



National Minimum Wage RIA

Increasing adult and youth rates in October 2006

March 2006

<http://www.dti.gov.uk/er>

This regulatory impact assessment (RIA) considers the impact of proposals to increase the adult and development rates of the National Minimum Wage (NMW) in October 2006. The proposals reflect the recommendations of the Low Pay Commission's (LPC) 2006 report¹ on the NMW.

The specific changes that the Government proposes to implement are that:

- The adult rate of the NMW increases from £5.05 an hour to £5.35 in October 2006, and the development rate for 18 to 21 year olds increases from £4.25 an hour to £4.45 in October 2006.
- The NMW for 16-17 year olds increases from £3.00 an hour to £3.30 in October 2006.

Purpose and intended effect of measure

Objective

1. The purpose of the NMW is to create a minimum pay level and thus to protect workers from unacceptably low rates of pay. The NMW forms part of the government's policies to make work pay, alongside Tax Credits and the New Deals.

Background

2. Decisions on the NMW rates are made by the Government following consideration of recommendations by the independent LPC. The LPC reports contain a large body of evidence and analysis on the impact to date of the NMW. The evidence and data collected and produced by the LPC have been used to inform this RIA.

3. The NMW was introduced in April 1999. The adult and development rates have increased in a number of steps, most recently in October 2005.

¹ Low Pay Commission: Low Pay Commission Report 2006

4. Previous LPC reports have announced staged increases in the minimum wage such the 2005 Report which recommended an initial increases in October 2005 and a further increase in October 2006.

5. Last year, in accepting the recommendations of the LPC's sixth report², the Government agreed that the Commission should report back in 2006 on whether the economic conditions are consistent with the second-stage of the minimum wage increase, provisionally proposed for October 2006.

6. There was no increase in the NMW for 16-17 year olds in 2005. Instead, the Government asked that the LPC review the operation of this rate in their 2006 Report, with any recommendations for any subsequent increase suitably adjusted to take account of the absence of any uprating in 2005.

Options

7. The LPC has confirmed in their 2006 Report that the adult and development rates of the NMW should be increased to £5.35 and £4.45 in October 2006. The LPC concluded that these recommendations would increase the earnings of the lowest paid without damaging their employment prospects. The Government accepts these recommendations. The alternatives would have been to choose higher or lower rates.

8. The government accepts the LPC's analysis, that these proposals represent an acceptable balance between maintaining and enhancing the value of the NMW and preserving employment prospects for many of the most vulnerable workers.

Costs and benefits

9. The impact of the proposed increases in the NMW rates will be to increase the pay of some workers above the level that it would otherwise have been. This will be a cost to employers and a benefit to workers. The NMW is now a recognised part of employment practices and implementation costs of administering the proposed increase will be minimal.

Business sectors affected

10. All sectors are affected by the NMW, although agriculture has its own minimum wage machinery. In practice, the impact of the NMW is most keenly felt in a number of sectors: retail; hospitality; cleaning and security; social care; manufacture of textiles, clothing and footwear; and hairdressing. In their report, the LPC paid particular attention to these sectors.

Number of potential beneficiaries

11. The latest official data on the prevalence of low paid jobs in the UK relates to spring 2005. At that time, it is estimated that around 1.9 million jobs held by those aged over 21 were paid below the proposed October 2006 adult rate of £5.35 and that 0.17 million jobs held by those aged 18 to 21 were paid below the proposed development rate of £4.45. Around 44,000 16-17 year olds were earning less than £3.30.

² Sixth report of the Low Pay Commission: "Low Pay Commission Report 2005
<http://www2.lowpay.gov.uk/lowpay>

12. The numbers of jobs that actually stand to benefit from the proposed increases in October 2006 will depend upon what has happened, and is likely to happen, to the wages of workers in the period between spring 2005 and October 2006.

13. The adult and development rates of the NMW were increased to £5.05 and £4.25, respectively, in October 2005, and it is assumed that these changes fed through into earnings for all workers earning below those levels (i.e. that there was full compliance with the October 2005 rates).

Increase in adult and development rates in October 2006

14. In this RIA, our main assumption is that the hourly pay of all those earning less than the October 2006 rates increases in line with average earnings growth (measured by the Average Earnings Index) between spring 2005 and October 2006. This is based on an average increase using actual data for the period April 2005 to December 2005,³ and a forecast rate of increase thereafter derived from the HM Treasury comparison of independent economic forecasts.⁴

15. On this assumption, the proposed October 2006 increase will benefit approximately 1.3 million workers. This comprises of 30,000 16-17 year olds; 110,000 18-21 year olds, and 1.17 million workers aged 22 and over.⁵ Of the 1.3 million beneficiaries, two-thirds will be women.

16. An alternative assumption, which is less likely, is that the hourly pay of all those earning less than the October 2006 rates will have increased in line with Retail Price Index (RPI) inflation between April 2005 and October 2006. This is based on an average increase using actual data for the period April 2005 to January 2005,⁶ and a forecast rate of increase thereafter derived from the HM Treasury comparison of independent economic forecasts.⁷ On this assumption, the number of jobs that would potentially benefit from the proposed October 2006 increase is approximately 1.7 million, made up of 40,000 jobs held by 16-17 year olds, 0.15 million jobs held by 18 to 21 year olds and 1.54 million jobs held by those aged over 21.⁸

Impact on labour costs of uprating

17. The impact of the upratings on wage and labour costs also depends upon the assumptions made about the likely path of wage increases between October 2005 and October 2006.

³ Average earnings (including bonuses) grew by 2.7% April-December 2005. ONS Average Earnings Index.

⁴ <http://www.hm-treasury.gov.uk/media/696/19/200602forcomp.pdf>

Median forecast for AEI growth in 2006 was 4.2 per cent in February 2006.

⁵ This is calculated by deflating the October 2006 proposed rates by actual and forecast headline average earnings growth (including bonuses), i.e. by 6.2 per cent over 18 months, producing the equivalent rates of £5.04 for adults; £4.19 for 18-21 year olds and £3.11 for 16-17 year olds. The numbers affected are then calculated from the cumulative distributions of jobs and hourly pay based on 1p pay bands from ASHE 2005. The total number of beneficiaries is rounded to the nearest 100,000.

⁶ RPI grew by 0.94% April 2005 –January 2006. ONS, Retail Price Index.

⁷ <http://www.hm-treasury.gov.uk/media/696/19/200602forcomp.pdf>. The February median forecast for RPI growth in 2006 was 2.2 per cent.

⁸ This is calculated by deflating the October 2006 proposed rates by actual and forecast growth in the retail price index, i.e. by 2.6 per cent over 18 months, producing the equivalent rates of £5.21 for adults; £4.34 for 18-21 year olds and £3.22 for 16-17 year olds. The numbers affected are then calculated from the cumulative distributions of jobs and hourly pay based on 1p pay bands from ASHE 2005. The total number of beneficiaries is rounded to the nearest 100,000.

18. The methodology for estimating the increase in wage costs for the uprating is as follows:

- We calculate the additional average hourly uplift in pay that is required to bring all those jobs paying less than the October 2006 proposed rates onto the minimum wage. The size of this average increase will depend on the assumption made about what happens to earnings in these low paid jobs between October 2005 and October 2006 (i.e. the two scenarios discussed above, using either AEI or RPI). It is assumed that there is full compliance with the October 2005 rate⁹. Multiply this average increase per hour by the average number of hours worked by those workers affected. The latest data¹⁰ shows average hours worked per week excluding overtime was 31.3 hours for low paid 16-17 year olds; 27.2 hours for low-paid adults (22 and over) and 25.1 hours for low-paid 18 to 21 year olds¹¹;
- Multiply by 52 weeks per year.
- Multiply by the number of potential beneficiaries (see above).

19. To go from the total wage bill to total labour costs, we multiply by 20 per cent to take account of the cost of employers National Insurance and any other non-wage benefits (such as pension contributions) that are linked to wages. We use a figure of 20 per cent, which is less than the 30 per cent figure used in other RIAs, because low-paying jobs are likely to be associated with smaller non-wage benefits.

20. It should be noted that the RIA only considers the direct impact of the uprating. We have implicitly assumed that the uprating has no significant impact on wage-setting behaviour above the minimum wage rates. This means we have not accounted for additional costs to employers or benefits to workers as a result of the uprating.

21. The size of the average hourly increase in pay that employers are required to pay to comply with the minimum wage policy depends on the assumption made about what happens to low-paid earnings between April 2005 and October 2006. The two scenarios discussed above were that in the absence of any uprating, earnings would have risen in line with RPI or average earnings.

22. Table 1 below, shows the effect on the aggregate wage bill and labour costs of the October 2006 uprating under the assumption that in the absence of any uprating, low-paid earnings would have risen in line with average earnings.

⁹ Although full compliance with the October 2005 rates indicate presumed minimum rates of pay of £5.05/£4.25, we need to maintain a constant price base. So, we deflate these presumed minima to £4.98/£4.19/£2.96 to take account of 6 months of earnings growth between April and October 2005 under the AEI scenario. Under the alternative RPI scenario shown in the annex, the presumed minima are deflated using the RPI.

¹⁰ Source: April 2005 Annual Survey of Hours and Earnings.

¹¹ Low pay defined by hourly pay excluding overtime in April 2005 for all ages earning less than or equal to the October 2006 minimum wages, deflated by 18 months AEI growth to give equivalent April 2005 rates. This was £5.04 for ages 22+; £4.19 for 18 to 21 year olds and £3.11 for 16-17 year olds.

Table 1: Impact of the October 2006 uprating on aggregate wage and labour costs (assumes low-paid earnings rise in line with average earnings)

Increase in wage bill for proposed 2006 rates	£89 million
Percentage increase in economy's total wage bill due to uprating	0.013%
Increase in labour costs for proposed 2006 rates	£107 million
Percentage increase in economy's total labour costs to employers due to uprating	0.015%

Source: DTI estimates, based on ONS sources.

23. Under the alternative, less likely assumption that low-paid earnings rise in line with the RPI, the impact on wage and labour costs would be slightly greater. This effect is shown in the Annex.

Costs for a typical business

24. The proposed changes to the October 2006 rates represent an increase of 5.9 per cent on the current rate for adults; 4.7 per cent for 18 to 21 year olds and 10 per cent on the current rate for 16-17 year olds. Those employers with staff currently paid at or close to the minimum wage will therefore see the earnings of these workers increase above the expected growth rate of average earnings. However, most workplaces do not employ people at or near current NMW rates and therefore will be unaffected. And most workplaces that do employ people at or near current NMW rates are unlikely to employ significant proportions at these rates. Thus most businesses are unlikely to see any large changes to their cost base.

25. 16-17 year olds see a proportionately larger increase in the rate this year. Using actual AEI from April to December 2005, and the median forecast from the Treasury for 2006 (4.2 per cent) thereafter, by October 2006 average earnings will have increased by just over 8 per cent since the introduction of the 16-17 year old rate. Therefore, this year's increase is adjusted to take account of the absence of any uprating in 2005.

Benefits

Increase in adult and development minimum wage rates in October 2006

26. The aggregate additional benefit for workers is expected to rise to around £107 million in the year commencing October 2006. This benefit is equivalent to an average pay rise per year before tax of £67 per worker.¹²

27. Under the alternative assumption that low-paid workers' earnings rise in line with the RPI, the estimated wage bill effect and aggregate benefit to workers is expected to be around £459million for the year commencing October 2006, equivalent to an average pay rise per worker of £221 for the year from October 2006.

¹² Based on average hours worked per week of 25.1 for adults, and 27.2 for 18-21 year olds and 31.3 for 16-17 year olds. ASHE 2005

Equity and fairness

28. The LPC report shows that increases in the NMW continue to benefit certain groups disproportionately: women; people from ethnic minorities; the disabled and part-time workers.

Small firms' impact test

29. The LPC recommendations were based upon extensive analysis and gathering of evidence, including evidence received from, and discussion with, small businesses and their representatives.

Competition assessment

30. The NMW provides a floor for wages and therefore ensures that firms cannot compete against each other by driving down wages to unacceptable levels. Most of the sectors where the impact of the NMW is felt most keenly are characterised by large numbers of relatively small firms. To the extent that the NMW increases labour costs, these are borne by all employers in a sector. It is therefore unlikely that the NMW creates significant barriers to entry.

Enforcement and sanctions

31. The NMW is enforced in two ways. The Inland Revenue takes proactive steps to secure enforcement and acts on complaints. Individuals also have a right of redress to an employment tribunal.

Consultation

32. The Low Pay Commission has undertaken in their latest report a thorough examination of the issues relating to the uprating of the existing minimum wage rates.

Monitoring and review

33. The Government issues an annual report on enforcement action.

34. More broadly, the LPC is charged with reporting on the impact of the NMW. In due course, the Government will formally ask the Commission to report again in 2007 on the operation of the minimum wage and the Government will provide the Commission with its own evidence ahead of the next report.

Declaration

35. I have read the Regulatory Impact Assessment and I am satisfied that the benefits justify the costs.

Signed

Date

**Lord Sainsbury of Turville, Parliamentary Under-Secretary of State – Minister
for Science and Innovation**

Contact Details

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Annex A

Impact of the 2006 uprating on aggregate wage and labour costs under RPI assumption

36. Table 1 in the main section of the RIA set out the effect of the uprating on the aggregate wage bill and labour costs under our main assumption that in the absence of any uprating, low-paid earnings rise in line with average earnings.

37. Table A1 below, shows the effect on wage and labour costs under the alternative assumption that in the absence of any uprating, low-paid earnings rise in line with the RPI.

Table A1: Impact of the 2006 uprating on aggregate wage and labour costs (assumes low-paid earnings rise in line with the RPI)

Increase in wage bill for proposed 2006 rates	£383 million
Percentage increase in economy's total wage bill due to uprating	0.055%
Increase in labour costs for proposed 2006 rates	£459 million
Percentage increase in economy's total labour costs to employers due to uprating	0.066%

Source: DTI estimates, based on ONS sources.

38. Other than the replacement of the AEI assumption by the RPI assumption, the methodology is the same as that described in the main section of the RIA:

- We calculate the additional average hourly uplift in pay that is required to bring all those jobs paying less than the October 2006 proposed rates onto the minimum wage. The size of this average increase will depend on the assumption that average earnings in these low paid jobs rise in line with RPI between October 2005 and October 2006. It is assumed that there is full compliance with the October 2005 rate¹³. Multiply this average increase per hour by the average number of hours worked by those workers affected. The latest data¹⁴ shows average hours worked per week excluding overtime was 31.3 hours for low paid 16-17 year olds; 27.2 hours for low-paid adults (22 and over) and 25.1 hours for low-paid 18 to 21 year olds¹⁵;
- Multiply by 52 weeks per year.
- Multiply by the number of potential beneficiaries under the RPI scenario (see above).

39. To go from the total wage bill to total labour costs, we multiply by 20 per cent to take account of the cost of employers National Insurance and any other non-wage benefits (such as pension contributions) that are linked to wages. We use a figure of

¹³ Although full compliance with the October 2005 rates indicate presumed minimum rates of pay of £5.05/£4.25, we need to maintain a constant price base. So, we deflate these presumed minima to £5.01/£4.21/£2.97 to take account of 6 months of earnings growth between April and October 2005 under the RPI scenario.

¹⁴ Source: April 2005 Annual Survey of Hours and Earnings.

¹⁵ Low pay defined by hourly pay excluding overtime in April 2005 for all ages earning less than or equal to the October 2006 minimum wages, deflated by 18 months AEI growth.

20 per cent, which is less than the 30 per cent figure used in other RIAs, because low-paying jobs are likely to be associated with smaller non-wage benefits.

Annex B.

Beneficiaries of the 2006 uprating by sex and government office region

The DTI estimates that over 1.3 million workers stand to benefit from the October 2006 uprating of the National Minimum Wage (NMW). This estimate is based on 1p pay bands from the ONS' Annual Survey of Hours and Earnings (ASHE) 2005, and takes account of actual and forecast average earnings growth between April 2005 and October 2006. Of the estimated 1.3 million workers who stand to benefit, two thirds will be women.

Table B1. Number of workers that stand to benefit from the October 2006 National Minimum Wage uprating by age and sex

	Male	Female	Total
16-17	20,000	10,000	30,000
18-21	60,000	50,000	110,000
22 and over	360,000	810,000	1,170,000
Total	440,000	870,000	1,320,000

Source: DTI estimates based on ONS' Annual Survey of Hours and Earnings (ASHE) 2005

Note: These data are based on 1p pay bands from the ONS ASHE and take account of actual and forecast average earnings inflation between the period Spring 2005 and October 2006; uprating from £3.00 to £3.30 for 16-17 year olds, £4.25 to £4.45 for 18- 21 year olds and from £5.05 to £5.35 for those 22 and over. ASHE 1p pay bands measure number of jobs; therefore beneficiaries calculated assuming workers do not hold more than one job at the NMW. Numbers may not sum to total due to rounding.

Estimates of beneficiaries by country and government office region are also provided (Table 2).

Table B2. Number of workers that stand to benefit from the October 2006 National Minimum Wage uprating by country and government office region

Country or region	Beneficiaries
Wales	80,000
Scotland	140,000
Northern Ireland	20,000
England	1,090,000
North-East	80,000
North-West and Merseyside	170,000
Yorkshire & Humberside	140,000
East Midlands	110,000
West Midlands	150,000
Eastern	110,000
London	90,000
South East	120,000
South West	120,000
United Kingdom	1,320,000

Source: DTI estimates based on ONS' Annual Survey of Hours and Earnings (ASHE) 2005

Note: These data are based on 10p pay bands from the ONS ASHE and take account of actual and forecast average earnings growth between the period April 2005 and October 2006; uprating from £3.00 to £3.30 for 16-17 year olds, £4.25 to £4.45 for 18- 21 year olds and from £5.05 to £5.35 for those 22 and over. ASHE 10p pay bands measure number of jobs; therefore beneficiaries calculated assuming workers do not hold more than one job at the NMW. Numbers may not sum to total due to rounding.