

The toxic politicising of the National Minimum Wage

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Abstract

Purpose – After 15 years of successful operation, the British Low Pay Commission's management of the National Minimum Wage was threatened in 2015 by the government's introduction of the National Living Wage. The purpose of this paper is to consider the underlying principles of previous minimum wage fixing, and the additional thinking of the Living Wage Foundation and the review of the issue by the Resolution Foundation.

Design/methodology/approach – The paper draws on the 2016 reports of the Commission to argue that the two statutory wages are unavoidably interlinked and are tied to incompatible criteria.

Findings – The paper concludes that the predicted eventual impact of the National Living Wage on the labour market will be unsustainable.

Research limitations/implications – The paper is relevant to minimum wage research.

Practical implications – The paper is relevant to minimum wage policy.

Social implications – The paper is relevant to low pay policy.

Originality/value – The paper provides original analysis of minimum wage policy.

Keywords Social partnership, Living wage, Minimum wages, Wages councils

Paper type Conceptual paper

Received 1 April 2017
Revised 18 May 2017
Accepted 29 June 2017

Will Britain's National Minimum Wage (NMW) be killed by its own success? Despite the extreme scepticism that greeted the introduction of Britain's first universal statutory minimum wage in 1999, it was quickly accepted. Its success owed much to the politically independent, social partnership constitution of the Low Pay Commission (LPC) that designed and ran it, and to the rigorous attention to evidence with which they operated. After 15 years, this was put at risk by increased political interference. The first threat came when the Labour Party's unsuccessful election manifesto for 2015 promised to fix the NMW by decree. The threat became real when, later that year, Conservative Chancellor Osborne announced the level at which a new minimum wage for those aged 25 and over, which he called a National Living Wage (NLW), would be introduced from April 2016. Have the Commission, and consequently the NMW, been fatally compromised?

This question gets to the heart of what is inherently a very political economic policy. The factual basis for answering it lies in the two reports that the LPC have published since the then Chancellor's announcement. The first was produced in March 2016 (Low Pay Commission, 2016a). The second came in November 2016 after the additional shock of the Cameron Government's fatal gamble on the European Union referendum (Low Pay Commission, 2016b). In common with previous LPC reports, these are substantial, written with great care and

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The author is grateful for the comments of George Bain, Tim Butcher, David Metcalf and Jackie Scott, none of whom are responsible for any factual errors or opinions expressed.



supported by meticulous use of all available evidence. But, to bring out the underlying political issues, it is useful to place them within a policy debate that goes back over a century.

Let us start with the sectoral “social partnership” aspect of Britain’s first statutory minimum wage institutions of modern times. These were the wages councils (initially trade boards), that were established in 1909 and, except for agriculture, abolished in 1993. These had been a response to growing public concern about inadequate, “sweated” wages and the rising number of children who as a result were growing up in poverty. The councils fixed basic wage scales separately for several dozen industrial and service sectors which were typically non-unionised and had no history of bargaining. At their peak in the 1950s, backed by their common inspectorate, they provided a safety net of around half of average sectoral earnings for about 17 per cent of the total employed workforce. The councils had equal numbers of representatives of trade unions and employers, with an independent chair and typically two independent members to prevent deadlock. From early on it was envisaged that they would foster a transition to the voluntary sectoral collective bargaining that was then the norm although, as it turned out, this rarely happened.

Implicit to this arrangement were three important principles. The first was that the product markets of different sectors differ in competitive conditions and in what they can afford at any point in time, making a single NMW too blunt a policy instrument. The second principle was that the wage rate that could be afforded was best haggled out between representatives of established employers and experienced trade union officials, both sides being familiar with the particular circumstances of their sector. The third principle was that, although these rates were in principle advisory, the Secretary of State would rarely challenge them, so that the councils were effectively independent.

The return of statutory minimum wages with the NMW at the end of the twentieth century was a response to similar problems to those which led to the wages councils at the century’s start. An increasingly open economy in terms of both trade and investment was destroying the collective bargaining institutions in the private sector that had developed earlier in the century. The consequence was a collapse of wages and working conditions at the bottom of the labour market and consequently rising family poverty. Instead of restoring selective, sectoral wages councils, the New Labour government decided to introduce a single minimum wage, applicable to all sectors and regions of the UK. This simplicity would aid enforcement. Lower rates were later added to protect younger workers and apprentices. Otherwise the principles were much the same. The LPC had a social partnership structure, with three representatives of employers and three of trade unions, and three independent members, one of whom was chair. It was advisory to the government and enforcement was the responsibility of Her Majesty’s Revenue and Customs (HMRC). Unlike the wages councils, the LPC has consistently maintained a method of working that places great emphasis on strong evidence, including regular field trips and an ambitious programme of its own and commissioned research.

These arrangements have generally been considered to be successful. After a cautious start, and despite a recession from 2008, the NMW has substantially improved in real value since it started in 1999. In relative terms, in April 2015 its “bite”, that is the hourly rate for employees aged 21 and over relative to median hourly earnings, had reached 54.5 per cent, its highest level since its introduction (at 45.7 per cent). The number of workers directly benefiting from the NMW was, insofar as can be judged, about 5 per cent, a figure greater than ever before. Indirectly, a larger and growing number of slightly better paid workers benefited from their employers’ consciously following NMW increases as its bite has increased. Yet, despite this slow cranking up of the NMW in real and relative terms, there was still no evidence of the substantial adverse effects on employment that had initially been feared. The LPC had become an uncontroversial part of the institutional scenery, unaffected by its membership turnover or by changes of government. All its major recommendations had been accepted. While it

considered that a necessary, if not sufficient, precondition of getting employers to make labour more productive might be to oblige them to pay more for it, it had no illusions that achieving such productivity improvement was other than a very gradual process.

The success of the NMW did not mean that the problem of low pay had gone away; it was merely ameliorated. In 2001, a charity called the Living Wage Foundation was set up to propose and update a higher wage rate, called the Living Wage, which was aspirational rather than statutory. It was to be a reference point for those employers wishing to be identified as “good” employers by consumers and wider society. It drew astutely on a growing concern of business with corporate social responsibility and with its downside of reputational risk. But, in complete conceptual contrast with the NMW, the Living Wage is fixed and updated with reference to the personal living costs of workers’ needs, whereas the NMW’s concern of necessity focussed on affordability to the employer. As a campaigning tool, it makes sense for the Living Wage to seek to protect decent standards of living; to win acceptance from government, the NMW has had to concentrate on not damaging employment.

Another charity then tackled the question of whether more could be achieved with the existing NMW. A non-partisan think-tank, the Resolution Foundation, set up an unofficial but authoritative review of the NMW, chaired by the LPC’s founding chair, Sir George Bain. Reporting in March 2014 (Resolution Foundation, 2014), it proposed changes to the LPC’s terms of reference to increase its impact on low pay more widely. These included a more active dialogue with government on policy objectives, and a wider research remit to look at barriers to achieving those objectives. It proposed that this should be done within the framework of an explicit government policy on low pay, a central part of which might be a medium term, perhaps five year, target for the NMW of a bite of 60 per cent of median earnings. To get over the bluntness of a single NMW when many sectors could afford to pay more, it suggested that the LPC should be asked to analyse affordability by sector so that a debate might get under way on higher aspirational, sectoral rates. In a similar way, it suggested a non-mandatory London-weighting for the NMW, again to influence public thinking on norms of decency. The intention was to maintain the independent, social partnership constitution of the LPC, while extending its research attention to low pay more broadly, and to do so in an open dialogue with government on how best to achieve its long term objectives. An important part of this strategy would be informing a debate on feasible aspirational minima at sectoral level, thus providing an additional, more authoritative and finer grained, basis for suitable pay targets for corporate social responsibility. In this respect the Resolution Foundation review built on the successful approach pioneered by the Living Wage Foundation.

This was the setting in which Conservative Chancellor Osborne announced, in a remarkable act of political theatre at the end of his July 2015 budget speech, the introduction of what he called the NLW. It was, in effect, a new age-band for the NMW, for workers aged 25 years and older, to be introduced the following April (2016) at £7.20 an hour. This was a massive 10.8 per cent higher year-on-year than the then full rate. But this was only the first step of a much larger intervention. Picking up a headline from the Resolution Foundation report, he stated that the target for the NLW was to be 60 per cent of median earnings by 2020. Although not consulted on this extraordinary invasion of its remit, the LPC was expected to advise on how both NMW rates and the new NLW would be phased to meet this target. Osborne accepted that it could lead to job losses; the NLW consequently marked a substantial change of policy from that on which the NMW had been built. It did not help that the timing of the start of the NLW forced the annual updating of the NMW to shift from October to April. By laying this political cuckoo’s egg in the LPC’s nest, he threatened its independence, its credibility, and the acceptability of the NMW.

The LPC’s response has of necessity been measured and practical, but its two reports of 2016 leave no doubt about the challenge it faces. For one thing the initial shock to the labour market of Osborne’s NLW in April 2016 was massive. The number of workers directly

affected by minimum wages immediately rose by more than a third, from 1.4 to 1.9 million, or to 7.1 per cent of jobs. The bite of the NLW for 2016 was estimated to be 55.8 per cent, an increase from 52.5 per cent for those on the full rate of the NMW in 2015. But these national figures conceal the disproportionate impact in some regions and sectors. Six regions had bites already over 60 per cent by the end of 2016. The bite was over 70 per cent in very small firms. It was around 90 per cent in low-paying sectors such as cleaning, hospitality, food processing, hairdressing, and retail. The workers affected are disproportionately from groups with relatively high vulnerability to unemployment – workers who are older, disabled and unqualified, women, part-timers, ethnic minorities, and migrants.

The LPC's history of caution in nudging up the bite of the NMW has always been informed by its understanding of the managerial importance of the pay structures within firms. There is a limit in terms of managing people as to how far pay differentials can be compressed between supervisor and supervised, between experienced and less experienced workers, and between the more and less competent. Among adults these crucial attributes are generally unrelated to age. It is consequently unsurprising that the LPC reports immediate upward spill-over effects to workers earning up to £9 per hour. Similarly, there are downward spill-overs to workers aged under 25, a similar proportion of whom appear to have gained from the NLW as for those for whom it was intended. As many as 7 per cent of all 16-24 year olds were lifted above the NLW of £7.20 on its introduction. The NLW is even blunter than the NMW.

This unavoidable entanglement of the NLW and the NMW greatly worsens the difficulty of the position in which the LPC has been placed. It has remits for the two rates that are inconsistent with each other. For workers of 25 and over it has to recommend the pace of increases towards 60 per cent of median earnings in 2020, subject to "sustained economic growth". For workers under 25 and apprentices it has to "help as many low-paid workers as possible without damaging their employment prospects". But their entanglement in practice means that it cannot allow the rates to drift too far apart. The reader can almost hear the LPC's recommendations for April 2017 being made through gritted teeth.

The challenges that face the LPC get much worse. If Osborne's commitment is fulfilled, the coverage of the NLW is set to rise by over a half to three million workers, or 12 per cent of jobs by 2020. That will put the bite in some regions such as Northern Ireland, Wales and the East Midlands close to 70 per cent. Nationally it will be over 70 per cent for firms with fewer than ten employees. It will be over 90 per cent for childcare, food processing, hairdressing and retail, and close or up to 100 per cent for hospitality and cleaning. The NLW will in effect become the "going rate" for these sectors, a curious legacy for a Chancellor committed to private enterprise. Official data were not yet available for the LPC to evaluate the initial impact of the NLW on employment or hours worked in their second report of 2016.

One expected response to this sharp rise will be increased non-compliance. It is already reported that under-payment doubled between 2015 and 2016 for workers aged 25 and over. This is important because nothing is more likely to erode employer respect for the NMW than increased levels of non-compliance and evasion. It should help that the first person appointed to the new role of the Director of Labour Market Enforcement in January 2017 was Sir David Metcalf, a Founding Member of the LPC who is familiar with the issues. His new role is to set strategic priorities for the Gangmasters' and Labour Abuse Authority and for the Employment Agency Standards Inspectorate, as well as for HMRC's NMW enforcement team. Britain is still far from having a comprehensive labour inspectorate, but the shock of the NLW makes this a timely step in that direction.

We conclude by returning to the three principles that lay behind the wages councils over a century ago. The first was that the effectiveness of minimum wages is increased if they reflect the competitive circumstances of different sectors. As when it was established, the strength of the NMW still owes much to its simplicity, although the arrival of the NLW for

workers of 25 and over has seriously compromised this. But the work of the Living Wage Foundation and of the Resolution Foundation's review has suggested a very practical way of protecting simplicity while still encouraging sectoral improvement. That is for the LPC to publish authoritative analyses to provide a basis for the development of voluntary sectoral norms which could guide debates on corporate social responsibility on pay. This would be in the spirit of the second principle of wages councils, with norms haggled out at sectoral level. It is on the third principle, of effective independence from government, that the NMW has been so seriously imperilled.

Have the LPC and NMW been fatally compromised? It cannot help the LPC to be tied to a minimum wage that is substantially higher than they would have considered prudent in terms of its likely adverse employment effects. It may be that the economic turmoil associated with leaving the European Union will give rise to conditions that halt "sustained economic growth" and thereby remove the 2020 target. It may be that dropping the target is seen by a future Chancellor as a trivial price to pay for placating rising unrest among employers with small enterprises and otherwise vulnerable.

What we can be sure of is that Britain will not abandon a statutory minimum wage. As Osborne was well aware, statutory minimum wages now play a crucial role in limiting the burden on the Exchequer of working family support payments and tax credits. Some sort of NMW will live on. But it might be hoped that lessons will be learned from this unhappy episode. One would be that Britain's time-honoured independent, advisory, social partnership method of fixing minimum wages has much to be said for it. Another lesson might be the folly of playing short-term political games with an institution as deeply embedded in the economy as a minimum wage.

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