Higher wages for UK's lowest paid improve productivity

May 26 2016, by Cerri Evans

A far-reaching new study has provided the most compelling evidence yet that the introduction of the National Minimum Wage significantly increased productivity in tens of thousands of UK companies over the decade since it became law.

A team of economists and labour market specialists developed an innovative analytical technique to estimate the impact of the National Minimum Wage (NMW) on productivity across Britain's low-paying sectors, as defined by the Low Pay Commission.

The researchers believe their findings provide robust contemporary evidence that raising salaries at the lower end of the wage spectrum leads to higher productivity by incentivising workers to work harder, smarter and more cohesively. Their study suggests similar 'wage incentive effects' could now be expected from the introduction of the National Living Wage in the UK in April 2016.

The study was conducted by academics from the University of Lincoln and Middlesex University in the UK, and Australian Catholic University. It is published in the British *Journal of Management*.

Productivity describes how efficiently labour and capital (economic inputs) are combined to produce goods and services (economic outputs). The UK is said to be suffering from a 'productivity problem' because on average British employees have to work more hours to produce the same level of output as their counterparts in many rival economies, such as the USA or Germany. Various explanations have been offered, from underinvestment in research and development, to poor labour management practices.

The latest research shows the significant impact that lifting the wages of the lowest paid workers can have on productivity at a company and sector level. Using financial and employment data covering more than 360,000 firms between 1995 and 2008, the researchers applied a novel statistical framework to model multiple channels of impact, explicitly capturing wage incentive effects. Changes in productivity were estimated within individual firms and across whole industrial sectors, enabling the researchers to control for potential biases and conduct extensive 'difference-in-differences' analysis to verify their findings.

They concluded that the introduction of the National Minimum Wage in 1999 produced a statistically significant increase in productivity across the UK's low-paying sectors. Gains were stronger in service industries, compared to manufacturing. The effect was also greater for larger firms. Productivity grew steadily over the period studied: rising cumulatively by 6.4 per cent in all firms in the low-pay sectors and by 15 per cent in the large service firms.

Lead author Professor Marian Rizov from Lincoln International Business School at the University of Lincoln, said: "Our findings offer compelling evidence that increasing wages for the lowest paid workers improves productivity, and that this effect applies in companies of all sizes and across most low-paying sectors.

"Employees' perception that they and their colleagues are being paid a wage commensurate with their skill and effort - the so-called 'fair wage-effort hypothesis' - has a powerful influence on productivity, alongside other wage incentive effects.

"This has important implications for businesses at a time when [wage inequality](https://phys.org/tags/wage+inequality/) is growing and suggests that the new National Living Wage could potentially be an important step towards tackling Britain's productivity problem."

Provided by University of Lincoln

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