Regulatory Policy Committee

# Increases in national minimum wage rates - 2015

## Department for Business, Innovation and Skills

## RPC rating: fit for purpose

### Description of proposal

The national minimum wage (NMW) is a statutory pay floor that provides protection to low-paid workers. The NMW came into force in April 1999 and, since then, NMW rates have been reviewed annually by the Low Pay Commission (LPC).

The Government's proposal uprates the adult rate, the development rate and the 16-17-year old rate in line with the LPC's recommendations. The Government is proposing to increase the rate for apprentices by 20.9% to £3.30 per hour, well in excess of the LPC's recommendation of £2.80. The new rates will take effect on 1 October 2015.

### Impact of proposal

Using data from the 2014 Annual Survey of Hours and Earnings (ASHE), the Department estimates the number of employees paid at or below the new NMWs to be about 2.4 million. Of this, 2.2 million are covered by the adult rate and 75,000 by the apprentice rate. This gives an overall cost of the proposal to employers of £738 million, with the benefits accruing to employees (£628.5 million) and (mainly) the Exchequer (£109.5 million). The latter comes from, for example, increased employers' national insurance contributions.

For the One-in, Two-Out (OITO) assessment, the figures are adjusted by the proportion of employees affected who work in the private sector. This gives a total cost to the private sector of £665 million, of which nearly £39 million is accounted for by the increase in the apprentice rate over and above the LPC's recommendation. Converted to 2009 prices, this represents an IN of £29.58 million.

The remainder of the proposal, which only goes as far as the LPC recommendations, are out of scope of OITO. This is because they represent a periodic adjustment to an existing regulatory regime provided for in existing legislation through the recommendations of a relevant independent statutory body, in this case the LPC. This assessment is consistent with paragraph 1.9.9 viii of the Better Regulation Framework Manual (March 2015).

### Quality of submission

The Department provides an adequate assessment of the costs and benefits to business of the proposed new NMW wage rates. There are, however, some areas where the impact assessment could be improved.

## **Main comments**

Appraisal period

The Department undertakes its assessment only over one year because "*the NMW is reviewed annually*" (page 25 of the IA). The BRFM (paragraph 1.9.36) states that the "*time period used in the calculation of an EANCB should be the time period in which the policy is active in the appraisal"*. However, the NMW will not revert back to its previous level after a year; rather it will be used as the baseline for the next uprating. On that basis, it is arguable that the "active life" of the proposal is longer than one year. In particular, an increase in the NMW is not reversed after one year and therefore raises the baseline for the next annual uprating.

The Department's approach is in line with its assessment of previous NMW upratings. The Committee recognises that an alternative approach, constructing an appraisal over a longer period, could be particularly difficult, notably around assumptions for the counterfactual. Nevertheless, the Department should demonstrate further whether one year is the correct appraisal period, or whether it is the only practicable approach. This should also take into account the metric chosen for measuring the Business Impact Target. This is particularly important where the uprating is above the LPC's recommendation. This is for two related reasons. First, the higher the increase, the more likely that its impact will last beyond one year. Second, the increase above the LPC recommendation will be in scope of OITO and will need to be scored appropriately. For example, the current approach means that the present uprating will score for one year only and would not, therefore, feature in an end-of- Parliament account balance. This issue will need to be addressed to the Committee's satisfaction in time for next year's uprating. The Committee would be happy to engage with the Department on this issue. The Department should also take this into consideration in any impact assessments on the 'national living wage', announced in the Budget on 8 July 2015

Employment impacts

The Department treats the proposal as a transfer from employers to employees and the Exchequer, with the net present value being zero. The Department explains why it expects no significant employment impacts from the proposal: "*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"* (page 23). The IA would, however, benefit from providing a fuller and more integrated discussion of this issue. For example, the Department describes a framework for assessing possible employment impacts at Box 1 (page 12) but does not use this framework as a basis for the evidence or analysis.

Rationale for the proposed NMW for apprentices

The Department presents its case for going beyond the LPC's recommendation on apprentices on page 14 of the IA. The Department should say much more about the rationale for the proposal on apprentices. For example, this should include whether the LPC considered these arguments and, if so, why the Government came to a different conclusion. In particular, if the Department's case is that the supply of apprentices is being constrained, it should explain why businesses are not paying apprentices more. In addition, if the overarching objective is to increase the quantity and quality of apprenticeships, the IA should at least reference analysis which examined options, including increasing the NMW for apprentices, for doing this.

Small and micro-business assessment (SaMBA)

The SaMBA is sufficient. The Department explains why it would not be possible to exempt small firms from the proposal. The Department provides useful information, drawing from the LPC report, which shows that smaller firms are more likely to pay their employees at or below the minimum wage. Small and micro-businesses account for just under 21 per cent of all employee jobs, but they make up over 35 per cent of minimum wage jobs. The IA also states that mitigation is not an option but could improve its assessment further by providing a fuller discussion around each of the options for mitigation listed. The Department could also provide a greater focus on the impact of its proposal on small firms that employ apprentices.

## Other comments

Exchequer impacts

The IA explains that the Exchequer will benefit, for example, from the increase in non-wage labour costs from employers and increased tax and national insurance revenue from employees. However, the IA also states 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 different from zero"* (page 16). It would be helpful if the Department's IA provided greater clarity around the size of the Exchequer impacts.

Impact on employment of apprentices

The Department discusses previous increases in the NMW for apprentices, including where the Government has gone beyond the LPC's recommendation. It concludes that there is no evidence that such increases have decreased the employment of apprentices. However, given the size of the current proposed increase in the apprentice NMW, the IA would benefit from further consideration of this issue.

EANCB for the out of scope increases

The Department provides an adequate assessment of the direct impacts on business (£665 million total). It would be helpful if the IA converted this to an EANCB for the out of scope increases. This would make it easier to compare with the EANCBs from previous IAs. In addition, the IA describes these impacts as "*exempt from the better regulation framework*" (page 11). This should be amended to "out of scope of OITO".

## Initial departmental assessment

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| Classification | Most of proposal out of scope; apprentice rate change above the LPC recommendation in scope |
| EANCB | £29.58 million (currently calculated for one year only) |
| Business net present value | -£38.76 million (in scope only) |
| Net present value | zero |

## RPC assessment

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| Classification | Most of proposal out of scope; apprentice rate changes above the LPC recommendation in scope |
| EANCB – RPC validated | £29.58 million (only validated for one year currently)<br>Analytical issues need to be addressed adequately before the 2016 assessment |
| Small and micro-business assessment | Sufficient |

**Michael Gibbons CBE** Chairman