

Adopting a minimum wage

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### **Introduction**

Minimum wage is defined as the minimum amount of remuneration requires to be paid by an employer to an employee in return of the duty performed by him or her in a given time period. It is not possible to reduce the minimum wage on the basis of an individual contract or collective agreement. The key goal behind minimum wage is protecting employees against unduly low pay. There are more than 90% member states of International Labour Organisations (ILO), in which there is an existence of minimum wages (National Institute of Economic and Social Research, 2018). Nowadays, in most countries, minimum wage laws are considered as well-entrenched labour market institutions. It is legislation, which is required to be implemented for the purpose of ensuring no fall of wages below a certain level.

Moreover, it also gives a mechanism of enforcing this. In different countries, minimum wage is also used in the form of a policy, for which there have been same basic arguments for decades (Hafner et al., 2016). While implementing it as a policy, an equitable, as well as just share of wealth to all individuals, can be ensured. Besides this, it can also help in overcoming poverty and reducing inequality (de Linde Leonard et al., 2014). There are different arguments for and against a country adopting a minimum wage. This research project is about critical analysis of different arguments for and against a country adopting a minimum wage.

### **Theoretical Background**

There have been different studies conducted to prove the impact of minimum wage on employment and jobs in a country for last many years. However, since 2008, the researchers shifted to find the effects of raising the minimum wage by questioning “when, where and why” about the concept (Marginean, 2013). As per analysis, it has been found that regulations associated with the minimum wage requirements tend to affect the labour market, which is one of the critical determinants of the country’s economy. The imposition of the minimum wage has both positive as well as negative consequences. Hence, the current study has been carried out to analyse how minimum wage affects a particular economy.

In order to assess the economic impact of minimum wage requirements, it is essential to develop an understanding of employment and labour force movements. There is varying literature on the consequences of the minimum wage, most of which favour the phenomenon. In this regard, Thomas and Luz (2016) referred to the classical theory of unemployment,

which indicates that minimum wage restriction increases the demand for labour, which implies an increase in employment. The phenomenon is evident from the graph below. Consider, for example, an introduction of the minimum wage which is higher than the worker's previous wage. As a higher wage is introduced, the demand curve shifts to the right. However, this is not always the case. The consequences of minimum wage policy depend entirely on the context.

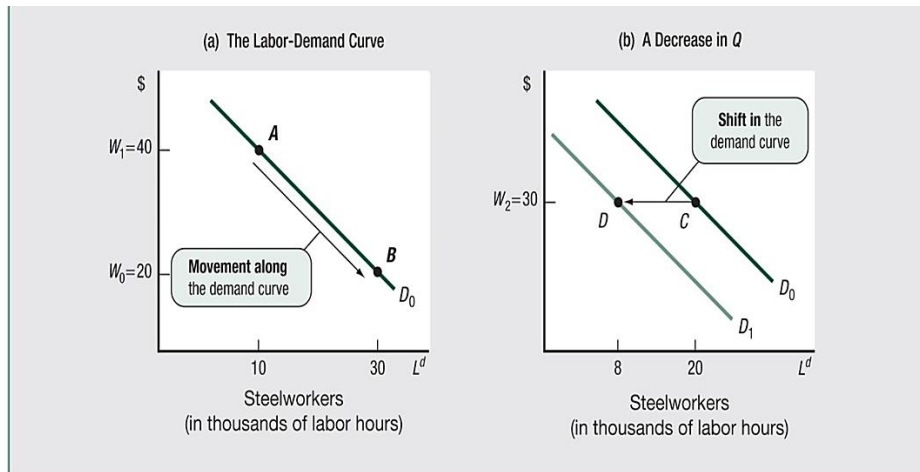


Figure 1- Shift in demand due to minimum wage

Hirsch, Kaufman, and Zelenska (2015) listed two distinct market frameworks, “competitive and monopsony”. If a market is competitive, minimum wage requirements will eventually lead to a decrease in employment. Since a competitive market is composed of homogenous profit-maximising firms, an imposition of NMW will provoke the workers to switch to a firm which offers more than the wage determined by the NMW. This implies that the firms covered by the NMW policy have to face unemployment. On the other hand, if a market is monopsonistic (as in figure 2), where one prominent employer attracts most of the labour force, minimum wage requirements will either increase or decrease the employment (Thomas and Luz, 2016). This is because a monopsonistic market depicts that workers do not have enough opportunities; they would be ready to work whatsoever the minimum wage is. On the contrary, a monopsonistic employer can even start laying off when the minimum wage rises., as evident in the graph in figure 2. When the minimum wage is increased up to  $W_3$ , the employment falls from  $E_3$  to  $E_1$ . This might be due to the increasing costs and thus laying-off by the monopsonistic employer. Hence, it can be assessed that the impact of minimum wage entirely depends upon the nature of the industry and status of the economy.

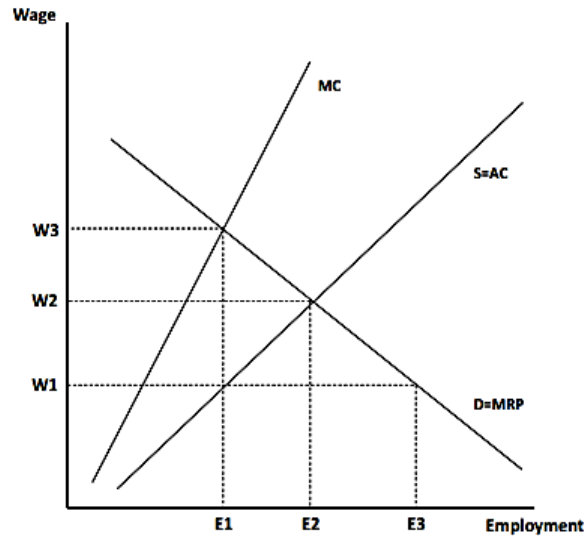


Figure 2- Demand and supply of labour force due to NMW policy in a monopsonistic market (Source: Bachmann and Frings, 2017). *S* = Labour supply; *AC* = Average cost of labour; *MC* = Marginal cost of labour; *D* = Demand for labour; *MRP* = Marginal revenue product of labour

### Favour of minimum wage

As stated earlier, literature favours the minimum wage concept more than it opposes it. Minimum wage requirement particularly provides benefits to people with lower skill levels who continuously receive low wages. When the UK government set the National Minimum Wage (NMW), the employment group whose pay was even lower than NMW benefited the most (Allegretto, Dube and Reich, 2011; Hafner *et al.*, 2016). This implies that the employers of that group would have no chance to exploit the employees since complying with NMW would be mandated by the UK government. In this regard, BBC (2019) favoured NMW requirement for the advantages it rendered to the low pay workers. A finance reporter at BBC, Peachy (2019) argued that it was only due to the UK's minimum wage policy that the workers saw their wage growing more than the inflation in the country, as illustrated in figure 4. In line with that, a statutory body established to assist in deciding minimum wage, Low Pay Commission (LPC), estimated that 1.3 million employees witnessed an increase in their wages, only after the inception of this policy (Stewart, 2004). Similarly, Hirsch (2017) commented in favour of national minimum wage and said that it should continue to rise as long as it does not produce any economic side-effect such as inflation. Hence, this establishes that a minimum wage requirement tends to benefit the low wage workers in particular.

Moreover, the literature suggesting little to no negative effect of minimum wage on employment and jobs also signals a favourable stance for the concept.

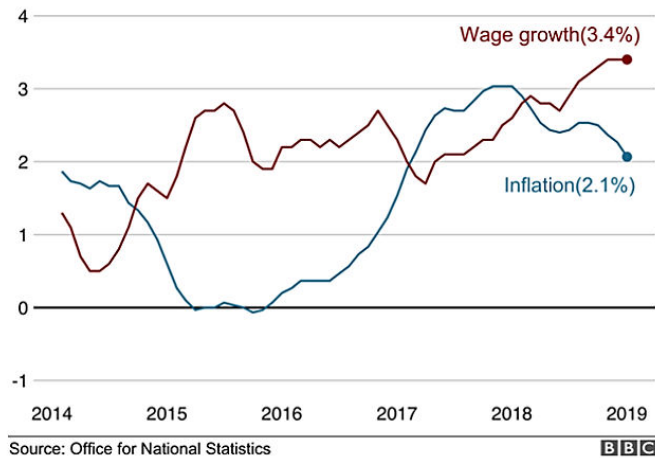


Figure 3- Comparison of UK's inflation and wage growth from 2014 to 2019)

### Against minimum wage

Although the majority of the literature argues in favour of the NMW requirement, however, there exist some studies against the policy. Critiques point out that the youth is profoundly affected by an increased minimum wage because this would make further education less attractive to them. Moreover, some minority groups were also found to be adversely affected by the policy. In this regard, Hafner *et al.* (2016) studied different labour market sub-groups (e.g. young people, men, women, and part-time workers) to report a very insignificant adverse employment effects of UK NMW on the sub-groups studied, which was evident from negligible values of partial correlation. The findings were in line with those stated by de Linde Leonard, Stanley and Doucouliagos (2014). However, both the studies argued for an adverse effect of NMW on two sectors in the UK, *residential home care and retail food industries*. However, this adverse effect was later labelled as insignificant by the researchers owing to its ineffectiveness across all econometric models (Hafner *et al.*, 2016). Researchers call it a special case since there is no sufficient literature to justify the variation. In addition to that, the Low Pay Commission (2019) also referred to some critiques on NMW policy by observing the labour cost-cutting by some employers. The Commission reported that some employers have made workers see a trade-off between the increased wages (due to NMW) but more impoverished working conditions. Their managers had to deteriorate the working conditions to manage the risk of increased costs due to NMW requirements. The effect was similar to what was stated by Wessel's effect that the firm would offset the increased wage by reducing the benefits. However, the Commission also reports that it is not

yet clear to what extent the NMW is responsible for such a trade-off as this might be a consequence of recession (Low Pay Commission, 2019). Hence, it can be concluded that most of the available literature argues in favour of minimum wage policy in the UK. There is only little to no evidence that signals the negative consequences of NMW, particularly on employment and jobs in the country. For those who argue against the phenomenon, the evidence is not sufficient to justify the negative consequences.

## Discussion

The analysis establishes that minimum wage requirement has been in practice in the UK since the 1900s. Even today, the government has set the wage requirement, which is labelled as National Living Wage (NLW) by the authorities. It was after the elections held in 2015 in the country that the Chancellor of the Conservative Party government unexpectedly introduced the National Living Wage (Giupponi and Machin, 2018). Hirsch (2017), in this regard, analyses that the introduction of NLW was, in fact, a move to broaden the boundaries of NMW. The primary change was in the minimum wage of workers aged 25 or above who were then entitled to 7.2 pounds for an hour, which was 10.8% more of what these workers were receiving a year before. Low Pay Commission (2017) reported that this increase in the minimum wage was the “joint largest ever”. Then a year later, another 4.2% increase was seen in the minimum wage when the authorities set the NLW at 7.50 pounds, as reported by the National Institute of Economic and Social Research (2018). As of now, there are five minimum wages, “NLW (workers aged 25 or above), NMW (21-24 years old workers), youth development rate (18-20 year olds workers), young worker rate (16 and 17 year old workers) and the apprentice minimum wage” (Giupponi and Machin, 2018). The government of the UK illustrates an increase in all these wages from 2016 to 2019, as in the table below. The rates are revised every April.

<b>Year</b>	<b>25 and over</b>	<b>21 to 24</b>	<b>18 to 20</b>	<b>Under 18</b>	<b>Apprentice</b>
April 2019	£8.21	£7.70	£6.15	£4.35	£3.90
April 2018 to March 2019	£7.83	£7.38	£5.90	£4.20	£3.70
April 2017 to March 2018	£7.50	£7.05	£5.60	£4.05	£3.50

Year	25 and over	21 to 24	18 to 20	Under 18	Apprentice
April 2019	£8.21	£7.70	£6.15	£4.35	£3.90
October 2016 to March 2017	£7.20	£6.95	£5.55	£4.00	£3.40
April 2016 to September 2016	£7.20	£6.70	£5.30	£3.87	£3.30

*Table 1- Changes in UK wage rates from 2016 to 2019 (Source: gov.uk)*

The table thus gives essential insights into the changes in the UK minimum wage policy for over three years (Gov.uk, 2019). The 2016 revision in UK NMW justifies the choice of years. This implies that the UK government is particularly considerate about its labour market. All the age brackets have seen a noticeable change in the minimum wage requirements. Therefore, the analysis establishes that the policymakers strive to make the workers feel more secure and eradicate any adverse consequences of the minimum wage policy on employment and jobs. Consequently, a secure labour market will render positive outcomes in the UK's economy, as explained in the essay.

## **Conclusion**

To conclude, the study establishes that changes in labour market tend to affect the economy of a country since it is a vital employability skill. The purpose of this essay was to assess the arguments both in favour of and against the minimum wage. Considering the scenario of the United Kingdom, it has been analysed that the changes in the labour market and the minimum wage requirements are the key drivers of the country's economy. The arguments evaluated conveyed that the phenomenon of National Minimum Wage (NMW) has both positive as well as negative outcomes; however, most of the evidence favours the concept. Assessing the UK NMW and then its latest revision to NLW, it can be established that the country's government is considerate about the security of its labour force. This is evident from the gradual increase in the minimum wage, particularly from 2016 to 2019. Moreover, there is little to no evidence about the adverse effects of minimum wage requirement on employment and jobs overall, except for the residential home care and retail food sectors. Therefore, it implies that minimum wage requirements tend to strengthen the

labour market in the United Kingdom, which will eventually lead to rapid development in the country's economy.



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