National Minimum Wage (Amendment) Regulations 2019: increases in the national minimum wage and national living wage rates

Department for Business, Energy and Industrial Strategy

RPC rating: fit for purpose

Description of proposal

The national minimum wage (NMW) was introduced in April 1999. The national living wage (NLW) was introduced in April 2016. These set floors below which hourly wages must not fall, protecting low-paid workers and providing incentives to work. The Low Pay Commission (LPC) reviews rates and makes recommendations to government annually.

The proposal would increase the NLW (for those aged 25 years and older), the main NMW (for workers aged 21-24 years) and the development (aged 18-20 years), youth (aged 16-17 years) and apprentice NMW rates; all changes are in line with the LPC's recommendations. The Government propose to increase the NLW by 4.9% to £8.21, the main NMW rate by 4.3% to £7.70, the development rate by 4.2% to £6.15, the youth rate by 3.6% to £4.35 and the apprentice rate by 5.4% to £3.90. The 'accommodation offset', an amount that employers who provide accommodation can count towards the NMW, is being raised in line with the LPC's recommendation, by 7.9% to £7.55 per day. It is proposed that the new rates should come into force on 1 April 2019. NMW and NLW rates were last increased in April 2018.

Impacts of proposal

Direct labour costs

The introduction of the new NLW and NMW rates would impose costs on employers by increasing the wages of employees who were paid less than the new statutory wage rates and associated non-wage labour costs. The impact assessment (IA) models these costs by estimating the difference between assumed rates of pay in the absence of an uprating of NLW/NMW rates and what they would have to pay in wages under the proposed NLW/NMW rates. To calculate the counterfactual wage, the Department has used a counterfactual in which wages increase at a rate equal to the assumed increase at the 20th percentile of the wage distribution. This rate was recommended by the National Institute of Economic and Social Research (NIESR) in 2017/18 in a report commissioned by the Department to analyse counterfactual wage growth. The 20th percentile is the point in the pay distribution above which the NIESR estimates that there are no more spillovers from the minimum wage uprating.

The IA explains that 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, using an assumption for counterfactual wage growth in line with the NIESR research. Based on this, the Department has used a two-year appraisal period.

The IA estimates that 2.1 million employees would be paid at, or below, the proposed NLW/NMW rates in April 2019. It is estimated that 1.76 million of these are aged 25 years or older and therefore covered by the NLW. This is based on data from the 2018 Annual Survey of Hours and Earnings (ASHE). All wage impacts have been increased by 20.66% to account for non-wage labour costs (employer pension and National Insurance contributions). The Department notes that some workers do not meet the NIC threshold; it will continue to review this assumption. The IA estimates the overall direct increase in labour cost to all (public and private sector) employers to be £366 million in present value terms.

Spillover effects

The IA explains that some businesses may also raise wages for employees earning above the new NLW/NMW rates in order to maintain wage differentials. The Department has classified the increase in labour costs caused by this 'ripple effect' within the earnings distribution as an indirect effect, because the only regulatory requirement for businesses is to meet the increased pay floor. This is based on evidence from the LPC and other sources that there is no significant evidence of pay differentials being built into employment contracts (which the RPC considers would make it a direct impact). This was the approach adopted for the 2018 NMW IA. The present IA estimates the ripple effect to cost employers £340 million in present value terms. Combining this with the additional direct labour cost to employers of £366 million, the IA estimates the overall impact of the proposals on labour costs to be £705.9 million.

Transition costs

The IA estimates that businesses would incur familiarisation costs of between £2.7 million and £3.1 million. This is based on five minutes of employers' time to consult the government website to determine the new rates, and an estimate that between 1,082,000 and 1,270,000 employers would be affected by the uprating. This uses 2018 Business Population Estimates and external survey evidence, and takes into account the proportion of businesses with workers paid in ranges affected by the current and proposed NMW/NLW rates. As in last year's IA, the Department explains why it does not expect any other significant implementation costs associated with this year's NMW uplifting, drawing upon evidence from the Bank of England Wage Dynamics Survey, the Workplace Employment Relation Study 2011 and NIESR (paragraphs 103-106, pages 27-28).

Overall cost and cost to business

The upper estimate of the transition cost (£3.1 million) is added to the labour cost estimate of £705.9 million to provide an overall cost to employers of £709 million, in present value terms. In order to arrive at a direct cost to business for business impact target (BIT) purposes, the Department makes two further adjustments. First, it applies the proportion of workers paid at each of the NLW/NMW rates who work in the private and voluntary sectors – equivalent to 89% for the NLW, 97% for the main NMW rate, 98% for the development rate, 96% for the youth rate and 90% for the apprentice rate (annex E, pages 52-54). Second, it excludes the indirect spillover cost of £340 million referred to above. These adjustments result in an equivalent annual direct impact on business (EANDCB) of £151.8 million in present value terms over the two-year appraisal period in (2016 prices; 2017 base year for discounting). In line with the BIT written ministerial statement of 20 June 2018, amendments to the National Minimum Wage Act reflecting LPC recommendations are now qualifying regulatory provisions that count towards the BIT.

Wider impacts

As noted above, the Department's IA provides a monetised assessment of the impact of the measure on public sector employers. The Department also provides an assessment of the impacts on employees and on the Exchequer. The £705.9m labour cost to employers is matched by a combined benefit to employees through increased wages (£585m) and to the Exchequer primarily through increased pension and National Insurance contributions (£121m). The net present value of -£3.1 million (-£2.8 million in 2016 prices; 2017 base year for discounting) also includes employers' familiarisation costs.

The IA provides a discussion of macroeconomic impacts, including potential impacts on employment, prices and productivity (pages 28-31). For example, due to the nature of the LPC's remit and the lack of evidence from numerous evaluations, the Department does not expect adverse employment effects from the increase in the NMW rates. For the NLW, however, the Department notes that the OBR expects a slight resultant increase in the equilibrium unemployment rate over the medium term.

Quality of submission

The RPC's opinion on the 2018 NMW/NLW uprating[1] set out in detail two main concerns with the Department's analysis. In summary, the first was that counterfactual wage growth at the lowest part of the wage distribution seemed likely to be much lower than that assumed by the Department, possibly even at, or close to, zero. The second was the omission of potentially significant 'base-raising' impacts from previous years' NMW uprating, arising from re-setting the counterfactual in each IA to the level of the existing NMW. Both factors meant that costs to business could be much higher than those estimated by the Department. The RPC strongly encouraged the Department to continue to consider ways to improve further its analysis and evidence in these areas and specifically suggested that the Department should seek comments and views from a range of labour market experts and stakeholders on the points raised in its opinion.

The RPC is pleased that the Department has continued to engage with the RPC on these issues and that it has undertaken a survey of labour market academic experts, aimed at addressing the points in the 2018 RPC opinion. The results of this survey are summarised on page 8 and reported in detail at Annex B (pages 39-43) of the IA. The response rate was low, but the majority of the respondents supported the Department's approach. The Department has, therefore, not altered its approach fundamentally compared to the previous year's IA. The Department has, however, helpfully updated its illustrative alternative quantitative assessment (annex D, pages 46-51). This shows very much higher estimated costs if one were to allow for a period of zero wage growth at the lowest end of the wage distribution, and, therefore, a longer period before which the counterfactual wage growth 'catches-up' with the minimum wage.

Given the improvement in the evidence base to the present IA, the difficulties presented by an unknowable counterfactual and the recognition that the Department's approach continues to be supported, overall, by labour market experts, the RPC accepts the IA is fit for purpose. Nevertheless, the RPC expects the Department to continue to seek to strengthen the evidence for its approach in IAs on future upratings. This could be, for example, through seeking views of more labour market experts, in view of the small number of respondents to the survey of academics. The Department could also explore further the views expressed by a minority of the respondents to the survey, who did recognise the issues raised by the RPC. These are around suggestions that a lower counterfactual wage growth assumption might be appropriate (paragraphs 152 and 176 on pages 41 and 47, respectively) and potential omission of the base-raising effect of previous years'

[1] https://www.gov.uk/government/publications/national-minimum-wage-amendment-regulations-2018-rpc-opinion

NMW upratings (paragraph 177, page 47). The Department should continue to investigate the views of labour market experts in these areas, perhaps alongside its stated consideration of an alternative business cycle (as opposed to an average uniform growth rate) approach, where the Department states that it will "…*consider exploring the feasibility of an ARIMA* [Autoregressive Integrated Moving Average] m*odel for future iterations of minimum wage impact assessments*." (paragraph 56, page 16).

The Department could also consider tracking more detailed longitudinal microeconomic evidence in order to test the assumptions made around these issues. This could also potentially inform broader areas of interest such as substitution among different types of labour, impacts on labour productivity, promotion rates, retention, duration/churn of employment and interaction with in-work benefits.

The IA would benefit from addressing the following comments:

- *Making a clearer distinction between the feasibility of different analytical approaches to assess the NMW and the NLW*. Appraising the full impacts of the NLW should be more straightforward given its much more recent introduction. The RPC remains of the view that best practice would be for the Department to provide an economic appraisal of the full policy ambition for the NLW to 2020, including the base-raising effect of earlier years. Failing that, the Department should, at each annual uprating, explicitly check that its assessment of the cumulative impact is soundly based.

- *A clearer explanation of the method used in Annex D* to provide an illustrative cost estimate under a period of zero counterfactual wage growth. This should include how the resultant cost figure has been calculated and why it is much higher than in the 2018 IA.

- *Accommodation offset*. The IA provides relatively little information on how the impact of the increase in the accommodation offset, a benefit to business, has been considered in the overall analysis. Due to the limited numbers of affected employers and workers, the impact of this element seems likely to be relatively small and on this basis the RPC judges the Department's overall assessment to be proportionate. The IA would, however, benefit significantly from setting out more clearly how the increase in the accommodation offset has been assessed and, more generally, how other benefits-in-kind might be incorporated into the analysis.

- *Employment effects resulting from NLW*. The IA reports that the Department will remain vigilant for 'negative employment effects' (paragraph 178, page 47). The IA would benefit significantly from providing further information on how these potential effects will be monitored and tested, especially in the sectors reported as 'particularly exposed' such as social care, convenience and wholesale (paragraph 34, page 10). The Department should also address explicitly the consistency of its approach to counterfactual wage growth with the OBR's expectation of an increase in unemployment rate over the medium term resulting from the NLW.

- The IA's discussion of employment effects would benefit from further consideration of substitution among workers earning different wages and shifts between capital and labour. It could also consider whether such effects could be stronger in the future as competitive pressures and the advance of automation/artificial intelligence increase incentives to reduce wage bills.

- *Counterfactual wage growth and appraisal period.* The IA would benefit from discussing the 'stickiness' of employee pay progression under the uprating and its potential implication for comparison against the counterfactual and choice of appraisal period. For example, in the counterfactual, some of those currently on the minimum wage would be promoted as their performance warranted, while under the uprating such promotions might be delayed until the marginal product of labour exceeded the new NMW/NLW.

  Stakeholder evidence of wider business impacts. The IA includes evidence from stakeholders, e.g. in relation to prices on page 29. The assessment would, however, benefit from further development and/or reporting of the stakeholder evidence base in relation to how businesses have been affected by increases in the minimum wage rates, including impacts on their staffing etc. practices.

- *Transition costs*. The Department monetises familiarisation costs but would benefit from further discussion of why other transition costs, such as redoing employee pay tables and tax codes, are not expected to be significant.

- *Spillover effects*. The discussion around there being no significant evidence of pay differentials being built into employment contracts would benefit from considering negotiated or collectively bargained pay scales, which will apply to many public sector workers.

Small and micro business assessment (SaMBA)

The SaMBA is sufficient. Small and micro businesses are estimated to employ 22 per cent of those covered by the NMW/NLW and incur approximately 34 per cent of the cost of the proposal. Although small and micro businesses are thereby disproportionately affected by the proposal, the IA explains clearly why they should not be exempt from the proposal (paragraphs 143-145, pages 35 and 36). The Department also states that the announcement of the rates in October 2018 and the Government's communications campaigns would help small and micro businesses to adjust to the new rates. The IA would benefit from discussion of further possible mitigation, for example along the lines of apprenticeship subsidies, and their competitive effects.

Monitoring and evaluation

The Department explains how the remit for the LPC will continue to include the requirement to monitor, evaluate and review the levels of the different minimum wage rates and that in making future recommendations the LPC will carry out extensive monitoring and evaluation of the current rates (page 37).

Departmental assessment

Classification	Qualifying regulatory provision (IN)
Equivalent annual net direct cost to business (EANDCB)	£151.8 million
Business net present value	-£572.2 million (including indirect costs)
Societal net present value	-£2.8 million (2016 prices; 2017 base year for discounting)

RPC assessment

Classification	Qualifying regulatory provision (IN)
EANDCB – RPC validated	£151.8 million
Business impact target score	£303.6 million
Small and micro business assessment	Sufficient

Regulatory Policy Committee