1 Introduction
Most countries, developed and developing, set a legal minimum level to wages either through statute or by giving legal force to the terms of collective agreements negotiated between employers and trade unions. Neoclassical economics, however, is hostile to minimum wage legislation and to labour standards more generally, seeing them as an unwarranted interference with the operation of the market and a cause of unemployment. In the early 1990s some striking empirical evidence from the USA and the UK showed that employment rose when minimum wage laws are introduced (Card and Krueger 1995) and fell when such laws were repealed (Dickens et al. 1993). Since then the implementation of a statutory national minimum wage in Britain has been achieved without significant disemployment effects (Metcalf 2007). Although it is now widely accepted that empirical evidence has cast doubt on the orthodox economic critique of the minimum wage, there is less consensus on what it might mean for economic theory or for the understanding of how the legal system affects the workings of the labour market.

This chapter will begin by briefly reviewing types of minimum wage legislation before looking at the standard neoclassical critique of the minimum wage. The recent empirical evidence is then examined and consideration is given to its implications for theory. Then the focus shifts to two practical issues arising from the contemporary practice of minimum wage regulation: the dynamic effects associated with introducing and raising a minimum wage, and the interaction of minimum wage laws with the tax and social security systems.

2 Types of minimum wage legislation
Minimum wage laws come in a variety of forms which reflect the wide range of rationales which have been given for this type of legislation and, to some degree, different national approaches to labour market regulation. In Britain the Trade Boards Act 1909 was based on the policy of curbing extreme forms of low pay which were associated with the ‘sweated trades’. These were sectors of the economy in which employers were seen as paying below a subsistence or living wage and were therefore receiving an implicit subsidy from the rest of the community. As it was put at the time,
it is doubtful whether there is any more important condition of individual and general well being than the possibility of obtaining an income sufficient to enable those who earn it to secure, at any rate, the necessaries of life. If a trade will not yield such an income to average industrious workers engaged in it, it is a parasite industry, and it is contrary to the general well being that it should continue. (House of Commons Select Committee on Home Work 1908, cited in Deakin and Wilkinson 2005, p. 233)

The causes of sweating were understood to include both an excess of labour supply and destructive competition between employers, leading to a downward cycle of cost cutting and wage reductions. The solution in the 1909 Act was to set up statutory wage-setting mechanisms in a small number of industries in which self-regulation by the relevant trade unions and employers’ associations was seen to have failed. By taking very low wages out of competition, ‘the enforcement of a common standard throughout the trade not only stops the degradation, but in every sense conduces to efficiency’ (Webb and Webb 1897, p. 767).

However while addressing the issue of very low wages, the trade boards were not well designed to achieve the wider efficiency goal which the Webbs and their fellow Fabians had envisaged for them, in part thanks to the limited powers which they were given and the small number of industries they covered. After the Second World War the trade boards, renamed ‘wages councils’, acquired a different function, namely ‘the use of State power to keep collective bargaining going when economic circumstances tended to destroy it’ (Bayliss 1962, p. 56). On this basis the number of trades affected by statutory regulation was greatly extended, but no attempt was made to put a legal floor in place in industries where voluntary collective bargaining remained in operation. In the 1960s the same policy of prioritising self-regulation wherever possible saw a major retrenchment of the wages councils sector, although as it turned out, voluntary collective bargaining was slow to return in many of the industries concerned (Craig et al. 1982). The remaining wages councils saw their powers reduced in the mid-1980s before being repealed completely in 1993. For the five years between then and the passage of the National Minimum Wage Act in 1998, there was no minimum wage legislation in force in the UK outside the agricultural sector, where wages boards were preserved.

Thus the British minimum wage system for most of the twentieth century was based on partial and selective statutory regulation and subordinate to the wider goals of labour law policy, which up to the 1980s were the preservation of a system of collective self-regulation by trade unions and employers. This was different from, for example, the model of wages boards in Australia and New Zealand. These institutions, which predated their British counterparts, put in place a model of legal enforcement of
minimum standards in pay and working conditions for all sectors of the economy, and not simply for those industries which were felt to be incapable of setting standards through collective bargaining. In the Australian and New Zealand model, which lasted more or less intact up to the early 1990s, the process of wage negotiation was both underpinned and, in some periods, actively shaped by judicial intervention. This intervention was aimed not just at setting a sectoral floor of rights, but at raising minimum terms and conditions to the point where they guaranteed a living or ‘breadwinner’ wage to full-time workers, ‘enough to support the wage earner in reasonable and frugal comfort’, as it was put in the 1907 Harvester judgment of the Australian Federal Conciliation and Arbitration Court. British trade boards and wages councils were more modest in their goals, seeking to ameliorate the more extreme consequences of low pay but holding back from the objective of instituting a living wage, in part for fear of undermining voluntary collective bargaining.

US minimum wage laws of the early part of the twentieth century were motivated by some of the same concerns about low-paying trades which led to the British legislation of the same period. However, following the judgment of the Supreme Court in the Lochner case (1905), striking down maximum hours legislation on the grounds that it amounted to an interference with individual freedom of contract (the ‘substantive due process’ doctrine), state-level minimum wage laws had to pass a strict test of constitutionality. Laws regulating the working time of adult women and of young workers were allowed, but a minimum wage law for women workers was struck down in Adkins v. Children’s Hospital (1925). The constitutionality of minimum wage laws was not established until West Coast Hotel v. Parrish (1937), in which the Supreme Court repudiated its Lochner jurisprudence. The following year the US Congress passed the Fair Labor Standards Act (FLSA), which remains the basis for national-level minimum wage legislation (Harris 2000). The FLSA was explicitly designed as an anti-Depression measure which would stop wage cutting, enhance purchasing power, help to reduce industrial conflict and enhance productive efficiency (Kaufman 2007b). However, these wide goals are not well reflected in the Act itself, which is limited in its scope. The FLSA sets a basic hourly rate of pay and regulates overtime work. In principle, the Act only applies to employers engaged in inter-state commerce. In practice, most employers above a fairly low threshold are covered by the law, and state-level laws may set higher minima, although state-level coverage is by no means universal. The FLSA contains no automatic uprating (or, in the US context, ‘indexing’) mechanism; thus for the minimum hourly rate to be raised, additional legislation is needed on each occasion. There have been long periods when no consensus on raising the rates could be achieved and
during which its real level has declined. In 2007, the FLSA was amended by legislation which provided for a staged increase in the minimum hourly rate from $5.15 to $7.25 by 2009.

In continental Europe minimum wage legislation dates from the post-1945 period. The French minimum wage was introduced in 1950 when the salaire minimum interprofessionnel garanti (‘guaranteed minimum inter-occupational wage’) was established. As its name implies, this was intended to be a national statutory minimum applying in all sectors of the economy and therefore setting a basic rate below that of the minima set by collective bargaining at the sector level. Sectoral agreements were also capable of being extended to non-federated employers so, in effect, there was both a general wage floor and a legally binding minimum for most industries. In 1970, the SMIG gave way to the SMIC, the salaire minimum interprofessionel de croissance (‘minimum inter-occupational growth wage’). Unlike its predecessor which was linked to price inflation, the SMIC is automatically uprated with both prices and wages: its annual revaluation must keep in step with each 2 per cent rise in the consumer price index and rise in line with at least half the growth in the purchasing power of the average wage. The legal power also exists for additional one-off increases by presidential decree. This power has been frequently exercised. Unusually for a statutory minimum wage, the SMIC is expressed not just as a basic hourly rate but also as a minimum monthly amount. By virtue of its legal structure, the SMIC has come to be expressed as a significantly higher proportion of the average (median) wage than is the case in most other systems.

The law underpinning the SMIC reflects a solidaristic and egalitarian labour law policy which goes beyond the goal of addressing low pay as such. It is premised on the view that the lowest-paid workers should participate in the benefits of the growth of the national economy to which they have contributed along with more highly paid groups. The SMIC’s relatively elevated level coupled with a recent policy of reducing social and fiscal charges for lower-paid jobs has meant that those receiving the minimum wage in France are a much higher proportion of the overall working population, over 16 per cent (Ministère du travail 2008), than in the United States, for example, where the corresponding figure is just over 2 per cent (US Department of Labor 2008).

Statutory minimum wages operate in certain other European systems (including the Netherlands, Portugal, Spain), but on a less interventionist basis than the SMIC, being linked in most cases to price rather than wage inflation (Deakin 1990). In Germany, there is no minimum wage as such, but in most industries there are mechanisms for the extension of basic rates set by multi-employer collective agreements. Concern about their effectiveness in practice has led to discussion on whether a
statutory wage floor should be introduced. In Belgium the same task is performed by legally binding national-level collective agreements while in Italy there are legal procedures originating in the constitution for the application to all employers of an ‘equitable wage’ based on sectoral rates. The Nordic systems rely mostly on collective agreements which, while not legally binding in themselves, are widely observed in practice in part as a result of trade union pressure. This pressure, in turn, depends on laws protecting the right to take industrial action in defence of collectively agreed rates of pay (McLaughlin 2007). In most central and eastern European systems, where collective bargaining is relatively under-developed, there are statutory minimum wages in place. Statutory norms also operate in most Latin American countries and in some Asian and African countries.

3 Standard neoclassical theory on minimum wages

In the orthodox neoclassical account of the labour market, competition between firms for labour and between workers for jobs ensures that wage rates for labour of comparable productivity are more or less equal throughout the market and beyond the power of any individual economic actor to affect. The movement of the market towards equilibrium acts as an implicit regulator of individual decisions on whether to trade and at what price. Firms which attempt to pay below the market rate risk losing their workers to competitors in the same way that workers who attempt to force up wages above the competitive level risk losing their jobs as firms at the margin substitute labour for capital or cease to trade.

Repeated empirical studies – surveys and case-studies of firms dating back to the first large-scale studies of low pay in Britain and the USA – have shown that labour markets do not display these characteristics (Nolan 1983). Firms do not automatically adjust wages to changes in demand for labour and there is considerable divergence in the pay and conditions offered by different employers to workers doing similar jobs. Neoclassical theory tries to explain away these findings by the argument that freely competitive markets tend towards equilibrium. Limitations upon the flow of information and upon the mobility and substitutability of factors of production are overcome in time by the unravelling of competitive market forces. The market itself is seen as a powerful force for equality: under conditions of perfect competition, equal pay for work of equal value would follow from the operation of supply and demand. Where apparent inequalities in pay persist, they are viewed as the result of pre-market factors: differences between individuals in terms of endowment and ability, differences in individuals’ ‘tastes’ for work, training or leisure, or differences in employers’ ‘tastes’ for discrimination (Becker 1957).
Regulation is also seen as an exogenous cause of inequality preventing market clearing. Public choice theory regards labour legislation as the outcome of organised pressure-group activity (Heldman et al. 1981; Rowley 1985). Trade unions, according to this point of view, are labour monopolists seeking to cartelise the labour market. By driving wages above the market or equilibrium rate, they depress demand for employment and divert resources into wasteful rent seeking. The costs of trade union activity are borne by consumers, in the form of artificially high prices, and the unemployed, who are ‘priced out’ of work. Trade union legislation, by supporting collective bargaining and the right to strike, ensures that these inefficient monopoly practices are protected against the market forces which would otherwise drive them out (Posner 1984). On similar grounds it is predicted that minimum wage laws would have a disproportionately adverse impact on the young, those without formal training or qualifications, and those re-entering the labour market after a long absence (such as the long-term unemployed) (Minford 1985).

4 Recent empirical evidence: a basis for reassessing standard theory?
The minimum wage has given rise to a vast empirical literature. Until recently the consensus was that the introduction of a minimum wage and subsequent rises in its level would both almost certainly lead to increases in youth unemployment and sometimes to increases in adult unemployment (Brown et al. 1982). However, this conclusion rested mainly upon time-series studies using long-term aggregate data of teenage unemployment derived from a single source: the US Current Population Survey. Critics suggested that these studies could not be regarded as definitive since the estimated employment effects are small and also highly sensitive to the choice of sample period (Card 1991).

Case studies by Card, Katz and Krueger examining the implementation of minimum wage reforms in various US states in the late 1980s and early 1990s presented a different picture (Card 1991; Card et al. 1993; Card and Krueger 1994, 1995). The research took advantage of the opportunity for comparative study which arose from the variations in rates of increase between states and by the decision of the US Congress in the late 1980s to raise the federal minimum wage after a period of several years when its nominal value remained constant and its real value declined. One study examined the effects of raising the minimum wage in California in 1987, comparing teenage employment rates with those in states which did not increase their minima at the same time. It was found that both the earnings and the employment of teenagers in California increased after the minimum wage was raised, despite over half the teenage employees in the state being affected, a very high compliance
rate, and few exemptions being allowed in the legislation. Similarly a study comparing New Jersey, which increased its minimum wage, with Pennsylvania, which did not, found evidence of increasing employment in the former state. An analysis of the implementation of changes in the federal law in the fast food industry in Texas, a sector employing mostly part-time workers and with labour turnover rates in excess of 300 per cent per annum, found that most employers observed the new adult rates for the minimum wage, but that few took advantage of the possibility of paying a teenage sub-minimum. Over 70 per cent of the firms interviewed did not report responding to the new rates by either dismissing workers or cutting fringe benefits.

In Britain during the same period, minimum wage regulation was being weakened as a consequence of legislation which cut back the powers of the wages councils (wage-setting bodies operating at industry level in certain sectors). After 1986, they were prevented from setting rates for younger workers and in 1993 their powers to set wages and conditions were completely removed. Prior to the 1986 Act, it was ‘confidently postulated’ that the abolition of the wages councils would ‘serve to expand employment [and] offer competitive wages for the socially disadvantaged’ (Minford 1985, p. 122). However, econometric studies found that employment in low-paying service sectors declined as a result of the decreasing effectiveness of the wages councils (Machin and Manning 1994; Dickens et al. 1993).

The US findings on the positive impact upon employment of minimum wage increases produced a stormy debate. Some critics argued against the use of a comparative case-study methodology, while others sought to provide different explanations for the observed employment effects (Kennan 1995; Neumark and Wascher 1995). As further studies have been carried out, disemployment effects of minimum wage regulation have been identified in a number of contexts, leading a recent review of the literature to conclude that around two-thirds of the relevant studies ‘give a relatively consistent (although not always statistically significant) indication of negative employment effects of minimum wages’, with stronger disemployment effects for the least skilled groups (Neumark and Wascher 2006, p. 121). The principal criticism of the studies by Card, Katz and Krueger is that they cover too short a period for the effects of minimum wage increases to be effectively evaluated; longer panel studies have tended to find negative impacts on employment (Neumark and Wascher 2006). But while the empirical literature continues to evolve, a simple return to the neoclassical orthodoxy seems unlikely. A lasting impact of the studies by Card and Krueger has been to stimulate interest in alternative theoretical approaches.
5 Alternative theoretical perspectives

One possibility which is compatible with orthodox neoclassical theory is that employers in low-wage sectors are monopsonists holding a degree of market power over their employees (Manning 2003). This enables them to keep their wages below the equilibrium or external market rate. It would be in the interests of such employers to avoid taking on new employees at the market rate if they then felt obliged, on the grounds of equity, to raise the wages of their existing employees. Under such conditions, a limited rise in the minimum wage would necessarily lead to a rise in employment as the higher wages attracted new recruits into the industry concerned. Too large a rise, on the other hand, would lead to unemployment, particularly where there were wide variations in the degree of monopsony power which individual firms possessed (Stigler 1946).

A more radical departure from the orthodox account is provided by theories informed by an institutionalist view of the labour market (Kaufman 2007a, 2007b). These can be seen as drawing on theories of incomplete contracts and bounded rationality in the context of the employment contract (Williamson et al. 1975; Simon 1951) as well as behavioural economics (Fehr and Falk 1999). Because of positive transaction costs and related imperfections in the way labour is contracted, low pay can arise independently of the productivity of the workers concerned. Studies which focus on the link between low pay and industrial structure have shown how wage inequality persists as the result of path dependence in the evolution of particular industries. It is argued that since low pay is concentrated in particular occupations and sectors, pay inequality cannot be wholly explained by differences in the skill and quality of individual workers (Craig et al. 1982). Rather low pay comes to be associated with jobs which are socially undervalued or which are performed by workers who are accorded a low labour market status. ‘Undervaluation’ is a consequence of a number of factors, including employer strategies, differences in the effectiveness of worker organisation, and the division of labour within the household. For example, one effect of the sexual division of labour is that skills traditionally associated with women’s non-waged labour in the home, such as caring and cleaning, command lower pay in the labour market than other comparable ‘male’ skills. Linking women’s pay to skill levels is, in practice, highly problematic. Studies comparing male and female earnings across a range of occupations have suggested that as much as three-quarters of the wage gap between men and women in comparable jobs could not be put down to skill-related factors (Horrell et al. 1989).

This perspective leads to a different view of minimum wage legislation (Deakin and Wilkinson 1992). Rather than being an ‘artificial’ interference in the free market, it becomes just one form of regulation which,
together with other conventions, norms and customary practices, governs the way in which labour is contracted. The case for legislation is that, as a consequence of differences in industrial structure, certain groups in the labour market will not have access to voluntary means of labour organisation, such as collective bargaining or the protection of professional rules governing entry and access to jobs. Hence the industries in which low pay is endemic are those in which there are structural factors, such as ease of entry by both firms (the result of low capital requirements) and workers (the result of the failure to develop and enforce formal skills and qualification requirements), which impede the effective organisation of labour and hence the application of common terms and conditions. Although these sectors appear more than any other to resemble the neoclassical ‘norm’ of free competition, in fact they are the exception. The persistence of these conditions means that low pay is in effect a subsidy enabling otherwise uncompetitive firms and industries to survive. Minimum wage regulation is therefore necessary in order to help create an environment in which firms compete not on the basis of low pay but instead through high labour quality and product and process innovation (Deakin and Wilkinson 1999). Equally, placing a floor under wages can augment the purchasing power of workers and thereby underpin effective demand (Michie 1987; Prasch 1996). These efficiency-orientated and macroeconomic effects have indeed been prominent among the justifications offered for the introduction of minimum wage regulation in most of the systems adopting it.

As Kaufman (2007a, 2007b) argues, an institutionalist position of the kind just outlined is at least consistent with the stated goals of minimum wage regulation in Britain and America, as we have seen, as well as in many other systems. Neoclassical accounts of the minimum wage, by contrast, ascribe to minimum wage legislation objectives which it either does not have or which can at best be described as indirect effects of this kind of regulation. Thus it is frequently asserted that one of the main objectives of the minimum wage is to reduce household poverty or to redistribute wealth in favour of lower-income households (Stigler 1946, p. 358; Sobel 1999, p. 763). Because most of the poorest households have no members in paid employment, it is perhaps not surprising that minimum wages are often found to have little impact on household poverty as such, although this is not to rule out the possibility that minimum wages, when effectively linked to other policies including fiscal measures, can improve income levels in households with low earners.

Evidence of disemployment effects presents a potentially more telling criticism of minimum wage laws. From an orthodox point of view, the ambivalence of empirical evidence on this point is perhaps best understood as suggesting that the neoclassical model is not inherently wrong. Rather,
the magnitude of the effects which it predicts may be much less than is generally supposed and, where they exist, can be addressed by means other than deregulation, such as active labour market policy interventions, including a reduction in the level of fiscal charges and social security contributions payable on low wage employment. Alternatively, the absence of a negative impact on employment may mean that the effects of a statutory wage floor are experienced by firms in the form of lower profits (Metcalf 2007).

From an institutionalist perspective, on the other hand, the possibility that minimum wage laws cause frictional unemployment as workers are displaced from low-paying jobs is not necessarily a reason to oppose them. In imperfect labour and product markets, inefficiently managed firms can survive by exploiting sources of undervalued labour. Minimum wage laws which rule out this managerial strategy provide inducements for the more efficient use of labour. More generally, labour laws, including minimum wage legislation, which set a floor of rights within the labour market, ensure a better alignment of private and social costs. If wages do not cover the long-run costs of reproducing the labour supply, there is a mismatch in the structure of production. Minimum wage laws, when introduced for the first time, would lead to unemployment in firms and industries which previously benefited from a subsidy, but the workers thereby displaced would find better paying jobs elsewhere and the capacity of the economy to offer high quality employment would be enhanced. Conversely, the effects of deregulating minimum wage laws or cutting minimum wages in real terms would be to shore up inefficient firms and limit opportunities for productive employment (Kaufman 2007b).

6 Dynamic effects of introducing and raising the minimum wage

The general case for retaining a minimum wage, if one is in place, is distinct from more specific arguments for and against introducing or reintroducing minimum wage regulation. A fundamental change of this kind in the regulatory framework may well have far-reaching effects which cannot be precisely predicted. Moreover, it is unlikely that the effects will all be in one direction. Although an argument can be made, as we have just seen, for long-term efficiencies arising from the presence of a statutory wage floor, these may have to be traded off against short-run adjustment costs as some enterprises go out of business and workers retrain. Other matters to be decided include the level at which the minimum wage is set, and the mechanism through which it is subsequently varied.

These issues were at the forefront of the policy agenda in Britain following the election of a Labour government in 1997 which was committed to reintroducing minimum wage regulation after an interval of several years
during which (the agricultural sector aside) no legally mandated minimum wages were in operation. The National Minimum Wage Act 1998 broke with previous practice by legislating a statutory minimum that would apply, in principle, to all sectors of the economy, a reflection of the decline of voluntary collective bargaining which had occurred since the early 1980s. However, rather than set a rate directly, the 1998 Act established a procedural mechanism for determining the statutory minimum in the form of the Low Pay Commission (LPC) (Low Pay Commission 2008). The LPC consisted of three representatives of employer groups, three trade union representatives and three independent members.

The LPC recommended an initial rate which was towards the lower end of the range put forward by advocates of the minimum wage, namely £3.60 per hour from April 1999, rising to £3.70 in June 2000. The £3.60 figure represented about 45 per cent of median earnings and affected about 11 per cent of the working population over the age of 20. Sixteen- and 17-year olds were to be exempt and 18- to 20-year olds received a lower rate of £3.20 per hour from April 1999, rising to £3.30 in June 2000. The LPC estimated that the effect of introducing these reforms would be to add 0.6 per cent to the total national wage bill. The sectors most heavily affected would be cleaning, catering and security, and the groups to benefit most included women workers and homeworkers. The government accepted the Commission’s recommendations for adult workers, but set the starting rate for 18- to 20-year olds at £3.00 per hour, rising to £3.20 by June 2000. By 2008 there had been several above-inflation rises in the basic adult rate, which was increased to £5.73 by October of that year.

The work of the LPC represents a significant example of the use of economic evidence to aid public policy. The first Commissioners included several economists and the LPC made extensive use of social science research in its deliberations. The LPC was sympathetic to the monopsony model, noting its implication that ‘moderate minima can be introduced without destroying jobs’ (LPC 1998, p. 114), while at the same time noting the broader ‘undervaluation’ argument, in particular as it applied to female labour (LPC 1998, p. 115). It also considered that the introduction of a minimum wage might have an impact on industrial structure:

Whatever the nature of the labour market, it is likely that a National Minimum Wage will have a greater effect on the structure of employment than on its level. Businesses which are inefficient or which produce low value-added goods may need to reorganise working practices. If the National Minimum Wage is properly enforced, business and employment are likely to transfer to more efficient firms or to those offering higher value-added products and services . . . minimum wages may cause a transfer of jobs between groups such as the substitution of more skilled for less skilled workers . . . (LPC 1998, p. 115)
Metcalf, one of the original commissioners, has recently assessed the impact of the UK legislation (Metcalf 2007; Arrowsmith et al. 2003; Stewart 2004a, 2004b; Machin and Wilson 2004; Ram et al. 2004). He found, first of all, that the national minimum wage (NMW) had a positive impact on earnings. Because of the various upratings which had taken place, the NMW had risen substantially faster than both prices and earnings, with the rate of increase intensifying after 2002. The fall in the relative earnings position of the lowest quartile of the distribution which occurred between 1993 and 1997, when no statutory minimum wage rates had been in force outside agriculture, was reversed. The NMW had also contributed to a reduction in the gender pay gap, measuring the difference between male and female earnings, of five percentage points (from 20 per cent to 16 per cent for full-time employees). Overall, wage inequality in the UK fell after 1998, having previously risen uninterruptedly from 1978; all the fall can be attributed to the NMW. Turning to the effects on employment, Metcalf’s review found that there was no evidence that the NMW had affected aggregate employment and unemployment in the UK in the period since its introduction which was, mostly, one of rising employment and falling unemployment. There had been no fall in employment in low-paying sectors (retail, hospitality, social care, cleaning, agriculture, security, textiles, clothing and footwear, and hairdressing) with the exception of textiles, which had been subject to a long-term decline. Studies of the effects of the NMW on particular demographic groups found no negative impacts for either male or female workers or by reference to age, nor was there evidence of a negative impact on groups of workers particularly affected by NMW upratings. Analysis of establishment-level surveys of workplace practice and of financial data relating to closure rates, profits and productivity also failed to find negative employment effects.

Metcalf’s study also discussed possible reasons for the absence of a disemployment effect. He rejected the possibility that the NMW had been set at or below a competitive rate or that there were significant gaps in coverage. He found some evidence of a positive but statistically insignificant association between the NMW and productivity growth, which was probably not caused by the substitution of capital for labour, but by employment stabilisation and an increase in training for workers. There was also evidence that firms were adjusting hours downwards to compensate for the introduction of the statutory minimum. There had been a reduction in the profitability of firms subject to the NMW. Studies had also found evidence of monopsony in the sense of firms having discretion and flexibility in adjusting wages independently of labour supply and demand. In short, ‘the LPC, via its evidence-based approach . . . has raised the real and relative
wage of low-paid workers without adverse employment consequences’ (Metcalf 2007, p. 53).

The impact of the NMW on industrial structure is harder to gauge. The absence of a disemployment effect can be interpreted in one of two ways: either firms responded to the statutory wage floor by switching to more productive uses of labour, a possibility for which there is some evidence in the form of the positive impact of the NMW on training; or the NMW was set too low to have the ‘shock’ effect which an institutional economic point of view would have argued for (Slichter 1932). The LPC’s 2003 report found ‘no significant impact, positive or negative, of the National Minimum Wage on productivity . . . the introduction of the National Minimum Wage had not provided a boost to productivity, but neither had it led to a general increase in unit labour costs’ (LPC 2003, para. 2.128). An independent assessment around the same time reported that the legislation had little impact on either business performance or on household poverty (Dickens and Manning 2003). Thus, it would seem that, for the time being at least, the NMW is not acting as a Fabian ‘national minimum’ should, that is, to guarantee a living wage while at the same time promoting productive efficiency (Deakin and Wilkinson 2005, p. 342).

7 The minimum wage, household poverty and work incentives

Depending on the level at which the minimum wage is set, it will alter the distribution of resources between households and shape incentives to supply labour. Minimum wage laws which seek to provide access to a subsistence or ‘breadwinner’ wage will attempt to incorporate a cost of living element which will enable a main earner to support both himself (a male breadwinner is normally assumed) and his dependants. Few systems currently come close to providing a legally mandated family wage in this sense, but the model has existed from time to time in certain systems, most notably in Australia following the Harvester judgment (see Section 2, above). It remains a relevant objective in the context of legal support for collective bargaining in many countries. Living wage laws have also been enacted in several American cities in recent years (Adams and Neumark 2005) and there have been campaigns to establish similar norms in British cities. A more common approach in national-level legislation, at least, is for the minimum wage to provide for only a part of low-income households’ needs. Minimum wage laws which help to raise the level of female pay, as in the case of the British NMW, can as a consequence play an important role in addressing the needs of dual-earner households (Metcalf 2007).

Another trend is for the tax and social security systems to be used to bring household incomes up to an implied subsistence level, on the assumption that the minimum wage itself cannot meet their basic needs in full. This
approach is the one followed since the 1990s in the United States through the Earned Income Tax Credit system (Economic Policy Institute 2004; Neumark and Wascher 2007) and in Britain since the 1980s through the Family Credit and the various working tax credits which have succeeded it (Deakin and Wilkinson 2005, pp. 185–95). It has the effect of keeping the level of the minimum wage itself relatively low, thereby reducing employers’ costs as well as avoiding possible disemployment effects, while at the same time enabling social security benefits to be targeted to those households with the greatest need. Such targeting is not possible through minimum wage laws which by their nature apply to single-member and multiple-member households alike. The disadvantages of using the tax and social security law systems in this way are twofold: first, there is a danger of simply subsidising low-paying firms and removing the pressure on them to improve their use of labour; and second, the means testing of social security benefits implies high marginal tax rates for the low paid which can operate as a disincentive to take up paid employment. How far advantages outweigh disadvantages depends on the level at which the minimum wage is set by reference to both subsistence needs and to the levels of social security and fiscal support provided by tax credits.

This type of intervention is not new. During the initial phases of the British Industrial Revolution there was an intense debate about the merits of minimum wage legislation, on the one hand, and the expansion of outdoor relief (the forerunner of social security) to meet the needs of households at a time of chronic oversupply, particularly in rural labour markets. In Parliamentary debates of the mid-1790s a minimum wage was opposed on the grounds, among others, that

by the regulation proposed, either the man with a small family would have too much wages or the man with a large family who had done most service to his country would have too little. So that were the minimum fixed upon the standard of the large family, it might operate as an encouragement to idleness on one part of the community; and if it were fixed on the standard of a small family, those would not enjoy the benefit of it for whom it was intended. (Prime Minister William Pitt the Younger, quoted in De Schweinitz 1961, p. 88)

Rather than legislating to put a floor under wages, Parliament loosened the rules on the granting of outdoor relief in order to encourage parishes (the local units of poor law administration) to top up low wages. The result was the so-called Speenhamland system of poor relief, named after the parish whose tables of wage allowances were widely followed at the time. The practice of wage supplementation was opposed on the basis that it implied ‘interference on the one side and dependence on the other’ (William Cobbett, quoted in Himmelfarb 1983, p. 418), but it only came
Labor and employment law and economics

under sustained attack when the costs of outdoor relief began to soar following the end of the economic boom sustained by the Napoleonic wars in 1815. Malthusian thinking was used to support the case for the retrenchment of poor relief.

Malthus (1798) argued that poverty resulted from population growth which, in turn, was driven by a lack of moral restraint or ‘character’ on the part of the poor. The well-being of the population was determined by a combination of the natural fertility of the land, the willingness of the poor to work, their propensity to reproduce, the rate of accumulation of capital, and the ‘wage fund’, the part of aggregate capital which was set aside for the payment of wages. The legal setting of a minimum wage was bound to reduce employment because the ‘wage fund’ was assumed to be fixed. The payment of poor relief in lieu of wages was just as much an interference with ‘natural’ market laws; attempting to alleviate poverty this way would be self-defeating as it would simply encourage population growth. Malthus’s conclusion that ‘the poor laws of England tend to depress the general condition of the poor’ was used to dismantle the practice of outdoor relief and replace it with the disciplinary mechanism of the workhouse system (Deakin and Wilkinson 2005, chapter 3).

Throughout the nineteenth century, public policy in Britain was hostile to wage subsidisation on the grounds that it tended to lower wages. The assumption at this point was that wages could not go below subsistence as they would then be unable to provide for the reproduction of the labour force; depopulation would be the result, restoring equilibrium in the labour market by reducing labour supply. Thus as long as there was no outside interference either from minimum wage or from poor relief, wages would ‘naturally’ find their subsistence level. As J.S. Mill put it:

When the labourer depends solely on wages, there is a virtual minimum. If wages fall below the lowest rate which will enable the population to be kept up, depopulation at least restores them to the lowest rate. But if the deficiency is to be made up by a forced contribution from all who have anything to give, wages may fall below starvation point; they may fall almost to zero... All subsidies in aid of wages enable the labourer to do with less remuneration, and ultimately bring down the price of labour by the full amount, unless a change can be wrought in the ideas and requirements of the labouring class; an alteration in the relative values which they set upon the gratification of their instincts, and upon the increase of their comforts and the comforts of those connected with them. (Mill 1909, pp. 368–69)

The Fabian attack on the ‘new’ or post-1834 poor law – under which outdoor relief was restricted and the ‘undeserving poor’ confined in the workhouse – incorporated elements of classical political economy, but with a new emphasis and with diametrically opposed implications for
policy. The wage fund theory had been abandoned in the 1880s as the idea of an invariably fixed proportion of capital set aside for the payment of wages came to be seen as implausible, in part as a consequence of the marginalist revolution in economic thought (Biagini 1987). At the same time, the empirical studies carried out by Booth and Rowntree (Williams 1981) revealed that the extent of urban poverty was far in excess (between 10 and 30 per cent of the population, according to which definition was used) of the numbers then in receipt of poor relief (around 3 per cent of the population). This was taken to imply that the condition of (most of) the poor could not be ascribed to their lack of ‘moral character’. The Webbs and Beveridge took the argument further by claiming that the disciplinary emphasis of the poor law was, in itself, a major cause of the casualisation of employment, the oversupply of labour, and, ultimately, of unemployment. The workhouse test for the able-bodied, by ‘establishing a worse state of things for its inmates than is provided by the least eligible employment outside’, was not simply responsible for ‘deliberate cruelty and degradation, thereby manufacturing and hardening the very class it seeks to exterminate’; it also ‘protects and, so to speak, standardizes the worst conditions of commercial employment’ (Webb and Webb 1909, p. 67). The ‘fatal ambiguity’ (Webb and Webb 1909, p. 72) of the poor law was that standards inside and outside the workhouse, since they were mutually reinforcing, would drive each other down until ‘the premises, the sleeping accommodation, the food and the amount of work exacted, taken together, constitute a treatment more penal and more brutalizing than that of any gaol in England’ (Webb and Webb 1909, p. 79).

The solution offered by the Fabians was not a return to the indiscriminate payment of outdoor relief which they associated with Speenhamland – to that extent they adopted Mill’s analysis. However, they rejected the claim of the political economists that wages would naturally reach a subsistence level as long as there was no outside ‘interference’ with freedom of contract. Rather they aimed to stabilise labour supply and promote the efficient use of labour in production by a series of institutional reforms, of which the minimum wage was one; the others, including the extension of the system of unemployment exchanges and the construction of a legal framework of social insurance, gradually displaced the poor law in the course of the first half of the twentieth century until its last vestiges were removed in the mid-1940s (Deakin and Wilkinson 2005, chapter 3).

The revival of theories of the self-equilibrating market, in the new form of the modern neoclassical synthesis, began not long after this point in both Britain and America, and from the 1980s onwards it has come to have a decisive influence on labour market policy. The revival of wage subsidisation policies is one aspect of this. Family Credit was introduced in Britain
in 1988. It was designed to be a supplement to low wages which, rather than being paid as a cash benefit to the household, was intended to be paid as an addition to the wages of the principal earner and set off against their social security contribution and income tax liabilities in the manner of a negative income tax. The government stepped back from the radical intentions of the measure and accepted an argument that the benefit would work more effectively to counter poverty if it was paid to the household as before. However, the principal move was enough to reestablish the principle of wage subsidisation 150 years on from the 1834 Poor Law report; it was expected that the Family Credit would compensate for expected declines in minimum wages following the abolition of the wages councils (Department of Employment 1988).

The original objective of the 1985 social security review, that Family Credit should be paid as an addition to wages and not as a cash benefit, was finally achieved in 2000 under its more comprehensive successor, the Working Families Tax Credit (WFTC). In 2003, a similar scheme including single earners, the Working Tax Credit, replaced WFTC. The tax credit system is premised on the assumption that low wages will not provide access to a subsistence income. The government accepted that the NMW, ‘by setting a floor for wages, is essential to ensure that low-income workers enjoy the full benefit of the tax credit’ (Treasury 1998, p. 17), but it rejected the idea of the living wage on the basis that it ‘could well have adverse consequences for the employment of low-skilled workers, particularly the young’. Tax credits, by contrast, ‘do not raise the direct cost of low-wage workers to employers’ (Treasury 1998, p. 16).

The expansion of tax credit systems in place of a statutory guarantee of a living wage has become a fundamental plank of post-welfare reform public policy in both Britain and America, but the policy is not without its contradictions, which include rising expenditure levels as the social security system extends further into the working population, negative supply-side incentives caused by high marginal tax rates for the low paid, and the subsidization by fiscal means of low-paying (and often inefficient) firms (Deakin and Wilkinson 2005, chapter 5). Whether tax credits prove any more enduring than the Speenhamland system remains to be seen.

8 Conclusion
The debate over the minimum wage demonstrates the remarkably tenacious hold which orthodox neoclassical theory has over the economics profession and public policy even when confronted with evidence which puts in doubt the predictive capacity of that theory. From the point of view of the economics of law, the minimum wage studies show how important empirical work is in testing and reshaping economic theory. The hostility
of mainstream law and economics towards labour regulation, as exemplified by the symposium on the labour market published in the *University of Chicago Law Review* in 1984, is just one of many instances in which apparently clear-cut normative conclusions were drawn from models which had only a weak link to real-world conditions. From an institutional perspective, the effects of the minimum wage – in particular, the consequences of introducing or raising the minimum – can be seen to be highly complex. There are trade-offs between short-run adjustment costs and long-run improvements to productivity and performance which are, however, difficult to assess. Thus one possible conclusion is that while the economic analysis of labour standards may help improve our understanding of how such laws operate, in and of itself it does not provide clear normative guidance to policy makers. At the end of the day, the case for social policy interventions will continue to be based on a range of grounds, of which efficiency is only one. Having said that, there is probably a good efficiency-based case for minimum wage legislation.

**Bibliography**


