LPC concerned how the NMW should be defined, the rate itself and what to do about youngsters; these issues are discussed in Sections 4–6 respectively. Section 7 analyses the likely impact of the NMW on the distribution of pay, employment, family income and the public finances. Concluding remarks on the success of this experiment in social partnership are given in Section 8.

Space considerations rule out discussion of some very important issues. In particular there is little analysis on the detailed impact on particular sectors such as retailing, hospitality and business services (this is dealt with in a companion paper, Metcalf (1998)). Implementation and enforcement are also

^{*} I am a member of the Low Pay Commission and have drawn freely on our first report (LPC 1998) in preparing this article. I wish to acknowledge the contribution of my fellow Commissioners and the LPC Secretariat whose ideas and research are reported here. But I alone am responsible for matters of interpretation in this piece. This paper is based on a presentation at British Universities Industrial Relations Association, Keele University, 3 July 1998. I am grateful for participants' comments. In addition, I acknowledge, with thanks, advice and comments from the anonymous referee, Charlie Bean, Sue Fernie, Paul Gregg, Amanda Gosling, Kirstine Hansen, Stephen Machin, Alan Manning and, specially, Richard Dickens.

neglected, partly because enforcement matters are outside the terms of reference of the LPC.

1. History of Minimum Wage Regulation

Great Britain has had statutory regulation of some wages for almost all this century. In the early part of the nineteenth century the wage fixing powers of local magistrates were abolished and until the 1880s there were no attempts at statutory regulation, but then concern grew over the plight of the low paid in the sweated trades such as clothing and textile manufacturing. The debates then, as now, turned on the degree to which the state should intervene in the labour market.

A Select Committee on the Sweated Trades opposed legal regulation of wages in its 1890 report but recommended a system of Fair Wage Resolutions (FWR) for employers engaged on public contracts. After authoritative data became available on the extent and depth of low pay a further report by the Select Committee on Home Work in 1908 led to the establishment of Trade Boards in specific industries (The LPC (1998) appendix 5, provides fuller details of the history of minimum wage regulation).

The 1891 FWR attempted to eliminate unfair competition for public sector contracts based on undercutting pay: it ensured 'recognised' rates of pay and terms and conditions of employment established by collective agreements. This protection for workers on government contracts was extended in 1946 such that the fair wage claim could be based on the 'general' level in the area rather than on the recognised minimum pay set by collective bargaining. The principle of the FWR was also spread to safeguard other private sector employees, initially in the 1940s and 1950s using the recognised rates under collective bargaining, and later in the 1970s under the general level mechanism. This whole apparatus of protection was axed via legislation passed in 1980 and 1983 (for more details on the development and impact of FWRs see Metcalf 1981, chapter 5).

Four Trade Boards (later called Wage Councils) in manufacturing were set up under the 1909 Trade Boards Act. These Boards set minimum pay rates and were made up of equal numbers of employers' and workers' representatives and an odd number of independent members. The long term aim was that the Boards would be replaced by voluntary collective bargaining – this original purpose of providing surrogate collective agreements remained uppermost until the 1980s. By 1953 the number of Wage Councils had increased to 66 covering 3.5 million workers in sectors like retail distribution, catering and hotels, clothing, laundries and road haulage. A further 0.4 million workers came under the separate Agricultural Wages Boards. The coverage and scope of the Wages Councils was reduced in the 1970s and 1980s and then they were simply abolished in 1993, when they covered some 2.5 million workers.

Both the union movement and the Labour party supported the Wages Council system of setting minimum wages, and were generally hostile to a statutory NMW, because they aspired to replacing the Councils by collective bargaining. But the advent of the Conservative government in 1979 stymied any such extension of collective bargaining. During the 1980s the Wage Councils' 'bite' – their pay rates relative to average pay – weakened, under 21 year olds were removed from coverage and inspection and enforcement efforts ground to a halt. Led by Rodney Bickerstaffe from (as it then was) the National Union of Public Employees – so ably supported by Chris Pond from the Low Pay Unit pressure group – first the TUC (in 1985) and then the Labour Party (in 1986) embraced the NMW. The election of the Labour government in May 1997 was followed within two months by the establishment of the Low Pay Commission. Its first report (LPC, 1998) forms the basis for the NMW which will be introduced in 1999.

2. Low Pay Commission

The LPC was established in July 1997. Its chair is George Bain, Vice Chancellor of Queens University. The nine Commissioners represent the interests of unions and employees, employers and the academic community but sit as individuals not delegates. The appointment process was one of the first under the new Nolan open government procedures. The civil service secretariat was deliberately kept small, fewer than a dozen professional employees plus associated support staff.

The Commission's terms of reference are:

- To recommend the initial level at which the NMW might be introduced
- To make recommendations on lower rates or exemptions for those aged 16–25
- To consider and report on any matters referred by ministers

In making recommendations the LPC must 'have regard to: wider economic and social implications; the likely effect on employment and inflation; the impact on competitiveness of business, particularly small firms; and the potential impact on costs to industry and the Exchequer'. There was considerable debate in government and Whitehall over these terms of reference particularly surrounding the merits or otherwise of exemptions, amusingly captured by the *Guardian's* pocket cartoon by Austin (14 November 1997) where one civil servant or politician says to another: 'The idea is to exclude the low wage sector.'

From the outset the LPC engaged in an open consultation process. Evidence was invited from nearly 600 employer organisations, trade associations, unions, voluntary organisations, pressure groups and academics. Written evidence was received from around 500 organisations and formal oral evidence was taken from 47 representative groups of employers, unions and pressure groups. Finally, the LPC visited 61 cities, towns and villages across the United Kingdom. These provided the opportunity to meet representative organisations and interested individuals at local level. The meetings – over 200 – were informal to encourage frank and open discussion.

George Bain stated early on that he wished to achieve a unanimous report which would also be acceptable to the government. It is a tribute to his magisterial conciliation and mediation that the report was unanimous and the government accepted virtually all of the recommendations: the LPC is a model example of social partnership.

The main recommendations of the LPC were:

- a NMW of £3.60 for those aged 21+ from April 1999
- a development rate of $\pounds 3.20$ for those aged 18-20
- the development rate of £3.20 also to be applied for a period of up to 6 months to those aged 21+ who are on a *bona fide* training course.

There were a further 21 recommendations concerning, for example, the definition of earnings, treatment of apprenticeships, and compliance procedures. The following groups are excluded from coverage: the self-employed, those aged 16 and 17 and those on apprenticeships.

The government accepted the recommended adult rate. But it decided that the youth rate should be £3.00 (rising to £3.20 in 2000) and should apply to those aged 18–21 inclusive, rather than 18–20 as the LPC recommended. Cost and coverage estimates are reported below for both the Commissions recommendations (LPC) and for the governments decisions (HMG).

3. Pattern of Low Pay

Some characteristics of individuals and workplaces prone to low pay are set out in Table 1. The data source is the autumn 1997 Labour Force Survey (LFS) and the low pay benchmark is arbitrarily set at £3.50. The first column reports the incidence of low pay – the percentage of the given group earning under £3.50. The distribution of low pay is given in the second column. Thus the incidence of low pay is far higher among 18–20 year olds (41%) than those aged 21+(10%) but those aged 21+ account for 82% of all people earning under £3.50 whereas those aged 18-20 comprise only 18% below that benchmark.

The incidence of low pay is higher for females, manuals, youths, non-whites, part-timers, disabled workers and lone parents than it is for their counterparts with opposite characteristics. It is specially noteworthy that a quarter of part-timers earn below $\pounds 3.50$ and they account for over half of all those paid under that figure. Similarly females have more than double the chance of being low paid than males, and they account for two thirds of all the low paid. One third of home workers (not shown in Table 1) are low paid but they represent only 5% of all those who are low paid.

The incidence of low pay is far higher among workers in the private than the public sector, among those in workplaces with no union recognition than where unions are recognised and in smaller rather than larger workplaces. According to the New Earning Survey (NES) which permits greater disaggregation by industry than the LFS, eight sectors account for the bulk of low paid workers:

Sector	Employees (Millions)	% earning below £3.50
Retail	2.30	14
Hospitality	2.50	35
Hairdressing	0.08	43
Contract cleaning	0.43	34
Security	0.16	20
Residential care	0.55	32
Textiles	0.36	11
Agriculture	0.26	10

Retail and hospitality alone account for some two-fifths of all low paid employees and the incidence of low pay is especially high in hospitality, hairdressing, contract cleaning and residential care.

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Characteristic of employees	Incidence: percentage of people with these characteristics who earn less than £3.50	Distribution: percentage of all people who earn less than £3.50 who have these characteristics
Personal		
Female Male Manual Non-manual Age 18–20 Age 21+ Non-white White Part-time Full-time Lone parent Not lone parent	$ \begin{array}{r} 16 \\ 7 \\ 18 \\ 7 \\ 41 \\ 10 \\ 13 \\ 11 \\ 25 \\ 7 \\ 19 \\ 11 \\ 11 \\ 11 \\ 11 \\ 11 \\ 11 \\ 11 \\ 11 \\ 11 \\ 11 \\ 12 \\ 7 \\ 19 \\ 11 \\ $	$66 \\ 34 \\ 62 \\ 38 \\ 18 \\ 82 \\ 5 \\ 95 \\ 52 \\ 48 \\ 7 \\ 93$
Workplace		
Private Public Voluntary sector Non-union recognition With union recognition Hospitality Retail and wholesale Health and social work Manufacturing Under 25 employees 25+ Employees	$ \begin{array}{r} 14 \\ 5 \\ 14 \\ 17 \\ 4 \\ 40 \\ 19 \\ 13 \\ 7 \\ 20 \\ 7 \\ 7 \end{array} $	84 12 3 83 17 15 26 13 12 58 42
All	11	100

Table 1Pattern of Low Pay, autumn 1997

Source: LPC (1998) tables 3.1, 3.2; from LFS Autumn 1997. Note: May slightly overstate low pay, see LPC (1998) appendix 2.

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4. Definition of the NMW

It is all very well recommending a NMW of £3.60 per hour, but how is it defined? There are three main issues here (see LPC (1998) chapter 4). First, which components of the wage count towards the NMW? Second, which hours are to be paid at the NMW? Third, what is the pay reference period for the NMW calculation? These will be considered in turn. The debates within the LPC on these thorny problems of definition were not really matters of principle. It was more a question of reaching a pragmatic, workable, easily understood definition which would deal with home workers, payments by results, tips, sleepers in care houses and others who live in, share fishermen and so forth.

The LPC adopted a hybrid definition of pay which includes certain components but not others. Essentially the definition includes all pay for standard working but excludes additional or premium payments. Thus the following components are included:

- bonuses, profit-related pay, merit pay and productivity payments
- piece rates
- sales commission
- tips and gratuities paid to the worker via the employer
- free accommodation (only up to £20 a week)

By contrast these components do not count towards the NMW:

- overtime or shift premia and call-out pay
- special allowances for working in dangerous or unpleasant working conditions (*eg* working at heights or in water), standby and on-call allowances
- London weighting and other location allowances
- pension and life assurance contributions paid by employers
- subsidised or free meals
- staff discounts
- cash tips paid direct to a worker by a customer

This hybrid definition seems fair to both employers and employees. If the NMW was limited to basic rates it would have been unfair to employers because it would undermine pay for performance practices. Equally, if the NMW were to include all earnings it would be unfair to workers because special allowances like overtime or shift premia are, by their nature, paid for non-standard working. In fact, few low paid workers receive such allowances. The LFS does not collect information on the components of pay, but the NES – which misses a large proportion of low paid work – indicates that in April 1997 (the latest available data) of those earning below £3.50 per hour, only 2% received shift pay, 3% received profit related pay, 4% received incentive payments related to output and 17% received overtime pay. For the minority of low paid workers who receive additions to their basic pay, however, such payments can make an important contribution to overall earnings (see LPC (1998) paras 4.8–4.12 for further detail).

Hours which count towards the NMW are actual working time including overtime hours and any downtime when a worker is present at work but unable to work through no fault of their own. But other time for which the employee is paid (*eg* unauthorised absences, holidays *etc*) are not covered. This definition of working time is similar to that of the EU Working Time Directive – *i.e.* actual working time. The LPC believes that this is fair for both employers and workers because any time when a worker is required to be at work or available for work should count towards the NMW. But an employer should not have to pay the NMW for times when the employee is resting or absent. In some cases like sick pay other law covers these periods anyway.

The NMW is to be calculated over the worker's normal pay period up to a maximum of one month. This means that the average hourly payment calculated over the pay reference period of one month was felt to be long enough to cover most fluctuations in earnings. Indeed, the high labour turnover of low paid employees may have rendered any longer period unworkable.

It is worth setting out what these rules mean for the three large groups with 'non-standard' working practices: workers on payment-by-results, sleepers in care homes and hospitality employees receiving tips. Many low paid employees - including homeworkers - in clothing, footwear, textiles and horticulture are paid by piece rates. The employer can average the total earnings over the agreed reference period, so that periods of lower output can be compensated by periods of higher output. An employee cannot, however, earn less than the NMW averaged over the agreed pay reference period. The definition of hours for homeworkers in particular will be tricky. But employers will have to be able to demonstrate that they have evaluated piece rates paid to homeworkers: to confirm compliance with the NMW the homeworkers must be paid no less than the NMW on average for the pay reference period. The issue of staff who are required to sleep on the premises to cover the eventuality of emergencies is complicated. While such staff are not in the same position as those who are on standby or on-call at home, neither are they 'working' or available for work when they are asleep. If such staff are woken and required to work by their employer then they should receive the NMW for all such hours awake and available for work. There is nothing to stop employers continuing to pay an allowance to such staff, as they do now, for the inconvenience involved. In hospitality employers can include any tips or gratuities collected centrally and paid out by the employer through the payroll (such as service charge or 'tronc'). These payments are measurable and can be monitored. Payments made direct to a worker by a customer as a gift for good service are not and hence are excluded.

5. Choice of the NMW

The process of choosing the NMW was, not surprisingly, pretty fraught, but the main elements we considered in coming to our decision are quite straightforward. Naturally the LPC took seriously the written and oral evidence and discussions with interested parties on site visits around the country. In addi-

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tion, our 'triangulation exercise' examined the previous Wage Council rates, international evidence and the coverage and cost of various potential NMWs. These will be considered in turn.

Wage Councils were axed in 1993 (see LPC 1998 Appendix 5). Their rates at the time of abolition provide an example of statutory minimum rates which appear to have had no significant impact on employment (see Dickens et al. (1997) and Fernie and Metcalf (1996) for a summary of the evidence). Table 2 sets out the rates paid by the major Councils in 1993 and uprated by the AEI to March 1998. The employment-weighted uprated Council rate was, for me at least, an upper bound for the initial NMW. There are a number of reasons for this. First, the NMW will apply to all industries, rather than just Wage Council trades, and average pay in some previously uncovered sectors such as business services and care homes was lower than Council rates at the time of their abolition in 1993 and remains so presently (see LPC (1998) figure A2.1, Business Services Association (1997) and Cleaning and Support Services Association (1997)). Second, although 2.5 million people worked in Wage Council sectors, around 2 million were paid above the statutory minima; only some 0.3 million workers were paid at the council rates while the remaining 0.2 million were paid below, reflecting incomplete compliance with council rates. (This latter estimate of 0.2 million may be an overestimate of previous incomplete compliance but it is not possible to be certain because the data on Wage Council coverage is quite inaccurate due to a lack of detail in industry and occupational codings, so many of those reported as being below the minimum may not, in fact, have been covered). Third, the distribution of earnings has widened since 1993 partly, of course, as a consequence of abolition of the Councils. Hence a NMW set at the uprated Wage Council rate would have had a broader and deeper impact than the Council system at abolition.

	0		
Wages Councils (GB)	Employees covered (millions)	Rates at April 1993 (£ per hour)	Uprated by the AEI to March 1998 (£ per hour)
Clothing manufacture	0.118	2.72	3.32
Hairdressing	0.069	2.88	3.52
Licensed non-residential	0.538	3.01	3.68
Licensed residential & licensed restaurant	0.417	2.92	3.57
Retail food	0.490	3.18	3.88
Retail non-food	0.736	3.16	3.85
Unlicensed place of refreshment	0.110	2.92	3.57
Employment Weighted average		3.04	3.72

Table 2 Wages Council Rates

Sources: LPC (1998) Table 6.2.

Notes: Employee coverage taken from IDS Report 649, September 1993. The employment weighted average is calculated from figures for all Wages Councils, covering 2.5m people.

It is not simple to compare minimum rates across countries. Comparisons using three commonly used measures are given in Table 3, but as the notes to the Table emphasise the evidence is not precise. Cash amounts at purchasing power parity (PPP) show that minimum rates vary between £1.65 per hour in Portugal and £4.56 per hour in Belgium. But they are an unsatisfactory guide for assessing the impact on the labour market, given the variations in average earnings across countries. The LPC also considered minimum rates as a proportion of full-time median earnings. These ratios vary widely, between around 30% and just under 60% of full-time median pay, which in round terms equates to between $\pounds 2.30$ and $\pounds 4.60$ per hour in the United Kingdom in April 1997 (using NES data). This is also an imperfect comparative measure as differences in earnings distributions imply that the same ratio may have a different effect on the labour market in different countries. The chosen NMW deflated to mid 1997 (£3.30) is equivalent to 45% of median full-time adult pay (43% of NES, 47% of LFS). Thus the United Kingdom is firmly in the middle of the international NMWs reported in Table 3. OECD and related evidence (Dolado et al., 1996) on the fraction of workers paid at the NMW in different countries is also set out in Table 3 but this evidence is very tentative because it refers to different times and uses different methods of estimation.

	Minimum wages per hour at PPP, at Day 1007 (f)	Minimum wages as a percentage of full-time adult median earnings, mid 1007 (%)	Workers at the NMW or
	at Dec. 1997 (2)	IIIIu-1997 (70)	Delow(70)
Belgium	4.56	50	4
Canada	3.80	40	5
France	3.97	57	12
Japan	2.41	31	10
Netherlands	4.27	49	4
New Zealand	3.18	46	1
Portugal	1.65	_	5
Spain	2.10	32	2
United States	3.67	38	5

Table 3 International Minimum Rates

Source: OECD (1998) reported in LPC (1998) Table 6.3, Appendix 6; Dolado et al. (1996).

Notes:

(i) PPPs refer to purchasing power parities for final private consumption expenditure for December 1997.

(ii) Data for median earnings were collected in different periods and have been extrapolated to mid-1997.

(iii) Estimates of the percentage of the workforce on a country's minimum wage are indicative rather then precise. The figures are based on different survey data, sometimes using different methodology, across countries. The main source (Dolado *et al.*, 1996) refers to 1993, but has been updated by OECD for Netherlands (1994), France (1996), USA (1996) and Portugal (1997). The incidence of work paid at the minimum wage will fluctuate over time and across countries as a result of changes in the real value of the minimum wage and changes in the distribution of earnings.

In particular the percentages at the spike of the distribution will decline between upratings.

The coverage and cost of various potential NMW were also central to our deliberations. This included both detailed analysis for the main sectors covered and possible knock-on effects on wage differentials and inflation. The NMW suggested by UNISON, TGWU and the Low Pay Unit was £4.61, ostensibly half male median earnings. This figure was calculated from NES data on full-time workers only, even though the majority of beneficiaries of the NMW are part-time. Further, the calculation is disingenuous because the weekly earnings of full timers, including overtime pay, is divided by weekly hours excluding overtime. Had the LPC plumped for this figure nearly 5 million employees aged 21+(1-in-4) would have been affected. On the other hand the figure of £3.20 suggested by some employers would only have covered around 1 million employees or 5% of these aged 21 or over.

Some members of the LPC felt, partly on the basis of international evidence in Table 3, that a reasonable upper limit on coverage was around 10% of all employees. As the number of youngsters covered was likely to be relatively high this pointed to a coverage of some 8% for those aged 21+. This is precisely the fraction of such employees estimated to be covered by the chosen NMW in 1999. It should be noted that this estimate of coverage is calculated by taking the proposed April 1999 NMW and deflating it back two years to spring 1997, the latest time of available information on pay distribution from both NES and LFS. If some of the people earning just below the proposed minimum achieve earnings increases before the introduction of the NMW in April 1999 the spike in distribution will be somewhat smaller than the 8% figure (for adults) reported later in Table 5.

The cost of the NMW mattered too. The Monetary Policy Committee of the Bank of England (1998*a*) and the Treasury were certainly concerned that the direct cost of the NMW should be well under 1% of the national wage bill. The LPC was also seized of potential knock-on effects. The low level of private sector unionisation, only around 1-employee-in-5 is a union member, coupled with decentralised collective bargaining suggests that any reasonable NMW would be unlikely to have serious consequences for pay differentials and so would probably not fuel wage inflation.

This evidence pointed, for me anyway, to a NMW of around £3.60 – the rate that was chosen. It puts the United Kingdom in the middle range of coverage by international standards – higher than the United States but below that in France. The cost is only 0.6% of the national wage bill and even allowing for any restoration of differentials the total cost is unlikely to be over 1%. And the figure is comfortably within the uprated Wage Council rate.

6. Youths

The LPC terms of reference required us 'to make recommendations on lower rates or exemptions for those aged 16–25'. This matter took up a disproportionate amount of time. Leaving aside those aged 16 and 17, a cohort which

virtually everyone who gave evidence, and all Commissioners, believed should be exempt from the NMW, the issues turned on the age at which the adult rate should start, the level of any youth rate and how a lower youth rate dovetailed with any training rate.

In their written and verbal evidence most employers and unions leaned towards adult rates starting around age 18/19 coupled with a lower 'development' rate for those engaged in *bona fide* training. By contrast academic evidence (e.g. Dickens *et al.*, 1997) favoured lower youth rates up to around age 20–22. The government evidence (DTI 1998), strongly influenced by the Treasury, argued for a lower rate for younger workers, hinting that 25 might be a suitable age for the full rate to start. For example: 'within the UK people under the age of 25 are defined as young for the purposes of student support, social security payments and the New Deal'. Further 'it might, in practice, be difficult to draw up a workable definition of training capable of being both clearly understood and enforceable. Against this background, exemptions or lower rates based on age could provide the best proxy'. And 'it is crucial that the minimum wage is set at a level which does not restrict employment opportunities for those looking for work, particularly for young people' (paras 59, 62, 65).

The youth rate recommended, and the suggested age brackets, reflected compromise within the LPC. The recommendation was for a rate of £3.20 (almost 90% of the adult rate) to apply to those aged 18–20, and those aged 21+ on a validated training course for up to 6 months. It is probably true that, among the members of the LPC, I took the strongest line in favour of a lower youth rate and extending that rate up to around age 22/23. If I set out my own arguments this will give the flavour of the debates within the Commission. I consider pay levels and mobility, jobs and unemployment and family incomes.

Average earnings rise with age (see Fig. 1) and correspondingly, the incidence of low pay declines dramatically with age up to around age 26 (see Fig. 2).



Fig. 1. Mean and Lower Decile Hourly Earnings by Age Source: LFS Spring 1997



If 18–20 year olds were to be covered by the adult rate half that age group would have their pay directly affected and the total wage bill for those aged 18–20 would rise by nearly a tenth. Younger workers have lower pay than prime age workers for a number of reasons. Youngsters are on average less productive because they lack labour market experience. Youngsters also work disproportionately in sectors which, on average, pay lower wages. For example two-fifths of those aged 18–20 (and over half those aged 16–17) work in retailing and hospitality which are both relatively low paying sectors (LPC 1998 figure 5.8). This is one way they gain experience and move up the earnings ladder. It is interesting that in these sectors like retailing and hospitality, the age pay differential is much narrower than it is in higher paying sectors. Further, leaving aside students working part-time, those in work aged under 21 are probably not mainly from the top third in ability. By contrast, adults in work are drawn from all ability ranges.

Average wages reflect acquisition of skills and experience and better job matches over time. So the wages of individuals who were previously out of work (re-)entering the labour market are probably a better indicator of pure productivity. Average entry wages by age (LFS Spring 1997) were:

Age	18 - 20	21 - 25	26 +
Hourly pay (£)	3.60	4.80	6.70

This strongly suggests that younger workers are, on average, less productive. Younger workers are also much more likely to move up the pay distribution than older workers (OECD, 1997b). The worst that can now happen for youths is that they stay on the youth rate for a maximum of four years and then get the adult rate.

The second set of reasons for arguing in favour of a lower youth rate concerns jobs and unemployment. It is crucial to bear in mind that youths already have much higher unemployment rates than those aged 25+. Over the cycle the unemployment rate for those aged 18–19 is more than double the rate for those aged 25+. So, while it is true that the main cause of fluctuations in youth unemployment is movements in aggregate unemployment (with an elasticity of about 2), it is important not to set pay rates which might worsen the already high spot rate of youth unemployment. The need not to boost youth unemployment is compounded by the evidence that *ceteris paribus* a spell of unemployment when young worsens future labour market prospects. Unemployment damages future earnings growth by preventing younger workers acquiring skills and experience. It also raises the probability of future spells of unemployment and inactivity (see egLPC 1998 para 5.25 and Nickell *et al.*, 1985).

International evidence also points to adverse labour market consequences for younger workers if their minimum wage is set too high. In its evidence to the LPC the OECD (1997*b*) stated: 'Employment of young and inexperienced workers may be particularly vulnerable to a high level of the minimum wage. For that reason most countries set reduced rates for young workers, though the size of the youth differential varies greatly across countries'. And the authoritative OECD *Employment Outlook* for 1998 has a chapter on minimum wages which states: 'Whilst sometimes conflicting, the weight of the evidence suggests young workers may be the most vulnerable to job losses at a high level of the minimum wage'.

My own view is that the key international evidence concerns Spain (Dolado *et al.*, 1996). There was what amounted to a controlled experiment when youth minimum wages were raised, relative to the adult rate, in 1990. The evidence is unambiguous. The employment of those aged 20-24 rose and that of 16-19 fell. The authors conclude: 'the most plausible explanation [for those changes in employment] is substitution away from younger workers who had become relatively more expensive'.

The third reason for a lower youth rate is that any link between the NMW and family poverty is weaker for youths than for adults: the great majority of youngsters receiving the NMW live in families with two or more earners. Given that productivity and employment considerations pointed to a lower youth rate, if the adult rate had started at age 18 instead of age 22, it would, for me anyway, have had to be lower than $\pounds 3.60$ in order to accommodate youngsters. This, in turn, would have lessened the overall effect of the NMW on the household income distribution considered below.

In the event, the government did not accept the LPCs recommendations concerning youngsters. When introduced in April 1999 the rate will be ± 3.00 instead of the recommended ± 3.20 and the ages covered will be 18-21 inclusive instead of 18-20. Some in the government were concerned that the LPC recommendation was too high relative to corresponding median earnings. Its own proposals reduce the youth NMW from around three-quarters to around two-thirds of the median (Table 4) and cut the increase in the wage bill from 3.9% to 2.4% (Table 5).

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		Nati minimu	onal m wage £		Media	n pay £		NMW a	as fraction	n of med	lian pay
A	ge	Sprin equiv	g 1997 valent	N April	ES 1997	L Sprin	FS g 1997	N	ES	L	FS
LPC	HMG	LPC	HMG	LPC	HMG	LPC	HMG	LPC	HMG	LPC	HMG
18-20 21+	$18-21 \\ 22+$	2.90 3.30	$2.70 \\ 3.30$	$\begin{array}{c} 4.16 \\ 7.04 \end{array}$	4.34 7.11	$3.63 \\ 6.36$	$3.75 \\ 6.42$	$\begin{array}{c} 0.70\\ 0.47\end{array}$	$0.62 \\ 0.46$	$0.80 \\ 0.52$	$0.72 \\ 0.51$

 Table 4

 National Minimum Wage as Proportion of Median Pay

Notes:

(i) 1999 NMW (LPC: ± 3.20 for 18–20, ± 3.60 for 21+; HMG: ± 3.00 for 18–21, ± 3.60 for 22+) deflated by actual plus estimated movement in average earning index (9%) between Spring 1997 and Spring 1999.

(ii) NES and LFS median earnings refer to all employees (*ie* part time and full time) and include overtime and shift pay. For a discussion of the relative merits of LFS and NES see LPC (1998) appendix 2.

		Number (00	s affected)0s)	Proportio affect	n of group ed (%)	Increase bill	e in wage (%)	Average in those affe	ncrease for ected (%)
LPC	HMG	LPC	HMG	LPC	HMG	LPC	HMG	LPC	HMG
All 18+	All 18+	2,050	1,960	9	9	0.6	0.6	30	30
$18-20 \\ 21+$	$18-21 \\ 22+$	235 1,815	225 1,735	21 8	15 8	$3.9 \\ 0.6$	$\begin{array}{c} 2.4 \\ 0.6 \end{array}$	32 30	30 30
Male full- workers	time	320	295	3	3	0.3	0.3	36	-
Male part	-time	240	230	26	25	3.0	3.0	36	-
Female fu	ıll-time	340	320	5	5	0.7	0.7	30	-
Female pa workers	art-time	1,150	1,120	22	21	2.7	2.7	25	-

 Table 5

 Estimated Coverage and Cost of the National Minimum Wage

Sources: LPC (1998) Table 7.1 for LPC and LPC secretariat calculation for HMG Notes:

(i) Estimates assume all 18-20 are paid the Development Rate (LPC) or 18-21 paid £3.00 (HMG)

(ii) Figures are based on ONS central method using combined NES and LF for Spring 1997, see LPC (1998, appendix 2).

(iii) Rates for April 1999 have been deflated back to Spring 1997 by RPI to ± 3.40 and $\pm 3.00/\pm 2.80$. Alternatively 10p can be added to the initial 1999 rates so that the NMW of ± 3.60 is equivalent to an average earnings figure of ± 3.70 reflecting *eg* overtime premia, shift premia and London allowance. The ± 3.70 can then be deflated by the average earnings index which also translates to an earnings figure of ± 3.40 in Spring 1997. Equivalent calculations were done for 18-20/21 year olds.

There was genuine concern, particularly inside the Treasury, that the original youth rate and age brackets proposed by the LPC would boost the inflow to youth unemployment, thereby resulting in problems for both the administration and funding of the New Deal programme for young unemployed

workers (for details of the New Deal see Employment Service (1997)). Ideally the Chancellor would have liked a lower youth rate up to and including age 24, in line with the age profile of income support. It was felt, in particular, that a lower rate for these age cohorts would make the six month £60 a week subsidy for private sector employment under the New Deal more attractive and would also encourage firms to offer permanent employment once the New Deal placements ended. However, while the LPC was seized of Treasury concern for the New Deal (LPC, 1998 paras 5.26–5.29) the LPC agreed that the New Deal tail should not wag the youth cohort dog: most youngsters would not have any experience of the New Deal and therefore it was not self-evident that aligning the NMW age-pay brackets for those in employment with those on income support was sensible. The Department of Trade and Industry – the LPCs sponsoring department – supported the LPCs recommendations and the outcome was a compromise.

The debates concerning youngsters were stimulating. But we should maintain a sense of proportion. Those aged 18-20 only represent 4% of employment, 6% of the working proportion by age and 16% of those in the lowest tenth by earnings. It is time to analyse the impact of the NMW.

7. Impact

The NMW of £3.60 is equivalent to around half median pay (in 1999) for those aged 22+. By contrast the 18–20 youth rate would have been three quarters of their corresponding median (see Table 4). The lower youth rate of £3 chosen by the government and applied to those aged 18–21 is equivalent to around two-thirds of their corresponding median. Estimates of aggregate coverage and cost are given in Table 5. Some 2 million people, 9% of employees, will have their pay raised, on average by nearly one third. The corresponding increase in the national wage bill is only 0.6%. Although the individual pay rises are substantial it should be emphasised that the chosen NMW of £3.60 is well below the ex-Wage Council's employment-weighted rates uprated by the average earnings index from their abolition in 1993 to 1999. Such an exercise yields a benchmark figure of £3.90. Further, the Councils' 'bite' – their rates relative to industry averages – was historically low in the 1990s and uprating from a time when their bite was stronger would yield a benchmark of over £4 an hour.

Many more young workers are affected by the NMW than those aged 22+. Over one-seventh of those aged 18–21 will receive a pay rise, causing the overall pay bill of this group to increase by 2.4%. Part-time workers are far more likely to be affected than full-timers: 1-in-4 part-timers will get a pay hike compared with only 1-in-20 full timers. And similar analysis by gender shows that three-quarters of those affected are female. Further, a third of homeworkers, nearly one-fifth of lone parents in work and over one-tenth of non-whites directly benefit from the NMW (LPC 1998 figure 7.5).

These groups are not static but the movement from low-paid to better-paid work is limited. Department of Social Security evidence (Ball and Marsland, 1996) showed that of those men aged 25–44 who were in the lowest decile of

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earners in 1978/79 under one-third (31%) were in a higher decile in 1992/93 and one-fifth (19%) remained in the lowest decile. The remainder were self-employed (5%), in partial employment (14%) or unemployed or inactive (27%). Thus there are large flows between unemployment or inactivity and work and that work tends to be low paid. Stewart and Swaffield (1997), for example, found that those in low pay face a higher tendency to experience low pay again compared to those in high pay, even when looking at those with an intervening spell of non-employment.

Certain sectors and firms will be most affected by the NMW because they have a higher incidence of low paid employment including retail, hospitality, security, cleaning, hairdressing, child care, social care, horticulture and clothing and footwear. Nearly two-thirds of those affected by the youth rate work in retail and hospitality. Small firms are more likely to be affected by the NMW because they tend to be clustered in these low paying industries.

It is impossible to forecast now whether the NMW will have any favourable or adverse direct employment consequences. However, for particular sectors we do know that in the 1990s minimum rates set by Wage Councils did not have negative employment consequences (see LPC (1998) appendix 11 and Fernie and Metcalf (1996) for a summary of the evidence). The employmentweighted Wages Councils rate for those aged 21+ in 1993 uprated by the AEI to Spring 1999 is equivalent to approximately £3.90, or £0.30 above the NMW. Around two-fifths of adult employees who will be affected by the NMW work in ex-Wages Councils sectors (see Dickens and Machin (1999) and LPC (1998) figure 7.3), so we can be reasonably confident that there will be no adverse employment effects in such sectors. Indeed, the trade associations representing retail distribution and hospitality have specifically welcomed the level of the NMW.

There are two approaches to analysing the impact of the NMW on macroeconomic indicators such as inflation, aggregate employment and the NAIRU (or equilibrium or natural rate of unemployment). If the NMW is thought of in real terms it will influence the NAIRU. The pay of workers newly covered by the NMW will rise by an amount equivalent to 0.6% of the national wage bill. Some of this will be offset via lower labour turnover, better work organisation, a repackaging of compensation components and incomplete compliance. Unless the remainder – say 0.5% – comes out of profits, non-covered workers must, on average, have one-off lower real wage growth of 0.5% points. This can be achieved in one of two ways. Either the Monetary Policy Committee (MPC) will raise interest rates, generating higher unemployment which in turn forces down nominal and hence, real wage growth by the requisite amount. Alternatively, assuming some short run rigidity in pay, the MPC may choose to accommodate the direct wage growth of 0.6% – essentially treating it as a one-off supply side shock. In this case the price *level* (not inflation) rises sufficiently, coupled with nominal wage rigidities, to reduce real wages by the requisite amount. This may mean missing the inflation target over a short period. Given that the amount involved is equivalent to only around one-quarter of annual real wage growth the accommodation option would seem more appropriate.

A different approach is to think of the NMW in nominal terms. The components of the extra wage pressure associated with the introduction of the NMW are the direct cost, any spillover into the restoration of differentials and a possible wage-price spiral. The direct cost was discussed above. It is unlikely that the knock-on (spillover) effects of the NMW will be serious. Four-fifths of private sector workers are non-union and union density in the sectors where the NMW will bite is very low: retail 14%, hospitality 8%, business services 13% (Cully and Woodland, 1998). What little collective bargaining which occurs is decentralised to company level so there will be no concerted campaign to restore differentials. The detailed survey of pay structures commissioned by the LPC confirms this (IDS, 1997). Managers were asked if a hypothetical £3.70 NMW would lead to claims for restoration of differentials. Out of a sample of 264 over half said no, one-fifth anticipated claims for partial restoration and one-quarter for full restoration. Well over half the managers in the latter two groups said they would resist such demands. Given that both the direct costs and any spillover will probably be modest it is most unlikely that the NMW will initiate a large hike in the AEI thus triggering a wage spiral.

The real and nominal approaches each suggest that the NMW is best thought of as having a once and for all effect on the price level rather than a sustained effect on inflation. This is consistent with the stance taken by the MPC. After taking into account restoration of differentials, monopsony, non-compliance, repackaging non-wage components of compensation and any substitution between workers covered by the NMW and other workers or capital 'the MPCs central projection assumes that the net effect of the NMW on the aggregate wage bill will be to raise its level by 0.5%. However, as some firms will have adjusted wages prior to April 1999, it is assumed that around half of the full effect will come through before then. The central projection assumes a small positive effect of about 0.4% on the price level' (Bank of England 1998*b*, p.30).

Calculating the impact of the NMW on the distribution of household income is a thorny problem. Table 6 sets out two possible ways of thinking about this. The first confines the sample to those households of working age and in employment. It reports the percentage of the aggregate wage gains from the April 1999 NMW – the 0.6% of the national wage bill – which will accrue to the households in each of ten equally sized income groups. But in making such a calculation it does not take account of any tax or benefit changes consequent on the adjustment in pay caused by the NMW. This evidence suggests a remarkably egalitarian impact for the NMW: almost twothirds of the aggregate wage gains accrue to household in the bottom quintile of the distribution.

The second approach yields a different interpretation. The sample consists of all households (*ie* not just those of working age in employment) and takes account of tax and benefit changes. It also only reports the percentage of households gaining, not the amounts by which they gain. It suggests that few households at the very bottom of the income distribution gain because those on very low incomes are predominantly non-workers including the unem-

Table 6

Income Distribution					
Household income decile	Working age and in employment households: % share of aggregate wage bill gain	All households: % gaining			
Poorest	39.8	3.5			
2	24.0	6.6			
3	9.7	7.4			
4	7.9	8.4			
5	4.6	9.0			
6	5.5	9.5			
7	2.8	7.7			
8	3.0	6.7			
9	0.1	3.1			
Richest	2.5	1.9			
All	100	6.4			

Household Gaining from the NMW across the Income Distribution

Source: Dickens and Machin (1999), IFS (1998). Notes:

(i) Household incomes are adjusted to allow for the number of people they contain.

(ii) The share of the aggregate wage bill gains is confined to households of working age and in employment. It does not take account of any tax or benefit changes consequent on the adjustment in pay caused by the NMW. The original data sources used by Dickens and Machin is the British Household Panel Survey.

(iii) The percentage of all households column includes pensioners and other non-working households and incorporates tax and benefit changes consequent on the adjustment in pay caused by the NMW. The original data source used by IFS is the Family Expenditure Survey.

ployed, inactive and pensioners. Using this sample, households around the middle of the income distribution are most likely to gain. The reasons for this are straightforward. First, women living with employed men account for around 40% of those who will be affected by the minimum wage. Second, a further 30% are young people who are still living with their parents. Among men, for example, even with the lower rate for under 22 year olds, the effects of the NMW are concentrated among the under 25s. Thus 7-in-10 of those affected by the NMW live in two (or more) earner households which limits the redistributive impact of the NMW (see also Gosling, 1997). The NMW will influence the distribution of earnings by truncating the lower tail. For those in employment the bulk of the aggregate wage gains accrue to those at the bottom of the income distribution. But, across all households the NMW has only a modest affect on the distribution of household income.

Government evidence to the LPC (DTI, 1998), independent research (IFS, 1998) and the LPC's (1998 chapter 6) own calculations all suggest that the NMW will be broadly neutral on the public exchequer finances. On the spending side any savings on means-tested benefits will probably be offset by a

small rise in the public pay bill and extra procurement costs; on the revenue side there will probably be only a minor change on taxation income flowing to the exchequer.

Savings made on income-related benefits consequent on the introduction of the NMW will total some £360 million in 1998/99 prices (see LPC, 1998, paragraph 6.92) split roughly evenly between the Working Families Tax Credit (WFTC) and other in-work benefits. Table 7 shows that these savings are a small fraction of the total amount spent on the different benefits, even on WFTC where state support is specifically targeted at families. IFS (1998) states that the reason for the small saving is that the overlap between low pay and low income is weak – the majority of those affected by the NMW are not on benefits. The savings from housing benefit and council tax benefit and, specially, income support are even smaller. Overall the total savings on means tested benefits is under 1% of the total spent on them.

Any such savings will be broadly offset by a modest rise in government spending. There will be a small direct effect – around 0.2% – on the public sector wage bill (see LPC, 1998, figure 6.8) with the biggest impact being on the National Health Service. The indirect effect on purchasing goods and services from the private sector – places in care homes or cleaning schools and hospitals for example – when it is faced by increased labour costs will be somewhat larger.

Revenue from income tax and national insurance, consequent on the NMW, will rise by some £800 million in 1999/2000, split evenly from each source, assuming no change in unemployment and no restoration of pay differentials (LPC, 1998 Table 6.6). Moreover, as many of the people whose pay is increased will be on low incomes, they are likely to spend most of their increased earnings. This will generate additional VAT receipts. These extra tax revenues are likely to be partially offset by a fall in corporation tax. Inland Revenue calculate (LPC, 1998, paragraph 6.95) that if any increase in wages and national insurance contributions is not passed on in higher prices, but instead leads to an equivalent fall in taxable profits for companies, corporation tax receipts would fall by around £500 million.

Table 7
Projected Savings on Means
Tested Benefits Stemming from
the NMW

Benefits	Saving as % of total money spent on each benefit
Housing benefit	0.9
Council tax benefit	1.1
WFTC	5.8
Income support	0.2

Source: IFS (1998)

1999]

8. Conclusion

The NMW will boost the pay of some 2 million workers by, on average, nearly a third. This will be achieved at a direct cost of only 0.6% of the national wage bill. The NMW will reduce pay inequality but will have a more modest impact on the distribution of family incomes. The rate is unlikely to have adverse overall employment consequences and will be broadly neutral on exchequer finances. Debates within the LPC – particularly concerning the rate itself and what to recommend concerning younger workers – were uniformly constructive and cooperative. Where initial disagreement existed it was not normally along 'them and us' lines. Thus the Commissioners were truly independent and achieved a very successful social partnership – a unanimous report and recommendations nearly all accepted by the government.

The direct impact of the NMW on the distribution of pay and family incomes must also be seen in the context of other reforms aimed at 'making work pay' including the New Deal and the tax and benefit reforms announced in the 1998 budget such as the introduction of the Working Families Tax Credit. Further, the NMW will also have the positive effect of reducing the subsidy to inefficient or collusive employers who are able to pay low wages, knowing that the taxpayer will top up income through the benefits system.

At some future date the uprating mechanism for the NMW will have to be chosen. It has been decided that the first uprating, the timing of which is presently unknown, will be on the basis of a recommendation from the LPC. It is possible that the subsequent upratings could be linked to, for example, movements in the AEI, ensuring that the low paid share in any real earning growth, or to median earnings which would make the bottom half of the pay distribution more stable than it otherwise would be. My own view is that such formulaic approaches to uprating are probably premature. It is necessary first to monitor the impact of the NMW on the pay structure, inflation and income distribution. Only when there is general agreement that the figure is about right will there be a case for some form of indexation.

Finally the NMW is just that – it is a *minimum* wage – a labour market plimsoll line for the whole nation. More than 9-in-10 workers will be paid above the NMW but the exploitation of those at the bottom of the pay distribution will be drastically reduced and, hopefully, completely eliminated.

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