The National Minimum Wage (Amendment) Regulations 2022: increases in the national minimum wage and national living wage rates

Lead department	Department for Business, Energy and Industrial Strategy
Summary of proposal	An increase in the national living, and minimum, wage rates in line with the Low Pay Commission's recommendations.
Submission type	Impact assessment (IA) – 17 December 2021
Legislation type	Secondary legislation
Implementation date	1 April 2022
Policy stage	Final
RPC reference	RPC-BEIS-5141(1)
Opinion type	Formal
Date of issue	26 January 2022

RPC opinion

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

Business impact target assessment

	Department assessment	RPC validated
Classification	Qualifying regulatory provision (IN)	Qualifying regulatory provision (IN)
Equivalent annual net direct cost to business (EANDCB)	£257.1 million	£257.1 million *(2019 prices, 2020 pv)*
Business impact target (BIT) score	£771.3 million	£771.3 million
Business net present value (NPV)	-£1,311.5 million	
Overall NPV	-£3.2 million	

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

RPC summary

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

Policy detail

Description of proposal

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

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

LPC NMW/NLW rate recommendations for April 2022 (Table 1, p. 11 of the IA)

	LPC recommendation	Current rate	Annual percentage increase
National Living Wage rate	£9.50	£8.91	6.6%
21-22 year old rate	£9.18	£8.36	9.8%
18-20 year old rate	£6.93	£6.56	4.1%
16-17 year old rate	£4.81	£4.62	4.1%
Apprentice rate	£4.81	£4.30	11.9%
Accommodation offset (per day)	£8.70	£8.36	2.0%

It is proposed that the new rates should come into force on 1 April 2022. NMW and NLW rates were last increased in April 2021.

Impacts of the proposal

Coverage

The IA estimates that around 2.47 million employees would be covered by the proposals, of whom around 2.14 million are accounted for by the NLW. Survey evidence and consultation with stakeholders suggests that around half of all employers would be affected. Using the 2021 Business Population Estimates, the Department estimates that this amounts to around 1.2 million employers.

Costs

The main impact on employers is increased labour costs, estimated at £1.588 billion (undiscounted, 2021 prices-based figures). The main component of this is the cost to employers of paying more to employees currently earning less than the relevant proposed minimum wage. This is estimated at £899 million. The next highest cost is to employers of having to raise the wages of employees currently earning above the new NMW/NLW rates to maintain wage differentials. This is estimated at £689 million. Finally, the Department estimates transitional costs to employers of familiarising themselves with the new rates, estimated at £3.7 million.

Benefits

The £1.588 billion increased labour costs to employers would provide an equivalent benefit to employees (£1.347 billion) and the Exchequer (£241 million).

Overall impact

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

EANDCB

Counterfactual

The IA explains that last year's increases in rates were low as they focussed on *minimising significant employment risks* from the Covid-19 crisis. The IA reports that the LPC deems the economic situation to have improved substantially and the proposed increases in rates are much higher this year. The recommendation for the NLW returns it to a level broadly consistent with meeting the Government's target of two-thirds of median earnings by 2024. The particularly large increase for 21-22 year-olds reflects the Government's aim to move them onto the full NLW by 2024.

The relatively high percentage increases in the NMW/NLW rates would impose substantial additional cost on businesses. This cost would partly be offset by significantly higher counterfactual wage growth, reflecting current expectations of a much stronger labour market than previously anticipated. The IA uses the median forecast for earnings growth provided by the Office for Budget Responsibility (OBR) in its October 2021 economic and fiscal outlook. As in previous years' IAs, the impact of the uprating is assessed over the period it would take for this counterfactual wage estimate to 'catch up' with the proposed NMW/NLW rates. In the present IA this period is expected to be three years. The Department's updated assumptions for counterfactual wage growth appear to reflect reasonably the economic and labour market circumstances and prospects available at the time.

The IA would benefit from discussing further the particular economic uncertainty at the present time, such as around the impacts of Covid-19, consumer price inflation, energy prices, tax increases and EU exit. This analysis could include considering how this economic uncertainty might affect the time horizon for impacts and whether the impact of the proposed new NMW/NLW rates could be higher in the face of a more generalised economic squeeze. (See also ‘uncertainty, risks and assumptions’ under ‘cost benefit analysis’ below).

Direct/indirect impacts

The IA correctly treats the cost to private sector employers from having to pay employees who are, or will be, on the minimum wage more than they would otherwise have been paid and the transitional costs as direct costs to business. It treats the cost to employers of maintaining wage differentials as an indirect impact because the only regulatory requirement for businesses is to meet the increased NMW/NLW. This assessment is reasonable and in line with previous IAs. The IA assumes that such ‘spillover’ effects extend to the 25th percentile of the wage distribution, as in last year’s IA. The Department should continue to check that this threshold remains the appropriate point to be used for the assessment of each year’s uprating.

The IA would benefit from discussing the impact on employers of maintaining wage differentials further, in terms of contracted/negotiated pay scales and grade and whether or not they bind firms to pay occupational, experience etc. premia.

BIT score

The IA helpfully includes cost estimates from previous NMW/NLW increases and the methodology used (Annex B of the IA). Following the RPC’s comments last year, this annex now includes the BIT scores. Given the slightly different length of appraisal periods used in each IA, BIT scores present a better measure of the comparative impact on business of each uprating. For the years before such measures were included in the BIT, this annex could be improved by presenting ’shadow BIT scores’ or equivalent to assist comparability over time.

SaMBA

The SaMBA is sufficient. SMBs are estimated to employ 27 per cent of employees and incur approximately 38 per cent of the total cost of the proposals. Despite this apparent disproportion, the IA explains clearly why they should not be exempt from the proposals (page 49). On mitigation, the IA refers to employer-targeted communications and guidance and an announcement before the legislation has passed through Parliament, in order to allow increased adjustment time for businesses. The IA would benefit from discussing further how these mitigations help

SMBs specifically. The Department also refers to wider mitigations, such as the exemption of SMBs from the Apprentice Levy and business rates relief. The IA would be improved by discussing briefly the possible sectoral, competitive and structural effects of these mitigations.

Rationale and options

Rationale

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

The IA's discussion of monopsony/oligopsony power at Annex A could be extended to discuss the possibility of firms with significant market power in upstream and downstream markets. It would also be helpful for the IA to consider more explicitly the trade-off between employment and real pay levels. Although the policy can be expected to reduce inequality among the employed, the IA would also benefit from discussing whether it could raise inequality between those individuals in paid employment and those not, for example if people are 'priced out of jobs' or leave the labour force as a result of poorer prospects or insufficient real wage growth.

Options

The IA looks at two options: leave the current NMW/NLW levels unchanged ('do nothing') or implement the LPC recommendations in full. The IA clarifies the second (preferred) option by explaining how the LPC collects evidence and data, and that this included a consultation period for stakeholders and external research to inform its assessment of the impacts of minimum wage policy. The evidence, research and data collected and produced by the LPC have been used to inform the IA. On this basis, the options presented in the IA are reasonable.

Cost-benefit analysis

Evidence and data

The IA describes how the NLW and NMW rates are underpinned by LPC research. The LPC received 76 responses to its written consultation, with representatives from 32 various organisations attending oral evidence sessions.

The Department has continued to engage with leading labour market scholars and has updated its literature review, in part to help ensure that its approach remains appropriate following the impacts of the Covid-19 pandemic (see Annex H of the IA).

The analysis in last year's IA contained added uncertainty because the Coronavirus furlough scheme distorted wage data. This year, the IA explains how additional variables in the ASHE 2021 dataset have enabled the Department to identify better the extent to which furloughed workers' pay may have been 'topped up' by their employers. This helps improve the estimation of the underlying wage distribution for low paid workers. The IA appropriately acknowledges significant remaining uncertainty, and usefully models alternative wage distributions. Overall, the analysis is more robust than that in last year's IA.

Modelling

As in previous years, the IA includes a sensitivity analysis using the 'shadow wage curve' approach, which the RPC previously suggested (Annex D). The Department has refined its approach this year and produced an illustrative cost figure in one discrete step. This change addresses confusion over the two-step approach in last year's IA and concerns over the assumption of zero counterfactual wage growth (step 1) in the first year only. The Department's revised approach also appears to follow more closely the graphical representation previously set out by the RPC. The RPC welcomes the Department's work in this area.

Annex D would benefit from discussing briefly why the estimates differ from those provided in previous years, i.e. whether these are due to changes in the economy or a consequence of the improved approach.

The IA would benefit from explaining further why an overall three-year appraisal period is used, particularly for 21/22-year-olds and apprentices where it is stated that counterfactual wage growth will take 14 and 16 quarters to catch-up with their respective new rates, respectively (page 22).

Uncertainty, risks and assumptions

The IA appropriately includes low and high estimates (e.g. for counterfactual wage growth) and extensive sensitivity analyses around several important variables (such as the extent of spillovers to higher levels of the pay distribution). These variations are discussed in the relevant sections and summarised clearly in table 14 and figure 4 (pages 34-35) of the IA. The IA also helpfully provides an explanation of the difference in cost estimates compared to the 2021 increases (pages 33-34).

In previous years' IAs, the Department's counterfactual wage growth assumption was obtained by taking historical wage growth at the first point in the wage distribution that was deemed to be unaffected by the NMW/NLW rates (usually the 25^{th} percentile). The Department selected an historical period to match best where the UK currently lies on the business cycle. The present IA takes a slightly different approach in using the OBR's forecast growth for median earnings. The Department explains that it does not consider any particular period of the last twenty years to provide a good match to the UK's current economic position. The IA also explains that the median is likely to provide a conservative estimate, as growth for lower-paid workers has outpaced that of median-paid workers in recent years. The IA would benefit from further discussion of the justification for using median earnings, particularly given the support from the National Institute for Economic and Social Research for the previous approach. IAs on future upratings should continue to review the appropriateness of the assumptions and approach here.

The IA would benefit from explaining why overall familiarisation costs are lower than estimated last year given that the assumptions, apart from a lower non-wage labour cost adjustment, appear to be the same.

The IA would benefit from discussing how far the main impact represents a pure transfer from employers to employees and justifying the implicit assumption of constant value-added. In particular, the IA could discuss whether some of the indirect cost is transferred as a benefit to other businesses, for example if raised minimum wages induce firms to contract out some activities (such as perhaps use of agency staff in care sectors). The IA recognises the concentration of NMW/NLW workers in specific sectors and attempts to take this factor into account qualitatively. The IA would benefit from discussing further the impact of indirect costs to maintain sufficient differentials to meet service requirements in areas like health and social care.

Wider impacts

The IA has a section on employment impacts, drawing upon an updated literature review at Annex C (pages 55-59). This has been updated with several 2021 studies, including one from the Institute for Fiscal Studies**.** The discussion of employment impacts is within a section on macroeconomic impacts, which covers possible impacts on areas such as prices and productivity. Following the RPC's comments last year, the IA helpfully includes discussion of how reduced pay differentials may reduce staff turnover (page 41). This discussion could be extended, for example to cover potential impacts of such reduced turnover on productivity or productivity growth. The IA also includes useful sections on fiscal, regional and international trade impacts. Following our comments last year, the latter helpfully includes a box on EU exit and the impact on EU-based labour (page 47). The IA could usefully acknowledge potential cross-impacts with the Government's Skills Bill.

The IA contains some references elsewhere to potential wider impacts, particularly on prices and employment, which could usefully be integrated further into the wider impacts section. For example, it is noted (page 14) that 2021 was the first year in which 23 and 24-year-olds were eligible for the NLW and that the LPC found their employment has not been reduced. The discussion of employment impacts could usefully refer to this and any plans to assess possible employment impacts for groups newly brought into scope of future NLW measures. The IA could also discuss further the evidence reported during LPC consultation around continuing challenges facing some businesses, with difficulties in raising prices, and concerns around business debt levels and fragility of the economic recovery (pages 8-9). This discussion could also cover potential impacts likely to persist beyond Covid-19, such as shifts in demand affecting, for example, the entertainment and transport industries.

Monitoring and evaluation plan

The IA explains how the LPC will continue to monitor, evaluate and review the levels of the various minimum wage rates and that future recommendations by the LPC will be based on extensive monitoring and evaluation of the current rates (page 51). In addition to the LPC's next review of NMW/NLW rates in Autumn 2022, the IA states that the LPC will undertake an assessment of the specific impact of the proposed 2022 minimum wage rates in Autumn 2023 (page 5).

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