Regulatory Policy Committee

National Minimum Wage (Amendment) Regulations 2021: 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 wage rate (applying to those aged 23 years and over from April 2021) and the minimum wage rates in line with the Low Pay Commission's recommendations
Submission type	Impact assessment (IA) – 16 December 2020
Legislation type	Secondary legislation
Implementation date	1 April 2021
Policy stage	Final
RPC reference	RPC-BEIS-5040(1)
Opinion type	Formal
Date of issue	25 January 2021

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 Department has also provided a good discussion of rationale and wider impacts. There are some areas for further improvement, outlined in this opinion.

Business impact target assessment

	Depts assessment	**RPC validated**
Classification	Qualifying regulatory provision (IN)	Qualifying regulatory provision (IN)
Equivalent annual net direct cost to business (EANDCB)	£217.9 million	£217.9 million *(2019 prices, 2020 pv)*
Business impact target (BIT) score	£435.8 million	£435.8 million
Business net present value	-£428.4 million	
Overall net present value	-£9.1 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. The RPC rating is fit for purpose or not fit for purpose.

RPC summary

Category	Quality	RPC comments
EANDCB	Green	The EANDCB is based upon good evidence and reasonable assumptions, adjusted to take account of recent labour market developments. 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 small and micro businesses and addresses exemption, disproportionality of impact and mitigation.
Rationale and options	**Good**	The IA provides a good discussion of the various rationales for the national living and 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 and improve its evidence base and provides good discussions of alternative modelling approaches and uncertainty, including a detailed sensitivity analysis.
Wider impacts	**Good**	The IA includes a good assessment of impacts on areas such as employment, prices, productivity and the Exchequer (pages 36-42). This year's IA also discusses international trade.
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 living wage rates.

Policy detail

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 from April 2021 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 2021 (Table 1, p. 10 of the IA)

	LPC recommendation	Current rate	Annual percentage increase
National Living Wage rate	£8.91	£8.72	2.2%
21-22 year old rate	£8.36	£8.20	2.0%
18-20 year old rate	£6.56	£6.45	1.7%
16-17 year old rate	£4.62	£4.55	1.5%
Apprentice rate	£4.30	£4.15	3.6%
Accommodation offset (per day)	£8.36	£8.20	2.0%

It is proposed that the new rates should come into force on 1 April 2021. NMW and NLW rates were last increased in April 2020.

The proposal would also extend the time period for which employers are legally required to keep records sufficient to show that they are meeting their NMW obligations, from three to six years to match the period of liability over which HMRC can enforce payment. The IA explains that engagement with HMRC indicated that few employers held records for less than six years and this aspect of the proposal would, therefore, not be expected to impose a significant cost.

Impacts of the proposal

Coverage

The IA estimates that 2.25 million employees would be covered by the proposals, of whom around 2.0 million are accounted for by the national living wage. Survey evidence and consultation with stakeholders suggests that around half of all businesses would be affected, amounting to around 1.2 million businesses.

Costs

The Department estimates a total cost of £428 million in present value terms. The main impact on employers is increased labour costs, estimated at £459 million (undiscounted, 2020 prices-based figures in table 11, page 32 of the IA). 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 £325 million (table 12). For private sector employers, this is a direct cost to business. The next highest cost is to employers having to raise the wages of employees currently earning above the new NLW/NMW rates to maintain wage differentials. This is estimated at £134 million (table 13). Finally, the Department estimates transitional costs to employers of familiarising themselves with the new rates, estimated at £9.1million.

Benefits

The £459 million increased labour costs to employers would provide an equivalent benefit to employees (£377 million) and the Exchequer (£82 million).

The net present value figure of -£9.1 million consists, therefore, of the transitional costs to employers. EANDCB

Counterfactual

The IA explains that the LPC's recommended rates for this year have focussed on minimising significant employment risks and are, therefore, much lower than last year (in the case of the NLW, 2.2 per cent compared to 6.2 per cent). This lowers substantially the overall impact on business. This is partly offset, however, by a much lower counterfactual wage growth than that assumed in IAs for previous NMW upratings. The IA uses wage growth during, and immediately after, the 'Great Recession' financial crisis (2008-10) on the basis that this is judged to reflect best the current UK business cycle. This is also similar to the Office for Budget Responsibility (OBR)'s latest forecasts for earnings growth. In last year's IA, the Department used long-term (since 2001) average earnings growth. 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 two years. The Department's assumptions for counterfactual wage growth appear to reflect reasonably the weaker current economic and labour market situation.

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, revised down from the 30th percentile used last year. This reduces the indirect impact of the proposal but the revised assumption appears to be supported by stakeholder consultation and pay settlement data.

Business impact target (BIT) score

The IA helpfully includes cost estimates from previous NMW/NLW upratings and the methodology used (annex B of the IA). Following past RPC comments, this annex now includes a reference to BIT scores. The IA would benefit from taking this further. Given the different length of appraisal periods used, the IA would benefit from presenting the BIT score as a better measure of the comparative impact on business of each uprating. For the years before the measures became qualifying towards the BIT, this figure could be presented as a ’shadow BIT score’ or equivalent.

Small and micro businesses assessment (SaMBA)

The SaMBA is sufficient. Small and micro businesses are estimated to employ 47 per cent of employees and incur approximately 43 per cent of the total cost of the proposals. The IA explains clearly why they should not be exempt from the proposal (paragraphs 194-196, page 45). On mitigation, the IA refers to employer-targeted communications and guidance, and an announcment before the legislation has passed through Parliament, to allow increased adjustment time for businesses. The Department also refers to wider mitigation, such as the exemption of small and micro businesses from the Apprentice Levy. The IA would be improved by discussing briefly the possible competitive effects of these mitigations.

Rationale and options

Rationale

As in previous IAs, the Department sets out the rationale for continued intervention for both the NMW and NLW in some detail (including a theoretical framework set out at annex A). 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 new NLW target of two-thirds of median earnings by 2024 (providing economic conditions allow).

Options

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 an extended 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

Evidence and data

The Department has sought to strengthen the evidence used to inform its assessment. This includes an academic roundtable held in November 2020 with labour market specialists to obtain views on future wage growth in the context of the Covid-19 pandemic and relevant counterfactuals.

The Department has usefully added a case study on experience in the USA (page 17 of the IA). The IA would benefit from discussing further its representativeness in terms of drawing inferences for the UK and its relation to the literature review, including UK studies, presented at annex C. More generally, the IA could benefit from providing more case studies to complement the strong use of economic theory in the IA. In particular, this might help to illustrate the potential impact on smaller businesses.

Modelling

As in previous years, the IA includes a sensitivity analysis using the RPC's previously suggested 'shadow wage curve' approach (annex D). Following comments in last year's RPC opinion, the Department has helpfully provided a clearer explanation of its approach and, moreover, revised its method so that it appears to match more closely the RPC's graph (figure 6, page 57). The RPC was concerned last year that the Department's approach overestimated costs by including part of the general increase in wages in the counterfactual. The Department's estimate of cost is now much lower than before (although still significantly higher than that produced by the Department's preferred method). The RPC welcomes the Department's work in this area. This part of the IA would benefit from explaining why the estimates differ significantly from those provided previously. The annex describes the approach as capturing 'base-raising' impacts and would benefit from clarifying whether this is the same as impacts of 're-setting the counterfactual', cross-referring to figure 1 (page 50) in NIESR's counterfactual research report.[2]

[2] https://www.niesr.ac.uk/publications/national-minimum-wage-and-national-living-wage-impact-assessment-counterfactual

As with previous IAs, the RPC considers that the IA would benefit from making a clearer assessment of the feasibility of using different analytical approaches to assess the NMW and the NLW. The RPC remains of the view that the Department should provide an economic appraisal of the full policy ambition for the NLW (to reach two-thirds of median earnings by 2024) including the base-raising effect of earlier years. Failing that, the Department should, at each annual uprating, explicitly check the validity of its assessment of cumulative impacts.

Uncertainty, risks and assumptions

Due to the particular uncertainties this year, the IA includes low and high estimates (for example for counterfactual wage growth) 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 in table 14 (page 33) of the IA.

The IA explains how the furlough scheme has distorted wage data that is used to inform the assessment, with people receiving 80 per cent of their normal pay (for hours not worked) potentially being classified as being paid less than the NLW/NMW. The Department uses the mid-point of a range, where the low estimate effectively excludes workers who have lost pay due to furlough and the high estimate takes no account of the distortion. The Department has looked at alternative ways to address this problem and explains why it was unable to identify a better method. The IA includes this in its sensitivity analysis section.

The analysis takes good account of the possible impacts of Covid-19, in particular providing a detailed discussion at pages 11-12.

The IA would benefit from addressing EU exit and the impact on EU-based labour, for example whether minimum earnings thresholds in a points-based immigration system would result in there being no significant impact.

Wider impacts

The IA has a section on employment impacts, drawing upon an updated literature review at annex C (pages 36-37). This includes addressing a previous RPC comment about possible impact on staff turnover. The Department states that empirical evidence is limited but notes that the Confederation of British Industry told the LPC that reducing pay differentials can have a potential negative effect on staff turnover. This is an area that future IAs would benefit from considering further.

The section on employment impacts is within a section on macroeconomic impacts, which covers possible impacts on areas such as prices and productivity. This also discusses the rates possibly leading to a short-term increase in consumption and aggregate demand (page 39). There is also a section on fiscal impacts, covering potential effects on, for example, tax revenue and welfare spending (pages 40-41).

In response to previous RPC comments, the IA includes an assessment of possible impacts on international trade (paragraph 187, page 43), concluding that the NLW/NMW will have a negligible impact on international trade.

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 (paragraphs 200-201, page 46).

For further information, please contact regulatoryenquiries@rpc.gov.uk.