

INCREASE IN NATIONAL MINIMUM WAGE RATES: PARTIAL REGULATORY IMPACT ASSESSMENT

This regulatory impact assessment (RIA) considers the impact of proposals to increase the adult and development rates for the National Minimum Wage (NMW). The proposed increases to the rate reflect the recommendations of the Low Pay Commission (LPC)'s latest report into the NMW. The specific changes that the government proposes to implement are that:

- The adult rate of the NMW increases from £4.20 per hour to £4.50 in October 2003 and to £4.85 in October 2004 subject to a further assessment by the Low Pay Commission of economic conditions nearer the time;
- The development rate for 18 to 21 year olds increases from £3.60 per hour to £3.80 in October 2003 and £4.10 in October 2004, again subject to a further assessment by the Low Pay Commission of economic conditions nearer the time.

Purpose and intended effect of measure

Objective

The purpose of the NMW is to create a minimum pay level and thus to protect workers from unacceptably low rates of pay. The NMW forms part of the government's policies to make work pay, alongside Tax Credits and the New Deals.

Background

The NMW was introduced in April 1999. The adult and development rates have been increased on three subsequent occasions, most recently in October 2002.

Decisions on the NMW rates are made on the basis of recommendations by the independent LPC. The LPC report also contains a large body of evidence and analysis on the impact to date of the NMW. The evidence and data collected and produced by the LPC have been used to inform this RIA.

Options

The government has chosen to accept the LPC recommendations on the increases in the NMW that should apply from October 2003 and October 2004. The alternative would have been to choose higher or lower rates.

The government accepts the LPC's analysis, that these proposals represent an acceptable balance between maintaining and enhancing the value of the NMW and preserving employment prospects for many of the most vulnerable workers.

Costs and benefits

The impact of the proposed increases in the NMW rates will be to increase the pay of some workers above the level that it would otherwise have been. This will be an additional cost to employers and a benefit to workers. The NMW is now a recognised part of employment practices and implementation costs of administering the proposed increase will be minimal.

Business sectors affected

All sectors are affected by the NMW although agriculture has its own minimum wage machinery. In practice, the impact of the NMW is most keenly felt in a number of sectors: retail; hospitality; cleaning and security; social care; childcare; manufacture of textiles, clothing and footwear; and hairdressing. In their report, the LPC paid particular attention to these sectors.

Number of potential beneficiaries

The latest official data on the prevalence of low paid jobs in the UK relates to spring 2002. At that time, it is estimated that 1.8 million jobs held by those aged over 21 were paid below the proposed October 2003 adult rate of £4.50 and that 0.1 million jobs held by those aged 18-21 were paid below the proposed development rate of £3.80.

The numbers of jobs that actually stand to benefit from the proposed increases in October 2003 and October 2004 will depend upon what has happened, and is likely to happen, to the wages of workers in the period between spring 2002 and October 2004.

It should be noted that the adult and development rates of the NMW were increased to £4.20 and £3.60 respectively in October 2002, and it is assumed that these changes fed through into earnings for people earning below those levels (i.e. that there was full compliance with the October 2002 rates). When assessing the impact of the proposed October 2004 increases full compliance with the October 2003 rates is also assumed.

Two alternative scenarios are considered in this RIA:

- (i) That the hourly pay of all those earning less than the October 2003 and 2004 rates increased in line with RPI inflation between spring 2002 and October 2004. This is based on an average increase using actual data for April 2002 to October 2002, and a forecast rate of increase thereafter derived from the HM Treasury comparison of independent economic forecasts. On this assumption, the number of jobs that would potentially benefit from the proposed October 2003 increase is 1.6 million, made up of 0.1 million jobs held by 18-21 year olds and 1.5 million jobs held by those aged over 21¹. The number of jobs that would potentially benefit from the proposed October 2004 increase on this basis is 2.4 million, made up of 0.2 million jobs held by 18-21 year olds and 2.2 million jobs held by those aged over 21².
- (ii) That the hourly pay of all those earning less than the October 2003 and 2004 rates increased in line with average earnings growth (measured by the Average Earnings Index) between spring 2002 and October 2004. This is based on an average increase using actual data for April 2002 to October 2002, and a forecast rate of increase thereafter derived from the HM Treasury comparison of independent economic forecasts. On this assumption, the number of jobs that would potentially benefit from the proposed October 2003 increase is 1.3 million, made up of 0.1 million jobs held by 18-21 year olds and 1.2 million jobs held by those aged over 21³. The number of jobs that would potentially benefit from the proposed October 2004 increase on this basis is 1.7 million, made up of 0.1 million jobs held by 18-21 year olds and 1.6 million jobs held by those aged over 21⁴.

¹ This estimate is calculated by deflating the October 2003 proposed rates by actual and forecast RPI inflation, i.e. by 3.5 per cent, producing equivalent spring 2002 rates of £4.35 and £3.67 for adult and development rates respectively. The numbers affected are then calculated from cumulative distributions of jobs by hourly pay based on the ONS low pay central estimates developed by the LPC.

² Calculated by deflating the October 2004 proposed rates by actual and forecast RPI inflation, i.e. by 5.9 per cent, producing equivalent spring 2002 rates of £4.58 and £3.87 for adult and development rates respectively.

³ Calculated as above but using the actual and forecast increase in average earnings rather than RPI inflation, i.e. by 6.2 per cent producing equivalent spring 2002 rates of £4.24 and £3.58 for adult and development rates respectively.

⁴ Calculated by deflating the October 2004 proposed rates by actual and forecast average earnings, i.e. by 10.8 per cent, producing equivalent spring 2002 rates of £4.38 and £3.70 for adult and development rates respectively.

Impact on labour costs

The impact of the proposed rates on wage and labour costs also depends upon the assumptions made about the likely path of wage increases between October 2002 and October 2004.

The methodology for estimating the increase in wage costs is as follows:

- For the 2003 and the 2004 increases calculate the additional average hourly increase for those jobs paying less than the October 2003/October 2004 proposed rates when they are increased. The size of this average increase will depend on the assumption made about what happens to earnings in these low paid jobs between October 2002 and October 2004 (i.e. the two scenarios discussed above). It is also assumed that there is full compliance with the October 2002 rate when calculating the average wage increase for the October 2003 up rating and full compliance with the October 2003 rate when calculating the average wage increase for October 2004 up rating.
- Multiply this average per hour increase by the average number of hours worked by those affected (taken to be around 26 hours)⁵.
- Multiply by 52 weeks per year.
- Multiply by the number of potential beneficiaries (see above).

Using these assumptions, the aggregate increases in the wage bill and in labour costs are provided in the table below.

	Scenario (i): Wages increase in line with prices	Scenario (ii): Wages increase in line with average earnings
Increase in wage bill for proposed 2003 rates (£ million)	363 million	163 million
Percentage increase in wage bill ⁶	0.07 per cent	0.03 per cent
Increase in labour costs for proposed 2003 rates ⁷ (£ million)	399 million	180 million
Increase in wage bill for proposed 2004 rates (£ million)	652 million	300 million

⁵ Source: 2002 grossed New Earnings Survey.

Percentage increase in wage bill for proposed 2004 rates ⁶	0.13 per cent	0.06 per cent
Increase in labour costs for proposed 2004 rates ⁷ (£ million)	718 million	330 million

Costs for a typical business

The proposed changes to the October 2003 rates represent an increase of 7.1 per cent on the current rate for adults and 5.6 per cent for 18-21 year olds. The proposed increases to the October 2004 rates represent an increase of 7.8 per cent on the proposed 2003 rate for adults and a 7.9 per cent increase for 18-21 year olds. Those employers with staff currently paid at the NMW will therefore see the earnings of these workers increase above the expected growth rate of average earnings. However, most workplaces are unlikely to employ anyone at or near current NMW rates and therefore will be unaffected⁸. Most workplaces that do employ people at or near current NMW rates are unlikely to employ significant proportions at these rates. Thus most businesses are unlikely to see any large changes to their cost base.

Equity and fairness

The LPC report shows that increases in the NMW continue to benefit certain groups disproportionately: women; people from ethnic minorities; the disabled and part-time workers.

Small firms' impact Test

The LPC recommendations were based upon extensive analysis and gathering of evidence, including evidence received from, and discussion with, small businesses and their representatives.

Competition assessment

The NMW provides a floor for wages and therefore ensures that firms cannot compete against each other by driving down wages to unacceptable levels. Most of the sectors where the impact of the NMW is felt most keenly are characterised by large numbers of relatively small firms. To the extent that the NMW increases labour costs, these are borne by all employers in a sector. It is therefore unlikely that the NMW creates significant barriers to entry.

⁶ As an increase on the total wages and salaries bill in the national accounts, uprating for expected earnings growth.

⁷ Calculated as the wage bill plus an additional 10 per cent for employers' National Insurance Contributions. A relatively low "mark-up" is likely to be appropriate for this group.

⁸ The 1998 Workplace Employee Relations Survey suggested that around one tenth of workplaces with 10+ employees did in fact employ anyone at a rate below the original NMW rate introduced in April 1999.

Enforcement and sanctions

The NMW is enforced in two ways. The Inland Revenue takes pro-active steps to secure enforcement and acts on complaints. Individuals also have a right of redress to an Employment Tribunal.

Consultation

The government will in due course consult on the Regulations implementing these proposals.

Monitoring and review

The government issues an annual report on enforcement action.

More broadly, the LPC is charged with reporting on the impact of the NMW. The government has agreed that it should report next in 2004.

Summary

The LPC has recommended that the adult and development rates of the NMW should be increased to £4.50 and £3.80 respectively in October 2003. The LPC concluded that these recommendations would increase the earnings of the lowest paid without damaging their employment prospects. As well as this they recommended that subject to a further assessment of economic conditions nearer the time the adult and development rates of the NMW should be increased to £4.85 and £4.10 respectively in October 2004. The government accepts these recommendations.

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