



Proposal to introduce fair piece rates for output workers, including homeworkers

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Introduction

1. This assessment estimates the costs and benefits of the proposal, outlined in the “consultation on draft regulations to introduce fair piece rates for output workers”.

Purpose of the Proposal

2. To introduce an improved system that delivers a fairer level of pay, linked to the national minimum wage, for output workers and homeworkers in particular.

Summary

3. The DTI believes that non-compliance with the existing fair estimates regime is a significant problem amongst low-paid homeworkers. This Regulatory Impact Assessment (RIA) suggests that total elimination of non-compliance by employers and their adherence to the new proposed system of fair piece rates would cost firms and organisations around £300 million a year and would directly benefit workers by around £250 million a year, all based on wage rates in force in 2002/03¹.

4. The total cost of the proposals contained in this RIA then depends on what level the new piece rate is set at. The analysis in this impact assessment suggests that if the new piece rate were set at 120 per cent of the minimum wage, the additional cost of the proposal would be around £230 million and the extra benefit to workers would be around £190 million, also based on 2002/03 wage rates. If the new piece rate were set at 100 per cent of the minimum wage, the extra costs and benefits of moving to fair piece rates (beyond those required to obtain compliance) are expected to be negligible.

¹ 2002/2003: the year from October 2002, when the minimum wage rates of £4.20 an hour and £3.60 an hour for adults and young people, respectively, were in operation.

Background

5. When introducing the minimum wage in 1999 the Government wanted to apply the minimum wage to output work and home working and decided to do this through 'fair estimate agreements'. Under these agreements, employers must set a fair estimate of the hours needed to complete the block of work to be done, which should be agreed with the output worker, and the minimum wage must then be paid for the hours worked up to the limit set in the estimate. The estimate for the number of hours needed is not regarded as 'fair' if it is less than four-fifths of the time that an average worker would take to do the same amount of work in the same conditions. If no fair estimate agreement is in place, then the workers should be paid the minimum wage for all hours that are actually worked.

6. The Low Pay Commission recommended in 2001 that "the Government should consult representatives of output workers and their employers to see whether there is a case for a change in the Regulations on fair estimate agreements". This followed representations to the Commission from both employer and employee groups that these agreements were not working well.

7. A variety of reasons were given for this but the principal point seems to be that they are seen as complex and difficult to administer, and that in practice it may be difficult to predict the estimated hours for each block or tranche of work taken on by an individual homeworker from week to week. Our proposals are designed to make the rules simpler and more easily understood – and this should mean that more employers take advantage of the new arrangements, and help homeworkers to understand and claim their right to the minimum wage.

8. Evidence submitted by the National Group of Homeworkers (NGH) to the Low Pay Commission in Autumn 2002 stated that the majority of homeworkers interviewed in Bradford received piece rates equating to £1.50 to £2.00 per hour. A larger survey conducted for the NGH in 2000 found an average pay rate of £2.66 per hour. However, both surveys were based on small samples. Even the NGH's "larger" survey only had a sample size of 100.

9. According to the 2000 NGH Report, few employers of homeworkers seem to have used the fair estimate agreements system and many homeworkers were unhappy with the terms of the agreement. They say that these agreements are complex and difficult to administer and that employers usually specify time periods for tasks which are unreasonably short, so that workers have been unable to earn the minimum wage.

10. It is possible to derive an estimate of the scale of this issue using data from the Labour Force Survey and analysing home workers by occupational group and their pay distribution. In total, data from the Labour Force Survey suggests that there are around 1 million employees

and self-employed who do paid work mainly from their own home or within the grounds or building of their own home. If we analyse this data by occupation and pay distribution, DTI's best estimate is that around 70,000 homeworkers may not be receiving their entitlement to the minimum wage. The Labour Force Survey indicates that most homeworkers are unaffected by the level of the minimum wage since they are in medium to high-skilled occupations. The vast majority of homeworkers are either already benefiting from the minimum wage or they are being paid well above minimum wage levels.

11. We understand that the NGH believes that the number of homeworkers earning less than the minimum wage may be significantly higher than 70,000. But on either NGH's analysis or DTI's analysis, there is a substantial number, and the issue clearly needs to be addressed.

12. The Government has considered how best to take this matter forward. Both homeworker employers and representatives have suggested that it would be more straightforward to introduce a system of fair piece rates that provides an hourly rate linked to the minimum wage. DTI has held a series of discussions with homeworker employers and representatives over the last eighteen months. (See Annex B).

13. The draft regulations that are now being consulted on provide that:-

- The present 'four fifths' rule, which in effect has allowed employers to pay output workers less than the minimum wage, will be removed. The draft regulations propose that an average output worker should receive a piece rate that would enable him to earn 120 per cent of the minimum wage, which would mean that the majority of output workers would earn more than the minimum wage. However we expect to receive views on this figure as part of the consultation process, and it is possible that this figure could be set at say 100 per cent instead.
- The present requirement to reach prior agreement with the worker is discarded, and instead the system is made dependant on the employer issuing a notice, which would effectively inform the worker of his or her rights under the new system.
- The draft regulations also discard the requirement to make an estimate of the hours needed to complete the task, and instead introduce a requirement for the employer to set a fair piece rate linked to the minimum wage. The employer must set this rate following a test of all or a representative sample of his workforce, or may in certain circumstances estimate the rate where a test has already been conducted.
- The central proposition is that this system would be more easily understood and that this – together with appropriate publicity and enforcement efforts in due course – should mean that more

employers will take advantage of the new arrangements, and that more homeworkers will be clear about whether they are receiving a fair rate.

Costs and Benefits

Costs and benefits of moving to new piece rate policy, including the impact of eliminating employers' current non-compliance

14. In preparing the set of estimates in this part of the RIA, we assume that the fair piece rate proposal brings about full compliance with the minimum wage, eliminating all the non-compliance indicated by the Labour Force Survey data. The main purpose of the proposed legislation is to improve significantly compliance with the minimum wage amongst homeworker employers, and this requires the costing of both the economic impact of eliminating non-compliance and any additional impact from extending coverage of the minimum wage amongst homeworkers.

15. It should be noted that the decision in this RIA to evaluate the cost of eliminating non-compliance does not follow the practice used in RIAs on other changes to minimum wage legislation. The reason for the divergence in practice is that in these other cases, non-compliance was far smaller and addressing non-compliance was not the motivation for the legislative changes. Nevertheless, in section (II) below, we show our estimates of the impact of the proposals without costing the extra impact due to employers non-compliance with existing legislation.

16. We do not have sufficient data on the rates paid to output or homeworkers to know exactly how many workers are likely to be affected. But DTI's best estimate is that currently around 70,000 homeworkers may not be receiving four fifths of the minimum wage, which is the minimum that an employer is required to pay to a worker with a fair estimate agreement.

17. Following the DTI's last consultation, there are now three main options:

A. Fair piece rate system at 120% of the minimum wage:

18. Moving from the current legislation (where employers are supposed to pay an average worker at least four fifths of the minimum wage) to the proposed new fair piece rate system of 120% (so that most homeworkers receive the minimum wage) should deliver a wage benefit to workers (and a wage cost to homeworker employers). We estimate that around 160,000 homeworkers would stand to be covered by the new proposal. To calculate the uplift in pay that would be required to comply with the new regulations, the NMW rates in force in the year from October 2002 to September 2003 have been used since this coincides with the latest available data covering the four quarters ending Summer 2003.

19. The required uplift in pay to take an average worker on a fair estimate agreement to a new piece rate set at 120 per cent of the minimum wage would be £1.68 an hour. Adding non-wage labour costs and multiplying by average hours worked per week, the direct cost to employers of the proposed change (including the cost due to eliminating all current non-compliance) would be around £530 million per year².

20. This estimate of £530 million includes both the cost of a pay rise for workers already on the minimum wage and a pay rise for workers who would now be covered by the new proposal. Workers benefiting from the new regulations would collectively receive around an extra £440 million, equating to an average benefit per worker of around £2,800 per year, before adjusting for taxes and any benefit entitlements.

B. Fair piece rate system at 110% of the minimum wage:

21. As an alternative, the new fair piece rate system could be introduced at 110 per cent of the minimum wage. If this were the case, we estimate that around 130,000 homeworkers would stand to be covered. Using the same methodology as when calculating the cost of moving to an average piece rate of 120 per cent of the minimum wage, the direct cost to employers of paying the average worker 110 per cent of the minimum wage would be around £410 million per year. Workers benefiting from the new regulations would collectively receive around an extra £340 million, equating to an average benefit per worker of around £2,650 per year, before adjusting for taxes and any benefit entitlements. These figures again include the cost due to eliminating all current non-compliance.

C. Fair piece rate system with the average worker paid 100% of the minimum wage:

22. As an alternative, the new fair piece rate system could be introduced at 100 per cent of the minimum wage. If this were the case, we estimate that around 100,000 homeworkers would stand to be covered. Using the same methodology as before, the direct cost to employers of paying the average worker 100 per cent of the minimum wage would be around £300 million per year. Workers benefiting from the new regulations would collectively receive around an extra £250 million, equating to an average benefit per worker of around £2,550 per year, before adjusting for taxes and any benefit entitlements.

² "Around £530 million" is calculated as follows: 157,000 (number of workers) * increased wage rate per hour from moving to new system (leading to more compliance) with the higher rate of 120% * 1.2 (non-wage labour costs of 20%) * 33.41 (average hours worked per week) * 52 (weeks per year) = around £530 million. NMW rates operating from October 2002 to September 2003 are used.

23. One of the key advantages of these proposed arrangements are that they should be more easily understood and we hope that this, together with targeted enforcement efforts, will help to substantially increase compliance with the minimum wage amongst home workers. Since obtaining a higher degree of compliance from employers is such a central aspect of the proposed regulatory change, we have not assumed as our starting position that employers are currently complying with existing legislation as we have assumed in other minimum wage RIAs such as those on changes to the rates. As a result, the above estimates are based on our estimates of workers' actual wage rates and the resulting wage costs and benefits to workers include the expected pick-up in compliance from the new proposals.

Costs and benefits of moving to new piece rate policy, excluding the impact of eliminating employers' current non-compliance

24. In this section we calculate the cost of the proposals without costing the effect of bringing employers not currently complying with the minimum wage back within the law.

25. The costings contained in the original National Minimum Wage RIA (1999) assumed that all workers are paid in accordance with the minimum wage regulations. So, in this RIA we could just evaluate the additional costs and benefits and not any other impacts that should already have been accounted for in the original RIA. If we do this, the costs and benefits would be significantly lower. This is because the original regulations stated that in cases where a fair estimate agreement has not been made, the employer is obligated to pay his workers the prevailing hourly minimum wage rate.

26. Evidence provided by the NGH suggests that most homeworkers on piece rates have no fair estimate agreement. In this case, the original regulations would have required that such adult homeworkers be paid £4.20 an hour in Spring 2003. Using this rate as a base, the cost of the "120 per cent" and the "110 per cent" proposals are around £220 million and £100 million respectively. The total benefit to workers is £190 million and £80 million and the average benefit per worker falls to £1,200 and £650 per year.

27. For the 100 per cent option, where the average worker has to be paid the minimum wage, there are no recorded costs and benefits of moving to fair piece rates assuming total compliance with existing legislation. This is because the current law requires that normal minimum wage rules apply if employers have not taken advantage of the existing concession that allows a Fair Estimate Agreement to be made at four fifths of the minimum wage. Our understanding is that since very few employers have taken advantage of Fair Estimate Agreements, the vast majority of homeworkers should be receiving a normal hourly rate of pay from their employers that complies with the minimum wage. These estimates therefore assume that employers are in compliance with

existing legislation by paying their output workers the minimum wage for all hours worked.

28. All these estimates in (I) and (II) are subject to considerable uncertainty due to the quality issues surrounding the data on homeworkers' pay and the lack of any specific data on the pay of piece-rate workers. We have also assumed in this analysis that the increase in compliance and coverage resulting from the various proposals do not lead to any job losses.

Administrative costs

29. It is possible that there could also be some small administrative costs of switching to a new fair piece-rate system. There could also be some savings if there are no longer requirements to keep a record of hours worked and to agree a new Fair Estimate Agreement for each pay reference period. However, any costs and savings are likely to be minimal for RIA purposes. Given the anecdotal evidence of the current low take-up of FEAs, any savings from switching to a new system are likely to be small. As for the costs side, the cost of implementing any new piece-rate system are expected to be only slightly higher than the costs implicit in the original 1999 RIA.

30. To estimate the extra administrative cost, we first calculated the number of employers that are likely to be affected by the proposal. Based on workplace-based data from the Labour Force Survey and breaking it down by occupational category, we estimate that the number of organisations employing homeworkers that would be effected by the proposed changes ranges from 6,800 to 8,400, depending on whether the fair estimate is set at 110 or 120 per cent. If we assume that new fair piece-rates have to be calculated and agreed in each case, then some extra managerial time will be required. Assuming that an extra half-day of managerial time is required in each case, the estimated cost would be £95 per employer³. For all organisations affected by the proposal, the total estimated administrative cost is between £500,000 and £800,000, depending on whether the new piece rate is set at 100 per cent, 110 per cent or 120 per cent.

Impact on small firms

31. There could be a significant impact on some smaller firms but as long as they are already paying in accordance with the existing minimum wage regulations, the impact on them should not be disproportionately larger than the impact on larger firms.

³ £95 per firm is calculated as follows: Personnel manager is used as a proxy for a manager. New Earnings Survey (2002) gives this as £18.67 an hour. For a half-day, uprating for one year's earnings growth since 2002 and adding non-wage labour costs of 30 per cent gives an estimate of around £95 per employer.

Consultation

32. We consulted in Spring 2003 on the proposal to replace 'fair estimate agreements' with a system of 'fair piece rates' linked to the minimum wage. The majority of responses to the consultation said that the fair piece rate should be set so that an average output worker could earn 120% of the minimum wage, thereby ensuring that most output workers receive the minimum wage. We circulated the draft regulations to key organisations on the 3 November 2003 and the consultation will finish on 30 January. Over the last eighteen months the DTI has held a series of meetings with the key stakeholders on the proposals. Both consultations were sent to the main interested employee and employer groups including leading small business representatives. More details of the consultation are contained in Annex B.

Enforcement and sanctions

33. The Inland Revenue enforces the minimum wage on behalf of the DTI (apart from the Agricultural sector where responsibility lies with the Department for the Environment, Food and Rural Affairs). If a worker or a third party makes a complaint about underpayment of the minimum wage, the Inland Revenue is duty bound to follow it up. As well as responding to complaints about underpayment, the Revenue also makes use of its own data and can proactively visit employers if non-compliance with the minimum wage is suspected.

34. Inland Revenue compliance officers find that in most cases of underpayment, agreement can be reached between the worker and the employer. Where this is not the case and the compliance officer believes the employer has failed to pay at least the minimum wage, the officer may serve an enforcement notice requiring the employer to start paying the minimum wage and to make good previous arrears.

35. If the employer ignores the enforcement notice, the compliance officer may serve a penalty notice. The penalty notice imposes a financial penalty on the employer of twice the hourly main minimum wage rate for each worker named in the enforcement notice from when the notice was issued. If the matter ultimately goes to court, the burden is on the employer to prove that he has paid the minimum wage.

Monitoring and review

36. The proposal to move to a system of fair piece rates linked to the minimum wage was recommended by the Low Pay Commission in their 3rd Report to Government in June 2001. In its future remits to the LPC, the Government will ask the Commission to report on how the new arrangements are working.

Declaration

37. I have read the Regulatory Impact Assessment and I am satisfied that the balance between cost and benefit is the right one in the circumstances.

Signed by the Responsible Minister:

Date:

Contact point:

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Employment Relations, Department of Trade and Industry

ANNEX I

Summary tables of costs and benefits

Table A1: Summary of costs and benefits of proposed changes to treatment of output workers under the 120 per cent proposal.

	Benefits (annual)	Costs (annual)	Costs (one-off)
Employers		£530 million wage costs (Autumn 2002 – Summer 2003 prices)	£800,000 (administrative costs)
Employees	£440 million (Autumn 2002 – Summer 2003 prices)		
Exchequer	£90 million		

Source: DTI

Table A2: Summary of costs and benefits of proposed changes to treatment of output workers under the 110 per cent proposal.

	Benefits (annual)	Costs (annual)	Costs (one-off)
Employers		£410 million wage costs (Autumn 2002 – Summer 2003 prices)	£650,000 (administrative costs)
Employees	£340 million (Autumn 2002 – Summer 2003 prices)		
Exchequer	£70 million		

Source: DTI

Table A3: Summary of costs and benefits of proposed changes to treatment of output workers under the 100 per cent proposal.

	Benefits (annual)	Costs (annual)	Costs (one-off)
Employers		£300 million wage costs (Autumn 2002 – Summer (administrative costs) 2003 prices)	£500,000
Employees	£250 million (Autumn 2002 – Summer 2003 prices)		
Exchequer	£50 million		

Source: DTI

Table B1: Summary of costs and benefits of proposed changes to treatment of output workers under the 120 per cent proposal, assuming previous compliance with the minimum rules

	Benefits (annual)	Costs (annual)	Costs (one-off)
Employers		£220 million wage costs (Autumn 2002 – Summer (administrative costs) 2003 prices)	£800,000
Employees	£190 million (Autumn 2002 – Summer 2003 prices)		
Exchequer	£30 million		

Source: DTI

Table B2: Summary of costs and benefits of proposed changes to treatment of output workers under the 110 per cent proposal, assuming previous compliance with the minimum rules.

	Benefits (annual)	Costs (annual)	Costs (one-off)
Employers		£100 million wage costs (Autumn 2002 – Summer 2003 prices)	£650,000 (administrative costs)
Employees	£80 million (Autumn 2002 – Summer 2003 prices)		
Exchequer	£20 million		

Source: DTI

Table B3: Summary of costs and benefits of proposed changes to treatment of output workers under the 100 per cent proposal, assuming previous compliance with the minimum rules.

	Benefits (annual)	Costs (annual)	Costs (one-off)
Employers		No additional cost, relative to baseline*	£500,000 (administrative costs)
Employees	No additional benefit, relative to baseline*		
Exchequer			

Source: DTI

* Reason for no costs and benefits in this table: Our understanding is that very few employers have taken advantage of fair estimate agreements, in which case the legislation requires that the normal minimum wage rules apply. Tables B1, B2, B3 are based on the assumption that employers are complying with existing legislation and that output workers are paid the minimum wage for all hours worked.

ANNEX II

History of consultation on proposals to introduce fair piece rates for output workers

1. When it introduced the minimum wage in 1999, the Government wanted to apply the minimum wage for output work and homeworkers. These workers often have no time limits on their work and often operate without employer supervision. The Government decided to enable employers and workers to enter into 'fair estimate agreements', under which employers must set a fair estimate of the hours needed to complete each block of work to be done and the minimum wage then has to be paid for the hours actually worked up to the limit set in the estimate. The estimate for the number of hours needed to complete a piece of work is not regarded as 'fair' if it is less than four-fifths of the time an average worker would take to do the same amount of work in the same conditions. If no fair estimate agreement is in place, then the output workers must be paid the minimum wage for all hours actually worked.
2. In June 2001, the Low Pay Commission recommended "the Government should consult representatives of output workers and their employers to see whether there is a case for a change in the Regulations on "fair estimate agreements". This followed representations to the Commission from both employer and employee groups, arguing for changes to the Regulations on these agreements.
3. It appears that few employers are actually making use of these agreements. A variety of reasons have been given for this but the principal point seems to be that they are seen as complex and difficult to administer, and that in practice it may be difficult to predict the estimated hours for each block or tranche of work taken on by an individual homeworker from week to week.
4. In February 2003 the Government issued a consultation note with a proposal to replace the present fair estimate agreement system with a system of fair piece rates. The consultation ended in May 2003, and the responses from all sides supported a move to a fair piece rate system and removal of the four-fifths rule. To ensure that most workers receive the minimum wage, the majority of responses to the consultation recommended that to determine the number of hours for which the worker must be paid, the employer should multiply the number of hours that the average worker was deemed to work by 120% and this is reflected in the draft Regulations.
5. In November 2003, the DTI commenced a further consultation on the draft regulations with a view to bringing in the proposed changes on 6 April 2004. Over the last year the DTI has held a series of meetings with key stakeholders on the proposals including the National Group on Homeworking, the Engineering Employers Federation, the TUC, the

Knitwear, Footwear and Apparel Trade Union, the Low Pay Commission and the Inland Revenue and the Department for Environment, Food and Rural Affairs. Both consultations were circulated to the main interested employees and employer groups, including leading small business representatives such as the Federation of Small Businesses, The Forum for Private Business and the British Chambers of Commerce.