National Minimum Wage (Amendment) Regulations 2023: increases in the national minimum wage and national living wage rates

Lead department	Department for Business, Energy and Industrial Strategy
Summary of proposal	An increase in the national living and minimum wage rates in line with the Low Pay Commission's recommendations.
Submission type	Impact assessment (IA) – 10 January 2023
Legislation type	Secondary legislation
Implementation date	1 April 2023
Policy stage	Final
RPC reference	RPC-BEIS-5253(1)
Opinion type	Formal
Date of issue	27 January 2023

RPC opinion

Rating[1]	**RPC opinion**
Fit for purpose	The evidence and analysis supporting the EANDCB and the SaMBA are sufficient. The Department has updated its analysis to take account of current economic circumstances and latest research. The IA provides a particularly good sensitivity analysis and useful discussion of rationale and wider impacts.

Business impact target assessment

	Department assessment	**RPC validated**
Classification	Qualifying regulatory provision (IN)	Qualifying regulatory provision (IN)
Equivalent annual net direct cost to business (EANDCB)	£280.8 million	£280.8 million *(2019 prices, 2020 pv)*
Business impact target (BIT) score	£1,123.1 million	£1,123.2 million
Business net present value	-£1,867.1 million	
Overall net present value	-£2.6 million	

[1] The RPC opinion rating is based only on the robustness of the EANDCB and quality of the SaMBA, as set out in the Better Regulation Framework. RPC ratings are fit for purpose or not fit for purpose.

RPC summary

Category	Quality[2]	RPC comments
EANDCB	**Green**	The EANDCB appears to be based upon good evidence and reasonable assumptions, taking account of current labour market developments and a broad range of economic forecasts. The IA's classification of impacts into direct and indirect is appropriate.
Small and micro business assessment (SaMBA)	**Green**	The IA provides a good description of impacts on micro, small and medium-sized businesses, and addresses disproportionality of impact, exemption and mitigation.
Rationale and options	**Good**	The IA provides a good discussion of the different rationales for the national living, and national minimum, wages. The consideration of options is sufficient for a final stage IA given the detailed consideration of different potential upratings by the Low Pay Commission (LPC).
Cost-benefit analysis	**Good**	The Department continues to update its evidence base and provides good discussion of risk and uncertainty, including a detailed sensitivity analysis.
Wider impacts	**Good**	The IA includes a good assessment of impacts on areas such as employment, prices and productivity.
Monitoring and evaluation plan	**Satisfactory**	The IA explains how the LPC will continue to monitor, evaluate and review the levels of the national minimum, and national living, wage rates.

[2] The RPC quality ratings are used to indicate the quality and robustness of the evidence used to support different analytical areas. Please find the definitions of the RPC quality ratings here.

Summary of proposal

Description of proposal

The national minimum wage (NMW) was introduced in April 1999. The national living wage (NLW) was introduced in April 2016. These measures set minimum hourly wage levels, protecting low-paid workers while providing incentives to work. The Low Pay Commission (LPC) reviews these rates and makes recommendations to government annually.

The proposal would increase the NLW (applying to those aged 23 years and older) and the four NMW rates; the main (21-22 years), development (18-20 years), youth (16-17 years) and apprentice rates. All proposed increases are in line with the LPC's recommendations.

LPC NMW/NLW rate recommendations for April 2023 (Table 2, p. 12 of the IA)

	LPC recommendation	Current rate	Annual percentage increase
National Living Wage rate	£10.42	£9.50	9.7%
21-22 year old rate	£10.18	£9.18	10.9%
18-20 year old rate	£7.49	£6.93	9.7%
16-17 year old rate	£5.28	£4.81	9.7%
Apprentice rate	£5.28	£4.81	9.7%
Accommodation offset (per day)	£9.10	£8.70	4.6%

It is proposed that the new rates should come into force on 1 April 2023. NMW and NLW rates were last increased in April 2022.

Impacts of the proposal

Coverage

The IA estimates that around 2.94 million employees would be covered by the proposals, of whom around 2.54 million are accounted for by the national living wage. Based upon survey evidence and the 2022 Business Population Estimates, the Department estimates between 670,000 and 770,000 employers will be affected by the changes to the minimum wage.

Costs

The main impact on employers is increased labour costs, estimated at £2,525 million (undiscounted, 2022 prices-based figures). This is nearly £1 billion higher than last year's increase, reflecting the generally much larger increases this year, particularly for the NLW. The main component of this is the cost to employers of having to pay more to employees currently earning less than the proposed relevant minimum wage. This is estimated at £1,431 million. The next highest cost is to employers of having to raise the wages of employees currently earning above the new NLW/NMW rates to maintain wage differentials. This is estimated at £1,094 million. Finally, the Department estimates transitional costs to employers of familiarising themselves with the new rates, estimated at £3.2 million.

Benefits

The £2,525 million increased labour costs to employers would provide an equivalent benefit to employees (£2,142 million) and the Exchequer (£383 million).

Overall impact

As the costs and benefits are effectively a transfer between employers and employees, the net present value figure consists of the transitional costs to employers. The EANDCB figure consists primarily of the cost to private sector employers of having to pay more to employees currently earning less than the proposed relevant minimum wage.

EANDCB

<u>Counterfactual</u>

The IA uses the same approach as last year in using forecast growth in median earnings to construct counterfactual wage growth, as opposed to that undertaken in some previous years of taking wage growth at the 25th percentile over a historical time period judged to best match the UK's current business cycle. In the present IA, it takes four years for earnings in the counterfactual to 'catch-up' with the new minimum rates (in contrast to three years in last year's IA); this is reflected in the calculation of the BIT score.

The difference in approach this year is that the IA uses the average of independent forecasts for median earnings growth, as monitored by the Treasury, rather than the OBR forecast. The IA provides a good explanation for the approach this year and argues that it remains consistent with the methodology recommended by NIESR in its 2017 report (paragraph 59, page 16). This seems reasonable, although the IA would benefit from providing confirmation from NIESR on this point. IAs on future upratings should continue to review the appropriateness of the assumptions and approach here.

The IA's approach would ideally separate the underlying assumptions for the independent forecasts to identify why the forecasts differ significantly, potentially adjusting for accompanying GDP growth forecasts, structural changes and different assumptions, for example about labour disputes. In principle, a central estimate for counterfactual earnings growth could be constructed around a central set of underlying assumptions. Further, the analysis could potentially construct measures of (ex-post) accuracy for the independent forecasts, and use weights based on their performance. The IA could discuss the proportionality of developing the analysis in this way.

The IA would benefit from describing further the adjustments it makes to the average independent earnings growth forecast (paragraph 66, page 17), in particular at how the 0.85 per cent quarterly growth figure (paragraph 90, page 22) is arrived, from the 0.94 per cent unadjusted figure (Table 3, page 15).

As in previous years' IAs, the impact of the uprating is assessed over the period it would take for this counterfactual wage estimate to 'catch up' with the proposed NLW/NMW rates. In the present IA this is expected to be four years. The Department's updated assumptions for counterfactual wage growth appear to reflect economic and labour market circumstances and prospects reasonably.

Direct/indirect impacts

The cost to private sector employers from having to pay employees more than they would otherwise be paid, and the transitional costs, are correctly assessed as direct costs to business. The cost to employers of maintaining wage differentials is assessed as an indirect impact because the only regulatory requirement for businesses is to meet the increased pay floor. This assessment is reasonable and in line with previous IAs. The IA assumes that such 'spillover' effects extend to the 25th percentile of the wage distribution, as in last year's IA.

SaMBA

The SaMBA is sufficient. Small and micro businesses are estimated to employ 24 per cent of employees and incur approximately 40 per cent of the total cost of the proposals. The IA explains clearly why they should not be exempt from the proposal (pages 39-40). On mitigation, the IA refers to employer-targeted communications and guidance, and an announcement before the legislation has passed through Parliament, to allow increased adjustment time for businesses. The Department also refers to assistance to small businesses more generally, as announced in the Autumn budget, such as an increase in business rates relief for the retail, hospitality and leisure sectors, although these do not appear to be designed to mitigate specifically an increase in the NMW/NLW.

Medium-sized businesses considerations

The IA usefully includes consideration of impacts on medium-sized businesses in line with the Government's recent announcement of widening, to businesses with fewer than 500 employees, presumed exemptions on regulation. The IA's breakdown of businesses by size, and discussion of exemptions, takes account of this. The IA also includes a case study of a medium-sized employer.

Rationale and options

<u>Rationale</u>

As in previous IAs, the Department sets out the rationale for continued intervention for both the NMW and NLW. The rationale for the NMW is based on maintaining a wage rate for younger workers that is close to the competitive market equilibrium. The Government have sought to achieve this by giving the LPC a remit to recommend an NMW rate that does not damage the employment prospects of low-paid workers. The rationale for the NLW is more equity-based, aiming to reduce wage inequality and ensure that low-paid workers benefit from economic growth. The Government have set a target for the NLW to reach two-thirds of median earnings by 2024 (providing economic conditions allow) and for the NLW to apply to workers aged 21 years and over by 2024.

<u>Options</u>

The IA looks at two options: do nothing or implement the LPC recommendations in full. The IA explains how the LPC collects evidence and data, including a consultation period for stakeholders and external research, to inform its assessment of the impacts of minimum wage policy. The evidence, research and data collected and produced by the LPC have been used to inform the IA. On this basis, the options presented in the IA are reasonable.

Cost-benefit analysis

<u>Evidence and data</u>

The IA describes how the NLW and NMW rates are underpinned by extensive consultation, analysis, and evidence-gathering by the LPC. The LPC received 52 responses to its written consultation, with representatives from 101 various organisations attending their oral evidence sessions. The Department has continued to engage with leading labour market academics and updated its literature review.

Uncertainty, risks and assumptions

The IA appropriately includes low and high estimates (and, for counterfactual wage growth, additionally estimates based upon OBR and Bank of England forecasts) and extensive sensitivity analyses around a number of key variables (such as the extent of spillover up the pay distribution). These variations are discussed in each relevant section and summarised clearly in table 4 and figure 4 (pages 23-25) of the IA. The IA also helpfully provides an explanation of the difference in cost estimates compared to the 2022 upratings (page 23).

The IA discusses particular developments that have emerged significantly since last year's uprating, notably a significant number of workers leaving the labour market (pages 9-10) and high inflation (paragraph 149, page 32). The IA would benefit from further consideration of the potential impacts of these developments, including, for example, if high inflation persists for longer than anticipated.

The IA would benefit from a more explicit analysis of the linkage between inflation and nominal wage growth, clarifying real and nominal differences. This could include discussion around the cost-of-living crisis and continued inflation particularly affecting the low-paid given the regressive composition of current inflation (for example, energy and food). The IA would also benefit from discussing the impacts of current labour disputes, including on productivity, and how these might play out, such as through scenario-based analysis.

Wider impacts

The IA has a section on employment impacts, drawing upon an updated literature review at its annex B. The section on employment impacts is included within a section on macroeconomic impacts, which covers possible impacts on areas such as prices and productivity. The IA helpfully includes discussion of how reduced pay differentials may have a negative impact on staff turnover (page 31). The IA also includes useful sections on fiscal, regional and international trade impacts.

The IA's section on prices notes that the current high-inflation macro-economic environment has introduced greater uncertainty about the potential for an increase in the minimum wage to push inflation higher. The IA would benefit from discussing this risk further. The IA also notes that some employers have reported to the LPC that they are investing in automation in response to the NLW and other cost pressures. The IA would benefit from discussing this, and the potential impacts on employment, further.

The IA notes a study that found no significant impacts of increases in the NLW on self-employment or zero-hour contracts. The IA would benefit from discussing this area further, including any potential knock-on effects on employment rights, benefits claims and enforcement issues.

Monitoring and evaluation plan

The IA explains how the LPC will continue to monitor, evaluate and review the levels of the various minimum wage rates, and that future recommendations by the LPC will be based on extensive monitoring and evaluation of the current rates (page 42). More specifically, the IA states that the LPC will undertake an assessment of the impact of the proposed 2023 minimum wage rates in Autumn 2024 (page 5).

Regulatory Policy Committee

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