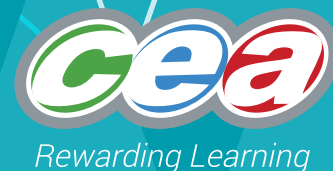


# FACTFILE: GCSE ECONOMICS

## UNIT 3.2

### PRODUCING AND CONSUMING



## The National Minimum Wage and the Living Wage

### Learning Outcomes

Students should be able to:

- explain and evaluate the advantages and disadvantages of a national minimum wage or a living wage.

### National Minimum Wage

A National Minimum Wage was introduced in the UK in April 1999. The rate of wage for adults aged 22 and over was £3.60 per hour. Adults aged 18-21 received £3 per hour and there was no minimum wage for workers aged 17 and under.

National Minimum Wage rates are subject to change in October of each year and have been increasing over time.

Below is a table showing the National Minimum Wage rates for individuals in the UK before the introduction of the National Living Wage.

**Table 1: Changes in National Minimum Wage Rates in the UK 2012–2015.**

Age	21+	18–21	<18
October 2015	£6.70	£5.30	£3.87
October 2014	£6.50	£5.13	£3.79
October 2013	£6.31	£5.03	£3.72
October 2012	£6.19	£4.98	£3.68

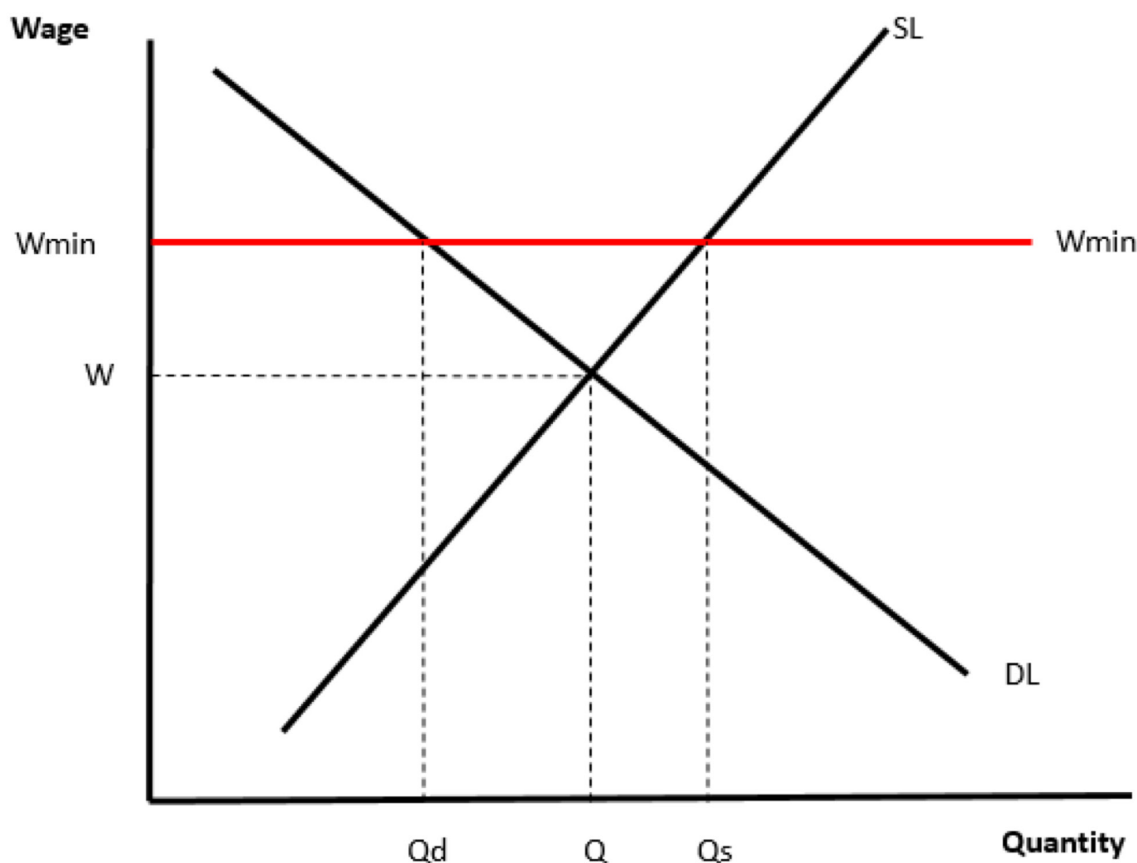


Source: Adapted from <https://www.gov.uk/national-minimum-wage-rates>

### How does the National Minimum Wage Work?

The National Minimum Wage is designed so that no employer can pay a wage lower than the rate specified by the government to any employee. This applies to full-time and part-time staff. The National Minimum Wage acts as a price floor, which the wage paid to employees cannot fall below.

Figure 1:

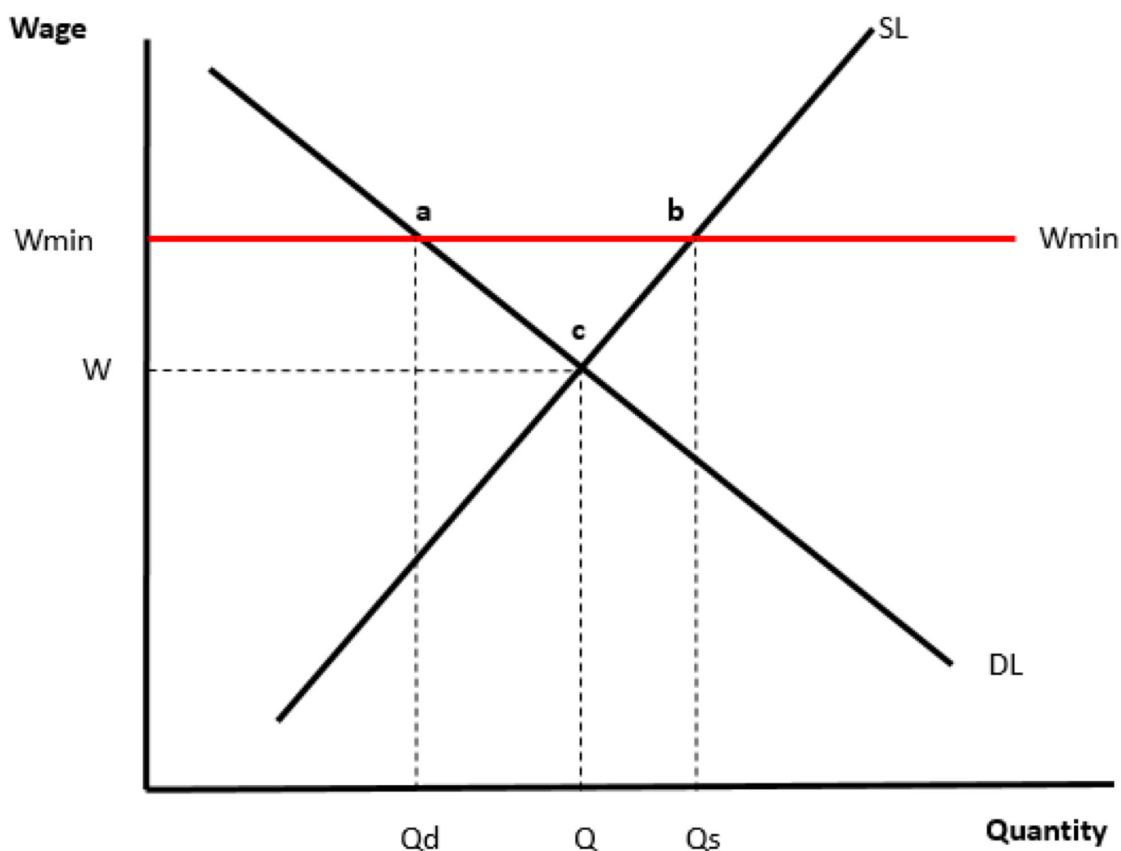


The free labour market equilibrium exists where demand for labour (DL) is equal to the supply of labour (SL) at a wage rate of  $W$  and a quantity of  $Q$ . In order to ensure wages remain at a level which will enable employees to maintain a basic standard of living the minimum wage is set above this level at a wage of  $W_{min}$ .

This acts as a price floor where employers cannot pay their workers a wage below the level  $W_{min}$ . As a result, this leads to an increased incentive to work and an extension along the supply curve for labour to  $Q_s$ . However, this also makes employing workers more expensive for firms and therefore leads to a contraction along the demand curve for labour to  $Q_d$ .

As the demand for labour is less than the supply of labour there will be a resulting increase in unemployment represented below by the area abc.

Figure 2:



### Advantages of the National Minimum Wage

#### 1. Equity.

It is argued that it is only fair that each worker receives the same rate for each hour worked. In a market economy, however this is not always possible. Due to the economic forces of demand and supply, wage differentials will occur in a market. For example, higher wages will encourage workers to take jobs which require higher skills, where supply is likely to be low in the market.

A National Minimum Wage will act as a price floor. This means that the market cannot force wage rates below this level, ensuring that all employees are rewarded with a wage rate that is fair and enables them to achieve a basic standard of living.

#### 2. Provide an incentive to work.

The National Minimum Wage, should lead to a higher wage rate than the free market. This higher hourly pay rate should lead to an increased incentive to work for individuals. Therefore, this should increase the number of people starting to look for a job to increase and encourage those who are actively seeking employment to search harder for work.

This increased incentive to work will lead to an increase in the supply of labour in an economy.

#### 3. Reduce labour market discrimination.

Implementation of a National Minimum Wage should ensure equity in pay amongst workers. This should reduce discrimination in the labour market whereby some groups of individuals, e.g. women and those under the age of 18 may be discriminated against and paid less than other demographic groups.

**4. Increase consumer spending in an economy.**

There is an argument that the implementation of a National Minimum Wage, leading to an increase in disposable income for low paid individuals, could lead to an increase in consumer spending in an economy.

If low paid individuals are paid more because of the National Minimum Wage, they will have more disposable income. This group of individuals is likely to spend a large proportion of any increase in income, which boosts demand in an economy and can lead to economic growth and further employment in the future.

**Disadvantages of the National Minimum Wage****1. Unemployment.**

A National Minimum wage will lead to a higher wage rate being paid to workers. This increases costs for businesses who may then have less incentive to employ as many workers. This could cause unemployment as illustrated in Figure 2 by the area abc.

**2. Loss of competitiveness.**

A National Minimum Wage will lead to higher costs for firms in that economy. This increase in costs could lead to a rise in prices of their goods and services to maintain their profit margins.

An increase in prices could lead to a loss of international competitiveness and therefore a decrease in demand for exports. Increasing international trade and globalisation has had an impact on this as UK firms face fierce competition from lower cost firms abroad who perhaps do not have to pay a National Minimum Wage to their employees, enabling them to produce their products with a lower cost.

**3. It may not reduce poverty.**

One argument in favour of the National Minimum Wage is that it will reduce poverty in an economy as lower paid workers will be paid a higher rate of pay. The problem with this is that many of the UK's poorest individuals are those who are not in employment, e.g. long term unemployed or pensioners.

Therefore, implanting a National Minimum Wage will have no impact on their standard of living. These groups of individuals will therefore see no benefit from a National Minimum Wage as they are not employed.

## The National Living Wage

The National Living Wage was introduced in the UK on 1st April 2016. It is designed to provide a higher rate of pay for individuals aged 25 and over. The National Living Wage rate as of 1st April 2016 was £7.20 per hour. This is expected to increase to £9 per hour by the year 2020.

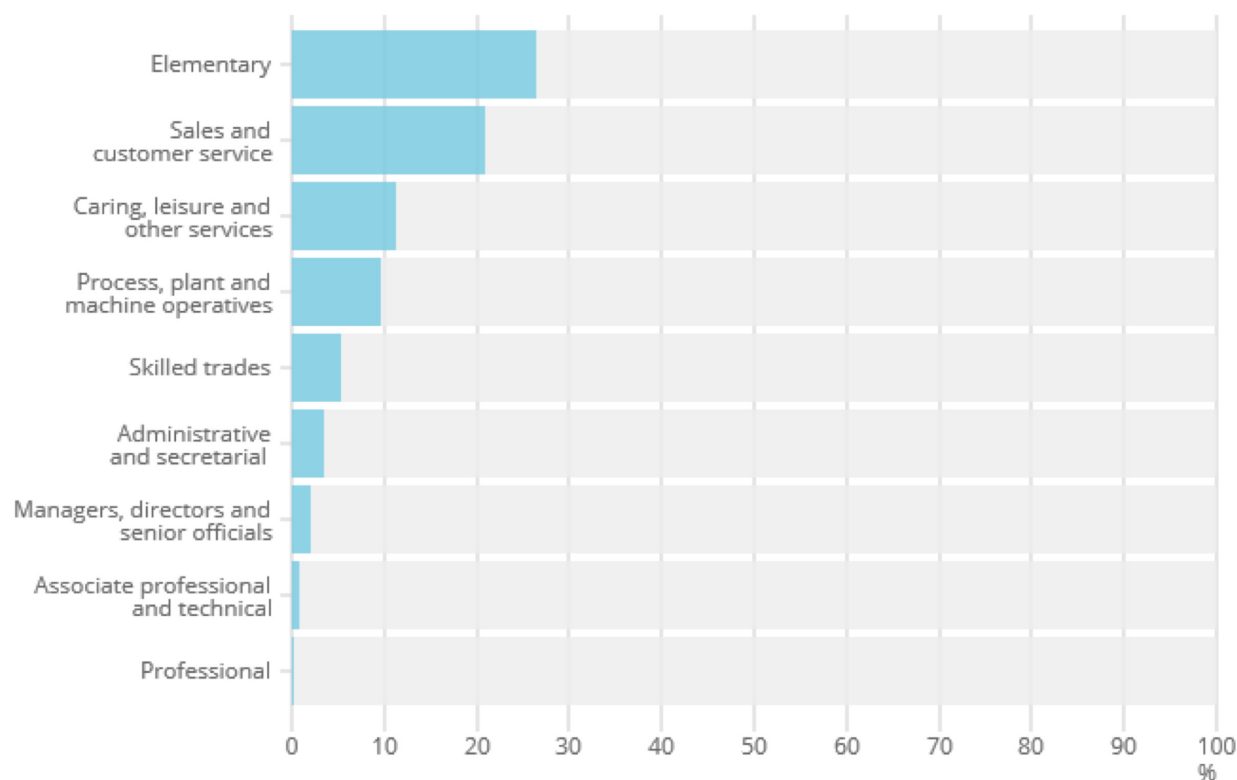
London will have its own National Living Wage rate to account for higher costs of living in the city. The London National Living Wage rate is £9.75. The National Living Wage is designed to give individuals aged 25 and over enough money to afford essentials and also be able to save.

## Who will the National Living Wage have the biggest impacts on?

According to research by the Office of National Statistics (<http://visual.ons.gov.uk/how-will-the-national-living-wage-affect-employees-and-businesses-in-the-uk/>) people in “elementary jobs such as cleaners and refuse collectors” will benefit most as approximately 26.5% of these employees were paid at a rate lower than that of the National Living Wage. These individuals will therefore see a rise in their wages due to the introduction of the National Living Wage.

Those in professional occupations will feel the lowest impact as less than 1% of employees in this sector are paid below the National Living Wage before April 1, 2016.

**Figure 3: Percentage of employees in each occupation group paid below the NLW before April 1, 2016, UK**



<http://visual.ons.gov.uk/how-will-the-national-living-wage-affect-employees-and-businesses-in-the-uk/>

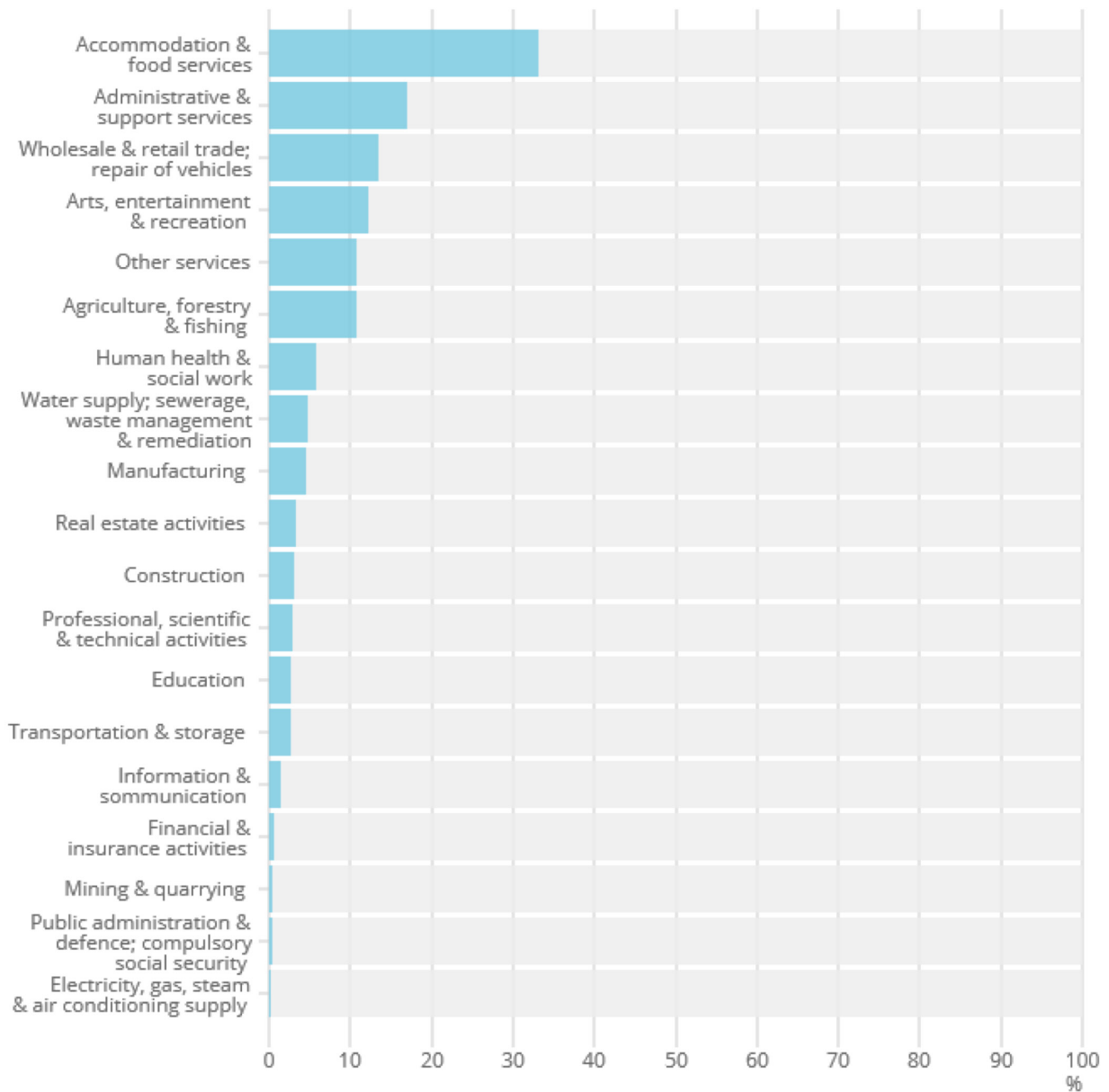
Individuals in lower skilled jobs, tend to be paid lower wages by employers therefore individuals in lower skilled jobs are the most likely to be paid minimum wage and therefore are most likely to benefit from a rise in their wage rate.

Businesses will incur an increase in labour costs if they pay the National Living Wage to employees aged 25 and over. This can lead to lower profits or a rise in prices. A rise in prices of goods and services will make a firm less price competitive which could lead to a decrease in demand for their services.

According to the ONS the industries which have the highest proportion of their workers who are paid minimum wage will feel the biggest impact of the National Living Wage. As seen in Figure 4, Accommodation and food services (33.2%) and Administration and support services (16.9%) are the industries with the highest proportion of their workers being paid the National Minimum Wage before April 2016.

In contrast public administration, defence and social security and electricity and gas supply have the smallest proportion of workers paid below National Minimum Wage, therefore the National Minimum Wage legislation is likely to have only a small impact on these industries and their costs.

**Figure 4: Percentage of employees in each industry paid below the NLW before April 1, 2016, UK**



Source: <http://visual.ons.gov.uk/how-will-the-national-living-wage-affect-employees-and-businesses-in-the-uk/>

### Advantages of the National Living Wage

**1. Higher levels of disposable income.**

The National Living Wage will provide higher levels of disposable income for people aged 25 and over who are in minimum wage jobs. This will enable them to have a better standard of living as they will be able to afford to purchase more goods and services.

**2. Increase incentive to work.**

The National Living Wage is higher than the National Minimum Wage and therefore will provide more incentive to work for people over the age of 25 who are currently unemployed. This will increase the supply of labour in the economy and also could reduce the number of individuals claiming welfare benefits which will reduce the opportunity cost associated with the payment of welfare benefits.

### Disadvantages of the National Living Wage

**1. Large increase in the cost of labour.**

Some industries and organisations will see large increases in their labour costs, decreasing their price competitiveness. This will have the biggest impact on industries which had a large proportion of their total workforce being paid the National Minimum Wage before April 2016.

**2. Higher prices for consumers.**

Increased costs for firms may be passed on to consumers in the form of higher prices. This will reduce consumer satisfaction and could increase the cost of living for individuals. Increased prices could lead to inflation within the economy.

**3. Unemployment.**

The National Living Wage will see a price floor, even higher than that of the National Minimum Wage for over 25 year olds. This increases labour costs for firms and may lead to a further contraction in demand for labour. This could cause a larger increase in unemployment than that caused by the National Minimum Wage, causing the impacts to be more severe on the UK economy.



## Summary

Both the National Minimum Wage and the National Living Wage have increased wage rates for employees within the UK with the purpose of increasing disposable income and standards of living.

However both the National Minimum Wage and the National Living Wage are not applied in all economies across the globe, or even in Europe which can have negative impacts on a firm's price competitiveness. They have both increased labour costs for firms and care needs to be taken that large increases in either do not lead to an increase in unemployment and inflation within an economy,

The impacts of the National Living Wage for the UK will depend on the size of the increases in National Living Wage. The National Living Wage is estimated to be £9 per hour by the year 2020. This is a significant increase in hourly pay rates over a short period.

If the National Living Wage does increase by this amount within 4 years, firms in industries such as accommodation and administration are likely to see steep increases in their total wage costs.

## REVISION QUESTIONS:

1. Explain the difference between the National Minimum Wage and the National Living Wage.
2. Explain two benefits and two drawbacks of the National Minimum Wage.
3. Using the table below identify which year saw the biggest increase in wages for a) 21 and over b) 18–20 year olds.

### Changes in National Minimum Wage Rates in the UK 2012–2015.

Age	21+	18–21	<18
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Source: Adapted from <https://www.gov.uk/national-minimum-wage-rates>

4. If Stephanie is aged 22 and works as an admin assistant for 28 hours per week, calculate her weekly wage in November 2015 if she is paid the National Minimum Wage.
5. Explain 2 impacts on firms because of paying the National Living Wage.
6. Evaluate why some industries will feel a bigger impact from the National Minimum Wage than others.

