Title:
Amendment to the National Minimum Wage regulations 2015- increase in NMW rates

IA No: LM002

Lead department or agency:
Department for Business Innovation and Skills (BIS)

Other departments or agencies:

Impact Assessment (IA)

Date: 04/06/2015

Stage: Final

Source of intervention: Domestic

Type of measure: Secondary legislation

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Summary: Intervention and Options

RPC Opinion: Awaiting Scrutiny

Cost of Preferred (or more likely) Option				
Total Net Present Value	**Business Net Present Value**	**Net cost to business per year** (EANCB on 2009 prices)	**In scope of One-In, Two-Out?**	**Measure qualifies as**
£0.0m	-£38.76m	£29.58m	Yes	IN

What is the problem under consideration? Why is government intervention necessary?

There is potential for exploitation in the labour market in specific areas or parts of the economy, in particular in situations where employers have unequal bargaining power, allowing them to pay unacceptably low wages, and where workers lack experience, skills, mobility or opportunities. The National Minimum Wage (NMW) is a statutory pay floor that provides protection for low-paid workers by preventing potential exploitation and providing a greater incentive to work. The NMW came into force in April 1999 and, in order to continue tackling exploitative pay, the NMW rates have been reviewed by the Low Pay Commission (LPC) annually since then. This Impact Assessment relates to 2015 NMW upratings.

What are the policy objectives and the intended effects?

The objective of the NMW is to maximise the wages of the low paid without damaging their employment prospects by setting it too high. The NMW sets a wage floor below which pay cannot fall ensuring protection for low-paid workers, while also providing incentives to work. Each year the NMW rates are revised to ensure that they still meet the policy objectives.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

The independent LPC was set up in 1999 to make recommendations on the NMW to Government. In making its recommendations to Government, the LPC has consulted extensively and undertaken substantial analysis. Details are contained in its 2015 report.

The Government has considered three options this year:

0. Do nothing - Reject all of the LPC recommnedations
1. Agree with all the LPC recommendations on NMW rates and implement the new rates
2. Accept the LPC's recommendations for 2015 for the Adult rate; Development rate; and 16-17 rate.

To increase the Apprentice NMW by 21% to £3.30, which is 50p higher than the LPC recommendation in order to increase the attractiveness of Apprenticeships, in particular for young people.

Will the policy be reviewed? The LPC will review and monitor these policy changes (they publish an annual report in the Spring on the NMW). In addition, the government will monitor these impacts and submit economic evidence to the LPC (this normally occurs in the Winter).

If applicable, set review date: Will be reviewed annually

Does implementation go beyond minimum EU requirements?			N/A		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	**Micro** Yes	**< 20** Yes	**Small** Yes	**Medium** Yes	**Large** Yes
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**Traded:** N/A	**Non-traded:** N/A	

I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs.

Signed by the responsible SELECT SIGNATORY: ______________________ ***Date:*** ______________

Summary: Analysis & Evidence — Policy Option 1

Description: Option 1 - Agree with all the LPC recommendations on the new rates and implement the new rates.

FULL ECONOMIC ASSESSMENT

Price Base Year 2014	PV Base Year 2015	Time Period Years 1	Net Benefit (Present Value (PV)) (£m)		
			Low:	**High:**	**Best Estimate:** £0.0m

COSTS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Cost** (Present Value)
Low				
High				
Best Estimate			£670.0m	**£670.0m**

Description and scale of key monetised costs by 'main affected groups'

As a result of increases in the Adult, Development, Youth and Apprentice NMW rates, the wage bill for employers will increase by £560.5m and an increase in non-wage labour costs of £109.5m (a total increase in labour costs of £670.0m). The Government's better regulation framework is currently being updated; under the framework used by the previous Government these impacts are likely to be out of scope because the recommendations are by an independent statutory body.

Other key non-monetised costs by 'main affected groups'

The evidence from the LPC report suggests that the NMW rates recommended by the LPC will not have a negative impact on employment, with negligible impacts on hours worked and training. Furthermore, as the NMW increases annually and is fully embedded in the UK labour market, we assume no transition costs to its increase. This is discussed further in the evidence section.

BENEFITS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Benefit** (Present Value)
Low				
High				
Best Estimate			£670.0m	**£670.0m**

Description and scale of key monetised benefits by 'main affected groups'

Employees – adults and young people benefit from higher wages (£560.5m) as a result of these rates being higher than our counterfactual assumption of a wage freeze. Exchequer and employees – benefits from increased non-wage labour costs as a result of increase in adult and youth NMW rates (£109.5m).

Other key non-monetised benefits by 'main affected groups'

Employers who provide accommodation benefit from an increased amount that can be offset against NMW pay. Exchequer – HM Treasury provided the LPC with a dynamic analysis of the overall fiscal impact of increasing the NMW, including the wider effects (employment effects and further adjustments that were likely to take place in the economy as a result of increases to the NMW). HMT analysis on other NMW changes suggested that we should not expect a large fiscal impact from the increase.

Key assumptions/sensitivities/risks — **Discount rate (%)** N/A

Main assumptions can be found in the Impact Assessment. We assume that in the absence of changes to NMW rates, the wages of the lowest paid would remain the same of the year beginning 1 October 2015.

The proposed 2015 NMW rates involve transfers from employers to employees and the Exchequer. As this Impact Assessment involves an annual uprating the time period is over one year.

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			In scope of OITO?	Measure qualifies as
Costs: £0.0m	**Benefits:** £0.0m	**Net:** £0.0m	No	NA

Summary: Analysis & Evidence — Policy Option 2

Description: Option 2 - Increase the Apprentice NMW rate by 21% to £3.30 and agree with all other LPC recommendations.

FULL ECONOMIC ASSESSMENT

Price Base Year 2014	PV Base Year 2015	Time Period Years 1	Net Benefit (Present Value (PV)) (£m)		
			Low:	**High:**	**Best Estimate:** £0.0m

COSTS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Cost** (Present Value)
Low				
High				
Best Estimate			£738.0m	**£738.0m**

Description and scale of key monetised costs by 'main affected groups'

As a result of increases in the Adult, Development, Youth and Apprentice NMW rates, the wage bill for employers will increase by £628.5m and an increase in non-wage labour costs of £109.5m (a total increase in labour costs of £738.0m). Over 90% of the non-Apprentice costs are direct costs to business but are likely to be out of scope of the better regulation framework because the recommendations was made by an independent statutory body. However, following 2013 case history, the costs of increasing the Apprentice wage by 50p above the recommended rate of £2.80 are likely to fall within scope and be scored as IN. This results in a total cost to all employers of £67.9m, with 57% of this cost impacting business.(£29.6m in 2009 prices)

Other key non-monetised costs by 'main affected groups'

The evidence from the LPC report suggests that the NMW rates recommended by the LPC will not have a negative employment impact. We have also assumed no impact on employment or training for Apprentices as the UK is undergoing significant reforms of Apprenticeship policy designed to increase Apprenticeships, the higher wage will attract more and better quality Apprentices, the Apprentice rate remains attractive compared to those of non-Apprentices, still being less than even the 16-17 rate of £3.87, and there is no clear data on Apprentice labour demand elasticities.

BENEFITS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Benefit** (Present Value)
Low				
High				
Best Estimate			£738.0m	**£738.0m**

Description and scale of key monetised benefits by 'main affected groups'

Employees – adults and young people benefit from higher wages (£628.5m) as a result of these rates being higher than our counterfactual assumption of a wage freeze. Exchequer and employees – benefits from increased non-wage labour costs as a result of increase in adult and youth NMW rates (£109.5m). This non-wage benefit does not differ from that of option 1 as we assume that Apprentices on the ANMW do not cross the National Insurance Contributions Threshold or make significant pensions contributions.

Other key non-monetised benefits by 'main affected groups'

Employers who provide accommodation benefit from an increased amount that can be offset against NMW pay. Exchequer – HM Treasury provided the LPC with a dynamic analysis of the overall fiscal impact of increasing the NMW, including the wider effects (employment effects and further adjustments that were likely to take place in the economy as a result of increases to the NMW). This suggested that we should not expect a large fiscal impact from the increase.

Key assumptions/sensitivities/risks — **Discount rate (%)** N/A

Main assumptions can be found in the Impact Assessment. We assume that in the absence of changes to NMW rates, the wages of the lowest paid would remain the same of the year beginning 1 October 2015.

The proposed 2015 NMW rates involve transfers from employers to employees and the Exchequer. As this Impact Assessment involves an annual uprating the time period is over one year.

BUSINESS ASSESSMENT (Option 2)

Direct impact on business (Equivalent Annual) £m:			In scope of OITO?	Measure qualifies as
Costs: £29.6m	**Benefits:** £0.0	**Net:** -£29.6m	Yes	IN

Evidence Base (for summary sheets)

Problem under consideration and rationale for intervention

The aim of the National Minimum Wage (NMW) is to provide protection to low-paid workers by avoiding potential exploitation by employers who, in the absence of government intervention, could undercut competitors by paying unacceptably low wages; and also to provide incentives to work. The NMW came into force in April 1999 and since then the NMW rates have been reviewed annually by the Low Pay Commission (LPC). The aim when setting the rates is to increase the wages of the low paid as much as possible, while making sure that their employment prospects are not damaged by setting it too high.

The Government commissions an independent body, the LPC, annually to recommend the appropriate NMW rates. The final decision on whether to accept the LPC's recommendations is made by the Government. As the decision on the appropriate NMW rates is an empirical one, the LPC report contains a large body of evidence and analysis on the impact to date of the NMW. The LPC considers the prospects for the UK economy by considering the latest available forecasts for growth, average earnings, inflation, employment and unemployment from the Office for Budget Responsibility and the median of the HM Treasury panel of independent forecasters. They also have an extensive consultation period to include the views and analysis of a number of interested stakeholders. The Government also provides evidence on the labour market and policy developments. The evidence and data collected and produced by the LPC have been used to inform this IA.

As young people can face a comparative disadvantage when entering the labour market, the LPC recommends separate NMW rates by age band (16-17, 18-20 year olds, 21 years and older). This primarily reflects the position of younger workers who tend to have less work experience, less knowledge of where to look for work and fewer in-work contacts. A minimum wage could therefore have more potential for negative employment effects for young people. The evidence shows that employment rates are lower for young workers than for adults and that young people tend to be more susceptible to economic cycles than adults[1].

The Apprentice National Minimum Wage (ANMW) was introduced in 2010 to ensure Apprentices previously exempt from the NMW received the legal protection of the NMW. It applies to those Apprentices who are aged under 19 or aged 19 or over and in the first year of their Apprenticeship. The level of the ANMW should provide a fair deal for Apprentices which protects them from exploitation whilst at the same time not deterring businesses from taking them on and providing training.

The LPC also makes recommendations for the value of the Accommodation Offset. The Accommodation Offset was introduced in 1999 and provides a mechanism to offset the cost of providing accommodation for workers against the NMW. Accommodation is the only benefit-in-kind that can count towards the NMW. The offset arrangements provide protection to workers and give some recognition of the value of the benefit, but are not intended to reflect the actual costs of provision. The LPC reviewed the accommodation offset in their 2013 report and concluded that accommodation should remain the only permitted benefit-in-kind that can count towards payment of the National Minimum Wage.

Consultation

Within government

The LPC seeks evidence from the Government, which makes submissions each year to help inform the deliberations.[2]

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[1] LPC Report 2015 p23

[2] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/365179/bis-14-p157-government-interim-evidence-for-low-pay-commission-2014-r1.pdf
https://www.gov.uk/government/publications/national-minimum-wage-final-government-evidence-for-the-2015-low-pay-commission-report

Public consultation

The LPC consulted a range of stakeholders including employee and employer organisations to recommend the 2015 NMW rates. A full list of those consulted and a summary of responses can be found in Appendix 1 of the LPC report.

Policy objectives

The NMW sets a wage floor below which pay cannot fall ensuring protection for low-paid workers, raising wages while also providing incentives to work. The aim when setting the rates is to raise the wages of the low paid as much as possible, while making sure that their employment prospects are not damaged by setting it too high. Each year the NMW rates are revised to ensure that they still meet the policy objectives.

Options identification

Options:

Option 0) Do nothing - Reject all of the LPC recommendations

Option 1) Agree with all the LPC recommendations on NMW rates and implement the new rates

Option 2) Reject all or some of the LPC recommendations

The LPC in its latest report to the Government have recommended the following NMW rates:

Table 1: Change in NMW rates from October 2014 to October 2015

Age band	October 2014 rate	LPC recommended rate for October 2015	Percent increase
Adult rate (for workers aged 21+)	£6.50	£6.70	3.1%
Development rate* (for workers aged 18-20)	£5.13	£5.30	3.3%
16-17 year old rate	£3.79	£3.87	2.1%
Apprentice rate	£2.73	£2.80	2.6%

Source: LPC.

The LPC has made two non-rate recommendations: that the Government further consults on the reform to the structure of the Apprentice rate; and that the Apprentice rate should not apply to Higher Apprentices, who instead should be due their respective age-related rate. The Government is considering options on reforming the Apprentice rate structure and notes the LPC's view that a consultation would be required. The reform of the ANMW structure and option to exempt Higher Apprentices from the ANMW is not covered in this IA, as clearance of this change would be sought if Government completes a consultation.

The LPC has recommended rates for October 2015 after a wide ranging consultation and careful consideration of economic evidence and the impact on the employment prospects of low paid workers. The LPC's analysis is set out in their report.

The Government's preferred option is to agree with the LPC recommendations for the adult, development and 16-17 NMW rates but to reject the proposed ANMW rate in favour of increasing it by 20.9% to £3.30.

We have rejected Option 0 as the policy objectives would not be met.

The analysis contained within this Impact Assessment is based on option 2. The total costs for option 1 are also presented in this analysis.

Rationale for the Government's decision

The adult NMW rate

The LPC concluded that increasing the adult NMW rate by 20 pence (3.1%) in October 2015 is appropriate given the strength of the labour market and the more optimistic economic outlook. It is the biggest cash and percentage increase since 2008 and the largest real increase since 2006. The LPC reported that they expect this to increase the number of jobs covered by the minimum wage to between 1.5 and 2.4 million, with the former estimate assuming wage growth of the lowest paid in line with average earnings and the latter estimate assuming no wage growth. They estimate that this increase will lift NMW worker's pay relative to others' earning.

The LPC stated that because of the improving economic and labour market conditions employers will be able to respond in a way which supports employment. The LPC has commissioned a wide base of research over several years that in general has found little to no adverse impact of the NMW on employment.

The 16-17 and Development NMW rates

The LPC has recommended that the 16-17 year old rate should be increased by 8 pence (2.1%) and that the Development rate (18-20 year olds) should increase by 17 pence (3.3%) in October 2015.

These are a smaller increase than for the adult rate, as has been the case in the last few years, as improvements of the labour market position for young people have been worse than for adults.

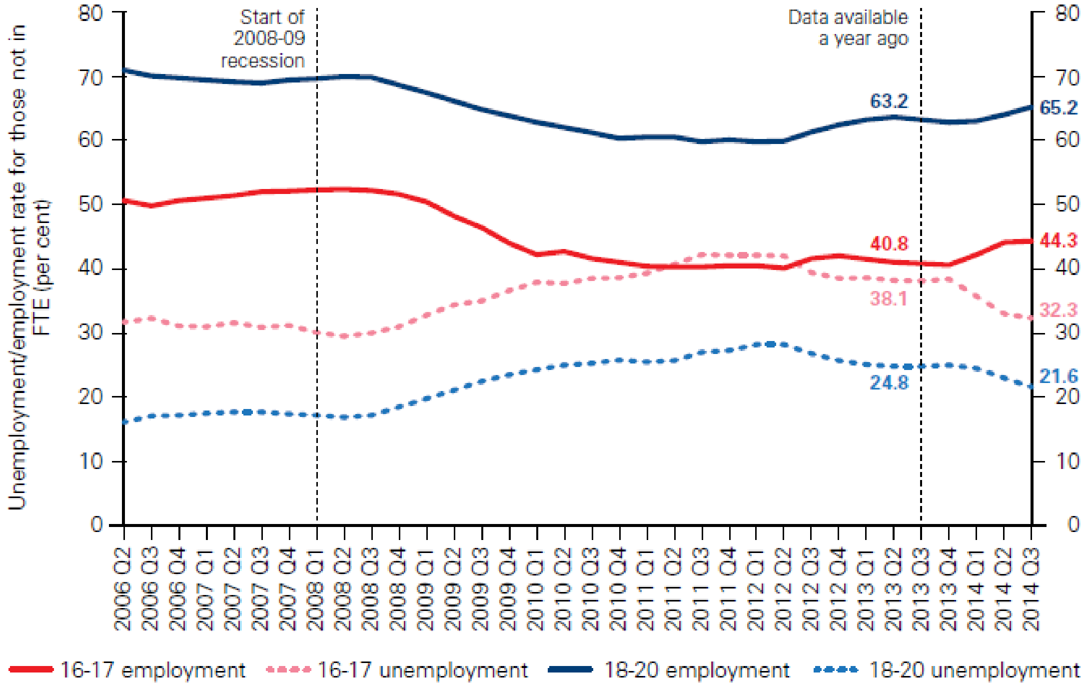
The report noted that this year wages for workers aged 18-20 have outperformed adults and, for this group, the bite[3] has fallen. There has been further improvement in the employment position and the abolition of employer National Insurance contributions for those under 21 from April 2015 should modestly reduce employment costs for about two-fifths of this age group on the minimum wage, as not all work enough hours to cross the required income threshold.

The LPC report stated that 16-17 year olds were recommended a smaller increase as their labour market position remains less strong than for 18-20 year olds, with improving unemployment but lower wage growth.

Chart 1 shows the employment and unemployment rates of young people excluding those in full-time education, with unemployment falling and employment rising for both groups over the past 12 months.

[3] The 'bite' is the ratio of the NMW to the median earnings of those covered and is a relative measure of its impact on the Labour Market. For instance, a high bite, indicating a minimum wage that is close to the median wage, is good for the relative position of minimum wage workers. However, it is more likely to affect their employment outcomes than a lower bite.

Chart 1: Employment and unemployment rates of 16-17 and 18-20 year olds not in full-time education[4]



Source: LPC estimates based on LFS Microdata, quarterly, four-quarter moving average, UK, Q2 2006-Q3 2014

The Apprentice NMW (ANMW) rate

The Government has rejected the recommended 7p rise in the Apprentice National Minimum Wage in favour of a higher increase of 57p, taking the rate from £2.73 an hour to £3.30.

Apprenticeship policy has a growing focus on quality, with ministers, including the Prime Minister, promoting Apprenticeships as a credible alternative to university for gifted young people. Employment remains an essential part of an Apprenticeship and the Government has stated that a larger increase in the Apprenticeship rate of NMW than that recommended by the LPC better reflects the role of Apprentices as productive members of an organisation's current workforce, as well as an investment in its future.

The Future of Apprenticeships in England: Implementation Plan in 2013 set out plans to improve the quality of Apprenticeships to make them attractive for young people and more relevant to businesses. Apprenticeships already represent a positive return on investment; the National Audit Office Report[5], published Feb 2012, found that adult Apprenticeships deliver £18 of economic benefits for each pound of Government investment. The report states that there are substantial productivity benefits to employers, amounting to spillover effects of 25% of the wage premium.

Furthermore, through the reforms, employers now have a greater role in designing Apprenticeships; deciding what Apprentices need to learn and how they will be assessed. In terms of quality and attractiveness, standards are designed by employers and include a synoptic assessment that will guarantee that the apprentice is fully competent. There is greater flexibility in assessment, so standards developers can choose the most appropriate way to assess Apprentices, for example through practical tasks, a viva or written exam. The Government has introduced grading to Apprenticeships for the first time, so there is an incentive for apprentices to try to exceed expectations.

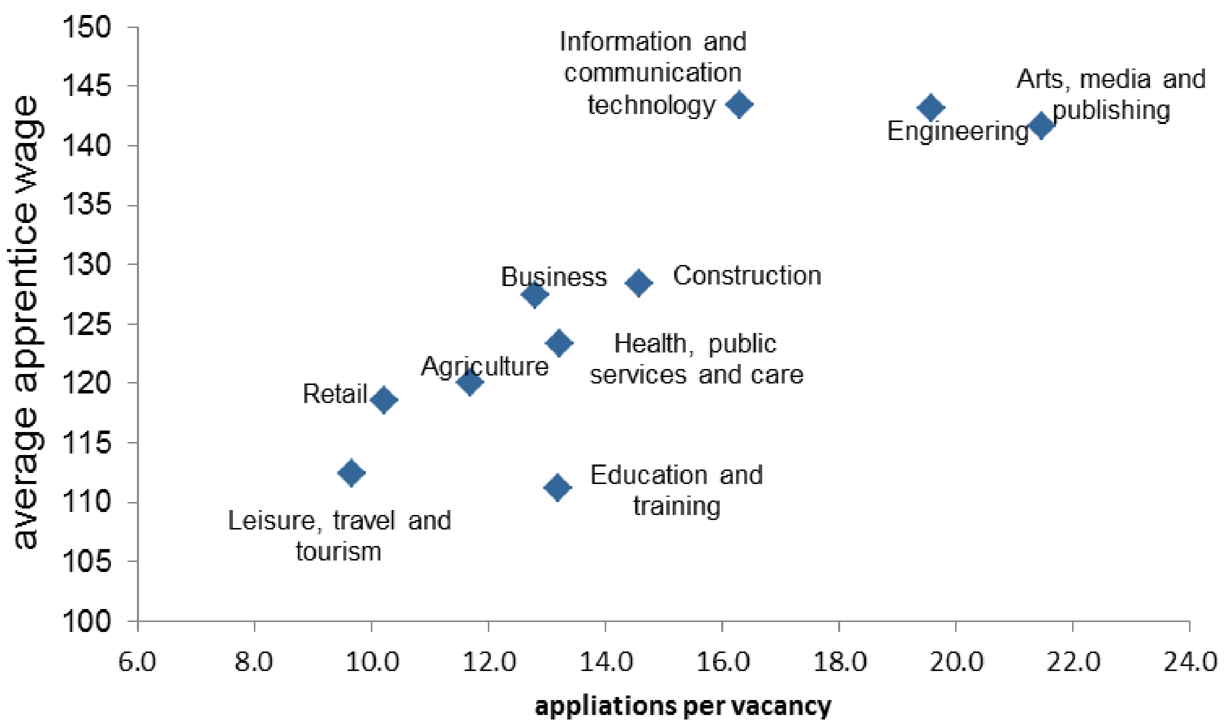
[4] LPC Report 2015 p141

[5] http://www.nao.org.uk/publications/1012/adult_Apprenticeships.aspx

Apprenticeships are being developed in new occupations, opening up new markets, for example within law, aerospace and the media. Apprenticeships are now available up to master's degree level and growing numbers include a degree.

Some employers have expressed concern about the quality of applicants for Apprenticeship positions. A significant increase in the Apprentice rate of National Minimum Wage is an important factor in helping to raise the profile of the programme, attracting greater numbers and a wider range of applicants. As can be seen from Chart 2, Apprenticeship applicants are sensitive to wages, as sectors with higher average wages attract a greater number of applications per vacancy. The Government wants to maintain the attractiveness of Apprenticeships, relative to other jobs with and without training, by closing the gap between the Apprentice rate and the age related rates. This, alongside wider reforms, will encourage more young people to consider Apprenticeships as a credible alternative to both higher education and jobs without training.

Chart 2: Apprenticeship applications per vacancy versus average wages by sector[6]



Source: Skills Funding Agency, Apprenticeship Vacancies System

When considering the possible negative employment effects of a 57p increase in the ANMW it is important to analyse previous increases. Before the ANMW was introduced in 2010, Apprentices were exempt from the NMW, though required to be paid at least £80 per week[7]. This is equivalent to £2 per hour if working for 40 hours per week. The 2007 Apprenticeship Pay Survey shows us that: before the introduction of the ANMW, 12% of Apprentices were not paid at all; a further 5% earned up to £2.45; and average hourly pay was £4.60. Applying this 17% to the 2009/10 starts gives us a rough estimate of 54,000 Apprentices affected. In comparison with increasing the ANMW to £3.30 in 2015, the 50p effective increase in 2010 was a greater increase relative to Apprentice average pay and affected a similar order of Apprentices. Following the 2010 introduction of the ANMW at £2.50, UK Apprenticeship starts increased by 56.5% from 320,000 to 501,000[8].

Furthermore, when drawing comparisons with the 2010 change, it is important to note that for the 75,000 Apprentices we estimate to be affected by the 2015 increase to £3.30, these numbers are relatively

[6] http://www.cipd.co.uk/binaries/the-match-factor-good-practice-in-apprenticeship-recruitment_2014.pdf
[7] http://dera.ioe.ac.uk/8726/1/DIUS-RR-08-05.pdf
[8] LPC Report 2015 p146

evenly split by Framework (the Apprentice terminology for sector), as show in Table 2. Less than 100 Higher Apprentices are affected by the change.

Table 2: Apprentice numbers affected by the increase in the ANMW to £3.30, split by Framework

Level 2 and 3 Frameworks	Business and related	Children's Learning and Development and Well Being	Construction and related	Customer Service	Electrotechnical	Engineering, Manufacturing Technologies and related	Hairdressing	Health, Social Care and Sport	Hosptiality and Catering	Management	Retail	Other 2/3
Number affected	12,400	7,400	5,100	5,100	1,100	11,500	10,500	7,900	2,900	100	4,300	6,600
Proportion of all affected	17%	10%	7%	7%	1%	15%	14%	10%	4%	0%	6%	9%

Source: BIS analysis of the 2014 Apprentice Pay Survey

In 2013 the Government rejected the LPC recommendation of a freeze in the ANMW, in favour of a 1% increase of 3p, in line with the youth rates and out of work benefit increases. In 2013/14 UK Apprenticeship starts decreased overall by 72,000, driven by a fall in numbers for those aged over 25. However, there was an increase of 5,000 in Apprenticeship starts for those aged under 19. It is not clear how the ANMW influenced Apprenticeship starts as over this period there were several interacting policy changes:

- Introduction of 24+ Advanced Learning Loans for Apprentices – Apprenticeship numbers were initially affected by the FE loans system, but once Apprenticeship were taken out of scope the number of starts returned to previous levels.
- Apprenticeship quality changes – In particular the requirement that Apprenticeships had to be at least a year in length meant that the number of Apprenticeships an employer could offer in a year declined.

The LPC found no direct evidence that the fall in starts for those over 25 or the increase in starts for those under 19 was due to the above recommended increase in the ANMW. The stakeholder EEF (The manufacturers' organisation) supported even higher increases to the ANMW to take it in line with the 16-17 NMW rate[9].

In theory, neoclassical economics suggests that, if a wage increase is above the market clearing rate this will reduce labour demand. Employers in a competitive labour market will seek to accommodate the increase in labour costs in a range of ways. If the response is to shed labour, there are two ways that this can be done; on the extensive margin – reducing the number of people employed, or on the intensive margin – reducing the number of hours worked by workers. The extent to which an increase in labour costs has an impact on labour demand depends on the 'labour demand elasticity'. To date there have been no studies looking at the empirical evidence of labour demand elasticities for apprentices in the UK[10]. NIESR (2013) have modelled labour demand elasticities for the low paid with an aim to give some indicative estimates of what the effects of increasing the NMW to the Living Wage might be. They made the rough assumption that all workers paid below the Living Wage have a labour demand elasticity of -0.3. This does not include apprenticeships, whose characteristics and employment status are very different to general low paid workers, so it would not be robust to apply it to model a reduction in apprenticeship numbers.

In summary, it is not clear that previous increases in the ANMW caused negative employment effects, including both the effective 50p increase at its introduction and the 2013 increase above LPC recommendations. In addition, there is a significant lack of evidence of Apprenticeship labour demand elasticities, so we therefore do not assume any significant impact on employment of this increase.

[9] LPC Report 2015 page 260

[10] See Fabbri, Haskel and Slaughter (2002) for an overview of estimates of labour demand elasticities in Britain.

The Accommodation Offset

In line with the recommendations from their 2013 report, for staged increases in the Accommodation Offset towards the value of the adult rate, the LPC recommended that the Accommodation Offset should be increased by 5.3 per cent, to £5.35 a day from 1 October 2015. The LPC do not estimate any impact on employment from this increase.

Analysis of options

Costs and Benefits

In assessing the impact of the 2015 NMW rates, we need to establish what might have happened in the absence of government intervention. We make the counterfactual assumption that, in the absence of an increase in the NMW rates, wages for the lowest paid workers would remain unchanged. A fuller discussion of the counterfactual can be found on page 11.

This counterfactual is reviewed annually alongside new and available evidence and is updated to ensure that the counterfactual is evidence based.

There will always be uncertainty surrounding the counterfactual as once policy intervention takes place we can never observe the outcome in the absence of Government intervention (we can only make inferences using appropriate evidence). It should be noted that the estimated cost to employers is higher by applying the rate freeze counterfactual, than if we assumed some wage growth for the lowest paid in absence of an increase of the NMW[11].

Business Impacts

Implementation by the Government of LPC rate recommendations falls is likely to fall out of scope of the better regulation framework (currently being developed) for the following reason[12]:

> *viii) Operation of periodic adjustments to an existing regulation or regulatory regime that are intended to maintain the current level of regulation in the face of general wage and price inflation – the adjustment must be provided for in existing legislation, either directly or, for example, through the recommendations of the relevant independent statutory body as set out in that legislation, for instance the Low Pay Commission for the National Minimum Wage."*

Therefore, under option 1 all direct costs to business and civil organisations (henceforth known as business) are likely to be exempt from the better regulation framework.

Under option 2, the direct costs to business associated with the uprating of the adult NMW, the 18-20 NMW, and the 16-17 NMW is likely to be exempt from the better regulation framework. However, following 2013 case history, the costs of increasing the Apprentice wage by 50p above the recommended rate of £2.80 are likely to fall within scope and be scored as IN.

[11] Due to the evidence base and inability to observe the true counterfactual we take these estimates as our best estimate.
[12] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/421078/bis-13-1038-Better-regulation-framework-manual.pdf

Box 1: The real National Minimum Wage

This Impact Assessment measures the costs and benefits of increasing the NMW in nominal terms. However the real value of the NMW, adjusted for inflation, has important implications for both employers and employees.

In their latest report the LPC show the real value of the NMW peaks in 2007, when adjusting for Consumer Price Index (CPI) inflation, at £6.74 (2014 prices). Between 2007 and 2013 the real value of the NMW fell each year as the LPC sought to avoid pricing workers out of jobs at a time when inflation was above average wage growth.

For 2015, the LPC have recommended a second real increase in the NMW, larger than the increase in 2014 and the biggest real increase since 2006. Forecast inflation at the time of the recommendation was 1.0 -1.5 per cent which would restore two-thirds of the fall in the real value of the NMW. However the latest CPI data from April 2015 shows a fall of 0.1%, so we expect the real value to be even closer to its peak.

Since the introduction of the adult NMW in April 1999 and October 2014, the NMW rate has increased by more than average earnings, CPI and RPI inflation over the whole period. Over this period the adult NMW rate has increased by over 81 per cent whereas growth in average earning over the same period was around 63 per cent[13] and CPI was 39 per cent.

The impact of a changing real value of the NMW will be different for employers and employees. Employers are more concerned about the real product wage, which is the level of labour costs relative to the price of the products they sell, typically proxied by the GVA deflator. Employees are more concerned about the real consumption wage, which is the level of labour income relative to the price of the goods and services they wish to consume, measured by CPI. The product wage will include non-wage labour costs such as employers' National Insurance Contributions (NICs) and also pension contributions, while the consumption wage is after the deduction of income tax and employee NICs.

A falling real product wage means that the expected labour cost to businesses of selling goods or services is reduced. When determining the balance of factors of production (capital and labour), a firm would tend to refer to real labour costs to determine how much labour they demand relative to capital. If real wages and real non-wage labour costs fall and the real cost of capital remain constant, in theory, a firm would substitute away from capital and would employ more units of labour in its production process. This is because labour would have become relatively cheaper as a result of the real wage fall.

The counterfactual

This Impact Assessment covers changes to the NMW as a result of the proposed increases in the level of the NMW rates from 1 October 2015. For the purposes of this Impact Assessment, the effect of the absence of government intervention would mean no changes to the existing NMW regime. There would still be a NMW (this Impact Assessment does not cover the overall policy of the NMW) but all the rates would remain at the level that is currently in force.

However, if our counterfactual is incorrect – and the lowest paid workers would have received a wage increase in the absence of a statutory requirement to do so - this could lead to an overestimate of the costs and benefits. The costs would never be underestimated as employers paying at the NMW could not reduce wages below the already existing NMW rates.

An alternative counterfactual would be to assume that the lowest paid would receive a pay rise in absence of an increase in the NMW, such as by OBR forecasts of average earnings or current average private sector earnings growth. This would reduce the estimated costs to business, but we do not believe that is the most robust assumption; analysis by Fry and Ritchie (2012a and 2012b) and Dawson, Ritchie and Whittard (2014) suggests that those paid closely above the NMW have their wage strongly influenced by the NMW rate, as employers use focal points or round numbers to set wages.[14] In addition,

[13] National Minimum Wage Low Pay Commission report 2014 page 31

[14] LPC Report 2015 page 273

there are a number of key reasons that support the use all the rates would remain at the level that is currently in force the counterfactual. The main arguments are:

1. **Evidence suggests that the NMW is binding on the labour market** – There is a spike in the earnings distribution at the NMW rate which moves to the new NMW rate each year; the 'bite' (the ratio of the National Minimum Wage to the average earnings of those covered) of the NMW has generally been increasing over time; NMW coverage has been increasing over time. The NMW results in some workers being paid a higher wage than they otherwise would without regulation. We therefore believe that, should the NMW not be uprated, some of those on the NMW would not receive a rise in pay.

2. **The NMW is an established policy** - There is evidence that the NMW is influential in pay setting more generally and a number of employers track increases in the NMW rate.

3. **Uncompetitive labour markets** – The NMW aims to cover workers who could potentially be exploited through low wages by employers who have market power. In the absence of a wage floor in an uncompetitive labour market (for example a monopsony), employers would pay lower wages and employment would be lower. In a competitive labour market, unemployment would increase because for many employers the competitive rate would be less than the wage floor. However, the LPC has found no strong evidence of negative employment effects of the NMW.

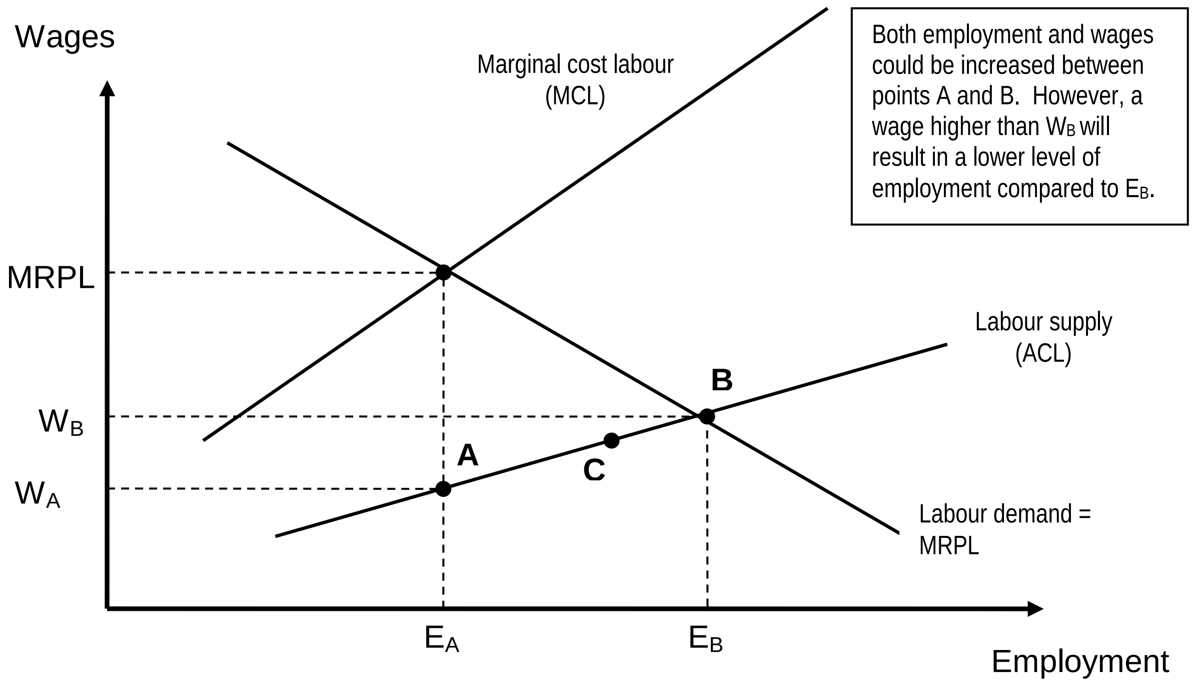
Economic Rationale

We assume that some of the lowest paid workers (NMW paid workers) have unequal bargaining power with their employer, and that without a NMW these workers would receive an unacceptable low wage. It is because of the NMW that these workers receive the NMW rates.

An increase in the NMW rate represents a transfer from employers (higher labour costs) to employees (higher wages). Leaving aside non-wage labour costs the wage element reflects a one-for-one transfer between employers and employees. This occurs because we assume no negative employment effects as a result of NMW policy decisions as the remit of the LPC recommendations is to help as many low paid workers as possible, while making sure not to damage their employment prospects. The transfer from employers to workers is as a result of mitigating potential exploitation of workers from low wages through a wage floor.

In a perfectly competitive labour market the wage rate and employment level are set where the labour supply curve and labour demand curve intersect at point B. However, the labour markets are not always perfectly competitive. For example, a monopsonist labour market (this is an extreme example, but illustrates the point) where there is a single employer must raise the marginal wage to attract new workers, and it must pay this wage to all existing workers. As a result the marginal cost of labour for each new worker is higher than the average cost of the labour supply curve. Assuming the monopsonist maximises profits it will demand labour at E_A, where the marginal costs of labour (MCL) equal the marginal revenue product of labour (MRPL). This level of employment intersects the labour supply curve at A and workers receive wages of W_A. The introduction of the NMW and subsequent increases in the rate moves us closer to the competitive wage rate at point B and above point A, for example point C. The aim is for the NMW to get as close as possible to the market clearing wage for low paid workers without going beyond it. The LPC's judgement is that we are now closer to B than we were in 1999. Increasing the NMW to a point on the labour supply curve above point B will lead to negative employment effects as the supply of labour exceeds demand.

Figure 1: A labour market characterised by market power for low paid workers



Economic Rationale for further increasing the ANMW

The Government wants to maintain the attractiveness of Apprenticeships relative to other jobs with and without training by closing the gap between the Apprentice rate and the age related rates. This, alongside wider reforms, will encourage more young people to consider Apprenticeships as a credible alternative to both higher education and jobs without training.

Neoclassical economic theory would suggest that suggest that such a wage increase would reduce labour demand. However, given that the ANMW of £3.30 is an attractive prospect for employers, still being less than the NMW of a non-Apprentice 16 year old and given that Apprenticeships provide substantial productivity benefits to employers[15], we expect no impact on employment of this increase.

Furthermore, some employers have expressed concern about the quality of applicants for Apprenticeship positions. A significant increase in the Apprentice rate of National Minimum Wage is an important factor in attracting greater numbers and a wider range of applicants. The stakeholder EEF (The manufacturers' organisation) supported even higher increases to the ANMW to take it in line with the 16-17 NMW rate[16].

The economic rationale for further inc

The NMW rates relative to median earnings

When considering the impact on employment, the LPC considers the NMW rate as a proportion of median earnings or the "bite" of the NMW. The adult bite has broadly been stable between 2007 and 2010, reaching its then highest level in October 2012 before falling back slightly in 2013. It has subsequently risen again to 53.9%, a record high. As mentioned above, research for, and analysis by, the LPC has not found significant evidence of negative employment effects as a result of the adult NMW. The LPC concluded that an increase which would roughly maintain the position of the lowest paid and is the largest increase that employers would pay without cutting jobs.

[15] http://www.nao.org.uk/publications/1012/adult_Apprenticeships.aspx

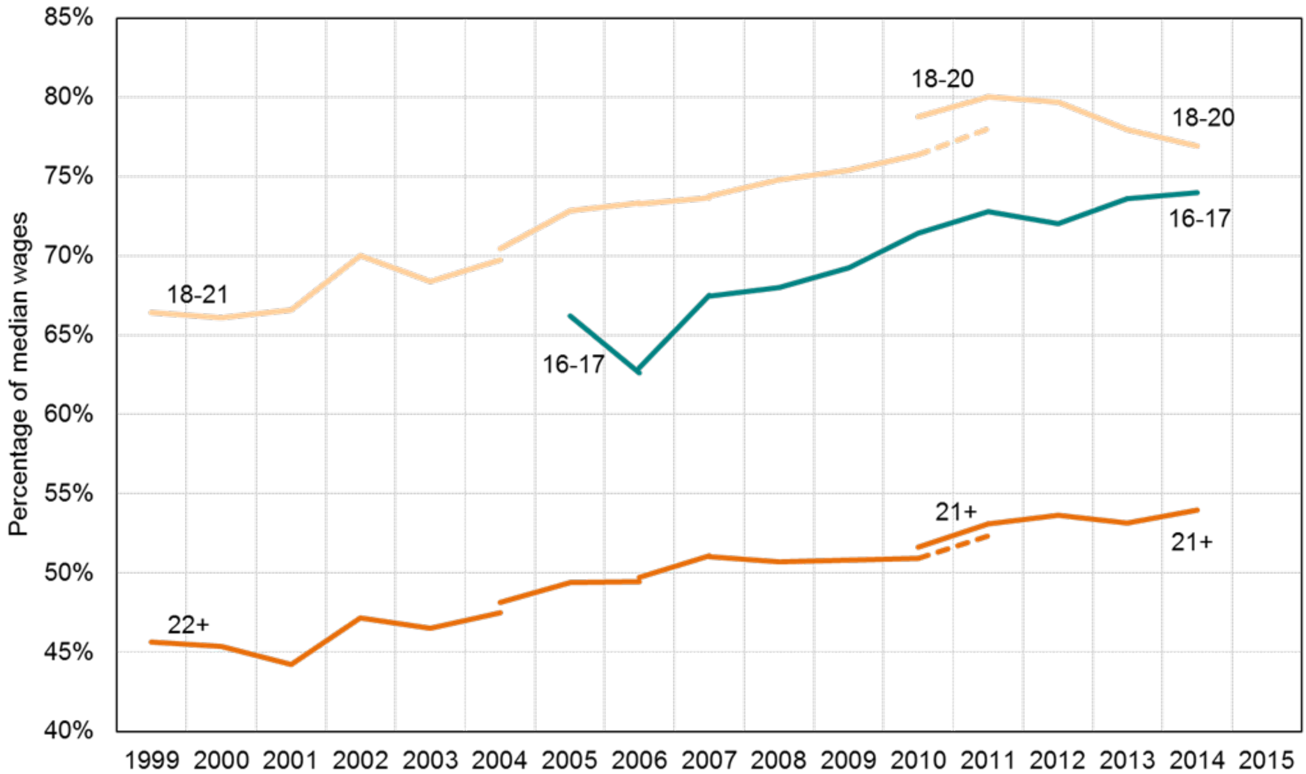
[16] LPC Report 2015 page 260

As in 2013, the earnings of 18-20 year olds saw relatively strong growth in 2014 compared with the years previous to 2013 and the bite of the Youth Development Rate fell. While the 16-17 year old rate was also froze in October 2012, the bite of the 16-17 year old rate increased in 2013 as median earnings for 16-17 year olds fell between 2012 and 2013. This can be seen in Chart 3.

The best measure of wages for Apprentices is from the 2014 Apprentice Pay Survey, which found Apprentices to have an average hourly wage of £6.19 (median gross pay).

Chart 3: The NMW rates as a proportion of median earnings

Minimum wage as a per cent of median earnings



Source: Office for National Statistics, Annual Survey of Hours and Earnings. 1999-2004 ASHE data - excluding supplementary information 2004-2006 ASHE data - old methodology. 2006-2014 ASHE data - new methodology.

Number of jobs covered by October 2015 NMW rates as at April 2016

The table below presents the number of workers working at or below the NMW rates recommended for October 2015, in April 2014, used for our analysis. These are based on ASHE 2014 data.

Table 3. Number of employees paid at or below the October 2015 National Minimum Wage by age

Age group	October 2015 rates	Numbers covered
Adult rate (for workers aged 21+)	£6.70	2,183,000
Development rate (for workers aged 18-20)	£5.30	126,000
16-17 year old rate	£3.87	22,000
Total		2,331,000
Apprentice rate	£2.80	53,000
	£3.30	75,000

Source: LPC analysis of ONS' Annual survey of Hours and Earnings (ASHE). Figures have been rounded. Numbers may not sum to total due to rounding.

Methodology for estimating the cost to employers

The methodology for estimating the increased cost in the wage bill is as follows:

- We calculate the additional **weighted average**[17] hourly pay for those due the respective rate who are earning between the proposed rate and the rate that would have prevailed under the counterfactual.
- We multiply this average cost per hour by the average number of hours worked by those workers affected using the 2014 Annual Survey of Hours and Earnings (ASHE).
- Multiply by 52 weeks per year.
- Multiply by the number of potential workers between the proposed rate and the rate that would have prevailed under the counterfactual. We use 2014 ASHE[18] to estimate potential workers affected.

To go from the total wage bill to total labour costs, we add 19.8 per cent to take account of the cost to employers of National Insurance and any other non-wage labour costs (such as pension contributions)[19]. This estimate cannot be split between benefits to the exchequer and others, such as pension contributions and the wider benefits package.

To calculate the Business Net Present Value we need to calculate the percentage impact on business for each rate. For the age related rates, we do this by calculating what percentage of affected workers for each rate are private sector employees. For the Apprentice rate calculations, although costings are made using the Apprentice Pay Survey, the survey did not ask if Apprentices were working for a Public or Private sector employer. We therefore used ASHE data to calculate the proportion of affected Apprentices that work for private sector employers. The result was 57%.

The NMW is fully embedded in the UK economy, with the NMW wages being revised each year since their introduction. The potential annual increase of the NMW is expected by businesses that employ workers on the NMW, so we therefore do not envisage any transitional costs to employers as part of the rate change.

Impact on public finances: Analysis by the Treasury estimates that there is no significant impact on public finances with changes in the NMW, and the net benefits on Public Sector Net Borrowing are very small, not significantly difference from zero. The full results of this analysis can be found in the Government evidence to the LPC on the additional assessment 2014 and has therefore not been replicated as part of this Impact Assessment.[20]

Our calculations for all rates can be found in figures 2-6 below.

Total costs and benefits for all rates

Table 4. Summary costs and benefits of option 1*

Age band	October 2015 rate	Employers Higher labour costs	Employees Higher wages for employees (benefit)
Adult rate (aged 21+)	£6.70	£634.7m	£529.8m
Development rate (aged 18-20)	£5.30	£26.4m	£22.1m
16-17 year old rate	£3.87	£1.2m	£1.0m
Apprentice rate	£2.80	£7.6m	£7.6m

Source: BIS. *Exchequer benefits from some of the increase in non-wage labour costs from employers (some of the non-wage labour costs will be accrued by the employee), increased tax and National Insurance revenue (from employees) and reduction in benefits and tax credits as a result of changes in the adult NMW rate.

[17] We use a weighted average as there will be some individuals that partially benefit (if they receive more than the old NMW rate but less than the forthcoming rate). Using a weighted average we estimate that on average individuals will benefit by 18 pence (this is lower than the 20 pence increase in the adult rate).

[18] The number earning at or below the proposed NMW in April 2014

[19] Source: Eurostat

[20] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/273345/bis-14-534-national-minimum-wage-government-evidence-for-the-low-pay-commission-on-the-additional-assessment-2014.pdf

Cost and benefits of the increase in the Adult rate (21+)

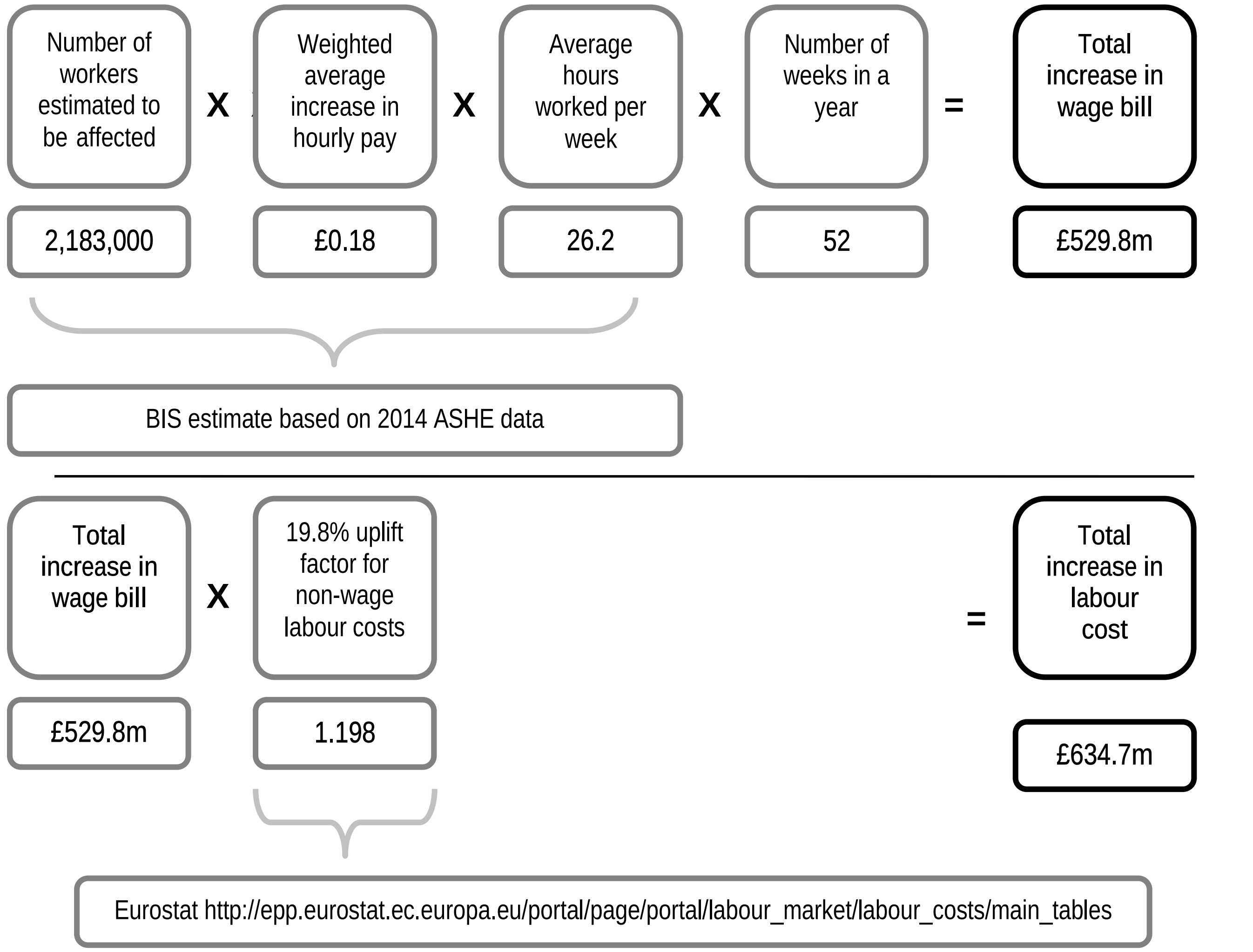
The proposed changes to the October 2015 rates represent an increase of 3.1% on the current rate for adults.

The total estimated cost impact of the 2015 adult rate is an increase in labour costs of **£634.7m for all employers (a direct impact on business of £599.1m as 94% of those affected work in the private sector).**

Adult employees benefit from increased wages (**£529.8m**) and non-wage labour costs will increase by (**£104.9m**).

We assume that there will be no negative employment effects from uprating the adult NMW rate as the aim of the LPC recommendations is to help as many low paid workers as possible, while making sure not to damage their employment prospects.

Figure 2. Estimated increase in labour costs from increase in adult NMW rate from £6.50 to £6.70 (figures have been rounded*)



Source: BIS calculations. * Individual parts may not sum to total due to rounding.

Cost and benefits of the proposed uprating of 18-20 year old workers

The proposed changes to the October 2015 rates represent an increase of 2.1% on the current rate for 18-20 year olds.

The estimated cost impact of the 2015 18-20 rate is an increase in labour costs of **£26.4 for all employers (a direct impact on business of £26.3m as 99% of those affected work for the private sector).**

18-20 year old employees benefit from increased wages (**£22.1m**) and non-wage labour costs will increase by (**£4.4m**).

We have assumed that there will be no negative employment effects from uprating the 18-20 NMW rate as the aim of the LPC recommendations is to help as many low paid workers as possible, while making sure not to damage their employment prospects.

Figure 3. Estimated increase in labour costs from increase in 18-20 NMW rate from £5.13 to £5.30 (figures have been rounded*)

Number of workers estimated to be affected	X	Weighted average increase in hourly pay	X	Average hours worked per week	X	Number of weeks in a year	=	Total increase in wage bill
126,000		£0.16		21.5		52		£22.1m

Total increase in wage bill	X	19.8% uplift factor for non-wage labour costs	=	Total increase in labour cost
£22.1m		1.198		£26.4m

Source: BIS calculations. * Individual parts may not sum to total due to rounding.

Cost and benefits of the proposed uprating of 16-17 year old workers

The proposed changes to the October 2015 rates represent an increase of 3.3% on the current rate for 16-17 year olds.

The estimated cost impact of the 2015 16-17 rate is an increase in labour costs of **£1.2 m for all employers (a direct impact on business of £1.2m as 100% of those affected work for the private sector).**

16-17 year old employees benefit from increased wages (**£1.0m**) and non-wage labour costs will increase by (**£0.2m**).

We have assumed that there will be no negative employment effects from uprating the 16-17 NMW rate as the aim of the LPC recommendations is to help as many low paid workers as possible, while making sure not to damage their employment prospects.

Figure 4. Estimated increase in labour costs from increase in 16-17 NMW rate from £3.79 to £3.87 (figures have been rounded*)

Number of workers estimated to be affected	X	Weighted average increase in hourly pay	X	Average hours worked per week	X	Number of weeks in a year	=	Total increase in wage bill
22,000		£0.08		10.8		52		£1.0m

Total increase in wage bill	X	19.8% uplift factor for non-wage labour costs	=	Total increase in labour cost
£1.0m		1.198		£1.2m

Source: BIS calculations. * Individual parts may not sum to total due to rounding.

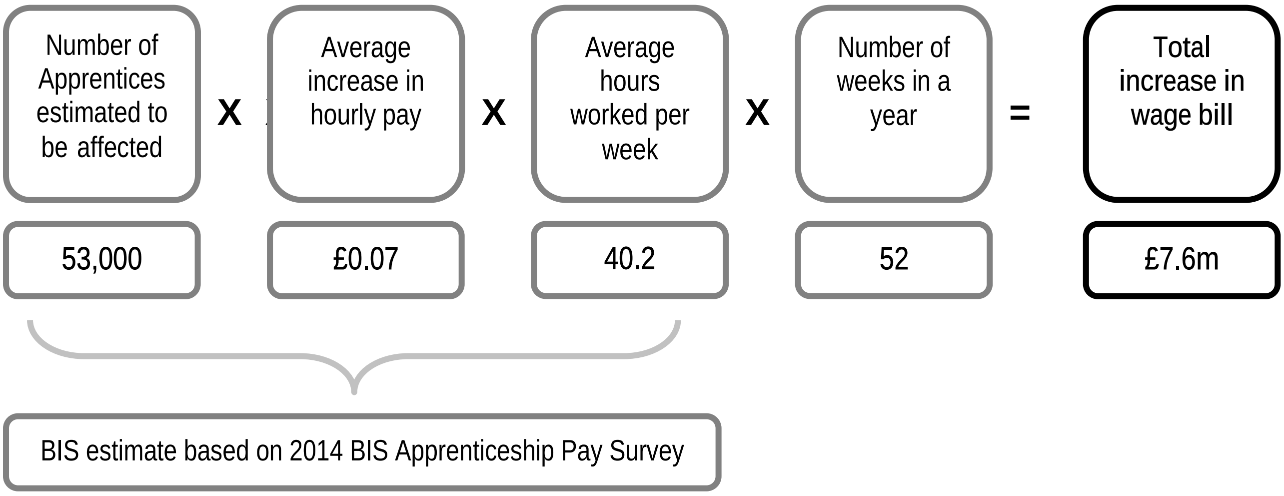
Cost and benefits of uprating the Apprentice rate to £2.80 (Option 1 – this not the preferred option)

The LPC recommended increase (Option 1) in October 2015, is of 2.6%, from £2.73 to £2.80. BIS estimates that around 53,000 Apprentices stand to benefit from the increase in the ANMW rate and that it will **cost employers £7.6m (a direct impact on business of £4.3m)** in increased wage bills. This represents a transfer and will **benefit Apprentices by £7.6m** in the form of increased wages.

We have assumed that there will be no negative employment effects from uprating the ANMW rate as the aim of the LPC recommendations is to help as many low paid workers as possible, while making sure not to damage their employment prospects.

Unlike adults, we assume no change in non-wage labour costs as the total Apprentice weekly pay tends to be entirely below the £8,112 secondary threshold (2015-16), beyond which employers start paying National Insurance Contributions.

Figure 5. Estimated increase in wage bill from increase in ANMW rate from £2.73 to £2.80



Source: BIS calculations. Figures have been rounded.

Cost and benefits of uprating the Apprentice rate to £3.30 (Option 2 – the preferred option)

The proposed changes to the October 2015 Apprentice rates (Option 2) represent an increase of 20.9% on the current rate. BIS estimates that around 75,000 Apprentices stand to benefit from the increase in the ANMW rate and that it will **cost employers £75.6m** in increased wage bills. This represents a transfer and will **benefit Apprentices by £75.6m** in the form of increased wages.

The methodology for estimating the increased cost in the wage bill is as follows:

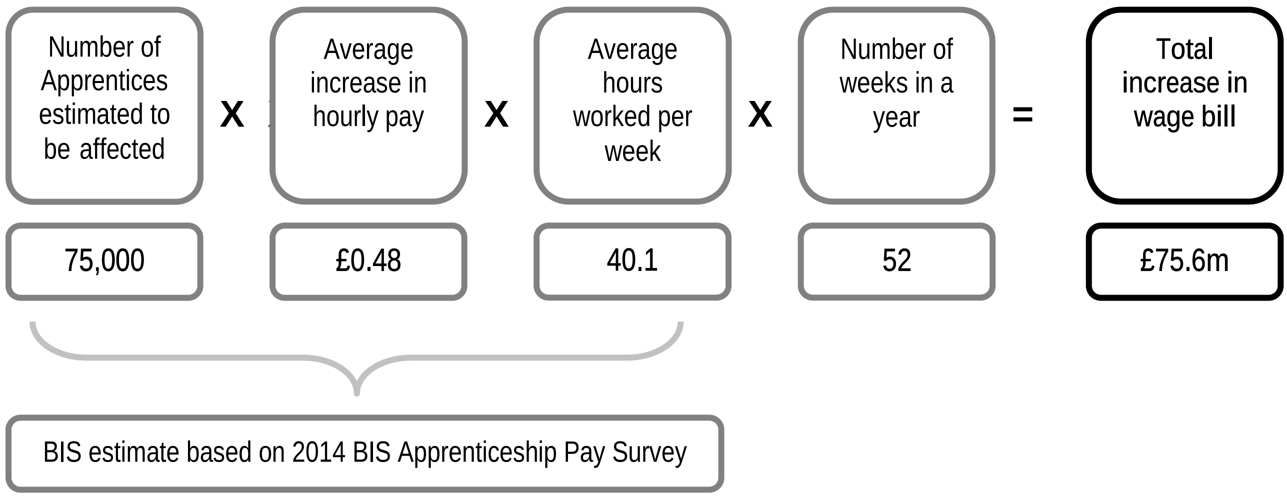
- Using Apprentice Pay Survey 2014 data we estimate that around 75,000 Apprentices earn at or less than the £3.30 per hour ANMW rate. The average pay rise required, from an assumed minimum of the previous ANMW of £2.73, is £0.48.
- We multiply the above by **40.1 hours** worked per week (the average hours worked by those selected).
- Multiply by 52 weeks per year.

As discussed on page 8, we expect no impact on employment of this increase.

Unlike adults, we assume no change in non-wage labour costs as the total Apprentice weekly pay tends to be below the point at which employers start paying National Insurance Contributions.

The increases in the ANMW above £2.80 are likely to fall within scope of the better regulation framework, amounting to £68.0m (£75.6 - £7.6m). As 57% of those affected work in the private sector, this results in a direct impact on business of £38.8m as 57% of those affected work in the private sector.

Figure 6. Estimated increase in wage bill from increase in ANMW rate from £2.73 to £3.30



Source: BIS calculations. Figures have been rounded.

Cost and benefits of the proposed uprating of the Accommodation Offset

Accommodation is the only benefit in kind that can count towards NMW pay and only up to the Accommodation Offset limit. The NMW Accommodation Offset was introduced with the intended purpose of protecting vulnerable workers whose employers might have sought to avoid paying their workers the NMW by levying excessive rent for their accommodation.

The proposed change to the NMW Accommodation Offset is an increase from £5.08 in October 2014 to £5.35 in October 2015. This represents an increase of 5.3%. The Accommodation Offset is a benefit to employers as it allows them to offer a greater amount in benefits in kind to workers, but its take-up is likely to be low. We have not monetised this benefit as it is very uncertain how many employers offer accommodation to workers. An example of where the Accommodation Offset applies is where an individual works in a hospitality establishment such as a pub and lives above the commercial premises. If their accommodation is also owned by the same business that operates the pub the Accommodation Offset applies.

Risks and assumptions

This Impact Assessment is based on the best available evidence alongside a set of necessary assumptions which we have set out below.

In assessing the impact of the 2015 NMW rates we have made the assumption that, in the absence of the uprating, wages for the lowest paid workers would not have changed in the year beginning 1 October 2015. However, if our counterfactual is incorrect – and the lowest paid workers would have received a wage increase in the absence of a statutory requirement to do so - this could lead to an overestimate of the costs and benefits. The costs would never be underestimated as employers paying at the NMW could not reduce wages below the already existing NMW rates.

We have not considered any potential displacement effects of possibly making younger workers relatively more attractive to adult workers given that the recommended increases in the youth NMW rates are smaller than that of the adult rate. With the current evidence base any estimate would be subject to great uncertainty. The LPC commissioned research for their 2013 report that looks at the substitution rate of young workers and adult workers. Lanot and Sousounis (2013) found some evidence that workers aged 18-21 years old were substantial, if not perfect complements to workers aged 55 or older. This suggested that the minor changes to the differences in the NMW between age groups since the introduction of the NMW had not affected the composition of the work force. Fidrmuc and Tena (2013) examined the impact of the NMW on employment and hours of young workers. They found some negative employment effects of the NMW for young men, a year before they became entitled to the adult rate[21].

We have assumed that there are no negative employment effects of uprating the adult and youth NMW rates. Before its introduction the lowest paid fared worse than other workers; since 1999 they have done better, including since the onset of recession in 2008. This has happened without evidence of adverse employment effects. The LPC's remit is to recommend NMW rates such that the employment prospects of low-paid workers are not damaged and their recommendations are based on a thorough body of evidence. Therefore, we believe that making such an assumption is justified. If there were to be negative employment effects of uprating the NMW, the quantified impacts would be uncertain.

We have also assumed that there is no adverse impact on employment or training for Apprentices. As discussed above, the UK is undergoing significant reforms of Apprenticeship policy and it is our view that the LPC's Apprenticeship rate recommendation was too cautious as a result of not taking this into account. If there is a decrease in the employment or hours worked of Apprentices and/or a reduction in the quantity or quality of training as a result of uprating the ANMW rate, we expect the adverse impact on employment to be small in comparison to the wider policy changes that are expected to increase demand for Apprenticeships.

In addition, while we might expect a behavioural response to a higher NMW rate in business demand for Apprenticeships, that needs to be balanced with the alternative for a business. The Apprentice rate still remains below all equivalent age rates for employing a non-Apprentice. Furthermore, the training element remains subsidised by the Government.

Government evidence to the LPC set out that with employment levels unaffected by the adult minimum wage uprating, any knock on savings to the exchequer via increased tax take and/or reduced support benefits would be transfers and will not affect the NPV. Therefore, we have not fully monetised all the impacts on the exchequer. The LPC have agreed with this assessment in their Report 2015[22].

[21] LPC Report 2013 page 91

[22] LPC Report 2015 page 275

Enforcement

The NMW is enforced by HM Revenue and Customs (HMRC) on behalf of BIS. HMRC investigates all complaints made to the Pay and Work Rights Helpline. In addition, HMRC conducts risk-based enforcement in sectors or areas where there is a higher risk of workers not getting paid the legal minimum wage. If HMRC investigates an employer that is breaking NMW law and issues a Notice of Underpayment containing details of the underpayments, the period to which they relate and the workers affected the employer will have to pay back the arrears owed to workers, face a financial penalty and can be publicly named and shamed under the NMW Naming scheme, unless it successfully appeals against the Notice of Underpayment.

We have assumed that there is no change in the cost to the Exchequer of enforcement due to the upratings of the various NMW rates.

Summary of preferred option

Implementation

The changes to the NMW regulations would be made by secondary legislation and would be expected to come into force on 1 October 2015. Any reforms to the ANMW structure are expected at a later date, as explained on page 5.

Impact on Busineess

Implementation by the Government of LPC rate recommendations is likely to be out of scope of the better regulation framework for the following reason[23]:

> *viii) Operation of periodic adjustments to an existing regulation or regulatory regime that are intended to maintain the current level of regulation in the face of general wage and price inflation – the adjustment must be provided for in existing legislation, either directly or, for example, through the recommendations of the relevant independent statutory body as set out in that legislation, for instance the Low Pay Commission for the National Minimum Wage."*

Under option 2, the direct costs to business associated with the uprating of the adult NMW, the 18-20 NMW, and the 16-17 NMW are likely to be exempt from the better regulation framework. However, the direct cost to business of rejecting the LPC recommended Apprentice rate above £2.80 and instead increase it to £3.30 falls within the the better regulation framework rule.

In order to calculate the direct costs to business, using 2014 ASHE data, we calculate the percentage of affected workers that work in the private sector for each rate. We find that for the Adult rate, 94% are in the private sector; for the Development rate the figure is 99%; for the 16-17 rate the figure is 100%; and for the Apprentice rate the figure is 57%. We take these percentages as the percentage impact on business. The appraisal period has been set at one year, as the NMW is reviewed annually, and we have used 2014 prices.

Table 5 shows the calculations for the additional costs to business of increasing the ANMW rate.

All of our workings to calculate the full costs to business (including those exempt from the better regulation framework) and net present values can be found in Annex 4.

[23] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/421078/bis-13-1038-Better-regulation-framework-manual.pdf

Table 5: Costs and benefits in scope of OITO preferred option (Option 2).

Impact on business (%)	Direct impact on business	In scope of OITO?	Cost or benefit	Year 0	Nominal total	Present value total	Business Net Present Value (OITO)
			Costs				
57%	YES	YES	Wage bill Apprentices (employer)	68.0	68.0	68.0	38.76
57%	YES	YES	Non-wage labour cost Apprentices (employer)	0.0	0.0	0.0	0.0
			Benefits				
0%	NO	YES	Wages Apprentices (employee)	68.0	68.0	68.0	0.0
0%	NO	YES	Non-wage labour cost Apprentices (Exchequer and employee)	0.0	0.0	0.0	0.0
			Totals				
			Total cost	68.0			
			Present value total cost			68.0	
			OITO present value total cost				38.76
			Total benefit	0.0			
			Present value total benefit			0.0	
			OITO present value total benefit				0.0

Source: BIS estimates. For the purposes of OITO, net cost to business on the front page is presented in 2009 prices. This IA has a 2014 price base year and the EANCB figures have been adjusted accordingly using HMT's GDP deflator. We have used the share of selected employees working in the private sector from ASHE 2014 to estimate percentage impact on business for costs and benefits.

Annexes

Annex 1: Specific impact tests

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 low rates. The LPC list the low paying sectors with the greatest proportions of workers on the NMW, with some of the largest being hairdressing, social care and retail. Most of the sectors where the impact of the NMW is felt are characterised by large numbers of relatively small firms. To the extent that the NMW affects labour costs, these are borne by all employers in a sector.

We conclude that the 2015 NMW rates are unlikely to hinder the number or range of suppliers; the ability and incentive for businesses to compete; and unlikely that the NMW creates significant barriers to entry.

Small and Micro business Assessment

For the purposes of this assessment, the parameter used to define small businesses is up to 49 full-time employees, and for micro businesses up to 10 employees.

The aim of the National Minimum Wage (NMW) is to provide protection to low-paid workers by avoiding potential exploitation by employers who, in the absence of government intervention, could undercut competitors by paying unacceptably low wages; and also to provide incentives to work. The National Minimum Wage Act 1998 (NMWA) applies to all workers working or ordinarily working in the United Kingdom who are over compulsory school age. All employers are obliged to pay the NMW at the rate which is set by the legislation to workers within its scope.

The LPC's remit required them to consider the impact of the NMW on small firms. Their recommendations were based upon extensive analysis and gathering of evidence, including evidence received from, and discussion with, small businesses and their representatives. The LPC noted in their report that smaller firms were more likely to pay their employees at or below the minimum wage. Micro (1-9 employees) and other small firms (10-49 employees) together only accounted for just under 21 per cent of all employee jobs, but they made up over 35 per cent of minimum wage jobs. There is a clear relationship between the proportion of minimum wage jobs and size of firm – the proportion of minimum wage jobs decreases as the firm size increases. Minimum wage jobs accounted for just under 4 per cent of jobs in large firms (with 250 or more employees); about 6 per cent of jobs in medium-sized firms (those with 50-249 employees); 8 per cent of jobs in other small firms; but 12 per cent of jobs in micro firms[24].

In the LPC report they found the bite of the NMW (the adult NMW as a percentage of median earnings) is much higher for smaller firms. Since 2000 the bite in micro firms had increased more or less continuously from 52.7 per cent 67.2 per cent in 2014. Similarly, other small firms experienced an increase in the bite from 48.2 per cent in 2001 to 60.1 per cent in 2014. Furthermore, the minimum wage has a higher bite in smaller firms and the low paying sectors than elsewhere in the economy. The LPC reported that although the bite was broadly flat in the economy as a whole between 2007 and 2010, it continued to rise in the low-paying sectors and in small firms, increasing further in 2011, 2012 and further still in 2014.

For the purpose of the small and micro assessment, the following exemptions were considered:

- Full Exemption
- Partial exemption
- Extended transition period
- Temporary exemption

[24] LPC Report 2015 page 39

- Varying requirements by type and/or size of business
- Direct financial aid for smaller businesses
- Opt-in and voluntary solutions
- Specific information campaigns or user guides training and dedicated support for smaller businesses

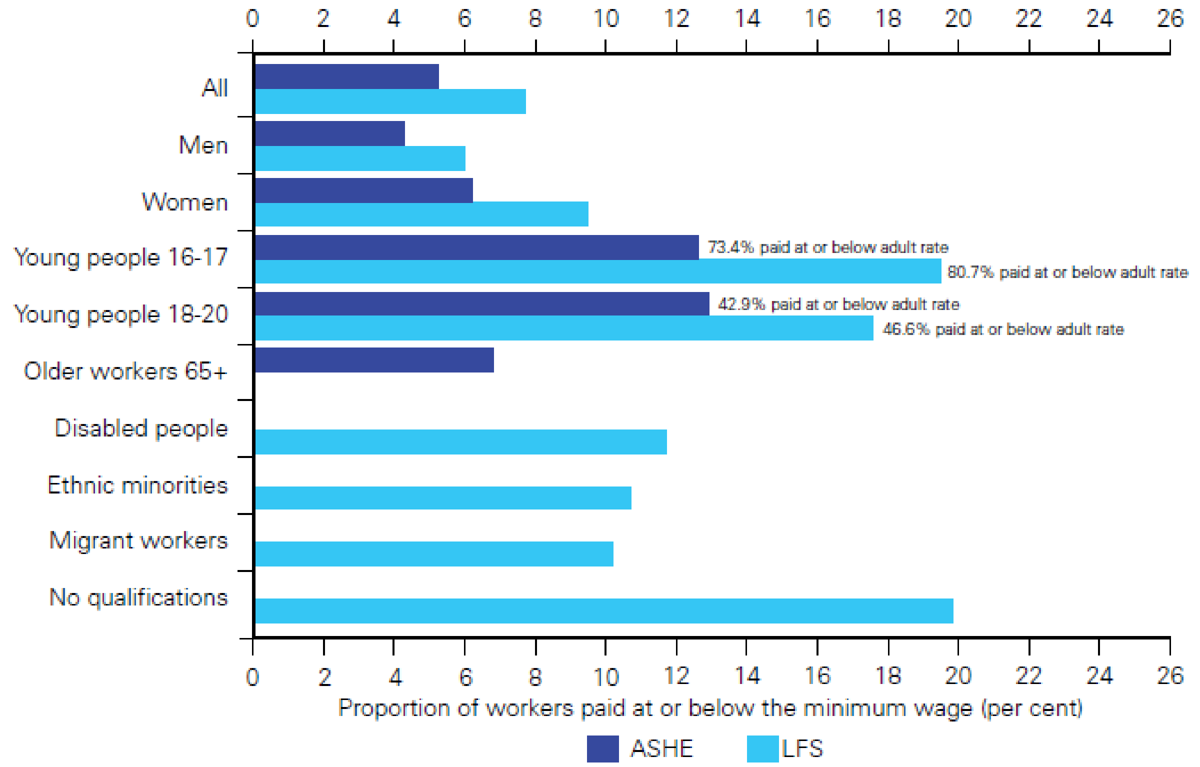
Following from the evidence above, allowing any exemptions targeted at small and micro business could have a negative impact on the primary objective of this policy, providing protection to low-paid workers by preventing exploitation, and providing incentives to work.

Public sector equality duty

The Department for Business, Innovation and Skills (BIS) is subject to the public sector duties set out in the Equality Act 2010. Equality Impact Assessments are an important mechanism for ensuring that we gather data to enable us to identify the likely positive and negative impacts that policy proposals may have on certain groups and to estimate whether such impacts disproportionately affect such groups. This assessment considers the impact of the NMW uprating.

The focus of part of the LPC analysis is on groups that contain high proportions of minimum wage workers. In the 2015 report, these groups include women, young workers, older workers, people with disabilities, ethnic minorities, migrant workers, and those with no qualifications[25]. Chart A1 below shows the proportions of minimum wage workers of each of these groups compared to the general population.

Chart A1: Minimum Wage Workers, by groups of workers, UK, 2014[26]



Source: LPC estimates based on ASHE, 2010 methodology, low-pay weights, including those not on adult rates of pay, UK, April 2014 and LFS Microdata, income weights, quarterly, not seasonally adjusted, UK, Q2 2014.
Note: Minimum wage workers are defined as adults (aged 21 and over) earning less than £6.36 an hour (or less than £2.73 if an Apprentice in their first year); those aged 18-20 earning less than £5.08 an hour (or less than £2.73 if an Apprentice under the age of 19 or in their first year); and 16-17 year olds earning less than £3.77 an hour (or less than £2.73 if an Apprentice) in April 2014.

[25] LPC Report 2015 page 43
[26] LPC Report 2015 page 44

Gender

Chart A1 shows that a higher proportion of women than men were minimum wage workers in 2014. This is also reflected in the coverage estimates by gender of the October 2014 NMW rates presented in Annex 4. These coverage estimates suggest a relatively even distribution of coverage as a result of the uprating of the youth rates. However, this is less true for adult workers. The 'bite[27]' of the adult NMW for women is slightly higher than for the general population (see chart A2).

The LPC notes that the median gender pay gap has narrowed over the last year, but is still remained close to its peak. In 2014, the growth in female earnings has been much higher than the growth in male earnings across the earnings distribution. This has resulted in completely reversing the widening of the gender pay gap that we observed in 2013 at the lowest decile, the median, mean and the upper decile. The gender pay gap at the lowest decile was 5.5 per cent in 2014, down from 5.8 per cent in 2013. The median gender pay gap in 2014 fell by 1 percentage point to 8.5 per cent and the upper decile gender pay gap fell by 2 percentage points to 18.5 per cent. These gender pay gaps were below those in 2011. Given that more adult women have been identified as minimum wage workers than men, an increase in the adult NMW rate could reduce the gender pay gap at the lower end of the earnings distribution[28].

Chart A2: Bite of the adult NMW at the median for those aged 22 and over, by groups of workers, UK[29]

Source: LPC estimates based on LFS Microdata, income weights, quarterly, four-quarter averages, UK, Q4 2007-Q3 2014.
Note: Due to changes in the data series, the estimates from 2011/12 onwards are not directly comparable with estimates for earlier years.

27 NMW as a proportion of median earnings

28 Assuming no decrease in employment or substitution between men and women

29 LPC Report 2015 page 59

Age

The LPC identified that a higher proportion of young workers and older workers are minimum wage workers. They noted in their 2015 report that there was an increase in the proportion of 18-20 year olds paid below or at (including those paid up to five pence above) their age related NMW rate. It is also possible that some of those paid below the age-related rates were paid at the Apprentice Rate or paid at focal points about the Apprentice Rate but below the youth rates. Research found that non-compliance was more prevalent among part-time employment and shift workers, which may also disproportionally affect young people.

Ethnicity

The proportion of workers of ethnic minorities that are minimum wage workers shown in chart A1 are slightly higher (10.7%) than the proportion of all jobs held by the same group (10.3%) according to the LFS figures. However, it is important to note that this category is made up of many different ethnicities, masking some of the variability between more detailed groups. For example, the proportions of black workers and Indian workers in minimum wage jobs (7.1 per cent and 7.9 per cent respectively) were lower than or similar to that of white workers (7.4 per cent). In contrast, 20.4 per cent of Pakistani and Bangladeshi workers earned the minimum wage[30].

Chart A2 shows the bite of the adult NMW over time on ethnic minorities. Since 2008, the bite has generally increased for white people (from 55.7 per cent to 58.0 per cent) and those from ethnic minorities as a whole (from 57.9 per cent to 61.7 per cent). But the bite for ethnic minorities disguises variations among different ethnic groups. The bite at the median for Indian workers is lower than that for white workers, and has increased from 50.3 per cent in 2007/08 to 53.6 per cent in 2013/14. The increase in the bite for Bangladeshi people increased similarly, albeit at a much higher level (from 74.0 to 78.6 per cent). The increase in the bite for black workers over the same period, from 56.9 per cent to 63.1 per cent, was much larger[31].

Disability

Chart A1 shows that the proportion of people with disabilities that are minimum wage workers is higher than for the overall population.

The uprating of the NMW will have a positive effect on the groups of people who are disproportionately affected by the NMW.

Removal of barriers which hinder equality

The NMW policy is a broad policy and is designed to have a positive impact on all workers in low paid sectors regardless of their characteristics. Therefore the 2015 NMW rates are unlikely to create any barriers to equality with regards to the protected groups.

Family test

We consider that increases in the NMW will have a positive impact on families, as the policy results in a transfer from employers to employees, increasing the wage of the lowest paid without impacting their employment.

[30] LPC Report 2015 page 48
[31] LPC Report 2015 page 59

Annex 3: Coverage estimates by gender and region:

As discussed above, the LPC has not made comprehensive forecasts of future coverage of their October 2015 NMW rate recommendations. Below are estimates of the number of people earning at or below the LPC's recommended NMW rates for October 2015. These estimates do not include Apprentices because ASHE data is not reliable enough to do so.

Table A2. Estimated number of workers (excluding Apprentices) that are covered by the October 2015 National Minimum Wage rates by age and sex

	Male	Female	Total
16-17	7,000	16,000	22,000
Development	51,000	75,000	123,000
Adult	825,000	1,358,000	2,183,000
Total	882,000	1,449,000	2,331,000

Source: BIS estimates based on ONS' Annual Survey of Hours and Earnings (ASHE) 2014. Figures have been rounded so totals may not sum up to individual parts.

Table A3. Estimated number of workers (excluding Apprentices) that are covered by the October 2015 National Minimum Wage rates by country and government office region

Country or region	Coverage estimate
Wales	122,000
Scotland	182,000
Northern Ireland	110,000
England	
North-East	110,000
North-West and Merseyside	302,000
Yorkshire & Humberside	228,000
East Midlands	202,000
West Midlands	235,000
Eastern	212,000
London	202,000
South East	233,000
South West	194,000
United Kingdom	2,331,000

Source: A BIS breakdown of estimates based on ONS' Annual Survey of Hours and Earnings (ASHE) 2014. Figures have been rounded so totals may not sum up to individual parts.

Annex 4: Net Present Value and direct cost to business calculations

The table below explain the costs and benefits that were fed into the Better Regulation Executive (BRE) IA calculator to calculate the net present values and Equivalent Annual Net cost to Business (EANCB)

Table A4: Costs and benefits of Option 2 - Increase the Apprentice NMW rate by 21% to £3.30 and agree with all other LPC recommendations.

Impact on business (%)	Direct impact on business	In scope of OITO?	Cost or benefit	Year 0	Nominal total	Present value total	Business Net Present Value (OITO)
			Costs				
94%	YES	No	Wage bill adult rate (employer)	529.8	529.8	529.8	N/A
94%	YES	No	Non-wage labour cost adult rate (employer)	104.9	104.9	104.9	N/A
99%	YES	No	Wage bill 18-20 rate (employer)	22.1	22.1	22.1	N/A
99%	YES	No	Non-wage labour cost 18-20 (employer)	4.4	4.4	4.4	N/A
100%	YES	No	Wage bill 16-17 rate (employer)	1.0	1.0	1.0	N/A
100%	YES	No	Non-wage labour cost 16-17 (employer)	0.2	0.2	0.2	N/A
57%	YES	YES	Wage bill Apprentices (employer)	75.6	75.6	75.6	29.58
57%	YES	YES	Non-wage labour cost Apprentices (employer)	0.0	0.0	0.0	0.0
			Benefits				
0%	NO	NO	Wages adult rate (employee)	529.8	529.8	529.8	N/A
0%	NO	NO	Non-wage labour cost adult rate (Exchequer and employee)	104.9	104.9	104.9	N/A
0%	NO	NO	Wages 18-20 rate (employee)	22.1	22.1	22.1	N/A
0%	NO	NO	Non-wage labour cost 18-20 (Exchequer and employee)	4.4	4.4	4.4	N/A
0%	NO	NO	Wages 16-17 rate (employee)	1.0	1.0	1.0	N/A
0%	NO	NO	Non-wage labour cost 16-17 (Exchequer and employee)	0.2	0.2	0.2	N/A
0%	NO	YES	Wages Apprentices (employee)	75.6	75.6	75.6	0.0
0%	NO	YES	Non-wage labour cost Apprentices (Exchequer and employee)	0.0	0.0	0.0	0.0
			Totals				
			Total cost	738.0			
			Present value total cost			738.0	
			OITO present value total cost				29.58
			Total benefit	0.0			
			Present value total benefit			0.0	
			OITO present value total benefit				0.0

Source: BIS estimates. For the purposes of OITO, net cost to business on the front page is presented in 2009 prices. This IA has a 2014 price base year and the EANCB figures have been adjusted accordingly using HMT's GDP deflator. We have used the share of selected employees working in the private sector from ASHE 2014 to estimate percentage impact on business for costs and benefits.